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Markets at attractive valuations, long term investors can invest in tranches: Vikas Gupta



In an interview with Varsha Inamdar of myiris.com, **Vikas Gupta**, executive vice president, Traded Markets and Investment Research, Arthveda Fund Management said, "Given current market scenario we are suggesting long term investors to start deploying their capital in tranches."

Excerpt from interview Myiris had with Vikas Gupta:

1. Where will you broadly position the Indian equity market on a valuation scale?

Markets are trading at attractive valuations currently when compared to market's long term average. Lower growth expectations arising from uncertainty in the near-term on various fronts such as the macroeconomic front (currency, deficits etc.) and the political front (scams, slow reforms, populism, elections) has kept the markets at suppressed levels. Arthveda believes that such concerns will be true only in the near term and that the long-term growth pillars of the Indian economy remain intact. Current discounts are genuine buying opportunities for long-term investors and we believe that patient investors will be rewarded appropriately, as they have been in the past.

2. Rupee touched a record low of 68 against US dollar. Do you think weakness in rupee will continue?

Over long term, exchange rate movements are governed by the inflation differential. Going forward, one can expect the rupee to depreciate further, at a rate determined by the inflation differential between India and US. Having said that, we would also like to highlight that in the short term currency is affected by many other factors such as the flows and deficits and that currencies can deviate from their fair values for long periods, just as the INR managed to appreciate against USD over 2002-07 inspite of a higher inflation in India.

3. According to you, which sectors will likely to outperform or underperform in near term?

ArthVedaAlpha L50 strategy believes in bottom-up approach to investing using value investing philosophy and does not take a sector call. In current market conditions, we would recommend investors to focus on high quality stocks with long history of operations and a proven management. High quality stocks can be defined as companies, which have been efficiently using its resources and have shown fat margins and profitability year over year. Of these high quality stocks, companies with a competitive edge over their peers and a strong position to maintain such lead are always a great buy.

Current market condition does provide opportunities to buy high quality companies at a bargain price. Without commenting on any particular stock, ArthVeda thinks that at current valuations some blue-chip PSU companies from natural resources segment which are cash rich and have low leverage looks attractive. A few private sector names from auto sector are also worth buying. ArthVeda Alpha L50 is overweight on auto, natural resources and capital goods segment of the market.

4. What is your investment strategy at current levels? What is the strategy for the next couple of quarters?

Current market behavior reflects investors selling in panic. For any long-term fundamental investor especially value-investor such panic times are a great opportunity to bottom fish and take positions. Recent sell-off has resulted in significant divergence of market valuations from the underlying intrinsic valuations. As Warren Buffett says "We simply attempt to be fearful when others are greedy and to be greedy only when others are fearful". So when Mr. Market is selling at a discount, value investors are buying and when eventually Mr. Market realizes the value and is ready to buy at or above intrinsic valuation value-investors sell.

The only guiding principle as per ArthVeda is to look at the intrinsic valuation of stocks and buy with a margin of safety. Margin of safety is defined as discount to the intrinsic valuation and could range anywhere from 20%-50% depending on investor's comfort and risk in underlying business. Buying with a margin of safety prevents potential downside and generates significant return when market return to its senses. Having pointed towards the attractive valuations available in the market today, Arthveda believes that it is possible to construct a basket of securities using Nifty 50 stocks that has a better fundamentals and even more attractive valuations.

Arthveda has applied the same underlying principles to its ultra-large cap equity product - Alpha L50 - and is confident about the soundness of its investment approach.

5. What is the growth that you are expecting in assets of equity funds in near future?

As per our internal estimates, market could deliver anywhere between 10%-15% CAGR over next 5 years on a conservative side but 15%-20% CAGR over next 5yrs looks more likely. These returns are significantly higher than what fixed income investors make after tax. Current obsession over fixed income instruments could be short-lived and soon money could flow back to equities. Average investors have poor timing ability and they tend to invest at highs and redeem at lows. One can therefore expect equity funds to gather more and more assets once the markets are up and consequently equity funds have already delivered decent returns.

6. What is your advice to investors at this point in time?

Investors should not just look at % decline from its recent highs or fall during panic selling. Stocks which have seen speculative buying falls the most during panic times. Even after the decline such stocks may not be a good buy though they might look cheap based on their historical valuations. Clearly investors should be aware of such value traps during panic times.

Given current market scenario we are suggesting long term investors to start deploying their capital in tranches. It is not the time to exit the market but buy more of it. Existing investors should churn their portfolio from speculative investments into high quality stocks with long history of operations and are trading below their intrinsic valuation. They should avoid buying anything with high debt and focus on companies with cash rich balance sheet and professional management. Investors should take a long-term approach to such quality stocks. Markets will reward patient and long-term investors eventually.

Investors should also be careful of valuations they are paying for such companies. A high quality company at a high valuation does not make a good buy. For e.g. in present market few high quality stocks in FMCG are trading at over 40x earnings which looks too stretched to us. Investors should be careful of paying anything over 20-25x earnings in current market scenarios. Anything over that should be well reasoned out. An easy way of losing money is buying high quality stocks at extremely stretched valuation. Many fundamental analysts and fund managers get caught in this quality trap and end up losing money for their investors. It is wise to remain in cash than overpay for anything.