

FROM THE

# CIO's DESK

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DECEMBER 2023

**“Uncertainty is the only certainty there is and knowing how to live with insecurity is the only security.”**

**– John Allen Paulos**

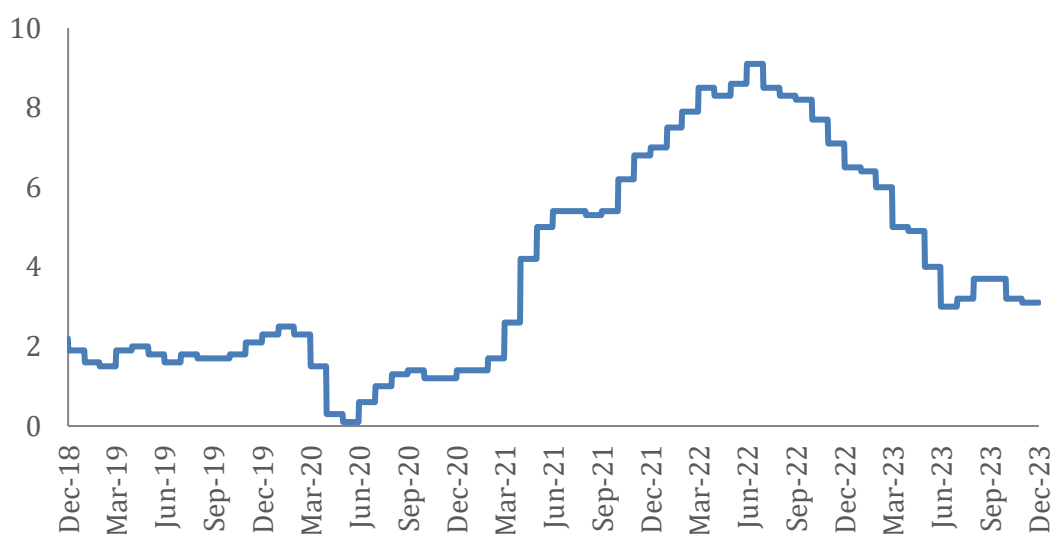
### **A dream year that was...**

2023 was a reminder that we are all living in a world where change, volatility and intermittent chaos is the normal. Against an anticipated year of recession, the year came up as a year of resilience. It was a dream year for many investors. Markets climbed series of wall(s) of worries from 4-rate-hikes over 4-months, stubborn inflation, heightened odds of global recession, collapse of 3-mid-sized US banks (including the 3rd largest banking failure in history), extension of the Ukraine war, and break-out of a new war in Israel, volatility in crude oil, slower demand environment, and uncertainties of weather Gods. Almost none of these were envisaged when the year began!!!

