Market Insight

August 2023

Market View - Summary

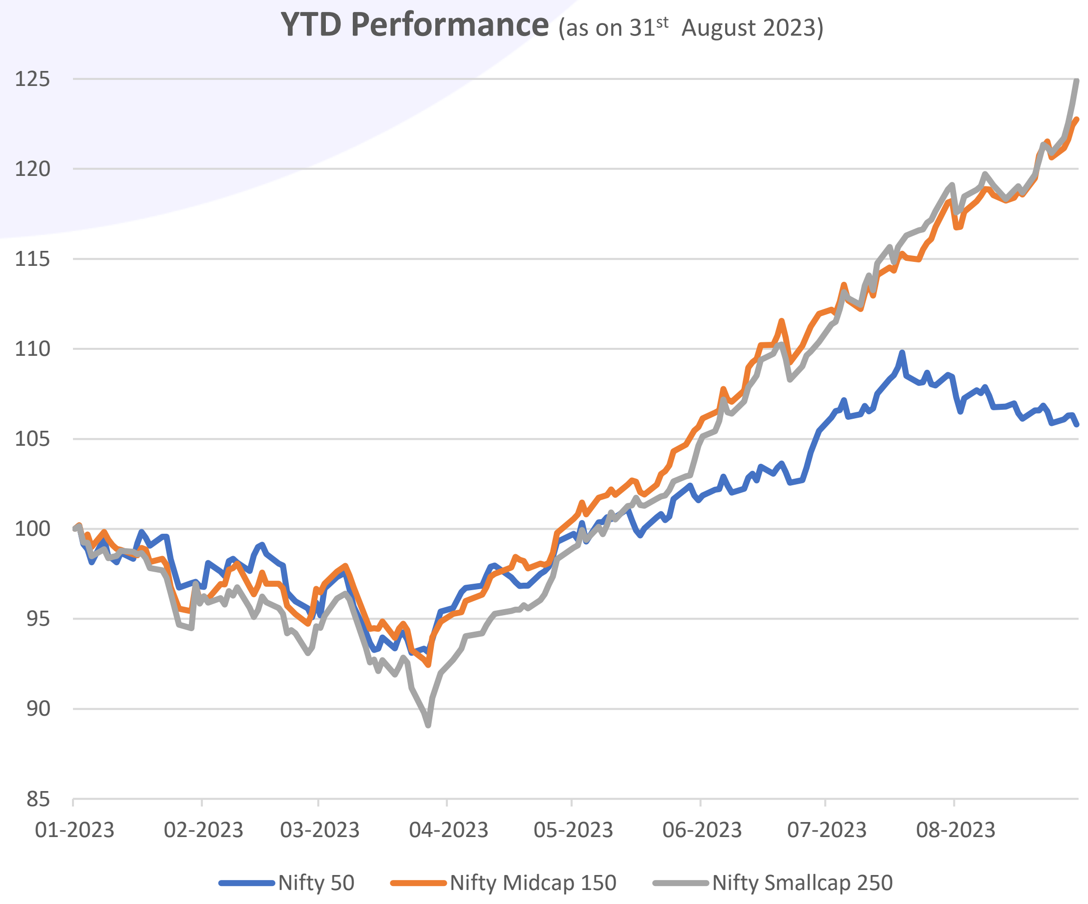
Equity

- From valuation perspective, markets are not cheap but are not very expensive either. Earnings growth is favourable as well
- From market cap allocation perspective, given the facts that Mid-caps have seen earnings upgrade in the 1Year as well as 2Year Forward EPS, within equities, we favor Mid-caps over Large caps. From technical perspective too, mid and smallcaps look positive.
- Media & Entertainment provides a large long term structural opportunity in India.
- MF industry has been bullish on Auto components and Industrials for a while.

Fixed Income

- From 1-year sovereign yield at approx. 7% and the longest end, 39 year, at approx. 7.3%, the curve is visibly flat.
- Considering all parameters, it is better to match investment horizon with the maturity of the investment.

Indian Equities made a comeback



Data as on 31st Aug 2023

- 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 sharp recovery in April and market continued its bull run for 4 consecutive months, thanks to strong FII buying.
- Nifty 50 Index has corrected a bit since the July highs and is now trading 3-4% below an all-time high. But there has been a one-way rally in the mid and small-cap space.

	Absolute		CAGR	
	YTD	1 Year	3 Years	5 Years
Largecap	5.2	6.0	18.7	9.9
Midcap	23.6	23.8	32.2	15.9
Smallcap	25.8	28.5	35.1	14.1

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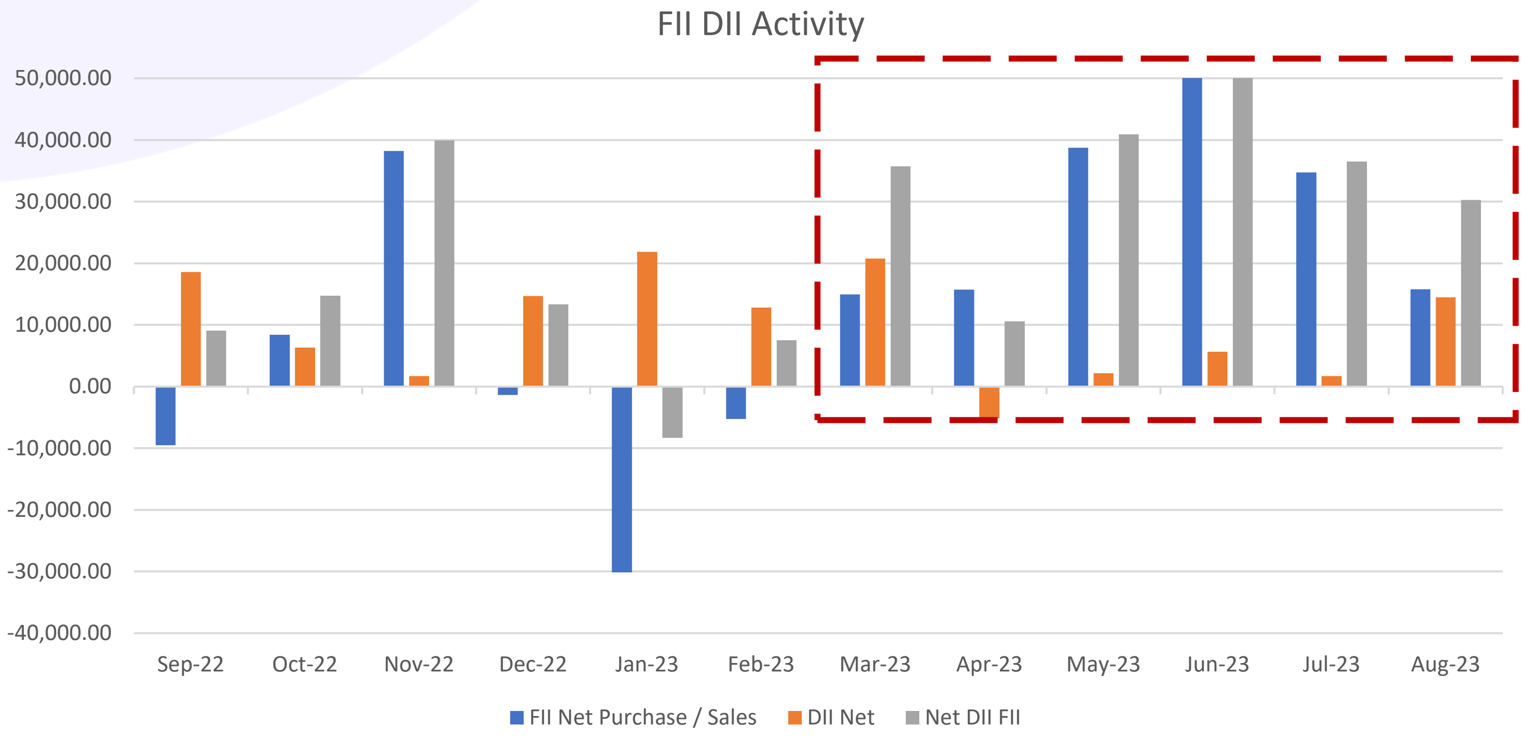
Recent rally fuelled by FII flows



- There was heavy selling by FIIs in 2022. However, Domestic flows supported big outflows
- 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 22 billion USD worth of Indian Equities in this CY.

