

# Value Education: My Experience

---

*Flame Investment Lab*

*June 2024*

 **Vetri Subramaniam**

**View contained here are personal and not those of my employer - UTI Asset Management Company Ltd.**

**The information herein is for educational/general purposes in summary form.**

**This is for participants at Flame Investment Lab, June 2024 and is not for circulation**

This is not a research report or investment advice. The statements contained herein are based on our current views and data relied upon here are from various public and private sources. The recipient(s) before acting on any information herein should make his/ her/their own investigation and seek appropriate professional advice and shall alone be fully responsible / liable for any decision taken based on information contained herein.

**MUTUAL FUND INVESTMENTS ARE SUBJECT TO MARKET RISKS, READ ALL SCHEME RELATED DOCUMENTS CAREFULLY**

## A few things I learnt in Value Education

- **Karm karo, phal ki chinta mat karo**
- Let us not become weary in doing good, for at the proper time we will reap a harvest if we do not give up.
- Never cut a tree down in the wintertime. Never make a negative decision in the low time. Never make your most important decisions when you are in your worst moods. Wait. Be patient. The storm will pass. The spring will come
- Whatever happened, happened for the good. Whatever is happening, is happening for the good. Whatever will happen, will also happen for the good.
- Aesop's Fable - the tortoise and the hare
- Wrong does not cease to be wrong because the majority share in it.
- *Nothing ever becomes real till it is experienced*

# Value Investing = delayed gratification



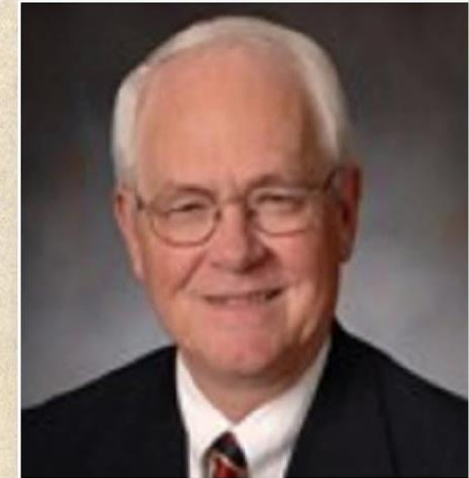
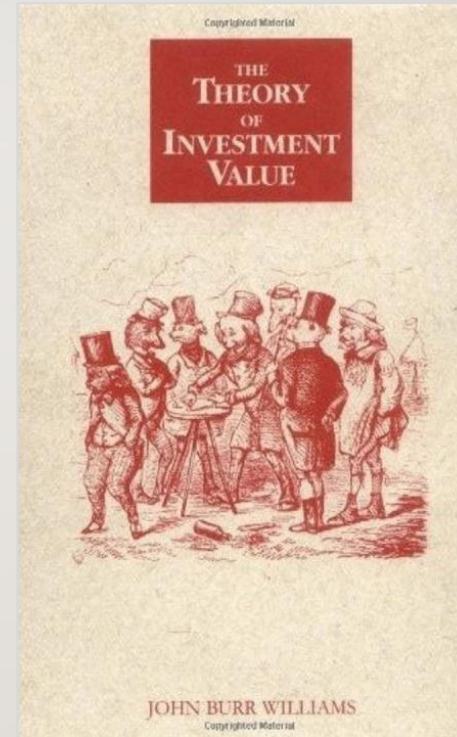


## Which brings me to...

- ✓ The opposite of **Value investing** is **NOT Growth investing**
- ✓ The opposite of **Value investing** is **Momentum investing**
- ✓ To be a value investor, you must pass the marshmallow test
- ✓ It requires you to stand apart from the crowd , quite often
- ✓ Patience is a must

# The theory of investment value - John Burr Williams

- The investment value of a stock is the present worth of all future dividends to be paid upon it . . . discounted at the pure [risk less] interest rate demanded by the investor.”
- “A cow for her milk, a hen for her eggs, and a stock, by heck, for her dividends.”



**John Burr Williams**

John Burr Williams was the author of "The Theory of Investment Value," published in 1938, and "International Trade Under Flexible Exchange Rates" (1954). He also wrote many articles for economic journals. He held four Harvard degrees, including a bachelor's earned in 1923 and a Ph.D. in 1940. He taught economics and investment analysis as a visiting professor at the University of Wisconsin. The Theory of Investment Value, based on his Ph.D. thesis, which was amongst the first to articulate the theory of Discounted Cash Flow (DCF) based valuation, and in particular, dividend based valuation.]

