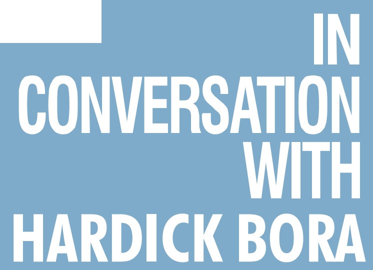
IN
CONVERSATION
WITH
HARDICK BORA

Fund Manager, Equity
Union Asset Management
Company Private Limited
("Union AMC")

Equities have been on a roller-coaster ride for most part of the ongoing calendar year amidst a number of adverse events. However, what is surprising is that valuations, in general, continue to remain out of the comfort zone, notwithstanding several rounds of corrections witnessed, of late. So, is that of concern, and if equities are still a better alternative compared to any other asset class? In an exclusive interview with Amit Singh Sisodiya, Deputy Editor, *The Global ANALYST*, Hardick Bora, Fund Manager, Equity, Union Asset Management Company Private Limited ("Union AMC"), talks of his views about the current volatility in the market, his expectations from the upcoming earnings season, the sectors which he feels are currently better placed, his take on India's consumption story, his fund house's investment philosophy and his outlook on equities from a long-term perspective. **Edited excerpts>>>**

■ **Equities have been on a roller-coaster ride, of late. What do you think has added to the volatility on the bourses in the recent times?**

The heightened uncertainty in the past few months has resulted in volatility on bourses. Factors that have contributed to this are the erratic nature of inflation, increase in interest rates to fight persistent inflation, the geo political tensions between Russia and Ukraine, and not to forget the global spike in prices of crude, coal and other commodities.

■ **Do you think a heady cocktail of inflation, hawkish stance of the global central banks including US, UK and India, and rising interest rates have been weighing on the domestic stock market at the moment?**

Today, as we stand in the middle of September 2022, we opine that, markets are at a level higher than when these highlighted risks started playing out. The adverse impact of these developments is yet to culminate in equity prices.

■ **What is your opinion on the Q1 FY2023 earnings season that concluded some time ago? How do you view the results in general? Also, what are your expectations from the second quarter earnings season? Which sectors do you expect to perform well during the July-September quarter? Do you think the IT sector will improve upon its performance in Q2FY23?**

Before drawing any conclusions for the said quarter, we would encourage the readers not to look at the year-on-year comparison because the two base periods, the quarter ending June 2020 and the quarter ending June 2021, respectively, were impacted with Covid-19 pandemic. However, if we compare the results with the quarter ending June 2019, on a three-year CAGR basis, not many businesses have managed to surpass their pre-pandemic levels of operations. Had the pandemic not been there, these companies would have been ideally forecasted to report much better growth. Hence, we can say these businesses are still operating below their potential. As far as expectations are concerned, the investment and analyst fraternity were not expecting the results to beat the pandemic level performance immediately but subsequently. Therefore, we see the numbers have come out to be in line with the expectations. To summarize, it was a mixed bag with some sectors performing better while a few others lagging behind expectations.

> ■ Despite the geopolitical tensions and economic uncertainties that lie ahead of us, valuations have remained at an elevated level. This is an area of concern since neither increasing interest rates nor the possibility of weaker economic growth seem to have been factored into the price. ■

To answer about the July-September quarter, we are of the view that the economy as a whole is expected to perform better than the global average. While it is difficult to foresee which sectors will do well in the subsequent quarter, we can give our opinion only for the medium and long term. Based on a risk-reward perspective, the sectors which we feel are better placed are financials, consumer discretionary, consumer staples, telecommunication and industrials. The reason is, these sectors are dependent on variables that are local in nature and are relatively less exposed to the global risks that are currently playing out. The sector which we are cautious about at the moment is commodities because this sector is affected by the global demand-supply equation, which currently is not so favorable for the manufacturers. We are equally cautious about utility sector as we do not find reasonably high-quality companies in that space. Lastly, we are also cautious about IT sector at the moment since it is largely dependent on the global economic growth. Therefore, any downside in the global growth rate may have a negative impact on the IT sector and we don't find the risk-reward favorable as yet. While the valuations of IT companies have corrected recently, whether the earnings and fair value estimates would be downgraded as well is yet to be seen. This is entirely dependent on the earnings performance in the forthcoming quarter. If the businesses call out a slow-

