

CREDENCE

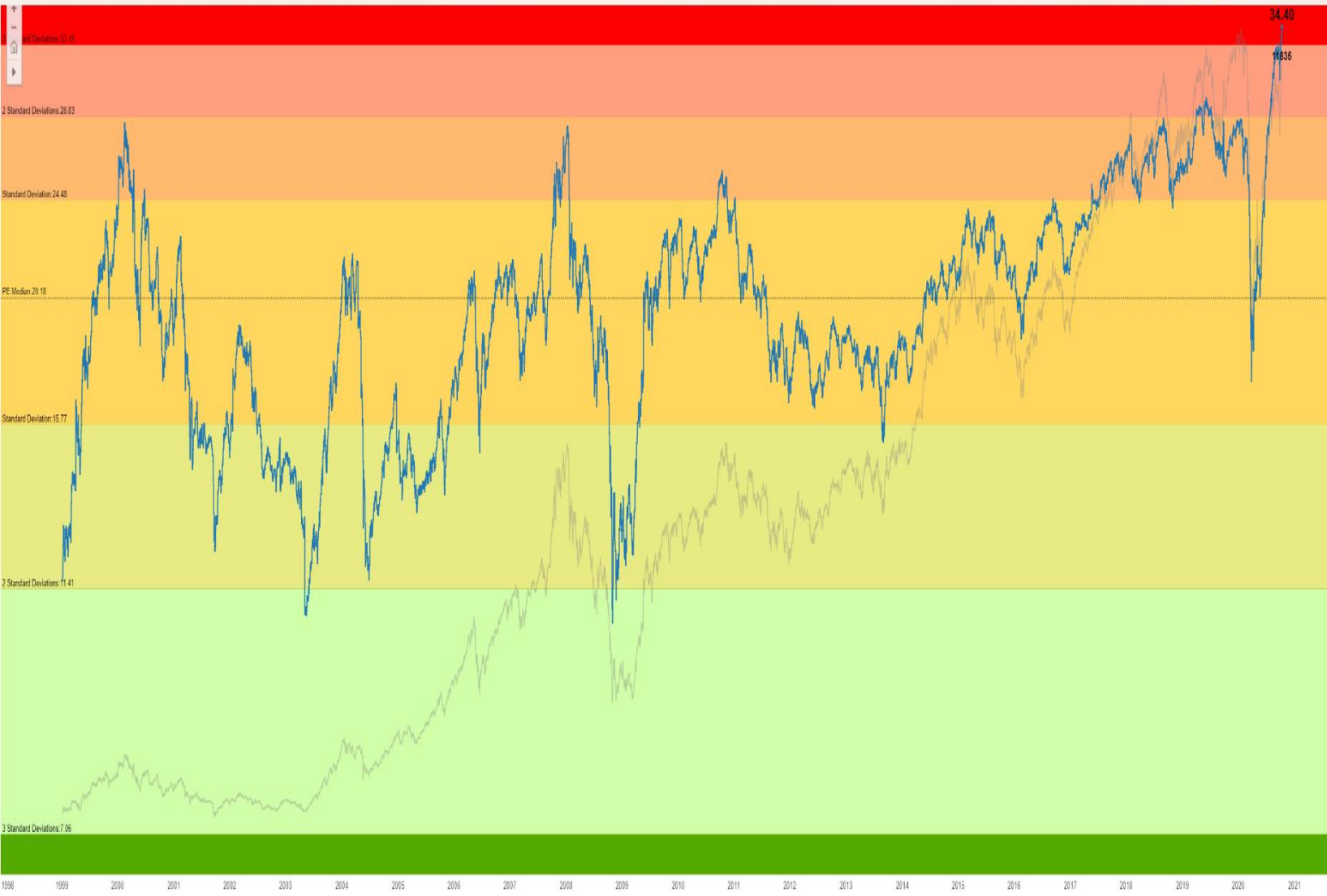


Credence Family Office

Asset Allocation_Equity_Oct'2020

"Investing is not a horse race & one invests in whatever asset class has been giving the highest returns. Rather, investing is a game of asset allocation & diversification across asset classes"

PE jumps to its highest levels ever! (3 Standard deviations above mean)



Nifty behaviour on every news around US Fiscal Stimulus



June 24, 2020 at 1:50 a.m. GMT+5:30

President Trump has told aides he is largely supportive of sending Americans another round of stimulus checks, expressing the belief that the payments will boost the economy and help his chances at reelection in November, according to three people aware of internal administration

Metrics show consumers pulling back on spending in September as Congress debates second stimulus

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President Trump Retweeted



Donald J. Trump @realDonaldTrump · Oct 3

OUR GREAT USA WANTS & NEEDS STIMULUS. WORK TOGETHER AND GET IT DONE. Thank you!

