From the CIO's Desk

June 2021

ENAM ASSET MANAGEMENT

Dear Investor,

I hope this letter of mine finds you and your family safe and healthy. The last quarter has been a very challenging quarter for everyone who lived through the second wave of Covid 19. The second wave casualties were far higher than the first wave. The second wave led to too many casualties, with a lot of lives being lost across the nation. The healthcare infrastructure of the country was severely challenged with a huge shortage of oxygen cylinders, oxygen concentrators, critical medicines, hospital beds and other medical supplies. This has been a very tragic situation that we have never witnessed before. April and May were months where people were happy to stay safe and not become victims to the second wave of Covid 19. While the memories of the second wave are still fresh in our minds, there is a talk of a third wave which is giving sleepless nights to both the Central and State Governments.

In the above situation, India went through many selective lockdowns announced by various State Governments. In the month of May, businesses were once again very badly disrupted, as a result of severe lockdown in most parts of India. As of 30th June 2021, the total number of Covid 19 cases in India stood at 30.5 Million, of which the number of recoveries were 29.6 Million, a 97% recovery ratio and a total deaths reported were 0.4 Million. The current active cases at approximately 0.5 Milllion are in a controllable situation when compared to the last few months. What is noteworthy is the efforts put in by the Indian government to get the entire population vaccinated. So far, Indians have received 335 million doses of the vaccine with 59 million people being fully vaccinated. The government is hoping to step up its vaccination drive and vaccinate over 100 million people every month. In a few months from now, this rate could step up to over 200 million vaccinations a month. At this rate, most of the population, barring children below 18 years of age should be fully vaccinated by the end of this year. Further, Cadila Healthcare's vaccine may get approval for the age group between 12 to 18 years, and Bharat Biotech vaccine may get approval for the age group between 2 to 18 years, which means that even the younger population should be fully vaccinated in the near future Now, there are more than three Indian companies with their vaccinations ensuring easy availability of the same. Further, the government is also considering approval and sale of global vaccines of Pfizer and Moderna.

The resurgence of Covid 19 through a deadly second wave has meant that the State Governments have become over-cautious, and many states are still in different phases of the lockdown. So far, no state is ready to totally open it's densely populated cities. Any possibility of the third wave is only creating huge uncertainty for normalcy to resume. This is badly affecting the economy and is likely to have an impact on the economic growth in H1 FY 2021-22. Globally parts of Europe too are reeling under similar pressures, for instance, countries like the U.K. are going in and out of lockdown type of situations. People will have to follow all safety protocols and adjust to the new normal as life will never be the same as it was pre-pandemic.

In FY 2020-21, the Indian economy witnessed degrowth of over 8%. We expect the current year to be a year of bounce back with the GDP likely to grow by 8 to 10%. This growth is on a low base of last year. This year witnessed a GDP growth, is despite little or no growth from the services sectors such as airlines, hotels, restaurants, multiplexes, malls, weddings, conferences, outdoor sports, etc. The outlook for these services sectors should improve in the next fiscal year after the entire nation is fully vaccinated. The demand in the first half of this year is slightly muted with an improved outlook and buoyancy in the second half. The challenge for the economy is the unemployment problem that the country is currently facing. This situation is likely to improve by next year and thereby help provide further growth to the economy in FY 2022-23. GST collection for May 2021 has touched a record high of Rs 1.41 Trillion and that too despite a severe lockdown in many parts of the country. Direct tax collections in April and May 2021 are up by 93% over the corresponding period of the previous year. The forecast for this year's monsoon is above average, leading one to believe that there should be a strong demand bounce back in rural India. The pent-up demand across sectors will be reflected in the second half of this fiscal year, helping the economy to record strong demand during the festive season. On 28th June 2021, the government further announced support measures of Rs 500 Billion for the creation of health infrastructure in non-metro cities and towns, Rs 600 Billion for the tourism-related sectors and an increase in ECLGS scheme for microfinance companies.

What is worrisome is the persisting inflationary trend that is causing worry to the Reserve Bank of India (RBI). Interest rate cuts are now behind us. The RBI has forecasted inflation of 5.1% in the current year. Anything above this could be a trigger for a small rate hike by the RBI. We expect interest rates to go up by 100 bps over the next 12-15 months. However, even after that the interest rates would be structurally low and would aid corporate profitability and a long overdue capex cycle. Last year, we recorded another landmark with a Current Account Surplus of 0.90% as against a deficit of 0.9% in the previous year. The CAD turned positive after a period of 17 years. A strong FDI inflow along with a lower deficit have ensured that our foreign exchange reserves remain at an all-time high. The foreign exchange reserves with the RBI now stand at over US$ 600 Billion providing comfort to the Indian Rupee which is moving in a narrow range with not much depreciation. Prices of petrol crossing Rs 100 is an alarming sign and is hurting consumer sentiments. We should carefully watch the movement in crude oil prices and its impact on retail fuel prices in the coming months.