ON SECTOR-SPECIFIC

BASED ON A RISK-REWARD PERSPECTIVE, THE SECTORS WHICH WE FEEL ARE BETTER PLACED ARE FINANCIALS, CONSUMER DISCRETIONARY, CONSUMER STAPLES, TELECOMMUNICATION AND INDUSTRIALS.

down, then we may see further pressure on the fair value expectations for the sector.

- **A major trigger for the recent rally in markets has been the return of Foreign Portfolio Investors (FPIs). Do you feel the inflows will continue to be robust notwithstanding the extreme volatility in markets despite headwinds such as rising inflation and unemployment in the US, and the fear of recession in most major economies, except India?**

If we retrospect, typically FPIs have participated in emerging economies if the future economic outlook globally is strong. Having said that, if the global growth rate is at risk, it will lead to a negative outcome for emerging economies as well and we can expect a weak FPI inflow. Conversely, if the economic growth conditions continue to be bright, we can expect a robust FPI inflow.

Another important factor for FPI flows has been a change in liquidity in the system, driven by monetary policy actions of global central banks. Since the start of the pandemic, i.e., February 2020, the world's largest central banks have infused liquidity into their economies to mitigate the economic slowdown caused by the pandemic. This in turn resulted into strong FPI flows in emerging markets. Since this excess liquidity is currently being sucked out of the system, FPI inflows are likely to be muted till the monetary policies normalize. However, we also note that FPI inflows are dependent on multiple other factors as well and it is difficult to pinpoint what will be the direction of this particular variable.

- **What is your view on India's consumption story, going ahead? Do you see demand to reviving in rural pockets also, given a good monsoon this year as well?**

The demand in rural India is dependent on two important factors, one being the monsoon which generates disposable income and the other being inflation. If we look at the data and commentary given by certain FMCG companies, we see that inflation has been a concern. We are observing that rural consumption has been weaker than urban consumption for the past few quarters. However, with the monsoon being above its Long Period Average (LPA) in the majority of sowing areas, we can expect better rural consumption going forward since the income levels could be bolstered and this could help overcome the inflationary pressure.

- **How worried are you over the heightened tensions between China and Taiwan and the prolonged war in Ukraine? How do you see their impact on domestic equities? Do you think that the risk has already been priced in?**

This situation is an unknown one. Such events may materially impact global trade and commodity prices and it is difficult to quantify their magnitude. Hence, to mitigate the volatility arising from such events, investors are encouraged to participate in equity markets in a staggered manner.

- **What is your opinion on valuation? Do you think recent bouts of corrections make valuation attractive again, or do you see prices correcting further in order to restore sanity?**

At Union Mutual Fund, we follow the fair value approach to valuation. We have our internal estimates for calculating the fair value of all the companies in the fund house universe and also for the NIFTY 50 constituents. Hence, we have a fair value estimate of NIFTY as well. We believe that the best way to judge the valuations of the market is to compare the current price of NIFTY to its estimated fair value. As per our in-house research, NIFTY is currently trading at a high single-digit premium to its fair value. As such, we believe that markets have borrowed returns from the future and returns will be back ended over five years. Therefore, we would encourage investors to participate in the market in a staggered manner.

- **Which are the sectors you would likely put your money on? Or, would you prefer sitting on cash at the moment?**

As a mutual fund house, we have a policy of managing portfolios that are true to the mandate. The portfolios follow the asset allocation pattern indicated in the Scheme Information Document (SID). We do not take any cash calls in any of our pure equity schemes. Asset allocation calls are taken only in hybrid funds, which are designed to benefit from an asset allocation strategy based on market valuation.

ON FPIs

IF WE RETROSPECT, TYPICALLY FPIS HAVE PARTICIPATED IN EMERGING ECONOMIES IF THE FUTURE ECONOMIC OUTLOOK GLOBALLY IS STRONG.

