PGIM India Mutual Fund

Market Outlook

March 2024

Equity Market

We find better relative value in the large cap category

The Nifty50 index recorded a gain of 1.6%, led by rally towards the end of the month. For FY24, the index was up 28.6%. NSE Mid Cap 100 index and NSE Small Cap 100 index saw respective correction of -0.5% and -4.4% compared to the respective increase of 60.1% and 68.9% during FY24. Indices for Auto, Infrastructure and Banking sectors outperformed the broader market while indices for Information Technology, Realty and FMCG sectors underperformed during the month.

Key macroeconomic developments for the month included Moody's and Fitch Ratings raising India's GDP growth forecast on the back of strong domestic consumption and capital expenditure; CPI inflation in February 2024 remaining unchanged at 5.1% versus January; India's industrial production in January 2024 moderating to 3.8% versus 4.2% in December; and India's CAD in Q3-FY24 moderating to 1.2% of GDP. Other key developments were India announcing the timelines for the upcoming Lok Sabha Elections and the US Federal Reserve guidance of three interest rates cuts during the remainder of 2024 despite higher inflation. During the month Foreign Portfolio Investors and Domestic Institutional Investors were net buyers to the tune of USD 3.7 bn and USD 6.8 bn respectively.

Going forward

We remain optimistic on Indian equity markets on medium- to long-term basis. However, valuations make us cautious on the near-term return potential. Valuation excesses are stark in the mid and small cap buckets, driven by hopes on continued strong corporate earnings growth and a stable policy environment. Large inflows in mid and small caps have also contributed towards this re-rating. We find better relative value in the large cap category and the strong (high growth + high quality) mid and small cap companies, and believe that they still present an attractive opportunity for long-term investors. Limited triggers to boost valuations further necessitates the focus squarely on capability of the companies to grow cash flows and earnings, and reinvest the same. The select group of companies that can deliver on that count may continue to benefit from the broader macro and demographic tailwinds.

Debt Market

Rate cuts may start from Q3 of CY2024 onwards

Indian bond markets were stable and rangebound during the month. Most of the action was concentrated in the money market segment where yields were volatile, as is normally the case during financial year end. The economic data continued its strong run with the composite PMI number staying above 60 after the strong GDP data earlier. IIP and inflation numbers were in line with expectations. Core inflation came in at 3.35%, near all-time low. Current Account Deficit (CAD) was also steady at 1.20% of GDP in Q3-FY24, as services and remittance flows negated a sequentially higher trade deficit. CAD is expected to be in the vicinity of 1% in FY24. Strong GDP growth, stable inflation and external position underscore the current strong macroeconomic position of India. Indian FAR (Fully Accessible Route) bonds were included in the Bloomberg EM local currency government index with a start date of January 31, 2025. The weight of the Indian FAR bonds will be 10%, and will reach their full weightage exposure by November 2025. While the initial news flash had come earlier, in January, the flows are not expected to be significant since the inclusion, as for now the flows are limited to EM local currency government index. However, this is definitely a positive step closer to inclusion in the bigger Bloomberg Global Aggregate Index. The flows expected from this inclusion are around USD 3-4bn, but as highlighted this inclusion can be the catalyst for subsequent inclusion into the larger global aggregate index. Since the announcement of the inclusion of Indian sovereign FAR bonds in the JP Morgan EM Index last year, FPI inflows into the bond markets have topped USD 10bn.

The yield curve, which had bull flattened after the presentation of the Union Budget, on 1st February 2024, continued to remain flat as the demand supply dynamics remained favourable with the central government borrowing calendar for H1-FY25 came in lower than expected at INR 7.5 trn which is 53% of the total gross borrowings budgeted for FY25. The market was expecting the H1-FY25 borrowings at around 58-60% of the total gross borrowings. In terms of percentage borrowing for the first half, this is the lowest since

FY19. The supply in the 10 yr segment is the highest at 25.60% of the total H1-FY25 supply. Supply in the 30-50 yr segment is at 37.30% of total H1 supply. The indicative calendar for gross SDL borrowing for Q1-FY25 came in at INR 2.54 trn, which is slightly higher than expectations. State Government (SDL) supply picked up sharply towards the end of the month with more than INR 1.50 trn of SDL issuance in the last two weeks of the month, which pressurised the longer end of the curve.

PFI inflows into debt continued, but lagged the pace of the first two months of CY24 with USD 1.64 bn inflow in bonds in March. INR weakened to an all-time low against the US Dollar, touching 83.43 even as India's FX reserves rose to an all-time high of USD 642 bn. Most of the Asian currencies were weaker on back of the weakness in the Chinese currency and INR also came under pressure as a result.

The 1 yr OIS was up 1 bps, closing at 6.75% at March end while the 5 yr OIS was at 6.35%, down 1bps compared to February. While the benchmark 10 yr bond yield was down 2 bps the 15 year segment outperformed. Most of the action was in the money market segment (up to 1 year maturity) where yields were volatile owing to the financial year-end related liquidity woes that pushed down yields by 20-30 bps across the money market curve at March end.

Bank of Japan ended its negative interest rate policy, which the markets were expecting, while the US Fed stuck to its forecast of 3 rate cuts, later in the year, in a close 10-9 decision. US economic data continues to be quite robust with sticky inflation leading the US bond markets to scale back their expectations of rate cuts this year. The bond markets, which were pricing in almost 150 bps of rate cuts in 2024 at the start of the year are now pricing in around 75 bps of rate cuts. At 4.20% towards end of the month, the benchmark US 10 yr yield was lower by 5 bps.

Going ahead, we believe that RBI is likely to be on a long pause and is likely to start cutting rates only after the developed market central banks start the rate-cutting cycle. Given the current growth-inflation dynamics in India, we believe rate cuts will start from Q3 of CY2024 onwards. Markets tend to react before the start of a rate cutting cycle and the current yield levels offers a good opportunity for investors to increase their allocation to fixed income as real and nominal yields remain attractive with favourable demand-supply dynamics playing out in the sovereign bond market.

Fixed Income Market

	February 2024	March 2024	Change (in bps)
Overnight rate (NSE MIBOR)	6.80%	7.90%	110
1 yr CD	7.80%	7.60%	-20
10 yr GOI Yield	7.08%	7.06%	-2
USD/INR	82.91	83.40	49 paise
IIP (Monthly with 2 month lag)	4.20%	3.80%	-40
CPI (Monthly with 1 month lag)	5.10%	5.09%	-1
5 Yr AAA PSU spread (bps)	45	38	-7
5 Yr OIS	6.35%	6.34%	-1
US 10 Yr yield	4.25%	4.20%	-5
CRR	4.50%	4.50%	0
REPO	6.50%	6.50%	0
SDF (Standing Deposit Facility)	6.25%	6.25%	0

Source: RBI Weekly Statistical Supplement & Bloomberg

Note: IIP has been revised lower for the previous reading.

Source: BSE, RBI & Bloomberg