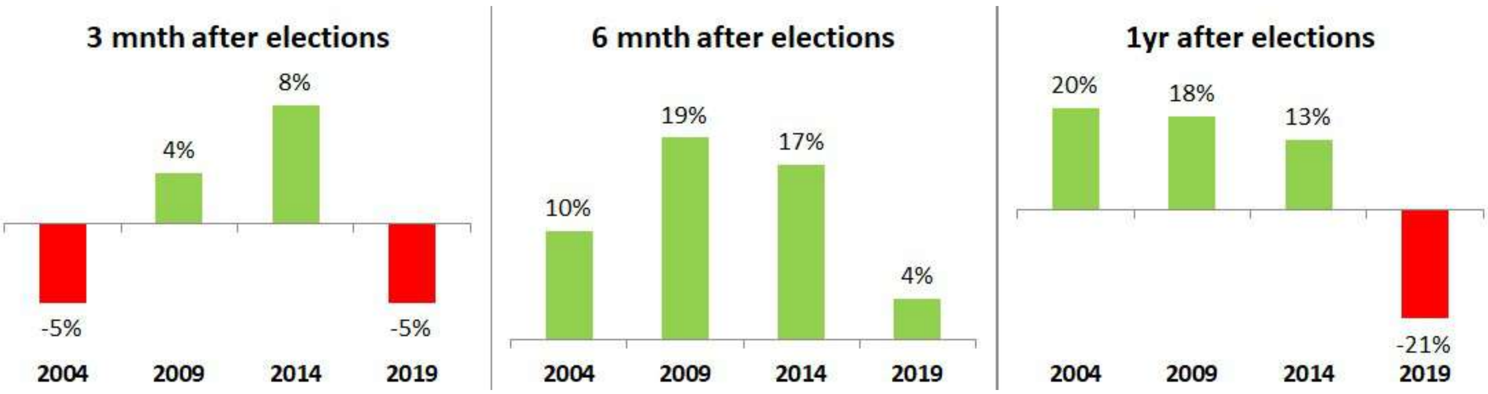
Introduction

As we embark on a new financial year, what's on every body's mind and conscience is the ongoing General Elections that has just begun. A lot of us are concerned about the impact of the election on equity returns and will base our investing decisions on the outcome of elections. In this note, we are trying to assess the impact of election event on equity markets over the last 20 years across four election cycles. Our inference based on this study will be a matter of much conjuncture, but we feel that data speaks for itself, which will give the reader some insight to untangle the election conundrum. How much ever we feel things will change, the more they remain the same. Do read on

Do election results really matter?

Short term roller coaster

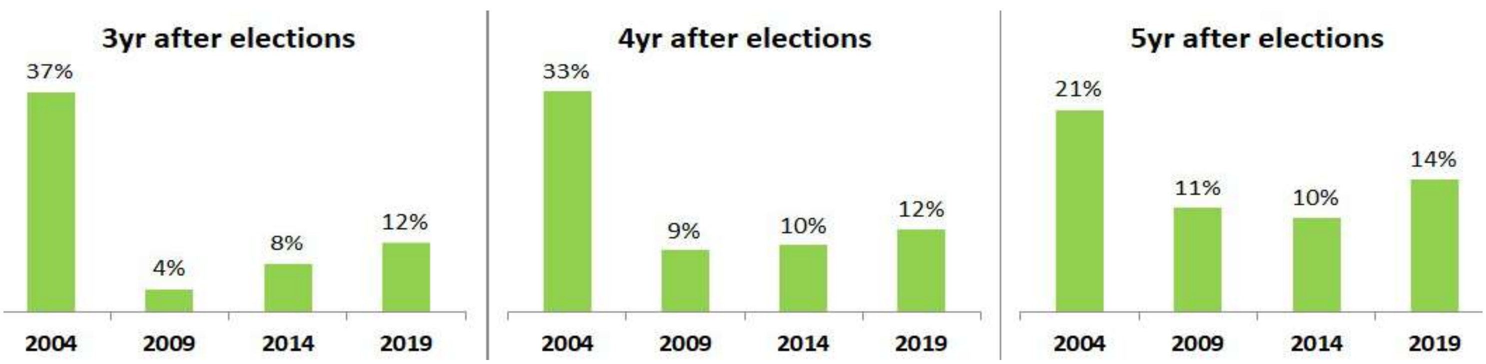
We have analyzed data since 2004 general elections covering a total of 4 general elections. We notice, markets are volatile post the election results in the short term as the sentiment oscillates between continuum, disappointment and hope about economic policies of the political dispensation which assumes power post elections. Please note the performance in 2019 was affected by the pandemic.



