

We have completed a full financial year in March 2018 and since inception we have completed 21 months. I have spoken about our process which trying to do as well or better than our benchmark both in terms of returns and drawdown and that record is intact till now. There may be periods where it may not be so, but we are confident that over a full business cycle of 3-5 year this will hold.

	Return <sup>1</sup>	Drawdown
AlphaBets	16.8%	6.5%
Nifty	11.7%	9.9%

“Everybody wants to scrape it off the top, because what everybody really needs, is a check every month. That’s what is comforting to human nature”

### Charlie Munger

Recently Charlie Munger (VC of Berkshire Hathaway) called out on Mohnish Pabrai in an AGM and reminded the attendees that Mohnish (who also follows the Buffett formula) has completed ten years where he was making up for the high watermark he hit in 2008. Buffett took 25% of the profits over 6% over annum with a high watermark. If the investor didn’t get 6%, Buffett would make nothing. This is also known as the “Buffett Formula” but he wasn’t the first one to do so. The first one to do so was Benjamin Graham, his professor, mentor, and boss. So Mohnish has not charged a performance fee and “sucked his living out of his own capital for ten long years”.

As you know we are one of the few fund managers in the country who do not charge a fixed managed fee. We only charge a performance fee above a hurdle rate. It’s a tough but fair system according to us. It makes us completely aligned with our clients. We were also featured in a study conducted by Guy Spier of Aquamarine Fund called “[Zero Management Fees](#)” on page 13.

**Anish Teli** runs a pool of managed accounts in India for clients which invests in long only equity with longer time frame holding periods.

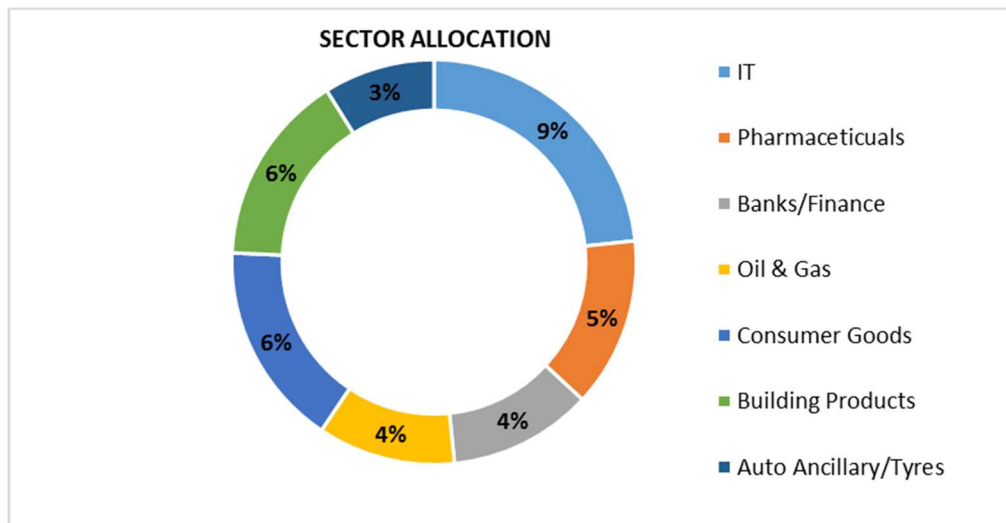
*To align with clients interests I don't charge any fixed management fee. There is only a performance fee above a hurdle rate with a high-water mark. This is why the firm is called QED Capital where QED stands for “Quad Erat Demonstratum”*

He believes in charging a fee only when he has demonstrated that he has made returns for his investors. [www.qedcap.com](http://www.qedcap.com)

The study also found common “in zero fee managers is their willingness to restrict the size of their AUM, to ensure they can generate returns at a level that will be sufficient to generate performance fees. They are far less prone to becoming ‘asset gatherers’ as this could potentially reduce their capacity to earn fees.” This is also our belief. We are not in the AUM gathering game. We are building a practice and not a business. We are ok with back ended and delayed gratification. And we try and explain this point to clients also so that we can build a likeminded group of people who are also in it with us for larger, backend and delayed gratification rather than keeping up with benchmarks on a quarterly or yearly basis.

