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LETTER TO INVESTORS| MAR 2021

EXECUTIVE SUMMARY

- TTM earnings of underlying companies fell by 15.8%. That of Nifty 50 and Nifty 500 grew by -6.2% & 3.3% respectively.
- NAV grew by 48.5% YTD with 71% funds invested. NSE Nifty 50 and Nifty 500 grew by 72.5% and 77.6% respectively.
- Covid-19 led worldwide lockdowns created 1930s like depression threat. Assets worldwide fell 30-50% in shortest time.
- Unprecedented global stimulus and vaccine development flipped sentiments and sent markets up 80-100% from lows.
- As guided earlier, all our companies have survived this challenge and have emerged stronger.
- **Stance: Cautious**

Dear Fellow Investors

Test match Vs T20 match

10 Overs, 40 runs, 0 wickets. How's this for a first innings cricket match score? You will rightly ask – What's the *format* of this game? It's a bad score for a twenty-twenty (T20) match, average score for a one day (ODI) match and a decent score for a test match. And if it's indeed a test match with bouncy pitch, overcast conditions and the best bowling unit in the world - you will say it's a *fantastic* score.

In cricket and in investing, it's impossible and, even, unfair to judge a score without knowing what format of the game it is. What's good for T20 may be bad for test matches. **What's good for momentum trading may be bad for long term investing**.

We are playing a test match and not a T20. The key to *success* – both in test match batting and long term investing - is to leave or defend the balls that are risky. And, hit only when the ball is in the *sweet zone*.

This investing sweet zone for us is buying sustainable businesses, run by able and honest management, at reasonable prices. And so long the ball is not in this zone – either the business and/or management and/or price are bad – and the last one is a case today - we wait, and wait and wait. For that juicy half volley or full toss right in our zone. They normally come.

T20s are more popular than test matches. Similarly, short term investment horizon and momentum based trading are more common than long term horizon and value oriented investing. Popular attention is focussed on what's going to happen next day, week or month in markets. This should not let us forget that **we are playing a different game**.

As we complete twelve Covid-19 affected months, the market sentiments have flipped from fear to greed. **Prices in most of the pockets, today, are discounting optimistic future earnings with low discount rates from today till infinity**. While risk should always be primary investing focus, it's all the more necessary when prices are discounting optimism. Reiterating in test cricket parlance, the batting conditions have again become difficult and it's time to protect our wickets. **Cautious stance stays.**

A. PERFORMANCE

A1. Statutory PMS Performance Disclosure

Portfolio	FY 2021	FY 2020*	Since Inception*	Outper-formance	Avg. 2021 Cash bal.
CED Long Term Focused Value (PMS)	**48.5%**	**-9.5%**	**34.3%**		**29.0%**
NSE Nifty 500 TRI *(including dividends)*	77.6%	-23.6%	35.7%	**-1.4%**	NIL
NSE Nifty 50 TRI *(including dividends)*	72.5%	-23.5%	32.0%	**2.3%**	NIL

**From Jul 24, 2019; Note: As required by SEBI, the returns are calculated on time weighted average (NAV) basis. The returns are NET OF ALL EXPENSES AND FEES. The returns pertain to ENTIRE portfolio of our one and only strategy. Individual investor returns may vary from above owing to different investment dates. Annual returns are audited but not verified by SEBI.*

For the year ended March 31, 2021, NAV of our aggregate portfolio was up 48.5% after all expenses and fees. NSE Nifty 500 and Nifty 50 were up 77.6% and 72.5% respectively. During the year we were invested in equities, on monthly average basis, to the extent of **71%.** Your returns may differ from this depending on the date of your investments.

One needs to guard against the desire to be a top performer at all times. Markets are not always rational and often go through bubbles. The most popular sectors during bubbles trade at exorbitant valuations and see a rise in their weights in benchmark indices. A top quartile performance during those times can be obtained only by going overweight on popular sectors. And what's popular is seldom cheap - tech in 1999, infra and real estate in 2007 and quality/ growth in 2020. Other things remaining constant, **an underperformance versus the benchmark is a leading indicator of risk reduction during buoyant times**.

