

**MONTHLY NEWSLETTER**

**JANUARY 2023**

# **THE MESSI(AH) OF GLOBAL ECONOMY: INDIA**



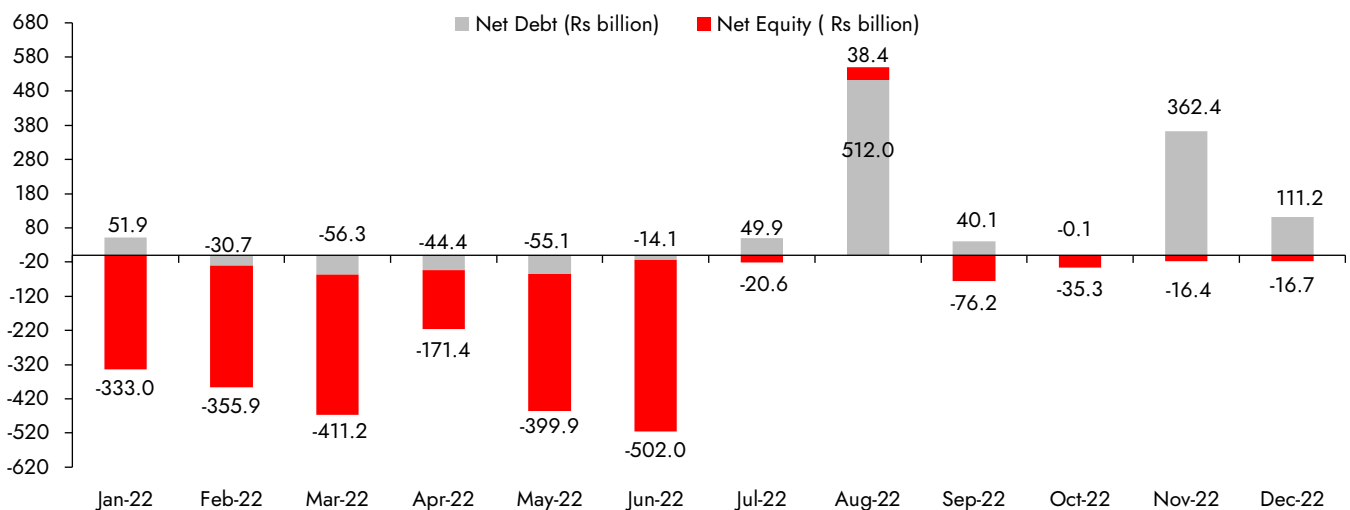
## The Messi(ah) of global economy - India

As the dust settles on an enthralling month of soccer, fans were treated to, arguably, one of the greatest ever World Cup finals in the sport's history. The final had superstar rivalries, classy goals, nail biting penalties, and goalkeeping masterclasses, and in the end a pièce de resistance, the iconic image of Lionel Messi – lifted aloft on his teammates' shoulders – with the World Cup trophy finally in his hands.

The opening 79 minutes were all about La Albiceleste, who led by 2 goals. France (primarily, Mbappé) turned around the game within 97 seconds, taking the game to extra-time. Mbappé – yet again – denied Messi the World Cup winning goal scoring in the final minutes to equalize AGAIN!

Drawing parallel to the see-saw battle, the Indian equity game (markets!) also saw shifts happening throughout the year (witnessed high volatility!). Capital flows from foreign portfolio investors (FPIs) in 2022 reflect two distinct trends – while the first half of the year witnessed an aggressive sell-off, the second half was about their return to the Indian markets (**Refer Exhibit: 1**).

**Exhibit 1: Net FII flow in CY22 – one of the sharpest outflows which couldn't deter the markets**



Source: FPI flows in 2022, NSDL

The sluggishness in the markets was due to multiple factors: the Russia-Ukraine crisis, which resulted in the highest ever inflation in 40 years in the USA, followed by the steepest rise in interest rates by the US Fed which led to a flight of capital from riskier assets, commodity pressures, and slowing consumption.

Despite several headwinds on both global and domestic levels, the Indian equity markets showed resilience and turned out to be one of the top performers across the globe against peers. Relatively strong growth and a healthy corporate earnings cycle acted as positives, making the fundamentals of the Indian economy much more attractive than most EMs. A worrisome current account deficit, tighter liquidity (compared to a year ago) and high inflation are challenges we expect to last for a few more quarters at least.

