

**Disclaimer :- This was originally published on 5<sup>th</sup> April 2022 and is part of our Q4FY22 letter. Link to the letter [here](#)**

**Why do we not own commodities?**

Our goal is not to buy what could provide the highest returns in the short term but what we believe will provide sustainable, long-term compounding.

We do not own Commodity businesses (ex. iron ore, steel, aluminium, etc.) as they lack earnings predictability and, across a business cycle, tend to be low ROCE. Profits are strongly dependent on global demand/supply gaps. Hence, profits/cash flows can have significant swings with significant balance sheet impairment if expansion (needed for growth) coincides with a significant external adverse event.

In instances, Government interventions on issues like import duties, mine leases, etc. have had significant bearing on the economics of the business. Global supply is also very sensitive to political decisions in China. We don't see Commodities as long-term holdings in our compounding bucket.

We may own them as "Special Situations" under the following circumstances.

- Overcapacity and valuations provide the leader an opportunity for industry consolidation.
- Valuations reflect deep pessimism and companies trade below replacement value and when we are not finding enough opportunities in our core compounding bucket.

This is not the case at present.

Buying the current hot theme is seldom the optimal decision from a medium-term perspective.

The performance of the biggest beneficiary from Covid (Zoom) vs the NASDAQ is a good example.

