Market Outlook – September 2023

ASK Investment Managers

Dear Investor,

This calendar year has been strong for the markets in general. While the large cap index (Nifty) is up 6% CYTD, midcap index (BSE Midcap Index) and small cap index (BSE Small Cap Index) are up 23% and 27% respectively. However, India has not been an outlier. Other countries like Germany, France, Mexico, Japan have delivered higher returns vs India during the same time frame. Where India differs is on long period returns. On a 3/5/10 years basis India's performance has been way superior vs other markets – clearly showing India's strength and value adding growth.

Markets	FYTD Returns	CYTD Returns	1 Year Returns	3 Year Returns	5 Year Returns	10 Year Returns
Germany	2.0%	14.5%	24.2%	0.4%	7.2%	5.2%
Europe	-0.4%	13.3%	22.2%	1.2%	9.5%	4.8%
France	-0.1%	13.0%	19.5%	4.7%	13.9%	6.2%
Mexico	-1.6%	9.4%	18.0%	-0.3%	12.9%	1.4%
Japan	16.3%	25.0%	16.1%	7.8%	12.1%	7.4%
US	4.4%	4.8%	10.2%	-0.9%	6.9%	6.0%
India	**9.9%**	**6.6%**	**8.9%**	**6.1%**	**18.8%**	**10.9%**
Brazil	13.6%	5.5%	5.7%	-1.3%	5.2%	8.6%
Australia	2.0%	4.1%	4.0%	-2.0%	6.4%	3.2%
Korea	3.2%	14.3%	3.4%	-10.6%	3.2%	1.9%
UK	-2.5%	-0.2%	2.1%	2.2%	7.6%	0.0%
China	-4.7%	1.0%	-2.6%	-6.2%	-2.8%	2.7%
Indonesia	2.2%	1.5%	-3.1%	6.3%	9.9%	2.9%
Hang Seng	-9.9%	-7.1%	-7.9%	-15.7%	-10.0%	-8.0%

Source: Bloomberg, ASK IM Research, in local currency, till date: 31st August

Factors leading to India's superior performance

India's long period superior performance is a function of sound and stable domestic macro-economic scenario, along with high real growth rate. India remains the fastest growing major economy of the world and expected to be 3rd largest economy by 2027. India's real GDP growth rate was over 7% in 2022-23 and expected to remain over 6% in 2023-24. India's growth rates are more structural and over period it has managed to reduce the impact of external global macro vagaries on domestic macro.

Another factor which is playing an important part in India's growth is strong demographics. With a relatively young and growing population, India is poised to take a competitive advantage as it would reach the highest working age population that is aspirational, young and with increasing income levels, by 2030.

The current quarter results point to continued strong corporate performance. Nifty posted a PAT growth of over 30% YoY. Oil Marketing Companies (OMCs) contributed to the major portion of this high PAT growth due to having a benign base of Q1FY23. Nifty (Ex OMCs) with ~19% growth in PAT, also posted strong performance. The growth in PAT can be attributed to the fall in input costs aiding in margin expansion across sectors. While the aggregate sales for the top 500 businesses grew 4%, margin expansion driven by benign commodity prices led to superior profit growth during the quarter. Sectoral growth was driven by Automobiles, oil and gas, insurance, banks and capital goods. Slowdown was more pronounced in globally linked sectors like

Chemicals, IT, Metals, followed by low ticket consumption have been the major pain areas. High-end consumption and capex are the areas which have been doing well.

Sectoral Trends in Q1 FY24:

- **Banks' picture perfect may be questioned:** FY23 was a dream year for banks with improving Net Interest margin (NIMs), rising credit growth and lower credit costs. However, in Q1FY24, NIMs contracted, although credit growth is strong (and stable) and credit costs are still benign.

- **Consumption:** While margins increased, demand barring auto and some premium products was weak. However, rural demand seems to be stabilizing, the growth is still awaited.

- **Exports:** Indian exports has taken a major hit with IT and chemicals reporting a soft quarter as global demand continues to remain weak. Pharma exports have been strong, driven by stabilization of prices in US generic space. The auto sector has also reported strong growth with passenger vehicle exports moving towards all-time high.

- **Commodities:** Oil Marketing Companies reported strong earnings, as we witnessed a turnaround from last year reported losses in Q1FY23. Fall in cost of crude for Indian companies driven by rise of cheap Russian crude has been a major cause of this strong Profit After Tax (PAT) growth. On the other hand, metals and downstream companies have reported weak performance in this quarter.

- **Investments:** The divergence in profits of cement and industrials continued in Q1FY24 as well. Industrial companies reported strong profits, while that of cement companies contracted. This was witnessed with strong future expectation of volume growth with healthy rise in order inflow and order book.\

While the corporate performance has been alright, markets have been buoyant too, there are few key monitorables at the current point in time.

