GUARDIAN CAPITAL PARTNERS

INVESTOR NEWSLETTER – QUARTER ENDED JUNE 2023

A. PAST PERFORMANCE:

Period:	Last 3 Months	Last 6 Months	Last 1 Year	Last 2 Years	Last 3 Years	Since Inception
						Jan-20 to Jun-23
Cumulative Returns						
Portfolio	15.3%	14.9%	36.7%	32.5%	153.7%	217.9%
Sensex	9.7%	6.4%	22.1%	23.3%	85.4%	56.9%
Outperformance	5.6%	8.5%	14.6%	9.2%	68.4%	161.1%
Annualized Returns						
Portfolio			36.7%	15.1%	36.4%	39.2%
Sensex			22.1%	11.1%	22.8%	13.7%
Outperformance			14.6%	4.1%	13.5%	25.4%

Market sentiment changed this quarter and animal spirits came roaring back! The Sensex was up 9.7% this quarter, but broader indices were up even more with the BSE Small Cap Index up 20.9%!

The underlying positives for the Indian market remain in place: A) strong earnings momentum with EPS growth for Sensex expected to be ~20% over the next 12 months, and B) India benefitting from the shift away from China as the preferred EM for investments.

What changed this quarter was the gradual receding of market concerns: A) with US and western markets inflation cooling, interest rate hiking cycle is closer to its end, B) no further western market financial stability risks visible (though bankruptcy rates are increasing quickly), C) allegations on the Adani group related risks gradually fading, and D) no further escalation in the Russia-Ukraine war.

Most importantly the market had become cheaper, with Sensex drifting downwards from 62k in Oct-21 to 59k at the start of this quarter. Almost 2 years from Oct-21 the Sensex's EPS has grown significantly, from 2,526 in CY 2022 to 3,656 in CY 2024E, a growth of ~20% per annum. This meant that P/E (next twelve months) at the start of the quarter was 18.2x, in line with historical averages.

With the fundamental Indian equity story in place, the receding of market concerns, and an acceptable valuation, the FIIs turned big buyers. FIIs bought $13.6 bn last quarter, the single highest purchase in the last 10 quarters. This quarter's net purchase was more than the net purchase in the last 10 quarters in total! It is interesting to note that FII purchases have been tracking valuation levels, and they only turn net buyers when valuations become reasonable.

We end the quarter with Sensex at 65k, the highest level it has ever seen. But valuations are only a little above average with P/E (next twelve months) at 19.2x, compared to historical average levels of 17-18x. If animal spirits remain in play the market could have further momentum.

Our performance remained solid this quarter despite the drag of having 19% cash on average this month. Our Portfolio returned 15.3% this quarter as against Sensex at 9.7%. The outperformance was broad based across the names in our Portfolio, but notable outperformers were:

- PNB Housing: completion of its rights issue, and a recovery in its quarterly numbers with the expected near-term resumption in the growth of its loan book, caused the name to move up strongly.
- Shriram Finance: with Piramal and TPG exiting the supply overhang in the name went away.
- All 3 large cap life insurance names: Our entry was well timed post the market overreaction to the budget news on the sector. The names snapped back quickly as growth concerns faded away with monthly numbers coming in.
- Equitas Small Finance Bank: completion of its reverse merger, and continuing higher than market growth in its loan book while emergence of a healthy RoA, caused the name to move up strongly.

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Changes to the Portfolio in the last quarter:

1) Bought Cipla: We identified the Pharma sector as having become cheap relative to its historical pricing levels a few quarters ago and have been researching the large cap names. Sectoral growth drivers remain in place, with the higher growth domestic formulations business becoming a larger part of the overall business mix of the sector. Cipla saw further weakness caused by an FDA inspection, which we think is relatively minor.

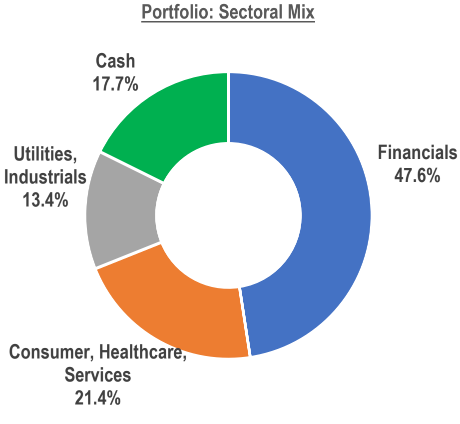
2) Bought Quess: We have been studying the business services sector names as they derated. We believe the near-term slump will prove to be temporary as these businesses adjust their pricing and margins in the market post Covid anomalies. For Quess, growth remains reasonable despite a weak IT Services/ITES demand outlook, which will normalize over time. And some early-stage business divisions are likely to turn profitable over the coming quarters. All of this is likely to cause strong EPS growth momentum in the coming years.

