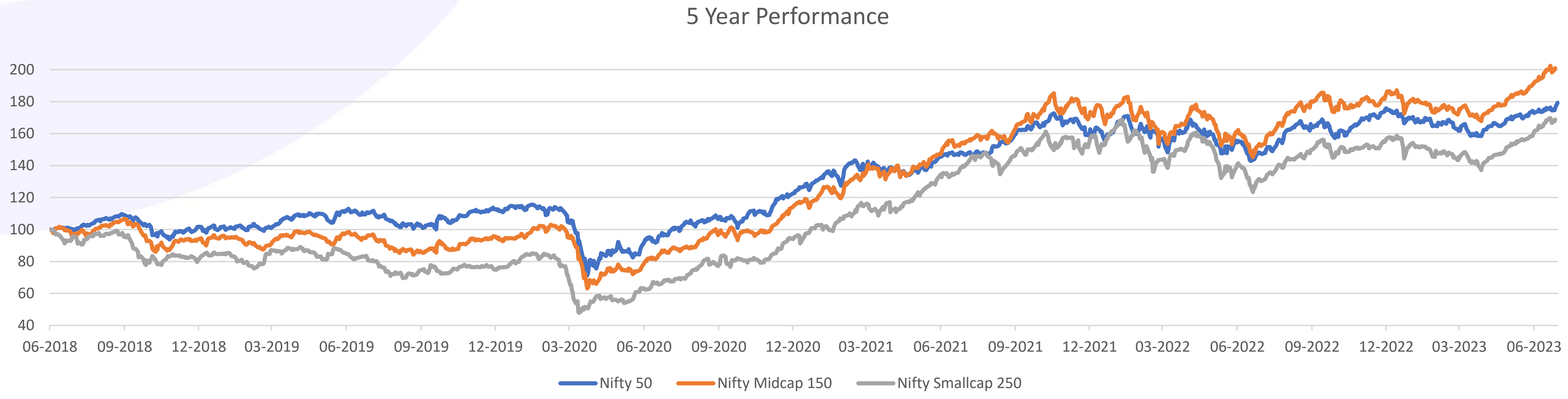
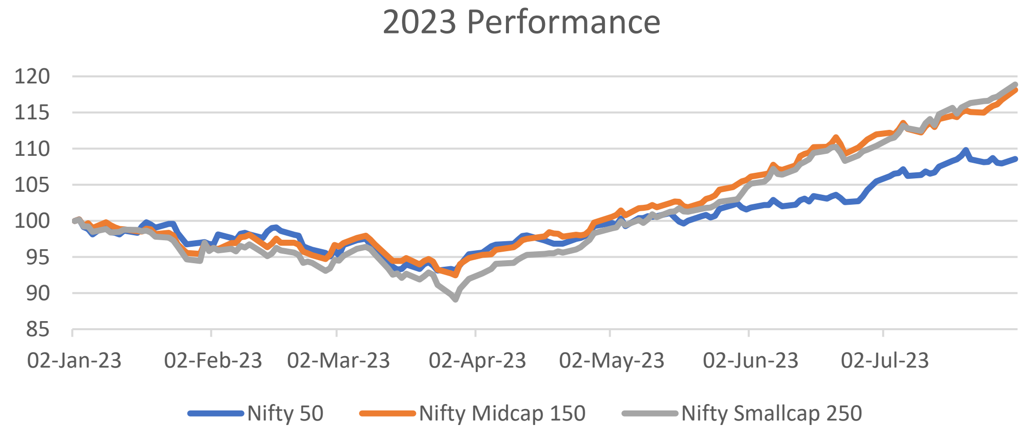
Market Insight - July 2023

Equity Outlook

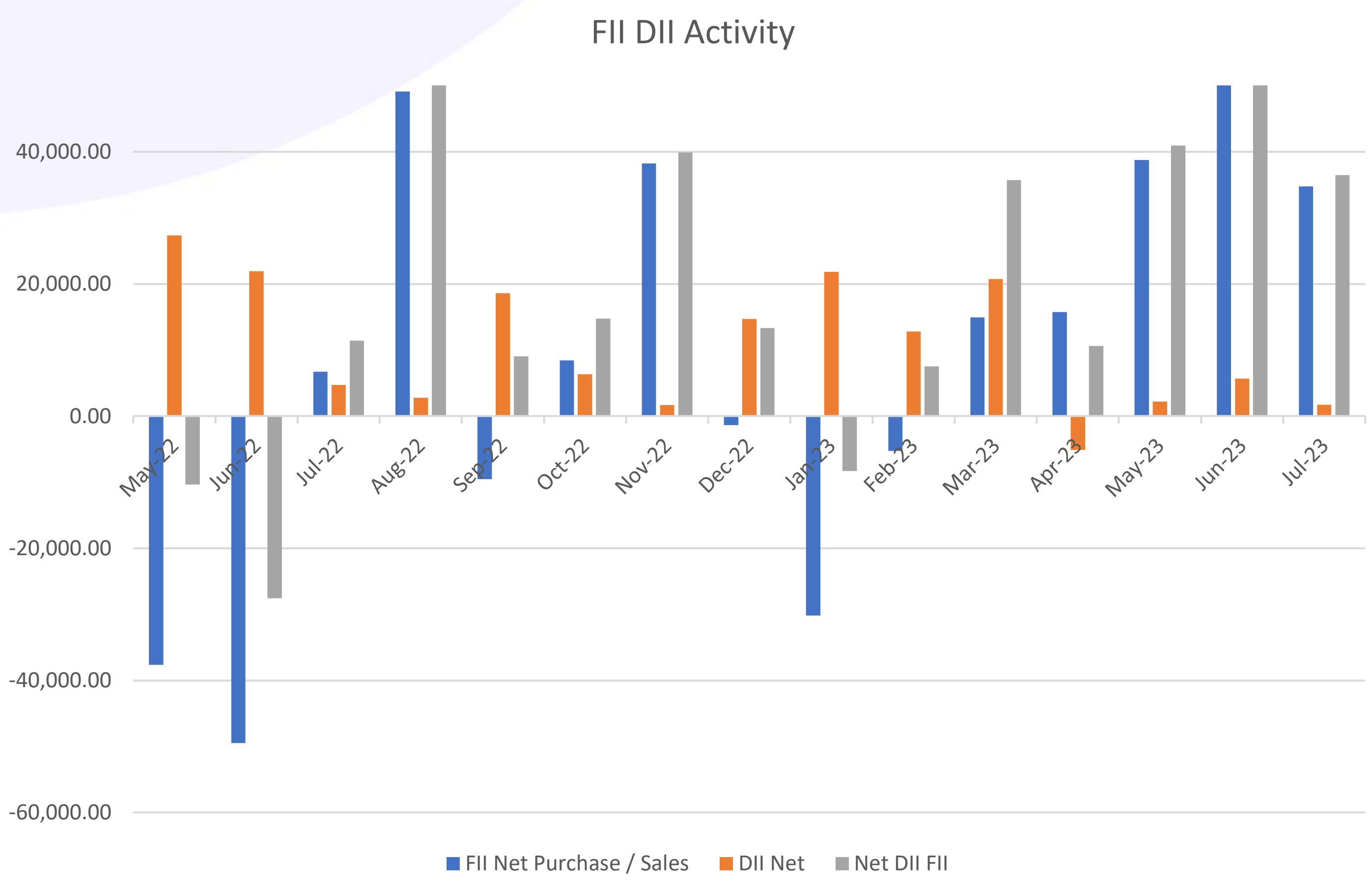
Indian Equities made a comeback : 2023 Snapshot





- Indian Equity markets turned positive for the calendar year in May 2023 after a severe fall in the first quarter of the calendar year.
- A correction was seen in Feb and March due to bad Q4 2022 GDP numbers, but markets saw a recovery in April and market has continued its bull run for 4 consecutive months, thanks to strong FII buying.
- From market cap perspective, Mid & Small caps have outperformed the large caps since the lows of March end.

