QUEST INVESTMENT ADVISORS
SEBI Registered PMS & AIF managers

Dear Investors,

The current global geo-political tensions has again awaken the past memories of a divided world a few decades back and is something new for the new generation which has been born post the Cold war period. The **truth about all great wars is that they have started on the flimsiest of reasons and have often been ignited to satisfy someone's ego**. If the damage caused due to the pandemic on global economies was not enough, we now have this new elephant to tackle in the room. It would be wrong on my part to downplay the event and project as if all is well. However it is important to also understand that such geo-political disruptions could also be an opportunity for investors as fear and panic takes center stage and rational thinking takes a back seat.

I don't know what weapons will be used in the 3rd World War but I can tell you what they'll use in the 4th – ROCKS! - Albert Einstein

During recent weeks, all my interactions with investors and market participants revolved around some common discussion points and I thought it would be a good idea to reflect on the situation and try to summarize some of these common questions which would surely be of interest to you as an investor:

What are the chances that the Russian invasion of Ukraine will grow into a full blown global war?

What seemed like a quick in-out shock and awe operation by the Russian army has definitely gone longer than anyone had expected. However considering that the US and NATO allies are unlikely to send their troops into Ukraine but would continue to impose more and more economic sanctions on all Russian things of interest, **we believe the chances of a full blown out Military World War 3 is very remote.** Dangers around the Nuclear facilities in Ukraine remain and as we see it, it could be misused both by the Russians or the Ukrainians as once they get pushed to the wall in a corner, irrationality takes over. So I feel Russia using nuclear weapons on Ukraine is very unlikely but Nuclear Power plants in Ukraine could be easy sitting ducks which even the Ukrainian army could destroy it in order to make it look like Russia has attacked it. This would be catastrophic for not just Ukraine but also most of Europe. However I believe we would be seeing an end to the current military conflict within the next few weeks before the end of March'22 either through some progress in talks and negotiations or a full blown out attack from Russia toppling the current government in Ukraine. However I believe **the damage that the recent conflict has done to global geo-political balance and alliances would take years to go back to normal and could be to India's benefit also in the medium to long term**.

What about inflation? How will commodity prices react and what about Crude Oil?

Russia is a significant player in global Oil & Gas market and the event has surely made a lasting dent on the crude and gas prices globally. Crude prices have reached unsustainable levels and will hurt all industries across the globe. So energy price inflation is staring at us for a good period now and could remain that way in near term. **Europe which gets nearly 50% of its energy requirement from Russia, is in a big soup.** Europe needs to decide if they want to castrate their industrial growth and punish themselves along with Russia or be more lenient towards Mr Putin with sanctions soon. Countries like India who depend on imports for all our crude oil requirements will find our import bill surging dramatically. At the same time coming this week starting 7th March'22 we would see some steep price hikes in retail petrol and diesel prices also which had been kept unchanged owing to the elections code of conduct. This would definitely add to the retail inflation in real terms and also dent margins in various industries. Globally high crude prices will dent demand which will be the natural course correction for prices to cool off in coming days. Also as countries across the globe keep importing Russian crude oil & gas, we could see come softening of the prices.

As crude oil and all commodities prices reach life time highs, it would make projects and businesses using them unsustainable and bound to bring demand down which would in turn cool off prices

With regard to other essential commodities, **between Russia and Ukraine, the two countries account for 25% of global wheat exports**, **and Ukraine is responsible for 13% of corn exports**, so food inflation is a major risk. On the brighter side, **exports of wheat from India could see some major increase as India is among the top three wheat producing nations in the world**. Additionally, Russia is the largest producer of ammonium nitrate and is a large exporter of palladium, platinum, nickel and aluminum. **This could also lead to increased exports of aluminum from India** as India is again among the top 3 aluminum producing nations. In an environment of rising global inflation, these commodity price hikes increases the pressure on industries consuming these as projects and businesses become unsustainable. Also Central banks would be compelled to act in order to dampen inflationary pressures, most likely through increases in Policy Rates. But unfortunately the inflation has been caused due to supply side disruptions and not demand surge and **rate hikes might lead to stagflation in global economy** without doing much to contain inflation. We believe crude prices could cool off once the current military situation cools off, but when is a question we don't have an answer to. Unfortunately we don't see the oil productions going up anywhere as producers are reluctant to put more capex on oil productions owing to governmental focus of pushing for ESG in energy production and focus on green energy. This **focus on green energy and climate change is surely coming to haunt the global energy market** and we have got a good glimpse of the same now with even someone like Mr Elon Musk commenting that, its time to increase fossil fuel production!!

