Insights

December 2021

"The big money is not in the buying or the selling, but in the waiting."
– Charlie Munger

GEORGE HEBER JOSEPH
CEO & CIO, ITI Mutual Fund

"The economic construct is looking very similar to the decade 2000-2010 period where the big economic growth happened because of the domestic economy doing well. So, our bet is that domestic economy will do very well relative to global sectors from hereon. Most of the global sectors apart from Refining stocks are trading at peak valuation & spreads which we have never seen before. Therefore our bets have moved to domestic oriented sectors than global sectors.

We believe domestic economy to do well and is coming out of a multi-year (14 years) slump in growth. This will mean earnings growth in the listed space is going to be very strong in the coming years. This is going to be the biggest differentiating factor relative to the past decade. As Nifty50 earnings compounds at >20% CAGR then markets will turn cheaper by day. In the previous decade i.e. 2010-2020 the only game in town was valuation, when valuation of the market was high, "sell" and when valuation is cheap, "buy" the market. I think there is a clear shift here which we need to realise. Last decade there was no earnings growth acceleration and therefore corporate profits to GDP went down towards 2% same like the year 2000-02 periods."

Dear Partners,

Happy New Year to you. Hope you and your family members are in good health. Thank you for your wonderful contributions in all our funds.

What transpired in the last one month?

Covid-19 again resurfaced across the world, unlike second wave this time the fatality rate is low and even hospitalisation requirements are minimal, moreover people are used to tests and masks and it is becoming a part of our daily routine. So, this time the panic seems relatively less.

How can CY2022 pan out in markets?

- We believe that in CY'22 Broad Based Indices like Nifty50 Index can potentially generate more than 15% return mainly looking at the earnings growth trajectory.
- **We saw IPO frenzy in the last one year. Looking at the IPO craze and the way investors were punting on loss making companies ignoring the fundamentals doesn't gel well with our investment philosophy. The biggest IPO is yet to come.**
- **Highest ever retail participation in history, not only in India, even globally. As long as Covid stays, people have lot of free time and this is going to continue.**
- **<u>We are extremely positive on the capex cycle recovery in the country and greenshoots are visible. So, this is the time to go overweight on infrastructure related sectors and also it is the time to invest in banking sector as well.</u> When the underlying sectors to which Banks are exposed to start doing well on a structural basis the sector should do well. After almost a decade of downturn in the cyclical sectors like Real Estate, Commodities, Construction, Engineering, Industrial Products and Power utilities companies, all these sectors started reviving and NPA issues of large banks are behind. So, this is the most appropriate time to have higher exposure in the Banking sector and Infra oriented funds.**
- If we look at market situations in the last few decades, there are sectors which have been favoured by the markets in each decade. At the start of the decade, those sectors /stocks were significantly undervalued and at the fag-end of the decade, those sectors/stocks went into massive over valuation zone or bubble valuations. For eg: In the early '90s, technology sector was a nascent sector and was trading below single digit P/E multiple but by the start of the year 2000, they became significantly overvalued and started trading at triple digit P/E in many cases. In Jan'00 even if you had invested into blue-chip technology stocks in IT sector, even after 20 years, i.e. as of 2020-21, the investments would have underperformed Sensex/Nifty50 Indices by a wide margin. What it clearly denotes is that we have to be mindful of market cycles, business cycles and valuations of various sectors to capture the upside and outperform the markets.
- If we go and buy the stocks or an asset class at the peak of the cycle, the experience would be terrible in markets. Most of the time investors come and invest at the peak valuations when IPO craze is on, valuation of the sector is at the peak or past performance of the sector/asset class is exceptionally good.
- US Federal Reserve has done massive Monetary easing over the last decade and also the money printing US has done in the last 2 years is at unbelievable pace, both these reasons have opened the flood gates of liquidity. When such easy liquidity flow is at unimaginable scale, which started flowing into various asset classes, countries, sectors and stocks and that situation has made a significant aberration to the paradigm of risk and valuation. Last month US Federal Reserve has

announced that the tapering of liquidity is going to happen at a faster pace and the accommodative stance will end by Feb'22, this is a big impactful newsflow. The liquidity that the market was enjoying all through this while is not going to be there from Feb'22 onwards and moreover rate hikes are going to happen.

- Few sectors which were looking very attractive in Mar'20 have moved into expensive zone. So, from end of Jun'21 onwards, we started re-positioning our funds by booking profits from expensive sectors and adding weights to relatively attractive sectors like Consumer Goods, Auto & Auto Ancillary sector, Pharmaceuticals, Oil & Gas and Mid/Small Cap Banks. This has not worked in our favour as the recovery in the economy that we expected didn't happen because of the Covid coming back. In the market correction which happened in last couple of months, all the value stocks that we were holding, corrected along with other expensive stocks as the sentiment was already bad and no buyers were emerging for these attractively valued stocks/sectors. So, with low volumes, these stocks were dropping and has affected the near term performance of our funds. We have made some changes in the fund 1) Moved from small/midcap banks to large banks. 2) shifted weights from Consumer goods to Capital Goods/Engineering/Real Estate stocks. So, the strategy remains intact and we do expect in the next 6 months, most of our funds should come back smartly relative to the market and peer group. Therefore, I would urge all our investors to believe in our investment philosophy and invest into our funds.

