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Global Private Client

KNOW THE NOW

Seeing the Light at the End of the Tunnel

November 21, 2020

PREFACE

With Pfizer and their German partner BioNTech SE reporting final trial test results that showed efficacy of their vaccine at 95%, and with the application to the US FDA for emergency use a few hours ago, the countdown to normalcy (or a new normal) has begun.

The AstraZeneca Oxford vaccine trial results are reported to be completed by late December and Moderna has also announced efficacy of 95% of its candidate - the world it seems will have its vaccine. And as home to the largest vaccine producer in the world, we should not be far behind in getting access to it.

The results of the US presidential election will bring in normalcy and stability in 2021, explains Sunil Sharma, our Chief Investment Strategist, in the enclosed note, **Know the Now: Seeing the light at the end of the tunnel**. "The US election has the potential to be a watershed event that will steer the world towards expansion, lower entropy, traditional geopolitics, and a kinder, gentler modus operandi than the tumultuous prior regime."

And though back home, some think that Trump was better for India, many draw some satisfaction from the US Vice President-elect's origins. On a slightly different note, isn't it surprising that its 2020 and the world's most powerful country is bringing its first **woman** to a high political office, It got one thinking that a real breakthrough on diversity of leadership would have been to witness two women fight it out on the race for the top job. Just like the unmissable television of the recently released season of *The Crown* reliving the 80's with PM Thatcher and the Queen of England running their country forty years ago (not to forget our own democratically elected PM Indira Gandhi in 1966).

Anyways, back to the markets which seem to have a life of their own as they continue their climb to new heights, with many investors waiting on the sidelines for a correction. The tsunami of liquidity and the signs of economic recovery makes it difficult to predict when and if this correction will happen.

Hope you enjoy the read, and as always do share your feedback or call us if you have any questions.

All of us at Ambit GPC wish you and your family a wonderful festive season as this tumultuous year comes to an end.

Stay safe - we are almost at the end!

Amrita Farmahan

CEO, Ambit Global Private Client

Seeing the Light at the End of the Tunnel

November 2020

Investment Strategy
Ambit Global Private Client

Summary:
The global and domestic economy are showing strong signs of recovery. The next decade holds the potential for strong economic growth. Key factors driving India's recovery are starting to come forward that we detail below. With strong flows, low interest rates, low inflation and supportive policy, equities hold strong promise for long term wealth creation.

State of the Global Economy

A Return to Normalcy & Stability in 2021

The U.S. election has the potential to be a watershed event that will steer the world towards expansion, lower entropy, traditional geopolitics, and a kinder, gentler modus operandi than the tumultuous prior regime. Markets are re-pricing for stability and normalcy. We believe investors are under-estimating the impacts and opportunities in the decade ahead. The news of multiple vaccines in the pipeline further raises hopes of a return to normalcy in coming months and a return to the freedoms we took for granted.

Markets are pricing for Stability and Return to Normalcy

The Economy is on the Path to Recovery

EPS earnings revisions are improving

U.S. Economic Recovery is Solidly Underway

The U.S. appears to be solidly on the path to recovery. A variety of indicators attached later in the piece demonstrate solid positive momentum.

Indian Economy is Poised for a Strong Recovery in 2021

The rural economy is in the best shape it has been in the past decade, and is driving a recovery in India's economy. Tier 2, 3, 4 cities look healthy. The Indian economy is also showing strong growth in manufacturing as the world gradually de-risks from China. (Charts and detail commentary on page 8).

