DSP Equity Savings Fund

Compound Annualized Returns for DSP Equity Savings Fund	Regular Plan - Growth Option
1 Year	2.0%
2 Year	12.9%
3 Year	7.3%
5 Year	6.3%
Since Inception	7.5%

As on June 30, 2022

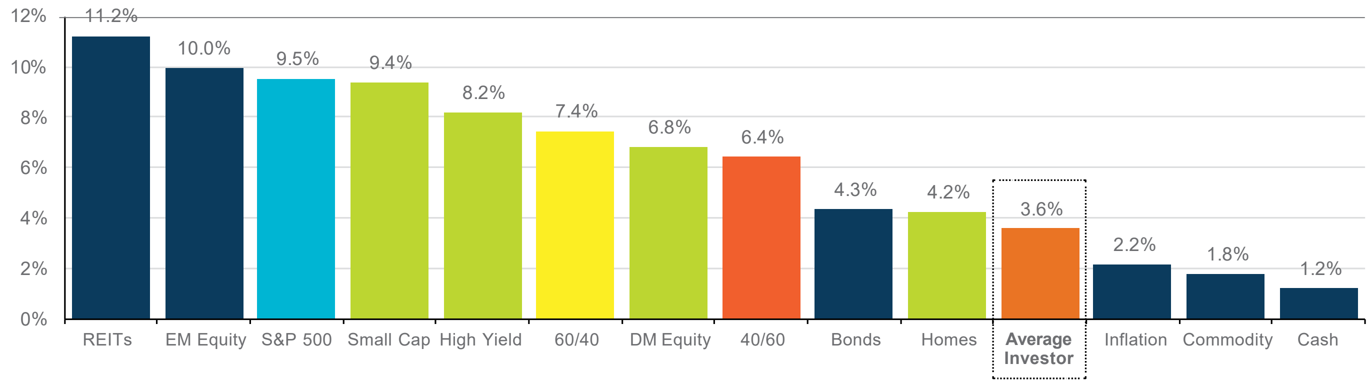
Dear Investor,

We are grateful for the trust you have reposed in us as the stewards of your hard-earned money. Thank you for staying invested.

I am sure you have been asked why do you invest in a “boring” scheme like DSP Equity Savings Fund (‘Fund’). Most of us think in binary terms. Equity or Debt? Often that is the question.

In the last 20 years an average US investor has earned only 1.4% higher returns than inflation. This is when a 60:40 Equity:Debt portfolio has delivered 4.2% higher and S&P500 Index has delivered 7.3% higher than inflation. I haven’t come across any such data for India, but my hunch is the results would be similar. All the debate in our industry is around when to increase or decrease Equity allocation, what are the best performing funds, what exotic strategy is the next big thing – when the low hanging fruits are just being patient and disciplined. Most investors would do fine with a “boring” fund.

20-year annualized returns by asset class (2002-2021)



