**Dear Investors,**

India has been one of the best performing markets globally on a yearly basis. While US and European markets are down between 24% and 25% from highs, India has performed relatively better. This difference is accentuated further in Q2 FY23, with India's outperformance scaling to ~14-16% on a one-year basis. Multiple aspects are going right for the country, including, but not limited to:

- Relatively stable forex and fiscal situation
- Correction in commodity prices including Crude
- Higher confidence in the earnings growth profile of India Inc in face of globally uncertain environment
- Even in the latest RBI policy, when RBI raised repo rate by 50 bps to 5.9%, in line with expectations, it was just business as usual. No alarm bells were sounded, despite the volatility around.

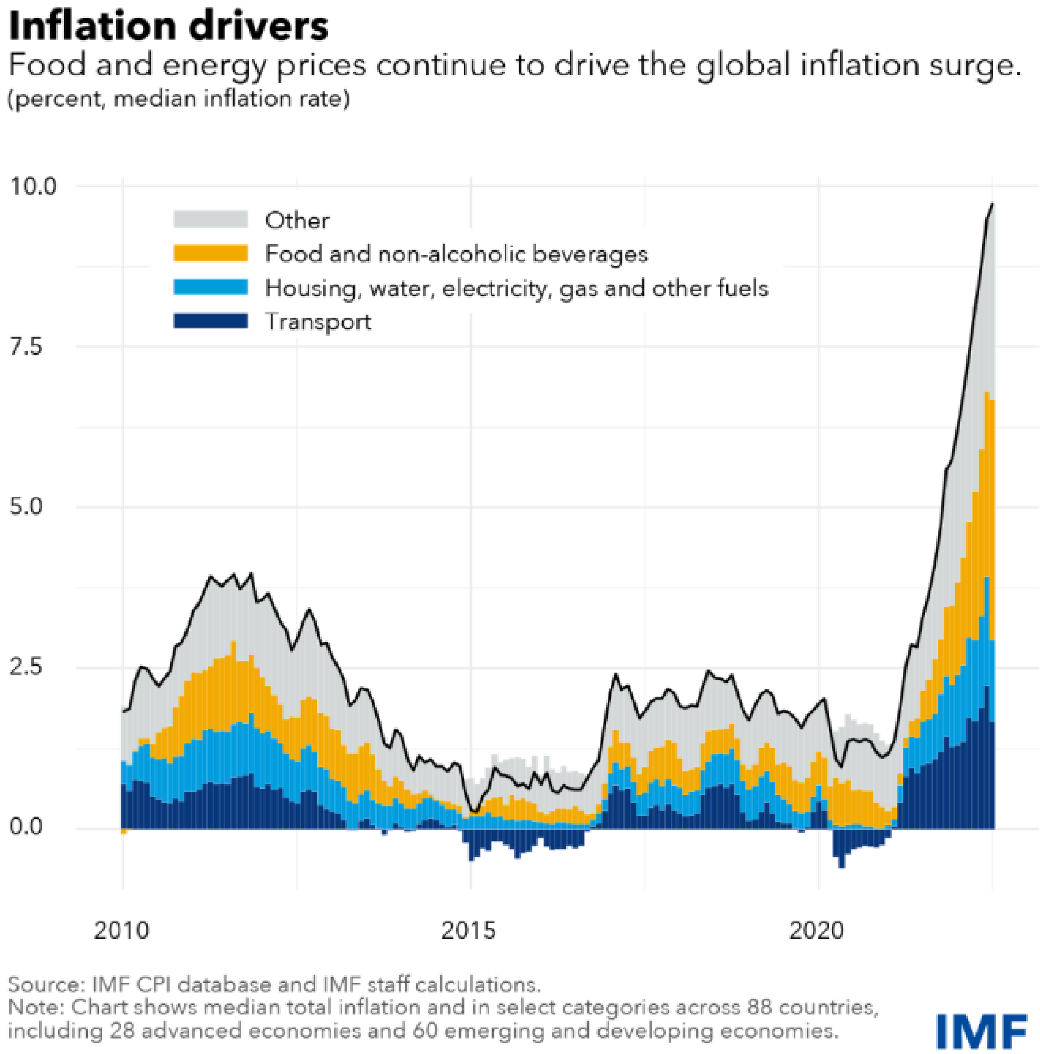
Amidst this outperformance, inflation continues to remain in an area that need closer evaluation. After a decade of low inflation, world is witnessing a general rise in prices not seen for long. Inflation data continued to be higher than expectations, globally and in India. This has further strengthened Fed's and other global central banks resolve to raise rates to tame inflation. Dollar Index too has strengthened, while most currencies have depreciated sharply. This will eventually push Emerging Markets (EM) central banks to keep with Fed on interest rate differential to protect their respective currencies.

