ELIXIR EQUITIES PRIVATE LIMITED

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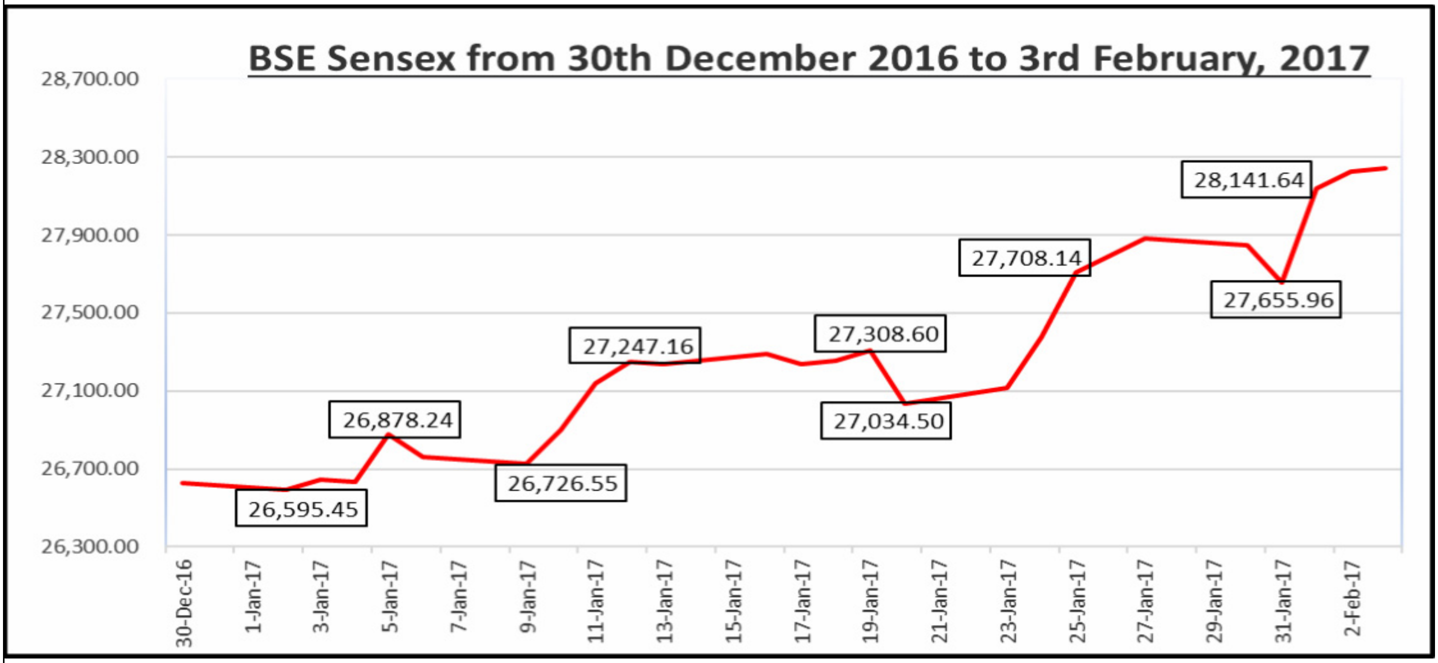
Markets Rally Post Demonetisation Shock



Revival of the Long-Term Bull Market

January saw the revival of the long-term bull market which started in September 2013. Post the demonetisation selloff in November and the sideways movement in December, equites posted a smart recovery in January. The reason for this rally is the realisation that scrapping of large denomination currency and the resultant cash liquidity crunch had only a transient impact on consumer spending. There was broad consensus that the slow down witnessed post 8th November was only temporary and normalcy is fast returning. This gave a boost the market sentiment and allayed fears which investors had on sustenance of corporate earnings. A benign yet balanced and realistic budget with absence of new taxes provided a further fillip to stock prices in the first 3 days of February. Although large cap indices viz. the Sensex and Nifty are about 4 – 4 ½ % from their all-time highs, the CNX Midcap Index at 16,040 (03/02/17) within striking distance of its previous peak of 16,120 which was scaled in October 2016.

Earnings a Catalyst for Turnaround

The turning point for the street was the results seasons which began on a very positive note. Industries favored by investors such as banks / NBFCs, and consumer oriented sectors such as automobiles, building materials and appliances delivered results which showed only a minor impact of the currency note ban. The management commentary post earnings release was also positive with CEOs sounding optimistic of future demand. There were a few concerns relating to inching up of raw material costs but that too seemed to be manageable. The earnings news flow clearly suggests that the economy faced only a minor hiccup due to demonetisation and is no medium term adverse implications of this controversial move.

