PGIM India Mutual Fund

Market Outlook

February 2021

Equity Market

Market shows promise of recovery after the unlock phase

The market that was

Amid volatile sessions, Nifty-50 Index gained 6.7% in February. The month started on a positive note with the announcement of the Union Budget. Key benchmark indices gained 5% on February 1 as there was no change in tax rates, the focus was on growth and increase in spending. After a strong start to the month, a sudden reversal in the declining Covid cases in India and a global sell-off triggered by the rise in US treasury yields pulled the benchmarks to close ~6% lower. Broader markets outperformed with Nifty Midcap 100 Index gaining 11.4% and Nifty Small Cap 100 Index gaining 12.3%. Among sector indices, the Metal Index gained 24%, followed by Power (+21%) and Utilities (+18%). Hindalco (+50%), SBI (+38%), Adani Ports (+33%) were the top gainers in Nifty index while Eicher (-9%), TCS (-7%), Hindustan Unilever (-6%) were the top laggards.

The rise in Covid cases in India prompted some states to consider new restrictions including partial lockdowns in hotspots. Prioritizing Capex over Revenue Expenditure held the promise of creating more jobs and uplifting long term growth potential. Moreover , the government's focus and commentary on privatization/divestments led to renewed interest in PSU stocks.

Both FTSE and MSCI announced an increase in India weight in their rebalances, which led to expectations of passive inflows in Feb/Mar. In Flow trends, FII buying accelerated to ~$3bn whereas DIIs continued to remain net sellers, led by domestic mutual funds which saw their 7th consecutive month of redemptions in January.

India's GDP grew 0.4% YoY Q3FY21, though slightly below market forecasts of a 0.5% gain. It is the first expansion in three quarters as the government opened economic activities in phases from June after a coronavirus lockdown in late-March. India's fiscal deficit soared from 4.6% of GDP in FY20 to 9.5% in FY21 due to the welfare measures taken to counter the pandemic. An expansionary budget & more transparent accounting led to the FY22 target of 6.8%.

India has administered ~14.3mn doses to healthcare & front-line workers. Starting March 1, the government plans to start the second phase that will cover ~100mn people who will be vaccinated at 10k governmental centres and 12k private centres. Active cases are ~84% below September 2020 highs. However, they have risen over ~25% in the last few days.

Going Forward

The FY22 Union Budget focused on growth and has relaxed the government's medium-term fiscal consolidation targets. The government's bigger focus remains on supply-side reforms with the objective of kick-starting the investment cycle. This is critical for India's medium-term growth prospects.

The government's decision to accelerate spending reflects its views on higher multiplier effects during the unlock phase and higher growth as a pre-condition for debt sustainability. Its revised targets suggest government spending will be frontloaded and will rise by 55-60% YoY in the final quarter of FY21 (Jan-Mar 2021). Higher deficits resulted in higher-than-expected market borrowings for both this fiscal year (INR 800bn) and next (INR 12tn). Much of the consolidation in FY22 will be occurring against the backdrop of higher nominal GDP growth of 14.4% YoY and gross tax revenue growth of 16.7%YoY, both of which are reasonable assumptions, given a weak base.

Q3FY21 results were strong. Nifty EPS grew 16% YoY in Q3FY21, ~14% above estimates. For 9MFY21, EPS growth stood at 0.5% YoY. Economic recovery and abnormally low base in the next 2 quarters are likely to ensure strong earnings in growth numbers in coming quarters. For the BSE100 firms, not only did sales growth climb sharply to +1% YoY in 3Q vs -7% in 2Q, but it was also broad-based, with only 22 firms reporting a decline in sales, the lowest since June-2019. The 1.4pp YoY expansion took BSE100 EBIT margins to a decade high, pushing EBIT +18% YoY despite a high base, with 38% of firms reporting 30%+ EBIT growth and only 20% (mostly banks that increased provision cover) seeing a decline. The consensus now expects ~14% growth in FY21 Nifty EPS vs +5% in Oct-2020.

In sharp contrast to about a year ago, visibility of fundamental growth has improved substantially. However, rising prices of commodities (especially crude in India's case) and rising global yields may have some impact on liquidity. We continue to stick to companies with improving visibility of growth.

Debt Market

Mixed signals in the market favour short and midterm products

GDP print

GDP data for Q3 came in at +0.4% around market consensus of +0.6%. GVA growth was higher at 1%, indicating a higher subsidy payout by the government in the period. Internals suggest a pick up in manufacturing, electricity and construction while mining is still in the negative zone. This is largely corroborating IIP prints in the last few months.

Services still remain affected by the diminished physical movements and discretionary activities such as travel and tourism among others, owing to the delay in vaccine roll-outs that are expected to happen post March. The revival of services, therefore, is expected to take a few more quarters.

Rates and liquidity

Rates sold off during the month. Pressures started accentuating post the budget as markets fully grasped the extent of the supply likely to hit the market in FY 22 besides the additional INR 800 bio issuance for FY 21. The second fortnight also witnessed a gradual hardening in US yields which added to a further pressure on local yields, as fears mounted of a gradual sell off from emerging markets. US yields rose from 1.29% to 1.61% in a span of a week with expectations of a strong recovery, further stimulus measures of USD 1.9 trillion and rise in commodity prices.

