<u>Sohum India Opportunities Fund: Investor Update Newsletter, March 2025</u>

As eminent economist and scholar of Great Depression Charles Kindleberger wrote,

"the international economic and monetary system needs leadership, a country that is prepared, consciously or unconsciously, to set standards of conduct for others and to seek to get others to follow them….Britain played that role in the century to 1913….

…But part of the reason for the length and the depth of the world depression was the inability of the British to continue their role of underwriter of the system and the reluctance of the US to take it on until 1936"

The US emerged as a great power after WW2 and assumed the mantle of the leader of the world in 1991 with the collapse of the Soviet Union. Unlike superpowers of the past, the American dominance was not driven by territorial conquests. If anything, the US adopted and promoted liberal values of freedom, democracy, free trade and human rights. The fact that the world avoided another Great Depression and WW3 in the last 80 years is a testimony to the US leadership. The point is not that America has never committed mistakes or that the world never resented the US hegemony; but the world economy by and large benefitted from a well-functioning global economic order led by:

1) globalization and free trade

2) US dollar as the reserve currency and the Fed as the lender of last resort

3) US military oversight under NATO

However, all good things do not last forever. To understand this one must go back to Ben Bernanke's famous speech (April 14, 2005) ***"The Global Savings Glut and the US Current Account Deficit".*** In this speech, he argues that "*one of the factors driving recent developments in the U.S. current account has been the very substantial shift in the current accounts of developing and emerging-market nations, a shift that has transformed these countries from net borrowers on international capital markets to large net lenders. This shift by developing nations, together with the high saving propensities of Germany, Japan, and some other major industrial nations, has resulted in a global saving glut. This increased supply of saving boosted U.S. equity values during the period of the stock market boom and helped to increase U.S. home values during the more recent period, as a consequence -* ***lowering U.S. national saving, increasing consumption, increasing debt and contributing to the nation's rising current account deficit".***

He also argues that *"**Another factor is the special international status of the U.S. dollar**. Because the dollar is the leading international reserve currency, and because some emerging-market countries use the dollar as a reference point when managing the values of their own currencies, the saving flowing out of the developing world has been directed relatively more into dollar-denominated assets, such as U.S. Treasury securities. The effects of the saving outflow may thus have been felt disproportionately on U.S. interest rates and the dollar. For example, the dollar probably strengthened more in the latter 1990s than it would have if it had not been the principal reserve currency, enhancing the effect on the U.S. current account."*

From the above it is clear than being the "Big Daddy" has cost the US in terms of:

1. **Perpetual large current account deficit:** By virtue of being the world's global currency the US is spared the BoP adjustments—an "exorbitant privilege" that no other country enjoys. However, this privilege renders the dollar perennially overvalued, which is tantamount to adverse terms-of-trade for the US manufacturers.
2. **Exorbitant rise in US debt:** This has been partly led by its role as a global custodian of peace (fighting terrorism, securing global trading routes, maintaining military and naval bases around the world).

Exhibit 1: US net international investment position

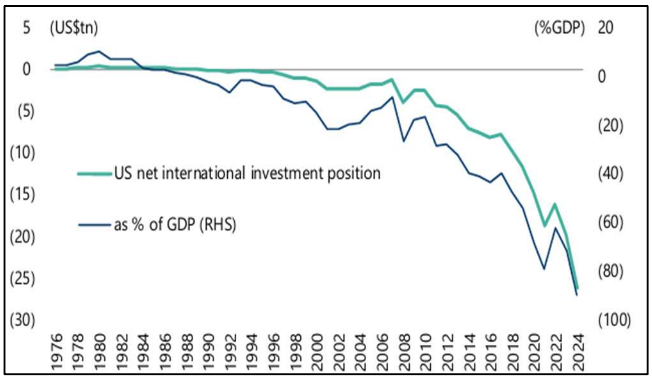
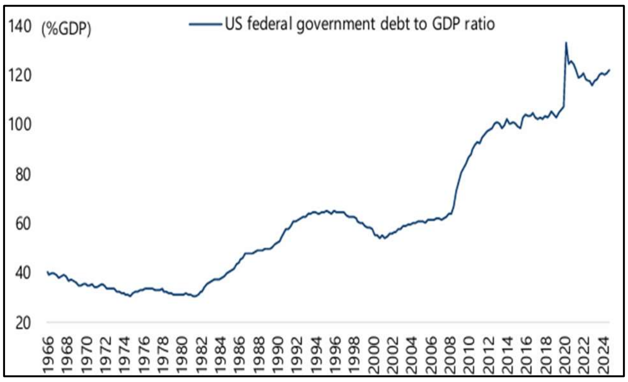


Exhibit 2: US federal govt debt (% of GDP)



Source: Jefferies

Thus, tariffs is one of the ways in which the Trump administration aims to correct the above two anomalies. While some tariffs were always expected, the scale and magnitude of the recent announcement has come as a large adverse negative shock to the global economy. Whether we will see some reversal of this hard stance in the new few days/weeks is unclear, but what is amply clear is that the world is staring towards the end of "US exceptionalism".

