

FUND CHAT

Benchmark
BSE 200

Portfolio Turnover
2.17

Expense Ratio
2.48%

AUM (October 2009)
Rs 119 crore

Fund Classification
Open-ended
diversified equity

Market Cap Bias
Multi cap

Inception of Fund
March 2008

Fund Manager
Jayesh Gandhi

Top 3 sectors (%)
Energy(14.84), FMCG
(13.60), Financial (13.15)

Top 3 stocks (%)
Reliance Ind (4.97)
ICICI Bank (4.53)
Infosys Tech (3.79)

Data pertains to the October 2009 portfolio

JAYESH GANDHI

Executive Director, Morgan Stanley Investment Management



Alpha Generator

MORGAN STANLEY A.C.E. FUND IS A RELATIVELY NEW OFFERING, HAVING BEEN AROUND FOR JUST 18 MONTHS. THOUGH IT DOES NOT HAVE A SUFFICIENT LONG-TERM TRACK RECORD, IT HAS IMPRESSED IN ITS SHORT HISTORY. FUND MANAGER JAYESH GANDHI TELLS LARISSA FERNAND WHAT MAKES THIS ONE TICK.

What has contributed to the tremendous alpha of the fund?

A combination of sector calls and bottom-up stock picking. Our portfolio sector allocation is similar to a barbell strategy, where we are overweight on stocks at the two ends of the risk spectrum; simultaneously overweight in high growth infrastructure sectors (power generation, gas pipelines, capital goods, industrials) and defensive sectors

(FMCG, pharmaceuticals).

During the last six months, we also increased the mid-cap exposure to participate meaningfully in the broad market rally.

Our attribution analysis report shows that the alpha generation is spread across the top 20-30 stocks. No single stock or sector has been a large contributor to performance, but multiple drivers spread across stocks and sectors. This is impor-

tant because concentration risk is lower and yet return goals have been achieved.

Can you name a few stocks and sectors?

Our call on being overweight on Power Generation, Gas Transportation, EPC Contractors, Pharma, FMCG and Banking (now underweight) have delivered handsomely. Being underweight on Telecom and Software also helped. A few of our bottom-up stock picks that contributed significantly to alpha are Jindal Steel & Power, Yes Bank, GSPL, Aurobindo Pharma and Sterlite Technologies.

Capitalising on the rally from March 2009 onwards at the very start also helped.

Yes, to some extent. Our top-down macro view in February 2009 was that the market had bottomed out on valuations. As a result, our portfolios were fully invested by February and March this year.

However, the biggest rise in alpha has taken place in the last five months, post May 2009. Basically, the 14-month bear market (January 2008 - March 2009) was more macro driven, with individual company fundamentals having a limited impact. Broad market participation took place in a meaningful way only post-May 2009.

With the macro tail-risk now behind us, stock returns and price performance are now driven more by individual company earnings and sector prospects. Our team's strength lies in sector allocations and bottom-up stock selection, which has begun to matter in the market in the last 6 months.

What makes you decide when to change your market cap allocation?

Multiple factors go into making the mid-cap allocation decision, the basic logic being economic growth. When economic growth is accelerating, the broad market is more likely to do better than the narrow

large-cap market and vice versa. So when economic growth is accelerating, the benefit from incremental economic activities in the economy would be felt across a large number of sectors and stocks. In a situation of economic expansion, it would be worthwhile to increase broad market participation — meaning mid caps, in the portfolio.

Is that why your mid-cap exposure has been rising recently?

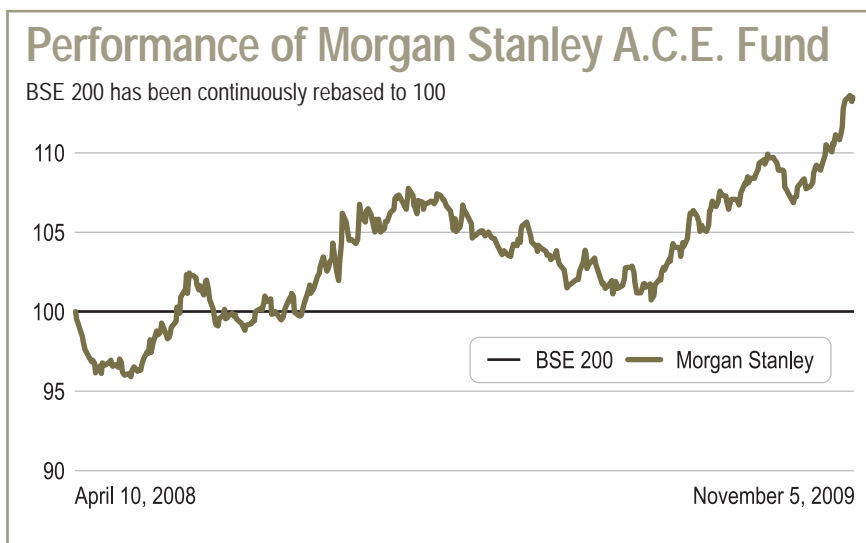
A year ago, we saw the reverse of the current situation when economic activity was decelerating. At that time, we built a portfolio that was predominantly large-cap oriented.

strong management track record, capital efficiency, operating cash flow generation, high promoter holding and limited dilutions.

Why do you have such a high turnover ratio?

It's the result of high volatility in the equity market. The market was down 50-60 per cent and then recovered the entire fall in a year's time. Over the last 6 months, we have had a rise of over 100 per cent in the equity markets. Typically, high equity market volatility leads to a high portfolio turnover.

Talking specifically for the A.C.E. Fund, our portfolio stance



Today, we have around a 35 per cent portfolio allocation to mid-cap stocks as we see economic activity picking up. Our mid-cap stocks have been picked based on bottom-up stock research spread across sectors. Being a multi-cap fund, our portfolio strategy allows us to dynamically change the mid-cap exposure depending upon our assessment of risk appetite of the market.

With higher mid-cap allocation, risk management assumes significance. We manage mid- and small-cap risk through diversification, spreading allocations across stocks and sectors. Each holds a limited but meaningful allocation ensuring that we do not run stock specific risk. We look for companies with a

and composition has changed significantly post May 2009. Pre-May was a bear market where the portfolio stance and composition was more conservative and capital conservation was a pre-dominant objective. Post May, the outlook for Indian equities improved dramatically and it changed from a bear to a bull market. Our portfolio stance and allocation underwent a change reflecting the new market realities. The extraordinary volatility in the equity market and the dramatic changes in outlook during the last 12 months prompted changes in the portfolio which has led to a high turnover. In a more normalized situation, we expect it to come down.