ETMarkets PMS Talk: How this fund manager gave over 60% return to HNI investors in 1 year using eQGP approach

By Kshitij Anand, ETMarkets.com - Last Updated: Aug 22, 2024, 08:36:00 AM IST

Synopsis
Alchemy Smart Alpha 250 delivered a 61.8% return in its first year, surpassing the benchmark's 35%. Fund Manager Alok Agarwal attributed this success to the eQGP framework, which balances quality, growth, and price action based on market conditions. The fund focuses on large and mid-cap stocks, aiming for stable yet high growth potential.

*"If you had invested 50 lakh and added another 61.8% to it, the 50 lakh would have become roughly 81 lakh over this period of one year," says **Alok Agarwal**, Head-Quant & **Fund Manager**, **Alchemy Capital**.*

In an interview with ETMarkets, Agarwal said: "We developed the eQGP framework. The last three letters—Q, G, and P—stand for quality, growth, and price action, respectively" Edited excerpts:

The Alchemy Smart Alpha 250 will be completing its first year in August. Many congratulations on that. Could you take us through the performance of the fund as well?
Alok Agarwal: Alchemy Smart Alpha 250 is a **large and mid-cap strategy** that invests only in the top 250 stocks by market cap. So, it is essentially a completely large and mid-cap strategy.

It completed one year just a few days ago, and I'm quite happy to report that in its first year, the strategy recorded a 61.8% return net of fees, compared to a benchmark return of close to 35%.

Impressive performance and returns, over 60%. For a user's perspective, how much wealth would investors have generated if they had invested, let's say, 50 lakh in the NFO one year ago?
Alok Agarwal: If you had invested 50 lakh and added another 61.8% to it, the 50 lakh would have become roughly 81 lakh over this period of one year.

Moving on to the markets, the Sensex and Nifty touched record highs earlier in August, but most of the wealth was generated in small caps. Why should one look at large and mid-caps at current levels?
Alok Agarwal: It's an interesting question. In fact, over the last year, we've been hearing a lot of strategy notes suggesting that the markets seem to be overvalued.

Instead of looking at the markets in terms of market caps, distinguishing them by sectors is more worthwhile in determining which sectors are performing better.

You'll notice that those backed by earnings growth are doing well, while those struggling with earnings are not performing as well.

Over the long term, at the index level, large, mid, and small caps generally deliver similar returns. However, the potential for higher returns is usually greater in smaller caps, which also comes with more volatility.

On a stability-volatility matrix, larger market caps provide more stability, while smaller caps offer the potential for higher profits and earnings growth, though with less stability.

We chose a combination of large and mid-caps, where the large caps bring stability and the mid-caps offer higher growth potential. This creates a solid sweet spot for our strategy.

How do you pick stocks for investment? I think you also use the eQGP framework. Could you take us through that?
Alok Agarwal: The idea behind launching this strategy was that equity markets, including ours, are cyclical in nature. Most strategies focus on a particular investment style—growth, value, quality, or special situations.

These styles are logical and yield good results over an investment cycle. However, to achieve consistent alpha throughout the investment journey, a strategy needs to adapt to changing market conditions.

To achieve this, we developed the eQGP framework. The last three letters—Q, G, and P—stand for quality, growth, and price action, respectively. These are the three lenses through which a company's strengths are evaluated.

To compare companies, an overall score is calculated by summing or averaging these scores. However, when using a simple average, equal weight is given to growth, quality, and price action, which might not be ideal depending on market conditions.

This is where the first letter, E, comes into play. E stands for the market environment we're operating in. In a bullish, risk-on, or aggressive market, price action becomes most important, followed by growth and then quality. In a bearish or defensive market, quality becomes more important, followed by growth and price action.

Instead of a binary approach, the environment is scaled from 1 to 100, allowing for 100 different combinations of weights, based on whether the market is bullish or bearish. In bullish markets, price action is emphasized, while in bearish markets, quality is prioritized.

Regarding sector weightage, you have over 10% in industrials, financials, and consumer discretionary. Is this where wealth creation is happening? What are your views?
Alok Agarwal: According to our framework, these sectors are showing strong numbers. Looking at the quality aspect, most of these companies report much better ROEs than their historical figures and peers.

Their debt numbers are improving, operating cash flows are increasing, and they are leaders in market growth today. In terms of price action, both absolute and relative performance are strong.

Industrials, utilities (especially power-related supply chains), and financials (dominated more by PSU NBFCs than by private banks or PSU banks) are showing significant growth.

We are currently in a risk-on mode, and all three sectors—industrials, consumer discretionary, and financials—are performing well in terms of price action, growth, and quality.

How do you manage the risk of the fund, especially when markets are rising rapidly?
Alok Agarwal: Our approach is to let the winners run and remove the laggards. I liken this to gardening: we water our flowers and pluck out the weeds. In this portfolio, we remove the weakest links and replace them with stronger ones.

Using the eQGP framework, the top 25 stocks by weighted average score are included in the portfolio. If a stock's rank falls below a certain threshold (let's say 45, though we don't disclose the exact number), it's removed from the portfolio, and the highest-ranking stock comes in.

This method might not allow us to sell at the peak, but the idea is to participate in the bulk of a stock's growth journey, even if not 100% of it.

What is the ideal time horizon for someone investing in this fund in 2024?
Alok Agarwal: Anything less than three years is extremely short-term for equity investing. To fully benefit, one should aim for a horizon of at least three years.

I'm confident that the fund can deliver on its promise, and given the first year's great performance, I believe that investors' experience will encourage longer holding periods.

Are there any sectors you're underweight on?
Alok Agarwal: You'll notice that there's almost no private bank exposure, very low weightage in FMCG, and almost zero weight in large IT companies. These sectors have underperformed significantly relative to the Nifty 500 or the BSE 250 large-mid index.

Their growth numbers are not keeping up with the overall market, which is why they rank low in the first two important metrics—price action and growth.

This portfolio stays true to its mandate, and if no stocks from these sectors rank in the top 25, we can have zero exposure to them.

However, if these sectors start delivering better growth numbers, their rankings will improve, and we would be happy to include them in the portfolio.

The consumption sector, especially post-budget, was expected to benefit. Any views on that, considering it hasn't shown the expected numbers yet?
Alok Agarwal: It's common for short-term events to lead to optimistic projections. Going into the budget, there was speculation that the government's dividend bonanza would lead to increased capex and consumption.

While more went into consumption than capex, ultimately, the bottom line and profit growth need to materialize.

If these numbers improve, my model will start picking them up, but I haven't seen strong signs yet. These are great quality franchises in a great quality sector, and I wouldn't want to miss them, but I don't want to jump the gun unnecessarily.

Indian markets have managed to navigate major events like elections, budgets, and geopolitical concerns without major setbacks. What's fueling the rally? It's certainly not valuations, I'm sure.
Alok Agarwal: Yes, valuations have been a concern, and Indian markets have been seen as overvalued compared to emerging markets, which are usually more commodity-oriented.

However, how many markets of this size can boast consistent double-digit nominal GDP growth, mid-teen corporate earnings growth, and early-teens ROEs?

Combine that with the diversification of over 10 sectors, and you have a unique market. With India at around $2,500 per capita income, which is likely to double every eight years, we're in for a good ride ahead.

Recent history has also seen a significant increase in domestic market participation through institutions, mutual funds, and retail buying. Financial savings as a percentage of household savings was low, but that's been improving.

The shift in mindset—recognizing that equity markets can create wealth for the long haul, just like FDs and real estate—is also driving the rally.

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