**In this note, we will take you through some of the notable points to summarise the year gone by (including Hits and Misses) and talk about the outlook for CY2023.**

## Sectorial overview of 2022 and the road ahead for 2023

We take a deep dive into a few key sectors and assess the year gone by and outline the key themes to look out for in CY23

### Exhibit 2: We remain bullish on Banks, Auto, IT Services, discretionary consumption in CY23

Sector	CY22		CY23
	Hits	Misses	Outlook
<b>Automobiles &amp; Auto-Ancillary</b>	<ol style="list-style-type: none"> <li>1. Automotive retails for the sixth consecutive month saw industry-wide PV volumes crossing the 300,000 unit's mark.</li> <li>2. Strong structural demand throughout the year with domestic PV sales likely to touch 40 lakh units (a record level) this year.</li> <li>3. Electric 2/3-wheeler growth story keeps getting better.</li> </ol>	<ol style="list-style-type: none"> <li>1. Global shortage of semiconductors.</li> <li>2. Rising commodity prices impacting margins of OEM's.</li> <li>3. Non availability of container resulted in higher costs for auto ancillary imports.</li> </ol>	<ol style="list-style-type: none"> <li>1. Sustained volume growth in 2023 and further embracing of clean technology.</li> <li>2. Lurking speed breakers of rising interest rates and cost increases due to new emission and safety norms. Gearing up to meet the stringent second phase of BS VI emission norms from April 2023.</li> <li>3. Sales of electric PV in India are expected to reach the 100,000 mark with the launch of more options by OEM's.</li> </ol>
<b>Building Materials</b>	<ol style="list-style-type: none"> <li>1. Housing demand continues to be robust along with change in consumer preferences which resulted in premiumization and shortening of replacement cycle.</li> </ol>	<ol style="list-style-type: none"> <li>1. Moderation in growth seen in pockets in volume growth seen in several segments due to unprecedented increase in prices of some of building materials.</li> <li>2. Consumer High inflation has led to a slowdown in construction activity &amp; higher product prices over the past 12 months continued to hurt the consumer affordability.</li> </ol>	<ol style="list-style-type: none"> <li>1. Rural which has been weak in the recent past is showing signs of recovery and along with drop in key RM's will lead to decent volume growth.</li> </ol>
<b>Chemicals</b>	<ol style="list-style-type: none"> <li>1. Broad based capex led growth fueled by China +1 and import substitution</li> </ol>	<ol style="list-style-type: none"> <li>1. Pockets of weakness across few segments such as textiles, pigments and pharmaceuticals</li> </ol>	<ol style="list-style-type: none"> <li>1. Chemical companies should continue to do well owing to better capacity utilization, moderating RM and logistics cost.</li> <li>2. The production constraints in China due to ongoing surge in COVID cases along with focus on stringent de-carbonization targets can impact the supply chains for several segments for Chemical companies.</li> </ol>
<b>Consumer Discretionary</b>	<ol style="list-style-type: none"> <li>1. Strong pent up demand witnessed across companies.</li> <li>2. Tier1/2 cities reported higher growth with increasing share of premiumization.</li> <li>3. Aggressive store expansion drove revenue growth.</li> </ol>	<ol style="list-style-type: none"> <li>1. High inflation in raw materials impacted margins adversely.</li> <li>2. Tepid demand witnessed for mass/value segments products due to high inflation.</li> </ol>	<ol style="list-style-type: none"> <li>1. Expect some moderation in growth due to high base</li> <li>2. Declining RM prices decline &amp; better product mix via premiumization to be silver lining for margin expansion.</li> </ol>
<b>Consumer Staples</b>	<ol style="list-style-type: none"> <li>1. Volume growth muted; revenue primarily led by pricing growth.</li> <li>2. Rural growth subdued owing to inflation; better urban demand witnessed in urban segment.</li> <li>3. Expansion of portfolio through the inorganic route.</li> <li>4. Increased focus on e-commerce and D2C channels to push sales.</li> </ol>	<ol style="list-style-type: none"> <li>1. Sustained high prices of certain raw materials especially agri-related and high cost inventories have led to continued margin pressure.</li> </ol>	<ol style="list-style-type: none"> <li>1. Companies to expand its revenue pool by entering into adjacencies which shall lead to capex, higher operating expenses &amp; revenue growth.</li> <li>2. Value proposition to be seen back where price cuts take place &amp; ensure volume growth which shall drive the value growth.</li> <li>3. Expect the FMCG sector to tap the inorganic route for entrance into niche segments like Health, Wellness, Beauty &amp; Cosmetics, Personal Care etc.</li> </ol>
<b>Financials</b>	<ol style="list-style-type: none"> <li>1. The improvement in credit growth has been broad based driven by revival in Industry growth; retail continues to drive higher growth.</li> <li>2. The banking sector witnessed the best asset quality trend (recoveries &gt; slippages) since 2016 leading to</li> </ol>	<ol style="list-style-type: none"> <li>1. Deposit growth lags the credit growth leading to increase in borrowings.</li> <li>2. Operating profit growth lower than the top-line growth due to lower treasury gains &amp; higher operating expenses.</li> </ol>	<ol style="list-style-type: none"> <li>1. <b>Liquidity:</b> Indian banks have bonds worth Rs17trn in excess of regulatory requirements which would add to the bank's ability to lend &amp; support growth.</li> <li>2. <b>Margins:</b> As the deposit rates rise in lagged manner along with rising operating expenses on account of branch expansion, rising wages &amp; tech</li> </ol>