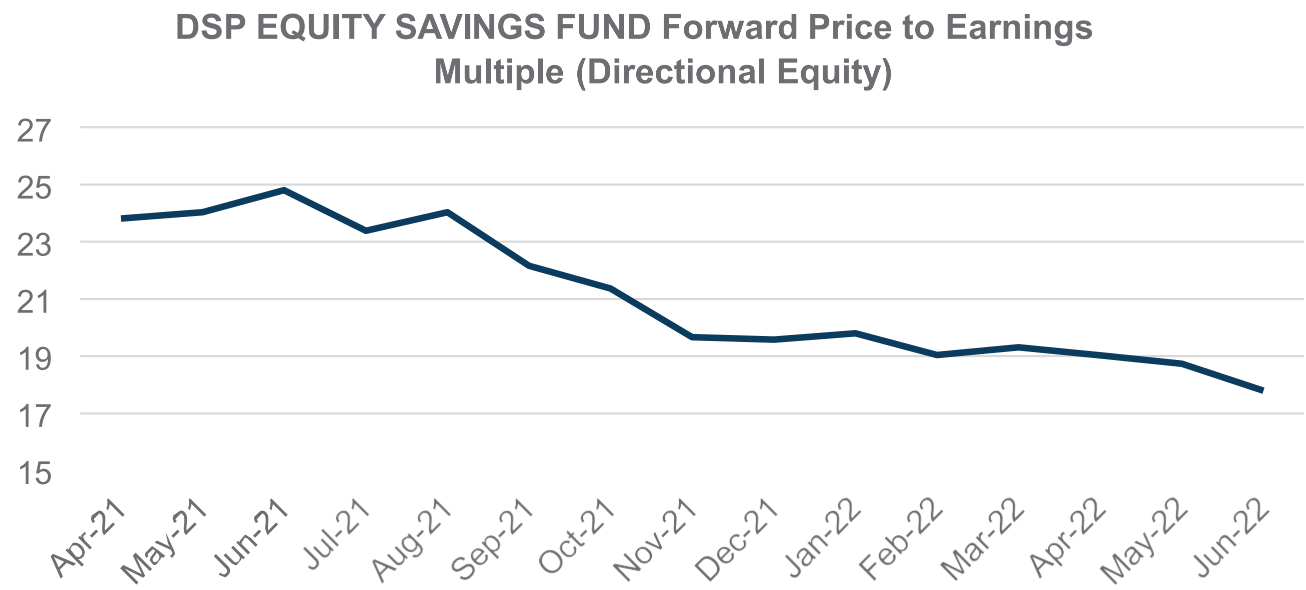
Source: JP Morgan, Guide to Markets Report

Retail investors should be focused on beating inflation and preserving the purchasing power of their capital. Fixed-Deposits might not be the best vehicles for that objective. Rich HNIs (High Net-worth Individuals) focus (or should focus) on staying rich. Their money should be treated as permanent, irreplaceable capital.

A lot of investors anyway have approximately 50:50 allocation to Debt:Equity. Hence the self-serving secret that these investors are better off taking this exposure in a relatively more tax efficient manner through a structure like this fund. The hedges (explained later) if executed independently are taxed at a marginal tax rate. Any rebalancing from debt to equity or vice versa incurs a tax liability if executed independently. A mutual fund structure is more tax efficient in comparison. DSP Equity Savings Fund typically has 40% exposure to Indian Equities and 60% exposure to debt or debt like securities (INVITs/REITs/Cash-Future Arbitrage/Short Term Debt).

40% Directional Equity is hedged with some index options- the cost of which over the last one year (ending 30th June-2022) has been about 0.7%. This is like an insurance premium that we pay to protect us from big unexpected negative surprises. They are more common than one might think. Our back-tests show that this cost is recovered in sharp crashes. It helps in reducing drawdowns (large fall in NAVs). It reduces one more decision that I must take – 'what should be the equity exposure'. I try and maintain it at close to 35% to 40% in the comfort that I have some protection in case of market turmoil (think a war breaking out). I believe the fund might do better if I make fewer decisions. **Structure beats activity** is one of the three core principles the fund operates on. The other two are: **Valuations Matter & Nobody Knows.**

I took over the fund in May last year. Since then, I have brought down the Price to Earnings (PE) multiples (one, often not very good measure of how expensive the portfolio is) of the equity portion in the fund.



Source: Bloomberg

Please note that this is a result of a bottom-up approach of creating the portfolio. I don't focus on what the portfolio PE is or what it should be. PE is not a good measure of valuations at all in case of many business – life insurance for example.

We are coming off a decade-long regime of low volatility and stable inflation. A lot of strategies (not all of them prudent) that have worked in the last decade probably won't work in the next. Geopolitical uncertainty, higher commodity prices & rising interest rates will need realignment in most portfolios that have done well in the past. More than a decade of complacence has made many market participants less sensitive to valuations. This goes against the fundamental tenet of investing: To make money consistently without being lucky, you must buy an asset, no matter how good, for less than its intrinsic worth. Markets will reassert this lesson sooner than later. They always have.

The equity component of this fund has a Value bias. It is not trying to identify the best company. It is trying to identify the best investment. They are not the same.

Over time, 10% from the Debt portion in this fund might be moved to foreign equities making it a balanced 50:50 fund. This will also provide currency diversification. The regulators currently have restricted investments in foreign equities and are in the process of reviewing the limits.

