PRELIMINARY ON EQUITIES-

As we continue to witness the volatility of the Indian Markets, decent correction in the month of October 2021 made markets take a breather from the bull run. Commodity prices wage inflation , higher oil prices, higher container freight and port conjunction coupled with supply side disruption like coal, power outages, etc. has raised many questions about the rally in the markets leading up to the month of October 2021

Results season so far has been a mixed bag but not indicative of any strong upgrades in coming quarters.

Key macro indicators are showing positive trends, consumerisation will help to sustain demand, Revenue growth on upward trajectory across industries, deleveraging of corporate Balance sheets and improving asset quality of banks gives some respite on the credit quality. Nifty earnings growth is expected to be in the range of 10% to 15% for FY.2021-22

Markets have given returns of almost 38% on Nifty 50 since last Diwali whereas Midcaps and Small caps have gone up about 63% and 83% respectively. Midcap and Small Caps are more expensively valued than large caps currently. Thus, risk-reward is against Midcap and small cap though certain Midcap stocks can still outperform large caps judging by their growing market share and earnings growth numbers this quarter.

NEXT PHASE OF INDIAN MARKETS-

As discussed earlier, easy money-making phase is over, and Nifty is fairly priced at 22 times of 2022-23 earnings. Thus, there is no room for error. Indian consumerization theme is looking good where we see 10% minimum wage growth and coupled with government efforts in terms of PLI Schemes where we have 13 schemes projected with 10 billion dollars investment in the first 2 years and 30 billion in total investment expected by 2024-25. India is also expected to attract fresh investment under China plus one policy adopted by Global majors.

No sign of third wave is excellent news and other economic data like credit card spend of Rs.80,473 crore in September (jumping 57% y-o-y) compared to Rs 77,981 crore in August with 1.09 million new cards added is big news. India is a consumption driven domestic economy. Therefore, demand will set off the impact of rise in commodity prices. Fed tapering may be just a passing phase for us with no real impact except for FPI outflow . Another positive number to watch is the Corporate Earnings to GDP ratio which 4% improving from 1.9% during pandemic times. We have reached this ratio of INR 8.4 trillion against GDP of INR 210 trillion after 2011-12 in percent terms.

VALUATIONS

We suggest focus on large cap with relatively lower valuation. We have seen valuations of many stocks running up beyond its fundamentals, and with a market correction these stocks are expected to correct their decent valuations. Avoid places of unreasonable valuation and book profit, moving to large caps at fair valuation.

Markets will not be able to sustain like this and in the long term two most important things which matter are fundamentals and valuation.

Some stocks are trading at very high valuations and Q2FY2021-22 growth was not that supportive. These stocks have corrected quite a bit and we opine that further correction in these will continue. Also keep in mind the inflated raw material prices, fuel costs, wage costs which will continue to impact margins.

Better industry according to us, for investment, is banking (selectively) , IT majors, pharma, NBFC and service sector, which is expected to benefit with opening of economy [logistic, travel, hospitality, etc.]

CONCLCUDING STATEMENTS ON EQUITIES

We are cautious in short term and very positive in medium to long term. In the long run equity will still emerge as best asset class despite current run up

One must moderate their return expectations to around 10% to 15% from Sensex or Nifty and try to remain as stock specific as possible (bottom-up approach). We don't expect big correction or earnings downgrade as most of the vulnerable sectors and cyclicals have shown significant deleverage and improved profitability e.g.- Telecom, auto, commodities, textile, infrastructure where losses have shrunk.

Most of the sectors have reached pre-pandemic level in terms of demand and volume growth

Consumption is on roll with huge financial savings and banks, NBFC have seen good pick up in retail loans in the last quarter.

Corporate loan has shown pick-up but overall things are still well capitalized. It will take some more time for corporate loans to pick up. Fresh investment in equity should be strictly in staggered manner and equal weight asset allocation at this stage.

Since our long-term view on Indian equities remains quite positive, we don't see a need to shuffle in any existing equity mutual fund allocation.

GOLD

We had numerous queries around gold last month. Let's put things in perspective. Gold is seen as a hedge against inflation and used when there is uncertainty around other asset classes specially when the growth is muted, equities are down along with commodities, and there is no risk of currency volatility too. Gold doesn't have any coupon except for 2.5% now paid by government on bonds. Thus, we always look at capital appreciation in case of gold.

It has given -5.90% returns last year showing significant underperformance against other asset classes. Looking at demand for gold globally, people bought ~ 1000 tons in 2020- 2021 as pandemic began through ETFs and now investors are exiting these ETFs and outflow is as high as 7% on YOY basis.

On the other hand, demand for jewelry as well as Central Bank's investment in gold is expected to go up and this will compensate fall in gold to certain extend. Thus, gold if at all someone want to hold will be 5-year asset class and best used for hedging against inflation. In the longer run it has potential of matching debt fund returns.

FIXED INCOME

Inflation has gone up significantly where in Sept CPI was 4.35% and WPI was 10.60% on account of higher commodity prices. Brent is at 83.74 USD and inflation fear in real globally if commodity and oil doesn't cool off. Government deficit at 6.80% for 2021-22 is achievable looking at divestment/privatization schemes. Tax collection is also decent, and economy seems to have gathered pace.

Government borrowing cost was lowest in the last 17 years at 5.79% and average maturity of primary issuance is at 14.49 years as compared to 16.15 years in the previous year. which is pretty good.

BOI held rate hike and US Fed has started to taper bond buying with 105 billion as against 120 billion USD. Bond yields are likely to go up globally.

Most of the inflation is on account of supply disruption (coal for steel production) and economic recovery is underway. We sense 10-year bond yield will move up slowly from 6.35% to 6.5% as short-term rates have already started moving up (call rate at 3.45%)

- 1 year GILT 4.20% against 4.06% 1 month ago.
- 5 years GILT 5.88% against 5.79% 1 month ago
- 1 year CP 4,80% against 4.50% 1 month ago.
- 1 year CD 4.35% against 4.28 1 month ago.

- 3 months CP 4.36% against 3.95% 1 month ago.
- 3 years GILT 5.13% against 4.97% 1 month ago

We advised to remain in liquid funds in the last month and this has avoided any MTM losses as yields have moved up across the board, one may look at floater as only option besides liquid funds for the time being,

Diesel prices along with commodities are likely keep WPI & CPI at elevated levels, thereby making RBI into difficult to take call on rates and even bond buying from secondary market.

We foresee hardening of yields to continue for next few months though speed will be muted and much depends on inflation trend and actions taken by global central banks