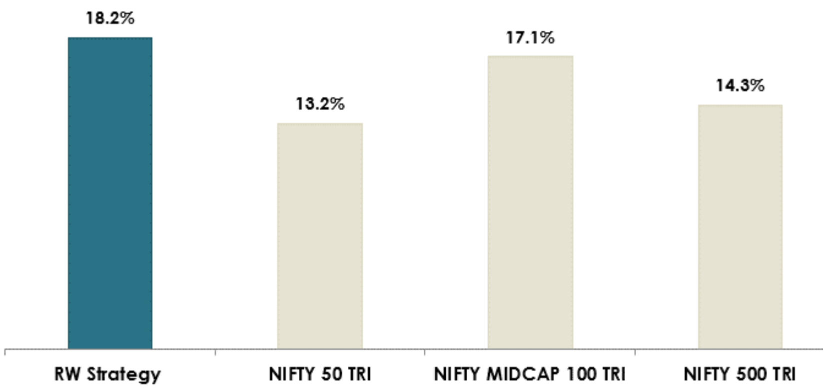
RW ADVISORS

Quarterly Update — March 2023

Investment Objective

RW Investment Advisors uses a proprietary framework that combines fundamental and technical factors to identify businesses that can create long term wealth. The guiding philosophy is capital protection and compounding over longer periods.

Chart 1: RW Strategy TWRR* (Since Inception)



Strategy returns shown above are post fees and expenses.

Top Performers

Scrip Name	Purchase Date	Adj. Purchase Price (Rs.)	CMP (Rs.) as of 31-03-2023)	Growth (%)
ASIANPAINT	01-Sep-2017	1,550	2,762	78.2%
ICICIBANK	23-Dec-2020	646	877	35.9%
HOMEFIRST	05-May-2021	598	743	24.1%
HDFCBANK	14-Feb-2013	1,345	1,610	19.7%
INDUSINDBK	07-July-2022	950	1,068	12.5%

Holding Companies

Asset Concentration	Holding
No. of Companies	25
Top 5 Company Holdings	37.2%
Top 10 Company Holdings	60.7%
Highest Exposure	ICICIBANK (8.9%)

Sector Allocation

Sectors	Allocation (%)
BFSI	34.2%
Auto & Ancilliaries	15.9%
Consumer	15.0%
Healthcare/Pharma	11.7%
Technology & Others	23.1%

Market Capitalization

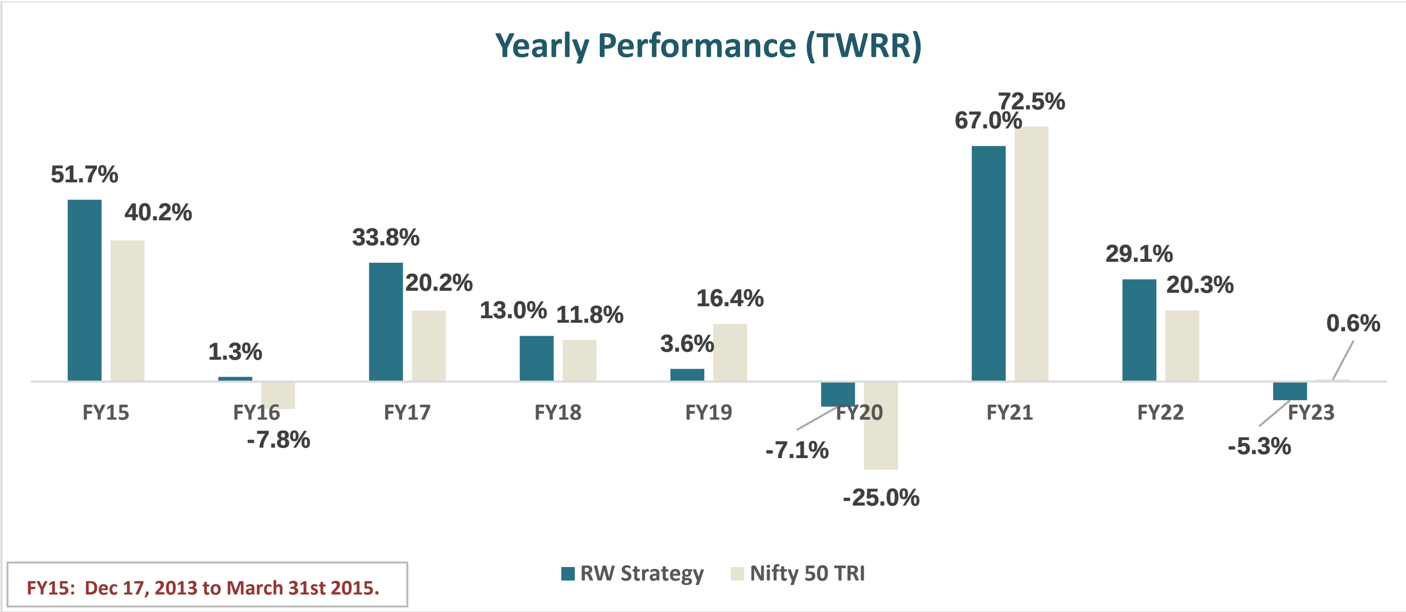
Market Capitalization	Holding (%)
Large Cap	51.4%
Mid Cap	10.5%
Small Cap	38.1%
Avg. Market Cap (Rs. Bn)	2,721

