Sanctum View

April 06, 2020

Investment Strategy

A Year On

More than a year ago on 23rd March 2020, the government of India announced its first nationwide lockdown of 21 days. The same day stock market hit the bottom. Since then, Indian equities (represented by Nifty Index) have rallied 70.9% as of 31st March 2021. Like every other market correction, this correction also taught us a few things. Firstly, markets tend to recover before the economy does and are focused on the future. The stock market bottomed much before Covid cases peaked in the first wave. In fact, on 23rd March 2020, India had reported only about

Performance of Key Equity Indices	1 Year	3 Year	5 Year
NSE Nifty 50 Index	70.9%	13.3%	13.7%
S&P 500 Index	53.7%	14.6%	14.0%
NASDAQ Composite Index	72.0%	23.3%	22.2%
Shanghai Stock Exchange Compos	25.1%	2.8%	2.8%
Nikkei 225	54.2%	10.8%	11.7%
MSCI Global Index	52.2%	10.0%	11.1%
MSCI AC Asia Pacific Index	48.8%	5.6%	9.6%
MSCI Emerging Markets Index	55.1%	4.0%	9.5%

Source: Bloomberg, Sanctum Wealth Management
Data as of 31st March 2021

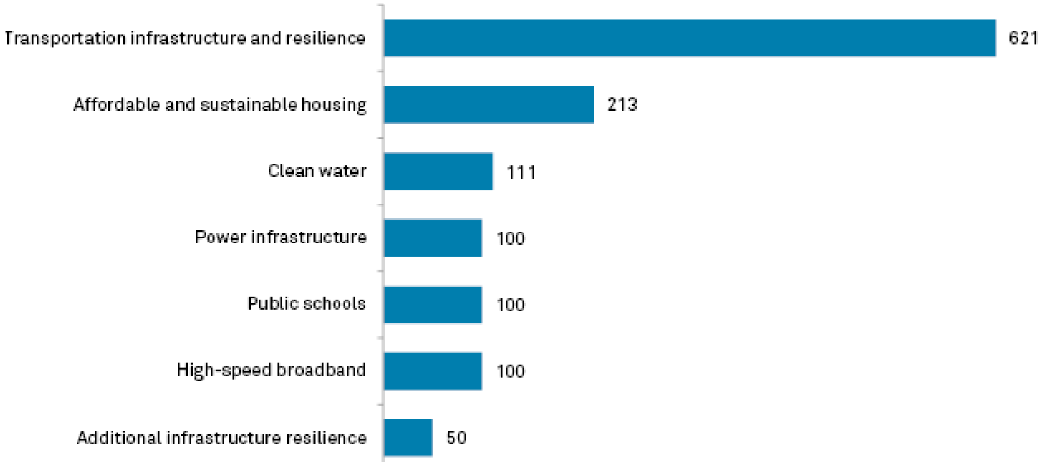
500 positive cases cumulatively, on 4th April 2021 India reported 1 lakh positive cases in one single day, the highest ever.

Secondly, the cliched saying than time in the market is more important that timing the market was again visible in this correction as well. Despite frequent and sometimes steep drawdown, stock markets tend to rise over time. Hence, the consequence of trying to time the market can be significant. We know of many investors that exited post the March crash and are still waiting on the sidelines.

Global Macro

The US president Joe Biden on 31st March 2021 unveiled a USD 2.2tn infrastructure plan called the "America Job Plan" to modernize US transportation infrastructure and invest in the green economy over the next eight years. Biden intends to fund this program by increasing corporate taxes for the next 15 years. Market participants were expecting corporate tax hikes in some form or the other and hence markets didn't react adversely to this news. In its current form, the program can create jobs and bolster US competitiveness against China, thus supporting structural growth which should offset the negative impact of corporate tax hikes. However, these are just proposals for now and will be open to significant debate in the two houses. The final plan is likely to take time and could look completely different from the current proposal.

