MONTHLY COMMUNIQUE

MAY - 2021

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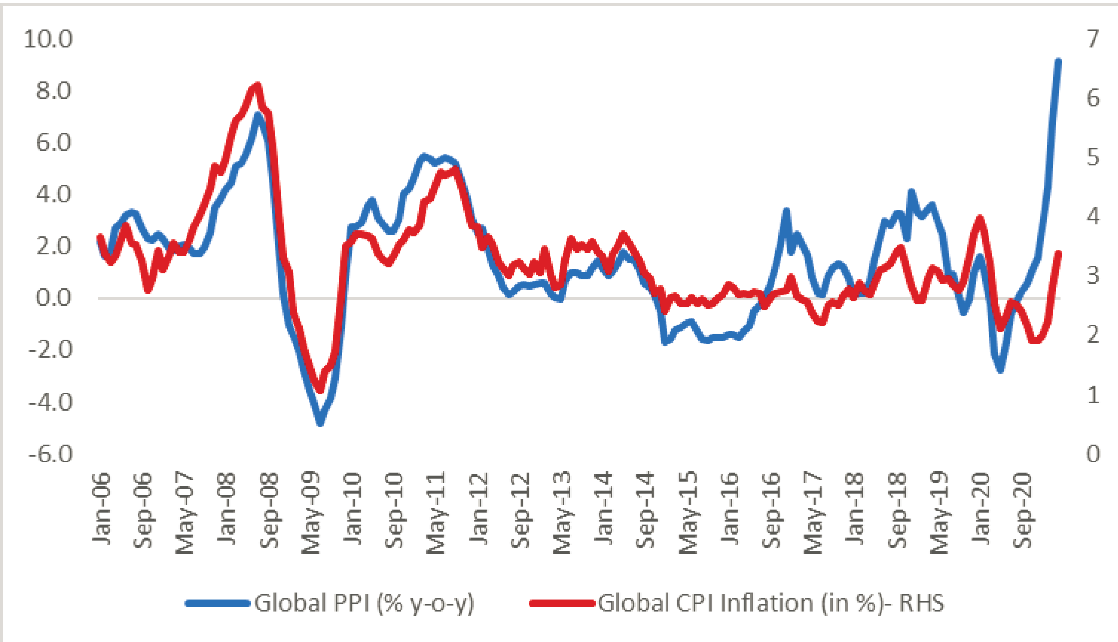
The debate surrounding the long-awaited revival of inflation and its implications on monetary policy settings has re emerged in recent times. At the same time, global central banks have so far firmly resisted any discussions about unwinding the extraordinary support measures. Central to the cautious approach has been the experience of the years since the global financial crisis, wherein developed markets central banks have consistently failed to achieve the 2% inflation target inspite of large monetary accommodation and unconventional policy measures including large scale asset purchases. At the same time, there remains the challenge in terms of disentangling the "durable" from the "transient" elements in the current phase of inflation upswing considering the pandemic induced supply shocks. Central Banks such as the US FED have also made material changes in their policy framework that allows an overshoot of inflation over the target.

The wedge between wholesale and consumer prices have been evident across most geographies. Higher commodity prices have fed into higher producer prices globally. US PPI inflation surged to 6.2% in April (vs. 2.8% two months ago). China posted 6.8% (vs. deflation through 2020). Indian WPI, proxy for producer prices, surged to 10.5%. This has not been passed onto consumer prices to similar strength and extent.

Until around 2013, there was a reasonably close correlation between headline CPI and PPI inflation. However, this has changed over the last seven-eight years: the correlation has weakened. What accounts for this is hard to say, but structural changes are likely at work, such as increased competition within industries that limit the pass-through from higher producer to consumer prices. Therefore, the latest spike in the PPI, largely driven by higher commodity prices, has not fed entirely into a major surge in consumer prices. Within consumer prices, the momentum appears to be faster for developed market economies vis-a-vis emerging market economies, as the former sees demand support from fiscal stimulus and faster vaccination. Emerging market economies, on the other hand, have a relatively contained Consumer price inflation (compared to their own history).



Source: SBIMF Research

The overwhelming presence of large fiscal stimulus apart from the recent trends of supply chain realignment and increasing use of tariffs present a new dynamic to monitor with respect to its impact on long term inflation formation. Whether these represent a turning point in the inflation cycle is yet to be known. However, given the role of low interest rates supporting asset prices, how central banks respond to signs of any durable pickup in inflation in terms of "tapering" the support currently being provided is crucial to monitor.

