

Pranitya Wealth LLP

Market Outlook

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Initial commentary

Many investors are still asking as to when the market will correct. We don't know how long one is going to wait for this expected correction. Many times, one needs to unlearn to learn.

The Indian capital market has structurally undergone a change and is presently in a multiyear bull run. Thus, applying an aged benchmark may not work. It is wise to stay invested, and we feel that the party is still on, and we don't see it getting over anytime soon.

We feel that the geo-political tension is the only reason where markets could pause their bull run.

Let us see what has changed.

1. Size of the Indian stock market is the fourth largest globally, with a market capitalization of USD 5 trillion.
2. Mutual fund portfolios have grown to 4.7 crores.
3. The number of Demat accounts has grown to 16.70 crores and the Central Depository Services Limited (CDSL) has opened 40 lakh demat accounts in the month of July 2024 alone. Annually, ~ USD 30 Billion are received as inflows via the SIP route.
4. We are the fifth largest economy globally by size.
5. India's weight in the MSCI index is presently at 16.3%
6. Year to date, the largest inward remittance of USD 135 billion was seen in 2024.
7. The entire economic fabric has changed, and it is virtually a blue-sky scenario for India in the long term.

Demographic dividend

Over 60% of the population in India belongs to the working age. This ratio is expected to remain positive till 2047. We have more people working, earning and spending. The corporate earnings growth is going to be compounding at the rate of 12% to 13% per annum during this period. This indicates a golden period for India.

Budget

The Hon'ble Finance Minister, Ms. Nirmala Sitharaman presented the Union Budget on 23 July 2024, and it has been seen as a continuation of the reforms and fiscal prudence as indicated in the Interim Budget presented in February.

Decreased spend on subsidies, maintaining the current spend on Infrastructure, defense and upscaling were positive steps that were taken. On the Direct Tax front there were some disappointing amendments but in long term investing, this does not matter.

Most interestingly, the markets have taken this in their stride even at such elevated levels and the Nifty and Sensex went up post the budget.

The focus of the policy making was on the following sectors - agriculture, manufacturing, services, energy, infrastructure, employment and skilling, social justice, urban development, innovation and R&D and next generation reforms. There was no extra borrowing seen and the capex spend was less than last year.

The overall fiscal deficit is proposed to be brought down to 4.5% of GDP by FY 2024-24 and 4% by 2025-26.

The meeting of the US Fed

The meeting of the US Federal Reserve held on 31 July 2024 indicated that the US economy has slowed down, the inflation is coming down as well and hence one can expect the first rate cut in September 2024. This is going to be big positive for all emerging markets, as one can expect increased investment to flow to the emerging markets especially, India.

Writing off China

It would be foolish to undermine the power of the Dragon, which has ~30% of the share of global manufacturing and ~13% of the share of global consumption.

China has 85% of the share of solar production. Further, 50% of global footwear are made in China, 86% of batteries are made in China. Thus, it is very difficult to beat China, and it can bounce back in some while once it handles its banking and real estate issues.

Global landscape

1. One cannot really bother about what is happening globally, as in the long run every country is pursuing a theme of de-globalization to decouple and use protectionism.
2. Global growth might go down to 3.2% in 2024 whereas India can grow at the rate of 7% in 2024 and 6.5% or more in 2025.
3. Japan has seen nominal growth in GDP and inflation is slowly coming back.
4. Recent new tensions due to the Iran and Israel standoff, is making airlines bleed as they must take a detour than flying the shortest route. We pray this would not escalate, as oil prices can dent economies badly.

Gold

Central bankers have loaded on gold this year, excluding the USD from their forex reserve. The finance minister via the Union budget has brought down the gold import duty from 15% to 6% thereby, bringing down the prices of gold in the country.

Gold should ideally go down by 9% equivalent to the drop in the duty. We still feel in the long-term gold prices will remain firm and the ETF route is a better option to access gold. One should keep in mind that returns on gold will not beat return on equities in India for a foreseeable period.

Factors supporting the current rally and why one should not time the market

Two decades of digital, physical, social and other reforms by government have started paying dividends now.

1. USD 30 billion (as per the latest run rate and this can very well go up) is the liquidity available and FPIs have newly invested over USD 26 billion in the India markets.
2. The flow into equities by the younger generation has accelerated and the risk appetite of this sect of investors is different. So, there is little likelihood that the flow can reverse at this stage.
3. The growth in Bank deposits has come down from 16% to 10.5% over the year which shows a financialization of savings among the investors.
4. Inflation coming down will help the interest rates to come down, which will in turn boost spending again.
5. The valuation of the Nifty and the scaling of Mt. 25K level is still around 20 times forward PE, which is not very expensive and acceptable for a 7% GDP growth in relative terms.
6. FPIs have lost several opportunities to enter the market and are presently waiting for an entry point to invest in India.

7. Earnings growth is strong and Q1 numbers so far denote a mixed bag but without any big disappointments.
8. Markets have raised Rs 1.23 Lakh Crore by way of IPOs, Offer for Sale, QIPs and preference shares quite easily.
9. Liquidity is very strong and today many mutual funds, and family offices are keeping it handy for an eventual correction.

To add to this, a good monsoon is expected to bring rural cheer and support.

The EPS estimate for Nifty is Rs. 1,143 for FY 2024-25 and Rs. 1,331 for FY 2025-26 and this can improve. With this estimate, the Nifty is trading at a multiple of 21.87 times FY 2024-25 earnings and at just 18.78 times of 2025-26 which poses the question – Where is this so-called froth?

At the same time, there are pockets of overvaluation which can be avoided. For example, in the Nifty 500, there are about 150 companies which trade over 50 times their PE.

Alongside, there are also other positive factors to consider. We have a stable government, with stable policies and a strong banking system. We have huge forex reserves at USD 670 billion which are further growing, with 17.6% in gold, 49% in USD, 16% in Euro and the balance in other currencies. The corporate profit to GDP ratio is at 5.10% which is a healthy ratio.

The Indian VIX indicates a stable market even at a level of 25,000 Nifty. If the market falls, at this moment we still have enough liquidity to support it.

Others

1. The Indian Debt market appears to be calm with the 10 years G-sec coming down slowly below 7%. This may further decrease with any eventual rate cut by the Fed.
2. Listed bonds, INViTs and REITs have become attractive with the 12-month holding period and tax rate change of 12.5% for long term capital gain tax.
3. Mutual Funds having a pure debt portfolio got a bad deal in the Budget, with no respite on taxation. Thus, for any holding period at all, you end up paying tax at the marginal rate.

We have discussed this at length over our call with Ernst and Young LLP recently.

Conclusion

At this juncture, we can say that the rally has just begun for long term investors as we see 10 – 15 years of a high growth phase for the Indian Economy. The Markets will have their own ups and downs on the eventual way up. The cost of timing the market could appear to be high.

Further, the market cap to GDP ratio is still way off the historical benchmark. Mr. Warren Buffet too, has highlighted this repeatedly. But who knows, this too may need to be unlearned.

We continue to focus on the 12%-15% compounding effect for the next 15-20 years, which will be an astonishing number. A caveat to this is that geopolitically, things do not escalate beyond a certain point.