Cohesion MK Best Ideas

Investment Report

July 2023

Cohesion®
Accessing Superior Growth

Jam today, jam tomorrow

Hopefully, the title of this quarter's newsletter will be familiar to most of you. For those of you left scratching your head, its origins are in Lewis Carroll's "Through the Looking Glass." In this wonderful story, our hero Alice is confused as to why the villainous Queen of Hearts always promises jam tomorrow but there is never jam today. We all like a balance in life; the promise of jam tomorrow, but also some today.

A very strong quarter in absolute and relative terms

It's pleasing to report that we've enjoyed a particularly strong quarter. This is against a backdrop of continuing momentum in the Indian equity markets. As the table below shows, Indian equities delivered excellent returns, amongst the best of their global peers. It is especially satisfying to report that our relative performance also looks strong. As explained in previous newsletters, we don't deliberately set out to try to beat any market benchmark or peer group. **Our sole focus is on delivering the very best risk-adjusted returns.** We believe that if we deliver returns of over 20% per annum compound, we may not beat the market every year, but over any reasonable time-period, we should easily outpace any benchmark or peer group. Over the last 30 years this approach has served Madhu and his team very well. During the quarter we returned 19.14 percent in USD. Although we don't pay particular attention to peer group comparisons, we would be in the upper top decile for those interested in such things. Returning to the title of this newsletter, we have delivered jam today, and the remainder of this newsletter will be devoted to how we have done so and the prospects of jam tomorrow.

USD (Data to 30.06.2023)			
	Performance (%)		Performance (%)
	3 Month		12 Month
Cohesion MK Best Ideas	**19.14**	Nasdaq 100	33.13
Nasdaq 100	15.39	Cohesion MK Best Ideas	**28.36**
Sector : FO Equity India	12.42	S&P 500	19.59
MSCI India	12.36	MSCI All Country World Index (ACWI)	17.13
Nifty 50	10.64	Nifty 50	16.99
S&P 500	8.74	Sector : FO Equity India	15.86
MSCI All Country World Index (ACWI)	6.35	MSCI India	14.72
MSCI Emerging Markets	1.04	MSCI Emerging Markets	2.22
MSCI China	-9.65	MSCI China	-16.69

Global asset markets remain polarised. There were plenty of places to have lost money in recent months and not just in obscure markets or obviously risky asset classes. Global bonds continue to be a miserable place to have your money. Predictions that 2023 would see an easing of inflation expectations and interest rates have so far proved to be optimistic. Thus, any recovery in bond markets has been put on hold again. Commercial property markets remain under pressure and many global REIT share prices are down more than 40% over the last year. A well-diversified investor with substantial assets in bonds and property might well be nursing losses of over 30% across these two major asset classes. Even within global equities, there is a stark contrast between the haves and the have-nots.

On the face of it, the US equity market has had another strong start to the year, but it has been widely publicised that all the gains made by the S&P 500 can be attributed to just a handful of technology stocks. To an extent, the returns generated by Amazon, Nvidia et al are a just reward for the revenues and profits that they have generated, but in larger part, the share price performance reflects the jam tomorrow expected by investors who have bought into the AI story. There is no doubt that AI will become an increasingly important part of our daily lives in the future, and there will be winners that do very well from this trend. However, there is no guarantee that any of the current S&P darlings will be the ultimate beneficiaries of AI. There is a risk that investors are paying a price today that reflects only a chance that they will benefit tomorrow. This has been a recurring observation across many of our previous newsletters. We fundamentally believe that investors have made two consistent mistakes. Firstly, investors have overpaid for perceived safety. When the majority were happily buying 30-year government bonds with a yield close to or below zero, that seemed nonsensical to us. If everything went well, and interest rates remained low, the returns were unexciting, and there was no margin of safety to protect investors from apocalyptic losses if interest rates rose. Secondly, post Covid investors had been willing to pay staggeringly high prices for the potential for growth in some markets, such as in technology-oriented stocks. Although a small number of tech stocks have continued to perform very well, many more have proved to be a disaster. If you are paying in advance for growth far into the future, with no certainty of delivery, that can be a perilous game. Amongst all this chaos, we have consistently reiterated our view that **Indian equities represent possibly the best risk-reward characteristics available to global investors**. We have a plethora of predictable growth companies supported by powerful economic and demographic tailwinds, and we find opportunities to buy these on relatively undemanding valuations that give us a sensible margin of safety. We've been telling this same story for many years, and it has translated into excellent returns for our investors. There is much more, we believe, to come.

