Investment Snapshot

For the quarter ended in September - FY 22

INDIAN MARKETS – RESILIENT AMIDST GLOBAL RUT

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Quarter gone by for Markets

The second quarter of FY23 was a mixed bag with July and August exemplifying as months of hope & optimism, while September 2022 being a month where markets were ambushed by the spectre of inflation and rising interest rates. The markets oscillated between positive hopes on lesser aggressive stance by Fed to renewed fears of aggressive tightening and recession. Equity and bond markets came under pressure globally on the back of signals of continued aggressive tightening by global central banks on persistent inflation. Emerging market and some developed market currencies also came under pressure as the dollar rose to multi-decadal highs. On the positive side, the quarter saw the global commodity prices correcting despite the ongoing Russia-Ukraine crisis. Indian equity markets were relatively resilient and ended the quarter largely flat. Domestic bond yields softened from the previous quarter, while INR depreciated on the back of dollar strength and some widening in trade deficits. High frequency indicators have been holding up quite well supported by the opening up of the economy and recovery in contact intensive services.

India has emerged as a shining star in CY22 and has outperformed the global markets significantly amidst varied global macro headwinds. Indian Equity markets have demonstrated their sheer resilience and structural strength by navigating effortlessly despite being confronted with myriad of crisis such as Russia-Ukraine standoff, US Fed's hawkish stance & rate hikes, persistent high inflation with commodity prices going to all-time highs, energy crisis in Europe, chaos in rates and currency markets along with unprecedented FII selling. Indian equity markets retained their premium valuations over EM and DM peers. Post strong up-move of 19% in FY22 in INR terms, H1FY23 has been relatively range bound with Nifty seeing 2% down move in last 6 months and ~8% up move in last quarter, despite volatile global backdrop. During Sep quarter, while Nifty was up ~5% in USD terms, MSCI emerging markets was down ~13% and MSCI world down ~7%, during same period. During this period, (H1FY23 & Q2FY23) the markets saw outperformance in Financials, Autos, FMCG, Utilities and Capital goods, while IT, Pharma, Metals were biggest underperformers. Earnings saw some downgrades mainly in export oriented sectors such as IT. This sector rotation reflects shift in earnings levers shifting from global growth driven earnings to focus on domestic recovery.

In terms of FII flows, after being relentless sellers during the period October '21 to June '22, FII's had turned net buyers during Jul-Aug-22 in Indian markets, but again turned sellers during Sept '22-Oct'22 YTD given the surmounting pressures from the current global macro headwinds. One of the key reasons for FII selling has been relentless strength in USD. However, despite witnessing strong FII selling, Indian markets remain well supported by strong flows in Mutual funds, and DII's and Retail direct participation. Going forward, while US Fed rate hikes may lead to some volatility in FII flows momentum in India(& overall EM's) in the interim, we reckon that the current FII selling is just a near term phenomena. As we believe FII's will continue to stay invested in Indian markets from a long term perspective, as India's long term structural growth story appears promising and lucrative and that India will likely remain the fastest growing among Emerging markets, which should bolster FPI confidence.

On the macro front, despite the tumultuous global macro-environment, India's fundamentals remain relatively resilient. Overall, in Q1FY23, the real sector remained resilient growing by 13.5% YoY. Contact-intensive services remained below pre-pandemic levels suggesting prospects for continued recovery in this sector. The manufacturing sector saw some pressure driven by margin pressures on account of elevated raw material prices. GST collections remain robust averaging ~₹1.47tn.

With respect to rates markets, inflation concerns remained at the fore, leading to continued tightening by global central banks. Consequently, we saw US Fed increase rates cumulatively by 375 bps, while RBI increased rates by 190 bps in this cycle. US yields rose by ~82bps over the quarter. Domestic yields moderated by ~5bps over the quarter supported by easing crude oil prices and relatively tame domestic inflation, although still hovering greater than ~7%. Expectations of inclusion of India in global bond indices fuelled an interim rally in domestic yields, although the inclusion did not materialise. With the RBI still focussed on withdrawal of accommodation, despite rates crossing the pre-pandemic level, policy rates may increase by another 25-35bps over the next few months, but this seems already priced in by bond yields.

