



March 09, 2020

## Investment Strategy

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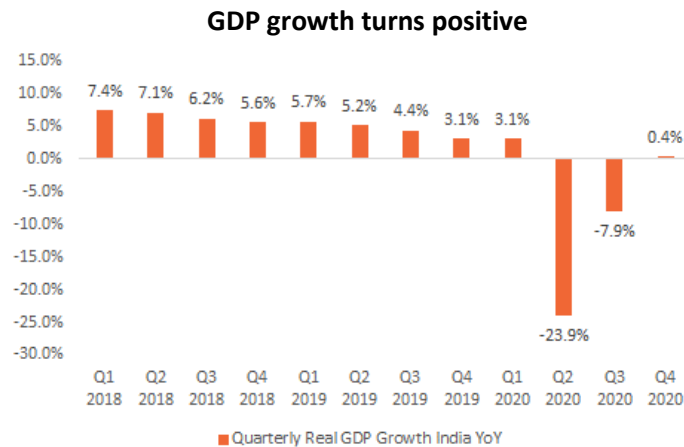
### Turning Tides

At times, bad news is good news for the stock markets. A backdrop of massive economic disruption caused many stock markets around the world to rise and hit lifetime highs. At the core of this risk on environment were interest rate cuts to multiyear lows that left investors little option but to take on more risk (read buy equities). And as a large dose of stimulus was injected, a fair bit of that money found its way to the stock markets. Today the economic recovery looks imminent - which is good news, but the stock markets are worried about rising yields and higher inflation which is resulting in volatility. Now with the Biden administration adding another round of stimulus, one needs to strap the belt on and be prepared for continued volatility. In the interim, we will continue to watch Gamestop kind of quirky episodes from the ringside.

Vaccination and with it, optimism, seems to have picked up pace across the world. This will also potentially accelerate the services sector re-opening and lead to another pillar of growth firing.

India reported growth in GDP of 0.4% in the last quarter, a reflection of the pick-up in activity and demand that we have been discussing over the last few months. The pace may be somewhat uneven across sectors but on an aggregate basis, we do see a sustained recovery.

Globally as well as domestically, inflation will continue to be a hinge factor for equities as well as bonds. Should the volume demand pick up sharply, manufacturers may be able to pass on higher input costs. Otherwise, a full bloom recovery would get pushed down the road.



Source: Bloomberg, Sanctum Wealth Management

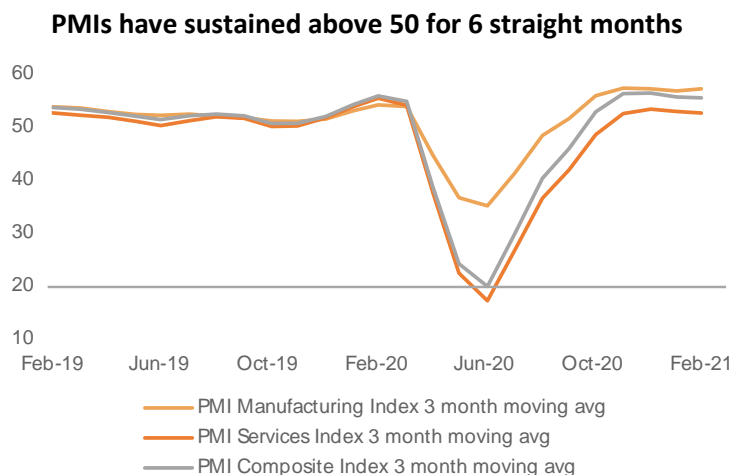
### Quarterly Asset Pair Allocation Update

With multiple factors influencing the markets, it was an opportune time for us to review our asset pair model and understand what the confluence of these factors are suggesting. As some of you might know we use our asset pair model as a guide to our tactical asset allocation. In major changes the score for equities moved slightly lower, but remains marginally in favour of equities, the score for gold turned marginally negative and the score for short-term bonds moved in favour of short-term bonds. In our model portfolios, we move to neutral weight gold from 2.5% overweight and add the 2.5% weight to midcap equities.

