VQ Perspectives

October 2024

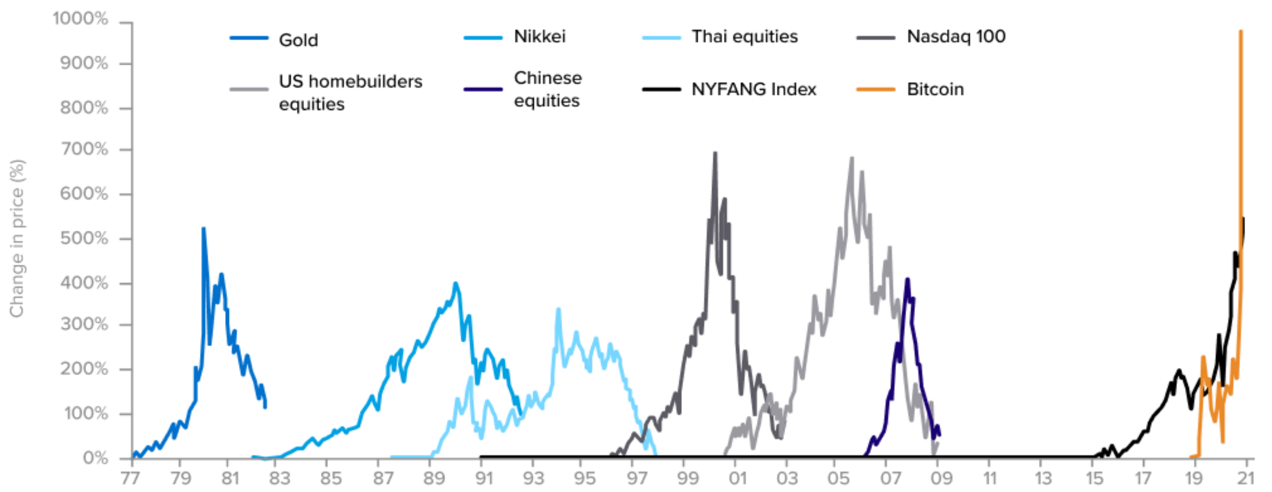
Beyond the Matrix:
Illusion of Comfort or Uncomfortable Reality

October 2024 marks the completion of 14 years of excellence and growth for ValueQuest. We extend our heartfelt gratitude to our clients, partners, and dedicated team for their trust and unwavering support. Your contributions have been vital to our success, and we look forward to many more years of shared achievements!

In the movie **"The Matrix," Neo** (played by Keanu Reeves) is faced with a choice: stay in the comfort of illusion or embrace the uncomfortable truth of reality. Investing often feels the same—facing uncomfortable truths about the market while resisting the urge to act on every short-term fluctuation. Like Neo, investors must see through the noise and focus on what truly matters: long-term fundamentals.

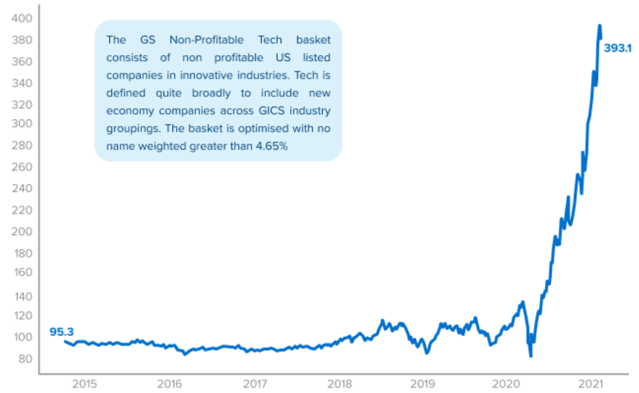
Back in January 2021, we posed the question: "Bubble or Bull Market?" Bitcoin was soaring, the Goldman Sachs Non-Profitable Technology Index was at a peak, and SPACs were the talk of the town. Despite the noise, we argued that the markets were not in a bubble.

45 years of asset bubbles...



