ALCHEMY
CAPITAL MANAGEMENT

Investment Matters

October 2021

Markets Continue to Rally

The markets were strong through September 2021 with a 2.8% rally in the Nifty led by Nifty Realty, Auto and Infra. Small- and mid-caps had a strong month with 2x returns over the broader markets (see table below). The focus now shifts to domestic financial stability and the opening-up of the economy against the backdrop of the upcoming earnings season. We remain positive on the broader markets and see cyclicals and opening-up trades as the key drivers. In the short term, however, there could be some volatility, but any correction would be a time to buy.

		Performance (%)			
	Sep-21	**1m**	**3m**	**6m**	**1Y**
Major Indian indices					
Sensex	59,126	2.7%	12.7%	19.4%	55.3%
Nifty	17,618	2.8%	12.1%	19.9%	56.6%
CNX-100	17,845	2.7%	11.8%	20.5%	56.7%
CNX-500	15,053	3.4%	11.7%	22.2%	61.1%
Mid-cap and Small-cap Indices					
BSE Mid-cap	25,253	5.9%	12.1%	25.1%	71.7%
BSE Small-cap	28,082	4.3%	11.3%	36.0%	88.9%
CNX Mid-cap	30,384	6.9%	12.7%	28.2%	78.9%
CNX Small-cap	10,890	6.1%	11.9%	34.2%	87.0%

Source: Bloomberg

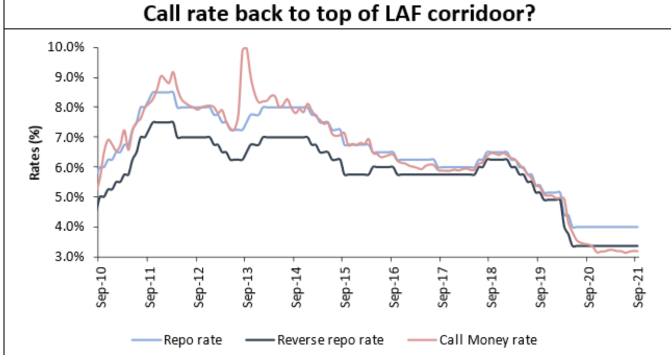
		Performance (%)			
NSE sector indices	**Sep-21**	**1m**	**3m**	**6m**	**1Y**
CNX Bank	37,425	2.7%	7.6%	12.4%	74.5%
CNX Auto	10,598	5.6%	0.0%	7.5%	34.0%
CNX Realty	514	32.8%	49.4%	53.8%	142.5%
CNX Infrastructure	5,025	6.7%	15.8%	22.9%	63.1%
CNX Energy	22,859	12.7%	15.3%	25.7%	52.1%
CNX FMCG	40,427	2.3%	12.0%	15.7%	35.5%
CNX Pharma	14,467	0.8%	1.1%	17.9%	22.9%
CNX IT	35,028	1.3%	20.1%	35.5%	75.6%

Source: Bloomberg

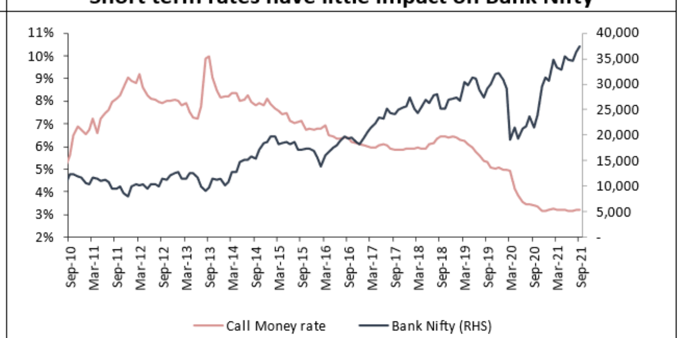
RBI "tightening" – too early to worry

Given the sticky inflation, there have been increasing calls for the RBI to absorb excess liquidity while holding rates steady. This would push up short term interest rates and partially flatten the yield curve. We see little risk to growth or overall financial stability from such a move. Effective lending rates to borrowers are not likely to be affected, except for short-term instruments like commercial paper that form a small part of the overall pie. The move may actually improve margins for banks sitting on excess liquidity.

