The Alternate Opinion

Quantitative & Alternates

Markets shifting PIVOT after 4 years. Time to move back into Consumption. Breath can contract rapidly

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Consumption coming back after 4-years. Positioning lightest in long time. Also, protection against any crash

- **Market shifting PIVOT after 4-years, back into Quality from Value**: *After a strong outperformance of Value investors since 2021, we are seeing markets slowly shifting back into Growth/Quality style*. The quantum may not be as sharp as 2017-2020 period (which was triggered post note-ban), but the direction seems to be changing. We first highlighted on strong Value cycle coming back globally in our report titled "A Decadal Shift in Trade from Growth to Value", dated 7th Apr, 2021.
- **All relative underperformance of Value stocks from 2017-2020 period reversed over the past 4 years**: Our flagship indicator is suggesting that all relative outperformance of a Growth oriented investor over Value style investor has got purged. There was an acceleration in outperformance of Growth investor from 2017 to 2020 (on back of collapsing global yields creating a leg of valuation expansion in this pocket). The past 4-years underperformance has pulled our ratio back to 2017/2018 lows. *This suggests that the worst underperformance for a Growth investor over Value may be over and we could see markets slowly moving back into Growth oriented stocks. Historically, Growth has been a style associated with Consumption/Quality outperformance (both FMCG & Discretionary). Value style has been associated with Industrial cycle (Cap Goods, Infra, PSU etc)*. In this report, we have broadly used this classification to bifurcate historical cycles.
- **Growth led outperformance has been in weaker markets**: *The drift from Value to Growth has historically been associated with weaker market specially a sharp contraction in breadth. Markets start moving back into Quality*. Similar inflection was seen in 2006, 2011, 2012 & 2018 period. Sometimes the correction has been instant & other times after a lag of few months. However, alpha starts shifting into Growth oriented sectors. Absolute market trends in this period have either remained range bound or downwards but with a big correction in breadth.
- **Consensus moved into the Value trade in Mid-2023:** Many of our Ownership and Thematic models suggests that consensus has finally been pulled into the Value trade after avoiding it for almost 2-years (CY2021 & CY2022). In 2023, index weight of many Value stocks became very large to be ignored. PSU weight in NSE500 Index expanded from 8% to 12% (between Aug'23 to May'24 period) which created a vicious chasing cycle. *Finally, the weight of PSU has started dropping hence the pressure on FMs to own PSU has waned*.
- **As soon as the Consensus was drawn into Value trade, market changing style:** Typical market trends have always peaked-out/bottomed-out after consensus has got drawn into a trade. *In the current scenario, the consensus has moved into the Value trade in CY23 after strongly resisting for 2-years. Shifting gears now will get very challenging even though market trends start making that shift slowly*. This has always been a dilemma. This is also a typical formation at cycle tops/bottoms.
- **Global liquidity matrix turning unfavourable after a long time**: Value rally has always been associated with strong liquidity in the markets. Once the marginal liquidity halts, we see markets slowly shifting back into long term quality stocks. *Yen carry trade was one critical factor for expansion in breadth of Indian markets between Jan'23 to Jun'24. However, that trade has started fading with the risk of bigger redemption with rate hikes in Japan*. Revival in China's economy is another threat. One round of liquidity shift has taken place but any structural economic recovery in China can continue to drive incremental flows there. GEM allocation has started shifting from India to China.

Key Metrics to watch

- **Low PE Index (for NSE500 stocks) finally starts underperforming the main index**: *This is first time post COVID that our NSE500 Low PE Index has started underperforming the main index*. In the recent history, breakdowns were seen in Jun'11, Feb'15 & May'17 period. This was followed by a sharp underperformance in Value stocks.

- **Time to move back into Polarization trade**: This leg of depolarization (which started in 2021) is one of the strongest since 2003-2007 period. *Many participants have moved their allocation from few large cap names into many smaller cap names to play the tail. We are seeing early signs of reversal in that trend*. We could see outperformance of larger names coming back across all indices (Large/Mid/Small). **One should start aggressively reducing the tail from the portfolio**.

- **Crowded move into Thematic/Sectoral funds created abnormal demand in select pockets in markets**: A general rule of thumb is that caution is advised when abnormal flows start moving from broader mandated funds (Large/Mid/Small) funds into Sectoral/Thematic funds (Manufacturing/Defence/Infra/PSU etc in the current context). *Although the buying by Thematic/Sector funds is in select stocks, we see relative valuations coming at play and shifting the valuation orbit higher for all stocks in that sector/theme*.

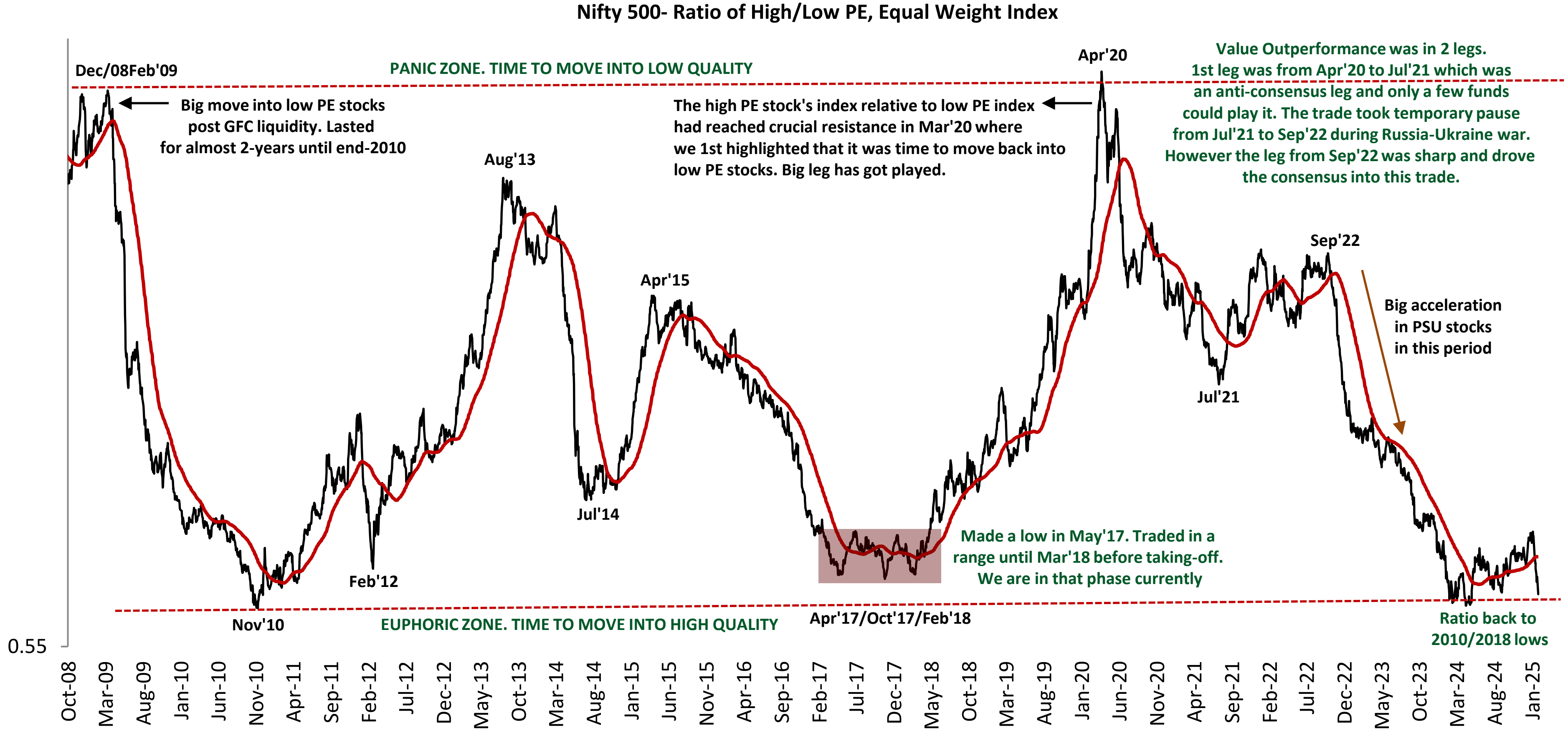
- **What would cause the reversal?** : Fund flow into Sectoral/Thematic fund has been the most crucial factor in creating the anomaly in one section of the market. *Since Aug'23, almost 40% of active fund flow have moved into Sectoral and Thematic funds (Inflow of INR 1,40,000 crores)*. 21% of these flows have gone into Manufacturing funds (INR 28,250 crores), 18% into Energy & Power funds (INR 24,200 crores), 11% into Innovation funds (INR 15,000 crores), 9% into Infrastructure funds (INR 12,150 crores) and 6% into PSU funds (INR 7,800 crores). Add to these the Defence, Manufacturing, Infra, PSU ETFs. *However, for the first time since Sep'24, we are seeing flows slowing down significantly in these funds and some part of it moving into Consumer Funds*. We had first highlighted this trend in our Sep'24 edition of Domestic Liquidity Tracker (DLT) titled "Consumption Flows accelerate to 4-year high. Sharp slowdown in Manufacturing & Infra fund. Largest outflow from PSU funds since 2021"

- **Consumption stocks earnings remain weak but stocks already pricing:** Consensus is already negative on Consumption stocks and rightly so as earnings are failing to recover. *However, we feel that markets are already pricing the worst in most names as stocks are not making new lows since many months despite incremental negative news flow*. This is the first sign that supply in this pocket is over and any small positive surprise can bring sharper price reactions on the upside.

- **Industrial Stocks- Earnings Slowdown v/s Valuation Contraction:** Empirical evidence suggests that the first sign of slowdown is generally visible in valuations. *We could have a scenario where numbers for most Industrial names remain inline but stock prices don't rally indicating beginning of a valuation correction phase*. Valuation is a function of incremental liquidity, which is already waning for this segment of stocks (as seen by sharp slowdown in Thematic & Sectoral flows). One metric to watch would be the price reaction post quarterly numbers.

FACTOR MODELS SHIFTING BACK INTO QUALITY AFTER 4-YEARS

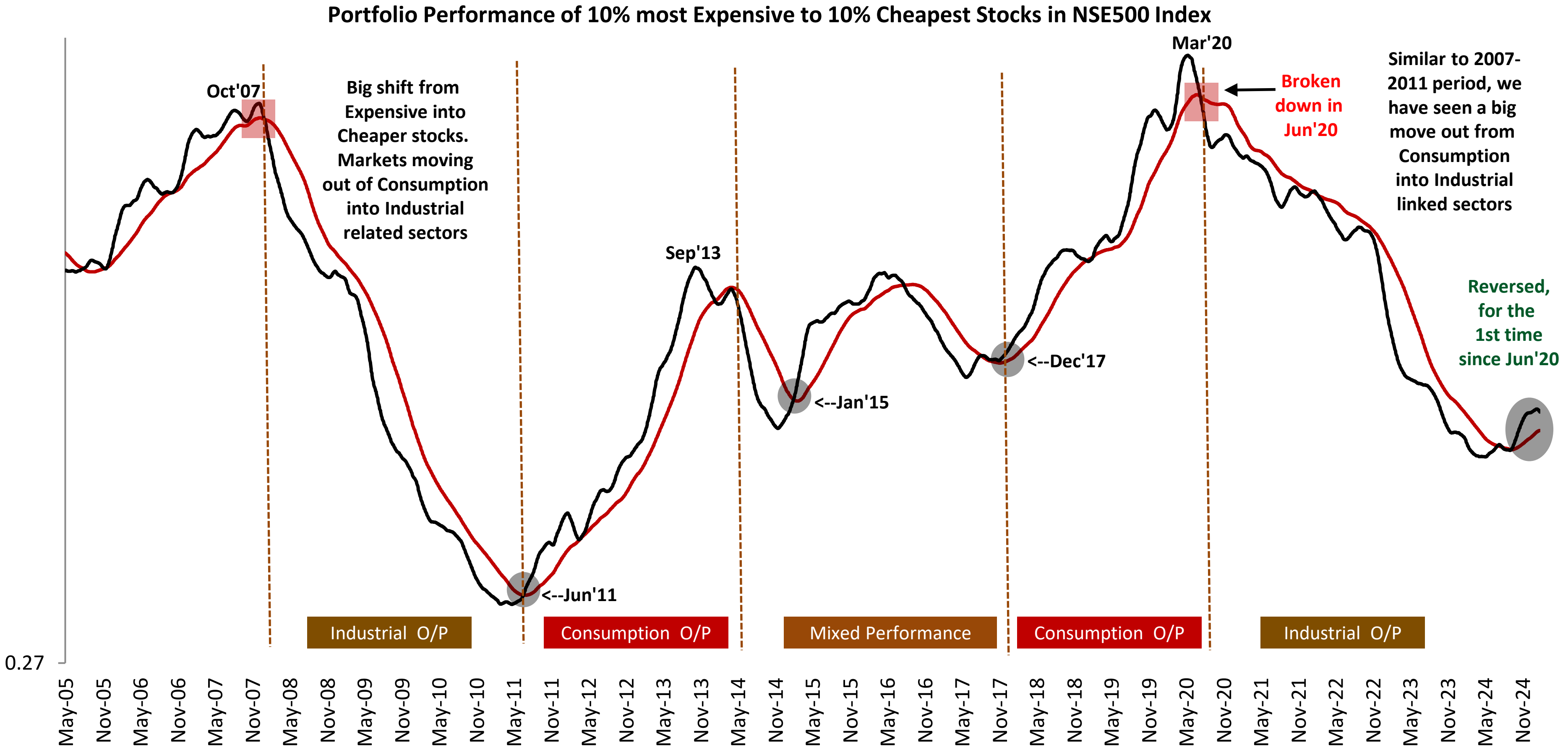
Growth underperformance (vs Value) hits 15-year low- All excess of 2017-2020 purged. Markets shifting PIVOT



Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

We have tried to identify the relative momentum of markets by understanding where incremental alpha is moving. By the end of CY20, we were among the earliest house to identify the big euphoria created in High PE (Quality Consumption oriented) stocks and suggested an aggressive shift back into Low PE portfolio (PSU, Cap Goods, Metals, Infra, Utilities etc). Our report titled "A Decadal Shift in Trade from Growth to Value" recommended this shift. *After 4-years of move into that trade, our models suggests that a big part of relative underperformance is already in the price since many portfolios have realigned their positioning to play this trade. At the current juncture, one should start to move positions back into Quality portfolio*. In past, this trade has sharply accelerated after markets have turned weak (in 2010/2012/2018 period). In this report, we showcase some long term trends in Indian markets and try to create a broader portfolio construction framework which could offer absolute upside as well as protection against shocks in the market.

