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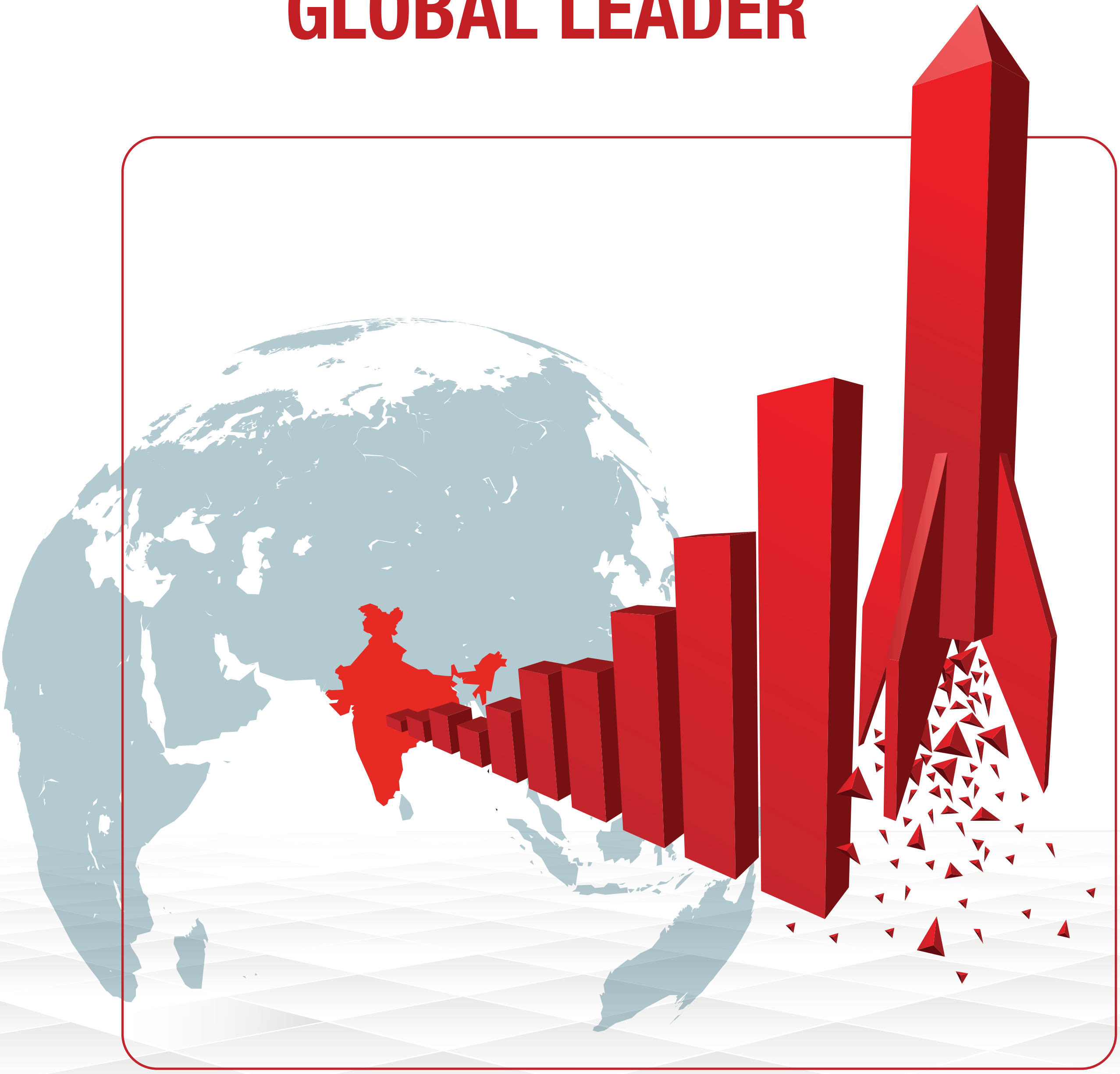
Investment Snapshot

For the quarter ended in June - FY 2024

INDIA - AN EMERGING GLOBAL LEADER



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Quarter Gone by for Markets

Post the Banking Mayhem witnessed in the US Financial sector in March 2023, the June quarter saw the contagion risk almost averted by swift actions taken by the government and central bank. However, tighter financial conditions coupled with political gridlock in the US over debt-ceiling negotiations and subdued recovery in China continued to weigh the economic and market activity. Core inflation remained sticky; manufacturing and services activity showed divergence, while the fallout from the rate hikes started to manifest with Eurozone and New Zealand entering a recession. Despite this challenging backdrop, equity markets have navigated swiftly from the despair, with Nifty delivering strong 10% returns in the quarter gone by. The broader markets' performance has been even stronger, with Nifty Midcap 100 Index & Nifty Small Cap 100 Index delivering 19% & 20% gains respectively. The relentless rally has continued post the end of June quarter.

