

## “Your success as an investor will be determined by how you respond to punctuated moments of terror, not the years spent on cruise control” – Morgan Housel

Dear Investors,

Financial year 2025 seems to be quite an eventful year with something or the other keeping investors on the edge of the seat every month not just in India but also the rest of the world. While April to June was dominated by local general elections in India, July was dominated by budget fears of increased capital gains tax. August onwards we had central bankers differing actions taking centre stage globally. While US Fed was in rate cut mode, we had the Japanese central bank increasing rates after decades and fueling fears of Yen carry-trade unwinding. However, in recent times the market volatility in Indian markets have been driven by three key factors which I believe could remain the near-term drivers for the markets. Let's look at each of these factors a little more in details to understand their implications on Indian markets.

### # Factor 1: China stimulus which could make China once more attractive for global investors

Chinese economy which has been seeing a steady decline in its economic activity since covid days, has been making all efforts to revive their growth but to no avail. Real estate crisis has been the biggest disasters there which has led to all around gloom among the locals. Government in a bid to revive the sentiments have done some aggressive policy announcements in September'24 as follows with an objective to give an immediate boost to the sentiments and domestic consumption there in China:

- Reducing the bank reserve requirements by 50 bps
- Reducing the 1-year medium term lending facility rate by 30 bps
- Reducing the 7-day reverse repurchase rate by 20 bps
- Issuing \$1.4 trillion extra debt to refinance local govt bonds and also approve purchase of idle local land and property

The immediate market reaction to all these major policy announcements was positive, with the Shanghai composite index witnessing significant gains in the month of Oct'24. Whether these can be sustained over time will primarily depend on whether the targeted objectives, i.e., resumption in consumption and growth, will be achieved or not. In that regard, a study of similar policy measures in the past and the corresponding movement of the Shanghai composite index in the short-term (6-months), medium-term (1-year), and long-term (2-years and above) could be interesting.

Year	Macro environment	Measures announced	Short-term	Medium-term	Long-term
2019	Trade war & Economic slowdown	- Cut the top tier of the value-added tax (VAT) rate to 13% from 16% - Increased the personal income tax threshold and allowed more pre-tax deductions - Total tax cuts amounted to 2.3 trillion yuan (US\$324 billion) in 2019	20.8%	23.3%	35.3%
2020	Covid 19 Pandemic stimulus	- Fiscal stimulus of around 4% of GDP, US\$ 506 billion - China's State Council called on banks to sacrifice 1.5 trillion yuan (US\$212 billion) in profits in 2020 to finance cheap loans to companies as a way to offset the economic fallout - China's central bank had temporarily purchased 40% of unsecured loans made to small and medium-sized firms from select local banks, using 400 billion yuan (US\$56 billion).	20.0%	23.9%	18.6%
2022	Economic Stabilisation Policies	- More targeted infrastructure investments - Central bank interest rate cuts and additional RRR cuts - Tax rebates for businesses and extended fiscal support for struggling sectors.	-6.4%	-14.9%	-8.1%
2023	Targeted Stimulus	- Increased fiscal spending on infrastructure projects - Incentives to boost consumer spending, particularly in auto and household appliances - Cuts to key policy rates to spur lending - Relaxation of real estate purchasing & borrowing limits.	-9.5%	-6.9%	-

Not surprisingly, considering that such measures take some time to percolate into the economy and engender the desired benefits, their impact on the market is usually more short-term in nature as can be seen from above. Over the longer term, structural factors hold more sway, and we would have to see how the recent policy measures impact the economy in the medium to long term. We believe the FII outflows are more hedge fund money looking for short term trading opportunities and not long-term investors.

*After decades of above par growth in China, the economy seems to be plagued with overcapacity and underutilisation*

*Past Chinese stimulus measures and its impact on equity markets in China don't give the confidence that current one would have any meaningful impact either*

*Q2FY25 is turning out to be the worst earnings quarter since the Covid bottom*

*Elections during Q1FY25 impacted the infrastructure and capex activity for 3-5 months which is resulting in all round weakness*

*There seems to be more structural positives under the new regime of Mr Trump and we would want to wait and watch how things play out*

## # Factor 2: Earnings weakness in Q2FY25 and expectations in H2FY25

With nearly 80-90% of the listed companies having reported their earnings so far, there has been more disappointments than positive surprises. Earnings of the Nifty-50 companies that have declared results so far have been flat YoY (vs. est. of +2% YoY). Q2FY25 was anyways expected to be a weak quarter due to base effect, election effect and also overall weakness in domestic consumption and infrastructure activity. However, it seems to be turning out to be the worst quarter in last four years since the covid bottom regarding growth in topline and bottom-line. In fact nearly 60% of the companies which have reported results so far have seen earnings downgrades. The aggregate performance was hit by a sharp drag from global commodities. Excluding Metals and Oil & Gas, Nifty clocked 11% earnings growth vs. expectations of 10% growth. The modest earnings growth was driven once again by BFSI, with positive contributions from Technology, Real Estate, Utilities, Telecom and Healthcare. Conversely, earnings growth was weighed down by global cyclicals, such as Oil & Gas (OMC's profit plunged 92% YoY), which saw a dip of 58% YoY, along with Metals (-28% YoY), Cement (-41% YoY), Chemicals (-23% YoY), and Consumer (+3%).

