PERSPECTIVE

DECEMBER 2018

If we don't follow media we are uninformed and if we follow them we might get ill-informed or even misinformed. As we start 2019, it's crystal ball gazing time again. We know at this time of the year, it is fashionable but we will refrain from that. I must say **most Financial Journalism, is dedicated to a basic principle of marketing: "When the Ducks quack, feed them".** So rather than giving Investment outlook for 2019, we want to talk about markets and economy on a broader sense.

2018: Recap

Typically what happens especially before 2018, in between 2014 and 2017 investors had started thinking mutual funds can only give positive returns and there is no risk attached to it. The year 2018 could well be termed as a bull market speed-breaker, A plethora of events rocked the markets, to start with - introduction of LTCG in the last Budget spooked the sentiment. SEBI's MF small cap classification ruined the companies which had a market-cap of less than Rs 8,000 crores. Bank frauds, Rising rates and NBFC crisis, trade wars, high crude prices, slumping rupee, RBI-Govt tussle further created havoc in the markets.

Whenever money making gets easier, the reversion to mean factor makes its way to neutralize the excess. Although Nifty ended with gains, there were less than 15% stocks listed on NSE that made any positive return. In terms of debt, the 10 Year started at 7.30 and went to 8 plus and came down again to 7.30.

NBFC FIASCO and Liquidity crisis: Downgrades do not always result in default. A drop in a paper's credit rating results in a revaluation of the market value of the paper, consequently influencing fund returns. Higher portfolio yields and returns come only in the face of higher risk.

Market Driving Forces: Election Earning and Economy

Over the past few years, India has executed significant structural reforms, including GST, Insolvency & Bankruptcy Code, Direct Benefit Transfer, Real Estate Regulation Authority (RERA) and a few more. It is almost after a gap of 10 years that India has witnessed such significant structural reforms and we term it as the "Third Generation of Structural Reforms" that India has witnessed since we embarked on the path of Economic Liberalization in 1991. As with any structural reforms, they tend to be disruptive in the first few years and have an economic and political cost in the short term, but their long-term benefits tend to surprise on the upside and are enduring. We firmly believe most of the reforms are game changers and the eerie consensus is grossly underestimating the potential benefits of these reforms.

A strong government at the centre will see a re-rating in the Indian equity market. The markets will now factor in it a little better and of course on Election Day; there will still be a 4-5% kind of move either way depending on who wins and losses. We hope, it is not a 20% up-down kind of a scenario which we had in 2004 and 2009.

We are at the peak of the NPA cycle in the banking system and going forward lower provisioning should create fresh lending capacity in the system. Decent growth in bank credit along with improving capacity utilization across the manufacturing sectors (already surpassing 70% mark) is utmost important to support corporate earnings trajectory, as populist measures ahead of election may apparently leave the government with paucity of funds for incremental public spending.

Crude has been kind in the last couple of months which will help companies attain better margins and provide much-needed relief to the country in its attempt to moderate the trade deficit. Inflation is expected to remain below 4%.

Fund flows in financial assets are expected to grow at a CAGR of 15-18 percent over the next decade, way superior to the 8 percent pace for physical assets. If one look at gold and real estate, we think the story is over. Gold is for capital preservation and one cannot create wealth through gold. Gone are the days when Indian investors used to shiver on heavy FII selling. This year, equity funds have mopped up investments worth over $17 billion which makes the FII selling figure of $4.5 billion look pale in comparison.

Since 2003, India's total market-cap has grown over 600 percent which is just second to China. With China sneezing big time this day, the next decade can very well belong to "The Decoupled India". As is the case globally, when economies undergo this transformation, the equity asset class creates wealth in the economy and outperforms most asset classes. India will witness the same phenomenon; equities will outperform most asset classes over the next 5-10 years.

While Indian markets would get impacted in the short term, due to any selloff in global equities, we firmly believe that India is in a much better situation to deal with any of the global risks than any other economy in the world and the Indian economy is now looking like an **"Oasis in the Desert (global economy)".**

Investment strategy for election year?

Answer: Just don't think too much

The stronger macros and earnings growth recovery will triumph over any political uncertainty. Election results for passionate long-term investors are as irrelevant as the case with Brexit or a change in RBI Governor. A different party at the helm is not going to disrupt the country's balance and affect business cycles of corporate India.

Empirical evidence shows us that in the last 30 years, irrespective of whoever came to power, the markets outperformed big time.

One has never lost money betting on markets prior to the election and staying put for the next 5-7 years. History, in all probability, is set to repeat itself this time again.

The biggest risk is from US and developed countries are reducing liquidity by increasing interest rates and rolling back quantitative easing. This would increase cost of capital worldwide.