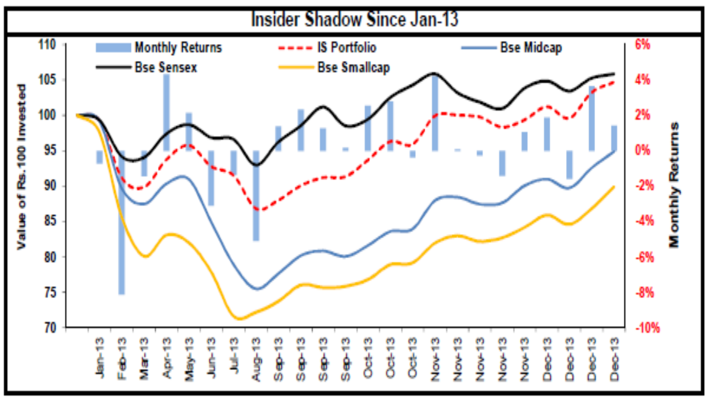
1st January 2014

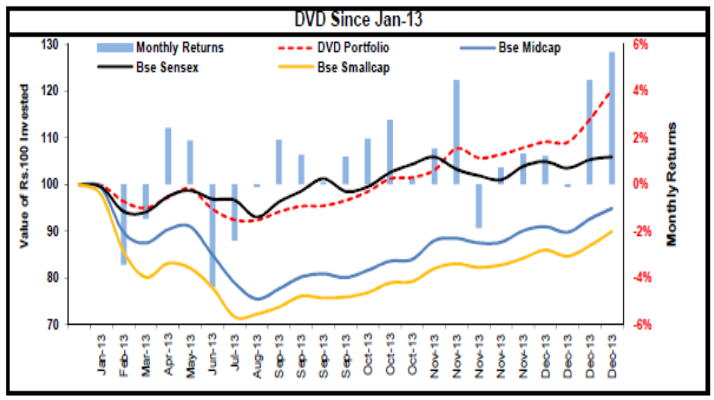
Hi,

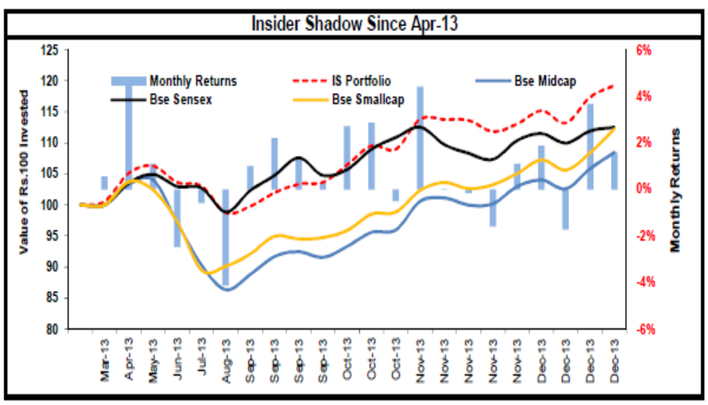
I'd like to begin by wishing you and your family a happy and prosperous 2014. We do certainly need a good year, particularly after a 6 year long dry spell in equity investments.

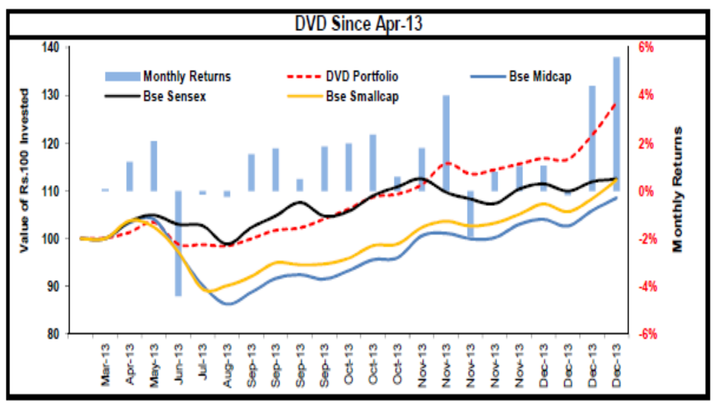
As an investor, usually you get a monthly or quarterly newsletter from your fund managers. Such letters do tend to have a subtle agenda of 'sales'. I am conscious of it. This letter is to present our performance for the calendar year 2013 intending to take you through our current thoughts about the likely risk-return payoff in coming years and address your concerns, if any, with regard to equities.

