



Shortages abound, Ideas galore: September 2021 Newsletter

We outperformed the best performing stock market

During the July-Sept quarter, India equities delivered the best returns relative to other global markets. One of the reasons was the sharp recovery from the brutal 2nd Covid wave. Under these circumstances, Ampersand fared better than most indices, a feat achieved for the 3rd successive quarter this calendar year. Our fund NAV has risen 17.8%, ahead of Nifty (up 12.1%) and benchmark BSE 500, which was up 11.5%. This period also marked the 4th anniversary of our operations, during which period our fund delivered returns of 21.2% CAGR, also surpassing all major indices.

As on September 30, 2021, our fund consists of 33 stocks and a cash surplus of just over 2%. This cash balance is similar to the previous quarter, as we have maintained a consistent bullish stance on equities.

Diversified portfolio has served us well

Although we have backed couple of themes, our portfolio is well distributed across most major sectors, so less prone to any singular theme lagging or going out of favour. This has aided our superior performance thus far. Although we have made some alterations to our portfolio holdings this year, the allocation has broadly remained similar in terms of sectors and themes. IT and financials continue to dominate our portfolio, while balance is distributed between Consumer, Pharma, Speciality Chemicals, and Construction/Engineering space.

Current phase reminiscent of earlier investment-led bull run

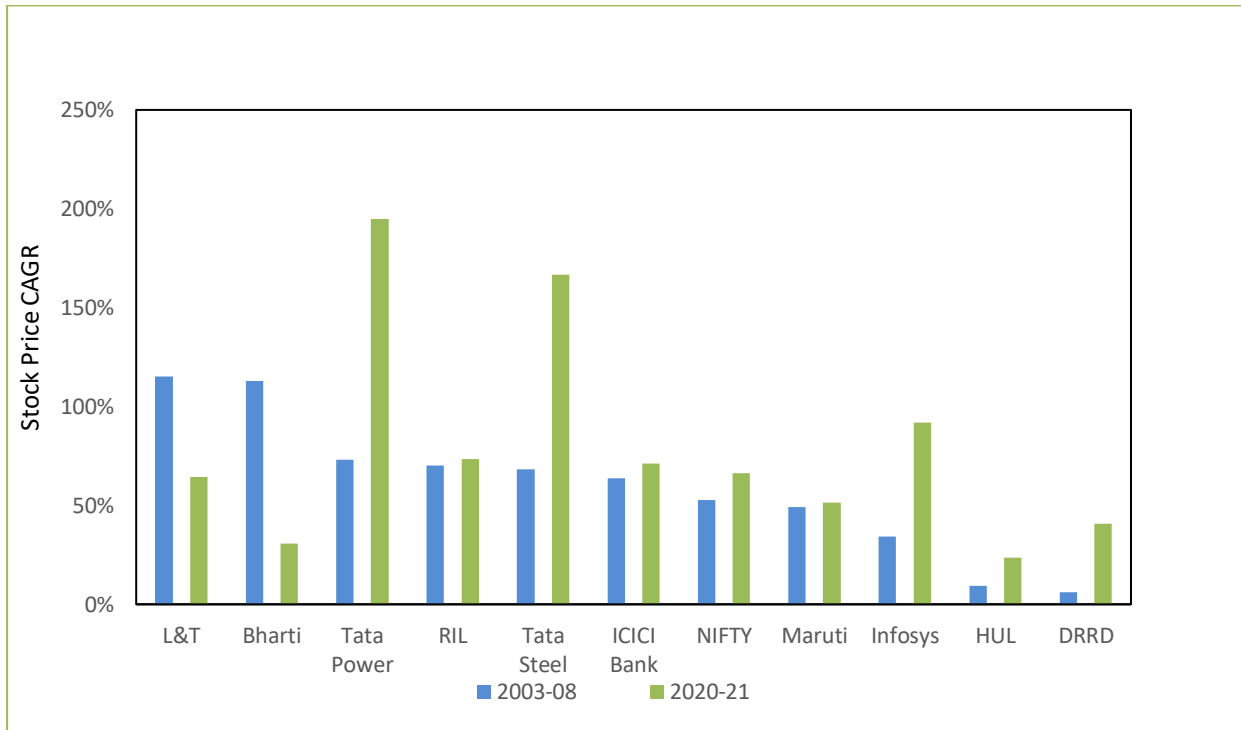
The current bull market which commenced in April 2020, is increasingly resembling the 2003-08 investment-led phase. In the earlier period, the Nifty had risen ~6x, mostly contributed by sectors such as Commodities, Capital goods, Utilities, Real Estate and Financials (all up ~10x). The ones which performed in line were IT and Consumer Discretionary including autos, but the ones which lagged Nifty were Consumer staples and Pharma. Since April 2020, the Nifty has risen nearly 2.5x. again led by sectors similar to the earlier phase, barring Financials which has lagged, and IT which has significantly outperformed. So, the current bull run largely finds sector commonality. A simplistic view suggests that the current bull market has some way to go, especially since the tailwinds are quite similar to the earlier bull market.

