From the CIO's Desk

September 2023

ENAM ASSET MANAGEMENT

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Opportunity is always delivered in a fog of uncertainty'....

Anonymous

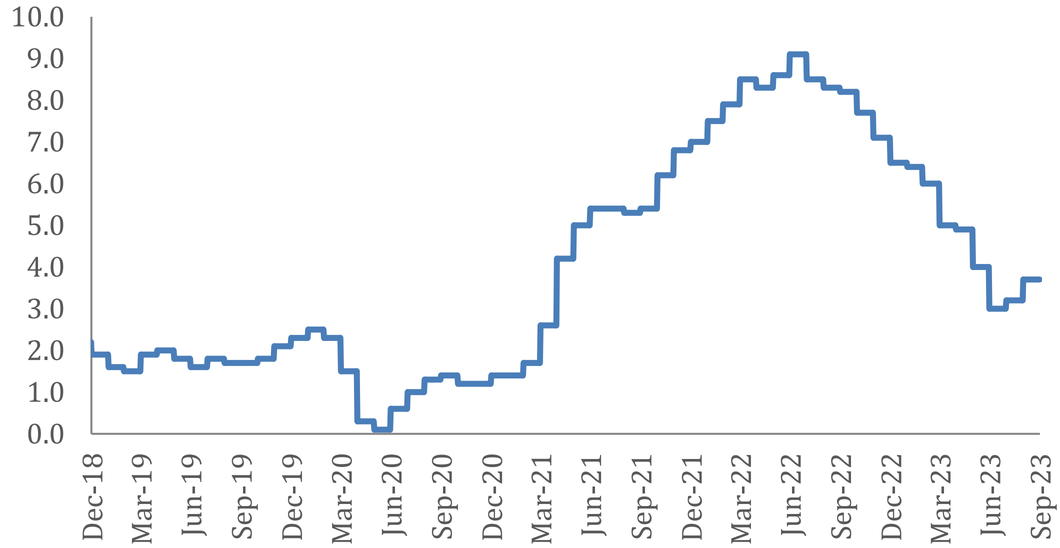
Where Is The World Headed? (VUCA)

The spontaneous common answer is ...who knows?? However, in the business of fiduciary money management, one needs to be cognizant of the world that surrounds us. While crystal gazing is not our forte, here is our tiny attempt to decode the current haze…

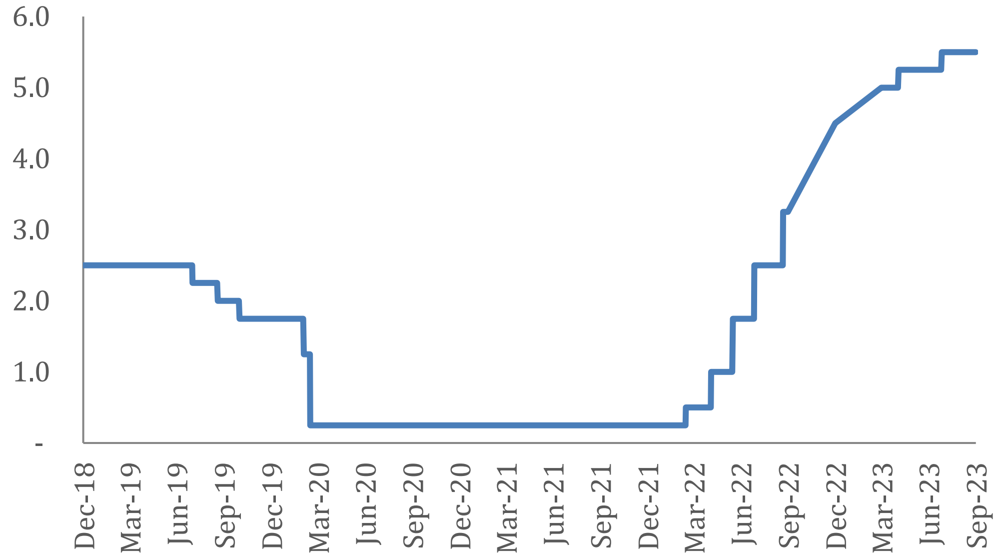
We have had a roller coaster of a ride in sentiments through the year. CY23 started with a market narrative from recession with a possible response of sharp rate cuts. The chronicle then got a sentiment tailwind of a possible soft landing over the summer - only to get moderated for "a higher-for-longer" narrative. Yields on benchmark 10-year U.S. Treasuries have risen to 16-year highs above 4.50%. Fed members reiterated 'higher for longer', 'one more to come' and shift from 'how high' to 'how long'.

