



# Between Trump and a Hard Place

Dear Fellow Investors,

Last week was brutal for mid-caps. Trump's 100% tariff on branded and patented drugs sent our high-quality contract research and development (CRDM) holdings tumbling. As usual, the market didn't bother with nuance—purely domestic healthcare stocks also got sold off for no reason other than herd instinct. The only consolation: we've stayed clear of plain-vanilla IT for years, so the H1-B visa mess didn't touch us. Even though we had warned of poor future returns last September and raised cash, our recent purchases are hurting. Hence, it is time to share my thoughts. Another reason for this memo is that a few new investors have joined us, and they may want to know my views on the market outlook and the health of our portfolios.

First off, I have been neutral to bearish about the Indian markets and economy. The Indian market structure has become lopsided, for multiple reasons:

1. Retail flows have flooded in at the worst possible time, inflating mid- and small-cap valuations.
2. Large companies face intense competition, high costs, and weak demand.
3. IPOs continue to arrive at nosebleed valuations.
4. The economy isn't structurally improving, despite cosmetic reforms and record government spending, as I have written in my columns (<https://moneylife.in/author/debashis-basu.html>).

The government has become an even bigger player in the economy through a massive tax-and-mispend process. At the ground level, it may help some companies at certain times but cannot create a secular trend. Just look at the stock prices of construction, infrastructure and railway-related companies—sectors that should have produced big winners from unprecedented government spending over the past three years. Last October and early November, I wrote three articles pointing to a clear economic slowdown in India, which also indicated a weaker stock market. A fourth article in mid-November was titled *More Dark Clouds Gather* (all links below). One year returns of all major indices have been negative.

Where there is clear growth, and wise capital allocation, valuations are still expensive, despite significant correction over the past year. Where valuations are more reasonable, Trump shows up to thump our heads. While I belong firmly to the “nobody knows anything for sure” camp, and have trained my mind never to forecast, I am inclined to believe that Trump's tariffs will backfire badly on the US. Indian pharma companies are likely to emerge stronger over time.

And no, GST 2.0—billed as GST Bachat Utsav—will not make a difference. Supposedly “a bonanza for 140 crore Indians”, it will be a damp squib. The reason is simple: raising consumption beyond its already hefty 60% of GDP is hard without far steeper tax cuts, which the state cannot afford. After all, the main economic strategy of this government has been to tax heavily and spend it on infrastructure, railways, defence and social schemes. Also, much of the consumption leaks abroad through imports from China. Finally, household debt has shot up

---

over the last few years, job growth has been poor, wages have remained depressed and households are burdened with huge taxes, tolls, cess etc. that has dampened household consumption for years now.

## Trump's Cards

Trump is right to rant about the real issues facing America today. Immigration is out of control, healthcare and insurance companies are scamming people, and big food companies are making them sick. Manufacturing has hollowed out, with the US relying on imports from Europe and Asia for nearly all its daily needs. Its dependence on China has become a national security issue, since China controls the supply of rare earths essential for defence equipment.

What has kept the US going is the exorbitant privilege of the dollar as the global reserve asset. This allows US politicians to run the country on massive debt—both private and government. US debt has now surpassed \$37 trillion, a 68% jump since 2019. Without the ability to issue dollar debt—eagerly bought by the rest of the world—the US would not have been able to finance its imports and would have weakened, looking more like England, Italy or Spain: not even regional powers, let alone a global one.

It is not that US policymakers are unaware of these challenges. Trump's first term identified the same issues, calling China enemy no. 1. Biden's administration continued with Trump's China tariffs and the policy of curbing China's rise. Trump's isolationism is also not new. Under Obama, the US stood by as Russia annexed Crimea from Ukraine. At home, Biden's Inflation Reduction Act was classic industrial policy to boost local manufacturing and jobs. Trump, out of spite, gutted it. Meanwhile, China has proved unstoppable. Despite Covid, it has made massive technological advances in areas targeted under Xi Jinping's "Made in China 2025" strategy. The US responses now look panicky and defeatist.

