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Dr. Ashok Ajmera's column as on August 01, 2020

IT and Healthcare stocks outperform in July's 2020 rally; correction in Indian equities would provide margin of safety for fresh entry..

On a weekly basis, Sensex was down by 1.36 per cent while Nifty declined by 1 per cent. Stock specific action was witnessed on Q1FY21 earnings announcement and the trend is expected to continue. In July too, the S&P BSE Sensex and Nifty50 were up by over 7 percent each. Midcaps and smallcaps too were on fire as largecaps are expensively valued after rally in last four months. In the last two months, the benchmark indices have rallied by nearly 16 per cent in the two months. The last time the benchmark indices posted bigger upmove than this was in May 2009, following the re-election of the Manmohan Singh-led United Progressive Alliance (UPA) government.

In the past two months, the Nifty IT index has rallied by 29 per cent, followed by Nifty PSU Bank Index rallying by 24.9 percent, Nifty Auto index up by 17.1 percent and Nifty Metal index also moving up by 14.2 percent. Individually, Reliance Industries which has a good weightage in Nifty continues to be hero of Indian equities. The stock, has rallied 41 per cent in the past two months. In July 2020, IT and Pharma have dominated. Stocks like Laurus Labs, Dishman Carbogen Amcis, Caplin Point Laboratories, Natco Pharma, Persistent Systems, Infosys, Wipro, Firstsource Solutions, Mphasis, NIIT Technologies, Larsen and Toubro Infotech, Dixon Technologies, MCX, Dr. Lal Pathlabs, Thyrocare Technologies, M&M Financial Services, Tech Mahindra, ITI have rallied by 20-80 percent.

On Friday, PSU Banking giant SBI posted good performance in Q1FY21 result. State Bank of India (SBI) ended over 2.6 per cent up at Rs 191.45 after the Bank reported 36.8 cent rise in profit before tax (PBT) at Rs. 5,559.7 crore for the quarter ended June 2020 (Q1FY21) on robust growth in net interest income. Bank has delivered a strong performance in Q1FY21 with all round improvement in Profitability, Capital Adequacy and Provision Coverage Ratio, including Additional Provision over Minimum Regulatory Provisions required. Net NPA ratio stood at 1.86% idown 121 bps YoY and 37 bps QoQ. Gross NPA ratio stood at 5.44% is down 209 bps YoY and 71 bps QoQ. Provision Coverage Ratio (PCR) has improved to 86.32%, up 698 bps YoY and 270 bps QoQ. Slippages Ratio for Q1FY21 has declined to 0.60% from 2.83% as at the end of Q1FY20. Credit Cost as at the end of Q1FY21 has declined 47 bps YoY to 1.56%. Cost to Income Ratio has improved from 57.21% in Q1FY20 to 50.02% in Q1FY21, an improvement of 719 bps. Capital Adequacy Ratio (CAR) has improved by 51 bps YoY to 13.40% as on June 2020. Return on Assets (RoA) increased by 17 bps YoY to 0.42% in Q1FY21 against 0.25% in Q1FY20.

Ajcon Global's view

The crisis caused by COVID-19 has been very harsh and unimaginable as it is a once in a life time event. Threat to life and threat to livelihood have rattled people. This crisis has spared no one and affected every common man. The situation has become so scary that even after COVID-19 era people would be reluctant to move freely, meet people, travel in public transport and eat in restaurants etc. Naturally, the containment measures like the lockdown of the entire country to break the chain of virus will have significant effects on the global economy. While this current situation is unique in many ways, fear and greed are still the common denominators of every crisis. India is no exception as the economy has to come to a grinding halt amidst the ongoing lockdown. The lockdown to curb virus spread has forced permanent damage in exports

markets for all the major economies except to some extent Indian Pharma. MSMEs would be the worst affected as there would no cashflow as income would be missing.

