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Seeing the Glass Half Full

2025 Opportunities

Dear Readers,

It's that time of the year again.

Another year is winding down and like every other time it is a great opportunity to reflect on the year gone by and ponder on what lies ahead.

So, as we savour this year, one sip at a time (as the season demands), we can't help but feel grateful. Why grateful?!

If you had told me a year ago that we would witness a heady mix of 60+ elections worldwide (including two of the most important and impactful ones from an Indian perspective, in the USA and India), several state elections, two raging world conflicts, a serious policy shift from the monetary easing of the last 15 years, the return of government-led stimulus in China (albeit with no real impact yet), a record FPI outflow, and the vagaries of weather among other things, and that amidst this volatility, Indian markets and our portfolios would be where they are today, there is nothing else to feel but gratitude.

The saying about India's 330 million gods must be true—they've certainly been kind this year!

> *"The skittish investor, no matter how intelligent, is always susceptible to getting flushed out of the market by the brush beaters of doom."*
> ***- Peter Lynch***

Some traits are not curable, and they often spread like malaises. The glass half empty syndrome amongst investors seems to be something along on the same lines. A quick search on the net defines the "Glass Half Empty" Syndrome as a pessimistic outlook in life. A person who sees the glass as half empty typically emphasizes what is lacking, leading to a mind-set that may overgeneralize negative outcomes, dismiss positive experiences (megatrends and emerging themes) and engage in catastrophic thinking (crashes in our case).

For this end-of-year newsletter—and as an ode to Charlie Munger, we highlight his mental model **"Invert, always invert"**—or, in our case, see the glass half full!

We have encountered plenty of half glasses this year, and here are some of the best ones we experienced and also our sober take on them.

- Is this the right time to buy?

The real question should be, is this the absolute wrong time to buy?

SME mania, IPO mania, yes, yes, we know the drill. But in the past 20 – 30 years, there have been only **four** such instances, when one should have taken an aggressive cash call and **four** instances when one should have mortgaged the house and bought into the market.

The rest of the time, well, the market being the market gives the illusions of both and just balances itself in the middle, sometimes slowly, sometimes not so slowly, drudging along.

We all know the Peter Lynch quote about trying to time the crash—or even events like COVID. The bad news, as we all found out, is that such events simply cannot be predicted. On the contrary, we need to put in sufficient effort beforehand, align our portfolio with our risk profile, have faith in India and its companies, and stay invested. So, is this the absolute wrong time to buy? - Broaden your horizon a little more, and you'll find the answer.

- FIIs are selling and have lost confidence in India?

Well, true, but if someone has been selling, then someone has been buying as well, right? Who would you rather have buying? The FIIs or the DIIs?

Also, it's worth noting that selling of emerging markets has been a **global theme and not restricted to India.** It was more of a US Election - USD trade versus other speculated factors. India remains a favourable destination—not only for FPIs but also for local investors—across both listed markets and the private equity (PE) space. There is a fair chance that FIIs will return as valuations normalize.

Furthermore, the quality of FII money has been improving, moving from hot money to more sticky money like sovereign funds, pension funds and long only funds etcetera. This certainly augurs well for the long-term prospects of our markets.

- Global Slowdown & Policy Action –

Its common knowledge that some of the large economies are struggling with growth and this stems from various factors both internal and external.

While India most probably will not be isolated from external factors or shocks, the flip side is that its internal macros are improving, and policy action has enough dry powder to provide support or facilitation should the need arise.

Howard Marks, in his book Mastering the Market Cycle, said,

> *"In investing, there is nothing that always works, since the environment is always changing, and investors' efforts to respond to the environment cause it to change further."*

These words are particularly relevant in the current environment, especially from an India-centric perspective.

With both services and manufacturing taking centre stage, there is the potential for double propulsion that could further fuel India's growth.