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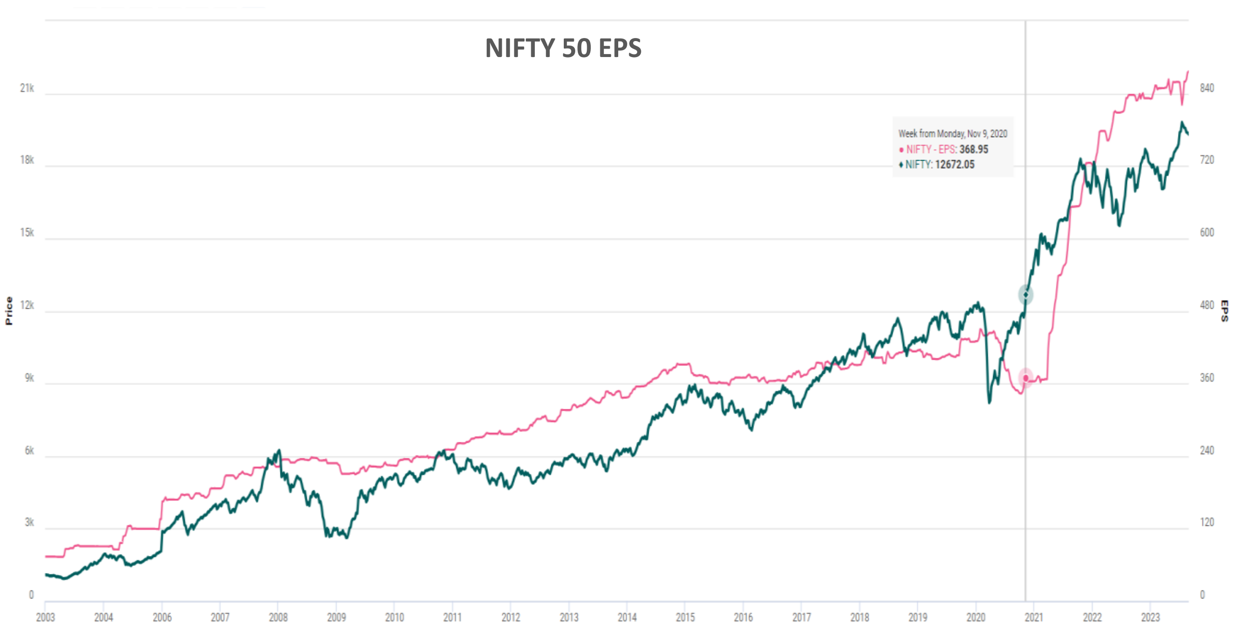
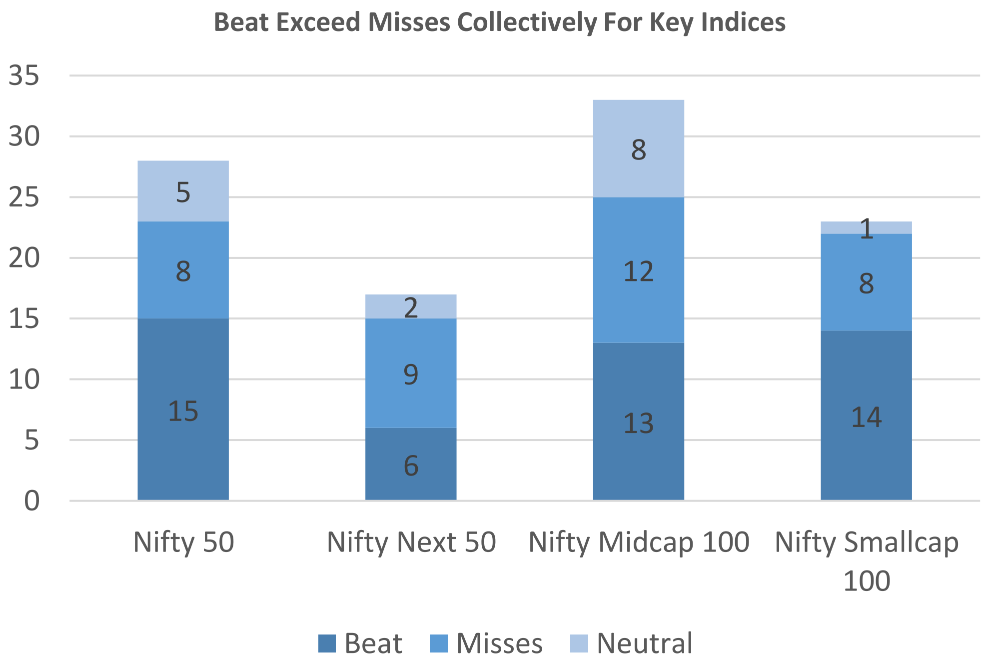
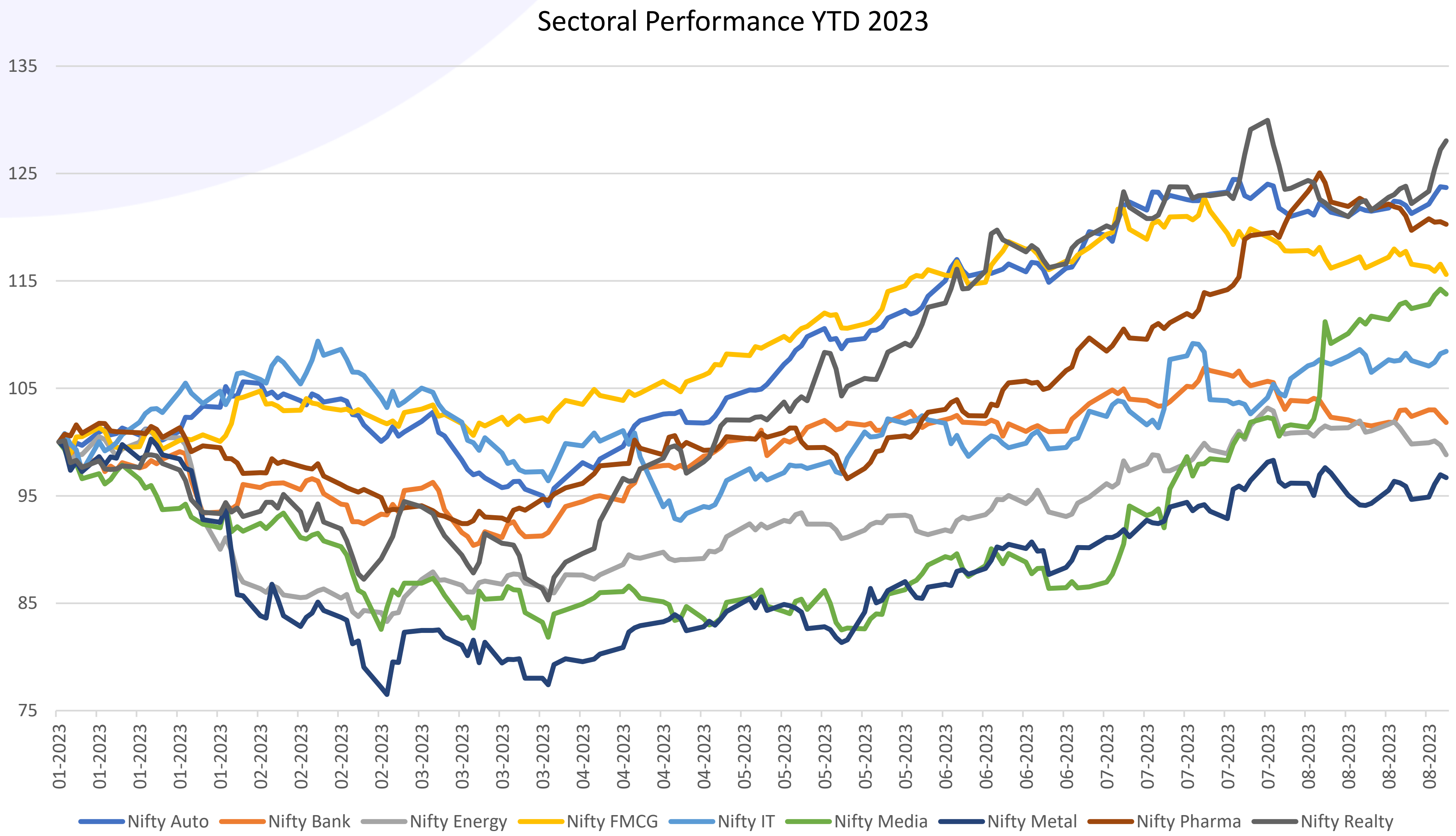
and by earnings growth

- 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.
- Further, The growth in Capital expenditure stood at 24.5% compared to revenue expenditure of 7.9%, shows the ongoing improvement in quality of expenditure and will add to future earnings.





