NEWSLETTER

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RISK AND RETURN

Do we really understand it?

HIGHLIGHTS

- Risk & Return
- Theme Agnostic Investment
- SSS Model Portfolio Performance
- Signing Off

Do you remember how we closed our last newsletter? Probably not!

The last statement read:

"Only when the tide goes out, we come to know who is swimming naked"

We reiterate this saying again today with a reason. The tide, today, has gone out. And those who were swimming naked- the optimists who thought that the rally would never end- are clearly visible.

We don't blame them. It is the way how most market participants typically behave. They believe that it is a risk worth taking in the quest for superior returns.

However, are they aware of the real meaning of these two terms: Risk & Return?

Risk in Rising and Falling Markets:

Perceptions & Outcome

A **layman's fuzzy understanding of risk** in stock market

This demonstrates that layman's understanding of risk is misplaced. Where they should be afraid, they are greedy and where they should be greedy, they are afraid. A correct understanding of risk will let an investor know when he should be afraid, and when he should be greedy.

Let us explain how. Risk, in its simplest form, is what could go wrong in any decision (not just financial or investment related). To correctly understand risk, therefore, we should think of all scenarios- optimistic, realistic & pessimistic. Let's say that today I plan to write five pages on a topic. Now, to understand the risk to this operation, I should ask these questions:

What would come in my way of finishing those 5 pages?

Am I busy in other important activities which would not give me time to finish my write-up?

Even if I manage the time, do I have sufficient expertise to write on that topic?

Am I in the right frame of mind to produce the right kind of material?

Questions like these force us to look at the operation from the opposite side and think hard on how it can fail. This will allow us to take better decisions.

If we look at investment decisions in a similar fashion we would ask the right questions. These questions could have been asked in the calendar year 2017.

Will this rally last?

Is it a bubble that would burst any moment?

If the share prices reflect company's performance, are companies really performing that well that their prices would continue to go up?

Have we seen anything like this in the past?

If I put all my savings today into equities to take advantage of the rally, what are the chances that I would lose my capital?

Should I blindly believe what is appearing in the financial media or should I take a second opinion?

Questions like these force us to take a balanced approach to the process of investing in stock market. The idea is not to get afraid and leave it altogether. All we are saying is that investment decisions should be taken in an informed state and not an ignorant state. So, if people had followed this approach, they wouldn't have been swimming naked today.

Return

A layman's fuzzy understanding of return in stock market

EXPECTATIONS

Rising Market

- They compare themselves with other investors
- They desire to beat others
- They seek relative outperformance like beating the various stock market indices

Falling Market

- They forget the performance of the market and other market participants
- They desire to check only own performance
- They desire to check only own performance

It shows that expectations of returns, like risks, are often ill-informed.

An adequate return varies from investors to investors based on their risk profile and varies from operations to operations depending upon the risk involved. Most investors fail to get this thing right and hence their understanding of both risks and returns remain hazy throughout their investment career.

Benjamin Graham, acknowledged as the father of Value Investing, confirms this by saying,

"An investment operation is one which, upon thorough analysis, promises safety of principal and an adequate return."

Due to this misconception about risk and return, most participants face a very difficult time when the tide runs out, like it has in the first three months of calendar year 2018. All major indices and portfolios are down significantly from their December 2017 levels. Look at the table below to understand it better.

RETURNS	2017	2018 (3M)
NIFTY	28.50%	3.10%
BSE SMALL CAP INDEX	59.50%	-11.86%
BSE MIDCAP INDEX	47%	-10.50%

The fall is even steeper when we calculate the magnitude from their recent highs in January 2018. The table below highlights the point and reinforces the fact that stock market works in cycles and we should always be prepared for a trend reversal both during upside and downside.

PERFORMANCE OF MAJOR INDICES IN THE RECENT MARKET TURMOIL

Particulars	Recent Highs	31.03.2018	Loss %
BSE Sensex (Made high on 29th Jan)	36443	32969	-9.53%
NIFTY 50 (Made high on 29th Jan)	11171	10114	-9.46%
S&P BSE Midcap (Made high on 8th Jan)	18247	15963	-12.52%
S&P BSE SmallCap (Made high on 15th Jan)	20047	16994	-15.23%

This brings us back to our theme to assess risk and provide adequate returns to our investors. In the following segment of the newsletter we discuss how our theme agnostic investment style helps us to focus on just risk and returns and cut out noise.

Theme Agnostic Investment

There is a difference between managing your own money and managing another people's money. In fact, in the true sense, fund management business is more about managing your clients' perception and less about managing his/her money. We do not want to label us as any kind of investors. We do not aspire to be known as only "Growth-oriented" or only "Value-oriented" or only "Buy and Hold" or only "Arbitrage Experts" or "Swing Traders". We believe we are a little bit of all.

Our theme agnostic philosophy has resulted in our owning a diversified portfolio of good businesses bought at reasonable valuations, capable of giving our clients an adequate risk-adjusted returns of 16-18% per annum in the long run.

We believe that being agile and flexible is the most important feature of our philosophy. Since we are not married to any style or genre of investing, we approach each investment opportunity with a clean slate of mind. Our investment decisions are made purely based on risk assessment and return expectations. So, we prescribe and advice our clients to not to be sold on a style of investing but be focused on risk and return only.

SSS Model Portfolio Performance

PERFORMANCE OF SSS AS AGAINST MAJOR INDICES

Particulars	31.12.2017	31.01.2018	28.02.2018	31.03.2018
Nifty	4.11%	9.03%	3.75%	0.00%
S&P BSE Midcap	15.29%	12.33%	7.15%	3.27%
S&P BSE SMALL CAP	19.63%	16.44%	12.77%	5.72%
SSIAS Model Portfolio	16.71%	14.88%	12.88%	9.29%

We can see in the above table that we have outperformed the NIFTY and the midcap indices significantly.

The return as on date (31.03.2018) is 9.29%. Even after this volatility in market, we believe we are comfortably positioned.

What it does not reflect is that in the model portfolio, we have booked profits of 14.52% for the first eight months. This translates into an annualized return of almost 22%.

If the market continues to remain volatile, like it has been for the last few months, we still have more than 20% cash in our model portfolio to take advantage of buying good businesses at bargain values.

Signing Off

The legendary American economist, John Kenneth Galbraith once rightly remarked, *"There are two kinds of forecasters: those who don't know, and those who don't know they don't know."* We certainly do not try to forecast anything with precision. And we bundle this thought with the opinion of a world-renowned investor and author Howard Marks, Partner of Oaktree Capital, who says,

"While we never know where we are going, macro wise or market direction wise, we should have a good sense of where we are. I think this is very important. And it is possible to enhance your investment results by making practical decisions suited to the market climate."

We believe that our agile and informed theme agnostic philosophy and the risk-return approach help us live in the present while being cognizant of the past and future.

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