Market Outlook: January 2023

ASK Investment Managers

Dear Investors,

Nifty touches lifetime highs…

December saw series of global central banks holding their last policy meetings of the year of which Fed and BoJ's stands out as:

- US Federal Reserve finally eased the pace of hike to 50bp from 75bp earlier, as month on month change in US CPI continued to trend lower for fifth straight month with Nov increase being lowest this year,
- Bank of Japan (BOJ) expanded its yield curve control range from -/+0.25% to -/+0.5%, while maintaining accommodative conditions – thus pushing 10 year yield and Japanese yen higher.

Apart from these, Reserve Bank of India (RBI), European Central Bank (ECB), few other developed countries' central banks continued to raise rates. While most of these banks saw an easing of pace of hikes during this month's meeting, commentary across the board remained hawkish, focusing on rate hikes to come in 2023, especially as wage inflation remains sticky, may end being a cause of concern in upcoming year.

In this backdrop, MSCI World (developed equities index) saw a 4.3% fall (in USD terms), giving up some of the November gains. Emerging Market equities (MSCI EM) were relatively more resilient with a 1.6% fall in December, post 14.6% up move seen in November, particularly on account of strong performance by China as country drops Covid zero policy in a much-anticipated move towards normalcy. However, the perception changed towards the end of the month when the cases spiked sharply.

Indian equities on the other hand, saw Nifty touching a new lifetime high of 18,812 on 1st December. Resilient performance of Indian equities comes in backdrop of strong earnings performance in last earnings season, which reinforced the idea of robust domestic recovery, especially and in backdrop of weakening global growth. In INR terms, Nifty50 has been down -3.5% during the month, post touching lifetime high at the start of month. Broader markets outperformed during the month as Nifty Midcap 150 delivered -1.7% and Nifty Smallcap 250 delivered -1.8% in INR terms.

PSU banks continued to be the best performing sector with ~8% upmove during the month in NSE PSU Bank Index, pushing CY22 returns to a strong 71%. This strong upmove in PSU banks has been backed by earnings recovery seen in sector post a prolonged lull (sector has given only ~18% returns over the last 10 years).

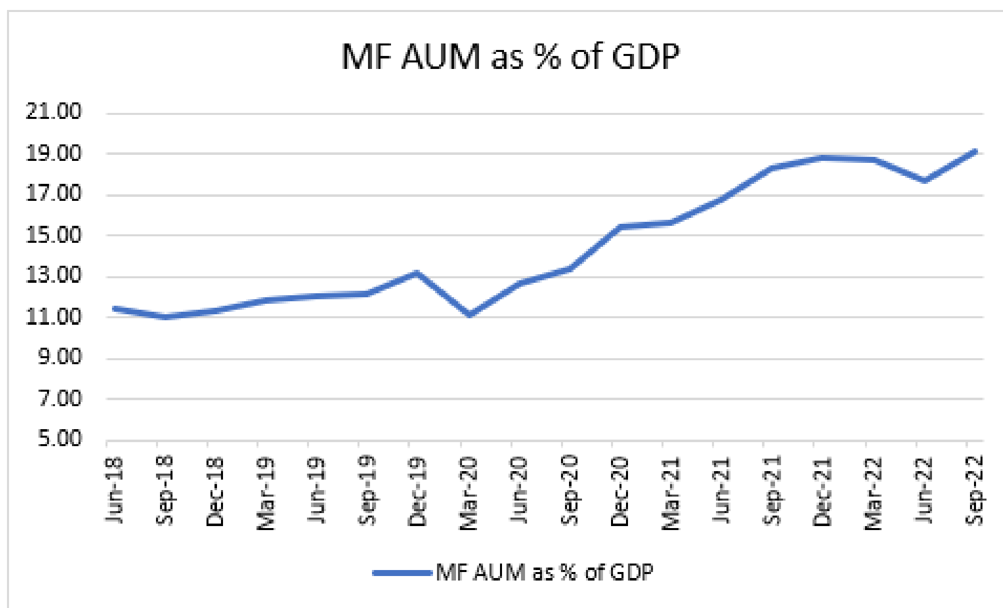
Financialization of savings continues to pick up pace, SIP flows at highest ever levels

November saw SIP inflows at INR133bn, highest ever so far, led by continued financialization of savings. Rising middle-class disposable income, directed efforts at financial inclusion, digitalisation, and ease of investing in mutual funds and stocks and government incentives have helped to channel savings to financial instruments.

Additionally, buoyant debt and equity markets have also encouraged many first financialization of household assets. Parallelly, there is a shift towards greater formalisation of the economy in the near term aided by the introduction of Goods and Services Tax (GST) and regulations such as the Real Estate (Regulation and Development) Act, 2016 (RERA) and the Benami Transactions (Prohibition) Amendment Act, 2016. Additionally, to boost financial inclusion, the government pushed banks to open no-frills Jan Dhan accounts for people in rural areas at an unprecedented pace. With an increase in the penetration of bank accounts, financial savings in the form of deposits jumped substantially.

Formalization of labour force also received an added impetus as GST and covid-19 pandemic led to the gradual shrinking of the informal sector. Employee Provident Fund Organisation (EPFO) net payroll additions stood at 12.2mn, ~60% higher YoY and almost double the FY19-20 average of 7 mn. ESIC additions – indicator of relatively lower strata of the employed labour force, witnessed ~30% growth in FY22 to 14.9 mn, nearly touching the pre covid average of 15.1mn. The increased formalisation of labour is not only increasing financialization of savings but also allowing a greater pool of credit worthy customers for bank and financial organisations.

