Sanctum View

May 4, 2020

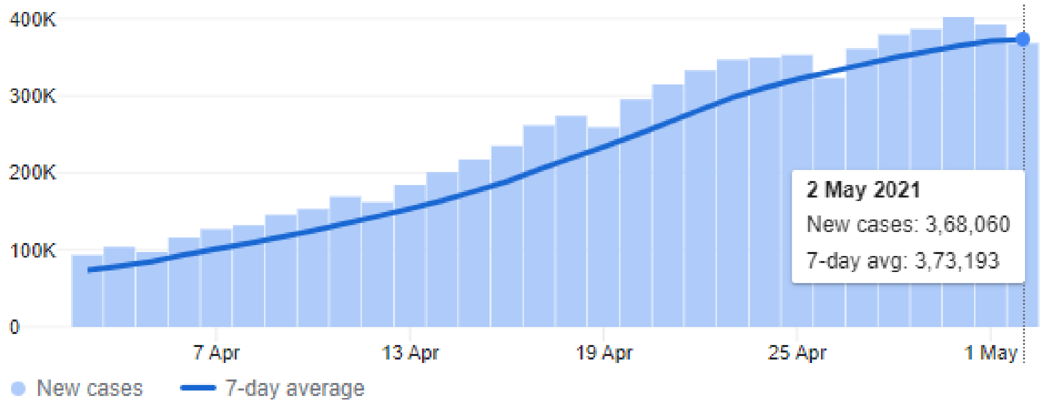
Investment Strategy

Testing Times

The last few weeks have been particularly difficult for many of us as the second Covid wave in India has been much severe than any across the world. However, there are early signs that cases in Maharashtra (and Mumbai within that) may be peaking and some of the other, larger severely affected states like Tamil Nadu and Karnataka may follow over the next couple of weeks. Thereafter, the focus would shift back to the vaccination drive that hopefully should have solved a fair bit of its supply disruptions by then. Additionally, administrations world over are also stepping in to help India deal with this particularly virulent strain.

While vaccination drives in the developed world, especially the US and UK, are progressing at a good pace, the potential spread of Indian mutation to the rest of the world could pose a material risk to economic recovery.

The curve of new daily cases has flattened in last few days



* Source: JHU CSSE Covid-19 Data

Global Macro

The US economy, supported by policy and vaccinations, continues its uptick. U.S. average household income surged 21.1% in March as federal stimulus reached people. US GDP grew by a healthy 6.4% in the quarter ended March 2021. Composite PMI numbers for April rose to a record high of 62.2 in April from 59.7 in March. Despite high unemployment, wage costs are ticking higher and this usually is an indicator of stickier inflation in coming quarters. And yet, the Fed has reiterated its commitment to hold off tapering until the economy gets closer to full employment and average 2% inflation.

Of the larger European economies, UK has been powering through its vaccination drive with a little over a fifth of its population fully vaccinated. This number for the other larger European economies is between 8%-10%. The pace of vaccination is a key determinant of getting growth back on track for these economies.

Countries	Doses Given (in Mn)	Daily Rate of Does Administered (in Mn)	% of Population Fully Vaccinated
India	**156.8**	**2.3**	**2.1%**
China	270.4	7.2	-
United States	245.6	2.4	31.5%
European Union	149.8	2.8	8.8%
United Kingdom	49.8	0.5	22.9%
Brazil	47.1	1.0	7.4%
Turkey	23.1	0.3	11.1%
Indonesia	20.2	0.2	2.9%

* Source: Bloomberg Vaccine Tracker as of 3rd May 2021

In Asia, China is showing signs of a slowdown in recovery post reporting 18.3% yoy GDP growth in the first quarter of 2021. Chinese Manufacturing PMI fell to 51.1, while Services PMI fell to 54.9 in April down from 51.9 and 56.3 in March, respectively. Additionally, with the Chinese central bank signalling its tightening bias amid rising consumer and producer inflation, the pace of economic recovery could slow down further. The other Asian countries have lagged in getting their masses vaccinated and are also seeing a rise in covid cases. This could impact economic recovery in those countries.

Equity Markets

Global equities markets were supported by strong economic and corporate earnings growth data. 86% of the companies that have reported earnings for Q12021, have beaten EPS estimates, according to FactSet. Almost 94% of US technology companies reported above estimates EPS. The analysts also forecast double-digit earnings growth for the remainder of the year.

US President Biden outlined a plan to almost double the corporate gain tax to close to 40% for Americans making over USD 1 Million a year. While some rise in taxes was expected as President Biden had suggested this in his Presidential campaign, the extent of rise is quite steep. However, most market participants believe that the proposal is unlikely to be passed in the current form and hence markets shrugged the announcement.