Equity:

Indian equities had a strong month as the Nifty and the Sensex surged about 6.5% apiece with the former recording fresh all time high and the latter in touching distance of it buoyed by moderation in Covid infections. Covid cases peaked in early May and continued to see a significant reduction through the month. Not surprisingly the up move has been led by pro-economy segments with Financials, Small caps, and Services and hospitality outperforming. There were other supportive trends at play too as global yields stayed moderate, the dollar weakened, and Emerging Market equities found a bid again. The ongoing result season has been strong as expected with the Nifty companies having reported so far suggesting nearly 18% and 40% year on year growth on sales and operating profits respectively off a weak base. The year has shaped up well too with net profit for Nifty rising in high teens. In a year when the economy contracted by 7.3% on a real basis and 3% even in nominal terms, this growth in earnings is quite remarkable and supports the thesis that corporate profits to GDP in India may finally be reverting higher after having plunged to multi-year lows.

A key factor driving profits for corporate India this year has been a significant expansion in margins driven by cost efficiencies. While some of the cost may come back as operations resume in full swing and raw material prices continue to see upward pressure, on the other hand as growth normalizes, operating leverage benefits should kick in and support margins. In addition, several sectors that have adversely impacted corporate profits over the past few years such as corporate banks, telecom, and metals appear to have turned the corner. Policy backdrop continues to be extremely favourable. Aggressive fiscal expansion in addition to super accommodative monetary policy in the West, most notably the US, should augur well for a reflation in the global economy. Stronger balance sheets for banks, healthier corporate balance sheets, leaner cost structures and reforms around formalization of the economy, corporate taxes, PLIs, GST, real estate, etc augur well. We therefore continue to believe that we are in early stages of a new earnings cycle.

Yet the path, at least in the near term, is unlikely to be linear. While the worst of second wave appears to be behind, how long does it take for the scars of the crisis to heal and how quickly does consumer and corporate confidence return on the other side of the current crisis is still a question mark. Distress in the unorganized sector and unemployment have soared. Whether and to what extent can the government provide fiscal relief to dampen the impact is yet to be seen. The progress on vaccination is another key monitorable as that will determine the true extent of reopening as well as the probability of another harsh wave. Globally, rates and dollar have stayed benign so far, even with rising inflation prints as central banks as well as markets see these as transient. However, continued high inflation prints may cause near term jitters. Above all, the most important near-term risk in our view comes from an elevated reading on our proprietary equity sentiment index which suggests overheated sentiment and may limit upsides in the short term. However, given our positive structural view, we continue to see any tactical corrections as welcome opportunities to add proeconomy assets and stocks.

Fixed Income:

The RBI's GSAP auctions and the continuing implicit yield curve control strategy has kept the benchmark 10y sovereign bond yield anchored around 6% in the recent period. This has come at the cost of the cumulative fiscal year to date gross dated securities borrowings being lower by around Rs 180 bn over the notified amounts. The RBI has had to reject auction bids/ devolve auctions on Primary dealers in its endeavour to hold the benchmark around 6%. Large cash balances from the previous fiscal year as well as a larger than budgeted surplus transfer by the RBI have provided sufficient cushion for the same in Q1 FY22. The RBI surplus transfer amounting to Rs 991 Bn is higher than the budgeted amounts by around Rs 450-500 Bn. At the same time, the impact of the second wave on overall government finances, both on the revenue side as well as additional expenditures is uncertain currently. Alongside the supply side reform measures and additional Government capex that has been budgeted, there may still be a case to provide more targeted income support or fiscal relief to mitigate the economic and social impact of the pandemic. The provision of additional liquidity or monetary policy support may be incrementally less effective and potentially create issues with respect to asset market distortion and financial stability.

In this context, the central bank would find it extremely challenging to hold the line on bond yields in the absence of robust natural demand at levels targeted so far. Additional GSAP / other market interventions would remain a necessary requirement for a while. While the overall indirect taxes had shown steady growth since the second half of FY21, the impact of recent regional lockdowns on account of the second wave could lead to a slowdown in Q1FY22. The gap between protected revenues to states and the compensation cess collection is likely to be bridged through market borrowings intermediated by the central government as in the previous fiscal year.