A busy quarter - taking profits and redeploying for future growth

Turning to our recent portfolio activity, we've had quite a busy quarter. We took advantage of the buying momentum in markets to sell some of the smaller holdings in our portfolio and concentrate positions into high conviction opportunities. It is good fund management practice to regularly tidy up a portfolio, raising cash to reinvest into stronger ideas. By doing so, the portfolio remains fresh and comprises only companies we have our greatest conviction for. However, we do not subscribe to the view taken by many fund managers that the tail of a portfolio should be trimmed regardless of cost. We have been patient and measured in this exercise, waiting for better target prices and anticipating catalysts that would allow us to sell some of our small holdings.

In some cases, we anticipated specific news items that we thought would lift share prices, and in other cases, it was simply a matter of being patient and waiting for the market's eye to fall on a particular stock. As a fund manager, even when you are almost certain that you will be right about the stock, you have no control over when you will be proved right. It's pleasing when the stars align and a lot of long-term holdings bounce at the same time. This was exactly what happened during the last quarter. We successfully exited positions in Ethos, DCX, and Macrotech, banking excellent profits for our fund and giving us fresh cash to redeploy later on.

Cash can be King sometimes

Fund managers don't often talk about cash during their reports to investors but as we have been holding higher than normal cash positions, we felt it worth commenting upon. Far from being a drag on the portfolio, this extra cash has given us the room to manoeuvre our investment decisions. Over the last 3 months, we have seen a lot of equity change hands in India, via offers for sale, block deals, IPOs and other fund infusions. This has created some interesting investment opportunities for us, and also led to some early exits. We continue to hold liquid cash and believe this will prove to be immensely useful over the coming quarters. We are seeing signs that the Indian market is becoming ever more divergent. There is clear exuberance in some parts of the market. Retail investors are getting excited about hot stocks, pumped up by media reports. Sadly, this rarely ends well for them, and we are willing to be sellers into this part of the market. Even though some parts of the market look frothy, others remain unloved and undervalued in our view. We are therefore expecting to see the turnover in our portfolio increase. To be clear, we are not traders at heart, but when opportunities arise due to the behaviours of others, we want to take full advantage. By selling to the greedy and buying shares from the disenchanted, we are able to take advantage of this wide disparity.

While this has been an important quarter for harvesting the profits from previous investments, it's also been a busy one, building positions that we believe will provide the jam tomorrow.

Sector in focus - Non-Bank Financials

An area that we are especially bullish about is the Non-Bank Financial Sector (NBF). Regular readers of our newsletters will be aware that **we are attracted to sectors in which sentiment is out of step with changing reality**.

The NBF sector hasn't been a happy hunting ground over the last few years and could have been rightly criticised in the past. Investors who backed certain NBFs at this time will still be carrying the scars. To still hold this view is to ignore the massive clear-up of the whole sector that has taken place. Government and regulatory changes have put the entire industry in much better shape. Companies have undertaken considerable self-help, especially in building stronger balance sheets through conservative provisioning, fresh capital injections, and retained earnings. Investors have eschewed the sector more recently because of the perceived negative correlation between interest rates and NBFs. Conventional wisdom dictates that you don't want to be in financial stocks when interest rates are rising. Whether there is intellectual merit in this argument is for debate; we believe there are plenty of NBFs that have very little interest rate sensitivity in their business model and indeed some that will have actually benefited. Nevertheless, the market comprises many thousands of participants and if they believe that NBFs are rate-sensitive, their views will determine the sector's trajectory. Unlike in much of the West, inflation and interest rate expectations have been moderating in India. As other investors start looking for sectors that will perform well in a post-rate-peak environment, we believe the first port of call will be NBFs. They will find conservatively managed businesses with robust books of business and solid growth prospects. It should be remembered that NBFs don't need red-hot economic conditions to do very well. They only need benign conditions and that's what India is currently enjoying. Western consumers are facing a vicious squeeze over the coming years, caught in a pincer movement by falling real wages and a hike in mortgage costs. In contrast, Indian consumers have lived with a little bit of inflation and affordable borrowing costs. Therefore, the pain felt by Indian consumers is far less acute than that felt in the West. We expect the best NBFs to be capable of delivering solid growth in their books over the coming years and that this will translate into double-digit earnings growth. The current misplaced prejudices about the NBF sector has left it trading on cheap valuations relative to its history and the broader market. We love these sorts of situations. **When shares are priced based on their history rather than their future, there is often a lot of money to be made.**

