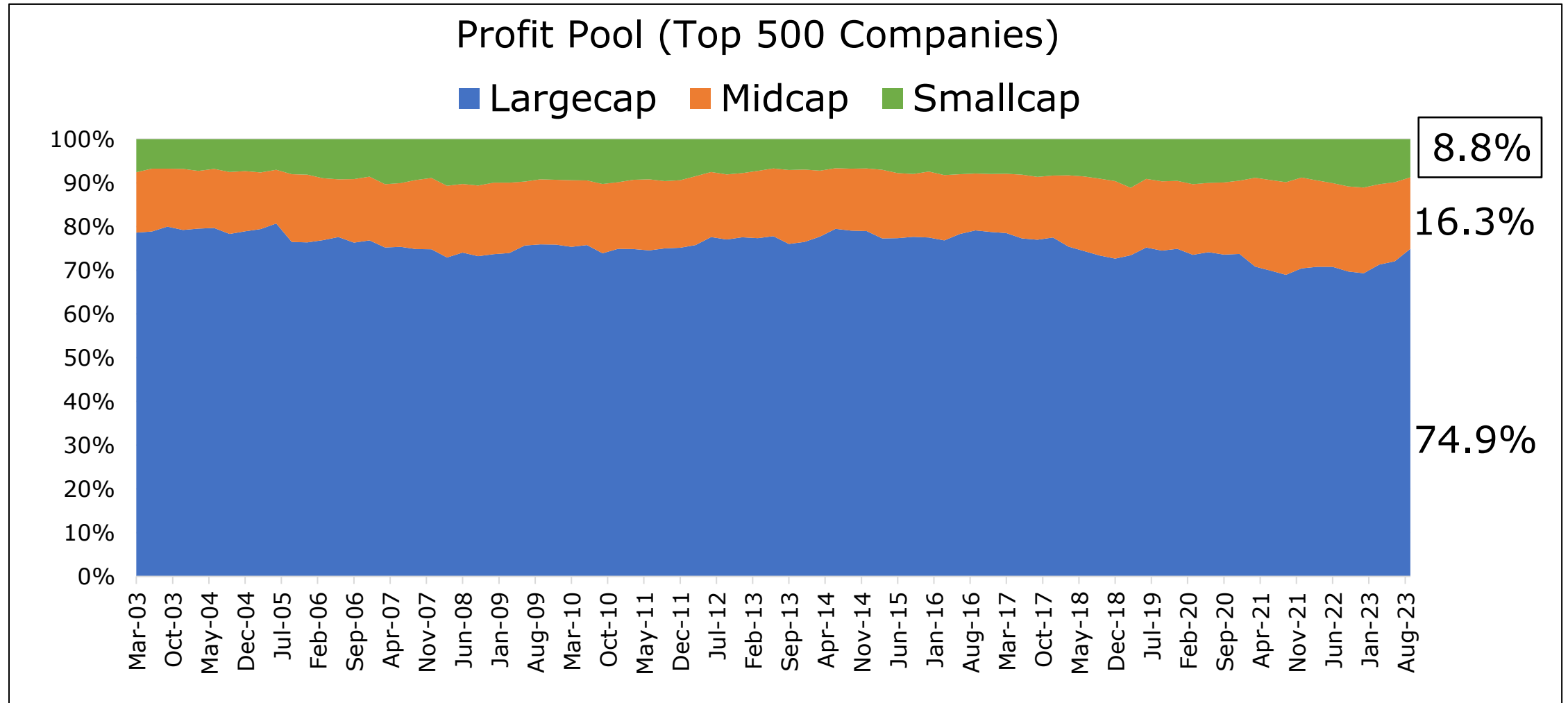


Navigating the Smallcap Landscape

Context

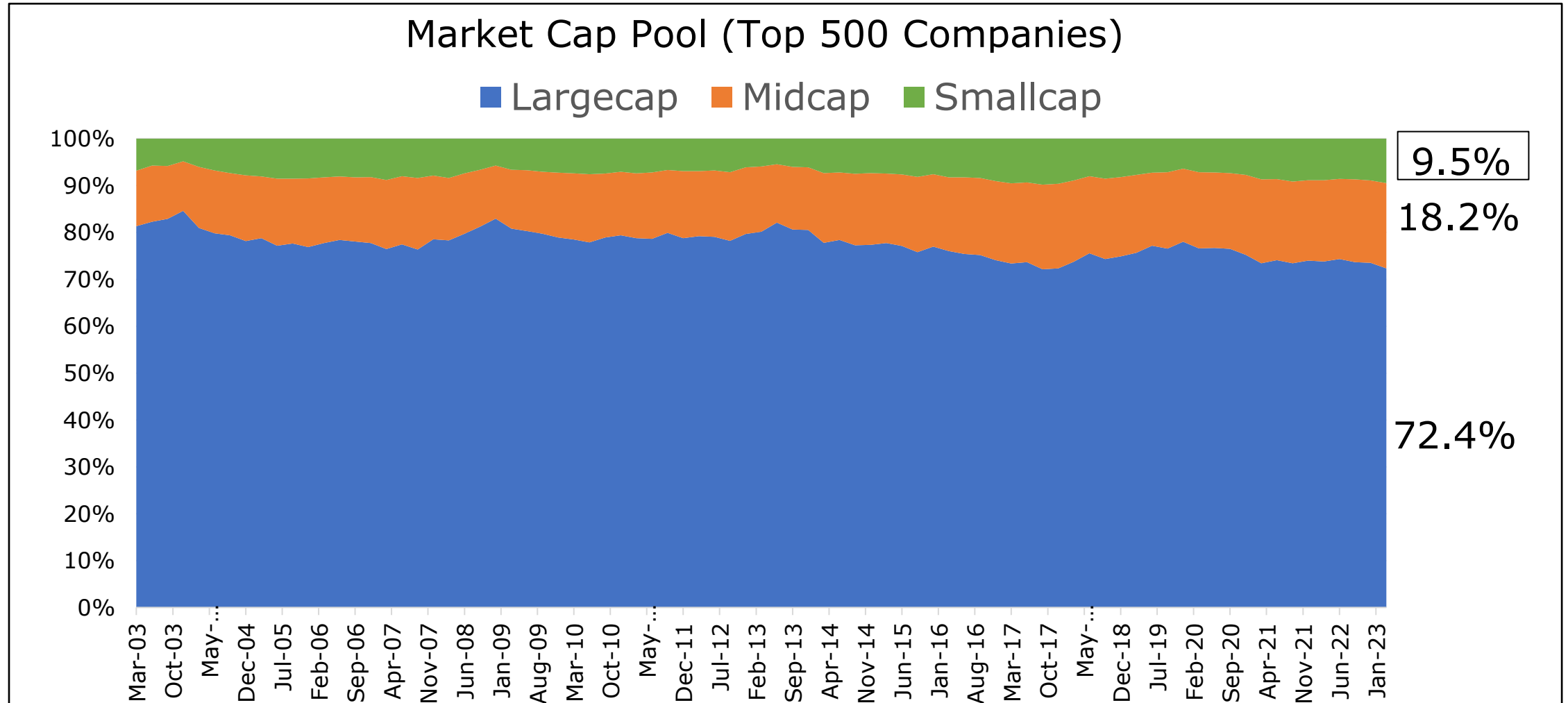
Smallcaps comprise 8.8% of Profit Pool



* Excludes Firms in Loss

Source: PPFAS AMC Research, Bloomberg, Ace Analyser

Smallcaps comprise 9.5% of Marketcap Pool



HRITHIK



HDFC Bank

Reliance Ind

Infosys

TCS

HDFC

ITC

Kotak Mahindra Bank

SALMAN



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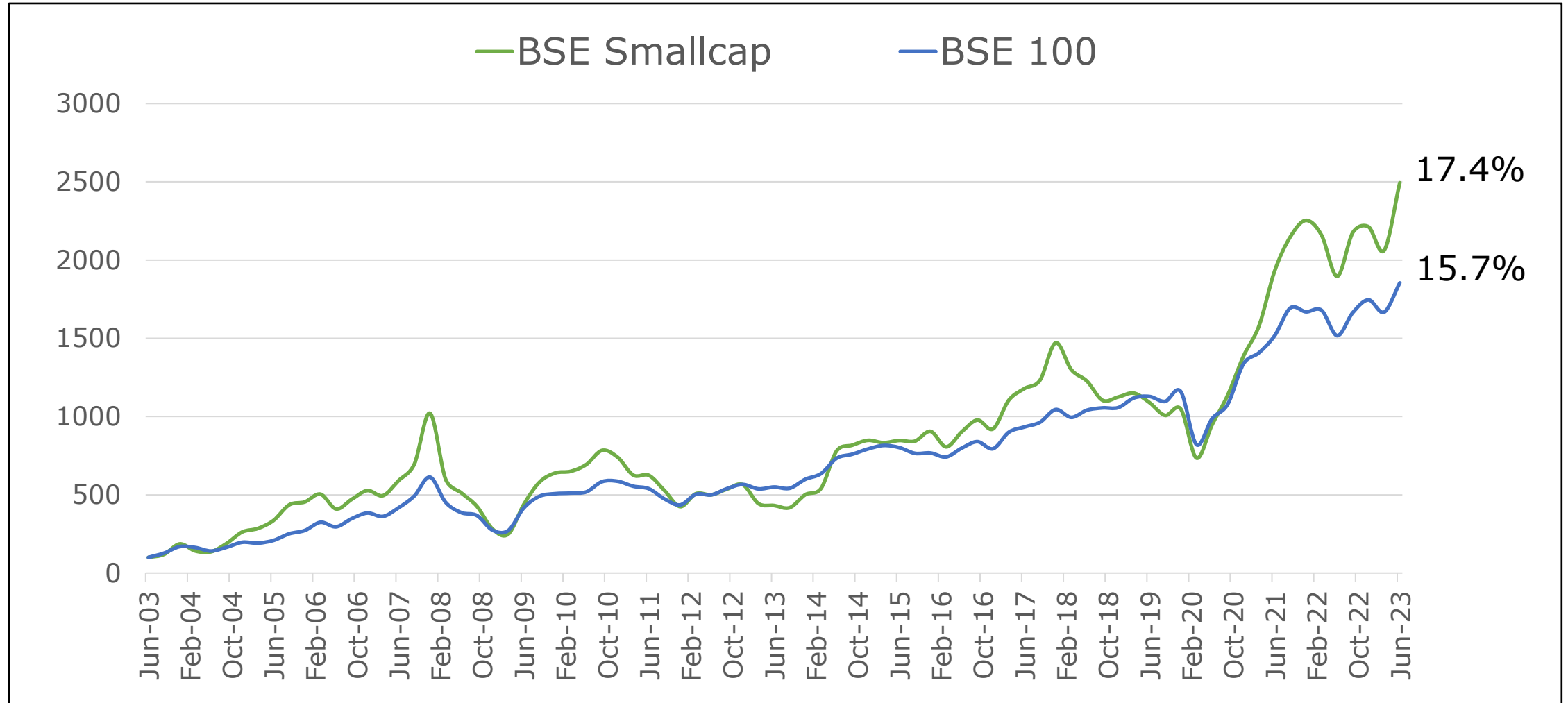
News / MARKETS / Stocks / 6 SALMAN stocks delivered up to 37% return, beating Sensex in 2022

