ALCHEMY
CAPITAL MANAGEMENT

Investment Matters

March 2021

EQUITY OUTLOOK

Buckle up for a choppy month

We expect increased market choppiness in March after the relentless one-way upswing for almost a year. Some near-term headwinds are building up: rising yields both in India and the US, rising COVID infections and commodity price pressures. This looks like a temporary blip – and we expect normal service to resume in 1QFY22, led by strong flows, economic recovery and earnings momentum. Our approach remains unchanged – we are minimising cash, focusing on quality names that are potential winners in the new economy. We will try to adjust our portfolio to favour cyclicals when the volatility gives us an opportunity. Investors with sub-optimal equity allocations should use any deep corrections to increase their exposure.

Table 1: Mid and Small-Caps Outperform Large-Caps

Performance (%)					
	Feb-21	**1m**	**3m**	**6m**	**1Y**
Major Indian indices					
Sensex	49,100	6.1%	11.2%	27.1%	28.2%
Nifty	14,529	6.6%	12.0%	27.6%	29.7%
CNX-100	14,668	6.7%	12.1%	27.6%	29.6%
CNX-500	12,181	7.8%	13.6%	30.0%	31.9%
Mid-cap and Small-cap Indices					
BSE Mid-cap	19,979	10.5%	18.1%	36.3%	36.8%
BSE Small-cap	20,155	12.0%	19.4%	40.6%	47.0%
CNX Mid-cap	23,269	11.3%	18.0%	39.5%	38.6%
CNX Small-cap	8,050	12.2%	22.5%	44.0%	41.8%
Nifty-Mid-cap 50	6,797	13.2%	22.3%	46.6%	50.4%

Table 2: Energy & Banking Indices Outperform the broader markets

Performance (%)					
NSE Sector indices	**Feb-21**	**1m**	**3m**	**6m**	**1Y**
CNX Bank	34,804	13.9%	17.5%	46.5%	19.4%
CNX Auto	10,170	3.6%	14.4%	29.7%	47.3%
CNX Realty	350	14.4%	33.9%	57.0%	24.7%
CNX Infrastructure	4,110	11.9%	20.0%	29.9%	36.5%
CNX Energy	18,793	16.3%	15.6%	20.4%	37.7%
CNX FMCG	32,443	-2.0%	2.3%	6.0%	10.7%
CNX Pharma	11,928	-2.0%	0.7%	7.7%	57.4%
CNX IT	24,301	-1.4%	11.7%	35.5%	59.7%

