The LightHouse

YOUR GUIDE TO BUILD WEALTH & BE FREE

| January 2023 Edition |

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DISCLAIMER

All content in this newsletter is for information and education purposes only. It should not be considered as a recommendation or investment advice.

ALL IT TAKES TO MAKE 2023 YOUR BEST YEAR YET

Let's boil it down to the simplest ideas to achieve health, wealth and happiness.

HEALTH

पैर गर्म, पेट नरम और सिर ठंडा (Head cool, Tummy soft, Feet warm) is one of oldest guidelines for a healthy body.

The three things I aim to do to get the above results is - Eat moderately, walk a lot and remain hydrated.

WEALTH

- Save well and save first
- Have goals to work towards
- Invest in a diversified portfolio
- Focus on compounding

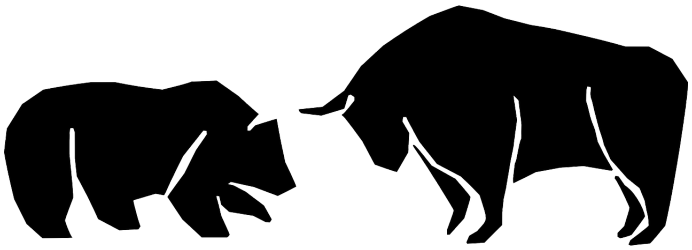
HAPPINESS

- Be curious - Learn something new
- Pay attention to this moment
- Help others grow
- Know that all life is interconnected

Wish you a very happy new year 2023.

STATE OF THE MARKETS

After a strong rally, the month of December 2022 did bring a scare with the increase in Covid cases. But no scare is too big. As of Dec 31, 2022, Nifty 50 benchmark fell to 18105 from it's ALL TIME HIGH of 18812 on Dec 1, 2022, down ~4%. Yet, it is up almost 20% from its low of 15293 in mid June 2022.



The volatility is lower (in India), which, in my view, is a contrarian sign. When market volatility tops, it is usually bottoming out. Doesn't seem to be the case for now.

SAME OLD SONG, YET AGAIN(^N)!
As investors, we have no choice but to work with uncertainty and take volatility in our stride to determine a course of action that reduces our downside and increases our upside. We continuously strive to do so.

Our tool of choice to manage the portfolio risk and building wealth is - **Asset Allocation and Rebalancing.**

So, let's find out where we stand and what needs to be done.

MARKET INDICATORS

ASSET CLASS	VALUATION ZONE	ACTION BIAS
EQUITY	CAUTIOUS	**HOLD**
BONDS	POSITIVE	**BUY**

Since June 2022, the PE of Nifty 200 has moved up from one of its lowest levels on a rolling 3 year basis. With the rising market, it is not as attractive.

ACTION → Follow your asset allocation and invest accordingly.

If you have SIPs in mutual funds, let them continue. However, one may want to restructure them to meet your asset allocation requirements.

If you have a lump sum to invest, it would be better to spread it out over 6 to 12 months.

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The fixed income yields have continued to stay high. Post the RBI policy announcement of a 35 bps hike on Dec 7, 2022, the rates did go up a bit. As of Dec 31, 2022, the 10 year rate is at 7.32% vs 7.28% as of the close of Nov 30, 2022.

The short term yields continue to inch up though.

Investment	Interest Rate or Yield to Maturity
SBI Fixed Deposit (1 year to <2 year)	6.65% (Dec 12, 2022) vs 6.10% (Oct 22, 2022)
Parag Parikh Liquid Fund	6.14% (Nov 30, 2022) vs 6.26% (Oct 31, 2022)
HDFC Short Term Debt Fund	7.51% (Nov 30, 2022) vs 7.54% (Oct 31, 2022)
HDFC Medium Term Debt Fund	7.96% (Nov 30, 2022) vs 8.07% (Oct 31, 2022)
RBI Floating Rate bond	7.35% (Jan 1, 2023) vs 7.15% (earlier)
Bharat Bond Apr 2032	7.56% (Jan 2, 2023) vs 7.53% (Nov 30, 2022)

Complied by Unovest

While yields are moving up, it looks like the medium term move is close to finality. In fact, some of the YTMs are cooling off. The SBI FD has moved up quite a bit. **You can now add short/medium term debt investments for your debt/bond allocation (lump sum and/or systematic).**

CURRENT INVESTING ACTION SUMMARY

Here's a summary table for better understanding.

