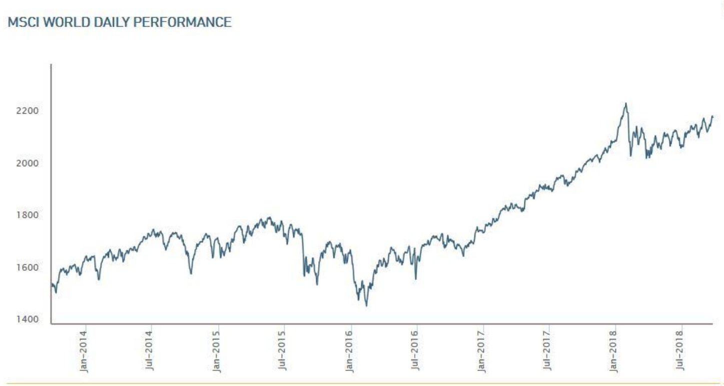
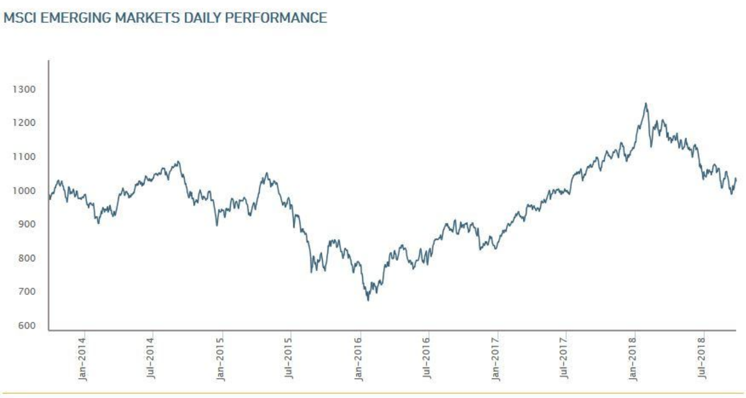
It is that time of the year again!! August-September Strikes again!!!

Introduction

Please recollect the previous two times we wrote to you a reassuring note in the recent past August 2013 and August 2015 (link to the reports at the end). Both these times the Indian equity markets experienced deep corrections and stocks and mutual funds gave up most of their recent gains, confidence wobbled and one began doubting the country, the economy and the dispensation of that time. On both these occasions and during our interactions with you we have assured you that the long term fundamentals of the economy were intact and there was no cause for panic once you see red in your portfolio statements by the end of the month. Well even now, we are doing the same. But frankly we ourselves are surprised that, we had not got a chance to write something similar in the last 3 years, which in itself is reason enough for the current correction we are experiencing.

Equity markets across the world have had a dream run in the last 2 years and guess it is about time they take a breather.





We believe that the correction we are experiencing now is very healthy and will help the markets to correct a lot of imbalances which have been taking place over the last 12 months. However, in the Indian context, markets have been correcting since January as the broader market and mid cap have lost significant value and now, the larger index is also correcting. The reasons being cited for this are

- Higher oil prices
- Unabated INR depreciation
- US induced trade wars and tariffs leading to global uncertainty
- Local Political uncertainty on account of impending elections.
- Rising Interest rates in the USA and India.