Realty, Auto 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
- Recently media has started to outperform and has been best performing sector in Aug.

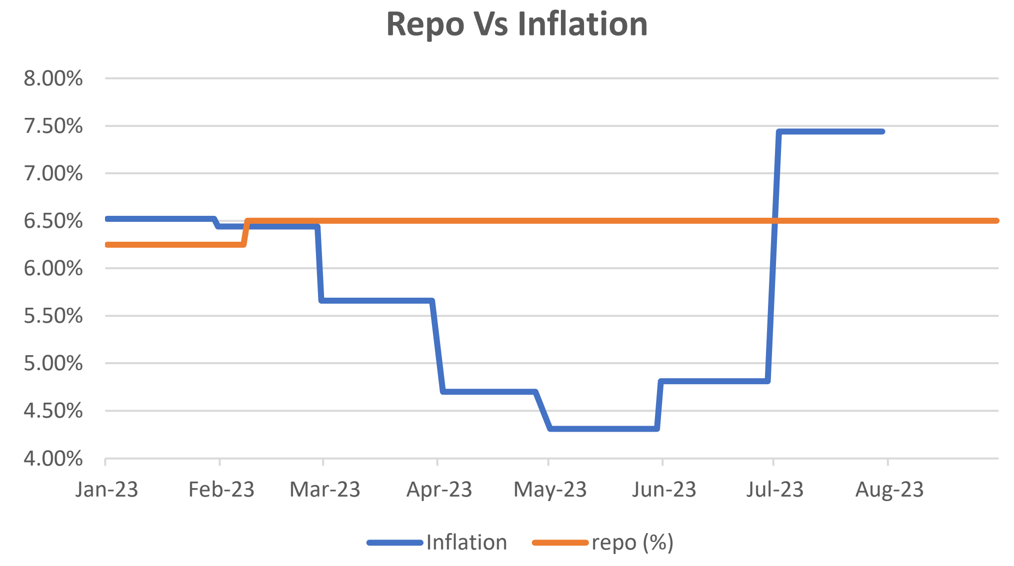
Reading the Markets ahead
Fundamental & Technical

Indian Marco's Supportive but Eye on Inflation

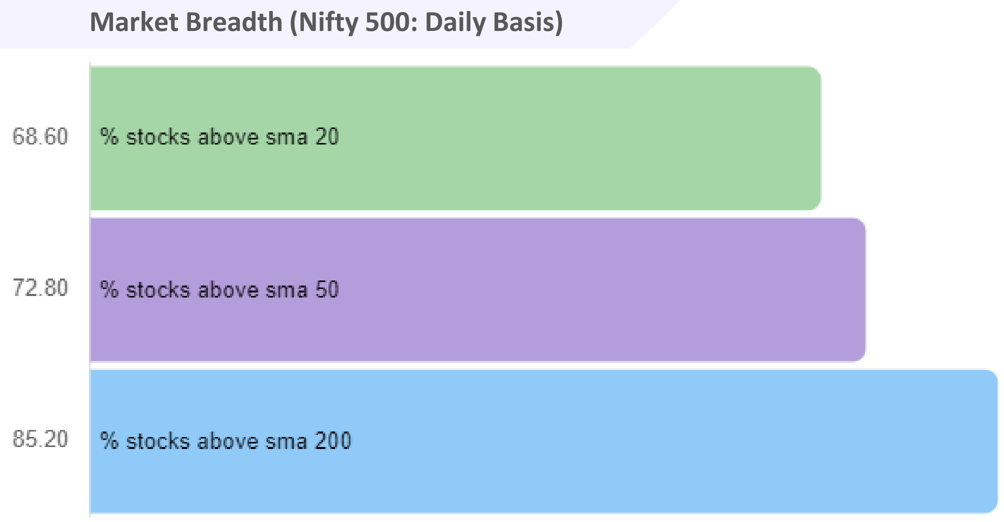
- On GDP growth, **India's GDP grew 7.8 per cent** in the Apr-Jun quarter and remained the fastest-growing major economy as China's GDP grew by 6.3%. The rise in GDP comes amid strong demand, robust service sector growth and increased government expenditure
- **Twin Balance Sheet Advantage for Growth**: Financial Sector has been stable and resilient as reflected in the sustained growth in Bank Credit, Low Levels of NPAs, and adequate capital and liquidity buffers.
- **Healthy** acceleration in terms of **Forex Reserves** as it is suffice to cover more than 10 months or 97% of the total external debt outstanding.
- Government **Debt to GDP ratio coming off their peaks** attained in FY21 to 86.5% (Comforting)
- **Manageable Current Account Deficit** (Current Account Balance as % of GDP – 2%)

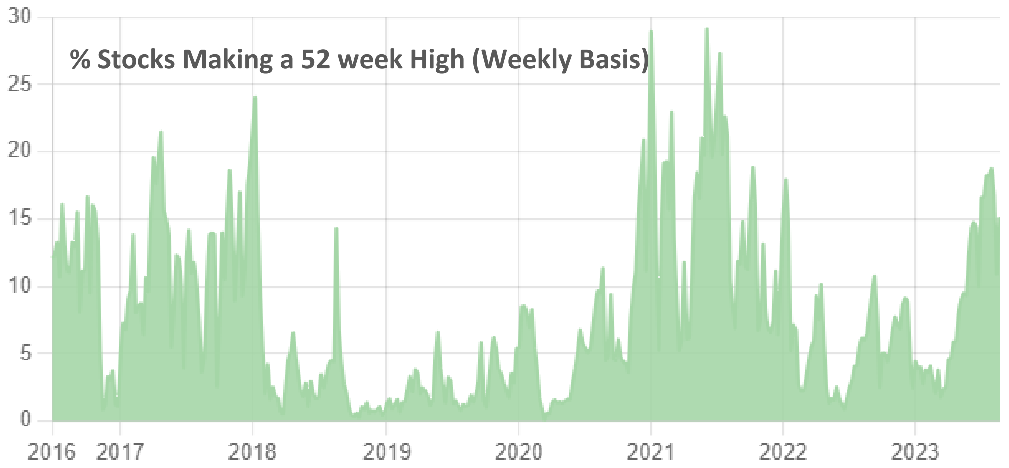
Keep an Eye on Inflation

- The RBI has paused on rate hike in the policy review on 6 April, 8 June and 10 August 2023. The RBI has maintained the stance of "withdrawal of accommodation", as inflation projection for FY24 has been revised upward from 5.1% to 5.4%.
- Rainfall in August had been the least in over a century, with India getting 36% less rain than it usually does in the month however the initial fear of the El Nino effect induced lower monsoons have been allayed.
- With Food and Inflation already surging by whopping 37.34%, lower rainfall might hamper the coming Kharif season and Inflation might Inch up.
- Inflation (7.44%), beyond RBI tolerance zone mainly due to vegetable prices. However, vegetable price shocks may reverse quickly and hence we don't expect any hike as of now



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. Nifty 50 DEMA is at 19300 (apprx) while 200 DEMA is at 18540. So fairly strong. While Both Mid cap and small cap Indices are far above both MA's.
- Mid cap and Small cap indices have also broken out of their resistance levels.
- Recently, Nifty 50 index is going through a small correction (3-4%) in August. But is still technically strong (still above 50-200 DMA)
- 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.

