Nippon india Mutual Fund

Wealth sets you free

(Formerly Reliance Mutual Fund)

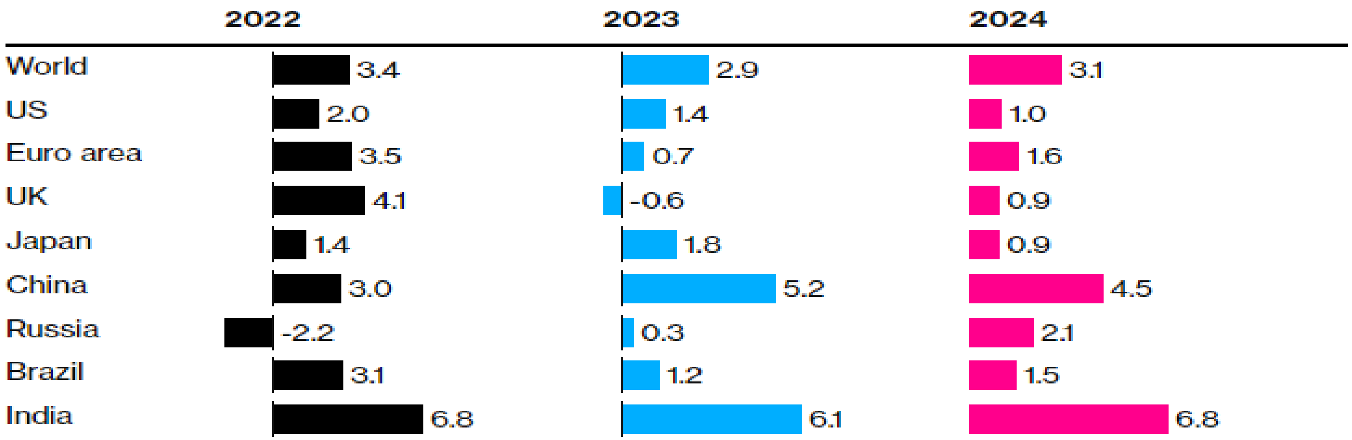
Macro, Market and More

June 2023

Ashutosh Bhargava

Good gets better

Global Growth a concern, but the extent of slowdown may not be very severe



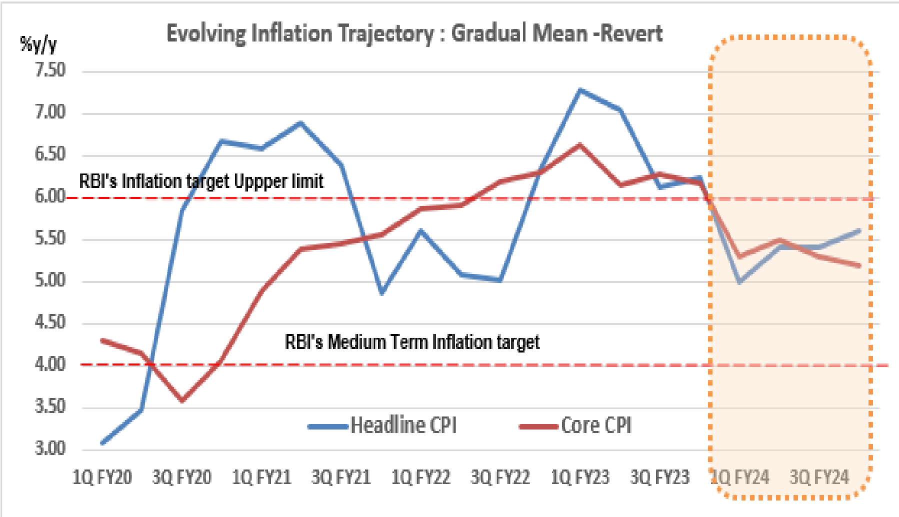
Source: International Monetary Fund World Economic Outlook update

- Global growth expected to slowdown led by developed markets.
- While growth slowdown seems, certain there are some silver linings:
  - Resilient consumer spending in the US
  - Re-opening of the China's economy
  - Lower energy prices
  - Fed and other Central banks changes the focus towards growth
- **India expected to be one of the fastest growing economies, to contribute 15% to global growth in CY2023 (IMF)**

Domestic Macro: Mixed now. Growth and inflation to moderate in FY24!

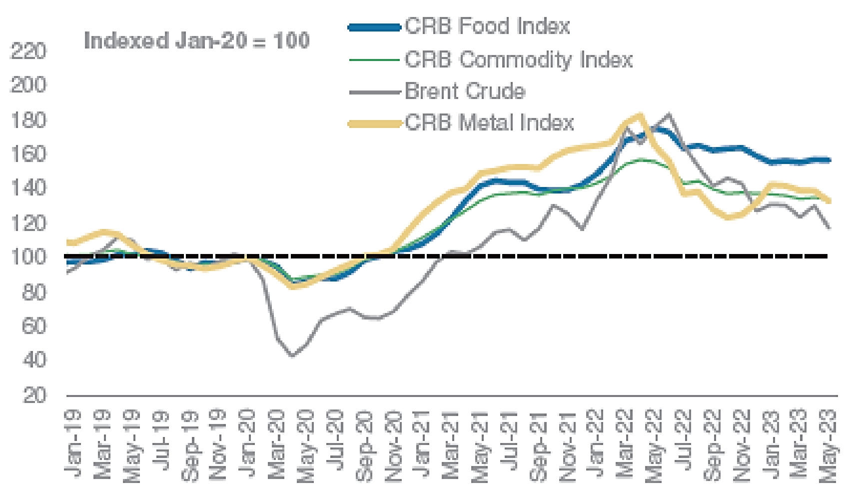
- Exports remains weak while some moderation is seen in consumption.
- Government finances are in good shape. GST collection at record high levels.
- Good quality of Government spending. Public capex growth remains robust.
- Current account concerns reducing at the margin.
- Worst of the inflationary pressure seems behind
- Nearing the end of rate tightening cycle
- Macro stability remains solid while overall growth likely to moderate.
- Witnessing early signs of recovery in rural demand as well as private sector capex revival. Monsoon impact needs to be watched.

