

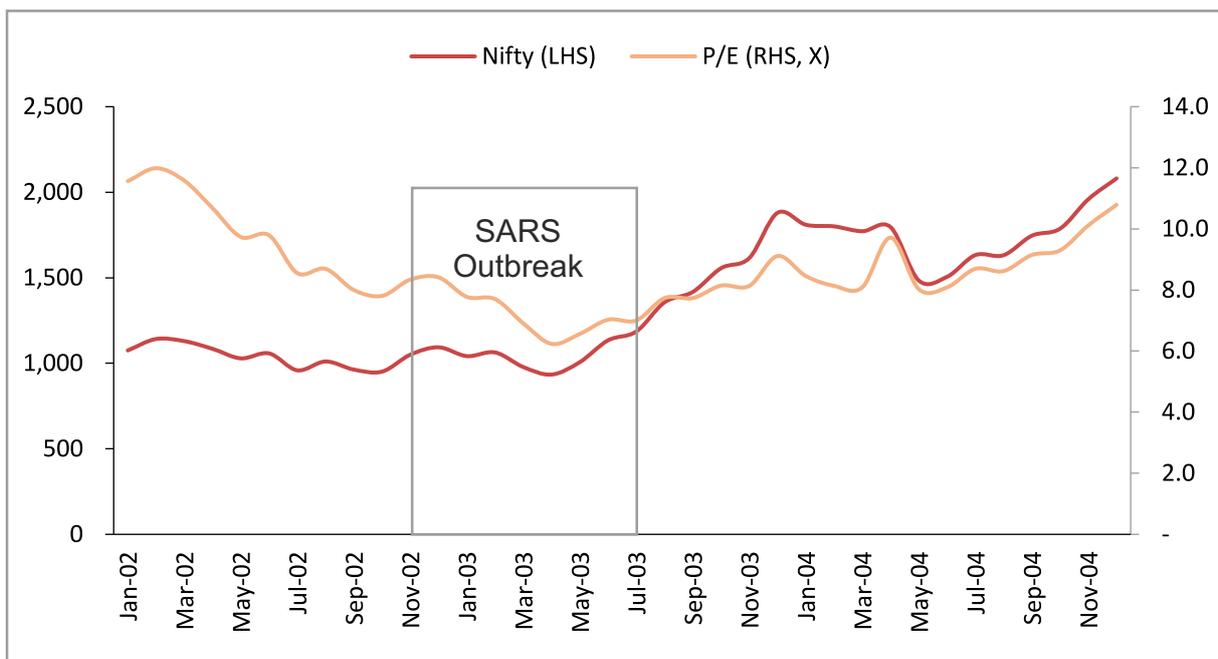
## What does Corona Virus mean for Indian Equities?

No two pandemics are alike, and Corona Virus has proved that – it is more contagious and has spread faster than other diseases that have impacted the markets in the last 20 years. Although the fatality rate has been much lower in Corona, the scale has been much bigger than previous such instances of SARS/H1N1/Ebola. While there have been comparisons made on the extent of market correction (for example, in the case of SARS, Sensex corrected 14% between November 2002 to July 2003), we believe that it cannot and should not be taken as an indicator.

### SARS vs. Corona – Different diseases in different economic scenarios

In the case of SARS, the correction was followed by a sharp domestic and global economic recovery which helped equity markets after 2003. This was aided significantly by the attractive PER valuations of <10x in 2003. In the present scenario, while the PER valuations of Nifty have corrected to a more reasonable level of 18x which is also the 10-year average, it is still not in the attractive zone. So, the recovery after the correction from the Corona virus impact could also be slow and gradual, in line with the economic recovery. Even from a global context, ample easy liquidity has supported equity valuations at higher levels over last 10 years, which is very different from the 2002-03 scenario where valuations were cheap after the correction post the tech bubble.

