Navigating the Pandemic: From Carona se Darona to learning to live with it

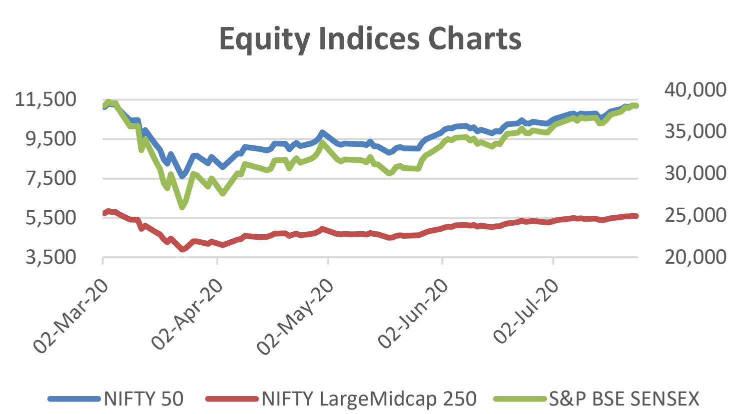
We write to you after our note in April, where we were in early stages of the pandemic but the stock markets had shown a deep cut and we were sitting on cash and gold and started deploying it systematically. Now, the situation looks more bizarre and disjointed, while we are in the full grip of the pandemic trying to safeguard lives, livelihoods and businesses from the virus and its aftermath, markets across the world seem to indicate completely the opposite or have been exhibiting an attitude of utter disdain to ground realities. Globally most markets are up more than 30% from the lows and some have even regained all the losses**. Welcome, to the world of equities!! Need we say more.**

However, by experience most of us by now know that a) markets are unpredictable in the short-term and the only way one can navigate this is through prudent asset allocation and staying invested irrespective of volatility and b) one can never time the markets.

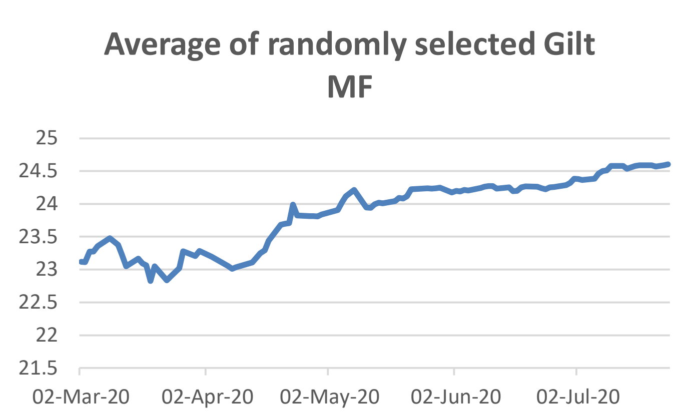
- We had shifted nearly 30%-40% of the portfolio from equities to gold and debt. This measure not only helped us withstand high portfolio volatility but also create certain alpha through Gold that has risen by almost 9% since 31 March 2020.
- Since, staying invested and not timing the market is a key part of what we do, we immediately initiated Systematic Transfer Plan from Liquid funds to respective equity schemes for a period of 3 months. This measure has helped the portfolios to participate in the rally witnessed since March 2020 till date.

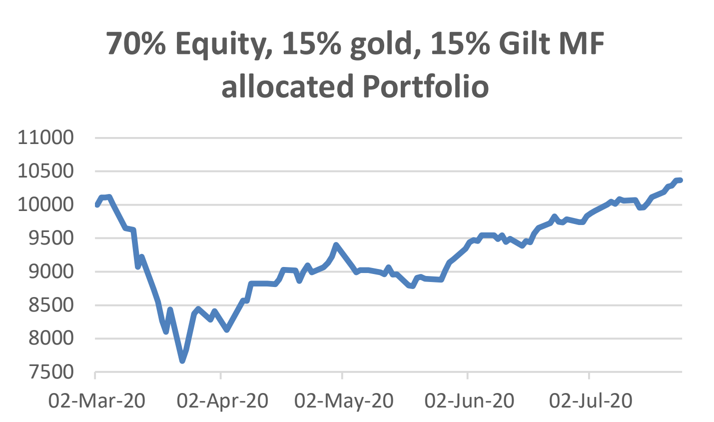
During the last three months our average Asset allocation has been in the range of 60-70% equity: 10-15% Gold and 10-15% Fixed Income. As seen in the graphs, this allocation has helped us recover from the March lows.

Recent Performance of Equity, Gold and Fixed Income



Asset Allocated Portfolio Performance: Up 3%



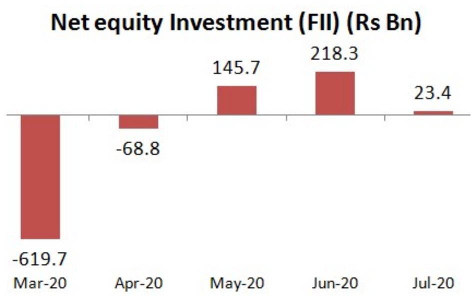


might not continue and there could be further bouts of volatility. We have reset portfolios back to 70% equity and stopped regular transfers to equity and staying put on gold allocations, while activating fixed income investments through GSec funds.

Reasons for these actions are based on what we think drove the recent rally - it doesn't seem sustainable

High Liquidity

The amount of liquidity created by the developed world post the pandemic has been unprecedented. While US financial packages amounted to 13% of the GDP, Japan's was 21% of the GDP. The European Union is likely to spend near USD 1.8 trillion for economic recovery. We believe that a significant part of these liquidities should have found place in stock markets across the world. Even in India, since March 2020 the FIIs have been net buyers, resulting in the momentum.



