QUEST PMS PORTFOLIO UPDATE – MAY 2020

QUEST

Dear Investors,

Hope all of you continue to remain in the best of health and making the most of the family time together.

Before I share my thoughts on the market currently, I would want to quote a couple of golden words of some Wall-Street legends who have seen more economic cycles than most of us:

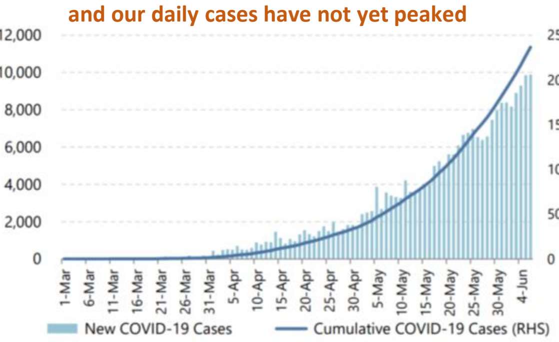
1. ***"The four most dangerous words in investing are: 'this time it's different.'" - Sir John Templeton***
2. ***"Bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria" – Sir John Templeton***
3. ***"Great investment opportunities come around when excellent companies are surrounded by unusual circumstances that cause the stock to be mispriced" – Warren Buffett***

These 3 famous quotes summarize our view on the market and also what we have been saying in our previous communications over the last few months since the pandemic broke out. If seen carefully the above three statements together make up the crux of any investment bible or rule book one can follow and the importance of which becomes all the more significant in an environment of great crisis and volatility like currently we are in. Lets see each of the statements and analyse the relevance of the same currently.

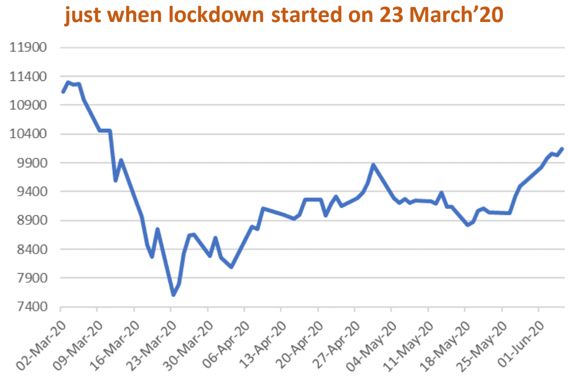
The first statement of Sir John Templeton reminds us that cycles in market are given. Prima facie the reasons which might lead to a bear or a bull market might seem different each time but the underlying reason remains the same. **Expensive valuations without support from earnings growth are potent cocktails** time and again for sharp sell-offs in market **which await a trigger**. This time the trigger was the spread of Covid-19 globally, which was followed by sharp sell-off from FIIs in emerging markets including India during the months of Feb-March'20. Also if we see the way governments around the globe have reacted to the economic crisis, it reminds us of a replay of what we saw post Global Financial Crisis in 2008. Relentless printing of currency to support the system was unleashed and led to asset classes moving up in tandem.

Before we move to the second statement above from Sir Templeton, lets look at three charts which will help us understand the scenario better.

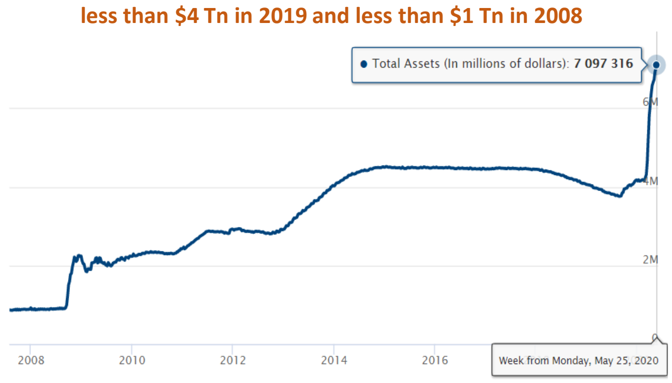
No of Covid-19 cases in India is rising since March and our daily cases have not yet peaked



Equity markets are also rising from the lows it made just when lockdown started on 23 March'20



