PGIM India Mutual Fund

Market Outlook

April 2020

Equity Market

Waiting for the economic activity to return

The market that was

The nation was under lockdown throughout the month of April. The Nifty-50 Index recovered 14.7% in the month (best calendar month since May'09). The BSE mid-cap and BSE small-cap Indices posted 14% and 16% gains respectively. Among sectoral indices, BSE healthcare gained 26%, followed by auto (+24%) and oil & gas (+20%) indices.

The Prime Minister extended the nation-wide lockdown until May 17th but gradual withdrawal has begun. The RBI announced liquidity and related regulatory measures to support the economy and the financial system (but credit offtake remains low and credit spreads continue to be high). US oil futures plunged below zero for the first time ever during the month. Facebook entered into a binding agreement with RIL to acquire 9.99% stake in Jio Platforms Ltd for an investment of Rs 436 bn (~US$5.7 bn) – one of the largest FDIs for a minority stake. A leading fund house decided to wind up six credit oriented debt schemes (further impacting already high credit spreads).

On the economy front, March CPI inflation moderated to 5.91% as against 6.58% in February. March WPI inflation moderated sharply to 1% as against 2.26% in February. February IIP growth improved to 4.5% as against a growth of 2.1% in January. Moody's slashed India's CY2020 GDP growth forecast to 0.2% from 2.5%.

FPIs sold US$503 M worth of equities in the month (compared to an all-time high single-month net sell of $8.4 bn in March) while DIIs sold US$184 M (compared to a net purchase of $7.5 bn in March)

Going Forward

Though the virus' intensity seems to have peaked in countries that were looking extremely vulnerable at the start of April, the future remains uncertain as worries of a relapse are real. The path to normalcy is still some time away as effective medications and vaccines are still being researched. In the meanwhile, lockdown, social-distancing and increasing work from home have become the new norm, at least in the near term. While this is an important step to save lives and counter the pandemic, it does come at a reasonably huge economic cost – lower growth, rising deficits, rising job losses.

While the early lockdown in India has certainly helped in containing the spread of the virus, we continue to see a steady increase in new cases as maintaining social distance is not easy in densely populated urban areas. In India, over 1 million people have been tested so far, with about 4% testing positive (much lower than many other large countries). Over 40% of districts in India are in green zones. India's response to the pandemic so far has had one of the strictest lockdowns and one of the lowest fiscal stimuluses (as % of GDP). As a country, we are paying a huge price due to the lockdown and there is an urgent need to restart economic activity. While an overall slowdown impacts all countries, India benefits from lower contribution of foreign trade to GDP, lower crude oil prices and healthy forex reserves.

We continue to believe that equities would offer superior returns over other asset classes over the long-term. However, sharp movement of stock prices (sharp fall in March and strong rally in April) clearly highlight the volatile nature of equities as an asset class and the need for proper financial planning, including asset allocation. One can expect increased volatility in markets as weak data starts coming – quarterly earnings and GDP numbers etc. We continue to stick to quality companies with lower leverage, higher capital efficiency and market leadership. We believe as and when this crisis abates India would emerge stronger.

Debt Market

Markets rally on surplus liquidity and rate easing hopes

Macro Review

CPI for the month of March 2020 came in at 5.91%, similar to market expectation but higher than RBI's target of 4%. Core inflation showed a slight decline from 4.08% to 4.06%. Headline CPI fell by 27bps m/m compared to a 73bps fall in the month of February, with the primary reason being the continued fall in vegetable prices. Consumer food price index fell on m/m basis and came in at -1.27% whereas y/y basis it was at 8.76%. Protein rich items showed marginal reduction (meat & fish, egg) while cereals & pulses witnessed marginal uptick in price on m/m basis. In light of the continuing lockdown due to Covid 19 pandemic, inflation is expected to remain soft in the coming months.

