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DIGITIAN CAPITAL

Future focus

FUTURE FOCUS

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“ With surge in pandemic inspite of a liquidity driven bull run, market growth is not sustainable given the looming threat of stagflation, but this may be the best time to build cautiously a well-diverified portfolio in covid-proof sectors gradually with a medium to long term view ”

Liquidity & Stagflation ? - Market Growth unsustainable

DIGITIAN VIEW!

Given the huge liquidity pumped by Fed at a near Zero cost and also other central banks (Refer Chart)**,** the market went higher for all Indices **as predicted,** in July **NASDAQ** crossed **11,000** for the First time and **S&P** flirted with its all time high**. Chinese market made a remarkable comeback followed closely by India.** African markets are mostly down with the spread of pandemic.

In the month of July 2020, the corona-virus surge spreading @77% per month was seen across globe except western Europe. Read our Monthly Dosier on Coronavirus (Click)

OUR USA RETURN in 2020 (30th July 2020):

27% vs S&P 500 YTD 1.5% (2019 28%)

As I mentioned in my earlier articles in 2020, what we are witnessing is unprecedented optimism in capital markets - **Is it sustainable? The clear answer is *NO*.** *So investors need to be cautious, only and only follow fundamentally strong shares in industries less affected by pandemic.*

Will there be a correction? ***Yes*** *for sure but nobody knows when. However, product like* ***surrogate investment*** *will help Individual investors since* ***investor has full control over his trading account*** *and* ***professional will guide daily real-time for trade.***

Markets generally values the future performances and presently discounting all the **negatives** - fall in GDP, high unemployment number, falling retail sales and real-estate growth, low price for energy and completely disrupted Aviation - **as temporary phenomeon.**

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MARKET WATCH

Equity Indices	Monthly Open	Monthly Close	Monthly Change %	2020 YTD %	2019 %
S & P	3100	3272	5.5%	1.3%	28.9%
Nasdaq	10059	10745	6.8%	19.8%	35.2%
FTSE 100	6170	5898	-4.4%	-21.8%	12.1%
Shanghai Composite	3008	3311	10.1%	8.6%	22.3%
NIFTY	10359	11073	6.9%	-9.1%	12.2%
Nairobi SE 20	1952	1811	-7.2%	-31.8%	-6.3%
Egypt SE 30	10765	10599	-1.5%	-24.1%	7.1%
Tanzania All Shares	1830	1800	-1.6%	-12.6%	0.9%
Ghana Composite	1884	1877	-0.4%	-16.8%	-12.2%
Nigeria SE 30	1070	1053	-1.6%	-10.6%	-16.9%
Morrocco All Shares	10169	10229	0.6%	-16.0%	7.1%
Bangladesh DSE 30	1341	1420	5.9%	-5.5%	-20.1%

Commodity	Monthly Open	Monthly Close	Monthly Change %	2020 %	2019 %
Gold	1801.55	1971	9.4%	29.7%	18.5%
Crude Oil	41.56	40.44	-2.7%	-38.8%	22.0%
WTI Oil	39.6	43.64	10.2%	-28.7%	33.6%
Copper	2.76	2.86	3.6%	2.2%	6.3%
Irone Ore	103.86	108.9	4.9%	19.0%	32.4%
Aluminium	1621	1709	5.4%	-5.3%	-20.1%

The history suggests within a year after a bear market begins, stocks rally an average of 40%+; that was the case at the time of Spanish flu in 1917 and also after polio pandemic in 1949. Further, **Warren Buffett**, famously advised investors to **"be greedy when others are fearful."**

Let's provide you with some market insights, essential for picking stocks :

Insight 1: Five of the largest companies in the S&P 500 - MSFT (Microsoft), AMZN (Amazon), GOOG (Google) & FB (Facebook) - make up nearly 25% or a quarter of the S&P 500's total market cap. For the Russell 1000 Growth Index, these five stocks make up 34% of the index. For the NASDAQ, the number swings up to 48%! The spread between these five companies' valuations and the remaining companies in the S&P 500's valuations, is wide and getting wider just like in early 2018. A major market correction that year narrowed the gap quickly.

