



May 12, 2022

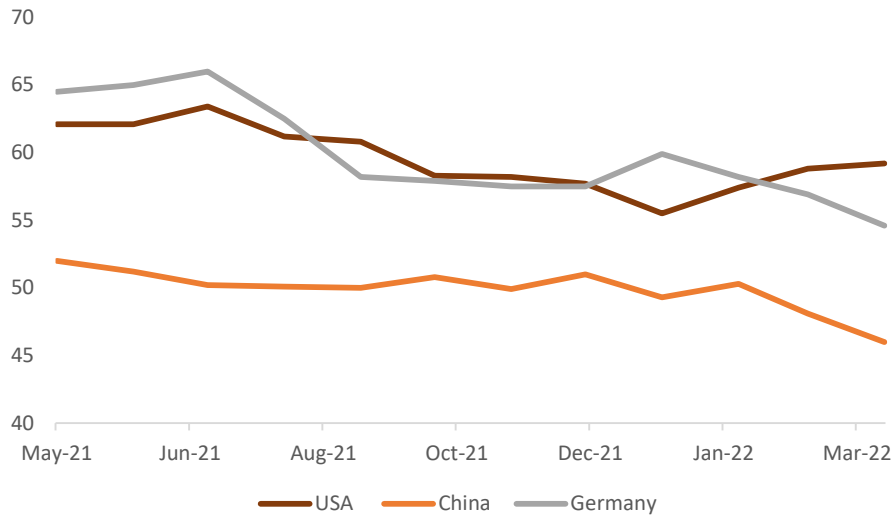
## Investment Strategy

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### Inflationary Concerns

Just last month, we wrote about attention moving from the ravages of the Russia-Ukraine war to economic growth concerns. We have moved further along the path and the debate is now centred around inflation higher for longer vs demand destruction and a global industrial recession. (We do think that we are headed towards a recession given the slowing PMIs in leading countries viz USA, China, Germany along with some other macro indicators). Hence, even as the Fed raised 50 bps this week the overall tone at the meeting was softer than expected and there are many that are wondering if the Fed will capitulate and pause hikes as early as the end of this year.

### Manufacturing PMI Trend

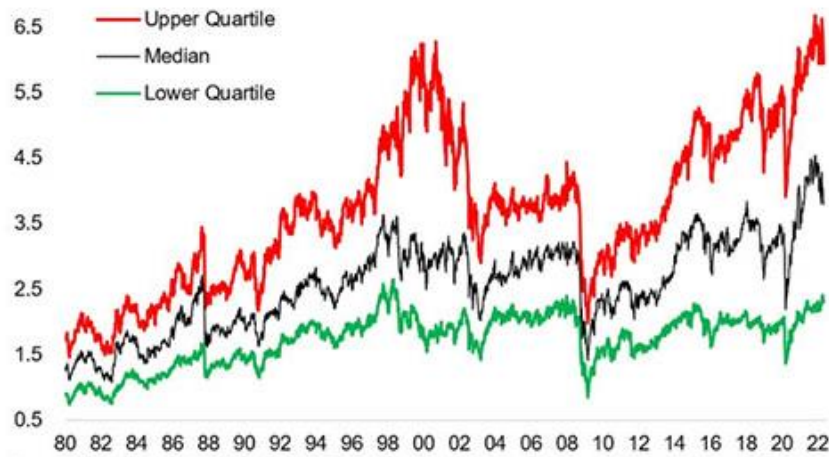


Source: Trading economics

In the meanwhile, oil prices continue to be a pain point for many countries. Despite a signalling move by the US to release some of its Strategic Petroleum Reserves (SPR), oil prices held up. The OPEC+ has been unwilling to change its stance and ramp up production further, as it awaits clarity from EU countries seeking a full oil embargo on Russia. The US in another signalling move has indicated its intention to refill its SPR which is meant to assure oil-exporting nations of demand for the next few years.

Tightening financial conditions, higher inflation and growth concerns intensified the risk-off sentiment. NASDAQ led the sell-off with a monthly return of -14.6%. Sundial Capital Research outlined the damage to NASDAQ stocks, noting that half of the index components are down 50% from their respective highs, while 22% are off by 75% and 5% have registered a 90% drawdown. Any earnings disappointment is being met with punishing price moves. The broader US equity market, despite the correction, is not a screaming buy.

### S&P 500 Price to Book Ratios (Trend across industries/ sub-industries)



Source: Sanctum GCIO weekly, Top-down charts, Refinitiv Data Stream.

For value investors, however, these markets could be a hunting ground. Berkshire Hathway spent a neat sum of nearly USD 41 bn on stock purchases. Their cash pile at USD 106 billion is now at the lowest level since 2018.

