PORTFOLIO MANAGEMENT SERVICES

Newsletter April 2016

DHFL Pramerica

EA Sundaram
Executive Director & CIO - Equities

Equity Outlook - April 2016

Let's keep it simple

Dear Investor,

We are very happy and excited to greet you as representatives of a new, bigger and stronger, entity. As you are aware, the Schemes of Deutsche Mutual Fund have merged with DHFL Pramerica Mutual Fund with effect from close of business hours on 4th March 2016, resulting in an entity with average assets under management (AAUM) of around Rs. 25,986 crores for the quarter of Jan-Mar 2016.

As we make a new start, we wish to share with you our approach towards investing in the important asset class of equity shares. We thought that a transparent way of sharing the roadmap that we shall take over the next many years is better than making any short-term predictions about the way the market is likely to move.

In any asset management company, equity assets are an important component, for more reasons than one. This asset class gets the maximum publicity in the media; it also attracts the maximum criticism!! Equity is an asset class that can potentially generate higher returns over the long term, but it is also an asset class that displays a higher element of volatility.

This higher volatility has created apprehensions and fear in the minds of several investors, most recently in the past couple of months. The sharp fall of the stock market index (the BSE Sensitive Index) from 29064.61 in April 2015 to a low of 22494.61 in February 2016 (i.e., a fall of more than 22% in a period of 10 months) had unnerved many investors. More specifically, the Index fell by 14% in the 2 months ending February 2016, and this caused some amount of panic.

As an asset manager, we have the duty of presenting the facts, and our inferences from the facts, in as unbiased a manner as possible to our investors. In drawing inferences, it is inevitable that we have to focus on the long-term.

Why do asset management companies talk so much on the "long-term"?

"Long-term investing" is, unfortunately, a much-abused term. It sometimes gets derided as "waiting for a long time before you make money". And some people who callously quote Lord Keynes who said "in the long run, we are all dead", implying that the great economist was dismissive of long-term economic policies, are actually misrepresenting facts.

Long-term investing essentially means focussing on the factors that really matter in the long-term, rather than on the trivial ones.

A shorter term time commitment (such as a bus journey that lasts nothing more than 30 minutes) and a longer term commitment (such as spending 4 years in a college dormitory), or an even longer time commitment (such as a marriage) would see very different factors being weighed in.

For example, in a bus journey, all that we want from our co-passenger is that he/she should not smell too much; or that he/she does not create a nuisance for the next 30 minutes till we remain in the bus. But a much longer commitment (such as a marriage) would force us to focus on the more important things:

(a) We want somebody without unsustainably high levels of financial commitments **(in other words, we want a balance sheet that is not highly leveraged)**

(b) We want our spouse to treat us well and respect our rights **(issues of governance)**

(c) We want someone with a good financial position and reasonable prospects of increased income in future **(sustainable earnings growth and predictability of cash flows)**

(d) Obviously we would look for someone without a wild or extravagant lifestyle **(efficiency in use of capital)**

There are other parallels too, such as a match in terms of chemistry of the alliance, etc, but here we have focused more on the more easily measurable indicators.

In the stock market, the short-term price movement of share prices is a function of literally hundreds of variables, over which none of us exercises any control. But in the long-term, these four or five important variables are all that matter, **and there is empirical evidence to show that there is a strong positive correlation between these factors and the share price movement over a period of time.**

To repeat, the focus on the long term essentially means focus on the more important factors. We are not suggesting that we should be married to the stocks we buy.

We acknowledge that this is not the **ONLY** way in which one can invest in the stock market. But this is the way that we will follow.

Investing and predicting

The advent of 24/7 commentary on business channels, and the popularity of several social media forums have brought with it a breed of people who seem to think that the real test of an investor (or a fund manager) is the ability to predict how exactly the stock market, or each individual stock price, will move.

Each prediction that is proven right brings with it an increased expectation about the next prediction. And this expectation increases in geometric proportion. It is impossible for investors to correctly predict all the time, simply because the number of variables that determine the short term price movement of stocks runs literally into the hundreds. Let us not even try to do this. Instead, let us focus on what really matters.

