

TURTLE STAR

Equity outlook (May 2018)- INVEST FOR 3 YEARS AND NOT COMING 12 MONTHS

As we always say stock prices are slaves of earnings. Earnings of companies are dependent on both macro as well as micro factors. Over long periods of time, stock prices track the profit growth. However in short period of time say 3 years or 5 years, stock prices can exhibit erratic movement and prices are never in equilibrium with the earnings growth. Stock prices either lead or lag the earnings growth. We are now in May 2018, almost one year away from the general election of 2019. Let us go back 5 years and wear those shoes again and re-think our thought process then i.e. in May 2013. There was all-round pessimism, the pink papers would carry headlines of scam after scam, each new scam would be bigger in magnitude and scale as well, eg:- Telecom scam, Coal scam, Common Wealth Games Scam etc etc.

There would not be any light visible at the end of the tunnel, it was all-round gloomy situation and that in hindsight turned out to be the best times to buy stocks. The only ray of hope that entire country had was in form of Mr. Narendra Modi coming to power in 2014 and the perception carried out was that with a magic wand in his hand, he would cleanse the entire country of all types of sorrow. The markets started to build optimism and rallied ceaselessly, as is exhibited in the table below, the Sensex has appreciated by 76% in the last 5 years, whereas its profits has grown by a meager 19%, if this is not surprising the mid-caps has delivered a return of 159% v/s a profit growth of -1% and hold your breath the small cap has ballooned by 192% on the back of a negative profit growth of -32%, yes read again, its negative profit growth.

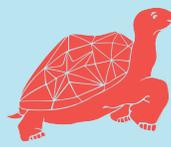
Index	Price Date	Index Levels	5 years ago	Index levels in 2013	% Change	PAT % Growth in 5 years
BSE Sensex	3/26/2018	33,066	March 2013	18,836	76	19
BSE Mid-Cap	3/26/2018	15,881	March 2013	6,142	159	-1
BSE Small-Cap	3/26/2018	16,923	March 2013	5,805	192	-32

What does all this mean? It means stock markets will not deliver returns like it did in the last 3 years in the coming 12 months. Back again in 2014, apart from Mr. Modi coming to power and changing sentiments, the macro too turned out to be favourable. Crude continued its southward journey as if there was no tomorrow, both current account deficit and fiscal deficit gave elbow room for government to take bold decisions. Currently, macro is deteriorating. Currency too is depreciating, interest rates are rising both in global markets and are close to its bottom in the domestic markets as well.

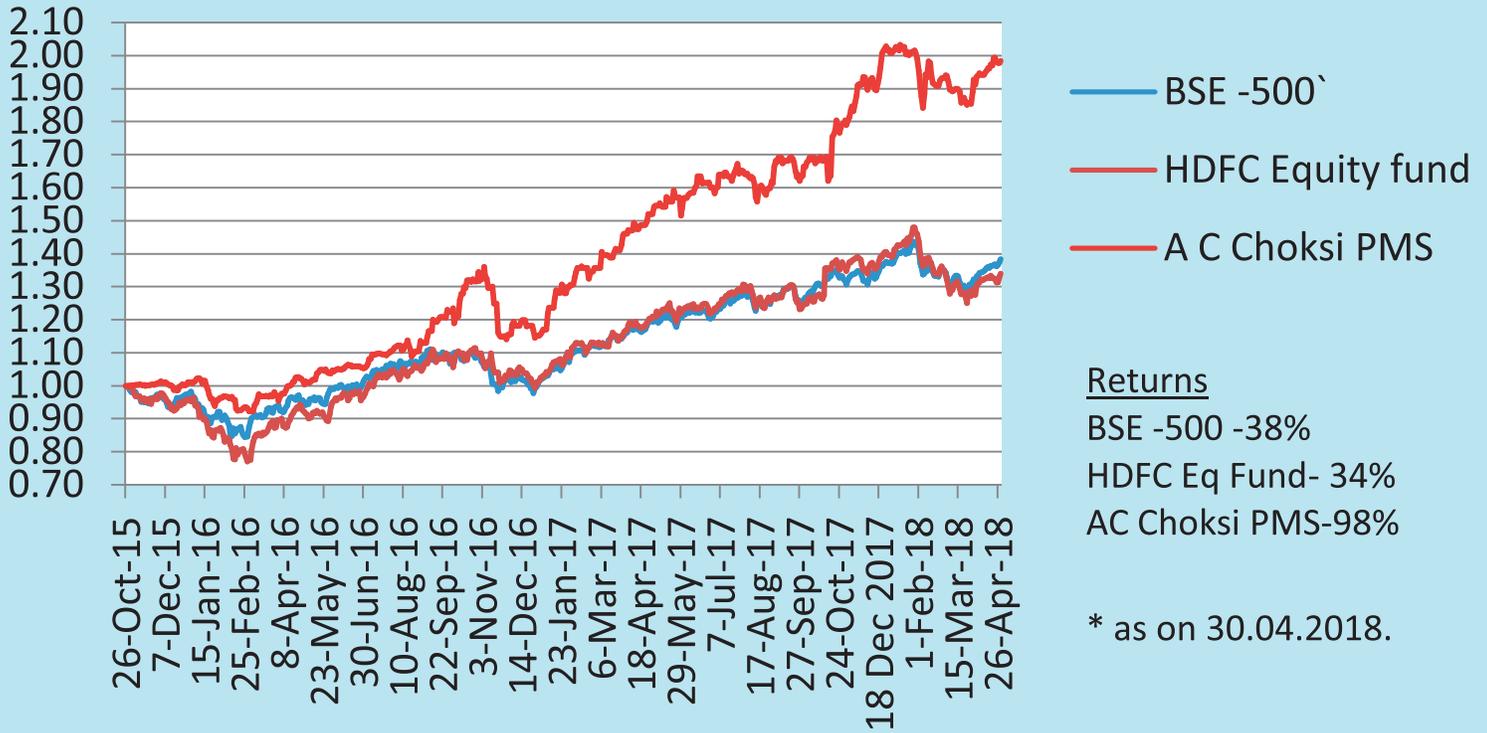
The big takeaway is that prices have run ahead of the earnings growth that it merits. Sentiments could change due to various factors or time correction could happen. However the extreme column on the right hand side in above table is likely to change from now on. The sagging problem for lack of earnings growth was slowdown in the business cycle. Indian business cycle was used to cash economy and demonetization put a spook in the wheel. Transition to GST mode of taxation was another shock for the industry. However both of them are moves in right direction to improve the health of the economy. Also finally we are seeing resolution of the NPA problem via the NCLT route. All of these will improve the much sagging earnings growth in the economy without doubt, but since the run-up is ahead of fundamentals, there could be time or price correction. Since the health of the patient is improving all of the noise that will lead to correction should be **bought into** NOT FROM 12 MONTHS BUT FROM 3 YEARS POINT OF VIEW – Country needs Mr. Modi for another term.

Happy Investing !!!

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