The LightHouse

YOUR GUIDE TO BUILD WEALTH & BE FREE

| June 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.

Make time your friend - 1 YEAR VS 10 YEARS

We have a faulty sense of time and its impact.

There is a quote that goes around on the internet attributed to Bill Gates, "*We overestimate what we can do in 1 year and underestimate what we can do in 10 years.*"

Take a moment to think about this.

Even in personal finance and investing, time plays a big role. The idea of delayed gratification takes center stage. The investor seeks to ensure that the value of your money does not erode with time. Better, it should grow.

Unfortunately, there is a big crop of influencers today, who are hell bent on making you believe that you can make 'quick and easy money'. Stock market trading and selling options seem to top the list.

There is an extreme short term focus which is highly likely to damage your wallet and the mind.

In contrast, by thinking long term, say 10 years, with your money, you allow your portfolio to take a very different direction and let compounding weave its magic.

All you need to do is build a good base for it to work through your savings. Building a base takes time - 10 years.

Take this example. Suppose you build a portfolio to double in 8 years - meaning it gets about a 9% annualized return. If you have put 1 lakh in the portfolio, it is likely to become 2 lakhs.

But what if you put in 10 lakhs or a crore? Even with the same rate of return, the outcome as an absolute amount is now huge - 20 lakhs and 2 crores respectively.

While you could always gun for a higher rate of return, the important distinction to make here is about what you can control.

Rate of Return OR Savings?

If you can save enough in the right kind of investments, time will play its role. Higher returns can be a bonus.

You may want to revisit the 1 paisa experiment.

The thing is you don't have to spend time finding the next lottery aka the "Laxmi Chit Fund" as in Hera Pheri, the movie.

You don't have to keep comparing if your investment is doing better than others. You just need to invest in an approach that is suits you. *Performance* *in markets happens in cycle - even within funds in the same category, different approaches can deliver at different times.*

The one thing you need to avoid is an investment option that is an outright fraud. Rest all can fall in place.

The conclusion is - make time your friend. Build the base - give it time.

My portfolio - 2023 version

In the March 2023 edition of Lighthouse, I touched upon the topic of Portfolio Insurance. At the same time, I started to implement it in my own long term portfolio.

The concept is quite simple.

I want to limit the downside of my portfolio. I, let's say, am not comfortable with a more than 5% drop in my portfolio at any given point in time.

To limit this downside, I hedge my portfolio - using PUT options for that market event.

PUT options are equivalent to insurance - if the markets go down 5% or more, I get paid by my insurance. This compensation allows my portfolio to stay at the same level as before the drop.

But there are more benefits to it.

1. Since insurance protects my portfolio, I can use equities and their wealth building power to the hilt.
2. The cost of insurance (buying put options) is usually less than the cost of any other diversification (*such as lost return via bonds, gold, etc.*)

3. I do not need to worry about market valuations and when I should invest. Having insurance eliminates the worry. (*If I have a lump sum to invest, I can go all in, right now.*)

Come on, how can anything be so good? It can't be. Let's see.

1. The idea of working with options can sound scary. After all, Warren Buffet called derivatives such as options and futures, weapons of mass destruction.
2. If the markets remain flat or keep going up, you will continue to lose the insurance premium. (*remember, insurance pays only when the markets drop*)
3. While the counter to the above is in the benefits, losing in any form is not psychologically acceptable. Even if it is a relatively small insurance premium.
4. You have to rebalance the portfolio when markets fall and the insurance pays off.

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Going to say this till you see compounding for real

The Journey of Wealth Creation and Compounding is hard. Only discipline and a structured approach can help you complete it. There is no shortcut.

MARKET INDICATORS

Our current view on Equity and Bonds/Fixed Income.

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

Equity - Given the state of the equity markets, the world doesn't seem worried any more. That itself is a cause for worry. :) The US is going to print more money, which will keep markets afloat for some time. But there will come a point, when this recklessness is going to come to bite bitter.

In India, markets have rapidly gone up. We are back to the same levels as the start of the year 2023.

