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Cutting exposure to capital goods, industrials; waiting for IT to bottom out: Devina Mehra

Synopsis
Devina Mehra of First Global reflects on the market's consensus shift towards capital goods, emphasizing the need to monitor potential sector peaks. She also discusses stock market volatility, election impact, and risk management strategies for smallcap stocks. Mehra says: "We have added a few commodity stocks in our last rebalance -- some amount of metal, steel, etc, and even some cement."

Devina Mehra, Chairperson, MD & Founder, **First Global,** says: “Capital goods, industrials is now consensus trade. We went overweight on it in October 2021 when it was considered a dog sector. It took the market another two years to discover it. The Stocks have doubled, tripled, even quadrupled and we have been cutting exposure. We have been changing the stocks. We do not hold as much as we used to, but we still are overweight. But that story may well get over in some quarters. On the other hand, the stocks which we still like are auto, pharma and some construction. While we are not hugely overweight on IT, we are waiting for it to bottom out. Sometime this year that will be the big opportunity.”

This comeback in the market has surprised everybody. From where we were in a turbulent March versus where we are in terms of May, benchmark indices have made a roaring comeback. Are you a bit surprised with this comeback in the market from the lows of March to the highs of May?

Devina Mehra: My view on a one-two year basis has always been positive on the market, especially on the non-frothy end of it. That is what I said last time also. Yes, we were expecting a little bit of volatility, which we have seen. We are still a bit cautious on the very short term in terms of possible volatility. So, we are hedged on our portfolios, on our PMS, we are hedged so that is still the case. But as I said, we do not see any risk of a big crash. We are fairly positive in the medium term, hence we have not made any cash calls. So, I mean, we are where we want to be.

For the longest time, we have used the Fed as a benchmark to judge liquidity, to judge the mood of equities. But in the last six-eight months, whatever Fed has said, it is not having an impact on the market. First, they said we will cut rates. Now, they are saying we may not cut rates. Markets are saying it does not matter what the Fed is doing, we will do our own bit. Isn't it amazing? The Fed is getting irrelevant and it used to occupy the centrestage.

Devina Mehra: Well, my view, which I have tweeted also in the past, is that the same set of circumstances you can use to explain whether the market is going up or down. So, if rates are not getting cut, you can say economic growth is so good that rates are not getting cut and therefore the market is going up. If the market was going up when the rates were getting cut, you would say the rates are the driver.

Therefore, the same thing can be looked at both ways. You can use it to explain the market going up or down. So, the stories always follow what is happening in the market and there is this good book called ‘Everything is Obvious Once You Know the Answer’. Depending on what is happening, you can always retrofit it.

In terms of the Fed itself, the rate cuts, I have never been in that camp which said that rate cuts would happen in a hurry. If you go back to 2023 beginning, at that time the consensus was that in the second half rates would be cut and I said, that is not going to happen. In 2024 beginning, the consensus was that March itself rate cuts would start. Again, I was not in that camp because the coming down of inflation is a very slow grind. It does not happen in a hurry. It does not happen in months. It does not happen in quarters.

Right now, the Fed is doing a bit of a balancing act. I mean, they are saying we are not driven by election year, but the fact that they have slowed down on the quantitative tightening, that while they are not cutting rates, they are still somewhat dovish. There is an overhang of election year everywhere.

Is it as obvious or is it going to be only foresight as to what our own elections would imply for the markets right now or do you think right now is a little early to try and pencil in what the market thinking is?

Devina Mehra: I think the market thinking and the whole consensus thinking is the same. I do not think people are expecting any surprises. By definition.

As per our systems whether it is election driven, geopolitical driven, whatever, are seeing possible volatility for another month or two - that is possible. But we spend a lot of time thinking what impact will the elections have and if you go back 20 years to 2004 which was an absolute surprise, you had the sitting government so confident that they advanced the elections by six months and then almost the entire cabinet lost.

So, it was a complete surprise and the market crashed on the day and if I am not mistaken, the market itself was circuit down and the trading was halted but it recovered in no time and that one year was one of the best years ever in market history. I think we spend too much time and effort trying to predict election results and the market has its own mind and it may not even mind a surprise at the end of it as we saw 20 years ago. But I do not think that is happening.

For the most part, the majority of the commodities have been on an upswing of late. How are you reading into this?

Devina Mehra: If I look at what we have done in the Indian markets, yes, we have added a few commodity stocks in our last rebalance, in fact a little before our last rebalance itself. So, some amount of metal, steel, etc, and even some cement but we are not heavily overweight or anything.

