Ist November' 2018

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FOR PRIVATE CIRCULATION

MONTHLY VIEW

FROM THE FUND MANAGER DESK

Fear Of Losing More?

Even seasoned investors succumb to this fear that fails them from capitalizing on the current market meltdown.

These are interesting times. When it comes to investing, incentive for action seems to have got inverted these days. There is hardly any incentive for quick actions. Go getter attitude may take one places in the corporate world, but in investing, in the current market backdrop, aggressive action puts one in poor light. On the other hand, procrastination has become a virtue that pays handsomely. It may look confusing, but that is a reality now with the market punishing anyone who rushes to buy (go getters) and rewarding anyone who sits on it and waits, by proving them right with persistent fall in stock prices. But, getting proved right in the short-term could be worst trap they could be falling into as they would lose an opportunity to get proved right in the long-term.

There is this typical dilemma the investors go through now. Should one invest in the fall or wait for the prices to stabilize? There are no easy answers. To understand this more, let us take a scenario in which we have a stock that has the potential to give you 2X returns in one to two years, but could go down by 10 or 20% in the immediate short-term. But the catch in this scenario is, if one decides to wait to time the bottom (to catch the last 10 to 20% fall), one could miss the entire upside. This catch is real because of presence of following factors:

- Many false starts (bounces) before the final rally.
- Final turn could be sudden and swift that investors could misread that as a false bounce and wait eternally for the low prices.

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- In the final turn, prices could quickly move up by 30 to 40% in just few trading sessions (as happened in the past cycles)

- Prices are best when pessimism is maximum.

From the above, it should be reasonably clear that, for value investing to work, there is no choice but to invest into the fall, however difficult emotionally it could be. But the pain could be made more palatable by pursuing stock-specific bottom-up investing, that too only in high conviction ideas where one would not hesitate to invest more if the prices were to fall sharply from the already low prices. If the down-turn turns deep and one runs out of cash, one could shift from relatively defensive to deep value and thereby continue investing all through the fall. This is time for turning aggressive on deployment, not defensive, though the high decibel media narrative manically mocks aggression. The reason why media does this is not anything obscure. It is fairly straight that they need to appear right in the short-term and hence toeing the line that is trendy than risking their reputation by swimming against the stream.

More importantly, investors need to be also aware of another trap, that is, to get lost in the innumerable problems that always surface in the down-cycles. To think about it, it is an interesting question to ask, why in an upcycle, one never gets to hear any problem? Is it a mere coincidence that India's inherent structural issues like weak current account and high inflationary pressures (hence high interest rates) pop up only in a bear-cycle? Change in stock prices can do strange things. Price action in stocks can magically change market's view on problems. In frenzied times, market is more magnanimous to see the brighter side of the problems while in depressed times, it takes a myopic view to magnify any troubles. It is price action (cycles) that drives the narrative, not the other way. This understanding is key to take appropriate action during cycles without getting lost in the accompanying magnified narrative. Moreover, current down-cycle has nothing to do with India

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specific, but has all to do with reversal of EM carry trade (money moving out of emerging markets). At some point (not too far), as in the earlier cycles, this trade will resume and lift all EM boats including India. During that time, now forgotten India's long-term structural story will come back to dominate the narrative once again. If one waits for those robins, spring (attractive prices) will of course be over!!

Investing is at its best when narrative goes negative.

> **"Time to invest is when drums are beating, not when trumpets are blaring"**

Follow the cycles (mis-pricing), not the narrative for the superior results in investing.

Happy Value Investing!!

ArunaGiri. N

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CORPORATE NEWS

- **Dr Reddy's** has sold its antibiotic manufacturing facility and related assets in Bristol, Tennessee, to Abu Dhabi-based Neopharma. It didn't disclose the financial details of the sale. DRL also announced that its subsidiary Promius Pharma, LLC, has sold its rights of Cloderm (clocortolone pivalate) Cream, 0.1% and its authorised generic to EPI Health, LLC, an affiliate of EPI Group, LLC.

- **Tata Motors,** wholly owned subsidiary JLR's September sales were down 12.3% at 57,114 units, year-on-year basis. The company said that the monthly sales were impacted by the ongoing uncertainty in Chinese market as sales in China declined by 46.2% resulting from import duty changes and continued trade tensions which held back the consumer demand.

- The **HSIL** is aiming to achieve revenue of over Rs 5 Bn from its consumer products business in the next financial year as it mulls expansion of this vertical going forward. The consumer products division had posted revenue of Rs 2.1 Bn in 2017-18 and is expecting to clock revenue of around Rs 3.7 Bn for the current fiscal.

