

From the CIO's Desk

September 2018

ENAM ASSET MANAGEMENT



Dear Investor,

It gives me great pleasure to share with you an update for the quarter ended 30th September 2018. The last quarter has been very volatile and has been a very challenging quarter in the year so far. India's market capitalization has come down from Rs. 1.51 trillion as on 31st December 2017 to Rs. 1.44 trillion as on 30th September 2018. While this decline of 4.53% in the absolute market capitalization of all listed stocks looks very nominal, it does not fully reflect the decline of 18.83% in the mid-cap index during the same period. The headline indices do not reflect the total loss in value of select mid cap shares. This problem got further compounded in the beginning of this fiscal when SEBI went ahead and provided the mutual fund industry with a classification of what can be defined as micro, small and mid-caps. A lot of fund houses had to re-jig their holdings across several capitalization ranges which led to a sharp sell-off in the micro, small and mid-cap shares in the last six months.

India has witnessed a steep reversal of the macro-economic tail winds that it enjoyed about a year ago. In fact, it has been caught in a global crossfire between the U.S., Iran and China. The Trump administration's decisions to put sanctions on Iran has meant that Iranian crude oil has moved out of the market causing a severe shortage of crude oil in the global market. This phenomenon has caused crude oil prices to spike up by over 20% in the 6 months period ended 30th September. Further, intense trade wars between the U.S. and China have sent jitters to many developing countries across the globe. Trade negotiations between several countries, that have happened over the last few years through the WTO, have been dismantled overnight. There is an environment of mistrust and insecurity that has engulfed global trade.

Apart from rising crude oil prices, the other macro headwind facing all emerging markets has been the hike in interest rates by the U.S. Federal Reserve. This has resulted in FII outflows from most of the emerging markets. This reversal of flows has led to a

sharp decline in almost all the emerging markets currencies in CY 2018. The worst performing currency has lost over 50% against the US\$. The Indian Rupee (INR) too has not been spared from this carnage and has depreciated by over 13% v/s the US\$ in the nine-month period ended 30th September. In CY 2017 the INR appreciated by 6.1% v/s the US\$. In CY 2018, apart from a strengthening US\$, rising crude oil prices have resulted in a steep depreciation of the INR and a widening Current Account Deficit (CAD).

At this point in time, the Indian economy is going through a very challenging time. All macro-economic parameters are showing signs of stress. In response to this change in the outlook, The Reserve Bank of India (RBI) has effected 2 rate hikes of 25 bps each in June and August 2018. With rising crude oil prices, higher inflation, higher CAD and a depreciating INR, the RBI could further increase the repo rates by 50 bps before 31st March 2019. This will surely result in the feel-good factor vanishing from the economy. Further, these macro headwinds are bound to lower the growth forecast for the second half of FY 2018-19.

The credit market is suddenly facing a liquidity squeeze with the non-availability of funds to the Non-Banking Finance Companies (NBFC) sector. This has set the cat amongst the pigeons with a panic amongst investors who have lent funds to these NBFC's on a short-term basis. There is a mismatch between the assets and liabilities profile of many of these NBFC's resulting in a temporary liquidity crunch. What has further compounded the problem is the default on its interest and principal repayments by The Infrastructure Leasing and Finance Limited (ILFS). ILFS's operations are said to be very complex with over 350 subsidiary companies in its fold. The government has recast the board of ILFS and is trying to resolve the issues at hand but it will surely take some time before we see light at the end of the tunnel as the ILFS group is said to have borrowed a sum of over Rs one lac crores.

With this sharp deterioration in the macro economic outlook, equity markets have witnessed a sector rotation with leadership being assumed by more defensive companies in industries such as software services, consumer discretionary, etc. In the last quarter, the stock market has been very polarized with a handful of stocks responsible for the headline indices being maintained at elevated levels. Over the last nine months, Foreign Institutional Investors (FII's) have been net sellers of equities to the tune of US\$ 2 Billion. During the same period, Domestic Institutional Investors (DIIs) have invested over US\$ 12.19 Billion into the equity markets. The domestic retail investors have been investing through systematic investing plans (SIPs) wherein markets are witnessing regular

inflows. FII's have also withdrawn a sum of US\$ 7.10 Billion from the debt markets so far in CY 2018 thus causing further pressure on the INR.