Markets drifting style after most players got sucked into the trade– Quality stocks start outperforming



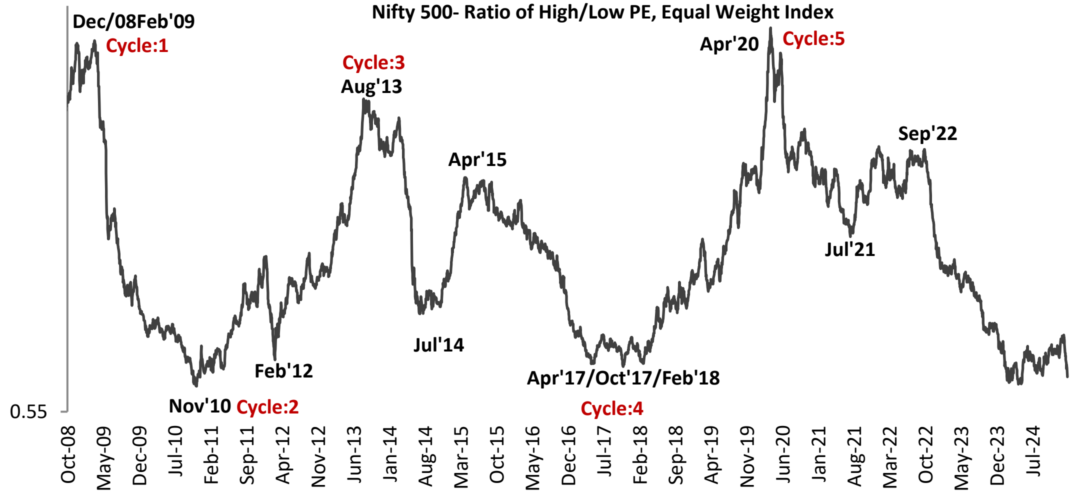
Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

For the 1st time since Mar'20, a portfolio of 10% most expensive names has started outperforming portfolio of 10% cheapest names in NSE500 Index. Such shift was last seen in Jun'11, Jan'15 and Dec'17 period. These periods were followed by a weaker market breadth and stronger outperformance in Consumer/Quality names. The shift of PIVOT is at a very early stage hence risk-reward is favourable. Interestingly, such trends in past have begun when fundamental visibility is lowest. We feel fundamental clarity will come at a later stage (which we call the Consensus zone). Such drifts also means that a big part of outperformance in Quality stocks comes due to weakness in the broader markets as liquidity starts moving into fewer quality stocks.

What has worked in previous cycles?- Consumption has outperformed. PSU & Cap Goods U/P

Assuming the cycle reverses again in favour of quality (like in 2010 and 2017), we have tried to asses which sectors could be in favour. The below table maps returns and outperformance (v/s Nifty) in key sectors in each cycle.

Consumption has always outperformed with such reversal (Cycle:2 and Cycle:4 (when relative returns started shifting back into Quality). Within Consumption, FMCG has outperformed in both the period. *Cycle:2 was marked with strong outperformance in FMCG while Cycle:4 saw stronger outperformance in Discretionary space*. In current cycle (5), Discretionary returns are already positive led by massive outperformance in Auto. We could see other Discretionary spaces catching up. IT has also outperformed in Cycle 2 and 4.



Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

On the other hand- Mid/Small cap, Capital Goods, PSU and Oil & Gas indices have underperformed in the period of recovery in the ratio. The extent of move on either side has been on basis of many other factors.

Importantly, the absolute return in this cycle has been negative. With this in background, we could see Consumption/Quality coming back in relative performance for sometime.

	Returns					Out/Underperformance v/s Nifty				
Broader Indices	***Cycle:1***	***Cycle:2***	***Cycle:3***	***Cycle:4***	***Cycle:5***	***Cycle:1***	***Cycle:2***	***Cycle:3***	***Cycle:4***	***Cycle:5***
Nifty	*134%*	*-13%*	*70%*	*-16%*	*219%*					
Midcap	*200%*	*-33%*	*174%*	*-38%*	*428%*	*66%*	*-20%*	*104%*	*-22%*	*209%*
Smallcap	*213%*	*-43%*	*185%*	*-55%*	*475%*	*79%*	*-31%*	*116%*	*-39%*	*256%*
Bank	*215%*	*-30%*	*150%*	*-24%*	*201%*	*81%*	*-18%*	*80%*	*-8%*	*-18%*
Private Bank	*263%*	*-14%*	*179%*	*-27%*	*184%*	*129%*	*-1%*	*109%*	*-11%*	*-35%*
PSU Bank	*220%*	*-62%*	*88%*	*-65%*	*469%*	*86%*	*-49%*	*19%*	*-49%*	*250%*
IT	*183%*	*22%*	*20%*	*18%*	*244%*	*49%*	*35%*	*-49%*	*34%*	*25%*
Pharma	*121%*	*39%*	*42%*	*-33%*	*226%*	*-13%*	*52%*	*-27%*	*-17%*	*7%*
Consumption	*104%*	*18%*	*78%*	*-10%*	*216%*	*-30%*	*31%*	*8%*	*6%*	*-3%*
Auto	*342%*	*2%*	*133%*	*-54%*	*466%*	*209%*	*15%*	*63%*	*-38%*	*248%*
Discretionary	*323%*	*-22%*	*181%*	*12%*	*244%*	*189%*	*-10%*	*112%*	*28%*	*25%*
FMCG	*101%*	*70%*	*45%*	*1%*	*158%*	*-33%*	*82%*	*-25%*	*17%*	*-60%*
Capital Goods	*170%*	*-57%*	*150%*	*-44%*	*661%*	*36%*	*-44%*	*80%*	*-28%*	*443%*
PSU	*131%*	*-52%*	*81%*	*-55%*	*457%*	*-3%*	*-39%*	*11%*	*-39%*	*238%*
Metals	*285%*	*-59%*	*48%*	*-47%*	*530%*	*151%*	*-46%*	*-22%*	*-31%*	*312%*
Oil	*101%*	*-27%*	*74%*	*-37%*	*262%*	*-33%*	*-14%*	*5%*	*-21%*	*43%*

Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

Low PE momentum breaking for the 1st time- Relative outperformance also broke uptrend goingon since 2020

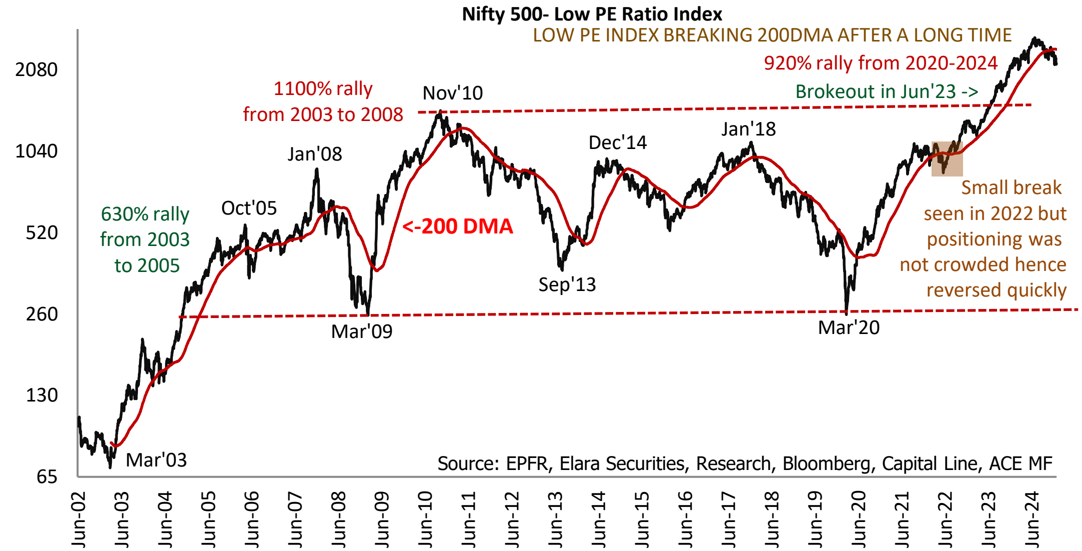
We measure performance of cheapest 10% stocks (based on TTM PE in NSE500). The Low PE in this case is relative to the universe of stocks and not on the basis of its own historical PE. E.g. A stock may be trading at historic high valuation based on its own history but still remains Low PE when compared to the universe. *The curve measure the returns generated by extreme low PE strategy since 2002. The current Low PE rally in markets (from 2020) is the strongest one since 2003-2008 period*. The Low PE index had breached 200DMA once in end-2005. This correction was used by participants, who missed the trade, to enter resulting in a parabolic up move in 2007.

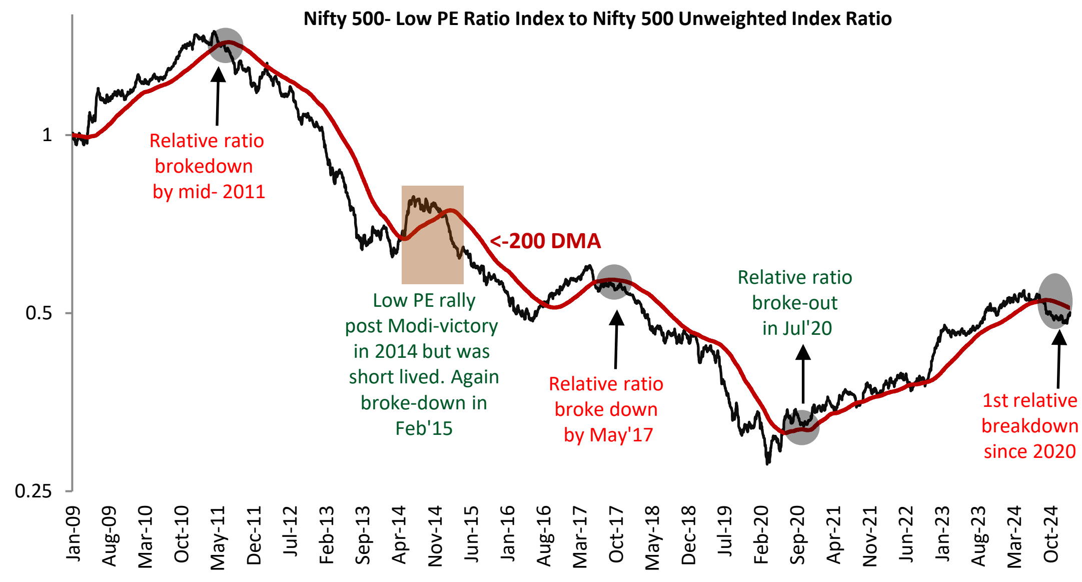
In the current cycle, such correction was seen once in 2022 during Russia-Ukraine war. *Once markets stabilised by 2023, we saw next round of buying in these names creating a sharp parabolic rise. The last of participants got drawn into the Value trade mid-2023 onwards.* Finally, that cycle seems to be getting challenged.

The break in the absolute index in Mar'08, Feb'11, Mar'15 & Mar'18 triggered a sharp unwind of this trade resulting in a multi-year correction in prices. Currently, the absolute momentum has started getting challenged while the relative momentum has already started trading below the big support for the 1st time since 2020. *This is a strong indication that demand for Value stocks has started fading*.

We would recommend to use any rally in Value stocks to be used to shift those positions gradually into Growth/Quality stocks.

After the sharp move into Value in 2nd half of 2023, we can see a lot of resistance by participants to shift out of the strategy. This reminds us of 2018-2020 period. Growth trade started accelerating in 2018 & crowd finally got pulled into the trade in 2019. When markets started reversing the strategy, we could find a lot of resistance. *It is tough to shift from one extreme to other especially when participants have just got drawn into a style after long period of resistance*.





Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

Valuations of Value/Industrial stocks reach 2008 highs –Relative valuation weakness visible after a long time

Median Price to Book Value (TTM) of a portfolio of Value/Industrial oriented stocks has reached 2008 highs. *Sharp expansion was seen from Jul'23 onwards which pulled a big crowd into this trade. There are initial signs of reversal in this euphoria*.

The relative PB of Value portfolio over Nifty has expanded to record high in this cycle. *Other phases of sharp expansion were seen in Aug'01-May'05, Mar'07-Feb'08, Mar'09-Apr'10 and Jan'14 to Jan'18 period. These are the periods when we saw Value (Industrial) oriented stocks doing much better than Nifty*. Currently relative valuation has also started reversing.

