Ist August' 2018

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M O N T H L Y V I E W

FROM THE FUND MANAGER DESK

A Tale of Two Tatas!

The Star and the Shoddy: *Closer look at the two titans of Tata to understand where the future unlocking opportunities may lie in the market.*

Let us start with the titans first. Contrast is stark and striking between these two stars of Tata stable. One is shining in glory while the other is staring at a dark abyss. Both are catching headlines, but not for the same reasons. One for becoming the first Indian company to reach & breach the $100 Bn market-cap and the other for its worst fall in its stock price to multi-year low. If there is anything similar at all between them (other than both belonging to Tata group), it is this: both derive significant part of their business from global customers.

To cut the suspense and come straight to the subject, as readers would have guessed, the companies we are alluding to are TCS and Tata Motors. Behind the "star and the shoddy" script of these companies, there is a bigger story that is playing out, understanding of which can help in identifying future winners. Let us take a closer look at the charts below. It is fascinating to know that the charts are not very different between TCS and TaMo if you take out the stock price from the charts.

More interestingly, has the growth rate materially changed for TCS for the stock to almost double from early 2016 levels. Numbers from the chart do not reflect any significant change in either top line or bottom line trend. Top line growth has been in single digit and not very far from that even for FY19 (estimates). If so, how does one explain the sharp surge in its stock price? If earnings had not changed materially, something must have changed materially to warrant near doubling of stock price. That something has a lot to do with how pessimistically or optimistically market views the outlook. In 2015 and early 2016, it is all about pessimism in the IT sector. Cloud and automation clouded the outlook in IT and market feared worst.

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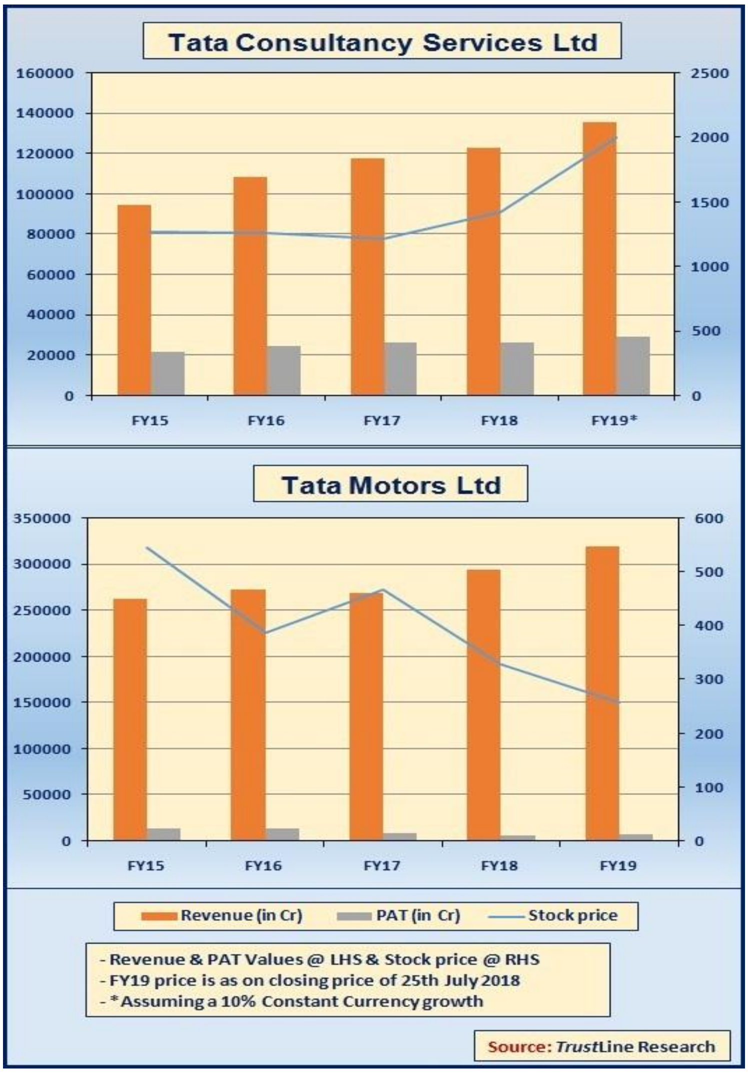
MONTHLY VIEW

As usually happens, in such times of cloudy outlook, market amplifies the ongoing challenges (normal otherwise) and manufactures a sort-of-perfect-storm for the sector. This is what happened when the market started magnifying the otherwise regular risks like H1B, wage hikes etc. When the worst did not happen (because of digital and automation), adjustment in price started happening, though the challenges continued. This gradual adjustment led to run-away optimism when the sector got the booster shot from the currency. To look back, none of the Industry's challenges have gone away, be it H1B issue, wage pressures, cloud, digital etc, except market's pessimistic view.



