

KUVERA CAPITAL PARTNERS LLP

JANUARY 2017 KUVERA FUND

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YEAR
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. Trump win creates uncertainty over future economic policy
2. Global environment challenging – downside risks persist
3. Rise in asset prices not a reflection of economic health
4. Effects of demonetization appear priced in
5. Portfolio positioned for asymmetric return

January '17	
Kuvera	+2.91%
Nifty	+0.97%
Avg. Gross	120%
Avg. Net	57%

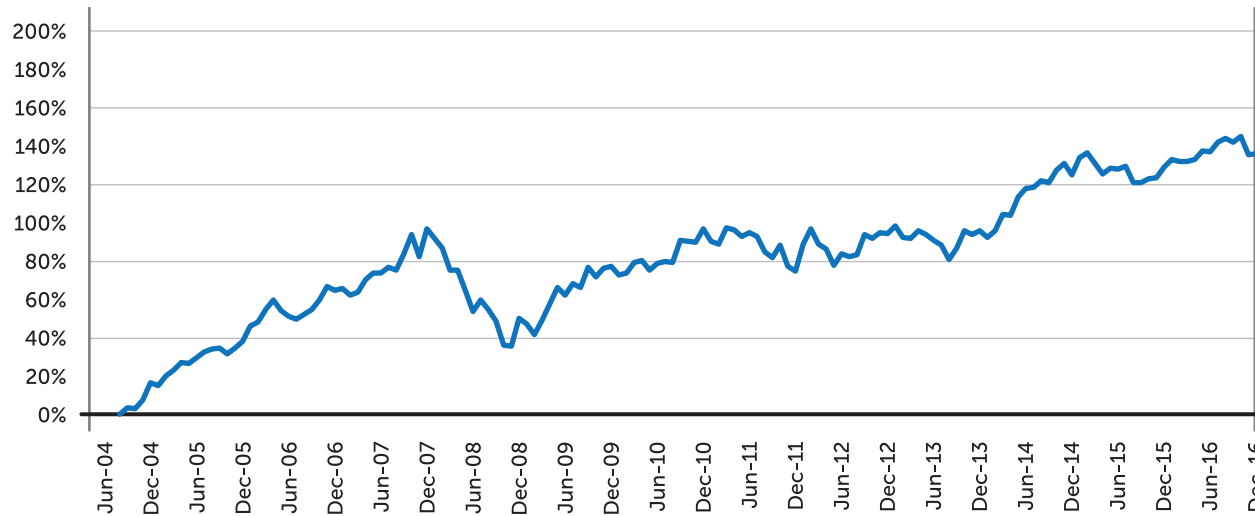
CONTACT

Kuvera Capital Partners LLP

Suite 4
8 Warwick Court
Warwick House
London
WC1R 5DJ

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

CUMULATIVE RETURNS



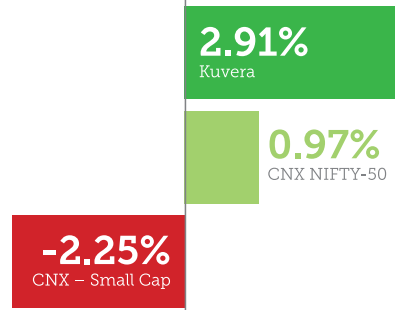
GLOBAL

The failed policies of central banks have caused a disconnect between nosebleed levels of asset prices and economic realities. This gap in part explains President Trump's election win. Central banks' interventionist policies post the GFC have failed to generate stable sustainable growth. Instead, interest rates are mispriced by supplying liquidity and increasing global debt to unsustainable levels – avoiding (necessary) liquidation at all costs. The massive increase in debt has resulted in little growth. The incentives provided by these policies have instead misallocated resources globally.

The extraordinary run in asset prices since the GFC, (despite the slowest recovery since the 1930s), has been a monetary phenomenon supported by central banks but not earnings. Low rates incentivized companies to swap equity for debt and magic earnings in the short term. Productivity has also been hit, with little of the debt used for private fixed asset formation.