Inflation seems to be cooling down from the unwind of pandemic demand-supply shocks. Spending normalization in goods vs services has resulted in softening of goods prices; in turn, dragging inflation down under a normalized demand. Wage growth too seems to cool down as skills mismatch gets normalized. Importantly, inflation declining through 2023 has come at the cost of economic growth. In Europe, manufacturing activity has slowed sharply.

US Inflation – CPI YoY



US Federal Interest Rate



While the policy-rates may have peaked, the current surge in bond yields suggests that the markets are moderating their expectations of any possible support from the monetary regime of developed economies. Persistent inflationary pressures driven by supply constraints means central banks will have to hold policy tight. China remains a black box with its internal issues on moderation of demand and the impending credit crises post the Evergrande collapse. Japan seems an outlier in this phase with above trend GDP growth and accommodative policy stance.

We feel the world is yet to realize silent risks of higher capital costs to asset classes. The plates in world order are shifting. We are amidst a multidecadal shift for inflation (structural & supply driven), reserve currency (dollar supremacy under question), political/military might of a superpower (multipolar pick-and-chose policy responses), a fractured supply chain, rising cost of capital & an increasingly deglobalized world (emerging global south).

These long decadal shifts take years, are incremental, slow, and subject to persistent bouts of volatility where the established order and emerging order are at crossroads. The established template & equations for currency, commodities, and capital might not work during this phase. We expect most of these asset classes to display persistent volatility.

We expect that the natural response from corporates in this VUCA (Volatile, Uncertain, Complex & Ambiguous) world would be to invest in creating an **agile-yet-antifragile** organization that requires increased buffer in capacities, resources, technology, and security. This means a world that moves away from its obsession to growth, efficiency, and returns, to build resilience, consistency, adaptability, and visibility to its business-food-chain.

Where Does India Stand

When everything is uncertain, hiding places are hard to find. India has been a shining star amidst the global chaos. With a recent successful hosting of G20 under its presidency, India is pushing its case hard on almost every meaningful global policy platform. This increased confidence stems from awareness of its global significance in terms of being –

a. Most populous in the world - yet a vibrant democracy
b. Among the large - yet fastest growing economy
c. A near-developed operational architecture - yet among the largest exploitable marketplace for coming decades
d. High on business confidence, backed by proactive, progressive and pro-reforms policy regime - yet under-invested

In a world that is focused on top-down, we remain excited about the bottom-up opportunities that are thrown by an economy that offers size, scale, diversity, and long-term growth visibility. India used the recent shocks of pandemic and global conflicts as an opportunity. It is now sitting pretty on a stress-tested prototype for an economy primed for a break-out; with firm building blocks like, demography (diverse & promising), policy (proactive & accommodative), development (public owned & contemporary), and entrepreneurship (innovative & growth focused). Built on these foundations, we expect some of the following themes to drive the India story from hereon are -

No	Underlying Themes	Key Drivers/ Outcomes
1	**Aspirational Consumption**	○ Young Population, ready at working age ○ Multiple cohorts at scale - Affordable aspiration a common DNA - driving megatrend of **premiumization**
2	**Digitization**	○ Digital Native population - supported by high penetration of mobile internet and policy support (incl G2C) ○ Government backed Digital Public Infra (DPI) - open architecture, population scale, public owned, interoperable & interconnected

		o Further feeding to multiple megatrends like **financialization, consolidation, formalization**
3	**Manufacturing Renaissance**	o Sizeable Local market anchor makes manufacturing an attractive proposition o Policy focusses to address the "missing piece" - outcome focused incentives o Primed to exploit white spaces emerging from **China+1/Europe+1** opportunities
4	**Capex Recovery**	o Government opening investments in **infrastructure upgrade** - ports, airports, roads, defense, railways, telecom, etc. o Individuals investing in home construction/ improvement riding megatrend of **urbanization** o Corporate balance sheets healthy, capacity utilizations at inflexion - with a focus on **automation, energy efficiency, sustainability, and green transition**

Markets… What Do They Say…?

