

From the CIO's Desk

June 2023

ENAM ASSET MANAGEMENT

The best time to plant a tree was 20-years ago.... The Second-best time is now....

Chinese Proverb

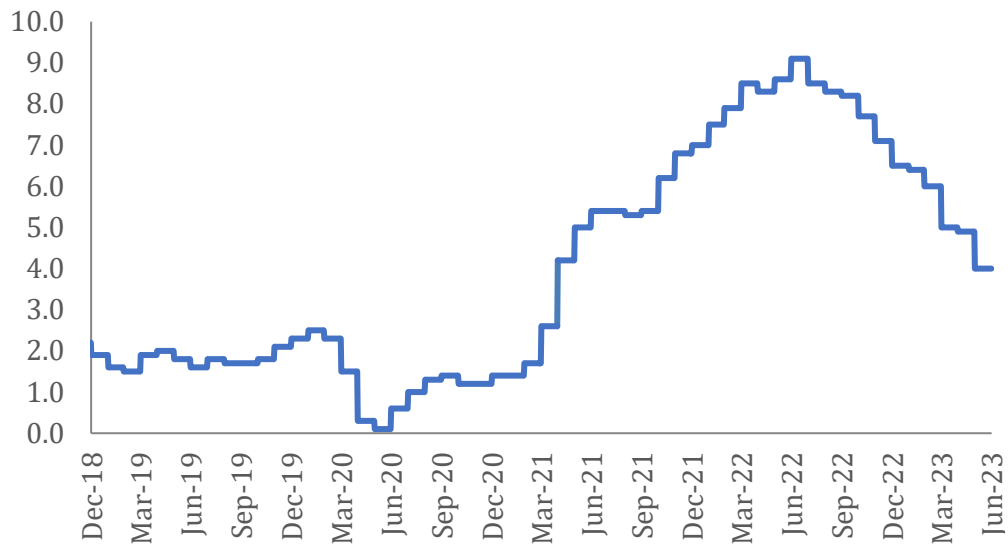
Global Scenario

Going by the current economic landscape, global growth has stabilized, but the improvement is fragile. Most of the economies are witnessing a fall in headline inflation on the back of a downturn in energy prices, despite higher prices on food and services. Core inflation has remained persistently high. The resultant fall in real wages is expected to moderate through CY23. The uneven data on economic growth and the persistent inflation makes it difficult for any case to pivot to a softer interest regime.

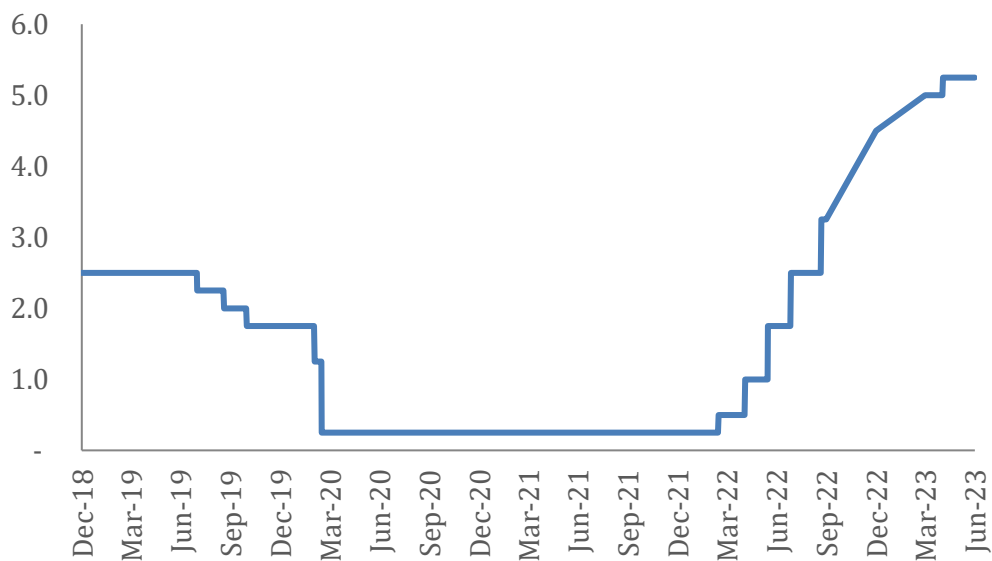
The macro landscape has witnessed a marked and permanent shift. We're now in an era where the influence of monetary policy to stabilize both inflation and growth is broken. It is no longer AND; it has to choose between them. In a demand-driven environment stabilizing inflation also stabilized growth – there was no trade-off. In an environment where multiple uncertainties co-exist on account of economic, political, military-conflicts and environmental vagaries, the central banks are yet to come to terms with adjustments they need to co-opt in their existing inflation-targeting frameworks. One can expect in this scenario the DM economies to revisit their policy stance on balance sheet expansion, a phase out of fiscal support, targeted investments, prioritizing spendings towards growth areas and sustained supply side reforms.

