September 28, 2011

The primary purpose of reaching out to you is to highlight a few seemingly difficult challenges in managing our family wealth which we have overcome through a disciplined, unique and differentiated approach.

At the outset allow me to introduce ourselves as a boutique investment house focused largely on equities research and analytics – both Indian and Global.

Multi-Act was started in 1997 by two Wharton graduates and has grown to a 40 member team today, of which, 25 are in research and investment. Most of them are CAs, CFAs and a few statisticians.

Since inception, Multi-Act has been engaged in creating a process for stock-selection and valuation in order to construct a portfolio of investments in Indian and Global markets. Our ***Global Rational Analysis Framework (GRAF)*** is a process which uses tools from fundamental, technical and quantitative analysis, and is set against backdrops of behavioral finance and Austrian economics.

Multi-Act has been providing research based investment advisory services for its principals' funds as well as to its institutional clients which include some highly respected global hedge funds.

Multi-Act's success with managing our "proprietary" funds over the last several years led to a few select families to request us to manage their funds as well. This led us to believe that ***GRAF*** could be of interest to like minded people who value their wealth and are focused on maximizing growth through prudent investing and a high degree of focus on capital preservation. Our principals have over 25 years of experience in investment management and research across the globe.

The cornerstone of Multi Act's investment philosophy is risk control. To that end, the primary goal is that of capital preservation. The belief is that the 'compounding engine' works most efficiently when there are no large 'draw downs' in the value of the portfolio – and no permanent impairments or 'permanent losses of capital' in any of the portfolio constituents.

Our discussions with like-minded investors have frequently come up with posers with respect to **"Challenges faced by families"** and I would like to share my views with you.

The biggest challenge that families face today is that the macro economic landscape is very different from the most recent past.

Memories in India of equity investors are most pronounced of the glorious 2003-2007 period. Even the experience of the 2008-9 period has not dented the basic correlation that equity investors seem to make between the expected GDP growth of 8%-9% and glorious equity returns in the future-especially when the equity markets are running hot.

Yet since 2003-2007 the macro environment, especially the impulses from overseas, are very different. India is no longer an isolated market and is very much buffeted by FII inflows. FII inflows are to a certain extent, captive to the macro environment globally.

The complexity of links in the Global Economy makes it very difficult for families to understand the crux of the issues that are relevant for investing in the appropriate Asset classes.

So what are the global macro- impulses that affect India and Indian investors?

In all the various mainstream press & media reports very rarely do I see a complete or honest discussion of what I consider the main risks facing the global economy.

For us the **main one is that the US $** , which is the de facto global currency (money ?) is clearly in it's death throes, with no credible candidate to take over the mantle of a global reserve currency. In fact the monetary authorities of all the candidates: the Yen or the Euro are more interested in devaluing their own currency in order to meet their domestic challenges.

This means that the entire global monetary system built on the accumulation of US$ reserves and the issuance of local fiat currencies is inherently flawed and facing its twilight years. We think there is alternative money that needs to be made a currency again, but that will be discussed later in this article.

US Monetary and Fiscal authorities no longer exercise the care that behooves of an entity that enjoys the "exorbitant privilege": The privilege of issuing your own currency in settlement of your liabilities. Quite clearly US authorities have come to the conclusion that Richard Nixon came to in the 1970's "it's our money but your problem".

So ever since the Global Financial Crisis in 2008-9, the US has tried vainly to export the impact of debt deflation to the rest of the world, but in particular to Asia, via low and negative "real" interest rates. The Asian "peggers" have had a choice: they can

1) either try and match these negative 'real" rates by lowering their own administered rates at the risk of sparking "asset bubbles" and high domestic inflation or

2) They can run a monetary policy more appropriate to their own domestic economic circumstances, and suffer a high and an increasing "real" exchange rate (with a concomitant deflation).

In the aftermath of the GFC, Asian Central Banks and Fiscal authorities bought into the story that they needed to engage in coordinated action of the same sort with the developed world, with the result that all the Asian countries suffer from persistent and high inflation today. With the domestic angst that has hit the more underprivileged sections of society as inflation is wont to do, Asian Central Banks and Governments are now reversing course and switching to policy option 2. The deflationary impact of this switch has yet to feel its impact on Asian economies, but sooner or later it will and exporters will be the most affected.

