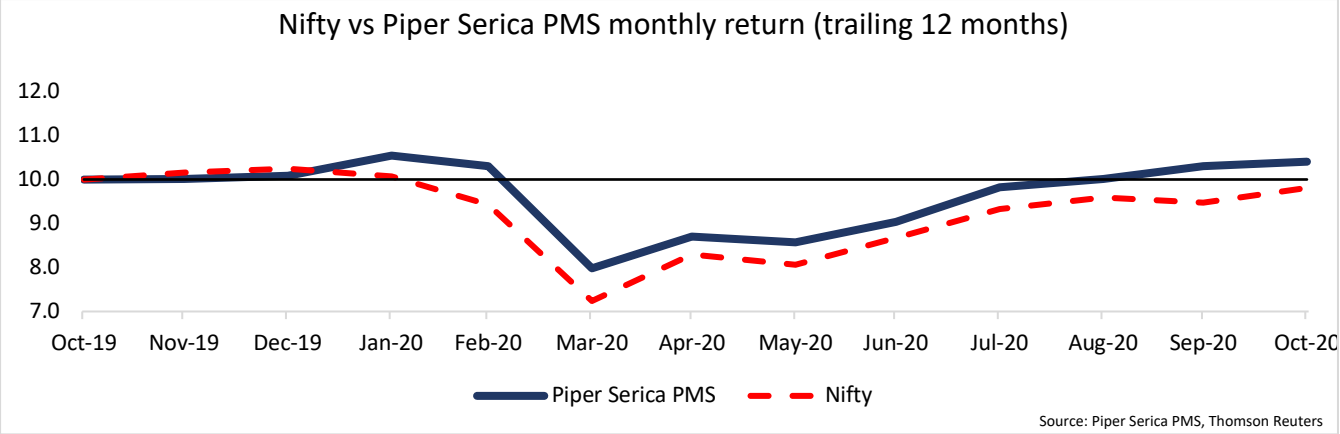
First Things First

PMS level aggregate absolute return for the three-month period ending October 2020 was 5.9%[1&2] against 5.1% for Nifty, 5.3% for BSE Sensex and 5.1% for multi-cap mutual funds. Nifty 500 index returned 6.0% during the same period. Trailing one-year return for the PMS is 4.3% compared to -1.7% for Nifty, -1.1% for BSE Sensex and -4.7% for average of multi-cap mutual funds. The annualized TWRR for the PMS since inception is 10.5% compared to -0.5% for Nifty.



Note:
1. This is the average absolute return for the entire portfolio. Individual portfolio returns will vary because of timing and allocation differences.
2. Calculated by an independent fund accountant on a TWRR basis after taking into account all fees and expenses.

Portfolio Activity

We reduced our cash holding from ~15.0% to ~ 8.6% by adding India's leading consumer Internet company to the portfolio. The company has consolidated its leadership position across each of its business verticals as the Covid-19 induced lockdowns have pushed consumers to digital channels. This company ranks very high on our Porter model because of its high competitive edge. We have been tracking the company for a couple of years and we believe that it is a great play on the long-term digital-migration trend. We have a comfortable cash holding of ~ 8.6% (*this is the average cash holding for the entire PMS and individual accounts may have different levels of cash*) giving us the ability to make additions to the portfolio. We are updating our Porter model scores as companies announce their quarterly earnings. We will take portfolio actions in case the scores change in a material manner. So far, based on their results and management commentary, almost all of our portfolio companies have improved their market share and competitive edge in the last quarter.

Top 5 Stock Holdings	Allocation*
Apollo Hospital Enterprises	7.0%
Dixon Technologies	6.9%
MCX India	6.2%
HDFC Bank	5.9%
Titan Company	5.7%

Top 5 Sectors	Allocation*
Financials	32.0%
Consumer Discretionary	23.0%
Consumer Staples	18.5%
Healthcare	12.3%
Telecom, Media & Technology	5.0%

*including cash in the portfolio

Large Cap	Mid Cap	Small Cap	Cash
60.9%	12.3%	18.2%	8.6%

Risk Adjusted Performance *(since inception in June 2019)*:

	Annualized Return %	Ann. Std. Dev.	R-Squared	Sharpe Ratio	CAPM Beta	Treynor ratio	Jensen's Alpha
PMS	10.5%	23.6	0.9	0.5	0.8	15.4	9.9
Nifty	-0.5%	26.7	1.0	0.1	1.0	3.3	0.0

Note: Risk adjusted performance gives a complete picture of the PMS performance by measuring the amount of risk taken for the return generated.

Portfolio Risk - Measurement and Management

Most investors make the mistake of judging the performance of a portfolio by looking only at its returns. Returns cannot be looked at in isolation of the accompanying risks. Higher return strategies typically carry higher risks. Investors tend to ignore such risks as long as they get the high returns. History has proved once and again that if risks are not measured and managed, especially when the going is good, they can destroy not only returns but also eat into the capital.

While looking at a portfolio of listed stocks, it is important to understand that it is exposed to two kinds of risk. First, the risks that are particular to each stock and second, the risks that emanate from the market as a whole. At Piper Serica, we use our investment process to mitigate the first risk. Our intensive research and Porter model scoring helps us understand the risks that the business of each of our portfolio companies is exposed to. These risks include competitive threats, demand-supply imbalances, regulatory risks, client concentration, supply chain disruption, human resources, high operating and financial leverage etc. We track each of these risks for each of our portfolio companies to minimize any negative surprises. A good understanding of these risks allows us to efficiently run our valuation models. Any valuation exercise that does not take into account business risks is just mathematical jugglery. Most analysts struggle to quantify business risks that are qualitative in nature. Therefore, their valuation models tend to be incomplete.

