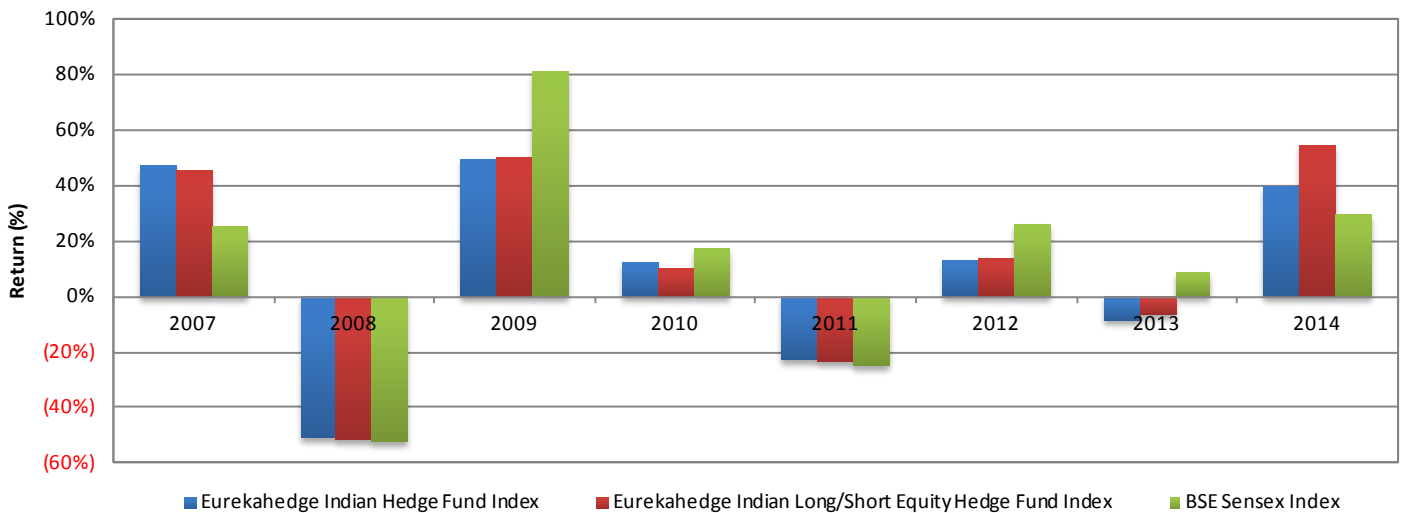


Introduction

India focused hedge funds have posted spectacular returns in 2014 against the backdrop of rising domestic equity markets, and a renewed sense of confidence in the Indian economy which is being led by Narendra Modi. Hedge funds investing with an Indian mandate have topped the performance tables in 2014 and in this special section of *The EurekaHedge Report*, we ask some of the top performing Indian hedge fund managers about their winning themes during the year, in addition to investor allocation activity and the key macroeconomic themes which they will be watching out for in 2015.

In 2014, the average Indian hedge fund was up 39.36%, outperforming underlying markets by almost 10%. Managers running long/short equity strategies emerged as the clear winner posting gains of 54.83% - their best performance in the last eight years. Figure 1 below details the historical performance of Indian managers relative to the BSE Sensex Index and shows how managers focused on the country have rebounded after a relative lull over the preceding four years.

Figure 1: Historical performance of Indian hedge funds



Source: EurekaHedge

In terms of asset growth, Indian hedge fund assets under management (AUM) are currently at a seven year high of US\$3.45 billion, though roughly 36% below their 2007 peak of US\$5.36 billion. The average Indian hedge fund was down 50.66% during the 2008 financial crisis, witnessing steep performance-based losses and investor redemptions from which the Indian hedge fund industry is yet to recover.

