QUEST PMS PORTFOLIO UPDATE – OCT 2020

QUEST INVESTMENT ADVISORS
SEBI Registered PMS & AIF managers

Dear Investor,

Hope my letter finds you in the best of health and spirits in this festive season! Wishing you and your Family a Happy Dhanteras and a Happy Diwali. Have a Prosperous and healthy year ahead!

As we are in the midst of the last quarter of an eventful 2020, it is a good time to look back and reflect and also look forward to how we end this year on a positive note both on returns and hope for the new year ahead. Managing money is one of the toughest jobs because **we have to marry both return expectations and safety at the same time**. On one hand comes the obsession of the industry to always have your fund in the top of the charts on performance. On the other hand its our moral responsibility to also ensure the risk is managed well in the portfolios. Thus **in the goal to seek returns we cannot forgo our basic principles of investing and managing risk** and hence we sometimes need to make some decisions which might not generate returns in the short run but become wealth protectors in the longer run. This is very aptly summarized by Seth Klarman in his famous quote – **"The cost of performing well in bad times can be a relative under-performance in good times".**

"The desire to perform all the time is usually a barrier to performing over time" – Robert Olstein

	Calendar Year Absolute Returns %						
As on 31st Oct 2020	**CY20**	**CY19**	**CY18**	**CY17**	**CY16**	**CY15**	**CY14**
Quest Flagship PMS	8.3%	-0.7%	-15.7%	47.5%	8.1%	12.4%	77.0%
Quest Focus PMS	2.5%	-1.5%	-20.0%	85.2%	2.1%	NA	NA
Quest Multi PMS	10.2%	0.0%	-22.5%	53.2%	8.3%	14.5%	20.4%
NIFTY – 50	-4.3%	12.0%	3.2%	28.6%	3.0%	-4.1%	31.4%
NIFTY – 500	-2.9%	7.7%	-3.4%	35.9%	3.8%	-0.7%	37.8%

As can be seen from the above table, we continue to maintain our outperformance over the benchmark indices in calendar year 2020 which so far has given negative returns on both Nifty-50 and NSE-500. However for reasons as mentioned above, we have been off late focussing on preserving the returns and ensuring low risk in the portfolio. This risk averseness can lead to some periods of under-performance to benchmark in the portfolios in the near term though the portfolios continue to generate positive returns. However **as long term investors looking for both wealth creation and wealth preservation, we would not be perturbed by this short term under-performance** because sticking to our investment philosophy and discipline will have its rewards in the longer run.

Coming back to the markets and reflecting back on how 2020 has been so far and what lies ahead would be interesting at this juncture as we have both Indian and Global Equity markets at all time high levels.

Back to polarized markets; market could become more broad based with midcaps smallcaps outperforming

2018 and 2019 was characterised by polarized markets where few sectors and selected few companies within them did well whereas broader market languished. Recent months have seen the markets behaving in a similar fashion. In fact if we analyse the market recovery **from the lows of March 2020, we see that only 18 stocks of the Nifty-50 stocks have out-performed Nifty**. In fact **50% of the Nifty-50 stocks are still below the Jan 2020 highs**. Looking at the valuations, around 80% of the Nifty-50 stocks have their FY22 P/E lower than the last 5 years average P/E. The sectors which have out-performed from the lows of March are IT & IT Services, Pharma, Autos and Metals whereas sectors like Banks, Capital Goods & Infra and Utilities have lagged a tad behind. **Over the next 2 years, Nifty-50 earnings is expected to grow at CAGR of 17%.** However we see the midcap and smallcap space growing at a faster pace. The consensus **estimate for the earnings growth of Nifty Midcap index over the next 2 years is around 32%.** All the more we currently have the midcap index valuations discount to the largecap valuations trading below the historical average and this along with stronger recovery in earnings, makes a good case for midcaps smallcaps doing well in the coming quarters.

