GUARDIAN CAPITAL PARTNERS

INVESTOR NEWSLETTER – QUARTER ENDED DECEMBER 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 Dec-23
Cumulative Returns						
Portfolio	9.9%	15.5%	32.7%	55.0%	106.4%	267.2%
Sensex	9.7%	11.6%	18.7%	24.0%	51.3%	75.1%
Outperformance	0.1%	3.9%	13.9%	31.0%	55.1%	192.1%
Annualized Returns						
Portfolio			32.7%	24.5%	27.3%	38.4%
Sensex			18.7%	11.4%	14.8%	15.0%
Outperformance			13.9%	13.1%	12.5%	23.4%

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
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We are excited to complete 4 years as a team! On a calendar year basis we have outperformed Sensex each year.

Period:	CY23	CY22	CY21	CY20
Portfolio	32.7%	16.8%	33.2%	77.9%
Sensex	18.7%	4.4%	22.0%	15.7%
Outperformance	13.9%	12.4%	11.2%	62.2%

Our performance was in line with Sensex this quarter. Our Portfolio returned 9.9% as against Sensex which returned 9.7%. This is despite having 26.6% in cash on average through the quarter and ending the quarter with 38.5% in cash.

The 3 key events this quarter:

i) The US Fed pivot: The Dec-23 Fed meeting has been widely seen as a pivot towards multiple interest rate cuts in 2024, causing a risk on environment across asset classes in Dec-23.

ii) State elections: In early Dec-23 BJP outperformed most expectations to secure mandates in MP, Rajasthan and Chhattisgarh. This has further strengthened the likelihood of a third continuous term for BJP in the upcoming general elections.

iii) The Israel Hamas war: This kicked off in Oct-23 and resulted in further geopolitical risk, given the ongoing Russia Ukraine war. The fear of commodity price risk and a general risk off environment prevailed for a short period.

The net result of these events was strongly positive for risk assets. Through Nov-23 and Dec-23 Sensex rallied 13%! And this was from a starting point which was already well above average valuation levels. We end the quarter with Sensex priced at forward P/E of 21.0x, well above it 17-18x average range.

Small Caps continued to outperform. The BSE Small Cap Index returned 13.6% as against Sensex which returned 9.7% this quarter. We struck a cautionary note about the Small Cap rally in our last newsletter and provide a summarized update later in the document reiterating our view. We used this bubbly environment as an opportunity to exit multiple Small Cap names. Our Small Cap exposure peaked in Aug-23 at 38% of the Portfolio and post our exits stands at 18% at the end of this quarter.

Key outperformers:

- Aster DM: The awaited transaction to separate the Middle East business was announced. This unlocked value as we had anticipated and caused a 25% move up.

Key outperformers: (continued)

- IOC: Strong operating performance in the last quarter and continuing moderation in crude price caused a sharp 43% stock price rise this quarter.
- Castrol: Along with being a beneficiary of crude price normalization, market expectations of better volumes driven by new initiatives caused a 30% move up.

Key underperformer:

- Cash: We had 26.6% cash on average this quarter. This was a drag on returns.

Changes to the Portfolio in the last quarter:

- Exited Aster DM: We finally exited Aster DM. We earned ~330% returns over 3.6 years in this position. Our thesis for entry was its low relative valuation compared to other hospital chains. The market was especially discounting the lower growth Middle East business. At the announcement price the valuation for the India business is now in line with other hospital chains and the ability to generate meaningful incremental alpha is lower.
- Exited Equitas Small Finance Bank: We had partially exited this position 2 quarters ago given the sharp move up post the reverse merger and strong operating performance. That exit represented ~100% returns over a 1.3 year time frame. We sold the remaining position this quarter earning ~160% returns over a 1.8 year time frame.
- Partially exited IOC: Our thesis on entry was that the large negative marketing margins would normalize when crude corrected from unusually high $120+ levels. Much of this has now come through and we are in exit mode on the name. We have earned ~80% over 1.5 years so far.
- Partially exited PNB Housing: We have been exiting the name over the last 2 quarters post the strong returns we have earned. PNB Housing rerated after the completion of the rights issue, the developer loan book being worked through and/or written off, and the entry of a new CEO. We now have a small remaining position which will likely be sold over the next few quarters.

Small Caps:

We wrote last quarter about the bubbly environment in Small Caps. The Small Cap rally continued this quarter. We see this as a big risk and continue to exercise caution. Our exposure to Small Caps has been trimmed meaningfully from its recent peak in Aug-23 at 38% of the Portfolio to 18% at the end of this quarter.