Inflation : Gradual Journey to RBI's target



Inflation : Gradual Decline

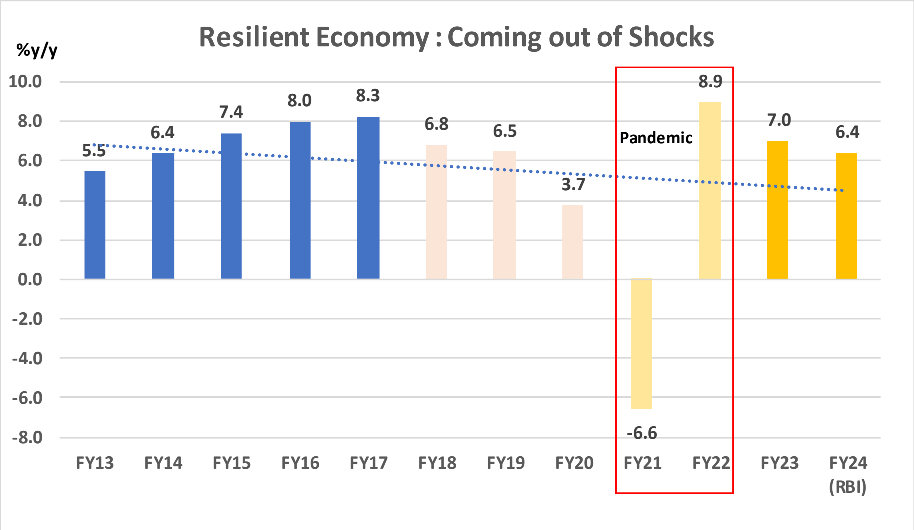
FY	Headline CPI	Core CPI
FY16	4.91	4.30
FY17	4.54	4.72
FY18	3.58	4.53
FY19	3.43	5.79
FY20	4.76	4.02
FY21	6.18	5.32
FY22	5.51	6.07
FY23 (P)	6.67	6.31
FY24 (F)	5.30	5.30



- **Worst of the inflation pressure is behind**
- **Stage is set for monetary easing by the end of FY24**

Source : CEIC, RBI, RBI forward looking surveys

Growth Dynamics : Gradual Moderation



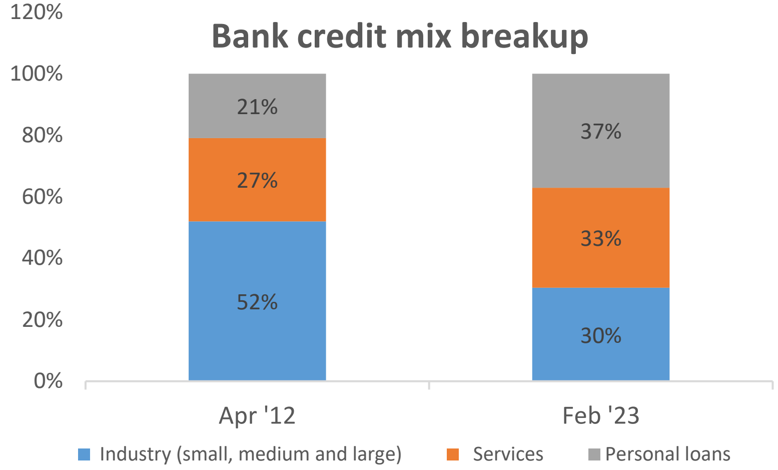
- **CY2023 probably first normal year in 2030s – after three consecutive years of shocks.**
- **Global headwinds to weigh CY2023 India outlook:**
  - Moderation in global growth & trade
  - Tight financial conditions.
- **Local Factors Still Supportive:**
  - Upside from Private Capex.
  - Rural Terms of Trade Improving.

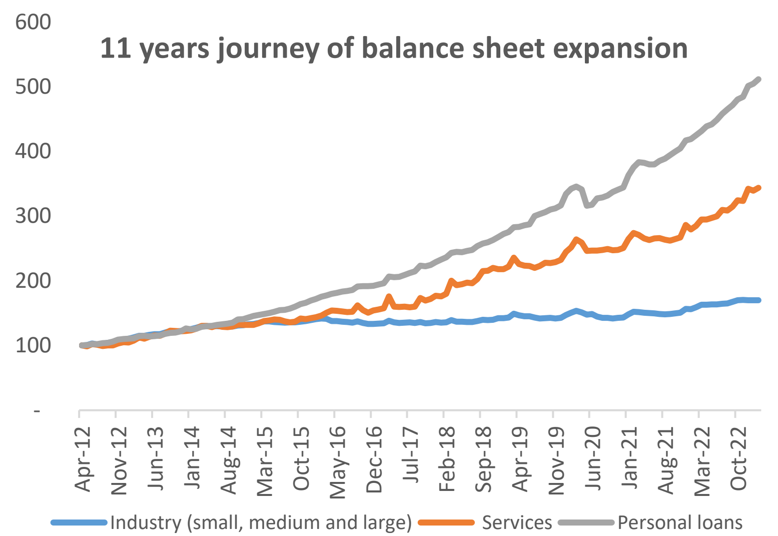
- **FY22 & FY23 : India emerged as fastest Growing Economy.**
  - Aided by Base effect & pick up in demand (especially services)
- **Limited impact likely from global spillovers in FY24.**
- **Downside risk :** *Very poor monsoon, global recession and loss of momentum.*

Source : CEIC, CSO, RBI, NIMF Research

Its all about the MIX: Huge dispersion in growth likely to persist!

Households B/S size blew up





How is India macro placed!

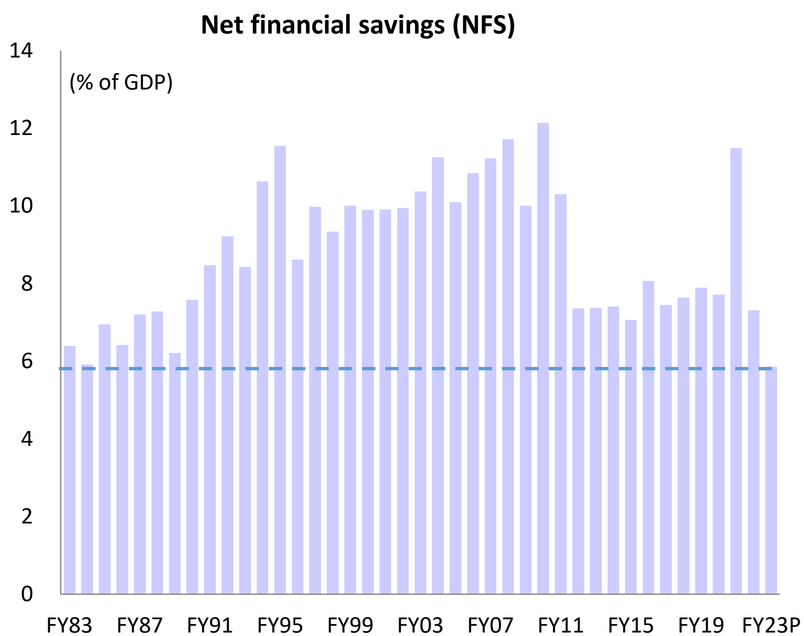
Exports: May take time to recover. Goods exports was most hit in FY23. Some weak recovery in goods exports partly aided by favorable base but services exports growth to weaken in FY24 after solid FY23.

