NETRA

Early Signals Through Charts

Aug 2024

DSP

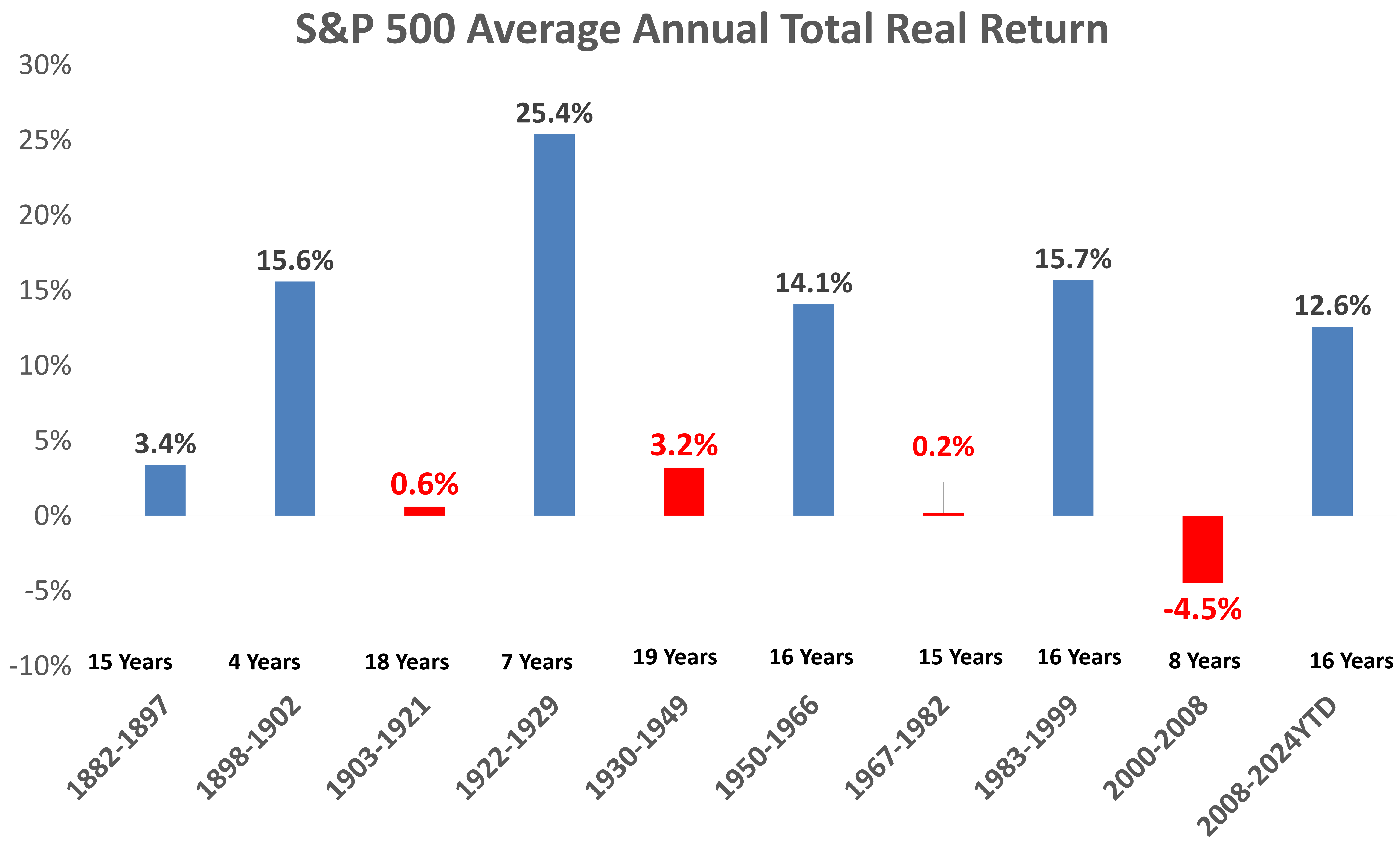
Booms and Busts: The Bulk of Our Investment Life Lies Beyond Our Control

"I am more afraid of remedies than diseases."
— James Grant

The reality is that achieving double-digit real returns is exceedingly challenging, even in the world's most prosperous countries. Even with an investment horizon extending over 140 years, one might only achieve an average return of about 9.5% by certain measures.

The tools and strategies we use to address this challenge—such as Buy and Hold, SIPs, stock picking, asset allocation, or speculative trading—are merely attempts to navigate the unpredictable rhythms of the market.

While it is beyond our control to dictate the period during which our investing lives unfold, we do have the power to choose where we invest. We can select sound businesses available at fair prices or chase stories and narratives driven by speculative fantasies. Choose wisely.



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Source: Gail Dudack, Sungard Institutional Brokerage, Global Financial Data; DSP. Data as of July 2024. The returns are on calendar year basis. Red means weak cycle, Blue means strong cycle

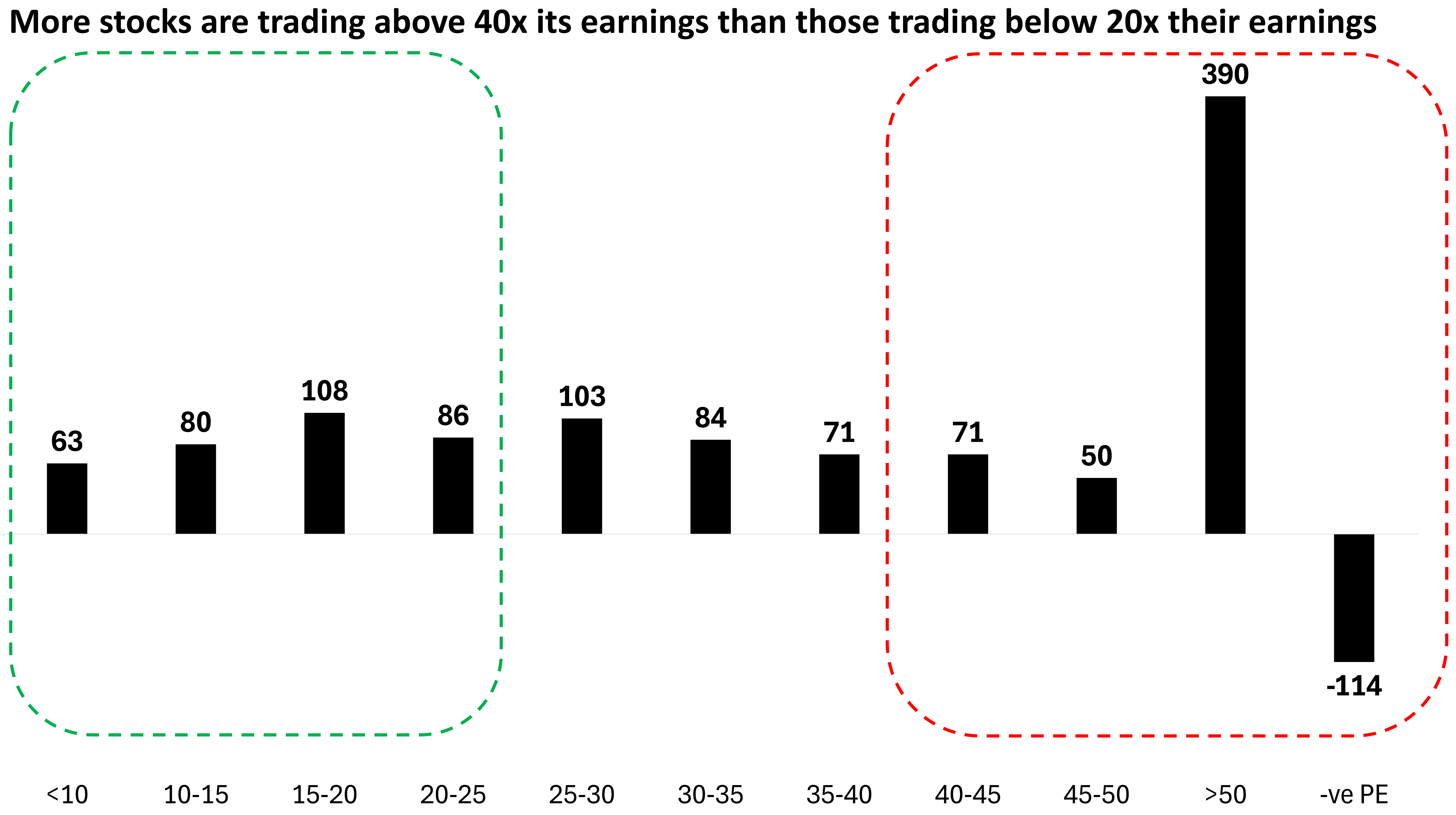
Bargains Are Becoming Harder to Find, Broader Market Remains Pricey

While everyone is enjoying the ride of the bull market, valuations are becoming increasingly crucial. Better priced opportunities that were abundant during the COVID crash are no longer available. Despite this, stock prices continue to rise as the market anticipates future earnings growth. However, the question remains: are we paying the right price for these stocks?

We analyzed all the 1220 companies listed in the BSE All Market index. More than half of these stocks are trading at 40 times earnings or more, including those generating losses. Very few stocks now have an earnings multiple below 20.

A significant portion of these stocks comes from outside the large-cap universe, making it more challenging to find a margin of safety in these areas. We also conducted a review of the segment-wise valuations, presented in a graphical format in the following slide.

