Market Outlook

September, 2019

Equity Market

DEFINITE SHIFT IN GOVERNMENT APPROACH TOWARDS CORPORATE INDIA

The market that was

Indian Markets saw its highest single-day gain in almost a decade, during the month when the Finance Minister announced sharp cut in tax rates for corporates. Many experts have hailed it as boldest reform in many years. Typically, government tends to go for such bold reforms when there is a crisis. Though there is a marked slowdown in the economy as can be seen from weak numbers across sectors, it can't be termed as a crisis. So, full credit to govt. for initiating such a bold move.

Nifty (+4.1% in Sep) rallied 8% in two consecutive sessions post the announcement. Nifty Midcap 100 Index and Small Cap 100 Index were up 2.4% and 2.7% respectively during the month. Among sectors, Infra (11.2%), Metals (6.6%), FMCG (6.4%), Autos (6.3%) and Banks (6.1%) outperformed in Sep whereas Pharma (-6.5%), Realty (-3.4%) and IT (-2.9%) lagged.

On the macro front, July IIP inched up to 4.3% vs 1.2% June print. August CPI inflation inched higher to 3.21% (3.15% in July) led by higher food prices, but remains muted owing to a favourable base effect. Fiscal deficit till August has reach 78.7% of the full year target. India maintained its borrowing plan for the second half of 2019-20 amid concerns that the government will overshoot its fiscal deficit target because of a surprise cut in corporate tax rates.

After two months of selling (~$2.2bn last month), FIIs turned net buyers in Sep (~$0.9bn) taking the YTD net inflows to ~$8.1bn whereas DII buying continued in Sep ~$1.7bn (vs ~$2.9bn last month) taking the YTD net inflows to ~$6.5bn. Domestic Mutual Funds were net buyers of $1.5bn in Sep and ~$7.4bn YTD.

Going Forward

Government has been talking about accelerating economic growth for quite some time and articulated it's aspiration to be $5tn economy by 2024 but something was missing to make this reality.

In recent weeks there is a definite shift in government approach towards corporate India, sharp cut in corporate tax is clear example of this. Now, corporate tax rates levels are largely in line with other emerging markets. To promote “Make in India” & to capitalize on changing global trade scenario, the Finance Minister also announced reduction in tax rates for new manufacturing companies created after 1st Oct’19 where tax rate is cut to 15% (no incentives) vs 25% earlier (with incentives). More importantly, it looks like we are at the beginning of next phase of much needed reforms. Large scale divestments (and privatization) would be another major move. Core group of secretaries on divestment (CGD) has cleared a proposal on privatization of five PSUs including BPCL. The CGD is expected to make recommendations for privatization to the Cabinet Committee on Economic Affairs (CCEA).

While the near term benefits of corporate tax cuts have possibly been factored in by the markets, the impact of potentially higher capital flows, capex cycle restarting and further tax rationalisation measures (if any) boosting consumption are yet to be seen. In addition, lower interest rates, good monsoon and increased spend by government would lead to revival of economic growth in coming months. To improve liquidity in the system, government is not just spending more but wants to clear all dues to its vendors.

What does it mean to stock market and economy? Corporate India is likely to report weak numbers in 2QFY20 and not so great numbers in 3Q also. Also, crisis in NBFC sector will continue to have its ripple effects across various sectors. While the near term outlook for Indian economy and corporate India is challenging, there is every reason to believe that outlook would change for better in the coming quarters. one of the golden rules of investing in Equities is - stock market is about tomorrow not today.

After the sharp correction in mid-caps, we believe there are opportunities across large, mid-cap and multi-cap funds depending on risk appetite and time horizon of investors. We continue to focus on high quality companies with visible earnings growth and trading at reasonable valuations.

Debt Market

FISCAL CONCERNS DEEPEN, PUSHING YIELDS HIGHER

Macro Review

CPI for the month of August 2019 printed at 3.2%, well below the RBI target of 4% and marginally below the consensus estimates. Core inflation eased as well falling from 4.5% in July to 4.2% for August. Fall in core inflation points to a further decline in pricing power for Producers. In contrast, food prices showed some uptick, rising 0.4% on a m/m basis. On a y/y basis the increase was 3.0% led mainly by perishables (vegetables) impacted by seasonal disruptions caused by weather.

Liquidity and Rates

Liquidity conditions which had started improving late July, continued into August and September as well. Daily liquidity balances at the system level remained steady in the month reflecting easy liquidity conditions. Average daily LAF balances for September stood at positive INR 1.15 trillion (INR 1.36 trillion in August). Easy liquidity is being maintained by RBI to aid policy transmission which has so far been quite sluggish.

The Rupee had a good month appreciating 54 paise (0.75%) against the USD over the month. The Govt during the month took a landmark decision to cut Corporate tax rates across the board granting significant relief to Corporates. However the fiscal impact of these tax cuts are estimated at 0.7 % of GDP and could lead to some pressure on yields. This ensuing gap will need to be bridged partly through alternative revenue raising measures comprising mainly non-tax measures such as disinvestment. Also there exists some room for expenditure compression since expenditure growth in the current financial year is projected at over 20%. Any unbridged gap will need to be plugged through additional supply of G Secs. This risk led to the markets selling off post these announcements, though they partly settled post the release of the G Sec auction calendar for the second half, which did not show any incremental borrowing.

The yield curve steepened during the month with the shorter end of the curve outperforming the longer end. The 10 year benchmark widened by 14bps in the month post the tax cuts while the shorter end continued to remain stable given easy liquidity. Corporate bonds fared better in the month with their spreads compressing from 60 bps to 47 bps.

Outlook

The longer end of the curve could continue to witness pressures from likely additional supply later in the year on back of tax cuts and weakness in tax collections. We expect liquidity to continue to remain comfortable with the assurance from RBI that the system would remain well supplied with liquidity to aid in the rate transmission process. This in our view, renders the short end of the curve viz the 1-3 year segment as a favourable segment and a sweet spot.

Recommended Products

We recommend short duration products in the average maturity range up to 5 years, given the evolving macro backdrop.

We recommend the PGIM India Banking & PSU debt fund along and PGIM India Premier Bond Fund within this category as suitable investment options for investors seeking moderate duration exposure and a preference for high quality (AAA) portfolio.

PGIM India Dynamic Bond Fund is recommended for Investors with a higher appetite for volatility.

Fixed Income Market

	August 2019	September 2019	Change (in bps)
Overnight rate (NSE MIBOR)	5.45%	5.52%	7
1 yr CD	6.50%	6.42%	-8
10 yr GOI Yield	6.56%	6.70%	14
USD/INR	71.41	70.87	-54 paise
IIP (Monthly with 2 month lag)	1.20%	4.30%	310
CPI (Monthly with 1 month lag)	3.15%	3.21%	6
5 Yr AAA PSU spread (bps)	60	47	-13
5 Yr OIS	5.02%	5.10%	8
US 10 Yr yield	1.50%	1.66%	16
CRR	4.00%	4.00%	0
Reverse REPO	5.15%	5.15%	0
REPO	5.40%	5.40%	0

Source: RBI Weekly Statistical Supplement & Bloomberg

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

Source: RBI & Bloomberg