
DV INVESTMENT ADVISORS
Disciplined Dynamism
Your partners for nurturing wealth for a lifetime

Dear Investors,

This newsletter marks the 5th 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, we intend to talk about ***"RISK NOT WORTH TAKING".*** The individual performance reports for your respective portfolios under our advisory for the period ended Dec 31, 2023 have already been sent out to you for your perusal.

RISK NOT WORTH TAKING

Let us start with an analogy. Imagine that you are driving from point A (say Mumbai) to Point B (say Pune). As you will agree, there will be various kinds of roads and traffic conditions that you will encounter during this journey. Also, there is a probability of a mishap – it is to be kept in mind that this probability is not dependent only on you, but on all other guys who are driving that day that moment in your route. You cannot do anything about others, but when it comes to yourself, you will do everything possible to minimize it.

So while everyone wants to reach in the least possible time, everyone will adapt by tailoring one's speed and driving to one's reading of these variables. Consequently, each one will take different time for the same journey – time is then an outcome, not a target to start with. Same is true for your investments. You take a call on the variables basis your understanding and size the risk and invest accordingly – returns you earn then become the outcome, not the target to start with.

Further, depending on fate you may or may not face an accident if you drive at high speeds between A and B, while someone else might. However, in the investment world this is not the case as there is no fixed end point B – rather it is a journey with increasing stakes (higher investment amount) as your portfolio keeps growing. The same investment style and allocation will meet with same or vastly similar results for everyone – in the short term, higher risk may not play out against you and give you the pleasure of returns, but if the risk is misplaced, it will eventually catch up and when it does, it will destroy the entire returns made in the journey, and more.

This brings us to the concept of ***"RISK NOT WORTH TAKING",*** meaning that different people will have different outcomes basis what they decide is a ***"RISK NOT WORTH TAKING"*** – someone else may still take that risk and live with its rewards – but it might not be the prudent thing for you as it might cause a permanent or irreparable damage in your journey if it turns otherwise. Lets keep in mind that no one intends to take higher risk consciously – this is only visible or apparent in hindsight when the risk manifests.

Dynamic Asset Allocation tries to do exactly this – by changing the mix between equity / debt / gold / REITs & INViTs, vs a static asset allocation – it avoids higher or lower weights in an asset class when it becomes a ***"RISK NOT WORTH TAKING".*** Mind you, the asset class can keep performing after you have reduced weight or underperforming after you have increased weight, as its impossible to call the "top" or "bottom". But the risk-reward becomes stacked up against you and therefore must be avoided, to ensure that no permanent damage happens to the portfolio when the risk becomes manifest, which it invariably does in the long run.

DV Model Portfolio Details (as on Jan 31, 2024)

a) Asset Allocation

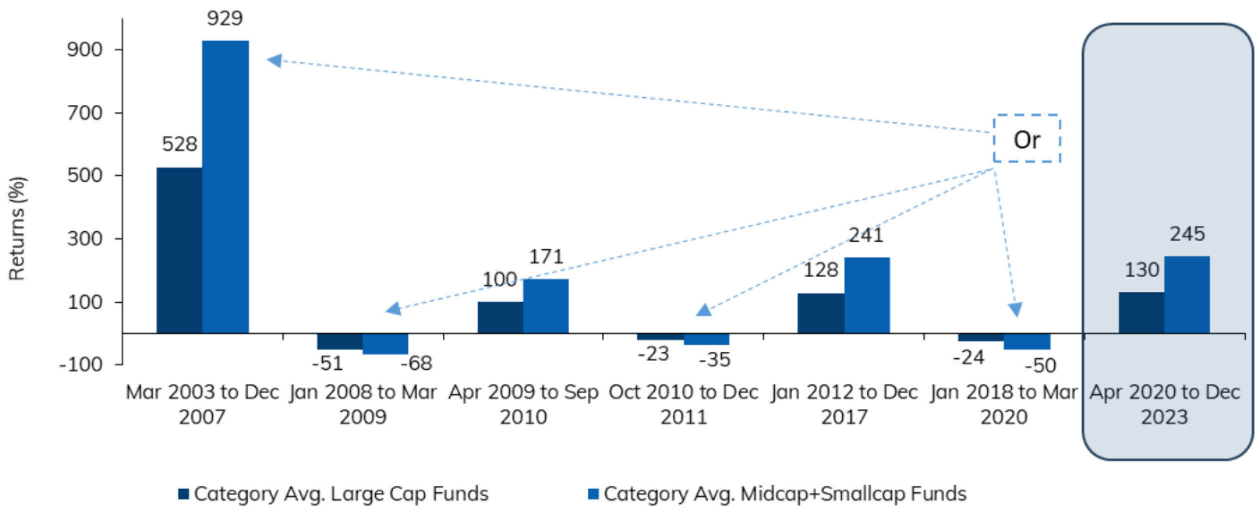
Below table captures the changes in Asset Allocation in DV Model Portfolio from Inception to date:

