



NETRA

Early Signals Through Charts

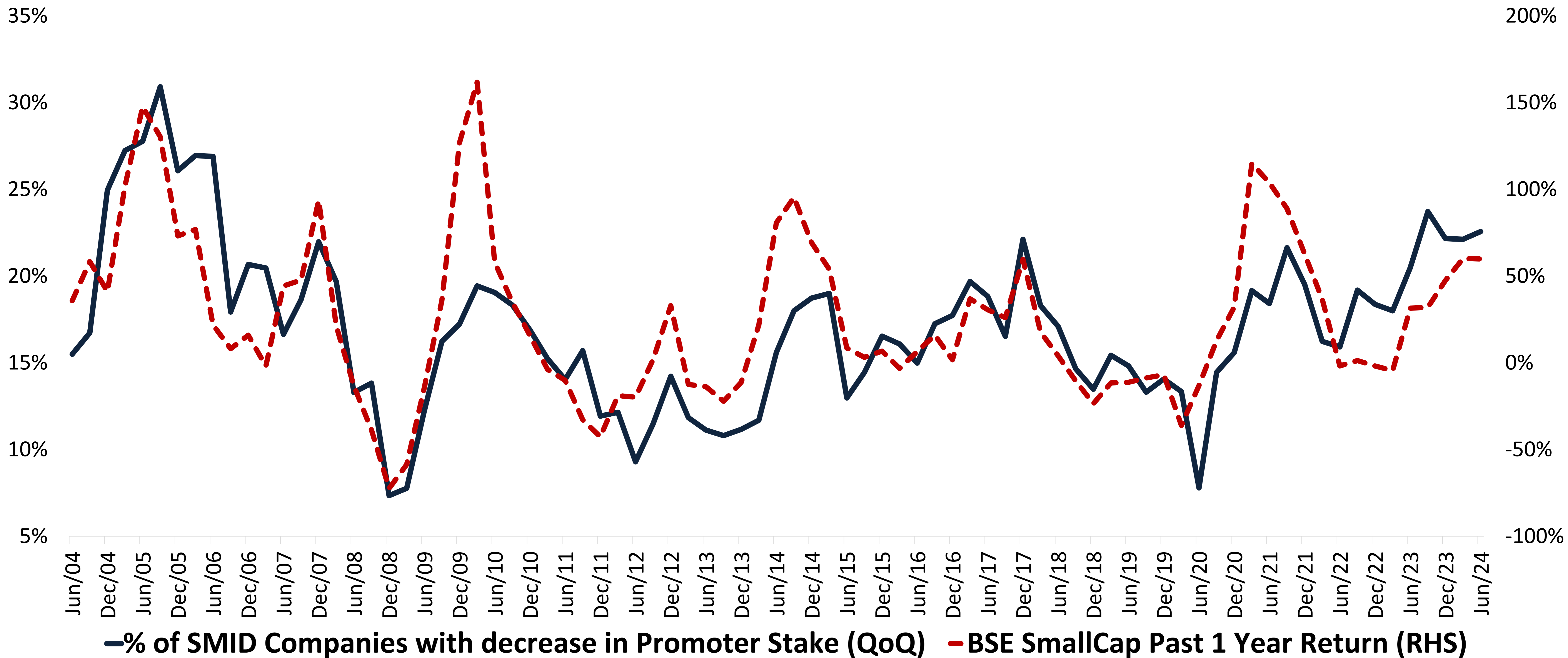
Sep 2024

DSP

Section 1

The Unsettling Calm & The Transition of Market Capitalization

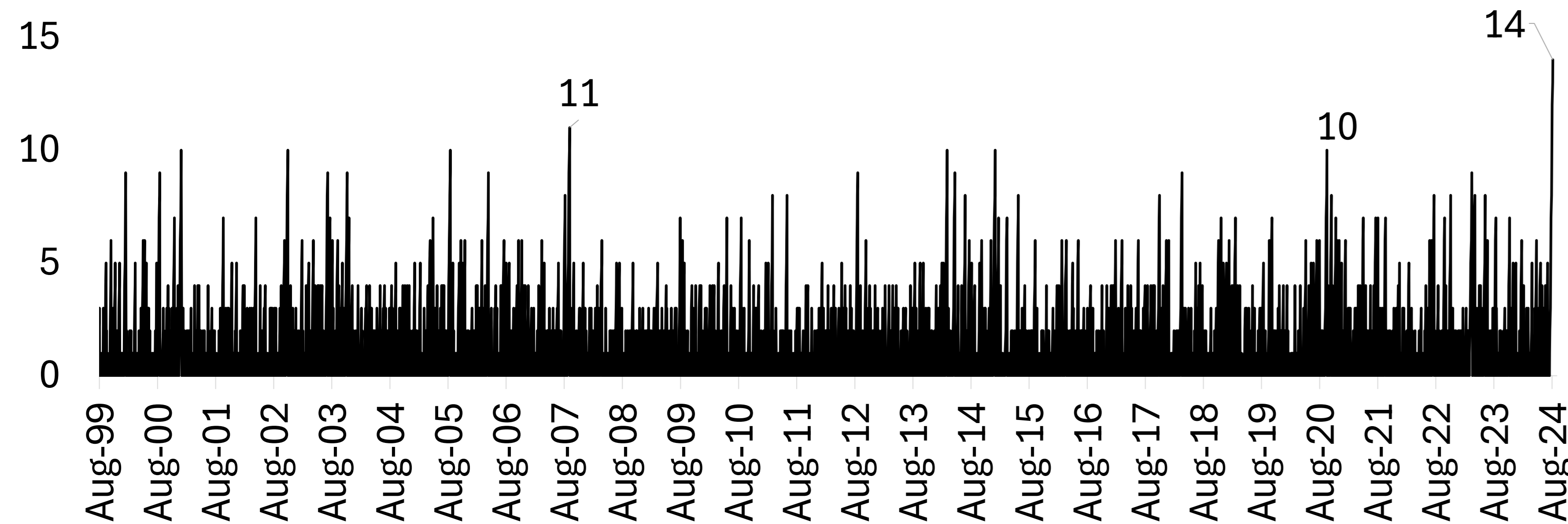
Who's Selling? Equity Dilution Nearing Levels Last Seen Two Decades Ago



