ITI Mutual Fund

Long-term wealth creators

Insights

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GEORGE HEBER JOSEPH

CEO & CIO, ITI Mutual Fund

"India's earnings growth trajectory could see some moderation in the next two quarters. Consumer facing sectors such as FMCG, durables, autos, building materials and energy intensive sectors like cement are likely to see margin pressures due to high raw materials and energy costs. However, banks, oil and gas, IT, industrials, power and metals should see decent earnings growth. Thus, despite adverse macros, earnings growth trends are likely to remain healthy.

High inflation results in lower economic growth which in turn reduces demand for energy and commodities, bringing inflation down. Thus, while next few months can be challenging, it is worth remembering that world is not short of oil or other forms of energy. India, with a balanced economic structure between consumption, investments and exports, remains best placed to take advantage of this.

India is well placed to benefit from global inflation in Agri-commodities with surplus food stocks with FCI and good agricultural production. Rising global prices of Agri- commodities can give a boost to rural India. The resultant rural buoyancy can then trickle down to urban India through higher economic activity.

India's capex cycle is expected to revive after a decade-long period of low growth. Government schemes such as PLI, developed world looking at diversifying sourcing away from China, improved balance sheet strength of India's corporate and banking sector, increased indigenisation of our defence sourcing and India's strong and large domestic market would continue to support the higher capex trend."

Dear Partners/Investors,

Equity Market Outlook

We believe the correction in the Indian market over time (time correction) rather through lower prices (price correction) may get belied given (1) aggressive lift-off and quantitative tightening policies of central banks and (2) change in expectations of retail investors. Valuations are still high. However, higher interest rates are largely in the price and inflation will start declining (simply due to high base effect). Higher-than expected oil price remains one big risk to the market now. The sharp increase in global and domestic bond yields over the past few weeks would suggest that bond markets are generally pricing in elevated inflation and higher interest rates even as several developed markets and emerging markets', central banks have finally started raising rates and reducing liquidity to counter high inflation. This is especially true both for the US and India given the large gap between bond yields and policy rates.

We expect domestic inflation to start tapering down in the second half FY23 once base-effect starts kicking even as prices may stay at elevated levels due to continued global and domestic supply-side issues. We do not see large demand destruction in India from moderate interest rate increases. Lastly, domestic bond yields may be peaking unless oil prices were to surprise massively on the upside. India can get away with another 70-100 bps rate increase even at oil at US$120/bbl.—policy rate of 5.25-5.5% (current 4.4%) and end-FY2023 inflation at 4.5-5% is not a bad outcome. However, higher-than-expected oil prices pose upside risks to inflation as we had discussed in our April 24, 2022, report, Oil over troubled waters.

In our view, a combination of low returns from the market (if the market was to stay flat or decline) and higher fixed deposit rates over the next few months may shake the faith of retail investors in equities. Retail investors have been impervious to high market valuations and rising bond yields, with return expectations anchored by historical high returns and 'risk' expectations by low fixed deposit rates. Both may change as we had discussed in our April 13, 2022, report - The 'gap' between bond yields and policy rates. Retail investors' inflows via domestic MFs have offset outflows of FPIs. The two sets of investors have had different expectations of market returns and cost of money so far.

Indian economic Scenario

Indian economy is relatively better placed to weather these tough macro-economic conditions.

- With Crude oil at around USD 100/barrel, Current account deficit for FY23 is likely to be around 3% of GDP, much lower than the 4.5% levels seen in FY12-13.
- External debt levels remain low. Forex reserves are strong and adequate to meet the projected CAD and external debt payments.
- Tax collections are strong and rising.
- Fiscal deficit, though higher than pre-Covid levels is oriented towards higher capital expenditure.
- Inflation differentials between India and developed world are much lower than the levels seen in FY12/13

Thus, while interest rates are likely to rise, the degree of liquidity tightening is likely to be much lower than seen in the previous periods of high oil prices.

Investing environment prevailing

Post Covid – Supply Chain disruptions – still prevailing

Energy Shock because of Ukraine- Russia war – expect to mellow down over next 1 year

Inflation going up – Probably the base effect to kick-in from 2023

Bond Yields – Probably lot of negatives are in the price

Equity Market Valuation (India): Still expensive, P/B @3.22x trailing and P/B @2.89x (1 year forward)

The investing backdrop is filled with uncertainty. Just as the global economy is looking to emerge from pandemic malaise, an outrageous war has applied new pressures to a global system that was looking to normalize interest rates and process the effects of the highest inflation seen in decades.

