Monthly Letter

July 2022

Invest well. Celebrate life.

We were -3.8% in June vs -4.8% for the NIFTY50. For the rolling 12 months ending June 2022, we were -6.3% vs +0.4% for the NIFTY50. We continue to hold elevated levels of cash in portfolios of approximately 25%, as markets trade below their long-term averages and the proverbial 'death cross' (short term moving averages crossing below the long term average) suggests that the long-term trend is still down. We have been repositioning ourselves towards domestic-facing sectors, and reducing allocations to global-facing sectors, as we believe that the Indian economy is likely to outperform the global economy going forward. The world economy is now staring at 'stagflation', and we believe that India will be impacted by the global slowdown, however, India should still manage to grow in real terms at 6% to 7% this fiscal year.

The big positive for this month has been the continuing correction in commodity prices, which are now down by 20% to 30% from their peaks (steel prices are down from Rs. 78k/ton to Rs. 58k/ton, copper is at 17-month lows). The expectation of a global slowdown, thawing of supply chains, and export taxes imposed by our government, have been the primary reasons for this. Supply-side inflation, which has been the biggest negative for our economy over the first half of this year should ease up with this development, a notable indicator is the freight rates, which are now down approximately 36% since the peak in May. Commodity price inflation has impacted corporate margins, as all of it could not be passed on to consumers. The price hikes taken to offset the same, have impacted consumer demand in sectors like FMCG and white goods. Thus, we see corporate margins recovering and demand stabilising in the quarters ahead.

The most critical of all commodities for India is crude oil. While it too is down from its peak by about 15%, it remains the single biggest risk to our economic growth. It impacts all industries to varying degrees as well as consumer spending power and is primarily responsible for our worsening balance of payments position. Our currency depreciation is also closely linked to the elevated cost of crude. We believe, that if crude prices fall further then there is a good chance that the bottom seen in June of 15300 on the NIFTY50 is the worst of this fall. If crude oil prices remain elevated or harden again, we may retest these levels and breach them.

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prodigy INVESTMENT MANAGEMENT

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While we have seen our currency hitting a new low against the USD and our market correcting significantly in the weeks and months gone by, India has stood tall in the face of global turmoil, outperforming many other currencies and markets.

Domestic high-frequency indicators remain robust. Strong advance tax collections, rising PMI (Purchase Managers Index) and GST collections, suggest that we continue to grow despite inflationary pressures. The monsoons appear to be on track, credit growth is strong, commercial vehicle sales are improving and inflows from domestic investors into mutual funds remain steady. All factors that a market needs to put a bottom are in place. FPI selling remains the most significant headwind, once again, hitting around Rs. 35k crores in June. We hope and believe that this should ease up in the months ahead, as the relative attractiveness of India's growth will increasingly stand out in a global slowdown, as well as the relative unattractiveness of other markets like China (due to their investor-unfriendly policies and political positioning), may result in a rebalancing of a portion of global investor flows towards us.

Given the easing chip supply situation, cut in fuel taxes, and improving demand, we have increased our allocation to automobiles and automobile ancillaries to over 10%. The commercial vehicle cycle is on the upswing after many years, which is also a positive lead indicator for domestic economic growth. We expect the automobile sector to be one of the leaders in the next up move.

As we enter the Q1FY23 earnings season, we hope to catch some positivity in business outlook from the corporate sector, on the back of the fall in commodity prices.

Thank you for your support.

RC

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