Elevated trade deficits and a strengthening dollar led to the INR depreciating by ~3% over the quarter, although the INR outperformed most other EM currencies. FX reserves have come off highs on the back of RBI intervention and mark-to-market losses on a strengthening dollar and rising US yields. Despite worsening of trade deficits, the worst of pressures on the CAD seem likely behind with the easing of crude oil prices. Although, CPI inflation remains elevated at ~7% levels it is expected to moderate going forward.

Macro - Economic and Fixed Income Outlook

Notwithstanding the aggressive monetary policy cycle globally, we remain constructive on the Indian economy's relative strength, as macro fundamentals remain strong when compared to peers. We believe in the current global landscape, India's positioning is quite favourable from domestic standpoint. On the domestic growth front, high frequency indicators continue to indicate resilience although export growth may face some headwinds from slowing global growth. Inflationary pressures though still elevated, seem to be easing at the margin. A good monsoon should support agricultural and rural growth with the recovery in contact intensive services remaining strong. Besides, a pick-up in government spending ahead of general elections in FY24 and a good Rabi crop may support consumption in these states. Improving utilisation levels, lower corporate debt levels, higher profitability and imperatives of inventory build-up augur well for a gradual uptick in investment demand. We reckon the Indian economy remains firmly entrenched on the path of recovery with broader long term fundamentals of the economy remaining intact. A blend of healthy capital expenditure, Product Linked Incentive (PLI) schemes and privatisation/strategic divestment of PSUs could lay a strong growth conducive platform for sustained long term economic growth for India.

With respect to external account and INR, while US Fed's aggressive tightening in the near term may impart some depreciation pressures on INR , we reckon the worst in terms of pressure on macro fundamentals (external account and rupee) is behind us with the softening of crude oil prices and the peak of Fed's hawkishness and FII selling being behind us. Thus, while external sector risks have been elevated hitherto, the prospects of global growth slowdown and correction in global commodity prices bodes well for Indian external sector. We expect the current account deficit to correct hereon ameliorating the external sector risks. With crude oil prices having corrected at current levels, India's external sector risks remain relatively manageable. Thus overall, we believe depreciation bias in rupee is likely to stay, but clearly worst is behind us.

From debt markets standpoint, clearly, we have seen the domestic and global bond yields treading higher, pricing in most part of the aggressive rate hikes and normalisation by central banks. As stated above, we believe that we are closer to the peak of Fed Hawkishness and Inflation fears. As we move forward, Inflation & Growth both will start treading lower globally, the risks of global slowdown will start getting more pronounced, and aggressive Fed rate hikes is likely to stoke a shallow recession in US by early 2023. In our view, the narrative could soon turn towards growth fears versus inflation fears, which will likely lower Fed's hawkishness. On the domestic yields front, we have seen Indian Bond Yields have already hardened across the curve in anticipation of rate hikes and have been resilient despite the recent turmoil in global rates and FX markets. We don't expect a major uptick in yields from here-on in FY23, unless the geopolitical situation continues to get worse from here or traverses to newer issues. This belief stems from the fact that we see inflation has peaked in H1FY23 and should start moving downward in H2FY23, thanks to favourable base, hardening of interest rates globally & impact of steps taken by Government & RBI.

Equity Outlook

We reckon the Global markets backdrop would soon stabilise, as stated above that the worst is behind and from hereon we may see the base catching up and cumulative impact of the Central banks rate hikes play out and hence would lead to stabilisation in global markets. With respect to domestic Equity markets, while the global headwinds are clouding the Indian markets and imparting bouts of volatility, we reckon structurally Indian markets are in a relatively good stead with strong economic and earnings recovery at sight coupled with multi-year investment cycle, which will continue to provide tailwinds and cheer the markets. High frequency indicators such as PMI's, GST, Electricity demand, Tax collections etc. continue to remain significantly into expansionary zone, despite the global data points cooling off/moving into contraction significantly. We believe Indian markets are at the cusp of a virtuous new earnings growth cycle. The current macro backdrop this time around is quite conducive with resilient domestic GDP growth, better Inflation management, deleveraged corporate balance sheets and fortified financial system balance sheets with lower NPA's and strong credit offtake, thus adding credence to our belief that strong momentum in India's corporate earnings growth cycle is imminent.

