June 3, 2006

From: Amitabh Singhi
To: Investors in the Surefin India Value PMS
Subject: The stock market fall in May 2006

Dear Investor,

I urge you to take the time to read this letter patiently. It will help you understand the way we work at Surefin and consequently affect your investment decisions and returns.

Fortuitously, I had written the following in my last letter to you in March:

"The Indian markets have experienced this kind of euphoria several times in the past. It is always interesting to see frontline stocks get stretched valuations so quickly. The fallout, whenever it comes, will be equally interesting."

Though we do not typically comment on short-term price movements of stocks, I wish to address the fall in the stock markets in the middle of May as it seems to have caused a lot of panic in the media and among market participants.

It is astounding how valuations of some large companies fell over 30% in a little over a week. If you ask the management of those companies, they will not be able to explain the change in the value of the underlying business in such a short period of time. The Indian stock market indicated that Indian businesses lost over $100 *billion* of value 'created' over the last three *months* (a very brief period of time in itself) in just ten *days* in May! It does not take a genius to conclude that a gain or loss of such a magnitude has not actually occurred in the underlying value of Indian businesses.

The fall was exacerbated the lack of margins available with market participants due to excessive leverage taken on by domestic traders and intermediaries. This mindless leverage taken on through banks giving loans against shares to brokerages, who in turn allow their clients to trade on margin in the futures and options segment (which are in themselves highly leveraged instruments) can allow retail investors to take on positions as large as 30 *times* the amount of money they have to put upfront. Then when prices fall sharply in a day, there are margin calls that start an unstoppable chain reaction. At Surefin we do not employ any leverage in our portfolios.

Many people were shocked by the *speed* and the *extent* of the fall. It is useful to remember that movements in the stock markets are usually 'lumpy' (which means that 80% of the action happens in 20% of the days) and always unpredictable. But people get more fearful (or excited) if stocks go down (or up) 10% in one day as compared to a decrease (or increase) of 30% gradually over three months. It is irrational to let the *speed* of the fall (or rise) affect one's investment decisions and it is important to be able to control one's fear (or greed) during times like this. We are confident about the companies we are holding and such falls do not hinder our ability to think rationally about their underlying values. As far as the *extent* of the fall is concerned, I do not that think that prices fell to mouth-watering levels.

Only some of the 'froth' built up during the last three to nine months was wiped out. The fall did not result in prices anywhere near the prices in May 2004 when stocks fell well below intrinsic values.

It is sometimes interesting and entertaining to understand why these falls take place posthumously. However, at Surefin, neither do we spend any time in trying to predict their timing or what might cause them in the future, nor do we try and draw 'trend lines' to predict where things might go after such sharp movements. What is valuable is to maintain a philosophy that yields benefits rather than falls prey to the vagaries of the stock market over the long-term. Volatility is a very dear friend of the long-term investor. If we buy something at 100 that we think is worth 200 and it subsequently falls to 60, why wouldn't we buy more (provided our allocation limit is not breached)? We do not allow short-term price movements of our portfolios come in the way of doing what we think will benefit our returns in the long-term. It is important however to recognize that such falls will come again. When that will happen? No one knows.

On a personal note, I made my yearly pilgrimage to Omaha during the first week of May. Listening to Warren Buffett and Charlie Munger speak was a treat as usual. The notes to the meeting are available at http://users.rcn.com/hpersson/BRKA_Meeting_Notes-2006.pdf. I hope you enjoy them.

Warm regards,

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