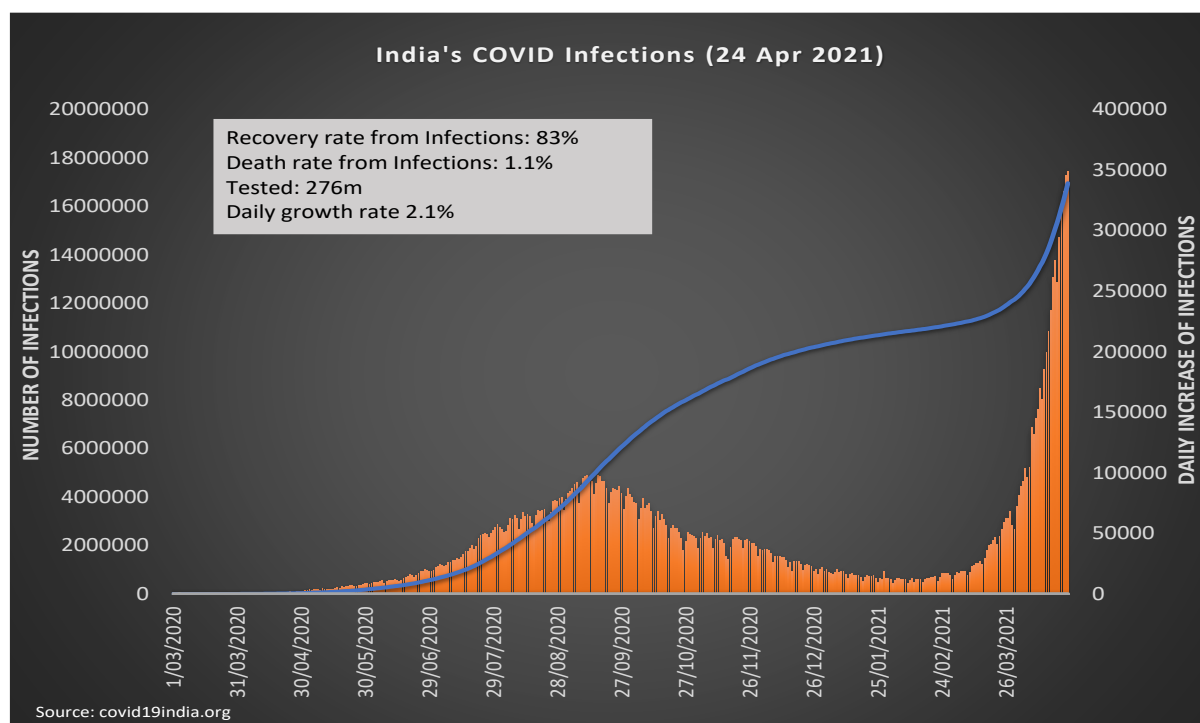


Investors riding the second Wave of COVID-19 in India

We thought we should address the issue of the second wave of COVID-19 infections in India, by putting together a short note. We express our deepest sympathies for people who have lost their lives during this pandemic, not only in India, but across the world. That tally stands at above 3.1m. Of this, unfortunately 195,000 are from India and the daily numbers are not showing signs of improvement yet, in this wave.

The dangerous surge in infection numbers is averaging 350,000 new infections per day at present. Positively, Mumbai as a city is showing signs of peaking and we expect Maharashtra (a state, where Mumbai is the capital), will peak closer to mid-May, with rest of India around June. The ferocity of the second wave relative to the first wave can be seen below:



Source: www.covidindia19.org, India Avenue Research

India's medical infrastructure (meaning hospital beds and oxygen etc.) is currently struggling to cope with these numbers. Prime Minister Modi addressed the nation last week, stating that there would be no national lockdown and the responsibility would be passed onto the States. He stated in his speech that the States should use lockdowns as their last resort, given the lasting social and economic impacts evidenced during Lockdown 1.

Whilst the situation is dire from a loss of life and wellness perspective, our clients do pay us fees to provide insights and views on India's equity markets and the impact on our Fund's returns. Keeping that in mind, we highlight our views on India's equity markets, our Fund's return profile and India's currency (Rupee or INR) relative to the AUD/NZD. These are the three factors which drive the return achieved by investors in the India Avenue Equity Fund.

