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India: Market Outlook

WHILE the central banks' focus and communication have been centered on concerns regarding elevated inflation, the recent inflation data reveal a notable improvement that marks a significant departure from the inflationary shock witnessed last year. Historically heightened and escalated inflation exerted adverse effects on both equity and bond markets, resulting in unprecedented and substantial declines in asset prices. The extraordinary inflationary shock last year triggered an exceptional disruption in asset prices, a phenomenon unlikely to occur again within a single generation.

Nevertheless, the current year has witnessed a contrasting narrative. There has been a substantial slowdown in inflation, which has provided an impetus to the robust appreciation of asset prices. Equities have surged by double-digit percentages, while high-yield bonds have generated returns of approximately 7% in the first half of the year, even in the face of ongoing measures taken by the central banks to tighten monetary policy.

Indeed, the Indian economy is witnessing a surge, fuelled by two key factors -- consumption and finance. This unique combination is bolstered by positive results. The current economic scenario resembles a relay race, with different sectors playing integral roles in driving overall growth. Interestingly, despite reporting lower earnings initially, the IT sector has outperformed the financial sector. The market appears to be in favour of sectors that exhibit strong performance and promising growth potential.

Market Watch

Indian Equities	May-23	1 Month	1 Year	3 Year	Currency	May-23	1 Month	1 Year	3 Year
Nifty 50	19,580.4	3.2%	14.1%	74.8%	USD/INR	82.3	-0.2%	-3.7%	-9.8%
S&P BSE Sensex	65,956.8	3.3%	14.6%	73.3%	EUR/INR	90.1	-1.1%	-11.2%	-2.0%
S&P BSE Midcap	30,083.9	5.3%	25.1%	118.7%	GBP/INR	105.2	-1.6%	-9.0%	-8.1%
S&P BSE Smallcap	34,475.7	6.3%	27.5%	165.9%	JPY/INR	58.8	-3.7%	1.3%	17.7%
Global Equities					**Economic Data (Abs)**				
Dow Jones (US)	35,282.7	3.4%	7.4%	32.9%	10-year Ind G Sec	7.2%	1.6%	-2.1%	22.8%
Nasdaq (US)	14,050.1	3.4%	13.4%	33.3%	CPI Inflation Ind	4.8%	4.3%	7.0%	6.1%
FTSE 100 (UK)	7,702.9	3.2%	3.9%	25.8%	WPI Inflation Ind	-4.1%	-3.5%	15.2%	-1.8%
Nikkei 225 (Japan)	32,766.5	-1.4%	17.9%	46.3%	US Dollar Index (DXY)	102.0	-1.3%	-3.7%	9.1%
Hang Seng (HK)	19,923.5	5.2%	-1.2%	-19.9%	CBOE VIX	14.1	4.1%	-33.9%	-41.5%
Commodity					**GDP Overview**	**Actual**	**Forecast**	**Previous**	**-**
Gold USD	1,949.4	2.2%	10.4%	-1.1%	Indian GDP YoY	6.1%	4.6%	4.4%	
Silver USD	24.2	7.1%	18.9%	-1.0%	US GDP QoQ	2.4%	1.8%	2.0%	
Brent Oil USD	83.5	12.3%	-24.1%	90.9%	China GDP YoY	6.3%	7.3%	4.5%	

Source: investing.com

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Global High-Frequency Indicators

- US Federal Reserve Raises Rates to 5.25%-5.5%, Reaches 22-Year High; Further Hikes Anticipated to Combat Above-Target Inflation.
- The contradiction: Low inflation and a weaker dollar oppose each other. A declining dollar can boost risk-on sentiment in global trade, leading to higher inflation from rising import costs.
- The Bank of Japan said it will allow "greater flexibility" in controlling bond yields, as it raised its full-year inflation forecast to 2.5 percent from its previous estimate of 1.8 percent.
- The Bank of England Raises Interest Rates to 5.25%, the Highest in 15 Years, and Signals Prolonged High Borrowing Costs Ahead.
- Fitch Unexpectedly Downgrades U.S. Credit Rating, Citing Fiscal Deterioration and Debt Ceiling Disputes as Threats to Government's Financial Stability.
- Contrarian views from renowned investors, Bill Ackman is shorting 30-year Treasury bills and Warren Buffett is buying Treasuries regardless of US downgrade by Fitch. Both investors may have different reasons and time horizons for their positions. It is also worth noting that the investment landscape is complex and dynamic, and different investors can hold opposing views while still achieving success in their respective strategies.
- After showing moderation for four months, consumer price inflation (CPI) in India surged to 4.8% in July, eliminating the possibility of rate cuts.
- The strong sales figures in India's commercial vehicle segment reflect a robust CV cycle, indicating the country's economy is on a firmer footing.

