Dear Shareholders and Investors,

Inflationary Boom – Is this the cycle we are in

As we finish the financial year (FY23-24), the equity markets globally continue to be strong. Flows and investments in the market have always chased past returns and this cycle is no different with an increased penchant to take risk across the board measured by the number of demat accounts, options volume, number of IPOs reaching an all-time high. While it is easy to call markets expensive and speak about discipline, this will miss the bigger picture around where we are in the cycle, notwithstanding, adding very little value to the reader.

Fig 1: India fundamentals are strong today which is reflected in the valuations.

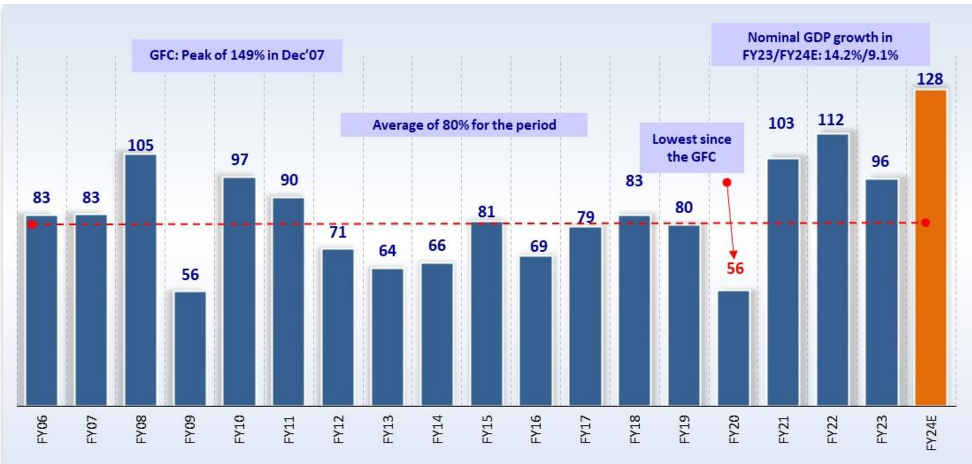
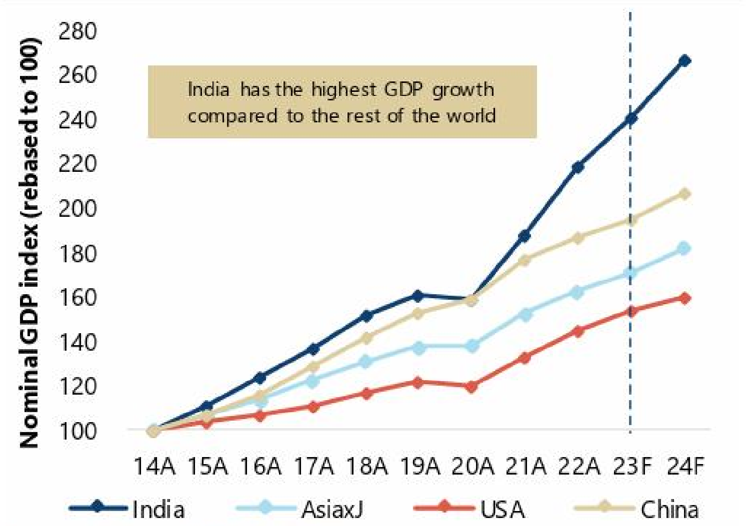


Exhibit 2: India vs USA/AxJ/China – Nominal GDP growth



Source: Jefferies, IMF, FactSet

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India has always been a market which has the potential to give a strong GDP growth, which in turn translates to a base case expectation of nominal returns annualizing at 12% over a 5-year cycle. Considering that our GDP growth continues to be robust, the markets have discounted this in the valuation from the viewpoint of broad averages (The market will continue to be an efficient discounting mechanism from an average point of view – reflected in the market cap of the broad index). Today, an investor is going to find it hard to construct portfolios from the point of view of absolute cheapness in the market (that would have been a potential conversation 3 years back as we were coming out of covid). Considering valuation is not the lever we can look at for margin of safety, it is important to look at the first principles on where the growth is strong and continues to be from a visibility perspective over the next cycle.

