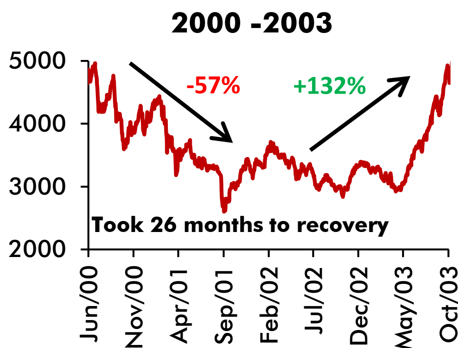
From The Fund Manager's desk…

2020 – A Roller-Coaster year!

Cricket fans would recall the recently concluded 3rd Test Match between India and Australia at Sydney. At the end of 4th day, victory was all but confirmed for Australia, only to be denied on the last day by a historical batting innings that lasted for more than100 overs which helped India draw the match. It was a game of patience and resilience which reminded us of Indian economy and market movement in 2020.

The year 2020 was marred by uncertainty and a Black Swan event where survivability, and not growth, was the key concern a few quarters back. A long *'innings'* of lockdown was followed by a gradual unlocking of the economy. The economic recovery since then is reminiscence of the partnership between Ashwin and Vihari in the last session of that 3rd Test Match. The leading Index is up ~90% from its 23rd March bottom, when the outlook was extremely pessimistic. While investors grapple with the question of what to do next, we look at some of the Green Shoots and ***why we believe that investors should remain invested***.

Exhibit 1: Post Dot com bust reversion



Source: Ambit GPC

Exhibit 2: Post GFC reversion

Source: Ambit GPC

Exhibit 3: Post-COVID reversion in longer term

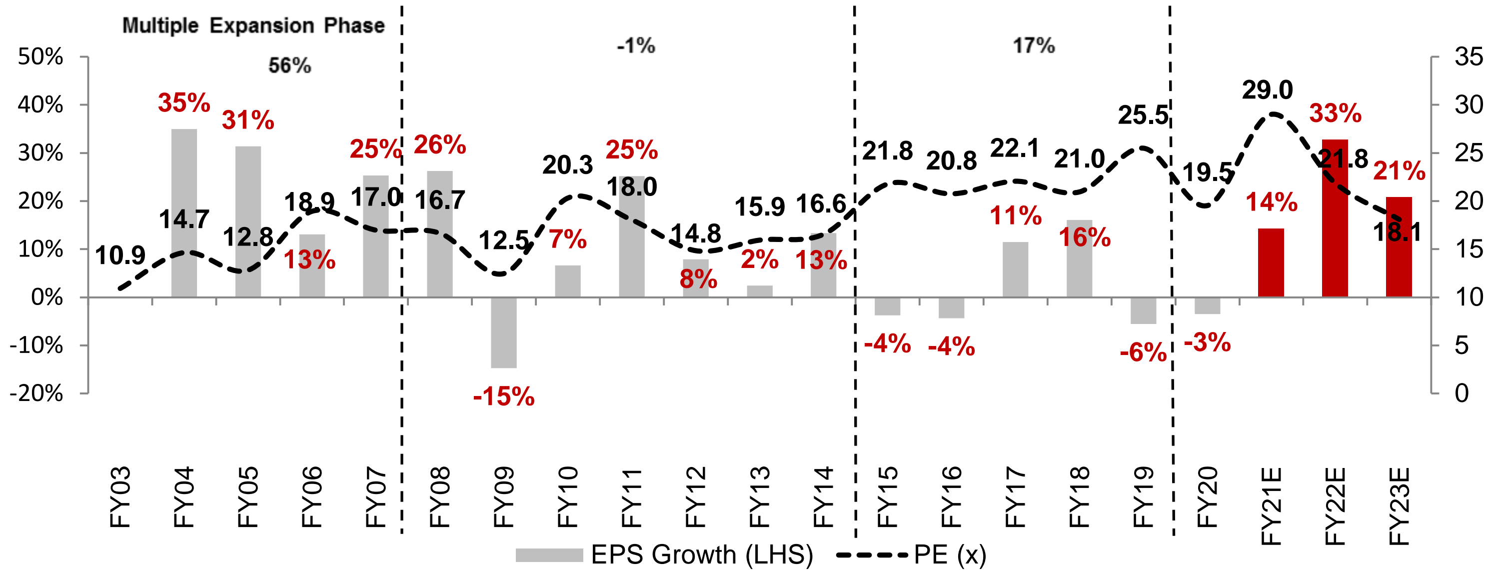
Source: Ambit Asset management

The Road Ahead – Why one should remain invested?

