



LETTER TO INVESTORS | DEC 2023

EXECUTIVE SUMMARY

- Trailing twelve months' earnings of underlying portfolio companies grew by 59%.
- NAV grew by 28.1% YTD with 73% funds invested in equity positions. Balance 27% is parked in liquid funds.
- We share our favourite learnings from Charlie Munger.
- We added to one position, it's now a major position. We exited from a minor position at a good gain.
- Euphoric retail participants drive flows into risky segments. Their lack of fear should be feared.
- **Stance: Cautious**

Dear Fellow Investors,

*"Bull markets go to people's heads. If you're a **duck on a pond**, and it's rising due to a downpour, you start going up in the world. But you think it's you, not the pond."*

-Charlie Munger, 1924 - ∞

Charlie Munger, partner of Warren Buffett, passed away last quarter at the age of 99. Warren credits Charlie for the mindset shift and phenomenal track record of Berkshire Hathaway. Charlie's teachings have had an important impact on our thoughts and behaviour. While it is difficult to do justice to cover it all here, but as a token of tribute, we take a shot at sharing some of his worldly wisdoms around thinking, living and investing better:

Better Thinking

1. Lifelong multidisciplinary learning: *"To a man with a hammer the world looks like a nail"*.

Munger said that a single discipline often lacks tools to look at the world holistically.

Having key **mental models from multiple disciplines** - compound interest from Mathematics, margin of safety from Engineering, natural selection from Biology, breakpoint, tipping moment and autocatalysis from Physics and Chemistry, behaviour from Psychology and many more – give better tools to analyse problems or opportunities. For eg. Economic theory predicts that demand falls as price increases. However psychology provides exception to this rule– often high prices of certain products indicate their exclusivity and in turn increase their demand.

2. Read read read: *"In my whole life, I have known no wise people who didn't read all the time – none, zero. Spend each day trying to be a little wiser than you were when you woke up. I believe in the discipline of mastering the best that other people have ever figured out. I don't believe in just sitting down and trying to dream it all up yourself. Nobody's that smart."*

The road to better thinking and learning is to read. Munger read in truck loads across diverse topics. Buffett said that Munger has the best 30 second brain, he can think about the answers before the question ends. Munger admits that he is able to do this because of hours of study and analysis that has gone into forming opinions on wide range of topics of general importance. Those who **keep learning** will keep rising.

3. Seek to invalidate: *"Any year that we don't destroy one of our best-loved ideas is probably a wasted year. Recognize reality even when you don't like it – especially when you don't like it."*

Seeking to invalidate long held incorrect beliefs is necessary to progress. The key is not to ignore disconfirming evidence but to embrace them. Munger gave example of Charles Darwin (father of the theory of natural selection), who trained himself to intensively consider any evidence that went against his hypothesis.

4. Human Biases: In his famous talk "*Psychology of Human Misjudgement*", Munger shared 25 human tendencies/ biases that lead to **judgement errors**. An awareness about them can reduce errors. Here are a few popular misjudgements:
- Incentive caused biases*: it is difficult to do something that goes against incentives. For eg: AUM based fee or brokerage will lead to asset gathering or portfolio churn respectively.
 - Reciprocity bias*: tendency to return favours and disfavours. For eg: releasing favourable equity research reports in exchange for investment banking deals (IPOs, M&A, block trades etc.).
 - Liking/ loving bias*: tendency to ignore faults or grant favour to those liked or loved. For eg: getting investment opinions influenced by good looking/ presentable top management of a company.
 - Confirmation bias*: tendency to look at facts selectively so as to support already held beliefs or conclusions. What a man wishes, that also will he believe. For eg: overlooking bad news around owned stocks.

