



Sanctum view

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Investment Strategy

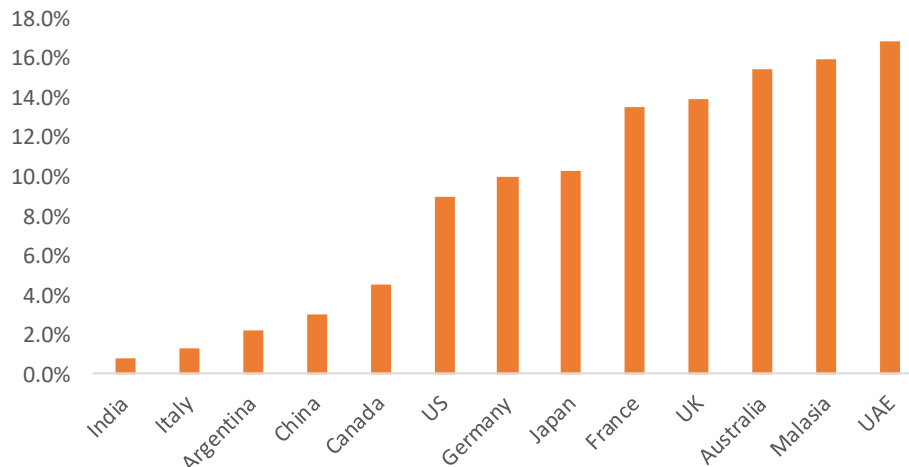
Muddling Through COVID-19 crisis

Nobel Laureate Esther Duflo a couple of days ago said that uncertainties are giving rise to uncertainties. That statement best sums up the economic environment we are in currently. Is Covid19 one quarter or a one year problem? Will we have an extended lockdown or is the end in sight? Or is a shut-start-shut the most effective way of flattening the curve? Different answers will have materially different outcomes.

Conversations around us have moved away from stock market woes and survival is now the dominant theme. Navigating through cancelled work orders, paycuts, lay-offs, demand destruction post lockdown are issues most are grappling with. The grim picture painted by the cumulative number of 1 crore unemployment claims filed in the US in just the past fortnight is telling. India doesn't have a similar indicator but a picture of migrant laborers queueing up to leave towns is an indicator that our numbers are likely to be grim too. The global economy will be in a recession and the consensus opinion is veering towards it being worse than 2008.

This is despite Central bankers pitching in aggressively with all kinds of stimulus. In 2008, the Fed and the ECB were criticized for their handling of the crisis and this time they seem to have upfronted the use of most of their ammunition by announcing large monetary stimulus.

Size of Fiscal Stimulus as a % of GDP



Source: IMF, The Economist, Sanctum Wealth Management

39 central banks around the world including the RBI have announced rate cuts. Along with the rate cut, RBI infused huge amounts of liquidity. We are now awaiting the fiscal package the FM had promised, a few days ago. We are firmly in the 'Go Keynesian' camp i.e. we think the government should pause on the path of fiscal prudence and unveil a large stimulus to revive the economy. Retreat from the battle to win the war.

The world after Covid19

At Sanctum, we are currently pursuing two threads of analysis: (a) What are the structural changes that this situation will bring about and (b) the second order impact of this situation. The answers will evolve as the uncertainties fade but both these may have a significant impact on investing in years to come. For example, could deglobalization be one of the themes as nations reshape supply chains, focus on job creation and by extension demand creation. The second question is of more immediate nature, as active equity investing requires one to be more discerning of that impact while buying companies in the portfolio. In that vein, we think the government spend may shift from its capex orientation to consumption orientation for the next few quarters.

After the onset of the covid19 situation, we reviewed our portfolios and skewed them towards companies that generate free cash flow, have low debt and a strong balance sheet. Effectively, companies that can weather this storm. While this sounds easy, it certainly isn't. We have seen examples of Page Industries and Asian paints in the past. Both strong, moated companies. But post implementation of GST, Page industries went through supply chain disruption and saw its p/e getting de-rated from 75x pre-GST to 64x in Dec 2019. Contrast that with Asian Paints which despite facing macro headwinds saw its topline and bottom line grow by 11% and 12% respectively during the same period. Consequently, saw its p/e expanding from 55x to 64x and delivering a 21% CAGR. This is an elaborate way of saying that all seemingly moated companies may not have equal advantage in current situation and investors / managers need to be discerning.

