Equity & Fixed Income Outlook

August 2019

Equity Review

The MSCI India Index started the month at 18.22 and closed at 17.69, decreasing by 3% over the month. As per latest data, FIIs were net sellers in Equity with outflow of USD ~2.18 Bn and net buyers in Fixed Income with inflow of USD ~1.60 Bn. Domestic Institutions were net buyers in equities with net inflow of USD ~2.56 Bn in the month.

Commodities and Inflation

NYMEX Crude Oil prices corrected by 5.95% from the previous month levels, ending at 55.10 per barrel; the prices were lower by ~21.1% yoy. LMEX closed at 2757.3 lower by 2.0% over the previous month (lower by ~5.8% yoy). Gold prices closed at USD 1525.73/oz ~6.6% higher from the previous month level (higher by ~26.4% yoy). The USD Index strengthened by ~0.4% vs. other currencies over the month; over the year the USD Index was higher by ~3.9%.

July's CPI inflation came in at 3.15% y-o-y compared to 3.2% last month. Core inflation (ex food, fuel, petrol, diesel, and housing) came in at 4.24% compared to 4.13% in June; while food inflation moderated marginally to 2.33% from 2.4% previously. Fuel and light inflation contracted 0.36%, housing inflation was marginally up at 4.87% from 4.84% a month ago and clothing and footwear inflation was seen at 1.65% against 1.52% in June. The cumulative CPI inflation has declined to 3.09% in April-July FY2020 compared with 4.63% in April-July FY2019

Markets & Real Economy

The Index of Industrial Production increased by 2.0% in June compared to 3.1% in the previous month. Mining, Manufacturing & Electricity grew 1.6%, 1.2% and 8.2% respectively. Output of primary goods grew by 0.5% while intermediate goods inched up by 12.4%. Similarly, output of consumer non-durables rose 7.78, however, consumer durables slipped -5.5%. Output of infrastructure or construction goods fell by 1.8%, and that of capital goods declined by 6.5%. The cumulative growth for the period April-June 2019 over the corresponding period of the previous year stands at 3.6%.

As per the latest RBI data, Foreign exchange reserves position improved to USD 429.05 Bn over the month. The Rupee depreciated by ~3.84% over the month closing at 71.465 Rs/USD vs. 68.823 Rs/USD last month.

Monetary Policy

Prioritizing growth revival by boosting aggregate demand, RBI deemed appropriate to reduce the policy rate by 35 bps to 5.4% in the August Monetary Policy. Dovish developments globally, announcement of rate easing by leading Central banks including the Fed and RBI's change in stance to 'accommodative' in the previous policy facilitated the 35 bps rate cut. CPI projections were largely unchanged from the June policy and Q1FY21 CPI was projected at 3.6%. RBI revised FY20 GDP lower to 6.9% (from 7% earlier) citing slowdown in growth momentum in advanced economies due to US-China trade tensions and geopolitical uncertainty and weak economic activity in Emerging Markets. RBI is expected to continue to ensure transmission of 110bps rate easing done so far via adequate liquidity. Scope for further easing remains, given that aggregate demand needs a meaningful boost and inflation is likely to stay within target levels.

Sector-wise Performance

Key outperforming sector during the month was Information Technology. Following the strong momentum over the previous month, IT stocks continued to remain positive in an otherwise subdued market as growth outlook remained steady. Weakening of the INR further supported sentiment for IT stocks as depreciation in the currency impacts the sector positively by way of higher realizations and improvement in margins. Given that the top tier companies in the sector continue to grow by 10-12% in an environment where the economy is struggling to growth at 10-12% nominal GDP growth rate, provides support to the steady growth profile of Indian IT companies. We continue to remain positive on the sector.

Key underperforming sector during the month was Metals. The sector has been one of the most impacted sectors during the weakness in markets as the US-China trade war continues to escalate. With no end to the trade issues in sight, outlook for global growth has deteriorated leading to lower demand for commodities and weakness in pricing. We have always maintained that the sector lacks long term growth visibility and pricing power and the highly cyclical nature of the business leads to sharp upswings and downswings. We maintain our negative stance on the sector.

Key Stock Movements

Ajanta Pharma – Ajanta Pharma is a pharmaceutical company with diversified presence across India, Asia, Africa and US markets. The company has seen some deterioration in earnings growth over the past year due to muted growth in Asia and Africa geographies and pressure on margins due to commercializing of new facilities. However, in the Q1FY20 results, the company has delivered a marked improvement in revenue growth driven by new product launches in US market and stabilization of Asia and Africa markets. In addition, margins have also started to improve as the fixed costs for the new plants get absorbed. With improving growth outlook and gradual improvement in margins, the company shall deliver healthy earnings growth going ahead. The company has a long track record of generating very heathy Return on Capital and Free Cash Flows.

