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SPOTLIGHT

'We're not deep value, quality or growth at any price investors'

Rahul Singh explains what's worked and what's not since he took over the reins of Tata AMC's equity division

Rahul Singh,
Chief Investment Officer
(CIO) – Equities,
Tata Asset Management



Lately, a few Tata equity funds have come under the spotlight for delivering exceptional returns. Rahul Singh, the fund house's chief investment officer of equities, sat down with us to explain the turnaround and the core philosophy driving them. During the interview, he also shed light on why their equity funds suffered in the 2020-21 period and which sectors can potentially deliver going forward. Here is the edited transcript of the interview.

Indian equity markets have been subdued. Given the concerns of a global slowdown and recession, how do you look at the markets?

The risk of a global slowdown is obviously real, as there is inflationary pressure and interest rates have risen. But thankfully, India is at a different stage in its cycle this time. Typically, when interest rates rise, countries with weak banks or a weak corporate sector experience a crisis or

slowdown. The balance sheets of both the corporate sector and the banking industry in India are in good shape today. So, while this is not a problem in India, the rest of the world may be under strain. While there will be some impact on Indian markets, it won't be as bad as what other markets are experiencing.

Second, our investment cycle is resuming, and India is benefiting from the geopolitical situation because many countries want to set up factories or expand their base in India. The current situation has some advantages and disadvantages for the Indian context. It will not be a major issue if the US and global markets or the global economy slow down gradually. In that scenario, Indian

markets will remain range-bound for a while longer, and returns will resume once the economy and valuations normalise. However, if there is a severe recession, everyone suffers.

Having said that, we have seen corrections in the Indian mid- and small-cap markets, and I believe now is a good time to continue

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investing. In the future, when the cycle shifts, mid- and small-cap companies tend to fare well. Given what's happening in the global markets, it is an excellent opportunity to build a portfolio or gain exposure to these segments, whether it is a mid-cap, small-cap, or multi-cap portfolio. I believe these portfolios will perform well over the next two to three years. In the near term, investors should also focus on asset allocation and make balanced advantage funds an important part of their strategy.

Have you altered your investment strategy in response to changing geopolitical factors?

So, while we must be aware of all these changes, our investment philosophy at Tata is growth at a reasonable price (GARP), meaning we seek growth but do not want to pay exorbitant prices. We want to find companies that are undervalued and entering a growth phase. And with interest rates rising, the market itself has become conscious of valuation, which is consistent with our philosophy. So, to be honest, our strategy has not required much adjustment in that regard, except that the fundamentals of the sectors are constantly changing, especially in IT and Banking. So far, we have been very optimistic about the financial services or banking sector. Similarly, capital goods and industrials have experienced a revival as manufacturing and investment have returned to Indian markets.

Can you elaborate on the 'growth at reasonable price' (GARP) and how you use this investment philosophy at Tata?

Our GARP strategy involves three steps before selecting a stock. We

look at companies trading at multi-year valuation discounts but whose earnings are in the early stages of improvement in the value trigger. We then examine if earnings recovery expectations are low, despite fundamentals indicating otherwise. This can lead to earnings upgrades. Finally, we look for more niche or turnaround stories in the thematic segment.

India is a growing market. We must continue seeking growth, as pure value strategy can be quite cyclical. As a result, we are neither deep value nor quality/growth-at-any-price investors.

We believe it's an excellent opportunity to gain exposure in mid-, small- and multi-cap portfolios. I believe it will perform well in the next 2-3 years.

You took over as the CIO of Tata Mutual Fund in October 2018. What were the measures you undertook to improve the performance of the equity schemes?

I joined four and a half years ago, and the philosophy has stayed the same, which is one of the reasons we have been improving. During such journeys, it is normal to undergo minor process improvements, such as incorporating macro inputs or making the research analysts more accountable for their recommendations. Second, we have defined the outlines of the GARP strategy, leading to improved teamwork. Furthermore, the team has been relatively stable over the last four to five years,

contributing to the steady performance of the schemes.

What role does benchmark allocation play in your equity schemes' portfolio construction?

