



Key points

- The markets are up sharply from the lows and have practically covered all the losses for the CY. While valuations are not cheap, over next 6-12 months, we think the overall economic recovery and a likely vaccine and treatment for the pandemic, are still going to be a key driver.
- However, near term we could see some volatility which may provide a better buying opportunity led by 2 factors (a) second wave in Europe and (b) the US elections.
- On the US elections, we are more worried about (a) whether we get a result on November 3rd or the high proportion of mail-in ballots delay the results and (b) whether there is a smooth transition of power. The last time we had a Court case to decide the results of the US elections, the market fell 8% in the 5 weeks between the election results and the date the winner was finally decided.

1. US Elections poses near term risk

In general, we believe that elections have very short term impact on the markets. As we head into US elections, we continue to hold similar views. The market is worried about a Biden victory given that it may mean higher taxes and downgrade in earnings estimates. However, rewinding back to the last election, the fear that a Trump victory would be negative for markets lasted less than a day. History shows that the first year post election is generally good for markets irrespective of a Democrat or Republican President.

The nightmare scenario is not who wins the election but whether we get a result on November 3rd. Firstly, there will be a much higher % of mail-in ballots than normal due to the pandemic. Secondly, there is a possibility that the transition of power won't be smooth and we could get into a Court battle like in 2000. Markets fell 8% in that period in the 5 weeks between election results and the winner getting decided. We are holding some cash to guard against any election related volatility in the market.

#1: How do markets do pre and post elections?

Overall, elections create uncertainty in the few weeks before and after the elections but history shows that impact of elections is negligible over a one year. Generally the markets tend to do well in the year

after elections with the lone negative spells being driven more by the tech bubble crash in 2000 than the elections.

Table 1: What did US markets do

Dow Jones Return (%)			Pre-Election					Post Election				
Date	President	Ruling Party	12M	6m	3m	1m	1W	1W	1m	3m	6m	12M
5-Nov-96	Bill Clinton	Democratic	26	11	7	1	1	3	6	11	19	26
7-Nov-00	George W. Bush	Republican	2	4	1	3	0	-2	-3	0	0	-13
2-Nov-04	George W. Bush	Republican	2	-2	-1	-2	1	3	5	6	2	4
4-Nov-08	Barack Obama	Democratic	-29	-26	-15	-7	6	-10	-13	-17	-12	2
6-Nov-12	Barack Obama	Democratic	11	2	1	-3	1	-4	-1	6	13	19
8-Nov-16	Donald Trump	Republican	2	3	-1	1	2	3	7	9	15	29
Avg Return (%)			2	-1	-1	-1	2	-1	0	2	6	11

Source: Yahoo finance, Valentis Research

The Indian markets too similarly have followed US markets with weakness around the election period but a strong spell a year after elections.

Table 2: What did Indian markets do

Nifty 50 Return (%)			Pre-Election					Post Election				
Date	President	Ruling Party	12M	6m	3m	1m	1W	1W	1m	3m	6m	12M
5-Nov-96	Bill Clinton	Democratic	-12	-21	-15	-2	-5	1	-9	9	19	23
7-Nov-00	George W. Bush	Republican	-9	-12	-5	-3	6	0	4	10	-9	-21
2-Nov-04	George W. Bush	Republican	17	1	11	2	2	2	10	13	6	33
4-Nov-08	Barack Obama	Democratic	-47	-40	-29	-18	17	-6	-11	-11	16	50
6-Nov-12	Barack Obama	Democratic	8	13	8	0	1	-1	4	4	4	9
8-Nov-16	Donald Trump	Republican	7	10	-2	-2	-1	-5	-3	3	9	21
Avg Return (%)			-6	-8	-5	-4	3	-2	-1	5	8	19

Source: ACE Equity, Valentis Research

#2: Which party is better for markets?

The markets are currently worried about a victory for Biden given that he has stated his desire to raise taxes which could lead to a fall in earnings estimates for next year. However, if we rewind to the previous elections 4 years ago, the general consensus was that a Trump victory would be negative for markets. However, the negativity lasted only a few hours.

If we look at history, a Republic or Democrat Government has not really mattered for markets. The state of the economy and the Fed policy are more important drivers of markets. If anything, Democrat President tenures have provided higher average returns than Republic President tenures. However, if we ignore the early terms of Herbert Hoover and Franklin Roosevelt, the returns narrow down



considerably between both parties.

Table 3: Republican vs Democrats - does it matter?