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Bonds - After making new highs last month, the fixed income yields have cooled off. As of June 1, 2023, the 10 year rate was at 6.981% vs 7.315% in April 2023.

The 3 month yield on Govt Securities is now at 6.76% vs 6.9% (April 2023). The cooling off has taken place across.

This is how they stack up in their yields or interest rates.

Investment	**Interest Rate or Yield to Maturity**
SBI Fixed Deposit (1 year to <2 year)	6.8% (Feb 15, 2022) vs 6.75% (Dec 12, 2022); *Senior citizens get 0.5% extra (UNCHANGED)*
Parag Parikh Liquid Fund	6.78% (April 2023) vs 6.76% (Feb 28, 2023)
HDFC Short Term Debt Fund	7.74% (April 2023) vs 7.97% (Feb 28, 2023)
HDFC Medium Term Debt Fund	8% (April 2023) vs 8.30% (Feb 28, 2023)
RBI Floating Rate Bond*	8.15% (April 2023) vs 7.35% (Jan 1, 2023)
Bharat Bond Apr 2032	7.28% (Jun 2, 2023) vs 7.62% (Apr 4, 2023)

*Complied by Unovest: Updated on April 4, 2023, *Tied to NSC rate which has gone upto 7.8%, FRB will start earning an extra 0.35% over NSC rate, that is, 8.15% from the next reset date.*

CURRENT INVESTING ACTION SUMMARY - JUNE 2023

OVERALL ACTION → Stick to your asset allocation and invest accordingly.

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. **Hybrid funds** can be a good option to consider now.

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

EQUITY ACTION →

- If you have SIPs in mutual funds, let them continue.
- If you have a lump sum to invest, it would be better to spread it out over 6 to 12 months, within the asset allocation framework.

Investors can consider insuring their portfolios in a way that an extreme event does not hurt the portfolios. In fact, done right, insurance can increase overall portfolio returns.

BONDS ACTION→

Yields are cooling off. However, **you can continue to add short/medium term debt investments for your debt/bond allocation (lump sum and/or systematic).**

Even with the long term capital gains tax provision going away, debt funds can deliver substantial capital gains as and when the RBI starts reducing interest rates.

PERSONALISED INVESTMENT ADVISORY SERVICES

The Lighthouse in your Portfolio

With a custom defined strategy in line with your expectations, we design a portfolio of investment instruments (funds, stocks, bonds) and allocate money to them.

An ongoing monitoring and review ensures that the portfolio continues to align with expectations.

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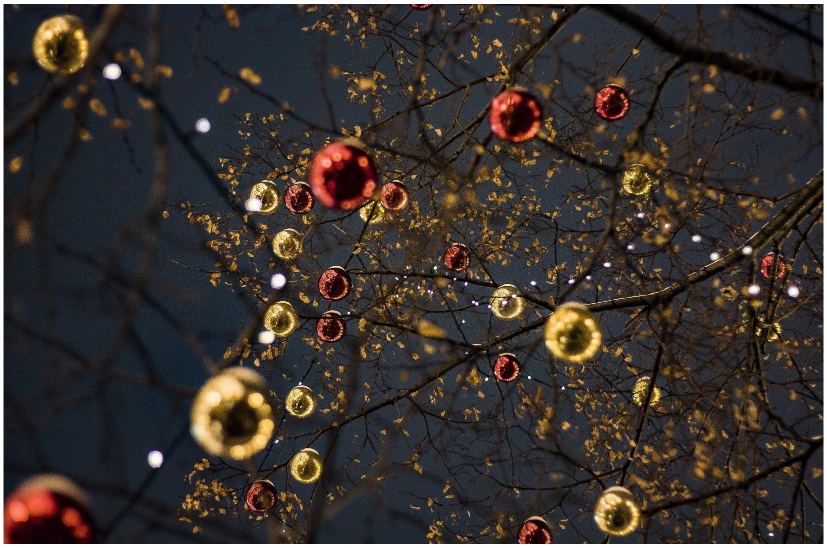
Fee Details – *Only fee*, *Commission free, totally aligned towards a long term relationship.*

Upto Rs. 50 lakhs portfolio: Rs. 20,000 + GST per year
For every additional Rs. 50 lakh slab, fees go up by Rs. 10,000 + GST per year
Example: If in a year, your portfolio is Rs. 90 lakhs, the fee will be Rs. 30,000. If your portfolio is Rs. 2 crore, your fees will be Rs. 50,000 for that year. For a portfolio of Rs. 5 crores, the fees will be Rs. 1.1 lakhs. GST applicable.

