

## The risks we live with



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*"He who is not courageous enough to take risks will accomplish nothing in life."*

*- Muhammad Ali*

If you wish to create wealth you must participate in equities. And equities are all about risk!

What investors must learn is how to manage this risk. One way to do that is to follow what we discussed [last month](#): Rebalance in line with your asset allocation framework and financial plans.

In my travels around the country in recent months I have been to Hyderabad, Kolkata, Delhi, Bengaluru, and Chennai. With the market in roaring shape and animal spirits well on display, it is good to hear many investors ask the question – "What is the biggest risk?".

This month therefore I thought I would put down what I see are some risks to be concerned about. In this exercise, we are limited by our imagination as the risks that do the most damage are often not on our radar screen. As for the risks that we know to exist here is my list of top things to worry about:

### **What if inflation accelerates?**

After the inflation spike of 2021 and 2022, the latter period of 2023 brought comfort in terms of a decline in inflation across the world. Core inflation (food and fuel) dropped to 4.1% in December '23 in India. Headline inflation has also largely held within the MPC target range of 4+/-2%. US CPI has also cooled sharply from the peak of 9% in CY22 and has ranged between 3 to 3.7% in recent months.

The Bond markets have turned more sanguine and now expect the US Fed to deliver nearly 150 bps of rate cuts in 2024. The US economy remains robust, growing at an annualised rate of 3.3% in the fourth quarter of 2023. The labour market has remained very resilient and wage costs grew at an annualised pace of 4.2% for the year 2023, which is well above the historical trend and creates a cost-push inflation. This combined with any supply chain disruptions stemming from geopolitics or otherwise could cause inflation to spike. That would upset the apple cart that currently expects inflation to decline and rates to follow.

## **What if recession is delayed but not denied?**

At the start of 2023, the debate was about 'when' a recession would hit the US economy, not 'if'. You may ask 'How can recession risk exist in the same universe where we just discussed a spike in inflation?'. That's because the tail risks reside at both ends of the spectrum. The economy may have dodged the recession bullet in 2023 but it could also be possible that it has merely taken longer than expected for the rate increase to bite. The slowdown anticipated last year could show up unexpectedly in 2024. It may also be caused by an extraneous event such as an exposure of fragilities in the financial system in the US due to the record interest rates.

## **An election surprise?**

Forecasting markets is difficult, and many would argue that the same holds for elections. 2024 will be a record-breaking year for elections. Around the world, more than 2 billion voters in 50 countries will head to the polls, according to The Center for American Progress, a US policy institute.

The two big elections that matter to us are of course India and the US. In India based on the results of the assembly election and other [opinion polls](#) the existing government led by PM Narendra Modi is in the pole position to maintain its majority in parliament. The market perception of risk to continuity in India is low. However, it's a very different story in the US with a bitter battle building, which could well involve legal issues and have significant political, economic and security fallouts. This is a known unknown and yet we can't ignore it.

## **What about the impact of geopolitics?**

From elections, we head to geopolitics, which remains on the boil. The two large conflicts that dominate the global landscape are Ukraine-Russia and Israel-Hamas. The most significant risk here is that of conflagration with more players or countries getting pulled into the fray. We just don't know yet. Alternatively, the conflicts may simmer down or for that matter reach a peaceful resolution. That would certainly be good for those directly in the line of fire and have a significant impact globally as well.

There has been a cooling down of tensions between the US and China in recent months. However, with the US election and depending on the new administration, we could see things deteriorate or change trajectory altogether. In the post cold-war era the US has dominated the world stage. It has been willing to deploy its military and economic power to play global superpower. That trend now appears to be in reversal and could well create medium-term ramifications. NATO and European countries are increasing their defence spending and even countries like Japan have changed course. In India, we face our own unique challenges and investing in our security and defence capability has become a must.

All government spending is eventually limited by their means, i.e. taxes and revenues. Increasing defence spending would call for offsets elsewhere to maintain fiscal discipline. This is the opposite of the peace dividend.

### **Should we worry about K-shaped recovery?**

In India, what we would worry about is the continued evidence suggesting a twin-track economy or what is often referred to as the K-shaped recovery. The extension of PMGKAY, the food security programme, announced in November 2023 entails the provision of food to nearly 800 million citizens for another five years. The cost of this programme is nearly Rs 2 lakh crore a year. Such wide coverage and the need to provide support suggests, even though the economic growth is 7%, a segment of India's population is perhaps yet to make a complete recovery from the COVID-19 setback.

The sales growth numbers of several FMCG companies and company commentaries reflect this stress. As more businesses face this challenge it might have an impact on the intent of businesses to invest and create jobs. Sustained growth of 7%pa driven by an acceleration in exports and a revival in the farm sector may hold the key to this turnaround.

### **Implementation is everything**

Risk-taking has been well-rewarded in the stock market over the last three years. To my mind, the biggest risk today is the overconfidence that is building in the minds of investors rather than in events or developments. The biggest risk is that we have already incorporated our collective potential into valuations. Now comes the hard part of implementation. In the words of Steve Jobs "To me, ideas are worth nothing unless executed. They are just a multiplier. Execution is worth millions."

My top five risks, as shared above, may be different from what others perceive. This is only a toolkit to think about risk. You can't avoid living with risk!

To end with the words of Peter Drucker: "People who don't take risks generally make about two big mistakes a year. People who do take risks generally make about two big mistakes a year."

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## Author's profile:



Vetri Subramaniam is the Chief Investment Officer of our Company. He holds a B.Com degree from University of Madras and a Post Graduate Diploma in Management from Indian Institute of Management, Bangalore. He joined UTI AMC as Head of Equity in January 2017 and assumed the role of Chief Investment Officer from August 2021. Prior to joining UTI, he was associated with Invesco Asset Management Private Limited, Motilal Oswal Securities Limited, Kotak Mahindra Asset Management Company Limited, SSKI Investor Service Private Limited and Kotak Mahindra Finance Limited.

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