YEAR-END NOTE FROM YOUR FUND MANAGER - ABHISHEK SINGH

DSP Top 100 Equity Fund

Large Cap Fund- An open ended equity scheme predominantly investing in large cap stocks

DSP Equity Savings Fund

An open ended scheme investing in equity, arbitrage and debt

DSP Aggressive Hybrid Fund

(erstwhile known as DSP Equity & Bond Fund)

An open ended hybrid scheme investing predominantly in equity and equity related instruments

January 2025

DSP MUTUAL FUND

The Relentless Chorus of What Ifs

Dear Investor,

In 2024:

What Did We Do?
You stayed invested.
I stayed rational.
We stayed the course.

How Did It Turn Out?
It was a good year.
(although we shouldn't get caught up in yearly performance)

What We May Need This Year?
You: Patience, Equanimity
Me: Discipline, Resilience
(always essential but near term may test us more)

Does Anything Change Medium Term?
No.
Our active, benchmark-agnostic strategy will have its ups and downs in the short term, but I'm confident we should do well over the medium term.

I believe equities will do well over time. You should continue with your SIPs. Have a simple asset allocation plan and execute it using simple products.

Outlook:

- I don't know what markets are going to do in 2025.
- Last year, I wrote that markets seemed expensive and suggested you should lower your return expectations. Nifty 50 and Nifty 500 gave 10% and 16.2% returns in 2024, including dividends (Source: Bloomberg). I'd be happy with double-digit returns this year. With single-digit earnings growth expected, this would need either earnings surprises or rerating in valuation multiples.
- The segments with opportunities appear to be Financials (as I believed last year, too), Oil & Gas, and Autos.
- Large cap returns could be more competitive going ahead.

Too much involvement often ends up hurting investors. Counterintuitively, investing returns go to those not chasing them too vigorously. So, you can stop reading here if you'd like.
In the rest of this letter, I share some debates I grapple with. We underestimate the role of luck in both poor and outstanding outcomes. But the things you are struggling with are often more revealing. These conversations aim to convince you that your savings are managed consciously and conservatively. Trust in the fund manager and staying invested is becoming more important with higher equity taxation.

Have a great 2025. May you cherish life's smaller joys (like staring at your family members). Most other things don't matter much anyway.

Regards,

Abhishek Singh

The (tempting) Case for Being More Tactical

On average, 27% of stocks move more than 20% each quarter*. There is always something urgent or interesting in markets. This creates anxiety that a policy change, business update, or flows will move certain stocks. Those stocks might be in your benchmark—and worse, in your competition's portfolio. And slowly, almost imperceptibly, the tempting question crawls onto you: Should I take a small exposure to capture these moves?

You justify it by saying you're not risking much—maybe a per cent. A related question is: it wasn't probably too hard to make educated guesses about which IPOs would perform well, at least on listing days. So why didn't I invest small amounts in these IPOs to make that extra 0.5% or 1%? (I didn't invest in any equity IPO in 2024. I am open to that possibility, but it would be rare.)

Because it's a slippery slope.

Portfolio management is a complex system; changing one element often affects the rest. To take these marginal positions and chase tactical moves, I would have to become someone who regularly takes such risks. That could lead to behaviours I deliberately avoid today. Systematic strategies might handle this better, and perhaps more capable men and women than me can manage this approach. But for me, some roads are better left not taken.

Additionally, the number of positions with this approach can grow quickly, diluting what you stand for. I prefer about 25 to 35 stocks. Sleep and Zakaria highlight the following in the Nomad letters:

In our opinion, just a few big things in life are knowable. And it is because of just a few things that are 'known' that Nomad has just a few investments. The church of diversification, in whose pews the professional fund management industry sits, proposes many holdings. They do this not because managers have so many insights but so few! In this context, diversity is seen as insurance against any wrong idea. Like Darwin, we find ourselves disagreeing with the theocracy. We would propose that if knowledge is a source of added value and few things can be known, then it logically follows that owning more stocks does not lower risk but raises it! Index funds offer real diversification at a fraction of the price of active management.

Sometimes, you may need to be tactical due to limited opportunities or constraints like stock, sector, or cash limits. However, as of now for me it remains a last-resort option.

The (contested) Case for Cash

In one of my funds, I held about 10% cash for a few months during the year. You can adjust equity exposure in hybrid funds, and I've been running closer to the lower bands.

Should your fund manager hold no cash? Should they buy the Index instead?

Holding 10% or even 20% cash is not a market call. This cash potentially earns mid-single digit returns. If forced to deploy, your fund manager might buy something down 30% in a rising market. You pick an active fund manager to make these decisions on your behalf. And if the argument is to deploy in "half-decent" ideas, please refer to the previous section.

