

HIGHLIGHTS

- Trusteeship
- Fiduciary Duties of an Investment Advisor
- SSS Model Portfolio Performance
- Signing Off

NEWSLETTER JUNE 2018**TRUSTEESHIP AND SYMBIOTIC GROWTH WITH CLIENTS**

When we released our March quarter newsletter to clients, one of our clients called me up. We had a review of her portfolio and a good long discussion on our process and strategy. I have pasted below a part of the conversation which I believe is worth mentioning. To protect her identity, we will call her Mrs. Patel.

MRS. PATEL: Good Morning Ankit! Thanks for the Newsletter. Now I think I understand what you mean by minimizing risk. I think I also understand how you intend to achieve adequate risk-adjusted returns for your clients. Your theme agnostic philosophy also makes sense to me.

ME: Good Morning Ma'am. Thank you so much. We are delighted to have a client like you. You make it a point to read all our communications. From time to time, you also provide your honest feedback on them. That has really helped us further improve our offerings. Please tell me how we can improve it further.

MRS. PATEL: I do not know about areas of improvement, however I have a confusion.

ME: Please go ahead Ma'am. Let me see if I can help you clear it.

MRS. PATEL: You charge me 1% management fee and your hurdle rate is 10%. That means, once you help me get a return in excess of 10%, you are eligible for getting a performance fee from me. I met a popular investment adviser, Mr. Shah, who told that he has a hurdle rate of as high as 20%. Don't you think he is giving me a better deal?

ME: Sure Ma'am! He might have a better deal on offer for you. May I know how much is the fixed management fee?

MRS. PATEL: It's only 2.5%, a percent and half higher than you.

ME: Ah! There you go. And what is his performance fee if the return is above the hurdle rate?

MRS. PATEL: It's the same as yours. They take 20% share in the profits made over and above the hurdle rate of 20% annualized return. Instead, you start taking a share in the profit once you cross your hurdle rate of 10% return.

ME: And do you know our share in your profits when we will help you earn say 20% return in a year?

MRS. PATEL: Yeah, I know it is 10% share in the profits made over and above the hurdle rate of 10% until your returns are up to 20%. Your share of profit increases to 20% for returns above 20%. But, what do you mean to say?

ME: Let's take an example that you gave me and Mr. Shah Rs 100 each to manage. And let's take 3 scenarios, Worst case: 5% return, Base case: 15% return, and Best Case = 25% return. Fees charged by SSS and Mr. Shah in all the scenarios would look like this:

Rs 100 invested for a year	SSIAS			Mr. Shah		
	Worst Case	Base Case	Best Case	Worst Case	Base Case	Best Case
Gross return	5%	15%	25%	5%	15%	25%
Rs 100 becomes	105	115	125	105	115	125
Management Fee	1	1	1	2.5	2.5	2.5
Performance Fee	0	0.5	2	0	0	1
Total Fees	1	1.5	3	2.5	2.5	3.5

ME: If you look closely, our fee structure is aligned with our philosophy of symbiotic growth with clients. We charge you a small 1% management fee. Our performance fee only increases when we improve performance. On the other hand, whether Mr. Shah earns 0% or 20% on your money, you incur 2.5% of your fund managed as management fees to him. The difference here may seem of only one percentage, however due to the effect of compounding it becomes a large figure over time. Ma'am, don't you remember my presentation on "Power of Compounding"?

MRS. PATEL: Oh yes, now I do! Why didn't I see this myself? I was almost about to start association with him immediately. Thank God that I checked up with you first.

ME: Ma'am, please don't get me wrong. Mr. Shah is a very reputed manager with exceptional stock picking skills. We do not have any problem in admitting that we are not as skilful as he is. However, being your investment adviser, my interest should be aligned with your interest. If I charge you exorbitant management fees upfront, I would make more efforts in growing my assets under advisory rather than making efforts towards good performance. In fact, in the above calculation we have not included the impact of brokerage and other transactional costs. For all our clients to whom we offer equity portfolio advice, we calculate return that is net of brokerage and other transactional costs. These transactional charges on percentage terms do appear miniscule at the time of transaction. However, over a long period it amounts to a sizeable amount of the cost.

