



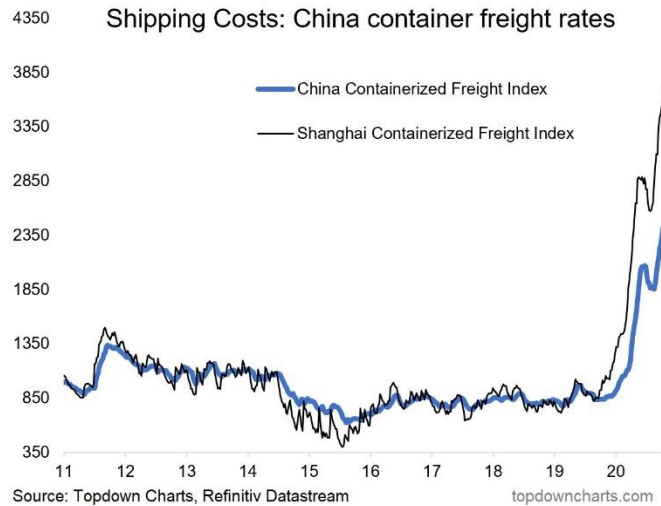
July 12, 2021

Portfolio Commentary

Inflation

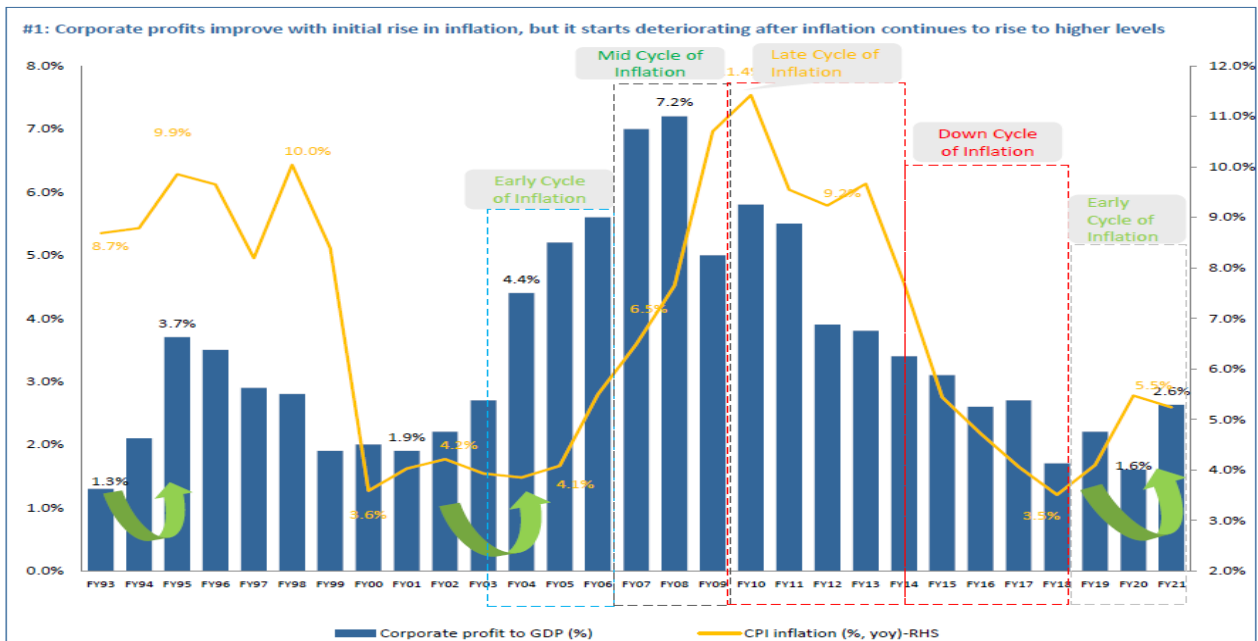
On 20th April last year, crude futures dropped 306% to settle at negative \$37.63 a barrel on the New York Mercantile Exchange. About fourteen months since, crude has moved all the way to \$75/bbl. And it is not oil alone, there has been an 80-200% price movement across all industrial as well as agricultural commodities from March 2020 lows. This brings us to the current hot topic - Inflation.

Major economies in the world are seeing inflation numbers not seen in the last 5 -10 years and are currently above the upper band of central bankers' range as well. Of course, we are cognizant of the fact that there has been a supply chain disruption caused by the pandemic and a low base effect is at play. However, one can't disregard that these numbers are largely above expectations.



It is pertinent to note that nominal inflation along with a healthy growth outlook is beneficial for any economy as a) it incentivizes entrepreneurs to take additional risk and invest in future capex b) it leads to higher nominal GDP growth and tax buoyancy for the government (that is why central bankers target minimum inflation in a low growth world!)

A nominal rate of inflation for a developing economy like India is a healthy sign. if we look at the corporate profitability to GDP (refer chart), some of the best years of profitability have been years when there is nominal to high inflation (mainly core inflation).