**Intrinsic value, not cheap valuations**

***“The choice is not really between value & growth,  
but between value today & value tomorrow.”***

- Howard Marks





# What could make value tomorrow > value today?

- **The owner approach – The business fundamentals (Phil Fisher)**
  - A superior product
  - Size of the opportunity, Growth
  - Execution & Management
  - Self fund growth - Cash Flows & RoCE
- **The intelligent investor - Margin of safety (Ben Graham)**
  - The future is full of surprises
  - Mean reversion
  - Agency risk
  - Margin of safety

What you choose to focus on – the similarities or the differences  
- **says more about you; rather than the approach**



# My value education is reflected in my positioning

**The owner approach**

**The intelligent investor**



**Businesses with sustainable competitive advantages and growth opportunity**



**Mean Reversion opportunities, characterized by attractive valuations**

**Buy what is underestimated; Margin of safety**



**Businesses with sustainable competitive advantages and growth opportunity**

- Steady & consistent growth
- Pricing Power
- Low margin volatility
- Capital structure- low or no debt
- Generates return on capital  $>$  cost of capital
- Growth through adjacencies
- Self-fund their growth
- Not about blue-sky outcomes

## Bringing margin of safety into play

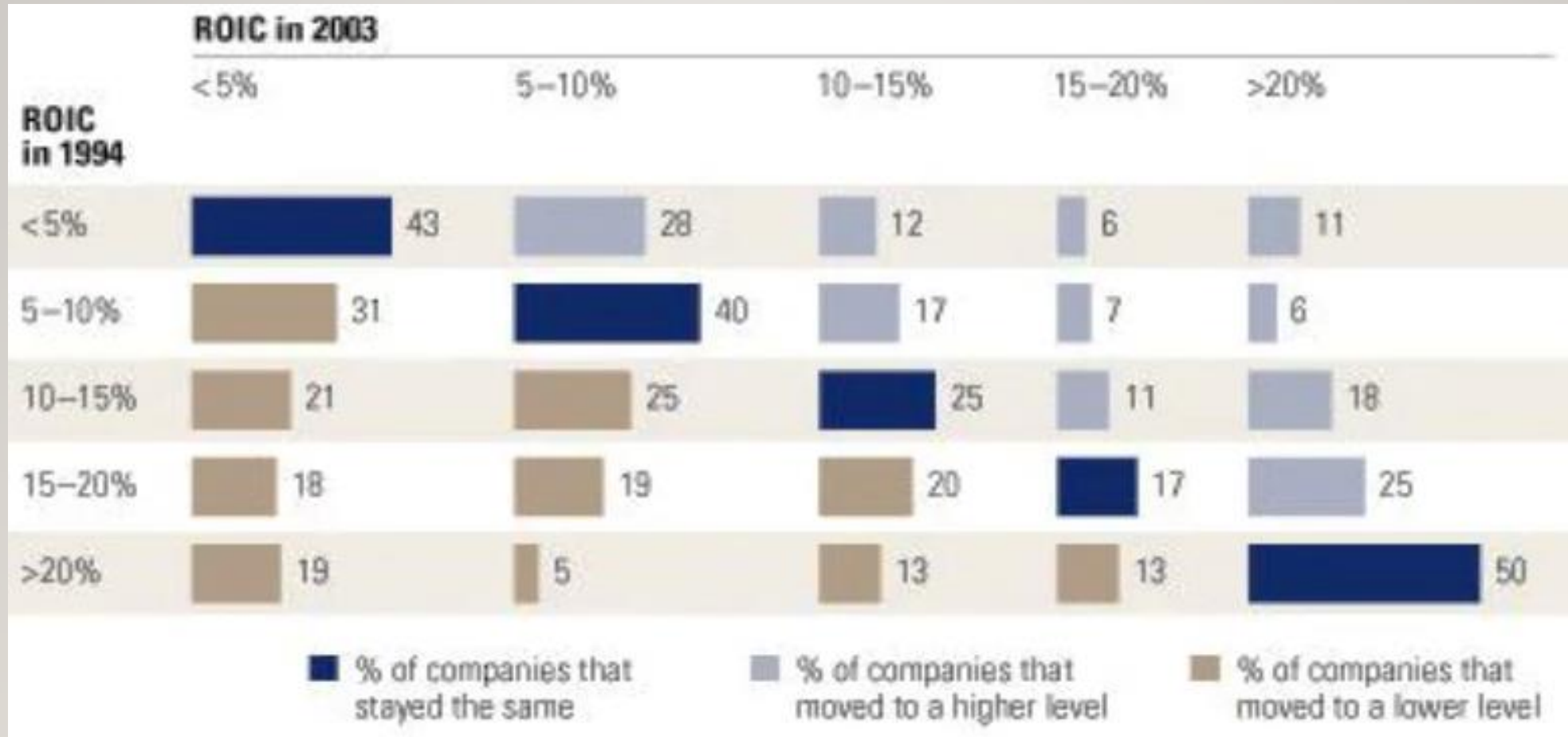
- Size of market
- Implied growth vs delivered growth
- Scope for margin expansion
- Base rates and comparisons- peer, global
- RoIC more important than Growth
- Track record – RoIC, Margin volatility, Capital structure

RoIC – Return on Invested Capital

# The persistence of RoIC

## Individual companies can sustain a high RoIC...

3-year average RoIC, without goodwill, of all publicly listed US companies with real revenues >\$200 million, %