As this is very much a portfolio of Best Ideas, **we are unafraid to back our convictions when our research points to a clear asymmetry with much more upside than downside**. We currently have more than 18.7 percent in NBFs, making it the largest theme in our portfolio. We, of course, love all of the companies in the portfolio. That's the beauty of only having to pick around 20 shares from a universe of thousands in the Indian market. To give just one example of a NBF, we would highlight Manappuram Finance. Manapurram is one of India's leading gold finance lenders and has a strong track record over more than 30 years. We have the highest regard for their management team who have delivered compound annual profit growth of more than 20% per annum over the last 10 years, despite a challenging backdrop. We are especially excited about their expansion into complimentary high growth areas of microfinance, MSME (micro, small and medium enterprises), and car finance. These areas are all adjacent to their core competence, and there is a near-perfect overlap with their existing customer base, allowing them to cross-sell while using their well-established risk models. None of this excellent historical performance, growth potential, or improving rate outlook is reflected in the current market multiple. Trading on just 4.5x 2025 prospective earnings, we see plenty of scope for Manappuram to double or more.

Although we are very willing to be patient, we won't turn down the offer of jam today if it's offered. We made more than 50% in PNB Housing in just two months and were happy to bank this, knowing that we can always return to this later if the share price softens.

Patience can sometimes be required

One of the key requirements of contrarian investing, is the ability to be patient and sometimes wait out periods of underperformance by a section of the portfolio. In previous newsletters, we have discussed at length our bullishness on select pharmaceutical companies. We take here the case of one of them – Shilpa Medicare, which has so far not performed to expectations and revisit why we believe this remains such a high-conviction idea. By way of a reminder, Shilpa owns a world-class portfolio of oncology products fully backward integrated and with market leadership in several active pharmaceutical ingredients (API). They leveraged this intellectual property to develop their own formulations and distributed them in regulated markets like the US. Alongside, the company invested cashflows from API business into biosimilars and complex biologics, transdermals, peptides and polymers among other products. While the API business is extremely profitable with best-in-class margin and return ratios, the company arguably focused too much on reinvesting into product development for the future. This investment program has held back its cash generation since we invested. Still, we remain confident that the company, and we as investors, will be rewarded as they turn their attention to monetising their portfolio. We believe that the API business alone (which represents circa 30% of its invested capital base) is worth more than the entire current enterprise value of the business. While it may take time for value to be recognised by other investors, we believe Shilpa remains profoundly undervalued.

In conclusion

With our mandate of delivering outstanding risk-adjusted returns, we must demonstrate various philosophies. Sometimes we have to focus on capital preservation as we did last year during a merciless global bear market. In recent months we have morphed to become more nimble again, taking excellent profits when available while reallocating capital into new or existing ideas that we are confident will provide the next wave of profitable exits over the quarters ahead. We have plenty of cash to take advantage of new ideas and yet have proved that holding cash does not prevent us from fully participating in and even beating markets that are currently roaring. **We have delivered jam today and are optimistic about delivering a lot more jam tomorrow!**

Strategy Performance: Data as at 30th June (Q2) 2023

Discrete Performance** (%)

		Q1	Q2	Q3	Q4	YTD	Since Launch: Aug 2020*
USD	2023	-7.06	19.14	-	-	10.73	78.54
	2022	-2.22	-13.25	13.45	2.18	-1.68	61.23
	2021	11.31	11.01	13.13	1.58	42.00	63.98
	2020	-	-	-0.19	15.70	15.48*	15.48
		Q1	**Q2**	**Q3**	**Q4**	**YTD**	**Since Launch: Aug 2020***
GBP	2023	-8.98	15.71	-	-	5.33	83.91
	2022	0.71	-6.41	23.69	-5.54	10.12	74.60
	2021	10.40	10.63	16.12	1.15	43.45	58.56
	2020	-	-	1.08	9.35	10.54*	10.54

