SUNDARAM ALTERNATE ASSETS LIMITED

Sundaram India Secular Opportunities Portfolio (SISOP)

SUNDARAM ALTERNATES
UNEARTHING OPPORTUNITIES

January 2020

Strategy Review (SISOP)

January saw the Sensex marginally decline by 1.3% to 40,723. The outbreak of the Novel Coronavirus (nCoV) was the overarching concern during January. Apart from nCoV, signing of the Phase1 trade deal, downward revisions in global growth and a flare-up in tensions between US and Iran were the highlights of the month globally. On the domestic front, strong manufacturing PMI prints, surge in CPI inflation on the back of onion prices and consequent softening seen in weekly retail onion prices were the domestic events in focus. The markets saw a net outflow of $0.2bn in January. The rupee remained flat at 71.4, while the dollar index (DXY) weakened by 1.9% during the month.

Global

The month was very volatile for the global markets. While the awaited Phase1 deal was finally signed and the markets breathed a sigh of relief, within a week from then, China saw an outbreak of the nCoV. Contrasted with this concern, that still lingers in the markets, the flare up of tensions between US and Iran faded in the backdrop. China's nCoV breakout started mid-January raising concerns that the virus would spread significantly as China's Lunar New Year celebrations were about to start. Markets were quick to react, and global equity and commodity markets witnessed significant corrections; fearing an increasing economic fallout from the nCoV spread. The World Health Organisation after initially announcing the nCoV outbreak to be a local crisis, declared it a global emergency. China has placed almost 60 million people under lockdown, with full or partial travel restrictions on 15 cities across the Hubei province that houses the city of Wuhan. Chinese holidays were extended to prevent the spread of nCoV. Experts suggest that the virus is likely to peak around mid-February and there would be a gradual return to normalcy by the month of March. Well before the breakout of nCoV, the World Bank and IMF slashed their global forecasts for 2020 by 20bps to 2.7% and by 10bps to 3.3% respectively. As the economic impact of nCoV unfolds, these numbers could see revisions in the months ahead. The markets have been toying with a 1% impact on GDP for China during 1Q 2018, this is compared to the 2% impact that was witnessed during the SARS episode in 2003. The month also witnessed US GDP growth in line with market estimates, a positive surprise in US manufacturing PMI and continued robust non-farm payroll numbers.

Central banks

The central banking space remained relatively quiet in January. The Fed left rates and policy language broadly unchanged. Fed Chair Jerome Powell mentioned that the Fed was not comfortable with inflation being persistently below its 2% target. Powell reiterated that the current stance of monetary policy was appropriate to support sustained economic growth, a strong labour market and returning to the 2% symmetric inflation objective. The Fed chair also mentioned that he saw global growth stabilising with risks at the horizon coming from the recent nCoV outbreak. He added that the Fed would continue its Balance sheet expansion until at least April this year. The slow pace of wage growth despite a strong labour market, surprised the Fed. In Eurozone, the ECB also left rates unchanged and added that against the current economic backdrop, the negative interest rate environment appeared justified. The ECB President Christine Lagarde commented that the ECB had to examine low inflation in the Eurozone and investigate the methodology of inflation calculation. Like the Fed and ECB, Bank of Japan also left its monetary policy unchanged and signalled that they were cautiously optimistic on the global economy. However, China's People's Bank, cut its RRR ratio by 50bps that helped infuse liquidity of $115bn into the system, ahead of the Chinese New Year. However, the nCoV outbreak meddles with this dynamic. Economists and analysts are trying hard to estimate the macro impact of nCoV on both Chinese and global growth. Therefore, deeper the impact, more would be the willingness of central banks to be proactive and try to offset any negative fallouts.

Domestic

Macro prints in January were very encouraging. Manufacturing and Services PMI numbers for January saw a sharp increase from both consensus and their previous prints. This was on the back of a multiyear increase in output and new businesses. Industrial production turned positive after three months of contraction and the trade deficit numbers softened. Inflation for December saw a significant rise on the back of surging onion prices. However, January saw continued drop in weekly onion wholesale prices as import-led supply increases eased the price of the vegetable. The month ended with increased expectations towards the Union budget presented in February that was broadly in-line and uneventful.