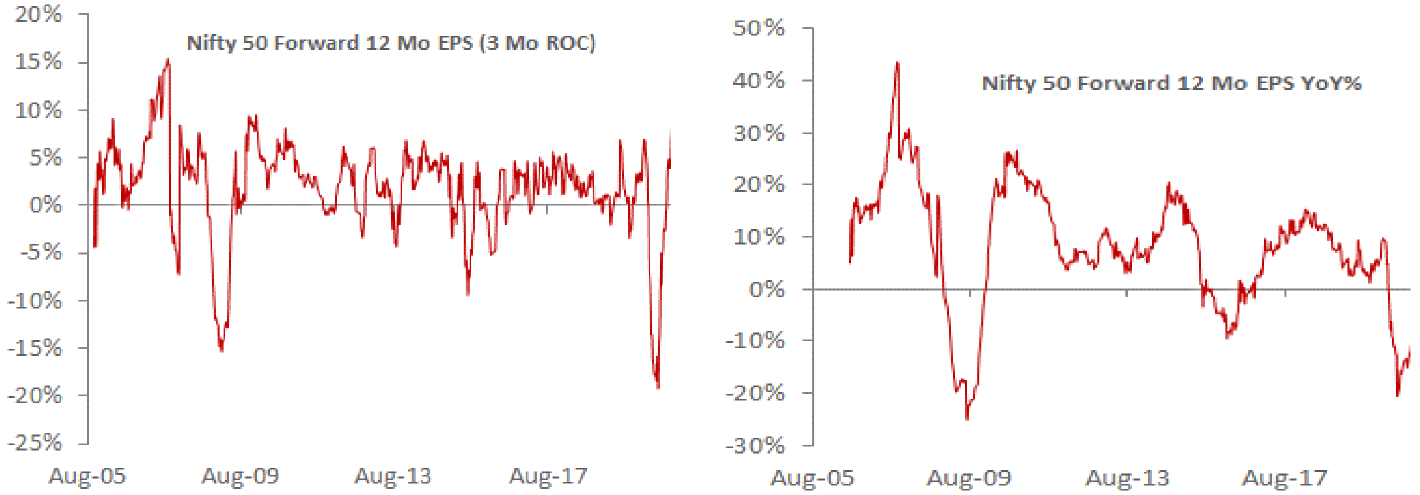
The 2009 Recovery Template Continues

We've been of the view that the current recovery would follow the 2009 recovery template. It continues to do so, and the market strength will continue into 2021. Skepticism still abounds, investors are largely under invested and don't understand the recovery. Large capital inflows will continue into markets as the recovery gathers steam and earnings recover.

Strong Earnings Recovery is Underway

The 3 month rate of change in 12 month forward EPS has accelerated in recent weeks,

Nifty Forward Earnings Estimates are Rising Rapidly in the Past Quarter



Source: Bloomberg

and analysts are upgrading earnings estimates at a strong double digit clip. With many sectors showing strength, strong earnings growth in 2021 off a very low base will drive markets higher.

Positive Forces for Growth Ahead

Capital Flows Tsunami from Retail Investors
With the rise of the retail investor globally, a tsunami of capital flows are likely to continue to flow into the market. The HNI investor is under-allocated in equities today. Finally, India remains the last large growth market for global investors to tap into. Global flows will also aggressively find their way into India, as our economy demonstrates strong, 8-10% growth in 2021.

Accommodative Global Policy to Remain
Global bankers have learnt a hard lesson in 2018 when they tried to shrink the central bank balance sheet. For the foreseeable future, central bankers are going to keep policy accommodative. This means low interest rates, low inflation and strong capital flows.

Strong Retail flows, accommodative policy, improving sectoral fundamentals provide growth impetus

Multiple Sectors Positioned to Dominate and Grow
Banks appear to have weathered the storm. The worst clearly seems behind us, and most business owners, entrepreneurs and SMEs can now see a return to normalcy sometime next year, and will position for recovery. Demand will return strongly, as savings rates have improved and consumers are desperate to get out and about.

Banks will benefit from rising consumer spending, Pharma and Specialty Chem are positioned to benefit from China plus one policy. Information Technology has executed a successful transition to consultative digital transformation leadership.

Valuations Remain on the Trend Line Relative to Interest Rates
The scatter plot of 10 year g-sec rates and P/Es demonstrates that valuations are right on the trend line, i.e., lower rates justify high valuations. Valuations remain sentiment driven, and we see sentiment improving as the economy recovery takes hold.

This Scatter Plot of P/Es and 10 Year G-Sec Rates Suggests Valuations Are Exactly Where They Should Be

Source: Bloomberg, NSE

Earnings Growth Improving in 2021

In our modelled scenarios below, high valuation stocks will continue to sustain their valuations as earnings rebounds with a recovery.

Many expensive equities will continue to remain expensive, while delivering double digit returns.

