

Market Outlook January 2022



Outlook 2022

Introductory Comments

We, at Pranitya Wealth, would like to wish you a very Happy and a Prosperous New Year! May this year bring stability and good health to each one of you and your family.

The objective of these Outlooks, at the beginning of each month, is to give you a perspective of the current market situation, of what to expect from the markets in the near future rather than just crystal gazing about the market's future. We hope you find them pertinent and beneficial in reviewing your wealth creation strategy.

CURRENT ECONOMIC SET UP

Indirect taxes

Indian Government did a commendable job on many fronts despite prevailing pandemic situation. GST collection now averaging about INR 1.30 lac crores per month. December 2021 showed collection close to INR 1.30 lac crores which was slightly lower than Nov 2021. But considering the fact that level of activity drops post festive season with lower auto sales, (more of logistic issue) etc., we sense collection will eventually pick up with increased compliance

Direct Taxes

On direct taxes front, the collection is up by 55% over last year. Direct tax collection as on 31st December 2021 is close to INR 9.6 lacs crore and still counting. It is therefore expected to overshoot the Budgeted estimate of INR 11.6 lac crores in the fiscal year easily.

Fiscal Deficit

Reported numbers up to Nov 2021 showed deficit to be 46% of the budgeted estimate. This is a 24-year low number. Though due to pandemic, government were conservative in estimation of fiscal deficit at 6.80% of GDP. Lower fiscal deficit was possible due to lower spend on capital expenditure and revenue expenditure (lesser subsidies). Government curtailed food subsidies and enhanced oil prices were passed on without subsidization. On the other hand, business did better than expected, which helped improved tax collection.

Government has enough fire power for the last quarter if the new wave of Covid is to disrupt business. We believe we will still remain 20bps to 30 bps below the budget estimate this fiscal .

Current Account Deficit

It was the first time India turned current account surplus this year. April- June 2021 quarter we were at a \$6.6 billion surplus. However, it slipped to \$9.6 billion deficit during the September quarter. This was mainly due a sharp increase in trade deficit and an increase in the net outgo of investment income. Trade deficit widened to \$44.4 billion from \$30 billion in the previous quarter on the back of increase in imports to \$149.3 billion. Current Account deficit is expected to end up around \$40-\$45 billion by the year end. Higher commodities, oil prices and lower inward remittances turned current account surplus to deficit. Now it is expected to be around 1.4% of GDP, which is still a manageable level

Rupee As Currency

Rupee is now widely expected to depreciate to seventy-five and if oil remains stable at current levels and the Fed starts unwinding faster than expected then one may see rupee going to 75-78 zone in near future.

India is sitting on huge pile of foreign exchange reserve of about \$635 billion and looking at flows into capital markets and buoyancy in FDI, we expect Rupee to remain in the range of 74-76 for next quarter

GOLD

Gold ended with negative 4% return for 2021. Going ahead, gold prices will mainly be governed by demand factor which has been a mixed trend off late. In India, gold has gone up last quarter, especially ornamental demand. Major buyer of gold is China, where demand is likely to weaken due to slow down in economy. With Fed taper dollar is going to strengthen, and we expect money to flow back to US treasuries with rising interest rate scenario and this would lead to outflow from emerging markets and commodities including gold back to US. There is an inverse relation between dollar and gold, thus with dollar strengthening gold prices will come under pressure.

EQUITIES

Nifty gave 24.21% return, Sensex rose 21.90%, BSE 500 Index grew by 20.11%, midcap index gave 46.06% and small cap yielded about 59.28% return for the calendar year 2021.

Equity as an asset class gave best returns among all asset classes i.e., gold, silver, debt, and real estate. Let's examine the determinants of the equity markets.

- FPI**

FPI plays very important role in Indian markets. Although on a net basis, FPI invested about INR 5500 crores in the current calendar year, last quarter they sold heavily in the secondary market of about INR 1 lac crores. They did invest in primary market with some large IPOs

FPI selling was on account of couple of factors like FED decision to start taper, expensive valuation of Indian market, interest rates going up, dollar strengthening, to name a few. Even with huge selling by FPI, market remained supported by local and retail money. SIP numbers show healthy growth and now are at over INR 11,000 crores per month.

We expect FPI inflows to pause for a while before they see fundamentals support the market valuation and may not return in hurry

- **IPOs**

One of the most crucial factors this year to change the course of liquidity in the Indian Markets have been the IPOs. IPOs are in fact a big drag on liquidity and hence secondary market may remain depressed due to these large roll outs. (Expected IPOs around INR 2 lac crores in 2022)

In 2021, companies raised a record of Rs. 1.18 lac crores in 63 IPOs. Just to give a comparative, in 2020 the same number was Rs. 26,613 crores.

