<u>Sohum India Opportunities Fund: Investor Update Newsletter, September 2023</u>

"PM Modi is a man whose time has come, just as India's time has also come. He and India are in a similar position to Deng Xiapong and China in the early 1980s, that is, on the verge of experiencing the fastest growth rates and the biggest transformations in the world. The country is at a juncture where a lot of opportunities will be created".

- Ray Dalio after meeting India's Prime Minister, Narendra Modi, June 2023

"I think the optimism of India is actually completely justified".

- Jamie Dimon at the JP Morgan India Conference, September 2023

It is amply clear that the world is sitting up and finally taking notice of India. This was further corroborated by Delhi's hosting of the G20 summit recently and the outcome statement balancing the Ukraine-Russia issue with economic issues. The mood on the ground remains fairly buoyant. The September manufacturing PMI clocked 57.5, albeit the slowest in the last 5 months but was the 26th straight month of the index being above the 50-mark. India's real estate sector is having one of its best years after a lull for the past eight. As per Knight Frank India's latest report, properties priced over Rs.1 crore saw a 39% yoy increase in sales in the period July-September, while the mid-segment, ranging from Rs.50 lakh to Rs.1 crore, witnessed a 14% yoy rise. Government capex spending has also been on a tear with central govt. capex expenditure up 48% yoy for the first five months of FY24. The key beneficiary of this spending continues to be railways and defence.

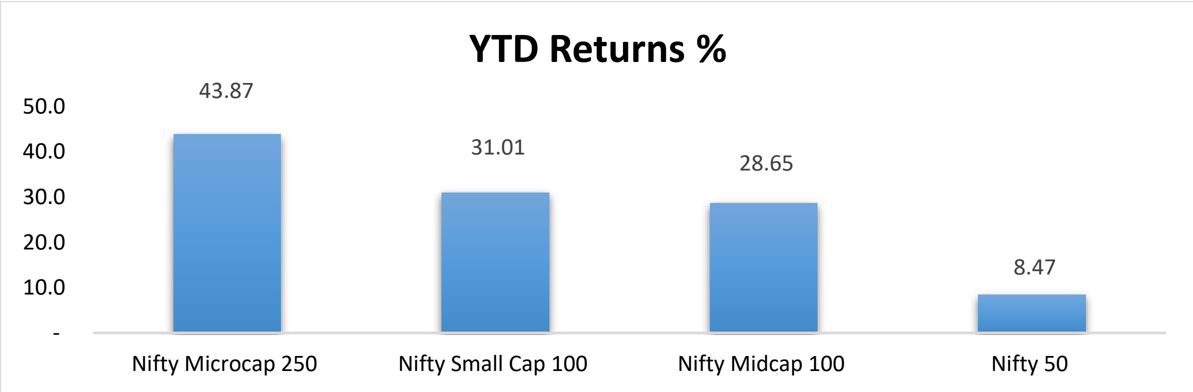
The Electronic Manufacturing Services (EMS) industry in India has been growing exponentially. In fact, electronic exports have now overtaken textiles, pharmaceuticals, and chemicals to become the fourth-largest item to be exported from India. For example, Apple exported Rs.20,000 crores/$2.4 Bn worth of iPhones from India in the 1Q FY24, +400% YoY. While the figure is tiny compared to the company's $383 Bn of annual sales (TTM), it makes a great headline for Indian manufacturing as one of the alternatives to China. Further, India has become the world's largest digitally connected democracy with the highest volume of digital payments in the world – more than the US, UK, Germany & France combined. This in turn, is helping in accelerated formalization of the economy.

Clearly, the Indian economy has taken off, with investments rather than consumption being the key driver after a fairly long time. This is likely to lead to a phase of steady growth with more job creation and less macro imbalances. The growth rate may not be as high as the best phase in the past (due to a slowing global economy), but it is likely to result in an exit from the slower growth phase of the last decade. **Moreover, as we have been highlighting, this take-off has been possible because of the strong balance sheets of all major stakeholders – households, corporates, banks and even the government as well as an extremely credible and responsible central bank (RBI).**

While the Indian economy has been moving from strength to strength, the global economic picture looks far less salubrious. In the US, while consumer spending has been holding up, financial conditions continue to tighten with the 10-year g-sec yield now up 70bps in the last one month to 4.8%. The result is that bond yields is now above the level of nominal GDP growth, making debt servicing a real challenge. Closer to home, China which has been a major driver of global growth in the past decades, is struggling to maintain its high growth trajectory as it looks to transition from a manufacturing economy to one that is more focused on services and domestic consumption. With youth unemployment at record highs, credit growth at lowest levels since 2009, household savings rate continuing to rise and one of the biggest property developers on the verge of default, there is increasing evidence that the **Chinese economy is in the midst of a likely "balance sheet" recession.**

With the growth engine of the world stuttering and given the clarity around the tailwinds to India's growth trajectory for the next decade, it does feel like India's TINA (There is No Alternative) moment. This exuberance is being well-reflect in Indian equities. Although the headline Nifty Index has performed in line with other global markets YTD, the broader markets have materially outperformed the large caps as shown in Exhibit 1.