On the other hand, even after a brutal 18 month correction, mid and small caps have taken further beating largely in line with large caps. By conventional standards the valuations may appear attractive. But nothing about the current environment is conventional. At this point in time, taking a call on earnings impact is fraught with significant risk and hence our limited exposure. The exposure we would have in the midcap will have similar traits to our overall

portfolio, low debt, strong balance sheet etc. We think there could be potential opportunity to add as the uncertainty dissipates, but until then we continue to favour large caps.

We have been re-organizing our portfolios to reflect this thinking and it has helped us shield the fall to some extent. It was a tough month for managers where major world indices declined by more than 20%. Indian markets were no exception as Nifty 50 Index saw 23% decline in the month of March'20. The fall in global markets was accompanied with extreme volatility (Dow Jones futures hit limit down thrice and limit up once all in the space of one month, similarly Nifty had 6 days of more than 5% change). All our strategies have continued to outperform their respective benchmark by a wide margin despite the tough environment.

Performance as on March 31, 2020	1 Month	3 Month	6 Month	1 Year	CAGR		
					2 Year	3 Year	Since Inc.*
Indian Olympians	-20.6%	-23.4%	-20.0%	-13.1%	-2.0%	3.8%	2.5%
NSE100 Index	-22.8%	-28.8%	-24.8%	-25.9%	-8.7%	-2.7%	-0.7%
Relative to NSE100 Index	2.3%	5.5%	4.9%	12.8%	6.7%	6.5%	3.2%

* Since Inception Returns are from 16-Sep-16

Performance as on March 31, 2020	1 Month	3 Month	6 Month	1 Year	CAGR		
					2 Year	3 Year	Since Inc.*
Indian Titans	-19.6%	-20.1%	-16.4%	-9.2%	-6.2%	0.6%	3.5%
NSE200 Index	-23.7%	-29.1%	-25.0%	-27.1%	-10.2%	-3.6%	0.9%
Relative to NSE200 Index	4.1%	9.0%	8.6%	17.9%	4.0%	4.2%	2.6%

* Since Inception Returns are from 18-Nov-16

Performance as on March 31, 2020	1 Month	3 Month	6 Month	1 Year	CAGR		
					2 Year	3 Year	Since Inc.*
Smart Solutions	-12.7%	-13.8%	-7.3%	-7.0%	-8.1%	-0.7%	0.8%
NSE200 Index	-23.7%	-29.1%	-25.0%	-27.1%	-10.2%	-3.6%	-1.0%
Relative to NSE200 Index	11.0%	15.3%	17.7%	20.0%	2.1%	3.0%	1.8%

* Since Inception Returns are from 03-Nov-16

All returns are on TWRR basis, after fees and expenses

Portfolio Actions

As the risk of pandemic started to rise in second half of February'20, we increased cash holdings in portfolios where hedging wasn't possible. Going into April hedging costs have become prohibitive and hence we switched to higher cash across all strategies. Higher cash, hedges and some of the portfolio actions helped us reduce the fall meaningfully in our strategies.

Financials have been the highest sectoral allocation for over three years in both our flagship strategies, Indian Olympians and Indian Titans. Prior to the break-out of the pandemic, Nifty earnings growth for FY20 & FY21 was expected to be driven by lower NPA provisions and recovery from IBC, rather than economic growth. Effectively, financials were expected to be key contributor to Nifty earnings growth. Our portfolios were to some extent tactically positioned to take advantage of the same. However, lending as a business has hit an air pocket with retail moratorium and corporate credit environment getting tougher. We have

therefore cut overall exposure to financials and now are underweight. We also swapped some of the exposure to lending companies for non-lenders such as asset management companies, life and general insurance companies where the earnings could bounce back once the situation normalizes. These companies are under penetrated in their respective segments and the long term growth story remains intact.