The other feature that was adding to the market nervousness was the continuous devolvement at the auctions, with a large portion remaining unsold. Notably, RBI moving to a "uniform price auction" for the longer bond did not help matters much as the devolvement kept on continuing. Markets seem to demand higher yields despite the Governor's repeated statements that the yield curve would be managed through an array of tools at RBI's behest and that the yield curve was a "public good" that needed more attention.

Market demand and preference for outright and larger sized OMOs (Open Market Operations) over Operation twists (which are liquidity neutral) has not been heeded by RBI fully, which is also reflecting the rigidity in higher yields. As a result benchmark 10 year yields move higher by almost 30 bps post the budget day, factoring in all of these worries.

On liquidity, markets seem to believe that the excess liquidity will be absorbed by RBI faster than indications in the statements in the February policy. Short OIS (2y), reflects this fear expressed in the steepness.

System liquidity however remained quite comfortable for the month, with LAF tracking upwards at INR 6 trillion on a consistent basis. Barring short term fluctuations, overnight rates such as Treps and Repo have also been under the Reverse Repo levels.

Outlook

Rising yields is the focus of bond markets and needs urgent addressing to soothe market nerves. Inflation which was rising through 2020, seems to be cooling off a bit. This is reflected in the last 2 prints that came off a peak of 7.60%. Base effects are favourable post March and the recent surge in food inflation should finally see some respite as the winter months end and the transport and logistical hurdles witnessed through most of the pandemic also ease off.

Forex which was appreciating for most part of the recent months witnessed some reversal in February given the EM sell off in bonds as US yields surged and market fears of a repeat of taper tantrum surfaced. It is unlikely though that the US Fed will tighten any time soon after having clearly communicated the willingness to look at average inflation going forward rather than a pure headline number. Moreover, full employment alone is not sufficient to alter the course of monetary policy.

RBI has its job cut out for itself as we enter the last month of the financial year and record G Sec issuance volumes are slated for the next fiscal. Given the backdrop of a strong recovery, large issuance volumes, a gradual normalisation of liquidity and stubborn commodity prices, and a rise in US yields, we remain watchful on the longer end of the yield curve. We prefer the shorter end of the curve in the 1-3 year duration, which offers better carry subsequent to the normalization in yields in January.

As such we favour our short and mid-term products such as the Corporate bond fund (PGIM India Premier Bond fund), the PGIM India Banking and PSU Debt Fund. The ideal way to have exposure to the longer end is through the PGIM India Dynamic Bond Fund. Investors with a shorter time horizon of upto 6 months should also look at the PGIM Ultra Short Term Fund, a high quality fund that invests predominantly in the 3-12 month segment to maintain duration under 6 months.

Fixed Income Market

	January 2021	February 2021	Change (in bps)
Overnight rate (NSE MIBOR)	3.47%	3.47%	0.00
1 yr CD	3.97%	4.25%	28.00
10 yr GOI Yield	5.95%	6.23%	28.00
USD/INR	72.95	73.66	71 paise
IIP (Monthly with 2 month lag)	-2.10%	1.00%	310.00
CPI (Monthly with 1 month lag)	4.59%	4.06%	-53.00
5 Yr AAA PSU spread (bps)	15	17	2.00
5 Yr OIS	4.67%	5.34%	67.00
US 10 Yr yield	1.07%	1.40%	33.00
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 lower for the previous reading.

Connect with us on: www.pgimindiamf.com 1800 2667 446

Riskometer

This product is suitable for investors who are seeking*:

PGIM India Premier Bond Fund (An open ended debt scheme predominantly investing in AA+ and above rated corporate bonds)

- Income over the medium term
- Investments predominantly in AA+ and above rated corporate bonds including bonds
- Degree of risk – MODERATE

PGIM India Dynamic Bond Fund (An open ended dynamic debt scheme investing across duration)

- Regular income for short term
- To generate returns through active management of a portfolio of debt and money market instruments
- Degree of risk – MODERATE

Investors understand that their principal will be at moderate risk

PGIM India Banking and PSU Debt Fund (An open ended debt scheme predominantly investing in Debt instruments of banks, Public Sector Undertakings, Public Financial Institutions and Municipal Bonds)

- Income over the short term
- Investment in debt instruments issued by Banks and Public Sector Undertakings, Public Financial institutions and Municipal Bonds
- Degree of risk – MODERATE

Investors understand that their principal will be at moderate risk

PGIM India Ultra Short Term Fund (An open ended ultra-short term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 3 months to 6 months)

- Income over the short term
- Investment in short term debt and money market instruments
- Degree of risk – LOW TO MODERATE

Investors understand that their principal will be at low to moderate risk

*Investors should consult their financial advisers if in doubt about whether the product is suitable for them.

Source: BSE, RBI & Bloomberg

The views of the Fund Manager should not be construed as an advice and investors must make their own investment decisions regarding investment/disinvestment in securities market and/or suitability of the funds based on their specific investment objectives and financial positions and using such independent advisors as they believe necessary. None of the information contained in this document shall be constituted as a recommendation to buy or sell any particular security.

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