The FED has a further tight ropewalk given that any further rate hikes would increase the odds of recession further. Its minutes suggest that rate hikes are not over yet. The slow-motion slowness in economic indicators, if extended, does increase the odds of a US recession. Across most of the economies, the near-term outlook is for slower growth in demand, in jobs and in profits. The Eurozone too is burdened with a sharp decline in bank lending, and persistent inflation, causing further tightening despite the lack of economic growth in markets like UK. Japan seems an outlier in this phase with above trend GDP growth and accommodative policy stance.

US Inflation - CPI YoY



US Federal Interest Rate



What we are witnessing is a concoction of multiple simultaneous and possibly permanent structural long-term shifts driven by four key factors:

- Inflationary environment is not transient and is structural - driven mainly from the supply side
- Near-Zero Capital cost environment is almost over in this new inflationary regime
- Declining supremacy of Dollar as a reserve currency - with waning economical-political as well as military influence on global ecosystem

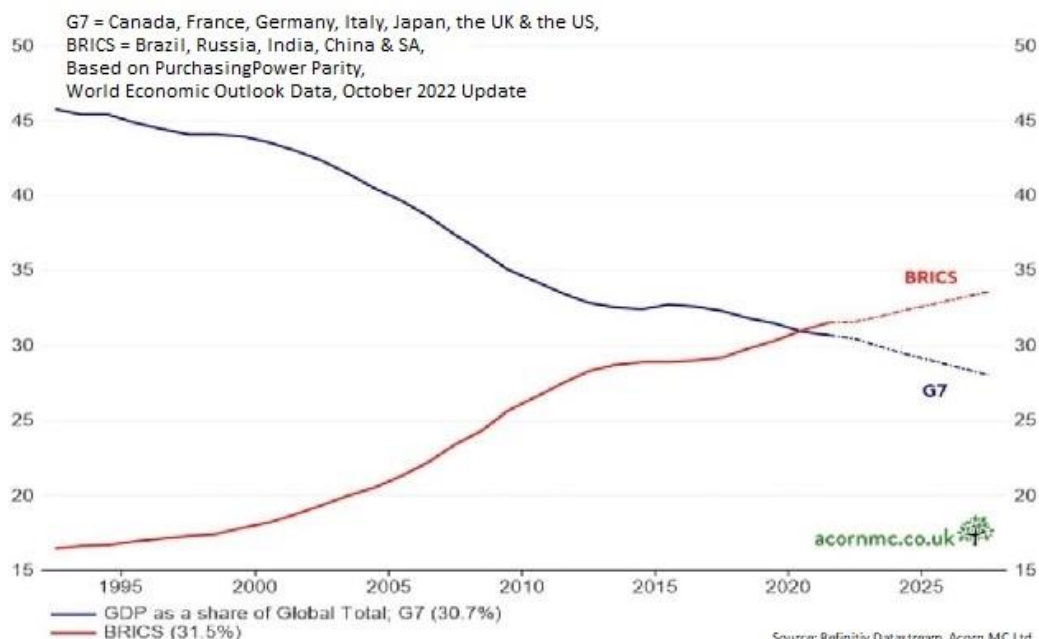
- d. A fragmented world - with a strong wave of deglobalization and multi-aligned trade block - (countries like the Gulf oil states, China, India, Brazil, Vietnam and Mexico have valuable resources and supply chain inputs) primarily focused on individual national interests with a rewired protectionist supply chain and industrial policy

Globalization – Plateaued



Source: BlackRock Investment Institute, Klasing and Milionis (2014), Penn World tables, World Bank, June 2023. Notes: The chart shows the sum of world exports plus imports, divided by world GDP. The yellow shaded area highlights the period between the first and second world wars when trade integration fell materially.