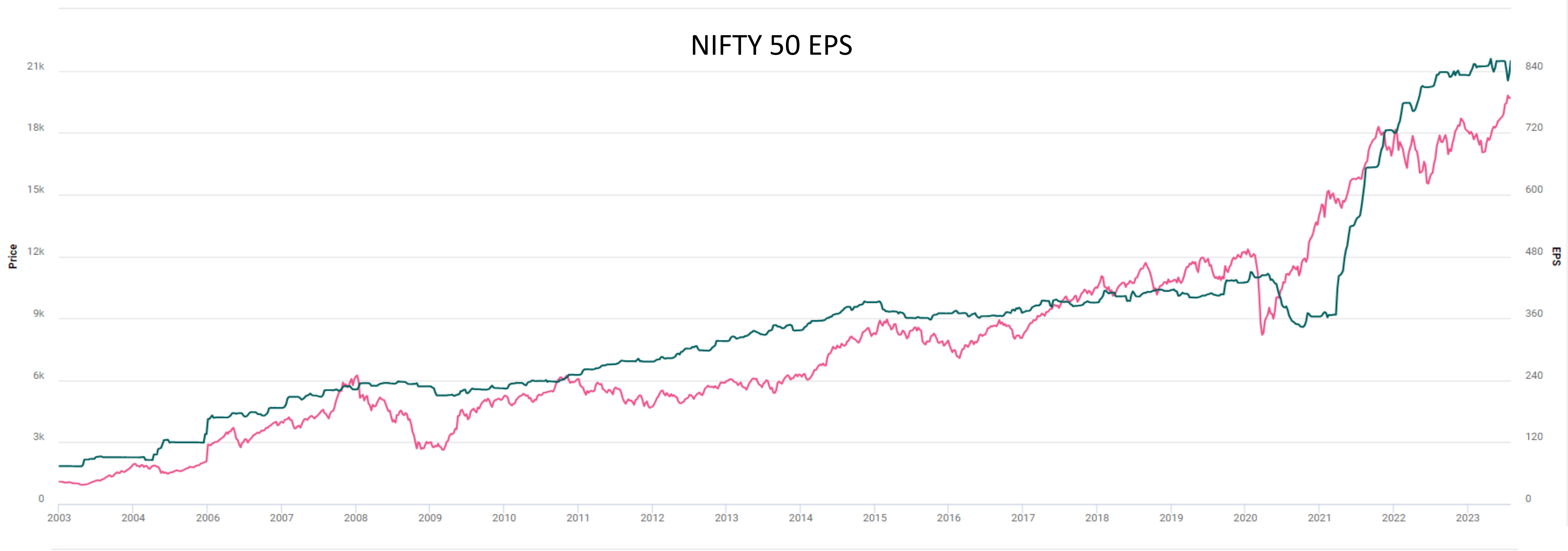
Recent rally fuelled by FII flows



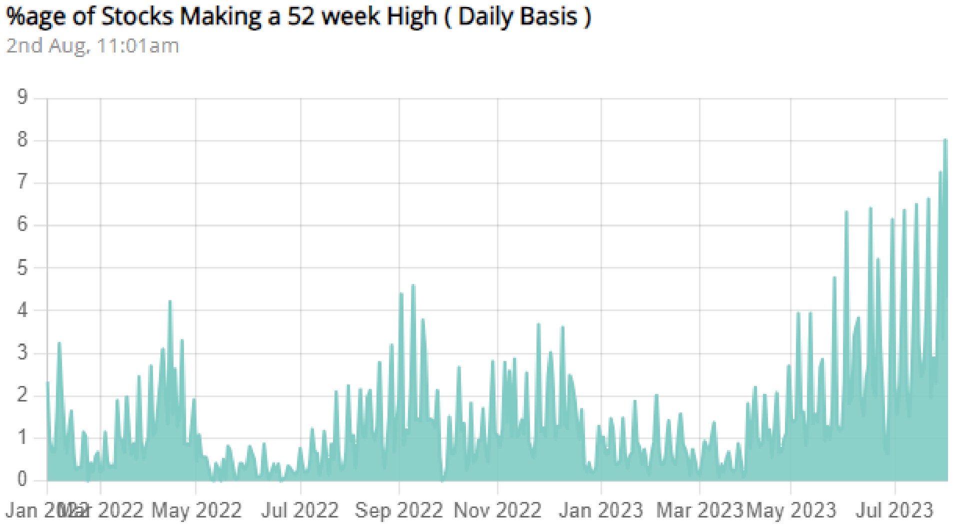
- There was heavy selling by FIIs in 2022. However, Domestic flows supported big outflows and now FIIs have reversed the trend.
- FIIs took a u-turn in 2023 and have been continuously buying in the Indian Equity Markets.
- June 23 saw highest inflow from FII in last 12 months.
- FIIs have bought nearly 20 billion USD worth of Indian Equities in this CY.
- Domestic Institutions have been on the sidelines in the past few months after buying in first three months of CY2023.
- Overall flows have been positive since March.

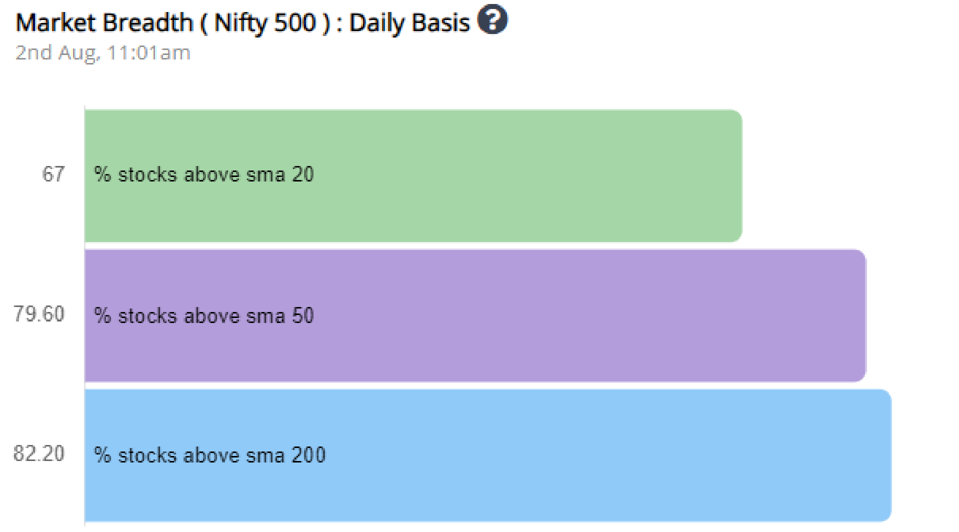
Bull Run Supported by earnings growth

- After a decade of draught in earnings, earnings made a comeback in 2021 in Indian Markets.
- Nifty 50 earnings are almost 2.5x in last two years.
- Last time such earnings growth was seen from 2004-2008 where earnings went up 3-4X during that period.



