

Composite Investments Pvt Ltd

Investor Communication - June 2020

We are pleased to have crossed the one year mark since the launch of our portfolio management offerings.

What a year it has been! The market has thrown a lot of variations at us since May last year with the euphoria of the election results, followed by the disappointment of the Union Budget, the unexpected corporate tax rate bonanza and then the more unexpected COVID-19 crisis to top the year off.

Market Commentary

The one thing that has been reinforced over the past three months is that the markets have a mind of their own.

In March we had people calling for levels of 6500 on the NIFTY 50. As is the case most of the time, consensus views on the worst-case scenario usually do not play out. What has instead played out is a ferocious rally, as we write this the S&P Index in the US is within 10% of its February 2020 peak and the NASDAQ Index has gone on to surpass its February 2020 level. In India the NIFTY 50 is still ~16% below its peak value seen around the same time. As is evident, the Indian market has lagged the developed market peers and for good reasons in our opinion. We aren't yet out of the woods in our assessment.

As surprising as it sounds, the fear of COVID-19 during March was much higher than its impact while it appears to be the other way around today. This is because the markets are forwarding looking and tend to price in developments before they actually materialize, no big surprises here.

We still aren't at a stage where one has been able to reliably quantify the impact of the lock down on individual businesses and sectors. We believe clarity may start emerging only from August onward, that is when the markets could start reacting to actual economic data points rather than to estimates and sentiment. Till then the uncertainty continues independent of where stock prices are.

In continuation of the previous newsletter, we would like to revisit the uncertainties facing investors today.

What is it that we do not know?

- How much time could it take for the health situation to normalize?
- The duration for which economic activity will stay affected. Lifting of the lock down does not necessarily imply mean reversion in economic activity across the board. Some segments may stay affected for longer periods of time; one needs to be very business specific here
- What will be the impact of the lockdown on corporate earnings over the next few quarters? We may know the extent and pace of post lockdown recovery only after Q2 results are declared

A big risk here on appears to be interim market volatility rather than any near-term economic development. Whether the markets continue to reinforce the current narrative of *"the situation is better than the initial assessment"* or revert to the narrative of *"this does not look good at all"* is anybody's guess. All we know is that the market rarely moves in a straight line, neither in price action nor in expectations of the future.

In terms of businesses and their stock prices, what is resilient is not cheap and what is cheap has a higher element of uncertainty. One needs to pick and choose pockets that offer adequate compensation for the uncertainties involved.

There is never any easy money to be made in the market on a sustainable basis. For this reason, we may not have straightforward answers to why we like certain businesses and why we dislike certain businesses.

Sometimes we like the business but we do not like the stock as an investment since the price fully reflects the positive possibilities.

In our opinion making money in the markets has always been about three simple things

- ✓ Having a view that is different from the market view
- ✓ Being correct in your view
- ✓ The market eventually coming around to your view

Hence, we choose not to speak in detail about specific businesses in our newsletters, if we did that each newsletter would run into several pages. Investors work with us for better investment outcomes, research only feeds as one of the inputs to an evaluation process that is iterative and never definitive.

Portfolio Activity

- We haven't been guilty of knee jerk reactions like increasing cash allocation excessively. We are at an average cash allocation of 20-25%, we believe this gives us enough buffer to ride out any negative possibilities while keeping a few options open
- We have exited/pruned some positions which have started to trade beyond the fair valuation zone. It did not appear prudent to hold onto these positions when a lot of other businesses were trading well below the fair valuation range. This was not an easy decision since some of these businesses have become consensus BUY's which investors are flocking to
- We have reduced allocation to sectors where we believe the impact of COVID-19 can be considerable over the medium term. In some of these businesses we did bite the bullet and exit the position at a loss. This is in line with our investment philosophy – when the operating conditions change, we will calibrate to the changed reality
- We have utilized the lock down to set our heads down and add good businesses to our investible universe. We have added 7-8 quality names to our investible universe after doing the requisite research, 2-3 of these have found their way into the portfolios

We request you to compare your portfolios as of date with the portfolio as of February end and see this for yourself. All of the above are in response to the changed operating environment while operating within the boundaries set by our investment process and risk management framework.

We will strive to keep this balance intact at all times. Based on our performance since inception, we are happy that we have been successful on this front.

There is no shortage of equity mutual funds and portfolio management offerings in the market. What will continue to keep us in business is an obsessive focus on the following

- ✓ Deliver benchmark beating returns while constructing differentiated portfolios
- ✓ Continue to see each investor portfolio as the unit of evaluation, not the theoretical model portfolio
- ✓ Navigate market cycles better through timely calibration

We aspire to get to a situation where investors view their allocation to Composite PMS as a core, long term strategy within their overall allocation framework. Needless to say, this has to be earned through performance and trust.

We have had a good start and we are confident of keeping this up.

Sincerely,
Team Composite