

From the CIO's Desk

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ENAM ASSET MANAGEMENT

Embrace uncertainty.....

...Some of the most beautiful chapters in our lives won't have a title until much later...

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The rollercoaster of 2022 continues in 2023....

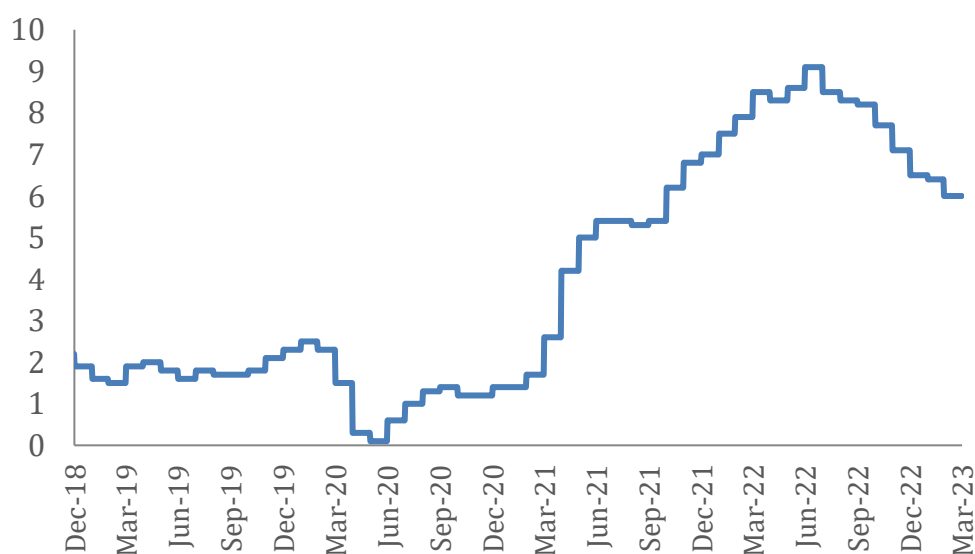
The only thing that seems certain in this world today is uncertainty.

Changing World... Shifting Sands...

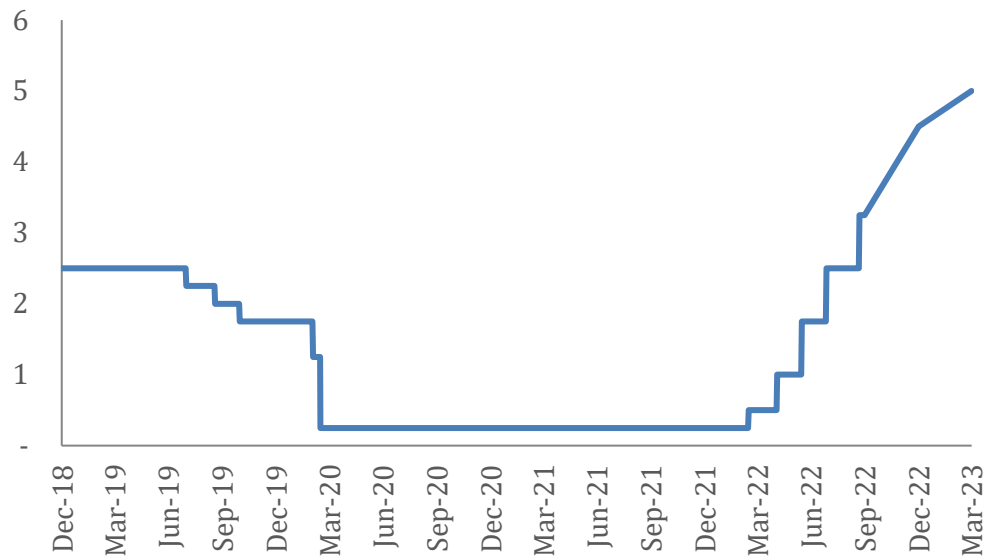
We are in a world that is changing ... and changing fast. The environment of the low cost of capital, supported by expansionary policies and excessive leverage has run its course. The environment incentivized behavior of higher risk-taking. Risk became a forgotten four-letter word in the investment templates. The fear was FOMO (Fear of Missing Out); the more risk you took, the more money you made – till one day you end up losing it all.