STRATEGIC ALLOCATIONS

Conservative Investor	Moderate Investor	Aggressive Investor
For Equity - Stick to large cap funds / ETFs and to less than 40% allocation to equities. **For Fixed Income** - Stick to Bank Fixed Deposits, EPF / PPF, RBI Bonds or other small saving schemes In debt funds, use only sovereign funds or funds such as Bharat Bond **Hybrid funds** can be a good option to consider now.	**For Equity** - You can use large cap funds / ETFs along with midcaps for not more than 60% allocation to equities. **For Fixed Income** - Along with EPF / PPF, RBI Bonds you can consider Dynamic Bonds, Short term debt funds and Corporate Bond Funds. **Hybrid funds** can be a good option to consider now.	**For Equity** - You can use large cap funds / ETFs along with midcaps / smallcaps for not more than 80% allocation to equities. **For Fixed Income** - You can consider Dynamic Bond Funds, Short / Medium term debt funds and Corporate Bond Funds.

Ultimately your goals and time horizon along with your risk profile should dictate your allocations.

THE MAGIC FORMULA on DIRECT STOCKS

Let's revisit - **The Magic Formula**. We built a shortlist of stocks 3 months ago. Let's see how the list changes now, if at all.

There are 2 basic rules to use in the Magic Formula.

1. Identify stocks with superior historical returns on capital employed.
2. From the above, further identify the stocks currently providing the best yield. In other worlds, not overvalued or overpriced.

Rank them and invest in the top 15, 20, 25 or 30 - pick your number based on your requirement of diversification.

We use a popular online tool, screener.in, to filter stocks with following parameters.

1. The stock should have a current market capitalisation of at least Rs. 20000 crores - the largest of the companies.

2. The average Return on Capital Employed (ROCE) in the last 10 years should be 20% or more.

In the display table, we added a column of historical 3 year PE (Price to Earnings) as well.

(You have all the flexibility to set the filters as you like - market cap, ROCE, PE, etc. There are multiple options and you can choose what you want)

75 stocks passed the above criteria and we downloaded the list for further working.

Next, we calculated the **Quality Score**. The highest average 10Year ROCE stock got the highest score.

Subsequently, a **Value Score** was provided wherein the 3Year PE was used to rank the stocks. The one with the lowest average 3Year PE got the highest score. (You see the opposite of P/E is E/P or the Earnings Yield)

We add the 2 scores to calculate the final rank.

Below is the list of the Top 30 ranked stocks - a combination of Quality and Value - based on the Magic Formula.

S.No.	Aug 25, 2022	Oct 7, 2022	Nov 30, 2022	Dec 31, 2022
1	Coal India	Coal India	Coal India	Coal India

2	Sun TV Network	Sun TV Network	L & T Infotech	Oracle Fin.Serv.
3	L & T Infotech	L & T Infotech	Oracle Fin.Serv.	LTI Mindtree
4	Tata Elxsi	Tata Elxsi	Tata Elxsi	Tata Elxsi
5	Oracle Fin.Serv.	Oracle Fin.Serv.	TCS	TCS
6	TCS	TCS	ITC	NMDC
7	ITC	ITC	NMDC	ITC
8	NMDC	NMDC	Bajaj Auto	Bajaj Auto
9	Bajaj Auto	Bajaj Auto	HCL Technologies	HCL Technologies
10	HCL Technologies	HCL Technologies	Infosys	Infosys
11	Infosys	Infosys	Hind.Aeronautics	Hind.Aeronautics
12	Hind.Aeronautics	Hind.Aeronautics	Mindtree	Hindustan Zinc
13	Mindtree	Mindtree	Hindustan Zinc	Petronet LNG
14	Hindustan Zinc	Hindustan Zinc	Petronet LNG	Colgate-Palmoliv
15	Petronet LNG	Petronet LNG	Colgate-Palmoliv	Tech Mahindra
16	Colgate-Palmoliv	Colgate-Palmoliv	Tech Mahindra	Supreme Inds.
17	CRISIL	CRISIL	Supreme Inds.	Eicher Motors
18	Supreme Inds.	Supreme Inds.	Eicher Motors	Indraprastha Gas
19	Tech Mahindra	Tech Mahindra	Indraprastha Gas	CRISIL
20	Eicher Motors	Eicher Motors	CRISIL	Coforge
21	Coforge	Marico	Coforge	Bharat Electron
22	Bharat Electron	Coforge	Bharat Electron	Vinati Organics
23	Marico	Bharat Electron	Vinati Organics	Marico
24	Vinati Organics	Emami	Marico	Persistent Sys
25	Emami	Vinati Organics	Emami	Britannia Inds.
26	Britannia Inds.	Britannia Inds.	Persistent Sys	Hind. Unilever
27	Persistent Sys	Persistent Sys	Britannia Inds.	Coromandel Inter
28	Hind. Unilever	Hind. Unilever	Hind. Unilever	Abbott India
29	Coromandel Inter	Abbott India	Coromandel Inter	Divi's Lab.
30	K P R Mill Ltd	Coromandel Inter	Abbott India	Bayer Crop Sci.

