INVESTMENT PERSPECTIVES

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10 JULY 2018

MARKET OVERVIEW

The largecap bellwether index, S&P BSE Sensex ended the June 2018 quarter on a positive note, going up by 7.45%. However, smallcap & midcap stocks underperformed their large cap counterparts. The S&P BSE Midcap index declined by 3.21% and the S&P BSE SmallCap index declined by 5.66%. FIIs sold $3.00 bn during the quarter ended June 2018 while DIIs bought equities worth $5.62 bn during the same period.

Q4 results were muted but in line with estimates. For FY18, listed corporates reported an annualized revenue growth of ~10% and earnings growth of ~11% indicating that the economic recovery is picking up post the implementation of game changing reforms viz., demonetization in 2016, GST and Insurance & Bankruptcy Code (IBC) in 2017. Equipped with these reforms, the Indian economy and hence, the corporate performance is expected to improve over the forthcoming quarters.

Monsoon has been delayed but has picked up its pace and is likely to keep its date with the rest of the country. All eyes would be on spatial and temporal distribution of rains over the next two months. Monsoon is critical for rural economy; good monsoon would reflect into a good harvest which could drive demand led consumption. Given the fact that we are staring at an election year, the markets would be keenly watching out for the announcements for MSPs for various crops.

Trade war between US and its trading partners are getting nasty. The U.S. has imposed a 25 percent tariff on up to $50 billion of Chinese products, prompting Chinese administration to respond with a 25 percent tariff on $34 billion of U.S. goods, effective July 6, 2018. President Trump further threatened additional tariffs at a rate of 10 percent on $200 billion worth of Chinese goods. In response, China's Commerce Ministry has promised counter measures if Washington goes ahead. US have also threatened to impose tariff on cars imported from EU. Escalation of trade wars is likely to cause risk aversion in the market as it will impact global growth.

The RBI hikes rates by 25 bps in the June Monetary policy and now repo rate stands at 6.25%. The RBI policy statement does not guide on the future path in terms of clarity. The stance remains neutral and has not switched to 'withdrawal of accommodation'. Given the dispensation on Liquidity Adjustment Facility haircut, it makes front end bonds more attractive on the margin. Current yield on 10 year G-sec has already factored in couple of rate hikes going forward. The 10-year government benchmark bonds crossed the 8% mark amid concerns of inflation and government budget deficit and at the time of writing, is trading at 7.87%. At current rate, we don't expect front end rates to rise significantly further from here. However, we do expect volatility to continue to play a role in the markets.

EQUITY MARKET RECAP

Indian equity markets remained volatile in the quarter ended June 2018. Stock specific action was witnessed in Mid Cap and Small Cap stocks which were hammered compared to their Large Cap counterparts. The S&P BSE Sensex gained 7.45% for the quarter ended June 2018, while the S&B BSE Midcap and S&B BSE Small Cap index continued to fall in this quarter as well by 3.21% and 5.66%, respectively.

On the sectoral front, the performing sector for the quarter ended June 2018 was S&P BSE IT which gained 15.04% followed by and S&P BSE FMCG (+8.97%), S&P BSE Bank Nifty (8.66%) and S&P BSE Healthcare (+6.43%). The top 3 Sectors which ended the quarter in negative terrain were S&P BSE Power (-8.43%), S&P BSE India PSU Index (-7.24%) and S&P BSE Realty (-7.02%)

Among Sensex stocks for the quarter ended June 2018, TCS (+29.48%), Kotak Mahindra Bank (+28.27%), HUL (+22.79%), were the top performers while Tata Motors(-17.77%) & Tata Motors DVR (-13.59%), ONGC (-11.22%) & Wipro (-7.18%) were laggards.

During the quarter ended June 2018, FIIs were net sellers of equity to the tune of Rs 20185 Cr while DIIs were net buyers to the tune of Rs. 37712 Cr & the domestic MFs bought Rs. 31467 Cr worth of equity.