Global Monitorable:

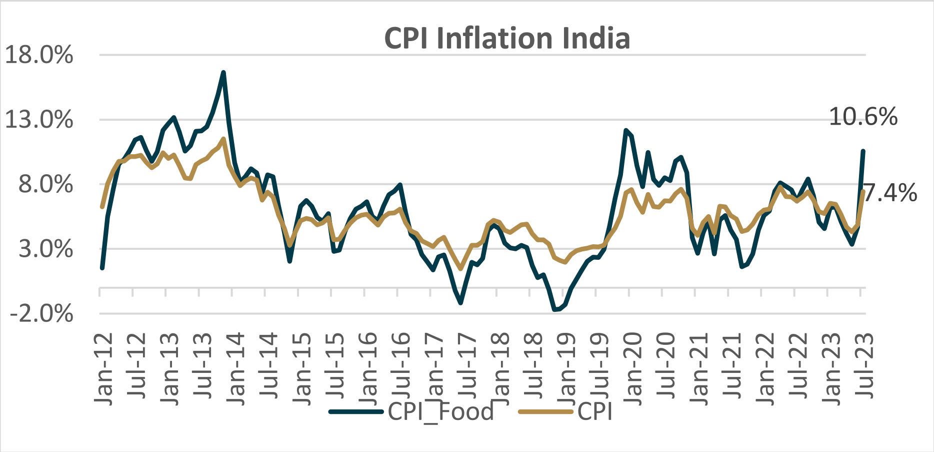
- **Hawkish Fed pushes up real rates –** US growth has remained resilient so far in 2023 averaging 2.2% YoY in 1st half of 2023 and the narrative of soft landing has gained strength vs expected recession at the start of 2023. With sticky inflation in the 3-3.5% range and unemployment rate near 4% in 2nd half of 2023, space for another rate hike remains open. This continued hawkish stance of Fed is leading to rise in US rates with 10y US benchmark yields surging to 4.3% levels – highest since 2007 and firming up of shorter end of the curve. Real rates in shorter end of the curve (3m yields) have increased to 2.1% vs 0.4% at the start of 2023 and corporate borrowing costs (Moody's Corp AAA rated bond yields) have also increased to 4.7% in July-23 vs 4.1% last year and real rates stand at 1.36%.

- **China's fragile economy could aggravate global downturn –** China's fragile economic recovery and potential of missing 5% growth target has emerged has one of the key risks to global economy in 2023. In the labor market, youth unemployment reached a record 21% - prompting the authorities to suspend data releases. In addition to real sector, default risks have been rising among private real estate giants (Country Garden latest to miss coupon payments, Evergrande has filed for Section 15 bankruptcies) and support for Local Government Financing Vehicles continue to paint a grim picture of Chinese debt (China's total credit to private non-financial sector stands at 297.2% of GDP in Q4CY22 vs 285.1% in Q4CY21 as per Bank for International (BIS)).

Domestic Monitorables:

- **Weak Rainfall:** Till August 25, cumulative rainfall was 7% below long-term average. The shortfall has been in the eastern and southern parts of the country, whereas the western and northern states witnessed heavy rainfall. Last year as well, rainfall in the east was deficit. Rainfall, though expected to reach long-term average levels on national level, the distribution across states is still erratic. This has been creating inflationary pressure. With the risk of El Nino still around the corner, the climate has been hotter than normal. Thus, it is expected that the inflationary pressure might not ease at least till October.

- **Domestic Inflation:** There was a sharp increase in Consumer Price Index (CPI) in July'23 (7.4%), driven by food inflation – as CPI Food Inflation was 10.6%. The relief has been on the larger domestic picture as the core CPI (excluding food and beverages, fuel and light and petrol and diesel) for July'23 dropped to 5.0%. High inflation puts extra pressure on the domestic currency along with the forex reserves.



Source: Bloomberg, ASK IM Research

- **Weakening Exports:** Most of the world is yet to recover from a slowdown and the fear of recession still hampers global demands. As commodities prices continue to fall this year, there has also been significant "de-stocking" globally, as inventories have seen a sharp decline. Further, there have been macroeconomic challenges, as investments continue to remain weak and debt vulnerabilities has been rising. These have adversely impacted India's exports and is important that it is carefully monitored. Two of the three factors that impacted exports viz. destocking and price deflation are transient in nature.

- **Anticipating a year packed with political importance:** India has recently seen the culmination of four state elections and the horizon is adorned with the prospect of nine more electoral contests as the nation steers towards its next general election, slated for May 2024. Markets may exhibit high volatility as the country approaches election season.

Notwithstanding the short-term irritants (which though needs monitoring currently), India is strongly poised at the current juncture to build on a strong structural and macroeconomic scenario. Market performance will never be linear – however, the foundation of long-term economic growth is being built and consequently for a solid value creation over long period of time.

Happy investing!
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