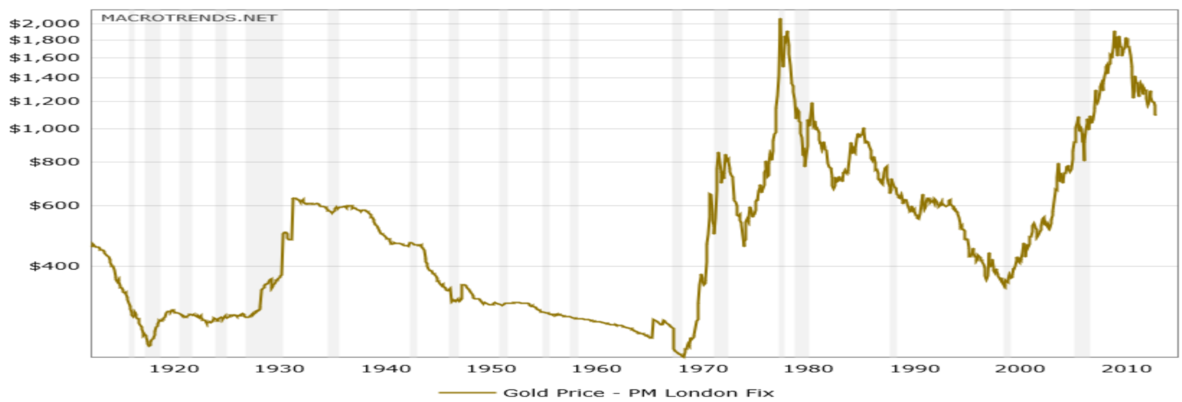
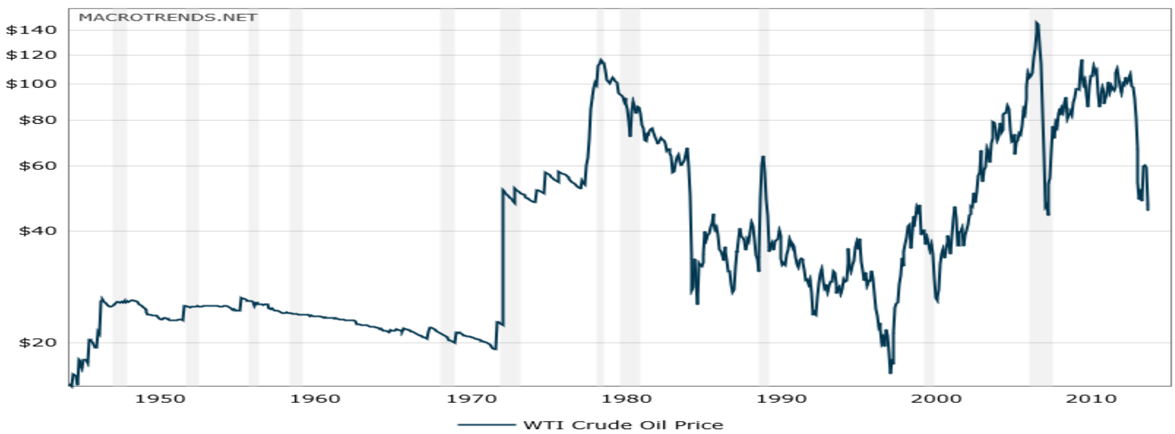
Tamohara Investment Managers - Monthly Newsletter **August 2015**

One of the more recent entrants in the debate over the state of the global economy - gloom or boom - has been commodities. Forecasters call the recent downfall in commodity prices as a sign of slowing global growth. An interesting debate, to our mind, would be whether global growth is slowing due to a fall in commodity prices or if commodity prices are falling due to slowing global growth (tellingly, amidst an already slow global trade, trade values are further shrinking due to falling prices). Nevertheless, we see little merits in these debates; after all debates are just that - *debatable*.