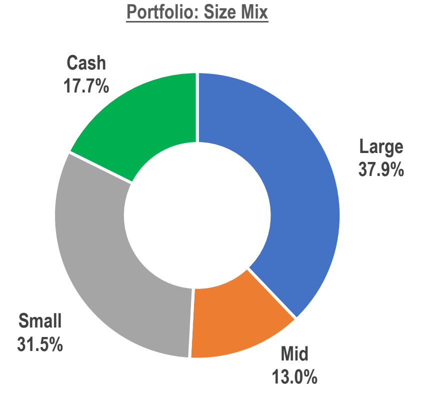
3) Partially exited Equitas Small Finance Bank: We have generated ~100% returns in this name over a short 1.3 year time frame. Our entry was in the Holdco at an effective valuation of ~1.0x P/B. Post the reverse merger and strong growth over this period the name rerated towards 2.0x P/B which was our target exit valuation in our Base Case. We still hold part of the position as growth momentum remains strong and the name is performing towards our High Case.

Portfolio Characteristics:

	P/E (forward)	12m EPS Growth (consensus)	PEG Ratio	P/B (trailing)	RoE % (trailing)	Sharpe Ratio (3 yr)	Beta (ex-cash)
Portfolio	15.2x	32.9%	0.5x	2.7x	15.6%	1.87x	0.75x
Sensex	19.2x	20.1%	1.0x	3.5x	15.7%		

Note: Portfolio details are ex Life Insurance





Top 10 Positions: *(of 22 total positions)*

Shriram Finance	Cipla	HDFC Bank	IOC	Axis Bank
PNB Housing	HDFC	Aster DM	ICICI Pru Life	Mahanagar Gas

Notes:
1) Market Cap Definitions: Large = largest 100 market cap companies, Mid = Between 101 and 250, Small = 251st and smaller. The average market cap of the small caps in the Portfolio is ~$1 bn