American Jobs Plan- Key Investments (in USD bn)



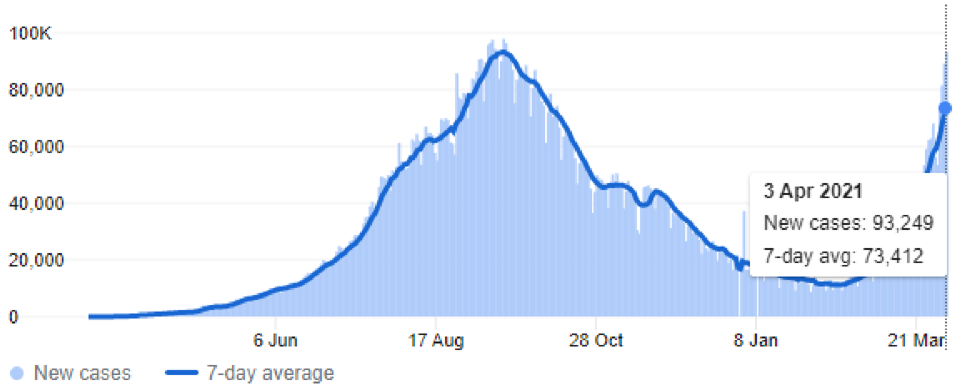
Source: S&P Global

The US economy created most jobs in seven months in March 2021, according to the Labor Department's employment report released on Friday. The strong pace of vaccination in the US and a massive, bigger than expected, USD 1.9tn pandemic relief package approved in March seem to be supporting US economic recovery. The worry has now shifted from covid to excessive stimulus which could lead to sustained high inflation. The supply chain disruption highlighted by the global container shortage and the recent blockage of the Suez Canal is also likely to impact inflation in the near term. While the Fed doesn't appear in the mood to react too quickly to increased inflation expectation, inflation remains a key risk to watch out for investors.

India Macro

The second wave of covid cases is truly underway in India. Daily cases now average more than 70,000 since the past few days and on 4th April 2021 crossed more than 1 lakh new cases a day. Maharashtra and India's financial capital, Mumbai are leading the case count, with both reporting the highest ever daily new cases over the last few days. While a complete lockdown like March 2020 seems less likely, restriction in some form or other is likely to be implemented by various states to curb the rise in cases. Domestic equities have been volatile on this count. A second wave and fresh restriction will have some sort of an impact on the strong recovery in economic activity seen over the last few months. While vaccination program in India is gaining pace gradually, a second wave and resulting lockdowns remain a key risk to watch out for.

New Daily Covid Cases in India



Source: JHU CSSE COVID-19 Data

The Indian government released its H1 FY 2021 borrowing calendar last week. Government plans to borrow 60% of the planned amount till September 2021. In line with the precedence bulk of the borrowing is in the 5, 10, 14 and 20-year maturity profile. The borrowing calendar is in line with expectations. Yields are more likely to be guided by inflation and RBI actions for now.

Active vs Passive

The debate between active and passive becomes pronounced when active managers underperform as they did in FY2021. However, before we delve further into this debate, it better to analyse the reasons for the underperformance in the last year.

Category	1 Year		3 Year	
	No of Schemes	Percentage (%)	No of Schemes	Percentage (%)
Large Cap Category Vs Nifty 100				
Out-Performance	2	7%	2	7%
Under-Performance	27	93%	27	93%
Mid Cap Category Vs Nifty Mid Cap 100				
Out-Performance	2	8%	17	74%
Under-Performance	24	92%	6	26%
Small Cap Category Vs Nifty Small Cap 100				
Out-Performance	2	9%	14	88%
Under-Performance	21	91%	2	13%
Multi Cap Category vs Nifty 500				
Out-Performance	4	17%	8	38%
Under-Performance	20	83%	13	62%

Source: Sanctum Internal Research; Morningstar, ACE MF
Data as of 31st March 2021

*Total Return Index (TRI) has been considered

Last year the pandemic led to a sharp drawdown which was followed by an even sharper recovery. This was accompanied by quick sector rotation. The swiftness of market action in the last year did not provide active manager time to pivot their portfolios. No sector has consistently outperformed in FY21 as can be in the table below. Financial services, a sector which most active managers were overweight on, underperformed in Q1 and Q2 of FY21. The sector then bounced back sharply in Q3 FY21, by then most managers had underweighted the sector. Pharma a sector which most fund managers were underweight in FY20 rallied hard in the first half of FY21 as the pandemic brought pharma into the spotlight. In the sector half of FY21 as managers turned overweight the sector, it underperformed. Commodities a sector that active fund managers have avoided for a few years now, also rallied in the financial year 2021. Such sharp sector rotations contributed to the underperformance by active managers.