Our interest lies in the longer term price movements of commodities, the factors driving such movements, and their impact on the Indian economy and stock markets. Amidst the chatter surrounding the jiggle-wiggle over short period gyrations in prices, it is easy to miss the long range implications of such movements. In this communiqué, we make an attempt to unearth some long term strengths from the recent weaknesses in commodity prices. **We start by assessing the long range price movement of the two major commodities that India imports - Gold and Oil:**





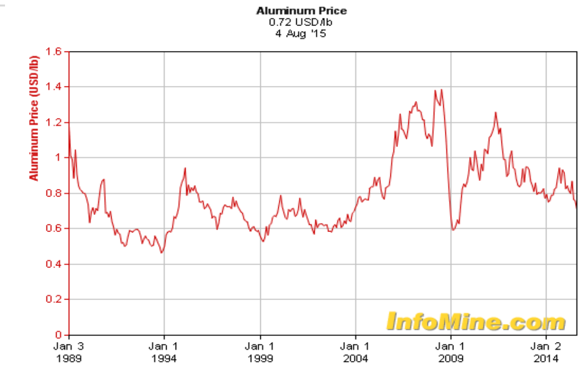
Source: Macrotrends.net

One interesting observation from the above charts is that long term price movements of Gold and crude mimic each other. This can be explained to some extent as higher crude prices are inflationary and gold is considered as a hedge against inflation

Another interesting observation from the chats above is that cycles in commodities are generally very long and has been unidirectional for decades together (save short term gyrations). **As we can observe, most 'down' cycles have tended to be longer than the 'up' cycles. For instance, both commodities saw a downtrend in prices from 1930s/1940s until 1970s (30-40 years), whereas between 1970-1980, prices rebounded sharply (10 years) before falling again during 1980-2000 (20 years) and then peaking again in 2010 (10 years)**

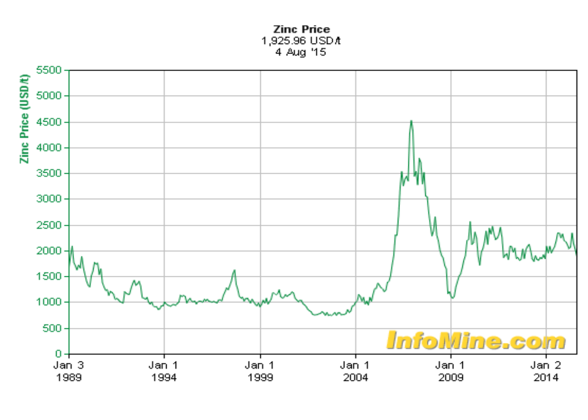
Further, while so far we have only spoken of two major commodities (partly due to lack of publicly available data), the trends in other commodities do not vary significantly, as depicted below:

Aluminium Price Chart (USD/LB)

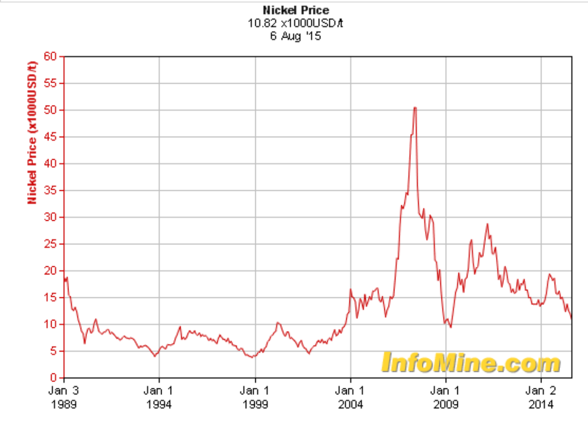


Copper Price Chart (USD/MT)

Zinc Price Chart (USD/MT)

