PGIM India Mutual Fund

Market Outlook

September 2021

Equity Market

Indian equity market outperforms peers

The market that was

The Indian equity market continued its positive run, with the NIFTY rising 2.8% in Sep 2021, outperforming both its developed and developing peers. A combination of lower covid case counts and healthy pace of vaccinations, has ensured that the market remained in a positive trajectory even as concerns emanating from China (a result of the debt of a large realty company) kept some of the other markets jittery. Further, a hawkish stance by FOMC put pressure on yields putting global markets under pressure. Sectorally, Real Estate (+33%) was the standout performer driven by a seemingly sharp uptick in property sales while Healthcare (-1.8%) and Metals (-1.1%) were the laggards.

On the Macro front, policy measures such as relief to telecom companies and structuring of the bad bank were positive developments.

India's retail price inflation rate eased to a 4-month low of 5.30% year-on-year in August 2021, remaining within the RBI's 2-6% target range for the second month in a row, potentially easing pressure for normalization of ultra-loose monetary policy. Core inflation remains sticky at ~6%, suggesting that the bulk of the lower inflation trajectory in the near term is likely to be orchestrated by food inflation.

Wholesale price inflation rate in India edged up to 11.4% in August of 2021, from 11.2% in the previous month - this was 5th straight month of double digit WPI inflation – only second time in the last 23 years.

India’s fiscal deficit stood at Rs 4.6trn or 31.1% of the budget estimate at the end of August. The government kept its 2HFY22 borrowing program unchanged. Given the strong tax collections, we remain optimistic about the Centre’s fiscal health. Additionally, potential inclusion of India in global bond indices can keep the Rupee stronger. The current account reverted to a surplus of USD6.5bn (0.9% of GDP) in Q1FY22 as against a deficit of USD8.1bn (1.0% of GDP) in Q4FY21.

OECD cut India’s FY22 growth estimate to 9.7% but India remained the fastest growing large economy in the revised list. After raising concerns in July and August, monsoon gathered momentum in September (29% above average) and with delayed withdrawal, it has restored the expectations of normal average rainfall for the entire season. Bank credit growth came in 6.7% YoY – at nearly an 18-month high. Acceleration in this variable will provide early indication for growth pick-up.

India’s power demand growth sustained its strong momentum in Aug-21, rising 4% MoM/18% YoY. Similarly, peak demand touched 196GW (up 18% YoY). With YTD demand rising 16% YoY (off a low base of -11% YoY), FY22 power demand outlook remains strong with a consensus growth expectation of over 7%.

FIIs were buyers to the tune of $1.1bn, while DIIs continued buying in Sep to the tune $0.8bn. DII buying was largely driven by Domestic MFs who bought +$0.9bn. YTD FII/DII/DMF inflows stand at +$8.5bn/$3.7bn/$3.7bn respectively.

Going forward

Q2FY22 earning season is about to start on an optimistic note and a favorable low base - earnings trajectory is expected to be positive. Further, opening up activities, festive season and monsoon recovery augur well for the economy as well. While markets have shown a strong growth in last 18 months, growth prospects continue to be healthy with demand revival, market share consolidation in multiple industries, commodity inflation, infrastructure spend by governments globally coupled with operating leverage and balance sheet deleveraging are strong drivers for earnings non-linearity.

Genuine concerns are emerging from elevated inflation levels, Fed tapering, possible concerns from China, high global energy prices and rising yields. Continued rise in yields and eventual hike by the Fed can potentially challenge high valuations. However, we also believe that medium to long-term prospects remain healthy for equities in general and India in particular. Policy initiatives, demand growth regaining normalcy and healthy pace of vaccinations should keep Indian markets in a sweet spot and in good stead. We continue to invest in structurally strong companies with good cash flows, balance sheet strength and corporate governance.

Debt Market

Short-term bonds still a good option

Inflation

CPI continued its downward trajectory from July (5.59%), coming in at 5.3% thanks to favorable base effects and softening food prices. Veggies rose by a mere 0.4% in August over July, as against a trend increase of over 4% witnessed in August.

However, core CPI remained steady, even as it witnessed a deceleration in momentum, helped by some improvement in supply.

CPI has now declined close to 1% from the peak (seen in May 21). Risks to food inflation further abated through the month, as rainfall picked up and mostly covered for the entire shortfall in August that saw a -24% fall over Long Period Averages for the month.

Rates and liquidity

Daily average LAF surplus for September stood at INR 7.9 trillion, reflecting the ultra-easy liquidity situation. In comparison, daily LAF averages were a tad lower at INR 7.43 trillion. Durable liquidity surplus (including Variable Rate Reverse Repos – VRRR, all the LTROs – Long Term Repo Operations) on most days was in excess of INR 10 trillion.

This has caused the overnight rates including Treps (CBLO) and Repo (Croms) to hover in the 3.30% to 3.40% band, closer to the Reverse repo rate of 3.35%.

The RBI however made two changes to its liquidity management framework during the month. The first is accepting a higher cut-off in the VRRR auction at 3.99% (for a 7-day tenor liquidity absorption option). The second is rendering the GSAP auctions, liquidity neutral by selling an equivalent amount of short bonds into the market.

