ELIXIR EQUITIES PRIVATE LIMITED

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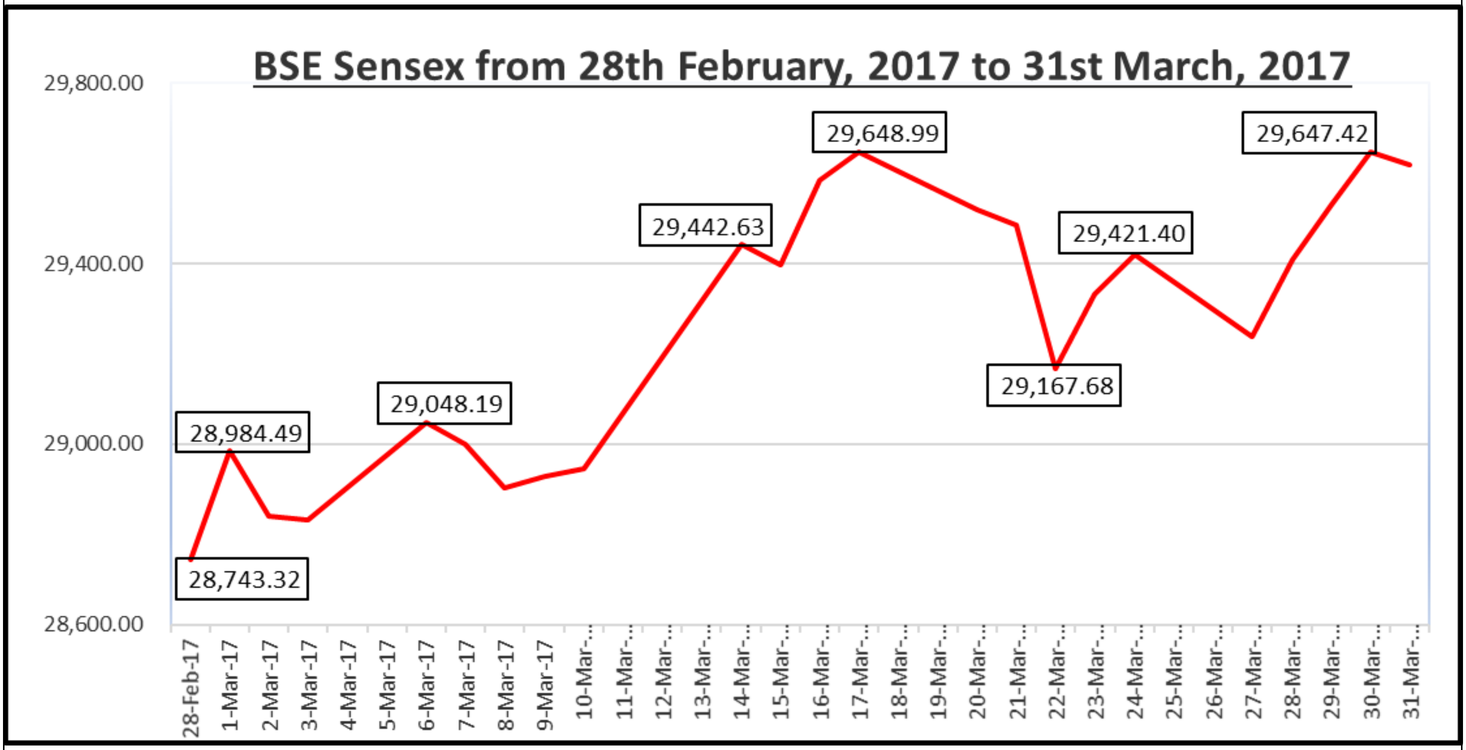
Markets on a Roll in March



Sensex Rallies by more than 3%

Stock markets continued their strong showing in March with the BSE Sensex rising by 3.05 %. This was the third consecutive month of gains in excess of 3%. The trigger for last month's rally was the UP election in which the BJP won record number of assembly seats. The referendum was a test for PM Modi's governance and he won with flying colours. This emphatic victory has many political pundits predicting a second term for the NDA when Lok Sabha elections are held in May 2019. This type of political stability has not been seen for decades and has deep implications for the economy and stock markets.

