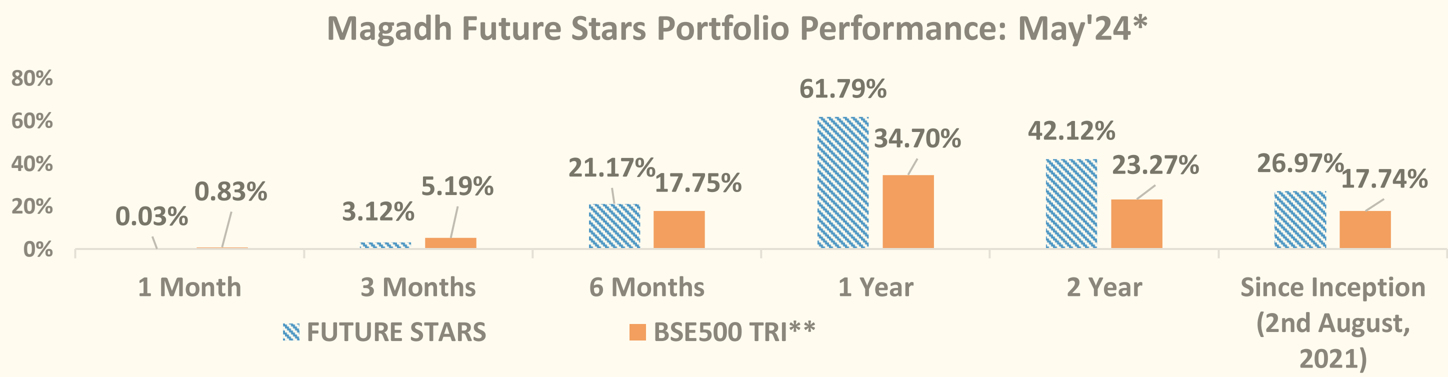
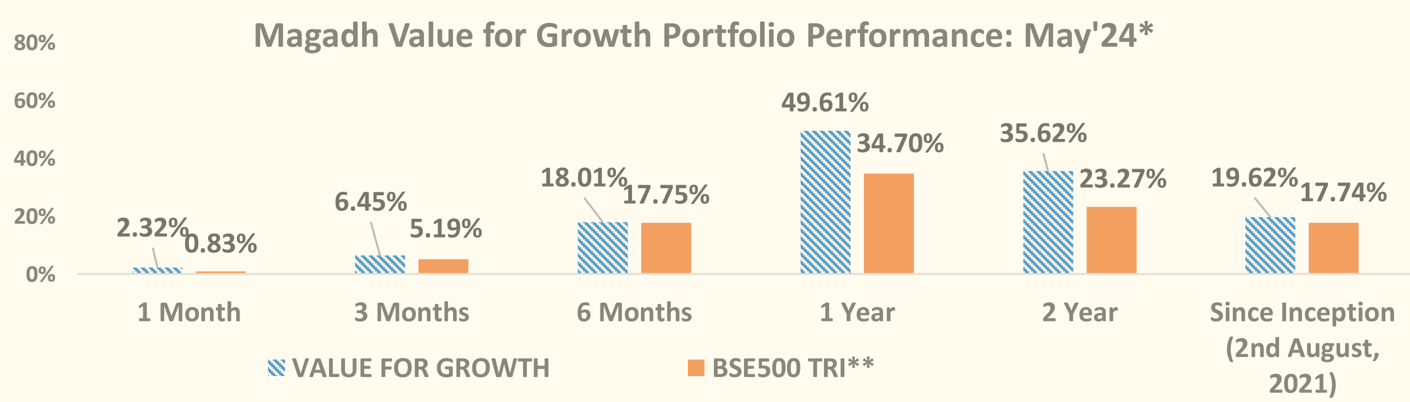
Inching Back to Fundamentals

With the elections having thrown up a result in favour of political continuity albeit with curtailed mandate the markets may now largely move on from politics. Once the new government has taken oath the focus may shift to the upcoming full budget to be presented perhaps next month. While this budget may have more relevance versus last 5-7 years' budgets, for investors we do not expect too many surprises. At the same time, the budget will for sure give some idea regarding the government's agenda and functioning over its duration.