P/E of all companies in BSE All Market index



Source: Bloomberg; DSP. Data as of July 2024

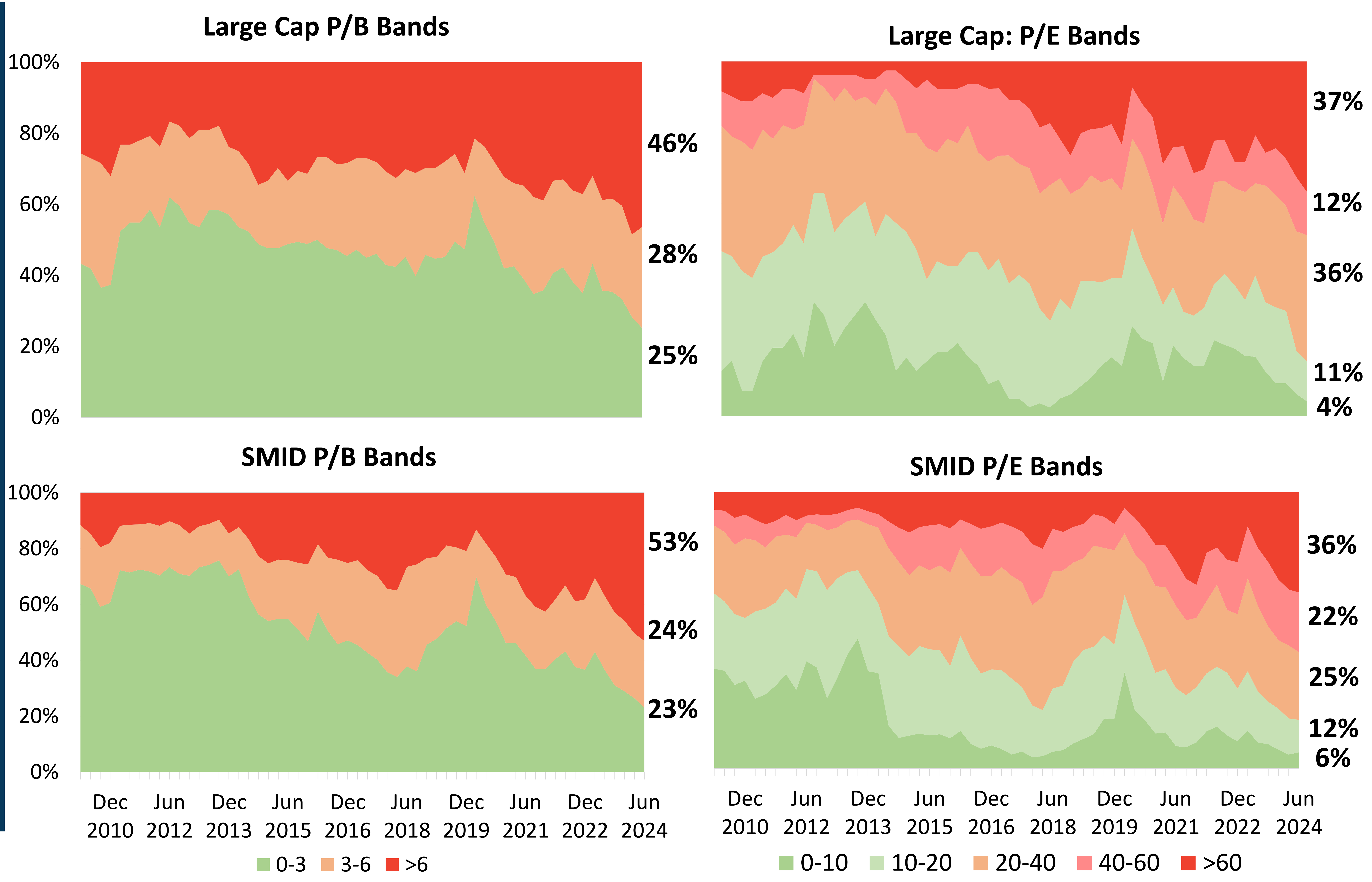
‘Margin of Safety’ Eroded

Within the NSE 500, the percentage of stocks trading below 3 times their book value has decreased from 70% during the COVID period to just 23% currently.

This contrasts with the historical average of 44%, highlighting the favorable conditions for purchasing SMID stocks during the earlier phase. As we now approach the phase of rich valuations in this cycle, a more cautious approach is warranted in these segments.

The large-cap space faces a similar challenge, although there are still areas where a margin of safety exists.

The number of companies trading below 3 times their book value is at an all-time low, indicating a need for a more focused, bottom-up approach to identify new investment opportunities.



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Source: Bloomberg; DSP. Data as of July 2024. Negative earnings (P/E) and book value (P/B) companies are excluded.

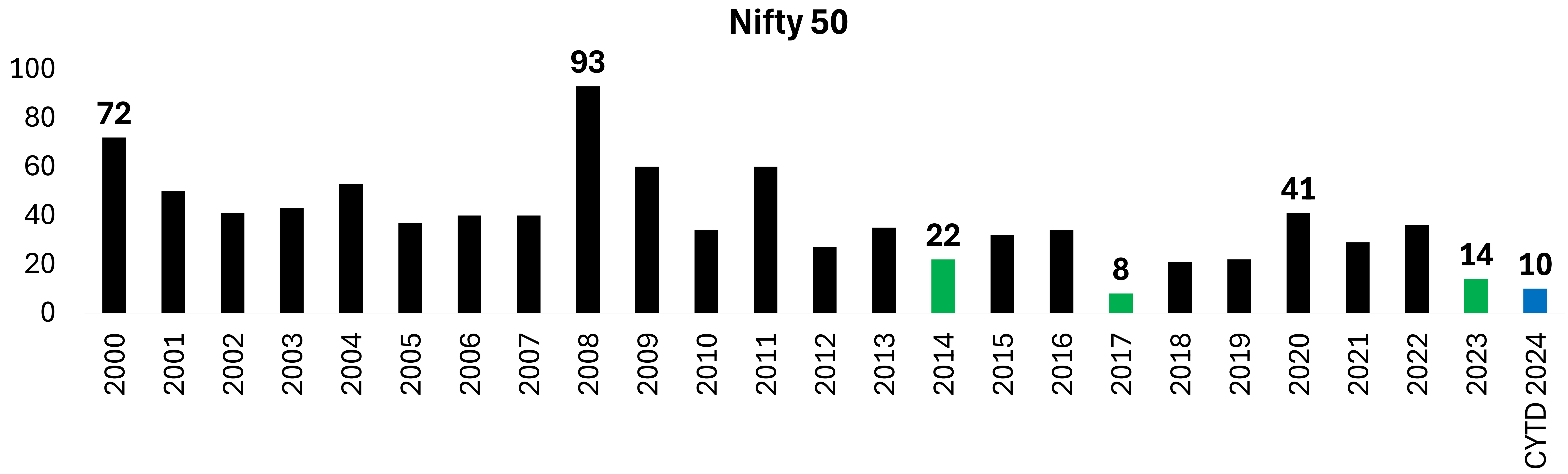
The Unsettling Calm Of Ultra Low Volatility Continues

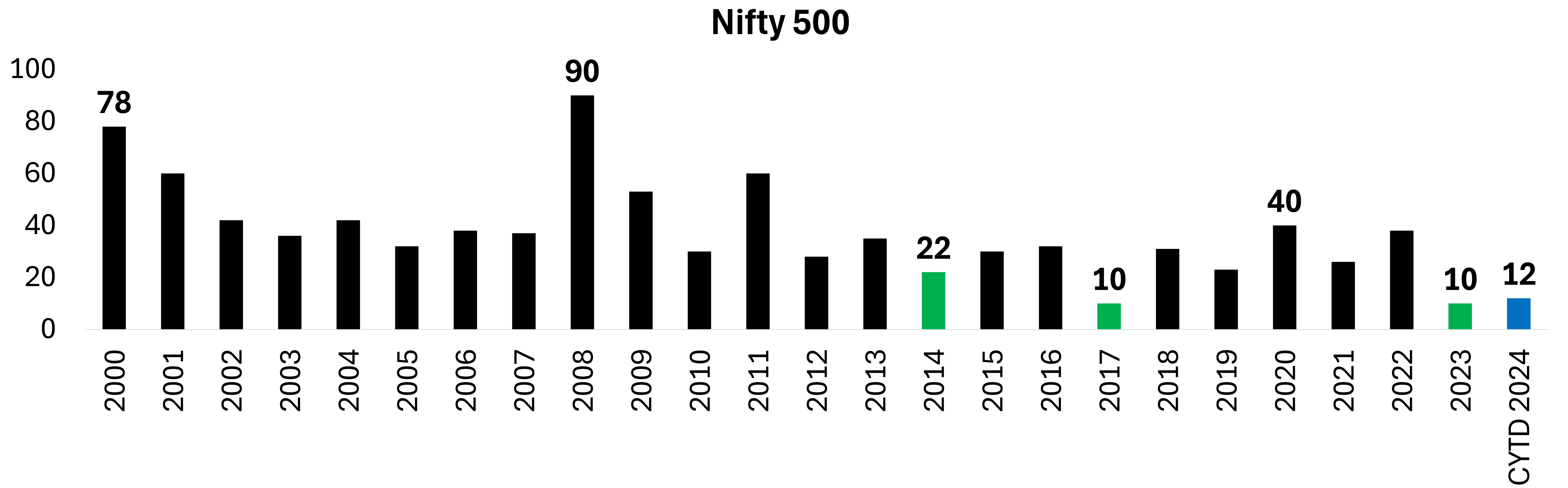
India has experienced several bull markets in the past, but what sets the current one apart is its unprecedented consistency. We have analyzed the number of days in a calendar year where the major indices experienced a decline of 1% or more. Even during the significant bull market from 2003 to 2007, the number of such decline days was higher than what we've seen since the COVID-19 pandemic.

This strong momentum in the current bull market indicates a significant reduction in market volatility, positioning India as one of the top markets globally with one of the lowest levels of volatility.

As we move further into the 2nd half of CY24, the number of decline days is nearing the low levels of 2023. The same trend is evident in the broader index, where the number of decline days has been amongst the lowest since the inception of these indices. This underscores not only the strength but also the consistency of the Indian stock market. But more importantly, it indicates the complacency at play.

Number of days in a year with a decline of 1% or more





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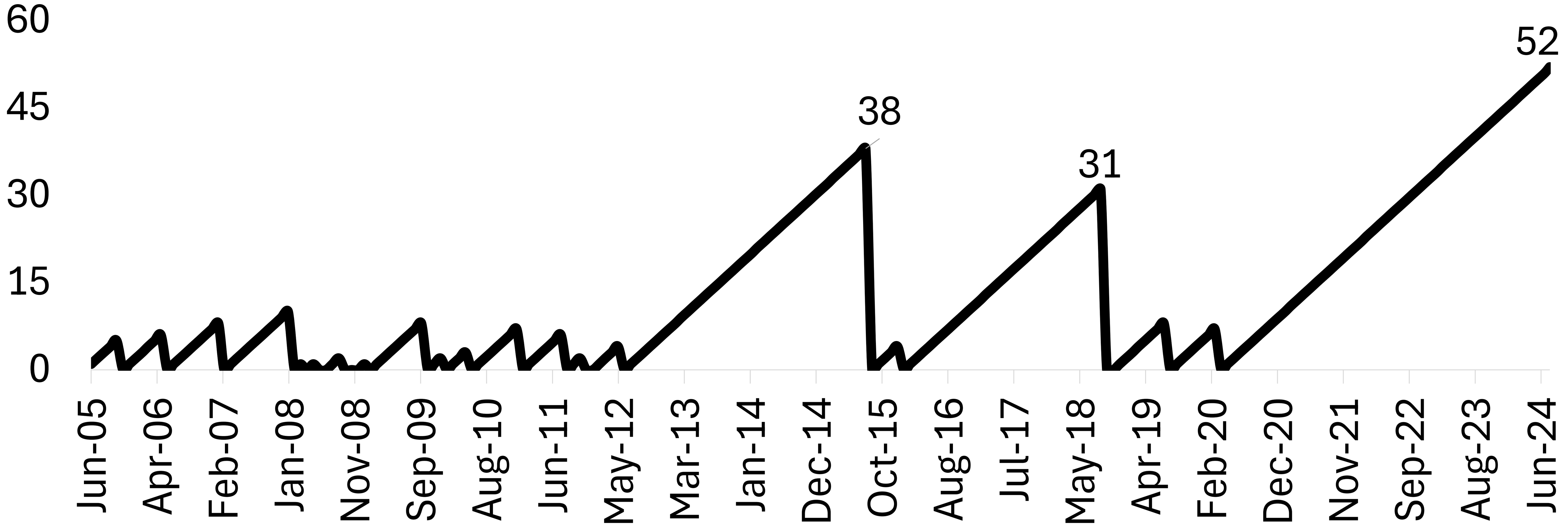
Source: NSE; DSP. Data as of July 2024. Total return indices are considered.

