KUVERA CAPITAL PARTNERS LLP

JULY 2017 KUVERA FUND

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YEAR
2017	1.30%	2.85%	2.69%	2.29%	2.26%	0.79%							12.80%
2016	1.28%	-0.60%	0.04%	0.54%	2.32%	-0.27%	2.26%	0.73%	-0.99%	1.44%	-3.89%	0.18%	2.91%
2015	4.01%	1.03%	-2.37%	-2.33%	1.32%	-0.29%	0.79%	-3.85%	0.15%	0.76%	0.30%	2.62%	1.89%
2014	-1.76%	1.90%	4.20%	-0.24%	4.71%	2.01%	0.32%	1.69%	-0.64%	2.92%	1.54%	-2.51%	14.79%
2013	2.10%	-2.89%	-0.23%	2.01%	-1.01%	-1.69%	-1.20%	-3.91%	3.16%	4.88%	-1.16%	1.19%	0.89%
2012	8.12%	2.01%	-1.80%	-1.42%	-4.39%	3.13%	-0.73%	0.45%	5.74%	-1.12%	1.60%	-0.23%	11.26%
2011	-3.18%	-0.92%	4.63%	-0.59%	-1.89%	1.03%	-0.72%	-4.14%	-1.65%	3.42%	-5.88%	-1.54%	-11.27%
2010	-2.61%	0.54%	3.19%	0.52%	-2.82%	2.27%	0.32%	-0.23%	6.32%	-0.08%	-0.17%	3.42%	10.81%
2009	-1.98%	-3.47%	4.99%	5.78%	5.28%	-2.29%	2.96%	-0.48%	6.19%	-2.61%	2.44%	0.65%	18.12%
2008	-2.46%	-2.41%	-6.25%	-0.13%	-4.95%	-6.49%	2.63%	-2.94%	-3.83%	-8.53%	-0.43%	10.58%	-23.56%
2007	0.96%	-2.54%	1.11%	3.93%	1.95%	0.08%	1.74%	-0.84%	4.79%	5.61%	-0.96%	2.19%	19.21%
2006	5.67%	1.25%	4.52%	3.17%	-3.41%	-1.95%	-1.08%	1.73%	2.04%	2.69%	4.71%	-1.33%	19.04%
2005	-1.47%	4.44%	2.49%	2.37%	-0.39%	3.16%	2.38%	0.94%	0.39%	-2.25%	2.63%	2.47%	18.32%
2004							-0.04%	0.10%	3.97%	-0.30%	4.10%	8.57%	17.22%

SUMMARY

June '17
Nifty +16.31%
INR +5.18%

1. India one of the best performing markets and currencies ytd.
2. Earnings growth required if valuations are to be supported
3. Front ended Govt. spending a fiscal risk if private sector does not participate
4. NPA position still unsatisfactory despite govt. initiatives
5. Global risks persist – remain unconvinced about global

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businessawards twothousand&fifteen Best India Focused Investment Boutique

