

Investment Outlook 2022

EQUITIES



Investment Outlook 2022

Equities

The Rear View

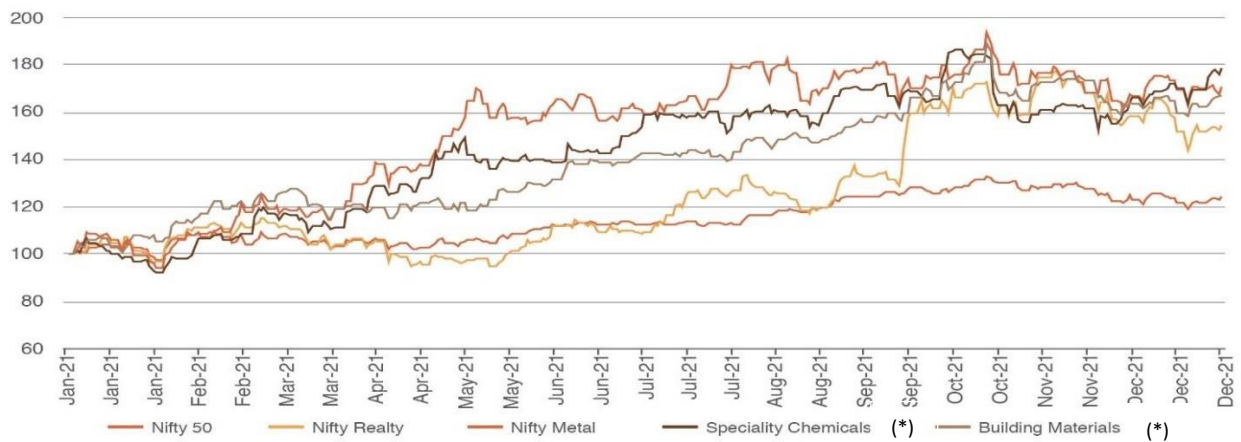
Every new year brings with it unexpected twists in the financial markets. Even as delta scarred us and omicron scared us, 2021 saw a slew of records.

- Stimulus and vaccines catapulted equity markets to record highs. Global market cap doubled from March 2020 bottom, adding roughly \$40 trillion. Of this nearly \$13 trillion was added in 2021 alone.
- The year also marked a record amount of capital raise – over USD 1 trillion in the US via initial public offering as well as the highest ever in a year in India at over INR 1,18,000 crores.
- US Inflation ramping to its highest since the 1980s, as the pandemic disrupted the global supply chain which made it difficult to meet the demand for everything from microchips to potato chips (record high commodity prices).
- Despite the Chinese crackdown, the crypto market also set records in 2021, with the total value of cryptocurrencies touching \$3 trillion in November of 2021. Bitcoin remained the most valuable of all, dominating > 40% of total market capitalization.
- High yield bonds (Junk bonds) hit a record \$432 billion in 2021 as interest rates in developing markets remained near-zero levels.

Indian equity markets were one of the best-performing markets in 2021 with Nifty 50, Nifty Midcap 100 and Nifty Small cap100 gaining by 24%, 44% and 57% respectively.

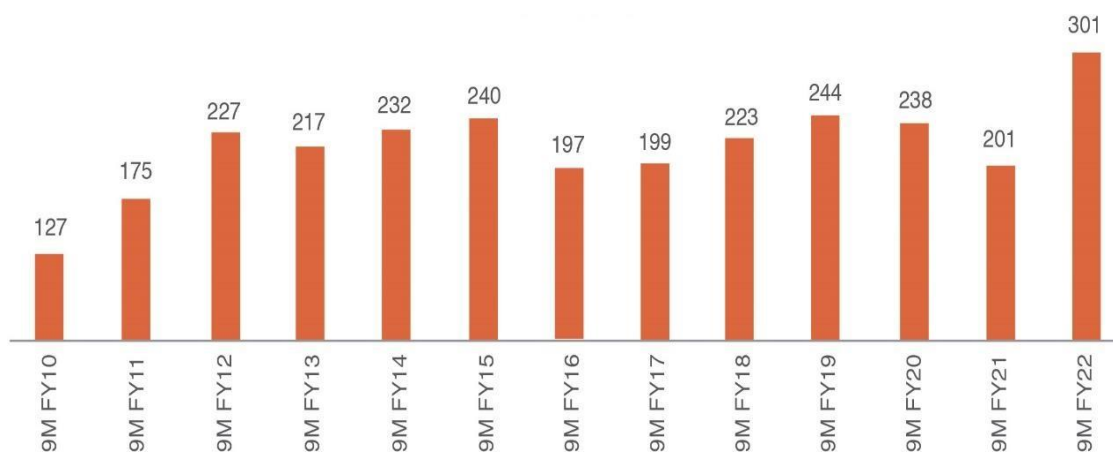
At the beginning of 2021, we anticipated a broader market recovery in India, as several sectors were seeing earnings upgrades. We had identified three broad themes which would play out over the next few years - Housing, Manufacturing, and exports as well as a rise in corporate profitability. Within these broad themes, we stated preference for sectors like Housing financiers, Materials (Building materials, Cements & Metals), Industrials and sectors to benefit both from domestic and exports opportunities like Specialty chemicals and Auto ancillaries. As we look in the rear-view mirror, the above sectors were some of the best performing sectors of 2021 except for Financials. Another year of higher provisioning held back the stock market performance of financials. We continue to be constructive on financials and we cover our thoughts in greater detail later in this note.

