Sanctum View

May 13, 2019

Investment Strategy

Moment of Truth

"We have the potential to go up like a rocket if we did some lowering of rates, like one point, and some quantitative easing. Yes, we are doing very well at 3.2% GDP, but with our wonderfully low inflation, we could be setting major records, and at the same time, make our national debt start to look small" – Donald Trump, 30 Apr 2019

A Trade War, Or…

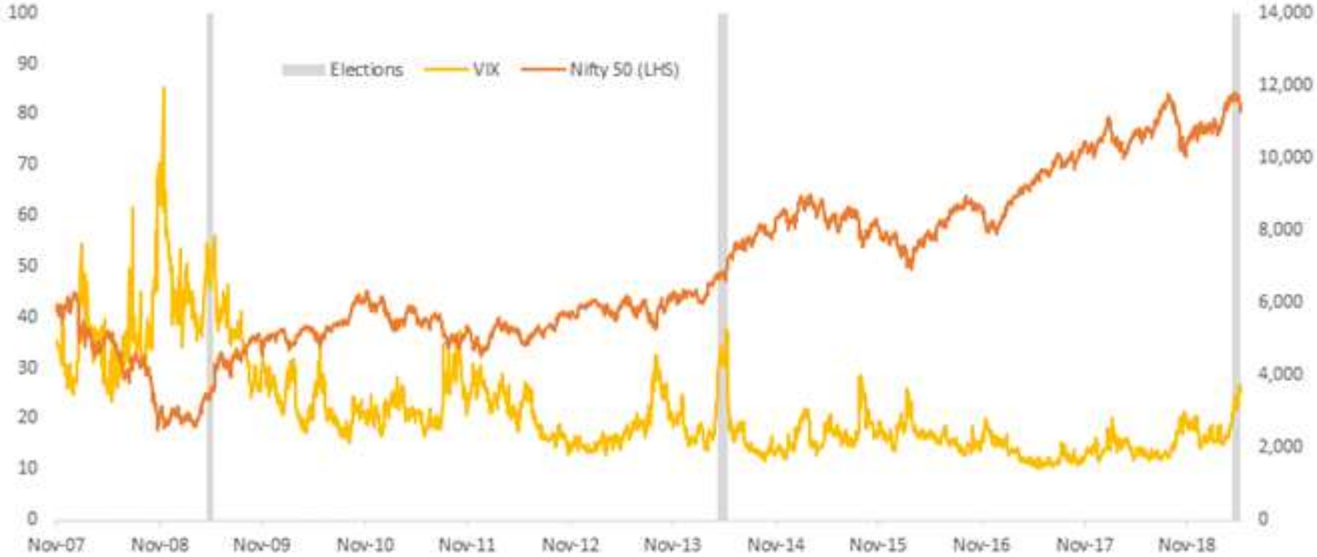
President Trump's twitter account could be the most powerful influence on global markets. A global market correction ensued last week after President Trump's tweet. The timing and global nature of the sell-off suggests this was FI driven selling, not associated with domestic happenings, such as election data, for instance.

The Fed will buckle under the pressure, in due course, and more QE – packaged in a new avatar – will probably be delivered. That becomes *the* next key milestone for global markets. Separately, U.S. shale oil production has soared, scaling 12 million barrels per day. U.S. imposed sanctions on Iran have decimated that nation's oil exports, particularly to India. The Europeans have eschewed the ban and continue to import oil from Iran. The underlying geo-politics are fairly obvious.

Earnings – Not a Great Show So Far…

Over the years, we have adjusted earnings and given companies the benefit of the doubt. This time around, companies have by and large, not delivered. It is the concentrated few market leaders that have delivered - TCS, HDFC Bank, Axis Bank, HCL Tech, L&T Tech, L&T Infotech and the like. There is a visible slowdown in the broader market, and top lines are not percolating to profits.

