ALCHEMY CAPITAL MANAGEMENT

CELEBRATING 20 YEARS

Investment Matters

August 2022

EQUITY OUTLOOK

Rupee weakness: no cause for alarm

The Indian rupee dropped sharply in July 2022, down 1.5% despite the strong end-of-month rally. We see however, no cause for alarm, as this is a relatively small slide compared to historical incidents, and the major headwinds seem to be dissipating. The markets and the economy should be able to absorb this. It is a tail risk, however, that we are keeping our eyes on, as it has a relatively high correlation with the equity markets. We also do not expect any knee-jerk reaction from the RBI, and we think that they will raise rates by ~100bp by the year-end, including a steep hike on August 5th. The tightening by the RBI is unlikely to destabilise growth.

Equity Markets in July 2022

	Jul-22	Performance (%) 1m	3m	6m	1Y
Major Indian indices					
Sensex	57,570	8.6%	0.9%	-0.8%	9.5%
Nifty	17,158	8.7%	0.3%	-1.0%	8.9%
CNX-100	17,401	9.2%	-0.3%	-0.8%	8.5%
CNX-500	14,666	9.5%	-0.8%	-1.7%	7.3%
Mid-cap and Small-cap indices					
BSE Mid-cap	24,051	10.8%	-1.5%	-2.3%	4.2%
BSE Small-cap	27,056	9.2%	-5.4%	-7.4%	1.0%
CNX Mid-cap	29,634	12.0%	-0.8%	-2.1%	6.5%
CNX Small-cap	9,171	8.6%	-10.6%	-17.5%	-12.8%

Source: NSE, BSE

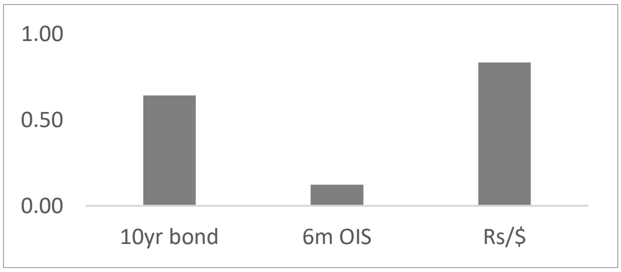
	Jul-22	Performance (%) 1m	3m	6m	1Y
NSE sector indices					
CNX Bank	37,491	12.2%	3.9%	-1.3%	8.4%
CNX Auto	12,543	7.2%	13.2%	7.2%	24.8%
CNX Realty	451	17.0%	1.6%	-6.1%	13.1%
CNX Infrastructure	4,891	5.9%	-4.6%	-3.3%	10.3%
CNX Energy	26,018	3.6%	-9.0%	4.1%	37.4%
CNX FMCG	42,487	12.8%	11.2%	16.5%	17.9%
CNX Pharma	12,777	5.1%	-5.1%	-3.1%	-11.4%
CNX IT	29,152	4.7%	-7.8%	-16.3%	-4.4%

Source: NSE, BSE

Impact on markets

- Currency movements impact the equity markets at multiple levels. There is a flow-through to earnings (discussed later in the blog), but it also affects domestic interest rates and foreign capital flows. The relationship between currency and flows/rates is complex and circular (cause and effect are hard to discern) but the net impact on equities is significant. As the chart below shows, the currency has the highest correlation with equity markets among the major macro indicators.

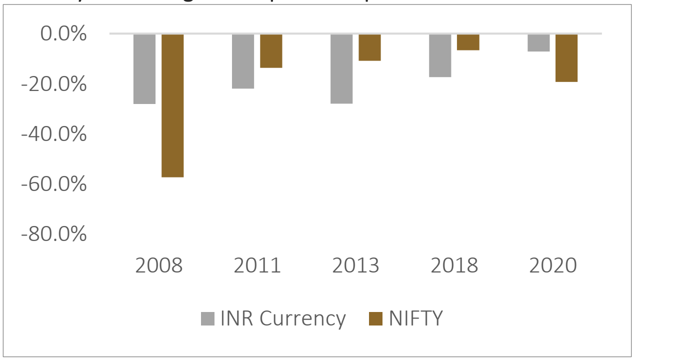
Equity markets have highest correlation with currency



Source: Bloomberg, Alchemy Capital , July 2012 to 2022

- Empirical observations show that sharp sell-offs in the currency are usually accompanied by some weakness in the markets. There is a lead lag, but the correlation is fairly clear. The biggest reason is FII flows – which is both a cause and partly an effect of a weakening currency. From our perspective as equity investors, it is therefore important to track the rupee market as it poses an extraneous risk for the broader markets.