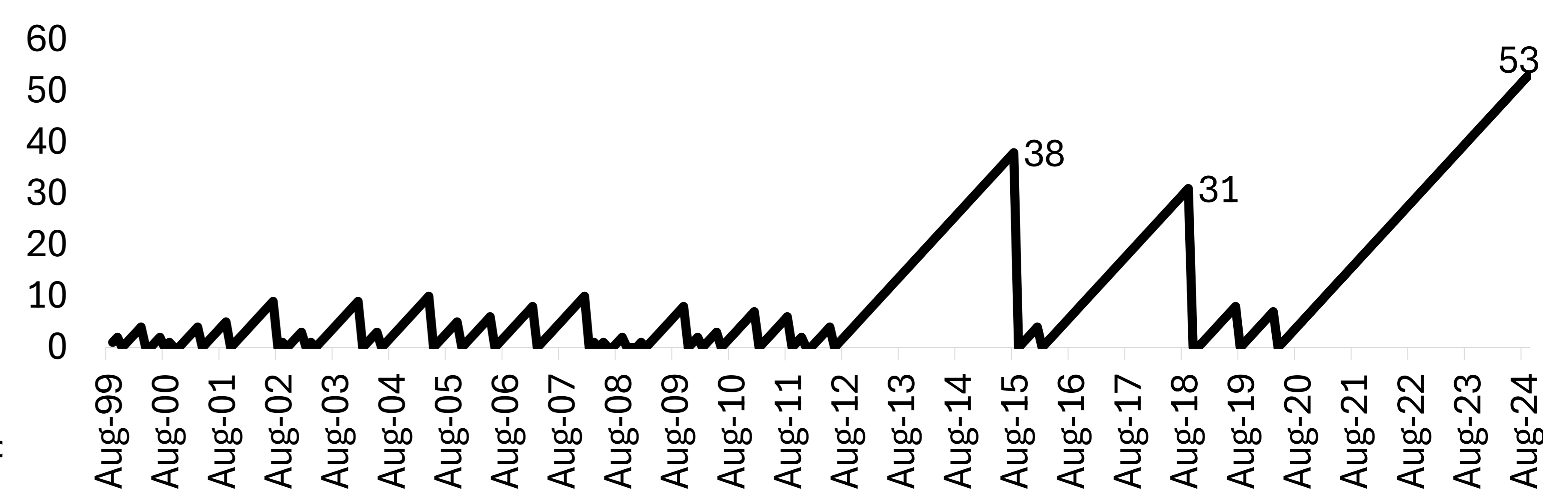
The 'Unsettling Calm' Stretches

All stats for Nifty 50 TRI index

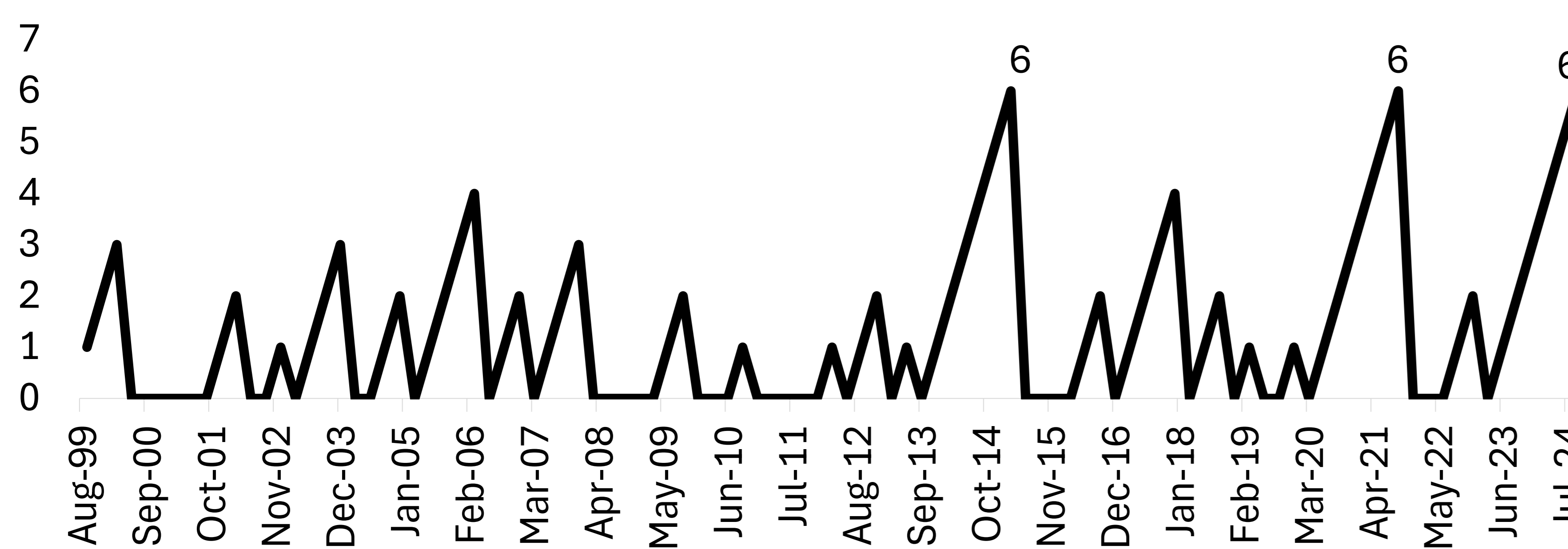
Consecutive Days With Positive Close



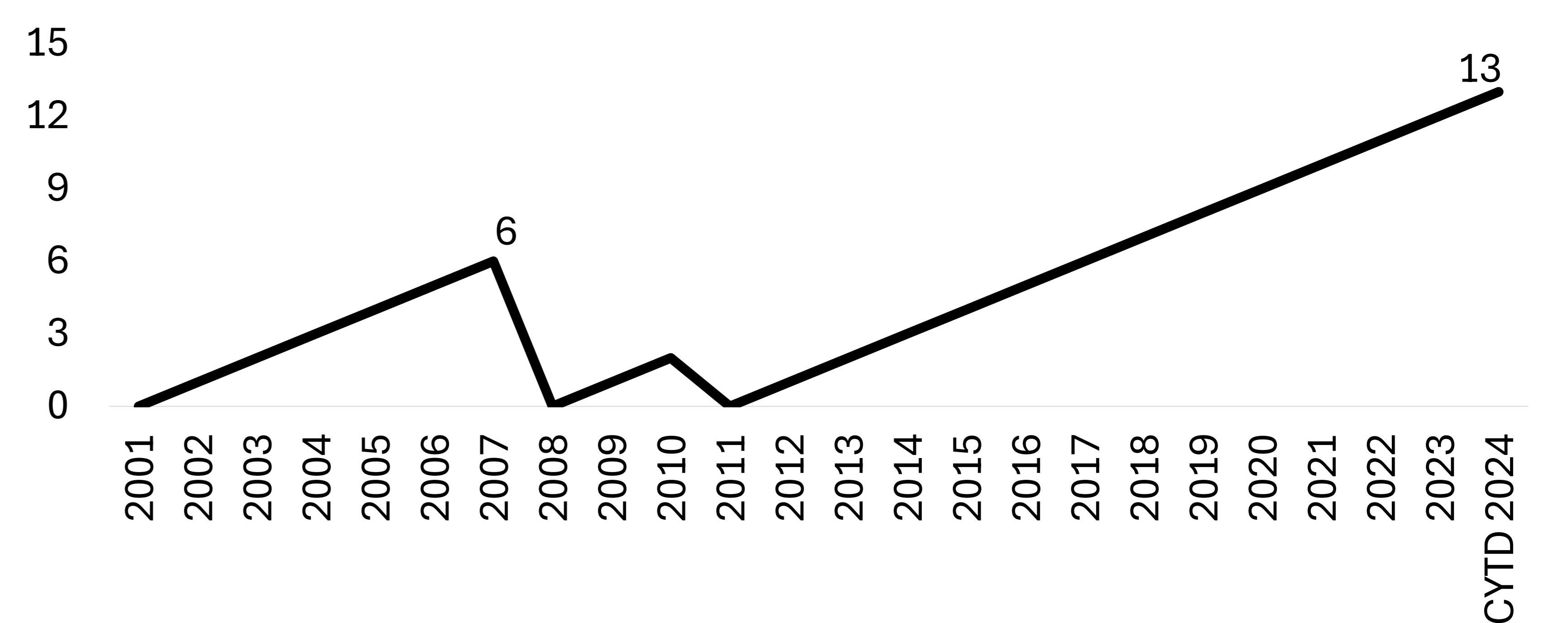
Consecutive Months Without A 5% decline



Consecutive Quarters With A Gain of more than 2%



Consecutive Years Without A Decline of More Than 10%

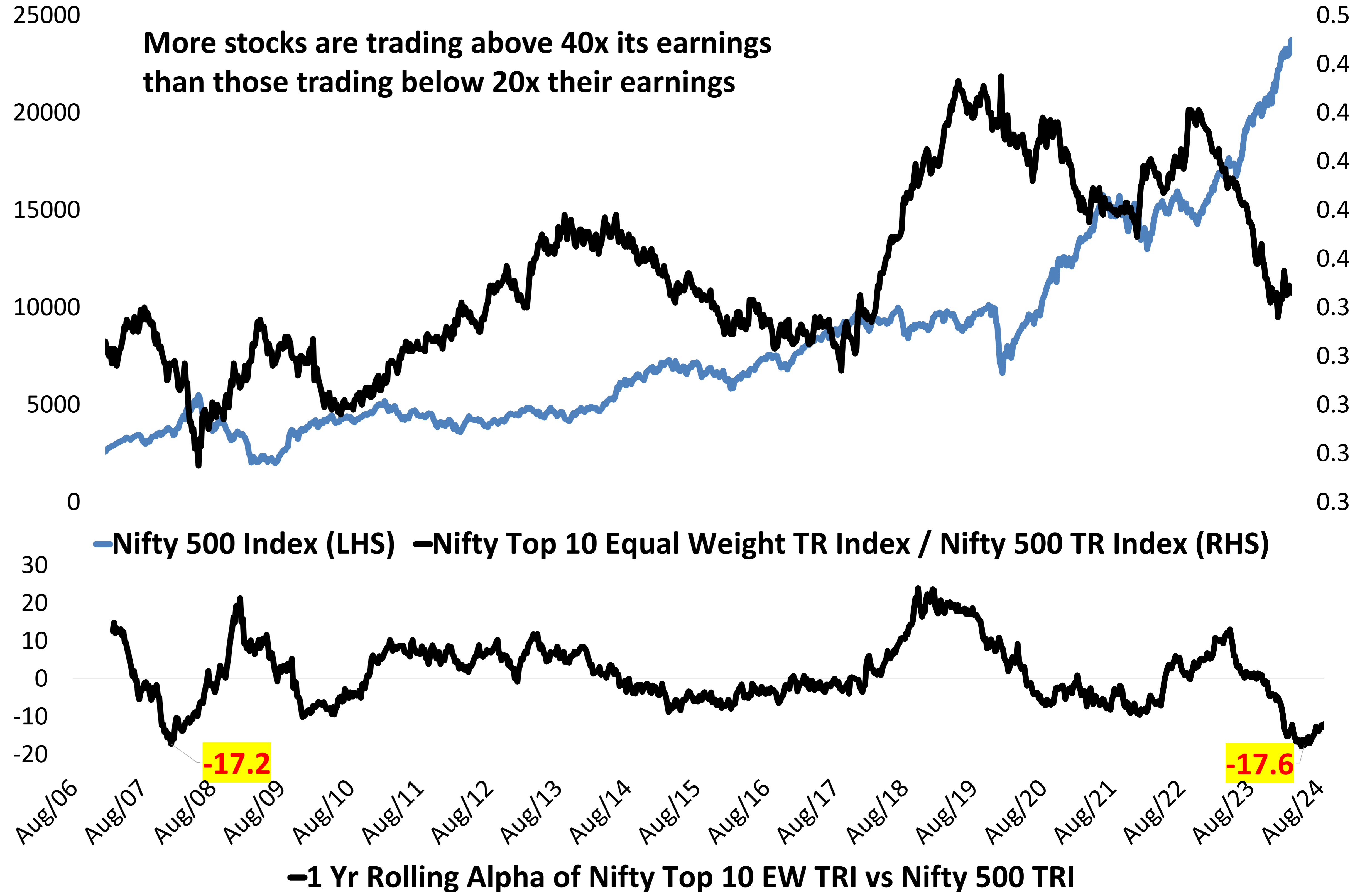


The Top 10 Stocks Are The Most Oversold Versus The Broader Market

The Largest Cap companies never had so bad. Not only their weight in the total market capitalization has dwindled to an all time low, but the relative price performance also made an all time low recently.

Historically, periods of inflection in underperformance of top 10 names versus the rest of the market have coincided with a general 'Risk-off' environment.

The large addition to India's overall equity market capitalization from new listings have made the top 10 cohort even more attractive. This is because more than two-third of new issues have listed at multiples which are upwards of 50x price to trailing earnings. This means that the new market cap addition has a low profitability base versus the top 10 stocks. On an absolute basis, even the top 10 stocks aren't cheap from historical standards and therefore they remain a relative play for those looking to add to equity exposure.



SmallCap to LargeCap Performance Diverges The Most On Record

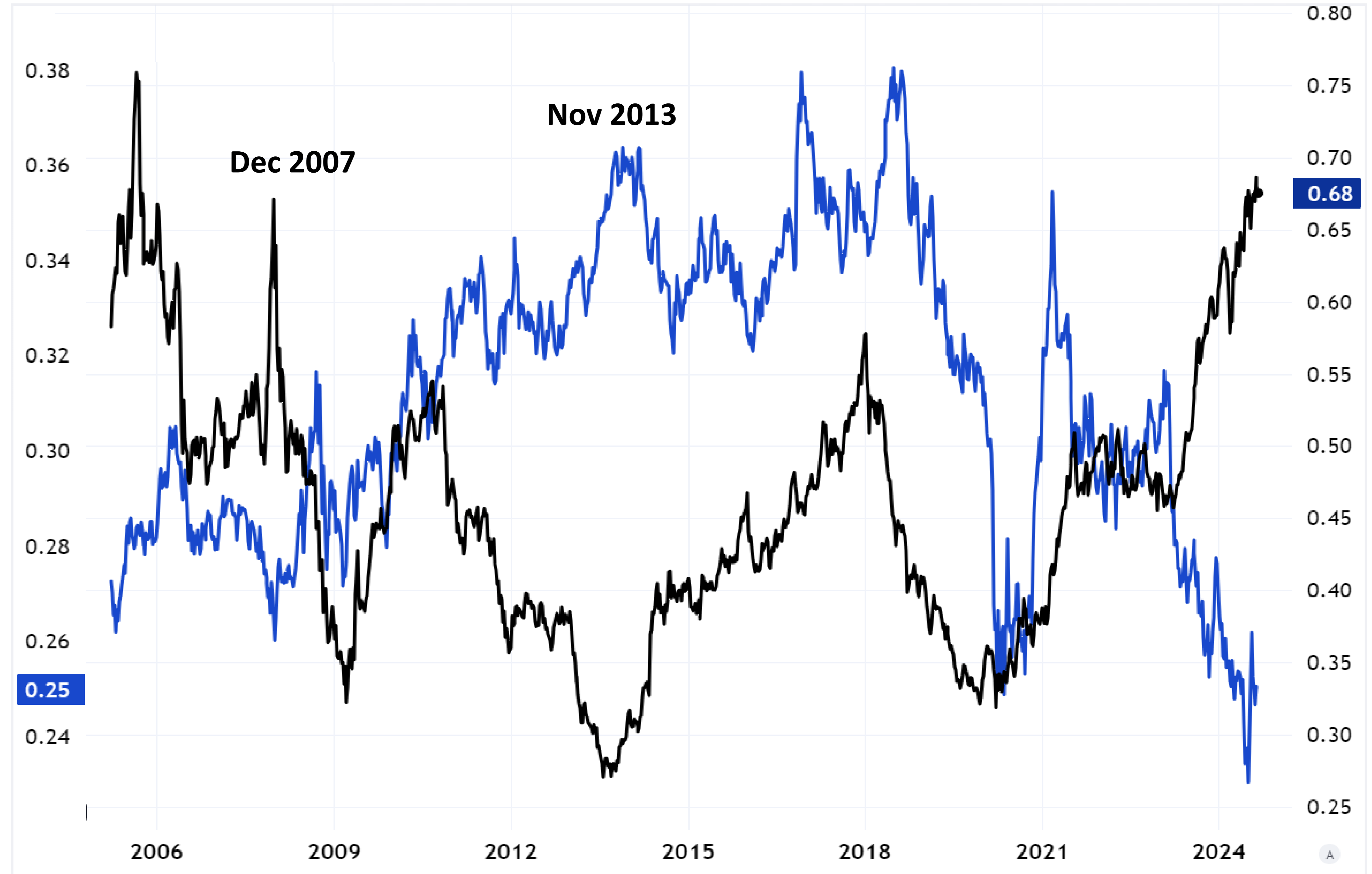
Smaller firms in India have delivered stellar profits and spectacular returns, while in the U.S., the opposite is true. Large firms in the U.S. have dominated not only market capitalization but also profits and fund flows.

