

# KUVERA CAPITAL PARTNERS LLP



## AUGUST 2019 KUVERA FUND

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YEAR
2019	0.03%	0.71%	6.46%	1.42%	-0.42%	-0.98%							7.25%
2018	3.27%	-4.24%	-3.11%	5.30%	-4.22%	0.58%	3.70%	3.12%	-3.50%	-5.39%	5.91%	-0.49%	0.01%
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. Business as usual with Central banks forcing down rates and injecting liquidity
2. Fed 'Put' back firmly in place
3. We continue to run a large net long position... but with protection
4. Long side focussed on rural consumption, IT & private banks. Short side metals
5. India election risk behind us... but valuation risk and domestic/global slowdown a real threat

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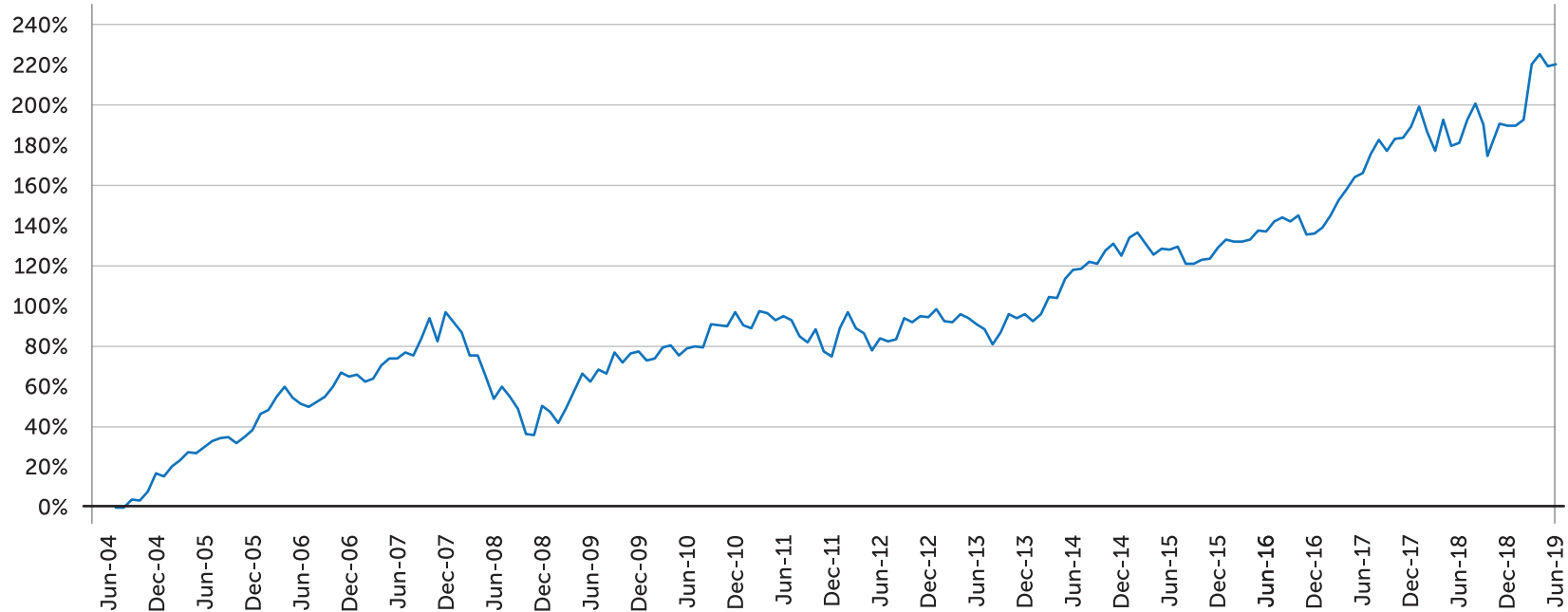
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## CUMULATIVE RETURNS



A continued theme of our portfolio positioning has been based on the quote to the right. Predicting the (long and short term) outcomes of the unprecedented global debt binge since the GFC, (especially given the unstated central banks objective of keeping asset prices inflated) is not difficult; forecasting the timing of a market crash as a result of this is almost impossible but we remain positioned to take advantage of this liquidity – (whilst protecting downside risk).