While major event risks are over but some uncertainties remain on US election front. The new stimulus package would pump additional liquidity into global markets

Event 1: Over without clear outcome; Event 2: tensions seem cooling off in the cold winters ahead

In our last month's newsletter we had mentioned about two major global events which could be triggers for market movement in the near term. The event 1 we are referring to was the US elections which seems to have come and gone without any clarity on the next President. Even though world leaders have congratulated the obvious winner Mr Joe Biden, there seems to be a different thought on Mr Trump's mind. The way he has been replacing the heads of various security and government agencies seems he is positioning himself for some showdown. This could be a big risk for global markets as and when it emerges. However **we cannot prepare for such an event as it would be more of a black swan event if it happens and we cannot attach any probability to it currently.** Nevertheless we would keep our eyes and ears to the ground and look for ways to mitigate such a risk in the portfolios.

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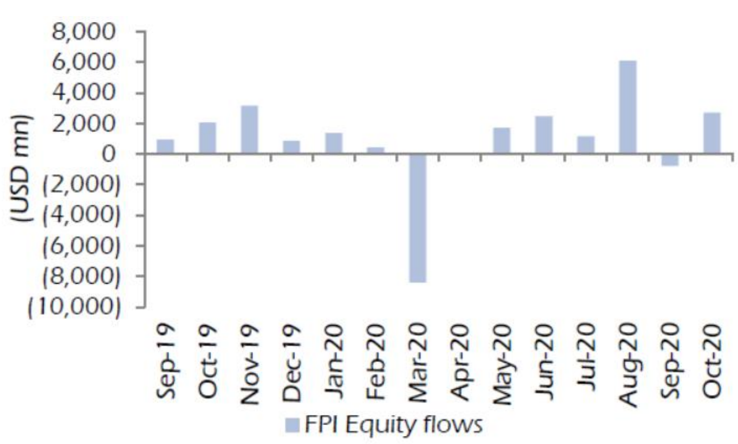
The second event which we had mentioned in our newsletter was pertaining to the tensions in Ladakh between India and China. Thankfully that seems to be addressed big time with both the countries now agreeing to scale down their military build-up on the borders and have agreed to go back to their older positions before the conflict. This would be a major development as **now both India and China seems to be getting back talking business and mutual development** also. We believe **this is a big geo-political risk deleveraged and improves sentiment of FDI investments towards India.**

FPI inflows into India continue at record levels and will extend into the month of November

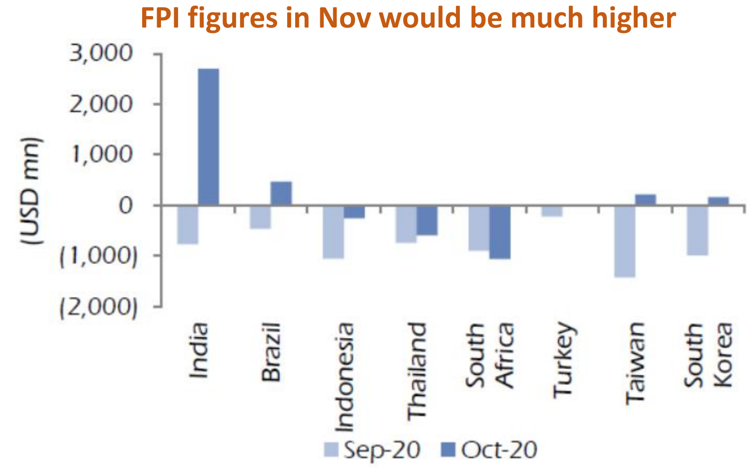
Liquidity flows to become big determinant of market direction

Since the first stimulus package was announced in the US, flows into Emerging markets (EMs) has been picking up and among them India stands tall with an exceptional Foreign Portfolio Investors (FPI) inflows of USD 6.2 bn. Post the recent US elections, the next stimulus would be announced which will mean more liquidity, leading to dollar depreciation and strong inflows across EMs, particularly India. Infact if we look at the inflows on FPI front in the first 10 days of Nov'20, its been setting some new records with almost USD 3.5 bn inflows in 10 days. Though domestic investors seem to be slowing down their investments and also SIPs have been reducing, but the SIP flows seem to have stabilized for now. However, **given continuing negative real interest rate and the recent strong market performance, we expect domestic flows to turn stronger in the medium term**. Investors have limited options in other asset classes to put their money to work.