Fixed Income Outlook – Shifting Narratives

The market narrative has been experiencing swift changes. Initially, there were speculations that the rate hikes by the US Federal Reserve were causing damage to the financial system. Subsequently, concerns about an impending recession and possible rate cuts emerged. However, the narrative shifted towards highlighting a resilient US economy and robust domestic demand in India, along with deflationary pressures in China. Meanwhile, the Eurozone faced a slump in growth.

- CPI increased to 4.81% y/y in June 2023 from 4.31% y/y in May 2023 led by a sharp increase in food prices.
- Merchandise exports registered contraction for the fifth consecutive month in June 2023, declining by 22% y/y. The contraction in exports was broad-based, with 21 out of 30 major commodities.
- Rural unemployment increased to 8.7% in June 2023, led by a sluggish progress in Kharif sowing on account of the late arrival and uneven spread of the south-west monsoon.

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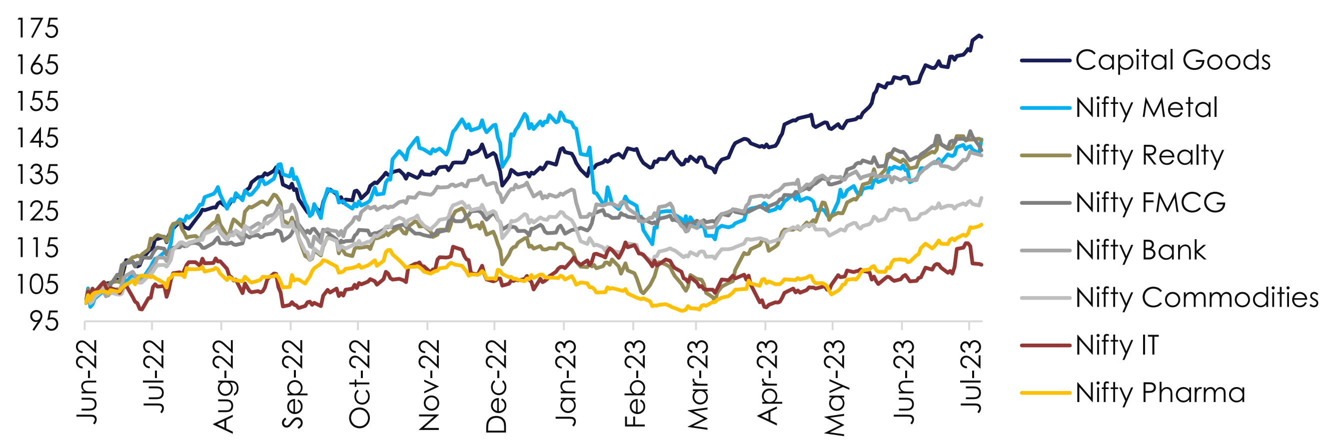
10Y Sovereign Yield

