KUVERA CAPITAL PARTNERS LLP

JANUARY 2018 KUVERA FUND

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YEAR
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. Rich valuations globally — fundamentals yet to catch up
2. Volatility at lifetime lows
3. Hardening of rates will expose weak economic fundamentals ending bull market for bonds
4. Portfolio positioned with convex return profile — benefitting from low volatility

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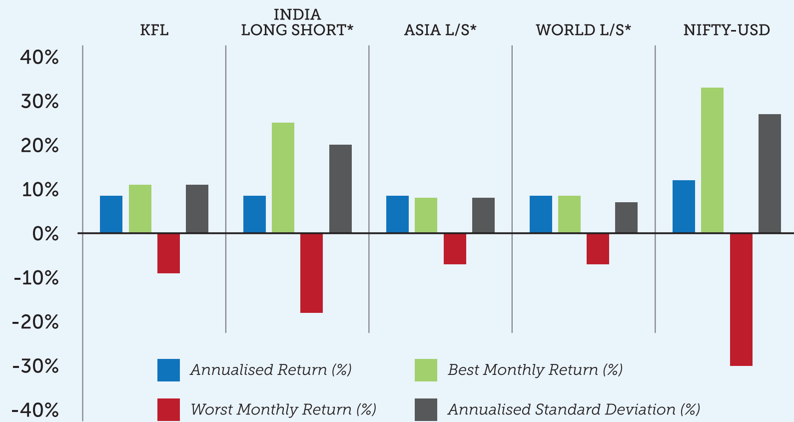
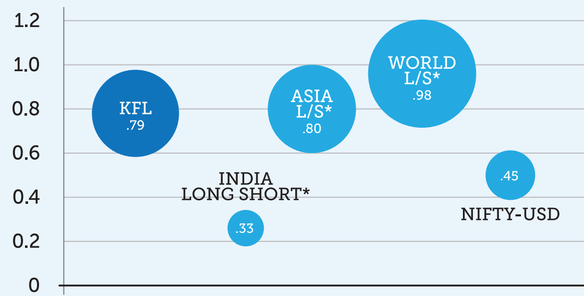
RISK COMPARISON



SHARPE RATIO



Kuvera Fund (KFL) vs. Eureka Hedge Indices*

KFL – Lower volatility & superior risk adjusted returns over 13+ years

Markets just don't go down anymore, despite increasing risks. Economies seems to have recovered but perceptions of recovery and central bank competence are both far from reality. The seeming economic recovery is not founded on strong economic foundations but instead on central bank created bubbles.

Financial repression unleashed by central banks has led to global repression of yields, volatility and an explosion in asset prices. The (mal)-incentives created by these policies are evident globally in stock and bond prices and specifically in the US student loan, auto loan, credit card and even subprime housing.

Are Stocks Indicating a Strong Economy or Strong Fed Actions?

130.51%
Cumulative S&P 500 Growth
2009-Present

16.70%
Cumulative Real GDP Growth
2009-Present

332.20%
Cumulative Reserve Balance Growth
2009-Present

The explosion in debt and central banks' balance sheets has resulted in only anemic economic growth. This debt is not backed by real savings (postponed consumption), but instead magicked and then monetized by central banks. Stock market performance is based around a narrow set of names with earnings being financially engineered by share buy backs. Valuations on most metrics are rich. To sustain, the future earnings being discounted will at some point have to become a reality. The relationship between the growth in central banks' balance sheets and asset prices tells the story clearly.

But don't take our word for it, the maestro himself, Alan Greenspan *(above right)*, one of the original architects of these policies, and Mervyn King former head of the BoE have recently opined; *(It's amazing how much more clear thinking central bankers get when they leave office)*.

"There is no means of avoiding the final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come sooner as the result of a voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved."

— Mises

"There is a stock market bubble and a bond market bubble .... only made possible by rising deficits ... federal debt to GDP is extraordinarily high...if you find where fiscal prudence went let me know"

— Alan Greenspan

"...the idea that a market economy can survive in a healthy way with long term rates at zero is impossible to sustain"

