

# Market Outlook

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*What expect from economy?*

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## Economy

We would like to do the current month outlook in a slightly different format than sticking to traditional one. We prefer to cover different points which are more relevant for the month ahead with some data points



## EQUITIES

### Market Valuation

Equities recovered 95% from the March lows, hitting new high by crossing 15000 on Nifty. It is likely to face some resistance at this level.

The threat of increasing Covid cases and high inflation is likely to dampen the mood on Dalal Street.

There has been decent catch up in midcaps and smallcaps now which bridged the valuation gap with respect to large caps. The S&P BSE Sensex rose 2.6 percent while the Nifty50 rallied 2.8 percent for the week ended March 5, compared to 3.05 percent

gains seen in the S&P BSE Midcap index, and 3.8 percent surge seen in the S&P BSE Small cap index in first week of March.

Some smart investors have resorted to booking profits and keeping cash in the portfolio. We may see some corrections owing to sharp bouts of profit taking in near future.

Market is trading at 21 times forward earnings which is slightly expensive provided global interest rate scenario doesn't change fast causing global sell off in equities.

## Economic Indicators

- FDI rises more than 40 % to \$51.47 billion in the months from April 2020 to Dec 2020.
- Urban unemployment rate falls to 2 year low in Feb 21 to 7% vs. 8.08% the month before. 12 million additional people found employment in Jan 2021.
- Goods and service tax collections in February clocked Rs 1.13 lakh crore, up 7% from the same month last year
- RBI report on the state of the Indian economy too was very resilient. Economic growth is currently supported by fiscal and monetary stimulus, vaccination drives and pick in demand.
- Farm output will continue to add to the growth along with a firmer manufacturing output.
- Oil consumption up 16% in spite of higher fuel costs and tax rigidity, indicate positive economic growth Y-o-Y basis.

## FII Activity -

FII activity is an important indicator of market trend, as new flows apart from SIP numbers (which have remained more or less consistent at Rs. 8400 crores per month) can come from FIIs which decides the trend. Though FIIs have sold on a few occasions in 2021, they remain net buyers of Indian equity to the extent of INR 51,025 for the first two months of this calendar year. There are positive indications for 2021-22 as most of the Emerging Market Funds are attracting new money.

## Corporate Earnings-

Corporate earnings for Q3 were more than expectations on a broader base even as quarterly profits for BSE 200 companies jumped by a record 56% on a Y-o-Y basis. (138 out of 180 companies showed increase in profits)

Moodys upped their GDP growth forecast for India FY 22 to 13.7 % versus the previous estimate of 10.8%. GDP for FY 21 expected to grow at -7% versus earlier estimate of -10.6%. Thus, we don't expect any surprises from corporate earnings with boost from Government like the PLI scheme, or ARC and Bad bank introduction for the financial sector, etc. According to the PM's latest address, PLI scheme is estimated to boost domestic manufacturing and exports by ~\$520 billion in the next 5 years.

Even the PMI India Composite (indicative of private sector activity for manufacturing and service industry) came in at 57.3 in Feb 2021 vs. 55.8 in Jan 2021. This was due to better demand pick up and any doubts regarding a pent-up demand factor disappeared after this quarter results. It is indicative of cyclical recovery.

## Inflation-

Recent price rise in commodities has taken everyone by surprise with half of the global economies still coming out of lockdowns and second wave of the virus. Oil is adding to fuel to the fire as OPEC extended production cuts.

The market is currently divided, where most of them believe it to be more of a supply side issue where other faction is talking about commodities super cycle. We feel only time will tell the truth, but if it's going to be commodities super cycle it will be harmful for the equities. Inflation is on the raise due to economic recovery and we expect it to remain in comfort zone of Central Bank. Currently, Food Inflation tapering off in early 2021 at 4.1% in Jan 2021 from 6.9% in Nov 2021 and Core Inflation is at 4.06% in Jan 2021.

## Long Term Trend

We do see a robust profit growth for next two years for India Inc. provided we avert lockdowns due to second outbreak of the virus and push out vaccinations efficiently. Equities remain strong with some short to medium term volatility. We expect few more sectors to join the party with vaccinations aided by international travel resumption.