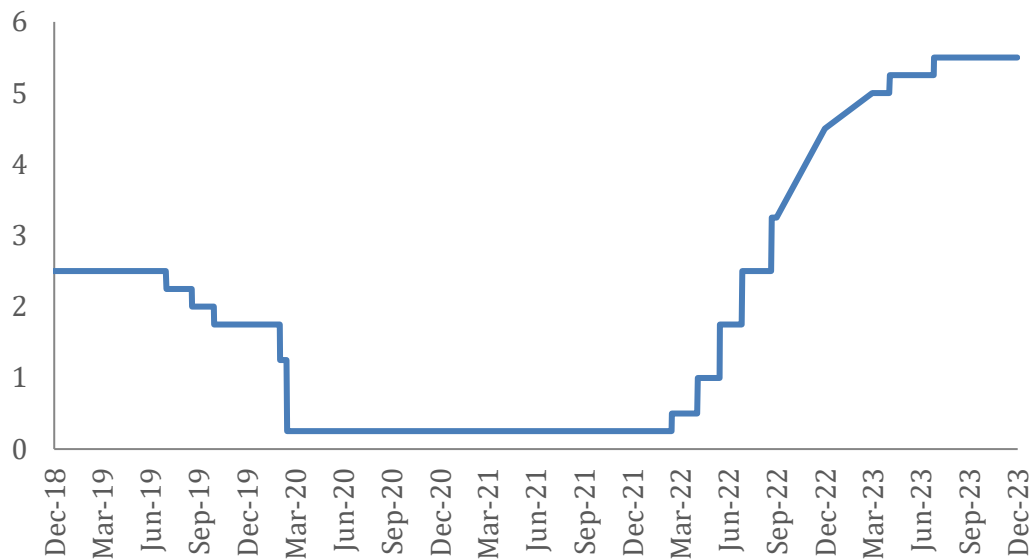
### **World full of uncertainties...**

The Fed appears to be successfully navigating a soft landing in which unemployment rises only marginally, while labour market tightness fades as demand for labour weakens. Disinflation is underway and developed market central banks have possibly through with their rate hike cycles. The impact of synchronized global rate tightening is likely to drag down Global GDP growth to a 4-year low of 2.93% in 2024, as per IMF's projections. US GDP growth is projected to decline by 0.6ppt to 1.5%, though an improvement in Eurozone from a low base will keep the overall Advanced economy growth decline contained at 0.1ppt YoY to 1.4%.

**US Inflation – CPI YoY**



### US Federal Interest Rate



As we enter the new year the expectations include, Fed engineering a “soft landing” to avert possibilities of US recession, Eurozone & UK to shaking on the brink of recession as inflation prevents easing, marginal improvements from Chinese economy despite current housing crises, possible diversion of Chinese policy from yield curve control and negative interest rates. Not to forget accentuated effects of dragged conflicts like Russia-Ukraine, Israel-Gazza and China-Taiwan heightened tensions of western world with China. The onset of election cycle though next 18-months in ~50% of the economies of significance, is worth a mention too.

If one conducts a fair reality check on what is changing in the world – the world is changing.... and changing slowly, steadily, ...permanently. The easy money period is gone; capital is costlier. The world is fragmented with broken supply chain(s), fractured socioeconomics, simmering conflicts and deep polarization. The existing economic frameworks, capital market rulesets, and the global powers-be are under challenge. These long decadal shifts take years, are incremental, slow, and subject to persistent bouts of volatility where the established order and emerging order are at crossroads. The established template(s), formula(e) & equation(s) might not work during this phase. We expect most of the asset classes (currency, commodities, and capital) to display persistent volatility during this period. The hiding places amidst these uncertainties which offer stability, visibility, and growth are rare to find at one place.

## **India – a mix of rare trinity – stability, growth and visibility**

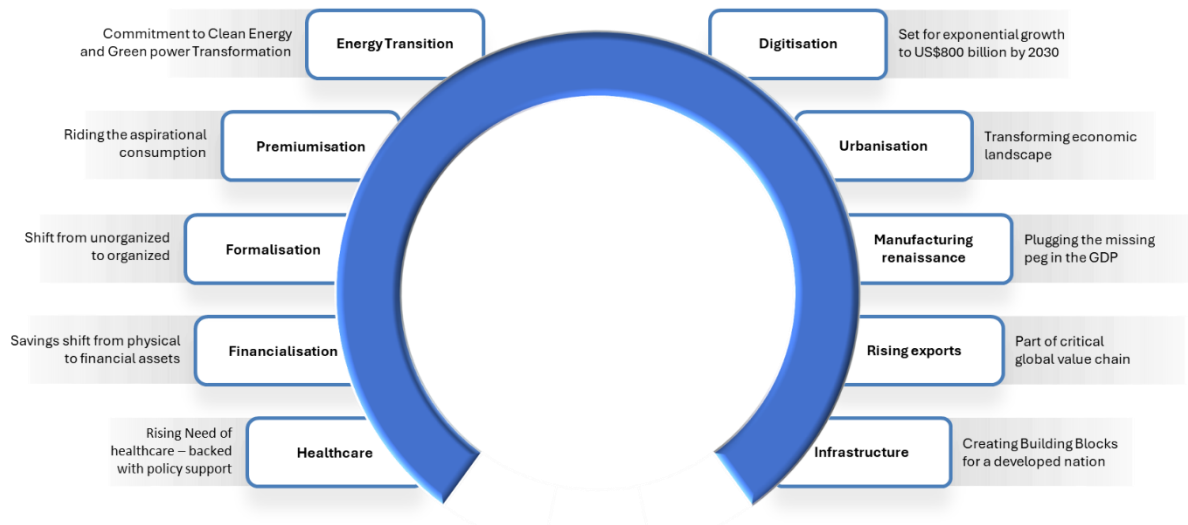
“Maturity is the capacity to endure uncertainty.” – John Huston Finley

