From the CIO's Desk

June 2020

ENAM ASSET MANAGEMENT

Dear Investor,

It gives me great pleasure to share with you an update for the quarter ended 30th June 2020. We continue to live in challenging times with very little respite from Covid-19. The lockdown in India from 25th March to mid-June helped in reducing the spread of the pandemic. As soon as the lockdown was lifted across the country, we started witnessing a spike in Covid-19 cases. This is one of the biggest challenges that the Government is trying to cope up with. There are no immediate solutions but the option for a second mass scale nationwide lockdown is surely ruled out. Of course, as I write to you, there are selective cities like Bengaluru, Chennai and Pune which are still under a lockdown. The pandemic has changed everyone's life and things will never be the same again. As on 30th June 2020, the number of cases positively tested and active cases were 2,20,478, the number of patients recovered so far were 3,47,839 and the total deaths stood at 17,409. While these are the numbers released by the Government, it should be noted that many persons who are positively infected have not been tested so far. The only bright spot within this gloom is that the pandemic has not spread like wildfire in many small towns and villages which remain isolated and unaffected. In fact, in certain small villages there is not even a single case of the pandemic detected so far.

Globally, the US, Brazil and Russia are the top 3 countries with the maximum number of positively infected Covid-19 patients. India is the 4th largest country in terms of the number of Covid-19 positive tested patients. The USA is amid a major crisis with nearly 3 million persons tested positive with Covid-19 so far. There is no respite in some of the countries as the people are not strictly observing disciplinary measures to fight the virus. We believe that every pharma company globally is working day and night to discover a vaccine or some sort of cure for this virus. Even though efforts are in full swing for commercializing a vaccine, we believe it is at least 12 months away before we can see a vaccine available in mass scale. There is a fear of a second wave in the US which is the major cause of concern. If this second wave does not happen then we could be out of the pandemic in a big way by December 2020. Even after the pandemic is over, we will see a big change in consumer habits and behavior. We are now witnessing a shift in behavior from extreme panic to extreme caution before a definitive cure.

There is a very big disconnect between investor behavior in the stock markets globally and with what is happening on the ground. Though the immediate near -term ground reality spells doomsday for the quarter gone by, there is a strong belief that the worst period is behind us. From now on there will be visible improvement in the economy, quarter after quarter, with an expectation that things will get back to normal in the quarter ending 31st March 2021. FY 2020-21 would be a year in which the GDP would shrink by 5% to 10% which is something India has never experienced for decades. The important thing to note here is that the worst quarter for the GDP de-growth would be April to June 2020 which is now behind us. From here on, there will be strong sequential improvement every quarter. Industries such as hospitality, aviation, organized retail, multiplexes, outdoor sports, conferences and events will take some more time to recover while manufacturing and other service industries will see a faster improvement. Since the pandemic has not hit rural India that badly, we are witnessing a sharp demand in rural India as compared to urban India.

The Government has announced a lot of economic packages and measures to help the small and medium scale industries which were worst hit since the lockdown was announced on 25th March 2020. Further, the Reserve Bank of India (RBI) eased the liquidity by introducing Long Term Reverse Repo (LTRO) Operations to ease the liquidity available to all corporates. Unfortunately, the RBI extended the moratorium available to borrowers by three more months from 31st May to 31st August. The extension of this moratorium has led the banks to take a very cautious view with most banks parking their surplus funds with the RBI under the reverse repo window. This has led to the risk averse banks depositing approximately Rs 6,00,000 crores of their surplus liquidity with the RBI. In the meanwhile, the RBI has cut the repo rates by a further 40 bps to 4% with and the reverse repo rate by 65 bps to 3.35%. This has eased the pressure on new loans availed but has not seen much of a rate reduction transmission from the banks to their existing borrowers. Further, liquidity for the small and medium scale sector players has not eased which is a major hurdle being faced by them. In response to the tight liquidity conditions, The RBI has announced several measures like LTRO, TLTRO, CRR cut, MSF borrowing, Refinancing of Nabard, etc. We believe that the interest rate reduction is structural in nature. We believe that interest rates could be further cut ruling out any rate hike in the foreseeable future. The real impact of lower interest rates will get fully reflected in the FY 2021-22 corporate results.

The Covid-19 pandemic is the second such shock faced by investors, the first being the Global Financial Crisis in 2008. This being the second such shock has made investors react with greater maturity as compared to the past. Domestic investors have reposed great faith in the market, and we have not witnessed large scale sell off by the domestic HNI's or retail investors. On the contrary, the monthly mutual fund flows have not seen any major decline with investor SIP's continuing to be positive. Foreign Institutional Investor's (FII's) who were net sellers to the tune of US$ 6.60 Billion for the quarter ended 31st March became net buyers to the tune of US$ 3.65 Billion in the quarter ended 30th June 2020. During the same period, the Domestic Investors poured in US$ 10.13 Billion into the markets for the quarter ended 31st March and US$ 1.70 for the quarter ended 30th June 2020. For domestic investors there are a few investment choices left with fixed income yielding very low interest rates and real estate now a forgotten asset class witnessing a perennial decline. Investors are taking a long-term view of equity as an asset class and are gradually increasing their allocations towards this asset class. While the economy will take some time to come back to normal, it is a general belief that this will happen 3-4 quarters down the line. We believe that most investors believe that FY 2020-21 earnings are a total wash out, but FY 2021-22 will witness a strong bounce back. Results season for the second quarter ending 30th September will be over by mid-November 2020 and by then investors would start discounting FY 2021-22. We believe that markets are already factoring a very healthy bounce back in earnings in FY 2021-22.

