The LightHouse

YOUR GUIDE TO BUILD WEALTH & BE FREE

| July 2023 Edition |

Vipin Khandelwal

—

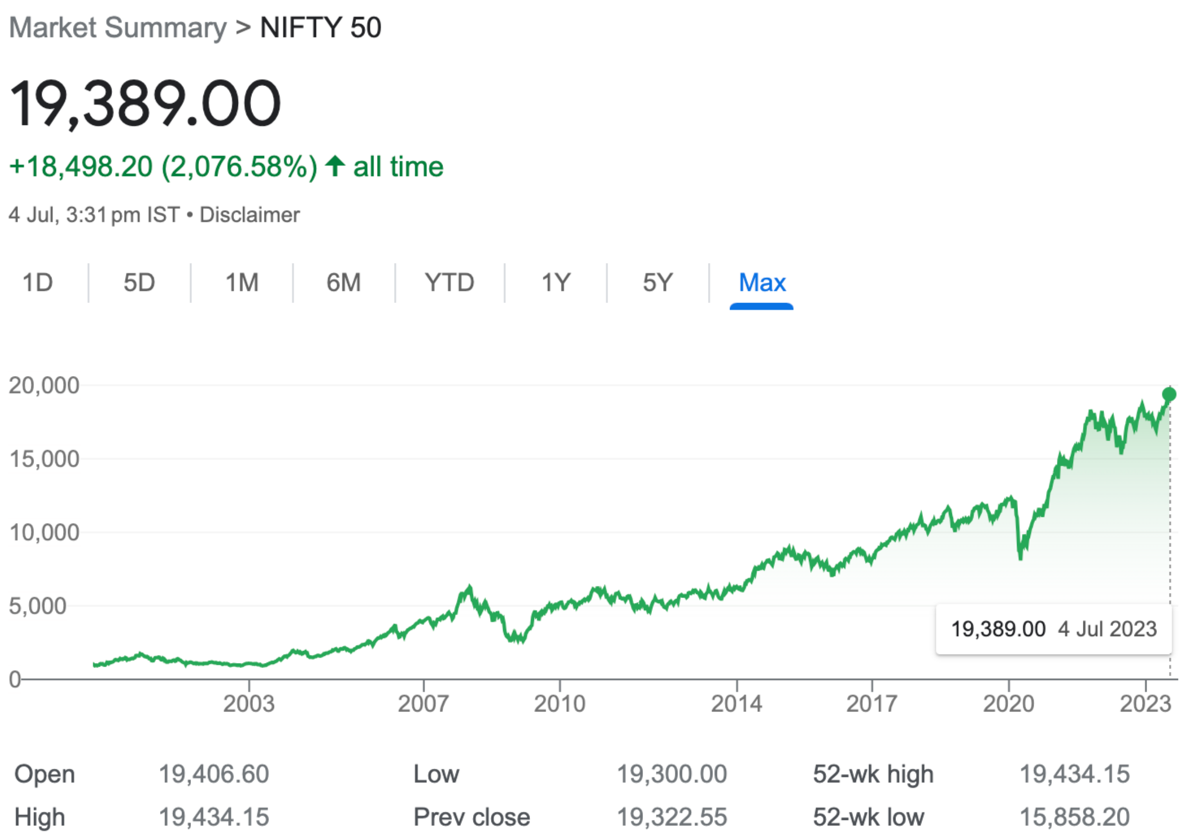
DISCLAIMER

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

The ATH Syndrome

The markets are at their all time highs (ATH). This means that an index such as a Nifty 50 or BSE Sensex have a number which was never seen before.

Take for instance this image below of the index Nifty 50. It feels nothing less than climbing Mount Everest. OR...Flying.



Flying, as a pilot puts it, can be summarised as **long periods of boredom, punctuated by moments of terror**.

I must say, investing is no different. The image says it all.

The thing about investing in listed stocks of businesses is that the ticker is a big distraction. It can scare us, freeze us and make us miss out on opportunities.

Try and see it differently. If you had invested at any point in time, as shown in the previous image, today you would still have positive returns.

If you had invested over a period of time, at different points (SIP), your returns could have been way different (and more positive).

Now you may say, *"A Fixed Deposit (FD) and real estate also give positive returns, what's the big deal?"*

No big deal and they are well deserved in a portfolio that can accommodate them.

Experience suggests that FD brings immense peace of mind yet struggles to beat inflation over an extended period of time.

Physical real estate is tangible and comes with a sense of ownership but needs large amounts of money (along with all the accompanying headaches).

An investor needs to assess what combination of all options is likely to work best for their needs and future goals.

–

Coming back, there is no perfect moment to invest. Highs and lows are part of the journey.

If you are a new investor, here's a simple way to go about it.

