

How to Approach the Markets Near all Time Highs; Can The Correction in Small and Mid Caps Turn into a Rout?

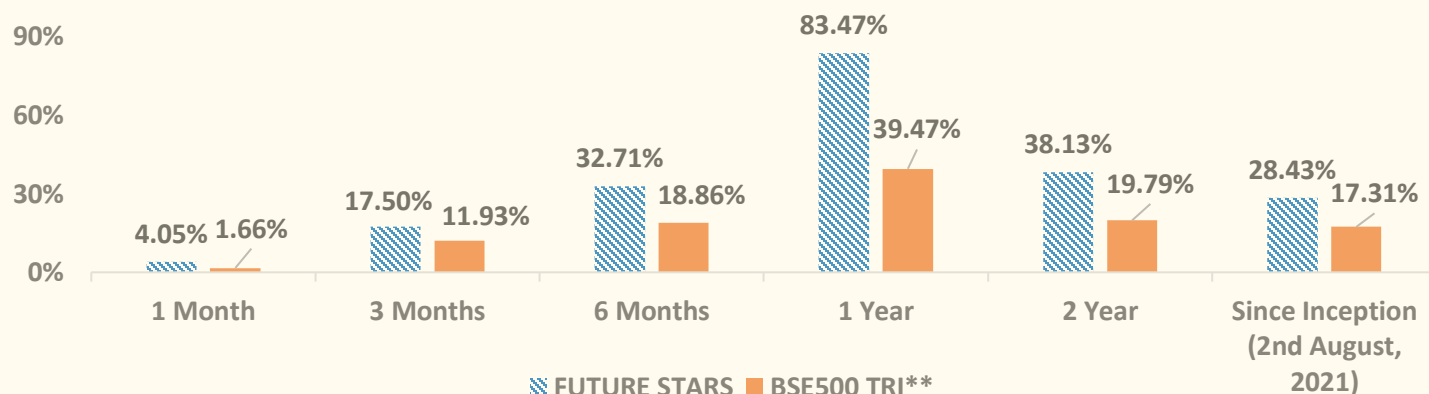
How to approach markets when the latter are near all time high ? Or, when small cap and mid cap indices seem to be falling like nine pins?

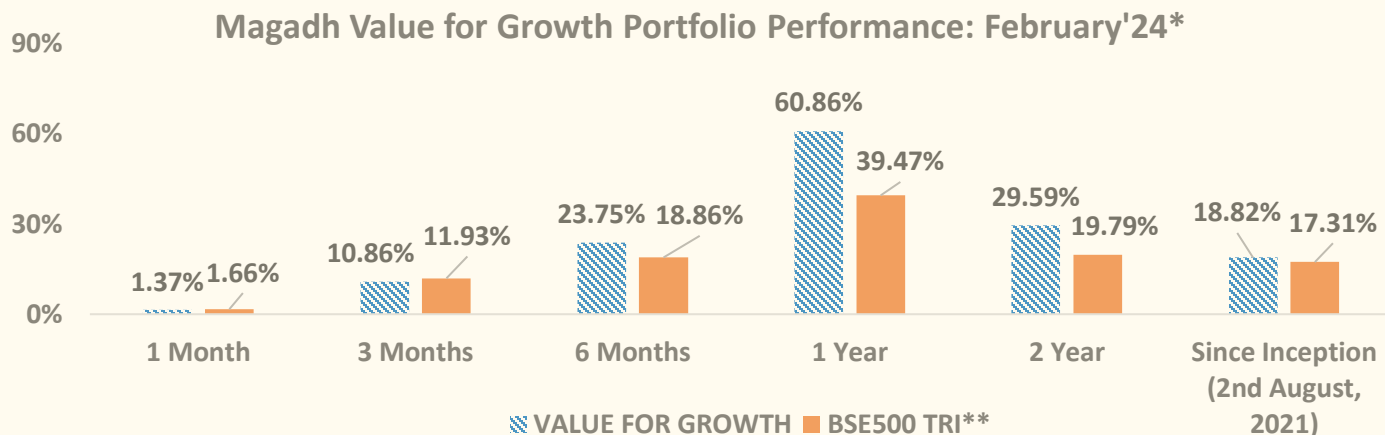
Below is how we at Magadh Capital PMS are thinking –

