

## Change is the Only Constant in Life

December 2016

*"I can't change the direction of the wind but I can adjust my sails to always reach my destination"*  
- Jimmy Dean

It is time to say goodbye to an eventful year. At this time of year, it is usual to reflect back on what transpired, and what are the new realm of opportunities and risks which will unfold. Looking back, 2016 turned out to be a year that will go into the timelines of history as one which completely changed the world we live in; it is the year where the world seems to have stepped back from Thomas Friedman's global and embracing "Flat World" to a more local and protectionist "Rounded" world.

### **The Year Gone By...**

On the morning of 24<sup>th</sup> June, 51.9% Britons voted in favour of BREXIT as against 48.1% who voted against - "BREXIT", an event which will change the way of life in Europe. At its July 2016 meeting, the WTO's Trade Policy Review Body (TPRB) discussed that trade-restrictive measures initiated by its members increased significantly and crossed the highest monthly average since 2011. There are many more such examples pointing to changes in the world order, however, the biggest surprise unfolded in the month of November when the largest and most powerful economy - the United States of America - elected Mr Donald Trump as its 45<sup>th</sup> President; another significant step towards world changing from FLAT to ROUND.

Closer home we witnessed an unprecedented event last month which would mark the beginning of a new digital era for the country; our Government announced Demonetisation of INR 500 and INR 1000 currency notes which created huge stir in the economy. As we covered in our last newsletter "**Rome was not built in a day**" we think that this is a landmark event which will have a lasting impact on our country and the way we transact business going forward.

Heraclitus, the famous Greek Philosopher, claimed that "*Change is the only constant in life.*" Indeed, changes in world order, both economic and geopolitical, have been an integral part of the history of mankind. Events like the end of Bretton Woods, Dissolution of USSR, Gulf war, Asian Crisis, 9/11 attacks, emergence of BRICS and the financial crisis of 2008 have had a significant impact on the world. However, humans have embraced these changes and emerged stronger and more resilient. As the late Marty Rubin put it, "Human nature is water, not stone."

### **The Way Forward...**

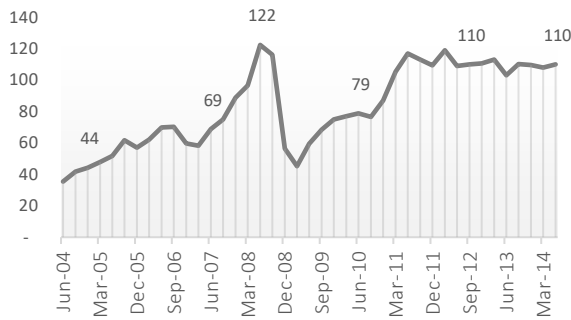
Looking ahead, we highlight a few changes which our economy has silently undergone over last couple of years which we believe will act as a catalyst for growth over year/s to come.

As we have always highlighted in our communiques, we are investors in businesses and not markets. The core of our philosophy is to focus on the opportunities and execution of the underlying businesses backed by capable management teams, and to invest for long term to reap the benefit of compounding. However, businesses cannot be isolated from the environment they operate in; we are cognizant of the fact that a positive environment does help in acceleration of growth and opportunities for well run businesses. We think there are multiple ingredients which make a successful business, however the core building blocks of any business, and in-turn any economy, are the resources used to produce goods and services, defined as the factors of production in economic parlance, namely: Land (Natural Resources), Labour, and Capital.

Tellingly, an entrepreneur builds a successful business by efficiently utilising the aforementioned factors of production to his advantage. However, one cannot ignore the role of positive macro tailwinds in providing the required thrust for the growth of a business and an economy. In looking beyond the near-term headwinds and noise around demonetisation, we find a host of such tailwinds gathering in favour of long term opportunities of growth and value creation.

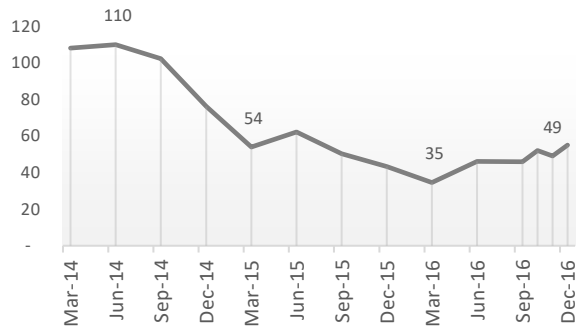
**Land/Natural Resources:** Natural resources form the core of any economy and more so in the case of a growing economy like India. As can be seen in the charts below, we witnessed a huge inflation in all natural resources during 2004-2014 driven by global growth, China demand push and huge liquidity across the world. Last 2 years have seen a reversal trend with most of these commodities coming off significantly from the peak. (Anecdotally, land prices have also had a similar journey, however, due to lack of availability of data, we focus on other inputs.) To put it in perspective, India's savings just on account of oil imports have been to the tune of USD60-65bn in FY16. We think this trend is a definite opportunity for our country and a lot of underlying businesses.