The Unsettling Calm: One Way Street To Record Consecutive Positive Closes

Number Of Consecutive Months Without A Monthly Decline Of 5% Or More

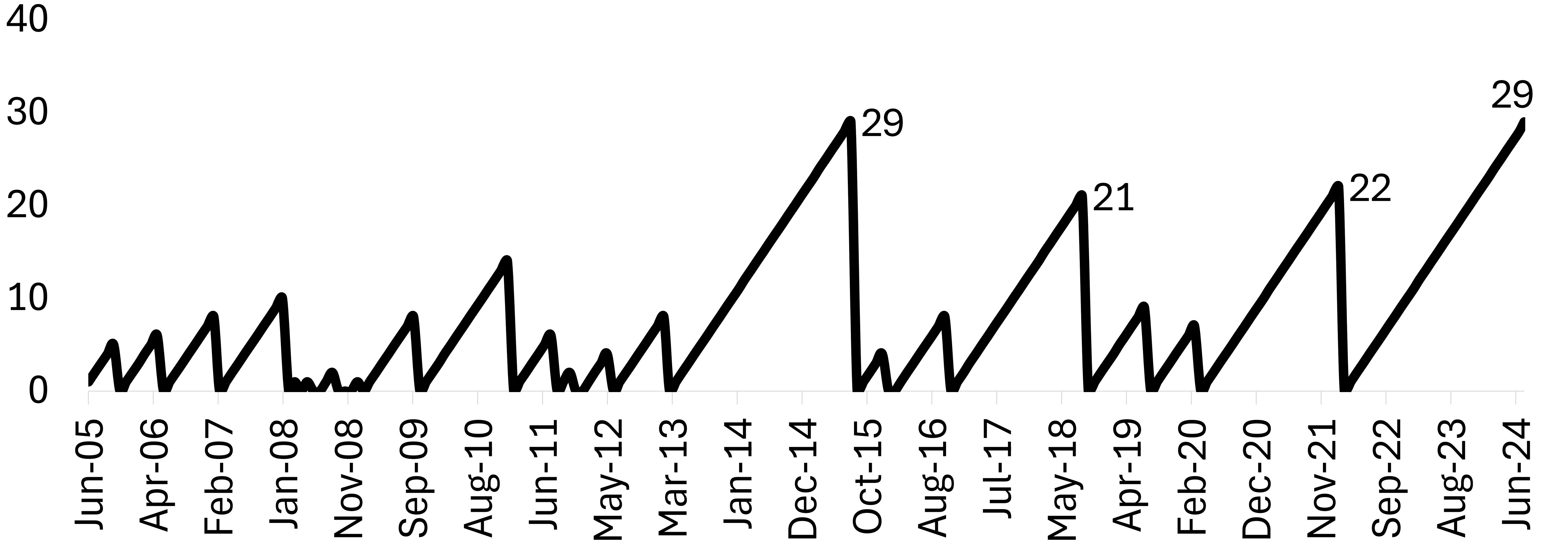
Nifty 50

New record



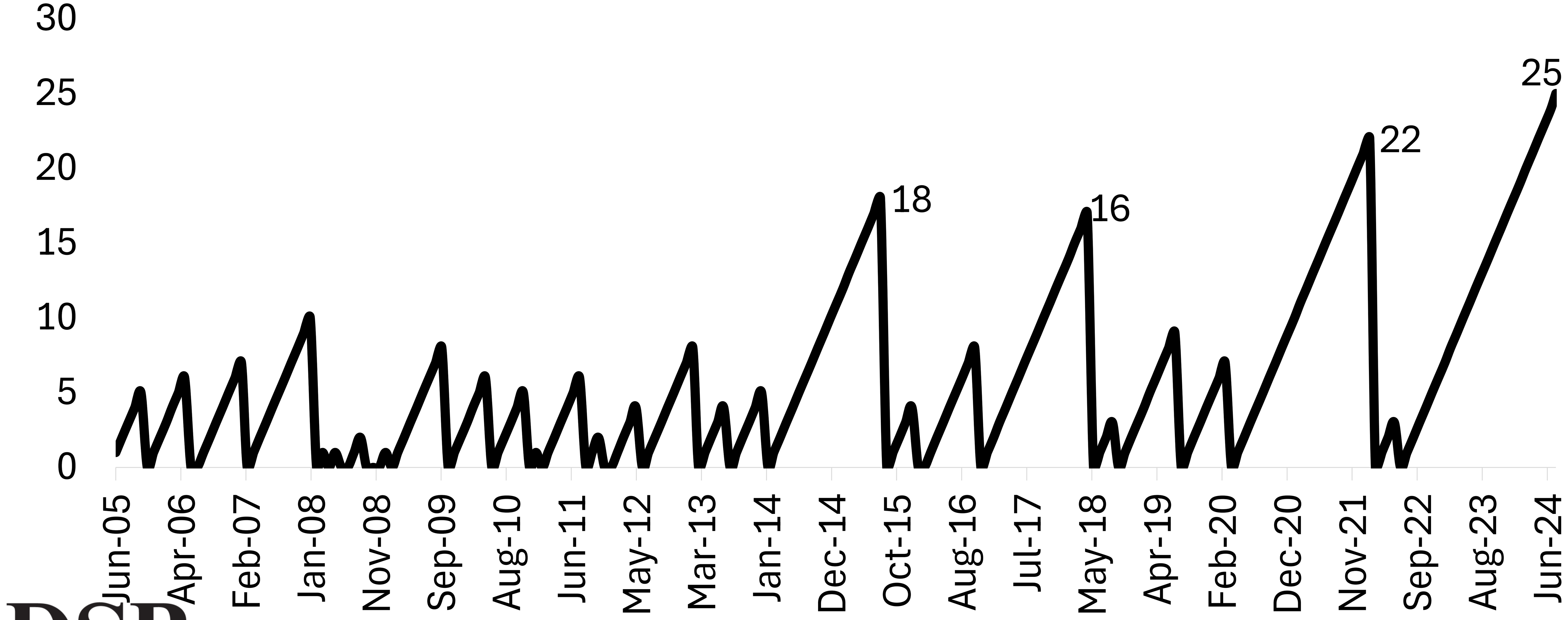
Nifty 500

New record



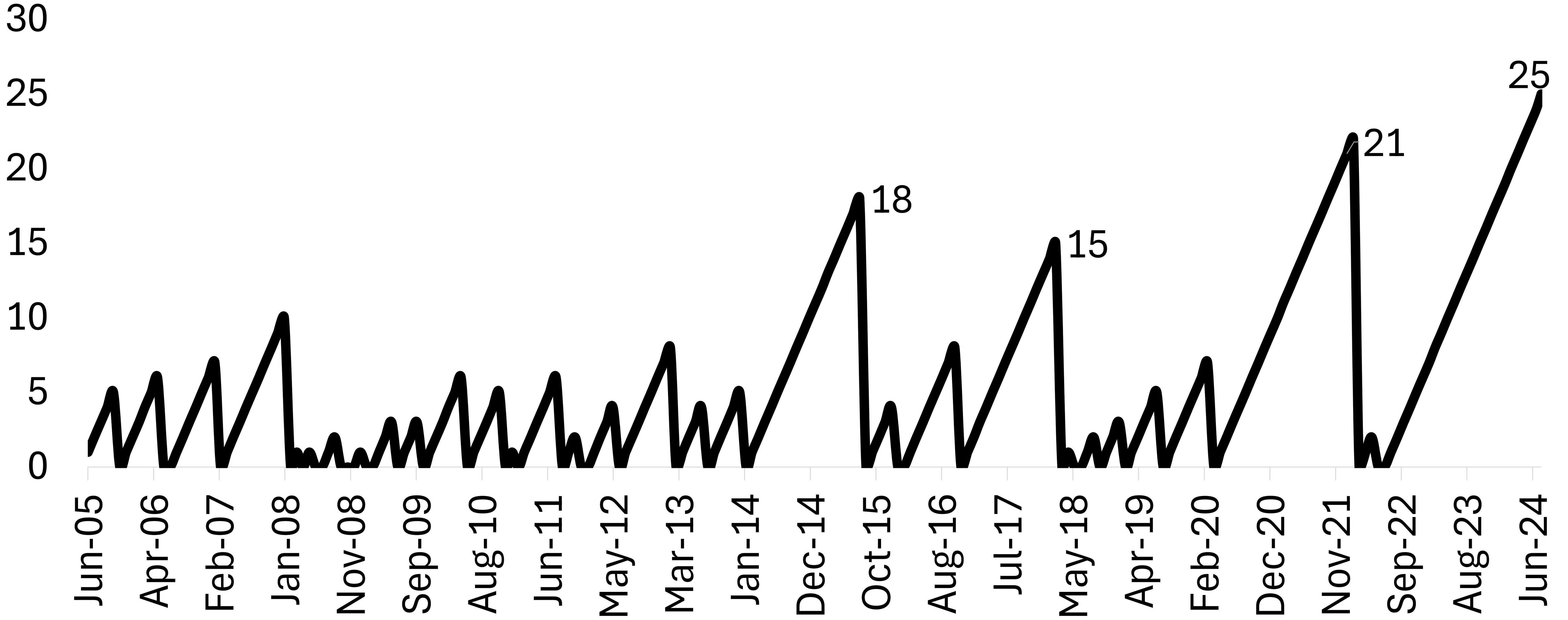
Nifty Midcap 150

New record



Nifty Smallcap 250

New record



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Source: NSE; DSP. Data as of July 2024. All Indices are Total Return Indices

Indian Equities: From Being Highly Volatile To Being One Of the Calmest, Consistently Pricey

1 Year Index Volatility

Year	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Brazil	1	4	3	1	2	6	3	2	2	2	2	1	1	1	1	1	3	4	4
Hong Kong	13	11	2	2	3	8	4	8	10	7	6	8	3	3	13	13	1	1	1
Philippines	8	5	7	17	17	14	17	7	3	13	9	6	5	7	3	2	5	7	7
China Mainland	4	2	1	5	5	5	13	6	5	1	1	5	7	2	16	18	13	13	13
UK	17	16	15	15	16	13	11	14	15	11	8	9	16	16	10	10	15	15	16
France	12	13	13	7	8	2	2	3	9	5	5	4	10	13	5	5	8	8	12
Eurozone	14	14	16	10	7	1	1	4	8	4	4	3	11	14	7	6	4	6	11
Malaysia	19	18	19	19	19	19	19	19	19	19	19	19	19	18	19	19	19	19	19
Vietnam	2	1	5	12	1	4	6	5	6	6	11	14	2	4	17	9	2	2	2
South Africa	6	6	10	9	11	9	14	13	11	8	7	7	6	6	8	7	7	5	3
Mexico	7	7	11	14	12	17	16	15	12	12	17	11	9	8	14	16	14	12	8
Indonesia	5	8	6	13	9	7	7	9	4	10	12	10	8	10	15	15	17	18	18
Canada	15	17	18	8	13	18	18	18	18	17	16	18	18	19	6	11	18	14	14
Korea	9	9	9	11	14	11	5	11	13	18	18	16	13	12	11	8	11	11	6
Australia	16	15	14	18	18	16	15	17	14	14	10	13	17	17	9	14	16	17	15
India	**3**	**3**	**4**	**3**	**4**	**12**	**12**	**10**	**7**	**9**	**13**	**12**	**15**	**15**	**4**	**4**	**12**	**16**	**17**
Taiwan	11	12	12	16	15	15	9	12	16	16	15	15	12	11	18	17	10	10	9
USA	18	19	17	6	10	10	8	16	17	15	14	17	14	9	2	3	9	3	10
Japan	10	10	8	4	6	3	10	1	1	3	3	2	4	5	12	12	6	9	5