Asset Class	Aug 15, 2020[1]	Highest Allocation	Lowest Allocation	Feb 29, 2024	Change since Aug 31, 2023
Equity – Indian	*45%*	*56.5%*	*28.75%*	*30%*	*-9.25%*
Equity – International	*0%*	*2.5%*	*0%*	*5%*	*+5.00%*
Total Equities	45%	56.5%	28.75%	35%	-4.25%
InvIT	5%	5%	0%	0%	0.00%
REIT	1%	15%	1%	10%	0.00%
Gold	0%	5%	0%	5%	0.00%
Debt	49%	57%	37.5%	50%	+4.25%

Equities

As we said in our last newsletter in Aug 2023, the rally in equities since Mar 2023 has been unprecedented in a lot of ways – both its quantum as well as its breadth (across market caps) and depth (across all kinds of stocks). Nifty-50 is up 26%, Nifty Midcap Index is up 58% and Nifty Smallcap Index is up 72% in the 10 months between Mar 31, 2023, when we last increased weights, and Jan 31, 2024 – backed by a mix of earnings growth and PE expansion (for already not so low levels). This has started the debate as to whether it is like the 2003-2007 boom cycle or the subsequent bust cycles:

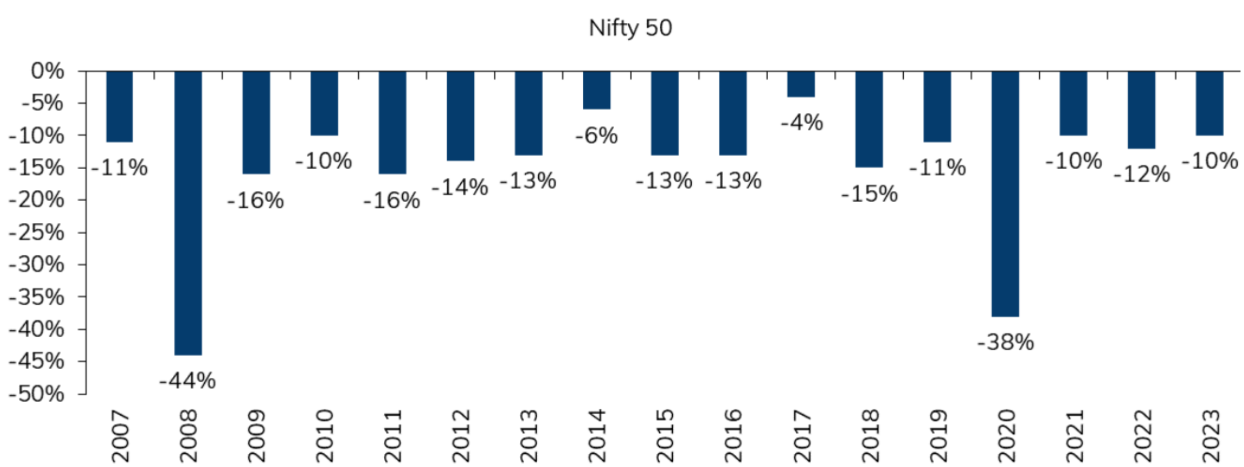
[1] *Initial asset allocation*



Source: IDirect report dated Dec 29, 2023

We have to say we have no clue and we doubt if anyone else has. Each and every segment of the market has seen a price movement which is difficult to explain on pure fundamental basis – to the extent that what was high PE earlier for a stock is now yet higher and the earlier high PE is now justified.

We for one are not of that view at all. We do believe that there are a lot of positives – quite a few of them structural – but we find it very difficult to convince ourselves that its not already in the prevailing levels. We believe that market is working with a "perfect world / goldilocks" scenario where nothing can and will go wrong and you start underwriting more and more aggressive growth/profitability assumptions required to justify the higher stock prices. We don't know what will or how will or how much of a correction will come. We do know that corrections come more often than we think for sure, as can be seen from the graph below:



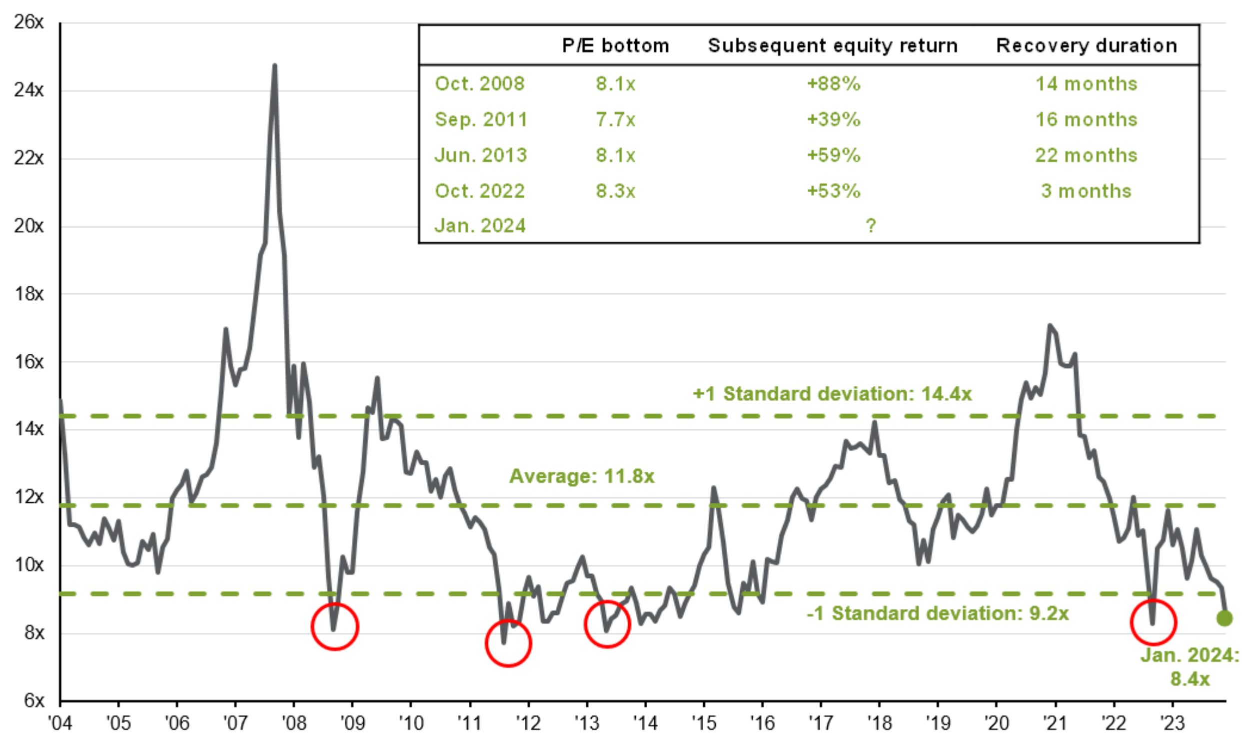
Source: Bloomberg

The drawdowns are worse in Mid/Smallcap indices.

Hence our stance is that it is a compelling proposition for us to step out as the moment of ***"RISK NOT WORTH TAKING"*** is here – which is why we have decreased our India equity allocation to 30% from 40% at end-Jan 2024. All we will do is to wait for is a better risk-reward for increasing weights back – and we have the time and patience and most importantly we think we have the mandate from our clients to do so.

At the same time, we have allocated 5% equity weight to International Equity through Greater China Funds – this is in contrast to what we had put out in our earlier newsletter in Aug 2023 where we had stated that international equities don't make sense from a post tax perspective (Indian Equities are on average taxed at 15% while international equities are taxed at 35%, resulting in a 20% leakage).

The rationale is that the bar is very high to go out of Indian equities and two things have to be met for us to go for international equities – the probability of making returns should be pretty high, and the potential IRR should be pretty high, to negate the tax leakage. We believe the Greater China market meets this requirement - it fits perfectly into our philosophy of adding perpetual asset classes at their worst time. Please see the chart below:



Rarely will we get such an occasion where US and Indian equity markets are at their peak, with peak valuations, and China is at half valuation with huge relative underperformance. We don't know if it will rebound from here or it will fall more, but the valuations factor in a lot of cyclical and structural negatives, leaving scope for incremental surprises to be positive and hence high probability of making good, if not outperforming, returns. In other words, the risk-reward is such that it becomes a ***"RISK WORTH TAKING".***

REITS

We continue to maintain allocation to REITs. We would like to elaborate our thought process on REITs as we have been asked about it by our clients on quite a few occasions – specially when it is underperforming for last year or so.

REITs have 3 components of returns:

1) A – the existing yield – which is nothing but what the REIT is distributing at present depending on its existing level of occupancy and rentals
2) B – the change in occupancy and rentals. Former is more impacted by cyclicality than the latter. However, the rentals have a dual movement – a normal increase every year or every 3 yrs or longer (perceptively to take care of inflation) over the course of the contract and a reset at the end of the contract to bring it in line with the prevailing prices (depending on how the asset prices have moved over the life of the contract). This makes REIT akin to an inflation indexed bond – which is one of its most compelling investment arguments vs a transmission InViT.
3) C – the growth – REITs can add assets to the portfolio with positive spread (yields higher than their cost of leverage) and thus add to the shareholder returns

In our view, for an equal weighted portfolio of the 3 listed office REITs (Brookfield, Embassy and Mindspace), today A is 7%, B is 3%-5% and C is 2%-3%, translating to an overall potential IRR of 12%-15%. Fact that major part of A is tax free and C is taxed at similar rates as equity, this makes it a very lucrative asset class in the current juncture when equities are displaying signs of a ***"RISK NOT WORTH TAKING".***

Conclusion

We wait for better levels to increase equity weights, and patiently keep earning decent post-tax returns on the debt allocation, while we wait for the air to clear out on elections, which to some is a foregone conclusion and so is already factored in. We for sure don't have a view on either side.

With Regards,

DV Investment Advisors LLP

Partners - Deepak Bakliwal and Vivek Agarwall

Annexure

Details of DVIA

SEBI Registration name – DV Investment Advisors LLP

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