<u>When to be worried about markets?</u>

When the earnings growth comes in full swing for many years and on top of it, if the valuations are looking expensive then we should be vary about the markets. Corporate profits improvement cycle has just started and has a long way to go, so this is not the time to be structurally bearish on markets. We are constructive on markets mainly because the earnings growth is 24% YOY in the last quarter and it has been improving consistently for last 5 quarters.

How do you pick stocks and construct the portfolios?

- We are bottom-up investors and we rarely care about the markets in general. We run equity oriented portfolios with more than 90% of AUM invested in stocks. So, we hardly take cash calls unless we see extreme market environments. As we speak, most of our funds are fully invested funds and we keep thinking whether the stock picks meet our SQL investment philosophy or not, if so, we are quite comfortable to hold on to those stocks and sectors.
- Attractive valuation, good quality businesses and low leverage bets are the ones we like in general while picking stocks. When valuation goes out of whack in some sectors, then we are very cautious on those sectors from medium term perspective because we know that as fund managers we have control only on two things 1) our buying price or valuation of the companies in which we bet on 2) analysing the quality of the business models and ascertaining the margin of safety. All other things that happen in the market are fluid or uncertain and not in our control.
- Whenever market starts pricing in 3 years and beyond, the chances of disappointments in the near term are higher in those sectors where the valuations are capturing even 3 years forward earnings growth, so we take a back seat in those sector exposures. We keep trimming exposures to sectors which are expensive in nature and doesn't meet our investment criteria, this means we would be away from crowded trades or momentum sectors which may cause underperformance in the near term, especially when the market is at an inflexion point.

Small Caps/Midcaps – More careful selection of stocks is critical

Whenever there is an uptick in the economy and earnings growth rebound is seen, small cap and midcap companies benefit more than large cap companies. They peaked around December 2017 and from 2018 onwards they were in a bearish cycle till about September 2019. We have been bullish on Mid & Small Cap space from October 2019 onwards which we have mentioned in our Oct'19 factsheet. Since then, we have been consistently communicating the same thing and can be seen in our factsheet commentaries & also from the con-calls that we have done with our partners. From June'21 onwards we have been communicating through our calls and factsheet that you need to put money into Midcap and Small cap funds of ours by way of STP or SIP only.

We are quite positive on the market outlook from a long term perspective. Yes, there can be significant corrections in the markets which are part and parcel of a bull market. It is difficult to time them. But after a big run up, generally market cools off and that can be brutal as well.

We see a clear Capex revival opportunity in India after a very long time. Most of the capex indicators had peaked between 2008 to 2010 period and have been moving down. We expect a good pick up in real estate and believe all four engines of Capex cycle picking up in India i.e. Government Capex, Private corporate Capex, Real Estate picking up and Exports, all are firing together this time and therefore we believe this is going to be a full blown capex cycle revival that India is going to witness. That gives a very good opportunity to pick up companies or sectors that are benefitting from the capex cycle revival. Good part is the earnings is suppressed because of the lacklustre growth in the previous decade and therefore looking at P/E multiple could be misleading while picking the stocks. Price to Sales or Price to Book value multiple could be a better valuation multiple in this context.

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, this is core to our fund management framework and approach to our portfolios.

We strongly believe that good quality (Q), low leverage companies (L) and 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.