Annual Average Price to Book

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Brazil	1.1	1.2	1.2	1.4	1.7	1.8	2.1	2.0	2.1	1.7	1.5	1.5
Hong Kong	1.5	1.4	1.3	1.1	1.3	1.4	1.3	1.1	1.2	1.1	1.1	1.0
Philippines	2.9	2.8	2.7	2.5	2.4	2.2	2.0	1.6	1.6	1.6	1.5	1.6
China Mainland	1.5	1.5	2.2	1.7	1.8	1.5	1.5	1.5	1.6	1.4	1.4	1.3
UK	1.9	2.0	2.0	1.9	1.9	1.8	1.8	1.5	1.8	1.8	1.7	1.8
France	1.4	1.4	1.5	1.4	1.6	1.6	1.6	1.5	1.9	1.7	1.9	2.0
Eurozone	1.3	1.5	1.6	1.4	1.6	1.6	1.7	1.6	2.1	1.8	1.9	2.1
Malaysia	2.3	2.3	2.0	1.8	1.7	1.8	1.7	1.5	1.6	1.5	1.3	1.4
Vietnam	1.8	2.0	1.8	1.8	2.3	2.9	2.5	2.0	2.6	2.1	1.7	1.7
South Africa	2.4	2.5	2.4	2.2	2.2	2.2	2.2	1.9	2.2	2.1	1.9	1.6
Mexico	2.8	2.5	2.5	2.4	2.4	2.2	1.9	1.8	2.2	2.0	2.1	2.1
Indonesia	2.8	2.7	2.4	2.4	2.5	2.4	2.3	1.8	2.1	2.2	2.0	2.0
Canada	1.8	2.0	1.8	1.8	1.9	1.8	1.8	1.7	2.1	2.0	1.8	1.9
Korea	1.1	1.1	1.1	1.0	1.1	1.0	0.9	0.9	1.2	1.0	0.9	1.0
Australia	2.0	2.0	2.0	1.9	2.0	2.0	2.1	2.0	2.3	2.1	2.1	2.3
India	**2.7**	**3.0**	**3.1**	**2.9**	**3.1**	**3.3**	**3.2**	**2.8**	**3.8**	**3.5**	**3.4**	**3.8**
Taiwan	1.7	1.8	1.6	1.6	1.7	1.7	1.7	1.8	2.3	2.0	2.0	2.4
USA	2.5	2.7	2.8	2.8	3.2	3.3	3.4	3.6	4.6	4.1	4.2	4.8
Japan	1.6	1.6	1.8	1.6	1.8	1.9	1.7	1.8	2.1	1.7	1.8	2.2

Higher rank means lower volatility

DSP

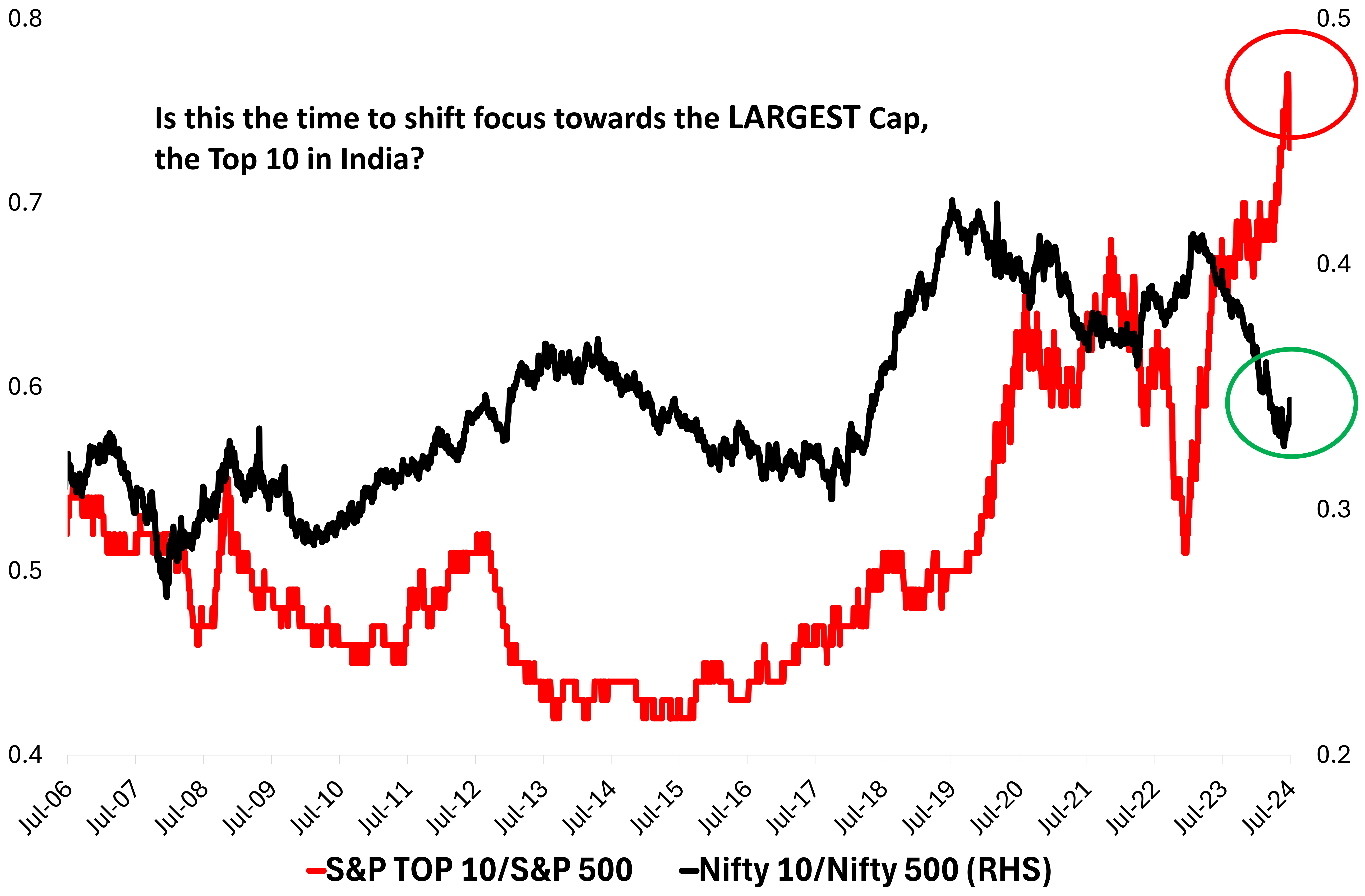
Source: Bloomberg; DSP. Data as of July 2024.

Remember The Phrase "Big Becoming Bigger" – Played Out In US, At Inflexion Point In India?

Globally concentrated portfolios have done exceptionally well. Be it NYSE FAANG+, Magnificent seven, or for a more diversified portfolios like S&P 500 Top 10 or S&P 500 Top 50 indices have performed well, because the prospects for the larger companies were much better than the smaller companies and the larger companies have outperformed the smaller companies over long term in the last cycle. One reason is that larger companies can upgrade and reorient using technological spending, which becomes a challenge for smaller firms.

A few years ago, the Indian market was abuzz with the phrase 'Big Becoming Bigger'. With the stellar performance of Small & Mid Cap stocks (SMIDs), that phrase is almost forgotten. We believe the LARGEST companies now offer a high margin of safety versus the rest of the universe.

India now has a concentrated index. The Nifty Top 10 Equal Weight index. The broader market has outperformed this strategy by record, recently by virtue of which the top ten stocks by market cap are now available at relatively lower valuations, lesser price froth and impressive return ratios.



DSP

Source: Bloomberg; DSP. Data as of July 2024

Large Cap Category Starved for Investment Flows

Sector & themes have received the largest share of flows over the years. Once regarded as the domain of experts and investors with specific goals, this category is not only witnessing inflows in broad sectors and themes but also in sub-industry groupings which is a first in the mutual fund industry. Large inflows in the SMID space is a function of consistent performance of this space over the last few years and is a phenomenon which repeats in each cycle.

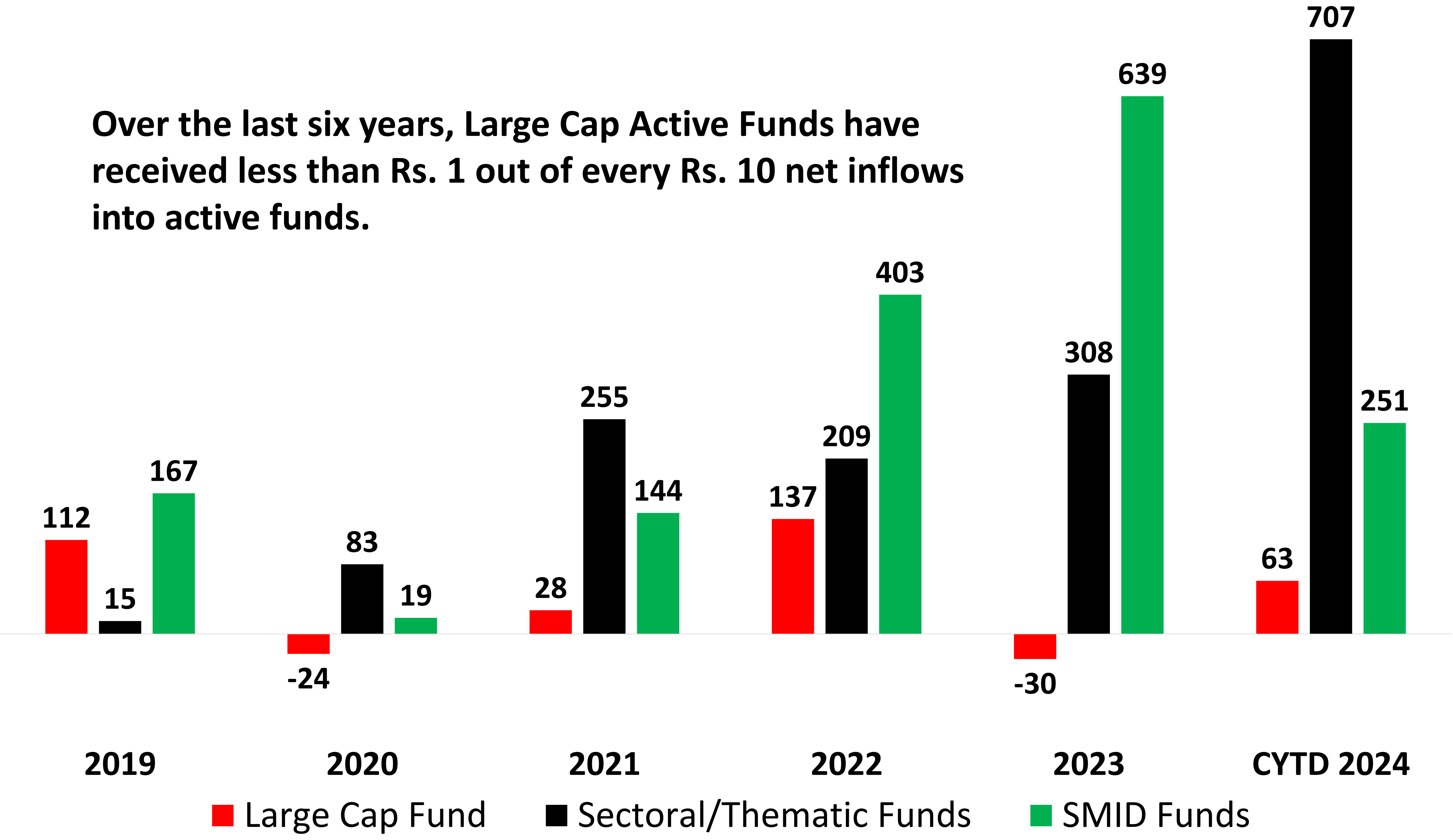
Flows follows returns. Flows don't cause returns.

