Ist July' 2018

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M O N T H L Y   V I E W

FROM THE FUND MANAGER DESK

The Untouchables?

Narrative has changed for small-caps, from one of gold mines to minefield of grenades in a short span of time. How should investors deal with this change in narrative?

From hidden gems to hidden worms, small cap investing has come a full circle now. In 2017, if you were not investing in small caps, you were missing out. Now if you are in small caps, you stand scrutinized and slammed. With tide changing from recklessness to risk-averse, it is quite astonishing how small caps have slipped from sacred to untouchables in a span of just six months.

Is it something unusual that investors should worry about? Or, is it rather a reoccurring theme that throws up opportunity for value investors? Let us go back to past such corrections in small & midcaps and examine how they played out eventually. Vicious corrections within a structural bull market are not something new. Let us take the previous bull cycle of 2004-08. In that period, small cap index corrected by over 10% at least 3 times and in two of them, the small cap index slumped by over 20%+ in 2005 and by over 40%+ in 2006. Of course, for individual stocks, there was no hiding place. Much of the stocks in the small cap space were slaughtered by over 50 to 60%+ in this period. Not much different in the current bull cycle which started late 2013. Savage fall in small caps occurred in two of the three declines we saw in this cycle i.e. one in Feb 2016 on fear of hardening interest rates in US and in Nov'16 on DeMon impact.

As can be inferred from the below chart, what is interesting is that the recovery was quick within few months and more importantly, the bounce was far greater than the bump. In each of these fall, predictably, the narrative turned negative on small caps, only to return back with vengeance on subsequent bounce. It is important to understand that the price-action

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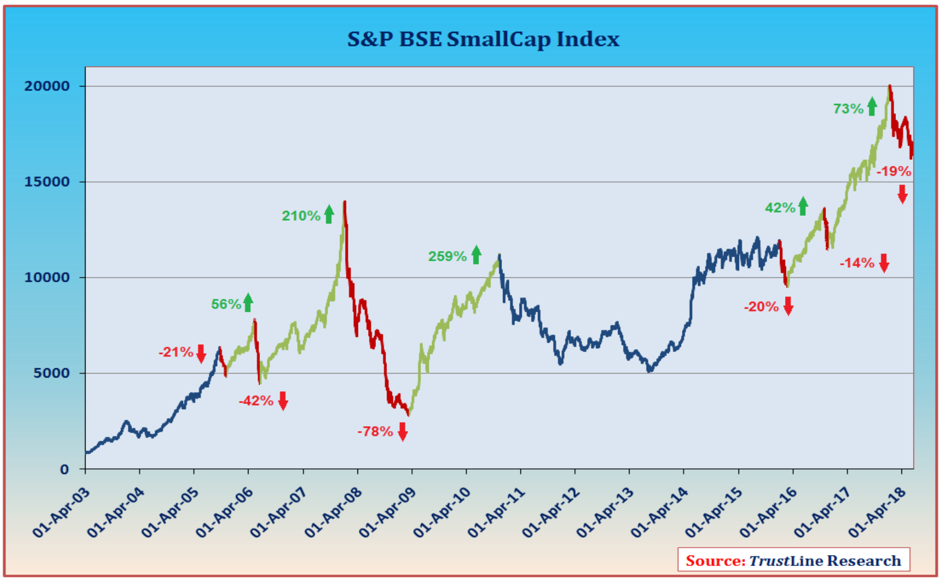
dictates narrative, not the other way around. Seasoned investors know what to follow and focus on. What is to be followed and focused is the cycles (price action), not the narrative. Unfortunately, noise that comes from amplified narrative numbs the investors into inaction. This is not one or two year phenomenon. Over a 14 year period, this has happened consistently over and over again without exception, as can be seen in the chart. Yet, most investors do panic and fall into the narrative trap instead of taking actions based on cycles. Few who learn from history make the most from these reoccurring cycles.



There is a reason why every fall has been followed by a quick and sharper bounce. It comes from India’s strong structural growth story. If anything, this story has only become stronger this year with economy getting closer to the pay-off time from structural changes like GST, Subsidy reforms thro’ DBT, RERA (real estate reform), Formalization/Financialisation initiatives thro’ increased tax compliance etc. With long waited recovery in investment demand showing signs of revival, growth in broader economy is coming back with vengeance giving fillip to corporate earning cycle. It is funny that market with its eyes fixated on global cues, is ignoring the local positive developments on the ground. It is no surprise.