**ABOUT TURN! – reduce rates and increase balance sheet size.**

The economic realities of the massive global liquidity expansion since the GFC, finally caught up with Fed Chairman Jerome Powell (JP). Having already back pedalled on his ‘auto pilot’ rate increases, it is almost certain in our view that there will be rate cuts and a return to QE.

The downgrading of GE’s credit rating in November 18 and the freezing of the Junk bond market for an unprecedented 40 odd days spilled over into the stock market in December 18 – it was clear the Fed could not let this continue and rate rises were taken off the table.

### BUDGET DEFICITS DO MATTER

The demand for US treasuries from foreign governments is also abating causing pressure at the short end of the yield curve, at the same time China and other central banks are looking to diversify their reserves away from usd. With US deficits structural and increasing, we believe that the Fed will have little choice but to step in and monetize government debt (increasing its balance sheet) and try to regain control of short-term rates. From a peak balance sheet of \$4.5T the Fed only managed to reduce it to \$3.8T before having

*“The Fed can either normalise interest rates and its balance sheets or maintain inflated asset prices – not both.”*

— Kuvera Fund, NL Dec '18

August 2019

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to throw in the towel. This is a resounding indictment on the supposed strength of the economy. **The rhetoric of a strong economy is in stark contrast to the actions of more ever more liquidity and lower rates.** Monetary easing has not unleashed productive forces in the real economy, instead all that has happened is that earnings have de-coupled from valuations.

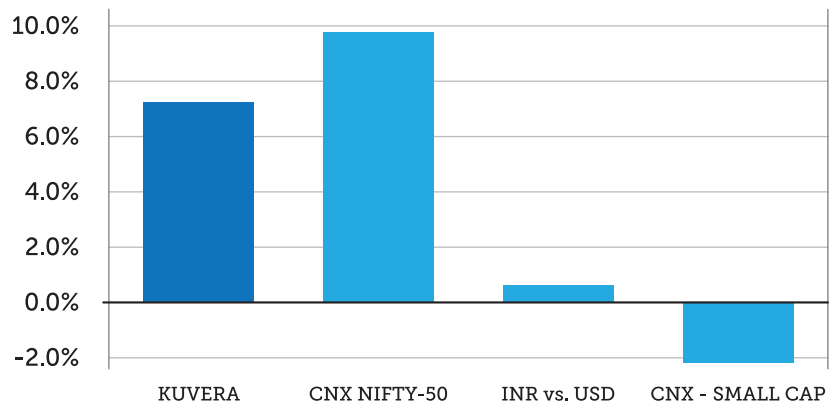


And asset prices driven by liquidity:



Given JP's comments before taking over as Fed Chair, there was an outside chance that he would normalise rates and let markets work. Unfortunately, like his predecessors he too gave in to the exigencies of keeping the bubble afloat. There will be no change at the ECB when Christine Lagarde takes over. As Head of the IMF she has already expressed her

### KUVERA FUND vs. INDIA ASSET CLASS RETURNS to JUNE 2019



view that QE, lower rates and more debt are the correct policy prescriptions.

It is extraordinary to think that a few 'wise' men and woman at central banks have the arrogant belief that they know better than markets in setting prices – using debt as a disguise for sage economic management. At their very core, economic models require scarcity as a constraint – something that does not exist as far as money printing is concerned.

The long-term cost of this monetary experiment is debasement of the currency – and all that comes with it. The short-term consequences are; Zombie corporations being kept alive; savers punished, increased leverage at all levels and income and wealth inequality at their high-

est levels. Japan has tried these failed policies and suffered from all the above. China which seemed to come out unscathed from the GFC is now also belatedly beginning to see similar consequences of these same economic policies.

Dollar weakness in the short term will help EMs whilst geopolitical uncertainty should keep demand for treasuries alive as a safe-haven asset. With rates at only 2.5% however, JP has little room for manoeuvre – unlike his predecessors who could take rates down from over 5%. How he must be wishing that Yellen had followed through on her rate increases. Our view is that JP will continue with the medicine of low rates and more liquidity – until the music finally stops (hopefully passing on the baton to a new Fed Chair before this happens). Running money