General election dates- May 2004, May 2009, May 2014 and May 2019

Long term- Steady State- muted impact of election results

On the contrary, long-term impact of general elections on market is largely muted as eventually corporate earnings decide the market returns. This is reflected from the average return per annum Sensex has provided over a 3 yr., 4 yr. and 5yr post-election results.

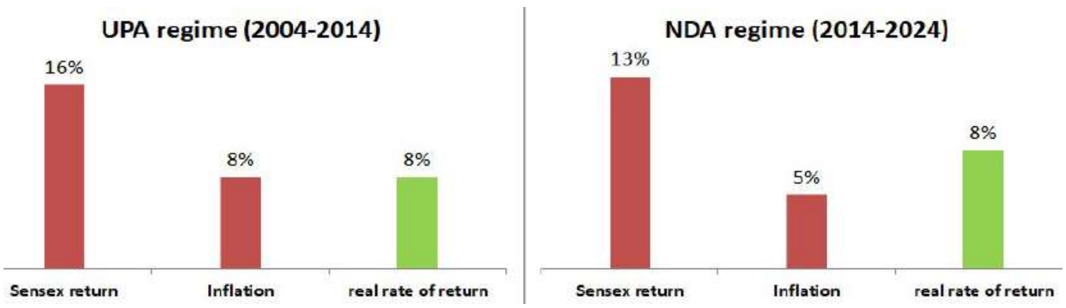


Now that we have established that elections have very little impact on long term equity returns, the question still looms regarding the impact on the market if the results are not on expected lines. In order to understand this better we analyzed market performance during the 10 year regimes of UPA (2004-14) and NDA (2014-2024).

Long term returns are largely similar, irrespective of who comes to power

Under UPA regime, market delivered an average annualized return of nearly 16%. However, adjusted to inflation of near 8% per annum, the real rate of return has been 8% per annum

Under NDA government between FY14 to FY24, market delivered an average annualized return of nearly 13% per annum which is lower than the previous 10 years. However, inflation under NDA regime was much lower at 5% per annum and therefore the real rate of return has been similar at 8% per annum. This return in our opinion is good when we compare it with fixed deposits where real rate of returns is negligible to say the least.

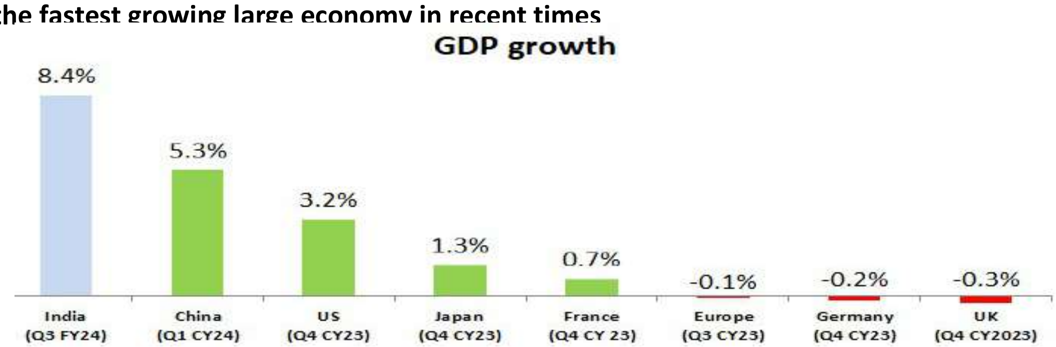


This data reiterates that market returns are only determined by earnings growth in the long term and any change in the government may only have short term repercussions. In our view, the larger economic policy remains more or less similar directionally under the main two national parties; the differences are only at the margin. We say this, because corporate performance seems to be largely similar under both regimes which is reflected in stock market returns. Please bear in mind we have not factored any externalities be it local or global in our analysis.

Outlook

The reforms undertaken by the government over the last 10 years like GST, RERA, Digitization, DBT etc. have laid an excellent foundation to create a virtuous growth cycle for the Indian economy perhaps last seen in the 2004-08 periods. This makes India one of the bright spots globally as it also has a favorable demographic compared to any other region of the world at least for the next 20 years. ***This means either the jobs will come to India or Indians will go to where jobs are***. This in our view will drive inbound investments and consumption for quite some time, leading to robust earnings outlook.