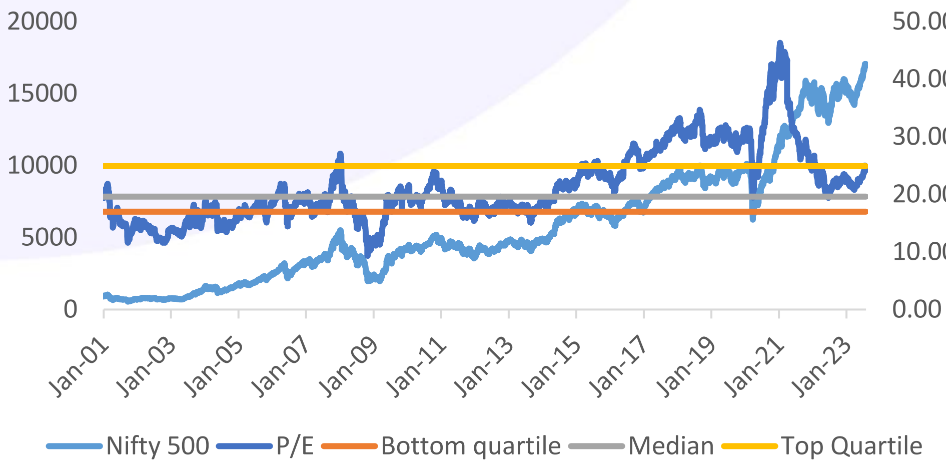
Technical Indicators look strong

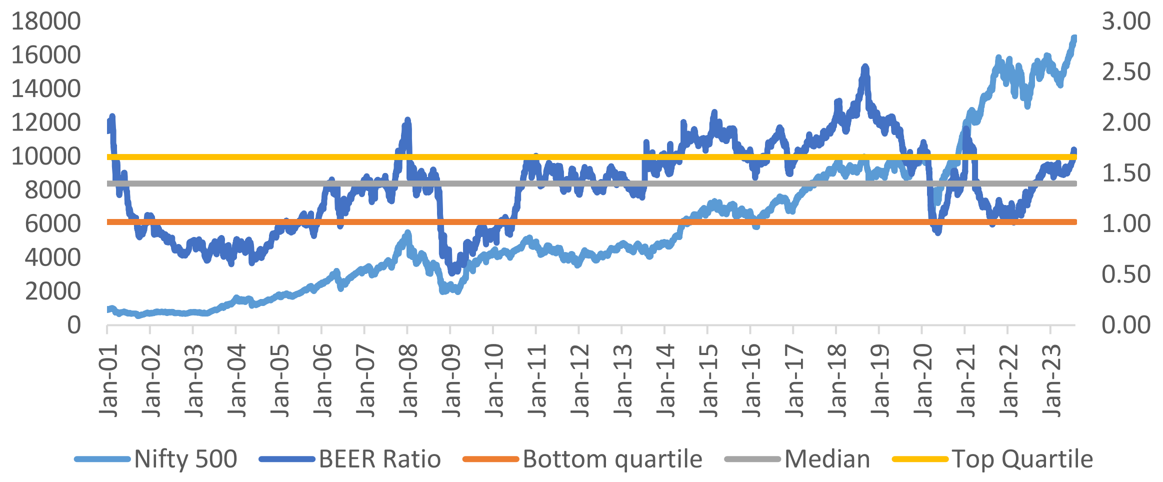


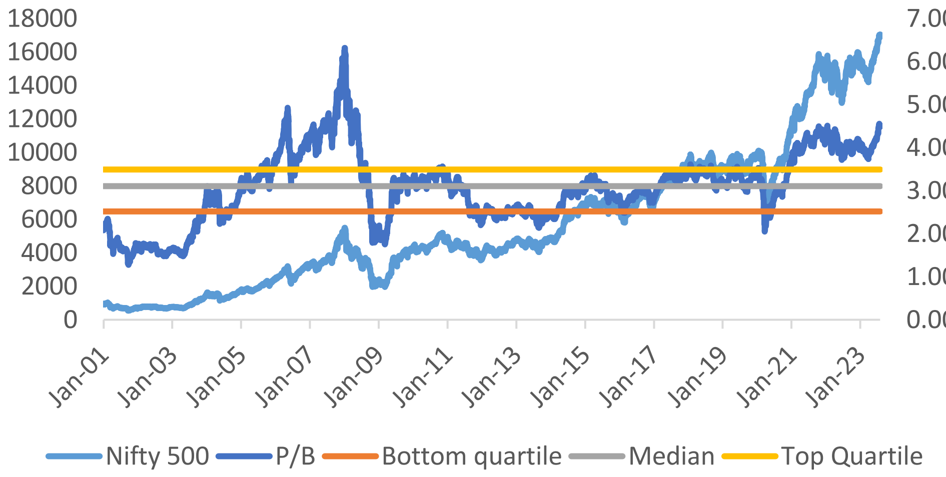


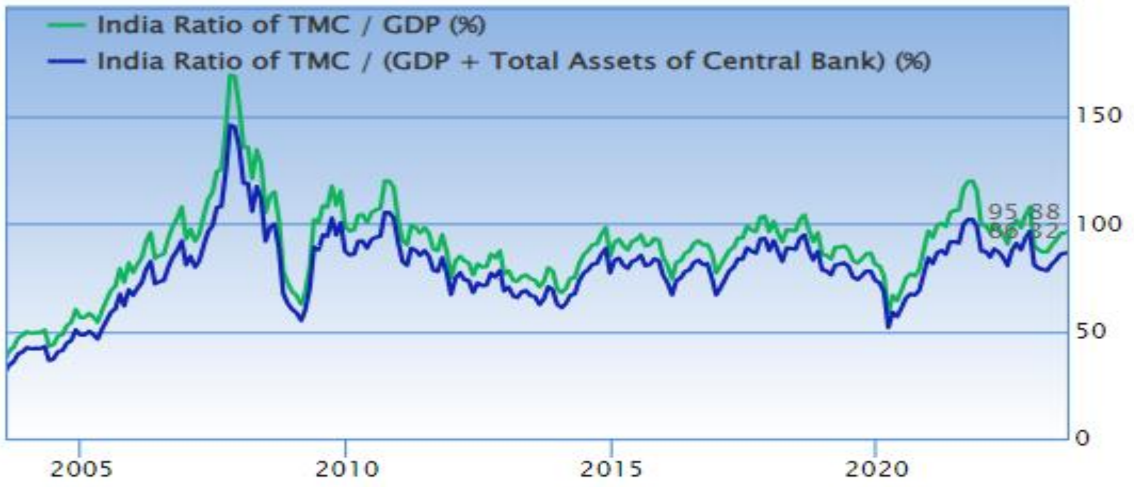
- The bull market that started in 2020 made a top in Oct 2021 near 18600 levels.
- Markets consolidated for nearly two years.
- Recently, Nifty50 index made a new all time high in June crossing Oct 2021 high. Trading above 50 and 200 DMA.
- Mid cap and Small cap indices have also broken out of their resistance levels.
- Other technical factors such as: no. of stocks making 52-week highs, % of stocks above 20, 50 and 200 DMA also indicate bullishness in the market.

However, Concerns remain on Valuations –near top quartile on PE, PB and earnings yield, fair on MCap to GDP



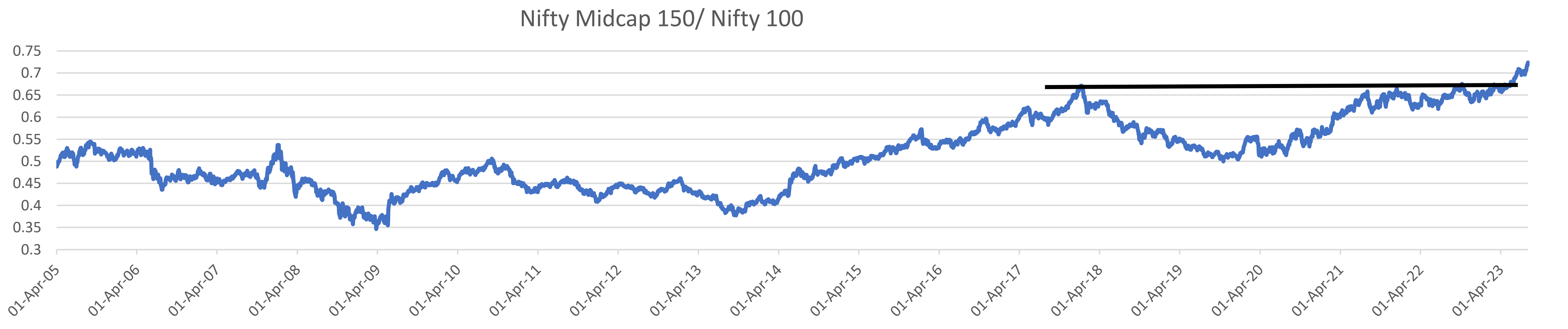






With respect to Mcap, Mid cap & Small Cap look Attractive

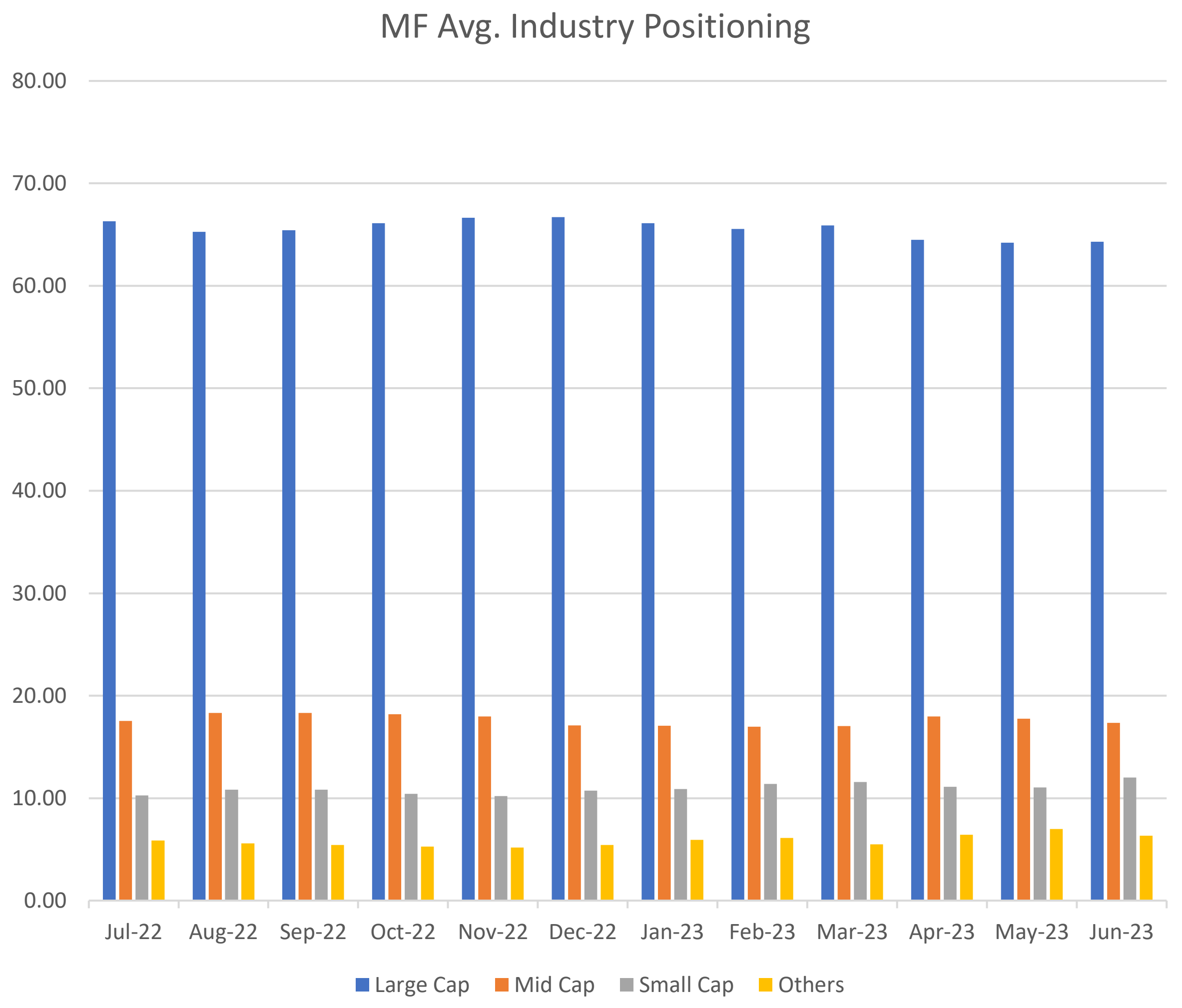
- On 2 year rolling return basis, mid and small cap are still below the largecaps
- Further, from technical perspective, Post Dec 2017, midcap to nifty levels have breached that mark In April-2023 and now look poised to continue upward trajectory.



Industry Positioning : Large, Mid and small cap

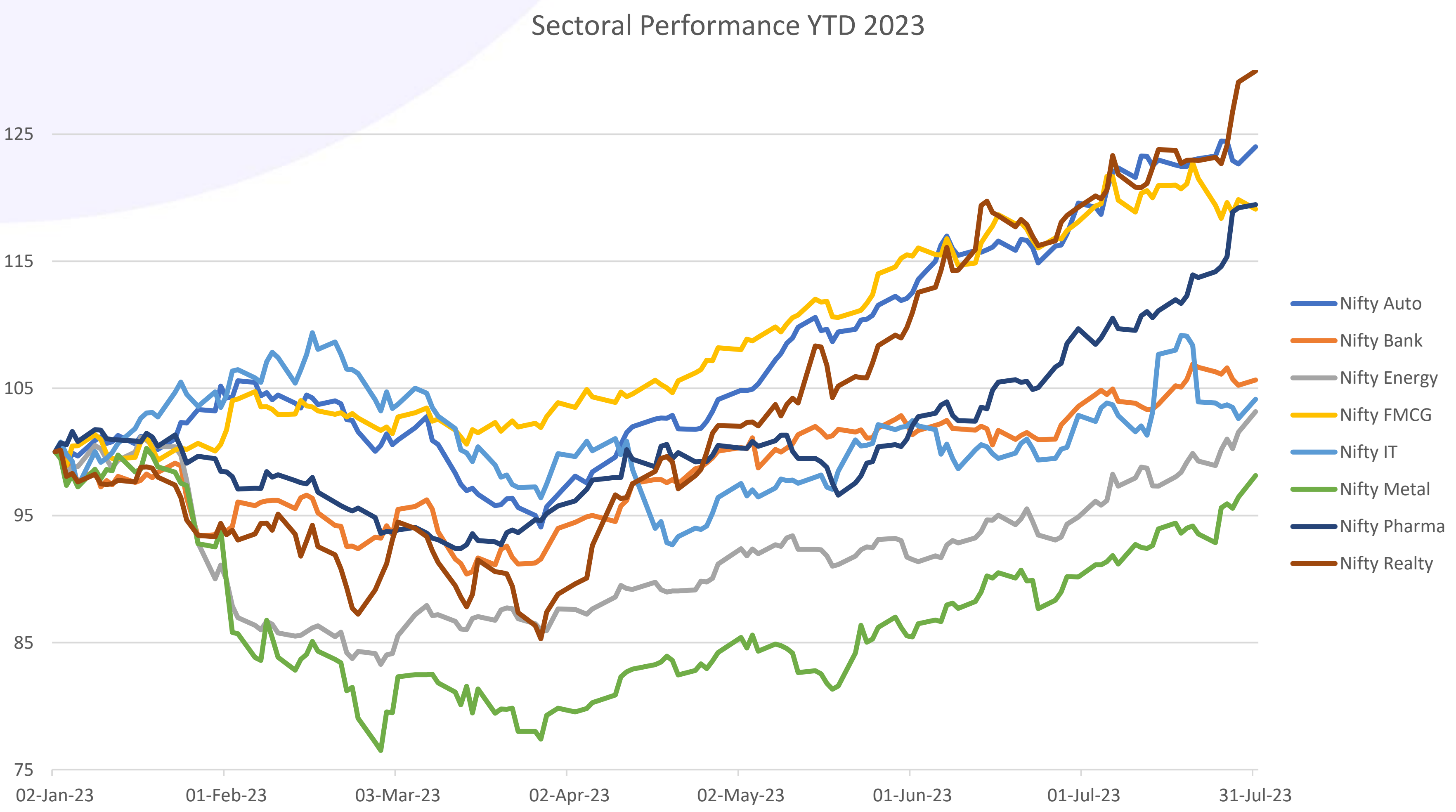
	Current	Nse 500 ETF	Industry last 12 m avg	Last 12 m min	Last 12 m max
Large	64.31	76.19	65.59	64.21	66.72
Mid	17.34	15.68	17.63	16.96	18.31
Small	12.02	8.03	10.95	10.21	12.02