Intraday market volatility has been dramatic and stock selling has become indiscriminate and therefore the prevailing backdrop highlights the importance of building resilience into portfolios. We believe this is best achieved through diversification and a focus on quality — particularly stocks of companies with strong balance sheets and healthy free cash flow characteristics.

The virtues of an active approach to both stock selection and risk management can be most evident at times of significant market disruption.

Amid the uncertainty, one thing we feel relatively certain about is that we are exiting the investing regime that had reigned since the Global Financial Crisis (GFC) of 2008. That was marked by low to moderate economic growth, alongside low inflation and interest rates. The new environment is still taking shape but will undoubtedly entail higher inflation and rates than we knew from 2008 to 2020.

We see stock selection becoming more important as companies navigate higher inflation and rates with varying degrees of agility. Stock dispersion, a measure of the potential risk/return outcomes for individual stocks, already sits well above its average since the GFC.

Higher inflation than the roughly 2% we knew before the pandemic will challenge companies' cost structures. Investors must discern which companies are most impacted by rising costs, and which have the pricing power to pass those higher costs through to consumers and maintain their profit margins. From there, the question is how much of this is (or is not) reflected in stock prices.

How to think of Indian markets at current juncture?

India's earnings growth trajectory could see some moderation in the next two quarters. Consumer facing sectors such as FMCG, durables, autos, building materials and energy intensive sectors like cement are likely to see margin pressures due to high raw materials and energy costs. However, banks, oil and gas, IT, industrials, power and metals should see decent earnings growth. Thus, despite adverse macros, earnings growth trends are likely to remain healthy.

High inflation results in lower economic growth which in turn reduces demand for energy and commodities, bringing inflation down. Thus, while next few months can be challenging, it is worth remembering that world is not short of oil or other forms of energy. India, with a balanced economic structure between consumption, investments and exports, remains best placed to take advantage of this.

India is well placed to benefit from global inflation in Agri-commodities with surplus food stocks with FCI and good agricultural production. Rising global prices of Agri-commodities can give a boost to rural India. The resultant rural buoyancy can then trickle down to urban India through higher economic activity.

India's capex cycle is expected to revive after a decade-long period of low growth. Government schemes such as PLI, developed world looking at diversifying sourcing away from China, improved balance sheet strength of India's corporate and banking sector, increased indigenisation of our defence sourcing and India's strong and large domestic market would continue to support the higher capex trend.

Sector preferences

We believe the sectors which can do well in this kind of macro construct have to be divided into two buckets - Aggressive sectors and Defensive sectors. Within Aggressive sectors, we think - Banks & Financials, Auto & Auto Ancillaries, Capital Goods & Engineering and Select Commodities can do well, whereas in the case of Defensive sectors: Pharmaceuticals & Healthcare, select consumer durable stocks can do reasonably well. So, if you look at our preference list, it has not changed pre-war to post-war kind of scenario, mainly because, the stocks are fitting into our SQL investment philosophy i.e. Stocks where margin of safety is higher, Quality of the business is good and at the same time having low leverage. We see a possibility of USD INR depreciation possible and therefore in the near to medium term, all INR depreciation beneficiaries look attractively positioned which includes IT and Pharma sectors. Most of the stocks in the sector has corrected also in the recent past, so provides some upside but will stick to large cap oriented companies in these sectors.

As part of our analysis, we look for companies with unique products or services, durable cost advantages, or that operate in consolidated and rationale industry structures. We think businesses selling labour-saving equipment and technology will benefit as companies seek to offset higher wages. Software solutions and some industrial equipment are two potential beneficiaries.

Value Theme can come back roaring in the next 5 years

Inflation has implications for both the overall level of the market and for market internals, particularly the value versus growth debate. Value stocks have dominated so far this year as rising rates weighed on growth stocks. Growth stocks are considered long duration because their cash flows are realized further into the future. Higher rates drag on the present value of these future cash flows. Value stocks, meanwhile, are shorter duration with cash flows that are front-end loaded — capital is returned to shareholders earlier in the investment lifecycle.

The period of extremely low interest rates was very good for growth stocks — and very challenging for value investors. The road ahead is likely to be different, restoring some of the appeal of a value strategy.

How are we positioned in our funds?

With macro situation being very dynamic and volatilities across asset classes increasing, we have adopted a more sector-neutral approach and broad based our portfolios. We are more focused on stock selections within the sector rather than trying too overweight / underweight sectors. The focus continues stock selection on a bottom-up basis anchored on our SQL Investment philosophy.

What should be your approach while investing into our Mutual Fund Schemes?