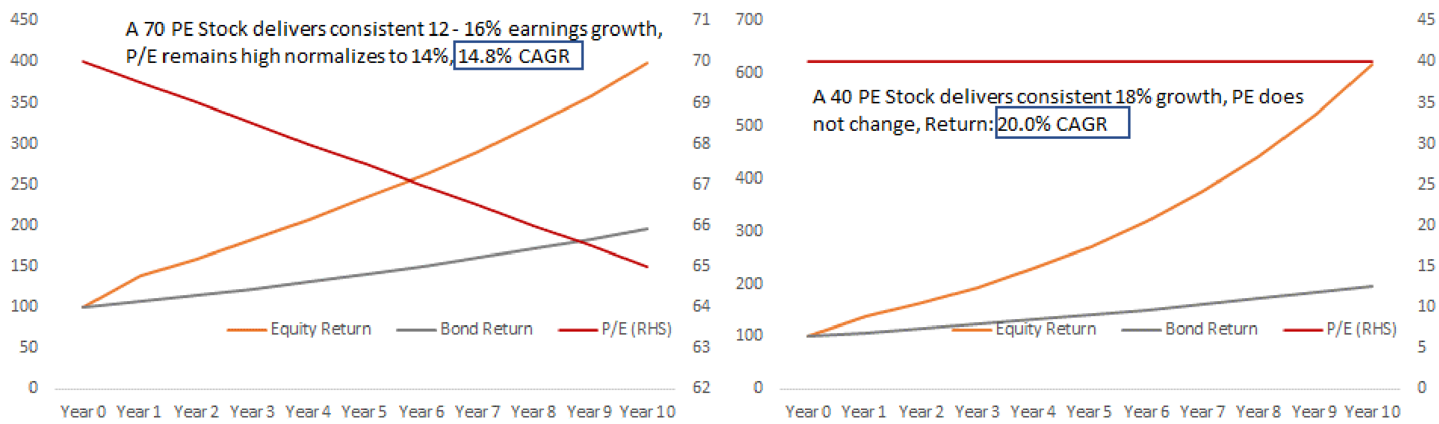
As noted in the chart at the bottom of the page, the P/E of the Nifty 50 has stayed consistently above 20, in a range of 20-25 times for the Modi tenure. As rates took a further step lower, in early 2020, valuations have moved higher.

Cost of Capital Likely to Remain Low for Years

Cost of capital is **likely to remain low for the next decade**. Therefore, **valuations are likely to remain high**. The valuation pendulum for the past few years now seems to be between 20 and 26 times. The recent leg up is assisted by the lowest rates in the Modi tenure, and evident and meaningful transmission to the consumer.

High P/E stocks Can Continue to Deliver Strong Gains as Long as Earnings Growth Recovers in 2021

Consistent EPS Growth Stocks Will Deliver High Returns and Can Sustain High Valuations



The P/E of the Nifty 50 Has Stayed Consistently Above 20 Since 2017…
…Primarily Because the 10 Year Rate Has Dropped From 8% to 5.9%

Stimulus is Now a Permanent Fixture in the Monetary Toolkit of Central Banks - Stimulus will be a permanent part of the investor lexicon and banker toolkit going forward. Stimulus appears to have been an effective supplement to traditional monetary policy. Therefore, expect investors to clamour for stimulus to generate growth.

Broadening Participation Means a Stronger Equity Wealth Effect - The broadening of the capital markets in India will lead to a more pronounced equity wealth effect. This is possibly the new transmission mechanism where a rising wealth effect spurs consumption, which then spurs investment.

Therefore, gradual deployments into assets and portfolios, maintaining a strategic and tactical approach to asset allocation, remains the way forward.

The new Pathway is Rising Stimulus, Rising Wealth Leading to Stronger Economic Growth

Investment Outlook – Equity

Stability in U.S. Policy

Markets clearly love stability and are re-pricing for stability and normality, with what appears to be a new President embarking on traditional stable U.S. policy. At least two promising vaccines add to further likelihood of a return to normalcy next year.

Rise of the Millennial Retail Investor

Retail traders have mushroomed in the U.S., China and India. Boredom. Work from Home. Free commissions. Information. Cult of Equity. Regardless the reason, large flows are coming into the market. FI money is flowing back into India.

Cash a Negative Yielding Asset

Holding cash in a rising inflation environment implies losing 2-3% in purchasing power every year if inflation is running at 6-7%. Holding 10-yr G-secs with a 5.8% pre-tax yield is also a loser in terms of purchasing power, setting aside potential duration benefits.

