JST Investments

July – Dec 2020 Update

This is the first quarterly letter to our Investors. Our letters will provide an update on our portfolio performance and present our views on relevant topics.

Performance

Particulars	Details
JST High Conviction Portfolio Return	**39.70%**
Nifty 50 Return	**34.40%**
No Churn	

A Message from our CIO

Respected Clients,

2020 has been a big learning year for a smart investor.

As COVID-19 brought the world to a standstill, Times were uncertain. The stock markets came down by nearly 40%!

Surprisingly, the recovery was even faster. By the end of 2020, we have started to break the 3-year long bear run we had seen since the beginning of 2018, with the markets starting to move up very fast.

Thankfully we were able to get through all this volatility without any hiccups. We have tried to minimize the risk for our clients. At JST Investments, our High Conviction Portfolio that started in July 2020 has delivered a return of 39.7%.

Will the Markets rise relentlessly in 2021?

The Legendary investor Mr. Warren Buffet says

Only two people know the markets in the short term

1. God
2. Liar

As the vaccine for COVID-19 starts to become available, the markets begin to start pricing in the recovery at a relentlessly fast pace. We are fast reaching the point where anyone and everyone who puts money in the stocks is starting to make money. Poor quality stocks are also continuing to rise in the broad-based rally.

At JST investments, we are always concentrating on capital protection for the clients. As the markets move to un-reasonable valuations, we will not celebrate. We will remain cautious.

As 2020 goes away we would like to thank you for your trust in us and we hope to generate returns while keeping the risk low for many years to come.

For us, it will be always Return of Capital >>> Return on Capital

Our advice:

When the market moves irrationally down, do not panic.
When the market moves irrationally up, do not celebrate.
Always be humble - There is a long way to go!

Best Regards,
Aditya Shah, CFA
CIO, JST Investments

As is our tradition to educate investors, we present our hypothesis on why 3 major sectors i.e Banking, Automobiles and Real Estate have bottomed out.

Predicting Market cycles

An essential aspect of investing is to predict the market cycle. If we know the broad trends across various sectors we can use them to our own advantage.

So where are we on the greed and fear cycle?

Let's dig deep into the 3 big sectors of the Indian economy to answer this

Banking

Credit in any form is the backbone for growth in any economy. Bank credit stands at Rs 105.04 lakh crore & Deposits stand Rs 145.92 lakh crore. The size is incredible.

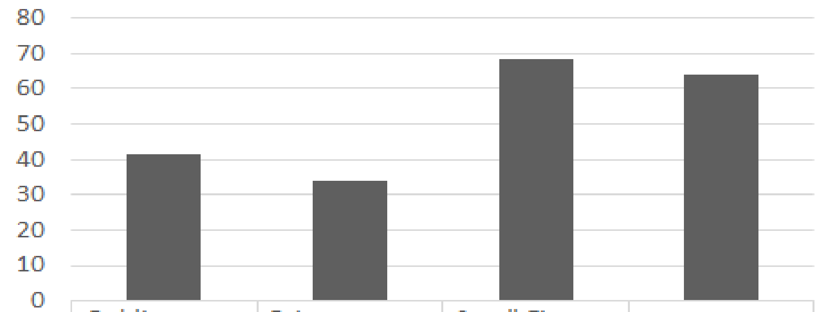
Over the last 3 years, the following events have taken place in the Indian economy which has led to a collapse in credit offtake

- IL&FS crisis
- DHFL crisis
- PMC Bank Crisis
- Yes Bank failure
- Franklin Templeton closure of Debt Mutual Fund schemes
- Freeze in credit/money markets
- Covid-19 NPAs
- Lakshmi Vilas Bank failure

The freeze in the credit market meant that many NBFCs were in deep distress. Banks stopped lending across the system which can be clearly seen below.

