

INVESTOR NEWSLETTER – QUARTER ENDED MARCH 2024

A. PAST PERFORMANCE:

Period:	Last 3 Months	Last 6 Months	Last 1 Year	Last 2 Years	Last 3 Years	Since Inception Jan-20 to Mar-24
Cumulative Returns						
Portfolio	1.3%	11.2%	34.8%	53.8%	70.8%	271.8%
Sensex	1.9%	11.9%	24.9%	25.8%	48.8%	78.5%
Outperformance	-0.7%	-0.6%	10.0%	28.0%	22.0%	193.3%
Annualized Returns						
Portfolio			34.8%	24.0%	19.5%	36.2%
Sensex			24.9%	12.1%	14.2%	14.6%
Outperformance			10.0%	11.9%	5.4%	21.6%

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
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India did not participate in the risk rally in the quarter ended Mar-24. The SPX Index was up 10.2% in the quarter (a year's worth of return in a quarter) driven by dovish expectations from the Fed around interest rate cuts through 2024 and retreating inflation (though some of this seems to be reversing in Apr-24). The Sensex was up 1.9%, and the BSE Small Cap Index just 1.2% for the same period. The market would have ended in the negative for the quarter, had it not been for the heavy FII participation in the last few trading days.

Our view is that this is because Indian markets are trading at big premiums already (P/E of 21x vs 17-18x long term average) and hence we could see time correction on returns for a while. Additionally, we have been forewarning of the bubbly environment in the Small Cap market. We are beginning to see a much more nervous pricing environment for Small Caps with the index down over 2% on multiple days. But so far, the momentum remains, and even the sharp correction of 12% of the index from the peak was quickly made back up due to strong domestic flows. SEBI has issued a clarion call on this matter as well, explicitly pushing fund houses to reduce inflows into their Small Cap and Mid Cap products. SEBI is also investigating mis-selling of risks especially the liquidity risk posed by Small Cap and Mid Cap funds to the end retail clients.

Our performance was muted at 1.3% this quarter as we are positioned to play defense. We have 35.6% cash at quarter end as we are finding fewer opportunities given stretched valuations due to strong market momentum.

Key outperformers:

- Shriram Finance: Up 15% this quarter. Quarterly performance remains strong and with the seller overhang removed the stock continues its bullish path.
- Cipla: Up 20% this quarter. Company's very strong quarterly performance last quarter surprised even bulls like us.
- IOC: Up 29% this quarter. The government continues to allow a longer period of supernormal marketing margin (despite fears than price cuts would have come pre-elections) and GRMs remain bullish as we expected on the refining side.

Key underperformers:

- HDFC Bank: Down 15%. The market is punishing the fall in NIMs due to low deposit growth. This is a cyclical sectoral issue made worse for HDFC Bank due to the merger. We continue to buy at each fall as we see this cyclical issue going away in the coming quarters. Based on the business update a few days ago financials for quarter ended Mar-24 will already look better.
- Cash: We had 37.2% cash on average this quarter. This was a drag on returns.



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Key changes to the Portfolio in the last quarter:

- Increased our position in SIS: We like the long term prospects for business services companies and are using the cyclical weakness now to continue to increase our exposure in the sector. SIS was witnessing margin weakness when we entered, and our thesis was margin will gradually improve driven by cancellations of low price contracts, which our channel checks had confirmed. Security services (domestic) and facilities management services (together 2/3rd of total EBITDA) have seen margins normalize as we had expected, while the offshore securities services margin lags. However, the stock has not participated in the strong Small Cap rally making it a stronger conviction call for us. We have doubled our position here towards ~5% of the Portfolio.
- Entered SJS Enterprises: We put on a new position after a while. SJS is an auto comp manufacturer making embellishments for the 2W and PV sector. Given the low overall percentage that their components are of the overall end vehicle, SJS has been able to extract a high margin and ROCE from its value add. SJS also benefits by being one of the only players in the organized segment in this niche. While our purchase price is at 18x P/E and we do not expect much rerating in our thesis, the strong growth profile is likely to deliver most of the returns. Given the purchase pattern for the auto majors they first try the vendor (beta), then start working with the vendor for local orders, and if successful they expand with the vendor through global orders. The company has already proven this path for some customers and stands to benefit on multiple others. Additionally, in India itself the value per vehicle of embellishments is rising due to the faster growth of aspirational end products, and that strong demand could be sufficient for a high return profile for us.

