ASHVA Capital Management LLC

January 2023

Dear Limited Partner,

As I write this letter in early January 2023, we find ourselves in virtually the inverse scenario of what we were facing in 2022. At the beginning of 2022, I felt that the vast majority of stocks across global markets were overvalued. Following a rough year in the market, I can justifiably make the claim that virtually the entire market is trading at a significant discount to fair value. From the perspective of a value investor, the current environment is certainly an improvement over 2022. The S&P500 ended 2022 down (19.44%) the worst single year performance since 2008 when the market declined by (36.55%). Traditionally, fixed income securities have tended to outperform when equity markets are struggling. The iShares Core U.S. Aggregate Bond ETF which essentially tracks the performance of all investment grade bonds in the US declined by (15%) in 2022. Thus, there were very few places to hide for investors. It's a rare occurrence to see both the equity and bond markets decline in tandem. In general, bonds tend to outperform in volatile markets as investors flee from equities. However, both asset classes underperformed for different reasons. Equities largely underperformed due to the widespread belief that the US will enter a recession in 2023. The bond market sold-off due to the significant levels of inflation that we experienced during 2022. In general, I view equities as the primary asset class that will generate the majority of returns in a diversified portfolio. Bonds can be an effective hedge in down markets but aren't capable of producing positive real returns in an inflationary economy.

As Warren Buffett stated in his latest 2022 annual letter, "please note particularly that we own publicly-traded stocks based on our expectations about their long-term business performance, not because we view them as vehicles for adroit purchases and sales. That point is crucial: Charlie and I are not stock-pickers; we are business-pickers." Although the near-term outlook appears bleak, I fully believe that the US economy will grow over time and that US equities will eventually recover. At the end of the day, you invest with us because you are long-term investors. We don't trade in and out of markets based on current events or short-term noise. Our goal is to purchase high-quality companies with significant competitive advantages at reasonable valuation levels. Fortunately, our job has become easier following the poor performance of the market in 2022 as a number of high-quality stocks across sectors have declined significantly in price.

Is the Fed Making a Policy Mistake?

