Ist February' 2019

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M O N T H L Y V I E W

FROM THE FUND MANAGER DESK

Dollar: Ready for Reversal?

Manner of its fall in 2019 matters most for emerging markets.

Dollar doesn't make daring moves. Measured by dollar index, its movement is never magnificent. But the few points fall or rise in the index can mean a lot for emerging market currencies. Its direction is more important than the quantum. Take 2018 for example. In percentage terms, its 4% rally (against narrow basket of developed market currencies) in 2018 was more meagre than meteoric. Yet, it had a ruinous impact on much of emerging market currencies, with some of them falling ferociously by over 20%+.

As we have seen in the past cycles, it is never a one way traffic. Dollar index is no exception to the dictum that what goes up eventually falls. So, is it due for fall? To understand this, let us go back to what triggered the tide for dollar. As understood well by now, the rally in dollar was rooted in the expectation that strengthening economy will lead to faster pace of tightening by Fed. That was the underlying narrative that kept the dollar in high spirits in 2018. But, financial markets have a funny way of self-correcting itself i.e. the prospect of an event has the potential to change the course of that event itself. In hindsight, one could see that the prospect of fast paced action from Fed had an unintended side effect of pushing US markets into a sizable slump towards the end of 2018, which in turn, has now dimmed the prospects for the prolonged tightening on fears of slowing growth amid market volatility. This whole cycle of self-correction happens all the time in financial market, because of its inherent design to discount all future outcomes in a dashing hurry. It was no different when it came to Fed tightening. The prospect of tightening triggered a spike in US 10 year yield to new high at 3.25% in early Nov, prompting some punters to even project 5% sooner than later. Rising yield amid trade disputes and slowing china, rattled investors by

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stoking fears of recession. The sharp slump that followed in the US market indices prompted Fed to sound a conciliatory tone with regard to its future hikes. With markets now penciling in more pause and less hikes, 10 year yield too turned to settle much lower at 2.75% level as we write this column.

How does this development change the track for dollar in 2019. As the recent column in Economist predicts, there could be two scenarios that could be emerging for dollar this year. In either case it is going to be a fall for dollar index. But, against which basket, it is going to fall, will be key to what is in store for emerging markets. First scenario is a more rosier one for emerging markets. Here it starts with an assumption that trade war de-escalates giving more headroom for china to initiate tax cuts and loose monetary policy as stimulus to spur private spending. This in turn leads to stronger revival in Europe and emerging markets amid slowing growth in US. On account of this, yields rise in Europe while softening stance from Fed in US keeps the yields there muted. This divergence in yield will lead to dollar weakening against its major currencies in Europe. This will be something similar to what happened in 2016. The year started with the scare of accelerated hikes from Fed, but ended with fewer cuts and prolonged pause which in turn led to surging emerging market flows amid weak dollar index. We may be in for another bout of strong emerging market flows if this scenario plays out.

The second scenario is more of gloomy one where China's stimulus (tax cuts and loose monetary) gets stifled by the rising trade tensions leading to soft patch in both Europe and emerging markets. This coupled with slowing US hits the dollar, but this time against Swiss and Yen (as the safe haven), as risk assets sell off across the board. Though probability for second scenario is far less, one can hardly rule that out. 2019 will be an interesting year to watch out for emerging markets based on which scenario plays out!

ArunaGiri. N

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CORPORATE NEWS

- **Wipro Ltd.** will reward shareholders with one free share for every three they hold in the software services provider. Wipro also announced a bonus issue of the same ratio for its American Depository Receipt holders too. The bonus shares are expected to be issued by March 17.

- **Tata Motors** is working closely with other group entities such as Tata Capital and Tata Power to create electric vehicle (EV) ecosystem in the country.

- **Dr. Reddy's Laboratories** received four Form 483 observations from U.S. FDA inspection on formulations plant in Andhra Pradesh.

- **Indoco Remedies** in initial discusstion to sell part of local business (Oxipod) for Rs 600 crore to investors such as Zydus Cadila, Lupin and PE funds like TPG Capital and Temasek Holdings. (ET)

- French dairy group Lactalis has signed a definitive agreement to buy the milk-processing business of **Prabhat Dairy** for about Rs17 bn through a slump sale.

- Competition Commission of India's gave nod to **Reliance Industries** for acquisition of stake in **Den Networks** and **Hathway.**

- Rajesh Sud, shortlisted by the **Yes Bank** board to succeed Rana Kapoor as the lender's next Chief Executive, has pulled out of the race for the top job, leaving insider Rajat Monga as the sole recommendation for the regulator to approve.

- **Lupin** received the approval from the US health regulator to market Levothyroxine Sodium tablets used for treatment of hypothyroidism.