President Trump an Overhang for IT and Pharma

The price volume action of the past month suggests that investors are now looking not only beyond the currency ban but also other disruptive events such as Brexit and election of Donald Trump as US president. While there is no talk at all about the dislocation which may be caused by Brexit, statements made by President Donald Trump are impacting export oriented sectors such as software and pharmaceuticals.

The recent bill introduced in the US to increase the minimum salary payable to employees in US under H1B visa and President Trump's pledge to reduce healthcare costs and impose border tax has generated fear amongst the managements and investors of IT and Pharma companies. In addition to this other structural changes taking place in the US within these industries has resulted in significant underperformance. These trends are unfortunate as IT and pharma have been massive wealth creators and many investors are still saddled with large exposure to these sectors.

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We have been negative on technology companies for the past few quarters but are still hopeful of the prospects of pharma companies. Global demographics favor them and their competitive edge has only sharpened in recent years. Notwithstanding, any highly disruptive move on the part of the new US administration, performance of pharma companies should improve and even if growth rates moderate, these companies will still provide compelling reasons to remain invested and deliver index beating returns. Another angle to consider is that unlike IT, all pharma companies cannot be painted with a single brush. There are significant differences in their target markets and strategies for advancement. We believe that a basket of pharma companies should still deliver decent returns and diversify company specific risks.

Trends Favouring Domestic Focused Companies

While there is a cloud over externally focused enterprises, domestic oriented businesses are in for good times. There are three powerful trends which will drive their growth:

1. Post demonetisation, there is a shift away from unorganised, essentially cash (*black*) transactions to the organized bank (*white*) transactions. This trend benefits the large listed companies as the competitive edge of their unorganised and small scale competitors is diminished. Consumer prefers to deal with organized entities rather than unorganised players, whose principal edge is cheating on taxes by offering their goods and services in cash without '*bill'*. This scenario has been created due to shortage of currency notes and fear of prosecution for dealing in cash.

2. This migration to the formal economy will gain further momentum once GST is introduced from 1st July, 2017. The basic structure of this nationwide tax and the checks and balances put in place are such that there will be little incentive, maneuverability or business logic to avoid indirect taxes. This will place small and medium enterprises (SMEs) at a disadvantage over large organized players. While there may be social repercussions, as SMEs are large employers as well, but the writing on the wall is clear that unorganised players whose main edge was ingenuity in avoiding excise and VAT will be largely marginalised and their market share will be captured by large corporates who are tax complaint and play within the legal boundaries imposed on them.

3. The third powerful trend is lower interest rates. Bank deposits are at all time highs as bulk of the banned currency notes have been deposited and there is easy liquidity in the banking system. Furthermore, the fiscal deficit as per the Budget is pegged at 3.2% and government borrowing is also lower than last year. With retail inflation being low, there is a good chance of at least a ½ percent cut in interest rates. What is even more interesting is that unlike past rate cuts, interest reductions, going forward will be transmitted to the borrower due to abundant liquidity and tweaking of rules by RBI for bank's lending rates.

It is for these reasons that we have a very positive outlook for equities. Another interesting aspect which needs to be re-iterated is the role of domestic investors.

Liquidity Support from Domestic Investors

We had touched upon this in our last month's newsletter wherein we had stated that:

'These investors absorbed the entire selling of the FIIs in the month of November and December ……and the average Indian investor continues to repose faith and confidence in the India story as played out through our stock markets.'

This phenomenon of domestic savings being increasingly channelised into our capital markets adds another positive dimension to this recent uptick in stock prices. Whereas the above three reasons provide the fundamental basis for continuation of this bull market, the liquidity support is being provided by domestic investors who have realised the benefits of investing in this asset class over other avenues such as real estate, gold and fixed deposits.

Unless there is a major upheaval in the global markets which may force FIIs to sell, Indian equities are likely to scale to higher levels. The risk return profile is also favorable with high impact events such as Brexit, Demonetisation, US Presidential Elections, US Fed interest rate hike and Indian Budget being completely discounted. We now seem to be sailing in calmer seas and reduced levels of uncertainty should support higher valuations.

Market Outlook

We advise increasing exposure to stocks by buying at corrections. Focus should be on financials and other domestic oriented companies which will ride the revival in the country's economy. There are the UP and other state elections to contend with and the possibility of temporary disruption when GST is introduced in July, but are not major speed breakers and markets will absorb these shocks in its strides and continue charge ahead. The short, medium and long term prospects for stocks is attractive.

