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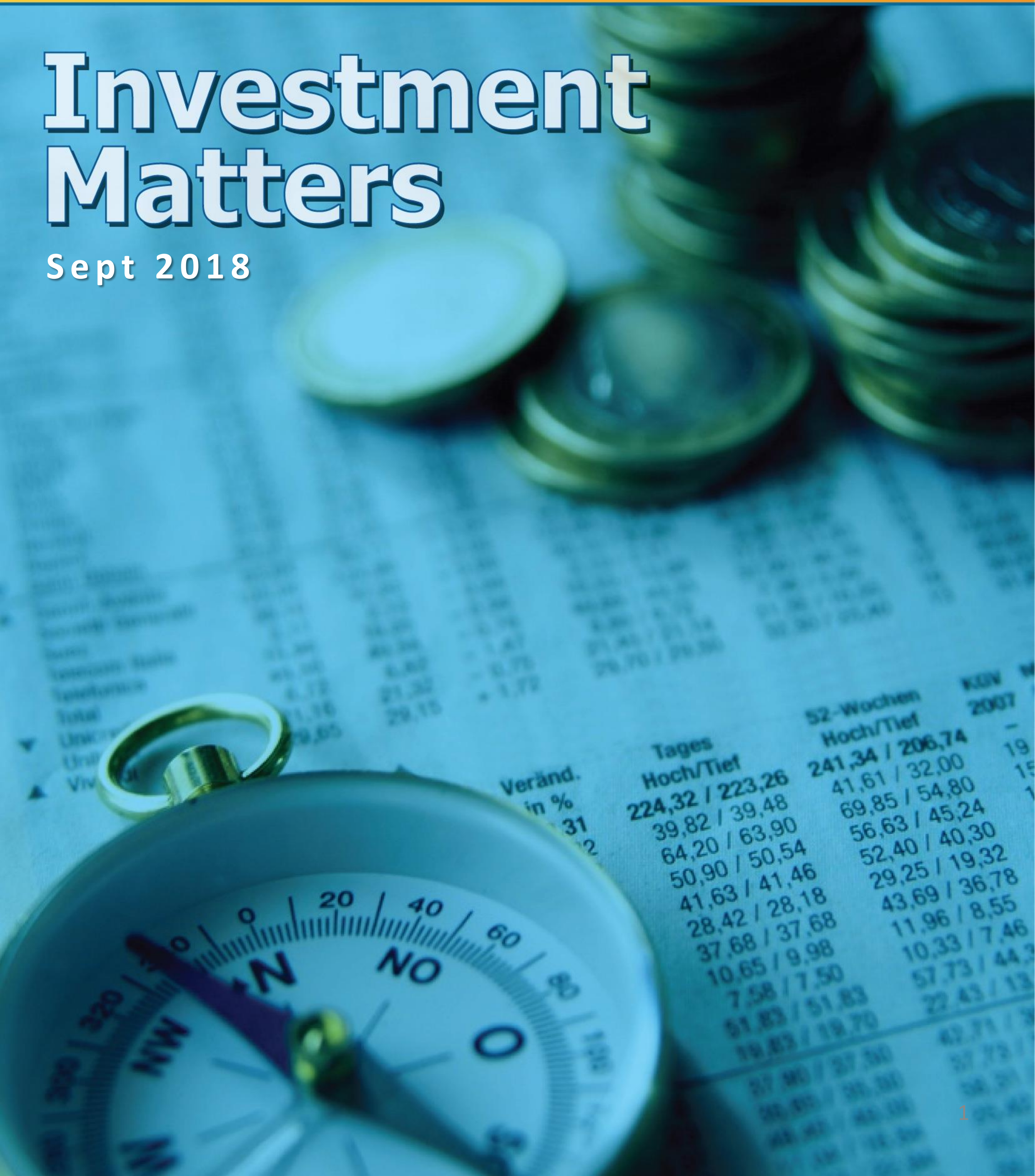
Investment Matters

Sept 2018



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EQUITY OUTLOOK

Wish you all a very warm and happy Janmashtami!

As I gather my thoughts to write this newsletter to you, out of my car window, I see a massive crowd gathered on the street. Most of them are in avatar of *Gopala* who will now come together to build 4-5 storey human structure to reach to Dahi-Handi hanging to a rope tied between the two buildings. The body language of the crowd is one of celebration and jubilation. There are no signs of any worries or despair on any of those faces. And that's the power of festivals in India.

India is a unique country in many ways but I think what most people have missed is the genius of our forefathers - a steady flow of festivals throughout the year. Each of our families and each of us at personal level go through difficult times. Festivals provide a natural way out of such pain, sorrow and despair. Festivals bring together friends and families who act as a springboard to keep our spirits high and provide us with constant supply of hope and happiness. At the same time, festivals lift up the economic activity. It boosts the consumption in multiple ways – Individuals and *Mandals* start making purchases either specific to each festival like dahi handis, Ganesh idols, kites, diyas etc or to celebrate the festival with preparation of specific food items, new clothes, painting & decorating the house or for gift purpose. In fact, sales for many industries including gold, cars and consumer durables rise substantially as people prefer to time these purchases on auspicious days.

So, as we enter the busiest festive calendar, I am keeping my fingers crossed wishing for a great festive season to all of us and the economy.

Market remains strong…but expensive and we remain steadfast

As we had expected in our July newsletter, Nifty50 and CNXMidcap continued to recover driven by strong earnings print for June'18 quarter and well supported by flows. Nifty50 for the month was up 2.9% while CNXMidcap gained a strong 5.5%.

