kotak Mutual Fund

HELLO!

Expert Speaks

Dear Friends,

The year gone by was the toughest in terms of making money. Start of the year was marked by high optimism reflected in valuations, which were above historical average by a margin. Rising oil prices, depreciating Rupee, Rising Interest Rate, Default by IL&FS, tight liquidity and FII selling resulted into crash in small and mid-cap stocks and correction in large cap stocks. However, among all the gloom corporate profitability kept on steadily improving. When everything was looking lost, suddenly oil prices corrected against all expectations. Drop in oil prices brought stability in Rupee and brought back FII flows. OMOs done by the RBI improved liquidity condition from extreme negative to negative. Drop in inflation and US Feds unexpected turn around on future course of Fed rate hike pulled Indian interest rates down by a significant number. Appointment of professionals to run IL&FS along with timely action by the government to contain NBFC liquidity squeeze has helped economy regain its growth momentum. Indian economy is at an interesting stage. Last few years structural reforms like GST implementation, Demonetisation, Insolvency Laws, Transparent Auctioning of Public Resources, Digitisation, Formalization of Economy through expansion of tax base etc. has created short term pain in terms of disruption and higher compliance cost. The long term benefits of the same are accruing in the years to come in 2019 and beyond. Indian economy also went through a transition where The RBI was transitioned from being an all-rounder to a specialist. Before 2016 the RBI was managing with remarkable success conflicting objectives like Rupee, Growth, Interest Rates, Inflation and Banking Sector stability. We ignored the adage don't repair what isn't broken. We adopted western world standard of inflation targeting and mandated the RBI to manage Inflation and Growth. In the early days to establish the credibility as Inflation Hawk and bring down the double digit inflation, the RBI controlled quantity of liquidity as well as price of liquidity. Real interest rates remained high and banking liquidity remained tight to bring down inflation within the mandated range. While RBI was extremely successful in bringing down the inflation, the inflationary expectations remained higher. High inflationary expectations pushed the RBI to pursue tighter monetary policy. This put a speed breaker on growth as quantity of liquidity and price of liquidity remained non supportive. Around same time The RBI started cleaning the banking system from the menace of non-performing loans which was long overdue. In absence of adequate capital , cleaning up took its toll on transmission of Credit depriving sectors like real estate, infrastructure, construction and NBFC of vital Credit flow. 2018 was a year where Indian Economy ran with a hand break on. There is an exciting opportunity in front of India through US China tariff war. In the 80s India and China were of similar size. China became manufacturer to the world. We missed the bus. Today China is about six times bigger than India. Due to tariff war many companies are moving out of China. If India can attract those manufacturers, our exports can take a quantum Jump and we can expand manufacturing base to create inclusive and faster growth. Indian economy can move to double digit growth in years to come due to the structural reforms undertaken in the past. It will require supportive liquidity, smoother transmission of credit and reasonable interest rates. With the RBI on top of inflation, this should be possible. It also require capturing supply chain disruption unleashed by the US China tariff war that will expand our manufacturing base. Indian Economy looks well poised for 2019 and beyond due to low inflation, fairly valued Rupee, under control fiscal and current account deficit and improving banking system. Obviously oil price movement will continue to play a crucial role in impacting Indian Economy. Market movement tracks corporate profitability trend. Better liquidity, lower real interest rates, fair value currency, smoother credit flow and improving capacity utilisation will support higher corporate profitability growth in 2019. The Indian economy, which was running on consumption engine can get a boost from investment side in 2019. With the correction in 2018, valuations have become fair. Small and mid-caps looks little better valued than large caps. Domestic flows slowed down in 2018 over 2017 by a significant amount. Hopefully they will be maintained at the same level in 2019 which will support the market. FII flows turned negative in 2018. It is difficult to take a call on the FII flows in 2019 as there are conflicting factors. India has outperformed other EMs by a big margin. Our valuation is at a historically high premium to other EMs because of that outperformance. India will be the fastest growing major economy in the world. All these factors will impact FII flows. In the past two decades election results have created material impact on market on the day of election result. Over the course of the remaining period elections don't make material impact. The General Election result will impact market on the result day. Market today is pricing in a stable government which will pursue the path of higher growth. From an opportunity point of view 2018 was an English or Australian Cricket pitch where making run was difficult. 2019 could well turn out to be like an Indian Cricket pitch where making runs might be easier. However the basic technique of making runs will remain the same. 2019 looks promising for making money. The basic tenet of long term investment and disciplined investment through asset allocation will hold good for investors.

Thanks and Regards,
Nilesh Shah
Managing Director