Composite Investments
Private Limited

Composite India GARP Fund
Newsletter - December 2021

In this third edition of the scheme newsletter, we delve deeper into

- How have we calibrated to the changing market texture?
- What factors impact individual portfolio returns over the short term?

Historical Performance

First up, some numbers to set the context

	(Annualized return for period > 1 Year, absolute return otherwise)				
	3 Months	YTD	1 Year	2 Year	Since Inception
Composite India GARP Fund					
Scheme Return	-1.4%	21.3%	28.4%	34.2%	28.6%
Benchmark					
S&P BSE 500	-2.3%	20.4%	29.2%	22.5%	17.2%

(Data as of December 28, 2021, Inception Date 22 April 2019)

Capital preservation over the medium term continues to be one of our key objectives.

Unless we can demonstrate success over the medium term, we are unlikely to succeed over the long term. The long term is a series of medium terms in our book, most investors in the Indian market would agree.

How have we calibrated to the changing market texture?

We continued to build up allocation to equities steadily since the beginning of the FY. We have continued to run a differentiated portfolio with less than 20% overlap with the NIFTY50 index.

As tempting as it was, we stayed away from a strict model portfolio approach for fresh inflows through FY22.

We also continued to take anything between 3-6 months to build up allocation. While this was not an explicit requirement from any of the investors, this has been the preferred policy of the scheme to minimize immediate event risks to some extent. Our preference continues to be to take time to deploy money when the valuation of stocks that fit our style is not in favour, as was the case from April till November.

After the recent bout of volatility (thanks to consistent FII selling), we finally have some valuation comfort and wouldn't mind being more aggressive in building up positions compared to our usual pace.

This is the cash allocation we've had through the FY; this was primarily driven by the fresh inflows where we took longer to deploy funds.

Date	Allocation to Overnight Fund
31 May 2021	~9%
31 Jul 2021	~29%
30 Oct 2021	~27%
28 Dec 2021	~12%

The cash allocation in July and October was high because we had inflows in those months towards the end of the month. Since October we have been more active deploying cash into the market than we were in the May to October period.

Our deployment decision is driven off these considerations –

- Our preferred policy of not deploying the entire capital immediately
- Valuation comfort in our universe of stocks, we want to buy at reasonable prices

Please note that the second point refers to a set of stocks, not to the overall market level. Every stock picking strategy and investment philosophy has its own mini cycle with the overall market cycle. This has a greater bearing on our deployment decision than does the overall market level. When it comes to the overall market level, we have no great skill in predicting what the market will do over the next 6 months.

Also note that our decision on buying individual stocks is driven off a 3-year time horizon, not off how strong the price momentum currently is. Sometimes chasing momentum works well over the short term, it is just that we are not into this game.

That said, cash allocation can be a double-edged sword depending on how the overall market swings.

What factors impact individual portfolio returns?

While the scheme return is what brings investors in, what will keep them invested over longer tenures is the return in their individual portfolio.

This is where the return data gets interesting, more specific and a better reflection of how returns from any investing strategy cannot be expected to be linear, especially within the first year of inception. We can broadly slot portfolios into the following categories

Category I - Portfolios with inception date of February 2021 or before, the individual portfolio return is at least 5% p.a. higher than the benchmark return. For the portfolios incepted before Jan 2020 the outperformance is more than 10% p.a. as you can see from the table on page 1

Category 2 - Portfolios with inception date between April 2021 and October 2021, the individual portfolio absolute return is between 2-6% lower than the benchmark return.

Category 3 - Portfolios with inception date post October 2021, the individual portfolio absolute return is higher than the benchmark return.

A wider range of outcomes can be seen across Categories 2 and 3. Why?

1) **Cash Drag**

   In a rising market, taking time to deploy works against investors. Simple arithmetic.

   In range bound and falling markets, cash allocation by itself can generate alpha. Again, simple arithmetic

   We followed the same process for both Category 2 and category 3 investors, just that the texture of the market changed post October. Same action but different outcomes, especially over the short term.

2) **Non linearity of the return from any investment style**

   What went up by a lot in FY21 took a bit of a breather in FY22. Buying a specialty chemicals stock at a TTM PE of 18 when the margins are trending higher will have a different investing outcome from buying the same stock at 27 PE when the margins are coming off their highs. For the record we chose not to chase prices higher in a few of these pockets, the stock prices there have moderated predictably. A similar trend can be seen across a few other sectors and pockets.

