



June 10, 2019

Investment Strategy

Glass Remains Half Full

*"I don't know where the stock market is going, but I will say this, that if it continues higher, this will do more to stimulate the economy than anything we've been talking about today"—
Alan Greenspan*

Bullard and Powell Signal Fed Ready to Act and Rate Cuts Ahead

We've made the case for months that the U.S. Fed would be forced to climb down from hawkish monetary policy, and the U.S. trade war presented the perfect foil for it to do so without loss of face.

Said scenario has come to pass. Fed Chairman Jay Powell was quoted last week stating the Fed was ready to act if trade wars hit the economy: "We are closely monitoring the implications of these developments for the U.S. economic outlook and, as always, we will act as appropriate to sustain the expansion."

The Fed's central mouthpiece for monetary policy, St. Louis Fed President James Bullard, stated that "A downward policy rate adjustment may be warranted soon to help re-center inflation and inflation expectations at target and also to provide some insurance in case of a sharper-than-expected slowdown."

Four Rate Cuts and a Favorable Market Environment

Futures markets are now reflecting 95 bps of expected easing during 2019-20, with 2 rate cuts in 2019, and 4 rate cuts by the end of 2020. That's good news for investors, as the S&P 500 has typically generated strong returns at the beginning of Fed cutting cycles.

U.S. Leading Economic Indicators Have Turned Lower... But Markets Are Already Looking Ahead to 4 Fed Rate Cuts



Source: Bloomberg, Sanctum Wealth

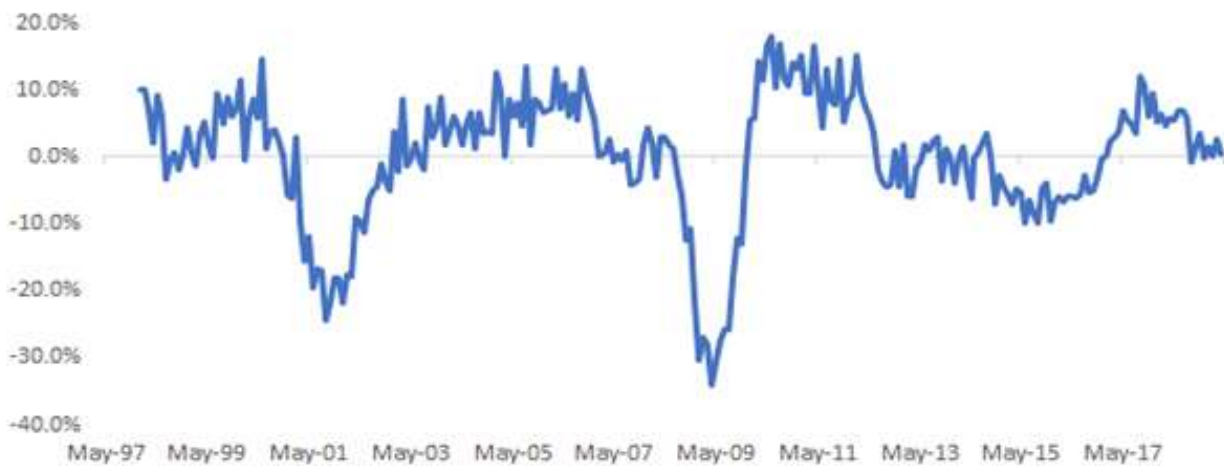
South Korean Exports – a Proxy for Technology Trade – Have Plummeted...



But U.S. Industrial Production - and PMIs - Remains in Decelerating Growth Mode...



And U.S. New Orders for Non Defense Capital Goods Are Holding Up as Well



Source: Bloomberg, Sanctum Wealth

Central Bank Climb-down in Europe as Well

ECB's Mario Draghi revised down growth and inflation expectations, acknowledge the rate hike expected last December was off the table, and re-opened the door to a possible rate cut. Further, more QE is looking likely.

Trump launching Mexican, Indian trade war; US labor market cracking; US GDP slowing; German manufacturing collapsing; S. Korean export drop needs a bigger chart; Global PMIs plunging; bond yields crashing...

Domestic

Macro Conditions Are Improving for Equities

The domestic financial media are having a field day writing about slowing economy growth. We think, and we're likely not in the consensus, that it's premature to talk about a significant slowdown in the domestic economy due to a few key reasons.

