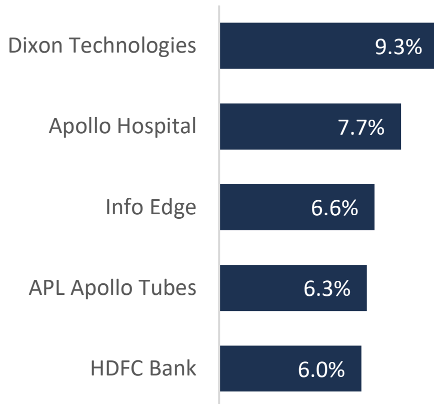
Piper Serica Leader Portfolio Strategy™

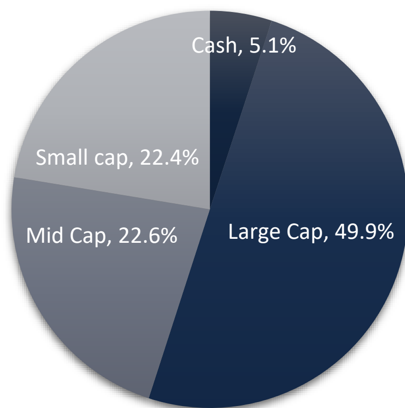
Investor Letter Vol. XXII

March 2021



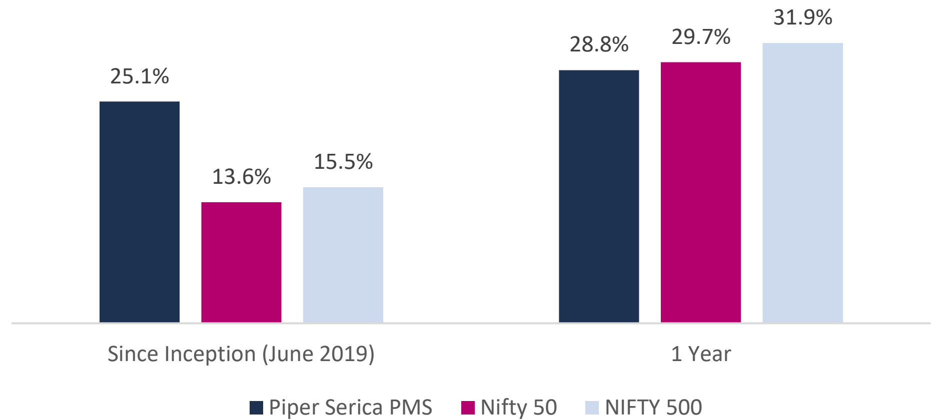
Top 5 Sectors	Allocation*
Financials	28.5%
Consumer Staples	15.5%
Technology	11.8%
Consumer Discretionary	10.0%
Industrials	9.3%

**including cash in the portfolio*



First Things First

PMS level aggregate absolute return for the month of February 2021 was 8.8%[1&2] against 6.6% for Nifty, and 6.1% for BSE Sensex. Nifty 500 index returned 7.8% during the same period. Trailing one-year return for the PMS is 28.8% compared to 29.7% for Nifty, and 28.2% for BSE Sensex. The annualized TWRR for the PMS since inception is 25.1% compared to 13.6% for the Nifty



Source: Piper Serica PMS, Thomson Reuters

1.Average TWRR for the entire PMS. Individual portfolio returns will vary because of timing and allocation differences.

2.Calculated by an independent fund accountant on a TWRR basis after considering all fees and expenses.

Portfolio Activity

There were no major changes to the portfolio in February. As part of our risk management practice, we reduced our exposure to Dixon by 1% to bring it below 10% of the portfolio. Our investors are aware that as part of prudent risk management we do not let a single company allocation exceed 10% of the portfolio. We used the proceeds to increase our allocation to IndiaMart and Info Edge. The former did a large QIP issuance. This put marginal pressure on the stock price and gave us a good opportunity to increase our allocation.

We have updated Porter model score for each of our portfolio companies after their Q3 results. We are happy to state that the model scores went up for each company indicating an improvement in their long-term competitiveness. We are happy to notice that each of our portfolio companies is aggressively investing in and using digital technologies to further increase their market share.

Our cash balance at PMS level is 5.1%, though it is much lower in older accounts that are almost fully invested. We do not plan to increase our cash allocation.

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	25.1%	24.3	0.9	1.0	0.9	28.8	11.1
Nifty	13.6%	26.3	1.0	0.6	1.0	16.1	0.0

Creating long-term wealth by investing in Businesses of the Future

Almost all of short-term investment strategies, based on flavors-of-the month, do not work in the long term. History has proved that there is only one way to generate above-average returns AND compound wealth over a long period of time, defined as more than 20 years. One needs to look at stock market investing as a way to intelligently allocate one's capital to promising companies and not as a betting game that may lead to quick gratification and then permanent loss of capital.

Once an investor is able to develop a long-term mindset, the easiest way to invest is to identify the businesses of the future. As different countries go through their own demographic and economic lifecycle, they give birth to industries that have high growth and longevity driven by rapidly increasing demand for their products and services. Identification of these industries requires a keen sense of observation and also an ability to benchmark them against the experience of other countries that are ahead in the same lifecycle.

