Piper Serica Leader Portfolio Strategy™

PORTFOLIO PERFORMANCE AND STRATEGY UPDATE
September 2023

Dear Investor,

As you would have seen from your latest portfolio statements, the performance of the portfolio over the last five months has been very strong. Since April 1, 2023 the absolute return generated by the PMS is almost 37% while Nifty generated less than 11%. This is even more remarkable considering we held 7% cash on average. This outperformance has further improved our long-term performance as can be seen from the table below.

Return Comparison

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	Since Inception* Feb-2015	**5 Year**	**3 Year**	**2 Year**	**1 Year**	**6 months**	**3 months**	**Aug-23**
PS Leader Portfolio	**20.2%**	**18.9%**	**23.0%**	**8.1%**	**24.0%**	**34.7%**	**18.8%**	**6.9%**
Nifty 50	10.2%	10.5%	19.1%	6.1%	8.4%	11.3%	3.9%	-2.5%
BSE 500	10.6%	11.1%	21.4%	7.7%	10.7%	15.2%	7.2%	-0.8%

The purpose of this short note is to address some of the questions that we have been asked by our investors recently:

1. Reason for the strong performance?
2. Will it sustain?
3. Are we booking profits? Are we hedging the portfolio risk?
4. Is there any change in the model portfolio? Are we changing any allocations or adding or removing any stocks?
5. General expectation of 3-5 year returns from the portfolio.
6. Our advice to investors.

Reasons for the strong outperformance

The result of the churn in the portfolio in the Jan-March quarter is exactly as we expected. As you are aware we increased the allocation to small and mid-caps to 75%. We saw a great opportunity in undervalued growth companies that had underperformed the large caps over last five years. We also decided to invest in certain out-of-favor sectors like textile exporters and small and mid-sized lenders because we saw near term growth triggers. We also focused on bringing down the P/E multiple of the portfolio to close to 20x forward earnings. While doing this exercise, our research team dug deep to look for companies that are not only poised for solid growth but also available at attractive valuation. The latter part is the difficult one since it requires us to have a contra view from other investors.

Not only did we get the investment calls right we also got the timing right. Mid and small cap indices have outperformed the large cap index over the last four months and have hit their all-time high. We expect this rally to pause for a while and consolidate before starting the next up move. Earnings for the current quarter will be the next trigger.

Will the outperformance sustain?

The good news is that the portfolio level valuation multiple has only marginally risen to 23x, well within our upper limit of 25x. The earnings have been largely in line with our expectations. Some of the recent additions to the portfolio like CSB Bank, Indostar, Himmatsinghka, SP Apparel etc. still trade at valuation multiples that are below their industry peers despite better growth prospects. We have also trimmed partially some of the positions that had gone well above our model portfolio allocation. Therefore, we are quite confident that the PMS portfolio will continue to outperform its benchmark.

Are we booking profits? Are we hedging the portfolio risk?

We regularly book part profits whenever a portfolio stock goes beyond the allocation in the model portfolio. We sell adequate quantity to bring down the allocation. Recently we have done this in multiple stocks that have run up – Gokaldas, Angel One, CMS, South Indian Bank and Spandana Sphoorty amongst others.

We use these funds to either increase allocation to other stocks or to add a completely new stock. For instance, the entire addition of Jio Finance was made through the part profit booked in Gokaldas Exports after its recent sharp run up.

We cannot hedge the entire portfolio. SEBI rules allow us to hedge only by buying put options. This is quite expensive with cost as high as 1% per month. Also, the put options can be bought for Nifty but there is an overlap of less than 20% between Nifty and our portfolio. Therefore, we do not hedge the portfolio but try to limit the portfolio risk by risk management practices including allocation management and profit booking.

Is there any change in the model portfolio? Are we changing any allocations or adding or removing any stocks?

We have reduced allocations to some small and mid-cap stocks that have hit the upper limit of our valuation model. At the same time, we have not excluded them from the portfolio since we still see them provide the target PMS level return over the next three years.

We have added Jio Finance to the portfolio in the last month after its listing. We believe that the company is poised to further grow the Indian financial services industry. We expect the company to emerge as a very large and competitive player over the next three years that will drive down pricing for customers through use of digital tech. It benefits from the large B2C platform provided by the Reliance group's telecom and retail businesses.

While we do not plan a major churn in the portfolio we will not shy away from utilizing opportunities as they present themselves. We find that to be a key part of active management and essential for generating long term alpha.

General expectation of 3-5 year returns from the portfolio.

A lot of easy money has already been made in the last four months as valuations have normalized. Now earnings growth will drive returns. We are confident that our portfolio companies will grow earnings at 18-20% per annum over next 3-5 years. Therefore, assuming valuation multiples stay flat our expectation is that the portfolio will generate a 17-19% IRR over the next 3-5 years. This is also consistent with our long-term track record of returns.

Our advise to investors

Long term investors need to look at benefitting from India's economic growth over the decade. If one takes a 5-10 year view, equity asset class will deliver the best returns to investors. However, volatility on the way is par for the course for investors.

We advise a 10% further allocation to the portfolio to benefit from the opportunities that we are seeing to add growth stocks to the portfolio at an attractive valuation to further boost long-term returns.