Sanctum Wealth Management

Sanctum View

August 7, 2021

Investment Strategy

The Eternal Debate

Global Market Update

Market participants have debated the benefits of Value vs Growth investing probably since these terms were coined. Over the last decade or so growth has beaten value hands down. When the global markets are being propelled by fast-growing tech and tech-enabled companies and billions of dollars are betting on innovation, is there room for the old economy in our portfolios? Is value investing finally, truly dead?

There isn't a universal definition of Value and Growth styles of investing, but broader characteristics of what comprises each style are as follows. Generally speaking, growth managers favour companies that are growing rapidly (topline / bottomline / RoCE). Such companies tend to trade at higher price multiples (p/e or p/b). Whereas value managers demonstrate bias for undervalued companies that may be out of favour or belong to mature sectors or be turnaround stories. Such companies tend to trade at lower price multiples and not uncommonly have higher dividend pay-outs.

Growth stocks typically tend to do well in markets where economic growth is strong, liquidity is abundant and interest rates are low (lower discount rate may justify higher valuations).

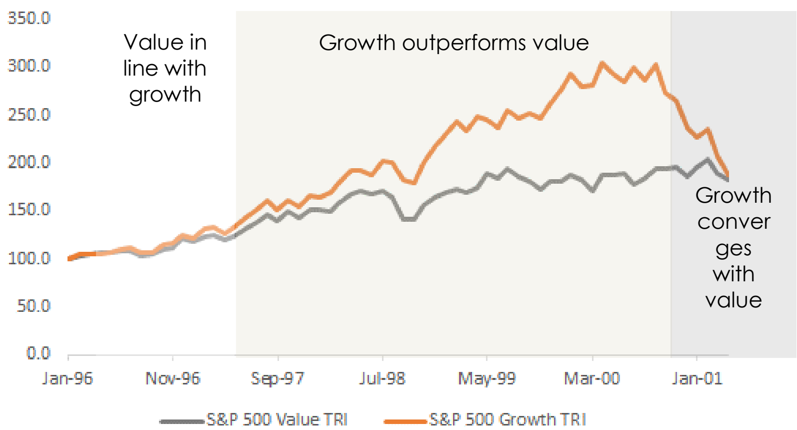
Also, value stocks are generally from the energy, industrials, financials and materials sectors which tend to do well when there is inflation and interest rates are rising.

Source: Scotiabank GBM Portfolio Strategy, MSCI, Mackenzie Investments

Looking at history

In the early 1990s, value and growth stocks outperformed each other in phases but by narrow margins. As the decade progressed, the use of technology boosted efficiency and productivity the world over. Also, US bond yields declined in the same period. A trio of growth, liquidity and high cash flow generation by technology companies resulted in a massive growth rally led by, of course, technology stocks, leading to what is now called the "technology bubble". However, as the technology bubble burst in 2000, value caught up with growth.

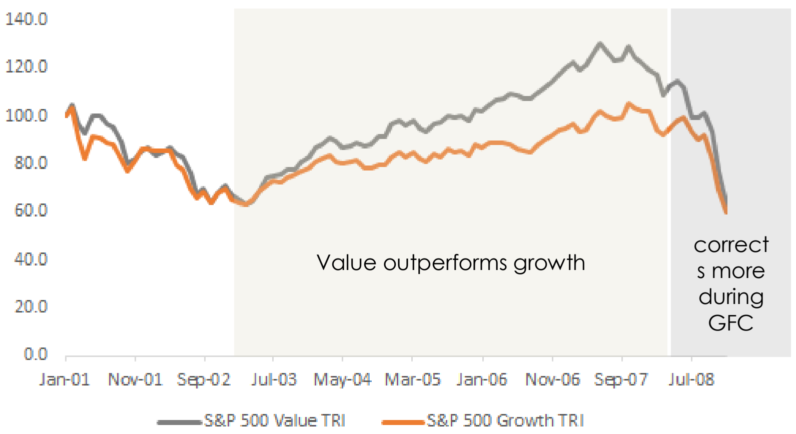
Growth rally led by technology stocks in the late 1990



Source: Bloomberg, Sanctum Wealth Management
Index rebased to 100 as of 1st Jan 1996

Between 2001 and 2007, the environment was favourable for value stocks as bond yields and inflation was rising. Also, some of the value sectors like financials, real estate, etc., were trading at a deep discount to the rest of the markets. Technology stocks were still growing but at a slower pace than anticipated earlier. As value-oriented sectors bounced back, value as a style outperformed growth. However, value stocks corrected more during the global financial crisis of 2008.

