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**MONTHLY NEWSLETTER**

**October 2019**

# AMBIT
# ASSET MANAGEMENT

GOOD & CLEAN
by Ambit

**Good & Clean Portfolio**

EQUITY INVESTMENTS & PMS ARE SUBJECT TO MARKET RISKS,
READ ALL SCHEME RELATED DOCUMENTS CAREFULLY BEFORE INVESTNG

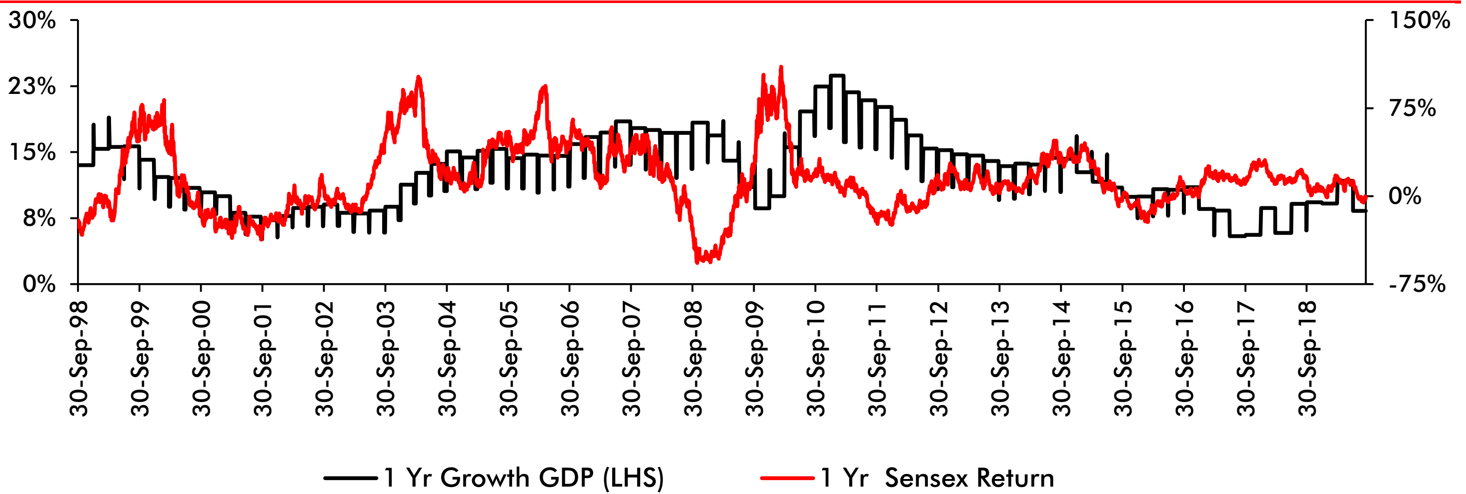
# Insight: Investing now investing how…

Dear Investor,

Over the last few months, there has been widespread perception of slowing consumption and a tight liquidity situation leading to economic slowdown. The 5% GDP (real) growth data (for Q1FY20), only acts as further reinforcement. The steps taken by the government on the 20th of September to boost the overall sentiment and encourage investment into manufacturing was due to the widespread phenomena of weakness in the economy although the high index levels of Nifty and Sensex did not suggest this. Let us delve into some of the finer details…

**A. Traditionally the Sensex has moved in line with the GDP but over the last few years the story has been somewhat different with the Sensex continuing its ascent despite slowdown in overall economy.**

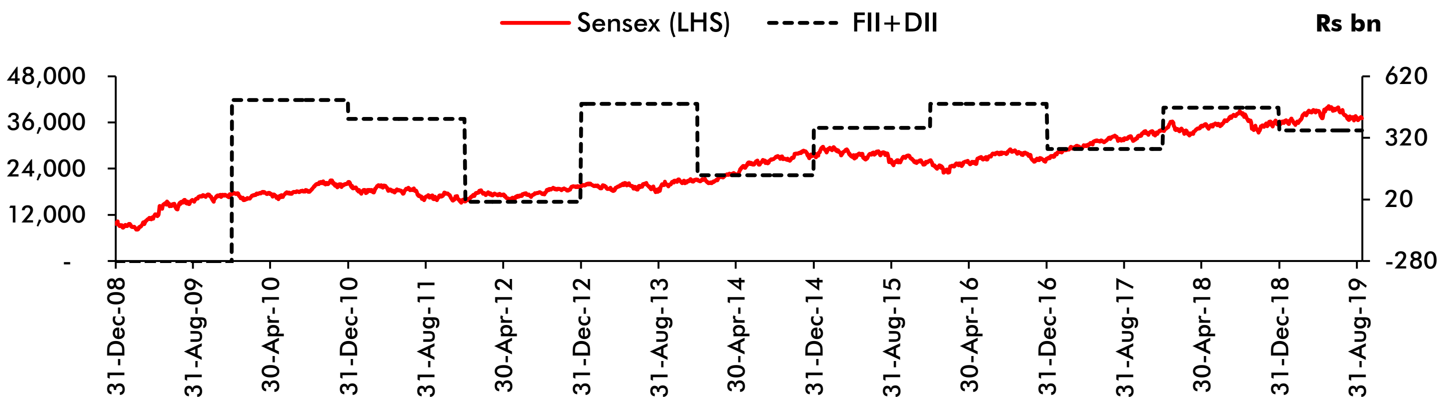
**Exhibit 1: One year GDP growth & Sensex return have traditionally moved together**