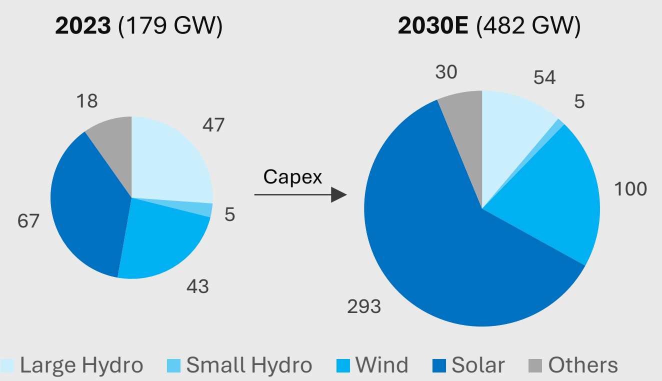
Post the 2024 elections, policy action and momentum may have momentarily paused, but knowing this government, they are more likely to double down rather than back down—and this will become evident over time. Moreover, with the kind of fiscal discipline the country has maintained, it is quite possible that India could be one of the few nations to transition from a deficit economy to a surplus economy. This, along with other factors, should ensure that the Indian market remains attractive.

- Geopolitical Conflicts –

This is the third year of the Ukraine – Russia conflict and it has been a year to the Israel – Palestine conflict. The past year has not been short of overnight shocks and there has been a consistent geo-political pressure on markets from almost all directions. It looks as if this might continue in the coming year as well, with a re-energised Donald Trump taking office again.

If there is a flip side to the war, at all, it's that it has made several countries realise the importance of being self-reliant, especially with their resources & energy. That combined with the focus on renewable energy has paved the way for a decadal mega trend in Energy Transition.

India targets 500 GW of non-fossil fuel electricity by 2030, driving INR 30 lakh crore capex (Source: IREDA). Energy has the highest sector concentration (HHI: 5,696/10,000) in India (Source: NSE). The field is wide open for small innovators in energy, to innovate and open up new blue oceans while gaining market share in the long-term.



Source: Ministry of Power, CEA

- <u>Market leadership</u> –

Every bull market run has its leaders and detractors and that identification is not given enough credit or focus.

There is genuine concern about rural consumption, the agriculture cycle and the slowdown of exports. These sections of the economy have been showing muted growth with a lot of ancillary plays around these sectors continuing to underperform.

On the other side, we believe, India's growth story rides on a modern economic Troika: **Real Estate, Private Capex,** and the **Consumption Cycle.**

These three engines, supported by macroeconomic stability and forward-looking government policies, promise to generate the entropy required to spark and sustain the economic boom.

- <u>Real Estate's Impending Transformation</u>

India's real estate sector, contributing 7.3% to GDP, is projected to grow to **13.8%** by FY34E and **17.5%** by 2047 (Source: CREDAI). Key drivers include:

Urbanization Boom – Urban population to rise from 36% to 40% by 2030, creating 7 crore additional housing demands by 2030 (Source: World Bank, NITI Ayog, CREDAI). Migration for jobs will fuel residential and commercial real estate growth.

Infrastructure Push – Metro expansions, bullet trains (Delhi-Varanasi, Mumbai-Ahmedabad), and INR 5.1 lakh crore allocated for railways and highways will enhance connectivity and decentralize urban clusters (Source: PIB, RBI).

Favourable Indicators – Rising GST collections (cement, steel), low unsold inventories, growing credit flows, and a 25% YoY rise in office leasing activity signal strength (Source: RBI).

Government Support – PMAY aims to build 3 crore homes, ensuring affordable housing and spurring demand across urban and rural areas.

Policy Reforms – Rationalizing tax rates for cement and steel and reducing home loan rates could further accelerate growth.

Real estate is set to become a major economic pillar, fuelled by urbanization, infrastructure, and policy reforms

Private Capex: The Catalyst for Industrial Growth

For the past four years, since the pandemic, the government has driven a supply-side, capex-led recovery across the country. However, as is typical during elections, this slowed to a trickle, leading to a surplus. With elections now over, the government has signalled a shift towards fiscal consolidation and discipline, focusing capex on housing and water schemes. The PM Awas Yojana, with the aim to build 3 crore homes, is expected to create a significant trickle-down effect.

Private capex, which has been at multi-year lows, is now showing signs of revival and gaining momentum. It is positioned for a major upturn, supported by favourable conditions:

- **Capacity Utilization:** Urban Currently at 75-80%, nearing the 80% threshold that triggered the 2003-07 capex boom. (Source: Bloomberg)
- **Deleveraged Balance Sheets:** Corporate debt-to-equity ratios are at all-time lows, and bank credit to corporates remains under-leveraged.
- **Rising Corporate Profits:** Corporate PAT to GDP has risen from 2% in 2020 to 5% in 2023, with projections to reach 8-10% by FY28, fuelling reinvestment in facilities, R&D, and expansion. (Source: Bloomberg)
- **PLI Schemes:** PLI incentives worth INR 1.97 lakh crore are driving investments across 14 sectors, including Electronics, Semiconductors, EVs, and Pharmaceuticals, creating opportunities for corporates to develop value chains. (Source: PIB)

Capex has a strong multiplier effect—every rupee spent generates 4.8 times its value across the economy (Source: National Institute of Public Finance and Policy). With structural tailwinds in place, the next 3-5 years could witness a sharp upsurge in private capex, catalysing industrial growth.