Many problems in our industry come from chasing relative performance. The notion that we must find a relative idea, no matter how weak in absolute terms, stems from this mindset. In sectors, everything gets benchmarked to the highest multiple often of the sector leader —even if it's multiple makes no sense.
You beat the benchmark over time by ignoring it. Else, you might win a few battles but lose the war. If you doubt it, browse through the SPIVA reports.

You should judge active fund managers based on their performance relative to benchmarks over the medium to long term. Therefore, the argument that this minor cash position affects your asset allocation doesn't hold water.

Most managers with good long-term records, I know, have had an absolute mindset. This mindset mandates holding some cash at all times and more at certain times.

If you're invested down to the last bip, how will you buy when the right opportunity comes? If this is a declining market, you will have to sell something that's fallen less, which can be a tricky balance.
There are worse things in life than sitting on some cash. And ideas come to you – eventually.

Internal, ARQ, over last 10 years, 2014 to 2024 | IPO- Initial Public Offering;* ***Disclaimer: Past performance may or may not sustain in future and should not be used as a basis for comparison with other investments.* *The investment approach / framework/ strategy mentioned herein are currently followed by the scheme and the same may change in future depending on market conditions and other factors.* ***Disclaimer:*** *The investment approach / framework/ strategy mentioned herein are currently followed by the scheme and the same may change in future depending on market conditions and other factors.*

The Case for Strategic Retreat

Assume a telecom company generates INR 35,000 Cr of free cash flow (FCF) at an ARPU of INR 300, with 35 Cr subscribers. If the ARPU increases to INR 400, the incremental revenue would be INR 100 × 12 × 35 Cr, or INR 42,000 Cr. With a 65% FCF conversion rate, this adds INR 20,400 Cr to FCF, taking the total FCF to INR 52,400 Cr.

Now, using an 11% cost of capital and assuming these cash flows grow at 5% in perpetuity, you would capitalize the INR 52,400 Cr at 6% (11% - 5%). This results in a valuation of INR 8.73 lakh Cr.

The question is: would you buy this telco at this price?

What if a competitor is planning an IPO? What if that IPO must achieve a certain valuation to give older investors a respectable IRR? Notice how convoluted this reasoning becomes—why should the "required" IRR of previous investors matter at all?

What if ARPUs typically grow slower than inflation? What if ARPUs in neighbouring countries are already at similar levels (INR 400), even though most products and services in our country are usually priced at a steep discount?

Now, your assumptions might differ, leading to a higher or lower valuation. And that's perfectly fine. But this line of thinking seems almost absent from the debate. The conversations are fixated on events, multiples, and narratives.

As a fund manager, revisiting the same debates is exhausting. One suggestion I often hear is to simply retreat—take a token position and focus time, energy, and mental bandwidth elsewhere.

So far, I've tried to resist this. But I keep grappling with the argument that 90% fidelity is easier than 100%.

ARPU- Average Revenue Per User, IPO- Initial Public Offering, IRR- Internal Rate of Return; ***Disclaimer:*** *The investment approach / framework/ strategy mentioned herein are currently followed by the scheme and the same may change in future depending on market conditions and other factors. The above-mentioned example is for illustration purpose only*

Buy, Hold Or Sell

You obviously want to get all three right: buy at the right price, hold for the right time, and sell near the top. But it's really hard to do that. That's why I feel you need to get at least one of them very right. For me and probably most 'value' investors, the focus is on buying at the right price.

Most such investors often sell too early. Over the past five years—until the recent market correction—many stocks that were sold went on to climb much higher. This led to a bias creeping into many investors' processes: holding on longer and being more tolerant of overvaluations when deciding to sell. It's a challenge that many investors are likely struggling with.

One way to counter this bias is to always look for new investment ideas. Having a new idea makes the decision to sell easier. Instead of trimming a position, you fully exit. However, for valuation-focused investors, the market hasn't been as rich in opportunities in recent times. This has made the problem harder, especially with the pressure many feel to replace a stock quickly instead of holding cash.

In a world where conversations increasingly focus on multifaceted approaches—adopting AI, incorporating technical and systematic signals—I remain convinced that the bulk of performance still comes from getting the price-value equation right—doing so in the precise, old-school way that many are eager to move beyond. Everything else has its place, but it offers marginal efficiencies compared to the importance of getting the core right.

What works for me is selling when my thresholds are met, even if I don't have an immediate replacement idea. I've always followed this but could have followed it more intensely.

I hope you notice how all these issues are interconnected – how it's always an evolving system where many elements need to change if you want to change anything. The relentless chorus of what-ifs can be exhausting).

