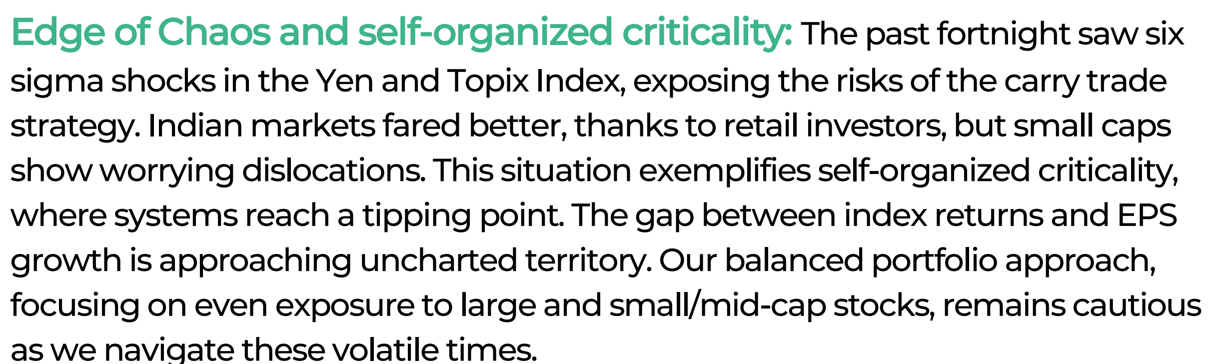
PORTFOLIO FACTSHEET

July 2024


Edge of Chaos and self-organized criticality: The past fortnight saw six sigma shocks in the Yen and Topix Index, exposing the risks of the carry trade strategy. Indian markets fared better, thanks to retail investors, but small caps show worrying dislocations. This situation exemplifies self-organized criticality, where systems reach a tipping point. The gap between index returns and EPS growth is approaching uncharted territory. Our balanced portfolio approach, focusing on even exposure to large and small/mid-cap stocks, remains cautious as we navigate these volatile times.

The Yen carry trade unwind

In the last fortnight, two six sigma events occurred: the Yen experienced significant volatility, and the Topix Index saw unusually sharp movements. The strategy of borrowing in low-interest rate countries and investing in higher interest rate regions while assuming a stable currency is inherently unsustainable.

The bill eventually came due, and the markets partially paid it. However, the trade has not been fully unwound, so this issue is likely to recur in the future.

While the Yen carry trade provided the trigger, as detailed in this newsletter, the principle of self-organized criticality suggests that anything unsustainable will eventually collapse.

Indian equity markets corrected significantly lower than their regional counterparts, attributed to the recent retail renaissance we discussed in June 2024 (link).

Regardless, on a 5-year rolling return, the large-cap dislocation (index returns vs. EPS growth) is much lower than the small-cap dislocation. In small caps, on 5 and 10-year rolling returns, we are in the 99th and 93rd percentiles, respectively, approaching uncharted territory.

Over the past few months, our approach has been to maintain a balanced portfolio with equal weights on large and small/mid-cap stocks, while steadily increasing allocations to core sectors.

Well, it may truly be different this time around, but we believe the risk-reward ratios in many small-cap and concept sectors are not justified. We have been bracing for impact for quite a while and will continue to do so.

Self-organized criticality

Imagine an apparatus that drops a single grain of sand on a large flat table. Initially, the sand spreads across the table, forming a slight pile. As grains accumulate, the pile rises, creating slopes on either side. Eventually, the pile reaches a height where it can no longer grow without becoming unstable. At this point, sand begins to trickle down the slopes faster than new grains are added, creating an avalanche. At its highest level, the sand pile is in a state of criticality—on the verge of instability. The last grain did not cause the avalanche; rather, the system was already unstable and merely waiting for a trigger for the eventual avalanche to occur.

In 1987, Bak, Tang, and Wiesenfeld (BTW) introduced the concept of self-organized criticality. They illustrated this with systems such as collections of electrons, piles of sand grains, buckets of fluid, elastic networks of springs, ecosystems, and stock markets. Each system comprises many interacting components, influenced by internal forces or information exchanges and external forces such as electronic or magnetic fields, gravity, or environmental changes.

BTW noted that these systems adapt to dynamic responses without significant external tuning. The states into which they organize themselves exhibit properties similar to equilibrium systems at critical points. In short, they hypothesized that **unsustainable systems will inevitably collapse**.