1. **A) Reasonable valuations –** There is an old saying that ***"returns should be assessed on an absolute basis while valuations on a relative basis."*** On an absolute basis the index is at an All-Time-High, but not on a relative valuation basis**.** The Nifty-50 valuation on Price to Earnings (PE) basis has gone through various phases of expansion / contraction since 2003, where earnings were a key catalyst. Going ahead, Nifty EPS is expected to grow on the back of macro-economic recovery and strong corporate earnings which might lead to multiple expansions as seen in the past ***(Ref to Exhibit: 4)***.

   B) Interest Rates – The Biggest Catalyst
   One could think of the ***role of interest rates in the economy as salt is to food - lower is better, higher is worrisome***! Interest rates have a bearing on PE multiples too. Reduction in inflation, and subsequently interest rates have led to declining yield on investments. ***Therefore, a 20x PE multiple in current scenario cannot be compared to a 20x PE multiple in, say, 2010 when interest rates were substantially higher.***

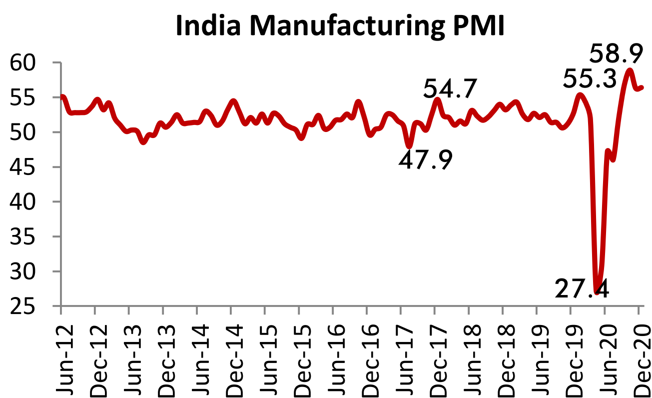
Exhibit 4: Nifty EPS and PE Multiple Change over the years



Source: Ambit Asset Management, Bloomberg

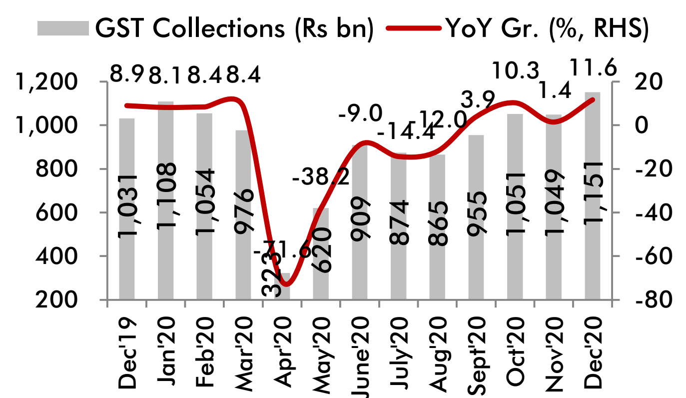
2. **Green Shoots of Economic Recovery:** Various economic indicators that we track closely are showing signs of recovery as the economy make its way back to normalcy.
   i. **Manufacturing PMI** is at decadal high and has remained above 50 (which indicates expansion) for 6 successive month ***(Ref to Exhibit: 5)***
   ii. **Labour availability** is back to 80-90% across projects post an exodus of labour migration.
   iii. **GST Collection** for Dec'20 grew 12.6% YoY to Rs1.15Lac Cr. A steady increase gives confidence on increased government spending, as it's a major source of funds for the government ***(Ref to Exhibit: 6)***.
   iv. **Auto:** Growth in wholesale auto numbers and increase in waiting period indicate towards a revival after nearly 2 years.
   v. **Government Spending:** Increase in overall government spending by +4.7% YoY in Nov'20 vs. +0.4% in Oct'20, led by increased capex spend (+12.8% YoY in Nov'20 vs. -1.9% in Oct'20) & revenue spending (+3.7% YoY vs. +0.7% YoY in Oct'20). This provides confidence on recovery in capex cycle which should bode well for Industrial earnings.

Exhibit 5: Manufacturing PMI is at a decadal high...



