OUTLOOK 2021 - A YEAR OF RECOVERY & RENEWAL

"Courage taught me no matter how bad a crisis gets...any sound investment will eventually pay off" - Carlos Slim

Last year will go down in history books as a year of extremes in equity markets across the globe - from panic and despair to markets climbing wall of worries with a sharp rebound and renewed optimism. Equity market precedes economic reality is once again proved with ground level recovery lagging market rally. We have begun to witness significant month-on-month improvement across economic data, Covid recovery cases in India as well as corporate earnings. Several high frequency data are showing improvement consistently - whether it is number of e-way bills generated, electricity consumption, railway freight volumes or car & house purchase registrations - all have picked up. In general, equity market has rightly been focusing beyond short-term demand issues and seems to be factoring-in fast approaching normalisation across many businesses.

Markets being forward looking mechanism, economy and markets can follow different paths in the short-term.

Market rally has been driven primarily by following factors -

- Massive stimulus announced by global central bankers,
- Low interest rates,
- Faster economic or business recovery,
- Reasonable to low equity valuations and
- Strong FII flows

Overall, huge fiscal stimulus announced by the respective countries and prudent monetary measures undertaken by the central bankers enabled the world economies to rebound in 3QCY20. We believe the **global economy will continue to heal through 2021 and beyond.**

While our April 2020 newsletter, encapsulating **'fear is more contagious than disease'** validated our belief to be aggressive in utilising panics as a buying opportunity, as we step into **2021**, we make another attempt to **list down probable behaviour** of India equity market during the course of this year. The summarised view is as under -

1) **Structural foundation of this bull market intact** with an expectation of low interest rate regime and accommodative stance to be maintained by central bankers in pursuit to revive respective economies and consequent job growth. This is likely to prevail for a fairly longish period of time globally. RBI too is expected to remain accommodative in the next fiscal. Meaningful inflation risk may still be some time away before this stance changes. Given depressed real interest scenario and lower cost of capital, equities will continue to remain as attractive investment options for all categories of investors.

“Interest rates are to asset prices what gravity is to the apple. When there are low interest rates, there is a very low gravitational pull on asset prices.” - Warren Buffett

2) **Emerging market flows likely to sustain -** With further stimulus and considering US debt at elevated levels, a potential depreciation of the dollar will serve as a useful tailwind for Emerging markets (EMs). This is expected to drive flows into the EMs. Given current scenario of subdued return from fixed incomes globally and continued soft monetary policy by the global central bankers, India is likely to continue getting a significant share of FII flows in 2021 as well. Factors, driving FII inflows into Indian equities include relative higher returns from Indian economy compared to several developing & developed nations, prospects of corporate earnings recovery, government reforms, low interest rates, weaker dollar and stable rupee (due to higher forex reserves).

3) **Corporate earnings to drive next stage of rally -** Despite one of the worst human crises in recent years; government stimulus, decent monsoon, some element of pent-up demand, low interest rates, improving liquidity and higher degree operating leverage are some of the factors that contributed to improved corporate sentiments. We may be **staring at the start of multi-year economic expansion** phase because of multiple macro tailwinds.
We remain optimistic on corporate earnings recovery with accelerating openings and higher consumer spending increases as vaccines are rolled out. A serious effort to revisit cost-structures and extract savings from all possible areas will aid in margin recovery despite some off-sets from commodity cost increases.
Private banks, which have made excess provisions are likely to lead earnings upgrade cycle. Autos, especially the truck segment would be next to clock volume growth while IT sector will witness upgrades due to shift to digital and accelerated tech spending post pandemic. Integrated metals players like steel besides non-ferrous (aluminium/zinc) will see sharpest earning growth on price increases. Consumer durables (washing machines, kitchen appliances) and building material (pipes, tiles/sanitary-ware/wood panels) will post a strong come back. Agri-input, specialty chemicals & pharma will be on a steady growth path.

Stock prices are nothing but slaves to earnings

4) **Rally to become broad-based & divergence to narrow -** Divergence in valuations across sectors is still high. Disparities in value exist across sectors, company and market caps. As such, from a valuations perspective, the erstwhile polarised market is becoming broad-based and this trend is likely to continue. Despite the strong rally, there is still disparity between performance of various sectors or companies and there are several pockets of value. As the market spends more time in bullish phase, 2nd line stocks or value or distress companies including the likes of cyclicals, utilities, manufacturing sector will continue to get recognised in terms of relative undervaluation. In small caps specifically, mean eversion of distress valuation is happening deeper down the market cap curve. Small caps recover the most when economy recovers and interest rates are kept low. We believe out of favour value opportunities exist and will outperform expensive quality stocks going forward.

