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Leadership has moved from US to Europe and other markets including India: Devina Mehra

Synopsis
"One can have an asset allocation attitude but I do not see outsize risks in equities just now and also sentiment is a contra-indicator. When there is uncertainty, when people think things are going wrong, the next period returns are above average. One just compounds bad decisions by going with the flow and how everybody is feeling."

"Last year was an absolutely outlier year. Now when we had such a disastrous year, the probability is higher that the next year is going to be an up year. Obviously now improbable does not mean impossible, but overall, the world asset classes and particularly equities are more likely than not to have an up year because that is what the data shows. This kind of year does not repeat," says ***Devina Mehra****, Founder, Chairperson and MD,* ***First Global.***

"Our view right now is that the leadership to some extent has moved from the US to Europe and some Emerging markets, India included. We are just watching to see whether that is like a shorter term change in leadership or whether that is going to be a multiyear thing like what happened in 2003 to 2007 when emerging markets went up 3.5-4 times and US could not come out of even its tech crash lows," says Mehra.

What is the market getting so spooked about? Is this just positioning ahead of the Budget?

Obviously the Budget brings uncertainty but I suppose it is also the recent news on the Adani Group that has spooked the market and that has an impact beyond just the group. It has become an overhang on banks also because for banks the whole story has been that the NPA cycle is behind us, but as I always say, even though right now we are marketweight to slightly overweight on banks, I am fundamentally never very comfortable with banks.

In the last interview with you also, I said the same thing that I am always scared of negative surprises in banks. Having been a banker, I know negative surprises hide somewhere and as an outsider, there is no way you can make a judgment on where those negative surprises can come from but then it is the highest weight in the index and that is also a reality.

As a market expert, analysing the selloff in the Adani Group of stocks because of a third-party report, do you think the market reaction is over done?

It is not a group that will follow very closely and so would not like to really comment on it but it is a fairly detailed report with a lot of facts and figures. I hope the Adani Group refutes it with equal rigor in terms of the particular things they have said rather than just a blanket rebuttal.

The selling in banks could also be a factor as the Adani Group of companies have exposure to banks. The debt of Adani Group of companies has come down. Is it also a worry as to what will happen to the debt and what will happen to the banking system? Is that fear for banks overdone?

As of now, it does appear a little overdone. I do not see any pending collapse of this credit. As I said, that is a more generic thing that in banks there are always some negative surprises hiding but the fact also is that in the last few years, a lot of those NPAs have been recognised and provisioned for. Now that the cycle has turned

for the better, I would think that this is a little more of a knee-jerk reaction given how much the banks have fallen and many of them may not even have exposure to that particular group in any case.

Of course, what we have been seeing is made by the domestic investors, who the central exchequer herself likes to call shock absorbers, wait and watch for 1st of February, something you have touched upon. We have seen how FIIs have also started selling India from the start of this year. I am going to ask you this on 1st of February also if anything can be done to make FIIs net buyers again?

As I have said plenty of times, I do not track FII buying or selling because actually data shows it has really no correlation with market movements. It is a waste of my time to do that and as far as the Budget is concerned, I am not one of those market people who think that the Budget should have "something for the market" because I do not think that should be the major focus for the government.

I do not want an increase in capital gains tax but having said that, the focus for the government should be on more longer term issues particularly education, health and employment. And education and health also tie into employability of people a few years hence. Employment, to my mind, is the biggest worry for me as far as the Indian economy is concerned because we have not been doing well on that at all.

Even pre-pandemic, we were at a 40-year high on unemployment. We all talk of demographic dividend but the demographic dividend actually has three components; one is out of the total population, how many people are of working age; the second is how many of them or what percentage are actually working and the third is the productivity.

We have the first for a limited period of time. We have already seen, for example in China, the population has started to decline and we will also get there after a few decades. We have the first but we are not able to get the working age population actually working and so that is a big gap and that also shows that 80 crore Indians require free food and that the economy as a whole is not doing that well at all levels.

Only when you get employment, will you get the businesses growing and therefore the stock market growing on a longer term basis. That is where the manufacturing and services output comes from and that is where when people are earning wages and salaries they go out and spend. That is the virtuous cycle we have to aim for and that should be the focus.

You also said that one has to watch out for the negative surprises. Very often the fine print is where the details that come out, That was the case of the retro tax as well. It was never part of the Pranab Mukherjee speech. But having said that, I want to come back to banks. SBI NSE -5.06% is of course in your top holdings as is ICICI Bank NSE -4.45%. Has the time come for you to give more weightage to HDFC Bank NSE -1.99%? Axis and Kotak are also playing catch up.

This time we have done a bit of rejigging. We do ground up rebalance every quarter. These numbers are as of December because that is the last fact sheet and so there has been a rejig and we have done some of these reallocations that you were mentioning as a possibility. We have reduced weight in some of these and put it elsewhere in banks.