Region	Country	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23	1M change (Bps)	YoY change (Bps)
WEST	US	2.65	3.10	3.83	4.05	3.61	3.87	3.51	3.92	3.47	3.42	3.64	3.82	3.89	7	124
	UK	1.86	2.70	4.09	3.52	3.16	3.67	3.33	3.83	3.49	3.72	4.18	4.40	4.31	-9	245
	Germany	0.82	1.51	2.11	2.14	1.93	2.57	2.29	2.65	2.29	2.31	2.28	2.40	2.42	2	160
LATAM	Brazil	12.99	12.29	12.02	11.87	12.74	12.69	13.24	13.45	12.82	12.34	11.57	10.70	10.79	9	-220
	Mexico	8.56	9.08	9.65	9.83	9.21	9.02	8.70	9.32	8.84	8.78	8.80	8.69	9.19	50	63
Asia Pacific	Japan	0.18	0.22	0.24	0.24	0.25	0.41	0.49	0.50	0.33	0.39	0.43	0.39	0.45	6	27
	Australia	3.06	3.60	3.89	3.76	3.53	4.05	3.55	3.85	3.30	3.34	3.61	4.02	4.02	0	96
	South Korea	3.19	3.64	4.28	4.24	3.70	3.56	3.25	3.75	3.28	3.35	3.49	3.66	3.66	0	47
	China	2.77	2.64	2.75	2.65	2.92	2.84	2.90	2.92	2.86	2.78	2.71	2.64	2.69	5	-8
	Indonesia	7.11	7.10	7.35	7.51	6.91	6.92	6.69	6.88	6.77	6.51	6.36	6.24	6.32	8	-79
	Singapore	2.64	2.98	3.47	3.47	3.06	3.08	2.95	3.33	2.93	2.76	2.84	3.06	3.01	-5	37
	India	7.32	7.19	7.40	7.45	7.28	7.33	7.34	7.43	7.31	7.12	6.99	7.12	7.09	-3	-23

When Good News is Really Good News

There has been a seismic shift in investor perspective, especially in Indian equities, where bad news is no longer good news. We encourage thinking of the market in this fashion because it makes news much easier to interpret. The best time to invest is when future earnings are strong, multiples are low, and stock prices are low. This is precisely the environment that creates a great rate of return on invested capital. While it has been a consistent occurrence that the stock market often disconnects from underlying profitability, that being said, it seems that the current rally is being driven by fundamental factors. The capital goods sector, along with pharma, appears intriguing.



Data Source: https://www.investing.com/

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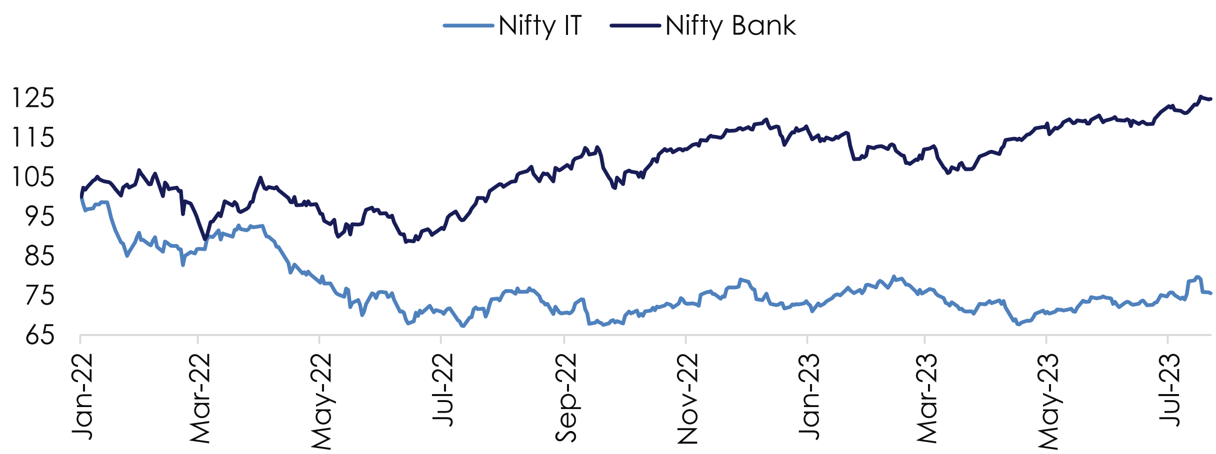
IT & BFSI: A Tale of Market Positioning

The stock market will continue to be essentially what it always was in the past: a place where a contraction is inevitably followed by an expansion, a place where a big bull market is inevitably followed by a big bear market. In Q4 of FY23, the Indian IT services sector faced the wrath of a meltdown triggered by weaker demand, compressed margins, subdued outlook commentary, and lower deal wins in the challenging environment. Heading into Q1 of the earnings season, market positioning was on the short side, with most participants continuing with their cautious stance on the Indian IT sector.



Data Source: https://www.investing.com/

AMCs Clamping Down on Lump Sum Investments in the Small-cap Category

In a development that is stirring quite a buzz in the Indian mutual fund arena, Nippon India Mutual Fund has rolled out a significant change by stopping lump sum investments in the small-cap category. This decision is likely to spark inquiries from both experienced and novice investors, compelling them to explore the specifics and ramifications of this decision. The decision to limit subscriptions by Nippon India MF is driven by the surge in the small-cap segment and investor participation. The aim is to gradually deploy the investment corpus in line with small-cap investing characteristics.

