

February 3, 2013

Dear Investors,

Our Performance So Far

Going forward we are going to use the performance of the model portfolio to provide performance updates. For most investors the performance should be within 2-3 % of the model portfolio depending on their inception dates. We have sent your individual portfolio performance separately which will show a detailed portfolio position as of February 3, 2013.

What the Future Holds

During the year 2012, foreign investors (FIIs) invested more than \$ 24 billion in Indian stock market but domestic investors sold more than Rs. 55,000 crores worth of stocks. So it seems that both have contradictory view of the Indian stock market and hence the economy going ahead. In the short term, the performance of the stock market isn't always dependent on the economy but driven very much by the fund flow from the foreign investors. With humungous amount of money been printed by the central banks all around the world, foreign investors are running out of safe investment options and are going after relatively superior investment destinations. India happened to be one over the past 13 months. **Can this continue?** It's extremely difficult to predict what the thought process of various types of foreign investors is going to be. Some other countries may become better options for them going forward. In that scenario, they may move money out of India and into better destinations even if Indian economy continues to improve in absolute terms.

There are too many moving parts for anyone to comprehend how world economic events would pan out. Knowing what the future holds is almost impossible to know, but knowing the fact that it's almost impossible to predict is the key to not committing grave investment mistakes. As Mark Twain said:

"It ain't what you don't know that gets you in trouble. It's what you know for sure that just ain't so"

Even though we follow the macro development around the world economy, we don't claim to know what the macro future is going to be. We are going to stick to what we can do best and that is to analyze companies at as micro level as possible. We want to find companies who will continue growing at more than 20% irrespective of what the macro climate is. We want to make sure we stick to our strengths and never forget our weaknesses. Entering unknown territory is what brings risk in our investment, and controlling risk is our main goal. **We are striving not just for high returns, but risk-adjusted high returns.**

So what has kept the domestic investors away?

Indians have nearly \$15 trillion invested in real estate, almost \$1.5 trillion in Gold and the value of the entire Indian stock market is just \$1.2 trillion. Out of this, majority equity is owned by the promoters and the foreign investors. Average Indian barely has 2% of his wealth in equities. Why is this so?

Most retail domestic investors are known to be always late to the party. When economic news are rosy all around, when they read markets making new highs, or when they hear about their friends having made huge returns in the stock market is when most retail investors rush to invest. This is the exact time (fortunately today is not such a time) when most advisors, be it local brokerages or foreign investment firms/banks, are shouting loud that everyone should be in the stock market. That is the time when they are equipped with a lethal weapon – that of historical returns of stock market. It's easy to convince people by showing how stocks have given 30%, 40% return last year and most believe that it's the norm and decide to jump in. This timing when most get convinced to jump in is typically the wrong time and they get burnt.

People have lost trust in their investment managers and they are perfectly justified in their views. Many investment managers have found to be buying/selling for themselves before doing it for their clients. Not only that, some have even taken opposite investment positions to what they have advised their clients. It's unfortunate that many investment managers have become rich at the expense of their clients.

According to us, along with sound investment approach, the two most critical attributes that are needed in an investment manager are Integrity and Competence. Unfortunately one of them or both have been found missing in majority of the investment managers.

Competence and investment approach can be measured by the returns, but integrity can only be reliably known through personal experience. Integrity is of utmost importance in our investment journey. Personally, we are doing this not just for money, but because this is our passion, we enjoy seeing investments grow and this is what we intend to do for the rest of our lives. I make it a point to stay disciplined to make sure that I also buy along with you at the same prices as I buy for you. Also I am invested with majority of my savings in the same stocks. It's extremely important for me that no investor has any doubt in his/her mind about any conflict of interest (in my personal investments) and hence my positions are open to any one of you at all times.

Should there be any queries, I'm always available. Please do not hesitate to contact me.

Warm Regards,

Samit Vartak, CFA

Chief Investment Officer