Flows

2020 started with positive flows into both Developed and Emerging Market's equities. However, US and Europe witnessed outflows with larger outflows from the US. A good part of the flows appears to be attributed to the first half of the month on positivity on Phase1 deal signing. The impact of nCoV and related macro impact concerns are yet to be seen in the data. In India, January saw inflows into equity to the tune of $1.4bn., while debt witnessed an outflow of $1.6bn.

Outlook

The last three years have been challenging for the Indian economy experiencing a slowdown. This phase of weakness started in FY17 when growth was at peak of 8.2%. Ever since then, market experts and economists have been trying to decipher the cause of this phase of weak growth. Explanations vary from demonetization to GST implementation. However, we believe that there are five clear drivers on this slowdown:

- Fall in rural income growth - A drop in food inflation appeared to greatly reduce farm realizations. The fall in wage growth added another layer to this, leading to a cumulative negative impact on consumption
- Low private capex - Low capacity utilization levels led to a continued drop in private capex, hurting investment growth
- Liquidity squeeze in the shadow banking sector - This led to a direct drop in subprime lending that was a key trigger for a slowdown in the real estate and automobile sector
- Sharp drop in automobile demand - This led to an overall weakness creeping into manufacturing
- High real rates - Demand and investment growth witnessed considerable pressure on account of high real interest rates in the economy

Despite low capex, the economy was growing at a decent clip till FY15, supported to a large extent by rural wage growth. However, five consecutive years of rural weakness clubbed with a drop in capex led to a substantial slowdown in the overall economy.

We see FY21 to be the start of an economic recovery that would be more gradual. We see India in FY21 to benefit from the following:

- Higher rural income on the back of a good monsoon and higher food inflation
- Normalization of liquidity in the shadow banking sector due on back of continuous government efforts
- Improving global growth post the trade-war phase would lead to a pickup in Indian exports
- Demand pickup in automobiles, supported by improved liquidity and rural income growth

Despite the current economic slowdown and weak corporate earnings our disciplined approach to stock picking has greatly helped us. This discipline has helped us generate significant alphas in your portfolios over the period of last 2 years. The key mantra for the outperformance has been betting on earnings growth along with a concentrated approach to portfolio construction. Even in weaker economic conditions, we notice that there are segments like private sector banks, chemicals and consumer discretionary where earnings growth has been impressive. We maintain substantial weight for these sectors in our portfolios.

As the economy recovers, we believe these sectors will continue to outperform, as India's young population spends more on consumer discretionary and our private sector banks/shadow banks gain market share from PSUs. We also see sectors like cement, capital goods and auto to start participating in the earnings growth over next 3 years.

Filters for stock selection within these sectors will always be driven by higher earnings, cash flow growth and a strong balance sheet with low DE/ROE ratios. The importance of a visionary and a clean promoter / management cannot be understated. In the long run companies with the above attributes will always manage to substantially outperform peers and create wealth for investors despite operating in tough economic conditions.

Stay positive, Stay Invested

EXPERT SOLUTIONS
HAND DELIVERED

SUNDARAM ALTERNATE ASSETS
SISOP Portfolio

Objective

To generate capital appreciation across market cycles by investing in a concentrated set of high conviction stocks.

Target Investors

This portfolio typically invests across cap curves targeting companies with sustainable competitive advantages and reasonable valuations based on our analysis of fair value.

