PGIM
India Mutual Fund

Market Outlook

October, 2019

Equity Market

GOVT. STILL NEEDS TO DO MORE TO REVIVE DEMAND AND CONSUMPTION

The market that was

Nifty was up 3.5% in October after gaining 4% in September and close to all time high levels. Nifty Midcap 100 Index gained 5% and Nifty Small Cap 100 Index gained 2.7% during the month. Amongst sectors, Autos (+13%) was a major gainer whereas Cement (-1.6%) and Telecom (-0.4%) were the laggards.

On the macro front, Aug IIP declined 1.1% yoy (capital goods -21%, consumer durables -9.1%). August CPI inflation inched higher to 4% (3.2% in July) again led by higher food prices. Core inflation came at 4% in line with CPI. RBI MPC announced a 25bps rate cut (CYTD cuts of 135bps in 2019) and gave signals for further rate cuts to support growth if needed. In Sep, Trade Deficit narrowed to $10.9bn as slowdown in import growth outpaced exports. In H1FY20, Centre's fiscal deficit reached 92.6% of target (113% without RBI dividend), thereby implying risks of fiscal slippage as GST collections remain subdued. India's core sectors, ranging from cement to steel and energy, contracted by 5.2% yoy in September, the most in 14 years, adding to a list of indicators suggesting that economic growth remained weak in the July-September quarter. India's gross tax collection growth in the first six months of the ongoing fiscal hit a decade low.

Buying by FIIs and DIIs continued with ~$2bn and ~$0.7bn of respective inflows during October (YTD net inflows to ~$10.2bn and ~$7.2bn respectively). Domestic MFs were net buyers in October to the tune of ~$0.8bn (YTD ~$8.2bn)

Going Forward

Result season of Q2FY20 is seeing decent earnings growth as many companies are shifting to the reduced tax rates as announced by the government. So far 27 out of Nifty 50 companies (with 75% weight in Index) have reported numbers. Their weighted average profits have grown 13.9% yoy, 1.3% ahead of Bloomberg estimates.

While lower corporate taxes address issues related to investments, Govt. still needs to do more to revive demand and consumption in the economy. RBI and Govt. are actively working towards a lower interest rate regime to revive the economy, this along with good monsoons and increased spend by the government would lead to a revival of economic growth in the coming months.

Key challenges are – 1) slippage in fiscal deficit as tax revenues are muted but expenditure remains higher, 2) the crisis in NBFC sector will continue to have its ripple effects across various sectors.

We believe these are good times to accumulate Indian equities.

Debt Market

SHORT END RATES FALL ON RATE CUT, LONG END UNCHANGED ON FISC WORRIES

Macro Review

CPI for the month of September 2019 printed at 3.99% very close to the RBI target of 4% and was approx 30bps higher than consensus estimates. Core inflation eased from 4.5% to 4.02% indicating continued decline in pricing power for producers in line with the falling GDP growth. Headline CPI inched up due to increase in food prices, rising 0.9% on a m/m basis. On a y/y basis the increase was 5.11% led mainly by volatile perishable food items but it was notable for its breadth of price increase in other items as well.

Liquidity and Rates

Liquidity conditions continued to improve in line with the 25bps rate cut in the October monetary policy and continued accommodative stance of RBI. Daily liquidity balances at the system level improved further compared to September. This was despite a higher currency leakage of INR 70,000 cr in October from state elections and the festive season. Average daily LAF balances for October stood at INR 1.9 trillion (INR 1.15 trillion in September).

INR marginally depreciated by 6 paise (-0.08%) against the USD over the month.

In a move that was highly expected, RBI at the October policy cut policy rates by 25 bps while maintaining an "accommodative" stance. Crude prices remained steady at close to USD 60 per bbl in October.

The yield curve steepened during the month with the shorter end of the curve outperforming the longer end as RBI cut the policy rates by 25bps and liquidity remained easy. The longer end of the yield curve witnessed pressure despite the rate cut, due to fear of extra borrowing and fading OMO purchase expectation whereas shorter end of the curve trended lower due to abundant banking liquidity.

Outlook

The longer end of the curve could continue to witness pressures from likely additional supply later in the year on back of revenue pressures arising from Corporate tax cuts and continued weakness in tax collections. We expect liquidity to continue to remain comfortable following assurance from the RBI that the system would remain well supplied with liquidity to aid in the rate transmission process. This in our view, renders the short end of the curve viz the 1-3 year segment as a sweet spot.

Recommended Products

We recommend Short duration products in the average maturity range of up to 5 years, given the evolving macro backdrop.

We recommend the PGIM India Banking & PSU Debt Fund along and PGIM India Premier Bond Fund within this category as suitable investment options for investors seeking moderate duration exposure and a preference for high quality (AAA) portfolio.

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

Fixed Income Market

	September 2019	October 2019	Change (in bps)
Overnight rate (NSE MIBOR)	5.52%	5.25%	-27
1 yr CD	6.42%	5.87%	-55
10 yr GOI Yield	6.70%	6.65%	-5
USD/INR	70.87	70.93	+6 paise
IIP (Monthly with 2 month lag)	4.61%	1.10%	-351
CPI (Monthly with 1 month lag)	3.21%	3.99%	78
5 Yr AAA PSU spread (bps)	47	45	-2
5 Yr OIS	5.10%	5.15%	5
US 10 Yr yield	1.66%	1.69%	3
CRR	4.00%	4.00%	0
Reverse REPO	5.15%	4.90%	-25
REPO	5.40%	5.15%	-25

Source: RBI Weekly Statistical Supplement & Bloomberg

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

Source: 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.