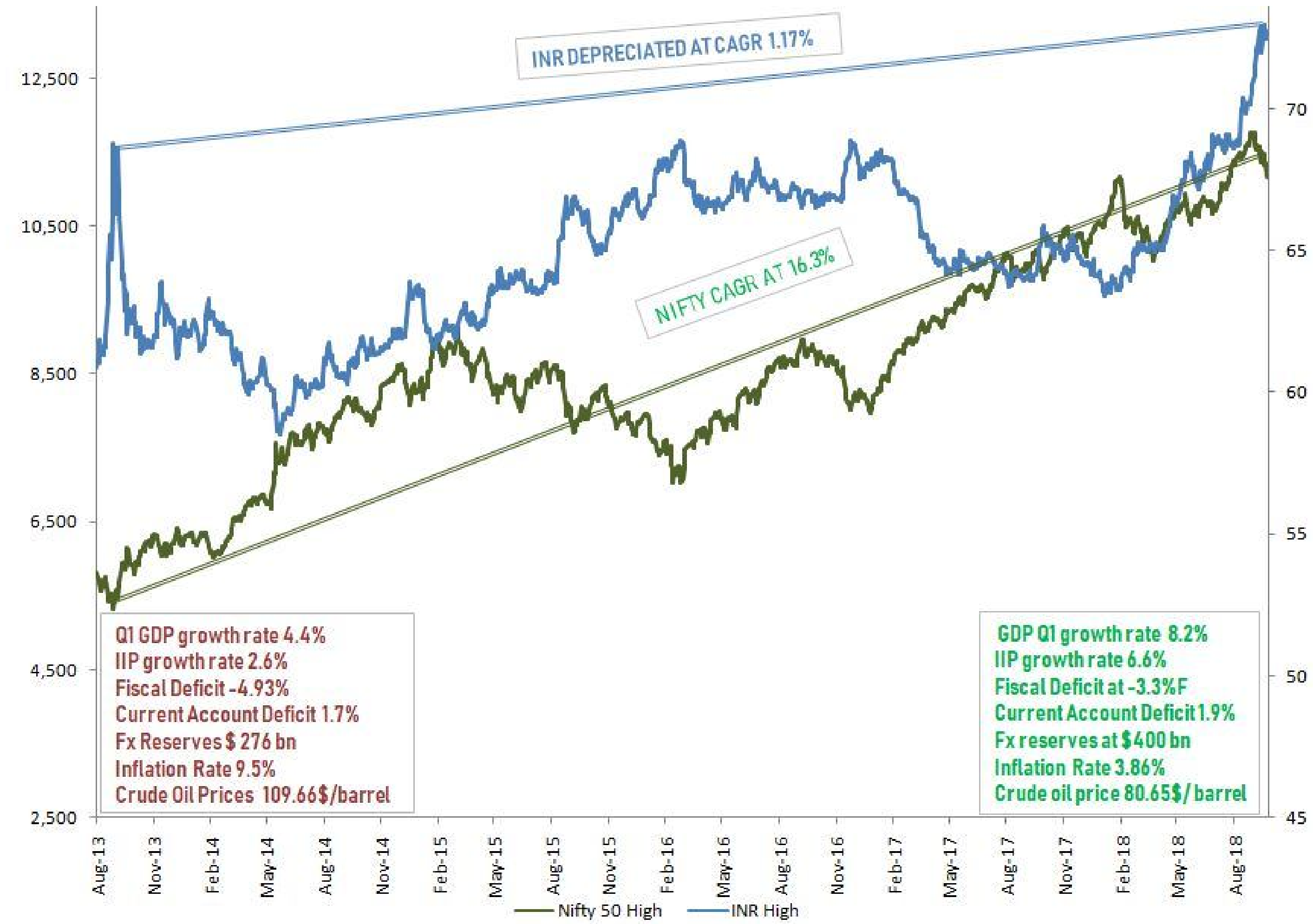
We acknowledge all these reasons, but one of the main issue also was excessive valuations, which had run ahead of its fundamentals. It is not that we had not anticipated this entirely, but like always we did not know that this will happen now. However, on a lighter note August- September seems to be the time of the year this happens and we should just get out of the markets for these two months!!! If only we could.

We had written to you all in our annual outlook in April itself about our cautious view for the short term but the long term remains intact. You can access that report here https://drive.google.com/open?id=18fEUfTcEpA0e4IW1zuK81gjEq41Wv_IT

In terms of action taken, we have booked profits wherever possible by following the time tested strategy of asset allocation principles and not timing the markets since January itself. Resultant impact: we have not lost our shirt but we are bleeding nevertheless because regular investments like SIPs, strategic holdings have also lost value.

