

Monthly Letter

June 2022



Invest well. Celebrate life.

We were -10.6% for May versus -3.0% for the NIFTY50. For the 12 months rolling basis we were +4.8% vs +6.4% for the NIFTY50. We experienced a particularly difficult month due to significant selling pressure by FPIs and weaker than anticipated earnings in a few of our holdings on the back of worse than anticipated cost pressures due to commodity inflation. While we have been cautious on market direction for the above reasons (as has been expressed in our last few Monthly Letters) and we have been shifting to higher levels of cash in portfolios, we did not anticipate such a severe downdraft in our holdings, especially where long term business prospects and our investment thesis remain intact. This fall is more likely due to the aggressive liquidation in stocks with low liquidity. We have nevertheless raised cash levels to over 20% (from 10%) of portfolios as a measure of caution. Having said this, we believe that we have passed through the 'eye of the storm' and there are nascent signs that the worst of commodity inflation, as well as FPI selling, is behind us.

We have completed seven months of market correction from the peak seen in October 2021. Market valuations have seen the froth come off and look more sensible now. China has also lifted the stringent lockdowns in its major cities, which were causing severe supply chain issues and raw material inflation. We also move towards a gradual improvement on the chip shortage front which has been an overhang on the automobile and the electronics sectors. Senior management on the recent investor calls we have attended have alluded to an improvement in cost pressure in the second half of May and believe that there will be further improvements ahead, especially as the Government has initiated measures to bring down steel and fuel costs domestically, and is likely to initiate more measures to bring down other raw material costs which would include textiles as well.

The recent FPI trade data also reflects an easing up of the intense selling pressure of the last few months. The last four months have recorded amongst the highest net selling by FPIs, over any period in our market historically (around Rs. 40k crores per month). For these reasons, we believe that we may have passed through the worst of the fall over the last month, as

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investors will once again focus on the longer-term business fundamentals of stocks, as well as how strongly India seems positioned amongst large emerging economies to grow sustainably in the years ahead (as has been discussed in all our past Monthly Letters). This trough may in hindsight, prove to have been a wonderful opportunity for long term investors to find value. Anecdotally we find a lot of vibrancy around us. Monthly property registrations in Mumbai are at a record high and it is hard to find parking in our leading city malls, and in food courts on the highway, over the weekends (in comparison, I was in Thailand recently and the lack of vibrancy in shopping areas and hotels was hard to miss).

Given the global headwinds, we believe domestic facing businesses especially Auto and Financials are likely to provide the market leadership in the next bull market. Accordingly, we are repositioning ourselves with the cash we are holding to reflect this. We firmly believe that most of the stocks we continue to hold through this severe correction will bounce back once sentiment improves, as they are unique businesses with strong growth prospects, where the profitability and margins will revert to earlier levels once inflation eases. A few stocks we are holding, to jettison into the bounce, as we believe they have overcorrected in the 'perfect storm' of the last few months.

There is a chance that we have seen the final bottom for the market. Given the many global headwinds we are experiencing, it becomes hard to make predictions (it's always hard!), especially in the extant environment. Fuel prices remain elevated, the US Fed has no wriggle room in rate hikes and monetary tightening, food and commodity supply chains still remain stressed and the war in Ukraine has completed 100 days without any sign of the end. Thus, we need to keep a sufficient buffer of liquidity till we are sure that the long-term upward trend reversal has occurred. At present, there is a 'death cross' in the NIFTY50 and at the very least this needs to be convincingly taken out before we turn positive. De-globalisation of supply chains and financial decoupling of major economies remain the biggest long-term threats to global growth.

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We have witnessed too many such corrections over our existence, yet each one feels unique and terrible in its own way. However, we have managed to bounce back and scale higher levels every time. This time should be no different. We once again need to reflect on our errors and absorb our learnings from this fall, so we can get better at what we do.

Thank you for your support.

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