PGIM
India Mutual Fund

Market Outlook

November 2020

Equity Market

A Period of Positivity

The market that was

The Nifty50 Index rose sharply in November (+11.4%), touching new lifetime highs and outperforming regional markets such as Indonesia, Taiwan, Hong Kong, Malaysia, and Philippines. A gradual improvement in economic activity, driven by pent-up and festive demand, pick-up in manufacturing activity and a much better results season compared to expectations are key reasons for the current rally. The broader markets also outperformed with Nifty Midcap rising 15.5% and Small Cap rising 13%.

The Indian markets were further supported by a global risk-on rally which was driven Joe Biden winning the US Presidential elections, positive news flows around COVID19 vaccination and dollar weakness (DXY fell by -2.3% in Nov). Emerging markets saw strong FII inflows during the month, and India received its highest ever monthly inflow of US$ 9.4 billion (a little over US$ 2 billion could be attributed to MSCI re-balance and increase in Foreign Ownership limits).

Banking, Metals and Automobile sectors were the key outperformers during the month. The Banking sector witnessed a sharp rally (+23%) on the back of inexpensive valuations, better collection efficiency levels and reducing asset quality pressures. Metal stocks (+24%) rallied on the back of dollar weakness and Automobile sector (+14%) due to pent-up demand and gradual re-opening of the manufacturing sector. However, defensive sectors such as I.T., Pharmaceuticals and FMCG lagged.

On the COVID-19 front, there is a marked improvement and relief. After touching a peak of about 97,000 new cases per day in September, there is a gradual decline to about 30,000 cases in mid-November. Though cases spurted after the festive season, the last few days again saw a drop in new cases to about 40,000 per day.

GDP declined by -7.5% y/y in 2Q (vs -23.9% in 1Q) which was much better than street expectations, led by the manufacturing sector which reported flat growth during the 2Q v/s -39% yoy decline in 1Q. India's fiscal deficit widened to over Rs9.5 trn, or 127% of the annual target as of October end. The India Manufacturing PMI declined to 56.3 in November 2020 from 58.9 in October, below market consensus of 57.3. This was the lowest reading in three months, but the latest reading was still consistent with a sharp rate of expansion, amid ongoing loosening of COVID-19 restrictions.

2QFY21(June-September) net profits of the Nifty50 Index increased by 16.4% yoy versus expectation of marginal decline. EBITDA increased by 9.4% yoy versus expectations of a 2.5% decline. Almost all sectors performed well with most sectors beating estimates. The better-than-expected results reflect (1) stronger-than-expected sales and volumes across sectors and (2) lower-than-expected costs as companies continue to maintain tight control on costs. Aggregate consensus for FY21 and FY22 earnings saw upward revision after the results.

After turning buyers in October, FIIs turned even more aggressive in November and recorded their highest ever monthly net inflow into India equities. FIIs net bought in November to the tune of US$ $9.4bn, taking their YTD inflows to close to US$ 16bn. On the domestic front, DIIs remained sellers due to redemption pressures and sold worth US$ 6.5bn during the month.

Going Forward

After a sharp rise in global and EM markets during the month, we can expect some consolidation in the near term. The gradual opening of the manufacturing sector, moderation in GDP decline and much better Q2 earnings season vs expectations are some of the positives as India adjusts to the new normal. This time we expect the rural economy to lead the recovery vs urban markets as it has been less affected by the COVID19 crisis.

Positive developments around fast-acting medications or vaccines for COVID19 would be a key supporting factor for global as well as Indian equity markets. India will continue to remain one of the fastest growing emerging markets in the world and potential long-term equity returns will continue to attract sizeable inflows. In terms of earnings, while FY21 is likely to be a muted year (primarily because of the pandemic), recovery expectations in H2 and a healthy exit run rate would provide a robust platform for earnings growth recovery from FY22 onwards. As companies and economies are adjusting to a newer normal, structural changes are taking place across multiple sectors. While some changes may be temporary, some changes are here to stay. We all are adapting to the same, and we are mindful of the same in our portfolios as well as in our endeavor to provide better risk-adjusted returns to our investors.