Better Living

- Invert, always invert – "If you want to achieve X, find how to avoid non-X. Invert, always invert. To live a good life, find how to live a bad life and don't do it. All I want to know is where am I going to die so that I don't go there. It is remarkable how much long-term advantage people like us have gotten by trying to be consistently not stupid, instead of trying to be very intelligent."
- Track Record: "I think track records are very important. If you start early trying to have a perfect one in some simple thing like honesty, you're well on your way to success in this world. Remember that reputation and integrity are your most valuable assets – and can be lost in a heartbeat."
- Work/ Career: "Three rules for a career: Don't sell anything you wouldn't buy yourself. Don't work for anyone you don't respect and admire. Work only with people you enjoy."
- Happiness: "Avoid envy, avoid self-pity, avoid resentment and have low expectations."
- Mistakes: "A meaningful life cannot be lived without making mistakes (corollary: pursuit of returns higher than risk-free rate will invite chances of mistakes). But try avoiding fatal ones by first learning from others' mistakes."

Better Investing

Below are few useful thoughts that Munger has shared on investing:

- All intelligent investing is **value investing** – acquiring more than you are paying for. You must value the business in order to value the stock. (inference: growth and quality are components of value)

2. A **great business at fair price** is superior to a fair business at great price. (Warren Buffett attributes the shift of his style and resultant success of Berkshire Hathaway to this one **secret**.)
3. There are worse situations than drowning in **cash** and sitting, sitting, sitting. I remember when I wasn't awash in cash—and I don't want to go back.
4. We have three baskets for investing: yes, no and **too tough** to understand.
5. The wise ones bet heavily when the world offers them that opportunity. They **bet big when they have the odds**. And the rest of the time, which can be very long, they don't. It's just that simple.
6. I want to think about things where I have an **advantage** over others. I don't want to play a game where people have an advantage over me. I look for a game where I am wise, and others are stupid. And believe me, it works better. God bless our stupid competitors. They make us rich.
7. How could economics not be **behavioural**? If it isn't behavioural, what the hell is it?
8. **Bull markets** go to people's heads. If you're a duck on a pond, and it's rising due to a downpour, you start going up in the world. But you think it's you, not the pond.
9. Understanding both the **power of compound return** and the difficulty of getting it is the heart and soul of understanding a lot of things.
10. It's (investing) **not supposed to be easy**. Anybody who finds it easy is stupid.

Book suggestion: Those interested in reading more about him can start with [Poor Charlie's Almanac](#)

A. PERFORMANCE

A1. Statutory PMS Performance Disclosure

Portfolio	YTD FY24	FY 23	FY 22	FY 21	FY 20*	Since Incep- tion*	Outper- form- ance	Cash Eq. bal.
CED Long Term Focused Value (PMS)	28.1%	-4.3%	14.9%	48.5%	-9.5%	15.5%		27.0%
BSE 500 TRI(<i>including dividends</i>)	34.1%	-0.9%	22.3%	78.6%	-23.4%	19.7%	-4.2%	NIL

From Jul 24, 2019; Since inception performance is annualised; 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. W.e.f. April 01, 2023 SEBI requires use of any one from Nifty50, BSE500 or MSEI SX40 as a benchmark. We have chosen BSE500 as our benchmark as it best captures our multi-cap stance.*

Protecting our wicket

Broader markets scaled new peak this year. BSE 500 index was up 34% since Mar 2023. Higher euphoria was seen in mid and small caps with BSE Midcap and BSE Smallcap indices being up 53% and 58% respectively. Despite being only 73% invested, we were also up 28% thanks partly to the general rise in market prices.

While evaluating investment performance in bullish times like current one, **entire focus needs to be on portfolio risk with a complete blind eye to headline returns**. For, these are the heady times that mess up human mind and engender mistakes. Without worrying about lagging index or FOMO, we continue to adhere to price and quality discipline while deploying capital in the current expensive market. This discipline, we hope, will allow us to fall less and make up for current relative underperformance versus the index. To invoke cricket parlance, the pitch is difficult, conditions overcast and the ball is swinging and bouncing. This calls for playing defensive and protecting our wicket. **Stance: Cautious.**

A2. Underlying business performance

Past Twelve Months	Earnings per unit (EPU) ²	FY 2024 EPU (expected)
Sep 2023	8.6¹	8.0-9.0³
Jun 2023 (Previous Quarter)	8.1	8.0-9.0³
Sep 2023 (Previous Year)	5.4	
Annual Change	59.3%	
CAGR since inception (Jun 2019)	14%	

¹ Last four quarters ending Sep 2023. Results of Dec quarter are declared by Jan-Feb only. Unadjusted.