### PORTFOLIO ATTRIBUTES

SECTOR	SECTOR CONTR.	NET EXP.
PHARMA	-1.64%	12.86%
AUTOS	-1.34%	3.91%
FMCG	-0.17%	8.92%
METALS	0.28%	-2.77%
CEMENT	0.48%	8.81%
TELECO M	0.58%	-1.31%
OIL & GAS	0.71%	6.91%
CAP GOODS	0.77%	4.38%
REAL ESTATE	1.17%	3.35
IT	1.64%	11.99%
OTHER	1.90%	3.93%
BANK	2.04%	13.92%

GROSS	101.91%
NET	74.91%
# of NAMES	54
# LONG	39
# SHORT	15

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in this environment one has really no choice but to be positioned to take advantage of the liquidity injections / weak dollar whilst they last, but at the same pay the costs of portfolio protection for when the music stops.

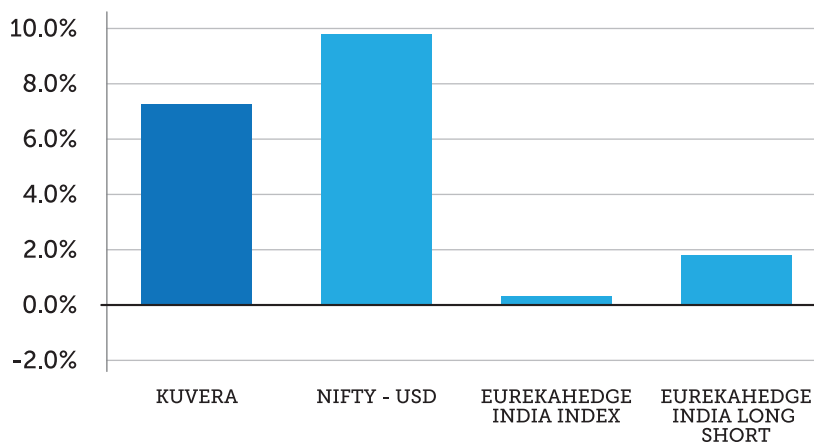
## INDIA

The May elections saw Modi's BJP government return with a strong majority. During the election his critics cited lack of job creation, demonetisation and the less than smooth implementation of GST as reasons he would not only lose his majority but the election too. Whilst some of these comments could be taken as opportunistic, they are also comments frequently cited by the financial press and brokers alike. What we can infer from the results is that these 'failings' were either exaggerated or that the Indian voter will put up with them as a cost for keeping the opposition out of power. We believe that a combination of both factors contributed to the BJP victory. What is sometime forgotten, is that the Indian economy is still largely non-corporate (only 15% vs 85% US) — and data capture can be sketchy. It is our view that the data, certainly as far as un-employment is concerned does overstate the problem. Additionally, much of the less glamorous on the ground progress rarely gets reported, but nonetheless affects many in the rural economy. A recent UN report indicated that India has raised more

than 271 million out of poverty, significantly reducing deprivation on many of their ten indicators.

Another reason, we believe, for the resounding Modi victory was that of India's increasing lack of tolerance for corruption (also evidenced by people's acceptance of demonetisation for the greater good of less corruption). India, it must be said has suffered more from outright banditry than mere corruption. There are several ongoing court cases relating to former ministers of the UPA government, together with several high profile (now bankrupt) businessmen who used PSU bank for 'preferential' lending — one of the reasons for our short position in PSU banks. Corruption is a charge hard to level at Modi — though Congress did try with little success.

## KUVERA FUND vs. INDIA INDICES to JUNE 2019



That said, the Modi government still has much to do to achieve its stated bold objective of a \$5T economy by 2050 — and voters will be less tolerant of lack of progress given the overwhelming majority.

The Indian market will be affected by a global slowing. Domestically too, indicators point to slowing economy. The Indian consumers animal spirits are abating, both rural and urban consumers have been subdued. With low wages growth, consumers have been increasingly leveraged, with 75% of incremental loan growth coming from NBFCs. The failing of IL&FS (NBFC), has reduced liquidity in this area. Additionally, with the May elections the model code of government came into force, lowering government expenditure — something that will be

## 2019 WINNERS

NAME	SECTOR	L/S	CON.
JET	OTHER	SHORT	1.77%
GODREJ PROP.	REAL EST	LONG	1.17%
AXIS	BANK	LONG	0.86%
RELIANCE C	TELECOM	SHORT	0.70%
ICICI	BANK	LONG	0.61%

## 2019 LOSERS

NAME	SEC-TOR	L/S	CON.
GLENMARK	PHARMA	LONG	-0.69%
CADILA	PHARMA	LONG	-0.62%
YES	BANK	LONG	-0.58%
MAHINDRA & MAHINDRA	AUTOS	LONG	-0.51%
TVS	AUTOS	LONG	-0.49%

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reversed now the election is over. Auto and consumer durable sales weakened in the third quarter – in line with the global trends – though consumer staples remained resilient. As mentioned above, Government spending couldn't take up the slack.

