Spark Asia Impact
Equity Asset Management

Handover from 2023 – A White Swan

It is not an oxymoron, and the swan is indeed white. Many missed what was relatively easy to spot. Which is that the Indian economy has been strong and getting broadly stronger after it recovered from the pandemic. Some of the reforms undertaken in earlier years such as GST and the bad debt resolution process started delivering. Sample these two different takes which told us the story.

One – RBI, in its post pandemic assessment of NPLs, expected banking system NPLs to peak at close to 15%. As a conservative regulator, RBI wanted to err on the side of caution and rightly so. The NPLs peaked at 11.8%. We need to highlight here that the work done by RBI has been exemplary overall and, in our view, RBI is one of the unsung heroes of the bull run in India.

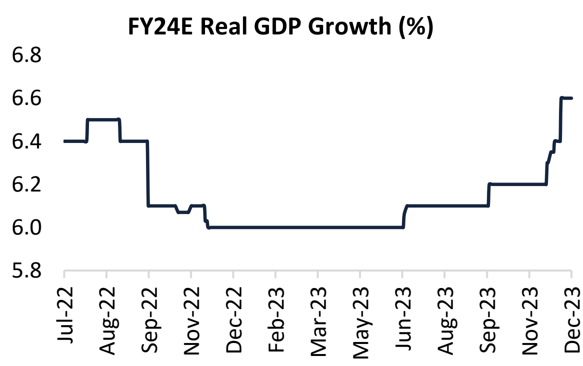
Two – a comment, perhaps off the cuff, from a very renowned economic expert on India in the global arena. The remark was that India would be lucky to be growing at 5% in FY23. The comment was made before FY23 panned out but after the troubles erupted on the rate side. India finished with a 6.5% growth in FY23.

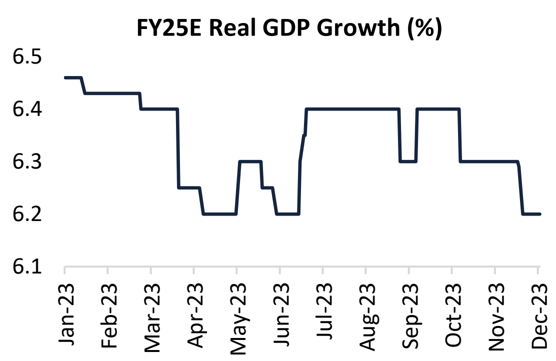
These encapsulate the unfolding saga of India delivering. Market has perhaps seen it coming on the fly and that accounts for the higher returns in Nifty over the last five years, pandemic factored in.

The newsletter that we put out in April 2023 was titled "What can go right ". To quote "If we get a surprise on the growth front, the market can do better than expected but it need not be the same old story with the same names leading the market". The handover from 2023 is a bunch of white swans. The choice is whether to wait for checking if the one with the dark shade will tumble out next. Otherwise, the picture that is emerging is one that is consistent and clear.

The economy continues to track well

- GST collections – Up 12% FYTD (till Dec 31, 2023)
- Direct Tax Collections – Net Direct tax collection Up 20.7% FYTD (as against budget estimates of 10.5%) (till Dec 17, 2023)
- CPI – 5.5% as on Dec 12, 2023, as against a peak of 7.8% as Dec 05, 2022.
- GDP growth forecast upgraded from 6.5% to 7.0% for FY24 (RBI).