*August 1st 2020
**net of taxes and fees, gross of performance fees

*Cash deployed cautiously during COVID-19 outbreak and 90% deployment reached by end of February 2021

	Equity	Cash
1st 6 months	45%	55%
1st 12 months	68%	32%
Since Inception	82%	18%

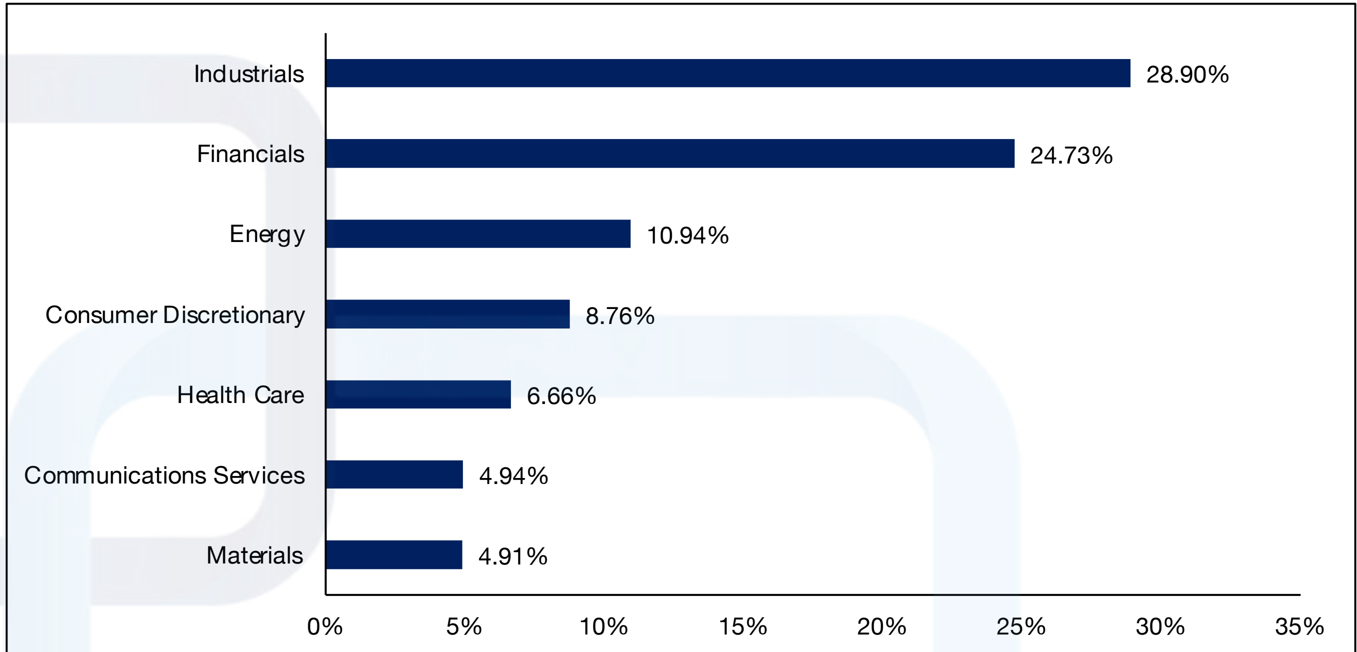
Portfolio – 30th June 2023

Top 5 Holdings

Security Name	% Holding of Portfolio
IIFL Finance Limited	7.71%
Ramkrishna Forgings	5.92%
NCC Limited	5.73%
Reliance Industries	5.51%
Ambuja Cements Limited	4.91%

