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AMBIT 365

THE SINE CURVE: RISK IS NOW PUSHED INTO THE FUTURE

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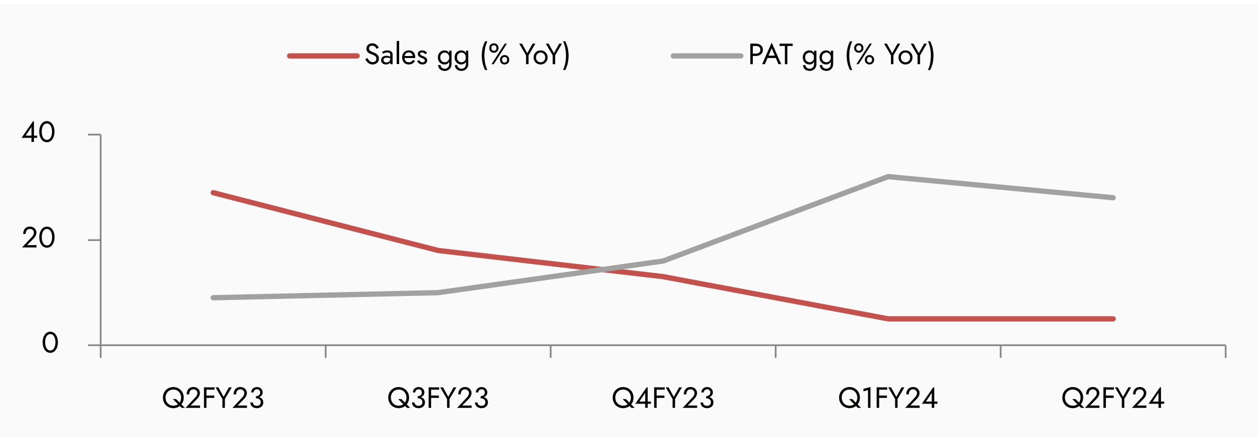
RISK IS NOW PUSHED INTO THE FUTURE

The narrative in November changed very quickly from rising bond yields in the USA to expectations of sharp rate cuts starting maybe as early as March 2024 next year. While the yield curves are forecasting 100-125bps of rate cuts in the USA in 2024, few of the global strategists are forecasting 250bps of rate cuts. Also, the US recession probability Index has dropped from 56% in the Oct month to 46.1%. As we mentioned in the last newsletter, as of now, interest rates and yields are the primary market drivers- and hence weak economic indicators are good news! US 10-year yields dropped from the peak of 5% to 4.3%, driving the best-ever month (8.9%) for the S&P500 in the last 12 months. FIIs turned buyers after 2 months of net selling- pumping $1.2bn+, driving Nifty up 5.5%.

We entered the month with cautious stance as we weighed the various risks in the market- US bond yields, the upcoming state elections in India, and the weakening top-line growth for Nifty in Q2 earning season shall hurt us during the month. While the long book did well for us - making 2.7% to the portfolio, despite the fact that the whole month we ran the book at >10% net long, short book offset the returns, losing 2.3%. Typically Nifty would have offset and made us some gains- but the volatility around Diwali- we got a few short triggers near very crucial resistance levels of 19300-500, and the short nifty book also hurt the performance. Ambit 365 lost 0.2% for the month.