The average returns generated by the portfolios under our management are as follows:

				ANNUALISED RETURNS AS ON		31/01/2017	From
Date From	**01/01/2017**	**01/11/2016**	**01/08/2016**	**01/02/2016**	**01/02/2015**	**01/02/2014**	**02/02/2012**
	1MONTH	**3 MONTH**	**6 MONTHS**	**1 YEAR**	**2 YEAR**	**3 YEAR**	**5 YEAR**
Elixir Equities Portfolio Performance	**7.80%**	**-4.00%**	**-2.14%**	**14.89%**	**7.08%**	**20.15%**	**19.78%**
SENSEX	**3.88%**	**-0.63%**	**-1.07%**	**10.74%**	**-0.50%**	**7.46%**	**7.54%**
NIFTY	**4.60%**	**-0.40%**	**-0.56%**	**12.64%**	**0.81%**	**9.01%**	**8.32%**
Performance comparison	**3.20%**	**-3.60%**	**-1.58%**	**2.25%**	**6.27%**	**11.14%**	**11.46%**

This month's Smart Investing Series is on a common situation which investors may be presented with when they need to liquidate their portfolio for meeting a large expense or purchasing an asset. The topic is '*Liquidation of the Portfolio for Asset / Expense'*

Dipan Mehta

SMART INVESTING – XVI
- Liquidation of the Portfolio for Asset / Expense

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Holding Period for a Portfolio

When Warren Buffet was asked about the holding period for his stocks, his response was: "*Forever*". If a company was steadily growing its profits and its stock price was moving up in tandem, what is the need to sell? Since such businesses do not exist (as companies cannot grow for eternity); and eventually even a great company will start slowing down, the inherent message of the legendary investor is to hold stocks for a very long period of time. Another angle to this concept is to invest in equities, as a basket, for the very long term perhaps from generation to generation. Just as the family wealth held in property, gold and jewelry is passed on from father to son / daughter, so should be the approach to stocks - intergeneration transfer of stock holdings.

Liquidation of Full or Part Portfolio for Meeting a Goal

While building a portfolio for the next generation is a noble thought, a vast majority of first generation wealthy individuals generally save and invest for a better life in future for one's own self or for their offsprings. Each individual has some long-term goals for savings. It could be financial security, luxurious retirement, paying for children's higher education or marriage or even moving into a larger or ownership house. All of these require structured planning, years and years of saving and savvy investing. Equities no doubt play an important role in achieving these objectives but what should an investor do when the large expense is now on the horizon. How to liquidate full or part of your portfolio for meeting this large expense or financing an asset purchase?

A Simple Plan

Smart Investing has a strategy which can be implemented with ease but requires discipline. To begin with, the basic premise is that the timing of this outflow is known i.e., the investor has a fair idea of when he / she needs the money to meet this large expense or commitment. A simple plan would then be to break up the total sale value into equal tranches and then sell each portion at periodic intervals. For example, if Rs. 30 lakhs are to be liquidated and the period over which the sale is to be executed is 15 months, then each sale order should be Rs. 2 lakhs. The investor should then proceed to sell Rs. 2 lakhs worth of stock every month. The advantage of this method is that no view is taken on the market and assuming that stock prices are within a range, the sale objective is achieved.

A Superior Plan for all Scenarios

In reality, however, stock prices move up and down and there is a degree of volatility which can impact the expected realization. An investor may also take advantage of this volatility. A better strategy should be to retain the same value of the tranche in a rising market but slicing by half when prices are falling and making up the sale deficit in the first month the market has risen. This is better explained by way of examples listed on the next page. In the first table, assuming a sideways market (+2%), the net gain by following the plan is Rs. 12,293. In the second table, in a falling market (-16.14 %), the net loss is restricted to just Rs. 19,726, and in the third instance, when the market rallied by 17.84 %, the gain was at Rs. 1,785.

In conclusion, in two of the three scenarios, i.e. when the market is sideways or rising, the strategy delivers superior results and only in a sharply falling market, there is a net loss which is restricted to less than 1 %. If the plan is followed in totality, the investor would be able to achieve his/her objective with ease and be able to meet the obligation within the set time period. Additional gains would accrue if the monthly sale proceeds are invested in liquid funds or short duration fixed deposits. By following such a plan, the risk in selling stocks to meet a set target can be achieved.

Dipan Mehta

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Outcome of the Plan in a Flat Market