	<p>superlative profit growth driving the overall index growth.</p> <p><b>3.</b> BFSI companies incurred highest digital spending in terms of services, platforms, apps or through fin-tech partnership, for few banks the tech spending is 6-9% of total operating expenditure.</p>		<p>spend, the margin pressure to persist in the later part of 2023 for banks &amp; for NBFCs the margin pressure has been witnessed due to lead-lag effect.</p> <p><b>3. Sourcing:</b> Various partnerships within Banks, NBFCs &amp; Fintech Partnerships in terms of co-lending model to be seen going ahead which is a win-win proposition for all the entities – Originator, Provide &amp; Borrower.</p>
<b>IT</b>	<p><b>1.</b> Normalizing attrition post H1</p> <p><b>2.</b> Decent Revenue growth thus far despite macro challenges</p> <p><b>3.</b> No meaningful sign of demand slowdown</p>	<p><b>1.</b> Margin pressure due to high attrition, subcontracting cost and wage hike</p> <p><b>2.</b> Pockets of slowdown - Mortgage BPO, Retail and select European clients.</p> <p><b>3.</b> Tech startups scaling down operation; Hyperscalers indicating slowdown and cutting guidance</p>	<p><b>1.</b> Macro headwinds of CY22 to play out with a lag effect in CY23.</p> <p><b>2.</b> Quantum of these challenges and client budget announcements will set course for stock performance in the near term. Deal pipeline growth for the companies in the IT sector to be moderated further as the base effect takes place along with budget cuts.</p> <p><b>3.</b> Remain positive on the sector over medium to long term given superior return ratios, Cash Conversion and benefit of increased Digitalization.</p>
<b>Pharmaceuticals</b>	<p><b>1.</b> Domestic Branded Generics: Strong growth (ex-COVID products) led by volume recovery in acute therapies.</p> <p><b>2.</b> Custom Synthesis / CDMO: Benefits of COVID product API / intermediate sale led to sharp growth for select companies.</p>	<p><b>1.</b> Continued Price erosion in US impacted smaller, plain-vanilla generic exporters much more.</p> <p><b>2.</b> Severe price erosion in some APIs like ibuprofen and ARV products due to excessive inventory and supply build up.</p> <p><b>3.</b> Margin erosion as not all companies were able to pass on higher cost.</p>	<p><b>1.</b> Expect the bearish trend of CY22 to reverse in CY23 with – (a) Improving container availability (b) normalizing API inventory (c) Stabilizing inputs prices (d) Resumption of client audits for CDMO players</p> <p><b>2.</b> Expect Domestic Branded Generic and API companies to O/P</p>

## Outlook for 2023 – Will Indian markets outperform in 2023?

2022 witnessed a roller coaster ride and with a meagre ~6% returns in INR terms. The recent resurgence of covid-19 in China is the kind of exogenous disruptions that the global equity markets could likely endure. However, as we usher in 2023, we do expect the Indian equity markets to bounce back and deliver handsome returns. Some of the key reasons that make us optimistic and need to be watched out for are as below:

- End of the tightening cycle:** The latest inflation data (for both USA and India) have been quite encouraging and makes us believe that globally inflation has peaked out. In India, with CPI inflation falling to 5.9%, the real policy rates are now in the positive. Thus, RBI rate hike cycle looks to be ending.
- Earnings growth trajectory to pick up:** CY23 is expected to witness strong earnings growth acceleration largely on account of margin expansion, softening commodity prices (including oil & gas) and meaningful pricing action (across sectors).
- Rural growth resurgence:** Over the last couple of years, a combination of rising WPI inflation and crop damage due to unseasonal rains meant that rural demand remained weak. However, factors such as encouraging early sowing data from Rabi crop, softening WPI inflation and rising rural consumer sentiment are indicative of a turn-around.
- Accelerated government spending:** In the run up to the 2024 elections, government spending is expected to accelerate especially now that the fiscal situation is quite better than expected. The upcoming budget could emphasis on rural growth, infrastructure, affordable housing and agriculture. This would ensure that the credit growth remains strong in double digit (even on a high base) in 2023.

So, overall we believe that macro-economy wise the worst is behind us and the situation looks to have stabilized. Softening export demand, depreciating INR, current account deficit problems, are now all behind us. All of this should augur well for Indian Equities heading into 2023.

## Conclusion

*“Argentina’s loss to Saudi Arabia in their first World Cup game was a turning point in the changing room”,* coach Lionel Scaloni had said, bringing out the grit to recover, winning six consecutive matches on the trot. Argentina’s path to glory is a parable for investors, there are quite a few lessons that one can draw from sports despite a tough start.

### **Time & Patience – more powerful than intelligence and talent**

The seeds of Argentina’s fortune were sown 4 years back when Lionel Scaloni, Argentina’s coach, was appointed to engineer a turnaround after Argentina’s 2018 World Cup nightmare. Despite losing the first game, his perseverance and calmness of not overreacting and playing to their strengths paid off. The same ought to be mimicked in one’s investing journey. This was aptly explained by Warren Buffet: “Investing is not a game where the guy with the 160 IQ beats the guy with the 130 IQ. Once you have ordinary intelligence, what you need is the temperament to control the urges that get other people into trouble in investing.”

### **Even the best underperform in the short term**

Argentina’s loss to Saudi Arabia, France and the well fancied, Denmark, loss to the lowly ranked Tunisia, the end of Belgium’s golden generation, or Vincent Aboubakar’s historic goal against Brazil, the tournament saw a lot of major upsets. Even the best underperformed. Similarly, the best of the company or economy will go through near-term blips. What is important is the long-term performance.

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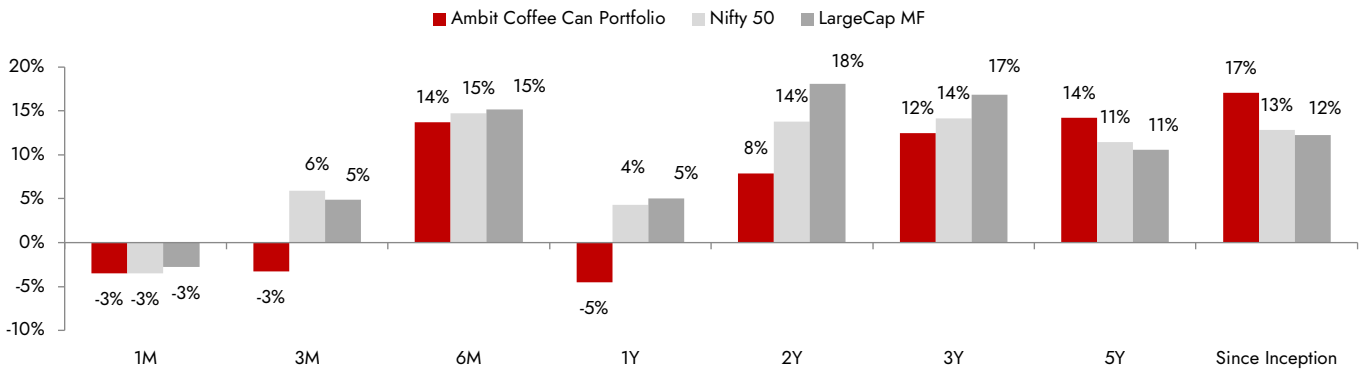
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### Ambit Coffee Can Portfolio

