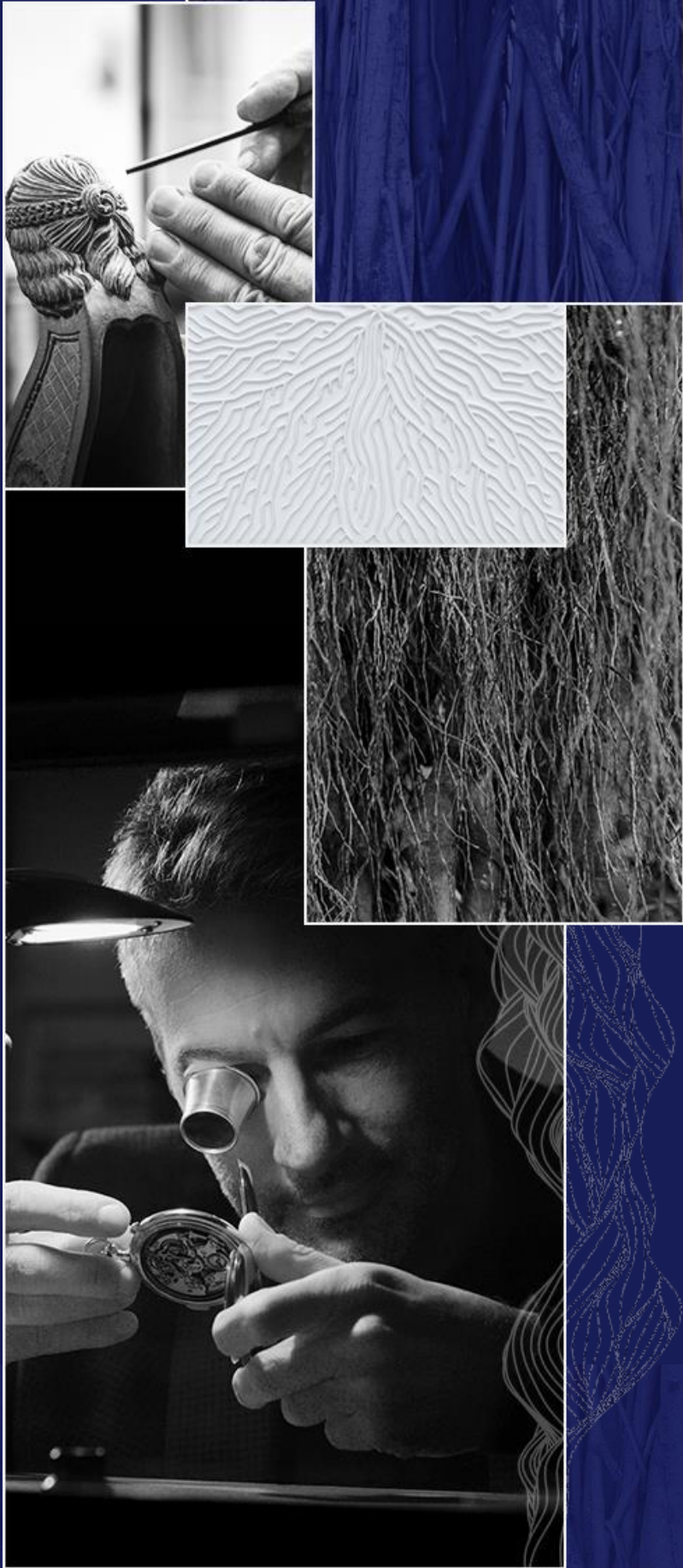


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NEWSLETTER
September 2023





Indian-Market Outlook

Bonds for safety and equity for growth – this is the basic formula for long-term investment planning. At first glance, one might naturally assume that the asset exhibiting less fluctuation represents the safer choice – often serving as a surrogate for the "risk-free asset". Over the past twelve months, US Treasury yields have exhibited daily fluctuations, encompassing a notable percentage change of approximately 34%, ranging from their March low to their most recent peak as of 27th September.