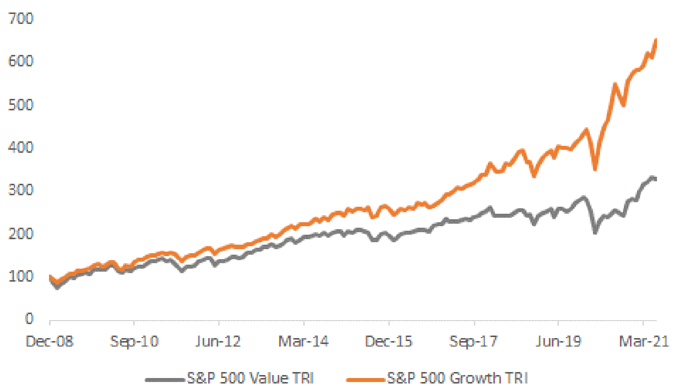
Value stocks rally between 2001-2007



Source: Bloomberg, Sanctum Wealth Management
Index rebased to 100 as of 1st Jan 2001

Over the last decade, the macroeconomic environment has been favourable for growth investing. In reaction to the 2008 financial crisis, global central banks have provided enough liquidity, which has kept bond yields and interest rates low. Additionally, the technology sector has rallied, led by the increased digitalisation of the world. The rally in technology stocks has increased the sector's weight to close to 28% currently from about 19%, 10 years back in the S&P 500 index. This has led to sharp outperformance by growth vs value.

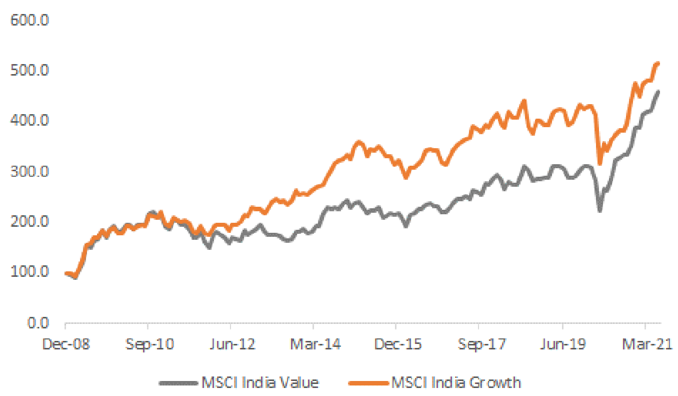
Growth has rallied over the last decade



Source: Bloomberg, Sanctum Wealth Management
Index rebased to 100 as of 31st Dec 2008

India has imitated the global trend over the years, but the deviation between growth vs value hasn't been as stark as that in the US over the last decade or so.

Growth has rallied over the last decade

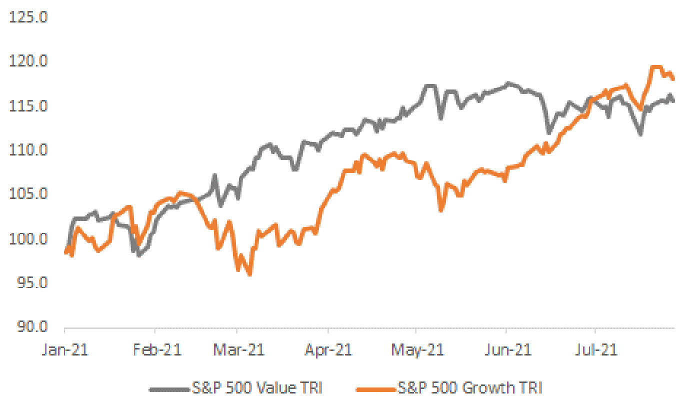


Source: Bloomberg, Sanctum Wealth Management
Index rebased to 100 as of 31st Dec 2008

Value investing could be on the brink of revival

We have seen value rebound early this year, but with the US Fed reconfirming its commitment to keep rates low and stating that recent inflation is transitionary, growth caught up.