Let's kick-off with some good news:









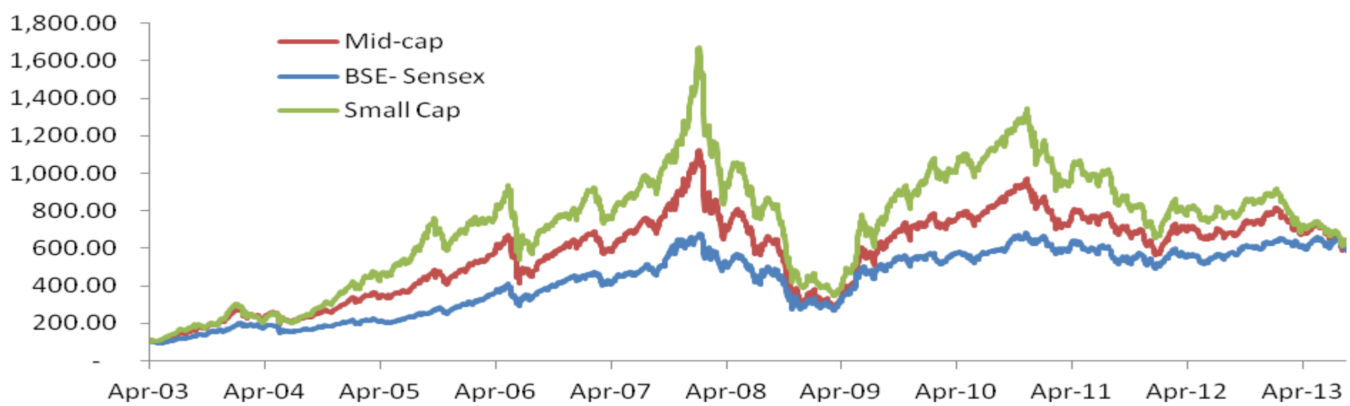
Returns Since JAN 24th		
	Absolute Returns	CAGR
Insider Shadow	4.69%	5.13%
DVD	20.40%	22.44%
Sensex	5.83%	6.37%
Midcap	-5.15%	-5.60%
Smallcap	-10.08%	-10.95%

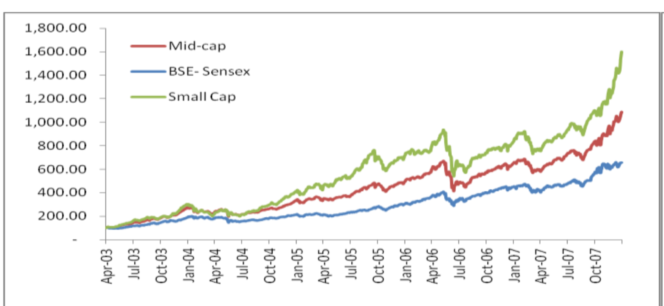
Returns Since APR 1st		
	Absolute Returns	CAGR
Insider Shadow	19.28%	26.50%
DVD	28.48%	39.67%
Sensex	12.52%	17.03%
Midcap	8.49%	11.48%
Smallcap	12.26%	16.67%

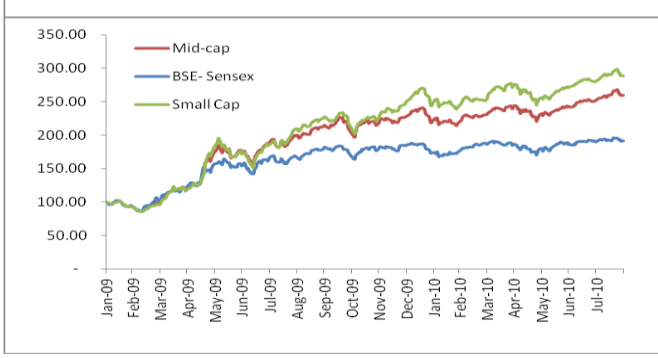
There is a Tamil saying: "To a crow, its baby crow glitters like gold". There are few investors/fund managers whose performance may be better than ours, but to me our performance looks the best.