If one attempts to peel the onion of events of last 5-years they offer among the most freak developments one would have dreaded to imagine. These events have been the “Agni-Pariksha” to demonstrate true character of businesses/ countries, and very few managed to come through unscathed. India has endured these crises as opportunity to permanently self-correct its policy, execution, regulation, and surveillance infrastructure across multiple sectors like banking, digital public infra, telecom, defense, railways, capital-markets, & healthcare, through a rightful blend of compassion, prudence, authority, and fairness to benefit each constituent of the economy to the least common denominator. Some of these decadal reforms have created a stress-tested prototype for an economy at scale primed for a break-out; with firm building blocks like, demography (large, diverse & promising), policy (proactive & accommodative), development (public owned & contemporary infra), and entrepreneurship (innovative & growth focused).

Scale is India’s core advantage making it a key ally either as a critical supply chain ingredient or as a final target market. It produces numbers when it comes to skill-backed workforce. Not to forget the at-scale cohorts akin to any global market. Many of these market segments were fulfilled earlier through an efficient import-driven supply chain. Pandemic-induced market compulsions fuelled the policy preference towards incentivizing localization & creating self-reliant supply chain. Manufacturing, which was the missing peg of the economy, is now set to experience renaissance when most of the factor cost efficiencies converge to feed at-scale-demand, creating an anchor for capacities that can now target global markets.

The lollapalooza effect of favourable market forces, internal development, at-inflection-per-capita income, proactive and vigilant policy regime, and competitive factor costs makes India a heady concoction of a vibrant alternative for global value chain across multiple industries (including equity investing). India’s GDP is likely to come ~7% for Q2 and ~6.2% for full year, outperforming the rest of the world. In short term, a slower global growth does pose an issue. As external sector recovers, growth will improve further. Manufacturing push from PLI schemes, efforts to benefit from global supply chain rebalance, augmenting private capital for infrastructure spend will also support growth.

Some of the megatrends that we expect to pan out through this period are –



## This tape has played in the past.....

This is not the first time that India has created excitement. The India story has flattered to deceive on at least 3-4 occasions in similar build-ups in the past.

Is it different this time....

How is it different...

Why is it different...

How sustainable is this...?

While we dread to say the words “This time is different...”, we would still jot down a few points to ponder that makes us feel this time the chances of this playing out are better –

- Scale – 1.4 bn+ – largest population in history in single market, largest democracy, favourable demographics in terms of working age, and a critical USD2200 GDP per capita
- Political stability – coalition years earlier, single party regime for 10-years, sufficient chance of continuity given recent political and electoral trends
- Balanced GDP constituents – growth seeking a more balanced GDP (EXIM, Mfg.)– setting right the piece on manufacturing, focus on increasing incomes at the bottom of the pyramid

- d. Superior Policy regime – proactive, better, efficient, and irreversible – balance between capitalists’ policies and social welfare, near-advanced-economy architecture
- e. Better balance sheets – individuals, corporate as well as government – willing to invest – given competitive cost of capital (5-decade lowest differential in inflation and interest rates against the developed world)
- f. Consolidated market structures – many industries are duopolies/ monopolistic competition, concentrated leaderships
- g. Triple sweet spot in manufacturing – large domestic market anchor complementing the appetite of global supply chains for the white spaces of China+1/Europe+1 sourcing alternatives, supportive government incentives regime
- h. Balanced capital market structure – contemporary institutional structure, rising financialization, strong flows to local institution, a well-diversified equities market, vibrant retail segment, underinvested local savings, underweight global capital

Never in the history so many factors have converged with strong tailwinds and long visibility for India at a single point in time. It is so much so that the local business houses together are seeking to invest close to USD 150+ bn over the next 5-7 years in new-gen sectors like electronics, energy storage, semiconductors, precision engineering, aircraft-manufacturing, rail infrastructure, etc. making way for the next India to keep on track for short term vision of USD 10 trillion by 2030 and USD 30 trillion by 2047. We feel the coming period of 3-5 year period for India to emerge as a multi-decade break-out nation.

### **Our Perspective(s)...**

Life is never a one-way street, neither are opportunities available in linear fashion. Cycles exist by nature’s law, while volatility is a man-made reality riding on greed & fear. Investors flock to opportunities seeking yesterday’s returns tomorrow. Further, investors end up getting money managers they deserve. We are proponents of investing for long-term, and therefore operate as bottom-up benchmark agnostic investors – where primary focus is to craft portfolios that navigate the misery of short-term volatilities.