The India VIX Has Risen in the Past 2 Elections…
…The Current Rise Is Along Expected Lines



A Fairly Dismal Show So Far, Well Behind Last Quarter's Run-Rate…
…Mediocre Top Line for Consumer Sectors, Mediocre Operating Performance

	Sales YoY		Operating Profit YOY		Net Profit YOY		Operating Margin		Net Margin	
	NIFTY50	NIFTY500	NIFTY50	NIFTY500	NIFTY50	NIFTY500	NIFTY50	NIFTY500	NIFTY50	NIFTY500
Consumer Discretionary	0.7%	7.4%	-13.1%	5.1%	-9.2%	13.9%	14.6%	15.6%	8.6%	9.0%
Consumer Staples	9.2%	8.5%	13.4%	9.1%	13.6%	33.7%	23.4%	20.3%	15.2%	15.1%
Energy	19.4%	17.7%	16.0%	16.7%	9.8%	14.0%	15.6%	14.7%	6.7%	6.2%
Financials	21.4%	18.6%	10.6%	14.7%	75.2%	56.3%	41.6%	44.7%	15.9%	14.7%
Health Care	NA	17.8%	NA	38.2%	NA	-72.7%	NA	33.2%	NA	11.5%
Industrials	NA	10.3%	NA	11.5%	NA	10.5%	NA	15.0%	NA	9.0%
Information Technology	17.4%	18.6%	16.2%	16.4%	17.8%	18.3%	27.5%	26.3%	19.0%	18.1%
Materials	7.8%	7.5%	5.8%	4.9%	219.0%	40.2%	23.8%	22.8%	8.1%	9.0%
Real Estate	NA	-3.6%	NA	-66.0%	NA	-83.2%	NA	26.5%	NA	10.0%
Communication Services	5.7%	9.4%	-5.8%	-5.8%	NA	NA	35.6%	32.2%	-5.9%	-4.3%
Utilities	NA	2.2%	NA	32.5%	NA	192.6%	NA	23.4%	NA	3.5%
Index	14.7%	13.5%	9.4%	10.3%	27.4%	14.0%	24.5%	24.5%	10.6%	10.4%

…Large Caps Beating Mid and Small

	Sales YoY		Operating Profit YOY		Net Profit YOY		Operating Margin		Net Margin	
	NIFTY50	NIFTY500	NIFTY50	NIFTY500	NIFTY50	NIFTY500	NIFTY50	NIFTY500	NIFTY50	NIFTY500
Small Cap	NA	12.1%	NA	4.9%	NA	8.7%	NA	15.4%	NA	7.4%
Mid Cap	NA	12.8%	NA	19.9%	NA	7.5%	NA	34.2%	NA	10.4%
Large Cap	14.7%	14.1%	9.4%	9.0%	27.4%	16.0%	24.5%	24.5%	10.6%	10.9%
Index	14.7%	13.7%	9.4%	10.4%	27.4%	14.2%	24.5%	24.5%	10.6%	10.4%

Structural or Transitory Slowdown?

There are two hypotheses for the slowdown. First, consumers have pulled back due to electoral and regulatory uncertainty. Second, there is a school of thought that has come forward stating that the top 100 million consumers driving India's consumption story are plateauing. It is too early to reach such a conclusion in our view. Consumers are, however, weighed down by low wage growth, job insecurity, rising cost of living, high taxes, rural stress, credit worries, real estate stress etc.

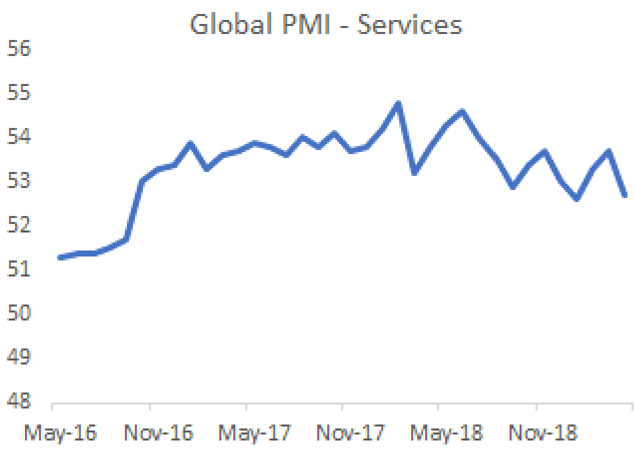
Passenger vehicle sales have been weakening for a few quarters. Ditto tractor sales, CV sales, two wheelers. FMCG names are reporting lacklustre volume growth. A bigger worry is dismal management commentary. Hindustan Unilever cautioned that their business was not recession proof. In general, firms are pointing to a slowdown in rural demand.