Keep squirreling away some part of your savings towards growth oriented investments, buying good businesses and you can build a better chance of meeting your future financial milestones.

That's what matters. Not the all time highs today or lows tomorrow.

–

If you have built a larger portfolio over time, use the ATH to restructure your portfolio, remove the weeds, focus the portfolio for long term compounding.

MARKET INDICATORS

Our current view on Equity and Bonds/Fixed Income.

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

Equity - What a rally it has been over the past week. Now, don't try to find any reason. It pushes us further into cautious territory.

–

Bonds - After making new highs last month, the fixed income yields have cooled off. As of July 3, 2023, the 10 year rate was at 7.11% vs 6.981% in June 2023.

Mild uptick but overall the rates have cooled down over previous months.

The 3 month yield on Govt Securities is now at 6.74% vs 6.76% (June 2023).

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% - *Senior citizens get 0.5% extra (UNCHANGED)*
Parag Parikh Liquid Fund	6.59% (May 2023) vs 6.78% (April 2023)

HDFC Short Term Debt Fund	7.64% (May 2023) vs 7.74% (April 2023)
HDFC Medium Term Debt Fund	7.85% (June 2023) vs 8% (April 2023)
RBI Floating Rate Bond*	8.15% (April 2023) vs 7.35% (Jan 1, 2023) UNCHANGED
Bharat Bond Apr 2032	7.45% (Jul 3, 2023) vs 7.28% (Jun 2, 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 - JULY 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	**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.	**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.	**Hybrid funds** can be a good option to consider now.	**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.

—---

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

(*WITH 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	Dec 31, 2022	Mar 31, 2023	Jun 30, 2023
1	Coal India	Coal India	Coal India	Coal India
2	Sun TV Network	Oracle Fin.Serv.	Tata Elxsi	Oracle Fin.Serv.
3	L & T Infotech	LTI Mindtree	Oracle Fin.Serv.	TCS
4	Tata Elxsi	Tata Elxsi	LTI Mindtree	ITC
5	Oracle Fin.Serv.	TCS	TCS	Hindustan Zinc
6	TCS	NMDC	NMDC	Bajaj Auto
7	ITC	ITC	ITC	Colgate-Palmoliv
8	NMDC	Bajaj Auto	HCL Technologies	LTIMindtree
9	Bajaj Auto	HCL Technologies	Bajaj Auto	Hind.Aeronautics
10	HCL Technologies	Infosys	Infosys	Infosys
11	Infosys	Hind.Aeronautics	Hind.Aeronautics	HDFC AMC
12	Hind.Aeronautics	Hindustan Zinc	Hindustan Zinc	NMDC
13	Mindtree	Petronet LNG	Petronet LNG	HCL Technologies
14	Hindustan Zinc	Colgate-Palmoliv	Colgate-Palmoliv	Petronet LNG
15	Petronet LNG	Tech Mahindra	Tech Mahindra	Supreme Inds.
16	Colgate-Palmoliv	Supreme Inds.	Supreme Inds.	Eicher Motors
17	CRISIL	Eicher Motors	Coforge	CRISIL
18	Supreme Inds.	Indraprastha Gas	Indraprastha Gas	Coromandel Inter
19	Tech Mahindra	CRISIL	Eicher Motors	Indraprastha Gas
20	Eicher Motors	Coforge	CRISIL	Bharat Electron
21	Coforge	Bharat Electron	Bharat Electron	Glaxosmi. Pharma
22	Bharat Electron	Vinati Organics	Marico	Tech Mahindra
23	Marico	Marico	Britannia Inds.	Tata Elxsi
24	Vinati Organics	Persistent Sys	Persistent Sys	Britannia Inds.
25	Emami	Britannia Inds.	Hind. Unilever	KEI Industries
26	Britannia Inds.	Hind. Unilever	Abbott India	Coforge
27	Persistent Sys	Coromandel Inter	Divi's Lab.	Marico
28	Hind. Unilever	Abbott India	Coromandel Inter	Hind. Unilever
29	Coromandel Inter	Divi's Lab.	APL Apollo Tubes	K P R Mill Ltd
30	K P R Mill Ltd	Bayer Crop Sci.	Page Industries	Divi's Lab.

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.

–

→ July 4, 2023 adhoc update:

The Total Absolute return on the portfolio is 14.1% (including dividends) vs the BSE 500 Index return of 8.19%.

