Honesty and Integrity Investment (HNI Investment)

Email for June 2020

Dear Friends,

Here are the details of performance of HNI investment based on the share prices as on 30th June 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%*
From Inception till 31st March 2020	***-28.7%***	***-14.9%***	***-13.3%***
From Inception till 30th June 2020	***9.7%***	***-0.2%***	***0.4%***

(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

Before I say anything, I would like to take back few words I have written last quarter. Earlier I said "Now, I have to debate which would be best stocks out of so many available opportunities". Unfortunately, soon after I wrote this last quarter, I changed my position after a careful thinking of fast changing landscape. I do not think we have widely available investible opportunities primarily because of significant deterioration in finances of many companies that can follow. However, there will be selective opportunities and we will act as soon as it is appropriate to do so.

I have presented factual data in June 2019 letter, indicating that equity markets have not done that well as is widely believed it to be (even at that time high level). Since then markets have corrected, interest rates have declined dramatically. In normal situation the outlook for next 3-5 years would have improved due to these changes. Unfortunately fundamentals have also deteriorated significantly since then due to continued problems in Indian financial system (both banks and NBFCs) and COVID. Overall I do not think equity indices will give good returns in real terms over next 3-5 years. However there is very high likelihood that they will outperform returns generated from government bonds. Moreover, small companies that can survive this crisis might do better than large/midcaps primarily due to valuation gap. But all that assessment is based on present level of valuations and fundamentals. Any substantial change in any one of them will deserve a careful reassessment.

Now let me come to the portfolio performance. Here I am going to present to you an ***irrelevant analysis*** which many market participant and investors believe as relevant to judge a manager's investment capability i.e. how a manager has performed during a downturn. Please have a look at the table below:

Absolute Returns	HNI Portfolio	Nifty	Sensex
Jan-March 2020 – COVID fall	*-32.0%*	*-28.3%*	*-27.7%*

April-June 2020 – COVID Recovery	35.6%	19.8%	18.5%
Jan-June 2020 – Overall COVID fall	**-7.7%**	**-14.2%**	**-14.5%**

As you can clearly see that HNI portfolio has done better as compared to the market during these six months of COVID crises. This is in spite of the fact that a) there has been no portfolio changes during these six months (else buying new/existing stocks at bottom would have added to outperformance) b) all of the HNI portfolio is made up of micro/small cap stocks while indices are all large caps. So what does that signify to investment manager's capability? Truly speaking nothing!!!. Let me know tell you why?

Firstly, the COVID crisis is not over yet and you do not know when will it be over and how numbers would stack up when it's over. Secondly, though we have done better than Sensex/nifty, we are still losing money (at least on paper). Be wary of anchoring bias. I have always said that Sensex/nifty is not the benchmark to judge our performance. It's just an indicator of the broader equity market environment. Thirdly, analysis is for a very short time frame and is unlikely to be an indicator of a manager's long term investing capability.

So then **what is the relevant analysis** to judge an investment manager? Though it might not be perfect but below are my views on this subject.

Good analysis would the long term investment performance preferably at least over 3-5 years (longer the better). This is being regularly presented to you every quarter.

Better analysis would be the returns in the portfolio of exited stocks because a portfolio might still have short term performance of some unsold stocks and exit capabilities of a manager will only be reflected in exit prices.

Best analysis would include conservative separation of luck and capabilities from the better analysis. Only investment managers themselves can convert a better analysis to best. Hence they should be wary of self-attribution biases. But it is in their own interest to judge themselves only by best analysis. Both better and best was presented to you in March 2018 letter and as and when an exit is made.

Rotten Tomatoes will spread TS Virus

Before I finally close the letter, I would like you to read an interesting story on my twitter and LinkedIn handle titled **Rotten Tomatoes will spread TS Virus**. It's a very interesting story on how some managers can siphon off money from a company and in a completely legal manner without shareholders getting to know about it from company's financial statement. It also has some resemblance to Wirecard (a fraudulent German company who has recently filed for bankruptcy). Here is the link to twitter and Linkedin

https://twitter.com/VaibhavBadjaty2/status/1277930492084383750?s=20

https://www.linkedin.com/pulse/rotten-tomatoes-spread-ts-virus-vaibhav-badjatya/

That's it for the quarter from my side. Happy to answer any questions that you may have.