

Market Outlook March 2022





Initial Commentary

Post our communication dated 24th February, 2022, the conflicts between Russia and Ukraine remain unsolved still. It turned out to be a war rather than a military action as initially thought of.

So far, it has not led to any nuclear war, nor have the other countries been dragged into it. No one thought the conflict will drag this long and that Ukrainians will reach the point of emergency evacuation. These geopolitical tensions had significant impact on commodity prices like oil, edible oil, gold, palladium, aluminum.

We would definitely like to address this with the changed circumstances.

Inflation

CPI rose to 6% in Jan 2022 from 5.62% in December 2021.

Commodity prices are expected to remain at elevated levels, which will mean impact on consumption, savings & inflation for economy. Central banks globally will have a new challenge to face with inflation as well as slowdown in the economy. For India it is a big challenge as we import 85% of our oil requirement along with the rupee depreciating to ~77/USD. Every \$10 per barrel increase in crude prices leads to an additional \$12.5 billion deficit – roughly 43 bps of India's GDP.

By raising rates, it will increase cost of funds for everyone especially RBI who will have to borrow substantially higher amount compared to normal year according to their borrowing calendar. Paying higher interest cost would leave less money to spend on Capex. India needs to ensure that we stick to high growth to counter the inflation shock to some extent.

We also hope that oil will correct on demand destruction and inflation will come off in the second half of this year.

Cost of Material

Due to higher commodity prices most of the companies will face challenge of cost absorption. Mainly it means lower margins if it is not passed on to the customers easily. Lower margins would mean lower earnings growth, so lower P/E multiple. We may see some adjustments in PE of many companies hereon.

FPI Selling

FPI have sold over one lac crores in this calendar year already and about 2 lac crores in last 5 months. Though markets have corrected a lot, mainly large caps owned by FII, midcaps remained relatively less affected as compared to the large caps.

	Gross (Rs.in Crs.)	Net (Rs.in Crs.)
Jan,22	182,524	41,346
Feb'22	181,983	45,720
March '22 till date	59,661	26,096

We are still wondering why they are selling so heavily after all the bad news is out. This is definitely different kind of selling India has ever seen in the past. It is possible that they are still “in-the-money” in India after making good gains in last 5 years where they look to book profit and reduce exposure.

Market will not go up unless FPI stop their heavy selling, as the quantum is difficult to absorb by the domestic players

Market Valuation :

Due to FPI selling large cap, Nifty 50 is looking much cheaper than midcap index.

Nifty has broken its technical supports and further correction is not ruled out. One must keep in mind that stock prices may not move in tandem with the Index. Just to give an example that prices of many stocks on 24th Feb.2022 fall are much below current levels. This happens when there is basket selling or trigger of stop losses.

Once the war ends, we will see sharp bounce back in the market and from the long-term point of view, market has finally come to a reasonable valuation level. Most of the global markets including India are at their 10-year average PE multiple.

Macro Factors :

Economy is opening up and all micro indicators will slowly turn positive. GST collection for Jan'22 & Feb'22 have shown remarkable comeback.

Now one can see all airports, highway traffic and travel has picked up. Wedding season is in full bloom and removal of restrictions on events will act as catalyst.

Diesel and Petrol consumption (even at elevated level of prices) power consumption and overall pick up in rural consumption is good indication of economic health. Oil can play spoilsport if crude prices remain above 100 USD barrel in the international market. Currency is still stable though depreciated to Rs. 76 plus. On the other hand, which helps exports. Fiscal deficit and current account deficit management will be a challenge.

Investment Strategy

We feel those who have already invested to the desired extent may wait to become overweight on equity. We really do not know how this war is going to end. For people who are coming to equity markets for the first time then this is an opportunity. We feel one can wait for market to stabilize more to invest a chunk, though one can invest small amounts on a particularly bad day.

This is more to do with getting at lower level/prices as we feel even at current level there is nothing to lose in the long term.

It is better to allocate fresh money in gradual manner. One can wait till clarity emerge and FPI to stop selling. We have UP election results on 10th march, which is important from 2024 election perspective.

Ideally Balanced Advantage Funds where equity allocation is dynamically managed. Multi asset funds, large cap funds and flexi cap funds will make sense.

We said in our note dated 24th February 2022 that even if the prices have corrected, wait till dust settles and clarity emerges.

Fixed Income

With inflation, bond yields are bound to rise. RBI is in dilemma over hiking rates as no one priced in this war a month ago.

War like situation is going to have an impact on few businesses and Govt. finances. RBI has to tread with caution while charting its path.

There is now a fear of credit crisis with some large countries like Ukraine suffering huge losses, and sanctions being imposed on Russia. Global trade & trade settlement is going to be a challenge. Most of Europe depends upon Russian oil/gas will face different challenges.

RBI may not achieve its divestment target for this fiscal with LIC IPO being pushed to next financial year, hence fiscal deficit is likely to be higher than estimate. With additional pressure on fiscal and current account deficit with rising prices, bond yields likely to rise even further.

We believe staying in short duration funds or even overnight funds. Arbitrage funds may not do well for this month but once markets turnaround than just going one way, arbitrage offers a tax advantage over the rest.

We will try & communicate again whenever we find things have settled down and even the technical indicators turn positive for buying equities. There is no harm buying some beaten down fundamentally good stocks even now.

We are also arranging concalls with few market experts who have handled last six months (very challenging period) very successfully.

Conclusion

1. Having discussed everything, war will hopefully end. India will still remain the fastest growing economy in the world.
2. Stock markets are already pricing in most of the risks at current levels
3. Equity as an asset class will still give better returns from current levels in the longer term
4. Oil may not sustain at current level as OPEC countries will start producing more oil at current price levels.
5. In the long-term fundamentals matter and Indian economy and companies are doing much better in terms of business operations (though margins may remain under pressure for some time)
6. Opening of economy travel and international business benefit is yet to come. This will help India to do better going ahead.
7. Thus, gradual allocation to equities with every fall will help you to build good portfolio. Stick to large caps at this stage as valuation is attractive and margin of safety is higher.

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