On valuations front, we would like to urge investors to be cognizant that from here on market valuations will be more a function of corporate profitability, healthy return ratios and fortified balance sheets. BFSI and Consumption facing sectors such as FMCG, Auto and infra push beneficiaries – Capital goods would be the key themes in the ensuing year. While the current valuations may look slightly expensive, markets presents an opportunity to compound wealth for long period of time. Also, markets have had a reasonable time correction. The returns over last 12 months has been negative 5%, while earnings have grown at healthy double digit and consequently valuations have become cheaper versus 1 year back. Thus, Indian Equity markets present attractive opportunities given the compelling macro growth prospects in sight and we expect Indian equities to continue to command better valuation premium compared to EM peers. Given this construct, we remain constructive on equities as an asset class and history has exemplified that we should be believers in the ability of Equities to compound wealth over long period of time. We advise investors to partake in long-term potential of India and stay on course to leverage any dips, as an opportunity to buy.

Snapshot of Macro Indicators

Indicators	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23
Real GDP % YoY	5.2	4.4	4.1	3.1	-24.4	-7.4	0.5	1.6	20.1	8.4	5.4	4.1	13.51
Real GVA % YoY	4.8	4.3	3.5	3	-22.4	-7.3	1	3.7	18.8	8.5	4.7	3.9	12.8
Agriculture	3	3.5	3.6	5.9	3.5	3	4.5	3.1	4.5	4.5	2.6	4.1	4.5
Industry	4.2	0.5	-0.4	0	-31	-1.6	1.6	5.5	40.4	9.3	2.5	1	8.6
Services	5.5	6.5	4.9	3.5	-24.9	-11	-0.2	3.2	16.1	11.1	9.2	5	17.7
Export Growth %	-0.8	-4.1	-2.2	-12.4	-36.8	-5.5	-4.9	19.3	86.3	39.4	36.4	29.3	26.7
Import Growth %	-0.2	-11.5	-12.5	-9	-51.7	-23.5	-3.5	19.2	105.7	66.49	52.6	29.7	35.6
Trade balance (US $ bn)	-46.2	-38.1	-34.6	-35	-10.8	-14.8	-34.5	-41.7	-30.7	-47.36	-64.3	-54.5	-68.2
Current account balance (US $ bn)	-14.9	-7.5	-2.6	0.6	19	15.3	-2.2	-8.2	6.3	-9.8	-23	-13.4	-23.8
Balance of payments (US $ bn)	14	5.1	21.6	18.8	19.9	31.6	32.5	3.4	31.9	31.2	0.5	-16.1	4.6
CAB as % of GDP	-2	-0.9	-0.2	0.1	3.8	2.4	-0.1	-1	0.9	-0.5	-2.7	-1.5	-2.8