- The **U.S. FDA** completed inspection of **Dishman Carbogen Amcis's** Bavla facility without any major or critical observations.

- **Reliance Industries** may soon buy controlling stakes in two of India's largest cable TV and broadband service providers, **Hathway Cable & Datacom and DEN Networks,** as it seeks to ramp up coverage of its ambitious high-speed broadband network.

- **The Reserve Bank of India (RBI)** rejected **Yes Bank's** plea to extend CEO Rana Kapoor's term to at least April 2019 and asked it to ensure that a replacement was in place from February 1 next year, in keeping with what appears to be a firm line on restricting the stints of chief executives.

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- Chanda Kochhar has quit as CEO of **ICICI Bank** with immediate effect. The private lender has appointed Sandeep Bakhshi as managing director & chief executive officer for five years.

- **LIC** makes open offer for 26% stake in **IDBI.** IDBI approved the proposal for issuance of preferential shares in favour of LIC to increase its share to 51%.

MACRO NEWS

- **Power tariff** soars to a decade high of Rs 17.61/unit in spot market due to low hydro and wind energy production and coal shortage at thermal plants.

- The **International Monetary Fund** (IMF) retained economic growth projection for India at 7.3% for FY19, lower than the Government's and the **Reserve Bank of India's** (RBI's) forecasts. This is, however, noteworthy as the IMF cut global growth projections by 0.2% points.

- **Govt reduces excise duty** on petrol, diesel by Rs.2.5/litre. Excise duty will be reduced by Rs.1.50 and oil marketing companies will absorb another Rs.1. After petrol and diesel, the government cut excise duty on jet fuel to 11% to give relief to the aviation industry that has been in recent weeks hit hard by rising fuel prices and plummeting rupee.

- The **crude oil import bill** for India is expected to increase by $37 bn to $125 bn during FY19, 42 per cent spike over the 2017-18 bill of $88 bn. The latest estimates were released by the **Petroleum Planning and Analysis Cell** (PPAC). The previous estimate for the year was $105 bn. Rising crude oil prices and a weak rupee are the main reasons for this rise.

- The **Reserve Bank of India (RBI)** allowed state-owned **oil marketing companies (OMCs)** to raise external commercial borrowings (ECBs) from lenders under the automatic route.

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- **Sebi** is planning to relax rules for listing of startups in India, which include giving promoters the flexibility to categorise themselves as ordinary shareholders and exempting them from the mandatory three-year lock-in period. The capital markets regulator may also free them from fiduciary responsibilities of a promoter.

- A day after farmer protests for better crop prices rocked the national capital, the **Centre** raised **minimum support Prices** (MSP) for winter crops to ensure farmers get 50% more than what they spend on cultivation.

FUNDS FLOW DATA

Data as on 26th Oct 2018		
FUNDS FLOW DATA (Rs in Cr)		
Category	***MTD***	***YTD***
FII	(22,487)	(37,549)
DII	16,089	1,04,344
Total	**(6,398)**	**66,795**

DEBT & FOREX MARKET

Data as on 29th Oct 2018			
Debt / Forex Market			
Category	***Day***	***1 Mnth***	***3 Mnths***
10 Yr Yield	7.8	8.0	7.8
Re/ US $	73.4	72.9	68.7

MARKET VIEW*

Global Rout…

There doesn't seem to be any relief for investors from the persistent fall in stock prices. For a while, it was currency and Gsec yield that were the pain points for the markets. With Gsec softening (by over 35 bps from its high) and currency stabilizing, market shifted its attention to crude. When oil boiled to 85$ mark, it gave the bears a good bargain to beat the market mercilessly. Now with crude retracing, rout in US markets couldn't have come at a better time for the bears to continue their bashing. Hope they will find another outlet to vent when US markets stabilize too. How far bears will go and when will they get squeezed on their shorts, only time will tell. But, given the heightening shorts they are sitting on (one estimate puts the net short position in Nifty index at over 1 lakh cr contracts), bears will not be able to breathe easy when their excuses run out and when their excesses come back to haunt them.

From the FIIs point of view, the bloodbath in Emerging Markets (EM) is lot more brutal. It has been more punishing for them because of the dual blow of falling currency and sliding stock prices. Having said that, for new funds that are waiting on sidelines, this dual blow has made the EM assets so attractive and compelling from medium and long-term point of view. It is question of time before they start making their strategic step to rush in to capture both the currency and stock upside. It will be a gush, not a gesture when money starts coming back. We may not be far from that point, if one goes by the glimpses of global views coming from large funds like Vanguard. In fact, last week, Vanguard, more specifically singled out India and Indonesia as the most attractive amongst EMs to invest from long-term. To quote,

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"A potential extension of the dollar's gains against EM currencies in the next few months presents long-term investment opportunities in India, Indonesia and Mexico. Emerging Asia is the most attractive region with the biggest returns seen in India and Indonesia, according to Vanguard group Inc"

Vanguard manages over $5 trillion+ assets, out of which over $1 trillion is actively managed. With this level of ammunition in its armory, even a small fraction of its firearms can do fierce fireworks for our markets. But to moderate the expectation, this is not something that will happen overnight, but gives an idea of long-term potential for Indian markets.