Markets remain divided on the outlook and possible outcomes. A section focused on long-term opportunities remains excited on using correction as a long-term investment opportunity while for the others, every synchronized movement of crude, US Yields, Inflation and currency is a trading opportunity. We belong to the first sect and hence view markets from the prism of long-term investing.

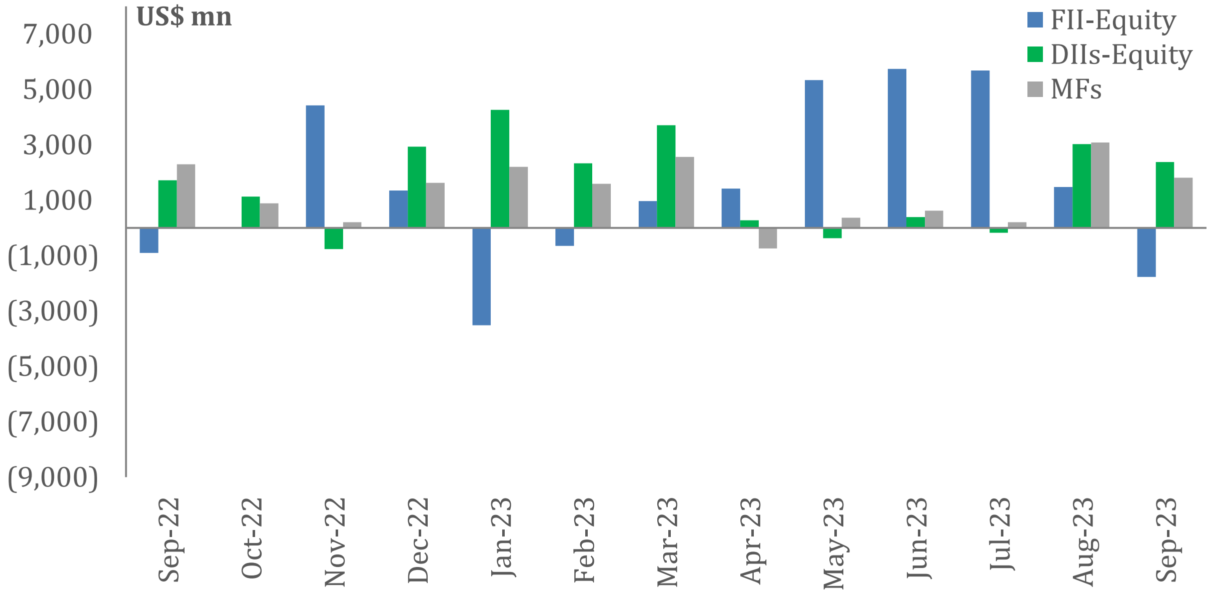
During the quarter, markets climbed every wall of worry to clock a new high. Market performance is a cumulative result of markets sentiments, earnings trajectory, participation structure and liquidity. We witnessed a confluence of all the four factors simultaneously.

