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THE SINE CURVE: WINDS OF CHANGE

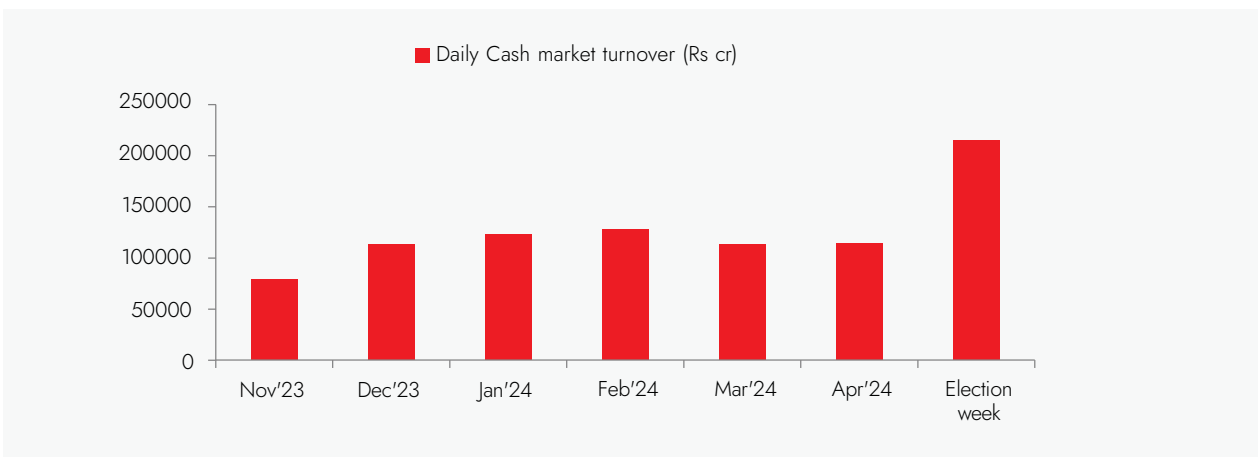


“VOLATILITY IS A SYMPTOM, THAT PEOPLE HAVE NO IDEA OF THE UNDERLYING VALUE” – JEREMY GRANTHAM

“WHEN A LONG TERM TREND LOSES ITS MOMENTUM, THE SHORT-TERM VOLATILITY TENDS TO RISE. IT IS EASY TO SEE WHY IT SHOULD BE SO; THE TREND FOLLOWING CROWD IS DISORIENTED.” – GEORGE SOROS

Despite the tumultuous volatility in May, Ambit 365’s unique strategies for managing such situations came through, leading to a strong gain of 2.85% (pre-fees and taxes). This propelled our year-to-date returns to 10.7% and returns since inception (6th Oct '23) to 15.0%. Our Nifty’s rule-based system, specifically designed to capitalize on such scenarios, demonstrated its value, contributing to about 60% of the month’s returns. A notable milestone of the month was the profitability of all our books – long stocks, short stocks, long nifty, and short nifty, further reinforcing the strength of our strategies.

Significantly, two highly respected figures in the investment world—Grantham and Soros—share a common perspective on market volatility. When a surge in trading activity coincides with high volatility, it indicates that the market is in a state of flux. The daily cash market turnover over the election week reached a peak of Rs. 2.15trn, 1.9x the average run rate of the last few months (please refer to the chart below). These challenge existing beliefs and suggest a shift in market sentiment.



Source: SEBI

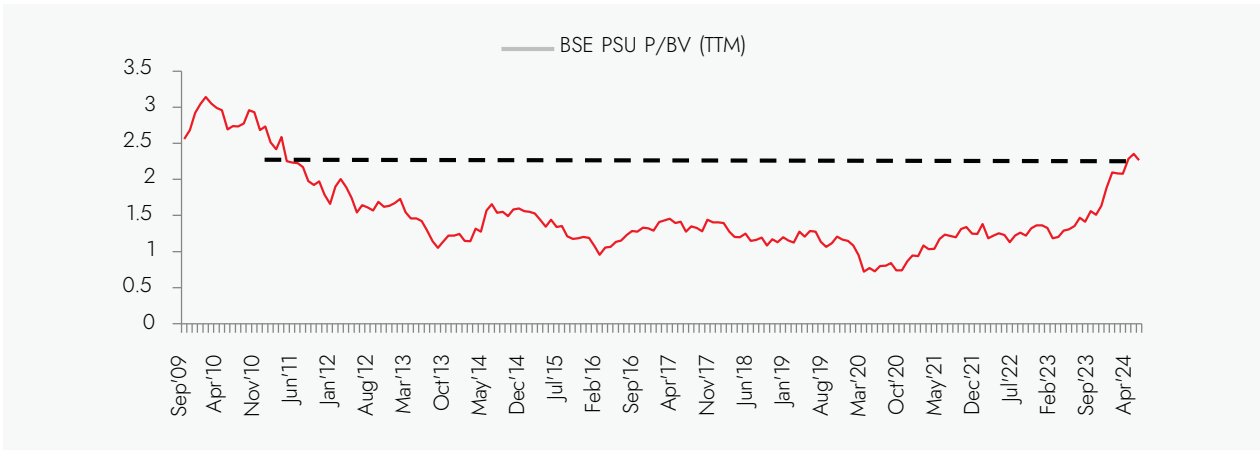
The Sine curve is in the introspection stage, questioning the sustainability of existing trends. While we don't have definitive answers, there could be a smaller counter-cycle within the larger one. The recent Union general election results, where the Modi-led NDA will form the government for the third time but with a weaker and fractured verdict, is a clear indication from the electorate that some changes are necessary. Since our inception, Ambit365 has maintained a long stance on capex/PSUs and a short stance on consumption/ techs. We are now considering if our curve is rotating. In this newsletter, we discuss the three strong trends that have been in place that could see a reversal.