The world has acclimatized to a low-inflation-low-interest environment over the last 15 years. In a world which was seeking a balance in a wonderland of safety with high returns, a large part of helicopter monies sought refuge in seemingly safe debt investments, taking duration risk as against the credit risk. The sequential 4-quarter rate hikes have created new problems for fixed-income investments.

US Inflation – CPI YoY



US Federal Interest Rate



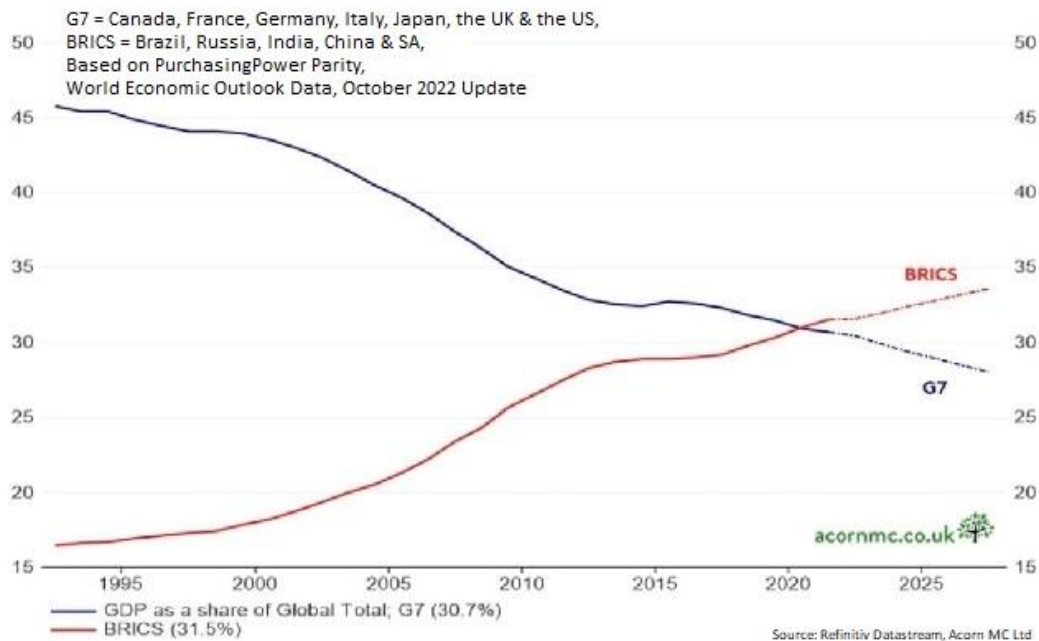
The initial hikes were absorbed by the system under the presumption of a short-term aberration to address “transient inflation”. With the subsequent commentary from the regulator and adjustment of inflation expectations to a new normal of 6.0% - the bond portfolios started feeling tremors. The SVB fiasco highlighted issues on excesses, risk management and systemic risks in bond repricing.

The ensuing run on SVB, resultant contagion in US Banking and the subsequent collapse of Credit Suisse has pulled forward the yield curve's regime shift from bear-flattening to bull-steepening. We expect this phase of the apparent disconnect between market expectations and the Fed to persist for some more time to come.

The unintended consequences of the policy stance have forced a wave of uncertainty across the financial system which is supporting the foundation for policymaking. As these episodes increase, at a higher scale with the passage of time, we should be cognizant of the shifting sand in the global socio-economic-political landscape. We discussed in our last few communications that we are amidst a period of transition where the cost of capital, demographics, socio-political priorities, the global monetary structure and the “one flat world” based global supply chain are concepts that are re-orienting with newer beneficiaries than what the world has been accustomed to.