But what is the trigger?

Yes, the markets were expensive, but what was the trigger? Despite the BJP winning a quarter fewer seats than expected and falling short of a simple majority in the general elections, the impact lasted less than two days.

As noted in our June 2024 factsheet (link), part of the explanation lies in retail investors generating unprecedented levels of wealth over the past four years, particularly in the small and micro-cap segments. These investors continue to invest in the same areas that generated their wealth, resulting in highly elevated valuations due to the relatively low free float in these segments.

	1-yr rolling		3-yr rolling		5-yr rolling		10-yr rolling	
	Index	EPS	Index	EPS	Index	EPS	Index	EPS
Large Cap Index								
Mean	18%	16%	17%	15%	15%	14%	14%	12%
Max	95%	49%	59%	37%	47%	33%	22%	23%
Min	-55%	-11%	-3%	0%	0%	3%	6%	6%
Std dev	24%	14%	12%	10%	9%	8%	4%	5%
Small Cap Index								
Mean	21%	15%	13%	13%	12%	11%	12%	10%
Max	176%	76%	54%	42%	42%	29%	23%	16%
Min	-75%	-15%	-20%	-6%	-10%	0%	2%	5%
Std dev	45%	21%	15%	10%	9%	8%	5%	3%

The table above provides the rolling index returns and rolling earnings growth for large-cap and small-cap indices. Key observations include:

- Share price returns and EPS growth converge in longer terms versus 1-yr rolling returns
- The range of maximum and minimum observations narrows as the time horizon increases, which is also reflected in lower standard deviation data.
- The standard deviation (across periods) is lower for large caps compared to small-cap indices.
- Surprisingly, except for the 1-year rolling return period, the Large Cap Index has generated higher returns than the Small Cap Index on average.

This indicates that over longer periods, earnings growth and share price returns tend to align, a trend evident not only in indices but also in individual stocks.

	1-yr rolling		3-yr rolling		5-yr rolling		10-yr rolling	
Mean	**Share px**	**EPS**	**Share px**	**EPS**	**Share px**	**EPS**	**Share px**	**EPS**
ITC	16%	12%	13%	12%	12%	12%	12%	12%
HDFC Bank	20%	20%	19%	22%	20%	22%	21%	22%
Reliance Industries	21%	13%	17%	12%	15%	10%	13%	11%
Infosys	16%	14%	14%	14%	14%	13%	13%	13%

If this trend holds true, then current dislocations—where share price returns are significantly higher or lower than earnings growth—must reverse. This correction could occur through:

- Earnings growing at a much higher rate than share price growth in the future, and/or
- Share prices correcting sharply to align with lower earnings growth.

The extent of dislocation is visible from the table below.

	1-yr rolling		3-yr rolling		5-yr rolling		10-yr rolling	
	Index	**EPS**	**Index**	**EPS**	**Index**	**EPS**	**Index**	**EPS**
Current observation								
Large Cap Index	31%	22%	18%	21%	19%	19%	14%	11%
Small Cap Index	50%	17%	28%	15%	35%	17%	20%	16%
Current obs as X of avg								
Large Cap Index	1.7	1.4	1.1	1.4	1.2	1.4	1.0	1.0
Small Cap Index	2.4	1.1	2.3	1.1	3.1	1.4	1.7	1.5
Large Cap Index Count data								
Total obs	261	261	236	236	212	212	152	152
No of obs > Current obs	65	80	77	64	43	52	76	71
Current percentile	75%	69%	67%	73%	80%	75%	50%	53%
Small Cap Index Count data								
Total obs	261	261	236	236	212	212	152	152
No of obs > Current obs	45	76	36	79	3	43	10	7
Current percentile	83%	71%	85%	67%	99%	80%	93%	95%

Our interpretation of this data is:

- On a five-year rolling basis, the current Large Cap Index returns are 1.2 times its historical average, while earnings are 1.4 times higher. For the Small Cap Index, these numbers are 3.1 times and 1.4 times respectively, indicating that small caps are considerably more expensive.
- On a five-year rolling basis, the Large Cap Index returns are at the 80th percentile, meaning 20% of the observations are higher than the current 5-year rolling returns. For