 Feedback

6 SALMAN stocks delivered up to 37% return, beating Sensex in 2022

NTPC has gained 33 per cent to Rs 165.55 compared with Rs 124.40 at December 2021 end. SBI has risen 30 per cent so far this calendar, to Rs 596.75 from Rs 460.45 apiece

Index Performance : Slightly Better Returns Much Higher Volatility



Academic Research

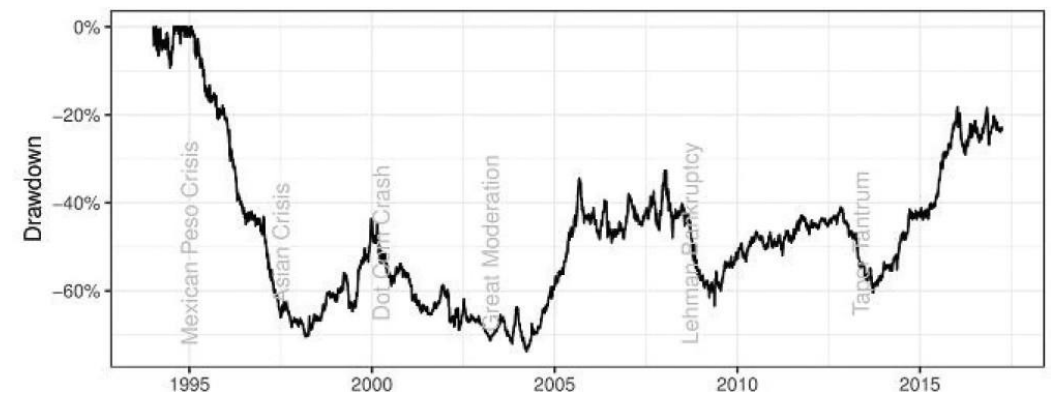
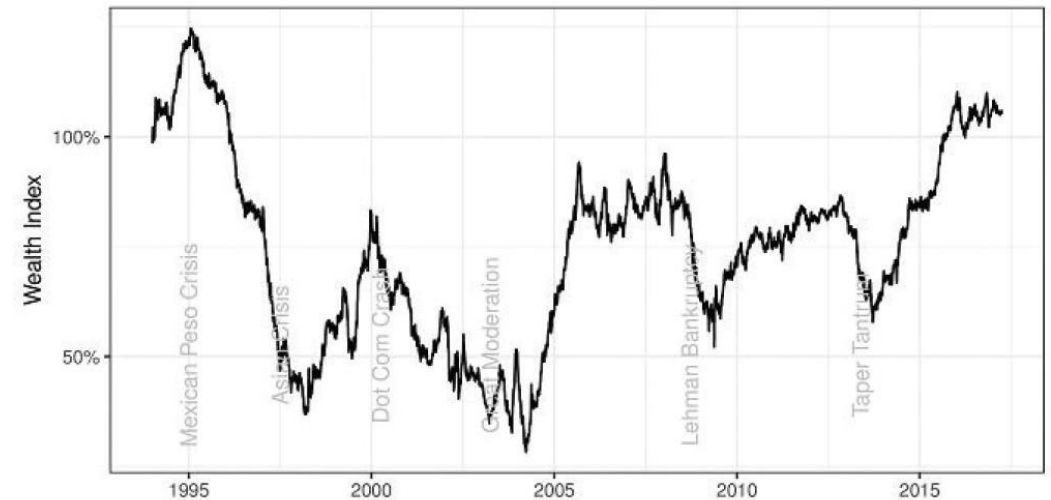
Research and Publications

Four factor model in Indian equities market

(Revised version of IIMA, W.P. No. 2013-09-05, Revised on September 5, 2014)

Sobhesh K. Agarwalla, Joshy Jacob & Jayanth R. Varma

Size Factor (SMB)



Source: Agarwalla, S. K., Jacob, J. and Varma, J. R. (2013), Four factor model in Indian equities market, Working Paper W.P. No. 2013-09-05, Indian Institute of Management, Ahmedabad

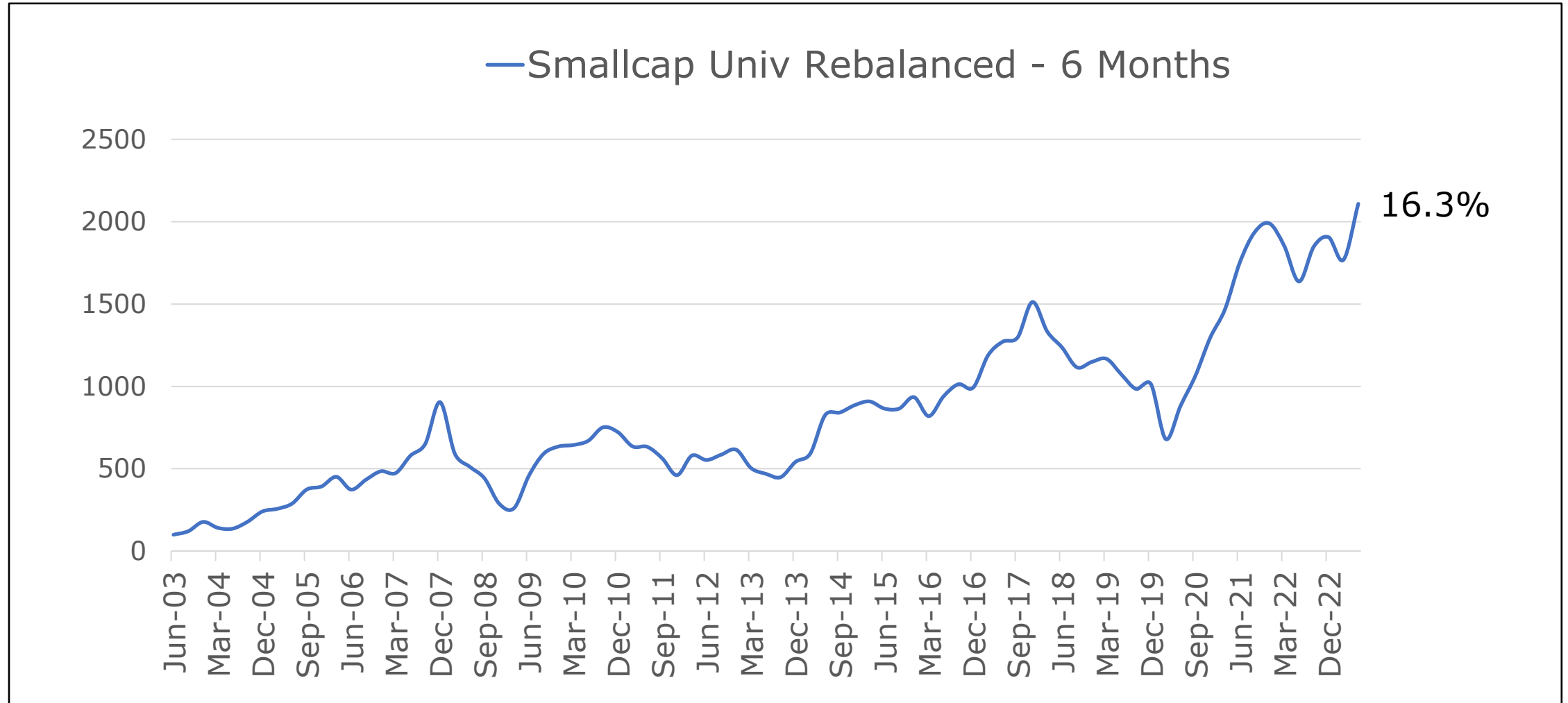
Academic Research

		Value as measured by B/M ratio		
		Value (V)	Neutral (N)	Growth (G)
Size	Big (B)	BV	BN	BG
	Small (S)	SV	SN	SG

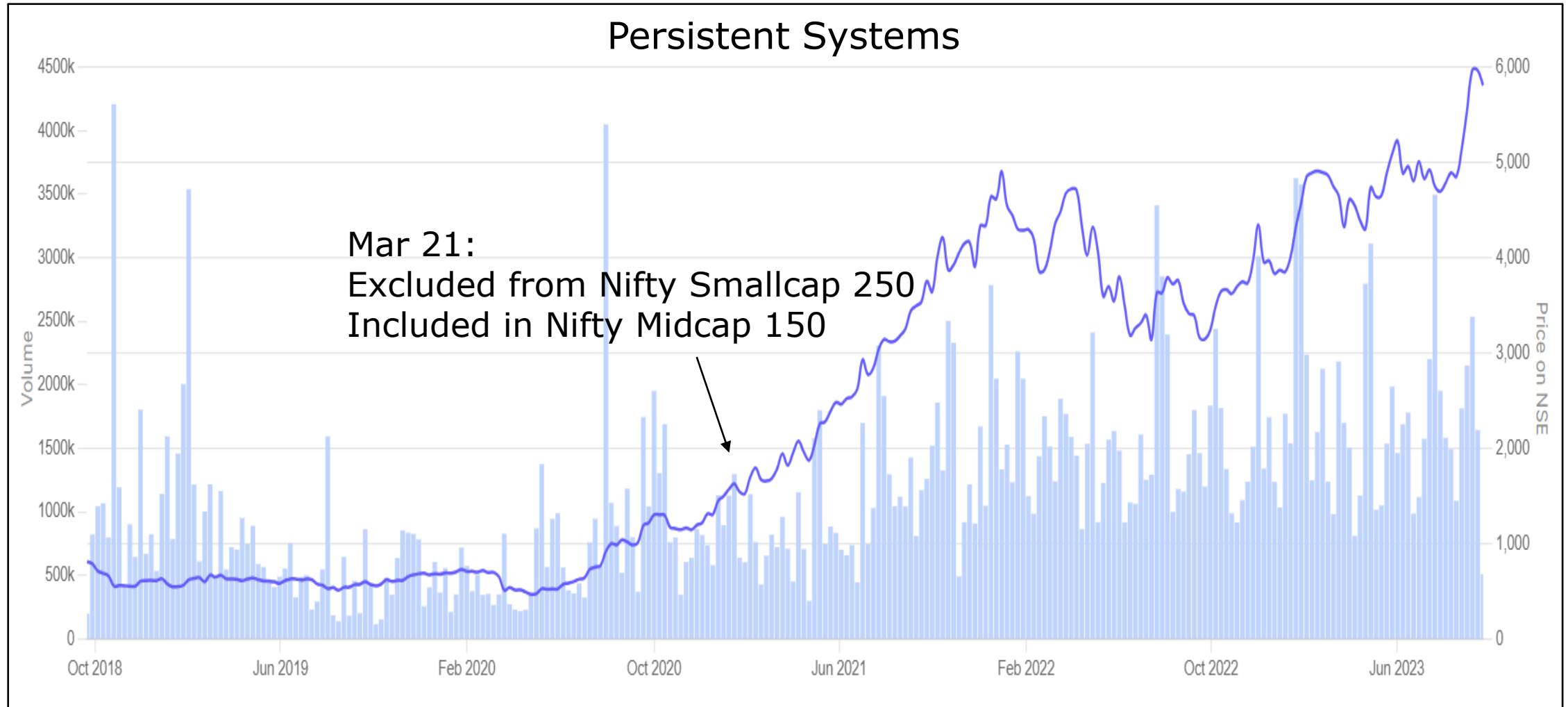
Put differently, SMB is the simple average of three return differences: $SG - BG$, $SN - BN$ and $SV - BV$, each of which is a difference between two portfolios that are matched in terms of value and differ only in size.