Consumption: Urban consumption may show some slowdown owing to: higher interest rates, high cost of living, depletion in excess savings post covid, peak job market and best of asset inflation (wealth effect) likely behind. High hopes from rural consumption seems misplaced. Services sector doing relatively better. **K shaped recovery intact for now.**

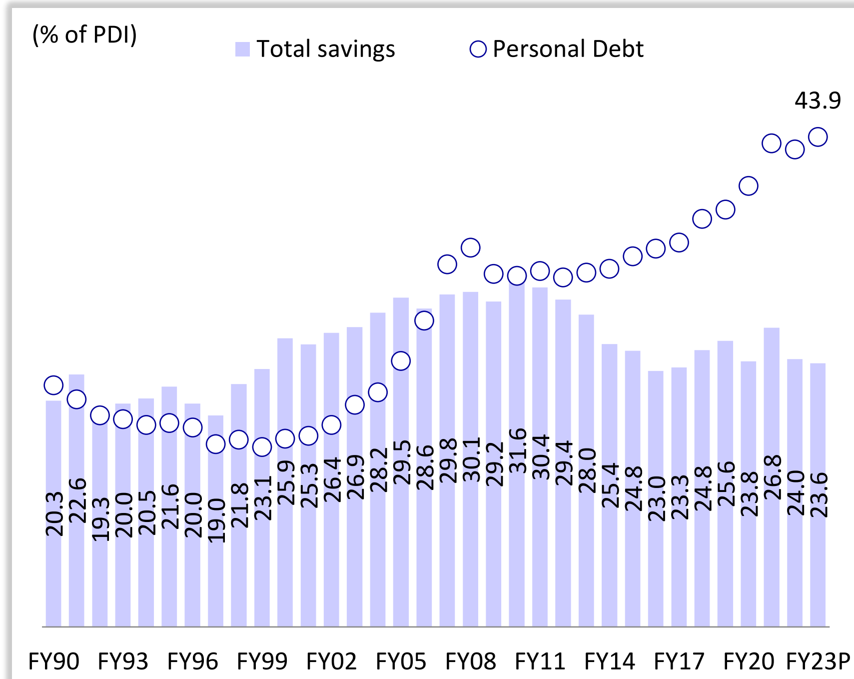
Capex: Central Govt Capex faring fine. State Govts may increase capex in FY24. Private Corporate capex is still muted. Household capex is growing fine. Global uncertainties and local election along with confusion about nature and longevity of demand may lead to some postponement of private capex. Import substitution is a huge theme.

Household Balance sheet look stretched owing to jump in non mortgage debt

Household net financial savings were just ~6% of GDP in FY23, the lowest in four decades…



…and the combination of lower household savings and rising debt continued in FY22/FY23



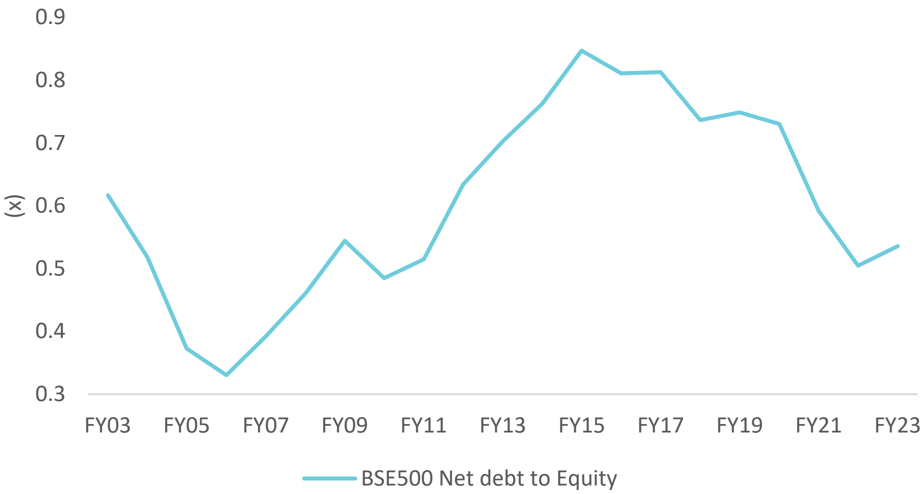
FY23 data is our estimates

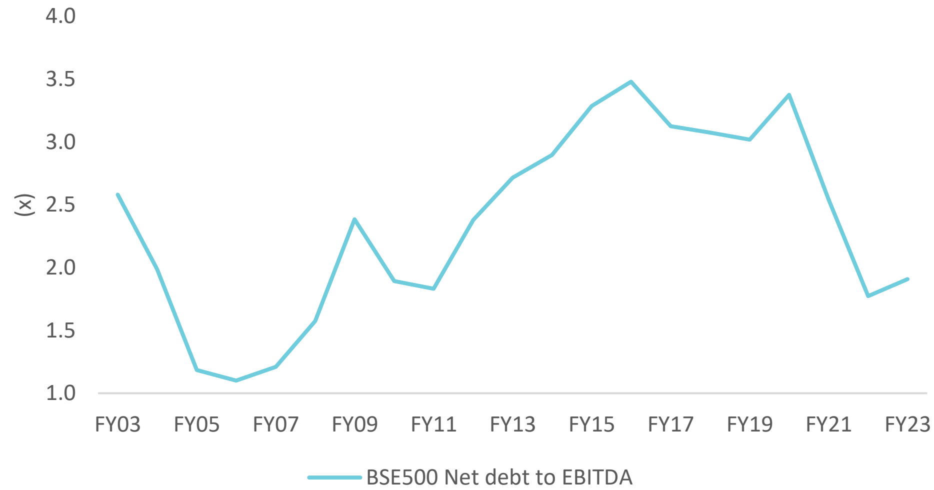
Total savings = Net financial savings (NFS) + Physical savings

Personal savings = HH debt a decade ago but increased to 1.7x/1.9x as of FY20/FY23

