GUARDIAN CAPITAL PARTNERS

INVESTOR NEWSLETTER – QUARTER ENDED JUNE 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 Jun-24
Cumulative Returns						
Portfolio	10.4%	11.8%	29.2%	76.5%	71.2%	310.7%
Sensex	7.3%	9.4%	22.1%	49.1%	50.6%	91.6%
Outperformance	3.1%	2.4%	7.0%	27.4%	20.6%	219.1%
Annualized Returns						
Portfolio			29.2%	32.9%	19.6%	36.9%
Sensex			22.1%	22.1%	14.6%	15.5%
Outperformance			7.0%	10.8%	5.0%	21.3%

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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Our Portfolio returned 10.4% last quarter, outperforming Sensex which returned 7.3%. Much of this performance was driven by Jun-24 returns of 8.4%. The strong market move was driven by extremely strong domestic fund flows some of which had been waiting on the sidelines prior to the elections. India saw its highest quarterly flow in mutual funds at 94k crores. Our outperformance was driven by i) our stock selection, and ii) utilizing part of our cash to buy more of our existing names on 4th June when the market fell sharply after the election results.

Sensex remains richly valued at 21.1x forward P/E, more than 1 standard deviation higher than its historical levels. And the NSE Small Cap Index remains near bubble territory at 21.5x, almost 2 standard deviations above its historical levels.

The increasing feeling we are left with after client pitches is that there is an increasing fear in people's minds about valuation levels, but they question what the trigger will be to normalize valuation levels. There are clear risks which we can talk about but we also realize that previous market corrections have always happened because of a risk none of us had really thought about prior to the event.

So far, we have been able to deliver on our investment objective of delivering superior **risk adjusted** returns by buying companies where there is a margin of safety in valuations. The Sharpe Ratio of our Portfolio on a 3-year basis is 123% as against 61% for the Sensex. Even for shorter periods like 1-year our Sharpe Ratio is double that of Sensex. We have been able to do this by having our Portfolio fall less when the markets have fallen (low Down Capture Ratio) and having our Portfolio rise materially higher that the market when markets have gone up (high Up Capture Ratio).

When Sensex fell 10.6% between Oct-21 to Jun-22 our Portfolio fell 6.7%. This is a 63% Down Capture Ratio. Even recently on election results day when Sensex fell 5.7% our Portfolio fell 3.6%, again a similar ~60% Down Capture Ratio. This has been achieved by judicious portfolio construction. It is important to point out on election day the more overvalued indices fell even more, i) the NSE Small Cap Index fell 8.2%, and ii) the BSE Capital Goods Index fell 12.1%!

And in the 2 long upswings of the market i) between Mar-20 to Oct-21 and ii) between Jun-22 to now, we have delivered returns 50-60% higher than the returns of Sensex. Within these long upswing phases our performance was lukewarm in the last few months of these upswings. From Apr-21 to Oct-21 we underperformed Sensex by 6%, and in the more recent 9 months (Sep-23 to Jun-24) we have performed just 2% better than Sensex. This is natural as we are exiting names in the last phase of upswings as they become expensive and are being left with lower beta names and some cash. But it has been exactly this positioning that has allowed us to deliver the strong through-cycle outperformance.

Key outperformers:

- Shriram Finance: Up 23% this quarter. Part of the strong additional outperformance for us came from increasing our stake on election day from which point the name is up 40%+.
- Emami: Strong bounce of 61% this quarter, first because of signs of rural recovery in quarterly financials of multiple rural focused companies and then post elections with the expectations of rural friendly policy announcements.
- CMS Info: Up 26% this quarter, principally driven by continuing strong quarterly financial performance.
- HDFC Bank: Up 16% this quarter, driven by good quarterly performance last quarter though it could give some of this back based on Jun-24 quarter's business update that came out a few days ago that shows continued stress on deposits.

Key underperformers:

- Life Insurance stocks: Down 2% for the quarter on average as against a sharp 7% move in Sensex. This was partly due to the regulatory outcome on surrender values. We have used this as a buying opportunity and increased these positions in the Portfolio.
- Cash: We had 25.0% cash on average this quarter, and 21% at quarter end. This was a drag on returns.