Political and Economic Ideology Aligned

With strong political will, sweeping reforms can be undertaken, as we have seen with the passage of the GST bill and removal of many impediments in its proposed implementation. But for political will and strong majority, this transformative indirect tax would not have been possible. Decisive leadership at the centre and progressive governments at the state level make a heady cocktail for progress on the development front. Recent elections have been won by parties promising growth and upliftment. Caste / religious biases have been set aside it does appear that the entire electorate is voting for all round progress. This should lead to action at ground level in the form of better administration and business friendly environment.

Expansion of PE Multiples

Stock markets have been recognizing this subtle change in the country; this new-found euphoria, and are now pricing a blue-sky scenario for earnings expansion. Only time will tell if this optimism is justified but for the present, there is considerable enthusiasm amongst domestic and foreign investors over Indian equities. Liquidity has been flowing into stocks from both these classes of investors and that has led to valuation ratios rising beyond fair levels. Many stock market pundits have been fretting over higher Price to Earnings (PE) multiple and we too are concerned on that front; however, if history is any guide, stock markets do not correct just because PE multiples are high. They fall when outlook for growth diminishes and that is certainly not on the cards for the present. Again, if past bull markets are studied, the conclusion we can draw is that these multiples can rise even more from these levels; taking stock prices to levels which may seem astounding. We are of the view that our markets are well and firmly on this path and although we cannot predict when the trend will reverse we are of the firm view that equites will scale to higher and higher levels.

Corrections are Buying Opportunities – Bad News Ignored

Investors who have patiently invested during the bear markets 3-4 years ago are being rewarded and those on the sidelines are finding it increasingly challenging to identify stocks which still have a reasonable margin of safety. Every correction is being bought into with vigour and even bad news such as the possibility of a sub-par monsoon or GST roll-out risks are being ignored.

The argument placed by the bulls is that this market has absorbed many shocks viz.

- Brexit
- Election of Trump as US President
- Demonetisation
- Shifting of RBI policy stance from dovish to neutral, and
- Rising US interest rates

Each of these should have triggered a bear market and yet, apart from a few days of down trend, indices – large and midcap have scaled to record highs. If this is the strength of the market in the face of adversity, then what can stop its advancement when threats are more subdued? With every passing day, uncertainty and risk perception is reducing and that is raising the confidence of the bulls in this market. It does appear that the tipping point for a trend reversal is not known and momentum will only accelerate going forward.

Investment Strategy

In such a scenario, we advise remaining invested and increase exposure in a selective manner as and when opportunities present themselves. These could be in the form of specific stock prices correcting on account of market forces or mildly negative news flow. Another chance could be when the company's stock price does not react positively to good financial results and that leads to PE ratio moving back into fair value zone. The upcoming earnings season could throw many such possibilities and investors will have to act fast when such a situation presents itself.

The returns of the portfolios managed by us are as under:

			ANNUALISED RETURNS AS ON			31/03/2017	From
Date From	**01/03/2017**	**30/12/2016**	**29/09/2016**	**31/03/2016**	**01/04/2015**	**01/04/2014**	**01/04/2012**
	1MONTH	**3 MONTH**	**6 MONTHS**	**1 YEAR**	**2 YEAR**	**3 YEAR**	**5 YEAR**
Elixir Equities Portfolio Performance	**3.52%**	**17.03%**	**2.51%**	**24.60%**	**12.08%**	**21.84%**	**21.54%**
SENSEX	**3.06%**	**12.34%**	**5.49%**	**17.22%**	**5.72%**	**9.56%**	**10.40%**
NIFTY	**3.32%**	**13.21%**	**5.70%**	**18.80%**	**6.85%**	**10.85%**	**11.05%**
Performance comparison	**0.20%**	**3.82%**	**-3.19%**	**5.80%**	**5.23%**	**10.99%**	**10.49%**

In this series of Smart Investing we discuss "*Checklist for an Investment Advisor*". These are a set of questions / checks which an investor should follow before selecting an investment advisor or portfolio manager.

Dipan Mehta

SMART INVESTING – XVIII
- Checklist for an Investment Advisor

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Importance of a Single Investment Advisor

The Ninth edition of our series on *Smart Investing* had a discussion on *Accountability*. In that piece, we had emphasized the advantages of sticking to a single investment advisor to manage the portfolio. We had argued that just as "*…too many cooks spoil the broth*" is a well-accepted principle in many activities, the same logic should be applied to managing a portfolio of stocks as well. Investors will benefit more from the wisdom of a single advisor rather than many professionals offering piecemeal recommendations. This makes the process of identifying an investment advisor very critical. Since the horizon for engaging a portfolio manager is long term (at least 3 years), investors must be careful in whom they select for managing their money. There are certain checks which must be followed to zero in on the right fund manager.