The sharp leg of valuation expansion in these stocks was seen post Jul'23. This was the period where we saw big liquidity emerging into Thematic/Sectoral funds continuing until Aug'24.

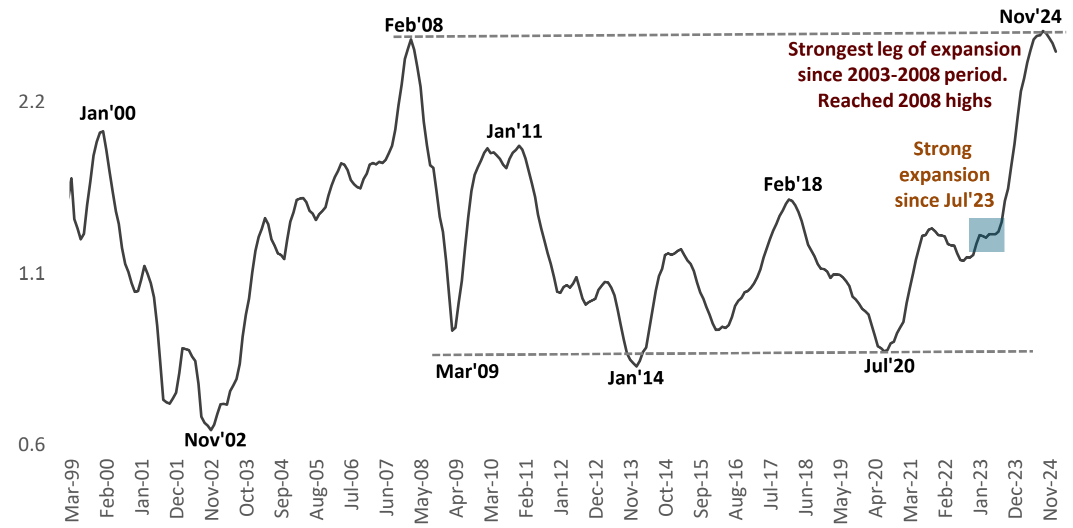
Sharpest P/B expansion since Jul'2023

Stock	Abs chg	% chg
ITI Ltd	13.04	290%
NBCC India Ltd	6.89	163%
Cochin Shipyard	5.56	281%
Bharat Dynamics	5.39	77%
Bharat Electron	5.10	74%
India Tourism	3.48	40%
Hindustan Copper	3.15	48%
HAL	2.89	52%
ABB India Ltd	2.28	12%
MMTC Ltd	2.16	53%
Thermax Ltd	2.09	26%
BEML Ltd	2.00	58%
HUDCO	1.77	221%
BHEL	1.50	112%
IRCON	1.37	79%
Indian Overseas	1.34	69%
L&T	1.32	32%
Siemens Ltd	1.26	10%

Most expensive P/B stocks currently

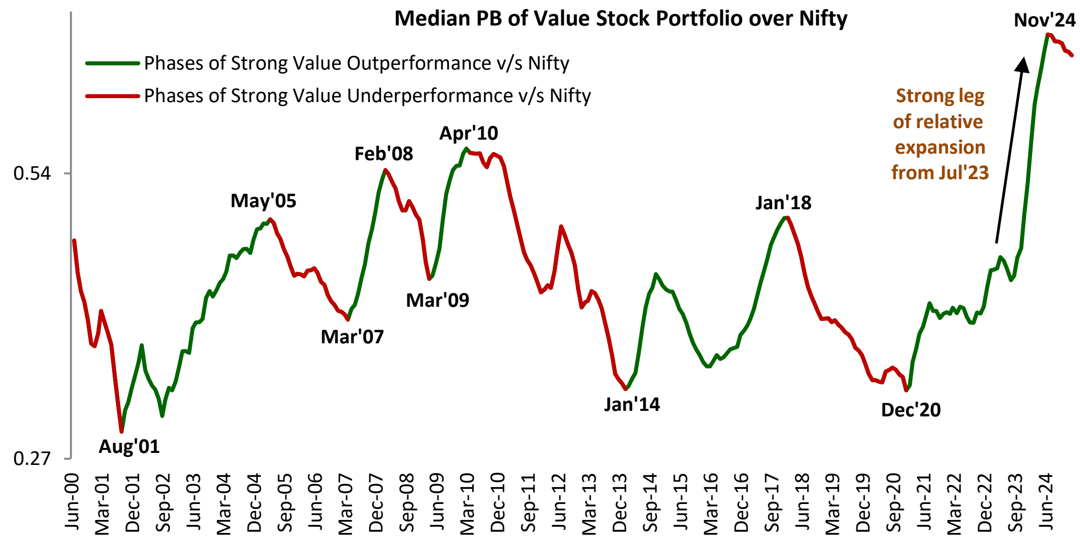
Stock	PB Jul'24	PB Jan'25
ABB India Ltd	19.5	21.8
ITI Ltd	4.5	17.5
Siemens Ltd	12.2	13.5
Bharat Dynamics	7.0	12.4
India Tourism	8.8	12.2
Bharat Electron	6.9	12.0
NBCC India Ltd	4.2	11.1
Thermax Ltd	8.0	10.1
Hindustan Copper	6.5	9.7
Hindustan Aerona	5.6	8.5
Cochin Shipyard	2.0	7.5
MMTC Ltd	4.0	6.2
L&T	4.2	5.5
BEML Ltd	3.5	5.5
Rites Ltd	4.2	4.6
Jsw Energy Ltd	2.5	3.7
Tata Power Co	2.6	3.5
Kalpataru Projec	2.2	3.3

Median Price to Book Value of Value Stock Portfolio



Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

Median PB of Value Stock Portfolio over Nifty



Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

Source: Elara Securities Research

WHY CONSUMPTION? MANY INDICATORS AT LONG TERM SUPPORT

Weight of Consumption stocks in NSE500 Index- Dropped to Jan’18 levels

Weight of Consumer names in NSE500 Index saw exponential increase in 2019-2020 period; from 10% to 15% between May’19 to Mar’20. *The spike created big chasing by fund managers resulting in over allocation into the sector to generate alpha*. The weights have been constantly drifting since then on back of underperformance which in turn is putting further pressure on weights. *Currently, the weight has dropped to Jan’18 low from where the previous big move had started*.

We saw one small phase of recovery in weights in 2022. That was during the peak of Russia-Ukraine war where participants tried to move into defensive positioning. However, the resumption of beta rally in 2023 (partially triggered by Yen carry trade which we mentioned in our Global Liquidity Tracker report dated 8th Aug, 2024) again resulted in a big leg of underperformance of this segment, which is when most fund managers turned underweight consumption and shifted allocation to sectors like PSUs, Capital Goods, Defence etc.

Once again we have started seeing gradual interest building up in this space. A few more months of outperformance has potential to trigger a round of chasing in Consumption names as weights will start expanding rapidly.

The 1-year change in Consumption weights turned negative in Feb’21, first time since 2015. We are seeing some improvement lately. *If the momentum turns positive, we feel outperformance can accelerate as FMs start re-aligning their underweight positioning*.

Domestic Mutual Funds are significantly underweight in FMCG, although that positioning is gradually improving since the past 3-months. Current underweight is at 170bps, which is largest underweight positioning since Feb’24 (190bps). Largest underweight is in HUVR, Nestle, Colgate, Britannia.

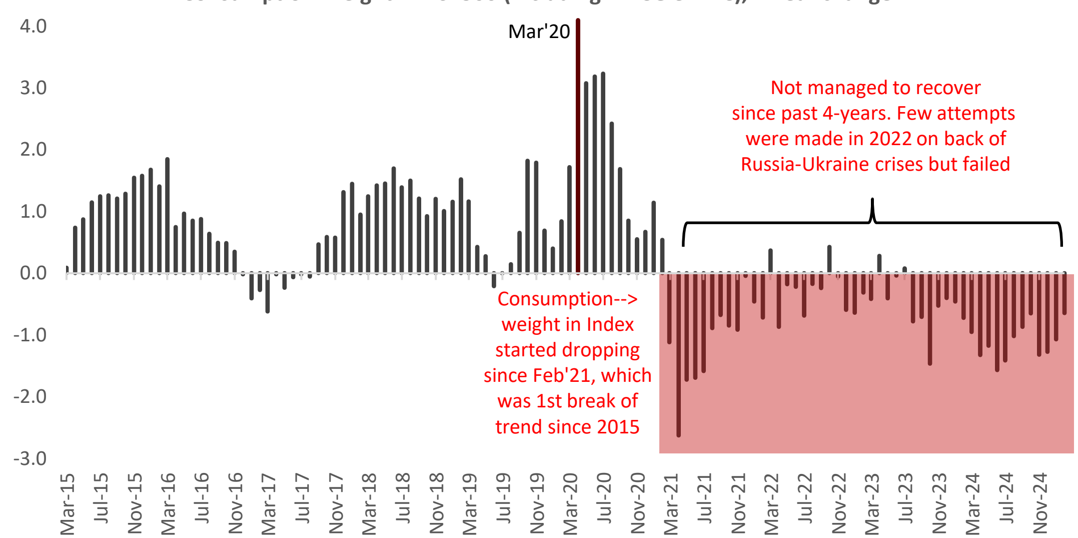
% Underweight positioning in FMCG among Active Domestic Funds

Feb-24	Mar-24	Apr-24	May-24	Jun-24	Jul-24	Aug-24	Sep-24	Oct-24	Nov-24	Dec-24
-1.9%	-1.6%	-1.6%	-1.3%	-1.6%	-1.4%	-1.5%	-1.7%	-1.7%	-1.6%	-1.7%

Consumption Weight in NSE500 (Including FMCG ex-ITC)

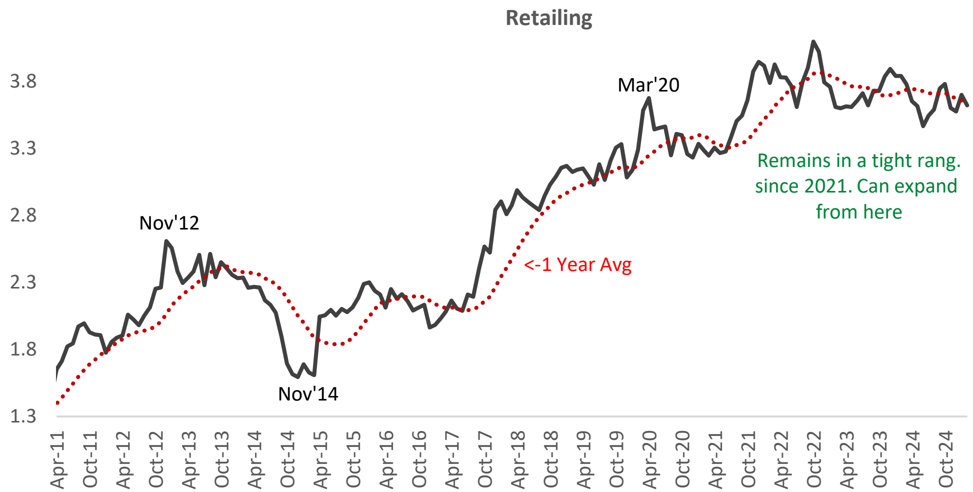
Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

Consumption Weight in NSE500 (Including FMCG ex-ITC), 1 Year change

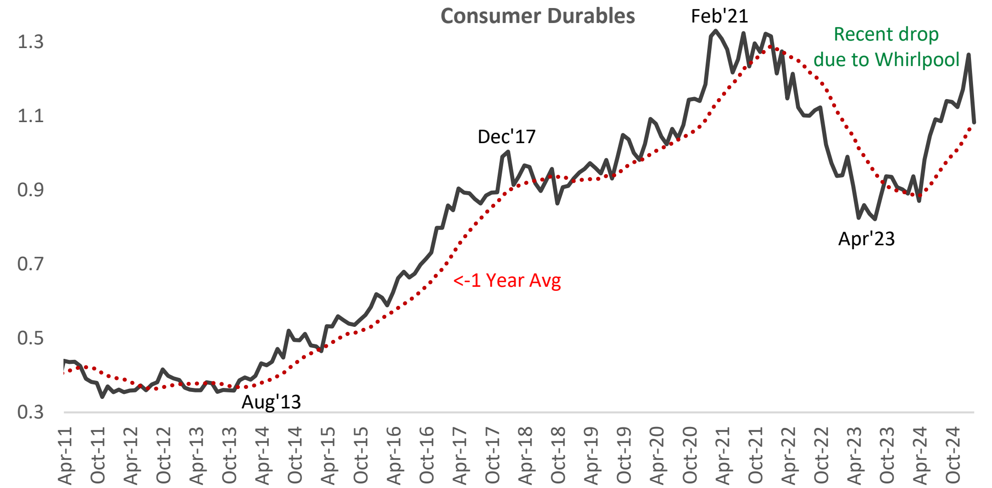


Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

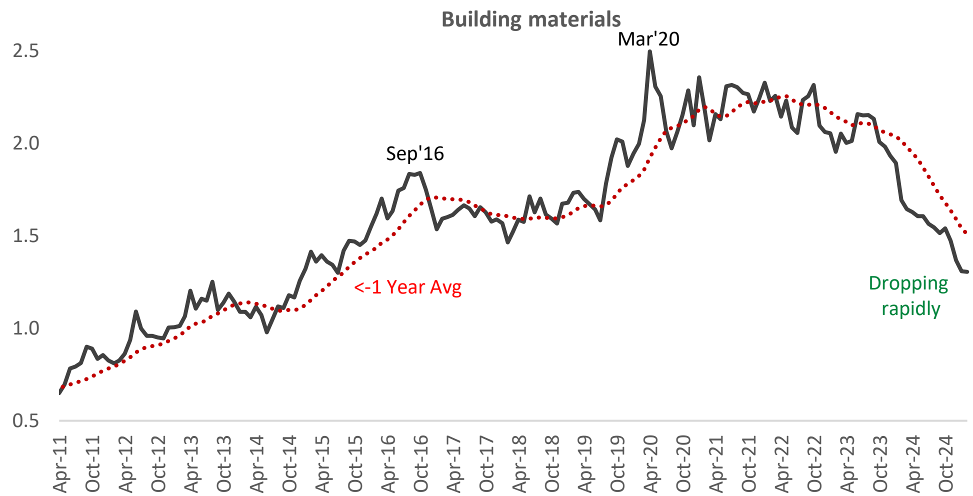
Break-up of Consumer Discretionary Weight- No recovery in Building Materials. Others improving



