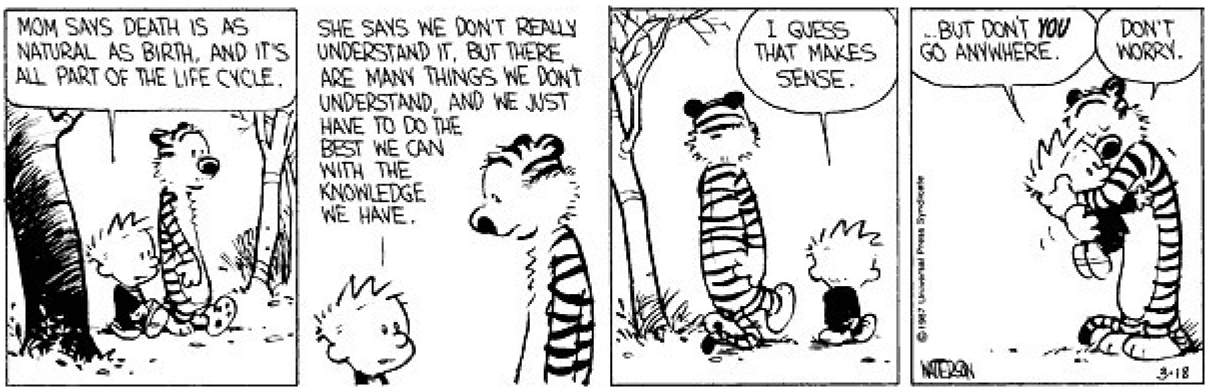
Mid Quarter Update — March 2020

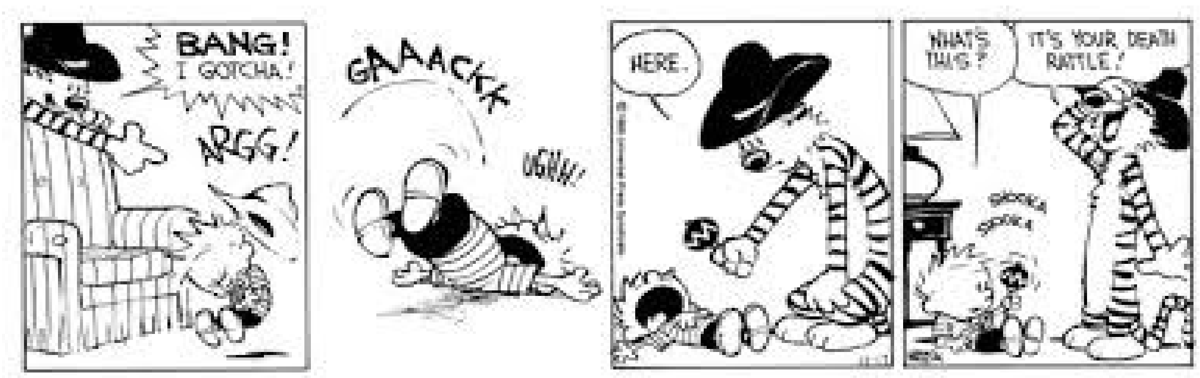
<u>A peek into the wild rides over the last few weeks:</u>



Source: Calvin and Hobbes by Bill Watterson

Well, Mom is spot on about the market! We know that the pace of fall over the last few weeks and the fear associated in the broader markets is almost palpable, unprecedented. We just don't know how long it lasts. This creates once in a decade opportunity and all the saving-up we did of conserving cash will come in handy now. It is indeed difficult to predict how things pan out or what's in store but <u>these are the times to stagger investments into the market at the right valuation and into the right businesses.</u> Some of the best investors in India such as Nalanda and renowned value investors in the US such as Baupost, Howard Marks are stepping out and buying slowly. <u>There are bound to be temporary mark-to-market losses but all for long term gains.</u>

Friday the 13th volatility:



Source: Calvin and Hobbes by Bill Watterson

As far as our plans go, at a sectoral level, banking stocks have become attractive, consumer names still have some more froth to go. We may even consider lightening up some of the richly valued consumer stocks to rotate into better valued companies. We will also be focusing on companies that could benefit from China substitution and rupee depreciation. Part of the plan also is to invest in the US tech sector, which has been badly beaten down.

Way Forward:

Lessons from China – getting back to normalcy

In India, PM has just announced 21 day lockdown to break the corona exponent. I think there's a lot to be learnt from what is happening in China now especially after one month of corona induced slowdown:

- Real estate sales have gotten back to 50%+ over where they used to be in January 2020
- Retail stores such as Nike and Adidas have improved from being 80 % down YoY in February to 40 to 50% down in March – Guidance is for 10% increase month on month over the next several months, which effectively means growth should be back on track by Dec 2020
- As most of the cities come out of lockdown traffic congestion has gone back to 60% of where it used to be before corona
- From the Voltas call mgmt. call that was held yesterday, labor utilization in its partner's factory has gone upto 80% currently and is expected to reach 100% by the end of April
- Power generation has increased 1% YoY and 11% month on month
- Importantly, supplies to Apple are improving as production is getting back to normal

This gives me confidence that other countries including India could follow a similar trajectory. With ample monetary and fiscal action, normalcy could be restored.

Market lessons from Spanish Flu of 1918:

Spanish flu was not quite the same as the current scenario as it was happening in the backdrop of World War I– so demand/supply was not hit to the degree it should have. There are many other similarities including

- incubation period of the flu
- rapid spread across several continents
- containment being the best strategy
- deaths due to second order impact and
- service sector being hit very badly.

The flu actually came in waves starting with the Spring of 1918 and then came back harder in the winter of 1918 and then again subsided after the summer of 1919 – something we need to watch for.

Corona event is likely to lead to a supply shock and end up in a recession. It should get worser before getting better both in terms of economy and the stock market. I foresee an year of consolidation from now. It is noteworthy that a recession not emanating from a financial crisis generally rebounds faster – the only silver lining perhaps in macros.

When the final wave of the flu subsided in 1919, the market began an increase of 50% which lasted until November 1919 – a sure sign that the market rebounds once the virus incidence subsides. <u>Pharma/healthcare/Staples did very well even through the last pandemic and after. These could very well be the leaders for the next bull market in India!</u>

		World War				Epidemic		
	1913	1914	1915	1916	1917	1918	1919	1920
S&P 500	8.4	7.4	9.5	9.8	6.8	7.9	8.9	6.8
Earnings	0.63	0.52	0.88	1.53	1.28	0.99	0.93	0.8
P/E	12.76	14.13	10.77	6.41	5.31	7.98	9.59	8.51

Source: RW Research

All the things we discuss during a bull market - about Indian demographics, runway for growth, growth despite Government policies, strong savings culture are still very valid reasons to be positive on India for the long run. As we have seen in previous crises such as Demonetization, GST, NBFC crisis, the best companies are likely to gain disproporationately as we move beyond the short term aberrations.

Our focus remains the same – continue to invest in Steady Eddies - leaders with strong defensive characteristics. Also one of these days, there is likely to be a day where we rotate close to nearly 30% of the capital into the market. Our best move - stay put, lie low and wait for the noise to pipe down.

In a nutshell:

- There are bargains available in the market i.e great companies at reasonable valuations
- Market bottom is very difficult to predict except for great traders like Mark Minervini
- There will be loss of output for atleast 6 months and could improve in a year – this is a far deeper shock than demonetization and hence needs Govt. package and forbearance for banks
- We have to stagger investments over the ensuing months

We will also come up with an annual performance update shortly.