The list hasn't changed significantly.

If you are wondering about the performance of the above shortlist, it is too soon to think of that. Let a few months pass and then we can start adding the performance tables too. (*The April 2023 issue will carry the performance for the first time.*)

What Joel GreenBlatt said about using the Magic Formula Shortlist

Well, isn't this a quick, smart way to build your own portfolio of direct stocks, if you choose to have one. It is highly recommended that you read the book too and see if this is a method you want to use yourself.

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FUNDTALK - HDFC Hybrid Equity Fund

HDFC Hybrid Fund is one of the OGs of Hybrid Investing style. Known as HDFC Balanced Fund in its previous avatar, the strategy was launched in the year 2000 as a truly balanced fund (split between equity & debt). But to retain its equity taxation status, over time, it moved to maintain a min 65% equity exposure at all times.

As of June 1, 2018, the fund was merged with another fund to adhere to fund classification as per SEBI norms. That's the true start date for now of the fund specially for measuring performance.

Now, hybrid funds are perceived to be lower risk compared to pure equity funds, courtesy the exposure to debt that they have.

But what if I told you that this Hybrid Equity Fund does better than a Nifty Nifty Next 50 Index Fund?

Don't believe me. Look at the numbers on the following page.

The Nifty Next 50 Index comprises the 51st to the 100th stock from the Nifty 500 universe. As a junior index, it is perceived to contain some of the fastest growing businesses that are ready to claim the top spot in Nifty 50 over a period of time. Hence, the index makes for a sweet spot for those willing to

stick around with a predominantly large cap index and yet deliver better returns.

But it looks like the NN50 index has a competitor - in the hybrid category. Look at the numbers below

unovest.co	HDFC Hybrid Equity Fund	ICICI Pru Nifty Next 50 Index Fund
1 year	10.12%	0.65%
3 year	16.26%	14.21%
SIP returns 3 yr	19.68%	15.40%
Sharpe Ratio	0.73	0.56
Std Deviation	18.21	21.79
Allocation		
Equity %	71.45%	99.91%
Debt %	25.82%	-
Cash %	1.96%	0.09%
Expense Ratio	1.12%	0.30%
Exposure		
Equity	Multicap	Largecap
Debt	Sov & AAA	-

Data source: ValueResearchOnline

The 1 year, 3 year trailing returns, 3 year SIP returns, sharpe ratio (risk adjusted returns), volatility - on every parameter the hybrid fund pips the pure equity nifty next 50 index fund.

Of course, the expense ratio of the hybrid fund stands out like a sore.

Why could this be an ideal time to add this to a portfolio?

The interest rates are almost at their peaks. The fund is likely to benefit from falling interest rates in the next few years which will add to capital gains in the NAV.

The equity will play the role it is supposed to. The near term volatility will allow some cost averaging either via SIPs or lumpsum spread over a period.

Together, the hybrid's equity + debt are likely to produce a superior outcome than a pure equity version fund.

SIP it?

