• Portfolio Performance

The PMS return for the quarter was -10.5%. This brings our since-inception TWRR to 15.9%, higher than the return generated by Nifty at 12.7% for the same period. The PMS return for the financial year 03/2025 was 4.4% compared to 4.7% for Nifty. The PMS level cash holding is at appx. 6.1% (may vary for individual accounts).

• Market & Strategy Update

Indian stock market corrected by 0.5% in the last quarter. The correction in small and mid-caps was more severe at 14.3% and 9.6% respectively. The sell off was triggered by:

1. Slowdown in earnings – Q3 earnings were below par due to economic slowdown.
2. Sharp fall in domestic consumption led by:
    a. High interest rates.
    b. High inflation.
    c. High direct and indirect taxes.

FPIs were net sellers of USD 16.9 billion in the last quarter. Their holding of Indian stocks falling to below 16%, a multi decadal low. Domestic investors continued to invest in the markets though their contribution was not enough to offset the FPI selling.

Lastly, the tariff war unleashed on the global economy by the US President led to investors reducing exposure to risk across asset classes.

We believe that the sharp correction in Indian stock markets is an overreaction by jittery investors and is providing a great investment opportunity to patient long-term investors.

• What We Are Seeing

Domestic consumption is coming back driven by:

1. Tax cuts in the Union Budget.
2. Interest rate cuts by RBI.
3. Lower inflation.

With an increase in buying power, the domestic consumer is back to buying consumer discretionary items like autos, home improvement and real estate. The recovery is uneven – urban seems to be recovering faster than rural but a good monsoon should even out the recovery.

Softer commodity prices, especially crude oil, will help improve margins for consumer companies and will have a cascading positive impact on the entire value chain.

The RBI, under the new governor, has switched to an accommodative stance from the earlier neutral stance. The recent actions from RBI show that it wants to focus on growth by reducing cost of capital and at the same time making sure that there is ample liquidity in the system. This will help kick start the credit growth and private capex cycle that had slowed down over the last twelve months.

Tariff war – India is a collateral damage in the ongoing tariff war. We have small share of the global trade and our largest exports to the US are pharmaceuticals (excluded from tariffs), textiles (other countries like Vietnam and Bangladesh will hurt more as they had zero tariff status) and handicrafts including gems and precious stones. Our IT exports are not under threat since services have been excluded from tariffs. Therefore, the current crisis is an opportunity for India to boost domestic consumption by replacing imports of electronics through the 'make-in-India' initiative.

We expect the tariff threats to roll back sooner than later as countries enter trade deals with the US. At the same time, the sharp correction in the US stock indices, US Dollar and a sharp increase in US bond yields is putting pressure on the US to conclude these deals quickly. The last thing the US wants is a sharp increase in inflation driven by higher landed price of landed goods.

India's macro indicators continue to be best ever. The sharp fall in crude prices will help cushion the deficit. GST collection for last month was the highest ever and bond yields are at the lowest in last 2 years. The country continues to attract long term strategic and financial capital.

- ## Model Portfolio Rebalancing

Major change: We have moved from underweight on banks to equal weight.

Underweight: IT services, real estate, autos, FMCG and capital goods

Our underweight stance on IT services and real estate has worked out well as they were the worst performing sectors in the last quarter with a fall of ~25% at the index level. We believe large cap IT services will continue to struggle for annual growth. We have reduced our annual growth estimate from 5% to 2% and we see higher risk of margin compression. Despite the correction the PE multiples are elevated at 20-25x. We believe that with another 20% price correction, the large cap IT stocks will get into attractive zone.

The real estate sector had run up sharply over the last couple of years and as the demand tapers off the stocks have suffered. However, we see this as a cyclical correction and believe that the demand will recover over the next twelve months.

Large cap auto stocks also went through a sharp correction despite a sharp fall in inventory levels. Global uncertainty, especially related to exports to the US has put pressure on companies with large export component. At the same time the companies with largely domestic market are also under pressure due to higher competition from US auto companies as the Indian government has substantially reduced import duty on US autos.

Overweight: Pharma.

Pharma continued to do well. Our investment thesis based on new product launches, better compliance, CDMO growth and more receptive US market continued to play out. We believe the tariff war has created a unique opportunity for Indian pharma companies to increase their market share in the US as long as they can manage the supply chain.

New addition: Small banks.

We have added 4 small banks to the model portfolio. We believe that these banks have unique strengths through their strong franchises and branch model. The beaten down valuation (mostly sub book value) makes them a very attractive opportunity. We believe that these banks will benefit from reduction in interest rates and increase in system liquidity. The quarter ended December 2024 was probably their worst quarter driven by high provisioning and lack of liquidity. Most of the short term challenges are getting fixed quickly as flows from Credit Guarantee Fund for Micro Units have started to kick in and collection efficiency has started to improve. These banks stayed profitable in their worst quarter and we believe that profitability will improve from hereon. These banks have actively reduced their unsecured portfolio and increased secured loan portfolio. We expect multi-bagger returns from these banks over the next couple of years.

To make space for these banks we have exited 3 stocks – APL Apollo, Akums and Star Health.

APL Apollo has been an underperformer over the recent past after a stellar multi bagger run. While we like its market leadership in its niche space we are not convinced about its capital allocation over the last year. We are worried that management is exploring adjacencies for growth as the growth of the core business has slowed down. Such slowdown will put pressure on the elevated valuation of the stock. We will continue to track the company.

Akums is an early exit for us. We are very positive on the domestic CDMO opportunity and continue to hold Windlas. However, the recent growth guidance from Akums does not justify its premium valuation. We will wait for the valuation to become more attractive.

Star Health posted weak Q3 results with retail and group loss ratios of 69.2% and 90.4%, pushing the combined ratio to 101.8%. Recent findings suggest improvement will take longer than anticipated. Persistent challenges include rising operating expenses, elevated claims due to healthcare inflation, and the high combined ratio—all suppressing earnings. With recovery likely extending 4-6 quarters and no catalysts on the horizon, we decided to exit our Star Health position.

The rebalanced model portfolio forecast return is 38% for 2025 based on our earnings estimates. The forecasted annualized return over next three years is 23.7%. We continue to maintain our portfolio risk management guardrails that we have discussed earlier.

- **Finally**

  We see the current market correction as a great opportunity for long-term investors to add multi-baggers to their portfolio. Our research team is very excited by the new investment opportunities that are presenting themselves due to the market correction. Our endeavour, as always, is to research these companies in great depth to understand their business model and build conviction about their high growth. Our portfolio management model will continue to diversify market risk.

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