CAPGROW CAPITAL

Quarterly Newsletter – March, 2020

These are one of the most unusual times for the financial markets. This is not normal. The most common question in everybody's minds is – when will this crisis end? What will happen to the financial markets in the short term? What will be the shape of recovery? Are we in a bear market?

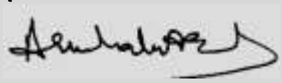
I will try to answer some of these fears which are arising in our minds. First of all, it is unprecedented. I am not a medical practitioner, but going by the statistics available, 90% of the patients are getting cured, and the mortality rate is quite low as compared to other epidemics in the past. The sense of optimism is also based upon the effectiveness of the medicines, and the life cycle of this virus, but "All viruses come and go". The lockdown across the world will ensure that it is contained in a reasonable period of time. What concerns all of us is the economic impact of lockdown. Most of the factories, malls and offices have been closed. The biggest impact would be on the contract labor, which has moved away to their homes and carry the risk of spreading as well as the ability to move back when lockdown ends. The challenges in distribution and consumption will continue to negatively impact the market but will get stabilized at a new equilibrium. These are uncertain times and that is why we expect the volatility to continue for equities. The credit markets have been hit hard with spreads widening, and will have to normalize first before even the equity markets rally. We have seen recently how bond portfolios have been severely impacted as well as the flight to cash (safety) in the market. The confidence has been shaken across the world about the sustainability and future growth. The incremental policy response from the developed economies may have short term negative impact as the market may not efficiently operate under any artificial pumping, but all central banks coming together and injecting liquidity to stimulate the economy will have a positive impact in the medium term. Going forward, we will see a lot of focus on avoiding a repeat of Coronavirus-end related epidemics. We will see trends of higher R&D spend on virus related influenza in the future. This will benefit pharmaceutical companies as this fear will lead to more caution and higher lab testing and spending.

What to do next? Our past experience and similar selloffs tell us that this requires a disciplined approach to investing and not panic. Navigating through the uncertainty and the sharp selloff, we are certain that this time will pass. India – M-cap to GDP is trading at 50% (all-time lows) v/s US at 100%, Oil at $26 –at multi-year lows (India might turn into a CAD surplus country for some time to come) & corporate NPA revival was clearly happening across the Indian economy. The recent Chinese PMI data is a huge positive surprise to each & everyone involved in the financial markets arena. We strongly believe with high degree of conviction that - these are the times to increase allocation to equities. Stock market returns are a function of risk-reward ratio and the probabilities attached to that ratio, and not a game of "Finding the top and bottom." We see limited downside from these levels. We don't know when the trough will be reached, or what is the best time or what index level to enter. Our advice is to increase your allocations to equities now as the risks being talked about are priced into the markets. The market is smarter than all of us combined together, and it will rally once the confidence comes in that the virus is contained and stability resumes. We are not believers of dooms day scenario, and the risk reward in the market currently seems favorable. We have enough evidences in the past that these sharp equity sell offs on rebound generate an average return of 20-30% in the next 6-12 months.

The Coronavirus will cut in the FY20 and FY21 earnings. The extreme fear currently prevailing in the investor's minds should not deter the long term goal of wealth creation over long periods of time. History and again, it has been seen that those participants who are able to cut the noise and see the situation one year from today, outperform the markets massively over the entire investing period. The long term future value of a business will not get impacted beyond 5% due to short term closure. India is in week 3/4 currently and we may see worsening of numbers, but as I said, these epidemics do not last forever and the prices reflect the risk to a large extent. The ugly headlines will continue in the short term that may rattle the investors. But we believe the stimulus and the cohesive response of central banks and the governments will bring the economy back to its growth path, by second half of FY21. "Volatility" is a very important organ of public markets as asset prices get traded on real time basis across the entire globe and that too with huge volumes. We have maintained in the past, the volatility is our best friend and we should use the current market scenario to our advantage by investing in good quality names available at reasonable valuations. Let us cut the noise, and focus on the opportunities that this crash has created. We are confident that the markets will rebound once the Coronavirus scare is over. This is a Black Swan event and the sharp decline has created a fear psychosis. There is a disconnect in the markets currently, and the emotional reactions of panic investors have created the irrationality in prices. This too will pass and we will have stability in financial markets. We want to reiterate in the end, that 80-90% of the price correction has already happened, and every incremental money put in equities today will generate an above normal return in excess of 20-30%.

We at CapGrow are working hard to make sure that we get out of this downturn unscathed. The damage to the portfolios will take time to recover, but we are making efforts to make sure that we own stocks that have strong financial profile and leadership in their businesses.

Best Regards,
Arun Malhotra
(Co-Founder & Chief Investment officer)



CapGrow Capital Advisors LLP