Equity Advisory Services

Quarterly Newsletter - June 2019

Dear Fellow Investor,

In June 2019, we have redesigned our equity advisory service and created an all-weather portfolio of stocks which are best positioned to capture the growth in India. This portfolio is branded as "Legacy", which symbolizes our view that these companies are best positioned to create economic and societal value, and generate superior shareholder returns into our next generation and beyond.

While designing this portfolio, we looked for large addressable opportunities, and quality & leadership within those segments. India's demographic dividend is a well-established driver of consumption, which forms the bedrock of our selection. Within this, digitization, formalization, premiumization and connectivity can open various investment opportunities, which could be capitalized by leading players who already have reach and structure.

The current environment is tough with falling growth, high unemployment and lack of capital availability. Several companies with dodgy business models and poor capitalization have been exposed in this environment, causing strong and well capitalized companies to gain market share. The environment will improve eventually, but when it does, these survivors will emerge even stronger than before and with larger market share. The scale, market leadership and capital position of these companies in itself is a competitive advantage.

One of the most important lessons in markets is to go with the obvious stories. Colgate Palmolive (India) Ltd (Colgate) is one such story in India. Colgate is a market leader in the oral care space, where penetration is still low and awareness is increasing. In rural areas, consumers upgrade from powder to paste. Additionally, there is premiumization, with consumers switching to value-added products like gels, mouth washes, sensitivity and teeth whitening products. Use of toothbrushes is also increasing, and people are using more of them. Colgate had faced intense competition from an Indian player, which offered oral care products based on natural products comprising of herbs, vitamins and minerals. Between 2015-2018, Colgate lost around 5% market share. However the market itself expanded due to the marketing efforts of the Indian player. Colgate has countered this with new launches in the natural segment and premiumization. The volume growth for Colgate has improved and there is evidence of margin expansion. The company's brand franchise with superior product offering, continuous innovation and premiumization, free cash flow generating ability, no leverage and leadership position creates a formidable business for long term wealth creation.

Since we have launched our "Plutus Legacy" portfolio only in June, the quarterly performance is not presented in this newsletter. We will update the performance of this portfolio from our next newsletter.

This quarter has seen consolidation across global equity markets, after a strong first quarter. Volatility showed up during the quarter, but has by-and-large been subdued on the back of lower interest rates. Interest rates headed lower for most of the world, including USA and India; with China being the only meaningful exception. However, participants remained skeptical and there was a rally in Gold, which hit a 5-year high. Oil was overshadowed by the US-China trade talks, and reacted on every (de)escalation.

The current economic expansion has now entered its tenth year and we are in late stage of the cycle. Central Bankers tried to tighten monetary policy between 2016 and 2018, but by early 2019, that strategy was abandoned. It seems that Central Bankers around the world are now convinced that another round of easing is needed. China announced tax rebates and other expansionary majors, ECB announced a new refinancing window from September, and the US Fed changed their view to no rate hike in 2019 and end to tightening by September. In June, India joined the bandwagon by reducing rates and changing stance to accommodative. However PMI data points to weakening economic sentiment across all major economies. There was considerable risk-off in bond markets, and by end June, around $ 13 Trillion of debt was generating negative yields – largely in Japan and Europe. Still, flows emanating from lower/ negative yields in developed economies are driving asset prices in emerging markets, including India.

Index	**Q2 2019**	**Q1 2019**	**H1 2019**
MSCI WORLD Index	3.4%	11.9%	15.6%
S&P 500 INDEX	3.8%	13.1%	17.3%
Euro Stoxx 50 Index	3.6%	11.7%	15.7%
Nifty 50 Index	1.4%	7.0%	8.5%
Gold Spot $/Oz	9.1%	0.8%	9.9%
Oil - WTI	-2.8%	32.4%	28.8%
Bloomberg Commodity Index	-1.8%	5.7%	3.8%
Govt 10 Year Bond Yield (Change in bps)			
India	-0.47	-0.02	-0.49
US	-0.40	-0.28	-0.68
German	-0.26	-0.31	-0.57
Japan	-0.08	-0.08	-0.16
China	0.17	-0.24	-0.07

Quarterly performance of major indexes. Source: Bloomberg

Regulatory interest rates in India are at their lowest in 9 years, on the back of poor economic outlook and benign inflation. Still, lower rates are not reaching borrowers as financial institutions, banks and NBFCs struggle to cope with liquidity and credit quality issues. Lending growth is subdued, with just a handful of banks and NBFCs taking all the opportunities in the market, while the competition is distracted.

Within domestic markets, flows by domestic institutions continue to provide support to the market, while foreign flows have moderated somewhat in this quarter. Most of the flows are coming into large cap stocks, and there is a day-and-night difference in performance of companies with established leadership and quality, and the rest. Any suspicion on governance or quality is being sold into, and promoters are monetizing assets to reduce leverage on their companies and themselves. Consumption is also facing a slowdown with auto sales turning negative and a general slowdown is reported by multiple FMCG companies, especially in rural areas. We can look at this as a purge of systemic excesses, which should lead to a healthier ecosystem.

Earnings growth has disappointed successively for 8 years. This year, the market expects earnings to grow by 34%, largely on account of banks becoming profitable after prolonged period of poor performance. Excluding the one-time impact from banks, earnings are expected to grow by 18-20%. We can take heart from the 17%+ overall revenue growth in top NSE500 companies in FY2019.

Going into the third quarter, the key event risks emanate from Brexit, and any potential fallout thereof. The US-China trade deal seems to be back on track, but as we have seen in the past, that can derail quickly. Geopolitics in the Middle East is another factor that has an elevated impact on the markets, especially tensions in the Strait of Hormuz. Extended periods of loose monetary policy are likely to have diminishing returns, as we have seen in Japan. The Union Budget, progress of monsoon and start of the earnings season in July will set the tone for the performance of 2019-20.

Happy Investing!

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