There is very little visibility to make any predictions at this juncture, but India's fiscal deficit is expected to be over 5% - 6% for FY 2020-21. The good news is that for the first time in many years we have had a trade surplus in June 2020 as our exports exceeded our imports. For the quarter ended 30th June 2020, India's trade deficit was US$ 9.12 Billion as compared to a trade deficit of US$ 45.97 Billion during the corresponding period in the previous year. During the quarter ended 30th June, the INR has been stable against the US$ witnessing a depreciation of just 0.30%. This was primarily due to lower crude oil imports which were to the tune of US$ 9.75 Billion v/s US$ 27.26 Billion during the corresponding period in the previous year. If things continue this way, then we will surely see a distinct improvement in the trade deficit.

The commodities sector has been one of the worst hit sectors witnessing a sharp decline in commodity prices. The CRB Index tracking commodity prices is down by 9.24% on a yoy basis. Crude oil prices which have averaged approximately US$ 58 for FY 2019-20 is expected to be in a narrow range of US$ 40-45 for FY 2020-21. The average crude oil prices in the last quarter were US$ 31.44 as compared to an average price of US$ 68.53 during the corresponding period of last year. This is a very sharp decline of over 54% which is very good news for India's subsidy bill, CAD and fiscal deficit as India imports over 70% of its crude oil requirements. The only bright spot has been precious metals with gold prices recording a sharp surge. Gold prices have surged to US$ 1781 on 30th June 2020 as against US$ 1410 on 30th June 2019 recording a significant rise of over 26% yoy. Gold prices have been very strong and is reflective of investors loss of faith in the US$ due to the aggressive printing of the US$ by the Federal Reserve. The US$ being the reserve currency of the world, has not depreciated much against other major currencies as the Central Banks of these countries too have resorted to printing more currency. The only hedge against a weak currency is gold and hence gold prices have been on the rise.

The Fed's stimulus packages running into Trillions of Dollars will surely have an impact on the fiscal deficit and long-term inflation in the US. There is ample liquidity in the system and with negligible or negative interest rates in some countries, this liquidity is bound to look for higher returns. In such periods of heightened liquidity and low interest rates, equities are the biggest beneficiary with stocks being re-rated across the globe. This additional liquidity coming from the stimulus given by the Governments and the Central Banks will find its way into emerging markets and will surely help lift these markets. In the quarter ended 30th June, the MSCI World Index has rallied by over 18% signaling that liquidity has overtaken fundamentals. India has been a big beneficiary of this global liquidity which has been gushing into the primary and secondary markets. In India, Reliance Jio has raised nearly US$ 20 Billion, Kotak Bank over US$ 2 Billion, Bharti Airtel over US$ 1 Billion and Glaxo Smith Kline over US$ 4 Billion by selling their holdings in Hindustan Unilever. These are signs of a very strong investor appetite with foreigners wanting to eagerly participate in the India growth story.

While the long-term outlook for India continues be very bright, there are many short-term challenges which will take some time to overcome. This disruption has created huge unemployment in the services sector. Further, small and medium scale businesses especially in the unorganized sector will witness massive displacement. While many sectors will witness a sharp decline in demand, the leaders in that sector may not be that badly affected. With the exit of small unviable and weak players, there will be massive opportunity for the big players to become even bigger. This could be a once in a life-time opportunity for the large organized players to acquire market share which they have been attempting to do for a long time. Most of the companies in your portfolio stand to gain from this trend and will demonstrate strong growth in FY 2021-22.

The world is now divided into 2 parts – Pro China and Anti-China outsourcing. Many large companies from Japan, EU and the US have started the process of de risking their supply chains by building alternate sources of supply from other nations. While many Asian countries are vying for a slice of the pie, India does feature in the list of countries which are attractive for setting up a manufacturing base as India offers a huge domestic market along with being a stable outsourcing destination. The possibility of a long-term shift and enhanced FDI into India is now a reality but will happen on a gradual basis. We believe this trend will only help Indian manufacturers to rapidly scale up their global presence. We remain optimistic about Indian companies tapping the world markets for being a steady source of supply for large multinational corporations.

There has been a tremendous setback for certain sectors, and we expect that sectors such as airlines, hotels, restaurants, multiplexes, organized retail, outdoor sports, etc. will take a lot of time to recover. The job losses in these sectors would take at least one year to recover. Certain sectors such as commercial vehicles are seeing deep pain and will see an extended cycle of degrowth. There is a huge momentum in technology stocks and globally many of these stocks are at new peaks which are far higher than their pre-Covid valuations. Small and mid-cap stocks have seen sharp corrections in their valuations with many stocks quoting one standard deviation below their 5 years historical valuations. We believe markets are richly valued in the frontline stocks which are now not offering too much of value. The market is poised for a rerating for some of these stocks offering deep value. This rerating will happen by the end of CY 2020. Patient investors will stand to gain immensely as there will be a huge delta in earnings and in ratings which will provide very good upsides.

We continue to position your portfolio to benefit from a sharp recovery in FY 2021-22. We remain confident that the Indian economy will revive and put most of the challenges behind it. The long-term outlook continues to be very promising with a sharp bounce back by the end of CY 2020. Your portfolio is well positioned to capitalize on the emerging opportunities of stronger companies gaining market share at the expense of weaker companies exiting the business. 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 are led by able management teams with strong execution opportunities that will be highly rewarding capabilities to deliver superior returns on a sustainable basis. We are convinced that the Indian market will continue offering many good opportunities.

Warm Regards,
Jiten Doshi
Co-Founder & CIO