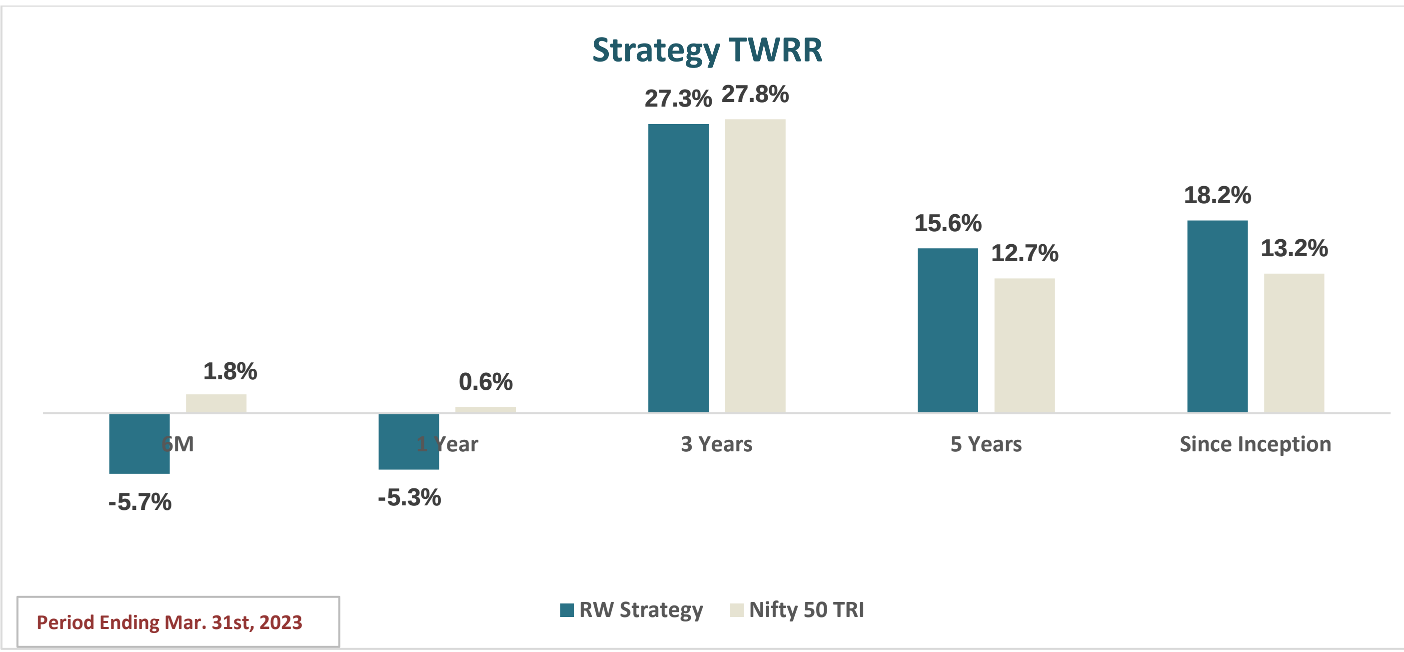
Qualitative Analysis

Parameters	TTM
PAT Growth	45.8%
PE	40.3x
ROE	19.25%

Holding Period

Holding Period	No. Of Scrips
Less than 1 Year	18
Between 1 to 3 Years	5
More than 3 Years	2





