Market Outlook

Abakkus
Believe in the Basics

July 2022

Market Update

June'22 was another challenging month for investors globally as markets remained concerned over high inflation, rising interest rates and its impact on global demand. With fears of recession / stagflation in focus, key benchmark indices globally fell in a 6-13% range. Indian equity markets also followed the weak sentiments, with NIFTY50 down 4.8% and S&P BSE Midcap and S&P BSE Smallcap down by 6.2% & 6.4% respectively. Broader market correction has been more widespread with stocks down 15-40% in this correction phase.

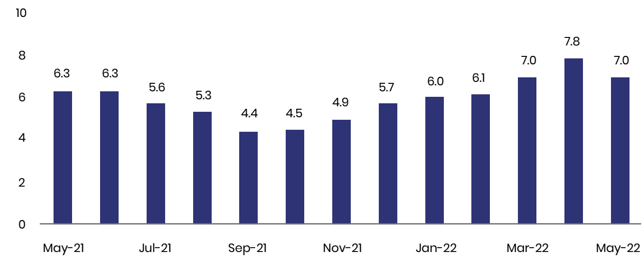
With US Federal Reserve indicating likelihood of a further hike of 50-75 bps in the July'22 policy, all economic debate is centered around how much is US Federal Reserve going to front load hikes to cool inflation. The other parallel discussion centres on the scenario of US Fed's response if demand takes a severe beating or if economy heads for a hard landing. RBI in its June'22 meeting, unanimously increased policy repo rate by 50 bps to 4.9% to curb inflation. GOI announced windfall taxes on oil and refinery companies to partially offset the impact of extreme high prices and margins. FII sold another ~USD 6.4 bn during the month while domestic institutions remained net buyers with a flow ~USD 5.9 bn.

Macro Update

India's current account deficit (CAD) decreased to USD 13.4 bn (1.5% of GDP) in Q4 of FY22 from USD 22.2 bn (2.6% of GDP) in Q3 of FY22. The sequential decline in CAD in Q4 of FY22 was mainly on account of a moderation in trade deficit and lower net outlay of primary income. However, trade deficit for June '22 came in at a record USD 25.6 bn. INR hit an all-time low of over 79 against the USD, though the depreciation in INR has been among the lowest compared to all other major currencies.

Domestic demand indicators remained strong. India's eight core sectors grew by 18.1% in May'22, highest in 13 months led by healthy growth in coal, crude oil, fertilizers, cement and electricity production. GST collection in June'22 touched over INR 1.44 lakh crore increased by 56% Y-o-Y, second highest collection next to the April'22 collection, showing strong underlying demand scenario in the economy. On economy front, IIP growth in April'22 came in at 7.1% compared to 2.2% in March'22. May'22 CPI inflation moderated sharply to 7.0% from 8 year high of 7.8% YoY in April'22. Wholesale inflation for May'22 rose to 15.9% YoY, highest in at least 17 years.

CPI Inflation (YoY %)

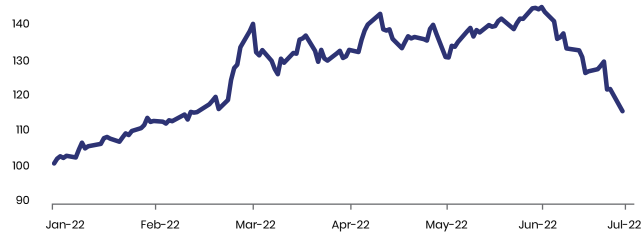


Source: Bloomberg

Commodity Prices

After a sharp rise, prices of commodities across the board have started to correct meaningfully. Metals, agri commodities as well as crude have come down substantially from their recent peak. The Bloomberg Commodity Index is down around 20% from its recent high in less than a month and makes us confident that the worst probably on inflation is behind us.

Commodity Index



Source: Bloomberg

Crude prices have been very resilient, a function of Russia/ Ukraine conflict as also the view that major oil producing countries have no spare capacity left. Our view over the last few months has been of crude correcting to USD 75-80 per barrel by August (read previous communication). Finally, we are seeing first signs of crude prices correct sharply, a function of increasing supplies but more importantly, a fall in demand due to very high prices at the consumer level. WTI crude prices have come off to a level of USD 100 per barrel, a more than ~20% fall from recent peaks.