   Trees rarely grow to the sky, hopping from one tree to another is easier said than done.

3) **Time since the portfolio inception**

   The short term tends to amplify the situation either way due to the impact of timing. Once the time since inception gets closer to the 12-month mark, the impact of timing starts to reduce and the portfolio construct starts to dominate the return profile. For this reason, return for portfolios in category 1 are mostly clustered within a tighter range.

   Longer the timeframe, lower will be the range of outcomes so long as we are consistent at execution; which we will be.

What is the good news here for investors in Category 2?

The above factors won't matter for much one year down the line and may not even matter two years down the line. So long as business growth and earnings trajectory for the portfolio stocks are good over the medium term, these minor variations in valuation multiples won't matter for too much, especially when aggregated for 20 stocks over a 12 month+ period.

In the short term, the journey will feel a bit uncomfortable if you see an underperformance compared to the chosen benchmark.

Composite Investments
Private Limited

In investing, following the same process can have markedly different outcomes in the short-term depending on the portfolio inception date.

We followed the same process for investors in Category 2 and category 3, yet they look different relative to the benchmark as of date for more or less the same portfolio of stocks. It is just that the process makes us look worse than we are for category 2 while making us look better than we are for category 3.

Though we were anticipating a bout of market volatility after the great run of the past 18 months, we had no way of knowing when exactly the volatility would hit and to what extent. In this bout of volatility since October, many proven businesses have fallen 20% from the peak which is par for the course even in a multiyear bull market. One can easily count more than 10 high quality (but expensive) businesses that have not delivered any return over the past 12 months when the benchmark index has delivered more than 25%.

Cash allocation might be a drag for a few months but this gives us dry powder and the option to build allocation at good prices once the exuberant phase of the market takes a breather. It ensures that we don't get too worried about the 8-10% index level corrections that can happen at any time in the Indian market. When such corrections occur, nothing gets spared though a few defensives may fall to a lesser extent.

For this reason, we do not deploy the entire capital immediately and prefer to hedge some of the event risk through a longer initial deployment phase. For this reason, we also run balanced portfolios without excessive reliance on a single sector, theme or a style.

There is limited utility in using market peaks and troughs as points of measurement. During the March 2020 crash, not many expected the benchmark index to dip below 8000, even if for a brief period. Through the 2021 run many investors watched in disbelief when the same benchmark indexed flirted with 18600, even if a for a brief period.

An actively managed portfolio is made up of individual stocks, each of which has its own cycle. Some peak out much before the benchmark index does, some of them bottom out before the benchmark index does.

Our deployment approach is at the stock level and is rarely driven off what the benchmark index does. Though our performance should be tracked against the appropriate benchmark index, our day-to-day decisions don't depend on whether we are outperforming or underperforming the said index.

Over the medium term the outcomes tend to converge when the portfolio construct is similar. We hence stress on the important of working with a horizon of 3 years and higher in the equity markets.

Sometimes what is good for the medium term looks suboptimal in the short term and vice versa.

Kedar B
Fund Manager
kedar@compositeinvestments.com

Disclaimer:

This newsletter does not constitute or form part of any offer, recommendation or solicitation to subscribe or to deal with Composite PMS. The information contained in this document is not a complete disclosure of every material fact, terms and conditions, the information herein alone is not enough to be used to implement an investment strategy and should not be construed as investment advice to any party.

Some statements and opinions contained in the document may include future expectations and forward-looking statements that are based on our current views and involve assumptions and other risks which may cause actual results to be materially different from the views/expectations expressed Readers shall be fully responsible for any decision taken based on this document. While utmost care has been exercised in preparing this document, Composite Investments Private Limited disclaims all liabilities, losses damages arising out of the use of this information.

Investments in securities are subject to market and other risks and there is no assurance/guarantee that the objectives of the of the strategy under the Portfolio Management Service will be achieved. Past performance does not in any way guarantee/indicate future performance of the Portfolio Manager The name of the strategy does not indicate returns in any manner whatsoever. The portfolio strategy may not be suitable for all investors.

This document is not for public distribution and has been furnished solely for information There are restrictions that apply including not circulating this in countries where restrictions apply on soliciting business from potential customers. Recipients shall be solely liable for any liability incurred by them in this regard and will indemnify Composite Investments Private Limited for any liability it may incur in this regard.

Composite Investments Pvt Ltd
Registered Office: 30/1, 3rd Floor, S J Towers, Mission Road, Bangalore – 560027
SEBI Portfolio Manager Registration INP000006396