Greetings!

Cometh the second wave

Exactly a year after the pandemic hit India, the market is staring at a risk that has been a known unknown; resurgence of Covid in India. This risk is a known risk because we and the market at large have been flagging this for the last 3-4 months when Covid was in a phase of retreat. It is a known unknown because no one has a clue about the timing of the resurgence, the extent and its destructive potential.

The timing bit has now been answered. The second wave for India is here. The question now is how far it will go and how much damage this could cause. We are hardly equipped to give a definitive answer. Nor is anyone else. In our mind, two factors stand out;

1. India is reasonably well positioned in the vaccine divide. The comparisons in the media based on vaccine penetration at the aggregate level may be missing the point. Given the formidable denominator, reaching herd immunity based on universal coverage will take a long time for India, if at all that is possible. It is debatable whether that is even necessary. India is administering about 3 million vaccines per day and that is more than any other country in the world other than the US. Given India's demographic profile and the uneven spread of the pandemic, there is hope. The ramp up in vaccination, targeted coverage and smart on-the-ground implementation will begin to make a difference.

Doses administered	Doses administered (till 5th April 2021)	
	Total (in millions)	Per 100 people
United States	165.1	50.0
Mainland China	140.0	10.0
India	79.1	5.8
U.K.	36.9	56.0
Brazil	21.1	10.0
Germany	14.4	17.0
Indonesia	12.6	4.7
France	12.3	18.0
Russia	12.1	8.4
Italy	11.1	18.0
Mexico	9.0	7.2
Spain	8.5	18.0
Poland	6.7	18.0
Japan	1.1	0.9
South Africa	0.3	0.5

Source: www.nytimes.com, Spark Fund Research

Our rough workings show that approximately 25% of Indians above 55 may have got at least one shot already. In a couple of months, about half of Indians above 45 may get there. The sero survey puts the percentage with antibodies at 20-30% in the worst affected cities before the new line of defence came in by way of vaccines. The risk is now shifting to younger people. Note the clusters being formed in universities and due to sports events. This was a trend noticed even in the developed world during the second wave there. The challenge for the public health system would continue but for the economy, the worst may soon come to pass. The wall of immunity being built will be even stronger for the urban areas. Cities have been the gateway for the virus to spread. As the more vulnerable people in the densely populated urban areas get their immunity shots, the virus is likely to meet with stiff resistance. This assumes that the mutations don't get to be lethal enough to cause major damage; we must go by what the scientific community tells us on this – which is encouraging.

2. Covid fatigue is clearly evident in public behaviour. Norms are openly flouted by people across the country and appeals by experts are being ignored everywhere; Be it in public places, sports events or at election rallies. This is the reality and this is not good news. This may lead to a higher peak in this wave but maybe, lower mortality and lesser impact to economic activity than was the case last year.

This is clearly a race between the virus and vaccines. The rate of immunisation in India exceeds the rate of daily infections by a wide margin. The odds are good for the vaccines to get ahead. What is important that India has steady vaccine supply. This is not what much of the world can count on right now.

There is a catch though. Considering the dynamics of the pandemic, the current wave will not stop suddenly. There will be restrictions on economic activities; call it lockdowns or localised containment efforts. The economy will feel the pain. We have argued for a while that consumption could be at some amount of risk from the secondary and tertiary effects of the pandemic. Note the RBI data on household financial savings which gives one facet of this. This has to be seen in conjunction with job losses which are uneven. Fresh restrictions can create further consumer fatigue. The resultant moderation in consumption may not be enough to derail the cyclical humming we are hearing for a few months now which is that of the investment engine revving up. But this can cause temporary hiccups.

RBI data on household savings

Year	Financial HH savings (% of GDP)
FY00	10.2%
FY01	9.9%
FY02	10.5%
FY03	10.0%
FY04	11.0%
FY05	10.1%
FY06	11.9%
FY07	11.3%
FY08	11.6%
FY09	10.1%
FY10	12.0%

Year	Financial HH savings (% of GDP)
FY11	9.9%
FY12	7.4%
FY13	7.4%
FY14	7.4%
FY15	7.1%
FY16	8.1%
FY17	7.4%
FY18	7.6%
FY19	7.2%
FY20	8.2%

Quarter	Financial HH Savings (%)
Q1FY20	4.0%
Q2FY20	9.8%
Q3FY20	8.1%
Q4FY20	9.8%
Q1FY21	21.0%
Q2FY21	10.4%

Households have built financial savings due to lack of choice and have drawn from the same. If you interpose this with the data on the number of households who have slipped down into the bottom of the pyramid, the impact of the above is very uneven. It has been our consistent point that at some point, consumption will disappoint the rather linear expectations; at least in pockets. It is not our case that consumption will plummet. It is unlikely to do that in a country like India (even in the US, it was less volatile during the global financial crisis). Rather, our point has been that the market expectations have been for a perfect outcome, which may be at significant risk.

