

Market Outlook

July 2021



Equities

As far as equity markets go, the month of June was completely dominated by mid cap and small cap stocks. The Sensex was up by 0.74% and the Nifty was up by 0.68% indicating flat market conditions in the broader market, with the focus of most of the action being on mid cap and small cap stocks. It is important to note that the Nifty Midcap Index has given a monthly return of 4.40% and Nifty Small cap Index gave 6.42% taking its 1-year return to 81.91% and 110.53% respectively. Nifty and Sensex delivered exactly half of this return.

Analyzing the data further with reference to the exposure by Mutual Funds – specially Flexi cap funds – which have shown least preference to mid-cap and small cap stocks. They have moved their allocation to large cap stocks as it appears from their latest holding. It is important to note that, Foreign Portfolio Investors ('FPIs') never buy small cap stocks, and thus most of this action in the mid and small caps is on account of high retail participation.

Q4 corporate results season is over, which was very positive overall and the recovery in earnings was broad based. We are again entering into the results season in the coming week and it will be interesting to see how the corporates performed during the two months of lockdowns of varying intensity across the nation. It is widely expected that consumption of low ticket FMCG items is affected on the affordability and availability count.

Price hikes have been done by many auto majors on account of a steep rise in raw materials (especially steel prices) which could be a test in the month of July. We expect that commodity prices will take a breather and commodity companies could deliver outstanding results on account of operating leverage.

The IT sector has seen a good re rating due to their ability to grow their topline, margins and 30% to 40% of its permanent cost savings which they achieved again during the second wave of the Covid-19 pandemic. We had highlighted IT to perform about two months ago.

Export oriented sectors should do well which include select pharma and specialty chemicals companies. A depreciated rupee will help export oriented companies, helping them to report better earnings for rest of FY 2021-22.

All in all, growth is certainly back and industries are slowly returning to normal level of operations.

We are presently trading at a higher zone of equity valuation and there are many factors which are supporting this valuation level. It is also evident from the Market cap to GDP levels of 1.13 times (approx.).

The Bank Nifty has underperformed, may be on account of higher NPA expectation, lower credit growth and the fact that expanding the retail book takes time when consumption falls. In the banking sector, we do not expect any large NPAs as most of them have not given any bulky loans post 2014. We see more impact limited to the informal sectors and looking at Q4 profit trends of the BSE Top 200 companies, the same is expected to further expand. One can not forget the fact informal sector employ about 80% of India's workforce.

PLI and other Government initiatives like ethanol blending and MSP for agri produce is likely to get inclusive growth in the future. Government has already realized that without infrastructure and enhanced capex, we can't cross 6% to 7% of GDP Growth. They are addressing this issue and are also hoping that incentives will generate desired employment. India is trading at a premium to the emerging market valuation thus forthcoming corporate results need to justify the same. Mid cap stock undervaluation is over and they are trading at par with large cap stocks. Small caps are completely in the over valued zone.

We remain cautiously optimistic at this stage. Any kind of large corrections is ruled out, as we have been saying consistently. Liquidity, retail participation with return of FPI has helped market to hold the current levels and run up to 16400 Nifty is not ruled out. Market is finding great support at 15500 currently and one has to track Q1 earning season, Oil prices, Fed commentary and FPI activity.

A good mix of value and growth along with allocation to Flexi cap strategy will help any new money to be invested in equities. We also feel that staggering of investment over the next 3 – 4 months will be a good strategy at this stage, maintaining neutral weight for equity is important.

Fixed Income

June was more of a flat month when it comes to 10 Year G Sec 5.83% 2030 paper. It remained range bound between 6.02% to 6.05%. Most of this paper is held by the Reserve Bank of India ('RBI') in recent buy backs. This was done to contain overall cost of its borrowing, since present total borrowing is at a much-elevated level.

Thanks to low credit offtake, the RBI found a lot of support for G-Secs by banks. Further, looking at elevated levels of commodity prices and oil which has now touched \$ 75 a barrel, it will be interesting to see how the RBI balances between growth and inflation going ahead.

The call market remained in the range of 2.90% to 3% and one needs to see how gradually rate will move up on the normalization of liquidity. Forex reserves touched \$608 Billion while the rupee depreciated during the month close to Rs. 74.50 from Rs. 72.62 of last month. Rates across the duration mostly remained very steady for the month of June 2021, barring one year CD which hardened by 10 bps to 4.10% from the close of the last month.

Inflation expectation is to remain at 5% for FY 2021-22 barring any shocks from crude prices and this will allow RBI to undertake rate normalization very gradually without much disruption.

The next 12-15 months are expected to be negative for any duration strategy and hardening of rates is very much on the cards. We have also observed that most of the duration strategy funds have raised substantial cash in the portfolio which is indicative of likely expectation of some indirect rate action in the near term.

The present strategy will be to look at accrual strategy and active management strategy for long term funds. As this will help investor to complete mandatory period of 3 years earlier, with only initial part of 12 months coming with slightly better than liquid fund returns (looking at carry of most of the funds).

For an investor who has invested over a period of 3 years, we feel they can stay in arbitrage funds for the time being to generate better returns and exit duration strategy if they have invested. For very short-term investors, it is better to stay in overnight funds or liquid funds which is at the lowest end of the yield curve to avoid any MTM impact in case of any hardening in the near future.

There is another school of thought which if of the opinion that the US Fed will not start to taper so soon and the same will happen only post 2023. The entire fate of the interest rates hangs on the inflation locally and what the Fed decides to do with tapering. According to this faction inflation is transient and likely to come of as effect of pent-up demand will wane soon and Fed will wait patiently for growth to come back.

In conclusion, following were the key rates as on 30 June 2021:

- Monthly CPI (May 2021) was at 6.30%;
- WPI (May 2021) was at 12.94%
- Call Rates: 3.00%;
- 10 Year Gilt: 6.04%;
- 364 days T Bill: 3.80%;
- 1 Year CD: 4.10%
- Manufacturing PMI: 48.10; and
- Forex Reserve: USD 605 Billion.

Happy to discuss further!

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