The macro-outlook is likely to remain challenging over the next few months. While markets have seen some correction in the last four months, valuations have not yet entered the attractive territory. Also, there is wide divergence in valuations of different sectors.

Investors wanting to invest in lumpsum ideally can invest in ITI Balanced Advantage Fund. More conservative investors can use the ITI Conservative Hybrid Fund, which can potentially give better returns than traditional savings products and with much lower volatility than that of equity or aggressive hybrid funds.

Investment in equity funds, particularly mid and small cap categories, should be done systematically over the next six months in the form of daily / weekly STPs or SIPs.

In debt category, ITI Dynamic Bond Fund is our flagship fund and more suitable for our investors to park the money from a medium to long term perspective. We believe this category can generate good inflation beating Risk adjusted returns which can be interesting for investors in the debt category. It is ideally positioned to take advantage of the volatility in debt markets.

Our Investment Philosophy – SQL

Based on our combined investment learnings of more than 50 years, we have institutionalized very strong and unique investment philosophy -SQL, which is core to our fund management framework and approach to our portfolios.

We strongly believe that good quality (Q), low leverage companies (L) bought with a reasonable good margin of safety (S) makes the investment very attractive and rewarding for our investors.

Investment Philosophy	Equity	Fixed Income
S	Margin of Safety	Safety
Q	Quality of the Business	Quality of the Business
L	Low Leverage	Liquidity

Our Risk Management Framework

Our risk management framework & our unique investment philosophy are well thought-out and institutionalised to generate superior investment performance and creating a smooth investment experience for all our investors. They are framed based on our own investment experience and also imbibed learnings from some of the great investment houses and investment managers globally, which will stand the test of time and keep our investors interest at high standards. We have put risk limits based on fund mandates, market cap segments, sectors and stocks.

Debt Market Outlook

- The US Fed expectedly increased policy rates by 0.5% in May 2022 and indicated additional 50-bps (100 bps = 1.0%) moves for the next couple of meetings. Furthermore, the Fed also announced its balance sheet runoff to commence from June and reach the maximum runoff pace of USD 95B from August.
- The European Central Bank (ECB) left its main rates unchanged in April 2022, but saw a growing consensus for a 25-bps rate increase in 3Q CY2022.
- The RBI surprised the markets on the eve of the US Fed FOMC May 2022 meeting, by not only raising the policy repo rate by 40-bps but also by increasing the cash reserve ratio (CRR) by 50 bps in an inter-meeting monetary policy committee (MPC) decision.
- Post the surprise inter-meeting action of the RBI, expectations of further front-loaded repo rate hikes over the coming few meetings have increased. As against our earlier base case of the India's policy repo topping around 5.0%, we now foresee a peak repo rate of 5.5% over the next 18 months.

A restrictive Fed policy which can take the Fed's benchmark rate above 2.0% - 3.0% neutral remains a risk and this would warrant a 50 bps increase in the repo rate to our base case forecast.

- Indian rates markets have largely factored the tail risk from a potentially restrictive Fed policy and we do not foresee the need to materially change our outlook and return expectations.
- In line with our outlook, the debt schemes of ITI Mutual Fund have been maintaining a low duration over a considerable period of time and we have benefitted from this positioning. The bumpiness experienced by markets over the past few months has further vindicated our view that actively managed strategies are better poised to navigate the expected volatility over the coming few years. Our duration funds remain well positioned to take advantage of evolving market conditions and continue to aim to deliver inflation adjusted real returns in these products.
- We continue to like front-end (2-4 year) bonds from an accrual perspective and see relative value in sovereign bonds as compared to high grade credit.

Investors are requested to review product labels for respective schemes which are provided below at the time of Investments.