If we accept the theory that the purpose of the capital market is to reward efficiency in use of capital, and punish inefficiency in use of capital, we also have to accept the argument that the real tasks before an investor is to (a) identify companies that efficiently use their capital, and (b) follow a discipline of using our own capital efficiently. The first would require intelligence, and the second would require temperament, which is essentially self-generated. We can call these external and internal factors in investing.

External and internal factors in investing

As in any other endeavour, stock market investing also needs some basic level of intelligence, but it also needs something far more important – a proper temperament. The "intellect" part of investing, which deals with the external elements such as economic trends, industry and company fundamentals, FII inflows etc are certainly very important, and are given adequate importance by many market participants.

While external factors are important, the investor (or a fund manager) also needs the right kind of temperament, which is essentially made up of internal factors.

What is meant by a proper temperament?

- It is the frankness needed to acknowledge what we know and what we don't;
- It is the capacity for self-appraisal needed to clearly demarcate which risks we are willing to take, and which ones we will avoid;
- It is the acceptance of the fact that shares of perfectly good companies can remain depressed for a long time, or that shares of highly mediocre companies can soar higher;
- It is the ability to remain committed (despite acknowledging the previous point) to buying only the kind of shares that we want to buy, and
- Lastly, temperament is acknowledging that the means are as important as the ends

It is our observation that while most investors attach a high importance to the "intellect" part of investing, the other vital aspect, that of temperament, sadly gets a significantly lower level of attention or importance.

This leads to an unfortunate consequence – we begin to expect the world to function the way we want it to function, and get frustrated when it does not.

Many investors are disappointed that the economy did not "take off" as expected after the incumbent government was sworn in with a big majority in May 2014. But seriously, if we expect an economy of about US $ 2 trillion to start soaring within a few months (after a 3-year slump) simply because one party won the elections handsomely, we have nobody to blame but ourselves.

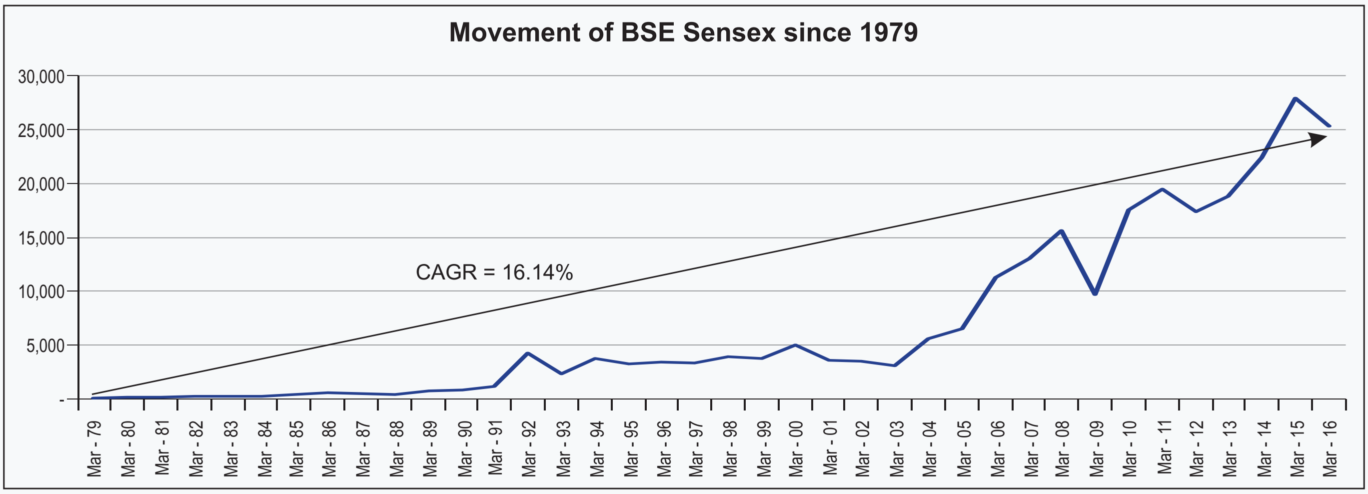
> ***"The fault, dear Brutus, is not in our stars, but in ourselves"***
>
> ***— William Shakespeare in " Julius Caesar "***

Having a reasonable expectation from the stock market is therefore the essential first ingredient.