But how much have we lost and is it time to panic??, definitely not, it is time to stay put or if you have not invested enough, to increase. Surprised? we will show you why

Indian Equity markets and INR over the last 5 years

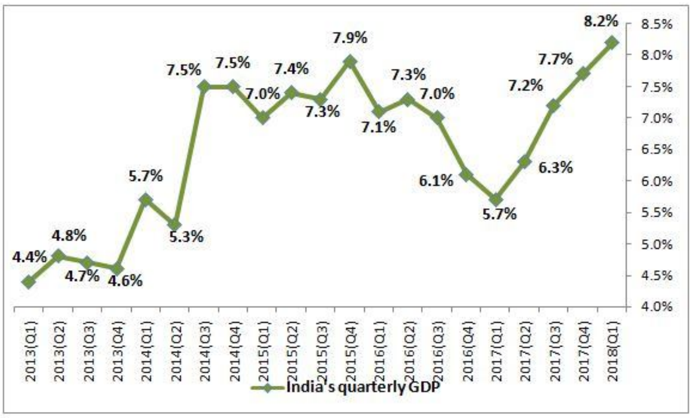


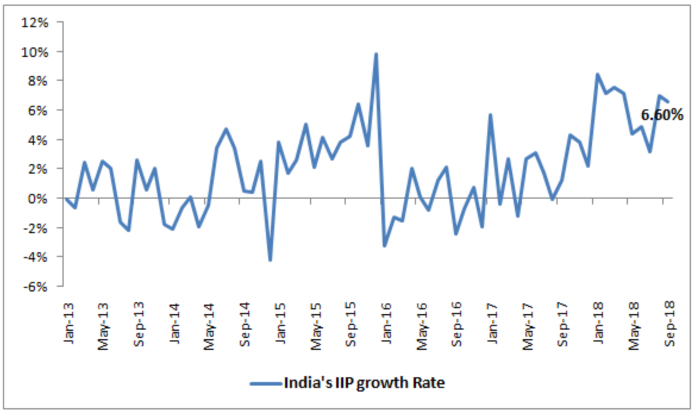
September 2013 was when the Indian economy was on the brink, characterised by low growth, high inflation and high deficits which put additional pressure on the INR, which resulted in a massive correction in the equity markets. This period was also a period of excessive global uncertainty as the US Fed decided to stop pumping liquidity into the markets which was called Taper Tantrum. If you notice the graph above from this point on (extreme panic) the NIFTY has shown a secular uptrend, returning close to 17% annualised return since then up to September 2018, while the INR has remained extremely stable by depreciating a modest 1.7% per annum in this period. So if we had invested at the time, investors made a lot of money, even in USD terms. Mind you this was despite poor macro fundamentals as pointed out.

Now in September 2018, we are witnessing a similar panic and market correction, but this time the macro situation is one of the best we have had in a long time. Growth has come back, inflation is down, deficits are fairly under control and we have enough forex reserves of USD400bn to help us tide over the global uncertainty which is currently underway. Given these conditions, we are confident that in the next five years markets will have a similar performance of what we have seen in the previous five years.

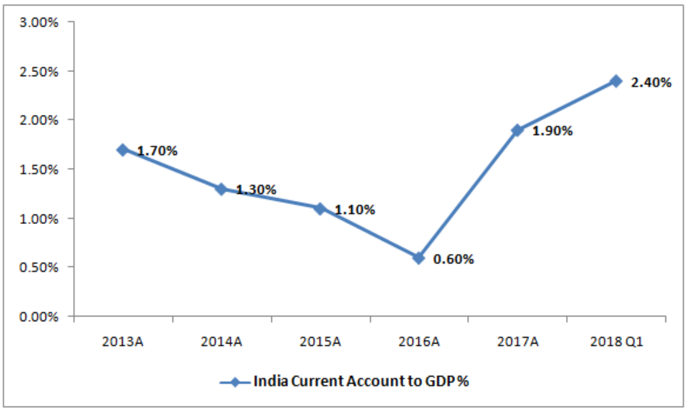
However, there are bound to be corrections and volatility which is the very nature of equity markets and they have also witnessed similar ups and down in the past as well. But the long term trajectory will remain positive and since we are investing for the long term we should not be bothered about the short term swings and should also be ready to take advantage of such opportunities and invest more if possible and take advantage of the good entry points given by the markets. The graphs below illustrate the current macro strength of the economy and we believe that it will keep us in good stead to take advantage of any opportunity the current US-China trade war might present to us as an economy.