From a market perspective, the continuation of excessively surplus liquidity and ongoing RBI intervention remains important to support or validate the existing market levels and credit spreads. This remains a key vulnerability factor. The market reaction in January 20 after the RBI initiated the resumption of the revised liquidity management framework through 14D reverse repo auctions is sufficient evidence of the potential vulnerability.

As the second wave subsides and activity levels start to normalise, there would sufficient reasons to start the normalisation of crisis era liquidity and monetary support. The liquidity impact of interventions in Government securities market, that may still be required in view of the larger borrowing requirements, may at the margin needs to be sterilised. Incremental GSAP auctions from the second quarter may well be accompanied by longer term variable rate reverse repo auctions. This may provide a signal for a gradual normalisation of money market rates away from the reverse repo floor.

Data Source: Bloomberg, SBI MF research,

SBI GROWTH WITH VALUES

JUNE - 2021

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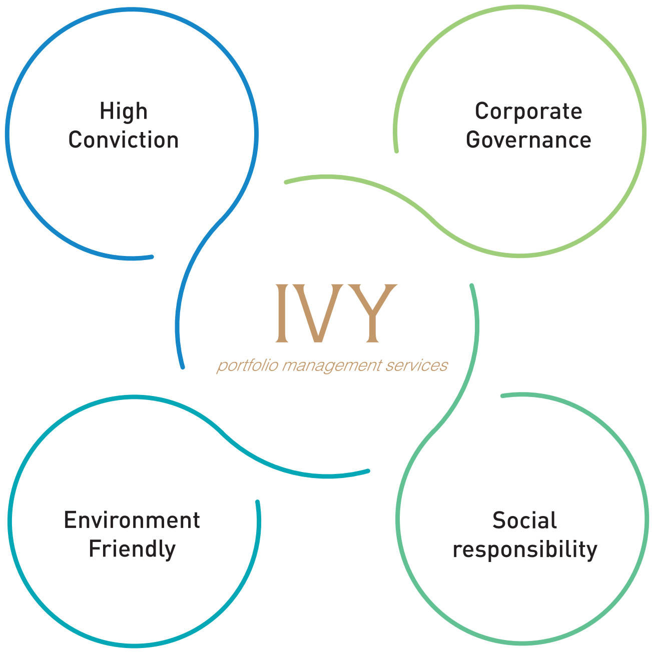
Portfolio Positioning

SEEKING GROWTH PRESERVING VALUES



High Conviction
Invest in businesses which benefit disproportionately by underlying economic growth, present in universe conducive for multi-fold growth. Expected to grow at high double digit in next 3-4 years and be out-performer to the underlying sector

Good corporate governance
Respecting the interests of all stakeholders

Social responsibility
Company's dealings with employees, customers and communities are cordial

Environment Friendly
Avoid environment destructing businesses

Please refer to disclosure document for risk factors and details about the portfolio before investing.

Stock Selection Process

STEP 1: Qualitative Factors

(1) Analysis of business model (2) Impact of Macro-economic variables on the business model (3) Company analysis based on factors including Porter's Five Factors (4) Sell-side research interaction

STEP 2: External Analysis

(1) Geo-Politics and its impact on business (2) Channel checks (3) Management Meetings (4) Work place / Plant visits

STEP 3: Quantitative Factors

Derive Quality Score with input of ROE, ROIC, Earnings Risk and Debt repayment capabilities

STEP 4: Investment Thesis

(1) Financial analysis of last 5 years (2) Building investment thesis (3) Valuation model (4) Target price (5) Strategic fit with other stocks in the portfolio

STEP 5: Investment Decision

(1) Market cap bucket fit (2) Stock weight allocation based on degree of conviction (3) Entry and exit points (4) Dissemination of new information (5) Ongoing monitoring

The strategy and the composition mentioned above, of the portfolio is subject to change within the provisions of the disclosure document. The parameters stated above are only for illustration purpose and may or may not be exhaustive. Please refer to the disclosure document for details.