² EPU = Total normalised earnings accruing to the aggregate portfolio divided by units outstanding. Includes cash equivalents.

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.

Trailing Earnings: Trailing twelve months Earnings Per Unit (EPU) of underlying companies, grew by 59.3% (including effects of cash equivalents that earn ~5%).

1-Yr Forward Earnings: We had upgraded the expected earnings per share for FY24 in the last letter from 6.5-7.5 to 8.0-9.0. The actual earnings are moving in the direction we had expected and therefore we maintain the guidance.

A3. Underlying portfolio parameters

Dec 2023	Trailing P/E	Forward P/E	Portfolio RoE	Portfolio Turnover ¹
CED LTFV	22.0x	21.0-23.7x	19.0%³	3.1%
BSE 500	25.8x ²	-	15.5% ²	3.4% ²

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

² Source: BSE ³ Portfolio RoE is on core equity positions

B. DETAILS ON PERFORMANCE

B1. MISTAKES AND LEARNINGS

There were no new mistakes this quarter. A rising market generally hides them, to be fair.

Update on Music Broadcast (Radio City) position: We have recovered our 30% loss in this small position. The position is up 3% as of writing of this letter. The annualised yield to maturity if we sell the equity position immediately and hold the preference share till maturity is 6%. This is net of tax and therefore better than liquid funds or FDs.

A brief background: We had participated in a special situation whereby we got free bonus preference shares of Music Broadcast (aka Radio City). Our thinking was that this play could give us a low risk 10% return on our free cash that otherwise was earning 6-7% in liquid funds (the tax effect is also favourable on former). The combined position (equity shares + bonus preference shares) was around 3% at inception. At the end of that quarter we were down 30% (or 1% of

portfolio). We had shared that we made a mistake and learnt that we should engage in these plays only if the underlying equity shares are traded in futures so that we can lock our selling price. However we decided not to sell immediately, believing that upcoming elections will help radio advertising.

Cut to today, the net position has changed from -30% to breakeven. Hike in central government radio advertisement rates before elections and a buoyant market helped. We will take a decision to sell the equity part of the position in due course to harvest tax losses (will save tax).

B2. MAJOR PORTFOLIO CHANGES

Buy: We increased our holding in **one position** in all accounts to 5%. Now it has graduated from a minor (<5%) to a major position ($\geq 5\%$).

Sell: We fully sold our position in Hindustan Petroleum Corporation Ltd (**HPCL**) at 19% annualised returns including dividends.

When to sell

Selling is easier when either the thesis turns out to be wrong or unexpected events impair the business fundamentals. However, the difficulty arises when business and share price both are doing well. The biggest mistake many renowned investors have admitted making is **selling winners too soon** (selling a potential 10-50 baggar at 2x). If the business is fundamentally sound, interim price fall may be temporary. Selling sooner would mean forgoing all the future upside.

On the flip side, however, **endowment effect** – overvaluing one's things/ efforts – can fool us to mistake an ordinary company to be a future winner. Even if we remain dispassionate in assessing the business quality and immune ourselves from endowment effect, we are **dealing with the future** which can bring negative surprises. Promoters often failing to predict the future of their companies is a case in point. **Therefore, on the sell date, we can never be fully sure that we have sold right.**

Another aspect around selling is an opportunity to re-balance the portfolio by reducing strongly **correlated** positions. Over time, the mutual weights of positions change. If price changes lead to increase in portfolio exposure to one or more themes/factors – capital expenditure, crude oil, rural demand or capital markets for instance - selling may allow lowering excess exposure to a single theme/factor.

The **middle road**, then, is to vary the extent of selling depending on dispassionate assessment of fundamentals, portfolio exposure to a theme/ factor and degree of overpricing.