We summarize our key findings from the last newsletter: The Nifty Small Cap 100 index is trading at well above its mean, in fact more than 1 standard deviation above mean. There are 3 times this has happened in the last 10 years. Each time the returns for following year was negative:

- Jan-15: next 12-month returns were -8%
- Dec-17: next 12-month returns were -29%
- Jul-21: next 12-month returns were -13%

You will see from the charts on the next page that the principal driver is the strong inflow of funds into Small Cap funds. Key question is whether this is symptomatic of an irrational bull market or whether there is a structural shift in the market. We are in the camp that believes the former.

From a research perspective we are not finding margin of safety in the names we are studying. While the research work continues to create Target Entry Prices on many Small Cap ideas, this is really preparatory work in the case these names (or the market as a whole) correct meaningfully.

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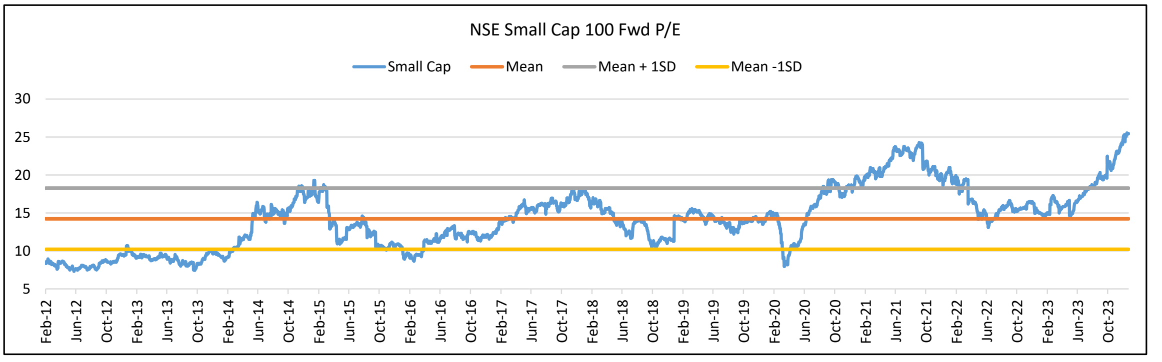