As things stand today, the BRICS economies represent a higher population, higher mass, and higher GDP today than their developed economies' G7 counterparts. The unusual alliance between the countries producing resources and countries offering complementary markets are set to evolve new economic and trade frameworks. These changing times will challenge the established capital market frameworks (separate

pricing of risks, excess leverage, structured instruments, and the accepted norms on reserve currency) and in turn create bouts of volatility in the global markets.



The biggest challenge therefore is embracing uncertainty. When one does that - the only option is going back to basics, to a world that operates on hard assets, cash centered, value(s) driven and multipolar in structure. Some things won't change in this world though. We are amidst this phase where the world is seeking -

- Large market in terms of value as well as volume
- An efficient source of goods and services
- A reliable, and transparent trade partner of scale
- An opportunity to invest for future growth

We strongly believe that India is setting itself up for being among the multi-year beneficiaries of these economic shifts.

India ... a possible long-term beneficiary

In a world seeking clarity, India has primed itself to play the game on its own terms and is poised to be a significant global player on account of its emerging vibrant marketplace, global value-chain position, and active participation in global policymaking. There are multiple core growth vectors going in favour of India -

- Scale - largest democracy with the largest population with already demonstrated the stress-tested performance of its low-cost-population-scale platforms for frictionless execution of its scale initiatives on trade (UPI)/

health (COWIN)/ food-for-all (PMGKAY)/ and direct benefit transfers (a Quasi UBI)

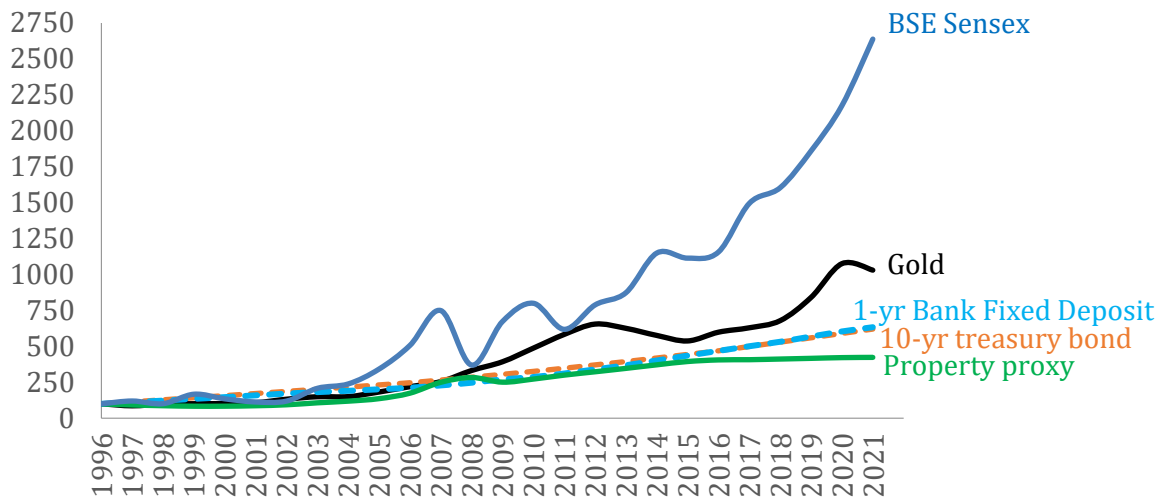
- b. Strong domestic market pivot - a marketplace with a flair for developed world architecture (With its young aspirational population, at inflection GDP per capita income, an accountable democracy, vibrant media, digital civilization, leadership in large-scale population initiatives and proactive policy machinery) with emerging market opportunity landscape (GDP size, growth rate and the per capita income inflection of ~USD 2250)
- c. Favourable factor costs - In multiple industries such as automobiles, pharmaceuticals, textiles, chemicals, IT Software Services, as well as light engineering - India has leveraged its large educated & skilled workforce, a strong local market anchor to build a globally competitive scale and competencies to exploit emerging China+1/Europe+1 supply chain opportunities
- d. Stable macro environment - world-leading growth, stable currency, manageable twin deficit, forex reserves, and controlled inflation. The inflation differential against the developed world is at its lowest in 5 decades
- e. Proactive policy environment - business-centric, reform-oriented, transparent proactive government, with a focus on building long-term strategic advantages

