

The MarketGrader India All-Cap Growth Leaders – September 2020 Rebalance Notes

The MarketGrader India All-Cap Growth Leaders Index completed its most recent semi-annual reconstitution and rebalance on September 18th, replacing 37 of its 80 constituents. This represented a turnover of 46%, above its historical average of 38%.

Before discussing individual stock picks in the newly reconstituted Index, it is useful to take a top-down view of the portfolio's sector composition. Given that the MarketGrader India All-Cap Growth Leaders uses a stock selection methodology founded on MarketGrader's GARP-based fundamental metrics to select its constituents, any over/under weighting of the sectors is an outcome of this bottom-up approach and not a result of a top-down sector weighting approach. This is important as the implied sector composition of the Index speaks to the financial state of the sectors as a whole, based on the fundamentals of the companies within those sectors, affording investors a unique view of where quality growth in Indian equities is available at a reasonable price.

Sector Exposure

The table below summarizes the sector composition of the September 2020 reconstituted and rebalanced Index and compares it to the prior version of the Index that was selected during the March 2020 rebalance.

Table 1. MarketGrader India All-Cap Growth Leaders Index: Sector Composition

Sector	March 2020 Count	September 2020 Count	Deletes	Adds	Change	Turnover*
Consumer Discretionary	7	0	7	0	-7	100%
Consumer Staples	8	6	5	3	-2	57%
Energy	5	2	3	0	-3	43%
Financials	14	11	9	6	-3	60%
Health Care	10	18	2	10	8	43%
Industrials	12	8	5	1	-4	30%
Materials	11	16	5	10	5	56%
Technology	12	17	1	6	5	24%
Telecommunications	1	1	0	0	0	0%
Utilities	0	1	0	1	1	100%
Total	80	80	37	37	0	

Source: MarketGrader Research. *For the purposes of this table, "Turnover" is defined as the sum of "Adds" and "Deletes" divided by the sum of the "March 2020 Count" and the "September 2020 Count".

Here are the major takeaways from the changes in the sector composition:

1. All seven of the consumer discretionary companies that were in the Index in the prior period were eliminated in the reconstitution. In addition, with no new companies selected from the sector, the reconstituted Index holds no consumer discretionary companies. This sector experienced the biggest loss in representation within the new Index. While this might seem unusual to many investors who might think that the opportunity for superior investment returns in India is tied to its rising consumer class,

we see two other factors at play here. First, India's consumer discretionary sector isn't as large, in terms of company count, as it is in other large equity markets such as the U.S. or China. In fact, among the 2,831 publicly traded Indian companies covered by MarketGrader, only 312, or 11%, belong to the consumer discretionary sector. Second, as has been the case across the world, the Indian economy shut down for most of the six months between rebalances in order to limit the spread of the novel coronavirus. While this has affected companies across most sectors, consumer discretionary companies have been clearly impacted the most and this is coming through in their MarketGrader Scores.

2. The loss of the consumer discretionary sector was the gain of the health care sector. The health care sector experienced the biggest increase in the number of companies within the Index. With two deletions and 10 additions, the health care companies in the Index grew from 10 companies in the March version to 18 in the September version. In terms of count, the health care sector now has the most favored sector status (highest representation) within the Index. Note, that in the prior version financials held the most favored sector status. It is not a coincidence that, in the middle of a global pandemic, the Index has shifted away from consumer stocks that rely on discretionary income in favor of health care companies.
3. Apart from health care, the other sectors that gained companies in the reconstituted Index were materials and technology with both of them picking up five names each. However, the turnover within materials was higher than for technology: While materials went from 11 companies to 16 companies by removing five of the prior companies and adding 10 new companies, technology grew from 12 to 17 by only dropping one prior company and adding six new companies. This speaks to the strength and stability of the technology sector within the India equity market, particularly during a period when most of the global economy was in shutdown mode, favoring technology providers over most cyclical sectors.
4. With 14 companies in the prior version of the Index and 11 companies in the new version of the Index, financials fell slightly out of favor thereby relinquishing its most favored sector status. This decline in representation came with significant turnover: With nine deletions and six additions, the sector turned over 60% of its names.
5. Finally, note that telecommunications had no turnover as it continued to have a single company in the Index (Bharti Infratel Ltd.). In addition, the new version of the Index also included just one utility (CESC Ltd.).

Companies Added, Deleted and Retained

The sector composition of the MarketGrader India All-Cap Growth Leaders is helpful in providing a bird's eye view of the evolution of company fundamentals by sector for the broad

India equity market. However, as mentioned earlier the Index actually behaves as a stock picker with the fundamentals and GARP metrics of individual companies driving the stock selection. Consequently, at each rebalance, the companies that are added, deleted and retained can be thought of as the “buys”, “sells” and “holds” as suggested by the Index methodology for the India all-cap portfolio.

The MarketGrader India All-Cap Growth Leaders is free float market cap weighted with no company being able to contribute more than 5% of the Index’s weight. This weighting constraint is included in order to limit concentration risk, especially since the Index is an all-cap portfolio. Keeping this mind, it is useful to focus on the largest companies that were added, deleted or retained as these are the companies that have the most impact on the Index’s performance.

Table 2 presents the four largest companies (of the 37) added to the Index that had a market cap greater than USD 10 billion at the time of the reconstitution. Interestingly, these four buys are from four different sectors with the largest being from the financial sector. Combined, these four companies make up 61% of the total market cap of the 37 companies that were added to the Index.