Source: CSO, RBI, MOFSL

Corporate Balance sheets are in great shape

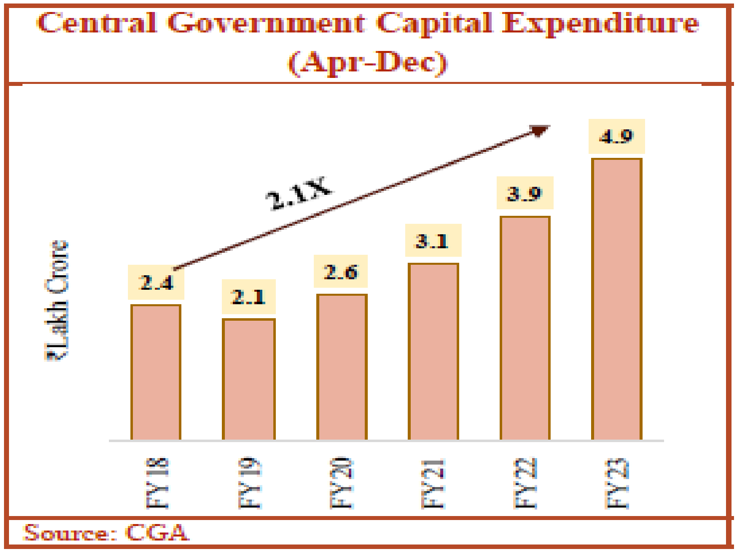




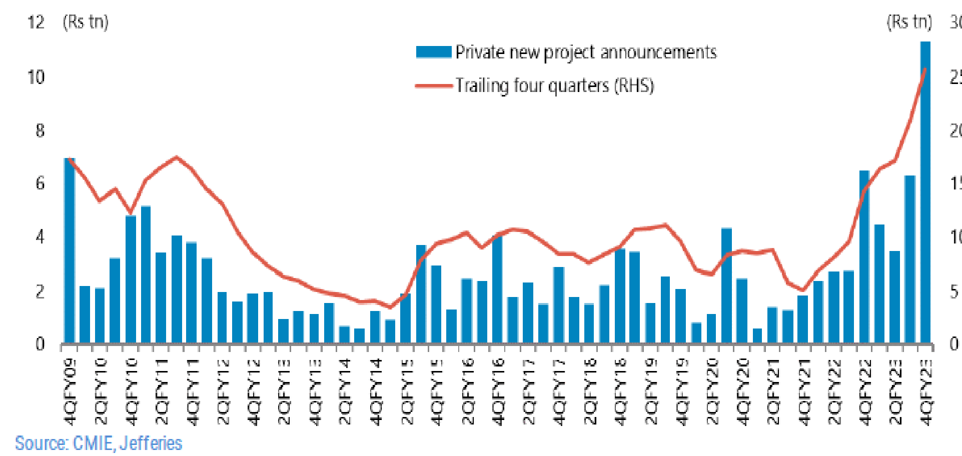
- Non financial Corporates Balance Sheets offer scope for expansion.
- Debt servicing unlikely to be a worry despite rise in interest rates.

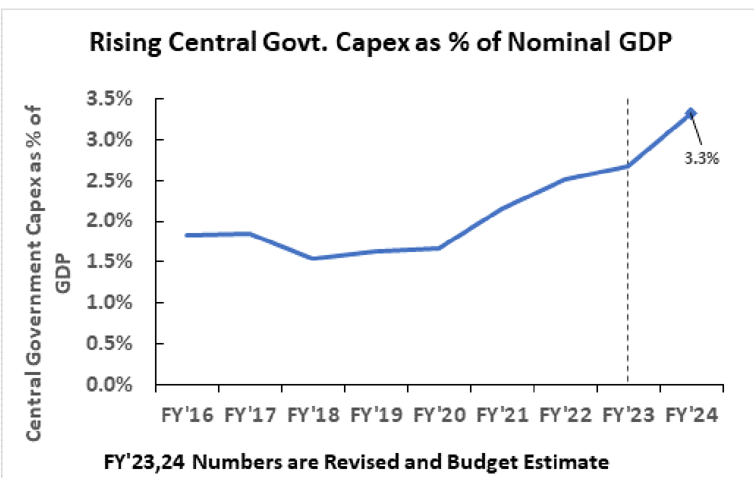
Source : Morgan Stanley Research

Capex as growth engine initially led by the Government



New Private Projects Rise to an All-time High in QE Mar





- Capex pickup is the key for Domestic Demand
- In turn create a virtual cycle of more jobs → higher income → higher saving → higher investment
- Deleveraging of corporate balance sheets provides potential for a sustained capex cycle

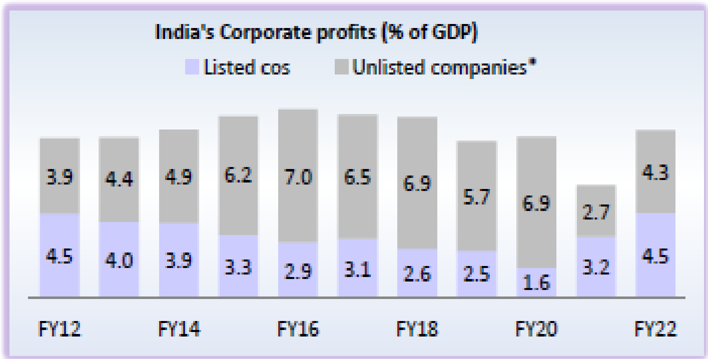
Source: CMIE, Nippon India Mutual Fund Research

Business Trends as we see it

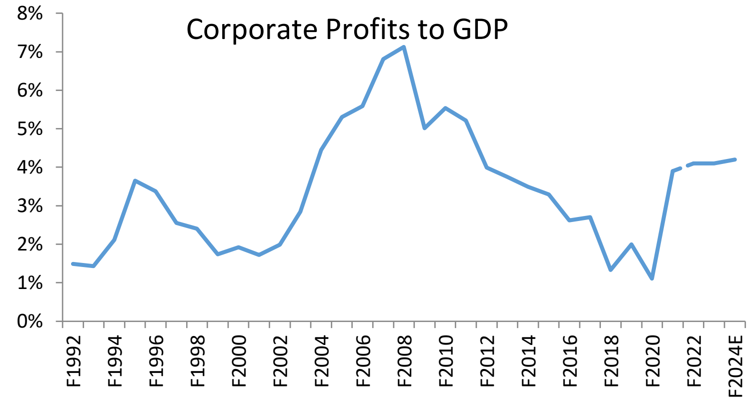
- Quarterly Results - Q2 and Q3 results below trend – Q4 relatively better led by financials, Autos
- Consumption slowdown both rural and urban. But its nuanced! Low ticket consumption weaker than high end consumption.
- Price increases for end consumer hurting vol growth in lower end segments
- End of Covid rebound – K shaped recovery giving away? – Not really!
- Growth in corporate profits likely to be higher than growth in nominal GDP in FY'24
- Global weakness still on – Should look better 12 months out but next 6 months could be challenging
- China reopening led recovery turned out to be weaker than expected.
- Green shoots on Industry Capex recovery – PLI, Localization, C+1. Import substitution is likely to be a big driver of Capex!

