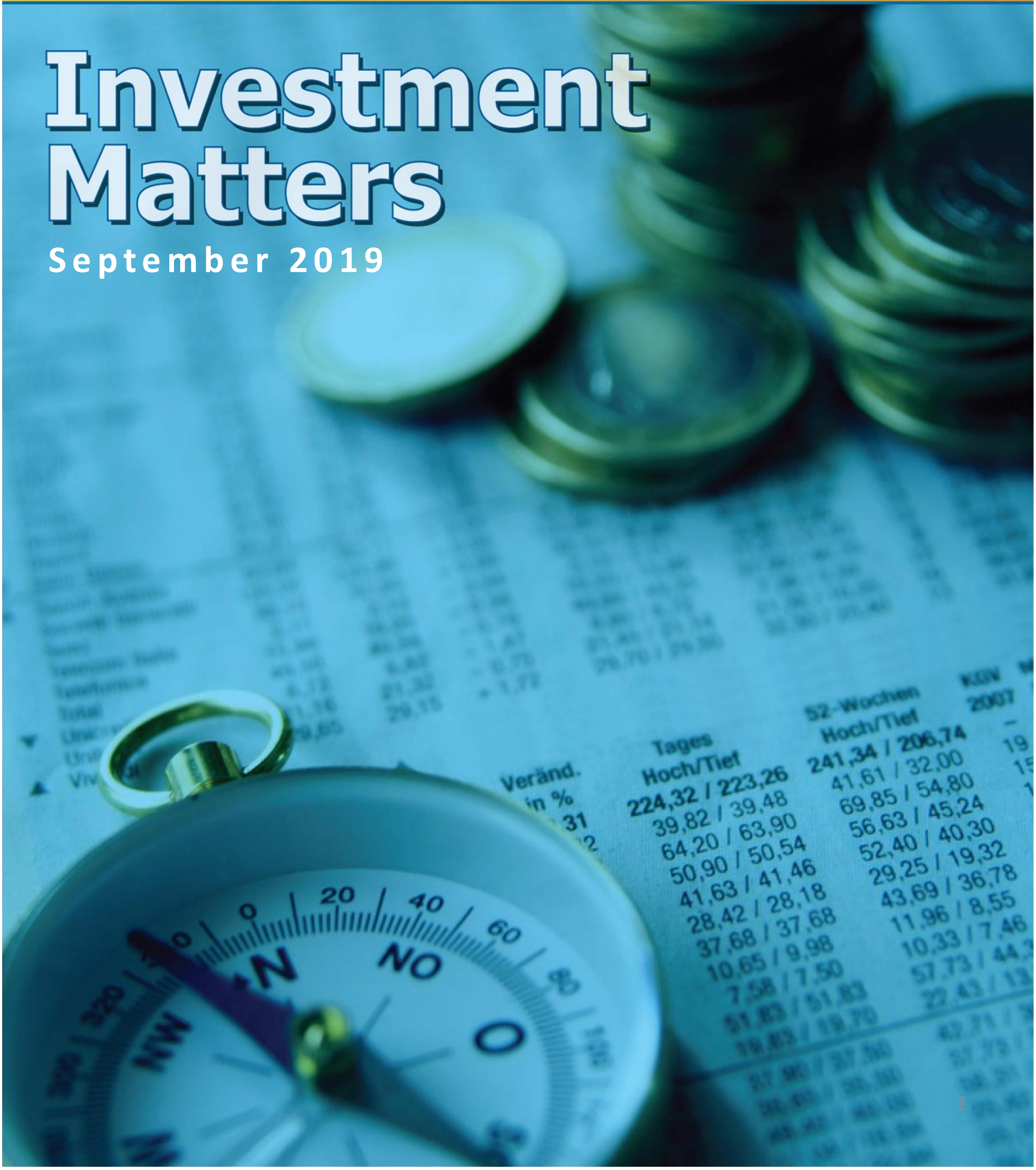
Investment Matters

September 2019



Fear of unknown risks

The 7% correction† in the market (with poor internals) since April 2019 has created a better sync between expectations and reality. The momentum in the economy remains poor and gives little reason for comfort, but some government action has created the hope for a recovery later this year. The risk, however, still comes from unforeseen events, especially with credit incidents like the ones we saw over the last 12-15 months.

Economy and earnings

We lead with the positives, as the negatives have been discussed threadbare.

- Interest rates are continuing to fall, and we expect transmission by the banks to improve in the next 3-4 months of CY19. Deposit rates are already falling, and the banks are cutting MCLR to the extent possible. The external benchmarking of loans should help faster transmission from 4QCY19 onwards. Of course, we do expect the RBI to continue cutting policy rates, given the weak growth impulses and benign inflation.

- The government has responded over the last month with a combination of short-term measures and structural changes. The combined effect of these measures - FPI tax withdrawal, auto sector stimuli, PSU bank recap - may decelerate the slowdown and create the environment for the recovery. We, however, believe that there are not magic bullets in the government's armoury as some market participants unrealistically expect.