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 Indutrial Production, GSec: Government of India Dated Securities, GOI: Government of India, FDI: Foreign Direct Investment, CAD: Current Account Deficit, CAGR: Compound Annual Growth Rate

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

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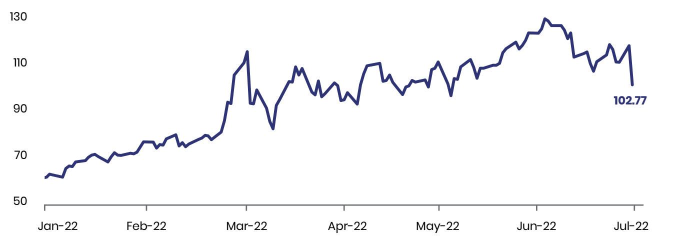
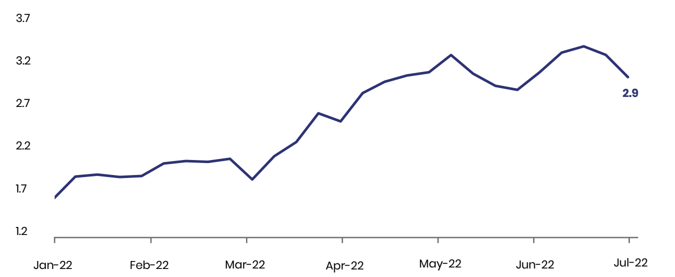
Brent Crude (USD Per Barrel)



Source: Bloomberg

Following the sharp correction in commodities generally, it is likely that inflation might have already peaked and might start to come off in the next few months. Accordingly, it is very much possible that rate hikes might subside sooner than what was earlier expected. This is reflected in the sharp fall in US 10-year GSec yields to 2.9% from its high of 3.4%.

US 10 Yr G-Sec Yield



Source: Bloomberg

Rainfall forecast to 103% of long period average.

While monsoon has seen a delayed start, over the last few days we have seen a pickup. IMD too in its latest forecast for 2022 is now predicting rainfall to be at 103% of the Long Period Average (LPA) vs 99% predicted in April. This bodes well for the rural economy.

Quarterly Results Expectations

On a reported basis, NIFTY50 Q1FY23 sales growth is expected to show sales growth of 32% while PAT growth is expected to ~20%. (Source: Bloomberg, Antique Estimates). Cost pressures is likely to be seen at multiple sector/company levels due to high input costs. Key focus would be on management commentary on overall demand environment in the backdrop of elevated inflation, price & interest rate hikes and slowing global growth. If the demand outlook remains strong then we expect markets wont be too worried on the margin slide as commodities have started to cool off.

Market Outlook

The last 2-3 months have been quite challenging for equity investors globally. Indian equities have also seen a sharp drawdown across the board and slightly more in the mid and small cap space. Apart from the macro economic concerns of rising inflation, rising interest rates, fear of growth slowdown and pressure on corporate profit margins; the record selling from FPIs has also been a major cause of this deep correction. Having said that, the situation on the ground continues to be optimistic.

Buoyant tax collections clearly indicate that demand scenario and economic activity continues to be strong. Government initiatives like "Make in India" are having widespread positive impact and so is the case on export opportunities owing to China+1 strategy. Normal monsoon is also an added comfort specially for the rural economy. Post the recent correction, valuations are just below 10 year average and opportunities have opened up in mid-small caps after the sharp fall in prices.

As highlighted earlier, commodity prices have fallen sharply and therefore a positive read through on inflation fears and interest rate increases is possible. Crude prices have corrected and any further fall can be the biggest positive for India that is largely dependent on imported crude. While US Dollar continues to rise to record levels, leading to global volatility in all asset classes and the Russia/Ukraine issue continues to be a cause of worry; the worst seems to be getting discounted and a gradual improvement is more likely than otherwise.

From Indian equities perspective, the near-term will continue to be volatile. However, we would recommend that investors make fresh investments over the next couple of months. While returns won't be linear, we are confident that healthy mid teen benchmark earnings CAGR over FY22-25 will eventually get reflected in market returns.

IMD: India Meteorological Department

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July 2022

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