ALCHEMY
CAPITAL MANAGEMENT

INVESTMENT MATTERS

April 24, 2007

Hiren Ved hiren@alchemycapital.com

2007 – Opportunities amidst Uncertainties

Since the beginning of this bull market in 2003, the rise in the markets has been very powerful and secular till it was punctuated by a deep correction in May 2006. Cheap valuations, strong GDP growth, 25-30% corporate profitability growth coupled with lower inflation and interest rates helped the Sensex deliver a 3X returns in 3 years (2003 to 2006). The macro environment both domestic and global was relatively benign. Therefore the rise was both secular and broad based. This helped most institutional money managers to outperform the markets by a significant margin. The tables below illustrate that the best performing MF schemes from the top fund houses of the country were able to beat the benchmark by a handsome margin.

	Jan 2003 to May 2006
Reliance Growth	744.73%
HSBC Equity	547.30%
ICICI Prudential Dynamic	430.75%
Franklin Blue-chip	423.74%
SENSEX Index	**272.03%**
HDFC Equity	228.86%

	May 2006 to April 2007
SENSEX Index	**12.05%**
ICICI Prudential Dynamic	11.07%
HSBC Equity	7.17%
Reliance Growth	6.86%
Franklin Bluechip	6.24%
HDFC Equity	-2.89%

Analysis of sector-wise performance during the period demonstrates the breadth or the broad based nature of the rally. Almost all the major sectors other than healthcare and oil & gas outperformed the Sensex between 2003 and early 2006. But post May 2006, the situation has changed significantly. While the markets have recovered from the lows of May/June 2006, the recovery has been very narrow and selective. As a result most money managers have struggled to outperform the benchmark See tables above.

Post May-June 2006, both the global as well the domestic economic environment has become challenging and as we have mentioned in our previous communiqué, there are now significant headwinds as apposed to the strong tailwinds we experienced between 2003 and 2006. Inflation, rising interest rates [impacting banking/finance, auto, real estate], interventions by government in pricing policies of certain sectors [cement, steel, pharmaceuticals], enhanced taxation on the corporate sector in the budget [dividend tax, IT/BPO profits, service tax on rentals of commercial space] have created challenges for many sectors. Analysis of sector wise performance for the period May 2006 to April 2007 demonstrates that majority of the sectors have lagged the benchmark. Even today a wide spectrum of the market still trades at 10-20% below their respective May 2006 levels.

Sectoral Returns	
	August 2004 to May 2006
Capital Goods	304.96%
Auto	208.04%
Metals	207.05%
FMCG	194.37%
Teck	187.33%
Infotech	162.69%
Sensex	**150.56%**
Oil & Gas	121.34%
Healthcare	94.11%

Sectoral Returns	
	May 2006 to April 2007
Teck	49.56%
Infotech	26.66%
Oil & Gas	19.05%
Sensex	**12.05%**
Capital Goods	9.46%
Healthcare	-1.19%
Metals	-12.91%
Auto	-13.96%
FMCG	-17.88%

Therefore given the challenges markets face, the days of a broad based all encompassing rally are behind us. From here on to generate reasonably strong returns would require a very careful and disciplined approach to theme/sector/stock selection and more importantly a solid conviction in markets and the ideas we invest in.

We at Alchemy have been disciplined in our approach towards stock/theme selection in the past. We continue the process of positioning our portfolios by focusing on a few secular themes which we believe have potential to deliver good returns in the future. Needless to mention that it is equally important to select the right stock with a good-risk reward profile within those themes

1. Alternative Energy – Need to diversify away from conventional energy sources, high crude oil prices, climate change and cleaner environmental issues will drive innovation and significant investments in this area. We believe years of debate will finally give way to decisive and accelerated pace of investments in the alternative energy space. Globally smart money has already started funding investment opportunities in the area of Bio-fuels, solar, wind energy and significant projects which would be entitled to receive carbon emission credits.

2. Developing and exploiting IP for the global markets – here the focus is on companies which have the capability to develop their own intellectual property (patents) and exploit it globally either on their own or through alliances. The idea is to bet on the non-linear business models of these companies. While such opportunities arise across sectors – we have identified Information technology, Life sciences and materials as sectors to focus on.

3. India’s infrastructure and corporate investment cycle – the Indian government and the corporate sector is expected to spend over $300 bn over the next few years on infrastructure and capacity creation. Our specific focus would be on beneficiaries’ of investments in the power, railways and the retail infrastructure sectors.

4. Domestic Consumption Story – Favorable demographic profile, rising incomes as well as aspirations will drive consumption across sectors. Our focus has shifted away from interest rate sensitive sectors to the ones in the area of consumer goods, leisure, entertainment and media – both traditional and new.

5.Divestures, De-mergers, M&A’s and Buy Backs – As Indian companies, restructure, exploit new opportunities, acquire or get acquired they create significant opportunities to unlock value. Also many multinational corporations are actively looking at acquisitions, enhancing stakes or completely privatizing their subsidiaries in India as their Indian operations start playing a significant role globally.

This is just an illustrative list and not an exhaustive one as we will continue to look for opportunities to maximize your returns.