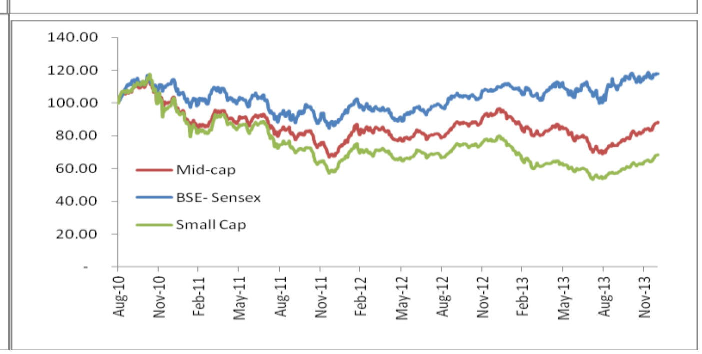
Most of you would have had experienced the above performance, some better and some worse off depending on when we actually commenced investing for your account. While the DVD theme was launched only this year, some of you would have observed the performance of ISF in the previous years as well. In its initial avatar when it began focusing on delisting names since launch in July 2009, it delivered 60+% in annual returns when markets delivered 20+%. After the delisting theme delivered sharply, realising most of its potential by July 2010 we rechristened the scheme and positioned it for investment into companies where we were seeing significant promoter buying. Most of the Insider activity was centered on small and midcaps. Since reaching its peak in Sept'10, small and midcaps had a dramatic fall till 2011-12 of about 30%. The theme has performed better then related indices, but the absolute returns differ depending on the investor's entry point.

The relative performance of small caps and midcaps vis-à-vis the Sensex (largecaps) can be observed from the following graphs:









Even though we are agnostic to size while investing, it is safer to assume ISF will have more stocks of Mid caps and DVD will have more of Mid & Small caps.

Observations:

1. Small caps and Midcaps significantly outperform largecaps in bullish markets and eventually the returns from both tend to converge but return variance at individual stock level is very high in small & midcaps leading to additional risk to an investor.
2. There are no predictable time-patterns of convergence and divergence of small cap/midcap valuations from the mean, sometimes leading to extended periods of stress that test the investor's patience. But such investors are rewarded handsomely during convergence.
3. When divergence occurs, non institutional investor participation drops resulting in absence of price discovery mechanism in small caps/ midcaps, in turn leading to a vicious circle of further divergence.
4. Insider buying activity increases as valuations diverge negatively as promoters tend to take advantage of cheap valuations. Similarly when valuations reach euphoric levels, promoter dilute through IPOs, QIBs, FCCBs etc. As of Sep'13 quarter, promoter holding across companies is at multi-year high and number of dilutions through IPOs is a record low. Indicating relative merit in valuations for a buyer.
5. As street research is focused more into large caps, information asymmetry risk doesn't exist in a theme with large cap benchmarks. Primary research in small caps is difficult and cost inefficient considering the lower allocable capital and hence mostly avoided by Institutions.
6. From a relative return perspective, it is easier to build a portfolio that will mirror large cap indices but relatively tough to build one that would mirror the midcap cap index. For example, with 10 stocks you can get 70% weightage correlation with a large cap index like the Sensex, whereas even 25% correlation is not possible with 20 stocks in the midcap index.

Portfolio Holdings:

ISF: We hold about 15 to 20 stocks from a pool of about 100 companies where insider buying has happened recently. Anticipated portfolio holding period of 2-3 years results in lesser churn and hence less costs and better post-tax return. One stock has doubled, about 5 have delivered about 30%+ and 3 have delivered negative returns.

DVD: Concentrated holding of less than 10 stocks with an intended churn ratio of less than 0.1, resulting in long term capital gains (NIL). During the first year of its launch, 2 stocks have doubled, 1 has dropped about 50% and the rest have moved up or down less than 50%. Our universe of ideas has grown more than 10 and hence we don't buy necessarily the same stocks when additional capital is allocated by the investor.