Over the last 5 years, the category average (CAGR) returns are as follows:

Large cap: 19%
Midcap: 29%
Small cap: 33%
Sectoral Thematic: 24% (best at 40%)

"The intelligent investor is a realist who sells to optimists and buys from pessimists."
Large cap category has dearth of optimists.

Active Mutual Fund Net Flows (₹ Billion)



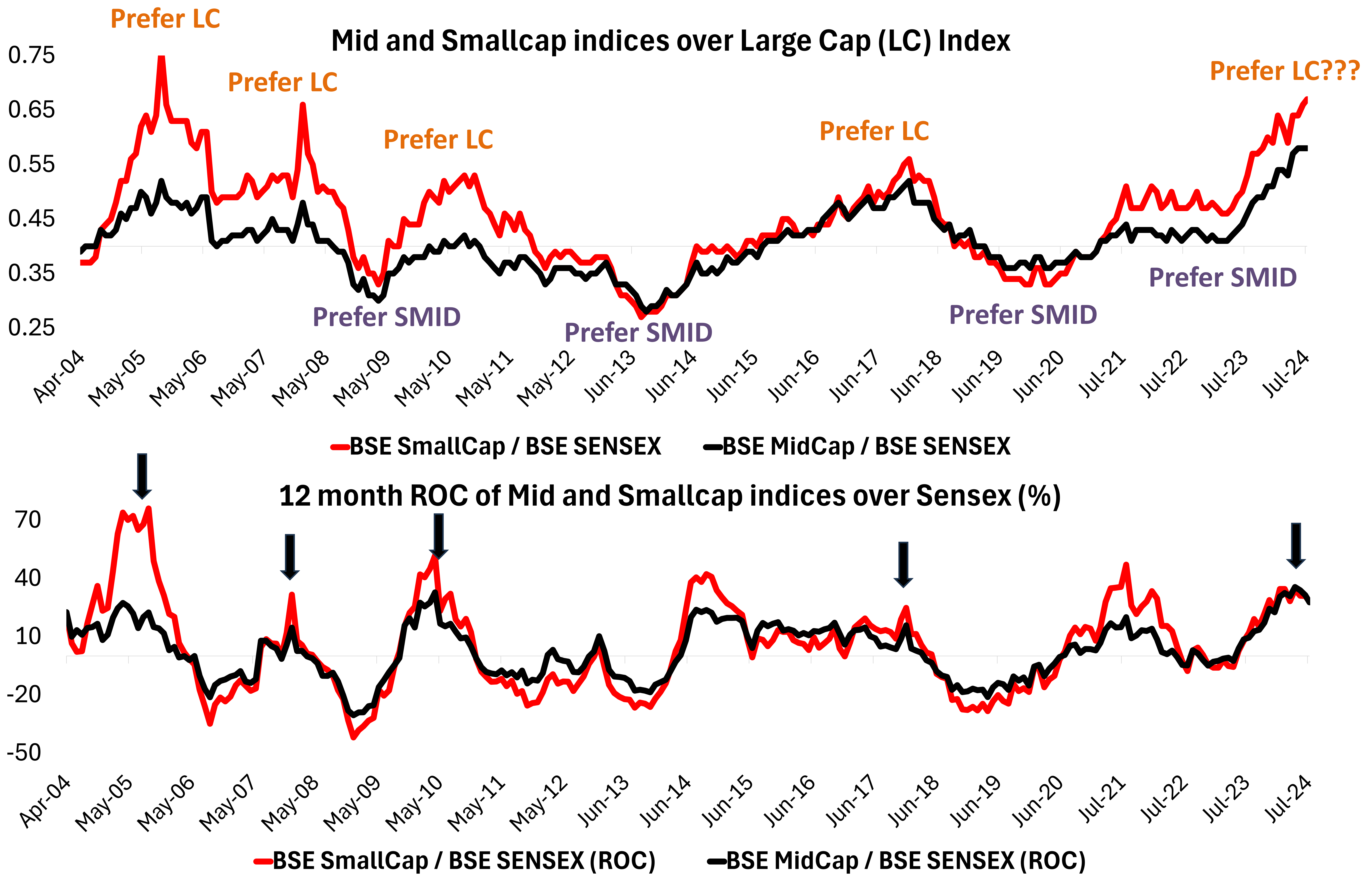
Source: AMFI; DSP. Data as of July 2024. Flows are of Calendar years.

Large Cap: A Favourable Risk Reward Makes Them A Place To Hide?

Is this the time for large caps?

History shows that at points like these, incremental investments in Small & Midcap only through SIPs are the preferred path.

Post-COVID, mid and small-cap indices have consistently outperformed large-cap indices, as evidenced by the rising Midcap/Sensex and Smallcap/Sensex price ratios. The Midcap Index is now trading at its highest relative level to Sensex, while Smallcap index is just shy of its 2005 record. This means that relatively, SMID cap space has done better and is at most expensive level relative to the large cap. The 12-month rate of change is now showing signs of reversion, suggesting that we might be approaching a period of mean reversion. This could indicate that it is time to consider allocating investments towards larger-cap indices. Even valuations for large caps are relatively favourable at this point. But remember that broadly valuations are above average or expensive.



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Source: Bloomberg; DSP. Data as of July 2024. ROC – Rate of Change

DSP Capex Tracker – This Isn't The Noughties, Yet!

2003-2011 was rightfully 'India Growth Story' marked by robust govt capex and buoyed by private sector investment at the same time.

	Units	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	8 Year CAGR (FY03 - FY11)
New Investments	INR Bn	2,980	5,003	5,705	12,940	24,619	26,400	27,340	24,424	26,059	31%
Central Govt Capex	INR Bn	745	1091	1139	664	688	1182	902	1127	1566	10%
Cement Volumes	YoY, %	--	--	--	12.3	9.1	8.1	7.3	10.5	4.5	8.6%*
Import of engineering goods	USD Bn	10.9	14.8	21.1	33.4	43.1	66.6	69.4	60.9	72.2	27%
Industrial credit	INR Tn	2.96	3.13	4.27	5.50	6.97	8.58	10.54	13.11	16.05	24%
IIP Capital Goods	YoY, %	10.55	13.63	21.85	18.06	23.34	48.47	11.30	0.99	14.75	18%*
Housing loans	INR Tn	--	--	1.34	1.85	2.31	2.60	2.79	3.01	3.50	17%**
Investment Projects Completed	INR Bn	651	657	1,031	1,167	1,919	2,279	3,046	3,948	3,550	24%

Capex cycle, post covid has been largely driven by govt action and remains constrained to it, with little private sector initiative.

	Units	FY19	FY20	FY21	FY22	FY23	FY24	5 Yr CAGR (FY19-FY24)
New Investments	INR Bn	19,021	19,698	11,343	23,913	39,552	30,354	10%
Central Govt Capex	INR Bn	3077	3357	4263	5929	7400	9502	25%
Cement Volumes	YoY, %	13.3	-0.9	-10.8	20.8	8.7	8.9	6.6%*
Import of engineering goods	USD Bn	101.1	97.0	76.2	100.7	125.9	127.8	5%
Industrial credit	INR Tn	28.38	29.47	30.32	31.81	33.66	36.53	5%
IIP Capital Goods	YoY, %	2.65	-13.93	-18.65	16.86	13.08	6.18	1%*
Housing loans	INR Tn	11.77	13.62	15.12	17.38	19.91	27.19	18%
Investment Projects Completed	INR Bn	6,540	5,424	3,496	6,584	6,898	9,158	7%

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Source: CMIE, DSP; Data as of July 2024.

***Average YoY%**
****6 Year CAGR (FY05 – FY11)**

For each row, best to worst

India’s Consumption Growth, Outpacing Most of its Global Peers

India’s 7%+ GDP Growth rate is not without merit, and a significant driver of this growth is household consumption expenditure, which constitutes 60% of the GDP. Both China and India have seen a consistent rise in this figure, resulting in impressive CAGR of 11.7% and 7.2%, respectively.
In developing economies, the consumption story is crucial. India's growth trajectory has been heavily based on this, with household consumption soaring from USD 200 billion to USD 2 trillion over the past 30 years.

China has historically maintained a conservative approach to domestic consumption, basing its growth primarily on investments. In contrast, the United States has consistently demonstrated strength in this area, with domestic consumption accounting for 70% of its GDP. US alone is almost 50% of the consumption of the largest 10 economies put together.

While India, so far has remained exceptional in its consumption number, both in isolation and relative to its peers, it needs to maintain this strength to instill confidence for domestic investment and thus set a base for strong foreign investment.

Households Final Consumption Expenditure (US$ Bn)

1990	1995	2000	2005	2010	2015	2020	2022	2023	33 Year CAGR
3809	4963	6767	8769	10260	12297	14206	17512	18571	11.7%
1608	2925	2666	2648	3275	4178	5611	6686	6967	7.2%
998	1444	1102	1642	2090	2479	2733	2366	2260	5.0%
726	876	1097	1610	1874	1877	1952	2084	2142	4.9%
701	856	735	1195	1587	1779	1634	2044	2119	4.3%
333	338	566	905	1464	1318	1598	1911	2065	3.9%
253	336	406	637	922	1241	1408	1484	1628	3.2%
215	230	299	471	917	900	941	1163	1182	2.6%
180	211	239	396	785	758	769	1100	1007	2.5%
170	206	120	382	635	718	693	824	856	0.8%

China, India, Russia, France, United Kingdom
Canada, Australia, Japan, Germany, United States

DSP

Source: World Development Indicators, DSP; Data as of July 2024.

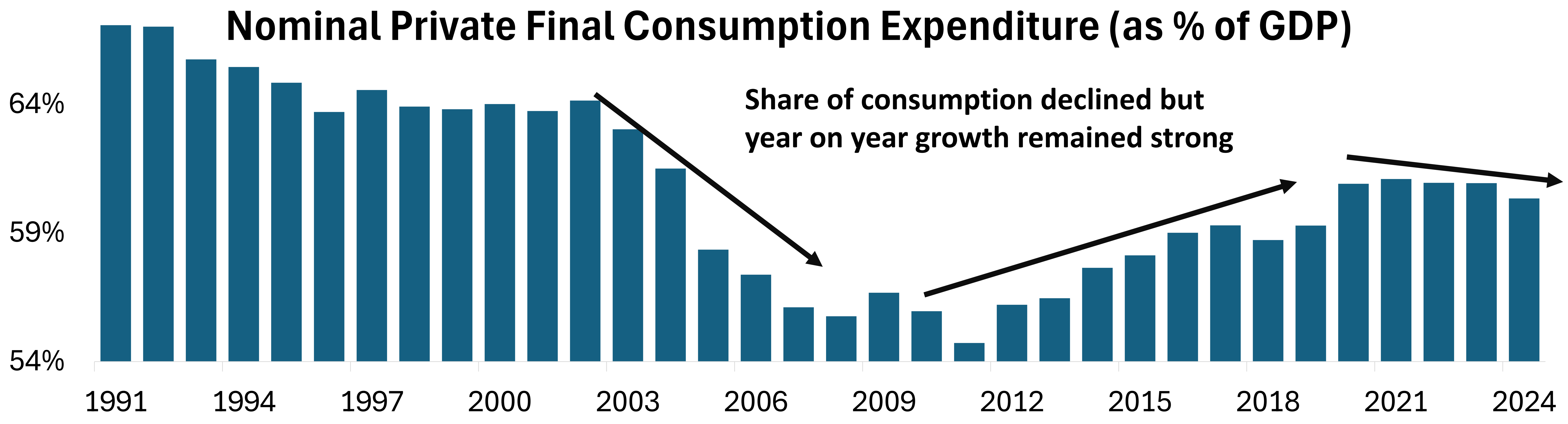
Consumption Cycle Has Slackened Over The Years

