

# MONTHLY NEWSLETTER

Portfolio Management Services

October 2024



LOWER  
RATES

HIGHER  
STAKES?

"When interest rates are low, risk premiums are narrow, encouraging riskier investment behaviour. When rates rise, the premium grows, and investors are more cautious." - Howard Marks

Have you ever played chess? If yes, then you might be aware that every move on the board carries weight—each action is significant, and even the smallest shift can have far-reaching consequences. In the same way, central banks, particularly the Federal Reserve, navigate the economic landscape with calculated precision. Every rate cut or hike is like a strategic move on this grand chessboard, with the potential to alter market dynamics, shape investor behaviour, and set the tone for future developments.

Market seems to be of a belief that Fed cut rates subsequent to recessionary trends as occurred during 2000 and 2008. However, unlike during 2000 and 2008 when rate cuts happened to arrest economic slowdown, this time around Fed has managed to tame inflation first and resorted to rate cuts as a measure to boost economic growth through reduced cost of capital.

In this newsletter, we attempt to explore the relationship between interest rates and financial markets, focusing on how fluctuations in interest rates affect equity and bonds, investor behaviour, and overall market dynamics.

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### A Look Back: Central Bank Actions Through History

Let's take a walk through history. It is the late 1990s and things are changing fast. The world is buzzing with the dot-com boom. The Federal Reserve, recognizing the need to fuel this growing energy, made a bold move by slashing interest rates. This decision didn't just cause ripples—it caused waves. The NASDAQ, driven by the surge in tech, rocketed up 400%. Yet, as in any good story, there was a twist. The bubble burst, and while some early investors benefited greatly, others were left picking up the pieces.

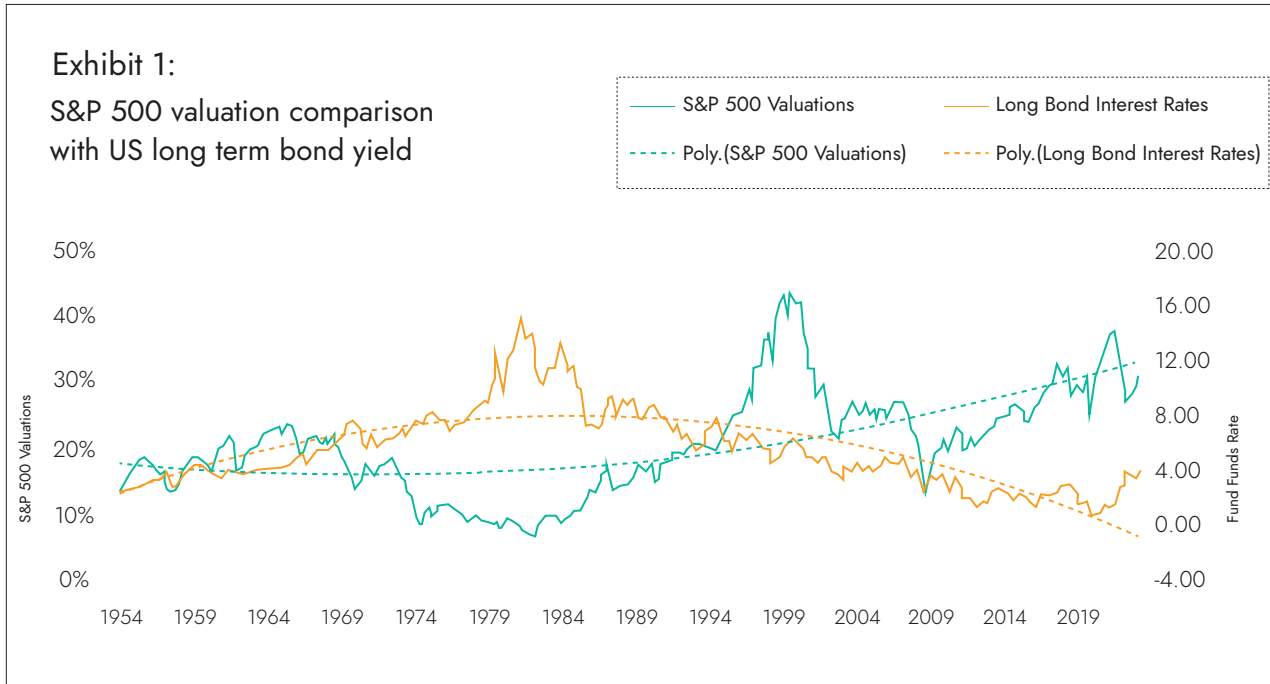
Fast forward to the early 2000s. After the dot-com crash and the harrowing events of 9/11, the Federal Reserve acted again, cutting rates from over 6% to nearly 1%. It was like throwing a lifeline to the markets. And just as expected, the markets caught it. The S&P 500, which had been in a free fall, rebounded, gaining 80% between 2003 and 2007, driven by cheap capital and investor appetite for consumer and housing-related sectors.

Then came the 2008 financial crisis. Interest rates were high—above 5%—but following the crash,

central banks slashed them to near zero. With this decision, quantitative easing (QE) became a tool to revive the markets, and once again, equities soared. The S&P 500 surged more than 400% from 2009 to 2019, and the pattern was clear: when the cost of borrowing is low, investor risk tolerance grows, driving the equity market to new heights.

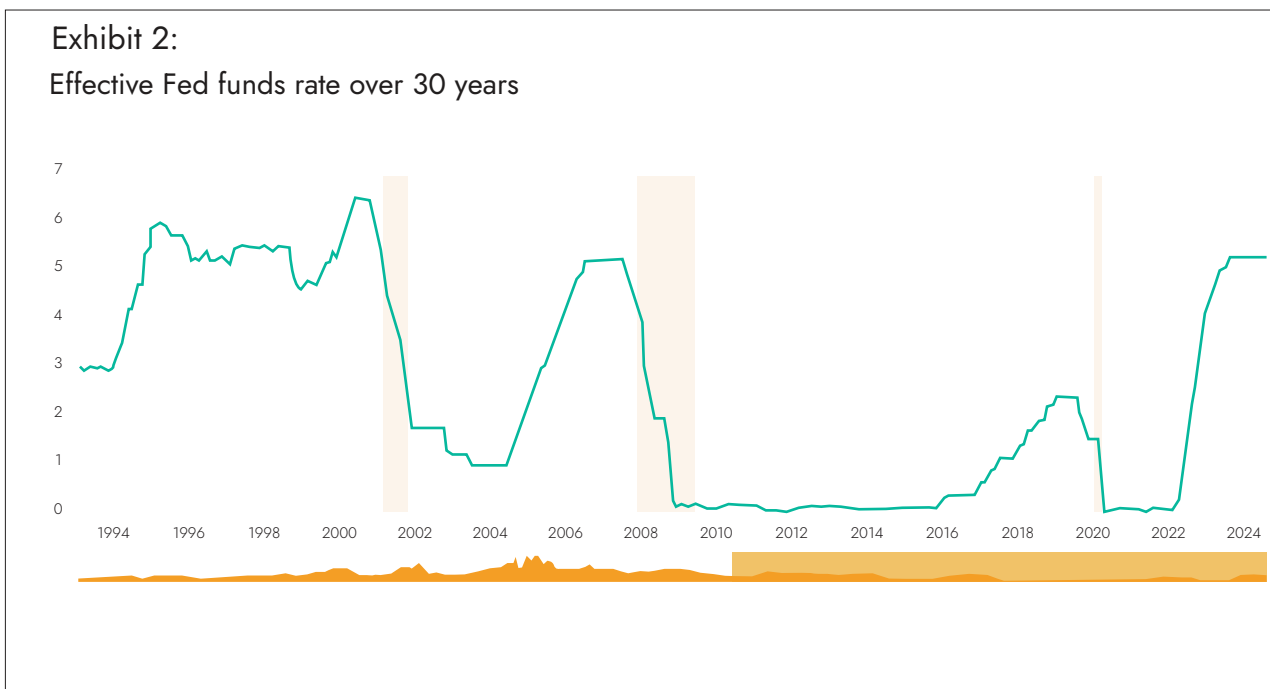
We saw a similar pattern in 2020 after the COVID-19 crash. The interest rates were further reduced and because of the ultra-low interest rates NASDAQ doubled in just 18 months from its March 2020 low. Speculative assets, such as cryptocurrencies, soared as liquidity poured into riskier investments. This wasn't just a coincidence; it was history repeating itself, with investors following the path that low rates had paved.