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The Good, The Bad & The Usual

The Good:

The portfolio performed well despite negligible exposure to industrials, infrastructure names, or any narrative-driven thematic stocks. While we had significant exposure to financials—which generally underperformed—some of the stocks we hold in that space, such as ICICI Bank, did well in 2024. Another major contributor to the portfolio's returns was Mahindra and Mahindra, a large position for us. Healthcare was one of our largest exposures, and it turned out to be among the best-performing sectors in 2024. What's often underappreciated is that this performance wasn't driven by narratives or reliant on major events in India or globally. Instead, it was fueled by strong performance across multiple segments—India branded, US generics, CDMO, Hospitals and others.

In an environment where it was tempting to loosen our frameworks, we were able to execute our process with a high degree of fidelity. There is always room for improvement, but our behaviour and the quality of conversations I've been having with many of you give me confidence that we are on the right path.

The Bad:

In some cases, I took longer to decide on selling or exiting certain positions. It's difficult to judge with absolute certainty how differently I could have acted in those situations. This wasn't due to a lack of information or analysis—just moments of fuzzy thinking. I will do better.
Separately, I have been and continue to be underweight in the IT sector. This positioning has hurt us, but I still haven't concluded that it was or is the wrong decision.

The Usual:

We continue to maintain significant exposure to financials, including banks, NBFCs, and insurance companies. Most high-quality franchises in these sectors are likely to deliver mid-teen ROEs (as per Bloomberg consensus expectations) over the next three years (potentially higher for certain NBFCs). This implies that the underlying value should also compound at this rate unless there's a meaningful derating in valuation multiples. However, it's worth noting that there are few areas today where large amounts of capital can be deployed to generate mid-teen returns. These returns, though, may come with periods of volatility.

It's also important to understand that concerns about credit costs or slower credit growth often reflect broader economic issues. Much of the economy, in turn, is currently trading at stretched valuation multiples.

We have significantly reduced our Pharma exposure from its peak, primarily in response to the sector's rerating.

CDMO- Contract Development and Manufacturing Organization, NBFC- Non Banking Financial Company, ROE- Return on Equity ***Disclaimer:*** *The sector(s)/ stock(s)/issuer(s) mentioned in this document do not constitute any recommendation of the same and the Fund may or may not have any future position in these sector(s)/stock(s)/issuer(s).The investment approach / framework/ strategy mentioned herein are currently followed by the scheme and the same may change in future depending on market conditions and other factors.*

We also hold substantial positions in auto and auto ancillary businesses. It's worth emphasizing that, when it comes to tractors, two-wheelers, and certain auto ancillary segments, India stands out as the largest and most competitive player globally—something that is overlooked at times.

On Funds

DSP Top100 Equity Fund: We typically hold around 30 stocks. Our recent performance has been good. As I often emphasize, our active, benchmark-agnostic strategy means we won't consistently outperform benchmarks on a monthly, quarterly, or even yearly basis. However, I am increasingly confident that we should be able to do so over the medium term. Given the portfolio's current positioning, I believe this Fund is well-suited to attract long-term equity capital with a 10-year horizon. The odds favour the large-cap category in the current environment.

DSP Equity Savings Fund: The equity portfolio in this Fund resembles the DSP Top 100 Equity Fund portfolio to a large degree. After a long time, our strategy of using out-of-the-money put options helped in the last quarter of the year, reducing the NAV fall. Much of the money we attract in this category comes from medium-term debt investors, who are generally OK with some drawdown. We also attract hesitant investors who eventually want to switch to equity but are currently uncomfortable with market valuations. If markets continue to correct, some of this money could move to the Large Cap or Aggressive Hybrid category. If I make such a shift in my personal portfolio, I'll share it with our teams so they can inform you. The typical Investor in this category is not focused on chasing an additional half or one per cent of returns but is more concerned about managing volatility and drawdowns. Our strategy is designed to reflect and, to some extent, address those concerns.

DSP Aggressive Hybrid Fund^: I took over the Fund in March 2024, and since then, we've made a fundamental attribute change:

- **Equity Allocation Range**: Adjusted from 65%-75% to 65%-80%.
- **Covered Call Option**s: Enabled the writing of call options.
- **International Equity**: Introduced a provision to invest in international equity, to be utilized if and when RBI limits reopen.

Most investors maintain 70%- 80% equity exposure in their portfolios and pay marginal taxes on their debt holdings. However, there's significant merit in managing the entire portfolio within the wrapper of an aggressive hybrid fund. These funds are market cap and sector agnostic for the 70% odd equity allocation, while the debt portion improves post-tax outcomes.