This divergence between small and large-cap firms isn't new, but the extent of Indian small-cap outperformance compared to that in the U.S. is at an extreme.

What does this mean?

1. Broader markets, like India's, where more firms participate, are generally healthier due to this participation. However, if this broad participation is driven by a large increase in valuation multiples, it can lead to market fragility and raise the probability of lower future returns.
2. In contrast, a polarized market like the U.S., which relies on a few firms performing well, is inherently riskier. Just as it needs a few things to go right, it also requires only a few things to go wrong for unexpected outcomes.

In both scenarios, the extremes are stark, so caution is advised.



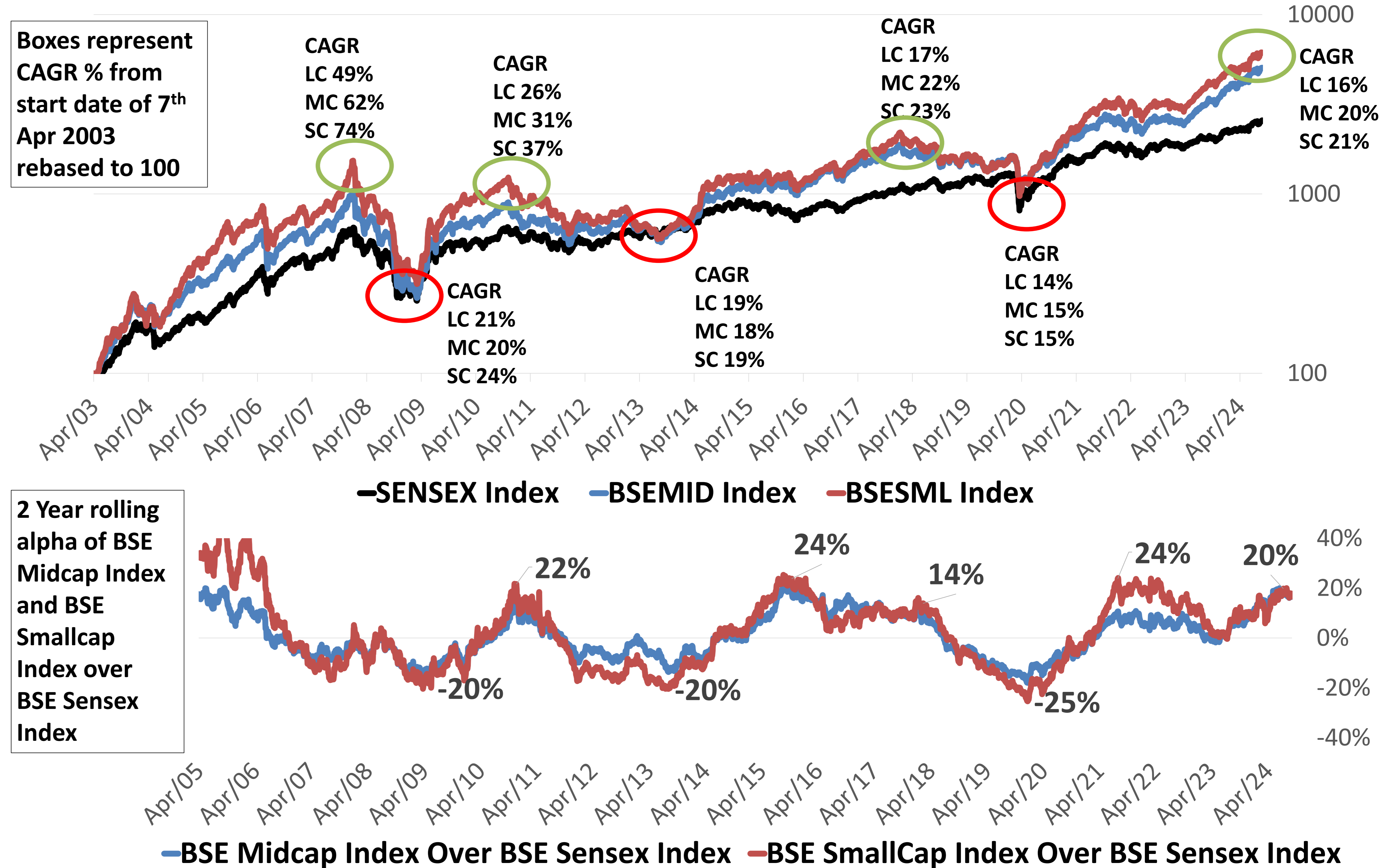
Why Bad Times Are the Best Times to Buy Small & Midcaps

In each upcycle, smaller firms from the mid and small-cap space exhibit stellar performance. This is marked by the significant outperformance of SMIDs (Small & Midcaps) over large caps (LCs) in every upcycle bull market.

As shown in the chart in the upper panel, during each downcycle, SMIDs lose almost all the alpha generated during the upcycle. This is consistent with the volatility readings for SMIDs, where the higher variation results in larger drawdowns and crashes during bear markets compared to the relatively shallower declines in large caps.

Therefore, to capture the extra alpha offered by the small and mid-cap segments, investors are better off focusing on the margin of safety rather than relying on recent outperformance. In fact, it makes enormous sense to be aggressive in SMIDs when their alpha over large caps has vanished. Currently, SMIDs have a large alpha over LCs, so investors might be better served by focusing more on large caps as a relatively better option.

In every cycle, Small & Midcap lose all their alpha over large caps and then build back gains in the next cycle.



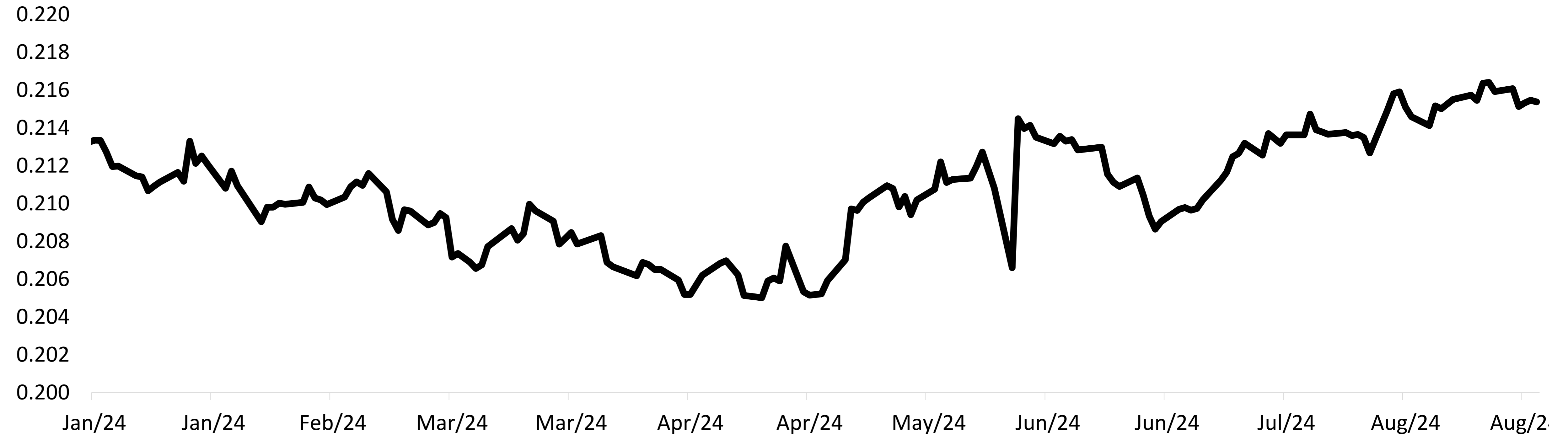
Quality Is Making A Comeback?

In May 2024, the complexion of the market changed. Although difficult to quantify, many historical cyclical peaks in stock markets are characterized by a shift in leadership and the factors driving the market. Recently, the momentum factor, which has been the dominant outperformer since the COVID-19 bottom, has started to lose its edge. Meanwhile, the quality factor, which had struggled over the past four years, has begun to see a revival.

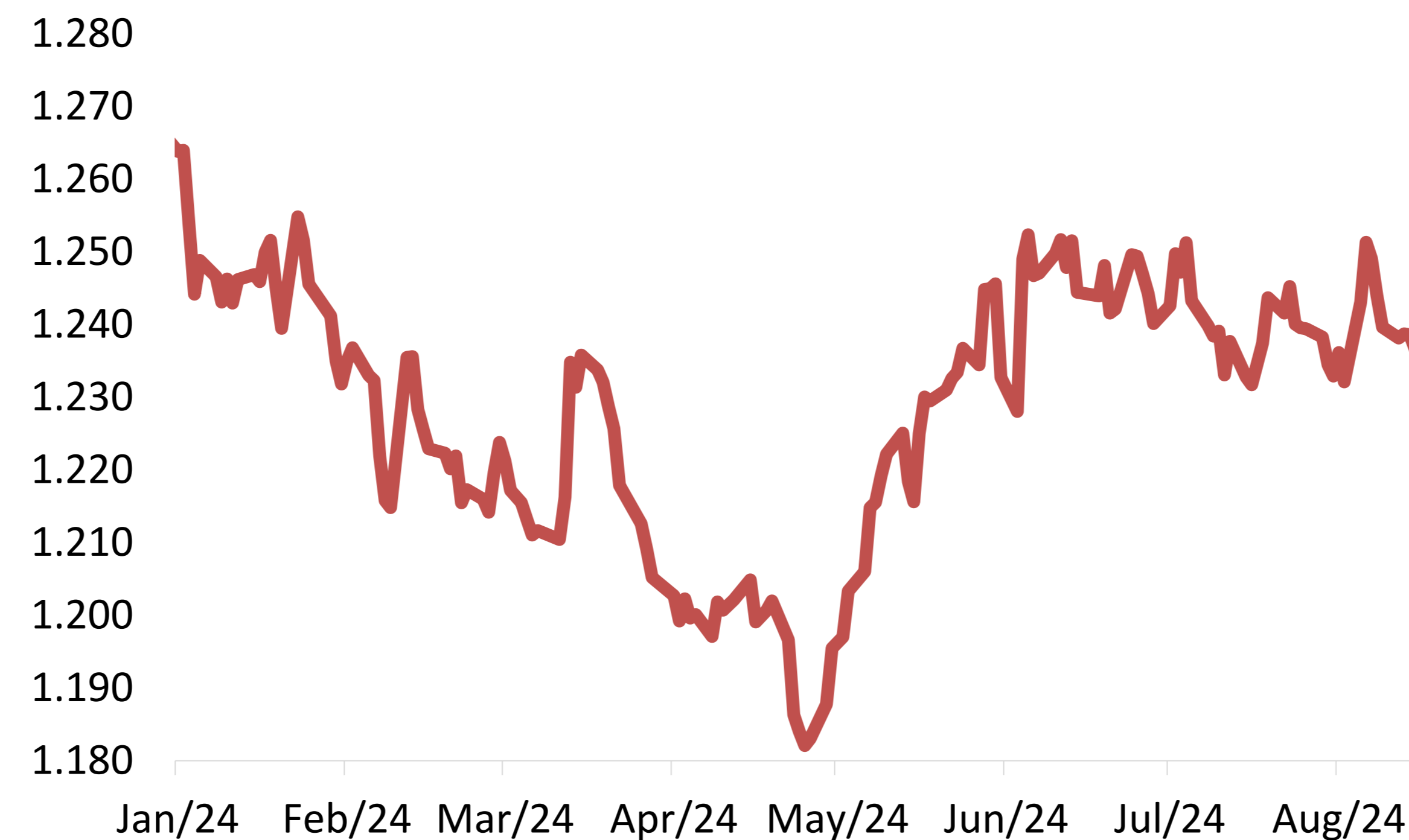
As often happens at cyclical peaks for stocks, an initial large decline—such as the one following the general elections—is followed by new highs. However, these new highs are driven by different factors than those that were dominant before the leadership change.

