Quarterly Update Letter to Investors

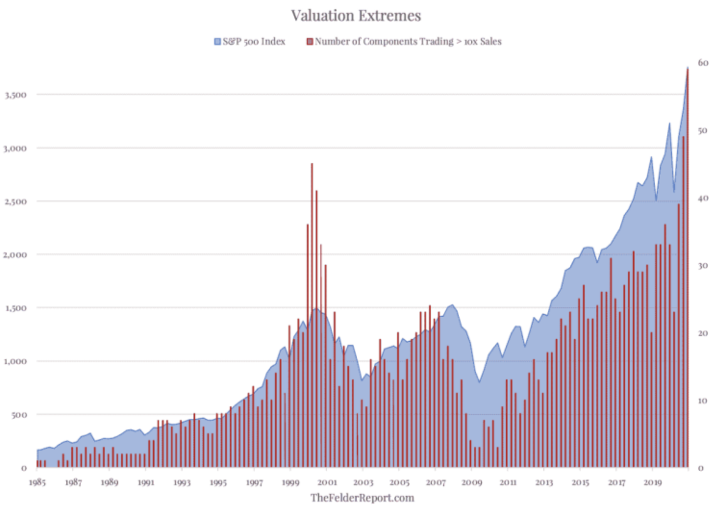
December 2020

There is nothing more supremely irritating than watching your neighbours get rich

Waiting for The Last Dance – Jeremy Grantham

Jeremy Grantham, co-founder of GMO (AUM $118 bn) and a legendary investor who has been through Japan, Dot Com and Housing bubble, lays out his case for the market being in an end stage of a long bubble that started in 2010. Grantham acknowledges that he has been early many a time and sometimes by a year or so. GMO exited the Japanese market in 1987, 3 years early, when it was trading at 40x, against a previous all time high of 25x. It cocked-a-snook at him as it went on to hit 65x earnings over the next 3 years. Japan is yet to see the highs it saw in 1990. Christine Benz, Director of Personal Finance at Morningstar opines "There's been a lot of ink spilled over why this market is different from the late 1990s. But there is a troubling common denominator: inexperienced newly arrived investors aided and abetted by financial services companies looking to make a buck off them. This will not end well."

In 1997, GMO exited many of its equity positions, as the S&P blew past the previous 1929 peak of 21x earnings. It was again a couple of years early and lost almost half its asset allocation book but made up for more than it in the decline that followed post the dot com bust.



Jesse Felder, writes in "What were you thinking?", his latest piece for Hedgeye that Scott McNeely, CEO of Sun Microsystems, asked of investors paying a "ridiculous" ten times revenues for his stock at the height of the Dotcom Mania. Indeed, what were investors thinking not only paying 10 times revenues for Sun Microsystems but also paying that multiple for 44 other stocks in the S&P 500 Index? Probably they were counting on the "greater fool theory" or that they had to keep dancing until the music was on. He goes on say that "we seem to have found even more fools today than we did back then. Nearly 60 of the S&P 500 Index components currently trade more than 10 times revenues. There's no telling when the current market will run out of fools this time."

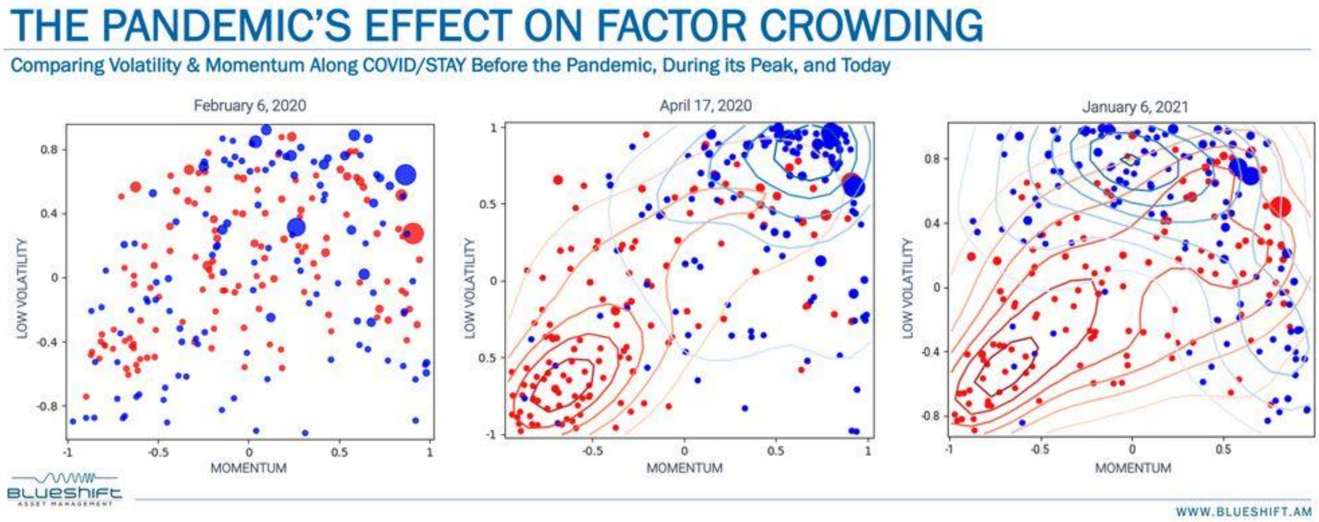
There are many market commentators who have called out Grantham for his bearish outlook more particularly over the last 5 years but then in 2018, Grantham also called for a melt up in prices which turned out to be correct.

