

Mutual Fund Insight

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NIRMAY CHOKSI

Buffett's philosophy, quantified

Balancing value and quality factors with discipline

“**V**alue” is one of the most overused words in investing. At its core, though, value investing is a straightforward idea, identifying companies trading below their intrinsic worth. Investors typically rely on familiar metrics like price-to-earnings (P/E), price-to-book (P/B) or the PEG ratio to spot such opportunities.

The underlying bet is that markets are inefficient in the short term but rational over time. Prices may deviate from fundamentals, but sooner or later, they converge. That process, commonly known as mean reversion, is what unlocks returns for patient value investors.

From Graham to Buffett, and beyond

Value investing built its roots with Benjamin Graham, who preached the virtues of a “margin of safety”, buying a dollar for 50 cents. Warren Buffett evolved the philosophy further by looking beyond cheapness to strong businesses. He sought companies with durable moats, capable management and predictable earnings.

Over the decades, the philosophy evolved from buying “cheap” stocks to identifying sustainable businesses trading below fair value. Indian investors, too, have shown an enduring fondness for low P/E names, a reflection of their instinctive belief that value eventually asserts itself.

Buying cheap stocks without examining quality is like catching falling knives—statistically defensible, but painful

The trap behind cheapness

Not all low-priced stocks are bargains. Even the seasoned investor sometimes faces the value trap: a stock that looks cheap but stays that way. Investors buy expecting a P/E rerating, only to be stuck with businesses that remain perpetually undervalued. The trap usually springs when low valuations mask deeper issues: weak earnings, high debt, poor cash flows, or governance lapses.

The data tells a clear story. When investors focus solely on low valuations and ignore quality, the results can be damaging. These ‘value traps’ generally exhibit higher volatility, steeper drawdowns, and a higher probability of loss.

The message is clear: buying cheap stocks

When cheap becomes costly

So-called bargains bring volatility and sharp losses

	Annualised volatility (%)	Maximum drawdown (%)	5-year loss probability (%)
Value traps	26.6	-81.3	25.0
Low valuation portfolio	23.5	-71.0	5.2

Source: CMIE, NJ Asset Management Private Limited Internal Research, and NJ's Smart Beta Platform (an in-house proprietary model of NJAMC). Calculations are for the period 30th September 2006 to 31st August 2025. Value Traps represents the bottom tercile stocks based on Quality from the Low Valuation Portfolio, which represents the top 100 undervalued (lowest PE) stocks within the Nifty 500 universe. Past data may or may not be sustained in the future and is not an indication of future return.

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Why quality is the new margin of safety

Quality is the antidote to the value trap. Businesses with sound balance sheets, steady cash flows, prudent capital allocation and transparent governance avoid the pitfalls that plague low-quality peers. These traits don't just reduce risk; they enhance compounding. But quality doesn't usually come cheap. The higher price tag is the market's way of saying these businesses can last. Paying up for such reliability is like paying an insurance premium for peace of mind. In today's markets, value investing without a quality lens feels incomplete. Price matters, but context matters more.

Enter QARP: Where value meets quality

The modern answer to traditional value investing is QARP (quality at a reasonable price), an approach to identifying strong businesses available at fair or modestly discounted valuations. QARP avoids both extremes, overpriced quality stocks that test patience and "broken" value stocks that test nerves. It focuses on balance, the intersection where fundamental strength meets valuation discipline. Data support this evolution. Portfolios that blend quality and value consistently deliver superior risk-adjusted returns. The QARP quadrant, low valuation and high quality, has historically outperformed its peers, offering better compounding and lower drawdowns. In practice, QARP investors aren't bargain-

hunting; they're selective pragmatists. They prize financial stability and governance standards as much as they do attractive entry points.

Buffett put it best: "It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price."

The anatomy of value and quality

High quality at right price is the sweet spot

	Low quality	High quality
Low valuation	Value trap	QARP sweet spot
High valuation	Overhyped risk	Expensive quality

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The new definition of value

QARP is value investing upgraded for modern markets, a framework where quality is the new margin of safety. It filters out short-term noise, resists the temptation of "cheap for a reason" stocks, and anchors portfolios in businesses that endure across cycles. It also aligns perfectly with NJ AMC's philosophy, 100 per cent rule-based, quality-focused investing that seeks undervalued opportunities within a quality universe. QARP reminds us that the real bargain is not the lowest price, it's the best value for money. ☑

Nirmay Choksi is the Director and Head of Investment at NJ Asset Management Private Limited. The views expressed above are his own.

The sweet spot of sensible investing

QARP portfolios strike the perfect balance

Portfolio	Annual return (% pa)	Sharpe ratio	Median rolling return (% pa)			
			1-year	3-year	5-year	10-year
QARP	21.3	0.63	18.2	24.5	20.9	21.6
Overvalued quality	17.0	0.50	14.9	19.7	15.8	16.8
Pure quality	19.5	0.60	16.2	21.5	19.4	19.8
Pure value	15.6	0.38	14.0	16.5	11.9	13.6

Source: CMIE, NJ Asset Management Private Limited Internal Research, and NJ's Smart Beta Platform (an in-house proprietary model of NJAMC). Calculations are for the period 30th September 2006 to 31st August 2025. QARP and Overvalued Quality represent the top and bottom tercile stocks based on Valuation from the NJ Quality+ Model (here referred to as Pure Quality). Pure Value represents the Top 100 stocks based on P/E from the Nifty 500 universe. NJ Quality+ Model is an in-house proprietary methodology developed by NJAMC. These methodologies are dynamic in nature and will continue to evolve with ongoing research and insights and may be updated from time to time. Past data may or may not be sustained in the future and is not an indication of future return.