QUEST INVESTMENT ADVISORS
SEBI Registered PMS & AIF managers

There is neither any perfect level to enter markets nor to exit; keep eyes on earnings and ears on the ground

Look at a chart of the S&P 500 over 40 years and you see an endless series of jagged peaks and valleys. Each one of those downs and ups was a moment of panic or elation. But step back for a wider view and you see the inevitable direction is up. Stick with it and ride the emotions and you are an investor – Charles Schwab

Dear Investor,

Hope my letter finds you and your loved ones in the safest of environment and best of health. Between my last letter and this, we have seen India go through the peak of the 2nd wave of pandemic and mostly it seems we have come out of the storm and ready to restart the economic engines. These last 15-16 months reminds me time and again of one old saying – "**anything that doesn't destroy you, makes you stronger**". Same can be said for most of us and for Corporate India. With most companies having announced the full year results for FY21 now, one thing has emerged clear – the difficult pandemic year of FY21 has gone down in history as one of the best years in recent time for most corporates when it comes to earnings growth, margin improvement, operational efficiency improvement and deleveraging of balance sheets. Little does any corporate finance or economics book teach us that your best would be seen in the worst years!

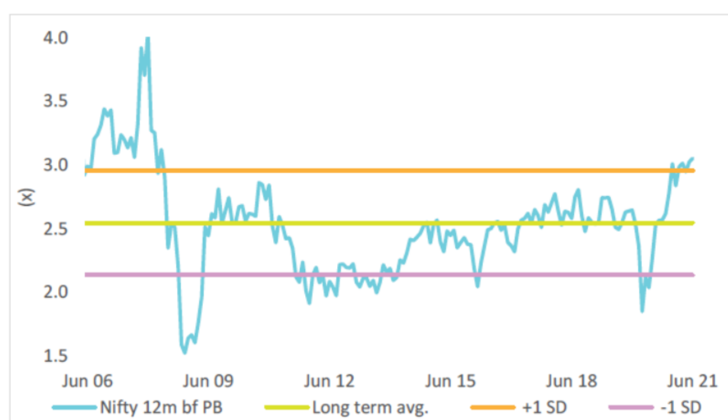
I have touched upon the reasons for this remarkable year in last couple of my newsletters. I have also highlighted on my reasons to believe why India Inc. would surprise nay-sayers by beating estimates over the next few years. However in my this letter, wanted to touch upon some of the common fears I get to hear from investors on the street and reasons that make them hesitate to allocate money towards equities.

Market valuations look stretched and shouldn't it see some correction?

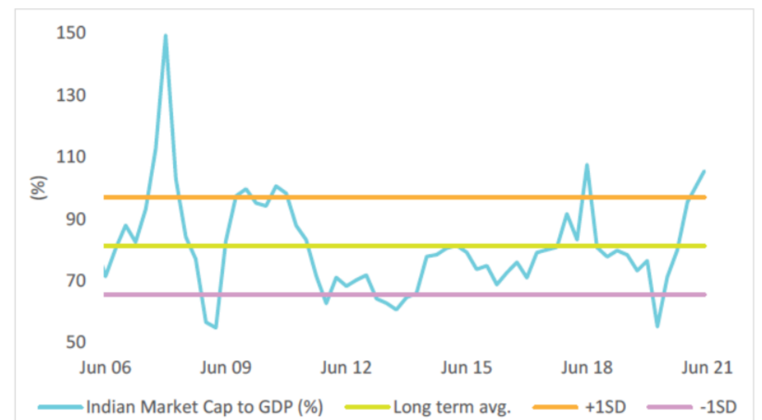
Though a few months back I could argue that the valuations look cheap across largecap, smallcap and midcap, but the same cannot be said now. **Valuations have definitely caught up but still I believe the valuations have a decent headroom for growth** if we have to look at the 2 year forward valuations considering FY23 would hopefully be a normal year without any disruptions from pandemic. FY22 has seen some downgrades in recent months owing to the second wave of the pandemic and hence the valuations look a bit stretched when seen from P/E (Price/Earnings) perspective but less stretched when seen from P/B (Price/Book) perspective which is a more stable and better measure to see market valuations**. The relative valuation of Indian markets compared to US markets and even other emerging markets look relatively attractive** which gives comfort that things are not stretched yet.

Relative valuation of India makes Indian equities an attractive bet even for foreign investors

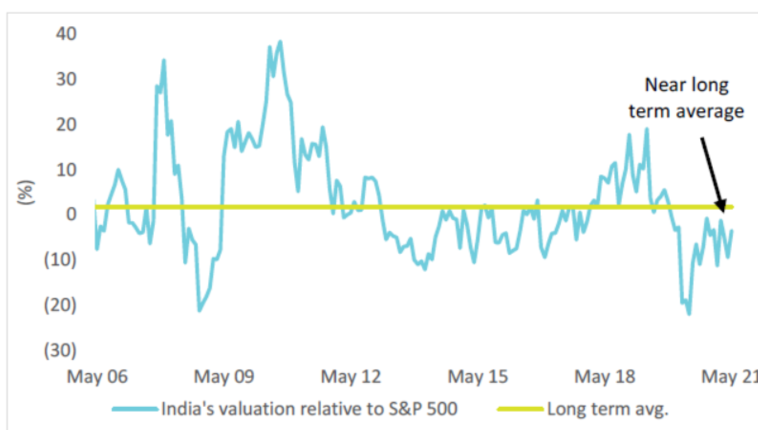
Nifty 1 yr fwd P/B above historical average….