Republican President	Tenure Period	Return (%)	
		Dow Jones	S&P 500
Herbert Clark Hoover	1929-33	-83%	-77%
Dwight David Eisenhower - 2 Term	1953-61	120%	130%
Richard Milhous Nixon	1969-74	-17%	-21%
Gerald Rudolph Ford	1974-77	25%	28%
Ronald Wilson Reagan - 2 Term	1981-89	131%	114%
George HW. Bush	1989-93	45%	52%
George W. Bush - 2 Term	2001-09	-22%	-37%
Donald Trump	2016-Present	39%	48%
Average Return (%)		15%	17%
Democratic President	Tenure Period	Return (%)	
		Dow Jones	S&P 500
Franklin Delano Roosevelt - 3 Term	1933-45	194%	141%
Harry S. Truman - 2 Term	1945-53	82%	85%
John Fitzgerald Kennedy	1961-63	16%	20%
Lyndon Baines Johnson	1963-69	28%	42%
Jimmy Carter	1977-81	0.24%	29%
Bill Clinton - 2 Term	1993-2001	225%	209%
Barack Obama - 2 Term	2009-16	138%	166%
Average Return (%)		47%	53%

Source: Wikipedia, Yahoo finance, Valentis Research

#3: What is the nightmare scenario in the elections?

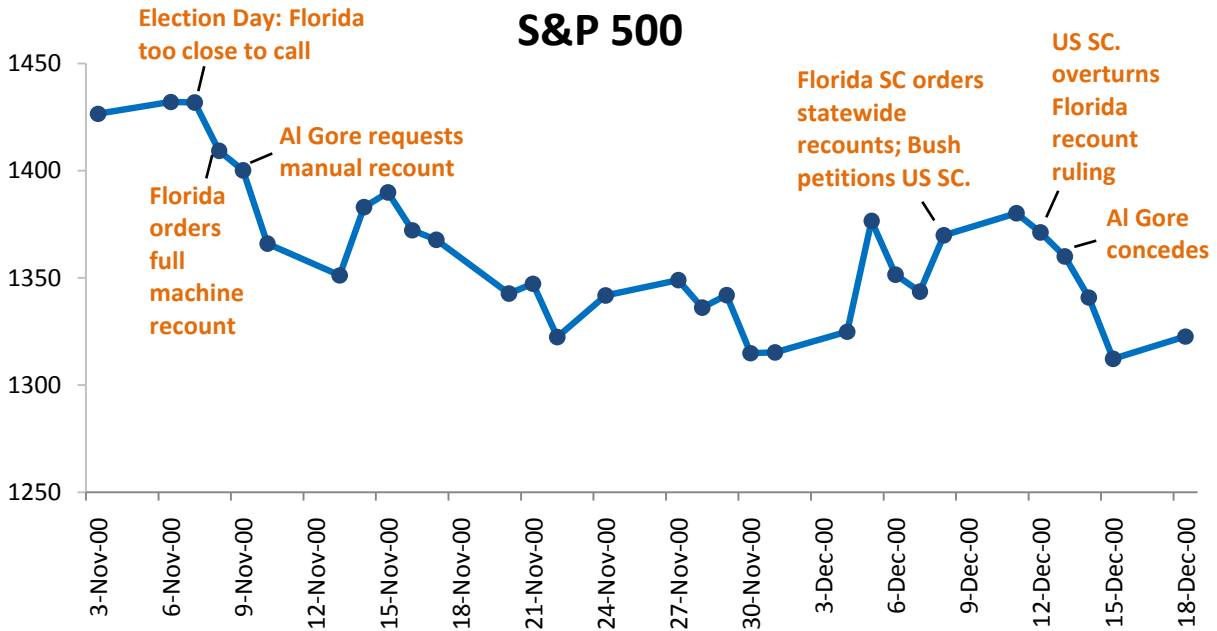
We think that more than who wins elections, the nightmare scenario is if we don't get an election result on November 3rd

1. There will be many more mail-in ballots than normal which means that a winner may not be decided on November 3rd but could be delayed by many days if it becomes a close election.
2. The bigger worry is if the transition of power is not a smooth process and ends up in courts.

The last time we had the Court finally resolving the elections, the market fell 8% in the 5 weeks between the elections and the winner being declared.