Bank Loan Growth trending downwards since the start of the decade

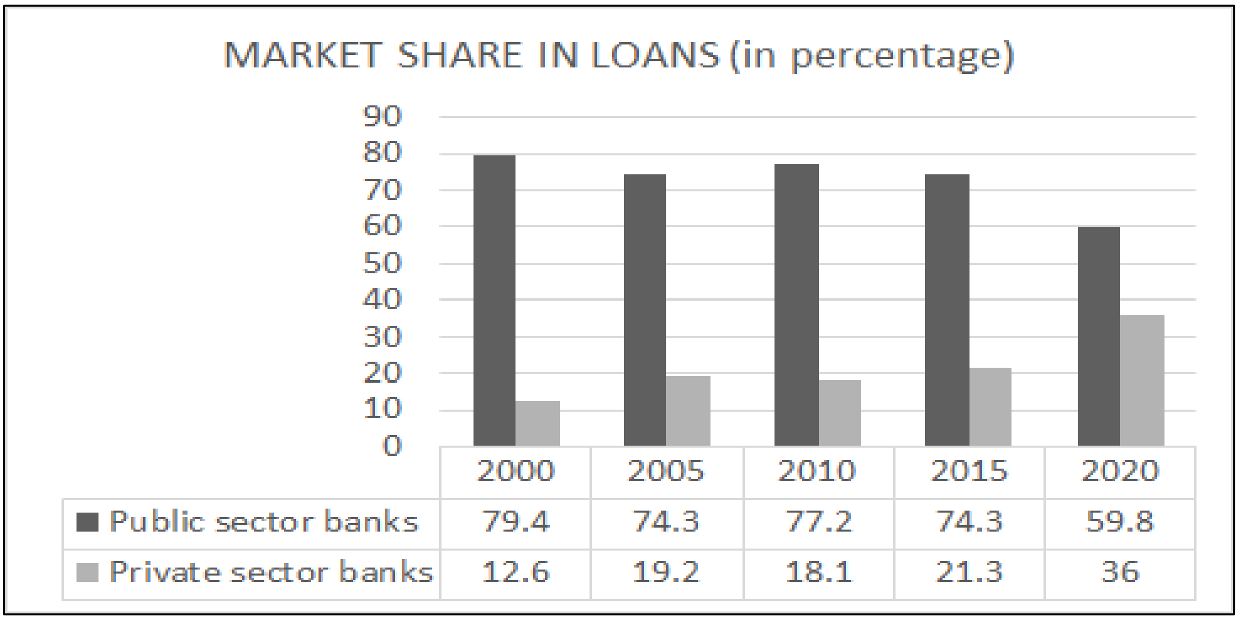
To make things worse the Covid-19 crisis has resulted in a massive surge in NPAs across the system will result in shown below from the RBI estimates



	Public sector banks	Private sector banks	Small Finance banks	NBFCs
Moratorium as a % of loan book (As on 31st Aug)	41.3	34	68.2	64.1

So why do we think that Private sector Banks have hit the bottom?

PSU Banks with their merger idiosyncrasies, expected COVID related NPAs & abysmal capital adequacy (an investor must note that the government has limited ability to recapitalise them for the near term) are set to lose the battle at a much faster rate.



	2000	2005	2010	2015	2020
Public sector banks	79.4	74.3	77.2	74.3	59.8
Private sector banks	12.6	19.2	18.1	21.3	36

Some pointers why big private sector banks will do well -

1. The continuous gain of market share
2. The Moratorium book or the book which is not paying interest is far lesser than any PSU bank.
3. The strong deposit inflow into all top private banks
4. Under the direction of the RBI, almost all private sector banks have raised nearly 1 lakh crores in total, which is readily available to lend.

As the economy recovers from the COVID-19 shock, private banks flushed with money will start the next leg of credit growth which will in-turn help the Indian economy growth.