## Inflation Woes Dominate

In recent months, global inflation continued its upward trajectory in some systematically important countries like US, where headline inflation albeit moderated but remained above consensus estimates. US inflation eased to 8.3% YoY in August from 8.5% in July even as core inflation moved up by 6.3% YoY vs 5.9% in July. Europe, which is suffering from energy crisis witnessed inflation rise to fresh record of 9.1% in August from 8.9% in July with core inflation rising by 4.3% YoY vs 4% in July. Inflation remained elevated in UK too, as headline inflation rose by 9.9% slightly lower than 10.1% in July on a YoY basis and core prices rose by 6.3% vs 6.2% in July. Turning east,China's consumer inflation eased slightly to 2.5% in August from 2.7% in July and India's headline inflation inching back up to 7% from 6.7% YoY in July. Japan, which traditionally witnesses low level of inflation, has witnessed its headline and core inflation (inflation ex-fresh food) rise to 8-year high of 3% and 2.8% in August, respectively.

A common feature of all the countries has been the elevated contribution of food and energy inflation worsened by supply chain disruption (Russia Ukraine conflict still impacting gas prices in Europe) and series of weather-related events impacting crop output this year (pushing food prices higher).

**Exhibit: Global inflation drivers Food and Energy lead the rise**




*Source: IMF*

Consequently, central bank's focus remains high on taming inflation. India too remains high on inflation trajectory. India's inflation inched back to 7% in August after easing to 6.7% in July. The upward push was on account of food and beverages inflation. The rise in food prices was mostly due to rise in vegetable prices. In line with decline in global crude prices, fuel and light component witnessed first MoM decline in 9 months. Kharif crop sowing was down marginally, with some impact being seen in rice sowing

However, the drivers of inflations have started to turn.

- Prices of major commodities (agri, fuel, base metals) have been corrected from highs. Price drops have been sharp in oil and base metals. Table below highlights drop in major commodities in the recent past.