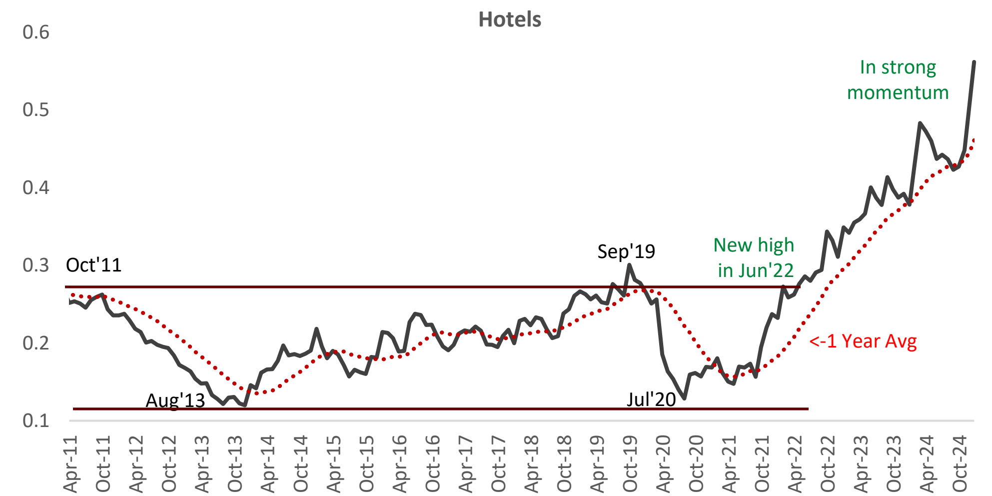
Weight of Retailing stocks peaked in 2021-22. Since then it has been in a tight range. Overall trend remains strong.



Consumer Durables weight sharply collapsed from 2021 to 2023. However, from Apr’23, it is recovering. The recent drop is on back of Whirlpool.



Building materials is failing to show any improvement with weights continuing to collapse. Recovery can boost the overall sector but no signs until now.



Hotels is showing the strongest recovery with weights continuing to surge to new highs since 2022. The absolute weight in index still remains very small.

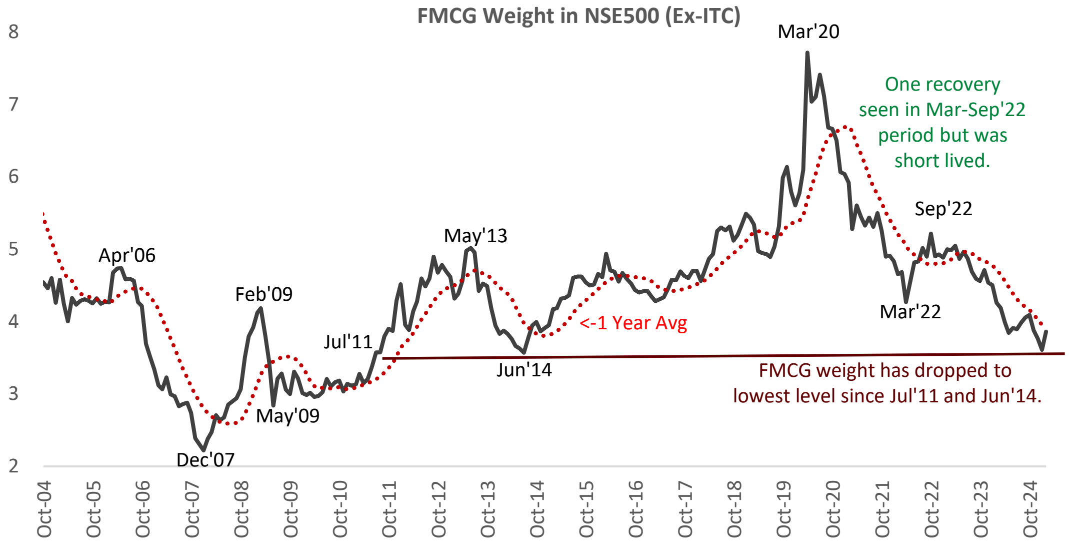
Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

Weight of FMCG stocks in NSE500 Index- Lowest index representation since 2011

FMCG weight has also been rapidly dropping since Mar'20. At 3% weight (ex-ITC), it is now at the lowest level since Jul'11 and Jun'14 period. *Due to the continuously falling weight, most money managers also remain heavily underweight on the sector (which has also been helping them). Any recovery here should be closely watched to play the next big round of outperformance*.

ITC's weight had peaked at around 7.5% in Jul'13 from where it collapsed to 1.5% by Feb'22. Finally, we are seeing some recovery there too.

ITC also remains a broad based underowned name. Almost 80% of active schemes are running an underweight positioning there compared to their respective benchmarks. *The current underweight of 56bps corresponds to INR 11,600 crores/$1.33bn worth of positioning*.



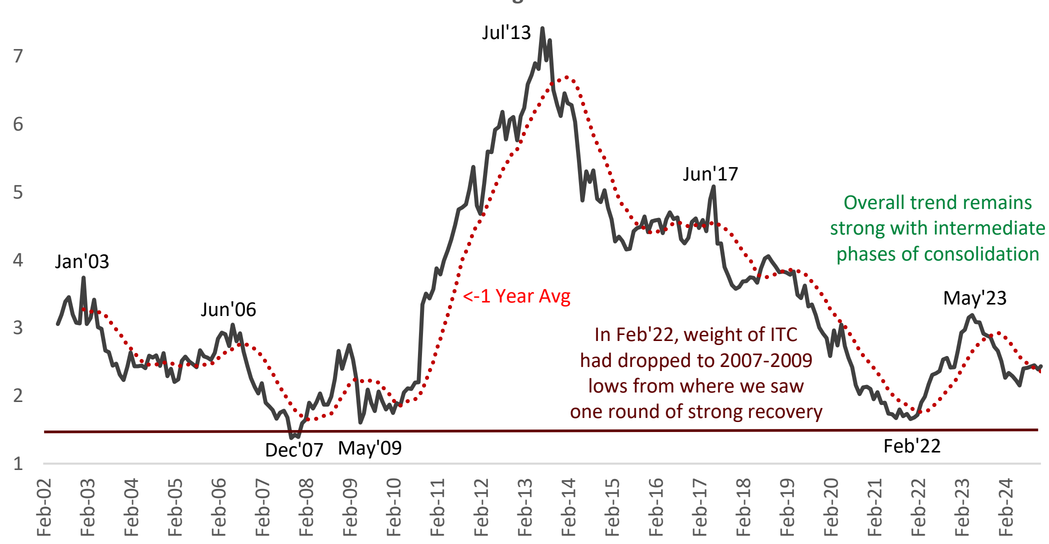
Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

% Underweight positioning in ITC among Active Domestic Funds

Feb'24	Mar'24	Apr'24	May'24	Jun'24	Jul'24	Aug'24	Sep'24	Oct'24	Nov'24	Dec'24
-0.89%	-0.63%	-0.62%	-0.54%	-0.63%	-0.62%	-0.61%	-0.56%	-0.61%	-0.58%	-0.56%

% of active schemes running under weight positioning

Feb'24	Mar'24	Apr'24	May'24	Jun'24	Jul'24	Aug'24	Sep'24	Oct'24	Nov'24	Dec'24
83%	77%	79%	79%	81%	80%	79%	78%	78%	79%	79%



Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

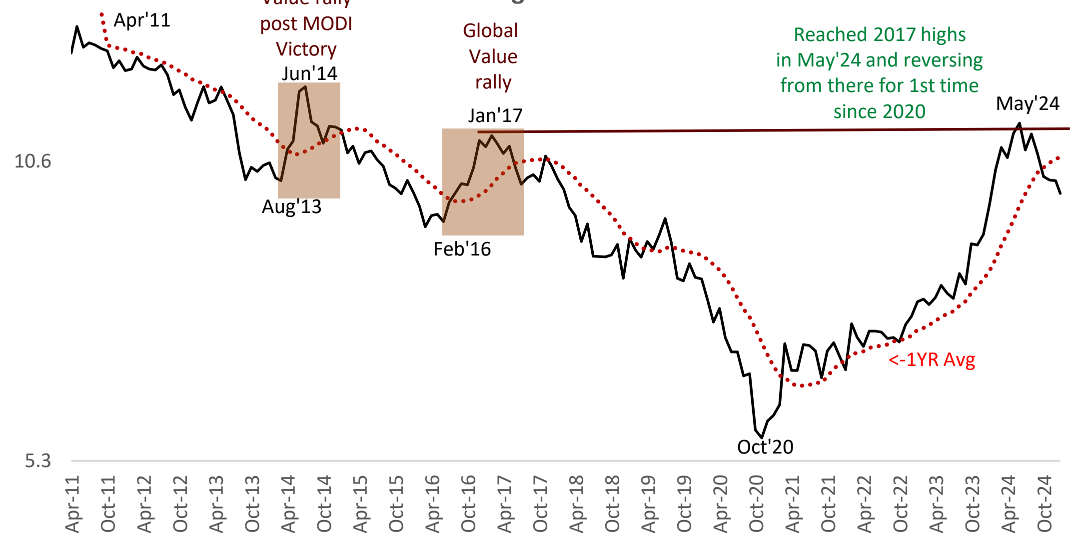
PSU Weight in NSE500 Index- Falling for 1st time since 2020. PSU Bank weight moving back into SBI

Weight of PSU stocks in NSE Index bottomed at around 5.6% in Oct’20 from where we saw a gradual recovery as Value trade revived globally. *However, it was in 2023 where we saw a vertical rise in PSU weight to a high of 11.6% which forced many funds to realign their allocation after taking the initial hit on performance*.

Consensus chasing leg has already played-out here from where the PSU weight has started falling. It has now broken below the 1-year average for the first time since 2019. This could be an indication that the best outperformance for this pocket is over for now. *With weights also falling, their will be no urgency among fund managers for buying PSUs*.

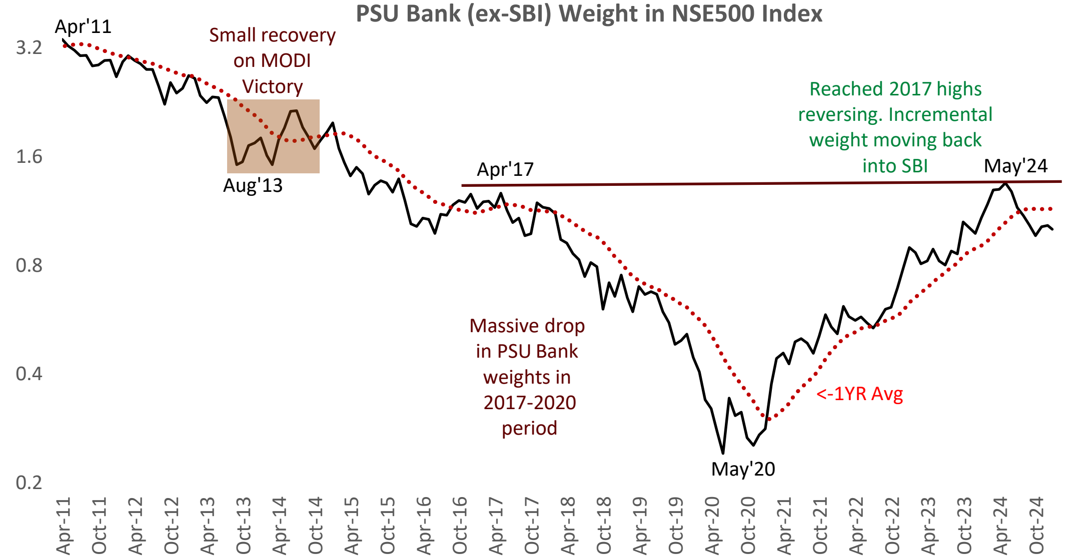
Similar trend is visible in PSU Banks too. Interestingly, within the PSU Banks, weight has started shifting back into SBI after 4-years. PSU Banking weight ex-SBI increased sharply from a meagre 0.2% in May’20 to 1.3% by May’24. *We are seeing a reversal here too with weight of other PSU Banking stocks shifting back into SBI*.

