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Heading into 2025, what stocks to avoid and what to buy? Devina Mehra answers

Synopsis
First Global's Devina Mehra discusses their investment strategy, focusing on pharma, healthcare, IT services, and auto components. They are generally underweight in banks. They reassess quarterly, looking for the best opportunities available. Devina advises staying invested in equities with a conservative, steady portfolio, considering market volatility and broader economic factors like inflation and currency management.

Devina Mehra, Founder & CMD, First Global, says they review investments quarterly and will be making adjustments soon. Their current focus is on pharma and healthcare, IT services, and auto components, having reduced the previous heavy investment in capital goods and industrial machinery. First Global typically maintained an underweight position in banks and lenders, except for a more balanced approach in 2022. Although banks don't look bad now, they prefer to stay underweight in that sector. They are also underweight in energy, power, paints, and durables, guided by our bottom-up analysis using AI and machine learning. Each quarter, they reassess our strategy as if we had cash to invest today, focusing on the best opportunities.

How has the year gone by personally for you with your funds doing so well? You have managed to really weigh both sides on the way up and for India on the way down as well, I should say, and including the volatility that came about.

Devina Mehra: Yes, 2024 was a good year, even though as always we were conservative, so we did not go towards the smallcaps, micro caps and managed volatility. This year, we spent 1.5% on hedges because we saw volatility several times in the year, but each time it was short lived which was good. But as I say, insurance does not go to waste just because you did not get hospitalised that year. So, it has been a good year.

The flip side of the good year and the good times we have been having in general, barring the very last few weeks, has been that the expectations for new investors and even some old investors have run ahead of expectations. I have people coming and telling me that I do not want great returns, 30% is good enough for me.

So it's fine if you triple in three years, which I said, yes, it has happened but does not mean that it will happen every three years and the only thing certain with taking high risk is that you are running the risk of high losses. High returns are not certain. And especially this year, when not just the good stocks – in fact good stocks have gone up probably less than the riffraff. So that is the lesson that the investors probably have not learnt, especially investors who come in the last few years and who have seen nothing but the market going up.

Yes, that is the problem because since the Covid lows, we have been just so spoiled with the kind of parabolic returns that until last year, anything you have touched has given you good returns without even thinking about it. How do you then prep and brace investors who are anticipating 30% return even going forward?

Devina Mehra: One thing you must remember is why we had that bull run from the Covid lows. We have this impression that the Indian equity market should give you about 15-16% because that has been the long-term compounding. But in between, there was a whole decade, 2010 to 2020, where returns were very subnormal. If you put in Rs 100, in 10 years, it would have become Rs 230 wherein fixed deposits alone would have given you something like 200. So, you got no returns for being in the equity market.

Contrast that with the 80s, where at the beginning of the decade if you put in Rs 100, it would have become Rs 700. That is what created the room for the bull market. I have been looking at long-term rolling returns, 10 years, 5 years, etc. We are still not at any extreme end. The risk of a sustained crash is only when you are at extreme ends, and that I do not see.

But for investors, I would say that if you have made a lot of money in some areas which look very frothy, get out of that and get into a steadier portfolio. But I would not recommend that you go into cash for whatever is your equity allocation. Do not have 100% of your assets in equity, but whatever is your equity allocation, remain invested because you may not catch the exact bottom.

For people who have been sitting on the sidelines and saying I will put in more or I will put in when the market goes down or there is a correction, my question is that, have you invested because there is also a risk to not being invested? Like this year, we bought hedges because we foresaw a volatility and volatility happened, but for a very short period. So, if we had gone into cash, we would have missed out that brilliant up move we have had. So be in a steady, conservative portfolio, but remain invested, that would be my recommendation.

I was recently reading something that you have written about asset classes. You have written that when a correction follows a bull market and there is an uptrend visible, it is not the same set of stocks that will participate in the next bull run. Heading into the next year, what is looking frothy, what should be avoided and what is looking good? What is going to participate in this rally if at all we see a rally heading into next year?

Devina Mehra: New investors do not know that even if the market goes up, very often the stocks that fall are not the stocks that go up in the next uptrend. And you can see this because there are only about 4,000-odd stocks that trade in the equity markets and listings have been many times more. So, not only do stocks not go up, a lot of stocks just disappear into the blue.

