PGIM
India Mutual Fund

Market Outlook

April 2021

Equity Market

Vaccines, earnings offer dose of relief

The market that was

Renewed restrictions across India, due to a surge in daily Covid-19 cases to 400k+, led to the Nifty (-0.4%) underperforming the global markets during April. FIIs turned net sellers for the first time in 2021 as the healthcare infrastructure of the country appeared to be overwhelmed with news reports of shortage of hospital beds, oxygen and medical supplies. However, positive news on the vaccine front (Sputnik EUA, allowing fast-track approvals for other vaccines, next phase for 18+ from May) provided some relief. Preliminary 4Q earnings came largely in-line (IT, Financials) or better than expectations (Materials, Staples) which helped support the market sentiment. In sectoral trends, Metals (+24%), outperformed as regional prices remained strong on the back of China's de-carbonization drive and resilient global demand. Pharma (+10%), Telecom (+3.5%) also outperformed while Realty (-8%), Capital Goods (-4%) and FMCG (-3%) were the underperformers.

FIIs were net sellers during the month to the tune of ~$1.5bn. This was the highest selling since March 2020 and the first selling month in 2021. YTD, FIIs have been net buyers of ~$5.7bn. Domestic Mutual Funds witnessed inflows in March after several months of redemptions.

Global Brokerages cut India's FY22 GDP Growth forecasts by 50bps to 200bps (new projections in range of ~10-12.6%) as renewed restrictions due to the second wave impacted activity levels across the country. Separately, Fitch affirmed India's BBB- rating with a Negative Outlook, forecasting a growth of +12.8% in FY22. Industrial production in February declined by 3.6% YoY – the biggest decline in 6 months. For Apr-Feb FY21 YTD, industrial production contracted 11.3% YoY. Infrastructure output, comprising eight core sectors of the IIP (wt. 40.3% in IIP), rose by 6.8% YoY in March 2021, which is the highest rise since July 2018. However, this came on a low base of March 2020, when output shrank 6.5%. which was the steepest rate of contraction since the series began in 2005. On 2-yr CAGR basis, output declined ~0.1%.

CPI print rose to 5.52% in March 2021 vs 5.03% in Feb 2021, largely on account of an unfavorable base. For FY21, average inflation stood at 6.2% - first annual print above 6% since RBI adopted the flexible inflation targeting framework. As expected, the Reserve Bank of India (RBI) kept its benchmark repurchase (Repo) rate at 4% during its April 2021 meeting, while maintaining an accommodative stance as long as necessary to mitigate the impact of the COVID-19 pandemic.

Six states/UT accounting for 1/3rd of India's GDP announced stringent lockdowns, and around 19 states accounting for 3/4th of India's GDP announced night curfews, and the states/UT accounting for half of India's GDP announced weekend lockdowns. This led to a broad-based fall in mobility across the country to levels last seen in Oct 2020.

India announced the next phase of vaccinations wherein all citizens above the age of 18 years would be eligible from 1st May. However, the shortage of vaccines meant a delay in implementation. To bridge the gap, the government decided to fast-track approvals of vaccines cleared for use in the US, UK, EU and Japan and allowed states/private players to procure the vaccines (up to 50% of supply) directly from the manufacturers.

A rapid increase in Covid cases led to a severe shortage of medical oxygen in the country, despite all the efforts to divert the supplies from industries to hospitals.

The end of state assembly elections in four large states and the victory of incumbents in three of the four states will result in greater focus on managing the ongoing Covid-19 pandemic in those states. The results of the state elections may not mean much for India's economic policies. However, it would be interesting to see the BJP's response to its loss in West Bengal where it had invested considerable resources and time.

India has a number of important state elections over the next 12 months, especially in two of BJP's 'bastion' states (Gujarat and Uttar Pradesh). The market will likely wonder if the BJP government would follow populist or reformist measures, or a combination of populist and reformist measures to 'regain' its popularity. The BJP has lost several state elections since late 2019 even though it won the 2019 general elections handsomely.

Going Forward

India is undergoing a severe second wave of Covid-19. Total cases have reached ~20mn with daily cases hitting ~400k. Total active cases is 3.3x of first wave peak and ~26x since Feb 2021 lows. Daily deaths also reached nearly 3x of first wave peak. Under 2% of the population has got 2 doses of the vaccine, while under 8% has got a single dose.

The impact on the economy and earnings will be clearer over the next few weeks depending on the duration and nature of lockdowns. There is little scope for earnings upgrades (barring global commodity sectors) and in fact, there is a possibility of seeing earnings downgrades. Upgrade momentum of FY22 consensus estimates has been decreasing recently, with upgrade downgrade ratio in BSE500 coming off to 1.4x in last 2 months from 2.75x in 5 preceding months. We observe lower-than-expected economic activity in 1QFY22 and margin pressures across sectors impacting earnings potential in near term.

The market has largely overlooked the second wave given consensus view of limited economic and earnings impact of this wave. Cash flows of 1-2 quarters of a company account for a very small share of its value (cash flows in perpetuity). However, we observe potential upward pressure on domestic bond yields given the increased pressure on government revenues. The second wave has exposed India's long-term structural challenges due to under-investment in education and healthcare. It would be interesting to see the governments' (central and states) post-pandemic stance on economic and social issues (stronger democratic institutions versus populism).