Key changes to the Portfolio:

- Increased our position in existing names like Shriram Finance and PNB Housing amongst others, on election day: We had about 29% cash at the time and we took advantage of the big price correction in these names to increase our exposure and deployed about 8% of our cash to be left with 21% at quarter end. These names have performed strongly since election day and have been strong contributors to our outperformance this quarter.
- Increased our position in Life Insurance companies: We have increased life insurance exposure from 10% of the Portfolio to 15%. This is driven by these companies having remained cheap on a P/EV basis. Part of the perceived risk was that of regulatory pressure around surrender values. The regulatory outcome this quarter fructified this risk to 1-2% of EV of these companies which we believe is a good outcome and helps remove the overhang of regulatory pressure. On a P/EV valuation basis these companies are trading at near Covid levels, which is not true for most large cap names.
- Entered Yatharth Hospitals: We put on our second new position this calendar year. Yatharth is a tertiary hospital chain focused on the Noida+ market in the north. This is an example of GARP (Growth at Reasonable Price) style investing, one of the 5 forms of cheapness that we have backed so far. Its growth rates have been and are likely to remain higher than that of the sector, while being available at lower than sector valuations. Our entry is at 14-15x forward EV/EBITDA. The other elements we liked in the name was that much of the additional EBITDA in the next few years will come from improved utilization of current hospitals, and that they currently have a debt free balance sheet despite being an asset heavy business (which means they have balance sheet capacity to buy further hospitals).

Small Caps:

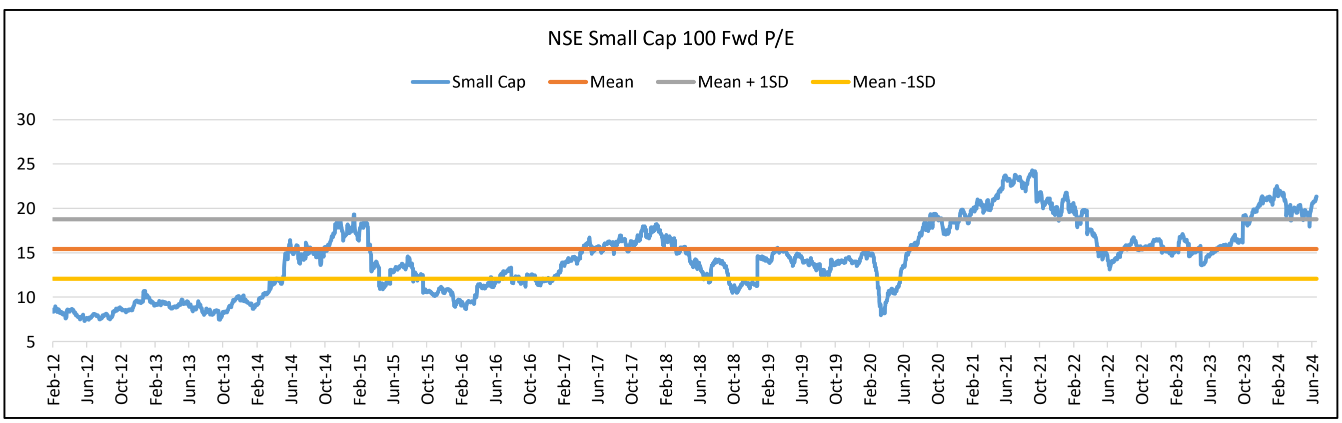
We started writing about the bubbly environment in Small Caps in our Sep-23 newsletter. We saw some correction in the quarter ended Mar-24 driven by SEBI trying to douse domestic flows, but domestic flows in Small Caps came roaring back this quarter to again increase valuations of the Small Cap Index to higher levels than that of Sensex.

