India Equity Strategy

Making It Covid-19 Resistant

A major step towards recovering not so hurt from the Covid-19 crisis as far as equity investing is concerned will be to identify the pandemic-resistant sectors and overweight them in your portfolio.

Many of us would have been falsely numbed to think that Global Financial Crisis in 2008/2009 was a lifetime experience that could not have been paralleled so easily. It took only a decade to jolt us from that slumbered thinking. When Coronavirus was originally detected in end-December 2019 in Wuhan, little did we realize that within three months, it will become an integral part of over 7.8 billion global population. Irony is it is still playing out with no solution in sight.

It took a while to catch up in India and when it did, the Indian equity market fell like a pack of cards. While the Nifty-50 index started the year at 12,000 levels, the Covid-19 impact made it reach 7,600 before rebounding to 10,400! That is volatility at its best. In percentage terms, Nifty Index fell by 37% (peak to trough in 2020) and rebounded 38% leaving with a YTD loss of 15%.

The spread of coronavirus has inflicted deep economic pain across the world, since it is the first recorded human triggered crisis that has impacted demand and supply simultaneously. After recording a real GDP growth of 4.2% in FY20, we are now expecting it to contract by 4.2% for FY21 though it is expected to jump to 10.9% in FY22 (due to low base effect). The fiscal deficit for FY21 is expected to deteriorate from the budgeted estimates of 3.5% to 6.6% of GDP. Therefore, in short, the economy has turned into a deep mess and companies will have to function within this gloomy economic environment.

While the Indian government doled out a much touted stimulus package equivalent to 10% of GDP, much of it is in the form of monetary stimulus with meagre fiscal support. With the current fiscal deficit, a large fiscal support is almost ruled out unless we decide to print money and throw it from the helicopter!

Covid-19 has destroyed earnings for companies. The Nifty EPS which was at ₹670 at the beginning of the year is now at ₹550. Overall earnings for the companies is expected fall by 10.6% during FY21 though they are expected to rebound by 30% in FY22. The fall in earnings and the strong market rebound has pushed the P/E and P/B ratios higher making Indian market unattractive to global investors.

With this challenging background, I will try to structure an equity strategy that can be COVID-19 resistant. Here are my five strategy recommendations:

1. **Identify Covid-19 resistant sectors:** We would identify Covid-19 resistant sectors and overweight them in the portfolio. Globally, there are sectors where social distancing has made their business model almost unviable. Examples will include airlines, retail, etc. Secondly, there are sectors that gets impacted both from the demand and supply side. E.g.: heavy industrials. Then there are energy companies that gets impacted due to oversupply. Finally, there are interest rate sensitive sectors like banks, life insurance and asset managers whose profits are tied up to the level of interest rates that plummeted. In the Indian equity context, we can notice that while all sectors fell during

P/E vs. P/B: Which Is Fairer of the Two!

	Trailing	Forward
P/E	20.9 (17.9)	22 (16.0)
P/B	2.4 (3.0)	2.1 (2.7)

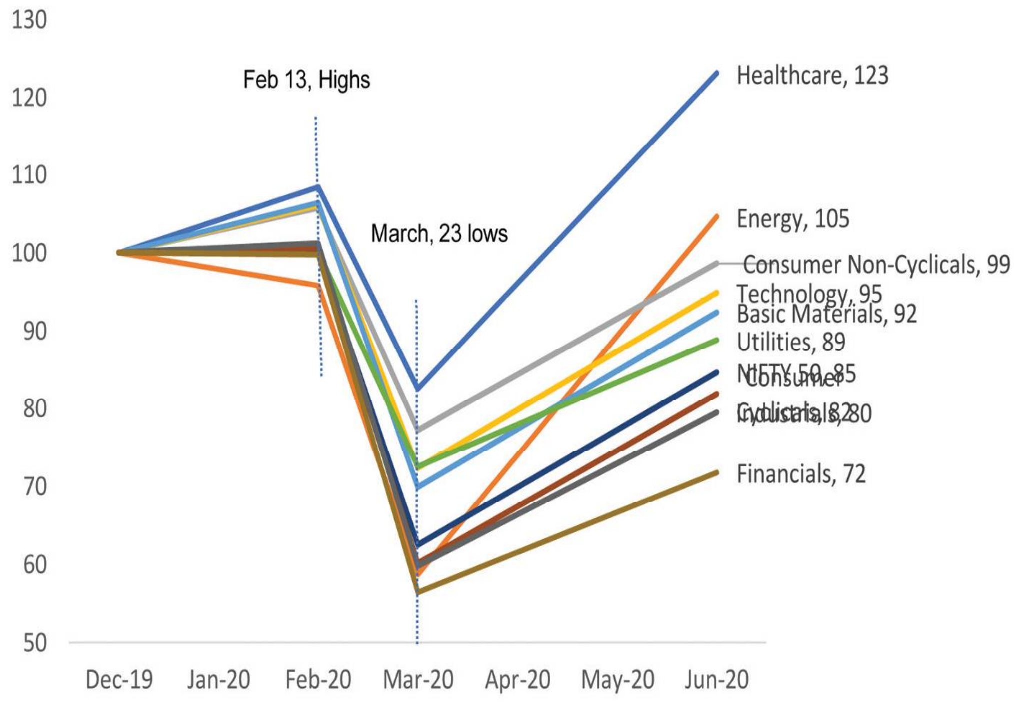
Note: Figures within brackets represent long-term average.

Source: Brokerage Estimates

the fall; some have recovered smartly while others are still licking their wounds.

Healthcare and energy represent two sectors that proved Covid-19 resistant during these times while all other sectors are still in loss, notably financials. Healthcare and consumer non-cyclicals are obvious candidates in these circumstances while the frenetic raise of equity for Reliance Jio propelled the energy index higher though most other energy companies tanked. Technology companies benefitted from digital dependence of people who are working from home.

Which Is More (Covid-19) Resistant?



Source: Refinitiv; Data as of Jun 25 markets close

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2. **Take portfolio insurance:** We have already experienced severe volatility in the market and we should expect more given the global uncertainty how this epidemic will play out both socially and economically. While aggressive asset allocation in the form of moving to cash while markets rebound sharply and vice-versa when markets tank will imply severe market timing, it can also be expensive due to trading costs. The best position would be to buy longer-dated put options or even better buy gold!
3. **Stay liquid**: Cash is king in this environment. Until we see some clarity in the Covid-19 situation, it is better to have them at least 30% cash in your portfolio till the end of 2020. While high cash position will enable one to minimise losses when markets fall suddenly, it also provides the gunpowder to buy quality companies during such times.
4. **Aim for quality**: In times like these, it is imprudent to go after weak companies with high speculative interests. On the contrary, it may be a good idea to take shelter behind strong brands and franchise as they have a higher probability of withstanding business challenges than small companies. Market leaders and owners of brands should be preferred to others.
5. **Volatility can be an opportunity**: Investors should take advantage of high volatility, as there is an inverse correlation between volatility and market performance. Hence, when volatility peaks markets presents great opportunity.

In conclusion, every crisis is an opportunity. While there is demand destruction and supply chain disruptions, there is also some good news in the form of lower cost of capital for companies, which makes investments attractive. The long-term growth story of India is very much intact and crisis like this provides investors with attractive entry points.

Happy Investing! ■

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