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AMBIT 365

THE SINE CURVE: SANTA RALLY!

NEWSLETTER • JANUARY '24

SANTA RALLY!

While the markets have seen a strong Santa rally in the past, December 2023 stood out in terms of strength of participation. Average Daily turnover was 50% higher than in November, and double that of December 2022. It was a solid month for IPOs- 12 IPOs raised Rs8932cr this month, compared to the Rs4120cr monthly average for 2023. 4 IPOs opened during the 'lean period' of Dec26-31, and were hugely successful. The key driver of this market has been retail investors- **retail has become the price-setter and institutions are price-takers.** Nifty rallied 7.9% this month. While the rally was broad-based, the most conspicuous part of the move was the revival in bank stocks. Bank Nifty was up 8.6% in December, which accounted for more than two-thirds of the sector's 13.5% move in 2023. HDFC Bank (+10%) is coming out of a 3-year consolidation and SBI (+14%) is coming out of a one-year sideways consolidation.

Ambit 365 made 3.8% in December. In our last newsletter- we observed that shorts were just not working during rallies. All macro risks are now back-ended. Our net stock exposure till about the 20th of the month was ~25%. This worked well for the book. Post 20th, we preferred to reduce the longs, to protect the gains and risk into the year-end. Long book attribution this month was a strong 4.4%, with an average weight of 44% during the month. Ambit365 generated most of its alpha from PSU names- NTPC, BHEL, HAL, PNB, BEL & REC/PFC. Energy, Defence, and convergence of PSU banks with the private banks in operating metrics and valuations are still the running themes. PSU entities have become institutional, reflected in their execution & performance which is largely dependent on political stability, reforms & governance. A few of these are discussed in more detail in this newsletter. Nifty also worked well for us this month

FLOWS & THEMES - 2023 RECAP

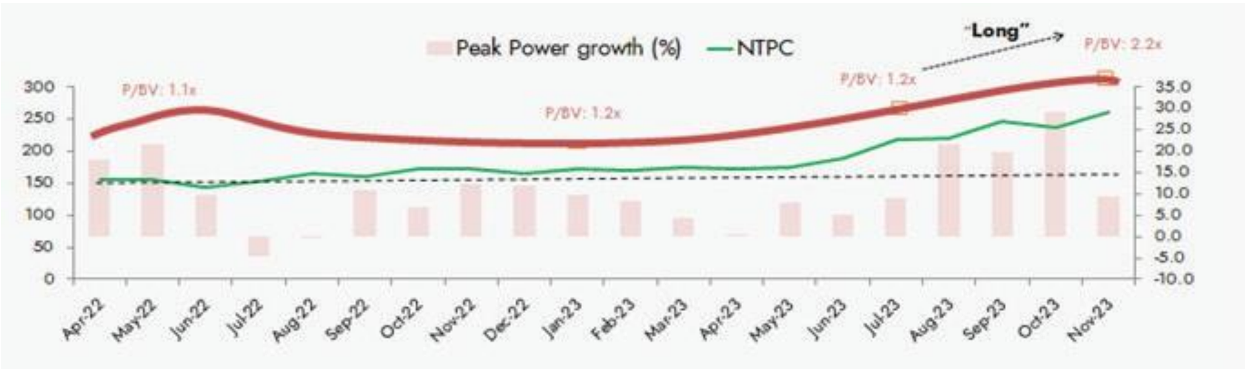
While most of the sectors ended in green this year, 3 themes stood out. —Strong performance PSUs (BSE PSU index up 61%; Energy and Defence led the pack), Mid and small-caps (up 47% and 57% respectively: 64%+ most of this year's inflows into domestic funds are in mid and small-cap funds), and the stark underperformance of banks. This year's 20% gain in the nifty was driven by both FII and DII inflows — of $20bn and $24bn respectively. Supply of paper responded well to this demand surge - total paper supply this year was ~$35bn - $21bn of promoter and private equity block sales, $7bn IPOs, and a similar amount raised by QIPs. Hence net institutional funds flow in the market was ~$9bn. Paper supply momentum is likely to continue into 2024- it is now like a high-speed treadmill. Markets will need incremental flows of $40-50bn/ year to sustain the momentum.