FPI inflows continue strong in recent months

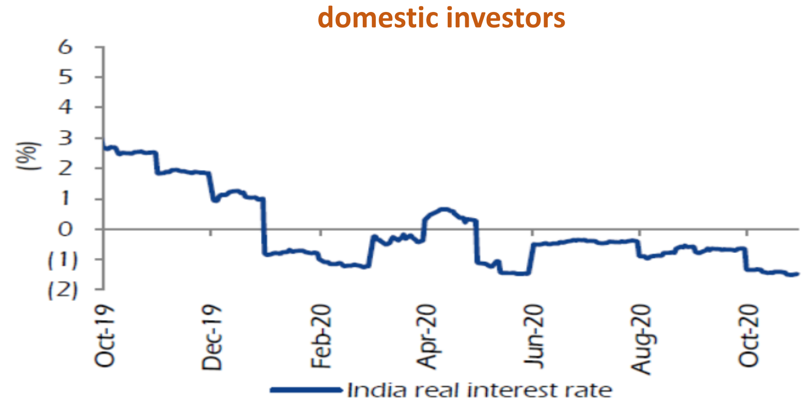


India emerges as favourite destination for FPI; FPI figures in Nov would be much higher



Equity as an asset class is bound to see increased allocation in people's portfolio as all other asset classes fail to meet decent returns and liquidity

With real interest rates in negative territory there is no reason equities would not find increased allocation in the portfolios of domestic investors



Government focus on reviving economy in earnest: Impact to be seen in coming quarters

Over the last few months we have seen several announcements from the government on the lines of Atmanirbhar Bharat through which they have been trying to put in place a framework and guidelines for stimulating manufacturing and job creation in India. We see many of these announcements as path breaking and would have its impact in the long run if not in the medium term. Announcements like the Production Linked Incentive (PLI) scheme in 10 sectors amounting to around INR 1.46 lakh crore will definitely give a big push to domestic manufacturing in many key sectors which would also create jobs. On the heels of this PLI announcement, the government also announced more stimulus package which contain measures to boost employment, making funds available to the MSME and stressed sectors, revival of the real estate sector, support to agriculture, ease of doing business, stimulate exports, financing of infra as well as towards R&D of Covid-19 vaccine. While the amount claimed to have been allotted is INR 2.65 trn however experts calculation suggest its fiscal impact is INR 1.2trn. We believe these would start showing their impact on the ground once full economy opens up in true spirit and action.

Government stimulus package is sending the right signal to global investors for making India their destination

