The Bottom Line... PLUTUS ALPHA

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Vineet Bagri
Managing Partner

As the result season progresses, the most striking fact is the divergence in results published by corporate India. The theme being played out is Winner Takes All. Across sectors, companies with good governance, low leverage and solid fundamentals are gaining market share. This is not restricted to large companies only, as several small and midcap companies are also declaring record results. Financial prudence and solid businesses are being rewarded like never before.

The global circus continues. USA continues to report record low unemployment figures and their consumer economy remains strong. However, it is a tough environment outside the USA. Brexit is delayed till next year and there is a new UK election in December. It seems that China wants to get a sense of next year's USA election results before they engage with the incumbent, given their turbulent negotiation history. Hong Kong remains in the spotlight, and is expected to slip into recession. However, there is some risk-on sentiment and flows into emerging markets have picked up to their highest since July 2018.

If there was a doubt that the Indian economy is facing headwinds, the reduction in India's GDP Growth forecast by the IMF, World Bank and RBI has put an end to the speculation. Repair is underway, and means have to be found to kick-start the economy again. The government has limited fiscal space, thus the only choice is to expedite divestment. The recent moves on Bharat Petroleum indicate that the government could do some big ticket asset sales quickly.

Divestment of assets by the government could provide very large flows into India. We can broadly divide this into two categories, viz. strategic and income generating assets. We have already seen interest from global fixed income investors to invest into income generating assets in India – toll, rent, maintenance contracts etc., anything which has an underlying income stream can be sold to potential investors. The possibilities are endless, more so in a world searching for yield.

Strategic divestment could be a one-time gain for the government and has to be expedited. The state owns several unique and non-replicable organisations; many of which interface with millions of consumers every day. The lure of these assets in a market of 1.3 billion consumers is a powerful magnet – we can gauge this by the reception of the IRCTC initial public offer. The entire hydrocarbon chain from exploration to distribution is largely owned and controlled by the government. Just this sector being divested could have gains from diplomacy, energy security and release of capital for other productive uses.

The key with divestment remains what is done with the proceeds. It is incumbent that these proceeds are used for fixed capital formation, building railways, roads, airports, hospitals, schools and the lot. This end use will find many repeat investors into India, and will also bring back animal spirits in the industry.

The discussion about valuation has become poignant. On one hand we have performers valued at high multiples, whereas on the other hand, many companies are quoting below book or at record low multiples. In most cases, there is a fundamental shift in business models. If we look at non-banking lenders, their ability to borrow from capital markets gave them an edge, which has now diminished. Similarly, compliance costs in several midsize businesses have become much higher. Most companies that are trading at lows are facing these challenges and have to devise coping mechanisms. Companies that learn to handle this changed environment will be the winners of tomorrow.

On the interest rate front, both the RBI and the US Federal Reserve cut benchmark rates in October. It certainly seems that the US Fed is done with rate cuts in this cycle, but that could change quickly if data disappoints. The RBI continues to have an accommodative stance and could cut rates further if the economy does not pick up. Inflation is forgotten or marginalised in the face of faltering growth; in any case where is comes from remains to be seen.

The question of transmission of rate cuts, however, is becoming acute. In the last five years, repo rates have reduced cumulatively by 2.85%. However, mortgage rates have compressed by just about 1.25% in this period. This is a telling statistic as home loans are usually the cheapest, everything else is much more expensive.

On the other hand, so many large lending institutions continue to sputter. More than a year has passed and the progress on IL&FS continues to confound. Due legal process is taking time as many of these challenges are new to the system, with no real precedence. Credit markets remain frozen, and the number of new issues is subdued. Outside of the top business houses, issuers are finding it extremely difficult to access capital from the debt market. Banks too have become cautious, after taking multiple hits over the last few years. In this situation, the natural consequence is a reduction in velocity - in consumption, trade and capital formation.

We face a unique problem, one of too little supply of money; at a higher than required cost. This credit cum liquidity impasse has to end. In its normal course, it could take much longer and hurt the economy further. It is therefore incumbent to find an immediate solution. In a similar situation in 2008, the US Fed resorted to what we now know as Quantitative Easing, by expanding their balance sheet and injecting liquidity directly into the system. This could potentially be one of the solutions that the government considers in consultation with the regulators.