Source: Bloomberg Finance LP, Deutsche Bank

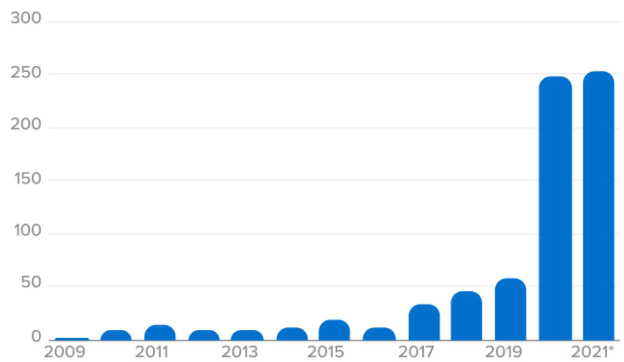
Goldman Sachs Non-Profitable Technology Index



Source: Bloomberg

SPAC Boom in the U.S.

Number of SPAC IPOs in the U.S., 2009-2021



*as of March 11, 2021

Source: SPAC Insider

> *"Denial is the most predictable of all human responses."*
> **– The Architect**

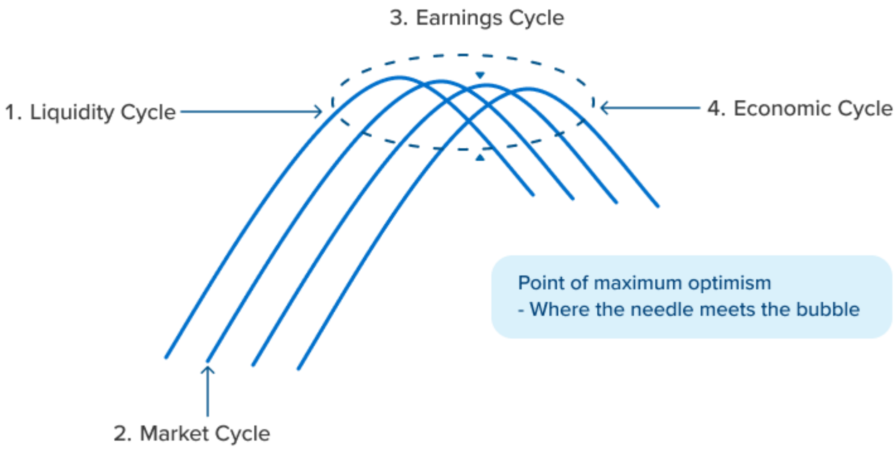
Much like the denial of living in a simulated reality in The Matrix, market bubbles often go unrecognized until it's too late. Investors, driven by optimism, can miss the signs of an impending bubble. Recognizing when optimism is excessive is key to navigating these market cycles.

How to Identify an Unsustainable Bubble

Recognizing a true market bubble involves understanding when the market reaches extremes in several areas at once:

- Peak Economic Cycle
- Peak Earnings (growth & profitability)
- Peak Valuations
- Peak Fund (Equity) Raising
- Peak Leverage

What major market top looks like



These signals often accompany each other, but no single factor is sufficient on its own. It's when all these conditions align that a needle, in the form of crises like a sudden rise in interest rates or geopolitical shock, can prick the bubble—draining liquidity and sending markets into a tailspin.

> *“Fate, it seems, is not without a sense of irony.”*
> **– Morpheus**

Fast forward three and a half years, despite bubbles bursting elsewhere, US, Japan, and Indian markets have created significant wealth, staying resilient. With rising valuations and global uncertainties, the chatter about a major market peak is reaching a crescendo again. This time, given the markets’ strong performance over the past four years, these warnings carry some weight.

However, we are going to use the same framework to make a slightly different case this time.

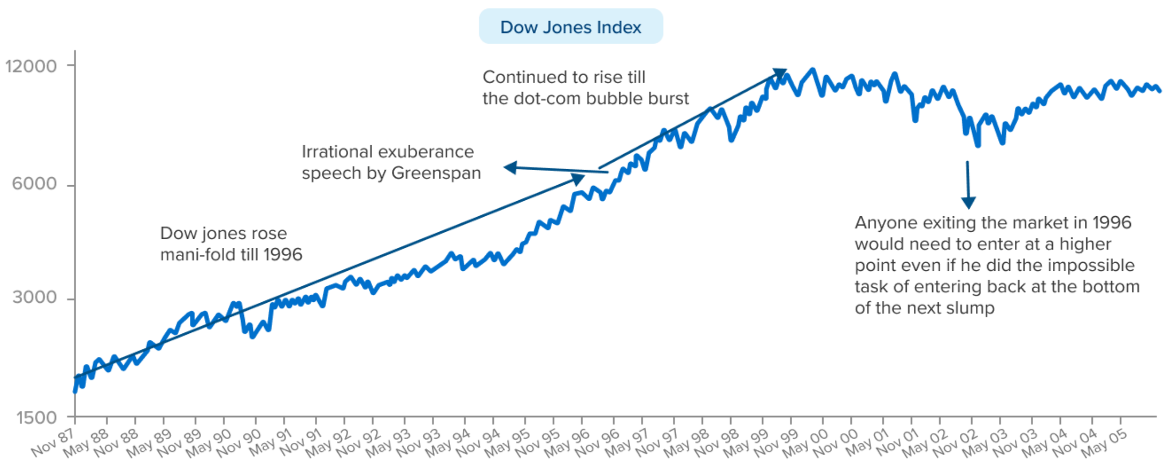
While we don’t suggest valuations are cheap or advocate going all-in, as we did in March 2020, we still believe India hasn’t peaked in terms of economic, earnings, or leverage cycles. Valuations for the current stage of the earnings cycle might be stretched but that can make a case for a correction not for a crash.

