QUEST INVESTMENT ADVISORS
SEBI Registered PMS & AIF managers

Verdict 2024 sees return of coalition govt; Short term volatility throwing opportunity for the long-term India story

Dear Investors,

Shaken but not broken is what we can say for Modi 3.0 government

Elections can always throw up surprises in places one least expects, and we got a good glimpse of it in today's election results. What was perceived to be an easy win for BJP alone, now seems like a narrow win for NDA and a coalition government with support from both Mr. Nitish Kumar and Mr. Chandrababu Naidu seems is in the making. Although BJP failed to get absolute majority, but it is praiseworthy that they emerged as the single largest party for the third term with ~37% vote share, same as last time, and NDA would be forming government for the third term in an environment of drought (last year), higher global inflation and huge prevalence of freebies and loan waivers. In an extreme scenario, if the opposition manages to wrest away the key allies of BJP in the future, the investment approach to India would change materially. As we consider it a low-probability event now, we would not discuss on the same currently.

What changes now after verdict on Policy action front and its sectoral impacts

The last two terms of the Modi government has been one with lot of focus on infrastructure and domestic production focused under PLI schemes. Focus had been more on headline macro numbers and economic growth, and **we believe government in its 3rd term along with its alliance would continue to drive the economic growth narrative**. However, there could be some changes in spending pattern from the government. The Indian economy has primarily seen growth led by investments and by Government push, while rural consumption has been lagging. Employment creation has also been a matter of debate as Agri appeared to see an increase in workforce but decreasing contribution, which was not ideal. In the near to medium term, we could see the following playing out in the markets:

The continuity of power would translate into continuity of policies, but could see small re-caliberation in government spending pattern

- **Rural Consumption Focus**: **Sectors linked to Rural consumption will take center stage as there could be increase in social spends by the government.** Along with that a good monsoon as is expected this year would augur well for the Rural consumption theme. The interim budget pegged the deficit at 5.1% with capital spending growth exceeding social expenditure. Since then, the actual trailing deficit was 20bps lower than estimate and the RBI dividend cheque has added about 30bps to revenues. How the government uses this extra 50bps will be key, but we believe populism will surely come back in some form or the other. The opposition promised many giveaway schemes this time - from filling up 3 million government vacancies quickly to paying Rs 100k annually to the poorest families. The better-than-expected mandate for the opposition will be seen as those policies gaining ground, and there is a risk that the new government may evaluate some of these as direct support schemes.

- **PSU re-rating to take a breather**: Going into elections a lot of PSUs had seen massive multiple expansions which defied logic and investor expectations had built up around disinvestments and higher than historical growth being unfolding in these. However, government would likely go slow on disinvestment and also capex spending on some of the fancier projects specially in railways (like bullet trains, modernizing of platforms, etc) could see some slowdown. **Power sector would continue to see investments and so would Defence as both are critical for the nation.**

Valuation correction in Cyclicals and high beta sectors would be seen in the near term

- **India's premium could see some moderation as fund flows would not rush**: Fresh FII and domestic capital which was waiting to get allocated once the election verdict is out, would take time to find its way to the markets as investors would want to see the current government's policies and actions for some time. This could lead to some time correction in the market which would lead to India's premium valuations seeing some moderation in the near to medium term. However, **we remain bullish on India's long-term growth story and believe Mr Modi would continue his vision 2047 plans and drive a more inclusive economic agenda taking along every section of economy and investors with a 4-5 year view should use this short term weakness to increase equity allocations.**

- **Capital goods and capex story could see valuation corrections**: Many of the capex related capital goods companies were trading at the upper band of their historical valuations and could see some moderations there as street would believe govt would go a bit slow on their plans and eye would be on private capex to pick up. **In that however we believe Power, Energy, Roads and Defence could continue to see government capex.**

- **Unlikely to see any controversial policies being pushed**: Most of the likely reforms in the coming five years would be in the arena of execution rather than focusing on making law changes. Farm Law reforms, GST reforms, Labour Law reforms could take a back seat immediately and may be reconsidered after some quarters, but we would have to wait and watch. Government would not want to get into anything controversial at this point of time. Constitutional amendments will be harder, but can change laws, especially with victories in Odisha and Andhra Pradesh helping its position in the Rajya Sabha. Things like Uniform Civil Code also would be shelved for the time being.

Way ahead for investors and your portfolios

No major changes expected in portfolios though some defensives in consumption, healthcare could find its way into

To be honest, hardly anyone would have expected to see this outcome in the elections. However, we do not expect to make any drastic changes to our portfolio positioning since we have been bullish on consumption, albeit on urban consumption, which now might see some rural consumption names too added. The near-term market would remain very volatile and taking any drastic actions is unwarranted.

We would in line with our above views, look at some re-alignment in the portfolios where some amount of high beta sectors are reduced, and low beta defensives gets added in the portfolio. However, would like to reiterate that thankfully we do not hold any of the frothy valuation companies in the PSU space. We do not see the India's growth story and vision to reach among the top three economies getting challenged. Short term hurdles would make the journey bit bumpy and not to everyone's liking but investors with a 4 – 5 year view should focus on increasing their India equity allocations in a staggered manner. As the new government releases its 100 day plans and also post budget 2024, we would get more clarity as to what lies ahead for the coming years.

Happy investing!

Team Quest Investment Advisors

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