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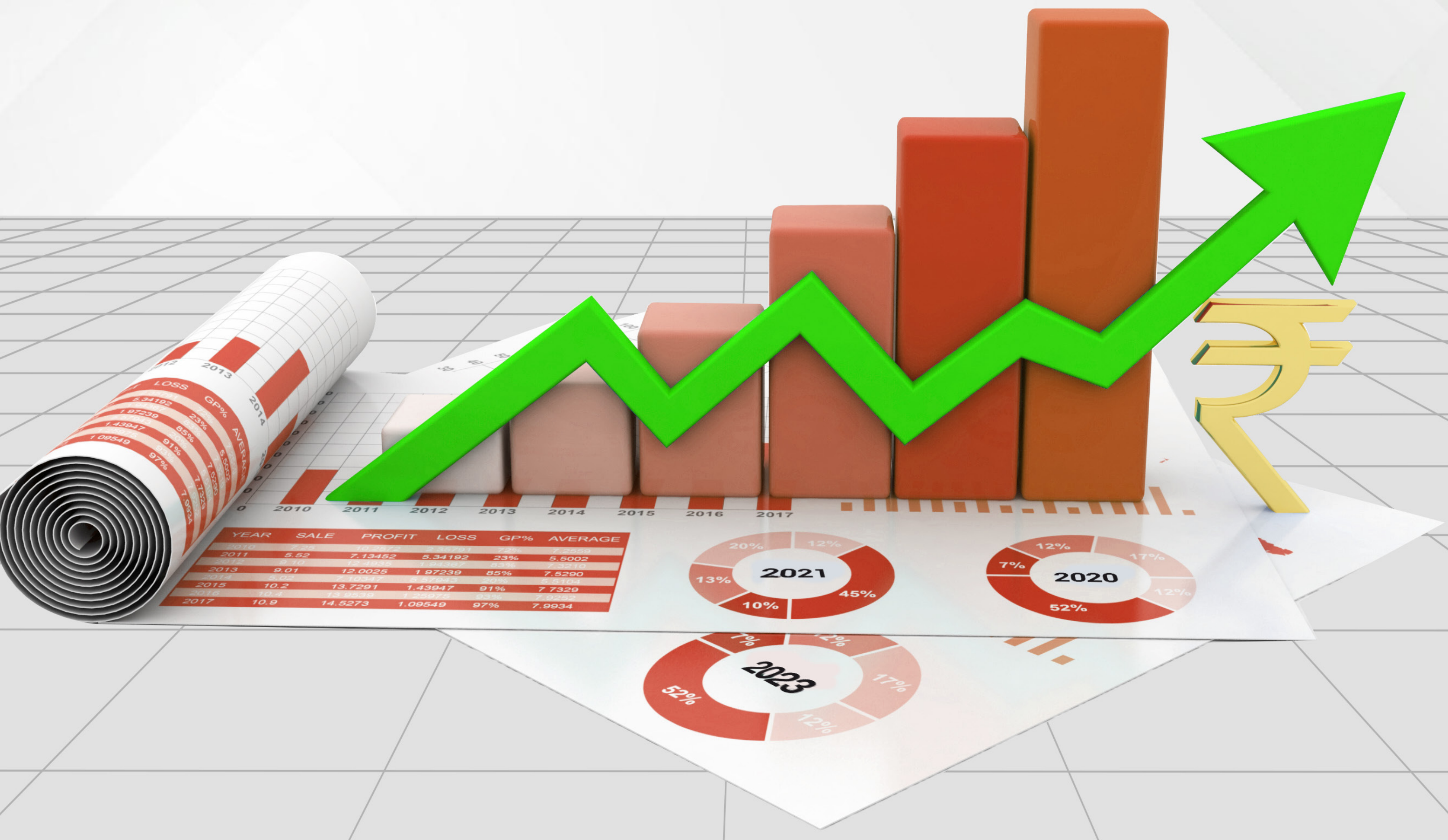
Investment Snapshot

