



Winning over uncertainty – September 2020 Newsletter

Plethora of challenges in our short journey so far

We have completed 3 years of managing our long only AIF. Notably, Nifty delivered 4.7% CAGR, which is amongst the poorest of any similar period. In fact, Mid and Small cap indices registered negative returns during the same period. This reflects the immense challenges faced by equity markets. While Nifty moved up marginally, several sectors and themes did do well but only lasted for short durations. Sector rotation was frequent - from IT in 2018, to financials in 2019, led intermittently by asset management cos, insurance and NBFCs, and now Reliance the dominant mover in 2020. Subdued economic conditions in India mainly on account of distress in the banking sector, trade conflict of the USA with China and the corona pandemic, highlights uncertainty thereby impacting equity markets across the globe. Long term equity investing has been tested to its limit, and increased churn rates were key to outperforming respective markets.



Source: Bloomberg

Best quarter we have had...since inception

To start with, we highlight that our NAV is up 27.6% since inception, significantly outperforming most indices. Not every quarter has seen consistent performance due to the challenges highlighted earlier. And during the quarter under review i.e. July-Sept, our fund NAV rose 17.3%, well ahead of benchmark BSE 500 and most major indices. With that, we crossed the pre-covid peak before other indices did. Now we have the added challenge of sustaining this performance.

As on Sept 30, our portfolio consists of 31 stocks and cash surplus stood at 6.4%.



Several hits nearly undone by an incorrect investment decision

Our strong performance during the quarter reflected an all-round showing for majority of our portfolio, including preferred sectors Pharma and IT. This more than made up for the one incorrect investment decision made in the telecom sector. Also, financials yet again performed poorly but while we too were impacted, it was not significant as we had cut our exposure to manageable levels leading up to this quarter. Incidentally, we were handicapped by minimal exposure to micro and small caps, but that was largely planned to restrict investment with stock liquidity issues as well as difficulties over forecasting business outlook.

Domestic macro does not appear too favorable...

During the April-June 2020 quarter, global GDP contracted by 15-20% due to various stages of lockdown. Subsequently, fiscal stimuli along with easing of lockdown restrictions aided the recovery process, restoring economic activity close to pre-covid levels. However, for the economy to recover further, and that too sustainably, appears tough over the coming year because, (1) pandemic situation will restrict certain key sectors like tourism and travel, (2) corporates unlikely to increase capex owing to business uncertainty, (3) loss of income could hurt household consumption growth. These factors can be neutralized by aggressive increase in fiscal deficit by respective governments across countries. However, sharp fall in tax collections as well as support extended to households during lockdown has already expanded the fiscal deficit. Lack of adequate fiscal space especially after yet another miss on divestment cloud the possibility of further pump priming the economy, particularly in India.

As such, India's economic recovery will be more dependent on (1) exports, and (2) import substitution, rather than consumption as in the past.

... but equities supported by easy liquidity offer downside protection

Corona related uncertainty is far from over and will likely dominate headlines until a vaccine is found. However, it is becoming increasingly clear that as far as financial markets are concerned, the virus is no longer an unassailable concern. And then there is the upcoming US presidential election, where the lead up and result could induce some market volatility, but that process too will end by Jan 2021. This should also bring an end to the uncertainty with respect to fiscal stimulus, tax policy etc. Several businesses are presumably holding back plans and will likely roll out the same in 2021. Historically capital inflow to equity markets has risen sharply post elections. In any case, the US Fed has stated that it will maintain an easy money policy for the next couple of years. Combination of the factors listed above will protect market downside and potentially compensate for concerns over sub-par economic recovery.

Our sector preferences have structural triggers, but diversity is the key

While subdued economic recovery could restrict corporate earnings here in India, we expect significant change in value chain. For instance, the majority of upcoming capex will move towards digital infra. Healthcare needs too will increase due to, (1) long lasting health impact



post-covid, (2) increased requirement to improve immunity, and (3) faster innovation as the regulator wants quicker remedies. Work from home will also push for better infra. Such a shift in value chain should typically favor IT and Pharma industries, while it could hurt travel and commercial real estate. In our view, companies that adapt to the new state of doing business could see much better growth prospects. We have therefore favored those very sectors i.e. IT and Pharma which have so far yielded superior returns. At the same time, one needs to be cognizant of underperforming sectors where there is definite value e.g. financials but need speedier recovery and better economic environment to provide necessary impetus to the stocks. Overall, our portfolio remains well diversified to deliver optimal returns.

Valuations may not be questioned despite sharp rally

In the previous newsletter edition, we had indicated that while the market could trade in a narrow 10% band for the remainder of the year, sector rotation and broader participation of mid and small caps was likely. And that seems to be happening. At this juncture, our market call is more constructive. Valuation comparison (presently 1-year forward P/E 22x, a 15% premium to historic average) may not entirely be the correct approach. We expect markets and therefore stock movements to be driven by further re-rating rather than surprise on earnings trajectory.



DISCLAIMER:

Ampersand Capital Investment Advisors LLP (Ampersand) is an Investment Manager of Ampersand Growth Opportunities Fund Scheme – I (Fund), a Scheme of Ampersand Capital Trust registered as a Category III – Alternative Investment Fund (AIF) under the SEBI (Alternative Investment Funds) Regulations, 2012.

This document is strictly for information and illustrative purposes only and should not be considered to be an offer, or solicitation of an offer, to buy or sell any securities or funds or to enter into any contribution agreements. Before anyone considers an investment, it is important to read through and understand the contents of the Disclosure and/or Offer Document.

This document does not constitute or is not intended to constitute an offer to buy or sell, or a solicitation to an offer to buy or sell financial products, units or securities. The information provided by Ampersand is obtained from sources believed to be reliable but is not guaranteed as to accuracy or completeness and expressly disclaims all warranties and conditions of any kind, whether express or implied.

This document is prepared by Ampersand strictly for the specified audience and is not intended for distribution to public and is not to be disseminated or circulated to any other party outside of the intended purpose. This document may contain confidential or proprietary information and no part of this document may be reproduced in any form without its prior written consent to Ampersand. If you receive a copy of this document and you are not the intended recipient, you should destroy this document immediately.

Any dissemination, copying or circulation of this communication in any form is strictly prohibited. In preparing this document, Ampersand has relied upon and assumed, without independent verification, the accuracy and completeness of information available from public sources. Accordingly, neither Ampersand nor any of its partners, employees, agents or advisors shall be liable for any loss or damage (direct or indirect) suffered as a result of reliance upon any statements contained in, or any omission from this document and any such liability is expressly disclaimed.

Investments in Shares and Securities are subject to market risks and investor's risk profile. In making an investment decision, Investor must rely on their own examination of the terms of the offering, including the merits and risk involved. Past performance may not be indicative of future results. Therefore, no current or prospective client should assume that the future performance will be profitable or equal to corresponding indicated performance levels. There is no assurance or guarantee that the objectives will be achieved. No client or prospective client should assume that any information presented in this document as the receipt of, or a substitute for, personalized individual advice from the registered adviser or any other registered investment professional.

All intellectual property rights emerging from this newsletter are and shall remain with Ampersand. This is for your personal use and you shall not resell, copy, or redistribute the newsletter or any part of it, or use it for any commercial purpose.