### Equities Vs. Bonds

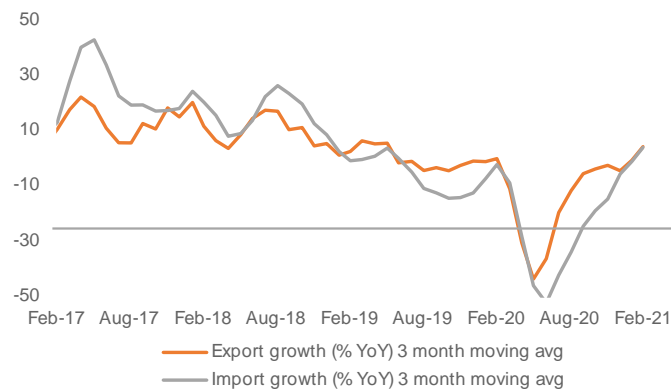
#### Strong earnings momentum even as valuations remain expensive

Almost all macro-economic indicators are in positive territory now. PMIs have remained above 50 (indicating growth in economic activity) for six straight months now. Industrial production (IIP), capital goods production, auto sales, export and imports witnessed growth. However, the sustainability of the macroeconomic activity will be closely watched going forward.



Source: Bloomberg, Sanctum Wealth Management

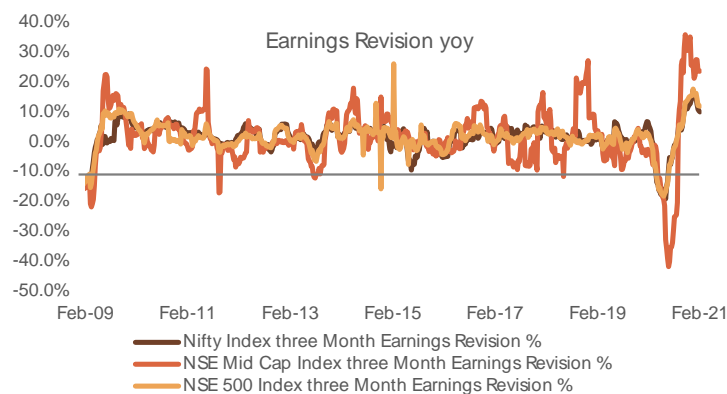
### Export and Import growth have seen a pickup



Source: Bloomberg, Sanctum Wealth Management

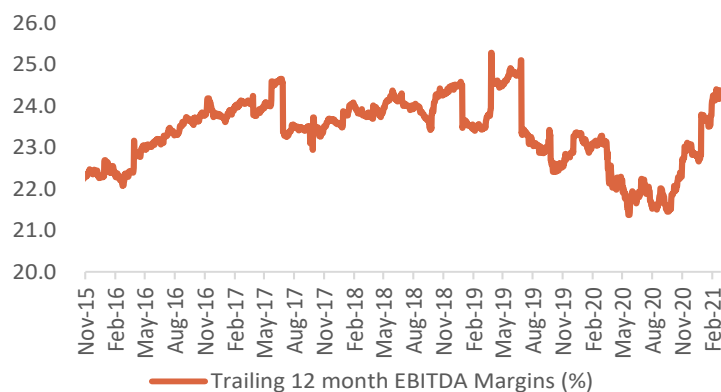
The revival in economic activity was also visible in strong corporate earnings result. We saw significant EPS upgrades; Nifty EPS has been upgraded by 10% over the last quarter. Operating (EBITDA) margins have been strong led by better capacity utilisation and due to the continuation of some cost-cutting measures. However, with commodity prices rising, operating margins are unlikely to remain at current levels. But, more on earnings later in this document.

### Sharp upward revision in earnings



Source: Bloomberg, Sanctum Wealth Management

### Margins rise amid improving capacity utilisation

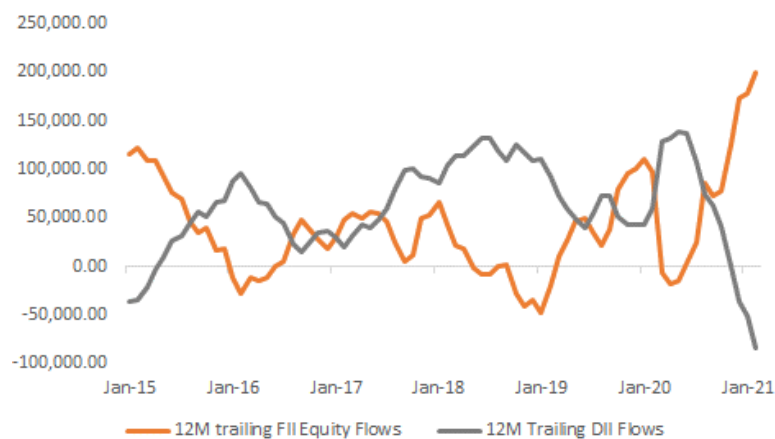


Source: Bloomberg, Sanctum Wealth Management

Indian equities remain expensive on all parameters. However, as we have seen multiples times in history before, equities can remain expensive for a while. Additionally, after many years we are seeing meaningful earnings upgrade. Finally, in an environment of low-interest rates, as investors look to increase equity allocation to compensate for lower yields, higher P/Es could be justified to some extent.