To maintain the defensive positioning of the portfolios we continue to hold some consumer staples companies. The demand in this segment will be least impacted till lockdown continues. However, we are vigilant as some of the companies may run into some supply chain disruption issues should the lockdown continue. (For example: one of the larger consumer companies is facing shortage of packaging as those vendors are under lockdown. This is a second order impact that we referred to, earlier). We also own some low-ticket discretionary names that have short term impact but are likely to bounce back quickly after lockdown ends. We are concerned that the earnings of the high-ticket discretionary names we own may be impacted as people review their buying decisions in times of uncertainties. While these companies have strong balance sheets and cash flows, earnings recovery may take time. Therefore, we are recalibrating our exposure to them.

Pharma has been an under-owned sector for a fairly long time despite strong balance sheets and cash flows. A combination of these factors and reasonable valuations indicate better resilience. We have therefore assumed overweight positions in the sector across strategies.

Despite a weaker rupee we have desisted from going overweight in IT, in the portfolio. World over businesses have been hit and ITeS spends may be reviewed. Also, if deglobalization as a theme gains ground, new order flow may be hit in the medium term as well. We may however, tactically adjust our weights considering the strength of balance sheets and cash flow generation by heavyweights.

Sanctum Indian Olympians has been traditionally a buy and hold strategy with very low churn. But in light of changing business environment, we are choosing to review our positions more actively. We prefer being vigilant and recalibrate portfolios in response to the situation as it unfolds, even at the cost of somewhat higher volatility in portfolio returns.

Our trend-based strategy, Sanctum Smart Solutions, also continues to deliver strong outperformance. In March, against Nifty200 performance of -23.7%, the strategy delivered a return on -12.7%. Active hedging on a timely basis helped limit the downside in recent months. Further, portfolio rebalancing between sectors and different market cap has helped reduce losses. Sizeable allocation to Pharma, FMCG and few consumption names along with reduction in Financials and NBFCs has protected downside. We also reduced mid and small cap allocation from 31% at start of January to 22%. Depending on market conditions, cash levels were raised upto 10%. We continue to skew the portfolio to large cap despite recent correction as we believe that the segment will outperform over the medium term.

Due to uncertainty and fear in the market, volatility has shot up making option premia extremely expensive. Hence going forward we will hedge only if the premia come to reasonable levels, else we will raise cash and actively manage stock positions to protect the portfolio

Fixed income:

Financial year end is typically a frenzied time in the fixed income markets. This time however the stress in the money markets was atypical until the RBI came with big bang relief measures. It was inconceivable to most investors that liquid fund category returns for fourteen days would be negative. This triggered another wave of redemptions by spooked investors as they moved to overnight funds. We sensed the stress early in the cycle and had recommended a move from liquid funds to overnight funds.

As detailed in our note dated March 27 2020, on the recent monetary policy, we expect the flow of credit to weaker balance sheets to be adversely impacted. This would mean in a few weeks more money would chase the AAA segments compressing spreads even as credit becomes more expensive for lower rated papers.

Gold:

Our multifactor asset allocation model had indicated a move in favour of gold even before the pandemic broke-out. As the trade war rhetoric intensified, increasing gold as a safe haven choice made sense. Also, the US yield curve inverted indicating a recession supporting the safe haven argument. This was also supported by technical indicators that showed a breakout after consolidation of several years. This prompted us to add gold in our asset allocation portfolios to bring it to equal weight.

Even as the trade agreement between China and US was being finalized, the US bond and money markets started showing signs of unexplained stress since September 2019 forcing the Fed to offer liquidity through repo. As the stress escalated it was clear that the Fed would need to expand its balance sheet further. Printing money and zero bound rates in the US and uncharted territory of negative rates in Eurozone prompted us to overweight gold. Also, technical indicators gained further strength, supporting our decision.

Further uncertainties emerged with China locking down Hubei and the spread of the virus internationally. Fed rates at zero, economic turbulence leading to global recession, massive printing of currency all make a case for stronger gold.

Currently there is a shortage of dollar globally causing it to spike against other currencies. This also has led to the rupee weakening versus the USD. A combination of weakening rupee and higher gold prices in dollar terms, improves the return potential.