[Know more here]

THE MAGIC FORMULA on DIRECT STOCKS

(*1st PERFORMANCE UPDATE*)



Let's revisit - **The Magic Formula**. We built a shortlist of stocks a few 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. 20,000 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 10-Year ROCE stock got the highest score.

Subsequently, a **Value Score** was provided wherein the 3-Year PE was used to rank the stocks. The one with the lowest average 3-Year PE got the highest score. (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	Dec 31, 2022	Apr 3, 2023
1	Coal India	Coal India	Coal India	Coal India
2	Sun TV Network	Sun TV Network	Oracle Fin.Serv.	Tata Elxsi
3	L & T Infotech	L & T Infotech	LTI Mindtree	Oracle Fin.Serv.
4	Tata Elxsi	Tata Elxsi	Tata Elxsi	LTI Mindtree
5	Oracle Fin.Serv.	Oracle Fin.Serv.	TCS	TCS
6	TCS	TCS	NMDC	NMDC
7	ITC	ITC	ITC	ITC
8	NMDC	NMDC	Bajaj Auto	HCL Technologies
9	Bajaj Auto	Bajaj Auto	HCL Technologies	Bajaj Auto
10	HCL Technologies	HCL Technologies	Infosys	Infosys
11	Infosys	Infosys	Hind.Aeronautics	Hind.Aeronautics
12	Hind.Aeronautics	Hind.Aeronautics	Hindustan Zinc	Hindustan Zinc
13	Mindtree	Mindtree	Petronet LNG	Petronet LNG
14	Hindustan Zinc	Hindustan Zinc	Colgate-Palmoliv	Colgate-Palmoliv
15	Petronet LNG	Petronet LNG	Tech Mahindra	Tech Mahindra
16	Colgate-Palmoliv	Colgate-Palmoliv	Supreme Inds.	Supreme Inds.
17	CRISIL	CRISIL	Eicher Motors	Coforge
18	Supreme Inds.	Supreme Inds.	Indraprastha Gas	Indraprastha Gas
19	Tech Mahindra	Tech Mahindra	CRISIL	Eicher Motors
20	Eicher Motors	Eicher Motors	Coforge	CRISIL
21	Coforge	Marico	Bharat Electron	Bharat Electron
22	Bharat Electron	Coforge	Vinati Organics	Marico
23	Marico	Bharat Electron	Marico	Britannia Inds.
24	Vinati Organics	Emami	Persistent Sys	Persistent Sys
25	Emami	Vinati Organics	Britannia Inds.	Hind. Unilever
26	Britannia Inds.	Britannia Inds.	Hind. Unilever	Abbott India
27	Persistent Sys	Persistent Sys	Coromandel Inter	Divi's Lab.
28	Hind. Unilever	Hind. Unilever	Abbott India	Coromandel Inter
29	Coromandel Inter	Abbott India	Divi's Lab.	APL Apollo Tubes
30	K P R Mill Ltd	Coromandel Inter	Bayer Crop Sci.	Page Industries

Magic Formula Performance Update (as of April 4, 2023):

We first shared the Magic Formula stock watchlist as of Aug 25, 2022. For the purpose of tracking performance, investment was made on Sept 1, 2022 for about Rs. 10 lakhs, actually, 9.93 lakhs.

We chose to invest in the top 25 ranked stocks from the list and they got an equal investment.

It has been over 6 months. In the journey of a portfolio, this is early days. Let's see what the portfolio has done.