What is a reasonable expectation from India's stock market?

The stock market Index with the longest track record in India is the BSE Sensitive Index. We shall therefore use this (details in Fig.1)

Fig.1 – Movement of the BSE Sensitive Index since 1979



Data source: www.bseindia.com

The Index has returned about 16.14% per annum since 1979. Including dividends, the total return from the BSE Sensitive Index between 1979 and 2016 has been around 17.5% per annum.

During the same period, India's economy (as measured by nominal GNP) has grown by 13.7% per annum. The sector-wise growth of India's economy during this period has been as follows:

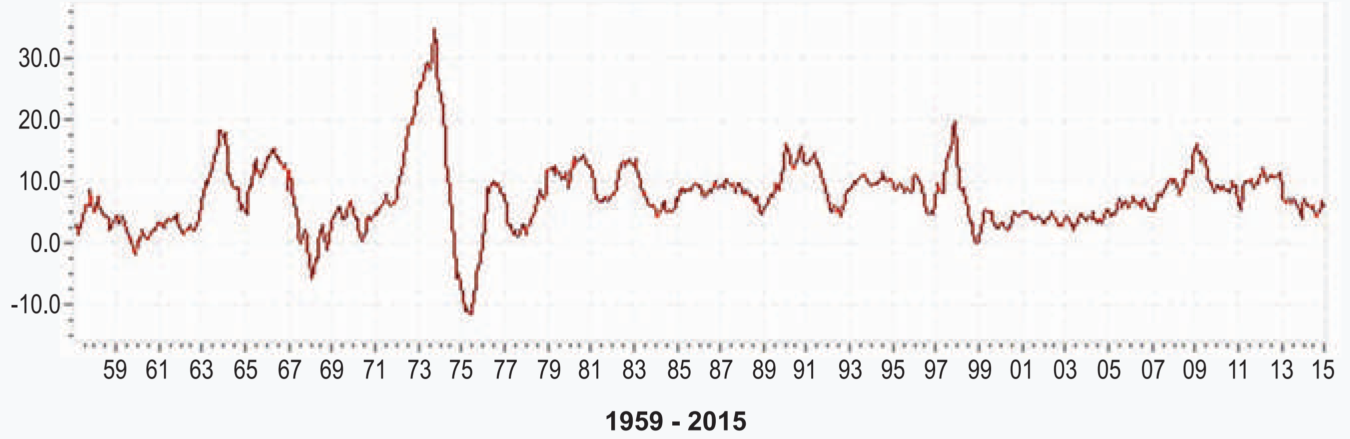
Components of Gross National Income (nominal)	% Growth p.a.
Agriculture and allied activities	11.8 %
Manufacturing, construction, etc	14.3 %
Trade, transportation, communication, etc	14.3 %
Finance, insurance, real estate and services	15.4 %
Overall Gross National Income	13.7 %

Data source: Economic Survey.

India's stock market is more influenced by manufacturing, trade finance and services, since these enterprises tend to be listed on stock exchanges more. These sectors have grown at about 14.5% to 15.5% per annum. It is presumed that the more efficient amongst these (i.e., those represented by the Index) would have grown at about 2% more than the average, leading to a long-term match between economic growth and stock market returns.

If we expect India's economy to sustainably grow at a real rate of 6.5% - 7.0% over the next several years, this means we expect the nominal growth rate to be around 13.5% - 14.5%. (The average inflation in India has been around 7.8% p.a. over the past 30 years, and in the recent past, it has been 7.7% p.a. over the past 5 years).

Fig 2: Inflation history in India (CPI)



Data source: www.inflation.eu

We can reasonably expect industry, trade and services to grow slightly higher growth rates compared to the overall economy. We can therefore assume that these sectors that are directly linked to the stock market to grow at 14.5-15.5%. The more efficient amongst these would probably grow at 1-2% more. At the same time, the cost of funds of today is lower than what it has been over the past 3 decades. Economic information too is more freely available than what it was several years ago. Therefore (assuming that our economy grows at a sustainable rate of 6.5 -7.0% p.a.) it is reasonable to expect that the average growth rate of our stock market Index over the next several years would not be much different from the long term growth rate the Index has seen in this country.