Historically gold has acted as a safe haven during market volatility



Source: IMF, The Economist, Sanctum Wealth Management

Case for international diversification:

It is evident that while central bankers around the world are pitching in, the scale and effectiveness of response will vary across different economies. A lot of emerging economies' ability to fiscally expand is constrained by their dollar dependence, leverage and trade considerations whereas, US as the world's reserve currency is committed to infinite QE. Also, geopolitical equations are changing as seen in the US-China trade war, Trump referring to Covid19 as 'Chinese virus', oil price war etc. These changes would give rise to investment opportunities around the world even as correlation could arguably be lower. India's performance relative many other key markets has been weak in the recent past and most investors were not invested in global markets to reduce this underperformance. We can't change that but we would certainly recommend diversification into global markets as a component of strategic asset allocation. Sanctum Global Allocator, our portfolio management strategy that invests in domestic feeder funds of global funds, has done well in the recent mayhem. We are currently holding 15% cash in the strategy to protect downside. We will reinvest the cash as further clarity impact of Covid19 situation emerges.

Performance as on	1 Month	3 Month	6 Month	1 Year	CAGR
March 31, 2020					Since Inc.*
Global Allocator	-9.2%	-13.2%	-4.2%	-0.2%	2.6%
Benchmark (75% MSCI World Index + 25% MSCI Emerging Market Index)	-10.6%	-17.5%	-9.4%	-6.6%	-2.6%
Relative to Benchmark	1.4%	4.3%	5.2%	6.4%	5.2%

* Since Inception Returns are from 29-Nov-18

Performance of Key Global Indices

World Indices	1 Week	1 Month	1 Year	3 Year	5 Year	% Fall from 52 week High	52 week High Date
NSE Nifty 50 Index	10.2%	-23.2%	-26.0%	-2.1%	0.3%	-35.0%	20-Jan-20
S&P 500 Index	5.6%	-12.5%	-8.8%	3.0%	4.6%	-26.7%	19-Feb-20
NASDAQ Composite Index	3.8%	-10.1%	-0.4%	9.2%	9.5%	-25.1%	19-Feb-20
Shanghai Stock Exchange Compos	1.0%	-4.5%	-11.0%	-5.1%	-6.0%	-15.9%	08-Apr-19
Nikkei 225	4.6%	-10.5%	-10.8%	0.0%	-0.3%	-26.1%	17-Jan-20
MSCI Global Index	6.3%	-13.7%	-13.0%	-0.5%	0.8%	-26.8%	12-Feb-20
MSCI AC Asia Pacific Index	7.4%	-12.1%	-14.4%	-2.3%	-1.3%	-24.4%	20-Jan-20
MSCI Emerging Markets Index	5.9%	-15.6%	-19.8%	-4.0%	-2.7%	-27.7%	20-Jan-20

Conclusion:

In our last monthly update we had said that we remain equal weight equities and would buy on dips. The nationwide lockdown has upended several assumptions on earnings and other market fundamentals. We continue to think that India may grow this year albeit at a much lower rate than was built in most models earlier this year. This in context of a contracting global economy means we are better placed than several other economies. But some visibility of triggers and composition of growth is important and hence we are refraining from adding further weight in equities in our model portfolio. But market action itself would have brought weight lower and hence we would recommend investors to consider rebalancing

at these levels. And keep those seat belts fastened! The markets will continue to be volatile for some time to come.

Just a few days ago, we put aside our recommendation to invest in credit funds. We would like to caution that credit funds (or funds that have lower rated papers) may go through a round of pain in months to come and hence recommend a review of all holdings. We prefer corporate bond funds as a category where portfolios are dominated by AAA papers.

We think the gold trade is just getting started. Even in the prior two recessions (2000 and 2008), gold outperformed other asset classes. Investors sold off everything they could as liquidity dried up. Gold then rallied to new all-time highs, well before the equity markets caught up. We think this time will be no different. Investors will gravitate towards gold as they seek to tide over the global economic turbulence.