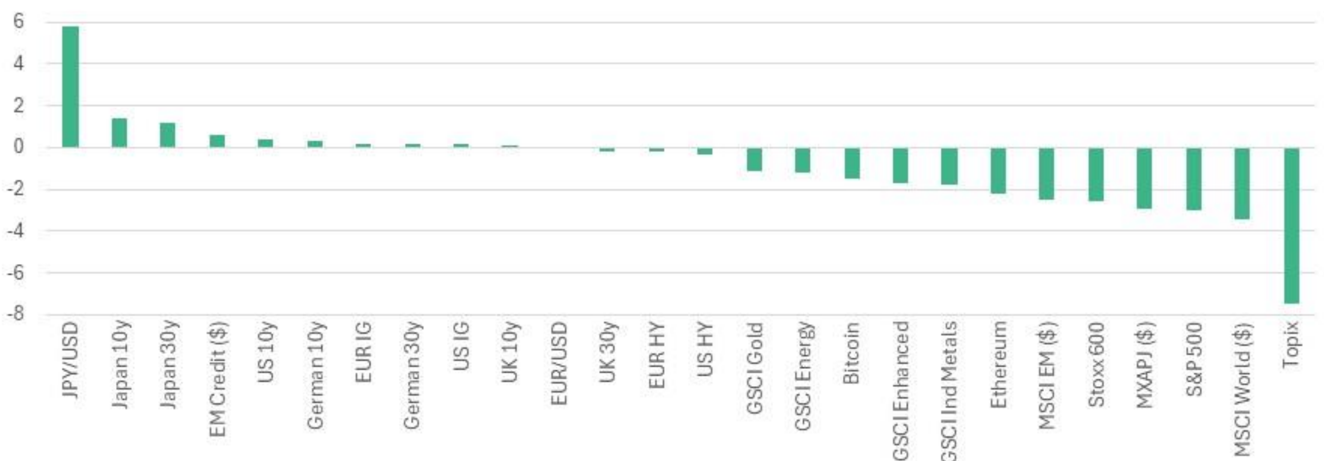
Small Caps, we are in the 99th percentile, indicating that only 1% of returns (or roughly on three occasions in the past) have been higher than current levels.

This data strongly suggests that we are fast approaching uncharted territory, based on historical trends. However, as they say, “maybe it is different this time”.

Taking the 1-year small cap current values, with index returns at 50% and earnings growth at 17%, we know from historical trends that these two numbers always converge. Therefore, either the earnings for small cap companies will rise dramatically over the next few years, or the share prices will correct. This situation just needs a trigger—any reason—for the adjustment to occur. This is the essence of self-organized criticality.

The USD-JPY carry trade implosion was one of those triggers. The strategy involves borrowing in JPY at near-zero cost, converting it into dollars, and investing at 5% treasury rates to make seemingly free returns. However, currency exchange rate changes are supposed to offset such arbitrage through the interest rate differential theory, but this adjustment typically happens in the long term. Recently, conditions have been stable, and there's a belief among investors that they can exit before any collapse occurs. A lot has been discussed on this topic lately, so we won't delve further into it. However, it's truly surprising that trillions of dollars are relying on this flawed logic.

What is even rarer is that the JPY-USD carry trade was hardly discussed as a major risk over the past few years. Despite this, adjusted for historical volatility, the returns (over the last fortnight) across asset classes for Japan (currency, rates, and equities) were in the six-sigma category. To put this in context, if we measure returns every day, a six-sigma event is expected to occur once every 4 million years. An eight-sigma event, such as the performance of the Topix, corresponds to an expected occurrence once every 6.429e+012 years, a period significantly longer than the entire 13.8 billion years that have elapsed since the Big Bang.



How large is this trade, and does any of it involve India? The exact figures are unknown. Japanese banks have issued USD 350 billion in short-term loans, which is the narrowest definition of this trade. However, a portion of this could be linked to commercial transactions, and not all is intended solely to earn the interest rate spread. Additionally, there may be undisclosed borrowings within Japan by individuals for overseas investments. In the broadest sense, Japan's foreign portfolio investment as of March 2024 was USD 4.5 trillion, with more than half in long-term, interest rate-sensitive debt assets.