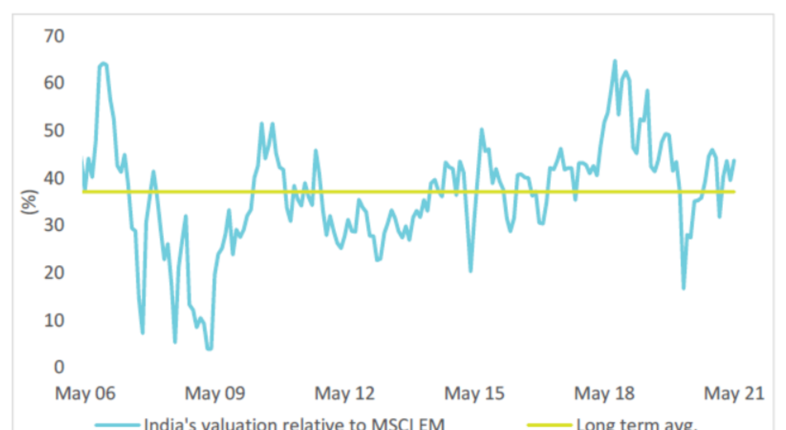
….Market Cap to GDP is also above +1 SD



But relative valuation of Indian equities to US looks attractive



Valuation attractive even compared to other EM



As can be seen from the above graphs, markets do not look stretched on valuations and more importantly something that I have always highlighted is **there is a large part of the market where valuations are way below even 1x PEG ratio** (Price to Earnings Growth ratio) which gives us comfort that we are not overpaying for those businesses and there are enough margins of safety. Having said that and considering that the markets have moved up considerably in recent months inspite of the 2nd wave hitting business earnings, **we believe it would be healthy for the market to take a pause and consolidate at current levels**. This could lead to some time correction if not price correction and we believe it is much needed.

Impact on economy from 2nd wave is expected to be quite low; companies, individuals and government is better prepared for facing a 3rd wave

3rd wave of Pandemic could hit us anytime soon and create more havoc?

As per Dr. Subramanian Swaminathan, Director – Infectious Diseases and Infection Control and Chair, the 2nd wave in India saw two variants of the virus namely Alpha and Delta with the later one being more virulent and major cause for hospitalizations and casualties. New covid cases are on sharp decline and we should be back to the Jan 2021 levels soon. Also considering there is no new variant of the virus detected yet, there seems a likely possibility that we should not see the 3rd wave anytime soon in the next 4-6 months. **The chances of the 2nd wave strain spreading in developed markets remains high** and could be a cause of concern for the world at large. Now with better equipped healthcare infrastructure post the 2nd wave, the governments are better prepared in India to tackle a third wave if and when it comes. Also **with increased vaccination over the next 3-4 months, we should see a much lesser contagion as and when the 3rd wave comes.** However I believe the fear of the 3rd wave could postpone some discretionary spending from both individuals and government and that could in near term hurt demand in some way and the earnings recovery which the market is factoring in could get delayed by some months. My only concern remains that what **if the 3rd wave coincides with the festive season in the later half of the year as that could hurt a lot of discretionary domestic spends.**

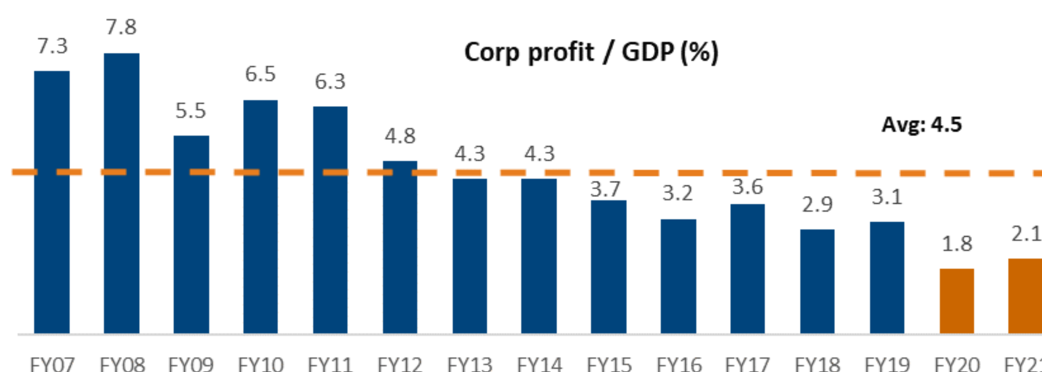
US Interest rates would rise anytime now and wont that hurt Emerging Market flows like in India?

