

ETMarkets Smart Talk: Sampath Reddy sees value in select banks, metals, consumer & pharma sectors

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Synopsis

"Corporate earnings have had strong growth for the past two years in spite of the Covid-led slowdown by registering a growth of about 18% and 37% in FY21 and FY22 respectively. While the earnings growth estimates for the FY23 continue to be good at about 18-20%, there remains a concern about rise in inflation and interest rates."



*"We are finding relatively more value in select banks, metals, consumer & pharma sectors. With the economic recovery, we expect credit growth to gradually pick up and asset quality issues to be largely behind us," says **Sampath Reddy, CIO, Bajaj Allianz Life.***

ETMarkets Smart Talk

In an interview with ETMarkets, Reddy said: "The valuation premium of mid and small companies have corrected, at this juncture, we prefer larger companies as they have better capabilities to deal with cost inflation." Edited excerpts:

Sensex, Nifty50 have slipped below crucial support levels. What are the top 5 factors which are weighing on D-Street?

Markets globally are witnessing correction, including India for the last few months, due to persisting geo-political concerns and a sharp rise in inflation.

As economies have successfully recovered from the Covid impact, the demand has been on an upswing, which has led to the rise in inflation.

Supply-side constraints in commodities and sanctions on Russia have further escalated the inflationary pressures to a multi-year high.

These factors have resulted in the withdrawal of excess liquidity measures and a rise in interest rates, which are affecting the overall market valuations.

Corporate earnings have had strong growth for the past two years in spite of the Covid-led slowdown by registering a growth of about 18% and 37% in FY21 and FY22 respectively.

While the earnings growth estimates for the FY23 continue to be good at about 18-20%, there remains a concern about rise in inflation and interest rates.

Overall, higher inflation and interest rates and lower level of liquidity are having an impact on the valuations and a potential downgrade to earnings estimate.

Small & midcaps have already entered bear territory (down over 20% from highs). How should investors play this theme? Time to turn cautious or if someone plans to invest now what is the kind of time horizon that one should look at?

Yes, the mid & smallcap companies have also corrected slightly more than larger companies. Even though the valuation premium of mid and small companies has corrected, at this juncture, we prefer larger companies as they have better capabilities to deal with cost inflation.

We are entering a phase where central banks have started tightening monetary supply to deal with inflation, as a result of which there is a possibility of some demand slowdown and also cost of financing would be higher.

In that backdrop, larger companies will have a better ability to withstand, therefore from a short-term perspective, large-cap companies seem more attractively positioned compared to mid & small-cap companies.

Since the markets have corrected, we suggest that the investors should continue to stay invested and may allocate money systematically into the market.

As far as the time horizon is concerned in the equity market, investors with a 3 to 5 years time horizon, are better prepared to deal with short-term market volatility.

When will the market bounce back? Some experts say that a recovery in commodity prices could help markets recover. What are your views?

It is difficult to predict how and when the market will bounce back and recover from these levels. In the past selloffs, such as the one during the Covid pandemic in March/April 2020, and the recent market correction due to the Russia-Ukraine-led conflict, the markets have recovered sharply thereafter.

This correction, which we are witnessing now is largely driven by a hike in interest rates and withdrawal of excess liquidity. In this interest rate cycle, we are at the early stage of monetary tightening.

Hence, we could see some market volatility for a couple of more months. Historically, we have seen that it is a prudent thing to buy when there is a significant market correction or pullback.

Is the market expensive at current levels?

The corporate earnings have done exceptionally well in FY21 & FY22 and are also expected to do well in FY23. Based on the projected earnings for FY23, the market is trading around 18x PE.

Though market valuations have moderated due to recent correction, it is still trading above the long-term average. There is a possibility that it could further moderate in the near term.

Hence, this year could be moderate in terms of returns, but the long-term India growth story still remains intact.

Any rules which one should follow when selling a stock amid a double-digit fall seen in the Nifty50?

Investors should focus on investing in good quality companies at a reasonable valuation. They should have a disciplined approach and long-term orientation in terms of their investment portfolio.

In the case of investing in direct equity, investors should use funds that are not required in the near term.

It is also advisable for them to refrain from timing the market as that can be a difficult thing to do. Historically, investors who ended up buying in pullbacks have been rewarded well.

What is your call on the rupee? Will the currency continue its down move against the USD? Is FII selling related to currency depreciation?

Rupee has been a relative outperformer among EM and other Asian currencies over the past year. Given the way inflation and interest rates are rising and with significant FII outflows, we could see some depreciation in currency in the near term.

Normally, the rupee is expected to depreciate about 3% annually in the long term. At times, the currency movement could be bulky or more volatile based on the macroeconomic conditions and fund flows.

Also, with elevated crude oil & commodity prices and a rising current account deficit, it is expected that the rupee may be under some pressure in the short term.

Where are fund managers placing their bet as most stocks are available at a steep discount compared to a month back?

We are finding relatively more value in select banks, metals, consumer & pharma sectors. With the economic recovery, we expect credit growth to gradually pick up and asset quality issues to be largely behind us.

The banking sector has handled the asset quality stress well amidst the pandemic and has been supported by moratorium/liquidity measures. Most of the banks have also been very well capitalized to absorb any shocks, and valuations remain attractive for the sector.

The metals sector has benefited from a sharp rise in metal prices, which has helped drive profitability. Also, metal companies have been able to use this uptick in earnings to deleverage their balance sheets. With the economic recovery and capacity utilization picking up, we expect the CAPEX cycle to also gradually recover.

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