Meet the Manager

Consumption can lead the earnings cycle

RADHIKA MERWIN

Given the slow-growth global environment, we should not expect a V-shaped recovery, says Roshi Jain, Vice-President and Portfolio Manager - Franklin Equity, Franklin Templeton Investments – India. Excerpts from an interview:

With equities off to a shaky start this year, what is your outlook? How much influence can global factors have on our markets?

From a structural perspective, we expect the share of global flows into India to increase in line with the rise in our share of global GDP. There are many global factors that will impact capital markets and the economy — many companies are in the commodity sector or have external linkages in the form of exports. But amongst many emerging markets, India perhaps has the least linkage (earnings sensitivity) to global cyclical factors. This should help us navigate the volatility much better. Further, India stands less correlated to the synchronised challenges the developed markets face and hence, provides a useful diversification from a global investor's perspective. These trends have generally played out in the past and will in the future, too.

Today, the growth cycle hasn't really picked up and global volatility is very high. That makes the medium to long-term visibility on our growth a little muddled. This is resulting in some outflow. But once the growth cycle picks up, India should start seeing increase in global flows.

But when do you think growth will recover? We have been betting on recovery for some time now.

First, we should not expect a V-shaped growth recovery, because we are operating in a slow-growth global environment.

Contribution from private sector capex in commodities like steel, is unlikely to recur this time. Growth will not be broad-based, because many parts of the economy are not firing as they were in the previous cycle.

The pace of growth in our economy will not be similar to the past. However, the quality of growth will be a lot better because inflation and current account deficit are not as big a concern as in the previous cycle. Fiscal deficit, too, appears under control. Market multiples are also a function of quality and sustainability of growth, not just the quantum of growth. The slower growth this time around will be offset by the better quality. There will be a lot of polarisation in the way sectors or stocks perform. And that is where our focus is — on sectors or stocks that have specific triggers, linked to a revival in domestic consumption or infrastructure.

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> ROSHI JAIN
> Vice-President and Portfolio Manager - Franklin Equity, Franklin Templeton Investments – India

But don't you think that capex recovery is critical for markets?

Markets are driven by earnings growth across various sectors. And yes, broad-based capex recovery may help in driving earnings of capital goods, and industrials sector. However, this is not a prerequisite for aggregate earnings growth.

Consumption can lead the earnings cycle in the foreseeable future, before investment-led growth picks up.

Also, we believe that this time capex will be led by government spending. We are looking at the government to kick-start investment activity through projects in roads, railways, power distribution, and renewable energy. So, betting on a comeback in capital goods or industrials will have to be very stock-specific. Not all companies will benefit indiscriminately.

How much of headroom do you think the Centre has on spending?

The soft oil prices have substantially wiped off oil subsidies and shored up government finances in the form of higher tax revenues. This gives the government enough leeway to direct its spending towards productive infrastructure creation.

However, the government needs to adhere to some fiscal prudence and this balancing act will play out in the near term. While there might be some near-term overshooting on the fiscal deficit (if the government decides to spend), the quality of fiscal deficit will be a lot better and hence, might not be inflationary as is commonly feared.

Which themes do you bet on?

The bet is on the domestic economy. We are betting on banks and consumer discretionary sectors. The banking sector has gone through a lot of pain in the last few years and is in the midst of a fairly deep restructuring.

Most of the stock prices have factored in this pain. So, there is opportunity in banking stocks from a risk-reward perspective.

Consumer discretionary, as a theme, should play out well too. The positioning of our funds is pro-growth.

We look at growth, not from a two or three-quarter perspective, but from a medium-term perspective. We look for growth at a reasonable price.