RoIC – Return on Invested Capital

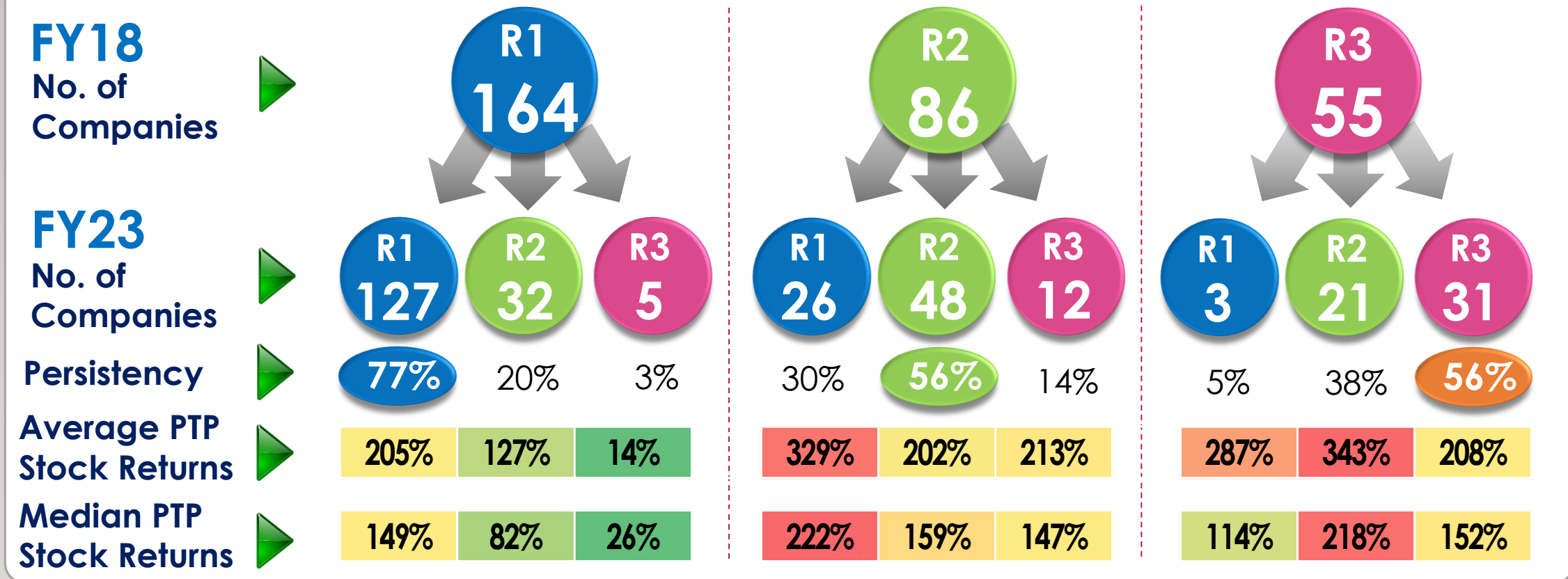
Source: <https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/balancing-roic-and-growth-to-build-value>



# Persistence of ROCE & Stock returns – Correlation & Probability

## Probability of Migration v/s Returns

### UTI INVESTMENT UNIVERSE



**Growth as a variable in the RoCE outcome - That's the owner approach**

Data period considered for returns: Dec-18 to Dec-23, Nifty 50 TRI returns 83%; Average returns of companies in UTI Universe 100%; PTP – Point to Point



**Mean reversion opportunities: Businesses experiencing challenges; characterized by attractive valuations**

- Current ROCE vs history
- Margins vs history
- Is there a hidden High ROCE/Cash cow
- Management change as a catalyst
- Supply side shakeout
- P&L risk not Balance sheet risk

## Pitfalls to mean reversion

- Management - Minority shareholder misalignment
- Debt
- No opportunity to re-invest
- Rising cost of compliance
- Disruption
- Decay in business/ No terminal value



## The owner approach

Don't stress the valuations,  
Consider the alternatives



## The intelligent investor

Business cycle/Valuation  
cycle

**Risk management : Position sizing, Portfolio attributes**



# What this approach does for me





## Learnings & Challenges

## ▪ Daily Report Card

- Process : buy/not buy/sell, position sizing , active share
- Risk management framework
- Understand performance cycles
- How do you evaluate & compensate a Fund Manager?
- How do you compensate

## ▪ The Behavior Gap

- Fund returns vs Investor returns (Morningstar - Mind the Gap)