With global liquidity remaining high and global markets being strong, the impact of second wave on Indian markets seem to be limited. We remain positive on medium to-long term. Any near-term volatility due to news flow around Covid-19 cases would be an opportunity to add equity exposure.

We continue to stick to growth companies with strong balance sheets in the portfolio.

Debt Market

Inflation to moderate this fiscal

Inflation

After hitting a low in January, both CPI and WPI have continued an upward trend over the last 2 months. In March, WPI rose to its highest in 27 months leaping over 200 bps from its February print to touch the 7% handle. CPI in March 2021 rose to 5.5% from 5.03% in February.

In addition to the continuing supply disruptions over the past several months , high fuel prices have played a critical part in increasing the transportation and logistics costs. Food prices are also yet to soften significantly after a bumper rabi harvest. Crude has globally started softening a little after peaking in March, but still reigns over USD 60 / bbl.

Average CPI for fiscal 2021 stood at 6.2%, rising from 4.6% in the previous year. CPI is expected to moderate in fiscal 2022 as disruptions ease and the second wave, while equally severe, is handled with lesser disruptions and without a 100% lockdown this time around. For instance, movement of freight and cargo has been permitted and commercial vehicles are plying to near full strength. Also, factories and infra / construction have been permitted to function with safeguards and onsite guidelines.

MPC – April meeting

The MPC meeting outcome was along expected lines with RBI leaving all key policy rates unchanged. At the same time, RBI committed to support yields and liquidity as in the previous meetings using the entire array of tools at its disposal.

The policy tone was clearly dovish, with the RBI acknowledging upward impulses in both headline and core inflation. However, the Deputy Governor clarified that most of the recent contribution to inflation has happened, in RBI's judgement, due to "pandemic related disruptions" rather than "demand pull".

The policy and the minutes of the meeting unequivocally reflect the need to "support growth" even as inflation remains high in the "near term". Most MPC members view the inflation uptick as temporary and believe that the effects will fade as supply disruptions normalize over time.

Rates and liquidity

Liquidity in April continued to remain in surplus as reiterated by the RBI.

The MPC at its April meeting also remained "pro-growth" in its orientation and committed to keep the stance accommodative and to maintain system liquidity in surplus for "as long was needed" to ensure a return to durable growth. Unlike in the past, RBI refrained from specifying a time limit to maintaining easy liquidity conditions, and linked it purely to a "need-based" manner instead.

Outlook

The April MPC policy stood out for having departed from RBI's hitherto orthodox stance. RBI announced a calendar for Open Market Operations (purchases of G Secs in the secondary market) for the first time, terming it as a Govt Security Acquisition Program (GSAP 1.0). Under the program, RBI plans to buy INR 1 trillion of G secs in the current quarter.

Also, RBI used the policy to announce continuation of its liquidity normalization, with planned introduction of longer-term variable rate reverse repo (VRRR) operations. Hence, the short term liquidity that is being sucked out should be infused through longer term operations (under GSAP). This could lead to a compression in term spreads and some flattening in the yield curve.

Bond yields have been anchored for now by RBI's continued intervention in the secondary markets. Borrowing calendar for the first half of FY 2022 does not have any major surprises, with RBI looking to mop up 60% of the aggregate requirement (of INR 12.05 trillion) in H1. There is also a higher mop-up planned at the longer end of the curve. In tenors up to 3 years, the planned borrowing is the least.

For now, RBI appears to want to get growth back in a more durable fashion and hence avoid actions that can negatively impact the early-stage recovery. Also, rather than wait for a full recovery to take place, and probably learning from the post-GFC 2008 inflation surge, RBI prefers to initiate baby steps towards liquidity normalization.

Given this environment, we prefer the short / mid end products such as the Corporate Bond (PGIM India Premier Bond Fund) and PGIM India Banking & PSU Debt Fund along with the PGIM India Dynamic Bond Fund for investors with a higher risk appetite seeking duration gains.

Investors with a shorter time horizon of up to 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

	March 2021	April 2021	Change (in bps)
Overnight rate (NSE MIBOR)	3.50%	3.43%	-7.00
1 yr CD	4.38%	3.90%	-48.00
10 yr GOI Yield	6.18%	6.03%	-15.00
USD/INR	73.10	74.06	96 paise
IIP (Monthly with 2 month lag)	-0.90%	-3.60%	-270.00
CPI (Monthly with 1 month lag)	5.03%	5.52%	49.00
5 Yr AAA PSU spread (bps)	5	20	15.00
5 Yr OIS	5.26%	5.20%	-6.00
US 10 Yr yield	1.72%	1.63%	-9.00
CRR	3.50%	3.50%	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 higher for the previous reading.

Riskometer

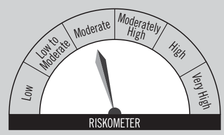
This product is suitable for investors who are seeking*:

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 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

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



Investors understand that their principal will be at moderate risk

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

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

Source: BSE, RBI & Bloomberg