Despite muted demand for commodities, the prices of ferrous and non-ferrous metals are witnessing a runaway boom. As of 30th June 2021, the CRB Commodities index is up by over 50% as compared to 30th June 2020. This runaway rise in commodity prices is causing inflationary trends across the globe. The prices of crude and steel have risen dramatically and are causing a huge impact on material cost for several industries. Most industries are finding it difficult to pass on raw material cost inflation to their consumers. Despite, the Chinese government having levied duties on the export of steel, the domestic steel prices are still 15% lower than international steel prices, thus leaving no scope for an immediate price correction. Experts believe that we are in a commodities super cycle and prices will not correct very sharply thus causing long-term inflation to stay abated. The higher commodity prices are also due to an imbalance in global trade and the unavailability of containers and increased freight rates globally. Crude oil prices have shot up by over 20% in the three-month period ending 30th June 2021. Crude oil prices at US$ 75 are now at a level of discomfort for India and any further price rise will not be good for the Indian economy. Petrol prices at over Rs 100 are affecting consumer demand and sentiment. The commodity price run up is beneficial for many commodity exporting countries and should help revive their economies at the expense of commodities consuming nations.

The stock markets are buoyant with the Nifty 500 up by over 9% in the last quarter. Markets are going up due to huge liquidity aiding a broad-based rally. Small and Mid-Cap stocks have performed very well with some of them crossing their previous peaks. In the last quarter, Foreign Institutional Investors (FII's) have invested US$ 848 Million in the Indian equity markets as compared to US$ 7.24 Billion in the previous quarter. The pace of FII inflow had come down due to global investors being worried about the second wave in India. In comparison to the muted inflows from FII's during the last quarter, the Domestic Institutional Investors (DII's) invested US$ 2.75 billion in the Indian equity markets, thus signaling the return of the retail investors through mutual funds. Last fiscal, the DIIs had sold equities worth US$ 18.23 Billion as against FII's which had purchased equities worth US$ 36.94 Billion. Market indices are at all-time high, and the breadth of the markets is signaling broad-based participation. We believe that markets could see a minor correction after such a huge run-up. We remain constructive on the equity markets and would view every correction as an opportunity to enter the markets. Given the geopolitical situation and the uptrend in the Indian economy, we remain optimistic about global capital flowing into India. This will keep increasing if we are able to provide global institutional investors comfort with the progression of reforms and visibility of growth.

India is entering a phase of strong economic growth in the next few years. Trends on the ground indicate early signs of a revival in the real estate market. The real estate industry is a backbone for any economy. It is one of the largest movers of the GDP and a large-scale employer. A sustained revival in the real estate market provides visibility for demand in core industries like cement, steel, and ancillary industries such as tiles, paints, plywood, consumer durables, etc. The growth in the real estate industry is a GDP multiplier and should result in a demand revival across sectors. Further, we are at the start of a new capex cycle as corporate balance sheets have witnessed significant deleveraging, very high utilization levels, increasing demand visibility and rising exports. The PLI schemes announced by the government have also been a catalyst for rising capex. There is a strong momentum favoring the capex cycle to sustain over the next few years and sustained GDP growth will help this momentum. While discretionary consumption has currently taken a hit, it is all set to return in a big way from the second half of FY 2021-22. After a long interval, India will witness a golden period of growth in this decade. Corporate profitability which has hit an all-time low of 2-3% of GDP is all set to grow to 5-6% in the coming years thus signaling a strong period for the Indian economy, corporate earnings, and stock markets.

Equity markets across the world have done exceedingly well. The loose monetary policy of various Central Banks has meant that trillions of dollars are finding their way into global equity, commodities, and real estate markets. Interest rates are at an all-time low in India and globally. There are signs of overheating across asset classes with no signs of the same slowing down. China's economy continues to grow despite the global slowdown. Multinationals are trying to de-risk their supply chains by moving out of China into other Asian countries. President Zi's remarks, at the Communist Party of China's centenary celebrations, of bloodshed against nations trying to bully them, was considered aggressive and has further spooked many long-term investors to look at other emerging countries instead of China. India is going to be one of the beneficiaries of this trend. The US Federal Reserve has signaled that there could be 2 rate hikes towards the end of CY 2022. This could also end the loose monetary policy situation. We also need to see how other Central Banks are reacting to the same. For the moment there is ample liquidity supporting elevated valuations globally.

We continue to position your portfolio to benefit from a sharp recovery in FY 2021-22. This is a year of cyclicals doing well as they are witnessing huge demand growth. While the first quarter of this year is likely to witness muted earnings growth, we remain confident that the Indian economy should pick up sharply in the second half of the year thus putting most of the challenges behind it. The long-term outlook continues to be very promising with a multi-year earnings growth visibility. While valuations in many sectors look stretched, the surprise could come from earnings upsides due to favorable macro trends. We expect a strong comeback by the private banks and a rebound in earnings in several other sectors. This year could mark the return of a cyclical upturn with strong earnings growth across cyclicals. Your portfolio is well positioned to capitalize on the emerging opportunities of stronger companies gaining market share at the expense of weaker companies, higher profit margins due to cost optimization and greater global opportunity due to “China plus one” strategy. We at ENAM 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 capabilities resulting in superior returns on a sustainable basis. We are convinced that the Indian market will continue offering many such good opportunities.

Warm Regards,
Jiten Doshi
Co-Founder & CIO