Foreign investors remained net buyers over the last few months as well. In fact, over the last 12 months, foreign investors have bought more than INR 1.8 lakh crores worth of Indian equities, the highest ever over a trailing 12-month period. This has been partially offset by selling from domestic institutional investors (DIIs). Over the last 12 months, DIIs have sold close to INR 50,000 crores worth of Indian equities, the highest in over 6 years.

#### Foreign Investors net buyers, DIIs net sellers



#### Equity valuations expensive



Overall while valuations remain a concern, strong earnings momentum, improving economic activity, ample liquidity and strong foreign flows suggest equities could remain buoyant in the coming quarters. However, as highlighted earlier, we could see bouts of equity volatility as we have been seeing over the last few weeks.

## Large Cap Vs. Midcap

### Marginally positive midcaps

Midcaps saw a sharp cut in earnings expectation post the pandemic. After two good quarters of corporate earnings results, midcaps have seen a much sharper earnings upgrade than large caps. Going forward as well analysts expect stronger earnings growth for midcaps compared to large caps.

### Significant EPS upgrades for both large caps and midcaps

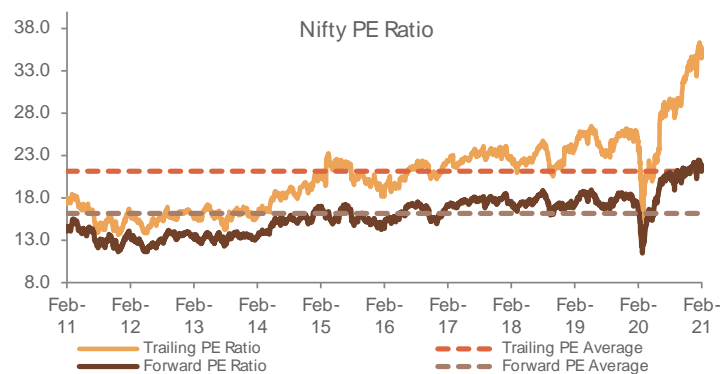


Source: Bloomberg, Sanctum Wealth Management

The equity rally in December and early part of January has been more board based. Additionally, midcaps have been slightly more resilient relative to large caps amid bouts of selling pressure seen in late January and February. The Nifty Midcap to Nifty 50 ratio, a key technical indicator, seems to have formed a base and is moving higher, suggesting technical momentum is also in favour of the midcaps relative to large caps.

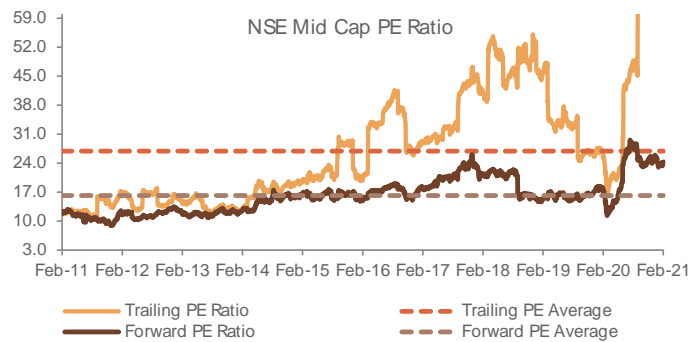
However, in terms of valuations, both large caps and midcaps are equally expensive. Overall, our asset pair score is slightly in favour of midcaps.

### Large caps are expensive



Source: Bloomberg, Sanctum Wealth Management

### Midcaps equally expensive



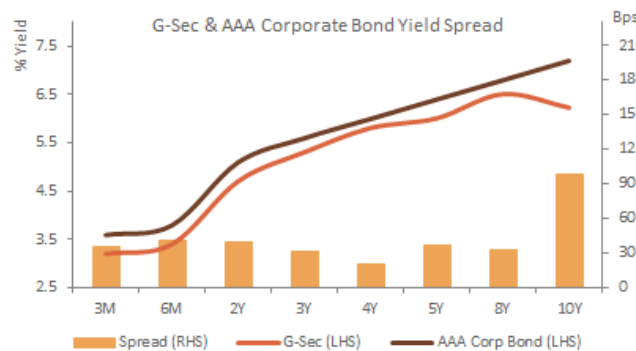
## Fixed Income

### Corporate Bonds Vs. Government Securities

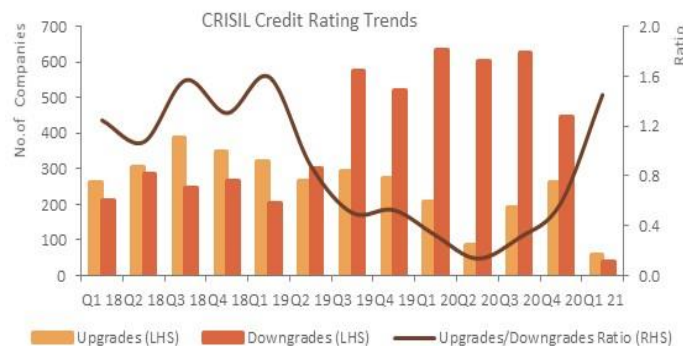
#### Limited credit spreads, but credit rating trends improving

