Invesco

Invesco India DAWN Portfolio

Portfolio Commentary - April 2024

(**DAWN: D-** Demand Recovery across cyclical & consumer discretionary sectors, **A-** Attractive valuation to provide margin of safety, **W-** Winning companies on the cusp of a new demand cycle leading to operating & financial leverage efficiencies, **N-** New credit & investment cycle to provide a boost to earnings recovery).

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Market Overview

The Nifty Index recorded a gain of 1.2% in April, rising for the third consecutive month. The mid-cap and small-cap. indices rebounded from the March sell-off and were up 5.8% and 11.4%. Global markets ended on a mixed note. Hong Kong (+7%), Russia (+3%) and Malaysia (+3%) were the major gainers, whereas US Dow Jones (-5%), Japan (-5%) and Germany (-3%) declined the most. While slower than expected US GDP growth, and pickup in inflation along with ongoing geo-political situation kept investors worried, the worries abated a bit, helped by fall in the crude oil prices from their recent peak. Other key developments: (1) the RBI Monetary Policy Committee (MPC) voted with a 5-1 majority to hold the repo rate at 6.5%; (2) International Monetary Fund (IMF), Asian Development Bank (ADB) and World Bank revised FY2025 GDP forecast upwards; (3) Indian Meterological Department (IMD) forecasts an above normal monsoon (>106% of long period average (LPA) rainfall); (4) India's general elections for 543 seats in the Lok Sabha, kicked off on April 19. (results are set to be announced on 4th June.

On the flows front, Foreign Institutional Investors (FIIs) sold in the month of April 2024 to the tune of $1.1bn and Domestic Institutional Investors (DIIs) remained net buyers to the tune of $5.3bn.

On the ongoing results season, so far, 4Q trends have been decent. Numbers for large cap IT were weak while for Banks it was mixed. The average earnings surprise so far has been +3%, led by auto and financial sectors; and the run rate on earnings growth is exceeding the muted expectations for 4Q. High-frequency data for April inched up both on a YoY and MoM basis, reinforcing our constructive outlook on India's growth trajectory. GST collections scaled to record highs, touching Rs2.1tn in April, growing 12.4%YoY, while manufacturing PMI softened a tad to 58.8. Credit growth (adjusted for the HDFC merger) remains buoyant, rising 16.1% YoY in April, with the loan-deposit ratio tracking at 77.6%. Within auto sales, while two-wheelers improved to a 5-month high on YoY basis, passenger vehicles moderated both on a YoY and MoM basis. Services PMI slowed a tad to 60.8 in April, as it continues to remain above 60 for 4 consecutive months, on the back of demand strength and rising new orders. Domestic Air passenger traffic slowed in YoY terms (international travelers' growth healthy), whilst it improved on a sequential basis, while consumer sentiment recorded a further uptick.

India's broad markets have had a virtually uninterrupted run for the last 12-15 months on the back of continuing strength in domestic industrial and investment activity and stability in consumer demand, particularly at the upper-middle and high-end of the income spectrum. While the general market and economic setup remains stable, the second half 2024 is likely to witness a series of events ranging from outcome of general elections, policy formulation by the new govt, progress of the monsoons and global developments relating to the US elections and the discourse on inflation and interest rates. We reckon these can induce higher volatility in the markets in the coming months. On the other side, on expected lines, we have observed an improvement in overall system liquidity coupled with better deposit accretion in the banking system in recent months. This in turn should support the credit cycle even as the RBI continues to remain vigilant about credit excesses developing within any part of the economy.

Meanwhile, global economies such as the US have been reasonably resilient in the face of high interest rates. While we have maintained that probability of recessionary conditions appears low, the recent economic strength does decisively push back the possibility of interest rate cuts in the near future. The path of global interest rates during the course of 2024 has turned quite uncertain given continued strength of labor markets and the recent recovery in commodity prices that threaten a comeback of inflation. It now remains to be seen if the deferment in interest rate moderation can be compensated by stronger earnings outcomes for the corporate sector.

We reiterate that while India's economy basks in a healthy mix of micro and macro factors that favor strong overall growth outcomes, equity markets may possibly overshoot and likely front-end returns with large gains coming in the early part of 2024 and moderate thereafter to reflect risks of various events stated earlier. Risk control will form an essential part of equity allocations for investors hereon, and ensuring diversity of exposure will likely be crucial in our view for 2024. Investors with a 2–3-year horizon can continue investing in a staggered manner. Our over-arching view is that India is at the cusp of seeing a much better economic growth cycle in the coming few years relative to its recent past, which in turn would make its equity markets one of the most attractive investment destinations on a 3–5-year scale, remains unchanged. Moreover, prudent stock selection and appropriate portfolio rebalancing will continue to play an important role to further enhance the overall risk adjusted returns at a portfolio level.

