

From the CEO's Desk

Dear Reader

Greetings!

Oil. Inflation. Interest Rate. Slowdown. US Recession. US Financial Sector Crisis. Rupee depreciation. Fiscal Deficit. Government adhocism. Politics. Truly a DASA VATHARAM of another kind marauding equity markets.

Through the past 3-4 months, Hiren has actively used CASH to bring some protection on the downside. This did help in our performance over the last month and last quarter. Going forward, Hiren will look for opportunities to deploy some cash as risk reward ratios are beginning to look favourable.

You have shown terrific resilience through this difficult period, despite the large fall in asset values. To us, it reinforces your long term faith in this asset class - equities. In today's lingo, it is your TRUST VOTE. But rewards are still some time away. And I seek your continued patience as we wait for the headwinds to clear.

Happy Reading.

Warm Regards

Vaidy

Vaidy@alchemycapital.com



CAPITAL MANAGEMENT

INVESTMENT MATTERS

July 15, 2008

hiren@alchemycapital.com

Hiren Ved

Red Ticker, Moody Blues & Dark Grey Clouds

As I sit down to write this month's letter, oil has already hit a new high of US\$147 over the weekend. As I mentioned in my last communication oil continues to play spoil sport with global equity markets. Never in the recent past has one variable played such an important role in determining the fate of markets, completely overshadowing everything else. So unless oil corrects significantly, a serious pull back is unlikely.

However, considering the criticality of oil to equity markets, yours truly invested some time to speak to people who are more experienced and knowledgeable than I am on 'oil'! While there are no clear-cut answers, a few whose views I respect, felt that that there was no real fundamental justification for such a parabolic rise in oil prices in the last six months. That the argument of strong demand would not hold as the world cannot sustain such high oil prices and demand destruction would eventually bring oil prices down. But even if such a scenario plays out, *in the near term oil prices can inflict more damage, as any asset class which is in a massive bull run can overshoot on the upside before it eventually corrects.* I share an interesting chart on the similarities between the parabolic rise in NASDAQ in 2000 and oil in 2008!

NASDAQ/Oil Chart



Investment Matters

Back home containing “inflation” continues to be the single most important variable for domestic policymakers. Therefore the political dispensation has its priorities cut out - somehow get inflation down before we get into elections - even if it means trading lower “growth” for sometime. But controlling inflation is going to be a challenging task. The three most important constituents of inflation in India are food, fuel and metals. As far as food is concerned, we are relatively well placed compared to several other countries, given the record production of food grains and better monsoon thus far. Steel has the largest weight amongst commodities and the government has already done what it can - cut excise, banned exports and warned the producers from hiking prices. Fuel prices are administered and fuel price hike had to have a direct impact on the inflation number, but what we will continue to see is the impact of rising transportation and other raw material prices which are based on oil to continue to impact inflation. *Our analysis of the inflation data shows that any benefits of base effect will start only from early next year. Until then the specter of inflation will continue to haunt us and a possibility of further monetary tightening is inevitable. A series of monetary tightening measures has already slowed industrial growth (IIP for the month of May'08 grew 3.8%) and is also likely to slow down corporate profit growth.*

Apart from economics, politics has also decided to take an interesting turn. It would be interesting to see if the gamble of the Congress to go for the nuclear deal will pay-off and whether the government will be able to survive the trust vote on July 22. Each outcome has different implications. If it survives, we will probably see a continuation of anti-inflation policy responses as the government sees this as a critical variable to control before the eventuality of elections next year. But I do see a possibility of some reforms slipping through as the Samajwadi Party would be less recalcitrant than the Left. If the government does not survive the trust vote, it could be negative for markets in the short run but at least the uncertainty over the elections would be over. *In the past, announcements of elections have actually led to the bottoming out of markets.*

We have experienced the worst negative month, in the last 18 years. The nifty was down -17% in June. The other similar negative months were May 1992 (-25%) and May 2006 (-17%). The study of historical monthly returns of Indian markets since 1991, suggests that after severe back to back negative monthly performance, there exists a reasonable probability that markets might give a technical bounce back in the near term. Where possible we do intend to take advantage of such opportunities to deploy some of the cash we have in portfolios.

Our strategy of maintaining a high level of cash stood us in a good stead in the last quarter. As mentioned in my previous communication, our focus would be on sectors and companies which are low leveraged to debt, generate free cash-flow, have already raised equity to fund their growth and have relatively strong business models. We will give significant weight to liquidity while adding to our investments. We have added to our positions in Praj (strong free cash-flows, no debt and hedge against rising oil prices), Tata Chemicals (global leadership in soda ash, strong soda ash prices, positive government policy towards DAP, high dividend yield and very attractive valuations) and HDFC Bank (best placed bank in a rising interest rate scenario as it has historically demonstrated due to its high CASA - current/savings accounts - ratio). We'll continue to evaluate opportunities in large caps and liquid mid-caps to judiciously deploy the incremental cash.