These signs indicate that the market has experienced a shift in leadership and likely undergone a pivot that will influence future performance. Quality-oriented active and passive funds could benefit from this change.

Largecap Quality / Largecap



Midcap Quality / Midcap



Smallcap Quality / Smallcap



Section 2

The Drivers of India's Economic Growth

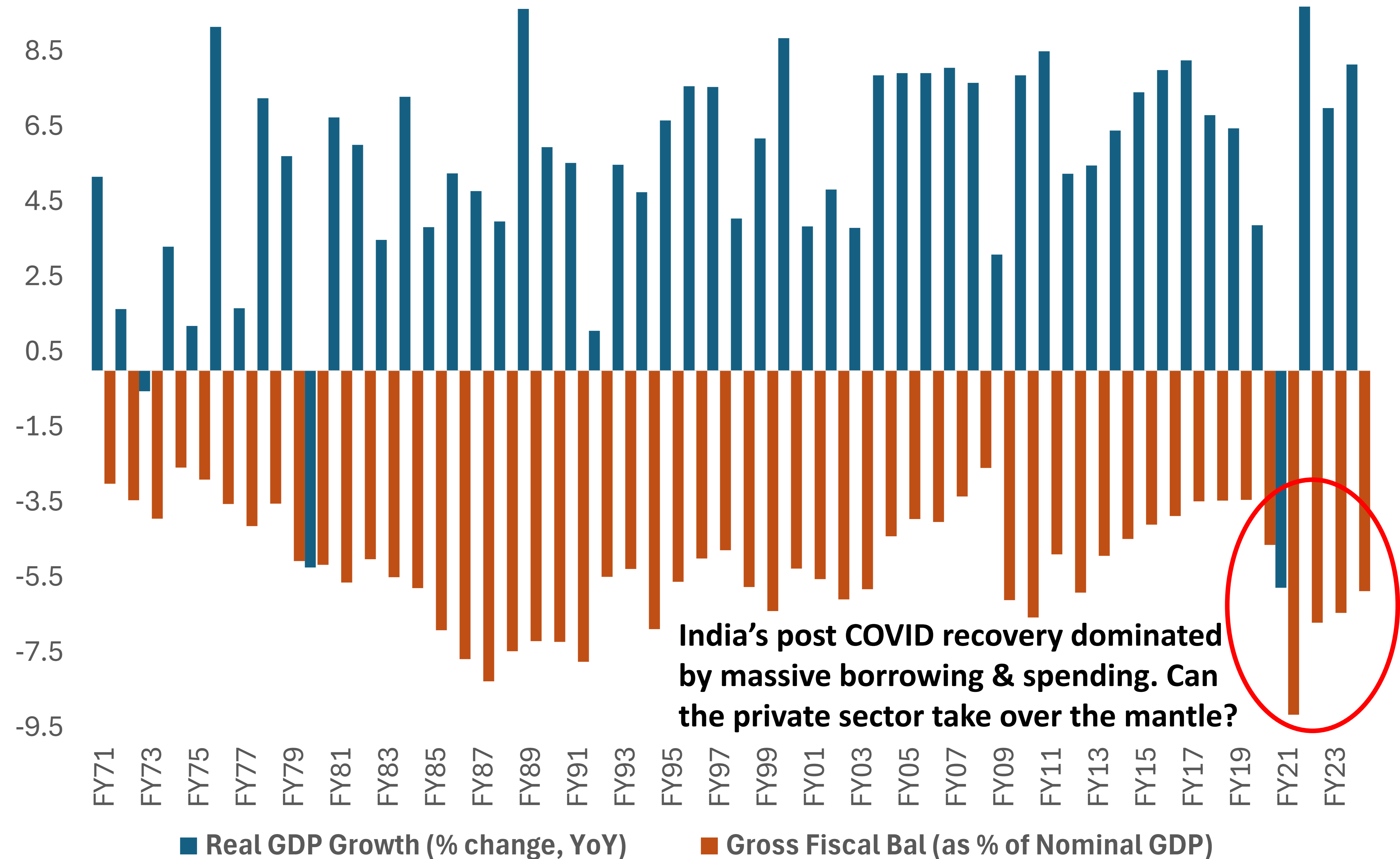
A Fiscal Deficit Led Economic Recovery

A large dose of fiscal deficit spending has helped India achieve a strong recovery from the COVID-19 disruptions.

As shown in the image, the significant fiscal deficit has coincided with a rise in GDP growth. The following slides will demonstrate how the private corporate sector and the household sector have contributed far less to the recovery compared to the substantial government expenditure.

The government spending has been almost entirely focused on capital expenditure, also known as investments. This implies that India's fiscal extravagance will have a direct impact on economic growth in the coming years, unless household consumption recovers, and the private corporate sector takes over the mantle of capital expenditure from the government.

A question to consider: What could have been the consequences of running a 5% to 6% fiscal deficit if other countries were not doing the same?

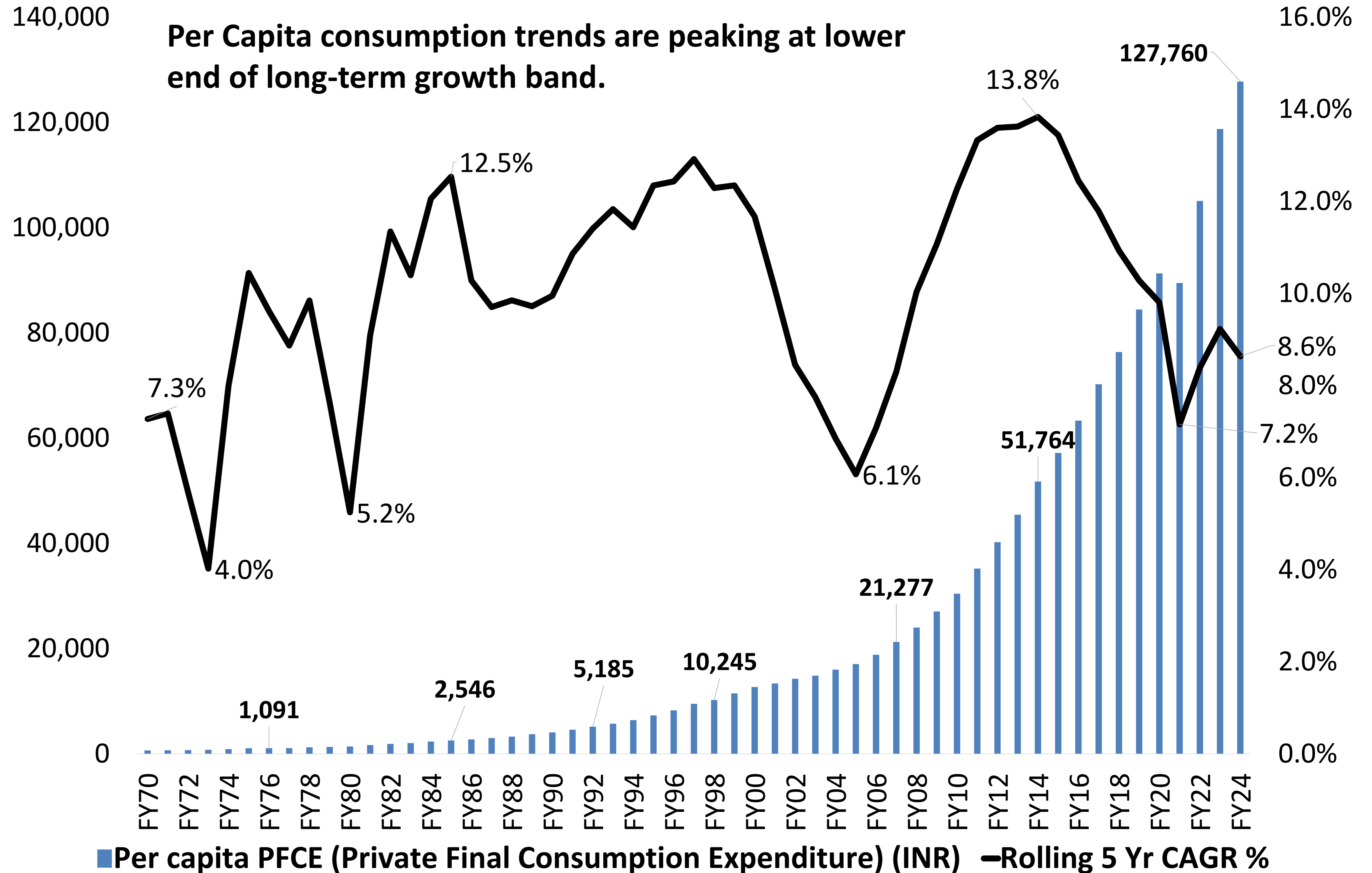


India's Consumption Growth Rates Are Slowing

In the Aug 2024 edition of DSPNetra we highlighted the K-shaped recovery of India's consumption. The strong performance of premium/tier 1 segment of India's consumption cycle marked the upper end of the K-shaped recovery. The non-premium, mass-market segments are still struggling to see a steady recovery.

The expectations have been that the lower end will 'catch-up' and the consumption cycle will strengthen with the resolution of K-shaped into a strong outcome. However, when we look at the long-term picture, India's per capita consumption is witnessing a slowdown. This slowdown is occurring from levels which are close to the lows of previous cycles.

Moreover, the high frequency indicators from rural wages, core inflation to staples volume growth, all indicate continued stress on India's consumption recovery. Consumption forms nearly 60% of India's GDP and it needs to grow at GDP+ pace to kindle stronger outcomes on private capex and the wider economy.



