

Reforms unlikely to be impacted

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Election results surprise the market...

- One big risk that we had highlighted in 2024 was an election shock like the 2004 Vajpayee defeat (<https://www.valentisadvisors.com>). While not on that scale, the BJP's seat share of 240 seats was below expectations and meant that the 3rd term of the Modi Government would be a coalition Government. The Nifty fell ~6% on the counting day.
- While various reasons will be attributed to the lower than expected performance of the Modi Government including rural distress, lack of employment etc., one of the key factors was the index of opposition unity. Overall, BJP secured close to 37% vote share, only slightly lower than in 2019 and higher than 2014 (see Table 1). However, with the INDI Alliance working out seat alliances in many key states like Uttar Pradesh, Bihar and Maharashtra, the BJP got substantially lower seats than in 2019.

So what does this mean for reforms?

(1) Continuity in Government: The good news is with Narendra Modi continuing to remain Prime Minister of the country, there will be continuity in the Government.

(2) Stable Government likely: We think the Government will be stable and last the full 5 year term with BJP being close to a majority on its own. Past Governments have lasted their full term with even lesser seats for the anchor party.

(3) Reforms will continue with some twist: We think economic policies are unlikely to change materially. We expect to continue to see fiscal consolidation and spend on infrastructure to continue. However, there may be tweaks to increase spend on rural areas and employment generation programs. Private capex will have to materialize to continue the strong investment demand in India.

(4) Social legislation where consensus is limited may take a back seat. Issues like One Nation- One Poll, Uniform Civil Code, and NRC etc. may not be possible without a consensus.

What to watch next?

1. **Cabinet formation** - We will be looking for the ministers who will head key portfolios like finance, defense and other infrastructure ministries. Even if some of these go to allies, we hope they will be reform oriented. Both JDU and TDP, the key allies have been pro-reform and that should make the reform process easier.

2. **Announcement of the 100-day program:** We think this will ease market fears of a slow-down in reforms as there will be a focus on infrastructure and renewable energy.

3. **Budget – capital gains tax will be a self-goal:** The task of fiscal consolidation is easier with the large RBI dividend reducing fiscal deficit by 0.3%. The FY24 fiscal deficit has been 0.2% lower than the budget. This gives the Government wiggle room to increase rural spends without hurting fiscal consolidation or the capital expenditure budget.
 - a. Any increase in capital gains tax on equity in the budget would be negative for equities and probably for the economy also. Firstly, retail investment has risen over past few years and with valuations now not cheap, any change in legislation could hurt equity markets and reverse the retail inflows into equities. Secondly, FIIs have been sellers of Indian equities over past year and an increase in capital gains tax (very few EM have capital gains tax) will lead to acceleration of the selling as post-tax returns in India become unattractive. Lastly, privatization of PSUs will be difficult in a coalition era. Hence, disinvestment through secondary market is required to meet fiscal deficit targets. This is easier in a buoyant equity market.

4. **Market – we still expect single digit returns**
 - Equity markets fell more than 5% on counting day. So what does a 5% fall for the market mean for the future? If we look at all cases where Nifty fell 5% or more since 2000: (1) 3 months later markets were up 3.9% on an average with a positive return 63% of the time (2) 6 months later markets were up 11.3% on an average with a positive return 66% of the time. (3) a year later markets were 23.5% on an average with a positive return 72% of the time (see Table 3).
 - If we look at past history of markets post elections (see Table 2), 2 things stand out:
 1. The first day reaction of the market to any Government does not reflect how the equity markets will react to the Government a year later. For example when Vajpayee Govt lost in 2004, markets fell close to 17% but in the next 1 year market went up by 19%
 2. Generally markets are positive 6 months and 12 months post elections as the market focus shifts to more fundamental issues.
 - We are not changing our market view post elections. The India growth story looks robust and we think strong GDP growth will drive sustained long term returns for investors. Near term, however, markets may see volatility and investors should use dips to build their portfolio. We continue to expect single digit returns for investors as stated in our January 2024 report (<https://www.valentisadvisors.com>)
 - Valuations continue to be our biggest concern with Nifty trading at 20x 1-year forward earnings (see Chart 1). We think time correction will lead to valuations coming in fair value zone.
 - Secondly, earnings are expected to slow from the sharp growth post-Covid (see Chart 2).