Strategy returns shown above are post fees and expenses

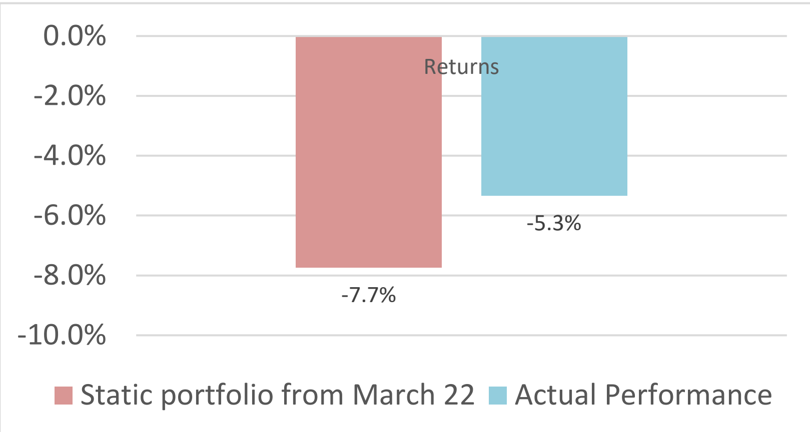
3 year performance is flashing yellow as one might see from the chart above. As you may recall, we experienced a similar, if not worse, performance in FY19, but then we came out stronger in FY20. As we approach the penultimate update before migrating to a PMS (Portfolio Management Services) structure, we believe it is crucial to finalize our strategy and address the nitty-gritties to improve our performance. Our sole purpose is to ensure the best possible outcome for our clients.

A big shout-out to all our clients, who have been with us through thick and thin. We are committed to making appropriate adjustments and navigating through this thin phase with determination and resilience

“We must not wait for things to come, believing that they are decided by irrescindable destiny. If we want it, we must do something about it.” Erwin Schrondinger

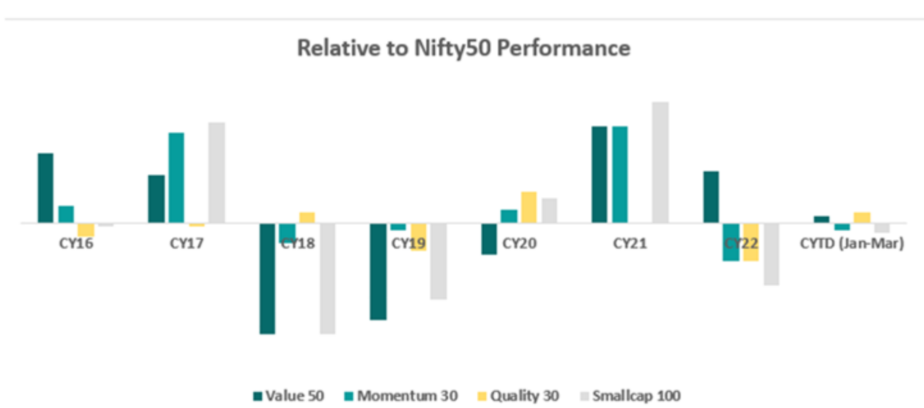
Given that last year was a roller coaster year, we reflect upon what could have been done better both in terms of process and stock picking:

Chart 1: Performance of a static portfolio from March of last year (March 22) vs Actuals (First Client’s Account):



As shown in Table 1, if we had just held onto the portfolio that we had in March 22 without any reshuffling, that portfolio would have delivered a negative return of 7.7%. As against that, actual portfolio performance was a negative return of 5.3%. With the myriad man hours put in to analyze and recommend multiple companies, one would question whether the effort was well spent. <u>Honest answer is that every percentage point counts in the long run. Churn, unfortunately, is a by-product of the process.</u>

Chart 2: Value outperformed over the last 3 years:



Factor - N50	CY16	CY17	CY18	CY19	CY20	CY21	CY22	CYTD (Jan-Mar)
Value 50	20%	14%	-32%	-28%	-9%	28%	15%	2%
Momentum 30	5%	26%	-6%	-2%	4%	28%	-11%	-2%
Quality 30	-4%	-1%	3%	-8%	9%	0%	-11%	3%
Smallcap 100	-1%	29%	-32%	-22%	7%	35%	-18%	-3%
Nifty 50	3%	29%	3%	12%	15%	24%	4%	-4%

Source: QED Capital

Last year, our portfolio recommendations underperformed the broader NIFTY TRI 50 by 5.5%. The easy answer is the inevitable cycle that is at play - value style (cheap stocks) has outperformed all other factors not just in the last financial year but 3 years in a row now. After this streak, it is the best performing factor in the last 8 years. Despite this what’s interesting is it is still underperforming momentum (price) strategy by 54% over the last 8 years – tells you how much value strategy suffered in low interest rate environment.