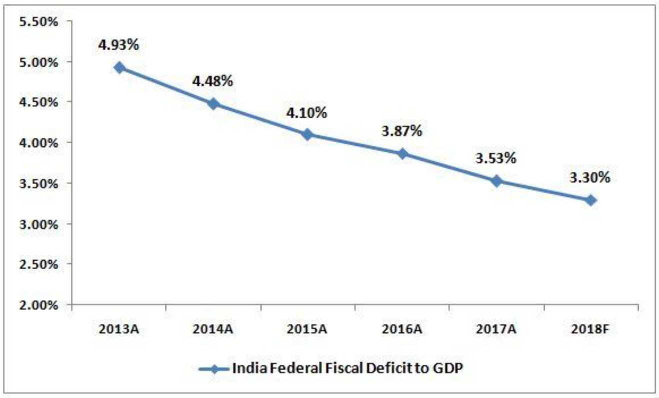
Below are detailed charts of Macro indicators



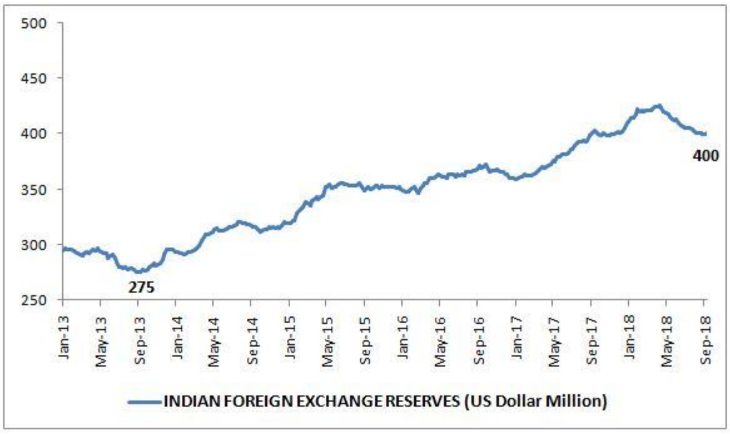


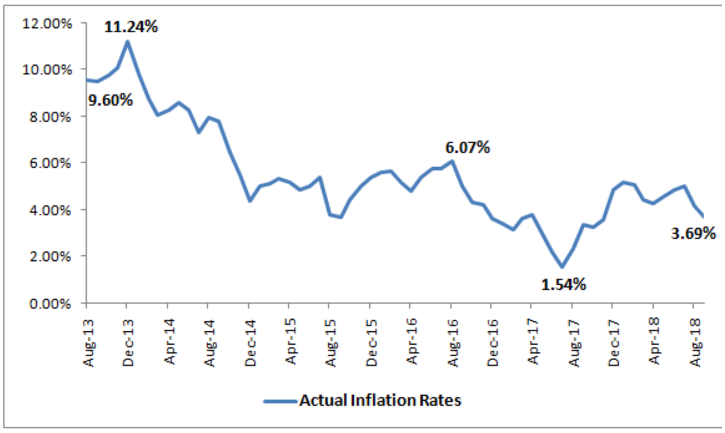
We are back on the high growth path of 8% GDP growth and also well supported by robust manufacturing, which makes it more sustanianble.

