SINHASI INTELLIGENT INVESTING FORUM - V

(FROM LEFT TO RIGHT)

- **Mr. Varun Daga** – Founder & Fund Manager, Girik Capital , Mumbai
- **Mr. Charandeep Singh** – Founder & MD , Girik Capital, Mumbai
- **Ms. Mimi Partha Sarathy** - Managing Director, Sinhasi Consultants Pvt. Ltd.
- **Mr. Prashant Jain** – ED and CIO HDFC Mutual Fund , Mumbai

Sinhasi is indeed proud to have conducted this **Investing Forum for 5 consecutive years** for our clients and investors who have found it very useful.

Speakers at Forum:

- **Mr. Prashant Jain** – ED and CIO HDFC Mutual Fund , Mumbai
- **Mr. Charandeep Singh**– Founder & MD , Girik Capital
- **Mr. Varun Daga** – Founder & Fund Manager, Girik Capital , Mumbai

The session was moderated by **Ms. Mimi Partha Sarathy**, **Managing Director, Sinhasi Consultants Pvt. Ltd.**

Booklet Content:

1. Current Market Scenario (specific to Large-cap, Mid & Small-cap):
2. Current scenario V/S 2008 Correction
3. Macro-Economic factors and their impact on our investments
4. Current Account Deficit
5. Rupee VS Dollar and its impact on investments and economy
6. Oil Price rise and its impact
7. Corporate Earnings and current market valuations
8. Banking sector
9. IL&FS default & NBFC collapse
10. Impact of election on market & political scenario
11. FII & DII (Domestic Institutional Investor) Investments in India
12. What an Investor has to do in the Current Market Scenario.

Details of Edited excerpts and highlights of the panel discussion:

Current Market Scenario:

Large-cap:

- As far as large-caps are concerned, some large sectors were experiencing challenges in profit growth like Corporate Banks, Metals and Capital Goods. That is changing now.
- **Profit growth in the large-cap space appears to be very strong. Large-cap space has corrected reasonably. Overall this is very healthy correction and it will take out lot of excesses in the market place otherwise it would have become a bigger challenge going forward.**
- Every 3^{rd}-4^{th} year, Large-caps do correct by 15%-20%.

Mid & Small-cap:

- Small & Mid-caps had to correct at some point in time due to the higher valuations which were unsustainable. We needed to see the current correction of 25%-40% with their outperformance over the past 4-5 years.
- **Fundamentally when something becomes overvalued and unsustainable, it will correct** and it is our human nature to link both the correction as well as whatever negative is happening around that time and spell them out as reasons for the corrections.

Current Scenario v/s 2008 Correction:

- **The present market correction has no correlation with 2008 correction.**
- That was a totally different environment as leverage levels and Indian valuations were very different.
- Short term corrections can always take place in India driven by outside but the key is that they don't last.
- Even if you look at the Lehman crisis, markets fell but they recovered very fast , just 12 months, because there is very small correlation between the real economy in India and what happens outside India.

Macro Economy:

- Macro does not impact the stock market as much as the micro (micro being corporate earnings).
- Our current account deficit 5 years back was 5%, currently we are under 3%.
- Inflation is at 5%, it was 10% few years back.
- Fiscal Deficit of the Central Government is 3.5%, it used to be 5-6%.
- Growth rates in India are certainly going to accelerate because underlying demand conditions especially in investments are pretty strong.
- **The micro environment in India does not look weak as of now. Yes, it was better 2 years ago because of lower oil prices.**

Current Account Deficit (CAD):

- CAD in FY13 was 5% of GDP which fell to 1% due to fall in oil prices and now oil prices are normalizing and 1% CAD of GDP is not sustainable in India.
- Present CAD of 1.5%-2.5% has been the long term average CAD in India.
- The good thing is that Foreign Direct Investment (FDI) which used to be 1% of GDP is now about 1.6% of the GDP. So, large part of the CAD is getting met by FDI.

Currency depreciation and its impact on economy as well as markets.

- Rupee has been depreciating forever because India's inflation is higher than that of the US. So, rupee will keep on depreciating.
- This is also o due to rising US interest rates
- Long-term depreciation of the rupee is between 3-5% but it is not a linear depreciation, it happens in steps.
- In the last few months, it has been as much rupee depreciation as it is the appreciation of the dollar. It means that most emerging markets currencies including the Chinese Yuan are down because US interest rates are moving up, and chances are that they will move up further.