Insight 2 : Even though the S&P 500 is nearing new all-time highs, **only about a quarter of stocks in the index are within 5% of their own all-time highs**. Nearly half of index constituents are over 20% from their all-time highs. **This provides good opportunity for entry.**

Insight 3: At the beginning of earnings season ending June 2020, **S&P 500** earnings were forecast **to decline -43%.** The actual outcome has been better than expected **as 445 of S&P 500** members that have reported **are down -34.8%. But 80% of these 445 index members have beaten consensus EPS estimates and 63% have beaten Revenue Estimates. But always remember these estimates were very conservative guesstimate.** Both revenue and profit have fallen YOY for most companies.

Thus, Investors cannot leave the market and I think **a well diversified portfolio** will have to be built gradually for medium to long term.

Please also refer to my last articles in **June 2020 (**6 Market Trends), **May 2020** (How Markets behave in Pandemic) and **April 2020**(Covid-proof sectors/Stocks) for getting full aspects of the Investment spectrum in Pandemic. (Newsletter click here)

Stagflation - Effect of Liquidity?

Stagflation blends Stagnation & Inflation - **combination of stagnant economic growth, stagnant high unemployment level and rising Inflation**. A complete double whammy. It was last seen in 1970 in US for a decade. Generally, in a weak economy, inflation is not expected as employment is not at full capacity (**Phillips Curve Theory**). In a liquidity driven monetary policy of Fed, stagflation may be an outcome since start of the year this is always the concern. The concern was raised as for july consumer prices, producer prices, and import prices - all rising at faster paces than economists anticipated. US Misery Index is going up too .

However, two things are different now a) energy prices are at low (in 1970s WTI were at $100-125) b) Gold prices are at all time high (in 1970 gold standard was abolished). **I think it may not happen in its full form but if the pandemic prolongs some elements may be seen. We need to keep a close watch as professional.**

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COUNTRY DATA

Countries	GDP (USD Bn)	Market Cap (USD Bn)	GDP Growth 2020 %	Inflation %
USA	21729	25689	-3.6%	0.6%
China	12238	10290	1.6%	-2.0%
India	2260	2305	-3.2%	4.2%
Egypt	331	53	1.6%	6.00%
Kenya	71	18	1.5%	5.1%
Tanzania	54	10	2.1%	3.7%
Ghana	43	20	2.5%	9.7%
Nigeria	405	101	1.00%	6.0%
Morocco	101	59	0.5%	1.0%
Bangladesh	221	40	1.0%	4.00%

Forex	Monthly Open	Monthly Close	Monthly Change %	2020 YTD %	2019 %
EUR USD	1.122	1.178	5.0%	5.1%	-2.3%
GBP USD	1.237	1.381	11.6%	4.2%	-10%
USD INR	75.553	74.750	1.1%	-4.7%	-2.1%
USD KES	106.600	107.750	-1.1%	-4.8%	-0.7%
USD EG POUND	16.140	15.970	1.1%	0.4%	11.60%
USD TZS	2315	2325	-0.4%	-1.1%	0.0%
USD CEDI	5.785	5.760	0.4%	-1.0%	-14.5%
USD NAIRA	360.500	381.000	-5.4%	-4.9%	0.5%
USD TAKA	84.860	84.820	0.0%	0.1%	-1.8%

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New Service : Surrogate Investment

Digitian Capital (DC) has launched a new service "Surrogate Investment". We have come across many of our readers who may not have USD 100,000 or equivalent to join the club and make their investment fortune. Further, we understand TRUST & BELIEF are two big factors confronting the medium value investors. The service is designed to address these issues while creating a family of DIGITIAN investors :

The features of Surrogate Investment (SI) :

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7. You transfer 20% of the profit you generated out of the sale of shares. (Say you invested USD 20000/- in Apple and you sold it at USD 24000 then you will pay DC, USD 800 (20% of gain of USD 4000)
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Why You should avail this service?