One major trend seen in all management commentary in this quarter was that the second half of the financial year (H2FY25) would be much better than the first half as the first half had elections and historically elections lead to infra and project delays across the economy. Among the consumer facing companies from Autos to Consumer staples and discretionary companies, Q3 is of major importance due to concentration of the festive and wedding season and hence lot of improvement in the numbers could be seen in the next two quarters. In the capital goods sector most companies have indicated that 2HFY25 will see an uptick in revenues and order inflows following the state elections and they have maintained their full year growth targets. Cement companies expect profitability to improve in 2HFY25, led by positive operating leverage, favorable fuel prices, and cost-saving initiatives. Even in Pharma and healthcare space we expect earnings growth momentum to sustain in the coming quarters, led by ongoing niche launches and improved operating leverage.

## # Factor 3: Impact of US Presidential election outcome

In the run up to the US elections, markets were anxious regarding the outcome though the opinion polls consistently showed the return of Mr Donald Trump to the Whitehouse. As Donald Trump prepares to begin his second innings at the White House, stock markets worldwide are already feeling the ripple effect. Investors are closely watching the potential implications of his return, with some sectors rallying in anticipation of his pro-business policies, while others brace for uncertainty amid his controversial economic strategies. Based on protectionism, tariffs, corporate tax cuts, increased infrastructure spending, deregulation, immigration control and strengthening local manufacturing, Trumponomics aims at fostering economic growth, raising incomes and creating more American jobs. But critics say these could stoke inflation, add to fiscal deficit and favour the rich citizens.

Let's look at what could be some of the positive and negative impact for India under the second term of Mr Donald Trump.

### BRIGHTER SIDE:

- **Commodity prices under check** – Trump's push for fossil fuels and tariffs on China could slow down Chinese growth further and keep commodity prices lower. India being a net commodity importing country, mainly crude oil, could benefit from the same as the import bill would be lower. Also as the nation continues capex building, lower metal prices could also keep project costs under check.
- **Boost to Indian manufacturing and exports** – Trump has repeatedly highlighted about higher import tariffs on Chinese goods and relatively lower tariffs on other countries including India. This could make Indian manufacturing more competitive relative to Chinese goods in the US Markets. Sectors like auto ancillaries, solar panels, chemicals, pharma API, etc could benefit. With improving US and India trade relations, this can potentially drive strong exports of electronics goods from India, which are quite low today. Potentially any exports of mobiles, RACs, PCBAs could be positive for Indian companies.
- **Geopolitical tensions could ease** – If global conflicts are resolved under his administration, it could ease supply chain challenges, benefiting Indian companies. Trump's focus on US manufacturing and military strength may also indirectly support Indian players and their JVs with US defense companies.
- **Boost for Indian IT companies and GCC work** – Indian IT sector growth primarily depends on i) how much AI LLM application work will come to us; ii) increase in IT Budgets of US Inc. as Presidential uncertainty is removed and iii) Fed rate cut impact on growth. The relatively less important direct effects of potential US policy changes are: Reduced Corporate Tax + Make-in-America (to help loosen US IT budgets). US Tax cuts would help Indian IT subsidiaries, US Banking recovery to help and any tightening of Visa restrictions may not affect our IT companies as they are more localized now than 5 years back.

*Tariffs has been the biggest concern under Mr Trump and that remains a overhang now for globalization*

## DARKER SIDE:

- **Tariffs galore to come** – Looking at the past term of Mr Trump and his election speeches in this year, its very clear that trade and tariffs would be the key narrative to look out for. In the past the US has chosen the countries it tariffs based on whom it has the largest trade deficit with. In the EM space, after China, Mexico and Vietnam, India comes next in the order of its goods trade deficit size. If one were to add services to it, the deficit would only get larger. However, with the incoming President Trump's narrative reportedly focusing more on China-tariffs, how India gets impacted we will have to wait and watch. Its tariff increases are apparently based on 3 considerations, i.e trade balances, currency manipulation & China threat to security. India comes mostly in the 2nd category; hence it is possible that some negotiations will occur about mutual tariffs on specified items rather than a blanket increase and a tariff war as it could be for China.
- **Rupee depreciation** – Any tariff increases by US (India being categorized as “currency manipulator”) could lead to global competitive currency devaluation. This is a worry for our macro as well as our US exports. Also, with growth picking up in US economy and more focus on domestic manufacturing in US, we could see continued FII outflow from India and other EMs and that would flow back to the US market. This could add further pressure on the Rupee.