Chart 1: 2000 experience: when we had a court decision



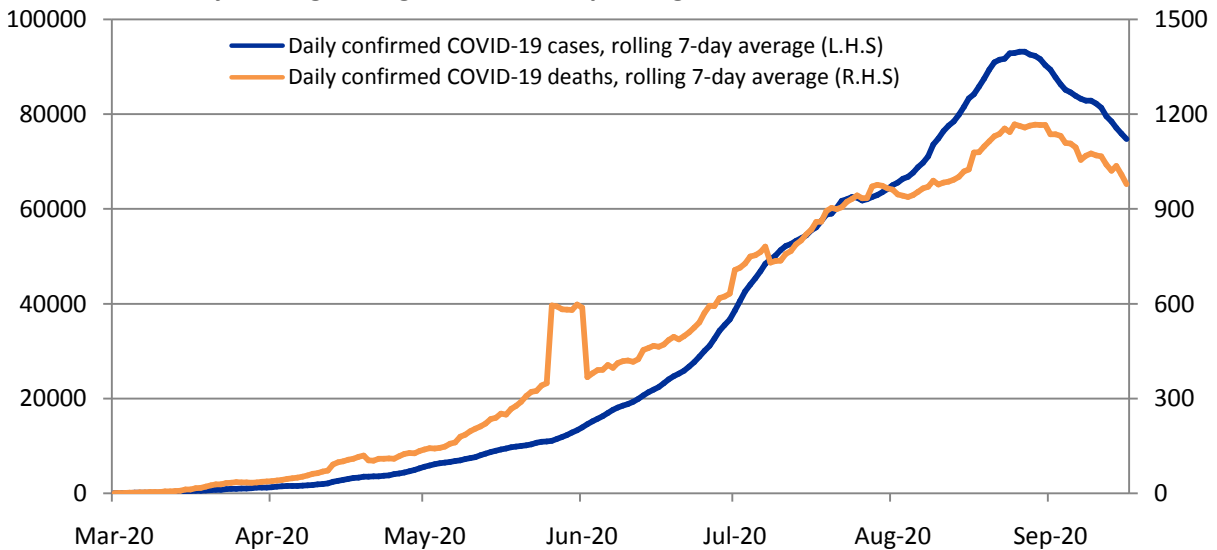
Source: Wikipedia, Yahoo finance, Valentis Research

2. Corona Virus – the good, the bad and the vaccine hope

Good news – peak in India cases

The good news is that the virus cases in India finally seem to have peaked. After hitting a peak of close to 95,000 cases every day, we are now seeing daily cases reduce to below 75,000. The active cases are now below 9 lakhs, a 1-month low.

Chart 2: India 7-day moving average shows some peaking

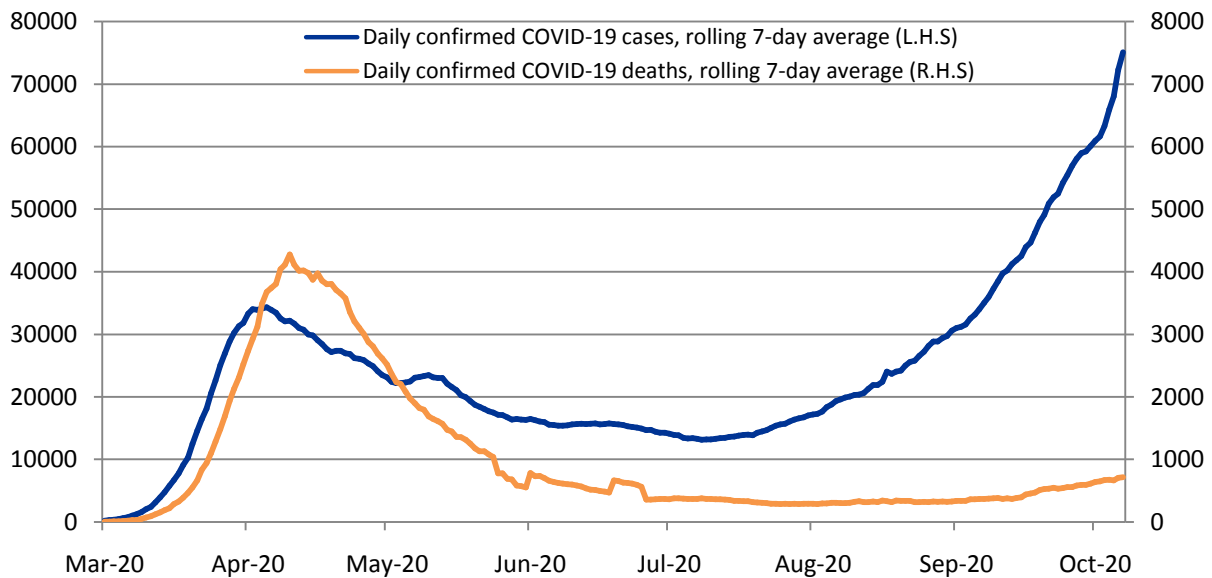


Source: ourworldindata.org, Valentis Research

Bad news - Second wave in Europe; but seems to be less deadly

The bad news is that Europe is having a second wave. While the surge in cases is a worry, we can draw a bit of comfort from the fatalities being much lower.

