VALUEQUEST

VQ Perspectives

July 2024

You must let go of the illusion of control...

– Grand Master Oogway

(Kung Fu Panda)

Road trips are a phenomenal way to travel

Road trips are a great way to experience life & you learn a lot, sometimes even about yourself, how resilient you are, how you can maintain equanimity over a longer journey & yes occasionally such trips can be used to espouse investment philosophy.

"There is no secret ingredient"

– Mr Ping

While there is no denying, India is on a new path, its building new roads, new bridges & along with the physical transformation, there is a lot more other infrastructure & opportunities opening up.

With such a change happening and it being an oasis in an otherwise dull and gloomy global environment, it's no surprise that this optimism has spilled over in the capital markets. While this is fully justified and as many have said its "India's Decade" this reflections in the markets with such tremendous speed & this speed and pace is taking even the seasoned travellers/ investors by surprise.

Market participants and fintwit are awash of comparisons, historical references, chart patterns and other indicators which all are pointing out to the proverbial market top. With even references thrown in the 2008 or the Nikkei top amongst other such comparisons

However, just like the road, we have to recognize what are the controllables and what are the uncontrollable.

We can control our vehicle, our speed, our choice of road, our destination, our stops and so on. What we cannot control are speed bumps on the road, poor weather, traffic conditions and most importantly we need to make the recognition that all vehicles have different destinations and different time horizons

Like the roads, there is no denying that accidents do, may and will always happen on roads & in the markets.

However as a fund manager, our goal is not get off the road, because we "think" that an accident is on the anvil, in fact while we exercise supreme caution and choose our vehicles smartly, the goal is to keep riding the road, even if it means adjusting the speed / sails translating into horizon/ expectations/sector/stocks.

We don't stop travelling on roads because accidents have happened or are going to happen, we learn from them and put measures in place & so we do the same in our investment journey, in fact statistics show - If an investor were to simply miss the 10 best days in the market, they would have shed over 50% of their end portfolio value. Making matters worse, by missing 60 of the best days, they would have lost 93% in value compared to what the portfolio would be worth if they had simply stayed invested.

"The strongest of us sometimes have the hardest time fighting what's on the inside."

– Po

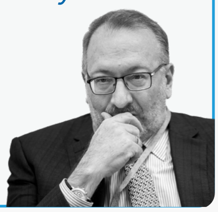
> *"If markets never fall, they wouldn't be risky and if they weren't risky, they'd get really expensive, and when they get really expensive, they fall"*
>
> **– Morgan Housel**

The basic gist of the above quote by Morgan Housel is that the entire reason you can earn good returns in the stock market over a LONG period of time is because they are volatile in the short run. That's the cost of admission that you have.

Trying to predict the markets direction and when it tops and when it bottoms and when it will correct and when it will stop correcting, is counterproductive.

Calling of a Market Top over the past year or so has been a case of "Sagan's Razor" but this claim is bereft of any evidence to prove it, infact the evidence is on the contrary, be it the bettering macros, the corporate books which are / have never been in a better shape than this & even the market technicals or ownership.