Small Caps:

We started writing about the bubbly environment in Small Caps in our Sep-23 newsletter. In the introduction we mentioned that the pricing environment is now more jittery (albeit the outcome is so far limited) with strong SEBI action trying to reduce flows into the space. Small Caps represent about 15% of the total market cap of the country (12% before the rally) and were receiving over 50% of all mutual fund flows from Mar-23 to Dec-23. The SEBI call to action seems to have slowed this down to 20%. However, the overall outcome so far is Small Cap pricing remains irrational in many cases, which we are studying on a bottom-up basis.

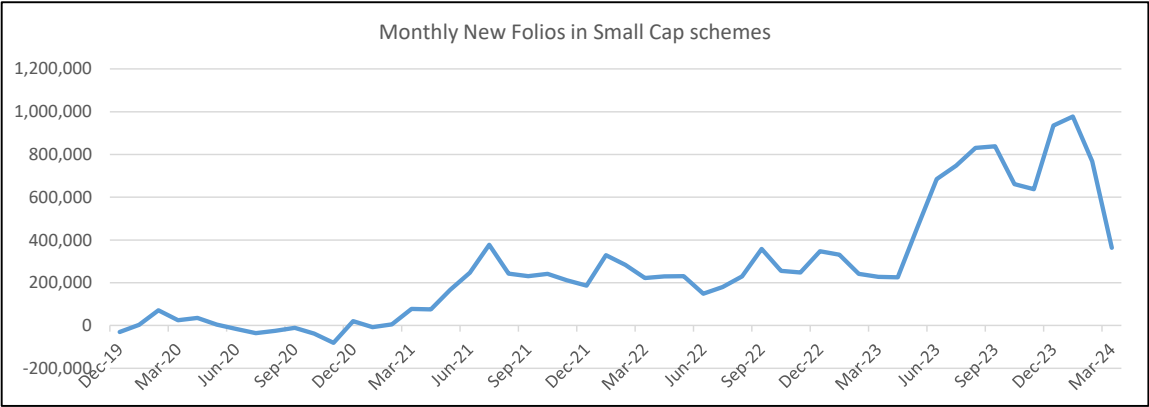
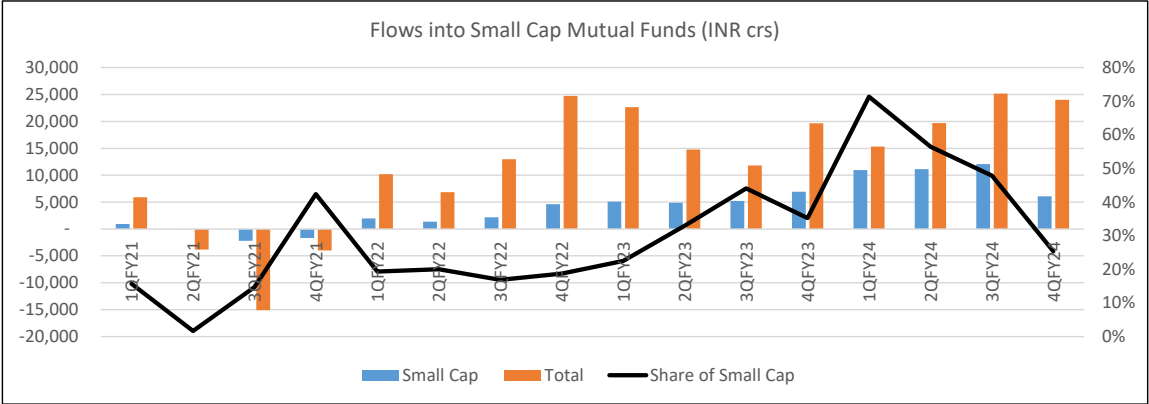
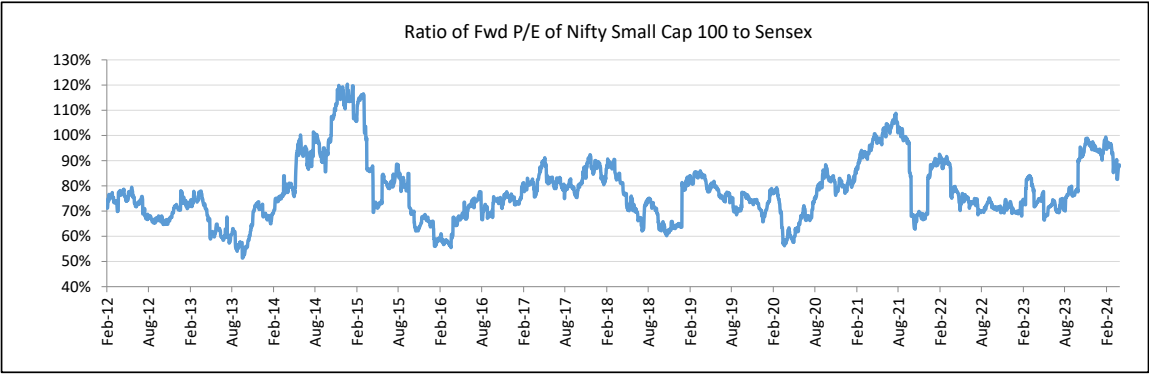
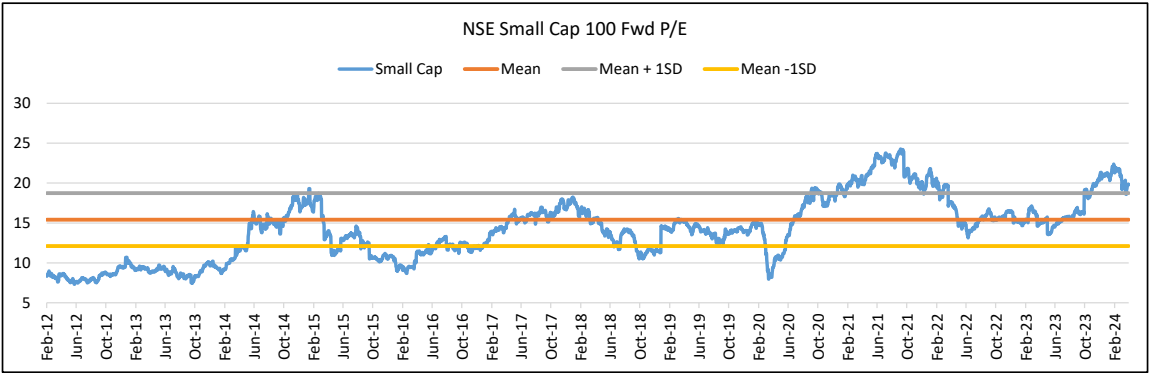
We summarize our key findings from the Sep-23 newsletter: The Nifty Small Cap 100 index is trading at well above its mean, in fact more than 1 standard deviation above mean. There are 3 times this happened in the last 10 years. Each time the returns for next year were negative:

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

While we did invest in a Small Cap name after a while (SJS Enterprises) we remain cautious. The research work continues to create Target Entry Prices on many Small Cap ideas, this is preparatory work in the case these names (or the market as a whole) correct meaningfully.



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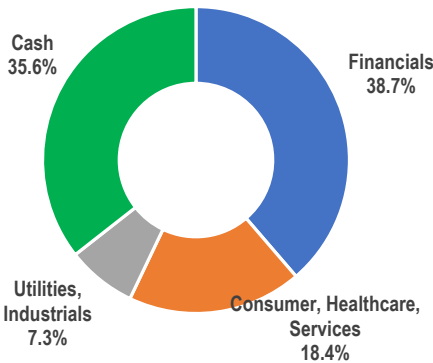
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Portfolio characteristics:

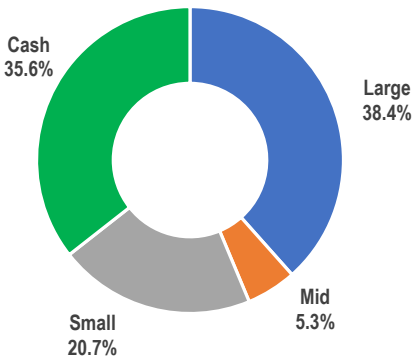
	P/E (forward)	12m EPS Growth (consensus)	PEG Ratio	P/B (trailing)	RoE % (trailing)	Sharpe Ratio (3 yr)	Beta (ex-cash)
Portfolio	15.6x	22.2%	0.7x	3.1x	16.3%	116%	0.70x
Sensex	20.9x	16.0%	1.3x	3.3x	15.5%		

