

2024 - The year of reckoning

2023 ended on a high. GDP estimates held on and with interest rates stabilising, it led to a "goldilocks" kind of scenario. Lack of earning downgrades despite headwinds in IT and Consumption was the key for equities. We had expected the markets to be broad based at the beginning in 2023 as investment cycle recovery across private sector and real estate recovery was truly underway after kicking off in 2022. In addition, India's ever improving position as an important player in the realigned supply chain dynamics over the next decade is real and there is enough evidence of it in our interactions with the corporates across sectors especially manufacturing. Notwithstanding the above tailwinds, the intensity of market breadth in 2023 beat all expectations as mid and small caps led the broader indices (Nifty 500) to significantly outperform the large cap ones (Nifty50, Nifty100) during the year.

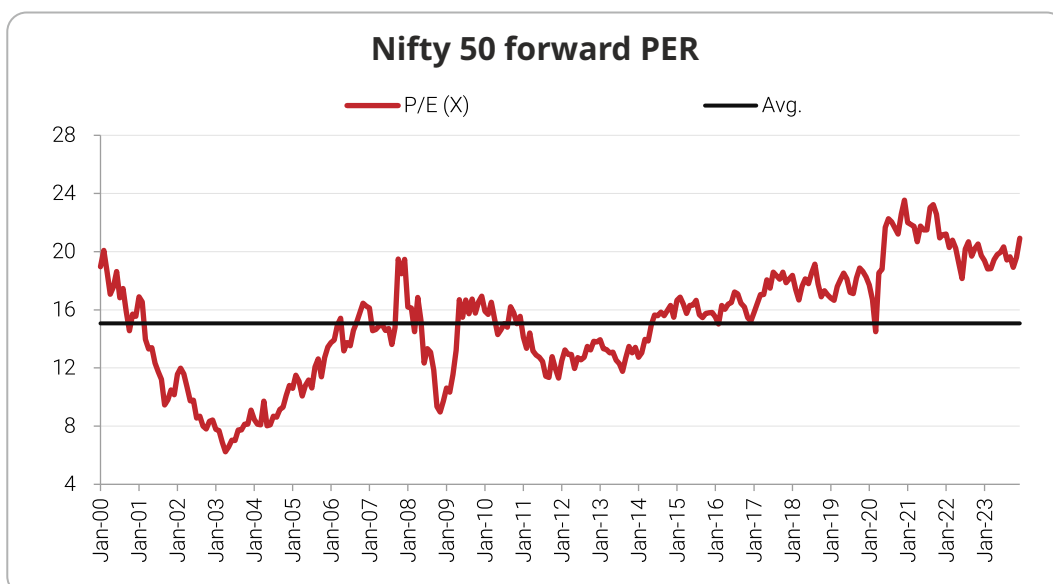
Infact, it is interesting to observe that all the "visible" risks in the markets at the beginning of 2023 have either faded or markets have become accustomed to it. Please note that the risks have not completely gone away but the perceived probability of it materialising into a market-changing risk-off event is much lower now.

- a. Russia-Ukraine war (and the Israel-Hamas conflict) are likely to be long drawn out with lower chances of escalation beyond the immediate boundaries
- b. The general elections in 2024 – much more belief in stable and strong government coming back post the state elections
- c. While economic strength in US despite rate hikes has been surprising, Fed is likely to press any further hikes although elevated budget deficits might keep the bond yields elevated vis-à-vis pre-Covid levels.
- d. The risk of a financial accident played out partially with the US mid-sized banks but the impact was contained.

How high can Nifty PE Ratio go?

The relative lack of perceived risks at the beginning of 2024 therefore begs the question - How high can Nifty-50 PER go?

We look at the long term history of fwd PER for Nifty 50 and its interesting to note that during the last period of sustained investment cycle and moderately declining interest rates, the PER peaked at 22-23x as compared to present levels of 20.5x.

