

# BUDGET EVE THOUGHTS

Read our PCG Research Head,  
**V K Sharma's** musings  
ahead of the Budget



Dear Investor,

## | A QUICK REALITY CHECK

The current FM's maiden budget (in July last year) was a damp squib. Markets fell steadily afterwards... However, Government did take some cognizance. Prime Minister alluded to the need respecting tax payers in his Independence Day speech. Thereafter the FM announced several steps to address the concerns of NBFCs and banks. Finally, it was not until her tax cut announcement during market hours on Friday 20 Sep 2019 that markets really bottomed out.

Markets have run up since then and naturally, expectations are also running high. The Nifty has risen 1,739 points or 16.26% from the Sep 20 low (when the tax break was announced) to an all time high of 12,430, on 20 Jan 2020. Meanwhile, GDP growth has hit a multi-year low and barring very few frontline and other fundamentally strong companies, earnings growth looks challenged. The FM, indeed, has a tough ask.

## ACTUALLY, MARKETS NEED ONLY TWO THINGS RIGHT NOW...

- A credible PSU disinvestment plan - keeps the fiscal deficit under control...
- Long Term Capital Gains tax must go!

The second proposal is actually easier (not much is collected any way via LTCG). However, bridging the fiscal deficit via large scale PSU disinvestment is a political minefield. The ruling dispensation does not lack numbers in Parliament, but its own think tank is in two minds.



## FISC RISK PALPABLE

Meanwhile, despite some efforts to streamline GST collections and restrict imports, Government will still suffer considerable revenue shortfall in FY20. This will also spill over into FY21, given weak macros. We had argued last year too, in favour of a higher fiscal deficit. Rating agencies, especially global, will accept anything that promotes macro growth. But that was last year. We are a little more circumspect this time around, and would worry about a down grade (esp. before a potential dollar debt offer from the Indian govt).

Considering the tight fiscal situation (fiscal deficit in 8mFY20 is 15% above target already) and slowing domestic growth, it will be challenging for the FM to balance fiscal constraints with growth impetus. Non tax revenues like RBI's dividends, partial payments by telecom companies following a court ruling, and divestment proceeds still hold out some hope for better fiscal balance.

We thus believe government is likely to miss its fiscal deficit target of 3.3% of GDP because of the recent cut in corporate tax rates, sluggish GST collections and a big miss on its divestment intent. Slower macros will only add to this challenge over FY21. Meanwhile, a fiscal deficit of 3.5-3.7% is likely in FY20, while it can perhaps be curtailed to 3.3-3.5% vs. the targeted glide

path of 3% by FY21. If the FY20 fiscal deficit is curtailed within 3.7%, and if LTCG is eliminated, markets are likely to remain steady. If these conditions are not met, brace for a fall.

## | **GOLDEN RULES FOR BUDGET DAY**

- ✦ If you must trade, do it with stop losses
- ✦ If you are long, don't lower your stop loss or if you are short don't raise your stop loss
- ✦ Buying options may seem less risky but on an eventful day, but they are actually very costly (you may pick the right stock, in the right direction as well, but you may still suffer as Implied Volatility cracks after the Budget!)
- ✦ Reduce your cost of options by using a spread. Watch out for our strategies as we get closer to B-Day!
- ✦ Limit the number of stocks you trade (one or two, especially if you are trading derivatives) so that you can actively follow them.
- ✦ Be ready to book intraday profits when you are in the money and thank God! Never allow profitable positions to turn into losses.
- ✦ Keep 2/3 of your risk appetite intact for late trades after the budget has been read, digested and discounted. We will also do a detailed note here in the following week
- ✦ Remember that if the Nifty tanks, the lately fashionable small caps (that have spectacularly beaten the Nifty in over Jan 2020) will tank...





## HOW CAN YOU USE OUR OPEN CALLS ON BUDGET DAY?

We have 17 open Fundamental calls... Of these, three (Axis, SBI and Ultratech) will probably mirror Nifty direction. The beaten down ITC may well swim against the current if the market falls after the Budget. It may also find tailwinds in case markets rise!

While we don't advocate adding to your positions (if any), you may want to take up fresh positions. These are not trading stocks. If you must trade, keep a strict stop loss in place. We will monitor them closely given their broader connection with the economy and policy evolution. We are likely to revisit them and possibly reiterate our buys after a detailed look at the Budget.

Happy investing!

Yours truly,

**Vinod K Sharma**

