Ist March' 2018

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M O N T H L Y V I E W

FROM THE FUND MANAGER DESK

It is time to invest, not to time the bottom…

Crack in the market always comes with cacophony. Investors should be wise enough not to wait for cacophony to clear and instead focus on picking undervalued stocks with high margin-of-safety without yielding to the temptation to time the bottom. As someone wise said, if you wait for robins, spring will be over.

Instead of timing, the focus should be on Margin-of-Safety (MOS). Let us turn to the anecdote of coin flipping to understand more on the concept of MOS. As we know, flipping the coin is a risky bet. Is there a way to improve odds in that? What if, heads you win and tails you do not lose? Though odds of winning do not improve, odds of not losing improve to 100%. This is exactly what Margin of Safety does in investing. Strangely, in investing, when you are focused on downside, upside takes care of itself. Value investing is all about downside protection and MOS is the magnificent tool to mitigate the downside risk. It is the magical concept that magnifies the portfolio returns by denting the drags from losers and by earning exceptional rewards from winners. To quote Ben Graham, "Confronted with a challenge to distil the secret of sound investment into three words, we venture the motto, **Margin of Safety**".

How does one get MOS in stock picking? If MOS is defined as the discount from the intrinsic value of the underlying business, primarily, it comes from the mis-pricing in the markets. Mispricing can happen on two counts. One from the broader market trend and the other from stock specific scenarios (when underlying business comes across short-term bumps). In general, mispricing is on the upside when the mercury is up and it is on the downside when there is meltdown. It applies both to stock-specific swings and to overall market moves.

The challenge is not so much about getting MOS opportunities. Vicious corrections even in a virtuous bull market are not very

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M O N T H L Y V I E W

unusual. Similarly, stock specific slumps are not scarce in a secular uptrend. The harder part is more about having the nerve to invest when such MOS opportunities arise, as in most cases, the accompanying high decibel narrative numbs the investors into inaction. Take for example the ongoing correction. Last week, small and midcaps were mauled mercilessly. For most of the stock prices, the clock was back by one year. Yet, the same people who were waiting on the fence for a sharp correction, turned frozen because of the changed narrative. As they say, money is made not in following narrative, but in following valuations. Narrative will take care of itself as time goes. As someone wise said, if you wait for robins, spring will be over. MOS grows in manic pessimism. Time to start nibbling is when narrative turns negative. If you wait for cloud to clear, MOS too will mysteriously disappear.

> **"Current market weakness is nothing but market's way of adjusting to the weakening macro. Market never adjusts in an orderly fashion. To that extent, as market adjusts to the new macro challenges, expect lot more bumps and humps in the coming months."**

But time to bet is when these bumps and humps bombard, not when it becomes seamlessly smooth. While macro may not be at its best, underlying recovery in micro (recovery in corporate earnings) may provide the required support in the medium to long-term.

Happy Value Investing!!

ArunaGiri. N

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MONTHLY VIEW

CORPORATE NEWS

- **Indian Oil Corp (IOC)** will invest Rs 700 Bn to raise its oil refining capacity by about a quarter by 2030 as it takes the lead to meet rising energy needs of the country. IOC will expand its refining capacity to 116.5 million tonnes per annum (MTPA) by 2030 from the current 80.7 MTPA.

- Pharma major **Dr Reddy's** has received the establishment inspection report (EIR) from the **US Food and Drug Administration** for its formulations facility in Srikakulam, Andhra Pradesh.

- **Allahabad Bank** said it has an exposure of Rs 5.17 Bn to crisis-hit **Rotomac group** and the lender has made required provisioning for the same as per RBI norms.

- **Tata Steel** trumped **JSW** with an aggressive all cash bid for 5 Mn tonne **Bhushan Steel and Power**, one of the largest non-performing assets in the Indian banking system.

- State-run **Punjab National Bank (PNB)** said it has unearthed fraudulent transactions of around Rs 114 Bn in one of its branches in Mumbai and filed a complaint with the Central Bureau of Investigation (CBI) on the fraud amid concern that the contagion could spread to other banks. Later PNB further revealed the possibility of additional fraud of Rs 13.25 Bn in the Nirav Modi case. This increase means that the total fraud now amounts to about Rs 126.22 Bn.

- **Mahindra & Mahindra**, which has so far invested Rs 6 Bn in its electric venture, plans to raise EV capacity to 1000 units a month by end-2018 from about 200 units now, and 5,000 by 2020. It has sought board approval to invest about Rs 8 Bn to develop two new electric vehicle (EV) products and set up a research and development centre for such vehicles.

- **Tata Motors Ltd** and **Warburg Pincus LLC** have mutually agreed to call off the US private equity firm's proposed investment of around \$360 million in **Tata Technologies Ltd**.

