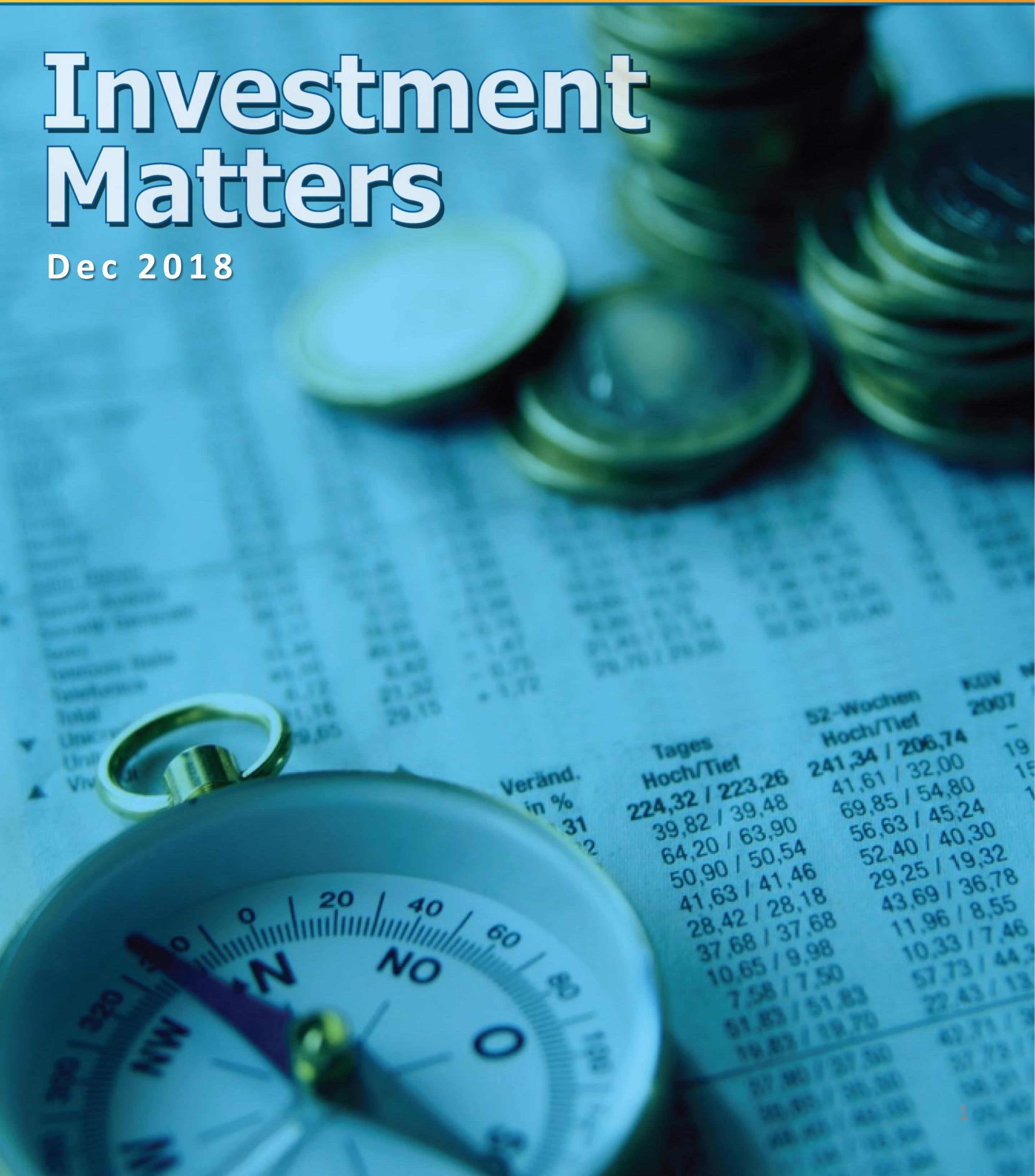
ALCHEMY
CAPITAL MANAGEMENT

Investment Matters

Dec 2018

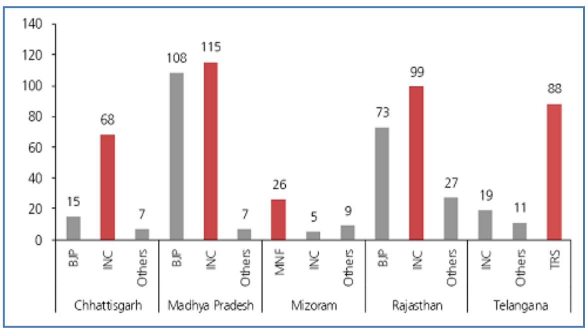


Market Overview

Event-heavy quarter

The Indian markets have seen extreme volatility since September 2018, dominated largely by some major events over the last 1-2 months. It started with the stress on the NBFC sector, triggered by a series of defaults by IL&FS. Once that settled down towards the end of November, two recent events have dominated –

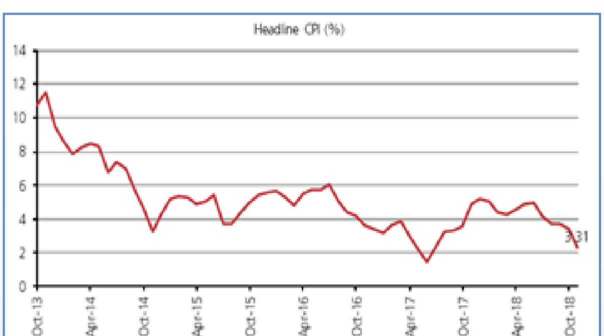
- BJP's loss in three state elections in the Hindi heartland have raised political uncertainty as the outcome of the 2019 general elections is now less clear. There is also the residual worry that the setback in the three states, widely believed to be led by agrarian distress, could prompt a pump-priming response from the government which would strain the fiscal deficit.

