Piper Serica Leader Portfolio Strategy™

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Portfolio performance and activity

The since-inception (June 2019) TWRR for the PMS is 20.7%. This compares favorably with our benchmark Nifty that returned 14.1% over the same period and multi-cap MFs that generated 17.1% return. Our standard deviation and CAPM beta continue to be well below that of the benchmark and our Sharpe ratio is well above, as detailed in the factsheet.

Our monthly factsheet can be downloaded here.

Portfolio and market update

There were no major changes to the portfolio other than those that you are already aware of through our earlier communications. We stay almost fully deployed with cash holding of 4% at the PMS level. For the new accounts we continue to invest funds in a staggered manner as we expect the markets to stay volatile over the next 3-6 months.

At the macro level, the government revenues through direct and indirect tax collections continue to be better than estimated. This will allow the government to spend on developmental activities without increasing market borrowings. At the same time, inflation has already crossed RBIs comfort zone of 6%. Major driver of this spike is crude price. If inflation turns to be sticky RBI will be forced to change its accommodative stance. The debt market has already seen a spike in short term rates in anticipation of this. India is used to inflation compared to its western peers. However, higher inflation will put more pressure on savers to earn higher returns as the low returns available from fixed income options are well below inflation leading to negative real return. The buying power of savers reduces in a high inflation environment unless they tweak their portfolio allocations to earn portfolio returns that are higher than the rate of inflation without taking excessive extra risk.

Inflation and innovation

Inflation is a global problem right now. US and Europe are both seeing inflation rates that are multi-decade high. These economies and consumers are not used to this level of inflation and therefore seem to be going into a demand shock. There is visible downtrading by consumers to protect against higher prices of premium goods. Economists consider this a rational consumer behavior as explained by Alan Greenspan in his book The Age of Turbulence. Rather than cutting down physical units of consumption consumers typically go for a cheaper option across all items of consumption including food and staples. For instance, to counter higher fuel prices consumers switch to smaller and more fuel-efficient cars but travel the same distance. However, discretionary demand for large-ticket items is postponed awaiting lower prices.

In such an environment the onus is on companies to drive cost efficiencies to protect their margins while holding the product price as steady as possible. Companies that can do this better than their competitors see increased brand loyalty and higher market share. An environment of high inflation sharply separates the innovative companies from their peers. Non-innovative companies, even sector leaders, typically resort only to squeezing the supply chain and distribution chain to reduce costs. On the other hand, innovative companies focus on improving or changing production processes, using different raw materials, light weighting of products, automation and insourcing as much as possible to bring down costs while delivering a better product to its customers. Apple is a classic example of this. It is using its own M1 chipset rather than depending on external suppliers like Qualcomm and Intel. Therefore, Apple can now work on the design of a chip for a product at the same time as the software, hardware, and the industrial design. It is also not impacted as much by the global semiconductor crisis. Practices like these make Apple the most valuable company in the world. Contrast this to Netflix, the once glorious FAANG stock that is now completely out of favor. Sticking to high priced subscription-only fees model has seen it lose subscribers to cheaper priced competitors that are using a mix of advertising and subscription fees to reduce the pricing for their customers. Netflix is now reacting to this change, but it will have to now play catch-up in a highly competitive industry.

We want to see constant innovation from our portfolio companies. We do not want them to rely only on their leadership positions because leadership can change in an extremely dynamic environment. We are happy to note when APL Apollo focuses on light weighting its steel pipes to reduce the raw material cost per running foot. Or when Lemon Tree improves its inhouse processes to reduce the count of employees per room to below 1, lowest in the industry. The share of digital brokers has increased from 15% 5 years ago to 45% now and is expected to increase to 65% over the next four years. Our portfolio company Angel One is leading this change through its digital only fixed-priced model while the traditional brokers that charge a brokerage based on percentage of order value are losing out. Affle is bringing down cost of customer acquisition by offering a robust purely tech-based advertising platform that charges its clients on a per conversion basis as against the industry standard of per impression.

High inflationary environment, while painful for consumers, gives an exceptional opportunity to innovative companies to garner market share by creating very strong brand loyalty. However, innovation is either part of the DNA of a company or not. It cannot be a relegated to only being a strategic initiative when times are tough. Thereby, companies that have a history of constant innovation, led by a management team that believes in reinvention even at the cost of cannibalization, come out on top by using every threat as an opportunity. These are the companies that we want in our portfolio.

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