India's Equity Markets

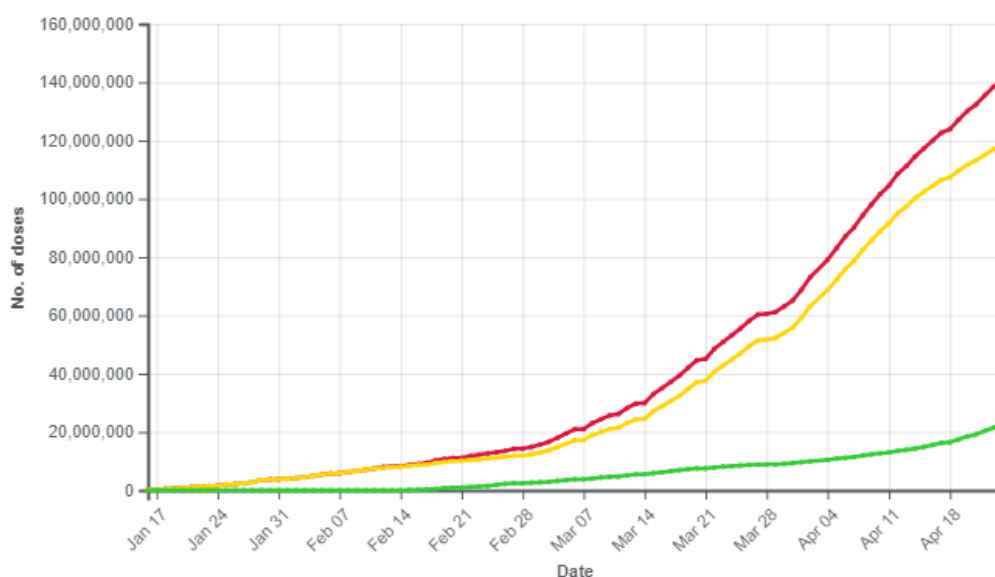
We consider the movement of the MSCI India in AUD (our benchmark) since its recent peak on 1 April. From the close of 1 April 2021 to 22nd April, the benchmark has experienced a fall of 6.41% in AUD terms. This is in response to the infections rising on a sustained basis since mid-March – almost exactly a year after wave 1.

The key difference so far in the response of markets can be attributed to the following factors:

1. Presence of a vaccine/s and the speed of its roll-out.
2. Decision makers, the economy, corporates already having experienced this scenario in recent history and being better equipped on response and reaction.
3. Strong earnings expectations from a base effect and sustained lower cost structures.
4. Potential for a reasonable monsoon to keep the rural sector growing.
5. Improving growth scenario as the global economy recovers.

1. Vaccination Drive

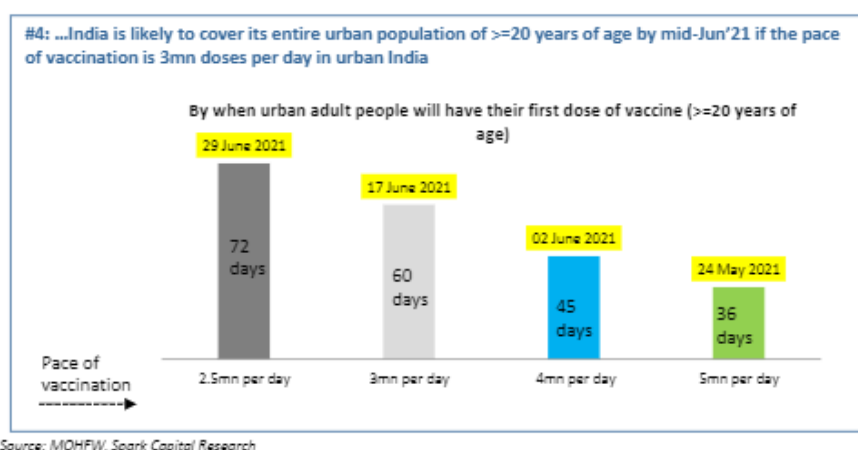
Close to 150m have been vaccinated now, with about 15% having had a full dosage (2 vaccinations, 28 days apart). Vaccinations are being administered at around 3m per day and it is expected this can increase as India ceases exporting of locally produced vaccines, offshore suppliers become available locally (currently Covishield – AstraZeneca/Oxford/Serum Institute and Covaxin – Bharat Biotech/Indian Council of Medical Research, with Sputnik 5 – Russia arriving soon) and urgency of administering and manufacturing doses rises (manufacturing capacity is being increased).



Red – total vaccinations, Yellow – first vaccination only, Green – both doses administered

Source: mohfw.gov.in

The term “Herd Immunity” will be heard with reference to India relatively soon in our view. Initially vaccinations were focused on those aged above 60, before being reduced to being available for those above 45. The most recent iteration extends availability all the way down to those above 18.