India is the fastest growing large economy in recent times



Corporate earnings outlook robust for the medium term

Financial sector, a major driver for earnings growth

Financial sector represents nearly 40% of weight in both Sensex and Nifty, and therefore, is the most important sector. We believe that the earnings growth in this sector will be predominantly driven by a robust outlook for PSU banks. These banks were suffering from poor asset quality for a long time before the course correction happened in the past few years. As of now the asset quality of PSU banks are consistently improving with significant improvement in operating efficiency. With a strong credit growth outlook, the impact on profitability may be more pronounced, going forward

- **Expected resurgence in capex cycle**

Former US president John F Kennedy once said "*American roads are good not because America is rich, but America is rich because American roads are good". We believe that this may apply for India as well.*

We expect a strong growth in capital expenditure particularly driven by infrastructure, manufacturing and real estate. **Infrastructure push** is largely supported by government through significant investments in roads, railways and ports witnessed in the past few years. To understand the extent of scale, since 2014, total length of national highway has increased by 56% from near 92,000 km to 1,45,000 km in 2023, the rate of growth is impressive at 30 km per day compared to 12 km per day in 2015. Similar scale has been achieved in railways and ports as well.

India's **manufacturing sector** is expected to get a significant push through government's Production Linked Incentive (PLI) scheme, lower corporate taxes, improving ease of doing business, improvement in labor laws and global MNCs desire to have a China plus one model to de-risk the global supply chain. The share of manufacturing sector is expected to improve from 16% of GDP in 2022 to nearly 21% by 2030.

Real estate sector, a significant contributor to India's GDP (7% of GDP) is witnessing steady revival after a decadal slump in demand. Annual sales in 2023 have surged to a 10 year high with heavy demand for the premium housing. Even the inventory levels are at historical low which is only at cumulatively 6 quarterly volumes of sale, as of 2023. This demand may sustain for many years to come, driving significant value creation in derivative sectors like paints, cement, housing finance, steel, etc.

Portfolio strategy

Continue to prefer value over growth

We have mentioned in our earlier report regarding dominance of value strategy/funds/stocks over growth strategy/funds/stocks. For the uninitiated, Growth oriented stocks are those companies where the potential to grow earnings are very high and for this reason their valuations are always at significant premium to value stocks. These companies typically do very well during a lower interest rate regime as their future cash flows get a higher value, as the discounting factor is very low. This phenomenon is reversed when rates rise, future cash flows seem less valuable in higher rate environments. For the past 15 years the growth-oriented companies outperformed the value peers by significant margin as rates were very low which got accentuated in the pandemic. However, as rates are higher now, in fact, 40 year high in the US, the paradigm seems to be shifting in favor of value as reflected from its performance over the past 2 years especially post covid. The BSE enhanced value index has outperformed BSE growth since 2020.

We believe that this outperformance may continue as rates are likely to remain higher for longer, as the high rates have not affected economic growth as expected in the Western world, and inflationary pressures still remain with unresolving geo politics impacting supply chains and energy prices.
We will continue to prefer value-oriented portfolio over growth-oriented portfolio for the medium term.
Portfolio exposure will be broad based with higher tilt towards mid and small cap companies. In spite of a significant rally of mid and small cap companies in this year, we continue to remain positive due to strong growth outlook and valuation remaining fair compared to large cap. Based on historical valuation, mid and small cap continues to trade at a fair valuation and provides attractive opportunities with a medium-term outlook

This chart is a monthly ratio of PE of BSE mid cap and PE of Sensex since 2015. This ratio touched nearly 1.8x in 2018 that showed mid cap trading at a significant premium over large cap. As of now the ratio is 1.1 which is much lower than the historical average of 1.24, reflecting mid cap available at a fair valuation

Conclusion

We prefer funds that are relatively value oriented or have reasonable exposure to value stocks. Preference will also be given to stocks and funds that have relatively higher exposures in the sectors mentioned earlier. We are in the camp of not favoring one section of the market over the other, whether it is large, mid or small. We prefer ideas where there is a reasonable runway of growth and rational valuations. In terms of funds, we will have our core portfolios in diversified equity like large and mid, flexi and multi-cap schemes. We are also fairly positive in small and mid-cap, just that proportional allocation should in line with the risk and reward. For our satellite portfolio ideas, we prefer thematic funds with strong growth prospects like housing, pharma, infrastructure, manufacturing, PSUs etc., we also bucket small caps as satellite allocation, as there is an element of timing in that asset class. Overall, we are bullish on the India growth story, to quote Minister of External Affairs Dr. S. Jaishankar, *"India is an oasis of stability in the increasingly difficult world"*. Nothing is truer if we see the recent GDP growth numbers (as mentioned earlier). Irrespective of the election outcome we believe that India's growth story may continue to witness sustained momentum, as it has in the past 3 decades.
Despite frequent changes, some things remain the same.

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