Sectoral Price performance



Source: Bloomberg, Sanctum Wealth

India's exports rose to \$301bn in 9M FY22 (highest ever in the first nine months of any financial year)



Source: MOC, Spark Capital Research

Our top-down view on these sectors combined with superior stock selections substantially contributed to the performance of Sanctum Indian Titans our flagship multi-cap strategy. We also tactically invested in companies that were expected to benefit from the India re-opening theme which added further alpha to the portfolio. We ended the year with Sanctum Indian Titans delivering a sharp 600 bps outperformance over the benchmark.

During the year our notable contributors to Sanctum Indian Titans are as follows:

Indian Titans	1 Year	Theme
Minda Industries Ltd	206.7%	Manufacturing, Exports, PLI
IRCTC Ltd	162.9%	Opening up theme
KEI Industries Ltd	145.0%	Manufacturing, Exports
Polycab India Ltd	103.6%	Housing
Schaeffler India Ltd	93.6%	Manufacturing
Astral Ltd	70.6%	Housing, Manufacturing
Nocil Ltd	62.0%	Manufacturing, Exports
Vinati Organics Ltd	64.6%	Exports, Make in India
Aarti Industries Ltd	62.7%	Exports, Make in India

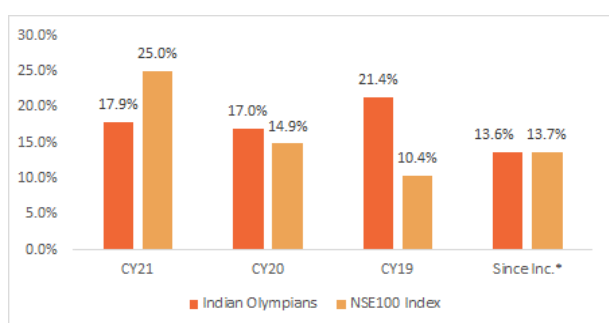
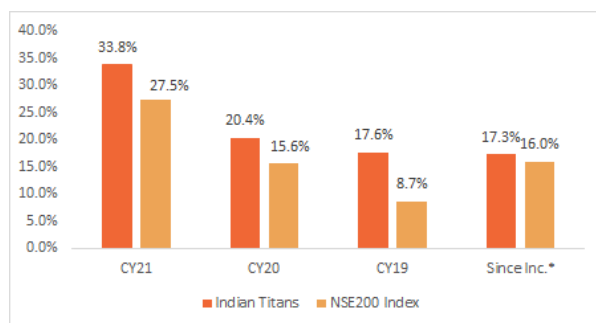
Our large-cap strategy Sanctum Indian Olympians continues to focus on high quality, moated companies with strong return ratios, that generate high free cash. The businesses we own in the portfolio have grown faster than the industry and gained market share. This is owing to their operating efficiencies and balance sheet strength that enabled them to navigate the supply chain disruptions and liquidity challenges even as the smaller, weaker competitors struggled.

The price performance of some of our key holdings reflects the confidence in the business:

Indian Olympians	1 Year	Theme
Titan Co Ltd	61.0%	Opening up & Formalization
Infosys Ltd	50.3%	Exports
Larsen & Toubro Ltd	47.2%	Capex & Exports (IT)
Pidilite Industries Ltd	39.5%	Housing
ICICI Bank Ltd	38.3%	Market share gain
PI Industries Ltd	35.4%	Exports

The strategy has consistently delivered on its mandate of investing in high-quality companies and by extension excluding cyclicals. However, in CY 2021 cyclicals witnessed a strong resurgence. Excluding the 6.7% return attributable to these sectors, the strategy has delivered an in-line performance relative to the benchmark.