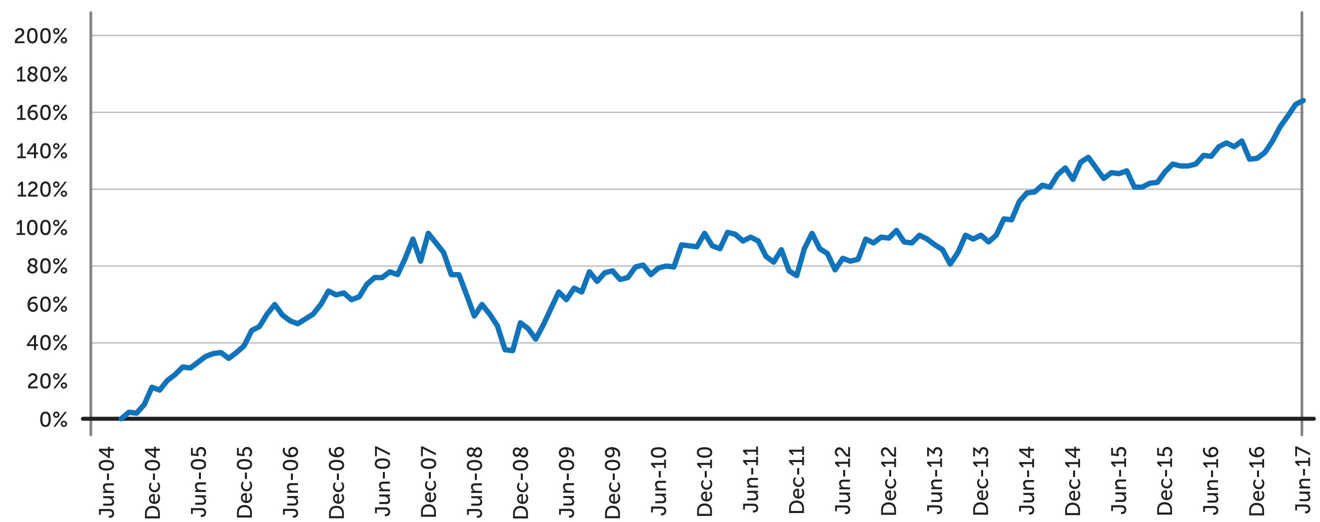
GLOBAL FUND Awards 2016 - WINNER -

alternative investmentawards twothousand&fifteen Best Indian Focused Hedge Fund - UK

AI M&A awards Best Boutique Emerging Market Investment Management 2015

GLOBAL FUND Awards 2015 CORPORATE LiveWire - WINNER -

CUMULATIVE RETURNS



PORTFOLIO ATTRIBUTES

SECTOR	NET WGT.	RETURN
AUTOS	5.97%	2.77%
BANK	8.08%	2.44%
CAP GOODS	3.22%	0.37%
CEMENT	12.80%	2.68%
FMCG	8.04%	1.25%
IT	9.84%	-0.42%
METALS	-6.65%	-1.32%
OIL & GAS	8.72%	0.87%
GOVT. SPEND	15.05%	3.40%
PHARMA	5.35%	-0.22%
REAL ESTATE	-3.78%	-1.31%
TELECOM	-2.90%	-0.29%

GROSS	130.64%
NET	63.74%

Our bearish investment thesis, continues to be informed by the ineffective central bank polices implemented since the GFC in 2008. Globally, asset prices have responded positively to the low interest rate high liquidity environment, in some cases doubling. In our view, this ignores the risks associated with the exponential rise in global debt and the market distortions created by low and in some cases negative rates.

Despite our overall negative view, we have been running net exposures of between 60% - 80%, using cheap volatility (resulting from higher asset prices) to protect the portfolio. *In the few periods that markets have fallen the portfolio has significantly outperformed because of long the volatility positions.* Outright market timing is risky strategy (especially in the current environment), and a portfolio positioned to only benefit from a market fall, would have suffered significant losses.

SO, WHAT'S WRONG?

The global monetary experiment unleashed by central banks has resulted in distorted incentives, the results of which we have documented in previous notes. The monetary stimulus in the form of suppressed interest rates and bloated central bank balance sheets has created even bigger risks, either in the form of potential bubbles such as the auto/student loan market, sovereign bonds or stretched valuations. *Put simply an unprecedented amount of debt has been used to try and solve a crisis that was caused by too much debt.* Meanwhile sustained growth remains elusive, global debt now stands at unsustainable levels and markets have been prevented from working.

IT HAS NOT WORKED FOR OVER TWO DECADES.

The Japanese experience shows, that despite decades of intervention using the same stimulus polices, growth

July 2017

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remains anemic but debt now stands at 250% of GDP with the BoJ a significant owner in both equity and bond markets.

Unsurprisingly, the results are going the same way in Europe and USA, (despite the gloss put on the results by central bank governors). *Despite the exponential growth in debt, US GDP is struggling to stay above 2%*.

Employment numbers that are the much-touted success of these policies belie anemic wage growth, lack of breadwinner jobs created and labour participation rates at all-time lows. *The major beneficiary of these policies is asset prices.* With stock markets hitting all-time highs, valuations look stretched, the S&P is trading at around 24x (based on LTM), where much of the earnings growth has been generated by share buy backs and the breadth of the rise limited to a few names.

Perhaps the best indicator of the real state of the economy is the Feds reluctance to normalise rates and balance sheet size. Yellens recent missive that she does not see a crash in our lifetime is a prediction that will surely rank along Bernanke's 2007 statement '...the subprime crises is contained' and Irving Fischer's Oct 1929 view that 'Stock prices have reached what looks like a permanently high plateau.'

