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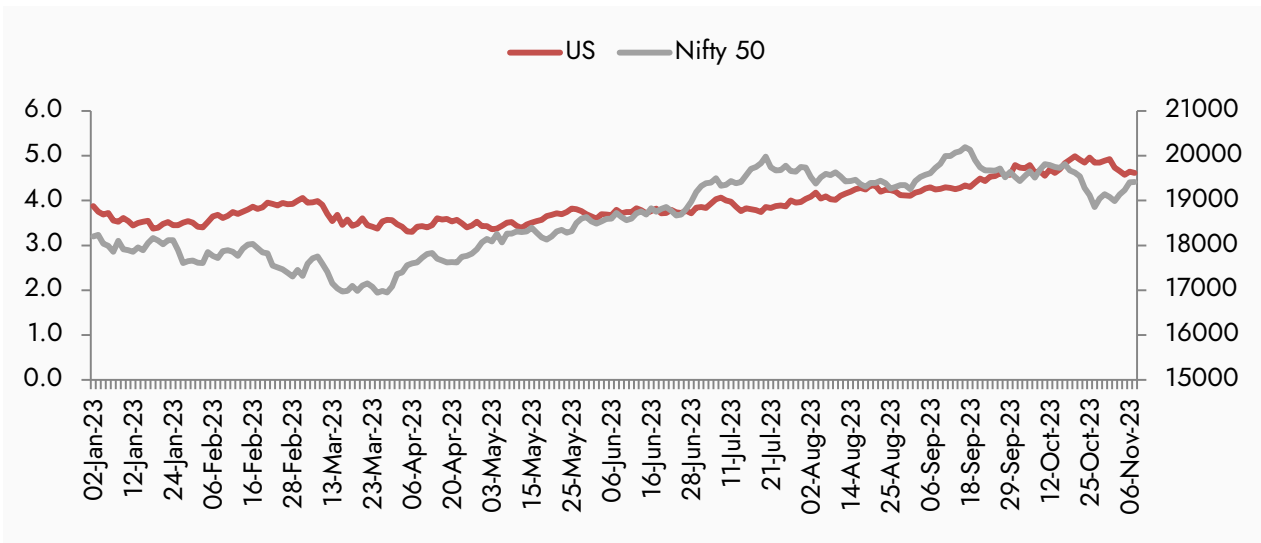
THE SINE CURVE: NEW RISK IN TOWN



THERE IS A NEW RISK IN TOWN!

Rising US bond yields have become a cause for worry for the markets. This year, after consolidating from January to April, yields have been rising. The US 10-year yield made its 2023 low of ~3.25% in April – the markets initially took the rising yield in its stride. Once the yield crossed the 2022 high of 4.25% in September, fear set in. Over April-July, Nifty rose 13.8% and over August-October lost 3.4%. In the last two months (September and October) FIIs pulled out Rs40,000cr from Indian equities. 5% bond yield is now considered to be the line in the sand perhaps because it is too uncomfortably close to the pre-GFC peak of 5.25%, seen in 2007!

Chart: US 10-year yields vs Nifty year-to-date 2023



Source Bloomberg

As we go into print, yields have pulled back from danger zone on weak US non-farm payroll print of 150,000 on 3 November. In a heads-I-win, tails-you-lose market – the focus is not on the fears of a weaker economy, but the joys of declining yields in the US and the rising probability of rate cuts. The markets are now building in a June 2024 rate cut by the Federal Reserve. Whether that happens or not will be tested a few months later, and until then we are back to the Goldilocks world. Not too hot and not too cold.

Are we close to a cycle top?

Nifty lost 2.8% in Oct, 2.4% since the inception of Ambit 365 (Oct 6) – but, it is the tale of 2 halves. Nifty was up ~1% till mid-month, only to sell off sharply in the second half of the month. Many top performers (in our portfolio) of the first half of the month become bottom performers during the second half of the month, neutralizing all our gains. While the short book made money this month, the sharp reversal in the long book took all the gains away. We closed the month slightly positive.

Table: Stock dispersion during the first and second half of Oct'23

October'23	First half	Second half
BAF	3%	-7%
Tata Motors	5.80%	-5.80%
Bharat Forge	2.20%	-8.80%
Interglobe Aviation	9.50%	-6%

Source Bloomberg

OUTLOOK

As we speak, it is yet unclear whether the pullback in the US yield is just a 'trade' or it has reversed for good and, consequently, Nifty's rally is just corrective or a new move has started. Also unclear is when the USA's economic weakness will start to pinch the markets. Sentiment can very quickly move from all news being good news to all news being a source of worry! One thing is for sure. We have entered a period of high volatility now, and the going from here won't be as smooth as it has been in recent months. Equity market volatility is always preceded by bond and currency market volatility, and we are seeing that play out. The nervous breakdown markets seemed to have with US yields touching 5% and the joyous rally on a pullback bear testimony to this trend.

Reflecting this view, we have started the month a little cautiously. And, as we see more signs of confirmation, we will build our book. Also, we have noticed that markets are focused on growth-adjusted valuations – we hear PEG (PE / Growth ratio) being talked of a lot more often now, more than ever in the last 5-8 years! Our current stock book takes this trend into cognizance.

Table: Existing stock positions – applied proprietary sine curve framework

Sector	Long	Short
Banking	IndusInd Bank	HDFC Bank
EPS gg - FY24E	23%	6%
P/BV(x)- FY24E	1.8	2.6
IT	HCL Tech	Wipro
Revenue gg - FY24E	8%	0%
P/E(x)- FY24E	22	18
Auto	Tata Motors	M&M
FCF gg - FY24E	54%	-2%
P/E(x)- FY24E	14	19
Discretionary	Godrej Properties	Asian Paints
Revenue gg - FY24E	20%	8%
P/BV(x)- FY24E	4.8	16

Source Bloomberg

CONCLUSION

We see risks rising. Markets will have to choose between the lesser of the two evils – a lower bond yield or a weakening economy. India sentiment continues to be robust, and domestic flows into equities are yet strong, and have the capability to offset the global headwinds. In environments like these, stock performances can display high degrees of dispersion. While this is an opportunity for Ambit 365, we need to exercise extreme rigour in stock selection.

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