Trump returned to power promising quick fixes: trade deals to re-establish US hegemony, boost revenues, control debt, and reshore manufacturing. But what he has unleashed has shocked even hardened policymakers, investors, and bureaucrats. When he was President-elect, I had noted: *"It would be suicidal to assume that his promised actions would be tempered by realpolitik or bogged down in the Washington 'swamp' or 'deep state'. Even if a part of Trumponomics is implemented, it will hit the rest of the world like a tidal wave."* That is exactly how it has turned out.

## The Silver Lining

Trump has correctly diagnosed America's ailments, but diagnosis does not guarantee a cure. His first term achieved little. Now he is cutting the Gordian Knot, bypassing Congress and issuing administrative orders at will. But the US is not a monarchy. Many of these orders are illegal or in a grey zone. Several have already been overturned in court, and the Supreme Court will hear arguments on the legality of Trump's tariff orders in October.

Second, you cannot make a country competitive through a recursive stream of consciousness that is combative, simplistic, unstable, nativist, and improvised. Nation-building is a slow, painstaking and long-drawn process of following a long-term plan and dogged implementation. This is why the number of countries that have achieved significant economic transformation in one generation is ridiculously small. Over the past 100 years, only Japan, Taiwan, South Korea, Singapore, China and Germany after the Second World War have been able to dramatically change their fortunes. No South American or African countries have "broken out" of their "normal" cycle of growth. It is hard.

Getting to an upper-middle income or rich world status requires building competitive strengths ground up through sustained high quality of education and research, a close cooperation between industry and government working under a common industrial policy, rewarding efficiency and innovation, continuously ‘learning by doing’, all the while avoiding making stupid fiscal and monetary mistakes. This is the recipe of successful nation-building from the past. Conversely, no rich country of last century have been able to reverse its fortune once it started to decline. Bullying, arm twisting, threatening, bad mouthing, insulting, announcing rash far-reaching public policies in social media are miles away from the correct and sustained policy steps.

Which is why, though wary of predictions, I believe Trump will fail to reverse America’s decline. He may curb immigration, but he cannot make the US more competitive. Reshoring will not happen. Inflation will rise. Last week, he targeted branded drugs, but the real rip-offs are in hospitals, insurance, and clinical services. US hospitals collected \$1.5 trillion in fees in 2023—three times the amount spent on drugs and one-third of total healthcare spending. Since 2000, hospital prices have soared 250%, far outpacing both medical costs and inflation. Can Trump fix this with a social media post?

Companies pledging to invest under Trump’s threats have no intention of sinking billions into uncompetitive US facilities, knowing another election looms in just three years. If this analysis is correct, the pain for Indian CDM companies will be temporary. That does not mean our portfolios will recover quickly. I cannot predict when Trump will start to look like a lame duck. But history suggests it will not take long. Recall how quickly he realised China had outplayed the US, before backing down—earning the nickname “*Trump Always Chickens Out*” (TACO).

## Our Approach

Against this backdrop, we are sticking to our core approach: buying stocks with earnings growth ahead. These remain in hospitals, green energy, CRDM, outsourced manufacturing, electricity distribution and some auto ancillary stocks. We are also increasing our hedging, which has worked well over the past three years. I am looking forward to adding some extra returns through this route. Unfortunately, new opportunities are scarce, given weak growth and high valuations. We will have to be patient until better risk-reward setups emerge.

With greetings for the festive season,



**Debashis Basu,**

Founder & Principal Officer

### Links to my old articles on the Indian Economy & Markets

11 October '24: <https://moneylife.in/article/economy-glass-permanently-half-full/75319.html>

25 October '24: <https://moneylife.in/article/economy-back-to-normal/75432.html>

08 November '24: <https://moneylife.in/article/the-economy-is-running-as-it-is-supposed-to/75536.html>

22 November '24: <https://moneylife.in/article/market-more-dark-clouds-gather/75654.html>

