Dear Investors,

As we all go through a worldwide lockdown for the first time in our lives of this scale and duration and also in India, it is gradually dawning on all of us the severity of something that started as a 'Chinese' problem and has now become a 'Global' pandemic. We humans are facing one of the greatest crisis of our lives and none of the present generations of people alive have ever faced a crisis of this magnitude and impact so widespread. In such an environment, we all are faced with two most critical questions before us: **we need to preserve both our health as well as wealth** as both are under attack from the pandemic and follow-on economic crisis. I thought it would be a good idea to address some common questions arising in our minds during such times of turmoil and despair as we would have already read and gone through heaps of market outlook and strategy reports over the last few weeks.

> "Is this a repeat of earlier global bear markets of 2008/ 2000/ 1987 or are we heading into a depression like 1929?"

It's a normal human behaviour to extrapolate to the extreme ends during the times of fear and greed. As for the current scenario, **Yes, we have entered a bear market** seeing the sharp drawdowns and panic sell-offs and redemptions from emerging and developed markets alike and sharp corrections in all asset classes be it gold, treasuries or equities. Drawing parallels between current crisis and the past crisis of 1929, 1987, 2000 and most recent 2008 has become the favourite pass-time of many in recent times. Though one thing common to all these past crises is the damage done to world economy and wealth of people at large, but **each bear market has its own making and how a bear market ends is different each time**. What makes the current crisis unique in its own way and without any precedent is the fact that it has become an existential crisis for humans and its seeds were planted in a healthcare crisis and soon became a supply crisis, then a demand crisis and seems to be heading into a financial crisis. However, the world has come a long way now and with more financial power at the hands of central banks and governments and learnings from the past crisis, **a depression like 1929 is definitely out of question** for the world to see now.

> "So how and when will the current crisis end?

What worked in the past crisis may not work with the same potency in current crisis and needs a multi-pronged approach of governments across the globe to tackle it. Another differentiating factor of the current crisis is the ferocity of the fall within a short time span of a few weeks and that has been further accentuated by the flight of capital from emerging markets as well as all asset classes including US treasuries, which are de-facto the safest of the lot. Average age of most bear markets, barring the 1929 depression, has been 12-15 months. This time we seem to have corrected around 35-40% in a few weeks and to be honest nobody was prepared for this rude shock. So, what **we can see ahead could be a time wise correction with only small price corrections left**. The nationwide lockdowns and shutting down of economic activity globally **will push most countries into recession in 2020** and will spare few. How fast India bounces back from this misery only time will tell as we have just entered the critical stages of spread of the virus. How well we are able to contain the spread would be a critical deciding factor in resuming all economic activities full-fledged in the country.

When the world will be able to get rid of this humanitarian crisis is anyone's guess but one thing is for sure, that economic engines would start roaring sooner or later and we are not headed for doomsday. **There will be economic and social adjustments though, which will find new leaders in the process**. Disproportionate amount of disruption in demand & supply and significant dent to consumer sentiment will make economic recovery a slow process. How soon the current pandemic will come under control is difficult to predict and would depend on how well we are able to address issues of public healthcare and vaccine discovery. Social distancing and

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lockdowns are good for controlling the spread of the virus but it can be brought under complete control only when vaccine is discovered and becomes widely available.

Lock-downs cannot continue for long as the economic repercussions of the same are very high. At some point policy makers will weigh the benefits and harms of such lock-downs and it is no surprise that the damage to economy and people's livelihood will outweigh the benefits. If we are able to flatten the curve over the next 15 days, we should be able to resume our lives to some extent though with some self-imposed restrictions. We need to anyways **write off part of Q4FY20 and to a large extent Q1FY21 numbers** as companies need time to get back on their front foot with their full work force. **So far India has fared a lot better** than most developed countries in keeping under control the spread of the virus for reasons ranging from timely enactment of restrictions/lockdowns, our immunity and lesser virulent strain of the virus in India.

> "Globally we are seeing capital infusion of unprecedented levels. When will it be business as usual? Will recovery be 'V' shaped or 'U' shaped?"

One good fallout of the 2008 crisis was that all global central banks and governments now know what it takes to handle a financial crisis. 2008 global financial crisis was tackled by massive bail out of financial institutions which went bankrupt due to their over leverage in sub-prime markets. This time around, in order to prevent the humanitarian challenge developing into a major economic recession considering the complete shutdown of economic activities, **central banks around the globe have been swift in announcing bond buying and capital infusion into the system of unprecedented quantum**. However, by doing these we can only reduce the financial stress in the system but cannot avert it completely. Theoretically many countries would be entering into the recession zone by seeing the dip in their GDP numbers. Sovereign debts will rise to unprecedented levels.