What makes for interesting thinking is the next chart which indicates the absolute and relative growth in the earnings that has driven the returns in the country in this cycle. It is always comforting when the returns of the portfolio are driven by earnings growth than PE expansion (the latter being driven by cycles).

Fig 2: Earnings growth of Corporate India relative to the large economies.

Source: Jefferies, Refinitiv Eikon Datastream

Considering that valuations are not the lever for margin of safety, there are two attributes that become non-negotiable in the portfolio construction today: a) Earnings growth and its sustainability b) Margin expansion and pricing power.

Today, our go-to levers in the portfolio construct are earnings growth and margin profile trend. We do not want to compromise on the two as these would act as a natural cushion during volatility. An analysis of the Dec quarter earnings (the recent quarter gone by 3QFY24 earnings) shows us the areas of strength from a sectoral perspective and the areas where there continue to be headwinds today (Table 1 Below).

Table 1 : Sectoral view of the earnings and our positioning

	Earnings Growth	Margins	Valuation (10 Y cycle)	Our positioning and Thoughts
Auto	17-18%	Expanding	Median end of 10Y range	We are currently in the 3rd year of the cycle. Bottom up positioning becomes extremely important
IT	4-6%	Expanding	Median end of the range	Do not see levers for growth yet. Continue to not position here
Pharma	11-12%	Expanding	Not expensive	Continue to show signs of volume growth , overweight here
FMCG	4-5%	Expanding	Expensive	Bottom-up opportunities exist, we continue to be underweight
Consumer Discretionary	30%	Decreasing but on a strong base	Higher end of the range	Difficult to find bottom-up opportunities here where we continue to see visibility of growth at a 20%+ number to justify the valuations
Banking	15-16%	RoA compression	Lower than the median	While banking looks reasonably priced, we continue to be underweight, as margin pressure should continue
Non Lending Financials	28%	Expanding	Higher end of the range	Markets doing well is reflected in the valuations. PE has expanded over the last 10 quarters and we do not find any margin of safety
Logistics	28-30%	Expanding	Median end of the range	With GDP expansion, we continue to be selective in positioning portfolios here
Building Materials	8-10%	Expanding	Median end of the range	Have trimmed our exposure here. Market share growth for many of the companies is yet to be seen though the real estate cycle is robust
Real Estate	19-21%	Expanding	Higher end of the range	We have been underweight the space, and should have positioned better. At todays valuation to buy does not provide room for error
Capital Goods	10-12%	Expanding	Median - Higher end of the range	Continue to look for bottom up opportunities

PS: We have not included sectors above where we have no positions on like Chemicals, NBFCs, Hospitals & Diagnostics etc.

Additionally, one sector where we should have positioned better is Hotels where we see visibility of growth, but the valuations are expensive today.

Valuations tend to act as a gravity effect to stock price returns – higher the valuations, the more common perception is, easier the possibility to derate and hence generate poor returns. While the statement is broadly true, what does not take into effect is the longevity of growth. Hence valuation can never be an absolute number but must be looked at from a relative context, because growth is linked to the same. To understand the significance of this, it would make sense to delve into the previous cycle (between 2010-2020) where there were a few sectors that showed structural growth and margin expansion (FMCG, Consumer and Banking). These sectors grew at a nominal 13% growth, but more importantly continued to protect or expand margins through most part of the decade. In comparison, because the GDP during the same cycle grew only by 3.6%, the market priced the former with significantly higher valuations (due to relatively higher growth). These continued to be expensive for most part of the decade. (The FMCG sector was priced at a multiple of 28 in 2010 and the same sector was priced at a TTM multiple of 72 in 2020). Purely focusing on the valuations would have ensured that an investor missed the bigger picture on the market microstructure and growth and hence meant a poor investor return if valuations were the only driver to invest.

Today, as we are in the middle stages of a new cycle, I see similar characteristics (of growth and margins) with the GDP facing sectors of the economy where the valuations would not be cheap, especially from a 10Y historical perspective. The important question to think about and monitor though, would be the sustainability of the earnings growth. I continue to maintain that these sectors would continue to be beneficiaries this cycle and our positioning in portfolios would reflect that. I would continue to focus on their margins and maintain that this cycle should see these companies having a better pricing power to protect them (this was one characteristic that was missing in these companies in the previous cycle between 2010 and 2020).

