Sanctum Wealth

Sanctum View

October 31, 2023

Portfolio Commentary

Taking stock of portfolios

- **The usual star sectors of the market, like financials and consumers, have taken a back seat in the current rally.**
- **Since equity markets witness sector rotation we have seen loss of interest in the quality theme.**
- **Valuations have gotten attractive as the market performance has been comparatively subdued even as the fundamentals have kept on getting better.**
- **We believe that the current rally in cyclicals and utilities will get overstretched at some point, and the focus will be back on earnings and quality of earnings.**

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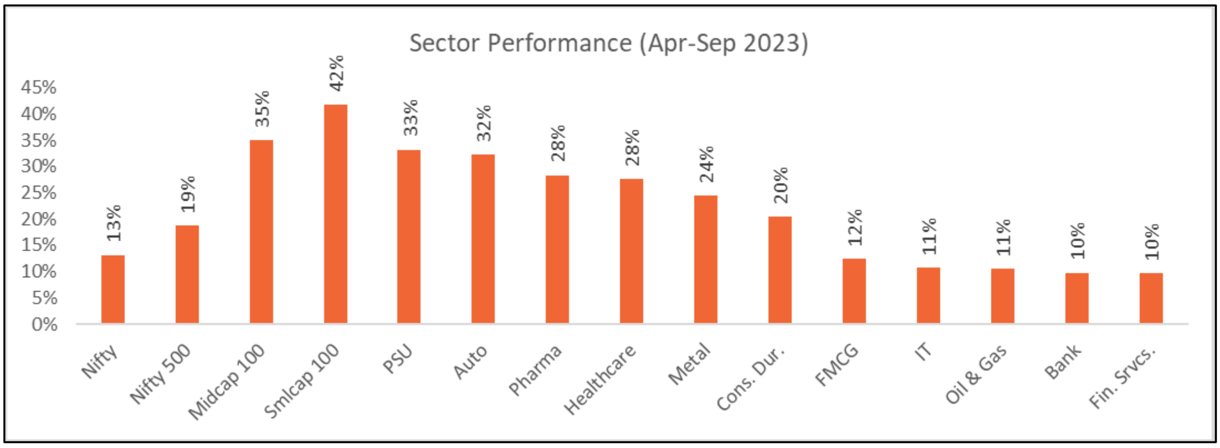
The headline indices saw some pullback in September from the August lows, ending with gains of 1.5-2%, while the mid and small cap indices continued their advance with gains of ~4% after giving up close of half of their monthly gains towards the end of the month.

As we highlighted in our previous month's note, the broader market rally over the last six months has been driven by the sectors that had long been overlooked, such as utilities, capital goods, pharma, and PSUs. The usual star sectors like financials and consumers have taken a back seat. As it happens in such an environment, larger and stably growing sectors and companies have lagged the broad indices during this period.

Our flagship portfolios, Sanctum Indian Titans and Olympians, which are quality-biased, have had a short-term lag recently. A part of this lag has been because of the relative underperformance of the financial heavyweights, which, though being marginally underweight, still form 28% of Titans and 30% of Olympians' portfolios. Financial services have underperformed the Nifty 500 index by a good margin in the last six months. While this may be a short-term hiccup, as sector rotations are a norm in stock markets, we can't write off the sector for its short-term underperformance, especially when the fundamentals of the sector have continued to improve.

The underperformance in portfolios has also been a result of our non-participation in cyclical sectors that have been responsible for most of the move in the index.



Source: NSE,BSE, Sanctum Wealth

Most sectors that have outperformed were undervalued at that time, however we chose to avoid them either because of a lack of earnings growth or cyclicality of earnings. Additionally, some of these themes also did not have a structural tailwind, which is a prerequisite for us while building the Titans portfolio.

The market's rotational nature has led to a loss of interest in the quality theme. Most of the index heavyweights have underperformed in the last year. We believe that the same rotational factor will benefit the quality theme and index heavyweights, when investors become a little risk-averse, especially in sectors where fundamentals continue to be strong.

Fundamentally speaking

- Financials

The earnings in the banking sector have seen a significant leg up, led by robust credit growth and a substantial decline in provisioning. The table below shows the earnings growth in the recent quarter and financial year.

	Q1 FY24		FY23
	YoY	QoQ	
Total Income	40.3%	0.7%	18.8%
Pre-provisioning Operating Profit (PPOP)	47.9%	0.4%	14.2%
Net Income	66.2%	20.2%	34.2%