For the quarter ended in March - FY 23

INDIAN MARKETS – A STRUCTURAL PLAY ON LONG TERM GROWTH POTENTIAL



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Year Gone by for Markets

The fiscal year 2023 was characterised by many challenges, viz. geopolitical tensions with the onset of the Russia-Ukraine conflict leading to high energy prices and, consequently, central banks embarking on drastic interest rate hikes unseen in decades to tame inflation. The outcome of these hikes led to some financial stability risks coming to the fore as a few regional banks filed for bankruptcy, hit by market-to-market losses on their bond portfolios. Despite these headwinds, the US was better than other developed markets, supported by resilient retail spending, steady consumer sentiment, and a tight labour market. Domestic macro stability risks came to the fore in the year, led by a rise in crude oil prices and a widening Current Account Deficit. However, eventual moderation in crude oil prices and resilient services exports have laid to rest macro stability concerns. Besides, Indian markets have been resilient to these shocks, aided by solid profitability in domestically oriented sectors, favourable conditions in manufacturing led by China +1 and PLI (Production-linked incentive), and solid macro fundamentals and political stability. Rise in interest rates and dwindling liquidity to some extent dampened equity market sentiment leading to significant FII outflows from India. However, domestic flows held up even as foreign investors pulled out of India, limiting the downside in equities.

The Quarter went by for Markets

The global reset continued into 4QFY23 as central banks raised rates amid elevated inflation. The last quarter of the fiscal year was marked by significant volatility in international bonds and equities as financial stability concerns weighed heavily on the markets. The macro-economic data points continued to be conflicting, with CPI continuing to fall for eight straight months in the US but still way above the 2% threshold; the US labour market remained resilient, a warmer-than-expected winter eased recessionary concerns in Europe and the Pace of rate hikes slowed down across key economies with expectations of pause within sight. Towards the end of the quarter, while financial stability concerns came to the fore, US Federal Reserve stepped in, providing liquidity backstops to depository institutions to meet their liability obligations and avert the pressure. Consequently, US bond yields declined by over 40bps over the quarter.

Concerning rate markets, inflation concerns remained, leading to continued tightening by global central banks. RBI increased rates by 25bps in Feb'23, while the US Fed raised rates by 50bps in 4QFY23. However, with financial stability concerns coming to the fore, there has been a moderation in bond yields given the anticipation that Fed would be nearing a pause in its rate hike cycle in the US and domestically, RBI's surprise pause in the April Monetary policy led the yields to trend lower. India's Union Budget 2023-24 was indeed a Progressive and Growth oriented budget, continuing the path and vision laid down in the previous Budgets, with a capex-oriented focus yet again the overarching theme of the Budget. The Government dexterously delivered a fine balancing act by sticking to the fiscal consolidation glide path while continuing the Pace of infra-led – capex spending, credible revenue and nominal GDP growth assumptions.

Amidst this backdrop, the equity markets began the year with a strong rally in January, buoyed by declining inflation and expectations of more accessible monetary policy. However, in February, the needs were weighed down by vital economic data and stubborn core inflation, which led investors to reassess their interest rate expectations. March saw financial stability concerns with the collapse of SVB and broader concerns around the financial sector, leading to a sharp fall in global banks' share prices and a subsequent fall in yields. However, the intervention of central banks helped stabilise the markets, leading to a recovery and a positive end to the quarter, with MSCI EM up by ~4% and MSCI World up by ~7% in Q4FY23. India, however, underperformed both its EM and Global peers in Q4FY23. Nifty was down ~4% in the quarter's USD and local currency terms. In terms of sectoral performance, domestic-oriented sectors such as FMCG rallied given its defensive nature and hopes of a recovery in rural demand, as well as the tax relief announced for the middle class in the current Budget, which is expected to boost consumption. Cap goods were also up, driven by a strong tender pipeline, softening commodity prices and robust order inflow growth. Utilities were the biggest underperformer because of a sell-off in Adani stocks, followed by Metals driven by subdued demand and softening metal prices.

