Investment Snapshot

For the quarter ended in June - 2021

FY 2022: **An upward journey** to normalcy

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The Quarter Gone By

After a challenging year of FY21 which tested the mettle of the human race, FY22 commenced with a sheer sense of Deja vu, mirroring the Q1FY21 quarter, as the nation was posed with a dire second wave over Apr-May'21, resulting in localized lockdowns and restrictions. Concerns around the sharp rise in 2nd Covid wave impeding the nascent economic recovery, yet again came to the fore. However, on a positive note, with the restrictions being less stringent this time around along with phased lifting of lockdowns and the pace of vaccinations picking up swiftly, the economy has begun to recover. This strongly adds credence to our view that the impact of 2nd wave is transient and is not as grave as the 1st wave and that the economy will remain resilient and shall sail through this as well.

As the global growth outlook is set on the mend, there have been mounting concerns in the bond markets around higher inflation stemming from US stimulus and rising commodity prices, coupled with expectations of consequent premature tapering of balance sheet, which had in turn led to a spike in bond yields globally. While Fed's pertinent stand on 'Inflation being transient' had quelled the market fears in the interim and aided to stave off further rise in yields, the rhetoric has seen some change in the June policy with at least two rate hikes by 2023, thus renewing the fears of policy normalization.

The equity markets have been nonchalant and largely looked through the turbulent period of April& May'21 and have shown strong resilience, with indices and market caps soaring to their all-time highs largely led by rally in broader markets with Nifty Midcap and small cap posting returns of 13.8% and 20% respectively in Q1FY22 vs 7% rise in Nifty. However, equity markets did suffer with FIIs pulling out money post the Fed announcement in June across the emerging economies. FII inflows in India have declined to $758mn in 1QFY22 vs. $7.3bn in 4QFY21. But despite some outflows, overall India witnessed one of the highest inflows among the EM countries during Q1FY22, thus exemplifying the confidence of foreign investors in India's growth story and its huge potential.

The Macroeconomic landscape and Fixed Income markets during the quarter

Q1FY22 saw a rebound of the Chinese and U.S. economies with the rapid vaccine roll-out besides an increase in global trade in merchandise and manufactured goods that has already reached pre-pandemic levels. This will in turn aid the global GDP rebound. Nonetheless, Europe's outlook is questionable currently due to signs of a new wave. The prospects of a full recovery are promising despite the risks emanating from the resurgence of Covid waves, as fiscal support is stepped up sharply, economies adapt to social distancing norms and vaccination roll-out gathers steam.

On the domestic front, belying the naysayers expectations, India's GDP declined by a modest -7.3% in FY21 with Q4FY21 posting a growth of 1.6% vs 0.5% in Dec'20 , thus exemplifying the resilience and sustained improvement in the economy. Amidst the second wave impact and regional lockdowns, In Q1FY22 most of the high frequency indicators such as Manufacturing PMI's, port traffic, export import growth, E-way bills, power consumption etc. remained resilient with positive momentum from mid-May'21 onwards. This testifies the fact that the economy is set to improve, as the Covid cases have receded and the vaccination drive has picked up pace. Retail Inflation, which was treading lower in December'20 and Jan'21 (aided by positive base effect and lower food prices), inched up in Mar, Apr and May'21 to 5.5%, 4.2% and 6.3% respectively, largely due to higher commodity prices and supply disruptions. Brent crude has been on a rise since Dec 20 largely due to pick-up in oil demand, lower production by OPEC and geo-political issues.

With respect to bond markets, improving growth prospects, commodity price increases, and short-term supply constraints in some manufacturing sectors have renewed focus on inflation risks and with US bond yields inching up by more than 70bps in 2021. However, the US 10Y bonds yields have fallen to 1.35%, as the market began to align with the Fed's view- that the spike in inflation may be largely transitory, while the best of the recovery may be behind. On the domestic front, RBI has been resolute in keeping the 10 yr bond yields anchored at lower levels to support growth and the huge government borrowing program, despite the specter of rising inflation. RBI has given panacea to the bond markets in the form of announcement of an explicit G-SAP program (G--sec acquisition Program) 1&2, which has put to rest the bond market concerns around absorption of large borrowings in FY22. Furthermore, it has been actively intervening in weekly debt auctions by devolving and cancelling auctions to keep yields at lower levels. However the 10-year G-sec yield has eventually inched up to 6.15% as the rising domestic inflation is now weighing on bond yields at the margin, but any sharp spike is likely to be soothed by the RBI.