Source: Bloomberg

Near-term challenges

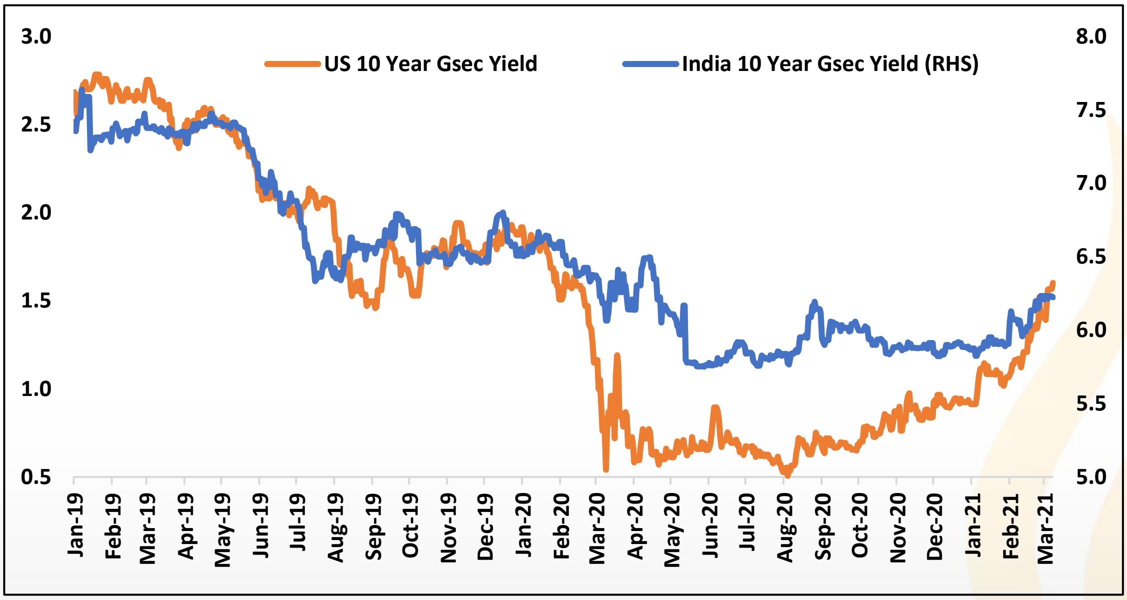
Rising yields

Long-term gilt yields have spiked, both in India and the US. Though they are part of similar narratives, they pose differing risks to Indian equities.

- The stress in the domestic bond market is escalating. The frequency of failed gilt auctions has intensified in recent weeks and the stress has spilled over into the corporate bond market. We think this is temporary. The RBI is trying to manage yields while market participants, especially banks, are wary ahead of the March year-end. This is likely to be a temporary phase and the market should settle down in a few weeks, albeit with yields moving higher.

- Rising local yields has twin impact a) squeezing private borrowing costs and slowing growth and b) hurting bank balance sheets. We are, however, far away from any of these risks crystallizing, especially because short-term rates have remained soft. Banks have also been cautious with their investment books and have enough cushion to deal with potential losses in their bond books. Private borrowing costs are unaffected, as was evident from banks cutting home loan rates in the same week as bond yields spiked.

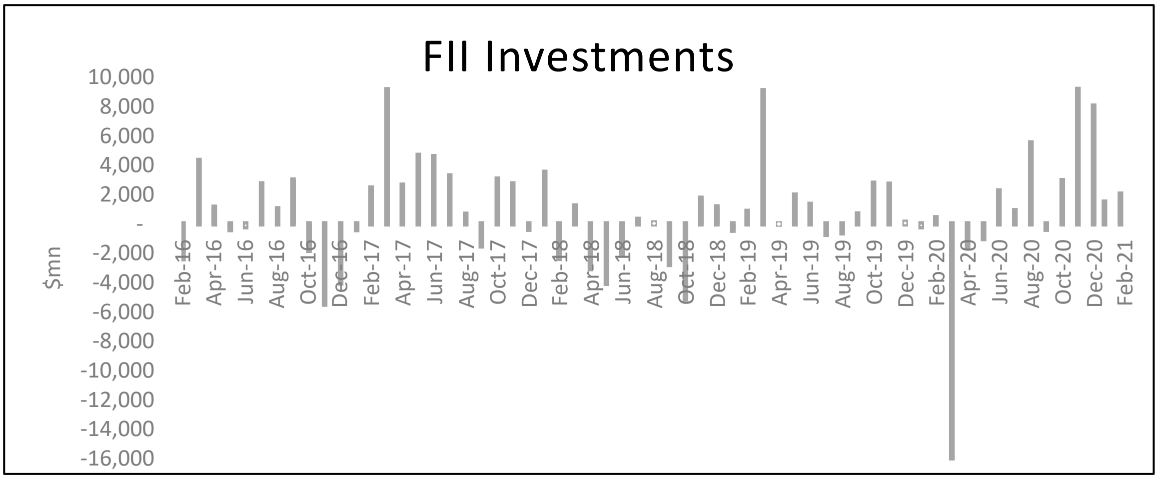
Fig 1: India and US bond Yields



Source : Bloomberg

- Hardening US yields could hurt flows to emerging markets and India, and that is a large potential risk to the markets. We, however, take comfort from the US Fed remaining steadfastly dovish, which would negate the impact of rising yields and sustain the capital flows. After months of sustained flows, a few weeks of disruption is unsurprising and does not indicate a trend reversal.