Unlike its global peers, India used crises as an opportunity. Over the last decade, India has implemented numerous groundbreaking once-in-a-lifetime reform initiatives in almost every aspect of its social, economic, and governance structures. These building blocks are yet to reflect their contributions in a normal economic year. While many term the previous decade as a lost decade of muddle growth, almost every year operated with a handbrake of either a reform initiative (demonetization, GST, IL&FS-led financial system issues) or global disruptions (Pandemic, Supply chain disruptions and Russia-Ukraine conflict) - things which cost India at least 150-200 bps CAGR growth. This phase has been like a caterpillar where the economy has strengthened its built-in resilience through carefully crafted policies that incentivize entrepreneurship, a self-reliant supply chain and investments in social, physical & digital infrastructure. An economy, like a butterfly, is ready for its take-off decade.

What does an Investor do here...

One needs to look through the prism of a 3-decades performance, equities have delivered a sustained superior performance. Even for a global investor, India has delivered among the best sustainable long-term USD returns over this period.

India: Equity vs. Other Assets Classes



Indian Equities vs. Other EMs

Indices	5 Years	10 Years	20 Years	30 Years
Brazil	-4.9%	-3.2%	9.3%	7.8%
Russia	-4.5%	-3.8%	5.7%	N/A
India	6.4%	7.3%	12.3%	8.0%
China	-7.5%	-1.0%	4.4%	3.9%
South Korea	-3.8%	0.5%	7.7%	2.8%
Indonesia	0.2%	-1.1%	12.3%	3.8%
Mexico	3.4%	-1.8%	8.8%	N/A
Turkey	-2.9%	-6.2%	7.9%	4.7%

We feel at the core, there are four factors which are unilaterally in favor of Indian equities -

- India has among the most diversified indices and has among the most balanced spread in terms of industries, market participants, themes, and ownership patterns
- It also offers the best-in-class template in terms of scale (in the number of transactions), governance (rules-of-the-game), regulatory surveillance, and technological prowess (fastest settlement)
- For an economy with a long growth highway across diverse segments - multiple sectors of the economy are yet unrepresented in the broad capital marketplace
- Reforms being a political agenda - almost every party has spent some time drafting them while being in power. With performing governments coming

back in power, any ideological change in power makes up a low-probability low-risk material event

A careful look at this period also suggests that time in the market is more critical than timing the market. If one is absent from the markets on the best days - the difference in returns is as high as 60%+.

Never let a crisis go to waste. As discussed, the hard work during the period of painful transformation has created the necessary building blocks for future growth. We expect multiple megatrends to converge in the investible universe over the coming decade(s). Some of them are -

