Cohesion MK Best Ideas

Investment Report

January 2024

Annual review 2023 and 2024 outlook

2023 - The progress of the swan

Cohesion MK Best Ideas had another excellent year. **During the twelve months ending 31 December, we delivered performance of 43.12% in USD**. This compares very well against MSCI India 21.29% in USD and MSCI All Country World Index (ACWI) 22.81. **Since launch in August 2020, we have delivered performance of 130.75% in USD** versus MSCI India 79.41% and MSCI All Country World Index (ACWI) of 41.49%. As Table 1 below demonstrates, this return compares favorably with all major and emerging markets and peer comparators.

Table 1	Performance (%)	
	2023	Since Inception 1st August 2020
Cohesion MK Best Ideas (USD)	**43.12**	**130.75**
Cohesion MK Best Ideas (GBP)	**35.83**	**137.17**
Nifty 50	19.26	79.41
MSCI India	21.29	76.69
Sector : FO Equity India	21.82	70.46
Nasdaq 100	55.13	58.59
S&P 500	26.29	53.92
MSCI All Country World Index (ACWI)	22.81	41.49
MSCI Emerging Markets	10.27	4.29
MSCI China	-11.04	-37.68

I'm sure you have all heard the metaphor of the swan moving apparently without effort through the water whilst its legs are kicking furiously unseen below the water line. This comparison seems apt to describe our journey throughout 2023. Having produced such strong returns, it might appear that last year was a classic bull market in which we could just allow the tide to carry us forward. That wasn't the case. Not only did we have to kick hard for much of the year, but we also had to make many small micro-adjustments as the economic winds and currents changed so frequently.

For much of 2023, investors were worried about the same things that had so vexed them through 2022, namely the direction of global inflation and the prospects for growth. These concerns created a volatile backdrop for markets. As we have previously commented, we do not fear the volatility that exists in all markets; we embrace it. When other investors act irrationally, share prices can gap higher or lower because of a knee-jerk reaction to a U.S. non-farm payroll number or an OPEC meeting. We don't place much importance on trying to predict such short-term factors, but we do like to take advantage of other investor's reactions to them. They offer us the chance to sell shares that have run ahead of expectations and also pick up shares in wonderful businesses that have been unfairly jettisoned by the fearful.

During 2023 we placed 218 trades. Some of these trades represented entire sales or purchases but many represented small top-ups or trimmings. Investors in private equity typically only get one chance to buy and sell their positions, but in public markets we can finesse our holdings and take advantage of volatility.

During the first half of the year, it became clear that excellent investing opportunities were developing in the financial sector as other investors had become myopic about short-term interest rates. Therefore, we took the chance to add to our weightings here. This proved a good decision as inflationary concerns eased in the year's second half. As other investors became more sanguine about the direction of interest rates and the outlook for the quality of assets in the financial sector, share prices soared, giving us a strong end to the year. We also identified a fabulous company in the Fintech space where, as a result of our reputation and long-term relationship, we could get warrants at a highly attractive valuation. Thus, we could commit only a very small part of the portfolio and yet benefit from an **almost doubling in its share price.**

Markets also gave us several chances to pick up world-class infrastructure and manufacturing names at highly attractive prices. Despite having healthy order books and clear execution visibility, some companies were trading on P.E. ratios of under 10x. Such purchases proved to be well-timed as they have performed strongly recently. We continue to hold most of these despite their price rises as they still represent excellent value in our view.

We aren't afraid to hold onto our star performers if the story has improved in line with the share price. Madhu and his team have a long history of identifying companies that have delivered 20x, 50x or even 100x returns and holding through the ride. **RK Forgings, the subject of our newsletter at the start of last year, has soared 176% over the last year on the back of sparkling results and delivered a 566% change in price since we invested.** We continue to hold RKF as ~7% weight and maintain the view that it has a long way to go through a combination of earnings growth and further rerating. **NCC** has also risen strongly, **more than doubling** over the last year but we have continued to add to our position.