Call rate back to top of LAF corridoor?



Short term rates have little impact on Bank Nifty



Short term rates could rise, flattening yield curve

We see little risk to the rupee

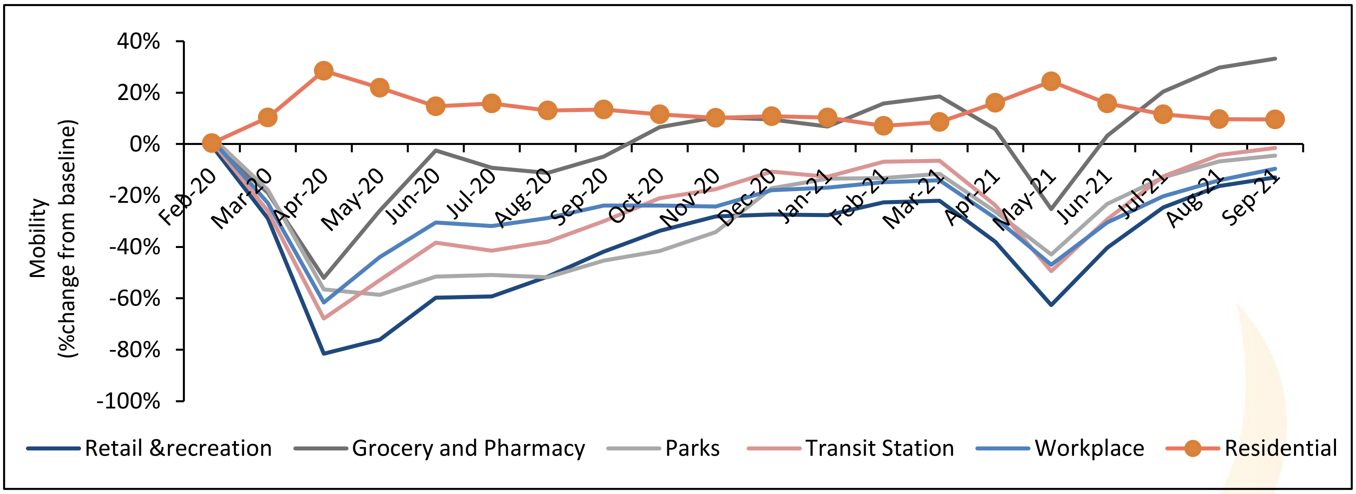
Source: Bloomberg, Ambit Securities

However, there could be a knee-jerk negative reaction in the markets to such an RBI Announcement, with financials and property most vulnerable. We think this would be short-term and the markets would quickly bounce back, once it becomes clear that the growth momentum is unlikely to be derailed. We believe that domestic financial conditions will remain benign and see little risk to growth or the currency. We would use any correction to add to our exposures in these sectors.

The normalising economy

High-frequency indicators reinforce the anecdotal evidence that the economy is improving as the opening-up gathers pace. The steps by various states to gradually ease the lockdowns (school reopening is a big step) is driving this momentum. While we are still below pre-covid levels in many segments, we feel it's a matter of time before normal service is resumed on the growth front.

