Ampersand Capital Investment Advisors LLP

Breathing much easier - Jan 2017 Newsletter

On to the Budget

The Union Budget, to be presented next week, usually brings with it a set of expectations as well as fear. While fear was the dominant element last year, this year it seems more balanced leading on to the B-day. This probably reflects in the milder-than-expected rally in our stock markets over the past month. Budget expectations of corporate tax cuts, personal tax reliefs and thrust on rural/infra spends (although nothing new in that) are being offset by the fear of alterations to capital gains on equity and further steps to curtail black money. That having said, there is still a lurking expectation of a popular (namely growth or reform oriented) rather than populist budget, to balance the pain of de-monetisation. This is why we believe stock markets may still display volatility post event.

Results season – separating men from the boys

Results season has been expectedly weak, but thrown in some positive surprises, mainly the private banks and cement majors. However, IT services sector either fell short or managed to just meet even the lowered expectations. Pharmaceutical companies are yet to report, but like IT, the stocks continue to languish on account of protectionist noises coming from US. Initial data also points to NBFCs faring slightly better than expected. We now await Consumer Discretionary including Autos and Building Materials sectors, also for the commentary on outlook.

Re-monetisation is the new buzzword

With the supply of new notes gathering pace (60% of pre-demo circulation now) and visible improvement, the post-earning commentary from the corporates indicate that the economic activity is likely to be back on track by end of this quarter or beginning-1QFY18. The goal post doesn't seem to be shifting further even as the recovery is uneven and certain pockets of the economy are recovering faster than the others. This coupled with moderation in valuations throws open opportunities for stock picking as we continue to focus on large caps and quality mid caps with superior financial resources and track record of managing growth, especially during periods of economic volatility. As a corollary to this, we think that the time to hide in the export-oriented sectors (IT, Pharmaceuticals) might be getting over and selective entry back into domestic centric stocks is warranted.

Cement – out of the woods?

Demand has held up in the last quarter despite the scale of impact and sharp slump in November. Southern region has seen limited impact and situation is already near pre-demonetisation era. In other regions barring the West, the trend continues to improve in January. In the next stage, we expect price hikes to mitigate cost increases, starting with South and then spreading to other regions. As such, while we maintain our preferred picks as Shree Cement and Dalmia, south based cement producers will perform better at least for another quarter; Ramco and India Cements can therefore be tactically added to the cement portfolios.

NBFCs – the ones that got left out

In last year's NBFC rally, growth was rewarded handsomely without pricing the risks adequately. That resulted in certain NBFCs not participating whole heartedly partly because they were putting their house in order at that time, and hence have more sensible valuations especially after the indiscriminate correction post demo. One such company is Shriram City Union Finance (SCUF) which is trading at 2.5x trailing book. Demonetisation will slow things down a bit for SCUF also but not a huge risk for the relatively reasonable valuations it carries. Given its target segment of small businesses, the market share gains from the unorganised money lender segment can provide growth alpha. Adequate capital means ROEs would be expanding over next 1-2 years, which will allow for potential re-rating if execution stays the course.