



# 3P INVESTMENT MANAGERS

The 3P way. Simple but not easy.

## 3P INDIA EQUITY FUND 1

(An open Ended Scheme of 3P India Equity Fund, registered with Securities and Exchange Board of India (SEBI)  
as Category III Alternative Investment Fund)

(JULY - SEPTEMBER 2024)

**1P**

Prudence of creating a  
portfolio of sustainable and  
reasonably valued  
businesses.

**2P**

Patience with businesses  
and markets. Risk in  
equities reduces  
as investment  
horizon increases.

**3P**

Performance is the  
outcome.



*“You don’t find out who’s been swimming naked until the tide goes out.”*

- Warren Buffett

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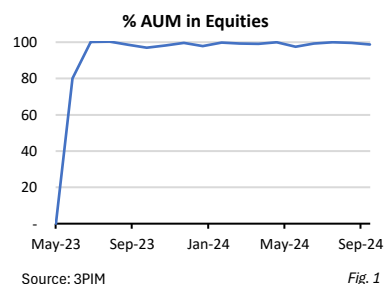
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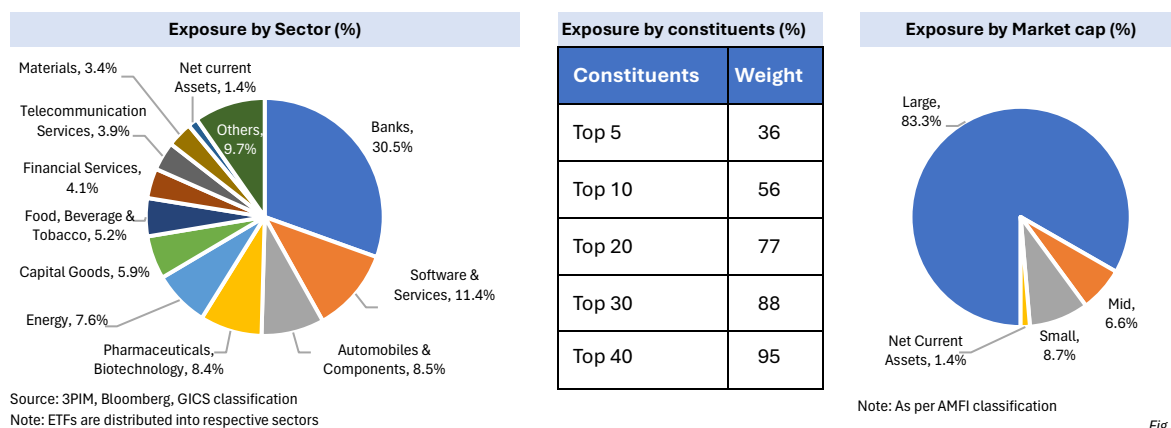
Dear Sir/Madam,

We are pleased to share the 6<sup>th</sup> quarterly update of 3P India Equity Fund 1 (3PIEF-1). This Fund was launched on 3<sup>rd</sup> May 2023. The Fund had a strong start in absolute and in relative terms.

We continue to be sanguine about the medium to long term prospects of Indian economy, corporate profits and markets, albeit with significant moderation in return expectations. In our assessment, equities – especially largecaps, should outperform cash over the medium to long term comfortably, largely driven by earnings growth. The long term case for equities over cash is further strengthened by the significantly lower taxation of capital gains on equities. Consistent with this view, the Fund continues to remain close to fully invested (Fig. 1).



The charts below summarise the key portfolio characteristics of 3P India Equity Fund 1 as of 30<sup>th</sup> September 2024.



The key changes are discussed in the portfolio strategy section.

## Indian Economy: Multiple Tailwinds for the Long Term

Indian economy continues to progress steadily. Favourable demographics, rising incomes and low penetration of discretionary goods and services, favourable external environment for manufacturing and services offshoring, headwinds for several emerging markets (EMs), sharp improvement in India's physical, digital and regulatory infrastructure etc bode well for sustained and higher economic growth in the current decade and next.

An expected ~7% CAGR of Indian economy will increase per capita income on one hand and India's share of world GDP on the other (Fig. 3).