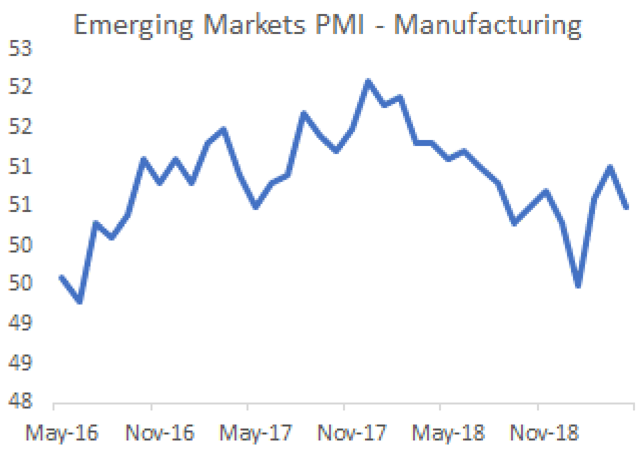
Certain data has picked up but should be discounted as it isn't sustainable in our opinion. Cement output clocked a five-month high growth of 15.8% YoY in Mar-19, steel output grew 6.7% YoY, coal 9.1% YoY. These are transitory, led by the government's pre-election focus on infrastructure and housing, and will likely ebb post elections.

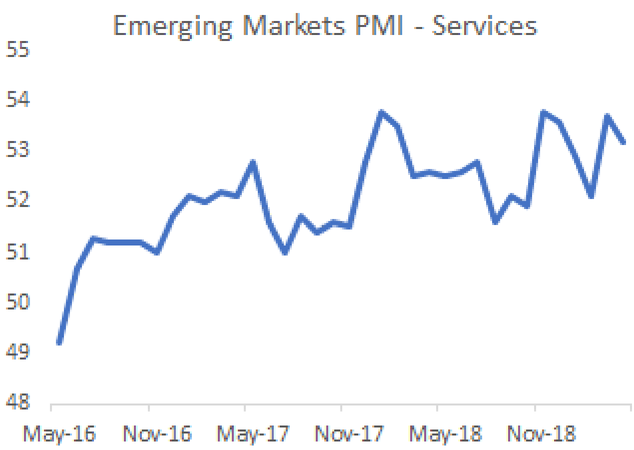
Global U.S. and India PMIs Are Tracking Lower…

Global manufacturing PMI eased to 50.3 in April and global manufacturing looks set to be headed into a contraction. China released dismal auto sales this past week. The U.S. does not look much better. India's PMI manufacturing is at an 8-month low of 51.8 and Services was equally weak. Survey respondents highlighted election related uncertainty and a challenging economic environment.

Global, U.S. and India PMIs Are Slowing…

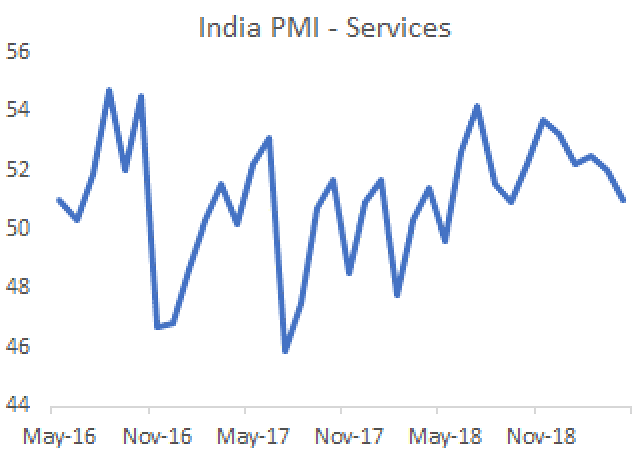






Amidst the Gloom, Crude Oil's Decline Builds the Case for a Rate Cut…

A welcome development – also incidentally initiated by a Trump tweet – is the decline in crude oil prices, creating the headroom for the RBI to deliver further rate cuts. We'd further hope that the RBI would finally move to an accommodative policy positioning.