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Fees for the Service :

a) ZERO UPFRONT Fees
b) Upside of 20% of the profit **only on realistion** of the profit (So Zero risk)

Process :

1) Sign up : digitiancapital.com
2) Start Your millionaire Journey

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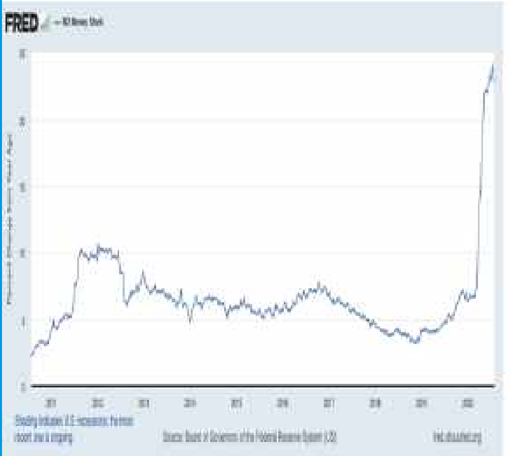
BEST CHART OF THE MONTH

M2 Money Supply Year-Over-Year Growth in the U.S.



Source: Federal Reserve Bank of St. Louis

"Pandemic made it prominent the role of liquidity in a crises. the balance sheets at global central banks are growing at a 33% year-over-year pace. In the U.S. the Fed's measure of money supply (M2) is growing at a 23% year-over-year pace. This has been able to create an unprecedented optimism spending among "

VALUE INVESTING

Debashish Neogi

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> “..there are periods (short term) when Value Investing doesn’t work. And that is a very good thing. The fact that the value approach doesn’t work over some period of time is precisely the reason why it continues to work over the long term.”

What a retail Investor should do now ?

Just to recap what I wrote in my two articles in March and April.I had clearly said that **Coronavirus is once in a life time opportunity.** We should invest in a staggered manner for long term.

I had reiterated about the famous Chinese proverb : **“Those who predict , do not know, those who know, do not predict. But nobody knows”**, Hence I had said :

So if you are long term investor and not bothered about short to midterm then slowly buy the market as it better valued relatively. **Buy not at one go but in staggered manner,** that is what we are doing ! One more important thing ,turn off the screen, be off from social media for some time, enjoy the nature, go for holiday, take a break, basically stop seeing the screen, you will be happy.

Like Warren buffet says "**If you aren't willing to own a stock for ten years, don't even think about owning it for ten minutes** ... “I buy on the assumption that they could close the market the next day and not reopen it for five years”.

……our actionable is to watch out for those businesses which are shepherded by great management and have a tailwind in their business operations with high free cash flow and low debt. Mr Market is already helping you with the valuations and is likely to help you with the valuations and is likely to help you more in the future!!

What’s the situation now : as I write this article. Both US and India market is close to its pre covid level. Though the stock market rebound is like “V” shaped but the economic recovery will not be likely - that is my view. There are many theories about its shape but again no one knows. Lets not worry on the shape and do again what we are suppose to do.

I read a post some time back wherein **Jack Schwager,** the author of Market Wizards series, when answering a question on whether value investing works, turned to the **wisdom of Joel Greenblatt,** one of the foremost experts on the subject. Schwager quoted this from his interview with Greenblatt – “**Value investing doesn’t always work.** The market doesn’t always agree with you. Over time, value is roughly the way the market prices stocks, but over the short term,which sometimes can be as long as two or three years, there are periods when it doesn’t work. And that is a very good thing. **The fact that the value approach doesn’t work over some period of time is precisely the reason why it continues to work over the long term.**”

If you feel “value investing doesn’t work” read the above quote whenever you have doubt .

Howard Marks in his latest memo **“Time for Thinking”** has also provided a perspective just as an argument and not as his supportive view. The demanded earnings yield from equities could be (Bond yield + equity risk premium – growth) = 2%; assuming 2% terminal earnings growth rate for S&P500. Given that PE= 1/earnings yield, a multiple as high as 50x can be justified and stocks have a long way to go if you were to use this theory.

