ET Q&A

SHIV PURI
Managing Director, TVF Capital Advisors

Invest with Idea of Whether Co will Gain from Tech or Not

The main concern in Indian markets is the midcap space, which is extremely overvalued, said Shiv Puri, managing director at Singapore-based TVF Capital Advisors.

Puri warned that multiples of many of the mid-cap companies could contract even if earnings come through. In an interview with **Sanam Mirchandani**, Puri said one should invest in companies that are a beneficiary of changing technology. Edited excerpts:

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Indian markets surged 29% in 2017. What would be your strategy in the Indian markets in 2018?
2017 has been a year where globally all markets rallied. It was not a uniquely India phenomenon. From a growth and earnings standpoint, a lot of that is yet to come. 2018 is going to be very bottoms-up story unlike 2017 where many stocks did really well. My concern is on the mid-cap space. The mid-cap space now is looking extremely overvalued. The midcap index is trading at a 40% premium to the MSCI India and over a 35% premium to the Nifty, which is the highest it has ever been, even beyond December 2007. For many of these companies it could well be a year where even if earnings come through, the multiples can contract such that the returns can be quite mediocre over the next year or two. My worry is more on those mid-cap names.

Will we see moderate returns?
For 2018, the economic backdrop globally is looking reasonably good. But you have a situation where interest rates are going up in the developed world so in a rising interest rate environment where valuations are quite full, you might have global growth coming but maybe the markets won't do as well in that setting. I would still see that what you had last year-increased liquidity, PE multiples, increased expectation of growth. Some of that might reverse next year, where growth might actually come through but the multiples may not hold up, liquidity might be a little lower, cost of capital is higher and as a result, the market doesn't do as well.

What are your expectations from the Union Budget?
I would be surprised to see if the Budget is not more populist because that's typically what happens 12 months before elections. There is going to be a lot of focus again on the rural side.

Will market react adversely if fiscal deficit targets are eased?
The fiscal deficit looks like it is going to expand by 30, maybe 40 basis points. A lot of that has to do with the fact that the GST collections are running a little lower. So maybe in the near-term you will have this as a concern; but give it another six or nine months, once GST collections normalise and economic activity picks up, I don't think this 30-40 basis points expansion is anything material especially in the face of the current account deficit also being at 1.5%. It is manageable. This is despite oil prices having gone up. It is something to keep an eye on but it is not alarming at this point.

A POPULIST BUDGET

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Do you see oil prices becoming a bigger pain point?
Around the $60 mark, it is something that we have to work harder to get the growth. At $80 it becomes a headwind where you will have to jog to keep up. And we will have to run to go ahead.

Is tighter policy environment of global central banks priced in by the markets?
The Fed has been very vocal and clear about what they are going to do in 2018. If they stick to their plan, I don't see any issue but if inflation rates in the western world pick up and they are forced to act then that is something that's not priced in.

Do you see the RBI also going that way, with a rate hike?
At the current macro scenario in terms of oil prices and inflation rates, it is a pretty fair balance. I don't see hikes coming.

MID-CAP WORRIES

The mid-cap space now is looking extremely overvalued. The returns can be quite mediocre over the next year or two

With 8 states going to polls this year, how do you expect the markets to react?
It could be because the markets are definitely pricing in the current government's being in power after 2019. Per se, the state elections won't be as crucial, but if it sends a signal that in the 2019 general elections there may not be continuity that could be a risk to the markets.

What are the investment themes you are looking at?
One should invest today with a clear idea whether this is a company that's a beneficiary of technology or is it a company that is going to get hurt by technology. Private sector banks and non-banking financial companies which are able to adapt like this will do well. Some of the insurance companies are also going to do really well.

Are you looking at PSU banks as well?
In PSU banks, our sense is that the loss they take on defaults of these companies is probably going to be higher than what the market expects. It seems that these losses could be as high as 60-70% and in some cases even beyond that. The other issues be it management, costs or using technology-still remain very real. So for me the private sector banks still represent a very structural opportunity.