PGIM
India Mutual Fund

Market Outlook

November 2023

Equity Market

Strong (high growth + high quality) Mid Caps & Small Caps present opportunity for long term investors

Nifty closed with strong 5% gains in November on the back of positive global market sentiment. The Mid Cap Index and Small Cap Index outperformed the Large cap Index and were up 10% and 12%, respectively.

The key triggers for the rally was US Fed keeping interest rate unchanged in their policy review. Their dovish remarks made towards the end of the month indicated that they may slow down the pace of tightening going forward. Sector-wise, all sectoral indices ended on a higher note - Realty (+18%), Pharma (11%) and Auto (10%) sectors outperformed, while FMCG (+3.4%) and Banks (+3.8%) underperformed.

FIIs infused US$1.1bn into Indian equities during November followed by another US$1.2bn on the first day of December alone. DII flows remained strong with inflows of USD1.7b during the month. Other key developments were BJP, the ruling party at the Center winning 3 of the 4 state election conducted in November, Moody's downgrading its outlook on US debt to negative from stable, Reserve Bank of India tightening norms for personal loans and credit cards in the form of higher capital requirements as a precautionary move and IMF and S&P Global rating raising its GDP growth forecast for India.

On the macro-economic front, October CPI inflation moderated to 4.87% from 5.02% in September. September IIP growth moderated to 5.8 vs 10.3% in August and GST collections for November showed 15% YoY growth led by good festive demand.

The NSE500 companies delivered strong earnings performance in 2QFY24, led by healthy earnings performance from the BFSI and Auto sectors. Key sectors with upward earnings revisions to estimates included Industrials, Healthcare, Energy and Auto while sectors with earnings 'miss' and earnings downgrades included Telecom, Materials and IT.

Going forward

Dovish US Fed statement on incremental rate hikes has boosted the global investor sentiment, while the recent BJP win in the four state elections has given a boost to the domestic investor sentiment as it indicates increased probability for political continuity in 2024.

We remain optimistic on Indian equity markets on medium to long term driven by strong economic growth. However, post the sharp runup in markets in the recent months, we are cautious on the near-term return potential of the equity markets.

Mid-Caps and Small Caps in general have become more expensive after the recent runup. Weak (low growth + low quality) Mid Caps and Small Caps are in bubble zone and caution is advised. 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-caps and small-cap stocks. Globally we are seeing growth slow-down in developed markets due to elevated interest rates along coupled with sticky inflation situation. This will have an adverse impact of export oriented businesses in India.

In India, rural consumption continues to remain weak and Government measures to boost the same is key near-term monitorable. On an overall basis we are positively biased towards domestic-oriented industries and are selective on the export oriented industries.

Debt Market

Rate cutting cycle in India may start only from Q2 2024 onwards

November may well be remembered as the month in which the global monetary policy tightening, which started last year, ended as the major global central banks paused and hinted that it may be the start of a long pause. Bonds yields came down across the curve in US and Europe, though the action in the Indian bond markets was much more muted given the fact that Indian yields had not reacted much on the upside even as global bond yields touched multi-year highs in October. Along with bond yields, crude oil also slumped by almost 9% towards $80 per barrel on back of uncertainty over demand outlook in 2024 and the failure of the OPEC+ alliance to convince the markets regarding the effectiveness of their production cuts even as the Middle East conflict lingers on.

The RBI governor continued to strike a cautious tone, though given the persistent tight liquidity there was no outright OMO sales announcement by RBI. In previous Indian monetary tightening cycles, we have seen that interbank liquidity goes into deficit mode in the last leg of the cycles and this time too it seems to be no different. The biggest surprise of the month, and probably for this entire fiscal, came in form of the much higher than expected GDP growth numbers for Q2. GDP growth for the July-September came in at 7.6%, as against expectations of 6.8%. The strong growth was led by surge in manufacturing, construction, and government expenditure. While RBI had been quite confident about its GDP forecast of 6.50% for FY24, the analyst community had been quite sceptical given the headwinds from weaker global growth and concerns about rural growth. The RBI Governor has been vocal about strong growth and the fact that growth could surprise on the upside, which has now proven to be correct.

After the release of the Q2 GDP numbers, the analyst fraternity has increased their forecasts for GDP growth for FY24 to 6.7%-6.9%, against the earlier estimates of around 6%. We expect the RBI to increase its GDP forecast for FY24 in its December 8 MPC meeting. The other major development from a market perspective has been the continuous weakness in INR despite the fall in crude oil prices, weakness in the dollar index, and the sharp retracement in developed market bond yields. INR touched an all-time low of 83.40 against the US dollar during November. Trade deficit touched a record high of $31.5 bn during October led by surge in imports of gold and crude, though expectations of FY24 current account deficit remain in the vicinity of 1.5%. RBI has been intervening quiet heavily in the FX market, both in the spot and the forwards. CPI inflation came in line with market expectations at 4.87% with the core inflation continuing to trend lower, coming in at 4.25%. GST collections went up by 15% to INR 1.67 trn for October underlying the strong growth momentum.

RBI followed up on its cautionary tone on unsecured lending by increasing the risk weightage on consumer credit, credit card receivables and loans to NBFCs while exempting home, auto and educational loans. Just to put things in perspective personal loans have increased by 25% yoy, and credit card outstanding have increased 30% yoy. This is expected to lead to an increase in interest rates on these products as cost of capital will go up for banks and NBFCs.

FII flows in debt crossed $5 bn on YTD basis touching a 6-year high. The OIS curve also came down in line with the bond yields. The 1yr OIS came down by 6bps while the 5yr came down by 15bps, keeping the curve inverted. We expect status quo on policy rates as well as the monetary stance, from the RBI, at the December 8 MPC meeting. Given the strong growth momentum, RBI is likely to continue with its stance of tight liquidity, though we do not think OMO sales will happen in December. As liquidity tightness persisted, the MSF rate continued to be the operation rate with the overnight rate at 6.75%. Money market rates inched higher on the view of continued liquidity tightness with 1yr CD rates touching 7.8%.

Global bond yields, led by US treasury yields, came down across the curve with the benchmark 10yr US yields down by 60bps as the US Fed paused and various fed speakers sounded dovish. The narrative of soft landing took hold with softer inflation data along with slowing growth.

We believe that the current global monetary tightening cycle, which started last year, has ended and the major central banks across will be on a long pause. RBI will also be on a long pause and the rate cutting cycle in India will start only when the developed market central banks start their rate cutting cycle, which in our view will happen from Q2 2024 onwards. Markets tend to react before the start of a rate cutting cycle and the current yields offers 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.

We expect the 10yr benchmark bond to trade in a range of 7.15% to 7.35% over the next one month.

Fixed Income Market

	October 2023	November 2023	Change (in bps)
Overnight rate (NSE MIBOR)	6.84%	6.90%	6
1yr CD	7.70%	7.80%	10
10yr GOI Yield	7.36%	7.28%	-8
INR/USD	83.26	83.40	14 paise
IIP (Monthly, with 2-month lag)	10.30%	5.80%	-450
CPI (Monthly, with 1-month lag)	5.02%	4.87%	-15
5yr AAA PSU spread (bps)	33	38	5
5yr OIS	6.68%	6.52%	-16
US 10yr yield	4.93%	4.33%	-60
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