

From the CEO's Desk

Dear Client

This country has been gripped with 1-2-3 for the past few months. The stock market seems to have taken it as a cue to run away.

Global factors - sub prime, carry trade, oil prices - continue to be 'iffy'. But corporate India continues to surprise on the upside. Liquidity flows from FII continues to be strong. And a 17-year record of biggest return in a month in India has been broken in October 2007. P-Notes became P-Silent.

As your money manager, we constantly weigh upside to downside - reward to risk. When downside (risk) appears higher, we take insurance. At a portfolio level, we use 'cash' as that insurance mechanism.

In this letter, Hiren has shared with you the details on the switch between brake and accelerator.

Team@Alchemy joins me in wishing you and your family a very happy and prosperous Diwali.

Happy reading.

*Warm regards
Vaidy*

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CAPITAL MANAGEMENT

INVESTMENT MATTERS

Oct 31, 2007

Hiren Ved

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Brakes, Accelerators, Headwinds and Tailwinds

My intention last time was to avoid commenting on broad markets and talk more specifically on the investment strategy and trends and experiences as we see in the current investment environment. However, the month of October has been dramatic and a short comment is merited. The most significant events of the month were the fastest monthly rise in the markets since 1990 (14.5% in October) and the new draft regulations on P-Notes put out by SEBI which subsequently with minor modifications has been converted into a final piece of regulation. The two most important considerations which motivated this action were a. to moderate the flow of FII monies (we received a record US\$ 4bn in the month of September) and b. to encourage foreign investors to register directly with SEBI as an FII than use P-Notes to invest in India and hence effectively have the ability to regulate the quality of investors.

The second is a much nobler cause and the first in the current global context, is a difficult objective to attain. Ever since the first fed rate cut in July, Asian emerging markets in general and India in particular have been receiving unprecedented flow of monies. There is a significant need for investors in developed markets (as well as all sovereign pools of money which have large FX reserves) to diversify away from dollar assets as also participate in the next global growth opportunity i.e. the emerging markets. Hence, this flow of funds will only get stronger with time. This tide of money is causing the Indian rupee to rise dramatically (up 12% YTD) thereby hurting some export intensive sectors and simultaneously posing significant challenges for the RBI to sterilize these flows.

Recognizing this, the government, through SEBI, decided to take some action. These steps caused considerable initial confusion on many technical aspects of how these new guidelines would actually be implemented and, more importantly, their immediate impact on many unregulated hedge funds which have increasingly played a larger part in the FII flows. We for one certainly believed that the new regime will put considerable restrictions on many India dedicated long short hedge funds to operate and specifically hamper their ability to hedge/short against their long exposure.

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This we thought could put tremendous pressure on markets in the short run as some of these funds would have to unwind their positions to comply with the new guidelines. Hence, in order to take insurance against such an eventuality, we decided to create some cash (25-30%). We did this through our holdings in Reliance and Power Grid, since they were the most liquid alternatives and in case we had to recreate them would be also be the easiest to execute.

But as always can be a case in such decisions - the eventuality may or may not occur but it was a prudent strategy to buy insurance by having some cash. So when post 25th October, when the final guidelines were communicated and the markets refused to react adversely, we decided to re-invest immediately. The rapid response was appropriate given the circumstances - as we all know that, in the recent past, speed of the markets in either direction has increased considerably.

We are certainly amused by the speed of rise that we are currently experiencing. It is difficult to gauge how long this can last without any significant period of consolidation. But we intended to be reasonably well invested. We have made certain changes - divested from Sasken and and Subex - both of which have faced considerable headwinds in their performance in the recent past - contrary to our expectations. While our hypothesis on the IT services companies has been bang on (all the big three IT services companies have delivered an absolute negative return vis-à-vis the markets), we have certainly been proven wrong in the product companies- though in the near term. We continued to fortify our portfolio with our best theme - Power- by adding Power Grid to our portfolio. We think their business model is very robust (absolute monopoly in transmission and distribution segment) with upside from the core business as well as from consultancy and telecom businesses. We also increased our position in the IP led pharma sector - Glenmark and Ranbaxy, while our usual bottom-up stock picking continues.

Know an Alchemyst



Anette Lobo

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Anette joined Alchemy Capital Management in June 2007 as Senior Manager - Operations.

She is a Chartered Accountant and has more than 3 years of experience in the financial services, primarily at Morgan Stanley in their Fund Accounting division. She loves traveling, watching television and is a foodie.

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Global Equity Market Performance

<i>Index Performance as on 31-Oct-07</i>	<i>1 month</i>	<i>3 months</i>	<i>6 months</i>	<i>1 year</i>	<i>YTD Returns</i>
Emerging Market Indices					
a) BRIC countries					
Brazil Bovespa	6.5	18.8	31.5	64.0	44.8
Russian RTS	6.6	10.8	14.1	36.9	14.9
BSE Sensex	14.9	27.8	43.2	53.3	44.1
China Se Shang Composite	-4.5	13.3	37.5	227.8	165.8
b) Other EM					
Korea Kospi	6.1	6.8	33.9	51.3	43.9
Taiwan TAIEX	2.5	4.6	23.3	38.3	24.1
KL Composite	5.8	2.9	6.9	43.0	29.0
Stock Exch of Thai	7.3	5.5	29.7	25.5	33.4
Jakarta Composite	12.0	12.6	32.2	67.0	46.4
PSEi - Phillippine Se IDX	5.2	7.4	14.9	38.8	26.0
Chili IPSA	7.0	4.1	10.0	46.1	29.1
Mexico BOLSA	4.9	3.7	9.6	37.9	20.2
Venezuela	5.5	-6.6	-9.3	3.1	-24.7
Developed Market Indices					
Japanese Nikkei 225	-0.3	-3.0	-3.8	2.1	-2.8
Dow Jones Indl Avg.	-0.7	4.4	5.6	14.2	10.7
Nasdaq Composite	4.3	10.6	11.5	19.0	16.6
German DAX	1.4	5.1	7.6	27.2	20.9
UK: FTSE 100	2.7	4.4	3.0	8.4	6.8
France: CAC 40	1.6	0.9	-2.6	8.5	4.8
Singapore: Straits Times	2.7	7.3	13.2	40.9	27.5
HK: Hang Seng Index	15.5	35.2	54.3	71.1	57.0



The Team at Alchemy Capital Management

Wish You and Your Family

A Very Happy Diwali

&

Prosperous New Year



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