QUEST INVESTMENT ADVISORS
SEBI Registered PMS & AIF managers

Who said budget is just a statement of accounts of the govt? Budget 2021 has awakened the 'Animal spirit'

Dear Investor,

With the markets making new life highs everyday, we hope that the spirits are high among all of us. We have all gone through a lot of uncertainties in the last few years in India as economy tried to find its footing amidst all the policy changes and announcements and economic roller coaster ride. The optimist amongst us looked forward for light at the end of the tunnel while the pessimists among us believed that this tunnel has a dead end.

"We cannot solve problems with the same thinking we used to create them"- Albert Einstein

Heading into Budget 2021, most believed that '**History would be repeated**' and a socialistic budget would be announced and taxes would be raised and it would dampen the spirits like before. Instead what Mrs Nirmala Sitharaman presented on 1st Feb 2021 in the parliament '**Created history**' as the budget moved away from socialism and spoke of growth and tried to give enough indications of the intentions of the government to **revive the 'Animal spirit**' of the Indian economy and set the stage for heading **towards a $ 5 trillion economy by 2025.** Whether we actually make it there in time or not only time would tell, but **the journey has surely begun**! We as investors need to ask ourselves now: Are we willing to ride along this journey or stay put where we are and watch from the side-lines?

Before we get into discussing what the Budget 2021 has laid roadmap for, it would be a good idea to take a few minutes and go through our Dec 2020 newsletter which we sent last month in which we spoke a lot about this new growth phase of Indian economy and our reasons for being bullish on India and Indian equities. Hearing the budget presentation couldn't have made us happier. Infact post the budget many investors asked us whether we would be making any major changes in our portfolios to align with the new growth orientation of the government? Our answer was, **Quest PMS portfolios are completely aligned to ride this new earnings super-cycle which India is going to witness over the next 5 year**.

So what's so special about Budget 2021

In a bold move our Finance Minister delivered a growth oriented budget. For me **this is a budget which will be one of the transformative budgets for Indian economy.** Though there is no major bold step as such like the 1991 budget but then in the current environment, this is a budget which **infuses the much-needed confidence** in corporate India about the intention of the govt to go after growth. Also, one important thing **is govt has shown its aggressive stance** and confidence by **not bothering about the fiscal deficit** and what the ratings agencies will think and has shown that they need to loosen the purse when the economy demands and would gradually go back to fiscal prudence when things improve.

Capex would be the key driver for economic growth: What we liked in the budget was that it refrained from supporting the economic recovery by pushing consumption. **It instead went in for investment spend** which will have far reaching mid and long term benefits. This is also stark difference from what most developed nations have chosen in the last one year of handing out cheques to its citizens and have indeed ballooned their balance sheets without adding any meaningful assets. Focussing on PLI schemes in 13 sectors to drive the Atma Nirbhar Bharat plan has got more power as **Govt has committed Rs 1.97 lakh crore over 5 years** to nurture global scale manufacturing. This will definitely go a long way in making India a formidable manufacturing hub.

Investment in infrastructure building, healthcare, roads, airports, railways and housing would be the drivers of India's nation building in coming 5 years

Over last few days I have been hearing some debates about whether its better to push consumption or investment. In this context would like to share that government spending multipliers are typically much larger than tax multipliers. A recent study by IMF shows that **increasing public investments by 1% of GDP can boost GDP by 2.7%,** private investment by 10.1% and employment by 1.2% if investments are of high quality and if existing public and private debt do not weaken the response of private investment.

Divestment makes way for Privatization: Divestment goals of the govt had become standard practice in the past several budgets though it missed the targets almost in every year. This time hearing **'Privatization' was a pleasant surprise** and talks of 'Monetisation' of assets was a more welcome stance. Govt along with Niti Aayog is surely working on the right track to increase the valuation of PSU units across board and not just look at selling them off at dirt cheap valuations to meet disinvestment targets. Government made its intentions clear that they would be privatising two PSU banks and a general insurance company in this fiscal.

Rural spends taking a breather: Over the last two budgets rural India had its lion share. Rural spending is expected to be lower by 5% in FY22 after clocking 40% CAGR in last 2yrs. We believe **some moderation is warranted** given the very large income transfers during the pandemic. Also it is important to note that the government has been working towards increasing the farm income over the last several years through multiple policy announcements and we need to see if there needs any significantly higher support required there in next budget. Direct transfer of fertilizer subsidy would also be a step in the same direction.

Taking the stress off the banking system through the creation of a Bad Bank is the need of the hour to free up capital from the PSU banks in order to enable them lend to grow

Tax men wont come to hound you: By keeping all direct taxes unchanged the government has achieved two objectives. First, it has **removed the fear of a covid-cess** and provided a big relief to the tax payers as their tax outgo does not increase. Second, it sends a strong message to the investors globally that the **government is committed to a long term low tax rate regime** and provides certainty on the broad tax policy framework. Administrative reforms such as faceless assessment at Tax Tribunal Level, reduction in the time period for the re-opening of the tax assessments and further impetus to the digital transactions, are all moves in the right direction to help India gain further on ease of doing business.

Financial sector could see a big upside surprise if the cards are played well: Creating a Bad Bank and a ARC/AIF to absorb the stressed assets of the banking system would be a major relief for the sector. Given the provisioning coverage carried by most banks, selling legacy NPAs to such an ARC/AMC should augur well for the sector. Such an ARC/AIF would also **help release significant bandwidth** on part of the banks' managements, enabling them to better focus on growth opportunities.