Debt Market

Pent-up Demand Aids Faster Recovery

Macro Review

CPI for October 2020 continued to remain stubbornly high, printing at 7.6 % (up from 7.3% in September). While food continues to remain the culprit as in the previous months, core inflation in excess of 5% also remains a source of worry. As the economy gradually emerges from the lockdown and activity levels rebound to pre-covid levels, we expect upward impulses to the core.

So, even as the headline may benefit from falling food inflation, core may pose problems as recovery gathers pace. Already crude oil is in the mid 40s and is showing signs of stabilising around these levels. While most of the developed markets continue to battle the second / third wave as winter sets in, the roll-out of the vaccine (expected in the US as early as December itself) globally in the first quarter may accelerate recovery as we go through 2021.

As such, while CPI is likely to soften, we expect the average for FY 2021 to be closer to 6% and to range in the 5.5% to 6% band for H1-FY 2022.

Liquidity and Rates

Liquidity conditions continued to remain ultra-benign with daily system average liquidity now crossing the INR 5 trillion comfortably. The woes of RBI are now being compounded as FDI flows are being supplemented by strong FII inflows as well. November was one of the strongest flows for equity ever, registering inflows of INR 69,476 cr. For the calendar year 2020, equity has witnessed inflows of INR 1.19 trillion, completely erasing outflows in debt which stood at INR 1.07 trillion in the same period.

For context, average daily LAF balances in September, for instance, stood at INR 3.31 trillion and at INR 3.68 trillion in August.

GDP data – Q2/FY 2020

India's second quarter GDP for the period from July to September 2020, rebounded strongly. For the 3-month period, the GDP contracted by 7.5% (over the previous year), much lower than the -23.9% (year / year) contraction of the first quarter and also lower than the consensus estimates ranging from -7 to -9%. GVA (Gross value added = GDP plus taxes minus subsidies) contracted by a lower amount of 7% in Q2.

Among the highlights, drivers of the rebound included a pick-up in agriculture (+3.4% y/y – flat vs Q1) and industry (much lower contraction of -2.1% as against -38.1% in Q1 FY 21). Industry constituents that did well include electricity, home goods, power sales, cement dispatches, consumer durables, auto etc. Part of the pick-up was led by pent-up demand and buying for the festive season. High frequency indicators have been signaling a pick-up in economic activity towards the end of Q2 which is also reflected in the numbers.

Alternatively, viewed on the expenditure side, the main drivers to a better performance in Q2 was private consumption (aided by the stimulus and gradual unlocking of the economy, pent-up demand and the festive season), net exports and gross fixed capital formation.

Outlook

While the second quarter performance has been promising, the outlook for the second half of FY 2021 will depend on continuation of demand post the festive season. While Q2 accounted for a lot of pent-up demand from Q1, spillover into Q3 and Q4 could be minimal. However, ground level activity as reflected in the high frequency data reflects that demand in tier 2, 3, 4 cities and towns is re-emerging.

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. Financial conditions in India in the last three years from 2017-March 2020 have been particularly tough, stifling demand and investment. Impact of stimulus (putting more money in the hands of rural population, agri sops), higher forex flows (both FDI and FII) plus RBI's buying activity in Government bonds (both G Secs and SDL) is also aiding liquidity.

With CPI likely to stay well over 4%, monetary space for RBI is limited. Coupled with the rebound, prospects of a rate cut appear low. However, RBI is likely to maintain the accommodative monetary stance for the foreseeable future as was reiterated in the previous policy, given the need for effective rate transmission which is still an unfinished agenda.

Recommended Products

In this background of an improvement in economic outlook, macro data and improving sentiments, we recommend short and mid duration products in the average maturity range up to 5 years, given the recent macro data on Q2 GDP and CPI trajectory. We recommend the PGIM India Banking & PSU Debt Fund 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

	October 2020	November 2020	Change (in bps)
Overnight rate (NSE MIBOR)	3.48%	3.40%	-8.00
1 yr CD	3.72%	3.57%	-15.00
10 yr GOI Yield	5.88%	5.91%	3.00
USD/INR	74.10	74.05	-5 paise
IIP (Monthly with 2 month lag)	-7.40%	0.20%	760.00
CPI (Monthly with 1 month lag)	7.27%	7.61%	34.00
5 Yr AAA PSU spread (bps)	26	20	-6.00
5 Yr OIS	4.32%	4.44%	12.00
US 10 Yr yield	0.87%	0.84%	-3.00
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