Monthly Letter

March 2021

prodigy INVESTMENT MANAGEMENT

Invest well. Celebrate life.

We were -8.2% in February vs -3.1% for the NIFTY50 and -4.1% for the Nifty500 (on one year rolling basis we are +28.2% vs +15.6% for NIFTY50 and +17.5% for NIFTY500). We have mentioned in our earlier Monthly Letters that risk management can be built for most scenarios, however, war is something that is hard to plan ahead for, given the extremely uncertain nature of how things may or may not unfold. Our view was that Putin was displaying extreme brinkmanship to extract concessions from Ukraine and the West, but that he would not actually initiate war. We were wrong. Even though we were holding some cash in portfolios, 10%, at the start of the month, the surge in commodity prices once the first missiles were fired, especially crude oil, as well as the shunning of riskier assets classes, has impacted us a lot. We have witnessed many events as asset managers, and this too shall pass (we got our SEBI license in 2005, and are amongst the oldest PMS providers in India).

War, of the nature we are witnessing, is an extreme event, and not one that can be fully built into risk management models (except at the overall asset allocation level based on individual risk profile). Finding the fine balance between the 'lines we draw in the sand', the point at which we exit holdings (corpus stop- loss), and absorbing the near-term volatility, is the challenge we face at this point in time. Suffering the proverbial 'whipsaw', should the news turn positive, is what we have to guard against, given that valuations have become quite attractive post this deep correction. What is inviolate, whipsaw or no whipsaw is the corpus stop-loss we set for each holding so that capital protection is never compromised, and we always have the ability to bounce back whenever the tide turns. Accordingly, our cash levels have risen to 15% over the month of February, as stop-loss levels have got triggered. This level will continue to rise automatically should markets fall further.

Even prior to this event, the elevated valuations, selling by FPIs and the impending rate hikes across the world on the back of the surge in inflation levels, were red flags for a 'risk off' sentiment building in markets. However, this has been exacerbated and accelerated by the events in Ukraine, and with crude oil as of today at over USD 110 a barrel, margins for all businesses are like to be crimped even further till prices cool off. Semi-conductor supplies, which seemed to be easing slowly, are likely to come under pressure again, as critical raw materials for the same are sourced from Ukraine and Russia. With the spate of sanctions levied on Russia; many trade and banking channels are blocked, and the repercussions of this are negative for industries with exposure to that region, as well as for banks. In fact, it is negative for global growth as a whole.

As of now, it is anybody's guess as to how long and how far this conflict will extend and how high commodity prices will spike. Especially since we don't know what Putin is hoping to achieve and how deep and desperate his ambitions are. Hopefully, the sanctions being levied will bite deeply and internal pressure to pull back from the conflict will prevail. However, as of now we will keep a defensive stance, and let cash levels rise. Our first and foremost goal is always to restrict capital loss during periods of severe distress so that we can thrive when the sun comes out again. We have successfully navigated through periods such as the Global Financial Crisis from 2007 to 2012, De-monetisation, the IL&FS scam, and Covid19 over the past few years. The founders of this company have also experienced the Harshad Mehta period, the Iraq wars, the Y2K crash, 9/11, and all the other mini-crises in between. Thus, we have seen and survived a lot, and have delivered a stellar performance, which includes the market crashes in these periods (24.2% CAGR from March 2012 to date vs 12% for the NIFTY50, post fees [all calculations are basis the SEBI mandated TWRR method]). This time will hopefully be no different.

We remain steadfastly bullish on India in the long run. We have covered why we feel so on numerous occasions in our Monthly Letters written over 2021. In hindsight, this crisis could be the correction that provides a great opportunity to load up for the decade ahead. Our market valuations have regressed to the long-term averages with this fall. With each large country that appears to shoot itself in the foot (read China and now Russia), the other large economies that are doing the right things in terms of reform, become more attractive to foreign investors (read India). So far India is moving in the right direction economically, and once the 'risk-off' sentiment abates we believe there will be a strong bounce back.

Thank you for your belief in us.

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