Imperative to Gradually Add Equity Exposure to Preserve Long Term Purchasing Power and Preserve / Grow Wealth

Given rising inequality, low rates, QE, and rising dispersion in risk asset returns, owning equities remains imperative to generate real returns and maintain purchasing power in a high inflation world.

Consistent High EPS Growth is the Primary Determinant of Price Appreciation

Recommendations

More Money Lost Waiting for Crashes…

We've are witnessing the worst of Covid as vaccines are on the way, and things will improve in coming months. That's the market's view. Disbelief amongst many investors remains high. Some strategists and investors have been predicting a crash since 2010. They got one and it lasted 3 months.

The Investor's Fallacy

The investor's fallacy is that we've had a long rally and it's time to expect a correction, or valuations are too high, or it's too risky, so I'm going to hold off. These decisions prove costly in the long run. It's a far better strategy to build quality portfolios and keep adding gradually.

Focus on Short Term Is Harmful to Long Term

Many investors have remained focused on a correction in the past few months. That stems from a short term perspective. A longer term perspective should be the focus. Therefore, gradually building a five year or ten year portfolio allows for wiser choices. Along the way, keep powder handy should a correction materialize. Tactical decisions add meaningful alpha.

Earnings Growth is Key

As we've highlighted, investing in large caps with earnings growth visibility is a safe approach. While it's preferable to invest with reasonable valuations, investing in expensive companies can generate reliable returns as well.

We've also made the case that for companies with long track records of consistent earnings delivery, valuation does not generally matter.

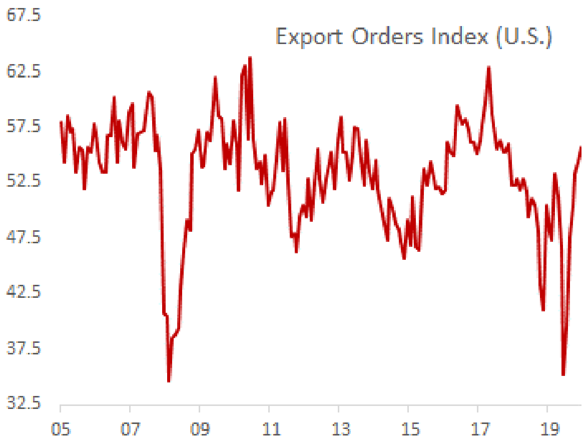
Invest in Specialized Strategies and Managers

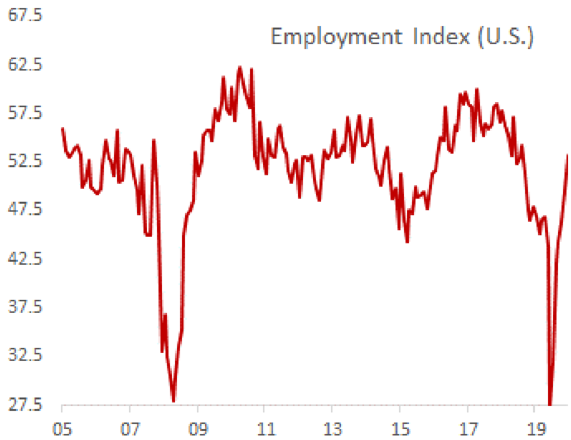
- Strong leadership growth segments of the market will deliver returns
- Specialized managers with proven track records
- Beaten down leadership stocks
- Pharma, Specialty Chem, Banking, Info Tech, Manufacturing look well placed
- Direct Equity portfolios with low fees and expenses
- Long short strategies can be considered for investors with concerns on capital loss
- Capitalization Tilts: large cap bias, but cap agnostic on companies with strong business models and earnings growth visibility.

With an improving economy, we would invest – gradually - in conviction names that meet the criteria we laid out earlier. Should the market correct, we'd average down our position. Lower interest rates suggest higher valuations are likely to continue.