Credit spreads across the curve remain low. Both G-sec and corporate yield curves have moved up. The 2 year to 5 year G-sec yields have moved up more sharply than the rest of the yield curve, compressing the credit spreads in that range completely. However, the environment for credits has improved. The upgrade to downgrade ratio after hitting a low in Q2 of the calendar year 2020 has moved up sharply. For the ongoing quarter, so far upgrades have outnumbered downgrades, first time in eight quarters.

### Very little corporate spreads across the curve



### Upgrade to downgrade ratio has bottomed out

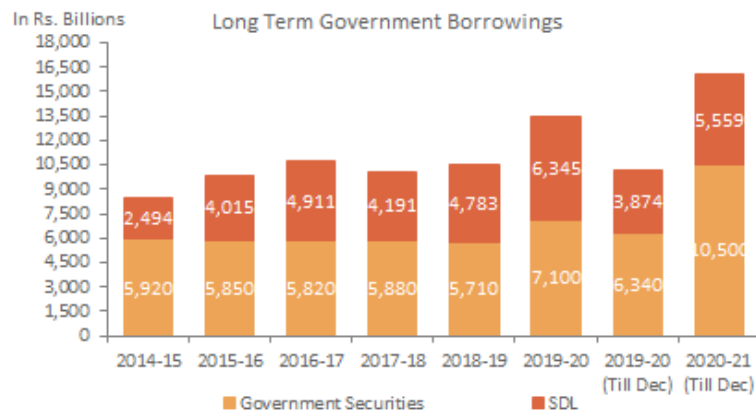




In the union budget 2021, the government announced a higher borrowing target, as expected, and announced their plan to deviate from the fiscal consolidation path for the next few years. However, after a few years, the fiscal calculation and assumptions appear more realistic. But the overall government bond supply is likely to increase which is negative for government bonds.

Overall, we are neutral between corporate bonds and G-sec. Although, as highlighted in our previous commentaries, we do recommend some allocation to carefully selected higher-yielding, collateralised debt for those looking at some yield pickup.

### Government borrowing to remain elevated, but fiscal maths more realistic



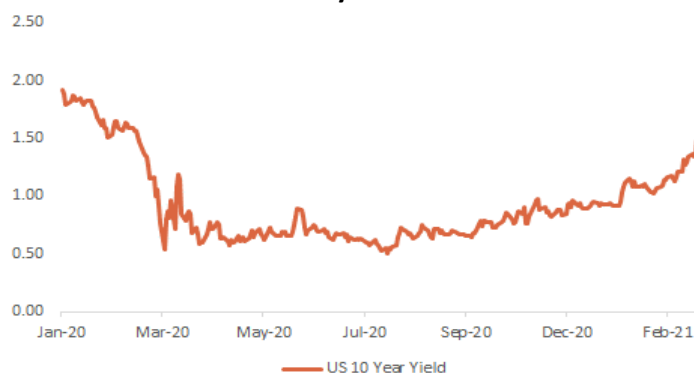
Source: Bloomberg, Sanctum Wealth Management

### Short-term Vs. Long-term bonds

#### A barbell strategy

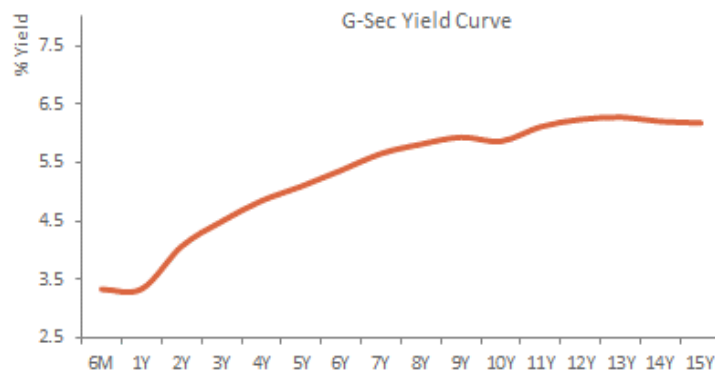
Globally bond yields have risen on expectation of liquidity tightening from the central bank amid a threat of return of inflation. While it is unlikely central banks will move too quickly on liquidity tightening and may tolerate a bit of inflation, global bond yields seem to have bottomed out. As bond yields rise, it might be prudent to take exposure in very short-term debt which gets repriced quickly. The Indian 10 year has been managed by the RBI so far and hasn't moved up as much as the US 10-year bond, but it might be difficult for the RBI to manage it at current levels permanently. As bond yields move higher high duration could lead to capital losses.