Performance of in-house strategies



Peek into 2022

The emergency responses to covid exacerbated imbalances around the world and we are facing intended and unintended consequences of the same. Central bankers' steps to unwind some of these such as normalizing liquidity and rates are expected to have a huge consequence on the equity markets. The tango of rising rates and moderating liquidity and inflation could create volatility this year. Hence, after a stupendous return in 2021, **investors should expect normalized equity returns in 2022 and brace for volatility in the initial part of the year.**

This scenario begs the question, should we pare our equity exposure?

We believe periodic rebalancing is always healthy. But to go underweight on an asset class it is important to consider fundamentals. Multiple, multi-year growth drivers are now firing together, and India is now at an inflexion point where trend growth is likely to be much higher

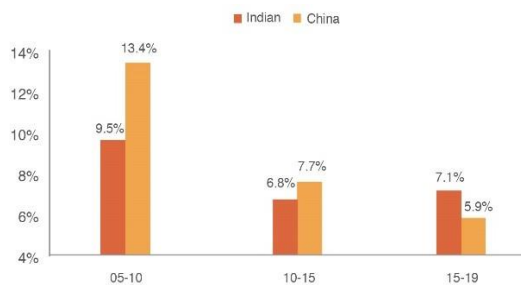
than that of the last decade. Higher corporate headline growth, lower leverage (corporate and households), improving incomes and increase in the pro-consumerism propensity of youth, wealth effect – all point towards a long-term wealth creation opportunity. Therefore, our view is that the nearer term pain can be used as an opportunity to build further exposure to equities to benefit from the longer-term cycle.

The structural upshift

The Indian economy has gone through a decade of cleansing and reforms. The reforms were initially disruptive, and we saw corporate profitability sink from 6% to <2% of GDP. We are at the beginning of a new upcycle post deleveraging and covid cost controls leading to stronger corporate balance sheets. Corporate profitability is now back at 4% of GDP. We believe the growth will be structurally higher than what we have witnessed in the past decade and the below-mentioned themes are expected to play out in a big way:

- 1) Manufacturing & Infra Capex Cycle** – India was one of the few major economies to see an acceleration in its manufacturing growth in the five years just prior to the pandemic, while the rest of the world slowed. Notably, India's manufacturing GVA grew faster than China's in that period, after a long time. In 2021 India's manufactured goods exports grew 39% faster than global growth in trade at 23%.

India vs China growth in manufacturing GVA (% CAGR)



Source: UNSTATS, Axis Capital

Estimated GDP impact from the PLI Schemes



Source: Mirae Asset Management

A confluence of factors such as China plus one strategy by global manufacturers, policy support under an effective Production Linked Incentive scheme and Atma Nirbhar Bharat are already creating long term tailwinds for the sectors. Interestingly, despite India's share of merchandise exports now at an all-time high, our global market share is less than 4%.

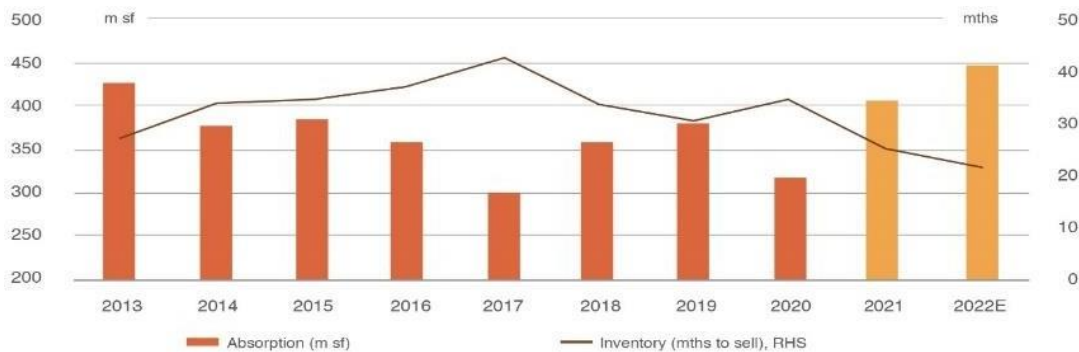
We are already witnessing an acceleration in traditional infrastructure build-out. Further, a gradual but definite change in our approach to energy is also creating capex opportunities. As a result of policy commitment towards de-carbonization, more than 50% of the expected capex of the decade (~ INR 23 lakh crores) will likely be towards renewable and clean energy.

While the capex opportunity linked to the transition to clean energy could drive earnings growth for industrial companies, other sectors might also benefit in terms of lower power costs and savings in logistics costs.

