

M

O

N

T

H

L

Y

V

I

E

W

FROM THE FUND MANAGER DESK

Liquidity glut: Best is Behind!

Opportunities ahead for potential mis-pricing in bond and debt market.

First anniversary has come and gone, yet animated arguments still continue on its original motive. You guessed it right, we are talking about DeMon. While opinions are still deeply divided on its broader impact, one area where even its detractors do not seem to disagree is on its benign impact on bank deposits. The sensational midnight move scripted the story of savings-glut that unfolded subsequently. Banks were flooded with deluge of deposits at a time when credit demand was weak, leading to huge surplus in liquidity in the system. Deposit rates fell as a result and led to one of the biggest blockbuster year for domestic flows into equities. That is not all. With support coming in from moderating inflation and stable currency (on robust FII flows), RBI rate action was on the dovish side leading to virtuous cycle of ever increasing liquidity in the system.

Surge in MF assets

If there is one business where the currency move left a biggest footprint, it must have been mutual fund industry. As direct fallout of the midnight move, assets managed by mutual funds across the spectrum soared to historic highs. The industry is staring at a eye-popping surge of 40% in its assets this calendar year. It is no coincidence that the monthly SIP book has nearly tripled to Rs 6000+ Cr from its earlier 2000 Cr level. This has brought tremendous stability to the Indian markets which otherwise used to dance to FII's unpredictable tunes.

Odds stacked against now?

2018 may not be as lucky. Footprint of DeMon is fading. Much of it has been used up in capital markets. One can see the first

BizNotes

FOR PRIVATE CIRCULATION

M
O
N
T
H
L
Y

signs of tightening liquidity in the whole sale deposit rates. Rates in this segment have hardened by over 40 to 50 bps in the last couple of months. Unlike the year gone by, there will be a competitive chase for attracting deposits by banks in the coming year. More so, with a likely pickup in credit growth. With much less fiscal elbow room on the fallout of faltering GST revenues, liquidity position is likely to get worse in the short-term, as Govt. won't be able to come to the rescue by boosting expenditure. Add to this the hardening hawkish undertone of RBI on firming inflation and rising risk of fiscal laxity on growing rural distress, it is difficult to build a case for neither softer rates nor for benign liquidity in the coming year. If this week's spike in ten year Gsec yield is any indication to go by, bond markets seem to be factoring in a worsening fiscal as well as liquidity scenario for the coming months. Ten year yield surged to 17 months high of 7.3% this week. Even if the RBI keeps the status quo on the repo thro' the year, rates on the ground will start inching up on tighter liquidity and on higher borrowing costs (higher deposit rates).

Year of Volatility?

V
I
E
W

If one goes back to early period of the current political administration and looks at some of the predictions for 2018, it was foreseen that this Govt. will gain more control in the upper house by 2018 and hence will steer some significant structural reforms in this year. But in an ironical twist, the current administration is losing some of its political capital in the rural segment precisely when it is gaining more control in the upper house, as reflected in the recently concluded state polls. Unlike the state in which polls got concluded recently, the states where series of polls have been lined up in 2018 have much larger share of rural population. Given this and the incumbency risks, it is not difficult to fathom a volatile period on account of noisy political narrative in the coming year. The economic backdrop is unlikely to be benign either. Rising interest rates, tightening liquidity, continued delay in earnings recovery, volatile crude amid normalization of rates in US etc are likely to keep 2018 much more volatile than the smooth ride we have seen in the current year.

BizNotes

FOR PRIVATE CIRCULATION

M
O
N
T
H
L
Y

V
I
E
W

Come back time for Debt

For debt investors, opportune time may be on cards. Short-term rates are likely to firm up and that should entice the savers back to debt markets. Investors who wants to add a kicker to the coupon thro' duration play (like the Gsec/gilt funds), good times may come soon as we expect ten year yield to spike in the early part of 2018 on tightening liquidity amid rising risks of fiscal laxity in the upcoming budget on pressures from the rural constituency to splurge on populist measures. Opportune time is not limited only to debt investors. The rub-off will be there on equities as well. Given the heightened valuations at which equities are trading, rocky narrative both on political and fiscal side will make the coming year more volatile times compared to the one-way run in the year gone by.

Happy New Year!