Emerging markets, including India, have mirrored this pattern. When the Reserve Bank of India (RBI) cut rates during the 2008 financial crisis, Indian equities rallied sharply, nearly doubling. And once again, in 2020, as rates were slashed, Indian markets rebounded, with technology, pharmaceuticals, and financials leading the way.



**What Happened This Time?**

In the lead-up to the Federal Reserve’s September meeting, many expected a modest rate cut—around 25 basis points. But to everyone’s surprise, the Fed cut rates by 50 basis points. This marked the first rate cut since the early COVID-19 pandemic days. The decision was particularly notable given that interest rates had been hovering near three-decade highs.



## Why Did the Fed Cut The Rate?

But why did the Fed choose to cut rates this time around? It might have to do with data points that showed rising unemployment and slowing business activity. In response, they decided to make borrowing easier, to help businesses and individuals keep moving forward.

There were several reasons for this largely unexpected 50 bps rate cut:

- **Weakening Economic Indicators:**

The Fed observed signs of a slowing economy, such as rising unemployment rates and declining business activity. The July job report revealed that the US had added 818,000 fewer jobs in the past year than initially reported.

- **Inflation Concerns:**

While inflation had been on a downward trend, the Fed remained cautious about the potential for future inflationary pressures. The Federal Open Market Committee (FOMC) members have predicted that Personal Consumption Expenditures (PCE), a measure

of inflation tracked by the Fed, will hit 2.3% in 2024, and then fall to 2.1% in 2025.

- **Global Economic Uncertainty:**

Geopolitical tensions and trade disputes were also contributing to economic uncertainty.

By reducing interest rates, the Fed aims to stimulate economic growth, encourage borrowing and spending, and prevent a deeper economic downturn. But as always, there are risks. In this scenario, it is the risk of higher inflation if the economy recovers too quickly.

## The Ripple Effect on India

Now, let us see how this move will impact the Indian economy.

Here are some of the possible implications of the Fed's rate cut on the Indian economy:

- **Lower Cost of Borrowing:**

The Reserve Bank of India (RBI) may respond to the Fed's rate cut by easing its monetary policy, leading to lower domestic interest rates. RBI reducing repo rates can encourage borrowing and investment, stimulating economic activity.

- **Rupee Appreciation:**

A Fed rate cut often results in a weakening of the US dollar as investors move their money to higher-yielding economies like India. This may cause the Indian Rupee (INR) to appreciate against the US dollar. While a stronger rupee makes imports cheaper (beneficial for oil imports), it can hurt Indian exports, which become more expensive for foreign buyers.

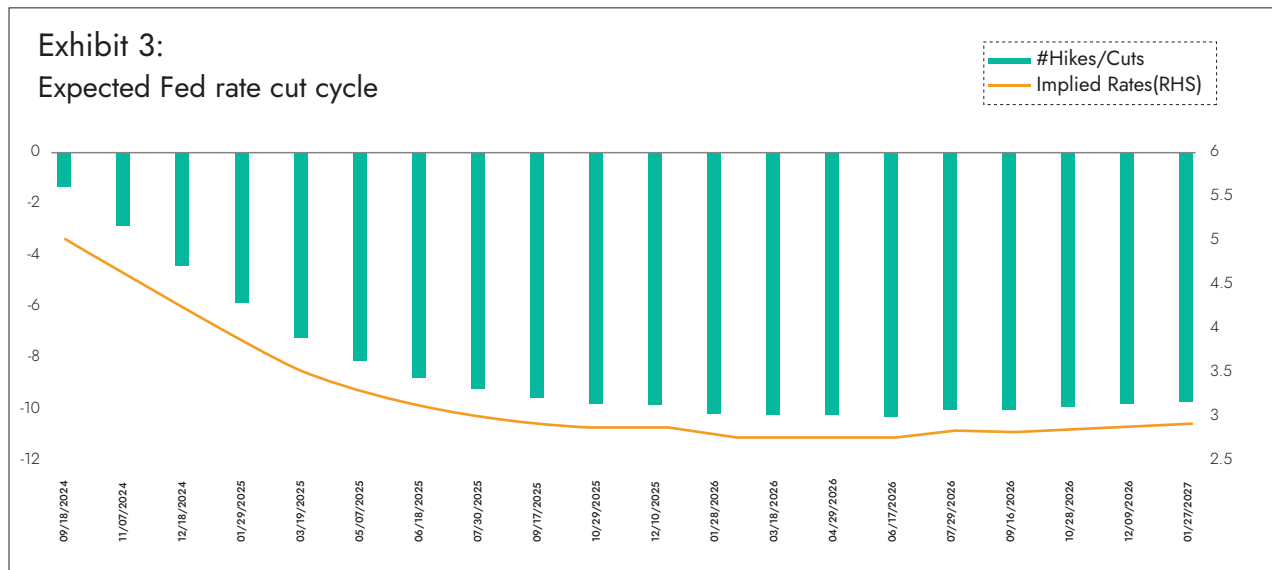
- **Inflation:**

A stronger rupee resulting from higher capital inflows makes imports cheaper, reducing the cost of goods like crude oil, electronics, and other essential commodities. This can help reduce imported inflation in India.

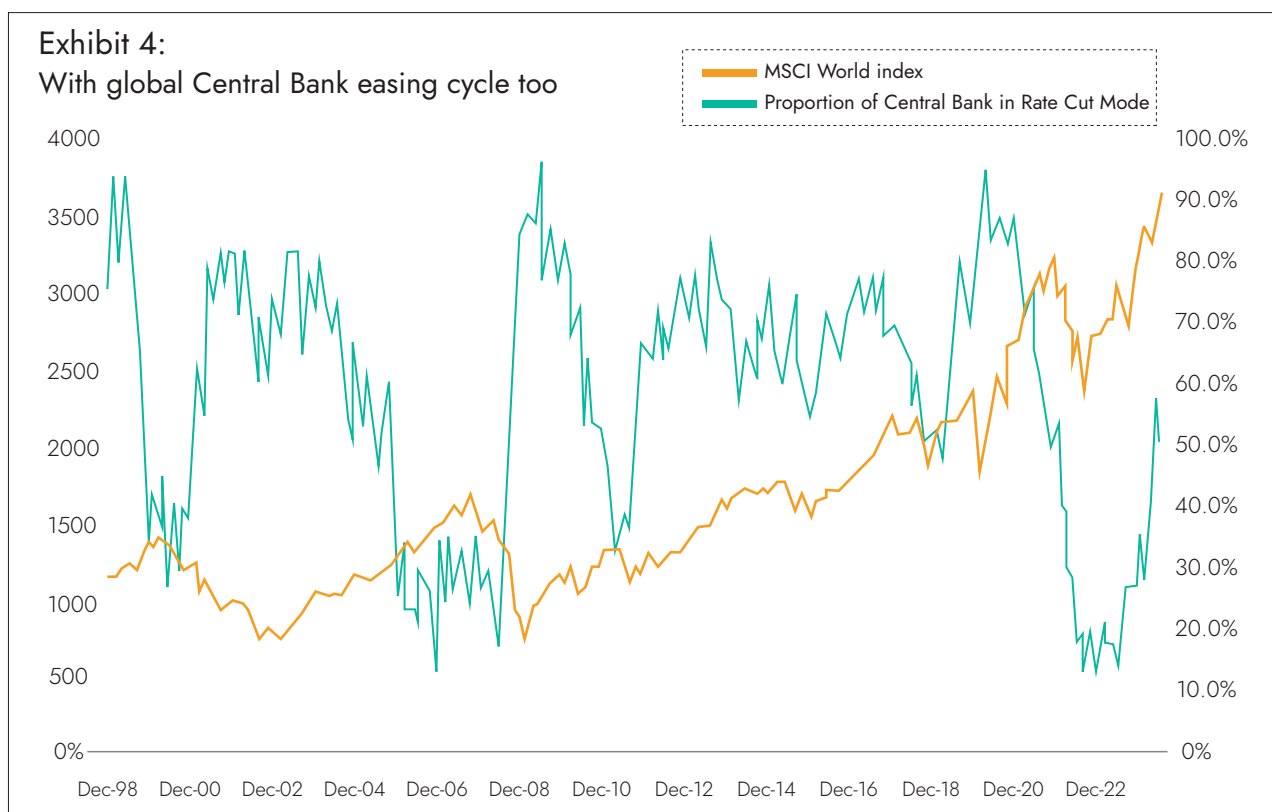
- **India's Monetary Policy:**

A Fed rate cut allows the Reserve Bank of India (RBI) more flexibility in lowering its interest rates. With the US offering lower interest rates, capital flight from India to the US becomes less likely. The RBI can reduce its repo rate without worrying about large capital outflows, helping stimulate domestic borrowing, investment, and consumption.