Investment Philosophy

DAWN is a value-oriented portfolio management strategy focused on companies experiencing cyclical recovery or demonstrating operating and financial leverage in earnings. Investments are made when stocks are trading below their long-term average valuations due to short-term profitability pressures, which may be attributed to internal or external factors. DAWN primarily invests in companies where the compressed profitability is mainly influenced by external factors. The strategy also identifies and takes exposure to areas of recovery within the economic cycle during periods of moderate economic growth. It also looks for companies on the cusp of a new demand cycle and beneficiaries of credit & investment cycle.

The success of the DAWN strategy relies on the mean reversion of businesses. As the economic and profit cycles revive, value investors benefit from both earnings' growth and valuation re-rating. To ensure success, two important safeguards are implemented: investing in industry leaders to increase the probability of benefiting from the recovery in the business cycle and maintaining a healthy balance sheet to mitigate the risk to the company's survival.

Current Portfolio Positioning

DAWN is a value-oriented multicap strategy with a large-cap bias. The current large-cap exposure is approximately 69%. Currently, the strategy is overweight on industrials, financials, consumer discretionary and utilities sectors where we find recovery and valuation comfort.

The strategy has focused on segments where recovery is already visible or anticipated, such as the BFSI (banks, sector focused NBFC's, capital market beneficiaries), industrials (engineering & construction, defense, airlines), consumer discretionary sectors (Food-delivery, Jewellery, auto OEM and auto ancillaries) and utilities (where there are positive catalysts).

Within the financial sector, DAWN has invested in banks that are participating in credit growth, exhibit good underwriting standards, exhibiting improving asset quality trends and possess a strong deposit franchise where valuations are trading attractive or below their historic averages. We also have exposure to NBFC's catering to the Power sector where there is a revival in underlying industry fortunes and where there is scope for further mean reversion in valuations. We have also taken exposure to beneficiaries of improving capital market activities viz. Angel One, where execution is strong and its absolute valuations are still attractive. In consumer discretionary, we hold auto stocks with both local and overseas exposure and discretionary pockets where consumption trends are healthy. Industrials include L&T (India Industrial/Infra/hydrocarbon and gulf capex cycle beneficiary), HAL (Defense opportunity). We also own Century Textiles (deep value play on an improving real estate cycle). Within utilities we have exposure to GAIL India (gas transmission business exhibiting both volume and realization growth) and NHPC (business entering into a medium-term high growth phase with improving ROE trajectory). Recently we have also added a pharma company viz. Gland Pharma, which is expected to benefit from reducing US generic pricing pressure, operating leverage led margin improvement journey and offers mean reversion to valuation.

Our portfolio has a significant proportion of value categories (~64%) and incrementally we have been gradually adding value-oriented companies with positive catalysts and more sector leaders, which are reasonably/attractively valued. Parallelly, we continue to trim positions/book profits where the recovery has weakened, valuations have gone up and risk reward is less favorable.

Quality quotient of the portfolio remains high, with portfolio weight of more than 63% having ROEs of 16%+. We believe that current positioning is better suited to the evolving market conditions as it is high in terms of quality and attractive in terms of valuation (QARP). Overall, DAWN's portfolio earnings are expected to grow at a CAGR of 18%+ over the next couple of years and the portfolio has a PE which is at a 10-15% discount to that of the index. Having a large cap tilt, it offers a reasonable margin of safety in case of sharp volatility in the broader markets and overall, it offers a good opportunity for investors over the long term (3-5 years).

PE arrived at using Weighted Harmonic Mean which is an average resulting from the multiplication of the reciprocal of the observation for each component by the weightage of that stock in the portfolio/index. ROE denoted Return on Equity, CV denotes Commercial Vehicles. QARP denotes Quality at a reasonable price), OEM denotes Original Equipment manufacturer.

Returns (%) (Data as on April 30, 2024)

Investment Approach / Benchmark	AUM (in Crs)	1 month	3 months	6 months	1 year	2 years	3 years	4 years	5 years	Since Inception
Invesco India DAWN Portfolio	**323.00**	5.42	8.74	31.79	46.83	26.04	24.24	30.16	18.67	12.49
S&P BSE 500 TRI		3.44	6.05	25.01	38.63	20.19	20.46	28.62	18.21	15.64

Past Performance ay or may not be sustained in future. Returns up to 1 year are absolute & over 1 year are Compounded Annualized. Return Calculation Method: Time Weighted Rate of Return (TWRR). Investment Approach aggregate level return has been calculated after taking into account all applicable expenses (including applicable exit load) & charges across client portfolios. The performance related information is not verified by SEBI. Returns & Portfolio of client wise portfolio may vary vis-à-vis as compared to Investment Approach aggregate level returns due to various factors viz. timing of investment / additional investment, timing of withdrawals, specific client mandates, variation of expenses charged & dividend income.