India was already in bad shape with India's GDP taking massive hit in last 2-3 years due to miniscule credit growth and slowdown in consumption. Investment led spending also took a hit. Various crisis and scams like IL&FS, PMC Bank, DHFL and Yes Bank tore apart the Indian Financial System and questions were raised on the regulatory front and on basic survival of Non Banking Financial Companies. Affecting Credit off-take: Bank credit growth was shattered to an over five-decade low of 6.14 percent in the fiscal ended March 31, 2020, amid a faltering economy, lower demand and risk aversion among banks, RBI data showed.

Bank advances growth in FY20 was the slowest since the fiscal ended March 1962, when loans had grown by 5.38 percent. In the week ended March 27, 2020, advances stood at Rs. 103.71 lakh crore as against Rs. 97.71 lakh crore as on March 29, 2019, according to Reserve Bank data. During FY20, bank deposits grew by 7.93 percent to Rs. 135.71 lakh crore as against Rs 125.73 lakh crore, the RBI data showed. The growth in deposits was slowest since FY18, when it had increased by 6.21 percent. In FY19, credit offtake was 13.29 percent while deposits grew by 10.04 percent.

The Government announced various measures in its 20 lakh crore package which RBI measures as well. The disappointment of no relief package for middle class who are also affected significantly in COVID-19 crisis will also remain an overhang. We like the agriculture reforms announced; major announcements made in sectors like Coal, Mining, Aviation, Defence and Power sector were also good and long term in nature. Certain announcements by Finance Ministry were not taken well by street participants with regards to measures like MSME loan not being interest free, no benefit to MSMEs who do not have an existing credit facility, market sentiments getting affected as the reduction in rate of TDS to increase liquidity in the system was announced as part of stimulus package etc.

The announcements with regards to MSMEs of Stimulus Package like Emergency Working Capital Facility for MSMEs and small businesses worth Rs. 3,00,000 crores + Subordinate debt for stressed SMEs worth Rs. 20,000 crores + Fund of Funds for MSME worth Rs. 50,000 crores was not implemented in a timely manner. The package is so ill designed that till date only about Rs. 1.00 Lakh Crore is sanctioned and about Rs. 50,000 Crores is disbursed under the package of Rs. 3.00 lakh crores. The subordinate debt scheme of Rs. 20,000 Crores and fund of funds of Rs. 50,000 Crores are not yet even formulated.

Domestically, disappointing GDP data would always remain an overhang on Indian equities which is expected to clock negative growth during COVID-19 crisis. The GDP growth for FY2019-20 stood at 4.2 percent as against 6.1 percent in FY 2018-19. India's gross domestic product (GDP) witnessed a growth of 3.1 percent during January-March 2020. At 3.1 percent, India's "real" or inflation-adjusted GDP growth was the lowest in 44 quarters, national income data released by the Central Statistics Office (CSO) on May 29, 2020 showed. According to RBI, economic activity Q2FY21 may remain subdued due to social distancing measures and the temporary shortage of labour. Recovery in economic activity is expected to begin in Q3FY21 and gain momentum in Q4 as supply lines are gradually restored to normalcy and demand gradually revives. Domestic economic activity has been impacted severely by the lockdown which has extended over the past three months.

Fitch Ratings revised its outlook on India's sovereign ratings to 'Negative' from 'Stable', citing a weakened growth outlook and challenges from a high public debt burden due to the Covid-19 pandemic. Fitch retained its rating at 'BBB-', the lowest investment grade. This comes just weeks after Moody's cut its rating for India. As things stand, all three major global ratings agencies – Moody's, Fitch and Standard & Poor's – have the lowest investment grade rating on India. Fitch and Moody's have a negative outlook while S&P has a 'stable' outlook which it reaffirmed days ago. "The coronavirus pandemic has significantly weakened India's growth outlook for this year and exposed the challenges associated with a high public-debt burden. Fiscal metrics have deteriorated significantly, notwithstanding the government's expenditure restraint, due to the impact of the severe growth slowdown on revenue, the fiscal deficit and public-sector debt ratios," the agency said in a report. To add to the woes, the US central bank projected a 6.5 per cent decline in the US economy's gross year and a 9.3 per cent unemployment rate at the year's end which is negative for global equities.

