

Monthly Memo

CIO Monthly Memo for March: New challenges; New opportunities

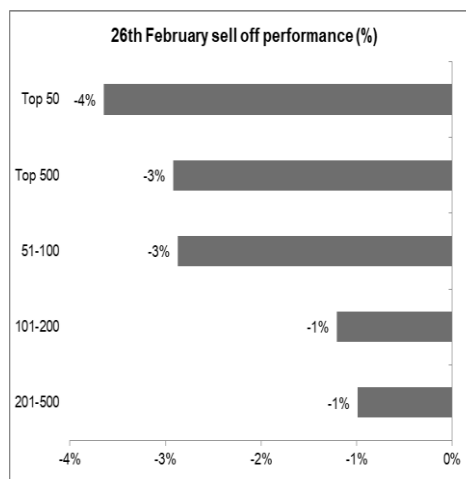
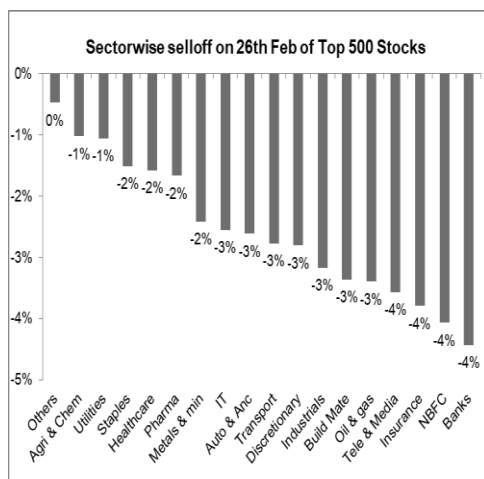
The month of February was a rollercoaster ride as it started with the big bang Union Budget day that had a marked effect on the market structure and the month ended with rising treasury yields that spooked the markets around the world. Even though the markets saw significantly higher degree of volatility during the month, the overall setup was constructive. The core sectors performed quite well during the month with PSU stocks delivering good returns.

As the market's structure changed, we scrambled to allocate our cash positions of various strategies. This took us some time but we managed to outperform the benchmark by a very healthy margin in our contra strategy while growth underperformed marginally. Our Retirement strategy continued to meet its objective of delivering positive returns during the month. Even as February closed on a positive note, we find that new challenges have started to emerge for the market. On one hand, earnings have started to recover and we are witnessing a very healthy earnings upgrade cycle after a prolonged period but on the other hand, rising global yields are posing challenges to valuations world over. The market sell off on 26th February was quite broad-based but PSU banks were hit the hardest. However, some recovery was seen the subsequent days.

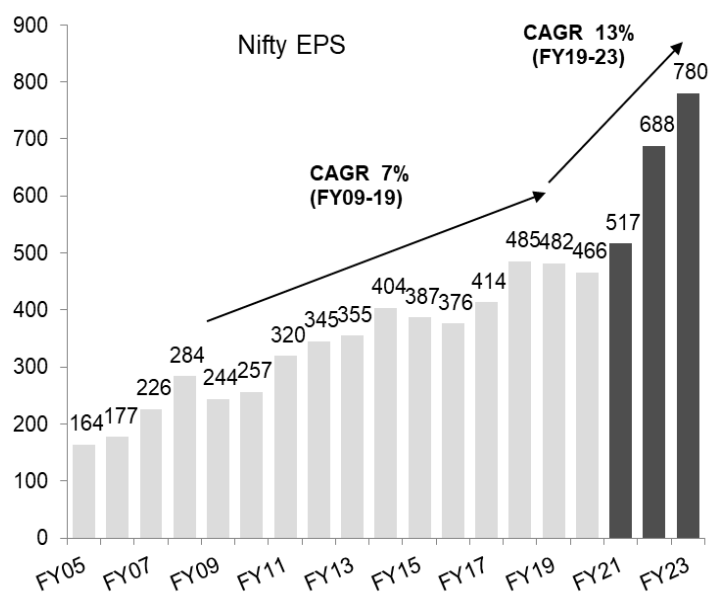


Naveen Kulkarni
Chief Investment Officer

Naveen has over 17 years of experience in the financial services and Telecom sectors. In his previous role, he was responsible for Institutional and Retail research as Head of Research with Reliance Securities Limited. He also served as Co-Head of Research with Phillip Capital India Private Limited in his 11-year long association with the organization.