President Trump Retweeted



Donald J. Trump @realDonaldTrump · Oct 7

If I am sent a Stand Alone Bill for Stimulus Checks (\$1,200), they will go out to our great people IMMEDIATELY. I am ready to sign right now. Are you listening Nancy? @MarkMeadows @senatemajldr @kevinomccarthy @SpeakerPelosi @SenSchumer

Nifty & its constituents since Mar'2020

Nifty Constituents	Performance - 31st Mar'2020 - 30th Sept'2020	Nifty Weight(%)		No of Companies	Contribution to the 31% rally in Nifty
		30th Sept'2020	31st Mar'2020		
Total Rally	30.82%			50	30.82%
Reliance	103%	13.2%	8.4%	1	8.97%
Auto	74%	6.5%	5%	6	3.7%
Healthcare	59%	4.1%	3%	4	2.1%
IT	52%	16.8%	14%	5	7.7%
Metals	31%	2.2%	2%	4	0.7%
Misc	30%	3.7%	4%	4	1.2%
Capital Goods	16%	2.4%	3%	2	0.5%
Financials	15%	33.1%	37%	11	5.7%
Oil & Gas (ex-RIL)	4%	1.5%	2%	4	0.1%
FMCG	3%	12.4%	16%	6	0.5%
Utilities	2%	1.5%	2%	2	0.0%
Telecom	-5%	2.6%	3%	1	-0.2%

Overall rally in Nifty from March'2020 lows was largely driven by –

- Reliance – New capital infusion by Global Partners, Debt reduction plan, fund raise by Equity made Reliance biggest performer for Nifty
- Auto – Rebound in Auto was long due and Covid acted a mechanism for this. Typically, Auto follows a 5-6 years of uprun followed by 3-4 years of downturn cycle. Some of rural focused players were large beneficiaries of this run up
- IT/Pharma (defensive stocks) - Whenever investors are worried about the economy, they opt for defensive stocks. This is because investors feel that these companies will be profitable even if the economy is not doing well. Indian companies in these two sectors mainly cater to the American or European market. On a relative basis, these sectors have a large share of revenues coming from outside India. As a result, their profitability is not linked to the Indian economy. This is why, you may often see IT and pharma company stocks rally whenever investors are bearish about the Indian economy.

Inflation effect on Equity

Does Equity (Stocks) benefit from the positive impact of Inflation, because it effectively pushes up the nominal growth and is alternate for Investors to preserve purchasing power of money?

The link between stocks and inflation is complicated; because, inflation is linked with growth concerns.

Positive correlation: For inflation that is backed by pure monetary phenomenon (rise in money supply) stocks indeed provide a hedge (All money created cannot be used for consumption and part of it moves to savings).

Negative correlation: However, as seen historically poor economic growth, leads to lower stock prices which effectively leads to an increase in government spending and unsustainable debt-to-GDP ratios; which, in turn leads to monetization of the debt through inflation. In valuation terms, price (*current*) of a stock is just a summation of all its discounted future cash flows. The denominator used for discounting is interest rate prevalent in the economy, which effectively has positive correlation with the inflation rate. So as the denominator (*interest/inflation*) increases the price of a stock decreases.

Does that mean investors over seeing an economy with high inflation expectations should not invest in Stocks at all?

There is no one word answer to this. Historically, studies have established a negative correlation between the two over a period of various decades starting from WW2 to end of 1980s. A relatively less studied phenomenon is that there are certain industries within the stock market that provide an inflation hedge i.e. companies that provide goods to have assets carrying a positive correlation with inflation. For ex – energy, natural resources, real estate etc. Simply put, companies which can pass on the inflation effect to end customers generally tend to perform well in inflation period. The take away here is not that Equities tend to underperform or are not an attractive asset class during periods of high inflation. The analysis simply states that historically Equities have not been a good inflation hedge and there are certain sectors in Equity that tend to carry positive correlation with inflation.

Key Takeaways

- The situation (read as liquidity) just seems to get better in the markets, while the economy stumbles over Covid. In our earlier notes, we have covered the rationale of markets not being a barometer of the economy. There's a lot of enthusiasm in stock markets, significantly from retail investors. This enthusiasm has shown in the volumes. From average volumes of **about 40,000 cr**, **we are now seeing average daily volumes cross 60,000 cr** in the last few months. This has caused a reasonable jump in the prices of a number of companies, and going by numbers in July, people have actually withdrawn from mutual funds to put in money directly into stocks. Movement of disposable income to instantly gratifying stock markets was covered earlier, thanks to the printing of money.
- The economy on the other hand continues to stutter. A -24% print on the GDP means we are about 1/4th less than a year ago. Private consumption is down 26%. While there are some indicators in October which are seemingly more positive, a closer look post the festive season will give us a better picture of the revival.
- We have to watch **liquidity**. The fresh breath of money flowing in – from the pockets of people who want to day-trade, from foreign investors that have just been giving more money through stimulus, from near-zero interest rates in the west and so on. That pushes up markets but if that's what pushes markets up, then taking away liquidity is what will push it down.
- While we're positive on the economy in the longer term, we anticipate that things will get worse before they get better. We believe in a situation like this Asset Allocation + risk adjusted returns warrant a closer attention. At 11,800-12,500 Nifty levels, **we would suggest clients to have a 20-30% lower allocations to equities** than what the asset allocation demands. E.g. – If your asset allocation demanded a 30% exposure to equities, one could look to have 21-24% in equities and have the rest to deploy at future corrections.
- In our previous note, we have also outlined the record levels of cash fund managers are sitting on. Hence, likely scenario could be a sharp/swift fall followed by a revival in price as some of this cash is put to work.