US Fed's balance sheet stands at over \$7 Tn as compared to less than \$4 Tn in 2019 and less than \$1 Tn in 2008



Source: MoHFW, Bloomberg and US Federal Reserve website

Chart 1 and 2 above reiterates the fact that **equity markets are leading indicators**. By simple logic, when India hardly had any cases of Covid-19, there was no reason for us to hit the recent lows of 7500 in Nifty and now when the daily cases have been surging everyday and total cases has almost touched 2.5 lakh cases, there is no reason for the 35% rally in market from the bottom. What exactly played out was that **in the months of Feb and March'20, there was extreme pessimism** among the global and local investors and general public alike on the ferocity of the impact of Covid-19 as was being seen in its relentless spread in European countries and US and how it would add up in India which owing to its populated cities seemed like a ticking time bomb. Continued fear and extreme pessimism followed with large selling pressure from FIIs led to nearly 40% correction in Indian markets by March end and **that is where the initial seeds of the current rally was laid**.

Markets have rebounded as much as 25% from the lows and in some cases specific beaten down stocks have seen a much steeper rebound. This is **leading to a Feeling Of Missing Out (FOMO) among investors** and that is worrisome. Its all the more worrisome in US markets, as just freshly printed dollars from **the Fed is fuelling the rally of unprecedented distortions.** Chart 3 above explains to a large extent the culprit behind the recent rally which shows the historic levels of US Fed's balance sheet expansion which has happened owing to the stimulus President Trump has announced in the US markets. Interestingly the US Fed balance sheet size expanded to around \$950 billion over a 100 year period from 1907 – 2007. Between 2007 and 2019 it expanded to \$3.8 trillion. And in the last 6 months it has surged to \$7 trillion!! In fact **the market capitalization of US has surged by ~\$3.5 trillion dollars in last few months which is equal to the additional stimulus pumped into the system** thereby making the case stronger of it being a liquidity driven rally. FII flows into emerging markets have been at historic levels in last couple of months owing to this liquidity pump in the system.

CONTACT: QUEST INVESTMENT ADVISORS PVT LTD, 188/3 GURUKRUPA BUILDING, FIRST FLOOR, JAIN SOCIETY, SION(WEST), MUMBAI – 400022
PHONE: 022-24066700

Now moving to the 3rd quote at the top from Warren Buffett, we have highlighted the same in our last month's communication wherein we discussed different sectors which were emerging as great investment opportunities considering the sharp corrections. **New bull markets have new leaders** and it would be same this time around. Quality companies across large, mid and smallcap are available at never before valuations and a patient investor like us are finding it too tempting to let go off the opportunity. At the same time the rallies like the recent ones also make us take some profits off the table as **the foundations of the rally seem to be just liquidity driven** and hence less robust as of now and we are not confident of the current rally sustaining for long. Also **how the second wave of the covid-19 hits us as lockdown opens up is yet to be seen**. However all hope is not lost as we see the Indian government making its intentions clear about how it wishes to emerge from this crisis.

Though the market was looking for some short term stimulus package from the government to kick start the economic engine, what the industry got finally was a 10 year vision plan to take India to the next stage of growth which was announced over a 5-day announcement by the Finance Minister. Through this **the Govt has clearly laid out its focus area of making India self reliant through Atma Nirbhar Bharat** mission and this would have two legs to it: **Import substitution and Export Growth**. Last 10 years saw India's growth being largely led by consumption, fueled further by government handouts to rural poor and financing led retail consumption boom in urban (which resulted in strong performance of consumption stocks and retail banks/NBFCs). High food inflation, high fiscal and trade deficit which emerged as a consequence of above due to infrastructure and manufacturing bottlenecks acted as automatic stabilizers. Cost of traditional factors of production (land, labour, capital) went haywire in early part of decade due to imbalances in growth model which has stalled the growth engine. However, we are now in a better situation with falling land prices and cost of capital, stable labour costs and lower corporate taxes.