Fig 2: Capital Flows to India



Source: Bloomberg, Spark Capital

Covid worries

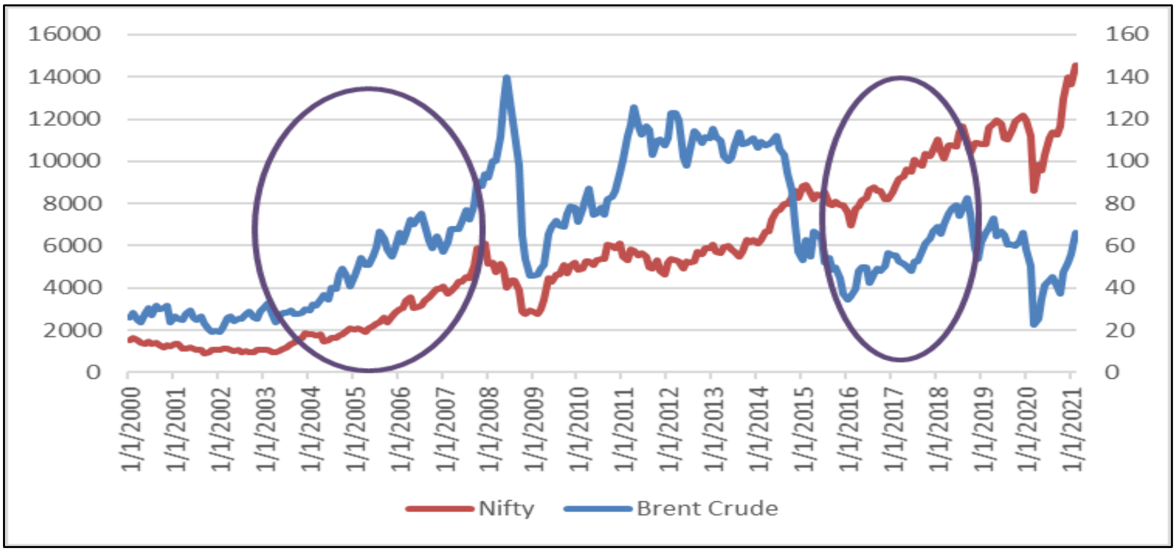
There has been a spike in Covid cases in some states like Maharashtra. This is a worry, given the "second surge" in some Western countries. We, however, think that there are mitigants. The new surge seems to be less lethal with a larger share of asymptomatic cases. The government response has also been more measured and a total lockdown looks unlikely. There could be some short-term impact on consumption and delay in the recovery in some service sectors, but we do not see the macro recovery getting disrupted. The increased pace of vaccination implies that we are not very far away from a return to full normalisation in the post-Covid era, likely in 2HCY21

Commodity price pressures

Commodity prices have been surging through this period and are now starting to make a significant impact. For India, the biggest worry is crude. We are not yet at the level that could destabilise India's macro, but persistent crude prices in the US$80-100 range would pose a challenge. There are some offsets, however. India's current account deficits are still benign, even adjusting for the low GDP growth in recent years. Moreover, the government has remained disciplined about passing on the rising crude prices to consumers (perhaps excessively so) to limit the impact on the fiscal deficit.

Inflation will be affected, but the RBI is indicating that it will not rush to tighten until it believes the pressures are long-lasting. Historically, Indian equities have been resilient to rising crude prices in the early stage of the cycle but reverses beyond a "tipping point".

Fig 3: Crude and Nifty: a non-linear relationship



Source: Bloomberg

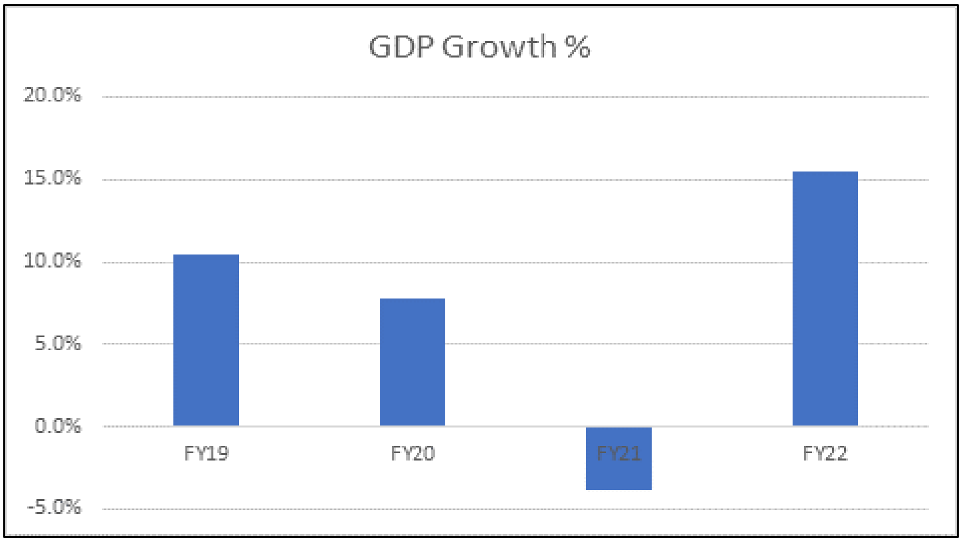
The India story remains strong

Despite these challenges, we remain constructive on the Indian markets. The short-term disruptions are unlikely to hinder the number of long-term drivers that are in play.