- MF industry too is bullish on midcaps over large caps. As seen in the allocation of flexi cap category on an average.
- The allocation to mid-caps is above the 12m average, while the allocation to large caps is below the 12m average
- Also, industry is bullish on small caps as the allocation is highest in last month. Well above the industry average and Index fund allocation.



Source: ACE MF

Sectorally - Industrials and Energy led the recent rally



- Almost all sectors gave Positive returns in 2023, except metals.
- April-July rally was led by Autos and Realty.
- IT recovered after its downfall on the earnings disappointment in Q4 2023
- Banks and IT have been flat for last 2-3 months
- FMCG and Pharma have done well YTD
- In banking, credit growth seems to be reviving (decadal high) while Banks CAR is at all-time high levels. MF Industry too is positive on banking.

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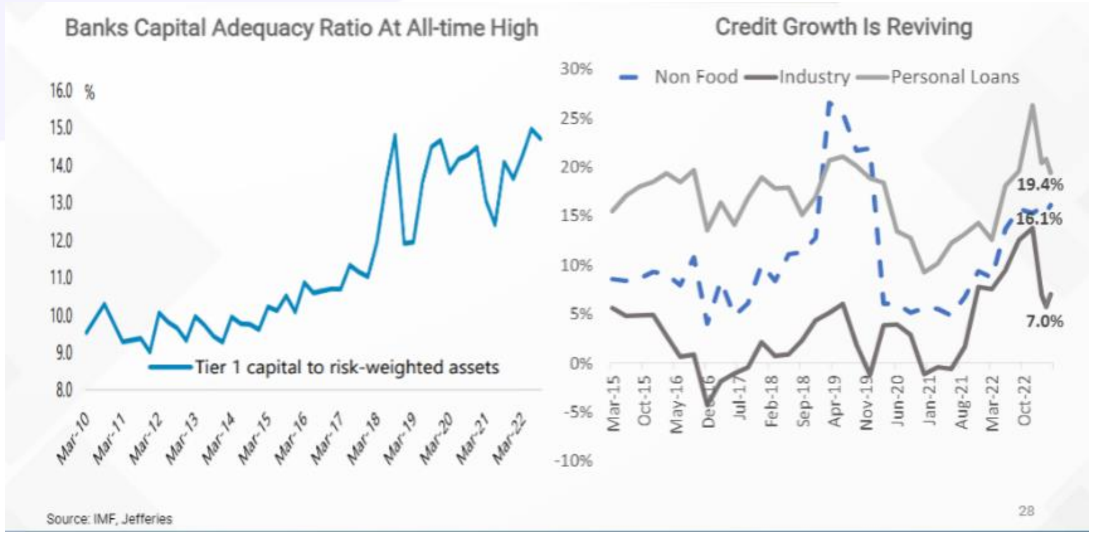
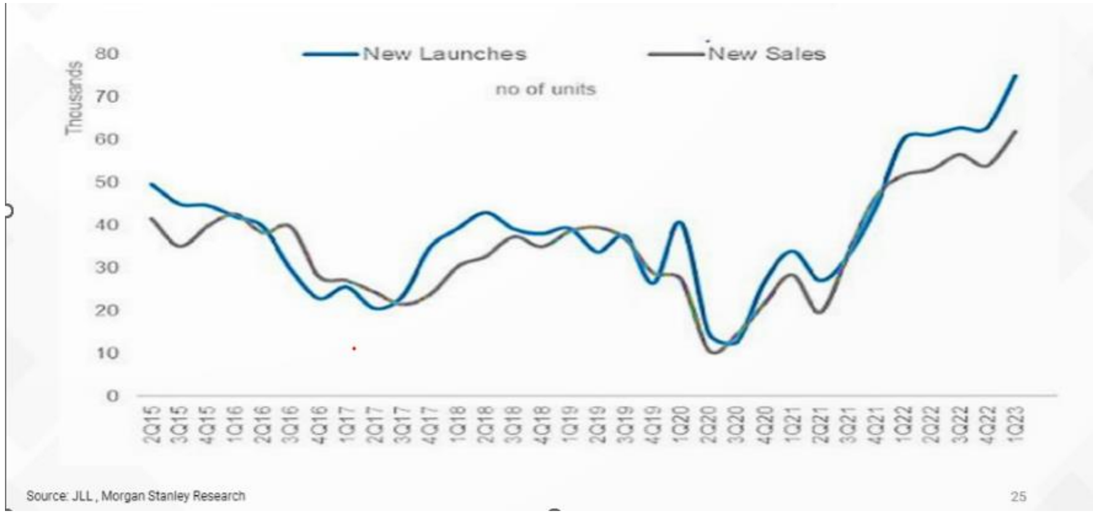
Sector Outlook: Positive on Auto’s, Banks, Real Estate

Banking: Decadal high Credit growth



House sales Pick Up



- Banks have seen highest credit growth in decade. Almost all banks showing improved ratios – NIM, CASA, low NPAs
- Revival seen in Auto Cycle in 2023. Many stocks from the Auto pack are making all-time highs breaking the highs of 2018 where the last Auto cycle peaked
- Real estate sector has picked up after decadal low returns. Real estate stocks are making multi year highs. House sales in key cities are at a decade high levels.

Source: Kotak MF

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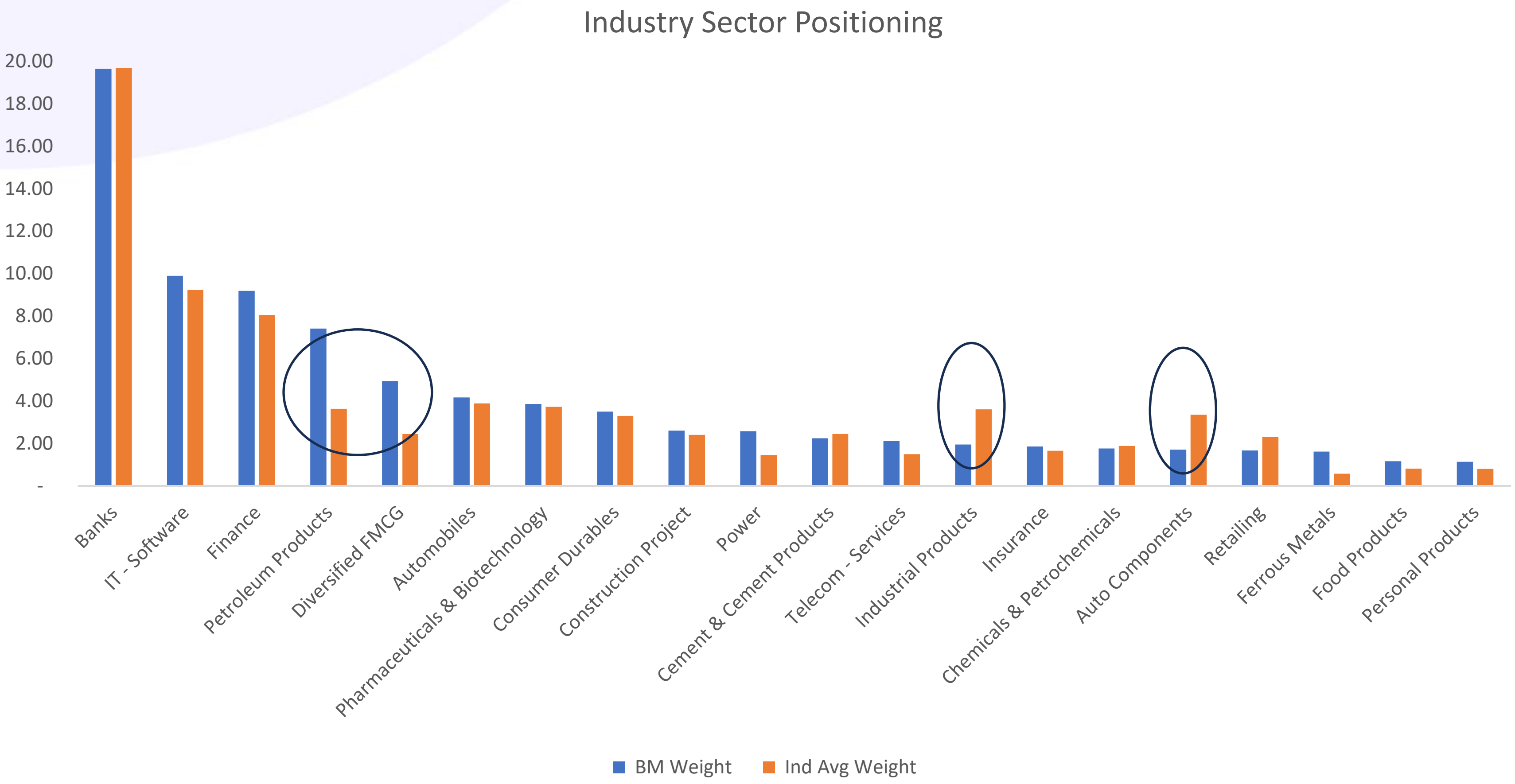
Industry placing bets on Auto components and Industrials



Source: ACE MF

- MF Industry exhibits notable overweight positions in Industrial Products, Auto components.
- Mainly underweight positions in Petroleum Products, Diversified FMCG, Finance.
- The industry is also bullish on cement as well as Banks.
- Whereas there is under ownership in IT stocks.