Chart 3: Europe 7-day moving average shows second wave



Source: ourworldindata.org, Valentis Research

Fatality low in Europe in second wave - Second Wave is less deadly

Europe's second wave started in mid-July and the case fatality rate (deaths per 100 infections) has been far lower compared with the period before. This could be because of a better understanding of the virus and management of cases with the experience acquired over months.

Table 4: Total Covid cases and fatality rate during first and second wave

Countries	Total Cases	Case Fatality rate	
		Till July 15	July 16- to Oct 4
Spain	7.9L	11.0	0.7
France	6.1L	17.4	0.5
UK	4.8L	14.0	0.8
Italy	3.2L	14.4	1.2
Germany	3.0L	4.5	0.5
Belgium	1.3L	15.2	0.6
Sweden	0.9L	7.7	1.0
Switzerland	0.5L	5.1	0.5

Source: ECDC, Valentis Research

Awaiting the vaccine

There are 4 companies that have entered Phase 3 trials – Oxford-AstraZeneca, Pfizer, Moderna and Johnson and Johnson. The general expectation is that by the end of this quarter we will get at least one and hopefully more than one vaccine. But both AstraZeneca and J&J have already had to halt trials once and hence we can't rule out delays.

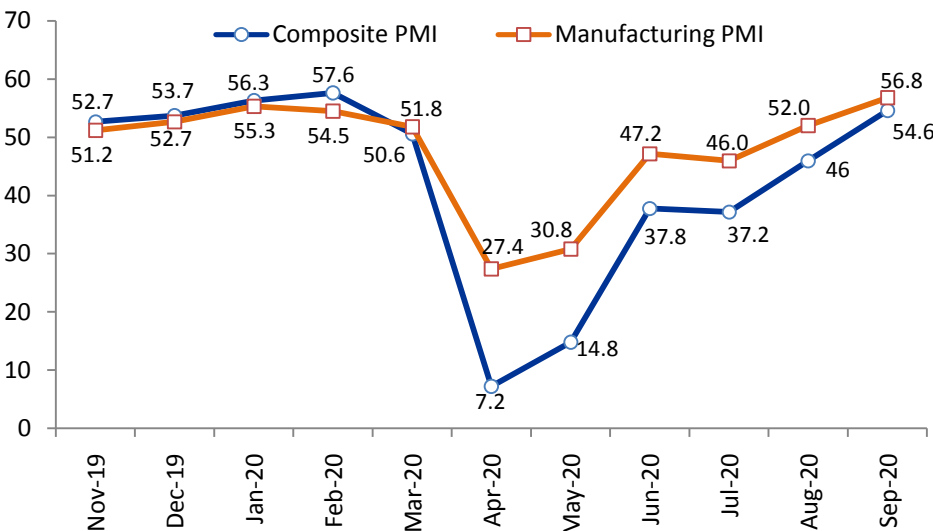
Mind you it will take a long time for the vaccine to be physically available to a large section of the world population. There is going to be logistic issues with cold storage and refrigeration issues. The second issue is whether enough people are willing to get vaccinated to create herd immunity since there will be some concerns on safety in a rushed vaccine program. But from the market point of view, we think an approval of the vaccine will signal to the markets that they should prepare for a normalization of the economy.

Firstly, the vaccine will be positive for the market in general as the economy will start normalizing. One can argue that the market is already priced for a normal economy but overall in the medium term it will be positive. Second and more important we expect the vaccine to lead to a sector rotation away from the “lockdown plays” to the “unlock plays”.

3. Recovery in India continues to gather pace

Meanwhile, in spite of the virus cases which kept going up, the economy in India continued to gather pace with most industries reporting sequential improvement every month since the economy opened up in May. Some industries have now hit a yoy increase in volumes while others are somewhere in the 80-90% range relative to yoy sales.