First, the recent quarter's activity was greatly affected by the uncertainty around elections. The election outcome was fairly uncertain, and along with uncertainty came fear

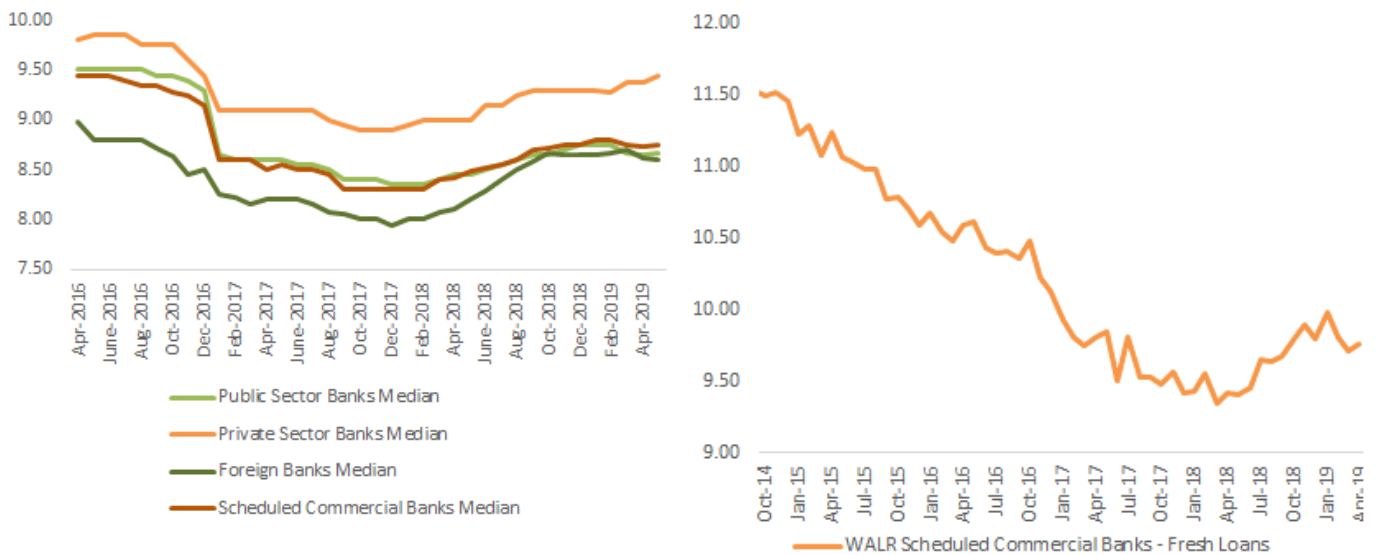
mongerers, leading businesses and consumers to pull back on investment and spending decisions.

Second, crude oil prices were rising into the mid \$70s on Brent, and have since dropped to below \$65, allowing the government some respite in terms of budgeted spending for oil, and hopefully the ability to pass some of that savings on to consumers.

Transmission and Credit Availability

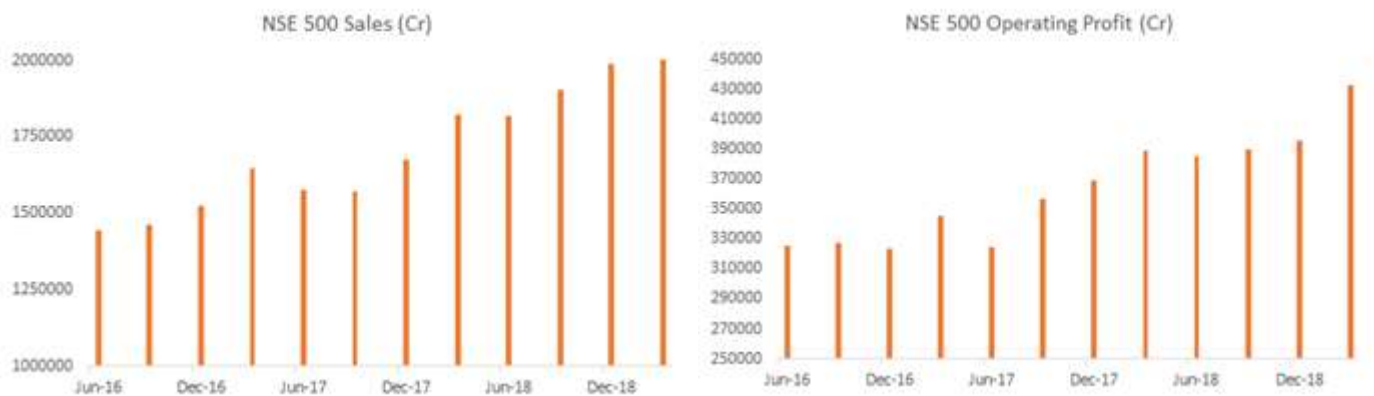
Third, interest rates have dropped meaningfully. Granted, this means little if bankers are unable or unwilling to pass on benefits. **Transmission is critical, and it's time the RBI look at solutions to unlock the transmission of cheaper capital to businesses and consumers that aren't driven by entrenched banking channels.**

