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'Global turmoil not over, volatility will remain'

The domestic economy has a strong multi-year tailwind. This will power equity-market returns, says **RAJESH BHATIA**, managing director and chief investment officer, IIT Long-Short Equity Fund. In conversation with **Sundar Sethuraman**, he lists out the crucial tailwinds domestic markets face and how a long-short fund can help protect the downside risks. Edited excerpts:

Since hitting lifetime highs in October 2021, Indian markets have swung wildly. How has the journey been for a long-short fund like yours?

In recent times, central bank policies of developed economies have become the primary driver of global asset markets, including equity markets. The post-pandemic response from the top 10 central bankers of infusing unprecedented amounts of liquidity into the global economy to support their economies had the desired effect of a collapse in interest rates.

Asset markets are strongly guided by the cost of capital. Naturally, as interest rates lowered, equity markets rose. Think of it as a price-to-earnings rerating of asset markets. It is for this reason one saw a one-way upward trajectory in equity markets between April 2020 and October 2021.

We recognised early on these policies were the primary driver of markets. When high and stubborn inflation worries emerged globally as a consequence of these policies and the evolving geopolitical situation, it became apparent it could force a reversal of the liquidity trend and, consequently, a reversal for this primary market driver.

Our gross exposure to equity markets peaked in October and has subsequently been in cautious mode. While global markets have corrected appreciably, admittedly, we have been pleasantly surprised by the relative resilience of Indian markets.

Did you manage to beat the Nifty in the past year?

As of September this year, our fund was up 1.17 per cent (gross return) versus Nifty's minus 2.97 per cent. Markets have become macro-driven, with central bank policy being the key determinant of market direction.

In an environment of external turmoil, the ability to react tactically is crucial,

even if the structural story is intact. As a long-short fund, we are at a distinct advantage of being able to switch our exposure with dexterity.

Will the next year be just as volatile? What should investors in long-short alternative investment funds expect from their fund managers?

We are fortunate to be here, given the multi-year tailwind India has. However, our markets have been struggling for the past year due to the insurmountable

challenges faced by global markets. We believe global turmoil is not over yet.

We expect markets to continue to remain volatile. If the environment deteriorates, then a long-short fund like ours will exercise defence and vice versa.

A long-short equity fund seeks to offer an asymmetric returns profile. We aim to capture the upside potential of equity markets, but aspire to prevent the downside.

Investors back the uncorrelated aspect of our fund to their overall portfolio. We believe an asymmetric profile makes a long-short fund a good product for wealth creation, especially on a risk-adjusted basis.

What are the key headwinds/tailwinds domestic equities face?

India is ideally positioned in global markets today. We are on the cusp of a credit and earnings cycle revival. Our corporate balance sheets are healthy, as are our bank balance sheets.

India has tailwinds from positive government actions of the previous few years, such as tax cuts, goods and services tax implementation, and therefore, formalisation of the economy. We are also likely to benefit from China Plus One in manufacturing. All these tailwinds mean a secular push to a \$3-3.5-trillion economy. As profits grow, so will stock markets in value terms.

The challenges are more cyclical in nature, driven by a collapsing global macro, which should not be ignored either. Rising interest rates globally, persistently high inflation, and a sluggish global economy will put macro

pressures on our economy as well.

Our exports are flagging, our current account deficit is high at 3-4 per cent, and there is little fiscal space, while interest rates are still rising. We may have to be more careful in assessing the short-term prospects.

Do you expect domestic liquidity to remain strong? Will tepid one-year returns weigh on incremental flows?

We don't see any sudden shift in attitude. The good thing about domestic liquidity is the Indian market's resilience, although it has also meant Indian markets are relatively pricier.

How has the July-September quarter earnings season played out so far? What are the earnings growth expectations for 2022-23 (FY23) and 2023-24 (FY24)?

In a nutshell, better than expected. What stood out were healthy banking results, weak consumer results, especially those serving the bottom of the pyramid. We think the earnings expectations have moderated for FY23. If there are no further global shocks, we could see earnings growth in healthy teens from FY23 onwards.

Q&A

RAJESH BHATIA

MD & CIO, IIT Long-Short Equity Fund



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