Chart 4: PMI data

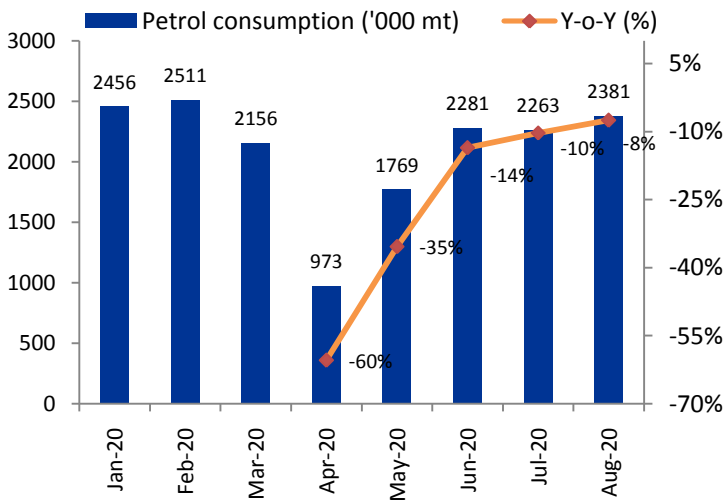


Source: MOSL, Valentis Research



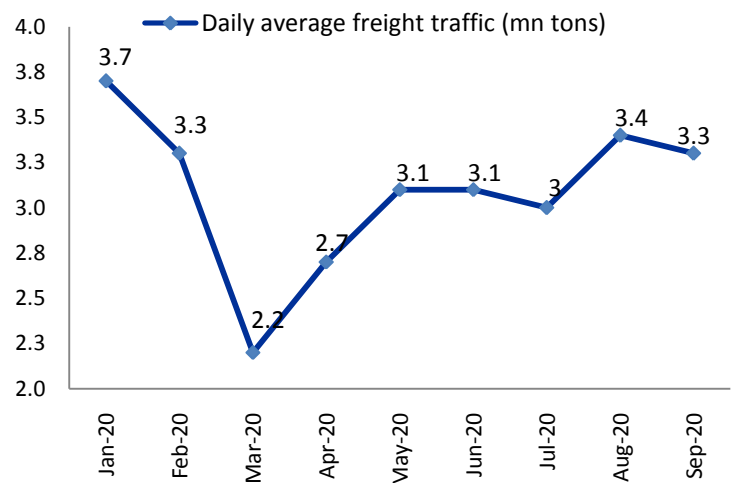
There are, of course, some questions on whether this was pent up demand and we will see the economy cooling off soon. Secondly, can a second wave lead to a reversal of the feel good sentiment? These are valid questions. Our thought is that even if we get a second wave we will not have a national lockdown like in April. Regional lockdowns have continued and may increase or reduce depending on the severity of the virus. The bigger hope is that a vaccine leads to optimism of a normalization of the economy in CY21.

Chart 5: Petrol consumption increased marginally in August; still lower than August 2019



