OMNISCIENCE CAPITAL
SCIENCE OF ALPHA FROM SAFETY

Global OmniView July 2020

Mr. Market Plays Catch-up While Scientific Investing Generates Alpha

OMNISCIENCE CAPITAL RESEARCH **July 2020**

OmniScience Capital Research—OmniView Global

July 2020

Mr. Market plays catch-up while Scientific Investing generates alpha

- Scientific Investing portfolios exhibiting broad-based outperformance
- All segments of the Omni Supreme US Multicap strategy have outperformed benchmark. All segments continue to be fundamentally strong with attractive valuations
- Omni Supreme US Multicap and AIoT are inevitables that investors must consider adding to their 'Core' equity portfolio.

"Alpha is created when companies with SuperNormal economics are bought at SuperNormal prices; the Alpha is manifested when Mr. Market agrees with this and is willing to pay higher prices."

Scientific Investing is delivering alpha across Developed (US) and Emerging (India) markets…

In June, Omni Supreme US[1] delivered 8.8% (in USD) as compared to S&P 1500 which delivered 1.8%, thus generating an excess return of 7%. The Barclay Hedge Fund Index, reporting on more than 800 hedge funds worldwide, was up by 1.77% for June 2020. Equity long-bias index from Barclay Hedge was up by 2.12% and the Technology index is up by 4.1%. According to the Lipper mutual fund report for June 2020, the US equity mutual funds delivered average returns ranging from 0.37% to 4.07% for different mutual fund categories, with multi-cap funds delivering an average return of 2.01%. Omni Supreme US has performed better than all these categories of hedge funds and mutual funds.

For the April to June quarter, Omni Supreme US delivered 32.2% compared to 18.5% for S&P 1500 and 21.4% for S&P 600, thus generating excess returns of over 13.7% and 10.8% respectively. Omni Supreme US also performed better than the mutual funds for the quarter. According to the Lipper mutual fund report, the multi-cap mutual funds delivered average returns of 22.38%. Again, the Omni Supreme US performed better than that.

Scientific Investing delivered alpha in the Indian markets as well. Last month, based on PMS-AIF World data, Moneycontrol ranked 3 schemes based on the Scientific Investing philosophy in the top-10 performers across all PMSes (Portfolio Management Services). A comparison on Value Research with the

[1] Based on the proprietary Omni Supreme US model portfolio returns on gross basis. See detailed disclosures at the end.

large-cap mutual funds shows that the Scientific Investing based large-cap strategies also beat all the mutual funds for the period.

In June as well, the performance of Scientific Investing strategies continued. Similarly, the Nifty 500 delivered 8.3%, while the Omni Supreme India model portfolio delivered 13.6%. Moneycontrol and Economic Times put Scientific Investing India strategies in the top performing bracket for the month of June and the April-June quarter.

It is interesting to note that Scientific Investing is performing across two completely different markets representing economies as different as US and India. This should not come as a surprise since the Scientific Investing philosophy and framework are based on the first principles of investing which apply across markets. It is an indication that Mr. Market is seeing the value in segments and stocks in the SuperNormal Portfolios based on the Scientific Investing framework.

Alpha is created when companies with SuperNormal economics are bought at SuperNormal prices; the Alpha is manifested when Mr. Market agrees with this and is willing to pay higher prices.

Alpha manifestation is not a one-time event but rather a process which works out over time. The current alpha manifestation is a result of Mr. Market realizing some of the fundamental strengths of the portfolio companies and the significant discount to their intrinsic values. A partial unlocking of the discount has been manifested in the current time frame.

The focus on the monthly returns is not with a view to highlight the returns per se, but rather to illustrate that there are periods when there is a change in the market perception and Mr. Market's view starts converging with Scientific Investing. While this happens in a spurt sometimes, it could take several such spurts before the full convergence happens. Further, the investor needs to have the patience to stick with the strategy until Mr. Market starts loving the portfolio companies and when it is time, eventually, for the Scientific Investor to bid adieu to those stocks once the convergence is near-complete.

Scientific Investing takes originality, character, and patience. Investing and winning in the stock market is a long-term endeavor requiring patience and holding power of more than 3 years and sometimes 5 years or more.