MF Industry positioning on stocks

Large cap

Overweight	active Weight	BM Wt	Ind Wt
Tri-Party Repo (TREPS)	1.73	-	1.73
ICICI Bank Ltd.	1.16	6.63	7.79
Axis Bank Ltd.	0.89	2.75	3.63
Sun Pharmaceutical Industries Ltd.	0.77	1.15	1.92
NTPC Ltd.	0.76	0.91	1.67

Underweight	active Weight	BM Wt	Ind Wt
Reliance Industries Ltd.	-2.50	8.75	6.25
Tata Consultancy Services Ltd.	-1.45	3.43	1.98
Housing Development Finance Corporation Ltd. - (Amalgamated)	-1.25	5.21	3.97
Kotak Mahindra Bank Ltd.	-1.17	2.75	1.59
Asian Paints Ltd.	-1.14	1.54	0.40

Mid Cap

Overweight	active Weight	BM Wt	Ind Wt
Tri-Party Repo (TREPS)	2.04	-	2.04
Cholamandalam Investment and Finance Company Ltd.	1.60	-	1.60
Bharat Electronics Ltd.	1.12	-	1.12
PI Industries Ltd.	1.10	-	1.10
Clearing Corporation Of India Ltd.	0.90	-	0.90

Underweight	active Weight	BM Wt	Ind Wt
Shriram Finance Ltd.	-1.60	2.28	0.68
Yes Bank Ltd.	-1.41	1.41	-
AU Small Finance Bank Ltd.	-1.26	1.78	0.52
Tata Elxsi Ltd.	-1.26	1.31	0.05
Max Healthcare Institute Ltd.	-1.06	2.18	1.13

Equity Outlook – Neutral on Equities, Bullish on mid & Small, Banking, Auto and Realty

- Indian markets have seen a sharp rise since March lows of 2023 and have made new highs, thanks to significant inflows from FIIs. Indian economy showed significant resilience during covid and Russia-Ukraine war and is **the fastest growing major economy and poised to become 3rd largest economy in the world.**

- Many global companies are looking to diversify supply constraints from China because of geopolitical tensions, and India stands to benefit from the same. **Hence, from macro perspective, Indian markets look attractive. From valuation perspective, markets are slightly expensive, specially on PB but fair on market cap to GDP perspective.**

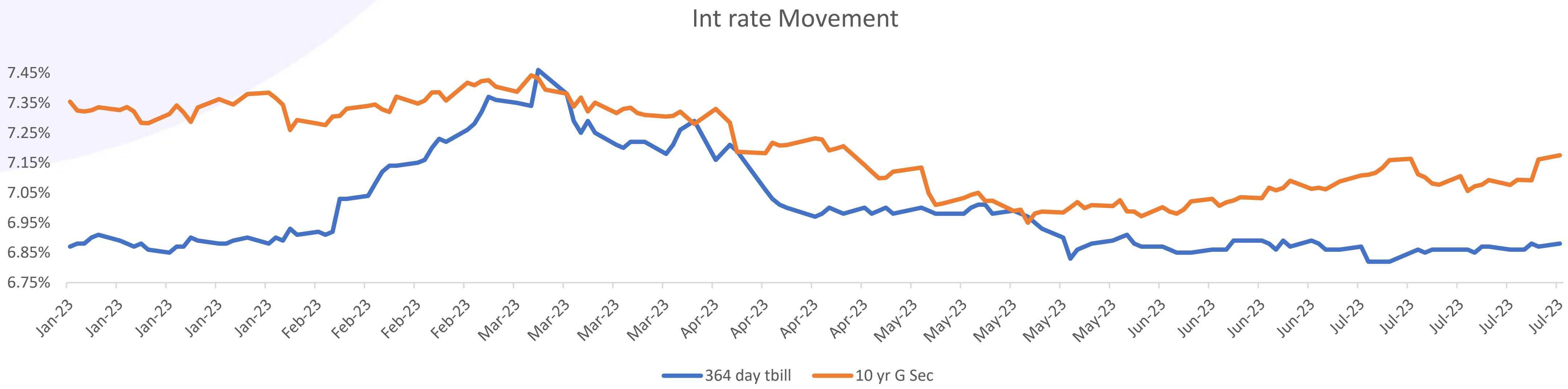
- Further, **risks remain because of the uncertain monsoon, recent rise in Crude price and 4 months of overstretched one-way rally. With general elections less than a year away, we may see volatility in the markets. Hence, we are currently neutral on the equity markets.**

- **Market cap –** From market cap allocation perspective, **we favor mid and small caps over largecaps**. From 2 year rolling returns perspective, mid and small caps are below the 10-year average differential between mid and large caps. Also, from technical perspective, mid and small caps are looking attractive compared to largecaps. We also analyzed the MF Mcap positioning of flexicap funds and largecaps are near the 12 months low allocation, so industry is also overweight on mid and small-caps.

- **Sector –** We are **bullish on banking** as credit growth seems to be reviving (decadal high) while Banks CAR is at all-time high levels. We also like **Auto** and Auto ancillaries as there is revival seen in Auto Cycle in 2023. Many stocks from the Auto pack are making all-time highs breaking the highs of 2018 where the last Auto cycle peaked. **Realty** also looks good with house sales in key cities are at a decade high levels

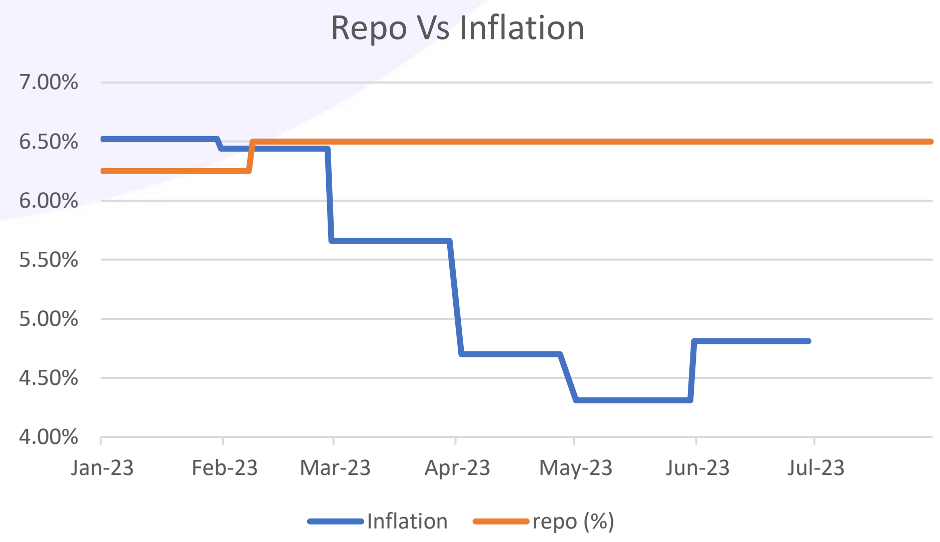
Fixed Income Outlook

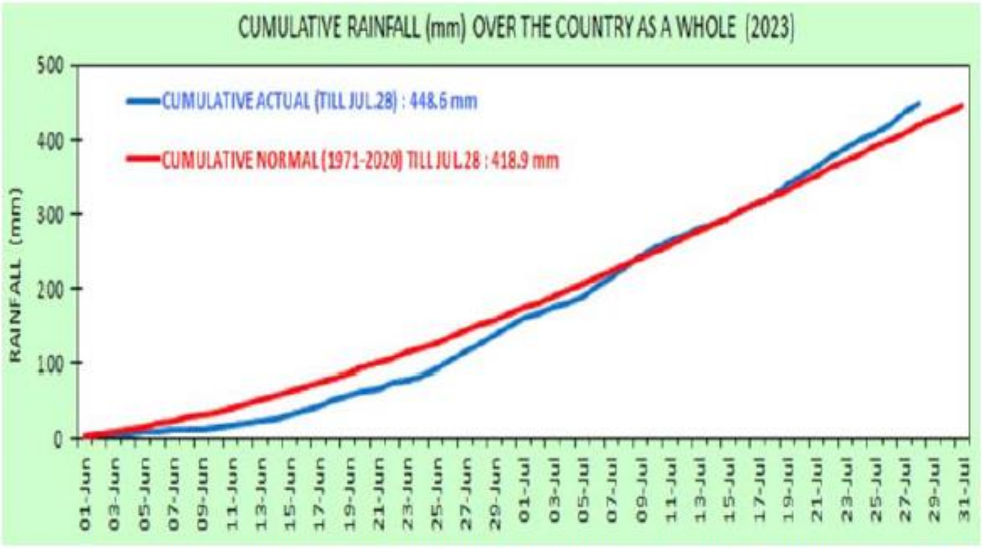
Rates were flattish for the month



- Interest rates were flattish for the month with both 1 year and 10 year moving in a very tight range
- Spreads have reduced from early part of the year as the RBI has paused on rate hike in the policy review on 6 April and 8 June 2023. It is expected that it will be status quo in the monetary policy committee (MPC) meeting on 10 August 2023 as well
- Given the broader expectation of rake peak or near peak, one can typically take longer maturity papers, however, yield curve has flattened significantly

Inflation in RBI s tolerance zone but may face upward pressure





(Source: https://mausam.imd.gov.in/imd_latest/contents/rainfall_time_series.php)

- Inflation is broadly within control. RBI CPI estimate for FY24 is 5.1%. In the meeting on 8 June 2023, RBI revised the projection marginally downward by 10 bps.
- CPI eased to 4.3% in May 2023. It inched up somewhat 4.8% in June driven largely by vegetable prices.
- In the forthcoming meeting on 10 August 2023, there is a probability for marginal upward revision of the inflation target of 5.1%, in light of theupward pressure from vegetable prices
- With respect to rainfall, Cumulative rainfall this season was deficient against long period average (LPA) till early June 2023. It started catching up thereafter and is now in surplus, However, uneven temporal and spatial distribution is a concern, the deficit being made up is a positive.