Currency crises: Negative impact on equities



Source: Bloomberg, Alchemy Capital

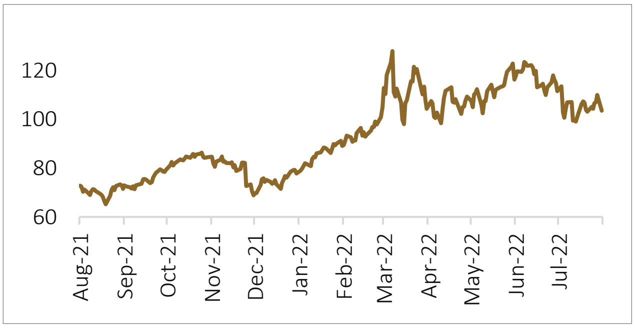
EQUITY OUTLOOK

- We are not worried this time for two reasons: First, the currency sell-off is relatively mild compared to past episodes. Second, the markets had already sold off in 1HCY22 – we have observed that there is a lead lag factor so the risks are now compressed. Chart on the previous page (Currency crises: Negative impact on equities) however, is also a warning - if the currency weakens further from here, we could see fresh risks emerge for equities.

Key drivers of the rupee

- The biggest source of weakness is the tightening by the US Fed. The Fed funds rate has already been raised by 225bps in CY22 and consensus expectations are of a further increase by end of the year. The RBI has raised rates but is unlikely to keep pace with the Fed, causing the rate differentials to probably widen further. This will cause additional pressure on the currency, but we do not think it is the clinching factor. The predominance of equity in India's external capital flows (55% from FY18-FY22) helps cushion the currency from being ultra-sensitive to rate differentials.
- Crude prices have corrected 36% from the highs of early March, giving some relief to India's potential current account deficit. This is an important determinant, as India is dependent on imported energy and a spike in crude prices directly impacts the CAD and the currency. The recent correction has taken the pressure off, but the outlook remains uncertain, and this remains a risk to the rupee and the equity markets.

Crude off the peaks



Source: Bloomberg, Alchemy Capital

- 1HCY22 was one of the largest equity sell-offs by FPIs in the Indian market - $28.5bn, unwinding almost two years' net purchases. Given India's dependency on equity capital flows, the depreciation of the rupee could have been much worse. Going forward, we believe that the selling should slow down as the large part of the portfolio adjustment is probably done. This would, in our view, ease the pressure on the currency.
- We expect economic growth to remain strong for India as the impact of "opening up" and the rebound in the informal economy drives the momentum. Indian consumption, unfortunately, remains import-intensive and could put some pressure on the current account deficit.

Our base case view is that the worst is over for the rupee and 2HCY22 should be easier for the currency. However, risks remain if either crude prices spike from here and/or the Fed tightens beyond market expectations. The rupee has been remarkably resilient in the past 6 months, largely due to support from the RBI. If the fundamentals weaken from here, the RBI will find it more difficult to defend the currency.

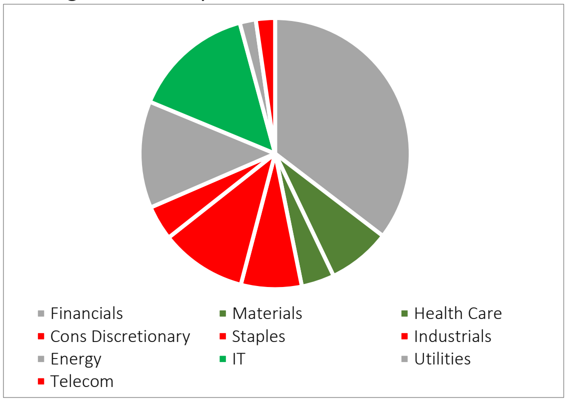
We, therefore, remain vigilant on the low-probability likelihood of a sudden slide in the rupee and the contagion effect on the equity markets.

Impact on earnings

Rupee depreciation has a net negative impact on the broader earnings basket, in our view. For a relatively small move such as the recent one, the drag is relatively small and it is also asymmetrical across sectors.

