ALCHEMY
CAPITAL MANAGEMENT

Investment Matters

June 2020

EQUITY OUTLOOK

Earnings visibility: moment of truth approaches

The Nifty had been resilient with a 3% correction in May 2020 followed by a 6% bounce in June 2020 (as on 08 June 2020). A clear direction will emerge, we think, only when there is greater visibility on the damage to the economy from the COVD-19 crisis. The next 2-3 months are likely to be critical in assessing this damage. As the lockdown lifts, we will get a better sense of how aggregate demand recovers and what the structural damage to the financial system, labour markets and the SME sector is. Our base case assumption is of a slow recovery through FY21 and possible normalisation in FY22.

Key macro trends

The large part of the lockdown stress is likely to be absorbed in Q1FY21. We believe that we will have to look at the quarterly progression of growth and earnings, rather than the aggregate for the year, as Q1 would be an aberration that would distort the numbers. The key factors we would watch out for are:

- The resilience of the financial system. RBI's early action helped avoid the worst outcomes, but we expect a sharp spike in non-performing loans(NPLs) to hurt capital and impact growth capacity in the sector. In our blog earlier this month (Lending Financials - Medium-Term Challenges) we see financial sector stress as a hindrance to the recovery.

- The humanitarian crisis hitting migrant workers may leave a lasting damage. The reverse migration could be temporary, and workers may start to come back once economy recovers. There is a risk, however, that labour mobility becomes structurally sticky, which would create supply-side bottlenecks and hinder the recovery. It is too early to call but will be a key factor in the recovery.

- The lockdown has left the SME, including the goods transport sector, with deep balance sheet problems. The government's Rs 3 trillion sovereign-guaranteed finance package could alleviate the pain, if successful. The worry is that many SMEs may not actually recover from the stress. This would have a negative impact on supply-side capacity, aggregate demand and blue-collar employment.

- The government has already announced a package, which was long on structural reform but lacked short-term stimuli. We would watch to see if there are further actions from the government, once the pain points become more visible as the lockdown gets lifted.

- The agriculture sector is expected to be a bright spot in FY21. The sector was anyway on an upswing from the strong winter crop of FY20. This is now complemented by far-reaching reform by the government on simplifying agricultural markets, which should cut the intermediation costs and arrest the structural multi-decade decline in farm profitability. This could have far-reaching implications for rural consumption and could throw up a fresh set of opportunities for companies with capabilities in this sector.

Portfolio positioning

The macro uncertainty and lack of earnings visibility continue to drive our cautious stance on portfolio positioning. We are adding, selectively to the portfolio, in companies with strong balance sheets, market leadership and opportunities in the new macro scenario. Our stock selection is generally driven by two underlying strategies:

a) “buy on visibility”- we are waiting till we are convinced on the fundamentals and are unafraid to pay the premium that this strategy entails

b) We are not emphasizing the rear-view mirror – our belief is that many earnings growth and multiples may structurally change for many sectors.

We may continue to hold cash for some time till risks in the system are more compressed.

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Source :
Alchemy Research
Bloomberg

Alchemy view on Market trends, analysis, and way forward; with additional inputs from industry experts about the different aspects to superlative asset management.

1. **Blogs – May & June 2020**
   - Lending Financials - Medium-Term Challenges
     Read More
   - Economic Package – Impact on Markets
     Read More

2. **Interview – May 2020***
   - Where do markets head after the push for an economy booster?
     Mr. Hiren Ved to ET Now

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