Value rallied early this year



Source: Bloomberg, Sanctum Wealth Management
Index rebased to 100 as of 31st Dec 2008

We expect global central banks to taper liquidity and increase interest rates in the coming few years as inflation rises. Globally sectors that have been out of favour such as, infrastructure are seeing massive policy support. Similarly, banks, after years of consolidating, are seeing higher levels of activity. And as the core tenet of value suggests are much cheaper than their growth peers. Global growth stocks are currently at a 60-year high relative to value which suggests mean-reversion could be in the offing.

In India, most managers don't have a distinct value or growth orientation rather tend to follow a growth at right price approach and tilt their portfolio based on available market opportunities. However, fund managers typically take time to align portfolios to a particular time.

Since value as a style has underperformed for a long time, most investor portfolios may have invariably exited value-oriented schemes. We believe it is an appropriate time to consider incorporating good value-oriented schemes once again in the portfolios. However, we must also caution that value rotation did signal style shift multiple times before, outperforming for a brief period but failing to establish a trend. Nonetheless, style shift trends once established tend to be multi-year trends, as observed in the past. Thus, there is merit in allocation to value strategies even at the cost of being early.

We see a similar trend in international portfolios as well, where most of the investments are heavily skewed to the US, which has outperformed other markets over the last decade. However, we believe Europe could be a good value bet. European economies are more dependent on manufacturing and other value-oriented sectors. Also, European equities are better placed in terms of valuation relative to US equities. While the technology sector might continue to show high growth, valuations are not in its favour. Given the large weight of technology in the US indices, a value rotation could lead to the underperformance of US equities relative to other markets.

Global Update

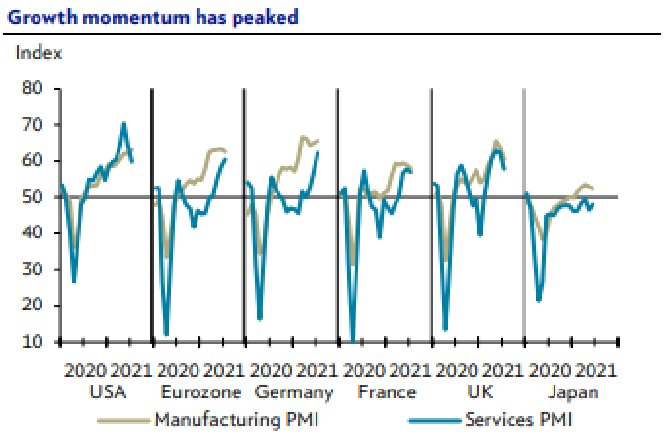
Last month Chinese company Didi (widely known as 'the Uber of China') got listed in the US via an IPO. Soon after, the Chinese government raised cross border data security concerns and decided it will not give any of the US regulators authority to audit Chinese companies listed in the US. This throws the fate of the currently 248 US-listed Chinese companies and all future aspirants into uncertainty. In an unrelated but significant development, last week China banned for-profit after school tutoring businesses. These policy shocks will force international investors to reassess their investments in China. We have already seen the Chinese equity markets correct sharply as a result of these policy actions and the tone thereof. We think this could benefit other emerging nations, including ours, in the medium term.

Performance of Key Equity Indices as of 31st July 2021	1 Month	1 Year	3 Year	5 Year
MSCI Global Index	0.6%	31.2%	11.7%	11.7%
MSCI AC Asia Pacific Index	-5.1%	19.8%	5.7%	7.7%
MSCI Emerging Markets Index	-7.0%	18.4%	5.5%	7.9%
MSCI China Index	**-14.2%**	**-1.1%**	**4.1%**	**10.4%**
S&P 500 INDEX	2.3%	34.4%	16.0%	15.1%
NASDAQ Composite Index	1.2%	36.6%	24.1%	23.2%
NSE Nifty 50 Index	0.3%	43.4%	8.5%	10.4%

Source: Bloomberg, Sanctum Wealth Management
All returns are price returns and in local currency

Global economic recovery continues but at a slower pace. (US GDP grew 6.5% in Q2 below consensus of 8.4%). Growth momentum has slowed as supply chain disruptions and labour shortages continue. Given fresh covid related lockdowns, the disruptions could be longer. Higher housing prices and wages tend to be sticky rather than transitory. When contrasted with the recent Powel statement of maintaining the status quo of rates and QE, it begs the question is the US on the brink of the most expensive policy error in its history?