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Similar script may be on play now in Tata Motors. Regular and ongoing cyclical challenges in JLR business are getting amplified by BrExit and trade war fears triggering all round pessimism on the prospects. Because of this overblown narrative on JLR, the stock has been punished to decade low valuation measured in terms of price-to-book. The last time it traded at such low valuation was in 2009. It is another matter that the stock returned 7 times in just three years post that crash.

If TaMo is a steal, what do you call the DVR (differential voting rights) version that trades at 40%+ discount (for no apparent difference in the economic ownership)? It is a classic 'Heads I win, Tails I don't lose much' situation.

> *"Time to invest is when drums are beating, not when trumpets are blaring." Investing is at its best when narrative goes negative. Follow the cycles (mis-pricing), not the narrative for the superior results in investing.*

Would you chase the star or the shoddy that is throwing up once-in-a-decade opportunity? Of course there is an emotional price to pay. If you align with the star, it will be very comforting emotionally with not much rewards in returns. On the other hand, sticking with shoddy, while emotionally wrecking, can be enriching and rewarding in financial returns. Choice is yours.

Happy Value Investing!!

ArunaGiri. N

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CORPORATE NEWS

- The Cabinet is expected to soon consider **IDBI Bank's** proposal to issue fresh equity to the **Life Insurance Corporation of India (LIC)**, offering the insurer a controlling 51 per cent stake in the lender as the government pushes for the deal to be completed by September.

- **HCL Tech** board approved the buyback of up to 3.63 crore fully paid-up equity shares with a face value of Rs 2, each, at a price of Rs 1,100 per equity share payable in cash for an aggregate amount not exceeding Rs 40 bn.

- **Dr Reddy's Laboratories** said it will appeal the decision of a New Jersey court that ruled against the company over the opioid drug Suboxone, for which a UK drugmaker claims a patent.

- **Tata Motors** said its much-awaited compact sports utility vehicle (SUV) will be called 'Harrier', which is being developed in collaboration with British arm **Jaguar Land Rover**.

- The department of telecommunications has given the final nod to the merger of **Vodafone India** with **Idea Cellular** to create Vodafone Idea Limited, the largest carrier in India by subscribers and revenue market share, clearing the last hurdle to the largest M&A deal in the sector.

- The govt approved infusion of Rs 113.36 bn in 5 public sector banks, including **PNB, Corporation Bank and Andhra Bank**, to help them meet regulatory capital requirements.

- **Maruti Suzuki** is in on track to reach 2 million units sales milestone by FY-20 and has set a goal of attaining a target to sell 3 million vehicles by 2025.

- **Banks** are set to finalize deals for about a dozen stressed power projects with more than **13,000 MW capacity** within the next 10 days even if they have to take a steep haircut. The lenders have set August 14 deadline to sign the deals.

MONTHLY VIEW

- **UPL** is set to acquire **Arysta LifeScience** for over $4 billion. The acquisition of Arysta LifeScience will help UPL enhance 'its solutions to fit local farming needs' and bring in synergies that can benefit its operations in overseas markets.

MACRO NEWS

- In its 28th meeting, the **GST Council** gave its approval to slash tax rates on over 100 items that were in the highest 28 per cent tax bracket under the Goods and Services Tax. GST rates on articles including consumer durables like smaller television sets, refrigerators, washing machines, paints and varnishes, lithium ion batteries, and more were brought down from 28 per cent to 18 per cent.

- **The government** decided to increase the minimum price sugar mills pay cane growers by Rs 20 per quintal to Rs 275 per quintal for the 2018-19 marketing year starting October.

- The government hiked the **minimum support price** for paddy by a steep Rs 200 per quintal as it looked to fulfill its poll promise to give farmers 50 per cent more rate than their cost of production. The decision, taken by the **Union Cabinet** headed by **Prime Minister Narendra Modi**, comes less than a year before next general election.

- **The Union Cabinet** eased the policies related to hydrocarbon exploration further by relaxing production sharing contracts (PSC) of Pre-New Exploration Licensing Policy (Nelp) and Nelp blocks. This includes giving relief to companies like **ONGC and Oil India (OIL)** on sharing royalty and cess in pre-Nelp exploration blocks.

- **The IMF** has trimmed India's growth projection by 0.1 percentage point to 7.3% for 2018-19 owing to high oil prices and a tight monetary policy regime. The effect of the twin headwinds on the IMF's projection for 2019-20 was much sharper 0.3 percentage points to 7.5%.

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- The government has increased the official **maximum load carrying capacity** of heavy vehicles, including trucks, by 20%-25% besides scrapping the mandatory annual renewal of fitness certificates for freight carriers.

