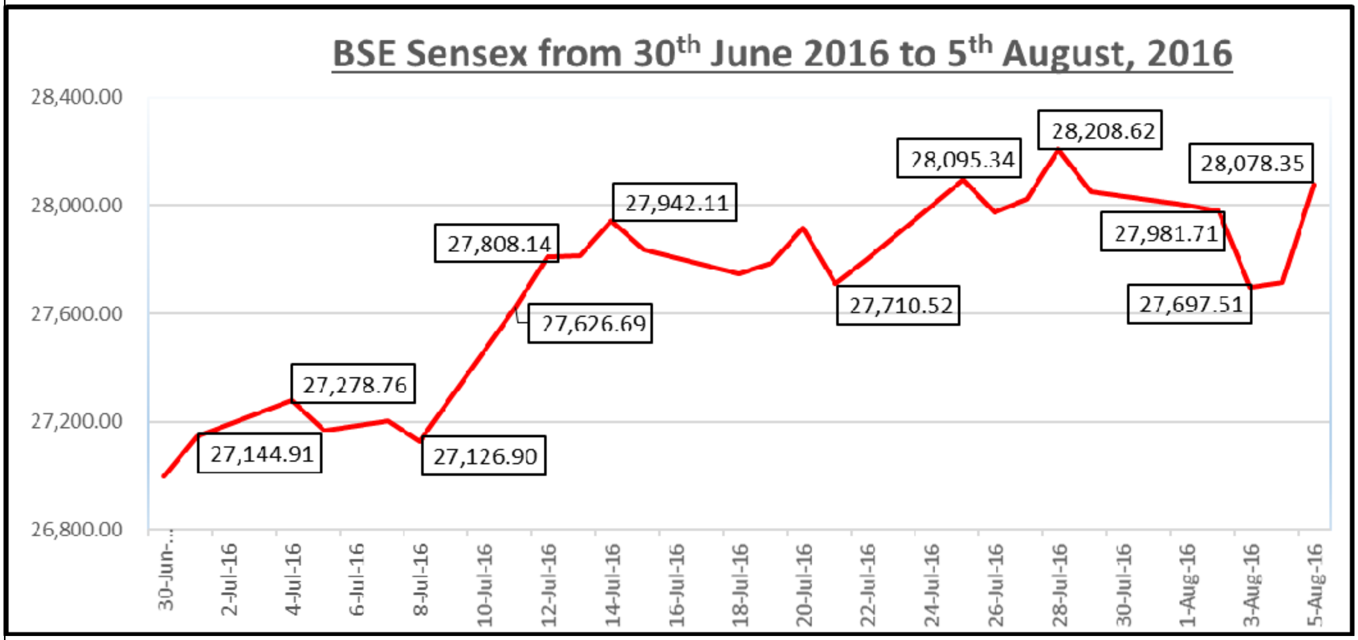
For Private Circulation **5th August, 2016**

Smart Rally in July



Markets on Upswing – Most Positives Discounted

Stocks staged a smart rally in July with the Sensex appreciating by 3.90% during the month. The gains in midcap stocks were even higher with the NSE Midcap index appreciating by 6.92 % in July. FII buying was at 11,338.97 crores and as usual, Indian financial institutions net sold Rs. 6,054.60 crores. The reasons for the upswing are not surprising and we have been discussing these over the past several months in our newsletters. Imminent passage of GST and above normal monsoons have been triggers for this up move and these factors came to full fruition in July and the first week of August. The June earnings season also played a positive role and at present, it does appear that with the exception of an interest rate cut, all the expected positive tidings have played out.

This poses a dilemma as there is not much to look forward to over the next few months, perhaps until the Union Budget in February 2017. The street has a way of discounting news flow, good and bad and our reckoning is that at this juncture, the favorable impact of a good monsoon and the launch of GST in the next fiscal have been largely factored. Liquidity remains very strong and that could drive equites even higher but our assessment is that the margin of safety in investing has eroded and that is a matter of concern.