High frequency data: Strong momentum but still below pre-Covid levels



Source: Ambit Capital

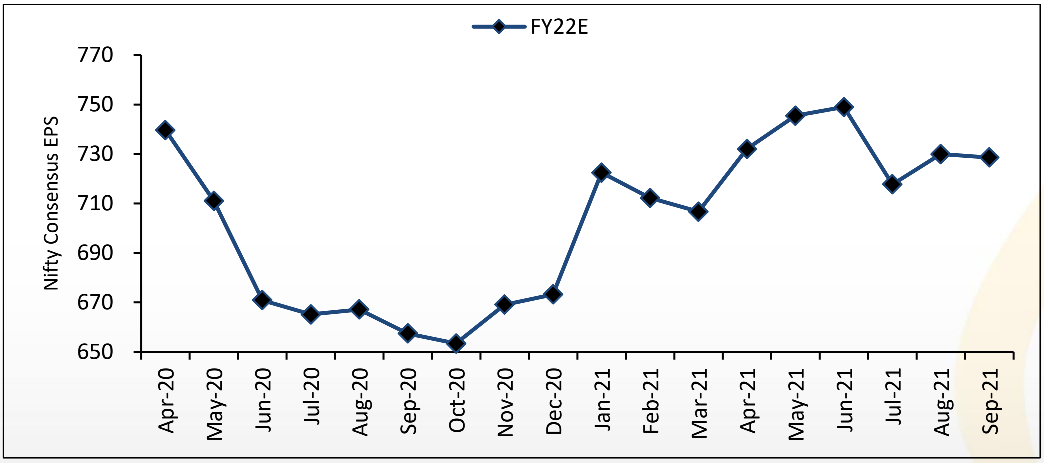
One worry we have been flagging is the impact of the second wave on consumer sentiment and consequently, demand. The good news is that anecdotal evidence suggests that the reverse could happen and there is a possibility of a surge in "revenge buying". The coming festival season will give us a clearer picture of the demand recovery, but companies seem to be optimistic of a strong festival season. Some of this optimism is in the price after the recent sharp rally in sectors like hotels, airlines, and consumer durables. This may be a short-term overhang but the high-quality companies in these segments remain attractive. We expect market leaders to gain share, having survived the post-Covid downturn at the expense of the laggards.

Earnings season – look out for margins

The 2QFY22 earnings season starts next week. Our key thoughts:

- Topline growth will be strong on a base effect from a weak 2QFY21. In line with the broader economy, however, sales are still lagging pre-covid peaks in many sectors. We are not worried about this, as the rate of change and momentum is a better indicator of future trends than absolute levels.
- We expect margins pressures to continue. Key input commodity prices have remained strong, and companies have been unable to pass this on to consumers for fear of disrupting the demand recovery. Other avenues of cost reduction were largely exhausted in FY21, and the only offset is from operating leverage, which is likely to play out in 2HFY22. Industrial companies are better off as it is easier to pass on costs in a B2B format. Consumer companies should face another quarter of soft margins.
- Management commentary will be important. The companies will have strong visibility on festival season demand when earnings announcement comes through
- The earnings upgrade cycle for FY23 could take a pause for a few months. Most of the post-pandemic recovery has been priced in and the earnings season is unlikely to give greater insight to the street on FY23 earnings. We expect the next round of earnings revisions to commence in early CY22, driven by the extent of the demand recovery, the consequent operating leverage, and the direction of commodity prices.

