Buoyant Capital

April 5th, 2020

Letter to investors: Update for year ended March 31, 2020

Dear Fellow Investors,

Let me start by paraphrasing what the great German philosopher Friedrich Nietzsche famously said – "*What doesn't kill you makes you stronger*." That, essentially, is the sentiment with which we are approaching the markets and portfolio construction as the world learns to cope up with the coronavirus and its associated social and economic costs. It's widely believed that 'the journey is more important than the destination'. However, on occasions as the time we are currently facing, we think that a sharper focus on 'the destination' will help us arrive there safely, and with the lesser pain.

In this newsletter, I intend to break down the discussion in three parts: (a) One: Markets: The Do's and Don'ts, (b) Two: How India is positioned and (c) lastly, how we are going about building a portfolio.

Indian announced a nationwide lockdown a couple of weeks ago, which will likely get extended by a few more weeks. In that scenario, in terms of economic costs alone, we are estimating the combined (center plus state) fiscal deficit would breach the 10% of GDP mark. In order to fund to INR18-20 trillion of deficit, the RBI may have to resort to monetizing the deficit (which involves printing currency notes and buying government bonds directly – instead of the indirect OMO/TLTRO route that it has been following for the last few years). RBI hasn't directly monetized the deficit in the last 23 years, a practice that was stopped in 1997 after an understanding between then RBI Governor C. Rangarajan and then Secretary in the Finance Ministry, Montek Singh Ahluwalia. This crisis therefore doesn't have a precedent in living memory which guides us on how best to navigate the challenge. Spanish flu in 1918 comes closest, but (a) it isn't in anyone's living memory and (b) the world was much rounder then (i.e. global trade was limited) and how that impacts economies is very different now versus a millenium ago.

Before we go on to the section, there is an important distinction we want to lay out. The current (or even the extension of) lockdown is really to beat the crisis, not the virus. From what we understand from various epidemiologists, the virus is here to stay with us for much longer, the crisis however will tide over at a certain point - as we develop immunity against the virus, or through a chance find of antiviral drug, or a probable vaccine in the next few months.

Then, lets discuss a general prescription of Do's and Don'ts before we move on:

DOs

- Coming out of the crisis, the idea is to identify businesses and companies that emerge stronger (from a balance sheet perspective, or a relative competition standpoint etc.).
- Secondly, although the precedent isn't available on a global scale, different countries are peaking in crisis at different points. Consumer behavior - during partial/total lockdown, and once the lockdown is lifted is presenting very valuable insights on how it might shape India's recovery, and
- Thirdly, lockdown as long as the one we saw could be habit changing. Would it lead to more people working from home? Lesser demand for alcohol or cigarettes? Would it lead to down-trading, the reverse of premization trend we have seen for over a decade in India now.

DON'Ts

- Firstly, don't confuse market prices as the true value of the business you own. In crises, marginal sellers set prices, and the majority's opinion has limited impact over the short run. Don't get disheartened by the MTM value of your portfolio. Think ONLY in terms of taking the right incremental decisions,
- Don't focus on the noise, instead - focus on fundamentals. Stocks that have held up very well in the crisis, might not be the best investments as we come out of it, and
- Lastly, try and not to time investments based on market feedback - i.e. start investing when markets are up, and start selling when they are down. Invest your time in identifying what business will survive, work out the best price you are willing to pay for it, and WAIT. As Buffett said: 'Activity can be the enemy of investment returns.'

Now. coming to the second part: How do we think India is positioned?

- Although Coronavirus has garnered a higher mindshare, to us, the steep fall in crude-oil prices is far more important. We think that crude will be lower for longer. Whereas, the negative impact of coronavirus is more near-term, the positive impact for lower crude oil prices (even adjusting for lower remittances) will both be more meaningful (to current account, BoP, government finances, and inflation) as well as enduring,
- Secondly, as a fall out of the virus, the global trade will likely shift as companies think of life-cycle costing, rather than just lower unitary costs today. This will likely move supply chains away from China, and India might have a serious shot in some areas,
- In the aspect above, India's strength (i.e. abundant english speaking engineering background pool) is unlikely to be replaced by countries offering to do it at lower costs. India can gnaw at their markets, while protecting its own turf.
- Lastly, India has traditionally been a savings economy. Yes, the savings rate has come off in the last decade, but, at the household level, India is not leveraged unlike some western countries. Indian consumption will likely normalize faster once the fog clears.