Appendix 1
Table 1: BJP Vote share lower than 2019 but only marginally

Vote Share (%)			
Overall	2014	2019	2024
BJP	31.0%	37.4%	36.6%
Congress	19.3%	19.5%	21.2%
AITC	3.8%	4.1%	4.4%
SP	3.4%	2.6%	4.6%
YSR Congress	2.5%	2.5%	2.1%
BSP	4.1%	3.6%	2.0%
DMK	1.7%	2.3%	1.8%
JDU	1.1%	1.5%	1.3%
Shiv Sena - Uddhav	1.8%	2.1%	1.5%
Shiva Sena - Eknath	-	-	1.2%

Source: Election Commission of India, Valentis Research

Table 2: Stock Market returns (%) – Pre & Post elections: Why worry about Elections?

Result Date	Prime Minister	Ruling Party / Alliance	Pre - elections Return (%)		Post Elections Return (%)			
			6M	3M	3D	3M	6M	1 Yr
01-12-1989	V.P. Singh / Chandra Shekhar	National Front	0	-6	0	0	16	75
20-06-1991	P. V. Narasimha Rao	Congress	25	14	-2	37	40	131
10-05-1996	Dev Gowda / I.K. Gujral	United Front	11	17	2	-5	-17	0
27-02-1998	Atal Bihari Vajpayee	BJP & Allies	-9	0	4	2	-20	-6
06-10-1999	Atal Bihari Vajpayee	BJP & Allies	32	8	7	15	4	-12
13-05-2004	Manmohan Singh	Congress & Allies	8	-9	-17	-5	10	19
15-05-2009	Manmohan Singh	Congress & Allies	30	29	17	27	38	38
16-05-2014	Narendra Modi	BJP	17	18	2	9	17	16
23-05-2019	Narendra Modi	BJP	11	8.2	1.6	-5.4	4	-21*
Average Return			14	9	2	8	10	27

Source: Election commission of India Ace Equity, Valentis Research
*includes Covid impact

Only 1 Negative in run-up to elections

First reaction to market is not necessarily correct

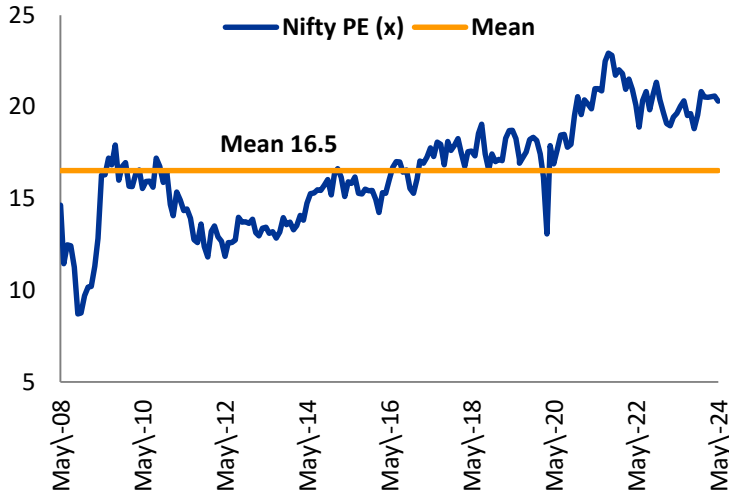
Table 3: 5% or more fall in Nifty in a single day and what happens afterwards