In the long term we do see equity to emerge as best asset class again. It is for the first time retail investors hold 8% of the market capital followed by about 55% promoters and rest by FIIs and DIIs.



## Fixed Income

### A) Interest Rates

Over the last year, RBI initiated several programs to enable ample liquidity in the system and continue an accommodative stance to support the economy. Mostly, there has been no change in the interest rate by the RBI which is an indication there is a pause on any further interest rate cut post the last Monetary Policy Committee meeting.

The Union Budget provided for an additional Rs. 80,000 Crs of borrowing for the month of February and March 2021 and again a gross borrowing program as large as Rs. 12 Lakh Crore (gross) and Rs. 9.70 Lakh Crore (net) for FY 2021-22. The Market

seemed not ready to believe that this can be done without disturbing the yields and the yields on the 10 Year G-Sec soared up from 5.85% to 6.22% in the past two weeks. The RBI will try to use various tools to indicate the Market whether it is comfortable borrowing on the 10 year paper – however, right now all indicators are pointing out to less than 6% for the 10 year paper, is what the RBI feels.

The US Bond Yields have also shot up from 0.90% to 1.60% on the wave of the inflationary trend backed by the economic activity which is also picking up. Most of the PSUs and the private corporates have avoided borrowing at elevated yields and it will be interesting to watch where the yields finally settle.

#### B) Divestment

The Department of Investment and Public Asset Management ('DIPAM') is very active and the Finance Minister is confident of raising the divestment target. Actually, post the Budget, the valuation of all PSU Companies' has gone up by 30% to 40% on an average – which could potentially mean achieving an even higher target than indicated by the PM Modi of about Rs. 2.25 Lakh Crore - which could be feasible if LIC IPO is done on time.

#### C) Banking System

With the surge in the deposit growth, banks may not rush for deposits this March. Credit growth is still to pick up pace and private banks with a retail focus are doing well as of now.

The NPA cycle fear is not over completely as we have seen a lot of stress on the unorganized and MSME sector during the lock down. It will be interesting to watch out for the Q1 of FY 2021-22 for the real health of the banking system. We continue to prefer larger private sector banks and large NBFCs' in consumer finance.

#### D) Gold

Gold has been declining throughout this year and touched a low of Rs. 46,000 which meant a decline of about 7% in the last couple of months. The demand of gold in India and China – which are the two largest consumers - is on the decline. Further, limitation on international travel has restricted alternate channels of gold demand. Low key weddings and other ceremonies too has lowered the demand for gold.

The strength of the dollar with the pick up in the US Economy, has also impact the fall in the gold prices.

#### E) NPA Expectation

According to a recent CRISIL report, they expect the following NPA's sector wise – and these very numbers will intimate you what we can expect going ahead.

Sr. No.	Particulars	Rate
1	Gold Loans	1.10%
2	Home Loans	1.80%
3	Unsecured Loans	9.10% to 10%
4	Car Loans	3.00%
5	Real Estate Loans	15% to 20%

Per this report, stressed assets of non-banking financial services companies (NBFCs) are expected to reach Rs 1.5-1.8 lakh crore, or 6.0-7.5 percent of the asset under management (AUM) by the end of the financial year 2021.

#### F) Debt Investment

We expect the debt markets to remain challenging for the next few months. The Government will finish about 70% of its borrowing by September 2021 and thus we can expect hectic activity for the next 6-7 months. Tussle between the RBI and the primary dealers is on and they recently offloaded certain amount at a discount, in the market. The 10-year G-Sec is at 6.22% and the sheer size of borrowing is putting pressure on the yields though inflation has cooled off for the time being.

Oil and commodities will continue to be in radar with regard to the inflation. Separately, it is critical to note that for the first time, dividend yield is lower than bond yield indicating stress in equity valuation, if one goes per history.

We feel that one can wait in the 6 - 7-month bonds for the time being and then take a call on locking money for the long term. Alternatively, medium term or floating rate may be considered by the long-term investors.

Another school of thoughts are of the view that Govt may not borrow as expected and would cut borrowing by canceling couple of auctions on account of improved finances and tax collections.