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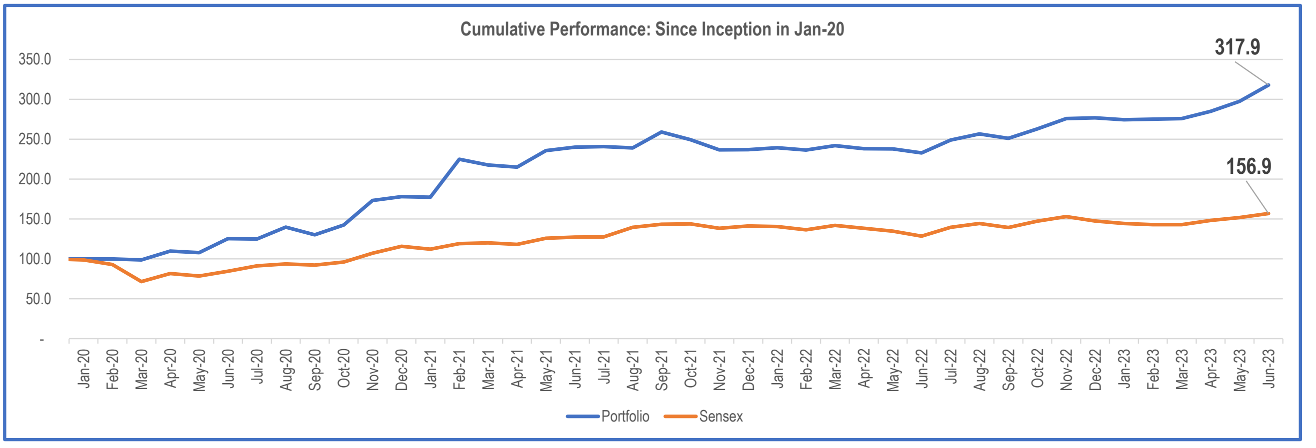
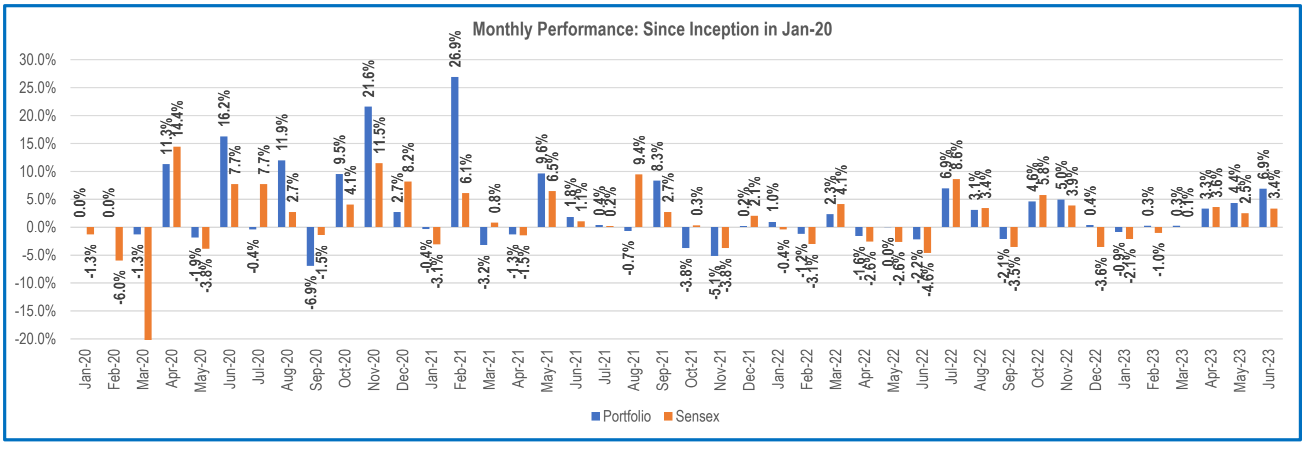
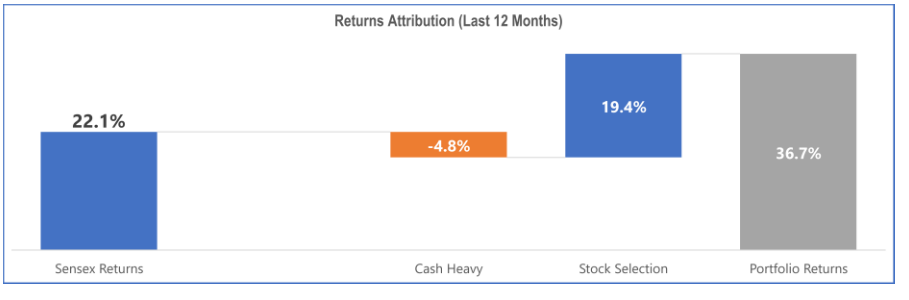
Detailed performance charts:



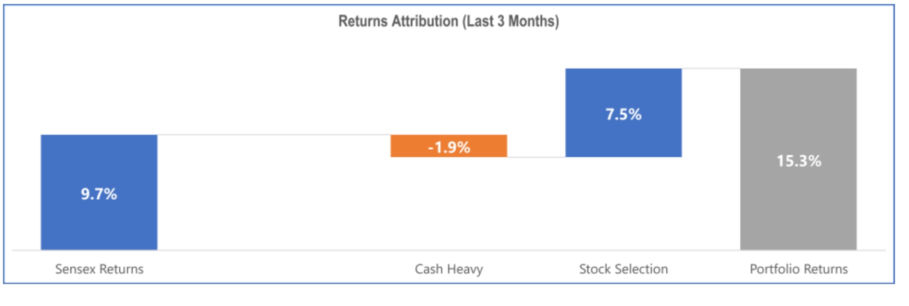


Returns attribution:

Outperformance
For Last Year:
+14.6%



Outperformance
For Last Quarter:
+5.6%



Notes:
1) Performance details for the Portfolio are before taxes, fees and expenses to make it comparable to Sensex
2) AIF license received in Q3 C21. Assets have been transferred into AIF as of 01/11/2021. Returns from Nov-21 onwards are for assets in the AIF
3) Before Nov-11 returns are for capital invested through the Sponsors' personal account, with HDFC Bank as Custodian providing performance statements

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Our strategy in action:

Our strategy is to buy good companies if they are cheap, and ONLY if they are cheap. If they are not cheap we stay on the side-lines in cash for periods. Especially for large cap companies we buy them when they trade at discounts to their long term average valuations and exit them when they start trading above long term average valuations without waiting for peak valuations.