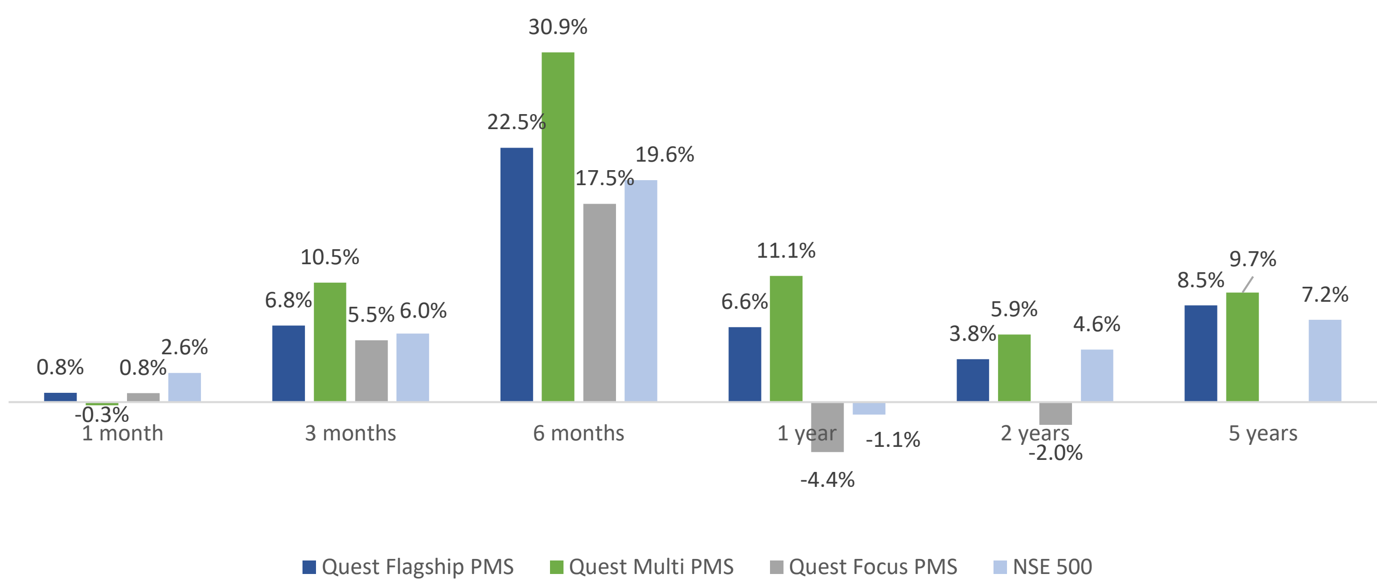
PORTFOLIO ACTIONS AND PERFORMANCE

In recent months taking advantage of the sharp movements in some of the portfolio companies we would have booked some gains in some of the companies even though they would be short term in nature because we believe if our price objective is reached and company looks fairly valued, its better to take profits off the table rather than hold it for saving some tax. At the same time, the polarized market in recent months, gave us opportunity to enter into some of the companies which were available at cheap valuations compared to their other industry peers.

We continue to re-align our exposure in the Pharma and Technology sectors adding new names there. We are also adding some new names in the Chemicals space

- We have been increasing our exposure to **Technology** space by adding some midcap names in the space which we find are going through a P/E multiple expansion owing to their better than expected growth in earnings and visibility of new projects
- We continue to **re-align exposure in the pharma** sector by replacing some names which look fairly valued with some smaller companies where we are seeing significant earnings growth
- We have around 5-6% cash levels in the portfolio which we would continue to hold

The underperformance of the portfolios to the benchmark NSE-500 as can be seen below in the month of Oct'20 is on account of polarized movement in the index during the month. The up-move during the month was largely on account of Banking & Financials which makes up nearly 33% of the index whereas our portfolios are underweight on the sector with around 23% exposure. At the same time, Pharma & Healthcare saw some sharp under-performance during the month in which we have been overweight. As mentioned earlier, we would not be perturbed by monthly movements of our portfolios as sectoral volatility has become the norm of the day and a new sector becomes the darling of the street every week. However we need to look at longer term trends in the sector and position our portfolios accordingly keeping the daily noise aside.



Note: Above returns are as on 31st Oct 2020. 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

We would continue focusing on our task that we need to deliver the best risk adjusted return for our investors across different market cycles. Balancing risk with return and ensuring minimum drawdowns in a falling market is what would set us apart from the crowd.

Looking forward to some exciting times for stock selection and wealth creation ahead. Happy Investing and be safe and stay healthy! Happy Diwali once again to you and your family.

Aniruddha Sarkar
Chief Investment Officer & Portfolio Manager

CONTACT: QUEST INVESTMENT ADVISORS PVT LTD, 188/3 GURUKRUPA BUILDING, FIRST FLOOR, JAIN SOCIETY, SION(WEST), MUMBAI – 400022
EMAIL: pms@questinvest.com PHONE: 022-24066700 Visit us at: www.questinvest.com

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EMAIL: pms@questinvest.com PHONE: 022-24066700 Visit us at: www.questinvest.com