Wanted to understand your outlook on ITC NSE 1.99% as well. Given the runup that we have seen in the stock over the last one year and FMCG business being the main growth engine for the company, what should the investors do right now?

ITC was our number two winner for last year. We got into ITC pretty early in the game, in fact that was the first FMCG stock that we bought early last year and we continue to hold it. That was such a dog for so long! So when that turn came, we got in fortunately at the right time and we continued to hold that. That bet still continues.

What about your view on some of the other capital goods and infrastructure stocks – the likes of SKF, Cummins India NSE -0.13% and Timken NSE 1.08%? Walk us through your views on what could emerge as strong contenders in the long run within the midcap arena?

We have been quite overweight on the capital goods & industrial machinery space for almost a year and a half from October 2021. That again has been a big winner and includes almost all the names that you mentioned that we are either holding or have held in the past. Now we have started to lighten up a bit simply because you know there has been a lot of profit in that and so we have been booking some of those profits.

In this rebalance, we would have reduced the weightage a bit but we would be quite a bit overweight still. That sector from 2009 right up to 2021 was a dog sector for a very long time. It compounded some two and odd percent as against the market compounding at about 10% and fundamentally also those were not doing well.

So once that turn came in the business and also after that underperformance it went into outperformance territory and that was going to last a long time. The other thing was that because it was a dog sector for so long, most companies cut costs and became much more efficient. So when the business picked up, you actually saw it in numbers. It continues to be our most overweight sector but we have cut down from where we were by booking profits in quite a few places. That is the position as of now.

In your multi asset allocation portfolio, I see gilts and gold right up there, I do not know what is the you know order of hierarchy here, but why gold? Yes it is sitting at an all-time high but is that also some indication that the world is going to find cover in gold?

In the multi asset portfolio, the whole logic is that it has to be equity plus-plus to reduce the equity volatility and it has delivered on that. And in India, there are not a whole lot of other assets. If I go to our global multi asset portfolio, there are many things to buy even in terms of commodities.

There are a whole lot of things that you can buy and also there are things like REITs. But in India, it is pretty much either fixed income and gold and we are often not comfortable taking credit risk. That is why we normally go to gilts and because the whole purpose is to reduce volatility. So I would rather not have too much of a credit risk.

We always hold some gold. We have increased allocation slightly now because the gold is looking better than it used to and it has done well off late as you mentioned so that is the position.

But are we in for one of those years where one is better off giving equity an underweight positioning whether it is at asset allocation level or whether it is in terms of in thematic level? Equity generally does not do well when valuations are rich and the environment is unpredictable.

When we were discussing inflation, the recession is definitely on the cards as far as the US and some of the other developed countries are concerned because all the indicators were showing that and when one is raising rates, it is definitely a likely outcome. Now the only thing in all of this is how much of it is in the price?

Last year was about the worst year globally for almost all asset classes, worst year even if you take a view of a century and for the US bond market, it was the worst year in 230 years, meaning from when records start. In equity, both bond and stocks being down significantly happened once during the Great Depression in 1931, once during the second World War in 1941, once in 1969 and then 2022. And not just the US; if you look at all geographies, all asset classes were in the red. The only two exceptions were within commodities. Even there precious metals and industrial metals had a boom and bust.

So net for the year, the only thing which was up was energy and a few agri commodities. So this was an absolutely outlier year. Now when we had such a disastrous year, the probability is higher that the next year is going to be an up year. Obviously now, improbable does not mean impossible but overall, the world asset classes and particularly equities are more likely than not to have an up year because that is what the data shows. This kind of year does not repeat.

Within equities, there might be some change in leadership. So our view right now is that the leadership to some extent has moved from the US to Europe and some Emerging markets, India included. We are just watching to see whether that is like a shorter term change in leadership or whether that is going to be a multiyear thing like what happened in 2003 to 2007 when emerging markets went up 3.5-4 times and US could

not come out of even its tech crash lows. That is something to be seen but overall, equities appear like a good asset class, number one. Number two, India continues in the outperformance bucket. So, I do not see big risks here and of course I am always in the asset allocation camp saying that you should not put 100% in equities even if you are young because you might need some money later and obviously with interest rates going up, even fixed deposits will become more attractive.

So have an asset allocation attitude but I do not see outsize risks in equities just now and also sentiment is a contra-indicator. When there is uncertainty, when people think things are going wrong, the next period returns are above average.

When people are all gung-ho, the next period returns are below average and this is academic research across the world, not just in US or not just in one or two countries but every single country they have tested this and have found the same thing whether it is Portugal or Brazil or whatever that sentiment is a contra-indicator that shows what you should be doing. In 2021, everybody wanted to get on the Nasdaq bandwagon. When Nasdaq fell 40%, then everybody wanted to get out. So one just compounds bad decisions by going with the flow and how everybody is feeling.