PGIM
India Mutual Fund

Market Outlook

March 2021

Equity Market

Constructive outlook despite an unrepeatable performance in FY21

The market that was

Amidst rising volatility, Nifty closed 1.2% higher in March 2021. It came off its highs as possibility of a second wave of coronavirus and rising bond yields played spoilsport. However, for the fiscal year, Nifty was up 71% which was its best performance in last ten years. Among sectors, Cement was the top gainer and IT, Basic Materials, Staples and Utilities also outperformed the benchmarks, while Banks, Auto, Energy, and Capital Goods underperformed.

On the macro front, Fitch Ratings raised India's growth projection for FY22 to +12.8% vs its earlier estimate of +11%. The CPI for February came at ~5% YoY (broadly in line) because of various factors such as a low base, higher food prices and higher fuel prices. Core CPI too came in higher at ~5.9% YoY and was again propelled by the Transport component of CPI.

Infrastructure output in India declined 4.6% YoY in February, which is the first decline in three months and the biggest since August. In January 2021, India's industrial production dropped 1.6% from the earlier year, reversing an upwardly revised 1.6% growth in the previous month and missing market expectations of a 0.9% increase. India Services PMI increased to 55.3 in February of 2021 from 52.8 in the previous month, which was the fifth consecutive month of expansion in the services sector, and the fastest expansion since February last year. India Manufacturing PMI edged down to 57.5 in February of 2021 from a three-month high of 57.7 in the previous month amid the restriction measures to contain the spread of coronavirus.

Centre's fiscal deficit for Apr'20-Feb'21 period came in at 76% of the revised estimate of ₹18.5 trillion. Brent crude was down 1.6% in the month of March. India recorded a current account deficit of USD 1.7 billion after three consecutive quarters of surplus in the last three months of 2020, which was equivalent to 0.2% of the GDP. While the current account balance turned back into deficit owing to a wider trade deficit, improvement in capital account balance led to a higher BOP surplus in 3QFY21.

FTSE Russell placed Indian government bonds on the watchlist for possible inclusion in its debt index, a move that may bring India closer to its aim of joining a global bond gauge after several false starts.

Capital markets saw action in the primary segment as well, with 27 deals worth ~$4.9bn (vs 11 deals worth ~$1.7bn in February on the back of stake sales and a slew of IPOs). FII buying dipped slightly to ~$2.5bn in March (YTD +$7.5bn) vs net inflows of ~$3bn witnessed in February. DIIs turning net buyers for the first time in 2021 with net inflows of ~$0.7bn (YTD -$3.2bn) was a change in near term trend.

Going Forward

Covid cases are again a near term monitorable as daily cases crossed 50k in last week of March from a mere 22k in mid-March. Active cases in India are ~40% below the numbers seen in September 2020, but 4.6x of lows seen in February 2021. However, the positive aspect is that a section of population has started getting vaccinated and with time as coverage increases the cases may not be as severe as seen in FY21. Further, given the economic impact of lockdowns, a repeat of the stringent conditions seems unlikely, though some restrictions may be put in place to curb the spread.

There is a serious push by the government to increase domestic manufacturing and reduce import dependence in many areas. Government has announced PLI schemes for quite a few sectors to kickstart corporate focus on local manufacturing.

The Nifty 100 components have seen consensus in upgrade of earnings. Margins played a major role in upgrades, but further upgrades will likely be revenue or operating leverage driven as cost pressures are set to rise.

After a stupendous FY21 for the markets, it's difficult to expect a repeat of such performance again in the near term. However, some trends such as digitalization, cost outs, manufacturing push are here to stay and set the stage for a longer-term growth story. While commodity price increase is a bit of a worry in general, the cyclical nature thereof tends to even out impact over the longer term as well. Excesses in IPO market is a major worry. Overall, the outlook on the markets remains constructive from a medium to long term perspective and continues to resort to quality to fend off any near-term volatility.

Debt Market

Macro trends favor short-mid-term products

Inflation

After the CPI softened in January 2021 (at 4.06%), it moved higher again at 5.03% in February. The uptick was broad-based with rise in prices across the board. Surprisingly, food prices declined on a sequential basis (by 0.44%), although they rose annually (up 4.25%). Furthermore we expect the winter harvest to keep food inflation in check until the start of the summer months.

Fuel inflation on the other hand rose both sequentially and annually as the fuel basket witnessed an upward pressure on the back of rising global crude prices.

Rates and liquidity

After a weak February, yields stabilised in March on the back of continued RBI action. Towards the latter part of the month, RBI also cancelled its last bond auction. This was well received by the market, which led to a strong rally, with benchmark yields coming off by 8-10 bps. The auction cancellation was made possible by robust Government cash balances owing to surprisingly high direct and indirect tax collections, for the March quarter. Moreover, GST collections in March hit a record INR 1.24 trillion, the highest since the start of the GST regime.

System liquidity continued to remain quite comfortable through the month. Core liquidity remained in surplus mode with LAF tracking upwards of INR 6 trillion on a consistent basis.

Outlook

Bond yields have been anchored for now by RBI's continued intervention in the secondary markets. Borrowing calendar for the first half of FY22 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. Tenors up to 3 years have the least amount of planned borrowing. The nature of planned market borrowing should in general lead to a natural steepening in the curve. However, much of the manner in which the yield curve reacts in FY22 will depend on RBI's intervention in the markets. The surprise element could happen from tax revenues that have been showing some buoyancy and could generate higher flows.

Given RBI's continued reiteration of keeping yields under control, we expect pre-emptive action if yields were to rise unusually at some point. For most part however, we expect the yields to remain range bound. Recent reversal in global yields and a rebound in the economy and rising inflation in our view leads to an upward shift in the lower end of the band. We expect the 10-year yields to range between 6.00 – 6.50%.

Given the backdrop of a strong recovery, large issuance volumes, a gradual normalisation of liquidity, stubborn commodity prices and a rise in US yields, we remain watchful on the longer end of the yield curve. We continue to prefer the shorter end of the curve in the 1-3-year duration, which offers better carry and lesser risk given lower government issuances as per the planned calendar.

As such we continue to favor the short and mid-term products such as the corporate bond fund (PGIM India Premier Bond Fund), the PGIM India Banking & PSU Debt Fund. The ideal way to have exposure to the longer end is through the PGIM India Dynamic Bond Fund. Investors with a shorter time horizon of upto 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

	February 2021	March 2021	Change (in bps)
Overnight rate (NSE MIBOR)	3.47%	3.50%	3.00
1 yr CD	4.25%	4.38%	13.00
10 yr GOI Yield	6.23%	6.18%	-5.00
USD/INR	73.66	73.10	-56 paise
IIP (Monthly with 2 month lag)	1.60%	-1.60%	-320.00
CPI (Monthly with 1 month lag)	4.06%	5.03%	97.00
5 Yr AAA PSU spread (bps)	17	5	-12.00
5 Yr OIS	5.34%	5.26%	-8.00
US 10 Yr yield	1.40%	1.72%	32.00
CRR	3.00%	3.50%	50.00
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

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