- **Ashok Leyland** has confirmed that it has bagged orders from IRT (Institute of Road Transport, Chennai), UPSRTC (Uttar

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Pradesh State Roadways Transport Corporation) and CTU (Chandigarh Transport Undertaking) for 2,580 buses.

- **KPIT Technologies** board approved allotting 7.7 crore equity shares to National Engineering Industries and Central India Industries in 9:22 ratio. On Nov. 29 NCLT had approved merger of KPIT Engineering, KPIT Technologies into Birlasoft.

- **Tata Steel** announced it has signed a definitive agreement with China's HBIS Group to sell 70% stake in its Southeast Asia operations for a cash consideration of $327 mn.

- Subhash Chandra's Essel Group said it reached an understanding with lenders having a pledge on **Zee** Group promoters' stake that a steep decline in the shares of group companies will not lead to a default.

MACRO NEWS

- The **International Monetary Fund** has scaled up projections for India's economic growth a tad by 0.1 percentage points at 7.5% for 2019-20, even as it cut the same for the global growth by 0.2 percentage points at 3.5% for 2018.

- Govt doubles **GST exemption limit** for **MSMEs.** The turnover limit for businesses availing of the GST composition scheme, which allows them to pay goods and services tax at a flat rate, was raised to Rs.150 mn.

- Some of the **public sector banks** are likely to come out of the **Prompt Corrective Action (PCA) framework** in next few months on the back of improvement in various parameters. Eleven out of the total 21 public sector banks are under the central bank's PCA framework, which imposes lending restrictions and prevents them from expanding, among other curbs.

- **The Reserve Bank of India** deferred the implementation of the last tranche of the capital conservation buffer (CCB) by a year, a move that would leave about an estimated Rs 370bn in the hands

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of banks. This would help banks increase lending by over Rs 3.5 tn.

- Concerned over a decline in **GST revenues**, tax officials are likely to examine the high usage of input tax credit (ITCNSE 0.11 %) to set off tax liability by businesses.

- In a bid to align with the best corporate practices, the Finance Ministry has asked the **public sector banks** to gradually bring down the government's equity to 52%, a top official said.

- Markets regulator **Sebi** asked stock exchanges to follow the policy of having uniform trading and delivery lot size for commodity derivatives contracts.

- The **Government** will construct 44 strategic roads along the border with China and over 2100 km of axial and lateral roads in Punjab and Rajasthan, abutting Pakistan, a CPWD document shows. The report stated that these 44 strategically road along the India-China border will be constructed at a cost of nearly Rs 210 bn.

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FUNDS FLOW DATA

Data as on 28th Jan 2019		
FUNDS FLOW DATA (Rs in Cr)		
Category	***MTD***	***YTD***
FII	(3,217)	(3,217)
DII	6,825	6,825
Total	**3,608**	**3,608**

DEBT & FOREX MARKET

Data as on 29th Jan 2019			
Debt / Forex Market			
Category	***Day***	***1 Mnth***	***3 Mnths***
10 Yr Yield	7.3	7.4	7.8
Re/ US $	71.1	69.8	73.4

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MARKET VIEW*

Emerging (markets) Divergence?

2019 started off with a hope for India. Emerging markets took cues from easing tensions on trade war between China and US, falling treasury yields on hopes that Fed would change its hawkish stance on fears of looming slow down, softening crude on surging supplies amid slowing growth and above all from prospects of weakening dollar, to chart out a promising recovery in their equities and currencies. One doesn't need to go beyond looking at MSCI emerging market index to get a grasp on this. This index is up over 7% since the onset of the New Year (As we had highlighted in Dec '18 BizNotes, "EM Carry trade does resume after a while" http://www.trustlineindia.com/Trustline-Biznotes-December-2018.pdf). That is quite a lot for an index that fell nearly 20% in 2018. But that is only one part of the story. The twist to the story comes from what is happening right here in the Indian markets.

India is not as lucky as other emerging markets when it comes to recovery. 2018 was a year of synchronized fall across emerging markets. India wasn't spared with any special treatment during the broad based correction last year. But, in the recovery, it is getting singled out with step-motherly treatment, so to say. Since the dawn of New Year, Nifty is down near 3%, reflecting 10% underperformance over MSCI emerging market index. Part of this reason could be rooted in the outperformance of Nifty in the fall last year (Nifty fell much less compared to other emerging markets). But, still, it doesn't explain completely the reason for this odd divergence between Nifty and broad emerging markets. One would hope that this under-performance will get adjusted when more confidence emerges on stronger earnings growth for FY2020.

As one looks ahead, with support coming from emerging markets on improved FII flows, it is question of time before India participates in the broad based emerging market rally. Meanwhile, during this odd un-explainable divergence period, market in its myopic mindset, once again is throwing brilliant opportunities for long term investors, esp. in small and midcap universe with fears and rumors ruling the roost in the broader space.

Happy Value Investing!

