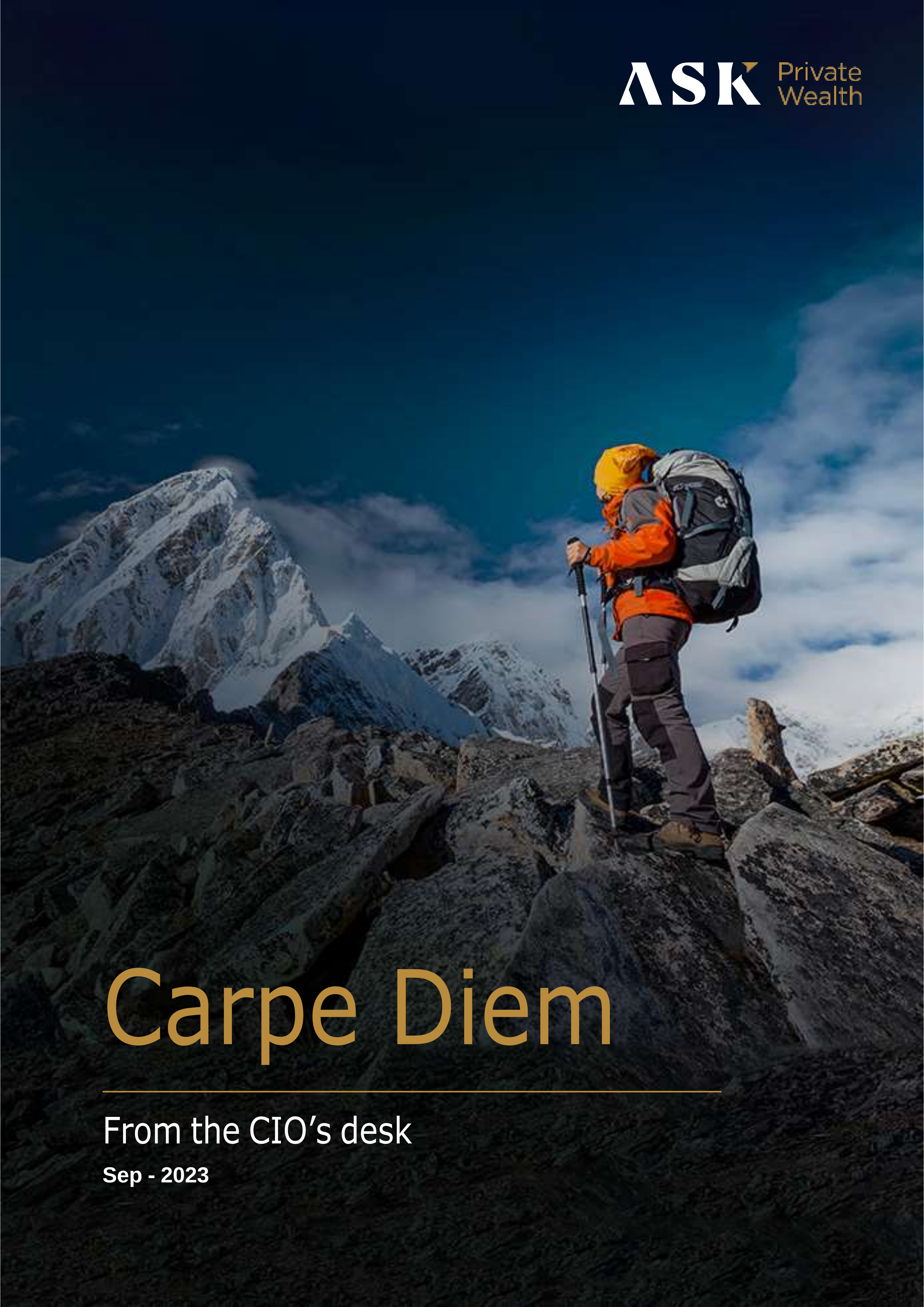

ASK Private Wealth

Carpe Diem

From the CIO’s desk

Sep - 2023

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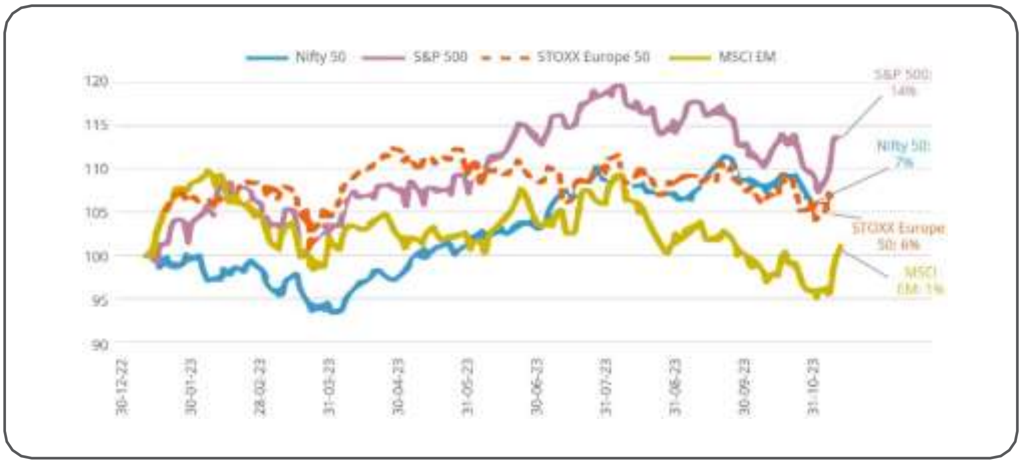
"May you live in interesting times" – thus goes what the Chinese believe is the best benediction a new-born can be given. It would seem the present generation has been blessed three times over! In the current decade itself, barely three years into it, we have faced a once-in-a-century pandemic, a European war (in Ukraine) with global participation, emergence of a new super-power (China) challenging the incumbent and now a potentially catastrophic conflict in the Middle-East. There are seven more years to go in this decade, and several are perhaps wishing for somewhat less interesting times during that period!

Markets have been remarkably resilient

Despite volatile geopolitics playing out across the board, capital markets have been remarkably resilient.

Figure 1: Markets have broadly moved up despite geopolitical uncertainties



Source: Refinitiv, ASK PW

Major markets have shrugged off both tightening US interest rates and geopolitical risks. After a major meltdown last year, US markets have led. India hasn't done badly either.

Part of investor sanguine-ness is due to realization that wars don't have much lasting impact on markets.

Figure 2: Geopolitical events and their impact

Market Shock Events	Event Date	S&P 500 Index Returns after (%)			
		1M	3M	6M	12M
Germany invades France	10-05-40	-19.9	-12.7	-4.5	-19.7
Pearl Harbour attack	07-12-41	-1.0	-11.0	-6.5	4.3
N Korea invades S Korea	25-06-60	-10.0	1.0	4.1	11.7
Hungarian uprising	23-10-56	-2.1	-2.8	-1.3	-11.7
Suez crisis	29-10-56	-4.4	-3.6	-0.0	-11.6
Cuban missile crisis	16-10-62	6.1	14.1	20.7	27.6
Kennedy assassination	22-11-63	6.8	11.9	15.5	23.2
Gulf of Tonkin incident	02-08-64	-1.6	1.9	5.3	2.7
