



January 08, 2025

LETTER TO INVESTORS | DEC 2024 - EXTRACTS

EXECUTIVE SUMMARY

- For the Dec'24 quarter, the BSE500 index reported a change of -7.8% including dividends. We reported -0.6%.
- Trailing twelve months' earnings of underlying portfolio companies grew by 25%.
- In an elevated market like current one, falling less might be more important than rising more.
- Looking at our batting average and equity IRRs.
- We introduced a new toehold position.
- Stance: Cautious**

Dear Fellow Investors,

Falling less > Rising more

Investment success is often celebrated through spectacular gains, but history and track record of great investors suggest that falling less is equally important. Focus on capital preservation and avoiding large drawdowns has higher probability of doing well than chasing high returns. **This is all the more important in an elevated market like current one.**

Mathematics of falling Less

20% annual returns for 6 years followed by -15% annual returns in next two years reduces the 8-year CAGR (compounded annual growth rate) to ~10%. Conversely, 12.5% annual returns for 6 years followed by 7.5% p.a. return in next two years leads to a CAGR of ~11%. The table below illustrates this:

Scenario	CAGR (Years 1-6)	CAGR (Years 7-8)	8-Year CAGR
Portfolio 1: Steady growth, no drop	12.5%	7.5%	11.2%
Portfolio 2: High growth, then drop	19.9%	-15.6%	9.8%

These are not imaginary portfolios. The first portfolio above is **Nifty 50** index and the second portfolio is **BSE Smallcap** index. And the 8 years in question are CY2011-2019 (a full cycle). This is neither a praise of the former nor a critique of the latter and may not hold true in all periods and portfolios. But it is a good reference period for the **largecap-smallcap divergence** we are seeing today. This illustration underscores that buying price matters and valuations & returns tend to mean revert.

Rising more + falling less?

It is tempting to imagine holding "Portfolio 2" during high growth years and switching to "Portfolio 1" before the downturn. While this strategy sounds appealing in hindsight, it's difficult to execute in practice. A "rising more" approach is pro-cyclical, encouraging higher risk-taking in an already risky market. It works like magic when things are going well amassing praise, confidence and money. FOMO (fear of missing out) makes it difficult to let it go. Also, professional managers following "rising more" style set wrong expectations for incoming investors/ money and find it difficult to justify moving to an opposite strategy. Some, either due to luck or skill, may be able to straddle both styles. But for most, it's either one or the other.

Buy high, sell low

A “rising more” strategy can lead to challenges when fund inflows and outflows are unrestricted. Stellar bull-market performance attracts inflows at peak valuations, raising the probability of subpar future returns. Conversely, during market corrections, such strategies often face deeper drawdowns, prompting panicked investor exits at a loss. The 2011-2019 performance of smallcap indices exemplifies this phenomenon. Morningstar’s *“Mind the Gap”* study consistently finds that investor returns lag fund returns by 1-2% annually due to poor timing decisions, with the gap widening for more volatile strategies. Lower volatility in a “falling less” strategy reduces these risks, ensuring newer investors are not disadvantaged and minimizing the likelihood of buying high and selling low.

Balancing risk and return

A simple way to minimize losses could involve staying 100% in **cash**, earning a risk-free rate (currently 6-7% p.a.). However, **risk avoidance leads to return avoidance too**. Plus, timing market tops and bottoms credibly is nearly impossible. **Hedging** using options is another way. It is hoped that options turn in the money when markets fall. However, hedges come at a cost, may not be fully efficient and need continuous monitoring and adjustments. They can take focus away from studying and tracking companies. We are yet to find a simple, cheap and effective way to hedge using options. The better path, for us, lies in selectively taking risks where rewards are commensurate and avoiding those where they are not.

Trying to fall less

We continue to stick to the following combination to improve chances of falling less in a heated market:

1. **Quality focus:** Investing in companies with strong balance sheets, large opportunity size, competitive advantages and being run by able and fair managements tends to cushion portfolios in volatile markets. While they too fall when aggregate markets fall, they normally **get stronger and recover faster**.
2. **Valuation discipline:** Quality stocks bought at expensive valuations may not protect the downside. Ensuring reasonable purchase prices is key. Result of quality focus and valuation discipline is **waiting** for right opportunities and parking money in safe *and* liquid instruments. As a sidenote, current cash balance of Berkshire Hathway (Warren Buffett’s company) has reached 30% of its asset values, highest since 1990s.
3. **Smart diversification:** A well-diversified portfolio reduces exposure to any single adverse event. Selecting quality companies at reasonable valuations across **less-correlated exposures** ensures resilience against unforeseen shocks.
4. **Careful performance evaluation:** A “falling less” strategy often underperforms in euphoric markets. Fair evaluation requires assessing performance over a **full market cycle** and focusing on metrics like batting averages (frequency of outperformance) and invested IRR (portfolio IRR excluding cash). We will share these metrics in a later section.