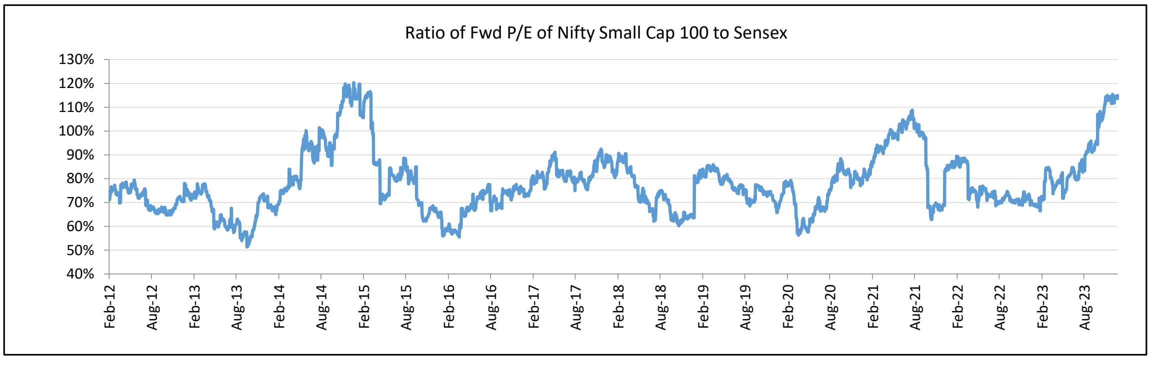

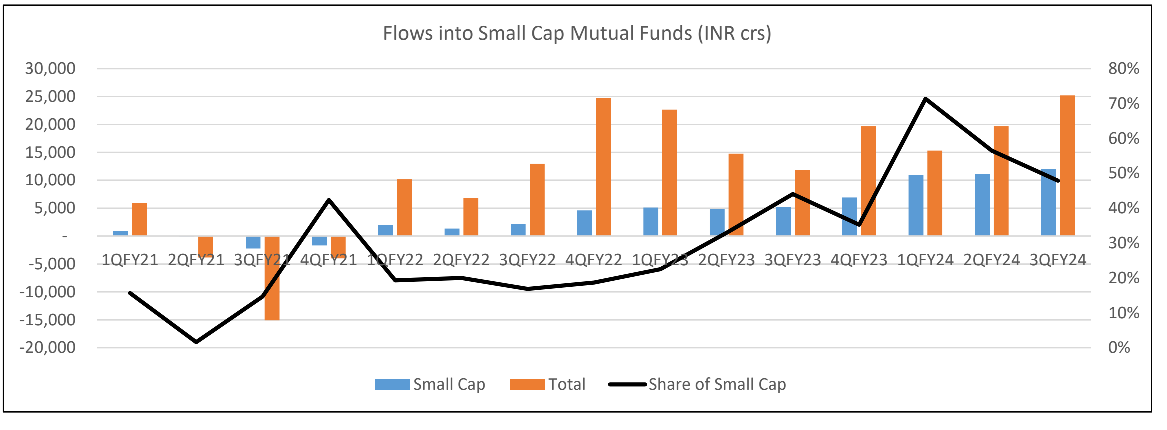

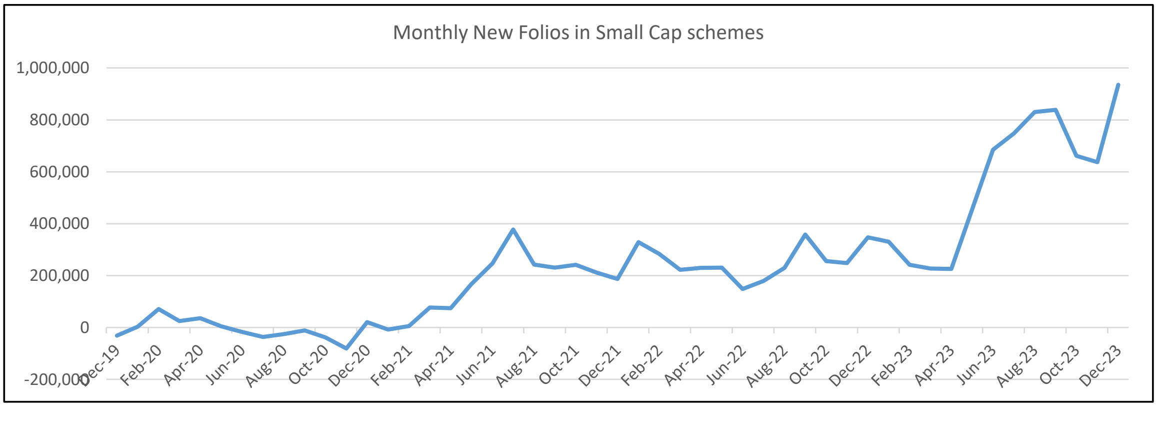

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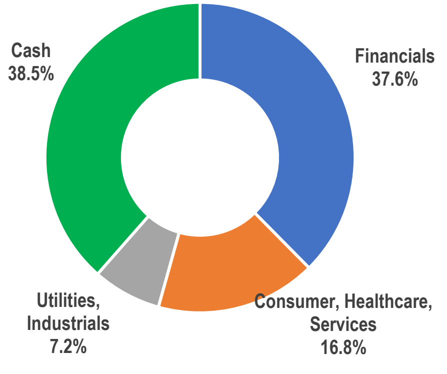
Portfolio characteristics:

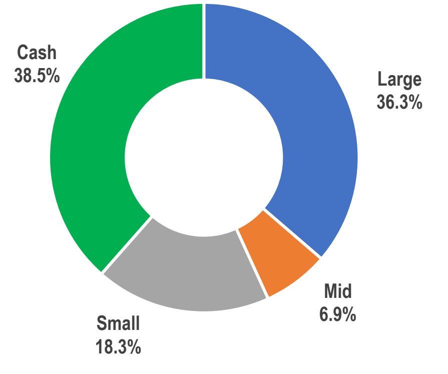
	P/E (forward)	12m EPS Growth (consensus)	PEG Ratio	P/B (trailing)	RoE % (trailing)	Sharpe Ratio (3 yr)	Beta (ex-cash)
Portfolio	15.7x	17.6%	0.9x	3.2x	17.0%	159%	0.71x
Sensex	21.0x	13.0%	1.6x	3.3x	15.8%		

Note: Portfolio details are ex Life Insurance

Portfolio: Sectoral Mix



Portfolio: Size Mix



Top 10 positions: *(of 19 total positions)*

Shriram Finance	CMS Info	Federal Bank	SBI Life	Castrol
HDFC Bank	Cipla	Axis Bank	ICICI Pru Life	Mahanagar Gas