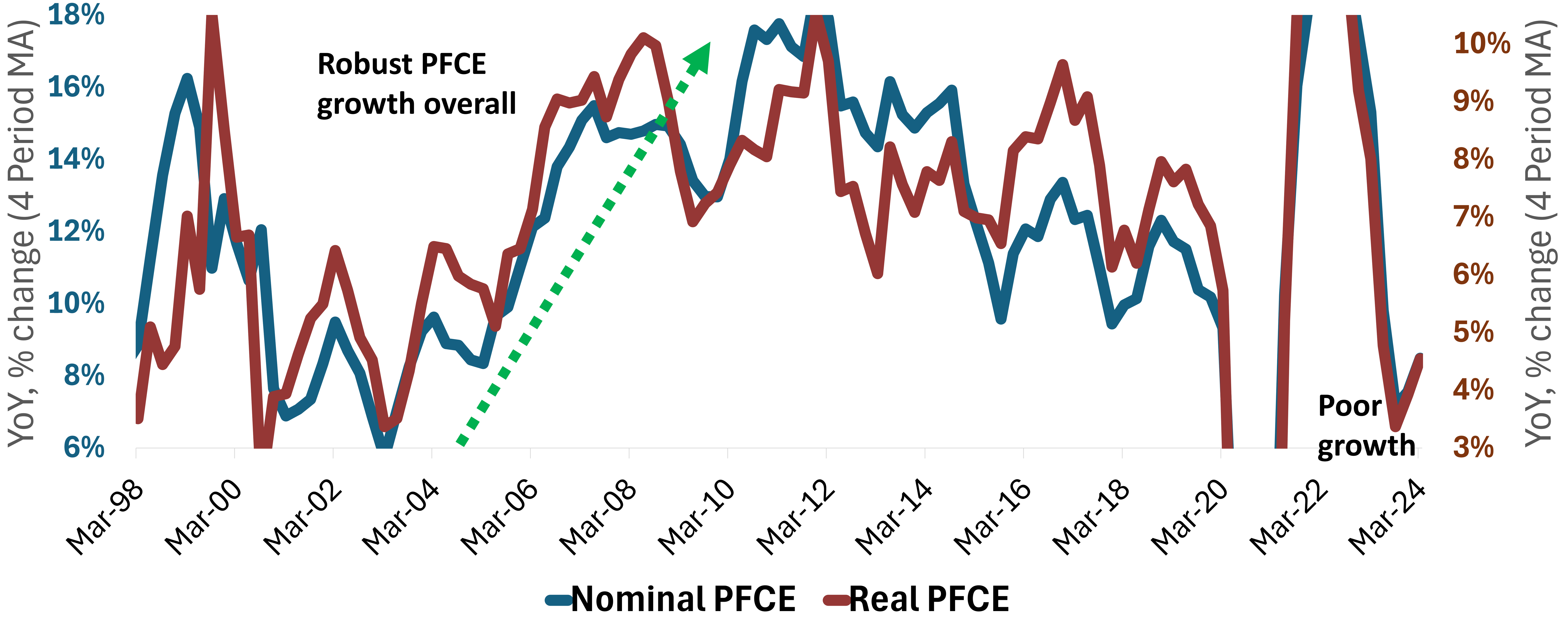
Consumptions' share in the Indian GDP has recovered but still peaks at close to 60%, compared to as high as 80% in the early '80s. This is a result of slowing consumption growth.

In the early 2000s, PFCE's contribution to GDP declined significantly as the investment cycle took hold, driven primarily by private capital expenditure. Even then, private consumption growth remained robust. However, the current push towards an investment-led growth model, seemingly at the expense of consumption, is a strategic choice.

PFCE's contribution to GDP in the last quarter has fallen to a mere 2.2%, compared to the pre-covid 10-year average of 3.7%.

Such disappointingly slow growth rate of consumption could further dampen the present robust GDP growth. Though the investment share has gained momentum, sustaining such growth requires robust consumption demand.





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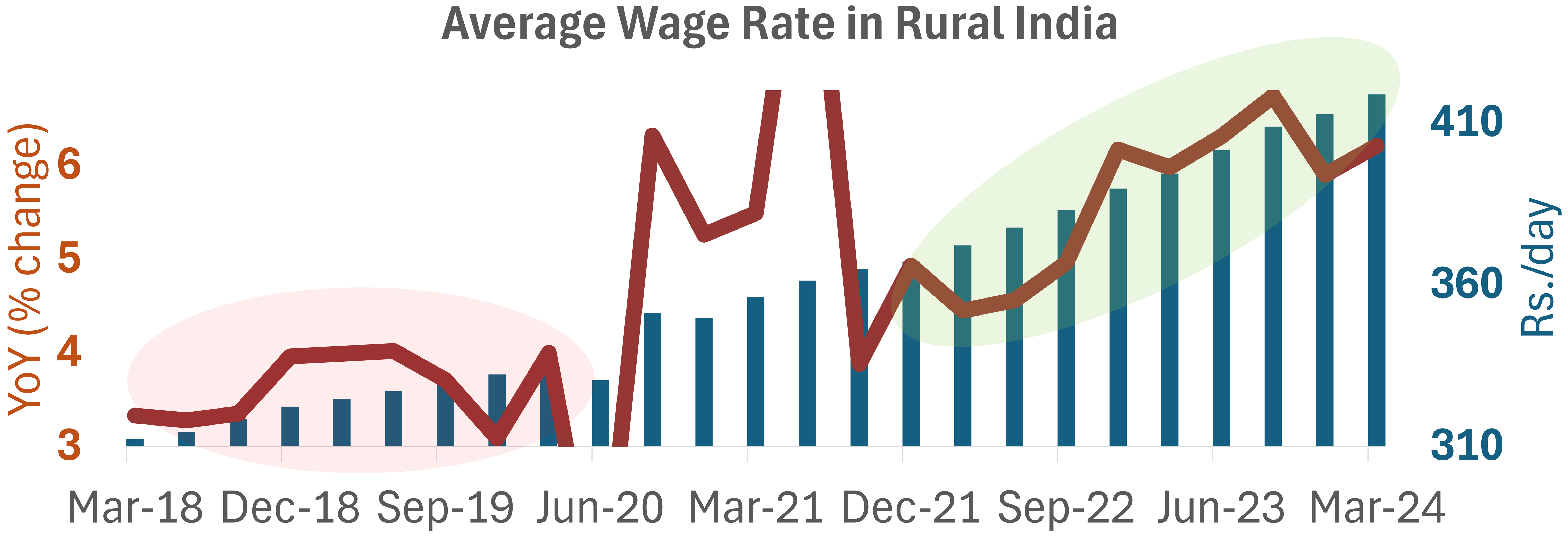
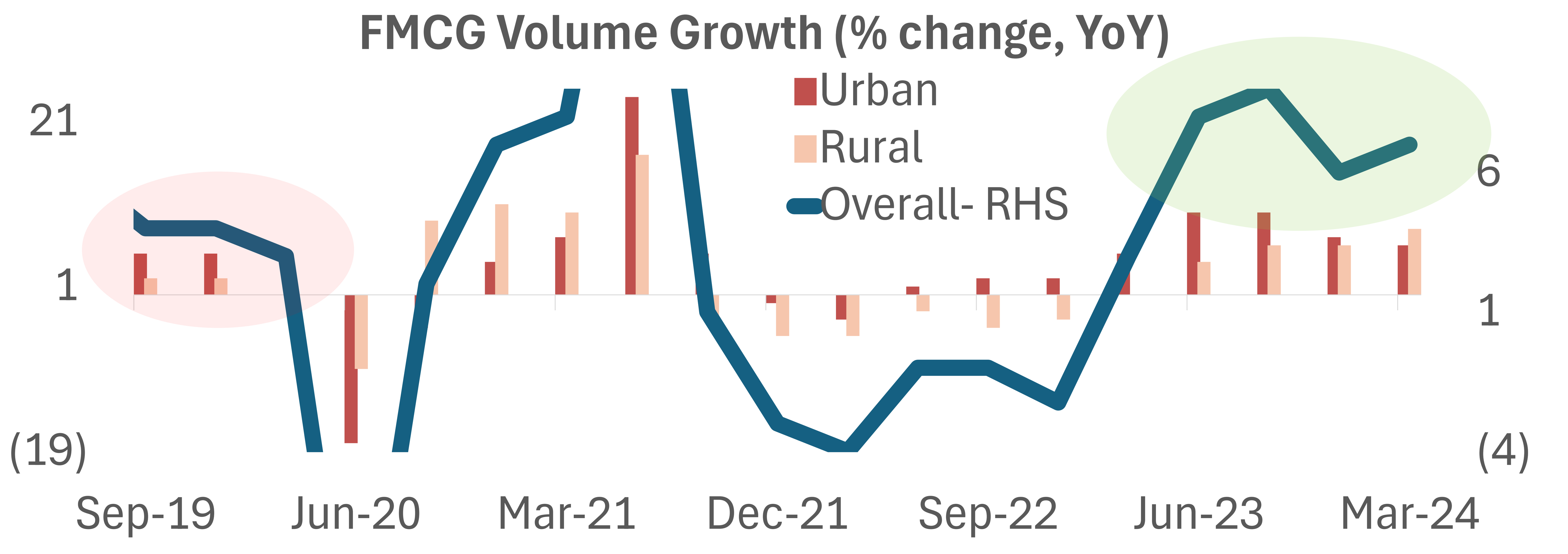
Source: CMIE, DSP; Data as of July 2024. MA: Moving Average

Though Not Concrete, Rural Indicators Instil Some Hope For Recovery

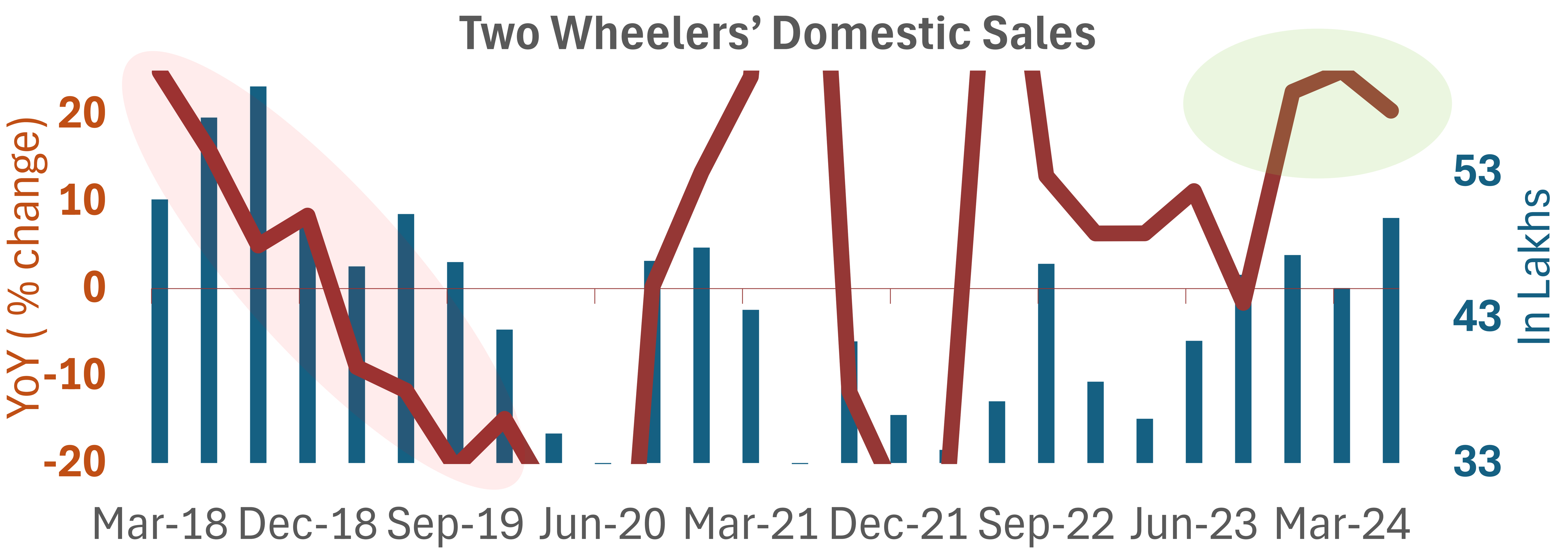
The sustained rise in rural wages is partly due to inflated food prices. Can this trend continue and correct the K-shaped recovery?