The FOMC members, however, seem to have differing views on liquidity and rates and we along with the rest of the investing world will watch this very closely.

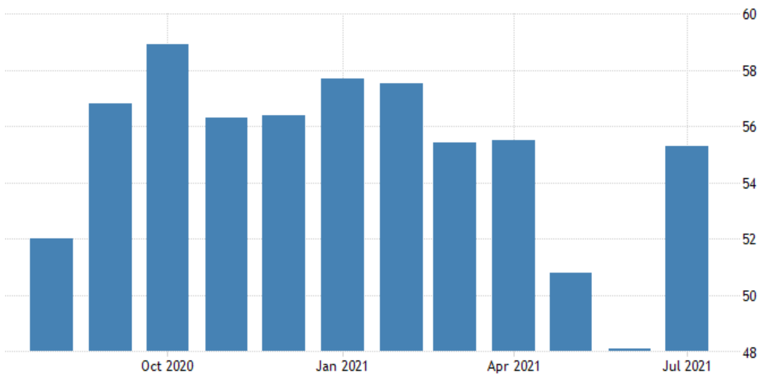


Source: Markit, Julius Baer

In the EMs, we have already seen Russia, Brazil and Mexico tightening monetary policies. The risk to India is we don't get to hold rates and liquidity easy long enough to recover our output loss.

India Macro

Locally, with restrictions easing post the second wave, cumulative activity indicators are now back to pre-second wave levels. India's manufacturing PMI surged to 55.3 in July 2021 after declining to 48.1 a month earlier. Exports have especially been strong, led by global demand. Exports rose by a healthy 14% (2-year CAGR) in June 2021. GST collections delivered a positive surprise month on month (33% higher than July 2020) as they stood at INR 1.16 lakh crores in July 2021. Government revenues are tracking better than expected for FY 2022. As we mentioned in our last monthly commentary, we had expected these numbers to bounce back with the reopening.



Source: tradingeconomics.com

India's CPI inflation for June 2021 came in at 6.3%, unchanged from last month. The momentum of the rise in food inflation slowed as it came in at 5.15% in June, slightly higher than 5.0% in May. While the slowdown in momentum is encouraging, the CPI inflation number is still higher than RBI's upper band of 6%. Bond yields reacted negatively to the data released. The RBI is expected to overlook this spike and continue with its easy monetary stance when it delivers its policy decision later this week. But if the trend continues, that will put pressure on the RBI to act ahead of schedule.

Technical Commentary

After being range-bound between 15,450-15,960 for the last eight weeks, the Nifty gave a breakout this week. It touched a new all-time high of 16,290 and is trading above the breakout level. Nifty has resumed its uptrend and the next key resistance level for the index is 16,580 followed by 16,790. On the downside, 15,900 and 15,600 are key support levels.

Source: Falcon7

The Nifty Bank index has also given a breakout from its trading range of 34,000-36,000. If it sustains above 36,000 levels an uptrend towards 37,700-38,000 levels is expected.

Even as Nifty has been range-bound, notwithstanding the recent jump, the BSE Smallcap has been hitting new highs almost every week since it gave a breakout in April. The BSE Midcap index moved above the key resistance zone of 23,050 levels.

Globally, the Nasdaq index has given a breakout after consolidating in a range of 13,400-14200 for four months. But it is now facing resistance at 14,860 levels. If the index can cross and sustain above it, the rally can continue towards 15,252 and 15,930.

Gold has found support at its long-term support trend line and is holding above it. If it crosses and sustains above 1,835 levels Gold can rally towards 1,874 and then 1,925 levels.

Indices	Next Resistance Level	Key Resistance Level	Current Market Price	Initial Support Level
Nifty Index	16,790	16.580	*16,259*	15,900
BSE Smallcap Index	29.445	27,700	*26,848*	25,000
BSE Midcap Index	24,570	23,960	*23,129*	22.400
Nifty Bank Index	38,000	37,700	*36,028*	35,200
Nasdaq 100 Index	15,950	15,252	*15,083*	14,160
USD Gold	1,874	1,835	*1,814*	1,790

* Current Market Price as of 4th August 2

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