PGIM
India Mutual Fund

Market Outlook

January 2024

Equity Market

Cautious on the near-term return potential for markets

After hitting a new all-time high during the month, Nifty50 closed flat in January. The Mid Cap and the Small Cap indices continued their upward trajectory with the Nifty Mid Cap 100 Index and the NSE Small Cap 100 Index closing the month with gains of 5.2% and 5.8% respectively.

The 3QFY24 results announced till January 2024 were largely in line with expectations with Healthcare and Cement sector companies reporting inline or better than expected numbers and Real estate, Retail and Consumer sector companies reporting disappointing earnings. Thirty-three of the Nifty50 index companies which declared result in 1st February 2024 reported an aggregate Sales/EBITDA/PAT growth of 6%/15%/21% YoY.

For the month, indices for Banking, FMCG and Metals underperformed the broader market while indices for Oil & Gas, Real estate, Power and Healthcare outperformed. Other key developments for the month were the US Fed meeting minutes indicating that interest rates in US will remain elevated for longer while keeping the rates unchanged, the National Statistical Office of India estimating India's FY2024 real GDP growth at 7.3%, and the IMF raising India's FY2025 GDP forecast by 20 bps to 6.5%.

On the domestic macro-economic front CPI inflation in December came in at 5.7% compared to 5.6% in November, while November 2023 factory activity moderated sharply to 2.4% from 11.6% in October. In the recent Interim Budget, the Government reiterated its focus on fiscal consolidation as FY2025 fiscal deficit was budgeted at 5.1%, with a target to bring it down further to 4.5% in FY2026 was reiterated.

The consecration of the temple for Lord Ram in Ayodhya in January was a key political development in January as this event is expected to boost the image of the ruling party. For the month FPIs were net sellers to the tune of $ 3.1 bn and DIIs remained net buyers to the tune of $ 3.2 bn.

Going forward

Indian equities have delivered strong returns in the past year on the back of relatively stable macro and micro-economic variables in India, strong corporate earnings growth momentum and a consistency in government policy environment. We remain optimistic on Indian equity markets on medium- to long-term basis as these drivers are expected to sustain.

However, post the sharp runup in markets in recent times, we are cautious on the near-term return potential. Mid Caps and Small Caps in general have become more expensive after the recent runup. We believe that Weak (low growth + low quality) Mid Caps and Small Caps are in bubble zone and caution is advised, while Strong (high growth + high quality) Mid Caps and Small Caps present opportunity for long-term investors. On a relative top-down basis we are finding better upside in large-caps stocks versus mid cap and small cap stocks.

With the markets already factoring in political stability post the 2024 union elections, any negative surprise on this front is a key downside risk to market in the near-term. Over the medium-term, pickup in pace of private capex is a key monitorable as the government focus on fiscal consolidation would entail normalisation of the government-led capex growth.

Debt Market

The current yields offer a good opportunity for fixed income investors

The first month of 2024 saw the continuation of the theme of macroeconomic stability as growth continued to surprise on the upside with 'core' inflation continuing its downward trend coming in below 4%. The first advance GDP estimate for FY24 came in at 7.30% against market expectations of 6.70% and PMIs also continued the robust trend. The combination of strong growth and low inflation makes for a goldilocks macro-economic scenario for India in a fragile global economic landscape. The Interim Budget presented on 1st

Feb 2024 further buttressed the strong underlying macroeconomic fundamentals as it projected a lower-than-expected fiscal deficit of 5.1% for FY25 leading to a mini bond rally. The markets were expecting a fiscal deficit of 5.3% and a gross borrowing number around INR15 trn. The gross borrowing came in at INR14.3 trn. Thus, the bond markets got a fresh lease of life post budget with the benchmark 10 yr bond yield lower by 9 bps on the budget day. The yield curve flattened during the month and after the interim budget, with the longer end of the curve outperforming the shorter end of the curve as the actual state government (SDL) borrowings are lower than the indicative calendar. Banking sector liquidity was tight for most of the month resulting in elevated money market yields. The key reason for the tightness in interbank liquidity continues to be a very high government surplus to the tune of INR 3-4 trn. One of the reasons for the high government surplus can be attributed to the strategy of meeting the redemption proceeds of government securities through the GST compensation cess, which is also the reason for lower gross borrowing for the next fiscal. Given the decelerating trend of core inflation and the fiscal prudence stance of the government, we believe that the monetary policy stance will be changed to 'neutral' in the February MPC meeting.

Brent crude rose by 6% during the month on back of continuing disruptions in Red Sea, though INR was pretty stable and appreciated marginally by 0.20% during the month. CPI inflation came in at 5.69% in line with consensus and core inflation continued its downward trajectory coming in at 3.90% which is a 4yr low.

PFI inflows in debt continue to be strong in the new year with USD 2.3 bn of flows in January 2024 after USD 7 bn inflow during CY 2023.

The OIS curve was flat during the month with the 1yr OIS down by 4 bps at 6.60% and 5yr OIS at 6.19%. It had outperformed the sovereign curve last month in consonance with the movement in US yields. The benchmark 10yr bond yield was down by 3 bps.

The FOMC policy was on expected lines with the Fed pushing back on expectations of an earlier / faster rate cutting cycle though bond yields in US were lower after the US treasury reduced its Q1 CY2024 borrowing to USD 760 bn against the market expectations of USD 850 bn, and lower than its own earlier estimate of USD 816 bn. Even the Q2 CY2024 borrowing number stands at USD 206 bn against the market expectations of USD 350 bn.

Global bond yields led by US treasury yields were flat during the month after the massive rally in the last two months of 2023. The US bond market is pricing in 125 bps rate cuts this year, which might prove to be optimistic given the cautious Fed stance amidst strong growth. RBI is likely to start cutting rates only after the global rate cutting cycle has started, which in our view, is likely to happen from Q2/Q3 of CY 2024 onwards. Markets tend to react before the start of a rate cutting cycle and the current yields offer a good opportunity for investors to increase their allocation to fixed income as slowing growth and moderating inflation is likely to lead to rate cuts in 2024.

Bond yields tend to move in advance of rate action and investors can look to increase allocation to fixed income as we expect long bond yields to keep drifting lower and expect the benchmark 10yr bond yield to go lower towards 6.50% by Q2/Q3 of CY 2024.

Fixed Income Market

	December 2023	January 2024	Change (in bps)
Overnight rate (NSE MIBOR)	6.90%	6.85%	-5
1 yr CD	7.85%	7.90%	5
10 yr GOI Yield	7.17%	7.14%	-3
USD/INR	83.21	83.04	17 paise
IIP (Monthly with 2 month lag)	11.70%	2.40%	-930
CPI (Monthly with 1 month lag)	5.55%	5.69%	14
5 Yr AAA PSU spread (bps)	45	45	0
5 Yr OIS	6.19%	6.19%	0
US 10 Yr yield	3.88%	3.91%	3
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