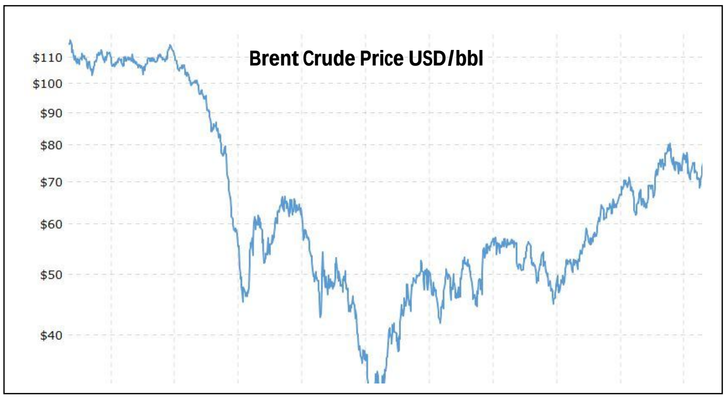




Deficits although higher (CAD) are largely in control and manageable







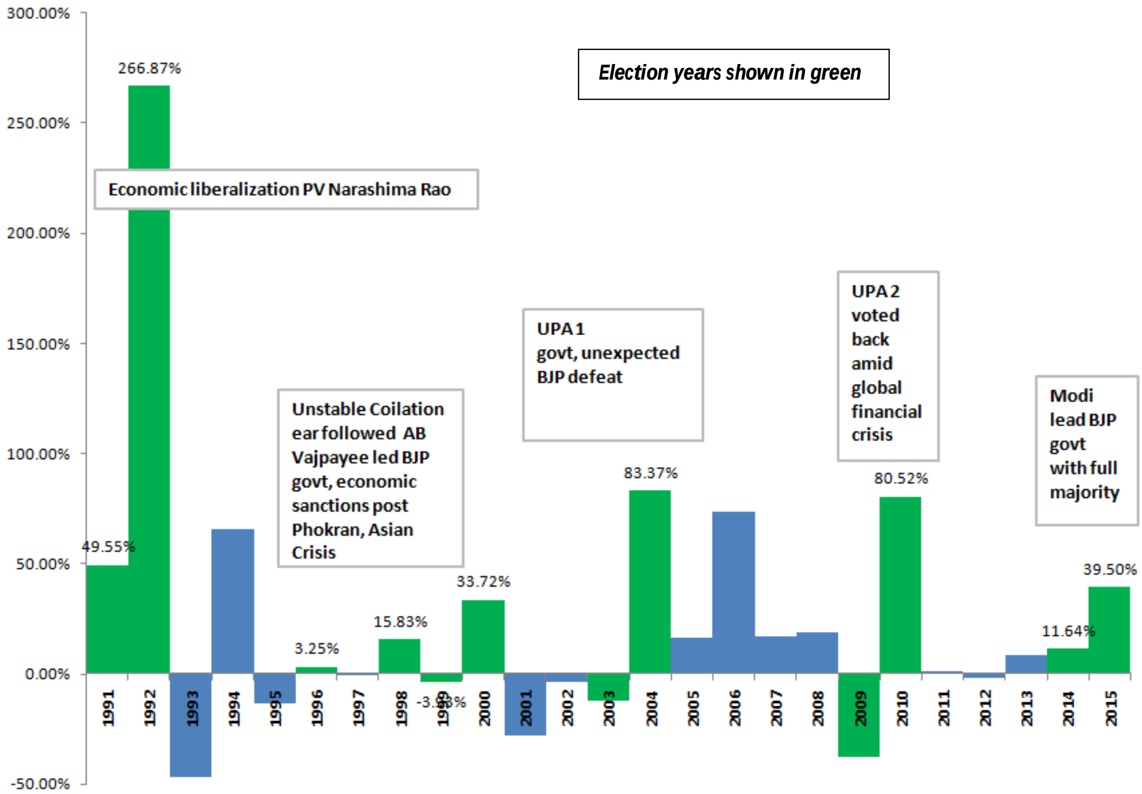
Inflation is at historic low should help tide through high oil prices, Forex reserves @ historic high – will help stabilise the INR

Earnings growth on the rebound

Stock markets although get affected by short term news but in the long term are slaves of corporate earnings. The current macroeconomic strength, coupled with good long term reforms initiated by the current government like Demonetisation, GST, Bankruptcy code and insolvency act, Improved ease of business, Financial Inclusion like JhanDhan, Ayushman Bharat, etc., will fester a positive growth environment for organised business and will throw up a variety of opportunities for businesses to grow at faster pace. Nifty profit growth for the next two years is expected to be in the range of 15-20%, which augurs well for the long term.