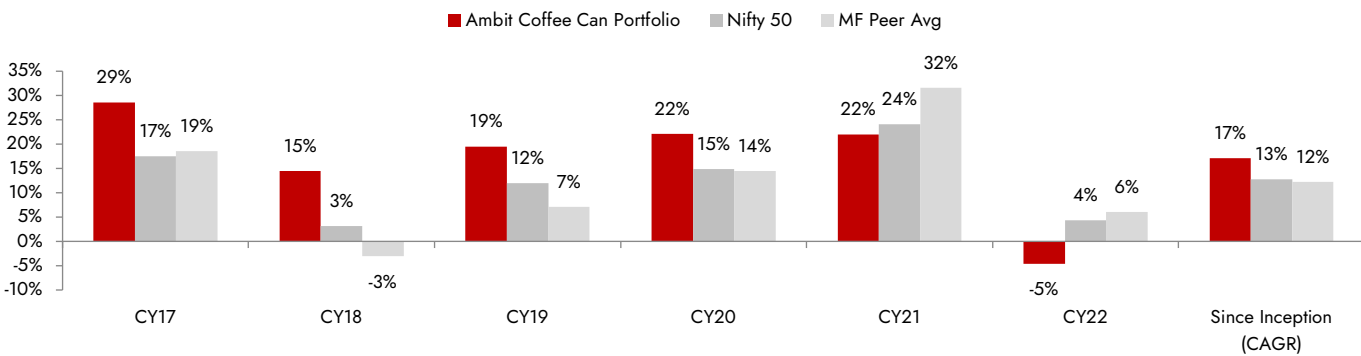
At Coffee Can Portfolio, we do not attempt to time commodity/investment cycles or political outcomes and prefer resilient franchises in the retail and consumption-oriented sectors. The Coffee Can philosophy has unwavering commitment to companies that have consistently sustained their competitive advantages in core businesses despite being faced by disruptions at regular intervals. As the industry evolves or is faced by disruptions, these competitive advantages enable such companies to grow their market shares and deliver long-term earnings growth.

**Exhibit 3: Ambit’s Coffee Can Portfolio point-to-point performance**



Source: Ambit; Portfolio inception date is March 6, 2017; Returns as of 31<sup>st</sup> Dec, 2022; All returns are post fees and expenses; Returns above 1-year are annualized; Note: Returns prior to Apr’19 are returns of all the Pool accounts excluding non-aligned portfolio, and returns post Apr’19 is based on TWRR returns of all the pool accounts.

**Exhibit 4: Ambit’s Coffee Can Portfolio calendar year performance**



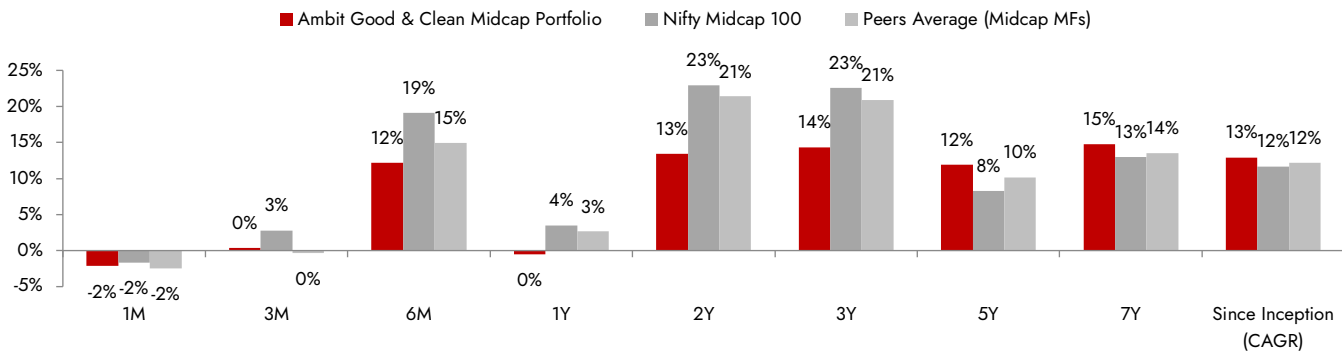
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## Ambit Good & Clean Midcap Portfolio