Product Labelling

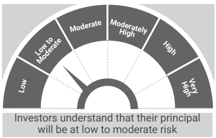
Scheme Names	This Product is suitable for Investors who are seeking^:	Riskometer of the Scheme	Benchmark Name	Riskometer of the Benchmark
ITI Long Term Equity Fund	– Capital appreciation over long term – Investment in equity and equity related securities.		Nifty 500 TRI	
ITI Multi Cap Fund	– Long-term capital growth – Investment in equity and equity-related securities of companies across various market capitalization		Nifty 500 Multicap 50:25:25 TRI	
ITI Large Cap Fund	– Capital appreciation over long term – Investment in portfolio predominately consisting of equity and equity related instruments of large cap companies.		Nifty 100 TRI	
ITI Mid Cap Fund	– Capital appreciation over long term – Investment in a diversified portfolio predominantly consisting of equity and equity related instruments of mid cap companies.		Nifty Midcap 150 TRI	
ITI Small Cap Fund	– Capital appreciation over long term – Investment in a diversified Portfolio which predominantly consists of equity and equity related instruments of small cap companies.		Nifty Smallcap 250 TRI	
ITI Value Fund	– Capital appreciation over long term – Investments in portfolio predominantly consisting of equity and equity related instruments by following a value investment strategy.		Nifty 500 Total Return Index	
ITI Pharma and Healthcare Fund	– ITI Pharma and Healthcare Fund – Investments in equity and equity related securities of companies engaged in Pharma and Healthcare.		Nifty Healthcare TRI	
ITI Banking and Financial Services Fund	– Capital appreciation over long term – Investments in equity and equity related securities of companies engaged in banking and financial services.		Nifty Financial Services TRI	
ITI Balanced Advantage Fund	- Capital appreciation while generating income over medium to long term - Dynamic Asset allocation between equity, equity related Instruments and fixed income instruments so as to provide with long term capital appreciation.		Nifty 50 Hybrid Composite Debt 50:50 Index	
ITI Arbitrage Fund	- To generate income by predominantly investing in arbitrage opportunities - Investments predominantly in arbitrage opportunities in the cash and derivative segments of the equity markets and the arbitrage opportunities available within the derivative segment and by investing the balance in debt and money market instruments.		Nifty 50 Arbitrage Index	
ITI Conservative Hybrid Fund	- Capital appreciation while generating income over medium to long term - Investments in debt and money market instruments and equity and equity related securities.		Nifty 50 Hybrid Composite Debt 15:85 Total Return Index	

^Investors should consult their financial advisers if in doubt about whether the product is suitable for them.

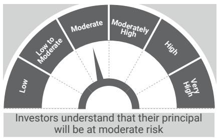
ITI BANKING & PSU DEBT FUND: This product is suitable for Investors who are seeking^:

- Regular income over short to medium term
- Investments in debt and money market instruments, consisting predominantly of securities issued by Banks, Public Sector undertakings, Public Financial Institutions & Municipal Bonds.

Scheme Riskometer



Benchmark Riskometer: "CRISIL Banking and PSU Debt Index"



Potential Risk Class Matrix

Credit Risk of Scheme → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)	A-III		

ITI DYNAMIC BOND FUND: This product is suitable for Investors who are seeking^:

- Regular income over medium to long term
- Investment in Debt and Money Market Securities with flexible maturity profile of securities depending on the prevailing market condition.

Scheme Riskometer

Benchmark Riskometer: "CRISIL Dynamic Bond Fund AIII Index"

Potential Risk Class Matrix

Credit Risk of Scheme → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)	A-III		

ITI OVERNIGHT FUND: This product is suitable for Investors who are seeking^:

- Regular income with low risk and high level of liquidity
- Investment in money market and debt instruments with overnight maturity

Scheme Riskometer

Benchmark Riskometer: "CRISIL Overnight Fund AI Index"

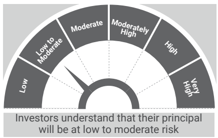
Potential Risk Class Matrix

Credit Risk of Scheme → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)	A-I		
Moderate (Class II)			
Relatively High (Class III)			

ITI LIQUID FUND: This product is suitable for Investors who are seeking^:

- Income over short term.
- Investment in money market and debt instruments.

Scheme Riskometer



Benchmark Riskometer: "CRISIL Liquid Fund AI Index"

Potential Risk Class Matrix

Credit Risk of Scheme → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)	A-I		
Moderate (Class II)			
Relatively High (Class III)			

ITI ULTRA SHORT DURATION FUND: This product is suitable for Investors who are seeking^:

- Regular income over short term
- Investments in debt and money market instruments, such that the Macaulay duration of the portfolio is between 3 months - 6 months.

Scheme Riskometer

Benchmark Riskometer: "CRISIL Ultra Short Duration Fund AI Index"

Potential Risk Class Matrix

Credit Risk of Scheme → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)	A-II		
Relatively High (Class III)			

The riskometers are based on the Scheme portfolios as on April 30, 2022. For more details, please refer to the respective Scheme Information Documents.

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Disclaimers

All figures and data given in the document are dated unless stated otherwise. In the preparation of the material contained in this document, the AMC has used information that is publicly available, including information developed in-house. However, the AMC does not warrant the accuracy, reasonableness and/ or completeness of any information.

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Mutual Fund investments are subject to market risks, read all scheme related documents carefully.