QUEST INVESTMENT ADVISORS
SEBI Registered PMS & AIF managers

Why are Indian markets not cracking like last year when 2nd wave is more devastating – trillion $ question

Dear Investor,

With the second wave having touched most of us or our near ones this time, hope this letter finds you and your family safe and sound and in good health. With cases nearing peak, we hope to see the 2nd wave subsiding soon and our lives getting back to a bit more normal than a semi-locked down state.

Market don't react in the same manner every time when exposed to the same conditions because its driven by human emotions and that is the most unpredictable factor

In midst of all the surging cases, numerous lockdowns across various states, vaccine shortage and non availability of drugs, a common question almost everyone has been asking and have it on their mind is – Why are Indian equity markets not falling when things are worse on pandemic front compared to last year? Is there some disconnect between stock markets and reality and is it liquidity driving the markets? Before answering these questions would like to first draw attention to the basic tenet of what drives a stock market up and down and if only market directions were so easy to predict extrapolating on an Excel spreadsheet. **Markets are barometer of investor sentiments and their expectations of earnings from companies in the future**. **Markets fall sharply when there is fear of the unknown or future looks uncertain. Markets trade sideways or are indifferent when the fear is known or when there is enough visibility on earnings trajectory.**

Factors holding up the buoyancy in the markets

- **We are better prepared this time and this time its indeed different** – Last year's national and international lockdowns was something none of the living people had seen or experienced in their lifetime. Also the lockdowns were more stringent and manufacturing and supply chains were shut for months at end not just in India but across geographies. It took months for things to open and start production at even 50% capacity. Also there was a lot of confusion globally on the treatment for Covid and how to handle it. Vaccines were also no where on the horizon. Compared to these, currently things are a lot better on all these fronts. We have a set protocol for handling covid patients and its treatment is well known now. Vaccination is underway globally and even in India it has been happening though at not the desired pace. We should see a sizeable part of population vaccinated in next 6 months. Lockdowns are more relaxed and manufacturing and industries have remained open though operating at lower capacities as demand has taken a short term hit. Hence **getting back to full production would not take time**. **With pent up demand likely to accumulate, most will then look at the higher than normal production post the 2nd wave**. More importantly investors have learnt from the last years sell off, that **selling equities may not be the ideal thing in a lockdown as things rebound fast once things open up. They do not want to be caught in the web of FOMO feeling this time around**.

Earnings recovery continues and with a pause in Q1FY22 should rebound again. Selling off here would be a hara-kiri for any long term investor

- **Earnings is what drives market and that continues to remain robust** – Inspite of FY21 being seen as a washout year because of H1FY21 being almost negligible on earnings, it has surprised almost everyone that most companies have closed FY21 with 15 - 18% growth on topline and bottom line as compared to FY20 base. In fact **the momentum of Q3Y21 earnings seems to have continued in Q4FY21** and out of the nearly 27 companies of the Nifty-50 which have reported their numbers so far, there has been a nearly 58% YoY growth in their profitability on the deflated base of Q4FY20. Even on a QoQ basis these have reported steady improvement. Growth is seen more broad based across cyclical sectors (metals and materials), Private Banks and NBFCs, Technology sector and Pharma & chemicals. **Two factors driving this earnings growth in the listed companies across market capitalizations are – pent up demand in the initial days and shift of business from unorganized to organized players**. During the last year's pandemic many unorganized players across sector have been forced to shut shop and this has made the position of the organized larger players more strong when the economy opened up and demand returned. This is a trend which continues to build quarter on quarter even now. **A strong monsoon this year too should bode well for demand from rural India also.**

- **Lack of an alternative asset class and liquidity remaining high** – Markets for last 1 year have faced two opposite factors which has largely driven equity markets higher not just in India but globally. One is **historic liquidity pumping by central banks in US and Europe and second is lack of a better asset class to park this money**. This trend continues even now and infact in India we have a lot of local money waiting on the side-lines to enter equity markets on some correction (if and when it comes). The lack of a meaningful sharp correction in the market is driving this money waiting to enter to find its way slowly and steadily.

