HIGHLIGHTS

- **India – Fastest growing large economy in the world**
- **Corporate profits to GDP(%) – at an inflection point?**
- **Sensex 20 year earning CAGR 12%**
- **NIFTY P/E ratios and returns**
- **Isn't It Confusing**
- **Investment Decisions**
- **Signing Off**

NEWSLETTER

SEPTEMBER 2017

GET STARTED RIGHT AWAY

At the end of the first quarter of our journey with you, our esteemed clients, we would like to first thank all of you for having faith in us. It's because of this faith that we have managed to start our journey on a positive note.

We believe that a journey together can be more enjoyable and rewarding when we share our thoughts from time to time. For us, it is important to now ensure that our investment philosophy and actions on the ground are in line with your expectation, which is long term wealth creation. We hope to achieve this through this quarterly newsletter. We also need to keep the investment process transparent. While we do e-mail all our trades to you and send a monthly portfolio summary, we believe that with a newsletter like this, we can make our investment process more visible to you.

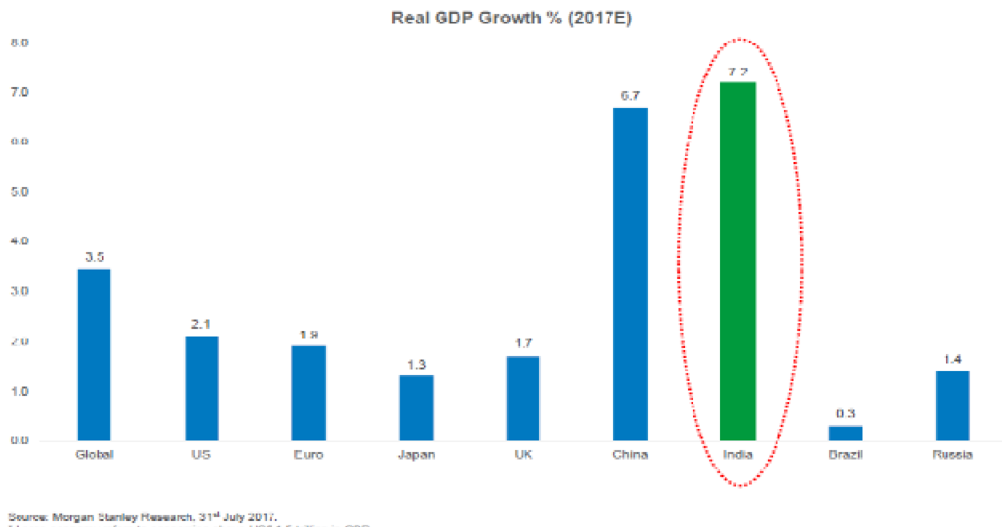
With these thoughts in mind, we present to you our first quarterly newsletter. Please take out some time to go through it and share your feedback. This will encourage us to improve further.

Man is a not a rational being; he is a rationalizing being. 'We are like that only'. We first make up our mind and then somehow manage to find a rationale to prove our hypothesis. It's not that we don't care for details or the process, but it is the only the outcome which proves or refutes the argument. The recent happenings in the Indian stock market is a great example of our rationalizing behavior.

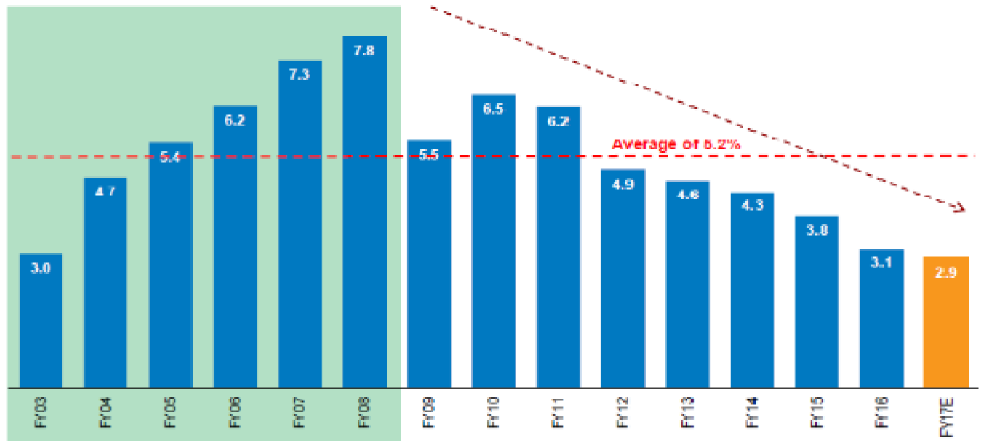
In the context of equity investment in India, people are divided into two camps – the exuberantly hopeful and the dispiritedly worried. The first camp believes that the Indian economy is at an inflection point where for a sustained period we are going to get good economic reforms, high growth in GDP and increased flow of household savings into the market. The mood in the other camp, however, is downbeat. Citing history, they feel that valuations are not providing any cushion to infuse fresh funds at this level.