How does this translate into our sector positioning today?

The table below gives a detailed breakdown of our positioning vs the index today. There is a significant deviation in our positioning across sectors and this decision is a conscious one from a top-down perspective basis our view on growth and where we see sustainability of future growth (Table 2 Below) .

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Table 2: Index Weights vs Itus Weights across the key sectors broken down by allocation.

Sector	Index Weight	Itus Portfolio
Banks	27.6%	7.5%
IT	13.5%	5.5%
Oil & Gas	11.9%	2.5%
FMCG	9.4%	4.5%
Auto & Auto Components	7.3%	20.2%
Telecom	3.0%	
Power	2.9%	5.0%
Capital Goods	2.0%	9.5%
Pharma & Healthcare	3.7%	6.5%

Though we are benchmarked, and our objective is to beat the benchmark on a consistent basis, we believe that positioning our portfolio in the right cycle is an important aspect of portfolio performance over any long-term period. Any changes we make to our portfolio positioning will be a function of the growth and changes in the macro environment we foresee. There will always be stock specific additions which we would make from time to time, from a bottom-up perspective, but this will not change our sector bias from an overall perspective.

Our Return & Portfolio Profile – Mar 2024

At Itus, our fund has delivered an IRR since inception (Annualized) of 20.1% (net of fees) (Jan 17 – Mar 2024) as against Nifty which has delivered an IRR (Annualized) of 16.2% over the same period. This healthy outperformance of 4.9% (since inception CAGR) is net of fees and expenses. The detailed performance of our fund is shown below in the table in a granular form:

Table 3: Breakdown of CY returns of the fund vs Nifty 50 on a yearly basis since inception of the fund

As I have written in the past, and at the cost of repeating myself, my focus continues to be on maintaining the liquidity of the portfolio and managing the downside from a risk-reward perspective. While we have increased our allocation to large caps over the last 4 months, we recently asked investors to potentially look at adding capital into the portfolios. The basis for the addition (call for capital) was to increase our 2W exposure in the portfolio where we see bottom-up risk-reward and to increase our pharma exposure. These are stock specific opportunities we are adding risk to. We would continue to want to maintain marginal cash in all portfolios for volatility into the year.

Today, the weighted average market cap of our portfolio is INR 1,35,000 Cr (USD 180 bn), which reflects our bias towards where we want to position ourselves from a liquidity perspective.

Portfolio Health and Its Measure

	Fund (%)	Benchmark - Nifty 50 TRI (%)
2024	1.15%	2.92%
2023	25.35%	21.30%
2022	-2.83%	5.69%
2021	29.26%	25.59%
2020	40.32%	16.14%
2019	17.31%	13.48%
2018	-7.31%	4.64%
2017	54.66%	30.27%
Since Inception (Cumulative)	275.82%	197.70%

The portfolio continues to have a strong earnings trajectory expanding the EPS by 18.4% on a yoy basis. As of the Dec 2024 (3QFY24) quarter, the health of the portfolio as measured by the earnings growth and the Return on capital is as shown below.

Portfolio Metrics	**ITUS (Rolling 4Q)**
GP Margin (TTM)	*54.7%*
ROCE (TTM)	*20.9%*

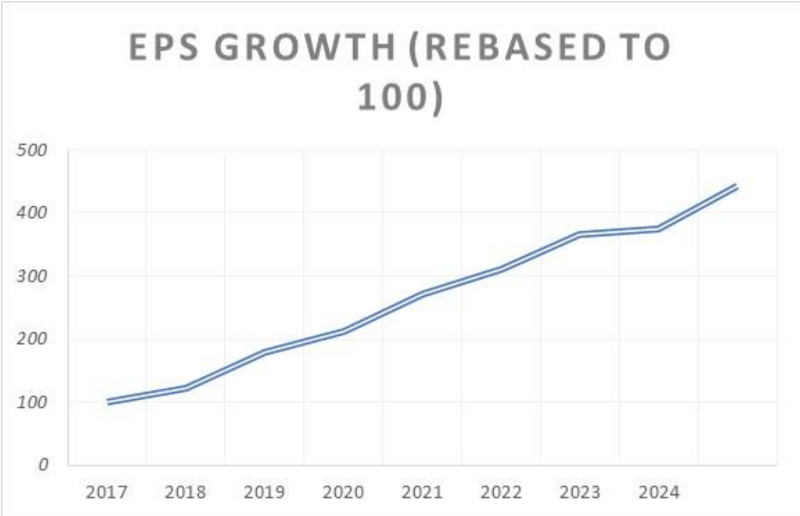
Our endeavor has been to construct portfolios to monitor the trend of the GP margin and ensure that the portfolio's margins stay on an upward trajectory which translates into a higher RoCE over time. Typically, doing this consistently means that one tends to overpay for these metrics (because getting growth cheap does not happen consistently over time). This is what we tend to avoid by measuring the multiple at which we own businesses and ensuring that the portfolio's PEG does not cross 2 through any point in time (currently this is at 1.55).