What are the other near term concerns we have?

Within the next few weeks we would have answer to two other concerns: State Election outcomes and US Fed policy rate hike action

There are two near term events which are keenly being watched by investors both foreign and local and would again decide the near term flows into or out of the market. **First is the outcome of the state elections** and more importantly outcome in UP state elections, which we would be getting an answer to on the 10th of March'22. If recent exit polls are to be proved right, then it would be a positive booster for the market sentiment as it makes BJP's position stronger for the forthcoming general elections in 2024. Any negative surprises there would be a dampener as the central government would then go on the backfoot for any reforms and become more populistic in all their policies and take back India to old appeasement politics. **Second is what action the US Fed takes on 15th March'22 with regard to raising the policy rates** which is expected to be raised by 25 bps. **Market is factoring in a 25 bps hike** and anything more than this would be seen as a negative factor for emerging markets which anyways has been seeing net outflows for most part of last 1 year. So basically we would be over both these events in the next 1 week and would give a lot of clarity to the uncertainties.

What about India Inc earnings growth? Will it get hampered?

India Inc. is expected to report a 15-17% earnings growth over FY22-24 even after adjusting for recent events unless demand dies everywhere completely

Inflation in commodity prices over the past few quarters would surely dampen the recovery that was expected to be on both top line and bottom line of corporate India. However a series of price hikes which have been passed onto the consumers in recent times and also some cost efficiencies carried out, would help in minimizing the impact of the inflation. Looking at the headline consensus numbers and earnings for the broader Nifty-50 index, FY23 was expected to report around 20% earnings growth over its FY22 earnings while FY24 was expected to report around 13% growth, thereby averaging around 17% earnings growth over the period FY22-24. However the **recent spate of events and inflationary pressures could dent this growth a tad lower to the 15% range over the next 2 years**. **Considering the high base that has been formed in the FY20-22 period where we saw a 28% EPS growth in Nifty-50, a 15% CAGR EPS in Nifty-50 doesn't look bad**. Also within the broader market we could see skewness in earnings wherein cyclical commodities could report strong cash flows and consumer oriented companies who have been impacted on margins and volumes could lag behind. Tech companies could continue to report strong earnings on account of both deal flows and weak rupee.

What should investors do now at 16000 Nifty-50 levels?

This is not first time we have seen War worries globally and all past events are testimony of the sharp returns seen post war over the next 1-2 years

We have time and again seen that **fear and greed takes us to the extremes on both sides of the market** specially during periods of gloom and boom. What we are seeing now is extreme fear among the investors which is again not without reason when we have war clouds looming and all commodities shooting over the roof. However we need to know that every war comes to an end and also commodity prices are not sustainable at current levels for long as sharp decline in demand would bring down prices to normalized levels. Whether we see normalization in 1 month or 3 months or 6 months, time would tell but it would surely happen. Now if we look at the valuations of the market, **based on FY23 expected earnings of around Rs 880 on an average, we are currently trading at 18x P/E and on a Rs 1000 EPS of FY24 we are trading at 16x P/E.** By all measures these are not expensive valuations and if one has the stomach to weather the current volatility in the global markets, we see no reason why one cannot look at equity returns over the next 2 years which would mimic the earnings growth as mentioned above over FY22-24.

We recommend investors to remain invested through this current turmoil and use additional liquidity and cash flows if any to top-up their existing equity allocations across all their existing investments whether with Quest or otherwise with a view of next 2 years. We should see the current turmoil as an instrument for bringing back markets to comfortable valuation levels from the recent highs and also giving investors an opportunity to build their long term portfolio. Word of caution here is that don't expect markets to give sharp rally in near term and don't get worried with some further blips in the market in near term.

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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