Market Update

January 2021

2020 will go down in history books as one of the most volatile years for equity investors. Investor sentiment swayed from extreme fear in the first quarter of 2020 and sharp corrections to an optimistic scenario towards the last quarter of 2020. While economic data continued to be challenging, benchmark equity indices almost doubled from their lows in a matter of just 9 months.

In December, Indian markets continued the momentum seen over the last few months with the NIFTY50 being up ~8%. The uptrend was again fuelled by the strong foreign inflows of ~USD 7.3bn, a phenomenon that was witnessed across emerging markets. Sentiment was extremely positive except for a one-day hiccup on news of new and more infectious strain of Covid-19 found in the UK. On the domestic front, daily confirmed Covid cases dropped ~50% vs November to ~20k levels, while net infected numbers fell to ~300k from a peak of one million. Farmer protests continued even as multiple rounds of talks were carried out to address concerns around recently implemented farm laws. On flows, DIIs continued to be sellers to the tune of ~USD 5bn in December. In terms of sectoral trends, Real Estate was the top performer during December as low mortgage rates, time-price correction and lower stamp duty fuelled property sales, particularly in cities like Mumbai.

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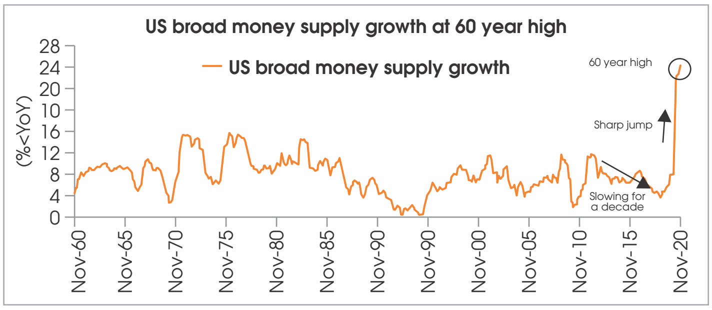
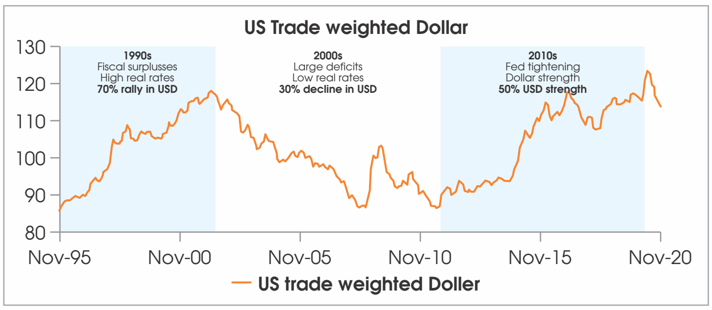
A combination of massive stimulus and resultant liquidity surge and low interest rates has led to investors seeking returns away from low yielding bonds and into commodities and equities. With central banks committing for low to zero interest rates for years to come, the risk of this liquidity drying or reversing in the near term is low.



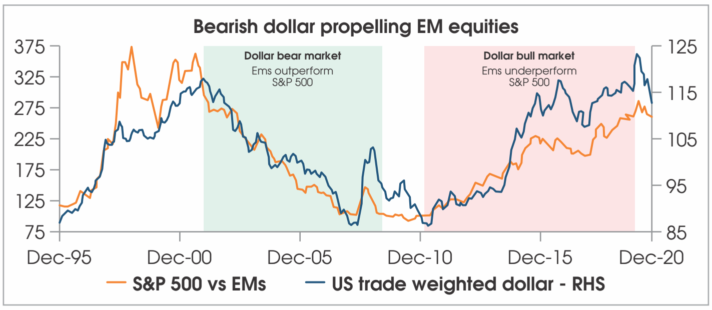
Source: Bloomberg, Edelweiss Research

The US Dollar, after over a decade of strength, has been showing decisive signs of weakness. This, along with low interest rates, is leading to a decisive move of investments into emerging markets and also commodities. This trend looks like getting stronger in the near term and should lead to higher flows into emerging markets bonds and equities.