### Global bond yields have risen



Source: Bloomberg, Sanctum Wealth Management

### Term spreads are attractive



Source: Bloomberg, Sanctum Wealth Management

Hence, while the yield curve is steep and term premiums (different between yields of high duration and low duration bonds) are attractive, a high duration play still doesn't have an attractive risk-reward. The 6 year portion of the yield curve has a better risk-reward, investors get a yield pickup due to higher terms spreads which can offset some bit of capital loss as yields rise.

Hence, a barbell strategy, with very short duration bonds at one end and around the 6 year maturity bonds or carefully selected credits at the other end, continues to make sense.

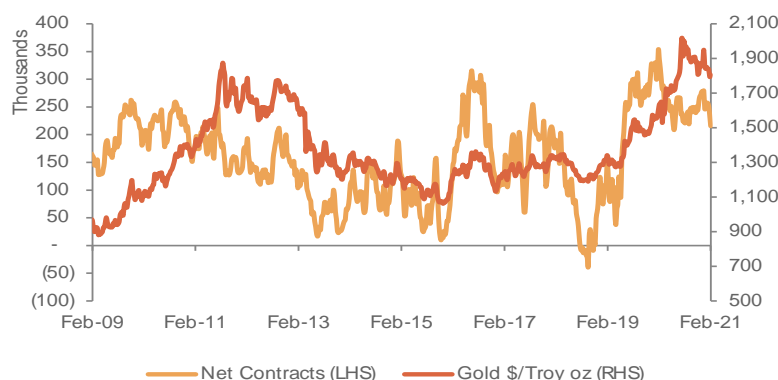
### Gold Vs. Cash

#### Marginally negative gold amid a decline in safe haven demand

With economic activity normalising, equity markets rallying and geopolitical tensions moderating the demand for gold as a safe haven has declined. While inflation has picked up, it's still not out of hand and hence, demand for gold as an inflation hedge isn't there. Additionally, with bond yields rising opportunity cost of holding gold, as gold doesn't provide any regular income, has also increased.

For long term investors gold continues to remain a hedge for any unforeseeable risk to equity markets. Hence, we suggest holding gold for the long term, however tactically we are moving neutral gold in our model portfolios.

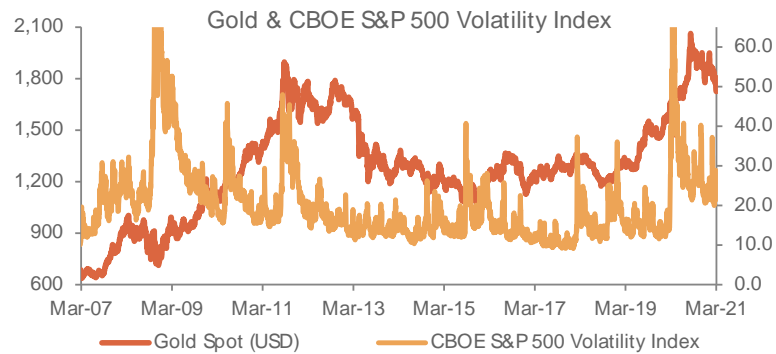
### Speculative position on a declining trend



Source: Bloomberg, Sanctum Wealth Management



### Reduced volatility negative for gold



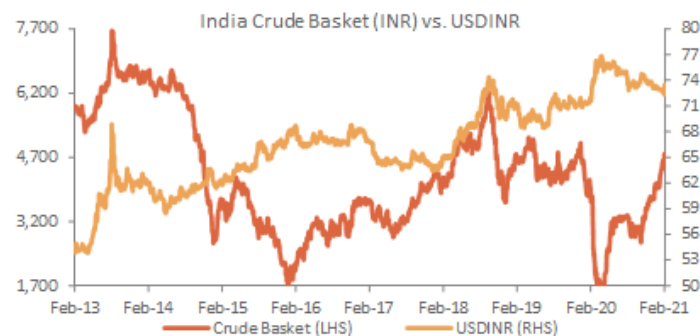
Source: Bloomberg, Sanctum Wealth Management