Omni Supreme US-The US multi-cap strategy

Omni Supreme US is a multi-cap strategy based on Scientific Investing. This strategy creates a SuperNormal Portfolio of 20-30 stocks from an investment universe comprising of the 1500 largest companies listed in the US markets. Selection from this is based on the Scientific Investing Framework which eliminates the *"Capital Destroyers"*, *"Capital Eroders"*, and *"Capital Imploders"* from the investment universe, leaving the *"Capital Multipliers".* From the "Capital Multipliers" a SuperNormal Portfolio of the best 20-30 stocks is created.

The Scientific Investing Framework establishes an economic alpha of companies with supernormal profitability as compared to the investment universe represented by the benchmark. Further, since these companies are bought at a discount to their intrinsic values, i.e. supernormal prices, a value alpha is established. The conservative allocation with caps on sector/industry allocation and stock allocation and the regular monitoring, realignment and rebalancing provides portfolio governance alpha. It is no surprise then that an alpha is embedded in the portfolio. Manifestation of the alpha requires that Mr. Market agrees with valuation and as Ben Graham says *"in the short run the market is a voting machine, but in the long run the market is a weighing machine".*

An important aspect of the Scientific Investing philosophy is that the investment process, i.e. the framework should be *original*, resulting in an original portfolio, different from the market portfolio. Allocation of investment capital to this original portfolio requires *character* to go against the herd, i.e. against Mr. Market. Further, it requires *patience* to allow Mr. Market to realize the value and agree with your assessment. This process can take 3-5 years sometimes. Sometimes it is a consistent gain when the economic alpha is manifested over the years and sometimes it is a sudden spurt when the catalyst might be economic gains, but the manifestation is in the form of value alpha. Probably the current performance is a result of the second scenario.

Digging Deeper—Segments and their performances

As discussed in an earlier OmniView, the Omni Supreme US portfolio can be classified into 4 segments, viz., AIoT (Artificial Intelligence and Internet of Things), HNWMA (High Net Worth & Mass Affluence), Sports & Wellness, and Consumption. Below we see the performance of these segments. All of the segments in the portfolio outperformed the benchmarks.

Consumption and HNWMA segment performed extremely well with a segment return of 20.5% and 19.5% respectively. Sports & Wellness also did quite well with 11.2%. AIoT segment which is primarily technology oriented delivered 6.7%.

S. No.	Segment	Avg. Return (Jun 2020)

1	Consumption	20.5%
2	HNW&MA	19.5%
3	Sports & Wellness	11.2%
4	AIoT	6.7%

Exhibit 1: The average performance of the companies in each portfolio segment for the month of June 2020 | Source: OmniScience Capital Research, Third-party data sources

Are these SuperNormal Companies?

Here we compare the Omni Supreme US Multicap portfolio with its benchmark S&P 1500 on selected fundamental parameters. We have added a comparison with Nifty 500 as well so that an Indian investor can do a comparative analysis of the strength of the US portfolio.

Cashflow based earnings have been used rather than the reported GAAP earnings. US GAAP earnings have a lot of non-cash components, including non-recurring expenses which make the estimation of normalized earning power difficult. Cash flow-based earnings have also been used to estimate the RoE and the RoCE. The Omni Supreme US portfolio has higher RoE compared to both S&P 1500 and Nifty 500. The asset turns are also much higher. The net debt to equity is much lower.

The fundamental superiority of the Omni Supreme portfolio arises out of the strong balance sheet signified by the low net-debt levels. The persistent competitive advantages of these companies is reflected in the higher RoE.

These strong fundamentals make these SuperNormal companies compared to the investment universe of S&P 1500. These are SuperNormal compared to the typical Indian companies, too, as can be seen in a comparison with Nifty 500.

Fundamental Parameters	S&P 1500	Nifty 500	Omni Supreme US
ROE (Cashflow basis)	23.9%	16.3%	**25.5%**
ROCE (Cashflow basis)	12.4%	9.1%	**11.9%**
Sales to Assets	0.7	0.7	**1.3**
Net Debt to Equity	0.7	0.7	**0.1**

Exhibit 2: Multicap portfolio, S&P 1500 and Nifty 500 fundamental parameters as of July 09, 2020 | Source: OmniScience Capital Research, Third-party data sources

Are these available at SuperNormal Prices?