Strong November and December rallies were underpinned by a) Expectations that the US Fed will start cutting rates from 2Q2024, b) strong earnings performance (nifty earnings growth in H1 is 35% y/y), and c) good performance of the BJP at state elections. As we are about to start the January results season most watched metric will be a) the sales growth pick up (1H sales growth has been weak at 4.2%), and b) how much the US economy slowdown (we can't have a steep rate cuts without a slowing economy). For a long time, we have not heard the term 'risk-off', we may hear more of it during this year. RBI suddenly seems worried about the rampant retail credit growth & gap between credit growth & deposit growth - especially unsecured personal credit growth and has taken measures to increase risk weights on unsecured credit and asked banks to keep credit deposit ratio <80%, and increase the CET-1 ratio for 2 domestically important large banks. This with tighter liquidity conditions (consecutive deficit for 4 months) can slow down credit offtake as well.

PSUs – CONVERGING METRICS

Sine Curve 1: Upturn in Power Sector

The power sector is a beneficiary of macro changes and a favourable policy environment – a) Reforms in the DISCOMs sector aiding financial discipline; b) High capex phase – 80GW of the new thermal pipeline leading to power capex at 9% CAGR where BHEL & NTPC to be the biggest beneficiary; c) Energy Transition – Renewable mix is estimated to improve from 26% in FY23 to 50% in FY30; d) Financiers - Demand for Rs10trn of additional funds will drive growth and DISCOM reforms should keep slippages and under control and e) Financials - PAT–CAGR improving from mid-single digit over FY13-23 to low double-digit over FY23-27E.



Source: CEA, Govt of India & Bloomberg

Sine Curve 2: PNB's Asset Quality Improvement

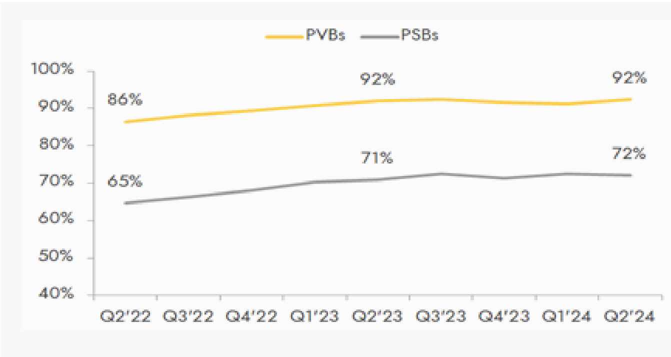
PNB is expected to see sharp asset quality improvement from 8.7% in FY23 to 3.6% in FY26E driven by higher recoveries & lower slippages. RoA is estimated to improve from 0.2% in FY23 to 0.8% in FY26E (Bloomberg consensus estimates).

Source: Bloomberg & Financials

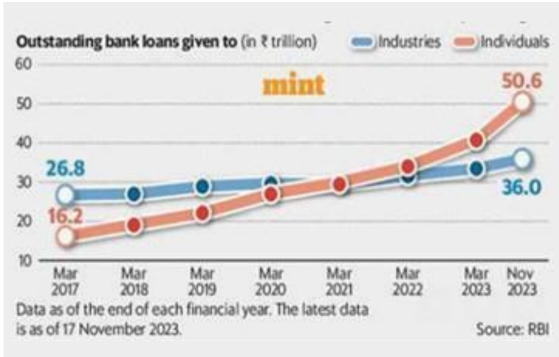
The underlying earning quality for PSBs has improved significantly & 1% RoA which was aspirational is turning into more of a reality. The sustainable earnings growth is driving valuations re-rating as seen in the other sectors.

There is little to differentiate between banks on growth now; growth across banks is estimated in the 14-16% range for FY25. Deposits growth (a key variable for margins, as the CD ratios are running high) is seeing divergent performance. PSBs are better placed — as the CD ratios are lower than the private banks. Hence, PSBs are expected to see lesser margin compression compared to private banks.

BFSI: CD ratio divergence for PSBs vs. PVBs



BFSI: Divergence credit share trend



Source: Companies Financials for CD ratio - PVBs (HDFCB, ICICIB, AXSB, KMB, IIB) and PSBs (SBI, BOB, Canara, PNB, Union)

OUTLOOK

We entered January with a cautious positioning. Nifty has had a record 8th consecutive year of positive returns. The last best was 6 consecutive years over 2002-07. We have built short positions in IT, reflecting our view that the US economy slowdown would stall the much-awaited pick-up in growth. We are long PSU banks and short private banks — PSU bank's CD ratios are well under the red line, and the exposure to unsecured credit is also lower. PSU-Private banks valuation convergence should continue. We continue to maintain a positive stance on energy and defence. In January we started building positions in pharma - on a strong US generics outlook, and plan to ramp it further as we go along.

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