Housing cycle – A revival in the housing cycle has multiple positives including job creation and wealth effect. Housing cycles also typically tend to be longer i.e 6 -8 years. After an eight-year long downturn, the sector started showing signs of revival in 2021. A combination of time correction of prices, lower inventory, wage growth and lower interest rates has sparked buying

interest. The prolonged downturn and the NBFC clean-up of 2018-2020 have driven out the weaker players and the sector has now consolidated into the hands of stronger ones. This further helps consumer confidence.

Residential sales and Inventory in Top-7 cities



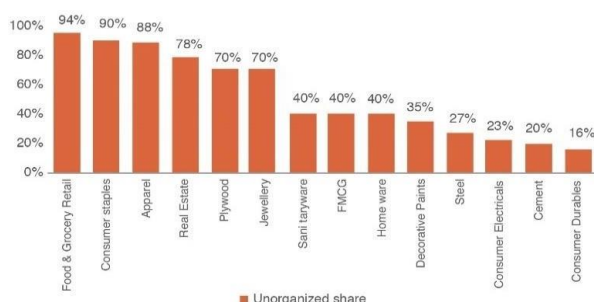
2) Formalisation

The theme got spotlighted after the implementation of the GST regime in India in 2017. Players who were earlier offering price advantage by staying out of the tax net and putting tax compliant players at a disadvantage had been forced to a level playing field with the introduction of GST. This accelerated formalisation of the economy. And yet unorganized players still have a significant (40-50%) market share in several sectors indicating that the formalisation theme will continue playing out for the next few years.

Digitalization and Financialization are the other two key drivers of the formalisation of the economy. Indiastack, an open-access digital infrastructure platform is at the core of this wave. The government and businesses are tapping into this platform to change the way India transacts. A nearly 4x rise in digital payments vs pre-covid levels is an example. Digital lending platforms, investment platforms are creating access for people in smaller parts of the country.

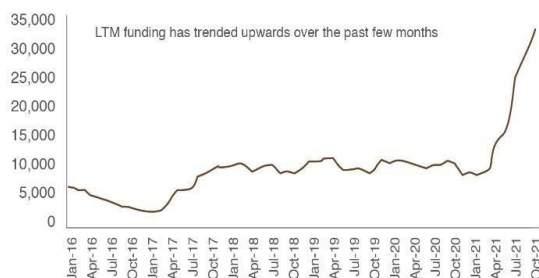
India's startup ecosystem has leapfrogged in the last 2 years with a 3x jump in the number of unicorns compared to the previous five years led by improved and affordable internet access, smartphone penetration, etc. According to estimates Internet funding now stands at 1% of the GDP. All these investments are going to be spent in the Indian economy and will lead to a heightened formalisation trend in India.

Sectors with Unorganised share



Source: BofA Global Research

Internet funding now at 1% of GDP



Source: Economic Times, Inc42.com, VC Circle, Entarckr, Crunchbase, Yourstory, CEIC, Morgan Stanley Research.

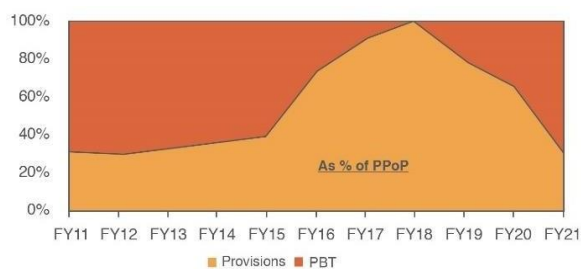
We will continue to build our core portfolios around these themes in 2022.

Financials

Earlier in this note, we had mentioned that we continue to be constructive on Financials. We believe a resurgence in the sector is impending.

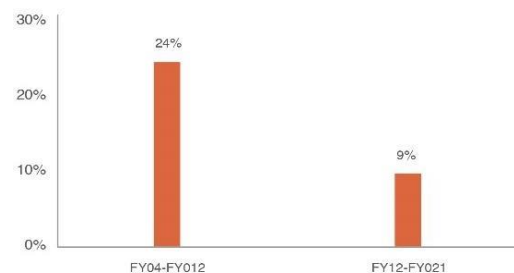
- Larger players have consolidated their position in the downturn, are well capitalised for growth and are flush with liquidity.
- Credit growth has bottomed out and is seeing sequential growth at +7% from 5-6%. With the potential of a multiyear capex and housing cycle picking up, we see potential credit growth to inch up in double digits over the next one year unlike in the last decade.
- The profitability of banks has been hampered due to excessive provisions done towards asset quality which is now reversing
- Rising interest rates typically help banks as assets get repriced faster than the liability book and this helps in increasing net interest margins.