In the 1990s, there were years when there were 1200-1300 IPOs and many of those stocks have just disappeared. That is why I am saying be in a steady portfolio because in many of these smaller stocks, it is really impossible to have an effective stop loss. When they fall, they fall like a stone. There are no hedges available because the only liquid hedge is on the Nifty which does not move along with that.

Coming to the sectors, I would not like to give a one-year outlook, because we look at everything on a quarterly basis and we will be rebalancing because the quarter is getting over in the next 10-15 days. So this may change. As of now, where we are overweight has been pharma and healthcare, IT services, and auto components. A sector we were overweight for a very long time, for three years, was capital goods and industrial machinery, where we are now underweight.

Most people discovered that sector only about a year or a little more than that in 2023¸but we were overweight from October 21. Now we are underweight. That is the way. In banks and lenders, we are normally underweight. The only year we were market-weight to overweight was 2022, not that they are looking particularly bad as of today, but I am just saying that that is a sector we are generally underweight.

Then things like energy, power, paints, durables, are the sectors where we have been underweight. But that is normally a result of our bottom-up picks using our artificial intelligence and machine learning system. That would be the broad pattern as of today. But every quarter, we look at everything as if we had cash today, where would we be? Where are the best bets today? And that is how we invest.

But you talked about being overweight on IT and I see in some of your portfolios, TCS, Infosys, Oracle Financial Services make it to the list. Why stick to the largecaps and not the midcaps which have actually outperformed?

Devina Mehra: We had little more midcaps a few quarters ago, now the weightage has become a little more towards the largecaps in IT. A year ago, we would have had more midcaps in IT, now it is different.

As far as our financials are concerned, the latest talk of the town is there is no differentiation left as far as the banks are concerned because they are all hit by those asset quality issues. Deposit growth is lagging and now credit growth will come under pressure as well. But valuations look comfortable. I see SBI in some portfolios. What about other large private banks?

Devina Mehra: We do have some of the private banks as well. Banking and finance is too large a sector to just not have in your portfolio because that is the highest weight in the index, which I wish was not the case, but that is the case. We always have banking exposure, except that, as I said, it is not as much as it is in the benchmark.

Again, about a year ago, we would have had many more PSU banks, now the mix is more towards the private sector banks. But on the credit side, I am always a nervous investor in banks and lenders because as an outsider you can never know the credit book and on a macro basis you see the pressures and I was in a conference where Mr KV Kamath also spoke and I had spoken about these two things separately, but I had not put it together.

He said, where do you think the derivative losses of some Rs 1.5 lakh crore are getting funded? They are probably getting funded through unsecured credit. Maybe it is not through banks but through fintech and NBFCs, but they are getting funded somewhere in the credit system. That was a light bulb moment for me.

The other thing is this entire slowdown which is currently taking place. It is a double-edged sword because the currency is also whacking you. While the FIIs have made a bit of a comeback, you can see why they are not really deploying funds into India and other emerging markets. Will this continue? Will the dollar strength continue for a large part of next year too?

Devina Mehra: It is a difficult situation for RBI. We are in a situation where people are pressing for cutting interest rates to boost GDP growth while inflation is still high even if it is driven by food inflation. They are trying to manage the currency because today the interest rate differential between India and the US, that is how much interest rates in India are higher than the interest rates in the US, is at almost two-decade low.

That puts pressure on currency because the currency becomes stronger theoretically when interest rates are higher. If you cut interest rates, there is pressure on the currency. While I do not try to predict FII flows simply because long-term data has never shown any correlation between FII flows and the market move. Now I only track FII flows from a balance of payment perspective, not really from the market perspective.

Also remember, for almost 12 years, the US in particular and developed markets in general, have hugely outperformed emerging markets and sometimes that trade will change. I am not saying it is going to change next quarter or maybe not even next year, but sometimes that trade will change because themes never last forever.

At some point, emerging markets will make a comeback, and one will have to watch for that. But it is a difficult job for RBI to manage interest rates and currency. If you are talking of a slowdown in the economy or consumption, the funny part is that people started talking about it only after the market correction started in October, November.

But I have been talking about it for a long time because in FY23-24, the growth in private consumption in GDP was at a 21-year low. Really, the way to drive that on a longer-term basis is an employment question because only if you have employment will you have consumption and so that is one big thing besides, the inflation part because in Indians' monthly budget, food is still quite a high percentage. If food prices go up, it crowds out a lot of other consumption, even basics like soap and shampoo and all that.