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How important the Union Budget is for equity investors

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The Union Budget is the big annual event which is considered the mother of all events for the stock markets. There is huge pre-budget speculation and anticipation of which sectors and companies will benefit from the budget and hence long positions are sought in those sectors prior to budget announcement. Similarly, short positions are sought in those sectors and companies that are expected to suffer from new taxes imposed on them or removal of earlier incentives. The analysts and media work on this anticipation and the whole trade in the few sessions before and after the budget is concentrated on entering these trades and exiting either successfully or unsuccessfully. Is all this circus justified?

As a long-term value investor one should remind oneself that a portfolio is created in a bottom-up manner, stock by stock, based on the merits of each stock. The primary criterion is whether the business model is stable. This is followed by an analysis of balance sheets. A weak balance sheet will spoil even a company with a stable business model as an investment. Stable business model in a strong balance sheet is a necessary condition for a stock to be included in a safe portfolio for value investors. Further, a strong track record of value creating capital allocation gives more strength to the portfolio and moral courage to the investor to hold the portfolio even when the market opts to price the portfolio below its buy value. Finally, the most critical condition for a value investment is whether a stock is available below its intrinsic value. If all these conditions are true then it probably is a good stock to consider investing.

Where does the budget come into all this?

Stable business model of the company itself implies that the business model would be stable before and after the budget. It should, typically, not be impacted too strongly by favourable or unfavourable external conditions. This is not to deny that some company might not have its business model destroyed by new policies announced in the budget or that some company might discover a new stable business model due to new policies when there was none earlier. But by and large the focus in creating a bottom-up portfolio is on companies which have an already proven stable business model which can withstand unfavourable external conditions.

Similarly, for companies which have a robust balance sheet and strong capital allocation, the impact of policy changes is not a game changer. It could help or hamper their profitability but in most cases it is not going to make a viable business unviable or a highly profitable business significantly less valuable.

Yes, the pricing changes a lot around the budget for many companies driven by the speculators. As a bottom-up value investor it can provide a lot of opportunities to take advantage of them.