EQUITY OUTLOOK

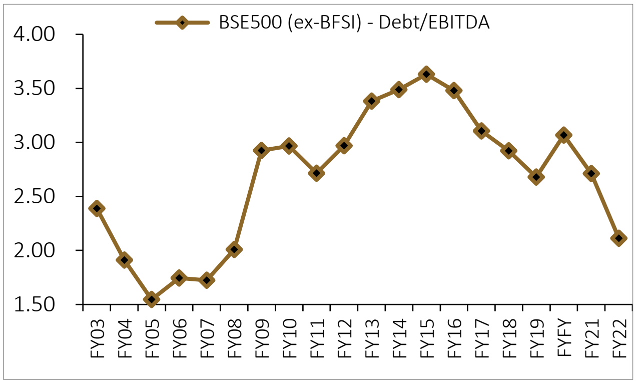
Earnings vulnerability is low



Impact of rupee weakness - Red: Negative, Grey: Neutral, Green: Positive , weights as of July-22 | Source: Ambit Capital, Alchemy Capital

- Exports are, obviously, positively impacted and the IT sector is amongst the biggest beneficiary. The flow-through is, however, not linear as there are some cross-currency headwinds that can dampen the benefits. Companies also have different hedging policies so the gains are sometimes harvested with a lag.
- The depreciation has a negative impact on margins for most consumer and manufacturing companies. Domestic-facing companies have no natural hedges against imported raw materials (RM), so a weak rupee leaves them vulnerable. In this cycle, however, the rupee played a bit part – the spike in underlying RM prices was a bigger culprit in dragging down margins. If global commodities correct from here on, the weak rupee will not hurt the importers much.
- There have been some worries raised on the large stock of external private sector debt, much of which could be unhedged. We do not see any cause for alarm yet: the slip in the rupee is relatively small; many of the borrowers have natural hedges and overall leverage for Indian corporates is under control. We also think that a large portion of this debt lies outside the listed universe – the risks, if any, lie at the macro level and would not impact listed market earnings.

Corporate deleveraging protects from overseas debt risks



Source: Ambit Capital, Alchemy Capital

Domestic interest rates

The pressure on the currency does have a significant impact on domestic monetary policy. We wrote a detailed May 2022 blog on how we see interest rates play out and its impact on the economy: TL;DR is that we are not worried. The following is a summary of our thoughts:

- RBI is not done raising rates and we expect hikes through to the end of the year. We expect the RBI to largely be in line with consensus expectations of a 100bp hike by end of FY23 with a possibility of further front-loading.
- This is still slower than the Fed hikes but we think the RBI will not follow in lockstep. If the risk factors we discussed (crude, faster fed hikes) do materialise, a direct intervention would work better than further rate hikes.
- The terminal repo rate of ~6% is unlikely to create any material risks to growth or corporate profitability. We see this as a normalisation of the Covid stimulus and are not worried about its impact.

Earnings trends

Consensus earnings have seen 1-2% downgrades through July. However, the overall expectations are of ~15% growth through FY23/FY24 – making it a rare instance of three successive years of double-digit EPSg for the Nifty. The market looked through the downgrades as we entered July on the back of a weak six months and the cuts are relatively

EQUITY OUTLOOK

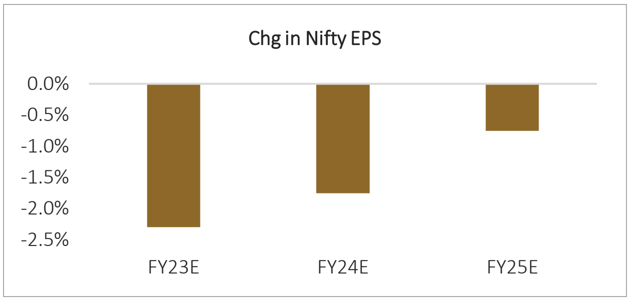
minor. Financials is the key driver of this elevated growth, making up almost half the EPSg over the next two years. Healthcare and consumer discretionary are the other high-growth sectors, but with relatively lower index weights.