Source: Bloomberg, Reuters & FG Research

Indicators	Yearly Data												
	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22
GDP Growth %	7.9	8.5	5.2	5.5	6.4	7.4	8	8.3	6.8	6.5	4	-7.3	8.7
GVA growth %	6.9	8	5.2	5.4	6.1	7.2	8	8	6.2	5.9	4.1	-6.2	8.1
CPI Inflation Avg	12.3	10.5	8.6	9.9	9.4	5.9	4.9	4.5	3.6	3.4	4.8	6.3	5.5
Exports (US $ bn)	182	256	310	307	319	317	266	280	309	337	320	296	422
Imports (US $ bn)	301	383	500	502	466	461	396	393	469	518	478	399	612
Trade Deficit (US $ bn)	-118	-127	-190	-196	-148	-144	-130	-112	-160	-180	-158	-102	-190
Trade Deficit (%of GDP)	-8.8	-7.6	-10.4	-10.7	-7.9	-7.1	-6.2	-4.9	-6	-6.7	-5.5	-3.8	-6.1
Brent Crude oil prices Y/E	81.3	117.3	123.8	109.3	107	53.3	38.7	52.7	69.1	70.3	21.5	62.4	106.6
Oil Import USD Bn	86.8	105.8	155	163.8	164.9	137.8	82.6	86.9	108.7	141.1	130.5	82.4	160.1
CAD $ Bn	-38.2	-48.1	-78.2	-88.2	-32.4	-27.9	-22.2	-15.3	-48.7	-57.3	-24.6	24	-13
CAD (% of GDP)	-2.8	-2.9	-4.3	-4.8	-1.7	-1.4	-1.1	-0.7	-1.8	-2.1	-0.9	0.9	-1.2
Capital account balance (US $ bn)	51.6	62	67.8	89.3	48.8	90	41.1	36.5	91.4	54.4	79.1	63.7	86
FDI (US $ bn)	18	9.4	22.1	19.8	21.6	32.6	36	35.6	30.3	30.7	43	44	39
FII (US $ bn)	32.4	30.3	17.2	26.9	4.8	40.9	-4.1	7.6	22.1	-0.6	1.4	36.1	-16.8
Total BoP (US $ bn)	13.4	10.9	-12.8	3.8	15.5	61.4	17.9	21.6	43.6	-3.3	59.4	87.3	47.5
Fiscal Deficit %	-6.6	-4.9	-5.9	-4.9	-4.5	-4.1	-3.9	-3.5	-3.5	-3.4	-4.6	-9.2	-6.7
Foreign Reserves (US $ bn)	279	305	294	292	304	342	360	370	425	413	478	579	607
Rupee (INR/$) Average	47.4	45.6	48.1	54.5	60.9	61.2	65.7	67.1	64.5	69.9	71	74.2	74.4
Repo Rate year ending	5	6.8	8.5	7.5	8	7.5	6.8	6.3	6	6.3	4.4	4.4	4.0
US-10 year end	3.8	3.5	2.2	1.8	2.7	1.9	1.8	2.4	2.7	2.4	0.7	1.7	2.3
GIND-10 year end	7.83	8.02	8.56	8.01	8.88	7.8	7.4	7.06	7.42	7.35	6.14	6.17	6.84

Note: Growth and External Account Indicators for FY22 are Forecasts

Source: Bloomberg, Reuters & FG Research

Market Performance

Performance of Indian Equities across Market Caps and Debt benchmarks as on Sep' 30th, 2022

Sector	7 year CAGR	5 year CAGR	3 year CAGR	1 year	6 months	3 months
Nifty	11.60%	11.80%	14.20%	-3.00%	-2.10%	8.30%
Sensex	11.90%	12.90%	14.10%	-2.90%	-1.90%	8.30%
Nifty Midcap Index	13.10%	11.10%	24.20%	0.90%	3.30%	15.90%
Nifty Smallcap Index	8.80%	4.50%	19.10%	-13.30%	-9.50%	11.80%
NIFTY Composite Debt Index	6.80%	5.90%	5.10%	0.10%	-0.10%	2.20%

Source: Bloomberg, Reuters & FG Research

Global Indices Performance (%)

	7 year CAGR	5 year CAGR	3 year CAGR	1 year	6 months	3 months
Dow Jones Index (USA)	8.4%	5.1%	2.2%	-15.1%	-17.2%	-6.7%
S&P 500 (USA)	9.3%	7.3%	6.4%	-16.8%	-20.9%	-5.3%
NASDAQ Composite (USA)	12.6%	10.2%	9.8%	-26.8%	-25.6%	-4.1%
Nikkei 225 (Japan)	5.9%	5.0%	6.0%	-11.9%	-6.8%	-1.7%
Hang Seng (Hong Kong)	-2.7%	-9.0%	-12.9%	-29.9%	-21.7%	-21.2%
FTSE 100 (UK)	1.9%	-1.3%	-2.4%	-2.7%	-8.3%	-3.8%
Shanghai Composite Index (China)	-0.1%	-2.0%	1.3%	-15.2%	-7.0%	-11.0%
DAX (Germany)	3.3%	-1.1%	-0.8%	-20.6%	-16.0%	-5.2%
iBovespa (Brazil)	13.6%	8.2%	1.7%	-0.8%	-8.3%	11.7%
MICEX (Russia)	2.5%	-1.2%	-10.7%	-52.3%	-27.6%	-11.2%

Source: Bloomberg, Reuters & FG Research

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