- **Tell us about your fund house. Also, what is your fund house's investment style?**

At Union Mutual Fund, we believe in process over intuition. We have tried to institutionalise a process-oriented approach to investing with an endeavour to deliver consistent outcomes. We believe that, as a mu-

tual fund house, it is our duty to deliver consistent outcomes to investors who are looking at mutual funds not only as a source of wealth creation but also as a product with better liquidity. This is in the best interest of our customers. To get a consistent outcome and minimize human bias as much as possible, we have a well-defined process of selecting stocks and constructing portfolios.

We invest in high-quality businesses and apply our fair value approach to evaluate each investment proposition. We define high quality companies as those having the best management practises, that are consistently growing at a faster rate as compared to the industry growth rate and that are consistently generating a return on equity higher than the industry they are operating in.

Our portfolio construction process is also driven by a quantamental approach where fundamental mandates as per SID of the respective schemes and quantitative inputs of growth, valuation and quality are taken into consideration for stock allocation.

- **How do you describe your asset allocation strategy?**

ON RURAL CONSUMPTION

WITH MONSOON BEING ABOVE ITS LONG PERIOD AVERAGE (LPA) IN MAJORITY OF SOWING AREAS, WE CAN EXPECT BETTER RURAL CONSUMPTION GOING FORWARD, SINCE THE INCOME LEVELS COULD BE BOLSTERED AND THIS COULD HELP OVERCOME THE INFLATIONARY PRESSURE.

We don't try to time the market and as per the internal mandate, all our equity products are fully invested at all times. We have a very small portion of cash which is meant for daily inflow and outflow. We also have asset allocation products like Balanced Advantage Fund and Equity Savings Fund in the hybrid category. In these funds, the asset allocation strategy depends on the market valuation, which is done based on our internal system.

For example, depending on whether markets are cheap or expensive, the net equity exposure in Union Balanced Advantage Fund will move between 30 and 80% of the net assets. The net equity allocation of Union Balanced Advantage Fund as on August 31, 2022, was around 49%.

- **What is your outlook on Indian equities, in the near- to- medium-term?**

While we refrain from commenting on short-term expectations of market returns, Nifty's fair value has historically grown at a low double digit CAGR on an average, as per our internal research. We expect this fair value growth to continue over the next five years. As mentioned earlier, markets are at a premium to their fair value and some of the returns will be back-ended. We encourage investors to participate in the market in a staggered manner.

- **What would be your advice to retail investors looking to invest in equities and why mutual funds could be a better way for them to take exposure to stocks?**

Historically, equities have been successful in beating inflation and thereby increasing the wealth of investors on a real basis over a long term period. We would encourage investors to expect the same from equities in the future as well. In the current scenario, we would want investors to look at not only the return potential but also the volatility that will accompany the returns. Here comes the role of mutual funds. Mutual funds provide the benefits of professional management. Also, mutual funds have proven to be beneficial for investors because they encourage a disciplined way of investing in the markets through Systematic Investment Plan (SIP).

- **Finally, would you like to share with us any issue(s), from the domestic stock market perspective, that worries you the most at this juncture?**

The current environment has been one of exuberance. The market has traded at a premium to its fair value more often than not in the past 12 months. Despite the geopolitical tensions and economic uncertainties that lie ahead of us, valuations have remained at an elevated level. This is an area of concern since neither increasing interest rates nor the possibility of weaker economic growth seem to have been factored into the price. The fall from this level could harm the sentiments of investors. Hence, investors should moderate their expectations of the equity market from this point in time. To sum it up, we want to highlight the issue of recent high valuations in the market. However, equities, in the long run, have proven to be an asset class that has helped investors to create real wealth, and we expect the same going forward. ■

ON VALUATION

WE DON'T TRY TO TIME THE MARKET AND AS PER THE INTERNAL MANDATE, ALL OUR EQUITY PRODUCTS ARE FULLY INVESTED AT ALL TIMES.

Reference # 20M-2022-10-04-06