A2. Underlying business performance

Period	Past twelve months Earnings per unit (EPU)[2]	FY 2022 EPU (expected) Earnings per unit (EPU)
Mar 2021	**4.8**[1]	**5.8**[3]
Dec 2020 (Previous Quarter)	5.1	
Mar 2020 (Previous Year)	5.7	
Annual Change	-15.8%[4]	**20%**
CAGR since inception (Jun 2019)	0%	

[1] Last four quarters ending Dec 2020. Results of Mar quarter are declared by May only.
[2] EPU = Total normalised earnings accruing to the aggregate portfolio divided by units outstanding.
[3] Please note: the forward earnings per unit (EPU) are conservative estimates of our expectation of future earnings of underlying companies. In past we have been wrong – often by wide margin – in our estimates and there is a risk that we are wrong about the forward EPU reported to you above.
[4] +5.7% if we exclude one position where there was temporary loss due to Covid-19

Trailing Earnings: In line with our earnings per unit (EPU) guided range of Rs 4.0-5.0, Mar 2021 trailing twelve months EPU came in at Rs 4.8, lower by 15.8% over last year (effects of 29% cash equivalents is included). *If we exclude one position which posted temporary loss due to Covid-19, our **EPU grew by 5.7%.*** In comparison, the adjusted earnings of Nifty 50 and Nifty 500 companies grew by -6.2% and 3.3% respectively in the same period (source: Capitaline).

1-Yr Forward Earnings: If the vaccination against Covid-19 gathers pace, the lower base of current year will help us put a healthy earnings growth for FY 22. Given the present conditions and assuming no material surprises, we expect our next year's EPU to close around **Rs 5.8, a growth of ~20%.**

A3. Underlying portfolio parameters (PMS)

Mar 2021	Trailing P/E	Forward P/E	Portfolio RoE	TTM[4] Earnings Growth	Portfolio Turnover[1]
CED LTFV	**28.0x**	**23.2x**	**13.5%**	**-15.8%**	**3.6%**
NSE 50	33.2x[2]	-	11.9%[3]	-6.2%[3]	-
NSE 500	35.9x[2]	-	17.2%[3]	+3.3%[3]	-

[1] *'sale of equity shares' divided by 'average portfolio value' during the year to date period.*

[2] *Source: NSE* [3] *Source: Capitaline* [4]*Trailing Twelve Months*

B. DETAILS ON PERFORMANCE

B1. MISTAKES AND LEARNINGS

The biggest treasure that we have built over last 9 years is not the compounded returns, but direct experiences of many mistakes. Mistakes are stupid, but they are also beautiful. Learnings from a mistake that comes with monetary loss sticks. And it is 10x (arbitrary number) impactful than learning from others' mistake. When we say that we should avoid bad businesses and/ or bad managements and/or bad prices, we know what it means. So we keep reminding ourselves:

From our two past mistakes- **"Cera Sanitaryware"** and **"2015-16"** - we learnt that unless fundamentals are extremely compelling, it is better to be gradual in selling and buying respectively. From our past mistake on **"Treehouse Education"** we have learnt that bad management deserves a low price, it's seldom a bargain. In **Dish TV** we underestimated the competitive disruption but thankfully sold at breakeven. **Tata Motors DVR** taught us that cyclical investing requires a different mindset to moat investing and one needs to be quick to act when external environment turns adverse. In **Talwalkars**, we learnt that assessing promoter quality is a difficult job and we should err on the side of caution irrespective of how cheap quantitative valuations look. From **DB Corp** we learned that industries in structural decline will fail to get high multiples even if the industry is consolidated, competition limited and free cash flows healthy.

