Inflation and Interest Rates

Inflation is no longer transitory or caused by temporary supply side disruptions and that the Fed has now accepted. Bond markets are factoring in three to four rate hikes. Fed is not committing to how many rate hikes or the quantum of rate hikes preferring to keep it dynamic which is the way it should be. RBI will have no choice but to follow. As expected, equities have not reacted well to this news because the punch bowl will be taken away. However, the market is now aware that interest rates will rise, and inflation control will be preferred over growth. It's not all bad though. Remember we had the bull run of 2003-2007 in spite of rate hikes along the way. Whether this time is different or not, time will tell. We will follow our process which has got us partially into cash already. And if the trend changes back up or sector rotation gets us entry into strong stocks we will not hesitate to get back in.

"To suppose that the value of a common stock is determined purely by a corporation's earnings discounted by the relevant interest rates and adjusted for the marginal tax rate is to forget that people have burned witches, gone to war on a whim, risen to the defence of Joseph Stalin and believed Orson Welles when he told them over the radio that the Martians had landed."

Jim Grant

Markets are bubble prone and not equilibrium bound says George Soros. And in fact he says that when he sees a bubble, he wants to participate in it and ride the trend as long as he can. Daily, weekly, monthly predictions abound but do they have any value in investing or are they pure noise. Instead, we believe in reacting to trends. And a system-based approach is what works for us in approach financial markets. Don't get us wrong. The captain is still flying the airplane even if it is on auto pilot. The humans decide which universe of stocks to invest in, the risk parameters and keeping a watch on whether the system or autopilot is on course Once decided,the followed in a disciplined manner with oversight. At times the captain does have to fly the plane. And usually, it is in times of distress. Or at key junctures like take off and landing. Similarly a human steps into our process to decide when fresh capital is to be deployed, how much risk is to be taken and deciding if one needs to override are equally important considerations. And it is only with experience, knowledge and research that **we know when to and when not to. And that makes all the difference.** As owning a bat doesn't equate one to a professional cricketer, I wonder why having a trading account, one equates oneself to a full-time investor or trader. But that is the nature of markets. And perhaps that is why if we naively assume that rational expectations, discounted cash flow models and price-earning multiples are how all investors think about investing, we would be grossly mistaken.

However, long-term patterns do not change, because human behaviour rarely changes. Returns will be driven by outliers as they have been in the past. Stock returns globally follow an 80:20 or a "Pareto distribution". In 2016, we looked at the data for to see if the same was true for Indian stocks. We looked at stocks listed on the NSE over a ten-year period from 2006 – 2016. And it turned out to be true for Indian stocks too. In fact, it was even lower. Only 17% of stocks accounted for all the gains in the market between 2006-2016. We updated this for 2011 – 2021 period and found the numbers didn't change materially. About 20% of all stocks accounted for all the gains in the period 2011-2021. This trend is prevalent in developed markets too. Henrik Bessembinder has noted in his paper "Do stocks outperform treasury bill", that "just 86 stocks have accounted for $16 trillion in wealth creation, half of the stock market total, over the past 90 years."

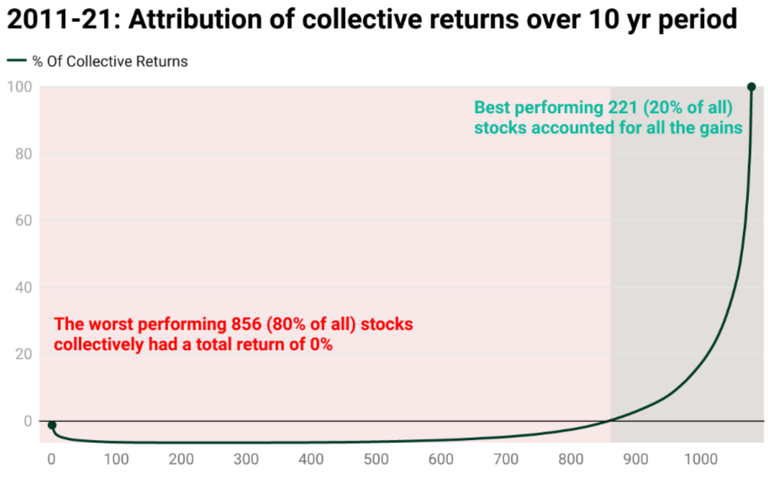


Chart: QED Capital • Source: acequity • Created with Datawrapper

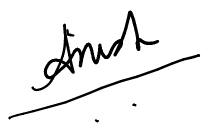
"Winners stay and losers go" has been our simple mantra. But executing a simple strategy, like ensuring planes land on safely and on time, is not simple and not easy especially during turbulence. And it takes skill, right temperament, and experience to keep doing that efficiently.

Performance

	AlphaBets	Nifty 50
CY 2021	37.0%	23.7%

It's been a good year for us. And we hope it continues to remain that way. We have several new initiatives that we are undertaking to educate and build awareness about systems and factor investing about which we will be emailing you separately

Thank you for reading! Mask up, get vaccinated, stay safe and take care. Thank you for investing with us.



Anish Teli and QED Capital Team

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