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Market Outlook

May 2022

Market Update

Global equity markets had a very volatile and challenging month of April. Indian markets also followed a similar trajectory, though they did outperform its global peers on the percentage of drawdown. Global risk off due to persistent high inflation and the resultant rising bond yields, prospects of aggressive monetary policy stance by the US Federal Reserve, and the continuing conflict between Russia and Ukraine war were the major reasons for this correction. Possible impact on global supply chain due to stringent lockdowns in China after seeing the surge in Covid-19, added to concerns on operating margin pressures on corporates. The NIFTY 50 ended the month down 2.1% though amidst huge volatility, the broader markets ended flat to positive with S&P BSE Midcap and S&P BSE 250 SmallCap being up 1.3% & 0.4% respectively.

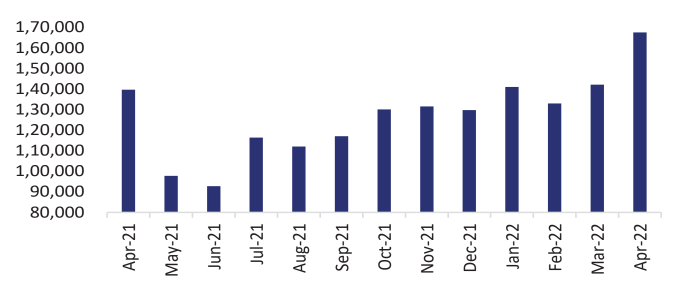
During the first week of May, RBI proactively hiked repo rate by 40 bps to 4.4% and CRR by 50 bps moving towards policy normalisation and tackling of inflation concerns. While the hike itself was not unexpected, equity markets turned nervous on the out of turn announcement as it stoked fears that inflation severity is higher than expected. On the global front too, US Fed in an expected move hiked rates by 50 bps and seems to have guided that next hike too is going to be in the similar range. Fed also announced the start of a program to wind down its balance sheet of roughly ~USD 9 tn, starting with shrinking of up to ~USD 47.5 bn a month for the next three months, followed by up to ~USD 95 billion a month thereafter. The steps announced in the latest Fed meeting (May 2022) marks the most aggressive tightening of monetary policy at one meeting in decades. Bond markets took these announcements positively and were stable. However equity markets continued to see profit booking especially in the new age technology stocks. The call in USA seems to be that in a rising rate scenario equity multiple will shrink and the most vulnerable will be high PE / growth stocks. The earlier growth estimates too have to be tempered down as inflation makes a dent in global demand. Adding to the selling pressure was ongoing weakness in China's economy caused by strict lockdowns and other containment measures. The first week of May has seen a much sharper correction, with the Nasdaq already in bear territory, having corrected more than ~20% from its recent highs. Indian markets also corrected much sharply than has been seen in the recent past.

FII have pulled out ~USD 2.2 bn from Indian equity market in April, much lower than a net withdrawal of ~USD 5.4 bn in March. However, the selling was broadly absorbed by the domestic institutions being net buyer of ~USD 3.9 bn in the month of April. Earnings season so far has been in line with expectations, reporting a strong double digit top-line growth along with selective margin compression.

Macro Update

On the economy front, March CPI inflation surged to 17-month high of 7.0% YoY compared to 6.1% in February. RBI in its Bi-Monthly policy, raised inflation forecast for the current fiscal year to 5.7% from 4.5%, hovering within tolerance band. March WPI inflation rose to 14.5% from 13.1% in February. February IIP growth picked up marginally to 1.7% from 1.5% in January. On the positive side, GST collection in April touched an all-time high of over INR 1.68 lakh crore, showing strong underlying demand scenario in the economy.

GST Collection (INR Lakh Crore)



Source: PIB

India remains the fastest growing economy according to IMF projection; expected to grow at ~8.2% in current fiscal, ahead of China & USA who will grow about ~4.4% & ~3.7% respectively. Russia will suffer ~8.5% negative growth due to its ongoing war with Ukraine.