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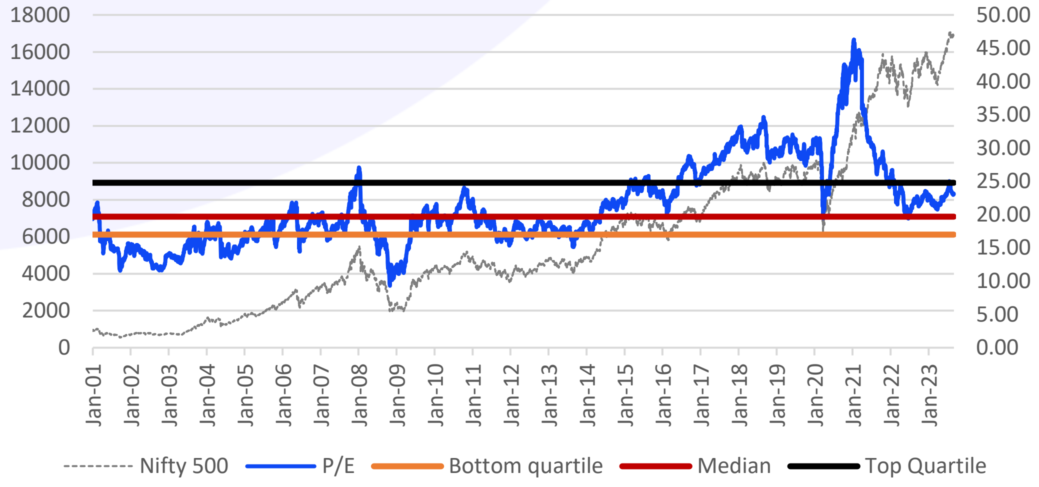
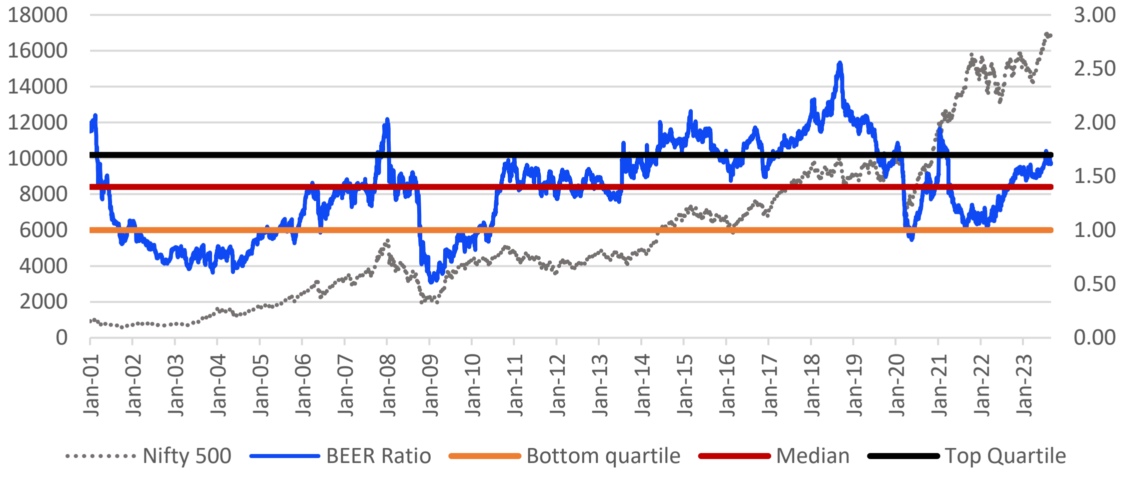
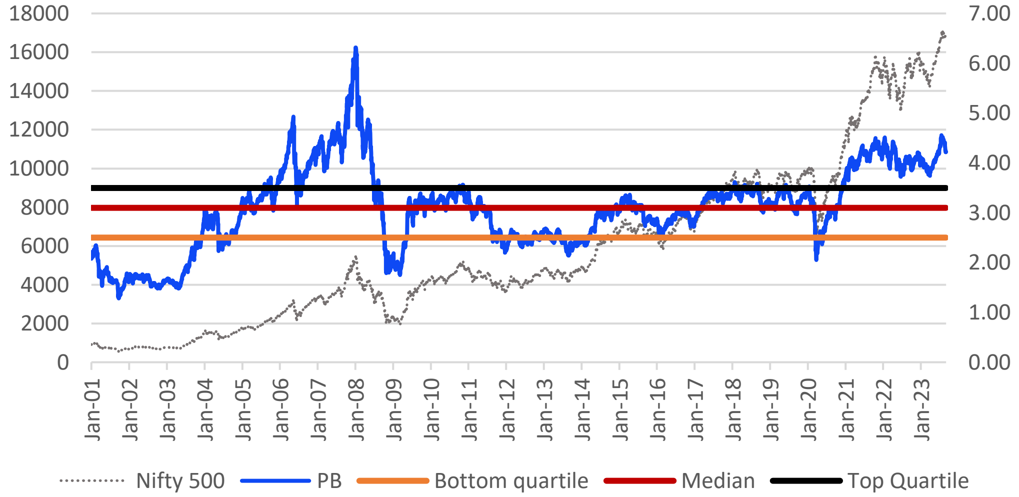
However, Valuations is a concern



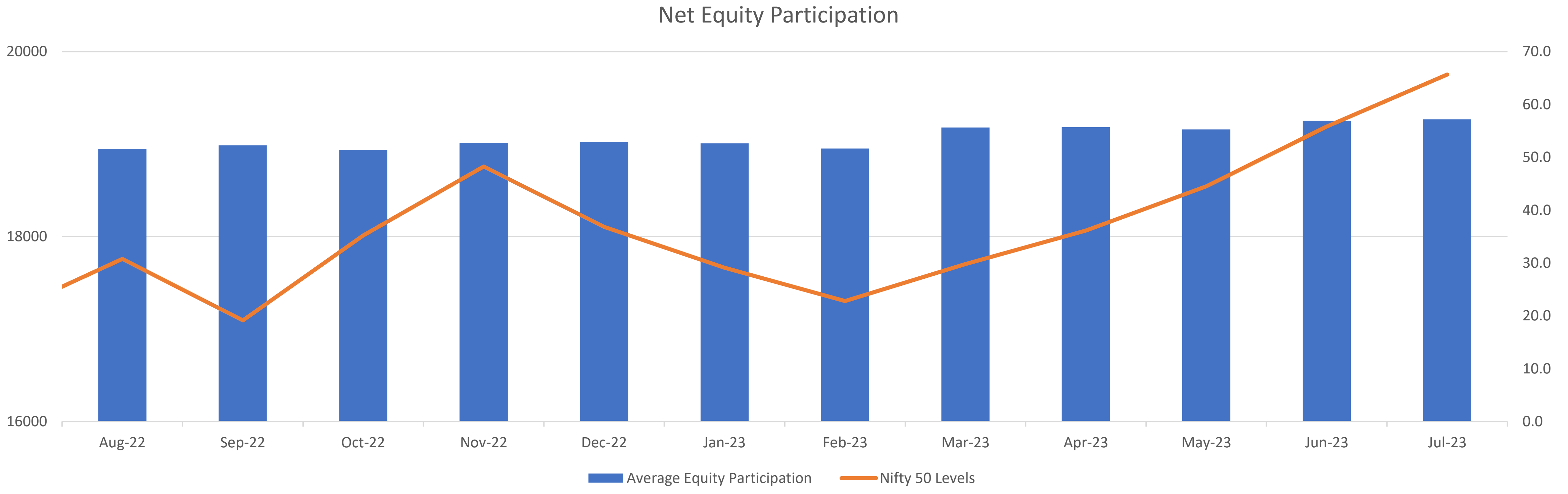




- Valuations near top quartile on PE, PB and earnings yield,
- Fair based on MCap to GDP

Even, MFs Industry look Neutral on Equities

- The average Net Equity Level (in BAF) stands just above 50% indicating the industry participation is not aggressive on Equities
- Majority of AMCs which follow valuation driven approach including HDFC and ICCI Pru have reduced equity allocation.



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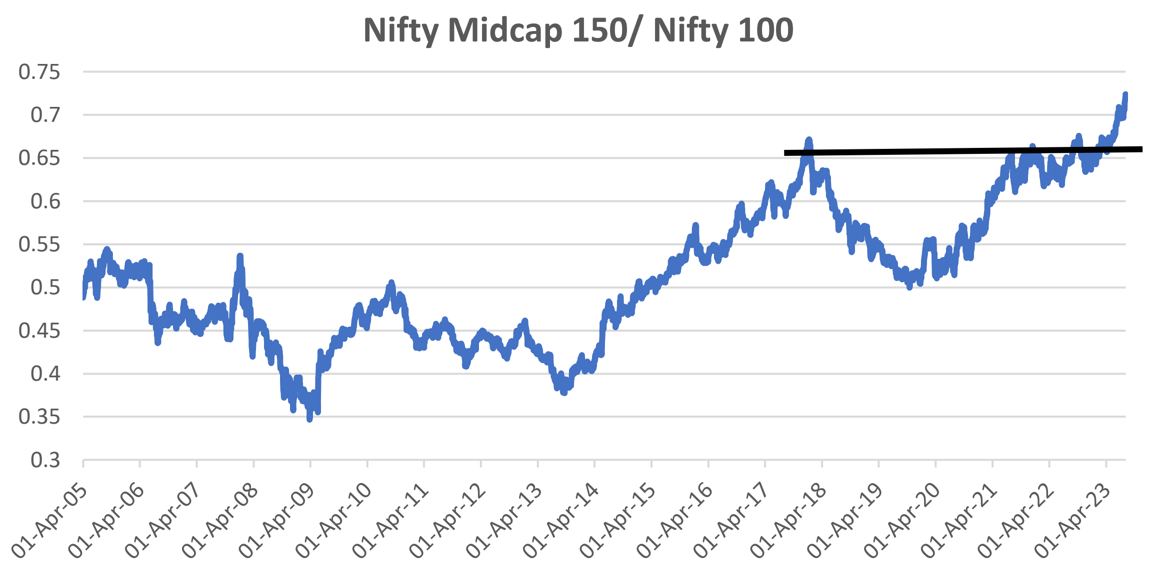
Within Equity, Mid cap & Small Cap show strong momentum