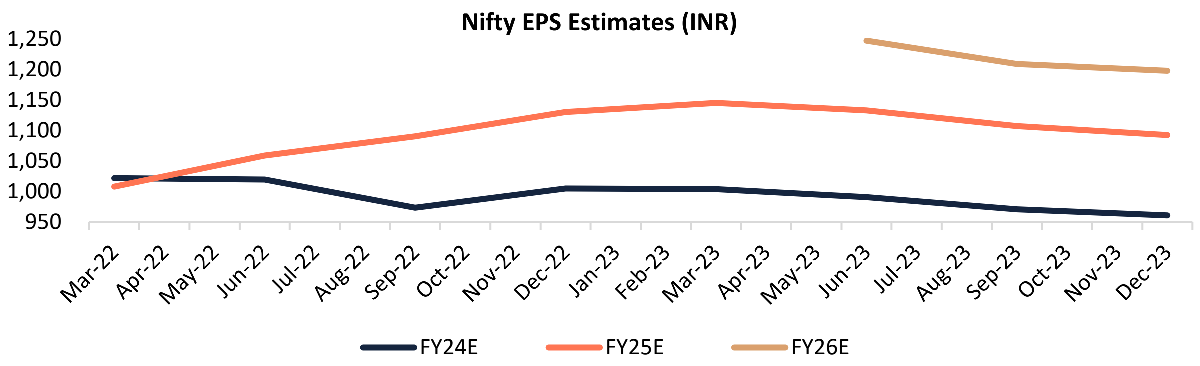




Source: Bloomberg, Spark Fund Research

The growth in FY24 could be about 7% and the forecast of 6.3% by IMF for CY24 (FY25 follows from that) will need to be upgraded. There is no reason for the economy to do a sudden volte face. As can be seen, consensus seems to be behind the curve on FY25 now.

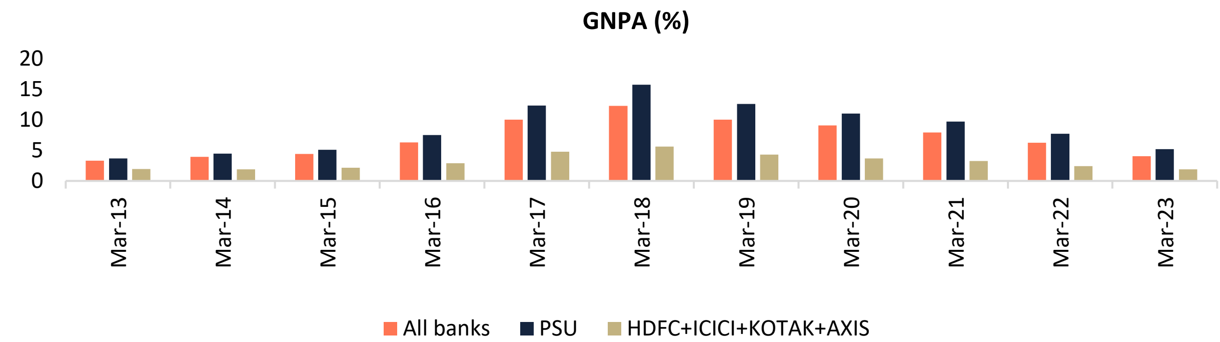
Earnings continue to track well



Source: IIFL Securities, Spark Fund Research

It is pertinent to note that the above does not bake in a growth of 7% plus for FY24 and beyond. Nor does it seem to factor in any kind of global recovery.

Banks continue to track well



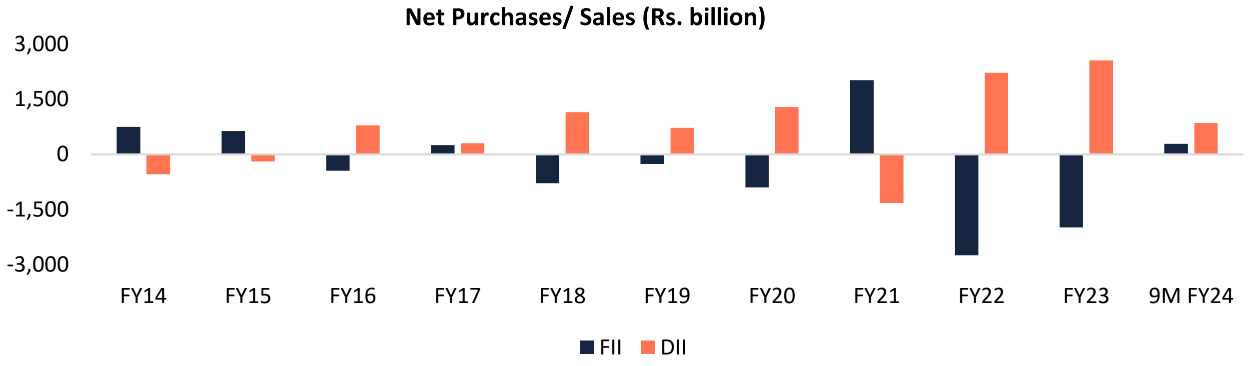
Source: Reserve Bank of India, Spark Fund Research

While the easy part of the earnings recovery is done, it is worth highlighting that the cycle will have more legs, stronger legs, and more durable strides if the economy continues to do what it has been doing.