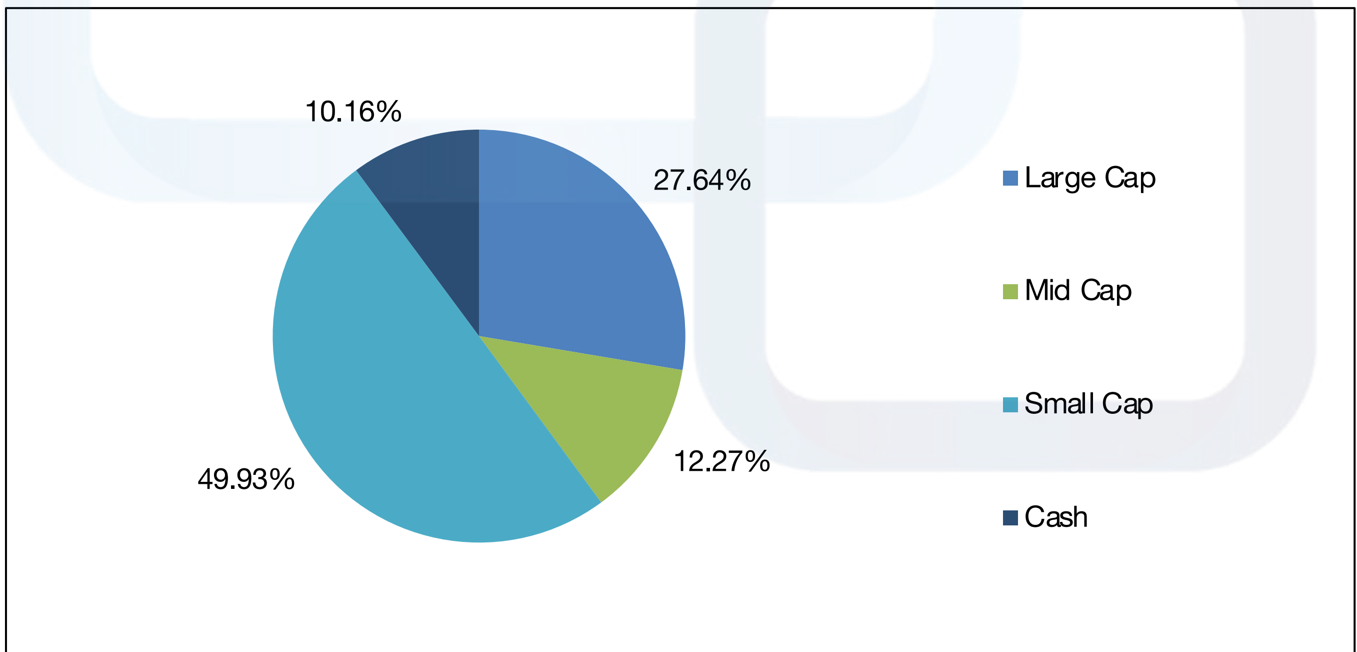
Portfolio – 30th June 2023

Sector Exposure



Portfolio allocations may not add to 100% due to rounding and cash holding

Market Cap Exposure



SEBI market cap breakdown – **Large Cap**: top 100 largest companies ranked by market cap,
Mid Cap: 101-250 companies ranked by market cap, **Small Cap**: companies ranked 251 and onwards

For further information:

Website: www.cohesioninvestments.com

Email: investor@cohesioninvestments.com

Disclaimer

This document has been issued by Cohesion Investments (Cayman) Limited (“Cohesion”) in its capacity as manager of Cohesion MK Best Ideas Sub-Trust (the “Sub-Trust”). It is intended only for the recipient, investors in the feeders to the Sub-Trust and those who are already considering investing in those feeders. It is provided for information purposes and for private circulation only and is not intended as any form of financial promotion, offer or solicitation, recommendation or investment advice nor should it be relied on as such. This document does not consider the specific knowledge, financial situation and background of the readers who should seek independent advice from sources that they deemed reliable, usually professional advisers, before making any decision to invest into the Sub-Trust.

This document includes the views of Invexa Capital LLP (“Invexa”), as investment advisor to Cohesion on the Sub-Trust. The information contained in this document is based on material that is believed to be reliable. Assumptions, estimates and opinions contained in this document constitute information we received from reliable sources as of the date of the document and are subject to change without notice. Neither of Cohesion, Invexa or any of their respective officers, directors, employees, agents, controlling persons or affiliates makes any representation or warranty, expressed or implied, as to the accuracy or completeness of the information contained in this document, and nothing contained herein is, or shall be relied upon as, a promise or representation, whether as to past or future facts or results. Potential investors should refer to Sub-Trust documentation before considering any investment and read the relevant risk sections within such documentation.