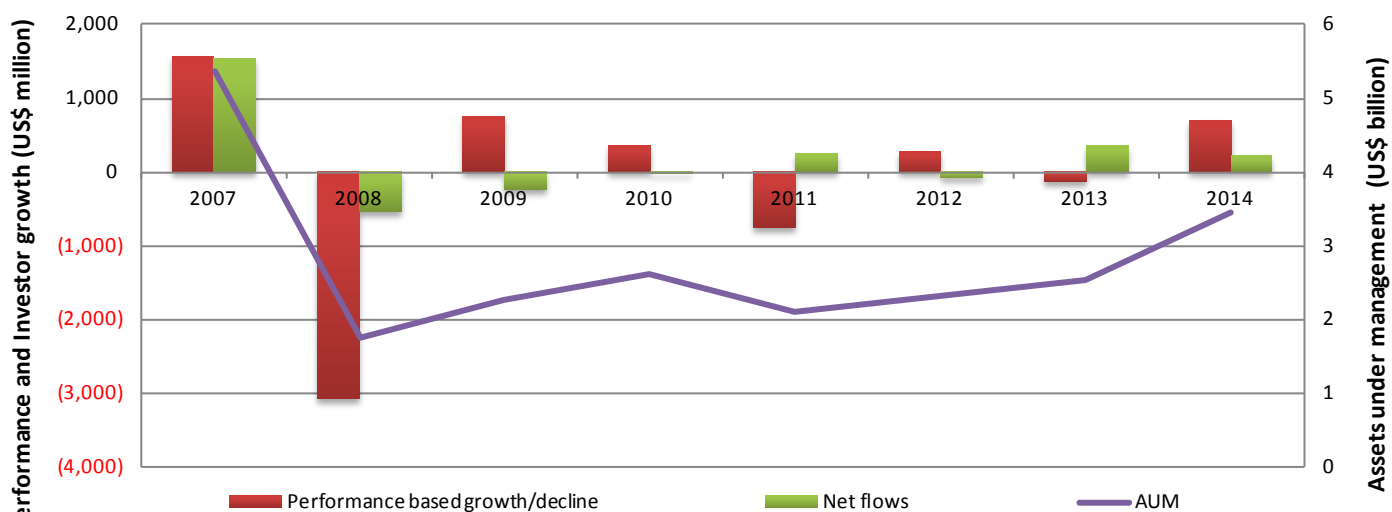
Since 2009, Indian managers have posted an eight year annualised return of 10.89%, and barring 2011, their AUM continues to trend upwards albeit at slower pace compared to the broader Asian hedge fund space.

Managers have raked in roughly US\$700 million in performance-based gains in 2014 while seeing net inflows of US\$215 million during the year. While investor flows have not kept pace with manager performance in 2014, going forward one should expect an uptick in investor allocation towards India as the country remains a much better value proposition for investors compared to some of its emerging market peers and a clear beneficiary of the lower oil prices. Structural weaknesses within the economy and the risk of capital flight following a rise in US rates could potentially upset the prospects of the Indian markets in 2015.

Table 1: Historical performance and risk-adjusted returns for Indian hedge funds

	Eurekahedge Indian Hedge Fund Index	Eurekahedge Indian Long/Short Equity Hedge Fund Index	BSE Sensex Index
3 year annualised returns	12.84%	18.25%	17.49%
3 year annualised standard deviation	15.85%	17.04%	13.13%
3 year Sharpe Ratio (rfr=2%)	0.68	0.95	1.18
5 year annualised returns	4.47%	6.92%	11.26%
5 year annualised standard deviation	15.05%	16.11%	16.55%
5 year Sharpe Ratio (RFR=2%)	0.16	0.31	0.56
8 year annualised returns	3.82%	5.01%	8.91%
8 year annualised standard deviation	19.97%	20.76%	25.16%
8 year Sharpe Ratio (RFR=2%)	0.09	0.15	0.27

Source: Eurekahedge

Figure 2: AUM growth of Indian hedge funds


Source: Eurekahedge

Fund Manager Insights



Anuj Didwania
Managing Director
(Redart Capital)



Harsh Agarwal
Co-founder
(AGacquisitions-I)



Kanishk Agarwal
Chairman
(AGacquisitions-I)



Nandita Agarwal Parker
Managing Partner
(Karma Star Fund)



Samir Arora
Fund Manager
(Helios Capital Management)



Sanjiv Shah
Director
(India Value Investments Limited)



Rakshit Sethi
Fund Manager
(India Insight Value Fund)

- Please share with our readers some of your main winning themes across industry sectors in India in 2014. Going forward into 2015, what is your expectation regarding Indian markets and which sectors are you most bullish on?**

Anuj Didwania: 2014 was a year that was characterised by a single theme in India – the NAMO trade i.e. the effect of a stable new government in India led by Narendra Modi. India is in a cyclical slowdown and therefore there is hope of a pickup in industrial/investment activity. Cyclical sectors like banks, autos, infra companies were our main winning themes this year. Going into 2015 – we feel markets will be very volatile and give low double digit returns. We continue to be bullish on cyclical sectors in 2015 and feel construction companies are worth looking at in addition to the cyclical sectors mentioned above.