The Index, as we all know, can suddenly soar in one year and give returns far in excess of this average (as it did in 2014). There would also be years in which returns from fixed deposits seem divine (as they seemed in 2015).

Successful stock market investing calls for accepting the fact that the returns from the stock market would vary widely from year to year, and still persist in investing with the same discipline.

There may be a few investors who have managed to enter the stock market precisely before it began to soar, and/or exited from the stock market precisely before it began to fall, but such successes can be attributed more towards good fortune than a knack for accurate analysis.

An assessment of the prospects of economic growth and prosperity in India

In order to be confident of a decent growth in the economy, we have to satisfy ourselves that the ingredients that enable a decent growth do exist in our country.

Any discussion about the economy is incomplete without a discussion about the population. We do not intend to bore you with more data on the age profiles of our population, or claim how young our population is. Enough has been written about this country's "demographic dividend".

Instead, let us focus on the following:

Year	India's population (crores)	Annual growth rate %
1951	36.11	
1961	43.92	2.0 %
1971	54.82	2.2 %
1981	68.33	2.2 %
1991	84.64	2.2 %
2001	102.87	2.0 %
2011	121.02	1.6 %
2021 (Est)	138.02	1.3 %
2031 (Est)	154.62	1.1 %

Data sources:(1) Government Census statistics
(2) Population Foundation of India (estimates)

How is our real per capita GDP moving?

Period	Real GDP growth %	Population growth %	Real per capita GDP growth %
1981-1990	5.57 %	2.2 %	3.3 %
1991-2000	5.60 %	2.0 %	3.5 %
2001-2010	7.55 %	1.6 %	5.8 %
2011-2016 (Est)	6.81 %	1.4 %	5.3 %

Data sources: worldbank.org

If we estimate our real GDP over the next several years to sustainably grow by 6.5 – 7.0% per annum, and if we agree with the projection that our population will grow by 1.1% per annum, then this means that the real GDP per capita in this country will grow by about 5.3 – 5.8% per annum.

The implication of this assumption is that we can expect the next generation of Indians to be at least 3 times as rich (after adjusting for inflation) compared to the present generation. (Of course, higher per capita GDP does not automatically imply equitable distribution of wealth. We have to periodically see whether there are checks and balances to enable this).

For an equity investor, this has tremendous implications. There are reasons to believe that the economic growth over the next several years will be a healthy combination of consumer demand-led growth and capital expenditure-led growth. This means that physical infrastructure in India will improve over the next many years, leading to growth in businesses that are linked to such activity. We as a company are also bullish on agricultural inputs, and on consumer-fronted industries.

Reasons for us to be bullish on India's growth

Despite its myriad problems, India does present reasons for optimism regarding the growth opportunities. The following points are about our country; some of these steps were started by the previous government, and some by this government. As investors, we have to be completely politically neutral:

- There are about 200 countries in the world, and in not more than 10% of them would a citizen experience the kind of individual freedom that this country offers.
- Planned capital expenditure on railway projects more than doubled. The UPA government started the Dedicated Freight Corridor project (very significant from an economic point of view) and the present NDA government is taking it forward. According to the Railway Ministry, the capital expenditure over a 5-year period ending 2019 is projected at 8.56 trillion rupees.
- Continuation of the Aadhaar program started by the previous government, and linking the direct payment of subsidies with the Aadhaar program
- Restructuring of the coal linkages and mining leases, and the spectrum auctions
- SEBs loans restructured under the UDAY scheme
- Road construction, according to the Ministry's website, has touched 17 km per day and there is an ambitious target of taking this to 30 km per day in the next 4 years.
- The fall in oil prices has helped the fiscal deficit to be reined in at 3.5% of GDP
- Consensus estimates for corporate earnings growth of the Nifty companies for the next 2 year period ending fiscal 2018 is 21%, whereas the PE multiple of the Nifty on a 12-month forward basis is 15.04. For the BSE 200 index, the estimated EPS growth for a 2-year period ending fiscal 2018 is 20.6%, and the PE multiple is 14.64 (Source: Bloomberg).

