



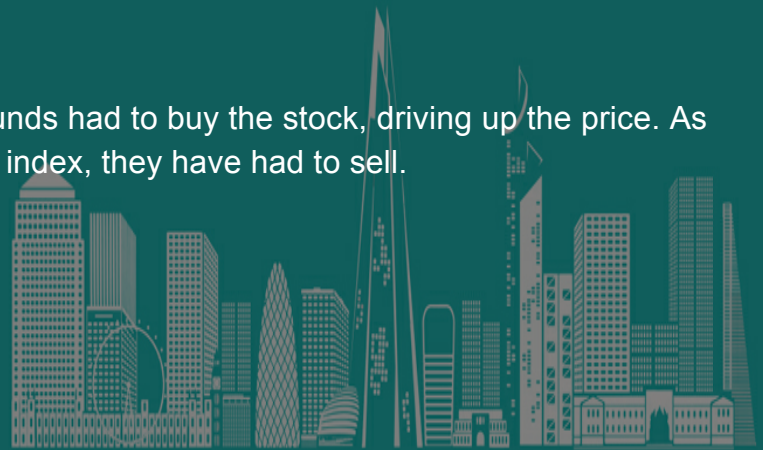
News

Buy High, Sell Low

When Adani came into the India index, passive funds had to buy the stock, driving up the price. As the price has fallen, reducing the weighting in the index, they have had to sell.



Samir Mehta



16 Feb 2023

Adani and Down

As Adani's share price fell, so did its weight in the index, forcing passive funds to sell



Let me declare upfront that as an active manager of equities, I am biased in this conversation. Morgan Stanley Capital International (MSCI) occasionally decide to include or exclude stocks into their indices. There is a rigorous process (no, seriously) on how those companies are selected to represent the best proxy for a country, a sector, or a theme. Many a times they do get it right. But sometimes they do not.

As an active manager, I have never owned any of the Adani related stocks. That could change in the future, but so far, they have not met our criterion for good quality long term sustainable businesses. Some like Adani Ports did tempt me but the financing structure was an issue. Inclusion into the MSCI index for some of the group companies in June 2021 led to a rise in stock prices, in part as passive investors had to buy these stocks.

On 24 January, it came out that a short seller had issued a report with some damning accusations, including what might have led to that rise in prices* . That report led to a dramatic fall across all of Adani Group stock prices. On 8 February MSCI announced they will reconsider the 'free float' methodology. Should this go ahead, the effect is likely to be to reduce the weights of all Adani stocks in the index. Passive owners should then be expected to sell those stocks, with the probable effect of having bought high and sold low.

I have made mistakes galore in picking stocks. 2018 was, as some of you might remember, a tough year for our fund but I did learn from my mistakes and subsequently put some of them right.

Since March/April 2022, I have held the view that Indian stocks are expensive relative to their growth expectations. The long-term outlook for the Indian economy and several businesses in India is sound. Yet the risks in my opinion (inflation, margin pressure, slower disposable income growth for consumers, rising interest rates and the Reserve Bank of India behind the curve on raising rates) were equally high. This episode around the Adani Group is a reminder for investors to recognise what was beneath the surface. One lesson (my bias seeping through) is active management does have a role to play in managing portfolios. The other is that when valuations are high and risks ignored, the subsequent fall in stocks can be good for us. As usual, we have some names on our radar to add to or purchase in India. Time is on our side and there is some further collateral damage that Indian equities will need to bear from the fallout of the Adani saga.

Source: *Reported on Bloomberg.com 25 January 2023.

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