Ist January' 2019

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BizNotes

FOR PRIVATE CIRCULATION

M O N T H L Y V I E W

FROM THE FUND MANAGER DESK

Road ahead: Not so bumpy for growth!

Speed breakers like high inflation and high interest rates have always spelt trouble whenever India's growth hits closer to double digit. Is that set to change?

As the famous quote goes, India disappoints both optimists and pessimists alike. It spares no one. One can never be too optimistic nor too pessimistic as India has stunningly surprised both when it comes to its economy. Its ability to bounce back when least expected gets marred by its magical prowess to let its faithful lieutenants down when expectations run high. Of course, there are reasons for this less reassuring spectacle. They come from the stifling structural constraints in the economy that come from supply side factors like inflation and credit risks (capital starved) etc.

This is the pattern we have seen in every growth cycle in the past without single exception. Every time when growth accelerates to near double digit, it hits the inflation and credit bumps that drag the growth in subsequent years. The drag (downturn) lasts for much longer time than the dazzle (upcycle) because of daunting bad debts, the growth cycle leaves as legacy.

Will the coming decade be any different? There are reasons to believe that this predictable pattern is in for a makeover, paving the way for more sustainable growth from the next cycle onwards. This optimism may be at odds with the current negative sentiment that has notoriously swept thro' the nation. Not getting swayed by the sullen mood across, staying objective, one can see the structural shift that will potentially get unlocked by some of the key reforms like Bankruptcy Code (IBC) and MPC (Monetary Policy Committee). IBC is one of the most under-rated reforms of this administration. In our view, IBC and MPC will go a long-way in addressing speed bump challenges to transform the current bumpy economic

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roadways into high-speed highways for sustainable high-growth era. More importantly, this is likely to happen, irrespective of shape and color of the next political formation at the center.

To look at them more in details, let us take the MPC first. For the first time, at CPI (Consumer Price Index) level there is inflation targeting, that too statutorily. MPC, by statute, is mandated to contain inflation at CPI level within +/-2% of 4% target. This key reform has the potential to transform the trajectory of inflation and interest rates in India. The positive rub-off on rupee can hardly be under-estimated as rupee's annual attrition can abate meaningfully in the coming years with the material reduction in the relative inflationary gap with US. As some estimates suggest, the annual depreciation in rupee can potentially fall from current 6%+ level (appx) to sub-3% level (in reality it happens in a dis-orderly fashion, not in a smooth manner year after year) because of this structural change in the trajectory of inflation.

Moving on to the next, IBC undoubtedly will be one of the lasting legacy of this administration. It's far reaching impact on the structural shape of the growth in the coming cycles has been least understood. One of the reasons why growth goes into huge grind (long drag) after every attempt to breach double-digit is because of humongous bad debt cycle that follows such high-growth cycle. With credit culture set for a massive clean-up on IBC's extra-ordinary effectiveness in making promoters lot more wary to default (else they lose their business in the new IBC regime) and thus setting the stage for more secular and cleaner growth in the next cycle. In this context, it is important to highlight the latest stance of Ruia's (Essar Steel) willingness to pay back the dues. This is a landmark event in the history of corporate defaults in India and one can expect more such positive surprises to come in future. This turnaround in borrowing and repayment culture is critical to break out into new growth orbit in the upcoming economic expansion.

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Add to this, the long-term impact of improvised GST and increasing tax-to-GDP ratio on growing compliance, one can build a case for structural shift in India's growth profile. It will not be a misplaced optimism to foresee a golden period ahead for India. Though, India had disappointed such optimists in the past, with these reforms, may be, time has come for India to disappoint the skeptics in a more convincing manner. Needless to say, India will offer exciting investment opportunities for stock-pickers in coming months and years. Watch out for interesting times!

Happy New Year!!

ArunaGiri. N

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CORPORATE NEWS

- Jaguar Land Rover owner **Tata Motors** has reportedly assured UK Prime Minister Theresa May of the company's commitment to Britain's automotive industry despite the ongoing turmoil of Brexit.**Tata Motors**-Jaguar Land Rover hired Boston Consulting Group for $3.2 billion turnaround plan.

- **Dr. Reddy's Laboratories** will have to wait a little longer before it can start selling a generic version of Indivior Plc's Suboxone Film opioid addiction treatment, a U.S. appeals court ruled.

- **Wipro's** digital business arm announced expanded global partnership with the U.S. based 'Alfresco' to offer open source digital solutions.

- **Sun Pharma** said its arm DUSA Pharmaceuticals has received relief from a US court in a patent infringement case.

- **Infosys** to divest stake in CloudEndure for $15.3 mn or Rs 1.1 bn. The company in 2015 picked up minority stake in CloudEndure for $4 million.

- **UFO Moviez** India's non-promoter investors agree to sell their shares in Qube Digital Cinema Pvt. Ltd. to UFO Moviez and ICICI Ventures at Rs 264.88 per share as against an earlier decided price of Rs 302.65.

- **HCL Technologies** to buy select **IBM** software products for $1.8 billion with the transaction is expected to close by mid-2019. The software products in scope represent a total addressable market of more than $50 billion.