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Investment Objective	Investment objective of this portfolio will be to generate long-term capital growth through investment in well-researched stocks.
Portfolio Attributes	• Investing in companies meeting positive standards of Environmental, Social, Governance responsibility. • Will focus on niche businesses having conducive universe for multi-fold growth with longevity. • Invest in companies which are disproportionately high beneficiaries of Economic Growth
Benchmark	S&P BSE 500 Index
Investment Horizon	More than 3 years
Fund Manager	Ms. Aparna Shanker
Min. Investment Size (initial purchase)	Rs. 50 lakh
Additional Purchase	Rs. 1 lakh
Subscription	On Each Business Day
Redemption	On Each Business Day
Valuation	On Each Business Day

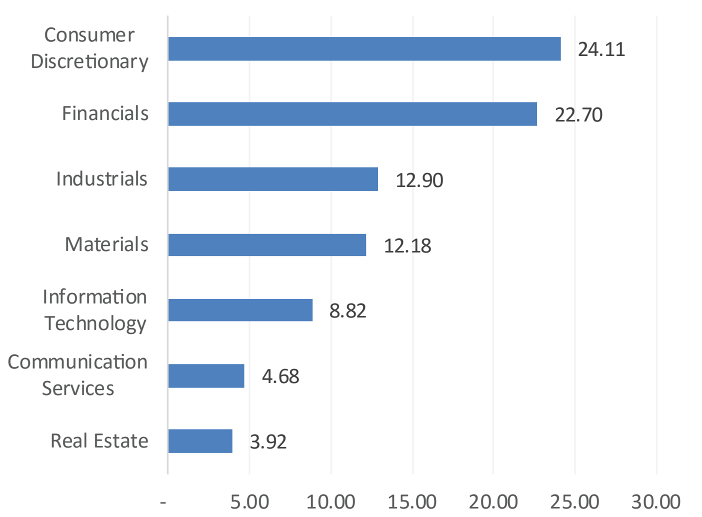
Top 10 Holdings (With Current % Allocation)

Company	Weight (%)
PERSISTENT SYSTEMS LTD.	6.21
AUTOMOTIVE AXLES LTD.	6.02
ICICI BANK LTD.	5.08
RAJRATAN GLOBAL WIRE LTD.	4.94
HDFC BANK LTD.	4.84
BHARTI AIRTEL LTD.	4.68
V-MART RETAIL LTD.	4.57
DIXON TECHNOLOGIES INDIA LTD.	4.36
ICICI PRUDENTIAL LIFE INSURANCE	4.18
NEOGEN CHEMICALS LTD.	4.07

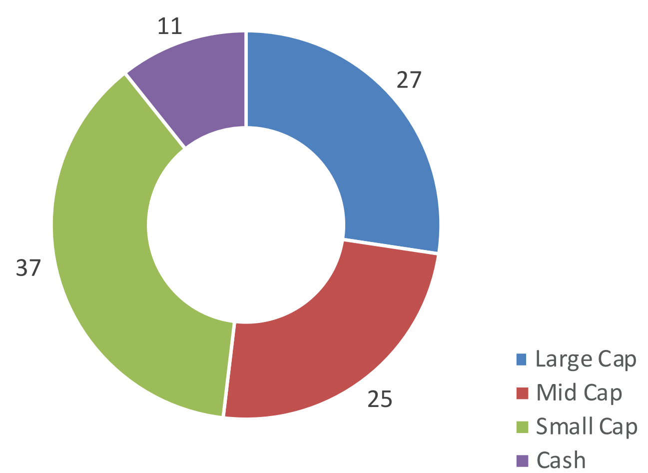
Top 10 Holdings by Returns

Company	Returns (%)*
RAJRATAN GLOBAL WIRE LTD.	416.15
DIXON TECHNOLOGIES INDIA LTD.	293.42
PNC INFRATECH LTD.	136.61
J K CEMENT LTD.	136.51
TEAMLEASE SERVICES	126.77
ABB INDIA LTD.	119.95
PERSISTENT SYSTEMS	114.93
NIIT	108.26
KEC INTERNATIONAL LTD.	103.66
NEOGEN CHEMICALS LTD.	99.49

Sectorwise Allocation (in %)



Market Cap Break Up (%)



*Returns mentioned are the returns of the stock in the last 1 year or since the time the stock has been included in the portfolio in case the stock has not completed 1 year.

1 year	Portfolio Volatility (%)	Beta
SBI Growth with Values Portfolio	16.15	0.76

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If you wish to invest, please contact your financial advisor or to invest Direct please contact us on pmsops@sbimf.com

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Portfolio Manager:
SBI Funds Management Private Limited
(A Joint Venture between SBI & AMUNDI), (CIN: U65990MH1992PTC065289)
9th Floor, Crescenzo, C-38 & 39, G Block, Bandra-Kurla Complex, Bandra (E), Mumbai - 400 051