### USD Vs. INR

#### INR could remain resilient against the dollar

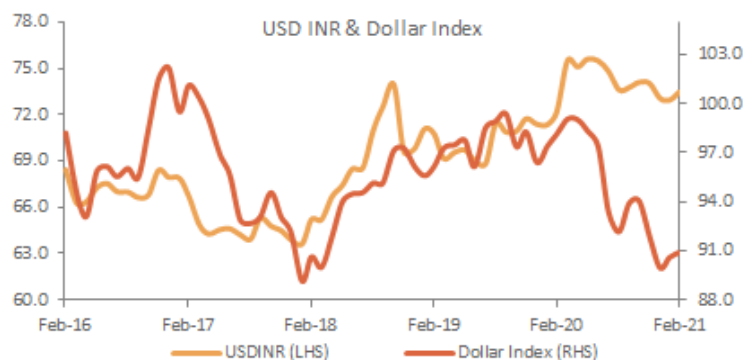
Crude oil prices have bounced back sharply over the last few months. Given crude oil makes up a large part of India's import, crude oil prices are a key risk for the balance of payments and hence for the INR. For now, the balance of payments remains in the positive territory supported by strong capital inflows.

### Rebound in crude prices a concern for the INR



Source: Bloomberg, Sanctum Wealth Management

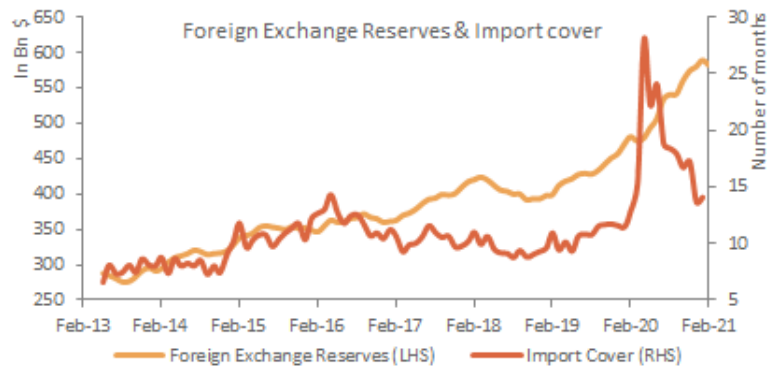
### Dollar weakness has supported the INR



Source: Bloomberg, Sanctum Wealth Management

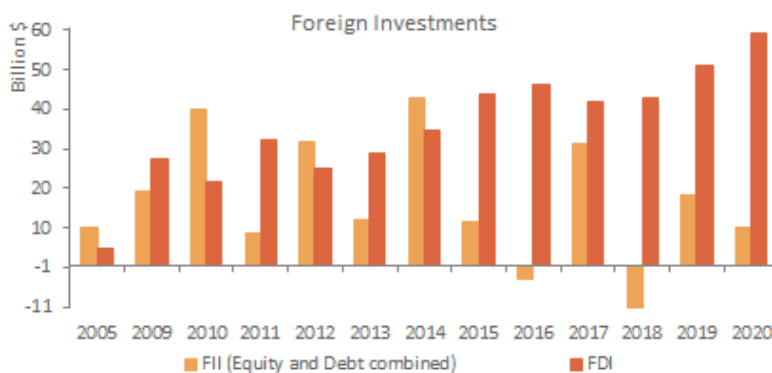
Also, the RBI has built up its FX reserves amid dollar weakness. Hence, in case crude oil becomes a worry or the dollar bounces back, the RBI has enough ammunition to intervene if required. Technical momentum is also in favour of the INR. Hence, our asset pair scores remain in favour of the INR.

### FX reserves at an all-time high



Source: Bloomberg, Sanctum Wealth Management

### Strong FDI inflow and FII equity inflow positive for INR



Source: Bloomberg, Sanctum Wealth Management

## Summary of Our Asset Model

Asset Class Pairs	Scale											View
	-5	-4	-3	-2	-1	0	1	2	3	4	5	
Equity Vs. Bonds								X←				Positive Equity
Large Cap vs. Mid Cap						X						Neutral
Corp Bonds Vs. G-Secs					→	X						Neutral
Short-Term Vs. Long-Term						→	→	X				Positive Short-Term
USD Vs INR					X							Positive INR
Gold Vs. Cash					X	←	←					Negative Gold