Harsh Agarwal and Kanishk Agarwal: When we take a back seat and reflect on 2014, the winning theme in our mind was anticipating and participating across a positive change in the business and economic environment. The reasons for this shift in sentiment/confidence can undoubtedly be placed on the favourable general elections that saw the BJP lead by Mr. Narendra Modi win an absolute and decisive mandate. This singular event has thrown open opportunities galore across various themes, be it cyclical or deep value allocations. To further add, we have a very interesting and so far impressive central bank lead by Mr. Raghuram Rajan that has managed to steer the monetary policy far effectively, at the same time listening to the concerns of business and investors at large. This undoubtedly resulted in the banking sector being a central focus and investment theme for 2014. We expect 2015, to be a good year for economy and markets in general. There is a case for further PE expansion that should set in once change in policies and a general uptick in economic activity seeps into corporate earnings. It would not be hard to fathom that markets could trade in the vicinity of about 25% higher from current levels.

Nandita Agarwal: Our performance in 2014 was due to a number of factors. First, we took a contrarian call on a number of stocks across sectors such as capital goods, financials, logistics and building materials. In late 2013, stocks were available at absurdly low valuations across market capitalisations. It was a great year for Alpha generation across large swathes of the market. We found valuation anomalies and exploited them, picking on the highest quality companies for our portfolio. Our Top 10 stocks, which are our highest conviction bets, outperformed the NIFTY index by 20%.

Samir Arora: We believe that it is much more productive for fund managers to distinguish between good and bad companies rather than trying to find artificial reasons to choose between two equally good companies for the sake of concentration. We therefore do not mind owning even 50+ stocks on the long side and are short around 20+ individual names so no individual stock or theme drives our returns. We believe in quality, secular growth companies in sectors like private sector banking, housing finance, consumer, pharmaceuticals, technology, automobile and infrastructure and have been investing in India for a very long time with this thesis. We are generally underweight to short stocks from commodity sector, state owned companies, Indian companies trying to aggressively become multinationals and companies which try to sell us 'Billion Consumer' dreams.

Sanjiv Shah: 2014 was a year in which sorted out the wheat from the chaff. The Fund benefitted from good quality companies in the consumer discretionary, financials, pharmaceutical and industrial space. On the other hand, sectors such as infrastructure and housing companies (where debt is high and balance sheets strained) and, more generally, companies where there is a question about the quality of the management have done less well. The Fund had avoided these companies. Valuations remain reasonable and we expect good quality stocks to continue to do well. INVIL takes a bottom up stock picking approach to portfolio construction so we do not have an a priori bias on the sector composition.

Rakshit Sethi: The Fund had as many as 14 investments which delivered an absolute return in excess of 100% in 2014 - ranging from 119% to well over 400%. These investments were broadly spread across two major investment themes: Consumption - primarily discretionary and; a revival in investment demand. Within both these themes, the Fund invested in robust businesses with strong moats and quality management, which were selling at a meaningful discount to their intrinsic value. As we move into 2015, equity returns in India will be more nuanced. Now is when we expect to start seeing a separation of the men from the boys. We believe financials, consumption and infra should do well this year though current valuations in some of these spaces will make it harder to find compelling opportunities. Meaningful policy impetus and the turning rates cycle will be the primary drivers for these investment themes. It will pay to have a longer term outlook and look for opportunities which will be disproportionate beneficiaries over the next two to three years.

2. Has your fund seen an uptick in investor allocations given the stellar performance posted by India dedicated hedge fund managers in 2014? How optimistic do you feel about the capital raising environment and which investor type (HNWI, family offices, institutional investor, etc.) has shown the most interest in your hedge fund offering?

Anuj Didwania: We are a close ended fund domiciled in India - and so we are not taking any additional funds at this time. We are focused only on HNWI investors as institutional investors (for hedge funds) do not really exist as a category in India. We feel there will be additional interest in India dedicated funds as we are the cleanest shirt in a dirty laundry basket within the emerging market world.

Harsh Agarwal and Kanishk Agarwal: There has been a renewed interest among a broad spectrum of investors looking to allocate capital across the geography. Owing to this response and our past experience managing an India specialist fund, we are in the midst of launching a dollar denominated, offshore fund aimed at the global investor base. The investor type that we look to target would include family offices and HNWI's to start with.

Nandita Agarwal: Our assets doubled in 2014 and we are seeing an increasing amount of investor interest from institutional and high net worth investors. Karma Funds have been in business for 11 years. In the past, institutional investors accessed the market through private equity vehicles. These, by and large, have delivered disappointing returns, causing investors to rethink how they get their exposure to India. Fund of funds and high net worth investors, participated in a part of the 2014 rally through ETFs, benchmarked to the MSCI indices, with sub-optimal results. Investors are now taking a closer look at our offerings.