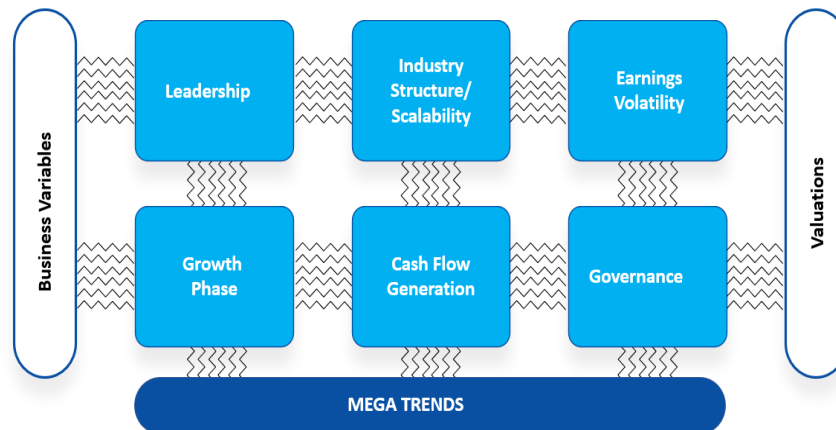
- a. Digitization (Government-induced, cross-sectoral, population-scale sachet size public owned facilitators, increased digital adaption in B2B, B2C, B2G, G2C..., data networks)
- b. Financialization (Increased compliance, faster digital adaption, emerging asset opportunities, and digital finance)
- c. Formalization (Increased regulatory vigil and compliance, increased representation of formal economy at marketplace, consolidated industry structures)
- d. Premiumization (Affordable aspiration, Fashion, QSR, Leisure, Premium durables)
- e. Urbanization (Real Estate, Urban infra, home improvement, Durables/appliances)
- f. Manufacturing Renaissance (At-scale businesses, favorable policy incentives, China+1/Europe+1 opportunity spaces)
- g. Capex Recovery (Government infra, private company capex - at utilizations nearing 70%+ thresholds)

Our Framework

Our philosophy concentrates on creating focused portfolios of high-quality businesses that are structurally well-positioned, have sustainable competitive advantages and have strong execution capability for consistent long-term growth!

Our investment strategy remains focused on bottom-up stock picking, seeking superior returns. Our investment framework respects scalability, capability, leadership, character, and cash flows as important variables. These businesses are characterized by existing/emerging leadership, operated by prudent and competent management, delivering value accretive growth (where business returns exceed the cost of capital).

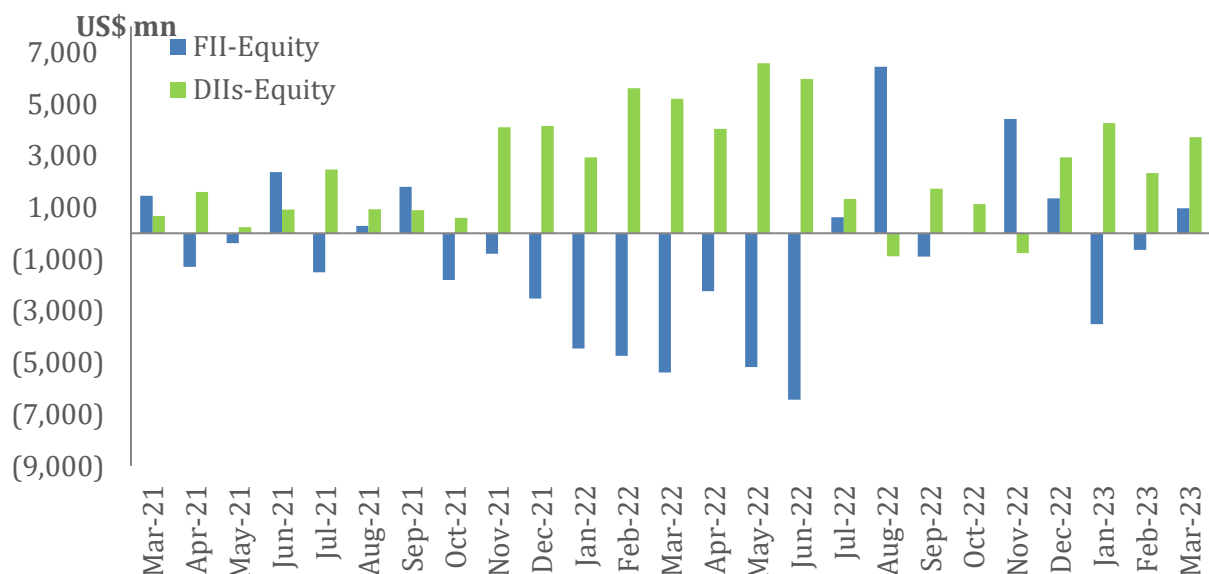
The driving factor is megatrends that are set to benefit the business in the medium to long term. We also use business variables and valuations as guardrails for our stock selection. The process also relies on strong exclusion lists and high reliance on management quality and governance. These positions are built through a period keeping the long-term investment horizon in mind and are built with a margin of safety (attractive price with sufficient growth visibility).