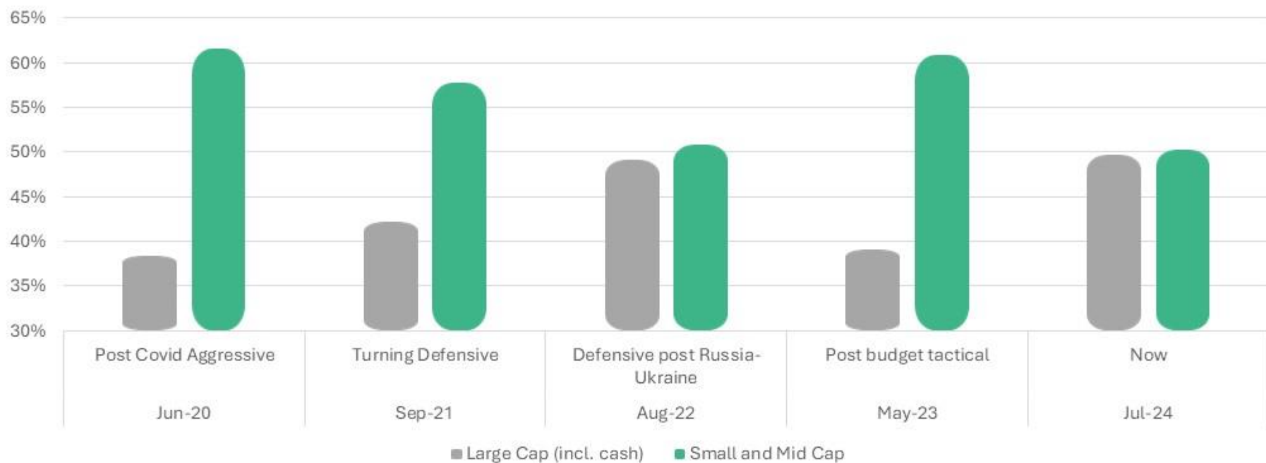
What portion of this trade is in India? Reports indicate that Yen-denominated assets invested in India have increased to approximately USD 21 billion, up from USD 6 billion in January 2023. The last time the carry trade unwound (Jan 2018 - Jan 2021), the impact was significant. However, that period also saw events like the introduction of LTCG in February 2018, SEBI MF alignment in mid-2018, the IL&FS crisis in September 2018, and COVID in March 2020, making it difficult to isolate the impact of the Yen trade. This time, retail investors are more resilient, but global interconnectedness through central banks means that a global risk-off scenario typically triggers foreign portfolio outflows. This event provided the needed correction trigger for the markets.

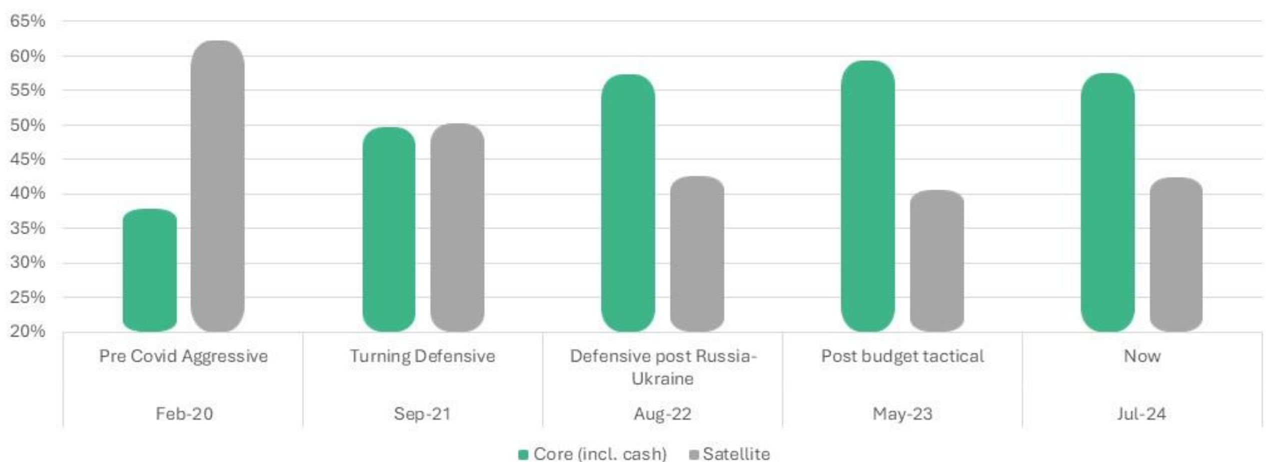
Buoyant funds positioning

We continue to run a balanced portfolio, with similar weights to SMID as large caps, and a largely core focused portfolio.