EQUITY MARKET OUTLOOK

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OPEC meeting at Vienna between OPEC and non OPEC nations ended with a resolution to increase crude oil production by 1 mn bpd, however it is unlikely to see more than 700,000 bpd supply in the open market because several OPEC members, such as Venezuela, Libya and Angola, are struggling with internal conflicts, while Iran’s exports will be limited by U.S. sanctions. Though the increase in quota has been below expectations, still higher crude production is likely to keep pressure on oil prices which should eventually benefit Indian economy given India’s dependence on imports for its oil requirements. Crude oil price is critical for the Indian economy as a rise in oil prices impacts India’s import bill and hence the fiscal balance.

US Fed has increased the policy rates by 25 bps in its last meet and signaled for two more rate hikes during the year, as the FOMC officials expressed confidence about US economy’s strength. The ECB, in its policy meet, reported that it will gradually taper the stimulus programme through the rest of the year, cutting its monthly asset purchases in half to €15bn after September and phase them out entirely by end of the year. Further they indicated that low interest rates are here to stay till mid 2019.

DEBT AND MACRO ECONOMIC OUTLOOK

RBI hikes rates 25 bps, repo rate now at 6.25%, but stance held neutral

- Persistence of inflation and higher projections flagged, but stance allows flexibility ahead

May'18 CPI inflation rises to 4.87% from 4.58% in April, as expected

- Though prices of fruit were higher, this was offset by other food products
- All segments in services (misc.) except recreation witnessed rise in inflation leading a rise in core inflation
- WPI inflation rose to 4.43% from 3.18% in April, on higher minerals, crude and petroleum products

April'18 IIP improved to 4.9% YoY, from 4.4% in Mar, still less than 7.1% in Feb

- Capital goods (machinery equipment, construction machinery) was the major contributor
- Textiles (all types) showed contraction, partially offset growth in construction goods and durables

May'18 trade deficit highest since February at USD 14.6 bn, No impact seen in trade finance debt

- Exports were up 20.2% YoY, driven by petroleum and 13.9% up ex-petroleum and precious items, boosted by engineering goods, chemicals, drugs and pharma, plastic and rice
- Imports grew 14.9%, and was up 18.5% ex petroleum and precious items, boosted by electronics, machinery, organic chemicals, fertilizers, iron and steel , non ferrous metals and coal (higher prices)

Risks from global markets are intensifying: Trade Wars, Hawkish Fed and EMFX Sell Off

- India, China and others imposed retaliatory tariffs on some US imports
- Oil price risk still persists, though low, on Iran not agreeing to pact with Saudi and tensions in Venezuela

Higher inflation readings, with broad based increase, as well as positive growth numbers, boosted yields in the first half of June

However, lower oil prices, soothing Finance Ministry comments, announcement of OMO purchases, and lower global yields brought this back down to May-end levels

RBIs latest announcement of OMOs is being seen as a tool to calm down the Gsec markets over concerns on slippages, elections and oil prices

Election related risks could also make themselves apparent later in the year (GST collections against ambitious targets, state fiscal dynamics, commodity prices, MSPs)

OIS markets are currently pricing another rate hike within the calendar year

We remain constructive on short term income funds which can be considered by investors with minimum investment horizon of 12 to 18 months Medium duration funds and Credit risk funds forming a part of the Axis Select List (erstwhile corporate bond funds) can be considered by investors with minimum investment horizon of 24 to 36+ months.

SPECIAL ECONOMIC UPDATE

RBI hikes rates for the first time in 4.5 years to 6.25% on concerns of inflation

- RBI noted that higher non-tradable inflation seen in core numbers was likely to be persistent; trajectory well over 4% targets argued for a hike
- However, trajectory remains flat, as opposed to rising, allowing for a neutral stance with scale and speed of response more dependent on evolution of inflation/growth dynamics
- Hardening of household inflationary expectations as per RBI HH surveys, stronger growth, demand side pressures, as well as MSP increases were roundly cited by MPC members to favour the hike

Stance maintained as Neutral

- Even dovish MPC members made hawkish arguments, implying that stance is not truly neutral, but indicates no urgency on future hikes

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