QuestPMS

QuestPMS Newsletter - March 2017

Victory in Uttar Pradesh gives India chance of 7 years of stability

Election of PM Modi in May 2014 after 5 years of scam tainted UPA 2 rule brought hope of a cleaner and more transparent government. Also, given the track record of Mr. Modi in Gujarat, one expected him to put the economy back on the path of growth and development. However, given the economic legacy of UPA 2 as also the macro-economic and global challenges, even the staunchest supporters of Modi admitted that the task was not going to be easy.

Last 34 month journey has been path breaking in many respects. The structural and economic reforms India has seen in such a short period doesn't have any parallel. One would venture out to say that even the reforms of 1991 pale in comparison. There have been hurdles (unwarranted actions of fringe right wing groups, dissidence in central universities) as well as setbacks (such as Bihar and Delhi elections) on the way. However, these hurdles and setbacks have not weakened the resolve of the present government nor has it resulted in slackening of pace of bringing about much desired changes to the process of governance. More importantly, leave alone scams, there is not a single allegation of any financial or economic wrong doing against any of the union ministers.

There have been periods of good governance both at centre and state level in the past as well. For example, Mr. Vajpayee provided good governance during his 6 year tenure and so did Mr. Chandrababu Naidu in Andhra Pradesh from 1995-2004. One can argue (and rightly so) that PM Modi has taken the reforms to a completely different level and that these changes will have much deeper and far reaching implications for the long term prospects of India. But nonetheless, both Mr. Vajpayee and Mr. Naidu immensely contributed to the economy during their tenure. However, both these gentlemen lost the subsequent elections and thereby the opportunity to carry on with their good work and provide long term stability to India / Andhra Pradesh.

PM Modi is probably the first politician to have mastered the art of carrying out path breaking economic reforms and winning elections simultaneously. This has been possible as some of his key economic reforms such as financial inclusion (Jan Dhan Yojana), subsidy reforms (Direct Benefit Transfers) and crop insurance have directly touched the lives of crores of common people and have indeed benefitted them. And so have some of the social initiatives like Swachh Bharat Mission or providing LPG connections to poor people in small towns and villages. Above all, PM Modi (and Amit Shah) understands the pulse of the nation better than anybody else and are master communicators to boot! Development, social inclusion and probably 'Hindutava' have been mixed into a heady cocktail that has won the UP elections in 2017 and will in all probability win the 2019 general elections as well.

Political & macro-economic stability: Just what the doctor ordered for the markets!

There is no denying that luck too has played a part in the significant improvement that we have seen in the macro-economic variables. Decline in crude prices since 2014 has been the single biggest reason for the improvement in current account deficit and improving fiscal situation. While we are no experts, it seems this decline is more structural in nature and India will continue to benefit from the same, at least in the medium term.

Most governments struggle to keep their approval ratings up in the last 12-24 months of their term. With a resounding victory in UP, PM Modi will now feel secure in his unique governance model that provides better business environment to industries and benefits the common man directly through well planned and executed economic and social programs. He will not only pursue his well thought out policies with greater vigor but also start planning for his second term and India of 2025. Our readers will do well to remember that Gujarat witnessed the bigger benefits of Modi leadership in his second term as the chief minister and same is likely to be the case with India as well.

QuestPMS Performance

QuestPMS has been doing well since inception. The same is reflected in the numbers listed below:

(Returns above 1 year are CAGR)

	PORTFOLIO	SENSEX	NIFTY 50	BSE MID-CAP INDEX	NIFTY MIDCAP 50	BSE SMALL-CAP INDEX	NIFTY SMALL 100
3 Months	20.8	11.2	12.1	17.2	19.7	19.8	20.8
6 Months	14.3	6.3	6.5	7.1	10.7	12.9	13.8
1 Year	47.7	16.9	18.5	32.7	37.0	36.9	43.0
2 Years	26.3	2.9	3.9	15.4	14.0	15.1	11.5
3 Years	34.8	9.8	11.0	25.8	21.2	26.8	23.7
4 Years	32.2	12.0	12.7	23.1	22.7	25.6	22.2
5 Years	26.8	11.2	11.6	17.3	13.8	16.8	15.6

The Above returns are of a Model Client as on March 31, 2017. Returns shown above are post fees & expenses.
Returns of individual clients may differ depending on time of entry in the Strategy.
Past performance may or may not be sustained in future and should not be used as a basis for comparison with other investments.