In 2019, when one looks back, any investment made any time in 2018 (barring of course calendar Q1), in hindsight, will look like a genius one. To repeat our often repeated view, it is time to invest (bottom-up stock specific), not to time the bottom.

Happy Value Investing!

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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 interview titled ***"We are not riding a bubble as severe as the 2008 one" by Howard Marks, legendary investor and co-founder of Oaktree Capital Management***

"The fact that other people agree or disagree with you makes you neither right nor wrong. You will be right if your facts and reasoning are correct"

- Benjamin Graham

We are not riding a bubble as severe as the 2008 one: Howard Marks

While factors like oil, rising rates can spook the markets, there are a lot of "I don't know" variables that can also hit market sentiment. How does one prepare for those unknowns?

Howard Marks: I made my own list in one of my memos back around 03-04. I thought about things that could hurt the market at that time. I talked about $100 oil. I talked about falling dollar. I talked about a few things and the last thing on my list was 'something else'. We should never deceive ourselves into thinking that we have anticipated all the issues and that we know what is going on. The market thinks about certain ones. It anticipates those. It may reflect those in prices. The market really is always at the risk of something that nobody has anticipated.

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Most people think currently we have anticipated all the things; and that rising interest rates are likely to be the greatest problem. From 1982 to roughly 2015, for 33 years, we enjoyed a climate of declining interest rates. I have a slip on my wall for a loan I had outstanding in 1982 and it said the rate on your loan is now 22.75 per cent. And 30 years later, I borrowed some money at two and three quarters! So, clearly, interest rates have come down almost in a straight line and by an enormous amount, and that has highly stimulated the economy. It has made capital cheap. It has made businesses profitable. It has encouraged all kinds of investment.

Now, we are going into a period when interest rates have risen from the lows. I cannot borrow at two and three quarters anymore, and even the Fed has said it expects five more interest rate increases from here on. Long-term rates, which were stubbornly low, have begun to take off, and that is really the immediate cause for the stock markets' decline in last 11 days. If interest rates increase, that will reduce corporate profitability, where companies have borrowed at floating rates. That is number one. Number two, even if they have fixed rate debt, when they go to the credit market at some future time to refinance that debt, their cost may be substantially higher than that the last time.

Rising interest rate costs reduce profitability and make companies do less well; they put the brakes on the economy. This is a concern. It is possible that this will interfere with the progress of the markets. To me, the interesting thing is, people should have anticipated this for the last few years. When the 10-year rate rose two weeks ago, it should not have come as a surprise. We have gone through a long period, when investors thought more about the positives than the negatives. And now, we finally have a negative pop-up. That is the nature of the market.

ET Now: If the headline memo of your topic is "World According to Me in 2023," which is five years from now, how would that memo start and end?

Howard Marks: The memo would start and end with a statement that I do not believe in predictions. You read the book and my position on forecast is very strong.

What I say is "we never know where we were going, but we sure ought to know where we are." That is why the essence of the book is to predicate your investment decision on an understanding of where we stand in the cycle today. It is possible to know where we stand in the cycle today. It is not possible to know what is going to happen tomorrow.

Having said that, where we stand in the cycle determines the probability distribution of returns that investors would face in the cycle. They should know what that probability distribution would look like, when it is in their favour and when it is against them. That really is the greatest theme of the book. I just wanted to add a quote from one of my heroes, John Kenneth Galbraith. He said we have two kinds of forecasters – 'the ones who do not know and the ones who do not know they do not know'. I am firmly in the first category: 'I do not know what is going to happen in the future'.

ET Now: But even so, in your latest memo, Seven Worst Words in the World are 'Too Much Money Chasing Too Few Deals', and you have also shared the significance of the number 10: ten years since the Lehman bankruptcy, 10 years since low interest rates. What happens in the 11th year? Would you be more cautious? How do you see things unfold in 2019?

Howard Marks: When things go well for a long time, people get more excited. Generally speaking, when things have gone well for a long time, I get more cautious.

