Monthly Letter Apr 2020

We were down 15% for the financial year ended 2019-20, versus a fall of 26% for the Nifty (Nifty Midcap 100 down 36%, Nifty Smallcap 100 down 46%). For the month of March, we were down 22% vs 23% for the Nifty. In spite of starting to sell from early March itself, we were impacted by the severe fall in front line financials like HDFC Bank, ICICI Bank and Bajaj Finance, which as much as halved in a space of weeks, as the financial sector is likely to be the worst impacted of all sectors in this period of the lockdown and in the months ahead (only worse than financials would be sectors like Aviation, Leisure and Entertainment, where we do not have any exposure). The speed of the fall from the peak has been the fastest amongst all crashes going back many decades, which highlights its intensity. As of date we are in 35% cash (parked in overnight treasury funds), which should cushion us from any further deep correction. We believe that a large part of the fall is over, but a second leg in the months ahead, may carry us further down once the true extent of the impact on earnings becomes visible down the line. Therefore, we prefer to be sellers on any pull back rather than buyers just yet.

To combat and cushion the impact of the economic shock, Governments and Central Banks globally have been rolling out significant monetary and fiscal stimulus packages, much larger than those announced in the aftermath of the Global Financial Crisis of 2007-8. The combined package in the US amounts to ~20% of GDP, and more is expected as the crisis deepens there. However, the package announced here, pales in comparison, and much more has to come through in the days ahead to combat the tailspin the lockdown has put our economy into.

How severely and for how long we will be impacted depends on how soon the lockdown is lifted. That would be our first sign post. We are hopeful, going by how things appear as of today, that the lockdown will be lifted after it completes 21 days, in stages except for the hotbeds of the virus that should be evident by then. This is the best-case scenario, and should that transpire, it would allow the economy to recover over the coming quarters. While pent up demand post lockdown would provide an initial push to the economy, we believe the second order impact is what is likely to make a 'V' shaped recovery highly unlikely, notwithstanding the stimulus packages announced. The severe shock to the cash flow cycle for businesses, the job losses, the migration back by informal economy labour which will need to be re-mobilised, the rise in bad loans for the financial system; is all going to make an economic recovery a slow and painful process. This event will make the formal and well capitalised businesses stronger, and hurt the leveraged and informal sectors once again, as it happened with demonetisation and the introduction of GST. An economy that was just recovering from these structural changes, has once again been severely impacted. Thus, we believe the recovery, in the best case, is going to be a long and slow one. More like an elongated 'U' shape. The world economy is already over leveraged, which will make the impact more pronounced.

Looking at how countries have responded to the spread of the virus, it would appear that India has been one of those that has handled the oncoming crisis better than many in the developed world. If a lockdown was the only way to 'flatten the curve' then we have triggered it at the right time. Any later and it would have been diluted, and maybe also for much longer. Thus, we appear to in better position to recover from the health situation aspect than many advanced economies. India could also now appear more attractive as an investment destination for foreign investors, given the fiscal changes to our tax structure over the last six months. However, much more of a fiscal stimulus is needed to aid an economic recovery.

We believe the stocks we hold will participate fully in the recovery when it happens. We have invested in strong businesses which have a robust business model and cash flows. No matter how bad the current situation may be for them, the fact is that this too shall pass, like the many Black Swans we have navigated before. This is likely to become an opportunity to buy great businesses at a reasonable price somewhere down the line, and we are positioned to take advantage of the same. For now, the market volatility is too high and the economic outlook is too hazy to attempt anything more than making a shortlist for the future. We are still in sell mode on any pull back. If and only if a cure is found very soon, that allays all future fears of this virus, will we be interested in the near term.

We are committed to recovering all lost ground once this period is behind us. We have been through more Black Swans than most, and have always emerged stronger.

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Disclaimer

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