Corrections are a natural part of the market, and as Warren Buffet said, **“Corrections are as normal as the seasons; they should never be a reason to panic.”**

> *“You know the prose: “Maintain buying reserves until current uncertainties are resolved,” etc. Before reaching for that crutch, face up to two unpleasant facts: The future is never clear; you pay a very high price for a cheery consensus. Uncertainty actually is the friend of the buyer of long-term values.”*
> ***- Warren Buffet***

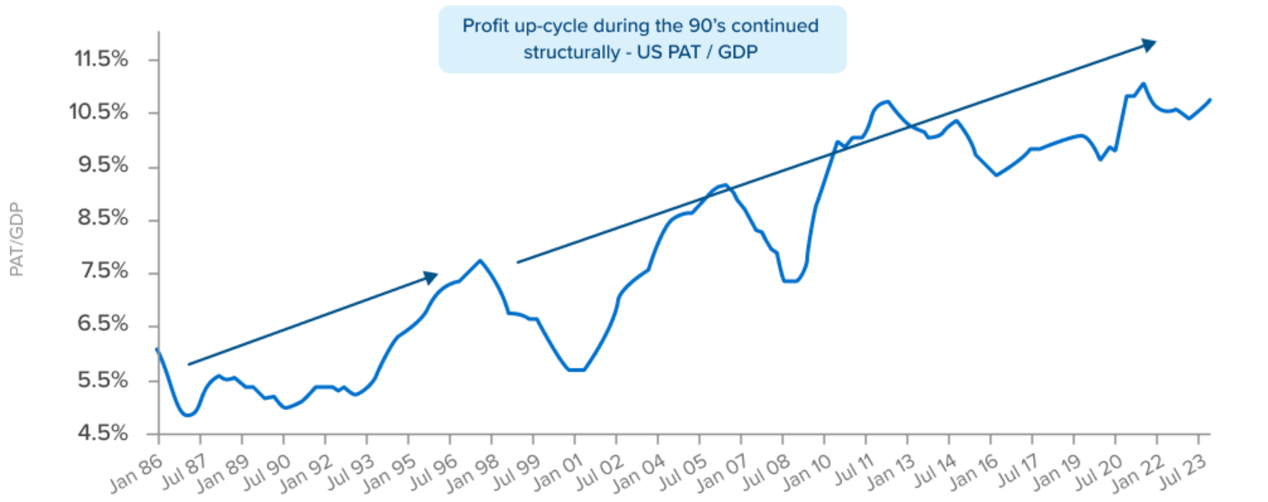
Also, it is futile to predict market tops when earnings cycle is on an upswing as is the case in India. The US market of the late 1990s offers a good case study of this point –

