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The pain is not over but India may outperform this year too: Devina Mehra

Synopsis
"The US is not looking as good as India is currently. As we sit today, it looks like India will continue to outperform because it has come out of a period of a very long underperformance and as far as the US recession is concerned, one will have to watch whether the Fed lets US go to that situation because as of now, on the labour market front, things are very buoyant in the US."

"Our slightly overweight basket continues to have IT services, though they have not done so well this year. Capital goods came out of the long funk; there has been textiles, telecom and oil and gas and a part of chemicals. So even within a theme, one has to drill down. Banks are never a safe sector," says **Devina Mehra**, Chairperson & MD, **First Global.**

It is getting bad to hard and hard to worse. Are we reaching that point of maximum pessimism?

You are sounding more downbeat than I have ever heard you!

I am optimistic. But the screen is telling me that it is not looking great. So, on behalf of those who have suffered in the stock market, perhaps wanted to get emotion in that question?

Are we at the end of the fall? Probably not. But in terms of where India is, I do not think there is a huge amount of downside. As we sit here today and see that there are fresh developments and as I have said earlier also, this year, India at least will be an outperformer. It was an underperformer for many years except for 2021.

So 2021 was the first time India became a significant outperformer. Among the major markets, it was number six.

Prior to that, for many years, it was number 20, number 24, 19, 25. So, that is the good news.

But obviously, global equity overall does not look great as of now. The other part is that unlike last year, when it was the tide lifting all boats kind of a market, this year, we have to be more selective and more nimble also.

Both in terms of sectors and even within sectors, one has to drill down to company levels as to what is happening and essentially be more selective. One might need to change strategies also midway and that is the way this game has been played out.

Markets always climb the wall of worry, which is they peak out at the peak of bad news. How much of the bad news is in the price now?

I do not think the pain is completely over if you look at the market as a whole. But then, one has to look at it in a more granular manner, because things change.

A month and a half ago, all commodities were up and then China went into this lockdown mode and cut back. Therefore, there was a significant drop in demand for many commodities.

For instance, almost all metals have given up all the gains they had and we are now below the December ending levels for most of them. Both precious metals and others - barring iron ore which is still up for the year. That is why, there is so much news flow and changing reality.

Life is only about probabilities. So one has to keep watching. The Fed for instance, also has to watch out for how things actually play out. So, it is very difficult to make a prediction. But for a year, things have been very dynamic. We are dealing, if not with unprecedented things, but on the macros we are where we have not been for decades.

For the first time in decades, the western central banks have inflation to target which was always a background variable for them. It never came to a situation where it was way out of their target rates.

If you look at India also, one has to watch many variables. As I said, even the central banks would not know where they will be six months or eight months later.

Given that India has fallen a lot less than the US markets, can this relative outperformance of India continue when you are anticipating more pain and economies like the US are talking about recession?

That is what: The US is not looking as good as India is currently. As we sit today, it looks like India will continue to outperform because it has come out of a period of a very long underperformance and as far as the US recession is concerned, one will have to watch whether the Fed lets US go to that situation because as of now, on the labour market front, things are very buoyant in the US. When I last saw it, there were two vacancies for every unemployed person in the labour force. So there is still a big gap to bridge.

So the Fed is thinking that there is that cushion but of course, there has been a huge amount of liquidity pumping over this whole Covid period and so on that front, there would be some pain.

It is a game of chicken and we have to see where the markets and the Fed stop.

In the US, fixed income was down about 8% for the year but now that part seems to be halting a bit.

In the year to date, in global markets, there has been almost no asset class barring commodities where one could hide and there too, some in the commodity bunch, like the metals, have given up their gains.

Otherwise fixed income is down, developed markets are down, emerging markets are down!

There were only four-five markets in the entire world which were up and most of them were commodity plays like Saudi Arabia or Australia or South Africa. There was virtually no place to hide in global assets.

Is there a place to hide when it comes to India? We may have fallen relatively lesser than our global counterparts, but we have fallen regardless and pretty much across the board?

The outperforming sectors are two themes, one of which is rupee depreciation. It has been our base case for this year much before the Ukraine conflict and in fact much before even the year began. Since last Diwali, I have been saying that in 2022, I see rupee depreciation as a big risk.

On the positive side, there are things like PLI. Our outperformer basket or slightly overweight basket continues to have IT services, though they have not done so well this year. They were huge outperformers for the year and a half before that.

Capital goods came out of the long funk; there has been textiles, telecom and oil and gas and a part of chemicals. So even within a theme, one has to drill down because in chemicals for instance, it depends on what is the degree of forward and backward integration and where in the cycle you are.