For Q3FY21, 38 out of the 50 NIFTY FIFTY companies beat the consensus expectations. The consensus earnings saw upgrade for FY21/22 by 9%/8% respectively. Earnings are seeing an upgrade cycle after a protracted period of earnings cut. The FY23 earnings have also moved by 7% to Rs 780 for the benchmark. A closer look at the earnings upgrades across sectors indicates a definite pattern. The cyclicals and the rate sensitive sectors are seeing a solid upgrade cycle. Metals, Automobiles and BFSI saw the strongest upgrades during the



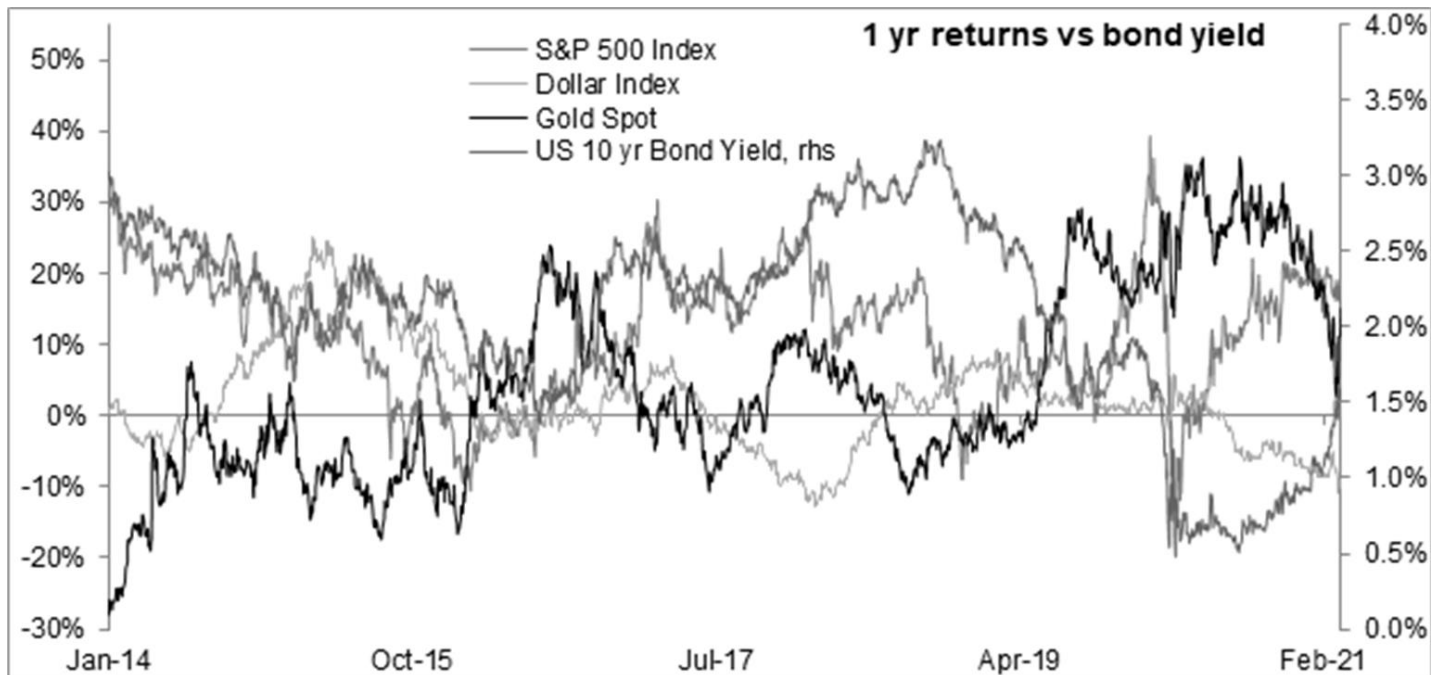
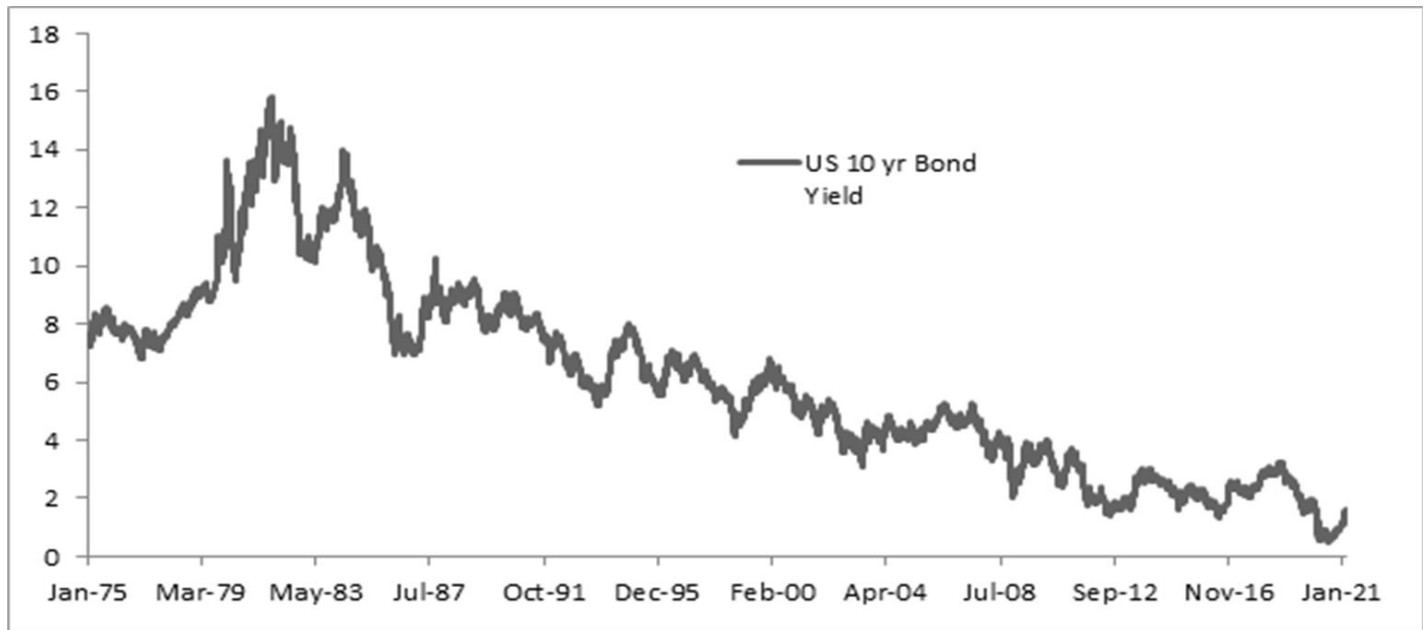
On one hand the corporate earnings are gaining traction but on the other hand the global bond yields have also started to move up. The rise in global bond yields is on account of inflation which seems to be seeing a strong come back. Commodity prices have moved up quite fast. Iron Ore and Copper were some the top performing major commodities in 2020. Also, as demand is surging core inflation is rising globally on account of supply side challenges. This will keep the pressure on bond yields but as we focus on inflation, it is not just the direction of inflation but also the level of inflation in the system will be critical. Equity markets during periods of booms

quarter. These sectors saw upgrades after Q2FY21 also and the traction has continued into Q3FY21. The IT sector saw a further earnings upgrade of another 5% during the quarter which was significant considering the elevated base of the sector. The IT sector continues to be in prolonged earnings upgrade cycle. Thus, our allocation to the sector continues to remain unchanged even after significant appreciation the stock prices.