In terms of FII flows, India saw volatile FII flows in FY23 with an overall outflow of $4.9bn, led by unprecedented rate hikes. However, H2FY23 saw a reversal with FII investing in Indian equities led by the valuation differential between China and India and India's robust earnings growth & revision. On the other hand, domestic flows have been buoyant, with DII investing $32bn during FY23, bolstered by strong SIP flows of $18bn during the year.

Macro- Economic and Fixed Income Outlook

Despite the global market turmoil, we remain constructive on the Indian economy. We believe the global macro environment may remain challenging as with a pronounced slowdown in global growth and lowering inflation, and central banks will gradually change their stance. With the Fed indicating a pause in the following policy, the RBI will remain on an extended break. However, from a domestic macro perspective, India's positioning in the current global landscape is quite favourable from a domestic standpoint. On the domestic growth front, high-frequency indicators indicate resilience, although export growth may face some headwinds from slowing global growth. While a worldwide slowdown will impact domestic growth, healthy corporate and bank balance sheets and government spending ahead of elections should provide a buffer. Besides the FY24 union budget, the announcement of INR 10tn capex (37.4% rise YoY vs FY23RE) will likely keep India's economic recovery steady in a year when the adverse impact of the global slowdown is expected to spill over on India. Inflationary pressures have already started decreasing, led by positive base effects and cooling of cereal and vegetable prices, although inflation in Jan and Feb'23 exceeded the RBI's 6% target. The critical risk for inflation going forward is unseasonal rains or an erratic monsoon. The IMD has forecast a normal monsoon in 2023. However, there is a potential risk of El Nino developing throughout the monsoon season.

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.

From a debt markets standpoint, we have seen bond yields off late cooling off given the receding concerns on high inflation, RBI's proactive pause & Fed indicating a break in the next meeting. Inflation has peaked globally and has started trending downwards, thanks to the hardening of interest rates globally & impact of steps taken by the Government & monetary authorities. In the future, with a pronounced global growth slowdown and lower Inflation trajectory, we believe we are done with the rate hike cycle in India & central banks are likely to become dovish and would be on a prolonged pause. Hence, we don't expect a significant yield uptick unless new challenges emerge and would remain range bound with a downward bias in the medium term. However, uncertainty around the monsoon & its likely impact on inflation & liquidity tightness may keep the GSEC yields under check.

