

November 17, 2021

Portfolio Commentary

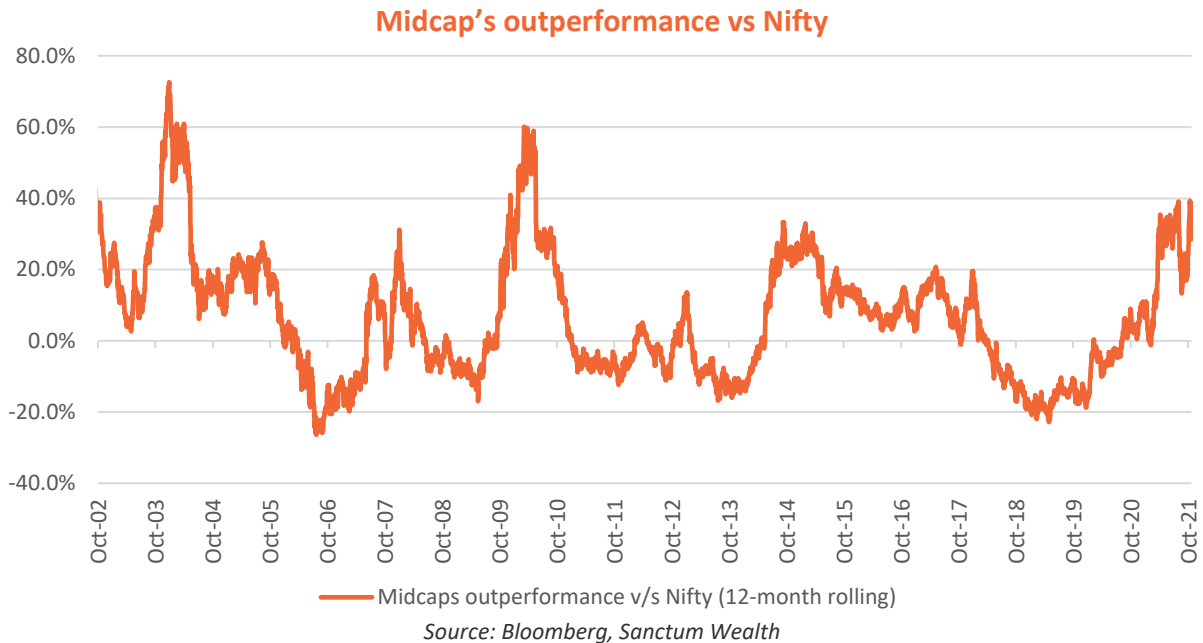
The Valuation Dichotomy

Indian markets have witnessed a stupendous rally over the last one and a half years partly driven by the economic recovery post the pandemic led meltdown and partly owing to the optimism in investor sentiments. Nifty has returned more than 50% over the last one year with only two months of negative returns. With such a stellar performance, Indian markets have significantly outperformed the emerging markets. Foreign investors too have been upbeat on the India story and have poured in more than USD23 bn in the last one year. However, post the rally, most investors are struggling with one question – are markets expensive? We try to answer this in the note below.

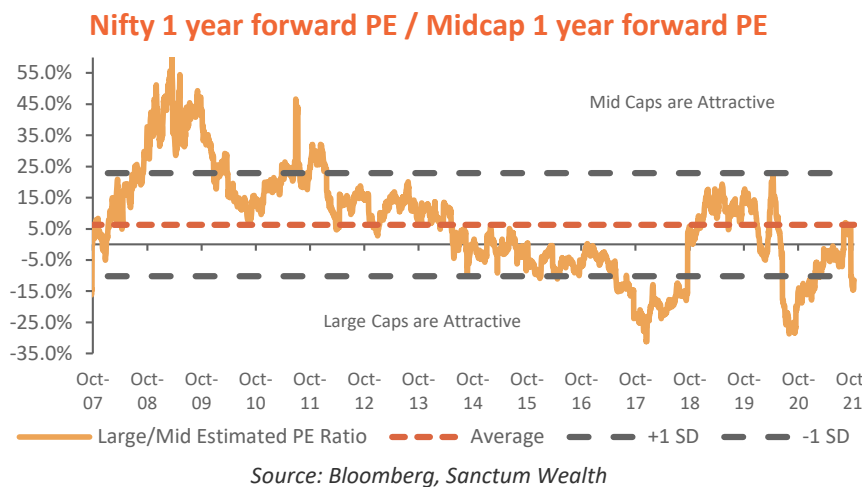
We have enough evidence from history where the sentiment pendulum has swung between euphoria and despair. This is even more true for certain pockets of the markets. There is always a certain segment of the market that has positive momentum and strong tailwinds leading to an optimistic outlook and thus, rich valuations. Does that mean it's time to short that space? Maybe not.

