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ASSET MANAGEMENT

Ambit Coffee Can Newsletter – December'18

Election "noise" does not impact long-term stock market returns

"In the short run, the market is a voting machine but in the long run, it is a weighing machine." – Benjamin Graham

It is a widely held belief that electoral outcomes, politics and stock market returns go hand in hand. This belief may just be a case of availability bias. The availability bias along with other heuristics and biases used in judgment under uncertainty have been detailed by Daniel Kahneman in his book "Thinking fast and slow". The availability bias is a mental shortcut that relies on immediate examples that come to a given person's mind when evaluating a complicated decision, rather than undertaking the laborious task of fact checking to arrive at a decision. For instance, when asked the following question - If a random word is taken from an English text, is it more likely that the word starts with a ''K'', or that ''K'' is the third letter? Most people are likely to overestimate the words that start with ''K''. This is only because it is easier to recall words that start with ''K'' as opposed to recalling words that have ''K'' as the third letter. In reality, in any given text there are actually on average two times more words with ''K'' in the third position than words that begin with the letter ''K''.

Similarly, when evaluating the relationship between stock market returns and electoral outcomes, people tend to give additional weightage to the relationship due to following easily recollectable instances from the past - 1) On 17th May 2004, BSE Sensex fell by 11% due to surprise defeat of the incumbent NDA government; 2) On 19th May 2009, BSE Sensex increased by 17% (hitting 2 upper circuits in a single day!) due to thumping victory of UPA; and 3) Between September 2013 (when BJP announced that Narendra Modi would be prime ministerial candidate) and May 2014 (when BJP formed a majority government at the center), BSE Sensex rallied by 25%. However, a deeper analysis shows that subsequent share market returns were a reversal from the immediate perception of the electoral outcome. After the single day fall in 2004, for the next 3 years BSE Sensex delivered a whopping 47% CAGR returns. 2009 was similar but in opposite direction - After a euphoric 17% single-day rise, for the next 3 years BSE Sensex delivered an underwhelming 4% CAGR returns. Even from the 2014 elections, BSE Sensex subsequently delivered only 8% CAGR returns for the next 3 years (Refer Exhibit 1 below).

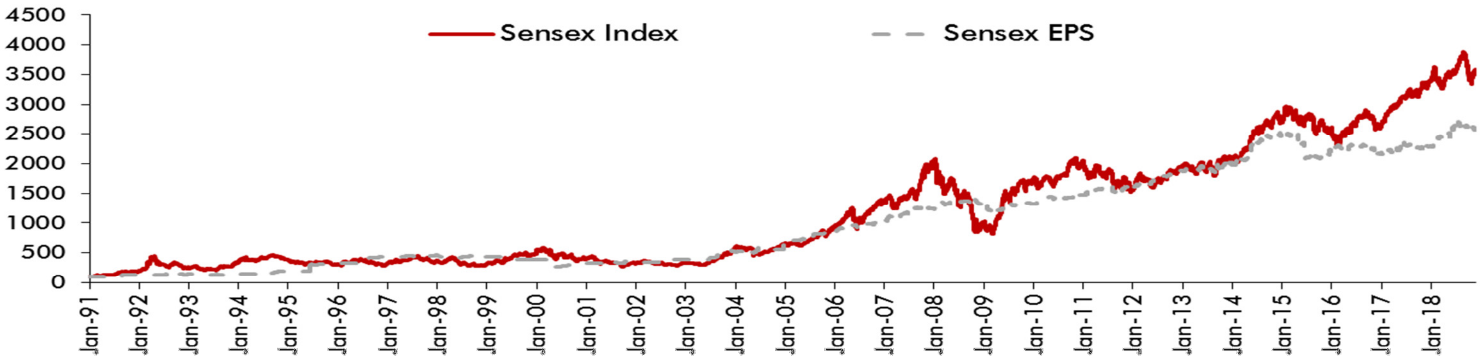
Exhibit 1 - BSE Sensex performance on election results day/run-up to elections and subsequent 3 years (2004, 2009 & 2014)

2004 Elections	BSE Sensex	2009 Elections	BSE Sensex	2014 Elections	BSE Sensex
On the day of election result (17 May 04)	-11%	On the day of election result (18 May 09)	17%	Market rally in the run-up to elections (Sep'13 to May'14)	25%
Next 3-year CAGR returns (May '04-May '07)	47%	Next 3-year CAGR returns (May '09-May '12)	4%	Next 3-year CAGR returns (May'14-May'17)	8%

Source: Ambit Capital Research
BSE Sensex returns are calculated excluding dividend.