<sup>1</sup> Annualised return post fees and expenses since inception i.e. July 2016 to March 2018

The portfolio currently consists of the following:



While selecting stocks we focus on company fundamentals and quantitative measures of stock performance. We also rank sectors on a regular basis. This simple exercise helped us gain exposure to IT even when the noise around the sector was negative. Opportunities are sometimes created by overblown narratives. We ignored the noise and negative commentary like H1B issues, automation, and inability of Indian IT sector to move up the value chain. We went by our process of what stock fundamentals, price and performance were telling us in aggregate. We also got lucky with a pharma company (yes, some pharma cos are still going up) and not so lucky with another one. The one that went up, we still hold, and the one we were not so lucky with, we exited at a small loss. Our portfolio turnover is quite low at approximately 10%. Our ideal portfolio would consist of about 15-20 stocks with a 5-8% allocation spread across the top 4-5 performing sectors.

The last two years have been extremely rewarding for equity markets. And no one knows when or how the trend will end. So we continue to follow our process and allocate risk capital at regular frequencies. If we get a major dislocation and an attractive point to enter post dislocation, we will be more aggressive in our allocation. Until then its wash, rinse, repeat.

General elections are coming up in India in the next one year and that may be a cause for some uncertainty in the near term. But over the longer term, markets don't care about who is power as long there is certainty and relative clarity in economic policy. No political alliance that comes to power will have policies that are any different that the other in the bigger scheme of things. Only semantics and optics are different. In 2004 we had a Cong government supported by left parties which caused markets to hit a lower circuit. A loose statement, by a leading Left leader on stock markets, led to a large intraday fall. Ultimately, we saw that 2004-2007 was one of the smoothest and largest bull markets globally and India wasn't left behind. Trump being election President was near impossible. Now he is being nominated for a Nobel Peace Prize for 'his tireless work to bring peace to our world'. Go figure! So if markets do decide to correct in 2019, it definitely wont be because who is or is not in power.

I can calculate the movement of heavenly bodies but not the madness of men

**Sir Isaac Newton. 1720**

Newton could have studied Joseph de la Vega, a successful Jewish merchant and philanthropist who had written the first book on the stock market titled *Confusion of Confusions* ([1668] 1996). In it, Vega presents the art of speculation as a dialogue between different market participants. It was a brilliant narrative tool, which helped the reader better understand speculation and trading.

Vega's *Confusion of Confusions* is easily summarized. In the Second Dialogue, Vega lists four basic principles of trading/investing as relevant today as they were 325 years ago:

**The first principle:** Never advise anyone to buy or sell shares. Where perspicacity is weakened, the most benevolent piece of advice can turn out badly.

**The second principle:** Take every gain without showing remorse about missed profits. It is wise to enjoy what is possible without hoping for the continuance of a favourable conjuncture and the persistence of good luck.

**The third principle:** Profits on the exchange are the treasures of goblins. At one time they may be carbuncle stones, then coals, then diamonds, then flint-stones, then morning dew, then tears.

**The fourth principle:** Whoever wishes to win this game must have patience and money, since values are so little constant and the rumours, so little founded on truth. He who knows how to endure blows without being terrified by the misfortune resembles the lion who answers the thunder with a roar and is unlike the hind who, stunned by the thunder, tries to flee.

Together, Vega, Newton and McKay are telling us something very important. The relationship between the individual investor and the stock market, which is nothing more than a collection of individuals, is a profound puzzle. For over four hundred years, it has perplexed the rich and the poor as well as the genius and the dim-witted.

*From - Investing: The last liberal art by Robert Hagstrom*

It is amazing how timeless these principles are with respect to investing given that they were written over 300 years ago. We try and follow these principles in our investing process. Investing is an endeavour where you will by design miss a lot of good investments in hindsight. But it is also structured in a way that if your process is designed as a funnel to weed out bad ideas and you are able to catch even a few good ones and hold on them in for a majority of the move, you will do well over the long run.

Investing is incredible noisy in today's time. From information being an edge not very long ago, today we need information cancelling filters to keep out the noise and receive only signals. The only edge which perhaps will remain is arbitrage of human emotions over a longer term. One major source of noise in the next one year is going to be political as we head for general elections. It will be interesting to see how our markets deal with that. More on this in the next letter.

Regards

**Anish Teli**

4<sup>th</sup> May 2018