- Typically, mid-cap stocks are high beta stocks. They outperform the large caps when markets are in an upswing. However, when markets go into a downswing, these mid-caps tend to grossly underperform the large cap stocks.
- Also, the Large caps (which are financials heavy) are lagging due to underperformance of large banks and financials.
- Another reason for the outperformance of mid cap stocks is that they are less driven by commodities and cyclical businesses as compared to large caps

- From market cap allocation perspective, given the facts that Mid-caps have seen earnings upgrade in the 1Year as well as 2Year Forward EPS, within equities, we favor Mid-caps over Large caps. From technical perspective too, mid and smallcaps look positive.

- Technically, the mid and small indices are exhibiting strong momentum. They have broken out of 2-year consolidation phase. Ratio charts (mid to large, small to large) also likely indicate relative outperformance of mid and small to large caps.



MF Industry bullish on Mid & Small Caps

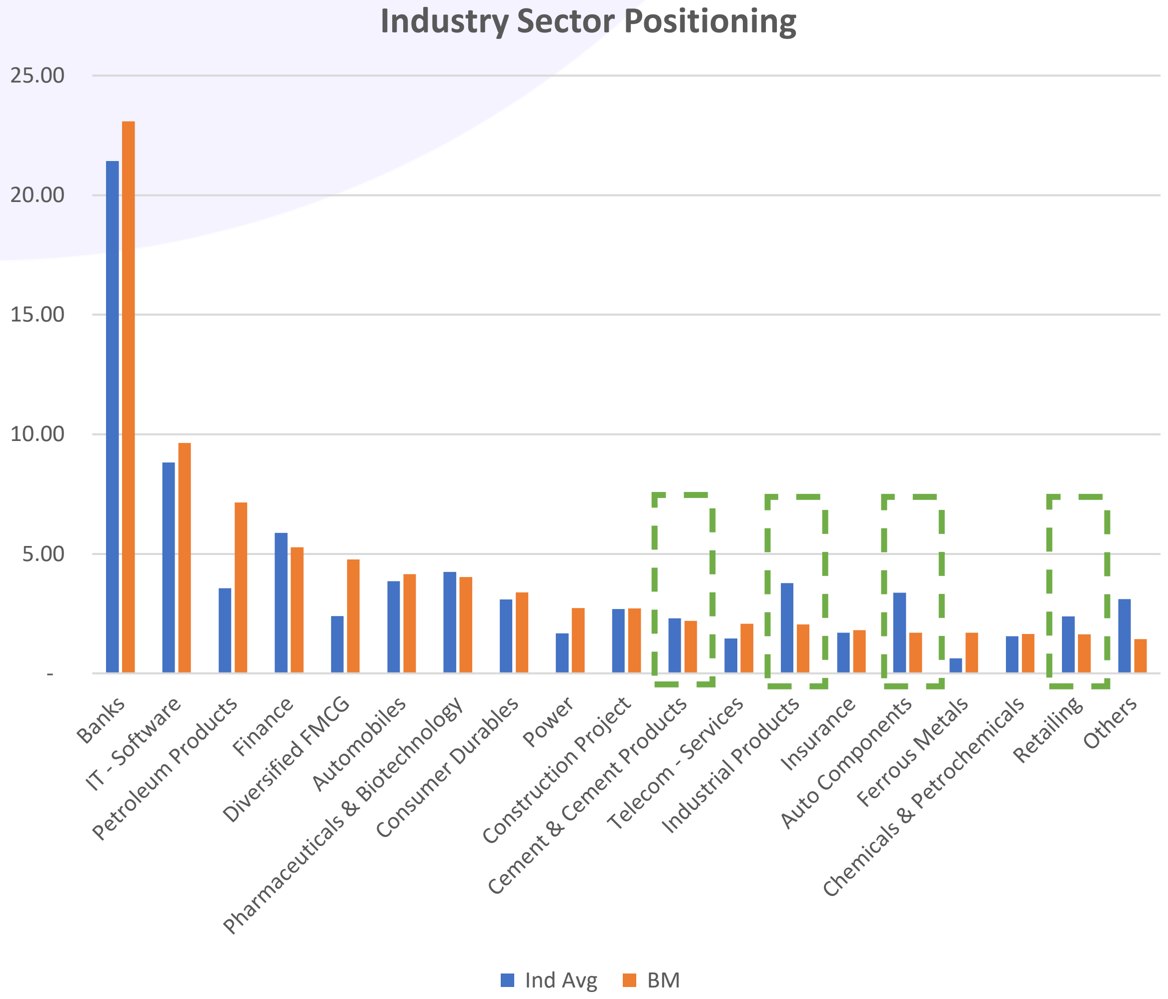
- The allocation to mid-caps is above the 12m average, while the allocation to large caps is below the 12m average
- Also, industry is bullish on small caps as the allocation is highest in last month. Well above the industry average and Index fund allocation.

	Current Allocation	BM*	Industry last 12M Average	Last 12M Min	Last 12M Max
Large	**62.07**	**74.87**	**64.37**	**62.07**	**66.30**
Mid	**18.06**	**16.01**	**17.99**	**17.38**	**18.49**
Small	**12.78**	**8.28**	**11.28**	**10.01**	**12.78**

Top AMC positioning	Large Cap	Mid Cap	Small Cap
Parag Parikh Flexi Cap Fund	57.25	4.77	7.13
Quant Flexi Cap Fund	42.61	7.42	14.67
ICICI Pru Flexicap Fund	75.18	10.09	10.00
MF Industry Average	62.07	18.06	12.78
*BM Positinong	74.87	16.01	8.28

