

Market Outlook

February 2023

Equity Market

Concerns remain, so do the opportunities

The Nifty Index declined 2% in February— its third consecutive month of decline. Mid-cap and small-cap indices were down nearly 2% and 4%, respectively. Sector-wise, power, metals and oil & gas were the laggards, while FMCG and capital goods were the only indices to close in green. Investors' concerns navigated around a hawkish policy stance by central banks, resurgent geopolitical tensions and the volatile move in a few conglomerate stocks. The Q3FY23 results season ended with earnings growth of 11% YoY for the Nifty. The earnings performance was impacted by global commodities such as Metals and O&G, while a positive contribution from the BFSI and Auto segments helped the earnings.

January CPI inflation surprised sharply on the upside at 6.52% from 5.7% in December, mainly due to a sequential rise in cereal prices. January WPI inflation moderated to 4.7% from 5% in December. The RBI MPC hiked the repo rate by 25 bps and remained concerned about high inflation, especially the core inflation, while being optimistic about growth. Minutes of the recent meetings of the RBI and the US Fed suggest that banks are willing to increase the interest rates further if inflation stickiness continues.

The GDP print for Q3FY23 came in at 4.4% which was slightly lower than consensus. Real GDP/GVA rose 7.7%/7.2% in 9MFY23 and Nominal GDP/GVA grew 18.2%/17.2%. The GDP numbers for FY21/FY22 were revised upward to -5.8%/9.1% from -6.6%/8.7%. December IIP moderated to 4.3% compared to 7.4% in November. India's output of eight core industries registered a 7.8 per cent growth in January 2023, against a 4.0 per cent growth during January 2022. January exports fell by 6.6% YoY. Moody's raised India's GDP growth estimate for 2023 to 5.5% from 4.8% due to a sharp increase in capital expenditure in the federal budget and a resilient economic momentum. GST collections rose 12 per cent in February to Rs 1.5 lakh crore on steady economic activity. January e-way bill generation, eased MoM, but in general, was strong at 82.44 million compared with 84.14 million in December, YoY growth was 20%.

In the capital markets, February saw 30 deals worth ~\$1.2bn executed. FIIs were net sellers in February 2023 to the tune of \$628mn and DIIs bought to the tune of \$2.3bn.

Going forward

Higher interest rates, slower growth, persistent selling by FIIs and an increasing risk of EL Nino in 2023 have impacted the markets, and valuations have corrected. Global uncertainty also added to the nervousness. On a 1-year forward basis, the Nifty trades at ~19x earnings vs a long-term average of 17.5x and the premium to long-term average has seen some moderation. While India continues to trade at a premium to some of its peers, we reckon the premium is justified given the healthy earnings growth prospects.

India seems to be on a balanced path of asset creation-led growth without deviating from fiscal prudence. The multiplier effect of asset formation should result in economic benefits in the long term, and importantly, for the long term. Hence, India is in a sweet spot and can see multi-year growth based on this phenomenon assuming the asset creation exercise continues. High frequency indicators like GST collection, peak power demand, recovery in Air Travel, PV, CV, Housing, Capital Goods and improving capacity utilization are showing healthy signs, and we expect things to improve when broader economic headwinds abate. While there are short-term issues, especially on the rural side, of consumption slowdown flaring up of inflation, rate hike cycle seeing elongation and high current account deficit, and we are mindful of them, we believe this situation would also lead to emergence of interesting opportunities for investing and allow for bottoms-up stock picking for healthy alpha generation.

A recent report by SEBI on analysis of profit and loss of individual traders throws some interesting insights. According to the report, while the number of traders has witnessed a multifold increase in the last few years, 89% of the traders incurred losses (In FY22) and only 11% of traders made profit. Further, top 1%-5% of profit makers accounted for 51%-75% of the total profit pool. While trading and F&O and related modes may seem easy and/or attractive in the short term, they are high risk propositions and can potentially result in permanent capital erosion. We reckon, wealth creation is best done through long-term investing and mutual funds offer a relatively safe, professional and institutionalized mode of long term investing and are well suited for the retail investors.

India remains a bright spot

Indian Bond yields rose across the board with a flattening bias as CPI Inflation surprised on the upside coming in at 6.52% against expectations of 6.00%, mainly due to higher food inflation as core inflation continued to be sticky. The MPC also increased the policy rates by 25 bps as expected, with a 4-2 majority with two of the three external members voting in favor of a “Pause.” The tone of RBI was on the hawkish side.

The upside surprise on CPI Inflation led the bond markets to price in another 25bps rate hike by MPC in the April policy. The yield curve flattened with the short end of the yield curve rising more than the longer end. The 10yr benchmark yield rose by 12 bps to 7.46% from 7.34% at the start of the month. The 1yr T-bill yield rose to 7.32% from 6.89%, rising by over 40 bps during the month.

Globally, the yield curve remains inverted as yields rose across the US and Europe, with inflation coming in higher than expected and growth numbers better than expected. In India, the OIS curve also rose with inversion sustaining as 1yr OIS rose by 30 bps to 7.04% from 6.73% and 5yr OIS at 6.70% from 6.29% at the start of the month. While there is a higher probability of RBI hiking the policy repo rate by 25 bps to 6.75%, inflation is not as serious an issue in India as it is in the developed economies as inflation is expected to gradually trend lower below 6% in the next two quarters, thus remaining within the RBI’s inflation targeting band. The RBI also has the flexibility to make the MSF rate operational as liquidity in the banking system tightens. Growth is also expected to moderate towards 6% in FY24 from an expected 7% in FY23, thus we believe that the RBI is in the last leg of the rate hiking cycle and the probability of a rate hike after the April MPC meeting remains pretty low.

INR depreciated against the US dollar by 0.90% during the month as the US dollar strengthened. Brent was flat during the month, ending at 83.89 as compared to last months close of 84.49.

PFI flows into Indian Fixed Income markets remained positive for the second consecutive month in 2023 witnessing inflows to the extent of USD 160Mn with CYTD 23 debt Inflows at USD 362Mn.

The incremental Credit / Deposit ratio of the banking system continues to be elevated with credit growth @16.10% and deposit growth@10.20% on a YoY basis putting pressure on short-term deposit rates and money market yields. This gap between the deposit and the credit growth rates means that the money market rates will continue to sustain at the current elevated levels with 1yr CD rates touching 7.90%.

We expect the 10yr Benchmark bond to trade in a range of 7.30% to 7.60% till March end.

Fixed Income Market


	January 2023	February 2023	Change (in bps)
Overnight rate (NSE MIBOR)	6.50%	6.70%	20
1 yr CD	7.75%	7.85%	10
10 yr GOI Yield	7.34%	7.46%	12
USD/INR	81.92	82.67	75 paise
IIP (Monthly with 2 month lag)	7.30%	4.30%	-300
CPI (Monthly with 1 month lag)	5.72%	6.52%	80
5 Yr AAA PSU spread (bps)	25	25	0
5 Yr OIS	6.29%	6.70%	41
US 10 Yr yield	3.50%	3.92%	42
CRR	4.50%	4.50%	0
REPO	6.25%	6.50%	25
SDF (Standing Deposit Facility)	6.00%	6.25%	25

Source: RBI Weekly Statistical Supplement & Bloomberg

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

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Source: BSE, RBI & Bloomberg

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