–

The next rebalance will also happen after 1 year of the start of the portfolio, 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:

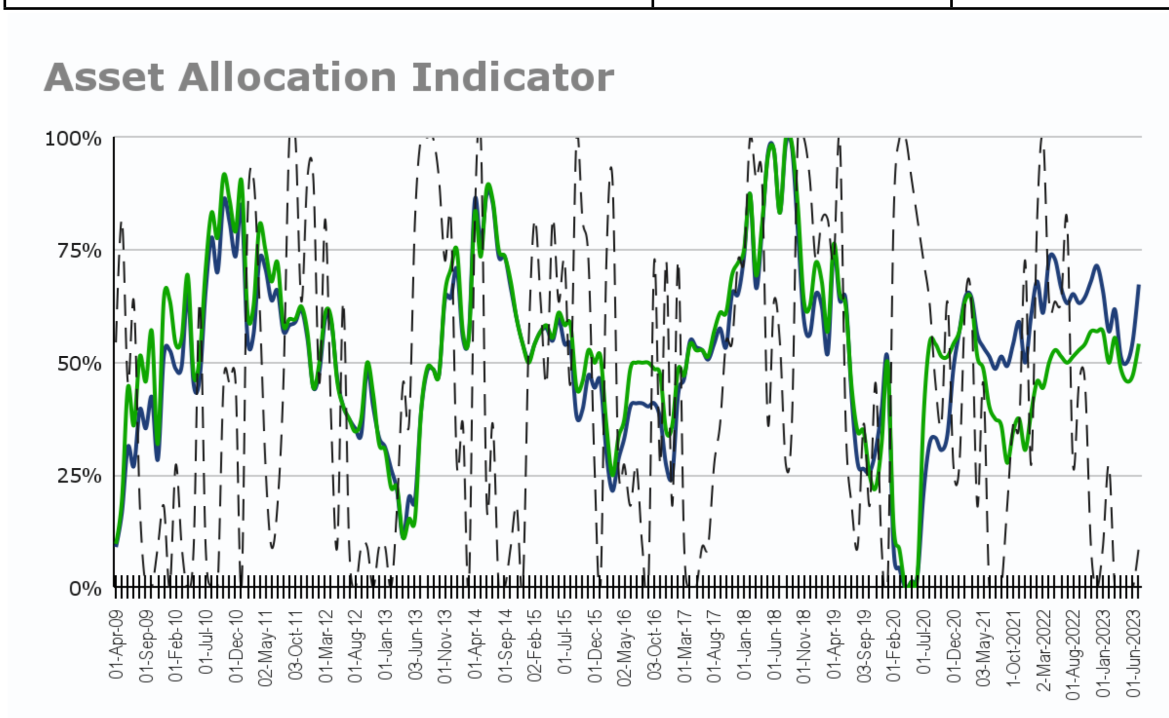
- Some of the international funds have started to accept new investments with a cap per PAN per month.
- Tax Saver funds have a lock in of 3 years during which you cannot sell the investment.
- All debt funds have a mark to market feature which makes their NAV fluctuate based on interest rate changes.

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**: 54.2%**	HOLD
Nifty 200 PE - PB - 10 Year GSec based Model (Blue line)	Score: **67.38%**	HOLD



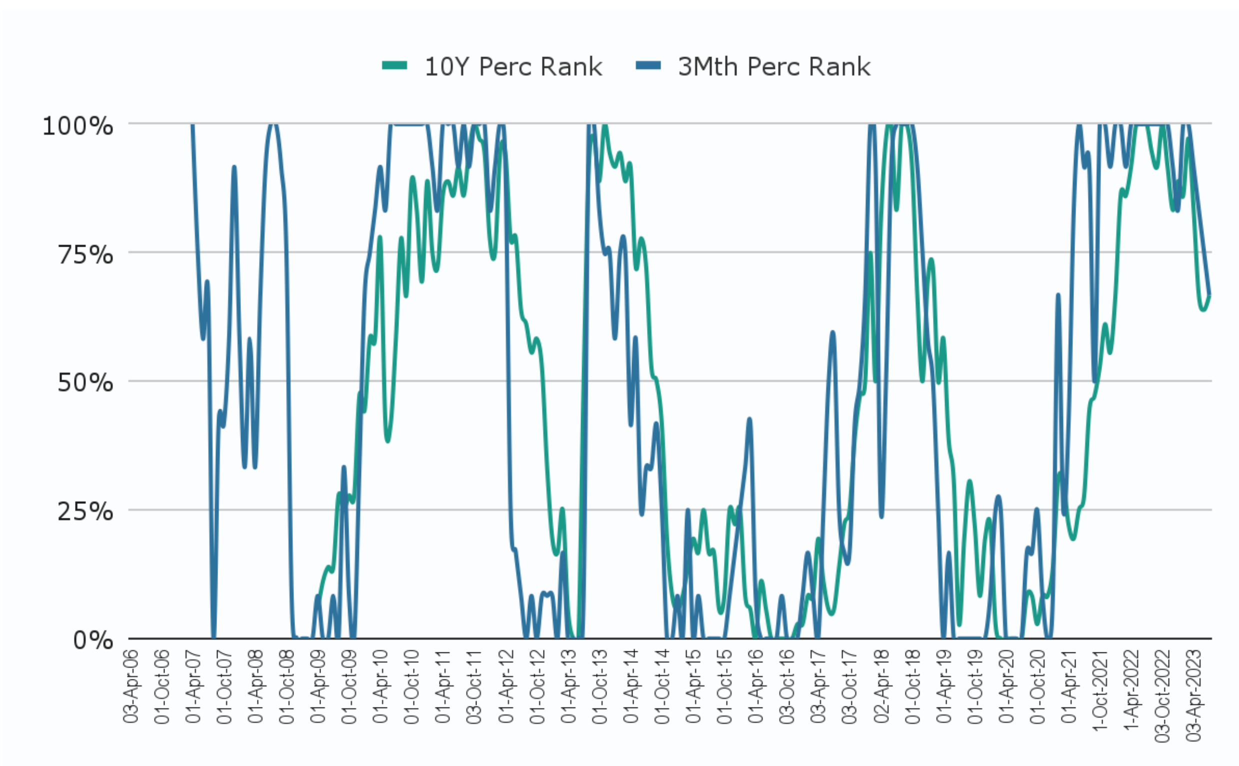
Data Source: NSEIndia.com and Investing.com, prepared by Unovest