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Gaming Industry on Edge as GST Council Meet Approaches Amid 28% GST Conundrum

Imposing a 28% GST on the entire value of online gaming could lead to users seeking illegal gambling options or offshore platforms. This move would primarily benefit unlawful and offshore gambling companies. Additionally, the GST council's decision to remove the distinction between skill-based and chance-based games for online gaming further exacerbates the issue. In today's technologically advanced era, relying solely on taxation does not offer a sustainable solution and may give rise to arbitrage, ultimately causing harm to customers and startups.

BRICS Countries Planning New Gold-Backed Currency

The BRICS countries are planning to introduce a new trading currency, which will be backed by gold. The trend of de-dollarization isn't some far-off future fantasy; it is happening now. US Federal Reserve notes' proportion of foreign reserves has been steadily declining over the past few years. Russia has had no choice but to pursue alternatives to the dollar in response to being blacklisted from the SWIFT international payments regime. The fact that gold is being considered by the BRICS countries as a basis for international trade should incentivize central banks – and individual investors – to accumulate the precious metal. In our opinion, any discussion of alternate currencies is indeed a much more medium- to long-term aspiration.

Era of Transition

We are currently experiencing a significant historical shift from the dollar era to a new bipolar economic system. This transition is likely to bring about several consequences, including:

- Transformation of trade relations, as countries adapt to the changing economic landscape.
- An increased emphasis on small, private and professional armies, and proxy wars, leading to a further consolidation of power dynamics.
- Greater integration of satellite economies into the global economic order.
- Establishment of agreements regarding spheres of influence, particularly in the energy and cryptocurrency sectors.
- The growing importance of Artificial Intelligence (AI) in enhancing productivity and shaping confrontations in the information space.
- A shift towards speculative approaches in the market, gaining prominence over traditional value-investing strategies.

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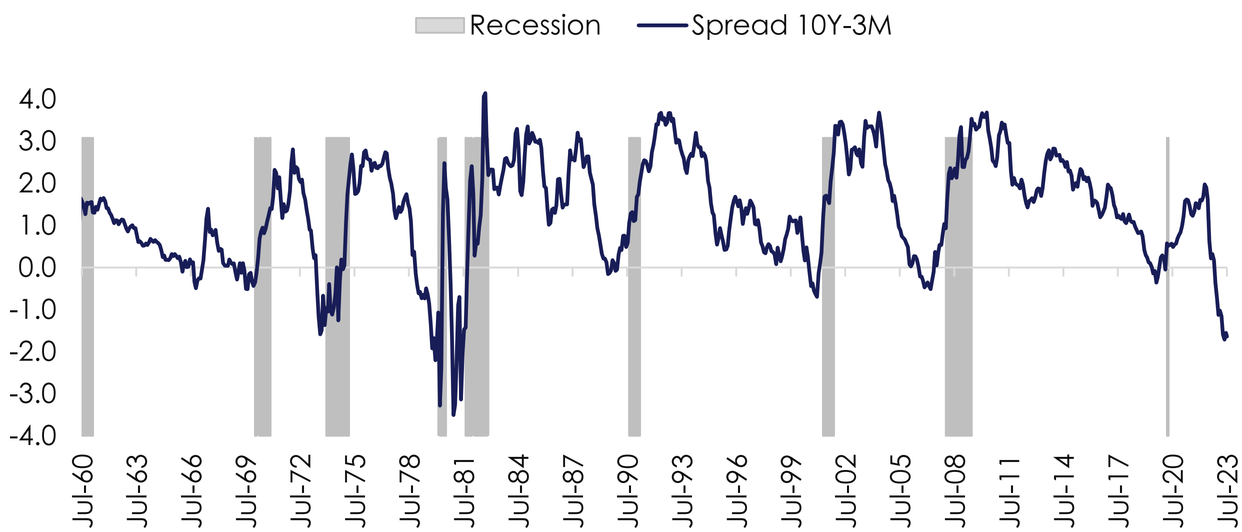
US Treasuries Indicate Rate-cut Possibilities

The present era is distinct from the 1970s, as there are significant divergences between the two periods. Notably, the levels of private and government debt were considerably lower in the 1970s compared to today. Despite this, the current decade is likely to share more similarities with the 1970s in terms of its macroeconomic trajectory than with any subsequent decade. One such resemblance is the anticipation of multiple substantial inflation waves, much like what occurred in the 1970s. Another similarity is the performance of the US yield curve.