We have maintained a 10-15% cash buffer throughout the year to take advantage of special situations, often in the form of primary issuances and secondary market blocks. Special situation trades such as Shriram Finance, IKIO Lighting, AB Capital, Inox Green, Kaynes, and JSW have contributed meaningfully to the overall performance. We did not shy away from booking profits and exiting positions whenever we felt that share prices had run ahead of fundamentals. PNB Housing, Shriram Finance, AB Capital are all excellent businesses, and we may return to them in the future, but we believed their share prices had simply run too far.

We continue to be very selective in our approach to primary issuances. Other investors overpaid for hot issues such as FSN Commerce Ventures, One 97 Communications, Cartrade Tech and Fino Payments and are nursing 50%+ losses since they listed. However, a careful approach to subscribing to new issues can prove to be highly profitable. Recently, we got a sizable allocation in **SW Solar** QIP, which was oversubscribed 5 times, because of our long established relationship with the company's management and bankers. The stock has already risen 25% in less than a month.

The outlook for 2024

Having enjoyed such a strong year, it is only natural for investors to question what the future might have in store. There are three questions that we most commonly hear, and these relate to **Modi**, the **rupee** and **equity market valuations**. We will address each of these in turn.

Five more years of political stability

We find it somewhat ironic when people worry about Indian politics. Looking around the world, we see many Western nations with leaders who are ineffective at best and corrupt at worst, yet investors remain happy to overlook such concerns. In India we are blessed with a Prime Minister who has been in office for almost a decade and is odds-on favourite to win a third term when Indians go to the ballot boxes in a few months. **In a recent poll, Prime Minister Modi scored a 76% approval rating, making him the most popular leader globally**. By comparison, the leaders of the U.S., UK, France, Germany and Japan currently have popularity ratings of 37%, 25%, 24%, 21% and 16% respectively. Looking ahead to the general election in April and May 2024, we (and most political commentators) predict another solid endorsement of Modi and his Bharatiya Janata Party (BJP). At the most recent state elections in December, the BJP snatched Rajasthan and Chhattisgarh states from the opposition Indian National Congress party and registered a record fifth term in central Madhya Pradesh. **Under Modi's stewardship, the banking system, government, and business world have been cleaned up, modernised, and digitised**. Indians recognise the real and lasting benefits this has brought to their lives and want more of the same.

A change in perceptions ahead for the rupee

When looked at through the rear-view mirror, the rupee has shown some currency depreciation historically against the dollar, as have most other currencies and many by more. Despite this, Indian equities have been an excellent place for international investors to be as the **returns from the market have dwarfed any erosion suffered by the currency**. To the end of Dec 2023, the MSCI India had returned 628 % in USD, compared with 375% for the MSCI World Index in USD. With India delivering such strong returns in local currency, did it matter if investors lost 2-3% pa on the currency?

USD	20 Years Performance (%)	
	Annualised	Cumulative
MSCI India	**10.44**	**628**
S&P 500	9.69	536
MSCI All Country World Index (ACWI)	8.10	375
MSCI Emerging Markets	7.20	301
MSCI China	6.62	261
MSCI Europe	6.31	240
MSCI Japan	4.85	158

However, when we look at the road ahead, there is every reason to believe that the perception of the rupee as an underperformer is about to change. **India has positioned itself as a manufacturing powerhouse** in everything from pharmaceutical ingredients and precision engineering to speciality chemicals. It is **forecasting a more than doubling of its manufacturing exports over the next five years** alone. We see companies such as Apple, Amazon, Microsoft, Tesla, Samsung, Nokia and Boeing moving significant parts of their manufacturing to India. A major part of this movement is due to Western CEOs no longer being willing to rely solely on China for key parts of their supply chain. Having established itself as the "Office to the World", **India now firmly has its sight set on being "Factory to the World"**. Supply Chain Management Review recently commented "As U.S. companies continue to shift away from Chinese manufacturing, a new frontrunner has emerged. A new study by Boston Consulting Group (BCG) has found that **India may be the biggest winner**." What is particularly important here is both the scale and time horizon attached to such moves. We are talking about major international companies making decisions that will shape their businesses over multiple decades. Indian exports and investments in India will all have to be paid for in rupees, creating a **sustained and growing demand for rupees that may give it a long-term tailwind.**

