Monthly Letter

November 2021

prodigy
INVESTMENT MANAGEMENT
Invest well. Celebrate life.

We were -1.2% for October versus +0.3% for the NIFTY50. Over the past few months, our holdings have been in a corrective phase after their significant run-up in the earlier quarters. We are making some changes in our allocations with the economic recovery strengthening; as fears of a third wave recede. This recovery is creating a rotation into sectors that are more economy sensitive. Notwithstanding this rotation, we find that the overall risk in the market has risen in the near term, and our stance going forward will be measured and cautious.

Many factors make us feel this way. While we do not believe the rally is over, or that one should exit the market, we believe that we may be entering a period of volatility, consolidation and intermediate correction. We would be happy to be wrong on this. The primary reason for this feeling is the across-the-board severe margin pressure visible in the ongoing earnings season. This is essentially arising from an unabated rise in raw material costs, freight hikes and wage pressure (the job market is so hot that attrition rates in a sector like technology have hit 25% for many mid-sized companies). While these factors appeared to be transient in nature a few months ago, we find that they have persisted and become stickier than anticipated. Fortunately, the strength of the recovery and buoyant demand has allowed for a significant part of this cost pressure to be passed on to consumers. We feel that a point is near when demand itself will be impacted. It is evident in the margin drop that most businesses have not been able to pass on these costs entirely. Secondly, we believe the ongoing IPO rush is likely to drain the market of a lot of the liquidity that it needs to sustain the current levels, and the growing pipeline of IPOs appears daunting (the fact that many of these IPOs are largely an exit for early-stage investors at a huge gain and seemingly super elevated valuations, may be the red flag pointing to a correction, as has been so many times in the past). Thirdly, we find the quantum and consistency of FPI selling to be of concern, especially with liquidity now getting shared with the primary market. This may be a sign of their belief that interest rates at a global level are likely to harden and the carry trade thus getting stressed. The US Feds tapering ahead is a sword of Damocles. Lastly, The RBI is sending signals that the excess liquidity it pumped into the economy last year to sustain it, is likely to be withdrawn slowly, and interest rates may harden a bit. When these factors occur with high market valuations, we need to be cautious. We find our quarterly pay-out approach works well in these times, as a reasonable part of the gains over the last six months have been booked and returned to those who have opted in for this avenue.

Against the backdrop of all this, the economy continues to recover sharply. High-frequency indicators, like e-way bills issued, fuel sales, air traffic statistics, exports, GST collections; all point in the right direction; notwithstanding the lower sales in the auto sector due to chip shortages. However, we feel much of this is in the valuations in the near term, and thus the caution.

With the plethora of large tech IPOs that have come to market recently, starting with Zomato, and with the extant pipeline of more such new age internet business IPOs, we are seeing an interesting and landmark development for our market. Before this, these businesses were the preserve of the private equity players. Even though these companies are going public at nosebleed valuations, and 'Smart Money' seems to be selling to 'Dumb Money', it is opening up an altogether new avenue for retail investors going forward, and creating a genuine Indian Tech and Internet Sector. Thanks to the pandemic, India has had a record number of 'Unicorns' taking birth over the last year and these are now getting listed. Once these businesses list and the dust settles post the IPO hype, we believe it is likely to present wonderful opportunities to make money over the next decade. We will be patient and let the euphoria fade before we start looking for something of value.

Thank you for being on this journey with us. Happy Diwali to you and your loved ones!

RC

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