Month No.	Market Movement	Sale Value	Cumulative Sale Value	Target	Remarks	Index / Stock Price	Actual Realisation as per plan	Actual Realisation if sold in equal tranche
1	1%	2,00,000	2,00,000	2,00,000	target met	101.00	2,02,000	2,02,000
2	-2%	1,00,000	3,00,000	4,00,000		98.98	98,980	1,97,960
3	1%	3,00,000	6,00,000	6,00,000		99.97	2,99,909	1,99,940
4	2%	2,00,000	8,00,000	8,00,000	target met	101.97	2,03,938	2,03,938
5	-1%	1,00,000	9,00,000	10,00,000		100.95	1,00,950	2,01,899
6	-3%	1,00,000	10,00,000	12,00,000		97.92	97,921	1,95,842
7	4%	4,00,000	14,00,000	14,00,000	target met	101.84	4,07,351	2,03,676
8	-1%	-1,00,000	13,00,000	16,00,000		100.82	-1,00,819	2,01,639
9	2%	5,00,000	18,00,000	18,00,000	target met	102.84	5,14,179	2,05,672
10	-3%	1,00,000	19,00,000	20,00,000		99.75	99,751	1,99,502
11	-2%	50,000	19,50,000	22,00,000		97.76	48,878	1,95,512
12	1%	4,50,000	24,00,000	24,00,000	target met	98.73	4,44,300	1,97,467
13	2%	2,00,000	26,00,000	26,00,000		100.71	2,01,416	2,01,416
14	1%	2,00,000	28,00,000	28,00,000		101.72	2,03,430	2,03,430
15	0%	2,00,000	30,00,000	30,00,000	target met	101.72	2,03,430	2,03,430
	2%	30,00,000					30,25,615	30,13,322
			Additional Gain / (Loss) as per plan				12,293	

Outcome of the Plan in a Falling Market

Month No.	Market Movement	Sale Value	Cumulative Sale Value	Target	Remarks	Index / Stock Price	Actual Realisation as per plan	Actual Realisation if sold in equal tranche
1	1%	2,00,000	2,00,000	2,00,000	target met	101.00	2,02,000	2,02,000
2	-2%	1,00,000	3,00,000	4,00,000		98.98	98,980	1,97,960
3	-2%	1,00,000	4,00,000	6,00,000		97.00	97,000	1,94,001
4	-2%	1,00,000	5,00,000	8,00,000		95.06	95,060	1,90,121
5	-3%	1,00,000	6,00,000	10,00,000		92.21	92,209	1,84,417
6	1%	6,00,000	12,00,000	12,00,000	target met	93.13	5,58,784	1,86,261
7	4%	2,00,000	14,00,000	14,00,000	target met	96.86	1,93,712	1,93,712
8	-1%	1,00,000	15,00,000	16,00,000		95.89	95,887	1,91,775
9	-2%	1,00,000	16,00,000	18,00,000		93.97	93,970	1,87,939
10	2%	4,00,000	20,00,000	20,00,000	target met	95.85	3,83,396	1,91,698
11	-5%	1,00,000	21,00,000	22,00,000		91.06	91,057	1,82,113
12	-3%	1,00,000	22,00,000	24,00,000		88.32	88,325	1,76,650
13	-6%	1,00,000	23,00,000	26,00,000		83.03	83,025	1,66,051
14	1%	5,00,000	28,00,000	28,00,000	target met	83.86	4,19,278	1,67,711
15	1%	2,00,000	30,00,000	30,00,000	target met	84.69	1,69,388	1,69,388
	-16%	30,00,000				-16.14%	27,62,071	27,81,797
			Additional Gain / (Loss) as per plan				-19,726	

Outcome of the Plan in a Rising Market

Month No.	Market Movement	Sale Value	Cumulative Sale Value	Target	Remarks	Index / Stock Price	Actual Realisation as per plan	Actual Realisation if sold in equal tranche
1	-1%	2,00,000	2,00,000	2,00,000	target met	99.00	1,98,000	1,98,000
2	2%	2,00,000	4,00,000	4,00,000		100.98	2,01,960	2,01,960
3	2%	2,00,000	6,00,000	6,00,000		103.00	2,05,999	2,05,999
4	2%	2,00,000	8,00,000	8,00,000		105.06	2,10,119	2,10,119
5	3%	2,00,000	10,00,000	10,00,000		108.21	2,16,423	2,16,423
6	-1%	1,00,000	11,00,000	12,00,000	target met	107.13	1,07,129	2,14,259
7	-4%	1,00,000	12,00,000	14,00,000	target met	102.84	1,02,844	2,05,688
8	1%	4,00,000	16,00,000	16,00,000		103.87	4,15,490	2,07,745
9	2%	2,00,000	18,00,000	18,00,000		105.95	2,11,900	2,11,900
10	-2%	1,00,000	19,00,000	20,00,000	target met	103.83	1,03,831	2,07,662
11	5%	3,00,000	22,00,000	22,00,000		109.02	3,27,068	2,18,045
12	3%	2,00,000	24,00,000	24,00,000		112.29	2,24,586	2,24,586
13	6%	2,00,000	26,00,000	26,00,000		119.03	2,38,062	2,38,062
14	-1%	1,00,000	27,00,000	28,00,000	target met	117.84	1,17,840	2,35,681
15	-1%	3,00,000	30,00,000	30,00,000	target met	116.66	3,49,986	2,33,324
	16%	30,00,000				17.84%	32,31,238	32,29,453
			Additional Gain / (Loss) as per plan				1,785	