Investing beyond NIFTY 50

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The NIFTY 50 index, which tracks the performance of 50 of the largest and most liquid Indian companies, has undergone significant changes between the two periods 2004-2014 and 2014-2024. The NIFTY 50 Total Returns Index (TRI), which includes both price appreciation and dividends, provides a more accurate representation of returns.

In this report, we compare these two periods focusing on:

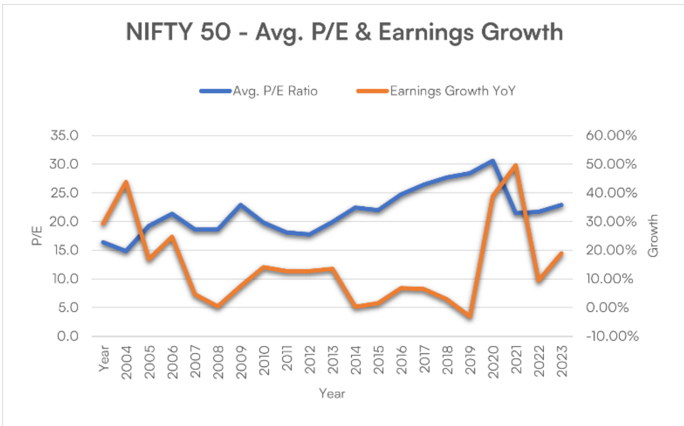
- **Price-to-Earnings (PE) Expansion**
- **Earnings Growth and Premium Valuations**
- **Market Outlook and Investment Strategy**

NIFTY 50 (TRI) PERFORMANCE (2004-2014 vs 2014-2024)

2004-2014 (Strong Earnings Growth Phase)

METRIC	2004-2014	2014-2024
CAGR (Total Returns)	17.11%	12.17%
NIFTY PE Range	10x-28x	17x-42x
Dividend Yield	1%-2%	1%-3%
Earnings CAGR	14.51%	11.98%
Avg. Earnings Growth	16.34%	13.12%

- The period from 2004 to 2014 was marked by a high-growth phase, supported by strong domestic consumption, high liquidity, and global economic recovery after the 2008 financial crisis.
- The NIFTY 50 (TRI) delivered a CAGR of around 17.11% over this decade, driven primarily by strong earnings growth, led by a global commodity boom, low valuations the period (around 10-13x PE), and strong foreign inflows.
- PE expansion occurred as earnings grew and optimism returned after the global financial crisis. By the end of this period, the NIFTY PE had moved up to the 20-25x range.
- Earnings growth was notable but varied in this phase due to global economic conditions and domestic challenges, including inflation and policy paralysis. The PSU banking system was left with turmoil and bad debts during this phase.



2014-2024 (Significant P/E Expansion Phase)

- The period 2014-2024 has seen lower total returns, primarily due to slower earnings growth, but partially compensated by PE expansion.
- NIFTY 50 (TRI) grew at a CAGR of around 11-12%, reflecting a more stable market environment but lower earnings growth compared to the previous decade.
- The valuation premium has continued through 2021-2023, driven by domestic liquidity, passive flows, and a narrow concentration of gains in large-cap stocks, while mid and small caps have strengthened.

MARKET OUTLOOK FOR 2024 AND BEYOND

Macroeconomic Factors

1. **Global and Domestic Growth**: Global economic growth is expected to moderate as inflationary pressures ease, but India is likely to continue to be a bright spot due to its demographic advantage, rising middle-class consumption, and government reforms.
2. **Monetary Policy and Liquidity**: With the rate cycle peaking out, liquidity conditions will improve, but excessive liquidity may not return as seen during the pandemic. The markets could remain range-bound but supported by selective sectoral tailwinds.
3. **Earnings Rebound**: After several years of sluggish earnings growth, there are early signs of an earnings cycle revival, particularly in sectors like infrastructure, manufacturing, and consumption. This could provide support to the market going forward.

Valuation Normalization

- **Valuations remain elevated** but are expected to normalize as earnings growth catches up. The market may not see the PE expansion witnessed earlier; rather, it could trade in a narrower PE range of 18x-22x, depending on how corporate earnings evolve.

NIFTY is trading at 19.4x 1-year forward EPS, which is at 1.6% premium to 15-year average PE of 19.1x.

Base Case: we value NIFTY at 15-year average PE of 19.1x and based on Sept26 EPS of 1459 and arrive at 12-month target of 27867

Bull Case: we value NIFTY at 5% premium to 15-year average PE 20x and arrive at bull case target of 29260

Bear case: Nifty can trade at 10% discount to LPA with a target of 25080.

INVESTMENT STRATEGY: FUTURE APPROACH

Selective Stock Picking over Index Investing

- With the valuation premium largely factored in, investors should shift focus from passive index investing towards selective stock picking/active investing. It's crucial to maintain valuation discipline.
- **Sectoral allocation**: Focus on sectors likely to outperform, such as:
  - **Manufacturing**: Government's push for Make in India, production-linked incentive (PLI) schemes, infra spending.
  - **Technology**: Digital transformation and AI-driven growth.
  - **Consumption**: Domestic consumption growth driven by demographic shifts.

Earnings Growth as Key Driver

- **Earnings growth** will be the critical driver going forward, as valuations are already high. Investors should prioritize companies with strong earnings growth potential and reasonable valuations.

Long-Term Investment Horizon

- Given the volatility and higher valuations, a long-term horizon is essential. Markets may remain volatile in the short term, but India's structural growth story remains intact over the long term.

CONCLUSION

Investors should adopt a **balanced, selective, and long-term investment approach**, focusing on sectors benefiting from structural growth drivers while keeping an eye on valuation and risk management.

Create a "Risk Budget" for your portfolio & focus on Capital Allocation. Finding the right managers both in the context of your goals and the portfolio's objectives will be essential.

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