Macro- Economic and Fixed Income Outlook

On the macro front, the Indian economy is set to embark again on the virtuous journey of recovery. India is expected to outshine the recovery expectations after the second wave with stellar performance across major macro indicators. With the widespread roll-out of the Covid vaccine, growth-conducive policies and the state wise unlocking phase, the growth outlook looks decidedly promising. We reckon the long-term structural growth platform of India remains intact and that the consumption and demand engines are set to improve aided by government support and reforms from hereon. The 2022 Union Budget was a path-breaking one with major reform initiatives being announced in conjunction with other policy reforms such as Atma-nirbhar, Production linked Incentive (PLI) and National Infrastructure Pipeline etc. would go a long way in transforming the growth landscape of the country. Besides the central bank's unflinching resolve to nurture growth amidst the impact of Covid would ensure financial stability and aid the growth recovery in the ensuing quarters.

From Covid standpoint, while the second wave may have receded, the threat of 3rd wave still looms. Nonetheless, the vaccination pace will be the key yardstick for economy and markets. While growth prospects look discernible, a key factor governing the future course of markets would be the rising inflation across economies and crude oil prices. Given the inflation risks are to the upside with impending recovery in economy and rising commodity prices, the central banks may claw back on their liquidity stance sooner and this in turn may have negative ramifications and create volatility in the markets.

From the debt markets perspective, going forward, we see policy rates to remain status quo and the liquidity stance is unlikely to diverge from the accommodative policy stance in the near-term. Nonetheless, the prospects for bouts of volatility in bond markets cannot be ruled out with the ongoing commodity rally and rising crude prices, which will have spill over effects on already elevated domestic inflation and as market participant's price in the impending normalization of monetary policy in line with macros. Furthermore with Fed's recent rhetoric on Fed rate hikes in 2023 and its stance on liquidity and rates will have a bearing on the direction of global and domestic bond yields. Clearly, this fear would linger and not get withered anytime soon and will continue to pose challenages for the bond yields globally and impact EM yields too.

On the interest rates front, While the 10 yr benchmark yields has slowly started moving upwards, the longer and shorter end of the curve have already started drifting higher, as the markets have already started pricing in the impending normalization of liquidity and policy rates. And as this gets more pronounced going forward, we would eventually see the 10 yr interest rates also drifting higher. Eventually we would start seeing the interest rates getting aligned to the fundamental and structural macro variables and will start inching up, as economy starts seeing recovery, inflation pushes higher, and liquidity starts normalizing.

Equity Market Outlook

An environment of record low interest rates and easy global liquidity has favoured equities as an asset class, globally. We do not anticipate any substantial pull-back in global liquidity at least in CY2021. Benign global liquidity continues be favourable for flows into EMs including India. The equity markets have seen consolidation in Q1FY22 and is expected to see further consolidation in FY22. In Q1FY22, Equity Markets delivered 7% returns higher than UK FTSE (4.8%) and US DJI (4.6%). Markets at this juncture are witnessing bouts of volatility, as on one side they are poised for an economic recovery after the second wave along with the global economic recovery, while on the other side they are juxtaposed with slight underperformance expected by corporates in some sectors in Q1 due to high input costs and lower volumes.

Beholding beyond the challenges posed by 2nd Covid wave, we see medium to long term domestic macro drivers to remain conducive for corporate earnings to grow at a healthy pace. We believe the long-term growth outlook remains intact as the Government policies have rightly laid the foundation for a growth-conducive platform, which would aid in a major economic reset for India. Going into FY22, we expect the growth momentum to continue to be driven by good monsoons and focussed government spends. We see the RBI's pro-growth and comfortable liquidity stance aid in giving a push to manufacturing, along with deployment of the PLI schemes across sectors. Besides, the global liquidity is also likely to remain benign albeit at a lesser pace, which coupled with stronger economic growth outlook are the key ingredients for driving the equity market performance in FY22. After FY21 having ended with a solid 15% EPS growth, we expect FY22 earnings growth to be normalized aiding the markets to perform reasonably well. Given this construct, we advise investors to believe in the long-term potential of India and stay on course to leverage any dips, as an opportunity to buy. We remain constructive on equities as an asset class. Equities are a long-term asset class and require patience from investors to reap the benefits of the long-term compounding stories we invest in. If you're investing for a horizon of five - ten years, we believe that Equities, as an asset class, represents the best opportunity for long-term wealth creation.

Snapshot of Macro Indicators

Quarterly Data

	Q1FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21
Real GDP (YoY%)	7.6	6.5	6.3	5.8	5.4	4.6	3.3	3	-24.4	-7.4	0.5	1.6
Agriculture	5.2	4.8	1.9	-0.4	3.3	3.5	3.4	6.8	3.5	3	4.5	3.1
Industry	8.1	5	5.3	3.1	1.7	-1.8	-2.6	-2.2	-35.8	-3	2.9	7.9
Services	7.2	7.1	6.8	7.8	7.2	8.2	7	6.4	-21.5	-11.4	-1.2	1.5
Export Growth (%)	14.7	9.7	4.7	6.5	-1.4	-3.9	-1.9	-12.7	-36.4	-5.2	-4.3	19.6
Import Growth (%)	12.7	22.8	8.1	-0.4	1.1	-11.3	-11.2	-9.2	-52.9	-23.2	-4.6	18.4
Trade balance	-46.6	-51.5	-50.1	-35.8	-49.2	-39.7	-37	-35.4	-9.8	-16.4	-35.1	-41.1
CAD as % of GDP	-2.3	-2.9	-2.6	-0.7	-2.1	-1.1	-0.4	0.1	3.7	2.4	-0.3	-1

