



OMNISCIENCE CAPITAL
SCIENCE OF ALPHA FROM SAFETY



India OmniView July 2020

Is Mr. Market chasing the SuperNormal Portfolio?

OMNISCIENCE CAPITAL RESEARCH

July 2020



Is Mr. Market chasing the SuperNormal Portfolio?

Market has just begun unlocking the value in the ‘Unique’ SuperNormal portfolio

- Recently, Scientific Investing strategies have had a high absolute performance and outperformance relative to the benchmarks, as well as to other PMS or mutual fund managers.
- The performance has been broad-based across market caps and countries (US and India).
- Despite the performance, the valuations remain inexpensive. Fundamentals have remained strong and positive developments in the segments provide secular growth opportunities.
- We advise investors to continue investing in a staggered manner.

“The top performance of this month is a testimony to the originality of the Scientific Investing thought process”



- 2/3 portfolio cos beating benchmark indicate broad-based unlocking.
- Portfolio and segment valuations continue to be attractive

Scientific Investing is working across markets

Last month, according to [Moneycontrol](#) several Scientific Investing strategies were ranked at the top across all PMS strategies. Further, a comparison with the large cap mutual funds shows that they beat all the large-cap mutual funds. This month, too, the outperformance continues with *Omni Supreme India** (multi-cap) delivering 13.6% outperforming the benchmark (Nifty 500) by 5.3%. Both [Moneycontrol](#) and [Economic Times](#) ranked Scientific Investing strategies in the top bracket for 1 month and 3 months. A comparison with the multi-cap mutual funds shows that Scientific Investing beat virtually all the multi-cap mutual funds as well. Scientific Investing worked in the US markets as well, with *Omni Supreme US** delivering 8.8% for 1 month and 32.2% for 3 months, beating the US multi-cap benchmark S&P 1500 by 7% and 13.7%, respectively.

What can be inferred is that the outperformance is broad based, i.e. across strategies, across market capitalizations and across different countries. This clearly indicates a possible qualitative change in the way Mr. Market is allocating across the market. Mr. Market seems to be tired of the *QRAP portfolio (Quality Required at Any Price)* and looking for other investment ideas. In this search, Mr. Market might be buying indiscriminately as indicated by the small-cap rally. Going forward Mr. Market is likely to start discriminating between the fundamentally strong companies and the junk

companies, with the rally in junk companies fizzling out eventually, while the fundamentally strong companies continuing to attract more investors.

* Based on the proprietary Omni Supreme India and Omni Supreme US model portfolio gross performance. See the detailed disclosures at the end.

Having an Original Portfolio pays off

We believe that investors should focus more on the investment strategy and less on the past returns as the returns are just an outcome of the investment strategy; in short, the strategy determines the future performance. One of the three Scientific Investing tenets is Originality, which implies that to have market beating performance you need to have an Original portfolio, i.e. a portfolio different from the market. Our multi-cap portfolio is clearly a original and differentiated portfolio with fundamentally strong and undervalued, i.e. SuperNormal, segments. Recent performance of Scientific Investing strategies across countries and market-caps is a testimony to the originality of the Scientific Investing thought process. Performance based on a strong philosophical foundation is sustainable over the long term while random rallies eventually fizzle out.

Digging Deeper, Segment performance...

The performance is also broad-based as far as the various portfolio segments are concerned. 5 of the 8 portfolio segments outperformed the market with Housing finance (38.5%), Defence (34.5%) and Power (31.6%) delivering more than 20% excess return over the benchmark. At individual company level also, the performance is broad-based with more than 2/3rd of the portfolio companies (17 out of the 25 stocks) outperforming the benchmark.

The illustration below lists down the average performance of the segment companies for the month of June 2020.

S. No.	Segment	Avg. Return (June 2020)
1	Housing Finance	38.5%
2	Defence	34.5%
3	Power	31.6%

4	Digital Transformation	12.3%
5	Financial Services	10.8%
6	Consumer	7.9%
7	Rail Infra	7.4%
8	Basic Materials	5.5%

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

It is important to know and understand this from the sustainability standpoint for the performance and alpha. Consider a highly concentrated portfolio with 5-7 stocks and a skewed allocation with the largest stock being 20% or more. An outperformance in such a portfolio can be due to a lucky, one-off increase for the largest stock. This performance is unlikely to continue in the long-term, thus making it an unsustainable alpha.

In contrast, the Scientific Investing portfolios are highly diversified with 20-30 stocks with nearly equal weightages at the time of allocation. Further, there are several unrelated sectors, industries, and segments in the portfolio. A broad-based performance across these segments and companies reinforces the likely sustainability of the performance. Also, while the segments are unrelated they do share one thing in common, that they are all fundamentally strong companies with strong balance sheets, persistent competitive advantages, high profitability and are all available at significant discount to their intrinsic values.

