'In life, as in markets, nothing is as good or bad as it appears'

Your Long Term Equity Fund has contained downside well in the last one year. What would you attribute this to? How much is your international exposure responsible for this performance?

The US markets have outperformed the Indian markets in the recent past and having around 30 per cent of our portfolio outside India has surely contributed to the performance of the fund. Having global diversification balances the portfolio and reduces overall volatility, thereby limiting the downside, as all markets do not move in tandem. Basically, we are reducing the country-specific risk by diversifying outside of India.

Also, sometimes valuations are stretched, and we do not get the opportunity to invest in companies at a price we feel comfortable. So, instead of chasing returns or valuations, we prefer to be patient and sit on cash. These decisions can be unpopular in the short term like 2007 or 2017. But I believe this process helps us limit the downside and avoid making big errors of overpaying for investments.

How do you pick stocks for your fund? What are your selection criteria for overseas stocks?

We filter our investment universe (to about 400–500 stocks) according to certain attributes we like in businesses. These business characteristics remain constant while selecting Indian as well as global stocks. Management quality is of utmost importance to us as we plan to partner with businesses for many years to come. We prefer cash-generating, low-debt, and high ROE/ROCE businesses. We want to choose businesses with a strong moat or some competitive advantages. And lastly, they need to be available at a reasonable valuation for us to be comfortable buying into them.

An additional criterion for selecting overseas stocks is our preference for globalised businesses with which we are familiar. We are already taking country-specific risk with the Indian portfolio, so we do not prefer single-country-focused businesses when we go abroad.

With just 20 stocks, you have quite a concentrated portfolio. How do you see that?

There are studies that show that after the 17th or 18th investment, the benefits of diversification start to diminish. Having 20–25 stocks in the portfolio gives us the desired diversification and allocation to stocks that we are comfortable with. We do not wish to be too concentrated nor too diversified, as it does not optimise the risk-adjusted returns that we feel are ideal.

How do you see the impact of COVID-19 on the business and economy over the next one year? Which sectors would be worst hit? Which would recover faster?

Just as the virus is more threatening to old, weak and ill people, it is similarly a threat to fragile businesses. Extremely leveraged businesses and poor capital allocators in vulnerable sectors (airlines, hospitality, travel, cinema, real estate to name a few) could face severe stress and could be forced to close down. One must look to be invested in robust and strong companies with zero or low debt and large cash reserves. These kinds of companies can in fact use this opportunity to make acquisitions and increase market share.

Amid the current volatility, what's your message to investors?

As it is said, volatility is a feature of equity markets and not a bug. So, equity investors will need to periodically ride this roller coaster of volatility. Even better is if you can take advantage of this.

The market oscillates between greed and fear. There are times where we see extreme fear prevalent in the markets and everything seems worse than it appears. In life, as in markets, nothing is as good or bad as it appears. Thus, having patience, controlling our urges, and managing our emotions well will be crucial to being successful in these markets.

Note: Viewers/readers should note that the objective of these articles/interviews is to communicate with our unit-holders and share with them our thought process. It should be noted that views expressed here are based on information available in public domain at this moment. Views expressed here can change depending on change in circumstances. Nothing discussed here, constitute a buy/ sell/ hold recommendation.

Mutual Fund investments are subject to market risks, read all scheme related documents carefully.