Certainly, it's worth noting that our cognitive process regarding bond yields differs from our approach to stock prices. Given that bond yields are inherently presented as percentages, accurately calculating percentage changes in yields can pose a cognitive challenge. Nonetheless, it's vital to recognize that a bond yield also represents a price – specifically, it serves as the cost of borrowing money, a market-driven value agreed upon by participants engaged in credit transactions. So, it's worth paying attention to those movements in Treasury yields and asking why they go up and down as much as they have been in the last year.

Encouragingly, this year's economic performance in the US & India has surpassed economists' expectations. In Q1 2023-24, India achieved a remarkable GDP growth rate of 7.8%, the highest in four quarters. This underscores the economy's resilience in the face of challenges. Key drivers of this impressive growth include the robust services sector, increased capital spending, strong consumer demand, and a revival in manufacturing activity. Despite elevated interest rates, the economy has not only navigated obstacles but also capitalized on opportunities.

Market Watch									
Indian Equities	Sep-23	1 Month	1 Year	3 Year	Currency	Sep-23	1 Month	1 Year	3 Year
Nifty 50	19,523.6	0.9%	16.1%	74.0%	USD/INR	83.2	-0.8%	-2.1%	-12.8%
S&P BSE Sensex	65,508.3	0.7%	16.1%	72.5%	EUR/INR	87.7	2.4%	-9.7%	-1.3%
S&P BSE Midcap	31,923.8	2.9%	30.2%	117.2%	GBP/INR	101.5	2.8%	-12.1%	-7.0%
S&P BSE Smallcap	37,347.6	2.2%	33.2%	151.3%	JPY/INR	55.7	1.6%	1.2%	20.2%
Global Equities					Economic Data (Abs)				
Dow Jones (US)	33,550.3	-3.7%	14.8%	22.2%	10-year Ind G Sec	7.24%	7.17%	7.40%	6.02%
Nasdaq (US)	13,092.9	-6.1%	21.9%	18.1%	CPI Inflation Ind	6.83%	7.44%	7.00%	6.69%
FTSE 100 (UK)	7,562.3	1.4%	10.0%	28.3%	WPI Inflation Ind	-0.52%	-1.36%	12.41%	1.32%
Nikkei 225 (Japan)	31,851.0	-1.2%	20.6%	35.3%	US Dollar Index (DXY)	106.4	2.7%	-5.2%	13.3%
Hang Seng (HK)	17,351.0	-6.1%	1.1%	-25.5%	CBOE VIX	18.4	27.2%	-42.3%	-30.0%
Commodity					GDP Overview		Actual	Forecast	Previous
Gold USD	1,875.6	-3.2%	13.0%	-1.2%	Indian GDP YoY	7.8%	7.7%	6.1%	-
Silver USD	22.6	-8.8%	19.9%	-6.7%	US GDP QoQ	2.1%	2.4%	-	-
Brent Oil USD	94.0	10.0%	6.3%	129.2%	China GDP YoY	-	-	-	-

Source: investing.com

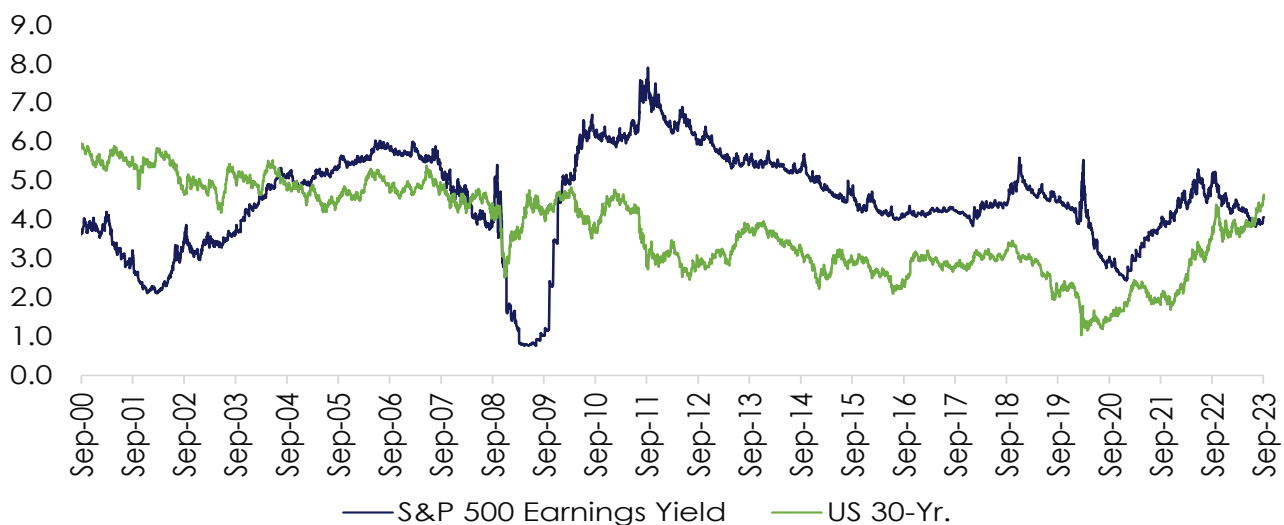
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Treasuries vs. Equities in a Battle of Crystal Balls