Economic recovery

The economy has bounced back from the post-COVID lockdown and the momentum is likely to sustain. As we have discussed earlier, we see a continued K-shaped recovery for the next few quarters driven by improved consumption from the relatively affluent segments. The growth should become more broad-based by FY23, as the capex cycle kicks in – helped by expansionary fiscal policy, global growth, and the turnaround in India's real estate cycle. The elevated FY22 growth (from a low-base effect) is likely to convert into strong momentum and we see India sustainably grow at 6%+ from FY23 onwards. Low cost of capital, higher government capex, and sustained consumer demand creates the platform for continued high growth.

Fig 4: GDP Growth



Source: Kotak Economics Research Estimates

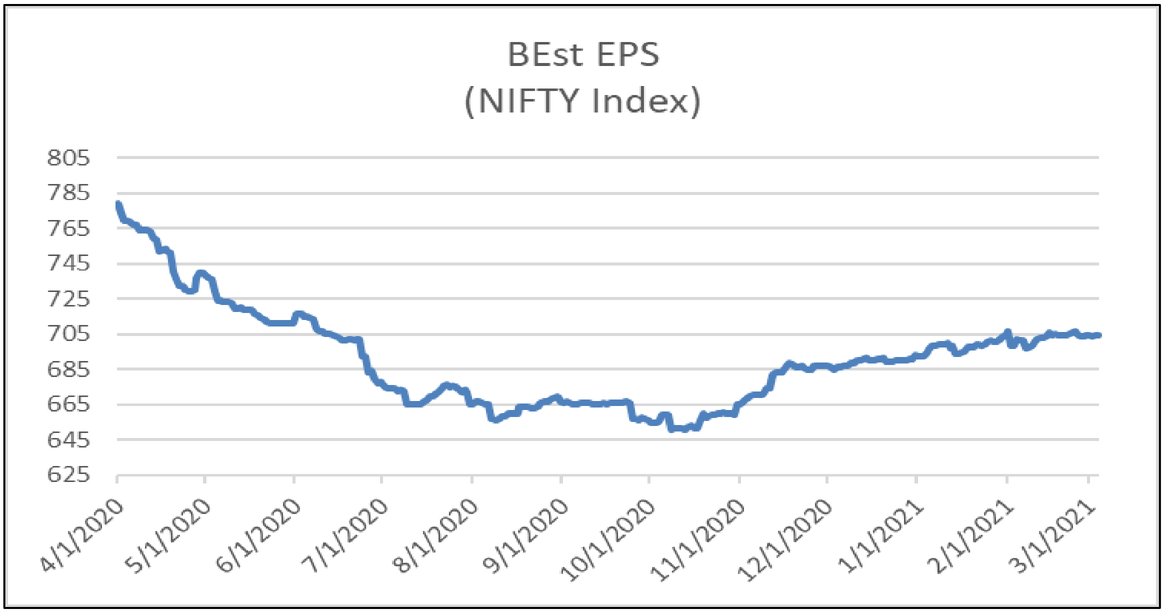
Structural reforms

The FY21 budget, announced on 1 Feb, heralds the beginning of a new stage of structural reforms. The government had already started off liberalisation in key sectors like labour and agriculture immediately after the lockdown. The budget took that to the next level with a comprehensive privatisation plan, which included banking. This is accompanied by increased support to domestic production. The new economic philosophy was reinforced by the Prime Minister's repeated statements on the objective of getting the "government out of business". The combined effect gives the government fiscal headroom to continue a sustained capex programme and helps unlock macro productivity by privatising inefficient assets. Of course, the execution on these, especially privatisation, will take some time but the markets will start to discount this early. We see the potential for India to get a greater share of emerging market flows as the reforms take shape.