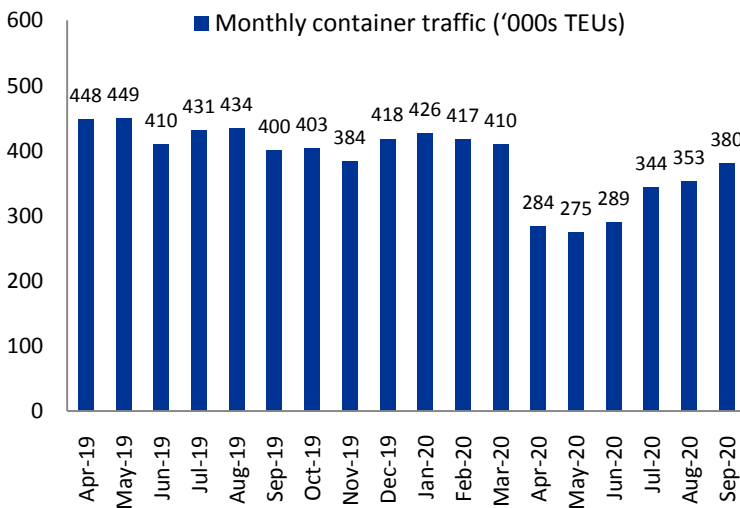
Source: MOSL, Valentis Research

Chart 6: A minor sequential decline in October for railway freight volume



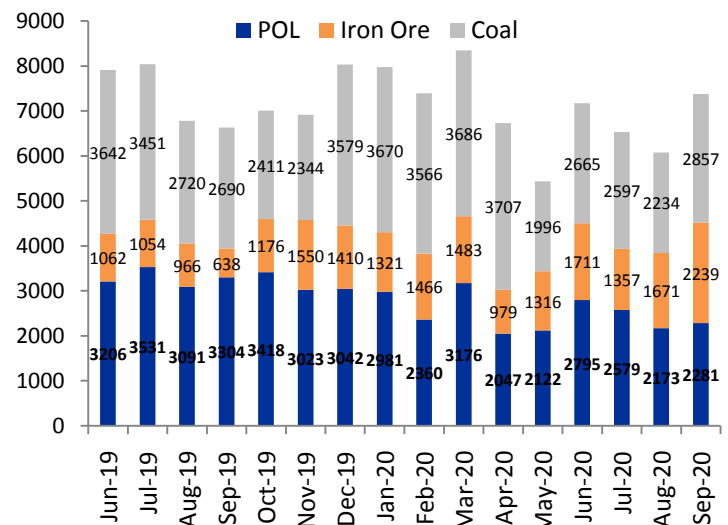
Source: Indian Railways, Valentis Research

Chart 7: Container traffic increased in Sept. at JNPT; still below pre-Covid levels however



Source: JNPT, Valentis Research

Chart 8: Volumes were up at Paradip port in Sept. with substantial increase in iron ore and coal volumes



Source: Paradip Port Trust, Valentis Research

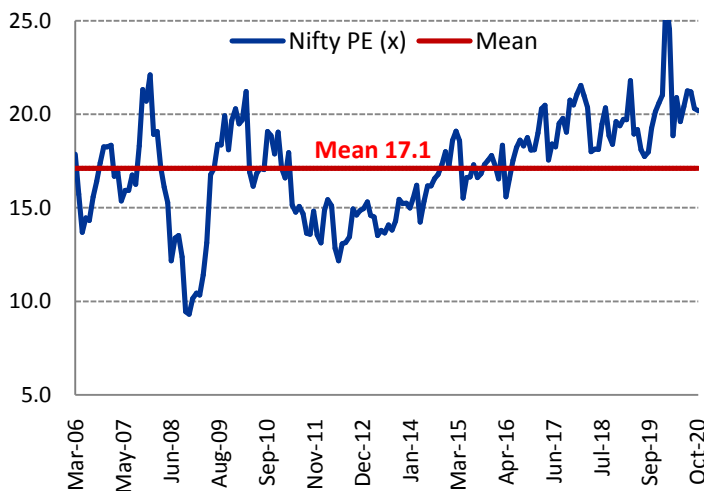


4. Valuations no longer cheap

After the sharp rally, valuations are no longer cheap but have inched closer to fair value. On a PE multiple markets are trading at 20.2x, well above long term valuations. However, given current extra-ordinarily depressed earnings, we think the P/B is a better measure. The P/B is currently at 2.5x, below a long term average of 2.7x but well above the lows of 1.7x. Overall, future returns in market will mirror earnings growth rather than valuation re-rating that drove returns last few years.

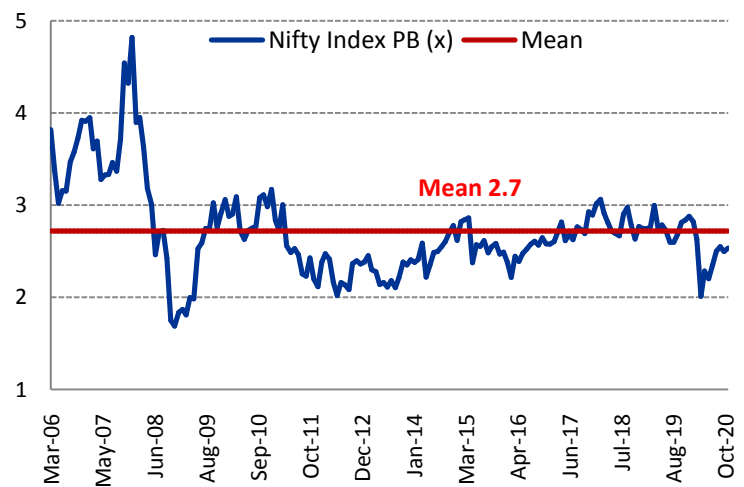
Returns in the market will be led by an improving economy and earnings rebound as well as a normalization of the economy once the vaccine is discovered.

Chart 9: 12M forward Nifty PE



Source: MOSL, Valentis Research

Chart 10: 12M forward Nifty Index PB (x)



Source: MOSL, Valentis Research

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