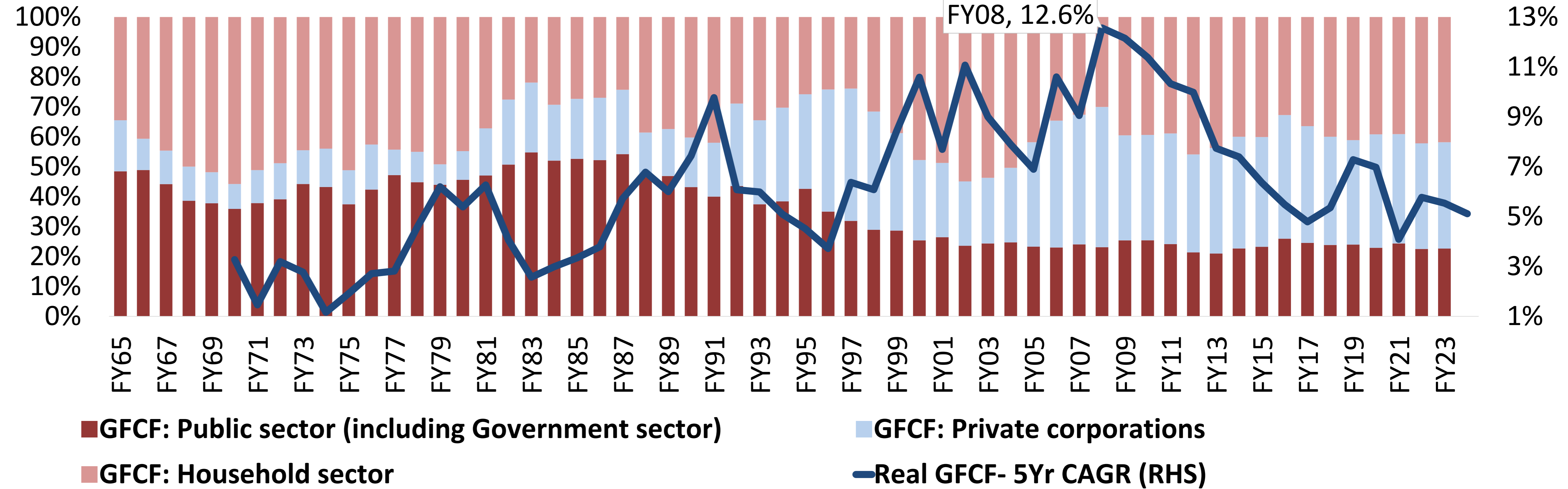
Govt Capex Push Is Incomplete Without A Private Sector Takeover

This investment cycle is so far driven by govt capex, and the private sector is yet to participate fully. It has the ability and conducive conditions like healthy balance sheet, availability of credit but what is questionable is, if there is enough demand?

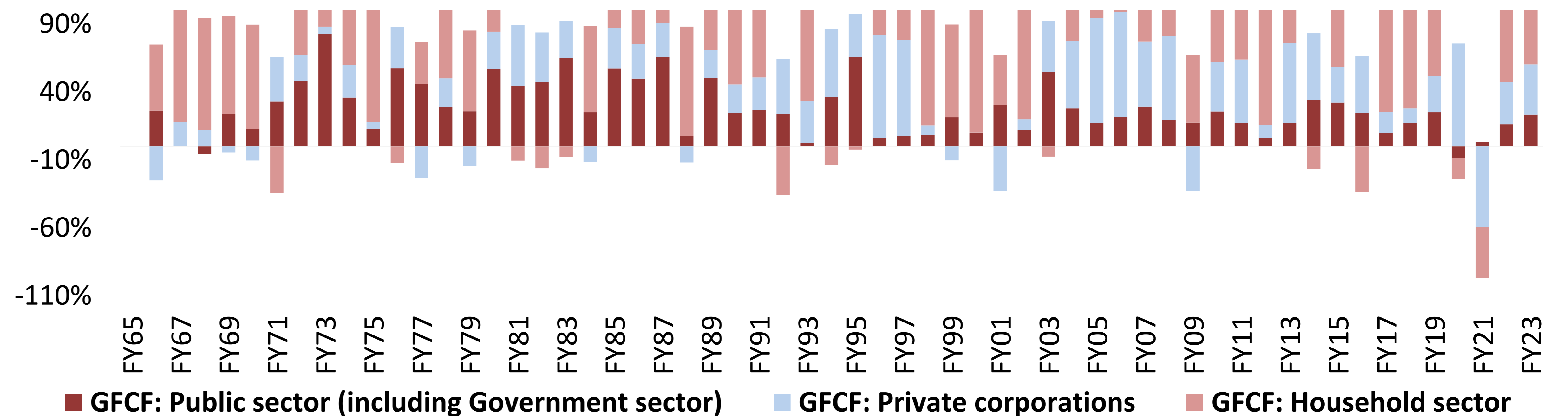
Putting aside the question of visibility of enough consumption trends or demand trends, one needs to look at who drives the capital expenditure in India.

Broadly speaking, it is the household sector and the private corporate sector which contribute more than 3/4th to India's gross fixed capital formation a.k.a. fixed asset creation. In the post COVID era, both these segments have suffered a setback and are yet to make a comeback. The recovery in GFCF is currently supported by robust government expenditure, but with its limited share, it is unlikely to have lasting impact unless the HHs and Private Corporate sector take over. As can be seen, the real GFCF growth trends are also slowing, indicating a drag on overall growth numbers.

Share of Gross Fixed Capital Formation by Segment



Incremental Contribution by Segment



Exports Continue To Remain Subdued As India Runs A Trade Deficit In Most Categories

10 Yr CAGR of Exports by Category:

Total: 3.3%
 Petroleum : 2.9%
 Agri: 1.2%
 Ores & minerals: 6.4%
 Leather: 2.5%
 Chemicals: 6.6%
 Engineering goods: 5.4%
 Electronic goods: 13.6%
 Textiles (Including RMG): 0.1%

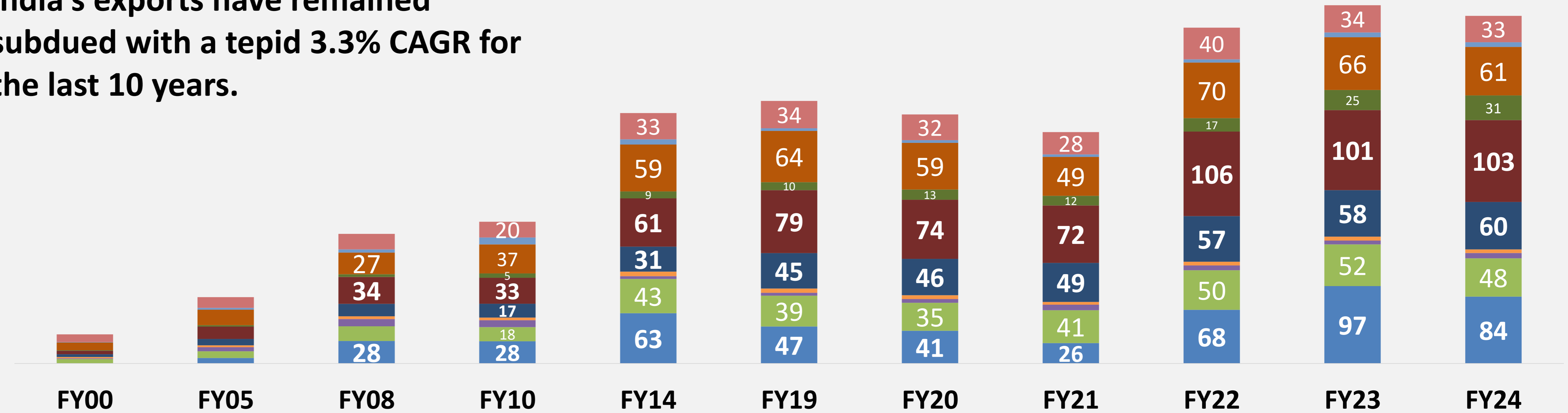
10 Yr CAGR of Imports by Category:

Total: 4.2%
 Petroleum : 0.9%
 Agri: 7.6%
 Ores & minerals: 7%
 Leather: 0.4%
 Chemicals: 5.7%
 Engineering goods: 5.8%
 Electronic goods: 9.8%
 Textiles (Including RMG): 6%

The third lever of growth that can help India grow faster is foreign trade. The growth rates in most segments are yet to see steady improvement.

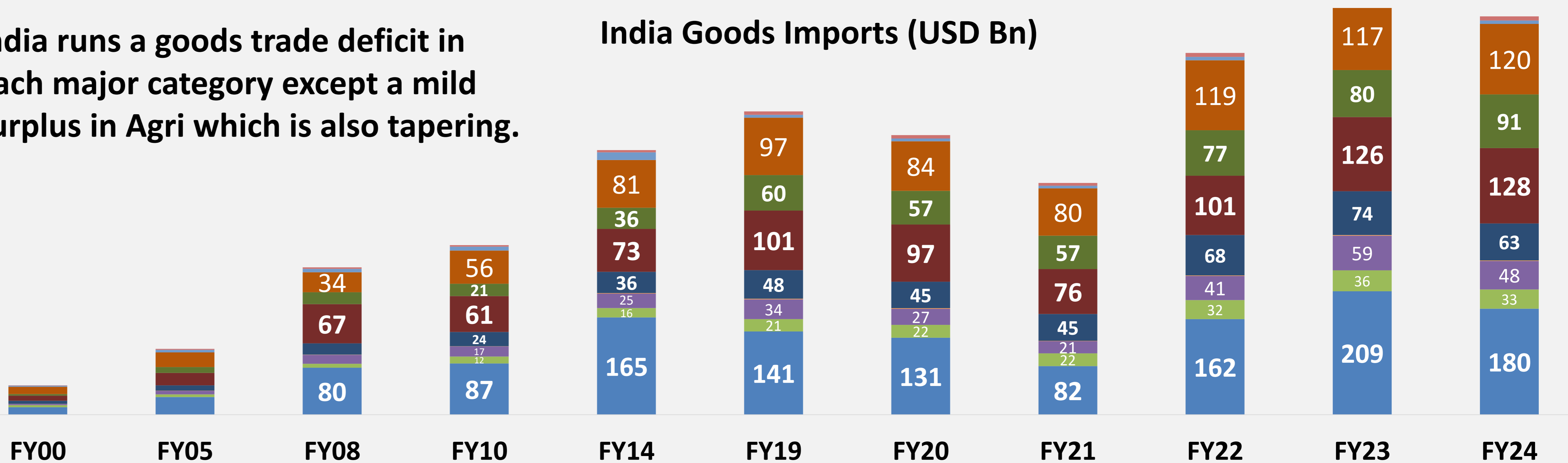
India's exports have remained subdued with a tepid 3.3% CAGR for the last 10 years.

India Goods Exports (USD Bn)



India runs a goods trade deficit in each major category except a mild surplus in Agri which is also tapering.