Is there an Opportunity?

Starting with Smallcap Universe(250-500) Mkt Cap Wtd: Rebalance every six months



Negative Momentum Effect – Selling Winners Early



Negative Momentum Effect – Selling Winners Early

- Smallcap Indices are reviewed every 6 months
- If larger Smallcaps do well, they become Midcaps and are removed from the Index
- Since 2018, 70 stocks removed from Nifty Smallcap 250 index were included in Nifty Midcap 150 Index

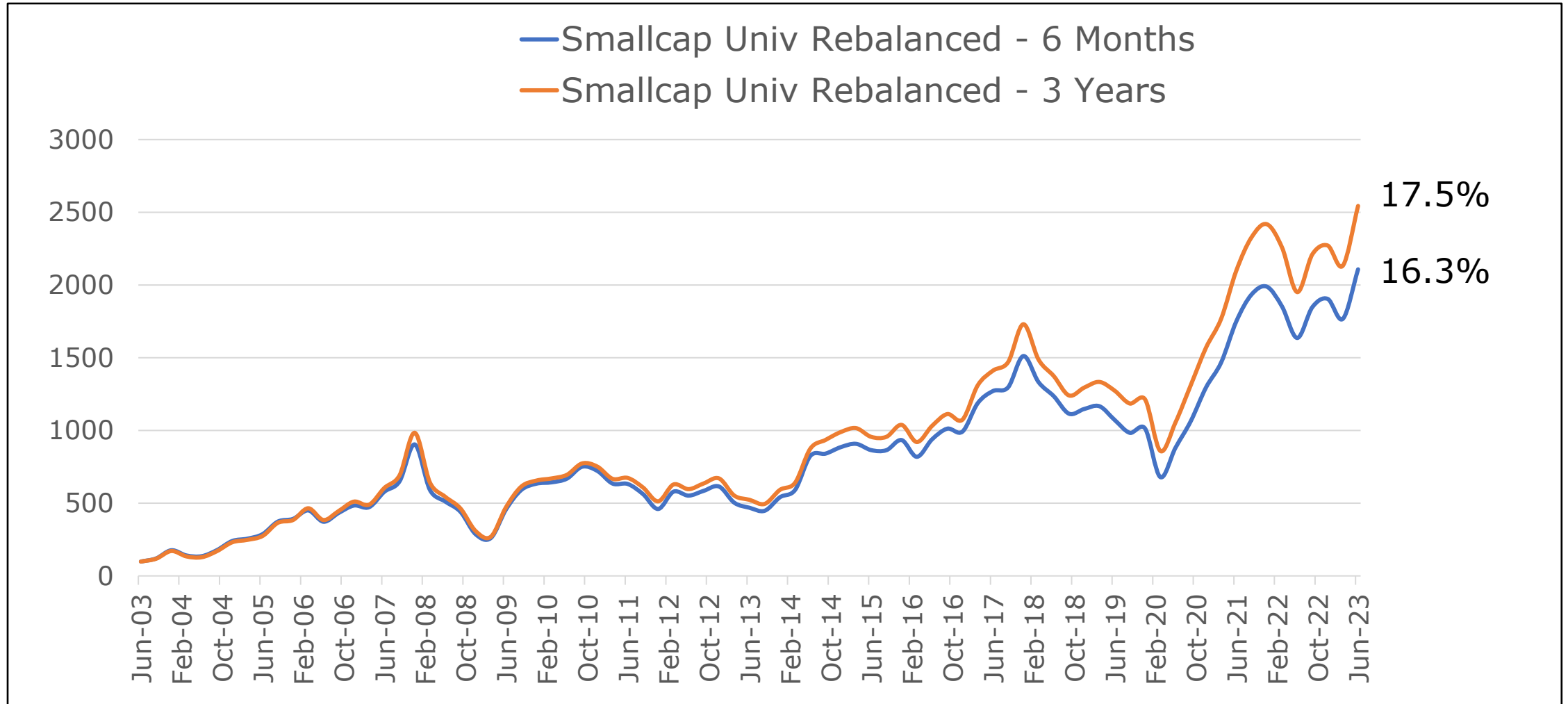
Stocks excluded from Smallcap Index and added to Midcap Index	6 Month	1 Year
Probability of Outperformance	53%	39%
Average Outperformance	6.6%	4.8%

** Excludes stocks which went through corporate restructuring post rebalance*

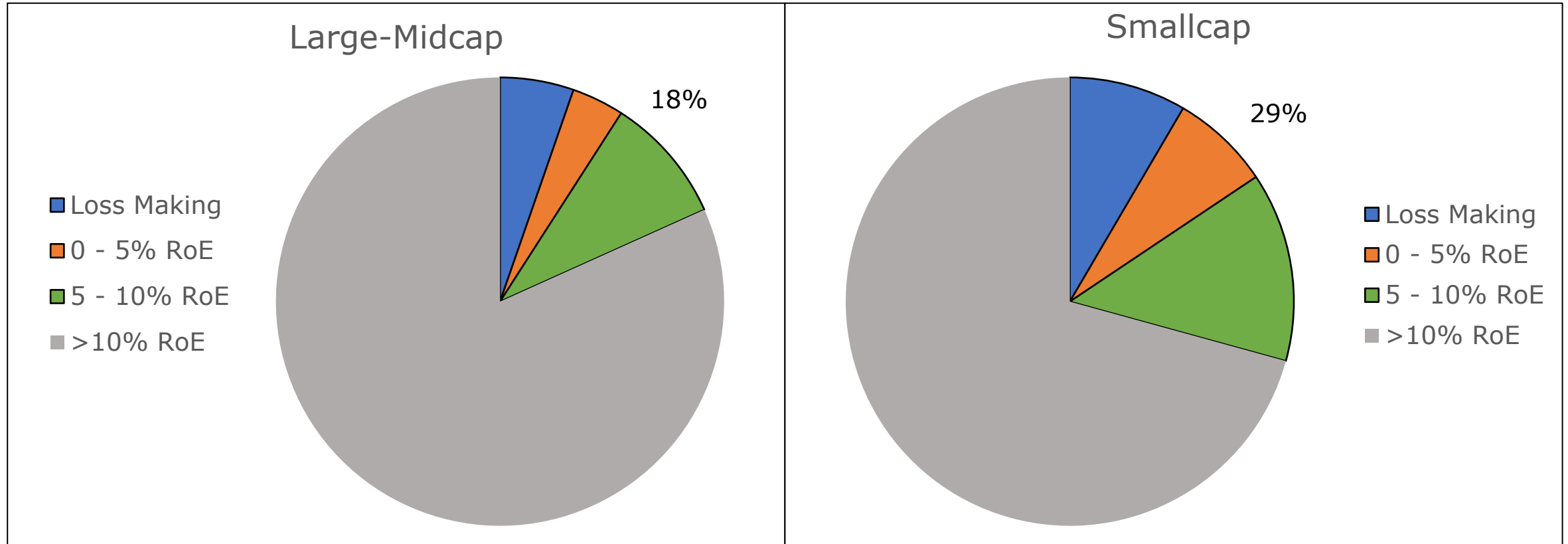
Active Mutual Funds have some flexibility in rebalancing and portfolio allocation

Select Smallcap MFs	Portfolio Composition (%)			
	Largecap	Midcap	Smallcap	Debt & Cash
Fund A	14	14	69	3
Fund B	4	9	80	8
Fund C	1	16	70	14
Fund D	3	16	71	11
Fund E	4	22	67	7
Fund F	18	3	69	11
Fund G	1	3	87	8
Average	6	12	73	9

