

17-10-2019

*Dear Investor,*

*We are in an economic slowdown. Businesses - big ones listed in stock exchanges as well as small ones in the neighbourhood around us, are all feeling the pinch of it. The positive thing is that the government is acknowledging and acting – albeit on whatever limited ways that they can. There has been a course correction on most negatives of the July budget and there has been a big bang corporate tax cut – a relief to many companies both listed/unlisted in the near term and a structural reform that would benefit all companies in the long term. However, beyond this supply side reform, more action to boost demand is needed –personal income tax cut and aggressive divestment/privatisation of PSUs are the need of the hour.*

*Despite any regulatory action either on the monetary or fiscal front, economy would take time to recover from slowdowns. And till then the fear of apocalypse is likely to float around – after all fear like greed is an extreme emotion that needs time to recede.*

*Our pain – the absolute apathy by market participants to the universe of the companies in which we have been investing in and for which our clients have entrusted us the funds, continues. I repeat that most of the stocks in our portfolio are fundamentally strong and some of them are industry leaders with the potential to create wealth. I also admit that our investments based on changing India theme has backfired and the handful of stocks in which we took big concentrated bets haven't turned out the way we expected. We expect these stocks also to recover eventually, though whenever and wherever possible, we are booking losses in the ones with lowest prospects of recovery and redeploying the proceeds to other beaten down ideas with better visibility.*

*The small/midcap investing without doubt would continue to create the greatest number of multibaggers. But this comes with higher risks of failure as well. We have been operating in this space for the last 16 years and have seen a fair share of both sides. Over these years our success has depended on our ability to identify and invest in a greater number of multibaggers than the ones in which we have burnt our fingers. In every downturn like the ongoing one, despite our stock ideas being looked down and despised, our value investing approach has survived the test of fire.*

*Perception of quality in investing has always been a function of the stock price. Higher the perception, higher the valuation multiples. But often people forget the most cardinal principle in investing that everything in equities has a price. Quality is not immune to bubbles and at 70-80 PEs and 8-10 PBs we are most likely witnessing a bubble in quality stocks. Just like most investors overlooked the bubble in small/midcap space in late 2017, market participants knowingly or unknowingly are ignoring the ominous signs in blue chips now.*

*The current polarisation between quality and broader markets, with irrational valuations at both ends, cannot sustain – but how and when the normalisation would happen remains an open question. Till then we as value investors investing predominantly in small/midcap space have no option but to be resilient and bear the pain.*

*Porinju Veliyath*