B4. FLOWS AND SENTIMENTS

The US government approved an additional 1.9trn$ Covid-19 stimulus. This along with previous rounds, takes the total US Covid stimulus to 6trn$ (28% of pre covid US GDP). The 10Yr US government security (G-Sec) yields have risen from 0.5% to 1.7% in last 8 months and inflation fears are making the rounds. The US Federal Reserve, however, repeated their tolerance for higher inflation till the goal of full employment is achieved. Thus, **fiscal and monetary stimulus in the US continue to support global sentiments towards risky assets including equities.** It is difficult to guess when this will pause/ reverse.

Back home, the markets were pleased with absence of any new tax in the Indian Union Budget 2021. Announcements on stimulating growth by increasing public capital expenditure by over 25% also improved market sentiments. **FPIs equity inflows continued and surged over 37bn in FY21 as against net inflows of USD 1.3 billion in FY20** (source: NSDL).

In sequel to the last letter about **observations of crazy behaviour** in markets, we continued to observe more such behaviours, as noted below. To clarify, it is still difficult to conclude a bubble, however we need to remain watchful.

Globally, IPO markets continue to remain buoyant. Airbnb that went public at 68$, closed 187$ recently despite Covid restrictions on travel. Kuaishou, a Tik-Tock rival, raised 5.4bn$ in the biggest IPO since Uber, and listed on HK with 160% listing pop. Bumble a loss making dating app, had 68% listing pop valuing it at 7.7bn$. Coupang, touted as baby Amazon of South Korea, raised $4.6bn in its IPO with an 81% listing pop.

Combination of social media and zero/low cost trading is promoting curious behaviour. **Gamestop**, a traditional US video game company, was a short squeeze target of Wallstreetbets, a chat forum on Reddit (social media site). Powered by social media and no-cost-Robinhood-trading, many forum members kept on buying the Gamestop stock, pumping the price up 15x in 20 days. This forced hedge fund Melvin Capital to close its short position (the hedge fund had borrowed and sold the shares in the bet that its price will fall) and raise 3bn$ to save itself.

As per a *Financial Times* report, **global mergers and acquisitions** (M&A) have seen their strongest developments in four decades in the March quarter of 2021. There were around $1.3 trillion in deals agreed, more than any first quarter since 1980 and higher than the dotcom boom of the 1999-2000.

The bubble in **Electric Vehicle** (EV) space continues to grow bigger. As per an *Economist* report, the collective market capitalisation of EV and EV related stocks such as Tesla, CATL, BYD, NIO, LG Chemicals, and Samsung SDI has jumped from $163bn in Jan 2020 to $1,275bn in Feb 2021. Their P/E ratio has risen from 30x to 123x.

Price of crypto currency **Bitcoin** hit 60,000$, a rise of over 9x in one year. Tesla is allowing customers to buy its car using Bitcoins. A few hedge funds have recognised it as an investible asset. We have no insight into crypto currencies, but it amuses us how a *currency* can be so volatile.

Back in **India**, like in the initial stages of every past bubble, **retail activity** is rising in direct equities. As per *AMFI*, equity mutual funds have seen net outflows for 8 consecutive months since July-Feb to the tune of INR 58,000cr. At the same time, 1cr new demat accounts were open in last year, a growth of 25%. Retail holdings in NSE listed companies have reached an 11 year high of 7% last year. Investors are booking profits in mutual funds and investing/ trading in direct equities on their own. Commissions of listed brokers', who cater mainly to retail clients, have risen 80-100% in recent quarters. Upstox a retail discount broker has become multi-year official partner of the Indian Premier League (the only capital market entity on IPL's sponsor roster) and is planning a US listing. A unidirectional rising market and listing pops in many IPOs continues to fuel retail investors' interest.

Since July last year, 29 **IPOs** have hit the India market. Of the Rs 30,000cr they have raised, around two-third was 'offer for sale, or OFS' – money going to the selling shareholders and not to the company. These insiders wait for market optimism to time their sale to maximise their selling price. This is reflected in their 31x median P/E. Yet the retail and institutional portions were oversubscribed by average 25x and 60x respectively. There are additional 21 IPOs worth Rs. 19,000 cr that have received SEBI approval. This doesnot include the proposed mega IPO of LIC.