Rise in provisions had driven the pressure on EPS



Source: Credit Suisse estimates

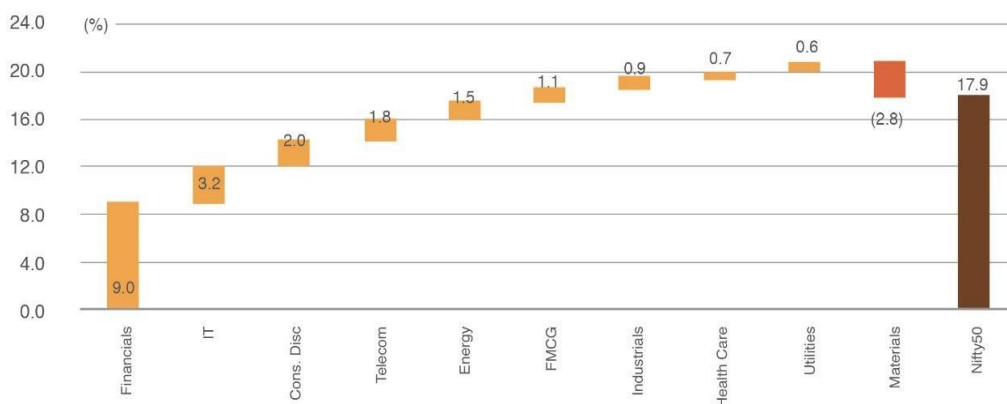
Credit Growth Cycle



Source: Credit Suisse estimates

Financials are the largest sectoral component of the broad market indices. Higher earnings growth of financials for reasons given above could drive the Nifty EPS growth for FY23 up by 18%. Other than financials, Autos are likely to see topline and margin expansion as supply chain issues ease in the year ahead. Digitalization trends will continue to support IT growth this year as well.

Contribution to Nifty earnings growth in FY23



Source: Jefferies

Valuations:

India has emerged as one of the best-performing markets in 2021 and India's weight is at an all-time high in MSCI EM.

After the rally, we had in 2021, it is natural to wonder whether valuations are frothy. While headline valuation looks rich at 20.9x P/E in FY23e which is higher than the 10-year average P/E of 19.2x, they must be seen in the context of depressed long-term earnings.



Source: Credit Suisse estimates

But there is always danger in generalising. There is undoubtedly froth in pockets of the markets. We do not believe in buying quality at any price, just like at the peak of 2018 we did not believe in growth at any price. While we are very constructive on the Indian equity story over the longer term, we are undoubtedly expecting headwinds in the near term. On an absolute basis, P/E can remain high, but equity risk premium domestically has room to fall led by tightening global liquidity impacting foreign flows in emerging markets, input cost pressures leading to earnings cut, and an adverse result in key local state elections. These are factors that could pose volatility in the near term after a strong trailing outperformance.

We expect to centre our portfolios on the core focus themes, financials, domestic cyclicals rather than global cyclicals and urban discretionary consumption-based companies. We will continue to carefully evaluate risk-return trade-offs while constructing portfolios, especially in light of the volatility we expect in the first half.

In 2021, thriving businesses and stock markets took some of the edge off of the frustrations that the pandemic created, in 2022 we hope relief from the pandemic and the promise of a rising India takes the edge off of the equity market uncertainty!!

Sanctum Wealth

Investment & Advisory

Roopali Prabhu**Chief Investment officer**roopali.prabhu@sanctumwealth.com**Hemang Kapasi****Head of Equities**hemang.kapasi@sanctumwealth.com**Rajiv Mehra****Assistant Fund Manager**rajiv.mehra@sanctumwealth.com**Salvin Shah****Investment Analyst, Investment Office**salvin.shah@sanctumwealth.com**Harsh Shah****Investment Analyst, Investment Office**harsh.shah@sanctumwealth.com

Disclaimer

Different types of investments involve varying degrees of risk, and past performance is not indicative of future results. Do not assume that future performance of any specific investment or investment strategy (including the investments and/or investment strategies recommended or undertaken by us) will be profitable. Results may vary over time and from client to client. Any projections or other information illustrated in this presentation which may have been provided to you regarding the likelihood of various investment outcomes are hypothetical in nature, and do not necessarily reflect actual investment results nor should they be considered guarantees of future results. Historical performance results for investment indices and/or categories have been provided for comparison purposes and index returns may vary substantially from past performance in the future. Other investments not considered in the analysis and the recommendations resulting from this analysis may have characteristics similar or superior to those being analyzed. Please remember to contact Sanctum Wealth if there are any changes in your financial situation or investment objectives or if you wish to impose, add or modify any reasonable restrictions to our services. The performance related information provided herein is not verified by SEBI