The US Fed has one of the most difficult jobs right now this year while its job of pumping money in the US economy was the easiest last year. With low interest rates and trillions of dollars of liquidity pumped into the system, the ugly head of inflation has risen. Wages are rising, commodity prices are rising and prices of almost everything on the consumers shopping list is rising. That by plain Economics means the Fed should raise interest rates. However the issue is with trillions of dollars of debt on its book**, a 1% increase in interest will increase the debt servicing burden of the US govt by more than USD 200 billion!** Unless they decide to use the axe on their own feet anytime soon, don't see a reason why the US fed would increase the rates in near term unless the job market improves and supply side picks up and inflation is brought under control. Meanwhile with regard to emerging market flows, India continues to gain increased preference in the whole emerging market basket owing to its stable economy, large demographic advantage, large potential of emerging as a factory to the world apart from being the service centre for the world and its ability to act as a counter balance to China in many aspects within Asia.

Rising inflation from time to time fuels speculation of interest rates rising in the US but the Fed has little choice but to keep rates low in view of the large debt servicing burden the govt would be faced with

What if earnings recovery is delayed for a prolonged period? Is market factoring in things too early?

As I mentioned in my opening comments, the earnings in FY21 surprised everyone by growing in double digits inspite of a difficult year. FY21 Nifty EPS grew by almost 15.4% as compared to FY20 inspite of nearly 6 months of FY21 being closed for business. If we look at the recently concluded Q4FY21 numbers, Net income for Nifty-50 companies grew by 111% while EBITDA surged 68% YoY. If we argue that last year Q4FY20 was a weak quarter, even for full year the numbers look a stark improvement. Gong ahead we might see some softening in the current quarter and the next, and also margin improvement might not be possible any more as input costs have risen substantially, but we could see price hikes being passed on to consumers as we have seen in recent times in various sectors. **As an investor we need to see beyond the next one or two quarters and build a portfolio of companies which will be participate in the next 2-3 years of earnings upcycle of India Inc. One interesting data point is corporate profits to GDP which is currently at decadal lows and is set to improve in coming years.**



Portfolio performance and positioning

In continuation to our search for mispriced opportunities in the market we have been adding exposure to some existing names and also added some new companies in portfolios in recent months. **We have been adding exposure to Philips Carbon** owing to its attractive valuations coupled with margin improvement on the back of steady growth roadmap ahead. **We have increased our exposure to the IT & IT Services space** as we continue to believe in our thesis that the sector is going through a major earnings upcycle on the back of global IT budget increasing in all sectors and further aided by margin improvements. We **continue to be overweight on our Pharma and Healthcare exposure** as we see Indian API makers becoming the preferred choice in the global pharma supply chain and also believe many approvals would be underway for the local domestic players. We have also been **maintaining our positive stance on home improvement and cement** and see the revival of demand in real estate as a sustainable trend after several years.

All the Quest strategies continue to outperform the benchmark indices in CY 2021 and have built significant alpha over the last 15 -16 months

As on 31st May 2021	1 month	3 months	6 months	1 year	2 years	5 years	Since Inception
Quest Flagship PMS	8.3%	10.4%	26.4%	77.0%	17.9%	14.4%	17.4%
NIFTY-50	6.5%	7.3%	20.2%	62.7%	14.3%	13.8%	8.0%
NIFTY – 500	7.0%	8.6%	23.4%	69.1%	16.1%	14.2%	8.3%
Quest Multi PMS	7.5%	11.4%	27.2%	89.5%	19.8%	14.9%	16.0%
NIFTY-50	6.5%	7.3%	20.2%	62.7%	14.3%	13.8%	12.0%
NIFTY – 500	7.0%	8.6%	23.4%	69.1%	16.1%	14.2%	11.1%
Quest Focus PMS	8.3%	8.4%	27.4%	72.1%	11.9%	15.0%	15.1%
NIFTY-50	6.5%	7.3%	20.2%	62.7%	14.3%	13.8%	15.2%
NIFTY – 500	7.0%	8.6%	23.4%	69.1%	16.1%	14.2%	14.9%

Note: These are TWRR returns as on 31st May'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 like to leave with this thought to investors **that if your investment horizon is going to be the next 3-6 months, then you have reason to worry and be cautious** and would be more prudent to try to time the market entry and exit with perfection. However **if you are here for the long haul and want to ride through the volatilities in the near term, we would suggest to keep nibbling into great companies at various market levels and build a portfolio** as there is no perfect price and time to enter all in and hence building the portfolio over time makes sense.

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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CONTACT: QUEST INVESTMENT ADVISORS PVT LTD, 188/3 GURUKRUPA BUILDING, FIRST FLOOR, JAIN SOCIETY, SION(WEST), MUMBAI – 400022
EMAIL: pms@questinvest.com PHONE: 022-24066700 Visit us at: www.questinvest.com