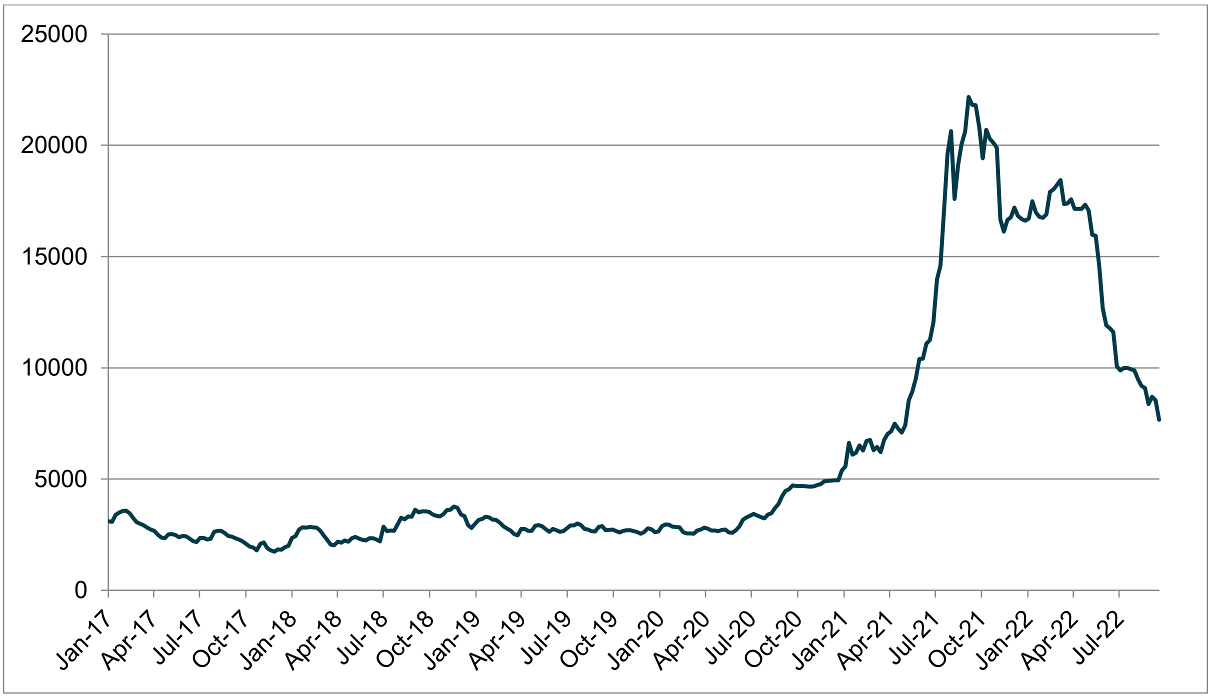
### Commodity Price Movements

| | 1M | 3M | 6 M | 1 Y | % Change from 52-week High |
|---|---|---|---|---|---|
| Oil | -11% | -23% | -15% | 13% | -36% |
| Steel | -1% | -16% | -49% | -59% | -59% |
| Aluminium | -9% | -10% | -36% | -23% | -45% |
| Zinc | -17% | -7% | -33% | -1% | -35% |
| Copper | -4% | -8% | -27% | -16% | -32% |
| Rice | 0% | 6% | 8% | 27% | -4% |
| Wheat | 12% | 3% | -9% | 24% | -33% |
| Sugar | 2% | -2% | -5% | -7% | -11% |
| Palm Oil | -21% | -39% | -53% | -39% | -64% |

*Source: Bloomberg*

- Supply chains have started to normalise. Below table shows how freight index, even though they are higher vs pre-covid, they too have fallen off sharply

### Freight Index – China to US East Coast




*Source: Bloomberg*

- Housing prices have also started to cool off. Increase in mortgage prices too have led to lower affordability

This may lead to inflation pressure easing gradually. Spanner in the works can be if we see incremental supply shocks. But for incremental supply shocks, lower inflation may have consequential impact on interest rates going forward.

**Valuation and Flows:**

Between Oct-21 to mid Jul-22, FIIs sold net of USD 34.6 bn of Indian equities. Led by relative strength in Indian economy, FII's saw a reversal of selling seen since Oct-21 investing net of USD 7.9 bn in Indian equities, Q2FY23, of which USD 235 mn came in Sep and USD 6.8 bn came in August. DII's have also invested similar corpus of USD 218 mn of Indian equities in September so far.

Overall, the markets have been positive on domestic economy, given the strength in earnings that we have seen. Downward revision in earnings has been led by IT, Metals, Cement, and Energy on account of margin pressures while consumer staples and Financials have seen marginal upward revision, prepping up markets' stance on domestic recovery. Consumer discretionary too have seen continued business strength. Markets saw mild correction in September, driven by continued higher inflation, banking liquidity turning to deficit, reduction in forex reserves, in turn driving depreciation of INR.

While markets have seen a mild correction in September, they have been buoyant over last three months. Owing to this, current Nifty 12-month forward PE may look higher vs 10 year average, however, this need to be looked in context of changing index composition towards high cashflow businesses. Overall, longer term, Indian economy is strongly poised with multiple drivers of value creation firmly in place – including dividends from demographic profile, own natural resources, creation of digital ecosystem driving huge shift towards organized businesses.