PSU Weight in NSE500 Index



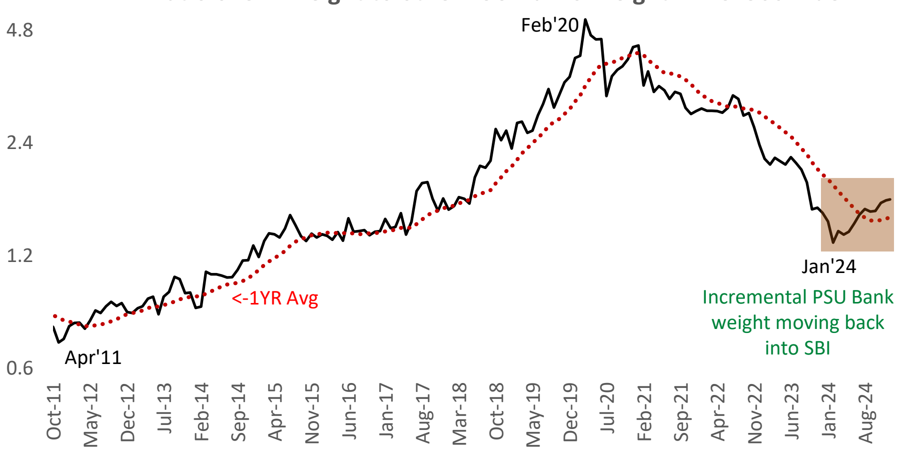
Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

PSU Bank (ex-SBI) Weight in NSE500 Index



Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

Ratio of SBI Weight to other PSU Banks Weight in NSE500 Index



WHAT ARE THE MARKETS PRICING CURRENTLY?

Relative performance of NSE Consumption Index- At a very crucial inflection zone

Relative performance of Consumption Index with Nifty had topped out in 2018, retested in 2020 and now reached back to 7-year high zone. However, in each recovery, the sectors which outperformed (within Consumption) were different (Table). In 2019-20, it was Discretionary names and later FMCG & Telecom which outperformed. Since 2022, it is Auto, Telecom, Hotels and Airlines largely. *We would closely watch for signs of a break-out in this ratio, which can then indicate a broad based recovery in outperformance. Such break will mostly happen if overall market turns weak*.

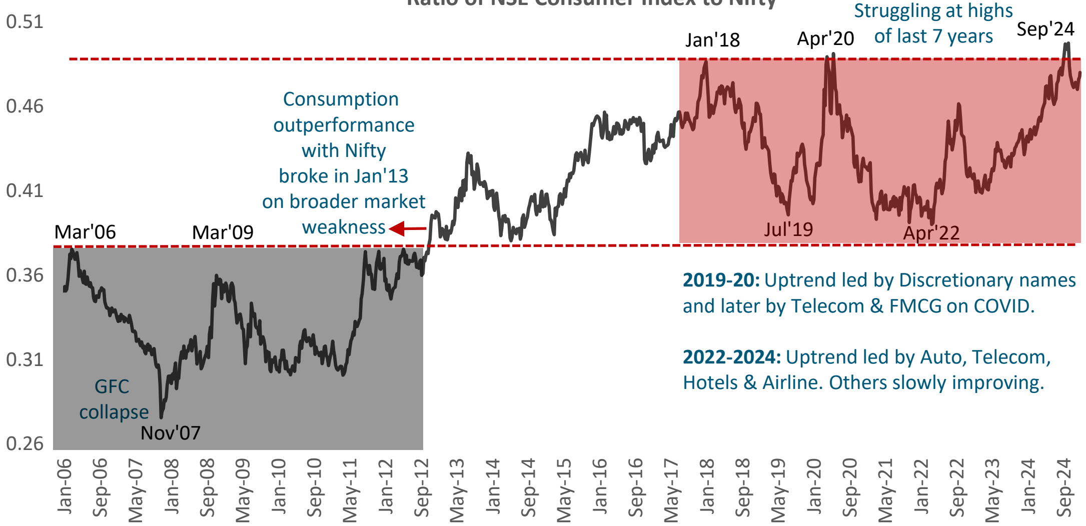
Importantly, the biggest excess over the last few years has been created in the Midcap space. Consumption relative to Midcap Index has dropped to the lowest point since Jan'08 and Sep'10. *In both the cases, Consumption outperformance came back sharply in a falling market*. Another strong outperformance was in 2017-20 period, again when overall market breadth was very weak and crowd was moving in this pocket.

The ratio has reached a big support of almost 2 decades indicating one should aggressively shift Midcap exposure into Consumption names. Market returns have always been weak from such zone.

Performance of Consumption Stocks in different cycles

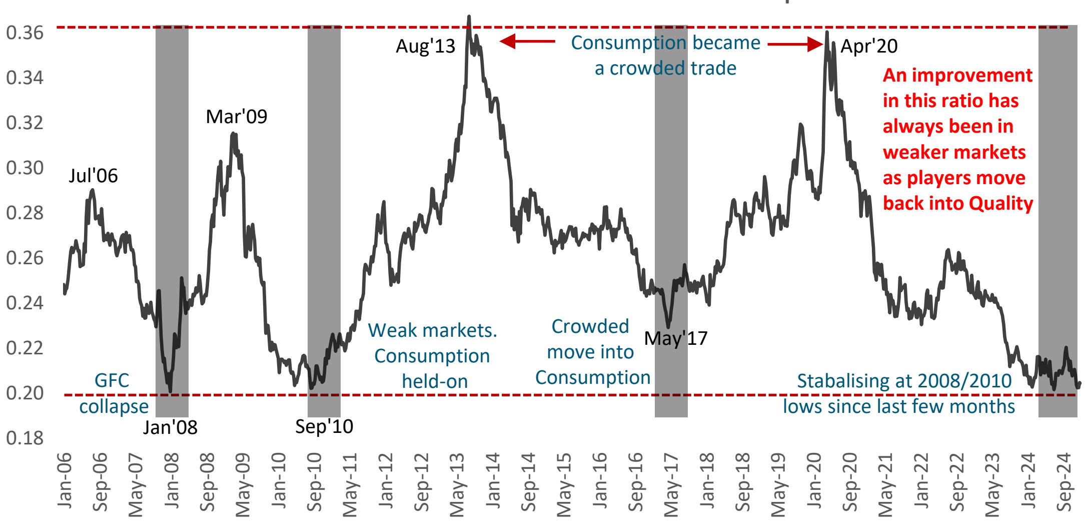
2019-2020	% Chg	2022-2024	% Chg	2022-2024	% Chg
DMART	67%	TRENT	463%	ITC	109%
NESTLE	54%	VARUN BEVG	413%	HERO MOTO	101%
BHARTI	48%	TVS MOTOR	280%	EICHER	100%
ASIAN PAINTS LTD	31%	M&M	274%	INFO EDGE	91%
COLGATE	30%	INDIAN HOTELS	267%	COLGATE	85%
TATA CONSUMER	29%	ZOMATO	230%	UNITED SPIRITS	82%
HUVR	24%	BAJAJ AUTO	154%	BRITANNIA	55%
BRITANNIA	18%	INDIGO	128%	GODJ CONS	47%
INFO EDGE	14%	DLF LTD	118%	HAVELLS	45%
TRENT	12%	BHARTI	112%	MARUTI	45%

Ratio of NSE Consumer Index to Nifty



Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

Ratio of NSE Consumer Index to Midcap



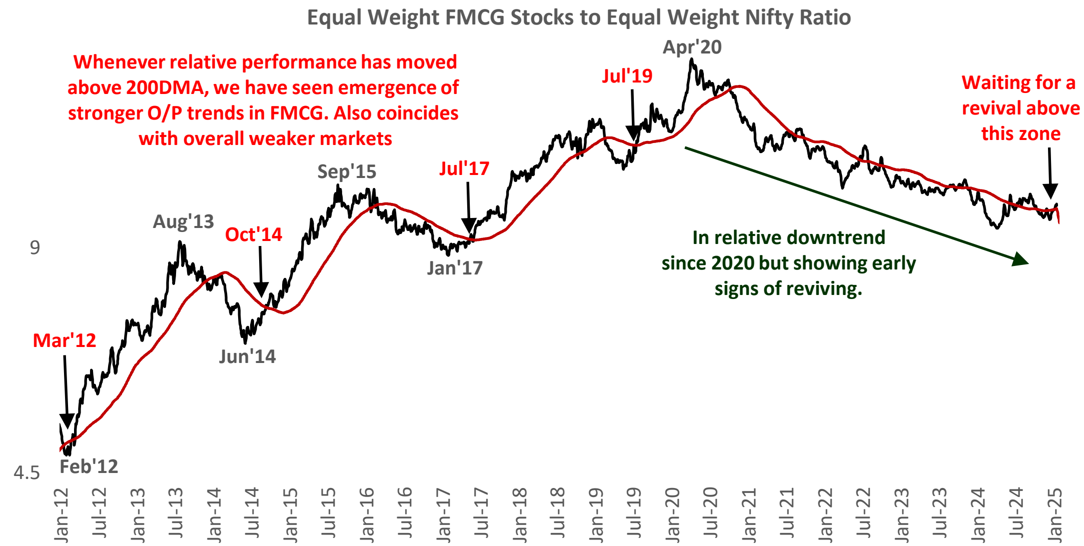
Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

Relative performance of FMCG over Consumption Index- At a better entry zone

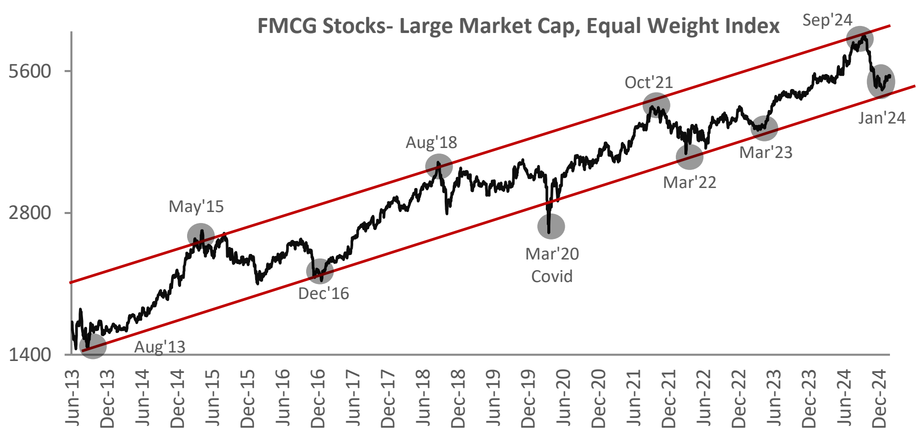
FMCG is one of the most hated sector with a consensus sell on back of disappointed numbers and outlook. The equal weight FMCG index has been severely underperforming equal weight Nifty index since Apr'20. Every recovery in this ratio was failing to cross the 200 day moving average. *However, despite the recent disappointment in FMCG numbers, the ratio has been showing signs of stabilising since the last few months. In past, whenever the ratio has managed to recover above its 200DMA, we have seen a strong phase of outperformance in FMCG stocks which has also coincided with weaker market trends*. Until now the ratio has not scaled higher but any recovery from here can indicate stronger outperformance trends.

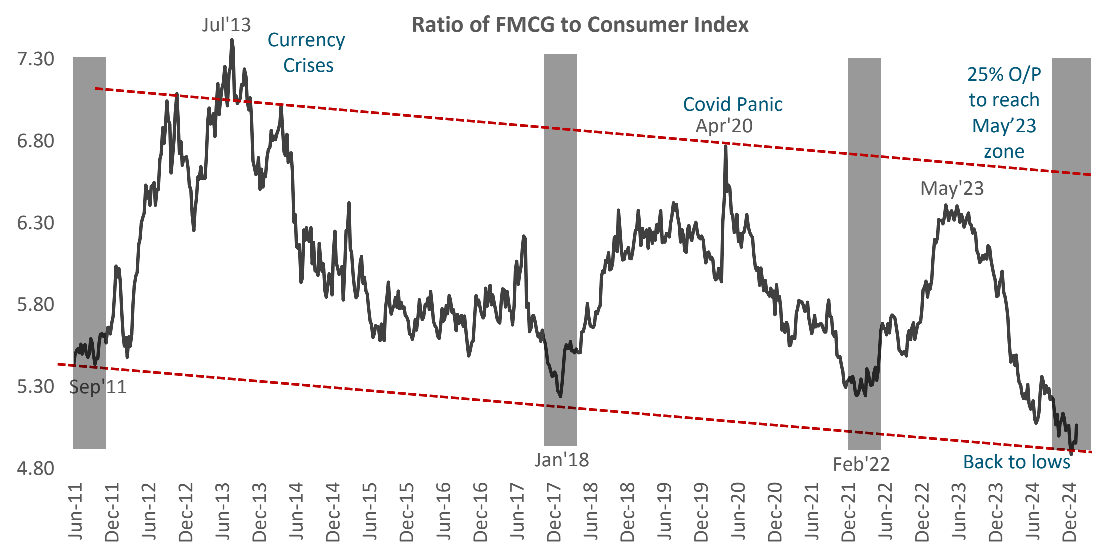
When compared with the overall Consumption index too, FMCG has reached a good support from where it had recovered in Sep'11, Jan'18 and Feb'22 period. Again, the outperformance of FMCG with Consumption has indicated correction in markets.

The equal weight index of Large Cap stocks in FMCG index has reached a strong support which has been held since 2013. There was one break during COVID sell-off but was quickly recouped. *A recovery back to higher end of the band indicates 30% rally in large cap FMCG names*.



Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF



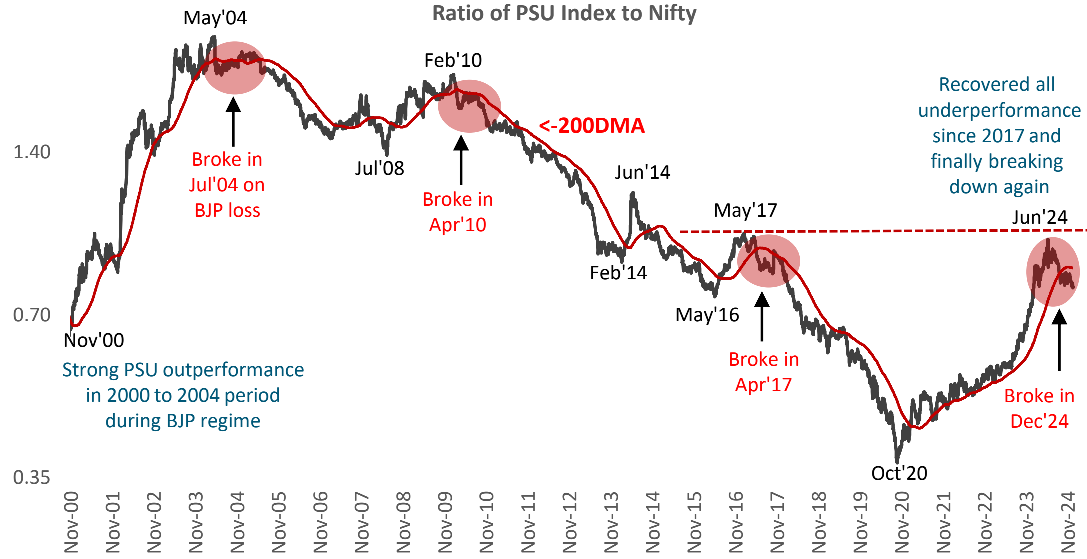


Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

Relative performance of PSU Index- Break of support for the 1st time since 2020

The relative performance of PSU index to Nifty is breaking down for the 1st time since 2020. It has been a strong leading indicator in past of dent in longer term relative trends. The previous big outperformance of PSU over Nifty was seen in 2000 to 2004 period, during the BJP regime. *As soon as BJP lost in May'04 elections, we saw relative performance of PSUs reversing sharply. Similar break of support was later seen in Apr'10 and Apr'17 period which was again followed by steep underperformance of PSUs*.

Even the absolute index (BSE PSU Index) is breaking down for the first time since May'20. *Generally, any breakdown which is quickly followed by a strong recovery have indicated continuation of the uptrend. However, in case of a failed recovery after such break-down, we have seen trends getting dented*. For E.g. in the 2004-2008 PSU rally, we saw the index breaking the support twice but the level was quickly recouped. Even in the current rally since 2020, we saw the support getting compromised in Jun'22 (Russia-Ukraine crises) but again it recaptured the zone quickly. *However, this time that sensitivity has got lost. We saw one recovery but it failed after reversing to the support. These are strong signs of a slowdown in buying momentum*.

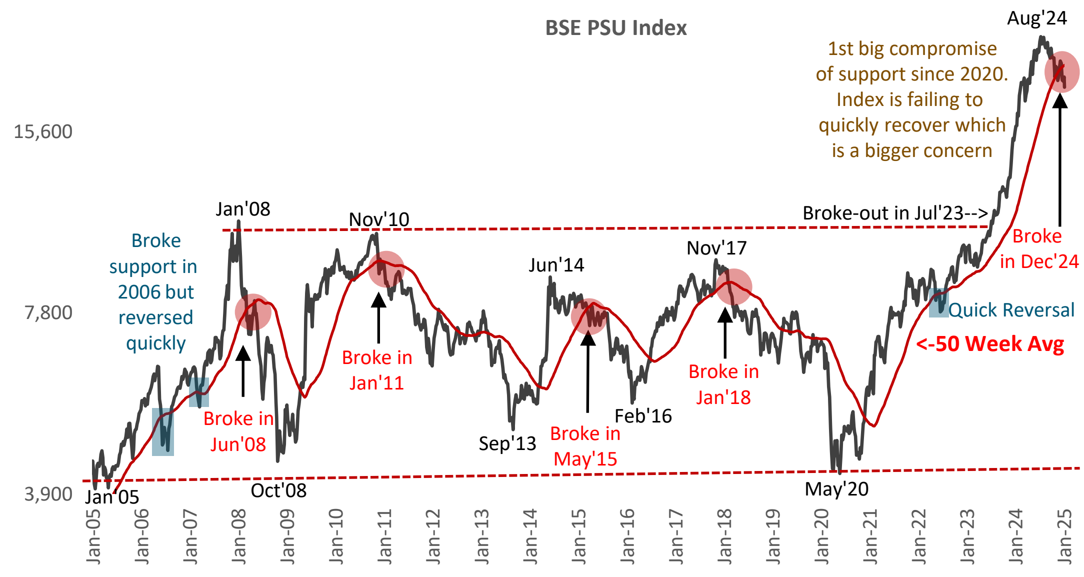


Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

Relative Ratio of PSU to Consumer Index

Date	PSU to Consumer Ratio	RSI	1yr Fwd Relative Performance
10-Feb-06	5.0	19	-11
24-Nov-10	5.0	17	-23
26-Aug-11	4.2	19	-16
01-Nov-12	3.3	20	-33
21-Mar-13	2.9	19	-18
04-Jul-13	2.5	19	14
25-Sep-14	2.4	18	-17
02-Jun-17	2.0	20	-22
09-Aug-19	1.4	19	-29
03-Feb-20	1.2	20	-14

The table marks those days when the RSI (Relative Strength Index) of the ratio of PSU to Consumer Index hit a new low in that phase for the first time. *1-year forward relative performance from there has always been negative except Jul'13 when PSU outperformance quickly revived post MODI victory*. In all other cases, PSU index underperformed Consumer Index in 10-30% range over next 1-year. *The average underperformance over next 1-year was 17% while median underperformance was 18%*.



Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

Relative performance of Capital Goods Index- Getting compromised for first time since 2020

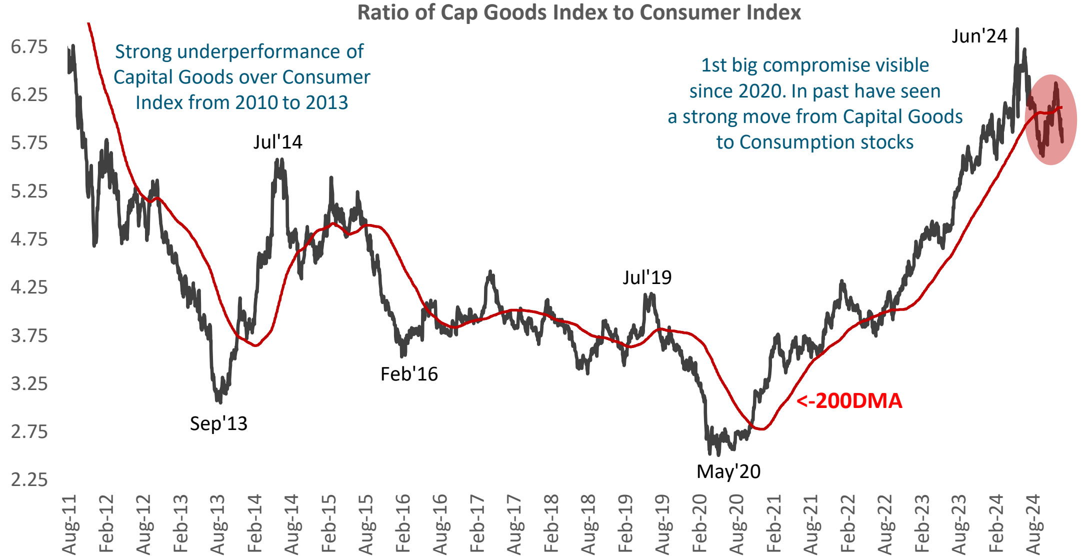
PSU and Capital Goods stock prices share a very strong correlation historically. With the PSU trend showing signs of getting punctured, we try to evaluate Capital Goods stocks in the same lens. *Capital Goods relative performance with Nifty is also showing signs of breaking down for the first time since 2020*. Unlike PSU, trends have not completely got dented here but many signs are visible. ABB was the leader of the Cap Goods rally in 2021-2023 while most other names followed at a later stage. And ABB is the first large cap name which is breaking down. It has even broken below the election day low which is concerning.

The ratio of Capital Goods Index to Consumer Index has also got compromised for first time since 2020. *In past we have seen a strong shift from Capital Goods stocks into Consumption stocks once the trend has reversed. We feel this time too, it could be a move lasting for more than a year*.

Ratio of Capital Goods Index to Nifty

Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

Ratio of Cap Goods Index to Consumer Index



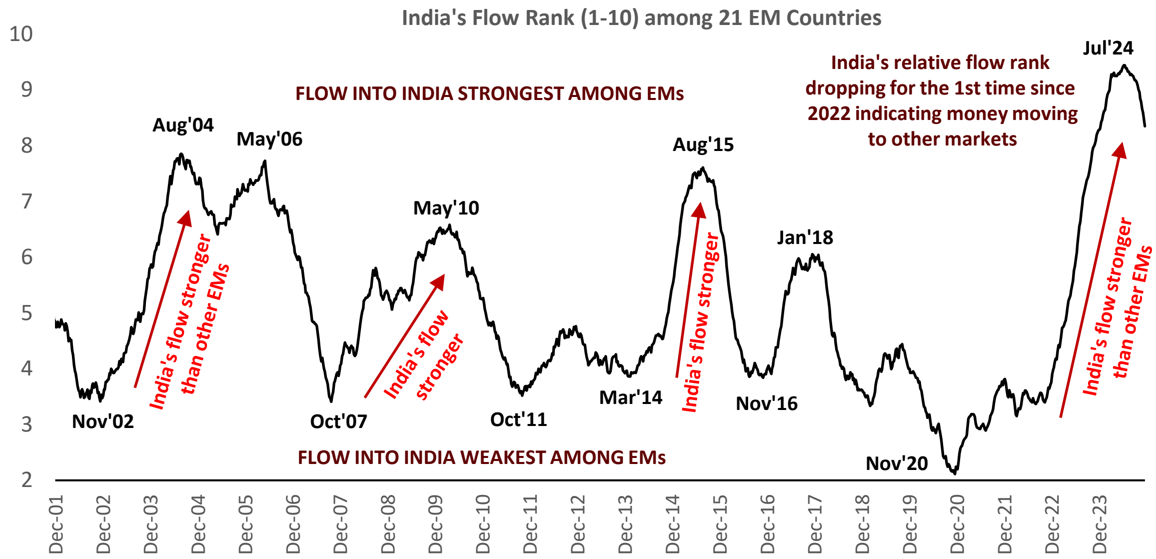
Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

LIQUIDITY CONTRACTION PHASE COINCIDES WITH QUALITY OUTPERFORMANCE

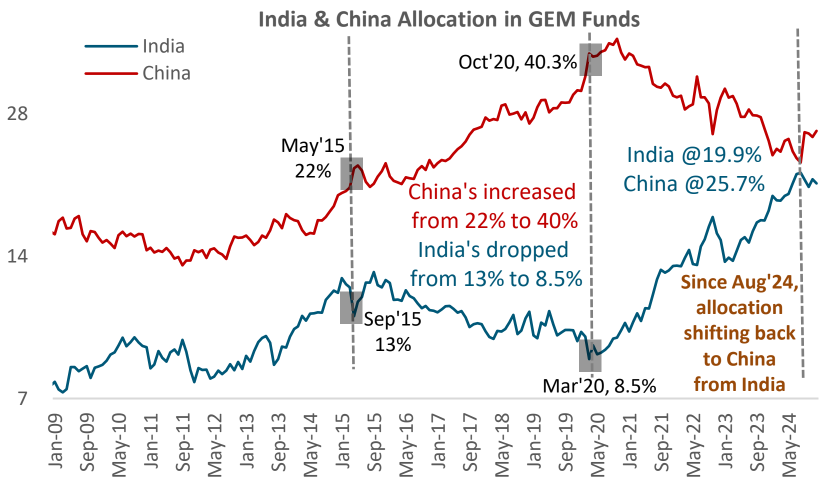
India losing relative sheen v/s other EMs. EM allocation gradually shifting back towards China

Relative strength of flows into India compared to other 20 EMs has started reversing from historic highs. Global fund allocation to India over other EMs was very strong since 2022, which is changing the course since Jul'24. *Previous phases of relative weakness in foreign flows for India v/s other EMs were in 2010-2011, 2015-2016, 2018-2020 period. In these 3 cycles we saw markets giving negative returns and Consumption/quality outperforming*. Incremental GEM fund allocation has also started moving into China from India since Aug'24.