Falling less isn’t about avoiding risk altogether; it’s about managing risk intelligently. By prioritizing capital preservation, one can position to participate in recoveries and harness the full power of compounding. When valuations are elevated, **defence is the best offense**.

Cautious stance stays.

A. PERFORMANCE

A1. Statutory PMS Performance Disclosure

Portfolio	YTD FY25	FY 24	FY 23	FY 22	FY 21	FY 20*	Since Incep- tion*	Outper- form- ance	Cash Eq. bal.
CED Long Term Focused Value (PMS)	17.3%	29.2%	-4.3%	14.9%	48.5%	-9.5%	16.0%		19.7%
BSE 500 TRI (including dividends)	10.8%	40.2%	-0.9%	22.3%	78.6%	-23.4%	19.0%	-3.0%	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.

Trying to fall Less

The BSE 500 index fell 7.8% including dividends in the December 2024 quarter - highest quarterly fall since June'22. We posted a return of -0.6% in the same period - **falling less by 7.2%**. Falling less in one quarter may be due to luck, or mean reversion of past few years' underperformance. Time will tell. To try falling less in an elevated market, we remain steadfast on price-quality discipline. For more colour on our performance, we share two metrics:

Batting Average (64%)- Batting average measures the ratio of successful investments to total investments. Here, we are defining success as generating an **IRR (internal rate of return) above 15%** - roughly the average long-term return of the BSE 500 index.

- **Batting average by Count:** Since our inception in 2019, we have made 26 investments. Out of these, 19 investments delivered IRRs exceeding 15%, resulting in a batting average by count of **73%**.
- **Batting average by Value:** Above metric doesn't account for the size of each investment. When we evaluate batting average by value—i.e., the proportion of capital allocated to investments generating over 15% IRR—the batting average is **64%**. This means that out of every ₹100 deployed over the last five years, ₹64 has delivered returns exceeding 15%.

Equity IRR (25.5%) - Of that ₹64 delivering IRRs exceeding 15%, there have been few investments that have delivered 25%-100% IRR. So, another way of assessing performance is to look at IRR of equity performance excluding cash. As of today, the actual IRR of our equity portfolio (excluding cash allocations) stands at **25.5%**, reflecting strong overall performance. Cautious stance and higher cash balance is the only factor that has led to slightly lower returns when compared to BSE 500 in last few years. To summarise:

SN	CED PMS (2019-2024)	Details
1	Headline returns	16.0%
2	Batting Average - 15% IRR threshold (count)	73%
3	Batting Average - 15% IRR threshold (value)	64%
4	Equity IRR	25.5%

A2. Underlying business performance

Past Twelve Months	Earnings per unit (EPU) ²	FY 2025 EPU (expected)
Sep 2024	8.9¹	8.5-9.5³
Jun 2024 (Previous Quarter)	8.8	8.5-9.5
Sep 2023 (Previous Year)	7.1	
Annual Change	25.4%	
CAGR since inception (Jun 2019)	14.1%	

¹ Last four quarters ending Sep 2024. Results of Dec quarter are declared by 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: Earnings Per Unit for last twelve months ending Sep'2024 came in at Rs 8.9 per unit, a growth of 25.4% over last year.

1-Yr Forward Earnings: We maintain FY25 forward earnings per unit guidance at Rs 8.5-9.5.

A3. Underlying portfolio parameters

Dec 2024	Trailing P/E	Forward P/E	Portfolio RoE	Portfolio Turnover ¹
CED LTFV	25.2x	23.6-26.3x	18.0%³	4.5%
BSE 500	26.1x ²	-	15.2% 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 mistakes to report in this period.

Among major positions, two companies are struggling right now. However, as we explain in the later section, they are going through temporary problems. We are waiting for few fundamental milestones to take next call.

B2. MAJOR PORTFOLIO CHANGES

Bought: We introduced one new toe hold position (1% weight). The company is a global leader in an emerging disruptive product and has returns on invested capital of over 80%. Valuations at over 50x trailing earnings stopped us from raising our position. We will share further details in future should we scale up this position.

Sold: We did not sell anything in the reporting period.