- **It is a misconception that a depreciating rupee is bad for the stock markets,** if you look at Nifty for example – about 30-40% of the Nifty is in sectors like IT, Pharma, metals. Oil & gas – they definitely benefit from a lower currency. Banking which is 1/3rd of the Nifty is neutral to the currency. **So, about 70-80% of the Nifty is either not impacted or positively impacted by depreciating currency.**
- **Lower currency is in a way positive for equities**. Depreciating currency in longer term is one of the reasons why inflation is high or vice-versa and that are why the nominal returns of the equities in India in rupee terms are high. Otherwise, why will there be 15% return in equities per annum?

Oil Price:

- 2-3 years back when crude was at $40, the current account deficit was at below 1%. That was too good to sustain**. Today oil prices have normalized, and so India's current account deficit has also normalized.**
- If you compare 10 years back oil was above $100, our current account deficit 5 years back was 5%, and currently our CAD is fewer than 3%. Inflation is at 5%, it was 10% few years back.

Interest Rate:

- Moderately high interest rates would be great for the banks because then their pricing power comes back for them to increase their margins and banks are a very large component of Nifty.
- Even other sectors like IT, Pharma, FMCG, automobiles are net cash balance sheets in the Nifty, even their income would go up.
- **At least for the large-caps and certainly for Nifty, moderately high interest rates would be positive for earnings.**
- **However, anyone who is leveraged, be it large-cap or small-caps will have negative impact because of high interest rates.**
- For the first time in past 2-3 decades, we are facing rising US interest rates. In the 80's interest rates in the US used to be 11-12% i.e. US treasuries in 80's used to be in double digits, they fell all the way down to 1.5% and now those yields have come up to 3.2-3.3% and may go to 4 – 5%.

- **The higher interest rates we keep in India, the better it will be for us because it will prepare us better for rising US rates and it means people will save more and our need for foreign capital on the fixed income side will reduce. It will lead to improvement in savings rates in India and slow-down in consumer discretionary spending** which should be made up by reviving investments. Overall GDP should not get affected.

Corporate Earnings:

- India should is on the way to becoming a very large economy globally. India was the 12th largest economy in 2007, and we are likely to be the 5th largest this year. We are a large and very fast-growing economy.
- Last 5 years, the Nifty EPS growth was just 3.5%, it was very low which was one of the reasons why large-cap stock lagged for almost 2 years.
- **The main reason why NIFTY EPS did not grow was because of the Corporate Banks as they went from healthy profits to losses e.g. SBI reported a loss last year. Now, estimates are that over next few years including current year, Nifty EPS growth should be extremely healthy.**
- While 2-3 sectors will drive this, **biggest drivers of the growth would be SBI, ICICI Bank, and Axis bank which are the largest corporate banks in India. (Balance sheets of these banks put together is around 50 Lakh Cr. If there is 1% profit, it will be 50000 Cr which will add a great boost to the Nifty.)**
- Banks are a large weight in the Nifty and it is going to drive growth. **After a fairly extended period, in large caps profit growth should be very strong going forward.**

Current Valuations of Market & Expectation:

- In the past, every time when Nifty P/E multiples crossed 24 or higher, the returns for the next 3 years were negative. Once it levels were between 18-20 or lower, the returns over the next 3 years will be becoming positive. Currently we are at these levels.
- The lower you go, the faster your comeback in the long run. And that holds same with the small and mid-cap. Mid and small cap move more erratic in comparison to the large cap. And it is not right to look at the P/E of the small and mid-cap index as the companies keep changing; So Nifty is a better benchmark to use.

Benchmark (Girik PMS):

- Girik has benchmarked all portfolios to Nifty because it is very liquid, and also very investable. One parallel example is Warren Buffet's Berkshire Hathaway. They benchmark their funds to the 10-year

  Bond yield as it is the most liquid and it has a risk-free rate of return. Girik has also done something very similar so investors understand the important of risk and time for alpha returns.

