Market Outlook

Abakkus
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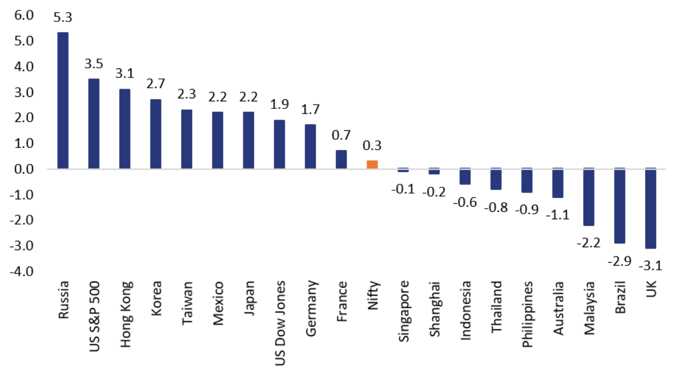
April 2023

Market Update

It was again a very challenging month of March, with news flows pertaining to global banking stress and stability taking precedence over everything else. The first half of the month saw a total risk-off globally as investors grew increasingly worried over issues related to Silicon Valley Bank and other regional US Banks and Swiss Credit Suisse survival. However, a combination of US Fed support and takeover of Credit Suisse by UBS allayed fears, leading to a smart recovery in equity markets. Surprisingly, most developed countries' equity markets ended the month with gains. All major US indices ended with gains, with Nasdaq rising the most. Indian markets also saw a better last week in March, with NIFTY50 managing a small gain of 0.3% for the month. Broader markets were generally weak with BSE Midcap and Small Cap 250 indices being down 0.4% and 1.3% respectively. After a long time, both FIIs and DIIs turned net buyers - FIIs to the tune of USD ~1 bn and DIIs to the tune of USD 3.7 bn.

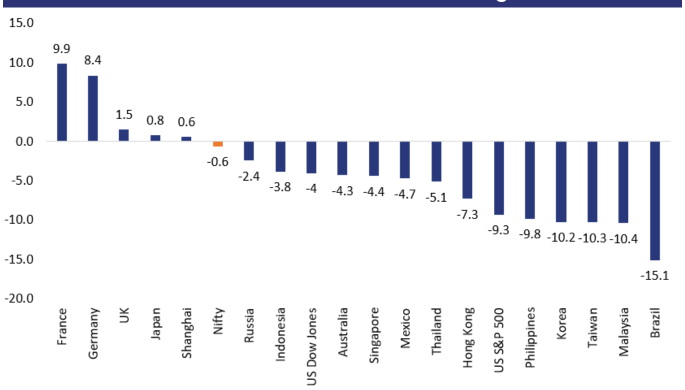
1 Month Performance of NIFTY50 Index versus global indices



Source: Bloomberg, Kotak. As on 31.03.2023, returns in respective country's local currency

For the financial year ended March 31, 2023, Indian equity markets ended flat. It was a difficult and challenging year with the Russia-Ukraine war, record high inflation, most aggressive interest rate hikes, bank failures and generally risk-off impacting all financial markets. In this context, the performance of Indian equity markets proved its resilience vis-à-vis the world, largely driven by the domestic nature of its economy.

1 Year Performance of NIFTY50 Index versus global indices

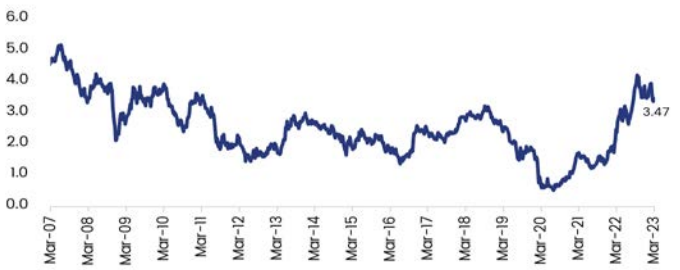


Source: Bloomberg, Kotak. As on 31.03.2023, returns in respective country's local currency

Macro Update:

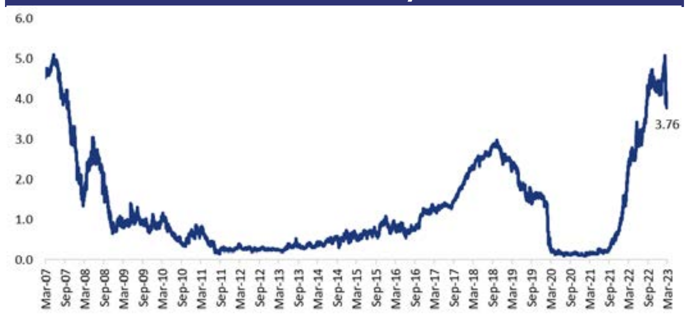
Interest Rates - Most central banks increased interest rates in March'23, with the Federal Reserve raising rates by another 25 bps to the range of 4.75% - 5%, the highest level since September 2007. Interestingly, the financial crisis in US banks was a result of sharp increases in bond yields and therefore huge mark-to-market losses in bonds. However, after the SVB blow-out, yields corrected sharply with US 10-yr yields now at 3.30% and US 2-yr yields at 3.76%**.**

US 10 Year G-Sec Yield



Source: Bloomberg Data: 31.03.2023

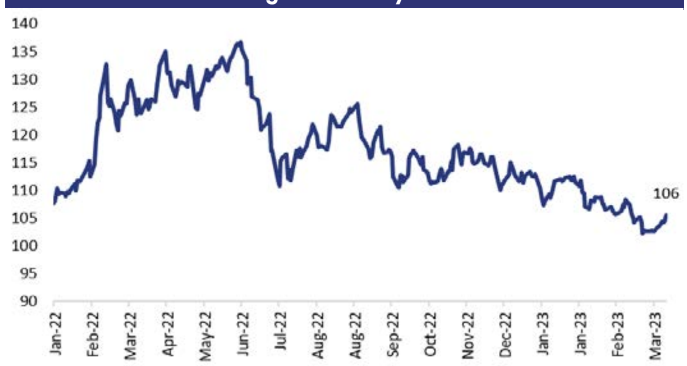
US 2 Year G-sec yield



Source: Bloomberg

In the wake of the banking crisis and slowing economy, markets are now pricing in a whopping 100 bps of Rate cuts by the end of 2023. The expected rapid cooling-off of inflation is also endorsing this view.

Bloomberg Commodity Price Index

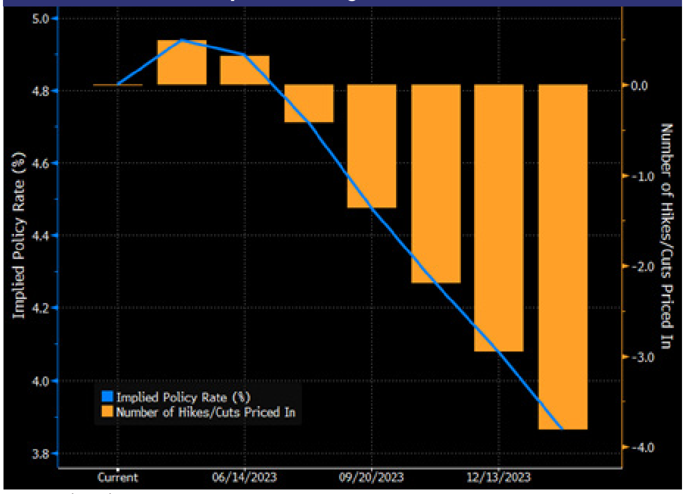


Source: Bloomberg

FY period: April-Mar, CPI: Consumer Price Index, WPI: Wholesale Price Index FII: Foreign Institutional Investors, GST: Goods & Services Tax, DII: Domestic Institutional Investors Fed: US Federal Reserve, IIP: Index of Industrial Production, GSec: Government of India Dated Securities, GOI: Government of India, FDI: Foreign Direct Investment, CAD: Current Account Deficit, YTD: Year To Date, CY: Calendar Year, WTI: West Texas Intermediate, UPI: Unified Payments Interface. Inflation numbers released with 1 month lag, Core Sector number released with 1 month lag, IIP number released with 2 month lag