Both of these hint at RBI's dipping comfort with allowing any more of an increase in system liquidity. We expect further fine-tuning to the liquidity operations at the coming policy and the use of liquidity to convey any change in messaging, given that a rate hike appears some time away.

As a result of these actions, the shorter portion of the yield curve, specifically the April to June 2022 and the July to Dec 2022 periods, witnessed an upwards correction in yields from 10-20 bps towards the end of the month.

Outlook

The economy clearly appears on the mend, given the significant pace of vaccinations, lower daily new infection rate, absence of a third wave yet and better management of the economy through the second wave shutdown.

Demand conditions on the ground clearly point to greater appetite amongst households for consumption of both goods and services, aided by the tailwind of pent-up and suppressed demand. Further, if conditions remain steady as we enter the festive season, the economy should further rebound on the back of a + 20% GDP rebound witnessed in Q1-FY 2022.

Government finances also appear to be in a better shape, aided by a surge in tax collections particularly on the direct front in the first 5 months. Until September 22, 2021, net direct tax collections at INR 5.7 trillion was up +74% over the previous year (INR 3.27 trillion). Net collections are also up 27% over the corresponding period in FY 20 (pre-covid).

Further, GST for September came in at INR 1.17 trillion, 23% higher than in September 2020. The corresponding number for September 2019 was even lower at INR 0.91 trillion.

No extra borrowings besides the decision to subsume the proposed additional borrowing to finance the GST compensation to states (of INR .9 trillion) within the schedule is a welcome relief for the markets. If the current pace of revenues is sustained, the Govt should manage to stick to its schedule. Divestment proceeds remain a wild card at this juncture with the exact timing (on BPCL, Air India and LIC IPO) still to be firmed up.

Given the faster than expected turn-around and rebound in the economy, the RBI may be inclined to act earlier than it had communicated, both on liquidity and stance. We expect the sequencing to be in the order to liquidity moderation first, to be followed by a return to neutral stance later, to be finally capped with a rate hike sometime next year. Risks remain, with continued pace of vaccinations being key to avoid or better manage any likely third wave post the festive season.

Given impending monetary and rate actions, we continue to recommend short products such as the corporate bond (PGIM India Premier Bond Fund) and PGIM India Banking & PSU Debt Fund for investors with a 1-3 year horizon. PGIM India Dynamic Bond Fund is an option for investors with an ability to handle some volatility seeking duration gains. Investors with a shorter time horizon of upto 6 months should also look at the PGIM Ultra Short Term Fund, a high quality fund that invests predominantly in the 3-12 month segment to maintain duration under 6 months.

Fixed Income Market

	August 21	September 21	Change (in bps)
Overnight rate (NSE MIBOR)	3.38%	3.49%	11.00
1 yr CD	3.80%	3.95%	15.00
10 yr GOI Yield	6.22%	6.22%	0.00
USD/INR	73.00	74.23	123 paise
IIP (Monthly with 2 month lag)	13.60%	11.50%	-210.00
CPI (Monthly with 1 month lag)	5.59%	5.30%	-29.00
5 Yr AAA PSU spread (bps)	15	15	0.00
5 Yr OIS	5.15%	5.32%	17.00
US 10 Yr yield	1.32%	1.53%	21.00
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.

Riskometer

This product is suitable for investors who are seeking*:

PGIM India Premier Bond Fund (An open ended debt scheme predominantly investing in AA+ and above rated corporate bonds)
- Income over the medium term
- Investments predominantly in AA+ and above rated corporate bonds including bonds
- Degree of risk – MODERATE

PGIM India Ultra Short Term Fund (An open ended ultra-short term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 3 months to 6 months)
- Income over the short term
- Investment in short term debt and money market instruments
- Degree of risk – LOW TO MODERATE

Investors understand that their principal will be at low to moderate risk

PGIM India Banking and PSU Debt Fund (An open ended debt scheme predominantly investing in Debt instruments of banks, Public Sector Undertakings, Public Financial Institutions and Municipal Bonds)
- Income over the short term
- Investment in debt instruments issued by Banks and Public Sector Undertakings, Public Financial institutions and Municipal Bonds
- Degree of risk – MODERATE

PGIM India Dynamic Bond Fund (An open ended dynamic debt scheme investing across duration)
- Regular income for short term
- To generate returns through active management of a portfolio of debt and money market instruments
- Degree of risk – MODERATE

Investors understand that their principal will be at moderate risk

*Investors should consult their financial advisers if in doubt about whether the product is suitable for them.

Source: BSE, RBI & Bloomberg

The views of the Fund Manager should not be construed as an advice and investors must make their own investment decisions regarding investment/disinvestment in securities market and/or suitability of the funds based on their specific investment objectives and financial positions and using such independent advisors as they believe necessary. None of the information contained in this document shall be constituted as a recommendation to buy or sell any particular security.

Mutual Fund Investments are subject to market risks, read all scheme related documents carefully.