Equity Outlook (August 2019)

Dear all – Stock market investment and returns are always from the investment horizon perspective. The biggest selling point for investment in stock market in comparison to any other asset class is that equity generates cash flows and the underlying asset namely the companies grows in profits over a period of time. These two basic assumptions calls for investment case towards equities in comparison to other asset class like gold, fixed deposits or real estate or commodities etc.

As usual we shall talk basics,compare the basics with the environment prevalent today and then make an assessment in the future. The first point is that companies generate cash flows, by cash flows it means cash flows from operations and not cash flows from financing and investing. In the current situation companies that were using all the tricks in trade to window dress the numbers by creating doctored document are facing impossible task of finding relief in the stock markets. There are also companies which acted hand in glove with these borrowers and they too are in the soup as we converse. We would call these set of companies the painful ones and the prices of these companies are taking a trip southward and will find an uphill task to come back again. Every bear markets throws up such names – few such stalwarts in early 1990s were names like Karnataka Ball Bearings, Mazda, Lan Eseda etc, in 2000 – 2001 – there was the famous pack of K-10 stocks – DSQ, Silverline, Pentafour and the likes, in 2008 – there were lot of Infra, Real Estate Companies like Era construction, unitech, DB Realty etc. Now we shall see the pain across sectors who borrowed heavily and lenders who lend them recklessly. These set of companies are in the permanent pain zone. This is affecting consumption, investments, exports, capital expenditure across the country.

There is another set of companies that are going through a turbulent time but the pain is cyclical in nature. There is lack of demand but the business inherently is not wrong. There are companies in sectors of Autos, FMCG, Metals, Cement etc. These companies are seeing significant price correction however it is due to slowing demand in the economy and the prices shall come up when the economy revives. The big question is when shall the economy revive (We shall touch upon this later)

The third category of stock is the ones in the comfort zone. These would include companies whose price does not correct significantly and they are large liquid companies and are absorbing most of the liquidity that comes in the markets. Eg – Bajaj twins, HDFC twins, MNCs etc. However these companies are currently richly valued in the markets.

The next and the last zone is the one in which opportunities are available. There are companies that are currently going through the process of NCLT and over the next 1 to 2 years, these set of companies would see change of management. This to our mind is an opportunity, we need to look at ideas where the business was inherently strong but giving the financial debacle, the company faltered and is now in safe hands. We need to look at this set of companies as the prices of this universe is beaten out of shape and can provide an opportunity for investments.

The big question is when the sentiments shall change. We believe that the price correction across the board has been significant. Once we see 10 + cases getting resolved in the NCLT ambit, the sentiments could change. As we speak we have been seeing new NPA spring up every second day but none of them getting resolved. The funnel of NPA is getting the dirt daily but it is clogged at the other end. With resolution of few NPAs in the next 2-3 months and money actual flowing to banks, it will mark a change of an era. Bad Assets will become good assets. This aspect would help change the sentiments. Also another statistical parameter that we track wherein equity yield shall be better than bond yield the day 10 year G-Sec falls below 6% or an approx 5% price correction happens in Nifty. This would indicate time to be overweight equity. This situation makes the broader markets attractive purely from a valuation perspective. For indications of trend reversal to happen, attractive valuation should be coupled with change in fundamentals, we believe resolution of few NCLT cases would act as a lead indicator of changing economic situation. We believe both these events of (Attractive Equity yield and NCLT resolution) is poised to happen in next few months, till that time markets could see final round of capitulation happen soon. There have been reasons to be unhappy as well, the recent budget announcement of tax on the super rich, also incremental tax on FPI has seen an outflow of over $ 2 Bn in July alone. The slowdown in the economy along with FPI sell off is even keeping the value investor at bay.

The cash flow of companies would change from bad hands to good hands and once the new management comes in and NPAs get resolved at an economy level, equity again would be an asset class to invest in. However as we say we are going through a transition and as usual change is permanent but is painful too. We are sipping in ideas we like and reducing exposure in companies we dislike.

Warm Regards

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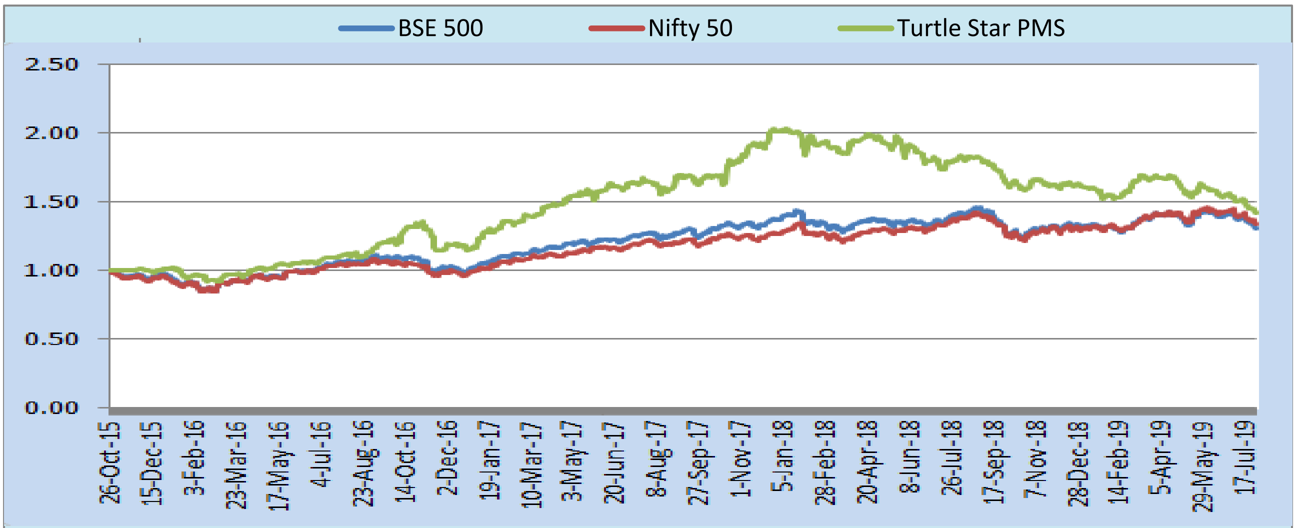

NAV performance - Turtle Star 42%, Nifty 34%, BSE -500 31%

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