MRS. PATEL: Thank you for clarifying it. Now I get it. I should always know how much of my returns go on to serve the management fees, performance fees and transactional charges (brokerage, stamp duty and taxes). Hence, return net of these fees is the one I should focus on.

ME: That's right. By keeping our fees low and being aware of the transaction costs involved in investments, we try to discharge our fiduciary duties with the right intent. We believe that we have been given the role of a trustee to safeguard a part of your wealth, and we take that role very seriously.

MRS. PATEL: I feel reassured now. Thanks a lot, Ankit. Would be waiting for your next Newsletter.

ME: Thank you Ma'am. Glad that I could clarify your doubts. Have a good day.

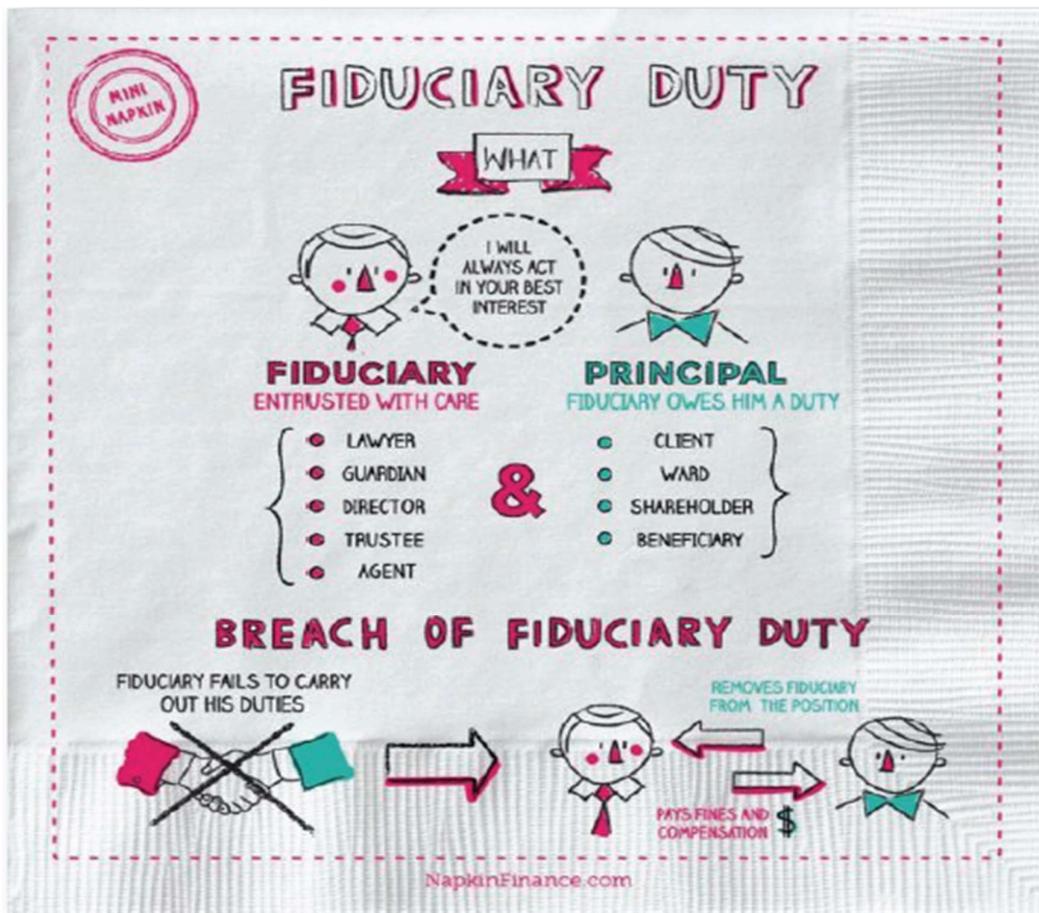
FIDUCIARY DUTIES OF AN INVESTMENT ADVISOR

This conversation set me thinking. As investment advisors, we should always act to maximize our clients' interests. This can happen only if we act as trustees of our clients' money.

Then I thought, "Why not make fiduciary duty and trusteeship the themes of this quarterly newsletter?"

Fiduciary Duty

I came across an interesting way of explaining fiduciary duty in the internet. I present it below:



Source: napkinfinance.com

Isn't this a great way of explaining fiduciary duty?

