KUVERA CAPITAL PARTNERS LLP

AUGUST 2018 KUVERA FUND

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YEAR
2018	3.27%	-4.24%	-3.11%	5.30%	-4.22%	0.58%	3.70%	3.12%					3.94%
2017	1.30%	2.85%	2.69%	2.29%	2.26%	0.79%	3.48%	2.58%	-2.04%	2.22%	0.18%	1.99%	22.51%
2016	1.28%	-0.60%	0.04%	0.54%	2.32%	-0.27%	2.26%	0.73%	-0.99%	1.44%	-3.89%	0.18%	2.91%
2015	4.01%	1.03%	-2.37%	-2.33%	1.32%	-0.29%	0.79%	-3.85%	0.15%	0.76%	0.30%	2.62%	1.89%
2014	-1.76%	1.90%	4.20%	-0.24%	4.71%	2.01%	0.32%	1.69%	-0.64%	2.92%	1.54%	-2.51%	14.79%
2013	2.10%	-2.89%	-0.23%	2.01%	-1.01%	-1.69%	-1.20%	-3.91%	3.16%	4.88%	-1.16%	1.19%	0.89%
2012	8.12%	2.01%	-1.80%	-1.42%	-4.39%	3.13%	-0.73%	0.45%	5.74%	-1.12%	1.60%	-0.23%	11.26%
2011	-3.18%	-0.92%	4.63%	-0.59%	-1.89%	1.03%	-0.72%	-4.14%	-1.65%	3.42%	-5.88%	-1.54%	-11.27%
2010	-2.61%	0.54%	3.19%	0.52%	-2.82%	2.27%	0.32%	-0.23%	6.32%	-0.08%	-0.17%	3.42%	10.81%
2009	-1.98%	-3.47%	4.99%	5.78%	5.28%	-2.29%	2.96%	-0.48%	6.19%	-2.61%	2.44%	0.65%	18.12%
2008	-2.46%	-2.41%	-6.25%	-0.13%	-4.95%	-6.49%	2.63%	-2.94%	-3.83%	-8.53%	-0.43%	10.58%	-23.56%
2007	0.96%	-2.54%	1.11%	3.93%	1.95%	0.08%	1.74%	-0.84%	4.79%	5.61%	-0.96%	2.19%	19.21%
2006	5.67%	1.25%	4.52%	3.17%	-3.41%	-1.95%	-1.08%	1.73%	2.04%	2.69%	4.71%	-1.33%	19.04%
2005	-1.47%	4.44%	2.49%	2.37%	-0.39%	3.16%	2.38%	0.94%	0.39%	-2.25%	2.63%	2.47%	18.32%
2004							-0.04%	0.10%	3.97%	-0.30%	4.10%	8.57%	17.22%

SUMMARY

1. Rising rates and a strong dollar will expose weak economic fundamentals globally
2. To avoid falling asset prices central banks will ultimately have to abandon normalisation of rates and balance sheets
3. Portfolio defensively position — long dollar earnings, reduced INR exposure & long volatility
4. Indian (mid-small cap) significantly underperform main market (-38% vs 0.36%)
5. *India growth story at risk?* No but stock market is short term.

CONTACT

Kuvera Capital Partners LLP
Suite 11
Blake Tower
2 Fann Street
London
EC2Y 8AF

t: +44 20 3129 9727
e: r.kamath@kuveracapital.com
w: www.kuveracapital.com

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CUMULATIVE RETURNS

200% 180% 160% 140% 120% 100% 80% 60% 40% 20% 0%

Jun-04 Dec-04 Jun-05 Dec-05 Jun-06 Dec-06 Jun-07 Dec-07 Jun-08 Dec-08 Jun-09 Dec-09 Jun-10 Dec-10 Jun-11 Dec-11 Jun-12 Dec-12 Jun-13 Dec-13 Jun-14 Dec-14 Jun-15 Dec-15 Jun-16 Dec-16 Jun-17 Dec-17 Jun-18

It's all about the dollar now The strong dollar is one of several events which could trigger a fall in emerging markets. Despite government rhetoric of improved economic fundamentals, the mere anticipation of the end of low interest rates has caused markets to wobble.

We believe central banks will ultimately have to abandon their attempts at normalising interest rates and balance sheets if they want to protect asset prices. Global debt is at historical highs of 2x GDP, with $21 trillion of new debt supporting equity, bonds and other asset prices. This debt has been issued at all time low rates and will not be sustainable (without financial turmoil) if the move towards normalisation continues.

Structurally, Kuvera continues to remain long (inexplicably) cheap volatility allowing us to run a delta adjusted net exposure of 79.31%, benefitting from a return to a looser monetary stance while protecting downside risk. Since the beginning of the year we had also reduced net currency exposure to approximately 20%.

We have been positioning the portfolio defensively for some time now and key net long positions have remained consistent and skewed toward USD earners *(see portfolio section)*.

Does this affect India growth story?

No. Though short term it will affect the stock market. Maintaining exposure is key to achieving a good investment experience and this can be achieved by managing market volatility.