- **SEBI** has eased disclosure norms for **initial public offerings (IPOs)** and tightened the definition of 'promoter group' to prevent fraudulent transactions. IPO issuers will now be allowed to announce the price bands two days before the issue opens for subscription instead of the previous five days. The new IPO norms include 'immediate relatives' within the definition of promoter and promoter groups.

FUNDS FLOW DATA

Data as on 26th July 2018		
FUNDS FLOW DATA (Rs in Cr)		
Category	***MTD***	***YTD***
FII	2776	(4730)
DII	(199)	74115
Total	**2577**	**69385**

DEBT & FOREX MARKET

Data as on 27th July 2018			
Debt / Forex Market			
Category	***Day***	***1 Mnth***	***3 Mnths***
10 Yr Yield	7.8	7.9	7.8
Re/ US $	68.7	68.6	66.7

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MARKET VIEW*

Is it all about carry trade?

It is fascinating to fathom that the set of stories that surface in every cycle in India is strikingly similar. In the upcycle, it is all about the structural India story in terms of growth potential, demographic dividend, financialization and formalization (un-organized to organized) etc. In the down-cycle, risks like twin-deficits (current and fiscal), falling currency and rising inflation etc. return to dominate the narrative. It is about shining macro in the upcycle and all about daunting macro risks in the down-cycle. It is not that this pattern has popped up only in this particular cycle. In every cycle in the past, without exception, one would find this striking script shaping the story.

What do investors infer from this? It is the simple fact that India macro is neither daunting (as feared in down-cycle), nor shining as scripted in the upcycle. Understanding what causes the underlying cycles that steer up the stories is far more stimulating for investors. These cycles, esp. in emerging markets, are caused more by the carry trade flows than anything else. These carry trade flows that triggers the big up-move or a sharp fall when they reverse, are dictated more by direction of Fed rates than any country specific chronicles. But what happens on the ground is grossly different. When the carry trade flows change the direction, narrative on the ground changes to suit the local script, thus amplifying the trend.

What we are currently going through' is one such amplified trend of downturn in the broader markets (though indices are at all time high because of skewed surge in few stocks). Though what has triggered this fall is a simple cyclical issue of EM (Emerging Market) carry trade reversal, the deficit and currency issues that normally accompany such reversal have come back to make the macro look murky and thus aggravating the fall. Local challenges like political uncertainties, SEBI's surveillance adventures and untimely mutual fund scheme rationalization etc. couldn't have come at a worse time to make this otherwise cyclical fall into deeper downturn. What is more important to understand is, this fall has nothing to with India-specific issues and is more triggered by carry trade reversal. All negatives (which are always present) come to the surface as normally happens in any down-cycle. More interestingly, when the carry trade flows come back, it will be time for positives to come to the surface to script the sensuous bounce. Early signs of such a reversal are already visible if one goes by the slow and gradual improvement in FII flows in this month i.e. about $400+ mn net inflows into equities so far in July. Investors who don't get lost in the narrative (like murky macro, political risks etc.), but focuses on the underlying cycles, will more likely to use the current fall as a great opportunity for stock picking and portfolio construction for long-term rewards.

We stay away from giving market outlook (except reporting the consensus view) as we believe that the short-term market movements are function of innumerable rational and irrational parameters and hence any attempt to predict the next market move would be a futile exercise. Hence, we would like to qualify the above consensus view on outlook with a clear caution that TrustLine does not have any specific view on the outlook and does not necessarily subscribe to that.

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VALUE EXTRACTS

- In this section of the newsletter, we attach an extract/write-up that we believe can add value to the readers from the "***VALUE INVESTMENT***" point of view or others that offer interesting perspective.

- Enclosed section carries an interesting article titled ***"Your Focus Should Be On Risk, Not Reward"*** by **Lawrence Hamtil**.

"As a very successful investor once said: The bearish argument always sounds more intelligent."

- Peter Lynch

Your Focus Should Be On Risk, Not Reward

A common theme of this blog has been that the assumption of more risk does not go hand-in-hand with the reaping of greater rewards. In fact, if anything, the opposite has been true historically, both in equity markets and in fixed income. Experience has shown again and again that, for example, higher returns have emanated from lower-volatility stocks, and higher quality bonds have tended to outperform those of lower credit quality. In both instances, - whether risk is defined by volatility (yes, volatility can be a risk), drawdowns, or total loss, - the more conservative option has generally performed better.