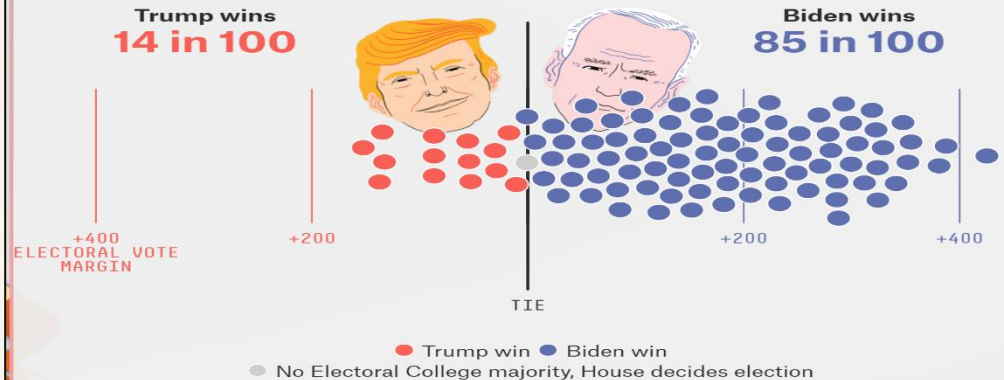
Threat to the hypothesis

Path #1 to stimulus: Trump and the Democrats agree on a stimulus deal in October.

- Changes in the likelihood of a stimulus deal happening have moved the markets dramatically over the past couple of weeks. Trump's strategy of walking away from negotiations, as he did on Tuesday (which caused the markets to drop) and coming back with a bigger offer (resulting in a rally) makes perfect sense. Trump is attempting to take control of the negotiations, as well as win credit for an eventual deal.
- Treasury Secretary Steven Mnuchin headed into talks with House Speaker Nancy Pelosi on Friday carrying an increased White House offer of \$1.8 trillion, \$200m higher than their previous offer, but \$400m less than the Democratic plan.

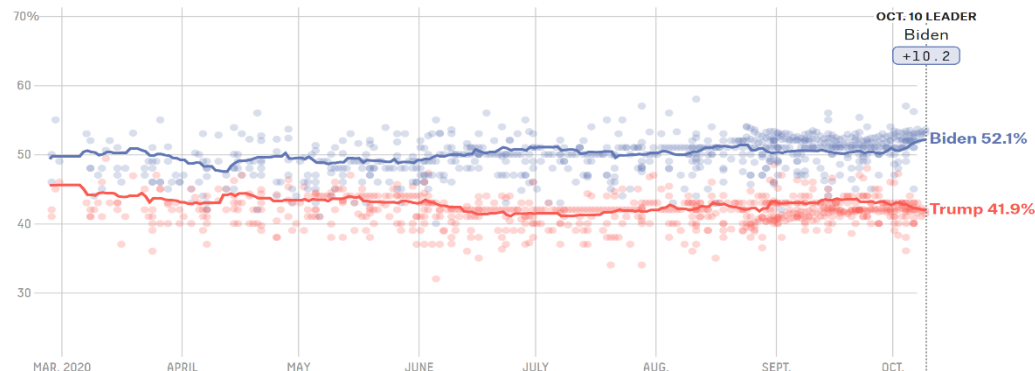
Biden is *favored* to win the election

We simulate the election 40,000 times to see who wins most often. The sample of 100 outcomes below gives you a good idea of the range of scenarios our model thinks is possible.



Who's ahead in the national polls?