The **second macro-economic impulse** is that Governments everywhere but especially in the Developed World, has decided to live in a "twilight zone", a world where interest rates are close to zero and fiscal deficits touch nearly 6% to 10 % of GDP in a variety of countries. When this "twilight zone" world is threatened by the inevitable increases in long duration interest rates, they unveil one Quantitative Easing (QE) after another. By perpetually penalizing savers and subsidizing consumers how in the world do Central Banks expect any "real" growth (domestic savings & domestic investments) to take place by having the private sector take the lead in investing.

Finally **the third macro- impulse** is that there still seems to be an underlying belief, naive to us, touching nonetheless, that somehow Central Banks and Governments-central planners both - will "fix" what ails us. So market participants, leveraged speculators and the "lady in Peoria "ever since March 2009, have been happy to buy and sell securities at prices that clearly do not take into account the possibility that CB's do not have a magic wand and midnight will surely strike. What then?

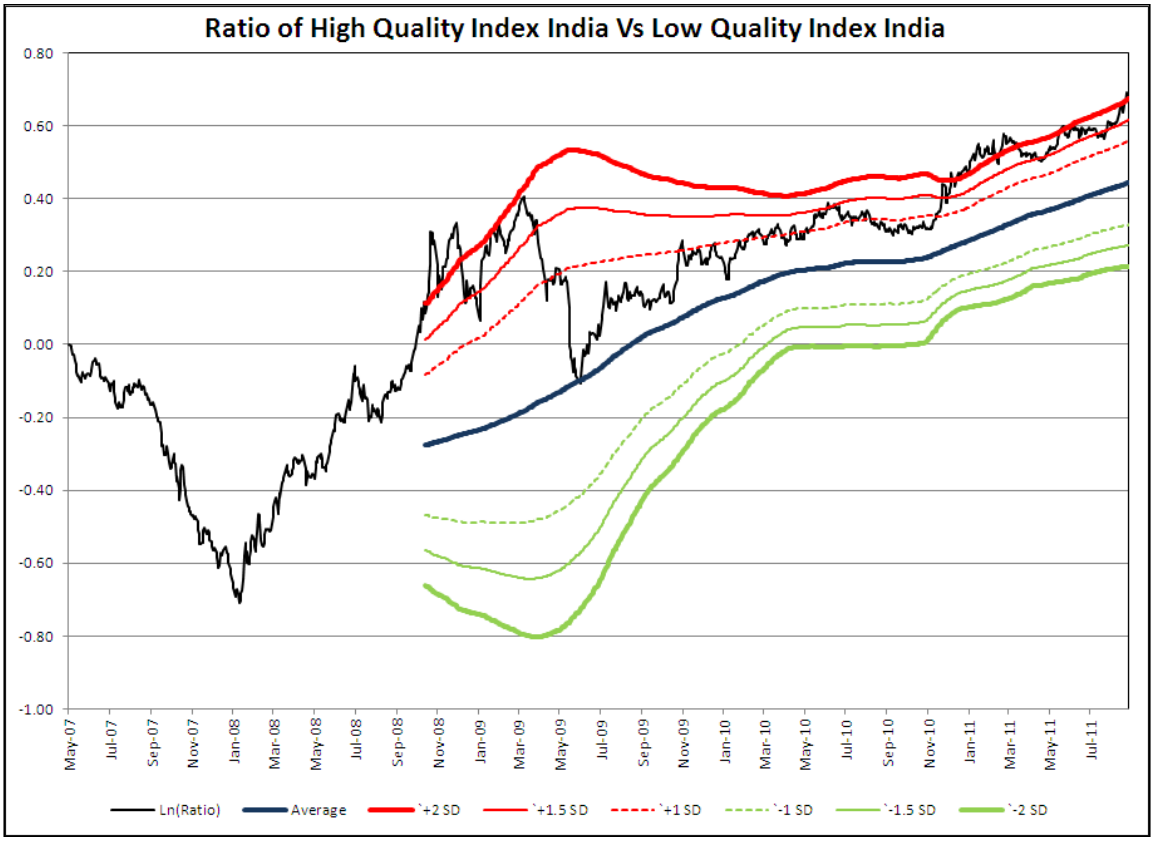
So what is the implication of all this for families that per force need and have to have some exposure to Indian equities and assets?

