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Should you raise allocation in midcaps and smallcaps? This is what Devina Mehra has to say

Synopsis
"It is not as if we do not invest in small and midcaps. We have capped that investment at a certain level, particularly in smallcaps because in smallcaps, the risk is when things go south suddenly, the liquidity disappears. We do not want to take those kinds of chances. That is why we will never be 40% smallcaps or something like that."

"Even our systems, on a bottom up basis, are liking more smallcaps and midcaps than they used to. We do zero base rebalance every quarter. When we did it in October, we noticed that a lot more of those are coming up and broadly that does look a bit better than the largecaps. Of course, we are a risk management-oriented PMS house and will not have a very high weightage to smallcaps. But we have upped our smallcap and midcap weight," says **Devina Mehra**, Chairperson, MD & Founder, **First Global**

When you see a market like this. It is worth getting up early, isn't it?

I am not a very day-to-day market watcher because that is not the way I work.

We are almost at an all time high and 1% here, 2% there does not matter for the way you look at things...

Of course. I would like to go by the broad thing rather than day-to-day movements which can just make you get caught up in things which do not matter, with a lot of noise.

When we touched an all time high exactly a year ago, the print and the underlying market conditions were very different. Technology stocks were in a bull run, inflation concerns were not there, everybody was excited about owning fintech or consumer tech and banks were on a back seat. Now the underlying bent of the market has changed completely. Was what we did last year real or will what we are reporting right now get challenged?

In markets, the leadership always changes and one has to be prepared for it. That is why there is no point making five-year forecasts and things like that. Last year, we were overweight IT, in fact we were overweight IT from 2020 onwards, about September 2020 onwards, and that had served us well.

Right now, it is the banks and financials and while we are not heavily overweight or anything because banks anyway are a very large part of the index, but for the first time ever, we are about market weight on banks.

Normally I am averse to buying banks because it is a leveraged, high risk sector with a lot of negative surprises which one cannot know sitting outside. I am wary of it. We had negligible weight in 2020, we had negligible weight in 2021 which worked very well. Banking went through a very long period of underperformance even in this huge bull run.

In 2020, that was the only sector that was in the negative at the end of the year. In 2021, while it was not in the negative, it went up only half as much as the Nifty. So, it has catching up to do.

Fundamentally, there are positive things like credit growth plus that most of this current cycle of NPAs is behind them. As interest rates go up, normally it is positive for banking margins at least in the beginning because the loans get re-priced immediately whereas the deposits get re-priced over a period of time. All those things are fundamental positives. They have had a long run of underperformance and so a sector, especially PSU banks, look like outperforming as of now.

Is manufacturing the way to go because of China plus one advantage? Where within manufacturing would you be placing your bets, if at all?

For about a year, we have been overweight industrial machinery and capital goods category. Even now in our portfolios and our PMS schemes, that would be the highest overweight. That again had some of these things which you talked about because some of the user industries were getting benefitted by PLI or China plus one and also because of the government capex, that was a sector that started to pick up last year after 10-12 years of underperformance.

Right from 2009 onwards, it has been a dog sector and now has been a big outperformer for us in the past year. There have been stocks which have gone up two or four times and the still continues to be number one for us.

In terms of other manufacturing, what we have started to like have been some of the auto four-wheelers and auto component stocks and selectively textile and chemicals that I do not like to talk of as a sector because the dynamics of individual companies are quite different.

But that is again a sector where because of certain stocks we have picked we would probably be somewhat overweight. So broadly, that's what we like in manufacturing.

What should be investors' approach when it comes to midcaps and smallcaps?

Our systems even on a bottom up basis are liking more smallcaps and midcaps than they used to. We do zero base rebalance every quarter. When we did it in October, we noticed that a lot more of those are coming up and broadly that does look a bit better than the largecaps. Of course, we are a risk management-oriented PMS house and will not have a very high weightage to smallcaps. But we have upped our smallcap and midcap weight from where it was because our systems are liking it more both as a category as well as the number of stocks that are now coming up in our systems.

Today we are going to see two IPOs close; first is Medanta, a hospital brand and the second one being Bikaji, a popular chip brand. Have you subscribed to any of these IPOs?

No, generally we do not subscribe to IPOs. We will wait for the post listing and see and take a view thereafter.

You have said that you like to stay away from the smallcaps as well as the midcaps, you like to have a little less of a risk-averse strategy. Would this be a time to hunker down and look at the smaller PSUs?

Within banks, we think the PSU banks would outperform. We may not go to very small banks but it is not as if we do not invest in small and midcaps. We have capped that investment at a certain level, particularly in smallcaps because in smallcaps, the risk is when things go south suddenly, the liquidity disappears so we do not want to take those kind of chances. That is why we will never be 40% smallcaps or something like that.

We may be at an all-time high on the Nifty, but if I look at sectors and the earnings which have come out so far, there seems to be a renewed optimism and vigour. For an investor, how would you map the risk reward ratio? Markets for a long-term investor are slave to earnings. If earnings are good, markets catch up and if earnings are bad. markets come down. So what should investors do?

While that is true it is not one to one on an immediate basis. If that were the case, then in March 2020, the markets in India and for that matter globally would not have rallied the way they did because there was so much uncertainty on the business and therefore on the earnings front.

I mean there were whole sectors which had practically no business for months on end. So while you are right that on a longer term basis, there has to be some synchronity, but it does not hold on year or definitely not on a quarter basis. That is why I always say that the economy and the markets are two different things.

Whether globally or in India, there might be issues in the economy but the markets might still look good. Vice-versa too - as China which is at half of its 2007 levels, even though GDP has gone up 6.5 times. So while one must look at all these things, it is not a one to one correlation. That is the case on a market wide basis. On a stock basis, it is different.

In India, the listed space has benefited because there has been more formalisation of the economy, more move towards the organised sector. That has been a positive for them. Also generally, the listed companies tend to cater to the more affluent customers, the part of the citizenry which has done well. It is the organised sector employees who have done well in the last couple of years. There is still a lot of part hurting below that and it has improved a bit but you look at NREGA numbers or free rations, still a lot of people are in distress.

Of course, even there, we have seen some improvement. So while two-wheeler numbers were at a ten-year low, from there, the situation has improved significantly. We really have to split out what is happening everywhere. That would be my advice.

As I said, even sectorally, we cannot always make calls. For example in chemicals, if you see the earnings are in two different directions depending on whether output prices have gone up or input prices have gone up for that particular company.