30 January 2025

Portfolio Commentary

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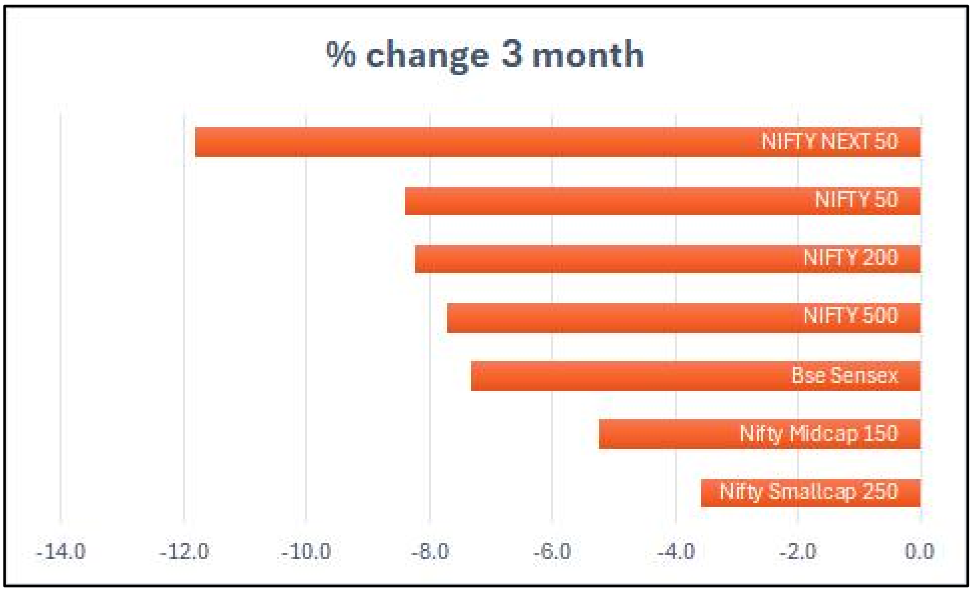
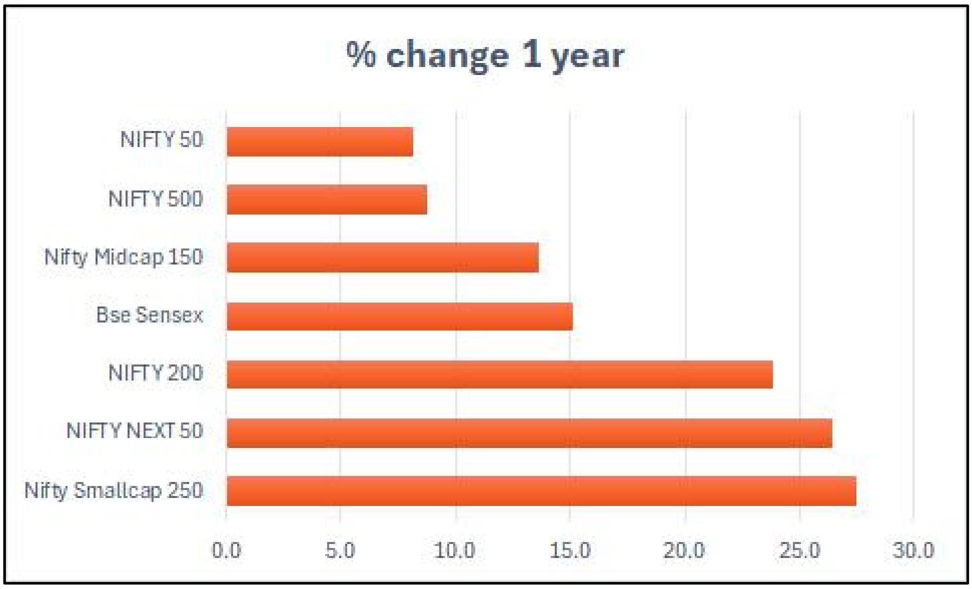
Reality Check – Are Expectations Running High?

The Indian markets saw some correction in the past quarter with mid-and-small caps outperforming the headline indices. The Nifty and Sensex declined by 7-8% in the quarter while the mid-caps declined around 5% and the small caps declined by a much lower 2%.

The headline indices posted high single-digit gain for the calendar year despite a Rs. 3 lakh crore outflow from the FIIs. Compare this to the 2008-2009 global financial crisis led selloff. FIIs sold 52,000 crores in domestic equities that led to a nearly 52% fall in Sensex in a single year as the selling triggered panic among local investors who lacked the financial capacity or confidence to counteract the sell-off. Or compare it with the 2013 taper Tantrum selloff when FIIs sold 30,000 crores in 3 months that led to a 10% decline in the Nifty 50.