Markets are anticipating a rate cut cycle, with rate cuts to the tune of 100 bps over the next 12 months.



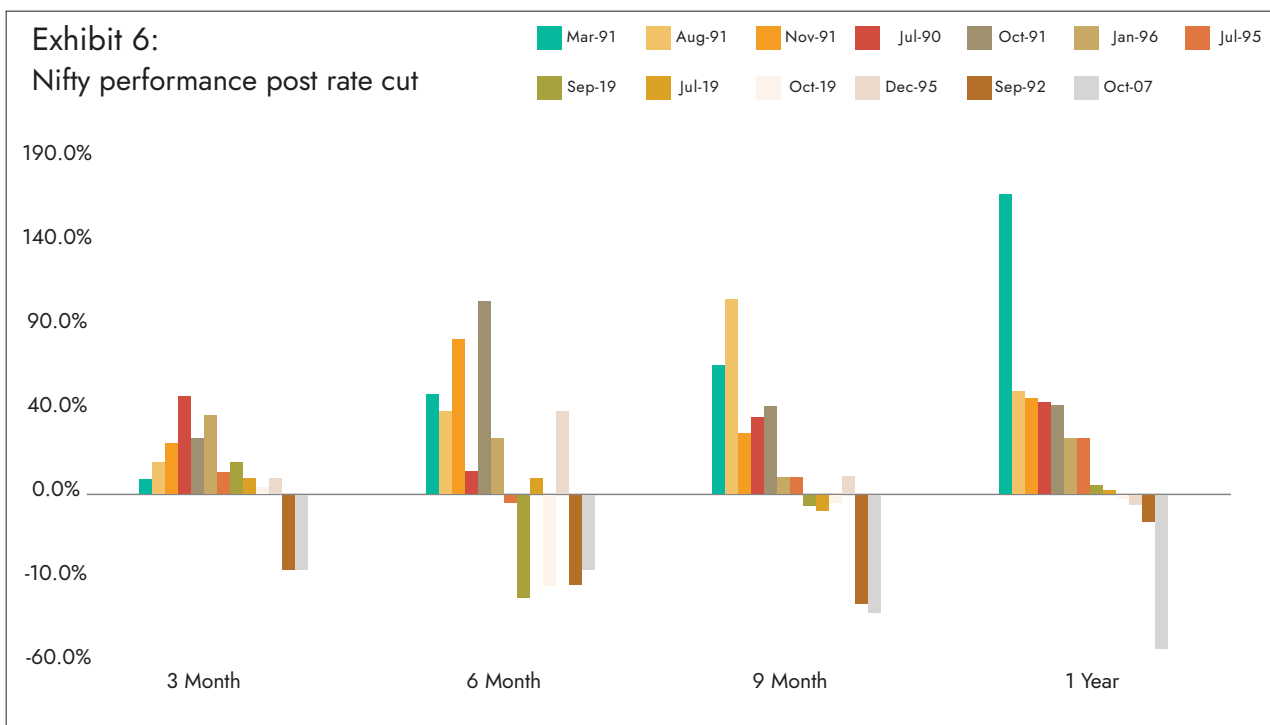
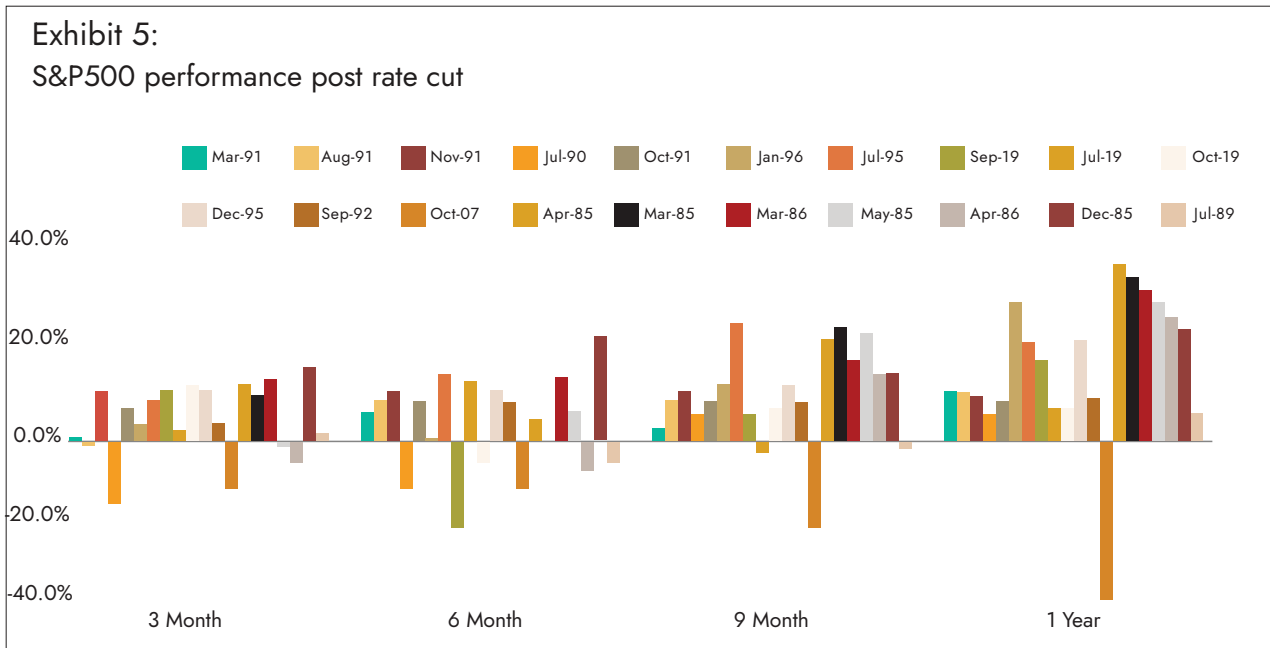
Source: Industry reports, Ambit Asset Management



Source: Industry reports, Ambit Asset Management

### What Can We Expect?

The Fed has cut rates 20 times when the markets were at or near all-time highs, and in 19 of those cases, the S&P 500 ended up higher a year later. The only time it didn't? 2008, during the financial crisis. Now, looking at the Nifty, it's been up strongly 54% of the time, while staying flat in 38% of the cases. And just like the S&P, 2008 was the year the Nifty took a big hit.



The current situation is very similar to 2019. While we're not facing a crisis, the economy is showing signs of weakening, particularly with the labour market cooling, even though inflation remains mostly under control.