Jerome Powell's address at last month's Jackson Hole symposium became the catalyst for a dramatic performance in the markets. Equities surged to the forefront, while Treasuries momentarily hit the brakes, unveiling an intriguing conundrum: which asset class possessed the true crystal ball? In a script that markets have played before, Treasuries provided the answer by surpassing the 4.3% level on the 10-year yield, coinciding with the US Federal Reserve's hawkish pause, hinting at a possible rate hike by the end of the year. Additionally, there is a notably tighter monetary policy outlook extending through 2024. All of this has brought economic complexity into the spotlight.

Fixed Income Risk Premiums Outpace Equity Risk Premiums



Data Source: www.gurufocus.com

Market Dynamics:

US Industrial Index Decline:

- An alarming 8% decline in the US industrial index has raised concerns about the impact of higher interest rates on the industrial sector.
- This decline reflects growing pressure on industrials.

Policy Dilemma:

- Maintaining interest rates while cracks emerge in the economy presents a challenging dilemma for the US Federal Reserve as they navigate how to sustain their hawkish stance in the face of economic uncertainties.

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Global Valuation Reset:

Diminished Attractiveness of Emerging Markets:

- Global markets are currently undergoing a valuation reset, largely due to the impact of higher interest rates.
- Given a scenario with a risk-free return of approximately 6.5% in the United States, achieving alpha through investments in emerging markets necessitates targeting a growth rate of approximately 10%, accounting for currency risk in EMs.
- As a result, this phenomenon is reducing the overall appeal of emerging markets compared to US Treasuries.

Economic Complexity:

Crude Oil and Core Inflation

- A fascinating economic phenomenon occurs when crude oil prices remain persistently high for an extended period, transforming non-core inflation into core inflation.
- This transformation can be likened to a financial magic trick, shedding light on the inner workings of economic dynamics.

Market Concerns Escalate as Crude Oil Ignites Inflation's Comeback

The shift in crude oil prices from around \$84 to \$95 within the past month aligns with the scenario we discussed last month. This development carries the potential to usher in a second wave of inflation, potentially jeopardizing the efforts made to curb and stabilize inflation levels.

- Dollar-denominated crude oil often moves inversely to the US dollar, with a strong US dollar tending to lower oil prices due to increased costs for holders of other currencies.
- Geopolitical tensions and global economic slowdown fears have caused investors to seek the safety of the US dollar in the past year, resulting in higher prices.
- Currently, we find ourselves in a situation where the dollar index is at a 6-month peak, while crude oil prices are at their highest in 10 months, driven by distinct and separate factors.

Moody's Alert: Fiscal Risks Loom for US Credit Rating and Markets

- Major credit rating agency Moody's said on Monday that the US government shutdown would harm the country's credit. The severe warning comes only a month after Fitch downgraded the US by one notch due to debt ceiling crisis.
- "Looking ahead, weaker fiscal policymaking that leads to persistently high fiscal deficits and higher-than-expected interest costs would put pressure on the US rating," Moody's said.

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India's Inclusion in JP Morgan Global Bond Index

India's upcoming inclusion in the JP Morgan Global Bond Index is a monumental development with profound implications. This move, akin to a stock joining a major stock market index, presents several significant advantages:

Passive Fund Opportunities: Passive funds favour index-based investments and will flock to Indian bonds. This includes global mutual funds, ETFs and sovereign wealth funds, tracking key global bond indexes like JPMorgan, Bloomberg Barclays, and FTSE Russell.