RBL Bank – The bank has faced some stress on its corporate exposure which has led to the management guiding for higher credit costs during the current year. This has also led to improvement of Return on Assets from 1.25% to 1.5% getting deferred by a year which has led to a de-rating of the stock. The management has however guided that the stress shall be limited to the current financial year only and shall get normalized during FY21. The bank is adequately capitalized with sufficient Tier 1 capital for the next few quarters. We are not adding exposure aggressively and are monitoring the corporate book closely. We may add to our exposure depending on the visibility of reduction in corporate stressed book and improvement in RoA.

Market Outlook

Sentiment in the equity market has deteriorated as the global outlook continues to worsen driven by US-China trade concerns, slowing growth in all major economies and rising risk aversion. On the domestic front, constrained credit, indifferent exports and Government's hard stand of fiscal restraint have led to weakened growth. While Monetary policy has turned accommodative, transmission of the same has been restricted. Further rate cuts by RBI, concentrated efforts to ensure their transmission, and some form of fiscal stimulus by the Government are needed to revive the growth momentum and bring it back towards the long term potential growth rate. The Government, taking cognizance of the situation, has announced a few measures over the last couple of weeks and more steps are likely going forward. The Indian economy has immense long term growth potential and timely moves by the Government can ensure that the economy reclaims its high growth trajectory. In the meantime, any further weakness in the equity market will lead to valuations getting attractive and will provide opportunity for long term investors to increase their exposure to Indian equities.

Fixed Income Review

India's consumer prices (CPI) held broadly steady at 3.15% in July 2019 from 3.18% in June 2019 even though there was an upward sequential momentum in both food and core inflation. Food inflation continued its upward momentum, increasing by 2.36% in July 2019 as compared to an increase of 2.25% in June 2019, primarily on account of sharp rise in prices of vegetables and fruits. The core-CPI inflation also inched up to 4.3% in July 2019 as compared to 4.1%% in June 2019, driven by higher sequential momentum in housing component, clothing & footwear as well as the miscellaneous basket. Fuel inflation moderated sharply to 0.4% in July 2019 from a level 2.3% in June 2019 led by sharp contraction in LPG prices and contraction in coal and charcoal prices. The Wholesale Price Index (WPI) decelerated to 1.1% in July 2019 from 2.0% in June 2019 on account of broad-based moderation across food, fuel and core inflation.

In its third bi-monthly policy review for FY2020, RBI Monetary Policy Committee (MPC) opted for incremental monetary easing. However, in a departure from usual convention of changing benchmark rates by 25 bps (or multiples thereof), the repo rate was reduced by 35 bps to 5.40%. While all MPC members voted for incremental monetary easing, four out of six voted in favour of a 35 bps cut, with the other two voting for a 25 bps cut. The MPC unanimously retained the monetary policy stance at 'accommodative'. The RBI continues to forecast inflation trajectory at sub 4% levels over the next four quarters. Inflation forecasts for FY2020 were revised marginally higher to 3.35% with H1FY2020 forecasts of 3.1% and H2FY2020 3.5-3.7%, with risks evenly balanced. More importantly Q1FY2020 inflation projections are at 3.6%, below the 4% inflation target.

India's GDP growth slowed to 5.0% during Q1FY2020 as compared with 8.0% during same period last year. Slowdown in domestic private demand amidst lacklustre private investment coupled with a global slowdown led to record low nominal GDP. Gross Value Added (GVA) growth for Q1FY2020 fell sharply to 4.9% YoY vs 7.7% earlier led by a higher than expected moderation in the manufacturing sector.

Outlook

RBI's MPC move to cut the interest rates by 35 bps was a pre-emptive one given slowing growth prospects domestically and globally. This move by the RBI was in cognizance with the global central banks which have adopted dovish stance in support of growth. Going forward, with the inflation trajectory remaining in the RBI comfort zone, any surprise on the downside on the growth front led by both domestic and global factors, could prompt the RBI's MPC towards further accommodation in future monetary policy reviews. The lower than expected first quarter GDP number indicates that the slowdown is more pervasive, underscoring the need for coordinated monetary support and fiscal policy actions. Therefore, we expect further monetary support with the terminal repo rate moving towards 5% in next 3 to 6 months.

The entire fixed income component is invested into sovereign bonds with majority exposure positioned towards the front end of the yield curve in order to generate carry by taking minimal credit as well as lower duration risk.

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