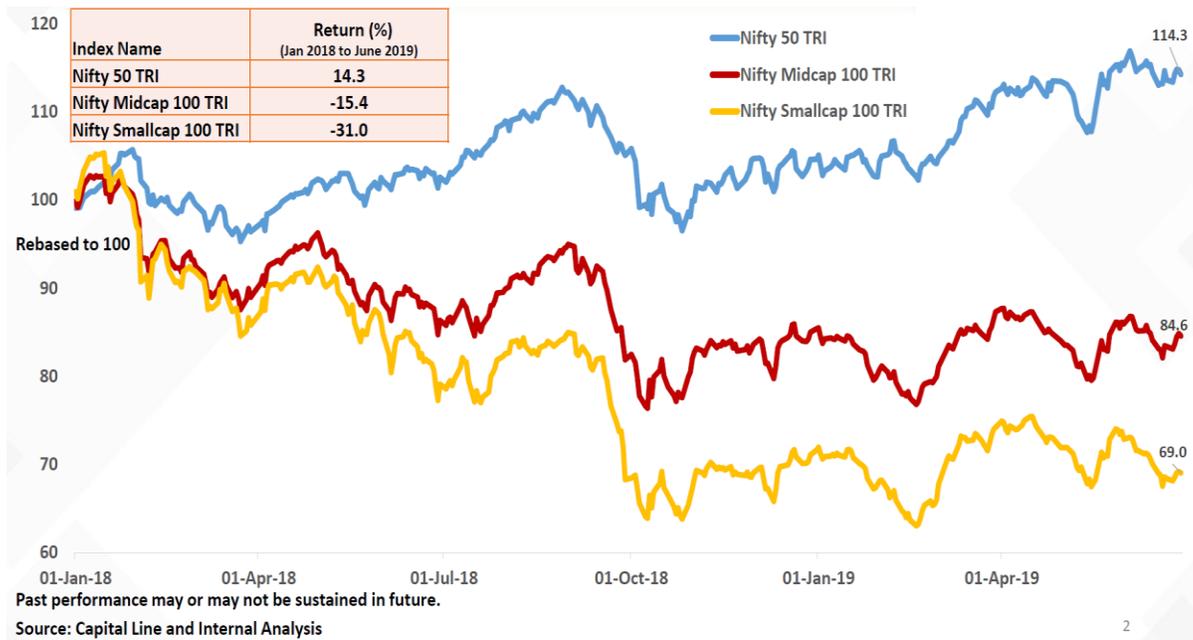


# 2019 Half-year Letter

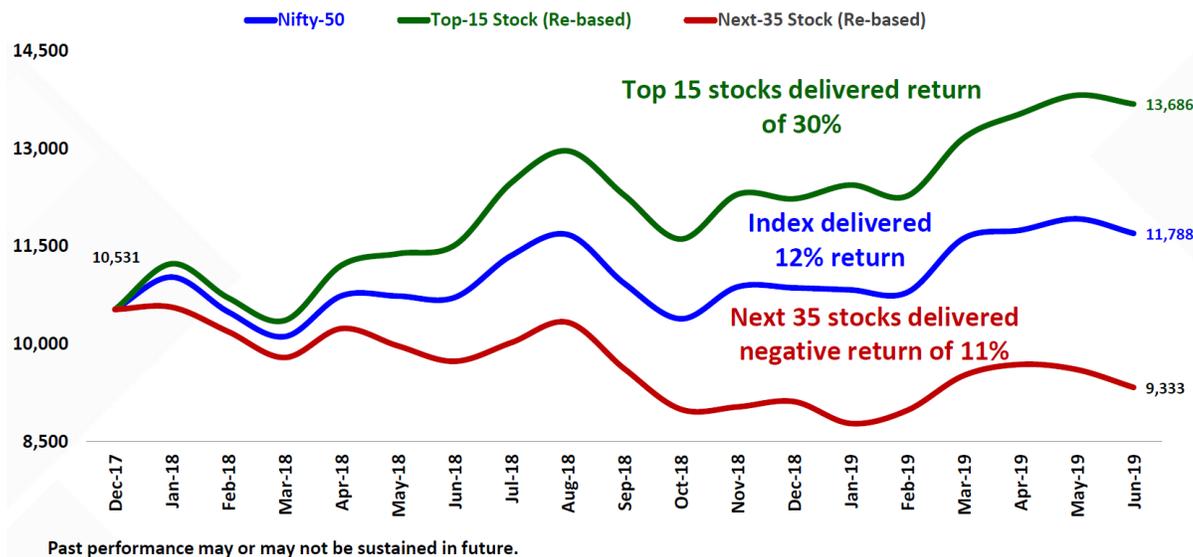
Dear Investor / Partner

Since 2018, Indian stock market has been a story of 2 caps!