## Quarterly Results – Earnings Momentum Continues

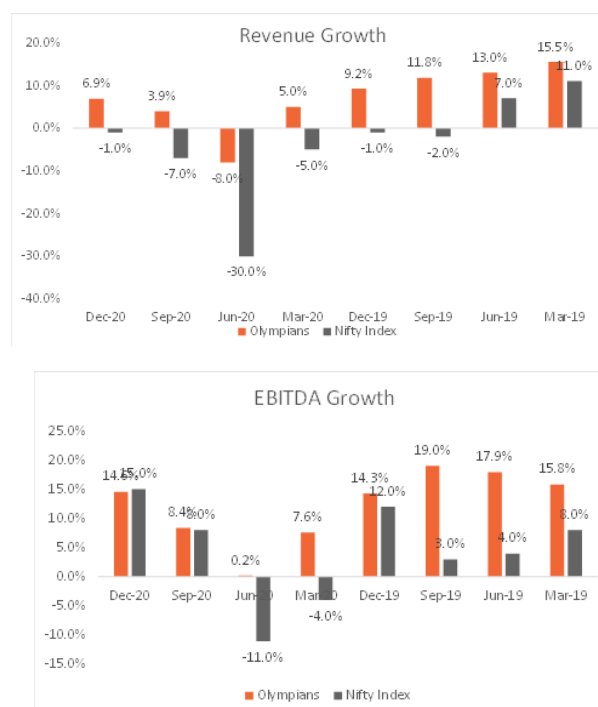
The earnings momentum continued in Q3FY21 on the back of robust economic recovery. The management commentaries on demand across sectors were upbeat, however, some caution on margins driven by input cost inflation was highlighted. Nifty sales were flat YoY overall, but excluding oil and gas, revenues grew by 10%, the highest in the last seven quarters. EBITDA and PAT grew 15% and 22% respectively, exceeding market expectation. The breadth of strong earnings was most encouraging, 60% of the Nifty companies have beaten the expectations and only 18% of companies reported results below estimates. As we have highlighted in our earlier commentaries, cyclicals are particularly showing a strong earnings growth trend after bottoming out in Q1FY21.

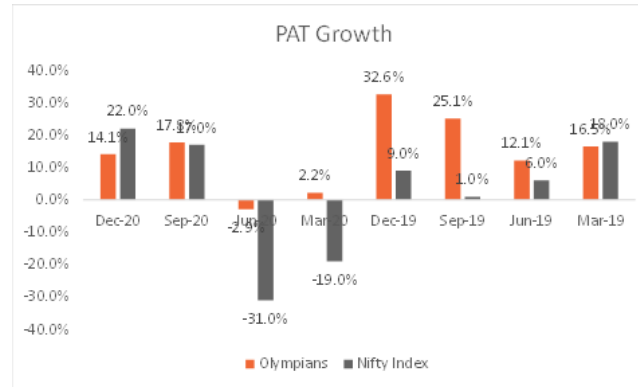
Strong earnings results have resulted in the second consecutive quarter of material upgrades for Nifty EPS. For FY23, Nifty EPS has been upgraded by 10% over the last quarter. With this upgrade, the consensus is expecting Nifty EPS to grow ~30% over the next two years (FY21-23). We believe this is achievable driven by (i) expectations of real GDP growth rebounding to 8-9% over the next two years, (ii) low base of FY21, (iii) larger companies gaining market share over the unorganised sector and (iv) fading credit cost in financials.