The characteristic of any bull market are intermittent corrections (up to 10%), which we are yet to witness this time around. We did correct by 7% during the early part of the 2nd Covid wave, but markets have rallied ferociously since then. While we don't rule out such corrective phases in future, it seems highly unlikely that our markets will see a severe decline. Not only are the macros on a recovery path, but the banking system is much healthier. Additional



variables like Fx stability, buoyant tax collections and pro-reform measures are tailwinds supporting Indian equities.

Chart 1: Nifty Stock-wise performance ranking of 2020/21 mirrors 2003/08 bull market



Source: NSE; tkr.com

Macro recovery intact, but pace uncertain

Despite frequent disruptions, India's economic recovery is intact, in our view. Business activity is now at pre-pandemic levels except for Education and Travel & Hospitality sectors. Following 7.3% contraction in FY21, GDP is expected to revert to 9.5% growth in FY22E and 7.8% in FY23E. Key drivers will likely include, (1) exports, due to favourable terms of trade, (2) government expenditure growth of 14%, driven by stronger tax collections, and (3) recovery in real estate, led by benign interest rates and strong job creation in the IT sector. Factors dragging recovery could be, (1) private sector capex, as capacity utilization continues to remain poor, and (2) household consumption demand, owing to high inflation as well as cascading impact of lockdown on personal incomes.

Pace as well as sustainability of recovery over the medium term lacks clarity, and poses key risk to the ongoing bull market. Reason for this uncertainty is the supply shock, which is driving up inflation, and the consequent price rise is hurting demand as well. Historically, central banks used to hike interest rates to arrest inflation, but the current inflationary bout is being considered as transitory, and hence central banks are refraining from hiking rates. Since credit growth is still well below historical trends in most countries, it also implies that central banks are unlikely to turn hawkish soon. In India, with increased levels of vaccination and reduced lockdown restrictions, we expect labour availability to improve. This will be the key



to return to normalcy, in terms of logistics and normalisation of the supply shock driven inflation pressures. Sustained easy money policy and benign interest rates too should aid macro recovery over next few years.

Banking on Excess liquidity and Digital Transformation

We are mainly invested in two macro themes (1) Cyclical demand recovery, primarily driven by benign interest rate, and (2) digital transformation. We are however avoiding stocks which may be impacted by shortages such as semiconductor, coal etc, due to unpredictability.

Benefit of low interest rates and easier availability of loans, on RBI's stated policy of remaining pro-growth, is boosting affordability of households. For instance, current home loan rates are the lowest in over 2 decades. Apart from low interest rate, the willingness of banks to lend is at a new high currently than anytime over last decade owing to (1) adequate equity capital, (2) surplus liquidity, and (3) better technology for credit monitoring and disbursal. We thus expect overall system credit growth will revert to trend line growth rate viz. around 12% from around 6% currently. Recovery in credit growth will favour consumer durables, capital goods and retail lenders, and we are invested in leading companies within these sectors.

The other space which has excited us is digital transformation, and its ensuing beneficiaries. Pandemic induced lockdown has accelerated the adoption of digital technologies, as it has enabled work from home. Most Indian IT services companies therefore seem confident of sustaining double digit growth over 3-5 years, which is based on the order and deal pipeline. Apart from IT services companies, other beneficiaries include those who are making the most of technology adoption such as logistics, retail and fintech.

Market at new peak ahead of challenging results season

Quarterly results season will be underway even as our newsletter is released. In our view, corporate earnings are likely to be mixed, although expectations are uniformly running high. So, it is likely that in line performances may see correction in several stocks. This is more so for sectors which have done well, and outperformed the market. We recognise that risk in IT, which is one of our preferred spaces. On the flip side, we expect underperforming sectors e.g., financials, to hold up if asset quality concerns are allayed. So, while we are underweight on this space, it still remains our second largest exposure, as has been for a while. Our overall take on the results season is that while stocks/sectors will experience some volatility as they usually do, management commentary and conviction will ultimately drive stocks. And that is where we will continue to back select sectoral and investment themes, rather than jump on the market bandwagon.



This bull market is far from over

Our view on market outlook has been consistently bullish, although the quarter under review has surpassed even our optimistic expectations (read *Riding the Wave*). We however did see corrective phases, albeit brief and limited, in small and mid-caps, and a possible trend reversal in favour of large caps during the middle of previous quarter. We envisage much of the same trend in the remainder of the year, with an upward bias across indices. Ampersand strategy will be to further move investments to higher quality names (which essentially would mostly be mid and/or large caps), something which we have already done in this quarter. This will enable minimise valuation risk. So far, we have stayed fully invested, and we see no reason to alter that strategy.



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