RW ADVISORS

Quarterly Update

September 2018

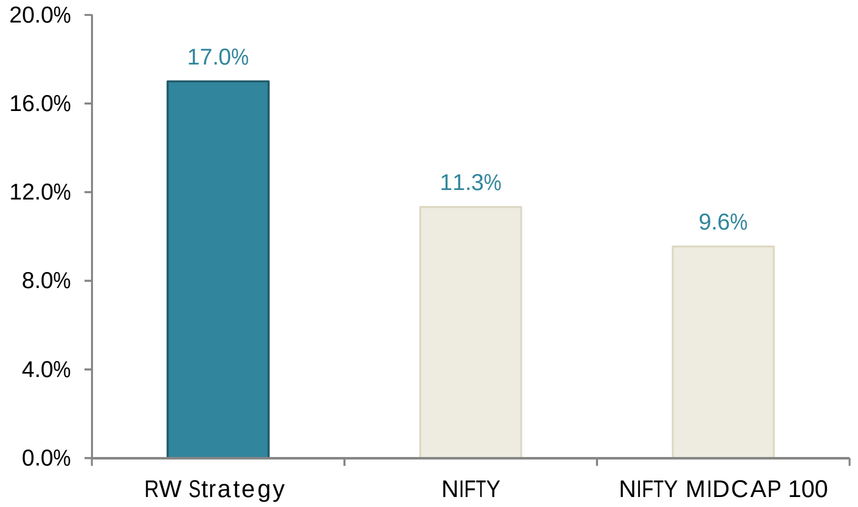
Investment Objective

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.

Holding Companies

Asset Concentration	Holding
No. of Companies	19
Top 5 Company Holdings	44.6%
Top 10 Company Holdings	72.4%
Highest Exposure	Kotak Bank (11.0%)

RW Strategy Performance (Internal Rate of Return)



Sector Allocation

Sectors	Allocation (%)
Auto & Auto Ancillaries	17.2%
Banking & Finance	34.0%
Consumer Durables	4.3%
FMCG	3.9%
IT Services	20.6%

Market Capitalization

Market Capitalization	Holding (%)
Large Cap	50.6%
Mid Cap	37.4%
Small Cap	11.6%
Avg. Market Cap (Rs. Bn)	1,201

Top Performers

Scrip Name	Purchase Date	Purchase Price (Rs.)	CMP (Rs.) as of 28-09-2018	Growth (%)
HDFC Bank	13-Feb-14	634	2,006	216.4%
Kotak Bank	22-Jul-14	437	1,144	161.5%
Maruti Suzuki	07-Apr-16	3,476	7,351	111.5%
Abbott India	17-Mar-17	4,524	7,813	72.7%
Indusind Bank	30-Nov-16	1,079	1,686	56.3%

Qualitative Analysis

Parameters	TTM
PAT Growth	27.2%
PE	35.8x
ROE	23.0%

Holding Period

Holding Period	No. Of Scrips
Less than 1 Year	10
Between 1 to 3 Years	6
More than 3 Years	3

Disclaimers and Risk Factors

RW Strategy Inception Date: 17th December, 2013, Data as on 28th September, 2018, Data Source: RW Internal Research. RW Strategy results are for an actual Client as on 30th September, 2018. Returns of individual clients may differ depending on time of entry in the Strategy. Past performance may or may not be sustained in future and should not be used as a basis for comparison with other investments. The stocks forming part of the existing portfolio under RW Strategy may or may not be bought for new client. The Company names mentioned above is only for the purpose of explaining the concept and should not be construed as recommendations from RW Advisors. Strategy returns shown above are post fees and expenses.