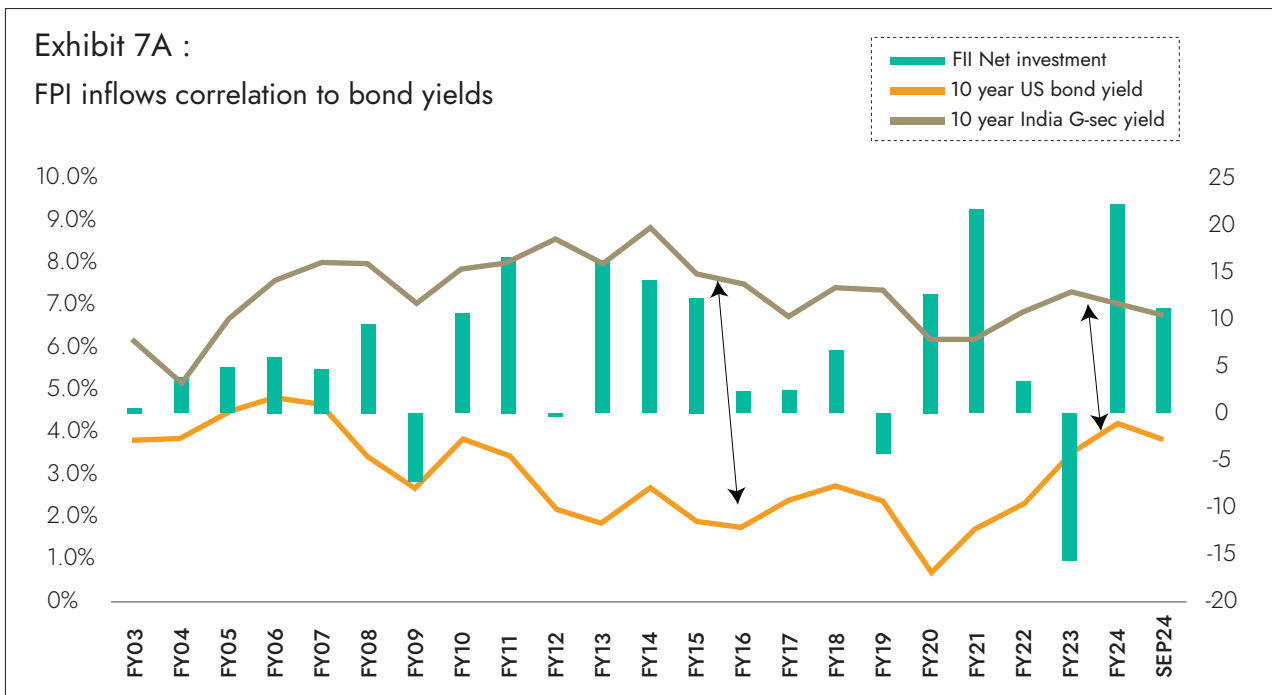
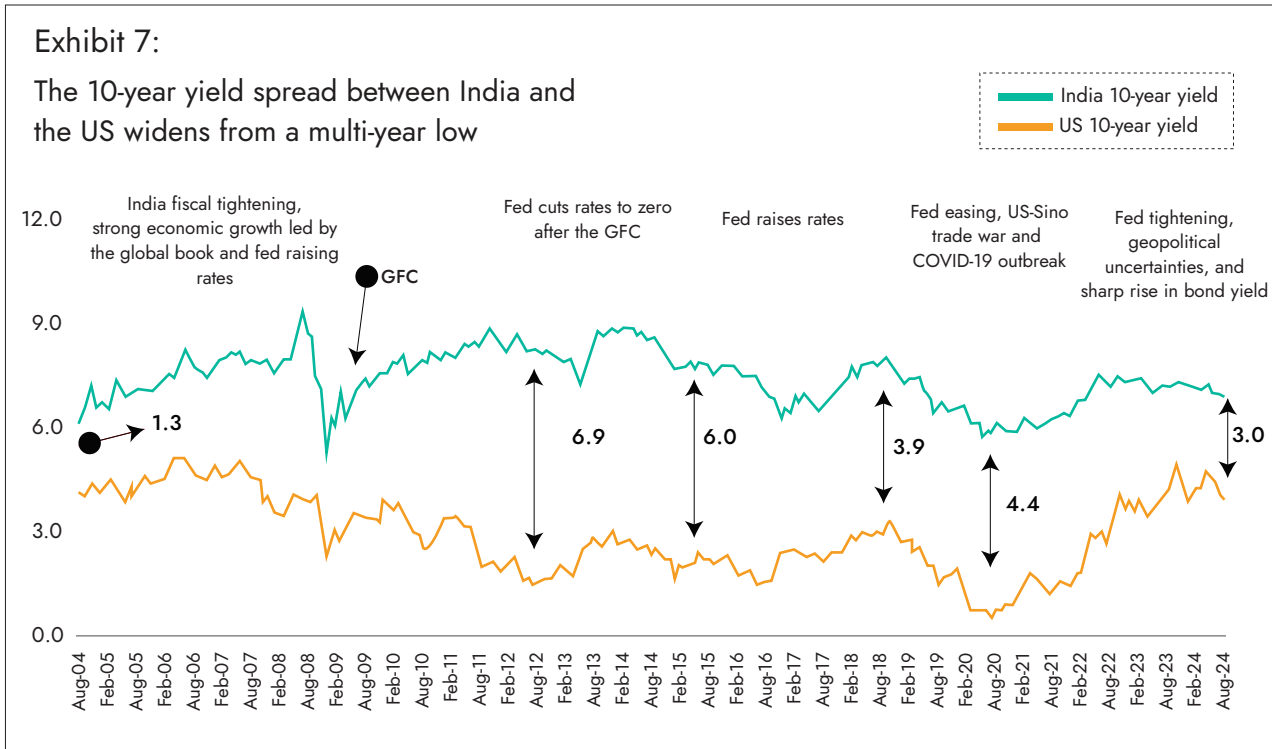
If we look at the 2019 rate-cut cycle, FPIs injected \$6.4

billion into India, driven by lower borrowing costs in the US. During that period, sectors like Consumer Discretionary, Real Estate, Financials, and Auto outperformed the Nifty, as companies benefited from earnings growth due to the inverse relationship between commodity prices and operating profits. We believe that this could very well be the case again.

**FPI Inflows Could See A Comeback**

Historically, FPI flows have remained strong during periods when the gap widens between the US 10-year bond yields and India's 10-year Government Securities (G-sec) yields.

After the pandemic, high interest rates in the US caused this gap to narrow to historical lows. But now, with the US Federal Reserve shifting into a rate-cutting cycle, we expect this gap to widen once again. This widening gap is likely to attract more FPI and Foreign Direct Investment (FDI) inflows into the country.

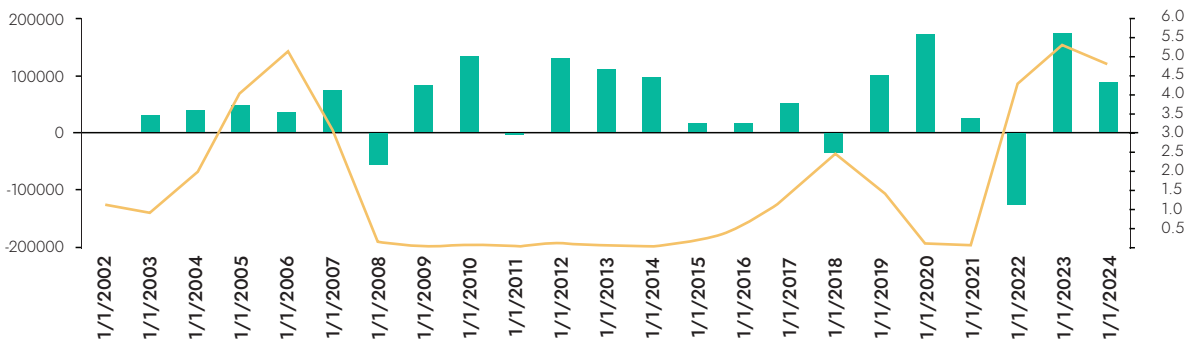


Unlike in previous years, we've seen a significant shift in the dominance of institutional flows in Indian equity markets. Domestic Institutional Investors (DII) have stepped up in a big way, with strong SIP flows and retail participation helping to smooth out the volatility caused by fluctuating Foreign Portfolio Investors (FPI) flows. In fact, cumulative DII flows into Indian equities

between CY21 and CY24YTD have been nearly six times higher than FPI flows—quite a jump compared to earlier periods. So far in CY24, FPI and DII flows stand at USD 8.6 billion and USD 38.4 billion, respectively. This shift has also contributed to a substantial reduction in the ownership gap within the market.

