PGIM
India Mutual Fund

Market Outlook

November, 2019

Equity Market

A MODEST RECOVERY IN GROWTH IS EXPECTED IN SECOND HALF OF FY20

The market that was

Equity markets made all-time highs during the month supported by better earnings and foreign inflows. Nifty closed the month up +1.5% and Nifty Midcap Index closed higher by +2.4%. In terms of sectors, telecom was a clear outperformer driven by price hike expectations and partial spectrum relief, financial sector was driven by public and corporate private banks as both Essar Steel verdict and government's move to bring non-bank finance companies under the ambit of IBC fuelled optimism.

GDP print for Q2FY20 came in at multi-year lows of 4.5% reflecting the broad based slowdown.

Output of eight core infrastructure industries for the month of October contracted by 5.8% yoy – lowest in at least 14 years, indicating the severity of economic slowdown.

Fiscal deficit (Rs 7.2 tn) in the first 7 months of the current fiscal has reached 102.4% of the full year target (Rs 7.04 tn).

FIIs continued to invest in Indian equity markets during the month. FIIs net flow was close to US$3bn vs US$2bn in October. DIIs turned into net sellers ~$1.1bn (after being net buyers in last 6 months). YTD net inflows for FIIs and DIIs now stand at ~$13.2bn and ~$6bn respectively.

Going Forward

Indian markets rallied in the second half of the month driven by both global risk-on and some positive reforms announced locally. Market sentiment was buoyed following the Supreme Court's positive verdict on Essar Steel (whereby a precedence has been set to give preference to secured creditors at the time resolution / liquidation). Also, government has notified framework for dealing with systemically important NBFCs under the IBC process. There is good progress on strategic disinvestment of 5 public sector companies including BPCL and Container Corporation. These strategic sales are imperative for government to meet its disinvestment target of Rs1.05tn. However actual completion of stake sale of before March 2020 looks challenging. For the 2QFY20, Nifty 50 reported weighted average profit growth of 3.9% yoy (17% growth excluding Telecom). For the full year FY20, the consensus estimate for Nifty earnings growth is about 20%.

Economic growth has slowed down meaningfully over the last year. A modest recovery in growth is expected in second half of FY20 driven by a favourable base effect, above normal monsoon, lagged impact of monetary easing and corporate tax cuts. Govt. still needs to do more to revive demand and consumption in the economy. RBI and Govt. are actively working towards a lower interest rate regime and to revive the economy. We continue to believe in structural growth story of India and remain positive on equities as an asset class with a medium to long term view.

Debt Market

YIELDS RANGEBOUND AWAITING POLICY CUES AND FISCAL CLARITY

Macro Review

CPI for the month of October 2019 printed at 4.62% higher than the RBI target of 4% and was also higher than market expectation of around 4.3%. Core inflation eased from 4.02% to 3.47% indicating continued decline in pricing power for producers in line with the falling GDP growth. Headline CPI inched up due to increase in food prices, rising 2.1% on a m/m basis. On a y/y basis the increase was 7.89% led mainly by volatile perishable food items and protein rich items. The recent price rise is widely foreseen to be transitory on the back of erratic weather conditions and supply disruptions. It may be noted that food prices have scaled upwards but fuel prices and Core-CPI continue to remain soft. July-Sep GDP growth slowed to second weakest in the new rebased series starting 2012 (4.5% yoy from 5% in April-June), while GVA also slowed to a record low.

Liquidity and Rates

Liquidity conditions continued to improve, consistent with RBI stance to maintain easy liquidity conditions. RBI reiterated its easy liquidity stance at the October monetary policy meet, wherein it cut the Repo rate by a further 25 bps. Average daily LAF balances for November stood at INR 2.38 trillion compared to INR 1.9 trillion in October. Currency leakage (until November 22) declined steeply to about 10,000 Cr compared to 70,000 in October, which also happened to be the festive month.

INR depreciated by 81 paise (-1.14%) against the USD over the month; the decline was accentuated by the Central Bank buying dollars in the market, which has also pushed up Forex reserves close to USD 450 billion mark.

Crude Oil price remained rangebound between 60-65 $/barrel for the month November and prices could rise if there is further supply cut to support the crude oil price by the OPEC members on 5 Dec.

The yield curve steepened during the month with the shorter end outperforming the longer end given the combination of easy liquidity conditions and absence of the extent of fiscal slippage and its financing.

Outlook

We expect a 25bps cut in repo rate in December monetary policy on the back of weak growth conditions. Another round of growth downgrade is likely, increasing the possibility of a dovish package including either a bigger cut or an enhanced forward guidance that underplays food inflation and fiscal fears and links policy stance to specific growth threshold. Despite cut expectation the longer end of the curve could continue to witness pressures from uncertainty on government finances and likely additional supply later in the year on back of corporate tax cuts effected in September and sub optimal tax collections. We expect liquidity to continue to remain comfortable with the assurance from RBI that the system would remain well supplied with liquidity to aid in the rate transmission process. This in our view, renders the short end of the curve viz the 1-3 year segment as a favorable segment and a sweet spot.

Recommended Products

Given this backdrop, we recommend short duration products in the average maturity range up to 5 years. We recommend the PGIM India Banking & PSU Debt Fund along 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

	October 2019	November 2019	Change (in bps)
Overnight rate (NSE MIBOR)	5.25%	5.25%	0.00
1 yr CD	5.87%	5.79%	-8.00
10 yr GOI Yield	6.45%	6.47%	2.00
USD/INR	70.93	71.74	+81 paise
IIP (Monthly with 2 month lag)	-1.40%	-4.30%	-290.00
CPI (Monthly with 1 month lag)	3.99%	4.62%	63.00
5 Yr AAA PSU spread (bps)	45	38	-7.00
5 Yr OIS	5.15%	5.08%	-7.00
US 10 Yr yield	1.69%	1.78%	9.00
CRR	4.00%	4.00%	0.00
Reverse REPO	4.90%	4.90%	0.00
REPO	5.15%	5.15%	0.00

Source: RBI Weekly Statistical Supplement & Bloomberg

Note:
IIP has been revised downwards for the previous reading.
New 10year GSEC Yield is taken instead of Old 10 Year.

Source: RBI & Bloomberg