Following three things have happened in this year -

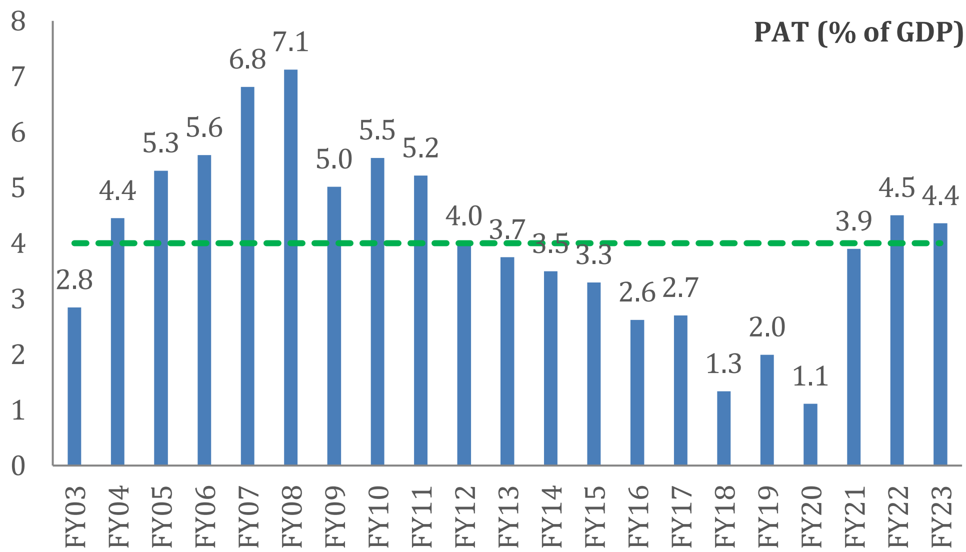
a. After a long hiatus the FIIs returned. YTD, their net buying stands at US$15.1bn - driven by relative attractiveness and diversion of otherwise incremental EM commitments away from China
b. During the same period, domestic institutions bought stocks worth US$15.7bn. These flows are riding a deep super-trend of financialization driven by surge of new investors, increasing-penetration, digital adaption, enhanced financial literacy and relative outperformance of equities against other asset classes
c. The pace of increase in interest rates has reduced, the input cost regime has softened, and base effect has played out on earnings as we resume to

experience first near normal year post turmoil of pandemic and Ukraine-Russia conflicts - resulting in better earnings visibility and improving ratio of Corporate Profits/GDP

FII and DII (US$mn)



Corporate Profits as % of GDP



As we enter the new quarter, the market backdrop has been cautiously optimistic given late dispersion of monsoon, firming of the oil prices, moderated input cost regime, steady macros, better fiscal health, and benign inflation.

Our Perspective…

At Enam AMC, we are immortally optimistic on India, with radical conviction. Our on-ground connects and engagement with multiple economic constituents ranging from corporates, policymakers, industry experts and top managements have further emboldened our confidence in the India story. This confidence stems from enduring visibility in all the three components of equity performance - earnings, policy, and flows.

Five core beliefs define our investment philosophy -

a. **Compounding** - Defined as sustained continuous incremental improvement over long-term.
b. **Mean Reversion** - Reversion to mean is nature's law. Cycles exist and do appear intermittently
c. **Focus** - Concentration and conviction are foundations of long-term wealth creation. Diversification is an outcome of focus (or lack of it!!).
d. **Big Hits** - Deep focus gets deep clarity on extent of change in business trajectory, thus generating big wealth.
e. **Risk management** - in life and investing, risk gets defined by the extent of bearable permanent loss - reducing misadventures brings outperformance.

Our investment strategy rests on five core tenets of Industry Opportunity, Leadership, Competitive Advantage, Improving returns and Margin of safety – thereby driving our efforts to - "**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.**"

We have engrained Business model sustenance, Business returns, and Medium-term cash flow growth as our core principles to help build a rational assessment of margin of safety - the Price-Value gap. We also have an ESG architecture overlay for portfolio construction. Well-defined risks, defined frequency monitoring and early flag-off for mitigation remain essential to avoid any accidents.

The stock selection, position sizing and portfolio construct seek a balance of conviction, market cap, liquidity, return potential and odds for opportunities that we intend to play. We have no specific affinity to either a sector, or any market cap. Embedding the margin of safety in the investment framework helps one navigate such an environment to avoid buying a stock expensive.

Does One Invest Now..?

The natural question of most investors is - Putting money to work at a new high!! does it make sense?

In investing three things are important - returns, risk, and time horizon. One must answer following three questions before putting monies to work…

a. What is my investment horizon?
b. Are the markets pricey?
c. What are the risks?

It is also important in investing that the investor and portfolio manager are aligned on all the three to deliver harmonious returns to the invested capital. Aligned committed capital allows the portfolio manager to navigate volatility and in fact embrace it for friendlier buying opportunities in conviction ideas.