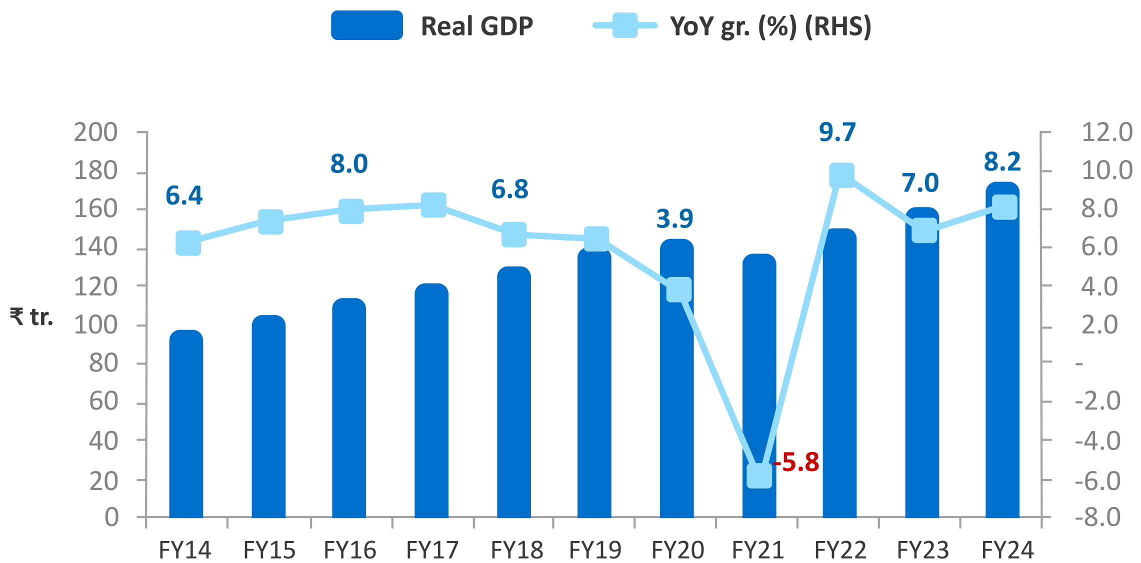
> *"People should be highly sceptical of anyone's including their own, ability to predict the future, and instead pursue strategies that can survive whatever may occur."*
>
> **– Seth Klarman**



Improving macros and corporate health

A) Overall growth remains on a very firm wicket:

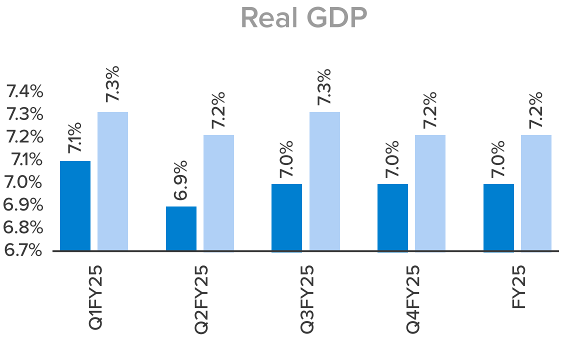
FY24 GDP Growth at 8.2%



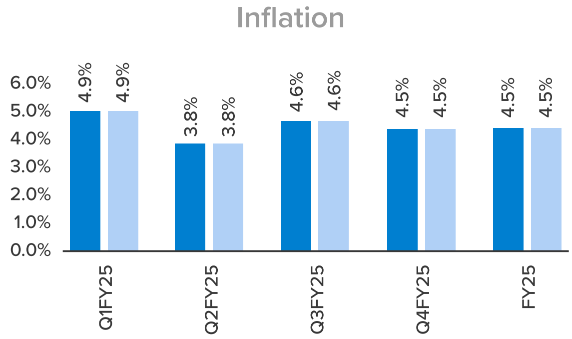
Source: MOSPI, PL

B) Outlook is strong:

FY25 GDP estimate increase to 7.2% from 7%



Inflation projection remain unchanged

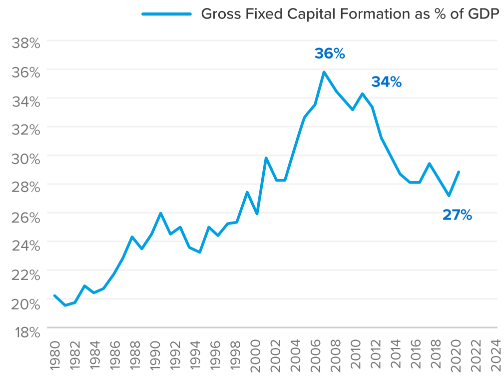


Previous estimate   Current estimate

Source: RBI, PL

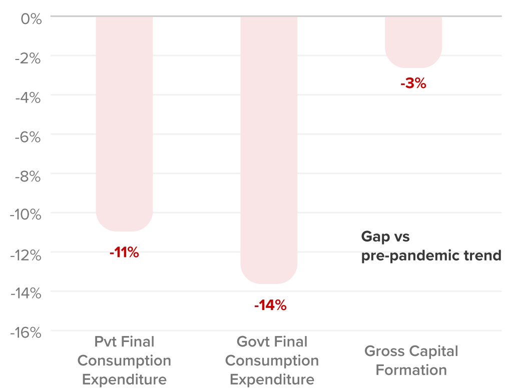
C) Capex cycle momentum in early stages:

Investment share of GDP rebounding from two-decade lows



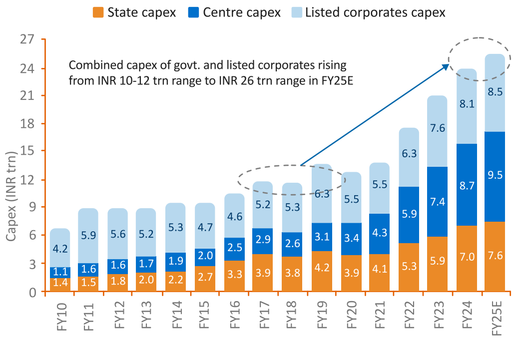
Source: MOSPI, Axis Capital

Investments have led the rebound in the economy



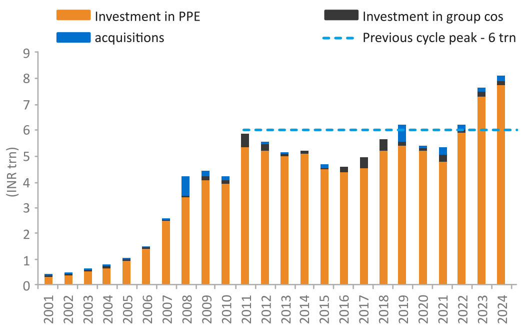
Source: MOSPI, Axis Capital

Capex cycle firing on all cylinders



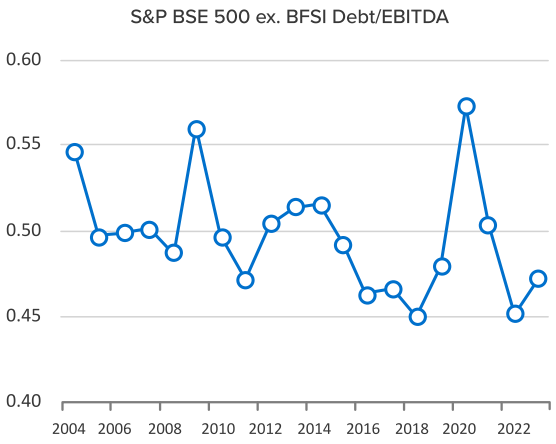
Source: ICICI Securities

Investments have led the rebound in the economy



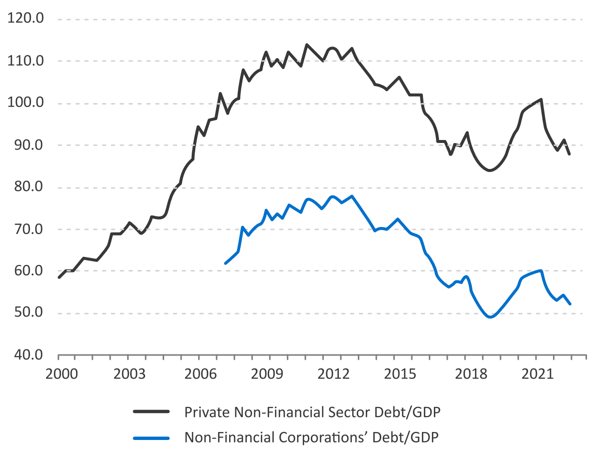
D) Clean and lean balance sheet:

India Inc. has deleveraged



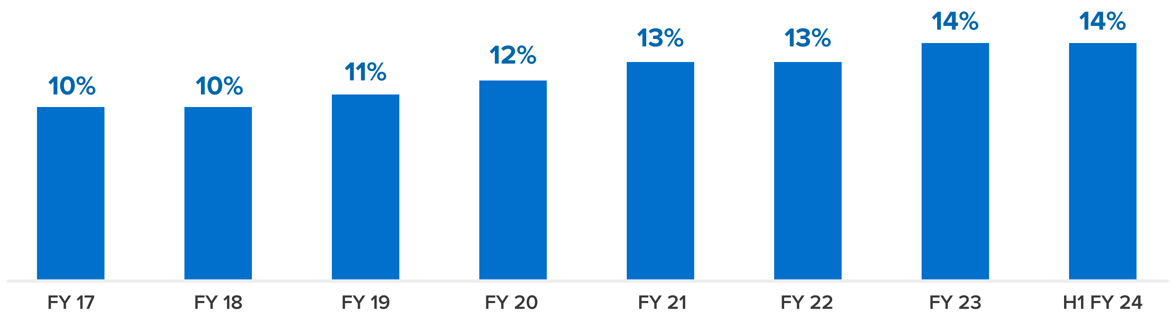
Source: Capitaline, Axis Capital

Debt/GDP Ratio (%)