Over the last quarter, we have increased weights to Materials, Industrials, and Oil & Gas, and reduced weights in Automobiles and Banking. We had significantly deployed cash in the run-up to the elections.

Exhibit 7





Sectoral allocation

Sector	%
Banking	24%
Insurance	8%
Industrials	7%
Materials	7%
Telecom	5%
HealthCare	5%
Chemicals	5%
FMCG	4%
Info Tech	4%
Automobile	4%
Building Materials	4%
NBFC	4%
Media	2%
Oil & Gas	2%
Misc	2%
Cash and equivalents	8%

Core vs. Satellite / Market-cap

Category	%
Core (incl. cash)	58%
Satellite	42%
Cyclicals	*18%*
Turnaround	*9%*
Value	*15%*

Market-cap	%
Large Cap and cash	50%
Mid Cap	17%
Small Cap	33%

Returns

For the month of July 2024, the Buoyant portfolio returned a 4.1 percent return compared to the BSE 500 Total Returns Index of 4.4%. In compliance with SEBI regulations, Buoyant returns are calculated post fees and expenses. The performance chart is presented below.

External publications rate the Buoyant portfolio as a top quartile fund across longer periods (3 years, 5 years and 7 years). However, our primary objective is not to generate the highest possible returns. We rather seek to generate superior risk-adjusted returns across market cycles. One part of that product promise is risk-adjusted returns, and as is evident from the table below, as the markets have risen, we have reduced the risk in the portfolio (to 0.9X as measured by beta). The second part of the product promise is across market cycles. The Buoyant portfolio outperformed when the markets have risen sharply post-COVID. We intend to keep this up should the markets correct in the ensuing cycle.

Performance consistency

%	1-yr rolling returns		3-yr rolling returns		5-yr rolling returns		7-yr rolling returns	
	Buoyant portfolio	BSE 500 TRI	Buoyant portfolio	BSE 500 TRI	Buoyant portfolio	BSE 500 TRI	Buoyant portfolio	BSE 500 TRI
Count (#)	2,620		1,890		1,159		429	
Average returns	28.0	17.4	20.5	15.1	19.9	15.0	22.1	15.4
Median	22.3	13.1	22.3	16.5	21.1	15.0	21.9	15.7
Maximum	133.4	102.1	52.7	33.9	29.5	22.8	25.6	17.6
Minimum	-42.7	-33.3	-7.9	-6.3	10.1	10.2	20.0	13.5
Outperformance against benchmark (% no of obs)	**59%**		**75%**		**94%**		**100%**	

Relative performance

31-Jul-24	1 month	6 months	1 year	2 years	3 years	5 years	Since Inception
CAGR (%)							
Buoyant Portfolio	**4.1%**	**18.3%**	**33.3%**	**34.7%**	**25.5%**	**29.3%**	**24.0%**
BSE-500 TR Index	4.4%	19.6%	38.9%	27.7%	21.1%	22.5%	17.9%
Absolute (%)							
Buoyant Portfolio				81%	98%	262%	478%
BSE-500 TR Index				63%	78%	176%	283%

Source: Bloomberg for Indices. Buoyant portfolio returns are post-fees and expenses. Returns are for Buoyant Opportunities Scheme - Discretionary portfolio. More than one year returns are annualized.

Risk metrics

Risk metrics	1-year	2-year	3-year
Sharpe ratio (X)	2.6	2.5	1.3
Jensen's alpha (%)	6.8	12.6	6.1
Information ratio (X)	-0.7	0.9	0.5
Standard deviation (%)	9.8	11.1	14.3
Standard deviation - benchmark (%)	11.0	11.6	13.1
R-squared (X)	0.5	0.6	0.7
Beta of portfolio (X)	0.9	0.9	0.9
Sortino ratio (X)	10.0	7.8	2.5

Blogs and Media

Our recent blogs and media appearances

Blogs

- Doing nothing could be the riskiest option – The Economic Times 14 May 2024
- Ten-billion-dollar lesson – The Economic Times 22 February 2024
- Habit loop – Moneycontrol 15 January 2024
- Small cap cycles – Moneycontrol 15 November 2023
- Privileging the hypothesis – Moneycontrol 5 September 2023
- Credit cards – Moneycontrol 18 July 2023
- Junk bonds and market cycles – The Economic Times 26 Jun 2023
- Network effects: a double-edged sword – Moneycontrol 12 Jun 2023