What the market is beginning to bake in

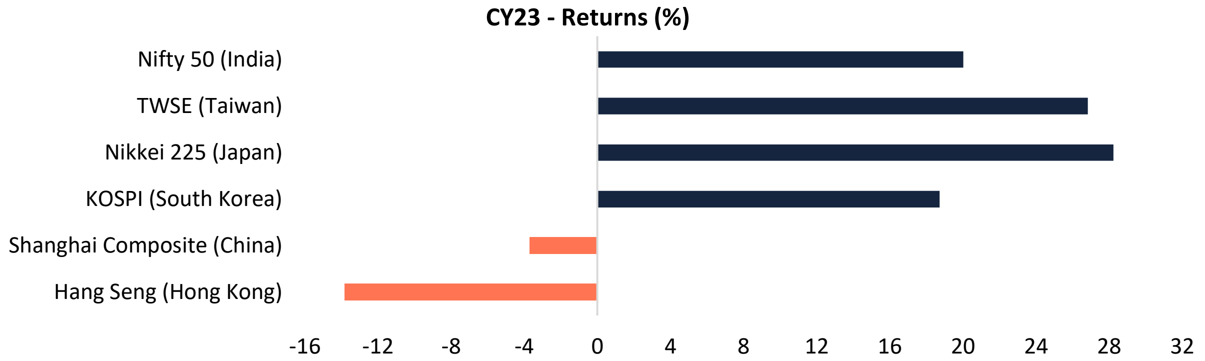
The market is beginning to sense that we may get earnings upgrades next – for FY25, FY26 and maybe beyond. Here are a few points to ponder,

1. Two recent RBI moves have the potential to end up as proactive masterstrokes. One is a circular imposing tighter capital requirement on unsecured loans. This will actually end up helping growth while smoothening the rough edges. The second is the move to clamp down on evergreening through AIFs. The numbers are not alarming right now and these measures once again mark the Indian regulator as amongst the better ones in the best in class. These will help growth sustain without the excesses building up too early.
2. While it is premature to call out election results, the results from the state elections and other surveys point to the fact that the younger voters in India have started to vote on the basis of which side of the bread is buttered for them. While we lack the credentials (nor is that part of our process) to analyse politics here, the writing is on the wall. Young voters and women voters are expressing their assent and dissent very clearly. They don't want several disparate groups coming together without a leadership or agenda.
3. FPIs have been net sellers in Indian equities for the last three years.



Source: Moneycontrol, Spark Fund Research

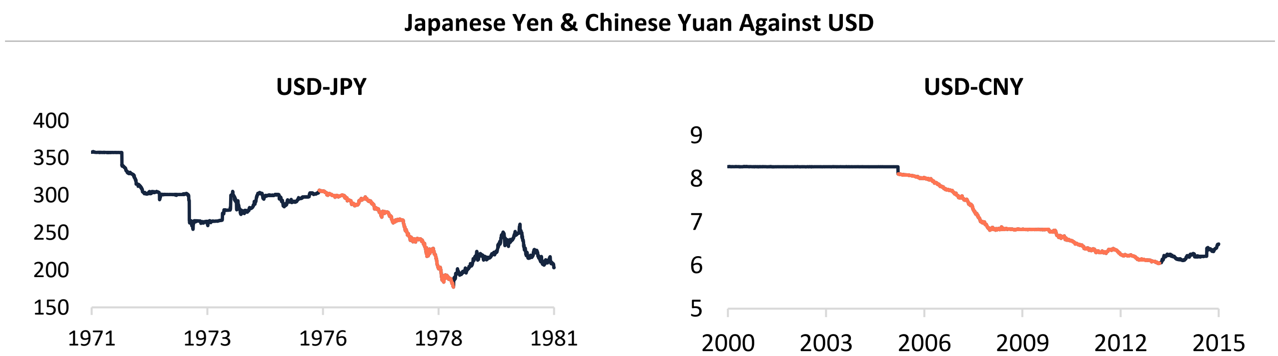
The selling in 2022 and much of 2023 was driven by the end of the carry trade. Not that the carry trade is coming back anytime soon. The Indian market has been resilient in the face of this selling and many underweight calls based on valuation concerns have fallen flat.