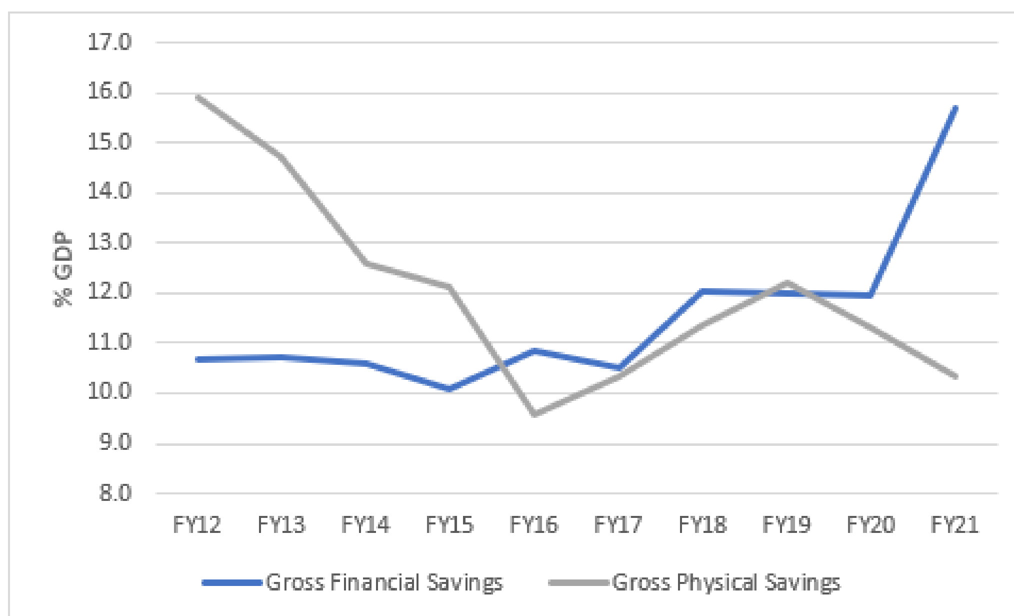
The intensity of the trend in favour of financial assets can be gauged by the fact that the Assets Under Management (AUM) of the Indian mutual fund industry touched INR 38 lakh cr, growing by 16.2% on 3 year CAGR basis.



Source: AMFI, Bloomberg, ASK IM Research

Gross financial savings rose to 15.7% of GDP in FY21 (latest year for which data is available) vs. 12% of GDP in FY20. Likewise, physical savings as a % of GDP fell to 10.3% of GDP from 11.3% in FY21. Bank deposit is a large part of financial savings. We see

continued long term shift towards other form of savings products like Mutual Funds, ULIPs etc.



Source: Bloomberg, ASK IM Research

Outlook:

FII's have invested net of USD 1.36bn in December, taking inflows to USD 7.7bn for this quarter. FII flow trends saw a sharp reversal of selling during second half of current calendar year. First half of the year saw FII net outflows worth USD 28.6 bn while second half inflows stand at USD 13.7bn.

India's massive outperformance in the last one year has now drawn global investors attention to India and confidence with FIIs to make standalone dedicated allocation is increasing. India's weight in global EM Index too has risen sharply. India is among few markets that offer stability of policy and long-term steady, diversified, and resilient economic growth unlike significant volatility seen in many other markets. Uncertain outlook on China and other emerging markets further makes India as an attractive market for global investors. Overall, we believe global allocation to India is still low and we believe India is likely to attract lot of India dedicated flows over the next few years.

CY22 has been a gloomy year for asset classes globally (global equities, global bonds and base metals). While MSCI EM is down 22% during the year, MSCI World down 19%, US Treasuries Bonds Index down 12% - all in USD terms, Indian equities (Nifty50) has outperformed by a fair margin with 6% down move in USD terms and 4% up move in local currency terms (divergence driven by sharp depreciation seen in INR). We believe India's outperformance has been a function of not only strong performance by India Inc, but also a relative uncertainty in other markets. We expect India Inc's earnings growth outlook to remain robust in the medium term driven by the twin engines of consumption and

investment firing together. However, in the short term, we need to watch out for the macro situation, which so far, India has managed well and the valuations, which currently, we believe are fair.

Q3 FY23 results are round the corner. We believe this quarter should see sequential improvement in margins for companies as the impact of high-cost inventory starts to wane. We believe FY24 earnings should be further aided by continued margin expansion and result in improvement in earnings growth. Most of our portfolios should report 25% or higher earnings growth in FY24 – higher earnings growth vs FY23.

Given the macro backdrop, it's important to focus on businesses that have strong long period earnings growth. Notwithstanding the global macro uncertainties, we remain positive on India growth story driven by India's superior growth profile vs large global economies along with sound macroeconomic fundamentals, gradually reducing sensitivity towards oil prices (though long way to go), fall in commodity prices like oil, metals, fertilizers, which in turn can have positive implication on inflation and also government finances, anticipated benefits of reforms undertaken in the past including GST, RERA, IBC etc, strong manufacturing growth. We see sustained earnings growth in domestic oriented sectors vs global viz. IT and commodities. The longer-term outlook remains bright, as domestically bank as well as corporate balance sheets are in a much better shape and on growth front as well and most macro indicators remain steady. We believe CY23 would be a stock pickers market. Focus on businesses rather than market will make a difference to the returns.

Happy investing.

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