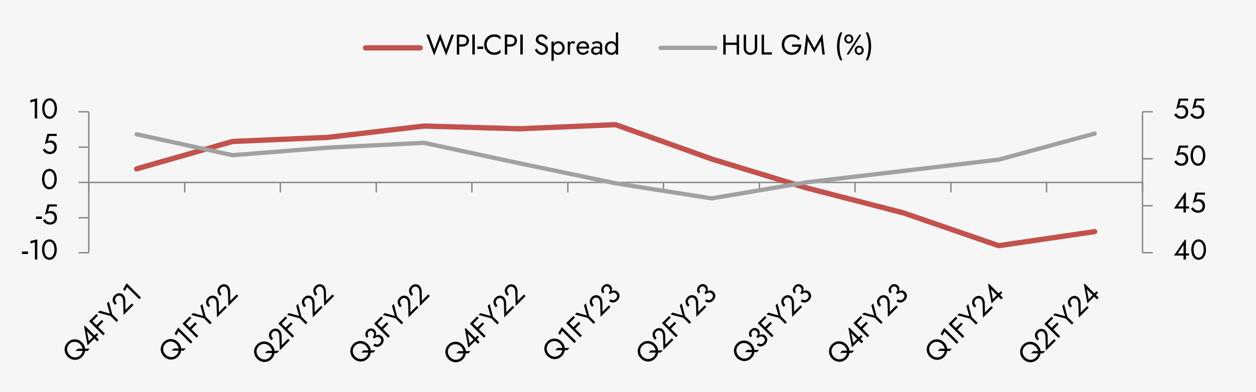
The best part about the market expectations that the rate cuts will start from the March—May period of 2024 is that the rate risk is now postponed to at least that time period. Also, as we go into print, the strong performance of the BJP in the state elections now postpones the political risk- also to May 2024, when the central elections are due. The recent state election win provides political stability plus lowers the fear of fiscal populism. Also, we expect RBI to maintain status quo in the upcoming MPC Meet in December. December and March quarter results will be closely watched though. During Q2, there was clear dispersion with Nifty50 between sales growth (4%) & PAT growth (16%) where earnings growth primarily driven by rising margins & lower credit cost and not supported by revenue growth.

Table 1: Nifty Sales growth vs. PAT growth



The margin expansion has been driven by a sharp fall in wholesale price inflation (WPI). Just 5 quarters ago, WPI had run hard and made a peak of 15.9%. More importantly, the WPI was ahead of CPI by +8.8%, implying that while the input cost for businesses has been rising, they were not able to pass it on to the consumers, resulting into gross margins contraction. The same has been reversed as WPI is into negative territory. We illustrate this- by taking the largest FMCG Company — Hindustan Unilever- as an example, where the swing clearly shows.

Table 2: WPI-CPI Spread vs. HUL's Gross Margin trend



Source: CEIC & Company's data

BIGGER TREND: PREMIUMIZATION VS. MASS

Our economy continues to move on two different tracks. While the premium end of the products is seeing good demand growth (Premium Home sales, cars above Rs30lakhs, diamond jewellery, apparels), for mass products demand growth is still tepid (FMCG, lower-end consumer durables, innerwear). Typically, slow-growing companies should have formed good shorts- but the rising tide has been strong enough to lift all boats. Also, there is a hope that rural and low-ticket urban demand may revive in the March quarter. Hence this risk (of disappointment) is also postponed to at least March.

Table 3: Premiumization vs. Mass consumption trends

Premiumization	Mass
Consumption	
Titan: Jewellery gg at 19%	**HUL:** Sales gg at 4%
Retail	
Trent: Sales gg at 10%	**Page Industries:** Sales gg at -8%
Consumer Durables	
Bluestar: Sales gg at 20%	**Orient Electric:** Sales gg at 11%
Building Materials	
Godrej Properties: Sales gg at 103%	**Asian Paints:** Sales gg at 1%
Footwear	
Metro Shoes: Sales gg at 14%	**Bata India:** Sales gg at -1%
Automobiles	
M&M: SUV volume gg at 26%	**Maruti:** Compact volume gg -42%

OUTLOOK

Don't fight a running train – corrective steps taken in our fund

Risks, as explained above will show up only by March- June period. Till then optimism can stay high. This means that shorts - even in companies that are struggling to deliver growth may not work witnessed in the month of November. We have moved our strategy to work with a very light short book for now, in the region of 20-25% (the framework provides for a minimum of 20%), while staying fully invested in the long book (50%). Hence, we will run our stock book in the ~20-25% net long. And we will use nifty in a smaller sizing as the primary hedging tool if we see risk.

For January – into the earnings season- we may still get a few clear short opportunities from names that would report disappointing earnings. We may nudge the short book up a little. But we will visit that next month. For now- it seems like all risks are in the future, and this is indeed Christmas!

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