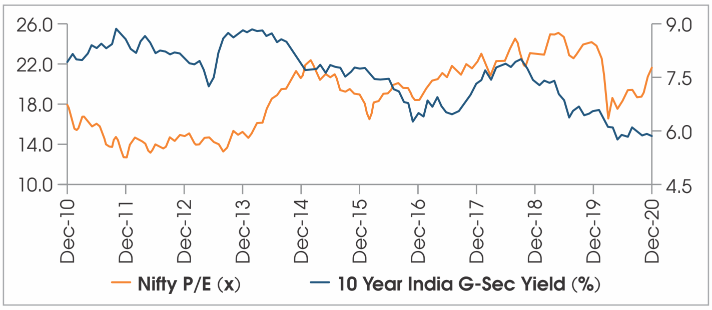
Source: Bloomberg, Edelweiss Research

Source*: NSDL, PTI, ANI, Bloomberg, BSE



Source: Bloomberg, Edelweiss Research

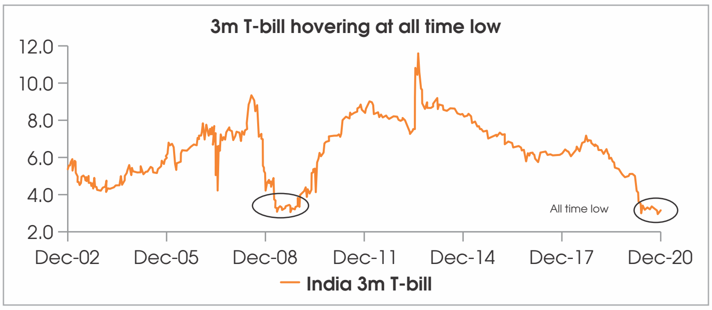
Low interest rates have also led to a case of valuations for equities trending up higher than the last few year's mean and median levels. Equity valuations in that context don't appear to be as expensive.



Source: Bloomberg, Edelweiss Research

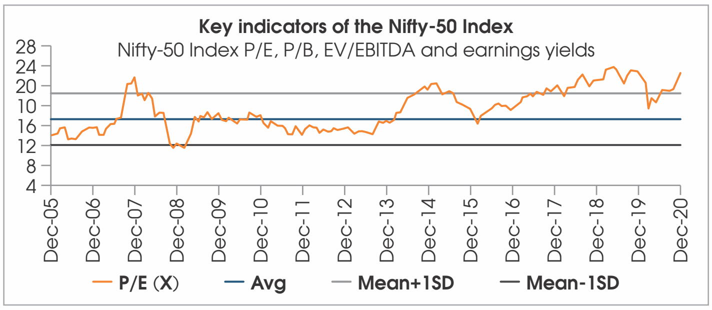
India is already seeing macro recovery despite being hit hard by the pandemic (only 10-15% of economy under stress). High frequency indicators – strong rural growth, pick up in exports, improving PMI's, buoyancy in GST and tax collections, green shoots in capex cycle – point to strong macro recovery ahead.

Low interest rate is the theme for India too. With record low repo rate of 4% and housing loans available at sub 7% there is a strong case for Real estate recovery (which accounts for ~23% ofGross fixed capital formation). Make in India initiatives from Govt of India plus global sourcing model moving to "China plus One" model, India has a strong chance to usher a meaningful private sector capex in manufacturing and infrastructure. There is ample liquidity in the banking system to help fund this expenditure.



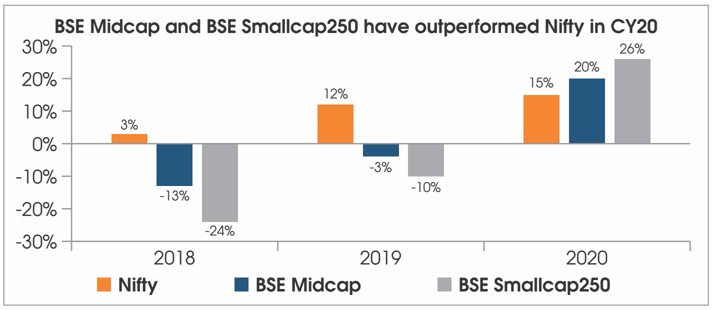
Source: Bloomberg

On the valuation front, NIFTY50 P/E earnings are trending higher than past averages. However, September 2020 quarter saw earnings trend up higher than expectations. Our view is that the earnings for the December 2020 quarter should also see much higher than expected earnings, leading to an upgrades in estimates and lowering forward P/E multiples.



Source: Bloomberg, Kotak Research

Another interesting trend has been the participation of the broader markets in CY20. Unlike the last two years, where the markets were focussed only a handful of large-caps, CY20 has seen the Midcaps and Smallcaps outperform the Largecaps handsomely. Given the valuation gap and also sharper profit growth expected, this trend looks likely continuing in CY21 also.



Source: Bloomberg, Edelweiss Research

Market View

The sharp rally in equities has led to apprehensions of its sustainability, particularly given the fact that challenges on the economic front still persist. Also the recent upsurge in commodities; industrial as well as agri, might lead to inflation and subsequent rise in interest rates. However, tailwinds are visible in the form of higher than expected earnings, positive news flow on Covid-19 front and reopening of global economy, ample liquidity and move towards emerging markets from a global perspective. Corrections are expected, though they should be short and swift, with the cautious positioning and low equity allocation acting as a floor to any major correction. The year 2021 should be a positive year for Indian equities, with broader markets expected to do much better than the NIFTY50. Be positive!

Contact us

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Source*: NSDL, PTI, ANI, Bloomberg, BSE