Investment Snapshot

For the quarter ended in March 2022

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Indian Markets (2022): **Long term growth intact despite challenges**

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Year Gone By

FY 2022 was indeed an eventful year for financial markets. The year saw the most lethal Covid 2nd wave in Apr-May'21, which tested the mettle of the human race and markets. Nonetheless, as testified in the past, the economies worldwide, including India, remained resilient and emerged stronger with economic activities rapidly normalizing, aided by less stringent restrictions, vaccination drive and coordinated monetary and fiscal impulses by the central bank and government. Indian markets have drawn the curtains for FY 2022 on a stellar note, with Indian equities outperforming its Emerging and World market peers, despite being plagued with multitude of headwinds ranging from a lethal pandemic wave to Russia Ukraine war with sky-high commodity prices along with tapering by the US Fed with hawkish commentary and relentless FII outflows.

FY 2022 witnessed the never seen buoyant Equity markets with record fundraising via IPOs, thus exemplifying markets' sheer strength and resilience. While the fear psychosis around Fed tapering did impart some bouts of volatility, the markets took this as well effortlessly in its stride. The performance of Equity markets in F20Y22 was indeed flattery especially given the backdrop of solid performance in 2021. The performance was a confluence of many factors, such as supportive monetary and fiscal policy with a structurally lower Interest rate regime, flush liquidity, stronger than anticipated post-pandemic macro recovery, and strong corporate earnings trends.

In FY 2022, Indian equities posted a strong show, with Nifty delivering a 15% return in USD terms while MSCI emerging market and MSCI world were down -13% and 9%, respectively. Nifty delivered a total return of 19% in rupee terms, with its performance divided into two parts, 1HFY22, where Nifty was up 20% and another 2HFY'22, in which Nifty ended up being down 1% amidst a volatile period. In terms of flows, FIIs have been net sellers to the tune of $18.4 bn in Indian equities in FY'22, with majority outflows in Q4FY'22 led by Russia and Ukraine standoff and normalizing liquidity. While markets were volatile in Q4FY'22, DII's have rendered the requisite support to FII's selling, thus keeping the market range bound. Besides, within DII, retail investors have emerged as the most influencing investor class in the Indian Equity markets in the Post - Covid Era. The significant structural change in retail flows has cushioned the exodus of FIIs from Indian Equities.

On the macro front, despite the tumultuous global macro-environment, India's fundamentals remain relatively resilient with economic recovery post the Delta and Omicron wave has been rock solid. Opening up trade is visible, especially in heavy contact sectors like airlines, hotels and theatres. The strong recovery was exemplified by the high-frequency indicators such as GST tax collections, PMIs, Power demand, Toll collections, Exports etc. which have consistently shown improvement in FY'22. Besides, Union Budget 2022 was a Capex driven growth-oriented budget touching upon the key chords in terms of infrastructure spending, support for micro, MSME and hospitality sectors in the form of credit guarantee schemes while continuing to be transparent by subsuming the Off Budgetary Resources (NHAI, Railways, FCI etc.) on to the governments' balance sheet. While the pro-growth measures entailed slightly higher than anticipated fiscal deficit and higher market borrowing, the government focussed on holistic infrastructure development as a key catalyst to growth.

With respect to Bond markets during the quarter, the Global and domestic yields saw upward movement in yields as central banks turned hawkish in response to the persisting geopolitical tensions and rising inflation concerns. However, the war did not deter the US Federal Reserve from continuing policy normalisation. The US hiked rates in March'22 by 25bps as US CPI hovered around 7%, with a dot plot in March'22 indicating seven rate hikes in 2022 vs three rate hikes in December'21. Consequently, we saw the US 10 –year yield rising from 1.51% as of Dec'21 to 2.33% as of Mar'22 and further increasing to 2.9% in April 2022.

On the domestic front, the bond yields faced upward pressure during the quarter because of a high borrowing announced for FY23 and increasing global yields amid elevated inflation pressures and a rise in crude oil prices. While RBI in its Feb'22 policy was more dovish than expected, in the April MPC policy, given the persisting geopolitical tensions and higher commodity prices, RBI made a hawkish pivot shifting gears from its earlier 'Dovish' tone while keeping the policy rates unchanged and retaining its accommodative stance. This was exemplified by a change in MPC's rhetoric, focusing on withdrawal of accommodative stance, effectively normalizing to pre-pandemic policy rate corridor through new liquidity measure of Standing Deposit Facility (SDF), inflation forecasts being nudged higher to 5.7% & lowering growth forecasts to 7.2%. Consequently, the hawkish shift by RBI spooked the bond markets, with 10-year Gsec up by 20 bps post policy, while the 5-year bond yields surged around 30 bps.