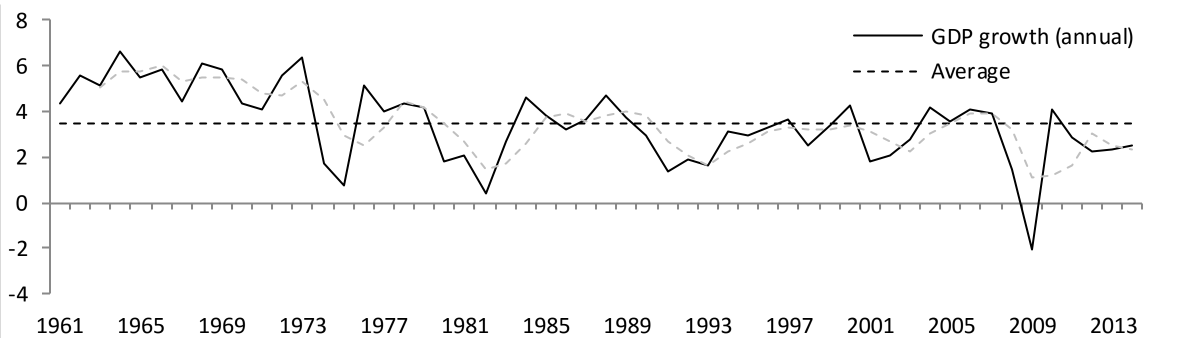


Nickel Price Chart (USD/MT)



Source: Infomine.com

A quick remark before we move further. It would be easy to look at the commodity price charts and infer that periods of high and low global economic growth may coincide with the period of boom and bust in commodity prices. Consider the following chart depicting global annual growth rates from 1961-2014:

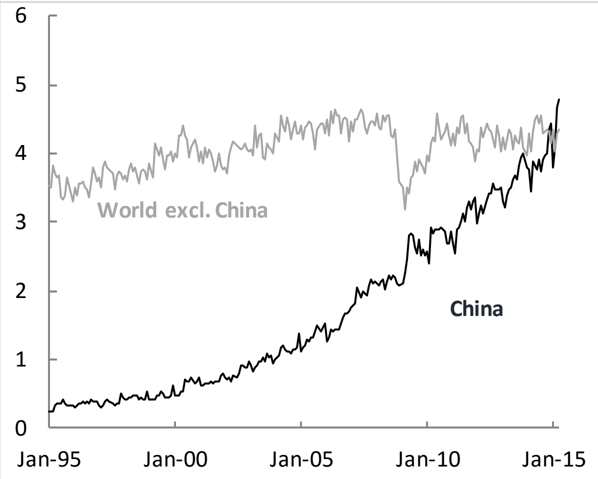


Source: World Bank, Tamohara

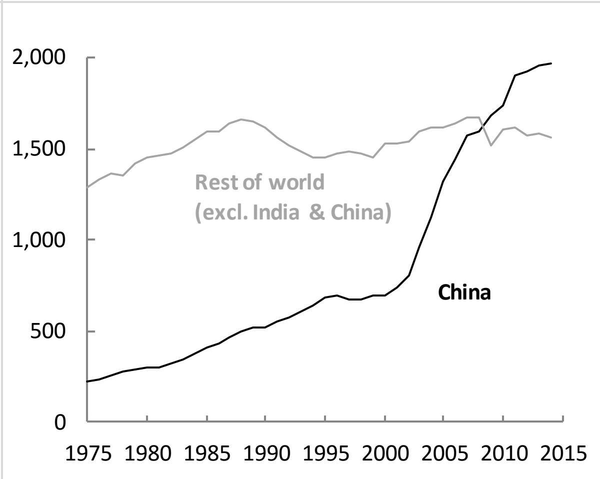
Global growth was the highest during the period 1961-1970, even as commodity prices were on a down trend. Similarly, during the next decade, while commodity prices touched a high, global growth oscillated above and below the long term average and ended the period sharply lower, and so on. **Thus a correlation between overall global growth and commodity prices may be too simplistic a study, yielding no strong results. Rather, we think that most of the cycles were driven by structural changes in some of the major global economies**

In particular, the last cycle - which started somewhere around 2000 - was mainly driven by commodity consumption boom in China which lead to a multi-fold rise in all major commodities. As China built is manufacturing capacities and infrastructure to meet the global consumer demand, its own demand for commodities started rising sharply. **In about 15 years, from 2000-2014, China's share in global consumption of major metals rose from less than 10% to over 40%**