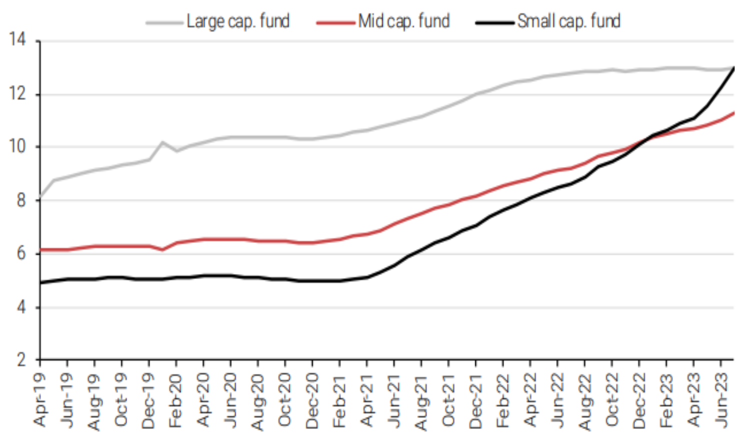
Exhibit 1: YTD Returns



Source: Bloomberg, Data as of 29th Sep 2023

While the recent rally in the broader markets has been backed by underlying fundamentals of the economy improving significantly, there seems to be an element of excessive liquidity at play also with retail investors' fund flow increasingly gravitating toward riskier segments. Mainboard IPOs are being heavily over-subscribed, the number of SME IPOs has seen a sharp jump over the last few years and mutual funds are seeing increased flow in small/mid-caps in place of large caps (Exhibit 2).

Exhibit 2: No. of folios under large-cap, mid-cap and small-cap funds (mn)

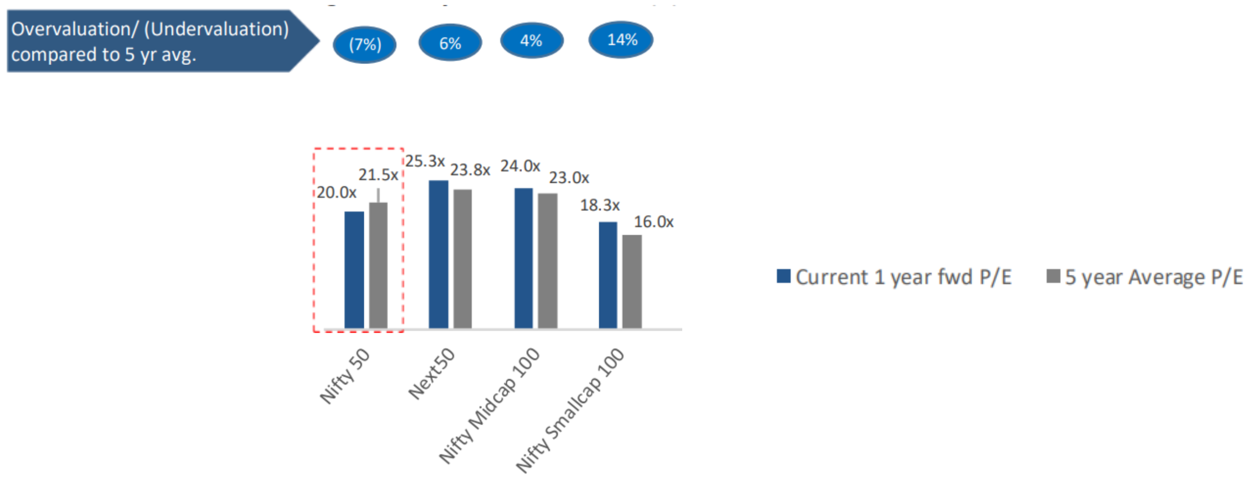


Source: Kotak Institutional Equities

As a consequence, valuations of the broader market now look quite stretched while large caps continue to trade at reasonable valuations (Exhibit 3). As hardcore GARP investors, our strategy has always been to buy growth at acceptable valuations. While we are willing to pay a small premium in some names where we see longevity of growth or high probability of outsized returns, our overarching philosophy remains 'buying right' with a reasonable margin of safety in valuations. ***For these reasons, our portfolio allocation continues to be tilted towards the large cap space (As of 29th September – 75.5% is large cap, 19.0% in mid/small cap & 5.5% cash).***

The recent consolidation in large-caps has been accompanied by earnings expansion, making risk-reward highly attractive viz-a-viz the broader markets. ***With FY24 EPS of Rs.950 and FY25 EPS of Rs.1080, we think that Nifty could move towards 21,600 levels in the next 9-12 months with possibility of 3-4% from current levels (19500) due to global uncertainties.***

Exhibit 3: 1 year Forward PE (x)