In terms of precious metals, our bet in our multi-asset portfolio, both in India and globally, has been to add a bit of silver. Again, these are not big bets, but we think silver is looking better than gold now. So, we have added a bit of silver. We do not see a very huge commodity upcycle in terms of either the quantum of the move or the length of the move, but right now, yes, as you said that there has been somewhat of an uptake.

In the last whole two years has been about the K-shaped recovery in the market, premiumisation coming stronger. But just looking at Dabur’s numbers yesterday and what the rural growth actually entails, from negative 5%, it has jumped to now 6%, the rural sales that is, do you think it is now time to start betting on a rural recovery? These are some of the exposed sectors which have been completely ignored, much like what is happening with IT right now?

Devina Mehra: Well, I have not seen the Dabur’s commentary or the details, but if you are saying it was down 5% and then it is up 6%, it is back to where it was two years ago, which is not saying much. I think that that part we cannot ignore completely, that there has been a big disconnect in what is happening in different segments of the market.

I was reading Rama Bijapurkar’s book *Lilliput Land*, and to me what stood out the most is that the bottom 60% of India now has no surplus at all, income minus, not even taking one-time expenditure, but routine expenditure, they are negative and there has been an absolute decline in their incomes. From FY16 onward, there has been a downward slope for the bottom 60%, most of all for the bottom 20%. Their incomes have gone down in absolute terms.

Those things are still an overarching thing. Yes, from a beaten down level, sometimes you will see that growth, but if you look at the GDP number also, consumption growth last I saw was sub-3%. The last time it was that low was 2002-2003. Hence those are still concerns. Employment is still a concern and employment and consumption are actually quite down, So, yes, from beaten down level, something might perform and we may see revenue, stock performance, but overall, the recovery is K-shaped. That story has not changed that much.

The general consensus was that smallcap is where the bubble and trouble is. Largecap is where the margin of safety was and that has really been the Street view for the longest time. But in this market correction, mid and smallcaps first fell hard. They were due for a fall, but they have also come back with the gusto. My question is are you a bit surprised with the price action in mid and smallcap stocks? For the holders it is a delight and for the non-holders it is a surprise.

Devina Mehra: You get these falls, bounces, falls, bounces, before anything big happens. Also, remember now, the definitions of small and midcaps are now number of stocks based, the top 100 stocks and 250 stocks like that. So, actually, what is now classified as midcap for instance would have been largecap not so long ago.

So, the way we look at it is from the risk management perspective rather than the paper perspective. So, we are very careful with anything below Rs 5,000 crore market cap. We do not look at anything below Rs 1,000 crore market cap. Below 5,000 also, we are careful because those kinds of stocks, simply because we always prioritise risk management first, because only if you do not lose, do you win, this is the basic principle in the market, it is a loser's game. Investing is a Loser's game. So, the problem with very small stocks is that unlike largecaps, you cannot have a proper risk management system either.

If you put a stop loss, you might never get a chance to exit that stock. When they fall, they can go all the way down without you getting an exit. Many of them just disappear. Only about 4,000-4,100 companies are traded in the Indian market. The number of listings, if you add it up, all the IPOs historically, was several times that. So, all those many companies are nowhere to be seen. The smallcap index itself churns 20% a year, 18% to 20%. So, in four-five years, it is a completely different index. So, all those things also have to be kept in mind.

As I always say, do not forget your school arithmetic. Even in 2018, 2019, the smallcap index fell nearly two-thirds. Even if it triples from there, you are at zero. Those things have to be kept in mind. I mean, basically we limit our exposure below Rs 5,000 crore market cap quite severely, even if things look good. Be careful on that end of the market. You need not avoid it completely. But where you are buying and how much of your portfolio is there, is where you have to be careful.

Divide the market into what is the consensus trade and what is a non-consensus trade. The consensus trade is capital goods, defence, machinery, energy The non-consensus trade, is consumer staples and IT to some extent. Now, it is getting on the wrong side of the trade. Where are you picking your spots? Would you like to be with the consensus or it is time to look at non-consensus?

Devina Mehra: Capital goods, industrials is now the consensus trade. But we went overweight on it in October 2021. At that time, everybody thought it was a dog sector. It took the market another two years to discover it. So, the question we ask every quarter right now is, is that story over? Because that has given us great returns. Stocks have doubled, tripled, even quadrupled and we have been cutting exposure. We have been changing the stocks, we do not hold as much as we used to, but we still are overweight. But that story may well get over in some quarters.

On the other hand, the stocks which we still like are auto, pharma and some construction. On the other side, while we are not hugely overweight on IT, that is the one we are watching for a bottoming out. Sometime this year that will be the big opportunity.