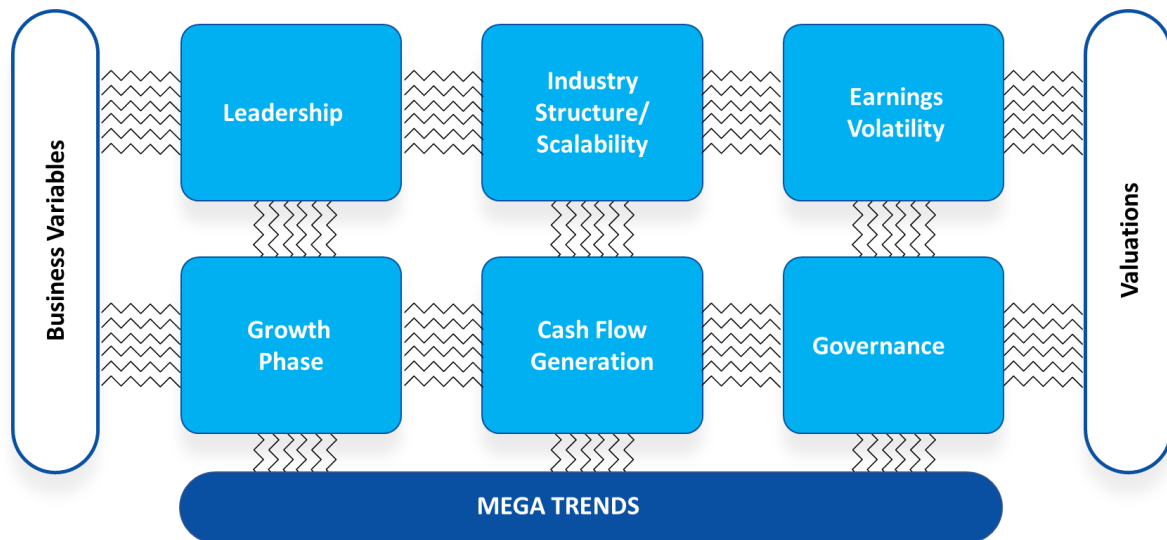
As discussed, we are living in an uncertain world, and we do not see them receding sooner. One needs to embrace uncertainty in these situations as a normal. Events happening frequently so play on expectations and stock prices – creating enough noise and distraction to get lost. We attempt to address these through –

- a. **Focus** – is defined as what you want to do. It is about clarity on what you are willing to compromise and sacrifice. Structured elimination improves selection. We have got this as our core DNA where we run concentrated portfolios
- b. **Deep Work** – Dig Deep – Concentration and conviction are foundations of long-term wealth creation. Diversification is an outcome of focus (or lack of it!!). Deep focus helps get deep clarity on extent of change in business trajectory, generating big wealth and navigate short term distractions
- c. **Stay Long** – Time is God’s remedy to everything – provided one manages his/her internal process. Deep work needs complement of patience – where time is a hard currency. Work that is built on foundations of focus and deep work, through time – deliver superior returns while navigating intermittent risks

We might sound like a broken record here, but good things are always boring. Excitement is enemy of patience. Our investment strategy rests on five core tenets of Industry Opportunity, Leadership, Competitive Advantage, Improving returns and Margin of safety – thereby driving our efforts to - **“identify select quality businesses, invest time/bandwidth/energy to understand the durability of their business model, gauge the management quality, decode to understand the value on offer and wait for the right price-value gap to lock-in a sizeable position backed by conviction.”**

We endure our close bond with three of our best friends to create generational wealth –

- a. **Business** – Stock investing is about owning a pie of the business. We value factors like Industry Opportunity, Leadership, Competitive Advantage, Improving returns, Management Quality while selecting the business
- b. **Time** – time is a friend of a good quality sustainable business. Our average holding period is in excess of 5-years – allowing market value of the business to mimic its economic value
- c. **Price** – stock returns are defined by price you pay. We actively monitor Price-Value Gap to assess Margin of Safety before entry in the stock



