**Monthly Letter July 2020**

In June we were +4.2% vs +7.5% for the Nifty. On a 12-month rolling basis we are -2.5% vs -12.6% for the Nifty. June witnessed a sharp pullback in the beaten down, economy sensitive sectors of the market, where we have chosen not to be highly allocated, and therefore the Nifty gains were higher than our portfolio. Over the month of June, we have reduced our cash holdings significantly, however, this has been done in defensive sectors, as we believe that the economy is likely to struggle for longer than anticipated, as the pandemic is still not under control. A part of the current rally is also reflective of the hope of an early vaccine (200 candidates are under development globally, with a few in accelerated clinical trials).

Many economic indicators in June witnessed a strong recovery (GST collections, electricity demand, two-wheeler sales, etc) as the lockdowns were lifted, which may be reflecting pent up demand rather than a sustained reversion to pre-covid levels. Rural demand has been a bright spot for the economy and is expected to sustain on the back of less restrictive lockdown measures and strong agricultural output. The skirmishes on the Ladakh border with China, also added a new dimension to the already prevailing uncertainty, and one hopes this will fade away if de-escalation prevails. What is hard to judge is the extent of economic scarring that will continue for a longer period of time, even after things seemingly return to normal. It is for this reason that we have chosen to stay defensive. The upcoming earnings season is where we are likely to get more cues, and we await the same.

At this point in time, it is better to treat the current up-move as a bear market rally. While the market bottom may be behind us, we believe the market needs to consolidate for a while, till more clarity emerges on the control of the pandemic, as well as on the extent of economic damage and the recovery period for the same. Our conversations with business owners do not give us the confidence to bet on economy sensitive sectors at this point in time, and thus our defensive approach. Given that some employment heavy sectors are likely to take a long time to recover, and cost cutting will remain the mantra for corporate India; demand is likely to stay muted for some time.

One of the surprises of the current rally is the resurgence of the broad market, which for the past many years has been languishing, indicating a more risk-on sentiment than one would expect in the prevailing situation. This is where valuations are probably more attractive, given how richly valued the frontline stocks have become over the past few years. Prevailing low interest rates and crisis driven structural reforms (some of which we have seen last month) can provide the essential ingredients for a structural bull market, once the negative effects of the pandemic start to truly contract. We may then take on a more aggressive positioning in economy sensitive stocks, once businesses no longer have to work well below their rated capacity.

Preservation of capital is more important than beating the indices in the current uncertain times. As long as we do what is sensible and according to our processes, we are confident that in the medium to long term we will do much better than the benchmarks, as has been in the past.

Thank you for your support through thick and thin.

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