As we go into FY24-25, earnings and margins will be the key drivers of how we would want to construct portfolios. While valuations are not cheap today, it does not mean that opportunities do not exist. Today, more than ever, our starting point is going to be, how do we minimize our risk and drawdowns if we get the macro and volatility wrong, rather than looking at maximizing returns.

If we look at our portfolio since inception, there are two characteristics that has stood out:

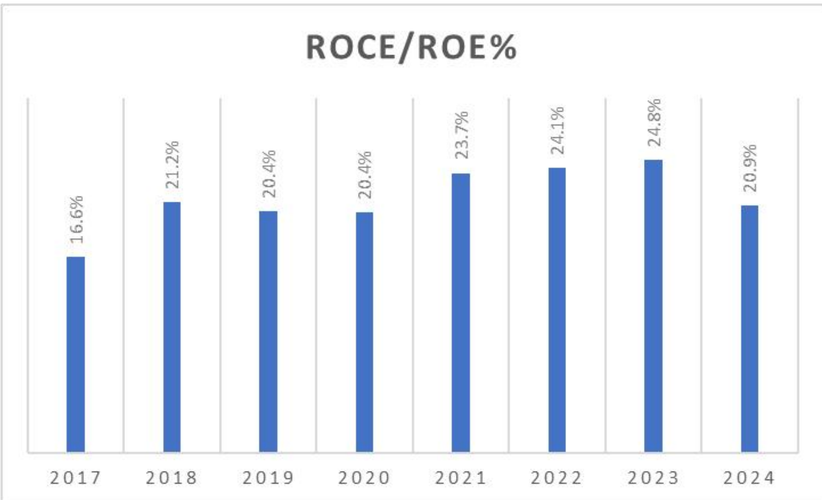
a) Strong Return on Capital since inception
b) Strong earnings growth at the portfolio level

Fig 3: Cumulative earnings growth of the portfolio since inception



The above figure gives a breakdown of the earnings growth of the portfolio since inception which cumulates to a total of 342% since 2017. Our cumulative returns since inception is at 275%, which gives a relative margin of safety of holding the portfolio today wherein the returns have been sustained through earnings growth.

Fig 4: Return on Capital of the Portfolio across time (measures the efficiency of the capital allocation for the portfolio construct)



Position Sizing and framework:

Over the last 3 years, the number of portfolio companies in a client's construct has increased (from 24, say 3 years back to closer to 33 today). Historically, the term given to this is diversification, however that's just another jargon without explaining how we are thinking through risk today.

In a world where everyone is interested in the next best idea, very little attention is given to position sizing, which is an important aspect driving the path of returns. Our ability to take a concentrated position in any investment is driven by the level of inefficiency the market offers at any given instance. There are times, where inefficiency is driven by a sector getting ignored, or possibly comes when a certain sector is going through a weak cycle. In either of these cases, valuation provides a significant margin of safety for us to build a position and concentrate over time. When this is accompanied by strong earnings of a particular company, the conviction to concentrate becomes higher as the inefficiency should contract over time.

Today, we are in a different macro whereby you do not have any ignored sectors. Sectors are either expensive, and hence are reverting to their mean through valuations or are priced fairly. Effectively, said another way, the returns in the portfolio for most part are going to be driven by earnings growth, only. During such instances, we do not see the merit in concentration, and we would rather build a portfolio through a higher number of investments through starting positions in each.