The indicative portfolio valuation median parameters are listed below.

Parameters	Sensex	ISF	DVD
Number of Stocks	30	20	10
Market Cap (In Cr)	105,000	5,500	2,500
Forward PE Ratio	15	12	10
Debt /Equity Ratio	0.6:1	0.3	0.2
Dividend Yield	1%	2.30%	2.50%
Price /Book Value	3	2	1.8
Earnings growth	9%	12%	15%
Return on Equity	17%	16%	19%

Even though ISF and DVD are not benchmarked to Sensex, the comparison table is only to highlight the relative merit of ISF & DVD stocks over Sensex that many of us track closely.

Meeting:

Lastly, I would like to highlight Sir John Templeton's quote: "Bull markets are born in Pessimism, Grows in Skepticism, Matures in Optimism and Die on Euphoria". I believe we crossed over Pessimism in 2011/12 and current market growth is still viewed with skepticism. It helps us to commit to equity a significant part of our portfolio before optimism shows up in price. I would ensure we exit when euphoria brings crowd back.

I look forward to meet with you soon to review our portfolio performance. As usual, our semi-annual stock level presentation by fund managers will be organized in the coming weeks, get ready to grill us.

Our investment idea flow has grown and valuations remain attractive inspite of the recent run-up. While equity allocation level within your portfolio is a function of "your risk tolerance", I would urge you to consider additional capital into niche themes like ISF & DVD within your overall equity allocation. It would be my delight if you could refer your friends or family who might be interested in meeting us. I am always available @ 98410 96034 & **maran@unificap.com**

Look forward to see you soon.

Yours Sincerely

Maran.G

I am listing below 5 major questions most of my investors have asked when I meet them to review portfolio performance.

01. **Now that Sensex is back to its peak, why should I allocate more to equities, on the other hand should I not be redeeming my equity funds?**

    Even though Sensex is back to 2008 peak in absolute terms; it is trading lower than the long term mean range in terms of PE multiple. This argument is as similar to saying Infosys @ 3500 is 5 times more expensive than Wipro @ 500 when their earnings per share are 150 and 20 respectively. PE wise, both trade in the ball park of 20-25 times. In 2007 when the Sensex was at 20K, its earning was about 820 per share; the same is now at 1300. While the long term average for Sensex PE is about 16, it has been in a broad range of 14 to 18 at most times. Only in panics it has fallen below 14 (remember 2008-9 when it touched briefly below 11) and only on euphoria it has risen above 18 (about 24 in 2007-8 peak).

    While Sensex earnings growth has been around 15%p.a over the last 20+ years, during 2003-08 the same was about 25%p.a. only to fall to 8%pa over the next 6 years. Considering the potential revival in GDP growth, under investment in capacities in the recent past and hence better capacity utilization and hence better profit margins, the earnings growth over the next 2-3 years is likely to be higher than the last 3 years and would inch towards the long term mean of 15%p.a.

    Hence there is a case for better Sensex performance driven by a revival of earnings growth and potential for PE expansion from current levels.

02. Election is around the corner: there are concerns of uncertainty in domestic economy and global markets, tapering by the US Fed has just begun; shouldn't we wait for clarity to emerge?

Over the last 20+ years, market performance during election years has mostly been positive. Nowadays we are being fed with lots of economic data and every analyst tortures these data so much till they reveal a pattern. We reproduced a famous Churchill quote in our ISF brochure: "Economists use statistics like drunks use lamp posts: For support more than for light". Instead of trying to time the market and decide on asset allocation based on headlines in media, focus on companies that perform, earnings growth, competitive situation, relative valuations, etc. In the back cover of my book on Warren Buffet, you may find his quote, "The basic ideas of investing are to look at stocks as business, use the market's fluctuations to your advantage and seek a margin of safety in your purchase price. There seems to be perverse human characteristic that like to make easy things difficult".

We find margin of safety in our stocks at current prices and hence suggest a buy. If market fluctuations provide an even more attractive price, an investor could allocate more capital if his liquidity permits instead of panicking. If an investor's portfolio lacks tolerance to a risk of 20% such a portfolio doesn't deserve to have any equity allocation in any case.