The global economy is holding on better than its anticipation. The high-frequency indicators from a developed world like US, unemployment, retail sales, and consumer confidence, continue to show resilience, while a few hands, like PMI, are in the contraction zone. However, as the lagged impact of the synchronous global tightening plays out over the next few quarters, global growth will slow down materially. While headline inflation has certainly peaked and has been drifting lower for many months, its key components, like Core inflation, Services inflation, have remained sticky and far beyond the comfort zone of the central banks. Resultantly, global central banks have continued their hawkish commentary and hinted at further rate hikes in the coming months. The stance of the central banks is familiar to us as any signal towards a softer interest rate regime can result in prematurely loosening of the financial conditions, which can risk undoing the hard-earned transmission of the last year. With inflation remaining sticky, mainly services inflation & core inflation, the expectations of the rate cuts in the US are getting pushed out from late 2023 to mid-2024. The prolonged period of higher interest rates is bound to impact economic growth.

Amidst the slowing global economy, India is a beacon of stability. India's macro-economic stability along demographics, political stability, and strong and credible institutional framework is a rare commodity in today's VUCA (Volatile, Uncertain, Complex & Ambiguous) world. A lot of preparatory work has been undertaken over the past many years- Insolvency & bankruptcy code (IBC), Cleaning up of the bank's balance sheet, RERA, Goods & Services Tax (GST), Jan Dhan (Financialization), Direct Benefit Transfer (DBT), Production linked Incentive Scheme (PLI) etc. These measures will not only spur growth in coming years, but will also increase the longevity of growth by bringing in economic efficiencies & by bringing the unorganized sector into the formal sector & thereby laying a solid foundation for the longer-term secular growth that India can deliver. India's economic importance is also getting recognized globally, with several global leaders going to woo the Indian PM on his trips abroad. The thrust on the manufacturing sector and indigenization is unparalleled in Indian economic history. So is the thrust on Infrastructure. The tech transfer by GE for defence is a significant milestone and diplomatic win since this has never been done with any country in the world. Similarly, global majors like Apple, Micron, Google etc., have committed significant investments towards India. With public CAPEX doing the bulk of the heavy lifting till now, we expect crowding in private investment soon.

We remain hopeful as ever about India reaching its true economic potential. We expect India to clock 6.5% to 7% GDP growth over the next few years. The external position of India remains solid with a manageable current account deficit (easily covered by FDI & FII flows), positive balance of payment & Strong Forex reserves. This would provide a lot of comfort to the foreign investors looking to make a comeback into Indian markets after a prolonged period of relentless selling (more than USD 40 Billion since October 2021)

Equity Market View

Global equity markets had a strong quarter-run-up. The rally has been spread across the developed world and Emerging Markets, with markets like Nikkei (18%), Nasdaq (~13%), Brazil (16%) & India (10%) leading the price performance. The rally has been premised on the resilience of global demand despite aggressive rate hikes and the expectation of a soft landing with inflation cooling off. At the same time, the job market remains reasonably buoyant. The expectation that we are at the cusp of the end of the interest rate hiking cycle has led to a significant softening of the US Dollar and consequent risk-on environment. Considering the risk-on environment, Indian equities have outperformed most of the Developed world and Emerging market counterparts which was also aided by the pause in the interest rate upcycle in India. The rally has been broad-based, with Mid-caps & Small caps rallying 19% & 20% respectively over the past quarter. It has been fuelled by anticipation of strong earnings growth, return of the FII money & continued domestic solid liquidity. While we remain structural bulls and believers in the long-term compounding ability of the Indian Equity markets, we are tempering down our near-term expectations after the recent sharp run-up. Even though global growth has held up better than anticipation, the lagged impact of the global synchronous monetary tightening will play out over the next few quarters resulting in a sharp moderation in global growth. This, along with the withdrawal of global liquidity, domestic uncertainties like the monsoon, rainfall distribution and a heavy political calendar, will cap the near-term upside. On the valuations front, while at 21X FY24 earnings, we are indeed trading above the historical average, we are not unduly bothered about it as we believe that variables such as structural improvement in the balance sheet of corporate India, sticky domestic liquidity & attractiveness of India as an investment destination warrants an above-average multiple. We thereby remain selective in our stock selection and have been increasing our cash levels and Fixed income exposure in our asset allocation funds, as we believe that Fixed Income is offering a very lucrative alternative to Equities to lock in interest rates at higher levels along with expectations of capital gains.