| | FY21 Nifty EPS Change | | | % chg | |
|------------|-----------------------|----------|----------|----------|----------|
| | Before Q2 | After Q2 | After Q3 | After Q2 | After Q3 |
| Financial | 159.2 | 170.5 | 187.3 | 7% | 10% |
| IT | 79.3 | 82.9 | 87.2 | 5% | 5% |
| Oil & Gas | 66.9 | 69.8 | 75.6 | 4% | 8% |
| FMCG | 38.0 | 37.4 | 37.6 | -2% | 1% |
| Power | 32.1 | 31.9 | 33.4 | -1% | 5% |
| Industrial | 20.6 | 26.5 | 22.0 | 28% | -17% |
| Pharma | 19.4 | 20.8 | 21.5 | 7% | 4% |
| Metals | 15.5 | 22.1 | 34.0 | 43% | 54% |
| Automobile | 12.8 | 15.0 | 19.6 | 17% | 31% |
| Cement | 4.5 | 5.5 | 6.4 | 21% | 16% |
| Telecom | -4.5 | -7.3 | -7.1 | NA | -2% |
| Total | 449 | 475 | 517 | 6% | 9% |

perform quite well even as inflation rises. During periods of bust or recession, the markets tend to be challenging but the recent monetary stance of central banks have aided the markets. It is during the periods when the economy gets overheated and a stagflation kind of a scenario emerges which results in major challenges to the equity markets.

Thus, a closer look at the long-term chart of the US bond yields indicates that we are still in a very comfortable zone as far as the long-term yields are concerns. Also, juxtaposing the yields against returns of various asset classes, we find that the equity markets are well placed in the current context of bond yields.



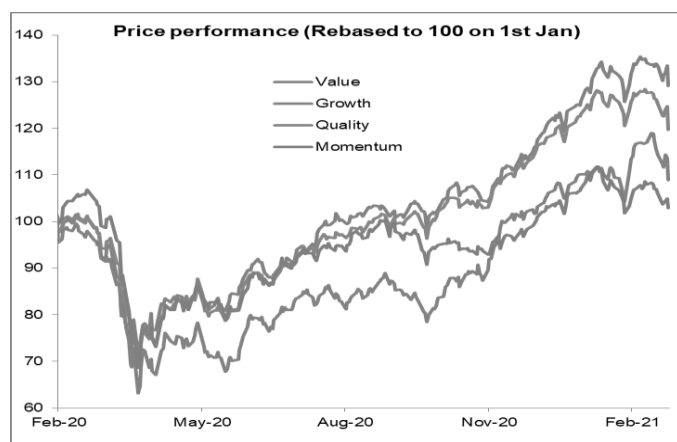
Now coming to the Indian context of inflation, our inflation basket is markedly different compared to the global (say OECD) basket. Inflation in India is dominated by food inflation. We have virtually dodged a bullet in the last food inflation cycle which generally starts in the second half of the calendar year and starts cooling off by the end of the year. This pretty

much sets the tone for the level of inflation and the headwinds thereof. Inflation started cooling off from January and it is now in a manageable zone. Inflation will remain around the 4% mark which is in the comfort zone of RBI to maintain a growth oriented accommodative stance.



Finally, the question boils down to the asset allocation stance and the investment styles which will outperform. Globally, the core sectors are coming back in flavor because of the demand uptrend and commodity inflation. This will work in

the Indian context also. Thus, value as an investment style is more likely to outperform the other styles. Value has outperformed growth, quality and momentum since the pandemic by a significant margin. This trend is more likely to sustain in 2021 also.



