

## How we do what we do?



Now that the dust has settled down post-elections and markets have turned back their attention on the earnings outlook and the present economic situation, this presents us an opportune time to talk about our investment style and process.

The investment philosophy at Tata Mutual Fund is "Growth at Reasonable Price". However, this is a widely used but less understood term. We therefore outline in the sections below what we mean by "growth at reasonable price" and how does it translate into day-to-day investment process for us.

But first let's delve a bit deeper on the two extremes of the investment philosophies

1. **Value** - One extreme end of investment philosophy is Deep Value - when valuation is right, but timing may or may not be right. Also, in case of Deep Value, neither are the immediate catalysts for earnings improvement or re-rating clearly identifiable nor when it would play out is known. Sectors which fall under Deep Value are those where the gestation period of capacity addition is longer, or the demand supply cycle is long. This strategy would typically require greater patience, less concentration and multiple smaller bets.
2. **Growth at "any price"** - At the other end is a philosophy that believes in buying companies with strong "quality" characteristics - strong management, predictable (even if moderate) growth, cash flow generation and capital allocation track record. This strategy at its extreme would ignore dips in the earnings growth trajectory. It works well till the time there are positive earnings surprise but has risks if and when the surprise element wanes relative to the market expectations. Given the nature of stocks which form a part of this strategy, corrections can tend to be more time-based rather than price-led.

While "Growth at Reasonable price" sits between the two extremes, it's a wide spectrum and we have therefore outlined three distinct segments that defines our investment approach.

### I. Value with triggers -

In this case the company is usually trading at multi-year valuation discounts but earnings are in early stages of showing improvements over next few quarters. This could fall under:

- Companies in sectors that were going through a period of cyclical downturn, and has the cycle turning visibly - for example hotels where the occupancy improvement is leading to tariff increase and margin improvements.
- Companies that have been impacted by regulatory or government intervention and there is high possibility of it reversing resulting in earnings improvement in near term - for example power utilities where the recent regulatory changes and other developments bode well.

## II. Earnings Upgrade Cycle -

Under this category of investment ideas, expectations from earnings are low while the fundamentals are indicating a strong and sustained earnings surprise leading to upgrades. Since the starting point for these stocks is not absolute but a valuation that is at a discount to their historical range, the best returns are made as a combination of earnings upgrade plus a valuation re-rating to historical levels (or more). For example, Corporate banks are seeing a sustained earnings upgrade cycle not only from the improvement in their stressed assets but also improving pricing power as a result of ongoing NBFC liquidity squeeze. Such a combination of reasonable value with potential earnings upgrades is unmatched and explains our overweight stance on these banks across our funds.

- Similar Earnings upgrades cycle could be a result of other global factors like for example speciality chemicals benefiting from pollution control in China
- Companies which are going through a strategy refresh with or without management change also are potential candidates in this category.

## III. Thematic -

This segment would typically be more niche or sector specific and possibly involve turnaround candidates. Typical example would be of industries moving on from a hyper competitive phase to that of price discipline (example Aviation). Improvement in earnings in old-generation HFCs due to the liquidity squeeze faced by a large part of others HFCs is another example. This segment would have overlaps with the previous two i.e. Value with triggers and Upgrade Cycle.

## What does our investment philosophy mean in the current context?

Consumption stocks (esp. staples) did very well in 2018 on the back of earnings upgrade cycle, driven by rural growth and aided by GST led cost savings, plus valuation re-rating. One of the theories for sustained consumption has been the growth in jobs in non-agri rural segments especially construction. This along with the NBFC credit led consumption and GST led gains kept consumer staples demand robust in 2017 and 2018 despite pressure on real rural wages. The credit and liquidity squeeze in NBFCs over last 6-9 months along with reduced construction activity during elections has potentially impacted rural spending. If that is true, some of it can reverse post elections with construction activity likely to pick up again. But, given the high base of 2018, staples demand will find it difficult to deliver positive surprise if subdued food inflation (driver of agri-based income) is any indication. Though surprise element in these high growth expensive companies might have gone off, these will continue their steady rate of growth providing a cushion for stock prices not to correct deeply, though time correction is likely.

Meanwhile, we believe that corporate banks will continue to deliver positive surprise given the tailwinds on the interest spreads and incremental improvement in asset quality. Private capex green shoots also has the potential to surprise on the upside given the low expectations.

## Happy Reading!



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