

Honesty and Integrity Investment (HNI Investment)

Email for June 2017

Dear Friends,

Here are the details of performance of HNI investment based on the share prices as on 30th June 2017.

Annualised Returns (IRR) ^{(1) (2) (3)}	HNI Portfolio	Nifty	Sensex
FY13	-10.6%	-5.3%	-3.7%
FY14	112.2%	21.1%	21.3%
FY15	21.6%	25.0%	23.0%
FY16	86.0%	-7.0%	-7.7%
FY17	168.3%	21.9%	20.1%
From Inception till 31st March 2017	85.6%	12.0%	10.8%
From Inception till 30th June 2017	85.3%	12.9%	12.0%

(1) For all HNI clients and promoters (2) Inception was in August 2012 (3) Gross IRRs excluding the impact of HNI investment fees

We continue to outperform the broader markets. In this market everyone is doing well. From dirt to diamond everything is going up. You really need to try hard to lose money. We are in process to sell one more stock from our portfolio. Post the completion of this sale, promoter's equity exposure will further reduce to just around 15-20% of the net worth. Though it's not a good situation to be in but it's better to be in bad situation than in the worst.

After proven wrong again and again over last 2.5-3 years about the equity market status, I do not have courage to express more. Neither do I have wisdom to change my views. Thus I will continue to bore you with my macroeconomics knowledge till the time I spit it all. Earlier I explained the importance of productivity as a means to grow. Today I will try to address the importance of exchange rates for the purpose of growth.

Currency depreciation as a means to create growth

Depreciation of currency below its fair value is widely used measure to propel growth. An undervalued currency shifts activity from other countries to the home country through higher exports/less imports. There is no doubt about that. Hence it brings growth to a nation with undervalued currency and the individuals of that country.

However there are few widely prevalent counter arguments which need to be addressed properly.

- a) Firstly, some will argue that so long as the competition between domestic manufacturers is good enough, competition will transfer all the benefits of undervaluation to the other country in form of low prices. True. However it will still render domestic manufacturers price competitive than foreign manufacturers and hence produce growth and more output for the nation.
- b) Secondly, some will also argue that higher level of growth/GDP will be less valuable as it will represent smaller claim on foreign assets/goods due to undervalued home currency. True. But then why a nation should measure its wealth in terms of how much foreign assets/goods it could buy unless and until it's going on a shopping spree?? So long as the nation continues to transact more, consume more within its borders, in its own currency, the nation's standard of

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living is improving no matter how much that is worth in terms of foreign currency. Why I should measure my wealth in terms of how many Audi's I can buy? I have a lot of appetite for food ☺ and I will measure my wealth in terms of how much food I can buy. In FY13 due to currency depreciation, India's GDP per capita in US\$ terms contracted by 1%. Did you really consumed/produced less in FY13 than in FY12? Was your standard of living lower in FY13 than in FY12? Do you really think so?

However there are three problems with this source of growth.

- a) First, for the world as a whole, currency depreciation of individual countries does not create any new growth. It just means one member of the family stealing growth from the other. Family is still not better off than it would have been otherwise. In fact it could be worse off. But more on that later.
- b) Second, it's not sustainable. Once a country tries to take such an advantage, slowly other countries walk into the same strategy and here begins the currency war. No one is really a winner in such a situation. However currency depreciation will create growth for a nation till the time the strategy is not adopted by other nations (it can be years or even a decade before it happens). Once other nations adopt this strategy they might even take back old unjustified growth through steeper depreciation. One generation will benefit at the expense of another.
- c) Third, a temporary growth created by such a measure creates disincentive to implement measures to create long term sustainable growth (to improve productivity). After all why would a thief think of working hard if he can continue stealing? But as said earlier, this theft is not sustainable. Slowly victim will itself become a thief and thief will become a victim.

Thus currency depreciation can lead to only temporary and unsustainable growth for a nation and individuals of that nation which can last for few years or may be a decade (which itself is a very long period). For the world as a whole, currency depreciation of individual countries do not create any new growth.

I believe India is currently trapped in a currency war being played between various developed and few developing economies. Indian central bank (RBI) has opted to stay out of it thinking that it has an option and means to do so. It has but only temporarily and that too at the cost of forgoing well deserved growth. RBI has probably (consciously or sub-consciously in the name of reducing volatility) confused the objective of protecting the fair value of rupee with protecting the value of rupee. But it's a just a matter of time. Sooner or later the invisible hands of the market will win the hand from RBI. Sooner the better...

But let's be clear that it's really hard to predict the direction and timeline for macroeconomic variables. I might be completely wrong in assessing the current state of exchange rates. Thus their assessment (consciously/sub-consciously) hardly enters into my stock picking criteria. It's always better to have the knowledge about the level of certainty. It helps.

That's it on currency depreciation as a means to grow from my side.

As usual please feel free to get in touch with me if you need any clarification on investment performance. Also please note that we have shifted our base to Mumbai area from Gurgaon. New address is available on our website.