In conclusion, we believe the complex interplay of oil prices, inflation/interest rate and politics will continue to overweigh equity markets over next few months. We will look for opportunities to deploy cash and tactically, use cash as the hedge for the portfolio.

Investment Matters

Global Equity Market Performance

Index Performance as on July 15, 2008	1 month	3 months	6 months	1 year	YTD Returns
Emerging Market Indices					
a) BRIC countries					
Brazil Bovespa	-9.6	-3.03	1.4	5.3	-5.0
Russian RTS	-5.6	-2.07	-8.0	13	6.5
BSE Sensex	-16.3	-21	-31	-16	-37
China Se Shang Composite	-2.5	-16	-48	-28	-46.6
b) Other EM					
Korea Kospi	-13.6	-13.3	-13.6	-22	-20.4
Taiwan TAIEX	-14.1	-22	-17.4	-25	-18.2
KL Composite	-8.0	-8.3	-23.5	-14.6	-20.3
Stock Exch of Thai	-11.3	-15.5	-8.8	-16.2	-17.1
Jakarta Composite	-6.5	-1.8	-17.5	-0.9	--18.0
PSEi - Phillippine Se IDX	-5.5	-16.51	-28.2	-34.3	-31.7
Chili IPSA	-9.7	-6.2	3.4	-16.1	-7.4
Mexico BOLSA	-9.5	-11.9	-0.3	-12.9	-5.6
Venezuela	2.27	-5.2	5.5	-2.1	4.7
Developed Market Indices					
Japanese Nikkei 225	-8.7	-1.8	-8.0	-21.1	-16.0
Dow Jones Indl Avg.	-15.5	-18.5	-10.5	-10.0	-10.1
NASDAQ Composite	-9.8	-3.0	-8.1	-17.5	-16.2
German DAX	-10.7	-8.3	-20.2	-25.3	-25.1
UK: FTSE 100	-10.7	-11.4	-11.9	-19.7	-17.8
France: CAC 40	-13.1	-12.5	-20.3	-31.3	-25.4
Singapore: Straits Times	-5.0	-6.0	-8.6	-19.3	-17.0
HK: Hang Seng Index	-6.1	-10.2	-16.5	-5.5	-22.4

Know an Alchemyst



Himanshu Parmar
Investment Analyst

himanshu.parmar@alchemycapital.com

Himanshu joined Alchemy Capital Management in April 2008 as Investment Analyst. He holds BTech and MTech degrees from IIT Kharagpur. Himanshu has four years of experience in Consultancy and Equity Research. In his last assignment at Fidelity, he was Pharmaceutical Sector Specialist. He enjoys travelling and playing basket ball.

Investment Matters

IMPORTANT INFORMATION AND DISCLAIMER

This report is for general informational purposes only and is not intended as a recommendation or an offer or solicitation for the purchase or sale of any security. The information in this report has been obtained from sources that Alchemy believes to be reliable. Alchemy, however, does not guarantee its accuracy and it may be incomplete or condensed. All opinions and estimates constitute Alchemy's judgment as of the date of the report and are subject to change without notice.

Investments are not guaranteed or insured by Alchemy, or any of their affiliates or subsidiaries. Investors investing in our products should be aware of the risk. Past performance is not indicative of future performance. Investment values can go up or down. This report is provided for general information and educational purposes only. Hypothetical scenarios presented are only to illustrate approaches to equity management that are not and should not be relied upon as investment advice; each person's individual situations may differ. Nothing contained in the material constitutes a recommendation for the purchase or sale of any security.

The information contained herein is believed to be reliable. We make no representation as to the accuracy or completeness of any information contained herein or otherwise provided by us. The Information set forth herein is intended for discussion purposes only.

This document and its contents are proprietary information of our and may not be reproduced or otherwise disseminated in whole or in part without our written consent.

Notwithstanding any contrary interpretations that may arise out of these contents, Regulation 14(3) (a) of the SEBI (Portfolio Managers) Regulations, 1993 require the Portfolio Manager to expressly declare that the Portfolio Management Services are offered without guaranteeing or assuring, either directly or indirectly, any return. Consequently, we hereby declare that the Portfolio Management Services proposed to be rendered in accordance with the contents hereof, shall be so rendered without guaranteeing or assuring, either directly or indirectly, any return.