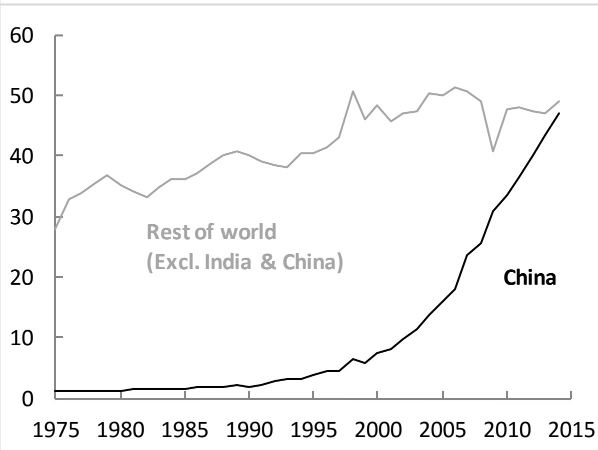
Consumption of *Refined* Metals (mn.MT)



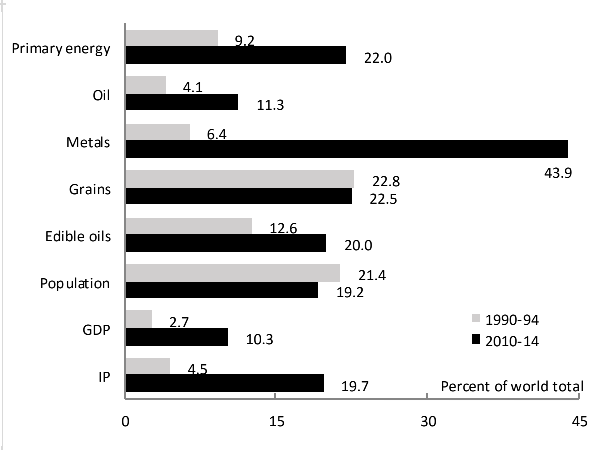
Consumption of Coal (MT Equivalent)



Consumption of 6 key Metals* (mn. MT)