Onto the last part then: How are we going about creating a portfolio

- The broad idea is still to own businesses with a strong balance sheet in the portfolio. As I said earlier, the businesses that come out of this crisis will likely have lower fixed costs, stronger balance-sheets, accompanied by weakening competition.
- The first instinct is to find 'antifragile' companies (i.e. ones that benefit from the virus). Within that bucket, businesses that manufacture pharmaceutical APIs are worth a lot less to us, compared to some companies that provide 'manned guarding' - the longevity of the latter business is higher.
- Within consumption itself, there are some areas that will take a longer to revive (i.e. Travel and hospitality, aviation, multiplexes and discretionary spends), but some might revive much sooner (i.e. Retail, QSR etc). Also, governments around the world might try and boost investment spending; related sectors (like cement) might do well.
- With Central banks infusing liquidity, some global commodities (i.e Metals) would get interesting at some point.
- Lot of bad businesses are down 25-50%, but a lot of good businesses are also down by similar quantum. Use this time to correct mistakes. If you know a business you are invested in is bad, don't wait for it to come back to your buying price. Book losses now, and invest in good business, even if it hasn't fallen as much as your investment.
- Lastly, it is pertinent to remember that each crisis alters the economic fabric. Many companies simply don't make a come-back. Investing in them, whatever the valuation continues to remain a mistake.

Let me end this by saying that times are challenging and we are in waters that are unchartered. But, like fundamentals, the investing wisdom passed on from generations doesn't change very often. Just like we are watchful of building resilience against the virus, we owe an equal duty to keeping emotions in check and building an equally resilient investment approach.

The performance of various periods since inception is listed in the table below.

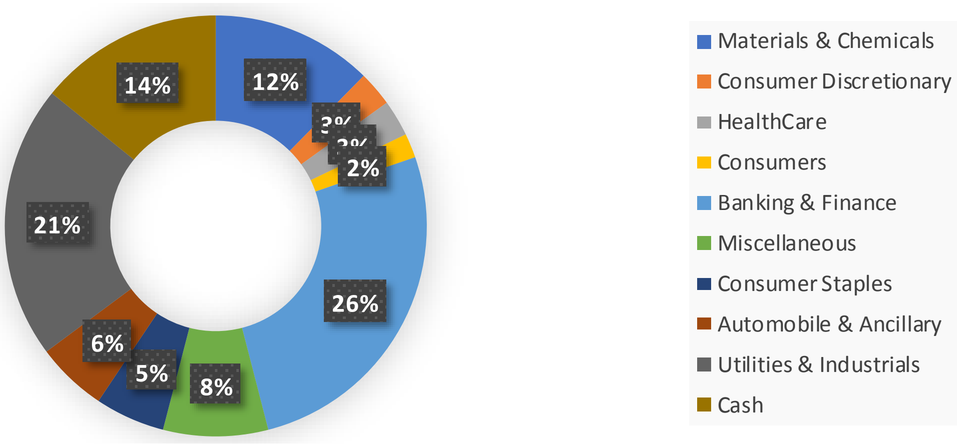
Total returns (%)	Buoyant Portfolio*	BSE 100 Index	Nifty 50 Index	BSE 500 Index	BSE SmallCap
Since inception (1st June 2016 to date) - CAGR	0.9%	1.2%	1.4%	0.8%	-3.8%
Last three years - CAGR	-5.8%	1.6%	1.8%	1.0%	-4.8%
Last one year	-40.8%	-26.6%	-26.0%	-27.5%	-36.1%
Last six months	-35.9%	-25.1%	-25.1%	-25.1%	-27.1%
Last three months	-41.5%	-29.2%	-29.3%	-29.2%	-29.9%
Last month	-40.6%	-23.2%	-23.2%	-24.1%	-29.9%

Source: Bloomberg for Indices. Buoyant Portfolio is **POST**-fees and expenses. More than one year returns are annualized

See disclaimers at end on how Buoyant Portfolio returns are calculated

Buoyant's average cash position for the quarter stood at c10%. The composite performance above is average across all client portfolios and individual returns will differ due to variations in holdings, the subscription timing and other client-specific circumstances (as mentioned in disclosures on page 5). You should have received your individual account statements via email by now. Please get in touch with us with questions, if any.

Portfolio composition



Top holdings: ICICI Bank, SIS, Welspun Corporation

Buoyant Investors: Thank you!

As always, we would like to thank all of you for your investment and partnership with Buoyant Capital. Your collective belief in our ability to make right investment decisions, your support and patience at testing times and your overall emotional stability are extremely valuable to us. We wish and hope for our continued and lasting partnership in coming times.

Regards,

Jigar Mistry, for Buoyant Capital

Disclaimers

Average returns are calculated across all the client accounts (aggregate portfolio) based on underlying data provided to us by Kotak Mahindra Bank's Fund Accounting team – the designated fund accounting partner. Returns are not audited. Individual returns will differ from the average returns presented in this note depending on the composition of portfolio, timing of deposit, withdrawals and fee structure specific to each account. Please contact either of us with any questions about your statement, returns, fees or anything else related to your account.

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