Equity Outlook

We are cautiously constructive on the Indian equity markets in the short to medium term. Our optimism stems from many positives like resilient services and manufacturing PMI, CPI inflation cooling off, and a pick-up in FPI flows into equities. Strong earnings growth led by domestic facing sectors like BFSI, Cement, Infrastructure, FMCG and Autos also enthused us. Our caution, however, stems from historically high-interest rates in developed markets, which may cast a shadow over developed markets, especially the US, and the uncertainty over normal monsoons in India that can have a cascading impact on the slowing rural economy. Unseasonal rains, especially in the North, have not helped either. We believe India is headed for a reasonably good earnings cycle in the medium term. 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 NPAs and strong credit offtake, thus adding credence to our belief that strong momentum in India's corporate earnings growth cycle is imminent. Pick-up in infrastructure spending ahead of next year's General election and margin expansion across the manufacturing sector on the back of ease in input cost inflation is likely to be near-term triggers amid bouts of volatility that may arise due to global growth concerns. Thus, Indian Equity markets present an attractive opportunity given the favourable domestic macro backdrop, and we expect Indian equities to continue to command better valuation premiums 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 a long period of time. We advise investors to partake in the 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	Q2 FY23	Q3 FY23
Real GDP % YoY	5.10	4.30	3.26	2.94	-23.37	-5.72	1.59	3.37	21.55	9.11	5.20	3.96	13.19	6.28	4.36
Real GVA % YoY	4.64	4.23	3.37	3.57	-21.05	-5.12	2.78	6.32	20.25	9.33	4.74	3.91	12.06	5.48	4.60
Agriculture	4.26	5.32	5.91	8.76	3.83	4.32	4.80	3.40	3.43	4.84	2.28	4.06	2.53	2.40	3.68
Industry	1.42	-2.14	-2.76	-2.06	-32.56	3.24	9.22	16.29	49.12	8.11	1.64	2.34	9.64	-0.36	2.43
Services	6.53	7.43	6.14	5.56	-20.98	-11.09	-1.49	1.46	12.50	11.07	7.58	4.90	16.32	9.38	6.19
Export Growth %	-1.36	-4.01	-1.78	-12.72	-36.46	-5.40	-4.23	20.60	85.88	38.60	40.96	29.38	26.56	7.83	-2.10
Import Growth %	1.10	-11.29	-11.14	-9.31	-52.91	-23.23	-4.54	19.33	107.47	62.67	50.66	30.29	44.47	28.23	6.21
Trade balance (US $ bn)	-49.18	-39.74	-36.99	-35.37	-9.84	-16.54	-35.06	-41.25	-31.52	-44.74	-60.17	-54.57	-62.65	-78.32	-72.78
Current account balance (US $ bn)	-15.00	-7.60	-2.60	0.60	19.10	15.30	-2.20	-8.20	6.60	-9.70	-22.20	-13.40	-18.00	-30.90	-18.20
Balance of payments (US $ bn)	14.00	5.10	21.60	18.80	19.90	31.60	32.50	3.40	31.90	31.20	0.50	-16.10	4.60	-30.40	11.10
CAD as % of GDP	-2.10	-1.09	-0.36	0.08	3.73	2.40	-0.30	-1.03	0.95	-1.28	-2.66	-1.55	-2.12	-3.75	-2.20

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	8.0	8.3	6.8	6.5	4.0	-7.3	8.7	7.0
GVA growth %	5.2	5.4	6.1	7.2	8.0	8.0	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)	310.0	307.0	319.0	317.0	266.0	280.0	309.0	337.0	320.0	296.0	429.0	454.0
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

Source: Bloomberg, Reuters & FG Research

Market performance

Performance of Indian Equities across Market Caps and Debt benchmarks as of March 31st, 2023

Sector	7-year CAGR	5 year CAGR	3 year CAGR	1 year	6 months	3 months
Nifty	12.2%	11.4%	28.0%	-0.6%	1.6%	-4.1%
Sensex	12.8%	12.3%	27.5%	0.7%	2.7%	-3.0%
Nifty Midcap Index	13.1%	9.9%	37.9%	1.2%	-2.1%	-4.7%
Nifty Smallcap Index	9.2%	2.9%	37.1%	-13.8%	-4.7%	-7.6%
NIFTY Composite Debt Index	7.0%	7.0%	4.8%	4.2%	4.3%	2.1%

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)	9.4%	6.7%	14.2%	-4.0%	15.8%	0.4%
S&P 500 (USA)	10.3%	9.2%	16.1%	-9.3%	14.6%	7.0%
Nikkei 225 (Japan)	7.5%	5.5%	13.7%	0.8%	8.1%	7.5%
Hang Seng (Hong Kong)	-0.3%	-7.5%	-4.2%	-7.3%	18.4%	3.1%
FTSE 100 (UK)	3.0%	1.6%	11.1%	1.5%	10.7%	2.4%
Shanghai Composite Index (China)	1.2%	0.6%	6.0%	0.6%	8.2%	5.9%
DAX (Germany)	6.5%	5.3%	16.8%	8.4%	29.0%	12.2%
iBovespa (Brazil)	10.3%	3.6%	10.9%	-15.1%	-7.4%	-7.2%
MICEX (Russia)	4.0%	1.5%	0.2%	-9.4%	25.2%	13.8%

Source: Bloomberg, Reuters & FG Research

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