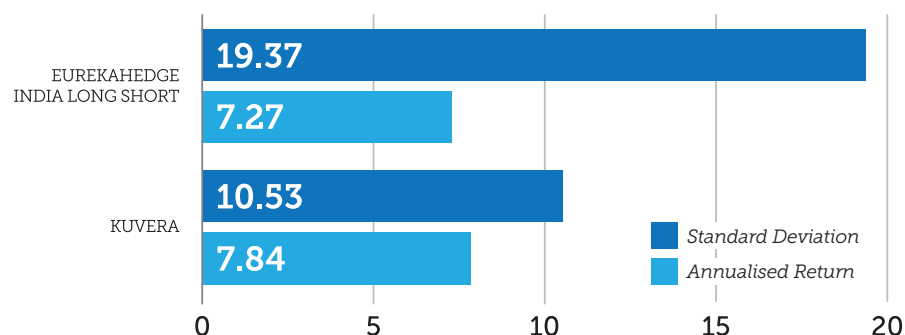
The **strong stock market performance** to June 19 was largely as a **result of premium expansion** as earnings continue to be revised downwards. The performance was also driven by a few large cap names with **small caps once again underperforming**.

Our portfolio positioning / thinking remains unchanged. The long side continues with exposure to government expenditure, in the case where we perceive there to be sector risks, e.g. autos, banks, we have also run short positions to hedge this. We continued with short positions in PSU banks (contrary to consensus) against long positions in private banks. The-matically, we remain short metals to counter the slowing China risk and continued with stock specific shorts to benefit from company specific distress. We also used long volatility position to protect the portfolio from general downside risk.

## PORTFOLIO HIGHLIGHTS

Stock wise our best performer for the year to June 19 was the short position in Jet Airways, contributing +(1.77%). It had the perfect combination of

## KUVERA RISK RETURN vs. INDIA LONG SHORT INDEX (since inception)



being in an industry where the competitive pressures are increasing significantly, together with high debt levels that it found increasingly difficult to service.

RCOM is a company that we had held a short position for some time. Once again significant debt levels coupled with pricing pressure from new entrants was the main reason for this exposure, contributing 0.7% to our gross return. Were it not for the help of his older brother, Mr. Anil Ambani – the promoter – was looking at a potential jail term after defaulting on a personal guarantee on payments to Ericsson.

Both these positions also benefitted from government regulation and new bankruptcy laws making it easier for creditors to force bankruptcy on defaulters. We have seen similar high-profile cases in other defaulting companies.

Sector wise the biggest losers were our net long position in Autos (-1.34%) and long pharma position (-1.64%). The long auto position focused on rural demand which suffered as a result of government removing stimulus going into election. Pharma as we mentioned in the previous NL is going through a structural change as a sector, with companies now having to move up the value chain – we will look to reduce our exposure during the year.

Both our long IT exposure and net long bank exposure worked well contributing (+1.64%) and (2.04%) respectively. IT companies are now successfully moving up the value chain and benefitting from digital investments – as evidenced by their earnings. We had positioned early to this theme and are now seeing the benefits come through.

SECTOR	L/S	CONTR.
BANK	LONG	2.17%
OTHER	SHORT	1.77%
IT	LONG	1.64%
REAL ESTATE	LONG	1.17%
CAP GOODS	LONG	0.77%
OIL & GAS	LONG	0.71%
TELECOM	SHORT	0.58%
CEMENT	LONG	0.48%
METALS	SHORT	0.28%
AUTOS	SHORT	0.24%
OTHER	LONG	0.12%
CAP GOODS	SHORT	0.00%
BANK	SHORT	-0.14%
FMCG	LONG	-0.17%
AUTOS	LONG	-1.58%
PHARMA	LONG	-1.64%

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