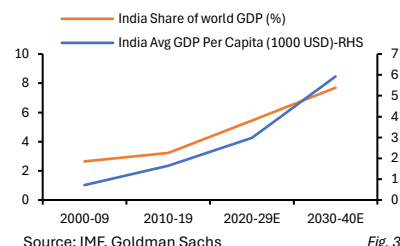
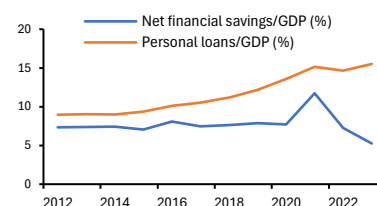


Fig. 3

In the near term, the economy is facing temporary headwinds of slowing consumption and exports. Consumption slowdown is probably due to growth in the past being supported by leverage (Fig. 4). Exports slow down is due to slowing global economy and surplus capacities in China.

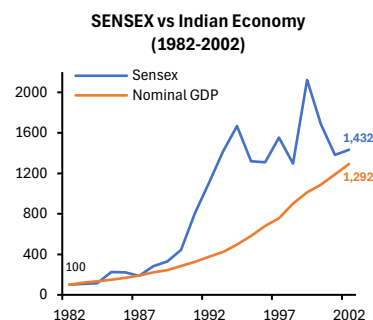


Source: RBI, KIE, Axis Securities, 3PIM calculations.  
Note: Personal loans - Loans disbursed by banks to individuals for Housing, education, vehicle loans, credit cards etc.

Fig. 4

## Is India expensive?

While there is general consensus about India's strong growth prospects, expectations about future equity returns vary considerably. It is true that equity market returns correlate well with the underlying growth in profits over the long term. However, what if past returns have exceeded profit growth? There are instances where markets/stocks have delivered low/negative returns for extended periods despite growth in underlying businesses. For example, between 1992 and 2002, the Sensex grew only 1.3x while the nominal GDP grew 3x in the same period. This was because in the preceding decade, SENSEX grew 11x while the nominal GDP grew 3.8x. Interestingly, between 1982-2002, Sensex grew 14x, remarkably close to 13x growth in nominal GDP (Fig. 5).



Source: BSE, IMF, 3PIM  
Note: Sensex and Indian economy values are based to 100 in 1982 for comparison.

Fig. 5

Are Indian markets expensive? Have the impressive returns of 125% over the past 5 years over-discounted growth? The answers to these straightforward questions are not easy. Unlike goods and services, whose value is well understood, value of equities is a function of future earnings over decades, making them hard to value! However, as John Maynard Keynes famously stated, “It is better to be approximately right than be precisely wrong”. With this in mind, we shall endeavour an approximate answer to this issue.

While Discounted Cashflow (DCF) is the best way to assess value of equities, given the wide range of outcomes based on assumptions, we shall use multiple approaches to examine this issue.

### Are Indian valuations expensive relative to the past?

This is the simplest and most commonly used approach. After all, if markets are rational and efficient over the long term, past averages should serve as a reasonable indicator of present valuations. The chart below clearly depicts that current valuations are 16% and 25% above 10 and 15 year averages, respectively. However, it would be erroneous to conclude solely from this that markets are expensive. This is so because, on one hand economic growth and growth prospects have improved and on the other, cost of equity has declined supported by lower yields and reduced volatility of equities, which in turn lowers equity risk premium (Fig. 6).

