The previous quarter (Jan-Mar 2020) has had far reaching and global impact across businesses and earnings. The Indian economy was coming off multiple years of low growth across sectors heading into the end of 2019. However, with businesses getting impacted due to Covid-19, the global supply chain across industries have come to a standstill.

It is easy for the volatility of one's thinking to match the volatility of the prevailing conditions. Time horizons have shorted to the extent that the usual market close in the evening seems to many like a long-term commitment.

To maintain a truly longer-term view of businesses, investors must be willing to experience near term drawdowns in their portfolio. This is inherently the core nature of equity investing towards wealth creation, which cannot be avoided. The ability to remain an investor (and not become a trader or a by-stander) confers an unprecedented advantage in this environment. The problem for an investor, is that this perspective will seem more of a curse than a blessing, till the fall in the market ends and some semblance of stability is restored.

One of the reasons, an environment like this is challenging to deal with, is the unprecedented nature of the business impact that we are dealt with and the second order effects it has on consumption, spending, saving and growth.

The greatest challenge of investing in this environment is neither the punishing price declines nor the extraordinary volatility. Rather it is the sharp declining economy which makes the analysis of company fundamentals that much harder. When fear sets in, it is crucial to distinguish the legitimate factors from extreme overreaction. At Itus, we are constantly on the lookout for such overreactions, especially when it happens in well run companies. Here again, there is an element of analysis, and comfort in the business model that comes about in the decision making – and I will explain the same with two examples – both of which are well run companies.

We own HDFC Bank in our portfolio, and we have owned it for a while now. Considering the stress the recent set of events will throw to the retail customer base, financial services across the board have been affected pricing in two unknowns – increase in the NPA of the existing customer base, and lower growth in the lending practices of most financial services companies. However, our view continues to be that, when fear sets in, customers first look for safety. Today, its this exact safety that HDFC Bank provides, considering the experience of Yes Bank is fresh in the minds of many. We continue to believe that HDFC Bank will be the beneficiary of this over the next few years, though the near-term headwinds for the industry are real. With this as the base case, we continue to add exposure to HDFC Bank in the fall.

Another extremely well-run company, which has created immense wealth for its shareholders in the last 10 years has been Bajaj Finance. Its loan book continues to be extremely diversified and granular – though the growth the company showed on a qoq and yoy basis was next to extraordinary, we did not want to own the business for two reasons

a) The valuation the market paid for the business was too expensive

b) The growth slowdown in the economy was real, but that did not get translated into the company numbers.
c) The company still does not have access to cheap CASA for it to rely on during times of a slowdown.

As the environment changed, our view remained that the risks to the business was increasing. In this market, where the pain across retail and businesses are real, we do not still own the business for the above reasons. The reason to bring up Bajaj Finance was to explain a phenomenally well-run company, that we do not own despite the 50% fall in valuations, as the business model comfort for us, does not exist.

The Slowdown

There have been days where fear has completely taken over the market. While the market fundamentals remain bleak, the moment will arrive when some of the cash will creep back into the markets, rejecting the low rate yields environment we are in globally (with India on its way there too). As 2020 gets underway, we expect a steady diet of bear market rallies and volatility, as economic woes and the continuous deleveraging cycle that most businesses were in, will oscillate the environment between greed and fear.

Timing the Market

While Itus has built a few new positions in the first quarter of 2020, it is always tempting to try and time the market, and wait for the bottom to be reached, such a strategy has proven to be deeply flawed over time. More often, many of the price movements at the bottom, happen on very low volumes, and many of the movements are violent in swings. A more prudent strategy to adopt is to buy good businesses amidst the bear market, anticipating that things will likely get worse before they get better, but with the comfort that they are getting good quality businesses at reasonably / low priced valuations.

Focus on the process, the outcome follows

Successful investing, as in life, requires resolve. When investing in the middle of a bear market, one has to be able to stand their ground and hold themselves accountable for every decision as the investors want to know what's happening to the money. Successful investing also requires an openness, and an ability to be flexible around the views one holds in the market. You can never be sure of the growth of the business, let alone the economy or whether a particular investment will turn out to be successful or not. However, a healthy uncertainty drives the quest for justifiable conviction. While we could be wrong, it's the flexible mindset that will help us sail through periods of uncertainty. In todays environment, the only thing we control are investment philosophy, investing process and a focus on the long term.

The quarter that was

There were a few investments we made into new portfolios of Itus as we look to position our portfolio in the new environment we are in – where we believe businesses that come out of this uncertainty have the following characteristics

a) Low debt on its balance sheet
b) Ability to ride through a growth slowdown
c) Historically has grown their business through internal free cash flows

We have taken a new exposure in HDFC Life in our portfolio and also added Whirlpool to our investment portfolio. We believe that both businesses display characteristics we look for in our investment portfolio and are primed to come out of the current environment stronger. As a result of the rejig, our current portfolio shape, represented by market cap is as below:

Sector	% Allocation
BANKING &FINANCE	26.7%
TYRES	3.8%
FINANCIAL SERVICES	8.7%
INSURANCE	7.1%
REAL ESTATE	1.8%
SOFTWARE	6.5%
MISCELLANEOUS	20.8%
CIGARETTES & TOBACCO	5.7%
CONSUMER DURABLE	5.6%
MEDIA	1.6%
DIVERSIFIED	6.1%
CASH AND CASH EQUIVALENTS	5.7%

Please feel free to contact us, if you like the complete portfolio of ours, and we would be happy to share the same.

FUND RETURN SINCE INCEPTION:

Year	2017	2018	2019	2020
Fund Return (After Fees)	55.1%	-8.4%	18.8%	-19.03%
Nifty (Benchmark)	28.65%	2.6%	12.1%	-30.34%

The main fund has compounded wealth at an IRR of 10.1% vs the Nifty 50 Benchmark at 0.9% (Since 2017). Over the same period the Midcap and Small Cap Indices have delivered negative returns on a cumulative basis for the investors.