Published on *mydigitalfc.com* (http://www.mydigitalfc.com)

Contrarian opportunities go abegging

Jun 29 2015

Banks, pharma and IT are among the most popular sectors that most market players are betting on. Blame it on our tendency to construct portfolios around the index or the history of earnings growth, these three sectors and some others always get the lion's share of fund allocations.

But what if you want to swim against the tide? Some market experts say PSU banks, industrials (including infrastructure), agrochemicals, PSU mining and two-wheeler stocks can be good propositions from a contrarian investment perspective.

For starters, contrarian investing is a strategy characterised by buying and offloading of shares in contrast to the prevailing market sentiment.

As Nitasha Shankar, head of research at YES Securities, explains, stock prices tend to track the fundamentals of a company in the long term and a contrarian opportunity arises when the market/consensus shun a stock simply on account of having a negative view on the sector or when the sector is out of favour.

"The investor needs to be confident of the fundamental strength of the company, i.e. fundamentally the company should remain strong due to its niche business model/unique strategy and management. In such a situation, the stock may actually be available at cheap/attractive valuation," she said.

Foreign financial major Macquarie has a "counter-consensus overweight stance" on the industrials sector (including infrastructure). Rakesh Arora, head of research for India, Macquarie, says: "Given the slow pickup in economic activity, persistent financial stress and uncertainty around the passage of the land acquisition bill, investors have been wary of the infrastructure stocks and moved over to defensives like IT and pharma."

The government has budgeted FY16E capex 25 per cent higher at $40 billion, out of which 30 per cent is allocated to railways and roads, with estimated spends of $6.5 billion and $5 billion, respectively.

"We are particularly bullish on the road sector as traffic growth has picked up dramatically since the second half of FY15. Our channel checks suggest strong momentum into FY16. In its effort to boost growth, the government is frontloading most of the spending: April saw the government spend 9 per cent of its annual budgeted expenditure, or roughly $25 billion, of which 4 per cent was spent by the ministry of road transport and highways," Arora said.

Macquarie's key recommendations include IRB Infra and Ashoka Buildcon. Aside from roads, L&T remains the best stock to play the overall India infrastructure story, said Arora. The company exceeded its guidance on order inflows, which grew 22 per cent in FY15 while the order book grew by 28 per cent YoY, showing clear signs of a pickup in activity. "We expect the recovery process to begin in FY16 and strengthen into FY17," he added.

Monsoon has covered the whole of India, but is expected to weaken in July. There is a lot of discomfort over monsoon rains and their spatial distribution, which can impact monetary policy outlook, as also the fortunes of many agri-related firms.

Conventional wisdom would tell you to avoid such stocks or sectors as of now. However, YES Securities is positive on the agrochemicals space despite the worries/risks related to the monsoon. "We believe rising demand for food with a disproportionate increase in land availability has and will lead to an increase in demand for agrochemicals in the country to boost crop yield. Therefore, companies that have superior brands and/or distribution networks/unique business models would benefit from this growth in the long term. This is why we are positive on companies like PI Industries and Coromandel International," Shankar said.

Vikas V Gupta, executive vice-president of traded markets & investment research, Arthaveda Fund Management, has put his contrarian bets on the PSU mining and two-wheeler stocks.

"In our view, PSU mining companies in the iron ore and coal sectors are expected to witness a radical positive change in their businesses and, hence, profitability over the next three-four years owing to the government's continuous efforts to address their age-old problems — easing of evacuation constraints through construction of railway tracks and signing of memorandum of understanding (MoUs) with the states and railways. In addition, these companies have large cash piles on their balance sheets, which may provide valuation comfort on the downside and present an opportunity to undertake capex projects in the future," Gupta said.

On two-wheelers companies, Gupta said they are facing growth concerns in the near term owing to a slowdown in the rural sector due to the unseasonal rains and lesser allocation under the MNREGA scheme. However, Arthaveda believes these short-term corrections are best times to increase exposure to these stocks given their superior track record of high returns and debtfree balance sheets.

Brokerage Systematix Shares & Stocks says in the prevailing economic scenario, uncertainties are seen in the banking industry due to a slowdown in credit offtake. Asset quality improvement combined with a healthy capital adequacy ratio are pertinent factors. The brokerage says public sector banks (PSBs) with their market dominancy and expected improvement in performance are expected to emerge as "dark horses" within the sector.

"We have a positive view on PSBs due to benefits from the bottoming out of credit growth, expected higher treasury gains and asset quality improvement. Our top picks are Bank of Baroda, Punjab National Bank and State Bank of India on the back of better CAR, higher profitability and higher return on asset/return on equity," it said.

While investing, Motilal Oswal Asset Management seeks companies that have very strong or improving fundamentals and are available at fair prices. This is usually irrespective of the market outlook for the stock.

"However, there have been cases where we believe we have had an edge over the market in understanding a company's fundamentals while buying its stock. One instance was the emerging market pharma companies. While most of the market was looking for the next big US generics story out of India, we found these companies' emerging markets focus and strong formulations and marketing skills to be very interesting. This allowed them to grow at a very rapid pace in under-penetrated markets and capture a very high portion of the industry value chain, thereby compounding earnings at more than 30 per cent for a long time," said Gautam Sinha Roy, vice-president and fund manager, Motilal Oswal Asset Management.

Another instance was the oil refining and marketing (ORMs) sector. Their 'earnings power' has been subdued for more than a decade due to a strict pricing regime. As a result there has been a lot of pessimism about their future earnings.

kumarshankar@mydigitalfc.com

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