ITUS CAPITAL

Dear Shareholders and Investors,

As we finish the first 9 months of the year in 2023, our fund delivered a net return of 16.3% (post fees and expenses) as against Nifty which was up 9.26% over the same period.

This brings the IRR since inception of Itus at 20.1% as against Nifty which generated 13.95% over the same period. INR 1 Cr invested in the fund since inception is currently worth INR 3.45 Cr today for investors. It is interesting that over the same period, we have seen 2 bear markets where the index was down more than 20%.

When I started the fund in 2017, I had maintained that Nifty would be one of the most consistent indices and (the index which would be) the hardest to beat in India. Sitting in the middle of 2023, I am happy to say that not only has Nifty been the best performing index but has been the index with a volatility of 30% of the small cap index and 52% of the multi-cap index. Having beaten the index over this period on a consistent basis makes us believe that we at Itus have done a reasonable job of delivering alpha to our investors. I continue to maintain that, while I am bullish on India and believe that public equities will be the best risk adjusted return asset class in the country, Nifty will continue to be the hardest index to beat this decade too.

Our performance since inception on a granular basis is broken down as below:

	Fund (%)	**Benchmark - Nifty 50 (%)**
2023	16.32%	9.26%
2022	-2.83%	4.32%
2021	29.26%	24.10%
2020	40.32%	14.88%
2019	17.31%	12.01%
2018	-7.31%	3.15%
2017	54.66%	28.66%
Since Inception (Cumulative)	244.78%	141.57%

In our prior letters, I have highlighted our positioning, why we continue to be overweight domestic manufacturing and auto-ancillaries from a portfolio construct currently (the supply side of the economy) as against the demand side of the economy (which would be consumption focused). In this letter, I delve deeper into the trends we are currently observing on the ground – both anecdotally and through our conversations with the promoters and management teams we continue to have.

Looking at the history of market-cap based investing.

The history of market-cap based investing can be traced to the regulator who introduced the concept of large, mid, and small caps based on the size of the company (In India, this has been demarcated based on the top 100, 101-250 and 250-500 companies by market cap). The genesis of this goes back to the fact that a large company is relatively safe (from the view of capital erosion) and a smaller company has a higher risk from the same vantage point.

Studying the micro market of India over the last 20 years (where data is relatively clean) gives a granular breakdown of this market-cap split.

Assuming an average investor does not have the time to research and do the diligence to invest in stocks, we work our analysis with the study of the index in each of the scenarios.

It is interesting to note that the average *5Y rolling return* of the Large Cap over the last 20 years is higher than the same return of Small Cap by an IRR of 2%. The same analysis done with 3Y rolling returns (shorter time frame) shows an equal return for Large-cap vs the Small-cap index.

However, during times of increased volatility (defined as the Large-cap index having a peak to trough drawdown of 15% or higher), the Small-Cap index has a liquidity profile which drops 65% as against normal periods. This effectively says that the Small-Cap index does not offer a significant risk premium over longer durations but hurts the investor on liquidity during each period of volatility.

It is important to realize that as a fund manager, my job has always been to prioritize drawdown-minimization over return maximization (Returns accrue to the investors with the benefit of time, rather than having an abnormal year of high returns to then follow it up with an increased drawdown in subsequent years).

While there will always be select bottom-up opportunities available which will have a significantly higher growth rate that will make us want to go deeper from a bottom-up focus, understanding market-cap cycles and focusing on valuations has always been an imperative focus around how we have managed our liquidity in the fund.

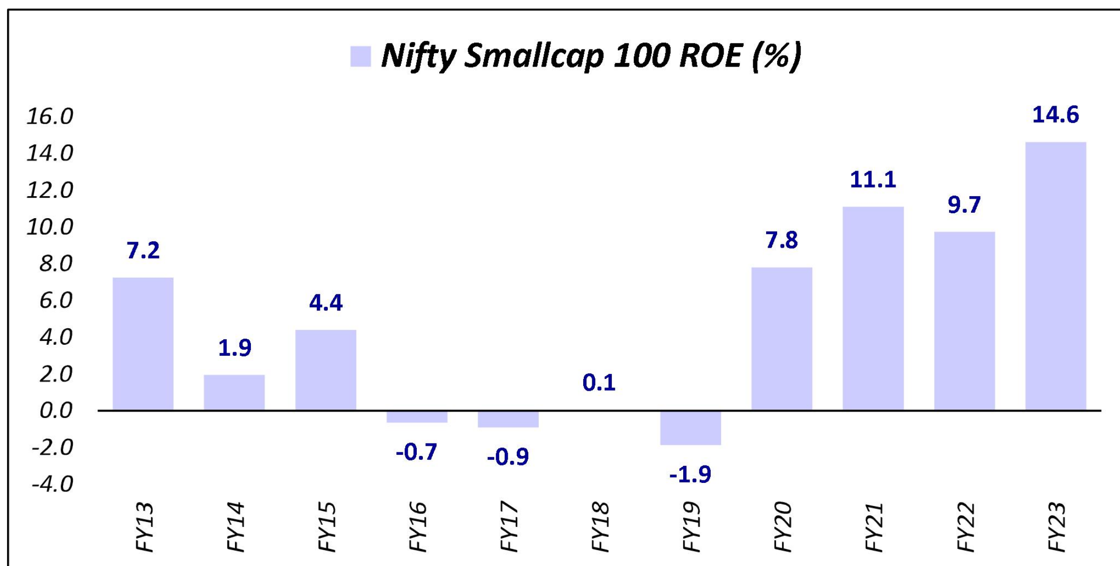
Fig 1 : Our fund positioning across market caps (historically)