Timing the market is futile - US example during the 90s



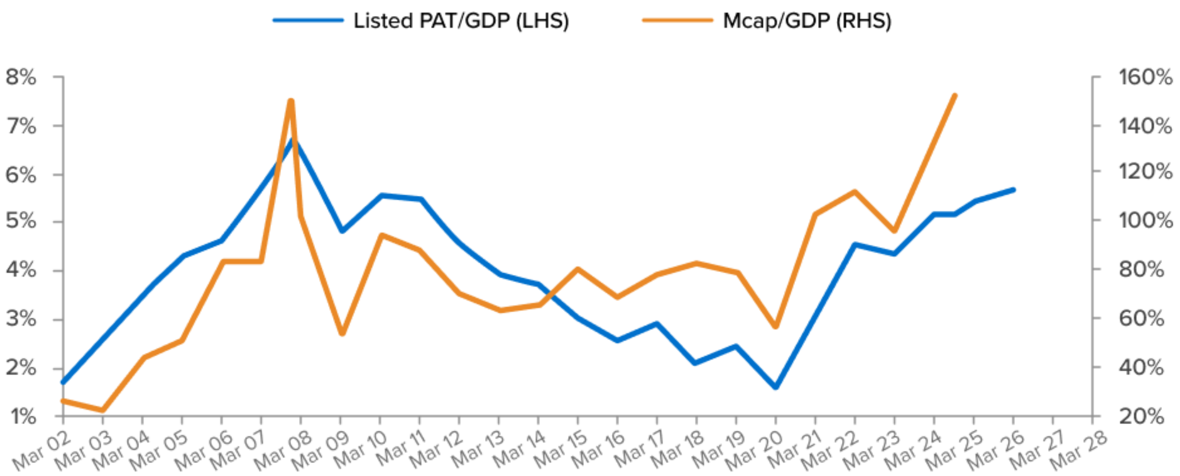
Source: Bloomberg, I-Sec research

US bull market in the 90s was supported by beginning of the profit up cycle which continued to rise structurally



Source: Fred, I-Sec research

Is it a repeat of the US PAT/GDP structural trend for India?



Source: Bloomberg, Capitaline, I-Sec research

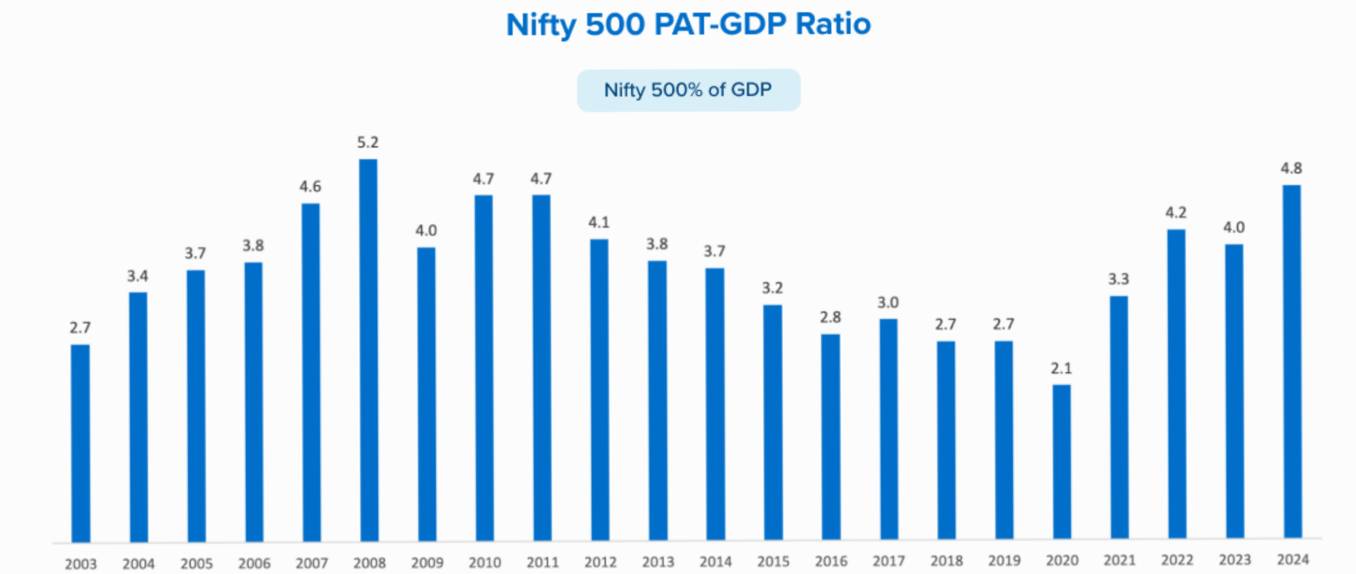
> *"If you read the news, it may seem like things can't get worse; if you study history, you'll realize they've never been better."* **– Anonymous**

Are we at the point of maximum optimism? Like we were in Jan 2000 before the Dot Com crash or in Jan 2008 before the subprime blow up or as we were in Jan 2018 as we encountered the SEBI Classification & LTCG. Even in these cases, a 5-year perspective would have yielded positive outcomes, despite the crashes.