Evaluation Criteria - Integrity

The first item on the checklist should be integrity. More money has been robbed by crooked financial advisors than even the most accomplished thieves. Any portfolio manager who places his / her interest before that of the investor has to be avoided. A thorough background check of the financial advisor must be undertaken and references must be sought before deciding on who should manage the savings. If the choice is between one who has lower returns but pristine reputation and one who offers higher returns but questionable background; we would advise going with the former. In the longer run, this choice will play out much better as in times of upheaval, when safety of capital becomes paramount, an honest financial advisor will be able to steer the ship far better than a dishonest one. Conflict of interest can be dangerous for the investor there should be no compromise on this count.

Capability of the Fund Manager

The second on the checklist is capability or skillset. The portfolio manager must have a decent track record for generating returns in good times as well as bad. A fair assessment of the aptitude of a fund manager should be over a long period of time and should encompass at least one bull market and one bear market. A competent fund manager is one who has successfully navigated a brutal bear market. This is the ultimate test as generating returns in a bull market is relatively easy. Mistakes in a bear market are more expensive than ones in a bull market. A complete cycle of bull and bear market will test all fundamentals of portfolio management - stock selection, patience, selling strategy and timing of purchase / sale. Experience is a good teacher and investors must give due cognizance to this quality. There is great similarity between different bull markets and different bear markets and someone who has seen and learnt from these cycles should make fewer mistakes and that will benefit investors in the long term.

Consistent Performance

The third aspect to consider is consistency. A portfolio manager who is consistently performing well should be preferred over one who is inconsistent. One could go more granular and check out the number of stocks which have performed well for the investment advisor. The higher the number, the better the fund manager. There may be instances of money managers reporting fantastic returns; but if the returns are the outcome of just a handful of stocks then that does raise a question mark. Our preference would be for portfolio managers who have many performing stocks in the portfolios rather than returns skewed by outstanding performance of just 3-4 stocks. This will demonstrate good internal stock selection criteria which is the foundation for good portfolio management. A fund manager who has delivered returns on the back of just one or two stocks could just be lucky and investors cannot bank on the continuance of this fortitude.

Scalability

The fourth point to evaluate is the scalability of the funds managed by the investment advisor. Many professionals are adept at managing small portfolios by buying into small and midcap stocks but as the size increases, returns will get compromised. The same small / midcap stock will not lead to overall outperformance of the portfolio. We would prefer investors to select money managers who have reported reasonably good portfolio returns from a selection of large cap / index stocks as well and not just from small and mid-cap stocks. Such portfolio managers are more risk averse and therefore more likely to protect the capital during uncertain times.

Exit Strategy

Selling Strategy of a portfolio manage must also be evaluated. There has to be a basis for booking gains and restricting losses. Many fund managers are either too early in booking profits or wait for too long by which time the stock has already declined or stagnated; thereby impacting cumulative returns. The tenacity of the fund manager to book losses must also be gauged. It takes courage to admit a mistake and take corrective action. All stock will not perform and there will be laggards. How an investment advisor deals with such losers will be a reflection of his /her investment philosophy.

Individuals over Organisation

Although this checklist is quite comprehensive, there are other criteria which may be applied such as understanding of the risk profile by the financial advisor, communication and transparency in operations etc.. These are also important but what is not important is the size of the organization or the number of analysts / fund managers. Investment management does not require a very large team. Historically, the best returns are generated by fund managers and proprietary investors who have acted on their own conviction and not followed a committee to evaluate their ideas. Independent thinking without being second guessed by others within or outside the organization leads to better performance.

Stock Picking in a Digital Era

In this modern digital age, every company is well analyzed by the media and sell side analysts. Companies have investor relations department which present the management viewpoint in great detail and alacrity. Information flow is equal and all that a good stock picker has to do is evaluate if the company will deliver performance which beats street expectations. The key question which needs to be answered is whether the company's business model is robust enough to generate secular growth such that the magic of compounding profits will be unleashed. These are qualitative assessments which are best done by deep thinking at an individual level and not a collective team effort.

Selecting a good investment advisor is akin to identifying a good lawyer or family doctor or tax consultant. Investors much follow due process before appointing one. It is said that managing wealth is more difficult than creating and a good reliable wealth manager can make this task a lot easier.

Dipan Mehta