Earnings upgrades

A common concern on Indian markets is that the previous decade saw a sustained PE rerating without any significant earnings growth. That could change in the coming years – we are already seeing many cyclicals showing signs of a recovery. The consensus Nifty EPS for FY22 has been upgraded by ~4-5% since October and FY23 growth is also looking robust. The recovery is being led by cyclical sectors such as select financials and industrials, and we think that it is the beginning of a multi-year earnings recovery.

Fig 5: Robust earnings upgrades for Nifty



Source: Bloomberg

Constructive on markets

We remain watchful but see no reason to change our overall approach to the markets. Our strategy remains built on these principles:

- We are minimising our cash holdings and are deploying fresh money as quickly as possible.
- We remain focused on high-quality companies with strong or improving balance sheets, proven market leadership and execution, robust return on capital and healthy free cash flows.
- We are increasingly focusing on cyclical sectors. If the markets correct meaningfully in the coming weeks, we will use the opportunity to realign our portfolios further towards cyclicals.
- We continue to be mindful of potential risks at both company and stock level; and will move quickly if the risk-reward trade-offs turn adverse.

Seshadri Sen
Head of Research
Alchemy Capital Management Pvt. Ltd

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 – Feb 2021

- A Growth-Stimulating Budget

  Read More

2. Interviews – Feb 2021*

- It's a pro-growth budget; domestic sectors to do well

  Mr. Hiren Ved to CNBC TV-18
- Budget 2021: Growth focus will take care of problems

  Mr. Hiren Ved to Bloomberg Quint
- Sensex surpasses 52,000-mark for the first time; stay invested in these sectors

  Mr. Hiren Ved to money9
- Panel Interview - Fund managers on whether this is the best decade for wealth creation

  Mr. Hiren Ved at PMS AIF World Summit 2021

3. Market Views – Feb 2021*

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*Hyperlinks to other websites made available here are to be accessed at the sole risk of the user; the content, accuracy, opinions expressed, and other links provided by these resources are not investigated, verified, monitored, or endorsed by Alchemy.

Q3FY21 Performance of Portfolio Companies

The following table summarizes the performance of portfolio companies** in Q3FY21 :