- **Increased realization of a structural and cyclical up-move in India led by Capex recovery** – We have explained in details this particular aspect of the next super earnings growth cycle for India in our earlier investor letters. Now with more and more companies putting up capex across sectors and order books getting stronger, the realization has hit even the skeptics that **we are poised to grow strongly albeit after a brief pause due to the 2nd wave**. Adding to the domestic capex cycle recovery we have the US economy which has embarked on a massive US$ 2 trillion infrastructure spending plan which would lead the global economy on a cyclical recovery in coming years and its ripple effect would be seen not just in US but rest of the world as demand for metals and building materials and other products goes up, incomes go up and leading to rising consumption spending - **a virtuous cycle in the making**.

Slower demand recovery, Inflationary pressures, geopolitical issues in middle east and rising commodity prices are some of the things that would continue to drive volatility

Having highlighted the brighter side of the current environment we would not throw caution to the wind and rather keep our eyes and ears alert for signs of any prolonged distress in the economy. Areas which could prolong the recovery trade in the market would be a sustained delay in economy opening up which could hurt the pent up demand from Urban and Semi-urban consumers. **Also this time around unlike last time, the people have been affected in Urban areas and consumers might not be willing to spend though they might have the ability to spend when things open up**. Rural economy slowdown and a rising inflationary pressure could derail the expected growth in earnings. **Increased input costs in all sectors could also hurt margins which had been one of the silver linings of last years recovery in bottom line**.

Portfolio performance and positioning

We continue to build our portfolio by balancing all the positive expectations and the fears and concerns as mentioned above and follow our core strategy of sector rotation and bottom up ideation looking for pockets of earnings growth at reasonable price. We **have increased exposure to deep value metal companies** where we see significant margin of safety and strong balance sheets. In our view the commodity cycle is a multi year cycle and has just started. We **maintain our underweight stance on the financial sector** and would still play it with differentiated ideas like State Bank of India and IDFC Ltd. Within banks we see the current wave of covid pushing back the normalcy for the sector by a few more months or quarters. We maintain our **overweight stance in IT & IT Services** which we see as being in a major earnings up-move for the next several quarters. Currently we have around 6-7% cash levels in the portfolios and would continue to look for alpha creation ideas in various sectors.

We have started FY2022 on a strong footing by building significant alpha inspite of all concerns around 2nd wave of pandemic

As on 30th April 2021	1 month	3 months	6 months	1 year	2 years	5 years	Since Inception
Quest Flagship PMS	3.1%	10.1%	31.5%	61.0%	15.3%	13.9%	16.9%
NIFTY-50	-0.4%	7.3%	25.7%	48.4%	11.6%	13.3%	7.6%
NIFTY – 500	0.4%	9.4%	29.0%	54.3%	13.1%	13.4%	7.8%
Quest Multi PMS	3.6%	12.5%	31.7%	72.4%	17.7%	14.6%	15.0%
NIFTY-50	-0.4%	7.3%	25.7%	48.4%	11.6%	13.3%	10.2%
NIFTY – 500	0.4%	9.4%	29.0%	54.3%	13.1%	13.4%	11.0%
Quest Focus PMS	3.0%	11.5%	33.9%	57.4%	9.8%	-0.21%	13.5%
NIFTY-50	-0.4%	7.3%	25.7%	48.4%	11.6%	13.3%	13.7%
NIFTY – 500	0.4%	9.4%	29.0%	54.3%	13.1%	9.19%	13.9%

Note: These are TWRR returns as on 30th April'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. Returns over 1 year are annualized. Inception dates for different schemes are as follows: Quest Flagship – 12th Oct 2007; Quest Multi – 4th Aug 2014; Quest Focus – 24th May 2016

In conclusion would answer one critical question which is on every investor's mind. **Is it a good time to add to equity exposure or to reduce it? We would say, there is no good time or bad time to enter the market if your investment horizon is 3-4 years**. Even at current levels of the market we are investing into companies quoting at single digit or low teens P/E multiples whereas their earnings are growing at 15-20% thus giving us the margin of safety. Thus **there are enough deep value opportunities available and our job is to ensure these ideas find its way into your portfolios for alpha creation**.

Happy investing and wishing good health from all of us at Quest.

Yours Sincerely
Aniruddha Sarkar
Chief Investment Officer & Portfolio Manager

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