Finally, irrespective of the asset class, one needs to be prepared for volatility. There were always many moving parts but the concurrence of significant developments makes it tougher to navigate. The world is united in finding a cure for the virus, leaders are being egged on to find mid path in the oil price war, central banks are pulling out all stops, citizens everywhere are yearning to find normalcy. Everything looks bleak and yet we are all willing to cling on to a ray of hope. Reactions will be magnified, we will oscillate between greed and fear. Eventually, this too shall pass!

Technical Trends

Sixth consecutive week of decline for the market. Front line large cap stocks took the brunt of the selling pressure last week leading to major decline in Nifty. The Nifty closed at 8084 levels down by 6.66% for the week. Broader market indices BSE Midcap and Smallcap outperformed the benchmark indices with a loss of 3.03% and 0.93% respectively for the week.

The bounce back rally from 7500 odd levels faced resistance at 9000 odd levels and now retraced back to current levels of 8084. Index has formed inside bar which is a reversal sign on weekly chart i.e. current period range within previous bar range. Now sustaining below 8200 expect further decline towards 7950 and then 7500 levels. On the upside resistance is seen at 8700 and then 9000 levels. Overall Nifty is likely to trade in a broader range of 7500 and 9000 levels before next directional move.

In Nifty April monthly expiry options, maximum open interest for Put is seen at strike price 8,000 followed by 7,500 and 7,000; while for Call maximum open interest is seen at 9,000 followed by 10,000. Nifty options distribution data is suggesting a wide range of 7500 and 9000 for now. India VIX index a measure of volatility after touching 11 year high of 86.6 has seen cooling off and currently at 55 levels. VIX needs to move below 40 levels for some stability to return in the market, otherwise expect volatile moves to continue in the market.

1-Nifty 50 - 03/04/20

F7



Source: Falcon7, Sanctum Wealth Management

Sanctum Wealth Management

Investment & Advisory

Roopali Prabhu

Head of Investment Products

+91 22 61064864

roopali.prabhu@sanctumwealth.com

Ashish Chaturmohta

Chief Advisor – Technical Strategies

+91 22 6106 4865

ashish.chaturmohta@sanctumwealth.com

Salvin Shah

Investment Analyst, Investment Office

+91 22 6106 4811

salvin.shah@sanctumwealth.com

Hemang Kapasi

Head of Equities

+91 22 6106 4815

hemang.kapasi@sanctumwealth.com

Rohit Laungani

Investment Analyst, Investment Office

+91 22 6106 4840

rohit.laungani@sanctumwealth.com

Anway Bhujbal

Technical & Derivative Analyst

+91 22 6106 4803

anway.bhujbal@sanctumwealth.com

Offices

Mumbai

Sanctum Wealth Management Private Limited

Unit 1501, Tower 2B, One Indiabulls Centre, 841, Jupiter Mills, Off Senapati Bapat Marg, Lower Parel, Mumbai, Maharashtra – 400013
Telephone: +91 22 6106 4800

Bengaluru

Sanctum Wealth Management Private Limited

Unit 1102, 11th Floor, HMG Ambassador, 137, Residency Road, Bengaluru, Karnataka – 560025
Telephone: +91 80 6742 7900

Kolkata

Sanctum Wealth Management Private Limited

Regus Business Centre Office no. 131, The Legacy, 1st Floor 25-A, Shakespeare Sarani, Kolkata, West Bengal – 700017
Telephone: +91 33 4400 0509

Delhi

Sanctum Wealth Management Private Limited

812 – 816, 8th Floor, Narain Manzil, 23, Barakhamba Road, New Delhi – 110001
Telephone: +91 11 66125713

Chennai

Sanctum Wealth Management Private Limited

Level 4, Suite no. 503, Apeejay Business Centre, 39/12, Haddows Road, Nungambakkam, Chennai, Tamil Nadu - 600006
Telephone: +91 44 2822 4949

Ahmedabad

Sanctum Wealth Management Private Limited

Regus Earth Rise Office no. 1134, 11th Floor Sarkhej-Gandhinagar Highway, Makarba, Ahmedabad, Gujarat - 380015
Telephone +91 79 6134 4593

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