Wealthy Nations - Shifting Centre of Gravity



These long-term trends do not happen overnight and would take some years. However, for the world which is set for a motion and direction for 50 years, these changes, however gradual, will result in near-term challenges and uncertainties with three core realities:

- a. A **higher volatility** with multiple possible geopolitical confrontations makes for an economic growth that is vulnerable to multiple shocks.
- b. **High investments** - mainly in areas such as technology, clean energy, infrastructure, defense, aerospace, and cybersecurity - which would seek safety, resilience ahead of efficiency
- c. Adjustments to **lower margin lower return** environment - with slow-but-steady shift rewiring of supply chains, increasing trade barriers, higher fixed costs (most of the key factor costs man, money, machines)

In the interim, the world would seek a destination that provides a large market, globally competitive resource base, reliable trade partnerships, visible steady growth and fair law of land. We strongly believe that India is setting itself up for being among the multi-year beneficiaries of these economic shifts.

India has demonstrated its resilience through every adversity. In this environment, India stands out with 3-Ps - Population, Productivity and Policy. It is a formidable play which uses every crisis as an opportunity. The last 10 years have witnessed a series of once-in-a-lifetime policy interventions (discussed later under policy section) in its social, economic, and governance anatomy. It is akin to repairing a plane during the flight or a critical multiple organ transplant. These developments, along with global disruptions (Pandemic, Supply chain disruptions and Russia-Ukraine conflict) - did cost India ~150-200 bps cagr growth during this period. These foundations are yet to deliver their contributions in a normal economic year. During this period, the economy has been wired for a built-in resilience through carefully crafted policies that promote entrepreneurship, form a self-reliant supply chain, and create an upgraded physical, social, & digital infrastructure - making it ready for a take-off.

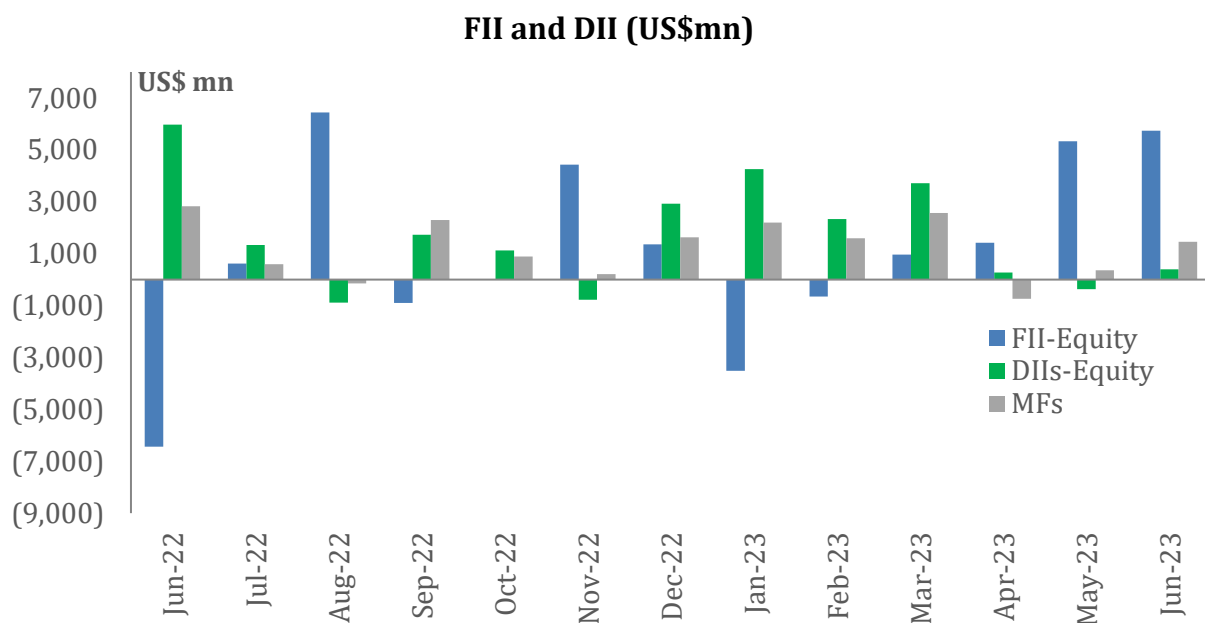
Driver	Parameter	Comments
Population	<i>Size</i>	Largest in the world - higher than combined G7 population
	<i>Diversity</i>	Multiple cohorts - multiple segments - opportunities for micro-segmentation
	<i>Demography</i>	Young and lowest working age - ½ of Developed nations