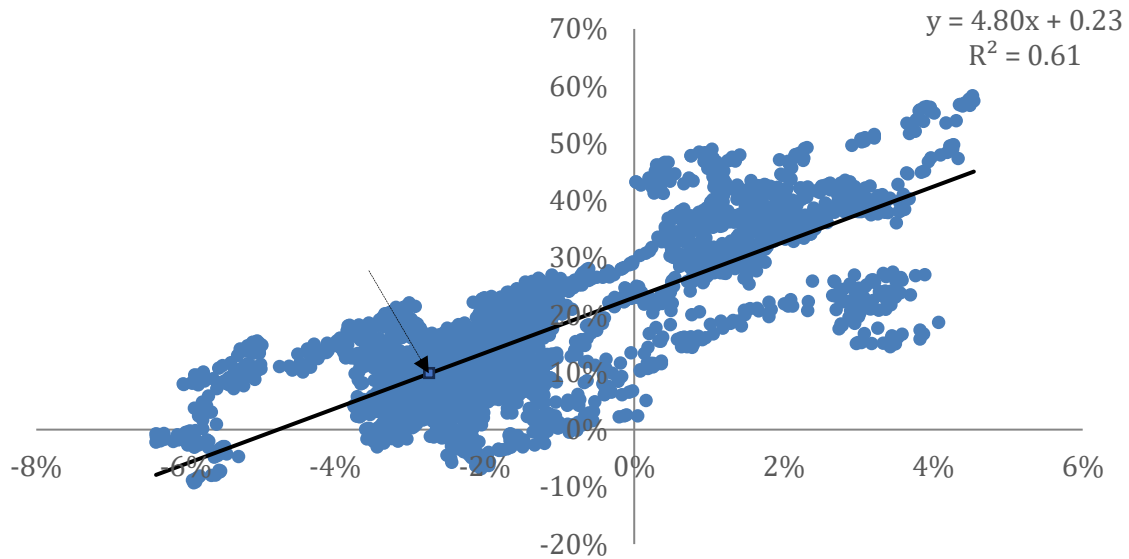
We have no specific affinity to either a sector, or any market cap. We have engrained Business model sustenance, Business returns, and Medium-term cash flow growth as our core principles to help build a rational assessment of margin of safety - the Price-Value gap. We also have an ESG architecture overlay for portfolio construction. Well-defined risks, along with monitoring frequency and early flag-off for mitigation, remain essential to avoid any accidents. What we also endure is relationship with our investors who commit their near-permanent capital aligned to this goal with frequent interactions to build confidence in our processes and diligence.

The stock selection, position sizing and portfolio construct are built upon balance of conviction, market cap, liquidity, return potential and opportunity-odds that we intend to play. Embedding the margin of safety in the investment framework helps one navigate such an environment to avoid buying a stock expensive.

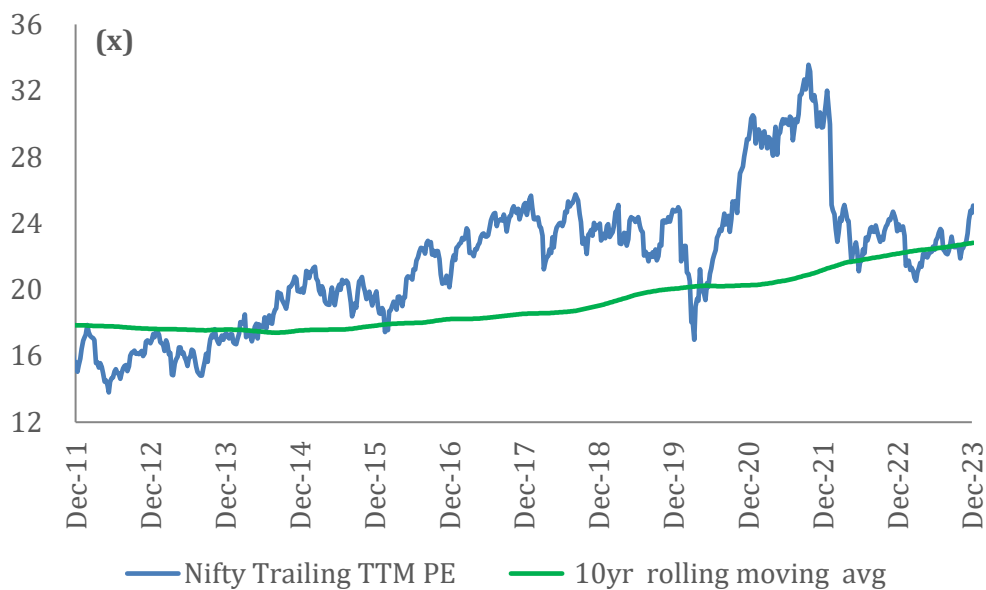
### Is it good time to commit...