All this is fine, but now the next major question in all our minds is what will happen in the next year as the government is up for elections and what if the government is not voted back?
We are once again saying that even that is not a problem to long term investors, let us see how

Market performance during election year



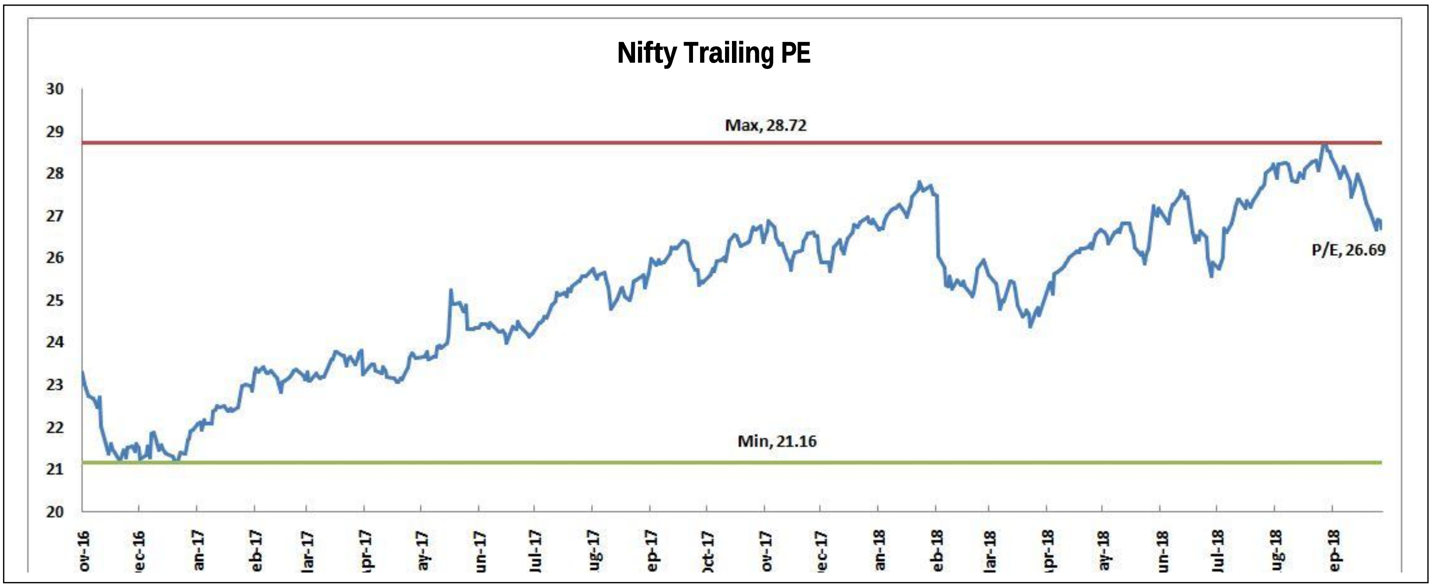
Equity indices have reacted favorably during election year since 1990.

Poor performance in the preceding year driven by election result uncertainty is followed by superior returns next year.

Fundamental factors seem to have to outweighed political uncertainty.

Conclusion and outlook

Macro-economic factors although not as good as a year ago (affected due to recent increase in oil prices) are reasonably stable and well in control. The current panic is mostly on account of global news flows as opposed to what is happening internally. On the contrary, earnings growth which is what drives equity prices are on a recovery path with increase in manufacturing activity, infra, high commodity prices and a competitive currency (helps commodity exporters like JSW steel, Reliance, Chemicals, IT).



In the short term though the markets are at higher end of valuations which has moderated a little post this correction, but we feel that there is further room for reduction, hence, we do not expect any immediate recovery, which is actually beneficial for us .

Our strategy of asset allocation and staggered investing into equity over 15-20 months will stand us in good stead for the long term as we expect the market to recover once the news flow on elections, global trade wars, etc., settles. We strongly believe that India is one of the only places in the world which offers growth and long term investors will ignore this market at their own peril. We expect greater flow of funds both from domestic and foreign as more international agencies like IMF, World Bank endorse this fact. Improving regulatory oversight of the financial sector like banks, NBFCs, MFs, intermediaries will only aid to this.

Past reports

September 2013- Portfolio Musing https://drive.google.com/open?id=1p6gn_7gptvTSpddB39RcNAvWjOviK6K-

September 2015- Portfolio Musing https://drive.google.com/open?id=1NrdatAARJ524pTQ3c0A88mWsNSj9xCW8