PGIM India Mutual Fund

Market Outlook

August 2021

Equity Market

Index, inflation trend strong

The market that was

The benchmark indices ended at record high levels, with the Nifty Index gaining 8.7% - the best month in CY21, led by index heavyweights. However, the broader markets underperformed, with the Nifty Midcap 100 Index gaining 2.3% and Nifty Small Cap 100 Index declining 2.3%. Among sector indices, Power, IT and Oil & Gas gained more than 10%. Metals and Realty indices ended with a marginal loss of 1.9% and 2.9%. India was the best performing market among global markets.

Globally, rising covid cases and consequent restrictions weighed on sentiment but hawkish expectations from Jackson Hole failed to materialize, supporting risk assets. Rising regulatory concerns in China and push on "common prosperity" seemed to support other Emerging Markets, including India. In India, new covid cases remained under control (30-40k) but a worsening situation in the state of Kerala kept authorities on alert.

A favorable base effect (-24.4%) aided a sharp spike in 1QFY22 GDP growth to 20.1% yoy, but 2-year CAGR shows a decline of 4.4%. The sequential momentum slowed (-16.9%) more sharply than expected in a quarter affected by the second Covid wave.

WPI Inflation came in at 11.2% yoy for July'21 – the lowest in 3 months, but the 5th straight month of double digit inflation – for the first time in 13 years. CPI inflation eased to a 3-month low of 5.6% yoy in July 2021, from 6.3% in the previous month. It was the first time since April that inflation remained within the central bank's 2-6% target range. As per an RBI survey, household inflation expectations reached their highest levels since Sep'14, in double digits for 14 months.

The RBI kept interest rates unchanged at a record low to support the economy, even as a split appeared among rate setters on continuing with the lower-for-longer stance. Policy makers voted 5-1 in favor of keeping the stance accommodative, a departure from the past when they were unanimous on the need to support growth amid an impending third wave of the pandemic. The RBI raised inflation forecast to 5.7% for the current financial year, from 5.1% previously and retained its own growth forecast for the current financial year at 9.5%. The minutes were hawkish at the margin. Consensus expectations are now of a calibrated normalization via more measures to manage transitory liquidity

The Finance Minister announced a National Monetization Pipeline (NMP) envisaging total asset monetization potential of Rs 6trn over FY22-25. While not completely new, the NMP promises to bring a more focused approach across government wings.

FIIs were net buyers to the tune of $1.2bn in August (YTD $7.5bn) vs -$1.7bn in July while DII buying moderated to $0.9bn (YTD $2.9bn) vs $2.5bn in July. DII buying was largely driven by Domestic MFs who bought $1.4bn (YTD $2bn), fueled by NFO-related inflows.

Going forward

Corporate earnings in the first quarter of FY22 have been in line with the elevated expectations, aided by the deflated base of 1QFY21 and localized and less stringent lockdowns v/s 1QFY21. Nifty Net Income growth came in at 101% yoy. While there have been some cuts to the FY22E estimates, the consensus number still stands strong around 30%. Management commentaries across the board suggest an improved demand environment post June'21, led by the easing of restrictions, lower active COVID-19 cases, and a pickup in vaccinations. However, the impact of rising commodity costs and higher inflation in general is reflected in the P&L.

High frequency data indicates a continuous economic recovery. Fertilizer sales, merchandise exports, railway freight, Manufacturing PMI, government gross receipts, daily e-way bill generation, GST collections are looking strong. India has inoculated at least 50% of its adult population with 1 dose and 15% with both doses. Rainfall worsened to 9% below average from -1% in end-July.

In a record low rate and high liquidity environment, economic recovery along with revival of corporate earnings growth bodes well for equity as an asset class. Nifty has delivered strong earnings growth trends during the past Fed hike cycles & market returns tended to track earnings growth. As long as we are in rising liquidity and low rate phase, the valuations can remain elevated and markets can remain buoyant for much longer than many think. We continue to stick to quality names with strong cash flow profiles and healthy growth prospects to play the India growth story.

