Monthly Letter

June 2021

prodigy INVESTMENT MANAGEMENT

Invest well. Celebrate life.

We were +8.3% in May, vs +6.5% for the NIFTY50. On a twelve-month rolling basis, we are +91.9% vs +62.7% for the NIFTY50 (based on TWRR mandated method, post fees). The returns for the year look exceptionally high due to the low base last year, due to the post lockdown crash, and this is likely to normalise in the month's ahead. The low-hanging fruits have been plucked and we see ourselves now having to grind it out going forward. Markets may have run up somewhat ahead of earnings revival, and therefore, we believe that the period ahead may see more muted returns. The focus is always on execution of processes on a daily basis, and the results are simply a by-product.

The second wave appears to be subsiding as fast as it arose; a positive surprise. Alongside this, there now seems to be much greater visibility on the vaccine supply side. Hospital beds and oxygen are no longer in short supply. This is a sea change from where we were just a month ago, and doubtlessly a very big positive for investor sentiment. FPIs, who were sellers for the first half of May, appear to have also turned buyers in the second half of the month, as the wave has receded.

The just concluding earnings season for Q4 of FY20-21 suggests that there is likely to be a strong economic revival once the Economy reopens after the second wave, as was witnessed once the first wave subsided. The signs are all there. The strong revival in demand in Q3 and Q4 of FY20-21, is a harbinger of the same. So while Q1 and, to some extent, Q2 of FY21-22 will be impacted by this second wave, businesses expect that from the second half of this financial year, the Economy will bounce back; driven by a resurgence in both, pent up and new demand. A likely pick up in the vaccination drive in the next few months, will also give confidence a big fillip. Fortunately, the economic impact this time has been significantly less than last year as the lockdowns were neither as stringent nor as coordinated as in the first wave.

Some of the trends that were engendered by the first wave of Covid-19, have been cemented by the second wave, producing structural changes that are likely to persist going forward. The biggest one is the shift of business from offline to online. Hardly any form of economic activity will remain untouched by this trend, and even the most unsophisticated users of digital mediums have been forced to learn, becoming comfortable with this new mode now. This is mostly a one-way street (the access to the CoWin app is a glaring example of how digitisation is forcing people to go online). The second significant acceleration has been the migration to the organised sector from the unorganised one. Many weaker businesses that managed to survive the first wave have been swallowed by the second, as a lack of digitisation, financial and managerial strengths have been exposed in them. This is a big reason for many listed companies experiencing a stronger than expected growth in the last two quarters.

Other examples of sectors gaining from this pandemic are home improvement, home appliances and real estate facing sectors. As work from home is becoming prolonged and is likely to continue in some form even when the world returns to normal, people have realised the need for more space and conveniences at home. One reason we have done well is that we have managed to identify and participate in these trends meaningfully.

The elephant in the room remains inflation. We have seen such large reflationary efforts by Central Banks globally; and now with the return of enlarged stimulus-driven consumer spending, along with a restricted labour force, many feel that the return of inflation in the medium term is inevitable. While the Federal Reserve remains dovish, the rise in gold prices recently seems to suggest that markets believe that the threat is real. Should it happen, it is a real danger to global markets which trade at elevated valuations. India will be impacted by the reversal of global flows that would ensue as interest rates rise. We will have to take it as it comes, as predicting the same is not easy to do. Besides, if India is able to establish a strong economic bounce back post-pandemic, the effect may be muted.

The other risk is that markets globally appear to be moving more on retail participation at the moment than institutional money. This makes markets more vulnerable to sharp corrections, as much of this rise may be fuelled by leverage. Some of this is evident in the ‘meme stock’ phenomena we are seeing, in the form of GameStop and AMC in the USA.

The volatility in cryptocurrencies may also be a sign of this. The sharp rise in new demat accounts in India suggests that the same is happening here too. All this is another reason to be cautious in the near term.

All in all, while we have done well over the last year, we feel we need to stay alert and be alive to the fact that when things look hunky-dory is when we should be chary.

Thank you for your support.

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