C. OTHER THOUGHTS

Low interest rates = Low future equity returns

Low interest rates have been often cited as a justification for higher current equity valuations. When fixed income instruments are yielding 0%-2% in the developed world, investors flock to riskier assets in search of higher returns and equities benefit from this lack of investible opportunities.

However, a corollary to this is lower future equity returns. If investors believe that lower interest rates offer arbitrage benefit to equities and bid up equity prices, this act should reduce the arbitrage and make future returns of all asset classes converge. In other words, if interest rates of 1% around the world pushes money towards equities, future returns from equities will not be different from 1%. Many investors are not taking this into account.

Secondly, there is an implicit assumption that interest rate will remain so low forever. If that's not the case and rates do rise, they will hit a long tenured asset harder. A 10 year bond falls more in % terms than a 1 year bond for a same rise in interest rates. And equities are perpetual assets. If interest rates do rise, equities are going to fall substantially more.

While everyone's happy that lower interest rates and abundant capital supports rising equity prices, here's an outcome that many investing carelessly today may not like: low equity returns if interest rates remain low; and negative equity returns if interest rate increase even marginally. When prices are bid up aggressively - heads you lose, tails you lose too!

The one safeguard against this is to buy equities assuming that interest rates are already high and leave some margin of safety.

Buy High. Sell Low. Repeat. Go Broke

Nothing is as financially ruinous as consistently buying high and selling low. Yet we see it happening all the time. **Ignorance, emotions, and miss-selling** interact with each other to powerfully induce this folly.

Without a sense of a company's worth, it is impossible to judge whether its share price is high or low. Assessing that worth requires understanding of underlying business and many investors donot have time, interest or ability to do it. **Price trend** is generally used as a substitute for this ignorance about intrinsic value. Companies seeing price rising are considered as good and vice versa. When more people believe in this momentum, it becomes a self-fulfilling prophecy. **Ignorance encourages buying assets that are rising**.

Nothing intoxicates human mind as rising prices. Rising prices trigger **emotions** of envy, FOMO (fear of missing out) and greed. Those sitting on side-lines get interested. And those making money feel invincible and take more risks even on leverage.

Times of rising markets is *business-season* for many *"experts"* – distributors, advisers, brokers, merchant bankers etc. Sadly, financial incentives of almost all "experts" are linked to *selling* financial products - stocks, mutual funds, IPOs, insurance policies - and not good *outcomes* for investors. This leads to **miss-selling**. Mutual funds, life insurers and capital raising companies paid over INR 37,000cr (rough conservative estimate) worth of commissions last year to these "experts". This was paid without any linkage to the buyers' returns from the financial products sold.

When willingness to buy during rising prices is met by advice that pays the advisor for selling expensive products, it creates a powerful force to buy high.

The same story reverses when prices fall. In absence of sense of intrinsic value most investors fail to assess whether paper losses are temporary or permanent. Momentum and emotions trigger a rush for the door. And those "experts" who peddled the products during rising prices either disappear or are not heard.

Here's a crude **antidote** to this: When past returns of an asset class are high, ignore all temptations and "expert advice" of even higher returns. Conversely, when past returns of an asset class are low or even negative, ignore anything that stops you from investing. Lastly, when taking help from “experts”, see that they are remunerated for results, not selling products. When you get a call from a life insurance agent, just hang up!

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We have been through a very difficult year. It posed serious challenge to many businesses including ours. Importantly, the volatility that it brought along unnerved many investors. Our businesses have withstood the litmus test well. Importantly and please don’t undermine this - your behaviour has been praiseworthy.

Thanks for sticking by. And thanks for your continued trust. You can be absolutely sure that we keep your investment interests at the fore of everything we do at this firm. That is the only way we will continue to be worthy of your trust.

Please feel free to share your thoughts, feedback and criticisms.

Kind regards,
Team Compound Everyday Capital
Sumit Sarda, Surbhi Kabra Sarda, Suraj Fatehchandani, Sachin Shrivastava, Sanjana Sukhtankar and Anand Parashar

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