Equity Outlook (January 2019) –

"One can't predict – One can prepare"

As we end 2018 and step in 2019 – one thing we learn is that equity returns cannot be extrapolated from recent past. 2017 was a year that showcased one of the best returns and consequently made people bullish or let me say greedy and obviously 2018 taught all of us a lesson. The bigger question is what do we make of 2019?

In stock market there is one prime approach and that is to identify stocks based on its fundamentals – the simple thing to do is understand business, management and take a view on how the business will shape up and take a call on how the earnings of the company will grow in foreseeable future with reasonable certainty.

The second approach is an add-on to the first one, wherein value of the business is determined and if the stock is available at a price that is lower than its intrinsic value, then it calls for a buy. So fundamentals and valuations are two basic approaches to investing in stock markets.

I would like to add a third tenant to this whole aspect. Let us call it the market cycle. It is about understanding the near term events that can have an impact on the overall sentiment, thought process and / or the liquidity that drives the stock prices. So we need to adopt the following step by step approach, First to make list of events that can have an impact on the markets, Second gauge the certainty on the outcome of the event and if the event is not predictable then thirdly assign probability to the outcome of the event. Fourth try to estimate the impact on the markets for each scenario and fifth make a list of actionable in each of the scenario.

What is written above might sound bookish or difficult to understand so as usual let me make it simple and put in simple words what I want to say. First, the two big events for 2019 are going to be deleveraging in the developed countries and consequently tightening of money supply and second event will be the election in the month of May 2019. Second we need to gauge the outcome of the event, obviously since global money supply will reduce, FIIs will be seller in world market in 2019 as well – that is almost certain, what is not certain is the outcome of domestic election. Third we need to assign probability to different scenario, given today's environment, Mr. Modi might manage to come through with support of allies to the PM. Scenario 2 – we have a hung parliament and an unexpected coalition takes the centre-stage, in that case markets could correct to lower levels.

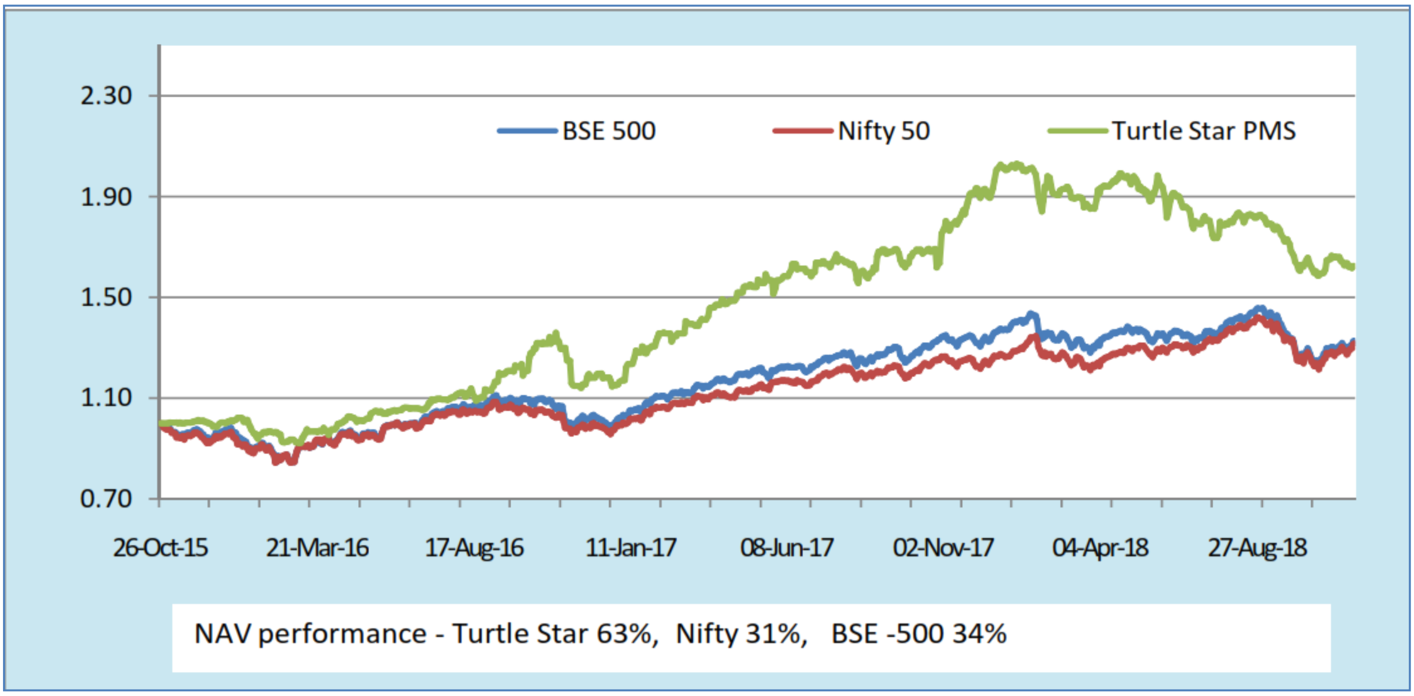
Forget about upside or the best scenario – let me take a look at downside or the worst scenario – based on earnings growth, valuation parameters, liquidity, available of alternate investment opportunities etc, I would say the low levels in the pre-election scenario can be utmost 32000 on the Sensex and in the post election scenario – with the worst of outcome it could worsen to utmost 29000. **I AM NOT SAYING THAT BOTH THESE LEVELS WILL COME – ALL I AM SAYING IS THAT THOSE LEVELS ARE THE WORST THAT CAN HAPPEN THE BEST CAN BE ANYTHING ON THE UPSIDE.**

Seeds of bull run are sown, when earnings cycle are on an upswing, there is fear in the markets, market participants are conscious of risk and prices especially of midcaps (down 17% in CY 2018 and Smallcaps down 33% in Y 2018) and small caps haven't moved to high levels. We are poised for great 2019 albeit with volatility. Time to be cautiously greedy than fearful. We agree that Auto and Auto Ancillary is our favorite investment theme and so we have our ears to the ground, we currently believe that in the short term say a quarter or so, all types of loans including auto loans could get impacted and that will reduce the off-take for auto and consequently 3Q could dampen their performance. As we always say it is important to differentiate between price and value likewise it is important to differentiate between structural and cyclical factors. We believe that it will have a short term impact and we shall use the liquidity created in the portfolio to invest in such market opportunities.

From entire team of TURTLE STAR - Wishing all our investors and readers a Happy 2019 and wishes that new year provides a platform to make us a better human beings…

Sunil Shah

Portfolio Manager, Turtle Star.



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