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That's what bear cycle does. It makes the investors to ignore the good news and makes them to focus on the amplified negatives.

It is interesting that opportunities always come knocking just before the dawn. This is one such time where a sharp correction in small and midcaps couldn't have come at a more prescient time, just when economy is likely to take off. With huge price crack, small and midcaps offer the best opportunity to capitalize on this upswing. Though it is tempting to move away from the small and midcaps because of the ongoing narrative, one need to take an objective approach taking evidence from past cycles. Having said that, unlike 2017 which was a one-way reckless rally, 2018 will be more a year of consolidation with heightened volatility. Given this, investors need to pursue a bottom-up stock-picking strategy, that too in a phased (nibbling) manner to get the best out of the crack in small and midcaps.

Happy Value Investing!!

ArunaGiri. N

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CORPORATE NEWS

- **The Life Insurance Corporation of India** (LIC) may acquire about 30 per cent additional stake in **IDBI Bank** primarily through the issuance of fresh equity shares by the beleaguered bank.

- **Tata Motors** is open to divesting stake in its financing arm, **Tata Motors Finance**, which is expected to have Rs 500 Bn of assets under management by 2020. Also there are plans to launch around 50 **commercial vehicles (CVs)** this fiscal as it looks to further consolidate its position in the segment. The auto major, which saved close to Rs 19 Bn in 2017-18 by enforcing cost-saving measures across CV and passenger vehicle segments, aims to achieve similar kind of savings in the current fiscal as well.

- **Ratnamani Metals & Tubes** received a domestic order for supply of Welded Carbon Steel Pipes valued at Rs 1.26 Bn and to be completed by March 2019.

- **Dr Reddy's Laboratories** said that a US District Court has issued a temporary restraining order on the sale and commercialization of its generic Buprenorphine and Naloxone sublingual film in the American market.

- **Wipro** awarded an air cargo management contract by **LATAM Cargo** and a supply chain management contract by **Nokia**.

- **Tata Consultancy Services** at its board meeting on 15th June 2018 approved a proposal to buyback of upto 1.99% of the total paid up share capital at Rs 2100 per share aggregating to about INR 16000 Crores.

- **Indian Railways** is set to put out its largest tender for 22,000 wagons at a cost of at least Rs 70 bn in the current financial year that could see big orders for **Texmaco Rail and Engineering, Titagarh Wagons, Jindal Rail and Jupiter Wagons**, among other wagon makers.

M O N T H L Y V I E W

- **Cipla** has received final nod from **USFDA** for generic Testosterone Cypionate injection used for replacement therapy in males for deficiency or absence of endogenous testosterone.

- The board of **ICICI Bank** has appointed Sandeep Bakhshi whole-time director and chief operating officer to run the affairs of the private lender. Chanda Kochhar, managing director (MD) & chief executive officer will be on leave, pending the probe.

MACRO NEWS

- **The World Bank** has forecast a growth rate of 7.3 per cent for India this year and 7.5 per cent for the next two years, making it the fastest growing country among major emerging economies.

- **Government** defers auction for 60 oil and gas fields by a month. Of the 60 fields which will be up for auctions, 22 fields belong to **ONGC**, five to OIL and 12 are relinquished discovered fields from the new exploration and licensing policy blocks.

- **India** has notified the **WTO** a revised list of 30 US imports on which it intends to impose retaliatory tariffs. India's retaliatory tariff on 29 **US** products worth USD 235 Mn will come into effect on 4 August.

- **The Reserve Bank of India (RBI)** enhanced the housing loan limits under **priority sector lending** (PSL) to Rs 3.5mn in metropolitan centers under the affordable housing scheme.

- **The Government** is planning to impose price caps on pharmaceutical consumables. By the end of this month, government is planning to introduce a new index for pharmaceutical products that will become the benchmark for prices of medicines. Drug price regulator **NPPA** revises these prices annually based on **wholesale price index (WPI)**.

- The capital markets regulator, **SEBI** 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 Sebi guidelines said. The new IPO norms include 'immediate relatives' within the definition of promoter and promoter groups.

- Over **225,000 companies and 7,000 limited liability partnerships** (LLPs) face the threat of being struck off official records, with the government launching a fresh drive against companies defaulting on filing statutory returns.