We would argue it has ***three implications***:

As far equity exposure goes

Firstly, the business model is more important than the valuation of the business. By that we mean that business models that do not depend upon access to the capital markets for their existence are prized over any business model that is dependent upon access to the capital markets-either debt or equity. When investing ask yourself this question: if the capital markets shut down for two years can this business survive?

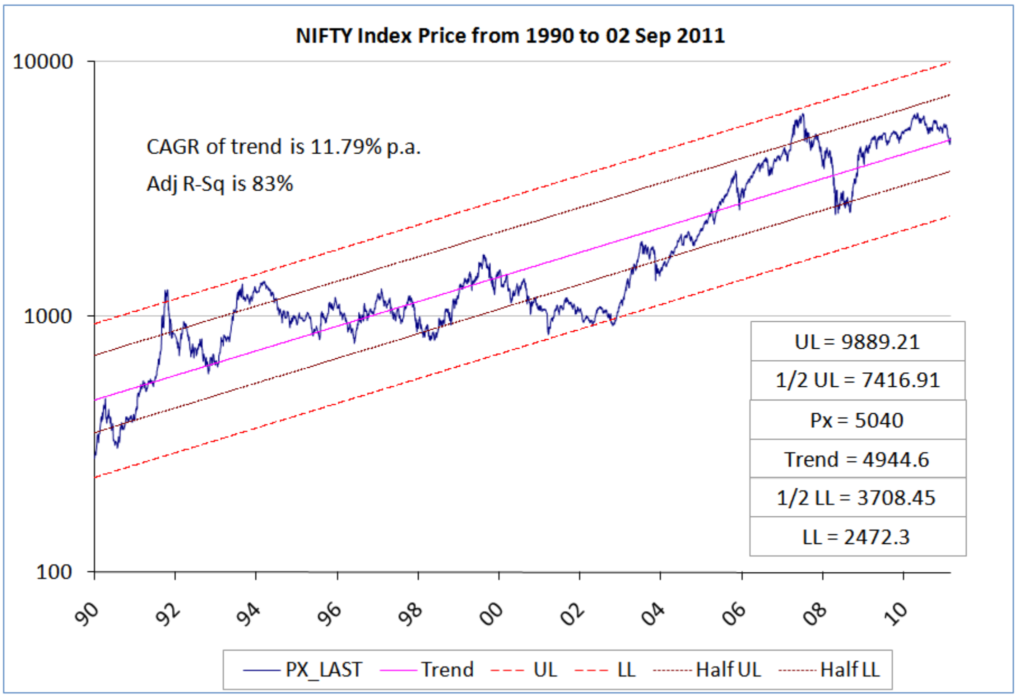
To demonstrate this point, Multi-Act track two indices High Quality and Low Quality and below we exhibit the performance of these indices and the ratio of HQ/LQ since May 2007.



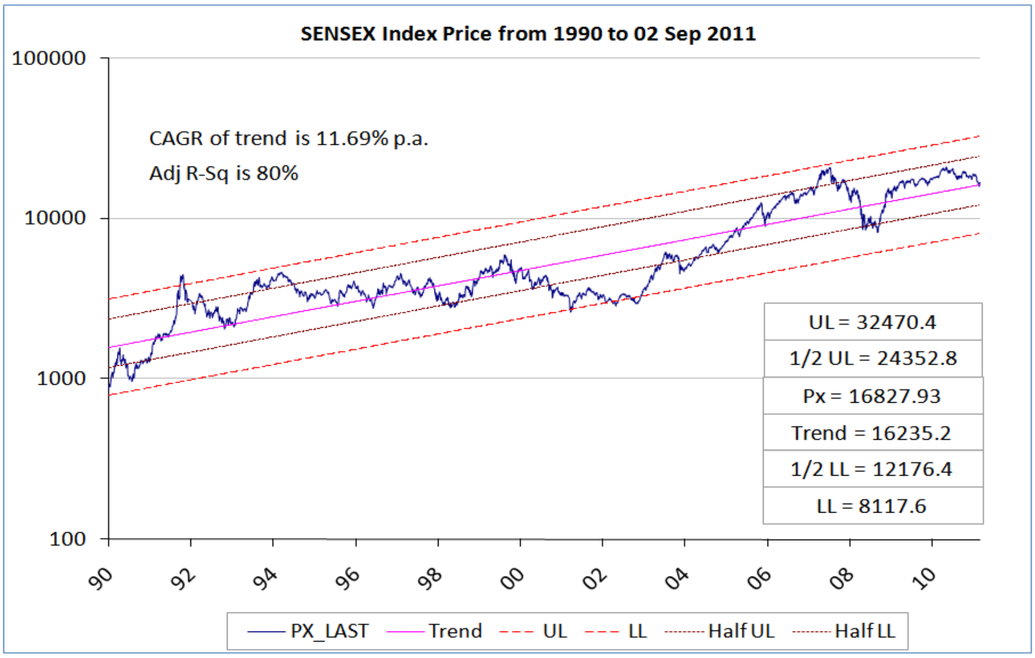
The second implication is that investors should expect periods of stable equity price performance to be interrupted by violent and heightened volatility when from time to time when international participants take fright on account of any one of the 3 macro challenges!