India Goods Imports (USD Bn)



India's Fiscal Support Comes From An Unlikely Partner: Tax Gains From Stock Gains

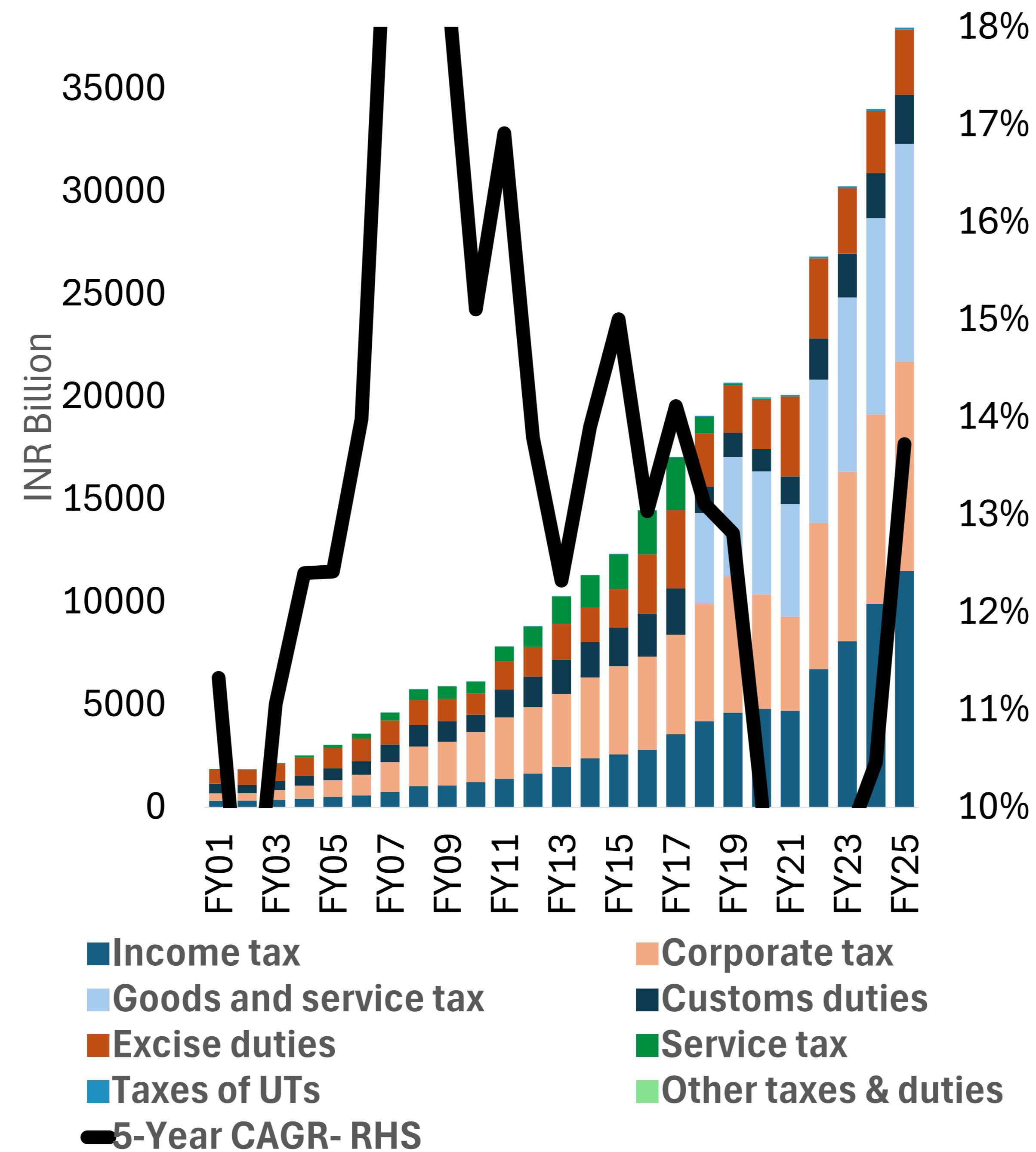
Tax revenues have rebounded strongly from their COVID-19 lows, with a 5-year CAGR of 14%, reaching levels they would have achieved without the pandemic. From FY19 to FY25, the CAGR for key metrics is as follows:

FY19 to FY25 CAGR

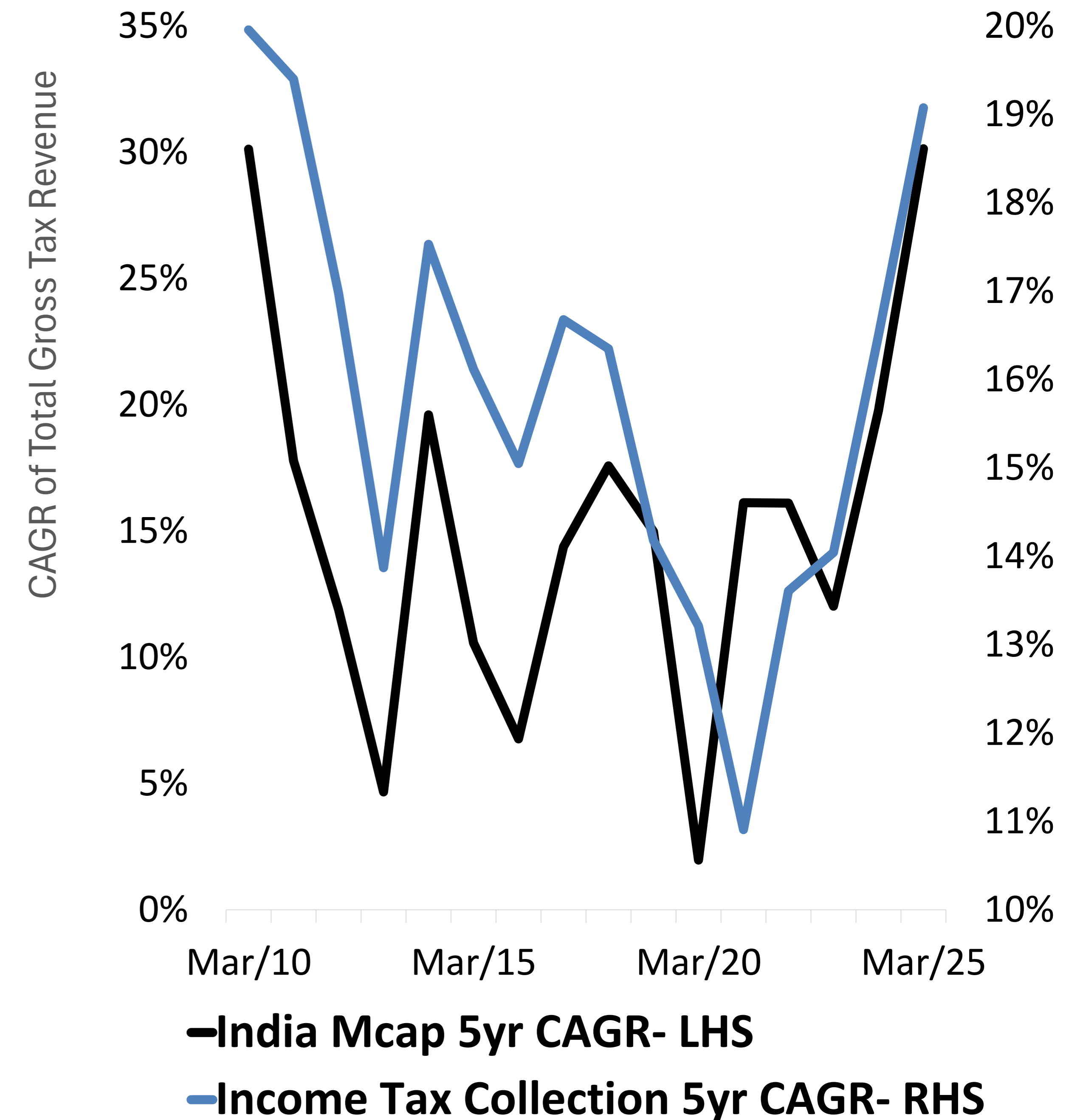
- Nominal GDP: 9.5%
- Income tax: 16.4%
- Corporate tax: 7.4%
- GST: 10.6%
- Customs duties: 12.4%
- Excise duties: 5.5%

Income tax growth has been a major driver of tax revenue normalization, significantly outpacing other taxes, which have grown at or below the rate of nominal GDP. This strong income tax growth is largely due to capital gains, making government revenues increasingly tied to stock market performance, introducing a vulnerability not previously experienced by India.

Gross Tax Revenue Has Recovered To Pre-COVID levels, Led by Income Tax



Income Tax Growth, Among Others, Has been Primarily Driven by Gains In the Stock Market



Section 3

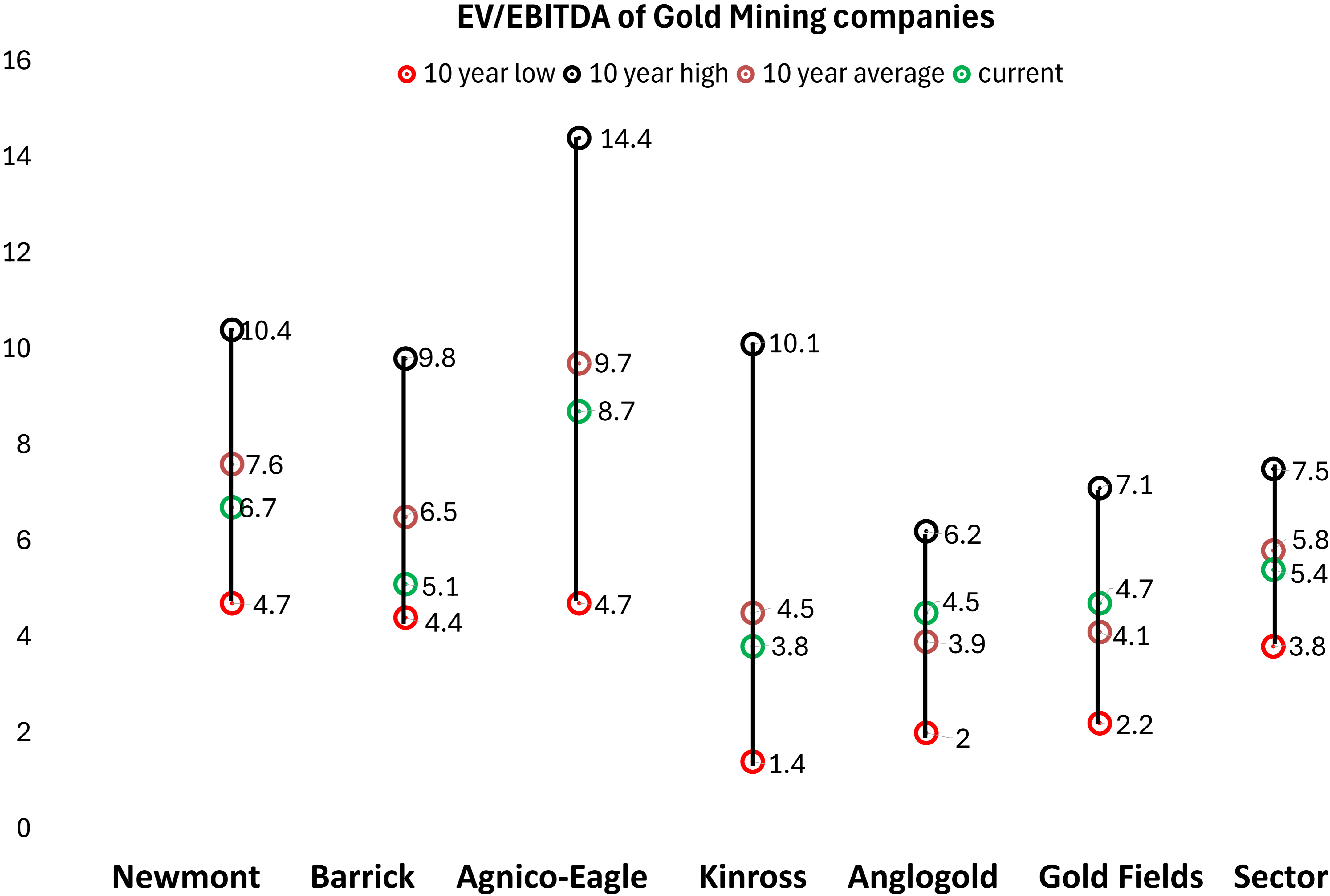
Early Signals

Gold Miners Are Available At Below Average Valuations

Recent strength in gold prices, coupled with operational improvements, has led to increased valuation appeal within the sector. Currently, the sector is trading below its 10-year average valuations, offering potential opportunities for investors.