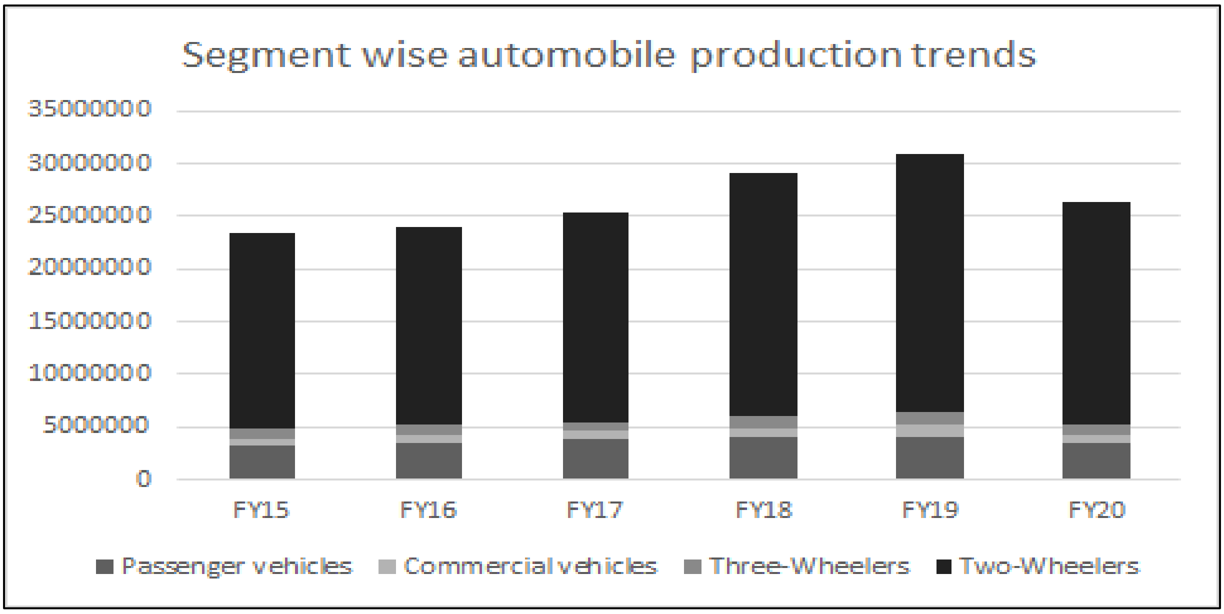
Automobile Sector

The auto sector is one of the biggest sectors in this country.

To put it in context, the Auto Sector contributes 7.5% of India's GDP & 49% of the Whole manufacturing GDP with a huge economic multiplier effect. If you consider the forward & backward linkages, the Auto sector directly & indirectly employs 4cr people. So, who gets affected if the auto is in a downturn? Almost everyone & if India has any aspirations to bring the manufacturing from the current 15% to 25% of GDP by 2025, automobile sales must increase at a much higher rate than in the past.

Ever since the economy started slowing down in 2018. The auto sector has been the worst-hit sector.

As can be seen, below we are at 2015 production levels for many segments



Various factors like

1. Strict lending rules due to NBFC credit squeeze
2. Higher taxes on fuel, to the tune of 65% of the cost
3. More expensive insurance cost
4. Increased taxation from the government
5. Cost of ownership reaches a new high led by BS6 norms
6. Shared mobility like Ola and Uber

Are we at the start of the next upcycle?

Bottoming out of a sector is a process.

The massive dent that the auto sector has taken means that valuations across the auto ancillary space are at bankrupt valuations.

Covid-19 is a trigger where people are already moving away from shared mobility to owning vehicles.

Government has actively understood the importance of the auto sector and the scrappage policy and the parliamentary recommendation of reducing the GST should help.

As more and more steps will be taken to revive the sector, the recovery will be slow but it will surely happen!