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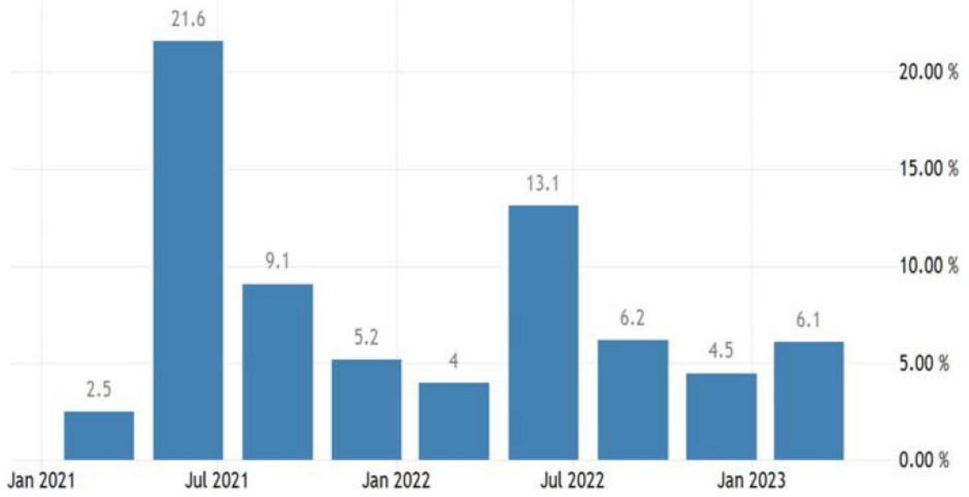
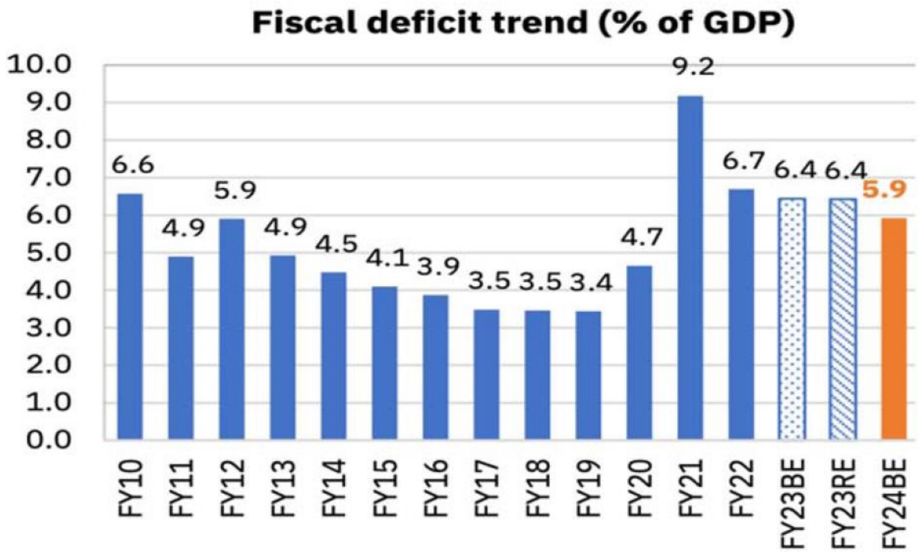
GDP growth showing traction and Govt finances remain comfortable

- In the meeting on 8 June 2023, on an overall basis, the RBI maintained the GDP growth projection of 6.5% for FY25, same as they projected in the previous meeting.
- In FY21, central fiscal deficit shot up to 9.2% of GDP, as the Government had to pump in money in a challenged phase. In FY22, it eased to 6.7% of GDP and further to 6.4% of GDP in FY23.
- For this year, FY24, the estimate is 5.9% of GDP. The fact that the Government is working towards reducing the deficit is a positive backdrop for RBI policy formulation.



(Source: tradingeconomics.com)



(Source: NSE Market Pulse)

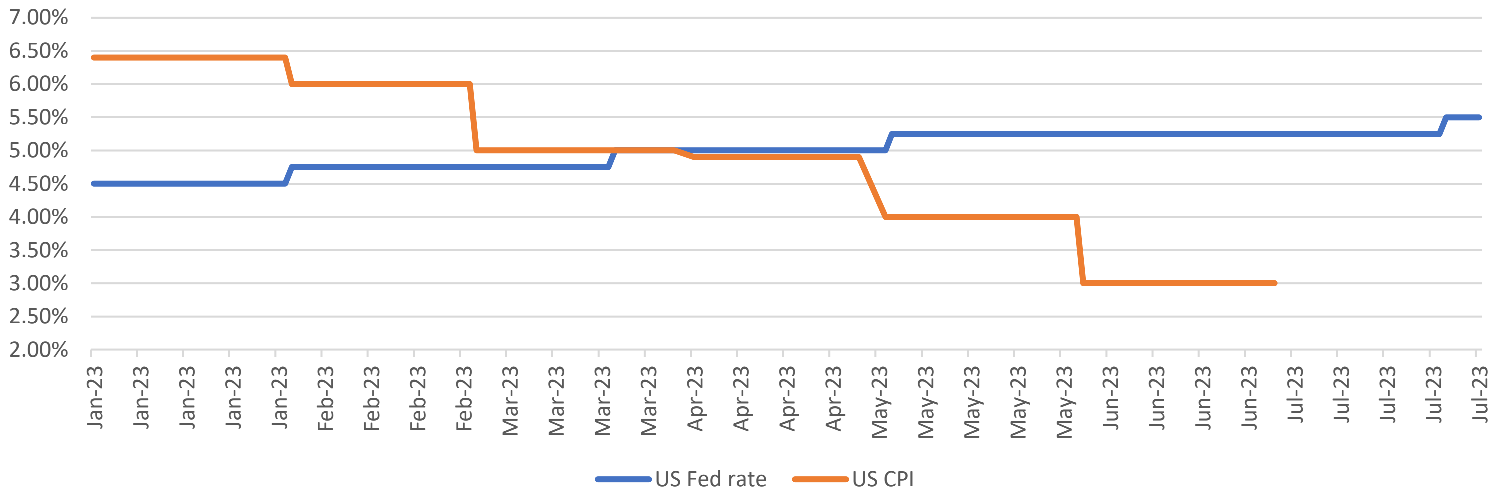
However, globally rates have been on rise, but now appears to be near peak

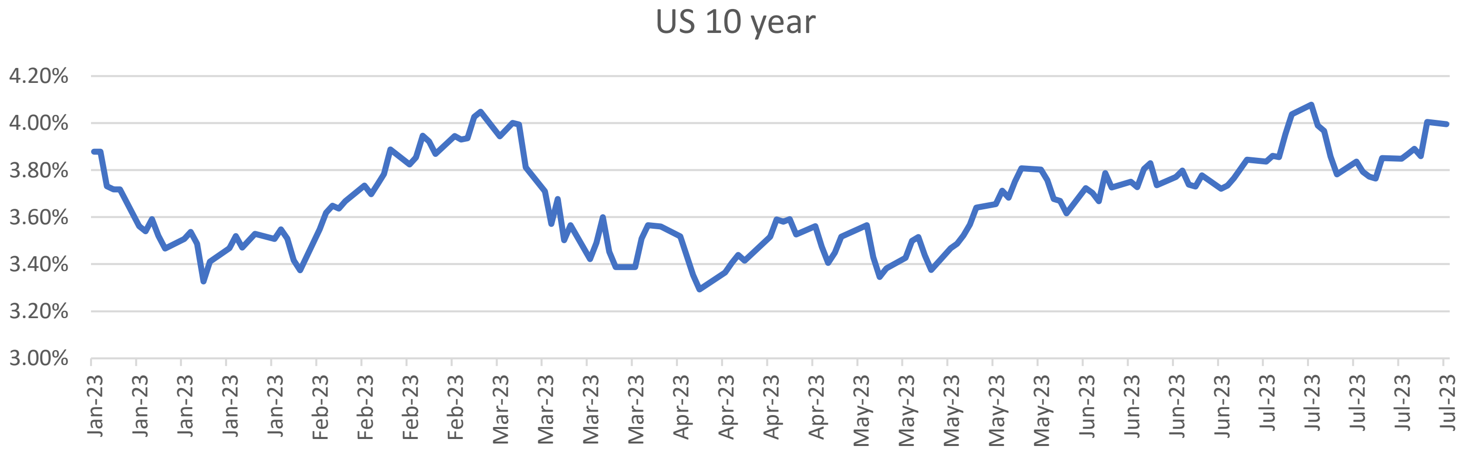
- US Fed continued to increase rates although inflation dropped significantly to 3% but still remain elevated compared to fed target of 2%

