

(Not-so) Great Expectations

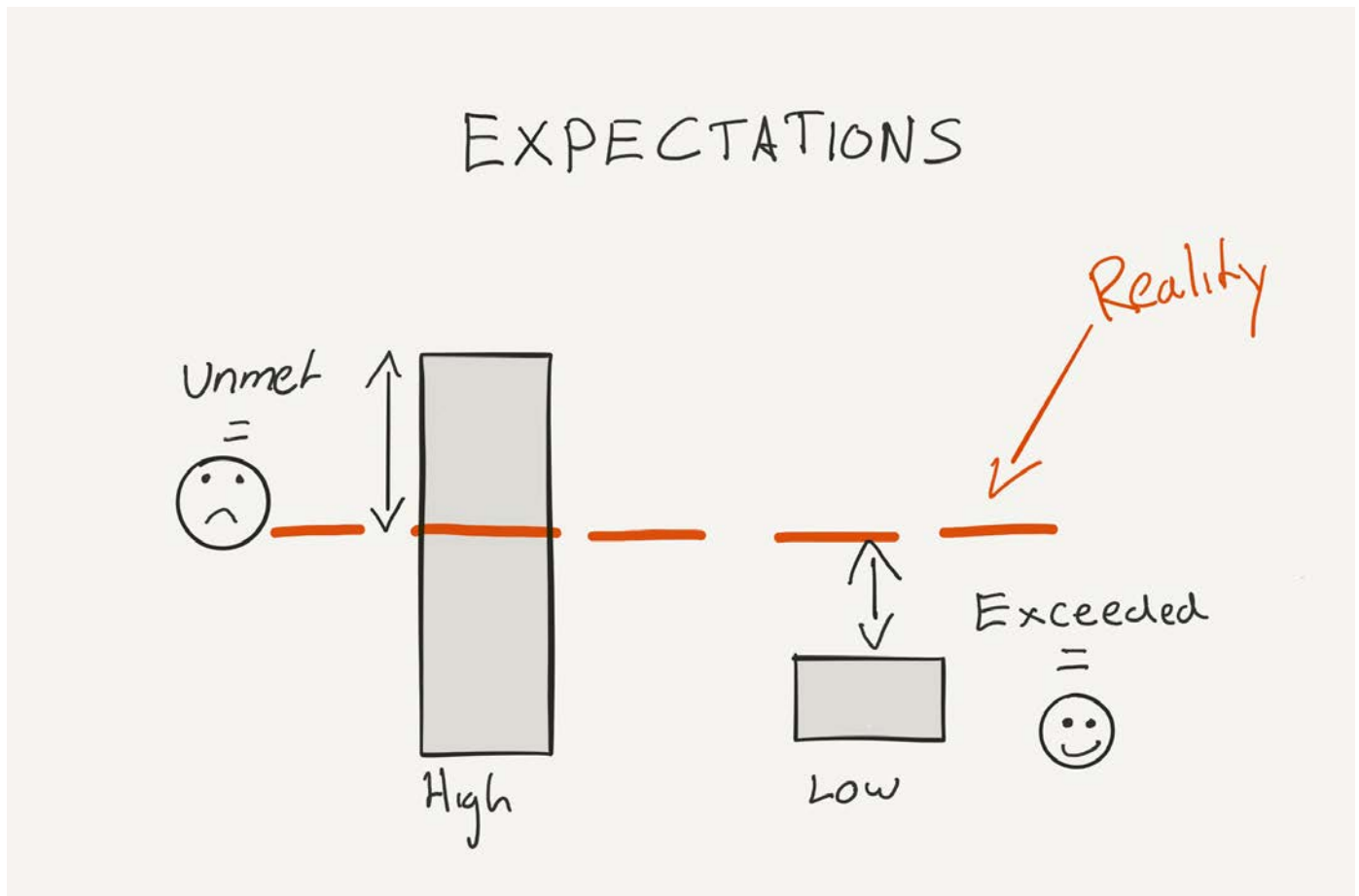


Image Source: *Get Rid Of Your High Expectations* by Darius Foroux

Elections are over and it delivered a stronger than expected mandate. But expectations are relatively moderate with respect to what this mandate can achieve economically. This positions India like a stock with more reasonable expectations and therefore open to upsides (best returns are made when there is a positive surprise). But firstly, why do we think that expectations are low?

One quick recall of the headlines and discussion post-2014 elections (see table below) and comparison with the mood in 2019 proves the point. We believe that the previous 5 years of tepid earnings growth has led to more reasonable expectations unlike the euphoria which usually follows such a verdict. In the weeks and months following 2014 elections, there was a sense of anticipation of pro-business policies, PSU reforms & privatisation, capex cycle revival, land reforms and shift away from conventional government institutions like Planning Commission. As a result, markets had continued to rally well beyond elections with mentions of lofty Sensex targets and rupee doing well too on expected surge in FDI. That kind of excitement is missing in 2019; infact, all eyes are on the immediate need to ease the NBFC liquidity concerns which is partly responsible for the present economic slowdown (GDP below 6% in March and possibly a weaker June quarter)

What did the news headlines say in 2014 (May-August)?

- **Mandate to refashion the country, brings hope**
- **Election mandate heralds new era**
- **Its Morning in India: Pro-Business policies point to strong sectors growth**
- **How new version of Land Acquisition Act will be industry friendly?**
- **Public sector banks rally as government plans to improve risk management**
- **Government scraps Planning Commission**
- **Rupee becomes best performing Asia-pacific currency** (Source: *The Hindu – Business Line*)
- **India's FDI set to double in 2014-15** (Source: *Trak.in*)
- **Modi could be India's Deng Xiaoping, says Arvind Subramanian**
- **Sensex seen at 100,000 in 2020** (Source: *Business Today*)

Despite the lack of exuberance this time around, there is one definite plus from the verdict which forms a strong base for the markets, namely political and policy "continuity". The election verdict has made India more predictable relative to rest of the emerging markets especially given the risks arising out of a prolonged US-China trade war.

Broadly speaking, the relatively low expectations could set the stage for any potential upside surprise from economic stimulus and reforms. Such steps in the form of demand stimulus, tax compliance, labour and land reforms will have positive implications for private capex cycle where some green shoots are visible. Any improvement in the economic activity will further broad base the markets (with midcaps and small caps benefitting more), very different from 2018.

Union Budget in July is likely to be the first event to watch to provide a direction to government's news policies. While the focus on infrastructure and social expenditure (farmer income support, pension) is already known, potential surprise can come from how government creates a demand stimulus or boost private capex cycle.

Meanwhile, over the course of the ongoing March-quarter earnings, we got more evidence of consumption slowdown while some pockets of value like power utilities have done better. Corporate banks are on track for a much better FY20 & beyond and we continue to be positive on them. Infact, the bad loan cycle in corporate lenders has taken long to improve and is on a recovery path independent of government policies.

If (i) the corporate profit trends witnessed in March quarter persist and (ii) government policies are able to lift the industrial activity, then Value vs. Growth debate will become even stronger, something which we discussed in the May newsletter.

Happy Reading!



Rahul Singh

Chief Investment Officer (CIO) – Equities

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