To us, the medium to long term prospects of Indian equity markets remain bright. India's economic growth should sustain around current levels while corporate earnings trajectory will likely improve over medium term. That balance sheets of corporates, banks, and the central government are all in good shape suggest that once private capex revives over next 4-8 quarters, India's economy will get a further boost. We are also constructive on the gains for the economy from rising disposable incomes from here. Valuations of Nifty 50 index is largely around historical averages on the other hand (please see Exhibit at the end of the letter).

The above backdrop helps us at Magadh Capital in staying focused on the key part of our investment philosophy and process i.e. bottom-up fundamental research. Our framework that also makes generous use of behavioural finance has been aiding our portfolio performance consistently since we started our PMS about three years ago. Below is our performance as on 31st May, 2024 which we find quite encouraging-





**Date is for the period Aug 02, 2021 till May 31, 2024. Performance is as TWRR - Time Weighted Rate of Return. Data for more than one year has been annualized. Past performance is no guarentee of future returns. Performance data provided herein is not verified by SEBI. **TRI - Total Return Index.*

What happens to the reforms now ?

Not much will change we believe. That the government has returned but as a coalition, does not change India's growth prospects much. There are some reforms that are so difficult from a socio-political perspective that they may not be implemented irrespective of the government's strength in the Lok Sabha. On the other hand there are some reforms that are in the realm of the executive - they do not require a new or modified law, and hence require resolve on the part of the government, more than numbers in the parliament.

Labour reforms - Legislative developments at the centre had been concluded in 2020 when 29 labour laws had been codified to create four new labour codes. Labour being in the concurrent subject of legislation (where both centre as well states are empowered to legislate) now it is upto the state governments to make state specific laws based on the new central labour laws. So far there has not been much progress on this front. In any case now parliament or central government does not have much role to play here.

Land reforms - In 2013, the land acquisition act had been passed during UPA-II era. In 2015 NDA-I government proposed to revamp this law. However, the plan was shelved in the face of opposition to the proposed changes. Since then this has never made it back to the agenda of NDA government. So there is no change on this count owing to the weaker mandate to the new government versus earlier.

Agriculture reforms - The government had got new agriculture laws - with an eye on reforming many parts of the agriculture chain in India including trade, commerce, price assurance to

farmers etc, passed in 2020. However in the wake of large scale protests in some states the government had rolled it back in 2021. Here too it was highly unlikely that the government would have tried to introduce similar changes to agriculture even if BJP had returned with a large mandate. While a solid thrust to agriculture sector is essential for steepening India's economic growth trajectory it has been clear for some time that large scale legislative changes for agriculture are unlikely to be introduced near term. It is worthwhile to remember that new agriculture laws were withdrawn after getting parliament's approval and president's assent, when the ruling party's strength in the Lok Sabha was more than 350. Thus, rather than just brute numbers in the parliament, framing and implementing new laws require prior consultations with all stakeholders and proper communication to public. Essentially a weaker mandate does not significantly alter the prospects of reforms here.

