

Pranitya Wealth LLP

Market Outlook

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Overview

The markets have achieved new record highs at the end of this month, with Nifty crossing the 24,000 mark and Sensex reaching 79,000. The final leg of the rally was swift, as anticipated, with large-cap stocks moving up, although many remain below their 52-week highs.

Nifty returns

As of June 29, 2024, Nifty delivered a 26.5% return over the past year. Other indices, except for Banking and Finance, delivered significantly higher returns, highlighting the performance gap between large-cap and midcap stocks:

Nifty Midcap: up 56.91%

Nifty Small Cap: up 69.74%

Nifty Realty: up 113.58%

Nifty Energy: up 70.90%

Bank Nifty: up 18%

Nifty Finance: up 17.73%

Is it time to exit mid and small caps?

A couple of years ago, Nifty midcap and small cap stocks were undervalued. Now, their valuations have caught up and they trade at a 30% premium to large caps. Despite this, there are still some opportunities in the mid and small cap space. However, we recommend considering a reduction in exposure to mid and small cap at this level.

Macros

Inflation: Core inflation is decreasing at 4.7%, while food inflation remains high. However, a good monsoon could help bring food inflation down. In the past inflation targeting was popular and RBI used to base their interest rate movement on inflation number only.

GDP: In Q4, the reported GDP growth was 7.8%. The government is more optimistic for the next year. RBI Governor said India is slowly moving towards 8% growth.

IIP: The IIP data is impressive, with all eight core sectors showing positive growth.

Advance Tax Numbers : Tax collection till June 2024 surged 27.6% year on year to Rs. 1.48 lac crore, signaling a robust economy and strong corporate performance (Rs. 1.14 lac crore corporate tax and 34,362 crore personal tax)

Private Investment: Confirmation of revival of private investment is emerging from dividend payout cycle of spectrum of companies last year. The dividend payout ratio of 1300 companies slid to a nine-year low as they drew down surpluses for company expansion. Investment growth numbers are higher than Income growth even before government tapers its capex which means private growth is contributing significant amount

Current Account Surplus: We have witnessed CAS of 5.7 billion in Q4 of 2024 against deficit of 8.7 billion USD in quarter 3. Current account situation might improve going ahead with expected FPI inflows into Indian debt and equity markets

Fiscal deficit: The government is aiming for a 3% fiscal deficit through fiscal consolidation and windfall gains from PSU dividends, continuing its commitment to fiscal prudence. Though the Centre has set a fiscal deficit target of 5.1% for FY 2025 and 4.5% for FY 2026.

Oil : Stable oil prices throughout the year have helped the government in achieving its fiscal targets.

FPIs. : FPIs were net sellers in April and May, but in June, they bought a net Rs 26,565 crore of Indian equities following stability in the markets post-elections. However, for the calendar year, their net purchases stand at only Rs 3,200 crore, indicating potential for significant flows post-election uncertainty. Another factor expected to drive FPI investments into India, alongside other emerging markets, is the anticipated Fed rate cut in the second half of 2024, likely between October and December.

Bond Index : This month also marked the inclusion of Indian bonds in JP Morgan's flagship bond index for emerging markets, which tracks the total returns for traded external debt instruments in these markets and has assets under management of about \$236 billion. As announced in September 2023, the index inclusion of Indian Government Bonds (IGB) commenced on 28th June 2024, with IGBs receiving a 10% weight in the JP Morgan EM index. Bond Index could lead to inflows worth \$21 billion (Rs 1.7 trillion) worth of investments by 31st March 2025. 1% weight will be added each month from June-24 till Mar-25.

Areas Of Concern

We have observed order book stress in certain auto ancillaries, and dealer stockpiles are becoming a concern. The resurgence of auto discounts after a prolonged period suggests underlying challenges within the auto industry.

The IT sector's lack of hiring after a long period is concerning. Historically, IT has been a major employer in the country, followed by auto and real estate. A slowdown in IT hiring could potentially impact the auto and real estate sectors over time.

