March 13, 2024

Dear Investor,

As you would have noticed the equity markets are in the midst of a sharp correction, led by small caps and mid-caps. The reasons are multiple:

1. Small cap and mid cap valuations had entered a frothy zone. There was a lot of speculative activity backed by leveraged positions, manipulation and pure short-term greed driving flavor-of-the-month stocks and sectors like PSUs, SME, power, capital goods etc. This bubble has been decisively pricked.
2. SEBI and RBI have very proactively warned various market participants to ensure that there is no build-up of bubbles in capital markets. This has led to stress testing by various asset management companies to reduce portfolio risks by getting rid of illiquid stocks.
3. The income tax department has been sending notices to assessees to ensure that they pay appropriate advance tax before the due date of March 15. This requirement of advance tax payments has led to investors being forced to liquidate their holdings.
4. Loan against shares has become a very big product for NBFCs and brokers chasing yields. In a sharp correction, lenders increase margin requirements to protect their loans that puts further pressure on underlying stock portfolio.
5. Incessant increase in FNO trading activity against margin of stock portfolio has increased downside risks for stocks that have illiquid FNO volumes.

Our perspective:

We see this sharp correction as a typical bull market correction that is vicious and weeds out weak hands and weak stocks. Corrections like these adversely affect portfolio NAVs in the short term but are very useful for a long-term investor. The flows to the Indian capital markets from domestic investors continue to be strong. While foreign investors have been sellers for past couple of months the amount of selling is not very large. We believe that this correction will provide an opportunity for long investors to increase their allocation to high quality stocks at a fair valuation which is the only formula for making robust long term returns from equity investing.

Our strategy:

We believe that our multi-cap strategy is best suited to capture India's economic growth while reducing volatility in the portfolio. With our deep fundamental research, we are very confident of the earnings growth of our portfolio companies. Market forces lead to periodical bouts of under and over valuation of all stocks. Our experience is that it is best to ignore short term gyrations and focus on long term earnings growth of the portfolio. At the same time, we do keep a sharp eye on market moves to benefit tactically from a selloff in high quality stocks that we have on our radar.

Piper Serica Research Team