In our view, the current market performance and weakness of the rally is reflective of three key concerns:

- **The stimulus package announced** which are aimed at structural reforms are **positive for the medium to long term economic prospects but falls short in boosting** the economy in the immediate term, especially **the demand side**
- Despite of an early and one of the most stringent lockdown in economic activities, **India continues to see increased COVID-19 positive cases**. We believe that the gains on the pandemic control front has come at a significant economic cost to India
- Though we have already seen steep cuts in FY21EPS and FY21 GDP, in our view, **cuts in both EPS and GDP growth have not hit the bottom** and therefore further cuts in both EPS and GDP cannot be ruled out.

Portfolio Actions:

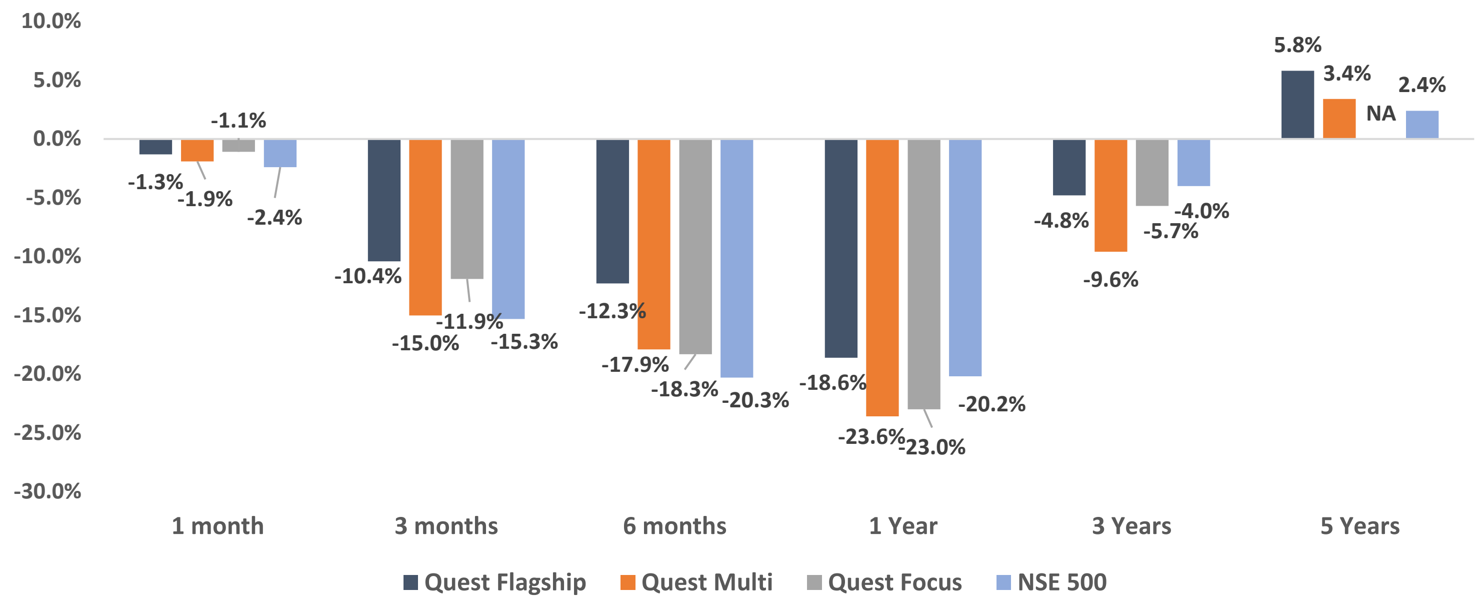
Relative to large caps, **midcaps and smallcaps are trading at a historically low level** and so are their rolling return discounts. On both these measures, the four year midcap – largecap and smallcap – largecap premiums have been practically wiped out and we are back in 2014 levels. We now believe that **valuations are compelling for a midcap smallcap recovery in coming quarters.** We would nevertheless continue to have a Multicap approach and do tactical shifts between the allocations of large, mid and smallcaps in the portfolios depending on opportunities.