Private & Confidential

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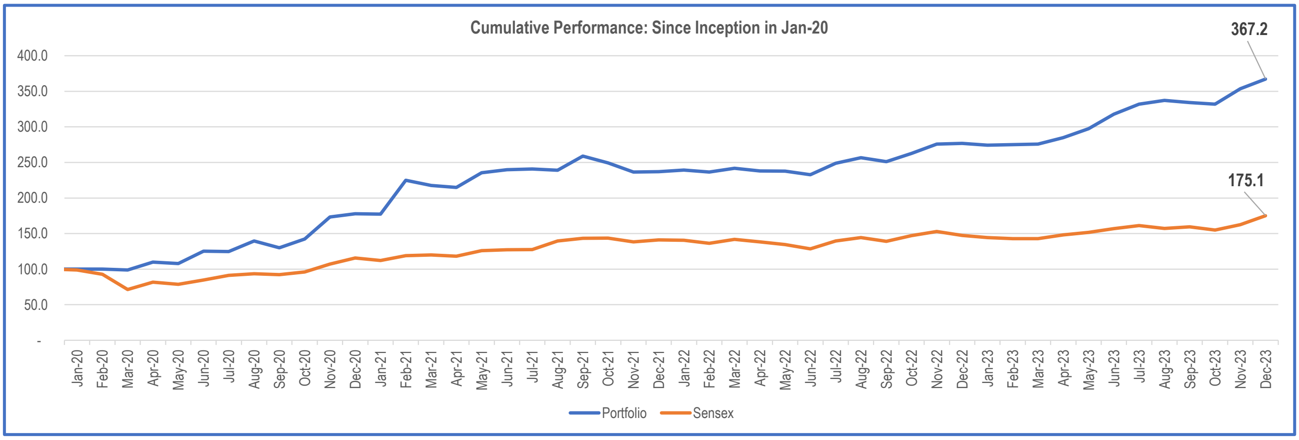
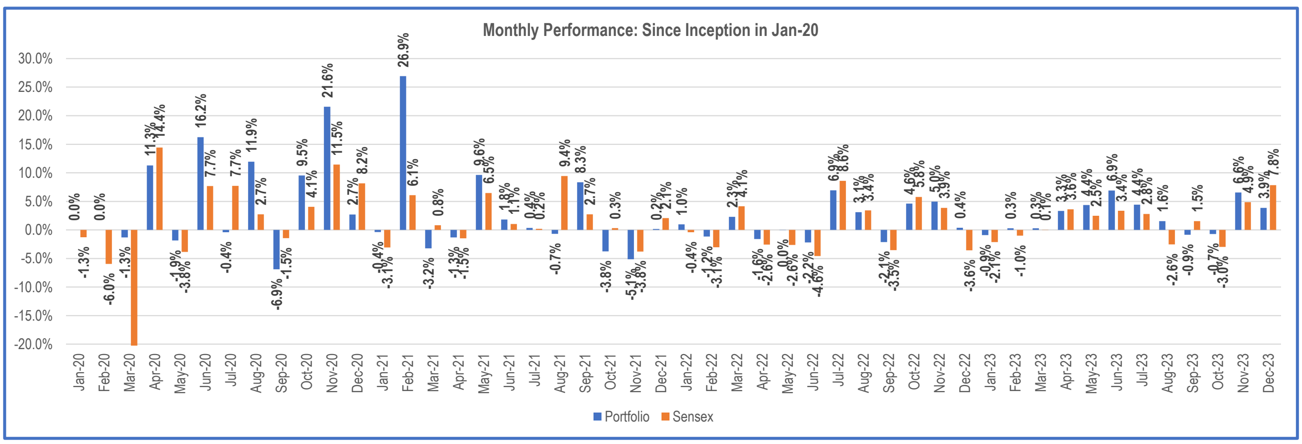
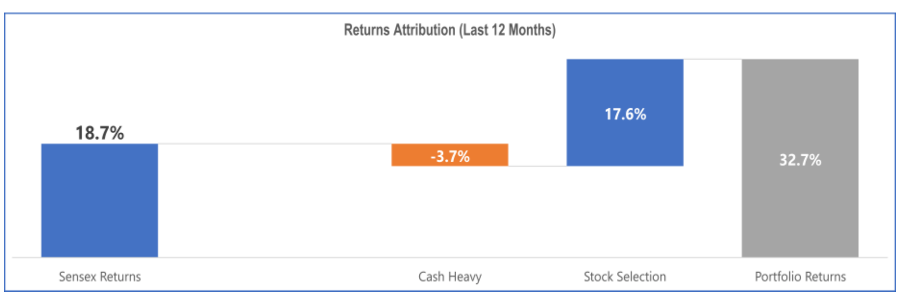
Detailed performance charts:



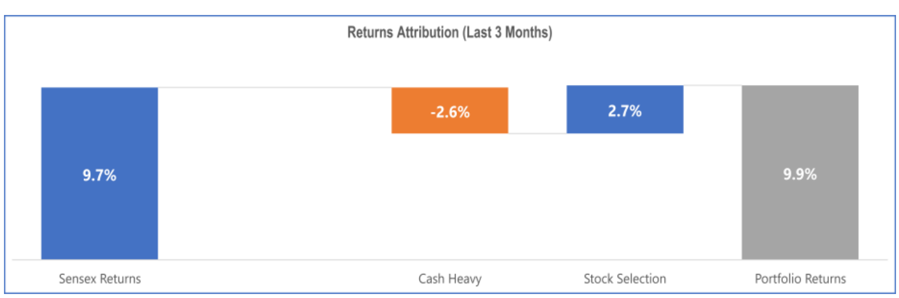


Returns attribution:

Outperformance
For Last Year:
+13.9%



Outperformance
For Last Quarter:
+0.1%



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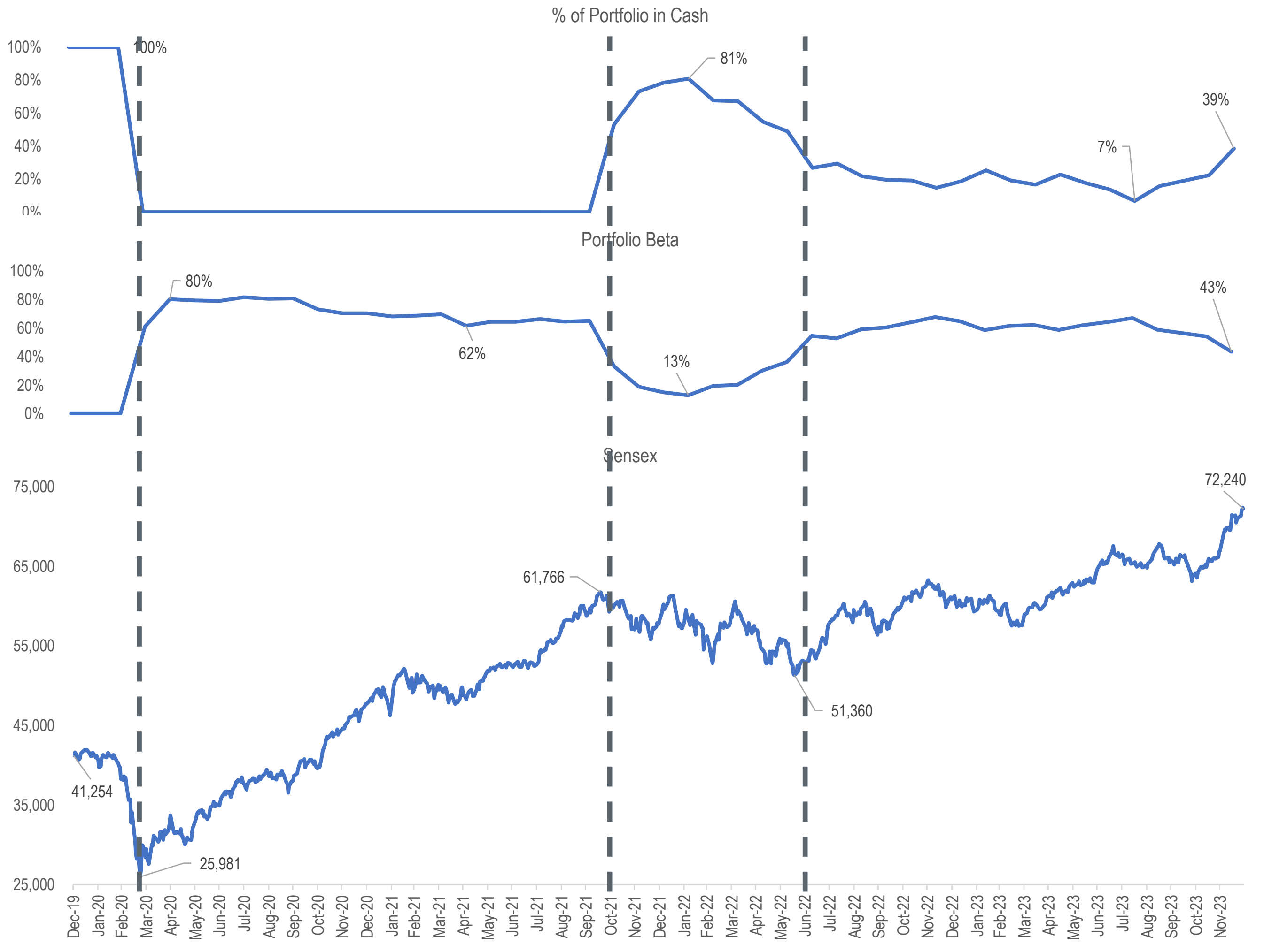
Our strategy in action:

<u>*Our strategy is to buy good companies if they are cheap, and ONLY if they are cheap.*</u> 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. 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 (Jul-22 onwards)	**20% in cash on average** Up Capture Ratio = 159% = Rise in Portfolio / Rise in Sensex = 36.3% / 57.8%

B. OUTLOOK:

We are finding fewer and fewer opportunities as the strong market momentum continues. We commented on the bubbly environment in Small Caps which continues. Even opportunities in Large Caps have reduced. In our strategy unless we see the ability to make a 20% annualized return on a Large Cap name or 25% in a Small Cap name, we don't invest. And as we see fewer opportunities we have pivoted to cash, ending the quarter with 38.5% in cash.

We look back at the previous time this environment prevailed – mid 2021. At that time, the valuations were even more stretched than they are now, and the issue was in both Large and Small Caps. This time around it is not quite as egregious in Large Caps. As a result of limited opportunities we had pivoted to cash. However, the market momentum continued through second half 2021 and for 2H21 we had a 12% underperformance to Sensex. This did not deter us or make us change our investment strategy, and we were rewarded for our patience with strong outperformance in 2022 and 2023.

What could make valuations correct? Domestic flows remain strong. FIIs also turned bullish in the second half of 2023 fueling the rally. Near term political risk of the general election seem low and a foregone conclusion. Is it then more likely an external event? The developed markets turning more cautious as the market realizes its too bullish on the likelihood of a dovish Fed? Or the theory of a US soft landing turning out to be incorrect? Or geopolitical risks increasing (remember there are 2 wars ongoing)? Or something that none of us has yet thought of?

The answer is we don't really know. Fund flows prevail in the short run, but valuations matter in the longer run. Without margin of safety we prefer the comfort of cash.

Sector	P/E Dec-23	P/E Dec-22	P/E 10 Yr Avg	vs Dec-22	vs 10 yr Avg	Our View
Auto	22.5x	21.7x	26.9x	4%	-16%	We continue studying this sector. 2W seeing increasing competition, PV cycle topping out
Banks - Private	15.7x	16.5x	20.8x	-5%	-25%	This is our largest sectoral position in the fund. Continues to offer opportunities even though market is expensive overall
Cement	31.5x	29.9x	26.5x	5%	19%	Still expensive
Consumer	45.7x	41.7x	40.4x	10%	13%	Very expensive, but we have a position in one of the cheaper names positioned to benefit from margin improvements post rural demand recovery
Healthcare	29.1x	23.4x	26.5x	24%	10%	We entered last year when opportnuties existed. Fewer opportunities now
Infrastructure	19.8x	15.5x	9.8x	28%	102%	Still expensive
Media	21.2x	15.9x	25.0x	33%	-15%	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 concerns
Metals	12.9x	7.6x	11.8x	70%	9%	We have studied the names here. Commodity prices have further downside. Once normalized many of these names are not cheap
Oil & Gas (ex RIL)	7.1x	5.8x	9.0x	22%	-21%	We have positions in O&G consuming / distributing companies as beneficiaries of normalizing commodity prices. With O&G prices normalizing we will exit
Specialty Chemicals	36.9x	31.5x	21.9x	17%	68%	Very expensive, we are staying away
IT Services	26.0x	22.2x	19.9x	17%	31%	Had corrected a lot, but then moved up a lot recently. We spent a lot of time researching the sector. We are tracking but opportunity has moved further away

Data Source: Motilal Oswal