Listed Corporate Profit Margin may improve

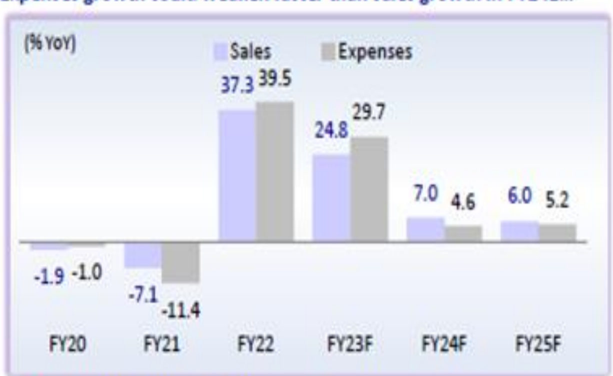
Listed corporate profitability has more than doubled in the past two years, while unlisted has suffered to a great extent



For the entire listed companies universe
Source: CSO, RBI, CEIC, MOFSL



Expenses growth could weaken faster than sales growth in FY24E...

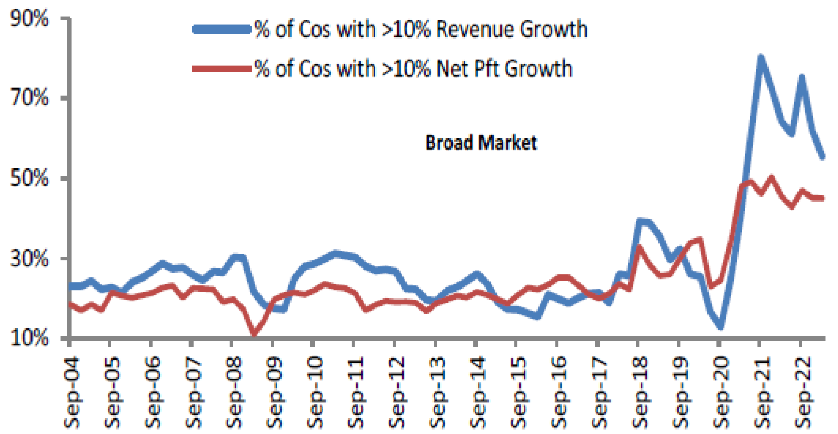


MOFSL ex-financial coverage universe
Source: MOFSL

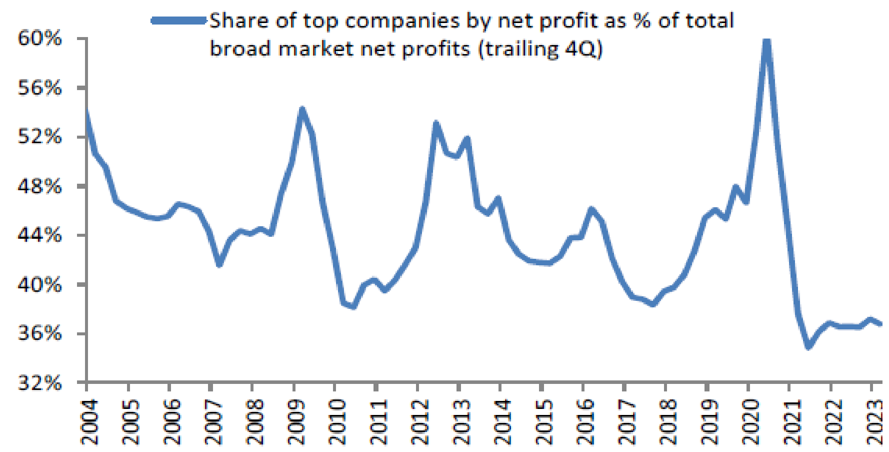
- Input costs may decline going ahead as inflation falls
- Employees' salaries and wage hike are expected to moderate

Broader markets contributing to earnings

Breadth of Corporate Performance



Large Companies' Share in Total Profits

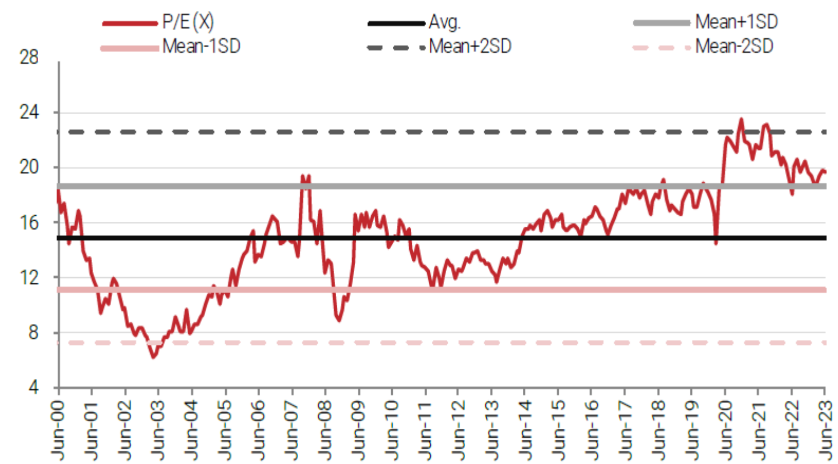


Source : Morgan Stanley Research

Market valuations matter only at an extreme. No point watching valuations all the time!

Pre Covid Data (Analysis From March 1998 upto December 2019)		
PE Bands	% of Occurences	MSCI INDIA 1Y Fwd return (Average)
< 9	1.5%	63.3%
9 -10	5.4%	51.3%
10 -11	5.9%	35.6%
11 -12	4.7%	34.4%
12 -13	10.0%	25.8%
13 -14	14.0%	21.1%
14 -15	8.1%	5.1%
15 -16	8.4%	6.1%
16 -17	10.6%	0.9%
17 -18	11.0%	3.4%
18 -19	7.0%	-1.5%
19 -20	2.3%	-9.7%
20 -22	6.0%	-52.2%
22 -24	4.7%	-45.8%
24 <	0.3%	-40.3%
	100%	16.2%

12-m rolling forward PE of Nifty-50 Index



- Mix shift and composition effect cannot be ignored when looking at multiples for the same index across different time frames.