Sectoral Indices	FY 2020	FY 2021	Q4 FY21	Q3 FY21	Q2 FY21	Q1 FY21
Nifty Commodities	0.5%	97.8%	18.5%	22.2%	9.6%	24.6%
Nifty Financial Services	8.3%	69.1%	3.4%	43.2%	0.8%	13.4%
Nifty FMCG	-1.7%	30.1%	2.9%	15.0%	-0.4%	10.4%
Nifty India Consumption	-1.7%	47.8%	1.2%	18.3%	4.8%	17.8%
Nifty Infrastructure	5.2%	76.1%	12.6%	19.0%	2.3%	28.5%
Nifty Pharma	-13.7%	71.9%	-4.7%	9.7%	18.2%	39.1%
Nifty PSU Bank	-4.0%	62.9%	23.1%	37.2%	-10.5%	7.8%

Source: Morningstar

A more structural reason for the decline in the alpha of large-cap funds has been the SEBI mutual fund recategorization of 2018 which restricted the exposure to non-large cap stocks in large-cap funds to 20%. Non-large cap stocks were salient contributors to alpha generation earlier since the large-cap stocks are well researched and have limited information asymmetry. Hence, large caps funds are going to find it difficult to outperform the benchmark consistently going forward as well, a concentrated and actively managed portfolio, like our Sanctum Indian Olympians would have a better chance of alpha generation.

Midcap and smallcap funds have done well over long periods. Since most of the stocks are under-researched, the information asymmetry is higher here hence providing enough opportunities for active managers to outperform.

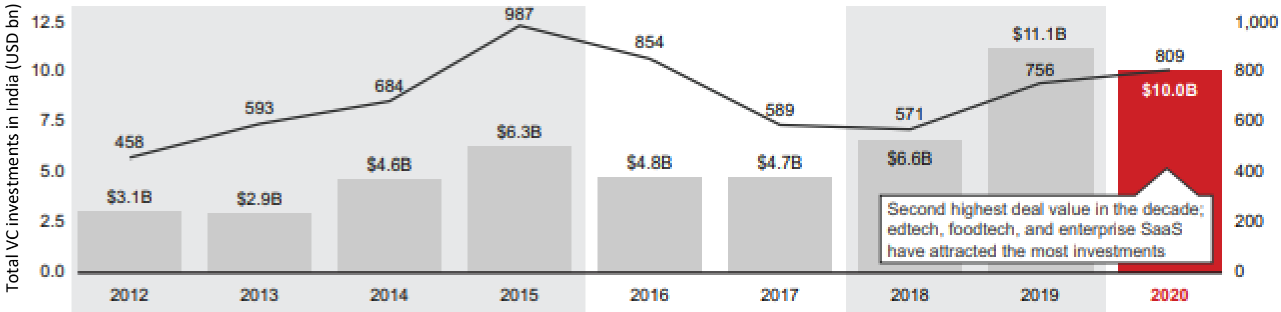
Actively managed Multicaps funds have struggled over the last 2 calendar years as markets were polarised in 2019 with very few large caps stocks making up the bulk of the returns, followed by sector rotation in 2020 as highlighted above. However, a large universe to choose from, allows fund managers of actively managed multicap funds legroom to position the portfolio to outperform over the long term.

Liquidity is a concern for mid and smallcap stocks. Low liquidity of mid and smallcap stocks could create higher tracking error for mid and smallcap passive funds. Additionally, large inflows and outflows from these funds could also impact the prices of mid and smallcap stocks. Hence, given the alpha generation over longer periods and liquidity concerns, active funds are likely to continue being relevant for small, midcap and multicap allocations.