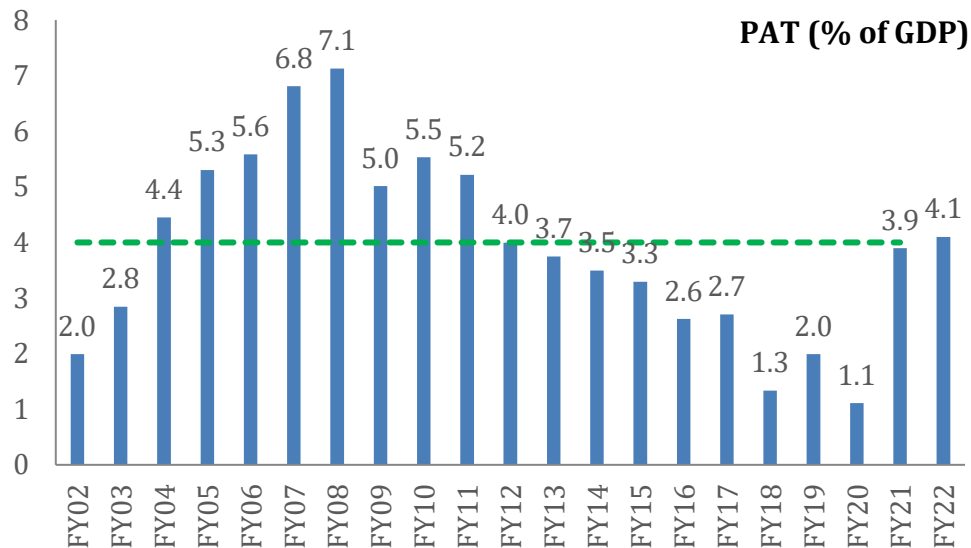
Valuations...A trillion-dollar question

Valuations as defined by the markets are nothing but price multiples. An indication of where the market is discounting the future. As things stand, markets have withstood substantial selling of USD 5.1bn+ over the last 12 months by Foreign Institutional Investors (FIIs).

FII and DII (US\$m)