There is no consensus on where we are in the cycle right now, but things look overheated. We will be careful about deploying fresh funds at this stage. As we continue to look for opportunities to add, all we can promise is an interesting year ahead of us.

AlphaBets

November 9, 2020 – Pfizer released a statement that its vaccine developed jointly with BioNTech was about 90% effective. A flip happened in the markets. Stocks that benefitted from WFH mode and were defensive in nature, took a hit. Stocks that benefitted from the economy opening i.e., industrials, commodities, auto and banking went on a tear.

As per Blueshift Asset Management's analysis, COVID prompted investors across the board to crowd into WFH stocks, turning the market into a binary trade - WFH Vs Covid Sensitive sectors/stocks. The Covid Sensitive stocks were and still are moving in the opposing direction to notch a strong negative correlation with WFH peers. One can see the picture below how the red and blue dots went into their respective corners since Feb 2020. In fact, the large tech stocks in US which benefitted from WFH, have not hit an all-time high since October 2020 and have underperformed the S&P500.



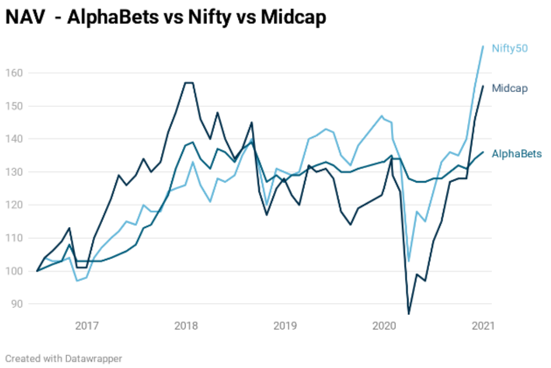
(Source: Blueshift Asset Management. Blue dots show stay-at-home stocks, red dots show Covid-sensitive stocks based on analyst reports.)

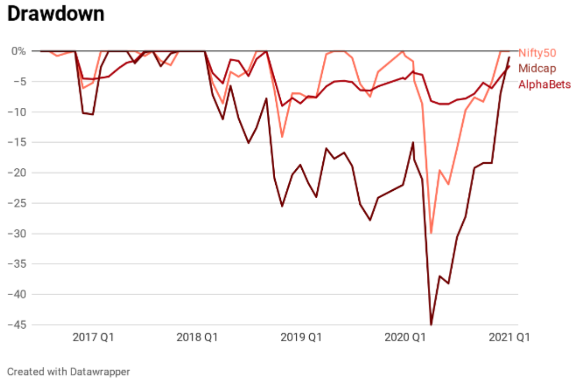
Such herding benefits more diversified index funds but is detrimental to concentrated portfolios like AlphaBets. which cannot be rebalanced on a dime. The price we pay for not falling in times like March 2020, is some amount of underperformance in sharp V shaped comeback. Even though we are slowly adding positions, it will take some time before we recalibrate, and position size more aggressively than we have in the past. We also looked at our IRR returns which worked out to 18% p.a. since inception. So stock selection or portfolio construction has been quite sound.

	AlphaBets*	Nifty 50	Nifty MidCap
Since Inception	7%	12.1%	10.2%
Max Drawdown	-9%	-29.9%	-45%
Sharpe Ratio	0.81	0.62	0.42

^CAGR Jul 2016 - Dec 2020 *Post Fees

The trade from here one in fact may be of the blue and red dots (in the graphs above) spreading out evenly and become more like the pre-pandemic picture of Feb 2020. And that may prove to be beneficial for concentrated portfolios like ours while diversified index portfolios may consolidate here.

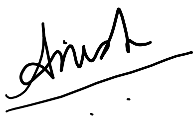




The chart above shows, the NAV since inception. November and December have seen huge gains in the benchmark driven by high beta names in financials, metals and industrial stocks and have crossed previous all time highs. I would be understating it when I say that we are feeling a fair bit of FOMO which is usually not the case. This is a hazard when one is looking at returns on a quarterly basis. The picture can change very quickly on the other side. We can claim a moral victory by looking at the higher Sharpe ratio for AlphaBets but then one cannot eat risk-adjusted returns or IRRs for that matter.

We are also live testing a hedging model which will help protect gains in falls like we experienced in March 2020. But all hedges and insurances come at cost. And so, will this. Before we implement it fully, we will communicate the features of the hedge in detail and you can opt in or out of it.

Stay safe and wishing you all a happy new year. Thank you for investing with us.



Anish Teli and QED Capital Team

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