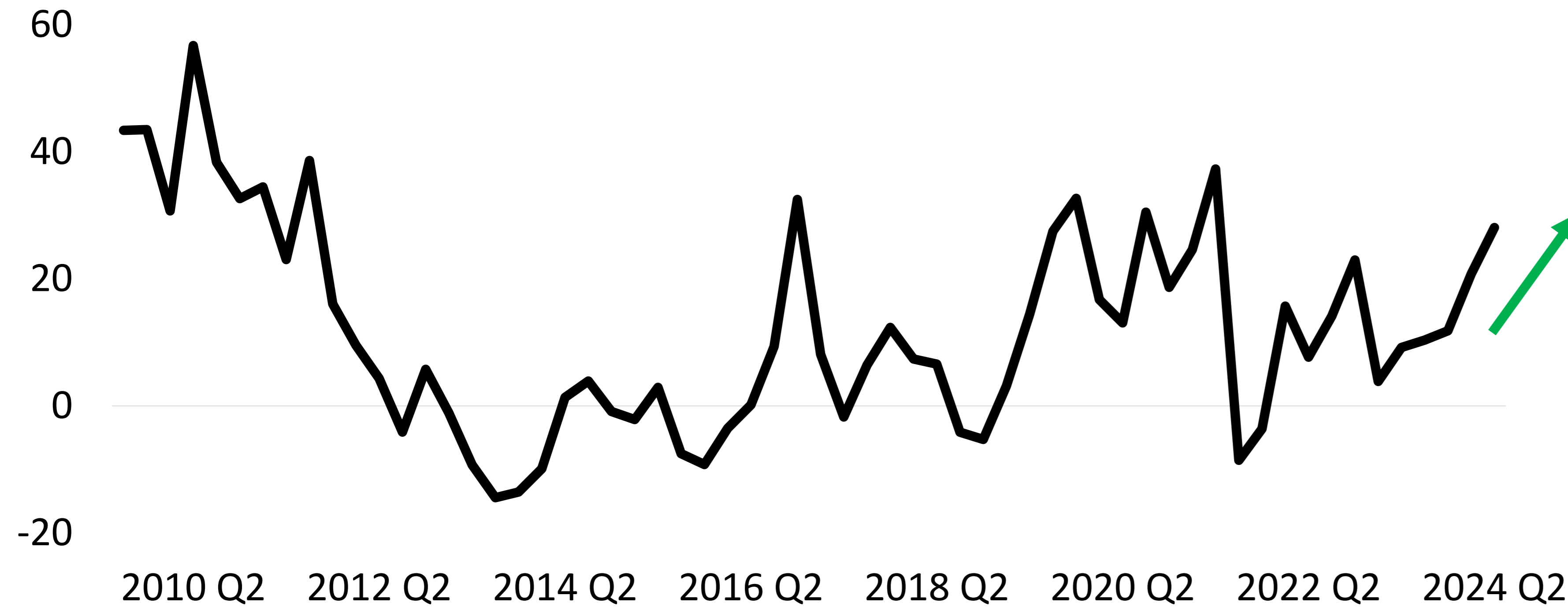
Key players in the gold mining industry—Newmont, Barrick, and Agnico-Eagle—are trading at valuations that are significantly below their historical norms. This is largely due to their stronger balance sheets and enhanced operational efficiencies, making them particularly attractive investments at these levels.

Historically, there has been a valuation gap between senior gold miners, such as Newmont, Barrick, and Agnico-Eagle, and their smaller counterparts, including Kinross, Anglo gold, and Gold Fields. However, this dynamic could be poised for change. The smaller mining companies may experience a valuation re-rating, driven by their robust operational performance, healthy cash flows, and growth potential, which are supported by higher gold prices.

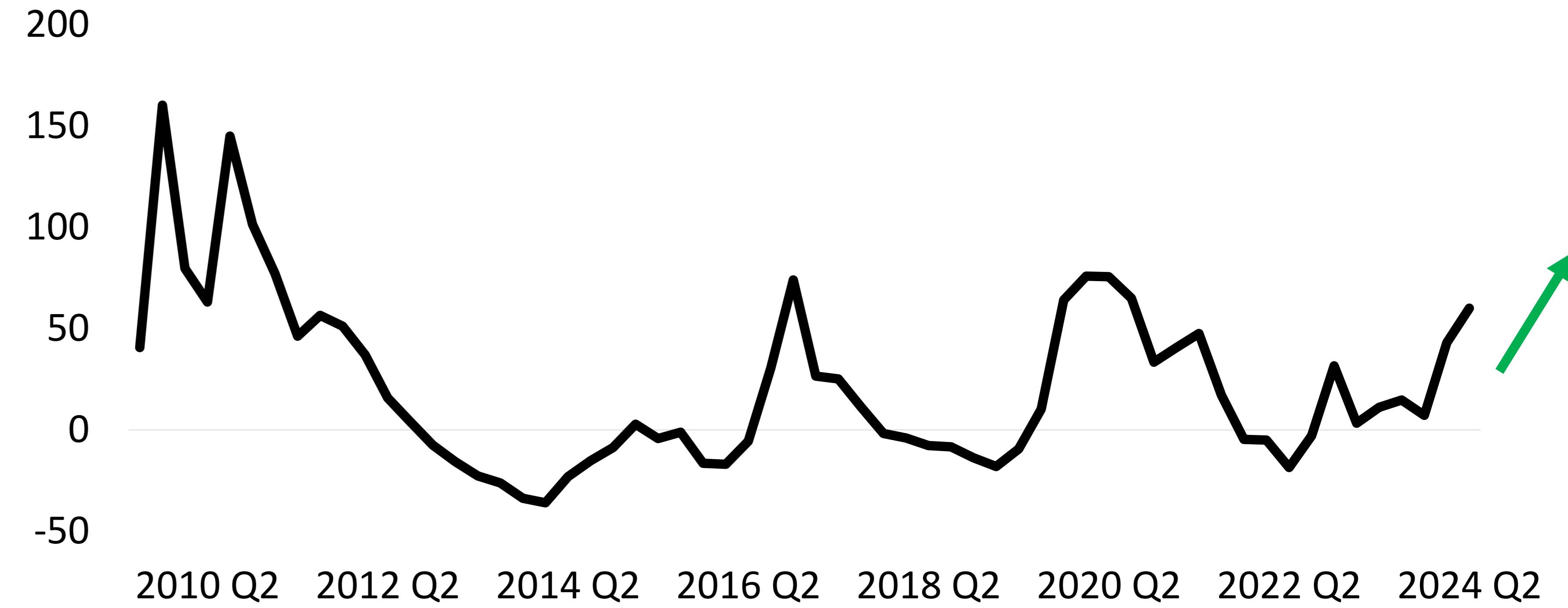


Gold Price Surge Beginning To Reflect On Miners P&L

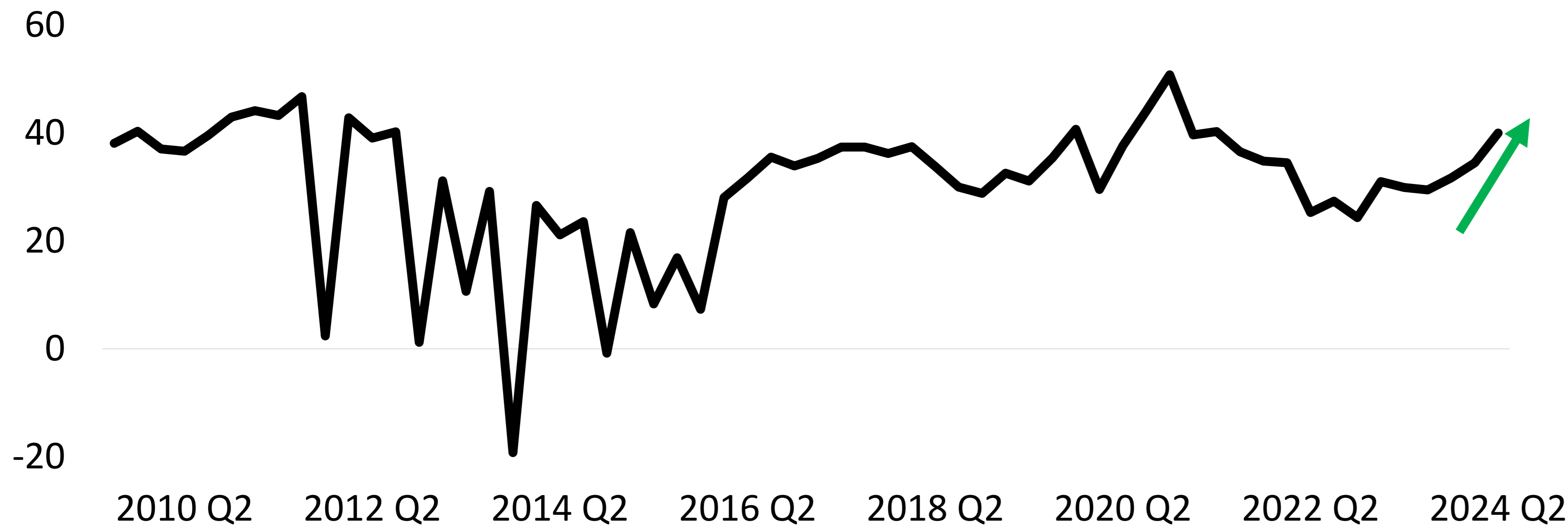
Sales Growth (YoY%)