B4. FLOWS AND SENTIMENTS

Fearing absence of fear

Retail participation and general sentiments towards equities remain worryingly exuberant. This is evident from highest ever flows to SME IPOs, higher number of smaller companies in main board IPOs, high inflows into riskier mutual fund schemes and record derivatives volumes. Insiders (promoters and private equity investors) are using this opportunity to happily exit at lofty valuations. It is not difficult to guess that in this bi-party trade involving retail buyers and insider sellers, who is going to be proven right.

SME IPOs are at the riskier end of IPO segment. 181 issues have raised Rs. 4,600cr in CYTD 2023. This is highest ever and double of past high recorded in 2018. BSE SME IPO index is up 99% in last twelve months indicating high retail participation even post listing. Many of these companies have weak business models and unknown governance track records.

45 main board IPOs concluded in CYTD 2023, second highest in last decade. The average size of IPOs this year is half of average of last 6 years indicating higher share of many smaller IPOs. Smaller IPOs indicate wider retail tolerance.

Smallcap, midcap, and thematic schemes of mutual funds garnered over Rs 87,000cr net inflows in last 12 months, constituting over 57% of all net inflows into actively managed equity schemes, an all-time high. These schemes gain favour mostly during bullish times.

Derivatives volumes as a factor of cash volumes has reached alarming proportions in India. Derivatives volumes that used to average around 26x of cash volumes in India between 2015 and 2021 and much lower in the world, have jumped to over **400x** of cash volumes in the current year. This is mainly due to higher participation in weekly expiring options contracts that allow low ticket bets. Sadly, as per a recent SEBI study, over 90% of retail derivatives traders lose money.

Promoters and private equity investors (insiders) have smartly used the retail euphoria to sell stakes in their companies. Insiders have sold over Rs 90,000cr worth of their stakes in CY2023, highest in last 5 years.

There is no fear among common investors today. This calls for fear.

C. OTHER THOUGHTS

India's inflation in last 150 years

What has been the rate at which Indian Rupee has lost its purchasing power in last 150 years? We stumbled upon an objective measure some days ago.



We had an opportunity to visit a coins exhibition. Amid coins and currencies as old as the 3000 years old Magadha silver coins, one gold coin caught our attention. This was an extremely rare 5-Rs currency coin of year **1870** weighing 3.88 grams in *gold*. The exhibitor was kind enough to allow us to take a picture.

This coin, which is of 22k (91.7% purity) gold, tells us the **price of gold** – Rs 5 for 3.88 grams or **Rs 1.4/gram in 1870 for 24K gold**. The price of same gold is around Rs 6,500/gram today. Rs 1.4 turned to Rs 6,500, a growth of **4600x in around 150 years**.

Gold is considered as a hedge against inflation. If we take liberty to equate rise in gold price as rough indicator of inflation, this translates to an **inflation of 5.5% annually** over 150 years.

To cross check, we inquired price of **Ghee** (clarified butter) with some senior citizens. They recollected it to be around Rs 5 per kg during 1940-1950. That also translates to inflation of over 6%.

What does this convey about future? We can take a 5%-6% as possible inflation range over this generation. A savings instrument should beat this *after tax* to keep the purchasing power of our savings intact. This translates to a pre-tax asking return of around 8% (for those in highest tax bracket).

As always, gratitude for your trust and patience. Kindly do share your thoughts, if any. Your feedback helps us improve our services to you!

Kind regards and wishing you a blissful 2024,

Team Compound Everyday Capital

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Annexure 1

Here below we briefly explain our investing, operating and reporting philosophy. We also take a moment to explain how we would like to be evaluated.

Investing and Operating Philosophy

Mandate: Long Term Focused Value, our one and only strategy, is a multi-cap and value oriented strategy with a mandate to build a portfolio of 10-20 stocks across market capitalisation and sectors. A multicap strategy allows us to pursue investment opportunities in widest universe. While our focus is on absolute long term returns, owing to regulations we shall benchmark our returns with total return indices (TRI) of NSE Nifty 500 and NSE Nifty 50. TRI includes returns from dividends.

