



Jan 27, 2020

## Investment Strategy

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### Looking Ahead On Multiple Frames

*"If we don't change the direction we're going, we're going to end up where we're headed" – Chinese Proverb*

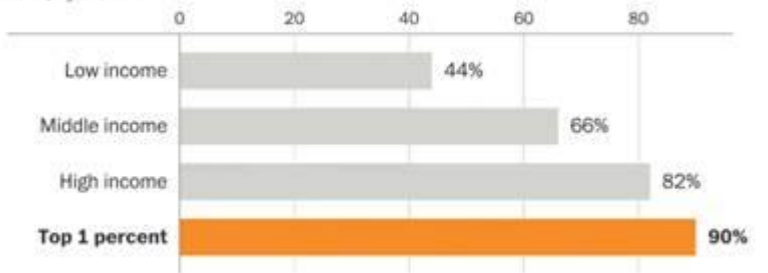
#### Money Buys.... Satisfaction?

A new poll by the NPR and Harvard finds that 90% of the top 1% income earners in the U.S. (> \$500,000 income) are very or completely satisfied with their lives; in contrast, the number shrinks to 44% for the lowest income group. Money clearly seems to buy satisfaction.

Previous studies indicated there appears to be a saturation point on money contributing to happiness, but this poll suggests life satisfaction is strongly impacted by money. The richest 1% may not be happier on a day to day basis, but they are a lot more satisfied. 97% of them believe they have achieved the American dream or are on their way to achieving it. For the vast majority of men and women that spend a significant chunk of their lives building financial security, the findings confirm what all humans know intuitively - money matters.

### Buying happiness

Percent of American adults saying they are "very" or "completely" satisfied with their lives, by income



Source: NPR/RWJF/Harvard poll

THE WASHINGTON POST

## Portfolio Strategy

### Portfolio Returns – Look Back and Look Ahead

On to portfolios, markets and returns. In looking back at the 2010s, it is abundantly clear that the Nifty 50 index has not been representative of the opportunities available to investors for healthy returns. While the Nifty 50 averaged a mediocre 11% CAGR, investors could have done far better by holding household names in Banking, FMCG et al. Investors focused with index levels would do much better spending that time on stock and manager selection. In looking ahead, **security selection will remain more important than index performance.**

### Asset Rotation, More than Asset Allocation

Further, if the equity index returned 11% CAGR and average debt returned let's say 8-9% CAGR, asset allocation would not have mattered as much as it has historically done so. Unless, there were tactical choices along the way.

Consider investors and managers that stayed committed to small and mid caps during the painful selloff in 2018, versus those that rotated out of mid and small into larger caps. Or, investors that rotated into duration, or out of credit, versus those that stayed the course. **Asset rotation was meaningful to portfolio returns and will continue to remain so.**

### Manager Selection & Fees

The last few years yet again reinforced the importance of manager selection. No further explanation necessary on this one. Most portfolios reflect the gain and pain of good and bad choices. Fees started to matter and investors smartened up to embedded fees, hidden fees, product fees and complicated structures.

Active strategies that charge exorbitant fees but didn't deliver performance will find it increasingly challenging to garner new assets. With information availability rising, investors are going to be increasingly aware and unwilling to pay for underperformance. **Specialized managers gained a healthy share of new capital from investors, and stand to continue to do so.**

### The Single Most Important Variable for Investors

However, the factor that encompasses each of the above, to us the **single most important variable in wealth creation and whether an investor achieves his financial objectives is**

the wealth advisor. Going forward, we continue to believe portfolio returns will be impacted by the quality of advice, decision making and partners clients surround themselves with.

