PGIM
India Mutual Fund

Market Outlook

December 2020

Equity Market

Ending the year on a high

The market that was

The year 2020 ended at close to all-time highs for markets, with Nifty gaining 7.8% in Dec 2020 helped by continued inflows from FIIs on the back of the risk-on sentiment. Interestingly, the month saw the Nifty Index closing in the red only on 3 days – the lowest number since its launch. The broader markets were also strong, with Nifty Midcap 100 Index rising 5.7% and the Nifty Small Cap 100 Index rising 7.9%.

Realty (+20.2%), Metals (+13.5%) and Consumer Durables (+12.4%) were the outperforming sectors, while Auto (+3.4%), Energy (+3.7%) and Power (+3.8%) were underperforming sectors.

While vaccines rollout started in developed economies and central banks continued their accommodative stance, there are some concerns regarding the emergence of a second wave on account of a more infectious and mutated strain of the virus. Even as Europe saw cases rising again, India's cases are on a notable decline (avg daily cases down 50% MoM and total active cases down 75% from September peak). On the political front, protests from the farmers continued over the contentious farm laws, and both sides are in discussions to resolve the impasse.

On the Macro front, RBI upped its FY21 growth projection from -9.5% to -7.5%, indicating a recovery in H2FY21. Inflation also saw some moderation, with CPI print coming in at 6.9% in Nov (from 7.6% in Oct) as supply chains further normalized. As expected (due to the pandemic), India's fiscal deficit touched 135% of the budgeted figures (Nov end) as revenue receipt lagged from the budgeted figures. RBI continued to maintain a dovish stance even as inflation remained above desired levels. Infrastructure output in India dropped by 2.6% percent year-on-year in November 2020 – the sharpest fall in 3 months.

India posted a USD 15.5 billion current account surplus in Q2FY20, or 2.4% of GDP, compared to a USD 7.6 billion deficit in the same period last year. FIIs were net buyers again for the third straight month (Inflows of US$7.3bn in Dec vs. US$ 9.6bn in Nov) and they have pumped in US$23.4bn YTD. DIIs, on the other hand, continued their selling spree with outflows of US$5bn, taking YTD outflows at US$4.9bn.

Going Forward

Stock prices are driven by liquidity in the short term and trend in corporate earnings in the long run. Both favor the market currently, and the same is reflected in the current valuations as well. However, the key question is whether they are fully reflected or not. This is a function of a) liquidity, b) earnings growth c) valuations. Liquidity is clearly in favor of the market as FIIs have been investing almost Rs 3000 cr daily for many weeks. Currently, most of the flows are part of increased allocations to emerging markets from developed markets. Soon we would start seeing country-specific allocations and funds. These flows are more than offsetting outflows from domestic mutual funds. Participation of retail investors in direct equities is also very high, and record oversubscription to recent IPOs clearly highlights excess in the market. Also, FII flows are part of global liquidity, and it doesn't take much for these flows to change course.

On the corporate earnings front, two things are clear 1) from a low base in FY21, one can expect strong growth in FY22 2) there is a clear delink in corporate profits from overall economic growth. In recent times, small firms and companies with weaker balance sheets have taken the brunt of economic slowdown and the current pandemic. In contrast, larger companies and companies with better balance sheets have become stronger as reflected in healthy profit growth in the September quarter results.

On Valuations, though equity valuations appear to be expensive, one needs to consider a) depressed earnings in the current year b) low-interest regime. If interest rates are lower, it is natural for P/E multiple to expand. However, sustained economic growth and earnings growth is a must. FY22 earnings growth may be great, but in six months, the focus would shift to likely growth in FY23. Though things appear to be returning to normalcy, it's not correct to assume that everything is back to normal. Job losses and resultant demand destruction are real. Govt. finances are already stretched, and we are a capital-starved economy. We continue to believe in the long-term structural sustainable growth story of India and equity markets. However, we are cautiously optimistic on the outlook for 2021. Asset allocation and diversification are key to long-term wealth creation. We continue to participate in this rally through quality companies with visible growth and strong balance sheets.

Debt Market

2020 ends with some good signs

Macro Review

The CPI for November 2020 finally showed some signs of easing with the headline dipping to 6.93% from 7.61% in October 2020. Most of the fall was led by food prices, which softened both sequentially as well as on a year-on-year basis.

Fuel inflation picked up by 3.5% given the rise in brent crude prices. Besides, gradual return to normalcy is also reflecting in higher electricity and coal prices. Core inflation as a result remained almost unchanged at 5.51%.

CPI has stayed over the upper end of the inflation band of 6% for all of the months in the current fiscal underscoring the inflation pressures the economy is facing. Supply side issues are taking longer to sort, causing CPI decline to remain very slow. Besides, the economic rebound is much faster than expected causing an uptick in input prices from metals to electricity and coal.

Macro Data

Liquidity conditions remained almost unchanged in the month aided by the ongoing surplus. Daily liquidity is now consistently in excess of INR 5 trillion.

The RBI at the December policy kept rates unchanged. RBI referred to the monthly inflation staying well over the target range, leaving little room for an immediate cut. However, it continued with its accommodative stance, pledging to keep liquidity in surplus for the current as well as the next financial year.

For the calendar year 2020, equity witnessed strong inflows of INR 1.16 trillion, which was almost completely offset by outflows in debt aggregating INR 1.08 trillion. This is the 3rd straight year of net outflows in debt by FPIs. Most of these outflows in the year happened in the March to June period, post which outflows slowed to a trickle.

The Govt collected INR 1.2 trillion GST in December 2020, being the highest single month collection ever since GST was launched in July 2017. The record GST collections, augurs extremely well for Govt finances and is reflective of the general buoyancy and pick-up in economic activity. Around 60.3 million GST e-invoices were generated in December 2020 compared to 58.9 million in November 2020.

Outlook

The economy had a good festive period sales, and level of economic activity continues to show good follow through in second half of November and December, as also reflected in GST numbers.

Inflation remains a bit of a concern for the Central bank, especially given the pace of recovery and firming up in prices of metals, commodities, oil etc. Given the improving data, prospects of a rate cut remain weak for now. Liquidity surplus however is expected to continue in the coming months and quarters, until the pace of recovery broadens.

The combination of manufacturing incentives for various sectors under the PLI (Production Linked Incentive schemes) and the impact of lower interest rates should also play a role in enabling demand pick-up.

Recommended Products

In this background of further improvement in economic outlook and macro data, we prefer the safety of short and mid duration products in the average maturity range up to 5 years. We recommend the PGIM India Banking & PSU Debt Fund along and PGIM India Premier Bond Fund, 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 slightly higher appetite for volatility.

Fixed Income Market

	November 2020	December 2020	Change (in bps)
Overnight rate (NSE MIBOR)	3.40%	3.51%	11.00
1 yr CD	3.57%	3.78%	21.00
10 yr GOI Yield	5.91%	5.90%	-1.00
USD/INR	74.05	73.06	-99 paise
IIP (Monthly with 2 month lag)	0.50%	3.60%	310.00
CPI (Monthly with 1 month lag)	7.61%	6.93%	-68.00
5 Yr AAA PSU spread (bps)	20	24	4.00
5 Yr OIS	4.44%	4.62%	18.00
US 10 Yr yield	0.84%	0.91%	7.00
CRR	3.00%	3.00%	0.00
Reverse REPO	3.35%	3.35%	0.00
REPO	4.00%	4.00%	0.00

Source: RBI Weekly Statistical Supplement & Bloomberg

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

Source: BSE, RBI & Bloomberg

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Mutual Fund Investments are subject to market risks, read all scheme related documents carefully.