Composite Investments Pvt Ltd

Investor Communication - March 31, 2020

“Unprecedented situation”
“Fastest correction in stock market history”
“Possibly worse than the 2008 crisis”

There has been no shortage of headlines ever since the COVID-19 outbreak started spreading across the world. When the equity indices fall by more than 30% within a very short span of time, such headlines are not surprising at all and are in fact justified to a good extent.

As investors we need to separate fact from opinion. We also need to accept that certain things cannot be predicted or prepared for. This is much tougher than it sounds, as many investors (including us) have found and experienced recently.

To define the limits of investor knowledge as it stands today

What do we know for sure?

- This market correction is unique in the sense that it was brought about by a non-economic trigger, a global pandemic of this scale was last seen in 1918
- The speed and ferocity of the market fall has been scary to say the least. The move from 11,000 to below 9,000 on the NIFTY 50 happened within 6 trading sessions
- Nations have gone into lockdown which will affect economic activity for sure over the next few quarters
- Central banks across the world have acted quickly to cut rates, announce Quantitative Easing (QE) measures and provide fiscal stimulus

What is it that we do not know?

- How much time could it take for the health situation to get better and for life to get back to normalcy?
- The extent of the fall in economic activity. Though we have China as a real time case study where economic activity is starting to show some encouraging signs, different economies have different characteristics and may take different paths
- The duration for which economic activity will stay affected
- What will be the impact of the lockdown on corporate earnings over the next few quarters?
- Where is the bottom for the equity markets?
- When will the markets bounce back?

In such a situation, investors are grappling with uncertainty on multiple fronts. The saving grace is that we are not alone, everyone else is in the same boat. Investors who have experienced previous such steep corrections and are humble enough to accept the limitations of their own knowledge seem to be thinking on similar lines.

In our humble experience, big investment mistakes in portfolios where a good chunk of the corpus is already deployed into equities happens due to the following sequence of events –

1. Buying in too early into a correction when there are clear and potentially damaging uncertainties
2. Losing one’s nerve at the worst possible moment and selling out before the eventual bounce back
3. Fail to participate in the eventual bounce back and live with the scars for a long period of time

Things are as much behavioural as they are logical in the financial markets. The sequence of events and our reactions to those matter as much as do fundamental factors.

What have we been doing since the correction began?

1. We have held onto the bulk of the cash portion in most portfolios with very few exceptions. While we aren't looking to time the markets, we are trying avoid potentially costly errors
2. We have started making some changes to the portfolios based on our risk mitigation framework. Positions where we either see more than acceptable risk for the specific business (in light of the changed economic environment) or we see the risk of high valuations eventually coming off are being addressed appropriately
3. We have been busy getting our buy list ready and at the appropriate price levels for these businesses we will start buying

While the temptation to buy once the NIFTY 50 level broke below 10,500 was there, we have managed to ensure that we aren't guilty of buying in too soon in this correction. This is because we know that in such steep corrections it is a misleading yardstick to base buy decisions on how much a stock has fallen from the peak.

Our decision to be prudent with the cash allocation in portfolios was due to our assessment that the operating environment might change in more ways than we could imagine over the next few quarters. Our decision was also driven by the humble acknowledgment that we aren't blessed with any unique gift of intuition which might allow us to predict where and when the markets could bottom out.

What are we likely to do over the next few months?

We will follow these broad principles –

- Prioritize portfolio risk mitigation till the situation specific to India stabilizes. The time to focus on return optimization will come but we may just not be there yet
- Continue to calibrate to the market conditions. This means tracking factors like other global markets, rate of spread of the virus across the world, status of clinical trials of the possible drugs and many more
- Focus on what we know, can understand and can control. We care more about making money for our investors than about sounding like we know everything about the current situation
- Adhere to our philosophy that our unit of measurement is each customer portfolio and not the model portfolio
- **Adhere to the defined investment process, outcomes more often than not will take care of themselves over the medium term**

We are in a situation where the time frame for evaluation appears to have shrunk drastically – the average investor is worried more about where stock prices could be one week down the line than think about where they could be one year down the line. But then, this is how steep corrections feel like. In that sense this time has been no different.

History teaches us that it pays to be an optimist, that the market eventually recovers from whatever shocks are thrown at it.

We continue to be optimistic over the medium term, especially from the current market levels. This however does not make the pain of staying invested through such steep corrections any easier.

What cannot be cured immediately has to be endured, irrespective of whether it is health or investing that one is talking about.

Sincerely,
Team Composite