Samir Arora: There has been very clear interest in India and increased allocations in the last quarter of 2014 based on optimism about Mr. Modi's emphatic victory in elections plus the decline in oil prices. We are currently seeing strong interest from all categories of investors for our fund for the India story remains sustainable and we have a 20+ year track record investing in India on the long side and nine years plus on the short side.

Sanjiv Shah: Last year, investor interest was subdued despite the strong performance. However, we expect family offices and institutional investors to allocate more money to India especially if the Budget in February shows that the

government remains strongly committed to reforms. Currently we are long biased but if markets rise and valuations get significantly more expensive, we will be looking to trade more aggressively on the short side.

Rakshit Sethi: Yes, we have. We have seen a significant uptick in investor allocations, from both existing and new, during the last two quarters of 2014. Going forward, we continue to see strong traction from existing as well as new investors. They include family offices, institutional investors and HNWI. We are fairly optimistic about the capital raising environment for an India dedicated Fund in 2015.

3. Finally, what is your biggest cause of concern going into 2015? (Managers may cite the most worrying global or domestic macroeconomic trend/theme or any other factor which they feel could undermine the performance of their fund).

Anuj Didwania: We feel the sharp fall in oil will cause large global dislocations – the high yield US credit market, the shale industry in the US, oil exporting countries – all these will see a gradual impact of this sharp fall. India will not be immune to capital flight/risk off trades should countries/banks/companies start defaulting in markets around the world. Therefore oil holding at US\$50 per barrel is our main concern for 2015.

Harsh Agarwal and Kanishk Agarwal: We remain confident that the improving domestic macro situation should allow for India to outperform global peers. There is a case for moderate decoupling when we look at larger time horizons. We believe that 2015 should see an increased amount of volatility as valuation sensitivity to external shocks increase. Another issue that we do believe that needs to be watched closely is the currency theme and the rupees outperformance when compared to other emerging markets. We believe that it is more important to watch global macro developments more from a point of adequately hedging ones portfolio during shorter time frames. Another larger risk factor is the overwhelming reliance on the Government and more importantly the Prime Minister Mr. Narendra Modi. The less said the better?

Nandita Agarwal: 2015 provides a great investing environment for Karma Funds. Ours is a ‘best ideas’ strategy. On the one hand, the broad market has recovered lost ground. On the other hand, the fall in global commodity prices will provide a fillip to earnings growth for a number of industries. India’s ‘virtuous cycle’ is yet to take hold. In addition, the government’s initiatives will provide a tremendous amount of opportunity for new businesses, and new industries are opening up. As the capital markets remain supportive, new IPO offerings will also present an opportunity to participate in new businesses. We are very optimistic that retail investors will regain confidence after seeing the turnaround in the economy. All of this sets the stage for a multi-year bull market in India. We are excited and scouring the market for new ideas on a daily basis. In a world of globally interconnected financial markets, our concerns for 2015 remain the influence of global events on India. On the domestic front, funding of about US\$100 billion per annum is required to kick-start India’s infrastructure building. This is not a spigot that can be turned on. Attracting foreign and domestic flows will require a healthy mix of sound policies and financial savvy on the part of the stakeholders.

Samir Arora: The biggest risk for India is ‘key man risk’ where Mr. Modi is the key man. We think that India can handle normally cited risks like increase in US interest rates, exit of Greece from EU, uncertainty related to steep decline in oil prices etc. better than many peer countries.

Sanjiv Shah: India itself looks well placed but there is lot of global uncertainty. The economy is picking, inflation is falling and the interest cutting cycle has just begun. In a troubled world, India looks attractive on a relative basis. However, if the US Federal Reserve raises interest more aggressively than is currently expected, there is a risk that money will be pulled from emerging market stocks and India would not be immune to this. However, the fundamentals in India are better than most emerging markets and the increasing buying interest in India will in part offset the likely foreign selling.

Rakshit Sethi: We expect 2015 to be a tricky year. While domestic fundamentals should continue to show robust improvement going forward, it will be global news flow which may play a spoiler. Domestic fundamentals across the board look far more robust today than they did six months ago. With the crash in oil prices along with almost all other global commodities, India should stand out as a disproportionate beneficiary of any prolonged global deflationary cycle. But that would not insulate India from the impact of any risk aversion or contagion that may engulf global financial markets during the year, whether it is on account of increasing US interest rates, re-emergence of a euro-crisis or the repercussions of the drastic fall in oil prices.