Exhibit 8:

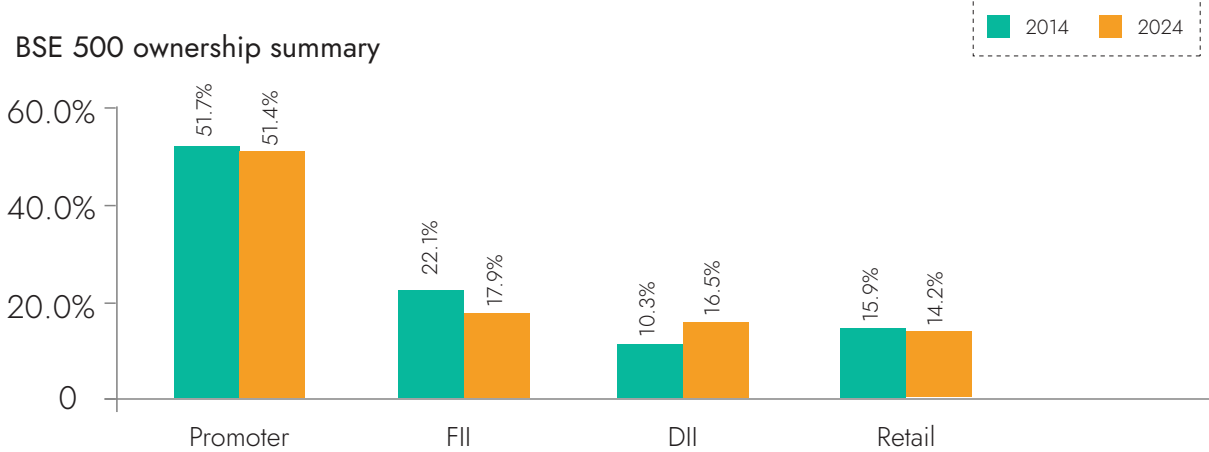
Lower Fed funds rate leads to higher FPI flows in Indian Markets albeit with a lag



Source: Bloomberg, Ambit Asset Management

Exhibit 09 :

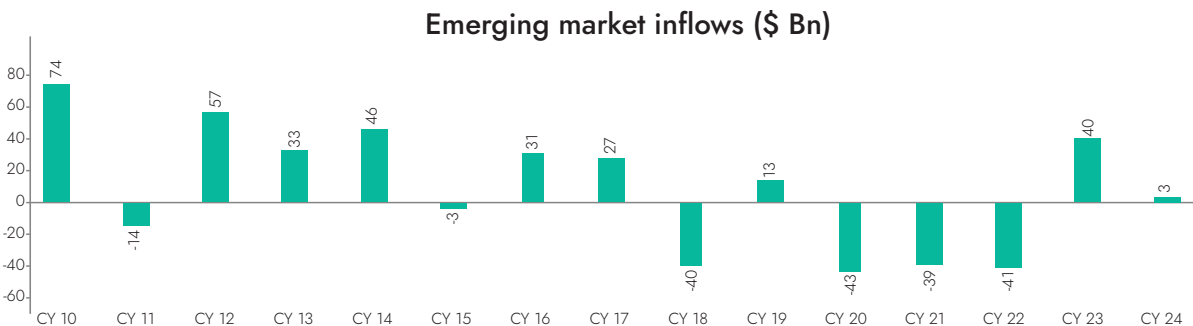
BSE 500 ownership summary



Source: Bloomberg, Ambit Asset Management

Exhibit 10 :

Similarly in CY24, FPI flows have remained muted in all emerging markets



Source: Bloomberg, Ambit Asset Management

## India's Market Position

Although the Indian stock market has outperformed other emerging market peers in terms of inflows and absolute returns, a deeper analysis shows that Indian stocks are still fundamentally better positioned. When you look at key metrics like the Price-to-Earnings Growth (PEG) ratio and Return on Equity (ROE), Indian markets continue to stand out. This explains why Indian markets have consistently outperformed their global counterparts.

### Exhibit 11:

#### Comparison of growth and return matrix across emerging economies

Country	FY23-25 earnings growth	FY 25 PE	PEG	FY25 ROE
<b>India</b>	<b>12.90%</b>	<b>20.4</b>	<b>1.6</b>	<b>16%</b>
Brazil	-2.40%	7.7	-3.2	15%
Indonesia	-2.50%	13.2	-5.3	14%
Japan	3.40%	18.6	5.5	9%
Korea	5.30%	7.9	1.5	10%
Mexico	5.20%	10.6	2.0	13%
Shanghai	0.80%	9.5	11.9	11%
Singapore	2.40%	11.3	4.7	9%
Taiwan	1.80%	15.7	8.7	10%
Thailand	-2.70%	14.2	-5.3	12%
UK	1.70%	12.5	7.4	14%
<b>US</b>	<b>8.10%</b>	<b>21.8</b>	<b>2.7</b>	<b>18%</b>
Emerging markets	3.10%	11.3	-	-
Asia	5.00%	12	-	-

Source: IMF

### Impact on Valuations

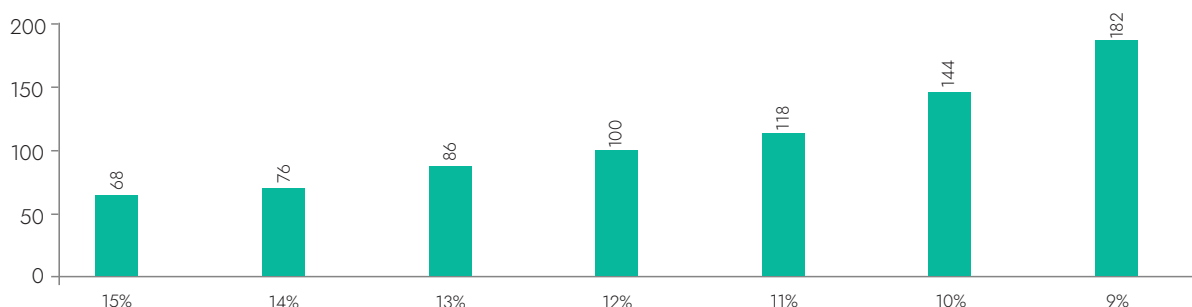
One of the key factors in company valuations is the inverse relationship between interest rates and valuations. When interest rates rise, the cost of equity also goes up, which leads to lower valuations. On the flip side, when interest rates fall, company valuations tend to rise.

example using a company's Discounted Cash Flow (DCF) model. The chart below shows how the company's value shifts for every 1% change in the cost of equity, starting with a base case of 12%. This assumes a 7% risk-free rate, a market beta of 1, and a debt-free balance sheet, with everything else staying constant.

To give you a clearer picture, let's take a look at an

### Exhibit 12 :

#### Fair value of the stock at different levels of cost of equity



Source: Ambit Asset Management

This example clearly demonstrates how sensitive valuations are to changes in interest rates. A mere 1% change in the risk-free rate can lead to significant shifts in valuation, underscoring the impact of the interest rate environment on company valuations. In low-rate environments, we often see inflated valuations, while rising rates can quickly dampen them as the cost of capital surges.

### The Impact of Falling Interest Rates on Debt and Equity Investments

When interest rates drop, debt investments become less attractive because bond yields also decline, which narrows the gap between bond yields and equity returns. Historically, India's 10-year government bond yield has hovered around 7-8%, but during significant rate cuts, it can dip below 6%. On the other hand, the Nifty 50 earnings yield (which is the inverse of the price-to-earnings ratio) usually stays between 5-6%. When bond yields are high, they provide a safer option compared to equities. But when rates fall and bond yields compress, the gap between bond yields and the Nifty earnings yield narrows, making equities a more attractive option. This reduction in the risk

premium encourages investors to move towards stocks in search of higher returns.

For example, in 2020, after a series of rate cuts, the Indian 10-year bond yield fell below 6%, while the Nifty earnings yield stayed around 6%, significantly narrowing the yield spread. A similar pattern was seen globally after the 2008 financial crisis, with U.S. Treasury yields falling to nearly 2%, while the S&P 500 earnings yield remained above 5%. This shrinking gap between bond and equity yields shifts the risk-reward equation, prompting investors to lean more towards equities and riskier investments. As debt instruments offer lower returns in a low-rate environment, equities become the go-to choice for capital growth, driving further rallies in the stock markets.

### Time For Quality Stocks To Shine

Moving ahead, in this current scenario, we are seeing that high-quality and low-volatility stocks are making a strong comeback, and we expect them to continue outperforming as earnings growth across industries begins to moderate.