Recently, S&P Global Ratings had said Indian economy is in deep trouble with growth expected to contract by 5 per cent this fiscal. "India's economy is in deep trouble. Difficulties in containing the virus, an anemic policy response, and underlying vulnerabilities, especially across the financial sector, are leading us to expect growth to fall by 5 per cent this fiscal year before rebounding in 2021," S&P said in a report. In its report titled 'Asia-Pacific losses near USD 3 trillion as balance sheet recession looms', S&P projected the region's economy to shrink by 1.3 per cent in 2020, but grow by 6.9 per cent in 2021. This implies a loss nearing USD 3 trillion output over these two years.

Sectors like Pharma and Healthcare, Speciality Chemicals, Insurance, E-Commerce, Companies with innovative business models especially in facility management, housekeeping and digital space would benefit from the COVID- 19 crisis while sectors like over leveraged NBFCs including micro finance, real estate, construction, hospitality, tourism and aviation sector would be affected significantly. We advise investors to remain cautious and be stock specific. Investors that have entered at the lower levels especially in last week of March 2020 and first week of April 2020 may book short term partial profits.

We feel apart from sectors like Insurance, FMCG, Agrochemicals, Pharma and Digital/internet, Q1FY21 earnings of other sectors would be disappointing. Negative newsflow related to economy will always give opportunities to investors to cheery pick quality companies at distressed valuations. We expect improved earnings performance in FY22 and FY23. Ideally, one should look at Companies which has seen massive destruction in their share price, companies that can survive due to the side effects of country lockdown, have strong portfolio of brands, strong management integrity, monopoly kind of presence, competitive advantage, have weathered the storm in different market cycles, low debt and debt free, able to generate positive cashflow consistently. The news related to faster discovery and launch of vaccine for COVID-19 may fuel the market.

We believe cooling of Indian equities will be healthy for investors as whopping rally in last four months was led by liquidity through FPIs. July 2020 rally can be attributed to positive developments related to COVID-19 vaccine, relaxations in Unlock 1.0, 2.0 and 3.0 and better than expected Q1FY21 result of majority companies announced so far. In June 2020, FPIs poured US\$2.73 billion in Indian equities, which is the highest this year and importantly surpassed pre-COVID-19 levels. The FPI inflows came amidst rush of liquidity in the markets globally after central banks around the world announced stimulus measures to help their economies. The stimulus measures given by the G4 central banks such as the US Federal Reserve, Bank of England, European Central Bank, and Bank of Japan, have helped fill the global markets with liquidity, marquee Indian companies tapping the secondary stock market by raising funds also contributed towards the increase in FPI flows. According to data on NSDL, the inflows in January 2020 stood at US\$1.3 billion against the June inflow of US\$2.73 billion. The inflows have currently become higher than the pre-Covid-19 levels in January where the markets were at all-time highs with the benchmark Sensex and Nifty trading at the 42,000 and 12,300 mark respectively. After hitting a record high in January 2020, Indian equity benchmarks crashed 40 percent to hit around four-year low level on March 24, 2020. The Benchmark indices in June 2020 quarter witnessed a sharp and fast rally of 20 percent in both Sensex and Nifty which is very sharp led by liquidity (by global central banks) and gradual re-opening of economies despite virus risk. Hence, utmost caution is warranted at current levels.

Exponential rise in COVID-19 cases and escalating India – China tensions would always remain an overhang on Indian equities. Equities rallying along with Gold make us uncomfortable as it is clear case of global liquidity as big economies have resorted to printing money as part of stimulus package. Progress of ongoing monsoon, global cues and management commentary in Q1FY21 earnings season will drive market direction.

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