Quarterly Newsletter

THE INVESTMENT TRUST OF INDIA
LONG-SHORT EQUITY FUND

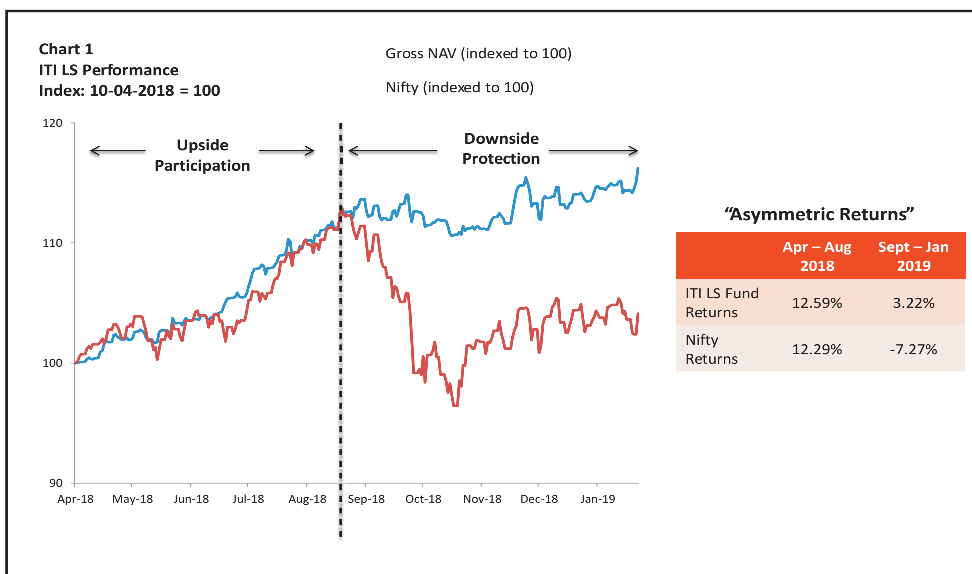
27th February 2019

Dear Investor,

For the quarter ended 31st December, 2018, our returns were +0.60% (vs -0.62% for the Nifty). For the month of January 2019, our returns were 1.83% (vs -0.29% for the Nifty) and since inception (i.e. from April 11, 2018 to 31st January, 2019) our returns are 15.71% (vs 4.12% for the Nifty). Kindly note, all returns are after expenses and before management fees and taxes. Please refer to Annexure 1 for additional details.

We have mentioned earlier that we are a fundamental driven, stock picking oriented long-short equity fund focussed on long term capital appreciation. Our fund objective is to outperform the Nifty Index over a full equity market cycle, while protecting downside during equity market downturns along the way.

The flexibility of the fund to participate in rising markets, while protecting capital during periods of decline (or even look to produce returns in declining markets due to the ability to short) creates an "asymmetric" returns profile for the fund. We believe this effectively helps lower volatility in performance, reduces risks and enhances the odds of beating the indices or even long only funds over a full cycle. Notice from the chart below that our performance so far has been in line with this expectation:



"Asymmetric Returns"

	Apr – Aug 2018	Sept – Jan 2019
ITI LS Fund Returns	12.59%	3.22%
Nifty Returns	12.29%	-7.27%

FUND PROFILE

Structure: Open-ended, CAT III AIF

Domicile: India

Currency: INR

Liquidity:

Contribution: Monthly

Redemption: Monthly

Min Initial Investment: INR 1 crore

Auditor: S.R. Batliboi & Associates

Investment Manager:

The Investment Trust of India

Fund Accountant:

IL&FS Securities Services Ltd

Custodian:

IL&FS Securities Services Ltd

Trustee: Vistra ITCL (India)

Managing Director & CIO

Rajesh Bhatia

Fund Managers

Rajesh Aynor

Siddhartha Bhotika

Research Analyst

Akash Jhaveri

Head –Business Development

Vinay Mahajan

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The “Art” in Risk Management: Why do smart people make fatal mistakes?

Over the past year or so, there has been a spate of news flow on several prominent sponsors/ promoters losing or on the verge of losing their entire companies under the Insolvency & Bankruptcy Code (IBC) mechanism. Corporate banks which had lent to the aforementioned companies have been reported to be equally bruised by high proportion of non-performing loans, leading to curtailed operations (as in the case of multiple PSU banks), significant change in management personnel and raising capital to meet regulatory guidelines and growth aspirations. More stark were events in mid-September 2018 when tightening of liquidity exposed other “fault lines”, especially in the NBFC sector pertaining to aggressive leverage, asset-liability mismatches and riskier lending, which in turn resulted in some tremors in the money markets. Echoes of this risk aversion was then felt by some leading corporate groups left exposed with their core shareholding in their companies pledged as Loans against Shares (LAS) to lenders; with the latter quite willing to unload the shares in the markets to any buyer to ensure recovery of their dues. **What is interesting to note is that in each of the above cases, the central problem was leverage (or an excess of it), with the end game becoming a question of survival for the risk taker.** To be sure, bankruptcies or bad debts are part of any credit cycle – in India or across the world – and hence such developments are no surprise at all.

