21-04-2020

Dear Investor,

These are extraordinary times. We are living through an unprecedented global lockdown to overcome one of the greatest crisis of our generation. The corona pandemic has taken both our health and wealth hostage. We have no choice but to embrace the hard measures needed to contain the virus.

Severe social controls and lockdowns could continue till the number of new cases are under control and manageable within limits of our health systems. Even after, lighter control measures could remain till we find a vaccine or cure. This is going to be a long war.

The economic cost of the lockdown is huge. The world is in a recession, may be worser than during the global financial crisis. Both demand and supply will take time to recover to old levels. There is also an imminent global change in consumer behaviour. Financial year 2020-21 could be a lost year for many companies including some we have invested in. Though our exposure to sectors which would be impacted for an exceptionally long time like Aviation, Travel & Tourism and Real Estate are limited.

When will humanity overcome this crisis? Will the market go to new lows before the crisis ends? Nobody knows. I believe that we will overcome this challenge, capitalism will survive, and we are not headed for doomsday!

The world is reconsidering its overdependence on China for manufacturing. India's responsible handling of the pandemic and paracetamol diplomacy has raised our stakes as a dependable alternative manufacturing destination. We also benefit hugely from lower oil prices, enhanced global liquidity, and record low global interest rates. Much of the corporate clean-up has been done and our dependency on global supply chains is lesser compared to other countries. All positives.

Macro perspectives aside, let me also elaborate on Equity Intelligence's approach to the broader market selloff since 2018 and the ongoing corona crises. It is a well acknowledged and humbling fact that we have been amongst the worst, performing fund managers for the last two years. However, we were also a top performer in 12 out of 15 years since our inception before that. Does the last two bad years mean that our approach to value investing - exploring unidentified multibagger potential ideas in uncharted areas, is no longer valid?

Anyone who understands equity markets would acknowledge that two years is too small a time frame to write off any investment strategy. A typical equity market cycle lasts around 10 years. The bull market which culminated with this corona crisis was the longest one in history and had begun in 2008, just after the global financial crisis. Small and midcaps space which had a tremendous bull run for 5 years from 2013 to 2017 saw the pendulum swing to the other extreme in 2018 and 2019. Mean reversion, a thing of delight when it is in one's favour and one of stark realisations when it is against, remains a recurring phenomenon in market cycles. Styles and strategies in favour keep changing and it is not practical to expect all styles to perform in all market conditions.

Stating the fact that small and midcaps, the space where we invest was out of fancy for the last two years is not by any means to suggest that we have not made judgement errors with respect to stock selection. Of course, we have made mistakes, some costly ones and learned a lot of new lessons in the last two painful years. But does it mean that we should abandon our area of expertise and try out the hot strategies of the day? Certainly not.

Successful equity investing, simply put, is making enough and more money in successful ideas than you lose in unsuccessful ideas. It is a dynamic ever-evolving discipline where everyone makes mistakes. As practitioners of value investing in non-mainstream stocks, our returns would invariably see higher volatility. We have no choice but to live with this fact. In our pursuit of identifying multibaggers, few of our investments would result in permanent loss of capital. Our success, as history suggests, depends on realising enough gains from our big winners to compensate and outdo such losses from our failures.

Our forte is value investing in less explored areas, identifying multibagger potential ideas. We would continue to do that incorporating our new learnings. Expecting us to chase strategies like momentum, growth at any price or quality at unacceptable premium etc is unjustified. Our investors have entrusted their funds with us to endeavour for capital appreciation through our style of investing with a long-time horizon. Attempting to flip-flop with investment approaches would not be in anyone's interest – we would neither do justice to our own strengths nor to our investors.

Let me wind up by repeating few frequent points that we keep communicating with our investors.

- Ours is a long term buy and hold strategy. This means portfolio churning would be extremely low and we might continue to hold stocks if the potential for value unlocking remains. There are no stop losses in this strategy. We believe, a recovery in share prices is possible anytime as long as the investment thesis is valid.
- All stocks and portfolios are regularly monitored, and any restructuring required is done at the stock level or the portfolio level in its natural course

at the appropriate time. We believe that during challenging times, when scope for action is limited, often no action is the best action.

- Equity Intelligence is a boutique investment firm that approaches equity investing as a profession rather than as a business. So please bear with us for not soliciting funds and not having dedicated relationship managers who frequently update you on portfolio developments. All client communication from us would be on a need/response basis.
- Capital entrusted with us is meant for immediate equity investing based on our investment approach. Any cash holding in the portfolio would be based on the tactical calls we make assessing the available investment opportunities. For any strategic asset allocation decisions between asset classes or shifting between equity strategies or on market timing and remaining in cash, etc. please make your own calls or consult your financial advisor.
- We invest only in equities and due to the inherent volatility in equities, it is not possible to give any definite timeline or plan for recovery from drawdowns. However, longer the time horizon, higher the probability for meaningful recovery/outperformance compared to benchmark indices.
- We believe small/midcap investing has enough potential to compensate for the big drawdowns seen in last two years and outperform the indices in the long run. Most of our stocks are leaders in their own niche areas and has good value unlocking potential.

Be relaxed and calm. This is not the first bear market and won’t be the last one either. I have myself seen many bull/bear cycles over the last three decades, each one with its unique characteristics and challenges but all similar in skeleton and essence. Every bear phase of the past has set the base for the next bull run, without failure. If you think India would survive and overcome Corona then this is a big buying opportunity, with significant longer-term upside. This too shall pass, and good times would be back.

Discount sale in stock markets like the ongoing one happens only once in a decade. I suggest you use this opportunity productively. Nobody can time market. Invest in equities systematically, through us or not, I leave that call to your good judgement. I strongly feel, our under-performance as a fund manager has bottomed out. I would be disappointed if we don’t bounce back and start covering lost ground soon. Recovery from this bear phase would be a broad based one and value investing would gain back its glory eventually.

Tough times won’t last long, we will overcome this crisis too.

Stay safe and take care.

Porinju Veliyath