All in all without stretching it any longer and getting into more details of the budget announcement, I feel there wasn't anything to complain or write negative about in the budget. Naysayers would surely find something but then I wouldn't want to take that part of their job for now and leave it to them to decipher from the budget.

Budget is over… so what next? Fundamentals of companies and Earnings trajectory would come back as the focus area for investors

We have been highlighting in all our investor communications over the last several months that **money will follow where earnings would be surprising on the upside**. Our job would be to seek the earnings trajectory and follow there. If we look at the earnings of the 28 Nifty-50 companies which have reported their earnings so far, the aggregate earnings growth of these companies have been a stellar 30% growth YoY. Moving to the BSE-500, if we look at the 220 companies who have reported their earnings so far, their aggregate YoY earnings growth is 68%! Obviously the base effect is to be somewhat credited for these stellar numbers but then adjusting for that too the **numbers are indeed much ahead of most estimates**. As per consensus estimates on street, FY22 numbers of Nifty-50 are expected to grow by 25-28% while FY23 are expected to grow by 18-20%. These are by all means stellar numbers if we have to see how weak the past 3 years earnings trajectory has been for the companies. And now as investors our job is to look for the outperformers within this strong growth pack.

Corporates have strengthened their balance sheets, improved margins, reduced leverage, improved cash flows; stage set for quality growth in next cycle. We would be chasing earnings cycle

In the same breadth we keep hearing that market valuations look over-heated and are at historical highs. What we miss out is that we are not buying Index and secondly we need to see the valuations seeing FY23 earnings and not a dismal Trailing 12 months of which 6 months had no earnings practically. There are enough companies out there infact many which we have also been buying off late which are still like One Standard deviation below their historical average on valuations if we adjust for their growth potential over the next 2 years. We see opportunities among chemicals, autos and auto ancillaries, home improvement companies, select pharma companies and even the old economy industrial companies.

Portfolio performance and positioning

As we have mentioned above, the portfolios at Quest are positioned to ride the next growth phase of Indian economy and within that we have **made higher allocations to sectors where we see the most steady and strongest earnings revival like Cyclical financials, Autos, Auto ancillaries, Chemicals, Pharma and healthcare, Home improvement and IT & IT Services**. We remain underweight on Consumer staples and consumer discretionary products owing to their elevated valuations which does not give us the comfort to own considering their sub par earnings growth. We also currently don't have much exposure into pure play infra companies but would want to wait for some signs of revival and actual implementation on the ground before we turn bullish there. Meanwhile we would continue to play the space through cement and cyclical banks.

QUEST PMS INVESTOR LETTER – JAN 2021

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All our strategies have begun the year on a strong footing and have outperformed the benchmarks

We have begun 2021 on a strong footing and all our strategies have outperformed the benchmark returns by a decent margin. We continue to work on finding the outliers in various sectors and believe there is no reason why we should not be able to deliver on our stated goals of outperformance over benchmark in 2021 too like we did last year in 2020.

As on 31st Jan 2021	1 month	3 months	6 months	1 year	2 years	5 years	Since Inception
Quest Flagship PMS	1.12%	19.40%	27.46%	20.85%	14.98%	13.41%	16.36%
NIFTY-50	-2.48%	17.11%	23.13%	13.94%	12.18%	12.49%	7.16%
NIFTY – 500	-1.87%	17.96%	25.09%	14.57%	12.02%	12.25%	7.25%
Quest Multi PMS	-0.51%	17.13%	29.48%	24.52%	16.21%	14.11%	13.54%
NIFTY-50	-2.48%	17.11%	23.13%	13.94%	12.18%	12.49%	9.23%
NIFTY – 500	-1.87%	17.96%	25.09%	14.57%	12.02%	12.25%	9.75%
Quest Focus PMS	2.11%	20.29%	26.64%	11.44%	9.16%	-	11.67%
NIFTY-50	-2.48%	17.11%	23.13%	13.94%	12.18%	-	12.80%
NIFTY – 500	-1.87%	17.96%	25.09%	14.57%	12.02%	-	12.52%

Note: These are TWRR returns as on 31st Jan'21 of all clients taken together of the individual schemes and individual client performance can be higher or lower than this depending on their joining dates and corpus in dates.

Preparing for the next big fall in the market is a futile exercise and detrimental to long term wealth creation

Investors keep asking us if its a time to take some profits off from their investments and wait for lower levels to re-enter. We understand there is **bound to be fear in minds** when we keep reading so many dooms day reports and articles talking of the next financial crisis hitting the world. However we believe the crisis as and when hits will be a black swan and **early preparation of the same would do more harm than benefit**. Domestically India and Indian companies seems to be catching up on the steam and **getting off this train at this time would be injurious to your long term wealth creation plans**. There would be stops and halts in this journey for sure but we have to be mentally prepared for it. Last time we had said in Dec end newsletter that when markets move up in a vertical path, **some corrections are bound to happen**, which we saw in January. But then again we wrote that the **bounce backs would be equally sharp** and would not give investors time and opportunity to enter back at a level of your choice which we saw in the 1st week of February. Unless we are into a trading mindset, these efforts of timing the entry and exit from the market is a futile exercise. As long as we know the companies we are buying into and their earnings cycles, there is no reason to get extra cautious.

We continue to look for new wealth creation ideas and would want to wish our invstors happy investing. Have a pleasant and memorable 2021 and may we all enjoy this journey more fruitfully and with memorable experiences.

Yours Sincerely

Aniruddha Sarkar

Chief Investment Officer & Portfolio Manager