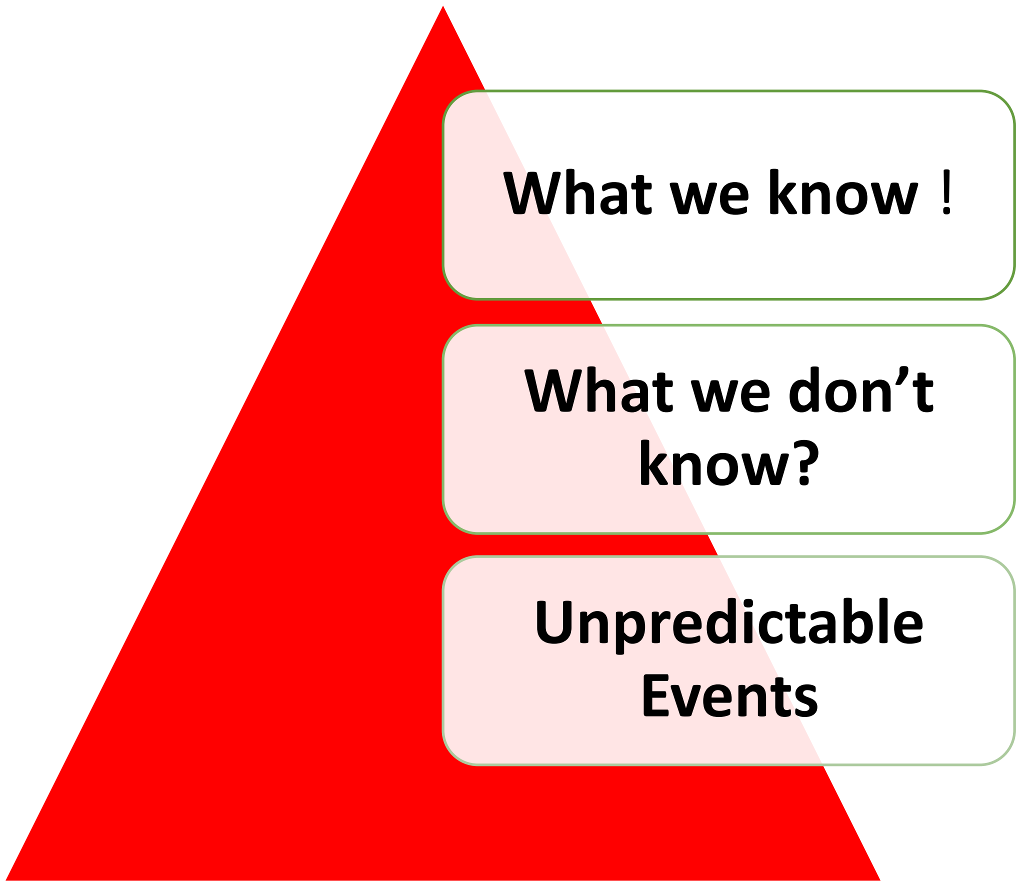
India's investment opportunities on its way to 5 trillion US$ economy

- Consumption premiumisation
- Manufacturing-Infrastructure nexus
- New energy
- Financials
- Equity savings cult

Sector Opportunities – Potential Winners where we are positioned!

Sector	Reason	Valuations
Financials	- Strong Balance Sheet - Market Share gains - Large FII selling	- Reasonable to attractive
Engineering/Industrials	- Start of and upcyle after a decade - Huge consolidation - Very strong order book - Large sustainable opportunity	- Rerating done but large and growing order book and strong earnings visibility
Select Consumer Discretionary (Autos, Hotels, etc)	- Growth upcycle sustaining	- Reasonable to attractive
Pharma	- Earnings to rebound in next 12 months - Strong long term market structure	- Valuations reasonable after consolidation

Managing the Knowable



(I) What we know

- Equities 'one of the top performing assets classes over the long term'

For instance: the S&P BSE Sensex has delivered CAGR of 15% over last 42 years

- Equity returns linked to Industry or Nominal GDP Growth

How do we manage

- **Sector & Stock selection** is the way to capture above average compounding returns

(II) What we don't know

- Political environment in the future
- Regulatory and Policy changes
- Forecast free market variables with certainty – like Interest rates, Commodities & currencies
- Foreign flows

How do we manage

- Diversification -**Diversification** into various themes and sectors. Holding 30 plus odd stocks across industries.
- Avoiding/UW companies with complexity and several moving parts dependent on above

(III) Unpredictable events

- Global Interest rate & Liquidity cycle
- China macro risks, US Recession, Ukraine War - Unreal jump in energy costs, etc
- Collateral damage arising from 'Black swan events' – Covid, etc

How should we manage

- Asset Allocation
- Systematic Investing

Long term benefits

- Risk understanding and taking right risk – drives long term value creation.
- Without the RIGHT RISK – there is no EXCESS RETURN possible – NO FREE LUNCH
- All risk DOES NOT lead to HIGH RETURN
- RIGHT RISK has greater probability to deliver Higher returns – NOT Guaranteed.
- NO RISK – is MOST RISKY in EQUITIES – OPPORTUNITY COST

Practical learnings over the years of Big Risks in Equity investing/portfolio management

- Single biggest risk in Equities is **Investor's/FM BIAS**
- Everything Changes – Constant **ability and willingness to learn and adapt** is a big advantage
- **Illusion of Knowledge is more dangerous** than not having knowledge
- Massively Overpaying for Companies of Any Quality, **Valuations Always Matter**
- Anybody who speaks in Certainty – is at the risk of having an uncertain future – **generally probabilities matter more**

Overcoming Volatility

- People don't like short term pain even if it would result in better long-term results. Here the role of advisor’s gains importance

- Very few investors can handle the volatility required for high portfolio returns.

They equate short term volatility with risk.

- **Volatility is not risk. Risk is permanent loss of capital. Volatility is..Volatility!**

Indian equities are well diversified in terms of sectors!!*

	Free Float Mcap Wt
Health Care	4%
Information Technology	12%
Materials	8%
Energy	11%
Financials	35%
Consumer Discretionary	8%
Industrials	6%
Consumer Staples	11%
Real Estate	0%
Utilities	3%
Communication Services	3%
	100%

Exports

Global Cyclical

Domestic Demand/Capex

Utilities

Well diversified markets offer relative stability!

Source: Bloomberg, BSE 100 Index

Dominating Themes of different times..