Mid-Caps vs Large Caps

The recent sharp gain in the midcap index has created a new benchmark. The NSE Midcap 100 index has generated consecutive positive monthly returns for 17 months delivering more than 100% return. This is the best such period of consecutive months of positive returns for the NSE Midcap 100. The Nifty Midcap index outperformed the Nifty 50 in 10 out of the past 12 months with the outperformance on a 12-month rolling basis at the highest levels since the GFC.

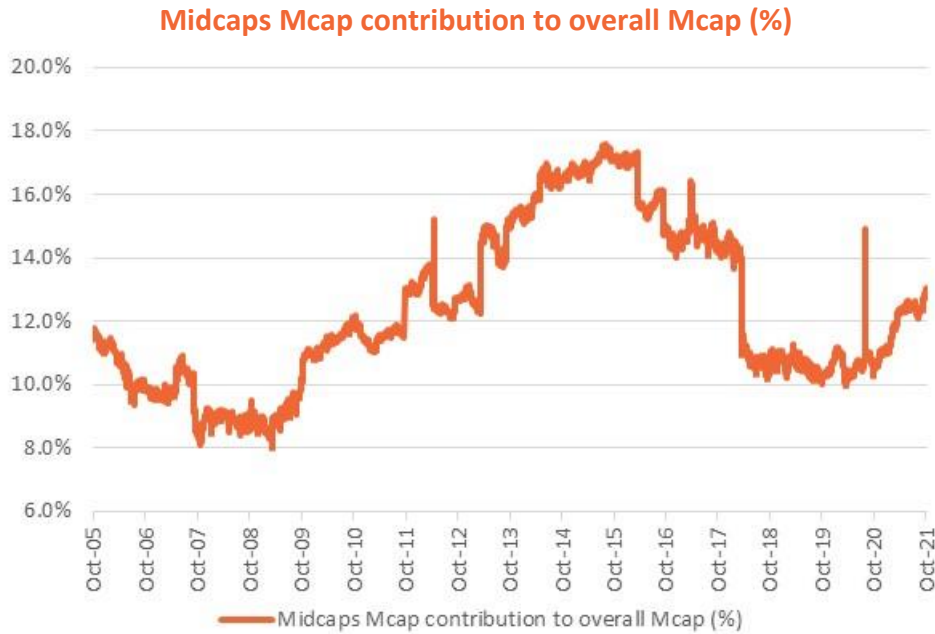


There exists a divergence in valuation multiples of these indices post the massive rally in midcaps. While the multiples for both large caps as well as midcaps have expanded, the magnitude of expansion in mid-caps has been far higher than large-caps. Hence, if one is to look at the ratio of forward PE multiple for large caps and mid-caps (Nifty PE/Midcap Index PE), it is evident that mid-caps are relatively more expensive.



PE Valuations, however, are hiding more than what they are revealing. The recent broad-based rally has led to a sharp increase in market cap contribution from the midcap universe. The market cap of

the NSE Midcap 100 index now contributes 12.8% to the overall market cap, up from 10% in April'20. Peak and trough contribution for the NSE Midcap 100 index is 17.2% and 8% of the total market cap.