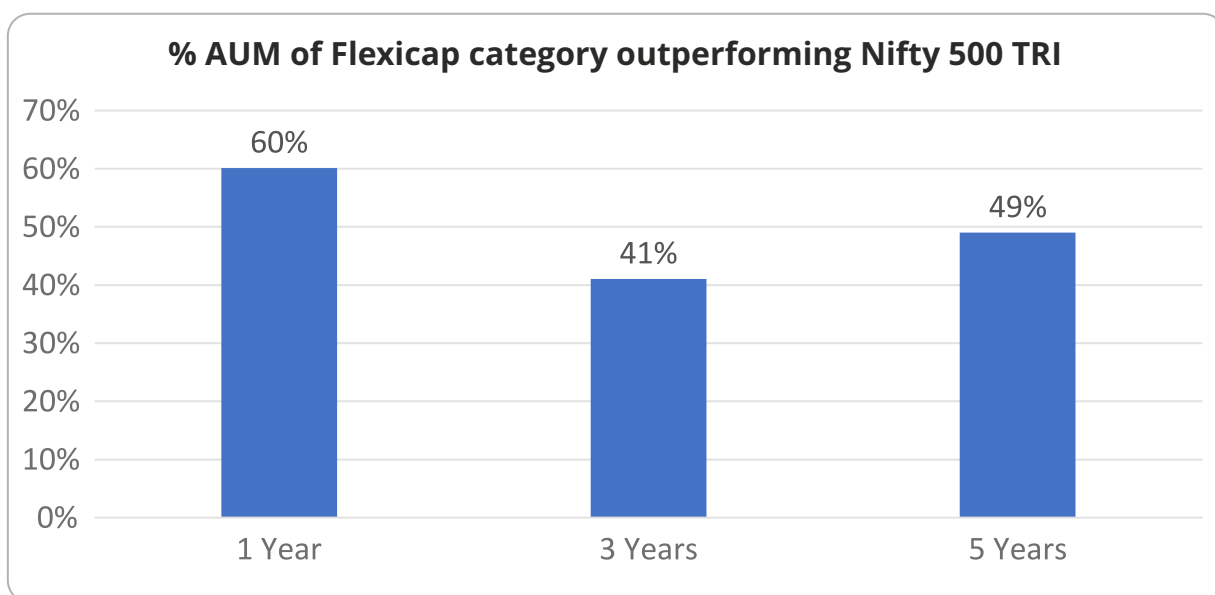


While the above chart makes the case for further upsides in 2024 (especially large caps) with reduced chances of a sharp correction, we also believe that it is important to watch out for signs of a bubble. No two bubbles are the same. History does not repeat but it rhymes. We have therefore identified a few of those warning signals from our past experience (especially 2008 given the similarities in the economic cycle). Investors should monitor the below and use it as an input either for asset allocation or category allocation (within equities).

- 1. Option value:** In the 2008 cycle, the valuation targets had started ascribing value creation from projects that had not even started or ascribing simplified valuation multiples to estimate the option value. In these cases, valuation targets of companies start moving from traditional parameters (PER, EV/EBITDA) to option values based on opportunity size. Typically, such valuation methods accompany sharp price movements based on simple announcements of market entry or expansion by companies. As an example, we are seeing signs of these in the electronic manufacturing space recently.
- 2. Holding company discounts:** In the last leg of the bull markets, the holding company discount narrows significantly vs. the historical mean. The price movement of listed holding companies therefore is usually a good indicator of where we are in the bull market cycle.
- 3. Quality of IPOs:** There has been a spate of IPOs recently, however, the quality has been reasonable with decent management track record. While the valuation in some of the IPOs can be questioned, nature and quality of businesses has been by and large robust. Most of the bull markets end with a large IPO with i) questionable quality and/or ii) stretched valuations. We feel that at least one of the two factors is not a risk as of now.

The Active vs. Passive debate

Whatever be the upside and the timing of it in 2024 i.e. either steady returns through the year or a sharp spike in the short term, it is clear that the economy is going through a broad-based recovery with structural drivers. Hence the opportunity for active funds to outperform the benchmark remain bright. We take this opportunity to compare the 1/3/5 year performance of Flexicap funds as a representative category for active funds which indicates a significant improvement over the previous year (January-December 2023) in terms of outperformance vs. Benchmark (Nifty 500). It is also important to note the 5-year performance since it has come after the period ending in 2018, which arguably was one of the worst years for active funds.