Source: Spark Capital

There have been a couple of false starts to economic recovery in the past decade, however, a lot of excesses that got created in the last upcycle have now been absorbed/ eliminated across industries.

Also, various government-led initiatives and particularly corporate tax rate cuts (**~Rs 1.6 trillion of savings for corporates with strong balance sheets**) and production linked incentive schemes will go a long way in creating an environment for sustained capital expenditure growth.

Additional tailwinds in the form of lower interest rates, supply chain diversification by MNC's, that are now looking for an alternate sourcing partner such as India that have a large domestic market, helps further boost the confidence.

We are positive about the capex story unfolding over the next few years. **We remain constructive on sectors like housing, manufacturing and firms catering to both domestic and export demand over the next 2-3 years.** ([Investment Outlook 2021](#))

We reflect these views in our In-house portfolio strategies – Sanctum India Olympians and Sanctum Indian Titans. With varying states and pace of recovery across the globe, we have also ensured a balance between our domestic and exports oriented exposure. Over the last few months, the portfolios have shifted towards businesses that are expected to benefit from the upswing in private capex, housing, and manufacturing.

We have added cyclical to the portfolios through business leaders and challengers. These companies have superior return ratios compared to peers and will hold our investors in good stead over the coming quarters. Despite the occasional underperformance, we steadfastly refrain from adding high beta stocks with inferior business models to chase returns.

As the economy started to normalize after the first wave, Indian corporates witnessed a sharp revival post the festive season in Oct-20. We were defensive in our portfolio stance till then, once we were convinced of the sustainability of the revival, we added beta to the portfolio by raising mid and small caps exposure to our Multicap portfolio, Sanctum Indian Titans, to capitalize on the ongoing recovery. Our exposure to mid and small caps (cumulative) has increased from ~25% to 35% over the last two quarters. Also, we have done adjustment to our large cap portfolio Sanctum Indian Olympians to reflect the recovery as well.

We have highlighted our positive view on housing in various commentaries earlier. To benefit from the rebound in the housing sector, we have invested in a low-ticket housing finance company with best in class return ratios and low GNPA's. The biggest competitive advantage is that it is one of the lowest cost borrowers among its peers enabling 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). Also, we have added a large cement company, which is part of a global conglomerate. It is currently expanding its capacity by ~60% to capitalize on growing demand.

The Specialty Chemicals sector in India which is going to benefit from supply chain diversification by MNCs is expected to double its size in the next 5 years. We have been bullish on this opportunity for the last couple of years due to rising environmental issues in China as well as due to the rising trade tensions between China and the US. We have ~9% allocation in Sanctum Indian Titans and ~4% allocation in Sanctum Indian Olympians.

Portfolio Performance

Performance as on June 30, 2021	1 Month	3 Month	6 Month	1 Year	CAGR		
					2 Year	3 Year	Since Inc.*
Sanctum Indian Titans	3.0%	11.6%	15.2%	52.6%	22.8%	14.2%	15.6%
NSE200 Index	1.5%	8.5%	15.1%	55.6%	16.8%	13.4%	15.4%

* Since Inception Returns are from 18-Nov-16

Performance as on June 30, 2021	1 Month	3 Month	6 Month	1 Year	CAGR		
					2 Year	3 Year	Since Inc.*
Sanctum Indian Olympians	2.0%	8.8%	7.4%	47.3%	16.1%	14.7%	12.9%
NSE100 Index	1.0%	7.8%	13.3%	52.2%	15.9%	13.2%	12.8%

Markets at an all-time high – Is it time to be cautious?

Equity markets have seen a huge run from the lows tested in March 2020. Large cap Indices like Nifty 50 gained 100% from those lows. Unlike the polarized rally of 2019, this has been a broad-based rally with the mid and small cap indices moving up a 140% and 190% respectively.

Defying expectations of a negative EPS growth in FY21, we ended with 14% earnings growth with Nifty 50 EPS at INR 539. The earnings growth saw multiple upgrades over the last three quarters as the economy started to normalize after the first wave.

Further, earnings are expected to grow at 30% in FY22, mainly led by a low base in select sectors and incremental profits coming from cyclical sectors. With these growth expectations in mind, the Nifty is trading at ~23x FY22e.

Midcap and Small cap indices have rallied sharply from the lows and have outperformed Nifty in the last 6 months. Many are worried about a possible bubble in this segment of the market. However, from a long-term perspective, things are not as frothy as it appears. From the peak of the last mid and small cap cycle in January 2018, the small cap 100 Index is still flat whereas the midcap 100 index is up 25% whereas the Nifty 50 Index is up 46%.

Post the sharp rally in the past year, easy returns are behind us. Return expectations need to be moderated in short term. We believe a bottom-up approach to stock picking would fare better. Being cautious doesn't mean the market will crash. Markets could take a cue from the upcoming result season of Q1FY22 and adjust momentum given the impact of the recent lockdown and already elevated margins.

We remain constructive on the Indian economy and equity markets over the next 3 years as India benefits from multiple tailwinds which could propel its growth to the next level.

Sanctum Wealth Management

Investment Management

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