Greetings!

A warlike event

It may be still too early to talk about the pandemic in the past sense. For most of us, this has already pencilled in an indelible dark chapter in our psyche. The aftershocks will keep playing out. All things end. That includes this pandemic. It is about time we as investors attempt to look beyond.

In order to assess the impact of the pandemic, we need to appreciate the scale of the event in terms of its economic and social impact. There is an impact on the way people live and the way businesses will evolve. Already, several corporations have done away with physical work spaces. Hybrid model in work places is almost a given for most businesses.

An understanding of this pandemic should start with an attempt to define the nature of this event and put it in a historical context. The world has seen previous versions of pandemics. Covid is being compared with the influenza pandemic that hit us a century ago. However, we feel that this event is more comparable to a world war. The reason is because we are living in a highly interconnected world. Instant and seamless mobility of people, goods and services has been a virtue of the 21st century. Such a linkage has proved to be the Achilles heel for the world. Covid crisis has been more like a war and the virus the invisible enemy.

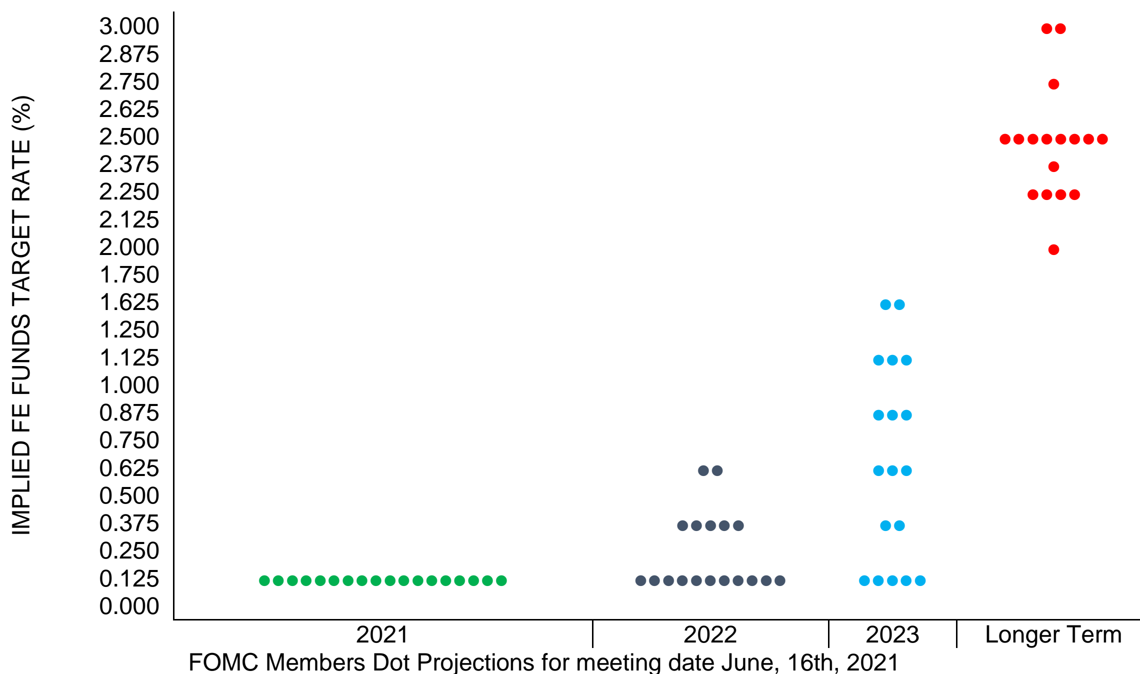
It is fair to say that the second world war changed the world economic order. Emergence of democracies and empowerment of women were social changes and they had an impact on the way economies developed. As regards growth in national incomes, the rise of Japan and Germany as industrial powers followed the post-war reconstruction effort. In general, reduction in abject poverty and rising global prosperity were part of the peace dividend.

The key takeaway from the above discussion is this. The end of the pandemic will pave the way for a fresh surge in forces that give an impetus to innovation and improvement in productivity. This will be positive for sustainable growth. This will also be positive for equities in the long run.

We highlight a few trends and themes that will define the road ahead for markets and for growth.

Tapering of the taper tantrum

In 2013, the Federal Reserve squirmed a bit and the global markets went into convulsions. The Fed decided to go slow on the purchase of securities which pumped liquidity into global financial markets. Such liquidity was keeping stocks higher. Emerging markets were the hardest hit. Interest rates went higher but not anywhere close to the levels prevailing at the pre-global financial crisis era. Stocks resumed their upward journey after a period of consolidation. The quantum of liquidity injected has been gone up from crisis to crisis. On one side, the incremental dollops of liquidity required to keep markets calm have kept inching up. On the other hand, the cost of a market slump has never been higher. Interest rates have already scraped the bottom of the barrel. However, the Fed is still committed to low rates and for longer. Take a look at the Dot Plot, a data point that did not even exist 13 years back. This is the summary of the expectations from Fed policymakers of a future assessment on interest rates, done through a poll and published officially.