## Quarterly Results of In-house PMS Strategies

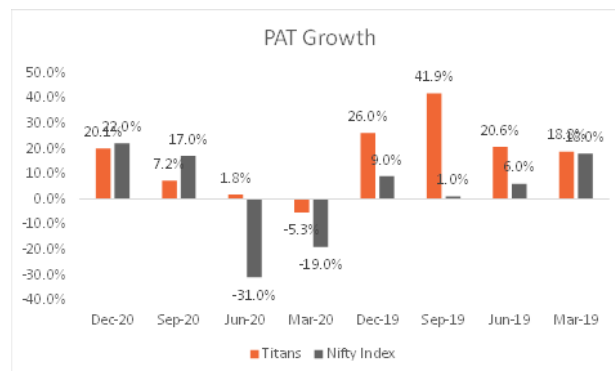
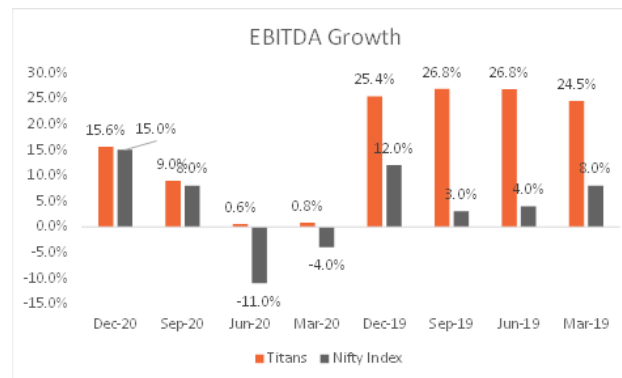
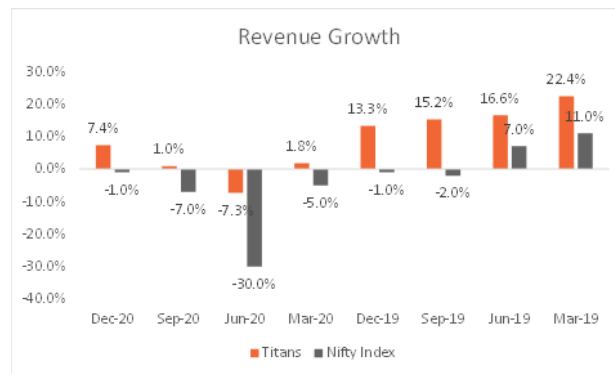
In our in-house PMS strategies, our endeavour has always been to find and bet on the companies growing faster than the index. Hence, we generally invest in companies operating in high growth industries or ones that are gaining market share from peers or both. The end result is to identify companies with superior and sustainable earnings growth along with a high return on capital. This is very evident from the growth reported by our portfolio companies over the past several quarters. While Nifty revenue has been flat YoY in Q3FY21, the weighted average revenue growth of Sanctum Indian Olympians was 6.9% and that of Sanctum Indian Titans was 7.4%. The same outperformance is visible in the earnings growth of portfolio companies over the last several quarters as well (see charts below for details). Further, it is worthwhile to note that 63% of the Sanctum Indian Olympians' portfolio and 60% of Sanctum Indian Titan's portfolio delivered operating profit growth in excess of 10%.

### Sanctum Indian Olympians Vs Nifty



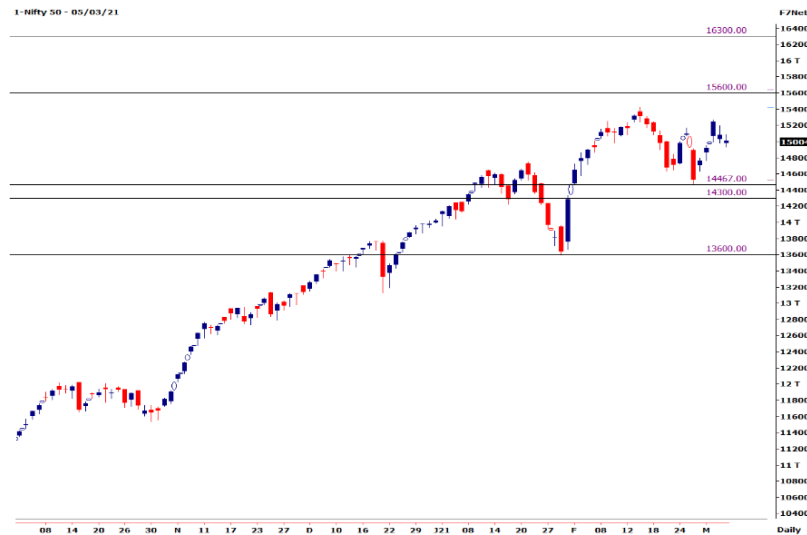


### Sanctum Indian Titans Vs Nifty



## Technical Commentary

Markets saw bouts of profit booking in the latter part of February. The Nifty touched 50% retracement level of the post-budget rally. However, after hitting a low of 14,467, Nifty has resumed its uptrend. The rally over the past few months has been broad-based and not led by a few stocks. In the immediate term, Nifty could touch 15,600, above this level, the next key resistance levels are at 16,300 and then at 17,100. On the downside, the recent low of 14,467 is a pivotal support now; a break below could lead to deeper corrections.



Source: Falcon7

Nifty IT Index has seen correction over the last seven weeks and is now showing signs of reversal. We expect the sector to lead the next leg of the market rally. The recent low of 24,200 becomes a critical support level for the Nifty IT index. If the index stays above it, a positive trend could continue.

Broader market indices BSE Midcap and Small cap showed resilience in the recent fall and have now crossed their respective February highs.

Indices	Next Resistance Level	Key Resistance Level	Current Market Price	Initial Support Level
Nifty Index	16,300	15,600	14,938	14,467
BSE Midcap Index	22,185	21,225	20,588	19,675
BSE Smallcap Index	22,460	21,835	20,936	19,600
Nifty IT	28,600	27,000	25,230	24,200

\* Current Market Price as of 7<sup>th</sup> March 2021

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## Sanctum Wealth Management

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