In sharp contrast though, the following was gleaned from Berkshire Hathaway’s recently published annual report, quoting its Chairman, Warren Buffett: “Berkshire held $112 Billion at yearend in US Treasury bills and other cash equivalents and another $20 Billion in miscellaneous fixed-income instruments. **We consider a portion of that stash to be untouchable, having pledged to always hold at least $20 Billion in cash equivalents to guard against external calamities.** We have also promised to avoid any activities that could threaten our maintaining that buffer”. Warren further adds “Berkshire will forever remain a financial fortress......I will never risk getting caught short of cash”.

Clearly, Berkshire’s conservative approach to risk management (creating a buffer) prepares it to endure extreme excesses of economic volatility, with negligible risk of blowing up. Not surprising then, this approach has ensured fifty-four years of hiccup-free performance of the company whilst navigating several credit cycles and boom-bust periods along the way.

It bears mention that we are merely seeking to make comparisons on the approaches to risk management and as to what can be learned from the contrasting styles. Of course, the future is uncertain and there is always a risk that investment decisions taken today, however careful and well thought-through presently, may result in some very adverse outcomes later. But in this discussion we are more focused on the “mindset” or the way of thinking while arriving at these investing decisions. According to us, risk management is the quality of preparedness for the uncertain future. **It has been our observation that several fatal errors of the kind mentioned above arose due to predictable irrationalities of decision makers as social beings. Simply put, these errors were caused due to human misjudgements.**

The following instances of misjudgements come to mind: **Envy/Greed** (One can recall a conversation with a Delhi-based industrialist, eyes green with envy, asking us in mid-2000 “Is Bharti Telecom’s market cap for real or just artificially inflated? - not surprising, newer players hoping to replicate Bharti flooded the market with twelve players per circle), **Institutional Imperatives** (“Our corporate lending book has to grow faster than competition, else we would be seen as losing market share – so let us look for large deal sizes”), **Imitating the crowd** (“Housing Finance/NBFC is a high growth market, which we must participate in – everyone is doing so!), **Incentives** (“The bank’s top management are incentivized by ESOPs and hence reporting of results must exclude bad news to keep share prices up”) and Short-term **thinking** (“Our fund has to show higher short-term returns, else we may lose clients and hence we must take greater risks”) or **Overconfidence** (“We made our mark in media, but we are confident that we can smoothly execute the large unrelated diversification into infrastructure funded by high leverage”). Any astute observer of corporate India would know whom these examples pertain to.

We believe that the strongest antidote to such irrational decision making is to keep things simple and use common sense – we hope to learn and ingrain this antidote deeply into our organisational culture. As a firm, we are sharply focussed on persistently improving our investing process with a desire to build a healthy long term track record.

Wish you a very happy 2019 !

Regards,
Rajesh Bhatia
Manging Director & CIO
ITI Long Short Equity Fund

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ANNEXURES

Annexure 1: Our Performance

Gross Returns	Since Inception*	Jan-19	Dec-18	Nov-18	Oct-18	Sep-18	Aug-18	Jul-18	Jun-18	May-18	Apr-18*
ITI LS	15.71%	1.83%	-0.66%	3.00%	-1.69%	0.53%	2.00%	4.66%	1.53%	1.34%	2.31%
Nifty	4.12%	-0.29%	-0.13%	4.72%	-4.98%	-6.42%	2.85%	5.99%	-0.20%	-0.03%	3.24%

*Since April 11; after expenses, before management fees and taxes

Annexure 2: Portfolio Snapshot as of 31st Jan, 2019

Strategic Long Positions

Stock	PF Weight
HDFC Bank	9.30%
HDFC Limited	7.10%
Infosys Limited	5.90%
L&T Infotech	4.60%

Top Tactical Longs

Stock	PF Weight
ICICI Bank	7.50%
Larsen & Toubro	5.60%
Axis Bank	5.30%

Top Tactical Shorts

Stock	PF Weight
Auto Ancilliary	2.00%
BFSI	1.80%

Annexure 3: Performance Attribution

Our portfolio return across four buckets of focus of strategic long (core long-term portfolio), tactical longs, tactical shorts and fixed income (primarily liquid funds) returns:

Stock	PF Weight
Strategic Long	3.8%
Tactical Long	3.9%
Tactical Short	3.4%
Fixed Income	4.6%
Total	**15.7%**

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