The overall risk-off sentiment hurt not only US equities but broader global markets in general. The strength in the USD add to the fall for foreign investors.

Performance Data as of 30 <sup>th</sup> April 2022	Local Currency Returns		USD Returns	
	1 Month	YTD	1 Month	YTD
NSE Nifty 50 Index	-2.3%	-1.4%	-3.2%	-4.1%
S&P 500 INDEX	-10.2%	-13.3%	-10.2%	-13.3%
NASDAQ Composite Index	-14.6%	-21.2%	-14.6%	-21.2%
Shanghai Stock Exchange Composite	-6.7%	-16.3%	-10.4%	-19.5%
Nikkei 225	-4.2%	-6.8%	-10.8%	-18.0%
MSCI Global Index	-9.4%	-13.4%	-9.4%	-13.4%
MSCI AC Asia Pacific Index	-7.1%	-12.6%	-7.1%	-12.6%
MSCI Emerging Markets Index	-6.4%	-12.6%	-6.4%	-12.6%
DOLLAR INDEX SPOT	5.3%	7.3%	-	-

Source: Bloomberg, Sanctum Wealth

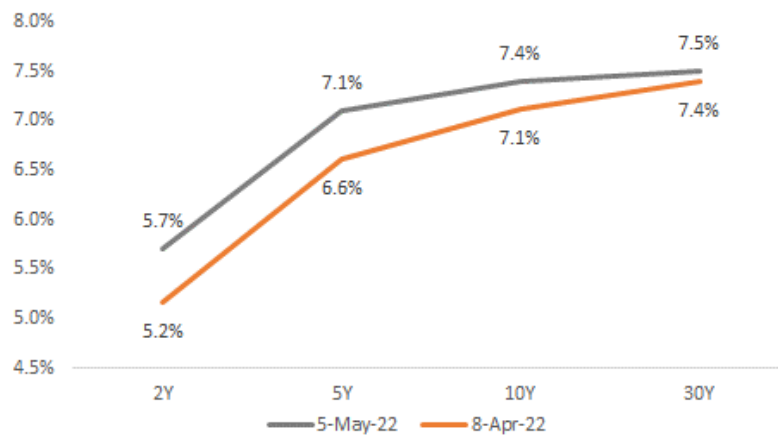
Meanwhile, China persists with its Zero Covid policy. Shanghai, after nearly six weeks of a harsh lockdown, is looking to exit lockdown in a gradual, cautious manner. The Shanghai port is the world's busiest for container traffic, and the Greater Shanghai Area is a major manufacturing hub. Opening up of Shanghai only helps in easing some of the supply chain pressure on the globe. All eyes are now fixed on Beijing, China's second largest city that also houses one of the busiest airports in the world, after the latest community lockdown.

## India Update

India has been holding up well relative to many other parts of the world. March was a record month for exports, at USD 42 bn. Overall, in FY2022 exports were at USD 416 bn exceeding the government target of USD 400 bn. Yet, the RBI shocked the markets with an off-cycle Repo rate raise of 40 bps and a hike in the Cash Reserve Ratio maintained by banks. While the data demonstrates a broad basing of recovery, the governor expressed inflation concerns. The governor emphasized that persistent higher inflation could hurt savings, investment, competitiveness and output growth. Their priority is to rein in inflation for sustained economic growth. The governor also highlighted their intent of careful and calibrated withdrawal of pandemic related extraordinary accommodation.

The move set up a sharp correction in both bond and equity markets. The 10 years quickly moved to 7.47% (+35 bps over the previous day) and the Nifty 50 index lost about 2.3%.

### India G-Sec Yield Curve



Source: Bloomberg, Sanctum Wealth

## Equities

From the highs of early April 2022, the Nifty sold off nearly 9% until the close of Friday at 16411. In April, of the top ten losers, five were technology stocks. During the quarter, Technology lost nearly 20%, while Oil and Gas posted over 25% gains. Relentless selling by FIIs continued in April '22 as well; the FII ownership in the Nifty 500 is now at a multi-quarter low.

International news flow has been challenging even as the domestic environment remains resilient. While Indian equities market hasn't sold off as much as some of the other markets, it has been volatile making it tougher for active managers to navigate. Mutual performance data is a reflection of this. We analysed the data to understand the extent of underperformance and its attribution.