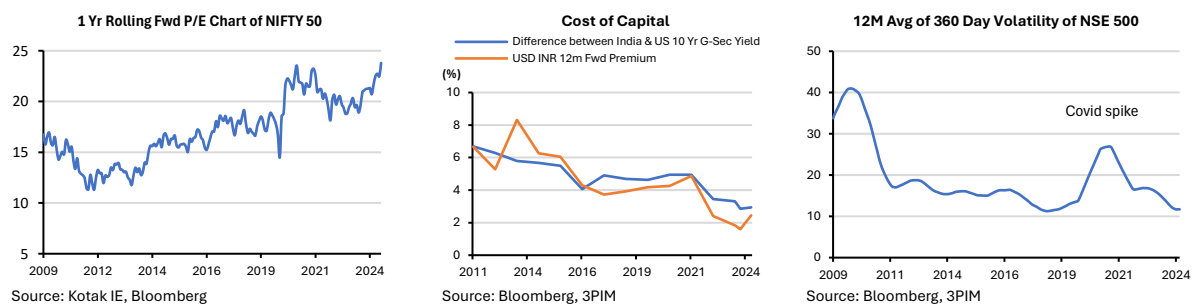


Fig. 6

While improved growth and lower cost of capital justify higher multiples compared to the past, the question of how much higher remains unanswered. Students of finance appreciate that multiples are inversely proportional to  $(k-g)$ ,  $k$  being the cost of capital and  $g$  being growth. Assuming earlier multiples of 16,  $(k-g)$  works out to 6%. Assuming  $(k-g)$  has reduced by 1% to 5%, in an approximate sense, fair P/E works out to 20 and if  $(k-g)$  is lower by 2%, fair P/E equals 25. While this is an imprecise approach, it does suggest that current 1 year forward P/E of NIFTY 50 of 24 is not extreme.

$$PE \propto \frac{1}{(k - g)}$$

$k$  is cost of capital  
 $g$  is growth

## Are Indian valuations expensive relative to EMs?

While India is classified as an EM given its low per capita income, there are important differences between India and other EMs. The Indian economy is large and its growth rate is higher. Additionally, the composition of India's economy and markets leans more towards services and consumption in contrast to the higher share of manufacturing, commodities and exports for many other EMs. This distinct composition of Indian economy and markets lowers volatility of growth and results in higher Return on Equity (RoE). These factors justify higher valuation of Indian markets over EMs (Fig. 7).

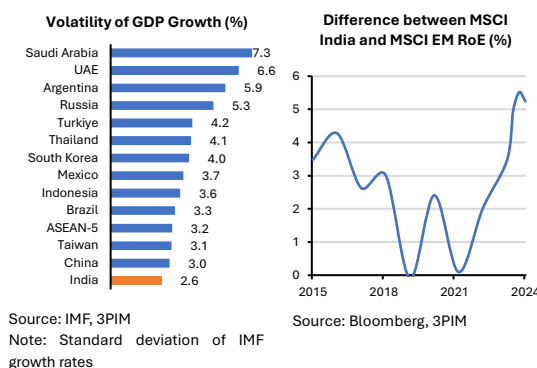


Fig. 7

Interestingly, India's premium has widened in recent years (Fig. 8), thus raising the question – *are current valuation premiums excessive or are they justified?*

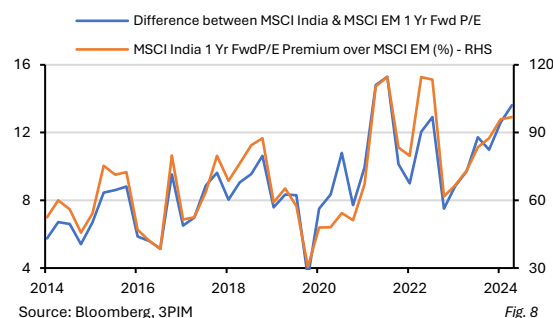


Fig. 8

The increase in India's premium is not solely attributable to rerating of India. Nearly 2/3<sup>rd</sup> of the rise in India's premium over EMs is on account of increase in India's valuations and the balance 1/3<sup>rd</sup> is attributable to the derating of other emerging markets (Fig. 9). Analysed this way, India's premium over EMs does not appear to be alarming but does leave the issue of higher attractiveness of other EMs open.

	1 Year Forward P/E	
	Dec-19	Sep-24
MSCI India (A)	22.8	27.7
MSCI EM (B)	14.5	14.1
MSCI India Premium (A-B)	8.3	13.6

Source: Bloomberg, 3PIM

Fig. 9

## Is India expensive with respect to its fair value?

This brings us to the final and theoretically the best way to assess valuations – the discounted cash flow analysis, popularly known as DCF. Since DCF values can vary considerably based on assumptions, the outcome of this approach is also indicative in nature.