— Mervyn King

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CUMULATIVE RETURNS

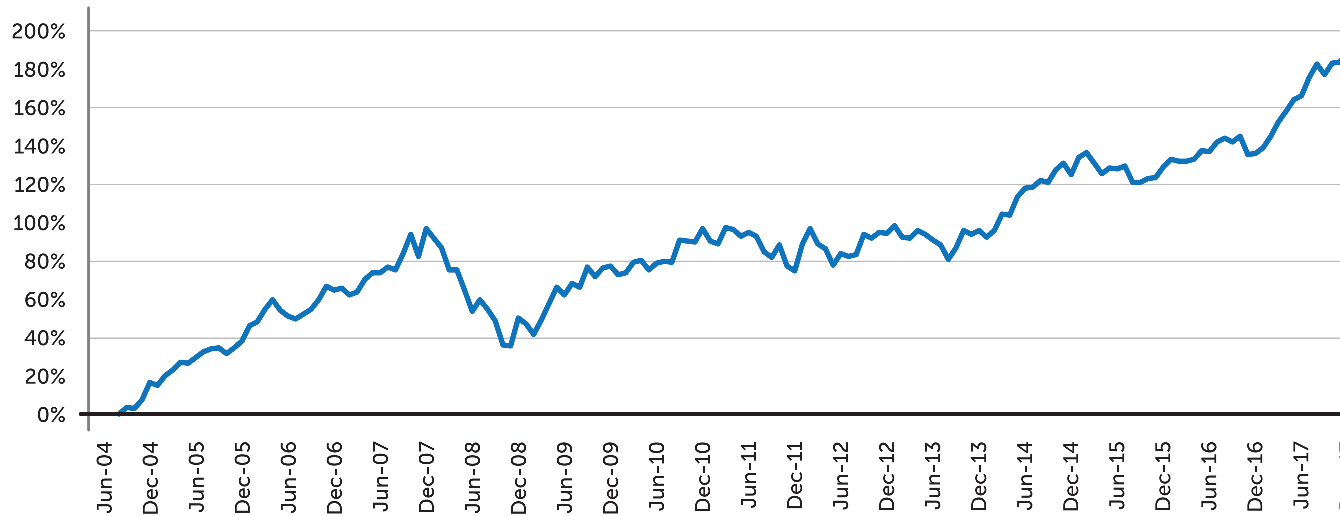


figure 1

Listed space share in GDP has come down

Share of listed companies in India's GDP

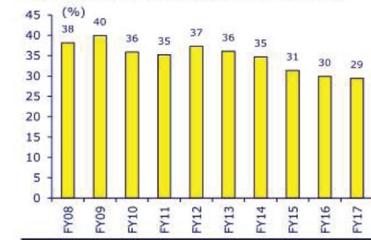
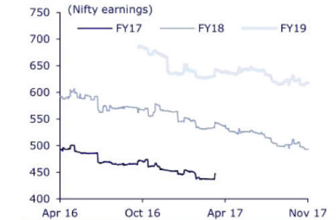


figure 2

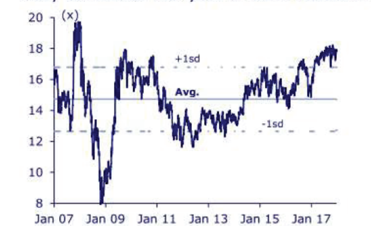
Nifty earnings revision



Source: Bloomberg

figure 3

Nifty consensus one-year forward valuation



Source: Bloomberg

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The true state of global risk/growth is better measured by central bank actions rather than their rhetoric. Whilst central bankers continue to pat themselves on the back for saving the world and generating growth (inflation), the reality is the that Fed has only been able to raise fed fund rates from 0.0 to 1.50 percent since December 2015 — hardly a ringing endorsement, (both the ECB and BoJ, meanwhile have continued with QE throughout this period). They continue to 'kick the can down the road' storing even greater risk for the future. With the first sign of a wobble, we will inevitably see them hitting the QE (panic) button again.

The bond market beginning to believe that rates will rise, (with hardening yields and a steepening yield curve), will be the catalyst to pop asset bubbles, as weak economic fundamentals are exposed to the reality of normalizing interest rates.

INDIA

Strong and consistent GDP growth numbers are what sets the Indian economy apart from others in the G20. In many other respects however, the issues facing India are similar; low productivity, a lack of pick up in private investment, the need for job creation and rising yields.

The Indian market performed strongly during 2017, in line with global and emerging market peers. The strength of the Indian equity market like its emerging market peers is more a result of a confluence of global factors; low rates (cheap money) a weak dollar and portfolio inflows rather than because of a significant improvement in Indian fundamentals.

We believe that the fundamental economic growth/consumption story is still very much alive, with real GDP growth consistently between 6%-7%. Simplistically, this is largely due to the demographic premium (70% of the population below 35)

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and a growing middle class. More relevant questions for equity investors though are, what price does one pay for growth and how much of that economic growth is captured by the equity market.

Like most markets, the Indian equity market is trading rich and has run ahead of earnings, (earnings growth over the last 5 years having a CAGR of only 4%). Despite this, at the beginning of every year brokers continue to predict a significant earnings recovery, whilst subsequently revising down their earnings estimates as actual quarterly earnings come through *(figure 2)*.

More than half of Indian national income is generated by the unincorporated sector, with only about 30% generated by the formalized listed sector – for most developed markets the percentage of economic growth captured by the listed market is much higher *(figure 1)*.

We are yet to see supportive fundamentals. Earnings growth, increase in capacity utilization, credit offtake and an increase in gross fixed capital formation, are yet to recover from decadal lows, but as broker continually reassure us, growth is always just around the corner *(figure 4 and 5)*.