Businesses in India and globally would take time to get back to their growth trajectory. Demand which drives businesses will take time to pick up to old levels. Supply constraints also would be playing equal spoil sport for some time. Consumer confidence needs time to come back as apart from the pandemic **there has been serious wealth erosion and that has a longer lasting effect on consumption than the impact of lockdown alone**. There would be some sectors which would be impacted for a very long time and won't see demand coming back anytime soon like Aviation, Travel & Tourism and Real Estate. Then there would be sectors which would see demand picking up in the medium term as people get around their lives again and the fear of losing lives gets over. These would be Automobiles, Consumer White goods, Consumer discretionary (clothing, electronics, etc). Then there are sectors which are relatively less impacted and would continue to see sustained stable trajectory in their businesses like Consumer Staples, Pharma & healthcare and select Financials.

What sets India's situation currently different from the 2008 crisis is that then we had entered 2008 on the back of a strong economic activity of 2005-2007 and hence we saw the pain mostly in the financial markets and the real economy did not see any lasting major downward impact. Hence the recovery of the markets in 2009 was equally steep. India being predominantly an inward economy with less dependence on exports and more of captive home market was relatively less immune to global slowdown then. Unlike that this time we have had economic slowdown in India across sectors both on the demand and supply side which had just gone through the twin shocks of demonetisation and GST over the last 3 years. It had yet not grappled out of these and was pushed into the Corona crisis.

What we are facing now in the form of 'Lockdown' and 'Social Distancing' is going to see far reaching impact on consumption for a few months if not quarters. Discretionary consumption and most economic activities have come to a complete halt. Only thing going of the shelves of stores are consumer staples, groceries and medicines. I feel **there would be new leaders emerging in the market when the recovery happens** and one needs to focus on earnings visibility ahead as that has become the most questionable for all companies. So **I do not see a V shaped recovery in the market and would be rather happy to see a U shaped gradual stable recovery** under the new leaders in the market.

"What should an investor be doing in such an environment"

The dangers lurking in the market can be hidden or delayed, but never eliminated. Like Vladimir Lenin says "There are decades where nothing happens; and then there are weeks where decades happen". One such period of weeks we just passed through where the dangers of the market have been unfolded. **For investors, bear markets are an opportunity for introspection and also new opportunity**. The current state of the market is a classic example of Buridan's Donkey Paradox theory! On one hand investors fear if they enter now, they would lose further and on the other hand they fear that what if markets rebound then they would miss out on the upside from these low prices. For anyone who has been there in the market for the last 2-3 decades he would know that this is not the first time we have seen sell offs of more than 20%. In-fact in the past 25 years, this would be the 6th sell-off of more than 20% from the recent peaks. However, definitely this time the intensity and the factors affecting the selloff are different as discussed above.

On a brighter side, the current sell-off has made valuations extremely attractive which we get maybe once in a decade or maybe much more rarely. **Nifty is now trading around 15x P/E on FY20 expected numbers and below 13x P/E based on FY21 numbers. On a Price/Book basis we have come below 2x P/B** on trailing basis which makes the case for getting into equities all the more compelling. Anyone sitting with some cash levels to be deployed into equity should use the current weakness to increase equity allocation into quality businesses which will emerge stronger or relatively resilient from the current turmoil.

If you ask me where do I see the market in 3 months, then the answer would be difficult. **We might see some more correction in the market in the near term** and I would not rule out the possibility that we might test new lows as we get more news flow globally of the cases surging, but the worst on price erosion seems behind us. If you ask me where do I see the markets in 6 months, then definitely the confidence increases that we would be inching back on our growth trajectory slowly. And **if you ask me in 2-3 years, then I would say, you would not get a better time to go overweight on equities** and buy excellent businesses and bet on top class managements than what you are getting now and that too at a price that would look unrealistic 3 years from now. One word of caution is that, **the market would reward bottom up stock picking** and it would not be a broad-based secular movement.

"So as a portfolio manager what has been your strategy and where do you see the opportunities ahead"

As a money manager for investors wealth, it doesn't do us any good to keep speculating for how long the stock market will continue to decline or to how low. These things are beyond anyone's guess or estimate. What really matters is whether the price at which we are getting the quality businesses is proportional to their fundamentals. **It's all about risk reward payoff and margin of safety that is there on the table**. Also, one needs to take into account the changing dynamics and find new leaders in the market as every bull run has a new leader. It is at these times that **active management of cash levels in portfolios adds alpha** in an environment where nothing has been spared and broader markets are down sharply. At Quest, we had actively raised significant cash levels in our client portfolios towards the beginning of the month and went up to almost 18-20% or more cash levels in portfolios and have been using the recent sharp dips in market to add quality businesses at attractive valuations that have high risk reward pay-offs.

New leaders will emerge and the market is giving a great opportunity to realign the portfolios at valuations that are compelling from a 3-4 years point of view. Where do we see opportunities?

- **Change in consumption and financial savings pattern** among consumers would become important growth drivers to observe
- **Managements who have credibility** and experience to steer their companies unscathed in this turmoil with **strong cash flows and margin maintenance**, will emerge as the new leaders.
- **Leverage was poison** and continues to be so all the more now and companies with high leverage would be shunned.
- **Healthcare and Pharma**, the sector loathed for last few years might emerge as the safety net
- **Financial sector** has its issues in retail NPA after some years of corporate NPA. Our sense is market has **over reacted to the retail NPA** debate and most of the quality financial companies with higher retail exposure have more than priced in any major jump in NPAs.

