Nepean Capital
Recession ? What Recession ?
Findings From My U.S. Trip

I had a 10-minute wait before I was allowed in

I just returned from the U.S. (my second visit in five months) after spending a week meeting institutional investors on the East Coast and attending an investor conference in New York.
Key highlights:

Financial pundits last year had predicted that the US and the world would go into a major economic recession, but we are into the 11th month of 2023 and it hasn't happened as yet. On this visit, I found that several U.S. economists and pundits have trimmed the probability of a recession. For example, Jason Furman, professor at Harvard University's John F. Kennedy School of Government, started the year with a 50% probability of a recession within the next one year but is currently at 20%. Mark Zandi, the chief economist at Moody's Analytics, has reduced his estimate from 50% to 33%. On the other hand, Goldman's U.S. economist, Jan Hatzius (I have been following him for the past 20 years), was an outlier with a 35% probability at the start of the year and is now down to just 15%.

Some are concerned about the fiscal situation in the U.S. and think rates will climb higher before the recession compels the Fed to cut rates by 50-100 bps in 2025. On oil, the general view is that the war in the Middle East is likely to be a prolonged one but should not impact its price significantly more. The Saudis are smart and understand very well that as oil moves up, substitutes, i.e. renewables become ever more economical.

While 30-year fixed mortgage rates near 8% are a cause for concern, apparently 96% of American households refinanced in the past 3 years. Hence it appears that overall consumption demand hasn't as yet materially slowed down in spite of high inflation.

Inflation is still raging from my trip in May this year. It still costs $100 for an Uber ride from Midtown Manhattan to JFK. Peet's Coffee in Terminal 4 at JFK continues to sell a large latte for $6, a price that upsets most New Yorkers that I met.

The lack of interest in China is very visible and the interest in India is the highest that I have seen in my working life. The view is not very different from my meetings with the financial community in Hong Kong in the first week of September. Evidence shows that in the last 15 years, the HSCEI performed poorly, -70% while the NIFTY50 rose a whopping +327%.

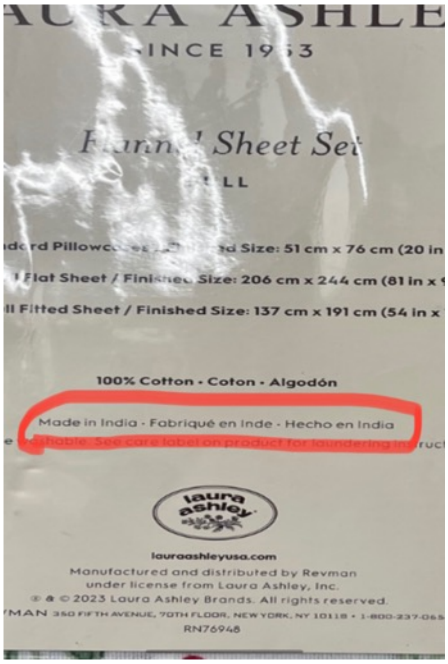
However, the single biggest pushback I got for incrementally investing more money in India today is the valuation, still the most expensive equity market in the world. At 20x CY24 P/E, it trades at a 115% premium to China, 64% premium to Asia (ex-Japan) and a 12% premium to the S&P500. However, despite FPIs pulling out $5.3 Bn in the past two months, the Indian market remains resilient, down only 4% since the highs in mid-September. This is primarily due to the strong inflows from retail investors into domestic mutual funds, PMSs (Portfolio Management services) and AIFs (Alternative Investment funds). Having said that, so far this year FPIs have invested the most in India (+$11.7 Bn) among Asian equity markets, and more than in China.

Some correction has set in. The number of stocks from the BSE200 universe that hit 52-week highs, have dropped sharply from the September peak of 82% to 55% today. We believe that Indian banks, in particular, are attractively priced vs. their historical valuations. For example, HDFC Bank trades at 2.4x FY25 P/B or a 40% discount to its 20-year multiple. Besides HDFC Bank, many blue-chip stocks have been flat or have underperformed since the past 18-24 months, such as Reliance Industries, Asian Paints, Eicher Motors, Dabur, Pidilite, Page Industries and Hero Motocorp.

The number of demat accounts of Indian retail investors hit a record 126 Mn, +11% from March this year. Even though INR bonds of AAA rated Indian companies are yielding anywhere between 7.5-8.1% (pre-tax), inflows from domestic investors remain strong. Mid & Small-cap funds continue to see the largest inflows while Large-cap funds have seen modest outflows.

Channel checks reveal that the current festive season in India (Oct 15-Nov 14) which accounts for as much as 40% of full year sales for consumer goods, is going well. Starting later this month (Nov 23-Dec 15) India will witness 3.5 Mn weddings, totaling to an estimated spend of $50 Bn.

Channel checks at Target revealed more products proudly *Made in India*.



On a lighter note…..

I didn't realize how big pumpkin spice has gotten until this trip. I remember reading an article in the LA Times a month ago that traced the growth of pumpkin spice from 2003 when Starbucks launched its pumpkin spice latte and I quote: "Come fall, pumpkin pie spice mix pervades all sorts of commercial goods, from Oreos and Twinkies to Pop Tarts and cake mixes; it surfaces in breakfast cereals, snack foods, ramen, even beer and dog biscuits. As if that weren't enough, pumpkin spice-ification has crept into nonedible products as well: air freshener, beard oil, trash bags, detail spray — yes, the list goes on." Hence no surprise when I spotted the below in a store in Durham, NC.

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