Equity Review

Commentary on Equity Markets

The MSCI India Index started the month at 17.81 and closed at 17.79, decreasing by 0.2% over the month. As per latest data, FIIs were net buyers in Equity with inflow of USD 2.03 Bn and net sellers in Fixed Income with outflow of USD 0.83 Bn. Domestic Institutions were net sellers in equities with net outflow of USD 0.08 Bn in the month

Commodities and Inflation

NYMEX Crude Oil prices rose by ~6.4% from the previous month levels, ending at 57.22 per barrel; the prices were lower by ~7.2% yoy. LMEX closed at 3058.0 higher by 3.7% over the month (lower by ~8.4% yoy). Gold prices closed at USD 1324.65/oz marginally higher over the previous month (higher by ~0.36% yoy). The USD Index rose by ~0.6% vs. other currencies over the month; over the year the USD Index was higher by ~6.1%.

January CPI at 2.05% came in lower than the revised 2.11% seen in December reflecting comfort on cost push as well as demand pull inflation. Supply side pressures remained contained with food inflation declining further while oil and INR remained stable. Core inflation came off to a fiscal year low of 5.38% (compared to 5.67% in December) supported by lower retail fuel prices (petrol & diesel). The steep uptick seen in two specific services, viz. 'Health' & 'Education' in the past two months has reversed and this further supported lower core pressures. April-January core inflation and headline CPI have averaged 5.94% and 3.6% respectively. Headline inflation is likely to remain subdued until food prices pick up.

Markets & Real Economy

December IIP at 2.4% came in higher than lower revised 0.3% seen in November. The previous two months (October: 8.4% and November: 0.3%) production data had reflected the festive demand surge and correction post that. December IIP marked normalization of the trend. April-December IIP stands at 4.6% v/s 3.7% seen in the same period of FY18. Mining, Manufacturing and Electricity grew -1%, 2.7% and 4.4% respectively. Primary goods (-1.2%) marked the first contraction in 18 months with negative contribution from petrol and diesel. Capital goods (5.9%) marked expansion in seasonally adjusted activity while Intermediate goods (-1.5%) declined. Infrastructure goods (10.1%) remained healthy with Consumer durables (2.9%) and non-durables (5.3%) turning positive post contraction in November.

As per the latest RBI data, Forex reserves position improved to USD 399.22 Bn over the month. The Rupee remained flattish over the month closing at 71.1025 Rs/USD vs. 71.1690 Rs/USD last month

Sector-wise Performance

Key outperforming sector during the month was Automobiles. Stocks within the sector have seen underperformance over the previous couple of months as volumes remained muted due to the impact of higher fuel prices / interest rates, insurance cost increase, and muted festival season. This led to inventory correction by dealers driving low primary sales for manufacturers. However, post the sharp correction in the stock prices, valuations now appear to be reasonable. Also, margins are likely to improve going ahead as benefit of low commodity prices starts to play out. Expectations of a pick-up in volumes, improvement in margins and reasonable valuations have driven outperformance for the sector during the month. We believe that the overall low penetration levels in India compared to global standards shall act as a long term driver for growth and remain positive on the sector as a long term play on India's economic growth and rising income levels.

Key underperforming sector during the month was Consumer Goods. While the sector continues to deliver healthy volume growth, there was some pressure seen on the margins due to raw material cost pressures. Given that the valuations within the sector were on the higher side, there was some selling pressure witnessed during the month which led to underperformance for the sector. We continue to believe that the sector is best placed to benefit from the long term growth in the economy and rise in living standards. We continue to remain positive on the sector

Key Stock Movements

Yes Bank Ltd – The stock has rallied sharply during the month as Yes Bank received the risk assessment report from RBI which observed Nil divergences in the Bank's asset classification and provisioning from the RBI norms for FY2018. This comes as a big positive for the bank as it removes all uncertainty regarding classification of non-performing assets. The appointment of MD & CEO Mr. Ravneet Gill is also a big positive for the bank as the former MD & CEO Mr. Rana Kapoor's term expired in January The biggest overhangs on the stock in the recent past were concerns on asset quality and the continuity of the top management which have now been addressed. We maintain our positive view on the bank.

