PGIM India Mutual Fund

Market Outlook

December 2023

Equity Market

We see lesser earnings volatility for domestic consumption-oriented sectors

Nifty50 closed with strong gains of 7.9% in December 2023, and ended CY2023 at near all-time high, on the back of retail participation, strong FPI/DII flows, domestic macroeconomic stability and positive earnings momentum. The NSE Mid Cap 100 Index and NSE Small Cap 100 Index were up around 7.6% and 6.9% respectively. At sectoral level, all sectoral indices ended on a higher note for the month; Energy, Infrastructure, Information Technology and Realty sectors outperformed broader market, while Auto and Pharma sectors underperformed.

During CY2023, Nifty50 index generated 20% returns and Indian markets emerged as one of the top-performing equity markets. During 2023, Indian Mid Cap and Small Cap indices outperformed the Large Cap indices, and were up 47% and 56% respectively for the year. FPIs bought $ 6.9 bn of Indian equities in the secondary market, whereas DIIs bought $ 1.6 bn for the month of December. During CY2023, FPIs were net buyers to the tune of $ 21.1 bn.

In other key developments, BJP – the ruling party at the Center – won three of the four state elections conducted during November. On the macro-economic front, the RBI maintained the status quo on rates and kept the stance unchanged, the US Fed held rates at 5.25%-5.5% for a third straight time and laid out the timeline for rate cuts in 2024 and beyond. CPI inflation in November spiked up to 5.6% from 4.9% in October, largely due to higher vegetable prices and October 2023 IIP was up 12% YoY vs 6.2% seen in September 2023.

Going forward

Indian equity market continues to outshine many global peers on the back of strong domestic inflows, encouraging economic data, strong corporate earnings growth and stable government policy. US rate cuts, weakening USD, falling oil and other commodity prices bode well for the Indian economy and earnings growth of domestic oriented corporates, though global growth slowdown may adversely impact the earnings of export-oriented corporates in the near-term. Premium valuation in the Mid and Small Cap segments of the market, any adverse union election results and rising geo-political issues are the key near-term risks to the Indian equity markets. Post the sharp runup in markets, we are cautious on the near-term return potential of the equity markets, while remaining optimistic for the medium- to long-term. Mid Caps and Small Caps in general have become more expensive after the recent runup. Many weak (low growth + low quality) Mid Caps and Small Caps are in bubble zone and caution is advised. Strong (high growth + high quality) Mid Caps and Small Caps may still present opportunity for long-term investors. On a relative top-down basis, we are finding better upside in Large Cap stocks versus Mid Cap and Small Cap stocks and see lesser earnings volatility for domestic consumption-oriented versus export-oriented sectors.

Debt Market

10 yr benchmark bond may trade in a range of 7.10% to 7.30% over the next one month

The bond yield curve flattened in the last month of the year as short-term yields rose marginally and long end yields came down after the policy pivot by the US Fed. The 3-5 yr segment of the bond curve outperformed. Money market yields up to 1 yr segment inched higher as banking system liquidity remained tight with RBI injecting short term liquidity into the market via variable rate repo (VRR) auctions. The key reason for the tightness in interbank liquidity has been a very high government surplus. In our estimates, currently, the government is running a surplus of around INR 3 trn. The government surplus will come down over the next three months on back of higher spending which can lower the liquidity deficit. Bond yields at the long end of the curve came down after the US Fed policy meeting as the Fed policy pivoted to a pause. The RBI MPC policy was on expected lines as status quo on rates was maintained though RBI reiterated its concern on food inflation while acknowledging the downward trajectory of core inflation. Bonds yields came down at the long end of the curve in sync with the fall in US and European bond yields though the fall in Indian bond yields has been muted relative to the fall in US and European bond yields.

Brent crude oil also fell by 7% as concerns remained on the demand outlook. CPI inflation came in at 5.55% and the core inflation came in at 4.10%, a 44-month low, which is heartening given the strong growth dynamics. Food inflation, especially pulses, remained elevated. RBI's intervention in the FX market found mention in IMF's annual review, which re-classified India's foreign exchange policy from floating to stabilised arrangement on account of excessive intervention by the RBI since December 2022. RBI strongly rebuked this observation suggesting that the time frame concerned was too short to make an assessment and any policy needs to be seen over a longer time frame of 3 to 5 yrs. Going by the numbers released in RBI's latest monthly bulletin, it seems RBI has been intervening pretty heavily in the FX market. RBI's gross intervention (buy and sell combined) was the highest ever in October, standing at $ 73 bn, with $ 36 bn intervention both on buy and sell. RBI's intervention in the FX futures and forward market has risen, and RBI's forward book went into negative zone at $ 14 bn, the first negative forward position after more than 3 yrs. This shows that the preference of RBI's intervention in the FX market has shifted from spot to forwards and futures. FPI inflows in the bond markets have increased post the announcement regarding the inclusion of Indian sovereign bonds in the JP Morgan GBI-EM Index to the highest in 6 yrs. In CY 2023, FPI debt inflows totalled at $ 7.27 bn, with $ 4.80 bn coming in last three months post the index inclusion announcement. The current account deficit moderated to 1% of GDP in Q2 FY24 compared to 1.1% of GDP in Q1 and 3.8% of GDP in Q2 FY23. The BOP surplus was modest at $ 2.60 bn in Q2 FY24 compared to $ 24 bn in Q1.

The OIS curve has outperformed the sovereign curve in December with the 5 yr OIS falling by 33 bps as compared to the 11 bps fall in the benchmark 10 yr bond yield. The yield of the 5 yr bond fell by 18 bps during the month. INR was stable ending the month at 83.21 appreciating 19 paise from its all-time low closing against the USD in November.

Global bond yields led by US treasury yields came down across the curve with the benchmark 10 yr US yields down by 45 bps. The narrative of soft landing took hold with softer inflation data along with slowing growth. The US bond market is pricing in 150 bps rate cuts during 2024, which might prove to be optimistic given the cautious Fed stance amidst strong growth. RBI is likely to start cutting rates only after the global rate cutting cycle starts, which in our view, is likely to happen from Q2/Q3 of CY 2024 onwards. Markets tend to react before the start of a rate cutting cycle and the current yields offers a good opportunity for investors to increase their allocation to fixed income as slowing growth and moderating inflation is likely to lead to rate cuts in 2024.

We expect the 10 yr benchmark bond to trade in a range of 7.10% to 7.30% over the next one month.

Fixed Income Market

	November 2023	December 2023	Change (in bps)
Overnight rate (NSE MIBOR)	6.90%	6.90%	0
1 yr CD	7.80%	7.85%	5
10 yr GOI Yield	7.28%	7.17%	-11
USD/INR	83.40	83.21	19 paise
IIP (Monthly with 2 month lag)	5.80%	11.70%	590
CPI (Monthly with 1 month lag)	4.87%	5.55%	68
5 Yr AAA PSU spread (bps)	38	45	7
5 Yr OIS	6.52%	6.19%	-33
US 10 Yr yield	4.33%	3.88%	-45
CRR	4.50%	4.50%	0
REPO	6.50%	6.50%	0
SDF (Standing Deposit Facility)	6.25%	6.25%	0

Source: RBI Weekly Statistical Supplement & Bloomberg

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

Source: BSE, RBI & Bloomberg