Ambit's Good & Clean strategy provides long-only equity exposure to Indian businesses that have an impeccable track record of clean accounting, good governance, and efficient capital allocation. Ambit's proprietary 'forensic accounting' framework helps weed out firms with poor quality accounts, while our proprietary 'greatness' framework helps identify efficient capital allocators with a holistic approach for consistent growth. Our focus has been to deliver superior risk-adjusted returns with as much focus on lower portfolio drawdown as on return generation. Some salient features of the Good & Clean strategy are as follows:

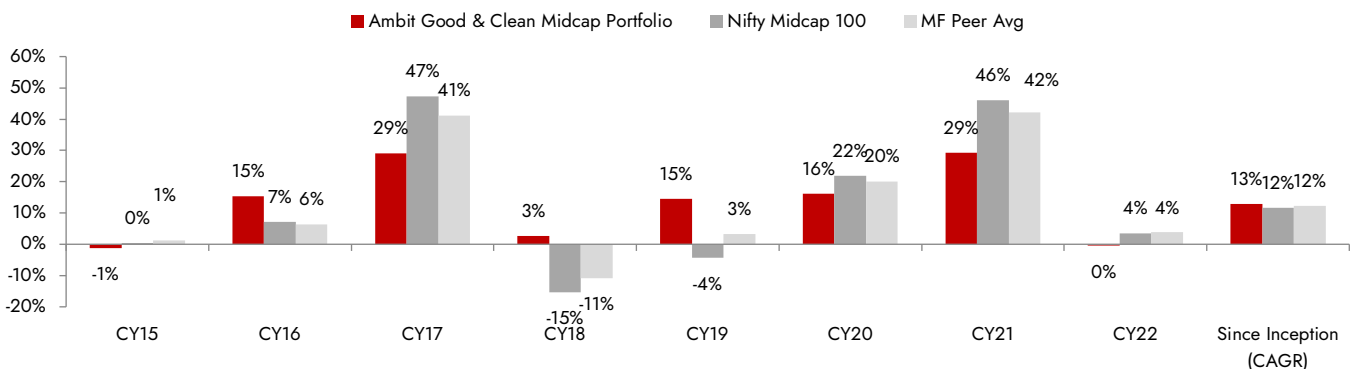
- **Process-oriented approach to investing:** Typically starting at the largest 500 Indian companies, Ambit's proprietary frameworks for assessing accounting quality and efficacy of capital allocation help narrow down the investible universe to a much smaller subset. This shorter universe is then evaluated on bottom-up fundamentals to create a concentrated portfolio of no more than 20 companies at any time.
- **Long-term horizon and low churn:** Our holding horizons for investee companies are 3-5 years and even longer with annual churn not exceeding 15-20% in a year. The long-term orientation essentially means investing in companies that have the potential to sustainably compound earnings, with this compounding earnings acting as the primary driver of investment returns over long periods.
- **Low drawdowns:** The focus on clean accounting and governance, prudent capital allocation, and structural earnings compounding allow participation in long-term return generation while also ensuring low drawdowns in periods of equity market declines.

**Exhibit 5: Ambit's Good & Clean Midcap Portfolio point-to-point performance**



Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of 31<sup>st</sup> Dec, 2022; All returns above 1 year are annualized. Returns are net of all fees and expenses