An updating average of 2020 presidential general election polls, accounting for each poll's quality, sample size and recency



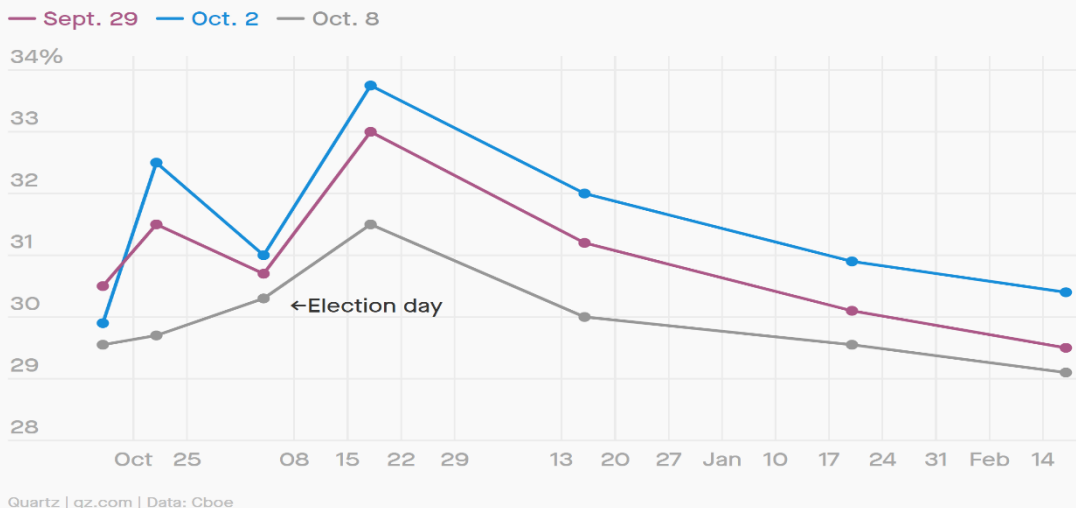
Threat to the hypothesis

A possible large Biden win reduces the contested-election risk

- Wall street think a contested USA presidential election is becoming less likely. Derivatives linked to volatility had jumped in recent weeks, after Trump claimed mail-in ballots were subject to fraud. These futures contracts are tied to the VIX volatility index, sometimes called the “fear gauge,” and they allow traders to speculate on whether stock market price swings will increase or decrease.

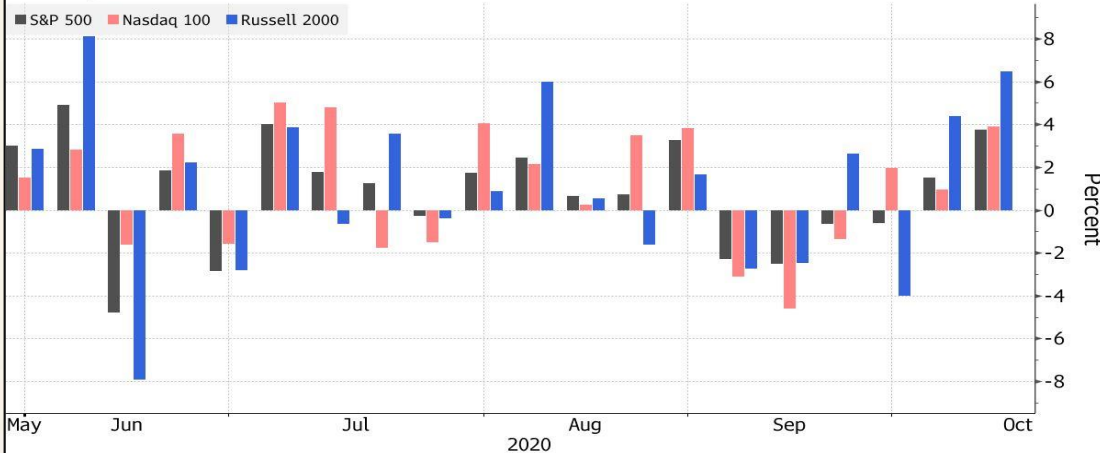
- Back home** - Festive season sales/ faster than expected domestic recovery/ our own version of stimulus/ bounce after a short correction as investors who missed the previous swift rally come in

VIX futures contract prices by expiration date



Broad Gains

All major indexes have best week in months



Our Research Team

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Co-founder and Chief Executive Officer

As the founder of Credence Family Office, **Mitesh** brings a near two-decade experience in managing wealth, investment advisory and family office.

Prior to founding Credence, he held senior roles with CITI bank and HSBC with a focus on developing investment strategies for high net worth clients.

He works with several clients on areas related to global investment strategy, succession transitions, mentoring the next generation, business strategy and more.

Besides Credence, he is also the co-founder of Wealthapp, a fintech platform with > 25,000 registered users, established with a vision to make financial planning available to all.

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An alumni of the Mumbai University, he is a Certified Financial Planner from FPSB and level 3 CFA aspirant. Prior to Credence, he has worked for Sykes & Ray Financial Equities (I) Ltd. as a senior financial planner and in Essel Finance at the Private Equity Desk as an assistant manager handling activities like Investor Relations, Fund Accounting and Asset Management.

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Thank You



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