October was also a successful month for our strategy of selling options. Post the RBI policy on 4th October, when the Nifty was at 11,350 we saw the opportunity to sell calls at 11,900 and purchased cover at 12,100. However, markets moved and we could only execute partially. Thereafter, on 14th October, we completed our transactions on calls, with total income of ₹ 26.56 Lacs. On the same day, when the Nifty was at 11,375, we also saw the opportunity to sell puts at 10,700 and purchased cover at 10,500, with income of ₹ 20.92 Lacs. The total income collected was ₹ 47.48 Lacs against a margin of ₹ 100 Crs worth of securities, and would be on the money as long as Nifty remained between 10,680 and 11,920. The markets remained well within this range till Diwali, but in the last three days of the settlement, the Nifty gained 325 points on the back of strong FII and retail buying. Therefore on the clearing day (31 st October), we closed out call positions through the day and booked income of ₹ 24.23 lacs for the month. **Thus, we generated income of ₹ 24.23 lacs in October. Our strategy has generated income of ₹ 6.19 Crs cumulatively since September 2018 on a margin of ₹ 100 Crs worth of securities.**

We have written about customer sentiment and the festive season. Feedback and trends are mixed. We can take heart from the fact that there is no dramatic collapse in consumption. On the other hand, foreign interest in Indian financial sector has certainly revived – Yes Bank received a bid of $ 1.2 Billion by an American family office; and Standard Life could sell 10 Crore shares of HDFC Life worth ₹ 5,750 Crs in one trading session to foreign institutional investors. It is clear that there is demand for Indian assets across the valuation and quality spectrum.

As we go into November, we watch for trends in foreign institutional investment in India. There is a high chance of a large ticket divestment by the government in the near future, which could perk markets. However, financial sector resolution will be watched keenly as that will determine any pickup in growth metrics.

Plutus Alpha Performance Update

Month	Trade Date	NIFTY Level	Recommended Position	Total Premia Collected (₹ Lacs)	NIFTY Closing	Net Income for Month ₹ Lacs	Cumulative Income (₹ Lacs)
October 2019	14 October	11375	Sold Puts at 10,700 and bought Puts at 10,500; Sold Calls at 11,900 and bought calls at 12,100	47.48	11,877	24.23	**618.78**
September 2019	3 September	11,023	Sold Puts at 10,400 and bought Puts at 10,200	33.13	11,571	52.30	**594.55**
	20 September	11,200	Sold Puts at 10,800 and bought Puts at 10,600	20.92			
August 2019	13 August	11,110	Sold Puts at 10,600 and bought Puts at 10,400; Sold Calls at 11,500 and bought calls at 11,700	70.68	10,948	70.68	542.25
July 2019	16 July	11,626	Sold Puts at 11,300 and bought Puts at 11,100;	29.18	11,252	(-) 2.30	471.57
			Sold Calls at 11,900 and bought calls at 12,100	27.68	11,842	27.68	**473.87**
June 2019	7 June	11,844	Sold Calls at 12,300 and bought calls at 12,500				
May 2019			No recommendations				446.19
April 2019	9 April	10,605	Sold Calls at 12,000 and bought calls at 12,200	40.46	11,642	40.46	**446.19**
March 2019	13 March	11,342	Sold Puts at 10,900 and bought Puts at 10,700; Sold Calls at 11,700 and bought calls at 11,900	43.21	11,570	43.21	405.73
February 2019	1 February	10,894	Sold Calls at 11,300 and bought calls at 11,500	41.85	10,793	81.72	**362.52**
	15 February	10,746	Sold Puts at 10,400 and bought Puts at 10,200	39.87			
January 2019	17January	10,891	Sold Puts at 10,500 and bought Puts at 10,300; Sold Calls at 11,200 and bought calls at 11,400	60.91	10,831	60.91	280.80

Calendar Year Returns	2018 (3 months)	YTD 2019
Total Return	₹219.89 Lacs	₹ 398.89 Lacs

Notes:

- This strategy commenced in September 2018. Details of transactions prior to January 2019 available upon request
- All options are sold for expiry of the said month with NIFTY50 Index as the underlying.
- This portfolio is based on a model portfolio of ₹ 100 Cr of shares given as margin.
- The entire premia collected is credited into the account of the investor
- There is no pledge or encumbrance on the securities that are used as margin

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