MARKET OUTLOOK

Equity market rally is spreading and is becoming even more broad-based, as reflected by small cap index touching all time highs. Several companies in small and mid cap space that have been long mis-appraised and undervalued, are finally getting recognised. Despite covid environment, we saw remarkable recovery in corporate earnings in 4th quarter of FY21 across sectors like autos, cement, technology, textiles, specialty and commodity chemicals. Steel in metals basket reported super cycle earnings driven by global price recovery. Engineering and capital goods showed clear signs of rising order book and indicates beginning of capex cycle recovery.

Corporate spending on capacity expansion is definitely looking up again after many years of continuous decline. This is driven by PLI linked investments, commodity up-cycle and growth in emerging segments like data centre and consumer electronics. New capex or investments are being done in several sectors of the economy.

However, the **new challenge** for business is not on the demand side as reflected by strong 4q results, but on the rising raw material or cost side of the equation or supply chain disruption including logistics and freight. This may probably have temporary negative impact on the margins of corporate sector in the near term. Though firms with pricing power and ability to pass-on cost hikes are better placed.

Post equity market rally, the pertinent question that is asked by many is how long will this bull market last and how far it will go? We continue to believe that **structural foundation of this bull market is very much on with low interest rates and earnings revival** despite near term cost pressures or covid-led disruption.

Corrections in markets are likely to be short lived given that other avenues like fixed income or real estate yield much lower returns to investors versus equities. The rise in equity culture is visible with number of new demat accounts being opened (though equity as an asset class in India is still a fraction when compared to China or US). With lessons of last year, any panic reaction in market will only be bought into.

Based on economic revival and growth outlook, we find investment opportunities across many businesses. Despite the run-up, value exists in capital goods & engineering, utilities, manufacturing sector and select quality PSUs. Incidentally, earnings of capital goods companies are at cyclical lows and can improve significantly as capex cycle picks up.

"Far more money has been lost by investors trying to anticipate corrections, than lost in the corrections themselves." Peter Lynch

Portfolio strategy

As bottom-up investors, our relative preference continues towards investing in growth companies with resilient earnings. Sectors such as **agriculture** (which includes crop protection and seed companies) and **speciality chemicals** (that are building blocks for agro-chemicals, pharma or flavors & fragrances that are in the essential consumer category) are a good part of our portfolio. Huge amount of capex (almost over Rs 4-5000 cr over next 3 years) is happening in this space which is an indicator of growth prospects of speciality chemicals business led by capacity expansion.

Other sectors we like include **pharma and health-care, engineering & capital goods, cement** as a good proxy to infra and housing investment. We have added select **technology** companies given cloud migration services could be a multi-year growth opportunity. Profitable and cash flow generating **digital platform** companies continue to excite us due to scalability and superior capital efficiency. Few companies we own in **food processing** due to shift to organised or branded players for health & safety reasons.

We believe **green energy like bio-fuel** and solar is a durable long term opportunity. Govt's initiative on ethanol blending programme is one example to reflect its focus on bio-fuel and to go green. Within this space, there are many businesses that one can chose - from engineering companies that provide machinery to produce bio-fuel to even sugar companies that may benefit from ethanol blending programme. Besides, select listed companies that are in Electric vehicle (EV) value chain may also benefit. This is a structural theme that may improve earnings of many companies in the green energy eco-system.

Covid pandemic has significantly accelerated the **shift to digital**. Many companies are yet to make the transition to a fully digital operating model and have only digitalized select functions. Some verticals like like travel, aviation may witness IT budget cuts but cloud migration appears to be a multi-year opportunity. Deal pipeline announced by IT companies appears to be in a strong momentum. Certain western economies are coming out of pandemic which augurs well for the IT sector. Banking & Financial services firms across the US and Europe have provided largely positive commentary on IT spending outlook. Indian IT will be key beneficiaries with expected increase in outsourcing. Companies are committed to investments in new IT initiatives.

In general, **our emphasis will continue to own companies** that will benefit from long term sustainable structural changes led by import substitution and thrust on local manufacturing, on-going digitisation wave, shift from unorganised to organised sector, increased automation, renewables and green technology.

To reiterate, days of easy money are behind us and buy & hold approach in reasonably priced sustainable growth companies that generate superior cash flows and high returns on capital will continue to be our stock selection strategy to get long term compounded returns.

HAPPY INVESTING,

Dhiraj Sachdev,

Managing Partner & CIO

Roha Asset Managers