While Value outperformed the other investment styles in 2020, quality was the second best performer. Momentum and Growth have been underperformers. However, in the recent months growth has gained good traction. Quality is more likely to take a breather as buy quality at any price is unlikely to work as investors will have multiple options in a demand surging environment. We believe that both Value and Growth will deliver good returns and a combination of the two themes, Growth at a reasonable price (GARP), will deliver solid returns. In terms of sector orientation, BFSI will be the key sector to focus as the sector will see higher than benchmark earnings growth and also

| Performance | Performance (%) | | | |
|--------------|-----------------|--------|---------|----------|
| | Value | Growth | Quality | Momentum |
| Till 23 Mar | -28.5% | -36.8% | -30.9% | -31.4% |
| Since 23 Mar | 80.6% | 72.2% | 73.3% | 49.9% |
| 2020 | 24.9% | 10.2% | 22.6% | 6.6% |
| 1m | 2.8% | 4.4% | -0.7% | 1.1% |
| 3m | 12.4% | 6.2% | 5.4% | 3.8% |
| 6m | 27.6% | 24.8% | 20.3% | 4.2% |

offers the comfort of valuations. Consumer discretionary will also see growth coming back which will aid outperformance.

Our orientation in growth strategy is changing with addition of more Beta with focus on Industrials, BFSI and Consumer discretionary. In contra, we continue to focus on cyclicals and BFSI sectors. We continue to scout for opportunities across the spectrum and will remain focused on macroeconomic trends across the globe. We continue to remain optimistic about the market returns for 2021 and will add positions accordingly with returns focus and less of drawdown as a major constraint.

Portfolio Strategy performance

| <u>February</u> | | | <u>Performance</u> | | | <u>Net Performance</u> | |
|-----------------|--------|--------|--------------------|------------|--------|------------------------|------------|
| Performance | BSE200 | Growth | Contra | Retirement | Growth | Contra | Retirement |
| MTD | 7.30% | 5.20% | 11.30% | 4.40% | 5.20% | 11.30% | 4.40% |
| Perf. | | -215 | 392 | -289 | -215 | 392 | -289 |
| 3 months | 13.40% | 11.60% | 17.30% | 6.50% | 11.40% | 17.10% | 6.30% |
| Perf. | | -181 | 393 | -692 | -200 | 373 | -711 |
| 6 months | 26.00% | 24.90% | 42.00% | 15.90% | 24.20% | 41.10% | 15.20% |
| Perf. | | -103 | 1604 | -1005 | -180 | 1515 | -1077 |
| Since Inception | 49.50% | 50.90% | 74.30% | 33.60% | 49.40% | 72.50% | 32.20% |
| Perf. | | 147 | 2479 | -1590 | -5 | 2305 | -1724 |

| Particulars | 1M* | 3M* | 6M* | 1Y | 3Y | 5Y |
|-------------------|--------|--------|--------|--------|--------|--------|
| Growth | | | | | | |
| Portfolio | -1.10% | 18.60% | 28.10% | 43.50% | 26.80% | 23.70% |
| BSE 200 | -1.50% | 17.80% | 23.60% | 39.30% | 14.70% | 8.90% |
| Performance | 47 | 80 | 454 | 424 | 1208 | 1478 |
| Contra | | | | | | |
| Portfolio | -1.30% | 21.50% | 37.10% | 56.60% | 20.90% | 14.60% |
| BSE 200 | -1.50% | 17.80% | 23.60% | 39.30% | 14.70% | 8.90% |
| Performance | 21 | 371 | 1354 | 1738 | 613 | 565 |
| Retirement | | | | | | |
| Portfolio | -4.50% | 7.60% | 11.10% | 27.90% | 22.80% | 17.30% |
| BSE 200 | -1.50% | 17.80% | 23.60% | 39.30% | 14.70% | 8.90% |
| Performance | -297 | -1012 | -1251 | -1137 | 801 | 836 |

* Live performance as on 28th Feb 2021

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