Ampersand Capital Investment Advisors LLP

High tide - July 2017 Newsletter

Historic highs earlier than anticipated

Let us start with this honest admission in our monthly review of Indian stock markets - we didn't see it hitting a historic high so early into the fiscal. However, we credit ourselves for the consistent view that, (1) positive momentum will sustain through this fiscal, and (2) it will be led by large caps. So the moot point is whether this trend will continue. In this newsletter, we therefore limit our attention mostly on the top down view rather than the sector/stock themes.

Favourable liquidity outweighs valuation concerns

Factors supporting the rally so far include favourable global environment and strong domestic inflows. Also, the Q1FY18 result season seems to have taken the temporary earnings disruption caused by GST related inventory adjustments in its stride, even as it focuses on the long-term structural gains. Meanwhile, RBI has very little option to cut rates 25-50bps in the remainder of the year given the southward trajectory in inflation. Notwithstanding these tailwinds, logic suggests that a phase of correction (or more likely consolidation), is imminent. Valuations are expensive (though not excessive) but that alone has not proved to be reason enough for the correction so far. And it may not in future too, given the sustained domestic flows and lowered risk thresholds.

Market needs a "breakwater"

It is difficult to see what can cause a correction, deep or shallow, but that also means market is pricing in absence of any risk. What we can do though is to try and identify market equivalent of "breakwater" which can protect the investors from this high tide encouraging excessive risk taking in the long run. We look at some of these factors which can soften the force of the waves of domestic savings.

1. New issuances (mostly good quality) in the pipeline for the remainder of the fiscal are estimated to raise INR 50,000-70,000 crs, approx. 30-50% of the likely domestic inflows and higher than the INR28,000 crs raised in FY17.
2. Risks lurk in global markets too specifically US where things (tax cuts, fiscal stimulus) have not gone as per plan so far.
3. Global and local geopolitical issues, of which there is enough noise going around

So what should be the course of action?

1. We still think market will deliver positive returns from here, albeit return expectations are lower given the rally so far. Hopefully, a dip should give better entry point and opportunity to buy.
2. Despite the YTD outperformance, we prefer large caps over mid caps, due to ability to manage growth and more importantly, manage risk.
3. Desist from moving down the quality chain or bet on stocks with seemingly attractive valuation, as it could be a value trap.
4. While continuously looking for new themes to invest, one should also be evaluating existing positions, more so the ones which have performed ahead of expectations.

A new initiative

Finally, we would also like to take this opportunity to inform our readers that Ampersand has received the SEBI approval for Alternate Investment Fund (AIF) which will be launched soon. We would intend to continue following the strategies and principles stated above.

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Ampersand Capital Investment Advisors LLP **LLPIN: AAF–1429**
Address: 75-A, Mittal Tower, Nariman point, Mumbai – 400 021
Tel: +91 22 4213 9500 E-mail: info@ampersand-cap.com