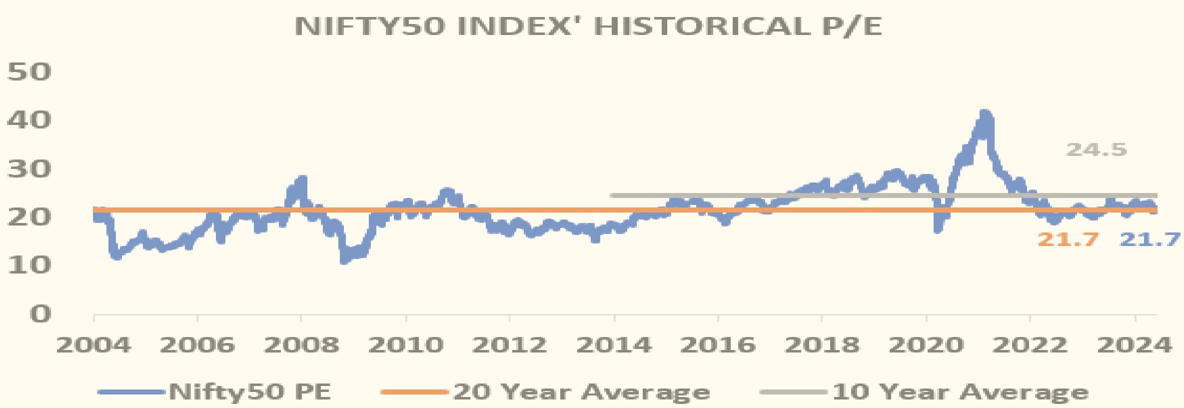
Reforms that depend more on executive action - Then there are fields like manufacturing, defence, PSU etc where reforms require more of executive action than legislative ones. Executive action, in turn, depends more on the balancing of finances, and ability to take the government's allies on board. We shall be surprised if there is a meaningful shift in the government's policies from NDA II's policies in fields like PLI schemes, Atmanirbhar Bharat, infrastructure development, defence manufacturing etc. In case of PSU's in any case, privatization was not on the agenda in last 2-3 years barring a few companies in poor shape. The new government might not consider this any more even though opportunistic divestment in order to plug revenue gaps may continue to be pursued.

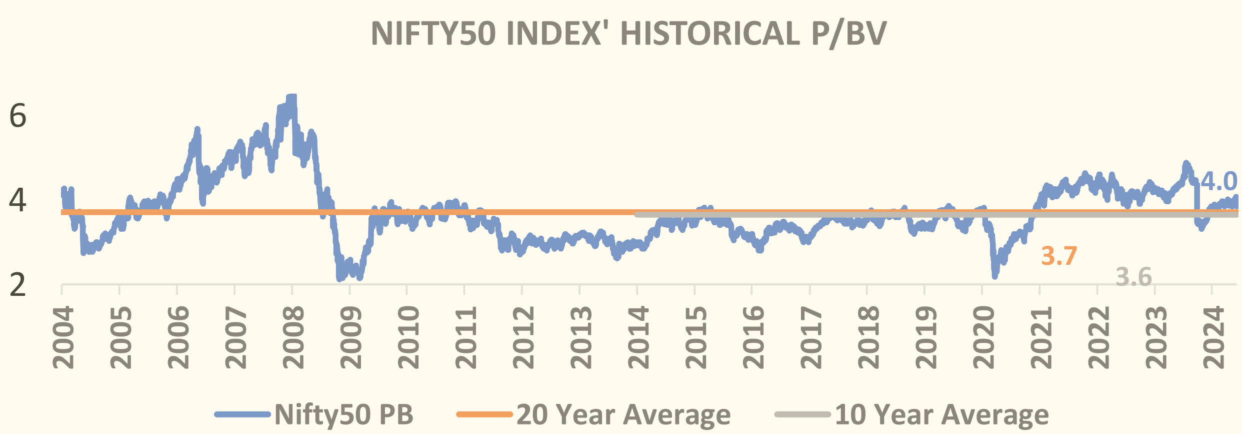
Reforms that depend more on budgetary support, and hence on the government's priorities - Then there is a class of reforms that again doesn't require any support form the legislature and indeed they may not even be categorized as reforms. Enhanced focus on education at all levels, healthcare, improvement of government services etc are some areas that can accelerate India's progress towards a more prosperous future. These do not require the government to be necessarily a strong one.

On the upcoming budget

Two areas where the new government will need to allocate incremental resources are) helping the NDA allies in fulfilling their promises to their voters and fulfilling their own expectations (very high probability), b) increased direct expenditure on pump priming the rural economy, and in enhanced welfare activities(high probability).

If this were to happen it would obviously impinge on growth in capital expenditure that the government has been ratcheting up in last two years. This looks particularly credible since after the below-expectation election performance the government may be averse to tax hikes. Also, we believe that the government may not take the foot off the pedal on inflation control suggesting that it will stick to the glide path on fiscal deficit diligently. On the other hand, higher allocation to the above two broad heads would drive higher consumption in the economy which eventually may contribute at least to some extent in encouraging private companies to augment capacities.





Date: June 07,2024