ArunaGiri. N

CORPORATE NEWS

- **Dr Reddy's Laboratories Ltd** has launched Melphalan Hydrochloride for Injection, a therapeutic equivalent generic version of Alkeran (melphalan hydrochloride) for Injection used in the treatment of certain types of cancer and approved in the US market by the **US Food and Drug Administration (USFDA)**.
- **Reliance Communications Ltd (RCom)** has finalized a Rs 390 bn debt resolution plan which involves the company selling assets and does not entail lenders and bond holders to write off their dues or convert it into equity. The company has also exited the **strategic debt restructuring (SDR)** process.
- **Wipro**, India's third largest software services firm said it will contest the lawsuit filed by **National Grid US** seeking damages of over USD 140 million for a project that began in 2009.
- Global private equity firm **Warburg Pincus** will acquire up to a 20 per cent stake in **Airtel's DTH arm Bharti Telemedia** for \$350 million. This will be the second innings for Warburg to invest in a Bharti Group entity.
- **Indian Oil Corp (IOC)** is evaluating setting up a Rs 200 bn coke gasification project at its Paradip refinery in Odisha to convert the lowest-cost fossil fuel into gas that can be used to generate power or make petrochemicals.
- **PVR Ltd** has inked a fresh strategic deal with South Korean cinema technology company CJ 4DPLEX, to increase the number of 4DX screens in its portfolio. With this extended partnership, PVR will add 16 additional 4DX screens at its cinemas, taking the total to 21 4DX auditoriums in India by the end of 2019.
- **Claris Lifesciences** said it has received a letter from the promoter Athanas Enterprise Pvt Ltd to consider delisting of shares of the pharma company from the stock exchange. The promoter/promoter group of the company has made a voluntarily

delisting offer representing 49.87 per cent of the paid-up share capital of the company held by public shareholders.

- **Shilpa Medicare** informed stock exchanges that it received 10 Form 483 observations from **US FDA** for its SEZ formulation facility at Jadcherla, near Hyderabad.

MACRO NEWS

- Centre looks set to breach the fiscal deficit target this year, with lower-than-expected revenue prompting it to go for **additional borrowing of Rs 500 bn** from the market. The borrowing is over and above the budget estimate of Rs 5.80 trillion for 2017-18, which would lead to the government missing its fiscal deficit target of 3.2% of GDP.
- **Wind power producers**, which have witnessed tariffs falling to record lows in recent months, have some reason to cheer, with the Andhra Pradesh electricity regulator disallowing any revision of contracted tariff rates.
- The government has announced Rs 26 Bn package for the **leather industry** in a move aimed at increasing employment and investment in the sector.
- **India's economy** is likely to expand by 7.2% in 2018 and go up further to 7.4% in the following year on the back of strong private consumption, public investment and the ongoing structural reforms, a **United Nations (UN)** report said.
- **The Maharashtra government** has approved the farm loan waiver of 4.1 mn farmers to the tune of Rs 195 bn till now, CM Devendra Fadnavis said.
- Sugar millers in Maharashtra are concerned with the drastic fall in the prices of the sweetener. According to the **Maharashtra State Cooperative Sugar Factories Federation (MSCSFF)**, prices have fallen by Rs 350-Rs 400 per quintal in the last 20 days from Rs 3,550 to Rs 3,175 per quintal. Millers say that they are unable to meet the cost of production and therefore it would

BizNotes

FOR PRIVATE CIRCULATION

M
O
N
T
H
L
Y

V
I
E
W

be difficult for them to pay fair and remunerative price (FRP) to sugarcane growers.

- Revenue collection from **Goods and Services Tax (GST)** for the month of November slipped further to Rs 808 bn, lowest since the implementation of the indirect tax system from July 1. The dip in revenue collection was mainly due to a decline in overall incidence of taxes on most commodities.

FUNDS FLOW DATA

<i>Data as on 26th Dec 2017</i>		
FUNDS FLOW DATA (Rs in Cr)		
Category	MTD	YTD
FII	(7833)	49799
DII	6955	116352
Total	(878)	166151

DEBT & FOREX MARKET

<i>Data as on 27th Dec 2017</i>			
Debt / Forex Market			
Category	Day	1 Mnth	3 Mnths
10 Yr Yield	7.2	7.1	6.7
Re/ US \$	64.2	64.5	65.7

BizNotes

FOR PRIVATE CIRCULATION

MARKET VIEW*

When negatives get ignored...

In a sign of growing, but dangerous complacency among investors, markets scaled all time high on a day when the ten year Gsec yield spiked to 17 months high of 7.3%. That is not all. Market in its manic rush to breach the next barrier (on the upside of course), it seems to be ignoring all round negative news-flow. Take a look at this. Crude is at a multi-year high. Interest rates are hardening on tightening liquidity and on rising inflation risks. GST collections are on steady decline month after month. Equity FIIs are on sell mode in December. Primary market supplies (IPOs, QIPs and Offer for Sale) are on all time high. On pipeline of supply of papers from Govt. (divestment), there is no sign of slowdown. IIP numbers continue to be patchy and do not inspire confidence on the ever elusive earnings recovery.