Data Source: https://www.newyorkfed.org/

The US yield curve (specifically, the 10-year-3-month spread) inverted in October last year. As a result, approximately 8 months have passed since the inversion occurred. During the period between 1973 and 1981, the longest duration from inversion to the onset of a recession was 13 months. However, as of now, there is no evidence suggesting that an extreme inversion is currently in effect. Yield curves inverting have a very good track record of predicting recessions, but their track record as a timing tool for a recession is not so good.

Anticipated Boost for Commodities as China Promises Stimulus Measures

Chinese authorities have pledged to introduce additional stimulus measures, bringing optimism to the global markets. The world's second-largest economy has been grappling with a worsening decline in both the manufacturing and real estate sectors, which have collectively impeded economic growth. Despite lingering concerns about high debt levels, the Politburo has been compelled to act in response to the economic challenges. The question now arises is: Will the current stimulus measures possess sufficient strength to effectively stabilize the Chinese economy and maintain investor confidence? Beijing has been cautious in implementing more aggressive measures, fearing potential repercussions on debt.

Hang Seng Index (HSI)

In terms of the valuation, as the index is now hovering around the decade-low level, the PE ratio for Hang Seng is quite appealing, much lower than S&P Global's price to earnings. It's also lower than HSI's three-year average at 11.7x and 10-year average at 11.6x.

Data Source: www.gurufocus.com

All eyes on AI

In 2023, the AI theme has played a significant role in propelling equity market gains, supported by increased investor interest in AI and the remarkable outperformance of major US technology stocks. However, the rally's significant magnitude and limited breadth have led to concerns about the potential for further growth and comparisons to the dot-com bubble. Despite these concerns, there are several compelling reasons to maintain a positive outlook on the AI theme and equities in general.

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This is Not a Repeat of Dot-com 2.0

- AI - Beyond Speculation, Leading Players Monetizing with Upward Earnings Revisions, Technology Valuations could be an issue.
- Technology Today Shows Stronger Fundamentals, Set Apart from Dot-com Bubble Era.
- Technology Sector Concentration Decreased: Nasdaq 100 Returns More Diversified Today.

Perspective on Wider Equity Markets

- The pharma sector could experience double-digit earnings growth over the next couple of years.
- Market breadth Improves, positive performance spreads across economically sensitive segments; Food inflation is becoming a concern.
- Valuations are attractive across several segments of the market. Despite the broadening of the rally.
- The central banks are set to hike more in the near term and hold tight for long thereafter.
- Is there a catalyst? Yes, given the recent surge in Indian & US Indices, some pullback in benchmark indices cannot be ruled out.

Key Takeaways: Fixed Income

- Historically, investors have been handsomely rewarded for holding on to longer-duration assets during the time between the last rate hike and the first rate cut, outperforming cash equivalents by a significant margin.
- Although short-term yields may seem appealing, it's essential for investors to be mindful of reinvestment risk and consider the advantages of securing long-term yields, as overnight yields can diminish rapidly.
- Inflation remains persistent, and the Federal Reserve's indications of potential additional rate hikes have prompted the markets to anticipate further increases in response.

While it is tempting for investors to sit in still high-yielding cash, we favour adding duration due to the higher yields of longer-term securities and their ability to benefit from any future rate cuts. A diversified multi-sector approach, focused on higher-quality credits across sectors, with active management.

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How Can Wodehouse Capital Advisors Help?

Wodehouse Capital Advisors has extensive network and prior experience across each of the service vertical

Family Office Services

- Investment Management
- Succession Planning
- Real Estate Advisory
- Business Consulting
- India Entry Strategy

Merger & Acquisitions

- Buy Side Representation
- Sell Side Representation
- Bolt- On- Acquisitions

Debt

- Structured Finance
- Refinancing
- Additional Funds for Set-up

Equity

- Growth Capital
- Strategic Capital

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