12th April, 2018

Aurum Small Cap Opportunities & Aurum Growth

21st Quarterly Portfolio Update – QE March 2018

Dear Investor,

As I write this quarterly communique, the world seems to be going through a tumultuous phase. Possibility of trade war between US & China, diplomatic isolation of Russia & cold war fears thereof, speculation over velocity of interest rate hikes by US Fed, Mueller investigation (into manipulation of US elections) leading almost to Trump's doorstep, Facebook under fire from Governments all over the world for serious privacy breach and China continuing to flex its muscles in South China Sea. On the other hand, there are water shed events playing out that give us a sense of optimism too – the rapid pace of social reforms in Saudi Arabia, Trump's willingness to talk to the 'rocket man' of North Korea and continued commitment to address Climate Change by rest of the world despite US pull out.

At home too, we have seen a fair bit of positives. Complete fading off of the 'slowdown effect' induced by Demonetization & GST, possible bottoming out of corporate earnings cycle, successful launch of the International Solar Alliance, some NCLT (banking NPA) resolutions, amongst others. However, the one big risk factor playing on the minds of many, including some of our existing and prospective clients is, '*What happens to the markets, against all expectations, if there is a political regime change in 2019? What if a weak coalition Govt comes to power?*'

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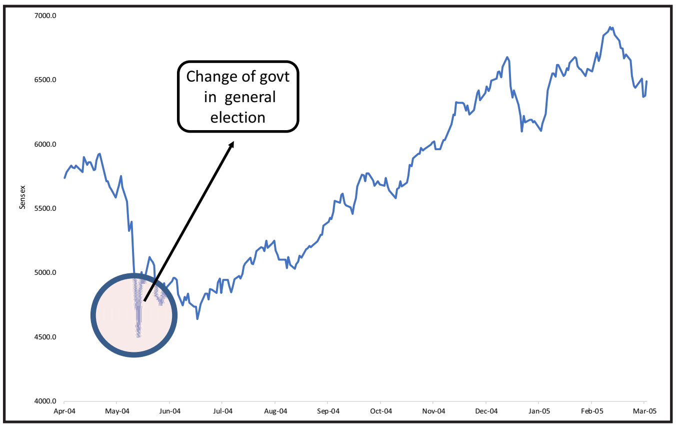
History holds the clue

We felt that it would be a worthwhile exercise to look into history to gather clues as to how markets behaved in the past when such a shock event took place. We went back to May 2004 **(Figure 1)**, wherein against all expectations, there was a sudden regime change and resultantly the broader market hit the lower circuit out of sheer 'shock'.

Figure 1 : 2004, NDA Govt. loses general elections



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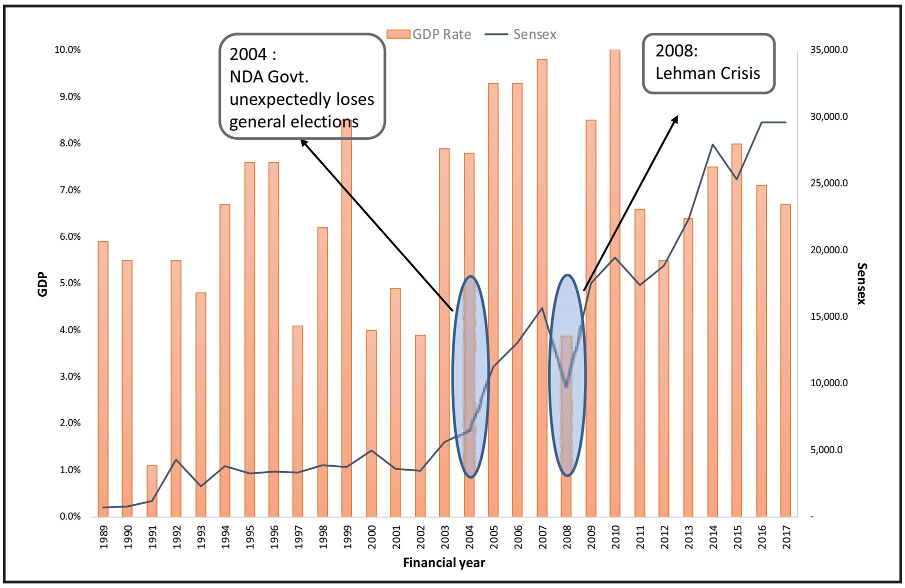
However, this shock phase of the market was quite short lived and thereafter we witnessed an unparalleled rally in the markets from 2004 to 2007 **(Figure 2)** before the markets corrected, triggered by the Lehman crisis.

Figure 2 : Continued GDP growth post 2004 elections & across different political dispensations (1989- 2017)



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The conclusion, we draw from these events (2004 & 2008) is that, ultimately, corporate earnings drive markets regardless of the ruling dispensation. In the very short term, however, political events do play on the sentiments of the market participants leading to market swinging both sides. In a role reversal of May 2004, in May 2014, a robust win by the current political regime lead to needless exuberance in the market, that had to be later toned down.

Therefore, we shouldn't be too worried of the political outcome of 2019 (or may be end 2018!) and focus our attention on the economy and its resultant effect on corporate earnings. That would help us take a better call on the broad direction of the markets in next few years.

How does the macro-economic outlook for India look?