*Source: Ambit asset management; Note: GDP growth denotes to yoy growth in Nominal GDP, Sensex data upto 17th September to avoid any specific big event based skew in data*

1. **Liquidity:** Part of this is explained by the huge fund flows that entered the Indian equity markets over the last few years driven by FII's and subsequently DII's.

**Exhibit 2: Net inflows have been rising and this has driven the indices up in the last few years**



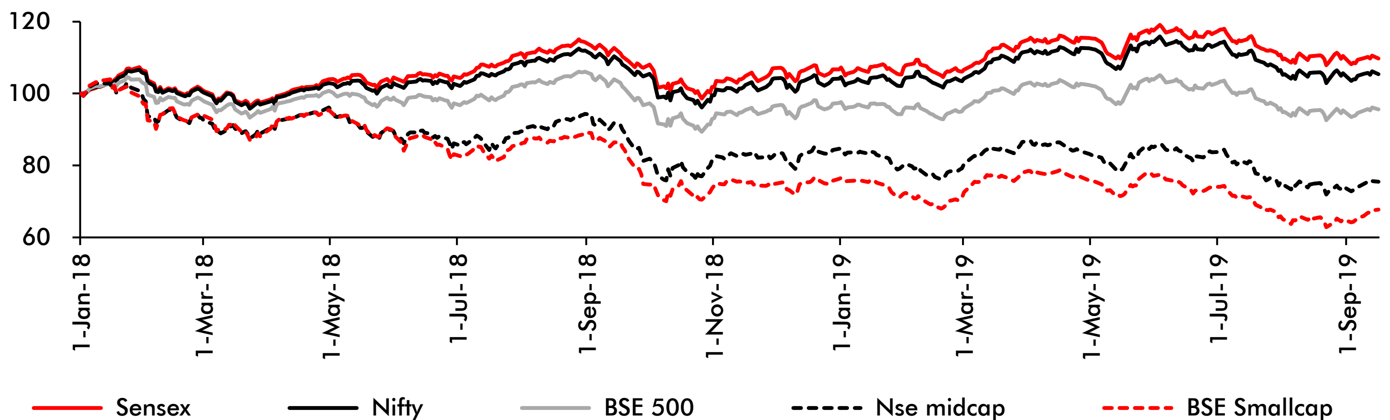

*Source: Ambit asset management, Note: Sensex data upto 17th September to avoid any specific big event based skew in data*

2. **Money is chasing a limited number of large cap index companies:** The increased focus on accounting quality, corporate governance and companies with stable business models has led to increased investment in these companies. Some might argue these are Sensex and Nifty 50 companies which explain why the correction has been limited in these indices.

**B. Although the Sensex and Nifty have remained range bound over the last year the broader markets have not done all that well.**

The graphs alongside showcase this phenomena quite clearly. It is immediately apparent that the Nifty midcap 100 *(-25%)* and BSE small cap indices *(-32%)* have fallen sharply since January 2018 peaks vs their large cap index peers like the Sensex *(+10%)* and Nifty *(+5%)*

**Exhibit 3: Disparity is noticeable between Sensex/Nifty & the small/midcap indices**




*Source: Ambit asset management, Note: data indexed to 100 for comparative analysis, upto 17th September to avoid any specific big event based skew in numbers*

**C. This might lead one to believe that large caps indices have been relatively unharmed by the gloom and doom and have done well overall. Investing in a so called "stable" company by virtue of it being part of an index might be enough right? Wrong!**

1. **Close to 65% of the Sensex companies have lost market capitalisation** over the last year with a median return of -4.1%. The Nifty 50 have fared no better with 67% companies giving negative returns while median returns were -5.6%.
2. If we take a closer look at the participant performance across various indices we notice that it is **generally the top 20% performers that contribute most to the returns** of the indices while the remaining 80% cumulatively have had negative returns thus far (Last twelve months).