Rebalancing every three year improves performance

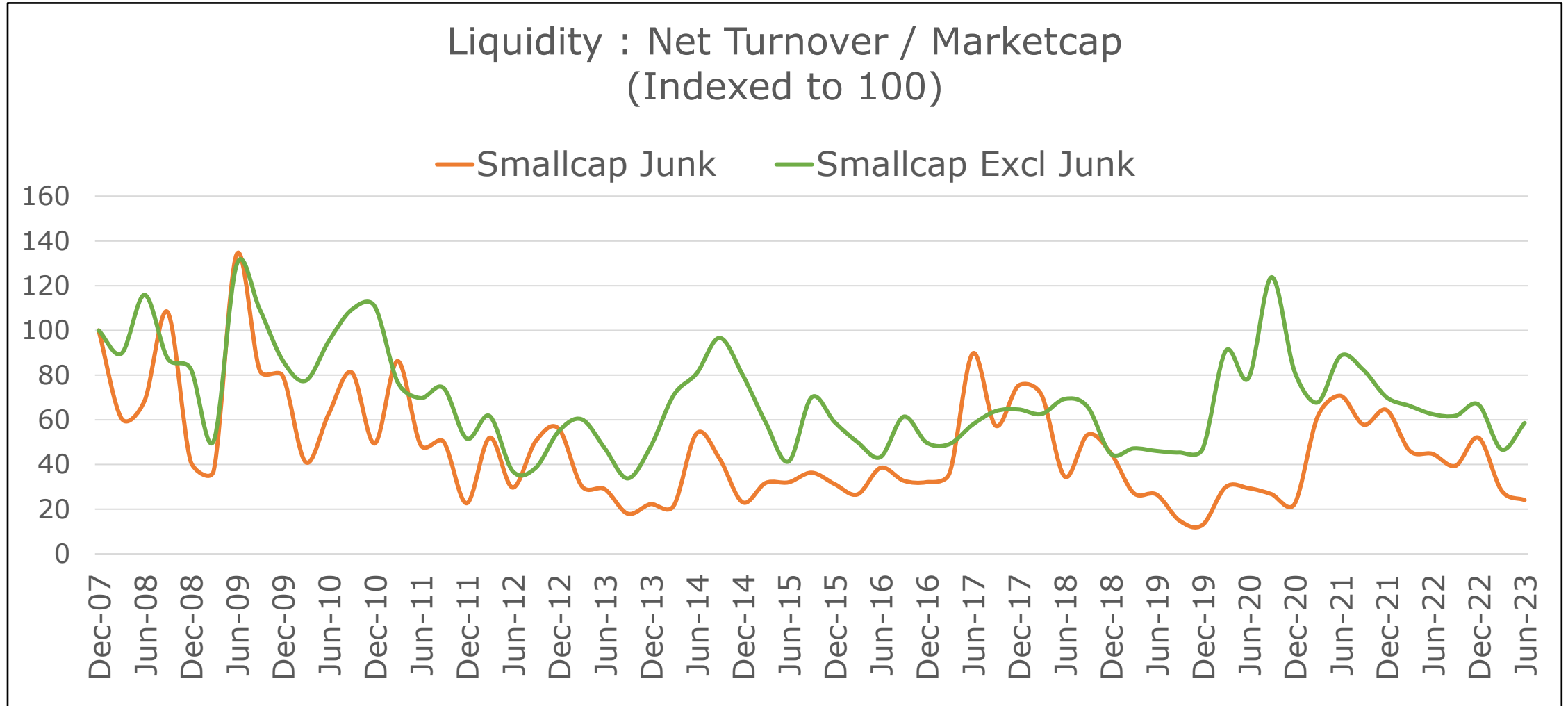


Smallcaps have more junk stocks

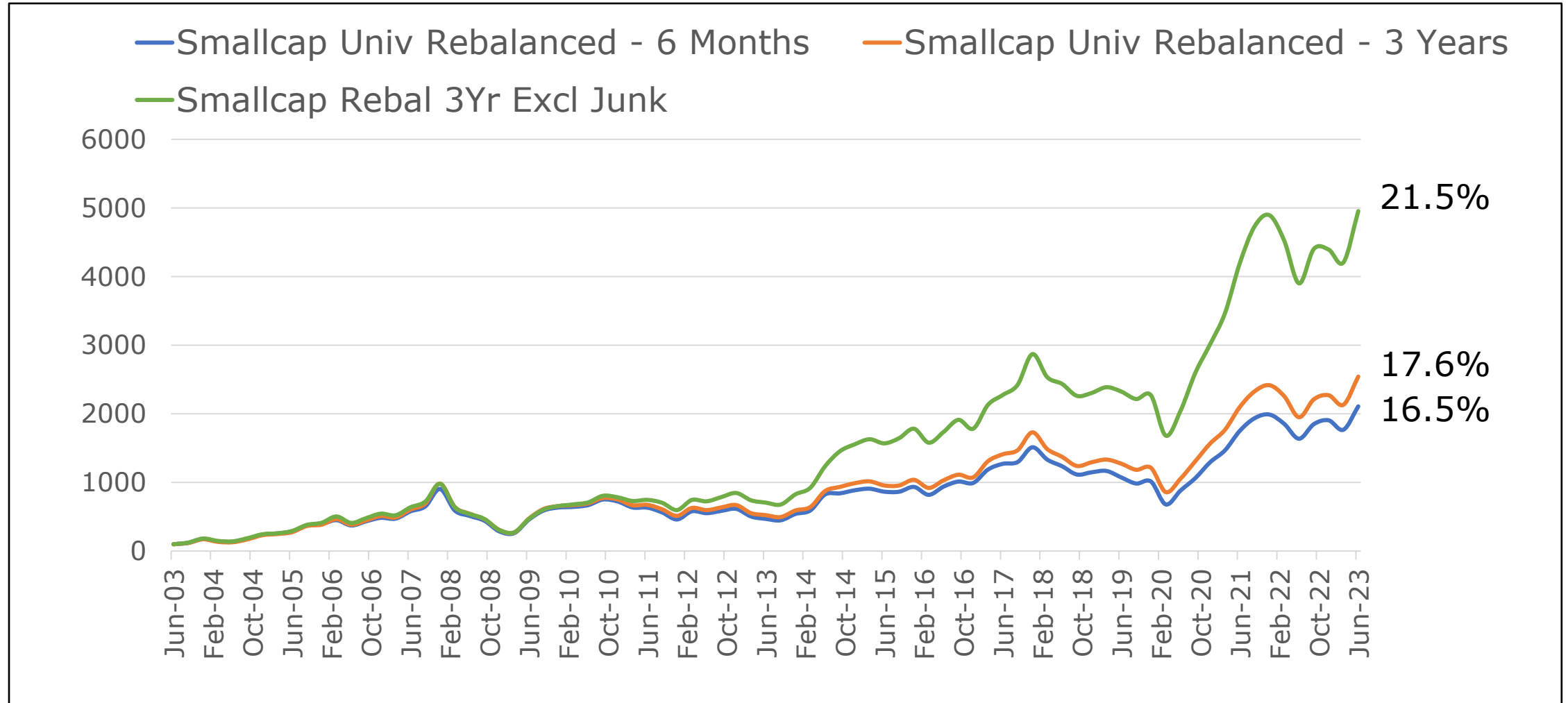


* 5 Year Average ROE; Data of stocks from 2003 - 2023

Junk stocks also tend to be more illiquid in bad markets

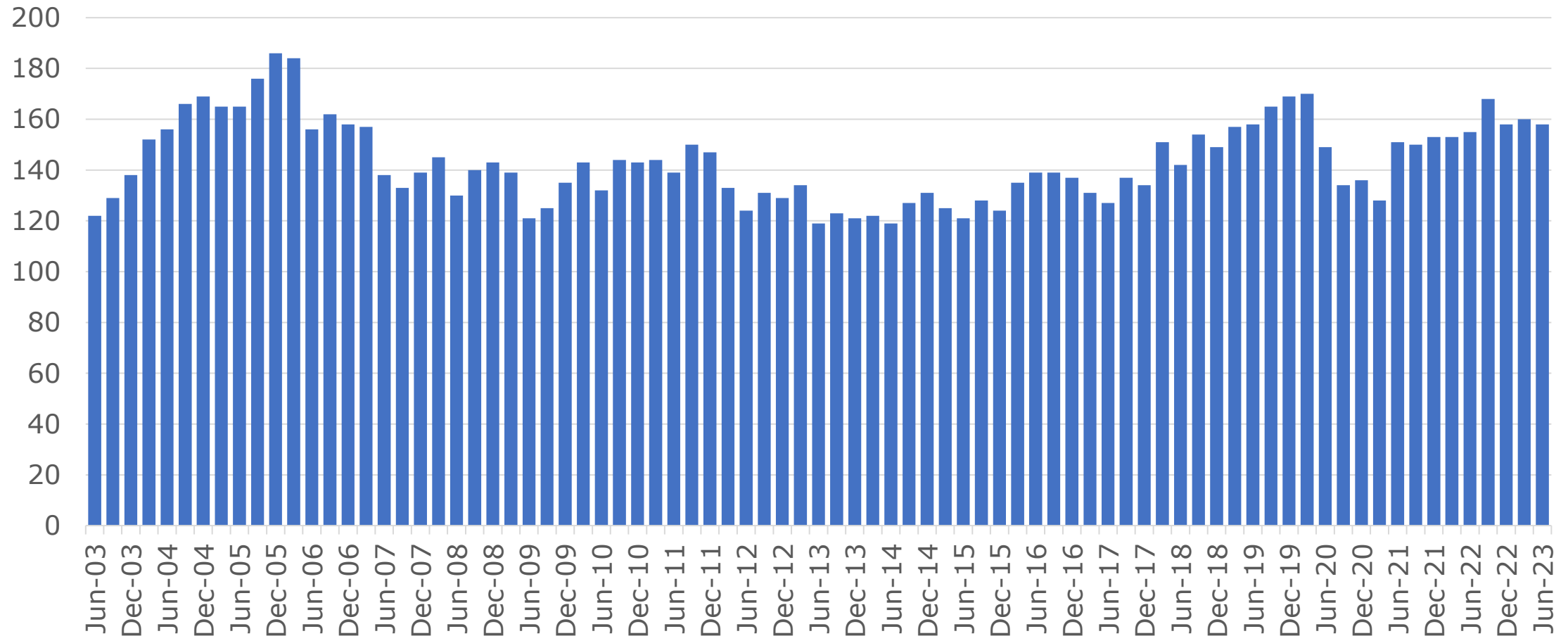


Smallcaps excluding junk can produce decent returns

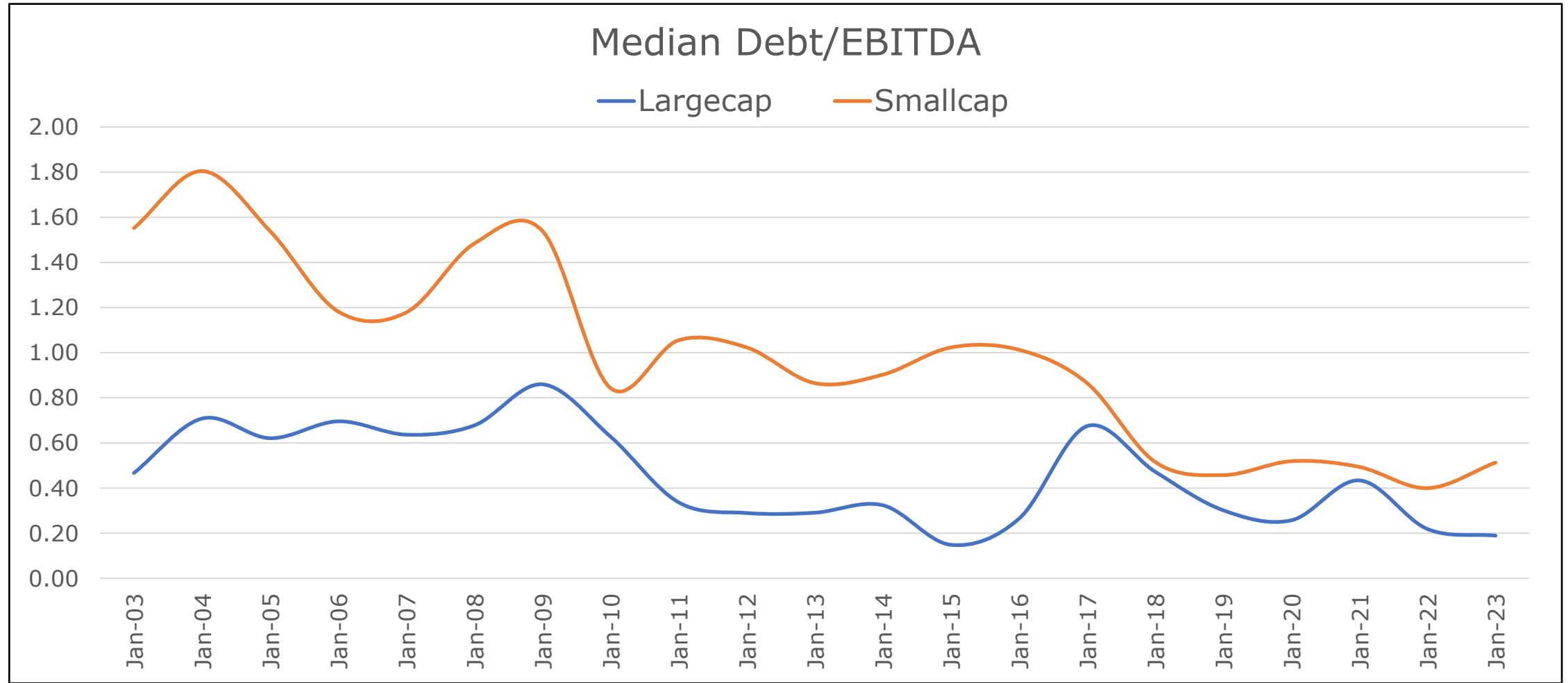


Smallcaps excluding junk is still a very large opportunity set

Number of Stocks in Smallcap Excl Junk Universe



Smallcap balance sheets have improved



* Excludes Junk Stocks; Excludes BFSI Stocks

Source: PPFAS AMC Research, Bloomberg, ACE Analyser