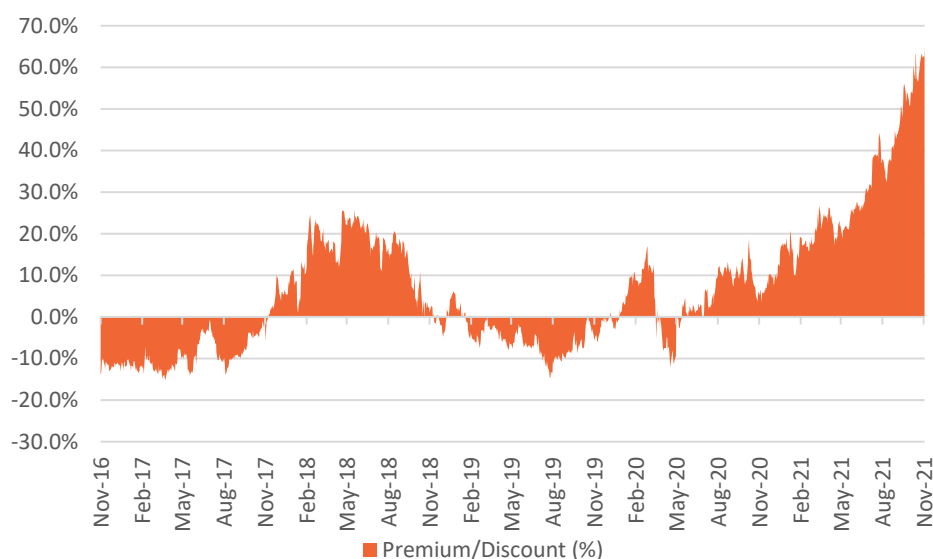
Source: Bloomberg, Sanctum Wealth

In terms of market cap contribution, the mid-caps are in a very comfortable range and any attempt to label midcaps “overvalued” will be premature.

IT - Mid-Caps vs Large Caps

While the dichotomy in valuation is visible in overall mid-caps and large caps, the divergence between mid-caps and large caps is even starker in the IT sector. Here too, the rally has been steep across the sector but the overall returns in mid-cap IT stocks have far exceeded the large caps. In the last one year when the top 4 large caps returned anywhere between 29% to 90%, mid-cap IT stocks rallied in the range of 122% to 240% thus leading to a sharp re-rating in the valuation multiple.

Mid-cap IT forward PE vs Large-cap IT forward PE (average of top 4 companies in each segment)



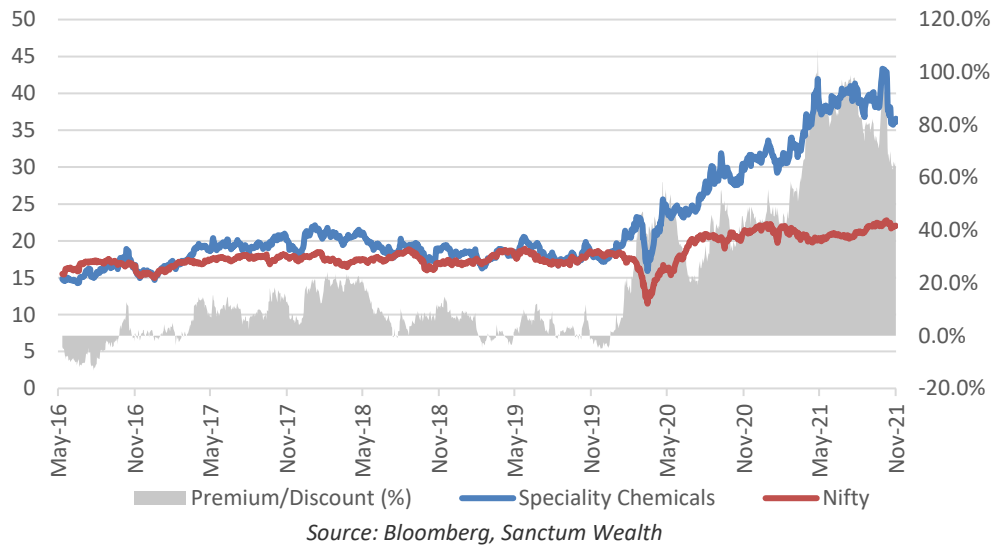
Source: Bloomberg, Sanctum Wealth

Historically, mid-caps IT stocks have traded at a discount to large caps owing to their size and vulnerability to any uncertainty. However, the discount has turned into a premium over the last year as the growth prospects for many mid-cap IT companies brightened / looked better than many large caps. We believe the premium is here to stay if these companies continue to deliver on their promised growth path, but the scope for further multiple expansion is capped.