Liquidity and Rates

Liquidity conditions continued to remain in surplus mode in line with RBI's accommodative stance and the pledge to improve transmission of past rate cuts. Average daily LAF balances for April stood at INR 4.70 trillion compared to INR 2.97 trillion in March. In April, liquidity was infused in the secondary market to the tune of 60k Cr through OMO purchase. Currency leakage in the first 3 weeks of April was around INR 75,000 cr compared to INR 99,000 cr in March. The Rupee appreciated by 22 paise (0.29%) against the USD in April. Brent Crude oil continued to trade in the range of USD 15/bbl to USD 35/ bbl in the month of April whereas WTI crude created history by registering negative price of USD -37/bbl as traders rushed to square their long May future contracts in order to avoid taking delivery of the oil and incur storage costs.

On 17th April, RBI in order to encourage banks to boost credit flow in the economy, cut reverse repo rate by 25 bps thereby bringing it down to

3.75% from 4%. In addition, TLTRO 2.0 was announced to hasten the monetary policy transmission to credit issuers. To flatten the yield curve RBI also announced Operation twist of 10k where they bought 6-10yr securities and sold T-bills and 2021 securities.

In the absence of a fiscal stimulus, RBI is currently doing the heavy lifting to calm markets and bring stability by announcing various out-of-turn measures. Ways and Means Advances (Overdraft) Limits were increased for state govts from INR 35,000 cr to INR 52,000 cr, in order to ease the borrowing pressure from states which had led to a sharp rise in SDL yields. Also WMA limits for the Centre was revised to INR 2 lakh cr for the first half of FY21. T-bill borrowing was increased for the first quarter as the revenues for the government are expected to decline sharply due to the lockdown. So, effectively, extra borrowing from dated securities has now been pushed forward to the second half of the financial year by which time, things should become clearer.

Government security and money market segment of the market saw truncated trading hours (10:00 – 2:00) starting from 7th April which led to a spike in risk aversion owing to which RBI had to announce the above measures to calm the markets.

Government bonds were very volatile with the 10Yr benchmark trading in the range of 6% to 6.50%. In the credit space, yields tightened following negative market developments. On 27th April, RBI announced a further INR 50,000 cr of Special Liquidity Facility for MFs (SLF-MF) to arrest the spike in yields.

Outlook

We expect the bond market to remain positive due to ongoing risk off sentiment and sharp fall in crude oil price with further easing of liquidity. With both monetary and fiscal stimulus to support growth in the ongoing health pandemic we expect the steepening bias of the yield curve to continue. Front end of the curve should move lower with the new lower policy rate whereas longer end will face a lot of volatility with extra borrowing due to fiscal stimulus and further OMO purchase announcement from RBI to support the borrowing program of the government. Corporate bonds spread increased due to risk aversion but is expected to eventually head lower on the back of surplus liquidity in the system and Reverse Repo Rate cut of 25bps. Given this backdrop, we find the short end of the curve (up to 5 years) attractive due to attractive term spread over the overnight rate and extremely easy liquidity conditions. The long end of the curve is expected to remain volatile.

Recommended Products

Given the evolving macro backdrop, we recommend short and mid-duration products with duration in the 3-4 years range. We recommend the PGIM India Banking & PSU Debt Fund 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

	March 2020	April 2020	Change (in bps)
Overnight rate (NSE MIBOR)	4.81%	4.41%	-40
1 yr CD	5.12%	4.79%	-33
10 yr GOI Yield	6.14%	6.11%	-3
USD/INR	75.33	75.11	-22 paise
IIP (Monthly with 2 month lag)	2.10%	4.50%	240
CPI (Monthly with 1 month lag)	6.58%	5.91%	-67
5 Yr AAA PSU spread (bps)	70	113	43
5 Yr OIS	4.70%	4.27%	-43
US 10 Yr yield	0.67%	0.65%	-2
CRR	3.00%	3.00%	0
Reverse REPO	4.00%	3.75%	-25
REPO	4.40%	4.40%	0

Source: RBI Weekly Statistical Supplement & Bloomberg

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

Source: RBI & Bloomberg