Some segments are only represented in Smallcaps

Commodity Exchange	Energy Exchange	MF - RTAs	Depository
Pathology Labs	Multiplex	Logistics	Steel - Refractories
Plywood – MDF	Mattress	Textiles	Packaging

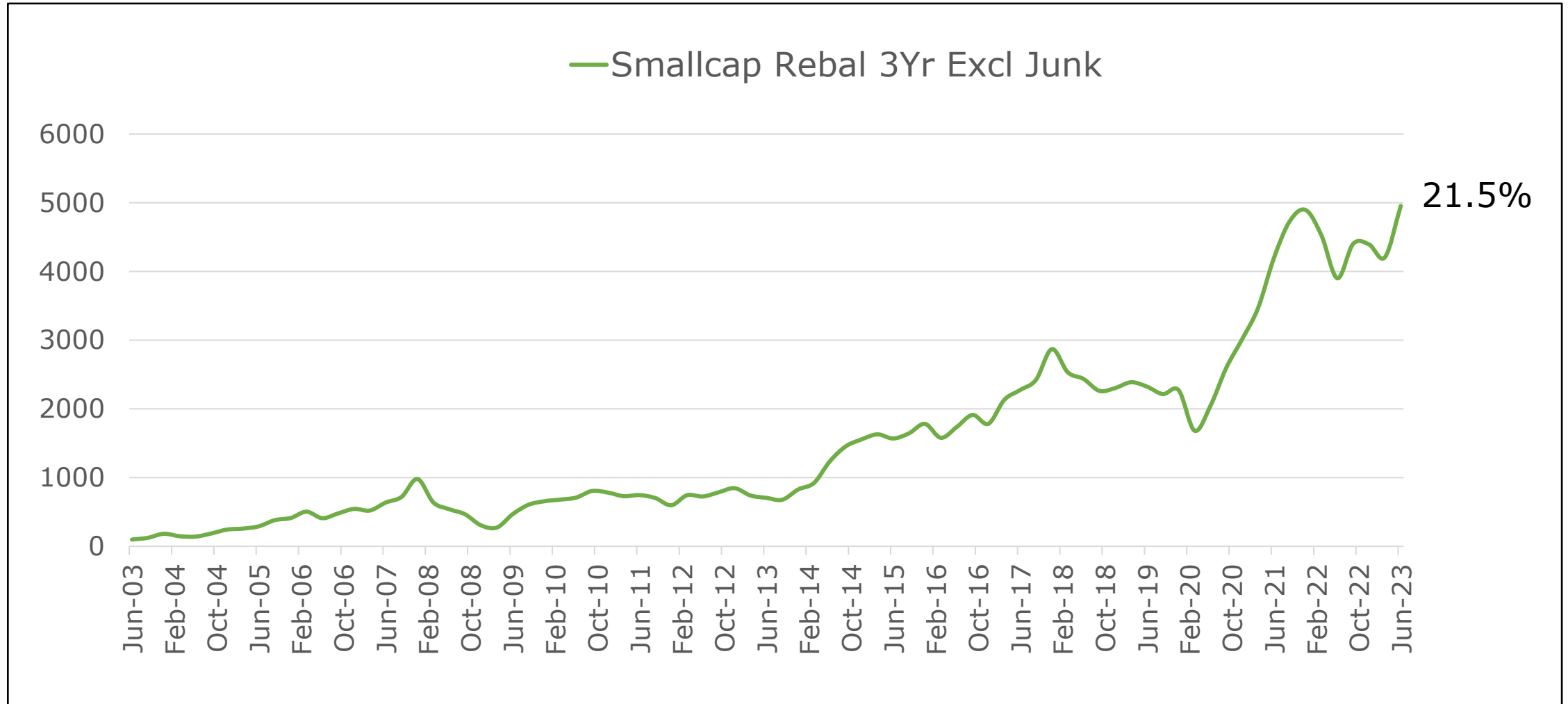
Most Smallcap MFs have outperformed the index

As of 15th Sept 2023

Smallcap Mutual Funds	5Y CAGR
Fund A	30%
Fund B	25%
Fund C	24%
Fund D	24%
Fund E	24%
Fund F	21%
Fund G	21%
Fund H	21%
Fund I	20%
Fund J	20%
Fund K	19%
Fund L	18%
Nifty Smallcap TRI	17%
Fund M	13%

Challenges

Smallcaps excluding junk can produce decent returns

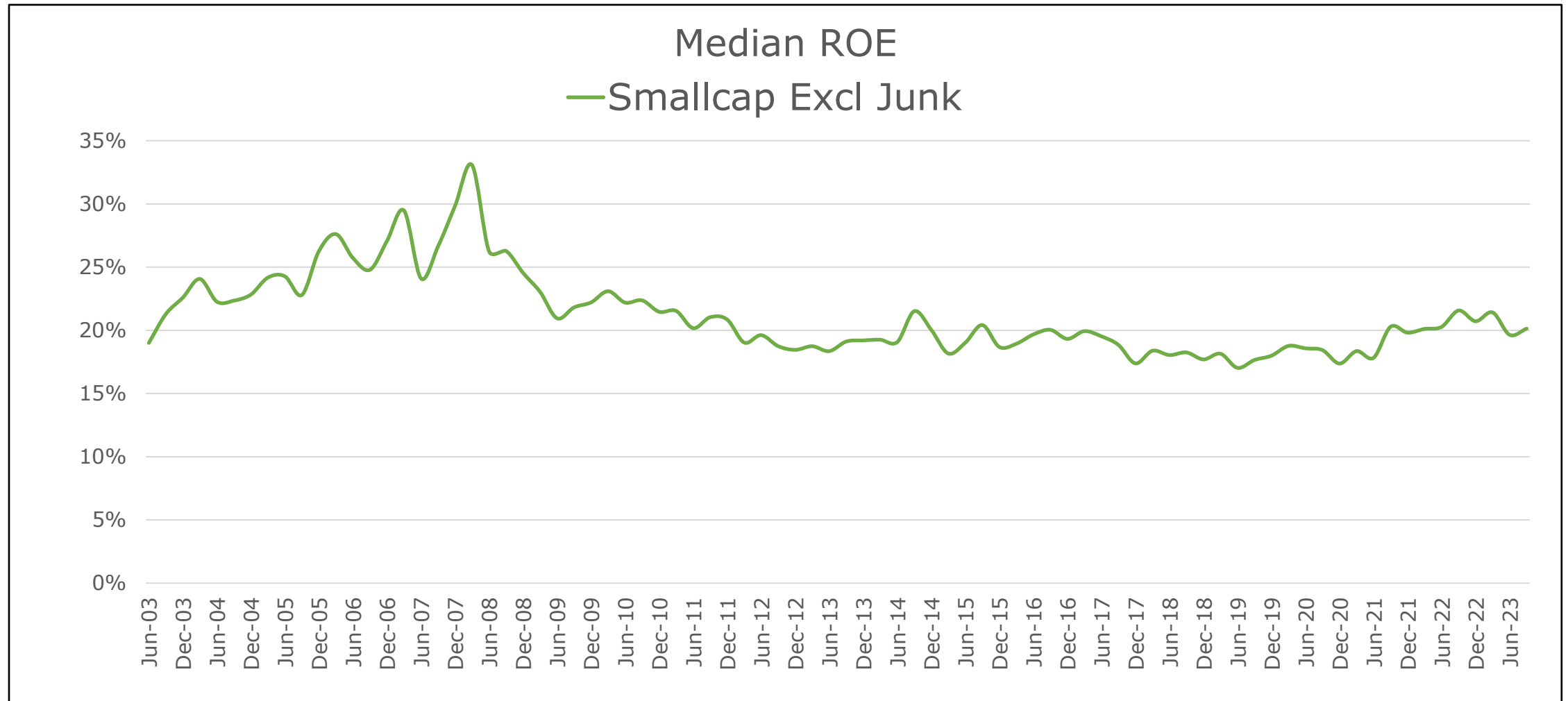


But...