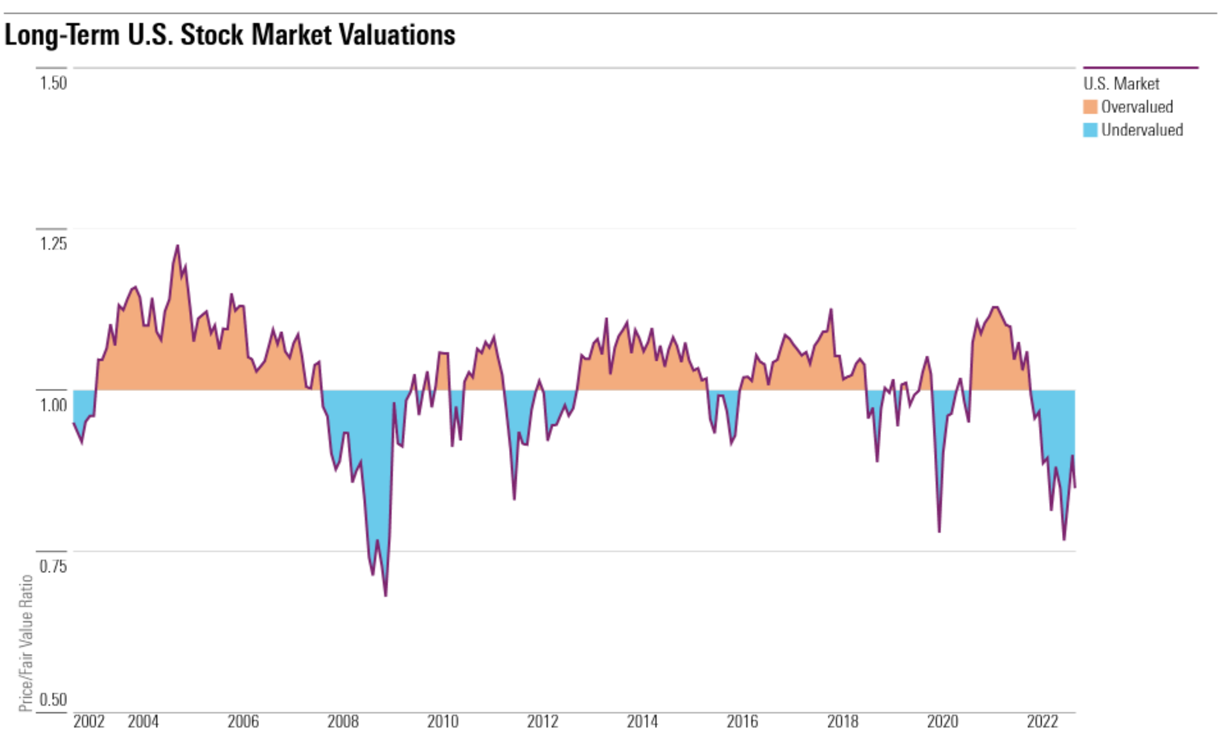
Most investors have been preoccupied with determining whether the Fed will tip the US economy into recession in their herculean effort to control inflation. Even if an investor could accurately assess whether the US goes into a recession in 2023, there is no guarantee that the market will continue to decline. The stock market tends to bottom 3-6 months ahead of the economy and to the extent that the Fed has manufactured a recession there is a significant likelihood that it will be a shallow one. The more important question to be asking as an investor is whether you are fully positioned to benefit from the inevitable recovery. The US equity market has never failed to go on to higher levels following any crash or correction. The scenario in 2008 was significantly scarier as the entire financial sector was in danger of imploding. In the current scenario, US banks are exceptionally well capitalized, and the job market remains strong. We are not facing another 2008 style financial crisis. The current market weakness will eventually end and most likely sooner than most investors believe. Based on the historical track record of the Fed, my base case assumption is that they will hike too far before realizing their mistake. Ultimately, nobody can consistently forecast the economy or time the market. As a result, the most reliable way to capture the full return of equities across the cycle is to simply ride out their frequent but temporary declines by staying invested.

Our Performance

In 2022 the S&P500 declined by (19.44%). In comparison the Ashva Capital LP fund declined by (20.94%) net of fees and (19.35%) on a gross basis. Our performance was in-line with the overall market. However, I want to emphasize that we have taken the opportunity to significantly upgrade our portfolio during the past year. I believe we have added companies that will grow revenue and profits at a rate faster than the overall index but also at significantly discounted valuations.

Thus, as the market recovers, I would expect our positions to outperform as the underlying fundamentals are strong and valuations return to more normalized levels. Essentially, stocks are trading at a meaningful discount to their fair value but likely won't rebound until we get some confirmation that the rate of inflation is headed materially lower.

The chart below from Morningstar Research, shows that the stock market has only been this cheap three times over the past twenty years: The pandemic crash of 2020, the Eurozone crisis in 2011 and the global financial crisis of 2008.



Source: Morningstar, Inc. Data as of December 19, 2022. Valuations based on average price/fair value ratios of the 847 U.S.-listed stocks covered by Morningstar analysts.

We've attempted to take advantage of this correction by fully investing all excess cash. As of January, 2023 our three biggest positions in the portfolio are Adobe (2.67%), British American Tobacco (2.57%) and Altria (2.61%). All three are undervalued relative to their forecasted earnings growth and offer an attractive risk/reward ratio at current levels. Additionally, both British American Tobacco and Altria currently offer an attractive dividend yield of 6.73% and 8.18%, respectively. It's extremely rare for the S&P500 to have two consecutive down years in a row. The last time it happened was during the dot-com bubble, where valuations were much more excessive on the upside. In my view, the market is already pricing in a moderate recession in 2023. It's likely that a new bull market will resume once we get confirmation that inflation is under control. I want to emphasize that we always base our investments on the individual growth outlook for each company. I'm confident that our current portfolio is set to outperform in 2023 regardless of the type of market environment we end up facing.

Sincerely,

Ankur Shah

Ankur Shah
Managing Member
Ashva Capital Management LLC

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