FUND WATCHLIST

FUND NAME	CATEGORY	BRIEF DESCRIPTION	INVESTOR RISK PROFILE	TIME HORIZON
PARAG PARIKH FLEXI CAP FUND	EQUITY - FLEXICAP	Go anywhere fund, international stocks, arbitrage, holds cash, low volatility & turnover with focus on capital protection.	ALL	5 YEARS PLUS
EDELWEISS BALANCE ADVANTAGE FUND	EQUITY - HYBRID (DYNAMIC ALLOCATION)	Trend driven Dynamic allocation to equity based on fundamental and technical indicators to reduce volatility & drawdown, tax free rebalancing.	CONSERVATIVE, MODERATE	3 YEARS PLUS
DSP QUANT FUND	EQUITY - LARGE / MIDCAP	The fund uses an in-house quantitative model to build its portfolio from the universe of BSE 200 stocks. It operates as a low cost, passive fund with upto 4 rebalances during a year.	ALL	5 YEARS PLUS
DSP VALUE FUND	EQUITY - VALUE	The fund builds its portfolio using a value style framework - a combination of quality and price. It also has a mandate to	ALL	10 YEARS PLUS

		invest upto 35% of its portfolio in international funds/stocks.		
MOTILAL OSWAL S&P 500 INDEX FUND	EQUITY - INTERNATIONAL LARGE CAP (PASSIVE)	A low cost index fund that replicates the portfolio of S&P 500 index (largest 500 companies) in the USA.	ALL	5 YEARS PLUS
FRANKLIN INDIA FEEDER US OPPORTUNITIES FUND	EQUITY - INTERNATIONAL FLEXICAP	A feeder fund that invests in Franklin US Opportunities Fund, a multi cap fund portfolio of US based listed stocks across market caps.	MODERATE, AGGRESSIVE	5 YEARS PLUS
MOTILAL OSWAL NIFTY MIDCAP 150 INDEX FUND / NIPPON INDIA NIFTY MIDCAP 150 INDEX FUND	EQUITY - MIDCAP (PASSIVE)	A low cost index fund that replicates the portfolio of Nifty Midcap 150 index (representing 101st to 250th rank of the Nifty 500 index) in India.	MODERATE, AGGRESSIVE	5 YEARS PLUS
UTI NIFTY NEXT 50 FUND	EQUITY - LARGE CAP (PASSIVE)	A low cost index fund that replicates the portfolio of Nifty Next 50 index (representing stocks from 51st to 100th rank based on various factors) in India.	ALL	5 YEARS PLUS
HDFC INDEX FUND - NIFTY 50 PLAN	EQUITY - LARGE CAP (PASSIVE)	A low cost index fund that replicates the portfolio of Nifty 50 index (representing stocks	ALL	5 YEARS PLUS

		from 1st to 50th rank based on various factors) in India.		
PARAG PARIKH TAX SAVER FUND	EQUITY - TAX SAVINGS	Tax savings fund based on the same investment philosophy as the Flexicap fund except international stocks	ALL	3 YEARS PLUS
AXIS TREASURY ADVANTAGE FUND	DEBT - LOW DURATION	Low cost, low volatility fund with low maturity profile and high credit exposure	ALL	2 YEARS PLUS
HDFC SHORT TERM DEBT FUND	DEBT - SHORT TERM	Predominantly high credit quality, low risk portfolio with one of the lowest expense ratios.	MODERATE, AGGRESSIVE	3 YEARS PLUS
QUANTUM DYNAMIC BOND FUND	DEBT - DYNAMIC BOND	A conservatively managed debt fund that manages its portfolios based on interest rates movements with a portfolio of Govt Securities and high rates PSU Bonds only.	CONSERVATIVE, MODERATE	3 YEARS PLUS
HDFC CORPORATE BOND FUND	DEBT - CORPORATE BONDS	A high credit portfolio of AA and higher ratings	ALL	3 YEARS PLUS
HDFC HYBRID EQUITY FUND*	HYBRID - AGGRESSIVE		MODERATE, AGGRESSIVE	3 YEARS PLUS

Compiled by Unovest, Click on the fund names to see rolling returns and other comparison

Note:

- Some of the international funds have started to accept new investments with a cap per PAN per month.
- Tax Saver funds have a lock in of 3 years during which you cannot sell the investment.
- All debt funds have a mark to market feature which makes their NAV fluctuate based on interest rate changes.

NETI, NETI

(*NOT THIS, NOT THAT -* A Guide to Avoid Big Mistakes)

DON'T DO MORE, DO LESS

'Do less of something' has better odds than 'do more of something'.

Like a sculptor whose focus is to 'remove' rather than 'add'. What if we focus on not adding but removing. Much like the sculpture, you may emerge a better version of yourself.

Heard of Charlie Munger? Google, if you haven't.

Charlie Munger's entire thought process has been to avoid big bad decisions. He says "tell me where I am going to die and I will never go there."

