Time to play it safe

Increase exposure to defensive stocks. If you have the risk appetite, take contra calls

SANJAY KUMAR SINGH

The Sensex is down 3.4 per cent over the past month. Besides election-related uncertainty, the perceptible slowdown in several key segments of the economy is weighing on market sentiment. While private investment has been in the slow lane for some time, the recent slowdown in consumption has further compounded the economy's woes.

Consumption losing steam: Consumption has been slowing down for the past nine months, since the onset of the IL&FS crisis. This can be partly attributed to business cycles. The ongoing crisis in non-banking financial companies (NBFCs) has also contributed. NBFCs specialise in giving loans to the sub-prime segment that banks stay away from. "With NBFCs facing problems in obtaining funds, the availability of loans for consumption has declined considerably," says Abheek Barua, chief economist, HDFC Bank.

The rural economy is facing distress. Low prices of agricultural produce have translated into lower realisations for farmers. This is getting reflected in weaker rural demand. The real estate sector, which was heavily dependent on NBFCs for developer funding, is also facing a funds crunch.

Lower government spending: The slowdown has accelerated over the past couple of months with the government too cutting back on spending. "Government expenditure has been curtailed because it fell short of its revenue targets and hence needs to spend less to maintain fiscal discipline," says Barua.

The elections, too, have contributed. Prior to a general election, both investment and big-ticket consumption decisions tend to get postponed. Also, a lot of liquidity used to be pumped into the system during past elections. Experts say this phenomenon was not witnessed to the same extent during this election.

Experts also attribute the current slowdown to the wealth affect. Gold and real estate have not performed for over six years. Equities, too, have faltered over the past year. "When a person's portfolio is not doing well, he tends to feel poorer even though his regular income may have remained unchanged," says Jatin Khemani, founder and CEO, Stalwart Advisors, a Sebi-registered independent equity research firm. Such a person may trade down (buy a product, such as a car, of lower value) or defer the purchase altogether.

Sectors to buy from: Expert believe infrastructure could be a good bet as valuations are not expensive and any incoming government is likely to provide a fillip to this segment. Chemical companies, too, have sound prospects. "Many Indian players will gain due to China enforcing strict pollution and effluent treatment norms," says Dilip Bhat, joint managing director, Prabhudas Lilladher.

Pharma's prospects have turned attractive as valuations have come off, and the US Food and Drug Administration (USFDA)-related problems are largely behind the sector. Experts believe it will be able to weather the current storm around price fixing. Bhat suggests investing in companies with a sound mix of domestic and international business.

CONSUMPTION-ORIENTED STOCKS HAVE TAKEN A HIT

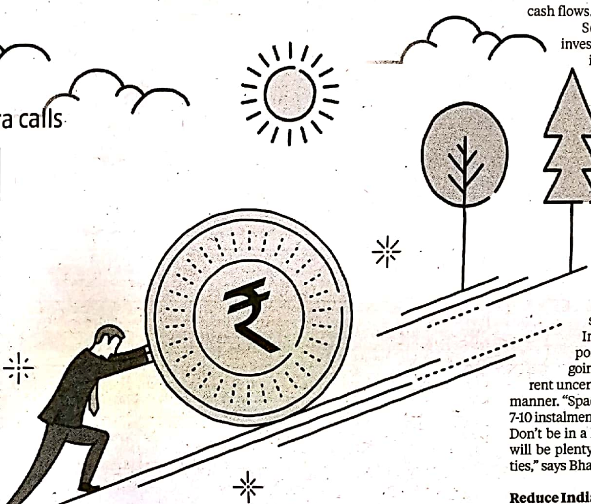
Stocks	Return-1 month (%)
Motherson Sumi Systems	-26.0
Tata Motors	-23.3
Apollo Tyres	-17.9
Ashok Leyland	-12.2
Amara Raja Batteries	-10.8
Bharat Forge	-10.7
Mahindra & Mahindra	-10.0
Godrej Industries*	-15.0
Avenue Supermarts	-12.7
Apollo Hospitals	-10.4

List includes stocks from auto, auto ancillaries, FMCG and consumption indices that have fallen more than 10%

Note: Motherson Sumi, Apollo Tyres, Amara Raja and Bharat Forge are included here as they sell to auto makers, which are under pressure

*Godrej Industries has large shareholding in Godrej Consumer Products, Godrej Properties, Godrej Agrovet and other group companies

Source: Exchanges



Two sectors that could be good contrarian bets are capital goods and fast-moving industrial goods (consumables used in industrial activity). Valuations are reasonable and earnings growth could revive over the next couple of years. Over the past six-seven years, there was hardly any private capex (only government capex happened), as excess capacity had been created between 2004 and 2012. In several industries capacity utilisation is at 75 per cent now. Companies will start undertaking new capex once it crosses 80 per cent. "Capital goods companies could start doing well from 2020 onwards. As manufacturing picks up, the consumables used in manufacturing will also gain," says Khemani.

According to Joseph Thomas, head of research, Emkay Wealth Management, selectively picked stocks from banking and financial services, information technology and consumption sector should be a part of long-term portfolios. Rajeev Thakkar, chief investment officer, PPFAS Mutual Fund believes there are opportunities in the auto sector. "Select opportunities have become available there after the recent correction," he says.

Sectors to avoid: Experts are wary of NBFC/HFC stocks, despite the recent fall in their prices. "Barring four-five quality names, be wary of the rest as they are over-dependent on the wholesale market and their asset quality could be suspect," says Thakkar. He also recommends staying away from expensive FMCG stocks. Thomas favours avoiding real estate, which has been plagued by high inventory and low demand for several years, and is yet to bottom out.

Stick to stocks with cash flows: Amid the tight liquidity conditions prevailing now, avoid investing in leveraged companies, which will find it difficult to roll over their debt or get access to cheap credit. Invest in companies with healthy cash flows.

Some experts suggest investors would be better off taking a bottom-up approach. "Look at the stock first and then at the sector," says G Chokkalingam, founder, Equinomics Research and Advisory. He suggests looking for stocks outside the benchmark indices. "Some smaller companies are still doing well even though their sector is not," he adds.

After the downturn in mid- and small-caps since January 2018, experts say there is more value in this segment than in large caps. Investors may add to their positions here, but without going overweight. Amid the current uncertainty, invest in a staggered manner. "Space out your investment into 7-10 instalments over the next few months. Don't be in a hurry to buy because there will be plenty of investment opportunities," says Bhat.

Reduce India-specific risk: A few steps can help you reduce the impact of a slowing economy on your portfolio. "Take exposure to international funds to the tune of 15-20 per cent of your equity portfolio, as different markets slow down at different times and to different extent. Exposure to IT and pharma, which derive income from abroad, also reduces India-specific risk. Vice stocks (say, of cigarette companies) also tend to be resilient during slowdowns," says Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors. Finally, investors who don't want to take the risk of going wrong on their sector and stock choices during this phase of slowdown may opt for a large-cap index fund or exchange traded fund to the tune of 25 per cent of the domestic equity portfolio.