- In our view, probability of a market collapse – of say, more than 25% in Nifty 50 index is low.
- Small cap and mid cap indices have witnessed some froth built up. Accordingly, “all boats get lifted with the tide” strategy may not work anymore in the small cap and mid cap space. Most stocks in small cap and mid cap space have been witnessing sizeable correction in last 3-4 weeks.
- On the other hand, there are clear pockets in this space where there is money on the table with sizeable margin of safety. There are many such stocks which we are holding happily based on our rigorous fundamental research framework with a 2-3 years horizon.
- If the market correction worsens we believe the stocks in our portfolio are better placed to ride out such correction. The small cap and mid cap stocks in our portfolios in general are set to deliver healthy earnings growth, are likely to witness further improvement in their return ratios, and are available at reasonable valuations. Generally these companies are notching higher market shares in their chosen fields of business, tapping onto new growth opportunities, and enhancing their operating scale without stretching their balance sheets. Our workings suggest healthy upside in these stocks in our base case scenarios, with relatively lower downside even in bear case scenarios. Accordingly, we expect these stocks to rebound handsomely post a correction if it were to worsen from here.
- As on 29th February, 2024 the weighted average P/E multiple for our Value for Growth portfolio is 18.8x based on our FY26E earnings estimate. Weighted average PAT CAGR (compounded annual growth rate) for FY24E-26E is 23.1% for the portfolio. For Future Stars portfolio the FY26E P/E multiple is 20.5x and PAT CAGR for FY24E-26E is 29.3% We have a high level of confidence in our earnings growth forecasts for the two groups. (**Continued....**)

Below is our portfolio performance as on 29th February, 2024.

Magadh Future Stars Portfolio Performance: February'24*





*Disclaimer - *Date is for the period Aug 02, 2021 till February 29, 2024. Performance is as TWRR - Time Weighted Rate of Return. Data for more than one year has been annualized. Past performance is no guarantee of future returns. Performance data provided herein is not verified by SEBI. **TRI Total Return Index.*

(.....Continued)

- Within the small cap and mid cap space there is likely to be a flight to quality. Thus strong companies available at reasonable valuations will likely do well from here over medium term.
- Our portfolios' risk-reward profile is well spread out aided by our FACTS box process of portfolio construction. Risk management and capital protection is a key focus area for us.
- Zero leverage is key source of edge for an investor. Another source of strength is no need of the invested funds in near term.
- Our behavioural finance based guardrails are of help too here. We strongly believe that without taking occasional and notional hits to her portfolio an investor cannot hope to achieve favourable returns over medium and long term. In any case, equity market returns are rarely linear – that is the nature of the beast.
- What one needs here is detachment, and control over emotions. Yes – it can be painful to see a dent on the market value of one's portfolio. One may get scared too if one allows oneself to get carried away with the dominant narrative in the market. But these are the times when good temperament can drive a big difference in wealth created over medium to long term.
- If we have worked hard to identify good stocks and followed a robust process to construct the portfolio then it does not make sense to act like the proverbial cat on a tin roof. Trying to sell at every top and buy at every bottom does not work in real life since it is difficult, rather impossible, to do so consistently. Trying to time the market is a poor strategy for fundamental investors.
- Given that our stock calls are based on deep fundamental research we are fairly confident regarding the medium to long term prospects of our portfolios. Even if there is a dip in market value of some of these stocks and of the portfolios, amid market irrationality – assuming the latter makes an appearance- we shall continue to maintain our positions (unless some fundamental reasons emerge to suggest otherwise).
- We believe that for an investor it is important to buy stocks whose fair value are comfortably higher than their current price without bothering much about markets levels. Indeed, this is the approach that can help her stay away from overpriced stocks inflated by market frenzy, and aid her in buying stocks available at bargains during periods of extreme pessimism.
- We are fully invested. For an investor with a time horizon of 2-3 years, this is a great time to put fresh money to work in India's stock markets.

Can the markets collapse – say, by more than 25% from here ?

As a part of our investing framework we at Magadh Capital PMS keep exploring answers to this question. We are always prepared for 10-15% market correction with the belief that such shallow, relatively short lived corrections do not inflict much of long term damage to the portfolio. In addition, such corrections are extremely difficult to predict. However deep and prolonged bear markets can cause permanent capital erosion – investors who had witnessed the bear markets of 2000-2003 and 2008-2009 will vouch for this. That is why we strive to pre-empt such episodes – of deep and prolonged bear markets.