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, CRR: Cash Reserve Ratio, IIP: Index of Industrial Production
Inflation numbers released with 1 month lag
IIP number released with 1 month lag

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

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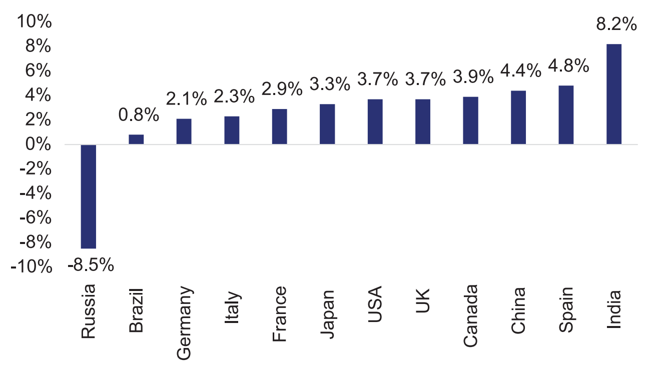
GDP Growth Rate Estimates for FY23



Source: IMF

Market Outlook

Equity markets in India have also reacted in line with the global trends. Rising inflation can impact demand and force central banks to rise rates faster than expected. Input costs inflation and high energy costs are also headwinds both for consumer demand as well as corporate margins. The global equity risk off has also led to unprecedented selling by FIIs, putting pressure on stock prices. However, on the positive side, demand continues to be very strong in the economy. Record income tax and GST collections highlight the inherent strength in the economy. Rural income is expected to be very strong, led by record food grain and agri productions and very high agri commodity prices. Domestic flows into equity continue to be strong and have more than negated the FII outflows, presenting stability to the equity markets.

Indian corporates selectively, too are facing inflation / higher input cost pressures, and this will have near term earnings impact. Some companies / sectors will be selectively hit and can offer good entry opportunity for long term investors like us. Earnings season has been decent with companies reporting inline numbers but the issue has been on guidance where many corporates have guided for margin pressure in the coming quarters. We are closely monitoring our portfolio companies performance on the earnings front and will not be shy to exit some names where we feel there is a permanent hit to margins.

IPO of insurance giant LIC is the big event for May 2022 and we feel government have taken the right steps of scaling down the size of the offering. By not deferring the IPO Government is sending the right indication that it is serious on the disinvestment front and maintaining fiscal balance. Domestic liquidity continues to be strong and we expect this trend to continue. Foreign flows too should normalise over the next 3-6 months once global inflation starts to temper.

We continue to maintain our view of softness in oil prices from a medium to long term perspective. Metal and other commodity prices have already started to soften from their highs. Some more correction in oil and commodity prices might allay the inflation fears to some extent and present the trigger for an upmove in the markets.

We believe that we are entering a phase of consolidation in the markets and expect very minimal correction from these levels. Though the markets might remain range bound in the very near-term, opportunities are opening up in selective stocks. We would be constructive and be investors while focussing on our fundamental philosophy of buying companies with profit growth and where fundamentals merit the valuations they are trading at.

LIC: Life Insurance Corporation of India

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As per SEBI Circular No. SEBI/HO/IMD/DF6/CIR/P/2020/24 dated February 05, 2020, details of industry benchmark and AIF level performance versus Benchmark Reports are available at

https://www.crisil.com/en/home/what-we-do/financial-products/alternate-investment-fundsbenchmarks.html

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Principal Officer/Compliance Officer Details under IA:

Mr. Biharilal Deora,
Tel: 022-68846600
Email: compliance@abakkusinvest.com

Principal Officer and Compliance Officer Details under PMS:

Principal Officer	: Mr. Sunil Singhania,	Tel: 022-68846600
Compliance Officer	: Mr. Biharilal Deora,	Tel: 022-68846600
Email	: compliance@abakkusinvest.com	

Compliance Officer details under AIF:

Mr. Biharilal Deora, Tel: 022-68846600
Email – compliance@abakkusinvest.com

For Queries/Grievances

Email: compliance@abakkusinvest.com

Contact Us

For Investor Service Queries

Write to us at service@abakkusinvest.com or call at +91 22 68846601 or +91 22 68846602

Abakkus Corporate Center, 6th Floor, Param House, Shanti Nagar, Near Grand Hyatt, Off Santacruz Chembur Link Road, Santacruz East, Mumbai – 400055.

Website	: www.abakkusinvest.com
Email	: info@abakkusinvest.com
Telephone	: 022-68846600
LLPIN	: AAM-2364