EQUITY INVESTMENT STARTEGY AMIDST GLOBAL TURMOL

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Opportunity for investors

'Volatile market environment should be treated as an opportunity for investors.'

WEAK SENTIMENTS CURRENTLY

- weak global noise such as inflation scare
- much rumored US recession
- Europe energy crisis and
- extreme volatility in currency markets.
- Chinese economy on a slower growth path

INDIA STANDS OUT

- Domestic growth
- Broad-based earnings recovery.
- Robust Consumption demand
- Inflation appears to be peaking out
- Gross collection of direct taxes is strong
- Banks are reflecting an uptick in loans and worst is behind
- Corporate capex outlook is looking up

2Q results preview

Strong earnings expected -

- Automobiles (led by improvement in chip availability),
- Banks (should see strong loan growth, NIM expansion and a sharp decline in loan-loss provisions)
- IT services is likely to have modest constant currency revenue growth besides margin headwinds
- Consumer companies in retail, travel & hospitality
- Chemicals - specialty (China + 1) and commodity (Europe energy crisis)

Weak earnings expected -

- Cement (high fuel and power costs), metals & mining (lower commodity prices, weak realization) and oil, gas & consumable fuels .

SECTORS WE LIKE FOR LONG TERM INVESTING

Capital Goods -

- driven by capex cycle recovery.
- healthy enquiry pipeline and broad-based capex recovery
- Railways, metros, cement, power (waste heat recovery and waste to energy), mining, sugar and ethanol, water treatment, chemicals, including EVs and data centers etc.
- All EPC and capital goods companies to improve on a strong order book.
- Margin benefit from moderation in commodity prices
- Defense PSUs doing extremely well and there is long run way to growth due to reducing import content and more localisation efforts.

Banks and Financials

- Worst of asset quality issues are behind.
- Banks are reflecting an uptick in loans and advances with lower NPA's.
- Higher lending rates are seen as providing a cushion for bank margins with higher interest rates passed on almost immediately.
- 2q earnings of banking sector can grow by close to 23 to 30%
- Positive on housing finance companies on the back of strong real estate demand, low interest rates and better asset quality.
- Overall valuations in the sector are in favor.

Building products

- Real estate cycle is coming back after multi year lows
- Lucrative interest rates of close to 7-7.5%.
- Multiplier effect on the economy - be it cement, steel, pipes and other building products including employment.
- Positive on residential demand while commercial space is also gradually coming back.
- Importantly, this is one sector where we are witnessing the biggest shift in demand from un-organised local builders to A grade developers.

Specialty chemicals

- Continued business shift from China due to pollution control norms or expected China+1 strategy to have India as an alternate supply source.
- Huge amount of capex is happening in this space
- Backward integration or import substitution or new molecules with export opportunities.
- Commodity chemicals too are witnessing abnormal margins due to energy crisis in Europe.
- Agro-chemicals, exports/international sales are likely to continue to grow faster, befitting from elevated crop prices and increased outsourcing.

Consumption

- Segments like travel, hotels, restaurants,
- Branded apparel, appliances or white goods, retail,
- Autos, footwear, jewellery sales

All witnessing massive recovery

Cement

- Cost pressures on power & fuel and margins in 2Q are likely to hit a bottom for cement sector in general.
- July & August are normally the weakest months.
- 2nd half, up-cycle in cement demand on improving volume and pricing, driven by rural housing and govt. infra projects.
- Construction of affordable housing across grameen and urban areas.

Technology

- IT sector currently faces is of attrition and higher salary costs.
- Besides deal wins are likely to be muted in 2Q given global backdrop.
- Few mid cap companies post correction as valuations have turned attractive.
- Business is free cash flow generating with superior return ratios.

What we are avoiding to invest ?

Metals

- Cautious on metals cycle now.
- Commodity prices have corrected for ferros and non ferros metals.
- Global stimulus, weaker dollar
- China’s import of industrial commodities supported metals prices in the past. These factors of support are now reversing.
- In 2Q. an average decline in steel realization of Rs12,000-13,000/ton qoq, led by price cuts in the domestic markets and export duty;
- Zinc/Aluminum/Alumina prices corrected by anywhere 10% to 18% qoq in 2QFY23 in US$ terms.
- So profitability can be severely impacted.

Oil & Gas

- Profitability for upstream companies will be impacted due to lower crude realization
- windfall tax of nearly US$28/bbl imposed on upstream companies from July 1, 2022. Volumes will remain muted.
- Downstream PSU Oil companies will also suffer due to continued losses on auto fuel and LPG, sharply reduced refining margins and large inventory losses in both refining and marketing businesses.
- Avoiding the sector being largely regulated.

Pharmaceuticals

- Cautious on investing in pharma companies given raw material cost pressures coupled with rising freight costs.
- There is still US generic price erosion
- Negative impact will be felt on account of EU/EM currency depreciation.
- In the US, there have not been any meaningful new launches in 2QFY23 for companies.

New age digital companies

- While they are disruptive companies, many are still in cash burn stage
- Valuations despite correction are ahead of time and offer little margin of safety.
- Some of disruptive businesses can themselves get disrupted and only a few will survive or make it big.
- Higher valuations will continue to lead to capital losses and hence our cautious stance.

FINAL SAY

- High macro and global concerns only act as a distraction to own individual companies on their respective business merit.
- Not succumb to such a fearful noisy environment
- Focus on long term investing.
- Good that we are currently passing though weak sentiments, largely driven by global issues, which means that prospective returns in Indian markets are going to be much better.
- Strategy is to stay invested in good Indian businesses and ride the global storm.