*Motilal Oswal Nse 500 ETF

Sector View – Industry bets on Auto Components & Industrials



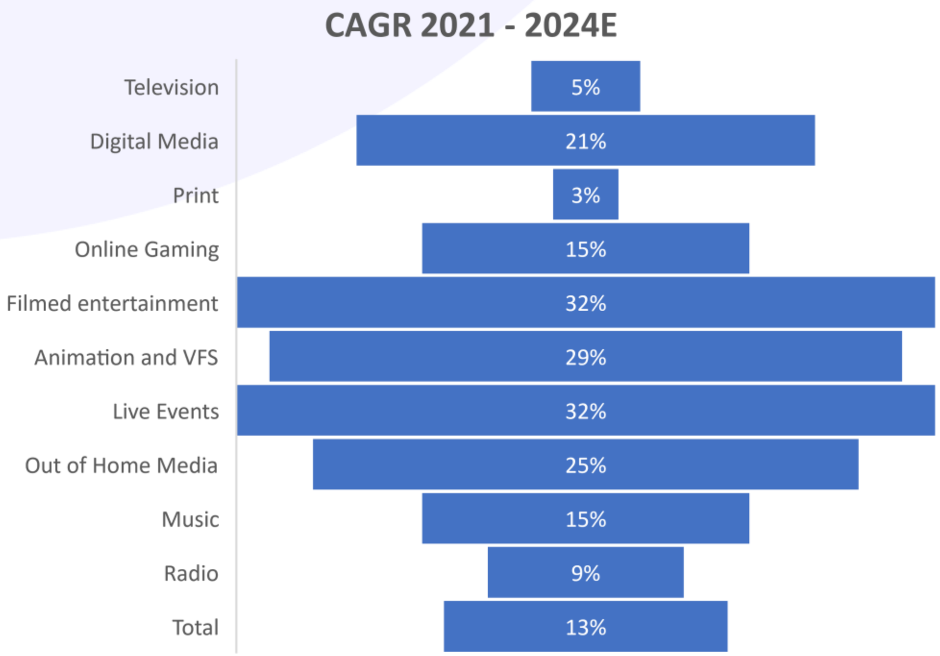
Over-Weight Sectors

- Industrial Products,
- Auto components,
- Retailing,
- Cement

Under-Weight Sectors

- Banks,
- Petroleum Products,
- Diversified FMCG,
- IT

Sector in Talk – Media & Entertainment



Sub-sectors		Key drivers
Television	Subscription	+ Strong performance by regional channels; Cost advantage vs. OTT - Second / Third pay TV connections getting curtailed on the back of OTT and Free dish
	Advertisement	+ Continued mass & wide reach with high penetration for building & sustaining brands + Ad revenue as share of GDP lags other countries, expected to increase
OTT	SVOD	+ Improved internet & smartphone access, and payment mechanisms + Investment in content, pricing innovations & bundling creating targeted niche properties
	AVOD	+ Significant increase in online content consumption + Ad technology and format innovations
Gaming		+ Mobile first gaming population with rising internet & smartphone access + Local games targeted specifically at local audience
Print		+ Focus on exclusive content with emphasis on credibility; reputed brands to gain - Shift to digital (esp. ads), reduced metro/English press subscriptions
Search & Social		+ Rise in online shoppers, social media users + Low ticket size makes it suitable for India's large SME segment
Audio		+ Growth in audio streaming, international & regional music + Wide reach with high penetration; Ad volumes shifting to Tier2++
Cinema		+ Expectation of growth due to a strong content pipeline and rebound demand - Shift to Digital/OTT release during the pandemic
Animation, VFX & Post-production		+ Increasing importance on content and better technology adoption + Availability of low cost and high skilled talent in India
OOH & Others		+ Upcoming infra projects, evolving digital OOH (DOOH)

Media & Entertainment is considered to provides a large long term structural opportunity in India and the consolidation in the sector is a great inflexion point for the business.

The sector is expected to Grow at CAGR of 13% and reach INR 2.32 trillion

Why Media Looks Interesting?

- **Consolidation in the Industry**: 1.4 billion Indians, distributed over 280 million households, need to be entertained and after the near to-complete industry consolidation phase, there will only be 3 large Indian players and a couple of international players that will be able to meaningfully cater to this need.

- **Consolidation leading to Pricing Power**: Consolidation in the industry will give pricing power to players and greater ability to negotiate with talent (very important factor in entertainment business)

- **High Growth expected:** Media and Entertainment Industry in India is about USD 27 billion with 1.4 billion consumers. This is expected to grow at 10-12% over the next decade to reach USD 55-70 billion in size offering a very large opportunity to leading players.

- **Attractive Valuations**: Media companies are available at very attractive valuations at the bottom of their earnings cycle. The earnings cycle for these companies, today, factors in very little growth in advertisement, no increase in subscription revenues for almost 4 years and peak losses on OTT platforms.

- **Tailwinds:** TRAI has finally implemented the New Tariff Order 2.0, now called NTO 3.0, starting April 1, 2023 and with this, broadcasters would now be able to now raise prices increasing their Average Revenue Per User (ARPU). Advertisement revenues are expected to bounce back from 2nd Half of financial year 2024 and losses on OTT platforms should also start coming down after peaking in financial year 2023.

viacom18

TV18

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Equity Outlook – Neutral on Equities, +ve on Mid cap, Media

- 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.

- Markets made an all-time high in July. The good news is this rally has been accompanied by a strong economy, robust corporate profit outlook and improving macros. From valuation perspective, markets are not cheap but are not very expensive either. Earnings growth is favourable as well. But, there has been a one Way rally in the mid and small-cap space since March lows. Hence a correction may occur. However, it may be swift and give a chance to add on more. At this juncture, FOMO is high and we would advise not to jump the gun.

- With general elections less than a year away, we may see volatility in the markets. Hence, we are currently neutral on the equity markets.

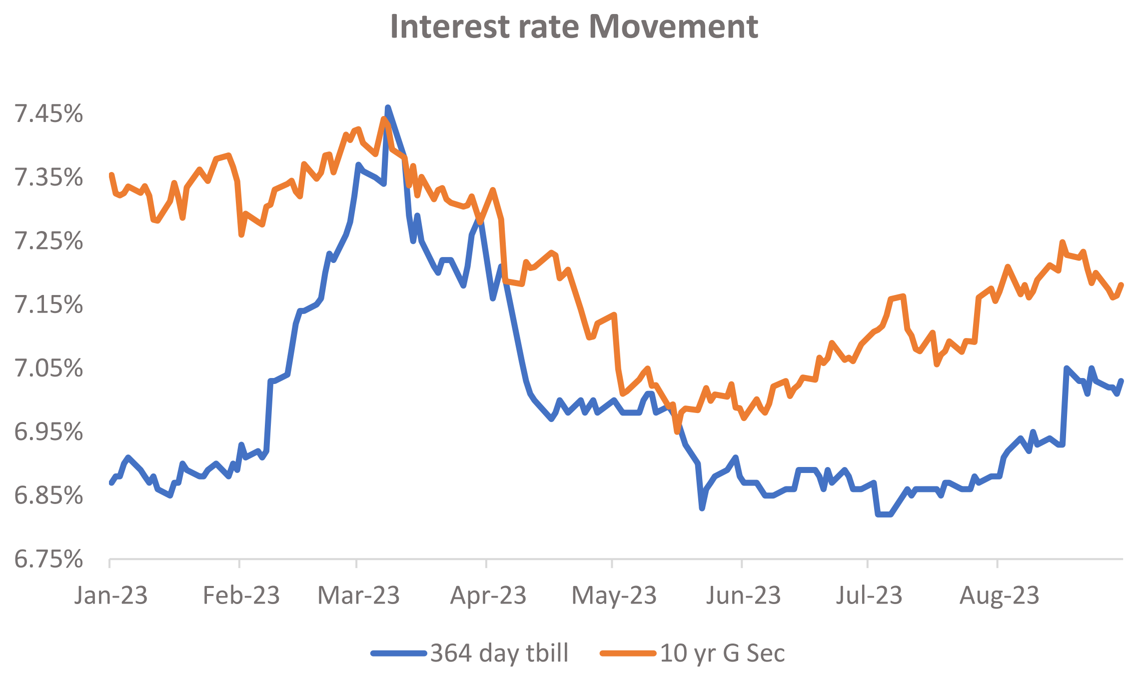
- From market cap allocation perspective, given the facts that Mid-caps have seen earnings upgrade in the 1Year as well as 2Year Forward EPS, within equities, we favor Mid-caps over Large caps. From technical perspective too, mid and smallcaps look positive.

- Typically, mid and small cap stocks are high beta stocks. They outperform the large caps when markets are in a bull run. We also analyzed the MF Mcap positioning of flexicap funds and largecaps are near the 12 months low allocation, so MF industry is also overweight on mid and small-caps. Technically, the mid and small indices are exhibiting strong momentum.

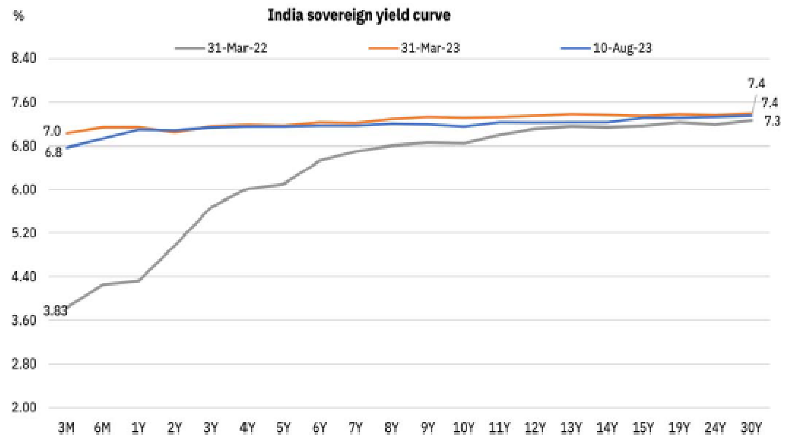
- Sector – **Media & Entertainment** provides a large long term structural opportunity in India and the consolidation in the sector is a great inflexion point for the business. MF industry has been bullish on **Auto components and Industrials for a while.**