Few Good Businesses at Reasonable Valuations

Another challenge is finding good businesses at reasonable valuations. As we scan the entire universe of investment grade stocks, there are very few growth companies available at attractive price to earnings (PE) multiple. As a thumb rule, we and most savvy long term investors, prefer to buy stocks at price-earnings to growth (PEG) of one, i.e. if the company's long term growth potential is 20%, then a PE ratio of 20 times may be reasonable and could offer decent long term returns. However, the scenario at present is such that businesses which are growing at 20-25% are trading at PE multiples of 35 to 50 times.

Compounding this situation is the deteriorating fundamentals of sectors which have created exponential wealth for investors viz. Software and Pharma.

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Software and Pharma, Large Value Creators under Stress

Growth has stagnated in the software industry. Global economic slowdown and shift in spending from traditional application development / implementation to smaller digitization projects has impacted topline. Margins are under pressure because of rising visa costs and annual increments to employees; which cannot be passed on due to intense competition and commoditization of *runoff-the-mill* services. This has led to sharply lower revenue and profit growth. The large base effect is also another negative to consider. An industry which was expanding at 15-25 %, until 2 years ago, has slowed down to 5-15 % and coupled with margin compression, profits have also leveled off. As we look ahead, there are few triggers for these trends to reverse and in all likelihood, this sector will remain stressed. There will always be a few outliers, but the larger players are unlikely to deliver good returns to shareholders.

The other favorite sector of investors - pharmaceuticals has its own set of challenges. Consolidation amongst the distributors of generic medicines in the US has led to steady price erosion in the world's largest pharmaceutical market. Heightened competition due to entry of several mid-sized pharma companies, stiff US FDA inspection norms, higher R&D expenses and government price controls has pushed them into the same situation as software companies. Pressure on sales and profit margins are leading to slower growth rates. Going forward, this industry is unlikely to yield the superior returns it has delivered in the past.

GST as an Investment Theme Discounted?

With these two large industry groups offering subdued investment opportunities, the list of performing sectors has reduced. Private sector banks, NBFCs and consumer centric businesses such as FMCG, building products, appliances and automobiles continue to do well but these are over owned and priced to perfection. Any disappointments here may lead to a disproportionate decline in their share values. The most popular theme in the market at present, is to target companies which benefit from implementation of GST. There is merit in this investment strategy as there are industries which will benefit from lower indirect taxes and therefore level playing field with the unorganized sector. However, stocks of these companies too have witnessed sharp rallies in recent times and risk related to the GST rate and implementation hiccups have not been factored by investors.

Market Strategy

To sum up, abundant liquidity is pouring into the market from global and domestic investors but the opportunities for deploying this cash is depleting. This puts the investors in a *Catch22* situation as stocks may continue to rally and short term returns may be impacted if he / she does not participate and retains cash in the portfolio. On the flip side, if investments are made at elevated levels, then long term returns may be compromised and the investor may not have the '*firepower*' to buy when a correction takes place. Given the choices, we would prefer to follow the latter strategy. Better to keep cash in the portfolio than to chase stocks at these levels. Rallies and corrections are two side of the same coin just as night and day. One will follow the other in an alternating pattern. Investors just need to be patient and wait for the right timing for increasing exposure to equities. In the immediate short term, markets are on a roll and may spike higher on the brute force of money. We would advise investors to hold their horses and seek out good quality stocks at reasonable valuations. We have been positive on stocks for the past few months and this call has proved to be accurate. While we are extremely positive on the long term prospects of the market, in the short term we envisage a correction once this phase of the bull market is over. We would advocate a wait and watch approach at this juncture.

In this month's Smart Investing Series, we are discussing *"Calculating Portfolio Returns"*, an important measure on which there is considerable confusion in the minds of investors.