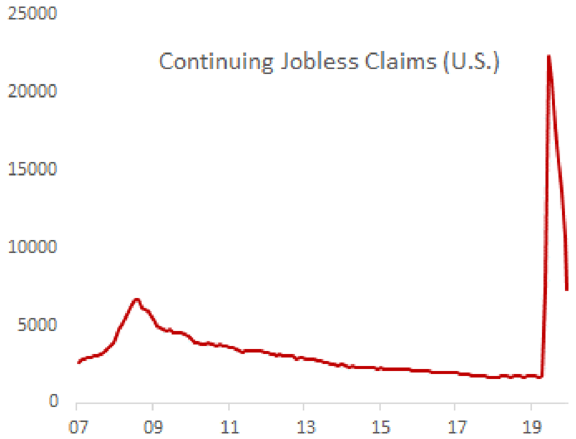
Investment Charts & Detail

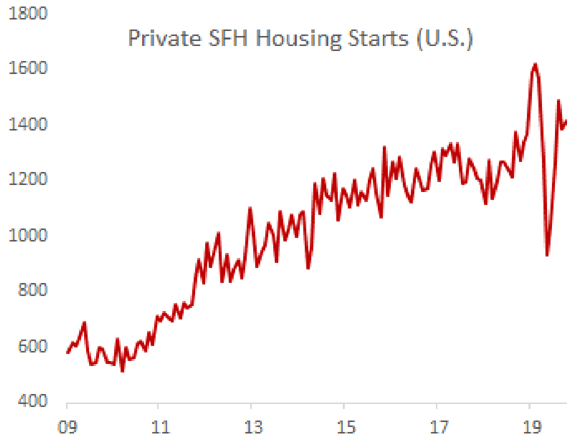
The U.S. Economy is Recovering Impressively, and Domestic Economy is Also Gradually Improving
U.S. manufacturing surveys show that conditions have improved dramatically in the past several months, and the outlook is rapidly improving. The chart below highlights growth in export orders for US manufacturers, a sign that the global economic outlook is improving.
There is also a needed improvement in U.S. manufacturers' outlook for new hiring, a recovery that appears to be tracking the 2009 recovery. Hiring generally coincides with a willingness to invest and expand operations.



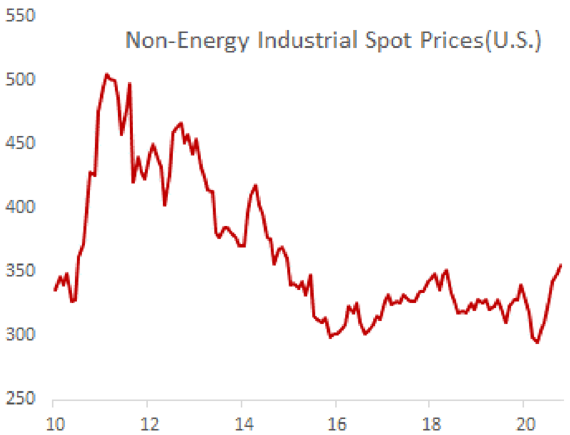


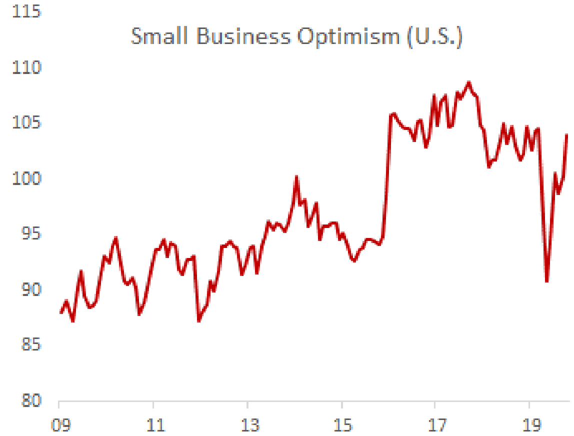
Continuing jobless claims of 7.28 million is a massive improvement from the high of over 20 million earlier in the year. People are returning to work. Single family housing starts are back on trend, as investors and consumers take advantage of historical low interest rates and depressed prices. Builders are turning optimistic about the future of residential construction.