During the month:

- We have **added some exposure to financials** which we had been underweight all these months. Within financials, we are not merely focussing on the banking space but a wider gamut of sub sectors like **Insurance, Broking and Asset Management along with NBFC**. Most of these had become consensus sells among the street participants that had led to the mis-pricing. We have added State Bank of India owing to its extremely cheap valuations compared to its historical average.
- We have been **booking some profits in our pharma** exposure as we had been extremely overweight in the sector. Even now we **remain overweight** with our exposure across Generics, Biosimilars and Diagnostics.
- We **have added to our conviction in the Agri and Rural demand theme** by adding Escorts and Coromandel to our portfolios.
- We continue to maintain between **10-15% cash levels in portfolio** as we see a W shaped recovery in the equity markets linked with a gradual recovery in the economy. We would be also looking at raising the cash levels as we see some profit taking in the market. We are okay being labelled opportunistic in the market, but for us the protection of the client portfolio in drawdowns is more important.

Performance snapshot:

Our overweight position in the right sectors and active management of cash levels in recent times has helped us in improving our performance significantly in recent quarters. We continue to maintain a balanced mix of consistent secular growth companies, P/E re-rating candidates and deep value companies in the portfolio and would continue to build a high quality high growth portfolio to weather the volatilities better. Some of the companies which had positive attribution during the month in the portfolios were Escorts (+22%), Balkrishna Industries (+15%), Ramco Cement (+9.0%), Metropolis Healthcare (+10.2%), Coromandel (+8.5%) and Bharti Airtel (+6.9%). Companies which dragged the performance during the month were ICICI Bank (-13.2%), Bajaj Finance (-16.3%), Kalpataru Power (-10.4%), HDFC Bank (-5.5%) and Tata Elxsi (-4.9%). Sectorwise positive contribution came from Autos, Cement, Chemicals, Telecom and Healthcare while negative contribution came from Financials, IT & IT Services and Consumer Discretionary.



Note: Returns for period of 1 year and less are absolute while for periods more than 1 year are annualized IRR returns. Quest PMS portfolio returns are for Model portfolio client. Considering different clients would have joined at different time frame, their returns could be different from this

In our **last month's communication** we had mentioned about **three buckets of stocks and sectors that would play out over the short, medium and long term**. We see exactly the same playing out and would continue to monitor and change the portfolio accordingly. We would continue to focus on Quest philosophy of looking for mispriced opportunities in the market across the market capitalizations and sectors and at the same time keep an eye on the risk and uncertain global and local environment to ensure our clients get the best risk adjusted returns from Indian equities.

Happy Investing and be safe and stay healthy!

Aniruddha Sarkar
Portfolio Manager & Co-Head Equities

Annexure: Comparison among peer strategies for the month of May 2020:

As on 31st May 2020	Peer Performance Comparison Snapshot												
Name of Fund house	Strategy Name	1M		3M		6M		1 year		3 years		5 years	
		Return	Rank	Return	Rank	Return	Rank	Return	Rank	Return	Rank	Return	Rank
Average performance of comparable Peer Portfolios		-3.68%		-23.22%		-22.17%		-19.99%		-3.21%		3.80%	
Quest Investment Advisors	Flagship PMS	-1.30%	3	-10.40%	1	-12.30%	1	-18.60%	10	-4.80%	11	5.80%	4
Quest Investment Advisors	Multi PMS	-1.90%	4	-15.00%	3	-17.90%	4	-23.60%	14	-9.60%	15	3.40%	9
Quest Investment Advisors	Focus PMS	-1.10%	2	-11.90%	2	-18.30%	6	-23.00%	13	-9.60%	15	NA	NA
Aditya Birla Capital	Core Equity Portfolio	-1.09%	1	-16.93%	4	-20.43%	10	-16.84%	9	-6.80%	13	1.94%	11
Aditya Birla Capital	SSP	-4.16%	14	-23.32%	12	-22.52%	13	-21.12%	12	-10.79%	17	0.43%	15
Alchemy	Select Stock	-2.50%	6	-26.70%	14	-27.50%	16	-28.10%	16	-3.10%	9	4.20%	8
Alchemy	High Growth	-3.30%	8	-25.30%	13	-27.50%	16	-30.00%	17	-6.80%	13	1.80%	13
ASK	IEP	-4.90%	17	-21.00%	9	-19.20%	9	-15.10%	8	1.80%	4	5.40%	5
ASK	India Select	-3.40%	9	-17.90%	7	-17.90%	4	-11.30%	1	1.75%	5	5.20%	6
AXIS	Brand Equity	-4.80%	16	-19.00%	8	-19.10%	7	-12.70%	2	3.50%	3	NA	NA
Alfa Accurate	AAA Focus Plan	-3.13%	7	-17.00%	5	-14.90%	2	-14.30%	6	-0.10%	8	5.10%	7
IIFL AMC	Multicap PMS	-3.45%	10	-22.12%	11	-19.18%	8	-13.89%	4	5.08%	2	11.77%	2
Kotak AMC	SSV Series 1	-3.50%	11	-27.60%	16	-29.20%	19	-35.50%	19	-17.50%	19	-4.10%	17
Motilal AMC	IOP	-4.73%	15	-31.68%	19	-27.56%	18	-33.56%	18	-16.61%	18	-1.82%	16
Motilal AMC	NTDOP	-3.55%	12	-21.59%	10	-24.16%	14	-21.11%	11	-4.78%	10	3.29%	10
Purnartha	Advisory Portfolio*	-4.98%	18	-28.50%	17	-22.11%	12	-14.65%	7	6.76%	1	13.38%	1
Sundaram AMC	PACE	-3.90%	13	-29.10%	18	-26.30%	15	-23.90%	15	-5.30%	12	1.00%	14
Sundaram AMC	SISOP	-5.20%	19	-26.70%	14	-21.10%	11	-14.00%	5	0.50%	7	1.90%	12
Tata PMS	Emerging Opportunities	-2.30%	5	-17.10%	6	-16.10%	3	-13.70%	3	1.10%	6	7.50%	3
NIFTY - 50	**Largecap**	-2.84%		-14.47%		-20.54%		-19.65%		-0.14%		2.58%	
NIFTY MIDCAP - 100	**Midcap**	-1.70%		-20.93%		-22.93%		-26.09%		-8.82%		0.14%	
NIFTY 500	**Multicap**	-2.38%		-15.31%		-20.29%		-20.22%		-2.16%		2.36%	
Source: PMS-AIF.com and PMSBazaar.com		*Purnartha is not a PMS but an Advisory portfolio											

Disclaimer:

The purpose of this Letter is to provide general information of the market and the house view of Quest Investment Advisors Pvt Ltd. to existing and prospective investors in a manner to assist them in understanding the market and equity products. The Letter is purely for information purposes and should not be construed to be investment recommendation/advice or an offer or solicitation of an offer to buy/sell any securities. This letter is for the personal information of the authorized recipient(s) and is not for public distribution and should not be reproduced or redistributed to any other person or in any form without prior permission of Quest Investment Advisors Pvt Ltd. While reasonable endeavors have been made to present reliable data in the communication, but Quest PMS does not guarantee the accuracy or completeness of the data in the same. Quest Investment Advisors Pvt Ltd or any of its connected persons including its subsidiaries or associates or partners or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained, views and opinions expressed in this Presentation. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information, opinions and estimates contained in this Presentation reflect a judgment of its original date of publication by Quest Investment Advisors Pvt Ltd and are subject to change without notice.

The performance comparison shown with peer strategies is just for illustration purpose and data has been taken from www.pmsbazaar.com and www.pms-aif.com which are available in public domain. The objective of showing the performance is merely for the benefit of the investors to provide them transparent information of strategy performances and where does Quest strategies stand vis-à-vis industry peers.

This Letter is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to local law, regulation or which would subject Quest Investment Advisors Pvt Ltd and its affiliates to any registration or licensing requirement within such jurisdiction. The product described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this Report/Presentation may come are required to inform themselves of and to observe such restrictions.

This letter is qualified in its entirety by the Terms of Agreement and other related documents, copies of which will be provided to prospective investors. All investors must read the detailed Terms of Agreement including the Risk Factors and consult their tax advisors, before making any investment decision/contribution to be managed under the Portfolio Management Services offered by Quest Investment Advisory Pvt Ltd.