

Market Outlook

April 2021



Equities

The month of March was very volatile and the Nifty ended with a monthly loss of about 0.50%. Foreign Portfolio Investors continued to remain sellers in this month on the back of rising US yields. In this issue of our Monthly Market outlook, we have penned down what the equity markets have in store for the upcoming month and how best we can manage this volatility.

Let us look at some headline numbers – important amongst which are the final direct tax collections which stood at Rs. 9.18 Lakh Crores which is approximately, Rs. 1800 Crores higher than the revised estimate. In absolute terms, while corporate tax was lower than the last year by 6%, personal income tax showed an increase of 2.5% over last year. One of the reasons for higher individual tax collection, could be on account of higher capital gain tax due to substantial rise in the markets along with change in dividend tax policy. These numbers also factor in the business losses and many logistical hurdles which India Inc. faced last year. However, with the result season starting soon and the GST collection number (Rs. 1.24 Lakh Crore) coming in, we believe that the Q4 numbers would be in line with market expectations.

Globally, equity markets were down as the US Treasury Benchmark yield rose to 1.71% for the first time in the last two years. Fed has announced further support of about USD 2.30 Trillion in its last meet. This has helped global equity markets to stabilize in the last few days.

Nevertheless, we will continue to see a lot of value buying, the commodities cycle helping commodity stocks to rise further and a general tilt towards defensive stocks. Accordingly, you may see IT, consumer durables, pharma and specialty chemicals to do well in India.

We expressed fear about the second wave of the Novel Coronavirus (COVID-19) – on which the nation is yet to get complete clarity. We are not experiencing a nationwide lockdown as of now, but we need to be watchful with past experience of rising COVID cases. Mostly, the Government should be able to get a decent percentage of the population vaccinated by June 2021, which may coincide with a downturn of the curve.

One needs to brace for volatility in the equity market for the next two months. There is absolutely no need to panic and it's a great time for long term investors to build or rebuild the portfolio. Looking at the nature of the volatility which has become common and more frequent, one needs to keep booking profits at regular intervals. You will see alpha generation if this is followed by keeping an eye on the valuation levels of the market.

As on 31 March 2021, Nifty delivered a staggering 70.87% returns on a trailing one-year basis, which was the second best in the decade after 2010-gain of 73.76%. Only a handful of large and multicap funds were able to beat these Nifty returns. The difference between various schemes is also surprisingly huge, ranging between 20% to 30% considering the funds with decent corpus.

However, if one computes the annualized returns for the entire period from 1 March 2020 to 31 March 2021 (normalized period capturing both the fall and the recovery instead of capturing only recovery) then one can see that the same drops to the range of 21% to 30%. Thus, looking at Nifty returns for last 12 months trailing as on 31st March does not give a correct picture. We want to make a point that one can replace the part of the large cap allocation with Nifty ETF (to a certain extent) going ahead and flexi cap, midcap and small cap funds will certainly add a lot of value.

In the last financial year, it is important to note that FDI which has been pumped in was Rs. 2.74 Lakh Crore or about USD 35 Billion whereas DIIs and Mutual Funds were net sellers. The next two months will allow you to nibble or undertake a systematic transfer plan ('STP') to witter out any likely volatility.

Looking at the dollar index, FPI flows, local news, risk of partial lockdowns and the rising cost of money – the equity market valuations might see a new benchmark setting.

On the positive side, as mentioned above, there have been robust tax collections (direct tax and GST). Rise in exports and imports, lowering of oil prices from its peak, sustained commodity prices are signs of a recovering economy and continued Government efforts to support the economy, improved manufacturing activity will certainly yield good results.

Thus, 15% to 20% returns over the year are possible from equity allocation – if India manages to avoid another complete lockdown.

Fixed Income

Indian Benchmark 10-year paper moved in the range of 6.12% to 6.20 % in the last month on the back of news flows. RBI, center decided to continue with 2-6% inflation target (CPI).

Looking at the demand scenario and constituents of CPI, we feel that RBI may not react immediately as good monsoon and a second wave of Covid would keep prices under check. Oil inflation may lead to overall commodity price rise and we need to gauge the extent of this impact.

Carry of most of the bonds, banking and PSU funds, medium term funds have started moving up slowly. One can certainly place their bets for an investment horizon of 3 – 4 years with good quality, long term and medium-term funds than waiting on the sidelines. It was important to get an additional indexation benefit by investing in March than wait for rates to go up by 100 bps in a fund with a carry of 6-6.5% and modified duration of 2-3 years. We will completely avoid any credit risk funds at this stage if India gets into similar nationwide Covid wave again.

Markets are still divided on the likely impact of the huge borrowing program where in the first half of the financial year the central government will raise 60% of its planned borrowing.

Thus, it will borrow 7.24 lac crores till Sept 2021. Most of the analysts expect benchmark yield to move between 6.10% to 6.5% during this financial year. Looking at current yield, market is factoring one rate hike already. We feel short term yields may go up first and long-term yields will go up very gradually.

It is interesting to state that we have been very conservative about our views on perpetual bonds simply because they have been bought to push the yields of the funds by MFs. Thus, action from regulator was eminent and welcome.

Change in valuation norms will have large bearing on modified duration of the funds and will bring in huge volatility in NAVs and performance.

We are having a negative real interest rate cycle where overnight rate is around 3.35% and if you remove food component from core inflation then CPI is much higher (more than 5%). Thus, rates have to go, RBI will keep on removing extra liquidity from the system. Thus yields going up is inevitable across the curve but we don't expect taper tantrums like we saw in 2013 as state of economy and underlying economic conditions are different.

Happy to discuss further.

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