Monthly Letter

January 2022

prodigy
INVESTMENT MANAGEMENT

Invest well. Celebrate life.

We ended the calendar year on a positive note. We were +4.6% vs +2.2% for the NIFTY50 in December. For the calendar year 2021, we were +53.8% vs 24.1% for the NIFTY50. Since March 2012 we are +26% vs +12.5% for the NIFTY50 and 13.5% for the NIFTY500 (figures are on a CAGR basis, calculated post fees, based on SEBI TWRR method). While we believe we are amongst the better performing investment vehicles over a sufficiently long duration, our focus continues to remain on managing risk prudently with returns being an outcome of diligent process execution. This seems to work well from the extant returns data.

This also brings us to a dilemma we are currently facing. The performing stocks at the moment are largely from the mid-cap and small-cap space, where liquidity is a major challenge, even for a boutique fund like ours. Thus, to follow market leadership, which is one of the key pillars of our investment strategy, has meant that our allocation to the mid-cap and small-cap space has increased meaningfully and with it the risk of holding a higher percentage of illiquid stocks in the portfolio. Also, many of the new and highly unique businesses we find extremely attractive are all falling into this category. We are acutely aware of this fact and to counter the same, we are limiting our allocation to any single holding to the minimum possible, as well as looking to book profits a little early into any rise. We are alive to the risk we see in this elevated exposure, and we will normalise it once we can see more opportunity in the large caps.

It is indeed interesting as to how many of the stocks we have invested in over the last few months are among the recently listed IPOs. The IPO pipeline for 2022 excites us and we expect it to present more such opportunities. So we look forward to the new year as one in which we will be wonderfully busy!

The current third wave of the virus appears to be less lethal than the previous waves in terms of severity and mortality. This may be because of the higher levels of vaccinations, better treatment options, as well as the new variant displaying milder symptoms. Thus, the dislocation caused may be much lower this time, and we hopefully only have to ‘batten down the hatches’ and wait for it to pass. Therefore, apart from directly affected categories such as malls and travel-related sectors, the market appears to be taking the same in its stride and looking beyond the current ‘noise’.

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We have been highlighting the risks the global economy faces in the past few Monthly Letters, and the same continues to run parallel to the rally for the moment, and it is hard to say when they will cross. The biggest bugbear, interest rates, have started hardening, as anticipated, and this could be the first major challenge ahead in 2022. The other factor that may erupt at some point in time, but is hard to factor into one's calculations, are the unfolding geopolitical tensions with regard to China-Taiwan and Russia-Ukraine. Any conflagration will have a cascading effect beyond just the countries involved directly. Given that world markets are 'priced to perfection', it is possible the impact will be significant. If there is an extant risk that makes one lose sleep at night, it is this one. This is because it is not something conventional risk management or our type of risk management, can handle sufficiently well, should the worst transpire. Therefore, we plan to pay out a larger share of the profits we book in 2022, so that we may shield our gains in some way.

Businesses continue to exude optimism with the continuing recovery in demand and with the easing of many of the constraints they faced last year. The chip shortage appears to be easing and this will mean a large sector like automobiles will see a strong recovery in 2022. The capital expenditure cycle is recovering strongly and bank loans are also trending up. There is growing confidence that India appears to be on the cusp of a new economic cycle is strengthening.

All in all, we believe that 2022 will be a rewarding year, more normal in equity returns than the previous two years have been, but better than all other available avenues. We feel optimistic about the year ahead.

Happy New Year!

RC

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