DV INVESTMENT ADVISORS

Newsletter *28Feb2023*

Dear Investors,

This newsletter marks the 3rd newsletter that DV Investment Advisors LLP (**"DVIA"**), a SEBI Registered Investment Advisor (**"RIA"**), with its disciplined and mindful dynamic asset allocation approach to wealth management, is sharing with you. In this newsletter, apart from the usual commentary on our performance, we would like to elaborate on an aspect which we consider very relevant but ignored by investors – asset allocation.

Static vs Dynamic Asset Allocation

While we have shared with you in the earlier newsletters, the reasons behind our choice of a "dynamic asset allocation", the year 2022 gives us the best real world example of the same. In the calendar year (CY) 2022, the *"dance of the asset classes"* continued in its full glory, with Gold being the best performing asset class, followed by Debt, Indian Equity and International Equity, which is in sharp contrast to CY21 when Indian Equity and International Equity were the two best performing asset classes, with Gold being the last.

Further, the classic 60/40 portfolio in the US, which consists of 60% stocks and 40% bonds and has been a successful investment strategy that offers both growth potential from equities and capital protection from bonds, suffered a 22% loss in 2022, the second-largest loss on record and the largest since 1931. India 60/40 portfolio fared better by being +2.8%, which while looks fine compared to the US 60/40 portfolio, is rather sub-dued.

Suffice to say, a static asset allocation simply fails to capture these excesses and rebalance in a timely manner to avoid the inevitable mean reversion that follows. As Albert Einstein said, "Life is like riding a bicycle. To keep your balance, you must keep moving." Same applies to the field of investments – Investing is like riding a bicycle. To keep generating returns, you must keep changing allocations.

DV Model Portfolio Details (as on Feb 14, 2023)

a) Asset Allocation

Below table captures the changes in Asset Allocation in DV Model Portfolio from Inception to date:

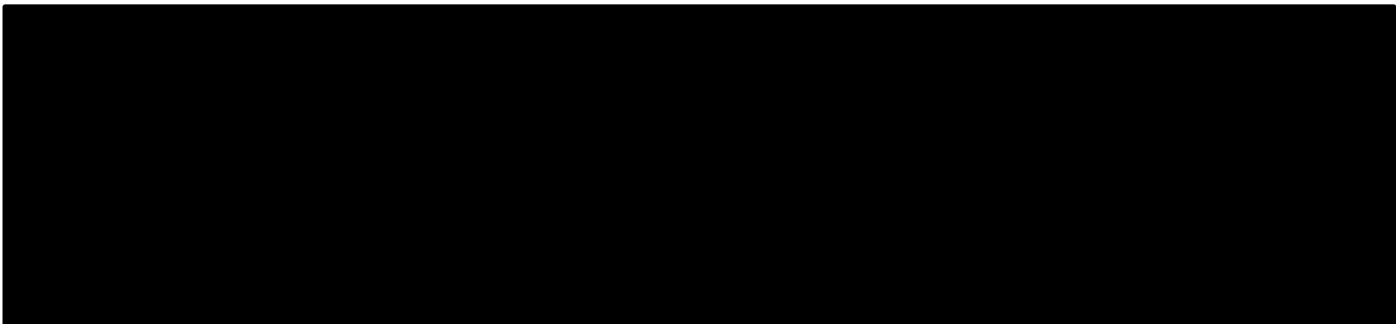
Asset Class	Aug 15, 2020	Highest Allocation	Lowest Allocation	Feb 14, 2023	Change since Aug 14, 2022
Equity – Indian	45%	56.5%	26.25%	28.25%	-11%
Equity – International	0%	2.5%	0%	2.5%	2.5%
InvIT	5%	5%	0%	0%	0%
REIT	1%	15%	1%	10%	-5%
Gold	0%	5%	0%	5%	0%
Long-duration Debt	0%	20%	0%	20%	10%
Medium-duration Debt	0%	7.5%	0%	5%	5%
Short-duration Debt	49%	49.25%	22.5%	29.25%	-1.5%

As can be noted, we continue to be at the lower end of our equity weights – which we have been at since Sep 2021, reflecting our apprehension as equities being able to generate superior risk-adjusted returns in foreseeable future (Nifty 500 TRI generated 4.3% return in CY2022).

We have added small weights in International Equities – in China – but not in US as we continue to be wary of “Di-worsification” in an attempt at “diversification”.