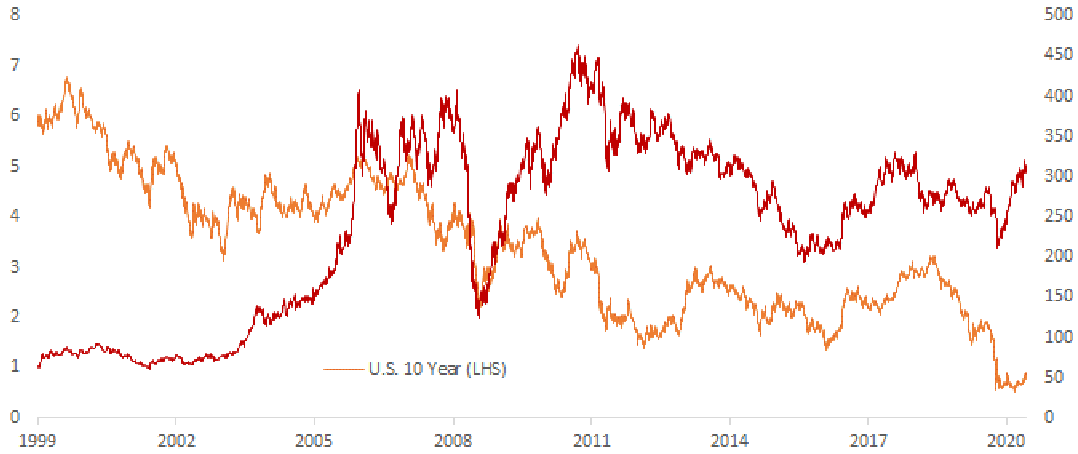


Finally, non-energy spot prices confirm the move in Copper. Small business optimism is also recovering, possibly buoyed by the U.S. government's massive stimulus and liquidity programs.





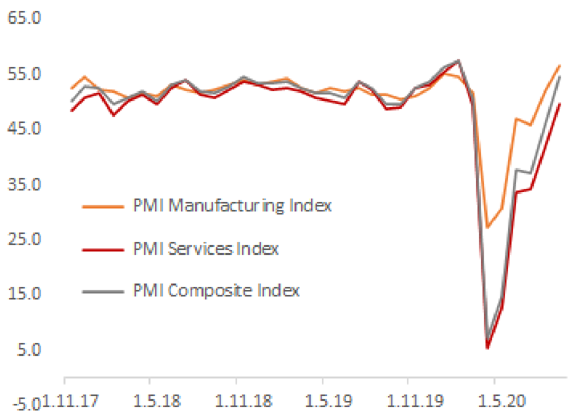
Next, Copper futures (red line) have risen in recent weeks to above 300, and so has the 10-yr Treasury yield, albeit marginally. More importantly, Copper is tracking previous recoveries in 2009, 2016. Both are suggestive of a nascent improvement in growth expectations globally, in particular U.S. and China. U.S. Treasury 10 year yields are at 0.91% is up 40 bps from the low in August of 0.5%.

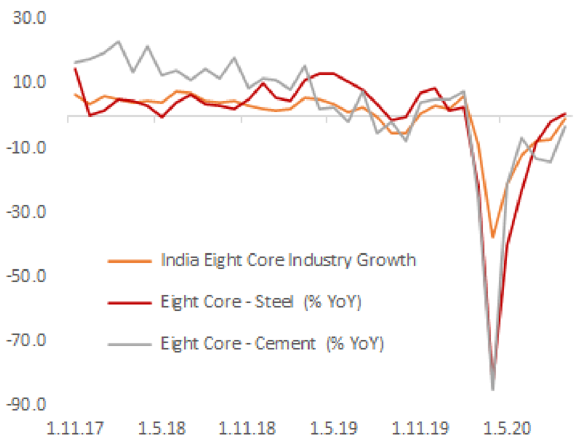


Low real rates and a positively-sloped yield curve strongly suggest we are in the early stages of what could prove to be an extended recovery. At the very least it's safe to say that the Fed poses no risk to the economy for the foreseeable future. Note that all previous recessions were preceded by high real rates and a flat or inverted yield curve slope.

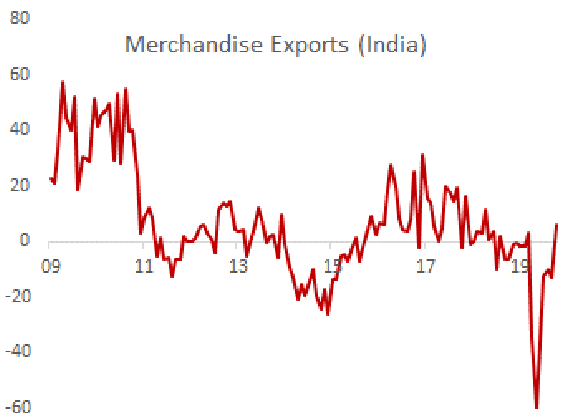
Indian Economy Showing Signs of Gradual Improvement