In our portfolios also, we saw some notable movements with gains in LTTS (+20%), InfoEdge (+20%), DCAL (+15%), AshokLey (+15%), Varun (+9%) while HDFC Bank (-6%), Federal Bank (-10%), Thomas Cook (-5%), Kalpataru (-5%) turned out to be on the losing side.

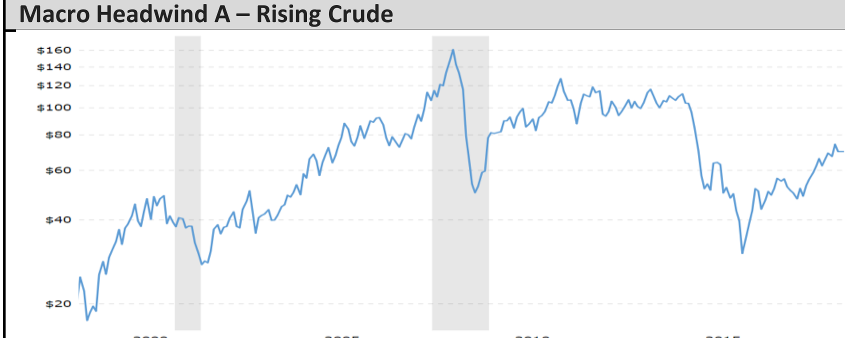
In line with our expectations, some signs of market differentiating between good, bad and ugly are quite evident. However, these are early days; macro challenges on rising inflation, weakening currency, rising interest rates are far from over and market continues to be top heavy with Nifty trading at trailing twelve-month price earnings ratio (P/E ttm) 28.1x, hardly any change from July end P/E (ttm) of (28.2). Whenever in the past, Nifty has seen such a high valuation it has corrected significantly ranging from 20% to 28%.

Despite such a high danger of market fall, we remain steadfast with our investments as we believe timing the market is a futile exercise. The best way to navigate tough economic periods and turbulent stocks markets is to ensure that you don't act in violation of your core investment philosophy or breach your sound investment process in a haste to position yourself tactically to benefit from short terms trends which would lure you to part with your hard-earned valuable capital. So, we have not participated in any of the Growth-to-Value trades (Consumer-to-Utilities, PvtBanks-to-CorpBanks) or Depreciating Fx Trades (IT/Pharma). Our stock selection remains bottom-up and strictly in line with our investment philosophy of buying into highly profitable strong business franchise led by able and honest management.

Giving a pass to current market trend means we might underperform in the short run but we are willing to trade short term under-performance to sustainable wealth creation in the long-run. In the following para you will notice how fruitful it is to avoid falling into trap of immediate gratification to build long term sustainable wealth.

How much should we fear about rising crude, rising inflation, rising rates and a falling currency?
A Lot! If you are a macro-hedge fund or a trader with short-term mindset. However, the empirical evidence suggests that there is no correlation between these macro variables and stock market performance or a negative impact on stronger individual businesses. The reason being i) the markets have a self-correcting mechanism to balance the impact in the long run and ii) macro variables impact equally to all the firms in an industry. So, to come up on the top, what an equity investor needed is an ability to not lose the far-sight and have a foresight to pick businesses which will not only survive but thrive during such economic headwinds as they further strengthen their competitive positioning. It's said that 'A picture is worth thousand words' and hence let me reproduce few graphs for you.

Macro Headwind A – Rising Crude



Impact in the long run

Nifty has gained 1306% since Nov 1998 while crude has been all over the places

- Up 3x from $18 to $49 during Nov'98-Nov'00
- 6x from $29 to $161 over Dec'01-Jun'08
- 2.5x from $49 to $127 over Jan'09-Apr'11

Macro Headwind B – Weakening Currency

Impact in the long run

Over 2008 to Sep'2018 as INR depreciated by over 70% from Rs40/USD to Rs72/USD, Nifty has gained over 160% to rise from 4360 to over 11500

Smart investors will notice that one need not go on producing such graphs for each of the multiple macro variable as the resulting long-term impact on the markets is the same. NIL. Our personal experience of managing personal money over 3 decades and clients' money over the last 16 years is no different. Hence, we will continue to stick to what has worked for us over the years – 1) Find great businesses 2) Ignore the noise and 3) Steadfastly hold on to these strong business franchises across the market/business cycles as long as our risk/reward metrics remain attractive. And what we will avoid is 1) to time the market 2) build short term tactical positions to dance to the tune of the market and iii) exit our winning positions due to fear of expected market falls.

One has to fight his own battle

In the last newsletter, I wrote to you, that a fund manager is only as good as his investors are. Let me extend this point even further, taking a leaf from teachings of Lord Sri Krishna. He himself was powerful enough to eradicate the entire *Kaurav Sena*, however, he firmly told *Arjuna* that he alone will have to fight his battle. The Lord was there to support him, guide him, however, Arjuna had to go through his own struggle to conquer his inhibitions, reservations and fears. Similarly, in life or investing, nobody else is going to achieve your dreams or financial goals for free. You will alone have to build the necessary repertoire, go through the pains and show the perseverance to walk the necessary path. The World's most famed investor, Warren Buffet has said that for successful investing temperament is more important than IQ. If you ask me, I would say its 70% about temperament and 30% intellect. ***And that 70% is the battle one has to fight for himself whether he is investing on his own or through a professional money manager.***

Amit Nadekar

Portfolio Manager
Alchemy Capital Management Pvt. Ltd

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Edited by: Sachin Pawar (Ph: +91-22-66171742)
Alchemy Capital Management Pvt. Ltd., B-4, Amerchand Mansion, 16 Madame Cama Road, Mumbai 400 001. Ph: +91-22-66171700
CIN- U67120MH1999PTC119811, Email ID: contactus@alchemycapital.com