Will there be a crash?

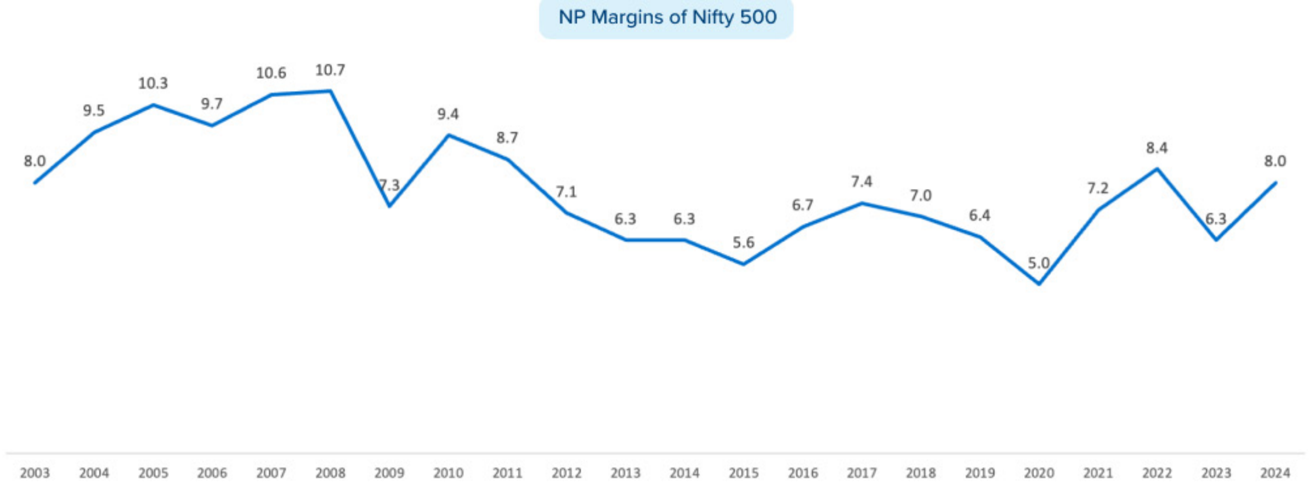
- Constantly looking for a crash is counterproductive.
- A good investor remains optimistic.
- Nobody buys when the market crashes (March 2020).
- Predicting bottoms is easier than predicting tops.
- In the past 30 years, only four significant crashes were worth avoiding—and we are not close to a fifth.

	Harshad Mehta	Tech Bubble	GFC	Today	Source
India Economic Data	1992	2000	2007	Oct 2024	
Mcap/GDP	54%	92%	139%	149%	Bloomberg
P/E (x)	56	27	26	24	NSE
Corp Profit / GDP	1.6%	1.9%	7.3%	5.0%	Ace Equity
Last 5 years returns (Cummulative)	740%	53%	501%	125%	Bloomberg
Last 5 years returns (CAGR)	53%	9%	43%	18%	Bloomberg
RoE	18%	8.40%	27%	16%	Bloomberg