	<i>Hard Working</i>	Average working hours 3x the developed nations average
	<i>Digital Native</i>	Largest in digital workforce & transactions with high penetration of mobile internet, banking, media
	<i>Aspirational</i>	Multiple cohorts at scale - Affordable aspiration a common DNA
Productivity	<i>Manpower</i>	Raising life expectancy, reducing mortality & expanding access to education About 24.3% of the incremental global workforce over the next decade will come from India Labour productivity continues to improve in India (1995 – 2008 CAGR = 3.8% and 2009 – 2021 CAGR = 5.5%)
	<i>Digital Public Infra</i>	Irreversible non-linear changes where each change is enabled by a new approach to solving societal problems using digital public infrastructure (Aadhar, UPI, FasTag, GST, eWaybill, Digi locker, Account Aggregator, ONDC) <u>Advantage of scale</u> - the price of data fell exponentially, and the use of smartphones grew proportionately
	<i>Airport</i>	No. of airports doubled in last 10 years further to increase by 50% by 2030 Domestic passenger traffic up 2.3x in last 10 years. Targeting 3x by 2030 Aircraft fleet size is up from sub-400 in FY14 to 700 in FY23. Targeting 1200-1400 planes by 2030
	<i>Road</i>	Roads constructed per day up from 5.2 kms in FY14 to 12.7 kms in FY23. Logistics cost targeted to <10% of GDP by 2030 (today @13%)
	<i>Port</i>	Improved connectivity & throughput at ~750 MMT - at 5% CAGR Increasing share of private ports - 45% today
	<i>Rail</i>	Railways' share in freight to increase to 45% by 2030 (now 27%) Freight train speed is expected to increase 3x by 2030 Metro rail connectivity (cities) is expected to double by 2030 DFC to improve lead time by 35%+
Policy	<i>Taxation</i>	Competitive at 25%. Promoting investment in capacity creation and innovation
	<i>Self-Reliance</i>	Manufacturing share in GDP targeted at 25% by 2030 (PLI scheme) Incentivizing Investments ~INR 1.7 trillion to generate 1.7mn jobs

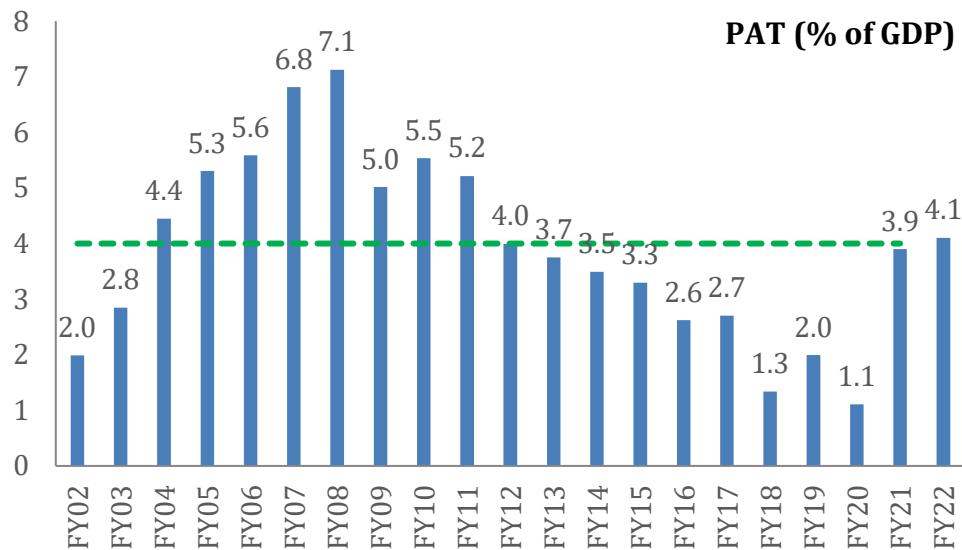
	<i>Revenues</i>	GST, RERA
	<i>Citizen Connect</i>	e-governance, Passport, Direct benefits
	<i>Banking & Finance</i>	Demon, UPI, NEFT, DBT, JAM, IBC, Inflation targeting, Digital Rupee
	<i>External Affairs</i>	Diplomatic dominance, Russian oil purchases
	<i>Education</i>	NEP draft
	<i>Health</i>	COWIN, Ayushman Bharat (ABHA - health Stack),

Valuations... Stretched?... not yet...

After a long hiatus FIIs returned to India in the current year. YTD, FPIs net buying stands at US\$9.7bn, while domestic institutions have bought stocks worth US\$10.8bn. Over the last two years the markets have almost retraced the previous high despite FPIs having sold close to US\$55bn. Large part of this market resilience is on account of increased flows into domestic funds and strong retail activity in direct equities. The DII flows have been strong on the back of the megatrend of accelerated existing under-penetration, digital adaption, financialization, relative attractiveness of equities against other asset classes, and enhanced financial literacy.