Now, hypothetically, we can try to be in either camp at a time and prove our hypothesis to you each time. Let's do that for the sake of clarity. If we belonged to the first camp we would provide you with the following data points:

INDIA – FASTEST GROWING LARGE ECONOMY IN THE WORLD

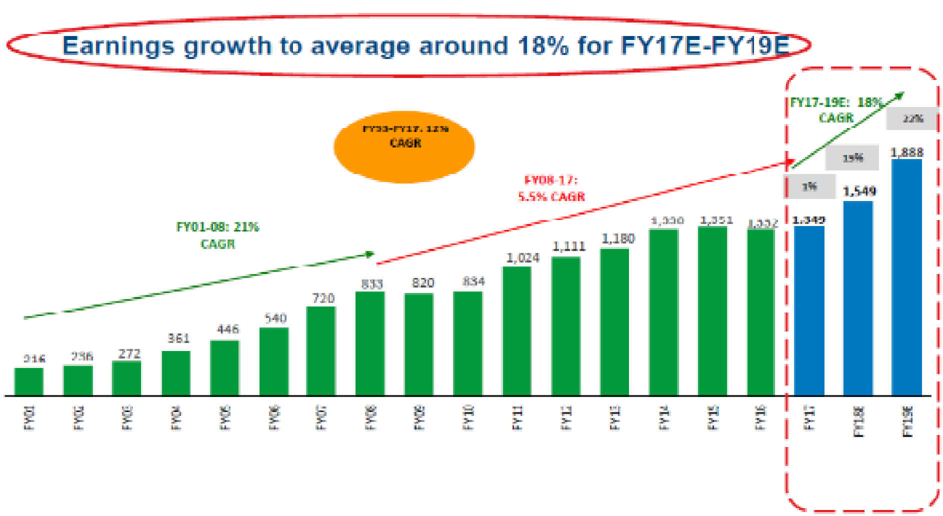


CORPORATE PROFITS TO GDP (%) – AT AN INFLECTION POINT?



Source: Motilal Oswal Research, 31st July 2017
The above chart is created using data from 9000 Plus Listed and unlisted Indian companies, as available on the Capitaline database.

SENSEX 20 YEAR EARNING CAGR 12%



Source: MOSL. Data as of 31st July 2017. CAGR – Compounded annualized growth rate. FY Note: There is no guarantee of returns/income generation in the Scheme.

If we belonged to the second camp, the worried one, we would give you the following data:

NIFTY P/E RATIOS AND RETURNS

P/E Range	3Y Returns	5Y Returns	7Y Returns	10Y Returns
Less Than 12	38.7%	29.2%	22.3%	18.9%
Between 12 & 16	28.2%	24.9%	18.9%	16.2%
Between 16 & 20	12.9%	13.4%	14.2%	13.8%
Between 20 & 24	4.0%	7.8%	11.4%	12.1%
Above 24	-4.9%	3.4%	9.6%	12.2%

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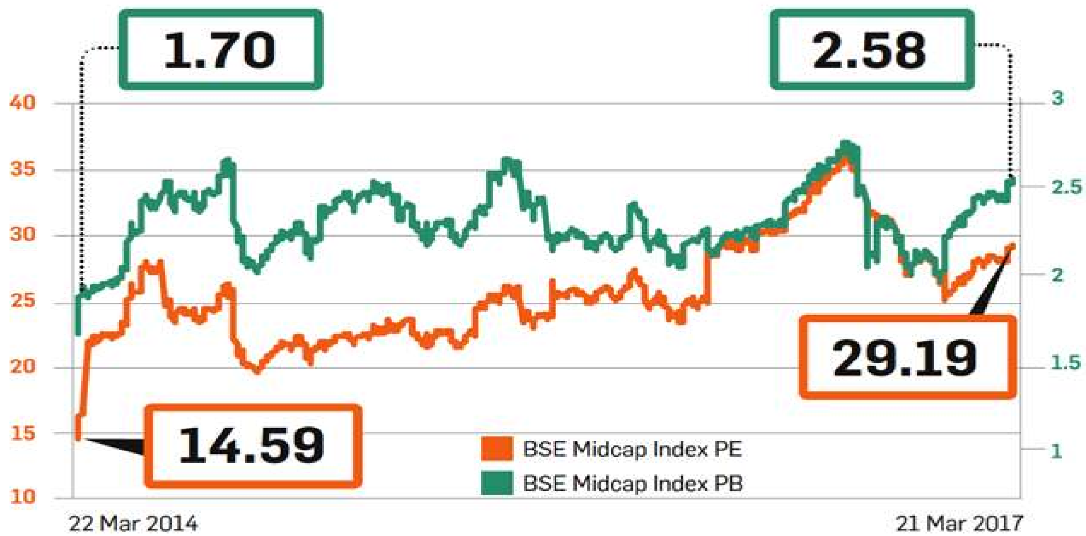
As we know the current P/E is between 20 and 24, if not more, one can make a case of low return from these levels.