## ▪ The Rise of Passive

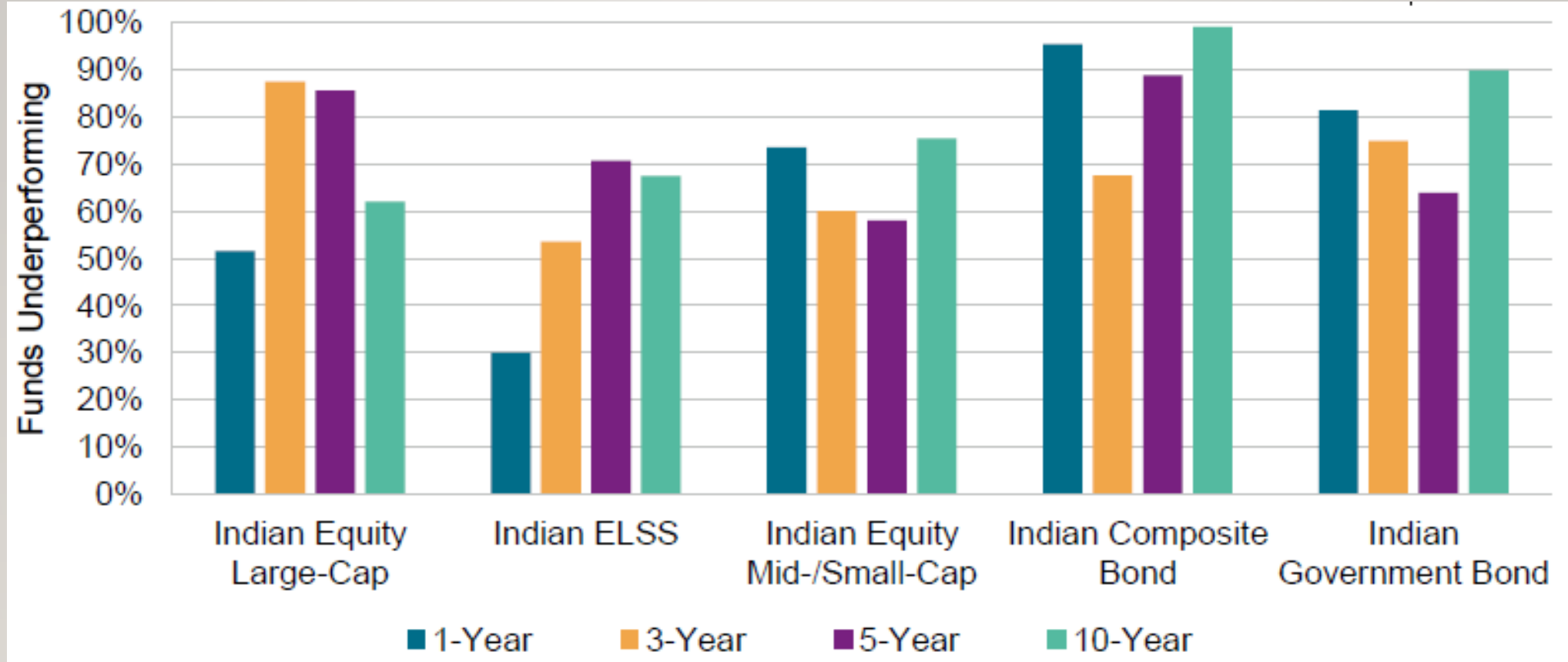
- Cost
- Certainty of outcome
- Active Fund selection- ex ante

**What we manage is the process,  
performance is an outcome**





## Percent of Underperforming Indian Active Funds



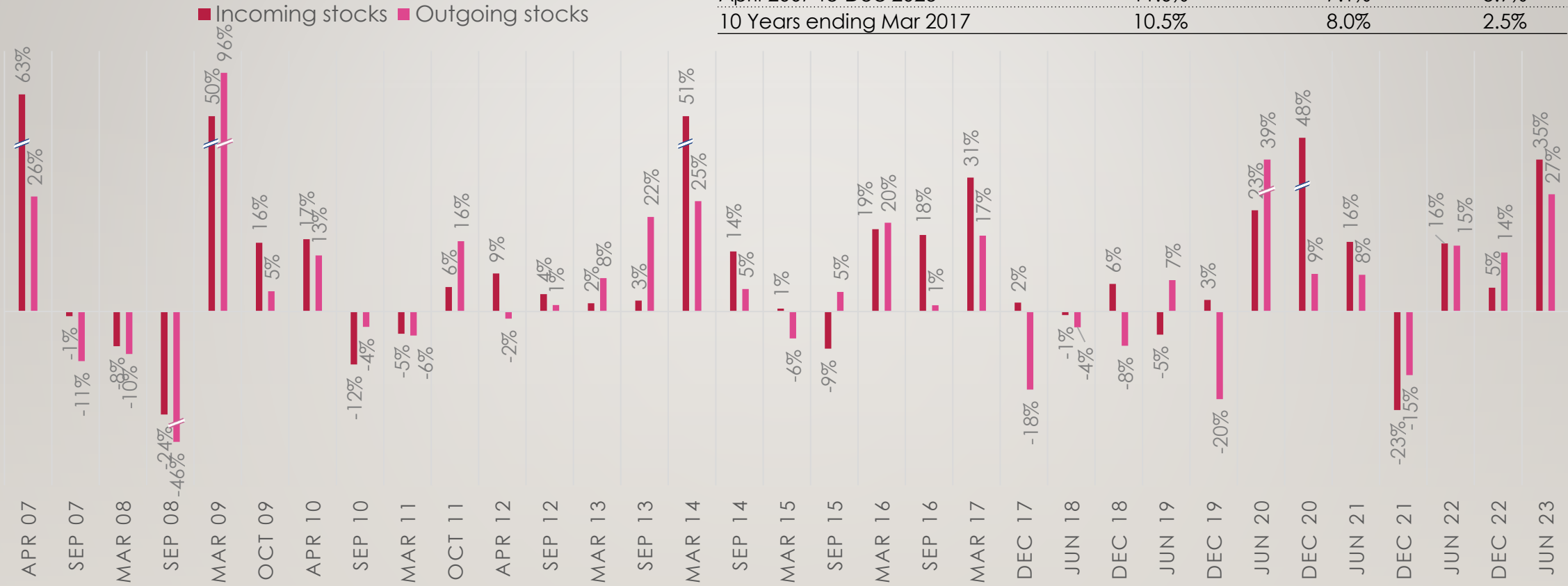
Source: S&P Dow Jones Indices LLC, Morningstar, Association of Mutual Funds in India. Data as of Dec. 31, 2023. Index performance based on total returns in INR. The S&P BSE 400 MidSmallCap Index was launched Nov. 30, 2017. The S&P BSE India Government Bond Index and the S&P BSE India Bond Index were launched March 12, 2014. All data prior to index launch date is back-tested hypothetical data. Past performance is no guarantee of future results. Chart is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.