Banking Sector & NCLT:

- Public Sector Banks and few Private Banks have dealt with the challenge of NPAs in the last few years.
- IBC, the Insolvency & Bankruptcy Code has been a very good reform and a fairly successful one. We have seen lots of resolutions (Electro Steel, Bhushan Steel, Amtek Auto, Monnet Ispat etc) and more will come through (Especially ESSAR).
- In ESSAR virtually the entire loans are likely to be recovered, and bids are around that.
- Worst of the asset quality pain is behind us and the liability franchise of some of these banks is pretty rich.
- **We are now moving to a resource constrained environment** where liability franchise will become extremely important. **The future for these banks is better now.**

IL&FS default:

- IL&FS default is significant and there is pain as its fixed income papers are widely held.
- However, **IL&FS is not a systemic issue and will not upset the entire system**.

About NBFCs, Domestic consumption & Savings:

- There are two sides to any NBFC or any bank business – the asset side and the liability side. And markets thought it is only about assets. As resources become constrained, the liabilities will become more important. Asset quality is cyclical, but the liabilities franchise is more structural.

- The NBFCs grew extremely fast mainly led by retail loans and also the wholesale lending rates were also virtually the same as retail cost of funds and times are changing for sure, there should be moderate growth rates going forward.
- **The retail lending led by NBFCs also caused the rise in domestic consumption (Consumer discretionary & FMCG) which contributed partly for moderating level of Current Account Deficit (CAD).**
- **Even the savings rate in India has reduced from 35% of the GDP to 28% because of too much lending which is now expected to balance out.**
- **NBFCs were trading at large premiums to banks having good retail deposit franchise which was not sustainable and that is precisely what happened.**

Impact of Election on Market:

- **It is wrong for the people to link stock markets to the elections; it should be linked to profits and valuations.**
- If you look at the annual returns of the SENSEX since its inception in 1979, you will notice that in each of the financial years in which elections took place the SENSEX has actually has delivered positive returns every time. Therefore there is a very weak linkage between elections and profits.
- **Post elections even if the outcome is unexpected, volatility will prevail for short term and after one quarter, focus again moves to profits and profits are not a function of election.**
- **It would be wrong to not invest in the markets because elections are down the line**. In any case if you have been a long-term equity investor in the markets and invested for 10 to 20 years, you have made the maximum money even though that period has seen so many election years.

Political Scenario:

- By and large this Government has implemented good reforms, some which happen to be populist also like Ayushman Bharat scheme or the replacement of physical subsidies with cash transfers.
- These are definitely going to help the under-privileged rural sector. While they might not appeal to many people, they are also the right steps to be taken in a society like ours.

- While all this is being done, the fiscal deficit is not being compromised upon. The Government has kept a very tight leash on the fiscal deficit. Despite so much of political pressure, oil prices have not been reduced. That is a very sensible positive decision.

FII & DII Investments in India:

- Foreigners have been investing in India for 25 years and barring 3 years out of those 25 years, they have been net buyers of Indian equities. Whenever selling happens, it is very small.
- **FII selling is not due to any challenges in India, it is due to conditions in their own countries. India is part of emerging markets, and if US rates are going up and if money is flowing out of emerging markets, so India will also see some redemptions.**
- Historically, the best periods to invest in India have been the ones when foreigners were sellers. As they will not sell forever.
- Domestic Mutual Funds are now very significant players in the flow towards the Indian markets. Mutual Funds get about Rs. 9,000 – 10,000 crores on a monthly basis and it has never happened before until few years back. This should reduce the volatility of the Indian markets going forward. Overtime it should also mitigate the impact of foreign selling.
- Foreigners have sold quite a bit this year (In CY2018 – Till Sept, 2018 – FIIs have withdrawn 61497 Cr from Indian markets) but if you look at the Nifty, it is only down by 8-10%.

Mutual Fund AUM size (Asset under management) & Fund performance:

(Kindly note, HDFC MF is managing some of the largest equity funds in India, AUM of HDFC Balanced Advantage Fund is 39,000 Cr, AUM of HDFC Equity fund is 22,000 Cr)

- One may feel the particular fund is a very large fund, but it is only 0.2% of the market.
- India is the world's 5th largest economy with a 2 trillion dollar market cap. The largest fund is 5-6 billion dollars only.
- In India, the biggest company is TCS and Reliance according to market-cap (both are around RS. 700,000 crores) and largest fund has assets worth only 39000 Cr which is

- Around 5% of TCS/Reliance market-cap. Hence, AUM Size is not a constraint towards performance of any fund.