As of April 4, 2023, the total return (including dividends) is 1.4%. In contrast, the BSE 500 Index has a return of (-) 4% approx.

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→ **June 2, 2023 adhoc update**:

The Total Absolute return on the portfolio is 10.8% (including dividends) vs the BSE 500 Index return of 3.4%.

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Let's take a performance update every 6 months.

The next rebalance will also happen after 1 year of the portfolio start, that is, on Sept 1, 2023.

Note: *If you would like a detailed transaction list for the above investments, please do write to me.*

FUND WATCHLIST

Some of the funds we like and watch.

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 / ICICI PRU NIFTY NEXT 50 INDEX 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	Asset Allocation to Equity: Debt reduces volatility.Tax free rebalancing with large cap like outcome.	MODERATE, AGGRESSIVE	3 YEARS PLUS

Compiled by Unovest

Note:

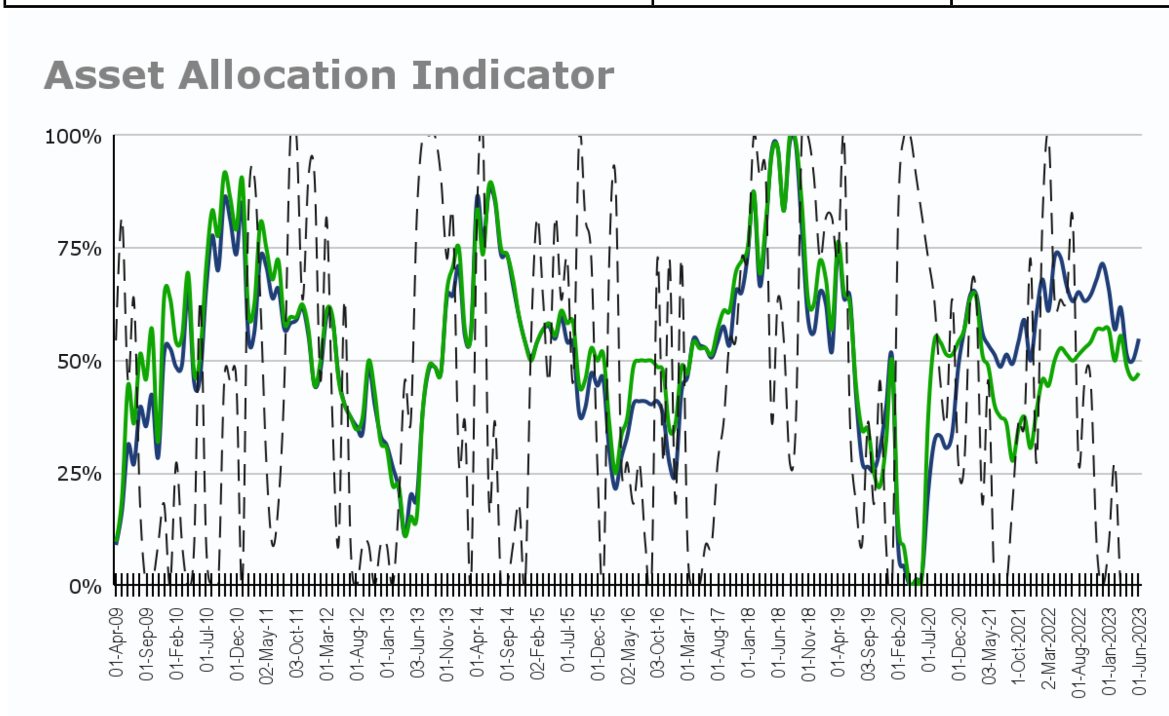
- Some of the international funds have started to accept new investments with a cap per PAN per month.
- Tax Saver funds have a lock in of 3 years during which you cannot sell the investment.
- All debt funds have a mark to market feature which makes their NAV fluctuate based on interest rate changes.

ANNEXURE - MARKET INDICATORS

ASSET ALLOCATION INDICATOR

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 June 1, 2023.