An effective way of mitigating portfolio risk is through optimal diversification of the portfolio across companies and industries that have low co-relation with each other. Nobel laureate Harry Markowitz provided a framework for portfolio construction in a way that optimized risk and return. Unfortunately, Indian equity market is too shallow for this model to work. However, with some iterations, a portfolio can be optimally diversified to lower its risk without reducing the expected return. Any excessive diversification in the portfolio only reduces returns and not risks. Therefore, it is no surprise that most of the actively managed mutual funds, holding a large number of stocks (more than a hundred in many cases) are chronic underperformers.

The second kind of risk mentioned above is the market risk, also known as the Systematic risk. Systematic risk affects the entire market, not just a particular stock or industry and it cannot be diversified. This type of risk is both unpredictable and impossible to completely avoid. It is what Nassim Taleb called as 'Black Swan'. Financial media spends most of its time agonizing over and trying to predict the onset of next bout of Systematic risk without realizing that it is a futile exercise that does little more than creating anxiety for even seasoned long-term investors. Managing liquidity in the portfolio in a nimble manner is one of the best ways for long-only fund managers to manage this risk.

We cannot manage what we cannot measure. Therefore, it is important for investors to consider the standard ratios that measure not only returns but returns that are adjusted for the underlying portfolio risk. This is the only way that investors should compare the performance of various portfolios and strategies. Thankfully, this data is now readily available. We have appended our risk adjusted return ratios overleaf with the purpose of familiarizing our investors with the ratios that they should consider while comparing investment opportunities.

Finally, it is most important to ensure that your fund manager has full skin-in-the-game. Almost 4,000 years ago, King Hammurabi of Babylon, laid out a set of 282 laws as Hammurabi's Code, most concerning punishment. Law number 229 seeks to manage the risk of new construction by stating that "If a builder builds a house for a man and does not make its construction firm, and the house which he has built collapses and causes the death of the owner of the house, that builder shall be put to death." This was enough for the builders to build high quality houses with an adequate 'margin of safety'. At Piper Serica we have a stated policy of making almost all of our personal investments through the PMS and of committing a substantial part of our net worth to the PMS to ensure that our interests are fully aligned with our investors.

Abhay Agarwal,
Founder & CIO

Rajni Agarwal,
Director, Research

ANNEXURE: PIPER SERICA PMS RISK ADJUSTED PERFORMANCE

Risk Metrics	Piper Serica PMS	Nifty	Explanation	Analysis of Piper Serica PMS
Absolute risk				
Annualized Return %	10.48	-0.51	Return generated by the PMS and Nifty on an annualized basis since the inception of the PMS.	
Alpha Return %	10.99		Excess annualized return generated by the PMS over Nifty.	Significantly higher returns.
Annualized Standard devia	23.61	26.65	Indicates the volatility of the PMS and Nifty. It is calculated as the dispersion of NAV from its mean. Lower the better.	Lower than the Nifty.
Downside risk				
Semi deviation	5.95	6.18	Indicates the downside risk of the portfolio by calculating only the variance of negative variances unlike the SD that is calculated by using the negative and positive variances. Semi-deviation indicates the worst-case performance to be expected from an investment. Lower the better.	Lower than the Nifty.
Realtive risk				
R- squared	0.87	1	Indicates the proportion of change in the PMS returns to the change in the Nifty returns. Since it only gives an idea of the co-relation it does not really matter if it is high or low.	Reasonable co-relation with Nifty
Tracking risk	2.82	0	It is the standard deviation of returns of the PMS to Nifty returns and indicates how well the PMS is replicating the Nifty. High Alpha Return will typically lead to high Tracking risk.	High because of high Alpha Return.
Risk Adjusted Returns				
Sharpe ratio	0.54	0.13	One of the most important ratios. Indicates the average return earned in excess of the risk-free rate per unit of volatility. High Sharpe ratio means the portfolio risk adjusted return is superior to Nifty.	High
M-Squared	14.32	3.34	It is derived from the Sharpe ratio but is more useful because it measures the scaled excess return of our PMS and that of the Nifty, where the scaled PMS has the same volatility as the Nifty.	High
CAPM Beta	0.83	1	Indicates how volatile or how risky a portfolio is relative to the Nifty. Lower beta means lower risk. Our PMS has made a significant alpha return with a low beta which means we are taking lower risk while generating higher returns than the Nifty.	Low
Treynor	15.38	3.34	Indicates how much return the PMS earned for the amount of risk the portfolio assumed. Higher the Treynor Index the better. The index is a performance metric that expresses how many units of reward an investor is given for each unit of volatility they experience.	High
Jensen's Alpha	9.93	0	Represents the excess return of the PMS, above that predicted by the capital asset pricing model (CAPM), given the PMS's beta and the average market return.	High

Note:
1. The data is from the date of inception of the PMS (July 24, 2019) to October 31, 2020
2. The PMS and Nifty performance and risk adjusted performance data is provided by Kotak bank fund accounting.