



Ajit Menon
CEO

Portfolio Co-morbidities

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Dear investors,

The world is currently torn between optimism about a massive vaccination drive that is underway and pessimism due to the onset of the second wave of Covid in various parts. The second wave in India has created an environment of gloom. Our medical infrastructure is struggling hard to cope with the enormity of the challenge. In this hour of crisis, we do hope and pray that the situation comes under control quickly.

Immunity is clearly coming up in the pecking order in the fight against COVID. The data so far suggests that people with co-morbidities are at higher risk than healthy individuals. Immunity cannot be built by practicing healthy living only during the crisis. Though genes do play a role, balanced nutrition, regular exercise, adequate sleep, a positive mental state are some of the factors that help build immunity over a long term. There is no short cut for building immunity as it takes years of effort and discipline.

In some sense financial portfolios are also like human beings. Like human beings go through an existential challenge during the pandemic, portfolios go through the challenge in a down cycle. Healthy human beings have a better chance of surviving and prospering during and post the pandemic and so do healthy portfolios. To build a healthy portfolio, like a healthy body it takes planning and discipline over the years.

We all know the comorbidities for a human being. Over the years I have observed what comorbidity looks like for a financial portfolio. I thought it would be appropriate to share my perspective on the same. Some of the factors that could prevent a financial portfolio from bouncing back after a financial crisis are higher proportion of illiquid assets, concentration to few securities or an asset class, lack of diversification across asset classes or an imbalanced asset allocation, having highly correlated assets. The good news is that you can correct these portfolio “co morbidities” faster than those related to human health and wellness.

We quite often see businessmen locking up their wealth either in their own business or real estate keeping very little liquidity. Whenever there is a severe economic downturn, liquidity dries up for business and to keep business going, the real estate must be sold at distress valuations or money borrowed at exorbitant rates inflicting permanent damage to the portfolios. On the other end of the spectrum some salaried individuals maintain a major portion of their wealth in the form of ESOPs of the company they work for. The conviction in the good future of the company they are working for is quite understandable. But today's world is full of disruption. Innovation happening in some part of the world could easily disrupt the incumbent in any industry. So having a major portion in shares of a single company may not be the best idea.

Similarly having exposure to a single asset class/ closely linked asset classes can also be a co-morbidity for the portfolio. Every asset class goes through a cycle. Some have short cycles while some have cycles that run for years. If the asset class is going through a down cycle when investor needs the cash flow, it will impact financial health in the long term. Having highly correlated assets will also be of little help. Some investors opt for safer asset classes to avoid any form of volatility. While such portfolios do not have liquidity challenges, they may not have the strength to outperform inflation over long term.

A good MFD/RIA can help you construct a health portfolio. My personal portfolio is managed by an expert. My recommendation would always be to have an experienced, competent and trusted guide. It helps mitigate the risks that arise from your personal biases that can have an adverse impact on your long term saving and investment objectives.

This is quite a challenging phase making it difficult to imagine life returning to normalcy; but in countries like Israel, US and UK where a large percentage of the population have been vaccinated, life is coming back to the pre-pandemic era albeit with some restrictions. Given our set of unique challenges it may take a little longer, but we will get there. Till then we cannot let our guard down. We already know that wearing the right type of mask properly, washing hands, maintaining a distance and ventilating spaces well are very important to protect ourselves and our near and dear ones. Stay vigilant, stay safe.

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