Nifty 200 PE - 10 Year GSec based Model (Green line)	Score: **47.25%**	BUY
Nifty 200 PE - PB - 10 Year GSec based Model (Blue line)	Score: **54.88%**	HOLD



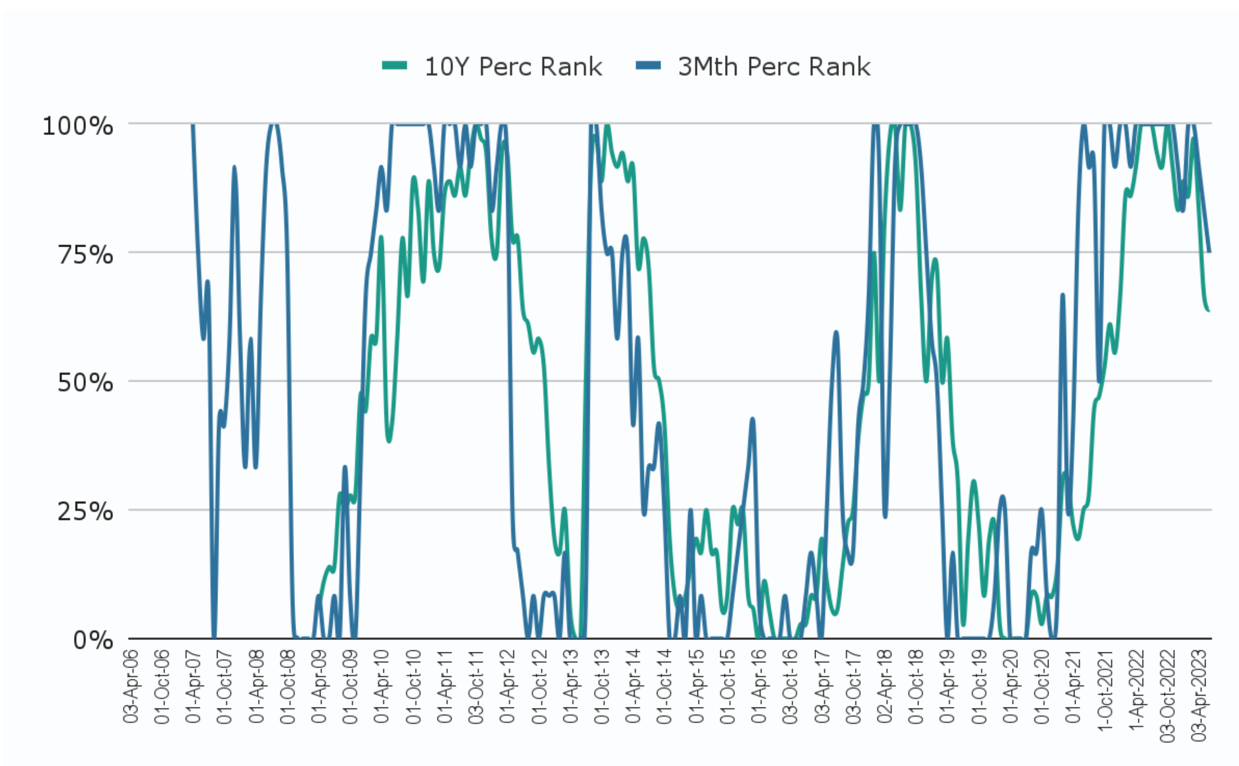
Data Source: NSEIndia.com and Investing.com, prepared by Unovest

The asset allocation model scores have moderated a lot since we sounded caution last time. It is still not a time to get adventurous.

Volatility indicator or VIX is an independent indicator to cross check the AA model.
The dotted red line in the above chart indicates the VIX percentile. It is at its bottom percentile. What do you think?

