Sanctum View

July 25, 2022

Portfolio Commentary

Bear Markets – There is Light "Before" the End of the Tunnel

The month gone by was not too different from the month before. The same factors, i.e., inflation, rate hikes, and impending-recession-haunted markets, and the indices, both headline, and broader markets, dived to a new correction low. The headline indices missed running into the bear market territory by a small margin, and the mid-cap index officially entered the bear market territory before bouncing back.

There is no denying that bear markets/corrections are psychologically painful. In all their maturity, avid investors understand that it's part of the game, but losing money is still sad. However, corrections are not all that bad. They remove excesses from the market and prepare it for the next move. Most importantly, they present newer opportunities.

All that matters in the correction is how the portfolio is positioned for the next up move. If it mostly contains adventures from the previous bull market, that's a big reason to worry.

Historically, most leaders of one bull phase of the market don't lead the next phase. Sometimes, those leaders don't come up for decades. For example, the dot com boom in 1999 was led by IT, which underperformed in the 2008 bull run and only started outperforming in the recovery from the 2009 bear market.

We term any sector as a leader when it surpasses its previous peak and outperforms the peak-to-peak market returns in any bull market.

Coming back to the correction and portfolio building, if the leaders of one bull market don't lead the next, there must be new leaders who would take the baton and move the markets higher.

Here is some history of how that has panned out for the Indian markets in the past.

The Nifty 500 delivered a trough to peak performance of over 700% in the bull market that started in 2004 and lasted till 2008; This rally was primarily led by Banks and Energy stocks, which delivered 983% and 1370% returns, respectively. Realty also led the bull market but wasn't captured in the index as the realty index itself was launched only in 2007. While all other sectors contributed positively, they lagged the index performance by a wide margin (details in the table below).

Index Name	2003-08 Bull Market Returns (Trough to Peak)
Nifty 500	709%
Nifty 50	591%
Midcap 100	993%
Smallcap 100	715%
Nifty Bank	983%
Nifty FMCG	260%
Nifty Auto	186%
Nifty IT	443%
Nifty Pharma	290%
Nifty Realty*	175%
Nifty Energy	1370%
Nifty Infra	644%
Nifty Commodities	440%
Nifty Services	659%

*Index launched in 2007
Returns are from trough to peak
Source Sanctum Wealth Research

The next up move was a recovery from the 2009 bottom, in which banks continued to lead but Energy and Realty lagged. The other sectors that did not contribute much to the bull market in 2008, namely FMCG, Auto, IT, and Pharma took the baton and led the recovery.

On the other hand, the energy index surpassed its 2008 high in 2018, and the realty index is still trading below its 2008 peak. Evidently, a portfolio built with 2008 leaders and held till the recovery would have significantly underperformed the index afterwards.

The new leaders from the recovery continued to lead the markets until 2015, with a grinding correction in between (shown in the table below). Post-2015, Pharma completely fell off the charts, while Autos and IT underperformed the market. Banks and FMCG still managed to lead by a small margin.

The primary lead in 2018 came from Energy, which became a leader after being a laggard for over a decade.

In the 2021 bull market, Energy continued to lead with IT returning to the forefront. All previous leaders like Banks, FMCG, and Autos became laggards.

Peak to Peak Perfromance	Early 2000 Peak	2008 Peak	Perf.	2009-2010 Peak	Perf.	2015 Peak	Perf.	2018 Peak	Perf.	2021 Peak	Perf.
Nifty 500	1759	5563.5	216.3%	5212	-6.3%	7428	42.5%	10175	37.0%	16004	57.3%
Nifty 50	1818	6357	249.7%	6338	-0.3%	9119	43.9%	12430	36.3%	18604	49.7%
Midcap 100		9781.7	NM	9853.5	0.7%	14237	44.5%	21840	53.4%	33243	52.2%
Smallcap 100		6048	NM	4620	-23.6%	6112	32.3%	9657	58.0%	12048	24.8%
Nifty Bank	1247	10774	764.0%	13303	23.5%	20908	57.2%	32613	56.0%	41829	28.3%
Nifty FMCG	3679.4	6779	84.2%	9660	42.5%	22716.7	135.2%	33168	46.0%	42021	26.7%
Nifty Auto		2392.4	NM	4256.7	77.9%	9110.5	114.0%	12108.8	32.9%	12139	0.2%
Nifty IT	9550	5857.1	-38.7%	7591.9	29.6%	12908.1	70.0%	16882	30.8%	39446	133.7%
Nifty Pharma	1140	3519	208.7%	5173	47.0%	14020	171.0%	10786	-23.1%	14938	38.5%
Nifty Realty		1878.45	NM	632.65	-66.3%	291	-54.0%	375	28.9%	560.9	49.6%
Nifty Energy	1273.5	12012	843.2%	10195.5	-15.1%	10687	4.8%	16841.85	57.6%	29304	74.0%
Nifty Infra		6261	NM	3880	-38.0%	3524	-9.2%	3749	6.4%	5346	42.6%
Nifty Commodities		3688.7	NM	3347	-9.3%	3239	-3.2%	4233	30.7%	6458	52.6%
Nifty Services	4543	7588	67.0%	7617	0.4%	11917	56.5%	17743	48.9%	25823	45.5%

Leading industries highlighted in blue.
Laggard industries highlighted in red.
Source: Sanctum Wealth Research

While the sector churn may not happen all the time, there are good chances of a high-flying sector from the previous move not participating in the next up move. That's because investors become overenthusiastic toward the leading sectors, pushing the valuations so high that it takes a long time before the performance catches up and valuations normalize. For some sectors, the tailwinds turn into headwinds, or execution goes for a toss, resulting in precipitated decline and long periods of lull like what happened with Real Estate and Infra.