Corporate Profits as % of GDP

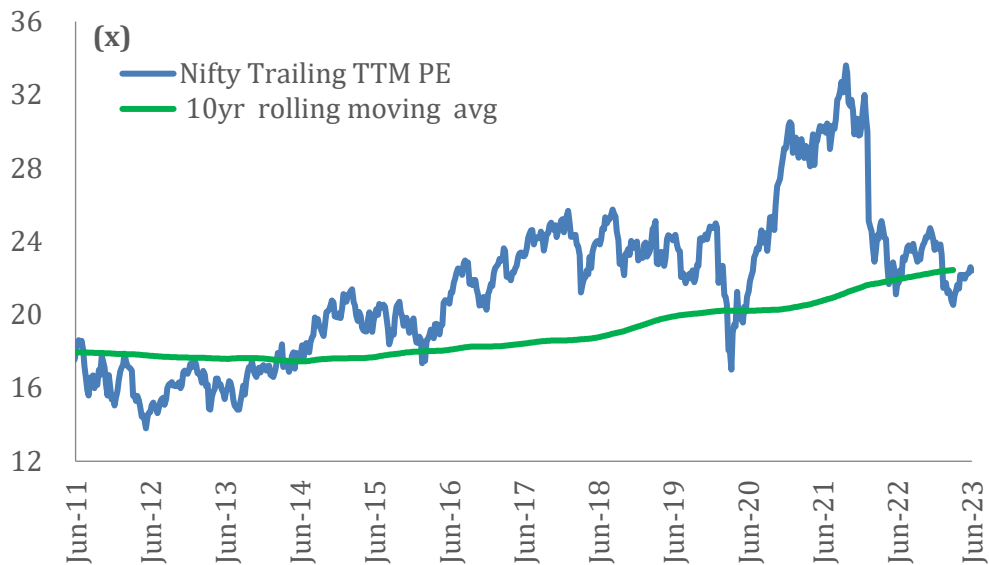


Market performance is a cumulative result of markets sentiments, earnings trajectory, participation structure and liquidity. We are witnessing a confluence of all the four factors simultaneously.

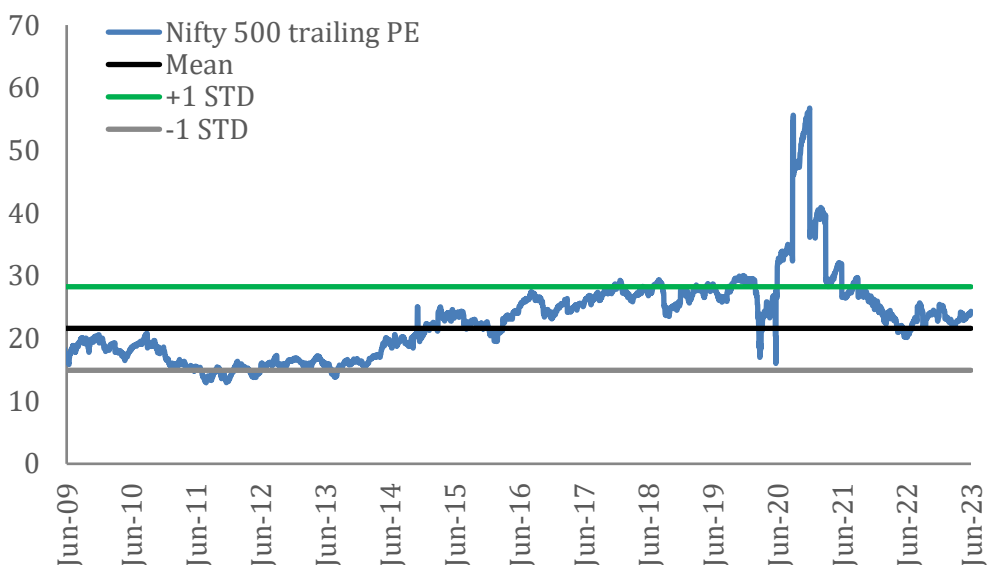
- Fundamentals are on the mend. As we come off a difficult three-year period from multiple headwinds, a better operating structure and improved balance sheets, make a case for better earnings momentum as demand comes back.
- Sentiments are favourable - with stand-out economic delivery & multi-legged growth opportunity on the back of multiple positive vectors like, near inflection GDP per capita, stable macro, strong local market anchor, reasonable cost of capital and proactive policy regime.
- The market structure too is balanced with institutions (local & global), Retail and HNI investors. Also, there is no sectoral skew. Systemic leverage both with corporates, governments as well as individuals is very low. Market breadth too has been good with most of the broader indices recent outperformance.
- Sustained inflows to DIIs and renewed interest of global investors - make liquidity favourable.