3Q Quality Approach To Stock Selection

Quality of Business

Pricing Power, Profitability, Growth, Brand Strength, Capital Intensity, Complexity of Business

Quality of Management

Past Track Record, Management Bandwidth, Corporate Governance

Quality of Financials

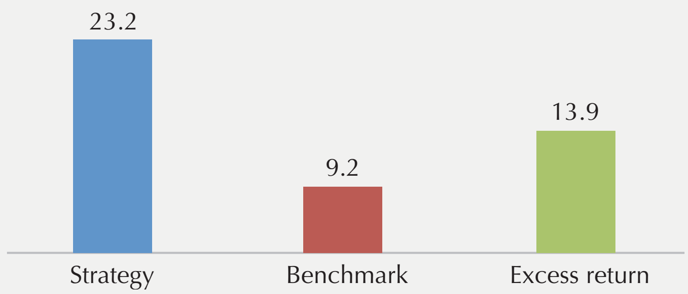
Capital Allocation, Leverage, Cash Flow Generation, Return on Capital

Performance (%)

	1Y	2Y	3Y	5Y
SISOP Portfolio	28.3	9.6	14.1	9.8
Nifty 500	9.5	0.8	10.1	6.6
Excess returns	18.7	8.8	4.0	3.2

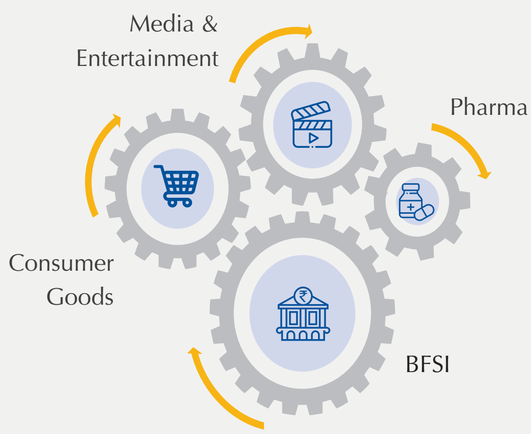
Time weighted returns for periods greater than one year

Performance Since Inception - February 2010 (%)

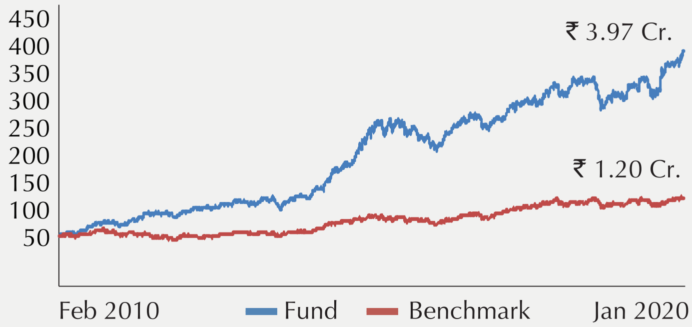


Compounded annualized returns (CAGR) are in percentage, excess returns is in percentage point

Sector allocation to capture the India Story



Value of ₹ 50 Lakhs invested at launch



Key Features

- Concentrated ~15 stock portfolio
- Invests across market cap – "Multi Cap" (skewed toward large cap)
- Long term orientation in portfolio building i.e. >3 years

Compounding Stories

i. **G**row more than 1.5x nominal GDP growth
ii. **P**otential to generate ~ 20% cash flow / earnings growth across market cycles
iii. **R**OE: > 20%
iv. **S**elf funded model - Growth through internal accruals.

- Companies should exhibit high Corporate Governance standards and have visionary leadership.

Performance Measures - Since Inception

	Strategy	Benchmark
Arithmetic mean	21.9	9.9
Annualised Standard Deviation	14.8	14.8
Beta	0.8	-
Sharpe Ratio	1.0	0.2
Correlation	0.8	-
Alpha	12.7	-
Tracking Error	10.1	-

All data as of 31st January 2020 *Source: Inhouse computation*

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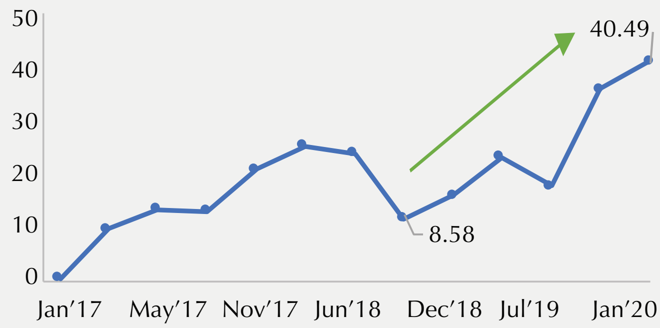
Calendar Year Performance (%)