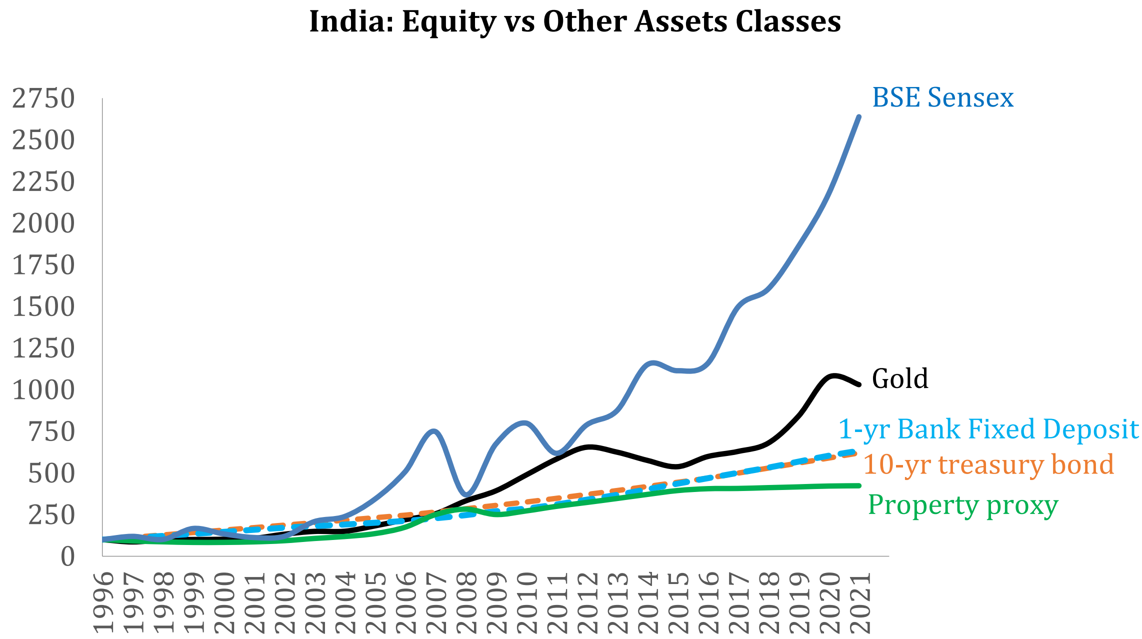
We attempt to address all the three here –

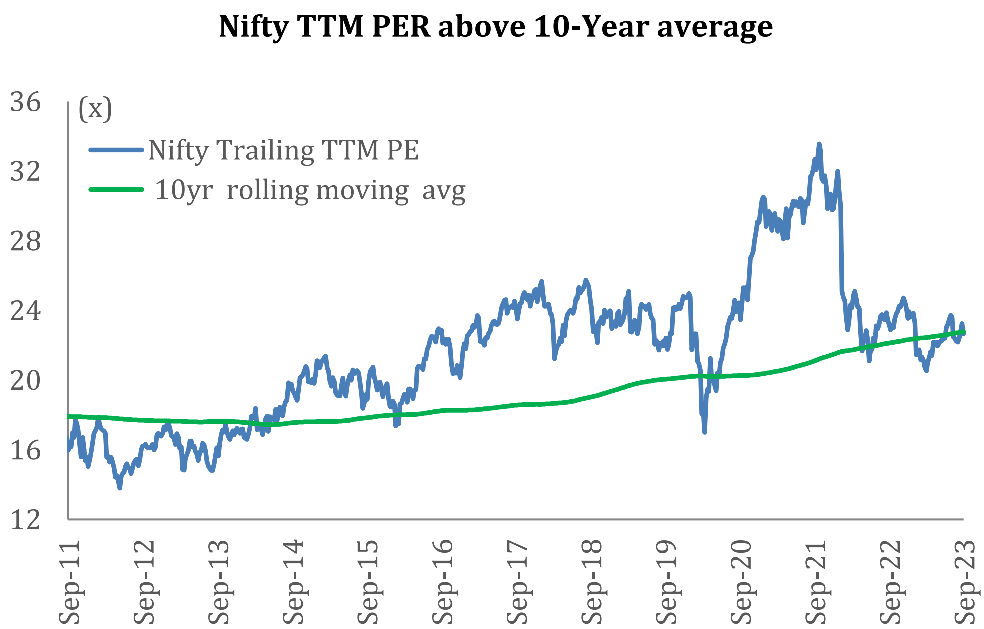
a. What is my investment horizon -

We are hard-coded craftsmen attempting to deliver center-of-the-plate generational wealth solution, through equities. This makes us long term investors.