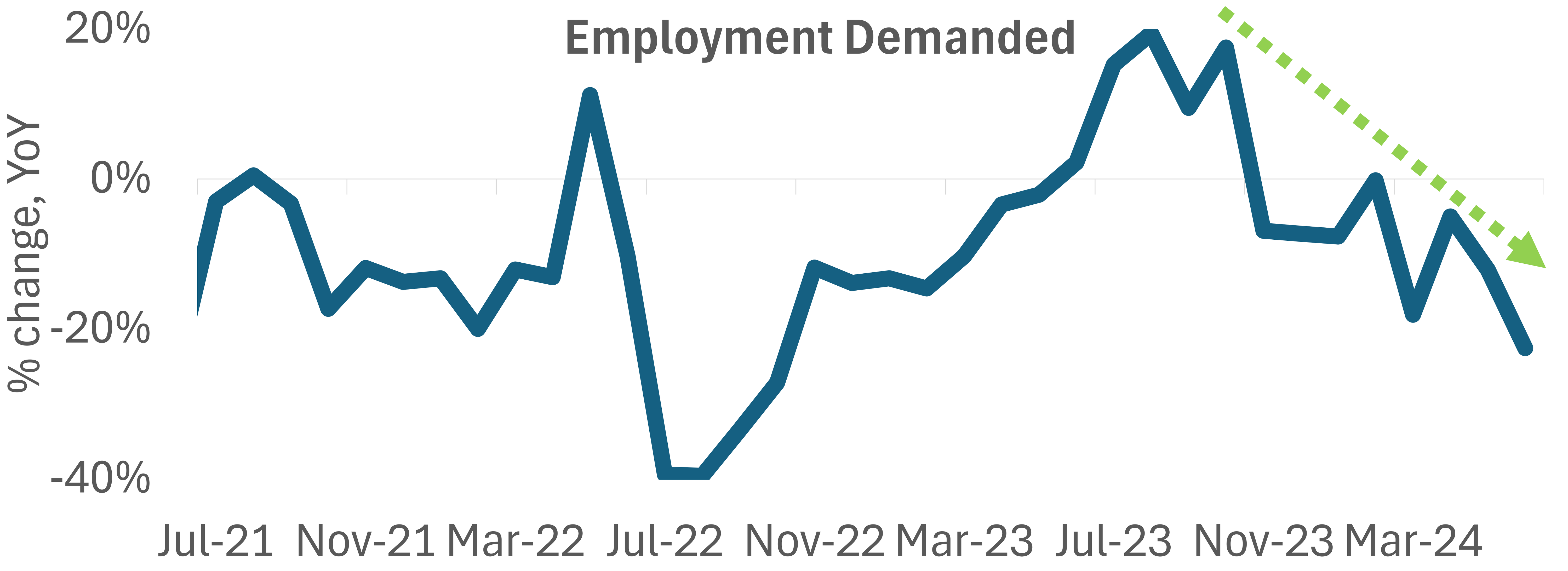
While these numbers could be reflecting the recovery of covid slump, management commentary is beginning to highlight some green shoots.



Sales in two wheelers, finally at levels seen prior to Covid



A decline in employment demanded suggests improved rural economic conditions



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Source: CMIE, Emkay, DSP; Data as of July 2024.

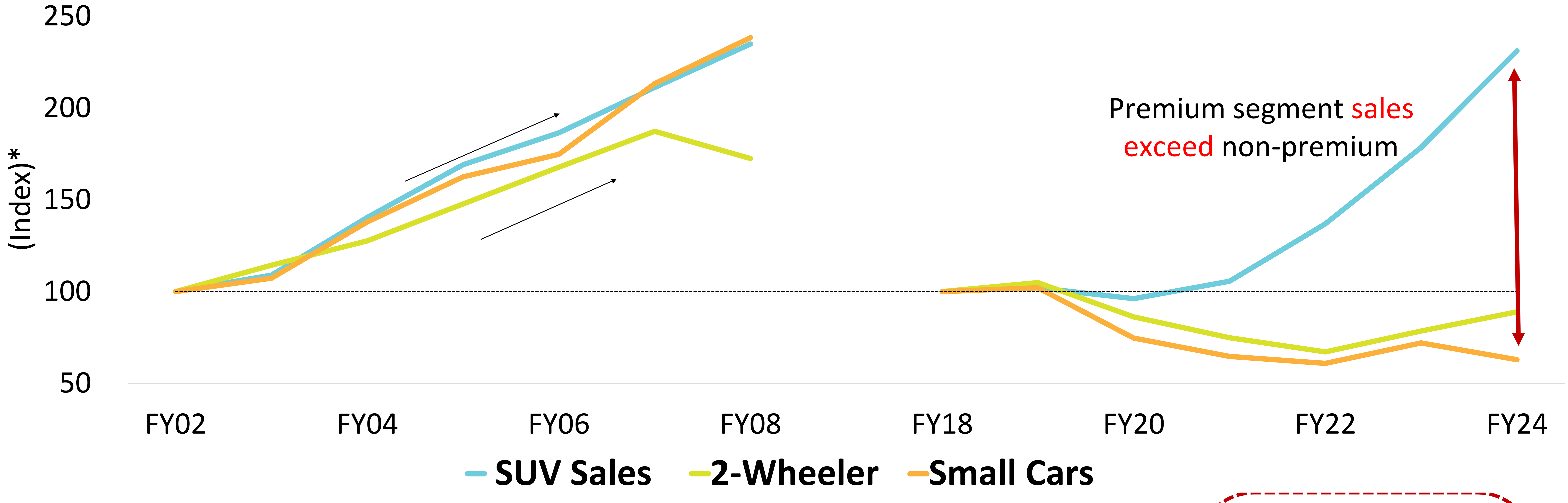
Consumption Recovery Has A Large Skew Between Premium And Mass Market

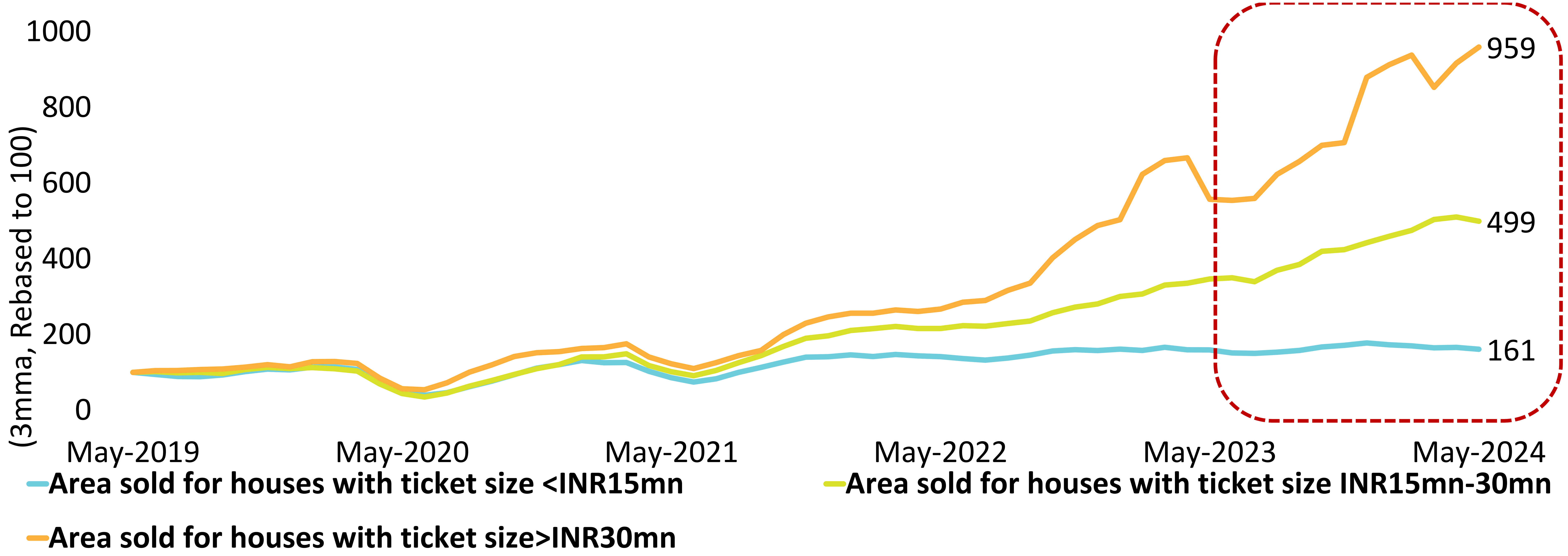
Income disparity is evident in post-Covid consumption trends. Premium consumption (luxury cars, jewelry, hotels) has been strong, while mass-market consumption (two-wheelers, FMCG) remains weak. For instance, two-wheeler sales have not reached their highs from five years ago.

In the 2000s, both segments did well, although SUVs outpaced others.

A similar trend is seen in real estate, where premium/luxury homes are performing well, but low-end housing lags. This disparity likely contributes to average growth in related industries (consumer durables) and real estate taxes (state stamp duty collections).

In the 2000s, a broad-based real estate boom generated significant growth in ancillary industries and stamp duty collections.