A starter investment is one where we are building our thesis over time. We have initial signs of the company's growth having visibility alongside an execution track record to back this growth. The execution to continue could be a variable and we would want to size up this position over time depending on capital allocation and competition. Such companies would merit a starter position (between 2.5-3.5% typically)

We may look at sizing some of the portfolio companies higher depending on the macro playing out or if the earnings continue to surprise on the higher end versus our own model and expectations. While an investor will always look at a higher return in the short-term with awe and derive comfort around the future return basis past return, I maintain that maintaining a consistent path to the returns are more important especially at a time, where volatility has been low for a good part of 6 quarters. To add to this, domestic flows continue to track month on month highs and act as a strong support to the broader markets adding to a sense of security to the liquidity today. These are times, where I would stress most on risk management and paying additional attention to liquidity.

We continue to focus on secular trends and position ourselves in pockets of future growth. To illustrate, we have attached a summary of how we are positioned today across sectors along with brief comments on the same.

Name	Sector	Position	Weight	Comments
Maruti Suzuki India Ltd. Bajaj Auto Ltd. Craftsman Automation Ltd. *Others* Total	***Auto & Auto Components***	*Overweight*	**20.2%**	*Strong OEM volume growth in PVs and 2Ws; bodes well for ancillaries.*
ABB India Ltd. AIA Engineering Ltd. RHI Magnesita India Ltd. Bharat Forge Ltd. Total	***Capital Goods***	*Overweight*	**9.5%**	*Good outlook for capex. Supportive policies, operating leverage*
HDFC Bank Ltd. IndusInd Bank Ltd. Total	***Banks***	*Underweight*	**7.5%**	*Bottoms-up outlook on lending growth*
Dr. Reddy's Laboratories Ltd. Syngene International Ltd. Total	***Healthcare***	*Overweight*	**6.5%**	*CDMO focus: strong growth outlook benefitting from low-cost manufacturing*
SBI Life Insurance Company Ltd. ICICI Lombard General Insurance Company Ltd. Total	***Insurance***	*Overweight*	**6.5%**	*Low penetration of financial products; good growth prospects*
Ambuja Cements Ltd. Cera Sanitaryware Ltd. Shree Cement Ltd. Total	***Building Materials***	*Overweight*	**6.0%**	*Healthy Unit sales across real-estate developers; Should lead to volume growth.*
L&T Technology Services Ltd. HCL Technologies Ltd. Total	***IT***	*Underweight*	**5.5%**	*Focus on ER&D and differentiated IT companies*
Indian Energy Exchange Ltd. NTPC Ltd. Total	***Power***	*Neutral*	**5.0%**	*Growing power consumption trend; thermal generation capacity increase*
ITC Ltd. Marico Ltd. Total	***FMCG***	*Underweight*	**4.5%**	*Expecting Rural recovery to drive volume growth*
Adani Ports and Special Economic Zones Ltd. Total	***Logistics***	*Neutral*	**3.0%**	*Manufacturing facing sectors to drive ExIm volumes*
GAIL (India) Ltd. Total	***Oil & Gas***	*Overweight*	**2.5%**	*New pipelines, gas field discoveries to aid volume growth*
Hindustan Copper Ltd. Total	***Mining & Minerals***	*Underweight*	**2.0%**	*Rising demand for copper in manufacturing, batteries, etc.*
Advanced Enzyme Technologies Ltd. Total	***Chemicals***	*Underweight*	**1.5%**	*Benefit from low cost of production and exports*
Ahluwalia Contracts (India) Ltd. Total	***Construction & Realty***	*Neutral*	**1.5%**	*Strong infra spends by Centre and State governments*
Computer Age Management Services Ltd. Total	***Financial Services***	*Neutral*	**1.5%**	*Growing financialisation in the country*
Titan Company Ltd. Total	***Consumer Discretionary***	*Underweight*	**1.0%**	*With rishing disposable income, we expect growing retail consumption.*

Note: The sum of above weights would not total up to 100%; remaining would be our cash holdings.

We wish you and your families a wonderful new year in 2024. We look forward to speaking with you **on our call at 9 AM on the 13th of April 2024.**

From the desk of the CEO

Naveen Chandramohan

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