Index	On the day	3 Month Return	6 Month Return	1 Year Return
04-Apr-00	-6.9%	5.8%	-9.1%	-20.4%
02-May-00	-5.2%	-0.1%	-8.1%	-14.7%
24-Jul-00	-5.7%	-12.5%	3.7%	-18.6%
13-Mar-01	-6.1%	0.4%	-13.6%	2.9%
14-Sep-01	-5.4%	18.3%	26.1%	7.9%
17-Sep-01	-5.2%	24.7%	34.1%	14.1%
14-May-04	-7.9%	1.0%	18.4%	25.7%
17-May-04	-12.2%	15.5%	36.0%	43.4%
18-May-06	-6.8%	-0.9%	13.7%	24.4%
22-May-06	-5.1%	9.2%	28.3%	38.8%
21-Jan-08	-8.7%	-3.3%	-20.1%	-48.0%
22-Jan-08	-5.9%	3.1%	-13.5%	-44.6%
11-Feb-08	-5.1%	2.6%	-4.9%	-39.8%
03-Mar-08	-5.2%	-4.8%	-9.1%	-47.1%
13-Mar-08	-5.1%	-2.3%	-8.5%	-41.2%
17-Mar-08	-5.1%	3.3%	-11.0%	-38.8%
06-Oct-08	-5.7%	-13.6%	-9.6%	39.6%
10-Oct-08	-6.7%	-12.4%	1.9%	50.8%
15-Oct-08	-5.1%	-18.0%	4.4%	53.0%
17-Oct-08	-6.0%	-8.0%	10.1%	67.2%
22-Oct-08	-5.2%	-11.5%	8.7%	62.8%
24-Oct-08	-12.2%	3.7%	34.7%	93.4%
11-Nov-08	-6.7%	-0.4%	21.0%	70.3%
07-Jan-09	-6.2%	11.5%	43.9%	80.2%
06-Jul-09	-5.8%	20.7%	26.8%	27.0%
24-Aug-15	-5.9%	0.3%	-10.1%	10.8%
12-Mar-20	-8.3%	4.0%	19.5%	56.7%
16-Mar-20	-7.6%	7.8%	26.2%	62.1%
18-Mar-20	-5.6%	19.2%	35.9%	71.9%
23-Mar-20	-13.0%	37.6%	46.3%	94.7%
04-May-20	-5.7%	19.4%	28.1%	56.0%
07-Mar-22	-5.5%	3.5%	11.1%	11.7%
04-Jun-24	-5.9%	?	?	?
Average		3.9%	11.3%	23.5%
+ve returns		63%	66%	72%
-ve return		37%	34%	28%

Source: Ace Equity, Valentis Research.

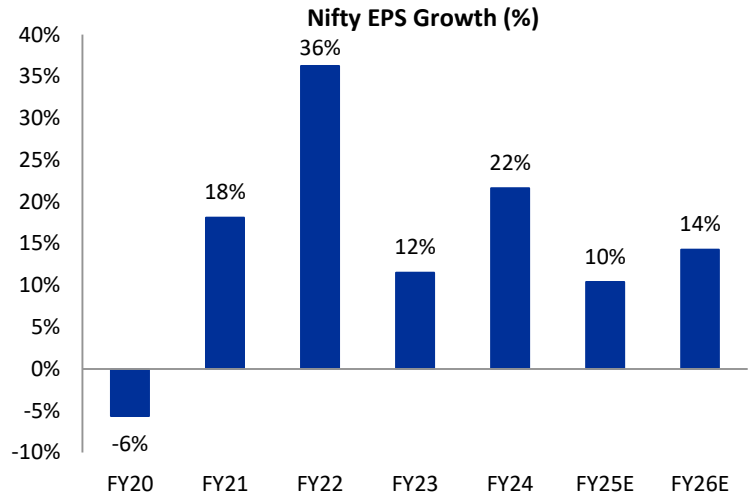
Note: time period considered is from April 2000-till now

Chart 1: Nifty 12M Forward P/E (x) – still expensive



Source: Edel, Valentis Research

Chart 2: Annual EPS Growth



Source: Kotak IE, Valentis Research

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