Fixed Income Outlook

Given the broader expectation of rake peak or near peak, one can typically take longer maturity papers. However, the yield curve is flat and you would not be compensated in terms of higher yield. **From this perspective, it is better to match your investment horizon with the maturity of the bond.**



- Interest rates were flattish for the month for 10 year while short term rates increased with high inflation numbers and decrease in liquidity
- 1-year residual maturity AAA rated bonds are available at approx. 7.65% yield levels; 3-year maturity bonds AAA rated are available at approx. 7.85% and 10-year AAA at around 7.80%;
- Spreads have reduced even more 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 and as we had expected, it maintained status quo in the monetary policy committee (MPC) meeting on 10 August 2023 as well



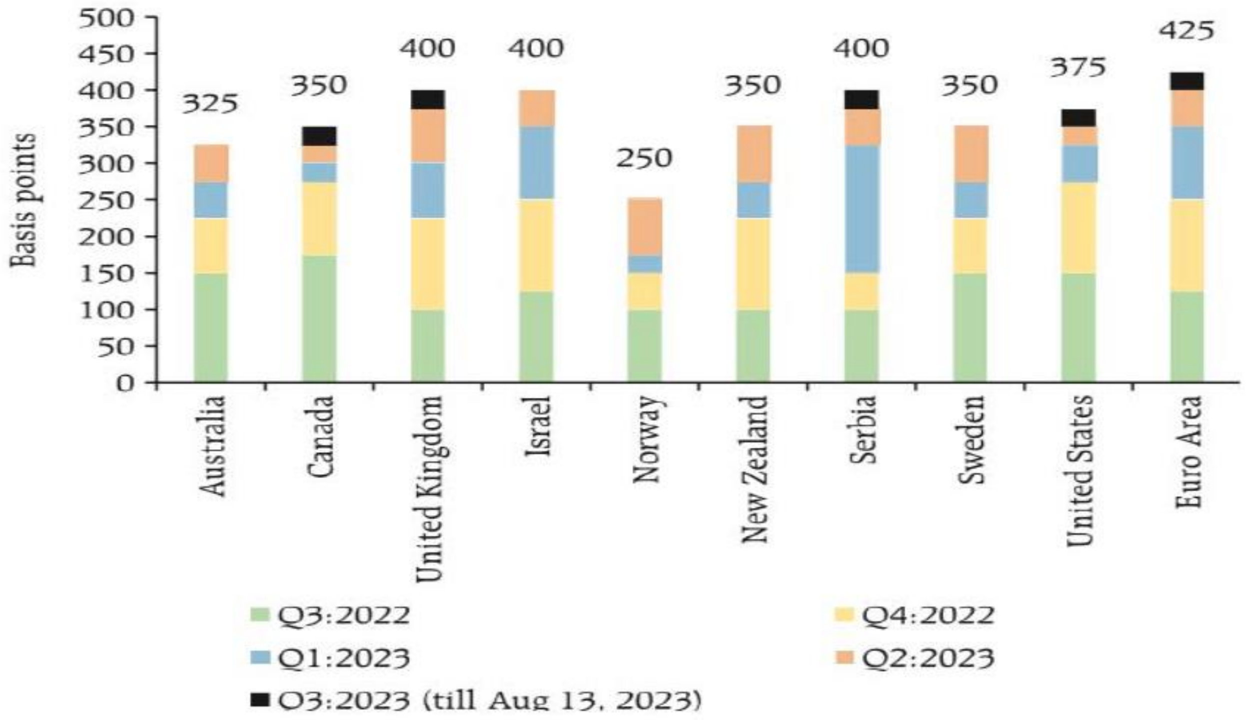
(Source: NSE Market Pulse)

Global Outlook

Rates in Global Economies

The advanced economies, given their historical interest rates, are not in a position to absorb high interest rates for a long time, without impacting their growth.

Global Rate Actions since July 2022 in Advance Economies

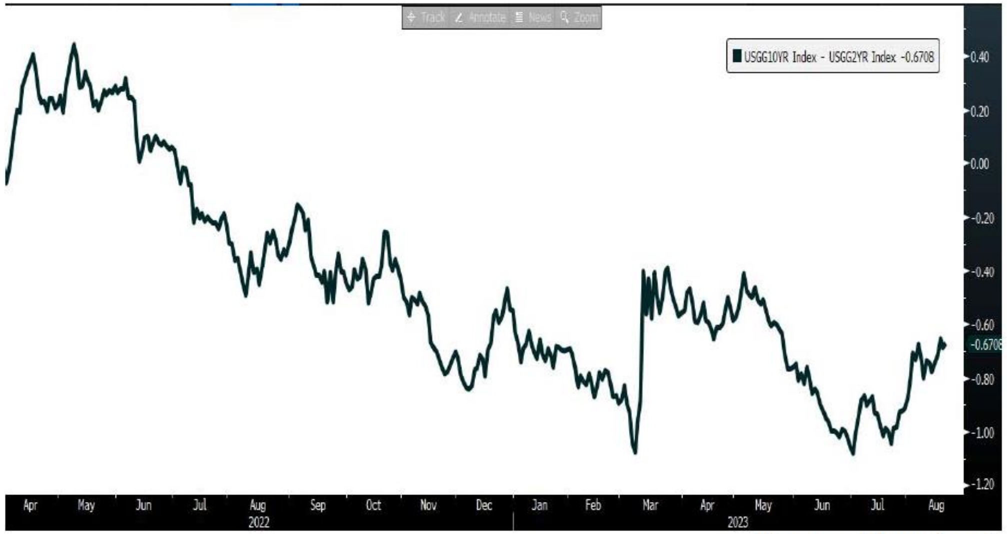


US not out of Cautious Zone

The graph below shows US Treasury 10-year yield minus 2-year yield. The term spread has been in negative zone since middle of 2022. May be not a recession, but negative 2-10 spread indicates at least muted expectation of rate action going forward.

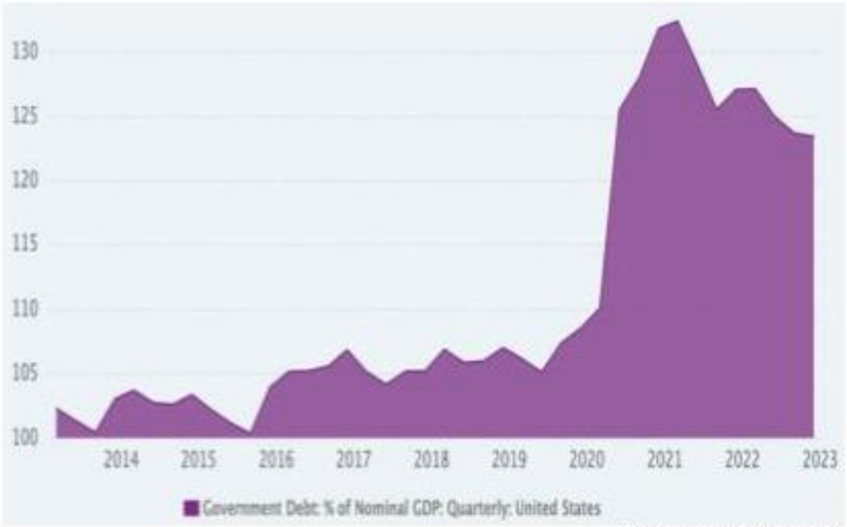
With outstanding debt of around USD 32 trillion and debt servicing cost of USD 1 trillion per year, it will be increasingly difficult to manage and service.