Different schemes have different approaches. For example, benchmarks play an important role in large-cap funds. In contrast, in sector funds (Tata has a digital fund and pharma fund, among others), we take more active bets, and their benchmark is relatively less important because you're trying to create alpha within the sector. At the fund house, we also adhere to some risk guidelines. For example, we have guidelines on how much liquidity we must maintain in a specific scheme. While all our funds are fairly within limits, we have certain liquidity thresholds and minimum cash holding requirements, especially for mid and small-cap funds.

How much flexibility does a fund manager have in managing their portfolio? How has it evolved over the years?

You will not find super expensive or deep-value stocks in our funds. Even if the fund manager favours growth, he will not purchase overpriced stocks. In addition, there are small variations as scheme mandates differ from each other (value, growth or thematic bias). It is necessary to understand what the scheme intends to accomplish. For example, I oversee the Tata Business Cycle fund, which is more than a year old. In this fund, I take more aggressive top-down bets on sectors and am less concerned about the benchmark. Having said that, we will not deviate from the core GARP philosophy.

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Most of your equity schemes slumped in 2020 and for most of 2021. Any specific reasons?

Covid and lower interest rates led to madness in the valuation of high-quality growth stocks and even IT stocks, which we typically didn't have in our portfolio due to the GARP philosophy. Second, we were overweight on banks, and many people feared the worst for them at that time. People expected banks to be saddled with bad loans, putting financial stocks under strain. However, our performances improved significantly when investors realised that banks were perfectly fine.

- 1 In fact, some of your funds – Tata Small Cap Fund and Tata Large & Midcap Fund being the prominent ones – recovered to deliver strong returns.

The same fund manager manages both funds. As

markets become more valuation-disciplined, the types of stocks we own improve, and while this improvement is most visible in these two funds, it can also be seen in other funds. This is the common thread that connects all of the funds. And it has worked even better in these two funds because the style is more bottom-up and valuation-conscious.

I also feel that five to six stocks must perform well for you to improve the performance of schemes. It's not just one stock; typically, five to ten stocks contribute to our performance. For example, one of the companies is a beverage company that was available at very low valuations, and we could see that because

they are entering new markets, their growth will be independent of market growth. Similarly, there are numerous examples of small-cap manufacturing companies. We saw a significant capex cycle and industrial cyclical recovery in the market. However, before investing in a small-cap company, we could consider an additional layer of quality: the company may have the potential to grow at 25 per cent at a reasonable valuation and have low debt.



However, some funds (like flexi-cap and mid-cap) still lag most of their peers in the respective categories. How do you plan to stage a turnaround?

We always try to reflect on our mistakes and correct them, which is an ongoing process, but we will not deviate from our core philosophy. We need to identify the causes of failure and what stocks did not perform well. It's a never-ending process. Even when large and mid-cap funds were underperforming, we performed a similar exercise and made minor tweaks. However, we left the overall portfolio alone because we were confident in our call in the banking sector.

It isn't always necessary to do

something to prove something. Yes, some funds may require additional corrective measures, and we have made significant changes in those funds in the last six months. We have added manufacturing names and reduced exposure to consumer names in some funds, and now we are just waiting for our call to play out. We are confident that some of our changes are in the right direction and will begin to improve those schemes as well. We now have a more aligned portfolio, which will be advantageous when the investment cycle recovers, resulting in better performances in banking and manufacturing sectors.

With over two and half decades of experience in the Indian equity markets, can you please share your learnings from evaluating businesses and managing portfolios? If you had to share a piece of advice with a new investor today, what would it be?

Asset allocation is critical, in my opinion. As a result, the 60-40 or 50-50 mix is an ideal asset allocation mix in today's markets. That is the most critical piece of risk management advice I would give. This is not a time to avoid equity; instead, it is a time to manage your risk properly. Portfolio sizing—how much to allocate to what types of ideas—becomes extremely important. That has been my most important lesson from a portfolio-building perspective. Another thing I learned is that while everyone talks about value and growth, I believe GARP is an evergreen philosophy for Indian markets because it allows you to avoid significant style bias and still focus on growth. ☑