Note: Portfolio details are ex Life Insurance

Portfolio: Sectoral Mix



Portfolio: Size Mix

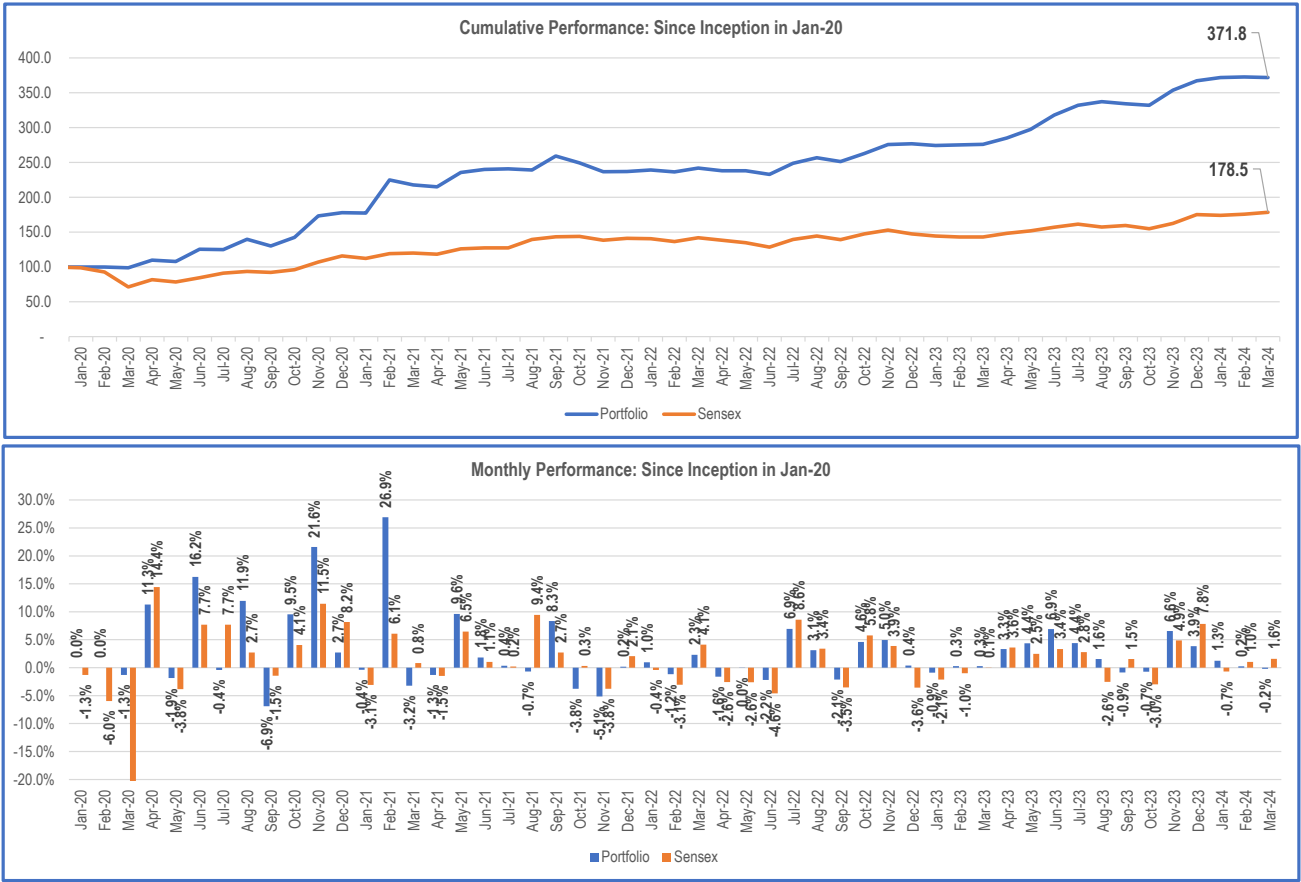


Top 10 positions: (of 20 total positions)