We do see some fatigue setting in and with SEBI reducing leverage, stricter disclosure norms etc., we expect response to IPOs will be a measured one rather than a frenzy which we saw in 2021.

2022 is also going to be a year where the largest IPOs rolling out will be that of LIC and NSE. As we understand this year will break all records in terms of collections.

Response to new age companies from market will be interesting to see. We do believe technology is the new future and some companies have successfully been able to bank on it. However, another aspect to consider before investing in these is their valuation. Only selective stories have been able to justify their valuation with visible cashflows, profitability numbers, future market share, lesser barriers to entry and orders in hand (e.g., Zomato, Nyka, etc.)

- **NIFTY VALUATION**

If you have read our market outlook for Dec 2021, and also the special note we shared when NIFTY broke 17000 level, we feel being proactive and keeping clients in the loop in these volatile markets is key.

Currently, Nifty is trading around 24 times for FY 2021-22 and 20 times of 2022-23 estimates

Nifty EPS was 442 as on 31st March 2021 and at 653 as on 30th Sept 2021. It is important to know the earnings growth along with the valuation.

GDP expectation for 2021-22 is 8%-9% and so is the case for next 2 years. Considering 20% earnings growth for 2021-22 Nifty is trading at 24 times. This is 19% above the historical average but at par with last 5-year average.

Market Cap to GDP is currently at 112% as compared to historical average of 78% (which also includes an extended period of below average growth). Global average for most of the indices is 138%.

In fact, one needs to consider most critical point, which is that in the last few years, central bankers resorted to high liquidity measures and low interest rate policy, which helped P/E to expand throughout sectors. If supportive factors turn negative one may see a contraction in P/E specially in Capex intensive industries (higher loan requirement)

Also note, studies have shown that for the past 4-5 years, lot of returns have come from this PE expansion rather than EPS growth.

So far as India is concerned, in 2022 there are certainly many positive factors to be considered along with a few triggers to be kept in mind. In the recent poll, about 76% of the listed companies expect ROE expansion which is a very good sign as that means earnings might as well catch up with valuations.

P/E expansion happens where there is a good earnings visibility, economy is in a sound state, liquidity is adequate and key factors like interest rates, currency is favorable.

WHAT TO EXPECT IN 2022

2022 is going to be a complete stock-pickers market and one can go extremely erroneous in prediction of trends. It is going to be volatile as pandemic is not over, interest rate, dollar strength and liquidity is going to be difficult to predict.

We believe Omicron is at an endemic stage of Covid and may not lead to lockdowns or business disruption.

Key headwinds according to us are –

Higher commodity prices, higher inflation, supply disruption, raising of interest rates, rich market valuation, rising oil prices and key state elections in the near future.

But we believe the glass-is-half-full approach , we see huge savings by Indians over the last 2 years (ample liquidity), level of private equity and IPOs (most of it through offer for sale), equity markets giving substantial returns even as operations begin to stabilize – all this created huge wealth effect and new millionaires in India. They are expected to drive demand going ahead. In general, fund managers are expecting banking, IT, chemicals, pharma, and capex to be favorable sectors.

We could draw simple conclusions, that if India overcame this third wave without much disruption, then two sectors - banking and information technology which derive about 50% of the Nifty profitability (barring 2020-21 where commodities contributed more) will be an obvious bet. One may then expect at least double digit returns from the market in calendar year 2022. Though the run up is not going to be smooth, it will be all about patience from here on.

We do expect that asset allocation will be key in the year to come. Even allocation to mutual fund needs to be carefully planned. Looking at valuations of large cap, mid cap and small cap stocks, distributed allocation all throughout market caps will help in achieving better risk adjusted returns. It is possible that excess allocation to small and mid-caps just might eat into your returns on an overall basis.

Even with funds' performance, one may see huge divergence in returns depending on the strategy, as we do not expect market as a whole to give stellar returns on a broader level.

FIXED INCOME

We have discussed a lot about macro-economic indicators. Everything is pointing to a hardening scenario. We expect short term yields to start going up. Last one month you can notice the changes in an analogous way –

	Current Yield	Yield a month ago
1 yr. Gilt	4.45%	4.40%
5 yr. Gilt	5.86%	5.79%
91-day T bill	3.62%	3.5%
1 yr. CP	4.94%	4.9%
1 yr. CD	4.50%	4.46%
10 yr. GSec	6.47%	6.43%

RBI may not take any drastic steps to raise rates immediately as this inflation appears to be a supply side and oil price driven where any monetary measures may not help contain it. Also, we expect in next 3 months, short term rates will harden more than long end.

It will be prudent to remain in funds with a duration of 1 to 1.5 years or floater funds where they will be able to invest at better yields at later date than you trying to time the markets. Now avoid money market funds and stay in overnight or liquid as even that slight additional risk is not worth at this stage, at least till March 2022.

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