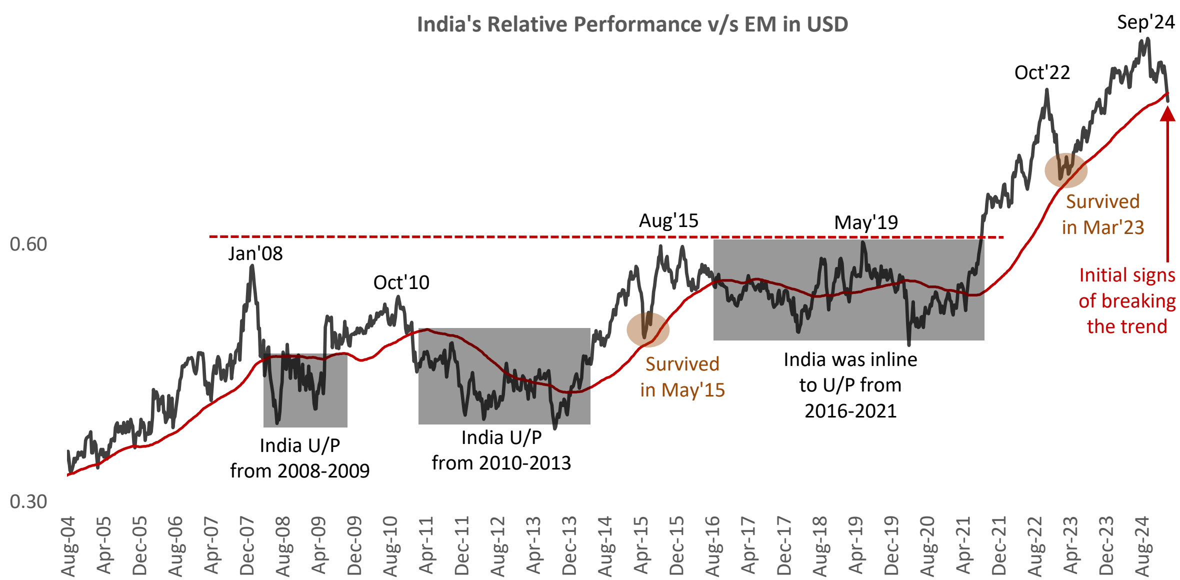
India's relative market strength v/s other EMs (in $ terms) has started showing first signs of weakness after 2020-21. *We had seen such breaks in Mar'08, Nov'10 and Jan'17 period. In the first two instances, Indian markets saw absolute correction with such readings*. In 2017, the foreign flow impact was absorbed by domestic funds in the first leg (due to large domestic inflows post Note Ban in Nov'16). However, from Jan 2018, the breadth in Indian markets started taking a severe beating and the pain lasted until 2020.



Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF



Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

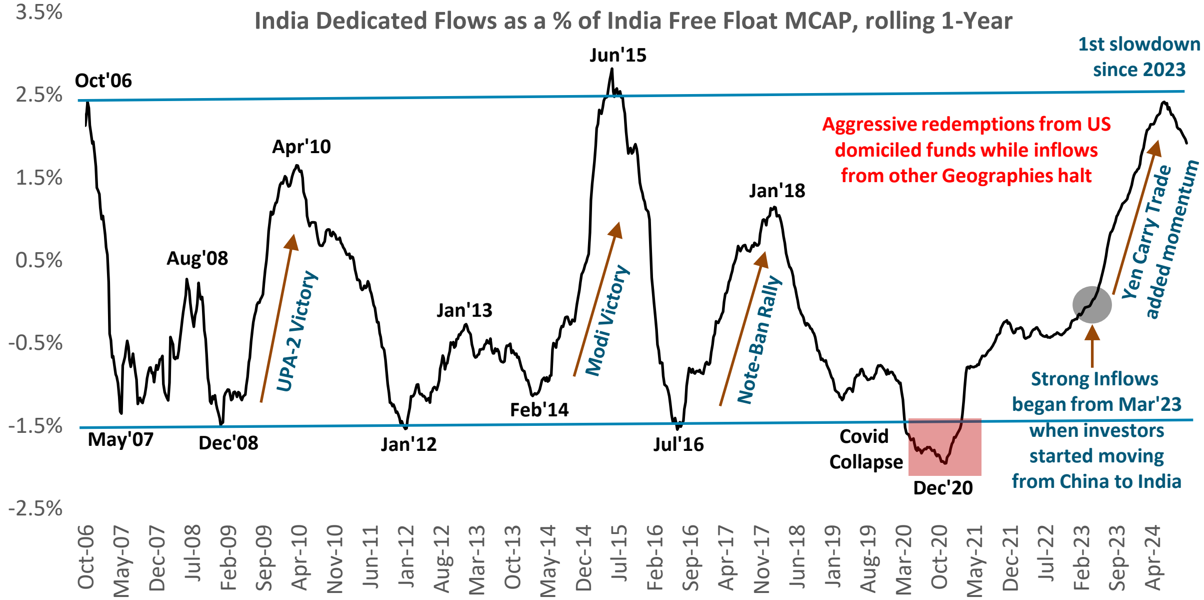


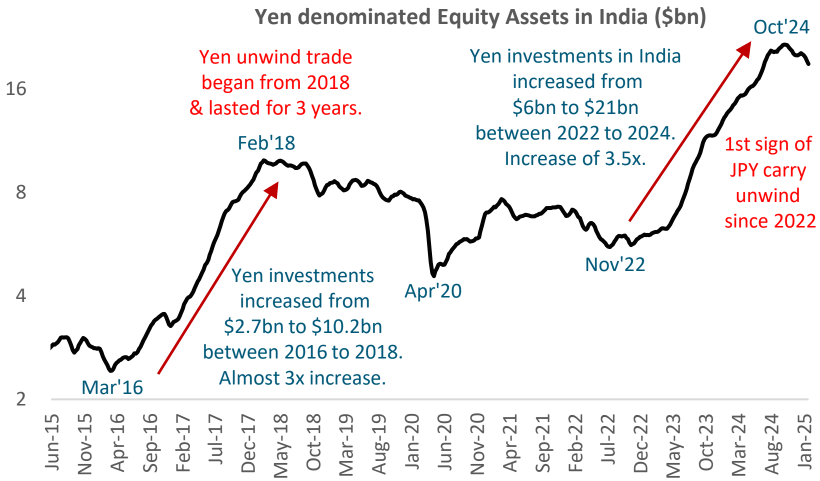
Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

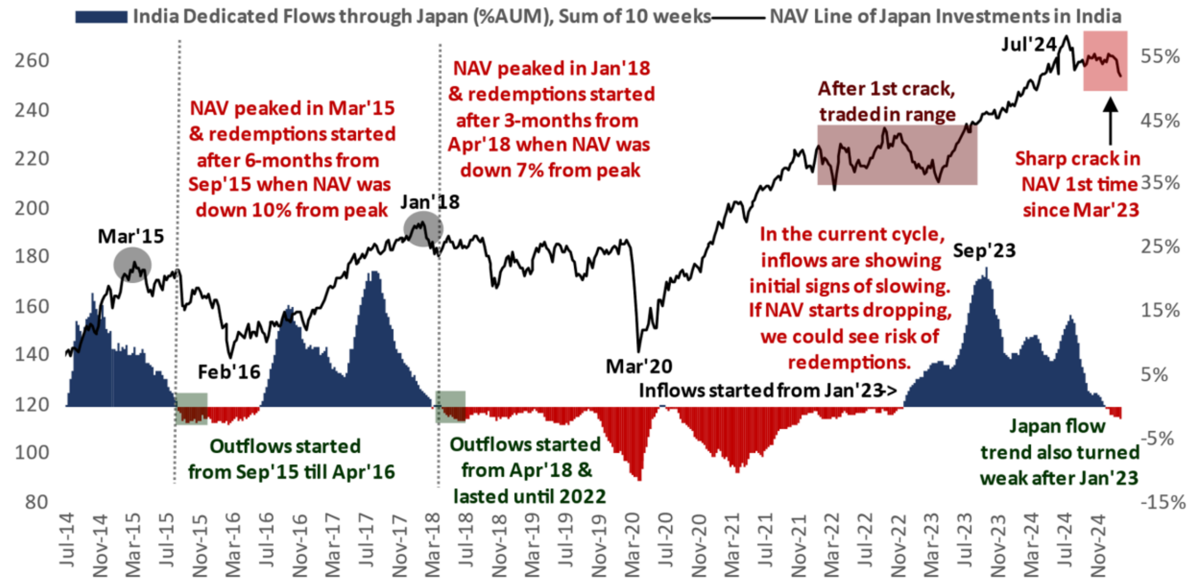
India flows as a % of FF MCAP reversing for 1st time since 2020. Unwind of JPY carry trade next risk for India

Fund flows to India as a % of free float market cap has started reversing for the 1st time in this cycle which started in 2020. *In past, it has been a strong indicator of weaker foreign liquidity for Indian markets for a prolonged period*. As of now, this first leg of reversal is largely on back of redemption from US domiciled funds post Trump victory (Dollar carry unwind). *US flows into India are predominantly ETF oriented hence we saw equal damage in Large caps as well as Midcaps*.

India has seen a big cycle of Yen carry trade from Jan'23. The total JPY investments in India increased from \$6bn to \$21bn in just 2 years. That trade has also started reversing. *An unwind of JPY carry trade has bigger impact on stock portfolio v/s Index since big portion of JPY assets in India are from Long-only funds compared to ETFs*. The previous unwind trade started in the beginning of CY2018 and lasted for almost 3-years creating a major havoc on breadth. JPY/INR currency will be one crucial data to monitor to assess the risk of unwind. (refer to our note dated 8th Aug, 2024 titled "US & India largest recipient of Yen carry flows since Jan'23. Previous Yen unwind trade for India had begun in 2018" for further details).

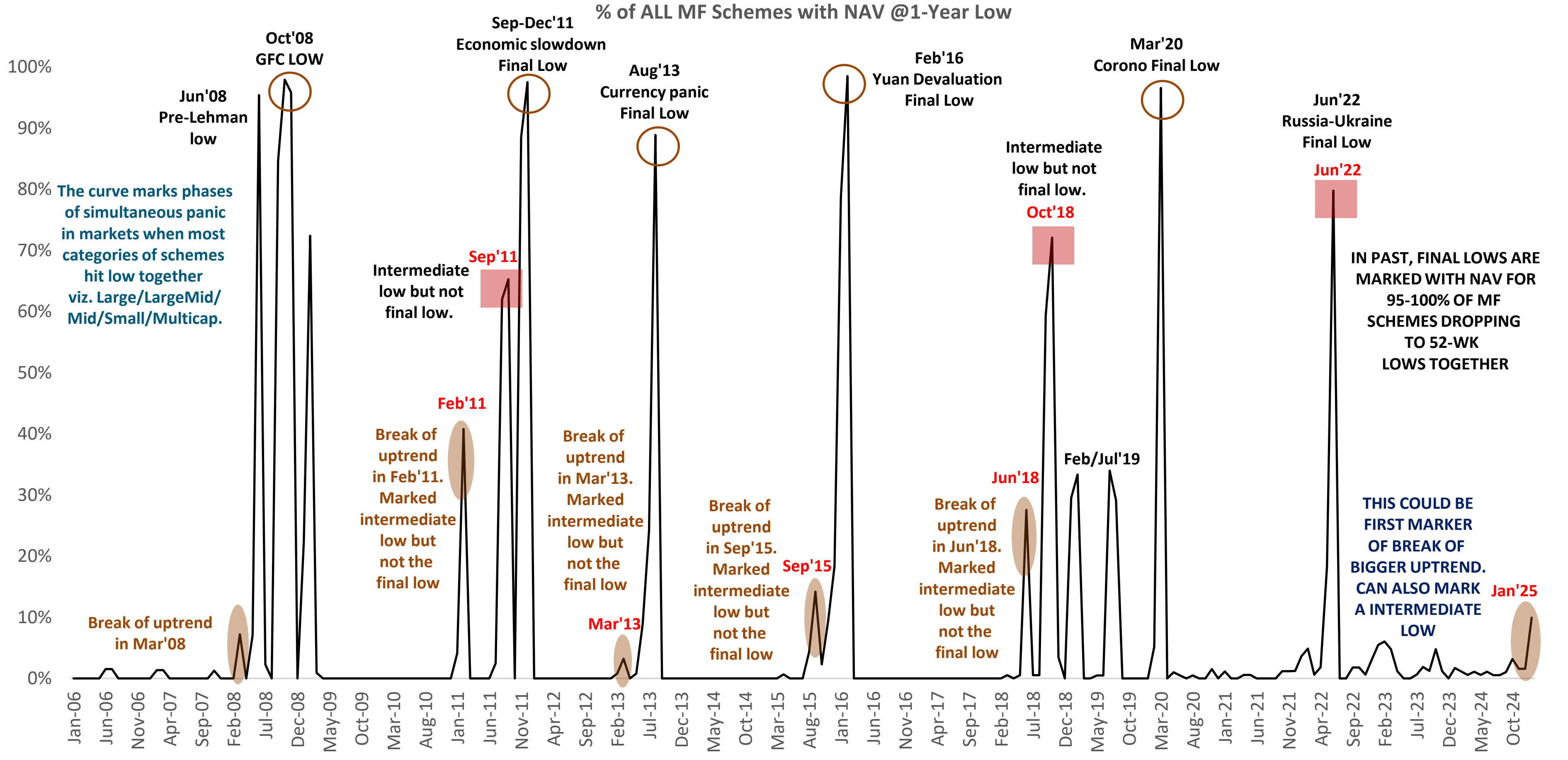






Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

Domestic Panic– % of schemes with NAV hitting 52-week lows show 1st spike. Marker of a bigger downtrend



Source: EPFR, Elara Securities, Research, Bloomberg, Capital Line, ACE MF

Panic among domestic investors can also be gauged by '% of equity schemes' where NAV is hitting 52-week lows simultaneously. In all the previous cycles, we had seen this curve as a lead marker of break of the bigger uptrend. The initial spike in the curve creates an intermediate low which is later followed by a bigger damage. *E.g. it first spiked in Mar'08, Feb'11, Mar'13, Sep'15 and Jun'18, for the first time in that bull cycle. All of those times we saw markets making a intermediate panic low for a few weeks to months before resuming the next leg of sharper sell-off. The final low is marked when this curve spikes to 90-100% band*. This is the period when almost all schemes (across categories like Large, Mid, Small, Multi, Flexi, LargeMid etc) simultaneously hits 52-week low marking extreme fear and panic. Currently the curve has shown the first spike in this cycle (at 10%). Hence, we could see one intermediate low around this zone but bigger shake-outs coming later.