The portfolios under our management have delivered the following average returns:

			ANNUALISED RETURNS AS ON			29/07/2016	From
Date From	**29/06/2016**	**29/04/2016**	**28/01/2016**	**30/07/2015**	**30/07/2014**	**30/07/2013**	**31/07/2011**
	1MONTH	**3 MONTH**	**6 MONTHS**	**1 YEAR**	**2 YEAR**	**3 YEAR**	**5 YEAR**
Elixir Equities Portfolio Performance	**10.10%**	**14.28%**	**22.06%**	**13.08%**	**22.96%**	**30.15%**	**19.84%**
SENSEX	**5.69%**	**9.65%**	**15.06%**	**4.36%**	**5.11%**	**11.01%**	**7.71%**
NIFTY	**6.22%**	**10.19%**	**16.68%**	**5.90%**	**6.88%**	**12.48%**	**8.38%**
Out Performance	**3.88%**	**4.09%**	**5.38%**	**7.18%**	**16.08%**	**17.67%**	**11.46%**

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SMART INVESTING – IX
- Calculating Portfolio Returns

Investors not Calculating their Returns

The topic of this discussion is simple yet important as investors are keenly interested in the returns their portfolio has generated in a given time period. Our assessment is that the average investor is not aware of how to calculate the returns on the sums invested in equities. Investors have a vague idea of what the value of their portfolio is from time to time, particularly at market highs and market lows, but few may have done a precise value calculation at regular intervals. Taking the market value of the portfolio from one point of time to another is inaccurate as the investor may have purchased or sold shares in the interim and there may be other transactions to consider.

Many Complexities in Calculating Portfolio

Unlike debt products such as fixed deposits or debentures, there are many complications as arriving at the accurate returns on stocks. There is the opening portfolio value, which is the market value of the portfolio at the beginning of the period (for which returns are to be calculated). If the investor chooses to calculate the returns from the time he/she decided to invest, then it could be the cost of the first purchase. After that, the purchases and sales during the period have to be accounted for at cost, including transaction charges and taxes. There may be dividends and rights issues and other corporate actions such as splits, bonuses and even spinning off the company into two or more listed entities. Then, there are costs such as demat charges or management fees and capital gains tax (short term). All of these have to be factored in for an accurate returns number.

As a result of these complexities, many investors are in the dark as to what returns their portfolios have delivered. They are aware of the profit / loss on each investment, but the consolidated return on the complete portfolio requires some number crunching, which many may not have done. Should the period be more than one year, then the investor may be interested in knowing the average annualized returns and not just the absolute return for the whole period.

Returns Calculation Methodology

Most portfolio management softwares and a few of the portals which facilitate investors to track their portfolio have this feature, but investors who are manually accounting their share purchases and sales or recording these transactions in their accounting packages are at a loss as to calculating their returns.

Excel and other spreadsheets have a formula for calculating returns from cash flows – in (sale) and out (purchase) occurring at irregular intervals. This formula is termed as the xIRR formula and is a very useful function in any spreadsheet software. The application of this formula is best explained in the underlying table.

Column A	Column B	Column C
Date	Inflow / Outflow (-ve)	Particulars
01-04-2014	-12,51,300.00	Opening Portfolio Value / First Purchase
06-05-2014	21,856.00	Sale of shares
20-06-2014	-51,345.00	Purchase of shares
14-08-2014	30,000.00	Allotment of rights shares
18-10-2014	500.00	Dividend received
01-01-2015	459.00	Dividend received
27-03-2015	56,778.00	Sale of shares
28-09-2015	45,678.00	Sale of shares
30-04-2016	200.00	Dividend received
04-06-2016	-550.00	Demat charges
09-07-2016	1,54,399.00	Sale of shares
13-08-2016	16,08,970.00	Closing Portfolio Value
	19.08%	xIRR return for the period 1st April, 2014 to 13th August, 2016
Formula is	=xIRR(B2:B14,A2:A14)	where B2:B14 are the cash flows and A2:A14 are the dates for these cash flows

The 19.08% return calculated by the xIRR formula is the annualized return for the period.

Importance of Returns Calculation

Calculating returns requires additional effort on the part of the investor, but it is necessary and important. It will enable the investor to compare his/her portfolio returns with benchmark indices such as the Nifty and Sensex and vis-à-vis other asset classes such as gold, debt market products, mutual funds and insurance policies.

Periodic calculation of returns and comparing it with other investors and indices will enable the investor to judge his / her investment strategy. If the returns are lower, then improvements are required. If the returns are higher, there will be the added confidence to increase exposure to this asset class. In both scenarios, measuring one's returns is an important facet of Smart Investing.

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