**Figure 1: Brent Crude Prices (USD/bbl; 2004-2014)**



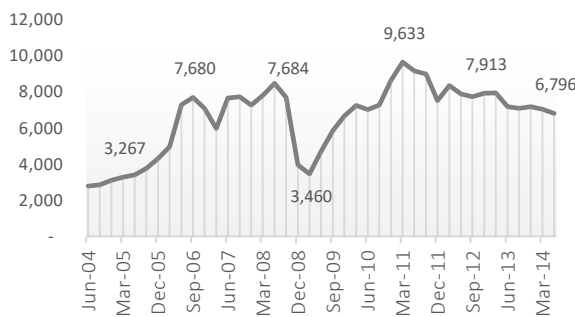
Source: Broker Research, Tamohara

**Figure 2: Brent Crude Prices (USD/bbl; 2014-2016)**



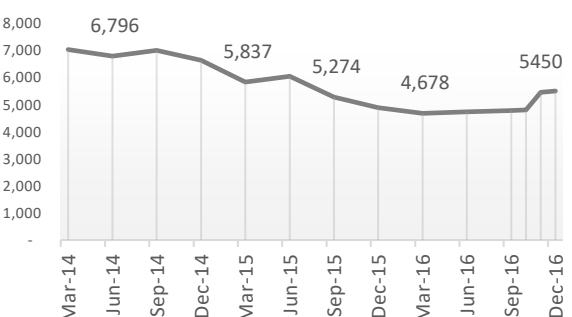
Source: Broker Research, Tamohara

**Figure 3: LME Copper Prices (USD/MT; 2004-2014)**



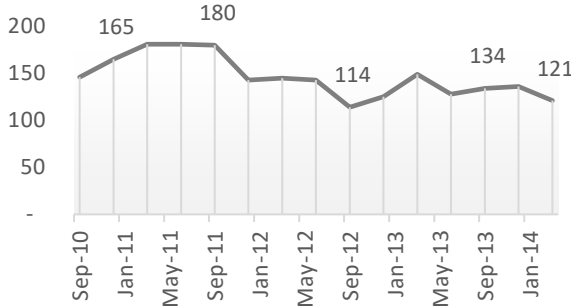
Source: Broker Research, Tamohara

**Figure 4: LME Copper Prices (USD/MT; 2014-2016)**



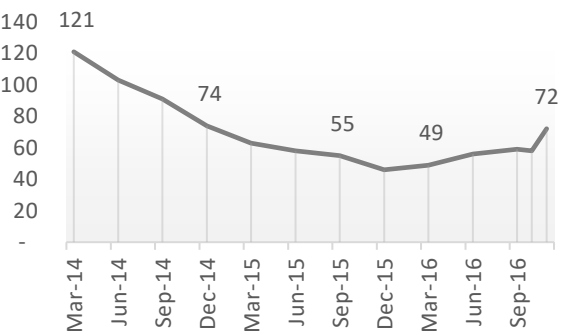
Source: Broker Research, Tamohara

**Figure 5: Iron Ore Spot Prices (USD/MT; 2004-2014)**



Source: Broker Research, Tamohara

**Figure 6: Iron Ore Spot Prices (USD/MT; 2014-2016)**

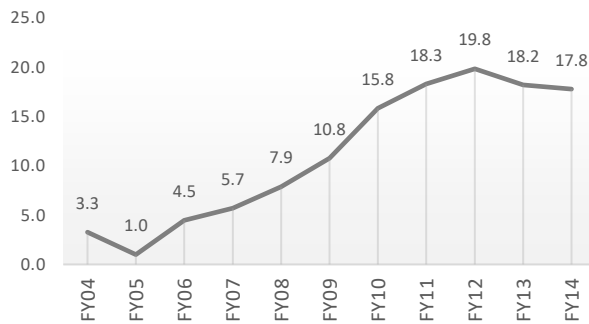


Source: Broker Research, Tamohara

**Labour:** Availability of cheap and skilled labour a critical factor in determining the competitiveness of major businesses and economies. With growth, there is an ever-increasing demand for labour, leading to scarcity

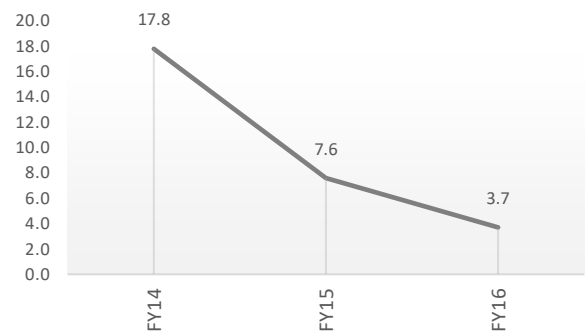
and/or cost inflation. India witnessed a huge labour inflation between 2004-14, especially on the back of rural wage growth (as shown below) mainly driven by factors like MNREGA, sharp MSPs hikes, and wealth effect of rising land prices across the country. This had put a severe cost inflation in a lot of businesses. With the new government controlling MNREGA spends and moderating MSP hikes, coupled with the much-awaited correction in land prices, rural wage growth rate and in-turn labour rates have rationalised. Although this would affect rural consumption growth in the short term, lower cost and better labour availability augurs well for business growth and employment generation in the long run.