Debt Market

Recovery seen, but will continue

Inflation

After two consecutive months of over 6% prints, CPI for July (released in August), came in lower at 5.59%. Besides a favorable base, slowing monthly momentum in prices across most categories of food and non-food helped the lower inflation. Fuel prices however continued their firm trend given higher prices of petrol and diesel and no significant easing in crude prices. Core inflation remained sticky, printing at 6.02%, down marginally from 6.25% in the previous month (a 7-month high).

IIP came in at 5.7% (-8.4% in the previous month) in June, after 2 consecutive months of contraction. High frequency indicators such as auto dispatch, electricity consumption, e-way bills, GST collections were signaling a revival, post the peaking of the second wave in June. For the month, the leading engines of IIP included manufacturing and electricity.

Rates and liquidity

Liquidity, already in a surplus, continued to rise steadily month-on-month. From over INR 6.85 trillion in July, the durable system liquidity rose further to over INR 9.5 trillion. Steady dollar inflows which continue unabated have been responsible in a big way for the excess liquidity. CIC outflows after the mid-year have slowed down as well, thereby leading to excess liquidity.

Decision to scale up VRRR at the MPC should help to soak up some of this liquidity, although the residual liquidity will still remain meaningful.

As a result of this excess liquidity, front-end yields rallied meaningfully. One-year CD yields fell by almost 20 bps with the long end (10-year benchmark) remaining flat. This led to a steepening in the yield curve through the month. The short end covering the 1-3 bonds, also rallied sharply given the limited liquidity bias and limited supply.

August MPC outcome

As expected, the August MPC was a status -quo with RBI leaving all key rates unchanged. A pro-growth stance will leave surplus liquidity in the system, as the MPC has been keen to revive growth in a sustainable manner. There was no change in the accommodative stance either.

However, the RBI initiated baby steps towards normalizing excess liquidity by proposing doubling of the liquidity suction under VRRR (Variable Rate Reverse Repo) from INR 2 trillion to INR 4 trillion.

Interestingly, the vote for an "accommodative stance" was not unanimous as in the previous meetings, with 1 member in favor of a "neutral stance". The inflation forecast was also raised from 5.1% to 5.7%. The road to normalization of inflation appears some time away, given stubbornly high commodity prices, supply disruptions, higher logistics costs. Besides, severe disruptions faced by the informal sector and small businesses have been highly inflationary, as these firms have competitive cost structures and are highly active in the production of a wide array of goods such as textiles, garments etc.

Outlook

Minutes of the MPC meeting reveal that both the Governor and deputy governor were highly accommodative in their stance articulating the need for handholding of the economy for a longer while as recovery was still nascent and was yet to take root. Given the ongoing support in most of the developed markets, wherein the fiscal support has also been higher, RBI is likely to err on the side of continued support for longer until the growth outlook is more certain and worries around a third wave recede.

Given this background, we recommend short products such as corporate bonds (PGIM India Premier Bond Fund) and PGIM India Banking & PSU Debt Fund for investors with a 1-3 year horizon. The PGIM India Dynamic Bond Fund is an option for investors with an ability to handle some volatility while seeking duration gains. Investors with a shorter time horizon of up to 6 months should 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

	July 21	August 21	Change (in bps)
Overnight rate (NSE MIBOR)	3.39%	3.38%	-1.00
1 yr CD	4.02%	3.80%	-22.00
10 yr GOI Yield	6.20%	6.22%	2.00
USD/INR	74.42	73.00	-142 paise
IIP (Monthly with 2 month lag)	28.60%	13.60%	-1500.00
CPI (Monthly with 1 month lag)	6.26%	5.59%	-67.00
5 Yr AAA PSU spread (bps)	15	15	0.00
5 Yr OIS	5.22%	5.15%	-7.00
US 10 Yr yield	1.23%	1.32%	9.00
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

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

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