ISN'T IT CONFUSING?

But then who said that investing is easy. Investing is simple, but not easy. As you can see the data of the two different camps, both can justify their stance based on solid proof. We would like to clarify, however, that we don't belong to any of the above camps.

We believe that forecasting is a fool's game, more so when it is a short-term forecast. So, we have no problem in admitting that we do not know whether markets would rise from here or go down in the next year or so. In our view, investing is a mix of science and art. We believe that we must find the hard data (science) and then use our judgment as rationally and carefully as possible(art).

While we have seen the two ends of the spectrum in case of data for the market, we try to walk in between. Let us consider the following data:

Comparison	2007 ending	2017
PE Ratio	28.25	24.91
PB Ratio	6.54	3.6
Dividend Yield	0.83%	1.22%
Earnings Growth (YoY)	28%	2%
Credit Growth	~ 23%	~ 5.5%
Capacity Utilization	91.7%	~ 73%
10 Year Bond Yield	7.8%	6.8%
US Fed Rate	5.25%	1%

Whether we like it or not, the above table presents the crude fact of the market levels today. So, there is no denying the fact that valuations are on the expensive side in terms of P/E ratio but on P/B we still have a lot of headroom. Moreover, the Earnings growth today is at 2% compared to 28% in 2007. So, one argument can be made that if the earnings recover from here, the P/E ratio should come down. But, who knows, we may be into this low earnings growth territory for a longer tenure. In that case, investing now could be very dangerous, as the market would become very expensive with low earnings (E) and price (P) rising every day. Eventually market would have to follow the law of gravity and fall down from such a peak.

So, nobody can have the foresight whether the market can rise from here or fall from here in the short period of say couple of years. Hence, we all make a guess, but that's just a guess. And your guess could be as good as mine. As fund managers we must take a prudent call and one which is not just based on guesses.

INVESTMENT DECISIONS

We started managing your funds a couple of months back. Our actions were made on certain observations below:

OBSERVATIONS	ACTIONS TAKEN
Overall market looks expensive, particularly the midcaps	• Set aside20% of portfolio for liquid funds to take advantage of a sudden fall in market. • Keep a balance of midcap and large cap stocks in the portfolio
Pharmaceutical sector was punished due to FDI rules	• Invested in a pharmaceutical company which has other businesses with prospects. Also, management has a proven long-term record of delivering shareholder returns. • Bought into a company which is a relatively unknown stock in the sector which has come out with a buyback offer which guarantees 30% returns from our purchase price.
Lot of good quality companies looking very expensive	Patiently waiting for prices to come down
"Electric vehicles" appears to be a good theme going forward.	• Bought a good chunk of a large cap stock which we expect is going to get benefit of this theme and also available at discounted valuations. • Also invested in a couple of companies which are suppliers to Electric vehicles manufacturers or electric vehicle parts manufacturers

SIGNING OFF

As of today, we are 48% invested into equity, 20% in liquid funds and 32% in cash in all our clients' accounts. By this strategy we mean to demonstrate to our clients that although these are very difficult times in the short term, but we are very confident about the long-term India story. By long term we mean at least 5-10 years. So, we have to be cautious in our approach given the current high valuations. But, we are not willing to be ultra-cautious and stay away from investing into good quality companies. We will keep moving, although slowly. **There is an old saying in stock market, “Be fearful when others are greedy, and be greedy when others are fearful.”** We can clearly observe quite a lot greedy participant all around. Hence, we are fearful. That is the reason we are only 48% invested into equity as of now. But on big declines, for which we are patiently waiting, we should not hesitate to increase our allocation meaningfully. **Remember, when bond yields are low and equity prices are high, it makes sense to increase our investment horizon and reduce our return expectations.**

With the above thought, we would thank you once again on trusting our ability to serve you well. We make a promise to you that we will continue to be transparent in our investment operations and share our philosophy with you from time to time.

SMART SYNC SERVICES

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

contact@smartsyncservices.com
+91 9978 988562