It does not stop there. Fiscal worries have come back to haunt the bond markets. If Govt.'s latest demand for additional borrowings of 50,000 Cr is any indication, fiscal slippage could be over 30 bps in the current year (fiscal deficit target of 3.2% will be breached and the actual number will be around 3.5%+). Bond markets seem to have expected this shock and factored part of this surprise with the ten year yield spiking to level not seen in the last many months.

Yet, stock market has not given up on making new highs. Where is the disconnect?

It is not that all these negatives have sprung overnight. They have been in the making for a while. But so far, strong and surging domestic liquidity offered the counter narrative. Domestic flows were so strong that weak fundamentals did not matter much to the markets that were in a hurry to make the next highs. It may not be so any longer with early signs of trouble for liquidity as reflected by hardening rates in the short-end of the yield spectrum and rising wholesale deposit rates.

Then why markets are ignoring all warnings? Probably, this is what happens when market goes thro' a one way run without any major blip for 12 consecutive months. To borrow from Buffett, nothing sedates rationality like the large doses of effort-less money. Market participants seem to be under serious intoxication by easy money. This is not to say that one should sell and scoot from the markets. That is not what we intend to say here. Though the long-term positive outlook is still intact, in the short-term, given the elevated valuations and emerging short-term risks, pruning positions selectively (stock specific) to build cash levels is critical to navigate the volatile times that may be in store.

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.

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 “**The Most Overlooked Trait of Investing Success**” from collaborativefund.com.

“Selling your winners and holding your losers is like cutting the flowers and watering the weeds.”

- Peter Lynch

The Most Overlooked Trait of Investing Success

I once asked a doctor: What’s the hardest part of your job?

It wasn’t the stress or responsibility. It was so basic. “Getting my patients to do what I ask of them,” she said.

I didn’t understand at first, but it made sense when she explained.

“You have an appointment with a patient and you say, ‘I need you to get this lab done, see this specialist, pick up this medicine.’ And they come back a month later and they haven’t done any of it.” They either couldn’t afford it, or it was too intimidating, or they didn’t have time.

She explained that becoming a better doctor meant spending more time managing her patients rather than managing those patients’ illnesses. There is a huge difference, she said, between an expert in medicine and an expert in healthcare.

BizNotes

FOR PRIVATE CIRCULATION

An expert in medicine knows all the right answers out of the textbook. They can diagnose with precision and are up to date on all the latest treatments.

An expert in healthcare understands that medicine from the patient's view is intimidating, confusing, expensive, and time-consuming. Nothing you diagnose or prescribe matters until you've addressed that reality with patients, because even a perfect solution makes no difference to the patient who doesn't follow it.

I love parallels between investing and other industries, and this one may be the clearest.

There is a huge difference between being a great investor and running a great investment firm. The difference is the latter realizes that no amount of good advice or strong performance matters to the client who doesn't follow it, or stick around long enough to benefit from it.

Josh Brown of Ritholtz Wealth Management put it this way:

Good advice is worth multiples of what a client pays for it. Mediocre advice is not worth a little less, it's worth nothing because it won't be adhered to.

Those who run great investment firms bridge this gap with a simple trick: Clear and honest communication that ensures clients know what you're doing, what to expect, and addresses the psychological barriers that pushes them away from adhering to good advice.

Financial professionals as a whole don't have a great reputation. Advisors have a reputation of being salespeople, and money managers have a reputation for being not very good at what they do, fixated on the short term and beholden to whacky strategies they profess will outperform.

But there's a chicken-and-egg problem here. I'd argue the main reason so many financial professionals stray towards short-termism is because it's the only way to run a viable business in

BizNotes

FOR PRIVATE CIRCULATION

an industry where customers flee at the first sign of trouble. But the reason customers flee at the first sign of trouble is often because the advisor has done such a poor job communicating how investing actually works, what their strategy is, what they should expect as an investor, and how they deal with inevitable bouts of volatility and cyclical. The advisor will blame the client, who he sees as shift and performance-chasing. But many clients are never educated by their advisors to behave differently.