Domestic Credit Growth Remains Strong, While Credit to Industry Has Picked Up…

Amidst the gloom, non-food bank credit growth remains strong at 14.2% YoY. Credit to industry has risen to 6.9% YoY in March versus 5.6% in February, the fastest pace of growth in nearly 4 years, driven primarily by large companies. Credit growth for personal loans eased marginally to 16.4% YoY in March vs. 16.7% in February.

The Bank NPA situation is Expected to Benefit Creditors to the tune of INR 80,000 crores in FY20…

In further good news, banks are expected to realize more than Rs 80,000 crore in FY20 from the IBC compared to about Rs 66,000 crore realised in FY19. The higher realisation in FY20 should be driven by the expected conclusion of the corporate insolvency resolution process of Essar Steel
and Bhushan Steel. Both these accounts are part of the RBI's list of 12 largest defaulting companies announced in June 2017.

3-4 More Banks Likely to Exit PCA, Will Improve Credit Availability

With three banks out of the PCA net, 3-4 more banks are expected to come out of RBI's PCA framework in the next 6-8 months, on account of improvement in financial health amidst capital infusion and falling bad loans. These will provide a marginal improvement in credit availability.

GST Collections Also Bode Well for the Bond Market

Gross GST revenue collections stood at Rs 1.139 tn in April, registering 10.1 % YoY growth. The rise in tax collections can partly be attributed to year-end adjustments. Nonetheless, GST collections for April are in line with the FY20 required monthly run rate, which stands at Rs. 1.14 tn.

Outlook

Equities

Credit Woes Remain Unaddressed and Central Bank Action Will Be Key…

Credit and liquidity issues remain unaddressed in the domestic economy. Globally, the world economy is slowing, and President Trump wants rate cuts and QE. The next government of India will have its work cut out to revive economic growth. With slowing data, stress in the financial sector, India needs monetary stimulus, fiscal stimulus, financial system clean-up and further structural reforms. Separately, the consumer needs a boost.

Portfolio Protection

Option premiums have been untenably high over the past few weeks, and rendered the risk reward of put options unattractive. A 3% premium requires a 400-500 point fall within a month or so in the Nifty 50, to obtain minimal 1-1.25%~ protection. Raising cash is equally challenging, as even a 20% cash position protects only 1% of every 5% drop in the portfolio, and that's assuming perfect market timing. Transaction fees, turnover create taxable events and whittle down the benefit further. The risk that the market could potentially deliver 10% upside on a positive election outcome makes the call that much harder.

Election Clarity Will Drive Market Action

Domestic investors have been on the side-lines for months, awaiting election clarity. The coming days are likely to witness increased volatility, politically and economically, and we hope they bring the necessary clarity. Election outcome will also provide clarity on market direction.

Should markets continue to sell off, we would look to increase allocations to equities on indications of a Fed QE announcement, a domestic bailout package or more attractive valuations. On the other hand, a positive election outcome could turn sentiment around, create capital inflows and drive markets higher.

For now, a neutral weighting remains appropriate. Quality large caps remain well positioned, and large cap concentrated portfolios with appropriate diversification based on risk preferences remains our preferred positioning.

Debt

The Likelihood of a Rate Cut Has Risen…

Given the global and domestic backdrop, we expect the MPC to come forward with rate cuts. The RBI will also likely continue OMO auctions to keep systemic liquidity close to neutral. India's overnight indexed swap rates – a measure of short-term interest rates – have moved lower with Brent crude oil falling to $70 per barrel, supporting our view of an improved likelihood of policy rate cuts in June and beyond.

U.S. central bank policy in status quo neutral increases the odds of monetary easing by India's MPC which has cut rates by 50 bps since February. April inflation data, due May 13, is likely to be muted, and should provide additional support.

G-sec Duration Looks Well Positioned…

In a scenario where the RBI reduces rates by 50-100 bps, long duration bonds can deliver solid returns, upwards of 10%, while providing a natural hedge to equity portfolios. In a world with low inflation, low interest rates, disruption and technological impacts, global forces are pushing rates lower. The government has demonstrated discipline in keeping borrowing steady over the past three years, choosing to work with levers within the monetary system to maintain fiscal discipline.

