

Pranitya Wealth LLP

Market Outlook

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Overview

It gives us great pleasure to present our 50th communication to you, a milestone in Pranitya's ongoing educational efforts. Over the past 4 years and 6 months, we have also conducted 21 webinars covering various topics, including market views, budget analysis, succession planning, and alternative investment products. This is entirely proprietary writing, presented in simple language to share our views and key facts, helping clients make informed and prudent decisions.

Why is the market going up?

This is a million-dollar question, and we've addressed it point by point in our August 2024 letter. In simple terms, investors prefer low volatility and steady returns. The equity market used to be more volatile when Foreign Institutional Investors (FIIs) held a large market share. Today, equity holdings are more evenly distributed, which has helped reduce volatility.

The market has become increasingly stable, which is one reason why people who traditionally invested in bank deposits are now finding them less appealing, especially since they often don't offer real returns after inflation and taxes. As the cost of capital decreases, equities are becoming more attractive compared to other asset classes.

Currently, about 10% of gross domestic annual savings are being directed into equity markets, and this share is expected to increase. Strong domestic inflows are driving the market upward, supported by a stable government, favourable market conditions, and robust economic growth. The final factor contributing to the market's positive momentum is liquidity, which continues to provide the necessary push for sustained growth.

Are valuations justified?

We would like to reiterate that old benchmarks may no longer be relevant from this point forward. With a significant inflow of ₹2 lakh crore annually from SIPs, along with increased interest from FPIs, DIIs, trusts, NPS, and HNIs, market flows are expected to rise further. Considering the 12% to 14% earnings growth of Indian corporates and GDP growth exceeding 7%, the current valuations, though slightly elevated, are justified.

That said, there are areas in the market with stretched valuations. For example, sectors like defense, railways, and certain IT stocks appear overvalued. It's crucial to recognize that midcaps and small caps have seen significant rallies, so increasing allocation in these areas should be approached with caution. However, with healthier corporate balance sheets,

minimal new NPAs, and continued government spending, we expect sustained economic growth.

IPO Activity

In India, only 15% of businesses are listed, leaving substantial room for more companies to enter the public markets. This will likely lead to a significant decrease in capital raised by banks. Increased supply will help to moderate that valuation run up.

All IPOs, regardless of their quality, are receiving significant responses, whereas fundraising on the SME exchange has been less promising. Caution is advised when investing in SME exchange companies, with the main board being the preferred option. We do not anticipate a slowdown in IPO activity this year, which will help balance liquidity and supply.

Keep One Eye on China

We have been considering investing in China for some time. Despite its current economic slowdown, China's scale and size make it a significant player globally. Even with growth rates of 3% to 4%, China's economic contribution remains substantial, with a 30% share in global manufacturing and 10% in consumption.

Recent Foreign Portfolio Investments (FPI) have been selling off in China due to a slower-than-expected economic recovery. However, the market valuation in China is currently attractive. Timing the entry into this market could yield significant returns if approached strategically.

Gold and Silver:

We are optimistic about both gold and silver investments moving forward.

Gold:

Demand and Supply Dynamics: In 2023, gold demand was strong across ETFs, forex reserves, and retail. Both China and India significantly increased their gold reserves in 2024 by reducing dollar holdings, driving up gold prices, which closed at USD 2,566.

Import Trends: India imported \$45.5 billion worth of gold from 2020-2024. To curb smuggling, India recently reduced gold import duty from 15% to 6%. Despite this, India has seen a threefold increase in gold and gold jewelry imports and has now banned the import of gold jewelry.

Price Pressures: Gold supply remains uncertain due to aging mines and high extraction costs, ranging from \$1,000 to \$1,200 per ounce. The number of operating mines is decreasing, which is likely to push gold prices higher.

Geopolitical Factors: As the second-largest gold importer after China, India's demand, combined with geopolitical tensions, has contributed to the price increase.

Silver:

Industrial Demand: Silver's use in solar panels, electric vehicles, power generation, and electronics makes it a key industrial metal. Although current demand is subdued, it is expected to surge as China recovers.

Consumption Patterns: About 55% of silver is used in manufacturing, with 45% going to jewelry. This contrasts with gold, where 77% of imports are for investment purposes.

Outlook:

Both gold and silver are expected to perform well in the coming years. Additionally, clearer taxation rules could attract more investments into gold and silver ETFs, with a 12.5% tax rate applicable after holding for 12 months or more.

Interest rates:

Bond Market Overview:

10-Year Yield: The 10-year government bond yield has decreased to 6.86% from 7.05% in March 2024.

Term Rates: Call rates are stable at 6.5%, 364-day Treasury Bills (T-Bills) are at 6.72%, 1-year Commercial Paper (CP) stands at 7.9%, and 5-year AAA-rated bonds are at 7.5%.

Interest Rate Outlook:

Federal Reserve: The Fed is expected to cut rates in September 2024.

Reserve Bank of India (RBI): Given India's persistent high core inflation, the RBI might not immediately follow the Fed's move. However, improved monsoon conditions could potentially ease inflation, leading to rate adjustments later.