Consumption: A Pause, Not an End

Consumption patterns showed a slowdown, impacted by an extended shraadh period and prolonged monsoons during the festive season—likely a seasonal blip rather than a structural downturn. This is a pause, rather than an end:

- **Mass Affluent Growth:** India’s middle class is expected to reach 715 million by 2030-31, driving discretionary spending. (Source: PRICE)
- **Retail Credit Boom:** Personal loans and credit card spends are growing at 15% & 29% YoY respectively, reflecting rising confidence. (Source: BCG Banking Sector Roundup H1FY25)
- **Auto Demand Strength:** 3.95 mn passenger vehicle units sold (Source: Statista)

Digital Payments Surge: UPI transactions crossed ₹20 lakh crore monthly value, for the first time reflecting rising digital adoption. (Source: BCG Banking Sector Roundup H1FY25)

Youthful Demographics: With a median age of 28.4, India's young workforce is driving demand for tech, education, and leisure. (Source: Worldometers)

Rising incomes, rural recovery, and evolving aspirations position consumption for robust, long-term growth.

"Fear has a greater grasp on human action than does the impressive weight of historical evidence."
- Jeremy Siegal

Morgan Housel wrote in 2016 – **"In investing, a bull sounds like a reckless cheerleader, while a bear sounds like a sharp mind who has dug past the headlines – despite the record of the S&P 500 rising 18,000-fold over the last century."**

It's always been this way. John Stuart Mill wrote 150 years ago, **"I have observed that not the man who hopes when others despair, but the man who despairs when others hope, is admired by a large class of persons as a sage."**

This problem goes beyond investing – he continues – "here are two other reasons that pessimism gets so much attention.

1. Optimism appears oblivious to risks, so by default pessimism looks more intelligent. But that's the wrong way to view optimists. Most optimists will tell you things will get ugly, that we *will* have recessions, bear markets, wars, panics, and pandemics. But they remain optimistic because they know that, like the universe, healthy markets grow. To the pessimist a bad event is the end of the story. To the optimist it's a slow chapter in an otherwise excellent book.

2. Pessimism requires action, whereas optimism means staying the course. Pessimism is "SELL, GET OUT, RUN," which grabs your attention because it's an action you need to take right now. Optimism is mostly, "Don't worry, stay the course, we'll be alright," which is easy to ignore since it doesn't require doing anything. Remember, it is enduring optimism that has earned a return of 18,000X over the last century. The opposite approach has failed, terribly "

Morgan was spot on, the questions and concerns on the market, the optimism built around it and the pessimism surrounding it are both there and will continue to be there.

It all comes down to your perspective - on how you see the glass - half empty or half full. The late Rakesh Jhunjhunwala once said **"Successful investors are both opportunistic and optimistic,"** and there cannot be a better north star or a guiding principle for us to approach the markets this new year.

The markets are inherently designed to challenge us, instil fear and ultimately test our convictions. Corrections, time wise or price wise, are often an important part of this test.

At the risk of being repetitive, corrections are a feature of the market and not a bug. Corrections also being the natural drudging mechanism of the market are inevitable. The case for a crash however may be unfounded. The conditions that must occur simultaneously for an unsustainable bubble, and hence a crash, are peak economic cycle, peak earnings, peak valuations, peak fund raising and peak leverage. As we stand, only valuations have peaked in certain pockets.

It's always easy to constantly see that the glass is half empty and have a pessimistic outlook, but being "opportunistic & optimistic" and seeing the glass half full while having moderate expectations and a focus on high quality stock selection will be an essential mantra for 2025.

"Everybody's got to believe in something. I believe I'll have another glass"
- WC Fields

– Happy 2025 and Happy Investing!

Best Regards,
Ravi Dharamshi

Founder and CIO,
ValueQuest

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