Media Appearances

- Jigar Mistry (CNBC TV18) 4 June 2024
- Jigar Mistry (CNBC TV18) 18 May 2024
- Jigar Mistry (CNBC TV18) 24 April 2024
- Jigar Mistry (ET Now) 21 April 2024
- Jigar Mistry (CNBC TV18) 13 March 2024
- Jigar Mistry (CNBC TV18) 2 March 2024
- Jigar Mistry (ET Now) 1 March 2024
- Jigar Mistry (CNBC TV18) 29 February 2024
- Jigar Mistry (ET Now) 28 February 2024
- Jigar Mistry (CNBC TV18) 11 December 2023
- Jigar Mistry (CNBC TV18) 16 November 2023
- Jigar Mistry (CNBC TV18) 8 November 2023
- Jigar Mistry (ET Now) 9 October 2023
- Jigar Mistry (CNBC TV18) 29 September 2023

Buoyant Capital Pvt Ltd

3501 Kohinoor Square, N C Kelkar Marg
Dadar (West), Mumbai 400028. INDIA
buoyantcap.com

Compliance/Grievances:

Mayuri Jangid
Email: compliance@buoyantcap.com
Phone: +91-22-6931-9912

Queries/Customer Care:

Gayatri Kadam
Email: care@buoyantcap.com
Phone: +91-22-6931-9963

ABOUT US

Buoyant Capital Pvt Ltd ("the PM") is registered as a Portfolio Manager with SEBI under SEBI (Portfolio Managers) Regulations, 2020 as amended from time to time and the Circulars and Guidelines issued there under from time to time, vide SEBI Reg. No.: INP000005000 and as an Investment Advisor under SEBI (Investment Advisors) Regulations, 2013 as amended from time to time and the Circulars and Guidelines issued there under from time to time vide SEBI Reg. No.: INA000016995 and as the Sponsor and Manager of the Buoyant Capital AIF (a Category III AIF) under SEBI (Alternative Investment Funds) Regulations, 2012 as amended from time to time and the Circulars and Guidelines issued there under from time to time vide SEBI Reg. No.: INAIF322231125.

DISCLAIMER & DISCLOSURES

This document confidential and is intended only for the personal use of the prospective investors/contributors (herein after referred as the Clients) to whom it is addressed or delivered and must not be reproduced or redistributed in any form to any other person without prior written consent of the PM. This document does not purport to be all-inclusive, nor does it contain all of the information which a prospective investor may desire. This document is neither approved, certified nor are its contents verified by SEBI. The PM retains all the rights in relation to all information contained in the document(s) and to update the same periodically (or otherwise) from time to time. The document is provided on a personal/confidential and Private Placement basis. The document is neither a general offer nor solicitation to avail any service offered by the PM (a SEBI Registered Intermediary) nor is it an offer to sell or a generally solicit an offer to become an investor in the services offered by the PM. The delivery of this document at any time does not imply that the information herein is correct as of any time subsequent to its date of publishing. The contents of this document are provisional and may be subject to change. In the preparation of the material contained in this document, the PM has used information that is publicly available, certain research reports including information developed in-house. The PM warrants that the contents of this document are true to the best of its knowledge. However, the PM assumes no liability for the relevance, accuracy or completeness of the contents herein.

The PM declares that the data and analysis provided shall be for informational purposes. The information contained in the analysis shall been obtained from various sources and reasonable care would be taken to ensure sources of data to be accurate and reliable. The PM will not be responsible for any error or omission in the data or for any losses suffered on account of information contained in the analysis. While the PM will take due care to ensure that all information provided is accurate, the PM neither guarantees/warrants the sequence, accuracy, completeness, or timeliness of the report. Neither the PM nor its affiliates or their partners, directors, employees, agents, or representatives, shall be responsible or liable in any manner, directly or indirectly, for views or opinions expressed in this analysis or the contents or any systemic errors or discrepancies or for any decisions or actions taken in reliance on the analysis.

The PM does not take any responsibility for any clerical, computational, systemic, or other errors in comparison analysis. There can be no assurance that future results, performance, or events will be consistent with the information provided in this document and the past performance of the Portfolio Strategies described herein, if any, is not a guarantee or assurance for future performance. Any decision or action taken by the recipient of the document based on this information shall be solely and entirely at the risk of the recipient of the document. The distribution of this information in some jurisdictions may be restricted and/or prohibited by law, and persons into whose possession this information comes should inform themselves about such restriction and/or prohibition and observe any such restrictions and/or prohibition. Unauthorized disclosure, use, publication, dissemination or copying (either whole or partial) of this information, is prohibited.