FUNDS FLOW DATA

Data as on 26th June 2018

FUNDS FLOW DATA (Rs in Cr)		
Category	***MTD***	***YTD***
FII	(3284)	(5546)
DII	5798	65170
Total	**2514**	**59624**

DEBT & FOREX MARKET

Data as on 26th June 2018

Debt / Forex Market			
Category	***Day***	***1 Mnth***	***3 Mnths***
10 Yr Yield	7.8	7.8	7.6
Re/ US $	68.3	67.4	64.9

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MARKET VIEW*

Nothing New?

Markets always give opportunity to write something new. Not this time. Story hasn't changed for a while. Broader story remains the same with Sensex barely moving, but hiding the humongous losses in individual stocks in the broader small and midcaps. FIIs haven't retreated from their selling spree. FIIs have sold over USD 500 Mn+ so far in this month, though some early signs of slowdown in their selling have started to surface. While overall flows in domestic side have come down, there is good news on the monthly SIP inflows into mutual funds. The fact that SIP inflows hit an all-time high in the month of May (crossing billion dollar monthly flows) in spite of the market volatility is extremely significant and positive for the improving profile of the flows. However, it hardly made a mark in the markets because of incessant selling by FIIs. Its impact will be more visible when FII selling recede. Currency continues to be weak, though much of the damage is done with. Same is the case with the benchmark yield which continues to flirt around 8% mark.

When it comes to investment strategy, again, nothing new to write about. It continues to be a bottom-up market for seasoned stock pickers. If there is something new to write about, it is on the micro. There is a lot happening on the growth cycle. More and more signs are emerging that economy is on the verge of take-off. New data points from RBI indicate that the capacity utilization is rising across industries and the output gap is narrowing. These points to early signs of rebound in investment demand and capex cycle. Corporate earning cycle is on the mend and is going to surprise on the upside.

> **"It is time to invest, not to time the bottom. When it is raining gold (in the context of small and midcaps), it is time to reach for the buckets."**

This is not a capital preservation time as some pundits suggest in TV channels. 2017 was the time to preserve capital when markets were on a reckless rally. Now, it is time to ignore notional losses and start investing in a phased manner for long-term gains.

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 ***"What Lunch with Warren Buffett Taught Me about Investing and Life"*** by **Guy Spier**.

"The person that turns over the most rocks wins the game."

- Peter Lynch

Guy Spier: What Lunch with Warren Buffett Taught Me about Investing and Life

It's been 10 years since I and my friend, investor Mohnish Pabrai, won the annual Glide Foundation charity auction for lunch with legendary investor Warren Buffett.

Together we paid $650,100, which, although it seemed like an enormous sum at the time, is dwarfed by the $3.3 million paid this year. My cost was around $220,000 because we split the donation — two-thirds from Mohnish, who came with his wife and two daughters, and one-third from me and my wife (our children were too young).

Why did we do it? In my book "The Education of a Value Investor," I offer several logical, well-thought reasons. But with the perspective of a little more time perhaps it comes down to plain and simple curiosity.

Over the years 2004 to 2007 my investing had gone well. I had some money in the bank and I simply wanted to sit down and break bread with this man I revered. On some level, all I was hoping for was to get a measure of the man, to size him up in person and get a sense of how he ticks. Was he really that smart? Was I like him in any way?

As the saying goes: "If you don't try, you'll never know." So I went for it.

Lessons on investing (or not?)

Even if I didn't match up to Buffett in terms of investing prowess, there was certainly a part of me that hoped that some of his Midas touch would rub off. Perhaps I would come away from the lunch having learned the lessons on how to beat the market and become a billionaire.

But that was not to be — at least, not directly. If only because questions about specific investments were off limits according to the rules of the auction. And in any case, Mohnish and I weren't going to take the conversation there. We wanted Buffett to be relaxed and to enjoy himself. Pushing hard into investment topics would not have been productive.

And yet, even though we were not asking, perhaps we did indeed get the most important lessons of investing and endless wealth. Because such lessons are less about specific investments, and more about life. Give a man a fish, and he can eat for a day. Teach him to fish, and you have taken care of him for a lifetime. In our case, the lunch became more about how to live your life such that you are most likely to become a billionaire. And if you don't become so wealthy it doesn't matter, because the journey has been so awesome.

The first distinction Buffett gave us was the concept of having an inner- vs. an outer scorecard. He asked: "Would you rather be considered to be the best lover in the world, but for you and your wife to know that, in reality, you are the worst? Or the opposite: To be considered the worst lover by the rest of the world, but for you and your wife to know that you are the best?"