Source: RBI, Spark Fund Research

The market can and will tend to discount the impact and try to move on. The major negative is that the market has gone up so much over the last few months that it lacks the shock absorbers in an inherently tricky situation. Thar brings us to the question of how India stacks up against the rest of the world in terms of the market positioning.

India versus the Rest – Wading into a sweet spot

Here are key issues that will keep the markets occupied for the rest of this year, and maybe beyond:

Factor	US	Euro Zone	China	India	ROW	Impact for Indian Market
THE PANDEMIC	✓The worst is probably over	✓Still in the grip of the pandemic ✓UK is the exception	✓Largely unaffected	✓Entering the second wave ✓Exit prospects look good	✓EMs are badly positioned. Vaccine divide is for real ✓Look at Brazil, Mexico or South Africa	✓Neutral to mild positive
BOND YIELD IMPACT	✓Steep rise from here unlikely ✓Fed has no option but to print	✓Minimal impact so far ✓Testimony to how bad the Euro area is	✓Have moved in tandem with the US ✓China is geared to global markets	✓Indian Bond yields have never been very low ✓There is some rise but that is no news in India	✓EM currencies have fared better this time ✓Most EM economies are dependent on US and/or China	Neutral
Factor	US	Euro Zone	China	India	ROW	Impact for Indian Market

INFLATION	✓On the boil - a key risk ✓Demand and not supply driving inflation ✓US growth can surprise on the upside	✓If inflation picks up, it is stagflation then	✓China has too much supply to worry about domestic inflation	✓Inflation is not a new worry in India ✓India is better positioned than in 2013 ✓Growth cycle is just picking up and has miles to go before inflation trips the cycle	✓Could be a worry for many EMs ✓US growth is a bright spot	✓Neutral to mild positive
GROWTH	✓Positive outlook	✓Uncertain to negative outlook	✓Growth cycle is already showing some signs of fatigue ✓Structural problems back in focus	✓Growth outlook looks set to improve ✓Cycle is young	✓Mixed signals ✓Positive from US angle/Uncertain otherwise	✓Big positive
EARNINGS	✓No great drivers ✓Innovation/Tech the bright spots	✓Tepid	✓Upgrade cycle is largely behind us	✓Still in upgrade mode ✓Earnings outlook can improve further	✓No clear triggers	✓Big positive
VALUATIONS	✓Risk to expensive pockets emerging ✓Valuation debate is everywhere now ✓Interest rates can move up - No free lunch	✓No bubble ✓Apathy is the word given lack of growth	✓Market has already done well in the pandemic ✓Tech stocks are at some risk	✓Expensive in pockets ✓Reasonable in large measure	✓Differs on case to case basis	✓Mild negative - only in pockets
MARKET POSITIONING	✓Leverage is an issue ✓Markets are not well positioned for an inflation surge	✓Directionless ✓Can suffer collateral damage from other markets	✓In pause mode after a good 2020	✓Complacency due to the surge in the last few months ✓Can find support but at lower levels	✓To track US and China ✓Leverage risk is for real	✓Negative
FLOWS	✓Equities are well bid but few options left	✓Euro area resembles Japan of the 1990s ✓Between a hard and a rock place	✓Flows cooling off after a great 2020 ✓Structural problems pose headwinds	✓Foreign interest likely to remain robust. India remains an attractive destination ✓Lack of alternatives for domestic investors to keep equities well bid	✓Lackluster	✓Positive in the medium term

Source: Spark Fund Research

On balance, it is clear that the Indian market is well positioned looking ahead. While the risks are obvious and live, we reiterate that the growth outlook will carry the day and the same is likely to strengthen as we go into the rest of 2021. Markets are all about earnings and while the resurgence of Covid will ratchet up volatility, Indian equities are a clear Buy on dips.

Judging from the prospects of earnings, India looks a better buy in 2021 than at most points in the last five years. Minus the expensive end of the market, which to us carries multiple headwinds.

Warm regards,

P Krishnan (CIO) and Team Spark Fund