Nifty EPSg: Financials leads the way

	EPS growth		Sector-wise contribution to EPS growth	
	FY23E	FY24E	FY23E	FY24E
Financials	23%	19%	53%	43%
Materials	-31%	4%	-38%	3%
Health Care	46%	19%	7%	3%
Cons Discretionary	229%	40%	29%	13%
Staples	13%	13%	6%	5%
Industrials	36%	20%	8%	5%
Energy	18%	7%	24%	8%
IT	8%	15%	7%	12%
Utilities	-8%	8%	-3%	2%
Telecom	181%	54%	7%	5%

Source: Ambit Capital, Bloomberg, Alchemy Capital

Small cuts in July



Source: Ambit Capital, Bloomberg, Alchemy Capital

Our view

We are constructive on the markets over the medium-term (3-4 quarters) but believe that there could be some short-term volatility, despite the strength in the markets in July. We are in stock-picking mode and continue to "follow the earnings" rather than play a broad market recovery. We believe that off-index stocks are more likely to deliver and are focusing on ideas along those lines, with suitable risk guardrails. Our deployment strategy remains cautious, and we are staggering fresh inflows over time to take advantage of market fluctuations. In most cases, we aim to deploy inflows over 30 days.

Seshadri Sen
Head of Research
Alchemy Capital Management Pvt. Ltd

Source: Alchemy Capital
Published Date: August 3, 2022

MARKET INSIGHTS

Alchemy's view on Market trends, analysis, and way forward; with additional inputs from industry experts about the different aspects to superlative asset management.

1. Market Views [Market Views - July 2022 - YouTube]

2. Interviews :

- Mr. Hiren Ved in an interaction with ET Now: Watch the video
- Mr. Hiren Ved in an interaction with ET Now Swadesh: Watch the video
- Mr. Hiren Ved in an interaction with Jagran Business: Watch the video
- Mr. Hiren Ved in an interaction with CNBC TV 18: Watch the video
- Mr. Alok Agarwal in an interaction with The Economic Times: Read the article
- Coverage by Moneycontrol: Read the article

*Hyperlinks to other websites made available here are to be accessed at the sole risk of the user; the content, accuracy, opinions expressed, and other links provided by these resources are not investigated, verified, monitored, or endorsed by Alchemy.

Q1 FY23 PERFORMANCE OF PORTFOLIO COMPANIES

The following table summarizes the performance of portfolio companies** which have published their results so far in Q1 FY23 :

Scrip	Sales (Rs Mn)			EBITDA (Rs Mn)			PAT (Rs Mn)		
	Q1FY23	Q1FY22	% chg	Q1FY23	Q1FY22	% chg	Q1FY23	Q1FY22	% chg
ANGEL ONE LTD	6,865	4,745	45%	2,527	1,692	49%	1,815	1,214	50%
AVENUE SUPERMARTS LTD	1,00,381	51,831	94%	10,082	2,242	350%	6,429	954	574%
BAJAJ AUTO LTD	77,689	72,166	8%	12,970	11,198	16%	11,733	10,612	11%
BAJAJ FINANCE LTD	92,830	67,430	38%	62,575	37,073	69%	25,963	10,024	159%
BAJAJ FINSERV LTD	92,830	67,430	38%	62,575	37,073	69%	25,963	10,024	159%
BARBEQUE-NATION HOSPITALITY LTD	3,149	1,020	209%	705	-178	NA	152	-426	NA
BLUE DART EXPRESS LTD	12,933	8,662	49%	2,672	1,591	68%	1,188	313	280%
DELTA CORP LTD	2,503	759	230%	875	-276	NA	571	-289	NA
DIXON TECHNOLOGIES (INDIA) LTD	28,551	18,673	53%	1,001	479	109%	454	182	150%
EASY TRIP PLANNERS LTD	876	313	180%	416	178	134%	331	154	115%
HDFC BANK LTD #	2,58,697	2,32,976	11%	1,53,678	1,51,371	2%	91,960	77,297	19%
HDFC LIFE INSURANCE COMPANY LTD @	19,040	15,610	22%	Nil	Nil	Nil	5,100	4,080	25%
ICICI BANK LTD #	1,78,752	1,49,316	20%	1,03,089	88,944	16%	69,049	46,160	50%
INFOSYS LTD	3,44,700	2,78,960	24%	78,640	74,320	6%	53,600	51,950	3%
JUBILANT FOODWORKS LTD	12,403	8,790	41%	3,045	2,115	44%	1,010	626	61%
KPIT TECHNOLOGIES LTD	6,857	5,674	21%	1,332	981	36%	854	602	42%
L&T TECHNOLOGY SERVICES LTD	18,737	15,184	23%	4,010	3,177	26%	2,742	2,162	27%
LARSEN & TOUBRO INFOTECH LTD	45,228	34,625	31%	8,308	6,477	28%	6,335	4,963	28%
MARUTI SUZUKI INDIA LTD	2,52,863	1,67,987	51%	19,121	8,211	133%	10,128	4,408	130%
MPHASIS LTD	34,112	26,908	27%	6,000	4,893	23%	4,019	3,397	18%
NAVIN FLUORINE INTERNATIONAL LTD	3,975	3,265	22%	991	778	27%	745	559	33%
RELIANCE INDUSTRIES LTD	21,93,040	13,99,490	57%	3,79,970	2,75,870	38%	1,79,550	1,22,730	46%
SUNDRAM FASTENERS LTD	14,101	11,124	27%	2,255	2,005	13%	1,360	1,196	14%
SYNGENE INTERNATIONAL LTD	6,445	5,945	8%	1,762	1,619	9%	739	773	-4%
TATA ELXSI LTD	7,259	5,583	30%	2,382	1,500	59%	1,847	1,134	63%
TATA MOTORS LTD	7,12,278	6,55,354	9%	24,127	52,427	-54%	-50,066	-44,509	12%
TVS MOTOR COMPANY LTD	73,157	46,893	56%	9,053	4,151	118%	3,054	-106	NA
UNITED SPIRITS LTD	24,191	17,217	41%	3,723	1,885	98%	2,662	555	380%
VARUN BEVERAGES LTD	49,548	24,498	102%	12,506	5,708	119%	6,142	3,183	93%
VIP INDUSTRIES LTD	5,906	2,062	186%	1,026	129	696%	691	25	2631%