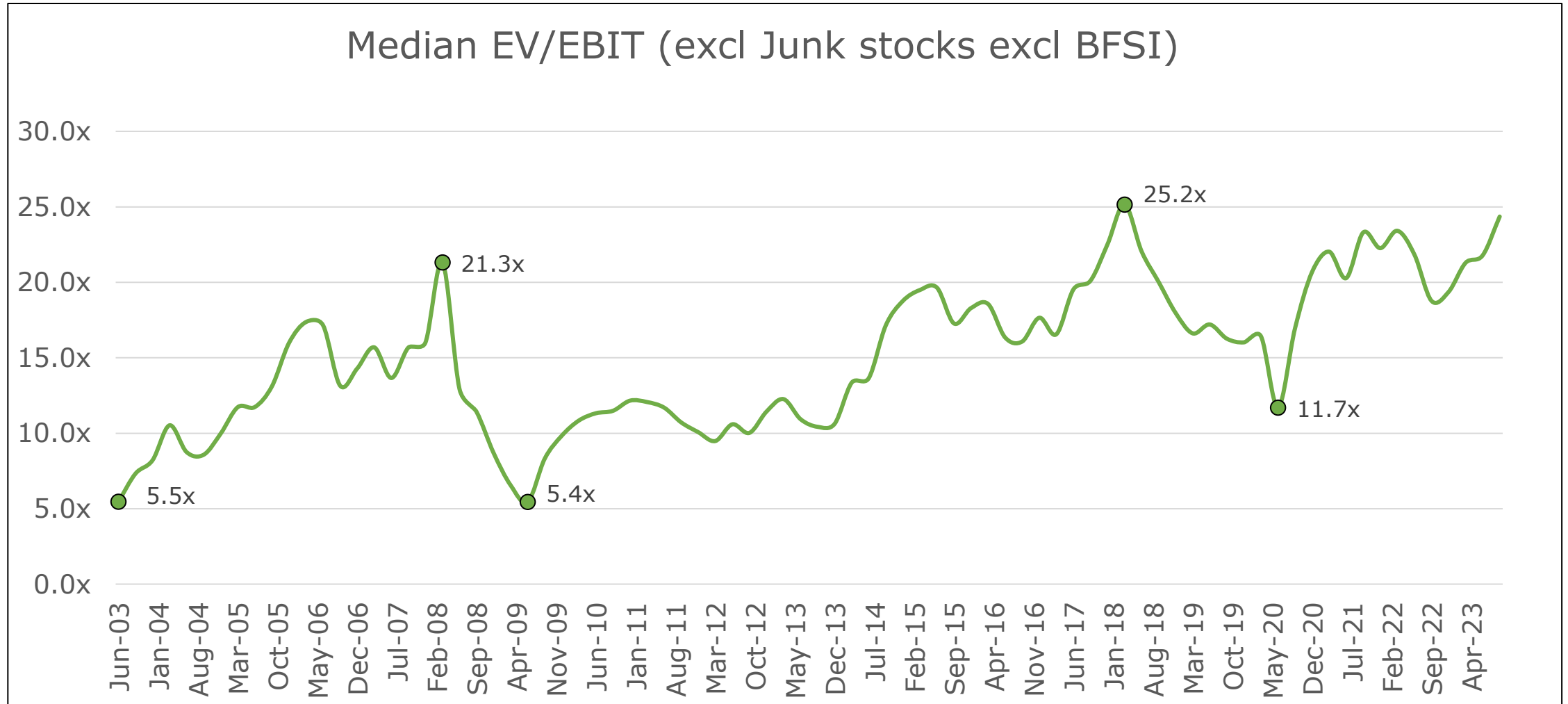
Smallcaps have more severe drawdowns

	Duration	Nifty 100 TRI	Smallcap Univ	Smallcap Excl Junk
Dec 2007 - Dec 2008	1 Year	-53%	-69%	-69%
Dec 2007 - March 2014	6 Years	18%	-35%	-6%
Dec 2017 - Dec 2019	2 Years	15%	-30%	-21%

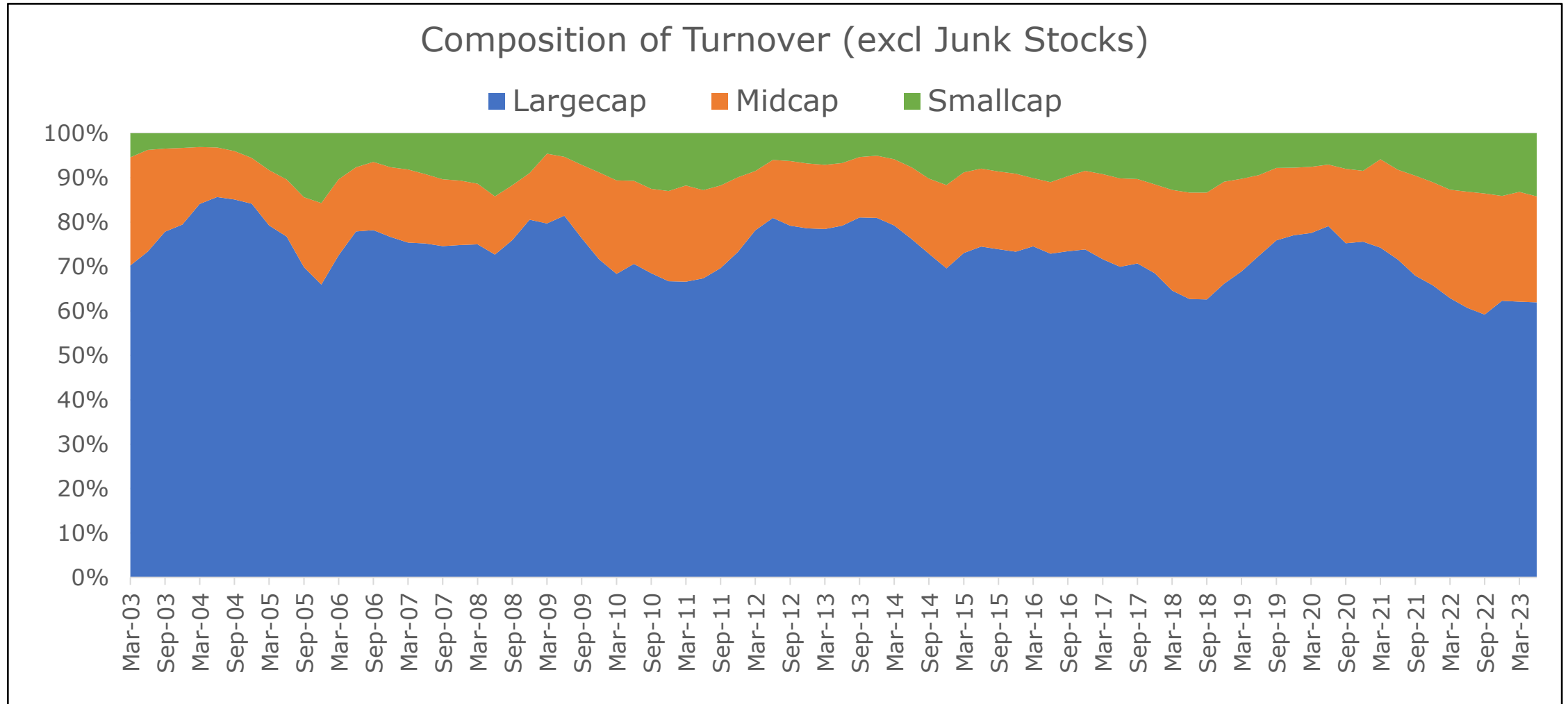
Smallcap Profitability is relatively stable



Smallcap multiples very cyclical : Important to avoid/mitigate when expensive



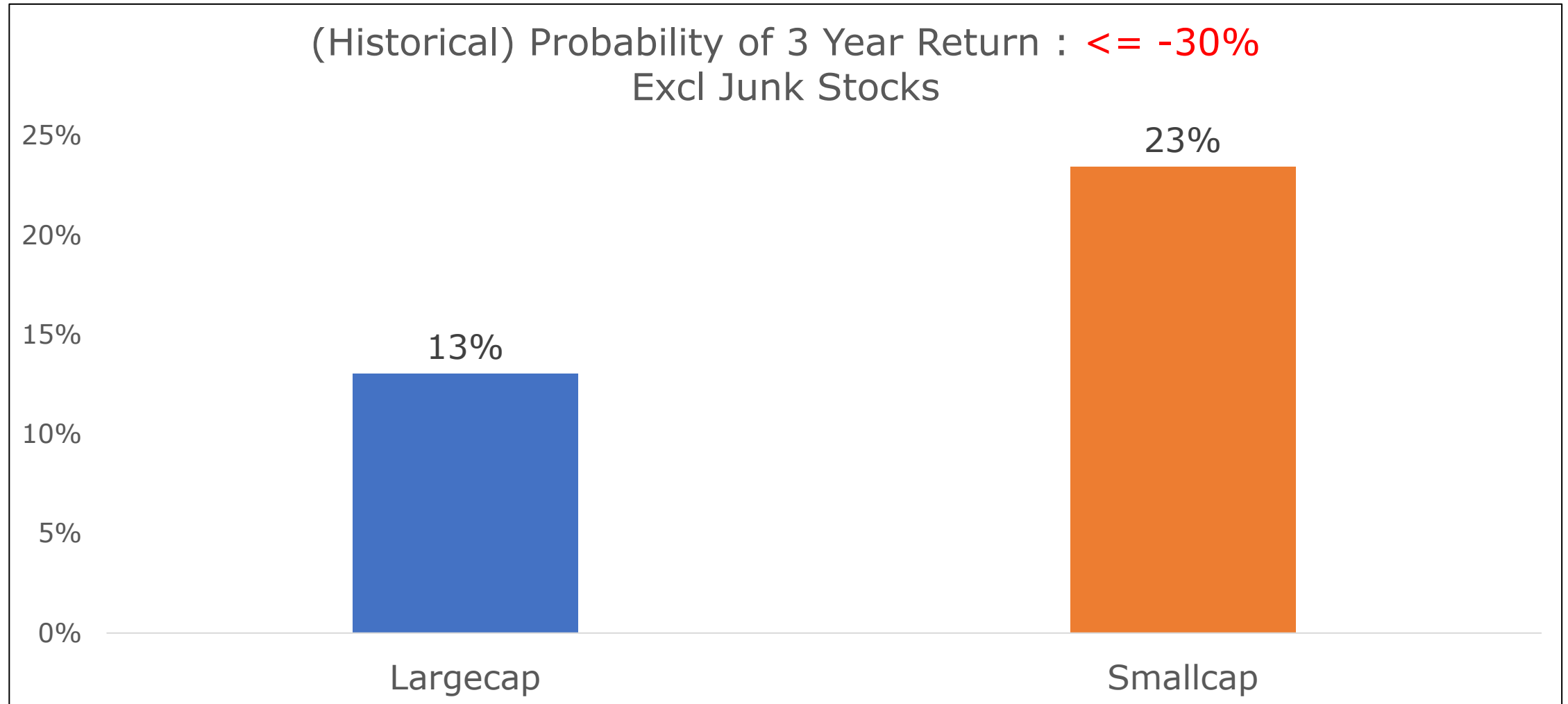
Smallcaps have lower liquidity



...During Bad Markets, Liquidity can further dry up in Smallcaps

Change in Liquidity : Net Turnover / Market Capitalization	Largecap	Smallcap
March 2014 vs. Dec 2010	-16%	-50%
Dec 2019 vs. Dec 2017	43%	-33%