Stock	Sales (Rs Mn)			EBITDA (Rs Mn)			PAT (Rs Mn)		
	Q3FY21	Q3FY20	% chg	Q3FY21	Q3FY20	% chg	Q3FY21	Q3FY20	% chg
ABB India LTD*	1,701	1,953	-13%	103	138	-26%	62	64	-4%
AIA Engineering LTD	6,987	6,941	1%	1,723	1,729	0%	1,554	1,560	0%
Avenue Supermarts Ltd	74,327	67,519	10%	6,914	5,931	17%	4,703	3,943	19%
Bajaj Auto Ltd	87,301	74,364	17%	17,296	13,672	27%	15,563	12,616	23%
Bajaj Electricals Ltd	15,001	12,839	17%	1,475	673	119%	982	94	945%
Bajaj Finance Ltd	42,958	45,349	-5%	29,062	29,999	-3%	11,460	16,132	-29%
Bajaj Finserv Ltd							10,956	11,256	-3%
Bayer Cropscience Ltd	9,182	8,540	8%	1,060	1,603	-34%	-451	1,379	-133%
Britannia Ltd	31,061	29,360	6%	6,115	5,020	22%	4,526	3,726	21%
Deepak Nitrite Ltd	12,347	11,199	10%	3,350	2,583	30%	2,166	1,567	38%
Delta Corp Ltd	1,208	2,051	-41%	185	860	-79%	13	551	-98%
Divi'S Laboratories Ltd	17,014	13,963	22%	6,912	4,939	40%	4,706	3,591	31%
Dixon Technologies Ltd	21,828	9,938	120%	1,005	515	95%	616	263	134%
Eicher Motors	28,283	23,710	19%	6,720	5,923	13%	5,012	4,821	4%
Garware Technical Fibres Ltd	2,784	2,358	18%	582	381	53%	432	289	49%
HCL Technologies Ltd	193,020	181,350	6%	54,420	44,700	22%	39,810	30,380	31%
HDFC AMC Ltd	4,819	5,247	-8%	4,988	4,809	4%	3,693	3,526	5%
HDFC Bank Ltd #	237,608	208,422	14%	151,860	129,454	17%	87,583	74,165	18%
HDFC Life Insurance @	21,570	18,260	18%	50,510	42,360	19%	2,600	2,500	4%
HDFC Ltd #	48,837	1,25,219	-61%	43,465	121,380	-64%	29,258	83,725	-65%
Hindustan Unilever Ltd	116,820	96,960	20%	28,540	24,450	17%	19,210	16,160	19%
ICICI Bank Ltd #	145,987	131,193	11%	88,198	75,486	17%	54,896	41,465	32%
ICICI Lombard General Insurance $	41,117	36,143	14%				3,135	2,941	7%
IndiaMart Intermesh Ltd	1,735	1,649	5%	877	436	101%	801	627	28%
Info Edge (India) Ltd	2,723	3,205	-15%	682	1,059	-36%	699	880	-21%
Ipca Laboratories Ltd	14,098	12,129	16%	3,669	2,737	34%	2,676	1,975	35%
JB Chemicals	5,482	4,286	28%	1,710	873	96%	1,541	663	133%
Kotak Mahindra Bank Ltd #	53,408	47,710	12%	30,828	23,881	29%	18,538	15,959	16%
L&T Infotech Ltd	31,084	28,111	11%	6,590	5,274	25%	4,661	3,767	24%
L&T Technology Services Ltd	14,007	14,229	-2%	2,756	2,863	-4%	1,861	2,041	-9%
Maruti Suzuki Ltd	222,367	196,491	13%	22,261	21,021	6%	19,414	15,648	24%
Max Healthcare Ltd	10,860	10,130	7%	2,520	1,600	58%	1,350	400	238%
Multi Commodity Exchange Ltd	1,009	893	13%	487	392	24%	718	556	29%
Nestle India Ltd *	34,175	31,307	9%	7,536	6,630	14%	4,833	4,730	2%
Pidilite Industries Ltd	22,990	19,266	19%	6,408	4,632	38%	4,418	3,418	29%
Reliance Industries Ltd	1,179,000	1,533,000	-23%	216,000	227,000	-5%	148,000	118,000	25%
Sundram Fasteners Ltd	11,087	8,225	35%	2,305	1,267	82%	1,427	1,042	37%
Syngene International Ltd	5,845	5,191	13%	1,762	1,535	15%	1,022	918	11%
Tata Consultancy Services Ltd^	420,150	398,540	5%	111,840	99,740	12%	87,010	81,180	7%
Tata Consumer Products Ltd	30,696	24,930	23%	3,613	3,181	14%	2,182	1,693	29%
Tata Elxsi Ltd	4,771	4,234	13%	1,436	942	52%	1,052	754	39%
Tata Motors Ltd	146,306	108,429	35%	8,497	-526	NA	-6,308	-10,395	NA
Titan Company Ltd	72,870	62,062	17%	8,580	7,356	17%	5,560	4,699	18%
Trent Ltd	7,254	8,697	-17%	1,800	1,735	4%	797	557	43%
United Breweries Ltd	12,897	14,533	-11%	1,735	2,208	-21%	1,264	1,064	19%
United Spirits Ltd	24,887	25,825	-4%	3,838	4,240	-9%	2,299	2,588	-11%
Varun Beverages Ltd *	13,309	12,202	9%	1,722	1,157	49%	-197	-593	NA
V-Mart Retail Ltd	4,700	5,622	-16%	1,038	1,168	-11%	479	582	-18%

Source-Alchemy Research

* indicates CY end - So Q3FY21 = Q4CY20
# indicates Net Interest Income + Other income, Pre-Provision Operating Profit and PAT for banks
@ Indicates Annual Premium Equivalent (APE) and Value of New Business (VNB) for life insurance companies
$ Indicates Net Written Premium and PAT for general insurance companies
^ Sales EBIT and PAT
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Alchemy Capital Management Pvt. Ltd (SEBI Regn No:INP000000365) |B-4, Amerchand Mansion|
16 Madame Cama Road| Mumbai 400 001.
URL: www.alchemycapital.com |Email ID: contactus@alchemycapital.com | CIN-U67120MH1999PTC119811