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 "**Investing Ideas That Changed My Life**" by "***Morgan Housel***".

*"The secret to investing is to figure out the value of something – and then pay a lot less." – **Joel Greenblatt***

Investing Ideas That Changed My Life

You spend years trying to learn new stuff but then look back and realize just a few big ideas changed how you think and drive most of what you believe.

A few ideas that had a big impact on how I think about investing:

Markets have to be pushed to crazy extremes once in a while, but it's never as crazy as it looks. It's the result of five innocent things playing out:

- Investors have different time horizons. Day traders, generational buy-and-holders, and everything in between.

- Each group tries to exploit profit opportunities within their own timeframe.

- Short-term investors are often after momentum. They can reasonably chase prices higher even when those prices are detached from a business's intrinsic value.

- Sometimes that momentum, and those profits, are strong enough to capture the attention of investors with longer time horizons whose strategy relies on businesses trading at or near their intrinsic value.

- Things get crazy when the actions of long-term investors playing one game become influenced by the actions of short-term investors who are playing a different game and appear to know something the long-termers don't. The long-termers usually don't realize this, which is why the process is both innocent and bewildering, even in hindsight.

When viewed this way, bubbles stop looking like the actions of crazy people and more like people being unwittingly influenced by false signals. Which hopefully helps you avoid those signals yourself.

Keeping money is harder than making money, because you can get rich by luck, but staying rich is almost always due to a series of good, hard decisions. The skills needed for getting rich and staying rich are often opposites—be bold and brave, then diversify and remain paranoid. Then there's the mental momentum that getting rich creates that staying rich has to step in and try to block. It goes like this: The more successful you are at something, the more convinced you become that you're doing it right. The more convinced you are that you're doing it right, the less open you are to change. The less open you are to change, the more likely you are to trip in a world that changes all the time. I'd be more impressed with a Forbes list of billionaires ranked by longevity vs. amount.

Investing brings out the gullible side of people because the stakes are high and it's hard to measure the odds of specific outcomes. So otherwise-smart people hang on the words of wild forecasts … *just in case*. If something has a chance of either destroying you or making you very wealthy and you don't know how to measure what that chance is, it's understandable that people default to high levels of credulity.

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You can't believe in risk without also believing in luck, because they are fundamentally the same thing—an acknowledgment that you are one person in a 7 billion player game, and the accidental impact of other people's actions can be more consequential than your own. But the path of least resistance is to be keenly aware of risk when it affects you, and oblivious to luck when it helps you. Investors adjust returns for risk; never for luck. Companies disclose known risks in their annual reports; lucky breaks are rarely mentioned. The danger is that experiencing risk reduces confidence when it should merely highlight reality, which can make future decisions more conservative than they ought to be. Luck increases confidence without increasing ability, which makes people double down with less room for error than before. Realizing that luck and risk are ever-present and normal makes you accept that not everything is in your control, which is the only way to identify whatever is in your control.

There's an art and a science to investing. Part of good investing is just arbitraging other peoples' future behaviors, and those people—all people—make decisions with some facts and some dopamine. Figuring out what's likely to happen next, to the extent it can be done, is the intersection of, "X is factually true, but people pay more attention to Y and respond by doing Z." It's a mix of the science of finance (earnings, discount rates, credit spreads) and the art of how people behave with that science (FOMO, extrapolation, embarrassment, career risk). I think it's fine to make decisions for yourself, and assume others will make decisions for themselves, based on things that can't be rationalized by data and facts. That's how the world often works whether you like it or not. If you think the world is all art, you'll miss how much stuff is too complicated to think about intuitively. But if you think the world is all science, you'll miss how much people like to take shortcuts, believe only what they want to believe, and have to deal with stuff that is too complicated for them to summarize in a statistic. Another way to think about this: Investing is not physics, which is guided by cold, immutable laws. It's like biology, guided by the messy mutations and accidents of evolution, constantly adapting and sometimes defying logic.

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There are two types of information in investing: stuff you'll still care about in the future, and stuff that matters less and less over time. Long-term vs. expiring knowledge. There's so much information these days that it's vital to align what you read with how relevant that reading will remain over time. Quarterly earnings are important, but their relevance declines over time and expires with a long enough time horizon. Same with economic news, market news, and many company missteps—asking whether news is important misses the bigger question of, "How long will this remain important given my strategy and time horizon?" I have a rule of thumb: Read more books and fewer articles. It's not that articles are bad. But books tend to be about timeless principles; articles tend to be more newsy. And the only way to know what kind of news is relevant to you is to have a deep understanding of the principles that will have the biggest impact on your strategy over the longest period of time.

- Article by Morgan Housel for collaborativefund.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 Alpha fund (AIF)
- ***Intrinsic*** Deep Value fund (PMS)
- ***Intrinsic*** Floater (Arbitrage Fund)

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