Equity Market Outlook

- When inflation is moving up, it is good for real assets like real estate sector. I do expect physical real estate prices also to inch up because of demand growth and also the underlying costs of materials also moving up. Real Estate sector would drive demand in steel, cement, consumer goods, construction activity picking up etc. Real estate being the second largest employer in the country when it starts picking up, we believe they will have massive multiplier effect on the economy and GDP.
- The economic construct is looking very similar to the decade 2000-2010 period where the big economic growth happened because of the domestic economy doing well. So, our bet is that domestic economy will do very well relative to global sectors from hereon. Most of the global sectors apart from Refining stocks are trading at peak valuation & spreads which we have never seen before. Therefore our bets have moved to domestic oriented sectors than global sectors.
- We believe domestic economy to do well and is coming out of a multi-year (14 years) slump in growth. This will mean earnings growth in the listed space is going to be very strong in the coming years. This is going to be the biggest differentiating factor relative to the past decade. As Nifty50 earnings compounds at >20% CAGR then markets will turn cheaper by day. In the previous decade i.e. 2010-2020 the only game in town was valuation, when valuation of the market was high, "sell" and when valuation is cheap, "buy" the market. I think there is a clear shift here which we need to realise. Last decade there was no earnings growth acceleration and therefore corporate profits to GDP went down towards 2% same like the year 2000-02 periods.
- Factors of production are reasonably placed, capital cost is low as interest rate is low, land prices have corrected relative to 2013 levels, and labour cost is also reasonably placed (post Covid/Demon/GST/RERA many have lost jobs in the unorganised sectors). Incentive schemes from the government in the form of production-linked incentives, Athmanirbhar packages for SMEs, manufacturing base shifting from China to other parts of the world including India are very positive developments for increasing our manufacturing base. This also would help in job creation.
- 2020-2030 decade, we are ready to bet on India's domestic economy doing well, earnings growth to accelerate, capex cycle boom to happen in full swing after a long wait, infra / capital goods / Engineering / Industrial products / Utilities / Construction / discretionary consumption / Corporate Banks to do well in this kind of environment.

Currently our portfolios are positioned towards cyclical recovery beneficiary sectors like Large Banks, Engineering & Cap goods sector, Real Estate, Auto, Auto Ancillary etc. and within defensive sectors, we like Pharmaceuticals & Healthcare as the sector is coming out of a lull period after 5 years of bad business performance.

Cyclical sector stocks are trading at cheap valuations across market capitalisations where we see earnings growth to accelerate and valuation multiples to re-rate. Most of our funds are positioned to capture this opportunity.

Volatility is going to be there in the near-term as people are confused and emotional swings will happen and that is part and parcel of the markets, but the broad market trend is upwards with a 5 year view. In between, we may see air-pockets which will be opportunities to invest aggressively.

Our message to all investors is that please don't miss this excellent opportunity to create long term wealth and invest in every big dip by way of lumpsum or put money systematically over next 5 months. We urge all our partners to practice asset allocation and systematic investment planning for

the benefit of your investors' long term wealth creation.

At this current juncture, we believe that ITI Multi Cap Fund, ITI Long Term Equity Fund, ITI Balanced Advantage Fund, ITI Value Fund are suitable for LUMPSUM investments in equity funds category. To give a kicker to the overall portfolio from a long term perspective, LUMPSUM investments into ITI Pharma and Healthcare Fund and ITI Banking and Financial Services Fund *(Both the sectors have underperformed the market in the last 18 months)* and Infra theme can provide a good experience to investors with >5 years investment horizon.

In ITI Mid Cap Fund and ITI Small Cap Fund, we believe SIP/STPs route (6 months period) is the most logical approach to have.

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 return which can be interesting for investors in the debt category.

If you are concerned about the markets and don't know what to do, then you can put money into ITI Balanced Advantage Fund on a Lumpsum Basis. This fund is doing well in the market place and can automatically adjust to market situations, capture the volatility and generate returns by investing into debt and equity on a dynamic allocation basis. So, this is a very good asset allocation solution product that we already have and is getting established in the market place. You don't need to bother about market timing because the fund takes care of all. You can just focus on your work and "MAX YOUR RELAX" by investing in the ITI Balanced Advantage Fund.

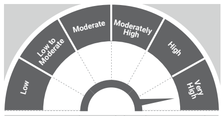
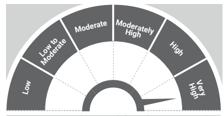
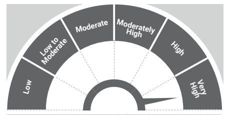
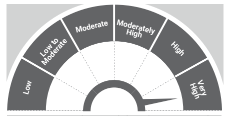
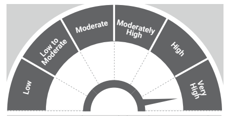
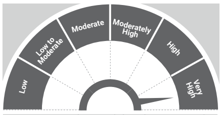
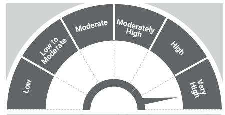
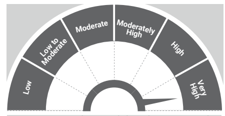
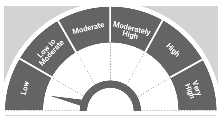
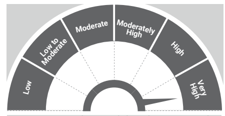
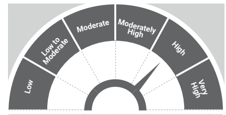
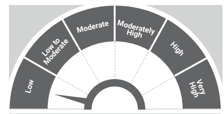
We are working on a product in the Conservative Debt Hybrid category which can provide a very unique value proposition to investors who are looking to make inflation beating returns with very limited volatility.