	Small Cap	Mid Cap	Large Cap
2017 Average	9.1	30.9	47.6
2018 Average	11.8	29.7	48.2
2019 Average	11.7	32.1	46.3
2020 Average	16.0	26.5	52.1
2021 Average	26.3	33.5	33.4
2022 Average	23.8	41.8	21.2
Today	20.5	38.0	26.0

At this juncture, we have been lowering our risk in the mid and small cap segments where we believe we are not getting paid incrementally for the same (there is no liquidity premium for going down the liquidity curve).

At the core of our investing philosophy is to have a growth-oriented mindset and we position ourselves in pockets where we find structural growth at the right valuations (with growth being the first point of reference we look for). The period where our small cap exposure increased materially was at a time we found structural growth in the companies where the RoE began to expand (Ref fig 2)

Fig 2 : Small Cap RoE historically represented (for the index).



While our current cash balance has increased recently, our additional re-deployment of capital continues to be in the large caps where we find growth with valuation comfort.

Financialization as a theme:

If I were to take a long-term view on India, as a fund manager investing in the country, there cannot but be a better time. We are going through an inflection point as a country with the savings in the country financializing at a faster pace and the domestic investors increasingly becoming savvier. Studying history around numbers shows you that our market cap is currently like what the US was in 1989 and the subsequent 10 years resulted in US seeing its market cap multiply by 3.5x

With the government creating a strong infrastructure led growth, it is within reason that we can see a similar trend panning out in India (the multiple of wealth creation that gets created can be a subject of debate).

With this as the background, it is obvious that many investors would want to overweight portfolios with financialization as the core theme. In this section, I would want to highlight the importance of the country at a more granular level and why one cannot have a homogeneous view on India.

I have maintained that our addressable market in India will be constrained by the addressable market defined by the taxpayers.

Fig 3: Total number of Tax payers by segment across years

Income range	FY19	FY20	FY21	FY22	YTDFY23
up to 500,000	43	46	39	44	46.5
500,000 - 1mn	10.1	10.2	8.9	9.8	11.1
1mn - 2mn	2.9	3.3	3.3	3.7	4.6
2mn - 5mn	1.1	1.2	1.3	1.5	1.9
5mn - 10mn	0.2	0.23	0.2	0.24	0.3
>10mn	0.1	0.11	0.09	0.11	0.2
Total	**57.7**	**61.4**	**52.8**	**59.7**	**64.6**

While the government writ large has set a strong base by increasing the absolute number of taxpayers, I believe that the absolute growth rate of 12% over the last 4 years has been steady at best. I would look at this base as the addressable market for any financial intermediary business and the growth rate they would look at.

During the same period, we have seen a staggering growth rate in the financialization of the economy measured through demat account opening and investment in Mutual funds (which have grown by 220% and 71% over the same period

Fig 4: Growth rate of financialization in the country

	FY19	FY20	FY21	FY22	FY23
No. of Demat accounts in India (in mn)	**35.9**	**40.9**	**55.1**	**89.7**	**113**
Total No. of MF Folio's (in mn)	**83.8**	**91.5**	**102.6**	**134.7**	**149.1**
Growth/Equity Oriented Schemes	59	64	69	89	101
NSE Active clients (in mn)	**8.8**	**10.8**	**18.9**	**36**	**34**

Fig 5 : Penetration of NSE Active Clients

Trend	FY19	FY20	FY21	FY22	FY23
Active Clients (NSE) / Total Tax Payers	15.3%	17.6%	35.8%	60.3%	52.0%

It is important to understand this before we make arguments of the runway for growth and the opportunity set around financialization in our country. This is one of the core reasons that we at Itus, continue to buy growth at a reasonable price.

Portfolio Summary:

We continue to focus on businesses that have market leadership or are growing their market share over time. This is a function of the people behind who we invest capital. This will continue to be the hallmark of our investment philosophy.

I continue to maintain that 2023 would be a good year to deploy capital on a purely bottoms-up basis into volatility that we see in the year. I look forward to speaking with you on **our call at 9:30 AM on the 14th of October 2023.**

From the desk of the CEO

Naveen Chandramohan