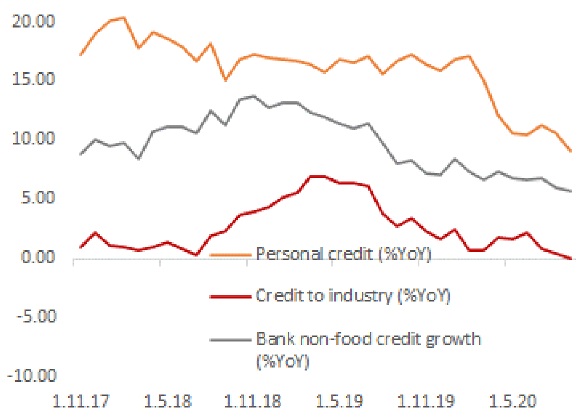
Coming over to India, PMI Services and Manufacturing are clearly indicating a recovering economy as well. The eight core industry data also show gradual recovery almost back to normal in steel, cement, overall.





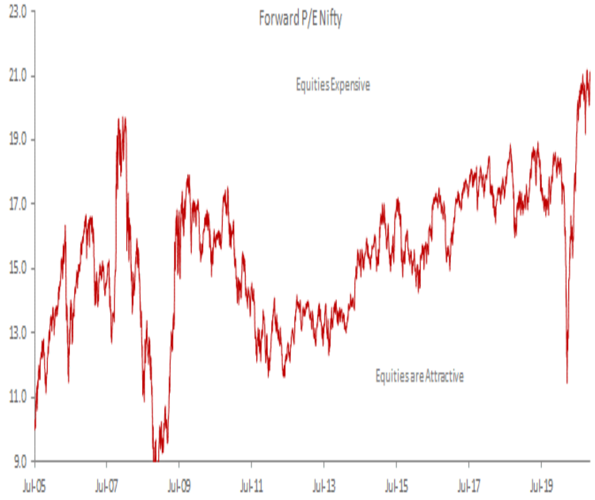
Part of the recovery appears to be driven by growth in merchandise exports, offsetting weakness in urban retail, entertainment, leisure. Meanwhile credit growth remains anemic, and continues to slow.