	Strategy	Benchmark	Excess return
CY 2010	58.2	20.7	37.5
CY 2011	8.5	-27.2	35.7
CY 2012	38.0	31.8	6.1
CY 2013	9.2	3.6	5.6
CY 2014	77.5	37.8	39.7
CY 2015	3.7	-0.7	4.5
CY 2016	7.6	3.8	3.8
CY 2017	28.6	35.9	-7.3
CY 2018	-3.1	-3.4	0.3
CY 2019	18.4	7.7	10.8
2020 YTD	5.0	-0.1	5.1

Returns are in percentage; Excess Returns are in percentage points

Important to Stay Invested (Absolute Return in %)

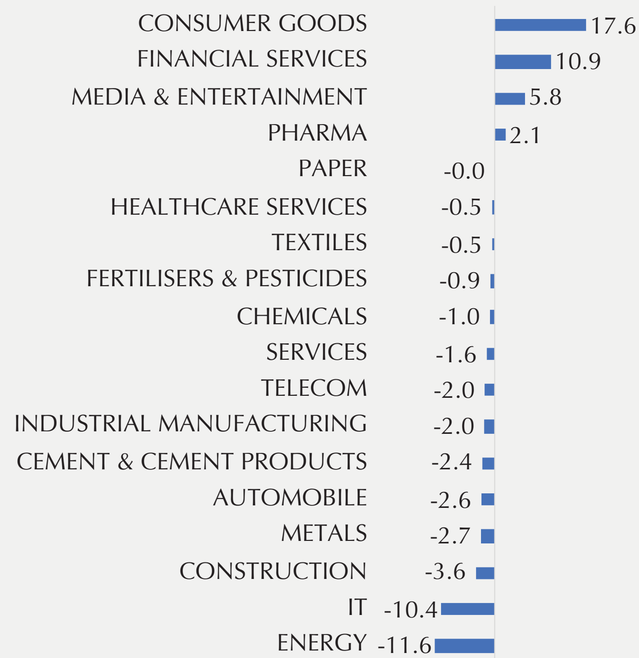


An investment made in Jan 2017 would have returned only 8.58% upto Dec 2018. However, over the next 1 year the returns have grown 5x to 40%. This illustrates the importance of staying invested the long termfor the long term.

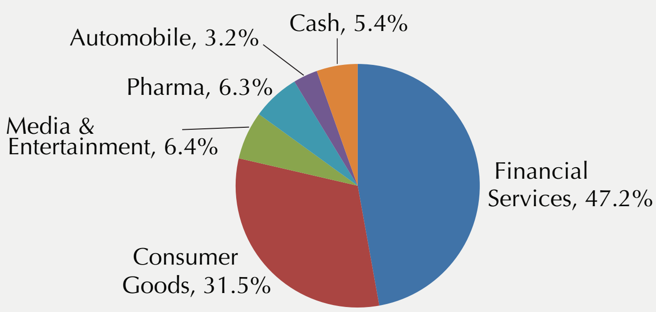
Key Contributors to the Strategy

Name of the stocks	Weighted Avg Cost (₹)	Market Price (₹)	Gain/Loss (%)
HDFC Bank	501	1,226	145
Kotak Mahindra Bank	917	1,692	84
Berger Paints I Ltd	317	560	77

Sector Bets (%) - Underweight/Overweight vs Benchmark



Sector Allocation



Wt. Avg. Market cap 1,78,263 Crs

Top Holdings - # Stocks -12

HDFC Bank Ltd

Titan Industries Limited

Bajaj Auto Finance Ltd

AU Small Finance Bank Ltd

Berger Paints I Ltd

Market Capitalization (%)

Large Cap	Mid Cap	Small Cap	Cash & Others
69	19	6	5

All data as of 31st January 2020 *Source: Inhouse computation*

Key Holdings

Titan Company Limited

Titan boasts a strong balance sheet and a track record of generating cash flows across business cycles. The current disruption and lack of trust in unorganized jewellery due to the Nirav Modi scam further strengthens investment case for Titan, a well managed business entity led by a team of professionals adhering to high corporate governance standards.