We continue with our philosophy of investing in quality growth companies at an absolutely reasonable price. This philosophy requires us to identify companies which for a brief time period experience a dip in their growth phase and later move back to their normal (high) growth phase or companies that have a temporary set-back and then over a period of time show signs of getting over it. Identifying such opportunities allow us to invest at reasonable valuations providing us with both a margin of safety and possibility of superior returns. This strategy has helped us differentiate from others and has enabled us to outperform the various indices across time periods, particularly in the medium and long term.

Over the last few months, the aforesaid strategy has also resulted in us very selectively buying some large cap stocks which had corrected significantly for various reasons and were offering value, margin of safety and good growth prospects over the next 3 to 4 years. We expect these stocks to do well and give returns in line with our overall portfolio. One of the main themes where we have been an early entrant is infrastructure where we have been extremely bullish on segments like Transmission & Distribution and Railways. Some of our investments in this space are already yielding good results and we believe that performance from this sector will only improve in the coming quarters and years.

Quest PMS portfolio is expected to deliver earnings CAGR of ~30 percent over FY16-FY19. Still, it is trading at a price earnings ratio of ~17 and ~13 on FY18 and FY19 basis giving us confidence in the strength of the portfolio and its ability to outperform the market in future as well.

Emerging challenges for the markets

Global economy is in a better shape today than it was 12 months back. The US economy has recovered to a level where Federal Reserve is now confidently increasing interest rates. Europe too has shown improvement over the last 12-18 months and fears relating to China have receded. However, the pain of the last few years have resulted in the rise of the right and (in some cases) left wing nationalists across several developed nations. The risk of 'protectionism' is real and can significantly impact overall growth prospects as well as fortunes of export oriented nations / sectors.

Monsoon, or the lack of it, has always posed a challenge for the Indian economy. El-Nino seems to be raising its ugly head for the third time in the last 4 years and may impact the second half of 2017. However, it is still early days yet and we will need to wait for another few weeks before we get more accurate monsoon forecasts from the IMD. We believe that despite the rise of the 'nationalists' and possibilities of El-Nino, prospects for the Indian economy remain bright. Political and macro-economic stability and an execution focused government will enable India to move a couple of notches higher in terms of development in all aspects of the economy over the next few years. However, the biggest challenge for investors will be to cope up with the pace of innovation which is making some products/

services (and therefore industries & companies) redundant and some products / services all pervasive (mobile / internet) at an increasingly fast pace (Moore's law). Smart phones, digitization, solar industry, changes in automotive technologies, internet of things, biotechnology, artificial intelligence, etc. are already changing our lives and impact of the same will be more profound going forward. Ability to successfully navigate through these risks and indeed opportunities will be crucial in delivering superior returns in the coming years.

Final Thoughts

India is among the few bright spots in the world today. There is no question about it. Tremendous amount of hard work and perseverance on part of the government and particularly the PMO has brought India to this stage. An excerpt from a recent speech of PM Modi probably describes the changes best: "We are bringing a shift from relationship-based governance to system-based governance, from discretionary administration to policy-based administration, from random interference to technological intervention, from favoritism to level playing field, from informal economy to formal economy".

All of us are part of this change and therefore do not see the same vividly and clearly just as the parents of a growing child do not notice the increase in height of their son or daughter as they see him / her every day. Probably, in retrospect, when we look back in a few years, we will realize that the country has indeed changed and a number of these changes have been for the good. It will not be a surprise to us if history talks of a pre Modi and a post Modi era a few decades down the line!

Markets and equity valuations are in a way recognizing these developments that are slowly but surely changing the face of India. We believe earnings growth that is currently subdued is likely to show good traction going forward and will drive stock prices over the next few years. The good part is that more and more Indians are now participating in this unfolding story as there is a clear shift in savings towards financial instruments and away from physical assets. Domestic inflows are now indeed matching and overtaking the FII flows and this trend is likely to continue in future as well.

Change is always painful and it will probably not be wrong to say that that most of us in our own unique ways have experienced the pain of transition. However, if we go by the experience of Modi's tenure as a chief minister of Gujarat where the second term saw him really pushing for wide ranging economic reforms and infrastructure development, we strongly believe that the India of 2020 and beyond will be far more prosperous and happy. There will of course be ups and downs. But we can say with confidence that THE LONG BULL RUN HAS BEGUN.

Bharat Sheth

March 31, 2017