Phased Inclusion: India's integration into the JPMorgan Index will be gradual, commencing from June 28, 2024, and increasing by 1% each month until April 2025, which should mitigate market disruptions.

Expected Follow-ons: Anticipating India's addition to the JPMorgan Index, Bloomberg Barclays and FTSE Russell may follow suit, drawing approximately \$40 billion from passive funds over the next 12-18 months.

Impact on India:

- **Government Benefits:** India's fiscal deficits could see reduced borrowing costs, with a potential \$40-billion inflow offsetting over 20% of the government's borrowing requirements, addressing fiscal deficit concerns.
- **Economic Support:** The influx of funds can reduce the trade deficit and mitigate concerns about the current account deficit, alleviating two major economic worries.
- **Currency Stability:** While substantial rupee appreciation may be managed by the Reserve Bank of India (RBI), the risk of severe depreciation diminishes.
- **Corporate Advantages:** Lower corporate bond yields can lower the cost of capital for Indian corporations, enhancing profitability and potentially bolstering the stock market.
- **Financial Institutions Gain:** Indian banks, mandated by RBI regulations to hold government bonds, will benefit from the increased market value of these bonds. Non-Banking Financial Companies (NBFCs), significant bond borrowers, may also reap rewards.
- **Deepening Bond Markets:** Enhanced investor involvement and changes in RBI's bond valuation procedures may encourage more companies to access bond markets, potentially bolstering infrastructure projects.

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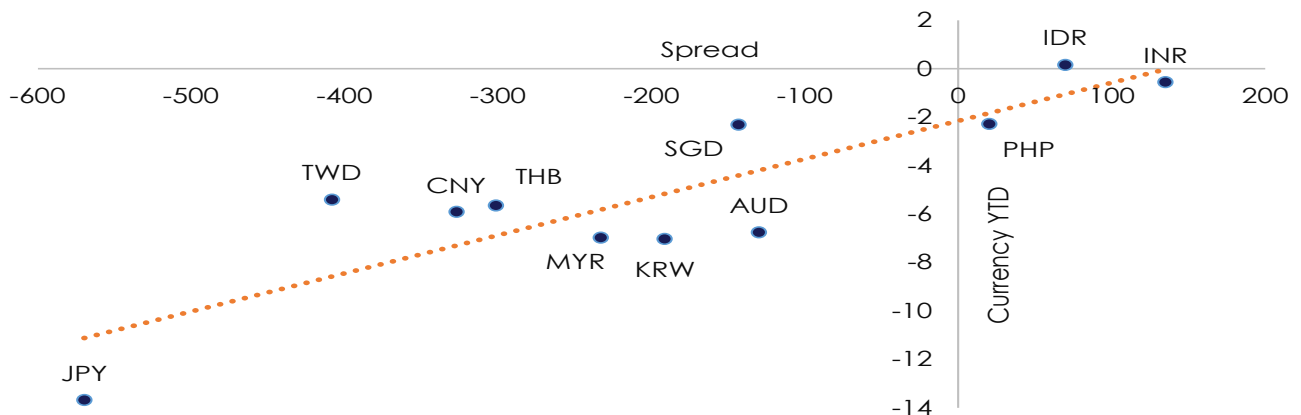


Although the immediate impact may be limited due to rising U.S. bond yields and a stronger dollar, these transformations are expected to unfold gradually over the next few years, reshaping India's financial landscape and economic prospects.

India's Economic Landscape: Strong Growth, Inflation Challenges, and Forward Prospects

- India recorded a 7.8% y-o-y growth rate in the second quarter, making it the fastest-growing major economy in the world.
- The country's growth stands in contrast to the slowdown in the Asia-Pacific region, which is responding to global and Chinese economic slowdowns.
- India's growth is primarily driven by domestic demand, particularly capital investment, with investment expected to boost long-term growth potential.
- Household consumption remains strong due to improvement in the labour market, reduced unemployment, increased labour participation, and falling inflation.
- India's sovereign credit rating of BBB- leaves its bond market vulnerable to downgrade risk, but recent global bond index inclusion of government bonds has mitigated these concerns.
- The Indian rupee (INR) has shown resilience by maintaining a narrow range against the USD, making it one of the best-performing currencies in the APAC region.
- The stability of the INR is attributed to Reserve Bank of India (RBI) intervention, rather than solely structural factors.
- Indian inflation briefly fell within the RBI's target range of 2-6% but rose again due to erratic monsoon affecting agriculture and seasonal food prices.

