Date: 06th August 2020

MONTHLY MARKET OUTLOOK AUGUST 2020

PRELIMINARY

The country is witnessing opening of economy as most of the cities have decided to lift the lockdown to a larger extent. Earnings season is coming to an end and it was a mixed bag as expected. Though the rate of infection is not coming down and we are yet to flatten the curve. Our views on asset classes are as follows.

FIXED INCOME

- For most of the month call rate hovered between 2.90% to 4.00%. Short term yields remained steady and we saw a contraction of yield on long end of the curve (5 years and above papers). 5-year gilt contracted from 5.28% to 4.99% and AAA 5-year papers came down from 5.70 % to 5.47%.

- Looking at GST collection of Rs. 82000 crores (which was lower than June 2020), we feel there is reason to believe in pent up demand story. Having said that, we saw few cities go into lockdowns in July could have led to this difference in collection.

- The fact that the Inflation will inch higher needs to be considered in the light of demand and supply paralysis in this unique situation.
- We expect rates to remain lower though RBI may take a pause on 6th August 2020 meeting.

- Currency is very steady and appreciating with USD weakness. We are sitting on good forex reserves of 520 bn dollars and looking at FDI flow we remain positive on currency

- Looking at credit pick up which is very sluggish and the risk aversion for lending to select industries will keep liquidity awash in the system. Almost all banks have seen huge deposit pile up, improving CASA and thereby lowering cost of funds.

- We feel seasonal spike in inflation may not change RBI stance and our estimation is that the rates are going to be benign for the next one year at least.

- Ideal space to park your debt money is 3-5 years zone with roll down maturity, this will ensure that you will generate better risk adjusted return. Liquid fund returns would remain lower at around 2.9% to 3.5 % and one may look at money market or short-term funds in lieu of that for less than 1-year money.

EQUITIES

- Equity markets rallied all the way to 11200 in July on the back of liquidity and better expected results with sound commentary from few companies. The overall results are still mixed bag and those corporates which beat the expectations found renewed buying interest.

- In fact, rally in RIL, HDFC Bank, Infosys and handful of other heavy weights helped NIFTY cross 11000 zone. Banking and Finance didn't participate much in this rally. Now most of the result season is behind us and in the absence of fresh triggers, market might take a breather.
  Correction to the extent of 5% to 10% cannot be ruled out considering relentless rally we have seen since 23rd March 2020 – Pharma rallied 73%, IT 63.40%, Energy 53%, Commodities 44%, and Telecom 41.50%. NIFTY itself is up 44% from the bottom made on 23rd March 2020. Usually it is always said that it's difficult

to buy into first 40% of the rally in the market where you see big correction like we witnessed in March 2020.

- Valuation of most of the large cap stocks have reached a peak and very narrow head room is left for them to go up in the short term. Fundamentals need to improve to justify these valuations. You need to take these parameters in consideration when liquidity chases assets like Gold, Silver and Emerging Markets

- According to us, one needs to change focus to quality midcaps which has shown resilience in the current downturn and potential of becoming sector leader eventually.
  Most of the fund managers we interacted with are still preferring Pharma, Speciality chemicals, IT and FMCG. Most of them are underweight on banking and finance for want of clarity on NPAs and RBI policy on restructuring. Extension of moratorium will be a big negative for the sector.

- We advised clients in April to diversify into international equity specially US and gold, these themes have delivered better than expected returns.

- We advise caution at current valuation level for any lumpsum investment and investing in phased manner over next 3 months is better strategy.

- Looking at 23 billion USD of FDI in the month of July 2020 (against 70 billion USD for 2019-20), we remain optimistic about 2021-22, where new FDI flow will address employment and consumption issues. We have seen unemployment drop to 7% in July and good monsoon, rural economy will lend support to economy going ahead.

- NIFTY to remain in new broad zone of 10500 – 11500 for next couple of months but stock specific action will be important to watch

- Risk reward is definitely in favour of equity today provided we don't get second wave and geopolitical situation remains under control.

Thus, to summarize we advise to focus on very high-quality midcaps as they are still trading at approx. 10% discount to large caps, where historically they used to trade at premium to large caps in normal economic situations. There is no need to rush into buying as September will see real test for many banks and NBFCs as to how they handle recovery post moratorium. Biggest threat to the current market rally is fresh wave of NPA cycle than anything else.