

## CAN BUFFETT BE AUTOMATED? - ARTHVEDA ALPHA INDEXING STRATEGY SAYS 'YES'

By Dr. Vikas Gupta  
Executive Vice President, Traded Markets and Investment Research  
Arthveda Fund Management Pvt. Ltd.



Warren Buffett, the renowned value investor, is actually an exception to the class of active fund managers. Trends show that active fund managers fail to beat the benchmark index, leave alone giving attractive returns on your investments. According to S&P's SPIVA US study of Mid-year 2013 60-85% Large-Cap active funds underperformed the benchmark for 1, 3 and 5 year periods. Another S&P's US study report for Dec 2013 - "The persistence scorecard" revealed that only 5.28% of Large-Cap active funds maintained a top quartile performance over three consecutive 12-months periods starting Sep-2011. Same is true for India.

S&P CRISIL SPIVA study of 2012 showed that more than half of Large-Cap active funds underperformed the benchmark over all analyzed periods. The bottom line - only very few active funds have been able to beat benchmark across geographies and across time periods. Because of stock-specific and portfolio manager risks actively managed funds are arguably not the best way to invest.

In developed countries, where markets are more efficient, beating the market is difficult and hence index funds are fairly popular and have 30% of the total assets under management (AUM). Even in India, which is an emerging market and which is presumed to be an inefficient market, beating the market is difficult as shown in the CRISIL SPIVA study. These facts lead to the inference that investing in index funds is a safe bet. However, traditional index funds being based on market-cap weighted indexes have two major shortcomings.

Firstly, a market-cap weighted index was designed to represent overall market action and not as an investment vehicle. If a portfolio is created replicating a market-cap

weighted index it will result in a skewed portfolio as there is no upper cap on allocation. For instance, Reliance Ind.'s weight in Nifty was as high as 15% in 2007-08. Secondly, traditional index fund gives an exposure which tends to be overweight on overvalued stocks and underweight on undervalued stocks; for it tracks only market capitalization.

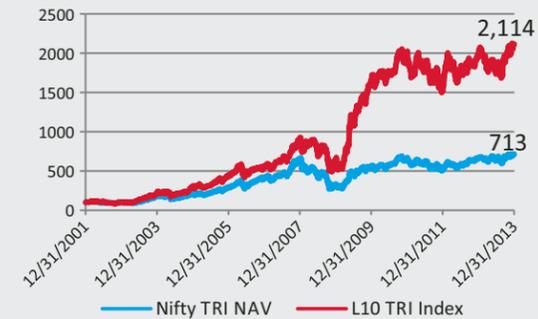
**Warren Buffett, the renowned value investor, is actually an exception to the class of active fund managers.**

ArthVeda's Alpha Indexing Strategy has answers to both these shortcomings. Alpha indexing strategy is an alternatively-weighted indexing strategy which gives weights according to "degree-of-undervaluation" of each stock. This Alpha indexing strategy can be classified with other alternatively-weighted indexes, popularly called 'Smart Beta' indexes, which are emerging at a very fast pace with AUM under such smart beta indexes growing at 60% pa. Large institutional players such as pension and sovereign funds are allocating substantial sums to such strategies globally.

Smart Beta indexes have been developed with an aim to outperform their respective market-cap weighted indexes. A better risk-adjusted return profile is generally achieved by exploiting few risk factors such as size, volatility, etc., which manifest themselves when one moves away from

### ArthVeda Alpha L10 Index

ArthVeda Alpha L10 Index is an equi-weighted Index of best 10 stocks from Nifty 50 Index. These 10 stocks are selected based on ArthVeda's Alpha strategy applied to the top 50 stocks of Indian markets which are also part of Nifty.



Returns	1 Mth	6 Mth	1yr	5yr	10yr	Since Jan 2002
<b>L10 Index</b>	3.3%	15.8%	6.8%	28.6%	25.4%	28.9%
<b>Nifty TRI</b>	2.1%	8.5%	8.1%	17.7%	14.4%	17.8%
<b>Excess Return</b>	1.2%	7.3%	-1.3%	10.9%	11.0%	11.2%

**Note:** L10 Index gives 25-30% return for longer holding periods, undoubtedly Buffett like returns.

#### Current L10 Index Constituents

BAJAJ-AUTO	HCLTECH
BHEL	INFY
BPCL	M&M
CAIRN	NMDC
COALINDIA	TATAMOTORS

Source: <http://arthveda.co.in/arthveda-alpha-l50/>

market-cap based weighting. However, these smart beta indexes do not necessarily tackle market-cap index shortcomings of skewedness and poor investment logic as discussed above. In contrast, ArthVeda's Alpha indexing strategy does not tilt an index towards any particular risk factor but rather it reduces exposure to risks while

increasing returns at the same time. It does this by evaluating the intrinsic value of each stock using fundamental parameters and giving allocation according to the discount to intrinsic value, i.e. capturing pure alpha. This way it safeguards an investor from the only risk in investing i.e. paying more than the true value of an asset. Hence, ArthVeda's alpha strategy can be termed more appropriately as "Smart Alpha".

Alpha strategy is based on the value investing philosophy, which requires buying stocks at below intrinsic value with a margin of safety in order to generate superior risk adjusted returns. Across the globe true value investors like Buffett, Templeton, Graham and Peter Lynch, have created significant wealth using value investing philosophy. Alpha L50 strategy is benchmarked to Nifty and has same 50 stocks but with different allocation delivering higher returns while taking similar risk.

Buffett has delivered more than 20% annualized return with a concentrated portfolio. On the same lines, Alpha L10 is a concentrated and aggressive version of Alpha L50. L10 selects top 10 stocks from the 50 stock universe of Alpha L50. L10 has delivered Buffett like returns of 25-30% CAGR over 5yr and longer periods as demonstrated above.

**Dr. Vikas Gupta** is Executive Vice President-Traded Markets and heads Investment Research and Product Development. He manages investment products on domestic and global listed equities targeted to investors from domestic and global markets. His value-oriented research framework transforms data and information into alpha-generating product and fund constructs.

Vikas has over 20 years of experience in research, strategy and operations in various CxO-level roles; he has been involved with several IPOs, private placements, and M&A transactions. His capabilities lie in strategic value creation by understanding the interplay of valuation drivers and sources of risk through in-depth research and analytics.

Vikas formerly served as Professor and research faculty at IIT Kharagpur and University of California. He has a B.Tech from Indian Institute of Technology (IIT) Bombay and earned his Masters and Doctorate from an Ivy League University - Columbia University, New York

**Adventure outside. Luxury inside.**  
Now own the new B-Class with special benefits.  
When you feel like going on a road, hit the road on the luxury tourer - the new B-Class. Now drive home the new B-Class with irresistible offers from Mercedes-Benz Financial - a low down payment and a low EMV on the exchange offer. To enquire, please call 4223562888.  
The new B-Class at a low down payment of Rs. 6 Lacs\* and a low EMV of Rs. 30,555/-\* with exchange offer.  
\*MSRP Start Assaid | Acceleration Stead Control | 81 service headlights | Best-in-class fuel efficiency\*

**AUTO HANGAR (I) PVT. LTD.** | Andheri (W), 400044 (M) 4210 9668-65, Praharshad, 400044 (M) 4290, 4210 4544 4244-44, Corporate & BPO Sales: 42235 47842 (M) 441 3639  
**METRO MOTORS AUTO HANGAR DIVISION** | Praharshad Road: 400044 (M) 4210 9668-65