Chart 1: Portfolio Performance as of Sept 2018

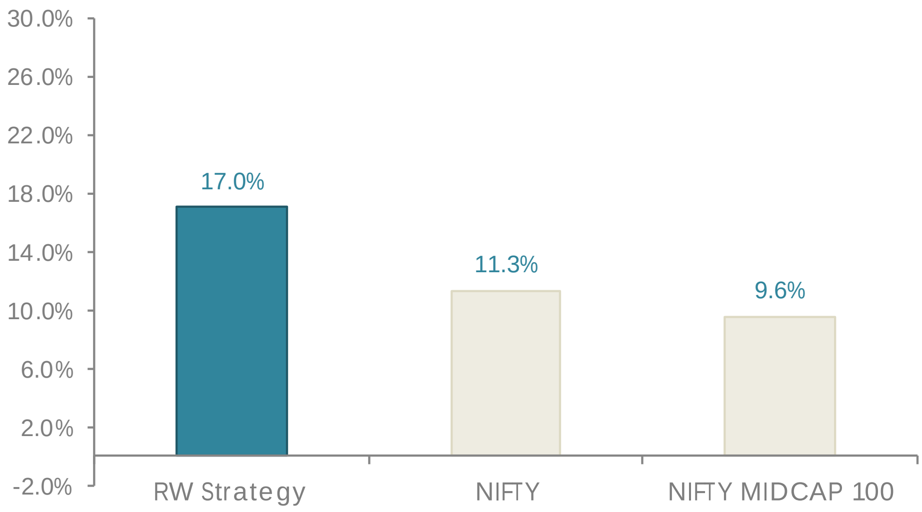
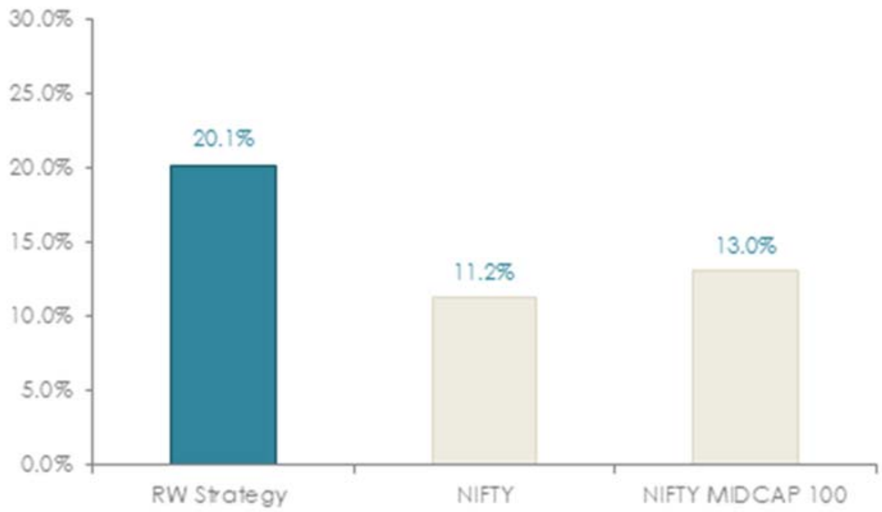


Chart 2: Portfolio Performance as of June 2018



In the quarter ending September 2018, portfolio was down 8%, while Nifty was flat. This drawdown in the portfolio is one of the highest that we have experienced in the last 4.5 years of operations. There is lot of 'panic' in the market that we have not witnessed since 2014 – market is punishing fund managers who went overboard on quality at any price. However, the key questions remain – is the panic justified Or is it market's way of responding to tightening liquidity conditions and rising cost of money?

What is the way forward for us?

Is the panic justified?

Chart 3: 8-year Median P/Es of BSE 500 companies

Source: RW Research

The chart above depicts the number of companies within the BSE 500, which are currently trading below their 8-year median P/Es. For the above analysis, we have eliminated 200 companies that are 1) PSUs or 2) don't have 8-year trading history or 3) loss making in any of the 8-year period from the list of 500 companies that constitute the BSE 500. The list then comes down to about 300 companies.

Higher you are on the graph, lower is the valuation of the companies and vice versa. In other words, companies were trading way cheaper between 2010 through 2014. We can also infer that, despite the recent correction, valuations have still not normalized in the backdrop of rising cost of money (higher corporate borrowing as the effects of demonetization and GST are behind).

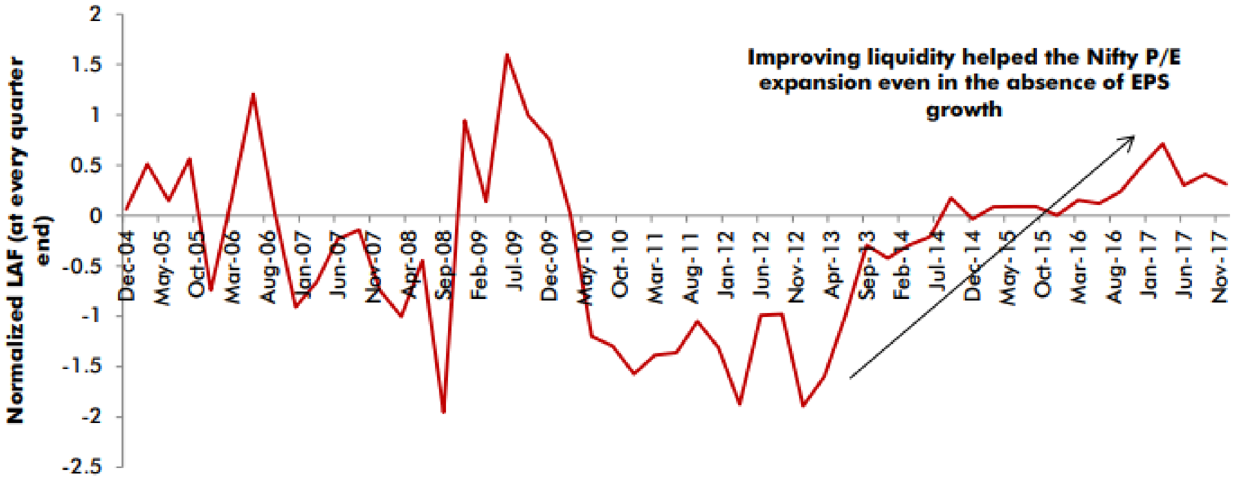
The choice of 8 years is not arbitrary. In 2009, there were extra-ordinary bargains and the market was coming out of major dislocation caused due to Global Financial Crisis of 2008 . Hence, we have avoided taking that year into consideration for the purpose of our analysis.