Debt Market Outlook

- In the Dec 2021 FOMC meeting, the US Fed kept the benchmark Fed Funds rate unchanged at 0.00% - 0.25%. Moreover, the Commi ee decided to double the pace of tapering; thereby indicating an end to the Fed's bond purchase program by March 2022.
- The FOMC commi ee's latest dot plot indicate 3 rate hikes in 2022, 3 hikes in 2023 and 2 hikes in 2024, with the likelihood of the first rate increase in 2Q2022. However, markets expect the Fed policy rate to peak lower around 1.5% and perceive the current rate increase cycle to be fast but shallow.
- We are seeing a situation where global central banks are reducing the COVID-19 led stimulus even though the economic outlook remains uncertain and labour market conditions remain "perplexing".
- The RBI expectedly maintained the policy repo rate at 4.0% in the Dec 2021 MPC meeting. Markets were divided on an increase in the reverse repo rate, and recent surge in the OMICRON variant infections may have prompted the Central Bank to keep the reverse repo rate unchanged. Furthermore, the RBI communicated its intent to predominantly resort to the variable rate auction route to control liquidity. This measure will allow the RBI to "anchor the effective policy rate" and thereby ensure the eventual increases in the reverse repo rate (over the coming months) to remain market non-disruptive.
- We continue to expect the repo rate to remain unchanged till September 2022 and anticipate it to peak around 5.0% - 5.5%. Moreover, we currently see it topping around the lower bound of 5.0% by late 2023 / early 2024 at the earliest (base case).

- Post the November 2021 FOMC meeting we had a 6.10% - 6.50% target range for the India 10 year GOI bond. In light of the US Fed's December 2021 announcement of a faster taper and the policy guidance, we foresee bond yield ranges to expand as volatility could lead to wider swings. Therefore we have revised the range for the benchmark 10 year GOI bond to 6.15% - 6.65% over the medium term.
- We prefer front-end (2-3 year) high-grade bonds from an accrual perspective. Off-benchmark government bonds in the 6-9 year maturity bucket seem a good value proposition from a medium term perspective.
- High grade dynamically managed strategies, having the flexibility and agility to navigate interest rate movements and cycles seem suitable to take advantage of volatility led opportunities over medium to long term.

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

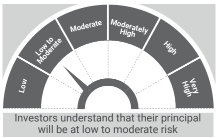
Scheme Names	This Product is suitable for Investors who are seeking^:	Riskometer of the Scheme	Benchmark Name	Riskometer of the Benchmark
ITI Long Term Equity Fund	– Capital appreciation over long term – Investment in equity and equity related securities.	 Investors understand that their principal will be at Very High risk	Nifty 500 TRI	 Investors understand that their principal will be at Very High risk
ITI Multi Cap Fund	– Long-term capital growth – Investment in equity and equity-related securities of companies across various market capitalization	 Investors understand that their principal will be at Very High risk	Nifty 500 Multicap 50:25:25 TRI	 Investors understand that their principal will be at Very High risk
ITI Large Cap Fund	– Capital appreciation over long term – Investment in portfolio predominately consisting of equity and equity related instruments of large cap companies.	 Investors understand that their principal will be at Very High risk	Nifty 100 TRI	 Investors understand that their principal will be at Very High risk
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.	 Investors understand that their principal will be at Very High risk	Nifty Mid Cap 150 TRI	 Investors understand that their principal will be at Very High risk
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.	 Investors understand that their principal will be at Very High risk	Nifty Smallcap 250 TRI	 Investors understand that their principal will be at Very High risk
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.	 Investors understand that their principal will be at Very High risk	Nifty 500 Total Return Index	 Investors understand that their principal will be at Very High risk
ITI Pharma and Healthcare Fund	– ITI Pharma and Healthcare Fund – Investments in equity and equity related securities of companies engaged in Pharma and Healthcare.	 Investors understand that their principal will be at Very High risk	Nifty Healthcare TRI	 Investors understand that their principal will be at Very High risk
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.	 Investors understand that their principal will be at low risk	Nifty Financial Services TRI	 Investors understand that their principal will be at Very High risk
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.	 Investors understand that their principal will be at low to moderate risk	Nifty 50 Hybrid Composite Debt 50:50 Index	 Investors understand that their principal will be at High risk
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.	 Investors understand that their principal will be at low risk	Nifty 50 Arbitrage Index	 Investors understand that their principal will be at low risk

^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 & 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 Composite Bond Fund 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 Index”

Potential Risk Class Matrix

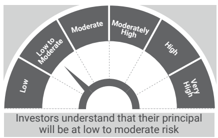
Credit Risk of Scheme → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)	A-I		
Moderate (Class II)			
Relatively High (Class III)			

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

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

Scheme Riskometer

Benchmark Riskometer: “CRISIL Liquid Fund 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 Short Term Bond Fund 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)			

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

Disclaimers

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