It would again be a case of availability bias, if one were to draw any sort of conclusion between 3-year returns and electoral outcomes. Despite short-term volatility, in the long run, it is only earnings growth that drives share market returns (Refer Exhibit 2 below). Smart investors have the capability to overlook this noise, and focus on companies with strong business models and earnings growth visibility.

Exhibit 2 - Earnings growth is the biggest driver of long-term share prices



Source: Ambit Capital Research
Sensex Price and EPS are based to 100 on Jan 1991

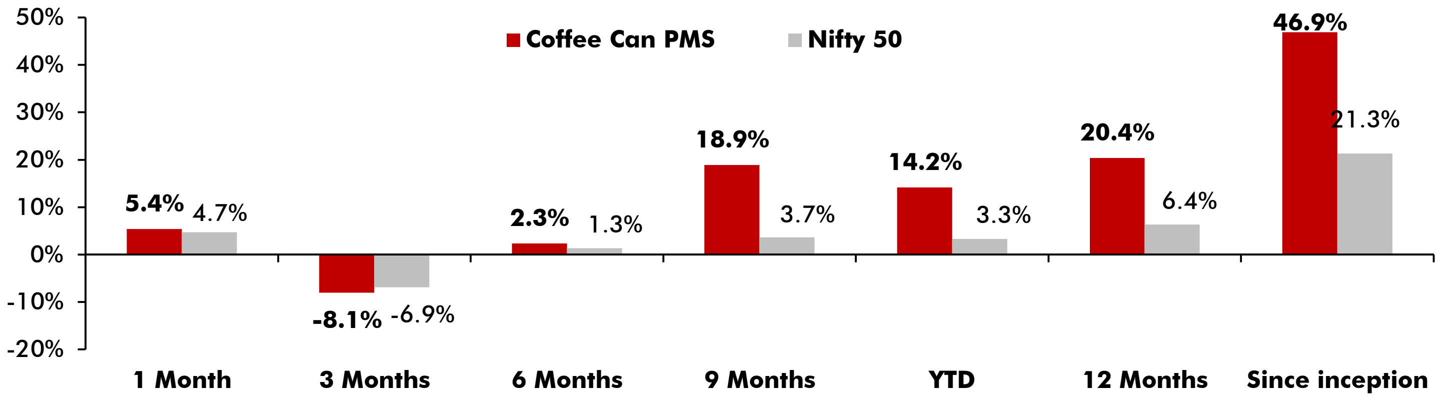
Macro update: Oil saves the day

While the quarterly earnings have maintained broad-based recovery, the big respite in equity markets has come in from the decline in oil prices. Rally in crude oil prices which began in mid-2017 from $50 per barrel has fizzled out and Brent has slumped almost 30% since its recent high of $86 per barrel in early October to less than $60 per barrel now. Falling crude prices helps in reducing the import bill (80% of Indian crude oil requirement is imported) and in containing the current account deficit (CAD which had recently inched up to -2.4% for 1QFY19 vs. average of -1.7% of preceding three quarters). Lowering CAD has also contained the rupee depreciation for now. Lower oil price should also keep the CPI inflation print below RBI's expectation of 3.9-4.5% and give the Reserve Bank headroom in keeping interest rates stable during the next policy meet in December.

Ambit Coffee Can Fund

Performance update – Ambit's Coffee Can PMS – as on 30th Nov 2018

The portfolio consists of 11 stocks of high-quality companies, spread across Financials (2 stocks), Home Building Materials (3 stocks), Consumer Discretionary (3 stocks) and Consumer Staples (3 stocks). **There has been no change in the list of stock holdings (i.e., zero churn) in the portfolio since inception of the PMS.** The intended average holding period of a stock in our portfolio is longer than 8-10 years, resulting in a churn of less than 1 stock per year on an average.



*Source: Ambit, Bloomberg; *Date of inception= 6th March 2017; All returns are absolute returns net of fees and expenses*

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