So, if we look at the data above, about 60%-70% of the companies used to trade below post-facto 8 year median P/Es. Back then, the economy was going through rough political and economic conditions. We are facing similar conditions presently, notwithstanding the hope we all had when BJP swung to power.

In my opinion, narrative and reality diverged since then with NIFTY EPS growth of sub 5% over the last 4-years (FY14-FY18). We are once again stuck in the same rut we were in 2010 to 2014 – Low growth, employment, dysfunctional PSU bank system, crony capitalism etc. It is only getting compounded with the political uncertainty with state/national elections due next year.

Presently, with $ 1 tn of liquidity going out of the global markets due to stricter central bank policies, the 10-year bond yields are breaking out from their 7 year bases for several countries including US. Cost of capital is increasing and respect for capital even more so. Therefore, earnings growth will be the central driving force for stock returns over the next couple of years.

Chart 4: Bank borrowings/System liquidity from the RBI



Source: Ambit Research

For four years between 2010 and 2014, we used to have INR 1 - 2 tn liquidity deficit in the LAF window (Liquidity Adjustment Facility - borrowing window for banks from the RBI) and liquidity tightness was part of the daily humdrum. This was despite the fact that global liquidity conditions were very favorable. Then came the taper tantrum of 2013, compounded by our current account deficit situation, which was doused by RBI on borrowed NRI money and time.

Given this backdrop of monetary tightness, political inactivity and stalled infra projects, there was all-round pessimism in the markets and 10 to 15% corrections were quite normal. The good part, though, was great companies were available at reasonable valuations. Please see the table below that demonstrates the point:

Chart 5: Number of price corrections greater than 15%

>15% corrections	Maruti	HDFC	Abbott	Eicher	TCS	HUL
CY						
2010	3	1	1	1	1	1
2011	3	3	3	2	1	2
2012	1	1	3	1	2	1
2013	2	1	2	2	2	2
2014	0	1	0	1	0	1
2015	0	2	2	1	2	2
2016	2	2	1	2	3	3
2017	0	0	3	1	1	0
2018	3	2	0	2	1	2

Source: RW research

From the table above, 2014 and 2017 have been aberrations with no meaningful corrections. In all other years, periodic stock price corrections of 15%+ were the norm in quality stocks too. Year 2017 particularly lulled us into thinking that the party will go on and that equity investing is not subject to market risks. If we park these two years aside, the recent correction looks very normal in the larger scheme of things.

We think valuation compression in premium stocks is already underway and some of the stocks have reached their 8-year median P/Es. This sudden panic in bond as well as equity markets has brought the market to the oversold levels last seen in 2013 (see below) – a relief rally is probably round the corner. From a medium term perspective, strategy for us is to bring valuations significantly back into focus without losing sight of business quality.

Chart 5: % of stocks above 200 EMA and weekly performance of NIFTY 50 over the next 52 weeks

