Insights

March 2022

"Markets can remain irrational longer than you can remain solvent."

– John Maynard Keynes

GEORGE HEBER JOSEPH
CEO & CIO, ITI Mutual Fund

"Today most of the market participants are focused only on returns but sooner or later all will start focusing on risk associated with the returns also. We have been cautious on markets for the last 6-9 months and therefore the returns have also been impacted. As a Fund house, we don't like to bet on expensive valuation stocks, because from our experience we have learned that in the long run this won't work. Today the market valuation itself is at an elevated level and the starting point of the investment itself is at an escalated price level which means the future returns have to be lower and therefore the expected return from the markets have to be moderated substantially relative to 1 year back or 2 year back market levels. With the existing macro and increased growth challenges visible, the expected returns must be further brought down, and our recommendation would be to focus on risk adjusted returns than focusing only on returns.

We see a situation where the high valued stocks will start coming tumbling down and that is when our funds will start outperforming the peers and the Index. We hope in the next 6 months, this over valuation in the market will start correcting and our value stock picks will start working in our favour which will reduce the underperformance automatically."

Dear Partners/Investors,

Firstly, let me thank all of you for the immense support extended to us since we started our operations as an Asset Management Company, 3 years back. We started off from scratch in April'19 and this is the third year of our AMC operations. Even though it was a challenging year, we have got tremendous participation from all of you, in the previous financial year as well. As we approach this new financial year, there are multiple thoughts crossing our minds - 1) Probably the ensuing financial year could be challenging in terms of market scenarios 2) After doing a SWOT of the company, we have identified few areas of improvement in our internal processes across functions so as to ensure our investors a good investment experience. Therefore, we are approaching this financial year with a renewed spirit & vigour. When we look back, we realise that there are many milestones that we were able to conquer together within these years and we are ready to achieve many more in coming years with your wholehearted support and feedback.

Equity Market Outlook

The month of March 22 saw a gradual reduction in volatility as the possibility of Russia- Ukraine conflict turning into a wider war between NATO and Russia subsided. Oil and other commodities retreated from their peak levels as the geopolitical risk premia reduced and equity markets worldwide welcomed this reduction in tension with decent gains from early March lows.

Equity markets, despite the recent relief, face many challenges in the near term:

- Energy and Commodity prices, despite the recent fall, remain at higher levels than pre-war period
- Geopolitical risks further increased the disruptions in global supply chain, keeping inflation higher across the world
- Developed world Central banks have ended the extra accommodative monetary policies which was started two years ago and have started monetary tightening
- With inflation increase, money available for discretionary expenditure reduces substantially which is expected to result in lower economic growth.

Thus, world economy is facing prospects of lower economic growth with higher inflation and a tightening monetary policy. We have not seen such stagflationary conditions since mid-70s.

How does this impact Indian economy?

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

- Economic activities, post the short-lived Omicron scare, have resumed strongly. Services sector, which was a laggard in growth for the last two years is also showing strong improvement.
- 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.

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.

Investing environment prevailing

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.

Global outlook

Lot of negative factors coming together set U.S. stocks up for a difficult start to 2022. Growth-oriented stocks were at the epicentre of the pain amid fears of rising rates and a slowing economy.

We see both, a short and longer-term opportunity taking shape. In the near-term, we believe indiscriminate selling has created attractive entry points, particularly into some high-growth-potential stocks across globe. At the same time, we believe investors should prepare for a longer-run regime shift as the familiar slow-growth, low-rate environment transitions to a new world order that may warrant greater selectivity and a rebalance toward value theme.

It is quite evident that the U.S. Federal Reserve is committed to start shifting policy and reducing liquidity. The tightening financial conditions weigh on equities, especially the more speculative stocks. Clearly the earnings misses get the headlines, nevertheless, consensus earnings estimate for S&P 500 for 2021, 2022 and 2023 are higher today than they were at the end of 2021. Overall, corporate America is healthier than Wall Street had expected. There is a continuation of strong company stock buybacks happening in US which supports the 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.

Also, it is worth remembering that the best cure for inflation is inflation. High inflation results in lower economic growth which in turn reduces demand for energy and commodities, bringing the 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.

Risk-Return Paradigm

Today most of the market participants are focused only on returns but sooner or later all will start focusing on risk associated with the returns also. We have been cautious on markets for the last 6-9 months and therefore the returns have also been impacted. As a Fund house, we don't like to bet on expensive valuation stocks, because from our experience we have learned that in the long run this won't work. Today the market valuation itself is at an elevated level and the starting point of the investment itself is at an escalated price level which means the future returns have to be lower and therefore the expected return from the markets have to be moderated substantially relative to 1 year back or 2 year back market levels. With the existing macro and increased growth challenges visible, the expected returns must be further brought down, and our recommendation would be to focus on risk adjusted returns than focusing only on returns.