## How are equity markets changing?

- Breadth & Depth are expanding – 150 IPOs in FY21-23
- Narrow moves are persistent – momentum factor
- Rotation is sharp – o/p and u/p rotate sharply
- Diversity of participants

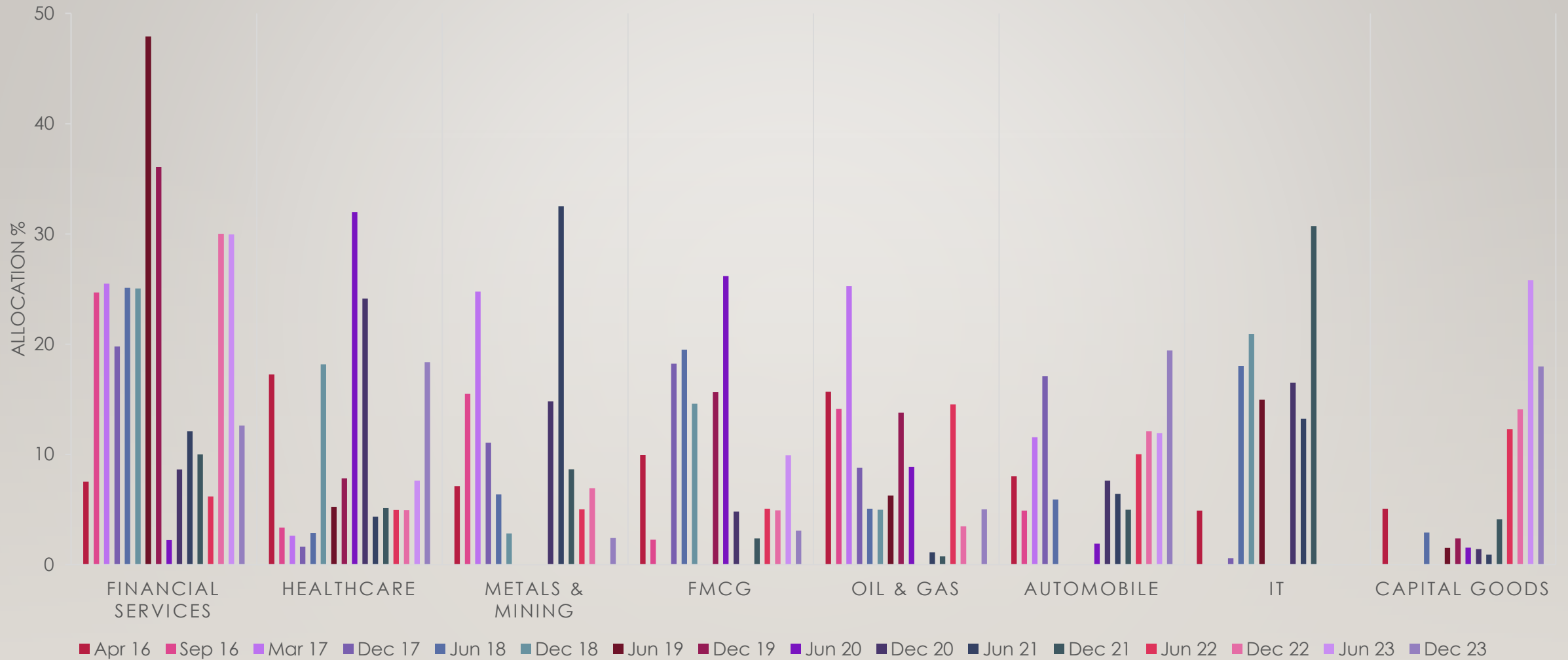
# Narrow moves are persistent - Momentum



Period	Average Returns		
	Incoming stocks	Outgoing stocks	Difference
3 Years ended Dec 2023	15.6%	10.0%	5.6%
April 2007 to Dec 2023	11.0%	7.1%	3.9%
10 Years ending Mar 2017	10.5%	8.0%	2.5%

**On an average, Incoming stocks have outperformed outgoing stocks by 3.9% (6 months forward returns) in last 16 years for Nifty 200 Momentum 30 Index fund**

# Sharp sector rotation - What has got the momentum?



Momentum index – Nifty 200 Momentum 30 index

# Performance of Factor based strategies - India

	CY11	CY12	CY13	CY14	CY15	CY16	CY17	CY18	CY19	CY20	CY21	CY22	CY23	Since April '05	Volatility
Nifty 200 Momentum 30 TRI	-16%	39%	13%	50%	11%	10%	57%	-2%	11%	20%	54%	-5%	42%	20.6%	22.6%
NIFTY 200 Quality 30 TRI	-10%	31%	20%	40%	2%	1%	30%	9%	6%	26%	26%	-4%	32%	18.9%	18.3%
Nifty Low Volatility 50 TRI	-18%	34%	5%	45%	10%	5%	34%	1%	7%	26%	25%	2%	32%	18.3%	16.6%
NIFTY 500 Value 50 TRI	-38%	32%	-14%	79%	-7%	25%	47%	-26%	-14%	8%	56%	23%	63%	16.9%	26.2%
Nifty 200 TRI	-26%	34%	6%	37%	-1%	5%	35%	0%	10%	17%	29%	5%	25%	14.7%	21.1%