M O N T H L Y V I E W

- In a move that will add heft to **Jio's** content strategy, Mukesh Ambani's **Reliance Industries** is acquiring 5% stake in NYSE-listed **Eros International**, holding company of Indian movie company Eros International Media (Eros India). As part of the deal, an overseas subsidiary of RIL will acquire Eros' shares for $15 apiece, at an 18% premium to the last closing price.

MACRO NEWS

- E-commerce players such as **Amazon and Flipkart** may get exemption from having to generate an electronic-way bill (e-way bill) under the **goods and services tax (GST)** if there are multiple deliveries on the same trip.

- Power produced from **wind and solar projects** will become viable and more attractive for discoms as the government last week waived off **inter-state transmission charges** for wind and solar projects commissioned till March 2022, in a bid to encourage the use of power generated through these sources.

- **The Indian information technology industry** expects to grow exports at a marginally higher 7-9 percent in the coming fiscal, slightly higher than its expected growth of 7.8 percent in the current financial year, **Nasscom**, the IT industry body said.

- The new **non-performing asset (NPA)** resolution framework announced by the **Reserve Bank of India (RBI)** is expected to weigh on stocks of banking companies. Experts, however, say that the PSBs will face a bigger impact as they have a large number of loans in various stressed brackets such as S4A, SDR, 5:25, and others, which are currently not classified as NPAs.

- **India's wind power tariffs** remained near a record low of Rs.2.44/unit in an auction conducted by the state-run **Solar Energy Corporation of India (SECI)**.

- Following consecutive years of low crop prices which led to farmer protests in several states, finance minister announced that the government will fix **minimum support prices (MSP)** at 50% over costs.

M O N T H L Y V I E W

- **EPFO** lowered the rate of interest on employee's provident fund to 8.55% for 2017-18, from 8.65% in the previous fiscal. EPFO received 8% returns on its bond investments but it is able to pay 8.55% rate because it has sold some of its investments in ETFs.

FUNDS FLOW DATA

Data as on 23rd Feb 2018		
FUNDS FLOW DATA (Rs in Cr)		
Category	***MTD***	***YTD***
FII	(8783)	4201
DII	15169	15568
Total	**6386**	**19769**

DEBT & FOREX MARKET

Data as on 26th Feb 2018			
Debt / Forex Market			
Category	***Day***	***1 Mnth***	***3 Mnths***
10 Yr Yield	7.7	7.3	7.0
Re/ US $	64.8	63.5	64.5

Ist March' 2018

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MARKET VIEW*

Year of Accumulation?

Shine is off from stocks. That is good and should be a welcome relief from the one-way reckless rally that has been ruling the roost for many months in a row. In a rare coincidence, multiple cues came together in a miraculous fashion to conspire a deadly blow to the bloated stocks. Global bond sell-off couldn't have come at a worse time. Just when the FM was lighting fire with his ill-thought LTCG tax (Long-term capital gains tax), global cues turned negative triggering a slump in Indian stocks. Macro fiscal worries from lavish MSP proposal and other rural largesse added to the ammunition with ten year Gsec yield spiking to levels not seen for many months.

All these are not completely unexpected except the eerie coincidence of all coming together. Though market has recovered from its lows, it is still edgy and weighed down by uneasy calm. The recent correction in broader markets should provide better entry opportunity for experienced stock pickers. The year 2017 has witnessed strong rally in equities without much volatility but with broader markets expected to be capricious in 2018, which should be an opportune time for thoughtful investors for building a stronger portfolio. In 2019, the portfolio should leverage from the structural reforms implemented during the past few years, which would drive ensuing breakout in GDP growth rates beyond 8%+.

> **"Indian economy will enter a new growth orbit above 7-7.5% (badly struck in this range for many years) from FY20 onwards, which are majorly driven by structural reforms such as Indirect tax reforms (GST), Inflation control, Bankruptcy code, RERA, Subsidy reforms thro DBT, Financialization of savings etc.,"**

Investors should ideally leverage this volatile phase of equity markets, driven by weakening macros, by allocating more weightage to equities (more investments), building diversified portfolio and appropriate stock selection. It is time to increase one's equity exposure in a gradual fashion, not to lose bearings on paper losses.

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 ***"America's extraordinary economic gamble"*** from **economist.com**.

"Charlie and I view the marketable common stocks that Berkshire owns as interests in businesses, not as ticker symbols to be bought or sold based on their "chart" patterns, the "target" prices of analysts or the opinions of media pundits."

- Warren Buffett in 2017 Annual Letter

America's extraordinary economic gamble

VOLATILITY is back. A long spell of calm, in which America's stockmarket rose steadily without a big sell-off, ended abruptly this week. The catalyst was a report released on February 2nd showing that wage growth in America had accelerated. The S&P 500 fell by a bit that day, and by a lot on the next trading day. The Vix, an index that reflects how changeable investors expect equity markets to be, spiked from a sleepy 14 at the start of the month to an alarmed 37. In other parts of the world nerves frayed.