Source: NSDL, PTI, ANI, Bloomberg, BSE, NSE, Abakkus Estimates, RBI

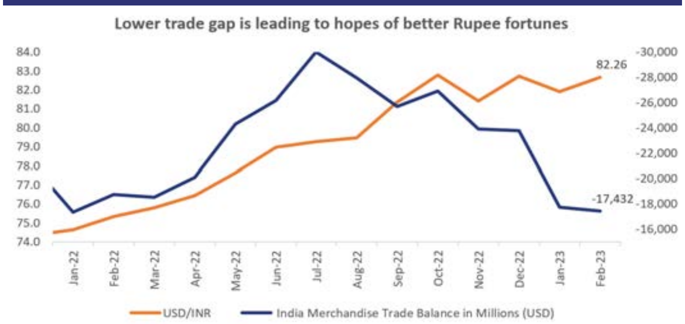
Estimated US Fed- Implied Overnight Rate & Number of Hikes/Cuts



Source: Bloomberg

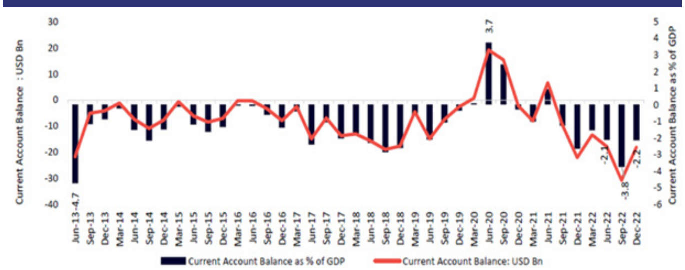
On the economy front, India's 3QFY23 Balance of Payment data confirms a positive trend for the external sector, which in our view will get further intensified in 4QFY23. Current Account Deficit dropped to 2.2% of GDP in 3QFY23 on the back of record service exports and remittances. The services trade surplus was strong at USD 14.6 bn in February'23, building on January's revised surplus of USD 13.8 bn. Services exports touched USD 30 bn in both January and February, an increase of about 40% on-year. Trade deficit has declined to lowest in thirteen months leading to hopes of better rupee fortunes.

India's Trade Balance



Source: Bloomberg

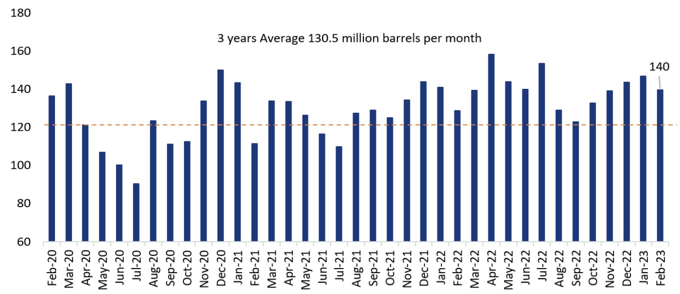
India's Current Account Balance



Source: Bloomberg, Nuvama

Brent crude price declined to USD 79.7/bbl in March'23 from USD 82.5/bbl a month ago. There was a surprise 1.16 million barrels per day (bpd) production cut announcement by OPEC in March'23 which flared up the prices else prices would have closed near USD 75/bbl levels. We stick to our stance that over the next 1-2 years oil prices are headed lower owing to slowing demand, rising production and the shift towards renewables. Softer crude prices may turn out to be the biggest positive for India, with import bill falling by a whopping USD 45 bn to USD 75 bn if average prices fall to USD 60 to USD 75 /bbl (Average crude price for FY23 for India was USD 94 /bbl).