Six-day war	05-06-67	3.3	5.9	7.5	13.5
Tet offensive	30-01-68	-3.8	5.1	5.2	10.2
Penn Cental bankruptcy	21-06-70	-0.1	7.2	16.8	23.6
Munich Olympics	05-09-72	-1.0	5.7	2.3	-5.8
Yom Kippur war	06-10-73	-3.9	-10.7	-15.3	43.2
Oil embargo	16-10-73	-7.0	-13.2	-14.4	36.2
Nicon resigns	09-08-74	-14.4	-7.0	-2.8	6.4
Reagon shooting	30-03-61	-0.9	-1.8	-14.0	-16.4
Continental illinois Bailout	09-05-84	-3.1	1.0	6.4	12.8
1987 stock market crash	19-10-87	0.1	10.9	14.7	22.0
Iraq's invasion of Kuwait	02-08-90	-8.2	-13.5	-2.1	10.1
Soros breaks Bank of England	16-09-92	-2.5	3.0	6.8	9.9
First World Trade Centre bombing	26-02-93	1.7	2.0	4.0	4.7
Asian financial crisis	08-10-97	-3.7	-1.8	14.1	-1.5
USS Cole Yemen bombing	12-10-00	2.7	-0.9	-11.3	-19.6
US Terrorist attacks	11-09-01	-0.2	2.5	6.7	-18.4
Iraq war started	20-03-03	1.9	13.0	18.7	28.7
Madrid bombing	11-03-04	3.5	2.7	1.6	8.4
London subway bombing	05-07-05	3.3	1.8	5.3	5.5
Bear Stearns collapses	14-03-08	3.6	5.6	-2.8	-41.5
Lehman Brothers collapses	15-09-08	-16.3	-26.2	-34.8	-11.7
Boston Marathon bombing	15-04-13	6.3	8.4	0.7	17.9
Russia annexed Crimea	20-02-14	1.5	2.6	8.0	14.7
BREXIT	24-06-16	6.5	6.2	11.0	19.7
Bombing of Syria	07-04-17	1.9	3.1	7.6	12.6
North Korea missile crisis	28-07-17	-1.1	3.6	14.9	13.4
Saudi Aramco drone strike	14-09-19	-1.4	5.4	-8.8	12.5
Iranian general killed in airstrike	03-01-20	1.9	-23.1	-4.2	14.4
US pulls out of Afghanistan	30-09-21	-3.7	2.9	-4.9	-12.0
Russia invades Ukraine	24-02-22	6.9	-7.2	-7.1	-7.1
Average		**-1.2**	**-0.2**	**2.0**	**2.1**
Median		**-1.0**	**2.2**	**4.0**	**7.4**
% Higher		**42.1**	**63.2**	**57.9**	**63.2**

Source: CARSON, Refinitiv, ASK PW

As can be seen in the table above, barring the two world wars, major conflicts have not really had any adverse market impact. If anything, some wars could have led to fiscal pump priming that propped markets up.