## Current Portfolio construct & Performance

In midst of all the market volatilities and market noise, we continue to focus on our core strength of finding pockets of earnings strength which is supported by the right valuations. We continue to remain fully invested in the market and have not taken any aggressive cash calls in our portfolio. We believe the current downturn in the market is more temporary and not a structural downfall which warrants any major risk aversion. As can be seen from the below table, we have been able to maintain outperformance in all time periods over the short term, medium term or long term in your portfolio.

(As on 31 <sup>st</sup> Oct'24)	1 Month	3 Months	6 Months	1 Year	2 Years	3 Years	5 Years	Since inception
<b>Quest Multi PMS</b>	<b>-3.88%</b>	2.93%	15.69%	60.26%	32.28%	20.34%	25.91%	18.19%
<b>BSE 500 TRI</b>	<b>-6.46%</b>	<b>-3.59%</b>	8.70%	35.88%	22.02%	15.67%	19.83%	14.99%

*Consistent outperformance over benchmark remains key focus area for the portfolio in all market conditions*

Month Ended	Large cap	Midcap	Small cap	Cash
31-Oct-24	40.3%	13.5%	42.7%	3.4%

Market capitalization wise we remain biased towards smallcaps and midcaps as we see higher growth opportunities in corporate earnings among the good quality smallcaps and midcaps as compared to largecaps over the next 1-2 years. Valuation wise also there isn't any froth in the smallcaps where we are invested into and hence we remain comfortable holding onto our portfolio companies.

*Urban consumption, followed by Industrials and Financials remain the key themes*

Sectors/Themes	Weightage	Sectors/Themes	Weightage
<b>Urban &amp; Semi Urban Consumption</b>	<b>34.8%</b>	<b>Financials</b>	<b>21.9%</b>
Auto & Auto Anc.	8.5%	Private Banks	10.5%
Consumer Discretionary	15.3%	PSU Banks	3.1%
Hotels	3.0%	Asset Management Co.	3.0%
Real Estate & Ancillaries	3.1%	Wealth Management Co.	2.0%
Chemicals	5.0%	Exchange	3.2%
<b>Industrial &amp; Capex</b>	<b>22.7%</b>	<b>Others</b>	<b>18.5%</b>
Capital goods & Engineering	3.9%	IT & ITeS	3.8%
Power & Utilities	11.7%	Pharma & Healthcare	10.4%
Logistics Shipping & Railways	4.1%	Diversified	4.4%
Telecom	3.0%	<b>Cash &amp; Cash Equivalent</b>	<b>2.1%</b>

With regard to sectoral exposures, we have trimmed our exposure from Real Estate as we see the sector maturing and entering a period of time correction due to unsold inventory build up across India in different regions. We have also booked some exposure from hotel sector owing to valuations being a bit stretched in some names but continue to like and hold Indian Hotel which continues to deliver strong numbers every quarter. We continue to remain overweight on Consumer Discretionary space betting

on Urban and Semiurban consumption. There has been some slowdown in consumption overall on a YoY and QoQ basis but we see this as a short-term consolidation rather than a structural downturn in India consumption story. After Consumer Discretionary, Power and Utilities remains the largest sectoral exposure as we remain confident on the power capex unfolding in the country to cater to the ever-increasing demand for uninterrupted power in the country. Pharma & healthcare as a sector has seen one of the highest increase in allocation in the last two quarters as we see the sector having bottomed out on margins and earnings growth also showing steady quarter on quarter double digit growth.

The current weakness in the market overall has a lot to do with a mix of weak Q2FY25 numbers coupled with FII outflows which is actually heading back to US post Mr Trump's victory rather than going to China which was perceived to be the case by many earlier. Global Fund managers seem to be betting on Mr Trump giving a substantial boost to Corporate America's profitability through tax cuts and push for domestic manufacturing. I believe some time correction in our markets can bring our markets back to attractive levels and India would continue to nevertheless trade at premium to rest of the world in the medium to long term.

*Index valuations are becoming more comfortable with every small correction in the market and offering good entry levels for long term investors*

After the recent correction of nearly 10% in Nifty-50, it currently trades at 19.3x P/E for CY2025 earnings and 17.4x P/E for CY2026 earnings. I don't see these valuations being expensive from a standalone perspective as its very close to historical average valuations. However, when seen on a relative basis to China it looks expensive because China has massively under-performed India in the last 5 years due to its own structural problems. If I look at NSE-500 which is more broad based, it currently trades at 20.7x P/E on CY2025 earnings and 18.7x P/E for CY2026 earnings. Again, a sharp drop from the recent 24x and 21x respectively it was trading just a few months back. With most commentary highlighting a stronger H2FY25, our view is that we would see some recovery in earnings from Q3FY25 and meaningful recovery from Q4FY25. From now till the end of the FY25 we see good opportunity for investors to pick quality companies at reasonable valuations during the volatile period.

Happy Investing!!

**Team Quest**



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