Source: NSE & BSE

The underperformance of large cap vs the mid and small caps can be attributed to relentless selling by foreign institutional investors (FIIs) the quarter. FIIs remained net sellers for most of 2024, shedding over ₹1.75 lakh crore worth of Indian equities in the last quarter alone. For the calendar year, this figure doubled, exceeding ₹3 lakh crore.

During the past quarter, market movements aligned with expectations, and the performance of our strategies relative to the benchmarks is as follows:

	QTD Returns		QTD Returns
Sanctum Indian Titans	-6.40%	Sanctum Indian Olympians	-7.80%
BSE 500 TR Index	-7.58%	Nifty 50TR Index	-8.30%

As on 31st December 2024

While we remain bullish on the long-term structural growth story of India, we are entering into short-term uncertain, volatile, consolidation and readjustment phase before we get ready for the next up move.

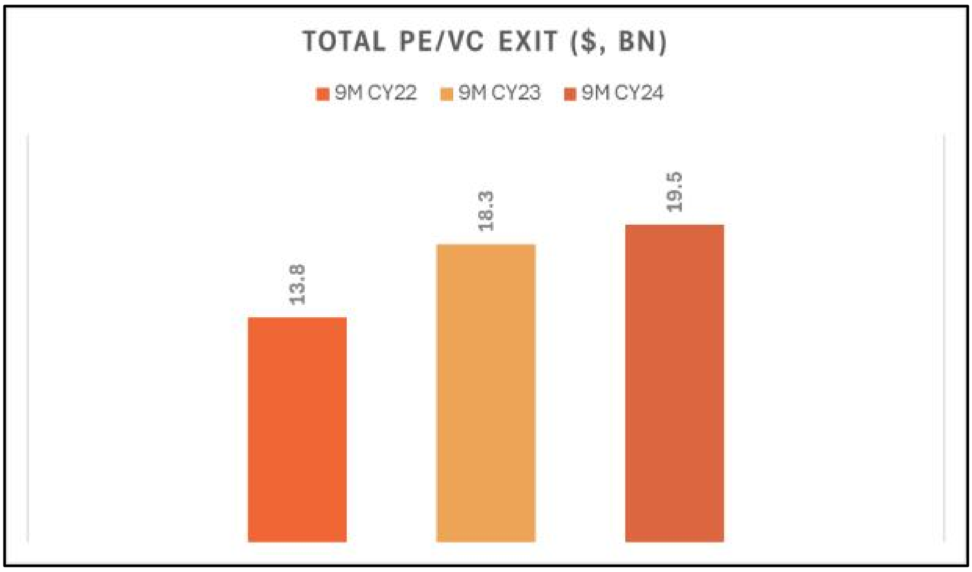
We had highlighted certain headwinds facing equity markets in our last note (Oct'24).

- Slowing corporate earnings and corporate tax collections
- Slowing government spend – both central and state
- Dwindling private sector capex.

Additionally, we foresee more headwinds both globally and domestically:

- **US dollar** – Uncertainty surrounds POTUS policies focused on higher tariffs and tax cuts. The extent of their impact on global trade, economies, and currencies remains unclear. Regardless of the direction, these policies will have market implications.

- **Domestically – apart from earnings slowdown**, rupee depreciation leading to sticky inflation has led to moderate interest rate cut expectation which could undermine growth. Also, continuous high supply of equity paper by MNCs and PE/VCs is leading to outflows from India as well. The upcoming Union budget would be keenly watched for any growth triggers either from incremental government spending or supporting consumer demand.



Source: Spark Institutional Equities

- **Broader market valuation remains elevated** – Within the three-market capitalisation buckets small cap segment continues to be the most expensive compared to long-term averages, trading at ~36% premium followed by mid cap at 26% premium. Large cap is largely trading at its long-term averages.