- Going ahead, Fed has not committed on pause or increase and will continue to depend on data though market expects a pause and rate cuts next year

- US 10 year jumped above 4% with hike and strop GDP data, but remains lower than fed rate as expectations are that rate cut cycle will begin next year

- In Europe too, inflation continued its downward trajectory, though much higher than US with CPI inflation at 5.5% for June 23





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Debt Outlook

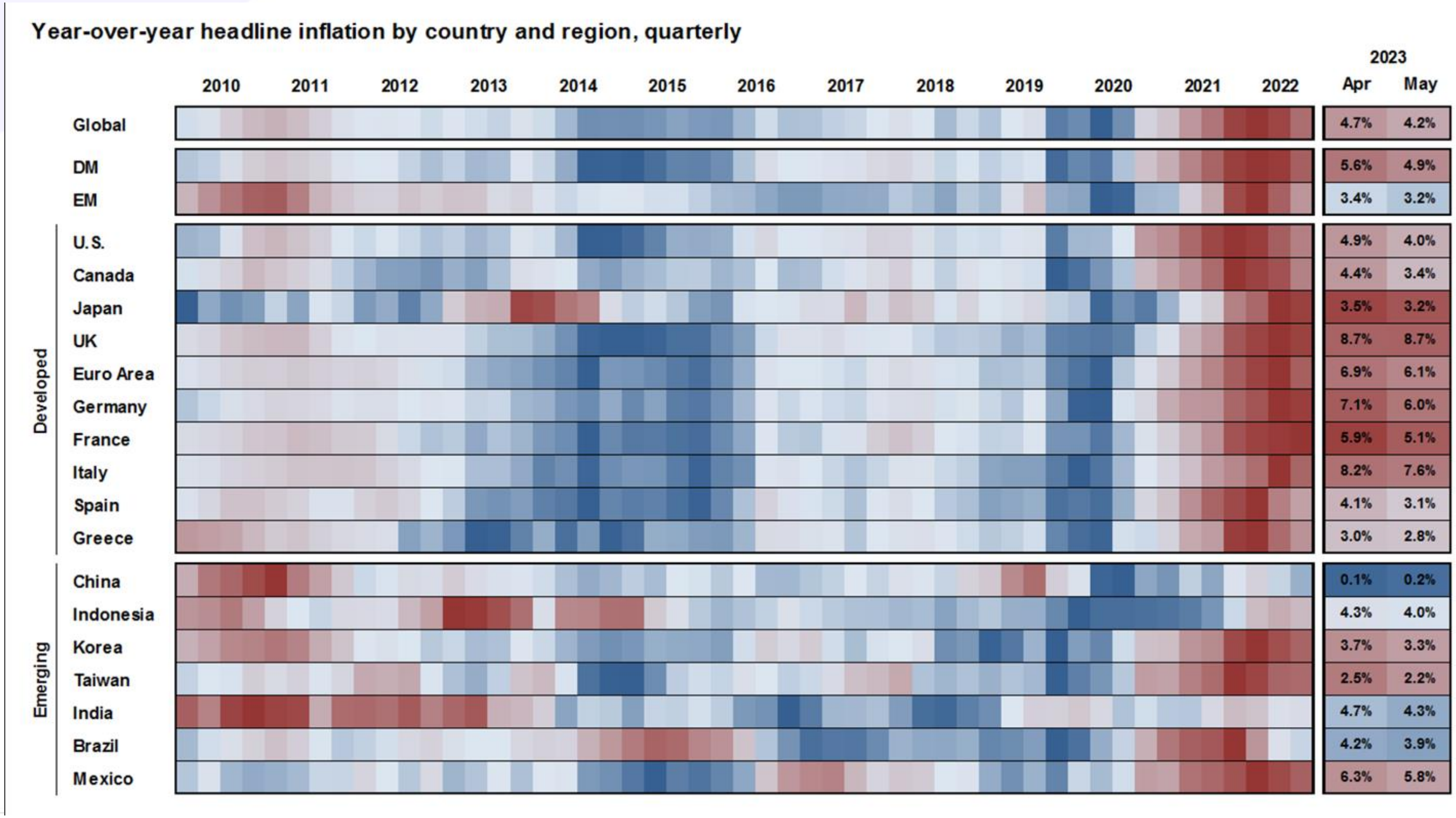
- In the forthcoming meeting on 10 August 2023, there is a probability for marginal upward revision of the inflation target of 5.1%.
- However, as long as it is not much beyond the central target of 4%, chances of rate hikes remain low. Further, chances of rate hikes reducing globally also provides comfort
- Hence, ideally one can look at long duration. However, since yield curve has flattened significantly, 1–3-year maturity looks attractive
- Dynamic duration funds too have reduced duration significantly from last month – average duration reducing to 3.38 in June 2023 from 3.96 in may 2023

	Current	Industry last 12 m avg	Last 12 m min	Last 12 m max
Duration	3.38	2.94	2.37	3.96

Global Outlook

Inflation Concern across the Globe

Globally inflation has been on the higher side and still cause of concern however good part is that it is not rising anymore.



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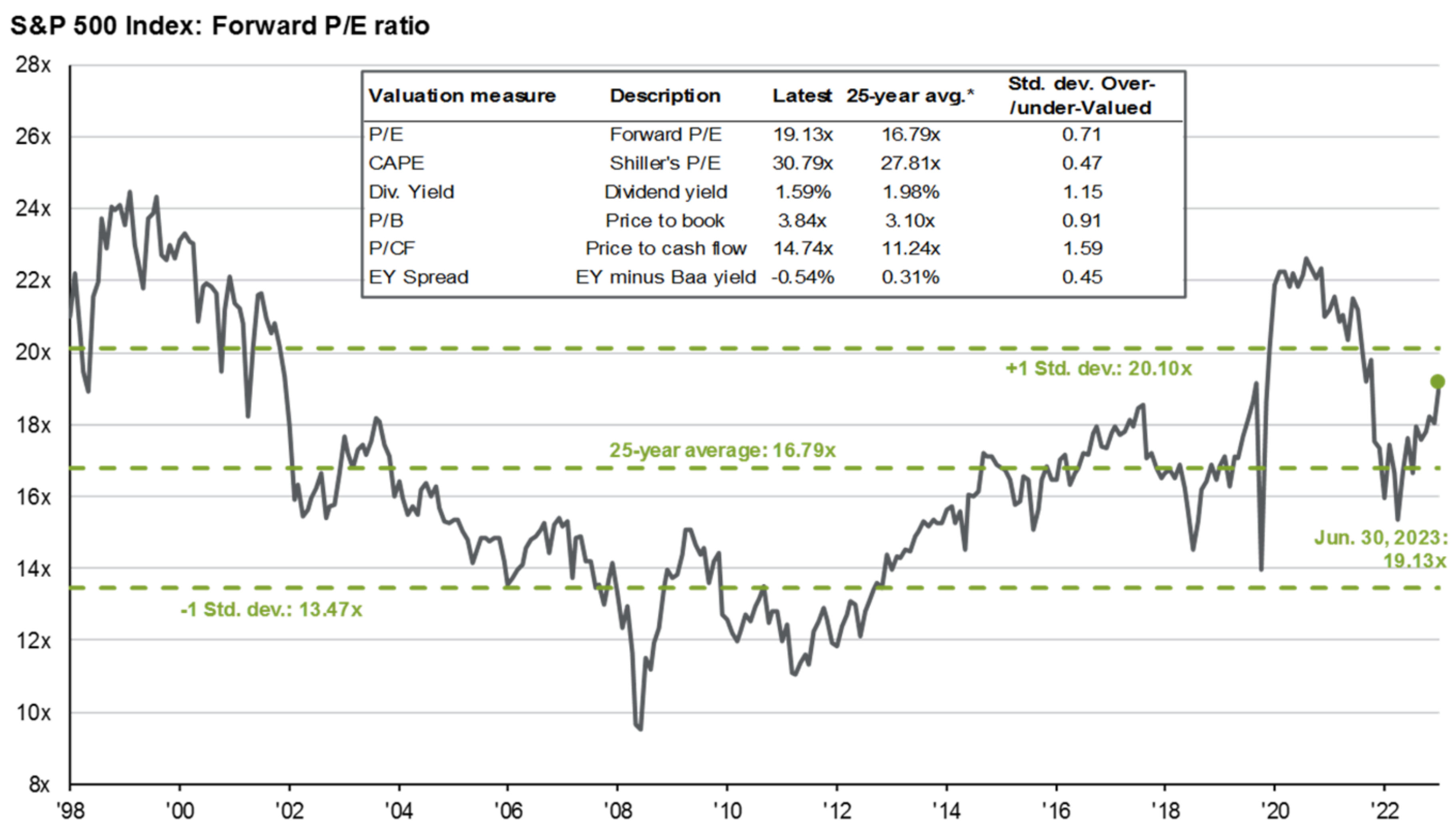
What is Happening in US?