Put simply, Buffett was teaching us to act with the right motivation — because it's the right thing to do, not because of what people will think. This was something I had not really thought about until that moment, and has been absolutely key ever since. This personal value ostensibly has nothing to do with value investing, but in truth it has everything to do with it. Because buying an undervalued, out-of-favor stock is all about doing what you know is right — even if the rest of the world may disagree.

Buffett offered up another, more profound lesson: In order to see the best opportunities in life, it's important that others also get a good deal — ideally one even better than they bargained for. Nowadays this way of negotiating is ingrained into my behavior and habits, but that wasn't the case 10 years ago. At the time, I still had this idea that being good in business was about gaining an edge and winning more than the other guy. Taken to its extreme, you become the guy where, after you shake someone's hand, they want to check if they still have five fingers.

But the man I met at Smith & Wollensky's steakhouse in New York that day 10 years ago had a completely opposite mindset. I can't tell you how startling it was for me: there was Warren Buffett, one of the richest men in the world, and all he wanted to do was serve us and please us. He told us that he was going to make damned sure this lunch was worth our while. And for the three or so hours he was with us, he enthusiastically focused on what we wanted to talk about, and shared as much as he could.

This taught me something very important. If Warren Buffett was working so hard to please me, how much harder should I work to please people around me — even if they are less wealthy, less able, less powerful?

While this question seems on the surface to have nothing to do with value investing, it may be the only thing. Because I have learned that, sooner or later, the only thing we have to go on is others' willingness to share back to us. And, over time, their willingness will have less to do with how smart, rich, powerful, or good-looking we are.

Rather, their willingness will depend on how willing we are to deliver genuine value to them. People who give a little more than they take live in a world that is rich with opportunity. As I have worked hard to deliver value to others, opportunities have multiplied in all sorts of ways. Better people have come into my life who are willing and interested to share with me. In terms of becoming a better investor, I now have more opportunities to learn.

At the end of our lunch with Buffett, what really drove that insight home for me was when I noticed that Warren was handing the waiters what seemed to be an enormous tip. Warren's desire to deliver generous amounts of value even extended even to the waiters. In other words, we need to keep investing in and generating goodwill.

Buffett has said: Spend time with people who are better than you, and you can't help but improve. But the real question is how to attract those people into your life. Luckily, I had a great teacher — my friend Mohnish Pabrai. When I moved to Zurich from New York, I enthusiastically adopted a number of his approaches to business.

Whether it was through my new association with Buffett and a closer friendship with Pabrai, or through my adoption of their approaches to generating goodwill, my learning environment improved greatly. For example, after the lunch I started getting invited to events at the Berkshire Hathaway annual shareholders' meeting that enabled me to meet and engage with some of the people who run Berkshire's subsidiary businesses — and who themselves are an extraordinary set of people to have in one's circle.

And although I've been lucky enough to have met with Warren subsequent to our lunch, I certainly can't say that we chit-chat on the phone or hang out together. But I also have no doubt that he would return my call in short order if I had something worthwhile for him. In my case, that would most likely be a deal that is of interest to Berkshire — perhaps a European power company, or a family owned business that I had managed to interest in selling to Berkshire rather than to a European private equity fund.

Cloning Warren: My own charity lunch

A few years after our lunch with Buffett, my friend Mohnish started auctioning off a lunch with himself to benefit the **Dakshana Foundation** in India. Taking his cue, this year for the first time I'm auctioning **a lunch with myself** — also to benefit the Dakshana Foundation. By offering the opportunity for some of India's least-privileged citizens to study at the country's best institutions, Dakshana is creating enormous amounts of value, both in the lives of those it helps and for India. In a way, a charity lunch with myself to benefit the Dakshana Foundation closes the loop for me; so much of what I learned at my lunch with Buffett, and from Mohnish, is embodied by the Dakshana Foundation that I feel an obligation to support it.

With just over three days left in the 10-day auction, the bidding is already at $11,100. Sure, that's far from the **$3.3 million the Buffett lunch just sold for**, but it's still interesting for me to see how much people will be willing to bid for up to seven of their friends to have lunch with me. Most of all I'm looking forward to meeting the winner and treating them to an experience that (in my dreams) will top the one I had with Warren and Mohnish a decade ago.

Article by Guy Spier from marketwatch.com, he is the Founder & Managing Partner of Aquamarine Capital.

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DISCLAIMER:

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 375+ 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)

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