## Economy and Markets

### Mid Caps Rise While Large Caps Stall

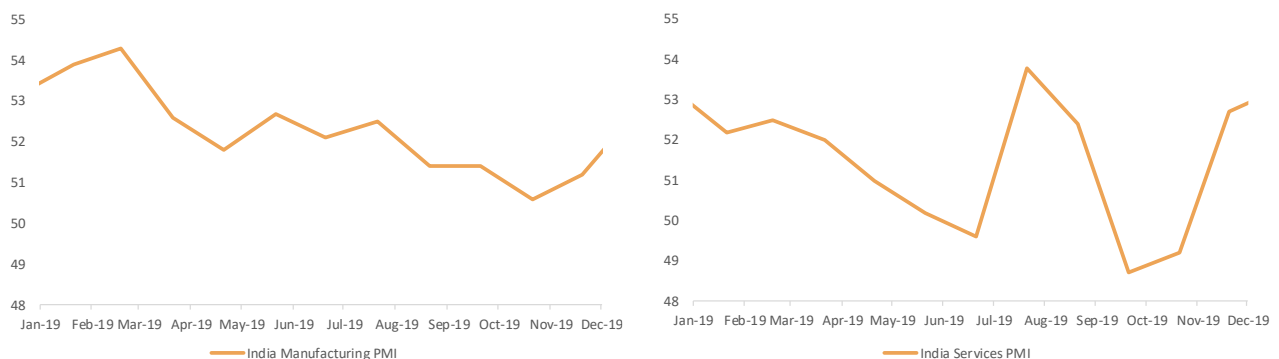
Midcaps have outperformed smartly of late, while large cap earnings and price action have stalled. Markets are selectively re-rating midcaps, leading to momentum picking up for the group. The rationale for a rotation makes sense if the markets are right about an economic recovery ahead.

### PMI Data Adds Credence to a Recovery

In attempting to ascertain the prospects of a recovery, the PMI Services and Manufacturing data are showing positive signs of a pickup. Based on surveys from business owners, these series have generally been reliable.

The corporate tax cut could be the reason for the pickup in manufacturing activity. It is certainly the reason our markets made a bottom late summer last year.

Manufacturing and Services PMI have rebounded from Nov-19 bottom



### But Personal Income Taxes are at a 10 Year High of 35.8%, Service Taxes At a High, and Consumer Debt to GDP is Rising

What gives us pause is that the consumer is tiring. The top marginal personal income tax rate in India is now at a 10 year high is 42.7%. Add to this a GST tax of 18% on goods and services. Service taxes used to be in the low double digits at the start of the decade. As a result of the heavy burden imposed on tax payers, household debt to GDP has risen consistently in the past four years, to 11.6% from being under 9% in 2014-15.

### The Budget is the Key Event Now for Market Direction

Therefore, clarity on the government’s strategy and direction now takes on meaningful importance. It’s safe to say that earnings are likely to be a mixed bag, and the trend is likely to worsen as the second and third batch of companies report earnings.

### A Consumption Stimulus Please...

Stepping back to a perch that allows us to take a decadal view, reforms have yet to kickstart higher quality economic growth. In fairness, cleaning decades of rot takes time and the moral hazard has shifted back to borrowers.

It is instructive to note that **President Trump – despite being a business friendly Republican – chose a massive tax cut for consumers and a stimulus package early in his tenure** which immediately boosted the U.S. economy, leading to the U.S. stock market being *the* dominant performer in the past decade.

Higher taxes, dismal wage growth, job insecurity, declining confidence and a steadily worsening balance sheet are taking their toll. Big bang reforms and infrastructure spending programs have not percolated benefits to the broader economy. Trickle down economics generally delivers dismal outcomes. **Big bang consumer reforms are the critical need of the hour.**

### Stagflation Surfaces as a Concern

Worryingly, stagflation is now a worry, with inflation picking up and growth decelerating, a decidedly toxic combination. Inflation also stays the hand of the RBI on monetary policy. In all likelihood, inflation will turn back lower as the underlying demand conditions look fairly muted but demand needs a booster shot.