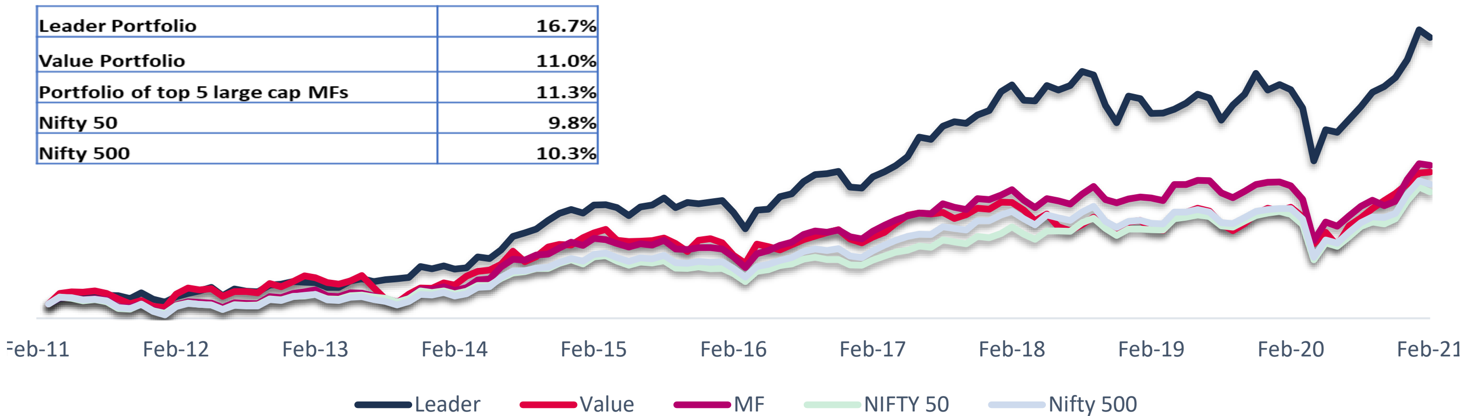
An easy way to identify these industries is to observe where the consumers are spending a larger part of their wallet. Mainstream media and financial analysts are typically slow in catching these trends. However, an astute investor can use empirical evidence to observe where is the flow of money from consumers wallets headed.

At Piper Serica, we spend a lot of effort in analyzing demographic and economic trends to short-list industries that we think will grow exponentially in the next 15-20 years. Based on our analysis we believe industries like healthcare, insurance, consumer Internet, consumer electronics, branded food and beverages, personal mobility, home improvement, travel and entertainment, financial services are some of the industries that will grow rapidly over the next decade and more as India crosses the demographic inflection point that led to rapid growth of these industries in other countries that we use as a benchmark for our analysis.

Once a fast growth industry is identified, the investor then has to identify the company in that industry to invest in. We believe that it is best to invest in the leader of the chosen industry. However, after identifying the leader, it is very important to ensure that the leader is a 'strong' leader with a significant competitive edge over its competitors. Highly competitive leaders create tremendous shareholder value over long periods of time by consistently increasing their market share in a rapidly growing industry. At Piper Serica, we use Michael Porter's 5-Forces Competitive Edge Model to analyze the competitive edge of a company. As part of this model, we rate the strength of each company while dealing with its suppliers, distributors, competitors, new entrants and new substitute products. We meet all stakeholders of the company to complete our analysis. This analysis helps us rate each company on a competitive edge scale.

We are fortunate to have a large number of investors. Many of them have asked us to analyze their direct investment portfolios. While analyzing their portfolios, we see one common mistake that individual investors make across-the-board. Even after identifying the right industry and the right company, they end up investing in the wrong company solely because it is cheaper as per traditional valuation parameters. They are attracted by the valuation gap between the industry leader and its closest competitor and mistake it to be 'margin-of-safety'.

However, the evidence is to the contrary. Companies that are strong leaders in fast growing industries are very rare and therefore, trade at a premium valuation for very long periods of time and create significantly more returns for shareholders than their 'cheaper' competitors. The following chart shows the massive outperformance (CAGR) by a portfolio of leader companies over their competitors and over the indices over a ten-year period:



A good way for an investor to get over the hurdle of valuation gap is by constantly reminding herself of the outstanding wealth created by the industry leaders over the last 15 years despite their valuation premium. These leaders were deemed to be expensive even in year 2005 by traditional valuation parameters and traded at a substantial premium to the industry average. However, the investors who stayed the course have been fabulously rewarded. These companies have beaten the benchmarks by a wide margin and have created very significant absolute shareholder wealth. The following table gives some examples:

	PEx 2005	Industry PEx 2005	Premium	Market Cap 2005 (Rs. Crore)	Market Cap 2020 (Rs. Crore)	CAGR	Delta over Nifty
HDFC Bank* (P/BV)	4.9	2.9	**69%**	20,578	7,85,648	26%	**12%**
TCS	27.5	21.5	**28%**	61,246	10,74,190	20%	**6%**
Asian Paints	21.6	16.8	**29%**	3,718	2,65,143	31%	**17%**
Nestle	16.4	11.5	**43%**	5,060	1,81,730	26%	**12%**
Titan	55.3	29.1	**90%**	972	1,39,006	37%	**23%**

NIFTY CAGR: 14%

Lastly, we would like to remind the investors that too much portfolio activity and tinkering is detrimental to returns. Long term investing is inherently boring because one needs to follow an investment process in a disciplined manner and cut out all noise and unnecessary activity in the portfolio. William J. Bernstein said it well - "If you find yourself stimulated in any way by your portfolio performance, then you are probably doing something very wrong. A superior portfolio strategy should be intrinsically boring." We have observed that successful long-term investors have a stoic temperament so that they are not distracted by short term events and noise.

We are happy to inform you that our model portfolios hosted on smallcase.com continue to do extremely well. ED+, our small-cap strategy was up 17.3% last month and Wealth Compounder, the multi-cap strategy was up 10.2%. They have generated absolute returns of 65.8% and 36.2% since their inception in September 2020 and August 2020 respectively.

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