Second, top notch companies are coming to raise funds in capital markets. We'd be buyers of high-quality corporate debt, particularly short to medium term maturity. Third, short term debt funds remain a conservative choice, accompanied by a bottom up review of underlying portfolios, avoiding funds with exposure to second, third tier real estate developer, NBFC paper. Finally, funds with the highest quality corporate AAA bonds, again with a bottom up review of portfolios, remain a decent alternative with an expectation of eventual spread compression.

Equities with high dividend yields are an alternative worth considering. For instance, a domestic Aluminum producer yields upwards of 9%, has delivered an uptick in earnings the past few quarters, and recently entered the lithium ion battery space, licensing cutting edge technology.

Overweight Debt, Underweight Gold…

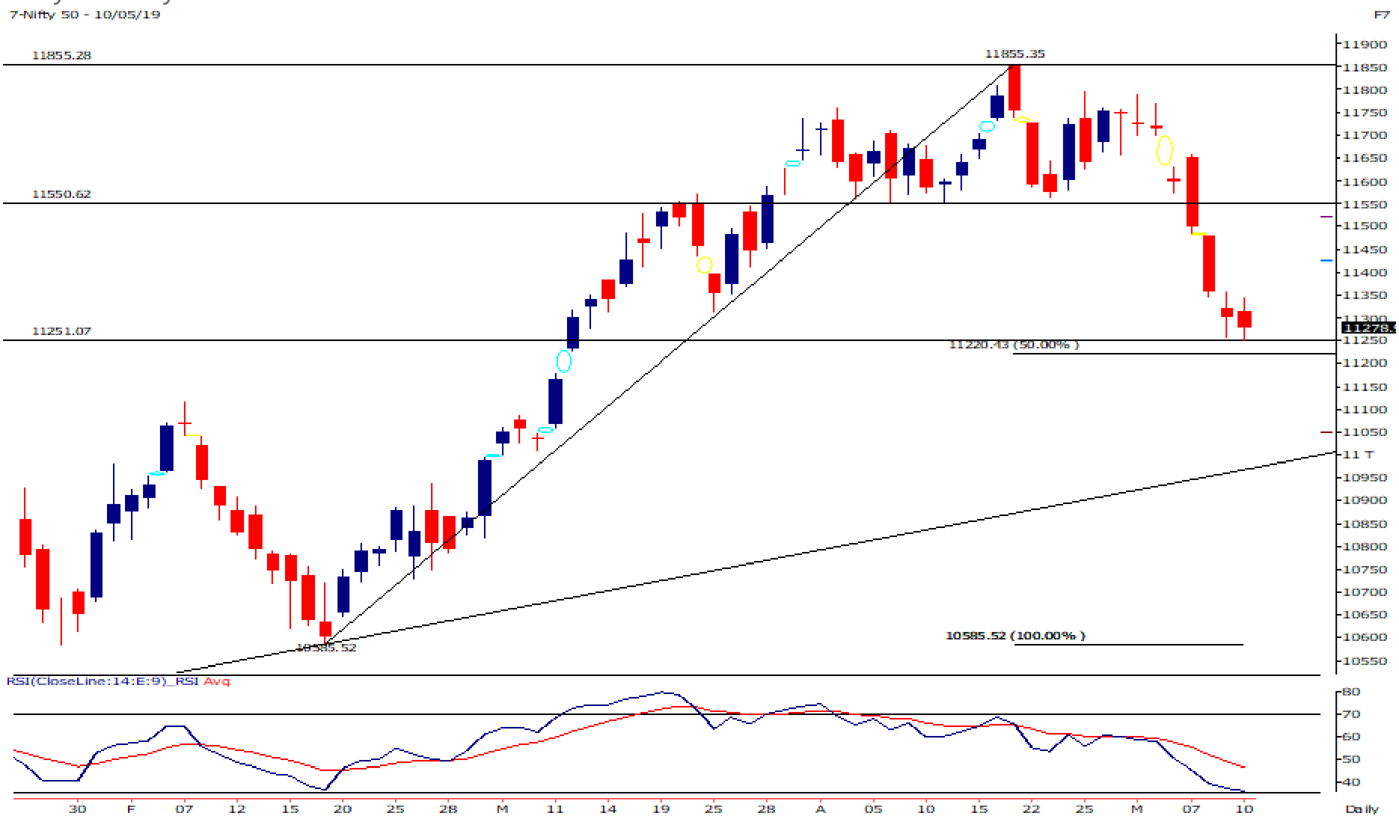
Debt investors are questioning the risk reward in debt funds today, and rightly so. Feeling let down by rating agencies, fund managers and regulatory authorities, caveat emptor is truer than ever.