We again illustrate the same companies on their valuation parameters. The Omni Supreme US portfolio is available at a Price to Cash flow of 7.3. This is a cash flow yield of nearly 14%. Compared to S&P 1500 with a Price to Cash flow of 13.8, it is nearly at 50% discount. It is at an even higher discount compared to the Nifty 500, busting the myth of the US market being overvalued. The other valuation parameters also clearly show that the Omni Supreme Portfolio remains at a significant discount. These multiples are a strong indication that the SuperNormal Companies are available at SuperNormal Prices.

Valuation Parameters	S&P 1500	Nifty 500	Omni Supreme US
P/E (Cashflow basis)	13.8	17.6	**7.3**
P/BV	3.3	2.9	**1.9**
EV/EBITDA	14.1	12.0	**21.4**
Dividend Yield	1.5%	1.5%	**1.5%**

Exhibit 3: Multicap portfolio, S&P 1500 and Nifty 500 valuation parameters as of July 09, 2020 | Source: OmniScience Capital Research, Third-party data sources

Portfolio Positioned for alpha generation

Economic Alpha

Given the persistent competitive advantages of the Omni Supreme portfolio, the economic alpha signified by higher RoE is likely to persist over the long-term and continue adding to the portfolio returns and alpha.

Value Alpha

If the valuation multiples of the Omni Supreme portfolio start converging to the market multiples, a large value alpha contribution can be expected as the value unlocking takes place.

Investor actionable—Continue investing in a staggered manner….

Consumption, HNWMA, Sports & Wellness, continue being important segments of the US economy. Irrespective of the temporary economic impact of the Covid19 situation, these segments are likely to continue growing on a secular basis in the long term. Due to the unfolding Covid19-related impact the near-term economic impact in terms of revenues and earnings as well as market prices is likely to remain volatile. This makes it a good situation to continue investing in a staggered manner to take advantage of the market volatility.

For Indian investors, the INR returns of the strategy have been quite rewarding. With the fundamental strength of the US companies it makes sense for an Indian investor to allocate to the US markets to have exposure to their growth opportunities. Further, the INR depreciation in the long-term adds to the returns favorably.

That the strategy has a low beta compared to Nifty 50 also makes an Indian portfolio with US allocation much less volatile compared to a pure India allocation portfolio.

OmniInsight

"Most market participants chase alpha but get risks, while one could chase safety and get alpha"

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A Global Investment Management firm focused on global equity investments empowered by its proprietary Scientific Investing philosophy.
OmniScience Capital is a joint initiative of Team OmniScience and the financial services conglomerate Asit C Mehta Group (35+ years, AUM: 3000 crores) to bring Scientific Investing to Indian and Global investors. [Read more…]

Global Investment Focus

OmniScience's vision is to provide global investors with global opportunities via SuperNormal Portfolios for US, Europe, India and Transformative Technologies. Our Omni Supreme US and AIoT investment strategies help clients take exposure to US markets. [Read more…]

Scientific Investing

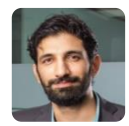
Scientific Investing creates a SuperNormal Portfolio designed to survive and thrive through uncertainties, delivering optimal "Return on Safety". [Read more…]

Dr. Vikas V. Gupta
CEO & Chief Investment Strategist

- Founder of OmniScience Capital & Inventor of Scientific Investing concept
- At an earlier firm he incubated the global equity vertical with US SEC license. The firm won international awards and rankings
  Former Professor/faculty at IIT Kharagpur & University of California and B.Tech (IIT Bombay), Masters and Doctorate, Columbia University, NY
- Columnist at Seeking Alpha, Mint, Moneycontrol, Economic Times

Ashwini Kr. Shami
EVP & Portfolio Manager

- Co-founder OmniScience Capital & leads advisory services and manages US, India & Technology portfolios
- At an earlier firm he set up one of the first Indian US SEC registered global money managers on the Interactive Brokers platform
- Previously worked at Goldman Sachs covering US and International stocks
- B.Tech and M.Tech from IIT Bombay; MBA from IIM Lucknow and Toulouse Business



Varun Sood
VP Quantitative Research

- Co-founder OmniScience Capital & heads investment research
- At a previous asset management firm, he developed 12 global strategies for US, UK & EU
- Earlier, at ING, Trefis and Masan group he covered US and International markets
- B.Tech from IIT Roorkee and earned his MBA from IIM Bangalore and EDHEC School of Business, France.

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