On the other hand, in each up move, there will be sector leaders that did not participate in the previous run but outperformed in the latest run. If investors can identify these sectors on time and tweak the portfolios accordingly, the portfolio returns will look much better.

To clarify, one doesn't have to change the entire portfolio but maintain a good mix of stocks from evergreen sectors like IT and Banks and exposure to the best stocks in other leading sectors.

Another point to note, the laggard industries have sub-sectors that frequently crop up and outperform, such as Pharma APIs and chemicals since 2015, NBFCs in 2018, and discount broking in 2021. These are also great places to look for leading stocks.

That brings us to an important question – how one can identify the leaders of the next move at the time of the correction.

Light "before" the end of the tunnel

The potential leaders behave slightly differently at the bottom and in the recovery. While the markets will be making lows and recovering slowly from lows, the leading stocks recoup their losses quickly and push higher, surpassing their previous high much before the index.

A case in point was the 2009 and 2020 recovery when the IT index took off its previous high twelve months and five months before the market took off its high, respectively. Nifty FMCG and Nifty Auto took off their highs seventeen months before the market in 2009. Some stocks within these sectors scaled to new highs even sooner.

There is some conclusive evidence that if a sector displays extraordinary price strength in an otherwise lacklustre market, it may lead to the next bull market.

In the current correction, while the market indices are significantly off their highs, the Auto index has already made a new high, and the FMCG index is close to its new highs. Interestingly, these sectors did not lead the 2021 bull market, and there are fundamental factors backing the themes. Banking is another laggard sector from 2021 with some fundamental drivers in place and may be ripe for outperformance in the future.

At Sanctum PMS, our philosophy aligns with this market function as we identify sectors and themes first and then go bottom-up in determining the best stocks within the sector. The sectors that look promising in the current correction have been our hunting ground for weeks now, and we have also done some early nibbling to get on the most potent leaders before they make their moves.

In Titans and Olympians, we keep a close eye on leading sectors and sub-sectors with several screens that we run on price and fundamentals. When our readings on stocks and sectors show danger signals, we get defensive, as we recently did with our underweight IT call. Similarly, when we smell opportunity and our systems play along, we get aggressive and load in like we are now on Autos and Consumer Discretionary.

Picking from the popular book How to Make Money in Stocks by William O'Neil,

"The majority of leading stocks are usually in leading industries. Studies show that 37% of the stock price's movement is directly linked to the industry group the stock is in. Another 12% is due to strength in its overall sector. Therefore, roughly half of a stock's move is driven by the strength of its respective group."

It's hard to overlook a factor determining this large proportion of the stock's move. Therefore, at Sanctum, we start with the theme/sector and work upwards to find leading stocks.

Performance as on June 30, 2022	1 Month	3 Month	6 Month	1 Year	CAGR			
					2 Year	3 Year	5 Year	Since Inc.*
Sanctum Indian Titans	-4.6%	-9.1%	-12.1%	2.1%	24.9%	15.5%	11.3%	13.1%
NSE200 Index	-5.2%	-10.0%	-10.1%	-0.4%	24.5%	10.8%	10.0%	12.4%
Relative to NSE200 Index	**0.6%**	**0.8%**	**-2.0%**	**2.5%**	**0.4%**	**4.8%**	**1.3%**	**0.7%**
Nifty Index	-4.9%	-9.7%	-9.1%	0.4%	23.8%	10.2%	10.6%	10.7%

* Since Inception Returns are from 18-Nov-16

Performance as on June 30, 2022	1 Month	3 Month	6 Month	1 Year	CAGR			
					2 Year	3 Year	5 Year	Since Inc.*
Sanctum Indian Olympians	-4.7%	-9.3%	-11.7%	-3.1%	19.5%	9.3%	10.8%	10.0%
NSE100 Index	-5.0%	-9.8%	-9.6%	-0.2%	23.3%	10.3%	10.1%	10.5%
Relative to NSE100 Index	**0.3%**	**0.5%**	**-2.1%**	**-2.9%**	**-3.8%**	**-0.9%**	**0.7%**	**-0.5%**
Nifty Index	-4.9%	-9.7%	-9.1%	0.4%	23.8%	10.2%	10.6%	10.7%

* Since Inception Returns are from 16-Sep-16

We calculate performance using Time Weighted Returns, net of fees and expenses. Returns over one year are compounded annually; returns for less than one year are absolute. Please note that SEBI does not verify the performance information provided above. Please note that past performance is not a guarantee of future performance.

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