This allows us to capture up market moves (High Up Capture Ratio), reduce our risk positions when markets are expensive, and wait in cash for opportunities when markets become cheap. We have been able to remain in cash for 2 down markets because of this strategy: i) before Covid, and ii) From Oct-21 to Jun-22. And this ensures that in down market moves our Portfolio falls less than the market (Low Down Capture Ratio). A high Up Capture Ratio and a low Down Capture Ratio combine to provide our Portfolio with meaningfully higher returns than the market and a high Sharpe Ratio.

Pre-Covid (Jan-20 to Mar-20)	**100% in cash before Covid** Down Capture Ratio = 0% = Fall in Portfolio / Fall in Sensex = 0% / -29%
Market Bounce Back (Mar-20 to Oct-21)	**100% in equity, with Portfolio beta gradually reduced as the markets rallied** Up Capture Ratio = 151% = Rise in Portfolio / Rise in Sensex = 153% / 101%
Market Correction (Oct-21 to Jun-22)	**Up to 80% in cash** Down Capture Ratio = 63% = Fall in Portfolio / Fall in Sensex = -6.7% / -10.6%
Market Bounce Back (Jun-22 to Jun-23)	**21% in cash on average** Up Capture Ratio = 166% = Rise in Portfolio / Rise in Sensex = 36.7% / 22.1%

B. OUTLOOK:

We have turned more bullish over the last 2 quarters as has probably been evident both from our newsletters and our portfolio construction.

We start this quarter at 19.2x P/E (next twelve months), slightly higher than historical average levels of 17-18x. But EPS momentum is strong at 20% per annum for the next twelve months. And we think there is a good chance that EPS momentum continues at mid to high teen levels for some more time. With the US rate cycle expected to turn over the next 12 months, we expect there will be more money chasing EMs, and given the lack of large EM markets to deploy in India could stay at elevated P/E levels. The market is offering mid teen IRRs even if markets were to shed part of the over-pricing in P/E terms, which is higher than historical return levels.

The recent Modi US state visit brings India further into the spotlight. Many large technology partnerships have already been announced and we think more will follow. The next few years look like a phase where India will benefit from its geopolitical positioning and its own macro cleanup (which took many years).

So we ask ourselves instead – what could go wrong? Is there a big unexpected business cycle downturn coming? Covid was the big 5-10 year move, and it is likely that the next one is still a few years away. Leading indicators of that typically are A) high valuations that keep getting higher (not the case today), B) high capacity utilizations across key core sectors (not really the case today), C) high private capex that keeps getting higher with a build up in corporate debt levels (not at all the case today).

In a more normal environment, we are likely to see periods of slight overvaluation and slight undervaluation. We are definitely seeing this today where the market as a whole is slightly overvalued but sectoral dispersion is high. Unlike 18 months ago where our Portfolio was concentrated on 2 thematic bets (A. financials are cheap, and B. commodities will normalize over time), we are finding many more sectoral opportunities (life insurance, pharma, and possibly IT services soon).

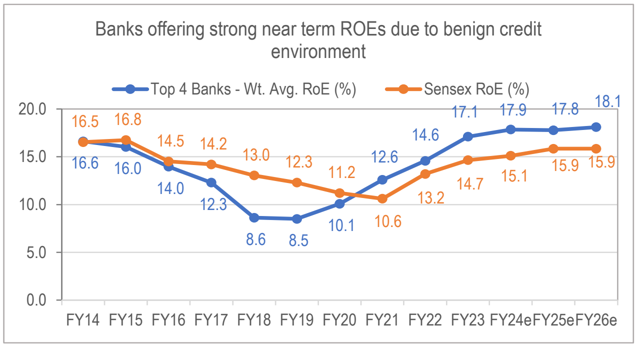
As a note of caution we keep reminding ourselves that some of the risks of the last 18 months have not gone away completely, but simply receded, and could easily come back out to haunt the market.