Sustainability: We are looking to own businesses that can thrive over decades and reward shareholders fairly. Key characteristics of such businesses include large addressable market, competitive advantage, and respect for minority shareholders. Such businesses witness unit volume growth and high returns on capital for long periods of time.

Value includes growth: For us value investing does not mean buying stocks in the lowest quartile of quantitative valuations. It, rather, means buying at or below conservatively assessed value and seeing that value grow over time. We were and are happy to own growth and quality stocks if available at *reasonable prices*.

Humility and Risk Control: We proceed with the assumption that counter party is intelligent, resourceful and motivated. Most of the time markets are efficient in pricing stocks. What looks quantitatively cheap or expensive mostly deserves so. Very rarely owing to ignorance, dislike, temporary hardships, human biases or institutional reasons, prices diverge from value. Picking this divergence, however, requires a good understanding of underlying business. We try hard to limit ourselves to business that we *honestly understand* and operate with *margin of safety*. With experience we have realised this is the best way to control risk.

Management quality: Management quality is difficult to assess. We tend to focus on what management has done vs. what they say. This includes study of company's history with an eye on past capital allocation decisions, quality of reported earnings and treatment of minority shareholders. Mistakes and learnings over last 9 years have trained our eyes to notice nuances. We have also learned that no price is too low for poor management quality at least in India where it is often difficult to replace management easily.

Profit share only: We operate on profit share only and donot free ride on investors' investments in form of fixed fees. Not only does this align incentives, it disciplines us to invest and raise money only when valuations make sense. Further we are not associated with any other conflicting business like broking, private equity or merchant banking.

Reporting Philosophy and Format

Reporting Philosophy: We take our reporting responsibility seriously. The underlying spirit of reporting is expectation we ourselves would have in case we handed our money to someone else –transparent, complete and accurate. Our reporting will try to go behind how and why of a period's results. Further, mention of mistakes will precede mention of accomplishments and bad news will preceded good news. Lastly, our reporting shall follow the below outlined format irrespective of good or bad performance.

Reporting Frequency and Format: Our custodian will send your portfolio updates monthly. Further, you can login anytime to our fund accounting portal with your login credentials to know updates including capital gains reports. In addition we

will share our thoughts through a quarterly letter. June and December quarter letters will be brief. September and March letters shall be detailed. The detailed letter shall be divided into three broad heads – (1) performance, (2) details on performance and (3) other thoughts.

The 'performance' section will contain the statutory performance table as mandated by SEBI and a voluntary section with some supplementary data. The statutory performance table will report return of all portfolios put together using weighted average method (similar to NAV method used by mutual funds) net of all expenses and fees. Owing to starting point differences your returns may differ from total portfolio returns.

The second section "details on performance" will have four sub sections – (a) mistakes and learnings, (b) major portfolio changes, (c) underlying fundamental performance and (d) flows and sentiments.

The third and the last section will contain thoughts about investing and economy in general.

Right way to evaluate

Our investment horizon is little longer than an average fund. We would urge you to evaluate our returns over 3-5 year period.

Prices are more volatile than fundamentals and therefore serve as an inadequate yardstick of our performance in short run. The litmus test of our long term wellbeing will be growth in earnings of our underlying businesses. We will report to you earnings per unit – EPU (our share of earnings divided by number of units outstanding) both on historical as well as forward basis (our expectation of next year's earnings). So long as EPU is growing and/or forward EPU is looking good, and we have not overpaid, intermittent price volatility should not bother us.

In our case unless forward EPU has materially deteriorated, it will be profitable for you to top-up/ refrain to sell when past returns have been poor and refrain to top-up when past returns have been stellar. While this is contrary to what your intuition will tell you to do, our past investors will testify that they have been benefitted when they have done so. We have also raised/ refused new money depending on whether valuations made/ did not make sense. We will continue to do so.

In the end, our behaviour will be based on your behaviour. Only when behave in sync with what works in investing – *buy low, sell high* – will we all do well. In our periodic letters we hope we will be able to guide you towards right behaviour.

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