Macro- Economic and Fixed Income Outlook

Despite the current macro challenges, we remain constructive on the Indian economy on the macro front. At the outset, while the current backdrop of global liquidity tightening along with rising inflation trajectory and hardening interest rates does impart headwinds to the economic outlook, we believe the impact on India's economy this time around may not be very adverse as long as Crude doesn't move significantly beyond $ 105 on a durable basis. India is better placed in the current cycle than in the past due to its more robust macroeconomic fundamentals and macro buffers. While elevated and increasing crude oil prices pose upside risks to inflation and the Current account Deficit, high FX reserves would enable India to weather' tapering' by the US Federal Reserve without a 'tantrum.'.

From a growth standpoint, the elevated inflation and increase in global and domestic bond yields would pose some downside risks to the growth outlook, especially if the crude oil prices continue to remain elevated for an extended period, as elevated energy prices can impact consumption & discretionary spending. Nevertheless, we don't see the magnitude of impact to be too high as the Indian economy remains firmly entrenched on the path of recovery with broader long term fundamentals of the economy remaining intact. India is expected to remain resilient. The government has embarked on the reform agenda laying the foundation for a conducive growth platform, and RBI's exit from covid-19 related policy support is well-equipped. The recovery in urban-focused sectors is likely to remain supportive. The rural cash flows are set to improve with firmer agro commodity prices, and the timely onset of normal monsoons should bode well and revive the rural demand. Besides Improved utilisation levels, lower corporate debt levels, higher profitability and imperatives of inventory build-up augur well for a gradual uptick in investment demand. 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 Bond markets standpoint, while the change in stance to neutral and consequent rate hikes in ensuing policies is inevitable, we believe the rate hike cycle for India this time around will be calibrated and shallow, unlike our western counterparts wherein they have switched to an aggressive mode. At this juncture, the incumbent domestic and global yields are pricing in a good part of the impending rate hikes and normalization. Nonetheless, even if things don't settle down in the interim as expected, we may not see a very substantial upward movement in the US and Indian Bond yield curve from hereon. For domestic yields, the underlying expectation remains that in India, the inflationary pressures are not as dire as their western counterparts, and hence drastic measures from MPC are not warranted. We believe the structural and economic fundamentals will continue to dictate the policy rates. However, the rise in yields will not be very significant from hereon, as we should see some cool-off in hyper-inflation over 4/6 months.

Equity Outlook

From an Equity markets standpoint, While there is no denying that there would be earnings pressure given the headwinds to growth and margins due to rising inflation and interest rates, we believe the overall impact may not be significant, as we think that any cuts in commodity consuming sectors (Auto, FMCG, Consumer Durables and cement) will largely be offset by an upgrade in earnings of commodity companies (such as Oil & Gas and Metals). Given the domestic benchmark's construction, we reckon that ~75% of NIFTY EPS is mainly unaffected by the recent events, which would provide downside support to the market. However, as we embark on FY23, we are likely to see a significant shift in sectorial performance. The winners of the next round of up-move will be different from the last rally that we have had over the last two years (e.g. banking), and that would present an opportunity for investors to leverage on.

While a rising interest rate environment would impart bouts of volatility in equity markets, we reckon India's strong economic and earnings recovery coupled with a multi-year investment cycle is expected to provide tailwinds at the same time. Hence, we consider the long term outlook for equity markets remains sanguine. We expect the market to go into a consolidation phase before the next move, which would be driven by domestic investment and consumption.

After witnessing a stellar broad-based rally in the post-pandemic era, we believe the period of easy returns for markets is clearly behind us. From here on, return expectations are likely to be moderate and more realistic. We remain constructive on Indian Equity markets and believe that markets have been resilient & have climbed the major wall of worries such as the Russia-Ukraine standoff, US Fed rate hike & hawkish commentary, State elections, and unprecedented FII selling, with limited price damage. Since many of these known risks are already priced in and as we transition from an unknown to known territory, we believe going forward, Nifty returns will be a function of earnings growth. Markets might consolidate over the next few months until further clarity on the impact of the Russia Ukraine standoff and the US Fed's actual quantum of balance sheet unwinding. While we continue to expect strong earnings growth in FY23, the trends will be divergent across sectors, and hence one needs to be careful about the sector/stock selection.