We would look to deploy most of the cash levels in the coming months into these quality businesses. We could see another round of sell-off as bear markets don't end so soon, but then we would be awaiting these dips with our dry gun powder of cash to deploy.

On the brighter side, I see some major positives in favour of Indian economy in the medium to long run:

- The current crisis has made the world sit back and rethink their **over dependence on China** for everything and is making India one of the most favourable alternate destination. Our impressive handling of the current Corona crisis has also raised our position in the global map as a responsible and dependable nation and could go a long way in putting India on the high stakes table globally.
- **Lower crude prices** to help in maintaining the government finances and could improve its fiscal deficit through raising excise duty on fuel
- **Falling US bond yields** coupled with **availability of excess low-cost liquidity** in the global market would lead to some major inflows into emerging markets including India.
- **Favourable tax environment** for existing corporates in India
- One of the lowest tax rates for new manufacturing units set up in India. This coupled with a big theme of "**Diversifying away from China**" would be one of the biggest themes to play out in India over the next few years.

As for our portfolio changes and positioning, we have been aligning our portfolio over the last few months to weather the current storm better and also focus on sectors and companies were earnings are resilient. Currently the portfolio has around 62% large-cap allocation and around 13% cash levels currently. Financials, Healthcare and Consumption remains the top sectoral allocations currently making up nearly 60% of the portfolio. I do not see this allocation changing materially in coming months. Below is the performance summary of Quest PMS across time periods in comparison to various indices:

(Returns over 1 year are CAGR)

	QUEST PMS PORTFOLIO	NIFTY 500	NIFTY 50	NIFTY MIDCAP 50	NIFTY SMALLCAP 100
1 Month	***-20.4***	*-24.2*	*-23.2*	*-29.6*	*-36.7*
3 Months	***-22.6***	*-29.1*	*-29.3*	*-32.3*	*-38.4*
6 Months	***-20.3***	*-25.1*	*-25.1*	*-27.6*	*-35.7*
1 Year	***-27.0***	*27.6*	*-26.0*	*-37.4*	*-46.1*
2 Years	***-17.0***	*-11.4*	*-7.8*	*-20.0*	*-32.1*
3 Years	***-5.9***	*-4.3*	*-2.1*	*-10.1*	*-19.9*
5 Years	***4.6***	*0.1*	*0.3*	*-1.2*	*-8.6*
Since Inception-Oct 2011	**12.7**	6.2	5.8	4.7	0.4

The above returns are of a Model Client of Quest Flagship PMS strategy as on March 31, 2020.
Returns shown above are post billed fees & expenses. Returns of individual clients may differ depending on time of entry in the Strategy.

Just for a matter of record, Nifty 50 fell by 23% in March 2020 and in the last 20 years, **this was the second worst single month fall after Oct 2008** when it had fallen by 27% in a single month. This shows the severity of the current wealth erosion in India. How well the markets performed 1 year from Oct 2008, is known to all so would not want to pre-empt anyone.

I would want to take your leave for now with some thoughts to ponder upon in this lockdown and self-isolation:

- ✓ The seeds of the next Bull run are always planted in a bear market, and we are in a bear market now!
- ✓ When was the last time you got to buy Nifty at 15x P/E and less than 2x P/B multiple?
- ✓ Do you think India will shut down for next 6 months or more? Are you investing only for a 6 month horizon or a longer time frame? Will India be back on growth path in 1 year?
- ✓ Humans by nature always fights back hurdles and challenges and emerge stronger. Will corona kill this spirit of humans?
- ✓ Economies over time only grow bigger in size and not smaller. There could be short term recessions but in the longer-term world has seen increased prosperity.
- ✓ Historically, after every 30% or more fall in Indian markets, the subsequent years have given superlative returns. We have already fallen more than 35%!
- ✓ India is one of the youngest economies and is bound to grow inspite of all hurdles in the long run
- ✓ Do you think Global MNCs and policy makers will see China in the same way as they saw pre-Corona? Will dependence on China decrease?
- ✓ Which other asset class has the potential to outperform equities in the long run of 5-10 years?

These are all questions and thoughts, answer to which will help you frame your own thoughts about whether one should be overweight on Indian equities or not at this point of time. Some of these might look a bit clouded currently considering the pandemic environment around but would get clearer once the cloud clears. If we as a nation are able to contain and have least casualties from the viral pandemic, India would surely emerge as a stronger more dominant nation in the future.

Stay healthy with your family and Stay safe and let us all come out victorious from this crisis!

Aniruddha Sarkar

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Quest Investment Advisors

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- Our past performance does not indicate the future performance of the portfolio manager and/or the portfolio management scheme.
- Investors are urged to apply appropriate caution while making investment in the Quest PMS.
- There is no capital guarantee in the Quest PMS product.

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