#### Exhibit 13:

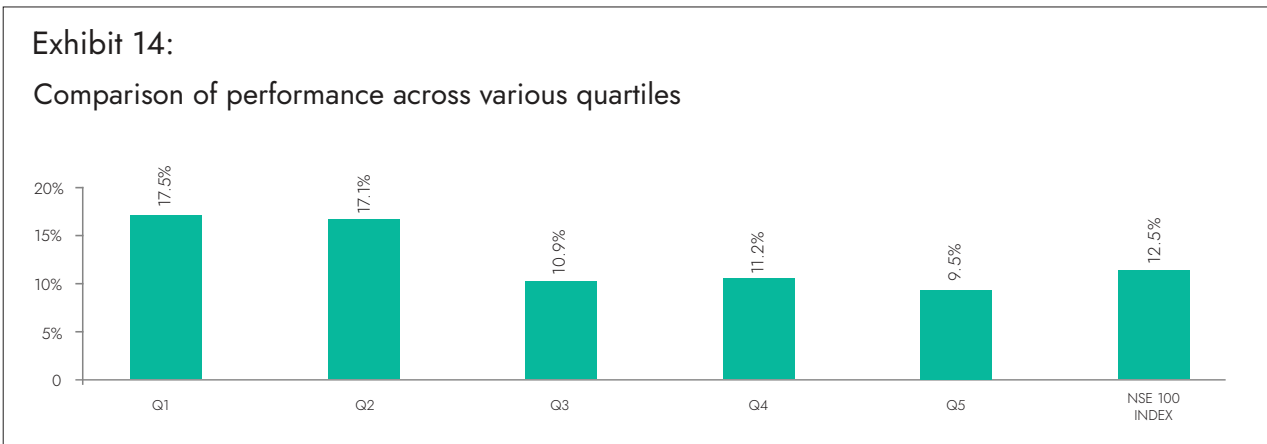
Over the past 3 months, quality and low volatility turned a corner and began to catch up

Date	NIFTY200 Alpha 30	NIFTY200 Momentum 30	NIFTY200 Quality 20	NIFTY200 Value 20	NIFTY200 Low Volatility 20	NIFTY High Beta 50	NIFTY200 Growth 20
Sep-23	6%	5%	3%	14%	1%	5%	0%
Oct-23	-5%	-4%	-2%	-2%	-2%	-4%	-1%
Nov-23	14%	12%	7%	10%	4%	8%	9%
Dec-23	10%	9%	7%	14%	8%	12%	8%
Jan-24	5%	6%	0%	10%	-4%	7%	1%
Feb-24	3%	3%	1%	9%	1%	1%	5%
Mar-24	2%	3%	0%	1%	-1%	0%	2%
Apr-24	6%	6%	1%	9%	-1%	10%	1%
May-24	5%	5%	4%	0%	-1%	0%	2%
Jun-24	6%	3%	6%	1%	6%	4%	7%
Jul-24	6%	5%	8%	10%	7%	4%	-1%
Aug-24	1%	0%	2%	-1%	3%	-4%	0%
Sep-24	-3%	-3%	0%	-4%	0%	-3%	-1%

Source: ACE Equity, Ambit Capital Research, Ambit Asset Management

Note: For compatibility with other factor indices, we have created indices for Value, Low volatility and Growth factors based on NSE 200 constituents, as factor indices for the same were not available.

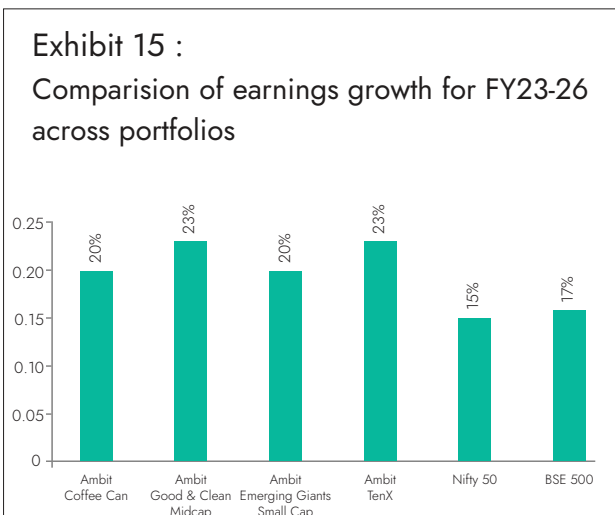
Historically, top-tier companies (those in the first and second quartiles) with industry-leading metrics like Return on Capital Employed (ROCE) and Return on Equity (ROE) have significantly outperformed the benchmark.



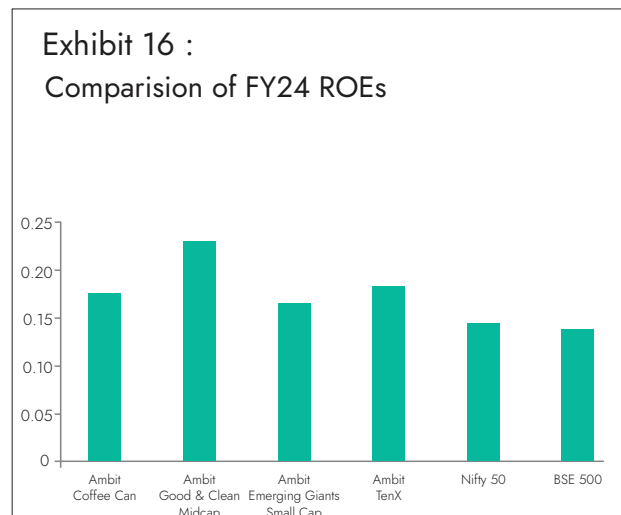
Source: Bloomberg, Ambit Capital Research

We believe the time is right for quality companies to truly shine and outperform the market. Our portfolios are heavily focused on high-quality companies in sectors like Consumer Discretionary, FMCG, and IT, which we see as the leaders in the next phase of growth. These portfolios are well-positioned to benefit

from both strong earnings fundamentals and favourable technical factors, such as increased FPI inflows. When we compare our portfolio's earnings and return on equity with benchmark indices, it clearly highlights the strength and inherent quality of the businesses we've invested in.



Source: Ambit Asset Management



Source: Ambit Asset Management

## Conclusion

Overall, the Fed rate cut is a positive sign for the emerging market like India. However, much will depend on the interest rate action that the Reserve Bank of India (RBI) takes.

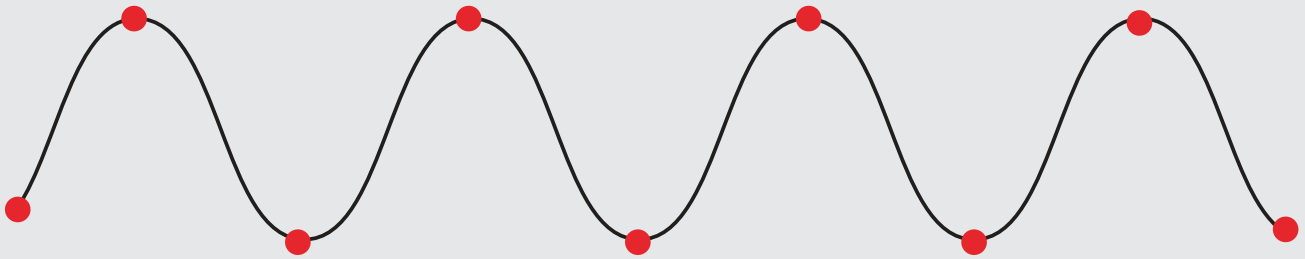
The Fed rate cut can provide a short-term boost to the economy. It is essential to monitor the evolving economic landscape and potential risks. The Indian government and Reserve Bank of India will need to carefully assess the situation and implement appropriate measures to mitigate any adverse effects.

India is currently in a favourable position, with GDP growth estimates around 7%, strong PMI expansion in both services and manufacturing, and a growing Forex reserve of US\$ 690 billion. This is in stark contrast to much of the global economy, positioning India as a relatively safe haven. However, it's worth noting that Indian market valuations are about 10% above their 5-year averages, 100% above emerging markets, and 25% above global comparable.

Foreign Portfolio Investors (FPI) ownership in the Indian market is at around 16.3%, the lowest it has been in 12 years, but we expect this to improve significantly in the future. In the current environment, we are focusing on domestic-facing sectors rather than global ones, especially with India benefiting from strong economic tailwinds while global markets face headwinds from slowing growth.

Looking back, we've seen an inverse relationship between interest rates and riskier assets. However, the pace of rate cuts will depend on several factors, including economic slowdown, inflation, and financial stability. In this context, companies with strong earnings growth, solid balance sheets, and a proven track record of capital efficiency are likely to come out ahead. Our portfolios are well-positioned to benefit from this shift, which has only just begun but could gain momentum in the months ahead.