What are the risks?

Of course, when we talk of opportunities, we also have to talk of risks, and there are several of them.

- External risks, such as the continued slowdown of major economies of the world
- Persistent weakness in China
- Geopolitical risks
- Natural disasters
- Increased supply of paper caused by PSU disinvestment, or listing of the many companies funded by the private equity funds.
- Continuing bad loans of Indian banks

In all of this, what do we propose to do as an asset manager?

- We shall offer a range of products within the equity space, with portfolios that invest in a wide variety of companies, starting from the companies in the fast-growing stage of the lifecycle, to mature businesses. The idea is to offer a range of products that cumulatively meet as much of the equity needs of the investor as possible
- We shall strive to ensure that each product remains true to its mandate
- In all products, do our best to ensure that we do not invest in
  - companies with unsustainably high levels of debt
  - companies where there is no alignment of interest between the minority shareholders and the majority shareholders
  - businesses that do not display significant competitive strengths
  - stocks where we believe the valuations are unjustifiably high

Dear Investor, in this Endeavour of building a strong and sustainable asset management company, we seek your support, and that of our friends engaged in distribution. We are aware that this industry will sustainably grow only if all three participants, the Investor, distributor and the AMC are mutually benefitted.

Looking forward to a long association with you.

With warm regards,

Yours sincerely,

(E A Sundaram)
Executive Director and CIO – Equities

Past performance may or may not sustain in future.

KEY PORTFOLIO PERFORMANCE INDICATORS

Quarter on Quarter Performance

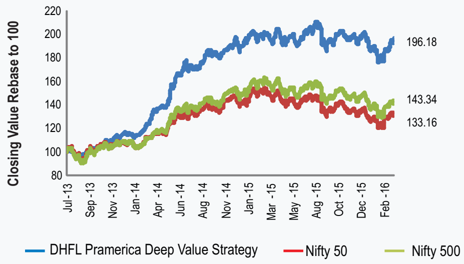
	Jul '13- Sep '13*	Oct '13 - Dec '13	Jan '14 - Mar '14	Apr '14 - Jun '14	Jul '14 - Sep '14	Oct '14 - Dec '14	Jan '15 - Mar '15	Apr '15 - Jun '15	Jul '15 - Sep '15	Oct '15 - Dec '15	Jan '16 - Mar '16
PDVS	2.38%	13.20%	16.77%	26.92%	7.12%	4.82%	1.67%	0.15%	-0.80%	3.16%	-2.40%
Nifty 50	-1.31%	9.92%	6.35%	13.53%	4.64%	3.99%	2.51%	-1.44%	-5.01%	-0.03%	-2.62%
Nifty 500	-2.43%	11.90%	6.31%	18.17%	3.91%	5.58%	3.02%	-1.16%	-3.64%	1.18%	-4.05%
Over/(Under) Performance to Nifty 50	3.69%	3.28%	10.42%	13.39%	2.48%	0.83%	-0.84%	1.59%	4.21%	3.19%	0.22%
Over/(Under) Performance to Nifty 500	4.81%	1.30%	10.46%	8.75%	3.21%	-0.76%	-1.35%	1.31%	2.84%	1.98%	1.65%

* Return for the period 8th July 2013 to 30th September 2013.
Returns calculated for 3 months gross of expenses.
Returns are Quarterly returns for DHFL Pramerica Deep Value Strategy - Discretionary Clients Regular Portfolio.