Earnings upgrade could take a pause



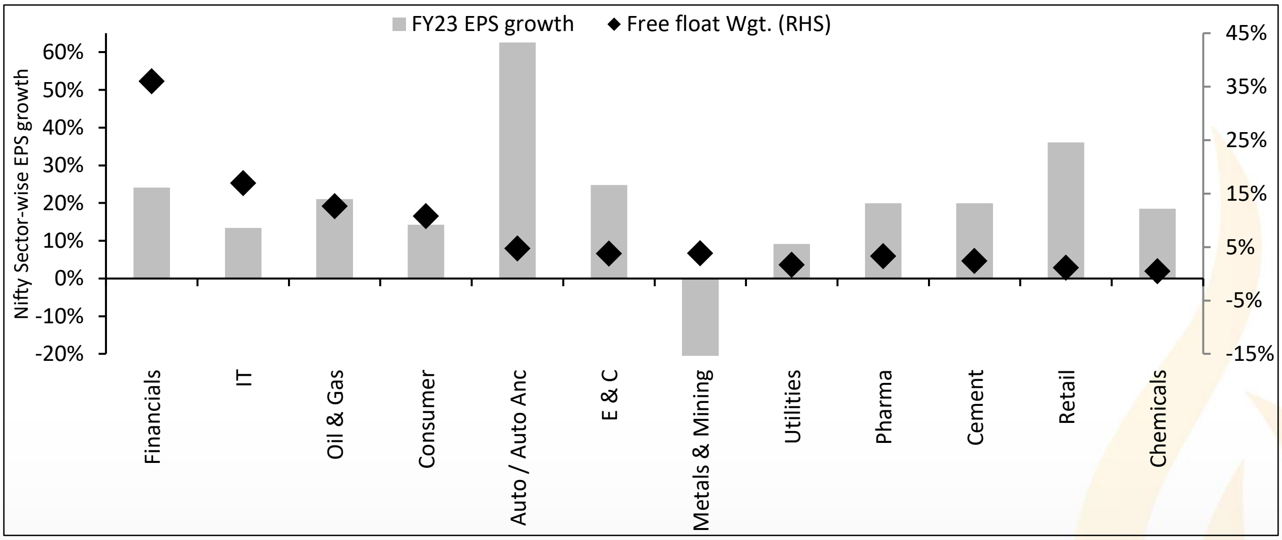
Source: Ambit Securities

Positive on markets

Our overall portfolio stance remains unchanged. We are minimising our cash positions and deploying fresh inflows as quickly as possible. Our focus remains on three broad sector groupings:

- **Cyclicals,** as we believe that the capex cycle, both government and private, will play an important role in the broader macro recovery. Cyclicals are coming out of a multi-year underperformance cycle and the surviving companies are now much leaner on costs and balance sheet structures. This trade is here to stay for some time.
- **Opening up**, as the economy recovers, companies that have suffered during the lockdown – travel and tourism, high-contact services, consumer durables – should benefit disproportionately. They will also benefit from survivorship – the stronger players who have emerged relatively unscathed from the lockdown are likely to gain market share.
- **Exporters,** as the global recovery is likely to be an extended one with government and central banks erring on the side of caution before they start tightening. That, coupled with China cooling its export engines, will benefit Indian companies and we see that flow through to multiple sectors like IT, pharma, chemicals, and auto ancillaries.

Autos, retail, and E&C driving FY23 EPS g



Source: Ambit Securities

EQUITY OUTLOOK

We believe that investors should not try and time this market and correct any under-exposure to equities. There may be corrections but those are difficult to anticipate – in the meantime, opportunity losses could erode long-term returns.

The biggest risk is a third wave of the pandemic. That would extend the pain for high-touch companies and put balance sheets under stress. It may also change priorities for all economic agents – government, consumers, and companies. The continued roll-out of the vaccine and the relatively low level of fresh cases have kept those fears at bay, but it remains a key risk that we are watching out for.

Seshadri Sen
Head of Research
Alchemy Capital Management Pvt. Ltd

Source:
Alchemy Research
Bloomberg

MARKET INSIGHTS

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

1. Market Views : September 2021

Market Views - September 2021 - YouTube

2. Blogs – September 2021

Reform Momentum Accelerates

Read More

3. Interviews – September 2021*

- Mr. Hiren Ved in an interview with CNBC TV18 : Mr. Hiren Ved to CNBC
- Mr. Hiren Ved in an interview with ET Markets : Mr. Hiren Ved to ET Markets
- Mr. Seshadri Sen in an interview with Money9 : Mr. Seshadri Sen to Money9
- Mr. Hiren Ved on Paisa Vaisa , IVM Podcast | The Alchemy Capital Special (Podcast) : Mr. Hiren Ved on Paisa Vaisa

*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.

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