	PE(x)							
					Current - Premium/Discount		6 months back - Premium/Discount	
Name	Current 1 Yr Fwd	1 Yr Fwd - 31st Dec 2019	5 Yr avg	10 Yr avg	5Y Avg	10Y Avg	5Y Avg	10Y Avg
NSE Nifty 50 Index	19.2	18.3	19.4	18.3	-1%	5%	7%	13%
Nifty Midcap 150 Index	31.1	19.9	26.5	24.6	17%	26%	30%	40%
Nifty Smallcap 250 Index	23.7	14.2	18.6	17.2	27%	36%	23%	33%

As of 20th January 2025, Spark Institutional Equities

From a sectoral perspective, we analysed some of the key investment sectors and compared their current valuations to historical pre-COVID levels. Pre-COVID valuations serve as a relevant benchmark, as the post-COVID period witnessed above-average economic and earnings growth, driven by corporate tax cuts and government initiatives. The equation for future returns remains: growth plus valuation change equals total return.

The past four years have delivered above-normal market returns, which is reflected in valuation premiums across market capitalisations, as shown in the table below.

Avg Sector Valuation 1 Yr Fwd	Mar-19	Current
NSE Nifty Auto Index (P/E)	19.7	20.9
NSE Nifty IT Index (P/E)	17.4	28.4
NSE Nifty Consumption Index (P/E)	30.4	36.3
NSE Nifty Pharma Index (P/E)	18.6	28.5
BSE Capital Goods Index (P/E)	18.2	34.8
NSE Nifty Infrastructure Index (P/E)	14.1	20.7
NSE Nifty Bank Index (P/BV)	2.3	1.7
NBFCs (P/BV)	3.2	2.5

Source: Spark Capital & Kotak Institutional Equities

Most sectors that benefitted from higher growth and valuation re- rating are now trading significantly above their historical averages on one year forward basis except for lending Financials.

If the growth outlook looks weak, the reverse happens. Case in point is Financials, especially the private banks and NBFCs that were high growth sectors with superior valuation pre-covid. They have significantly underperformed in last 5 years compared to the broader markets.

Over the past four years, India has experienced strong tailwinds on both the macroeconomic and earnings fronts, driving market performance. However, most sectors continue to trade at stretched valuations. Looking ahead, some of the headwinds discussed earlier will need to subside before the next bull run begins. Until then, the market is likely to remain in a correction phase.

Way forward and portfolio perspective

As we have previously highlighted, an earnings slowdown and certain macro headwinds could lead to heightened volatility, particularly in the first half of the year, as markets adjust to both global and domestic challenges.

As investors, we have limited control over macroeconomic factors affecting the markets. However, we can minimize micro risks by establishing robust investment processes and adhering to them diligently to achieve superior risk-adjusted returns.

Historically, during an initial market sell-off, most stocks tend to decline regardless of portfolio philosophy—whether quality, fundamentals, momentum, or value. However, once the initial correction settles, fundamentals take precedence, and this is where we believe our edge lies.

Sanctum Wealth

We believe this will be a defining year for our in-house strategies, Sanctum Indian Titans and Sanctum Indian Olympians. The past few years have been particularly challenging for large-cap-heavy strategies and those with a core focus on quality, but we see conditions turning favorable. As momentum recedes and the focus shifts back to business fundamentals and earnings delivery, we expect both our strategies to outperform their respective benchmarks. Additionally, if an earnings slowdown occurs across the board, mid and small caps—still trading at a significant premium to their long-term averages—are likely to face a sharper multiple de-rating. In contrast, large caps, with relatively lower valuation premiums, are better positioned to limit downside risk.

In the stock markets, success ultimately hinges on one key principle—investing in quality companies with long-term structural growth. As long as this remains the core of portfolio management, long-term performance is unlikely to disappoint.

Here's how our flagship strategies have performed across different time periods:

Portfolio Performance

Performance as on December 31, 2024	1 Month	3 Month	6 Month	1 Year	CAGR			
					2 Year	3 Year	5 Year	Since Inc.*
Sanctum Indian Titans	-2.0%	-6.4%	-0.7%	13.8%	15.6%	10.0%	16.5%	14.6%
BSE500TR Index	-1.5%	-7.8%	-0.7%	15.8%	21.0%	15.4%	19.1%	16.9%

* Since Inception Returns are from 18-Nov-16

Performance as on December 31, 2024	1 Month	3 Month	6 Month	1 Year	CAGR			
					2 Year	3 Year	5 Year	Since Inc.*
Sanctum Indian Olympians	-2.1%	-7.8%	-0.9%	9.5%	12.0%	8.4%	11.9%	11.7%
Nifty 50TR Index	-2.0%	-8.3%	-1.1%	10.1%	15.6%	12.2%	15.5%	14.1%

* Since Inception Returns are from 16-Sep-16
All returns are on TWRR basis, after fees and expenses

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