Source: Bloomberg, Spark Fund Research

Given the growth prospects and the probability of political stability, FPI buying can potentially resume. When it rains there, it usually pours.

4. We argued earlier in the year that given the narrowing inflation differential (over a four- decade observation) between India and the US, capital flows could be strong towards India and that in turn can make INR stronger. INR has been relatively weak so far. Given the expected bond inflows from June due to India being included in a major global bond index, and given softening of rates in the US, INR can be a surprise pack still. Exports however have been very weak and that continues to be an issue. RBI has always maintained that they don't want to control the direction but only the volatility. However, the market has always believed that the policy is in favour of a weakening currency.

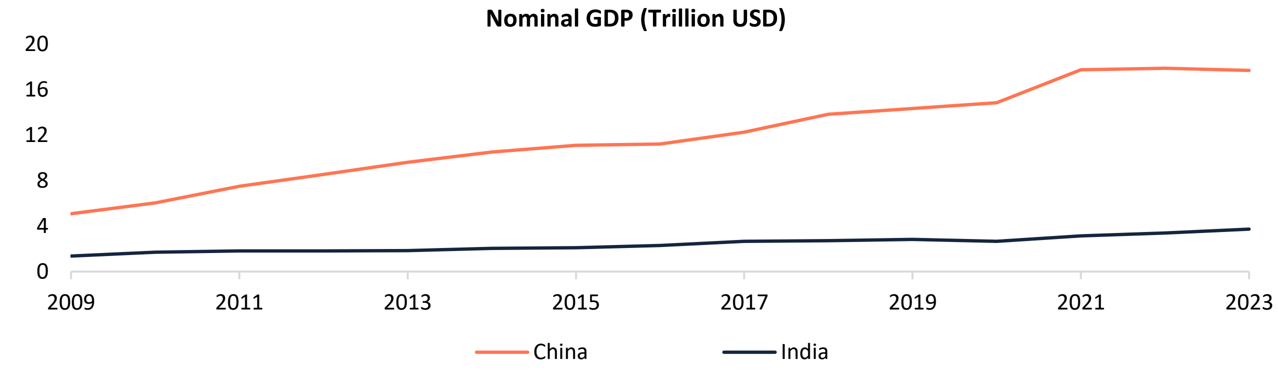


Source: Bloomberg, Spark fund Research

Successful economies have seen periods of currency strength. This is clear from the charts above. Of course, it is well understood that India does not run a trade surplus. However, a unidirectional INR which keeps weakening all the time may be a fallacious assumption. We may get a period of a narrow range. Maybe even some strength.

5. Oil has been soft. While this is a tough one, there are no great drivers for oil in the long run. Growth in renewables globally, EV push, slow growth in China et al are pointers to a weaker crude. Maybe the long run is creeping up faster than many would have thought.

India could deliver on its promise



Source: International Monetary Fund, Spark Fund Research

This is one of those charts that transform optimists into the eternal variety. While not getting ahead of ourselves, it is useful to observe that the Chinese economy reached 4 trillion USD just after 2008 starting off from 1979 (under Deng Xiaoping). It went on to triple in under a decade after that. Such an acceleration may not be within the reach of India given structural rigidities. India is knocking at 4 trillion USD as we go into 2024. A meaningful acceleration could be waiting to unfold. There is no dearth of sceptics here though.

The big lesson from 2023 is that what is visible may be what investors may have a huge reluctance to get convinced about. For instance, the budget deficit for FY24 is likely to be comfortably ahead of expectations. But no one wants to give any credit for the positives that could come out of it. India deserves a higher credit rating, and the CEA has stated that. However, no one is convinced that can happen. Political stability is within reach, but no one is fully convinced that the voters will follow through. Maybe there is a shadow looming from the false starts of the past.

The biggest handover from 2023 could be that while the market may have run up a lot, it may not be so risky to invest in after all. Provided we listen to what the market is trying to tell us. And follow the data, growth and stocks that are well-placed to drive that growth and benefit from the same. Caution is always in order when stocks have done so well. Fear needs to take over only when we run on empty. 2023 has offered too many data points that suggest otherwise.

Warm regards,

P Krishnan (CIO) and Team Spark Fund