Investment Option:

Current Options: Listed bonds, Infrastructure Investment Trusts (InvITs), Real Estate Investment Trusts (REITs), and hybrid funds are attractive due to favorable taxation.

Corporate Strategy: Corporates may consider investing in banking and debt funds or long-term bond funds to benefit from anticipated yield reductions over the next couple of

years. Given the lower corporate tax rate, these investments may offer better post-tax returns compared to traditional bank deposits.

This summary provides a snapshot of current bond market trends and investment strategies considering the anticipated changes in interest rates.

Oil Consumption Trends in India:

Growth in Consumption: India's oil consumption has increased significantly from 3.23 million barrels per day (bpd) in 2014 to 4.5 million bpd in 2024, representing a 40% rise.

Economic Expansion: During this period, India's economy has grown from \$1 trillion to \$4 trillion, reflecting robust economic growth.

Oil Diplomacy: As the second-largest consumer of oil globally, India has effectively managed high prices through strategic oil diplomacy, sourcing oil from 37 different countries.

Impact of Alternatives: EVs, Ethanol, and Solar: The rise of electric vehicles (EVs), ethanol fuels, and solar energy has helped reduce some of the demand for oil. These alternatives have played a role in moderating oil consumption.

Where to Focus:

Economic Growth

Q1 GDP Growth: July reports indicate a real GDP growth rate of 6.5% to 7% for FY2024-25. This is a positive sign for the economy, reflecting robust growth.

Post-Election Activity: The Ministry anticipates an increase in economic activity following the elections, supported by improved business sentiment and fiscal consolidation.

Fiscal and Revenue Insights:

Government Spending: Government spending, which was constrained due to the elections, is expected to increase, supporting economic activity.

Tax Collection: The tax collection data expected on September 15, 2024, will be crucial. Strong revenue collections can bolster government spending and fiscal health.

Foreign Portfolio Investment (FPI):

Recent Withdrawal: FPIs withdrew investments in July and August. It will be important to monitor their actions in the coming months, especially following comments from Jim Rogers, who mentioned he missed out on India's opportunities.

Business Activity and Revenue:

July Upswing: Business activity saw an upswing in July 2024, supported by revenue collection and fiscal consolidation efforts.

Indian Macros

1. **Q1 Growth:** Despite Q1 GDP growth of 6.7% being below some estimates, it is noteworthy that the Gross Value Added (GVA) grew at 6.8%. Additionally, private consumption increased by 7.50%, showing a significant improvement from previous quarters.
2. **Net Tax Collection:** Up by 19.54% as of July 11, 2024.
GST Collection: Remarkable improvement with collections reaching ₹1.65 lakh crore, marking a 15% YoY increase.
Tax to GDP Ratio: Expected to hit a record high of 11.7% for FY 2024-25, surpassing even some developed nations.
3. **Foreign Direct Investment (FDI):** Increased by 26% to \$22.4 billion in Q1 of this year. This growth has significantly helped bridge the current account gap, which recorded a surplus of \$5.7 billion in Q1 of FY 2024-25.
Foreign Portfolio Investment (FPI): Also showing notable improvement.
4. **Economic Stability:**
Currency: The rupee remains stable.
Banking System: Stable with the lowest Non-Performing Assets (NPA) levels in a decade.
GDP: Surpassed \$4 trillion.
Oil Prices: Remain below \$80 per barrel.

Conclusion:

The improved economic indicators are driving investor confidence, resulting in increased investments in the Indian stock market. With the potential for Nifty to reach 26,000, and expectations for Q2 results to outperform Q1, the market outlook is positive.

Monsoon Impact: Expected to boost the rural economy, supporting higher consumption.

Long-Term Forecast: Barring minor corrections, the equity market in India is poised for moving much higher over the next 5 to 10 years, presenting significant investment opportunities

Key Highlights

- **Market Stability:** Reduced volatility due to diversified equity ownership; equities more attractive than bank deposits.
- **Valuations:** Slightly high but justified by 12-14% corporate earnings growth and over 7% GDP growth. Caution advised in overvalued sectors like defense and IT.
- **IPO Activity:** Positive outlook with more companies expected to list; prefer main board over SME exchange.
- **China Investment:** Attractive valuations despite slowdown; strategic entry could be beneficial.
- **Gold & Silver:**
 - Gold: High demand and limited supply; prices up due to geopolitical tensions and increased reserves by India and China.
 - Silver: Industrial demand expected to rise; currently subdued but set to increase as China recovers.
- **Interest Rates & Bonds:**
 - Current Rates: 10-year yield at 6.86%; Fed expected to cut rates; RBI may delay due to high inflation.
 - Investment: Favorable options include listed bonds, InvITs, REITs, and hybrid funds.
- **Oil Consumption:** India's consumption rose 40% over a decade; strategic oil diplomacy and alternatives like EVs moderate demand.
- **Economic Focus:**
 - Q1 GDP Growth: 6.5% to 7%; expected boost post-election.
 - Fiscal Health: Increased tax collections and spending; strong FDI and stable rupee.
- **Outlook:** Positive market growth anticipated over the next 5-10 years, with potential for Nifty to reach 26,000.

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