I believe it surely is.

Trusteeship

The word “trusteeship” invokes trust, and a responsibility to deliver on that trust. It implies a commitment to handle the responsibility entrusted in the best interests of the beneficiary. It calls for a high level of integrity on the part of the practitioner and transparency in dealings.

Investment advisors have the responsibility to provide advice for growing their clients’ hard-earned money. This is trusteeship in action. Forgetting this or deliberately misleading clients run contrary to this philosophy. As Mahatma Gandhi explains in his simple style, *“Supposing I have come by a fair amount of wealth – either by way of legacy, or by means of trade and industry – I must know that all that wealth does not belong to me; what belongs to me is the right to an honorable livelihood by millions of others. The rest of my wealth belongs to the community and must be used for the welfare of the community.”*

He further goes on to say:

“In the first instance, everything must be surrendered to God and then out of it one may use only that which is necessary for the service of God’s creation, according to one’s strict needs.”

A guideline for trusteeship

This quote of the Mahatma can be modified to serve as a guideline for our community:

“In the first instance, all returns must directly flow to your clients and then out if it an Investment Advisor or a Portfolio Manager may use only that which is necessary for the service of clients, according to one’s strict needs.”

The SSS Philosophy

At SSS, our stated philosophy is symbiotic growth, i.e., to **“Grow as Our Clients Grow”**. Our growth, then, is inextricably linked to that of our clients. If this is not trusteeship, what is?

Some of the ways we walk the talk on trusteeship– investment rationale letters for every trade recommendations, monthly performance reports, registration as direct mutual fund advisor, etc.

SSS MODEL PORTFOLIO PERFORMANCE

Let us have a look at the table below to see how our model portfolio has performed as against the major indices

PERFORMANCE OF SSS AS AGAINST MAJOR INDICES (Starting from 01.08.2017)					
PARTICULARS	31.12.2017	31.01.2018	28.02.2018	31.03.2018	30.06.2018
Nifty	4.11%	9.03%	3.75%	0.00%	5.88%
S&P BSE Midcap	15.29%	12.33%	7.15%	3.27%	-0.10%
S&P BSE SMALL CAP	19.63%	16.44%	12.77%	5.72%	-0.26%
SSIAS Model Portfolio	16.71%	14.88%	12.88%	9.29%	9.15%

We can see in the above table that we have outperformed the NIFTY and the midcap indices consistently in the last year. The return as on date (30.06.2018) is 9.15% which is higher than all the major indices by a big margin. **The portfolio returns of the clients who have joined us late will be different from the model portfolio. However in due course, their portfolio's returns will mirror the model portfolio rate of returns as the allocation remains the same for them as well.** Even after this volatility in market, we believe we are comfortably positioned. If the market continues to remain volatile, like it has been for the last few months, we still have more than 15% cash in our model portfolio to take advantage of buying good businesses at bargain values.

SIGNING OFF

“Buying good businesses at bargain values” reminds me of Professor Sanjay Bakshi. Prof. Bakshi, who is an adjunct professor of “Behavioral Finance and Business Valuation” at MDI Gurgaon, is arguably the best value investor in India, and certainly the most well-known. I can proudly say that being his student has not only made me a better investor but also a better human being. I had the good fortune of meeting him prior to designing the fee structure for our clients. He made a very good comment on management fees which clearly explains our fiduciary duties to our clients. I would like to sign off with that quote:

“Management Fees should always be your cost center and not your profit center.”

This statement perfectly matches with the trusteeship principle which I have been speaking throughout. As my fiduciary duty to safeguard your wealth, I should never try to make profit out of management fees. Management fees should be just enough to cover the expenses occurred in managing your wealth. My profit should be linked to my performance. By keeping our management fee low, and linking our profit to our performance, we at SSS make sure that we do not just preach about trusteeship but follow it as well.

ANKIT KANODIA

Email: ankit.k@smartsyncservices.com

Mobile: +91 9978 988562

SMART SYNC SERVICES

401, Siddhraj Zori, Sargasan Cross Roads, S.G. Highway, Gandhinagar - 382421 Gujarat. India.

www.smartsyncservices.com