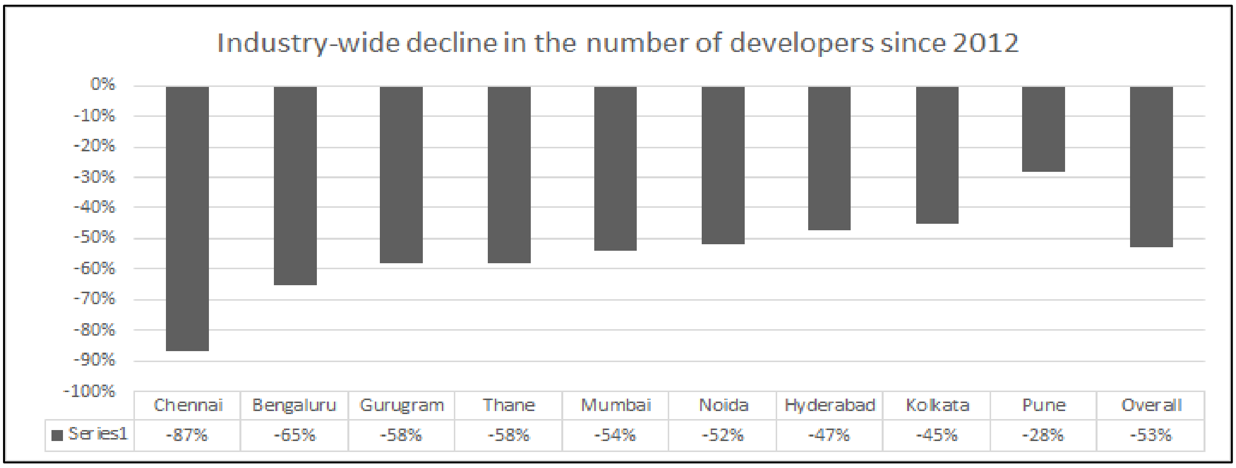
Real Estate

Though RE was one of the highest return generators from 2004-2012, it hasn't done much in the last 8 odd years. The last decade has brought significant time correction where prices have more or less remained stable. Developers bore the suffering due to the reckless underwriting of projects during the last upcycle.

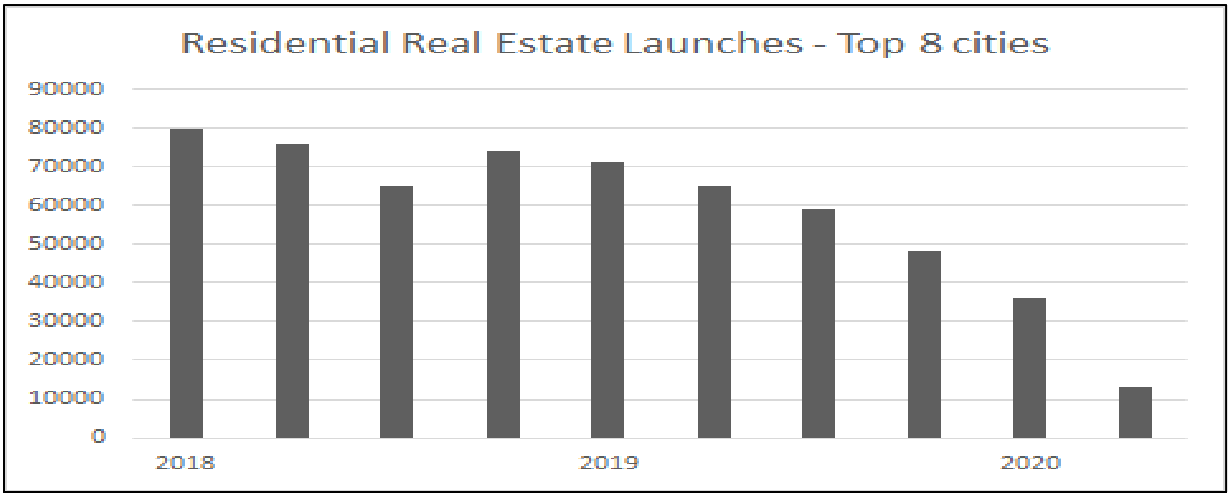
This was further strengthened by external shocks like

1. Demonetization
2. RERA,
3. GST,
4. IL&FS crisis which leads to severe liquidity environment for NBFCs (ones who are forefront lenders to developers)
5. The final nail in the coffin, COVID-19

Summing it up, it has led to a massive contraction in the number of developers in all key markets.



As a number of developers went out of action, those who stayed weren't spared. Their balance sheets have consistently deteriorated due to high unsold inventories, also taking away their focus from new projects. Massive consolidation will benefit developers with an established track record.



So why do we think Real Estate has bottomed out?

1. Interest rates which are one of the key inputs are at a multi-decade low.
2. A lot of builders with poor balance sheet quality are out of the system
3. There is has been a broad-based clean-up in the books of lenders.
4. States offering incentives to 1st-time buyers is the cherry on the cake.

As all of these 3 sectors start to bottom out, we will see wealth created across these sectors and therefore the Indian Economy will start coming back on the growth path.

We at JST Investments have identified these cycles and are working to capture the returns across client portfolios.

If you have any queries about your portfolio, about JST Investments or Investing generally do reach out to us –

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