CRACKS SHOWING?

The European banking system continues to appear vulnerable — Deutsche bank with its opaque derivatives exposure and more recently with Italy bailing out two banks (once again breaking EU bailout rules). Both the US auto and student loan markets are beginning to show signs of fragility — (having been encouraged by central banking and government policies). Interestingly though the BoE recently sounded a note of caution increasing banks capital requirements.

Our negative assessment is not a view universally shared either by commentators or brokers. With many believing that growth numbers are sustainable and based on sage macroeconomic management.

One certainty is that at the first sign of a wobble, Yellen and her fellow central bankers will abandon any ideas of normalizing rates and balance sheets and revert to priming the pumps.

INDIA

India is affected by some of the same issues affecting developed markets, namely *high level of NPAs, rich valuations, tepid earnings growth, and the need to create jobs* — (Indian demographics require that approx. 10m new jobs are created annually), however unlike developed markets, India's debt to GDP remains relatively low at 68% (eurozone at 90%, US at 100% and Japan 250%), GDP growth is high at approx.7% and Fx reserves are at all time high at about $390bn. Whilst the government is to be commended for implementing some much-needed reforms e.g. deregulating oil prices, *it has been slow to recognise and deal with the high level of NPAs* and in our view created further moral hazard with a $15bn farm loan waiver program. Private capex has yet to recover, (in part due to high balance sheet leverage and low utilization).

Government (state and central) has taken up this slack and front ended infra structure spending in the hope that this will kick start private sector growth. *If the corporate sector does not start to deliver on earnings growth it will be difficult to justify valuations on yet more premium expansion.* Additionally, this could lead to a deterioration in the fiscal position.

TOP 5 WINNERS

NAME	SECTOR	L/S	RETURN
JET	GOVT. SP	LONG	1.66%
TVS	AUTOS	LONG	1.34%
GRASIM	CEMENT	LONG	1.23%
BEML	GOVT. SP	LONG	1.07%
MARUTI	AUTOS	LONG	1.02%

TOP 5 LOSERS

NAME	SECTOR	L/S	RETURN
DLF	REAL EST.	SHORT	-1.51%
TATA S	METALS	SHORT	-0.76%
IDEA	TELECOM	SHORT	-0.69%
OBEROI	REAL EST.	SHORT	-0.50%
TECH M	IT	LONG	-0.49%

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Valuations Rich — Needs Supportive Earnings Growth

At the time of writing the NSE has hit all-time highs. Valuations on trailing earnings remain rich at approximately 25x *(figure 1)*. Earnings growth to date has been tepid, and we believe that to sustain current valuations, consensus forecasts between 15%-20% need to be achieved. This seems high given that the CAGR for the period FY09-FY16 was only 4% and that forecasts continue to be down-graded through the year.

Credit Growth Weak — Government spending strong, but for how long?

Credit growth remains weak (in part due to low utilization levels, high leverage and NPAs.) with private sector capital formation yet to recover. Central Government spending continues to be strong, growing 30% in FY16 primarily driven by roads and railways, we also see further support for the housing sector, with various government initiatives. If private sector growth is not forthcoming this will either result in a decline in government spending or a risk to the fiscal position.

At the state level, we are already seeing a reduction in spending, with some states exceeding the 3%, budget deficit and the spread between state and central govt bonds widening to 100bp.

Strong currency (+5%) RBI unable to intervene

The INR gained approximately 5% — outperforming most other EM currencies for the first half year helped by strong portfolio flows (approx. $13bn) and relatively high real rates. Due to the liquidity in the banking sector (from demonetisation), the RBI was unable to intervene, despite indicating that they were uncomfortable with the strength (50% of nifty eps linked to global economy). Sterilizing these flows would only increase liquidity. We had increased currency exposure over this period.

PSU banking problems remain short (8.73%) / private banks gaining — long (16.80%)

A recent Mckinsey report highlighted the woeful position of Indian public sector banks. Indicating that in aggregate stressed assets are more than 50% of net worth. Whilst still accounting for 70% of the banking system, market share for PSU banks has declined from 85% to 79% over the last 5 years. The report concludes that both capital injections and structural changes would be required to provide long term sustainable growth. These conclusions echo our long-held view of the banking sector — and has informed our long position in private sector banks (+3.52%) vs short PSU banks (-1.08%). *Government attempts to solve these have been ineffective as they have not address the fundamental issues of capital and ownership/incentives*.