As you have said, we are in the 10th year of an economic recovery; there has never been a recovery in the US that went on for more than 10 years. We are in the 10th year of a bull market in stocks. By some measure, we are in the longest bull market in history. So, the point of my book is that when the odds shift and when you are in the 10th year, which is historically a long time, you cannot say we are likely to go another 10 years! The odds of it extending decline. The subtitle of the book really holds the key: getting the odds on your side. I do not know what is going to happen in the 11th year, but I do know based on history, based on norms, we are less likely to have a strong economy than usual; it will be less likely in the 12th year, less likely in the 13th year.

One of the important themes I always try to repeat and remind people about is that people get excited when things go well and cautious when they do poorly. They should do the opposite. In my imagination, people say 'oh we are in the fifth year of recovery, it could go two more'. But when it gets to the 10th year of recovery, they are really excited about how well it has gone, and they say 'maybe it will go five more' and that is counterintuitive. With each passing year, probabilistically speaking, we are closer to the end of the recovery and that is what I believe.

ET Now: But there are some litmus tests that the market is reacting to. In the book, you have spoken about the credit cycle, the real estate cycle, the distressed debt cycle -- all sensitive to rising rates. Do you think 3.5-4% will perhaps go out of control and normalisation to 4-5% is not wise at this juncture?

Howard Marks: I know 3-4 per cent is harder for companies to deal with than the old 2 per cent, and the rates will probably go higher over time. Higher rates are consistent with prosperity. We have had prosperity; we will have more prosperity. Bear in mind two things; number one, this recovery has been the slowest since World War II, which means its life could be extended.

Number two, our government passed a very strong tax cut in December, which has the effect of stimulating the economy greatly. These factors tell me that rates will continue to rise and that would be challenging. But this should not come as a surprise. People should have been prepared for this. The fact that they flipped from positive to negative so fast and so radically in last 11 days just shows you something about the market and about human nature.

I wrote a memo called 'On The Couch' in early 2016. That year, the market got off to a terrible start. I wrote this memo pointing out that sometimes the market needs a trip to the shrink because in real life, things fluctuate between pretty good and not so hot. But in the minds of investors, they fluctuate from perfect to terrible. And everything is exaggerated in the marketplace, the good while things are going well, and then the bad when it shifts. I want your listeners and my followers to try to remain calm about these things and not be guilty of overdoing it.

ET Now: There is an old saying on Wall Street that bull markets do not die of age, but when they end, they end badly. Whenever this cycle ends, what do you think the shape of the world would look like?

Howard Marks: Well, there you go again. As Ronald Reagan said, 'trying to get me to make a forecast'. But I commend your perseverance. I do not describe what we are having now as a bubble. People have got used to the concept the bubble and crash. It so happens that if you lived through last 20 years, the last two cyclical episodes were of bubbles and crashes. We had the internet tech bubble, which crashed. We had the subprime mortgage bubble, which crashed. That does not mean every upswing becomes a bubble.

I do not think this upswing has been as dramatic as those two; and I do not think the correction has to be as dramatic as those two. That does not mean it is going to be fun because in those two, roughly speaking, stocks went down 50-odd per cent. Maybe in this one, they will only go down 30 per cent. So, it does not mean it is going to be fun. But I do not think we are as levered as a society today. I do not think our essential financial institutions are as levered. I do not think we have anything in the mix, which is as fraudulent as subprime mortgages. As a consequence, I do not think we are riding a bubble of the severity of the last one.

ET Now: It seems the world is perhaps sitting on higher debt levels than in 2008. The US is sitting on $20 trillion of federal debt right now, double from 2008 levels. India's bad loans amount to $130 billion. China's corporate debt is 160% plus to GDP at the current juncture. How high is the correlation of global credit today? If things were to go southwards, how bad could it get?

Howard Marks: It is easy to say that the more leveraged we are, the more precarious it is. It is easy to say higher debt is worse than lower debt. It is impossible to say what level of debt has what implications. When I was a boy, there was an active debate as to whether it was proper for governments to have national debt and Keynes became famous for saying that the government should run deficits and run up debt in bad times to stimulate their way out of recessions and then run surpluses and pay off the debt in good times and end up with no debt.

That concept has gone out of the window. Now, the US has a $21 trillion national debt, but it seems to be doing okay. People are still buying our debt when we want to issue it, and we will be okay as long as they will. Of course, I am for more fiscal responsibility than is being shown currently. I am opposed to running large deficits in good times to stimulate an economy that does not need stimulation and adding so radically to the debt as is being done currently.

Yet, I cannot tell you where the debt reaches critical mass and what the impact is. That will be a matter of destructive testing. We will find out the answers when these things bind, and unfortunately, when it will get unpleasant.

Interview of Howard Marks, for ET NOW.

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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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