Speciality Chemicals vs Nifty

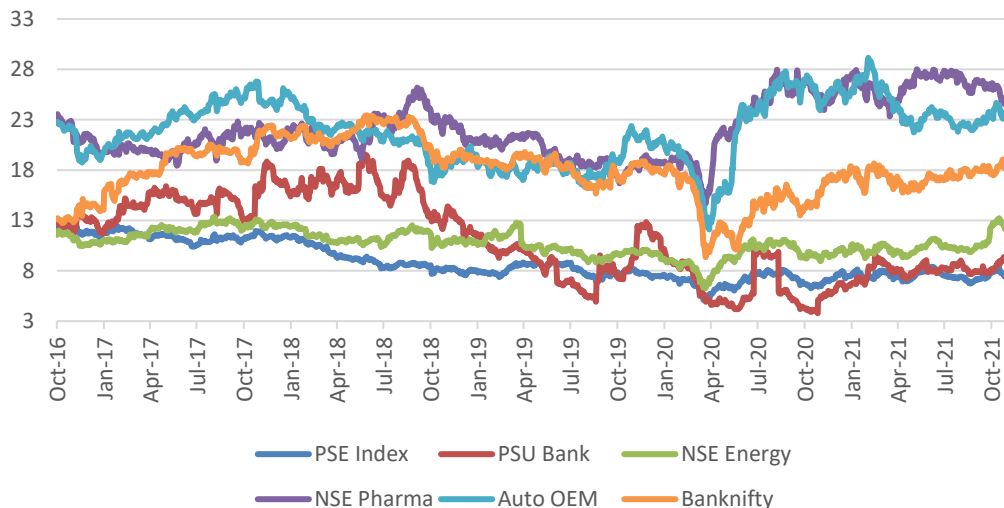
Another sector where we have seen a sharp rerating is speciality chemicals. The sector has been in favour for the last few years owing to change in strategy of global companies as they look for alternatives to China for sourcing raw materials. Various initiatives by the Indian government like Make in India and incentives to boost local manufacturing like PLI scheme has also helped. Here too the stock returns have been phenomenal with returns in the range of 50-200% over the last year and 32%-83% CAGR over 5 years. The average forward PE multiple has expanded from 15x to 36x over the last five years. In comparison, Nifty's forward PE multiple has expanded merely from 15x to 22x over the same period.

PE multiple premia of speciality chemical companies have risen sharply



While there are a few pockets of the markets which are trading at a premium to their historic averages, we believe their valuations are justified considering the earnings growth potential. We are not turning net sellers on these pockets unless we see these companies start to falter on earnings growth. Having said that, we do believe that further scope for multiple rerating is limited and sector rotation at this level led by profit booking cannot be ruled out. To generate any incremental alpha, one needs to start looking for ideas beyond these hot sectors, albeit supported with earnings traction.

Sectors that have not seen significant multiple expansion on 1 yr fwd basis



It All Boils Down to Earnings

As we reach the fag end of Q2FY22 earnings season, we take stock of how corporates have fared as the economy is almost back to normal. 44 out of 50 Nifty companies and 373 out of 500 NSE500 companies have reported results so far. While, the YoY growth looks abnormally high due to low

base, on a two-year CAGR basis, Nifty revenues (weighted average) grew 9.2% and PAT grew 19.2% CAGR.

Margins saw the maximum divergence as the consumption universe was massively hit on margins driven by almost vertical commodity inflation, supply chain issues and reflation trade. Margins also look thinner on a YoY basis as many cost saving measures taken by companies last year (e.g., reduction in marketing, travelling cost etc.) are back to normal levels now. While, consumer companies were on the receiving end, the commodity companies made bumper gains as a result of high commodity prices and operating leverage benefits.

Even as India's overall credit growth remains tepid at ~7% YoY, private banks continue to gain market share and post strong results led by 1) lower provisions seen for ICICI Bank, Axis Bank, Kotak Bank and HDFC Bank and 2) robust loan growth seen by ICICI Bank, Kotak Bank and HDFC Bank. Within the PSU banks, SBI delivered good results on a strong core NIM and low incremental stress.

