

FORUM VIEWS



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MISTAKES DON'T MATTER

By Rahul Rathi
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Covid and the current market situation has created a lot of questions about stock markets running ahead of the real economy. A presentation named "Anatomy of a recession" which has analyzed recession over a 100 years and current macro question is available at <https://www.leggmason.com/global/campaigns/anatomy-of-a-recession.html>

While I am currently fully invested in the markets with a bullish view. No investment thought process or style is complete without discussing risks. Some of them include US fiscal deficit, Markets volatility, GDP growth uncertainty, technology impact and the list goes on. I equate this to me being like the seven blind men and the elephant story. Every time there will be a different risk and that has the potential to create loss of capital or mistakes. My view is to invest based on the principle of maths (compounding) in the stock market. To me it means time in the market vs timing the market. The key risk parameter that I track for different styles is recovery days to come back to the previous peak. If the recovery days deteriorate then I know that my capability/ style needs upgradation. Building data references for many styles help.

The last few years have been a volatile time for the markets in India. Demonetization, GST, ILFS and now Covid means that financial market participants like myself need a framework to manage volatile times. Robust framework for me simply means a set of historical data points to support a portfolio where my fears come true and I still beat the index with lower volatility.

I decided to search/build for a framework that allows me to beat NIFTY demonstrating with the following uncertainty. I chose NIFTY as it had outperformed other broad indices with lower volatility over 3 year, 5 year, 10 year period. The framework should allow for the following fears.

- 1) No/low allocation to expensive darlings like Bajaj Finance, Asian paints, Nestle, Pidiliteetc
- 2) Allow for mistakes like Yes bank, Punjab National Bank, Tata Steel
- 3) Exit a stock before it goes up - example - Reliance before CY 2019

Yes, it is possible to beat Nifty and have lower volatility than Nifty even with the above constraints. Nifty Value 20 is an index that has all the constraints and still has beaten NIFTY and other indices with lower volatility. I have shared the index details below. My learnings from analyzing this index are below.

- 1) This index does an amazing job of avoiding sectors where performance (ROCE) have reduced relative to other sectors in the NIFTY. For example the index was underweight

finance sector from the start of 2018. My learning was that when a sector is underweight in the index it is best to avoid the sector specially the midcap/small cap names in the sector.

- 2) Momentum matters for weights - once you are part of the index then weights are determined by free float. If there is momentum in that counter then it will get higher weightage.

“Robust framework for me simply means a set of historical data points to support a portfolio where my fears come true and I still beat the index with lower volatility.”

To summarize, If the sector has poor relative business performance, exit and for higher relative performing business at a certain valuation, use momentum to decide weight. the most important decision that I as an advisor makes is what sector to avoid and this index does a bulk of the analysis for me. If I know which sector to avoid then even mistakes are easily forgiven. Weights adjusted for momentum will drive returns.

Details and Analysis of the index are below.

Performance vs Nifty 50:

Following data is taken from the NSE Oct-20 factsheet and our Purnartha platform:

Index Returns	CAGR		
	Oct-19 to Oct-20	Oct-15 to Oct-20	Oct-09 to Oct-20
Price Return	3	9.9	11
Total Return	5.3	12.1	13.1

Statistics	Oct-19 to Oct-20	Oct-15 to Oct-20	Oct-09 to Oct-20
Volatility	26.8	17.1	17.2
Beta (Nifty 50)	0.77	0.82	0.84
Max Drawdown	30.1	31.2	31.2
Recovery Days	99	121	121

Fundamentals	P/E	P/B	Div. Yield
	21.6	2.9	3

Nifty 50

Index Returns	CAGR		
	Oct-19 to Oct-20	Oct-15 to Oct-20	Oct-09 to Oct-20
Price Return	-2	7.6	10.1
Total Return	-1	9	11.5

Statistics	Oct-19 to Oct-20	Oct-15 to Oct-20	Oct-09 to Oct-20
Volatility	30.8	18.1	17.5
Beta (Nifty 50)	1	1	1
Max Drawdown	38.4	38.4	38.4
Recovery Days	NR	NR	NR

Fundamentals	P/E	P/B	Div. Yield
	31.9	3.3	1.4

The index has outperformed Nifty 50 on all the parameters over the years. Over the 5-year period the NV20 index has returned TR 12.1% vs 9.0% by Nifty 50. While demonstrating the higher return the risk observed is lesser in terms of Volatility and Max drawdowns and faster recovery. The index captures the momentum better than Nifty 50, currently its weightage towards IT sector is 45% (outperforming sector) and 0% weightage to the financials (underperforming sector), whereas Nifty 50 has 35% weightage towards financials and 17% weightage towards IT sector. Exhibit 1 provides 5-year details of sector and stocks.