Secondly, the market is not factoring in any slowdown and appears to be in a state of complacency.

We anticipate that global IT budgets will increase following the Fed rate cut. We expect the first rate cut to be implemented by the Fed in November or December 2024. Thus, the period between July and October appears to be challenging as Q1 numbers are going to be flat as widely estimated.

What direction is the market heading in?

Equities have experienced a stellar run over the last 12-15 months, fully recovering post-election results. Looking ahead, we do not anticipate a similar trend. We believe the market will pause and await progress updates on the monsoon and Q1 earnings reports.

Valuation of small and midcaps have reached premium to large caps which usually is not the case. We feel large cap will improve further and midcaps and small caps will give up some part of their gains.

Sensex or Nifty may not experience a correction, but small and midcaps, which are not part of these indices, could undergo either a time correction or a price correction. We plan to invest cautiously, aiming for long-term targets higher than current levels.

Sectoral comments

The auto and real estate sectors are expected to pause after their significant returns. Banking and finance are likely to lead the next rally.

The power sector, especially government PSUs, may see selective gains.

Commodities are poised for a comeback, as indicated by recent trends in cement. We remain bullish on gold, silver, and other commodities this year.

Industries producing aspirational goods, such as white goods, interior products, luxury cars, and holiday services, are also expected to perform well.

Special Theme

We are waiting for one pre- IPO plus fund to get launched this month and will organize a call with the fund manager soon. We believe securing good allotments in pre-IPO and anchor stages can generate significant alpha in the fund, and we plan to invest in such opportunities. Quantitative investing has proven to be a successful investment style, and we are looking to allocate more to this approach. Additionally, we have noticed some traction in the business cycle and special situation investments and have started allocating funds accordingly.

Asset allocation

Please always keep asset allocation in mind. When your country is growing at over 7% GDP with a stable government at the center, it's an optimal time to allocate more to equity than debt, especially if your time horizon is 3 to 5 years. Under-allocation can hamper long-term compounding, and frequent changes in asset allocation in anticipation of any short-term volatility which can negatively impact long-term returns. Corporate earnings grew at the rate of 25% but the same may not be the case for 2024-25. They may remain around 14-15% and so will the return on equities as returns track earnings.

Budget

NDA government will walk the path of reforms. Budget is expected to be progressive and with no major changes in taxation. Agriculture as a sector will get priority and rural spent may see a higher allocation. The government will prioritize infrastructure spending, affordable housing and reforms in all factors of production to boost manufacturing and remove supply-chain bottlenecks. The market will approach budget with lot of caution.

Debt

Banking liquidity is set to increase with higher government spending, benefiting short-term bonds. The US Fed is expected to cut rates, supporting a dovish tone, while the 10-year G-sec may trade around 6.75%. Domestic bond markets remain fundamentally strong, boosted by the inclusion of Indian Government Bonds in JP Morgan's EM index. Improved bond supply dynamics could lower yields at the shorter end of the curve due to enhanced liquidity. Investors can consider gilt funds for short-term and long-duration investments, while short-duration funds are suitable for medium-term strategies.

Conclusion

Additional investment should be made using a systematic transfer plan (STP) strictly at this stage. It will be also advisable to move from small caps to large caps. Look for opportunities in undervalued and high-growth companies. Though the Indian market is in a structural bull run, it will inevitably create excesses on the way up. We have numerous examples of well-valued gem stocks and market leaders like HDFC Bank, Bajaj Finance, and Infosys that have not delivered any returns over the last three years of the bull run. These stocks had factored in all positive news, leading to subsequent price and time corrections. For those not actively seeking to generate alpha or not looking to take much risk on their stock portfolio, simply staying invested for five years in these large market leaders, and it will still yield incredible results.

Market are slave to earnings; we believe earnings of Indian companies are expected to grow and so will the prices and markets as a whole.

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