I believe that India is a very expensive market. A lot of businesses of similar or better quality are available at lower valuations globally. There are a lot of great businesses that are not available in India at all. We are looking for the proverbial one-foot hurdles – wherever we may find them.

I believe it's easier (not easy) to pick three businesses that might beat the Index than a portfolio of 20 stocks. This coupled with currency diversification, lower correlations and a larger consideration set makes including global stocks in the portfolio an easy and prudent choice.

We have about 7.5% exposure to INVITs. I have stayed away from REITS because the power INVITs had assured cash flows and were available at an attractive yield. REITs have uncertainty regarding occupancy and rental escalations. The number of publicly listed Invits/Reits is probably only going to grow over time. I plan to keep evaluating this space.

DSP Equity Savings Fund will probably not be the best performing fund in your portfolio. I believe it might help you avoid panic during market turmoil and stay invested longer. It might help you do better than the "average investor". If you are sure Equities will do well and you think you are temperamentally equipped to handle the associated volatility, you might consider being in an Equity-only fund. If you think Equities are going to crash or stay range bound for a long time you should probably be in Debt funds. Many investors are unsure most of the time and they are rarely right when they are sure. I believe this "boring" fund of yours could be a default choice for many of them.

In my first letter I had mentioned that I am happy investing my incremental savings in DSP Equity Savings Fund. I have significant investments in the fund and I will continue to invest more. From June-2022 I have been appointed as the Fund Manager for DSP Top 100 Equity Fund as well. I will be investing over and above the regulatory requirements in that fund as well, going ahead.

For any queries you can write to me at ESFPortfolio.Queries@dspim.com. The rest of the letter (Appendix) is about some dumb and some not so dumb decisions that I made during the last year managing your capital and some views on the businesses that you own through this fund.

Thank you for being patient, conservative and a little detached. It makes my job easier and improves the odds of better investing outcomes for you.

Sincerely,

Abhishek Singh

Appendix

Appendix

Directional Stock Portfolio (As on 30th June 2022)

No.	Stock	% of AUM	% of Equity (Assuming 40% Exposure)
1	HDFC Bank Ltd	4.9%	12.3%
2	ICICI Bank Ltd	3.9%	9.6%
3	SBI Life Insurance Co Ltd	3.1%	7.6%
4	ITC Ltd	2.8%	6.9%
5	HCL Technologies Ltd	2.6%	6.6%
6	Sharda Cropchem Ltd	2.2%	5.6%
7	Axis Bank Ltd	2.1%	5.1%
8	Hero MotoCorp Ltd	1.8%	4.5%
9	Aptus Value Housing Finance India Ltd	1.5%	3.9%
10	Crompton Greaves Consumer Electricals Ltd	1.4%	3.5%
11	Cipla Ltd/India	1.3%	3.2%
12	Lupin Ltd	1.2%	3.0%
13	Ipca Laboratories Ltd	1.2%	2.9%
14	UltraTech Cement Ltd	1.2%	2.9%
15	Coromandel International Ltd	1.1%	2.8%
16	Eureka Forbes Ltd	1.1%	2.8%
17	Alkem Laboratories Ltd	0.8%	2.1%
18	Infosys Ltd	0.8%	2.0%
19	TeamLease Services Ltd	0.8%	1.9%
20	Manappuram Finance Ltd	0.7%	1.7%
21	ICICI Lombard General Insurance Co	0.5%	1.1%
	INVITS/REITS		
1	PowerGrid Infrastructure Investment Trust	3.90%	
2	India Grid Trust	3.40%	

Source: Internal

The Dumb Stuff

I added Manappuram, a gold finance NBFC which was trading at single digit PEs. This business has high capital adequacy, and the call was "it doesn't even need to grow". If you continue to make 20% ROE (Return on Equity), that is the rate at which you compound your book value. But I still ended up paying too high a price in retrospection. This was due to high competition in the segment. Our core thesis based on multiple channel checks was that a gold loan consumer doesn't go beyond a 3 KM radius of his home for the loan. He doesn't hunt. This is not true in the higher ticket size segment. But it seems the consumers are hunting. The competetive intensity has started to wane. And there is significant margin of safety at current price. But I misread the situation and got my value estimate wrong before.