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Using the above theory, India should always trade at lower multiples than the US. This has rarely been the case as India generally trades at premium valuation not only to the US but also to most high growth emerging markets. Even though the above theory can't be relied upon, I believe that the expected returns from the investors have a significant impact on valuations. Let me showcase my point with an extreme example on how sensitive PE multiple can be.

Let's assume two companies with identical profitability, growth and free cash flows (FCF). The only difference is the discount factor (expected returns) used to discount the FCF .If we change the discount rate by just 3% (use 9% instead of 12%), the valuation increases by whopping 51% ! Yes you read it right –increases by more than half !

Hence if you assume that because of Covid the interest rates have come down by 3% then logically the PE of Nifty which most of time traded in the range of 16-20 in last decade should be trading at 24-30 – infact it is trading in this range now and that also without earnings expansion. On the contrary the earnings have reduced. Valuation is a complex topic and hence can be argued in either way to make one's point. Our job is not to look at Nifty valuation whether right or wrong but look at individual stock and invest in them if we find the valuation in our favour.

We recently invested in ITC during Covid times and have high hopes on this stock from long term point of view. **See the way we look at things :**

ITC is like a great convertible bond – It has changed it's dividend policy recently and announced that it will pay out 80-85% profits. On the latest dividend, at current price of around 200 it translates to 5% dividend yield.

But for it to be like a Bond the current profits need to be maintained. What are the chances that the profits will continue to be high especially given that Cigarette is the golden goose for the government to raise taxes. Consider this:

ITC's latest Annual report: "Cigarettes category remains heavily impacted by punitive and discriminatory taxation.*In the period between 2011-12 & 2017-18 taxes on cigarettes almost trebled."*

Interestingly, Cigarette Volumes have fallen by 17% from 82 bn in FY 12 to 68 bn in FY19. However, EBIT per cigarette has gone up from around Rs. 0.84 to 2.14 And Hence: Cigarette EBIT has gone up 2.57x from FY 11 to FY20.

Thus even in very high tax regime ITC has managed to show a CAGR of 11% in EBIT over a 10 year period. Also during this period, the Cigarette EBIT/Total EBIT has averaged at 85% where it is currently at.

In the worst case, if the taxes become even more punitive which is likely and the profits do not grow, they should be at least able to maintain profits.

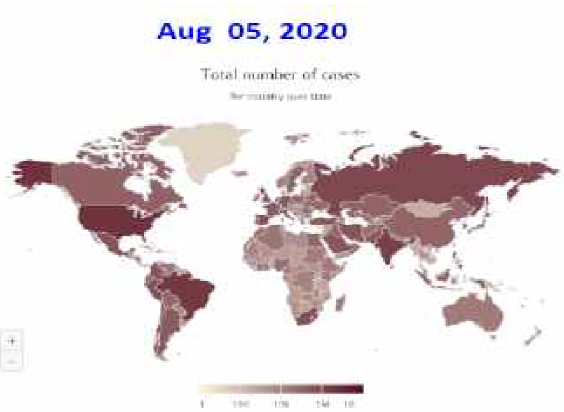
So bond like payout is a high likelihood (add to this any special dividend which acts as a buffer due to huge cash pile in its book **).**

What about other convertible parts? I think ITC's FMCG business, specially food provides the first optionality. ITC's food business crossed the Rs 100 billion in sales milestone in FY20 and its EBIDTA is increasing every quarter. The second optionality comes from a more benign tax regime for cigarettes. The case in point is that a category that accounts for 9% of tobacco consumption pays 80% of the tax revenue. Hopefully government will take the foot off the gas pedal.

As I said instead of looking at Nifty valuation look for stocks which offers value. In this market where stocks are either expensive or have risks, ITC looks like a safe haven.

ITC is just an example I gave. **We through our private investment and surrogate model keep suggesting our investors opportunity at regular interval more so with stocks which are not in the radar of investors or many analysts**.

Happy Investing!!



World as Infected

DIGITIANS are those who born in or after the year 2000 and will be a dominant force through 2075. They are completely different in usage of their left brain and motor nerves. They are different from the Millennials in behaviour, thinking and action.

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