"We must free ourselves of the hope that the sea will ever rest. We must learn to sail in high winds."
— Aristotle (Onassis)

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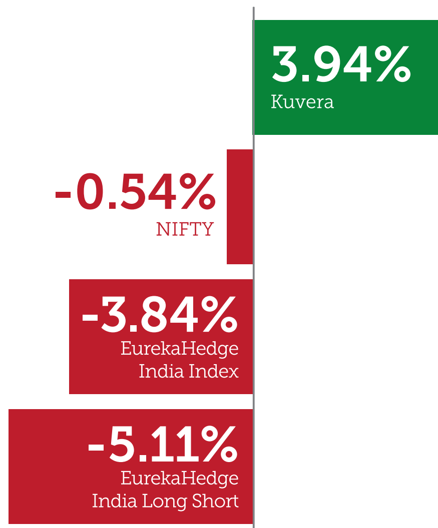
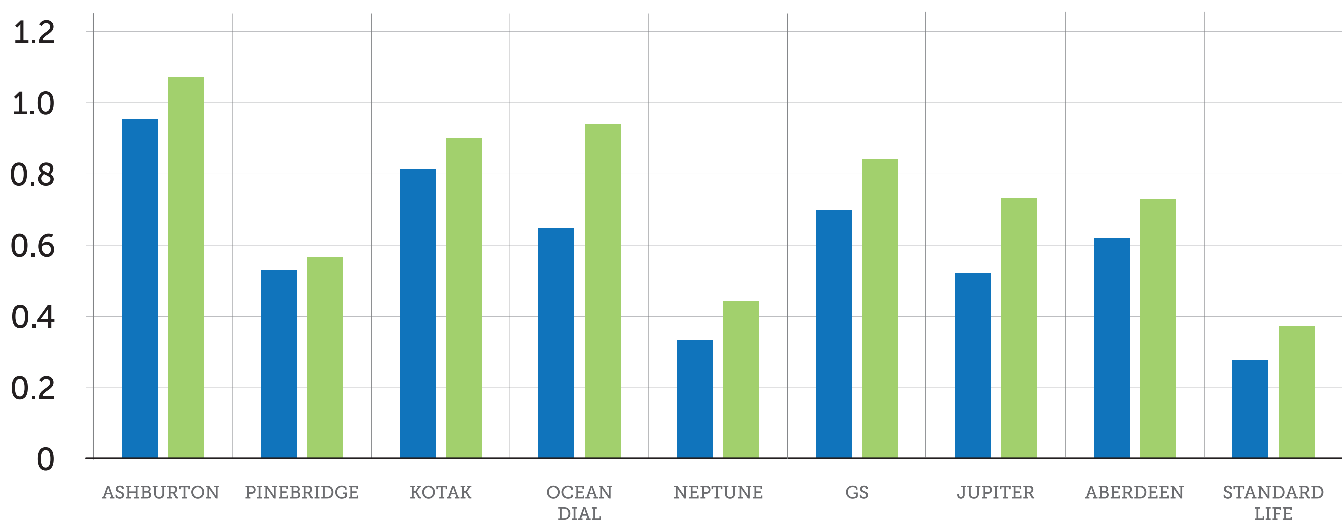
2018 YTD AUGUST RETURNS



RISK ADJUSTED RETURNS vs. KUVERA*

(Inception to May 18)



...THE RHETORIC

Of concern to EMs should be the view that both the IMF and the new Fed Chair (Jay Powell) have expressed;

> *"...whilst higher US rates and weakening EM currencies could cause capital to return to advanced economies... the most likely outcome for EMs will be manageable...'*

While we are not expecting Volker style rate increases, it remains to be seen if Powell will continue with the Feds defunct economic policies and attempt to support markets or continue with quantitative tightening.

...THE REALITY

Borrowing is not a problem when dollars are cheap and stable. Low interest rates mean the cost of servicing that debt is low. However, a lot of debt has been accumulated in EMs.

Because of the Fed's rate hike cycle and quantitative tightening (QT) stance, the dollar has become much stronger, increasing the cost of debt and reducing the supply of dollars just when EMs require this.

As risk aversion increases there will be an increase in demand for safe assets (US treasuries), perpetuating a vicious cycle of stronger dollar and a dollar shortage in EMs.

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...THE RESULTS (A COINCIDENCE?)

Since announcing QT in Oct. 17...

1. *Wall Street dives in February 18 and later that month currency woes take their toll on Argentina which in turn raised rates to 45% to protect the Peso. (Did they really get demand for 100-year bond?)*

2. *After raising rates again in March 18, the Russian Rouble takes a hit in April.*

3. *The South African Rand in June... and then after raising rates again in June, Turkey experiences a full-blown crisis, with the currency falling 24%.*

All the while the USD has remained resilient

The RBI governor also commented on this sequence of events;

> *"...Global spill overs did not manifest themselves until October of last year. But they have been playing out vividly since the Fed started shrinking its balance sheet..."*

Emerging markets are not homogenous, and each country has idiosyncrasies that could explain their falls.