Indian Equities – Well-priced, But Earnings Keeping Up

There has been persistent fears of earnings tapering off in India. But fears have been found to be unfounded, so far. Nifty earnings are on track to end this year with high-teens/near-20% levels of growth. High frequency indicators at the beginning of the festive season – travel, cars, consumer durables, GST, bank credit – are all heavily in the "green". The momentum is with the upper hand of the K, but even a small upper-hand is a large number in absolute terms for India.

Mid-cap Valuations – Much Ado About Little

Over the last couple of months, there have been persistent fears on valuations of Small and Mid-Cap (SMID) stocks. While there is some intuitive appeal to the fears, data doesn't support the same.

When large part of the market is on one side, its usually not a great side to be on. Too many people are cautious, barring retail investors. Neither Earnings not valuation multiples are supporting the fear case on SMID.

Figure 3: Valuations of both large and mid-caps are closer to their historical average

Figure 4: Earnings potential placed higher for mid-caps at present

Source: CMIE, Bloomberg, Refinitiv, ASK PW

In a nutshell, SMID have similar comparative valuations as large-caps, both at historical and at relative levels. But they are offering better growth profiles than large-caps. There isn't a great daylight on relative risk that is visible for us to make an allocation call.

There is some more justified apprehensions about absorptive capacity of SMID markets, given the large AUMs being collected by MF/PMS/AIF structured around SMID themes. However, managed fund AUMs still comprise a relatively modest 10-11% of total free float of SMID space. Ergo, while a little stretched at specific fund levels, there isn't a market-level issue on SMID.

If anything, the recent blip in markets (post the conflict in Gaza) saw the small-cap index outperform Nifty, while Mid-cap was broadly in line with Nifty.

The Name is Bond, Sovereign Bond

The space that shows the highest margins of safety in the capital markets today is sovereign bonds. Inflation has cooled, but policy rates and bond yields remain high. Real interest rates are the highest they have been in many years.

With global growth slowing, Indian macro growth also showing signs of slowdown, rates are likely to come off significantly in the foreseeable future. Extending duration of bond holdings is a high conviction call that investors can make. As a quick illustration, if 10 year G-Sec yields fall by 1% in the next 18 months, the investment will yield 11-12% IRR for the investor. On the other hand, the downside risk of going wrong (or delayed) is limited, given the high yields already embedded in bonds today.

Figure 5: Real policy rates are positive now and much above historical average

Source: CMIE, Refinitiv, ASK PW

Harmony Portfolios Positioning – Long Bonds, as long as we can, Keeping Equities at Equal-weight

- Long bonds is the definitive idea of the moment. High grade, long duration bonds offer the best risk-reward spot of opportunity. We have extended our bond maturities, with average maturity of 7.5 years in our AAA/sovereign bond positions.
- In equities, we are keeping even weightage on SMID, while being strictly neutral on overall equities allocations. We are fully allocated to Strategic Asset Allocation (SAA) limits of each strategy but disciplined about trimming profits when allocations tip over.
- Financials are looking good, in fact present greatest value in the equities patch. It is what Tech is to US markets, and unlike US Tech it is offering relative value and growth.

Pascal's Wager on Markets – Be Strongly "Bonded"but Keep the Faith!

Pascal's Wager is a practical argument for belief in God formulated by French mathematician Blaise Pascal. Using game theory, Pascal showed that belief in God is rational. He argued that people can choose to believe in God or can choose to not believe in God, and that God either exists or he does not. Under these conditions, if a person believes in God and this God actually exists, they gain infinite happiness; if a person does not believe in God and God exists, they receive infinite suffering. On the other hand, if a person believes in God and God does not exist, then they receive some finite disadvantages from a life of Christian living; and if a person does not believe in this God and God does not exist, then they receive some finite pleasure from a life lived unhindered by Christian morality. There is a similar, though somewhat more ephemeral, case for a strong wager on sovereign bonds. Especially useful in a world where there is too little blood in the equity street to make outsized bets on equities. On the other hand, a Pascal's Wager on markets generically in the long term remains good - it always pays to keep the faith in markets!

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