DSP

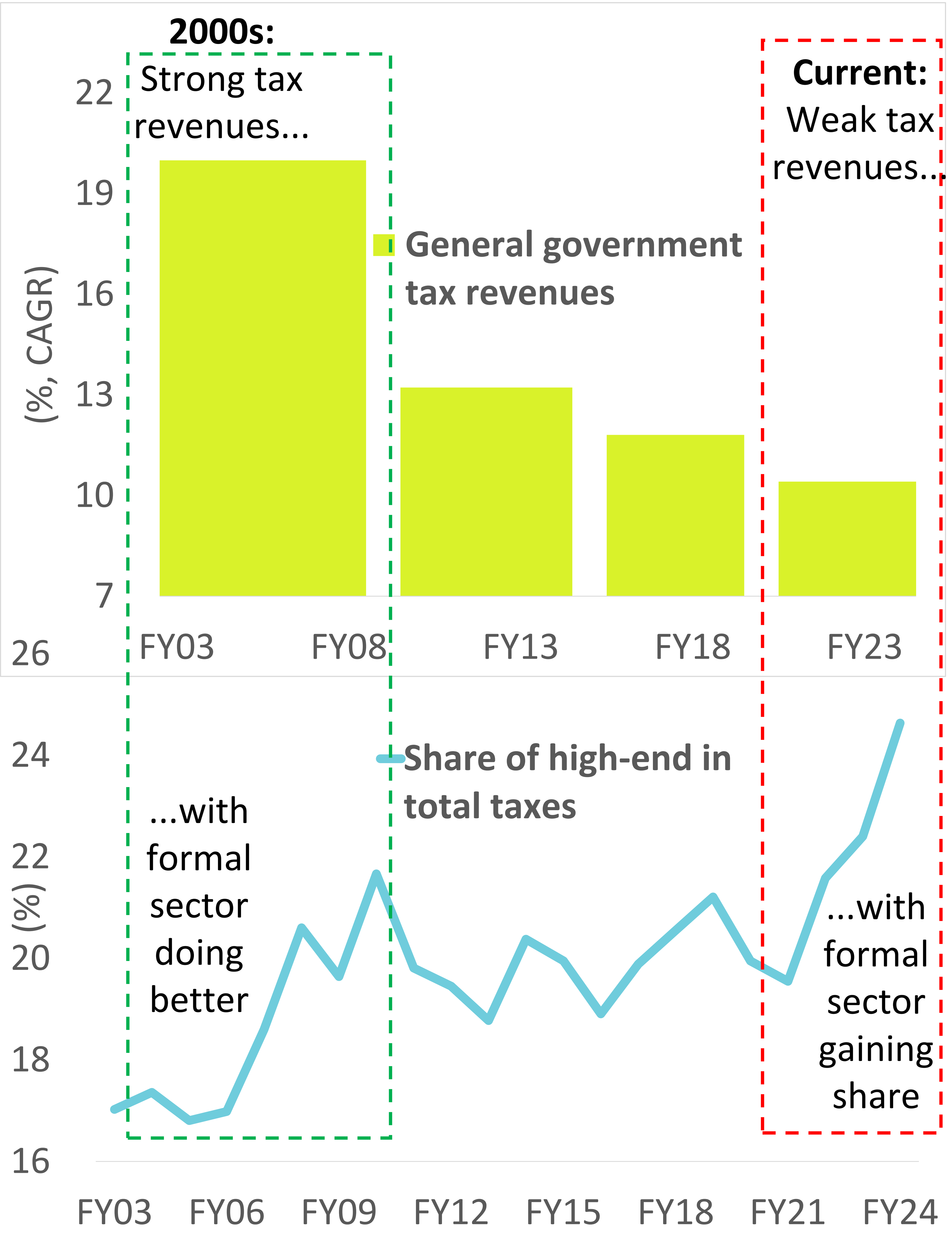
Source: Kapil Gupta, Nuvama, CMIE. Data as of July 2024. *Note: FY02=100 for analysis of 2000s phase; FY18 =100 for recent trend analysis

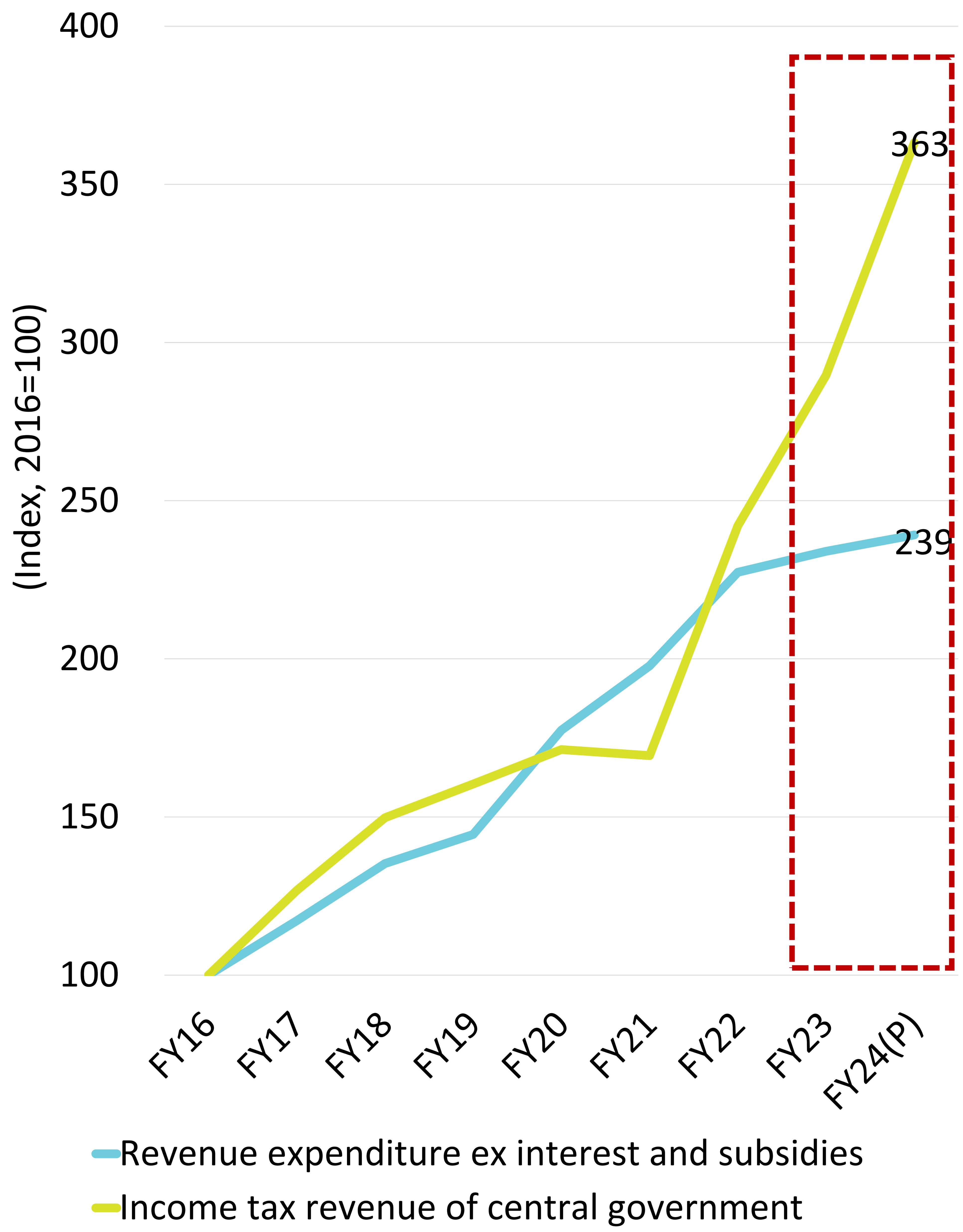
K-Shaped Recovery Is A Threat To Consumption & Needs Correction

The skewed K-shaped economy hasn't affected government tax revenues significantly, as most taxes come from the high-income segment, large corporations, and luxury consumption. Over the past two years, strong tax buoyancy has improved the fiscal position but hasn't increased transfers to the lower-income group, despite weak income dynamics at the lower end.

Overall tax collections have grown at a 10% average rate over the last five years, masking the skew. Taxes from the organized economy (income tax and BSE500 corporate tax) grew at a 14% CAGR during FY19–24, up from 13% during FY14–19, with personal income taxes leading. In contrast, taxes from the broader economy (GST, non-BSE500 corporate taxes, property taxes) grew at a 9.4% CAGR, slower than the 11.6% CAGR during FY14–19. Corporate taxes excluding BSE500 increased at just 7% CAGR during FY19–24, revealing the K-shaped economic recovery from the Covid lows.

But these increased taxes have not been used to help support a consumption recovery, especially in non-premium segment.





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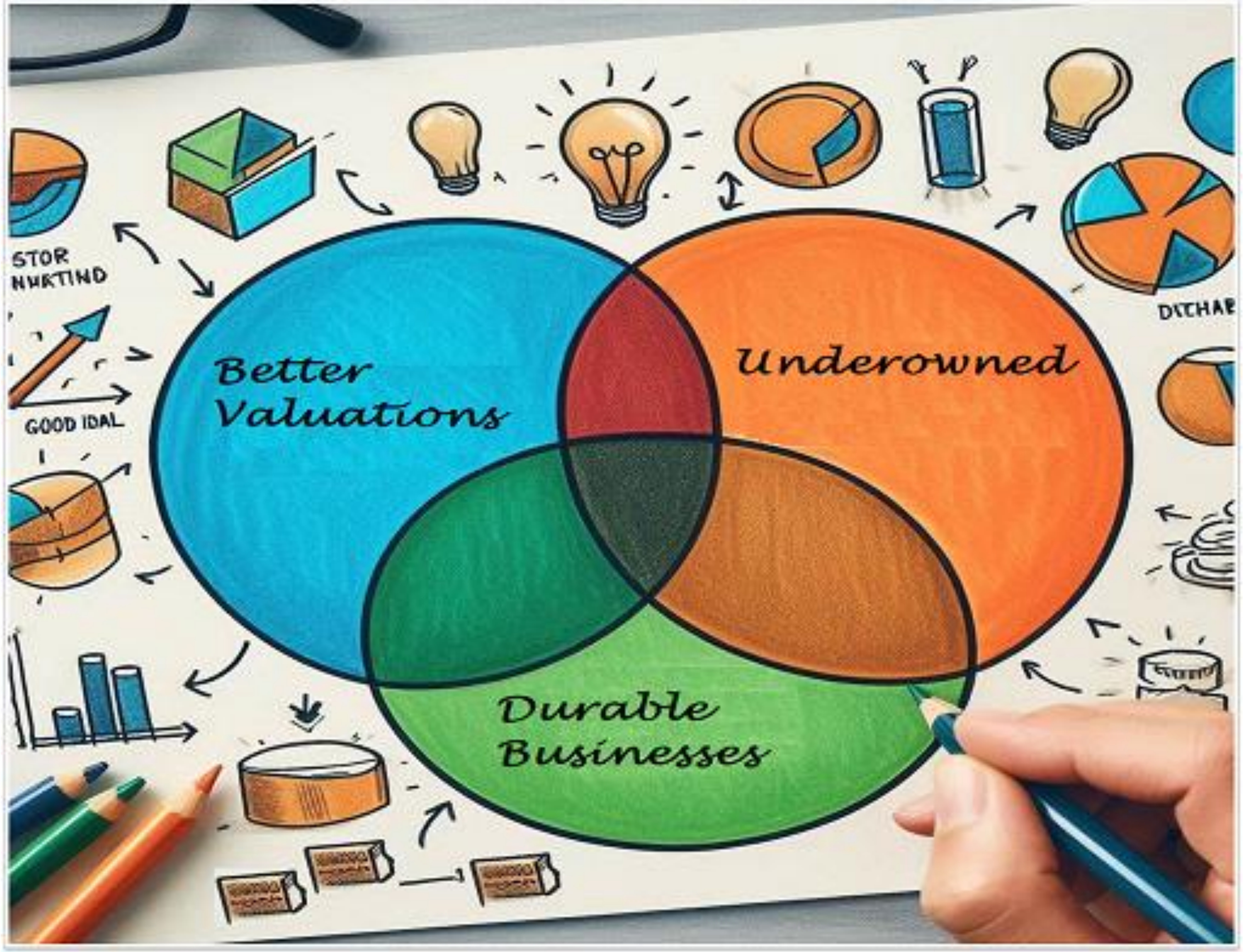
Source: Kapil Gupta, Nuvama, CMIE. Data as of July 2024

A Good Space To Invest

Better valuations:
Give you margin of safety

Durable Businesses:
Provide longevity & survival

Under ownership:
Helps avoid price froth



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