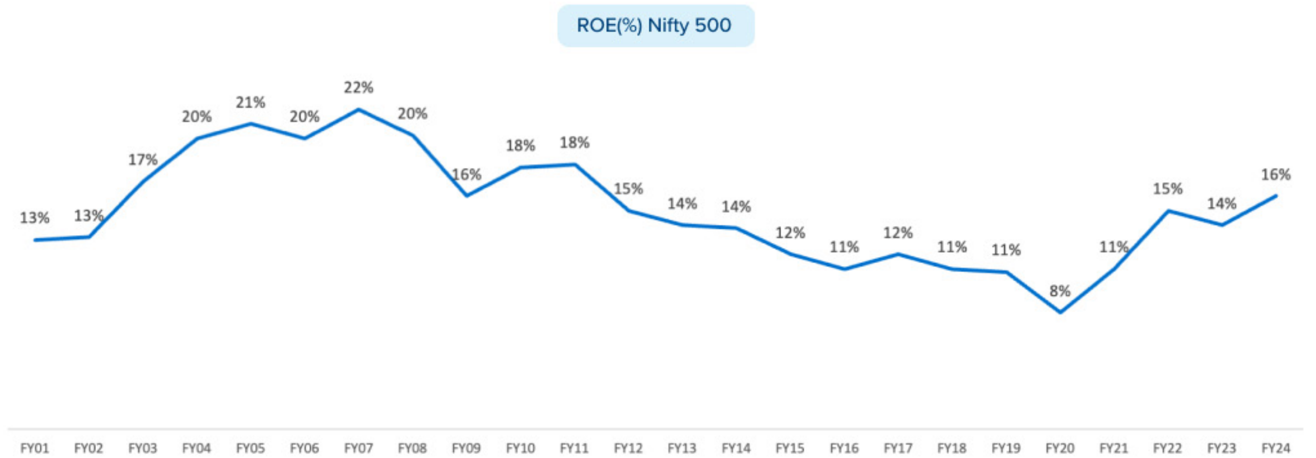
Source: Motilal Oswal

Net Profit Margins (%)



Source: Motilal Oswal

ROE (%)



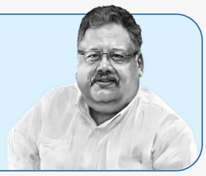
Source: Ace Equity

Correction always possible, crash not imminent

The last major bull market experienced 6-7 corrections within 7 years

Source: Trading View

> *“The market is rational over time, but emotions drive it in the short run.”*
> ***- Rakesh Jhunjhunwala***



Just as the Matrix manipulates reality, the market is constantly shaped by short-term emotions and noise. There’s growing noise about a possible downturn, yet when you look at the fundamentals, India’s markets are in a strong position.

- **Corporate India** is the most deleveraged it has been in 15 years.
- **FII positioning** is at its lightest in 12 years.
- **Domestic flows** remain healthy, with no major liquidity retraction on the horizon.
- **India’s macro fundamentals** are solid:
  - Fiscal deficit is on a controlled path.
  - Current account deficit remains stable.
  - The currency depreciation is under control.
  - Inflation is contained, tax collections are strong.
  - Proactive regulators like SEBI and RBI are managing systemic risks effectively.

> *“The big money is not in the buying and selling, but in the waiting.”*
> ***- Charlie Munger***

In **“The Matrix,”** Neo learns that the path to success is not about quick decisions but about mastering patience and focus. The same holds true for investing. Staying invested through corrections and avoiding the temptation to constantly react to market noise is key. Just as Neo’s greatest strength came from seeing beyond the surface, investors must resist the urge to time every move and stay focused on long-term growth.

Warm regards,
Ravi Dharamshi

Founder and CIO,
ValueQuest

ValueQuest Investment Team

Ravi Dharamshi | Sameer Shah | Varun Goenka

www.valuequest.in @VQIndia / @ravidharamshi77 @ValuequestInvestmentAdvisors

This document prepared by ValueQuest Investment Advisors Private Ltd, is meant for the sole use of the recipient and not for public circulation. This document should not be reported or copied or made available to others, either in part or full. The information contained herein is obtained based on internal data and publicly available information and other sources believed to be reliable. ValueQuest does not claim or warrant the accuracy, correctness or completeness of the data mentioned herein. As such, this document should not be relied upon for any purposes including investments in any security. This document is for personal information only and does not constitute an offer, invitation, or inducement to invest in any security whatsoever. ValueQuest or any of its employees are under no obligation to update the information contained in this document. As permitted by SEBI regulation, ValueQuest and its affiliates, associates, officers, directors, and employees, including persons involved in preparation of this document may: (a) from time to time have a long or short position, or buy or sell, any of the securities of any company mentioned herein or otherwise; or (b) be engaged in any other transaction involving such securities. Client has an option for direct onboarding without intermediation of person engaged in distribution services. Performance related information provided in this document is not verified by SEBI. Past performance is not a guide for future performance. Investment in equities involves substantial risk including permanent loss of capital (in whole or in part) and hence may not be suitable for all investors. The statements contained herein may include statements of future expectations and other forward looking statements that are based on our current views and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance, or events to differ materially from those expressed or implied in such statements. Readers shall be fully responsible / liable for any decision taken based on this presentation. Readers should before investing make their own investigation and seek appropriate professional advice. Investments in Securities are subject to market and other risks and there is no assurance or guarantee that the objectives of any of the strategies of the Portfolio Management Services will be achieved. Clients under Portfolio Management Services are not being offered any guaranteed/assured returns. The distribution of this document in certain jurisdictions may be restricted by law, and persons in whose possession this document comes, should inform themselves about and observe any such restrictions.