### A Reduction in Personal Income Tax Rates is Urgently Necessary

With meaningful corporate tax reform sealed and delivered, we look for a **cut in personal income taxes comes through increasing disposable income** in the hands of the consumer. Currently tax payers with incomes up to 5 lakhs are given a rebate of INR 12,500. We expect this rebate to be extended to tax payers with income up to 10 lakhs, effectively reducing the tax outlay of roughly 15-20 million individuals.

### Rural Spending

Reviving rural spending will be equally high on the government's agenda. Higher allocations through the National Rural Employment Guarantee Scheme could be one approach. Allocations to PM Kisan are unlikely to be increased, as this government ideologically tilts towards upliftment via dignity of labor, rather than handouts.

### Revival of Real Estate

Besides consumption, real estate is the sector with meaningful multiplier effects on growth. We look for the government to expand the definition of affordable housing, or increase the deductibility limit for interest on housing loans, currently at INR 2 lakhs.

### Capital Markets & the Vision

Capital markets are expecting a reduction in dividend distribution taxes and hoping for some respite on long term capital gains, either abolition of the tax or a shorter holding period such as two years. Capital markets will also be looking to understand the vision and strategic direction of the government.



## Outlook

### Equities

Markets have been racing higher in the past few months, driven by liquidity, optimism and possibly expectations of big announcements in the budget. The government is well aware that the economy remains lacklustre and needs shock treatment. The budget is a perfect platform to accomplish a change in sentiment and re-kindle consumer and business confidence. P.M. Modi's meetings with industry leaders suggest that the government recognizes the need for action. On equities, we **stay the course**.

As discussed earlier, we recommend investors **increase exposure to quality mid cap funds and move to neutral strategic weight in mid caps**.

### Fixed Income

As a result of lower than expected nominal GDP growth and slowing tax collections, we expect the fiscal deficit to rise upwards of 3.6% versus an FY20 budgeted 3.3%, barring any surprise divestments or windfalls. Direct tax revenue is likely to rise by a marginal 3.1% year over year, versus expectations of double digit growth, primarily due to the massive corporate tax cut. Indirect tax revenues will rise by low single digits similarly, versus expectations of double digit growth, primarily due to a shortfall in GST and excise duty collections.

With credit growth slowing, we expect banks to re-direct excess funds into g-secs and SDL, aiding flows into the bond market. On the flip side, lower tax collections, the corporate tax cut, rising inflation and higher borrowing requirements are going to be headwinds for the bond market.

The RBI is likely to continue to support the yield structure via operation twist. We expect yields to remain range bound, with the possibility of volatility on interest rates around the budget, and risk weighted towards additional pressures on bond yields. We continue to favour high quality corporate bonds, and would review our position on credit risk and duration post the budget.

### Technical Outlook

The rally in last couple of session helped Nifty reduce its losses after a negative start last week. The Nifty finally settled at 12,248 down by 0.84% for the week. Broader market has been witnessing participation and BSE Midcap, Smallcap indices outperformed the benchmark with a gain of 0.72% and 0.93% for the week. On the daily chart Nifty has formed bullish but weekly it has formed a bearish engulfing candle. In spite of the fall last week, index is yet to break sequence of higher top and higher bottom on daily chart, thus the trend still remain up. Now sustaining above immediate support level of 12,180 index can see bounce back towards 12,350-12,400 zone. Next levels for Nifty are seen at 12,700. On the downside 12,000-11,950 is the support zone breaking below which market can see correction towards 12,700 levels. In Nifty January monthly expiry options, maximum open interest for Put is seen at strike price 12,000 and 12,200; while for Call maximum open interest is seen at 12,500 followed by 12,300. Good amount of Put writing was seen in strike price 12,200 and 12,250 indicating as immediate support zone for the market. Nifty option distribution is suggesting a range of 12,000 and 12,500. India VIX closed at 15.56 up by 10.12% for the week. VIX has been on up move since the start of this year as market is witnessing volatility at all-time high levels. It is likely to persist as market approached into Budget this week.

### Nifty Weekly Chart

1-Nifty 50 - 24/01/20



Source: Falcon7

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