Euphoria created by MF Sectoral/Thematic Funds- Signals bubble similar to 1999-2000 & 2005-2008 period

		SECTOR FUNDS							(INR Crs)
Month	**Thematic**	**Infra**	**Banking & Finance**	**Energy & Power**	**Pharma**	**Consumer**	**IT**	**Global**	**MNC**
Jan-24	2,985	684	471	211	259	224	61	-23	-42
Feb-24	2,239	1,156	276	6,869	274	284	-7	-44	-102
Mar-24	5,092	811	168	1,091	166	144	1,234	1	-87
Apr-24	3,877	726	-184	807	57	118	68	28	-104
May-24	16,565	1,456	-53	955	124	260	40	-68	-159
Jun-24	12,714	2,132	470	1,104	78	396	-385	-15	-146
Jul-24	7,328	2,061	-7	9,945	-15	669	-396	5	-133
Aug-24	14,039	1,089	681	1,907	314	682	344	108	-74
Sep-24	5,326	150	698	941	445	5,213	579	-69	-87
Oct-24	4,108	1,042	730	458	425	1,553	479	-18	2,287
Nov-24	4,351	630	692	241	288	990	786	14	23
Dec-24	12,158	323	558	66	742	674	765	-21	-63
CYTD	**90,783**	**12,258**	**4,500**	**24,595**	**3,158**	**11,207**	**3,569**	**-104**	**1,312**

THEMATIC FUND FLOW- BREAKUP (INR Crs)

Month	**India Opp**	**Quant**	**PSU**	**Business Cycle**	**Mfg.**	**Innovation**	**Defence**	**Momentum**
Jan-24	747	160	751	53	549	223	66	316
Feb-24	841	210	950	-954	443	159	87	567
Mar-24	655	55	784	605	1,498	1,109	96	261
Apr-24	840	176	730	402	653	898	121	192
May-24	991	261	1,508	1,403	11,610	360	150	241
Jun-24	367	2,580	1,117	754	4,504	288	147	100
Jul-24	691	192	1,157	3,018	1,633	268	258	69
Aug-24	795	158	599	1,828	2,137	8,126	206	60
Sep-24	603	39	-335	2,049	389	662	183	-24
Oct-24	896	168	-0	746	1,332	421	229	-38
Nov-24	932	66	244	512	225	1,915	251	-7
Dec-24	360	3,434	62	1,509	-7	214	220	1,803
CYTD	**8,717**	**7,498**	**7,568**	**11,925**	**24,967**	**14,642**	**2,013**	**3,540**

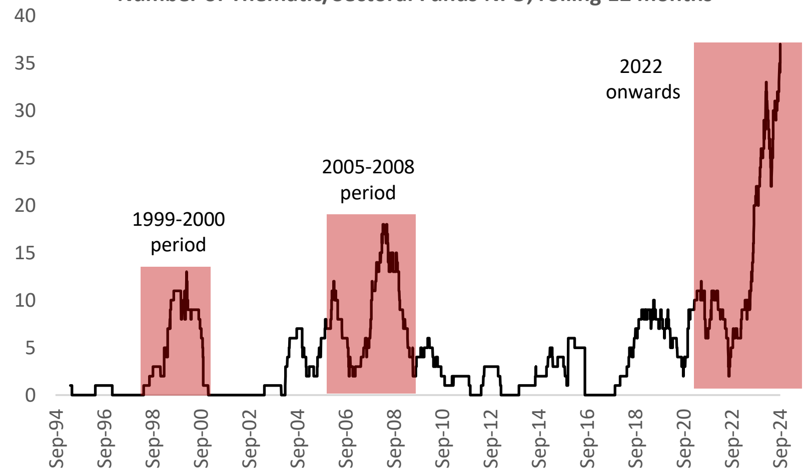
Source: Elara Securities Research, Bloomberg, Capital Line, Ace Mutual Fund

Fund flow into Sectoral/Thematic funds has been a key factor for creating a big anomaly in price action in one section of the market. *Since Aug'23, almost 40% of active fund flow have moved into Sectoral and Thematic funds (Inflow of INR 1,56,358 crores/$18.6bn) led by Manufacturing, Energy & Power, Innovation, Infrastructure and PSU funds*.

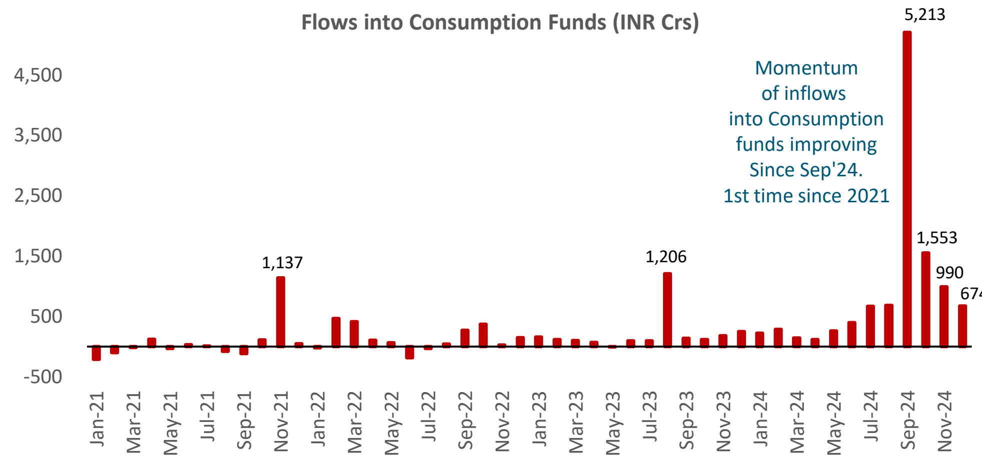
Many retail players have also directly loaded on these stocks in anticipation of buying by the funds. This has resulted in big valuation expansion. We are already seeing a slowdown in these inflows since last 3 months. *On other hand, incremental liquidity is turning better in Consumer funds*.

The euphoria in Thematic/Sectoral funds is stronger than 1999-2000 and 2005-2008 period.

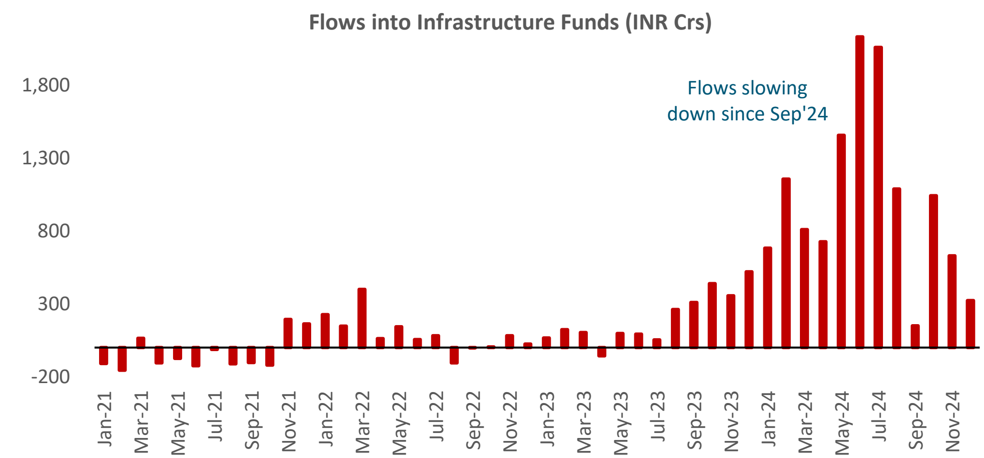
Number of Thematic/Sectoral Funds NFO, rolling 12 months



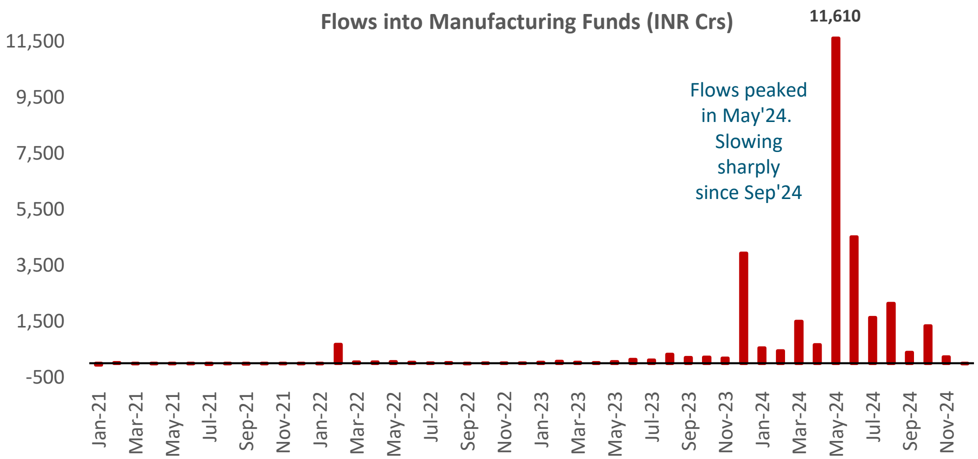
Domestic flows into Sectoral/Thematic Funds- Biggest slowdown in PSU and Manufacturing flows



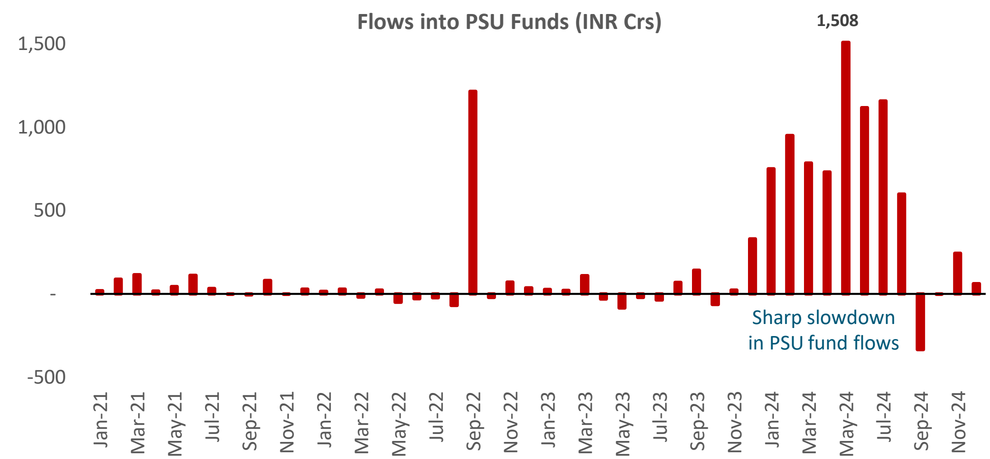
Flows into Consumption funds were languishing since 2021. We are seeing a slight improvement in this trend since the last 5-months.



Infra fund flows have been slowing down since Sep'24 after a euphoric phase of inflows for almost a year between Sep'23 to Aug'24 period.



Manufacturing fund flows have seen the sharpest slowdown among Thematic funds. Will watch for signs of any redemptions beginning here.



PSU flows went into euphoria zone post Dec'23. Some cracks have already started building here.

Source: Elara Securities Research, Bloomberg, Capital Line, Ace Mutual Fund

Conclusion

We feel that it is important for participants to know the current positioning of markets ahead of the budget and how one should react based on the budget outcome.

- **Scenario I**: We see stronger probability that government will do something to boost consumption. In that case the trade (that we highlighted in the report) can start accelerating.
- **Scenario II**: If the budget remains strongly focused on capex, we could see one round of rally in Industrial names but that could be short lived. We would advice to use that to shift allocation from Industrial to Consumption/Quality names.
- **Scenario III**: If it is a mixed budget then most of our relative models are anyway showing a strong tilt towards Consumption/Quality.

To summarise the note:-

- **Shift positioning into a Consumption/quality portfolio**: Incremental alpha to shift on this side after 4-years. Will cushion from price correction too.
- **Align portfolio closer to index weights**: For the 1st time since 2020, our models suggests to re-align portfolio back into polarization trade.
- **Reduce Midcap exposure**: Midcap's relative performance remains in euphoric zone. Liquidity can turn weaker here.
- **Start cutting on tail stocks which are insignificant in weight:** Reduce the number of stocks in portfolio to avoid underperformance.
- **Is it too late to sell?** This would be a typical question arising in minds of many people after one round of strong damage. We feel that the bigger cycle has reversed in favour of selling the breadth but we could see intermediate period of strong recoveries lasting a few weeks to months. What will be of more importance is to select the correct portfolio of stocks which can help outperform the market. We have tried to address the top-down thought process one should have in such market conditions.
- **One intermediate bottom could be around the corner:** We have started seeing signs of selling climax over the last few days. Short interest has risen with spike in implied volatility. Many stocks have broken their 200 day moving average, creating a consensus selling leg and inducing short open interest. Stronger names have started caving-in, indicating forced selling, a feature seen towards last leg of a panic. Most results are already priced-in.

We will come out with a follow-up note on market breadth cycles to showcase where we currently stand and how things have unfolded in the past.

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