'Markets could see a time and price correction'

Lockdowns imposed across several cities in the backdrop of rising Covid cases has seen market analysts tweak their strategy. **JYOTIVARDHAN JAIPURIA**, founder and managing director of Valentis Advisors, tells Puneet Wadhwa in an interview that they have raised cash in their portfolio to over 10 per cent, which gives them some firepower to invest in a market downturn. Edited excerpts:

Is the risk-reward still favourable to buy stocks at the current levels?

After the sharp rebound in financial year 2020-21 (FY21), returns in FY22 will be relatively more muted, but still healthy in the low double-digits. Markets could see a time and price correction. A parallel was the market in FY10, where they nearly doubled from the March 2009 lows, yet gave a double-digit return for FY11. However, it was after a period of 4-6 months of consolidation in the first half of 2010. The surge in the virus cases in India and the consequent lockdowns; possible weakening of the economy and earnings as a consequence of the lockdowns; and rich valuations are the three things that could worry the market in the near term.

Q&A

JYOTIVARDHAN JAIPURIA

Founder & MD, Valentis Advisors

What about foreign flows?

There are two factors that helped foreign institutional investor (FII) flows in India in FY21. First was the weakening of the dollar, which led to a move from developed markets (DMs) to emerging markets (EMs). Second was the increase in India's MSCI weight owing to change in the free float norms. In the medium term, dollar weakness should continue and EMs will outperform DMs. But in the near term, we see weakness in FII flows because of a bounce in the dollar leading to a move away from EMs, and faster vaccination in developed countries, which is easing virus fears there.

Do you expect the market performance to get more polarised going ahead?

We are at the initial stages of a revival in the economy and expect earnings to double over next five years. Within this period, there will be blips with the lockdown providing one weak spell this quarter. However, the market will be less worried about the rising cases this year compared to last year owing to two reasons. First, we have a better knowledge of the virus compared to 2020. Second, the vaccinations will continue at a rapid pace, providing some light at the end of the tunnel. While our overall sector strategy favours sectors that are likely to gain from an improvement in the economy, we have added to defensives as a tactical hedge against rising virus cases.

What is the optimum portfolio mix you suggest between cyclicals and defensives?

Over the medium term, we would be more inclined to be overweight domestic cyclicals that will benefit from the economic and earnings recovery in India.

These would include sectors such as financials, cement, and some capital goods. However, in the near term, we recommend a barbell approach with domestic cyclical on one end, and sectors such as pharma, which are relatively immune from a lockdown, at the other end.

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Can you elaborate on your investment strategy?

Over the past six months, we have been focussed on sectors like cement, financials, auto ancillaries, and select early cycle capital goods to play the economic recovery. However, following the sharp rally in the market, we had made two tactical changes in the portfolio. First, we have raised cash in the portfolio to over 10 per cent so that we have some firepower to invest in a downturn. Second, we added weight to sectors like pharma by cutting weight to financials, purely as a tactical move. We'll look at corrections to get back into corporate banks and infra plays like cement.

Given the new curbs being put in place that can impact businesses, can FY22 earnings disappoint?

The March 2021 quarter results will be strong — and possibly — be in line with the heightened analyst expectations.

Going ahead, looking at year-on-year (YoY) earnings comparison will be meaningless, given the muted base of last year. The June 2021 quarter could be more challenging not just in the view of the lockdowns, but also costs starting to go up. These are commodity costs as well as staff and other logistic costs which are now normalising.

What about commodities, specialty chemicals and the consumption-related plays?

Within the commodities space, we have seen a sharp rally in steel stocks. While we remain bullish on infra spending in India, we prefer to play this through the cement stocks, in which capacity utilisation levels are likely to increase, leading to better pricing power. Within global commodities, steel is still on an uptrend.

However, there are better values in stocks in graphite where the cyclical uptrend is probably just starting. Specialty chemicals as a sector is poised for a multi-year growth. Companies here can become substantially bigger in the next five years. But following their strong performance over the last few months, valuations are not cheap, and hence, stock returns will be more muted. Valuations in the consumer staples sector are too expensive.