**Exhibit 4: LTM Disparity noticeable between Sensex/Nifty & small to midcap indices**

| Index | Top 20% | Bottom 80% | Overall | Median |
|---|---|---|---|---|
| BSE Sensex | 15% | -12% | -4% | -4.1% |
| Nifty 50 | 16% | -15% | -6% | -5.6% |
| BSE 500 | 16% | -9% | -23% | -19.1% |
| Nifty midcap 100 | 29% | -29% | -18% | -18.5% |
| BSE Smallcap | 28% | -36% | -20% | -33% |

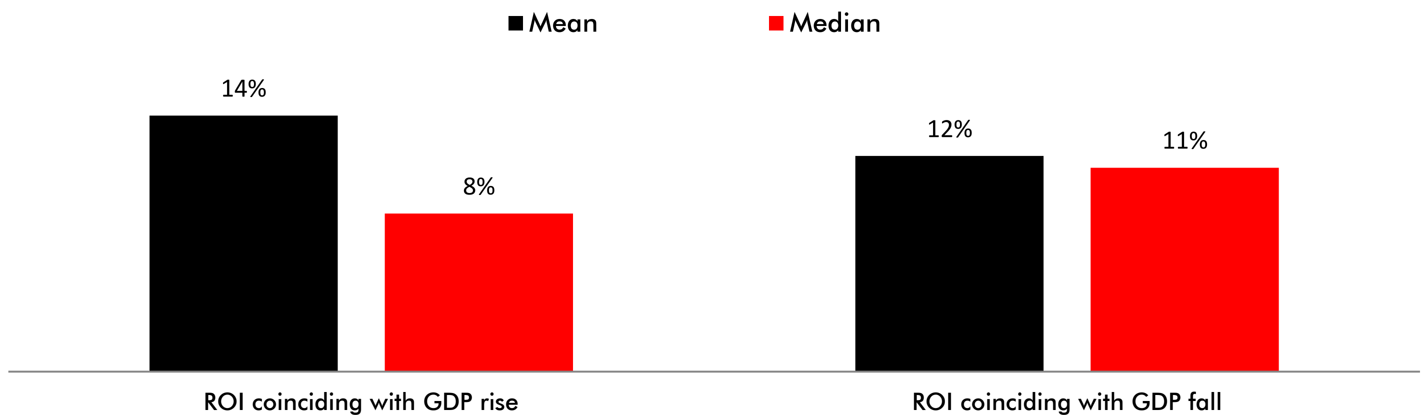
*Source: Ambit asset management, note: LTM stands for last twelve months upto 17th September to avoid any specific big event based skew in data*

**D. Finally does this mean that this is not a good time to invest given the uncertainty? Quite the contrary specially as we feel further government stimulus cannot be ruled out**

It is times of uncertainty that yield great investment opportunities for an intelligent, well diversified and quality focused investor. A careful look at the last 20 years' history of the Indian stock markets tells us that every macro crisis has been an opportunity.

1. Even at times when outlook has been challenging, sentiment has been low, GDP data poor and index has corrected returns over 3 year periods have been highly positive and have outperformed all other asset classes.
2. If one were to invest in the market coinciding with times when GDP was revised downward over the last 2 decades you would be able to make an average return of 12% and a median return of 11% corresponding to this investments made coinciding with upward revision of GDP has yielded returns of 14% (mean) and 8% (median)
3. The analysis busts the myth that money is not made when times are bad or is limited to only good times.

**Exhibit 5: Investments in Sensex coinciding with when GDP was revised downwards have returned 11% vs 8% (median) for investments made coinciding with upward GDP revisions over the last 2 decades**




*Source: Ambit asset management, kindly note that GDP data used is from 1997 to June 2016 in order to be able to calculate returns of Sensex 3 years ahead, impact of 20th September announcements not factored in*

***To conclude although optically the Sensex and Nifty have remained strong there has been a polarisation in the larger market. While few have outperformed the larger majority have underperformed. However despite any of this uncertainty history teaches us that it is always a good time to invest (SIP) without any exception as long as one keeps in mind:***