Analysis by one of India's leading brokers highlights that given the existing drive, India's **urban population above the age of 20 will be fully vaccinated by mid-June 2021** or far earlier if the pace is upped to 5m administered every day. Given that the outbreak is predominantly a metropolitan one, the pace of vaccination will be critical.

2. Second time has less "risk of the unknown" built into current share prices

Given the recency of the first wave and the lockdown of 2020, which put India at a standstill, the Government of India has advocated that future lockdowns be initiated at the micro rather than macro level. Companies are also in a better place to deal with the impact of slowdown/lockdown on their business given they have recently "weathered the storm".

Most investors appear to be looking through the grim "valley" at present to an emergence of demand, private investment, infrastructure, whilst interest rates remain low. If anything, the Government and RBI will compensate and allow for some inflation in the pursuit of growth, post wave 2 – particularly if herd immunity is approached.

3. Companies and earnings

Earnings for Q4FY21 (March ending) and 1QFY22 should exhibit significant growth given the low base effect of the lockdown and weak growth prior to COVID (2018-2020). When looking at earnings with a 2-year lens from F19-FY21, companies will have a solid growth trend which should continue into FY22/23. Earnings will be driven by lower provisioning from banks, rising metals and commodity prices and demand for technology services. Earnings growth can be expected to average 20% p.a. over FY20-23, which places India at a P/e of 17x on a 2-year forward basis (March 2023/FY23). We think this is attractive relative to 20% plus annualised earnings growth over the period.

The earnings growth story is not just being driven by a bounce from COVID and a low base effect. It is also because prior to COVID, India's corporate profit-to-GDP had fallen from peak levels of 6-7%, to as low as 1.8%. We expect some of the profit growth will be driven by mean reversion as interest rates remain low and incentivisation and budget spending have been highly growth directed.

4. Reasonable monsoon

The monsoon has a significant impact on India's rural population and food inflation. Given significant rain over the past two monsoons, India's water supply is substantial. Additionally, the bureau has forecast a normal monsoon in 2021, which bodes well for sowing and harvesting. This is likely to lead

to a bumper festival period in Q4CY21 – especially if wave 2 has been weathered by then. The “wealth” effect of the rural sector can have a profound impact on local consumption.

5. Global growth resuming

With global growth showing signs of resuming after most countries have weathered the second wave, metal and commodity prices have been strong. Additionally, with low interest rates and significant liquidity in the system it is expected that capex increases particularly in areas like technology, healthcare, infrastructure, renewable energy, and manufacturing. This should be positive for India’s global cyclical, pharmaceuticals, and IT outsourcing firms.

6. Other Positives

Domestic investors have turned into buyers as foreign investors sell, indicating their confidence that valuations are becoming more attractive. Secondly some of India’s attractive industries like IT, Pharma and exporting businesses are benefitting from global recovery and a weaker Rupee.

The India Avenue Equity Fund

Our Fund is philosophically aligned to investing in businesses which are experiencing the following:

- Compounding earnings growth, with a financial moat that will protect higher valuations (consumption and banks).
- Companies traversing from low ROE to high ROE, thus making the journey from market or discount valuations towards a premium (manufacturing, pharmaceuticals, real estate).

However, in recognition of strong global growth, we have also added a sleeve for companies which will benefit from their ability to win global market share from their capabilities rather than discounting i.e., IT services, manufacturing, and exporting, auto and auto ancillaries. As India becomes a more significant economic presence globally, its businesses are starting to win market share not only for pricing (labour cost advantage and scale benefits) but also technical excellence (skill and IP).

The INR vs AUD

The Australian Dollar has appreciated significantly since the deep and impactful effect of COVID-19, witnessed in March 2020. The rebound has been spectacular, rising from Rs.43 to Rs.58 for 1 AUD (a 34% appreciation from the bottom to now). This has curtailed returns for investors in AUD terms on an unhedged basis. The positive impact for the AUD has been driven by Australia’s low impact from COVID, stimulus and rising commodity prices, particularly Iron Ore. The impact has been slightly lesser for NZ investors (20% appreciation from the bottom to now against the Rupee). The NZD has not been as jet propelled as the AUD, when it comes to Iron Ore.

At present the Rupee has been under pressure given some foreign investors withdrawing funds or curtailing additional flows after a period of significant gain (12 months to March 2021) and more recent weaker export performance than expected. **In our view the Rupee is poised for a rally as India’s Central Bank has accumulated substantial foreign reserves and in the balance of inflation, currency, and growth, are likely to heavily lean in favour of growth. In conjunction with high level of forex reserves, our view is that the currency will be well bid once the second wave is addressed.**

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