Valuations is a puzzle which makes the investing an interesting craft. The craft about finding intrinsic value which is technically defined as present value of future cash flows. Simple...but not easy. Stocks get traded in a marketplace based on demand and supply. Therefore, separating price from the value. Thus, when one uses the term valuation - it is expression of price indicating foreseeable future. As things stand, the recent market rally to the new high has moved valuations to 21.7x on 1-year fwd earnings - ~10-12% premium to the 10-year average.

Nifty TTM PER at 10-Year Average



Nifty 500 TTM PER near 15-year Average



India, on account of the better return profile, established transparent market structure, better earnings visibility, and better governance architecture stands out in the global landscape struggling with issues on volatility, growth visibility and economic vulnerabilities. We feel in a world of limited opportunities Indian stocks would retain their premium to peers.

Our Take...

At Enam AMC, we are perma-bulls on India, with ultra-high conviction. This optimism stems from our deep engagements with multiple cohorts of corporates, policymakers, industry experts and top managements. This confidence is a function of long-term visibility that entails all the three components of equity performance, i.e. earnings trajectory, policy tailwinds and sustained flows.

Our investment philosophy is based on following four vectors:

- a. In the long-term, market value of the stock (and hence wealth generated) mimics its economic value
- b. Reversion to mean is a reality and appears intermittently in short, medium as well as long term - creating interim opportunities of price-value GAP
- c. Big wealth is generated when a business changes trajectory, where future is better than past
- d. Eliminating white spaces of potential misadventures - is a strong contributor to relative alpha

This is embedded in our investment strategy - **“identify select quality businesses, invest time-bandwidth-energy to understand the durability of their business model, gauge the management quality, decode to understand the value on offer and wait for the right price-value gap to lock-in a sizeable position backed by conviction.”**

The strategy seeks five key dimensions:

Tenet	Key Determinants
Opportunity	Industry size, penetration, structure, growth runway
Leadership	Top 3, Challenger, Early-stage niche, profit leaders
Competitive advantage	Uniqueness, Earning Power, Growth, Value Creation
Improvement	Change that impacts margin – Industry, Regulation, Balance Sheet, Management, Financials
Margin of Safety	Intrinsic value, Price-Value Gap

We categorize investment opportunities in 4 cohorts:

- a. **Structural opportunities** - long-term, scalable, well-discovered
- b. **Emerging opportunities** - early stage, profitable, at inflection, changing trajectory
- c. **Exceptional opportunities** - discontinuous, event driven, with something new
- d. **Disruptive opportunities** - new age challengers, business model disruptors

The stock selection, portfolio construct seeks a balance of conviction, market cap, liquidity and type of opportunities that we intend to play. Business model sustenance, Business returns, and medium-term cash flow growth are our core tenets to help build a rational assessment of margin of safety - the Price-Value gap. Well-defined risks, defined frequency monitoring and early flag-off for mitigation remain essential to avoid any accidents. We also have a well-programmed ESG overlay to portfolio construction.

While we remain extremely positive on long term India opportunity, we expect some of the following megatrends to converge in the investible universe over the coming decade(s):

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

Embrace Volatility...Stay Invested

We remain positive on the long-term growth potential of Indian equities. Concurrently we remain cognizant of the gyrations the violent volatility will create in Indian markets with heightened unpredictability of global equations.

In a hyperconnected world - currency, commodity and capital are intertwined. Thus, every major event has its financial ripple - sometimes more pronounced than reality. We expect global uncertainties to amplify the short-term effects of volatility (both in terms of value and frequency). Coming period also adds additional volatility with incoming political cycle (where 4 of the top 5 economies enter an election cycle) and issues like worries on El Nino, monsoon, etc. We would advise investors to ignore the interim noise and add to their commitments through the coming period to this long-term wealth-creation opportunity. 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. We feel in the coming period, the risk/reward set-up for India is very favorable on account of multiple long-term themes, sustained growth vectors & reasonable valuations.

Warm Regards,

Jiten Doshi

Co-Founder & CIO

Disclaimer:

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