Disclaimer: *The sector(s)/stock(s)/issuer(s) mentioned in this document do not constitute any recommendation of the same and the Fund may or may not have any future position in these sector(s)/stock(s)/issuer(s). The portfolio details are as on 31st December 2024. The investment approach / framework/ strategy mentioned herein are currently followed by the scheme and the same may change in future depending on market conditions and other factors. Large caps are defined as top 100 stocks on market capitalization, mid caps as 101-250 small caps as 251 and above. The investment approach / framework/ strategy mentioned herein are currently followed by the scheme and the same may change in future depending on market conditions and other factors.* Please refer to Notice cum addendum dated October 22, 2024 for change in fundamental attribute of scheme with effect from November 28, 2024.*

^ erstwhile known as DSP Equity & Bond Fund

Additionally, fund managers are compelled to buy more equity during sharp market corrections and sell after sharp rallies to rebalance the equity allocation. This automatic rebalancing and other features make this my favourite mutual fund category. It's a versatile option suitable for a wide range of investors.

Currently, 67% of the equity portfolio is allocated to large caps. There is significant overlap across the portfolios of all three funds. However, when the mid- and small-cap space becomes significantly more attractive, the DSP Aggressive Hybrid Fund portfolio could diverge meaningfully from the DSP Top 100 Equity Fund portfolio.

I feel a small sense of pride in the quality of investors that I have been able to attract. I hope to fully justify the trust you have placed in me. I am a better investor today than I was three years ago. And every three years, I promise to be able to say the same.

For any queries, feel free to write to:

- DSPTop100@dspim.com
- ESFPortfolio.Queries@dspim.com
- DSPAggresiveHybrid@dspim.com

Thank you for investing with us.

Abhishek Singh

January 2025

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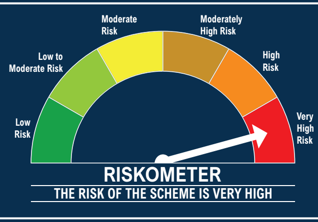
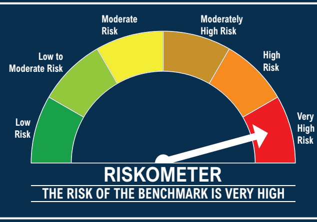
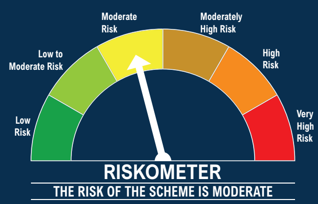
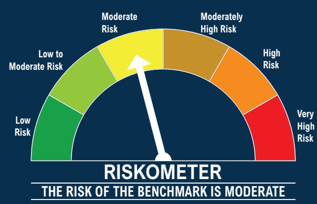
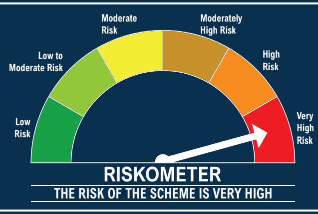
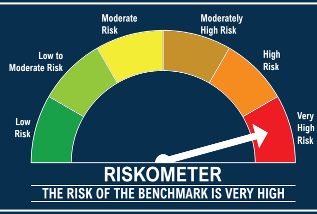
Large-caps are defined as top 100 stocks on market capitalization, mid-caps as 101-250, small-caps as 251 and above.

Scheme	Product Suitability	Riskometer	
DSP Top 100 Equity Fund Large Cap Fund- An open ended equity scheme predominantly investing in large cap stocks	This product is suitable for investors who are seeking*: • Long-term capital growth • Investment in equity and equity-related securities predominantly of large cap companies	**DSP Top 100 Equity Fund** 	**Benchmark - BSE 100 (TRI)** 
DSP Equity Savings Fund An open ended scheme investing in equity, arbitrage and debt	This product is suitable for investors who are seeking*: • Long term capital growth and income • Investment in equity and equity related securities including the use of equity derivatives strategies and arbitrage opportunities with balance exposure in debt and money market instruments.	**DSP Equity Savings Fund** 	**Benchmark – Nifty Equity Savings Index TRI** 
DSP Aggressive Hybrid Fund (erstwhile known as DSP Equity & Bond Fund) An open ended hybrid scheme investing predominantly in equity and equity related instruments	This Open Ended aggressive hybrid scheme is suitable for investors who are seeking* • Capital growth and income over a long-term investment horizon • Investment primarily in equity/ equity-related securities, with balance exposure in money market and debt Securities	**DSP Aggressive Hybrid Fund (erstwhile known as DSP Equity & Bond Fund)** 	**Benchmark - CRISIL Hybrid 35+65- Aggressive Index** 

*Investors should consult their financial advisors if in doubt about whether the scheme is suitable for them.

Mutual Fund investments are subject to market risks, read all scheme related documents carefully.