PGIM
India Mutual Fund

Market Outlook

April, 2019

Equity Market

VOLATILITY TO CONTINUE IN THE NEAR TERM

The market that was

Indian markets started the financial year on a volatile note (Nifty +1.1%) with large caps outperforming midcaps and small caps (down 3.8% and 3.1% respectively) amidst general elections being conducted, rate cuts by RBI, crude inching up and global uncertainty in trade talks. Among the sectors, IT and metals were the top outperformers while Realty, Infrastructure and banks underperformed versus the benchmark in April. The US has announced end of all Iran-sanction waivers after 2-May-19 for 8 countries and has asked India to cut oil imports from Iran to zero.

Feb IIP stayed moderated significantly to 0.1% vs 1.3% in Jan largely due to continued contraction in the manufacturing sector. CPI came in at 2.86% in Mar'19 versus 2.6% in Feb, while WPI also increased at a similar clip. We note that local fuel price hike this year has been only 5% vs brent crude rise of 35%. Moreover, Food inflation in WPI has spiked to 5.7%. There could be upside surprise in inflation from June. RBI reduced repo rates by 25 bps to 6%, (50 bps so far in CY 2019). Mar trade deficit came in at $10.9 bn, up from $9.6 bn MoM with exports rising 11% YoY and imports rising 1.4% YoY. The RBI executed its second USD 5bn forex swap auction with a three-year tenor on 23 Apr '19, infusing rupee liquidity worth INR 348.74 bn into the banking system and it also announced OMOs of Rs 250 bn to be done in May in two rounds (Rs 125 bn each).

Interest in India remained robust from FIIs and continued in April, with FIIs bringing in close to $1.7 bn (YTD USD 9.9 bn) while domestic investments saw continued outflows at $0.6 bn (YTD $2.5 bn). Domestic Mutual Funds were net sellers to the tune of USD 0.8 bn (second straight month of net sell, first time in 33 months).

Going Forward

Q4 earnings have been a mixed bag so far, though results season has still one month to go. On 23rd May, the results of the ongoing general elections would be announced and provide short term direction to the markets. The near term stagnation in economy and government activity due to election, should restart post the formation of new government, thought the possibility of a fractured mandate cannot be ruled out fully (which may be construed as negative for the markets). Crude prices have also inched up, and USD is strengthening (dollar index very near to 52 week highs), which do not augur well for the Indian economy. As per IMD, monsoons are expected to be normal in CY19 which in turn would be a positive after last few years of erratic monsoons. We expect volatility to continue in the near term and believe that the best way forward is to be invested in quality companies with strong track record, cash flow profile and growth prospects.

Debt Market

ELECTION EVENT RISK, TIGHT LIQUIDITY KEEP YIELDS ELEVATED.

Macro Review

CPI: CPI remained within RBI's projection for March 2019 (released in April 2019) printing at 2.86%. It was the eight consecutive reading below 4%, being RBI's medium term CPI target. The good news was that the Core CPI Inflation moderated to 5.1%, we expect Core Inflation to moderate further towards 4.5% in FY20, given the continued weakness in the economy.

Liquidity and Rates

Liquidity conditions remained negative which is unusual at the start of the year. Liquidity remained negative throughout the month of April on back of surplus in the government balances with the RBI. Generally the government spends at the beginning of the year but this being an election year, government spending has been much more muted which has resulted in lower liquidity. RBI announced and conducted the second USD INR Buy / Sell FX Swap of 3 yrs for USD 5 bn on similar lines as the first one. The amount offered in the FX swap was USD 18 bn though the forward premia went up in this auction. RBI also announced an OMO of INR 250 bn to be conducted in May, thus indicated that RBI will deploy different tools to manage liquidity.

Crude prices went up by 6.40% on the implementation of full sanctions on Iranian Oil though it is expected that the rest of OPEC countries and Russia will increase their production to match the reduction in supply from Iran. Brent Crude prices have risen by 32% since the beginning of 2019.

The rupee depreciated by 0.6% during the month on higher oil and appreciating USD. FII Inflows into debt market turned negative reversing the March Inflows. FII's outflows in fixed Income are more than USD 2 bn since the beginning of the year.

RBI cut the Policy rates by 25 bps though the market was disappointed in respect of its tone and degree of dovishness. The sovereign curve flattened after the policy announcement as traders rushed to unwind their long positions at the short end of the curve. The markets were expecting a change in the Monetary Policy stance to "Accommodative from Neutral", which did not happen and also a lack of clarity regards the stance and approach of RBI towards system liquidity.

The curve has flattened with short end of the curve underperforming the long end of the curve because of technical unwinding as well as profit booking.

Rise in crude prices along with fiscal uncertainty have kept the bond markets jittery.

Outlook

The outcome of the general elections will be important for the bond markets from a fiscal perspective. The movement of crude oil prices will also have a bearing on the markets as it affects Inflation, fiscal deficit and growth in India.

Currently the market is factoring in a win for the incumbent BJP led NDA coalition government. Any surprise on the election front will be a negative both for INR and bond yields.

We believe that GDP growth has slowed down markedly in India and there is distress in the rural economy. The new government will have a challenge to revive growth while being constrained on the fiscal side. We continue to expect further 25-50 bps rate cuts by RBI through FY20 to support growth. In our view the short end of the curve offers a better risk reward given that fiscally the situation is not that great and the rate cuts will support the short end of the curve.

Recommended Products

We recommend short duration products in the average maturity range up to 3 years, given the evolving macro backdrop.

We recommend the PGIM India Banking and PSU Debt Fund along with PGIM India Premier Bond Fund for investors seeking moderate duration exposure with a preference for high quality (AAA) portfolio. The PGIM India Credit Risk Fund in the 'accrual category' is recommended for investors seeking a higher 'carry' and with a slightly risk appetite.

PGIM India Dynamic Bond Fund is recommended for Investors with a higher appetite for Volatility.

Fixed Income Market

	March 2019	April 2019	Change (in bps)
Overnight rate (NSE MIBOR)	8.80%	6.20%	-260
1 yr CD	7.34%	7.63%	29
10 yr GOI Yield	7.49%	7.53%	4
USD/INR	69.15	69.56	41 paise
IIP (Monthly with 2 month lag)	1.44%	0.08%	-136
CPI (Monthly with 1 month lag)	2.57%	2.86%	29
5 Yr AAA PSU spread (bps)	64	50	-14
5 Yr OIS	5.94%	6.35%	41
US 10 Yr yield	2.40%	2.50%	10
CRR	4.00%	4.00%	0
Reverse REPO	6.00%	5.75%	-25
REPO	6.25%	6.00%	-25

Source: RBI Weekly Statistical Supplement & Bloomberg

Connect with us on: www.pgimindiamf.com 1800 2667 446

Source: RBI & Bloomberg

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