Individual Smallcaps have higher prob of less than - 30% return over a 3 Year period



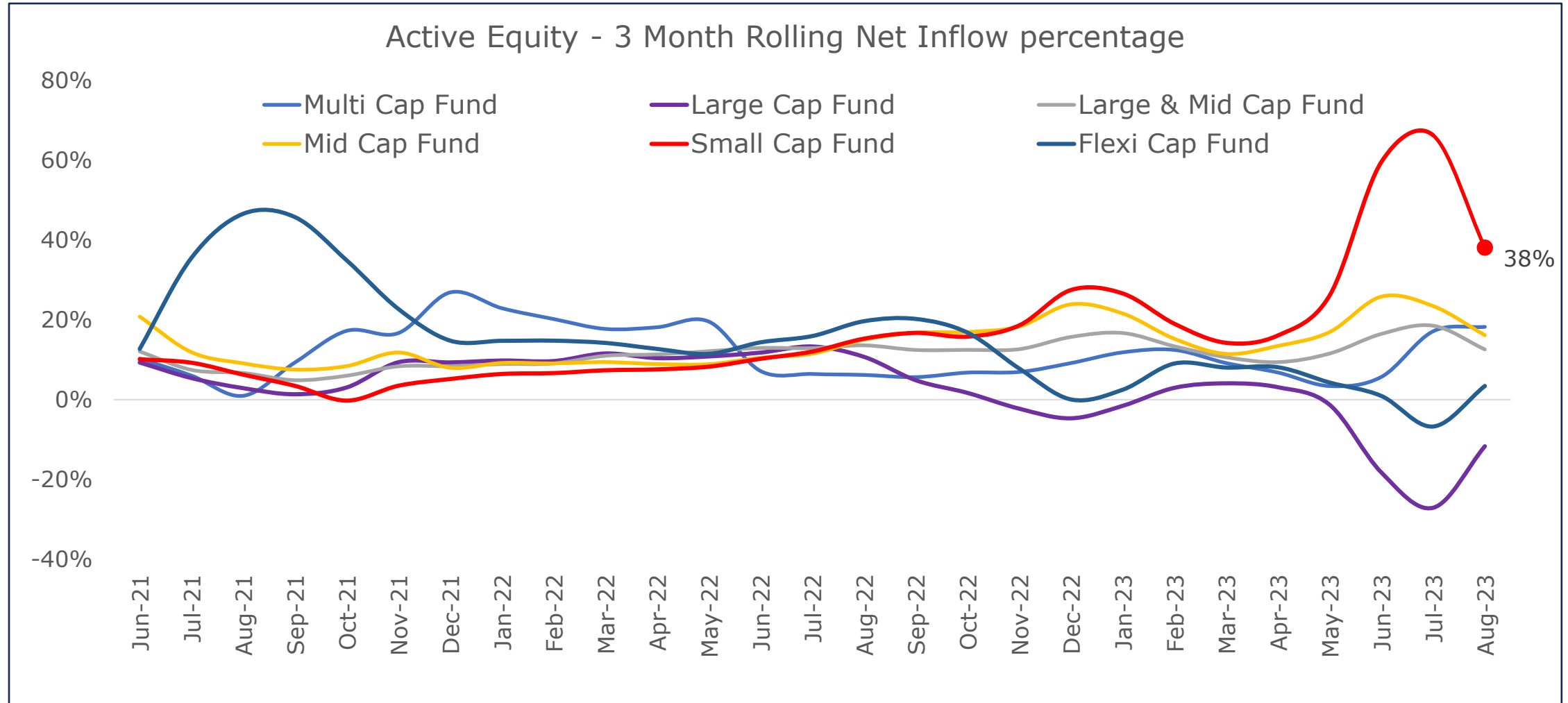
Smallcaps: Possible Reasons for high probability of downside

- Businesses may not be adequately diversified
 - Fewer lines of business or products OR Single geography
- Excessive dependence on few customers or vendors
- High operating leverage
- Management / Governance Risk
 - Key Person Risk OR Decision making concentrated with few individuals
- Risk of Unrelated Diversification or Capital Misallocation

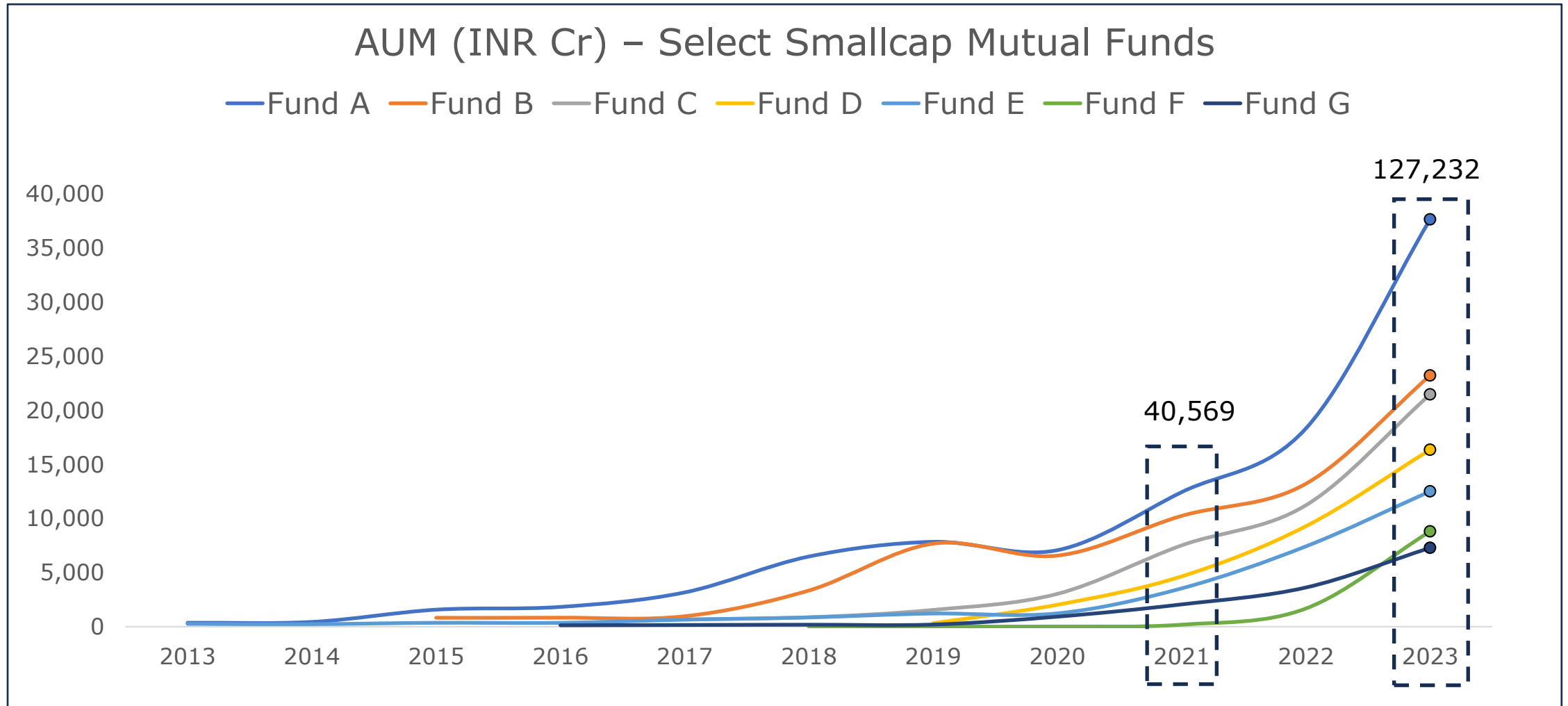
Diversification may be essential to mitigate these risks

Where are we right now?

Inflows into Active Equity MFs have been skewed towards Smallcaps



Smallcap MFs: AUM has increased considerably in last 3 years



Smallcap MFs: Diversified with number of stocks increasing with AUM

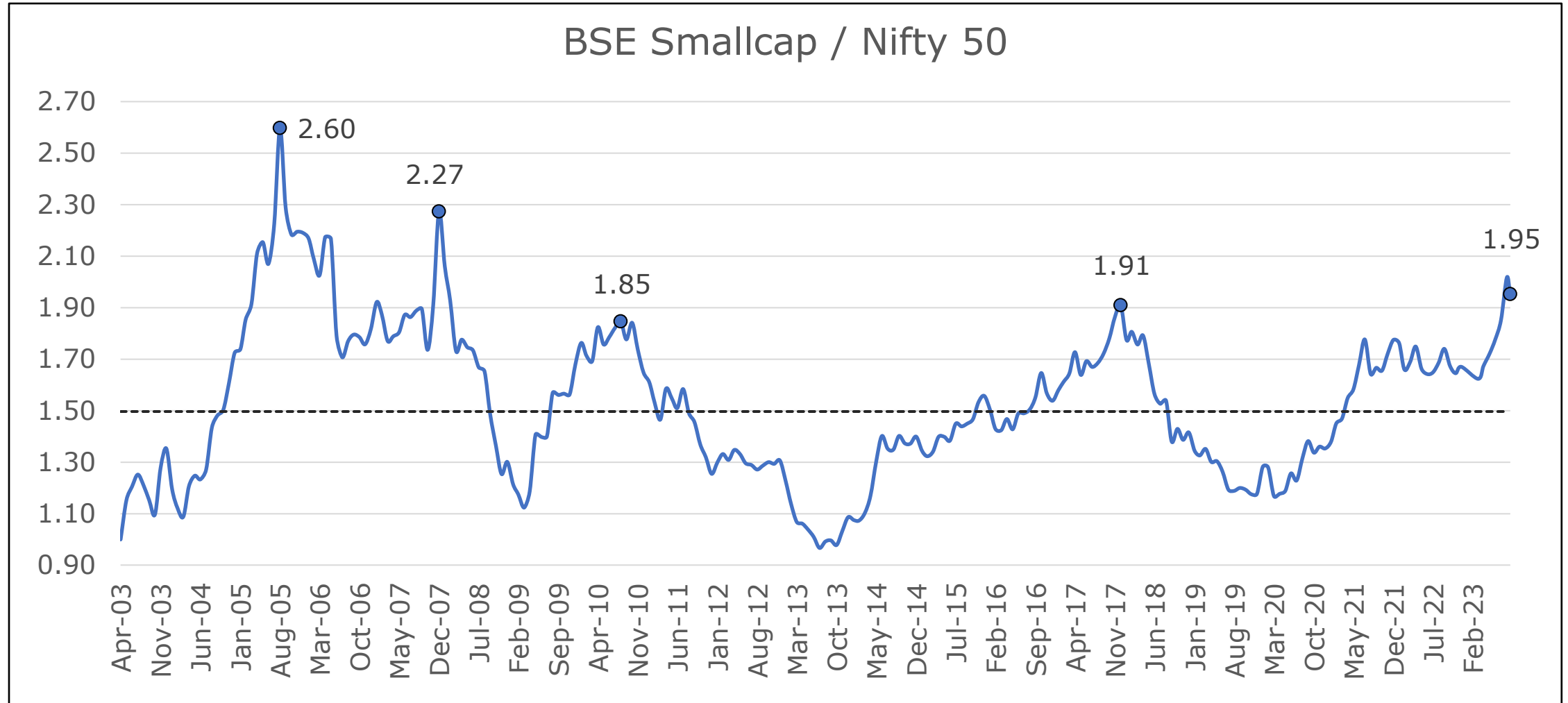
Smallcap Mutual Funds: No. of Stocks					
	2019	2020	2021	2022	2023
Fund A	124	112	121	142	196
Fund B	71	71	68	63	75
Fund C	49	46	50	48	55
Fund D	30	48	50	63	93
Fund E	64	61	64	72	77
Fund F	25	21	40	56	80
Fund G	51	66	62	55	66
Median	51	61	62	63	77