India's Crude Oil Imports (Million barrel per month)



Source: Bloomberg

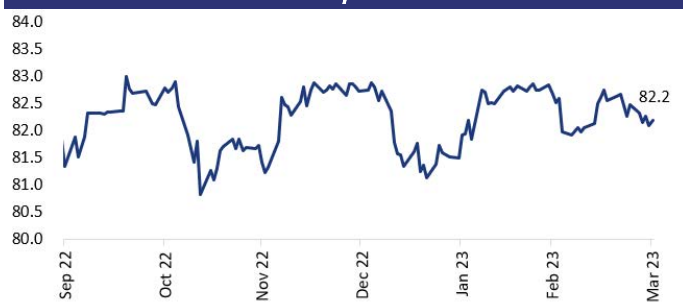
Owing to these favorable external factors, India has seen improvement in its forex reserves and INR currency is amongst the best performing.

India's forex reserves rise to over eight-month high

Source: Bloomberg Data: 31/03/2023

Another point to note is that Indian currency (INR) and Indian 10-yr yields used to spike sharply up whenever there was a hint of crisis in global financial markets. This was seen in 2008, 2013 and even 2017-18. This time, in fact, India 10-yr bond yields corrected a bit and even the Indian Rupee has seen sharp appreciation vs the USD post the SVB and Credit Suisse crisis.

USD/INR



Source: Bloomberg Data: 31/03/2023

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April 2023

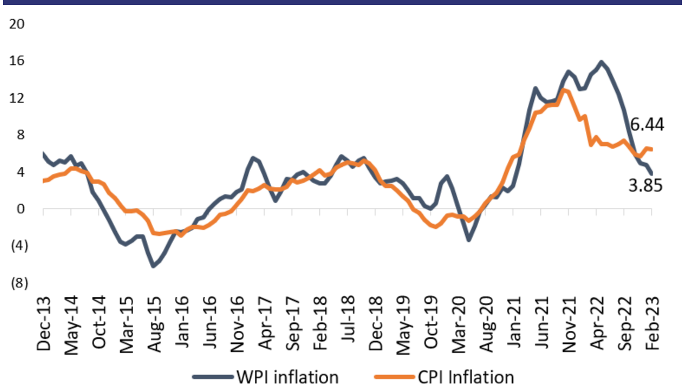
In India too in the bond markets yields have stabilized in the 7-7.5% range with expectations that we are nearing the end of the rate hike cycle.

India 10 Year G-sec Yield

Source: Bloomberg Data: 31/03/2023

In India, CPI inflation increased to 6.4% in February'23 from 6.5% in January'23. WPI inflation eased to a 2-year low with February'23 print at 3.9% vs 4.7% in January'23 dragged down by a fall in overall input costs. Cooling commodity prices too are contributing to lower inflation.

India Inflation



Source: Bloomberg

PMI rose to a 3-month high of 56.4 in March'23 from 55.3 in the previous month, topping market forecasts of 55.0. The GST collections continued to be robust in March'23 rising 13% YoY to INR 1.6 lakh crore registering second highest collection since implementation of GST in July 2017.

Market Outlook:

Year 2022 was a year of global risk-off. The first quarter of 2023 has also seen concerns led by banking crisis. However, we believe that the second half of 2023 should see a meaningful improvement in global macro-economic and growth parameters. Peaking inflation and the possibility of interest rate cuts are a possibility. Stability and recovery in consumer sentiment and spending are also visible, as household spend on energy costs comes down and normalizes. There has been a sharp surge towards risk-off assets, with gold prices crossing USD 2,000 per ounce. The all-time high AUM in US money market funds also indicates the safety-first approach adopted by global investors. Slight improvement in sentiments has the potential of huge funds flowing back to equity markets and India should also see good flows.

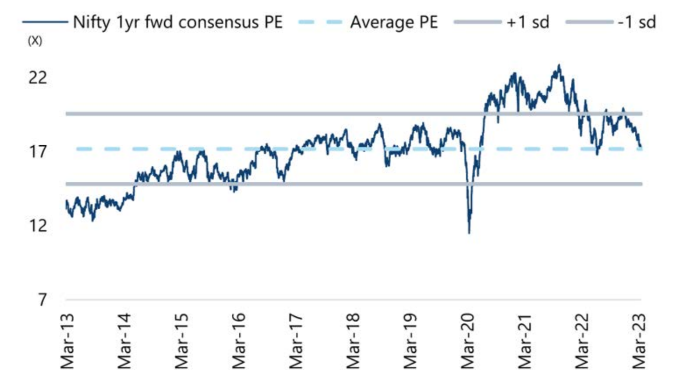
US Money Market Fund Asset (USD bn)