**Exhibit 6: Ambit's Good & Clean Midcap Portfolio calendar year performance**

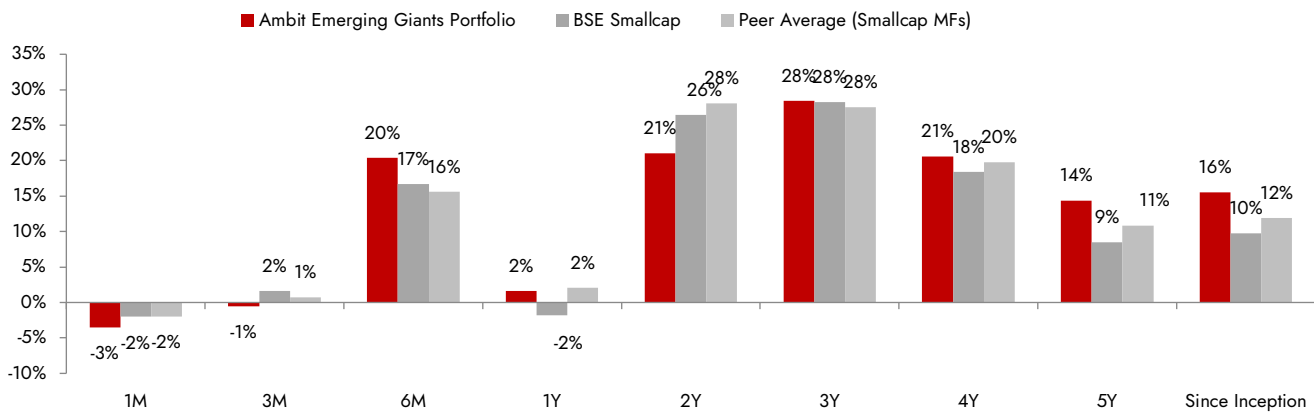


Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of 31<sup>st</sup> Dec, 2022. Returns are net of all fees and expenses

## Ambit Emerging Giants Portfolio

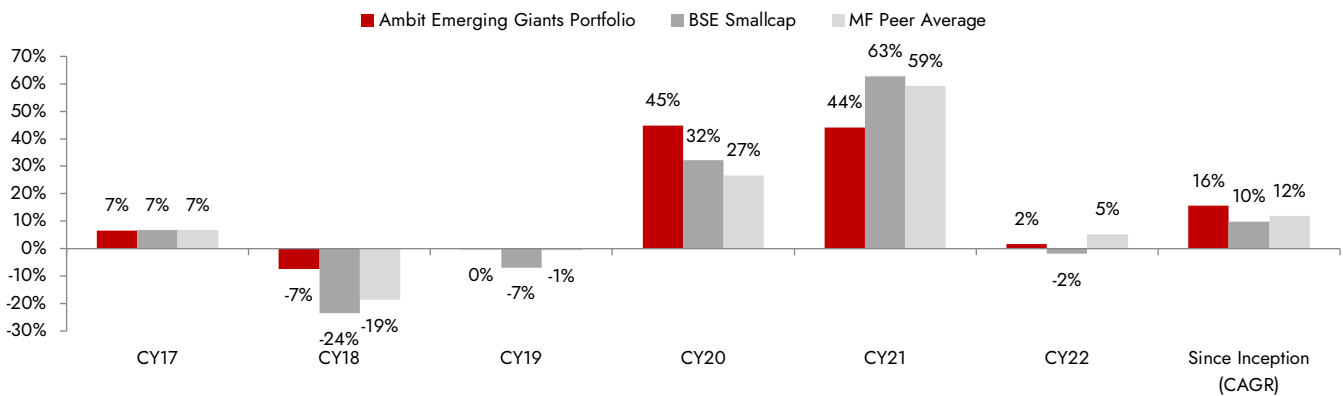
**Small caps with secular growth, superior return ratios and no leverage** – Ambit’s Emerging Giants portfolio aims to invest in small-cap companies with market-dominating franchises and a track record of clean accounting, governance and capital allocation. The fund typically invests in companies with market caps less than Rs4,000cr. These companies have excellent financial track records, superior underlying fundamentals (high RoCE, low debt) and ability to deliver healthy earnings growth over long periods of time. However, given their smaller sizes, these companies are not well discovered, owing to lower institutional holdings and lower analyst coverage. Rigorous framework-based screening coupled with extensive bottom-up due diligence lead us to a concentrated portfolio of 15-16 emerging giants.

**Exhibit 7: Ambit Emerging Giants Portfolio point-to-point performance**



Source: Ambit; Portfolio inception date is December 1, 2017; Returns as of 31<sup>st</sup> Dec, 2022; All returns above 1 year are annualized. Returns are net of all fees and expenses

**Exhibit 8: Ambit Emerging Giants Portfolio calendar year performance**



Source: Ambit; Portfolio inception date is December 1, 2017; Returns as of 31<sup>st</sup> Dec, 2022. Returns are net of all fees and expenses