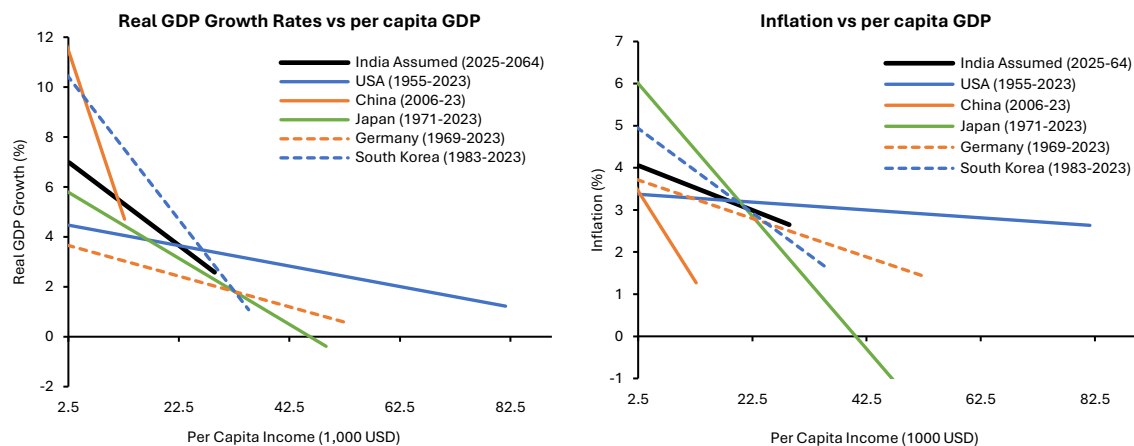
We have attempted a simple DCF of **NIFTY 50**.

The key assumptions for this exercise are summarised in the adjoining table (Fig. 10). The assumptions for real growth and inflation are based on the past trajectories of other countries (Fig. 11). It should be noted that the starting year for all the countries is the year when their GDP per capita was close to \$2,500.

(%)	FY25-44	FY45-54	FY55-64	Terminal
<b>Real Growth</b>	6.5	5.0	3.0	2.0
<b>Inflation</b>	4.0	3.0	3.0	2.0
<b>Cost of Equity</b>	12.0	11.0	11.0	10.0
<b>FCF/PAT</b>	70.0	75.0	80.0	85.0
<b>Projected Per Capita GDP (\$) at period beginning</b>	2,656	11,910	20,473	28,961

Source: 3PIM calculations, UN

Fig. 10



Source: FRED, 3PIM calculations, UN

Note: The graph is a best fit line of a scatter plot of the respective values of respective countries.

Fig. 11

For FY25 to FY44 the assumed FCF/PAT is close to FY25 estimates of Kotak Securities. Further, as growth slows, PAT to FCF conversion ratio tends to increase.

Based on these assumptions, DCF of NIFTY 50 (implied market capitalisation) is ₹187trn (\$2,234bn) compared to the actual marketcap of NIFTY 50 at ₹208trn (\$2,477bn) (as on 30<sup>th</sup> September 2024). This is suggestive of a moderate overvaluation (~11%) of NIFTY 50.



## Conclusion

The message of each of the 3 approaches to valuations of NIFTY 50 is summarised below.

- India's current 1 year forward P/E ratio of 24 is 16% and 25% above 10 and 15 year averages respectively. This premium is directionally justifiable by improved growth prospects of the Indian economy and lower cost of capital.
- India's premium over EMs has expanded from 65% in CY19 to 97% today. 1/3<sup>rd</sup> of this increase is due to the derating of other emerging markets and the balance is attributable to higher Indian valuations.
- DCF of Nifty 50 suggests moderate overvaluation.

In conclusion, the message of each of the three approaches is broadly consistent. NIFTY 50 appears to be moderately overvalued. However, the overvaluation is not substantial to warrant pessimism about the long-term prospects of Indian equities. Nevertheless, considerable moderation of return expectations is in order. With the higher growth and lower cost of capital priced in, any margin of safety is clearly missing. This conclusion is aligned to what we had shared in our last quarterly commentary.

