Piper Serica Leader Portfolio Strategy PMS
Investor Letter Vol. VI
November 2019

First Things First

Our portfolio return for October 2019 was 3.31%[1&2]. This was slightly lower than market indices (3.78% for BSE Sensex and 3.51% for Nifty) and Mutual Funds (3.7%) for the same period. However, our last five-month[3] return is 10.12%, much higher than broad market indices (1.04% for BSE Sensex and -0.40% for Nifty) and average of Mutual Funds (1.7%). Large part of the underperformance for the month was because of our nil allocation to autos and PSU Banks, both of which rallied strongly in October.

Portfolio Activity

The portfolio is well-diversified and top holdings continue to do well. 16 of our portfolio stocks hit their 52-week high in October. We have increased allocation to two branded-QSR companies and a domestic branded formulation MNC. The only auto stock in the portfolio rallied strongly and we took that opportunity exit completely at a profit along with a credit-rating company. Our cash holding continues to be below 5% of the total AUM. We continue to see ample long-term opportunities to deploy incremental capital.

Top 5 Stock Holdings	In %
Info Edge	5.53%
ICICI Lombard	4.60%
Apollo Hospital	4.08%
HDFC Ltd.	3.83%
HDFC Life	3.80%

View on optimal portfolio diversification and risk management

While our rigorous industry and company research covers risks arising out of 'known unknowns' there is no way that an investor can protect herself against stock-specific risks arising out of 'unknown unknowns'. Our attention has been brought to this issue as we engage with investors blindsided by sudden corrections in large cap stocks like Infosys and some small cap stocks like Hikal. Interglobe Aviation (Indigo Airlines) corrected sharply after its recent quarterly results and Apollo Hospitals fell almost 10% in a day after some adverse reports on social media and later recovered. All these companies are run by professional management with no past issues related to integrity. However, stock specific negative issues can arise from completely unknown quarters like whistle-blower complaints, auditor resignation, sudden negative disclosure by management, regulatory action, resignation of senior management, revelation of hidden liability, loss of or default by largest customer, sudden exit by a large shareholder, resignation by senior directors, entry of a new competitor etc. The list can go on and on.

The risk of unknown-unknows can be covered only by optimal diversification of the portfolio. There has been a lot of academic discussion on what is the ideal number of stocks in the portfolio that allows for optimal diversification i.e. where risk and return are optimized. In reality it goes beyond esoteric mathematics. For a fund manager there is always this huge temptation to over-allocate to a favorite stock. This risk can only be covered by putting in place a strong portfolio allocation and risk management strategy.

We have discussed with you our allocation and risk management strategy that is pretty much cast-in-iron. It has worked well for us. We have not had any episode of sudden drop in portfolio NAV because of a sharp drop in one single stock in the portfolio. In fact, we have actually benefitted by being able to increase allocation when there were sudden drops in portfolio stocks like MCX, HDFC Life, UPL and Interglobe Aviation (Indigo Airlines) for technical reasons.

Note:
1. This is the average absolute return for the entire portfolio. Individual portfolio returns will vary because of different allocation to same stocks in different portfolios and different time of making the investment.
2. Calculated by independent fund accountant on a TWRR basis after taking into account all fees and expenses.
3. The PMS is 5 month old so we have presented 5 month comparative data.

While some of our investors wonder whether our allocation strategy will reduce portfolio returns, we have data to the contrary. Our allocation and risk management strategy has helped provide steady and market-beating returns even when the markets were volatile. We have no plans to change our strategy.

Outlook

Results for quarter ending September 2019 have been quite positive and, in some cases, have surprised on the higher side. While management commentary continues to be cautious, especially related to rural demand, and there is little to say that the worst is behind us, none of the management teams that we interacted with are pointing towards calamity. At worst, there is a general sense of wonderment about how long the slowdown will persist and when will consumer demand pick-up. Some of our portfolio companies in the business of healthcare, insurance, entertainment, Internet and QSR have announced results that were better than expected and the stock prices have reacted favorably.

Festive season sales in October were a mixed bag. This is expected from a country as big and diversified as ours. We are bound to get conflicting views from different industries from different parts of the country. Overall, we are hearing that consumer discretionary demand related to autos, real estate and gold is slightly better than expected. It will be interesting to see how much inventory is left after the festive season. Consumer financing seems to be getting easier.

BSE Sensex hit an all-time high on the last day of the month. We have been positive on the broad market-level valuations and continue to maintain the twelve-month NIFTY target of 13500. While November is traditionally a good month for the markets, we need to see a consistent inflow from FPIs to support any further rally. Till the FPI flows reverse we continue to see the near-term pressure as a great opportunity to invest in high quality Leaders while they are still available at reasonable valuations.

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