The IT sector's Q2 results were broadly in-line, with a strong demand outlook led by digitization drive, deal wins and cloud migration. Most companies handled margins well despite attrition pressure and wage hikes.

	Sales YoY		Operating Profit YOY		Net Profit YOY		Operating Margin		Net Margin	
	NIFTY50	NIFTY500	NIFTY50	NIFTY500	NIFTY50	NIFTY500	NIFTY50	NIFTY500	NIFTY50	NIFTY500
Consumer Discretionary	15.5%	23.0%	-8.3%	4.3%	-84.8%	-25.5%	12.5%	13.0%	0.5%	2.4%
Consumer Staples	10.8%	15.2%	7.1%	10.6%	5.8%	10.7%	28.5%	20.1%	18.9%	12.9%
Energy	49.7%	50.6%	19.5%	17.1%	26.8%	16.9%	10.7%	9.8%	5.1%	4.7%
Financials	6.1%	2.0%	7.7%	6.2%	55.6%	42.2%	38.6%	40.5%	21.7%	17.0%
Health Care	12.9%	7.4%	16.0%	-7.1%	15.7%	5.0%	29.0%	22.6%	19.3%	15.6%
Industrials	12.9%	27.4%	1.3%	17.1%	-71.1%	-46.6%	23.0%	16.4%	8.0%	5.7%
Information Technology	18.5%	18.8%	11.5%	13.7%	11.7%	14.7%	27.3%	24.2%	17.7%	15.6%
Materials	39.3%	36.7%	58.0%	47.3%	106.4%	128.6%	28.2%	25.4%	15.9%	13.7%
Real Estate	NA	84.2%	NA	79.1%	NA	317.9%	NA	34.3%	NA	16.8%
Communication Services	13.0%	25.2%	24.6%	38.7%	NA	533.4%	49.1%	45.4%	1.5%	5.7%
Utilities	14.6%	26.7%	4.4%	9.8%	-3.2%	16.1%	44.6%	32.8%	16.3%	13.4%
Index	25.7%	25.1%	12.2%	14.3%	19.6%	28.9%	22.6%	22.8%	11.0%	10.2%

In-House Strategies

Overall, our portfolios remain centred around the themes of housing, manufacturing, and export opportunities. We are incrementally raising weights in lending financials as we expect cyclical demand recovery to pick up and NPA provisioning to trend lower resulting in better operating performance for the sector going forward. Earlier this year, as the economic rebound seemed to percolate to mid-sized companies, we added midcap exposure to Sanctum Indian Titans. Our underlying companies delivered strong growth and were rewarded richly. Post this strong outperformance as a prudent risk measure, we have reduced some exposure in mid and small cap space.

Performance of In-house PMS Strategies

Performance as on October 31, 2021	1 Month	3 Month	6 Month	1 Year	CAGR		
					2 Year	3 Year	Since Inc.*
Sanctum Indian Titans	1.3%	11.9%	29.1%	61.5%	28.5%	25.4%	18.2%
NSE200 Index	0.2%	11.2%	21.5%	55.0%	23.3%	19.3%	16.9%

* Since Inception Returns are from 18-Nov-16

Performance as on October 31, 2021	1 Month	3 Month	6 Month	1 Year	CAGR		
					2 Year	3 Year	Since Inc.*
Sanctum Indian Olympians	1.0%	10.3%	21.6%	41.6%	19.4%	21.2%	14.5%
NSE100 Index	0.2%	11.5%	20.9%	51.9%	21.9%	19.0%	14.5%

* Since Inception Returns are from 16-Sep-16

Performance as on October 31, 2021	1 Month	3 Month	6 Month	1 Year	CAGR		
					2 Year	3 Year	Since Inc.*
Sanctum Smart Solutions	1.1%	10.6%	24.8%	52.7%	27.6%	19.0%	13.4%
NSE200 Index	0.2%	11.2%	21.5%	55.0%	23.3%	19.3%	15.3%

* Since Inception Returns are from 03-Nov-16

Performance is calculated using Time Weighted Returns, net of fees and expenses. Returns over 1 year are compounded annually, Returns for less than 1 year period are absolute. Please note that the performance information provided above is not verified by SEBI. Please note that past performance is not a guarantee of future performance.

Sanctum Wealth

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