So where does India stand in this new world order? While India is not decoupled from global growth cycles, it remains highly resilient to global recessions. Since 1980, India has largely avoided full-blown recessions (except for Covid-19). We believe that there are four factors that set India apart in this turmoil:

1. **Low Export Dependence and a Domestic-driven growth story:** India's merchandize exports contribute only 11% (US$430bn) of its GDP, one of the lowest among emerging markets, which limits the impact of global trade slowdowns. Private Final Consumption Expenditure (PFCE) accounts for about 60% of GDP for India compared to 39% for China. It makes India less reliant on exports, insulating its economy from global trade disruptions. Reciprocal tariff on India (26%) is lower than most Asian peers – China (34%), South Korea (25%), Thailand (36%), and Indonesia (32%). Also, India's trade openness as per World Bank (CY23) stands at 31%, lower than countries such as South Korea (74.4%), Vietnam (158.1%), Thailand (111.5%), and overall world (45.5%), which is likely to lower the impact.
2. **Low Leverage Across Private, Government and Household Sectors, and Healthy Bank Balance Sheets:** Indian corporates and banks are maintaining robust balance sheets. While household debt increased after Covid, the RBI's timely interventions in late 2023 helped manage the situation. With health balance sheets and de-leveraged banks and corporates, India is well-positioned to bounce back quickly when global uncertainties subside.
3. **Accommodative Monetary Policy:** While the Fed remains in a Catch-22 situation, we believe that the RBI has enough ammunition to further ease monetary policy. Thanks to its pro-active liquidity measures, banking system liquidity has moved to surplus zone (Rs.2.2tn surplus as of

3rd April). A weaker dollar will further make it easier for the RBI to maintain a durable liquidity surplus. We expect the RBI to announce another 25bps rate cut in April MPC.

4. **India in a better position to negotiate:** Unlike other countries, India has refrained from retaliating. China has already imposed 34% tariffs on US exports to China and the EU is contemplating retaliatory tariffs on US exports. Countries such as Malaysia, Taiwan, Thailand and Vietnam, with a large dependence on the US, may not be in a position to retaliate and will aim to seek trade deals through lower tariffs on US imports, which may not necessarily help meet with the US's objectives. Countries such as Bangladesh, Cambodia, Sri Lanka, etc. may struggle without special concessions from the US, given their small markets. It could be easier for India to deal with reciprocal tariffs by increasing imports from the US to protect its existing exports to the US. India's exports to the US are around 19% of its total exports, while its imports from the US are around 6.6% of its total imports. Imports from the US are dominated by energy, gems and jewelry, electronics and transport. The US would likely want India's imports to increase in agricultural goods, commercial aircraft, defense goods, electronics, machinery, etc.

Portfolio Composition & Performance

Global markets have seen a very sharp sell-off across asset classes post Trump's liberation day announcement of reciprocal tariffs. Indian equities have also not been spared with the Nifty Index down 5% (since April 2) and the Mid-Cap/Small-Cap indices down 6%/7% respectively. We have lowered our EPS forecasts for NIFTY from 1200 to 1160 for FY26 and from 1350 to 1320 in FY27. Based on the above, Nifty (@22,160) is trading at 19x FY26 earnings and 17x FY27 earnings which is broadly in line with historical average. Further, the gap between bond yield (6.6%) and earnings yield (5.2%) is currently at 140bps vs. historical average of 180bps suggesting that equities are cheaper. As we have highlighted above, the Indian economy remains relatively better-placed vs. the rest of the world in terms of the tariff impact. In terms of the market composition – banks and financial services, consumer, energy, insurance, materials, telecom, construction and engineering, retail and utilities – that collectively constitute ~80% of the Nifty Index are also not directly impacted by Trump Tariffs. However, as Howard Marks says, *"You should know what you don't know"*. While the direct impact on India is likely to be minimal, there tariffs and any counter measures by other nations will create near-term uncertainty, which is likely to be detrimental for both business environment and economic growth.

In terms of our portfolio positioning, we continue to be positioned towards domestic cyclicals and our underweight/neutral global facing sectors like IT and Pharma. We believe the situation remains quite dynamic and there are potential developments that could move the economy, earnings, and markets either way. The big positive would be a more dilutive form of these tariffs coming into play or the deadline getting extended as individual countries negotiate. The global coordinated monetary easing is the other upside, and India would be well positioned to attract the resultant global flows into risky assets and equities. On the downside, an intensification of these tariffs (e.g. if pharma is brought in later) would pose further earnings risks which would be compounded by additional P/E derating.

Overall, as of 31st March 2025, our flagship Sohum India Opportunities Fund has in the last one year, gained 7.23% (pre-tax), net of applicable fees. In the same period, the Nifty Index has delivered 5.34% and Nifty TRI Index has returned 6.65%. Since our inception (20th May 2022), we have delivered 69.96% returns (an outperformance of 20.32% over Nifty TRI) with average large cap holding of 78% and consequently much lower risk. As we end FY25, I would like to take this opportunity to thank all our investors for their kind, relentless and unwavering support to Sohum Asset Managers. We will continue to collaborate in FY26 and ensure that we act as enablers and partners in each other's progress and growth.

Warm Regards,

Sanjay H Parekh