Performance of Key Equity Indices as of 30th April 2021	1 Month	1 Year	3 Year	5 Year
NSE Nifty 50 Index	-0.4%	48.4%	10.9%	13.3%
S&P 500 Index	5.2%	43.6%	16.4%	15.1%
NASDAQ Composite Index	5.4%	57.1%	25.5%	23.9%
Shanghai Stock Exchange Compos	0.1%	20.5%	3.8%	3.2%
Nikkei 225	-1.3%	42.7%	8.6%	11.6%
MSCI Global Index	4.2%	43.5%	11.3%	11.7%
MSCI AC Asia Pacific Index	1.4%	39.5%	5.8%	9.5%
MSCI Emerging Markets Index	2.4%	45.7%	5.0%	9.9%

* Source: Bloomberg, Sanctum Wealth Management
Above returns are local currency returns

Indian markets had a volatile month as the second covid wave turned out to be more virulent than before causing several localized lockdowns. However, market trends turned out to be resilient on three accounts – (i) lockdowns are localized not pan-India, (ii) although delayed, a vaccination drive gives visibility to the endgame and (iii) companies are better prepared to carry out businesses under restriction of movement than last year. As the covid cases peak over the next few weeks volatility in markets could continue. However, over the medium-term economic activity should recover, as observed in the last two quarters, which could keep markets afloat.

Quarterly Results – What to Expect

After two straight quarters of strong earnings upgrades, Indian corporates are set for yet another quarter of strong earnings growth. During Q4FY21, most high-frequency lead indicators pointed at a robust recovery in the economy. Also, a low base of Q4FY20 (due to lockdown in the last week of March-20) helped. The listed players are expected to outpace the growth in the overall economy driven by two key factors: (i) a shift in market share from unorganised to organised players and (ii) various cost optimisation measures undertaken by the corporates. As a result, Nifty Sales and PAT are expected to grow at 18% and 65% respectively. With this Nifty EPS is expected to grow at 13% for the full year FY21, a very respectable growth in a year full of challenges.

While more than two-third of the sectors are expected to report earnings growth in excess of 20%, the key sectors which will lead the Nifty EPS growth are (i) Materials (sharp rise in metal prices and volumes), (ii)

Automobiles (robust volumes partially offset by higher RM costs), (iii) Banks (mid-teen Net Interest Income growth despite higher slippages) and (iv) Oil and Gas (due to inventory losses in Q4FY20).

One-third of Nifty companies have already posted their performance for the quarter and as expected, 11 out of 17 Nifty companies that have declared their results have witnessed operating profit growth in excess of 15%. Banks witnessed a huge flush of liquidity thus, lowering their cost of funds. IT companies continued strong growth momentum led by cloud adoption and increased automation initiatives, while Auto companies benefitted from robust volume growth.

Portfolio Actions

In our annual outlook, we highlighted India's increasing focus on manufacturing and exports. One of the sectors that benefit the most from this is Speciality Chemicals which is expected to grow in double digits over the next decade led by (i) import substitution and (ii) rising share in global exports. For the better part of the last 20 years, MNCs consolidated their supply chains into China to benefit from its scale and cost advantages. The pandemic forced a re-think of this strategy of depending on a single source as supply chains were majorly disrupted. Tables have now turned – MNCs are now actively looking to partner with countries like India that have a huge domestic market as well as can be alternatives to China. Further, the Indian government is incentivising domestic players with initiatives like the PLI scheme. We have, therefore, positioned our portfolio to benefit from this opportunity. We have ~9% allocation in Sanctum Indian Titans and ~4% allocation in Sanctum Indian Olympians to Speciality Chemicals.

Technical Commentary

Since mid-February Nifty has been range-bound with a negative bias. Even as Nifty gave a break-out it declined below the falling trend line. The Nifty needs to make a decisive break above 15,000 and sustain to continue towards its all-time high of 15,431. 15,785 is the next resistance if 15,431 is broken. On the downside, immediate support is seen at 14,500-14,460 which is the 100-day moving average. The recent low of 14,150, which has been tested multiple times, is the critical support for the index.

Source: Falcon7

After being rangebound for the last couple of months, the BSE Smallcap index hit its all-time high last week. Now, a move above 21,900 could suggest that the rally could continue towards 22,430 and then 23,000 levels. On the downside, support is seen at 21,000 levels.

Globally, US equity indices Dow Jones and Nasdaq hit new-all time highs last week, and they could consolidate their gains before the next round of up-move. The US dollar index has seen a sharp correction last month from a high of 93.50 to a low of 90.4 level. 90.4 is now key support for the index. Brent crude after seeing a correction from a high of 71.38 to a low of 60 is now inching higher. The next resistance level is 69 and then 71.4.

Indices	Next Resistance Level	Key Resistance Level	Current Market Price	Initial Support Level
Nifty Index	15,431	15,000	*14,630*	14,500
BSE Smallcap Index	23,000	22,430	*22,009*	21,000

* Current Market Price as of 3rd May 2021

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