## Variation in annual performance; Discipline drives longer term outcomes

Calendar year & Since Inception Performance of various style Indices

Outperformers and Underperformers over 10% of Nifty 200 highlighted in Green & Red respectively

\*Since inception period considered as 1st April 2005 to 31st Dec 2023, outperformers highlighted in green for since inception period.

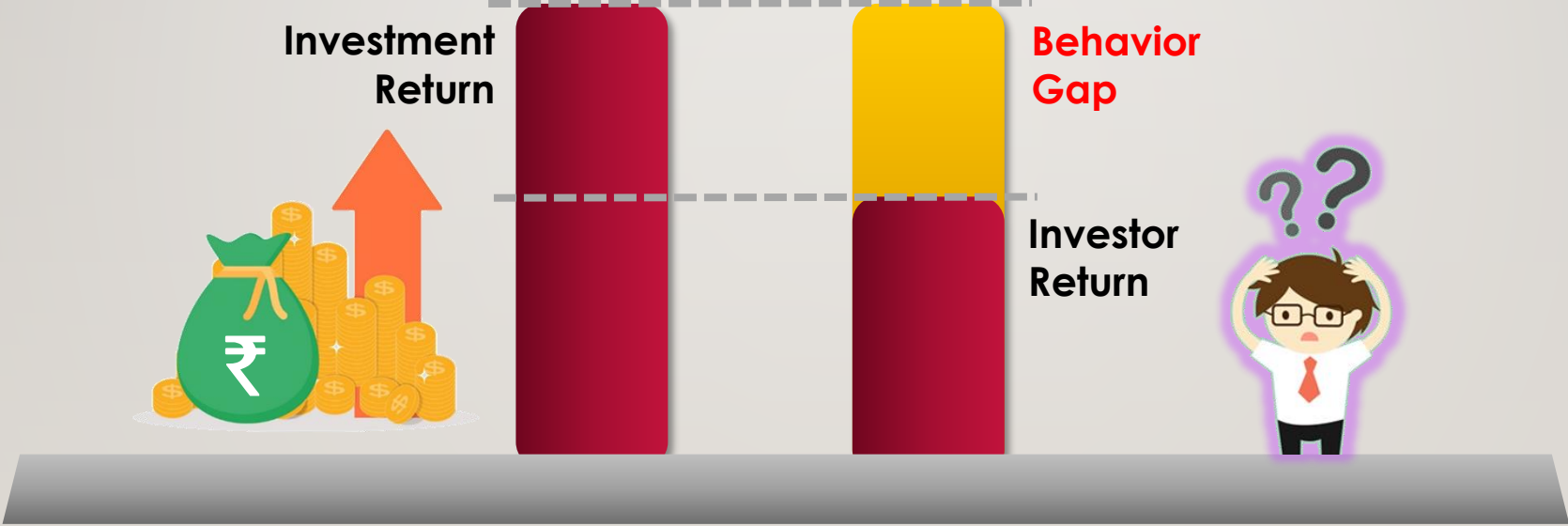


## Nifty 500 – Volatility spread of companies

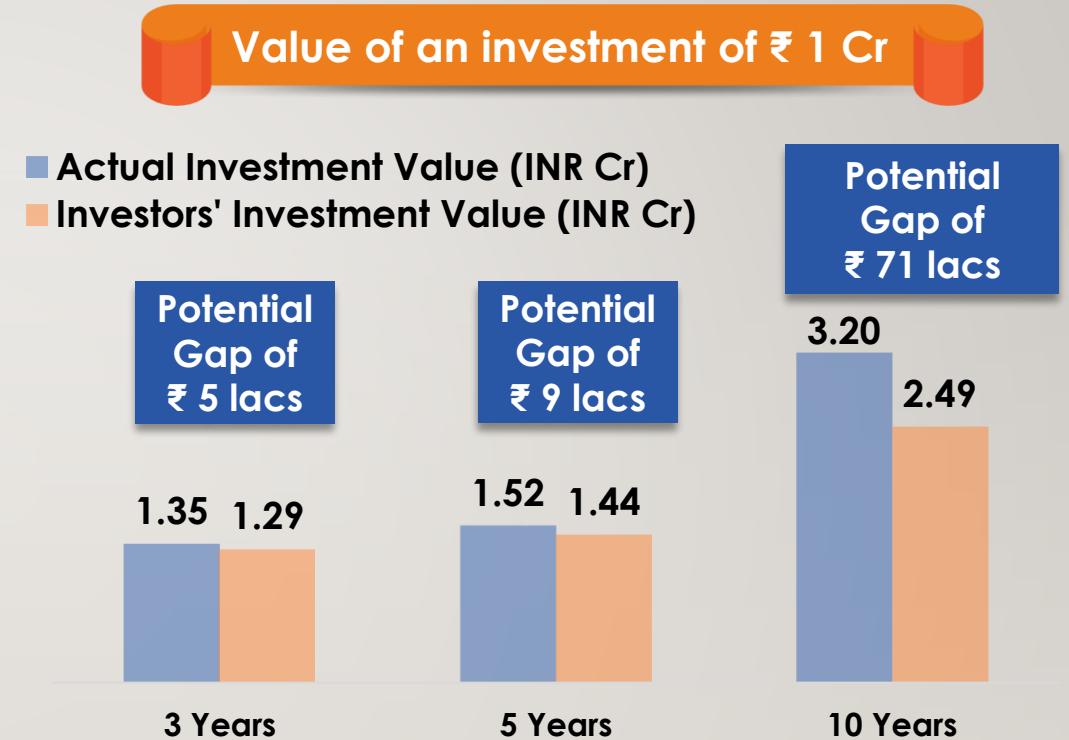
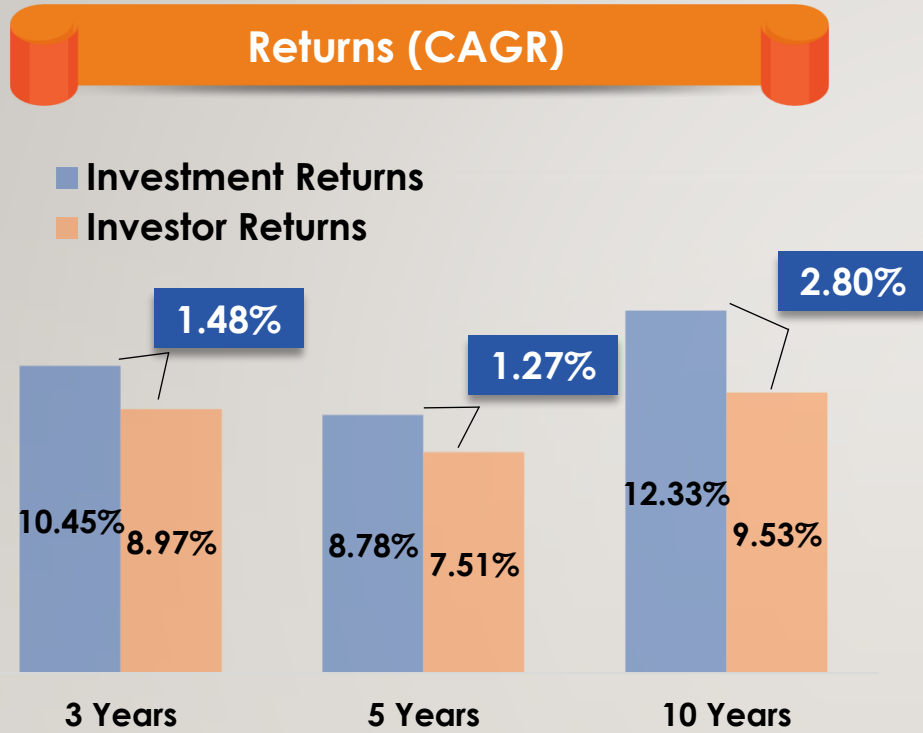
Volatility	Dec'11	Dec'12	Dec'13	Dec'14	Dec'15	Dec'16	Dec'17	Dec'18	Dec'19	Dec'20	Dec'21	Dec'22	Dec'23
<b>Below 25</b>	37	72	44	20	28	35	85	34	56	1	32	24	133
<b>25 to 30</b>	71	82	69	69	57	89	129	93	98	3	73	77	122
<b>30 to 35</b>	99	91	81	67	94	91	110	94	100	20	85	103	93
<b>35 to 40</b>	103	66	77	75	111	84	59	85	69	56	79	115	63
<b>Above 40</b>	185	181	220	265	206	199	109	190	176	421	232	182	88
<b>NSE 500 Index</b>	<b>19.5</b>	<b>15.1</b>	<b>17.1</b>	<b>13.4</b>	<b>16.5</b>	<b>15.5</b>	<b>10.0</b>	<b>13.5</b>	<b>13.8</b>	<b>30.0</b>	<b>15.6</b>	<b>17.8</b>	<b>10.4</b>

Segregation of Stocks based on their annual volatility of the respective period end.

# Investor Experience: Compromised by Behavior



# Volatility & Emotional Responses result in the Behavior Gap



**Compromising the investors experience**

Source: Morningstar – Mind the Gap Study – Nov 2022. The study considered asset weighted returns across India Mutual Fund categories for the data as of Jun 2022. **Past performance may or may not sustain in future.**

- Cash flow from clients now rivals the investment process itself as the main determinant of total return.
- When a fund manager goes from absorbing a trickle of cash flow, to drinking from a fire hose, to surfing a tsunami, his past performance loses all relevance.
- Rather than trying to achieve the lowest tracking error and the highest time-weighted relative returns for their portfolios, firms should focus on producing the highest rate of asset-weighted returns for their clients





## Lifelong learning

## Investing is personal : Long Cold Winter 1994-2003

- Sensex June 1994 to April 2003
- IT, Consumer, Pharma performance
- Long cold winter
  - ROCE, management, Skepticism
  - The distinction between owning a company and the market
  - In difficult times, divergences-accentuate