Top 15 Holdings of DHFL Pramerica Deep Value Strategy Discretionary Portfolio Regular Plan as on March 31, 2016

Date of Purchase	Equity	Sector	%
Jul/2013	Indraprastha Gas Ltd.	City Gas Distribution	7.48%
Jul/2013	Container Corporation of India Ltd.	Logistics	5.93%
Jul/2013	Bosch Ltd.	Auto Ancillaries	5.54%
May/2014	Infosys Ltd.	Computers - Software	5.33%
Jul/2013	Hero Motocorp Ltd.	Motor Cycles/ Scooters	4.76%
Sep/2015	State Bank of India	Banking / Financial Services	4.69%
Dec/2014	Colgate-Palmolive (I) Ltd.	FMCG	4.64%
Jul/2013	Siemens Ltd.	Engineering	4.34%
Jun/2015	ITC Ltd.	FMCG	4.18%
May/2015	HDFC Bank Ltd.	Banking / Financial Services	4.02%
Jul/2014	Oil & Natural Gas Corporation Ltd.	Oil Exploration	3.99%
Apr/2014	CRISIL Ltd.	Credit Rating	3.81%
Jul/2013	VST Tillers Tractors Ltd.	Agricultural Equipment	3.72%
Jul/2015	Tata Motors Ltd. DVR	Automobiles	3.53%
Aug/2015	Sun Pharmaceutical Industries Ltd.	Pharmaceuticals	3.51%
	Total		**69.47%**

Performance Comparision



Portfolio Details

Portfolio Details as on March 31st, 2016	
Weighted average RoCE	37.90%
Portfolio PE (1-year forward)	15.99
Portfolio dividend yield	1.80%
Average age of companies	55 Years

Portfolio Composition as on March 31st, 2016	
Large Cap	41.00%
Mid Cap	36.00%
Small Cap	16.00%
Cash	7.00%

The above holding represents top 15 holdings of DHFL Pramerica Deep Value Strategy – Regular Portfolio based on all client portfolios existing as on the date stated above, excluding any temporary cash investments. The above holdings do not represent the model portfolio being offered to the clients (including prospective clients) and hence it is possible that these stocks may not be part of the portfolios constructed for new clients. The above holdings are for illustration purpose only and it should not be considered as investment recommendation or analysis or advice or opinion from the Portfolio Manager on the above mentioned stocks. The above portfolio holdings are provided on an "as is" basis, and the Portfolio Manager makes no express or implied warranties or representations with respect to the accuracy, completeness, reliability, or fitness of the above portfolio holdings or any financial results you may achieve from their use. In no event shall the Portfolio Manager, its directors or employees or its affiliates have any liability relating to the use of the portfolio holdings.

DHFL Pramerica Deep Value Strategy Portfolio Performance as on 31st March, 2016

Period	Portfolio	NIFTY 50	NIFTY 500
1 Month	11.00%	10.75%	10.67%
3 Months	-2.40%	-2.62%	-4.05%
6 Months	0.69%	-2.65%	-2.92%
1 Year	0.09%	-8.86%	-7.54%
2 Years	20.55%	7.43%	11.12%
Since inception date 08/07/2013	28.04%	10.66%	13.77%
Portfolio Turnover Ratio*	37.19%		

*Portfolio Turnover ratio for the period 1st April 2015 to 31st March 2016.

Important Disclosures regarding the consolidated portfolio performance: Performance depicted above is based on all the client portfolios under Regular Portfolio of DHFL Pramerica Deep Value Strategy existing as on such date, using Time Weighted Rate of Return (TWRR). Past performance is no guarantee of future returns. The above portfolio performances are before charging of any expenses. Please note that the actual performance for a client portfolio may vary due to factors such as expenses charged, timing of additional flows and redemption, individual client mandate, specific portfolio construction characteristics or other structural parameters. These factors may have impact on client portfolio performance and hence may vary significantly from the performance data depicted above. Neither the Portfolio Manager, nor its directors or employees shall in any way be liable for any variation noticed in the returns of individual client portfolios. The Portfolio Manager does not make any representation that any investor will or is likely to achieve profits or losses similar to those depicted above. Return for period upto 1 year is absolute. Since inception date stated is considered to be the date on which the first client investment was made under the strategy.

Investment objective of DHFL Pramerica Deep Value Strategy: DHFL Pramerica Deep Value Strategy seeks to generate returns by investing in a portfolio of value stocks which have the potential of superior wealth creation over long term.

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This document is dated April 07, 2016.