Long (15.05%) — government spending (defense, railways & infra)

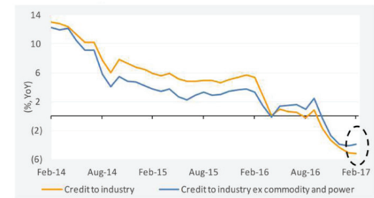
We continue to focus long positions in those areas that will benefit from predictable government spending, defense (also benefiting from the make in India initiative), housing and infrastructure.

Exposure of 15.05% to government spending contributed 3.40% for the year to June 17, this was primarily focused on defence and infra.

Cement which will benefit from the governments housing for all policy *at 12.8% contributed 2.68% for the period.* In addition to government

figure 1

Weak Credit Growth



Strong Govt. Spending

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policy the industry dynamics of low capacity additions, falling input costs and low utilization will outweigh the short-term demonetization impact.

Short Telecom — competitive pressures and high debt (Net exposure -2.90%, -0.29% contribution)

Having taken partial profits in this position we continued with the balance of the short exposure. Competitive pressures within the sector are intense. Despite the Reliance Jio 'free period' having now ended, their minute pricing is still approximately 3x below incumbent players. The short position in RCOM (with the added problem of debt) worked well falling over 35%. Consolidation within the industry remains a key risk, as takeover rumors in Idea forced us to cut our position. taking a loss of 0.69% *(figure 2)*.

Oil and gas — oil marketing 8.72%, 0.87% contribution

We have been running long positions in OMCs for over a year now with price performance varying between 50% -70%. Despite this outperformance we continue to see upside. On a regional level Indian OMCs remain cheap with refining margins well below regional peers, ROE of 30% however place them in the top quartile. *Part of the reason for the discount vs regional peers is the risk that government subsidies would hit the companies directly* — this risk is now further reduced by the prospect of daily pricing which will provide additional earnings certainly (less inventory and fx losses) and expedite positive margin creep. With daily pricing lowering risk of govt intervention we expect the rerating to continue *(figure 3)*.

Technology continues to under-perform (long 9.8% contribution -0.42%) — pure valuation play

Current valuation levels are pricing only single digit growth, we see little stock specific downside, especially given recent earnings guidance.

Autos — net long 5.97% (gross 18.24%). 2.77% contribution — structural shifts within the industry

We are positioned (both long and short) to take advantage of what we think are structural shifts in the auto industry. This is happening across the range from the scooter segment to heavy commercial vehicles. *Maruti in the PV segment, (albeit a consensus long), continues to perform exceptionally well.* Now a virtual monopoly (48% of the PV market) it has adapted well to the premiumization of the PV market, competing across all segments and increasing market share by 9% in the past five and with over 2000 dealerships five times that of its nearest competitors. Geographical diversity is key to addressing the Indian market, and the one size fits all employed by foreign competitors is not working, with some like GM leaving all together. *The short position initiated in Tata Motors worked well with the name falling 7.51%.* Domestically, it is losing market share to Ashok Leyland (long) as demand for higher tonnage vehicles increase.

Internationally we see weakness in the US market (20% of sales) where prices have fallen about 10%. Finally, we continue to *short Bajaj Autos*, which is absent from the fastest growing scooter segment, and losing out on the export side — (40% of volumes) not helped by a strong currency.

figure 2

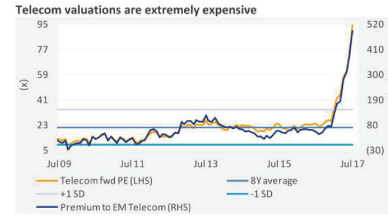
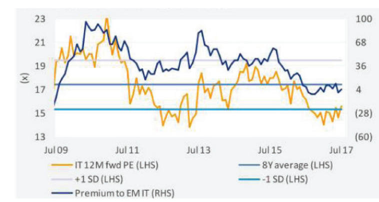


figure 3

IT Cheap



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