Questioning the three trends

THE PSU UPTREND

PSU resurgence and the broader disbelief in it—has been a strong three-year trend. The BSE PSU index bottomed out at near bankruptcy valuations of 0.7x P/B in 2019-20 and has since surged to 2.4x. While still lower than the previous cycle peak in Jan '10, this is now at a 13-year high. The Sine Curve has been a believer in the longer-term PSU upcycle, but it could be time for a pause, even if temporary, here.

Chart 2: BSE PSU P/BV valuations at 13-year high

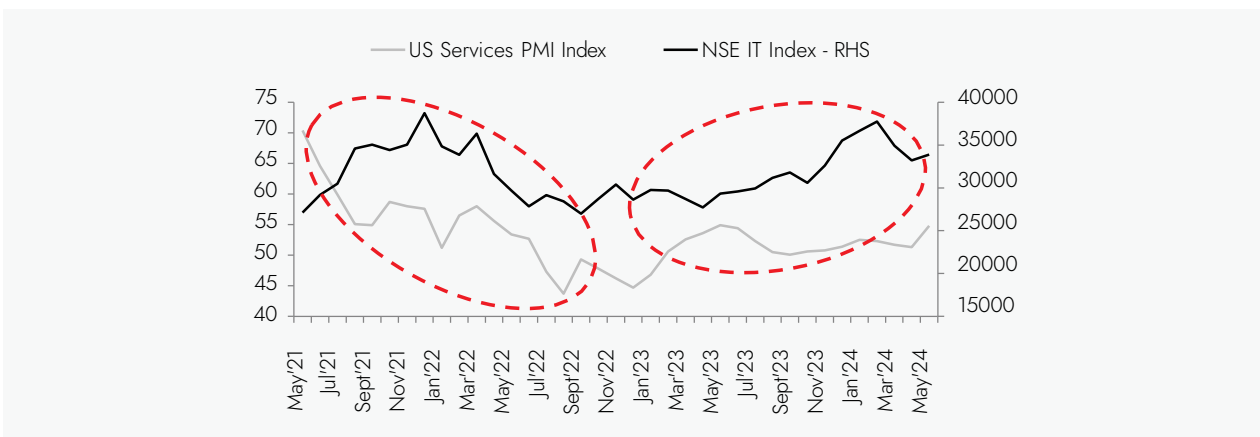


Source: Bloomberg

THE IT DOWNTREND

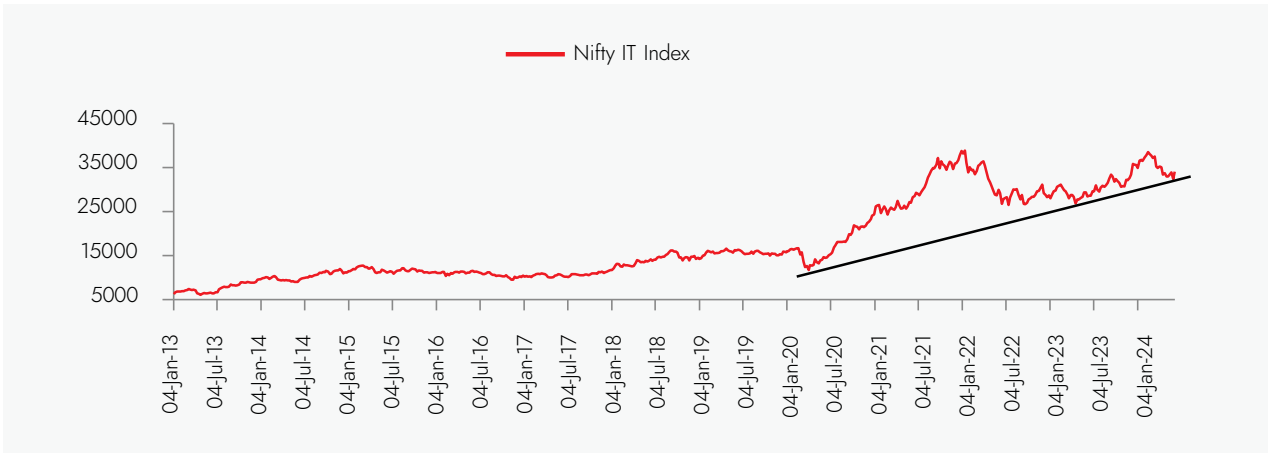
IT sector growth has been decelerating over the last two years. Until a few months ago, analysts were confident of a revival in FY25, which has been pushed back to the end of FY25 or FY26 after the March quarter results. The US economy has been resilient. Even so, extreme capitalist US companies often claw back discretionary expenditure, even on fears or analysts' forecasts of a slowdown. However, there has been a gradual shift in the macro trends. US PMI has turned up. While it started with manufacturing, now services PMI is also showing a clear turn. This, if sustained, can change the expenditure sentiment. The NSEIT index shows strong signs of making a bottom near its key support areas (please see chart 4). Valuations are now at a five-year average, down 25% from the peak, and the sector is under-owned.