Some useful numbers in relation to the debt market are as follows:

Sr. No.	Particulars	Rate
1	Repo Rate	4%
2	Reverse Repo Rate	3.55%
3	WPI	2.03%
4	CPI (January provisional)	4.06%
5	USD/Rs Rate as on 5 March 2021	72.7572

The current liquidity provision of Rs. 12.9 Lakh crore (amounting to 6.3% of the nominal GDP of 2019-20) since February 2020 has kept the systemic liquidity in check which has eased the domestic financial conditions.

As per the decisions taken in the last monetary policy committee meeting the repo rate has been kept unchanged at 4% and the reverse repo rate at 3.55%. The MPC has reiterated that it will continue its accommodative stance as long as necessary to revive growth.

However, the bond yields paint quite a contrary picture. Bond Yields have seen an upward trend with the 10 Year G-secs touching almost 6.20% last week, which is the highest since April 2010. The RBI has tried very hard to keep the yields in check, so that the Government can borrow money cheaply. However, ever since the Union Budget it is seeming that the investors are not obliging the RBI. The excess in supply (The government has already borrowed more than Rs. 13 Trillion from the market and the states have borrowed an additional Rs. 10 Trillion) surpasses the demand, leading the prices to fall. A fall in prices conversely leads to an increase in the bond yields. And an increase in the yields means the Government cannot borrow money cheaply anymore.

A rise in the G-SECS raises the over all interest rates for borrowings in the economy i.e. banks make their rates costlier. Further, any new issues of corporate bonds shall



face demand for higher interest rates to meet the corporates' financial needs (for example, if the secondary market. This impact the profitability of the companies, who have recently so shown improved financial performance. Being a crucial input cost, rising yields tend to push up the overall cost in the economy.

The RBI is presently hesitant to sell the bonds at the current yields being quoted. However, it has continued with aggressive buying so that the market can offload old bonds and subscribe to new ones. We believe that the RBI may continue to push for lower yields by supporting the Bond Market through upcoming OMO purchases and Operation Twists. The RBI will have to delicately balance the rising inflation and the liquidity along with the oversupply of bonds.

On the inflation front, the WPI inflation in January 2021 stood at 2.03% from 1.22% in December 2020. While, the CPI lowered to 4.06% in January 2021, after breaching the comfort line of 6% last month. This decline in the headline inflation could be on account of deflation in vegetable prices and cereal prices with kharif harvest arrivals and a consequent fall in the prices of meat and eggs. The base effect of the vegetable prices could be instrumental in keeping the food inflation in check for the coming months as well. However, one cannot rule out the spike which may happen in the summer months in vegetable prices.

On the global cue, the rising interest rates in the USA have partially spooked investors by rising to around 1.5%. If one views that the interest rates are rising because of the growth in the economy post opening up after Covid, it may be a fair assumption because pre-Covid the rates hovered around 1.8%. Good economic recovery with the yields reverting to what they were could be a possibility – but with the increasing rate of infections and hospitalizations in the U.S it may be wise to be cautiously optimistic of this view. Another reason could be the resurgence of inflation in the USA, which was indicative when the Federal Bank bought about the change in its inflation estimates to an *average of 2% from a 2% target*.

Further, the Federal has reiterated that they will continue their accommodative stance and are in no hurry to withdraw its stimulus from the market anytime soon – and when it does happen, the process is expected to be gradual. It is important to be mindful of the factors that are driving this yield curve in the USA, as ultimately it could affect the equity flows into the emerging markets as well.

Speaking of flows into emerging markets, it is important to note that in the year of 2021, FPIs have pumped in a net of Rs. 44,379 Crores up to 5 March 2021 in equity markets and have withdrawn a net of Rs. 14,601 Crores from the debt markets. This has been in the backdrop of the Budget announcements which has placed renewed hope in Indian equities. The decline in the number of infections, a strong vaccination program led by the Indian Government, growth in earnings of Corporates further support this inflow. Trends prove that the FPIs are interested in banking and IT stocks, after a strong pharma rally last year. Although the trends seem encouraging, FPIs may continue to book profits in a rising market which could impact retail investors.

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