Source: Ace Equity, Sanctum Wealth Research

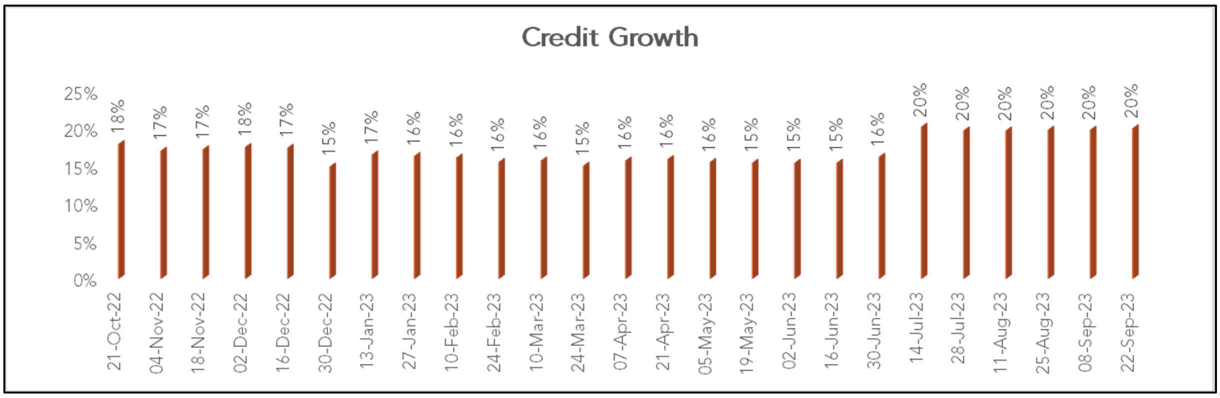
There has also been a significant improvement in asset quality in the last five years, as seen in the table below.

Particulars	FY18	FY19	FY20	FY21	FY22	FY23
GNPA	6.04	5.02	4.61	5.24	4.14	3.04
NNPA	3.20	2.02	1.66	1.97	1.28	0.80

Source: Ace Equity, Sanctum Wealth Research

Apart from this marked improvement in recent years, there has also been a drastic change in credit culture in the country. With the introduction of the Insolvency and Bankruptcy Code (IBC), the promoters have become much more conservative in using borrowed money to fund expansions. Retail credit quality has also improved as quicker reporting to credit bureaus has helped banks make informed lending decisions and instilled credit discipline amongst borrowers.

The credit growth in India also continues to be robust, as highlighted below by the RBI data.



Source: RBI, Sanctum Wealth

Even after excluding the impact of HDFC and HDFC Bank merger from the recent data point, the credit growth was still over 15%.

The bank credit is expected to moderate going forward because of lower working capital requirements from corporates led by declining commodity prices and robust bond market issuances. Retail credit, which is on a solid wicket growing higher than the average, shall continue to support the overall growth going forward.

- **IT**

We maintained an underweight position in the IT services sector in Titans (8.4% vs 10.1%) because of the headwinds from spending slowdown in developed countries. Though there is not a meaningful slowdown on the economic front, corporates are facing the heat of higher rates and are reducing discretionary spending meaningfully, which is hampering growth in IT companies.

We believe that after a tough FY24, these companies shall see better prospects in FY25 as the rate hikes get fully absorbed in the system and corporates start reinvesting in IT to strengthen their digital preparedness.

- **Healthcare**

Healthcare is one of the sectors that is seeing a structural change, and we are tweaking Titans portfolio to benefit from the theme. Apart from our exposure in pharmaceutical companies, we are also taking exposure in hospitals, which benefit not only from rising incomes and improved insurance penetration but also from government support in healthcare. Several hospitals are expanding their bed capacity as they see improved occupancies and rising average revenue per operating bed (ARPOB), leading to robust topline growth and expansion in margins.

- Chemicals

We have also started increasing our chemicals exposure in Titans portfolio as some names in the sector are approaching decent valuations after the fall. There could be some more pain in the sector as the prices of several chemicals continue to be under pressure. However, companies use this time and the cash flow they earned in the previous cycle to enhance their capacities. They are getting into forward integration to improve their revenue profile and into backward integration to secure supplies and improve margins. We believe many of these chemical companies will come out stronger at the other end of the cycle, as there is a huge macro opportunity in the sector due to India's rising competitiveness in the space and the capabilities that some of these companies have built over the years.

Conclusion

We believe that the current rally in cyclicals and utilities will get overstretched at some point, and the focus will be back on earnings and quality of earnings. When that happens, the sectors and index heavyweights that have underperformed recently shall again be back in favour.

We further continue to hunt for structural themes that we believe will continue to perform for longer periods and deliver less volatile, stable returns to investors. We also continue to tactically add to existing themes to benefit from the current period of lull.

Portfolio Performance

Performance as on September 30, 2023	1 Month	3 Month	6 Month	1 Year	CAGR			
					2 Year	3 Year	5 Year	Since Inc.*
Sanctum Indian Titans	0.1%	3.5%	18.1%	13.1%	5.9%	21.9%	16.1%	14.5%
BSE500TR Index	2.1%	5.5%	19.4%	17.5%	8.5%	24.3%	15.1%	15.8%

* Since Inception Returns are from 18-Nov-16

Performance as on September 30, 2023	1 Month	3 Month	6 Month	1 Year	CAGR			
					2 Year	3 Year	5 Year	Since Inc.*
Sanctum Indian Olympians	0.3%	0.6%	13.2%	9.4%	3.6%	16.4%	12.6%	11.3%
Nifty 50TR Index	2.0%	2.7%	14.0%	16.1%	6.9%	21.9%	13.8%	13.6%

* Since Inception Returns are from 16-Sep-16

The detailed performance can be viewed and compared with other PMS performances on this webpage.
Performance is calculated using Time Weighted Returns, net of fees and expenses. Returns over one year are compounded annually; returns for less than one year are absolute. Please note that SEBI does not verify the performance information provided above. Please note that past performance is not a guarantee of future performance.

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