A weak currency is often associated with a weak economy. It is hard to make such an argument in the case of India. India's debt-to-GDP ratio of around 84% compares favourably with 128% for the G7, and its corporate debt levels are much lower than found internationally. India's current account balance is very healthy and foreign exchange reserves are at record highs. India is forecasted to grow by around 7% per annum in each of the next 3 years, which positions India **as the fastest-growing major economy in the world**. Furthermore, with the resurgence of inflation and interest rates in many Western economies, the differential with India has narrowed.

Against this backdrop, we believe a strong case can be made for the rupee to no longer be a detractor. Indeed, we expect it has the potential to provide a mildly positive boost to returns over the coming years.

Equity valuations in context

After three and a half years in which we have compounded at more than 25% per annum, it is only sensible to take a step back and look at valuations. In doing so, **we must ask ourselves the right questions if we want the right answers**. If we simply ask whether the MSCI India Index is cheap according to its P.E. ratio, the honest answer has to be no. However, as we have discussed in previous newsletters, the P.E. ratio as a standalone metric tells us very little about value.

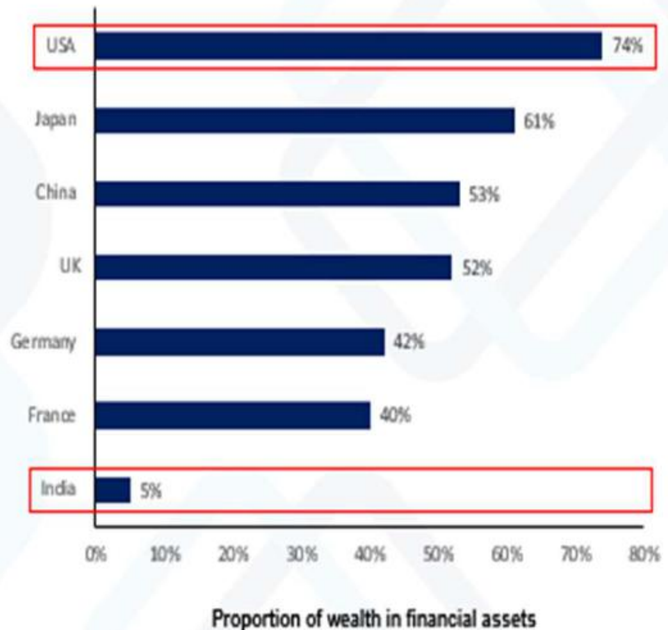
A P.E. ratio doesn't tell us anything about anticipated earnings growth. When we look at Indian equities based on PEG ratios, factoring in growth as well as valuation, they look much better value, especially when compared with their Western equivalents. We see countless Western blue chip stocks delivering practically no earnings growth (and negative real earnings growth when adjusted for the new inflationary environment). Are these really "cheap" on 10-15x earnings when those earnings are moribund? One must also look at the quality and predictability of earnings when assessing relative value. Surely, we would rather buy a stream of earnings growth driven by long-term structural factors in India rather than buy into a hoped-for cyclical recovery in a comparable company in the West? As the old adage goes, **"Price is what you pay, value is what you get."**

So why are we so confident about the future earnings growth in India? Of course, we have history on our side as India has delivered more earnings growth than any investible country over the last thirty years. Nevertheless, the past is not necessarily a guide to the future, and we should constantly reassess whether a country's best days are ahead of it or behind it. We believe there are two key reasons to think it is the former for India.