As investors in equities we would urge you to make sure that your cash positions allow you to take advantage of these periodic sightings rather than being forced to react. Re-balancing at the ½ Upper and Lower limit is critical in being able to take advantage of this volatility rather than become a victim of the volatility.

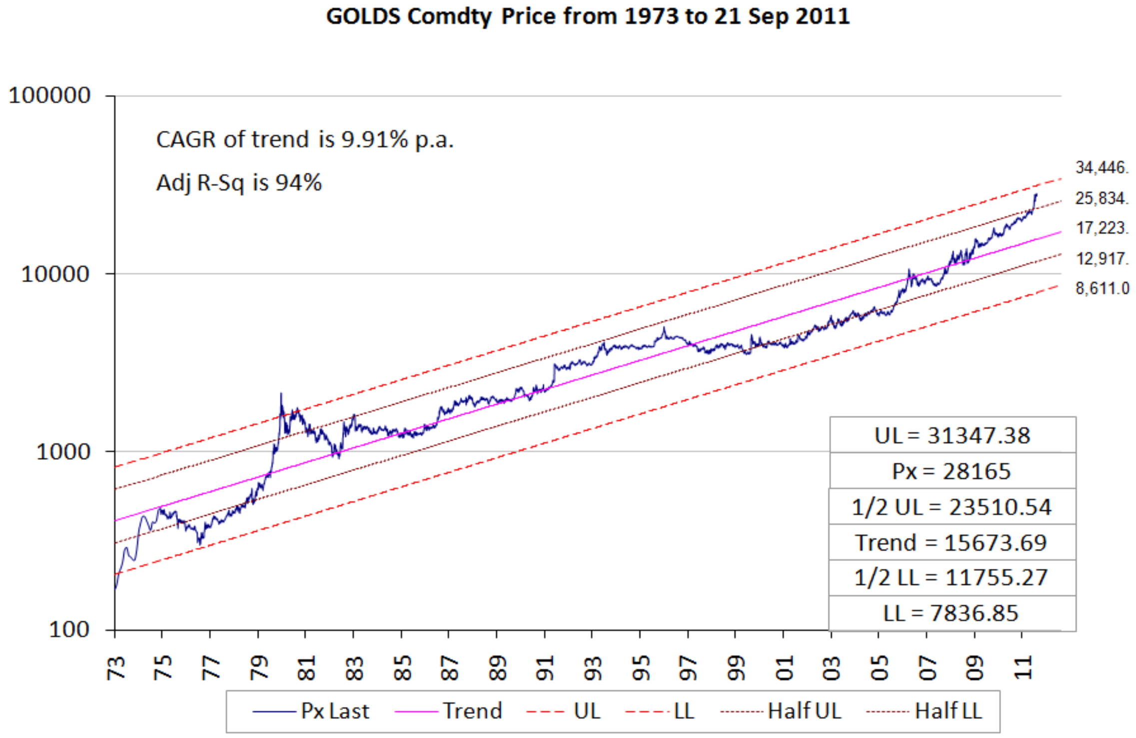
NIFTY TREND CHART



SENSEX TREND CHART



The third implication is that we think that Indian families need to have a healthy exposure to gold and gold mining shares, as much as perhaps 10% of their investable assets.



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