Median MCLR and WALR for Fresh Loans Continue to Trend Steady to Higher

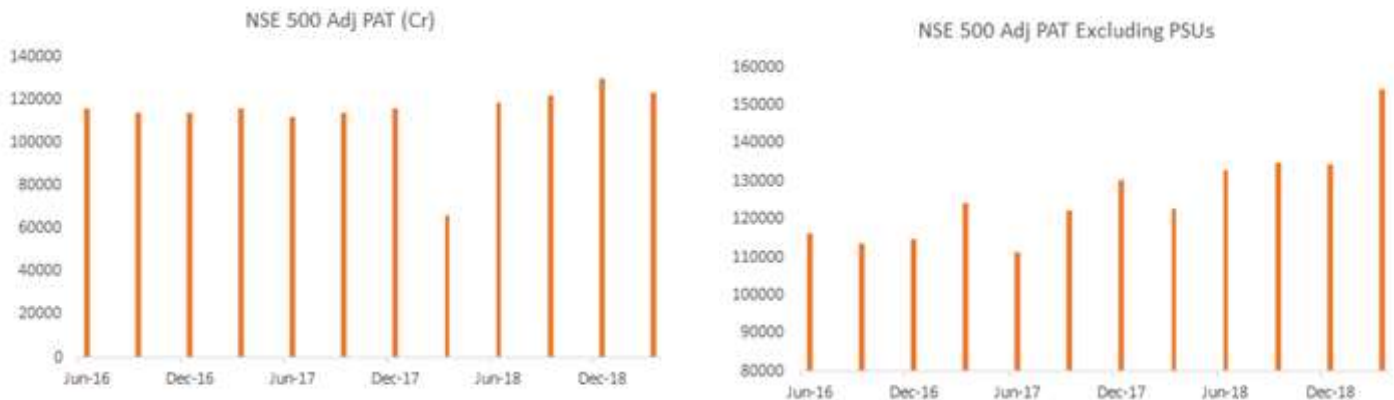


Source: RBI, Sanctum Wealth

NSE 500 Sales and Operating Profits Have Grown Consistently Over the Past Three Years...



While CNX 500 Profits (Left Chart) Have Been Flat,
CNX 500 Ex PSUs Profits Have Grown Handsomely...



Earnings To Date Ex PSUs Paint a Fairly Robust Picture...
...But are Skewed by Windfall Profits for Certain Companies

	Sales YoY		Operating Profit YOY		Net Profit YOY		Operating Margin		Net Margin	
	NIFTY50	NIFTY500	NIFTY50	NIFTY500	NIFTY50	NIFTY500	NIFTY50	NIFTY500	NIFTY50	NIFTY500
Consumer Discretionary	-1.3%	2.6%	-14.8%	-9.3%	-20.0%	-13.9%	12.9%	13.0%	5.4%	5.6%
Consumer Staples	10.9%	11.7%	13.8%	16.0%	16.8%	31.0%	33.5%	20.7%	21.9%	13.9%
Energy	11.6%	10.2%	23.8%	24.5%	18.9%	20.9%	14.4%	13.1%	6.7%	6.2%
Financials	11.3%	11.1%	8.9%	12.6%	146.8%	37.9%	38.7%	48.8%	9.0%	13.0%
Health Care	10.3%	13.2%	2.0%	13.0%	-22.0%	-40.7%	21.6%	23.1%	9.7%	10.4%
Industrials	9.5%	13.1%	13.0%	11.3%	16.6%	11.5%	22.2%	17.3%	9.9%	8.1%
Information Technology	16.8%	15.6%	14.6%	14.7%	15.9%	15.8%	26.8%	23.5%	18.5%	16.0%
Materials	11.1%	11.0%	3.7%	3.7%	42.0%	12.1%	21.6%	20.5%	7.1%	7.7%
Real Estate	NA	18.2%	NA	-29.0%	NA	-51.4%	NA	28.6%	NA	12.0%
Communication Services	6.6%	23.5%	-6.1%	-0.1%	NA	NA	35.3%	27.5%	-4.1%	-23.6%
Utilities	6.2%	11.9%	9.8%	13.9%	129.6%	114.1%	33.9%	32.7%	29.0%	20.7%
Index	9.7%	10.6%	9.6%	10.4%	30.2%	25.6%	22.0%	21.2%	9.2%	8.3%