Based on performance of Direct growth plan of schemes under Flexicap category as on 31st Dec 2023

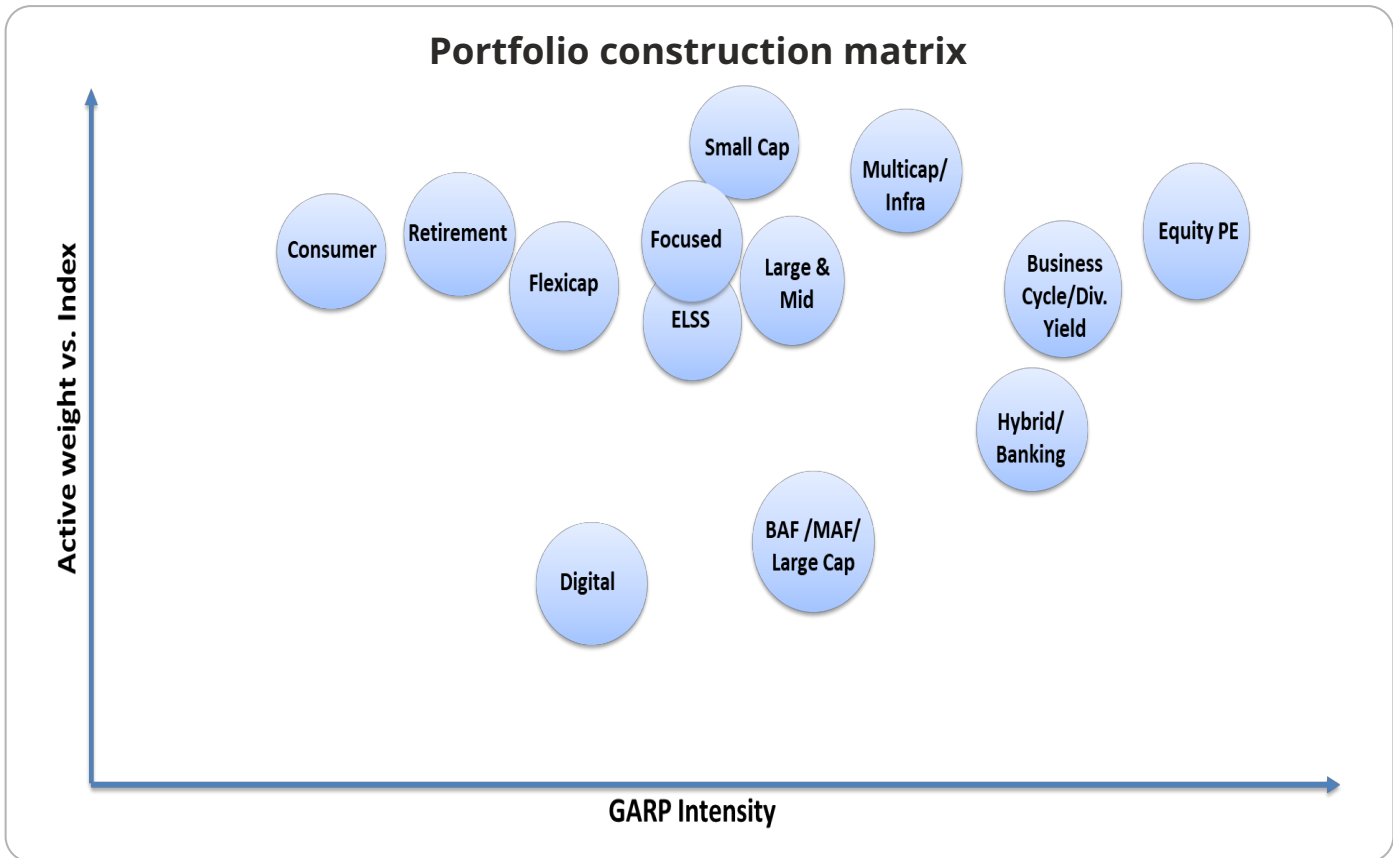
What role does Investment philosophy and portfolio construction play?

