Navigating a Choppy Market

Dear Fellow Investors,

In my last note issued in November '21, I had mentioned that while the market has recorded such strong gains over the 18 months that future gains would be muted. I had anticipated a changing market climate. The market was supported by low-interest rates in India and abroad. But there was a growing perception that we are exiting the low-inflation, low-interest regime and headed towards a higher-inflation, higher-interest regime. Indeed, the US Federal Reserve in its meeting in December announced that it would taper off its liquidity support and also talked of three hikes in interest rates this year. The stock market has been selling off in anticipation, right from 19th October.

Along with a change in the perception about liquidity and interest rate, a new Covid variant Omicron pushed the market down. Banks stocks were hit the most as a result of the Fed announcement. Our portfolios have been less affected by the decline in financials because we hardly have 5-7% exposure to financial stocks in each of the schemes.

In the last quarter's note I had mentioned that I would follow three main strategies: diversify a lot, increase profitable churn without increasing risk and vary cash position. We have implemented all three with good results.

One, to derisk the portfolio as well as to not miss out on the new growth stocks, we have taken much smaller positions across 5-6 promising new stocks. Almost all our new holdings have been up, during this volatile period (such as Birla Software, Mirza International and Gland Pharma in Growth and Gujarat Fluorochemicals, CG Power and Globus Spirits in Prime) or at least done better than the indices. Our focus remains on high-quality companies from sectors that have tailwinds, and are exhibiting strength. There are a couple of older picks in the portfolio that continue to languish but these are such exceptional businesses at attractive valuations, that we will have to give them some more time.

Second, we have taken shorter-term positions in one of the largest and safest segments of the Indian market – the mega-cap software stocks. This has paid very off well in Prime (Tech Mahindra and Wipro) and in future, will pay off for Growth as well. As we said last time, this strategy will be limited to maybe 20-30% of the portfolio. Third, we had 15-20% in cash at least, before the market headed down in December and deployed them successfully in mid-cap stocks and software stocks, which have done well.

This would remain the standard strategy for some time now – raise cash as and when we think the market looks toppy and redeploy the cash across multiple high-quality stocks that are the strongest. I am hoping that we can play these cycles multiple times in a year. We hope this will give us an edge in navigating the choppy market that I suspect may continue for a long time. We had also said we would buy protective Nifty index puts to hedge the portfolio when anticipating a significant correction coming up. This strategy will be used very rarely. We could have used it in December but we didn't. We will deploy this in the next correction when we hope to put 0.5%-.75% of the portfolio value in protection. If the market does go down, the protection can be substantial but if it doesn't, we lose very little.

While our strategy has changed, one thing that hasn't is the opportunity we see. India has now hundreds of outstanding companies listed and investors are spoilt for choices. The IPO route has brought at least 30-40 excellent companies over the last two years. While these are expensively priced, there is no denying the quality of their robust business models. Some of these would be part of our portfolio at the appropriate time.

As we head into 2022, we are hoping to see the end of the pandemic (since the latest variant, Omicron, is a weak one, though highly transmissible). However, if we think that that the end of Covid-19 will be great for all companies across the board, we may be in for a surprise. Remember, the impact of Covid-19 turned out to be exactly opposite to what we all had anticipated. No one expected the best possible corporate performance in the last decade and a soaring index when the world came to halt. While the end of Covid will be great for 'social-contact' businesses like travel, tourism, hospitality and entertainment, we don't know whether other businesses would continue to boom, as costs would go up sharply. Obvious correlations and forecasts often fail. This is why we don't forecast. We simply focus on medium-term profit trends and market direction. I hope you had a great year-end holiday. We wish you a very peaceful and prosperous 2022.

Debashis Basu,
Founder & Principal Officer