Second wave & Impending lockdowns – Flash Note

This wasn't completely unexpected, was it?

Other countries across the world have gone through multiple waves post the first wave, India cannot be too different. Going back in time 100 years, the Spanish Flu had the same playbook. People relaxed their guard after the first wave started petering out, only to be hit by a bigger second wave. For all the technological advances of the past century, the human hindbrain continues to be as stupid as it was.

From a market point of view, the situation today is different from when the first wave hit the market in March 2020 -

- The element of surprise, the unknown unknown factor is lacking today
- Lack of visibility into the duration of the health problem, which is not the case today
- No existing playbook to deal with it, today we have a playbook to deal with it and to bring it under control
- No visibility of a medium/long term solution, today we have many vaccines being administered across the world

Markets care about the longevity and consistency of cash flows; not about how bad one particular year or quarter can get.

In 2020, the duration of the pain was unknown which is why terminal values of assets collapsed. Today, we know it is about hunkering down for a couple of months, while the vaccine drive continues in the meanwhile. Terminal values of assets do not fall too much in such a situation.

I have been sounding a note of caution since January of this year, not because I had a premonition of when the second wave would hit or if we would go into localized lock downs again. Investor behaviour influences prices, fundamentals aren't everything.

Investing is a social science with inbuilt reflexivity. Participating in the process modifies the outcome, unlike in physical science.

Many individuals never wrap their heads around this simple concept, they work with definite and precise assumptions in investing and wonder why they end up with sub optimal outcomes. Investor behaviour through the past few months has shown lower regard for risk while focusing a bit too much on the reward part. You always make allowance for contingencies; this really isn't rocket science.

See the post vaccination numbers of countries like Israel, UK and a few others (with the exception of Chile), the trend is encouraging. India with a 130+ Cr population will take much longer to vaccinate its people but the urban centres should be the first to get past the 50% vaccination mark. Hence, there is a medium-term solution in sight.

What should investors do from here?

A 6-month period of consolidation is par for the course in equity investing, a 10% fall from the peak isn't much to fret over. You should stick to your allocation plan and pace, go about doing things as planned. The market will no doubt react to the current situation but it may not react so much that we need to get very concerned. Stay within the bounds of your allocation plan.

Investing is about disciplined execution once the research and risk management parts are in place.

Do not jump in to buy in an accelerated manner, the time for that may come only if the NIFTY 50 goes below the next level of 13600. For the time being 14250 is a key level to keep watching.

It is to be expected that businesses which have balance sheet risks built into their business models will see more volatility, while those without balance sheets risk will fare better. The market may revert to the playbook of Q1 last year with Financialization, Pharma, IT, Speciality chemicals and consumer staples holding fort.

The portfolio companies have minimal balance sheet risks, we have just one lender in the portfolio which has demonstrated the ability to raise capital even at the bottom of the cycle. All of the portfolio companies are well placed to deliver some earnings growth even if the health situation continues to be bad for a few months.

Please note that this is how I operate at all times, not because I've fallen in love with my approach but because it works across market cycles.

You always go with an approach that maximizes your possibility of survival in the long run.

There is a price to pay for prudence, we should happily pay that price.

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thinking about businesses in general. Effective learning calls for specific examples to drive home the core concepts and that precisely is the endeavour here.

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We sincerely suggest that you view this as a learning exercise and nothing more.

Please consult a qualified and registered investment professional before taking any investment decision.