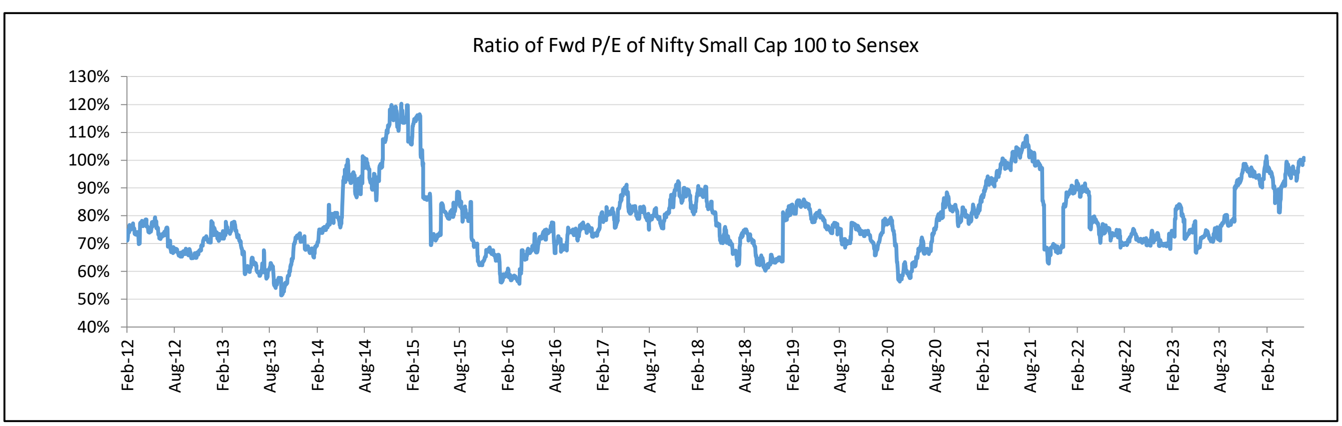
Small Caps represent about 18% of the total market cap of the country (12% before the rally) and have received about 46% of all mutual fund flows from Mar-23 to Jun-24. And this is before considering thematic funds, most of which are Small Cap focussed. If we added that to the Small Cap section then Small Caps are getting ~70% of all domestic flows! This quarter the flows in thematic funds through new fund launches (NFOs) was at record levels. When so much capital chases such a small pool of the market cap of the country it is not surprising that bubbles could form.

We summarize some of our key findings from earlier newsletters: The Nifty Small Cap 100 index is trading at well above its mean, now about 2 standard deviations 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 this quarter (Yatharth Hospitals) our overall view on Small Caps remains very 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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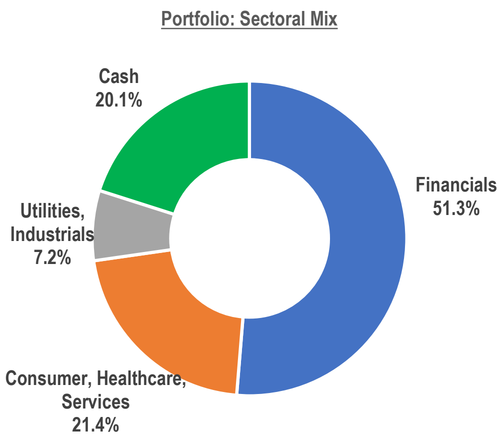
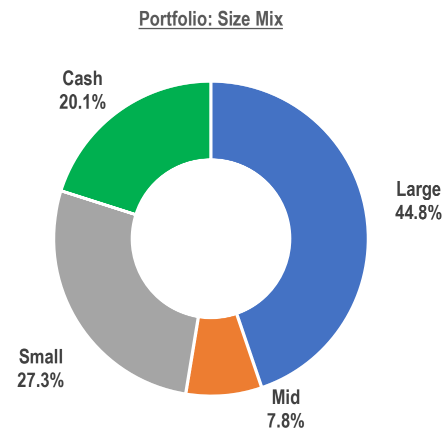
Portfolio characteristics:

	P/E (forward)	12m EPS Growth (consensus)	PEG Ratio	P/B (trailing)	RoE % (trailing)	Sharpe Ratio (3 yr)	Beta (ex-cash)
Portfolio	18.0x	15.8%	1.1x	3.4x	17.7%	123%	0.82x
Sensex	21.1x	12.7%	1.7x	3.7x	15.8%		

Note: Portfolio details are ex Life Insurance





Top 10 positions: *(of 18 total positions)*

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

Annualized Performance:

Period:	CY24 YTD	CY23	CY22	CY21	CY20
Cumulative Returns					
Portfolio	11.8%	32.7%	16.8%	33.2%	77.9%
Sensex	9.4%	18.7%	4.4%	22.0%	15.7%
Outperformance	2.4%	13.9%	12.4%	11.2%	62.2%

Period:	FY25 YTD	FY24	FY23	FY22	FY21
Cumulative Returns					
Portfolio	10.4%	34.8%	14.0%	11.1%	120.6%
Sensex	7.3%	24.9%	0.7%	18.3%	68.0%
Outperformance	3.1%	10.0%	13.3%	-7.2%	52.6%

