Readjust Your Lens of Financial Planning to See Through Rising Inflation, Nityanand Prabhu, ED & Business Head, LIC Mutual Fund

"We believe we have entered a rising inflationary regime which needs a readjust the lens to relook at their investment approach and strategy. Inflation is expected to keep equity markets edgy in the near-term. Investors with relatively high-risk appetite may look at equity mutual funds," Prabhu says

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by Nityanand Prabhu, Executive Director & Business Head, LIC Mutual Fund

May 2022 has been an eventful month with the Reserve Bank of India (RBI) surprisingly increasing the benchmark repurchase rate (repo) by 40bps. The financial markets were quick to react to the RBI action. The 10-year benchmark 6.54%-2032 bond yield rose 26 bps to 7.3783% on the day of the rate hike. The stock market, still reeling under the rate hike, was jolted again when data showed consumer-price inflation accelerated at the fastest pace since 2014. Retail inflation jumped to 8-year high of 7.79% in April weakening the financial markets. By 13th May, the Nifty 50 fell to 15782, or 13% lower from its close on 4th April.

We believe we have entered a rising inflationary regime which needs a readjust the lens to relook at their investment approach and strategy. Inflation is expected to keep equity markets edgy in the near-term. Investors with relatively high-risk appetite may look at equity mutual funds.

Typically, investments in equity markets are for value or growth. In value investing, the fund houses invest in companies which are industry leaders and have legacy of core business operation with established dominance in the industry through performance, command high brand value and enjoy strong customer loyalty. These companies clock moderate but a sustained growth rate. Value companies have established strong foothold across their chain of operations with large balance sheet and reserves.

Growth companies are usually the emerging ones with focus on innovations and thrive on unique selling proposition (USP) and competitive advantage. Their uniqueness lies in advanced technology, product differentiation, distribution set-up, dynamic pricing, among others. They are sometimes the disruptorsas they have a less profit accreting business model. They pay very little or no dividends because of a reinvestment protocol. They focus on attaining brand loyalty or product acceptance.

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From an investing point of view, both the above type of business have been proved to be wealth generating investment in a long run. However, in current situation of rising inflation, value stocks appear to be better placed than growth stocks.

Inflation in general has a negative impact for profitability. For consumers, it impacts their affordability as the per unit purchasing power of consumption reduces. Rise in input costs puts pressure on corporates' margins thereby impacting the profitability making it a vicious cycle. This is precisely why growth stocks witnesses correction in valuations during such time. Unlike Value stocks, valuation of growth stock is a function of revenues growth and as consumer affordability reduces, revenue growth subdues. Data suggests that inflationary environment bodes well for value stocks. Value companies finds it easy to take price hikes without much impact on the incremental sales because of the brand awareness and acceptance among the consumers. Customers tend to stick to the brand despite price hike, due to quality and brand connect.

This is already visible from the corporate earnings result. Fast-moving consumer good companies hiked prices of soaps and detergents to coffee and biscuits in Q4 FY2022 as raw material prices soared. The moot point here is that high inflation is transitory in nature and may decelerate in couple of years, but corporates do not roll back price increases when inflation abates. Over the years, margins of value companies have expanded significantly for the same set of companies mentioned above. It is evident that value companies make a good case for investment in the rising inflationary regime.

This is not only reflected in the profitability but also on the stock prices. Bloomberg data indicates that the quarterly outperformance of value stocks overgrowth stocks has been the strongest in the last year. This is precisely why such companies are not only successful in holding on to business when inflation accelerates but such businesses also witness strong margin and profitability when the pace of price-rise slows. Such companies also gain market share from the growth stocks and unorganized players in a rising inflationary regime. The practice of identifying & investing in value businesses is woven in the investment philosophy of LICMF.

At LICMF, our flagship funds like the LICMF Large Cap Fund and LICMF Large & Midcap Fund, follow a rigorous selection, scrutiny & monitoring process in value investing. The philosophy entails investment in predominantly business with strong leadership, legacy of operation, strong brand loyalty, competent corporate governance, and sustainable business growth model. Investors may look at investing in our flagship funds either through lumpsum or SIP. However, we recommend investors to take help of financial advisors after careful discussion on risk appetite, return expectation and investment horizon in order to take an informed decision.

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