Table 2. MarketGrader India All-Cap Growth Leaders Index: Four Largest Companies Added

Name (Market cap larger than USD \$10 Billion)	Sector	Industry	Market Cap (Billions of USD)	MG Score
Housing Development Finance Corporation Ltd.	Financials	Finance/Rental/Leasing	\$43.8	53.2
Britannia Industries Ltd.	Consumer Staples	Food: Specialty/Candy	\$12.2	62.0
Divi's Laboratories Ltd.	Health Care	Pharmaceuticals: Other	\$11.6	66.4
SBI Cards & Payment Services Ltd.	Financials	Major Banks	\$10.3	57.4
Total			\$77.9	
Total as % All Adds			61%	

Source: MarketGrader Research.

Table 3 presents the seven largest companies (of the 37) deleted from the Index that had a market cap greater than USD 10 billion at the time of the reconstitution. By sector, these seven sells cover consumer discretionary (2), consumer staples (Hindustan Unilever Ltd.), energy (2) and financials (Bajaj Finance Ltd.). Combined, these seven companies make up 67% of the total market cap of the 37 companies that were added to the Index.

Table 3. MarketGrader India All-Cap Growth Leaders Index: Seven Largest Companies Deleted

Name (Market cap larger than USD \$10 Billion)	Sector	Industry	Market Cap (Billions of USD)	MG Score
Hindustan Unilever Ltd.	Consumer Staples	Household/Personal Care	\$69.3	44.0
Bajaj Finance Ltd.	Financials	Finance/Rental/Leasing	\$28.8	45.2
Avenue Supermarts Ltd.	Consumer Discretionary	Specialty Stores	\$20.0	36.6
Oil & Natural Gas Corp. Ltd.	Energy	Integrated Oil	\$13.1	36.0
Bajaj Auto Ltd.	Consumer Discretionary	Motor Vehicles	\$11.4	49.8
Coal India Ltd.	Energy	Coal	\$11.2	51.9
Total			\$153.7	
Total as % All Deletes			67%	

Source: MarketGrader Research.

Tables 2 and 3 together suggest that the Index added fewer large companies (market cap greater than USD 10 billion) than it deleted. This was in fact the case: The total market cap of all of the 37 companies deleted from the index was USD 230 billion. But the total market cap of all of the 37 companies added to the index was only USD 127 billion. This is typical of a GARP strategy: buy undervalued small/mid companies and cash-in gains from the larger companies that have limited growth to offer.

At the time of the reconstitution, the MarketGrader India All-Cap Growth Leaders is also rebalanced to the free float market cap weights (with the 5% ceiling). The implication of “selling” some of larger names from the index and “buying” smaller names means that when the reconstituted Index is rebalanced to the free float market cap weights, a greater total weight is given to the companies that are retained within the index. These are high quality companies that continue to be attractive from a GARP perspective. Table 4 presents the eight largest companies (of the 43) retained from the Index that had a market cap greater than USD 10 billion at the time of the reconstitution.

Table 4. MarketGrader India All-Cap Growth Leaders Index: Eight Largest Companies Retained

Name (Market cap larger than USD \$10 Billion)	Sector	Industry	Market Cap (Billions of USD)	MG Score
Tata Consultancy Services Ltd.	Technology	Information Technology Services	\$119.1	64.07
HDFC Bank Ltd.	Financials	Regional Banks	\$83.2	60.29
Infosys Limited Sponsored ADR	Technology	Information Technology Services	\$53.0	69.84
ITC Ltd.	Consumer Staples	Tobacco	\$31.8	52.74
HCL Technologies Ltd.	Technology	Information Technology Services	\$26.2	66.39
Wipro Ltd.	Technology	Information Technology Services	\$21.6	70.64
Nestle India Ltd.	Consumer Staples	Food: Major Diversified	\$21.6	60.92
Dr. Reddy's Laboratories Ltd.	Health Care	Pharmaceuticals: Generic	\$10.0	64.95
Total			\$366.5	
Total as % All Retains			83%	

Source: MarketGrader Research.

These companies can also be thought of as the “holds” based on the MG Score[®]. Clearly, technology is the dominant sector here with four of the eight largest companies, something that bodes well for the index as the Indian economy remains partially shut. In the current

environment the expectation is that technology and health care names will outperform consumer industries and other cyclical parts of the economy. The remaining four companies are from consumer staples (2), financials (HDFC Bank Ltd.) and health care (Dr. Reddy's Laboratories Ltd.). Combined, these eight companies make up 83% of the total market cap of the 43 companies that were retained in the Index. Keeping in mind that because the adds (buys) in total market cap were less than the deletes (sells), the Index rebalancing methodology favors the retains (holds), which means that these are the stocks which continue to be the key drivers of the Index's performance.

The Workhorse Companies

At any given time, there are companies that serve as the core to the exposure of any equity market. In the case of the MarketGrader India All-Cap Leaders portfolio these are the companies that have been in the portfolio continuously for the longest period. These companies are different from those that have been selected the most number of time (for the most frequently selected companies click [here](#)).

Table 5. MarketGrader India All-Cap Growth Leaders Index: 10 Longest Serving Companies

CompanyName	Sector	Consecutive	
		Years	MG Score
Wipro Ltd.	Technology	5	70.6
HCL Technologies Ltd.	Technology	5	66.4
Tata Consultancy Services Ltd.	Technology	5	64.1
Tech Mahindra Ltd.	Technology	5	58.9
Larsen & Toubro Infotech Ltd.	Technology	3	76.0
Coforge Ltd.	Technology	3	66.7
Mindtree Ltd.	Technology	3	66.4
Mphasis Ltd.	Technology	3	65.2
Nestle India Ltd.	Consumer Staples	3	60.9
L&T Technology Services Ltd.	Industrials	3	55.6

Source: MarketGrader Research.

Table 5 presents the 10 companies that have been in the index for the longest continuous time. Given that eight of the 10 companies with the most longevity in the Index are from the technology sector it is obvious that for now, the technology sector is the workhorse of the Indian equity market.