# INVEST SUCCESSFULLY ACROSS MARKET CYCLES WITH AMBIT ASSET MANAGEMENT



Successful investing takes acumen

The acumen to have a solution for every need

The acumen to navigate volatile conditions

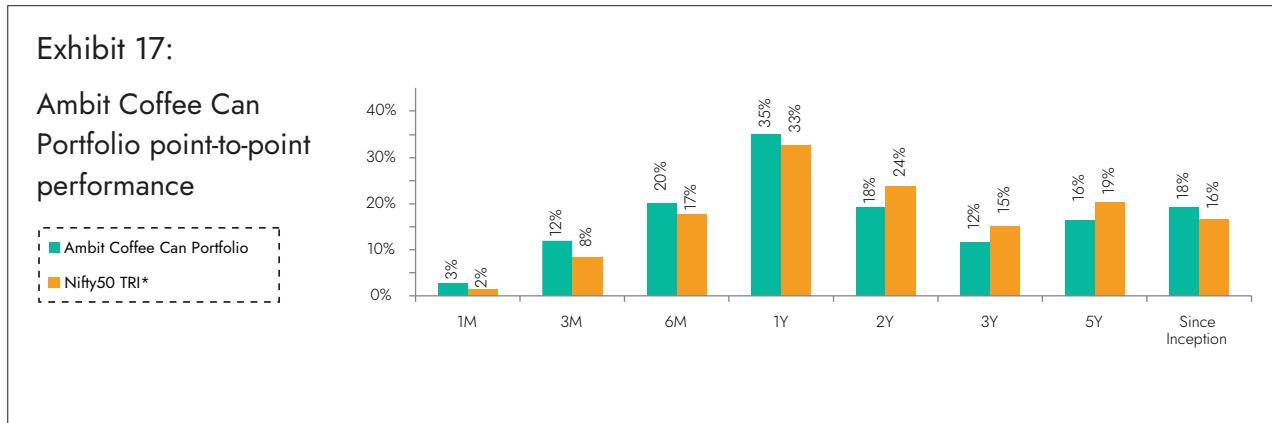
The acumen to always stay true to character

At Ambit Asset Management, it is this acumen that helps you invest successfully, with products that stay true to character across market cycles

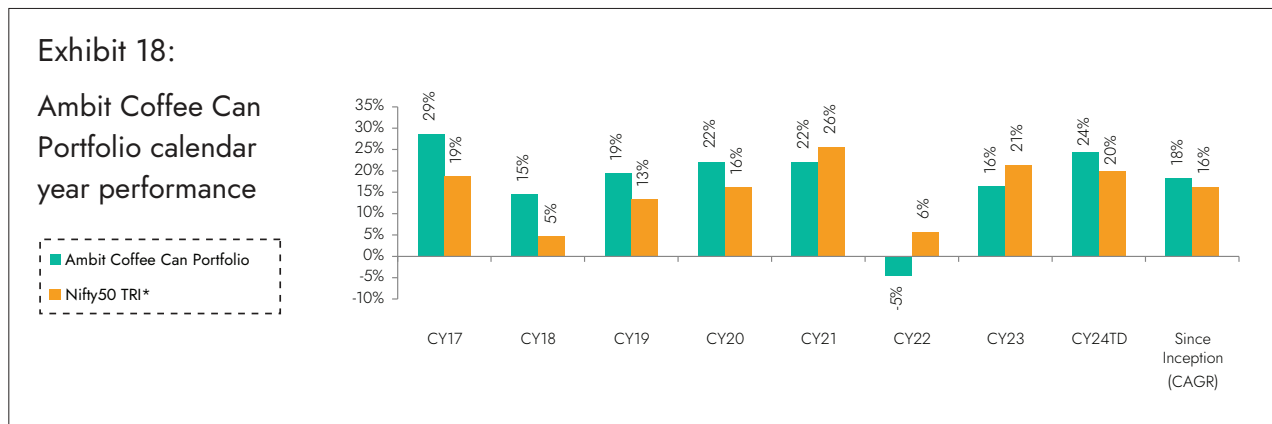
# Ambit Coffee Can Portfolio

At Coffee Can Portfolio, we do not attempt to time commodity/investment cycles or political outcomes and prefer resilient franchises in the retail and consumption-oriented sectors. The Coffee Can philosophy has an unwavering commitment to companies that have consistently sustained their

competitive advantages in core businesses despite being faced with disruptions at regular intervals. As the industry evolves or is faced with disruptions, these competitive advantages enable such companies to grow their market shares and deliver long-term earnings growth.



Source: Ambit Coffee Can Portfolio inception date is Mar 06, 2017;  
 \*\*1M Return: 1st - 30th Sep'24; 3M Return: 1st Jul'24 – 30th Sep'24; 6M Return: 1st Apr'24 – 30th Sep'24; 1Y Return: 1st Oct'23 – 30th Sep'24  
 \*Nifty 50 TRI is the selected benchmark for the Ambit Coffee Can Portfolio. The same is reported to SEBI.



Source: Ambit Coffee Can Portfolio inception date is Mar 06, 2017;  
 \*Nifty 50 TRI is the selected benchmark for the Ambit Coffee Can Portfolio. The same is reported to SEBI.

# Ambit Good & Clean Midcap Portfolio

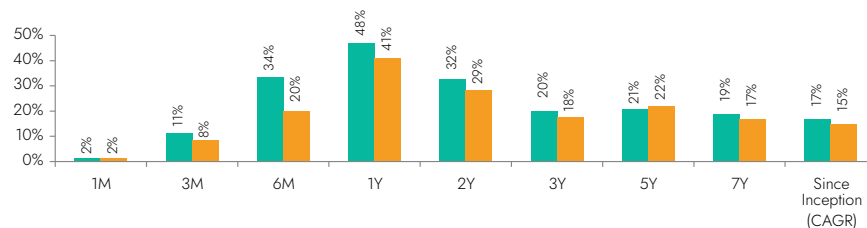
Ambit's Good & Clean strategy provides long-only equity exposure to Indian businesses that have an impeccable track record of clean accounting, good governance, and efficient capital allocation. Ambit's proprietary 'forensic accounting' framework helps weed out firms with poor quality accounts, while our proprietary 'greatness' framework helps identify efficient capital allocators with a holistic approach for consistent growth. Our focus has been to deliver superior risk-adjusted returns with as much focus on lower portfolio drawdown as on return generation. Some salient features of the Good & Clean strategy are as follows:

1. Process-oriented approach to investing: Typically starting at the largest 500 Indian companies, Ambit's proprietary frameworks for assessing accounting quality and efficacy of capital allocation help narrow down the investible universe to a much smaller subset. This shorter universe is then evaluated on bottom-up fundamentals to create a concentrated portfolio of no more than 20 companies at any time.
2. Long-term horizon and low churn: Our holding horizons for investee companies are 3-5 years and even longer with annual churn not exceeding 15-20% in a year. The long-term orientation essentially means investing in companies that have the potential to sustainably compound earnings, with these compounding earnings acting as the primary driver of investment returns over long periods.
3. Low drawdowns: The focus on clean accounting and governance, prudent capital allocation, and structural earnings compounding allow participation in long-term return generation while also ensuring low drawdowns in periods of equity market declines..

Exhibit 19:

## Ambit Good & Clean Midcap Portfolio point-to-point performance

■ Ambit Good & Clean Midcap Portfolio  
■ BSE500 TRI\*



Source: Ambit Good & Clean Mid cap Portfolio inception date is Mar 12, 2015;

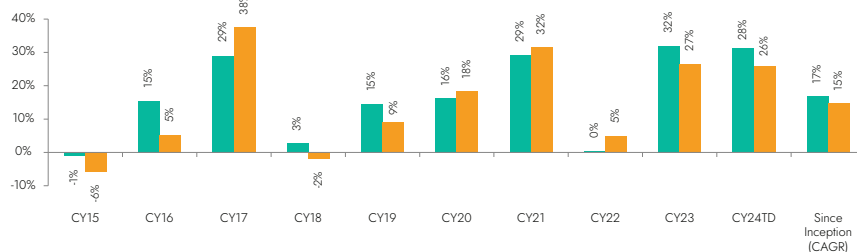
\*\*1M Return: 1st - 30th Sep'24; 3M Return: 1st Jul'24 – 30th Sep'24; 6M Return: 1st Apr'24 – 30th Sep'24; 1Y Return: 1st Oct'23 – 30th Sep'24

\*BSE 500 TRI is the selected benchmark for the Ambit Good & Clean Mid cap. The same is reported to SEBI.

Exhibit 20:

## Ambit Good & Clean Midcap Portfolio calendar year performance

■ Ambit Good & Clean Midcap Portfolio  
■ BSE500 TRI\*



Source: Ambit Good & Clean Mid cap Portfolio inception date is Mar 12, 2015;

\*BSE 500 TRI is the selected benchmark for the Ambit Good & Clean Mid cap. The same is reported to SEBI.