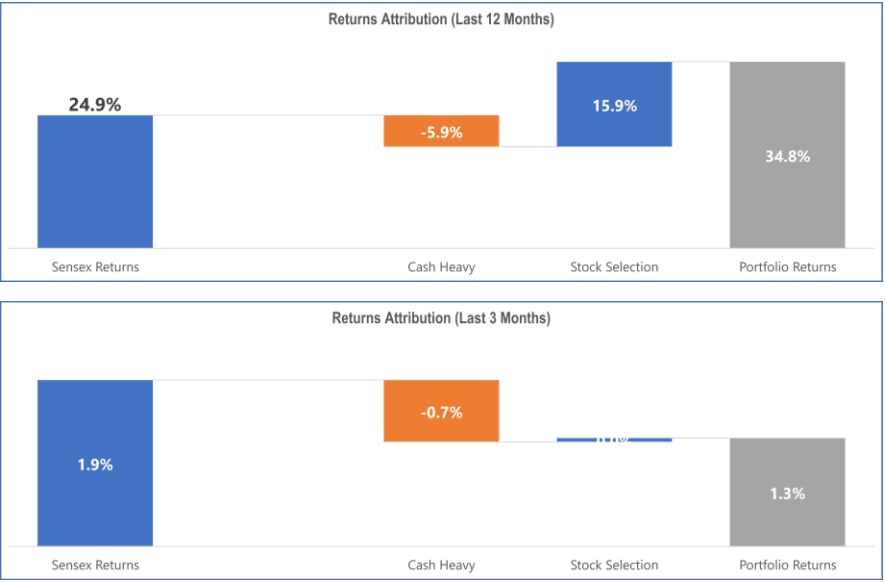
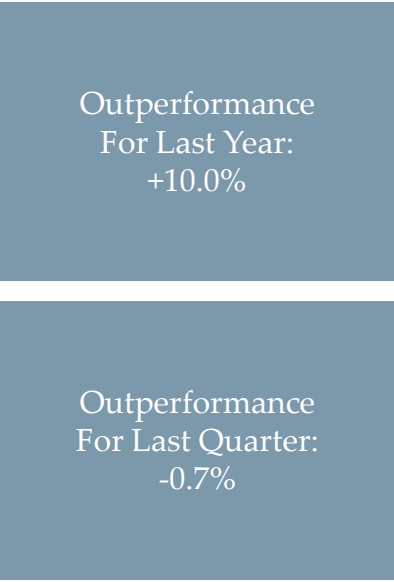
HDFC Bank	CMS Info	ICICI Pru Life	Cipla	HDFC Life
Shriram Finance	Axis Bank	SIS	Federal Bank	SBI Life

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Detailed performance charts:



Returns attribution:



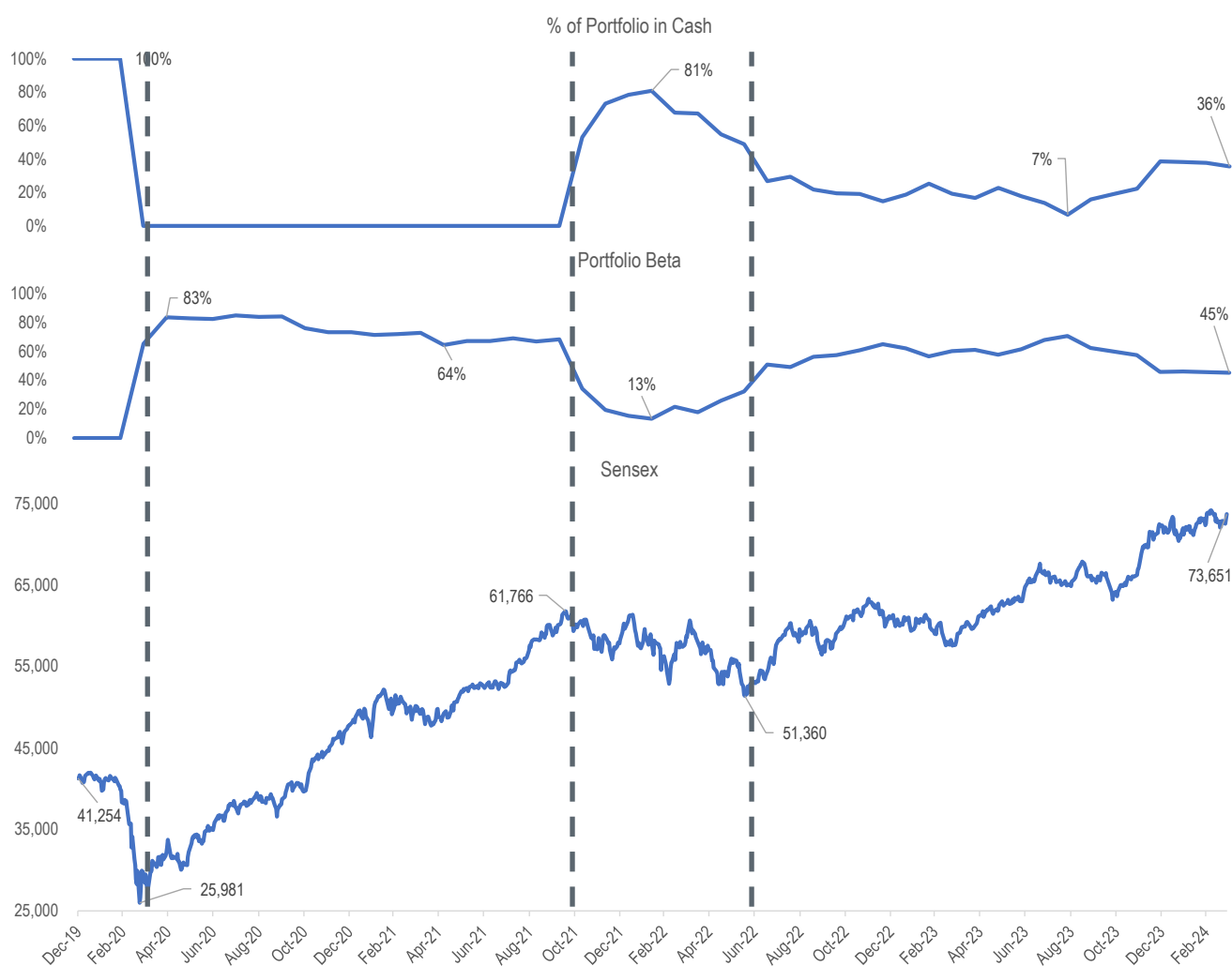
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Our strategy in action:

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. 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 onwards)	22% in cash on average Up Capture Ratio = 154% = Rise in Portfolio / Rise in Sensex = 59.8% / 38.9%

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B. OUTLOOK:

Our portfolio positioning remains defensive. We wrote last quarter that the Indian markets are pricing to perfection with near term risks looking benign. While we are also strong believers in the India story, we look for margin of safety before putting our money to work, and there are not too many names offering that once you study them bottom-up.

In the recent past some global macro risks are threatening to flare up. At the point of writing this the Israel conflict has just taken on an additional dimension with Iran explicitly entering the fray. The last US inflation print was stickier than was expected and market calls for rates to be “higher for longer” are becoming more common.

We remain constructive in our research studying names in the healthcare, auto component and textile sectors. We think there are many exciting companies benefitting from the Indian growth story and we think there will be an opportunity to enter these at reasonable levels if a correction or even a time correction were to come. Hence, we are working hard to remain prepared.

Our cash position remains high at 35.6% of the Portfolio at the end of Mar-24. We look back at the previous time we had run out of opportunities and cash had piled up – 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 few opportunities again 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.

We remain patient.

Sector	P/E Mar-24	P/E Mar-23	P/E 10 Yr Avg	vs Mar-23	vs 10 yr Avg	Our View
Auto	23.7x	19.6x	27.0x	21%	-12%	We continue studying this sector. 2W seeing increasing competition, PV cycle topping out. We have added an auto comp recently
Banks - Private	14.6x	14.9x	21.0x	-2%	-30%	This is our largest sectoral position in the fund. Continues to offer opportunities even though market is expensive overall
Cement	30.2x	27.7x	26.8x	9%	13%	Still expensive
Consumer	43.3x	40.2x	40.6x	8%	7%	Very expensive, but we have a position in one of the cheaper names positioned to benefit from margin improvements post rural demand recovery
Healthcare	31.3x	22.4x	26.8x	40%	17%	We entered last year when opportunities existed. Fewer opportunities now. Working on hospital names
Infrastructure	25.4x	14.3x	10.5x	78%	142%	Still expensive
Media	16.0x	16.8x	25.2x	-5%	-37%	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	12.6x	8.8x	11.8x	43%	7%	We have studied the names here. Commodity prices views have further downside. Once normalized many of these names are not cheap
Oil & Gas (ex RIL)	8.6x	5.4x	8.9x	59%	-3%	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	33.9x	28.1x	23.6x	21%	44%	Very expensive, we are staying away
IT Services	24.7x	21.3x	20.1x	16%	23%	Had corrected a lot, but then moved up. We spent a lot of time researching the sector. We are tracking but opportunity has moved further away

Data Source: Motilal Oswal