ALCHEMY
CAPITAL MANAGEMENT

Investment Matters

May 2018

EQUITY OUTLOOK

Global crude prices stand close to $80 per barrel up 60% over the past 12 months, Copper up 24%, Aluminum up 27%, Steel up 30%+. Commodity prices have been on a tear specially Crude prices. This does pose a risk to inflation expectations going forward globally leading to higher bond yields and expectations of central banks having to raise interest rates thereby impacting outlook on currencies and equity as an asset class. Equity markets have been trading in a tight range for the past 6 months as can be seen in the table below –

Performance of global and regional indices (%)

	Performance (%)				
Name	1m	3m	6m	YTD	1Y
Global and regional indices					
India	5.9	(2.9)	5.1	2.5	16.7
France	5.5	(0.5)	(0.9)	2.7	3.5
UK	5.2	(1.5)	(1.0)	(3.5)	3.0
Japan	4.7	(2.7)	2.1	(1.3)	17.0
Mexico	4.7	(4.3)	(0.7)	(2.1)	(2.0)
Singapore	4.4	1.2	6.0	5.1	12.7
Australia	3.4	(1.4)	0.8	(1.8)	0.5
Germany	3.3	(5.2)	(5.5)	(3.2)	0.5
Korea	2.2	(2.6)	(1.0)	1.3	13.3
Brazil	1.2	1.7	16.2	13.1	32.1
US S&P 500	1.0	(5.6)	3.6	(0.2)	11.9
US Dow Jones	0.9	(7.0)	4.0	(1.6)	16.1
Hong Kong	0.4	(8.1)	7.0	1.0	22.7
Thailand	(0.0)	(2.8)	3.2	1.3	13.4
Malaysia	(0.1)	(0.4)	6.5	3.6	5.3
Shanghai	(2.8)	(11.5)	(9.2)	(6.8)	(2.3)
Taiwan	(3.4)	(5.0)	(2.2)	(0.8)	6.9
Philippines	(3.6)	(12.2)	(8.0)	(10.1)	0.4
Indonesia	(4.5)	(10.5)	(1.6)	(7.0)	4.0
Russia	(8.2)	(10.6)	3.0	(0.7)	2.9

Source: Bloomberg, Kotak Institutional Equities

Corporate India is likely to benefit from a cyclical economic recovery along with higher commodity prices and a depreciating Rupee. As per consensus expectation, earnings growth for the Nifty/Sensex – the benchmark indices – is expected to be higher by 18-20% CAGR over the next 2 years with improving ROE and higher capacity utilisations. Average corporate capacity utilisation has moved higher to 75% from 60% 3 years back. Over the next 2 years this number is likely to be 80%+ driving fresh capital expenditure sustaining the economic recovery cycle for the next 5+ years. Historically India has seen a typical 6-8 year high growth period followed by 5-7 years of weaker economic situation. If profit growth performance delivery is as expected by consensus then we may well be on our way to seeing a strong equity performance over the next 3-5 years. CY17 Nifty delivered an up move of 28.6% on the back of these expectations resulting in valuations moving higher. As we have been highlighting in the past, CY18 is likely to be a year of consolidation, with the investment community looking at earnings delivery closely over the next 2-4 quarters on the back of global macro headwinds in terms of higher commodity prices leading to higher inflation and higher interest rates.

EQUITY OUTLOOK

India is entering into an election phase with important states coming in for a verdict starting with Karnataka in May 2018 followed by MP, Rajasthan, Maharashtra and then General Elections in mid 2019. Fiscal constraints for state and central government is unlikely to allow room for very large capital spending and in fact may get constrained further due to more populism specially farm loan waivers (Karnataka election manifesto for BJP promises a farm loan waiver if they come to power).

We at Alchemy are looking to navigate through this period of consolidation with confidence backed by 30%+ profit growth delivery expected from our investee companies.

Chandraprakash Padiyar

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