- **Max India** to sell entire Max Bupa stake to True North. After the Max India stake sale, the new joint venture will have True North as the majority partner, while British partner Bupa will continue to hold 49% in Max Bupa Health Insurance.

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- The new board of the insolvent Infrastructure Leasing & Financial Services Ltd. has put its road assets on sale as part of its debt-resolution plan. The road assets/businesses are classified under the "Domestic Roads Vertical", and belong to subsidiaries, including **IL&FS Transportation Networks Ltd.**

- Sebi directs Fortis to recover Rs.4.03bn from Singh brothers; seven others. Sebi has barred Singh brothers from associating themselves with the affairs of **Fortis Healthcare** and Fortis Hospitals in any manner whatsoever.

- **Hindustan Unilever (HUL)** said it was merging **Glaxo-SmithKline (GSK) Consumer Healthcare** with itself in a transaction worth Rs 317 bn, in the largest deal of the consumer goods space in the country.

- **Cadila Healthcare** received U.S. FDA approval to market Albendazole tablets. This shall be manufactured at SEZ, Ahmedabad.

MACRO NEWS

- **Fitch** has lowered India's growth forecasts on weaker-than-expected momentum in data (GDP), higher financing costs and reduced credit availability. Fitch now see GDP growth at 7.2 per cent in the fiscal year ending March 2019 (FY19), followed by 7.0 per cent in FY20 and 7.1 per cent in FY21.

- **The GST Council** reduced tax rates on 23 goods and services, including movie tickets, TV and monitor screens and power banks, and exempted frozen and preserved vegetables from the levy. The reduced rates are likely to come into effect from January 1, 2019.

- In a major overhaul of the fee structure that mutual funds charge from investors, **SEBI** has issued new norms to cap total expenses for investment in mutual funds. The maximum **TER** for open-ended equity schemes will be 2.25 per cent, 2 per cent for other open-ended schemes and 1.25 per cent for closed-ended equity schemes.

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- To ease their cash crunch, Govt to put in Rs 830 bn in public sector banks. The fresh dose of capital will be given to enable banks to meet regulatory norms, allow better-performing PCA banks to achieve 9 per cent capital adequacy ratio, strengthen merging banks such as the recently merged **Bank of Baroda-Vijaya Bank-Dena Bank** combine and prevent non-PCA banks, such as **Punjab National Bank**, that are on the borderline from coming into the framework.

- **The Reserve Bank of India** constituted an expert committee headed by former governor **Bimal Jalan** to review its economic capital framework, and whether the central bank needs to hold as much reserves as it currently does.

- **Government** expects to complete processes for **5G spectrum** auction by August and the services will be rolled out by 2020.Trai has given a preliminary set of recommendations, which the working committee at the Department of Telecommunications is looking at.

- **India** will import crude oil from **Iran** using a rupee-based payment mechanism, with 50% of those payments will be used for exporting items to Iran.

- **RBI** has decided to reduce **statutory liquidity ratio** (SLR), by 0.25% every quarter beginning January. The calibrated reduction in SLR will continue till it reaches 18%. The current SLR is 19.5%.

- **SEBI's** decision to ease **offer for sale** (OFS) norms is likely to help a number of small companies, including public sector firms. Sebi to reintroduce differential voting right shares for listed firms. Sebi has made a sub-committee for reintroducing DVRs, which will make recommendation next month.

- **Govt** plans to increase share of **natural gas** to 15% in India's fuel basket. Mumbai and Delhi have each crossed the one million mark in piped natural gas connections.

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FUNDS FLOW DATA

Data as on 24th Dec 2018		
FUNDS FLOW DATA (Rs in Cr)		
Category	***MTD***	***YTD***
FII	2,971	(33,491)
DII	1,063	1,18,602
Total	**4,034**	**85,111**

DEBT & FOREX MARKET

Data as on 26th Dec 2018			
Debt / Forex Market			
Category	***Day***	***1 Mnth***	***3 Mnths***
10 Yr Yield	7.3	7.8	8.1
Re/ US $	70.4	71.7	73.0

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MARKET VIEW*

Curious Case of 2018!

If anything 2018 has taught us, it is on the futility of forecasting. Investors learnt once again, but in a more brutal fashion that forecasting is not the game any sensible investor should venture into. Investors who had structured their portfolios for a vigorous wobble in 2018, ended up facing an accident, esp. in the small and midcap space. Swings in many asset classes were so sharp that it wrecked much of the portfolios with no places to hide. Kudos to those investors who have survived 2018 and still have steam left to stitch together a promising portfolio for the coming months and years. Such is the mayhem in many asset prices.

Take for example, the rise and fall of crude prices. In late Oct, when crude was all set to cross 85$ mark, urge to forecast did not spare even the seasoned ones sitting in the swanky offices of Dalal street. One of the famous one, in his tweet, even ventured to throw a 100$ mark for crude just in few months. Of course, he was trolled later by twitterati when the crude crashed by 30%+ in few quick sessions, not long after his infamous tweet. The story is not much different when it comes to Rupee or the 10 year Gsec yield. Who would have guessed that 10 year would rise all the way from 7.15% in the beginning of year to 8.15%+ only to crash all the way back to 7.25%. That much for forecasting.