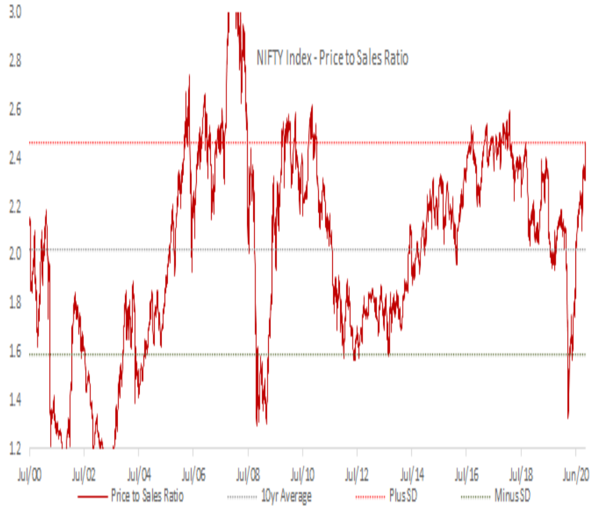




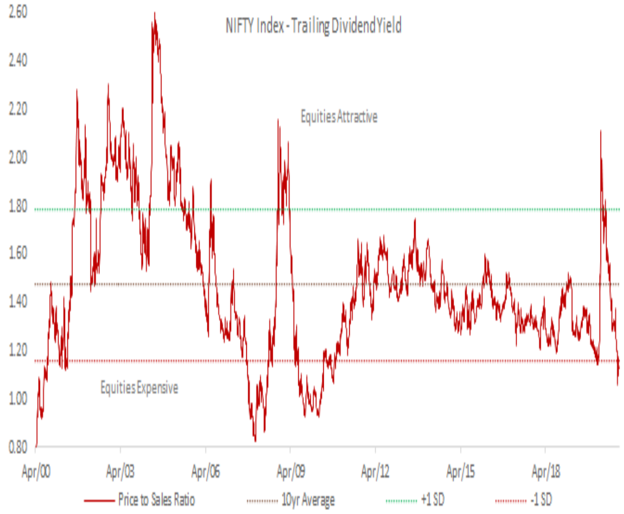
Valuation for Indian Equities

Forward P/Es and Nifty Price / Sales

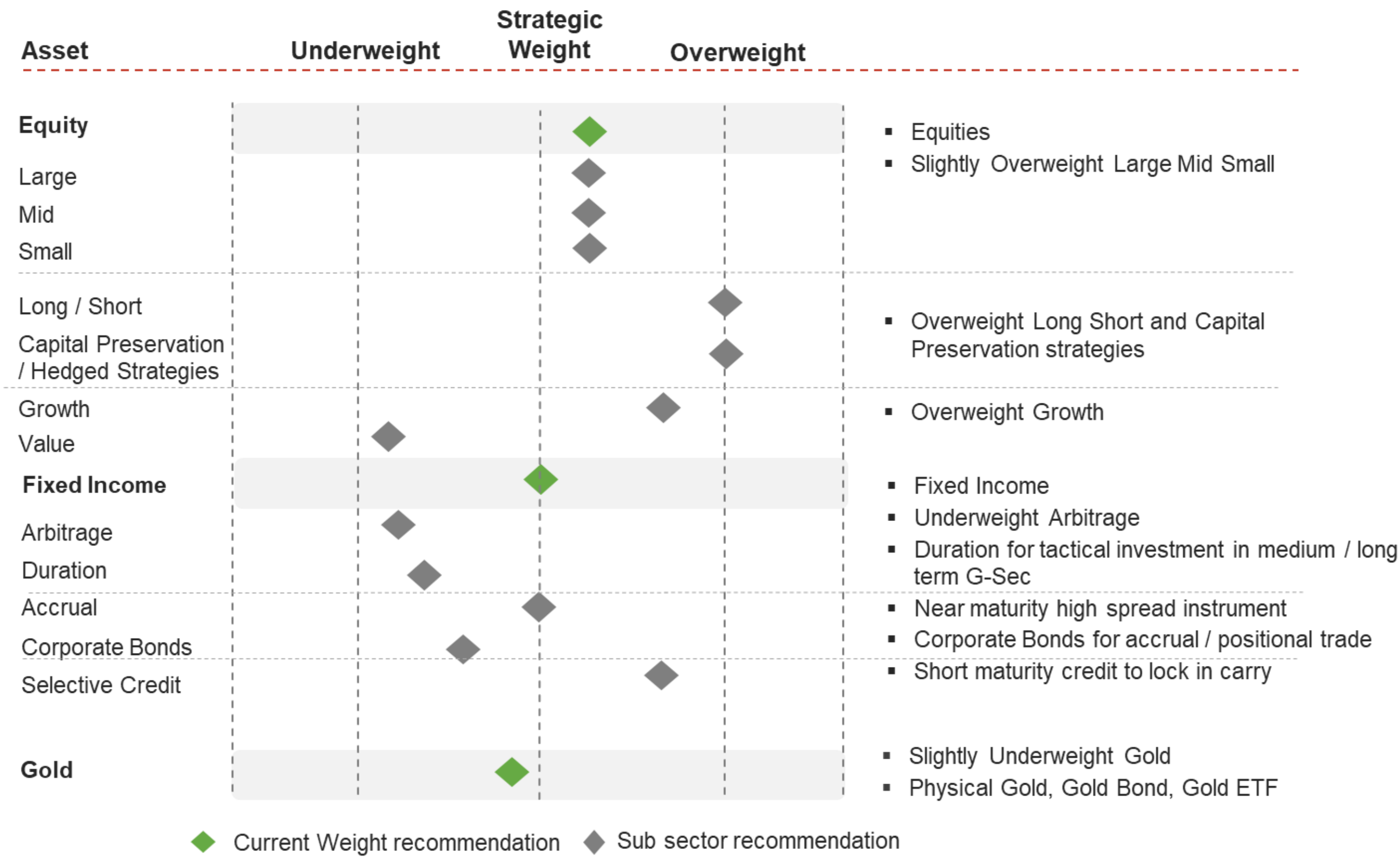




Price to Dividend Yield and Premium to Emerging Markets



Asset Allocation Relative to Strategic



Report Authored by Sunil Sharma

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Sources: All sources unless otherwise noted are Bloomberg, NSE.

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