In terms of valuations, they are off-peak on the price correction and earnings revision. As policy normalisation continues, market valuations will be more a function of corporate profitability, healthy return ratios, and fortified balance sheets. While there may be some minor underperformance by Indian equities given the stretched valuations, we expect Indian equities to continue to command a better valuation premium than EM peers. Given this construct, we remain constructive on equities as an asset class and 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

Quarterly Data

Components	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Q2 FY22	Q3 FY22
Real GDP % YoY	5.2	4.4	4.1	3.1	-24.4	-7.4	0.5	1.6	20.1	8.39	5.4
Real GVA % YoY	4.8	4.3	3.5	3	-22.4	-7.3	1	3.7	18.8	8.45	4.7
Agriculture	3	3.5	3.6	5.9	3.5	3	4.5	3.1	4.5	4.5	2.6
Industry	4.2	0.5	-0.4	0	-31	-1.6	1.6	5.5	40.4	9.3	2.5
Services	5.5	6.5	4.9	3.5	-24.9	-11	-0.2	3.2	16.1	11.1	9.2
Export Growth %	-0.8	-4.1	-2.2	-12.4	-36.8	-5.5	-4.9	19.3	86.3	39.41	36.4
Import Growth %	-0.2	-11.5	-12.5	-9	-51.7	-23.5	-3.5	19.2	105.7	66.49	52.6
Trade balance $ bn	-46.2	-38.1	-34.6	-35	-10.8	-14.8	-34.5	-41.7	-30.7	-47.36	-64.3
Current account balance $ bn	-14.9	-7.5	-2.6	0.6	19	15.3	-2.2	-8.2	6.3	-9.8	-23
Balance of payments $ bn	13.98	5.12	21.60	18.79	19.85	31.57	32.48	3.39	31.87	31.19	0.47
CAB as % of GDP	-2	-0.9	-0.2	0.1	3.8	2.4	-0.1	-1	0.9	-0.45	-2.7

Source: Bloomberg, Reuters & FG Research

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	9.0
GVA growth %	6.9	8	5.2	5.4	6.1	7.2	8	8	6.2	5.9	4.1	-6.2	7.1
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$bn)	182	256	310	307	319	317	266	280	309	337	320	296	414
Imports (US$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	-198
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	-6.3
Brent Crude oil prices year ending	81.3	117.3	123.8	109.3	107.0	53.3	38.7	52.7	69.1	70.3	21.5	62.4	107.9
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
CAD $ Bn	-38.2	-48.1	-78.2	-88.2	-32.4	-27.9	-22.2	-15.3	-48.7	-57.3	-24.6	24.0	-56.4
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	-1.8
Capital account balance (US$bn)	51.6	62	67.8	89.3	48.8	90	41.1	36.5	91.4	54.4	79.1	63.7	84
FDI (US$bn)	18.0	9.4	22.1	19.8	21.6	32.6	36	35.6	30.3	30.7	43.0	44.0	36.0
FII (US$bn)	32.4	30.3	17.2	26.9	4.8	40.9	-4.1	7.6	22.1	-0.6	1.4	36.1	-13
Total BoP (US$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	27.5
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	-6.9
Foreign Reserves (US$bn)	279	305	294	292	304	342	360	370	425	413	478	579	620
Rupee (INR/$) Average	47.4	45.6	48.1	54.5	60.9	61.2	65.7	67.1	64.5	69.9	71.0	74.2	74.5
Repo Rate year ending	5.0	6.8	8.5	7.5	8.0	7.5	6.8	6.3	6.0	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	1.6
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	6.3

Note: Growth and External Account Indicators for FY'22 are Forecasts

Source: Bloomberg, Reuters & FG Research

Market performance

Performance of Indian Equities across Market Caps and Debt benchmarks as on Mar 31st, 2022

Sector	7 year CAGR	5 year CAGR	3 year CAGR	1 year	6 months	3 months
Nifty	10.9%	13.7%	14.5%	18.9%	-0.9%	0.6%
Sensex	11.1%	14.6%	14.8%	18.3%	-0.9%	0.5%
Nifty Midcap Index	12.5%	11.5%	17.6%	25.3%	-2.3%	-2.5%
Nifty Smallcap Index	9.2%	8.4%	16.1%	28.6%	-4.2%	-7.6%
NIFTY Composite Debt Index	7.5%	6.6%	7.7%	3.9%	0.2%	-0.2%

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)	10.0%	10.9%	10.2%	5.1%	2.5%	-4.6%
S&P 500 (USA)	11.9%	13.9%	16.9%	14.0%	5.2%	-4.9%
Nikkei 225 (Japan)	5.4%	8.0%	9.5%	-4.7%	-5.5%	-3.4%
Hang Seng (Hong Kong)	1.5%	0.5%	1.1%	11.9%	6.1%	1.8%
FTSE 100 (UK)	1.7%	0.7%	3.2%	14.3%	3.7%	5.1%
Shanghai Composite Index (China)	-2.0%	0.2%	1.7%	-5.5%	-8.9%	-10.6%
DAX (Germany)	2.7%	3.2%	7.7%	-4.0%	-5.5%	-9.3%
iBovespa (Brazil)	13.0%	13.1%	7.9%	2.9%	8.1%	14.5%
MICEX (Russia)	7.5%	6.3%	2.7%	-23.7%	-34.1%	-28.6%

Source: Bloomberg, Reuters & FG Research

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