To top it all, fag end of 2018 is witnessing US markets behaving more like an emerging market in terms of sharp intra-day swings on growing noise on recession fears. This is another forecast that market participants are fearing which could put global markets on a rout. The still-fresh 2018 experience should guide the rational investors not to get swayed by such gloomy forecasts, but to stay focused on portfolio building with a keen eye on buying prices. This is not to suggest that recession fears have to be ignored. All it suggests is that no one knows the future and it is impossible to predict macro given the large numbers of inter-dependent moving parts.

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In hindsight, when one looks back one year down the line, one would realize that 2018 was an eventful year, not only for all the irrational swings, but also as one of those years that gave great entry points for long term believers in India story.

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 "***The perils of trying to time the market"*** from "***The Economist".***

"I'd advise you to approach the entire subject of forecasts and forecasters with extreme mistrust." – ***Howard Marks.***

The perils of trying to time the market

Jesse Livermore earned his reputation as a talented speculator by pocketing a tidy sum during the Panic of 1907. Mindful that a scarcity of credit and a giddy stockmarket were a dangerous mix, he began to sell stocks short that autumn. When share prices crashed on October 24th, Livermore was up by $1m ($27m in today's money). He then changed course. He started to buy stocks, which were now a lot cheaper. The market rallied. By the end of the year Livermore had made $3m.

Anyone who has ever invested in stocks has at one time fancied that they can time the market as exquisitely as Livermore did. Very often, they hope that a benchmark of fair value, such as the cyclically-adjusted price-earnings ratio, or cape, will be their guide. History shows that when stock prices rise a lot faster than profits—as they did in the 1920s, 1960s and 1990s—they tend subsequently to fall back (see chart). So the market-timer will sell when the cape is high and buy them back when it is low.

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It seems simple. In practice, it is surprisingly hard to use valuation gauges to time the market. Investors who try often sell far too early. As a consequence, they miss out on some of the richest returns. Selling stocks when everyone is still buying may actually be the easy bit. It is harder to find the nerve to buy stocks when others are selling them in a panic.

The purist view is that market timing is a mug's game. It says stocks are a random walk: their past indicates nothing about their future path. In the 1980s academics questioned this creed. Since stock prices tend to revert to a mean value, they must be somewhat predictable. They deviate from this fair value only because investors over-react to news. When profits are strong and stocks are rising, there will be keen buyers almost regardless of value. The reverse is true in recessions. This herding—or, if you prefer, this rational pricing of risk—creates the opportunity for market timing.

There is a drawback. What is "cheap" or "dear" is defined by reference to the full history of prices. But an investor active in any period could not have known this in advance. Nor is it obvious at the time whether the capeis close to a peak or trough. Without the benefit of hindsight, timing produces disappointing results.

A study in 2017 by Cliff Asness, Antti Ilmanen and Thomas Maloney of aqrCapital Management tested a timing strategy. Their gauge was a rolling 60-year average of the cape. When the cape was below its historical median—that is, below fair value—the strategy would borrow to buy stocks. When it was above fair value, it would lighten up on stocks in favour of cash. Over the whole period (1900-2015), returns to the market-timing strategy were scarcely better than to a buy-and-hold portfolio with a constant 100% stockholding. And over the latter half (1958-2015), returns were no better at all.

A big failing was that the strategy was under-invested in stocks for too much of the time. The average cape has trended upwards since the 1950s. Too often stocks were deemed dear based on historical valuations. Timing works no better in

countries other than America. A study in 2013 by three academics, Elroy Dimson, Paul Marsh and Mike Staunton, found no consistent link between valuation and subsequent returns in 23 stockmarkets.

Value is too weak a signal to be much use. But it can be improved upon. The aqr researchers found that combining the value benchmark with a "momentum" signal of the underlying trend in stock prices yields better results. This is intuitive. The problem with value benchmarks is that prices drift away from them for long periods. But a blend of value and momentum represents "value with a catalyst", as the authors put it.

This strategy is too complex for ordinary investors to profit reliably from it. But there is a simpler form of market timing, which has some empirical support: rebalancing. It requires investors to decide first how they want to divide their investments. It could be, say, an equal split between American and non-American stocks. The precise weights matter less than that they are stuck to. That requires regular rebalancing to restore the original weights. It means shedding assets that have risen a lot in favour of those that have gone up by less.

The virtue of rebalancing is that it is simple. You are less likely to make a costly mistake than if you follow a more complex strategy. The drawback is that you must give up the delusion that you can time it like Livermore. To do what he did takes nerve and a rare feel for markets. You may think you have such talents. You almost certainly don't.

- An Article from the Economist.

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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.

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

TrustLine Holdings (P) Ltd

39/19, IInd Floor, Aspen Court, 6th Main Road, Raja Annamalaipuram, Chennai – 600 028.

Tel: 044 – 42083877, Email: pms@trustlineindia.com, aif@trustlineindia.com,

Trust Line