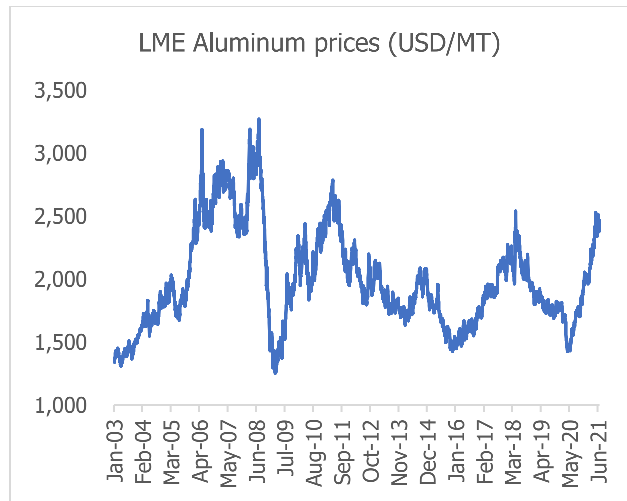


Source: Bloomberg, Spark Fund Research

It is amply clear that the US Fed is likely to keep the liquidity tap open for a long time. Growth is there but it is too fragile for the policy makers to mess with rates. The conclusion is that the equity markets may not repeat a 2013 style tantrum. Not on account of liquidity at least.

End of No Cost Money

Green shoots of growth are sprouting up everywhere. Nothing exemplifies this more than the rise in global commodity prices.



Source: Bloomberg, Spark Fund Research

The notable change is that the governments have been doing part of the heavy lifting in this crisis. Expansionary fiscal policy is the order of the day. While this should support growth, there is one clear implication. Inflation will inch up and money will have a cost. Moderately higher inflation is something that policymakers always wanted. They did not get it earlier despite trying to spur demand with injection of more and more liquidity. Now, we are getting inflation due to a normal cyclical process of demand reviving even as supply has slowed down over the years. Supply has also been constrained due to environmental considerations which are for real.

This crisis has affected all segments of society unlike the global financial crisis. Fiscal response has therefore been evident right from the word go. Public spending has the most bank for the buck if it is directed towards building infrastructure. That looks to be a likely trend even in the advanced economies.

For India, cost of capital never went down to nothing. A fair price for capital may be no bad news for Indian equities. India's valuation premium over emerging markets has a lot to do with the good record of select Indian companies (only select companies present in benchmarks count when valuation premium is computed) in putting capital to proper use and ensuring that return on capital exceeds the cost.

New sources of productivity boost

While supply side factors are causing some inflation, all of that may not end up as CPI. Corporates are seeing unprecedented savings in other operating costs. Work from home, lesser time lost in commute, less of travel and rationalisation of brand-building expenses have all resulted in cost savings.

	Opex / Sales*		
Sector	FY21	FY20	FY19
Consumer Durables	17.0%	18.9%	18.4%
FMCG	28.2%	29.3%	29.8%
Healthcare	41.9%	45.7%	44.9%
IT	11.5%	14.5%	15.9%
Retailing	17.2%	18.3%	22.7%
Cost to income ratio of private banks	50.9%	52.9%	54.7%

**NSE200 companies* *Source: Aceequity, Spark Fund Research*

The data above is for Indian companies but the photo is pretty much the same everywhere. The efficient enterprises have tweaked the costs and continued to deliver. Feedback from companies seem to suggest that some of the cost savings are here to stay. Overall, some of the hit from commodity prices will be absorbed by efficiency gains elsewhere.

There will be several new sources of productivity gains that we will witness in the new order that the pandemic leaves us with. Technology will be a common enabling factor in this game.

Micro-trends all over is the Big Trend

There is change everywhere. What changes will be a matter of its own detail in each sector, business sub-segment, geography or niche. For example, travel will come back but business travel may not ever be the same again. Leisure travel may define the priorities of the hospitality sector. Weddings may never be the same again in the way they are conducted. Classrooms may change forever with remote learning staying put as one leg of the new normal. Video consultation will remain an integral part of the medical profession even after the virus recedes. The micro trends are too numerous to list down. Many of these trends are yet to take shape but will come about when the world gets back to business once again.

The common thread in all of these changes is that new sources of demand will spring up. Some services and products of the yesteryears will go redundant to be sure. For instance, it is safe to conclude that the definition of office wear will be dictated by where the office is. However, the lesson from history is unequivocally clear. This will not be a zero-sum game. There will be winners and losers. But consumers will remain relevant in one form or the other, and the show will go on.

Building of a post-pandemic world

This will be a growth driver of its own. And a powerful one at that.

For India, we have just begun to hear the rumblings. If we are to look at the hiring plans of companies who are market leaders, the writing on the wall is clear. We are looking at growth ahead. There are job losses in many sectors. The bottom of the pyramid is having a tough time. It is useful to recall the days when the trade unions went on strike against job losses when railway reservations were computerised and banks got automated. Eventually, employment did not fall. Productivity gains more than compensated. When the trucks from Mumbai to Chennai cut their travel time by 75% after the golden quadrilateral was built, the number of trucks required did not go down. Activity boomed and the CV industry went on to have one of its biggest ever upcycles instead.

Productivity growth is what will lead the way for meaningful and sustainable employment growth. India may be at the cusp of a multi-year growth phase. The signs are visible in sectors such as IT services, Fin tech, electronic manufacturing, specialty chemicals and bulk drugs. We will see more evidence emerge once the economy steps out of the long shadow cast by the pandemic. We do recognise there are risks to this journey and the pandemic itself is a continuing risk factor. Markets however will price in the eventual outcome and may already be doing that.

The inherent problem with the optimistic view is that a part of the positivity is already priced in. It is hard to tell how much. The market is at a juncture where it is accident prone. Sharp corrections may happen suddenly and one has to be prepared for that. If we however look at this as a multi-year journey, the risks become manageable. Be ready for the marathon. Mind your step, one at a time.

Warm regards,

P Krishnan (CIO) and Team Spark Fund

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