La Opala RG Ltd – The stock has been under pressure as demand environment has remained muted and volume growth has been below expectations. Also, there is a concern of increasing competition within the opal ware category. However, we believe that the opportunity for growth for the category is large as the penetration levels are low, and there is scope for multiple players to grow. Also, the company is putting up new capacities which shall become operational within the next 12 months driving further growth. We are using the current weakness in the stock price to build up exposure gradually.

Market Outlook

A budget with a clear focus on providing growth impetus to the economy through support for the agriculture sector and higher discretionary income in the hands of the middle class failed to enthuse the equity market as investors remain on the sideline waiting to see outcome of the general elections. Corporate results for Q3FY19 presented a mixed bag with no clear-cut evidence of a broad based recovery. Towards the end of the month, tensions between India and Pakistan due to a pre-emptive non-military strike by the Indian Air Force of terrorist camps in Pakistan and retaliation by the Pakistan Air Force led to some nervousness in the market. While market may remain volatile in the near term due to this, we believe that the probability of the current situation escalating into a full blown war is very low and the long term fundamental drivers of the economy shall continue to lead. We would also like to emphasize that India is a large and stable economy with the ability to absorb such minor skirmishes without any material impact on the core growth potential. To re-iterate, at the current point in time, probability of an escalation seems very low and as such, we would encourage investors to keep focusing on the long term growth potential of the Indian economy.

Fixed Income Review

India's consumer prices (CPI Inflation) eased further to at 2.05% in January 2019 from 2.11% in December 2018 on account of broad based softening across segments. Food inflation continued on deflation territory and declined by 2.17% in January 2019 as compared to a decline of 2.65% in December 2018, on account of sustained contraction in prices of vegetables, fruits, cereals and pulses. The core-CPI inflation moderated to 5.4% in January 2019 as compared to 5.7% in December 2018, led by deceleration in miscellaneous goods inflation. The inflation related to fuel and light declined sharply for a second consecutive month to 2.2% in January 2019 from a level of 4.5% in December 2018 primarily on account of continued decline in LPG prices. The Wholesale Price Index (WPI) further moderated to 2.8% in January 2019 from 3.8% in December 2018 led by lower fuel and core inflation.

February's monetary policy was a maiden policy by the RBI Governor Shaktikanta Das who was appointed in December 2019. With Governor Das at the helm, the MPC committee changed the stance from calibrated tightening to neutral and also cut the repo rate by 25 bps. During the policy meeting, the RBI also significantly lowered its inflation trajectory as they explained that they do not anticipate inflation crossing 3.9% till the end of the 2019 calendar year. The policy stated that there is a modest opening of an output gap which indicates that RBI is more concerned about growth, and were comfortable about the inflation trajectory and showed little concern about the fiscal slippage announced in the budget.

GDP growth for Q3-FY2019 slowed to a six quarter low of 6.6% as compared to 7.7% during Q3-FY2018, while Gross Value Added (GVA) growth came in at 6.3% as against 7.3% same period last year. The fall in GDP growth was led by agriculture sector slowdown, domestic credit squeeze and external headwinds. The second Advance Estimate for FY19 GDP shows a downward revision in GDP growth to 7.0% from the earlier estimate of 7.2%.

Outlook

On account of some supportive factors both on global as well as local front, the RBI presented a dovish outlook along with a 25bps reduction in India's repo rate and a change in stance to 'neutral' in the monetary policy. The global backdrop has become conducive to this outlook, amidst growing concerns of a global growth slowdown, a softer stance expressed by Fed Chairman Powell with regard to US policy rates and the pace of balance sheet reduction. Oil prices also remain supportive and contained at around USD 60-65$ a barrel. On the domestic front, retail inflation prints have approached the lower band of the targeted inflation target of 4%+/-2% (2%-6%). The rate cut from RBI was substantiated by a sharply lower inflation projection for the next financial year FY2020 hinting at the possibility of further easing ahead from the central bank this year.

On account of benign inflation prints in recent months as well as expectation of inflation remaining well below the central bank target of 4% for entire 2019, we expect another 25-50bps of rate easing from the central bank in this calendar year with high probability of a 25 bps cut happening in next policy due in April. Since the environment is supportive of local bond yields, we have moved from an underweight stance on duration last year to a moderately bullish one and therefore added duration in the fund in last three months.

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