The Middle India Mega Market Opportunity Through Technology

In our annual outlook of 2021, we wrote about how we think private markets offer attractive investment options. We are seeing most opportunities in firms that are using technology to access the mega-market of middle India, i.e. 40 crore Indians with more than 5 lakh and less than 25 lakhs of household income. This market is huge, but firms faced issues accessing the market opportunity. These issues included affordability, differentiated needs compared to Indian elites, high transaction and acquisition costs and poor unit economics. With more than 90% of Indian enrolled in Aadhar, close to a billion Aadhar linked bank accounts, 500 million smartphone users, very low cost of mobile data and a very young population, India has seen increased digitalisation over the last few years. Additionally, the pandemic has forced those hesitant to also adopt the technology. This has made this market segment quite attractive to firms that are using technology to reduce transaction and acquisition cost, making products and services affordable and solving the needs of this segment of the market.

Investment Momentum Continued in 2020 Despite the Pandemic



Source: Bain Capital Report on India VC 2021

The vibrancy in the technology VC/PE in India is also visible in the investments done by global companies, Reliance's Jio platform raised USD 20bn in May – July 2020, Google set aside USD 10bn for the next 5-7 years for its India digitisation fund, Amazon is planning to do USD 7-8bn investment in India over next 6 years and finally, firms like Byju, Zomato, Swiggy, Udaan, etc., that use technology to solve some issues are unicorns.

We see the technology VC/PE space to continue gaining traction in the coming years as well and we will look out for investment opportunities in this space.

Portfolio Actions

In our Investment Outlook for 2021, we had articulated 3 themes. Among them one of the prominent themes was Housing. A host of factors like low interest rates, work-from-home adoption, policy support for affordable housing with fiscal policy incentives like lower stamp duties and reduction in developer premiums, consolidation of developers post RERA regulations could trigger the next housing cycle.

As per industry reports, the demand for India's residential real estate has surpassed pre-Covid levels in Q1 of 2021. Top 7 cities residential sales surge 29% in Q1 of 2021 along with 51% rise in new launches as well. We believe this is just the start of a multi-year upcycle in the housing sector.

City-wise Absorption (in Units)	Q1 2021	Q1 2020	% Change
NCR	8,790	8,150	8%
Mumbai Region	20,350	13,910	46%
Bangalore	8,670	8,630	0%
Pune	10,550	7,200	47%
Hyderabad	4,400	2,680	64%
Chennai	2,850	2,190	30%
Kolkata	2,680	2,440	10%
India	**58,290**	**45,200**	**29%**

To benefit from this theme, we have recently invested in Can Fin Homes (CANF) in our multi cap strategy, Sanctum Indian Titans. CANF is a leading player in the low-to-middle income housing finance segment. 90% of the loan book is home loans with an average ticket size of INR 1.8mn (affordable housing segment which is the fastest-growing segment). The biggest competitive advantage is that it is amongst the lowest cost borrowers in the housing finance company (HFC) market that enabled it to maintain healthy spreads of 2.5-2.8% over the last few years despite catering primarily to the salaried customer segment (most competitive segment). Healthy NIMs of 3%+, low expense ratio and benign credit cost helped the company generate an average of ~19% RoE over the last three years. CANF is of the very few listed HFC to make high teens RoE consistently.

Performance Analysis of Sanctum Indian Titans

In the last investment strategy note, we highlighted the operating performance of our strategies. Here we try to analyse the performance of one of our flagship strategies, Sanctum Indian Titans. Sanctum Indian Titans has outperformed across years except in 2018. In 2018 we witnessed a sharp correction in the midcap and smallcaps while large caps were relatively resilient, our portfolio had a higher tilt of mid and smallcaps causing us to underperform. However, Sanctum Indian Titans recovered most of the lost ground in 2019 when it outperformed all its peers, in 2020 also our strategy has done well relative to benchmark and peers.

Calendar Year Returns	CY2020	CY2019	CY2018	CY2017
Sanctum Indian Titans	20.4%	17.6%	-13.2%	38.2%
Median Multicap MFs	14.3%	8.5%	-5.4%	38.0%
Nifty 200 TRI	16.8%	10.0%	0.3%	35.2%

Early in 2020, we had a cautious stance in our portfolios on account of rising geopolitical tensions. We increased cash and reduced exposure to financials which helped significantly cushion the March 2020 crash. Owing to high levels of earnings uncertainty through the lockdown and very rich valuations, we maintained defensive positioning throughout Q2 2020 in line with our philosophy of managing risk over delivering top of the table returns. This led to some underperformance in Q2, performance recovered in Q3 and Q4 of 2020 as we reduced our defensive stance when economic recovery looked more likely.