Source: Ambit Asset Management, Investing.com

Exhibit 6: ... GST Collection too is above Pre-COVID level

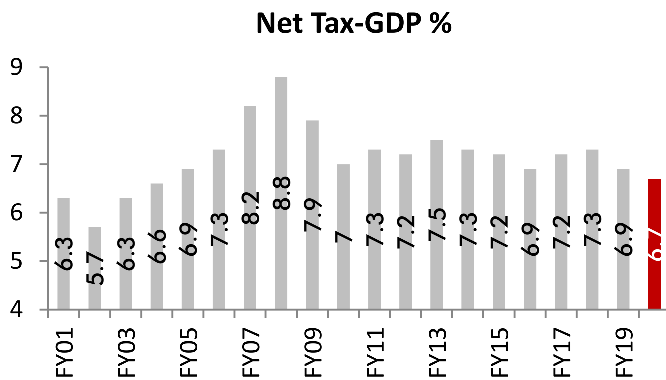


Source: Ambit Asset Management, gstcouncil.gov.in

3. **K-Shaped recovery** – The K-shaped recovery ***(Ref to Exhibit: 8)*** theory implies that Winners or Leaders in a particular sector will leverage their position and become bigger while other smaller players may continue to struggle. In our Fund Managers Desk note in July-20 we talked about this scenario playing out. Since then, we have seen signs of that and expect this trend to continue. Divergence between companies with winning traits and losing traits will become fairly evident going ahead.

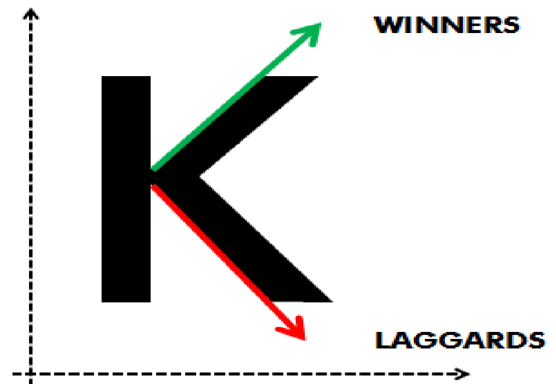
   Effect of reforms in last few years should start flowing now – We believe the effects of past reforms like GST and RERA will be evident now with a lag effect. GST, being a huge reform, has gone through a learning curve of its own. Moreover, recent reforms like Labour Bill and Agriculture Bill will further help formalize the economy and aid Unorganized-to-Organized shift.

Exhibit 7: Improvement in Net Tax to GDP should help reduce dependence on borrowings and reduce Fiscal Deficit



Source: Ambit Asset Management, Research reports

Exhibit 8: We see the overall recovery to be more K shaped above all

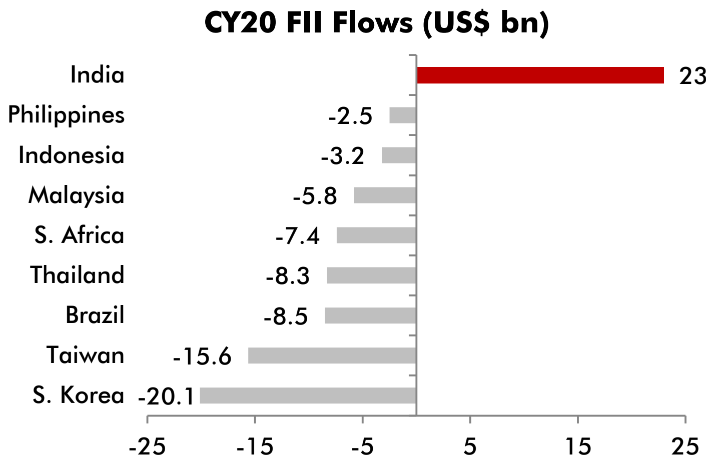


Source: Ambit Asset Management

4. **India as a preferred investment destination for foreign investments –** High COVID Relief packages and increased infrastructure spending across major economies have led to twin deficits (Fiscal & Trade). This coupled with falling Dollar Index has put Emerging Economies (EM) in a sweet spot. The points we highlighted above have helped India become a preferred investment destination among other EMs. India has seen massive foreign fund flows in the last few months – highest among other major Emerging Markets ***(Ref to Exhibit: 9)***.

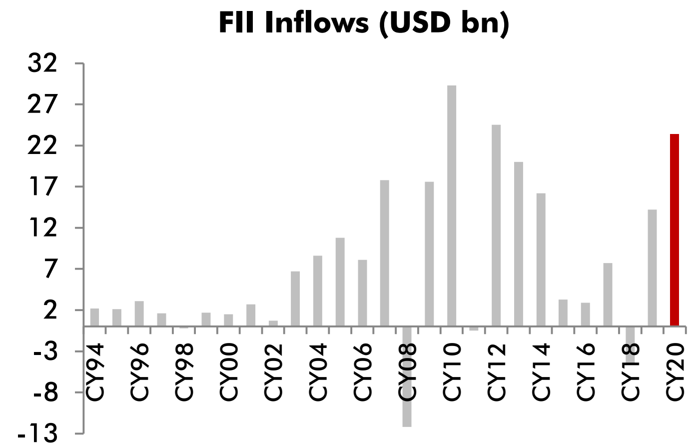
   China, one of the most favourable investment destination so far, is grappling with bad-press and negative investor perception post COVID. The recent news reports of China planning to nationalize Alibaba and Ant group have added to investors' anxiety. EM focused funds will look for a safe and stable destination to park their funds of which India could be a major beneficiary.