India – Fast Closing the Gap

Consumption expenditure[6]					
Category	India (USD per Capita)	Equivalent Year for China	China Multiple	Japan Multiple	USA Multiple
Non-alcoholic beverages	6	1994	13x	34x	45x
Household appliances	1	1990	56x	230x	165x
Telecom services	11	1998	9x	50x	75x
Air transportation	1	2000	17x	55x	165x
Healthcare	39	2000	5x	22x	207x

Consumption expenditure per capita in India is a fraction of that in China, Japan and USA in many day-to-day categories, showing the huge potential for growth in India as the gap closes



The first reason India will continue to lead the world in predictable growth is its population. Ernst & Young recently published a detailed study of India and concluded, "India is projected to become the most populous country in the world in 2023. Currently, about 67% of India's population lies in the working age group. Approximately 25% of the incremental global workforce over the next decade will come from India. By 2030, India's working- age population will exceed 1 billion. On the other hand, the population is rapidly ageing in the developed world." This is hugely significant. Economists agree that long-term economic growth can only come from two sources: labour force growth and productivity. India has a massive advantage here. It has a rapidly growing pool of young, hard-working, entrepreneurial people with a fierce determination to improve themselves.

The second reason why we so passionately believe in the multi-decade outlook for India is where it is in the cycle of aspirational consumption. The table above is one of our favorites and shows the vast gap between India and other countries concerning ownership of common consumer goods. Although it is a little outdated, and the gaps may have closed a little, the big-picture story remains the same. Indian consumers have a LOT of purchases to make before they get close to the spending in other countries. When combined with the rapid growth and increasing urbanisation of India's population, it tells a story of tens of millions of fresh consumers every year being able to purchase aspirational items for the first time.

In a recent report, Morgan Stanley forecast that the Indian retail market will grow by an incremental $1.1 trillion per annum over the next decade. It is estimated that an additional 500m Indians will become online shoppers over the same period. As an Indian company, you don’t have to worry about where your product demand comes from; you only have to supply what these newly affluent customers want. Many international companies must be envious of this. They have consumers choked with debt, facing unmanageable interest rate hikes to pay for goods they have already purchased. Where is the growth going to come from for such companies?

Equity valuations in our portfolio

So far, we have focused on providing some context for equity valuations in the entire Indian market. We have consistently argued that an investor who simply buys an ETF tracking the broad Indian market will probably do very well over the long term because of the structural growth forces for the whole Indian economy.

We do not have to buy the whole Indian market. At any time, we are only looking for around 20-25 truly exceptional companies out of a universe of around 7000 listed Indian stocks. At the time of writing this newsletter we can find plenty of well-known stocks that we would regard as being somewhat overvalued. Many of these are perfectly well managed businesses with bright futures and we may well invest in them in the future but not today. Tracker funds and some of our over-diversified peers will be owning such stocks simply because they are index-heavyweights but **we are solely focused on delivering the very best risk-adjusted absolute returns** rather than managing tracking errors. For every over-priced stock we can find another that looks good value. In short, we have plenty of choice if we only need to select 20-25 Best Ideas.

Looking forward with confidence

Does it worry us that some well-known stocks are currently overvalued? Not at all. If we look back to the start of last year, there were plenty of stocks that seemed too expensive to us and yet we were able to construct a portfolio that delivered excellent returns. Indeed, EVERY year, for as far back as we can remember, some stocks looked too expensive, but that does not concern us. Investors who bought Kotak Mahindra, HDFC Life Insurance or Hindustan Unilever three years ago would have made little or no money but we have demonstrated that there has been plenty of money to be made by picking great companies at undervalued prices and by the judicious use of trading.

Despite its size, **India remains an under-researched market, providing a wealth of opportunities for those with the best on-the-ground access**. As we move into 2024, our portfolio looks far better value than the Indian market overall. As table 2 below demonstrates, we have built a portfolio that is demonstrably **cheaper than the market** and yet offers **superior earnings growth**, **greater visibility of growth**, and plenty of catalysts for this value to be realized. This is summarised neatly in the PEG ratios which show the **very attractive asymmetry of our portfolio** versus both India and the world's largest market – the US.