*“Markets offer compounding prospects in line with earnings growth and should deliver around 12% CAGR over the long term. These markets are thus suitable for the patient investor.”*

- extract from our June 2024 letter

Lest one forgets, the above analysis applies only to NIFTY 50 and to largecap stocks. These findings should not be applied to midcap and smallcap stocks given their sharp outperformance over largecaps in recent years (Fig. 12).

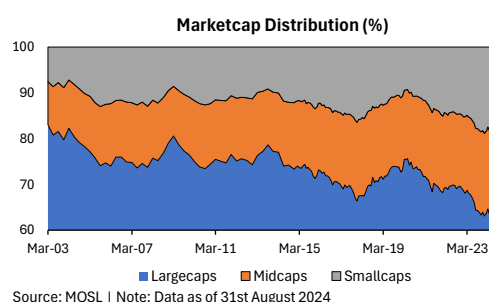
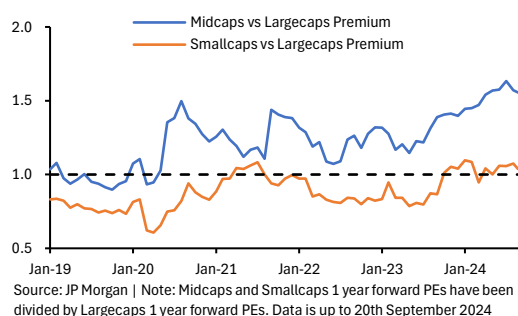


Fig. 12

As suggested in our previous letter, we reiterate, in our view, the risk-reward is superior in large caps.

*“Post the significant outperformance of SMIDs in the last few years, the risk-reward continues to be less attractive.”*

- extract from our June 2024 letter

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## Portfolio Strategy and Positioning

Sustainability of businesses and valuations are the two cornerstones of 3P investment philosophy. Avoiding weak businesses lowers the risk of permanent loss of capital and avoiding excessive valuations lowers the risk of poor long-term returns. This approach's relevance has increased in today's buoyant market conditions.

The best investment opportunities are often found in the worst of times while the worst mistakes are often made in the best of times.

Nearly 90% of the Fund, in our judgement, comprises of companies that enjoy leadership/strong positions in respective businesses and should be able to increase/maintain their market share.

The portfolio continues to be well diversified across sectors and key economic variables. The Fund is overweight consumer discretionary, financials, healthcare and industrials and is underweight consumer staples, materials and oil & gas. Exposure to IT and Telecom is close to markets. Key portfolio changes made recently are:

- Increased allocation to large banks and pharmaceuticals
- Reduced weight in power NBFCs and utilities
- Initiated a small allocation to metals based on attractiveness of individual companies

The markets are witnessing a sharp increase in supply of stocks. The acceleration in selling/stake reduction by promoters and PEs though IPOs etc at demanding valuations and yet large listing gains suggest need for caution. Excessive market conditions can also be gauged by the ability of stressed companies with not so strong fundamentals to raise substantial amounts of equity capital.

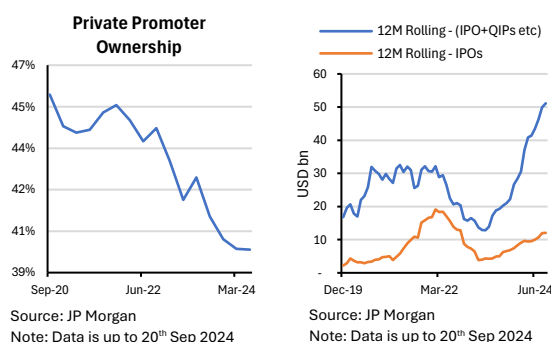


Fig. 13

We are resisting the temptation of short-term gains and participating in select issuances where fundamentals are strong and valuations reasonable.

September 2024

The performance of 3P India Equity Fund 1 is summarised in the adjoining table (Fig. 14). The absolute performance was supported by strong market returns and strong relative performance was enabled by some sharply undervalued pockets in the market that the fund was able to take advantage of.