Yearly Data

	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21
GDP Growth %	8.5	5.2	5.5	6.4	7.4	8	8.3	6.8	6.5	4	-7.3
CPI Inflation Avg	10.5	8.6	9.9	9.4	5.9	4.9	4.5	3.6	3.4	4.8	6.3
Exports (US$bn)	256	310	307	319	317	266	280	309	337	320	296.3
Imports (US$bn)	383	500	502	466	461	396	393	469	518	478	398.5
Trade Deficit (US$bn)	-127	-190	-196	-148	-144	-130	-112	-160	-180	-158	-102.2
Trade Deficit (%of GDP)	-7.6	-10.4	-10.7	-7.9	-7.1	-6.2	-4.9	-6	-6.7	-5.5	-3.8
Brent Crude oil prices year ending	117.3	123.8	109.3	107	53.3	38.7	52.7	69.1	70.3	21.5	62.4
Oil Import USD Bn	105.8	155	163.8	164.9	137.8	82.6	86.9	108.7	141.1	130.5	82.4
CAD $ Bn	-48.1	-78.2	-88.2	-32.4	-27.9	-22.2	-15.3	-48.7	-57.3	-24.6	23.9
CAD (% of GDP)	-2.9	-4.3	-4.8	-1.7	-1.4	-1.1	-0.7	-1.8	-2.1	-0.9	0.9
Capital account balance (US$bn)	62	67.8	89.3	48.8	90	41.1	36.5	91.4	54.4	79.1	63.7
FDI (US$bn)	9.4	22.1	19.8	21.6	32.6	36	35.6	30.3	30.7	43	44
FII (US$bn)	30.3	17.2	26.9	4.8	40.9	-4.1	7.6	22.1	-0.6	1.4	36.1
Total BoP (US$bn)	10.9	-12.8	3.8	15.5	61.4	17.9	21.6	43.6	-3.3	55.5	87.3
Fiscal Deficit %	-4.9	-5.9	-4.9	-4.5	-4.1	-3.9	-3.5	-3.5	-3.4	-4.6	-9.2
Foreign Reserves (US$bn)	305	294	292	304	342	360	370	425	413	478	579.3
Rupee (INR/$) Average	45.6	48.1	54.5	60.9	61.2	65.7	67.1	64.5	69.9	71	74.2
Repo Rate year ending	6.8	8.5	7.5	8	7.5	6.8	6.3	6	6.3	4.4	4.4
US-10 year end	3.5	2.2	1.8	2.7	1.9	1.8	2.4	2.7	2.4	0.7	1.7
GIND-10 year end	8.02	8.56	8.01	8.88	7.8	7.4	7.06	7.42	7.35	6.14	6.2

Market performance

Performance of Indian Equities across Market Caps and Debt benchmarks as on June 30th, 2021

Sector	7 year CAGR	5 year CAGR	3 year CAGR	1 year	6 months	3 months
Nifty	10.9%	13.7%	13.6%	52.6%	12.4%	7.0%
Sensex	10.9%	14.2%	14.0%	50.3%	9.9%	6.0%
Nifty Midcap Index	13.5%	14.3%	14.0%	83.4%	29.4%	13.8%
Nifty Smallcap Index	8.8%	10.9%	10.7%	110.9%	37.3%	20.0%
NIFTY Composite Debt Index	9.0%	7.9%	10.0%	3.7%	0.4%	1.8%

Source: Bloomberg, Reuters & FG Research

Global Indices Performance (%)

Sector	7 year CAGR	5 year CAGR	3 year CAGR	1 year	6 months	3 months
Dow Jones Index (USA)	10.8%	14.0%	12.4%	33.7%	12.7%	4.6%
S&P 500 (USA)	11.9%	15.4%	16.5%	38.6%	14.4%	8.2%
Nikkei 225 (Japan)	9.6%	13.1%	8.9%	29.2%	4.9%	-1.3%
Hang Seng (Hong Kong)	3.2%	6.8%	-0.1%	18.0%	5.9%	1.6%
FTSE 100 (UK)	0.6%	1.6%	-2.7%	14.1%	8.9%	4.8%
Shanghai Composite Index (China)	8.4%	4.2%	8.0%	20.3%	3.4%	4.3%
DAX (Germany)	6.7%	9.9%	8.1%	26.2%	13.2%	3.5%
iBovespa (Brazil)	13.2%	19.7%	20.3%	33.4%	6.5%	8.7%
MICEX (Russia)	14.6%	15.2%	18.7%	40.0%	16.8%	8.5%

Source: Bloomberg, Reuters & FG Research

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