03. Equities have delivered NIL or negative returns in the last 5 years. FMPs offer about 8% to 9% post tax, is equity return potential higher enough to take the risk?

Since inception Sensex has delivered about 15%p.a. Over the last 10 years as well as for 20 years the return has been in the same range even after including the nil returns earned over the last 6 years. This is not the first time 6 year return in Sensex is nil. If you pick a peak period after a long and sharp bull market and measure over the next few years, returns could be negative. 5 years period return prior to 2008 when Sensex moved from 3000 to 18000 was about 30+% pa. If you invest only after 5 years of 30%p.a. return, not before and not after, but measure the performance over the subsequent 3-4 years, you should be surprised if you earn a positive return.

On the other hand, if you invest at all times whenever Sensex return over the previous 3 years was NIL, your average annual compounded return over the next 3 years would have been 22%p.a. The last recent time when Sensex return over previous 3 years period was NIL was August 2013.

If you decide on equity allocation only when prior period returns were above 20%p.a consistently for longer periods, your equity experience will always be negative. On the other hand, investing systematically will help avoid these timing issues partly. Even with SIPs, seasoning time required to evaluate performance should be longer than 3 years.

04. If investing in Sensex (large caps) makes sense, why should I consider small caps/mid caps oriented themes like ISF/DVD of yours?

As you may have observed in the convergence/divergence pattern of midcaps vis-à-vis large caps, the current midcap index (Dec'13) must rise 65% from here to get back to where it was trading in Jan'08. Assuming it will take another 3 years from now, the current investor will make a 65% return for the 2008 investor to breakeven in 10 years.

Midcaps are more volatile than large caps as the underlying companies face lot more challenges in an economic down cycle: like accessing capital for sustaining growth, cost of capital, retaining management talent, reduced economies of scale and hence less room to cut costs etc. Similarly when the cycle improves, due to their nimble size, smaller base and focused operations, their growth rate will be in most businesses relatively higher than that of larger companies.

While part of the volatility in midcaps can thus be explained, what is not explainable is the extent of fall or rise disproportionate to the changes in earnings. While large caps have constant price discovery mechanism due to institutional presence, midcaps/small caps are mostly driven by non institutional investor participation. Since such investors' participation is again cyclical, more in boom years like 2006/07 and absolutely nil in down years like 2011/12, the impact of the crowd entry as well as exit have acute impact in small/midcaps than large caps.

The only class of "Non-Institutional" investors who are counter cyclical is "Insiders". Their activity level is inversely proportional to market performance. During boom years they are busy diluting through IPOs/QIBs/FCCBs and down years they increase their stake in respective companies by acquisition of shares through open offers or market purchases or company buybacks. For example during 2007 when Sensex rose from 14K to 20K there were 120 dilutions through IPOs/QIBs/FCCBs. During Dec'08 when Sensex crashed below 8K there were not even a single IPO but 160 out BSE 500 companies witnessed promoter buying.

Investors who buy when insiders buy (bearish markets) and not when they sell (bullish markets) will have superior returns as compared to others

05. Since equities are cyclical and small and midcaps are even more so and since ISF/DVD themes are oriented towards them, will you return capital when you perform or let it ride the rally, seek more capital then and lose it all in the next fall?

The promoter holding in Corporate India as on Sep'13 is at a multi-year high as valuations are attractive. As markets rally and valuations become rich, promoter insiders will again turn to dilutions instead of aggressive stock purchases. During such times when the crowd returns to the market, small and midcaps will offer outsized returns attracting a major part of the crowd. Our universe of investment ideas will reduce and offer enough signals to wind down the theme to wait for the next down cycle in market. While we can't time stamp such a development, with the benefit of hindsight that valuation divergence is already 3 years old and earnings revival is round the corner, our waiting period for convergence might not take longer than 3 years. On the other hand, if your investment perspective is for shorter period, it is advisable to avoid these themes. DVD, in any case is designed with tenure of 3 year or 100% absolute return whichever is earlier.