The government will be under pressure to maintain its fiscal deficit target for FY 2018-19. The CAD for September appears to be lower than in August despite higher crude oil prices in September. The INR could settle in the range of Rs. 72 to Rs. 74 to the US\$. There is no respite from higher fuel prices at the retail level. Going forward, inflation could stay above the comfort zone of the RBI resulting in the possibility of another 50-bps hike in repo rates. Unfortunately, the hike in retail fuel prices has come nearer the time of five state elections and a general election in April-May 2019. The sentiment on the ground is not very positive for the NDA government.

Like I mentioned in my last quarter's letter, the markets are a bit nervous about the upcoming elections both at the state and centre. It is getting very difficult to predict the outcome of the general elections in April-May 2019. The FII's focus has now shifted on the next government and its priorities. Foreigners are waiting for a stable political environment and are waiting on the sidelines to further invest in Indian equities. There are a lot of global funds that could be invested in India post the general elections as both the markets and the INR have depreciated sharply. This surely augurs well for fresh allocations to India. The period after the general elections could see a massive run up in the equity markets as by then India's macro situation could get better with valuations already at compelling levels.

We at Enam AMC have followed a consistent investment strategy without any deviation from the same. Our results validate our thought process which has helped us to deliver superior results over extended periods of time. Any under performance in the short term should not worry us if the fundamentals of the underlying stocks in the portfolio are strong and the outlook of each of the businesses is bright. As a team, we do take cognizance of the macro trends but as bottom-up stock pickers our attention is always on the micro opportunities ahead of us. We believe that in the long term a well-balanced portfolio is the right way forward rather than a portfolio which rides on momentum.

Our investment style of having a concentrated portfolio of not more than 20 stocks with a high active share built on a strong conviction backed by a sound research process is the only way for us to deliver superior returns over the long term. In this mayhem, our team is focused on picking winners and considers the current turmoil as an opportunity rather than a threat.

The current turmoil resembles many such periods that our country has witnessed in the past. India is an inherently strong economy that rides out of all these crises and emerges even stronger. Our growth is not because of our politicians but is despite our politicians. We are an internal economy unlike many other developing economies that are heavily dependent on exports. The last few years have seen India undergo some major reforms. The most important of all reforms has been the introduction of The Goods and Service Tax (GST). This has still to play out fully and will result in the emergence of a strong organized corporate sector. The resolution of bad loans via the auctioning of assets through the NCLT is another positive step that will play out in the years ahead. Some of these landmark reforms are setting a strong foundation for a bright future. We should not let the current turmoil cloud our minds and create doubts about the future which we believe is very robust.

As mentioned in my earlier letter to you, FY 2018-19 would be a very volatile year for the economy and the equity markets. Selective sectors and companies are expected to report strong earnings growth. There could be a sectoral rotation which could mean that money will move from a slow growth sector to a high growth sector. Having said that, we at Enam AMC believe in a de-risked philosophy and would not like to go overboard on any one single theme. While your portfolio is concentrated with less than 20 stocks, it is also well diversified across different themes. We believe there is enough opportunity across different sectors, companies and themes such as secular growth, savings, consumption, cyclical recovery, global outsourcing and cost-efficient commodity producers. Thus a balanced approach will help us preserve and grow your capital in these challenging times.

We continue to position your portfolio to benefit from the emerging trends. We remain confident that the Indian economy will be resilient to some of these challenges and will continue to grow well. Your portfolio is well positioned to capitalize on the next phase of growth and should deliver superior returns over the next 3-5 years. My team and I, continue to focus on a bottom-up approach for stock selection with well researched and deep conviction ideas. We continue to ensure that any new addition to your portfolio complies with our approach of investing in high quality businesses that are structurally well positioned and led by able management teams with superior execution capabilities to deliver superior returns on a sustainable basis. We are convinced that the Indian market will continue offering many such opportunities that will be highly rewarding.

Attached, please find a detailed portfolio summary and performance for the quarter ended 30th September 2018. In case you require any further information on your portfolio our team will be available to attend to the same.

Warm Regards,
Jiten Doshi
Co-Founder & CIO

Disclaimer:

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