2002-2007

Asset Heavy Models

1. Infra & Construction
2. Real estate
3. Power
4. Metals
5. Engineering

2007-2012

Asset Light Models

1. Consumption
2. NBFCs
3. Agri/Rural
4. Pharma
5. Textiles exports
6. Consumer NBFCs

2012-2020

Debt Light Models

1. Consumer Finance
2. Housing Finance
3. Small caps
4. Exports oriented
5. Consumption
6. New/Niche concepts

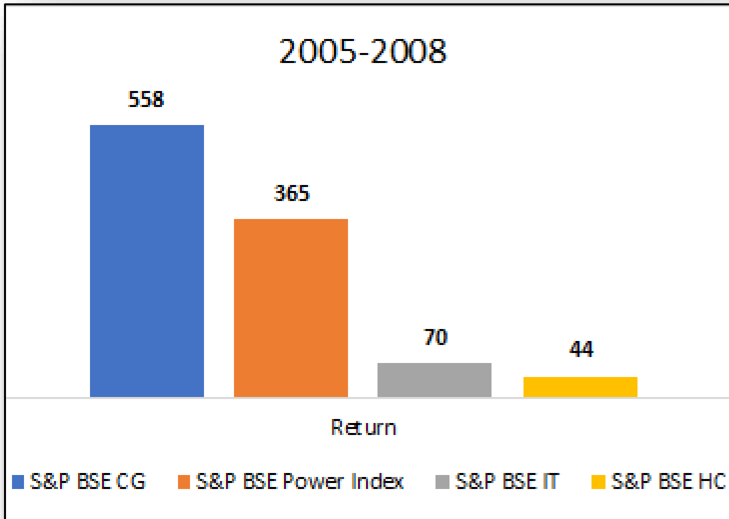
2020 & Beyond

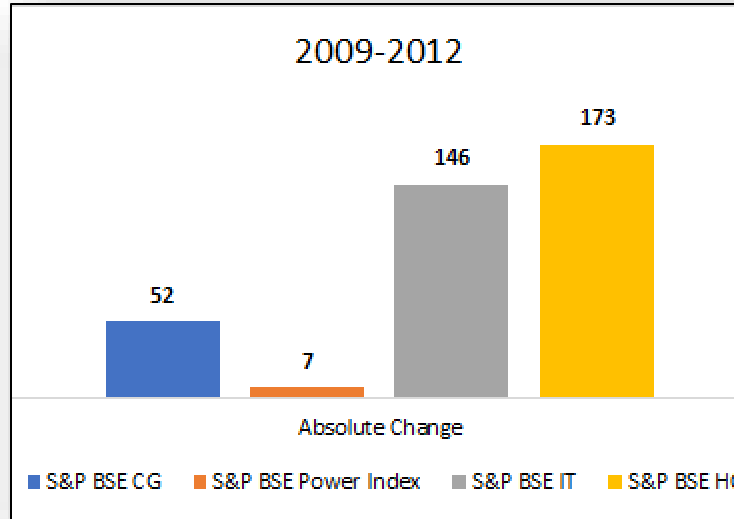
Capex and Tech combined

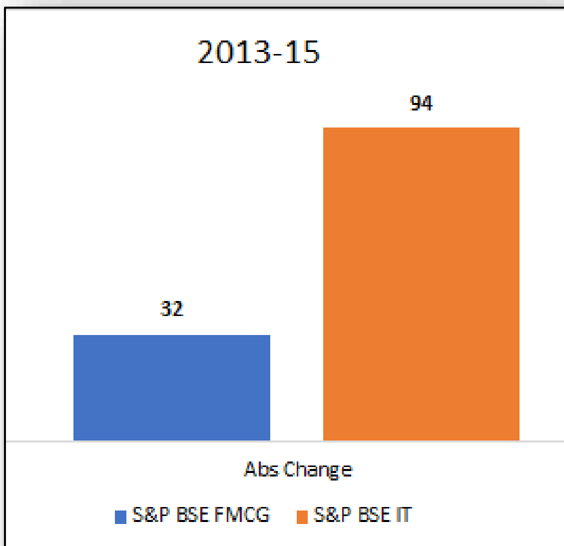
1. Cap Goods (Defense/ Railways/ New Energy)
2. Tech
3. Hospitality
4. Hospitals
5. Public Sector Banks
6. Other PSU’s

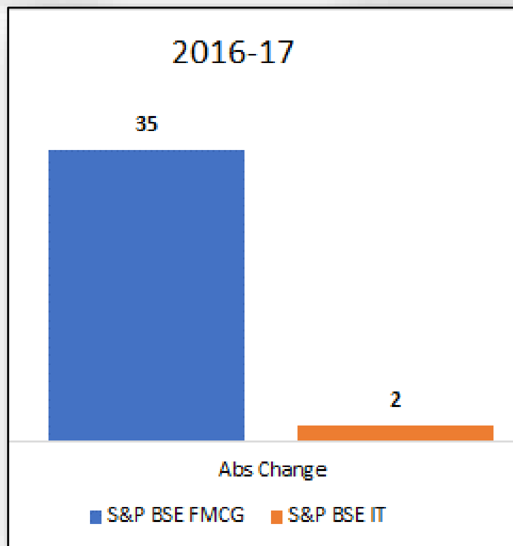
Right Risk: Volatility as a “positive lever”

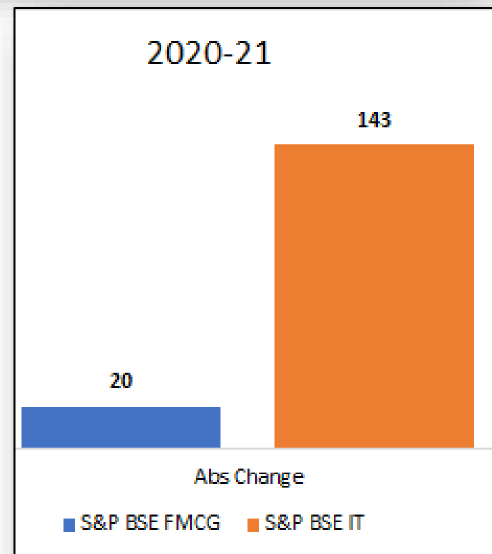
Mispricing can provide interesting opportunities











Last 10 years some businesses (sectors) have generated massive wealth while some underwent significant wealth erosion

Rank	Sector	Market Cap %change
1	Chemicals	**972%**
2	Infra. & Construction	**685%**
3	Misc	**543%**
4	Consumer Services	**456%**
5	Industrials	**451%**
6	Financials	**430%**
7	Building Material	**390%**
8	IT Services	**319%**
9	Consumer Products	**319%**
10	Automobiles	**292%**
11	Other tech	**262%**
12	Telecom	**243%**
13	Oil & Gas	**222%**
14	Healthcare	**211%**
15	Power Utilities	**173%**

Best performing sectors

Worst performing sector

- ***While the BSE500 index has given 266% return in last 10 years; Chemicals, Infra, Industrials and Financials have outperformed and have emerged as the best performers in the market***
- ***Other sectors like Power Utilities, Healthcare, Oil & Gas have underperformed the broader markets.***

..but not all the companies in the out-performing sectors are star performers..