Table 2	PE Valuation	Earnings Growth	PEG Ratio
	FY25E PE	FY25E	FY25E
Cohesion MK Best Ideas	**15.8**	**48.1**	**0.5**
MSCI India	21.5	16.5	1.5
S&P 500	18.2	12.7	1.6

There will doubtless be periods of volatility over the coming year, just as there is every year in every market, but we can think of no country that we would rather be invested in than India, and we look forward to preserving and growing the real value of your capital.

Strategy Performance: Data as at 31st December (Q4) 2023

Discrete Performance** (%)							
		Q1	Q2	Q3	Q4	YTD	Since Launch: Aug 2020*
USD	2023	-7.06	19.14	12.60	14.78	43.12	130.75
	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	17.25	9.99	35.83	137.17
	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	83%	17%

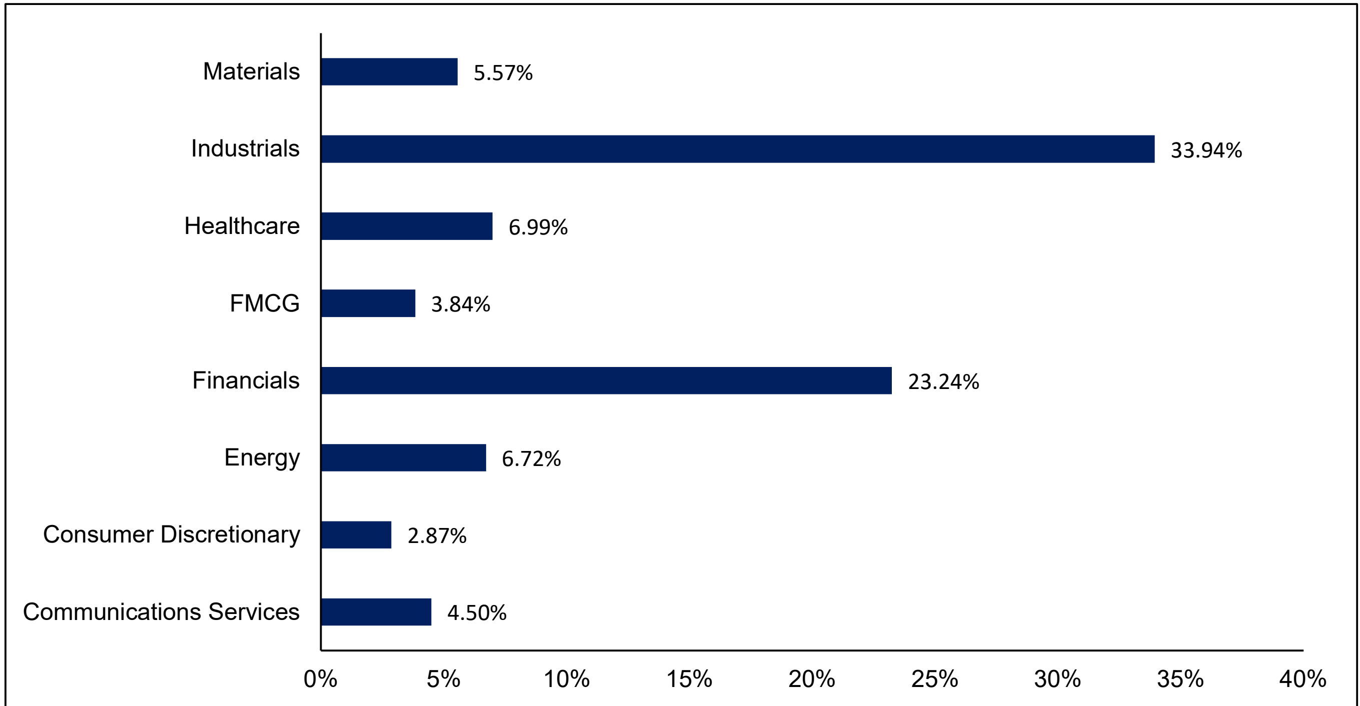
Portfolio – 31st December 2023

Top 5 Holdings

Security Name	% Holding of Portfolio
Ramkrishna Forgings	7.19%
NCC Limited	6.72%
Transformers and Rectifiers Limited	5.17%
Manappuram Finance Limited	4.61%
IIFL Finance Limited	4.54%