It is conventional wisdom that no factor outperforms all the time, but the degree to which value outperformed surprised us. To gain deeper insights, we conducted further analysis by breaking down the data into multiple quarters to identify which strategy was performing better in different market conditions

Chart 3: Growth started outperforming starting 3Q:

	Average	Nifty 50
Q1		
	Average	**Nifty 50**
Overall Return	3%	10%
S& BSE Momentum Index	7%	
RW Return	**5%**	
Value Return	13%	
Nifty50 Value 20 Index	14%	
Q2		
Overall Return	-6%	2%
S& BSE Momentum Index	-12%	
RW Return	**-6%**	
Value Return	-4%	
Nifty50 Value 20 Index	7%	
Q3		
Overall Return	-3%	-4%
S& BSE Momentum Index	-12%	
RW Return	**-3%**	
Value Return	-8%	
Nifty50 Value 20 Index	1%	

"Overall Return" is the return from a custom built index consisting of 35 stocks with highest earnings growth and with ROCEs higher than 15%; Similarly "Value Return" is the return from a custom built index consisting of top 35 stocks with highest earnings growth, minimum ROCEs of 15% and trailing PE ratio less than 25.

"S&P BSE Momentum Index" and "Nifty50 Value 20 Index" are published indices which track price momentum and value respectively

Q1 return means return from June 22 to March 23; Q2 return – return from September 22 to March 23; Q3 return – return from Dec 22 to March 23

Based on LHS data:

- Returns of our recommended portfolio are in line with a custom-built index that focuses on high growth characteristics
- Large Cap value, specifically Nifty50 Value, continues to outperform Nifty 50, which is noteworthy
- <u>Encouragingly, there are early signs of the broader growth strategy outperforming both value and NIFTY 50 again</u>
- <u>Our stock picking strike rates have reverted to the original base rates, indicating positive performance trends</u>.

Could we have done better in scouting for opportunities?

The process of selecting companies with earnings tailwinds has proven to be successful in sectors that were not typically the focus of our portfolio. Just like Vishwamitra's tryst with Menaka, it was challenging for us to resist the allure of quick returns that could have been made in those sectors. However, we had our own reasons for staying out, based on our investment strategy and risk assessment:

- **PSU banks** – PSU banks have been performing well due to favorable macroeconomic conditions, but it has been challenging to fully understand their lending practices and governance. In a benign macro environment, they have been reaping benefits. However, there is a concern about what could happen if the macroeconomic conditions were to turn negative. The potential impact on PSU banks, given their lending practices and governance challenges, remains uncertain and requires careful monitoring?
- **Defence Stocks** – Although the government has been promoting the indigenization of manufacturing, it was a complex decision for us due to factors such as high working capital cycles and lingering concerns from past scandals like the Panama Papers. While there has been a push towards self-reliance in manufacturing, we had to carefully evaluate the risks and challenges associated with these efforts before making investment decisions. Ensuring transparency, governance, and managing working capital requirements were important considerations in our decision-making process
- **Hotel stocks** – with average base ROCEs sub 15% prior to Covid, it was a non-starter
- **Capital Goods** – We could have delved deeper into the Capital Goods sector during our research. Our focus was primarily on companies like ABB, L&T, Ratnamani, and Siemens, but we could have expanded our analysis to include companies like AIA, Apar, CG Power, Tube Investment, Carborandum Universal, KEI Industries, Tega Industries, and others earlier in the cycle. Reflecting on this, identifying one or two big winners could have made a significant difference.

- **EMS companies** – Many of the companies in this space including DXC/Avalon/Syrma/Kaynes do not have long enough history of strong performance to take a call but we are actively engaged in understanding the businesses.

While we did look at few companies in the EPC/Capital Goods space with strong earnings tailwinds at dirt cheap valuations, we were not comfortable with certain aspects related to their governance practices. They mainly relate to promoter pledge, promoter family disagreements, political connections etc. In hindsight, we realize that our decisions may have resulted in missed upside potential but downside risk management i.e. capital protection is paramount and will continue to be so.

Like the waxing and waning of the moon, value and growth typically take turns to outperform. Since value has now outperformed for 3 years in a row, it may not be too far-fetched to anticipate a potential resurgence of growth investing. As discussed in our previous newsletters, factors such as global recession and a pause or decline in Fed rates could serve as key triggers for this shift. The good part is we have seen years like FY19, yet came out strongly. We just have to retain a lot of what we already do, with some minor tweaks.

Looking back, the past year has been a valuable learning experience for us. As a result, we have identified three key changes that we will be incorporating into our investment processes:

1) Valuations will be given extra consideration, irrespective of the growth prospects.
2) We will strive to expand our research beyond our comfort zone and dig deeper into sectors that may not be in our usual focus, but exhibit strong earnings tailwinds.
3) When launching a PMS (Portfolio Management Service), we plan to introduce *two distinct schemes*. One will be long-term focused with minimal churn, while the other will be an all-weather scheme that follows the same operating principles as RW, but may entail higher levels of churn.

These changes are aimed at refining our investment approach and positioning ourselves to navigate market challenges and capitalize on emerging opportunities.