RoCE – Return on Capital Employed

## Investing is Personal: The Boom years 2003-2008

- Cheap valuations + Capital + Global growth acceleration
- Narrative > Management quality
- Limited or no focus on cash flows
- Value of business – related to metrics other than cash flow
- In good times - convergence
- Kindle in 2007, Free Cash

RoIC – Return on Invested Capital





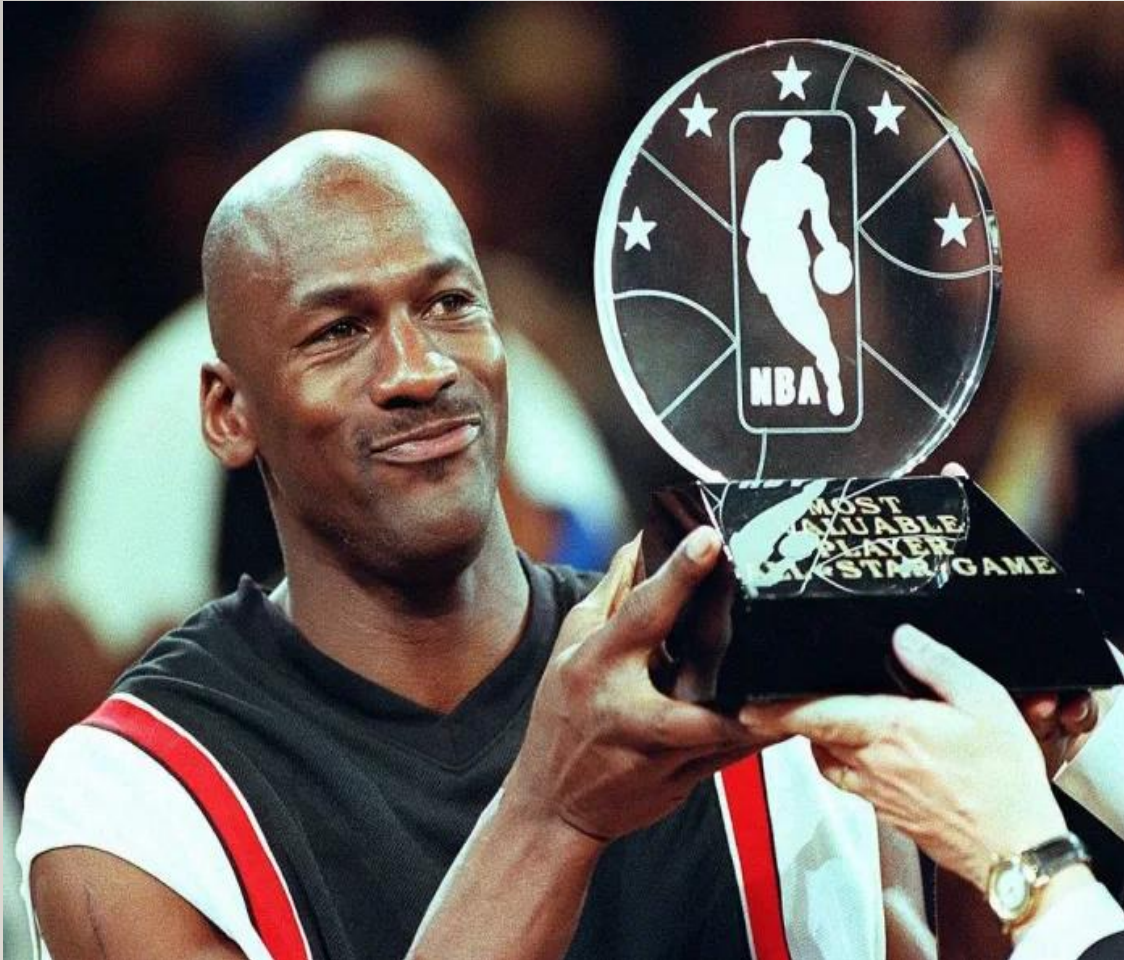
- The Dot com meltdown – crisis
- GFC – an opportunity
- Covid – Investing witnesses a growth explosion

**In the abstract, life is a mixture of chance and choice. Chance can be thought of as the cards you are dealt in life. Choice is how you play them**

***Edward O Thorp***  
**A Man for all Markets**



## Losing is part of the Process



“ I've missed more than 9,000 shots in my career. I've lost almost 300 games. Twenty-six times, I've been trusted to take the game-winning shot and missed. I've failed over and over and over again in my life. And that is why I succeed.”

- **Michael Jordan**



“And when we do face a downturn today, from our position of strength, the message I want to convey is that, the last man standing has the best chance at being the first man forward. The first man forward to consolidate market positions, to show superior performance in each industry and get a few steps ahead of competition.”

- **Kumar Mangalam Birla**

In general, survival is the only road to riches.

- **Peter Bernstein**



## Always a student

- Keep an open mind
- Keep your friends close but enemies nearer
- Read varied subjects
- Mentor
- Fund Management is not for everybody
- Compounding – ‘time’ is the most important variable
- Survival is underrated

THANK YOU