Data as of 30 <sup>th</sup> April 2022	Category Median Return vs Benchmark			% Funds that Outperformed Benchmark		
	6 Month	1 Year	2 Year	6 Month	1 Year	2 Year
Large Cap MFs	-5.3%	16.0%	29.2%	10%	13%	4%
<b>Nifty 100 TRI</b>	<b>-2.0%</b>	<b>19.4%</b>	<b>33.5%</b>			
Flexi Cap MFs	-4.1%	17.6%	32.1%	17%	19%	20%

Large & Midcap MFs	-3.7%	19.8%	36.3%	21%	39%	41%
Value and Contra MFs	-3.2%	18.7%	35.6%	29%	44%	41%
<b>Nifty 500 TRI</b>	<b>-1.6%</b>	<b>20.9%</b>	<b>37.2%</b>			
Midcap MFs	-1.7%	23.2%	45.3%	46%	36%	17%
<b>Nifty Midcap 100 TRI</b>	<b>-1.5%</b>	<b>24.7%</b>	<b>50.1%</b>			
Small cap MFs	1.5%	32.6%	57.2%	88%	91%	32%
<b>Nifty Small cap 100 TRI</b>	<b>-4.4%</b>	<b>20.9%</b>	<b>60.0%</b>			

Source: ACEMF,  
2-year returns are annualized

The trend is no different amongst PMS although the organization of that data is not as seamless as in the case of mutual funds.

A closer look at the benchmark return attribution shows that across time horizons Utilities as a sector,

despite being a minor weight (about 4%) in the Nifty 500 index, has been one of the largest contributors to benchmark returns. Energy is another sector that has contributed significantly to benchmark returns. Within these sectors, the Adani group of companies and Reliance Industries have been large contributors.

Data as of 30 <sup>th</sup> April 2022	6 Month	1 Year	2 Year (Absolute)
Nifty 500 Index Returns	-1.60%	20.90%	88.20%
Return contribution by Utilities and Energy	2.50%	6.70%	17.00%
Return contribution by Adani Group and Reliance	2.30%	5.20%	13.70%
Nifty Midcap 100 Returns	-1.50%	24.70%	125.30%
Return contribution by Utilities	1.90%	6.50%	20.10%
Return contribution by Adani group	2.10%	3.30%	14.10%

Source: ACEMF

Adani companies typically don't clear the filters of most active managers, while most managers have been underweight Reliance Industries.

Even in the case of the Nifty Midcap 100, Utilities make up close to 8% of the benchmark, the sector contributed close to 1/4<sup>th</sup> of returns over the last year and 1/6<sup>th</sup> of returns over 2 years.

Since the SEBI recategorization exercise, we have held the belief that large-cap funds are unlikely to beat the benchmark on a sustainable basis. In the case of multi-cap schemes, there is potential of outperformance to be derived from allocation to a market cap segment (large/mid/small) and stock selection. Particularly in the case of mid and small-cap stocks, information asymmetry offers an opportunity to create value.

We believe that the recent underperformance by multi-cap funds is an aberration and should get corrected. Therefore, we continue to recommend select active managers in case of multi-cap and mid-cap strategies.

## Conclusion

In our last monthly note, we mentioned that we are watching out for profit margins and commentaries of corporates to understand the impact of inflation. The results are underway and are a mixed bag. We will monitor these in the run up to a review of our neutral equity position.

We have been neutral debt and overweight gold. While gold has moved only marginally, the debt sell-off makes the gold overweight look like a wise choice.

The OIS curve is discounting steep rate hikes over the next 12 months suggesting a terminal repo rate of 7%. We think, this is overdone and believe that we will get attractive levels for buying duration over the month or two. We have followed a barbel approach for building debt portfolios, for several months. Given the correction in bond prices, we think staggered buying of instruments/roll down funds in the 6-7 years would serve investors well.

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## Sanctum Wealth

### Investment & Advisory

**Roopali Prabhu***Chief Investment Officer*[roopali.prabhu@sanctumwealth.com](mailto:roopali.prabhu@sanctumwealth.com)**Rajiv Mehra***Assistant Portfolio Manager*[rajiv.mehra@sanctumwealth.com](mailto:rajiv.mehra@sanctumwealth.com)**Alekh Yadav***Product Manager*[alekh.yadav@sanctumwealth.com](mailto:alekh.yadav@sanctumwealth.com)**Hemang Kapasi***Head of Equities*[hemang.kapasi@sanctumwealth.com](mailto:hemang.kapasi@sanctumwealth.com)**Deepak Khatwani***Investment Analyst, Investment Office*[deepak.khatwani@sanctumwealth.com](mailto:deepak.khatwani@sanctumwealth.com)**Harsh Shah***Investment Analyst, Investment Office*[harsh.shah@sanctumwealth.com](mailto:harsh.shah@sanctumwealth.com)

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Registered Office: CoWrks, Level 3, Birla Centurion, Compound, Pandurang Budhkar Marg, Worli, Mumbai 400030, Maharashtra, India |

Tel. +91 22 6177 9500 | [sanctumwealth.com](http://sanctumwealth.com) | CIN # U74140MH2015PTC264932