You talked about rupee depreciation. You have been overweight on IT for a long time,

since 2020 through the pandemic. But now given the IT sector's underperformance, the [blue chip](#) fatigue which is seeming to set in. Are you still overweight on IT?

Yes. We are still somewhat overweight because this is a more of a long-term theme. In 2020, it was also an anti-FMCG bet. FMCG was the flavour of the season for that entire year and we really thought that this is another sector where you have predictability and reasonable margins as well as reasonable returns. Though the returns are not as high as FMCG, but still pretty good while the valuations were a fraction of FMCG.

So some re-rating has happened and as I myself said, that year to date it has not been great bet but these cycles come.

On a fundamental basis, we continue to like it. Also more so on a relative basis, our base case is rupee depreciation. So yes, we continue to remain somewhat overweight in the sector.

We have looked at the employee cost and attrition question and I think we are past the peak in that or peaked on the employee front. So, both on the rupee depreciation front as well as the predictability front, it is a sector that we continue to like.

Do you think banks will be a safe bet and the best way to go because as far as the macros go, investments and the changing capex cycle, it is relatively insulated from the Russia-Ukraine conflict?

Banks are in my book never a safe bet and always a risky sector. It is a highly leveraged sector which is why I rarely like it. Even in 2020, it was the only major sector in the red in a market which was so buoyant. In 2021, it was not in the red, but went up only half as much as the market.

This is a sector which always gives more negative surprises than positive surprises always and as an outsider it is very difficult to know when and where those negative surprises will come. All that aside, considering this is such a high weight sector in the indices, we had a negligible weight in 2020 and 2021. From there, we have increased our weight but we would still be somewhat underweight and that has been our broad strategy on banks.

Of course, the one positive for banks is that at least on their loan book, as interest rates go up, the margins go up because loan books are repriced first. Basically, interest rates on loans are raised first, whereas on the deposits, it happens over a period of time. So to that extent, you get that cushion and on the other side, the bond book you take a hit because as interest rates go up bond prices come down. That has led to a little bit of a balancing act for Indian banks. We are not as underweight as we used to be but we are not overweight either.

The challenge is in a rising interest rate environment, if you sit on cash, that cash is going to lose its value and whenever markets reverse, we will not be able to catch the upturn. So what should be the ideal strategy in this kind of market?

What we are recommending right now is that whatever you want to invest, it would be better if you split it over two-four months and get your toes wet. It is almost impossible to call the exact bottom. We are in the range where you can start at least getting back in and, of course, we are holding slightly higher than normal cash in our portfolios and keeping the powder dry for any other thing that we see. So, cash is definitely on the higher side than normal.

Let us look at the bright side and the bright side is that the bond yields have come down from 3.1% to sub-3%, crude is definitely not going above $110; with the exception of iron ore and one more commodity, all commodities are down on YTD basis. So while central bankers are worried about inflation at its peak, the internals are indicating that the reversal has already started. Will equity markets gain confidence from that?

One has to look at it country by country. I had done a piece on the March inflation numbers around the world and I had said that in the US, inflation is close to peaking whereas in Europe, it was a different story. Europe was still on the way up.

In the US also, it has not gone down in the April number as much as I thought it would, mainly because as mortgage rates are rising, people are just scrambling to buy the house and get to lock in today’s mortgage rate.

That is why what they call the shelter part of the inflation, which is the housing related inflation, has not come down yet. But that will play out pretty quickly and in fixed income, the pain is somewhat behind us as far as the US is concerned.

But the US is a particular type of market because one also gets safe haven flows into the US treasuries and that is why yields have come down from the peak. That is not something one can extrapolate to the rest of the world.

Commodities have come down mainly because China demand has come down and except for energy, the oil and gas part, prices of other commodities have come down from the peak. Agri commodities again have not come down and that is relevant for India because the market as a whole or for that matter the economy as a whole faces a situation where the household budget is under a lot of pressure because food and fuel prices have gone up.

If you look at the last inflation CPI number, clothing prices are up by 10% year on year and that is not surprising because cotton prices are up and petrochem prices are up which is used to make synthetics. So, there is a lot of pressure on the household budget which will weigh down demand for everything else because if you are paying more for essentials, you will try to postpone what you can – be it a fancy face cream or shampoo or a motorcycle purchase.

In India, for a large percentage of the population, there is still economic pain. It is not there for the organised sector employees and that is why in IT, you see that employees are earning more and that is the case more or less across the organised sector. But below that, there has been a lot of pain, which will be a demand drag for a lot of industries in India.