Source: Ace Equity, Sanctum Wealth

Finally, the market has taken recent news on select company specific defaults or possible defaults in stride. The RBI's decision to support systemic liquidity, while not supporting moral hazard and solvency, is the correct decision for the longer term strength of the financial system.

Key Drivers for Equities

The main drivers for equity remain interest rates and corporate earnings. To date, the trade war has put downward pressure on global interest rates, and the RBI has helped moved domestic interest rates lower. Central banks are dovish in the advanced economy and India.

With respect to earnings, the charts above demonstrate that the broader market has grown top line sales and operating profits consistently over the past 12 quarters. NSE 500 profits after tax have been stagnant; however, NSE 500 profits ex PSUs are also demonstrating a strong upward trend.

The Road Runner Market

The Nifty 50 has consistently displayed a propensity to race ahead of fundamentals since P.M. Modi's victory in 2014. In Feb 2014, the market raced ahead and investors were caught

napping, and forced to invest at higher prices. The market displayed the same character in 2017 and now in 2019.

The market today sports high valuations, yet investors are more focused on declining interest rates, declining crude and the prospects for growth in a world increasingly deprived of growth. In Modi 1.0, investors were handsomely rewarded for staying invested in equities, despite high valuations. Modi 2.0 looks to be a similar scenario.

Fixed Income

We've been of the view for the past few weeks that interest rates were likely headed lower and adding duration to portfolios made sense. Much of that move in the short term has come to pass. The global backdrop now includes an ECB and Fed that are looking at rate cuts. Domestically, the budget will be the next event with rate implications.

In all likelihood, we expect the government to adhere to the fiscal glide path. Two factors loom in the government's favor in regards to setting a budget in light of collection shortfalls: one, the decline in crude oil prices, and two, the Jalan committee report on excess RBI reserves that can be made available to the government.

High quality corporate credit remains the favored choice to play the current macro environment. We would continue to avoid low quality credit. With the 10 year, the duration play becomes the primary driver to g-sec returns and that's a less appealing opportunity today with the yield at 6.97% than it was at 7.45%.

Technical Strategy

Last week started a positive note to hit new all-time of 12,103, but profit booking in later part of the week saw the Nifty closing off its peak. The Nifty ended at 11,871 down by 0.44% for the week and up by 0.23% for the day on Friday. Broader market indices underperformed the benchmark with BSE Midcap and Smallcap losing 1.3% and 1.4% respectively for the week. For the week Nifty has formed spinning top candlestick at the top indicating indecisiveness in the market. On the daily time frame too, index has formed indecisive pattern Doji, but with long lower shadow which means buying coming at lower levels. Thus, holding above Friday's low of 11,769 market can see bounce back towards 12,000-12,100 which is the overhead resistance zone for the market. On the downside breaking below 11,769 level expect profit booking in the market towards 11,591 levels where rising gap support is seen. In Nifty options maximum open interest (OI) for Put is seen at strike price 11,000 followed by 11,500; but significant amount of OI is seen in 11,800 and 11,700 indicating as support zone for the market. In Call options maximum, OI build up is seen at 12,500 followed by 12,000 indicating as 12,000 as immediate hurdle for the market. India VIX closed at 14.86 down by 7.6% for the week. Over the last couple of weeks VIX has seen steady decline and reached pre-election levels. It is likely to stabilize at current level and sharp rise from current levels would see profit in the market.

Nifty Weekly Chart



Source: Falcon7

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