### Market movement vs. 1-year forward PER multiple of Nifty-50 (2002-04)



Source: Bloomberg

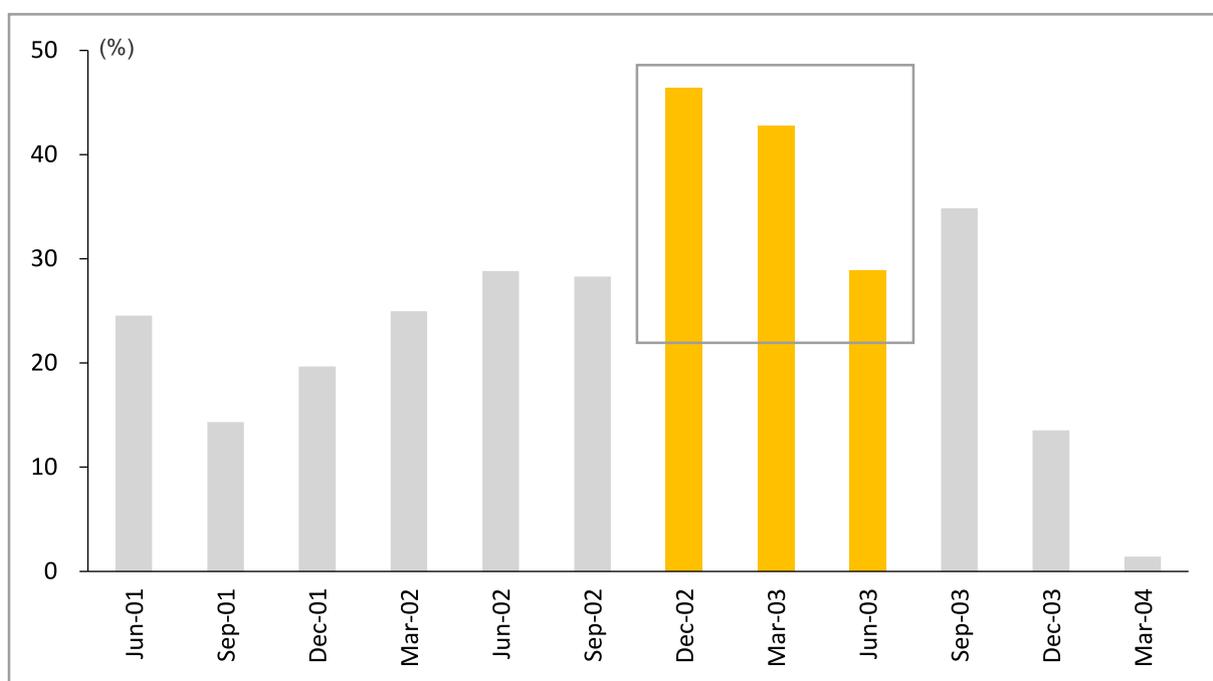
## What is the impact on Indian economy and earnings?

India is relatively insulated given the relatively weaker link to Asia's supply chain. Given that the incidence of Corona virus has been surprisingly low in India (probably aided by under-reporting but also helped by warm weather) and assuming that it does not increase in the coming weeks, we prefer to analyse the impact of a global slowdown and possible China linkages on the earnings of specific sectors instead of a broader impact on India's economy as of now.

China is a large supplier of raw materials, components and intermediates for textiles, pharmaceuticals, chemicals & consumer durables/electronics. Decline in Chinese export capacity will impact India's output and exports from these sectors. Our interaction with Indian corporates however indicates that the inventory levels are adequate and some of the Chinese capacities are coming back gradually and they don't expect the situation to get worse. Earnings of commodity driven companies however would be impacted as global slowdown has impacted commodity prices including crude oil.

While India is still at risk of Corona virus spreading widely in the country and the earnings impact can be much wider than what we have discussed above, it is interesting to note that the earnings growth of BSE Sensex companies remained quite robust during the SARS outbreak in 2002-03. One word of caution here is that SARS was less infectious than what Corona is proving to be, therefore India is not completely out of danger.

## YoY quarterly earnings growth of BSE-30, FY2002-04



Source: Bloomberg/Kotak Institutional Equities

## Current account balance to gain

Corona virus and its impact on global GDP will keep crude and commodity prices down which can keep the non-food inflation and current account deficit in check. The GDP impact at the global level would be mainly on account of a) drop in Chinese demand, b) decline in Chinese exports due to supply chain disruptions and c) decline in international travel and tourism.

This macro stability on the external front is critical especially when government has been forced to adopt a mild fiscal boost through relaxation in the fiscal targets for FY21. In the medium term, the weak outlook on crude prices and potential for improvement in Indian exports due to shift in supply chain logistics away from China can provide an useful counter balance.

## Domestic economic recovery will be gradual, led by Agri-economy

On the domestic front, the GDP growth slowed down further in the December quarter as consumption slowed down even as investment slump continued. Government expenditure and relaxation in fiscal targets continues to provide support to GDP growth. Meanwhile, there have been green shoots visible in terms of power demand in February and low inventory levels (e.g. Autos) provide scope for support to IIP and GDP growth numbers. However, the biggest driver in the short term is likely to come from the good rabi crop and higher agricultural income (aided by higher food inflation).

In this context of expected gradual economic recovery and assuming no major outbreak of the virus in India, we continue to build our portfolios around earnings stability and identifying stocks with potential to beat earnings expectations thus providing the alpha. Selective bottom-up midcap stocks and rural recovery plays remain in focus.

## Happy Investing!



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