Valuations too appear rich. The S&P is trading at about 25x (based on actual earnings) and the breadth of rallies is narrowing. High valuations are obscured with the 'smoke and mirrors' of analysts valuing equities

2016 Return



on forward non-GAAP earnings. Forward estimates continue to retreat, with final actual reported earnings being far less than original estimates. Constant talk from the Fed of 'improving economic

PORTFOLIO ATTRIBUTES

SECTOR	EXPOSURE
AUTOS	11.51%
BANK	5.63%
CAP GOODS	0.85%
CEMENT	10.12%
FMCG	4.32%
IT	10.26%
METALS	-4.57%
OIL & GAS	7.78%
OTHER	11.65%
PHARMA	11.19%
REAL ESTATE	-4.46%
TELECOM	-2.71%
GROSS	111.13%
NET	61.57%

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

fundamentals' does not bear scrutiny. Falling headline unemployment numbers, which they claim as one of their main successes, conveniently excludes low participation rates and (as per a recent Harvard study) the fact that nearly 94% of jobs created in the last decade are part time. If the Fed's rhetoric is to be believed, interest rates would now surely be at more normalized levels.

The US student and auto loan markets are other areas where misallocation of resources is evident, not only because of their growth (student loans have quadrupled over the last decade to 1.2 tr) but we are now beginning to see rising default rates, similar to those in the housing market prior to the 2008 crash. The effects of these policies in skewing incentives are evident globally; be it in the delicate state of European banks, overcapacity and bad debts in China (estimated to be 20% of GDP) or the BoJ providing so much support to the market that it owns approximately 36% of the JGB market as well as significant amounts of the equity market.

THE FUTURE IS ORANGE

Knowing that central banks will support asset prices at any cost, (by providing a continuous bid in the bond market or coming to the rescue whenever there is a wobble in

equity markets), has made managing money a function of trying to guess when this support will end or markets will eventually capitulate. A case could now be made for President Trump being the catalyst that finally punctures the 'big fat ugly bubble'- (even though in the case of the equity markets the bubble got a bit fatter and uglier post his election.)

Globally bond yields have hardened. The US bond market may now be re-pricing a Trump reflation trade, or reflective of the fact that the PBOC has begun to reduce its holding of treasuries (ironically to prevent the Yuan from weakening). In the case of Japan, the BoJ has also stepped back from recent bond auctions, deciding that low rates at the long end of the curve are not helpful for pension fund insurance companies and banks. The ECB too have announced that they will be reducing monthly purchases to 'only' \$60bn. It may be premature to call the death of the 30-year bull market for bonds. If interest rates do normalize however, this will finally dispel the myth that central banks could engineer escape velocity whilst ignoring the gravitational pull of low confidence, capex and productivity. Trumps stated economic policies are a un principled mixture of protectionism and more government spending on the one hand and reduction in regulation and taxes on the other. Implementation of the

former would be further damage economic growth. His comments on currency manipulators though may not be too far off the mark. The Germans in particular may find it harder to sit back and blame the ECB for the weak euro in pursuit of their 2% inflation target. The Trump victory does however bring into question whether the predictable economic policies of the past will continue.

Do we think that rates will be allowed to normalize and that Central banks will unwind their now \$12 trillion balance sheets? Probably not. The short-term pain, though necessary, would be political suicide. That said given his views on the Fed and the 'big fat bubble', if anyone were to change policy direction it would be Trump.

... AND THE BIG NEWS IN INDIA

Not to be outdone by the surprise results of the US election, on 8th November 2016 Prime Minister Modi pulled his own rabbit out of the hat, by announcing the demonetisation of 88% of currency (1000 and 500 INR notes). The stated purpose being to fight corruption and terrorism.