The PM shall not treat the recipient/user of this document as a client by virtue of his receiving/using the contents of the document in full or part. Neither the PM nor its affiliates, directors, partners, employees, agents, or representatives, shall be responsible or liable in any manner, directly or indirectly, for the contents or any errors or discrepancies herein or for any decisions or actions taken in reliance on the information in the document.

The person accessing this information specifically agrees to exempt/absolve the PM or any of its affiliates or employees from, any and all responsibility/ liability arising from such misuse/improper/ illegal use and agrees not to hold the PM or any of its affiliates or employees responsible for any such misuse/improper/illegal use

and further agrees to hold the PM or any of its affiliates or employees free and harmless from all losses, costs, damages, expenses that may be suffered by the person accessing this information due to any errors and delays. The PM (including its affiliates) and any of its Partners, officers, employees, and other personnel will not accept any liability, loss, damage of any nature, including but not limited to direct, indirect, punitive, special, exemplary, consequential, as also any loss of profit in any way arising from the use of this document or any information in any manner whatsoever.

This document may include certain forward-looking words, statements and scenario which contain words or phrases such as “believe”, “expect”, “anticipate”, “estimate”, “intend”, “plan”, “objective”, “goal”, “project”, “endeavor” and similar expressions or variations of such expressions that are forward-looking statements, words, and scenario. Actual outcomes may differ materially from those suggested by the forward-looking statements due to risks, uncertainties, or assumptions.

The PM takes no responsibility for updating any data/information. This document cannot be copied, reproduced, in whole or in part or otherwise distributed without prior written approval of the PM. Prospective investors/clients are advised to review this Document, the Private Placement Memorandum / Disclosure Document, the Contribution Agreement / Client Agreement, representations and presentation(s) and other related documents carefully and in its entirety and seek clarification wherever required from the SEBI Registered Intermediary/PM.

Prospective investors should make an independent assessment, consult their own counsel, business advisor and tax advisor as to legal, business and tax related matters concerning this document and other related documents before investing with/through the PM.

The information contained in this document has been prepared for general guidance and does not constitute a professional advice/assurance and no person should act upon any information contained herein without obtaining specific professional advice/Assurance. Neither the PM nor its Affiliates or advisors would be held responsible for any reliance placed on the content of this document or for any decision based on it.

Each existing/prospective client, by accepting delivery of this document, agrees to the foregoing. The Investment portfolio is subject to several risk factors including but not limited to political, legal, social, economic, and overall market risks. The recipient alone shall be fully responsible/ are liable for any decision taken based on this document.

The PM, its partners, employees, PMS clients, AIF schemes, Advisory clients may have existing exposure to the stocks that form part of the PMS portfolio/Advisory portfolio. Further, in view of the investment objective/strategy of the PMS/Advisory there may be situations where the PM may be selling a stock which is part of the PMS portfolio/Advisory portfolio scheme/AIF Portfolio scheme, as the case may be. The PM (including its affiliates) may offer services in nature of advisory, consultancy, portfolio management, sponsorship of funds, investment management of funds which may conflict with each other.

The PM operates from within India and is subject to Indian laws and any dispute shall be resolved in the courts of Mumbai, Maharashtra only.

In the United Kingdom this document is only made available to, and directed at, (a) investment professionals falling within Article 19(1) of the United Kingdom Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, as amended (the "Order"), (b) high net worth entities falling within Article 49(1) of the Order, and (c) other persons to whom it may otherwise lawfully be communicated.

Buoyant Capital Private Limited ("BCPL") is also an investment adviser registered with the U.S. Securities and Exchange Commission (the "SEC") under Section 203 of the Investment Advisers Act of 1940, as amended (the "Advisers Act"). Our CRD number is 327612 and SEC File number is 801-129223. The regulatory disclosures and brochure are available at https://adviserinfo.sec.gov/firm/summary/327612

SEBI-related regulatory disclosures & disclaimers are available here.

3501 / 3704 Kohinoor Square
Dadar West, Mumbai

Tel: +91 22 6931 9999

info@buoyantcap.com