1 **Chemicals** 972%

Top performer

Worst performer

Company	% change
Navin Fluorine	14062%
Rallis India Ltd	49%

2 **Infra** 685%

Top performer

Worst performer

Company	% change
Borosil Renewabl	3566%
Nbcc India Ltd	344%

..similarly not all of the companies in the under-performing sectors have eroded wealth..

3 **Healthcare** 211%

Top performer

Worst performer

Company	% change
Caplin Point Lab	8953%
Lupin Ltd	17%

4 **Power Utility** 173%

Top performer

Worst performer

Company	% change
Adani Power Ltd	748%
Nlc India Ltd	52%

Note: Data taken is for BSE 500 companies listed as on June 27, 2023;
Percentage change calculated baisis difference in Market cap as on Jun 27, 2013 and Jun 27, 2013

Practical Principles – learned over the years

Accepting the Right Risk, Rejecting the unexplainable/unfathomable

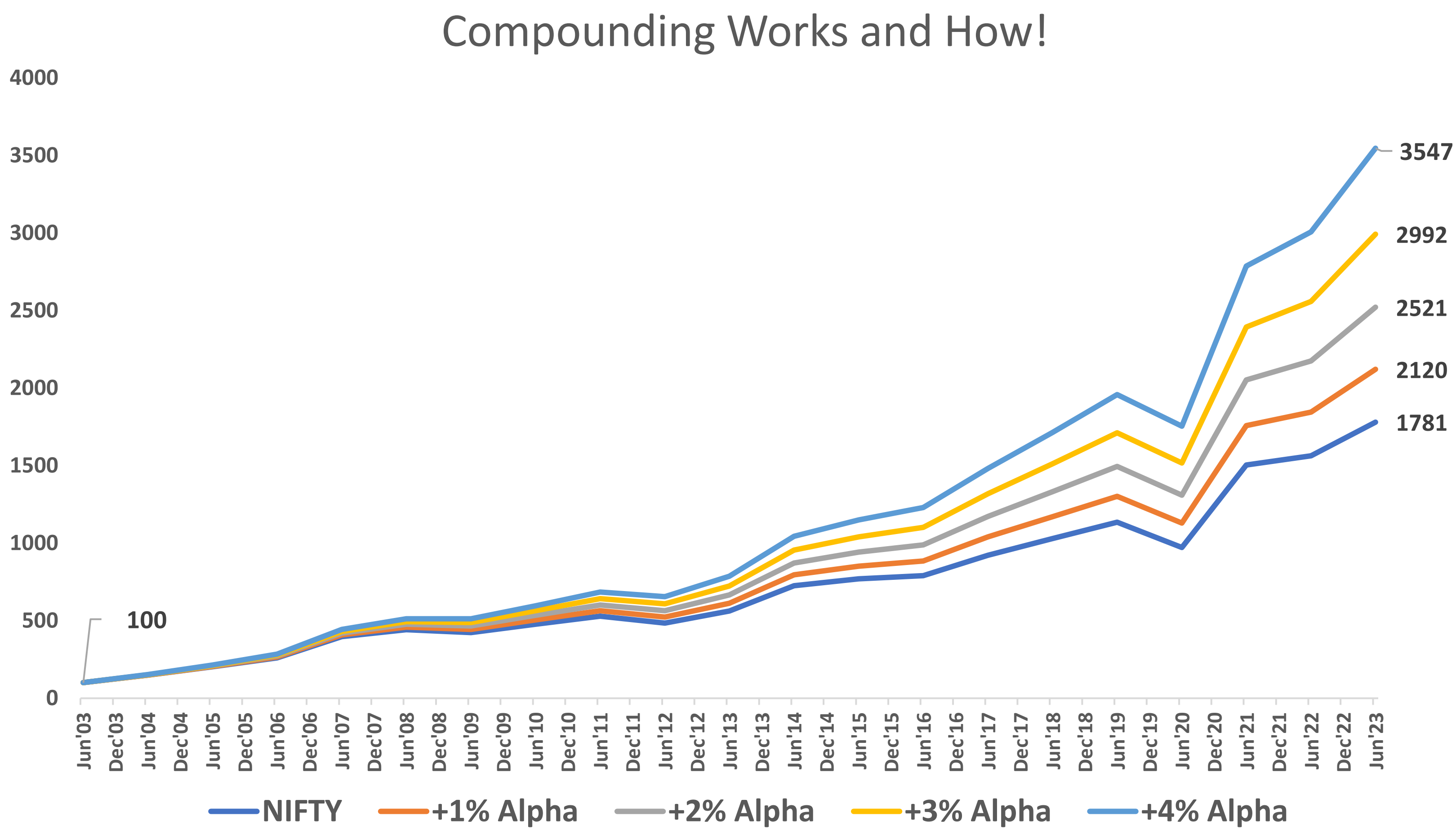
1. Not Overpaying for growth/Euphoria or high expectations,
2. Sensible diversification
3. Sustainable Profitable Growth at reasonable prices
4. No leverage – at any level
5. In cyclicals – choosing category leaders
6. Rejecting unexplainable valuations for even great businesses
7. Good News – Bad Prices to invest, Bad News – Good Prices to invest
8. **Market gives what you seek!** If you are looking more for excitement over returns this is what you will get!

Thinking of RISK – For PFP (Personal Financial Professional)

- In a bull market everyone is an investor and has a long-term horizon with an Investment Philosophy.
- In a bear market – there are neither investors nor philosophies.
- Risk is conveniently seeing – what you want to see and ignoring learning and questioning.
- If you ask the right questions – You can truly lower risk
- If you are buying something to show your friend that you own, it – its truly risky
- Easy Money leads to Lazy Decisions – Biggest Risk
- If you don't know what you are doing in the market – you are truly risky
- If you leverage – risk multiplies/compounds – difficult for people to imagine
- Getting caught into narratives – is truly risky. Eg – Driverless Cars, Disruption, MMT Theory, Crypto, etc.

Last but not the least is the 8th Wonder of the World

Compounding of returns



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