Corporate Profits as % of GDP

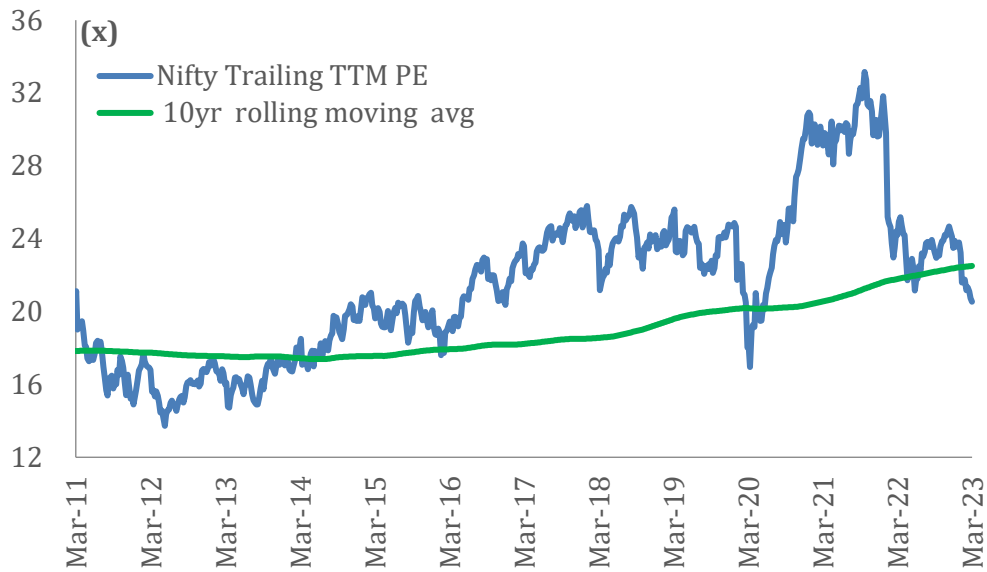


While sentiments on global macro and valuation concerns remain short-term inhibitors, the sustenance of DII flows in the current environment remains critical. The 3-year SIP returns have been sluggish for equities. Any sustenance of this trade would mean the SIP commitments would need to withstand their moment of truth compared to other asset classes like gold/ fixed income. One needs to be vigilant on the balance of these equations in the coming months.

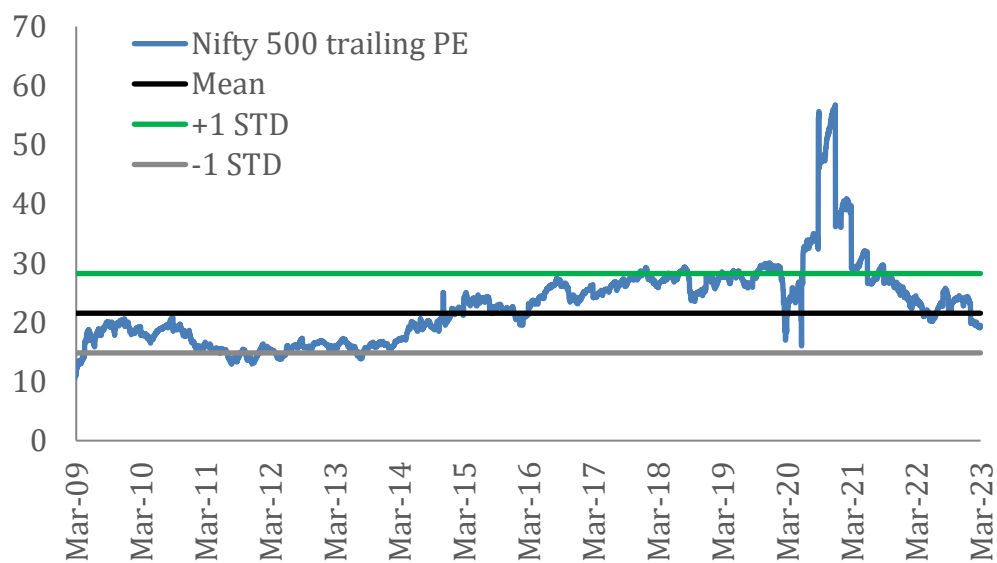
As things stand, the recent correction in the market has made valuations more palatable at 17.3x on 1-year fwd earnings. As much as 56 of the Nifty100 stocks now trade below the 10-year historical average. Recent improvement in CAD, weak commodities driving WPI softening, and recent weakening in crude oil prices augur well for the macro-economic outlook.

There are three components of multiples - sentiments, fundamentals, and liquidity. Sentiments are a tad negative with concerns about the on-ground demand recovery and the effects of monsoon on rural incomes. The valuation (1-yr fwd consensus PE) has declined 25% since March-22.