Chart 3: US Services PMI has a high correlation with NSE IT Index



Source: Bloomberg

Chart 4: Nifty IT Index taking support on the upward-sloping trend line



Source: Bloomberg

RURAL WEAKNESS

Rural demand has been the weakest spot in the economy. Many analysts attribute the BJP's weaker-than-expected performance in the recently concluded general elections to rural stress, raising expectations of some targeted spending programs by the government. The government has been reducing revenue expenditures to support the infrastructure capex (please see chart). While this is a welcome longer-term trend, it is possible that the needle swung a bit to the extreme, and some restoration of balance is needed.

Chart 5: Revex to GDP ratio decelerating

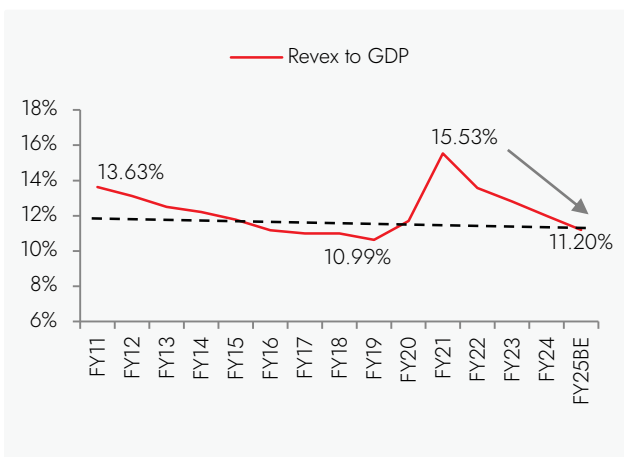
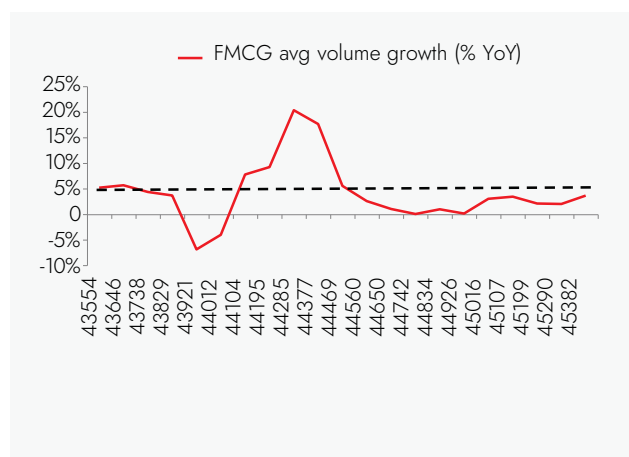


Chart 6: FMCG cos volume growth bottoming



Source: CSO, FMCG companies (HUL, Dabur, Britannia, Colgate, Marico, Emami, Nestle, GCPL)

OUTLOOK: THE ONLY CERTAINTY IS THAT UNCERTAINTY HAS RISEN

Our fabulous performance in May was due to the continuation of the old trends. The top performers in the long book were power and defense- Siemens, ABB, HAL, and BEL; and the top performers in the short book were consumer and IT names. While we have been thinking about some rotation and entered June lightly positioned, we are bound to get some pain on the chin when the trend change kicks in. Therefore, we expect to keep the exposure levels low to manage this volatility while assessing and building confidence that the status quo is changing. More on this in the next newsletter. **Meanwhile, it is appropriate to close this 'introspection' with a quote from another legendary investor- Howard Marks – “You can't predict the future, but you can prepare for it.” We are preparing for the possible winds of change.**

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