BOND YIELDS

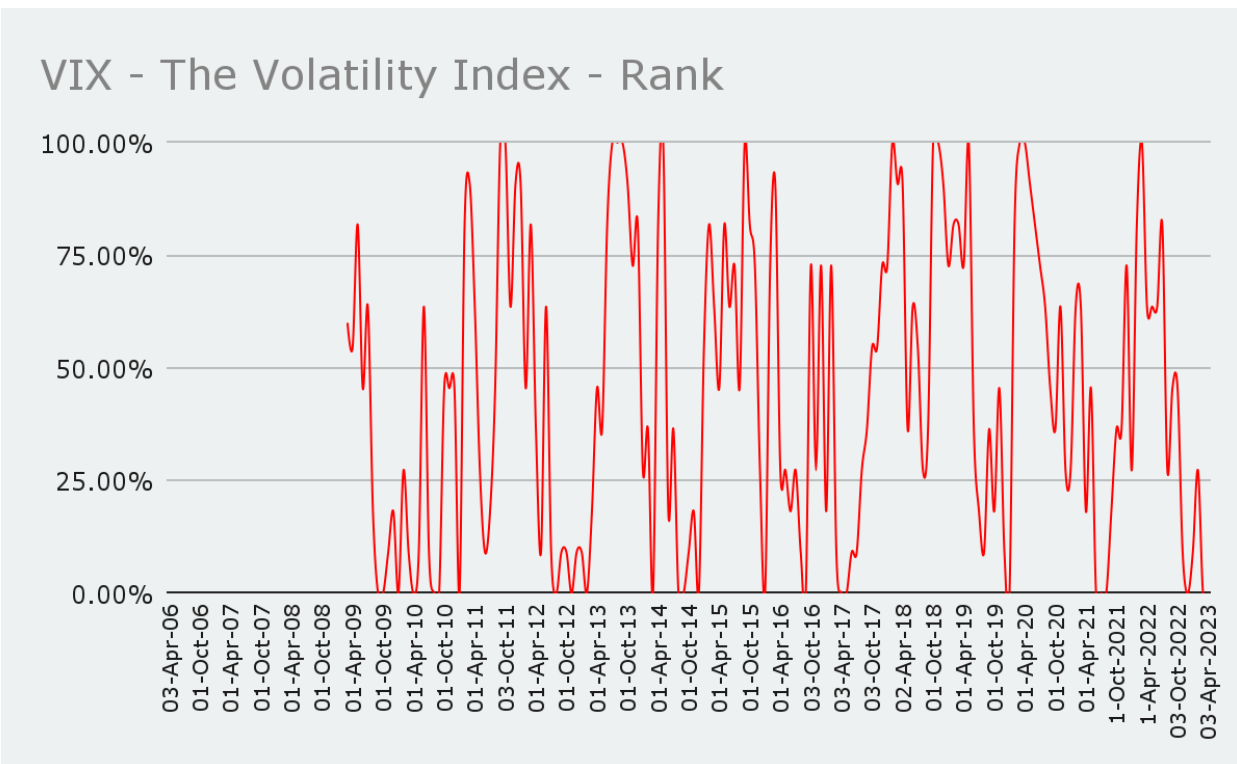
The 3 month and 10 Year yields have corrected and are now much below the 100th percentile levels (as of June 1, 2023). See chart below.



Data Source: Investing.com, prepared by Unovest

VIX - A new insight into diversification or loss prevention

Volatility Index or VIX is a measure of the market expectation of volatility in the near term. Higher the VIX, higher the expected volatility and vice versa. India VIX is a volatility index based on the NIFTY Index Option prices. From the best bid-ask prices of NIFTY Options contracts, a volatility figure (%) is calculated which indicates the expected market volatility over the next 30 calendar days. India VIX uses the computation methodology of CBOE, with suitable amendments to adapt to the NIFTY options order book. (Source: NSEIndia)



TERMS SIMPLIFIED

TRACKING ERROR

In case of funds/ETFs that track an index, tracking error helps to evaluate how closely or not the fund is doing the job effectively. Lower the tracking error, the better it is.

Tracking error is the result of buying, selling, delay in adjusting the fund to the benchmark, etc.

Mathematically, it is the annualised standard deviation of the difference of returns of the fund and the index.

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.

Do send your responses, queries and feedback to vipin@unovest.co