- Some stressed credits are slowly getting resolved. We have seen some leveraged groups willing to sell assets to pay back lenders, even if they are the so-called "family crown jewels". In other cases, the banks need to accept the necessary haircuts and the judicial process should reach their logical conclusions. There is still a mountain to climb on this front, but some recent progress is a positive.

- After a slow start, the monsoons have delivered a better outcome than initially thought. The overall rainfall has been normal and kharif sowing is 1.7% below last year. This is a significant relief as rural consumption has been weaker than urban over the last year. A turn in agri sentiment could be a major catalyst.

The silver linings are getting thicker, but the dark clouds are yet to be dispelled. We believe that the stress points persist on multiple fronts.

† - Performance of S&P BSE 500 Index since 31 Mar 2019.
Source : Bloomberg

EQUITY OUTLOOK

- The real estate market is caught in a vicious cycle. Slow sales have put balance sheets under stress, especially in a post-RERA world. This has affected the ability to complete projects and put pressure on existing credit to the sector. Consequently, sales are slowing even further as buyers risk appetite with developers is shrinking. The cycle can be broken with liquidity but the mountain of stressed debts is deterring fresh lenders to this sector.

- Falling interest rates are not transmitting to Lower-rated borrowers, as the bond markets are still in deep-freeze. The multiple credit events have destroyed investors appetite for bonds and pushed up credit spreads. The biggest impact of this is on NBFCs and HFCs, whose loan disbursements are very sluggish.

- The NBFC stress (and other factors) has frozen liquidity to the SME sector. This has cascaded into a demand slowdown across categories, both via lower employment and through slower flow of products through channel pipes. The government and the RBI have stepped in to ease credit flow to the sector. It will take a little time for this to permeate to the weaker NBFCs, who face the bigger challenge.

- The current growth scenario remains weak. Auto sales are collapsing, most consumer categories are witnessing sluggish demand and capital goods companies see very little order-book joy. There is no visible sign of a recovery, despite all the positive changes in lead indicators in recent months.

- The earnings scenario remains challenging. The stress has shifted from the banks to the consumer sector, especially among the discretionary sub segments. Aggregate earnings for the Nifty has remained challenged for some years now, and the continued pressure on the economy has sustained pressure on analyst earnings estimates.

Future risks

The recovery would be hurt by any further credit incidents, like we saw in the last 12-18 months. There are multiple pockets of vulnerability that we worry about

- Real estate: the sector has been very sluggish, and the nature of the business model depends on continuous flow to keep credit healthy. Leverage levels are generally high and this makes the sector vulnerable to accidents.

- Many NBFCs/HFCs have large and lumpy exposure to the Real estate sector. The security could turn very illiquid and, in times of tight liquidity such as this, could impact these balance sheets.

- Promoter leverage has already created a number of accidents in the recent past. The worst should be over, but any more such incidents would trigger a fresh round of credit aversion. The worry is that NPAs from this segment is procyclical with a falling market.

Conclusion

- We remain cautious on deployment and are not accelerating our deployment to any significant degree. We would prefer the macro risks to be priced in better.
- The mid cap correction has given us a larger pool of stocks to choose from. Our bottom-up strategy of building a quality, high-growth strategy does not change.
- The correction in the market has made equities more attractive. Instant gratification is unlikely but longer-term returns have become more attractive now.

Source-Alchemy Research

Seshadri Sen
Head of Research
Alchemy Capital Management Pvt. Ltd

DISCLAIMER

General Risk factors

All investment products attract various kinds of risks. Please read the relevant Disclosure Document / Client Agreement carefully before investing.

General Disclaimers

The information and opinions contained in this report/ presentation have been obtained from sources believed to be reliable, but no representation or warranty, express or implied, is made that such information is accurate or complete.

Information and opinions contained in the report/ presentation are disseminated for the information of authorized recipients only, and are not to be relied upon as advisory or authoritative or taken in substitution for the exercise of due diligence and judgement by any recipient.

The information and opinions are not, and should not be construed as, an offer or solicitation to buy or sell any securities or make any investments.

Nothing contained herein, including past performance, shall constitute any representation or warranty as to future performance.

The client is solely responsible for consulting his/her/its own independent advisors as to the legal, tax, accounting and related matters concerning investments and nothing in this document or in any communication shall constitutes such advice.

The client is expected to understand the risk factors associated with investment & act on the information solely on his/her/its own risk. As a condition for providing this information, the client agrees that Alchemy Capital Management Pvt. Ltd., its Group or affiliates makes no representation and shall have no liability in any way arising to them or any other entity for any loss or damage, direct or indirect, arising from the use of this information.

This document and its contents are proprietary information of Alchemy Capital Management Pvt. Ltd and may not be reproduced or otherwise disseminated in whole or in part without the written consent.

Alchemy Capital Management Pvt. Ltd., B-4, Amerchand Mansion, 16 Madame Cama Road, Mumbai 400 001.
Ph: +91-22-66171700
CIN- U67120MH1999PTC119811, Email ID: contactus@alchemycapital.com