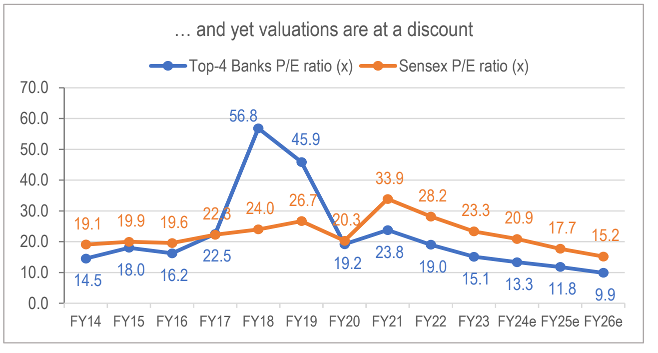
Sector	P/E Jun-23	P/E Jun-22	P/E 10 Yr Avg	vs Jun-22	vs 10 yr Avg	Our View
Auto	21.8x	23.0x	26.6x	-5%	-18%	We are studying this sector, especially 2 wheelers, where new introductions and EVs are causing market disruption
Banks - Private	15.4x	15.2x	20.8x	1%	-26%	This is our largest sectoral position in the fund
Cement	29.5x	23.9x	26.2x	23%	13%	Still expensive
Consumer	43.7x	40.5x	39.8x	8%	10%	Very expensive, but we have positions in the cheaper names positioned to benefit from margin improvements post rural demand recovery
Healthcare	26.3x	23.1x	26.2x	14%	0%	We recently entered into the sector after many months of research. Sector offering sporadic cheapness in the largest names principally
Infrastructure	15.8x	13.6x	9.0x	16%	76%	Still expensive
Media	15.1x	13.7x	25.2x	10%	-40%	While it looks cheap we have studied the companies here and have decided to pass due to risk in business models and / or due to corporate governance
Metals	9.6x	6.8x	11.1x	41%	-14%	We have studied the names here, and the cheapness is an illusion due to high commodity prices. Once normalized many of these names are not cheap
Oil & Gas (ex RIL)	4.7x	5.6x	9.3x	-16%	-49%	We have positions in the sector in O&G consuming / distributing companies as beneficiaries of normalizing commodity prices
Specialty Chemicals	32.3x	31.8x	19.5x	2%	66%	Very expensive, we are staying away
IT Services	22.2x	22.2x	19.4x	0%	14%	Has corrected a lot, and may soon get to our Target Entry Prices. We has spent a lot of time researching the sector recently

Data Source: Motilal Oswal

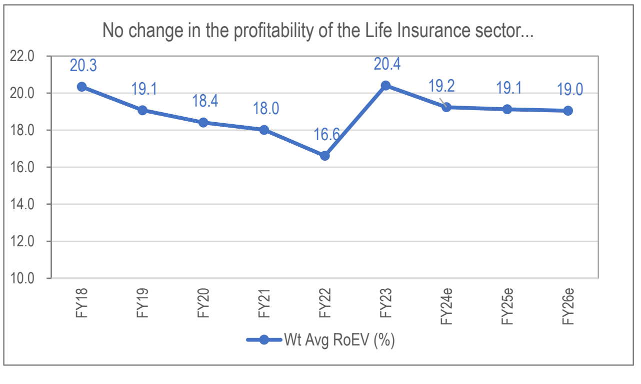
Portfolio positioning:

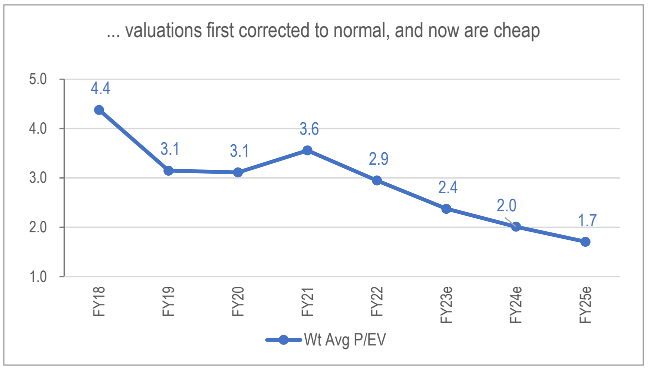
1) Continue to be long Big Banks and select NBFCs: Despite strong returns in the last year we think there is a long way to go on many Financials. You will see below that the credit cost environment in the near term is benign, keeping risks low in the sector. And given our investment style of investing in names trading at discounts to their long term valuations, we believe that the risk adjusted return profile of our Financials names is very attractive still.





