

## We will get through this

Equity markets globally have been surprised by the speed of spread of Corona Virus (outside of China). But what really shook the markets (atleast in India's case) is the early response through lockdowns. While the move is much needed, it also creates an immediate and sharp impact on economic activity. While this will hopefully flatten the curve, the visibility around “what happens after April 14” remains low.

When will the peak daily infection rate be achieved in US and in India?

How fast can the infection rate decline from there?

Will the lockdown be extended further if it is proving successful?

Will it be a staggered resumption?

Does it give enough time for vaccine to emerge and improve medical preparedness?

Will the earnings impact last for only 3 months or longer?

Will certain industries take much longer to recover? Will consumption habits change?

**We have summarised our views, potential scenarios and stance on these issues and more below in a Q&A format.**

### **Q. Is there any way to come out faster of this economic slowdown that is about to hit us?**

A. The best case is 8-10 weeks if the lockdown is successful in reducing the increase in infections. Worst case is 6-9 months if community spread happens despite the lockdown and takes a longer toll on the economy and a slow recovery thereafter. But the key is that from a response point of view, India is probably reacting better than some of the more developed countries. When faced with such an unknown uncertainty like Corona virus, it is important to over correct. Like in sports where sometimes in order to correct a faulty technique, a player has to overcompensate for some time in order to become correct in the long term. So 2-3 month disruption would be worth the trouble if it shows results. The problem is that we do not know the exact duration of the lockdown or reduced activity, whether a full lockdown will be followed by a partial one. But eventual recovery in economy is a question of when and not if. Which is why it is important to, depending on the individual situation of the surplus cash as I mentioned earlier, look at equity investments as an opportunity in these times.

## **Q. The markets have been hit and hit very sharply – where does it end, what is the bottom?**

A. Let me begin by making a slightly generic statement that markets are reflecting the deep uncertainty that a lot of us as individuals are facing in our personal lives. If someone is worried about their livelihood and regular income, it is a far bigger worry than investments. Also, like we have seen people hoarding essentials, there is a parallel behaviour in financial and money markets – funds have liquidated investments to sit on cash, at least the global investors. This is reflected in the FII figures during the March. In India, we even saw corporates sell even their most liquid investments to hoard cash and prepare for the unknown needs maybe for their working capital during shutdown. So in a way, beyond a point it is not very useful to try and call exact market bottom in terms of valuation parameters alone – PE, PB, Market cap/GDP – as the markets are being driven by flows in the very short term.

## **Q. So then how should an investor approach their equity allocation and when to increase that, should one wait for the precise bottom?**

A. In the present context, the Nifty forward valuations have become very reasonable (though not as cheap as it was during the Global Financial Crisis) even if one assumes that there will be 10-15% cut in next year's earnings (FY21). Market cap to GDP ratio, while not the best indicator is also at its low broadly indicating higher allocation to equities. How much is a function of the individual's profession, present level of savings to ride through the present slowdown (especially if it gets prolonged) and his/her exposure to equities. Someone who is employed in the travel/leisure industry with say 80% savings invested in equities needs to think hard whether that is too high and should he be raising some cash given the high uncertainty in his employer industry; is the equity market risk worth taking at the same time? On the contrary, a more stable profession say a dentist can afford to be much more aggressive in investing his surplus cash into equities at these valuations. So the perception of the market bottom can be different for different investors depending on their frame of mind. Since the market is made of all different type of investors (including the FIIs) it is therefore very difficult to exactly time the bottom irrespective of the current PE or PB multiples. In extreme cases, markets can tend to overshoot these valuation frameworks.

Considering the valuations and the risks, are we are deploying the idle cash in Tata Mutual fund schemes (approx. 7%) and increasing allocations to equity in the dynamic allocation fund? The answer is YES, on every decline. In every major correction in the last 20 years, in 2000-01 and 2008-09, the outlook has appeared equally uncertain but economies have bounced back from that.

## **Q. What are the structural changes which will happen and that can have an impact on investing themes going ahead for the next 5-10 years?**

A. There is a chance that assuming we get the virus in control globally (say in 2-3 months) which we would tend to agree with, even then the risk of it recurring annually will remain like the seasonal flu. But we will be better prepared for that with vaccines, drugs etc the next time around. However, a pandemic of this scale can trigger 4 fundamental changes in the next 3-5 years which one has to keep in mind while investing in stocks or sectors.

- i. Digital delivery of services, products will only accelerate with likely reduction in unnecessary human interaction. One of the related impact could therefore be a long-term reduction in demand for corporate travel and commercial real estate.
- ii. Health services delivery and increase in insurance penetration (health insurance and term life insurance) will be key as India builds higher level of preparedness for future generations. Infact, one should not rule out special incentives for the private sector too to build this infra as India's expenditure on healthcare is extremely low as a % of GDP right now. As our country ages over next 10 years, this will become even more important.
- iii. There is also a view that an event like this will promote more “savings” and discourage “consumption driven by personal loans”. While there would be some impact on discretionary purchases in the next few months, we would worry less about an overall consumption slowdown in a country like India where penetration in a lot of categories still remains low.

- iv. India will also benefit from higher contract manufacturing as global companies diversify their supply source away from China. Government's recent steps to promote the same would help. This could benefit companies in Chemicals, Pharma intermediates, electronics and consumer durables.

**Stay Safe, Stay at Home and we shall meet soon!**

**Happy Investing!**



**Rahul Singh**

*Chief Investment Officer (CIO) - Equities*

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