We see extra-ordinary valuation risks in many stocks & sectors which many market participants are not considering at this point of time. We have been guiding our investors to invest systematically for the last 8-9 months and we have been taking very careful bets in the funds especially in the low valuation sectors. We see a situation where the high valued stocks will start coming tumbling down and that is when our funds will start outperforming the peers and the Index. We hope in the next 6 months, this over valuation in the market will start correcting and our value stock picks will start working in our favour which will reduce the underperformance automatically.

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 Ancs, 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, our preference list has not changed pre-war to post-war kind of scenario, mainly because, these stocks fit into our SQL investment philosophy ie. Stocks where Margin of Safety is higher, Quality of the business is good and at the same time having Low Leverage. Few sectors like IT, FMCG, Chemicals are significantly over valued and have less margin of safety now but nevertheless the external environment is quite unpredictable at this juncture, so our investment process has been re-defined and modified to give a much more predictable & smooth investment outcome.

As part of our analysis, we look for companies with unique products or services, durable cost advantages, or which operate in a 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 focused more on stock selections within the sector rather than trying to be overweight / underweight sectors. The focus continues on 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 a 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 0.25% in March 2022 and indicated that it saw ongoing rate increases to be appropriate. Furthermore, the Fed Governor stated that an announcement related to shrinking of the Fed's Balance sheet could come as early as in May 2022.
- The latest Fed median forecast shows policy rates at 1.9% in end 2022 and 2.8% by end 2023. However, the expected resilience of the US economy amidst supply shocks emitting from the geopolitical upheaval led sanctions on Russia have prompted the markets to not only price-in higher end 2022 interest rates but also front ended rate increases of larger magnitude.
- The European Central Bank (ECB) left its main rates unchanged in March 2022, but announced a faster winding down of its asset purchase program. Comments from the ECB Board members indicate a significant likelihood to the ECB hiking interest rates in late 2022 / early 2023.
- The ruling BJP party's strong showing in State elections results in March 2022 augurs well for India as this allows policy continuity; which is especially important in current times when the country is facing a commodity supply shock led adverse macro environment.
- Our view remains that the Reserve Bank of India (RBI) will increase the repo rate in either August or October 2022, but heightened geopolitical and macro challenges may force the Central bank to act a meeting sooner. We continue to expect the repo rate to peak around 5.0% - 5.5% and currently see a base case of it topping around the lower bound of 5.0% by late 2023 / early 2024 at the earliest.
- We do not foresee the need to materially change our outlook and return expectations. Our duration funds remain well positioned to take advantage of evolving market conditions and remain confident in our aim to deliver inflation adjusted real returns in these products.
- We continue to like front-end (2-3 year) high-grade bonds from an accrual perspective as markets have largely priced the future repo rate path. Off-benchmark government bonds in the 4–8-year maturity bucket seem attractive from a medium-term perspective.

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

Product Labelling

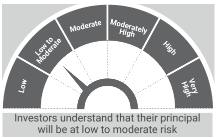
Scheme Names	This Product is suitable for Investors who are seeking^:	Riskometer of the Scheme	Benchmark Name	Riskometer of the Benchmark
ITI Long Term Equity Fund	– Capital appreciation over long term – Investment in equity and equity related securities.		Nifty 500 TRI	
ITI Multi Cap Fund	– Long-term 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 Mid Cap 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.

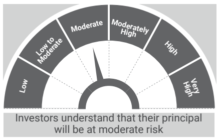
ITI BANKING & PSU DEBT FUND: This product is suitable for Investors who are seeking^:

- 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 & 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"

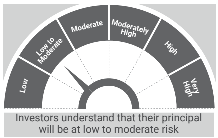
Potential Risk Class Matrix

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^:

- 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)			

The riskometers are based on the Scheme portfolios as on March 31, 2022. For more details, please refer to the respective Scheme Information Documents.

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

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.

The information provided is not intended to be used by investors as the sole basis for investment decisions, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific investor.

Investors are advised to consult their own legal tax and financial advisors to determine possible tax, legal and other financial implication or consequence of subscribing to the units of Mutual Fund. The information contained herein should not be construed as a forecast or promise nor should it be considered as an investment advice.

The AMC (including its affiliates), the Mutual Fund, the trust and any of its officers, directors, personnel and employees, shall not liable for any loss, damage of any nature, including but not limited to direct, indirect, punitive, special, exemplary, consequential, as also any loss of profit in any way arising from the use of this material in any manner.

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