Debt Market View

Global Fixed Income markets have been closely tracking the Inflation trajectory & its consequent impact on the course of monetary policy. With the Inflation trajectory being relatively stubborn in US & Europe, developed bond markets have seen an uptick in their 10-year sovereign bond yields. Hawkish rhetoric by major global central banks on the backdrop of puzzling growth inflation dynamics has resulted in the same. While on the contrary, emerging markets such as Brazil, Indonesia, China & India have seen a moderation in their 10-year bond yields, given the weakening of USD and well-contained domestic inflation. Despite the Global central banks continuing to sound hawkish, we reckon we are at the fag end of the interest rate upcycle. However, the bias for more tightening in DM's would continue to keep the EM central banks on tenterhooks. We believe the baton of monetary policy would now traverse to liquidity management, as post the initial spurt in liquidity injection by US FED (after the onset of the regional banking crisis), we have seen a swift reversal with nearly 500 billion USD of liquidity drained out. This would be the key variable to watch out for going forward.

From domestic markets standpoint, India's inflation has been well contained in the tolerance band of RBI (2% to 6%), with Q2CY23 inflation averaging at 4.6%, prompting RBI to pause its interest rate hiking cycle. Unlike its global counterparts, we believe that any further rate hikes in India are almost ruled out and that we have hit the terminal rate for the cycle. Nonetheless, RBI is likely to remain watchful of the interest rate trajectory in the developed markets, as it would have ramifications on its Forex. RBI's pause, coupled with expectations of undershooting of the government's borrowing (given the strong momentum in tax collections to provide fiscal space), would assist in the Indian bond markets in the interim. In the future, we believe that as global growth slows down and the sticky part of the inflation (Core & Services inflation) cools off, bond yields worldwide, including India, will have a downward bias. Thus, the current interest rates trajectory offers a very lucrative opportunity to lock in rates at elevated levels with the likelihood of capital gains over ensuing quarters.

Snapshot of Macro Indicators

Indicators	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	FY21	FY21	FY21	FY21	FY22	FY22	FY22	FY22	FY23	FY23	FY23	FY23
Real GDP % YoY	-23.4	-5.7	1.6	3.4	21.6	9.1	5.2	4.0	13.2	6.3	4.4	6.1
Real GVA % YoY	-21.1	-5.1	2.8	6.3	20.3	9.3	4.7	3.9	12.1	5.5	4.6	6.5
Agriculture	3.8	4.3	4.8	3.4	3.4	4.8	2.3	4.1	2.5	2.4	3.7	5.5
Industry	-32.6	3.2	9.2	16.3	49.1	8.1	1.6	2.3	9.6	-0.4	2.4	4.7
Services	-21.0	-11.1	-1.5	1.5	12.5	11.1	7.6	4.9	16.3	9.4	6.2	7.4
Export Growth %	-36.5	-5.4	-4.2	20.6	85.9	38.6	41.0	29.4	26.6	7.8	-2.1	4.0
Import Growth %	-52.9	-23.2	-4.5	19.3	107.5	62.7	50.7	30.3	44.5	28.2	6.2	-4.0
Trade balance (US $ bn)	-9.8	-16.5	-35.1	-41.3	-31.5	-44.7	-60.2	-54.6	-62.7	-78.3	-72.8	-52.6
CAD (US $ bn)	19.1	15.3	-2.2	-8.2	6.6	-9.7	-22.2	-13.4	-18.0	-30.9	-18.2	-1.3
BOP (US $ bn)	19.9	31.6	32.5	3.4	31.9	31.2	0.5	-16.1	4.6	-30.4	11.1	5.6
CAD as % of GDP	3.7	2.4	-0.3	-1.0	1.0	-1.3	-2.7	-1.6	-2.1	-3.8	-2.2	-0.2