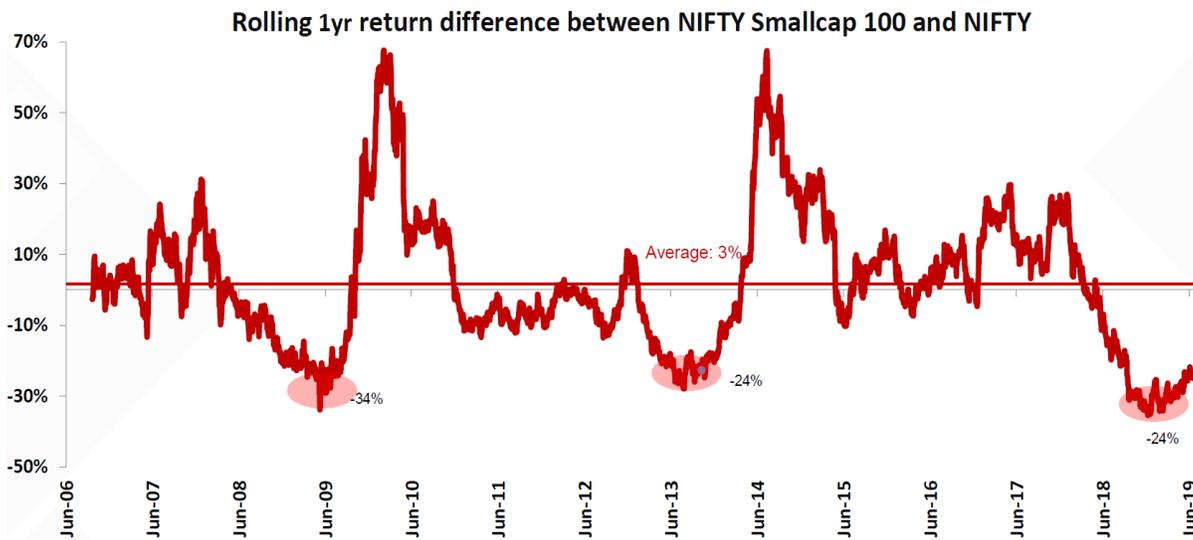
- Small and mid-cap stocks: Nifty small-cap is down 31%, Nifty mid-cap is down 15.5%
- Large-cap stocks: Nifty 50 is up 14.3%



Even within Nifty 50, only a small handful of stocks have driven the performance.



Given this sharp variation in performance, rolling 1 year difference between Nifty 100 small-cap and Nifty is at a decadal low.



Past performance may or may not be sustained in future.

While small and mid-cap indices have performed poorly, many individual stocks have seen worse performance. We think that these performances are being driven by investor psychology:

- Investors having taken 18 months of the pain are ready to throw-in the towel.
- Redemption from these portfolios is causing fund managers to sell these equities.
- Many of these stocks don't have deep markets and hence either buying or selling pressure can move the stock wildly.
- Selling is begetting more selling thus causing stock prices to fall.

## Future Expectations

For the first time in 5 years we are starting to see select equities at mouth-watering levels. Our crystal ball is hazy as ever. However, at current valuations we think that upside/downside ratio is squarely in our favor. This is the time to step up and take advantage of the opportunities that stock market is providing us. Some of the key tenets that guide as we step forward include:

- **Management is paramount:** We choose managements with the same care that we choose partners in our business.
- **Long-term orientation:** We think a few years out when other market participants are thinking a few months (or worse a few weeks) out. Thus, we can wait patiently for the value to come to us rather than worry about the daily moves in the market.
- **Pick the best risk/reward stocks from our investment universe:** We force rank all our ideas and will pick the best among them as per our investment process. This process has done very well for us in the past.

- **Select investor base judiciously:** Our investor base understands the value of compounding and let us follow our process. We are delighted with our investor base and we will continue to be selective as we work with the new ones.

To finish up this missive, here is a table that shows how the mid-cap and small-cap indices have performed after significant drawdown. While the past mayn't not be a good predictor of the future, it is a good prologue. The key takeaway is: **keep the faith!**

Mid-Cap returns				Small-Cap returns			
Years	Return	Next 1-Year	Next 3-Year CAGR	Years	Return	Next 1-Year	Next 3-Year CAGR
2001	-30%	24%	55%	2001	N/A	N/A	N/A
2008	-59%	99%	18%	2008	-71%	107%	17%
2011	-31%	39%	27%	2011	-34%	37%	25%
2018	-18%	?	?	2018	-32%	?	?

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*Postscript: All charts and tables in this letter have been taken from Kotak Mutual Fund presentation on mid caps and small caps*