Exhibit 9: India a key beneficiary of FII EM fund flows



Source: Ambit Asset Management, Research Reports

Exhibit 10: ~70% of the CY20 flows took place in Nov, Dec

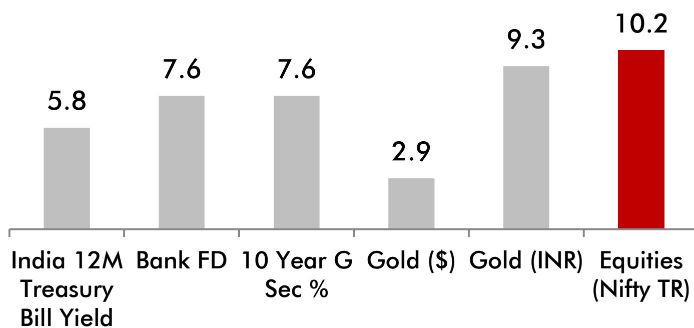


Source: Ambit Asset Management, MOSL

5. **Limited avenues to invest for Indian Households –** Retail participation in the Equity Market has been increasing and is at a decadal high ***(Ref to Exhibit: 12)***. Historically, Indian retail Investors have stayed away from equity markets, choosing to rather invest in Gold, Real Estate and Fixed Income Instruments. While accessibility in the pre-internet era was an issue, the stock markets have also suffered due to its negative perception. Earlier it was often viewed as a form of Gambling rather than owning a business.

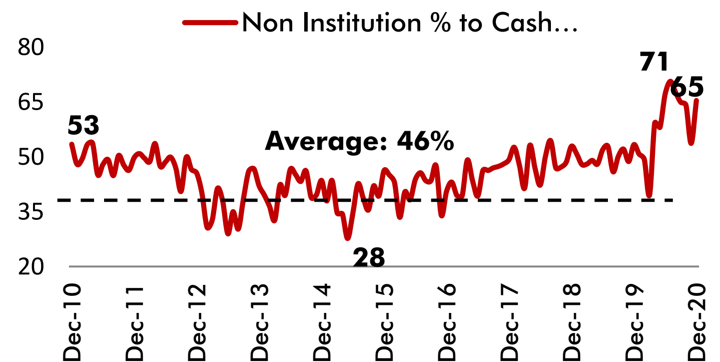
   Discount brokerages and easy data availability have helped close the accessibility gap in the last few years. On the other hand, declining returns on traditional investment instruments – especially Fixed Deposits and Real Estate, have acted as a nudge for retail investors to look for alternative avenues of investments. As a result, retail participation in equity markets is at a decadal high and is expected to further increase as Indian households become more aware.

Exhibit 11: CY10-20 returns for various asset classes (%, CAGR)



Source: Ambit Asset Management, MOSL

Exhibit 12: Increasing % share of Non-Institutional volumes implying high retail participation



Source: Ambit Asset Management, MOSL

What could play spoil the party?

While the above stated points give us confidence, we highlight some of the risks which we feel could drag the overall recovery

1. **Threat from a new disease –** Threat from a new disease like Bird Flu which could escalate to a pandemic situation, or mutation of the COVID virus into a new variant that may render the vaccines ineffective.
2. **Vaccine availability and effectiveness –** Any challenges with regards to vaccine distribution that may substantially delay the vaccination drive. Moreover, any adverse effects to the vaccines in the longer run could delay the vaccination programme.
3. **Partial Lockdown or restriction in store operations –** Any increased restriction in opening of public places or store operations may prove to be a drag and further delay the recovery.
4. **Upside risk to Inflation and interest rates** – Continued high inflation above the upper range set by RBI which may lead to higher interest rates. This will be negative for the economy.
5. **Global liquidity tightening** – Liquidity tightening by Global Central banks could lead to rise in interest rates impacting markets negatively.

Conclusion…

According to an analysis conducted by Fidelity on US S&P 500 Index from 1980-2020, missing the 5 best days of market movement in those 40 years would have reduced overall returns by 35% while missing 10 best days would have more than halve the long term returns ***(Ref to Exhibit: 13)***. As a result, we would like to re-iterate our philosophy **of Time-In-The-Market rather than Timing the Market.** We believe that Top-Quality businesses will continue to outperform over the longer-run and subsequently generate huge investor returns.

Exhibit 13: ~0.5% of the days accounted for >90% of the overall gains in the last 4 decades

Source: Ambit Asset Management, Fidelity

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