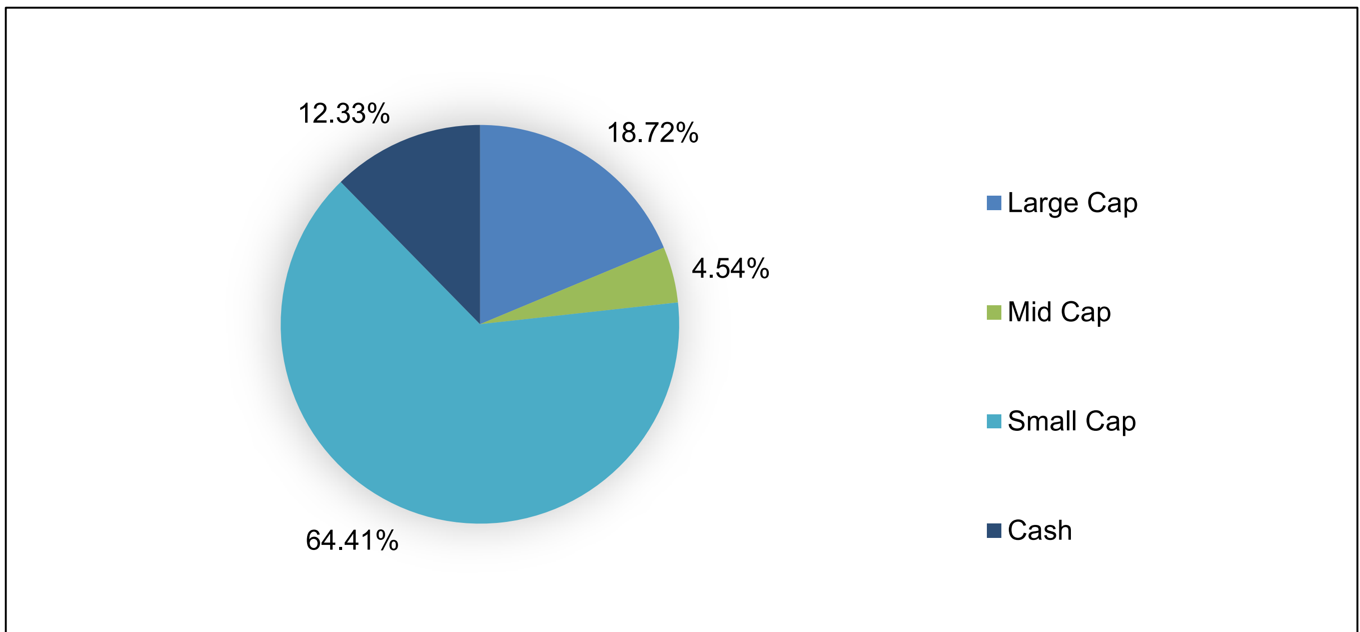
Portfolio – 31st December 2023

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:

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Sources:

[1] Times of India - Approval rating of 76% for Prime Minister Narendra Modi

[2] Livemint - A 1 trillion manufacturing export market by 2030

[3] Business Today - India's debt to GDP vs major economies

[4] The Economic Times - 6 reasons why Indian rupee could head towards 75/USD before 2025

[5] Visual Capitalist - Government Debt by Country, in Advanced Economies

[6] Goldman Sachs Report – India Consumer Close-Up 2016 & Credit Suisse – Global Wealth Report,2019

[7] Invexa Capital and Bloomberg

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