PGIM India Mutual Fund

Market Outlook

June, 2019

Equity Market

CONSUMER SENTIMENT AND SPENDING SEEMS TO BE SLOWING DOWN

The market that was

Indian markets (Nifty -1.3%) had a weak month with most sectors under-performing. Metals and Utilities were the only sectors in the green, whereas Pharma, Energy and Cement were the top laggards in the month. Political and geopolitical news, both international and domestic, hogged limelight – i) India imposed higher tariffs on 28 US products with US demanding withdrawal ii) Newly appointed Home Minister tabled and passed the J&K reservation bill in LS, also extending the President's rule in the state iii) On global front, tensions between Iran-US escalated as Iran shot down a US drone aircraft on violating its airspace iv) Oil also saw volatility as OPEC + stirred up fear in markets on news flow around the extension of supply cuts for 6-9 months.

April IIP picked up to 6-month high expanding to 3.4% from 0.3% in March with broad-based sectoral contribution. Manufacturing growth, however, still remained subdued at 2.1% with 14 of 23 industry groups showing positive growth. May CPI print inched up to 3.05% after 6 consecutive months of sub-3% inflation while the broad story of weak core inflation and rising momentum in food prices continued. Core inflation fell to 22-month low of 4.2%. WPI also eased to 2-year low of 2.45% stoking expectations of another rate cut by RBI. RBI cut repo rate by 25bps to 5.75% and changed its monetary policy stance to "accommodative" from "neutral". FY20 GDP growth forecast was revised further by 20bps to 7.0% with GDP growth for 1HFY20 being revised down by 40bps to 6.4-6.7%. May trade deficit widened to 6-month high of $15.4bn as import growth outpaced export growth on the back of a 37% spike in gold imports.

FIIs buying slowed down significantly in June with inflows of $231mn, taking the YTD total to $11.4bn. Domestic Mutual Funds were buyers in the month with net inflows of $1.2bn YTD while Insurance companies were sellers with outflows of ~$2.4bn YTD.

Going Forward

Come July, the full year budget, progress of monsoon, trade war developments and RBI policy meet would be key monitorables. Economic growth and earnings recovery are key for the markets to perform and all is not clear yet to have a long runway for the same. Government finances need shoring up for the capex momentum to continue as private sector is still not on a spending spree. Further, consumer sentiment and spending seems to be slowing down as evident by commentary and numbers such as auto sales. News flow regarding liquidity and solvency issues at some NBFCs, airlines and debt laden corporates can accentuate further, if not managed properly. Hence, near term pick up in volatility cannot be ruled out. In such a scenario, we continue to stick to quality. Strong cash flows, unquestionable corporate governance and strong balance sheet are three non-compromisable qualities in the current environment and we too would continue to follow the same.

Debt Market

WEAK GROWTH, IMPROVING LIQUIDITY, AUDRATE CUT PUSH DOWN YIELDS

Macro Review

CPI remained within RBI's projection for May 2019 (released in June 2019) printing at 3.05%, while the previous reading was revised upwards slightly from 2.92% to 2.99%. This was the tenth consecutive reading below 4%, being RBI's medium term CPI target. Additionally, core CPI Inflation moderated to 4.2 from previous 4.5%. In line with the ongoing slowdown, we expect Core inflation to moderate further.

Liquidity and Rates

Liquidity conditions improved during the month of June turning positive after a long time. Liquidity remained positive in the month with the surplus rising through the first fortnight before falling after the second week to account for advance tax and GST related payments.

Liquidity in general improved on the back of higher government spending. RBI also infused durable liquidity in the system by conducting total OMO purchase of INR 275 bn in the month of June.

Crude prices went up marginally by 1% during the month due to rise in geopolitical tension as Iran shot down a US military drone. However, trade tensions between US and China continued and helped in taming the rise in price of crude oil.

The rupee saw appreciating bias during the month as FII flows continued during the month. Bond yields fell during the month as dismal Jan-Mar GDP growth led to RBI's decision to cut repo rate by 25 bps accompanied by change in stance to 'accommodative' from 'neutral'. With this, market players hoped for further easing in upcoming policies improving market sentiments. Additionally, market sentiments bolstered after FOMC hinted at future rate cuts in its monetary policy.

Bond yields rallied in June as RBI not only cut Policy rates but also sounded dovish. There was concern within the MPC regarding continued weakness across various sectors of the economy.

Both the sovereign and the AAA curve flattened with the sovereign curve outperforming the Corporate Curve. The flattening was more pronounced in the corporate Curve as compared to the sovereign curve as the yields in the 2-5yr AAA segment rose while yields at the longer end of the corporate curve declined owing to demand from pension and insurance companies.

FPI inflows into debt were positive to the tune of USD 900mn though they remained negative by USD 1bn on CYTD basis.

Outlook

The outcome of the monetary policy is a positive for the market. Domestic growth concerns persist with incoming data reinforcing the weakness across sectors. Global bond yields have been coming down on growth concerns amid heightened uncertainty on trade wars. The US yield curve is factoring in rate cuts by the US Fed by the end of the year. Crude oil prices have fallen and are likely to stay in a range.

We continue to expect a further 25-50 bps of rate cut by RBI through FY20 to support growth. In our view the short end of the curve continues to offer a better risk reward given that fiscal pressures persist and lack of fiscal space given strain on revenues plus the need to continue spending on infra and other poll commitments could lead to higher eventual borrowing by the Government. As a result, the longer end of the curve could still face obstacles.

Recommended Products

In line with our view, we recommend shorter duration products in the average maturity range up to 3 years, given the evolving macro backdrop.

We recommend the PGIM India Banking and PSU Debt Fund along with PGIM India Premier Bond Fund for investors seeking moderate duration exposure with a preference for high quality (AAA) portfolio. The PGIM India Credit Risk Fund in the 'accrual category' is recommended for investors seeking a higher 'carry' and with a slightly risk appetite. PGIM India Dynamic Bond Fund is recommended for Investors with a higher appetite for Volatility.

Fixed Income Market

	May 2019	June 2019	Change (in bps)
Overnight rate (NSE MIBOR)	6.00%	5.97%	-3
1 yr CD	7.20%	7.16%	-4
10 yr GOI Yield	7.03%	6.88%	-15
USD/INR	69.7	69.03	-67 paise
IIP (Monthly with 2 month lag)	0.36%	3.43%	307
CPI (Monthly with 1 month lag)	2.99%	3.05%	6
5 Yr AAA PSU spread (bps)	45	55	10
5 Yr OIS	5.86%	5.67%	-19
US 10 Yr yield	2.12%	2.00%	-12
CRR	4.00%	4.00%	0
Reverse REPO	5.75%	5.50%	-25
REPO	6.00%	5.75%	-25

Source: RBI Weekly Statistical Supplement & Bloomberg

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

Source: RBI & Bloomberg