The recent run up in the markets have pushed the lines and pushed the indicators to the upper half. 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 continues to be at historical lows. Is this when it can bite? What do you think?

BOND YIELDS

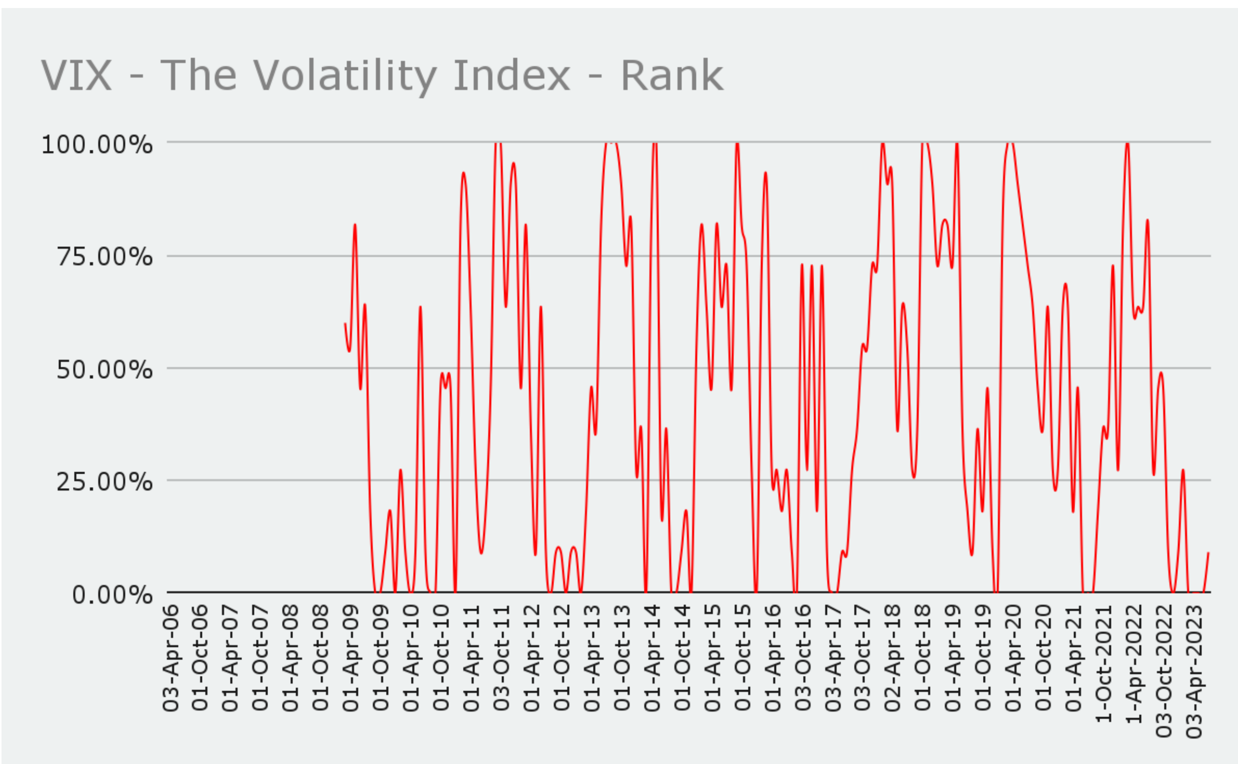
The 3 month (6.74%) and 10 Year (7.11%) yields are now much below the 100th percentile levels (as of July 1, 2023). See chart below.



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