**Figure 7: Rural Wage Growth (%; 2004-2014)**



Source: Broker Research, Tamohara

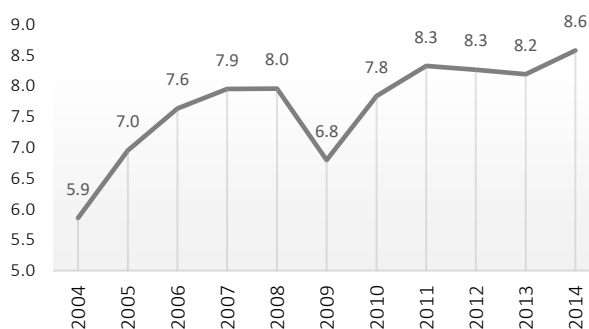
**Figure 8: Rural Wage Growth (%; 2014-2016)**



Source: Broker Research, Tamohara

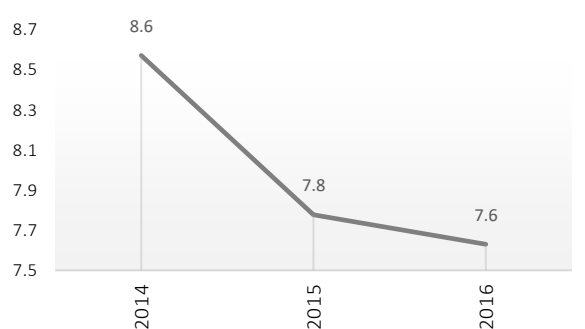
**Capital:** Cost of capital, represented by 10-year G-Sec yields, saw a steep increase till 2014, barring 2009 where it saw a one-time dip. However, post 2014 the yields have seen a sustained fall leading to a significant reduction of the cost of capital for the economy. Lower cost of capital is important for ingredient in a growth economy. Indian companies have suffered from higher capital cost in the world flushed with liquidity which has negatively impacted their competitiveness in the past. We think we are entering a sustained phase of lower interest cost which will increase the ability of companies to increase profitably and improve returns on capital. Further improved government finances along with ability to borrow at competitive rates augurs well for much awaited capex cycle to restart.

**Figure 9: India G-sec Yields (%; 2004-2014)**



Source: Broker Research, Tamohara

**Figure 8: India G-sec Yields (%; 2014-2016)**



Source: Broker Research, Tamohara

**To Sum It Up...**

India has undergone many years of policy indecisiveness which had affected the entrepreneurial ability to steer growth. Lack of direction coupled with crony capitalism negatively affected the business environment in past. However, in the current regime, we have seen positive momentum in policymaking and focus on improving business environment and proactive approach towards attracting foreign investment. Many sectors like power, roads, mining, renewables, railways, defence which were in total logjam have again started gathering momentum. Government's clear focus continues to be towards increased digitisation,

indigenous manufacturing, and improved tax compliance, all of which will further accelerate growth and will be significantly positive for organised businesses and clean entrepreneurs.

At Tamohara, we have always focussed on long term opportunities and believed that market volatility caused by short term news flows almost always presents opportunities to build a strong portfolio. At present, we are passing through once such phase when the markets are ignoring fundamentals due to fear and uncertainty caused by demonetisation and global news-flow. History has been replete with examples of the over-reaction of investors and markets to short-term events. History has also supplied numerous examples of the success of investors focused on the long-term fundamentals of businesses rather than the economy or the market averages.

We think, structurally, we are well placed to get back on the growth path with long term fundamental factors falling in place. We do understand that near-term events have been sudden and represent a big change, however, we believe that investors that will weather this volatility will emerge profitable; as they say: *one who risks nothing gets nothing*. Thus, as we step into a new year, we urge investors to use the short-term noise to buy into opportunities that will benefit from the underlying changes in the economy in the long term. We, certainly, are using this opportunity to re-shuffle our holdings and buy in to businesses that, in our view, offer very high long-term value. The winds are changing, and it is time to adjust the sails.

***On that note, we wish you the best of the festive season and hope that the new year blesses us with improving health, wisdom, and prosperity.***

Until next year,  
On Behalf of Team Tamohara,  
**Arpit Agrawal**

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