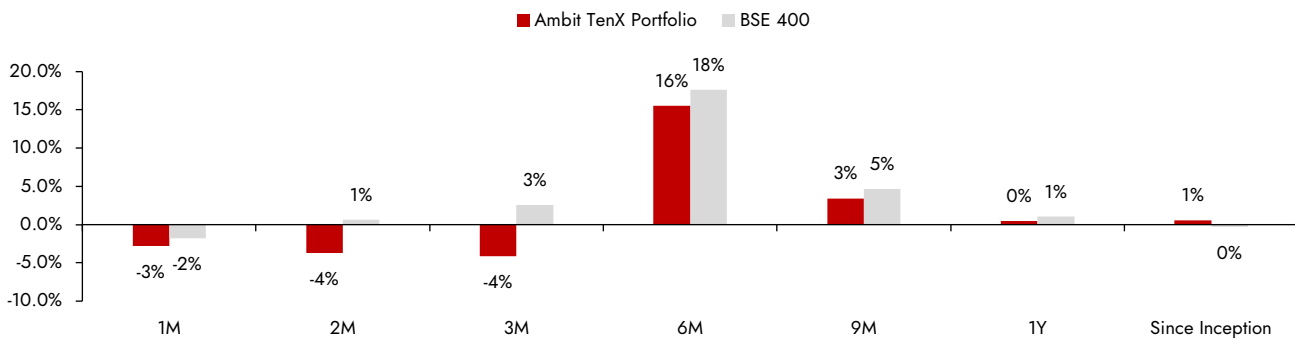


### Ambit TenX Portfolio

Ambit TenX Portfolio gives investors an opportunity to participate in the India growth story as the Indian GDP heads towards a US\$10tn mark over the next 12-15 years. Mid and Small corporates are expected to be the key beneficiaries of this growth. The portfolio intends to capitalize on this opportunity by identifying and investing in primarily mid & small cap companies that can grow their earnings 10x over the same period implying 18-21% CAGR. Key features of this portfolio would be as follow:

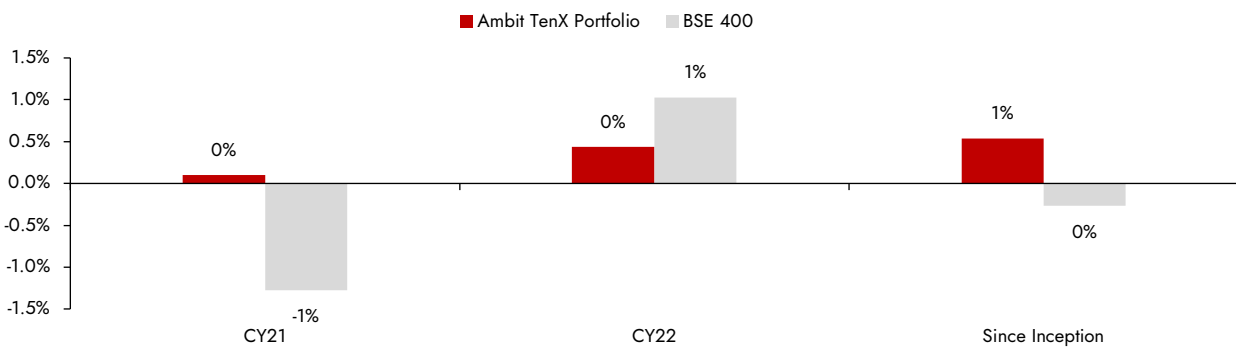
- **Longer-term approach with a concentrated portfolio:** Ideal investment duration of >5 years with 15-20 stocks.
- **Key driving factors:** Low penetration, strong leadership, light balance sheet
- **Forward-looking approach:** Relying less on historical performance and more on future potential while not deviating away from the Good & Clean philosophy.
- **No Key-man risk:** Process is the Fund Manager

**Exhibit 9: Ambit TenX Portfolio point-to-point performance**



Source: Ambit; Portfolio inception date is December 13, 2021; Returns as of 31<sup>st</sup> Dec, 2022; Returns are net of all fees and expenses

**Exhibit 10: Ambit TenX Portfolio calendar year performance**



Source: Ambit; Portfolio inception date is December 13, 2021; Returns as of 31<sup>st</sup> Dec, 2022. Returns are net of all fees and expenses

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The performance data for coffee can product between 6th march 2017 - 19th June 2017 represents model portfolio returns. First client was on boarded on 20th June 2017. The performance data for G&C product between 1st June 2016 to 1st April 2018 also includes returns for funds managed for an advisory offshore client. Returns are calculated using TWRR method as prescribed under revised SEBI (Portfolio Managers) Regulations, 2020