Overall, the strategy has outperformed the benchmark during the last 3-month, due positive contributions from portfolio companies within the consumer discretionary and utilities sectors.

From a medium-term perspective, the strategy has continued to outperform the benchmark over a 1, 2 and 3 years period.

Earlier, our low exposure to Mid and small cap stocks (which as a category has broadly done well during the last 3-6 months) was one of the causes of marginal underperformance. We have been cognizant of this and have been selectively recalibrating our mid and small cap exposures. From peak 84% large cap exposure 6 months back, we are now at 69%. We have introduced some good companies in mid and small cap space and increased exposure to such companies, which are a part of tail-winded sectors, offering recovery and were available at reasonable/ attractive valuations. These have started adding to the alpha and we would continue to build on this. Over the next 2-3 months, we may selectively add some more mid and small cap exposure which fits the strategy and offers favorable risk reward, as and when we get relevant opportunities.

Key Contributors and Detractors during the last 3 months

Key positive contributors:

- Hindustan Aeronautics Ltd.
- Century Textile & Ind. Ltd.
- Zomato Ltd.

Key detractors:

- Tube Investments of India Ltd.
- AngelOne Ltd.
- Ultratech Cement Ltd.

New Entry / Complete Exits (Last month):

New Entry:

None

Exit:

None

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Investment Objective	To generate capital appreciation by investing in companies available at reasonable valuations.
Type of Securities	Equity & Equity Related Instruments, Money Market Instruments, Units of Liquid, Money Market and Overnight Mutual Fund Schemes and Cash & Cash Equivalents
Basis of selection of such types of securities as part of the investment approach	The focus of this portfolio would be on identifying sectors and stocks which are expected to benefit from revival in cyclical recovery. Cyclical Recovery refers to a period of transition from recession to expansion as part of business cycle which is affected by ups and downs in the overall economy. The Portfolio will also favour companies that will benefit from operating /financial leverage. Operating & Financial Leverage refers to Companies ability to make more operating profit & net operating profit from each additional sale as demand recovers. In addition, investments would be made in companies which are out of favour and are available at a discount to their fair/intrinsic value. For selection of stocks, the portfolio would lay emphasis on mean reversion & value style investing with focus on companies with quality business models & management. The portfolio will follow bottom-up stock selection approach, without bias towards market capitalization or sector. The portfolio would generally comprise of 10-25 stocks.
Allocation of portfolio across types of securities	Under normal circumstances, the asset allocation of the portfolio shall be as follows:

Instruments	Indicative Allocations (% of portfolio value)
Equity & Equity Related Instruments	65% to 100%
Money Market Instruments, Units of Liquid, Money Market and Overnight Mutual Fund Schemes and Cash & Cash Equivalents	0% to 35%

	The asset allocation pattern indicated above may change from time to time, keeping in view market conditions. It must be clearly understood that the percentages stated above are only indicative and not absolute and that they can vary substantially depending upon the perception of market conditions of the Portfolio Manager, the intention being at all times to seek to protect the interests of the Client. Such changes in the asset allocation pattern will be for defensive considerations.
Strategy	Equity
Benchmark & Basis of Benchmark Section	S&P BSE 500 TRI Basis of Benchmark Section: S&P BSE 500 TRI benchmark includes the top 500 companies in the listed space in India and is a broad representation of the listed companies in India, across sectors and market capitalization range; an appropriate representative of the universe of stocks that the portfolio endeavors to invest in.
Indicative tenure or investment horizon	The portfolio is suitable for investors seeking long term wealth creation by investing in equities with an investment horizon of 4 years and above
Risks associated with the investment approach	The portfolio may underperform the broad market if the cyclical recovery in sectors and stocks takes a longer than anticipated. The benefits of operating and financial leverage may not materialize as expected. Also, value investing involves the risk that the market may not recognize a security's intrinsic value for a long time, or that a security thought to be undervalued may be appropriately priced when purchased. Also, adverse tactical asset allocation between equity & cash could affect the performance of the portfolio. This portfolio is recommended for investors with higher risk appetite seeking long term capital appreciation.
Other salient features, if any.	Not Applicable

Direct Onboarding: We do offer direct onboarding of clients, please write to us at pms@invesco.com for more details.