Price is what you pay; value is what you get – Ben Graham

5) **Sharp but short-lived corrections on the way -** Post this rally, it may be reasonable to see some consolidation or periodic corrections, including risk of developed market sell-off triggering correction in EMs. However, we expect India market declines or corrections to be violent & sharp but short lived given that incrementally factories & businesses are accelerating back to pre-covid levels. Easy money is made in times of investing & hunting for bargains during panics, a time & year that just went by. Investors will have to brave hurdles of corrections with patience for eventual returns.

Markets test patience and reward conviction.

EMERGING AND FUTURE BUSINESS TRENDS IN INDIA

ROHA ASSET MANAGERS
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1) Rise of India's manufacturing

Now given current geopolitical scenario where a large number of nations started looking for China's alternatives in the aftermath of COVID-19 outbreak, India is catching the eyes of a large number of global companies to set up their manufacturing base. The government's Performance Linked Incentives (PLI) scheme is likely to play a vital role in achieving size and scale in manufacturing segment. Total outlay for this scheme is estimated at Rs 1.5-1.7tn. Even if we assume 5% of production value is an incentive, minimum production due to PLI scheme can be close to a whopping Rs 35tn in five years ! A huge leap indeed

2) Restart of private capex cycle

We believe that finally private capex cycle may start driven by several factors like low/negative real interest rate, India becoming part of global supply chain due to China +1 strategy, improving cost competitiveness, creating land banks & its acquisition for industrial projects, initiation of labour reforms, production linked incentive scheme, Rs 105tn Infrastructure pipeline, reduced corporate tax rate (15%) for new manufacturing units and favourable tariff policies to aggressively support local manufacturing. Progress on PLI along with the continued protectionist measures (import duties on Chinese goods) will crucially determine the capex activities for some key sectors such as auto, electronic manufacturing etc. Additionally, we shall continue to witness anti-China elements aiding the pharmaceuticals (API) and specialty chemical companies.

Manufacturing and capex oriented sectors are best placed now than ever before to ride the new growth cycle.

3) Digitisation & Green technology, the next big thing

Digitisation wave has already accelerated by many years due to covid environment and can benefit technology service & platform providers, e-commerce companies across various verticals in retail, lending & insurance. Besides, there will be increasing thrust on automation and green technology that will benefit players in robotics, AI (artificial intelligence) and renewable energy. The green transformation of some of the traditional industries could be just a tipping point that will accelerate with government regulations, carbon neutral targets and subsidies to achieve replacement of fossil-fuel with renewable energy, accelerate electric vehicles and use of digital solutions to improve efficiency.

4) **Health & hygiene consumption**
This is another area which is emerging as a high growth area driven by spending on branded products, packaged food, nutrition & healthcare.

5) **Shift to organised players**
Theme of market share gains by the organized players from the unorganized segments due to working capital stress marred by lockdown-led disruptions and consequent unviability will continue to help several sectors like building materials (tiles, sanitary-ware, furniture, pipes, footwear, jewellery retailing, staffing services, etc). This shift will include real estate sector where large deep-pocketed organised players will gain at the cost of local small builders.

We are mindful of a few existing pain points

While we do expect several interesting and positive structural and long term trends in business, as highlighted above, that will drive economic growth and equity markets over long term, it is imperative to also be mindful of some pain points that do exist in few pockets. Rise in virtual meetings can negatively impact aviation & transportation sectors. Besides, there could be impact incomes and job creation due to accelerated automation, digital disruption (e-commerce) and cost cutting drive undertaken by the corporate sector. Cost-led inflation will cast its shadow eventually, though still not yet high enough to pinch corporate sector or disrupt equity valuations.

Overall, Structural positives far outweigh the negatives to be constructive on Indian economy, business and equities.

PERFORMANCE & INVESTMENT STRATEGY -

"It is impossible to produce superior performance unless you do something different from the majority" - Sir John Templeton

For CY2020, our Investment team has generated about **34% outperformance v/s market (BSE 500)** in **Roha Emerging Companies Fund,** which puts us amongst the top quartile performers in the peer-set. With self-belief, conviction on investment ideas and discipline to steer the portfolio in the right direction, the fund has made the most of this roller coaster year. The quotational fall in March '2020 was clearly an overreaction as it does not alter cash flows generated by a quality business over the long-run. **We enter 2021 with similar conviction & investment passion and position our fund with superior stock selection. As we are in the next stage of bull market cycle (v/s last year's initial stage when markets climbed wall of worries) where money is loose, market is running hot though not a definite market peak yet, we will continue to avoid frenziness, exuberance, noise and short term fads in the market and keep our heads down to focus on our investment journey of identifying & investing in sustainable growth-oriented, capital efficient & cash flow generating businesses available at attractive valuations, to take advantage of earnings upside and valuation re-rating over the next 3-4 years.**

AS ALWAYS,

HAPPY INVESTING

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