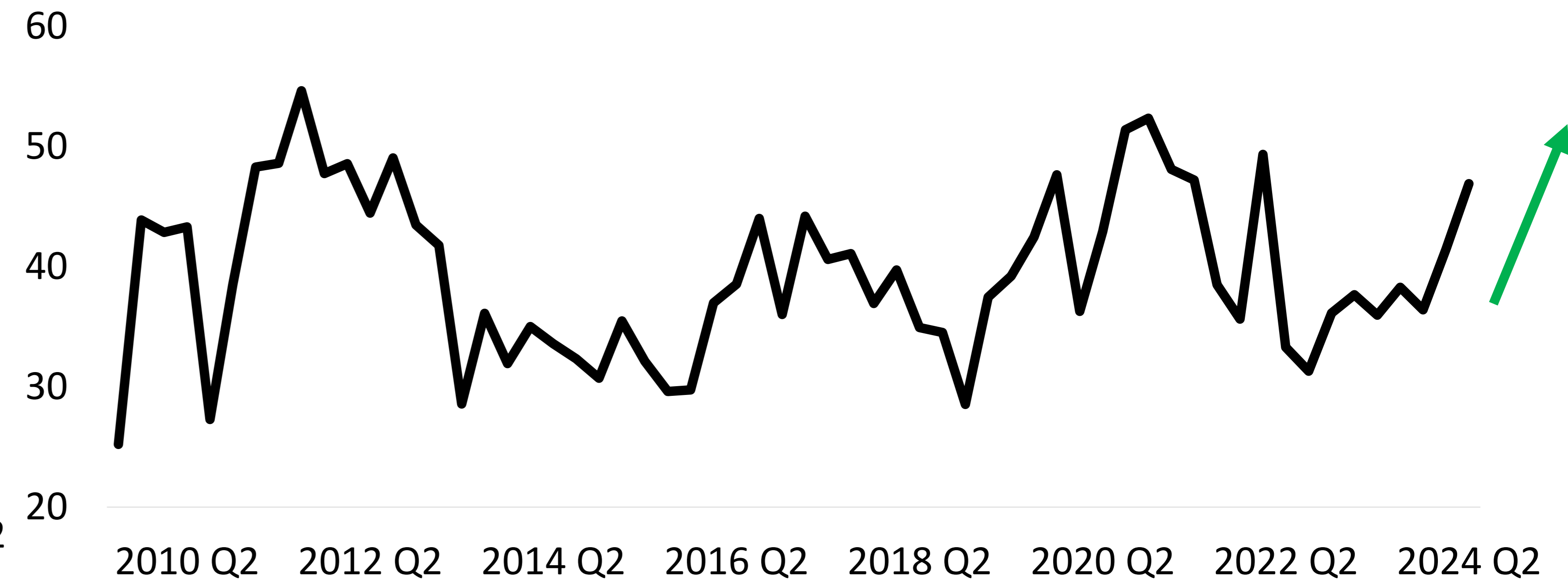
EBITDA Growth (YoY%)



Gross Margin



EBITDA Margin



Source: Bloomberg, DSP. Data as of Aug 2024. Data taken is of Senior Gold Mining companies which are Agnico Eagle Mines Ltd, Barrick Gold Corp, Cia de Minas Buenaventura SAA, Kinross Gold Corp, Newmont Corp, Zijin Mining Group Co Ltd.

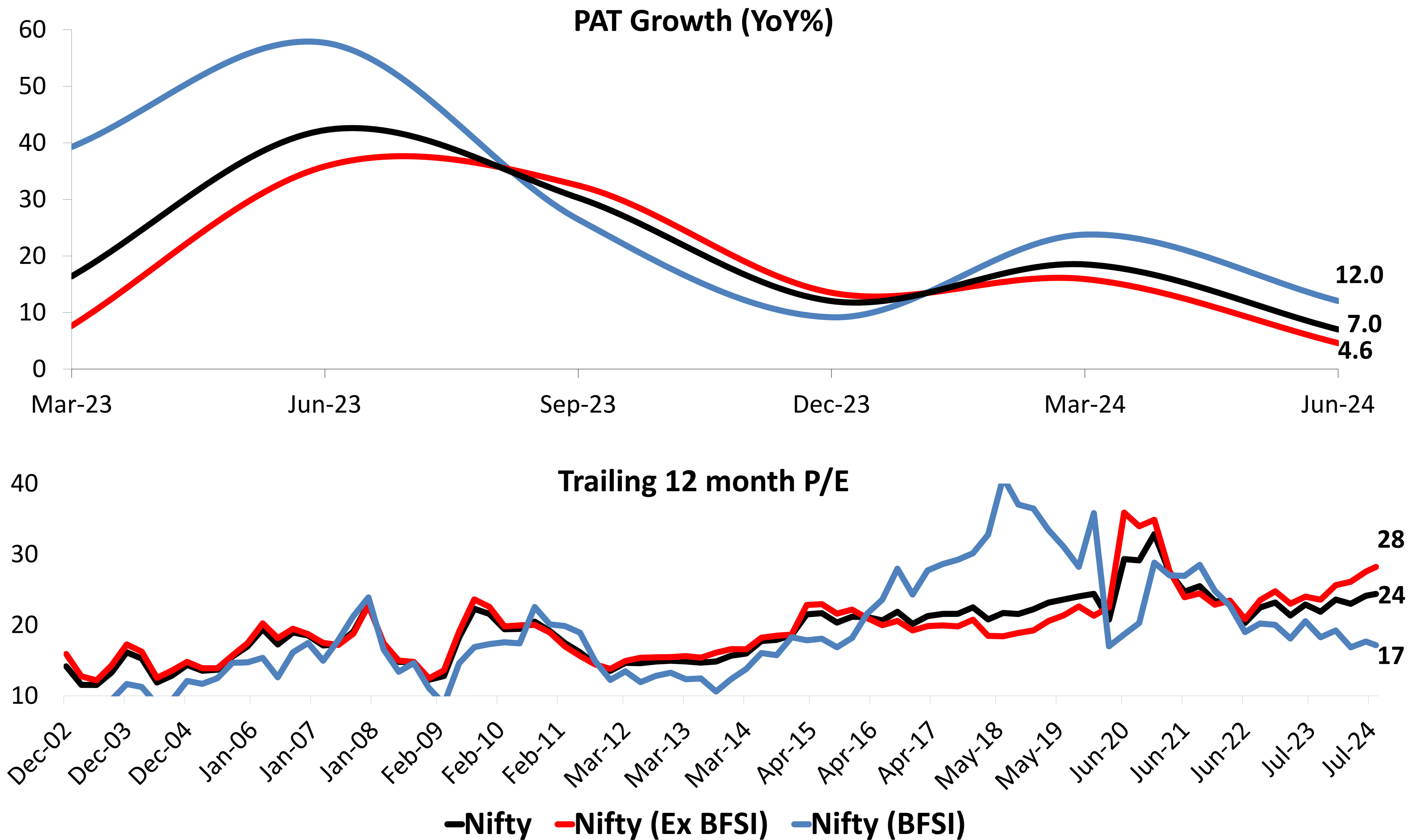
Is BFSI Sector Well Positioned?

The Nifty 50's earnings are currently being driven by the BFSI sector. As the June quarter results were announced, a significant divergence in bottom-line growth was observed.

The BFSI sector posted a 12% increase in PAT growth, while companies outside of BFSI saw a 4.6% growth. Clearly, the overall earnings of the Nifty index are heavily reliant on the BFSI sector.

From a valuation perspective, the BFSI sector is particularly appealing. The Bank Nifty Index is currently trading at a Fwd Price to book multiple of 2.1x versus its 15-year average of 2.1x, making it the only sector available at long term average valuations.

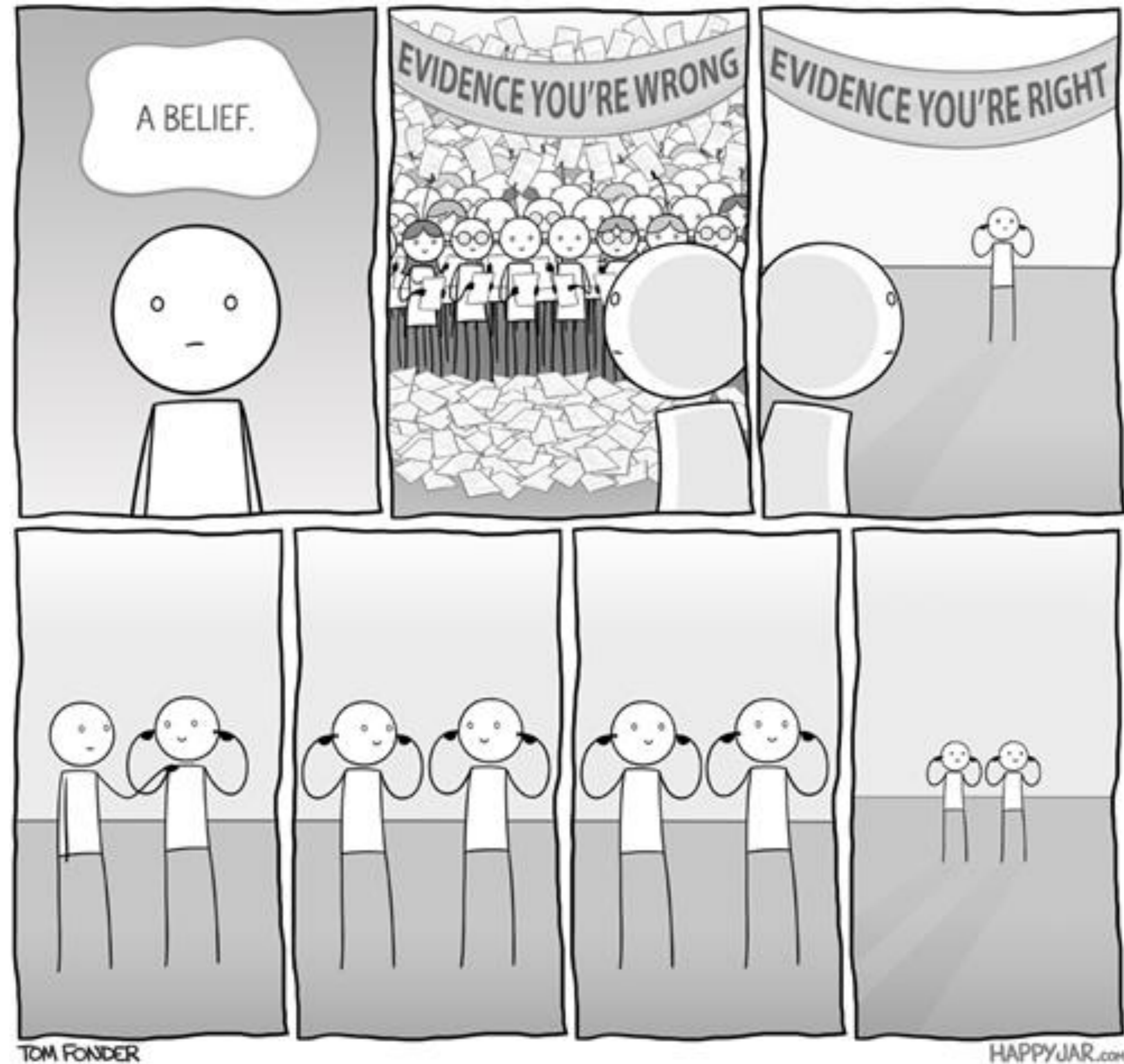
Nifty BFSI is trading below both the Nifty P/E ratio and its five-year average of 22. Meanwhile, Nifty ex-BFSI is trading at a historically high premium of 44% over Nifty BFSI on a 12-month forward P/E basis, far above its five-year average premium of 5%. Given the growth potential and valuation comfort within the BFSI sector, it may represent a strategic investment opportunity at this time.



Avoid Confirmation Bias

Desist from confirmation bias. Be objective and open-minded.

Seek non-confirming evidence. Listen to opposing views & ideas.



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