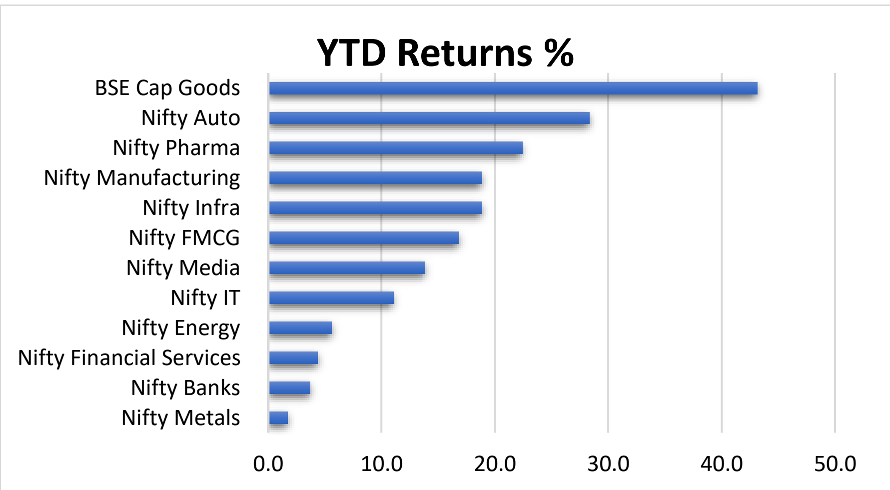


Source: Haitong Research, Data as of 29th Sep 2023

<u>Portfolio Composition & Performance</u>

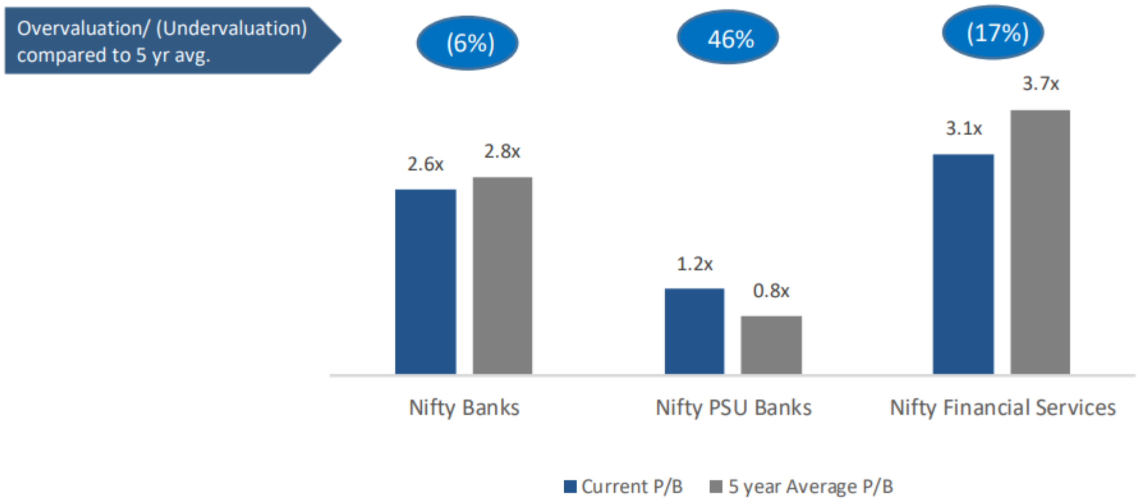
We remain sanguine about the pick-up in investment cycle in India and are looking to play this theme via our exposure to domestic cyclicals like banks, auto, real-estate, construction material, power and infrastructure/capital goods. We continue to remain underweight IT and consumption. Exhibit 4 shows the YTD performance across sectors. Quite surprisingly, in the last three months, NSE Bank Index has underperformed the NSE IT by 12%, with concerns being raised about the extent of NIM compression for banks. We believe that these concerns are exaggerated. In our view, with deposit rates now stabilizing, margin pressure should start to ease from Q3 onwards. In addition, strong credit growth, benign credit costs and some moderation in cost-income ratios will continue to keep earnings growth and return ratios healthy for the banking system for the next couple of years. On the other hand, IT services may have to continue to contend with an uncertain DM outlook going into FY25. Also, while valuations for the IT sector still remains above its 5-year average, the banking sector has seen a significant moderation in its multiples despite decadal high RoA/RoE (Exhibit 5).

Exhibit 4: Sectoral CY23YTD change (%)



Source: Bloomberg, Data as of 29th Sep 2023

Exhibit 5: Banks valuations have moderated.



Source: Haitong Research, Data as of 29th Sep 2023

Overall, as of 29th Sep 2023, our flagship Sohum India Opportunities Fund has since its inception (20th May 2022), gained 34.7% (pre-tax), net of applicable fees. In the same period, the NSE 50 Index has delivered 20.73% and NSE 50TRI Index has returned 22.97%. Despite markets being close to their all-time highs, there are significant divergences in performance of large-caps vs. mid/small-caps and across sectors. We believe valuations will become an important driver for stock picking to drive outperformance given the divergence seen so far in CY23YTD. Our approach remains the same – buying fundamentally strong companies which are available at reasonable valuations relative to their growth (GARP). Our portfolio companies across all segments large, mid and small cap are well poised to deliver industry-leading earnings growth and we anticipate the same to translate into benchmark outperformance in the near to medium term.

Warm Regards,

Sanjay H Parekh