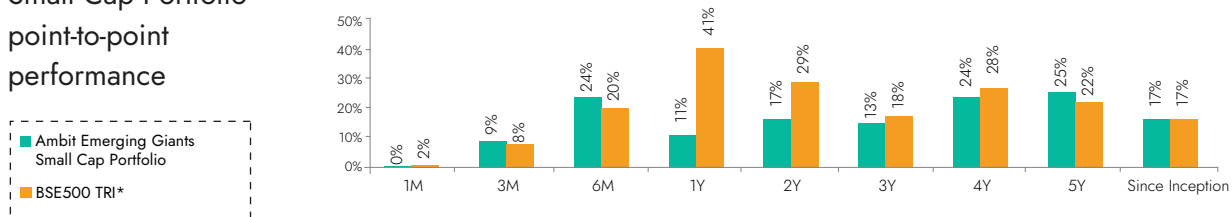
# Ambit Emerging Giants Small Cap Portfolio

Small caps with secular growth, superior return ratios and no leverage – Ambit's Emerging Giants Small Cap portfolio aims to invest in small-cap companies with market-dominating franchises and a track record of clean accounting, governance and capital allocation. The fund typically invests in companies with market caps less than INR 4,000cr. These companies have excellent financial track records, superior

underlying fundamentals (high RoCE, low debt), and the ability to deliver healthy earnings growth over long periods of time. However, given their smaller sizes, these companies are not well discovered, owing to lower institutional holdings and lower analyst coverage. Rigorous framework-based screening coupled with extensive bottom-up due diligence led us to a concentrated portfolio of 15-16 emerging giants.

Exhibit 21:

Ambit Emerging Giants Small Cap Portfolio point-to-point performance



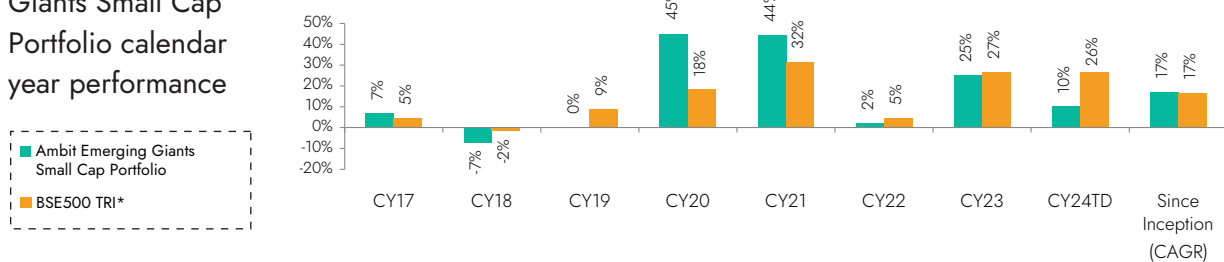
Source: Ambit Emerging Giants Small cap Portfolio inception date is Dec 1, 2017;

\*\*1M Return: 1st - 30th Sep'24; 3M Return: 1st Jul'24 – 30th Sep'24; 6M Return: 1st Apr'24 – 30th Sep'24; 1Y Return: 1st Oct'23 – 30th Sep'24

\*BSE 500 TRI is the selected benchmark for the Ambit Emerging Giants Small cap. The same is reported to SEBI.

Exhibit 22:

Ambit Emerging Giants Small Cap Portfolio calendar year performance



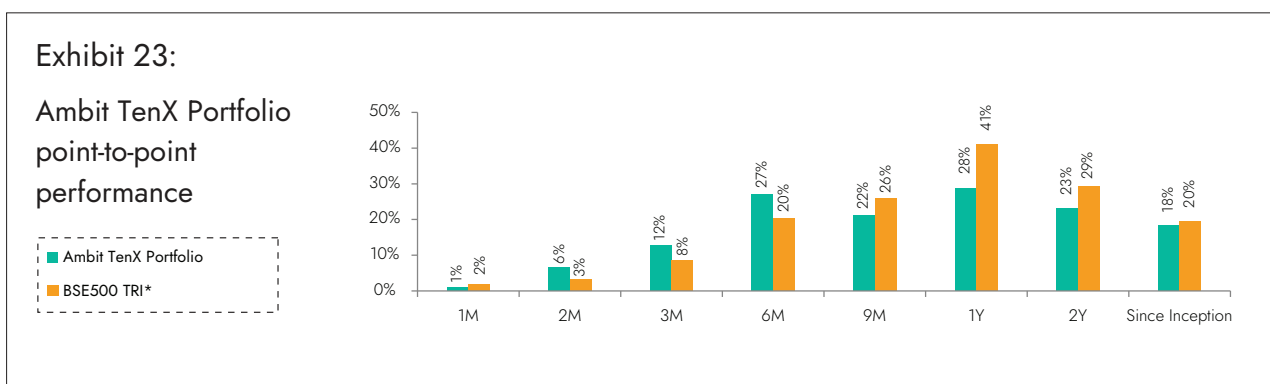
Source: Ambit Emerging Giants Small cap Portfolio inception date is Dec 1, 2017;

\*BSE 500 TRI is the selected benchmark for the Ambit Emerging Giants Small cap. The same is reported to SEBI.

# Ambit TenX Portfolio

Ambit TenX Portfolio gives investors an opportunity to participate in the India growth story as the Indian GDP heads towards a US\$10tn mark over the next 12-15 years. Mid and Small corporates are expected to be the key beneficiaries of this growth. The portfolio intends to capitalize on this opportunity by identifying and investing in primarily mid & small cap companies that can grow their earnings 10x over the same period implying 18-21% CAGR. Key features of this portfolio would be as follows: Key features of this portfolio would be as follows:

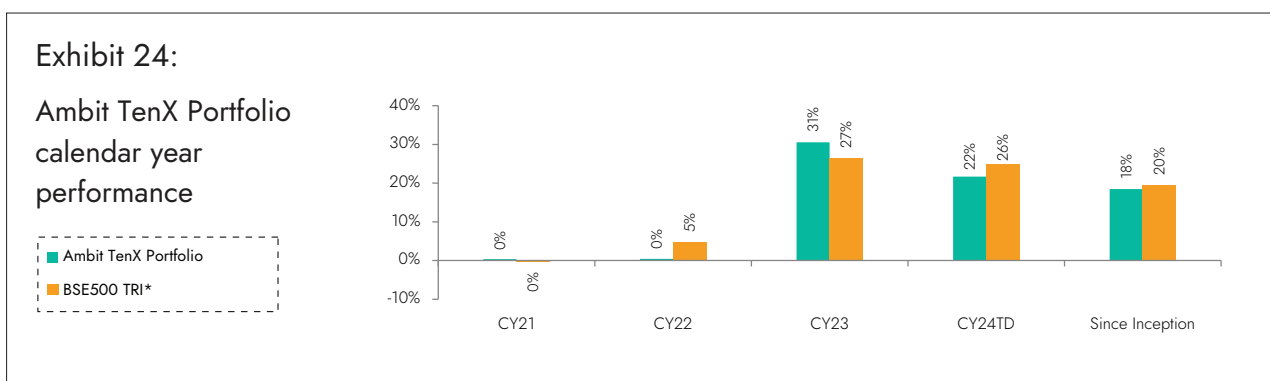
1. Longer-term approach with a concentrated portfolio: Ideal investment duration of >5 years with 15-20 stocks.
2. Key driving factors: Low penetration, strong leadership, light balance sheet.
3. Forward-looking approach: Relying less on historical performance and more on future potential while not deviating away from the Good & Clean philosophy.
4. No Key-man risk: Process is the Fund Manager



Source: Ambit TenX Portfolio inception date is Dec 13, 2021;

\*\*1M Return: 1st - 30th Sep/24; 3M Return: 1st Jul'24 – 30th Sep/24; 6M Return: 1st Apr'24 – 30th Sep/24; 1Y Return: 1st Oct'23 – 30th Sep/24

\*BSE 500 TRI is the selected benchmark for the Ambit TenX Portfolio. The same is reported to SEBI.



Source: Ambit TenX Portfolio inception date is Dec 13, 2021;

\*BSE 500 TRI is the selected benchmark for the Ambit TenX Portfolio. The same is reported to SEBI.

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The performance data for coffee can product between 6th march 2017 - 19th June 2017 represents model portfolio returns. First client was onboarded on 20th June 2017. The performance data for G&C product between 1st June 2016 to 1st April 2018 also includes returns for funds managed for an advisory offshore client. Returns are calculated using TWRR method as prescribed under revised SEBI (Portfolio Managers) Regulations, 2020.

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