

Honesty and Integrity Investment (HNI Investment)

Email for March 2020

Dear Friends,

Here are the details of performance of HNI investment based on the share prices as on 31st March 2020

Annualised Returns (IRR) ^{(1) (2) (3) (4)(5)}	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%
FY18	66.4%	17.0%	18.8%
FY19	-19.2%	16.9%	18.3%
FY20	-45.8%	-28.6%	-26.9%
Q4FY20 – IRR	-79.1%	-74.0%	-73.2%
Q4FY20 – Absolute Change	-32.0%	-28.3%	-27.7%
From Inception till 31st Dec 2019	34.2%	14.5%	15.6%
From Inception till 31st March 2019	-28.7%	-14.9%	-13.3%

(1) For all HNI clients and promoters (2) Inception was in August 2012 (3) Gross IRRs excluding the impact of HNI investment fees (4) Return during the quarter is reported only when it's adverse i.e. negative or lower than Sensex/Nifty. Quarterly IRRs looks overblown due to compounding effects of short periods (5) Absolute change is calculated based on IRR numbers for the quarter

I would also like to highlight the fact that though the returns since inception has turned negative, it's primarily because of relatively high deployment of capital since June 2018 due to increase in number of clients. We report IRR of all cash flows of all clients and promoters put together. There is relatively large number of clients who were not investing with us from FY2013 to FY2018 which were the good years. These clients have just seen one part of the cycle till date and yet to witness the other. The large difference between long term returns of last quarter and the current for both HNI and Index is also because of the same reason. I have highlighted the same point in December 2018 newsletter as well. Unfortunately we cannot perfectly time the markets or stocks. We can just buy when individual stocks offer margin of safety relative to intrinsic value. Rest will follow over long term if we are right.

Our portfolio value is significantly down during the quarter and the year. Out of the four liquid stocks that we hold, I see very high chances of permanent loss of capital in one of the commodity stock. Had it not been trading below cash, we would have sold it. Also the business even now has low probability of losing cash over long term. Hence it does not make any sense to sell it at these prices. Apart from that, I do not see any significant change in the long term outlook of any of the other three holdings as of now. But situation is very fragile. My opinion can change very quickly. Hence it does not have any value.

In markets like these everything is falling apart. Shares prices produced during these times rarely have any sanity from a longer term perspective. But I must say one think, in short term most of our portfolio companies and companies across the globe are going to get impacted because of

Honesty and Integrity Investment (HNI Investment)

COVID 19. But there is no doubt that all of our portfolio companies (including troubled commodity stock) will survive this extreme shock. They will be around 3-5 years down the line.

From July 2016 to June 2018, we were faced with a situation of lack of investment opportunities. Then opportunities started coming selectively and we deployed our money in select 4 stocks till Dec 2020. Now, I have to debate which would be best stocks out of so many available opportunities. It's the time to invest but with piece of mind and without fear of missing out. We should maintain calm and carefully analyse the situation. As I said earlier, earnings of most of the new investments as well will be impacted in near term due to COVID 19. But what we need to make sure is the survival abilities of the companies we invest into. Hence there should be no hurry and worry to act.

After effects of COVID 19

COVID 19 is an unprecedented global health crisis. No doubt about that. The speed of spread is astonishing. I have full sympathy for the people affected across the globe. Governments should do whatever is possible to help the affected and stop the spread. Economic costs to contain it don't matter.

But currently, I worry less about its impact on global economy because that is transitory. One can debate how long it will take to solve this pandemic. There is no need to debate whether it will be solved or not, simply because it will be. But for sure global slowdown is upon us due to this pandemic. It can last for 1-2 years may be 3 years and not more. This is not the end of world or humanity.

I am more worried about the long term after effects of actions of governments and central banks across the world in response to this pandemic. These after effects can last for really long time and can be very sever. Everyone in my view should devote more time than they currently do, to think about these after effects. But i guess this has not been done primarily because there was an urgency to act and a perceived readymade solution was available.

Across the world, sense of urgency to act has been given priority over debate for suitability of the action and it's after effects. In some countries like the US, urgency to act is also driven by the upcoming elections. Moreover monetary easing has worked in the recent past to solve global financial crisis of 2008/09. This successful experiment was readily available to central banks when COVID 19 hit the global economy. Hence global central banks in sense of urgency applied the readymade solution to a totally new problem instead to wasting time to think otherwise. It can be a typical example of man with a hammer syndrome (People are biased to use the tools they possess to solve problems at hand even though these might not be the right tools).

I worry how effective a solution to a global financial crisis is to a global health crisis. How can two totally different crises have exactly the same solution? Moreover even if it's an effective solution, it's possible that it's no more so, simply because world has already used it once. Think of it in a medical analogy. You take some sleeping pills its fine. You will sleep. But you take it again or take an overdose and you can sleep forever. We also know that monetary easing significantly created income inequality across the globe and it might accelerate now. Is the world a better place with such a high level of income inequality? Till how long the democracies will tolerate such a steep increase in income inequality?

Honesty and Integrity Investment (HNI Investment)

During 2008/09 financial crisis, president Obama said – “While the cost of action will be great, I can assure you that the cost of inaction will be far greater”. I am worried this time it might be the opposite. No one knows for sure. But we should be prepared for all eventualities. Currently everybody is demanding actions from central banks and governments without thinking about “eventualities” that might follow. That worries me a lot.

This is not to say that some people do not need economic/health support. They do and they should be helped. But scale and generosity of stimulus by governments and central banks deserves a more careful thought w.r.t its long term consequences. We should not forget that we and our children will, for sure, survive this crisis to bear the after effects.