We assign a low probability to Nifty 50 index falling by 25-30% since –

India's economy – Aided by a sustained reform process and a disciplined set of fiscal and monetary policies India looks well grooved for a sustained phase of healthy economic growth. Its status as the fastest growing large economy is also assisting India in attracting robust capital inflows – as FDI as well as FPI. Softening long term trend in crude oil prices is providing a healthy structural base for India's economy. On the other hand, uncertain economic situation in large part of the world is bolstering India's macro economic situation even further.

Valuations - Nifty 50 valuations on P/E or P/BV multiples are not too different from historical levels.

Earnings growth – Corporate earnings growth in next 3-4 years are likely to be in mid teens, substantially above last ten year average. Return ratios too are trending at better than historical averages and are likely to improve further we believe.

Market psyche – In general the market seems far from a frenzy even if there may be some froth in some pockets. For every 2-3 market participants/observers who are constructive on the markets there seems to be 1-2 market participants/observers who are calling for caution. Regulators and some large public funds too seem to be doing their bit to tone down the exuberance wherever the latter may be present. Those who had witnessed the bull markets of 2003-2007 or of 1998-2000 will remember that in the period leading to the market collapse, the voices of sanity are boxed into a tiny minority and are seldom able to air their views.

Remain sceptical, Be prepared for occasional correction - always

Yes - one should watch for minefields in the portfolio. But this attention is critical for investors, always-whether markets are at all time high or they are in a free fall. We at Magadh Capital too, keep testing our stock investment theses regularly to identify and cull out weak areas, if any, in our portfolio.

Similarly, one should be prepared for some correction in markets and in portfolio value. This too is always true, at every market level. Markets can decline by 10-15% anytime.

In fact, the Nifty small cap 100 index is down by about 11% in March'24, and by about 13% since its peak on 7th February, 2024.

Disclaimer and Risk Factors: The above viewpoint/newsletter is only for reference / information / educational purpose. The stocks, if any, mentioned above are only reference and as example and are not recommendations. Any use of the information contained herein for investment related decisions by the Investors/ Recipients is at their sole discretion & risk. Please read the Disclosure Document and the Client Agreement along with the other related documents, if any, carefully before investing in the investment approaches of Magadh Capital Advisors LLP. Investments in Investment Approaches are subject to market risks, various micro and macro factors and forces affecting the capital markets and include price fluctuation risks. There is no assurance or guarantee/ warranty that the objectives of any of the Investment Approach will be achieved. The investments may not be suited to all categories of Investors/ Recipients. Investors must make their own investment decisions based on their own specific investment objectives, their financial position and using such independent professional advisors, as they believe necessary, before investing in such Investment Approaches.

Past performance is no guarantee of future returns. Performance data provided herein is not verified by SEBI. MCA LLP does not guarantee the future performance of any investment style, process or any level of performance relating to any products of MCA LLP or any other third-party service provider. Investment in any product including mutual fund or in the product of third-party service provider does not provide any assurance or guarantee that the objectives of the Investment Approaches are specifically achieved. MCA LLP shall not be liable to client for any losses that they may suffer on account of any investment or disinvestment decision based on the communication or information or recommendation received from MCA LLP on any product or on this document.

Magadh Capital Advisors LLP (LLP IN - AAG-4940) SEBI Portfolio Managers Registration No. INP000007155	
Principal Place of Business	603 The Coworking Space, Matulya Centre, 2nd floor, Lower Parel, Mumbai, Maharashtra 400013, India.
Contact Details	Ph: +91-9821627938 Email: investor.info@magadhcapital.com Website: www.magadhcapital.com
Investment Approach	Value For Growth (Multicap) Future Stars (Mid cap and Small Cap)
Investment Approach Launch	August 2021
Custodian and Fund Accountant	Kotak Mahindra Bank
Minimum Investment	Rs. 50,00,000/-

Investor may invest with us directly. To invest in any of our PMS investment approaches directly or for any additional details / clarification, please write to us at **investor.info@magadhcapital.com**

For any grievances please write to our Investor Relations Officer / Compliance Officer Mr. Vivek Prasad - **grievance.pms@magadhcapital.com**.