Us Curve Inversion still pronounced



(Source: Bloomberg)

US Government Debt to GDP – 120%



(Source: ceicdata.com)

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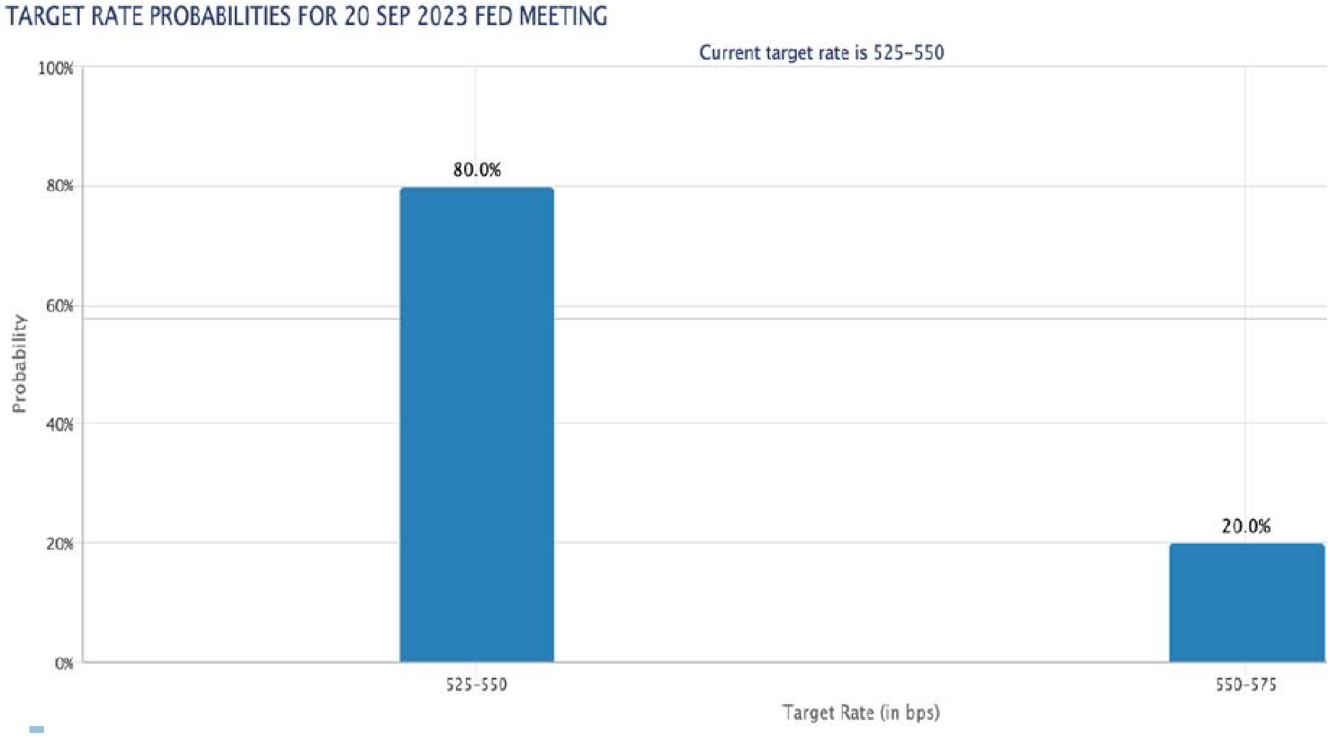
Even Valuation are not Looking Attractive

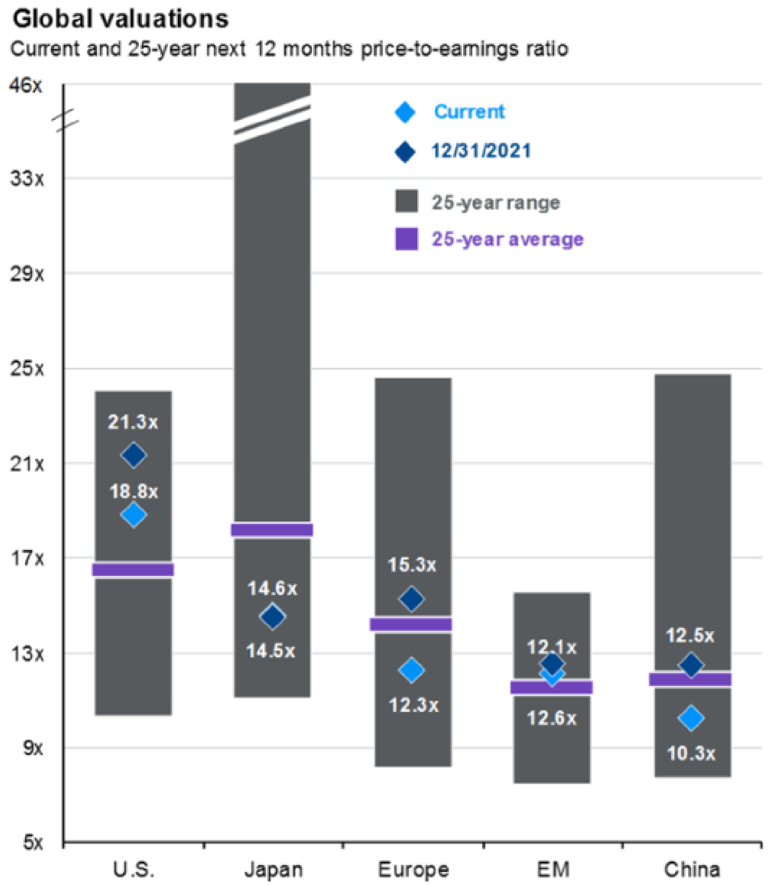
Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	18.85x	16.77x	0.63
CAPE	Shiller's P/E	31.09x	27.76x	0.53
Div. Yield	Dividend yield	1.59%	1.98%	1.15
P/B	Price to book	3.80x	3.10x	0.86
P/CF	Price to cash flow	14.43x	11.26x	1.44
EY Spread	EY minus Baa yield	-0.63%	0.32%	0.50

US Fed action: Market call - 20 Sep 2023

As per the Probabilities calculated from US Fed Funds Futures, there is 80% probability of Status Quo.



If not US, then where?



International equities are trading at a significant discount right now and that they offer an attractive yield pickup relative to U.S. equities on average.

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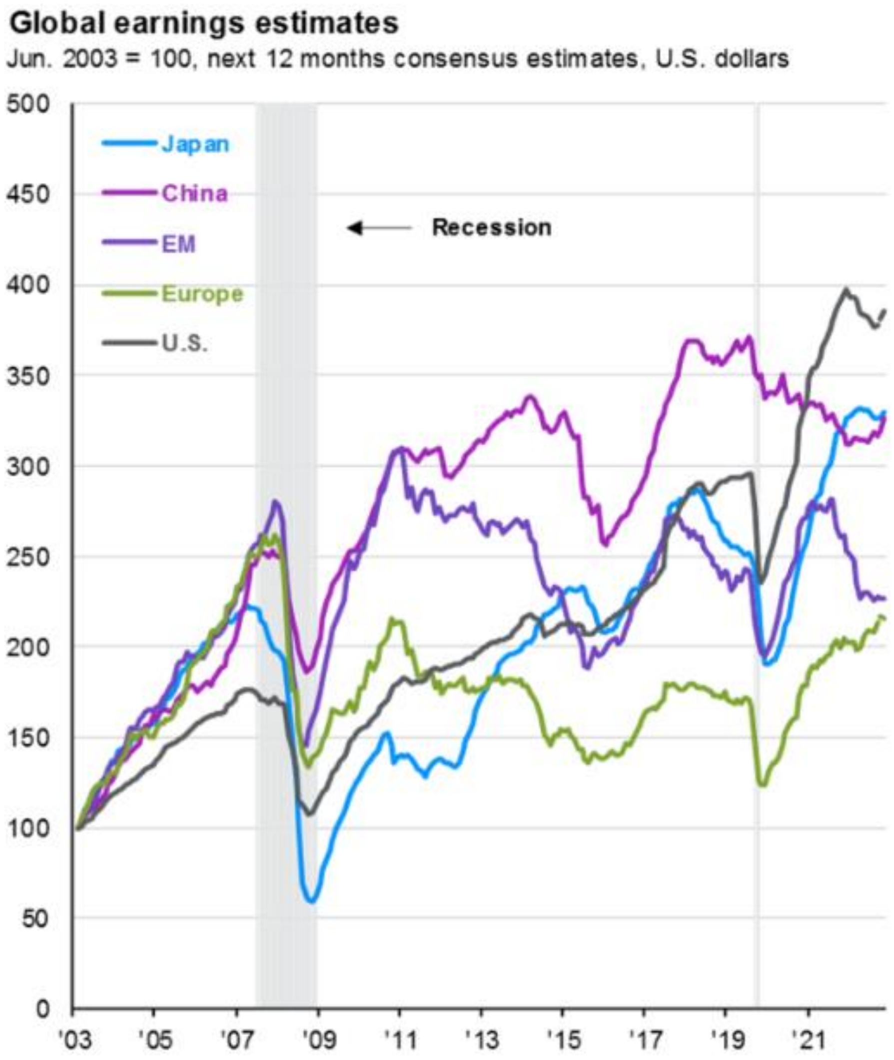
Where in International Markets?

- Earning growth in international markets a combined with discounted valuations, help make the case for investing in non US Equities.
- However, Relatively Japan Looks most promising compared to Europe, China, or other EMs



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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.

Thank You!

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