As at end-CY23, the markets are locked a new closing high. The 12-month forward P/E rose to 22.1x. Absolute P/B rose to 3.9x. Relative P/E was up on a MoM basis in December at 1.7x. The valuation premium relative to EM (ex-China) is now at 67% (marginally higher than historical average). At these valuations we are at ~1sd above the 5-year average, and the adjusted EYBY gap is now ~-2.9, making earnings surprises an important ingredient for superior market performance from hereon as markets are primed for low-teen returns from 3-years perspectives at this set-up.

### EY/BY Gap



### NSE500: Valuation band chart



India story sits pretty with positives like – better return profile of corporates established transparent market structure, higher earnings visibility, and better governance architecture- in an otherwise messed up world. Institutional flows have been robust, where FPI net buying stood at ~USD 22 bn in FY23, while domestic institutions have bought stocks worth USD 22 bn. The monthly domestic SIP inflows remain strong at ~INR 17 bn, riding the super-trends on financialization & digitization (driven by rising-penetration, heightened retail interest, next-generation investing, sustained market buoyancy and increased financial literacy). On this backdrop of better sentiments, above-

average earnings growth, and strong capital flows, one can expect these premia to continue.

The markets pendulum has swung towards positivism further upon the favourable results of recent state elections for the national ruling regime. Post this, the markets seem to be factoring among the most favourable scenarios when it comes to economic, political as well as corporate performance like possible policy continuity, acceleration of next-gen reforms post-election and sustained better-quality consistent earnings trajectory. While this does risk erosion of margin-of-safety to an extent, the positive surprises from higher-than-expected government spend, higher FPI flows on the back of better allocations and a hint of rural resurgence (on a weaker base) can balance the same out over medium-term.

Markets are never under or overvalued, stocks are. One must also spend some thoughts on separating price and value. What we tend to broadly talk of valuations are reflections of price performance. Prices are derivatives of demand and supply. As things stand, the market clearly has more buyers than sellers, predominantly with better outlook on performance, perceived longevity of growth in the expectations and flows seeking a performing asset class.

Any investor while committing for any investment needs to ask following questions–

- a. Why am I investing – investment vs speculation
- b. What is my investment goal – wealth creation vs cash flows
- c. What is my investment horizon – short-term vs long-term
- d. How much can I risk – permanent loss vs volatility

A thoughtful assessment of answers to these questions is necessary by investors while committing to markets. We are perma-bulls on Indian equities. However, we are watchful too. We intend to build portfolios on rational optimism and avoid reckless risks.

We would suggest three things for any investor actively seeking engagement/additional exposure(s) in equities –

- a. Look for long-term – Time vs Timing. Allow sustained compounding. Address time-pain (if any)
- b. Stagger your investments – Nothing is permanent. Embrace uncertainty. Make volatility your friend
- c. Switch off noise – Life is tranquil in absolute. Comparisons forces disorientation from focus. Sustained committed continuous improvement helps create mega-multiplier to wealth

**In Conclusion...**

When it comes to investing, it is important to set expectations on all the three parameters on expectations about risk, returns and time horizon of investment right and commit orderly exposures to equities with long-term perspective.

We are structurally positive on India equities with a bias towards prospects that present long term growth visibility with business franchises well-positioned to navigate megatrends like aspirational consumption, home improvement, step-up in capex recovery, digitization, financialization, and are positioned to play the same in our holdings. We remain watchful to exploit any adverse effects of global environment and its rub-off on prices of our belief stories to lock-in from a medium-to-long-term perspective.

We feel with our committed focus to create generational wealth through right exposures to the emerging India growth story, we possess a template to deliver sustainable risk adjusted returns over long-term. We remain committed to our process of finding long-term sustainable value from such opportunities while remaining agile and equipped to add to our current positions at every prospect of price-value divergence.

Wishing you and your family a happy and prosperous new year ...!!!

Warm Regards,  
**Jiten Doshi**  
**Co-Founder & CIO**

**Disclaimer:**

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