

Market Outlook

October 2021

Equity Market

Cautiously Optimistic View

The market that was

The key equity benchmarks hit all-time high levels in the middle of the month. However, the gains were not sustained and the indices ended almost flat amid concerns over steep valuations, rising commodity prices, inflationary pressure and liquidity normalization signals by the central bank. Nifty closed the month with gains of 0.4%. However, the broader markets underperformed, as Nifty Midcap Index gained 0.3% for the month and Nifty Small Cap Index declined 1.1%. Auto (+6.2%), Consumer Durables (+4.5%), Banks (+4.5%) outperformed, whereas FMCG (-5.6%), Healthcare (-4.1%), Realty (-2.9%) and IT (-2.3%) were the laggards.

The IMF retained India's GDP growth forecast for FY22 at 9.5% (in-line with RBI forecast) and for FY23, IMF's forecast stood at 8.5%. With this, India retained the tag of the fastest growing large economy, both for FY22 and FY23.

India's retail price inflation rate eased to 4.35% in September 2021, from 5.3% in August. It is the lowest reading in five months, remaining within the RBI's 2-6% target range for the third month in a row. WPI inflation rate in India fell to a six-month low of 10.66% in September 2021, from 11.39% in the previous month. However, this was the 6th straight month of double digit inflation – first time in 23 years.

The Centre's fiscal deficit stood at just 35% of the annual target by 1H-end. Gross tax revenues continued to beat expectations, with 1H collections at 53% of full-year budget being 10ppt higher than the usual trend.

The RBI in its monetary policy has kept the repo rates unchanged at 4%. Its accommodative stance has been continued with a (5:1 vote) to revive and sustain growth on a durable basis while ensuring that inflation remains within the target going forward. The RBI has acknowledged that the outlook for aggregate demand is progressively improving but the output is still below pre-COVID level, and the recovery is uneven and largely dependent upon policy support. Hence, the RBI continues with its accommodative stance.

Covid cases during the month remained under control (daily sub-20k) even as vaccine doses crossed the 1bn mark. India witnessed 99% of its long period average rainfall (normal) in 2021, although with significant variations across regions.

FII's turned net sellers to the tune of ~\$2.3bn (highest monthly outflow since March 2020), taking YTD net inflow to \$6.3bn. DII's were net buyers of ~\$0.6bn (YTD +\$4.3bn) driven by both MFs (+\$0.2bn) and insurance companies (+\$0.4bn).

Going forward

Earnings seasons has been reasonably strong so far. Thirty-six out of Nifty 50 companies have reported numbers (86% weight) with the aggregate net profit showing growth of 15% YoY and ~10% ahead of estimates.

Equity markets have rallied significantly from the lows of March 2020. Nifty is up 2.4x, while Midcap is up 2.8x and Small Cap is up 3.2x since March 2020 closing lows. Even this calendar year, the markets have remained buoyant.

India's economy has shown strong resilience after the jolt of Covid's second wave. All dots are coming together with 1) Normal monsoons; 2) Strong tailwind in IT service; 3) Improved visibility on PSU divestment post sale of Air India; 4) Improving standing of Indian companies in Pharma, Chemicals, Textiles etc. in China+1 strategy; 5) High probability of private sector capex to kick start led by cement, steel, Oil and Gas; 6) Digitization wave sweeping across, with Fintech, Consumer Tech and EV-led transformation. Although some of these factors will play out over the long term, India looks set for new growth horizons in the coming years.

Despite this recovery, a large part of market returns is also likely due to unprecedented liquidity and record low interest rates. However, now markets are facing the prospect of Fed tapering along with rising inflation globally posing risk for rate hikes eventually.

India is entering the festive season and initial signs reflect good demand. Continuation of good demand through the festive season would pave the path for earnings delivery. We see growing risks to the market from 'higher-for-longer' inflation even as earnings estimates look achievable. Another risk is from the huge pipeline of companies planning to raise significant amounts from IPOs.

We maintain a cautiously optimistic stance and continue our focus on investing in companies with strong earnings growth visibility and strong financials.

Debt Market

Global Bond Yields Rise

Bond Yields rose across the curve by 10 to 20 bps in October 2021 as RBI ended its Bond buying program or GSAP (G-Sec Acquisition Program) and also increased the size of the liquidity absorption through the Variable Rate Reverse Repos. (VRRR). Increase in yields across world markets also impacted the yield curve. Though the flatness in the curve was not as pronounced as in other markets, the rise in yields was almost parallel across the curve. The 5-yr segment outperformed on back of lower supply. CPI Inflation came in at 4.35% on back of lower food prices but Core Inflation remained sticky to close at 5.75%. The swaps curve witnessed a bigger rise with the most traded 5-yr Overnight Indexed Swap rising by 33 bps during the month.

INR depreciated by 0.86% during the month as Brent prices continued to rise, adversely impacting India's trade deficit as well as inflation and inflation expectations. PFI (Private Finance Initiatives) flows were negative both in debt and equity. Debt outflows were at USD 448 M and equity outflows pegged in at USD 2.23 Bn, the highest outflow for a given month during CY2021.

We are in underweight duration as we believe yields may continue to rise on the back of higher-than-expected inflation due to elevated commodity prices and rising demand as the economy starts to operate at pre-Covid levels with the rapid increase in vaccinations.

We expect the RBI to increase the reverse repo rate to 3.75% by February 2022 from the current 3.35% .

Currently, we expect the policy repo rate hike to start from April 2022 onwards, though an earlier hike cannot be ruled out if Brent continues to rise. We continue to favor the 4/5-yr segment of the sovereign curve as there is less supply in this segment and carry roll down effect is pretty attractive.

Fixed Income Market

	September 21	October 21	Change (in bps)
Overnight rate (NSE MIBOR)	3.49%	3.42%	-7.00
1 yr CD	3.95%	4.31%	36.00
10 yr GOI Yield	6.22%	6.39%	17.00
USD/INR	74.23	74.88	65 paise
IIP (Monthly with 2 month lag)	11.50%	11.90%	40.00
CPI (Monthly with 1 month lag)	5.30%	4.35%	-95.00
5 Yr AAA PSU spread (bps)	15	15	0.00
5 Yr OIS	5.32%	5.68%	36.00
US 10 Yr yield	1.53%	1.58%	5.00
CRR	4.00%	4.00%	0.00
Reverse REPO	3.35%	3.35%	0.00
REPO	4.00%	4.00%	0.00

Source: RBI Weekly Statistical Supplement & Bloomberg

Note: IIP has been revised lower for the previous reading.

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Source: BSE, RBI & Bloomberg

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