Avoid momentum plays, bizarrely priced IPOs; bullish on IT, PSU, consumption: LIC AMC's Ahmad

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As we are transitioning from early cycle economic recovery to a mid-cycle one, the volatility is likely to resurface and drawdowns in magnitude of 5-10 percent should be considered as normal and as an opportunity to enter into equity markets, says Azeem Ahmad, Head of Portfolio Management Services and Principal Officer, LIC AMC. He also believes that India can become the poster boy of emerging markets in this decade.

Azeem Ahmad is Head of Portfolio Management Services and Principal Officer, LIC AMC, and is managing over Rs 1,650 crore belonging to institutional investors and high networth individuals. A two-decade plus veteran of financial markets, Ahmad shared his thoughts on investing and market trends in an e-mail interview with cnbctv18.com.

Key takeaways from the interview:
- Compared to the bull markets of 2000 and 2008, we are still in our early days of earnings recovery growth story
- The list of quality companies has expanded, but there are still so few of them. They are expensive for a reason
- Avoid momentum plays and little-known companies that have come out IPOs at exorbitant valuations
- Retail investors must accept the fact that the market will not rise at the same pace as it has in the last 18 months
- A reduction in bond-buying by the Federal Reserve is inevitable, but a 2013-like selloff in emerging markets looks less likely this time

Below are the edited excerpts:

Q1. What is your investment approach right now, in a market where majority of the quality companies are seen to be overvalued?
The notion of quality companies priced exorbitantly is misplaced to some extent simply because the definition of quality itself has widened from 20 (give or take -/+ 5) companies pre-covid to 50-60 these days. Often talked about space like paints, clearly has one undisputed leader in terms of market share, growth visibility and resultant superior relative competitiveness but the quality definition for some is more broad-based in this space itself. Similar examples are flushed across the sectors. Hence, once needs to be cognizant on what is a quality company and where it stands valuation wise with peers group.

Fundamentally speaking, corporate earnings have been nearly stagnant in the recent past with FY19-21 Nifty earnings compounded monthly growth rate (CAGR) at around 5 percent. Currently, we are on the cusp of high double-digit growth trajectory with earnings CAGR over FY21- 23E at around 26 percent, the key driver for markets to inch higher. We value 20,000 to Nifty, valuing it at 24.5x P/E on FY23E (which implies 10 percent upside). For market to reverse course, we need some new risk that no one is fathoming currently as the COVID, oil and inflationary shocks are getting priced into the sectors of the market. Having said that, as we are transitioning from early cycle economic recovery to a mid-cycle one the volatility is likely to resurface and drawdowns in magnitude of 5-10 percent should be considered as normal and as an opportunity to enter into equity markets.

Q2. Does the current bull-run have parallels with the technology-led boom in the late 90s and the infra-real estate boom in 2007-08?
With about 150 percent (rise) on a trot, surely enough parallels are being drawn to 2008 and 2000. But compared to 2000 and 2008, we are still in our early days of earnings recovery growth story. On corporate profits to GDP as percentage is still very low and credit growth is yet to show strong uptick. Even business cycle wise, we are in early mid cycle. In fact, how China has been poster boy for emerging markets for the last two decades, India could challenge that in this decade.

A combination of technology-driven businesses, consumer-driven (insulated to exogeneous shocks) businesses and manufacturing-led businesses will ensure that bull market in India continues for a couple of years. The $5 trillion economy is going to have significant contributions from different areas. Share of manufacturing and industrials which is less than 20 percent is going to increase quite disproportionately. This will be driven by a lot of reforms that have happened, which directly benefit the manufacturing sector. Increasing cost competitiveness and the increasing need for global companies to adopt China+1 strategy has made India a very vital component of the global supply chain.

Q3. Which are the sectors/companies you like, and why? Where would you not be putting money?

As suggested earlier, we are past the initial recovery stage and easy money by being courageous to invest in equity amid a weak macro is trade that is now in rearview mirror.

At the risk of sounding cliche, market dynamics now warrant a very stock specific approach, especially if one has a diversified portfolio across market capitalisation.

One can approach the current allocation by investing into areas, where

--Growth is intact: Information Technology, Consumption

--Valuation wise (gives a hedge): Pharmaceuticals and depressed pockets of reopening of economy trade

--Value unlocking: Public Sector Undertaking (PSU) space, quasi-play with large PSU banks

What should clearly be avoided is--

A) Momentum based approach is prone to wobble in mid cycle transition of the market and various sectors perform in sporadic ways. Hence, if momentum based investing is followed it should be with strict stop losses and should be agnostic to market capitalisation and sectorwise

B) Many midcap and smallcap companies that have recently listed at an exorbitant premium. This IPO frenzy has listed many companies that are valued way more than the already established companies.

Q4. Retail investors are putting Rs 10,000 crore in SIPs every month. What would your advice be to people who have just entered the market?

SIP inflows have been unrelenting and now have reached the magical Rs 10000 crore-per month mark. As more and more “new” investors are jumping onboard with equity allocation, the important thing to keep in mind is that the last 18 months bull-run trajectory and pace is an exception and not a rule. Simply speaking, the new investors should come with longer time horizon with a mindset to avoid:

--Recency bias: Markets will not go up at the same pace of last 18 months
--Herd Mentality bias: When markets correct, not to act like other participants and stay resilient with their equity allocation

This can be achieved by staggered allocation into:
--Cyclical Sectors (that will benefit from opening up and normalising of economy) will generate Alpha
--Quality and Defensive Sectors (that have companies with superior balance sheet and P&L, and has been able to deliver strong growth across different market conditions) will help in stabilising the returns and stock market journey

Q5. Should Fed decide to pare its asset purchases earlier than usual, what would its implications for India be, vis-à-vis other emerging markets?
While anything is obviously possible, the fact that investors are conditioned and thinking about a taper tantrum should by itself reduce the shock and market volatility. It will be less of a surprise than 2013. Real yields have already moved up from extreme levels and some of the yield adjustment has been done.

The external balance of most emerging economies is far better today. Among the countries of the erstwhile fragile five, all except Turkey have dramatically improved their current account balance and foreign exchange reserves and reduced their dependence on external capital. There should be no run on their currencies this time. While fiscal deficits are much higher, as are public debt burdens, this is true globally (COVID induces fiscal profligacy was the need of the hour, which all able governments adopted).
The big difference between today and 2013 is in the dollar. In 2013, the dollar was low and rising against all EM currencies, while today most experts believe the dollar is poised to continue weakening. A weaker dollar favours emerging markets.

While a reduction in bond-buying by the Federal Reserve is inevitable, a consequent big sell-off in the EM asset class is not necessarily a given. A repeat of the taper tantrum seems unlikely. EM assets are normally a derived play on global demand. The year 2021 will be one of the strongest years for global growth in history. It seems unlikely that investors in the asset class will get spooked out of their positions by Fed’s Unwind.

India within EM space stands out on the key macro indicators that are required to fight an EM exodus like high foreign exchange reserves, low CAD, low FX volatility and strong financial markets, that will see lot of interest on any intermittent declines.

(Edited by : Santosh Nair)
Note To Readers