Source: Bloomberg, Reuters & FG Research

Indicators	Yearly Data											
	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
GDP Growth %	5.2	5.5	6.4	7.4	8	8.3	6.8	6.5	4	-7.3	8.7	7
GVA growth %	5.2	5.4	6.1	7.2	8	8	6.2	5.9	4.1	-6.2	8.1	6.7
CPI Inflation Avg	8.6	9.9	9.4	5.9	4.9	4.5	3.6	3.4	4.8	6.3	5.5	6.7
Exports (US $ bn)	310	307	319	317	266	280	309	337	320	296	429	454
Imports (US $ bn)	500.0	502.0	466.0	461.0	396.0	393.0	469.0	518.0	478.0	399.0	619.0	718.0
Trade Deficit (US $ bn)	-190.0	-196.0	-148.0	-144.0	-130.0	-112.0	-160.0	-180.0	-158.0	-102.0	-190.0	-264.0
Trade Deficit (% of GDP)	-10.4	-10.7	-7.9	-7.1	-6.2	-4.9	-6.0	-6.7	-5.5	-3.8	-6.0	-7.8
Brent Crude oil prices Y/E	123.8	109.3	107.0	53.3	38.7	52.7	69.1	70.3	21.5	62.4	106.6	79.3
Oil Import (US $ bn)	155.0	163.8	164.9	137.8	82.6	86.9	108.7	141.1	130.5	82.4	162.0	208.0
CAD (US $ bn)	-78.2	-88.2	-32.4	-27.9	-22.2	-15.3	-48.7	-57.3	-24.6	24.0	-38.8	-61.3
CAD (% of GDP)	-4.3	-4.8	-1.7	-1.4	-1.1	-0.7	-1.8	-2.1	-0.9	0.9	-1.2	-1.8
Capital account balance (US $ bn)	67.8	89.3	48.8	90.0	41.1	36.5	91.4	54.4	79.1	63.7	86.0	70.0
FDI (US $ bn)	22.1	19.8	21.6	32.6	36.0	35.6	30.3	30.7	43.0	44.0	39.0	35.0
FII (US $ bn)	17.2	26.9	4.8	40.9	-4.1	7.6	22.1	-0.6	1.4	36.1	-17.0	-5.0
Total BoP (US $ bn)	-12.8	3.8	15.5	61.4	17.9	21.6	43.6	-3.3	59.4	87.3	47.5	8.7
Fiscal Deficit %	-5.9	-4.9	-4.5	-4.1	-3.9	-3.5	-3.5	-3.4	-4.6	-9.2	-6.7	-5.9
Foreign Reserves (US $ bn)	294.0	292.0	304.0	342.0	360.0	370.0	425.0	413.0	478.0	579.0	607.0	579.0
Rupee (INR/$) Average	48.1	54.5	60.9	61.2	65.7	67.1	64.5	69.9	71.0	74.2	74.4	82.2
Repo Rate year ending	8.5	7.5	8.0	7.5	6.8	6.3	6.0	6.3	4.4	4.4	4.0	6.5
US-10 year end	2.2	1.8	2.7	1.9	1.8	2.4	2.7	2.4	0.7	1.7	2.3	3.5
GIND-10 year end	8.6	8.0	8.9	7.8	7.4	7.1	7.4	7.4	6.1	6.2	6.8	7.3

Source: Bloomberg, Reuters & FG Research

Market Performance

Performance of Indian Equities across Market Caps and Debt benchmarks as on June 30, 2023

Sector	7 year CAGR	5 year CAGR	3 year CAGR	1 year	6 months	3 months
Nifty	**12.7**	**12.4**	**23.0**	**21.6**	**6.0**	**10.5**
Sensex	**13.2**	**12.8**	**22.8**	**22.1**	**6.4**	**9.7**
Nifty Midcap Index	**14.4**	**14.5**	**34.5**	**35.2**	**13.5**	**19.0**
Nifty Smallcap Index	**9.2**	**8.6**	**32.9**	**28.3**	**11.4**	**20.5**
NIFTY Composite Debt Index	**7.3**	**7.9**	**5.1**	**8.4**	**4.1**	**2.5**

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)	9.7	7.2	10.1	11.8	3.8	3.4
S&P 500 (USA)	11.3	10.4	12.8	17.6	15.9	8.3
Nikkei 225 (Japan)	11.3	8.3	14.2	25.7	27.2	18.4
Hang Seng (Hong Kong)	-1.3	-8.2	-8.2	-13.5	-4.4	-7.3
FTSE 100 (UK)	2.0	-0.3	6.9	5.1	1.1	-1.3
Shanghai Composite Index (China)	1.3	2.4	2.4	-5.8	3.7	-2.2
DAX (Germany)	7.4	5.6	9.5	26.3	16.0	3.3
iBovespa (Brazil)	12.4	10.2	7.5	19.8	7.6	15.9

Source: Bloomberg, Reuters & FG Research