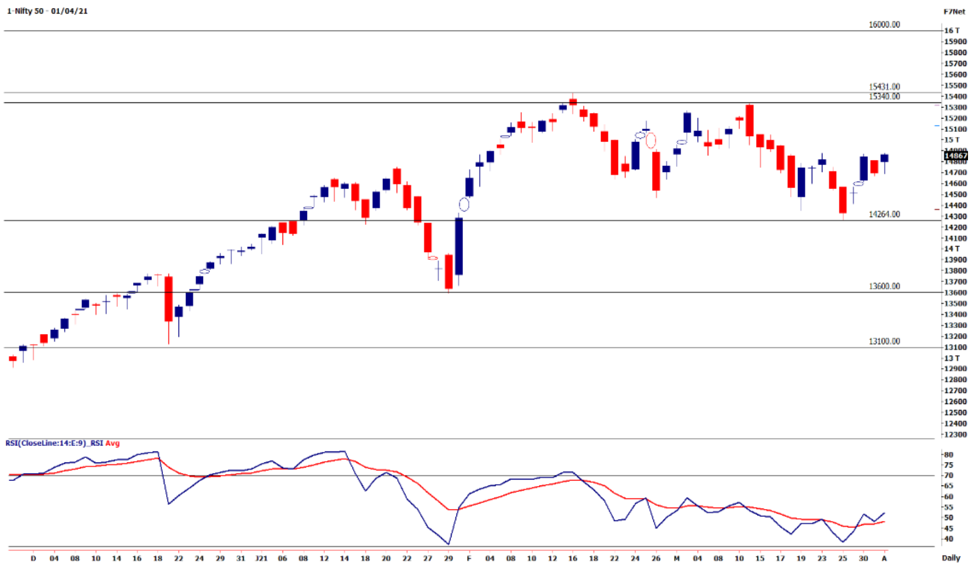
Quarterly Returns	YTD 2021	Q4 2020	Q3 2020	Q2 2020	Q1 2020
Sanctum Indian Titans	3.5%	21.3%	9.2%	16.2%	-22.4%
Median Multicap MFs	8.6%	21.9%	9.6%	18.9%	-27.9%
Nifty 200 TRI	6.3%	23.9%	9.7%	20.8%	-28.9%

Significant theme rotation in the markets in the current year, 2021 (from quality growth to under-owned, beaten names irrespective of quality) has caused the portfolio to underperform. However, given the quality of our portfolio, we believe our portfolios are positioned to recover lost ground soon. Additionally, as economic recovery is gaining strength, we are adjusting to reflect higher cyclical exposure in our portfolio.

We believe a multicap, market cap agnostic strategy, like Sanctum Indian Titans that invests not only in structural, consistent growth stories but also looks at pro-cycle opportunities with distinct catalysts is well placed to do well over the next few years.

Technical Commentary

Nifty consolidated last month, closing higher by 1.2%. The index has formed Doji candlestick i.e. opening and closing prices are around the same levels for the month, indicating indecision in the market. The index had corrected to 61.8% (14,297) Fibonacci retracement level of the last rally from 13,597 to 15,431, this indicates a good support for Nifty around 14,867. The index has also seen short-term consolidation between 14,264-14,883 and formed a base around these levels. Hence 14,883 is a key resistance, a break above could suggest a retest of 15340-15430 zone. Above this next level is seen at 16,000. On the downside, a break below 14,264 levels could suggest a decline towards 13,597 and then possibly towards 13,100.



Source: Falcon7

While Nifty IT has bounced back it continues to remain in consolidation mode. The recent low of 24,200 has become a critical level and as long as it is held, the trend remains positive.

Indices	Next Resistance Level	Key Resistance Level	Current Market Price	Initial Support Level
Nifty Index	15,340	14,883	*14,867*	14,264
BSE Midcap Index	22,185	21,225	*20,516*	19,200
BSE Smallcap Index	22,460	21,835	*21,072*	19,600
Nifty IT	28,600	27,000	*25,980*	24,200

* Current Market Price as of 1st April 2021

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