The implementation of reforms is often cited by commentators as a key catalyst for market performance, but it should be remembered that the strong performance during the period of 2004-08 happened with little or no reform, global factors again being a key reason for the strong market performance.

Reforms nevertheless are an important factor for sustainable growth in the real economy, removing supply bottlenecks and increasing the ease of doing business.

To their credit the Modi government has made much progress in this area, especially in bold high-level reforms, evidenced by India's' jump in ease of doing business league tables. In our view the most important of these has been the devolving of power to the states, and away from the center. Other noticeable policies include the implementation of GST, demonetization and 'make in India'. Execution of some of these reforms has attracted criticism, especially with delays in awarding contracts. In our view though being late to recognize and deal with the NPLs, is one of the major policy failings of the NDA government.

Fiscal risk is cited as a concern for investors in India, (but apparently less of a concern when investing in other markets — with India having one of the lowest debt/GDP ratios in the G20.) As bond yields rise, with one eye on upcoming national elections, the bond market is beginning to price in some of this risk. The government has already responded to tax shortfalls by a new tax on long term gains for equity investors. To its credit however it has resisted the temptation to re-impose oil subsidies on oil companies, despite significantly higher global prices.

PORTFOLIO

With a different view from the market, we have been able to create (cheap) convexity in the portfolio, (taking a long position in volatility at all-time lows). ***In the event of a market correction the portfolio would benefit significantly but does not suffer if markets rise.***

figure 4

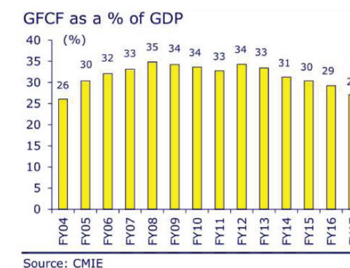
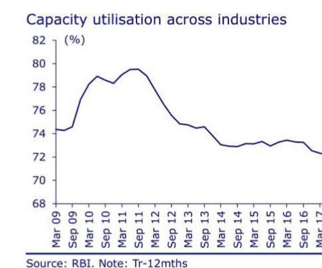


figure 5



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SHORTS

Running short positions in a rising market is never going to be easy. Where we were forced to cut/reduce thematic shorts, either because of government or corporate events, we increased long volatility exposure to manage risk. Stock specific short positions however were more successful. We started the period with a long term short in PSU banks, but were forced to cut this position in response to the governments $30billion bailout. We have previously highlighted that the only long-term solution to the NPLs crises would be a recapitalization, diluting existing shareholders, instead of a full-scale bailout by the government.

The government bailout both impacts on the fiscal deficit and perpetuates moral hazard. The market took this bailout as a positive, (as it had initially done for all the other failed 'solutions' since 2010), discounting a scenario where better capitalized banks will result in better credit offtake and growth. We remain skeptical. The bailouts do not address the ownership issue, which is the root cause of the NPL problem.

The expiry of the non-compete agreement between the Ambani brothers allowed the arrival of Reliance Jio into the telecom space. With its aggressive pricing, Jio is now the 3rd largest player, from a standing start. The debt heavy industry with new competitive pressures was an obvious short, with Reliance Communication (RCOM) being the main candidate. RCOM (-70%) had defaulted on its debt whilst losing market share. We cut our short exposure to the sector during the year through profit taking and industry consolidation.

With our overall negative global outlook, we continued with a short in the metals sector but reduced this through the year adding long volatility positions to manage risk.

Stock specific shorts included BHEL (-9%) — which we have held as a long term structural short based on competitive pressures and a falling order book and Tata Motors (-9%), with its exposure to a weakening international luxury car market and falling domestic market share.

LONG

Long positions were much easier to manage and performed well. We continued to be defensive focusing on areas of 'certain' government expenditure; infrastructure, roads, defense and housing. Coming into an election year we believe that spending on rural demand will also increase as the government attempts to gain back the rural vote. Thematically, long positions in IT underperformed though at current valuations and with improving operating results we continue to hold these positions. We significantly reduced pharma exposure. Faster approvals and competitive intensity are increasing in the US with consolidation and margin pressure now being a feature of the industry.

PORTFOLIO ATTRIBUTES

SECTOR	NET WGT.	RETURN
AUTOS	4.95%	0.49%
BANK	14.97%	0.33%
CAP GOODS	5.80%	0.25%
CEMENT	10.02%	0.26%
FMCG	7.59%	0.27%
IT	12.79%	0.60%
METALS	-3.93%	-0.40%
OIL & GAS	9.79%	0.04%
OTHER	12.52%	0.33%
PHARMA	7.64%	0.33%
REAL ESTATE	2.32%	-0.11%
TELECOM	-4.30%	-0.77%

GROSS	111.17%
NET	80.19%
# of NAMES	52

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