Gold remains an underperformer and stagnant. Underweighting Gold remains the appropriate choice. We prefer to re-allocate towards steady, reliable fixed income streams.

Technical Outlook

US and China global trade war concerns and uncertainty of election results led to profit booking in the market last week. Benchmark Nifty lost 3.7% to close at 11,278 for the week. After consolidating between 11,550-11,860 levels, index has seen breakdown. It has formed bearish long body candle for the week indicating selling and downside pressure. But for last couple of sessions on daily chart, index has formed kind of spinning top candle indicating indecisiveness. Thus, in the short-term market may see bounce back if it holds above 11,250-11,220 zone. It needs to clear 11,360 for rebound towards 11,450 and then possibly 11,550 levels. However, breaking below 11,220 level, the decline will continue towards 11,000-10,950 levels. In Nifty options, maximum open interest for Put is at 11,000 indicating as support level for the market. India VIX jumped by 9.6% this week to 26.34. Ahead of election results VIX is likely to rise further and volatility to continue in the market.

Nifty Weekly Chart



Source: Falcon

Sanctum Wealth Management

Investment & Advisory

Sunil Sharma
Chief Investment Officer & Executive Director
+91 11 6612 5803
sunil.sharma@sanctumwealth.com

Ashish Chaturmohta
Chief Advisor – Technical Strategies
+91 22 6106 4865
ashish.chaturmohta@sanctumwealth.com

Salvin Shah
Investment Analyst, Investment Office
+91 22 6106 4811
salvin.shah@sanctumwealth.com

Hemang Kapasi
Portfolio Manager
+91 22 6106 4815
hemang.kapasi@sanctumwealth.com

Rohit Laungani
Investment Analyst, Investment Office
+91 22 6106 4840
rohit.laungani@sanctumwealth.com

Anway Bhujbal
Technical & Derivative Analyst
+91 22 6106 4803
anway.bhujbal@sanctumwealth.com

Offices

Mumbai
Sanctum Wealth Management Private Limited
Unit 1501, Tower 2B, One Indiabulls Centre, 841,
Jupiter Mills, Off Senapati Bapat Marg,
Lower Parel, Mumbai, Maharashtra – 400013
Telephone: +91 22 61064 8000

Delhi
Sanctum Wealth Management Private Limited
812 – 816, 8th Floor, Narain Manzil,
23, Barakhamba Road,
New Delhi – 110001
Telephone: +91 11 66125713

Bengaluru
Sanctum Wealth Management Private Limited
Unit 1102, 11th Floor, HMG Ambassador,
137, Residency Road,
Bengaluru, Karnataka – 560025
Telephone: +91 80 6742 7900

Chennai
Sanctum Wealth Management Private Limited
Level 4, Suite no. 503, Apeejay Business Centre,
39/12, Haddows Road, Nungambakkam,
Chennai, Tamil Nadu - 600006
Telephone: +91 44 2822 4949

Kolkata
Sanctum Wealth Management Private Limited
Regus Business Centre Office no. 131, The Legacy,
1st Floor 25-A, Shakespeare Sarani,
Kolkata, West Bengal – 700017
Telephone: +91 33 4400 0509

Ahmedabad
Sanctum Wealth Management Private Limited
Regus Earth Rise Office no. 1134, 11th Floor
Sarkhej-Gandhinagar Highway, Makarba,
Ahmedabad, Gujarat - 380015
Telephone +91 79 6134 4593