Conditions have since changed – market returns should now moderate as discussed earlier and there is a dearth of meaningful pockets of undervaluation. The recent sharp up move in Chinese markets after a period of significant underperformance could lead to FIIs diverting flows from India in the near term. Coupled with the large pipeline of stocks, a cautious approach is pragmatic.

In cricket parlance, we are now batting on a pitch where the ball is turning and the bowler is maintaining a good line and length. In such conditions, defensive play and scoring singles and doubles is preferred over boundaries.

Consistent with this, portfolio risk has been reduced. On one hand allocation to small / midcaps is low and on the other, allocation to select sectors post sharp outperformance has been lowered. Portfolio holdings are being maintained at ~50 as dispersion in valuations is low. If and when there is meaningful undervaluation in some pockets, portfolio's diversification should reduce.

The Fund's NAV is on a post-tax basis. We expect the tax rate to further reduce gradually over time as more holdings qualify for long term capital gains.

The Fund Managers of 3P India Equity Fund have invested a sizeable part of their net worth in the Fund to align their interests with that of the customers. Further, under normal conditions, members of the 3P investment team will not purchase direct listed equities in the secondary market.

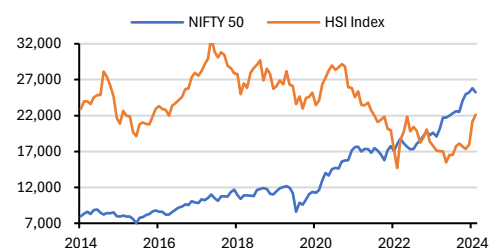
[Annexure A](#) details the Fund Portfolio as of September 30, 2024, sectoral composition and a brief rationale for the same. [Annexure B](#) contains regulatory disclosures.

Fund	Returns (%)		
	3PIEF-1	Nifty 50 TRI	Nifty 200 TRI
1 Year	45.6	33.0	40.4
Since Inception (CAGR)	45.7	29.6	37.1

Source: Bloomberg, 3PIM

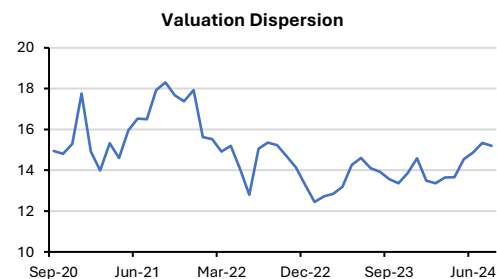
Note: Pre-tax returns, pre-management fees. Data as of September 30, 2024.

Fig. 14



Source: Bloomberg, 3PIM

Fig. 15



Source: Bloomberg, NSE, KIE, 3PIM calculations

Note: Valuation Dispersion is defined as the standard deviation of sector PE (ex-financials) at a point in time. Data as of 31 August 2024.

Fig. 16

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MANAGERS**

September 2024

The 3P India Equity India Fund 1 has grown to ₹11,937 crores (\$1.4bn). The assets under management of 3P Investment Managers stand at ₹13,885 crores (\$1.7bn). This growth is a result of our unitholders' trust in us for which we are grateful. Our long-term focus, disciplined approach, low costs and complete alignment of interests provide resilience to this partnership.

We plan to share the next Fund update around 1<sup>st</sup> week of January 2025.

Kindly note that 3P India Equity Fund 1 is an open-ended Fund with zero exit load. The Fund is available for transactions on every 15<sup>th</sup> /last working day of the month, provided it is a business day.

Please feel free to reach out to the undersigned or services ([services@3pim.in](mailto:services@3pim.in)) for any clarifications, feedback or suggestions.

Warmly,

CIO and Fund manager

(Prashant Jain)

Email: [prashantj@3pim.in](mailto:prashantj@3pim.in)

Portfolio Strategist and Co-Fund manager

(Ashwani Kumar)

Email: [ashwanik@3pim.in](mailto:ashwanik@3pim.in)

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📍 2nd Floor, Nirlon House, Dr. Annie Besant Road, Worli, Mumbai - 400030.

🌐 [www.3pim.in](http://www.3pim.in) ✉ [services@3pim.in](mailto:services@3pim.in) ☎ +91 (22)-69544454