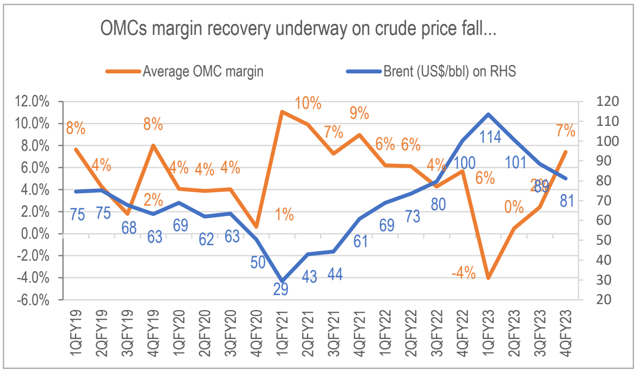
2) Recent entry into Life Insurance: The Life Insurance sector has been correcting downwards through much of 2022 and we had initiated our work. The final catalyst for our investment came through the breakdown in valuations post the budget announcement which removed tax benefits for non-ULIP life insurance policies with annual premiums of more than Rs5 lakhs. We do not believe this changes the longer term growth outlook of the sector. Analyzing the direct impact of the new regulation we see that just 5-10% of the annual premiums fall in the affected category. It is also worth mentioning that for the below INR 5 Lakh ticket segment the highest post-tax return method of participating in the Indian debt markets remains the insurance sector, after the changes made to the tax structure for debt mutual funds recently. We benefitted from our timely entry in the sector in the sharp correction which followed the budgetary announcements, and since then there has been a sharp recovery in stock prices. That said there is a lot of upside still left.

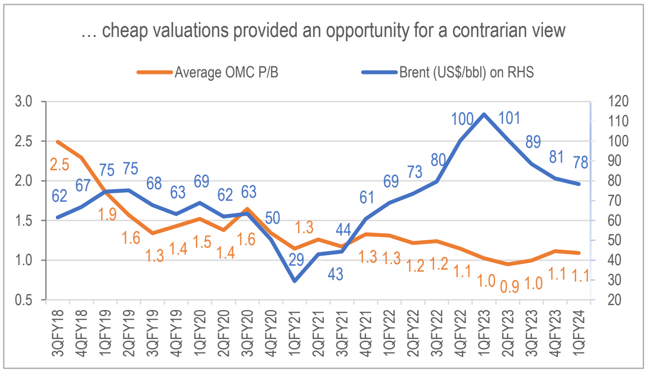




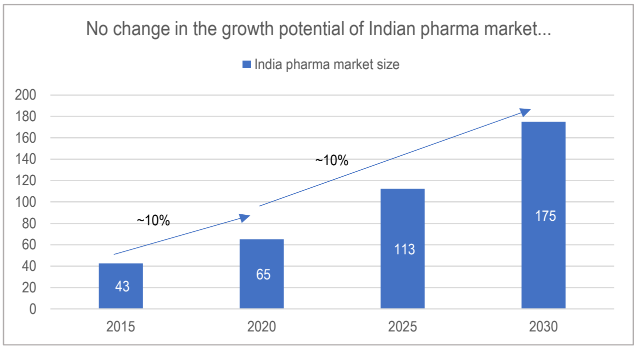
Portfolio positioning: (continued)

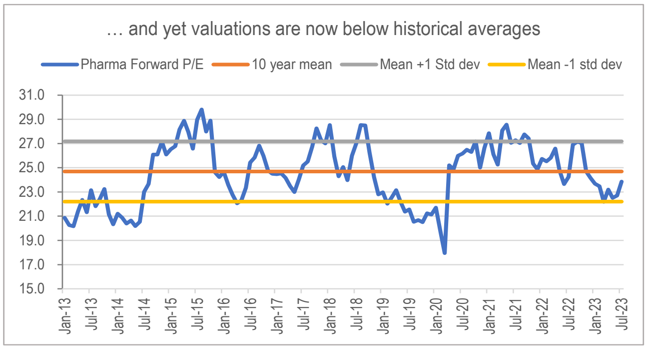
3) Continue to be long commodity consumers: Commodities have corrected across the board. The passthrough to the ultimate consumers takes many quarters and we believe the equity markets will reward these companies when they see this come through the numbers over the next few quarters. This has started in our oil and gas positions, but not in our FMCG positions yet. FMCG companies have passed on the benefit of commodity price reductions to consumers through lower price increases in order to stimulate demand, which has been weak especially in rural India.





4) Recent entry in the Pharma sector: Valuations had been trending to below long term averages for some of the players principally driven by growth in EPS. In our view growth prospects remain robust over the foreseeable future. We added Cipla last quarter and continue to look for more opportunities to deploy in the sector.





5) We are beginning our work on IT Services: We think that the recessionary environment in the Western markets could lead to a meaningful further correction in IT Services, making it attractive to us in the later stages of this year. IT Services company have corrected but further corrections are warranted.