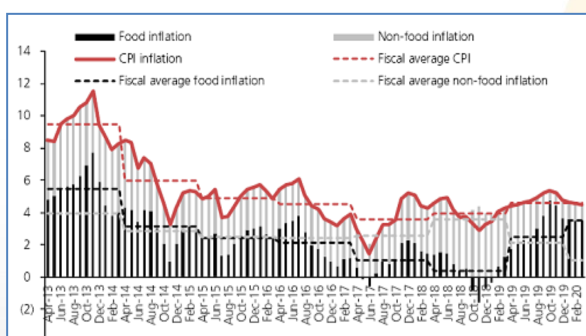


Vote share of BJP and INC, 2013 and 2018 assembly elections and 2014 general elections (%)

	Assembly elections		General elections	Change from	
	2013	2018	2014	2013	2014
Chhattisgarh					
BJP	41.0	33.0	49.7	(8.0)	(16.7)
INC	40.3	43.0	39.1	2.7	3.9
Madhya Pradesh					
BJP	44.9	41.0	54.8	(3.9)	(13.8)
INC	36.4	40.9	35.4	4.5	5.5
Rajasthan					
BJP	45.2	38.8	55.6	(6.4)	(16.8)
INC	33.1	39.3	30.7	6.2	8.6

- Change of guard at the RBI, with Mr Shaktikanta Das swiftly replacing Dr Urjit Patel who resigned abruptly. This raises a question on the independence of RBI as Mr. Das has been a key finance ministry official in the early days of this government. However, the good news is that there has been a significant softening of global crude prices, and inflation is benign at <3%. As a result, the outlook for the macro-stability indicators like the current account deficit and interest rates are now more benign than they appeared in Aug-Sep 2018.





Continued macro uncertainty, with some silver linings

In our earlier newsletters, we have clearly highlighted that the risk of consumption slowdown had increased because of higher crude oil prices and liquidity constraints in the domestic economy. This was also evidenced by the weak festival sales across most categories.

However, the subsequent fall in crude oil prices have resulted in a low inflation trajectory which has created the room for an easier monetary policy stance early next year and hopefully offsets some of the consumption headwinds. In response to the lower inflation data points in recent months, the yields have corrected back towards 7.5% and RBI has recently decided against any rate hike.

Post the new RBI governor's press meet and his discussions with various stakeholders in the banking system, RBI is likely to come out with measures to improve liquidity further in the coming months to push growth.

<u>Global uncertainties – Brexit and USA-China trade dispute</u>

Globally, the Brexit situation continues to be volatile. At the present moment, the possible outcomes span the entire range with diametrically opposite impact on global financial markets. The optimistic view is that there will be a second referendum and Britain stays within the EU. The pessimistic view is that there is a no-deal Brexit.

The US-China trade war also remains clouded in uncertainty. The meeting between President Trump and Premier Xi Jinping in Argentina led to a 90-day moratorium on any further action by both sides, while they work towards a resolution of outstanding issues. The positive development was however offset by the arrest of the Huawei CFO in Canada on Dec 1, 2018. There is still hope that the trade war rolls back by Feb 2019 but the uncertainty still persists.

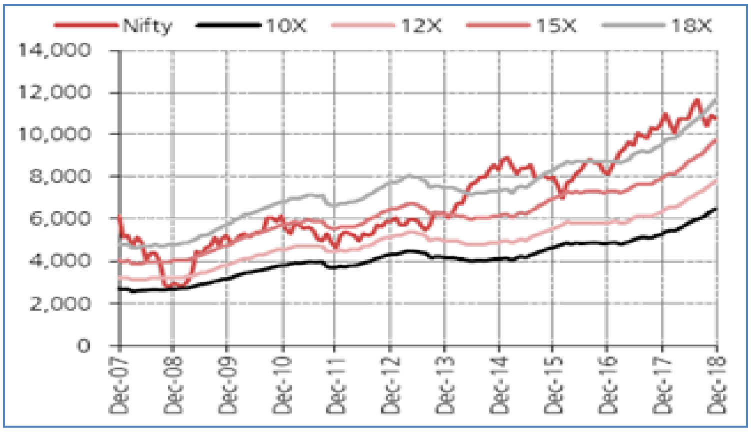
EQUITY OUTLOOK

Cautious approach to the markets

Amidst all these uncertainties and the series of extraneous shocks, the market has broadly remained resilient over the last 3 months. The Nifty is down just 7-8% from the peak, though individual stocks in the financial sector have been affected quite badly. The worst in terms of event-led shocks seems to be over, though macro uncertainties still prevail.

We do not see a runaway rally in the broader market, because of the uncertainties listed above. The aggregate valuation indices remain fair at a P/E of 17x on FY20 estimates, with a high risk of downgrades due to a possible consumption slowdown.

We continue to deploy cautiously in the markets, staggering out our entry points to nullify the volatility in prices. Our philosophy of investing in growth-oriented companies with strong balance sheets and quality managements with a proven track record is reinforced in times of macro uncertainty such as these.



Note-Source for all charts – Kotak Institutional Equities

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