Network expansion into tier 3 cities and beyond, strong sales growth from the existing stores to be the growth drivers for the future. Focus on high value diamond jewellery, wedding jewellery and new stores addition is likely to facilitate 15-20% growth in top line for Titan. Management guidance for a 20% revenue CAGR for next 5 years fits into our “Buy and Hold” philosophy of SISOP.

Increase in market share facilitates improvement in operating leverage which allows the company to deliver higher earnings growth compared to the revenue growth. A stable balance sheet, capability to invest and nurture multiple consumer discretionary products like watches, eye wear and ethnic women's' wear like sarees is another reason to invest in the name.

HDFC Bank

HDFC Bank is the market leader in most of the retail segments (ex Housing) the bank operates in. On the corporate front the bank now has full capabilities on the DCM, project financing and syndication front which puts the bank in a lead position to gain market share from PSU banks. In addition to banking services, HDFC Bank also offers securities trading through HDFC Securities and other financing products through HDB Financials.

The key differentiation of HDFC Bank is that it is one of the few banks to offer all products in all the branches for all the segments of customers in all geographies. This together with lowest cost of funding and strong processes means that the customer especially the good quality borrowers get the best deal. On the liabilities front HDFC Bank has one of the best technology platform and a wide branch network essentially giving best in class service to customer. 11 of the 21 PSU banks are in PCA which puts severe restrictions on their lending capabilities. Banks like HDFC Bank will benefit from the situation to gain market share in corporate lending. HDFC Bank is likely to deliver PAT growth of 20% CAGR over next 2-3 years which should translate into EPS CAGR of 18%.

AU Small Finance

Increasing mobile penetration and digitization will help new generation companies to reach customers quickly and help them to gain market share at the cost of large PSU Banks. Also, a bank which has access to low cost of funding would be able to cross sell their products and be competitive compared to NBFCs. This is where AU Small Finance Bank is in a sweet spot. AU has deeper penetration in specific markets, and having transitioned into a Bank, they would be at an advantage compared to other PSU Banks and NBFCs.

AU operates through ~400 branches across 11 states; based out largely in Rajasthan. MP, Gujarat, Maharashtra and Punjab are its next leg of regions in terms of presence and growth. 60% of their presence are in Tier 2 to Tier 6 Cities, which we call as “Deeper Penetration”.

We expect AU Small Finance bank to grow in book size at CAGR of 35% over the next 3 years till FY22. The company has launched new products like home loans, 2-week loans, gold loans etc., from cross selling point of view. This is likely to drive growth for AU over the next 5 years. We expect CASA ratio to improve to 32-35% by FY22. This should help in reducing their cost of funding. Expectations are that ROA, which has been beaten down due to aggressive branch additions and due to their transition into a bank, should start improving from Q4 FY19 onwards. In the long term we expect AU to maintain ROE of 18-19%

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Customer Services

Reporting Statements and Servicing	Monthly performance Statements Transactions, Holding & Corporate action reports, Annual CA certified Statement of the account & Online access

Why Sundaram PMS ?

1. Strong Track Record
2. Low Churn
3. Time Tested Stock Selection Process
4. Reach Across Country
5. Transparency
6. Strict Adherence to Risk Guidelines
7. Shared Research Capabilities

Fund Facts

Investment Horizon	Above 3 years
Benchmark	Nifty 500
Fund Manager	Madanagopal Ramu

Disclaimer

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