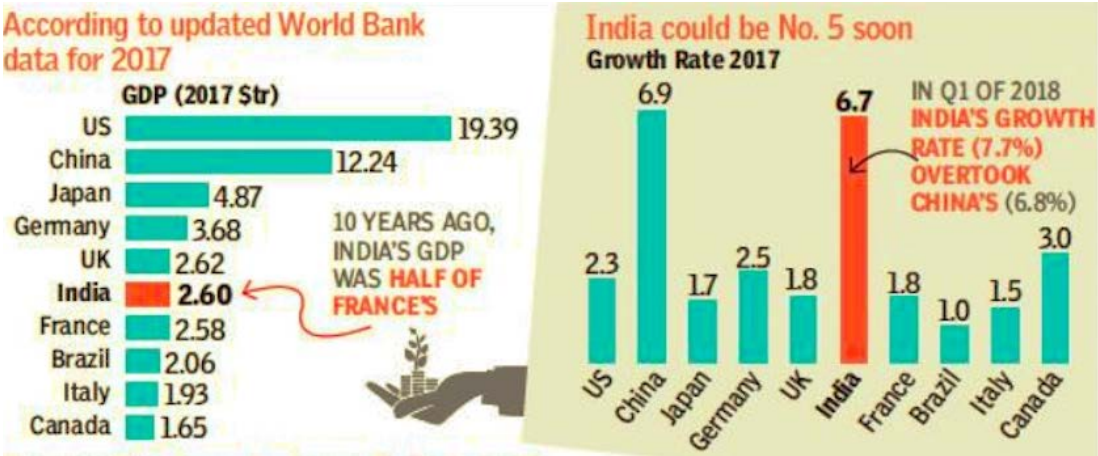
Where should we invest (Gold, FD, and Equities):

- The rupee GDP growth in India is about 15% and that is what SENSEX is tracking over the past 20 plus years.
- SENSEX in 1979 was 100 and today it is around 35,000. In these 39 years, the CAGR (Compounded Annualised Growth Rate) SENSEX is 16%.
- **SENSEX is basically a diversified portfolio of businesses which represents the diversified Indian economy and that is growing at 15% per annum in rupee terms - 7-8% is the real growth (volume growth) and the balance is inflation. So, 15% growth in 39 years becomes 33,000 (As on 31-March-2018) i.e. 330 times.**

- If you had invested **the same money in a bank FD or Gold at 8-9%, the returns would be just about 23 times vs 330 times with equities**. So, compounding in equities makes a huge difference to your wealth. Equities are able to compound over a much faster pace. This is what equities are all about.

Year End	FD @ SBI	Gold	Sensex
Mar-79	100	100	100
Mar-90	224	317	789
Mar-00	634	611	5001
Mar-10	1241	2509	17528
Mar-18	2387	4327	32969
X times in 39 years	**23.87**	**43.27**	**329.69**

- **Indians choose to be very long-term investors in Gold and are comfortable with volatility in gold. You should do this with equities also, it will compound much faster and it is also good for India.**
- **Currently India is 6th largest economy & will soon be the Top 5 economies in the world, thereby making returns from equity very positive & high for long term investors.**



Source: IMF, World Bank

What should we do now?

- **It is very important to have a Financial Plan. You have to plan your liquidity, your future goals, your disposable income, it is important to save and have buckets for the money you need over different time-horizons. This is where Sinhasi comes in. The longer your time-horizon is in case of equities, there are better chances of alpha returns.**
- It is always a good time to invest in Equities as long as markets are not seriously overly valued. It depends upon your time-horizon and tolerance for volatility. The Indian Economy is doing well; profitability in large-caps should recover.
- Even at high index levels, the large cap valuations were not too high. With this correction, lots more shares have become cheaper.
- **You should invest that portion of your wealth into equities that you don't need for next 4 - 5 years and if you can tolerate volatility. The balance can go to fixed income assets based on your asset allocation.**

- **Currently there are lot of high quality businesses available at really cheap valuations. The stock market is the mechanism to transfer wealth from the impatient to the patient. So, the more patient you are, the more money you will make. These falls gives you opportunities to invest in great businesses. Anyone with 5 year investment time horizon would definitely come out as a winner.**
- In equities, you should invest 1/4th to 1/3rd in small cap or mid-caps because every 10 years there are market down-turn events and you get great investing opportunities. You should maintain discipline between small, mid and large-cap and also equities and bonds. **Asset allocation and financial planning with a sound investment advisor is the key to success with investing.**

Thank you

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