

Market Outlook

August 2021



Equities

With lockdowns and restrictions easing out in July, economic activity has seen an impressive rebound in the past few weeks. Most of the production facilities have been opened up and are almost at 90% of pre-Covid levels. In fact, manufacturing activity in India has rebounded to a 3-month high in July after contraction in the previous months. Exports too, have shown glimmer of recovery with merchandise exports from India rising to \$35.17 Billion in July which is the highest in 9 years, while imports are also up by 59% to \$46 Billion. Economic recovery is also reflective in GST collections for July 2021 which were of Rs. 1.16 Lakh Crore.

The equity markets have resonated with this recovery and the Nifty has crossed the 16,000 mark on 3 August 2021. Further with the result season upon us, we have noticed that Q1 results are mostly in line with market expectations although one surprise element was that consumption has taken a big hit. Further, in the banking sector we have seen a renewed risk of NPAs from retail loans as most of them faced a lock down over 2 months and banks yet have to normalize with credit costs likely to stay elevated in the near term and credit growth remaining muted.

IT and specialty chemicals have come out with good results but again going ahead we feel IT will start facing margin pressure as cost of manpower is going up very fast. In the case of specialty chemicals, margins have already come under pressure this quarter but we don't expect the topline to get affected in this case. Even on the employment front, three major industries which employ most of India's formal workforce are IT, construction and auto – all of which are appearing promising. At the same, time, India has over 80% of work force in unorganized sector- which is another stressor. Companies have also initiated wage hikes, which are albeit 6% on the lower side compared to the last year.

With the Nifty touching 16,000 we don't expect any big correction based on known factors. One school of thought sees most of the Auto, Banking, industry and pharma are still much below the 52-week peak and this gives us the confidence that once the economy recovers, all these sectors may come back stronger with a gap of one or two quarters. Also, worth noting is that newer commodities and technology stocks have led from the front and the mid cap and small cap stocks have dominated the show for July 2021 – where the Nifty Mid cap index gained 2.46% and the Nifty Small Cap Index gained almost as much as 8.10% in July 2021.

On a YTD basis, Nifty is up by 12.70% and returns have mainly been driven by metals, PSU and real estate. However, for the month of July 2021 the Nifty was up by about 0.30% while mid and small caps really led the rally as mentioned above.

Any tactical correction on account of over optimism and high liquidity is not ruled out and this could be a great opportunity to enter the market. The trailing PE has reached 27.01 and the P/B is 4.12 times with the market cap to GDP of 108%. However, considering robust growth in 2022 we expect these numbers are not over expensive.

Foreign Institutional Investors ('FIIs') sold Rs. 43,467 Crores worth of stocks in this FY so far while Domestic Institutional Investors bought Rs. 40,099 Crores in the similar period. Retail Investors have been very active in this market and have been strongly buying into equities. Mutual Funds have been the biggest beneficiaries of inflow from HNI and individual investors, where monthly SIP amount have crossed over Rs. 900 Crores. This has been evident from the recent NFO of the ICICI Prudential Flexicap Fund which saw a stellar response of close to Rs. 10,000 Crore. Besides new NFOs, flows into ongoing funds has been encouraging. Response to IPOs has been fascinating specially when they are aggressively priced – it is an indicator of enough liquidity in the system.

On the liquidity front, global central banks are not in a hurry to start tapering liquidity and the US 10 Year Bond has retracted back to 1.19%. Ample liquidity in the system can prove to be good news for the equity market. At the same time, one needs to be watchful as the US Fed decisions will have an impact on all global markets. US is indicating economic recovery and coupled with surging inflation, there is a possibility that the Fed may accelerate its taper program earlier than expected.

In India, inflation continues to be closer to 6 to 6.50% which has become a case of worry since it could affect consumption.

Similarly, on the Covid front India has fully vaccinated around 10.4 Crore people (7.6% of its population) and the Government is trying to achieve roughly 50 Lakh doses per day. On the other hand, the State of Kerala is leading in newer infections than any other state. When most of the world is witnessing a third wave of Covid, we are still about at 10% of the peak level of infections which we saw during the second wave. Thus, over 35,000 plus cases may not indicate that we are in the third wave.

On the monsoon front, news is positive with its encouraging progress which will help help rural demand and help containing food inflation.

Going forward, we need to continue being cautious and watch out for any geopolitical, oil and Covid related set backs on the equity market. Overall, expectation from the market is that it will be range bound throughout the result season and find its direction based on global cues and how the Covid situation unfolds of an expected third wave. Thus, we continue to have a cautious stance this month with taking some profit off the table.

Fixed Income

Overall, the tax collection has been encouraging and surprisingly fiscal deficit is kept under control. This will further improve as economy is also opening up slowly post the June quarter. Many broad economic indicators like petrol/diesel consumption exceeded pre-Covid levels in July. Manufacturing PMI has moved up from 48.10 in June to 55.30 in July 2021.

There has been a hardening of yields across the board in India where as globally yields are coming down and especially with the US Fed where the yields on the 10 Year Bond have reached 1.16%. India has a typical problem as RBI has to manage the Government borrowing keeping the overall cost under control and we expect that the 10 Year G-Sec will slowly move up from 6.20% to 6.50% by the end of this FY.

However, the rise in yields ahead of the policy puts some pressure on the RBI. It wants to keep yields low to aid the government borrow at a cheap rate, but at the same time, it has to keep the domestic investors happy at a time when the global investors are withdrawing their debt investment from India. Presently, the RBI is letting the market forces play out the yields, while ensuring that the movements remain orderly.

Inflation is constantly on the rise, but mainly on the supply side as the cost of oil, commodities and food items are on the higher side. The view remains constant to stay away from any duration strategy funds and look at short term strategy and wait for investing in any accrual or duration strategy.

The next US Fed meeting will be critical and the RBI too, is likely to keep the rates constant on its meeting on 6th August 2021. Gradually, we feel that yields will move up on short and long end funds for the foreseeable future.

Happy to discuss further!

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