Smallcap MFs: As AUM increases, Liquidity can be a challenge

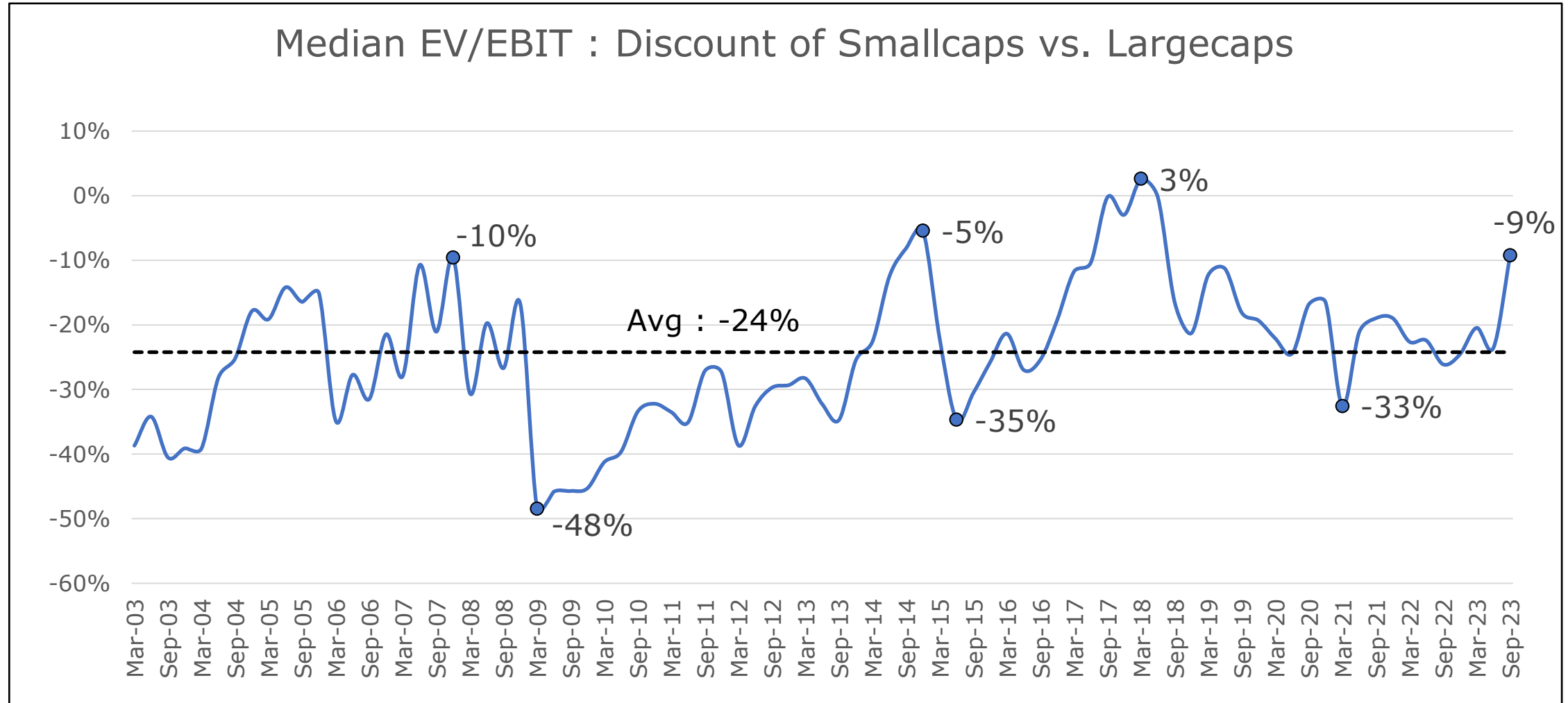
% of Assets	Less than 1 Month	1 to 3 Months	3 to 6 Months	6 to 12 Months	More than 1 Year
Fund P	20.1	21.8	36.0	10.6	1.9
Fund Q	32.3	23.1	20.1	14.5	2.4
Fund R	35.6	23.7	20.2	7.7	0.0
Fund S	39.6	32.6	14.0	4.4	1.2
Fund T	41.9	41.0	4.5	0.0	0.0
Fund U	9.2	22.0	24.1	19.6	6.3
Fund V	66.0	10.3	0.0	1.3	0.0
Median	35.6	23.1	20.1	7.7	1.2

Assuming participation of 30% in ADTV. ADTV calculated based on past 1 year volumes

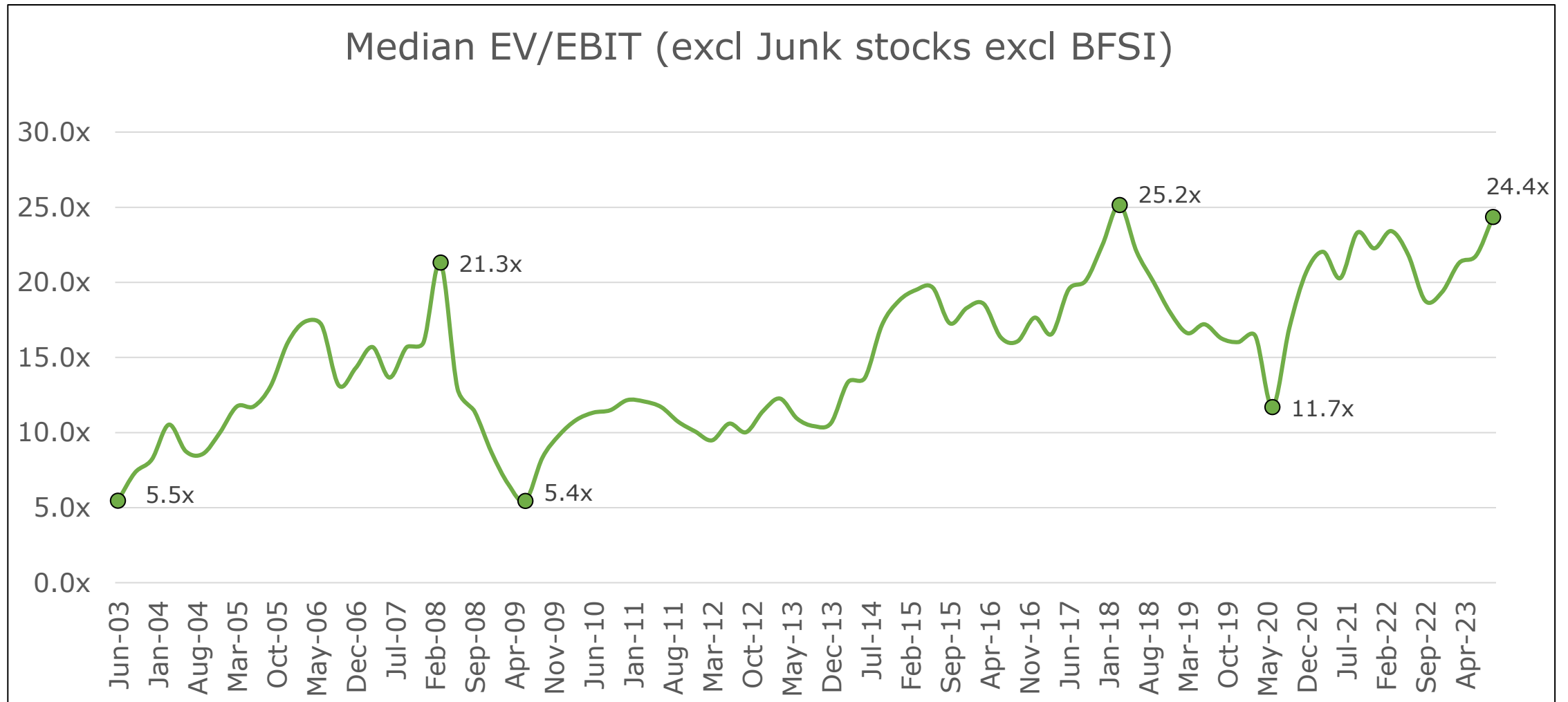
Relative Performance: Smallcap vs. Largecap



Relative Valuation : Smallcap vs. Largecap



Absolute Valuation: Smallcap



Summary : Smallcap Investing

- Small portion of the overall profit pool and market pool
- Opportunity
 - ❑ Generate alpha if you avoid Junk stocks
 - ❑ Participate in segments not present in Largecaps
- Requires Long time horizon: Can go through sharp intermediate drawdowns
- Smallcaps have wide swings in valuations. Important to be mindful of entry valuations
 - ❑ Smallcap Valuations are not cheap right now
- Recommend Diversification
 - ❑ Low liquidity and High Probability of Downside in Individual names