This paradox, which in essence is that a defensive mindset often trumps an aggressive one, can be observed elsewhere in life, particularly in many instances throughout military history. A particularly glaring example comes from the arms race leading up to World War I, when rival nations Great Britain and Imperial Germany focused on very different things as they made trade-offs in the design of their battleships, with stark differences in terms of balance among speed, armament, and armor plating. The British Royal Navy adopted a very aggressive posture, deciding to sacrifice armor plating in favor of speed and armament, while the German Imperial Navy's focus was decidedly defensive-minded, focusing instead on ruggedness and survivability.

In his magnificent *The Great War: A Combat History of the First World War*, historian Peter Hart sums up the British attitude by quoting First Sea Lord Sir John Fisher, who was a proponent of speed and hitting power above all else:

The first desideratum of all is speed! You fools don't see it - they are always running about to see where they can put on a little more armour! To make it safer! You don't go into battle to be safe! No, you go into battle to hit the other fellow in the eye first so that he can't see you! Yes! You hit him first, you hit him hard, and you keep on hitting. That's your safety!

Mr. Hart goes on to describe how, obsessed with increasing their rate of fire, British naval crews were taking, in Mr. Hart's words, 'suicidal risks,' such as propping open magazine doors and accumulating cordite charges in large piles for easy access, all of which went against basic damage control protocols in the event the ship's armor was penetrated by enemy shells.

In marked contrast, the German philosophy was focused on armor protection with the idea that the more damage their ships could sustain, the more likely it was that they would outlast their more lightly armored British opponents. Given the rudimentary aiming technologies of the day, scoring lethal hits was somewhat a matter of volume, so the longer a ship was serviceable in a fight, the more likely it was to deliver knockout blows.

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With this in mind, Mr. Hart goes on to say, the German navy was focused on having its ships armored to the maximum degree possible, and crews were drilled not with added emphasis on rate of fire, as were their British opponents, but on damage control. Mr. Hart captures the German mindset by quoting Admiral Alfred Tirpitz:

So long as a ship is afloat, it retains a certain fighting value and can afterwards be more easily repaired...We soon found that we had to experiment with real explosions in order to gain sufficient experience. As we could not sacrifice modern ships, and could not learn enough from the older ones, we built a section of a modern ship by itself and carried out experimental explosions on it, with torpedo heads, carefully studying the results every time.

When the two navies clashed during World War I, the merit of the German focus on risk management became obvious, as time and time again its ships proved able to withstand damage and survive to fight another day, while the British system proved to have dire consequences for its crews, many of whom perished in catastrophic explosions after only a couple hits on their ships.

In essence, the British philosophy of sacrificing armor for speed, and safety for rate of fire, was a kind of leveraged risk with the hope of quickly reaping grand rewards in battle. The German philosophy was focused not on maximizing results by sheer rate of fire, but on surviving the encounter long enough to land lethal hits. This is, in my opinion, an apt analogy for the investment world, where, as Nick Maggiulli points out, even with a high degree of certainty regarding future outcomes, leverage can lead to catastrophic results. All too often when investors are behind on savings, or lagging a benchmark, they try to make up ground quickly by taking on more risk, neglecting of course the possibility of being wiped out should things go wrong.

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The prudent investor always starts with the end in mind, vigorously testing his assumptions, contemplating worst-case scenarios, and focusing on risk management. As the example of the World War I naval clashes illustrates, a defensive mindset does not mean that you will come short of your goals for lack of taking on sufficient risk. On the contrary, a keen awareness of risk will help you achieve your goals by helping you weather the markets when the tide goes out, thus keeping your portfolio intact when it is needed most.

Article by Mr. Lawrence Hamtil from fortunefinancialadvisors.com.

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About TrustLine

At TrustLine, we run a specialized PMS fund (Portfolio Management) for exclusive set of high net-worth clients (long only value based fund). We are a company with a single mission- to deliver superior long-term returns to our clients. We are managing over Rs.350+ crores of AUM for over 400+ highly satisfied clients. This makes us among the top 25 discretionary portfolio managers in India, with industry leading performance.

Over the years we, at TrustLine, have gained rich domain expertise by focusing and specializing in Portfolio Management Services (PMS). Unlike our competition, we are a unique firm focused only on PMS. This sets us apart and gives us a competitive advantage in the PMS space. At TrustLine we believe, the quality of "Research" is fundamental to delivering out-sized returns. When research is complemented by contrarian investment approach, the rewards can be dis-proportional. This forms the foundation of our investment choices and stock selection in our core PMS business. Our disciplined practice of this "Value Investment" principle has enabled us to deliver superior risk adjusted returns with significant out-performance over bench-mark indices.

With a client retention rate in excess of 99%+, we have grown as an organization through strong references, primarily driven by solid track record of building wealth across good and bad market cycles, through focused and disciplined approach to investing.

TrustLine products include:

- ***Intrinsic*** (Deep Value fund)
- ***Intrinsic*** Floater (Arbitrage Fund)

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