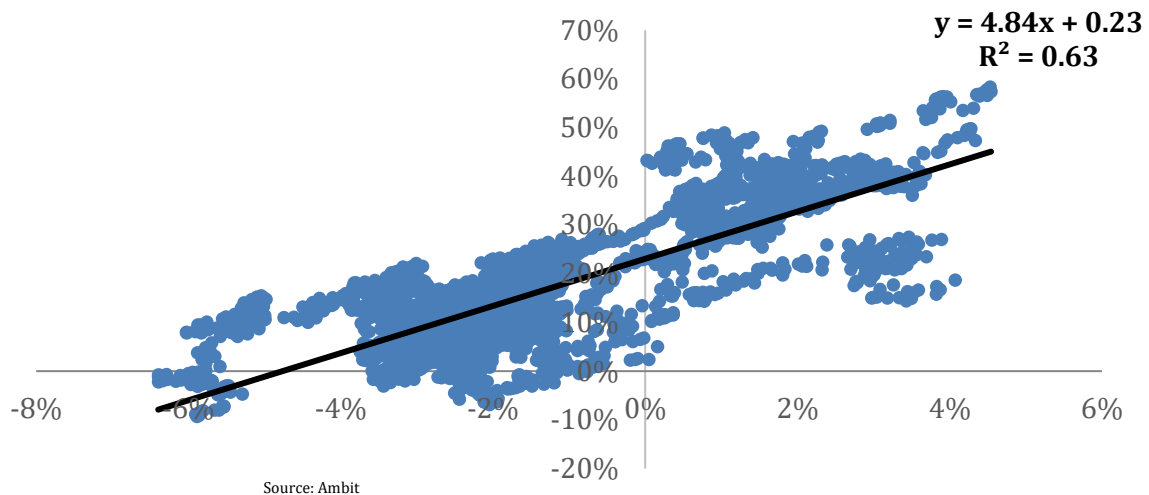
Nifty TTM PER at 10-Year Average



Nifty 500 TTM PER near 15-year Average



The current gap between Earnings Yield (EY) and Bond Yield (BY) stands at a 5-year and 10-year average of $\sim -2.5\%$ and against the historic dispersion suggests the 3-year average limited downside and possible 12% three-year CAGR returns from these valuation levels.



Our Take...

We would like to use an axiom here.... **Markets are neither overvalued nor undervalued... stocks are...!!!**

There are two games in existence in every stock in the market at every time -

- Value Game** - played by the corporation in its business ecosystem with its core stakeholders like customers, vendors, employees, shareholders, society and environment. Simply put it is the value of future cash flows attuned for sustainable business visibility
- Price Game** - played by stock market participants - which focuses on high-frequency macro and micro data points and is purely driven by technical factors of demand and supply at any given point in time

We attempt to live by the quote(s) of Ben Graham...

- Markets are voting machines in the short term and weighing machines in the long term
- There is no investing without value

We stick to what we can do best - separating the signal from the noise by identifying good businesses, investing time/bandwidth/energy to understand the durability of their business model, gauging management quality, attempting to understand the value on offer and waiting for the right price-value gap to lock-in sizeable positions backed by conviction.

We feel value and growth are tied at the hip. Business returns, business model sustainability and medium-term cash flow growth remain our core filters to build a rational judgement to buy with a margin of safety - the Price-Value gap. Investing trusted monies is a job where we need to operate one eye like a telescope to find long-term

opportunities and the other like a microscope to avoid infection in the portfolio with near-term developments. Well-defined risks, monitoring and mitigation remain critical to avoid any mishaps.

Stay Put ... make volatility your friend....

In the VUCA world (Volatile, Uncertain, Complex & Ambiguous), volatility is the only constant. We humans, tend to overestimate and extend recent trends into the deep future. While remaining focused on the long-term potential of the India opportunity, we remain cognizant of the fact that the interim market volatility would test the conviction and commitment of every participant in this opportunity.

The last 3-years have tested the business model resilience of every business in India - making agility, balance sheet strength, and cash flow reserves important traits to delivering superior performance. We remain committed to our process of finding long-term sustainable value from such opportunities while remaining agile and equipped to add to our current positions at every prospect of price-value divergence.

India is an opportunity in plain sight. While the short-term volatility caused by the Fed's dilemma on interest rates is playing over the mind of every investor. We expect current global uncertainties will amplify the short-term effects of volatility (both in terms of value and frequency). Add to this, slower than expected demand recovery and increasing automated trading component remain short-term realities; we feel they present prospects to log in the high conviction opportunities from the India story given its multiple long-term themes, sustained growth vectors & attractive risk/reward set-up. We would advise our clients to ignore the interim noise and add to their commitments in the coming period to this long-term wealth-creation opportunity.

Warm Regards,
Jiten Doshi
Co-Founder & CIO

Disclaimer:

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