In our last newsletter we explained our SEED (Structural, Emerging, Exceptional, Disruptive) opportunities template of investing. A large part of our portfolio is committed to long-term structural opportunities in businesses where there is visible sustainable growth. Our typical investment holding period has been more than 6-7 years in most cases. As discussed, we do not define volatility as risk - and treat it more as an outcome and opportunity. Further, one must also accept the fact that Equities have outperformed almost every other asset class when it comes to the horizon of 5-year plus.

When we look at investment opportunities, our typical horizon is more than 5-years; therefore, our assessment of markets/stocks is exclusively through this prism. This long-term mindset shifts our attention to volatility as a friend particularly when value emerges against the price at which the target security is traded.



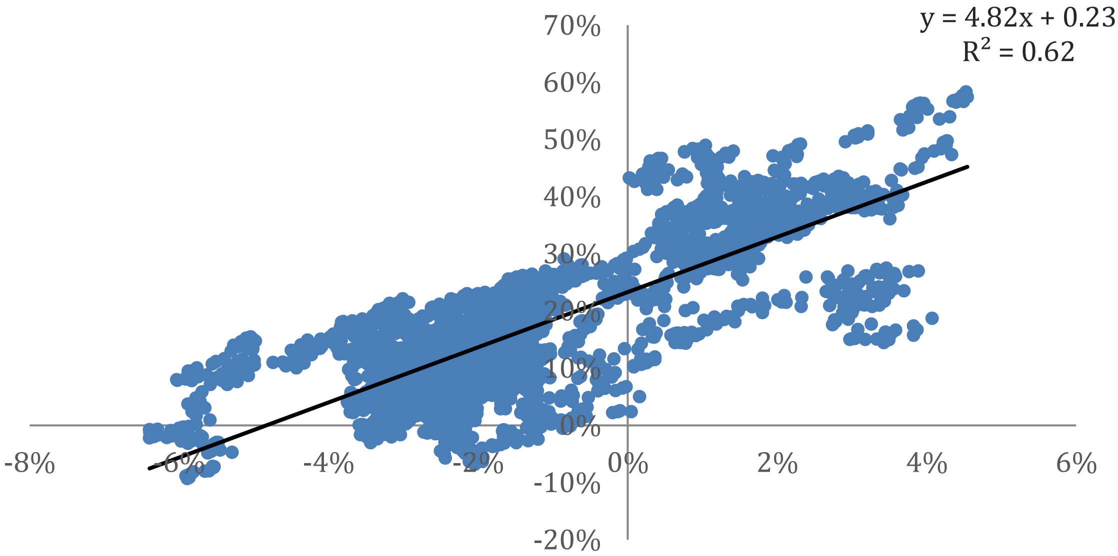


b. Are the markets pricey?

