

Omniscience Capital's Four-Folio Study Reveals Investment Opportunities in Overvalued Markets

- Companies are categorized as Capital Destroyers, Eroders, Imploders, and Multipliers to enable investment decisions
- India's equity markets require a well-defined strategy to navigate over 5,000 listed companies
- Large caps are pretty reasonably valued; midcaps and small caps overvalued but with latent growth opportunities

Bangalore 27th January 2025: According to a report by smallcase manager - Omniscience Capital, "**Omni Four Folios: Study on Indian Equity Markets**" —The Indian stock market has over 5,000 listed companies. This requires a structured and disciplined investment strategy. It reveals that, as of December 25, 2024, the trailing twelve-month price-to-earnings (PE) ratios for major indices such as Nifty 50 (23.3), BSE Midcap (29.9), BSE Smallcap (32.6), and Nifty 500 (26.7) reflect a market close to its historical averages for large caps but overvalued in midcaps and small caps. Despite this, the deep pool of smallcap stocks often presents some hidden opportunities for significant growth when approached strategically. The study advises against market timing and instead focuses on long-term wealth creation through systematic analysis.

Index	TTM-PE Ratio
Nifty 50	23.3
BSE Midcap	29.9
BSE Smallcap	32.6
Nifty 500	26.7

Speaking on the study, Dr Vikas Gupta, smallcase Manager and CEO, of Omniscience Capital said, “Our view at OmniScience Capital is to always invest in at least 20 companies. Typically, our recommended portfolio would have 20-50 companies. We would suggest the same to investors when selecting companies for their portfolio; never allocate more than 5% to a single company. Further, attempt to diversify across sectors and industries. Ideally, one would allocate to 4-6 different industries.”

Total investible universe chosen for this study are companies having Market Cap of INR 1,000 crores or above. As of 25th December 2024, this number stood at 1,377 companies. Once the total investible universe is selected, Omniscience Capital applies their proprietary Scientific Investing Framework to the universe, dividing the market into the above categories.

The core of the research by Omniscience Capital is the Scientific Investing Framework, which incorporates the mental model of ‘inversion’ inspired by Legendary investor Charlie Munger. This approach starts with identifying and eliminating companies likely to destroy or erode investor wealth. The research highlights the challenges of the current market landscape, where perceptions of overvaluation and conflicting advice leave many fund managers sitting on cash instead of identifying alpha-generating opportunities.

The framework categorizes companies into four distinct groups: **Capital Destroyers, Capital Eroders, Capital Imploders, and Capital Multipliers.**

- Capital Destroyers have weak fundamentals with high risk.
- Capital Eroders are profitable companies that generate a low return on capital.

- Capital Imploders are fundamentally very strong but extremely overvalued and likely to underperform.
- Ideal investment targets will be Capital Multipliers, which show strong balance sheets, competitive advantages, and favorable valuations.

Basis the study, Omniscience Capital has detailed some actionable insights.

Capital Destroyers folio companies are likely to cause the largest damage to investors. Smallcaps dominate this folio, 341 of the 374 companies are Smallcaps. Chemicals, Real Estate Operations, Textiles & Apparel, Construction & Engineering, Telecommunications Services, Metals & Mining, and Automobile & Auto Parts are some of the industries which are represented significantly in this folio. If one is allocated in these industries, one should do a rigorous due diligence of these companies.

Capital Eroders folio is dominated by industries such as Automobiles & Auto Parts, Chemicals, Oil & Gas and Machinery/Components. Many of these industries also constitute a significant proportion of the Capital Destroyers portfolio, suggesting that some of these industries are avoidable due to the underperformance and/or weak competitive advantage of the industry as a whole. (Having said that, any industry can and probably would have at least some companies within the Capital Multipliers portfolio, dependent on having superior growth and better competitive advantages over their competitors).

Capital Imploders folio companies have strong balance sheets, consistent profitability and high growth rates. However, these companies are extremely overvalued and thus need to be avoided. For example, one could avoid the Personal & Household Products & Services companies since most of them are overvalued. The Capital Imploders portfolio also has presence of Chemicals, Software & IT Services, Pharmaceuticals, Textiles & Apparels, and Food & Tobacco companies. Many of these companies have high growth rates but are extremely overvalued even accounting for those high growth rates.

Where to look for Potential Alpha?

Capital Multipliers are the favorite hunting grounds for alpha-generating opportunities. Even better is the Super Folio which is a subset of Capital Multipliers folio. This folio has companies with strong balance sheets, persistent competitive advantages, high growth rates and are, typically, available at significant discounts to their intrinsic values. For example, Banking Services is more than 50% by weight and large caps are more than 80% by weight. This means that one could look at large cap banks as a potential investment.

Besides, some specialized infrastructure NBFCs, and housing finance companies could hold a higher likelihood of undervaluation. Besides, the Banks, Construction & Engineering, Chemicals, Automobiles & Auto Parts, and Metals & Mining are some of the other industries in this folio. The most promising subset of the Capital Multipliers is called the Super Folio, which consists of companies with high growth potential, competitive moats, and undervaluation. These companies have the highest probability of delivering exceptional returns in the long term. This framework is to be applied to about 1,400 companies with a market capitalization of INR 1,000 crore or more, in order to guide investors to make informed decisions on the Indian markets.

About OmniScience Capital

OmniScience Capital is a Global Investment Management firm focused on global equity investments empowered by its proprietary Scientific Investing philosophy.

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