We believe though that the explanation, at least in part, is systemic. A continued path of tightening will lead to indiscriminate selling of anything with the EM label. We saw what happened to markets in 2008.

So much for a dollar shortage being manageable for EMs. If this plays out, Asian economies, which have borrowed significantly in dollars could be next. At $19B, 2018 has already seen the largest withdrawal since 2008 by overseas funds from the major Asian EMs (Inc. India).

There are now many pins looking for a bubble to pop.

Will the Fed let this happen?

Recent history would suggest not. The already 'certain' Sept. Fed hike looks unlikely in our view. If they want to avoid the economic realities of too much cheap debt, central banks will have to revert to the Bernanke/Greenspan Put, supporting markets with yet more liquidity. There is an outside chance however that this new Fed Chair, (who is not a career academic/ bureaucrat) may take a different view, and maybe allow markets to work, letting economic realities play out.

...AND INDIA?

Indian External debt stands at about $500B, with Foreign reserves of

INDIA TOTAL EXTERNAL DEBT

SOURCE: TRADINGECONOMICS.COM | MINISTRY OF FINANCE, GOVERNMENT OF INDIA

about $400B. Fx reserves/debt stands at approximately 80%. Debt maturing within 12 months accounts for approximately 40%.

Though on the face of it these numbers should not be cause for immediate concern, most measures of the external coverage ratios have been in decline — with the INR declining 8% ytd.

Indian GDP at 7%-8% is still a bright spot in the global economy. The make-up of Indian national income however is very different from other developed markets, with about only 30% derived from private corporates vs. about 85% in the U.S. Earnings, particularly in the large cap space are more linked to global factors and as we saw in 2008 India will not be immune from a crises.

Private investment is yet to pick up and below peak levels. Whilst gross

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fixed capital formation is rising this is mainly due to government spending. On the positive side credit growth is beginning to pick up, with private sector banks sitting on large reserves (public sector banks are still side-lined with NPA issues).

Deleveraging has also happened at the company level, median gearing reducing from 1.37 (2015) to 1 (fiscal 2018).

The nuances of Indian fundamentals however will be largely irrelevant in the face of an emerging market crises.

Co-incidentally, we are also starting to get notes from investment banks offering cheap short exposure to India as the market "...has yet to decline in line with other EMs."

PORTFOLIO POSITIONING

Long

IT (16.80%) which had been under-performing has recently has started to outperform together with Pharma (+16.24%) and Refiners (+6.52%). These positions have been based largely on valuations and performance though also have the benefit of significant foreign earnings.

With national elections due in 2019 we have also kept the long side exposed to government spending (+14.04%) inc. cement. Some of these positions significantly under-performed, BEML (-50%), Bharat Forge (-14%), BEL (-35%). The investment thesis for staying long these names has not changed and we believe that part of the under-performance can be explained by the significant underperformance of non-large cap stocks in general. Our risk management/portfolio construction has mitigated the effect of these names to the portfolio has a whole.

Auto sales look strong and we continued with long positions in Mahindra and Mahindra (a purer play on rural consumption), Maruti and AL (re-gaining CV market share) against short position in Hero Moto (absent from the fast growing scooter segment) Bajaj auto and Tata Motors.

We played the general domestic consumption theme long positions in ITC and Hindustan Levers and Asian Paints all of which outperformed the market.

Short

We have been running a short position in metals expecting a global slowdown and this position is just beginning to perform. On a stock specific basis, we initiated a short position in Jet airways (-60%).

Despite the much-hyped view of the country's growing airline industry, Jet has been hit by debt, rising fuel prices and lower growth whilst also having a high percentage of USD based costs. A delay in publishing its accounts recently helped increase the return on this position.

We continue to run a short in PSU banks against along in private sector banks. The NCLT has provided a mechanism for resolution of bad debts, but the results have been mixed. We continue to believe that a change of ownership will be required as a permanent solution to the problem. As an aside, recent high-profile cases, seeking to extradite 'wilful defaulters' — maybe in time for the elections? — could be a much stronger deterrent — breaking the nexus of crony capitalist with politicians.

Tata motors has been a long-term non-consensus short — falling over 40% this year. Our reasoning; 78% sales from JLR and weak demand in the global auto sector, negative cashflow (due to continued investment) and a declining share in the domestic CV market.

PORTFOLIO ATTRIBUTES

SECTOR	NET WGT.	RETURN
AUTOS	6.31%	0.48%
BANK	12.73%	0.12%
CAP GOODS	3.28%	0.07%
CEMENT	9.46%	0.51%
FMCG	9.38%	0.14%
IT	16.80%	1.31%
METALS	-3.49%	-0.16%
OIL & GAS	6.52%	-0.17%
OTHER	2.12%	0.29%
PHARMA	16.24%	1.66%
REAL ESTATE	2.30%	-0.09%
TELECOM	-2.34%	-0.18%

GROSS	117.11%
NET	79.31%
# of NAMES	54
# LONG	39
# SHORT	15

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Suite 11
2 Fann Street
Blake Tower
London
EC2Y 8AF

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