Tata Mutual Fund follows Growth at Reasonable Price (GARP) as investment philosophy for alpha generation and adopt it in different levels in portfolio construction across various schemes. We believe that GARP as an investment philosophy offers best chance to create alpha in the current economic cycle not only by taking advantage of the opportunities but also managing the risks through market cycles which are driven by fundamentals and sentiment.

Refer to the schematic below which depicts each of Tata MF schemes in two parameters –

- i) GARP intensity i.e. how much the scheme relies on GARP to generate alpha. While we follow GARP as investment philosophy across all categories of funds, the proportion of it might vary depending on category of scheme (for example thematic vs. large cap vs. small cap) and the scheme mandate (for example BAF vs. Business Cycle vs. Multicap)
- ii) Active weight - how much the scheme portfolio deviates from the benchmark index. Higher the active weight, greater the deviation from benchmark in search for alpha.

To further explain with examples, Tata Balanced Advantage Fund and Tata Large Cap will be low on active weight and moderate on GARP intensity. In contrast, schemes like Tata Equity PE and Tata Business Cycle Fund will be high on active weight and higher on GARP intensity. In other words, the scheme mandate and goals decide the portfolio construction within the overall investment philosophy.



It is quite clear that the markets are entering 2024 with stable domestic macros, global structural tailwinds favouring India and an investment led economic growth outlook which bodes well. In addition, the perceived risks have been reducing. Markets can therefore remain constructive in 2024 although the starting point of valuations offers lower upside. At the portfolio level, combination of GARP and active weight provides opportunities to create alpha even while managing the inherent risks. Meanwhile, looking for any early warning signs of a bubble combined with focus on asset allocation will be important for investors.





Wish all the readers a very happy and prosperous 2024

Happy Investing!



Rahul Singh
Chief Investment Officer (CIO) – Equities

**Source: Tata AMC estimates, Bloomberg*

<p>These products are suitable for investors who are seeking*:</p> <p>Tata Large Cap Fund: (An open-ended equity scheme predominantly investing in large cap stocks.) • Long Term Capital Appreciation. • Investment predominantly in equity & equity related securities of large cap companies.</p> <p>Tata Equity P/E Fund: (An open ended equity scheme following a value investment strategy.) • Long Term Capital Appreciation. • Investment (minimum 70%) in equity & equity related instruments of companies whose rolling P/E is lower than rolling P/E of S&P BSE Sensex.</p> <p>Tata Business Cycle Fund: (An open-ended equity scheme following business cycles based investing theme.) • Long Term Capital Appreciation. • An equity scheme that invests predominantly in Indian markets with focus on riding business cycles through dynamic allocation between various sectors and stocks at different stages of business cycles.</p>	<p style="text-align: center;">Scheme Risk O Meter</p>  <p style="text-align: center;">RISK - O - METER</p> <p style="text-align: center;">Investors understand that their principal will be at Very High Risk</p>	<p style="text-align: center;">Benchmark Risk O Meter</p>  <p style="text-align: center;">RISK - O - METER</p>
<p>Tata Balanced Advantage Fund: (An open ended dynamic asset allocation fund.) • Capital Appreciation along with generation of income over medium to long term period. • Predominant investment in equity and equity related instruments as well as in debt and money market instruments.</p> <p>*Investors should consult their financial advisors if in doubt about whether the product is suitable for them</p>	 <p style="text-align: center;">RISK - O - METER</p> <p style="text-align: center;">Investors understand that their principal will be at Very High Risk</p>	 <p style="text-align: center;">RISK - O - METER</p>

(It may be noted that risk-o-meter specified above is based on internal assessment. The same shall be updated as per provision no. 17.4.1.i of SEBI Master Circular on Mutual Fund dated May 19, 2023, on Product labelling in mutual fund schemes on ongoing basis).

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Mutual Fund investments are subject to market risks, read all scheme related documents carefully.