He also says this:

"It is remarkable how much long-term advantage people like us have gotten by trying to be consistently not stupid, instead of trying to be very intelligent." — Charlie Munger

In 2023, what are you choosing **'less'** of?

What about your investments?

Do think about it.

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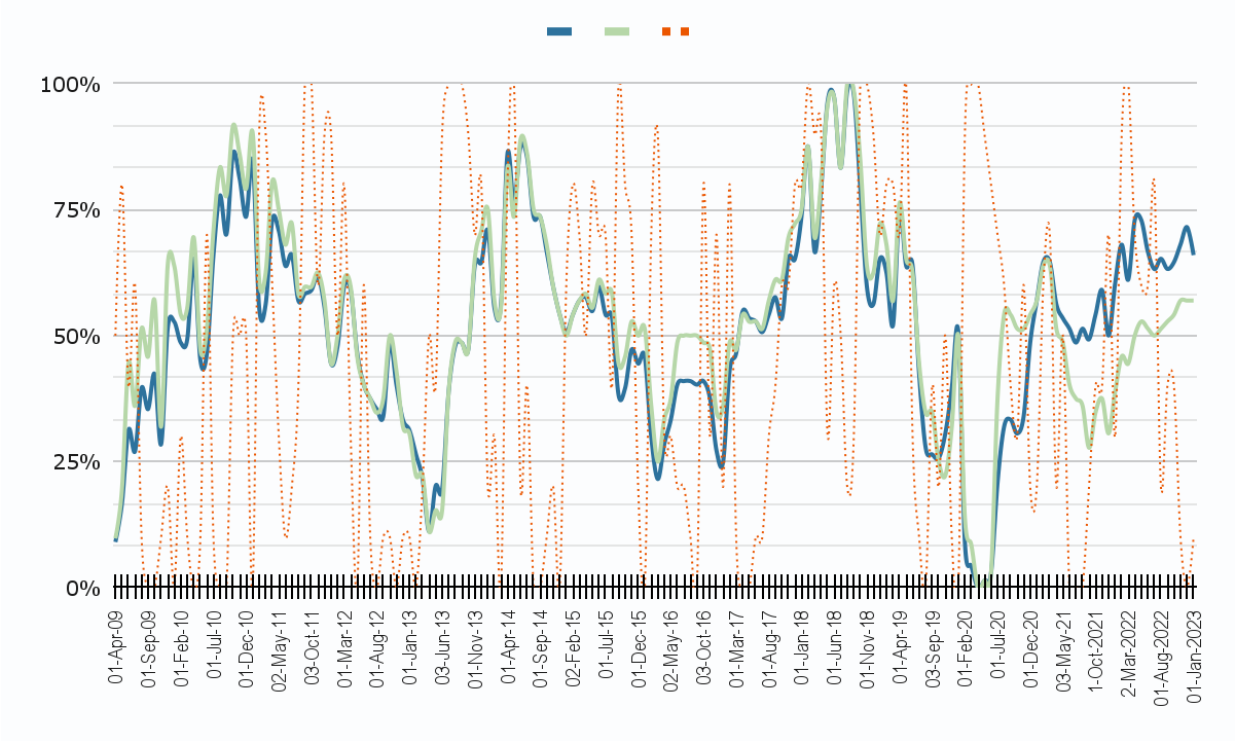
ANNEXURE - MARKET INDICATORS

We use 3 inputs in our models - Nifty 200 Price to Earnings, Nifty 200 Price to Book and 10 Year G-Sec Yield. We have built 2 indicators and this is what they tell us. Scores are as of Jan 1, 2023.

Nifty 200 PE - 10 Year GSec based Model (Green line)	Score**: 56.95%**	CAUTIOUS
Nifty 200 PE - PB - 10 Year GSec based Model (Blue line)	Score: **65.98%**	CAUTIOUS