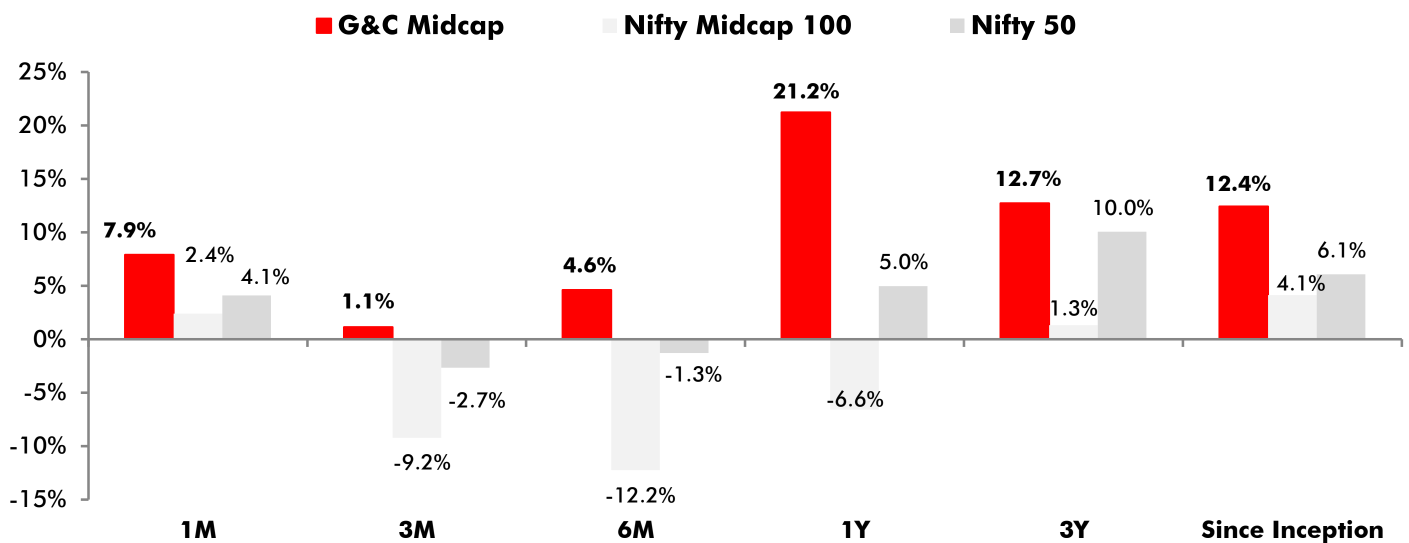
- **Invest in quality names** – corporate governance and quality of management are of paramount importance (as we believe in our Ambit Good & Clean PMS) and no substitute exists for these.
- **Look for growth stories** – rather than looking for value play, investors would do well to look for steady structural growth stories (as advocated in our Ambit Coffee Can PMS).
- **Focus on the long term** –Time in the market is more important than timing the markets. The focus should be on long-term portfolio building. (as advocated in our Ambit Emerging Giants PMS)

# Ambit Good & Clean Portfolio

Ambit's Good & Clean strategy provides long-only equity exposure to Indian businesses that have an impeccable track record of clean accounting, good governance, and efficient capital allocation. Ambit's proprietary 'forensic accounting' framework helps weed out firms with poor quality accounts, while our proprietary 'greatness' framework helps identify efficient capital allocators with a holistic approach for consistent growth. Our focus has been to deliver superior risk-adjusted returns with as much focus on lower portfolio drawdown as on return generation. Some salient features of the Good & Clean strategy are as follows:

- **Process-oriented approach to investing**: Typically starting at the largest 500 Indian companies, Ambit's proprietary frameworks for assessing accounting quality and efficacy of capital allocation help narrow down the investible universe to a much smaller subset. This shorter universe is then evaluated on bottom-up fundamentals to create a concentrated portfolio of no more than 20 companies at any time.
- **Long-term horizon and low churn**: Our holding horizons for investee companies are 3-5 years and even longer with annual churn not exceeding 15-20% in a year. The long-term orientation essentially means investing in companies that have the potential to sustainably compound earnings, with this compounding earnings acting as the primary driver of investment returns over long periods.
- **Low drawdowns**: The focus on clean accounting and governance, prudent capital allocation, and structural earnings compounding allow participation in long-term return generation while also ensuring low drawdowns in periods of equity market declines.

**Exhibit 7: Ambit's Good & Clean Portfolio performance update**




*Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of Sep 30, 2019; Since inception & 3Y returns are annualized returns.* ***Returns are net of*** *all fees and expenses*

## For any queries, please contact:

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