Markets later regained some of their composure. But more adrenalin-fuelled sessions lie ahead. That is because a transition is under way in which buoyant global growth causes inflation to replace stagnation as investors' biggest fear. And that long-awaited shift is being complicated by an extraordinary gamble in the world's biggest economy. Thanks to the recently enacted tax cuts, America is adding a hefty fiscal boost to juice up an expansion that is already mature. Public borrowing is set to double to $1 trillion, or 5% of GDP, in the next fiscal year. What is more, the team that is steering this experiment, both in the White House and the Federal Reserve, is the most inexperienced in recent memory. Whether the outcome is boom or bust, it is going to be a wild ride.

Fire your engines

The recent equity-market gyrations by themselves give little cause for concern. The world economy remains in fine fettle, buoyed by a synchronised acceleration in America, Europe and Asia. The violence of the repricing was because of newfangled vehicles that had been caught out betting on low volatility. However, even as they scrambled to react to its re-emergence, the collateral damage to other markets, such as corporate bonds and foreign exchange, was limited. Despite the plunge, American stock prices have fallen back only to where they were at the beginning of the year.

Yet this episode does signal just what may lie ahead. After years in which investors could rely on central banks for support, the safety net of extraordinarily loose monetary policy is slowly being dismantled. America's Federal Reserve has raised interest rates five times already since late 2015 and is set to do so again next month. Ten-year Treasury-bond yields have risen from below 2.1% in September to 2.8%. Stockmarkets are in a tug-of-war between stronger profits, which warrant higher share prices, and higher bond yields, which depress the present value of those earnings and make eye-watering valuations harder to justify.

This tension is an inevitable part of the return of monetary policy to more normal conditions. What is not inevitable is the scale of America's impending fiscal bet. Economists reckon that Mr Trump's tax reform, which lowers bills for firms and wealthy Americans—and to a lesser extent for ordinary workers—will jolt consumption and investment to boost growth by around 0.3% this year. And Congress is about to boost government spending, if a budget deal announced this week holds up. Democrats are to get more funds for child care and other goodies; hawks in both parties have won more money for the defence budget. Mr Trump, meanwhile, still wants his border wall and an infrastructure plan. The mood of fiscal insouciance in Washington, DC, is troubling. Add the extra spending to rising pension and health-care costs, and America is set to run deficits above 5% of GDP for the foreseeable future. Excluding the deep recessions of the early 1980s and 2008, the United States is being more profligate than at any time since 1945.

A cocktail of expensive stockmarkets, a maturing business cycle and fiscal largesse would test the mettle of the most experienced policymakers. Instead, American fiscal policy is being run by people who have bought into the mantra that deficits don't matter. And the central bank has a brand new boss, Jerome Powell, who, unlike his recent predecessors, has no formal expertise in monetary policy.

Does Powell like fast cars?

What will determine how this gamble turns out? In the medium term, America will have to get to grips with its fiscal deficit. Otherwise interest rates will eventually soar, much as they did in the 1980s. But in the short term most hangs on Mr Powell, who must steer between two opposite dangers. One is that he is too doveish, backing away from the gradual (and fairly modest) tightening in the Fed's current plans as a salve to jittery financial markets. In effect, he would be creating a "Powell put" which would in time lead to financial bubbles. The other danger is that the Fed tightens too much too fast because it fears the economy is overheating.

On balance, hasty tightening is the greater risk. New to his role, Mr Powell may be tempted to establish his inflation-fighting chops—and his independence from the White House—by pushing for higher rates faster. That would be a mistake, for three reasons.

First, it is far from clear that the economy is at full employment. Policymakers tend to consider those who have dropped out of the jobs market as lost to the economy for good. Yet many have been returning to work, and plenty more may yet follow. Second, the risk of a sudden burst of inflation is limited. Wage growth has picked up only gradually in America. There is little evidence of it in Germany and Japan, which also have low unemployment. The wage-bargaining arrangements behind the explosive wage-price spiral of the early 1970s are long gone. Third, there are sizeable benefits from letting the labour market tighten further. Wages are growing fastest at the bottom of the earnings scale. That not only helps the blue-collar workers who have been hit disproportionately hard by technological change and globalisation. It also prompts firms to invest more in capital equipment, giving a boost to productivity growth.

To be clear, this newspaper would not advise a fiscal stimulus of the scale that America is undertaking. It is poorly designed and recklessly large. It will add to financial-market volatility. But now that this experiment is under way, it is even more important that the Fed does not lose its head.

Article from economist.com, Feb 08, 2018

Ist March' 2018

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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 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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