Hope of a Vaccine

The hope for a potential vaccine in the near term has also helped the stock market to undermine the impact of short term pain that has been witnessed across the world. Although it is anyone's guess on the time period of vaccine's success on human trials and mass production thereafter.

Can this rally sustain?

Frankly, we don't know, hence the caution. But we can gauge the severity of impact of Covid and the measures to combat it will have on the economy for the next 12 months.

- All the important world institutions have forecasted a severe recession, worse than 2009 financial crisis for the current fiscal.
- RBI in its recent Financial Stability Report has projected deterioration of Asset quality by nearly 400 bps in the base case and 600 bps in the worst-case scenario. Please note that financials alone contribute 40% of the Indian Indices and any stress will highly reflect in the indices performances as well.
- As on April 2020 nearly 50% of the loan outstanding is under Loan moratorium availed by RBI, any deterioration in the asset quality will demotivate banks to lend aggressively in the near term. The muted credit growth despite the government's best efforts may have impact on GDP as well. NBFCs that account for 24% of the overall lending have already seen a serious liquidity crunch in the past few months.
- We may also likely witness a significant hit in domestic discretionary consumption as many important contributors to GDP like travel and tourism, restaurants, education, hospitality would be in prolonged standstill.

- However, certain segments of the economy like healthcare, agriculture, staples and some pockets of rural consumption are expected to do better and limit the damage to some extent.
- Initial trends from the IT sector post the pandemic doesn't seem as negative, as the sector seems to have withstood the shocks quite well. And also companies are expecting increased outsourcing as global business look to cut costs and create business continuity plans. But short term risks due to slow economic growth and logistics still persist**.**

Overall, we believe that the outlook of Indian Economy may remain muted in the next few quarters that may reflect in the market Indices i.e. Sensex and Nifty. We therefore, suggest some caution and have sufficient liquidity at hand to participate in the event of a correction in the near term. But our base case assumption is that we might not test the March lows, hence, there is no plan of drastic reduction in equity allocation.

Asset allocation changes:

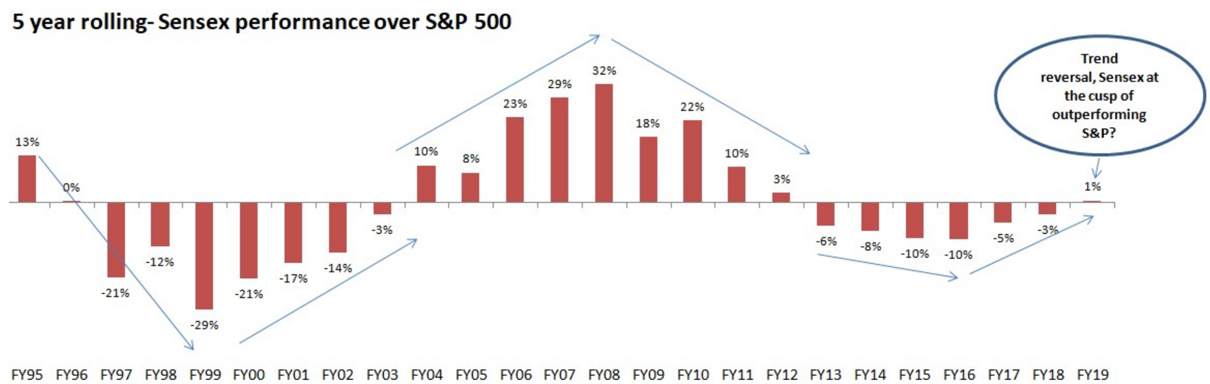
- We have again switched nearly 30% of the portfolio from equities to Gold and debt funds. We believe that we have captured a majority of the rally witnessed since March and we expect insignificant loss of opportunity even if the market go up largely due to liquidity and reaches the February 2020 peak.
- The average portfolio now has 10-12% exposure in Gold that as mentioned earlier is doing well and may continue to do well in these times of uncertainty
- A majority of the debt funds are parked in Gilt funds that have exposure to long term, fixed income Government securities. We expect some alpha from Gilt funds in the current year as RBI, as a part of monetary stimulus, may likely further ease its hold on benchmark interest rates that may reduce the yields further.
- As our outlook for Gold and debt funds is to generate decent alpha we expect insignificant opportunity loss if the market reaches its peak again.
- However, if the market witnesses a second round of correction then we will have enough cash at disposal to participate on a downside event and thereby reduce our average cost of purchase, the lower equity exposure will also help prevent downside.
- We may switch another 10%-15% from equity to cash and gold if the equity rally sustains and comes close to February Peak. This is in continuation of our belief that the rally is bereft of the inherent state of the economy and is primarily liquidity led.

The idea is that we will remain underweight equity on a relative basis and for the next couple of years, a higher tactical allocation to gold may help the portfolios. Fixed income will be used as a buffer to increase or decrease equity allocation.

Please note these are tactical deviations only, we will revert to long term asset allocations for each portfolio once we see reasonably predictability of macro events.

Outlook

As we have been consistently saying in every report that as long as we stick to equity investments in good performing funds with high portfolio quality we will continue to outperform benchmarks over a period of time. We adhere to our belief that India structurally has long term growth prospect which will only accentuate post Covid-era as de-risking of supply chain from China would be the key objective of many developed economies and India will likely be a key beneficiary. Also we feel that the 10 year trend of developed market outperforming emerging markets is reversing and India will be a significant beneficiary of that trend.



As for the current status of the portfolio, our focus will remain on capital preservation. We expect that the non-equity part to generate sufficient alpha during the year, but since we will have a substantial part invested in equity so even if the rally sustains the portfolio upside is not entirely compromised. However, if the markets witness another round of correction, we would have enough war chest to participate. We therefore, believe that we are currently at a position where **“Heads we win and Tail we won’t lose much”.**