

# PERSPECTIVE

DECEMBER 2020

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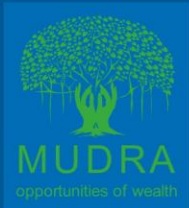
Our internal data mining indicated that **final expansion can be explosive and can take Sensex to 41,500** but interestingly Sensex **exceeded everyone expectation and closed at 47500** for Calendar year 2020. From 'aur kitna neeche jayega' to 'aur kitna upar jayega' tells that **in bull markets, we are blind to risks and in bear markets, we are blind to opportunities.**

So with above note, let's understand current market Scenario: Central bankers are pumping in money at a mind-boggling rate of \$1bn+ every hour. Free money led to negative yields (\$18 trillion of global bonds) which led to more equity participation. Stimulus is like drugs! More you give more people wants but finally it take the person either to rehabilitation center or ruin people's life. **Similarly extreme stimulus has worked well on the way in but exiting will prove harder to do & for that the first signs of rising inflation will be a test.** After election result and **Biden win, only green shoot visible is Falling DXY** (Dollar index against basket of 6 developed economy currencies) which will keep the fund flow intact in Emerging markets. Remember, **one can't run a marathon on one leg.**

**March 2020: Use more courage; Dec 2020 onwards: Use more knowledge.**

Valuations don't matter are winning the argument right now. However, **eventually we always realize that "Valuations do matter"**. Over the short run, markets are driven by multiple factors such as **fund flows, headline-grabbing news, and sentiments**. Over the long run, **equity returns are driven largely by fundamentals**. Either earnings will have to go up substantially or markets will have to correct for these overstretched valuations to revert to mean/fair value. **Corporate earnings are slaves to Nominal GDP (GDP + INFLATION)** in long run. With **Nominal GDP growth of 8-9%** one **can't expect 18-20 % earnings growth** to justify current higher valuation.

In a nutshell: **"Fundamentals"** market ko jeene nahi dega aur **"Liquidity"** Market ko marne nahi dega. **Low interest rates** justify high valuations in equities; remember they also **justify low future returns**. Investing at **high valuations** tend to reduce long-term returns and also **increases the probability of making losses** and their extent.



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**Balancing out all above views, here are the numbers:** We have seen in 2020 **price action is two steps ahead of fundamentals. Media focus upon mood** and chase price action but **our major focus is on studying underlying value** through statistical analysis of wide array of valuation metrics. Our valuation implied forecasts indicates that **fair value of Sensex has risen from 33,000 to 37500-38000 (Overweight@ Equity)**. Reason behind for the same is earning growth in last quarter and coming quarter due to pent demand (Demand which was suppressed due to lockdown) and various cost cutting/saving measure across industry.

**Our guesstimate based on internal prop model** tells that **valuation band during – Harshad Mehta scam** (which too driven by liquidity) translates today into **51000-52000** (Best case scenario – **Underweight@ Equity**).

**Action plan for investor:** Focus on minimizing drawdown. **Not losing Capital is more important than not participating in Upside** when markets are in irrational euphoric zone. **Following process** in ups & downs **requires complete detachment from emotions** arising out of Gaining or Loosing. Our internal Model asset allocation (Valuation-based framework) **currently shows 45-50% max towards Equity for Aggressive investor. Ideal/prudent allocation** at this elevated valuation should be **25-30%**. Do not get carried away by looking/chasing quick and easy money. Apply logic and stay cautious.

**Summing it all:** Markets have random environment hence **focus on process, everything else is noise. Sticking to well back-tested strategy** in irrational times yields better experience & outcome over time. Liquidity has helped us to **fly high like aeroplane** but **keep Asset allocation model as Parachute & safety kavach. When cheap: Buy and wait; when expensive: Wait and buy.**

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