B4. FLOWS AND SENTIMENTS

हर शख्स दौड़ता है यहाँ भीड़ की तरफ़

पि र ये भी चाहता है उसे रास्ता मिले

(everyone is running towards crowds and still wishes to get a clear path)

-Wasim Bareilvi

Retail investors' activities have increased by factor of **3x-11x** over last 5 years and have been the key determinant of ~25% and ~32% CAGR returns of midcap and smallcap indices respectively in that period. The below table captures the growth in retail participation metrics:

SN	Particulars	2019	2024	Change
1	Equity oriented active mutual funds - assets under management (lac cr.)	10.6	37.7	3.6x
2	Demat accounts (cr.)	3.9	18.2	4.7x
3	Unique investors (PAN) (cr.)	3.0	10.2	3.4x
4	Gross monthly SIP in equity mutual funds (Rs cr./month)	8,500	25,300	3.0x
6	Individual Future & Options participants (lacs)	8.5	95.8	11.3x

Source: SEBI

To be fair, before 2019, Indian retail investors were under invested in capital markets. Their higher equity participation is welcome. However, looking at various parameters, it seems things are going to the other extreme. FOMO and not valuations is the main driver of investor enthusiasm today. And in a classic example of circular loop, the resulting momentum of flows is raising the stock prices and rewarding their risky behaviour.

One outcome of higher retail participation is the **outperformance of smallcaps over largecaps**. While largecap indices have risen 2x, smallcaps have surged 4x in last 5 years. In CY2024, largecap indices gained 9%, but smallcaps outperformed with a remarkable 29% increase. Post September-October, when most broader indices fell nearly 12%, smallcaps' recovery has been notably faster. Smallcap indices are now only 5% below their recent peaks, compared to largecaps being lower 10%. This trend is unusual. Historically, largecaps have rebounded faster than smallcaps after a correction. The divergence can be partially attributed to foreign investors, who have been net sellers primarily targeting largecaps, while retail investors (directly or through mutual funds) have channelled their buying efforts into small and midcaps.

Smart money is exiting. Promoters, and private equity investors have sold stakes worth **Rs. 3 lac crores** in CY2024, highest ever through IPO/ QIP/ stake sales. In a first, India has outpaced China in value and the US in volume of IPOs launched in CY2024. In addition, foreign investors have sold 14bn\$ in Oct and Nov 2024, highest ever in two months.

In a welcome move, **regulators** have started introducing curbs on excessive speculations. SEBI has issued restraining circulars on three high risk pockets – zero-day options, SME IPOs and distribution commissions on NFOs (new fund offers). RBI has also put restrictions on unsecured lending a part of which might have been going into equity markets.

C. OTHER THOUGHTS

HANDLING INVESTMENT ADVICE IN A BULL MARKET

A bull market often acts as a "business season" for the investment and financial world. Brokers experience a surge in trading activity, investment bankers work on more IPO and QIP deals, and mutual funds see higher inflows. At the same time, mischievous promoters, influencers, and tipsters (often fraudsters) find opportunities to exploit unsuspecting investors.

With the rise of app-based trading, acting on recommendations has become effortless—one moment you're reading a stock tip, the next you're executing a trade. But this convenience can also lead to costly mistakes.

Ultimately, the investor's best defense against subpar or risky products is vigilance and self-awareness. Here's a checklist to help navigate any investment solicitation:

Questions to Ask Yourself

1. **Do I understand the company or product?**

If the investment doesn't make sense even after thorough research, it's best to avoid it.

2. **Are the past returns unrealistically high?**

Extraordinary returns often revert to the mean. Be cautious if it seems too good to be true.

3. **Am I following the crowd?**

Are you drawn to this investment because friends, family, or social media are hyping it up? Social proof can be misleading. Return to Question 1.

Questions to Ask the Seller

1. **Are you an Insider?**

If the proposer is sharing a material non-public information obtained from insider access, strongly avoid and prevent falling foul with insider trading violations.

2. **Are you SEBI-registered?**

If the seller isn't registered with SEBI, it's a clear red flag. Avoid.

3. **What are your incentives?**

Find out how the seller benefits:

- Are they earning commissions or fees based on your investment or training course purchases?
- Or are they incentivized by your actual investment gains?

Be sceptical if it's the former, even if they are your friends or family (especially if they are).

4. **Are you personally invested in what you're selling?**

Request for documentary proof of their own investments in the product they are selling. If the seller hasn't put his/her own money into the product, it's a sign they may not believe in its potential.

By asking these critical questions, maintaining a healthy scepticism and using calm judgement, you can avoid being taken for a ride and protect your hard-earned money.

We welcome two CA industrial trainees –**Dhruva Koolwal** and **Aayush Choudhary** to our team. Dhruva is a school topper, holds rank in CA Foundation and is district topper in CA Intermediate exam. He is ex-Grant Thornton. Aayush cleared CA Foundation and Intermediate exams in first attempt mostly through self-study. He is ex-Protivity.

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

Wishing you a great 2025!

Kind regards,

Team Compound Everyday Capital

Sumit Sarda, Surbhi Kabra Sarda, Punit Patni, Arpit Parmar, Dhruva Koolwal, Aayush Choudhary

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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 in to 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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