There were multiple errors of omission (which I assure you will always be the case). But the one I regret the most is Mahindra and Mahindra at Rs. 700. All our analysis showed that the downside was limited from that point. You can see, I do not have significant exposure to Autos - the only segment in consumer sector, probably, that according to me was trading below intrinsic value. I was just too greedy waiting for a better price. A large part of my framework is buying businesses where the downside is low.

Download my framework here.

Markets tend to surprise on the upside on these names. Similar situations panned out in a few utilities.

The Not So Dumb Stuff

I reduced exposure to IT & Cement (probably not aggressively enough) when things were looking good. The companies were surprising positively on earnings and the street was upgrading estimates. The thesis here was- at greater than 30X forward PE, some stocks were factoring in 15% growth figure for many years. Given historical base rates and industry structure, this is unlikely. It was as simple as that.

I am happy buying IT at mid-teen multiples of normalized earnings and extremely happy buying them at low teens. This is simple algebra for me.

I also exited from textile, dairy & chemicals company primarily based on what in my view were extreme valuations.

A decision that worked better than expected was an investment in Shardacrop Chem Ltd. This company was available at a single-digit PE with significant growth (reported as well as potential), clean balance sheet, high return ratios. This business, thankfully for us, is not understood very well (same as insurance). I am a little concerned with the sharp rerating in the stock. Something that doubles in 6 months just makes me anxious.

I bought ITC Ltd. when the downside seemed low. Such ideas are not exciting. People want a good narrative and triggers. May the tribe of such people grow for the sake of value investors.

The Usual

As you notice, your fund has significant exposure to Banking, Financial Services and Insurance. These businesses are trading at a significant discount to their historical averages at a time when their balance sheet quality is probably the best it has ever been and credit growth has been low for a long time. So we are buying them at a low point in both their valuation as well as business cycle. Banking is a polarizing business. Some (great) investors absolutely hate it. Levered business that lend long and borrow short. Valid criticism. Hence it has not been profitable on average to be in turn around stories in the sector or in trying to hunt for the next HDFC Bank. A 500% ROIC (Return on Invested Capital) business is inferior if it doesn't require capital and is not growing compared to a 20% ROIC business growing at 15% and constantly reinvesting profits.

There are four names in the portfolio that I want to switch out of, at an opportune time. A year is a blip in investing. Hopefully by the time I write next to you this number would be zero.

For any queries on specific holdings feel free to write to ESFPortfolio.Queries@dspim.com

Fund	Product Suitability	Scheme Riskometer	Nifty Equity Savings Index TRI
DSP Equity Savings Fund (An open ended scheme investing in equity, arbitrage and debt)	This Scheme is suitable for investors who are seeking* • Long term capital growth and income • Investment in equity and equity related securities including the use of equity derivatives strategies and arbitrage opportunities with balance exposure in debt and money market instruments		

*Investors should consult their financial advisors if in doubt about whether the product is suitable for them.

Past performance may or may not be sustained in future and should not be used as a basis for comparison with other investments. There is no assurance of any returns/capital protection/capital guarantee to the investors in the Scheme. The investment approach / framework/ strategy / portfolio / other data mentioned herein are dated and currently followed by the scheme and the same may change in future depending on market conditions and other factors. The sector(s)/stock(s)/issuer(s) mentioned in this document do not constitute any recommendation of the same and the Fund may or may not have any future position in these sector(s)/stock(s)/ issuer(s).

The comparison with Bank Fixed Deposit (and other traditional saving instruments) has been given for the purpose of the general information only. Traditional savings instruments are comparatively low risk products and are backed by the Government (except 5- year recurring deposits). Investment in mutual funds carries high risk as compared to the traditional saving instruments. Scheme Performance in SEBI prescribed format and Performance of other schemes managed by the fund manager and other scheme related details and disclaimers **click here**

Mutual Fund investments are subject to market risks, read all scheme related documents carefully.