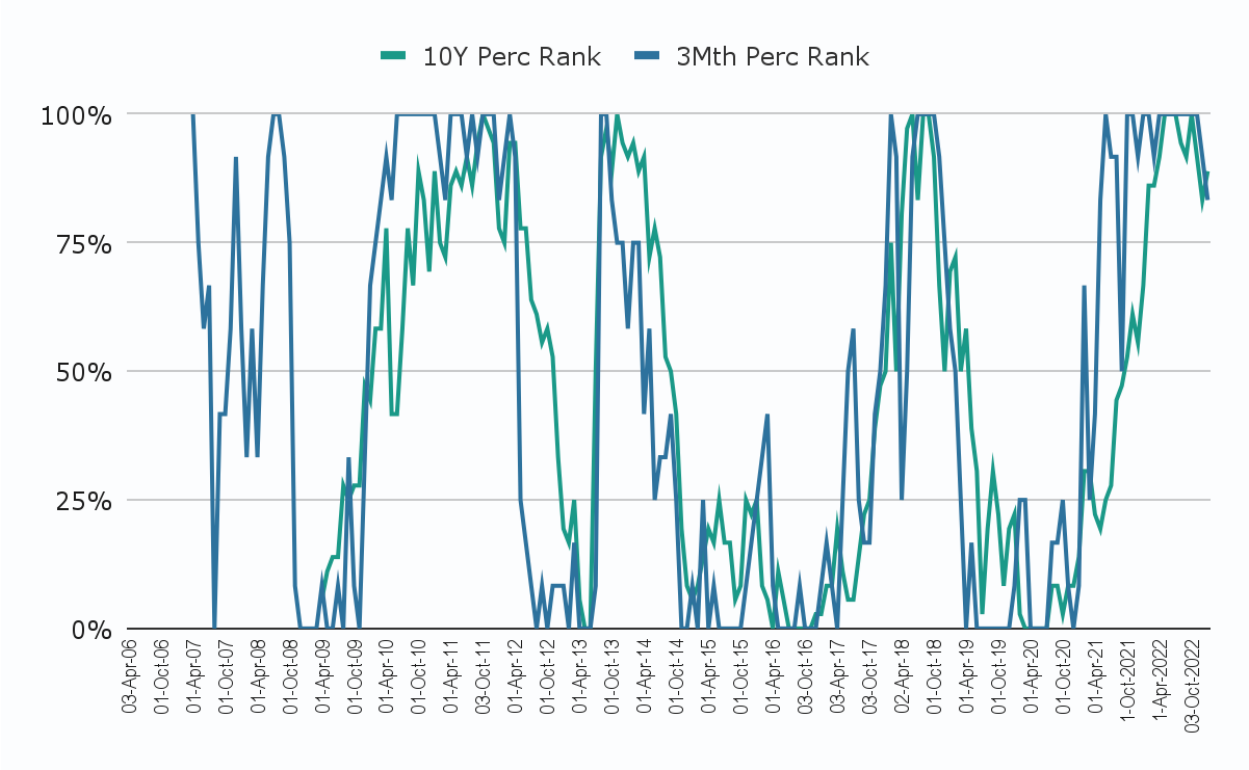
Data Source: NSEIndia.com and Investing.com, prepared by Unovest

The asset allocation model scores are cautious. It is not a time to get adventurous.

We added a new perspective - Volatility - an independent indicator to cross check the AA model. I see that the anti volatility model is as good as the AA model.

Check the dotted red line in the above chart. What do you think?

The 3 month yields have come off further a bit, currently at 83th percentile levels (as of Jan 1, 2023). See chart below.



Data Source: Investing.com, prepared by Unovest

TERMS SIMPLIFIED

PRICE TO EARNINGS OR PE

Price to Earnings is a measure which helps evaluate the relative valuation of a stock. ***Divide the earnings per share of EPS by the Price of the stock and you get the PE.*** The lower, the better.

However, you need to check it with respect to the historical trend as well as in relation to the peers of the business / industry to get a better picture.

YTM or YIELD TO MATURITY

We know that every bond has an interest rate attached to it. The RBI Floating Rate Bond, 2020 pays out 7.15% per year, for example.

Now, this assumes a static value of the bond. Again, for example, the RBI Bond has a face value of Rs. 1000 per bond unit.

But when the value is marked-to-market, it can change. This Rs. 1000 may become Rs. 1100 or Rs. 950.

At that point, if you, as an investor, buy the bond at Rs. 1100, that becomes your buy price. However, the interest rate on the bond is still 7.15%.

So, the rate of return on your investment will be the interest rate divided by the price.

7.15% divided by Rs. 1100, that is, 6.5%. This is also called the yield.

If you have understood this then you can grasp the fact that yield to maturity indicates all the returns that a bondholder will receive if s/he holds to bond till its maturity. There is a formula to calculate that and you can easily find it on Google.

THANK YOU FOR READING THE LIGHTHOUSE.

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