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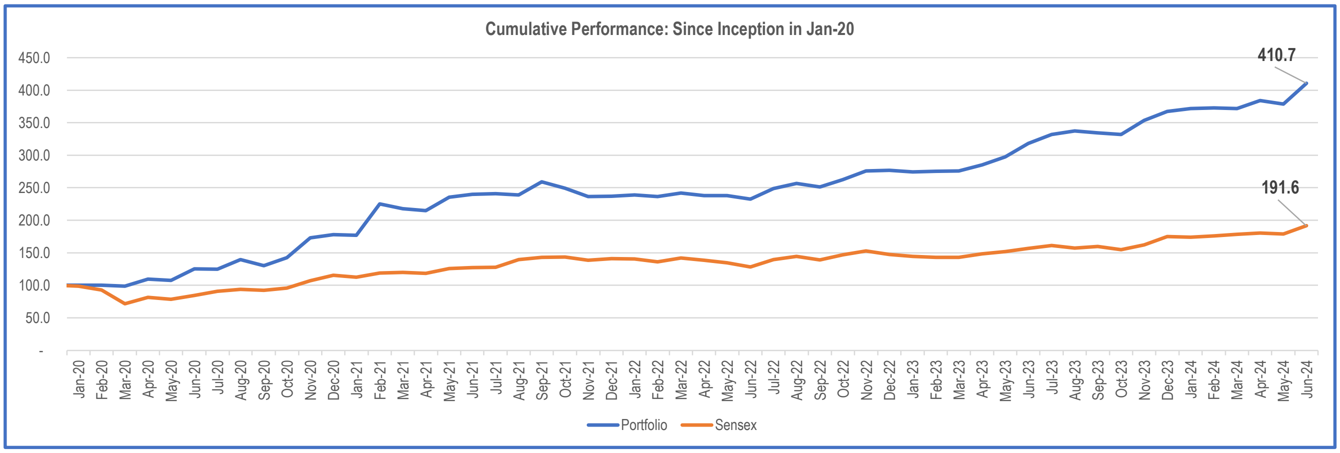
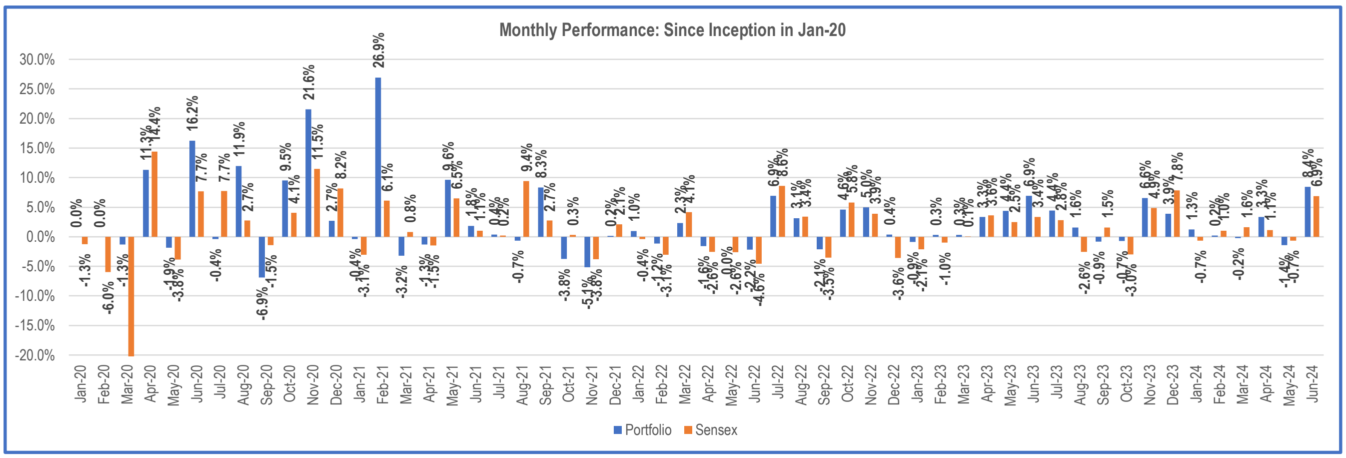
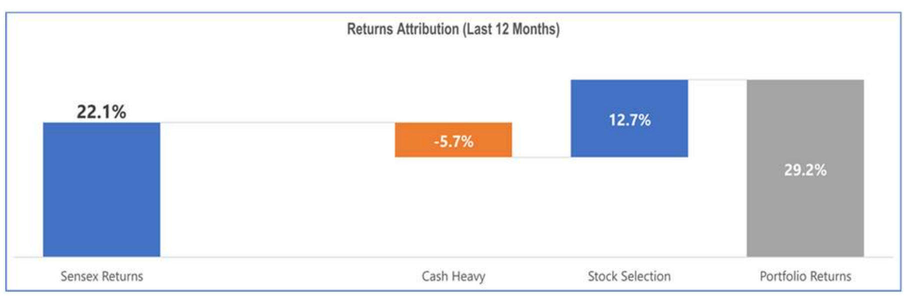
Monthly performance charts:



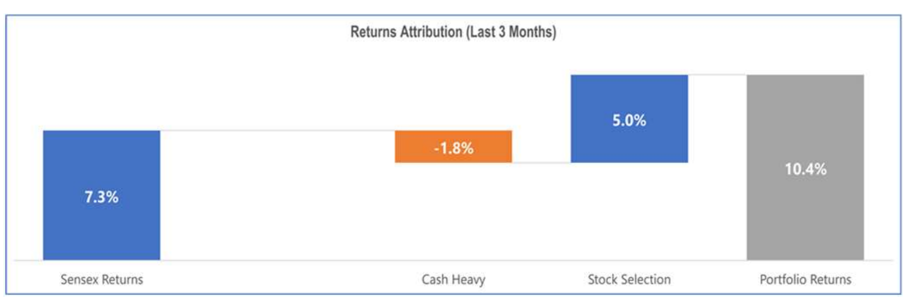


Returns attribution:

Outperformance For Last Year: +7.0%



Outperformance For Last Quarter: +3.1%



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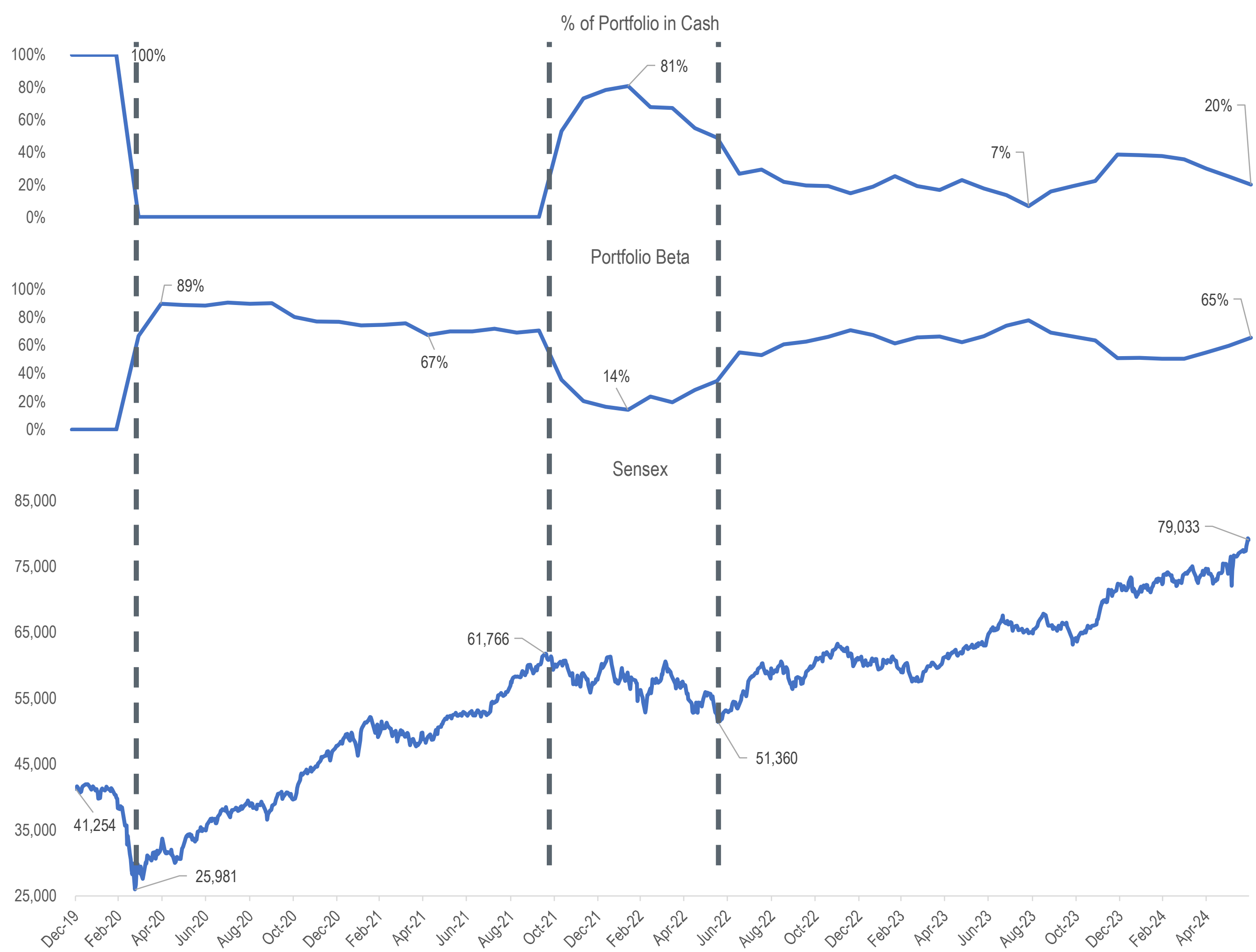
Our strategy in action:

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)	**23% in cash on average** Up Capture Ratio = 156% = Rise in Portfolio / Rise in Sensex = 76.5% / 49.1%

B. OUTLOOK:

Our portfolio positioning continues to remain defensive. While we deployed part of our cash when election day presented an opportunity, we still own a larger portion of lower beta stocks and continue to have 21% cash at quarter end. The Portfolio is more concentrated with 18 stocks now, but our disciplined portfolio allocation approach continues of maintaining a max of 9% in Large Cap names and 2.5% in Small Cap names (with a couple of higher conviction Small Caps names run at 5%). Our Portfolio is primarily concentrated in lending financials, life insurance companies and business services companies, all of which offer margin of safety in an otherwise fully valued market. We remain very cautious of the bubbly environment in Small Caps which has been driven by extraordinary flows.

This positioning is an outcome of high valuations in the market, which has been ignoring and / or quickly digesting potential risks. Some of the key risks which we are thinking about include:

- Coalition politics: both the smaller parties supporting BJP in forming a coalition government are leaders from cash hungry states. India's history with coalition politics suggests that there could be a substantially noisier next 5 years relative to the last 10 years of single party majority.
- Potential for increasing populism: One of the takeaways of the election outcome was the strong pushback from both the rural and poor sections of the country. The market widely expects glimpses of this in the upcoming budget in the end of Jul-24. Increasing populism could come at the cost of fiscal discipline or additional taxation, both of which will be negative for market outcomes.
- Elections in the west: This is a key election year in the US and Europe. Some of these election outcomes could have meaningful impact on India's exporting sectors.
- Geopolitical risks: Its easy to forget that 2 large scale geopolitical conflicts are ongoing and a risk of flare-ups can not be ruled out.
- US recession: Another risk which people are thinking less about is US recession / slow down. Many of the US market commentators continue to focus on potential unemployment rate increases in the second half of 2024.

On the flip side, inflation and interest dynamics in the west could allow the RBI space to cut rates through the next 12 months given the lower inflation dynamics in India.

We remain constructive in our research studying names in the business services, healthcare, auto component and textiles sectors. We think there are many exciting companies benefitting from the strong demand environment in India 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.

Sector	P/E Jun-24	P/E Jun-23	P/E 10 Yr Avg	vs Jun-23	vs 10 yr Avg	Our View
Auto	25.6x	21.8x	27.1x	17%	-6%	We have studied the sector. 2W seeing increasing competition and peaking volumes, PV and CV cycle topping out. We are instead spending time on auto comps.
Banks - Private	16.0x	15.4x	21.0x	4%	-24%	This is our largest sectoral position in the fund. Continues to offer opportunities even though market is expensive overall
Cement	35.1x	29.5x	27.0x	19%	30%	Still expensive
Consumer	44.9x	43.7x	41.0x	3%	10%	Very expensive, but we have a position in one of the cheaper names positioned to benefit from margin improvements post rural demand recovery
Healthcare	31.2x	26.3x	27.0x	19%	16%	We entered last year when opportunities existed. Fewer opportunities now. Working on hospital and diagnostic names
Infrastructure	28.3x	15.8x	11.0x	79%	157%	Very expensive, we are staying away
Media	19.7x	15.1x	25.3x	30%	-22%	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	9.6x	11.0x	31%	15%	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)	8.5x	4.7x	8.6x	81%	-1%	We have positions in O&G consuming / distributing companies as beneficiaries of normalizing commodity prices
Specialty Chemicals	37.2x	32.3x	23.2x	15%	60%	Very expensive, we are staying away
IT Services	24.8x	22.2x	20.3x	12%	22%	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