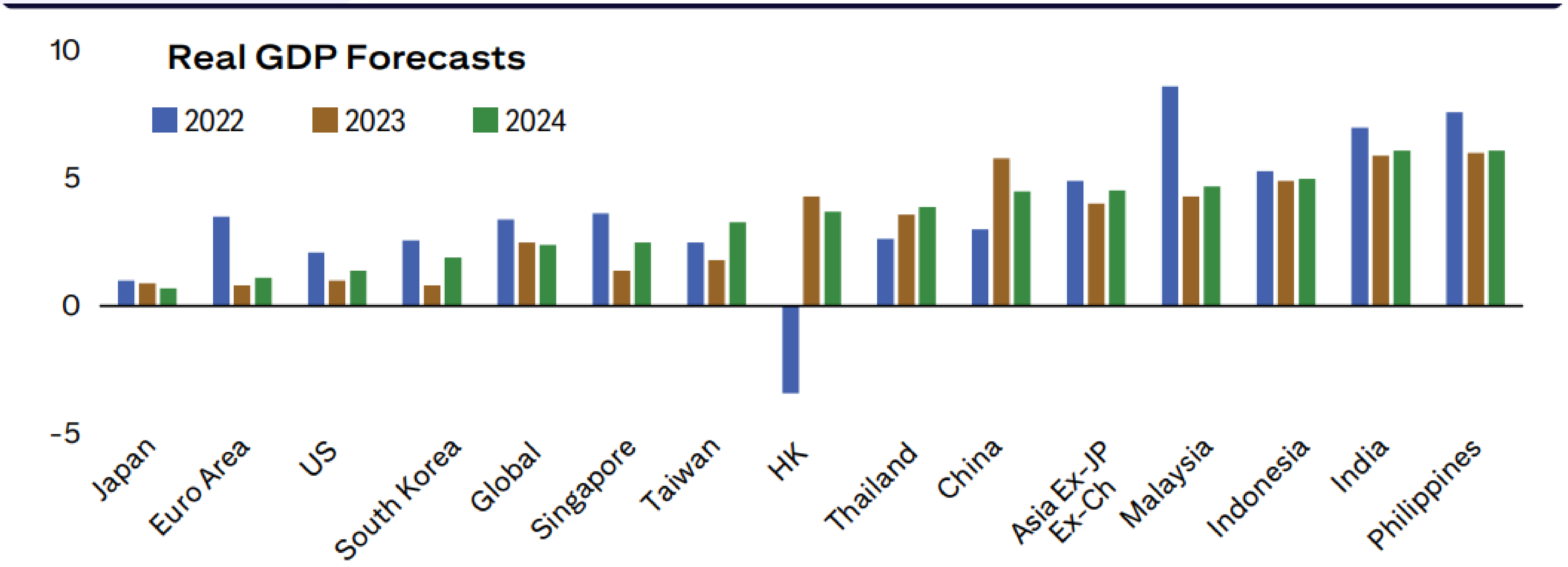
- In last meet US Fed unanimously hiked interest rates by 25 bps nudging the Federal Fund rate to a range of 5.25% to 5.5%, Highest since 2001.
- Quantitative Tightening (QT), reduced bank leading, restrained capital entrepreneurs.
- Weakening commercial real estate fundamentals, spillovers to SMID banks
- As the 2Q23 earnings season draws to a close, a trend emerged – more than 70% of companies have beaten earnings estimates despite softer revenues.
- In the face of input cost inflation, companies had been raising prices in an effort to pass along these costs and defend margins. If inflation eases further, the company might not be able to raise prices as easily, which could lead to them needing to reduce staff and cut expenses to keep their profits safe.
- Business spending appears to be one of the most “at risk” areas of the economy. Recent layoffs in the tech sector could weigh on R&D spending while increased caution among lenders and slowing corporate profits could constrain capital expenditures.
- After nearly two years of hot inflation squeezing consumer wallets and contributing to a swift rise in interest rates,
- Cooling demand for labor suggests that job growth should decelerate in the coming months.
- Looking ahead, increased risk of recession and softness in the labor market could keep consumer sentiment depressed this year.

Even Valuation are not Looking Attractive



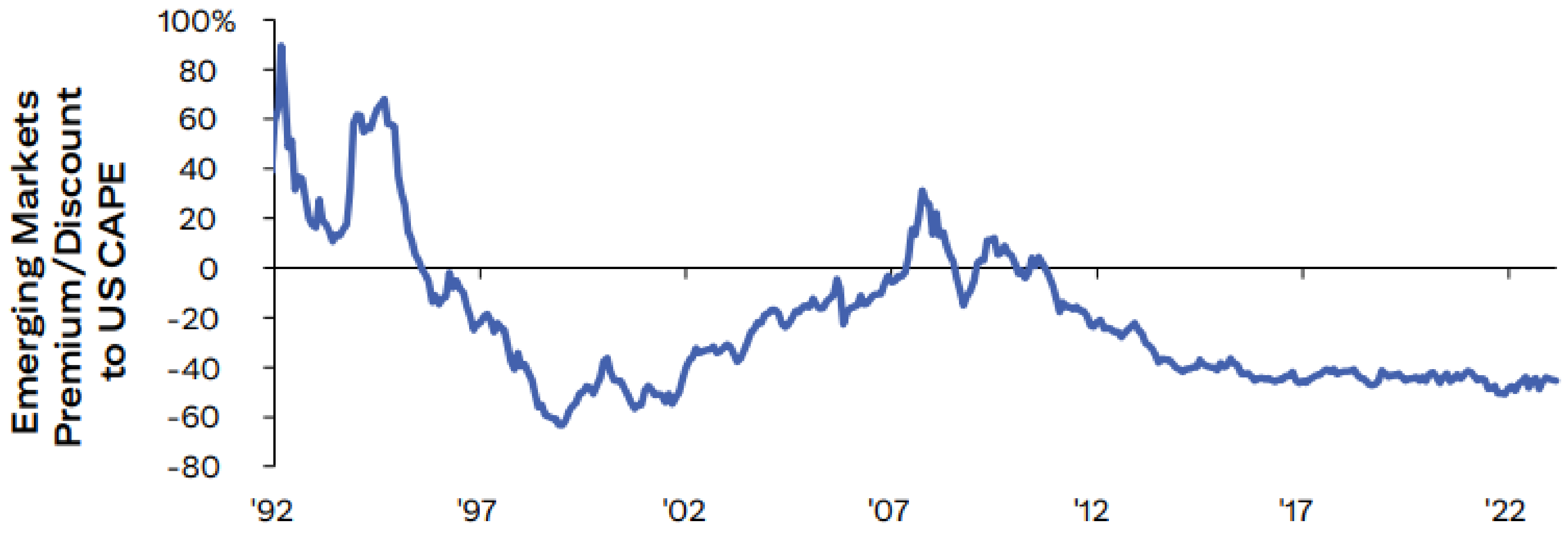
Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	19.13x	16.79x	0.71
CAPE	Shiller's P/E	30.79x	27.81x	0.47
Div. Yield	Dividend yield	1.59%	1.98%	1.15
P/B	Price to book	3.84x	3.10x	0.91
P/CF	Price to cash flow	14.74x	11.24x	1.59
EY Spread	EY minus Baa yield	-0.54%	0.31%	0.45

Even GDP growth remain elevated in Asia for 2024



Will the next cycle be of non-US stocks?

- A highly concentrated US tech rally this year masks the value still present in global equities following the 2022 bear market.
- Of the $4 trillion in global market cap created so far this year, 89% can be attributed to just 10 companies
- While US large caps look expensive relative to prevailing interest rates, one can see value in non-US equities



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Where all in Asian Markets?

- Asia is set to outgrow and outperform relative to other regions over the years to come. Demographics, diversification of supply chains, a weaker US dollar and a more accommodative Federal Reserve should provide the fuel.
- We see Japan, China and Southeast Asia receiving increasing attention from global investors.

Why China?

- China's recovery has been uneven. Consumer spending, driven by a boom in travel and other service sectors, leads the way. But residential real estate and manufacturing continue to face headwinds, as it will take some time to digest inventories
- At current valuations of under 10 times forward earnings, recent disappointing market performance appears overstated as potential for a substantial and sustained economic recovery remains.

Why Japan?

- Global investors increasingly see Japanese equities as a means to access Asian development, especially amidst US-China tensions.
- We expect that the Bank of Japan will purposefully exit its ultra-loose monetary policy, which could take place in the second half of this year. If this happens, the yen has room to strengthen further.

Why Indonesia & Philippines?

- Indonesia, and the Philippines, all of which saw stronger earnings growth.
- Equity prices have rallied in tandem, but continue to lag earnings, so valuations remain at the lower end of their historical multi-year range
- We expect improved equity performance in the second half of this year, supported by potential weakness in the US dollar, rising demand in the region and increasing direct foreign investment due to US-China strategic competition

Preference stays on Japan

- **Reforms are front-and-center again:** Current the reforms are being led by Tokyo Stock Exchange where it has urged all companies trading below their book value to devise a plan to improve capital efficiency and support their stock price. The scope for improvement is high as 50% of the stocks listed on TOPIX and 26% of stocks in MSCI Japan are currently trading at PB<1. We believe this could be a potential catalyst for structural re-rating of Japanese equities, an issue which has long haunted investors and would add to the tailwinds from ongoing accommodative policy stance.
- **Expect renewed interest from both foreign and domestic investors:** Japanese equities have been seeing renewed interest from foreign investors who have poured in 50.6$bn of money this year, which is the highest foreign institutional flow seen in Japan since 2013. Retail investor ownership has fallen from 40% in 1970s to ~17% now– we expect retail investor participation to also increase as households break-out of 'saving' mindset to 'investing' mindset led by inflation, wage growth and high savings.
- **Breaking the deflation spiral**- Japan is seeing inflation, which is at 3.3% after hitting a four decade high of 4.3% in Jan 2023. Return of inflation, reasonable growth and low unemployment rate is expected to bring change in consumption and investment patterns in Japan, and we are already seeing early signs of a shift with healthy wage growth, increasing capex and falling savings with steady consumption activity
- **Attractive valuations and robust earnings support -**Even though Japan market has delivered strong returns YTD, up 22% in local currency terms, the market still looks attractive on valuations. MSCI Japan is trading at 15.0 x fwd PE vs. US market at 20.6 x PE.

Why not UK and Europe?

One of the key risks to economic activity will be higher interest rates and stricter bank lending standards following aggressive central bank tightening. Although policy rates will likely peak in mid-year 2023.

More persistent core inflation could continue restraining the purchasing power of households and force a stronger response of monetary policy, with broad macro-financial ramifications.

Things to Look ahead

- GDP Growth: It grew by 0.3% in the EU and by 0.1% in the euro area in the first quarter of 2023 but there are lot of headwinds
- Turbulence in the financial sector which adds pressure to the cost and ease of accessing credit, slowing down investment growth.
- Labour Market and wage growth ahead
- Inflation and central bank actions

ThankYou!