Small hiccups notwithstanding, we believe our macro-economic outlook for next 3-5 years is quite robust on account of the following factors:

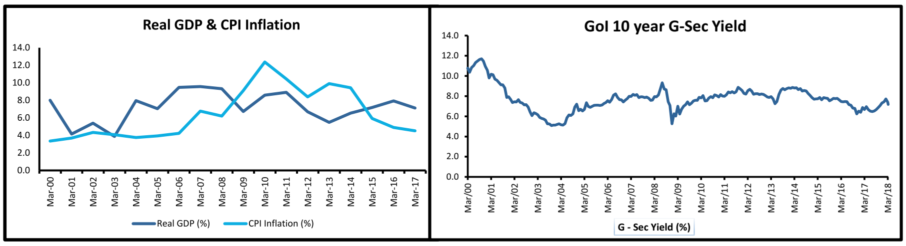
1) **GDP accretive factors triggered by DeMo & GST playing out well** – The transition from informal to formal economy, that DeMo triggered and further powered by GST implementation, is expected to continue and last for a couple of more years. Further, longer term benefits of GST (by way of significant reduction in logistics cost and improvement in operational efficiency) will also start kicking in and its full effect is expected to play out over the next 3-5 years.

2) **Oil prices expected to remain in our 'comfort' zone** – One key risk to India's economic growth can come from rising oil prices. In recent times, Brent crude shot up to ~US$ 70 a barrel but could not hold up and the same has corrected again to ~US$ 65 per barrel. We believe, the current spike in oil prices is more due to speculative reasons and is unlikely to sustain. With US become a net crude exporter, OPEC production cuts not really working out and a huge new discovery of 80 bn barrels of oil in Bahrain, prices are expected to remain benign. Further, the build of renewable energy capacities continues at a brisk pace worldwide, including India and that bodes well to keep oil prices under check. Barring a major disruption in oil supplies due to conflicts in the Middle East, we believe oil prices should not be a worry for India.

3) **Private Sector Capex finally picking up** – As already mentioned in our last quarterly update, our ground research suggests gradual pick up of private sector capex and the same is now gathering pace. Alongside robust Government spending on infrastructure building (roads, railways, defence), buoyancy in private sector capex augurs well for corporate earnings.

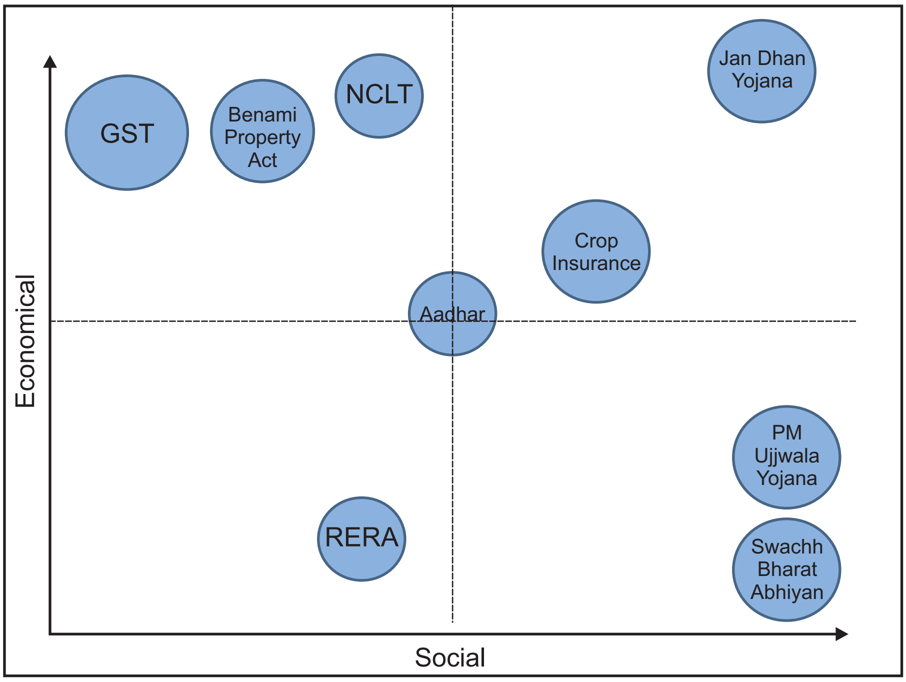
4) **Domestic inflation and interest rates likely to remain benign** – The fear of inflation going out of control, as articulated by some economists, seem to be overstated in the current environment. As can be seen from **Figure 3** below, inflation and interest rates remain under check and are expected to remain benign. Expectations of a normal monsoon and benign oil prices provide further comfort on this front.

Figure 3: Benign interest rates likely to continue to support GDP growth



5) **Progressive socio economic policies and regulations in place** – Assuming, there is a regime change in next elections, it seems unlikely that there will be a backtracking of progressive legislations introduced/implemented or reversal of the technological enabled transparent ways of doing business that have been introduced by the current regime. **Figure 4** captures the universe of forward looking regulations and policies that have been introduced or implemented.

Figure 4: Socio- Economic regulations & policies initiated by Govt.



In conclusion, we believe that on the back of robust economic growth, our markets are expected to do well in the coming 3-5 years. However we may witness increased volatility in the next 12 months as we get closer to the general elections. Continuing to selectively invest in good quality businesses at reasonable valuations is an apt strategy to ride this phase of the market.

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