We have used the subdued debt performance over last year (owing to rising interest rates) to add “duration” to the portfolio as part of a “ladder” strategy across the three buckets of low (<1Yr), medium (<1 yr and <4 yr) and high (>4 yr) modified durations, and in the process have shifted from “no duration” to “staggered duration in Mutual Funds” both for potential higher returns as well as lower tax incidence.

b) Performance (as on Feb 14, 2023)

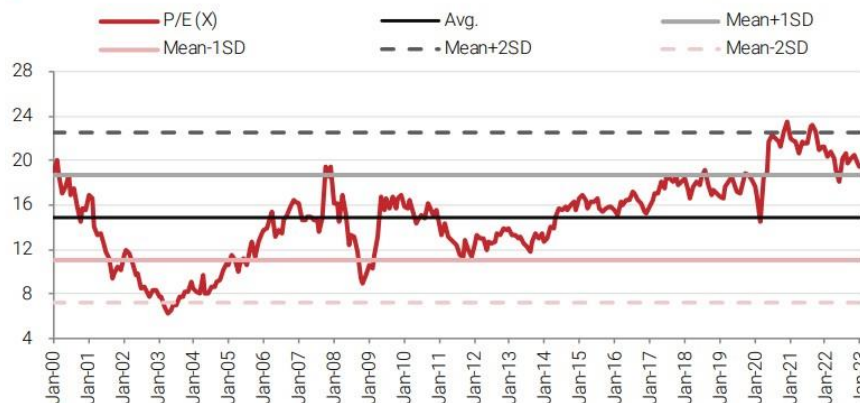


2023 Outlook

The last couple of years have been macro driven – and while initially global central banks drove the macro and markets, its now the turn of macros to drive central banks and consequently the markets. As is the problem with macros, it is impossible to predict – and the more the macro factors, the more the impossibility. At the current juncture, the biggest macro is inflation, but the related macros are interest rates, liquidity and forex. What we can however do is to see how things are stacked up at the moment and therefore, ceteris-paribus, potential of returns of various asset classes over the next couple of years.

Equities

Below chart from the 17Feb2023 report of Kotak Institutional Securities shows that the Nifty 1-yr forward P/E multiple is still at 20x which is more than 1 SD above mean:



The issue is that with such expensive starting valuations, equities are likely to give subdued returns, as can be seen from the historical observations over last 20 years

MSCI India starting P/E and Forward Return (since 2003)

When India P/E is...	% of obs	Average Returns		
		3-mo	6-mo	12-mo
Less than 13x	12	14 %	29 %	45 %
13x to 15x	22	2 %	5 %	21 %
15x to 17x	17	5 %	8 %	12 %
17x to 19x	33	1 %	3 %	8 %
Greater than 19x	15	4 %	6 %	6 %

Source: Goldman Sachs, MSCI India, FactSet, Period Jan 2003 till Dec 2022

This is without even taking into account the negative impact of rising interest rates and / or its impact on growth and therefore potential for earnings downgrades. We will get more clarity on this as we move further into CY23.

While domestic money has remarkably neutralized and some would say even trumped the FIIs over the last year, and we believe in the "financialization of savings" and this being a structural change, we are not of the view that such "domestic inflows" cannot trump the fundamental inherent challenges of valuation, slowing growth and rising interest rates.

Debt

We believe that interest rates may rise in shorter term but should trend downward over the longer term. Hence we intend to keep adding duration as interest rates rise and generate superior risk-adjusted returns for the next 3 years – as a mix of carry income and potential MTM gains - and thus help portfolio generate income in periods of expected subdued equity returns.

REITs

REITs have got a negative tax treatment in the recent budget and consequently have seen a decent correction of 15%-20% in the last 3 months. We believe this is owing to the exit of investors with a shorter term horizon who had invested only for tax gains.

There is no change in our view that REITs will generate steady returns over next 3-5 years and thus keep attracting investors with a longer term horizon. A mix of rising occupancy and rising rentals (backed by rising inflation and rising occupancy) will aid the yield from these instruments and help outperform equities.

Gold

We always view Gold has a hedge against extreme market events – whose returns will be unpredictable. This happened in the last quarter of CY22, when it generated ~15% returns. We don't have any view of how gold will do in CY22 except that the macro situation being what it is, it is a must include in any asset allocator's portfolio.

Conclusion

We believe that over the next 2-3 years, from existing levels, returns are going to be generated by Debt and alternate asset classes such as REITs rather than Equities. We, in the DV Model Portfolio, are positioned for the same.

With Regards,
DV Investment Advisors LLP
Partners - Deepak Bakliwal and Vivek Agarwall