SuperNormal Companies at SuperNormal Prices?

The portfolio continues to be a SuperNormal Portfolio @ SuperNormal Prices. As per the exhibit below the multi-cap portfolio continues to have much stronger fundamental parameters compared to the broader market such as ROE (13.5% vs. 8.5%), ROCE (19.7% vs. 10.2%) and much lower debt levels; rather, the SuperNormal portfolio is cash rich. The popular valuation metrics also indicate that the portfolio is attractively priced. This is important on two counts. Firstly, the outlook for this portfolio is strong and it is expected to continue to deliver good performance. Secondly, the performance seen so far is delivered by a set of companies with strong fundamentals and is not driven by a rally in a set of poor-quality, distressed stocks, which is a high-risk and unsustainable approach.

	Parameters	Nifty 500	Multicap Portfolio
Valuations (as of Jul 8, 2020)	P/E	30.6	8.2
	P/BV	2.6	1.1
	EV/EBITDA	12.6	4.0
	Dividend Yield	1.7%	5.6%
Fundamentals (as of Jul 8, 2020)	ROE	8.5%	13.5%
	ROCE	10.2%	19.7%
	Sales to Assets	0.7	0.8
	Net Debt to Equity	0.7	-0.2

Exhibit 2: Multi-cap portfolio and Nifty 500 valuation and fundamental parameters as of July 08, 2020 | Source: OmniScience Capital Research, Third-party data sources

SuperNormal Segments: Fundamentals and Valuations

The selected portfolio segments, as shown in the exhibit below, have strong fundamentals with attractive valuation. Specially, even after the recent run up all segment valuations are still very attractive.

Ratios (As of Jul 8, 2020)	Nifty 500	Omni Multicap	DX	Power	Rail Infra	Defence	Financial Services	Basic Materials	Housing Finance	Consumer
P/E	30.6	8.2	14.4	3.7	8.5	12.7	11.7	7.0	3.7	14.5
P/BV	2.6	1.0	2.7	0.5	1.3	2.1	1.1	1.1	0.3	4.2
EV/EBITDA	12.6	4.0	8.2	1.5	5.9	6.1	9.5	2.7	2.1	9.2
Div. Yield	1.7%	5.6%	3.7%	14.6%	3.8%	5.2%	7.0%	9.2%	6.2%	4.2%
ROE	8.5%	13.5%	19.0%	12.6%	15.7%	16.6%	9.5%	15.4%	6.9%	29.0%
Net Debt to Equity	67.4%	-23.4%	-34.1%	NA	27.4%	-41.8%	NA	-41.3	NA	-24.4
Interest Coverage	3.3	7.6	8.6	NA	5.1	35.1	NA	172.3	NA	123.8
EBITDA Margin	16.2%	20.5%	17.7%	18.7%	12.2%	25.7%	49.9%	56.9%	13.9%	18.9%

Exhibit 3: Valuation and Fundamental ratios of key portfolio segments as of Jul 8, 2020 | Source: OmniScience Capital Research, Company filings, Third-party data sources

Scientific Investing Alpha generation continues

Scientific Investing alpha has three drivers, Economic Alpha, Value Alpha and Portfolio Alpha. The economic alpha is at continuous play as all portfolio companies are SuperNormal Companies with superior resources in the form of strong balance sheet and growth opportunities. Further, the companies have persistent competitive advantages to capitalize on these opportunities. The Second source of alpha is Value alpha which manifests when Mr. Market realizes the mispricing and starts repricing the SuperNormal Portfolio companies.

A number of these segment companies have had revenue and earnings surprises on the positive side. Several segments are exposed to much large growth opportunities due to recent government initiatives like Self-reliance and the rearchitecting of the global supply chains from China to India and other countries. This is what has started in the last three months and, given the fundamentals and current valuations, should sustain.

Investor Actionable: Investors should continue investing in a staggered manner...

Scientific Investing portfolios have typically seen significant value unlocking happening during a volatile event. A volatile event breaks the momentum rally of the overvalued stocks which had become high-risk bets with market giving them hefty premium given these names had been giving good returns. The volatility event, followed with price correction of the overvalued stocks, compels market participants to undertake a reevaluation exercise which results in identification of undervalued stocks. We see that this trend has started, and it is expected to continue till the undervalued stocks rise to become fairly priced or overvalued. **We continue to advise clients to add staggered allocation to their Omni Supreme India/US portfolios and speak to their advisors or reach out to us for any queries.**

Note on the Addition of Secondary benchmarks

We have added secondary benchmarks across all the major strategies for a better performance comparison. India, US and Technology multi-cap strategies warrant a small cap index comparison as up to 40 to 60% allocations have been made to small cap stocks. The right benchmarking is important to be aware of the relative performance which helps investors and advisors to take better capital allocation decisions.

OmniInsight

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

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