This was a bold political move, especially in an economy where it is estimated that approximately 2/3 of the GDP is driven by cash and approximately 50% of the GDP is generated by the unincorporated

TOP 5 WINNERS

NAME	L/S	RETURN
HPLC	LONG	1.58%
YES	LONG	1.10%
BHEL	SHORT	0.91%
OBEROI	LONG	0.73%
RCOM	SHORT	0.70%

TOP 5 LOSERS

NAME	L/S	RETURN
HINDALCO	SHORT	-1.30%
VEDANTA	SHORT	-0.96%
TATA STEEL	SHORT	-0.95%
TITAG' WAGONS	LONG	-0.85%
SUN PHARMA	LONG	-0.47%

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 8 Warwick Court
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 London
 WC1R 5DJ

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



sector. The impact is significant causing much short term pain, and it is easy to see why for reasons of political expediency previous governments did not follow through with this. What is perhaps more remarkable is that despite short term pain the mood on the ground has been supportive of Modi. Many see demonetization as a necessary evil in the fight against corruption. The BJP's recent landslide win in local municipal elections in Chandigarh underlined this support.

Though earnings have been downgraded (in part due to demonetisation), the pace of downgrades has not been high. With regard to sectors, earnings downgrades are more concentrated in domestic consumption companies. Current FY16/17/18 consensus Nifty EPS are 410/447/525. Though the Jury is still out, recent results indicate that the initial effects of demonetization may not have been as bad as feared and now appear to be reflected in prices.

INDIA RISK

The combination of a rising dollar, rising interest rates and tightening liquidity together with potential protectionist policies will not be a good recipe for asset prices in general and emerging markets in particular. If this scenario plays out, India will not be immune from the

negative effects. Having GDP that is domestically generated has not and will not keep the markets immune from a global slowdown. India is capital constrained and as we saw in dramatic fashion in 2008 very sensitive to global tightening.

PORTFOLIO

Tactical

Despite our fundamental bearish outlook (that markets have ignored), we have been running the portfolio to benefit from supportive central bank policies and continue to run a net long position of between 60%- 80%. At the same time, however, we have taken advantage of cheap volatility to protect downside. This proved effective at the beginning of the 2016, with the market down over 14% and the Fund for the same period up +0.67%. Our positioning aims to balance our bearish fundamental view, whilst benefiting from rising equity prices – (in case we are wrong and markets do not agree with us – which they haven't since the GFC).

Key Themes

We continue to run long positions (11.65%) that will benefit from relatively predictable central government spending primarily infrastructure and defense. Exposure to the Banking sector (gross 20%, net 5.6%), contributed 2.1% to the year's return making money on both

long and short positions. Though this contribution is volatile we are still of the view that the NPLs in the PSU banks is far from being resolved, while private banks are beginning to see growth.

Cement

10.12% long, contribution 1.13%). Though the sector was impacted by the effects of demonetisation, we believe this to be a short term reaction. The fundamental reasons for being long, namely that of lower capacity addition in the sector, falling input prices and expected strong demand continue to remain valid.

Metals

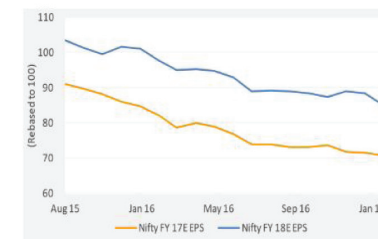
(-5.42% short exposure contributing -3.21%). Anticipating a slowdown, we started the year with a 12% short position in the sector. Initially this worked well - but we were forced to cut this position in response to commodities rallying strongly during March 16. We also added to long positions in oil to mitigate some of the losses.

Telecoms

(-2.71 % short exposure contributing +1.5%). We initiated a short position in the sector in response to the entrance of Reliance Jio, where aggressive pricing to gain market share will disrupt the economics of the sector. We have taken profits reducing the short exposure at the end of the year to 2.71%.

INDIA SNAPSHOT

EPS downgrade slowing



Rally based on premium expansion



Valuations at 10 year average



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8 Warwick Court
Warwick House
London
WC1R 5DJ

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

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Suite 4
8 Warwick Court
Warwick House
London
WC1R 5DJ

CONTACT

Kuvera Capital Partners LLP

Suite 4
8 Warwick Court
Warwick House
London
WC1R 5DJ

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

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