Source: Alchemy Capital

# indicates Net Interest Income + Other income, Pre-Provision Operating Profit and PAT for banks
@ Indicates Annual Premium Equivalent (APE) and Value of New Business (VNB) for life insurance companies, EBDITA is not shown for Life insurance companies
** For Alchemy High Growth, Alchemy High Growth Select Stock

DISCLAIMER

General Risk factors:

- All products / investment approach attract various kinds of risks. Please read the relevant Disclosure Document/ Client Agreement/ Offer Documents (includes Private Placement Memorandum and Contribution Agreement) carefully before investing.

General Disclaimers:

- The information and opinions contained in this report/ presentation have been obtained from sources believed to be reliable, but no representation or warranty, express or implied, is made that such information is accurate or complete.
- Information and opinions contained in the report/ presentation are disseminated for the information of authorized recipients only and are not to be relied upon as advisory or authoritative or taken in substitution for the exercise of due diligence and judgement by any recipient.
- The information and opinions are not, and should not be construed as, an offer or solicitation to buy or sell any securities or make any investments.
- Nothing contained herein, including past performance, shall constitute any representation or warranty as to future performance.
- The client is solely responsible for consulting his/her/its own independent advisors as to the legal, tax, accounting and related matters concerning investments and nothing in this document or in any communication shall constitutes such advice.
- The client is expected to understand the risk factors associated with investment & act on the information solely on his/her/its own risk. As a condition for providing this information, the client agrees that Alchemy Capital Management Pvt. Ltd., its Group or affiliates makes no representation and shall have no liability in any way arising to them or any other entity for any loss or damage, direct or indirect, arising from the use of this information.
- This document and its contents are proprietary information of Alchemy Capital Management Pvt. Ltd and may not be reproduced or otherwise disseminated in whole or in part without the written consent.
- The information and opinions contained in this document may contain “forward-looking statements”, which can be identified by the use of forward-looking terminology such as “may”, “will”, “seek”, “should”, “expect”, “anticipate”, “project”, “estimate”, “intend”, “continue” or “believe” or the negatives thereof or other variations thereon or comparable terminology. Due to various risks and uncertainties, including those set forth under the Disclosure Document/Offer Documents, actual events or results or the actual performance may differ materially from those reflected or contemplated in such forward-looking statements.

Regulatory Disclosures:

- All clients have an option to invest in the above products / investment approach directly, without intermediation of persons engaged in distribution services.
- This document, its contents, especially the Performance related information, is not verified by SEBI or any regulator.