China's consumption of key commodities

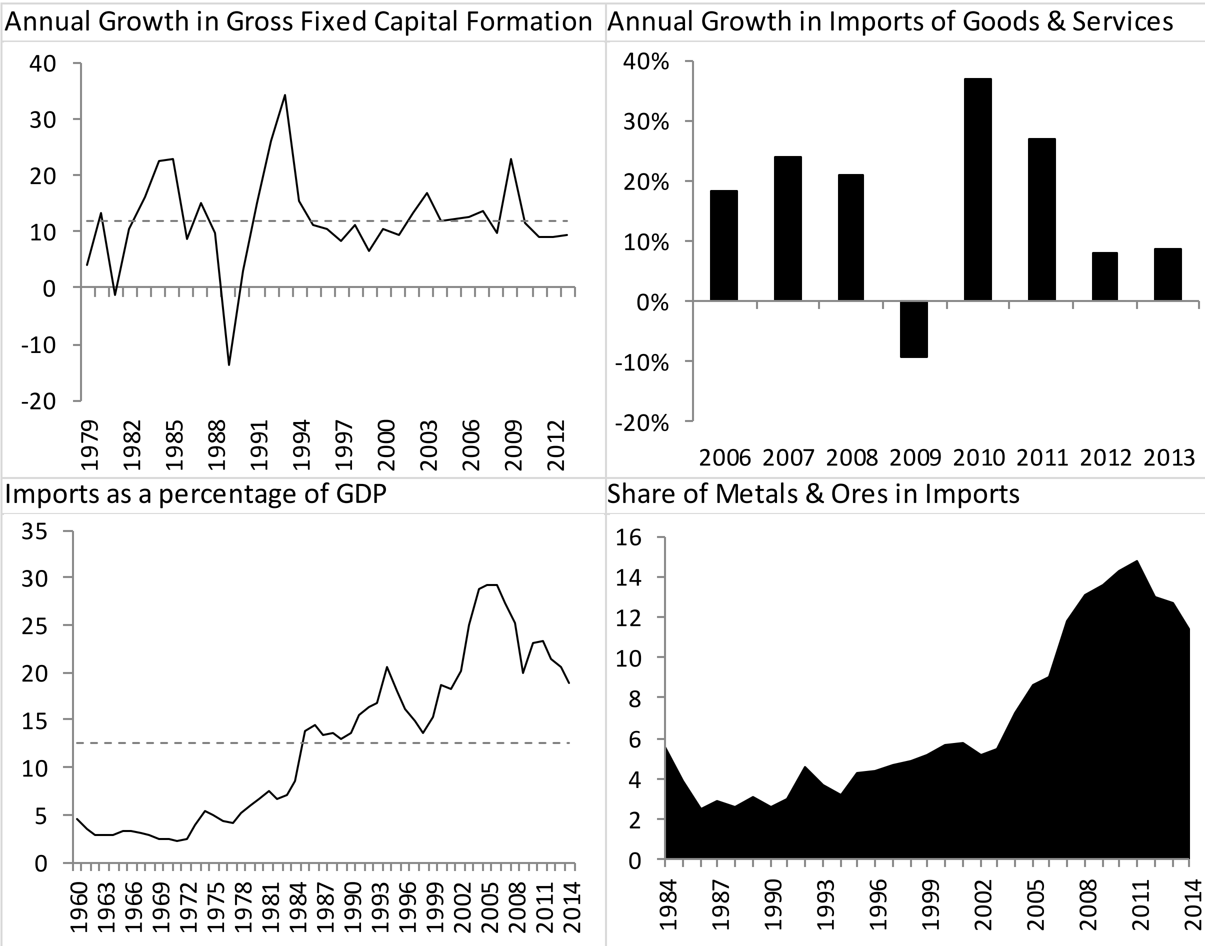


Source: IMF, Tamohara

* Note: Last observation is 2014. The six metals are: Aluminium, Copper, Lead, Nickel, Tin, and Zinc.

Indeed, with such a large share of global consumption of major commodities, the Chinese economy remains an important driver of commodity prices. As policy makers in China try to rebalance the economic growth from infrastructure driven to consumption led, incremental demand for commodities will dwindle. Already some of these measures are being reflected in numbers : growth in gross fixed capital formation in China is already below long term average and closer to lows seen in

1999-2000. Similarly, the overall growth of imports as well as the share of imports as a percentage of GDP is falling over the last few years. Furthermore, the share of metals and ores in imports is also falling indicate a much more rapid slowdown in consumption of commodities by one of the largest consumers of the last decade.



Source: World Bank, Tamohara

The data on multi-decadal price trends for commodities read along with slowdown in china makes us believe that we may be in for long term commodity down cycle. As we enter this environment of lower commodity prices, we will try and assess its impact on the Indian economy and businesses

The fall in global commodity prices especially crude and gold which have fallen by 40-50% from their peaks is a major positive for the Indian economy. Gold and Crude itself constitute nearly 35% of India's import basket. While the fall in prices has significant positive impact on the fiscal and current account situation of the country, they have also aided some structural policy changes like the removal of fuel subsidies and introduction of market linked fuel prices without inflationary headwinds. Further lower gold prices would definitely have a dampening effect on the investment demand of the yellow metal. These should also help the Government reduce its fiscal deficit burden and achieve the targeted 3% deficit over the next couple of years. Additionally, inflation has significantly come off its peak in India - wholesale inflation is currently in the negative territory while retail inflation has nearly halved to around the 5% mark - thanks to fall in prices of all major commodities.

These developments are significant for Indian economy as it is coming out of a multi-year growth slowdown and is poised to restart its capex cycle and focus towards infrastructure building. Fiscal headroom and lower commodity prices coupled with positive policy environment will help in accelerating the capital investment cycle and add to our GDP growth over coming years. Indian corporates which are grappling with issues of slower demand, high interest rates, idle capacities, and stretched balance sheets are expected to benefit from strong operating leverage aided by pick up in GDP growth leading to increased capacity utilisation and benign input costs with lower RM prices.

