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There are better trades than equities just now: Shankar Sharma

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We are now at a 52-week low. All kinds of historic targets are being cut this morning in India and across the world. The last time we spoke, you had clearly said things were looking a little difficult but were you expecting this kind of a fall?

I was saying that in terms of strategy, we saw a pretty decent fall globally and India of course coming up, which we implemented in the first week of February. So, while it is obviously an absolute meltdown, what we were seeing was that alternates, away from equities, will do better and that is what you are seeing right now. Gold has done better, fixed income has done better. We particularly pivoted out of equities in the first week of February. So far, that thesis has been borne out by what we are seeing right now. So, does it get any worse? Things can have a force of their own…you know it is just like a big boulder sliding down a mountain side. It is just gathering momentum as we go. It is not looking pretty.

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We had a variety of speakers who have suggested not to panic and to buy in dips and that things will stabilise, this is not the end of the world. What would you say to counter that?

I always believed that one should be smart in the market but one should not be oversmart and one should let things play out rather than try and say that the worst is over! Anyway nobody on your show has any clue about what the virus and how it is going to end. I do not pay any attention to financial people becoming medical doctors. My view is let this thing play out. It is better to buy 10% higher rather than just go and blindly risk losing 20-30%.

One more thing is very important. People liken it to SARS, but SARS happened in 2003 when globally and in India markets had halved. Sensex in 2006 was around 6,000 and at the time of SARS, it was around 3,500 or maybe 3,000. It depends on when a problem like this happens. It is not simply a problem but the context in which that problem happens today. You have seen this at all-time highs in India globally when markets were anyway looking pretty vulnerable, given the narrowness of breadth of India and in the US and elsewhere. When something like this strikes, you can fall a long way because you are at the highs and you are not at the lows like at the time of the SARS virus…

None of us have any clue where the bottom is going to be. Would you stay out of equities altogether as you said you have decided to pivot out of them in first week Feb or would you look for opportunities at lower levels?
This year, equities is a troubled spot. It is not to say that there is nothing like equities. We have equities worldwide, but it is the only way. We cut equity exposure in the first week of February. It is not a view that there is nothing worth buying or there is nothing worth owning. It is simply that looking at the way this thing is unfolding, an aggressive stance in the market is unwarranted. The US was the engine of growth for the world. It was the engine of stock market growth for the world and you are seeing numbers on this virus which are pretty scary. My view is it is not wise to say no equities, but obviously you just turn the tide away from equities a bit and that is pretty much what we have done.

A lot of market experts are also predicting a fairly gloomy scenario from here on and talking about a recessionary scenario across the globe. Are there fears of that as well?
If you take broad estimates, crude does not go to $30 like this without a recession being in the works, number one.

Number two, let us focus on India. The world was anyway in a pretty good shape prior to this. The problem spot was India where we were seeing 15-20 years lows in terms of growth rates. On top of an already very weak economy, we have a problem like this and that is worrisome. It was not as if India was growing 8% and then you see a 2% cut and you will go to 6%. We are growing 4-4.5% and that is also exaggerated. May be, India is growing at 2.5% and when you get a cut like this, maybe you lose 1% point on growth or maybe 2%. Where does that leave you? Remember, I am putting the context and all this is happening at all time highs on the Indian markets -- at least in the narrow markets like the Nifty and the Sensex. It is not happening when the markets have fallen 50%.

India was already struggling for economic and earnings growth. We have not seen earnings growth of any meaningful quantum over the last six years. On top of that, what we are seeing now was anyway going to happen, may be not with this ferocity, but as I have said, the narrow market can run for a while but when it collapses, it does not ever end well. It never ended well. The virus or something else can happen or there can be some other reason. Narrow markets do not end well and that is really the thing that happened here. We have to worry about India, the world can take care of itself. The rich economies can figure things out. For India, it has come at the absolutely worst time possible.

Apart from perhaps staples, what else does it really leave on the table to nibble on?
Remember one more thing. 2019 was a crowded trade for the FMCG companies. Everybody and their uncle was parroting this theme of buying quality and buying high returns on capital and buying incremental ROCE which are very good and all that. It became a crowded trade and this year so far by and large, trades are not holding up particularly well. Obviously those are unleveraged companies. They will not crack 50% but you are buying them at such crazy valuations and the interesting thing was everybody would say quality but would never attach a price to that quality.

So 2019 worked very well for that trade. But since it became crowded and as all crowded trades eventually end, that trade is also petering out. The areas in the market that might not fall as much might actually be the ones that actually did very badly in the last two years which are the small caps. It is not a safe place for a retail investor. It is a damn tough place even for professionals like us. But at least, that place has already fallen 30-40-50% and probably little room is left to fall.

The mainline, over-owned companies can fall 30%. I do not see why an over-owned staples company cannot fall 20-30% especially in an environment where you are trading at crazy multiples. The economic growth is already very poor and on top of that, you will see some effect of the virus on Indian growth rates as well. It is not going to be immune to that. My view is that the least owned part of the market is the small cap space. It is the only place where you can probably lose a little less. The large caps are over owned and that is exactly what you are going to see that you are going to see big cuts on that part of the market.

What is your take on what is playing out with YES Bank right now and how you are looking at the RBI's move to write off the AT1 bonds of YES Bank? That really seems to be hurting appetite now with IndusInd Bank as well deferring the AT1 bond plan.
I know the AT1 bonds writeoff has been a very-very controversial thing and people have been asking how can they bear the brunt of the write down while equity still has some value? Typically, we do a lot of distressed transactions. It is again counterintuitive. But in a distressed company, whether it is a bank or industrial company, the bonds can go to zero while equity can still have some value. Usually bonds should have some value because they have some assets backing them, while equity is just unsecured asset and it should go to zero but it does not actually play out the same way in real life. Equity will have some value, the stock will not go to zero, it will trade at 50 paisa, one rupee too while the bond goes to zero. That is what you are seeing here. The larger point which I made in my tweet was this. I feel very strongly about the fact that the entire brunt of building infra in India or building industries that support infra in India have fallen on the state owned financials. While private sector banks have got a homerun or free run just to go sell credit cards to consumers and housing loans and whatever they are selling, they do not touch anything to do with infra. This is an unequal situation.

India does need infra but why should one end of the market enjoy market caps of $100 billion or $50 billion dollars while the other end of the market has to keep on shelling out bailout plan after bailout plan whether it is a bailout for divestiture or a bailout for a failed bank like YES Bank. I feel quite strongly about it. There should be some parity here. You cannot just let SBI and IDBI become the dumping ground for everything that the world does not want to own.

Stock specific smallcaps could offer an opportunity. Is there a rationale by which you are looking at those buying opportunities?

We do not have any money to buy so we will just write them down, I am just kidding. What I am saying is there will be opportunities but I am not of the camp that believes in just rushing in. We will wait it out. We will let it play out. This virus is a dangerous one and that has been my view for a month. Like I said, we cut our equities well before this whole thing melted down. There are better trades in this world than to own equities just now. But like I said, we will get back in if we see things improving but right now it is still a pretty grim situation.

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