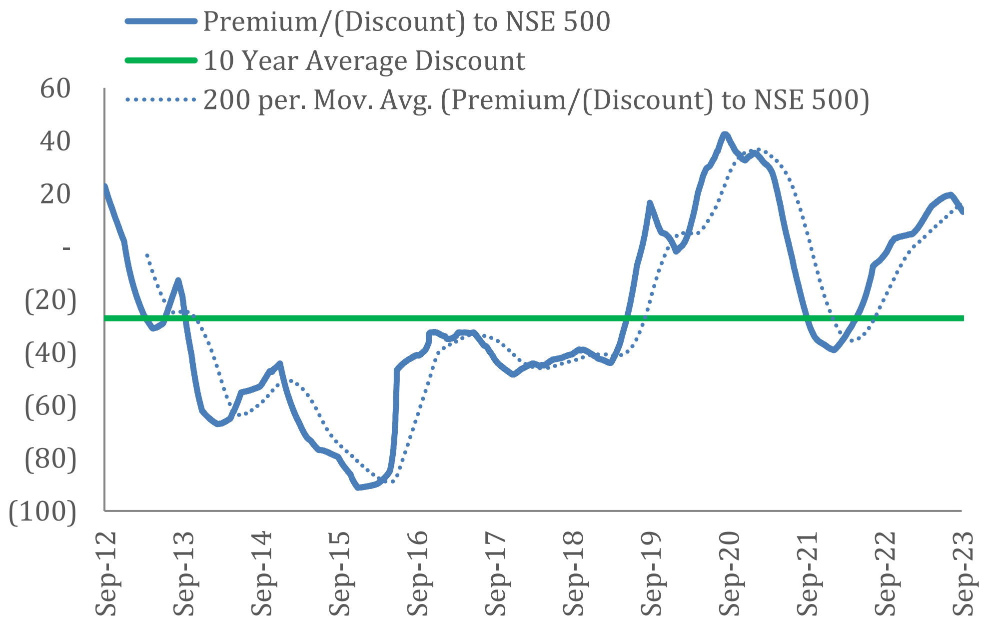
After witnessing a new high, the market has been consolidating. The 12-month forward P/E is now at ~21x and absolute P/B at~3.7x (~10-12% premium to the 10-year average). Relative P/E against EM peer set is now at ~1.89x. As things stand, prices are high, but has the value changed - not necessarily. The EY/BY gap is now stretched at -2.83%, marginally above historic averages - suggesting a 3-year return

CAGR of lower teens on frontline markets. The exuberance in broader markets at new highs though can be a transient phenomenon and does raise the probability of a likelihood of interim correction. This makes earnings growth a key driver of the market performance hereon.

EY/BY GAP



NSE Small Cap Prem/(Disc)to NSE 500



The recent phase has also resulted in higher optimism in the SMID (Small & Mid Cap) segment of the markets. This segment experienced a long phase of underperformance as against their larger peers over the last few years. Midcaps demonstrate a higher vulnerability to the economic environment as well as market sentiments. Add to this, the headwinds created by pandemic, war and their allied effects on logistics and material price inflations. Most of these corporates have used the crisis as an opportunity to correct their business and balance sheet architecture. As fundamentals improve, the sentiments and liquidity become favorable. That starts a virtuous cycle of renewed investor appetite and prices, resulting in an upswing in valuations.

India stands out in an otherwise messed up world with its better return profile, established transparent market structure, better earnings visibility, and better governance architecture. Further, through the prism of India's evolution in the global food chain on commerce, policy, and supply chain has further enhanced long term sustenance of its consistent delivery. A large part of corporates in the investible universe, has emerged stronger through the last 3-years adversities with better balance sheets, better operational performance, and cash focused resilient business models. We feel this enhanced long-term performance visibility through haze should continue to reflect in its premium valuation.

c. What are the risks?

As we discussed, we define risk as bearable permanent loss of capital. The risk, for our focused investing approach, is about wrong security selection or wrong position sizing. When it comes to security selection, the extent of damage to the investment thesis and the nature of damage (structural or transient) are the key monitorable risks. A bottom-up selection and deep engagement model of security selection reduces the risks of unknowns.

There does exist an overlay of market risk, which in the current scenario emanates from events in global financial markets and their rub-off to Indian equities. we remain cognizant of the gyrations the violent volatility will create in Indian markets with heightened unpredictability of global equations.

The other visible event risk remains that of impending elections in CY24. We believe that the current regime, over the last decade has been instrumental in cleansing, & creating structural irreversible reforms - something that is reflected in the buoyant state of the markets. Markets hate uncertainty; elections create uncertainties, where market sentiments and opinions precede outcomes. Election outcomes do have an influence on policy making, something which is materially relevant when the economy is well-poised for its take-off. While the long-term India growth story remains strong, consistent, and resilient, one can expect this phase to weigh-in market performance in the interim.

In Conclusion…

When it comes to investing, it is important to set expectations on all these three variables right and commit orderly exposures to equities with long-term perspective. We feel with our committed focus to create generational wealth through right exposures to the emerging India growth story, we possess a template to deliver sustainable risk adjusted returns over long-term. 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.

Wishing you and your family a happy festive season…!!!

Warm Regards,
Jiten Doshi
Co-Founder & CIO