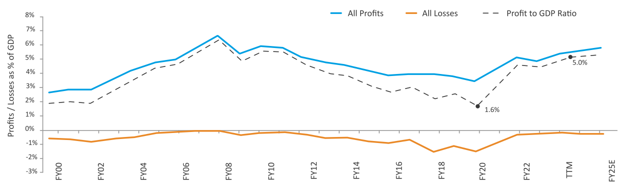
E) Banking health extremely strong:

Banking System Capitalization (CET1 Radio)

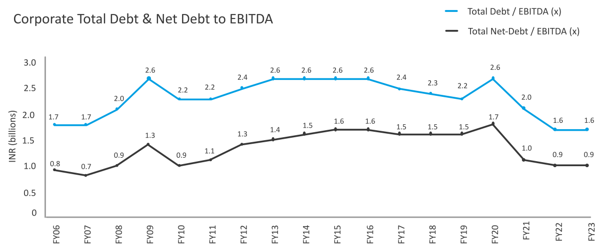


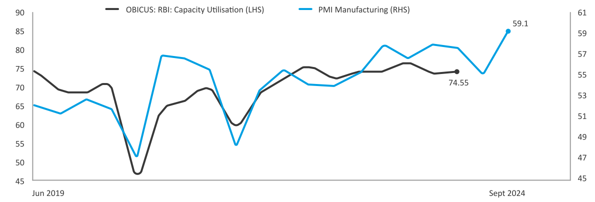
Source: RBI

F) India Inc profitability:

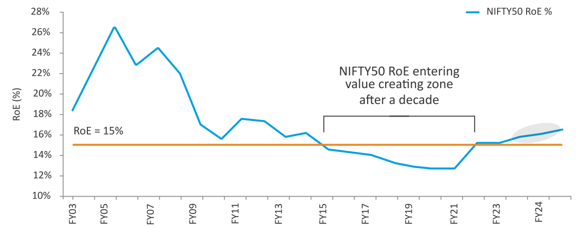


Source: ICICI Securities





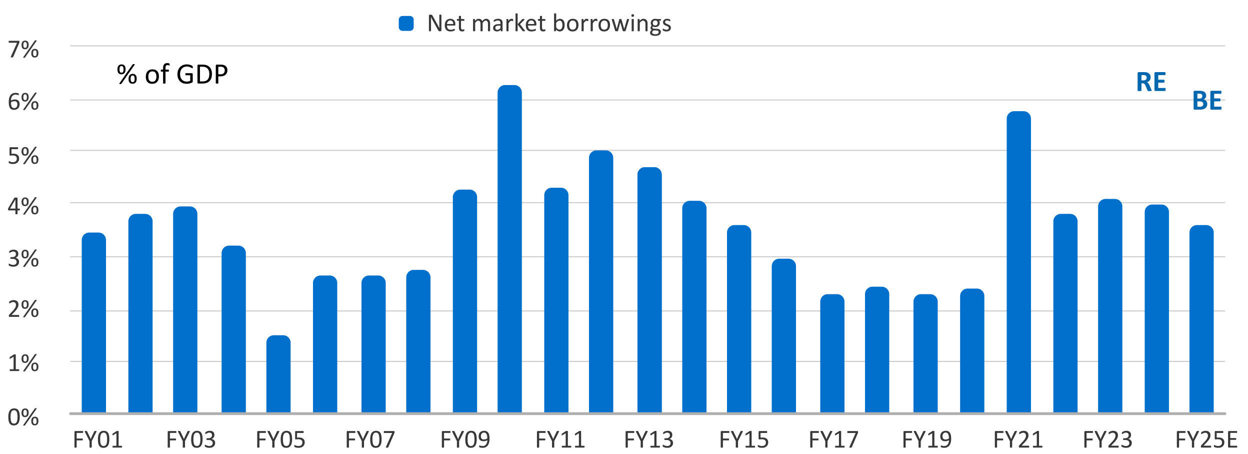
Source: ICICI Securities



Source: ICICI Securities

G) Improving government finances:

Impact: Less crowding out of private investments



Source: Budget documents, Axis Capital

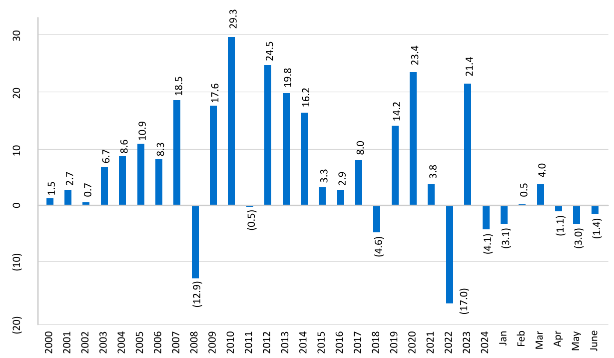
RE - Revised Estimates *BE - Budgeted Estimates*

H) FIIs are still not back:

2022 to 2024 till date net FPI flows far lower than historical averages...

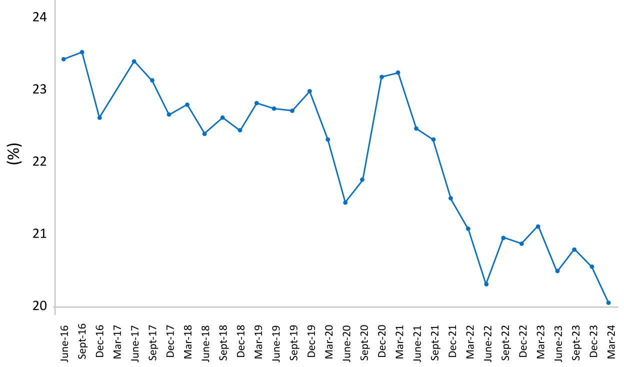
... and consistently declining FII ownership of the Indian market

FPI equity outflows at US $4 bn in CYTD24



Source: Bloomberg, Kotak Institutional Equities

FII ownership trend in the BSE500 universe



Source: Capitaline, Elara Securities Research

Let's assume for a minute, we actually know stuff, it will STILL be extremely serendipitous to actually invest in moments of extreme panic such as March 2020 during the Covid fall or divest your holdings and raise a cash call at the peak of the 2000 bubble or even before the GFC in 2007-2008. And make no mistake, being right during these events can fundamentally alter ones portfolio for a life time & there will be such days when it is good to try and do that, but recognizing those days itself is not easy.

As Howard Marks says "Nobody performs great all the time. Now, even if you are correct in identifying a divergence of popular opinion from eventual reality, that varying perception that I mentioned, it can take a long time for the price to converge with value and it can require something that acts as the catalyst. Under-priced does not mean, going up tomorrow. Overpriced does not mean, going down tomorrow."

Such calls will always be rare & there is a good reason for that, as these events in the market journey account less than 5 % of the time. While markets, well, they tend to spend 95 % of the time traversing from the lows of undervaluation to the peaks of over valuation and exuberance and there is no one to say how long that journey will be, for as we all know "markets can remain irrational longer then we can remain solvent."

"To make something special you just have to believe it's special."

– Mr Ping

The No 1 trait of a good investor should be to be an Optimist. This is a position that has been proven irrefutably over years and years of economic and capital market history.

Accidents like mistakes are bound to happen especially when it seems so good and there is the perennial “this time it’s different” feeling. But as we all know its otherwise or as the late Rakeshji used to say, “The worst of the mistakes happen in the best of the times”.

“The only true limit is the one you set for yourself.”

– Master Shifu

So while we keep our eyes firmly on the road, our speed limit, seat belts and dash cams, are also important, we asses for ourselves, what is the path we want to take, the goal we want to reach, the vehicles we want to travel in and in the case of an accident we need to make sure how much damage can we and our car withstand, so that our journey continues.

Warm regards,

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