Ticker	Date/Time	% of stocks above 200 EMA	Close	t + 1	t+2	t+3	t+4	t+8	t+12	t+26	t+52
Nifty 50	09-06-2006	16.97	2866.3	-9.13%	6.42%	9.14%	7.31%	10.83%	19.86%	38.23%	48.21%
Nifty 50	16-06-2006	15.42	2890.35	88.13%	8.23%	6.42%	8.06%	13.29%	20.10%	34.54%	48.67%
Nifty 50	21-07-2006	15.99	2945	43.96%	7.87%	11.18%	13.98%	18.12%	24.82%	38.88%	48.89%
Nifty 50	11-02-2011	17.02	5310	32.67%	-0.12%	4.31%	2.55%	10.02%	4.55%	-4.46%	-1.98%
Nifty 50	25-02-2011	18.46	5303.55	20.21%	2.68%	1.32%	6.61%	10.96%	3.45%	-10.48%	1.47%
Nifty 50	19-08-2011	17.98	4845.65	-4.62%	4.01%	4.41%	4.92%	5.92%	6.67%	14.83%	7.64%
Nifty 50	26-08-2011	17.15	4747.8	23.09%	6.56%	7.09%	2.53%	6.36%	3.33%	14.35%	12.06%
Nifty 50	07-10-2011	19.04	4888.05	14.18%	3.31%	9.67%	8.10%	3.32%	-5.40%	8.90%	16.43%
Nifty 50	18-11-2011	16.99	4905.8	-11.36%	2.94%	-0.80%	-5.18%	-0.81%	9.70%	-0.29%	16.14%
Nifty 50	25-11-2011	15.06	4710.05	24.63%	3.33%	-1.24%	0.08%	7.19%	18.14%	4.47%	20.73%
Nifty 50	02-12-2011	18.77	5050.15	-11.99%	-7.89%	-6.66%	-8.43%	3.06%	7.51%	-4.13%	10.37%
Nifty 50	09-12-2011	16.52	4866.7	-22.88%	-3.14%	-4.98%	-2.46%	9.43%	10.12%	4.14%	15.61%
Nifty 50	16-12-2011	12.74	4651.6	-3.92%	-0.59%	2.05%	4.61%	15.69%	14.66%	10.48%	26.40%
Nifty 50	23-12-2011	12.24	4714	4.49%	0.70%	3.22%	7.10%	18.04%	12.81%	9.17%	25.32%
Nifty 50	30-12-2011	12.79	4624.3	20.25%	5.23%	9.18%	12.55%	17.41%	14.14%	14.16%	27.15%
Nifty 50	07-01-2012	15.38	4746.9	28.67%	6.36%	9.64%	12.20%	12.90%	11.56%	12.01%	23.19%
Nifty 50	13-01-2012	19.79	4866	11.27%	6.96%	9.45%	10.60%	9.61%	9.39%	7.42%	21.42%
Nifty 50	22-03-2013	18.62	5651.35	0.05%	-1.74%	-2.17%	2.33%	9.48%	2.78%	6.38%	15.49%
Nifty 50	28-03-2013	18.63	5682.55	10.95%	-2.71%	1.77%	3.32%	5.30%	-0.26%	2.65%	14.46%
Nifty 50	02-08-2013	16.75	5677.9	5.25%	-2.99%	-3.63%	-3.63%	2.74%	8.22%	7.25%	34.98%
Nifty 50	08-08-2013	17.63	5565.65	4.71%	-1.69%	-1.69%	2.06%	6.14%	13.51%	8.94%	39.97%
Nifty 50	16-08-2013	18.46	5507.85	-4.12%	-0.65%	3.13%	6.22%	10.68%	11.49%	9.81%	38.03%
Nifty 50	23-08-2013	17.7	5471.75	-3.73%	3.81%	6.92%	9.88%	13.11%	10.68%	12.50%	38.32%
Nifty 50	30-08-2013	17.04	5471.8	14.32%	6.92%	9.87%	6.60%	12.30%	9.57%	14.71%	42.40%
Nifty 50	06-09-2013	19.48	5680.4	18.89%	5.84%	2.69%	3.99%	11.21%	8.73%	14.90%	39.31%
Nifty 50	28-09-2018	18.17	10930.45	-7.48%							
Nifty 50	04-10-2018	16.81	10599.25							@Prashanth_Krish	

Source: Prashanth_Krish (portfolioyoga.com)

From the table above, overall market is in an oversold condition with 82% of the stocks below their 200 day moving average, levels last seen 2011 and 2013. Every year this happened, NIFTY rallied by 20%+ in the next 52 weeks/ one year. This time around, valuations are still not conducive to support such a strong upmove in the next one year, atleast in quality names. My best guess for the next one year performance would be bouts of volatility with valuations settling down lower . In the interim, there will be sudden sharp rallies that would tempt us into action. Instead, we would be better off sticking to the basics of median valuation framework.

Way forward for us:

We should expect this kind of volatility. Broad philosophy of sticking to quality names should not change. Be miserly when it comes to valuations. Do not participate in the panic (easier said than done). Look for small positive differences in arbitrage opportunities, that will help in bumping up the returns.

To repeat:

- Don't participate in the panic (of selling), endure
- Stick to quality, bring valuation back in focus
- Market will throw short term opportunities in the form of buybacks etc.
- Brace for 15 to 20% corrections in mainstream stocks