As Charlie Munger would say: *at times, when two or more forces come together in the same direction, the result isn't a simple addition of the forces but is more akin to a rapid multiplication - a Lollapalooza effect*

In sum, we think that the fall in commodity prices are a long term positive for India and investors in India. Rather than worrying about their correlation with global growth, investors would be better off measuring the many positives that lower commodity prices can bring in. As for the worry on global growth and other such matters, history has time and again demonstrated that bull markets start on the heal of some major crises. During the 1990s, we had a series of crises: collapsing commodities, the Asian currency crisis, Russian default, the Brazilian crisis and the Argentine default. India itself was reeling under a massive non-performing assets problem and a bad fiscal situation. However, the achievements of the following decade came on the heels of these difficulties. Amidst the continued flux in the global economy and regional politics are many gains to be made for the long term investor.

Until next month,

Team Tamohara

__Important Disclosure:__ All stocks discussed above and the views presented are purely for illustration purpose only and should not be construed as in investment advice. Tamohara Investment Managers, its employees or their relatives may have holdings in the companies mentioned above.

Disclaimer

This document has been prepared by Tamohara Investment Managers Private Limited ("Tamohara") and is provided to you for information only. This document does not constitute a prospectus, offer, invitation or solicitation and is not intended to provide the sole basis for any evaluation of the investment product or any other matters discussed in this document. This document is made available to you because Tamohara believes that you have sufficient knowledge, experience and/or professional advice to understand and make your own independent evaluation of the risks and rewards of the investments and/or other matters discussed in this document and to make your own independent decision whether to implement the same. Any view expressed in the document is generic and not a personal recommendation and/or advice. It does not consider your risk tolerance, financial situation, knowledge and experience. Please discuss with your investment advisor if you seek advice on whether the proposed investment product are appropriate for you. The investments discussed in this document may not be suitable for all investors. Investments are subject to market risk. There can be no assurance or guarantee that any investment will achieve any particular return. Unless expressly stated, products are not guaranteed by Tamohara or their affiliates or any government entity. Past performance is not necessarily an indicator of future performance. Actual results may vary significantly from the forward looking statements contained in this document due to various risks and uncertainties, including the effect of economic and political conditions in India and outside India, volatility in interest rates and the securities market, new regulations and government policies that may impact the business of Tamohara as well as its ability to implement the strategy. The information contained in this document has been obtained from sources that Tamohara believes are reliable but Tamohara do not represent or warrant that it is accurate or complete, and such information may be incomplete or condensed. Neither Tamohara, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any upon this document or its contents, or for any omission. The views in this document are generally those of Tamohara and are subject to change without notice, and Tamohara has no obligation to update its views or the information in this document. Tamohara or its affiliates may have acted upon or have made use of material in this document prior to its publication. Tamohara does not provide legal or tax advice and should you deem it necessary to obtain such advice, you should approach independent professional tax or legal advisors to obtain the same. This document is confidential and may not be reproduced or disclosed (in whole or part) to any other person without our prior written permission. The manner of distribution of this document and the availability of the products may be restricted by law or regulation in certain countries and persons who come into possession of this document are required to inform themselves of and observe such restrictions. This document is not directed to, nor intended for distribution or use by, any person or entity in any jurisdiction or country where the publication or availability of this document or such distribution or use would be contrary to local law or regulation, including for the avoidance of doubt the US. The contents of this document have not been reviewed by any regulatory authority in India or in any other jurisdiction. If you have any doubt about any of the contents of this document, you should obtain independent professional advice. The product strategies mentioned in the document may change depending upon the market conditions and the same may not be relevant in future. The sector(s)/stock(s)/issuer(s) mentioned in this document do not constitute any recommendation of the same and Tamohara or its directors, officers, partners or employees may or may not have any position in these sector(s)/stock(s)/issuer(s)