Exhibit 1

Sector	2015	2016	2017	2018	2019	2020
AUTOMOBILE	5.5	5.6	5.7	5.7	6.8	5.1
BANKS	25.9	26.8	28.1	2.5	1	0
CONSTRUCTION	0	0	0	0	0	7.8
FMCG	5	4.5	5.8	9.6	12.8	22.5
IT	32.3	30.6	27.7	39.7	43.1	45.1
MEDIA	0	0	0	0	2.1	0
METALS	4.8	4.8	5	8.6	12.3	7.6
OIL & GAS	20.3	21.5	24.5	26.9	12.9	6
POWER	2.4	3.1	3.2	7.1	9.1	5.9
TELECOM	3.8	3.1	0	0	0	0

Name	Dec-2015	Dec-2016	Dec-2017	Dec-2018	Dec-2019	Dec-2020
Axis Bank	6.1	5.8	5.7	0	0	0
B P C L	1.9	2.5	2.4	2.1	3.7	2
Bajaj Auto	2.8	2.7	2.7	2.7	3.9	2.6
Bank of Baroda	1.2	1.1	0	0	0	0
Bharti Airtel	3.8	3.1	0	0	0	0
Coal India	3.4	2.9	2.1	3	3.8	1.6
GAIL (India)	1.4	1.6	1.9	2.4	2.1	1.1
H P C L	0	0	1.9	1.4	0	0
HCL Technologies	3.8	3.5	3	4	5.8	6.3
Hero MotoCorp	2.7	2.9	2.9	3	3	2.5
Hindalco Industries	0	0	0	0	0	1.7
Hindustan Unilever	5	4.5	5.8	9.6	12.8	12.7
I O C L	0	0	0	2.5	3	1.4
ICICI Bank	12.3	11.2	12.1	0	0	0
Infosys	15.4	15.3	12.4	15	15	15.8
ITC	0	0	0	0	0	9.9

JSW Steel	0	0	0	0	2.6	2.1
Larsen & Toubro	0	0	0	0	0	7.8
NTPC	2.4	3.1	3.2	3.7	5	2.9
O N G C	3.5	3.9	3.3	3.4	4.1	1.6
Power Grid Corp	0	0	0	3.4	4.2	3
Punjab National Bank	0.7	0	0	0	0	0
Reliance Industries	13.6	13.5	15	15.1	0	0
State Bank of India	5.6	5.9	6.9	0	0	0
Tata Steel	1.4	2	2.9	2.9	3.3	2.1
TCS	10.2	9.5	8	14.6	14.5	16.2
Tech Mahindra	0	0	1.9	3.3	4.4	3.4
Vedanta	0	0	0	2.8	2.6	0
Wipro	2.9	2.3	2.4	2.8	3.4	3.5
Yes Bank	0	2.9	3.5	2.5	1	0
Zee Entertainment	0	0	0	0	2.1	0

Nifty Value 20 Index Methodology:

The Nifty 50 Value 20 Index (NV20) comprises the 20 stocks selected from the Nifty 50 universe. Stocks with high ROCE (40% weight), low PE (30% weight), low PB (20% weight) and high dividend yield (10% weight) are shortlisted from the Nifty 50. The stocks with the top 20 "value rank" are chosen to be part of the index. The index is calculated using free float market capitalization methodology and has a base date of January 1, 2009 indexed to a base value of 1000.

At the time of rebalancing of index, the weightage of the index constituent is capped at 15%. Weightage of such stock may increase beyond 15% between the rebalancing periods. The portfolio is reviewed annually but with quarterly compliance checks. If a stock from the top 20 is still part of the top 30 upon review, it will be retained in the portfolio to minimise churn. If there is a new entry within the top 5, then the bottom stock in the existing portfolio will be replaced with it.

Essentially, it comprises companies that offer the most value among the Nifty 50 stocks. This is evident in the average price-to-earnings or price-to-book multiple of the NV20 Index relative to the Nifty 50. The value index also offers higher dividend yield than Nifty 50 Index.

The index has more concentration towards criteria fulfilling sectors rather than diversification as represented into Nifty 50.

Rahul Rathi is the Chairman and Fund Manager at Purnartha Investment Advisers (Purnartha) Private Limited. He has over 20 years of investment and risk management experience gained from working with global financial institutions in New York, London and Asia.

For over 10 years, he has designed and driven the Purnartha Investment philosophy of long-term wealth generation and has an audited, stellar performance track record. The Purnartha Portfolio has delivered a 37.30% CAGR versus 10.1% of NIFTY from April - 2009 till March - 2020.

He is an active contributor in society and is a trustee of Pune Blind Men's Associations H.V Desai Eye Hospital and Laxminarayan Devasthan trusts. He is an academic expert on Kaveri group of Institute's College.

He has a Master's in Industrial Administration from the Carnegie Mellon University and BE in Polymer Engineering from the University of Pune.