Put yourself in the client's shoes. They're trying to pick a good advisor or investment manager from a sea of thousands of options. They don't have that much information to judge you on. Sure, there's past performance. But that can be driven by luck and broader market returns. When a client has something as important as their life savings on the line and limited information to judge you on, can you blame them for bailing at the first sign of trouble? Unless you've held their hand, told them your story, been utterly honest with them and explained what they should expect, it's hard for them to distinguish between run-of-the-mill volatility and a manager who lacks skill. So they leave, unwilling to take a flyer on something that's so important to them. Bailing out after a decline is self-destructive behavior. But if you're a client who's just thrown a prospectus and told, "Good luck, hang on tight!" I can't blame you for doing it.

The most overlooked trait of investing success is communicating to your clients the softer and emotional side of investing. A knowledge of market history. An acceptance of volatility as a normal part of investing. That you can be wrong on half your investments and still do well over time.

On a recent podcast with Patrick O'Shaughnessy, Jason Zweig of the *Wall Street Journal* said:

We talk about investment management firms, but we don't really talk about investor management firms. For anyone who's in the portfolio management business, managing your investors is at least as important as managing your investments. There is

BizNotes

FOR PRIVATE CIRCULATION

a reason why value stocks tend to outperform over the long run ... the whole reason they work in the long run is because they fail in the short run. And for any investor to be able to capture a premium return from any factor, you have to be there long enough to participate. There are a lot of active managers who have a great approach and philosophy and implementation, but I think the ones who are most admirable are the ones who think a lot about managing their investors as well as the investments.

Ben Carlson, an investor who's also a brilliant communicator, wrote recently:

Investment people who deal with finance stuff on a daily basis take for granted the fact that the majority of the public doesn't pay much attention to the markets, asset allocation strategies, investment products, the Fed, interest rates, valuations and such. Plenty of people go about their lives never giving these things a second thought. The ability to not only understand this stuff, but also effectively communicate it to clients or prospective clients is a skill that far too many financial firms and practitioners overlook.

Just as in medicine, making good decisions is not the same thing as convincing your clients to make good decisions. Hedge fund manager Kyle Bass summed this up well, saying: "It's easy to maintain conviction. It's harder to maintain investors."

Look around at some of the best investors of all time and you'll see a common denominator: They are excellent communicators.

Warren Buffett – amazing writer.

Charlie Munger – amazing writer.

Ben Graham – amazing writer.

Seth Klarman – amazing writer.

John Bogle – amazing writer.

Joel Greenblatt – amazing writer.

Ist January' 2018

TrustLine

BizNotes

FOR PRIVATE CIRCULATION

Howard Marks – amazing writer.

Jim O'Shaughnessy – amazing writer.

I don't think this is a coincidence. These investors' ability to write let them effectively tell their story, set expectations, and reassure investors. That made their investors more likely to stick around when times got rocky. And investors who stick around when times are rocky is exactly what you need to succeed over time as an investment firm. It's what allows you to actually take long-term risks and exploit opportunities other firms can't because they're dealing with fleeing clients.

There is a reason no Berkshire Hathaway investor chides Buffett when the company has a bad quarter. It's because Buffett has so thoroughly convinced his investors that it's pointless to try to navigate around 90-day intervals. He's done that by writing incredibly lucid letters to investors for the last 50 years, communicating in easy-to-understand language at annual meetings, and speaking on TV in ways that someone with no investing experience can grasp.

Yes, Buffett runs an amazing investment company. But he also runs an amazing investor company. One of the most underappreciated part of his success is realizing that the former couldn't happen without the latter.

Article by Mr. Morgan Housel from collaborativefund.com

Ist January' 2018

TrustLine

BizNotes

FOR PRIVATE CIRCULATION

DISCLAIMER:

This document is provided for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Nothing in this document should be construed as investment or financial advice, and nothing in this document should be construed as an advice to buy or sell or solicitation to buy or sell the securities of companies referred to in this document. The intent of this document is not in recommendatory nature. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. This document is being supplied to you solely for your information and may not be reproduced, redistributed or passed on, directly or indirectly, to any other person or published, copied, in whole or in part, for any purpose.

Copyright of this document vests exclusively with TrustLine Holdings Private Limited.

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.300+ crores of AUM for over 350+ highly satisfied clients. This makes us among the top 20 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)

TrustLine Holdings (P) Ltd

39/19, IInd Floor, Aspen Court, 6th Main Road, Raja Annamalai Puram, Chennai – 600 028;
Tel: 044 – 42083877, e-mail: pms@trustlineindia.com.

The logo for TrustLine, with "Trust" in white text on a blue background and "Line" in white text on a red background.