Source: Bloomberg

For Indian equity investors, the year FY22-23 was also very challenging with the war, interest rate hikes, high inflation, global banking collapses and sporadic cases of covid still lingering, playing their role. Equity returns were almost non-existent with heightened volatility. There have also been sharp sectoral churns with focus shifting to profitability in businesses in the high interest rate environment. There was also mean revision in most input prices and many companies had to give away their covid period gains. This volatility has come as an opportunity for value conscious style of investors like us as we get to accumulate and gradually build positions using this volatility.

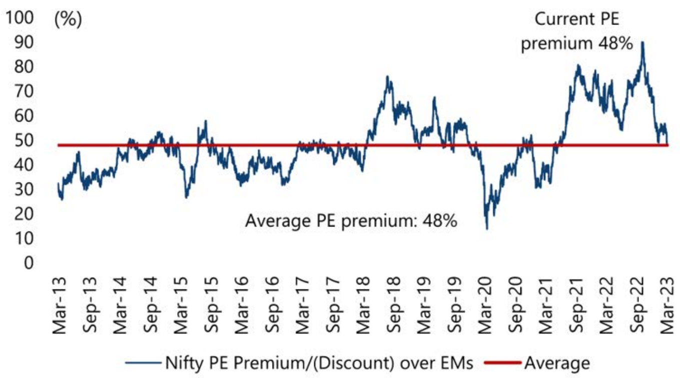
There have been no returns delivered by Indian equities over the last 18 months. This, along with the almost 25% growth in earnings during that period, has led to the valuations of Indian markets come almost to 10-year trend. NIFTY50 now trades at ~18x FY24 and ~16x FY25 earnings, providing opportunities to generate decent returns. The sharp fall in broader markets have also opened-up avenues to generate alpha over the market returns through investing in the less obvious names.

NIFTY50 Forward P/E



Source: Bloomberg

NIFTY50 P/E Premium/Discount over EM's



Source: Bloomberg

In the challenging global outlook, India stands out for the global investor. The potent combination of Democracy, Demographics, Domestic economy, and Digital Infrastructure; is being appreciated and that should mean that Indian economy will be the fastest growing large economy for the next few years. India is embracing digital payments and transactions with open hands, and this is bringing in rural inclusion along with productivity gains. Manufacturing has picked up owing to government focus on "Make in India" and the attractive Productivity Linked Incentive scheme (PLI) is leading to capex for capacity additions. China + 1 has meant that it is not just IT+ Pharma, but new sectors like chemicals, textiles, garmenting, consumer goods, etc that have seen pick up in exports.

With a pragmatic and focused government in place we can expect this momentum to continue. Last couple of quarters quite a few sectors faced headwinds, due to sharp volatility in input prices as also the impact of higher energy and freight costs. However, all these cost headwinds: input, energy, and freight; have subsided meaningfully and we expect margins to start improving from March 2023 quarter and fully normalizing in the June 2023 quarter. This should lead to earnings growth trajectory for Indian corporates trending back to 15%+ annually from FY24 onwards.

Our interaction with a climate expert suggests that the 2023 monsoon may be normal one despite the possibility of El Nino (Australian Met has ascribed 50% possibility) as seen in 1994/ 1997/ 2006/ 2007. The assumption is because the other two factors that also influence monsoon in India, namely Indian Ocean Dipole and snow cover, are favorable.

Looking at the above macro and micro positives along with valuation comfort, we are now very constructive and believe that the next two years can be good period for investors in Indian equities. Sharp correction in broader markets have led to quite a few companies now available at reasonable valuations. We will continue to focus on Profit making companies, where there is visible decent profit growth, and where what we pay today will be more than made up by way of future profitability.

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April 2023

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You may refer the Disclosure Document available at https://abakkusinvest.com/regulatory-disclosure/ for detailed disclosures.

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