Spread over US policy rates and currency performance.



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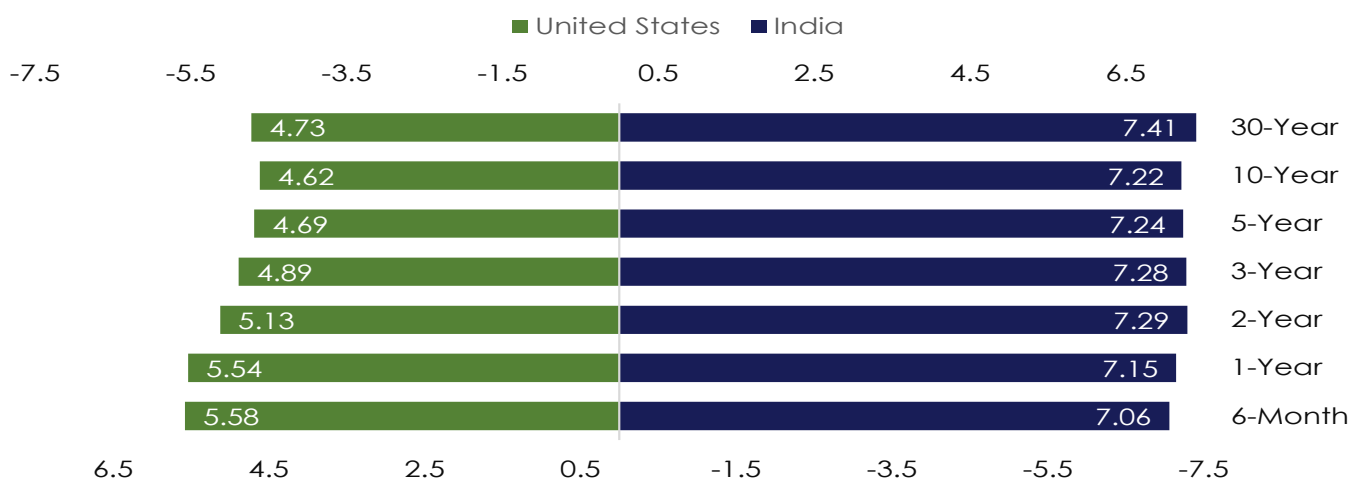
Data Source: www.investing.com

India is currently experiencing robust economic growth, with expectations of it continuing in the near term. However, a recent spike in inflation suggests that policy rates may not be eased immediately, likely until next year. Despite the Reserve Bank of India's support, the Indian Rupee (INR) is also benefiting from overseas investments and equity listings. The inclusion of India government bonds in global bond indices next year will further boost the INR. This sets the stage for a return to the 7% economic growth rate in 2023, inflation within the RBI's target range, and potential policy rate easing in 2024, supporting continued strong growth.

WCA Outlook Fixed Income

- The US Bond yields rose primarily because the Fed pivoted to a much more hawkish position, as investors anticipated aggressive interest rate hikes to rein in inflation.
- Rising bond prices are a challenge for existing bondholders because of the inverse relationship between bond yields and bond prices. When yields rise, prices of current bond issues fall. This is a function of supply and demand.
- In the US, an "inverted yield curve" persists, meaning certain shorter-term securities offer higher yields than some longer-term instruments.

The inverted yield curve persists in the US.



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Data Source: www.investing.com

- Given the current market conditions, bond investors are presented with various options:
 - Opportunities are clearly more attractive due to today's higher yields.
 - For Indian bond investors it makes sense to consider spreading fixed-income investments across the shorter and longer-term maturity spectrum, with a focus on higher credit quality.
- Additionally, for Indian bonds, a different perspective is offered:
 - Over time, interest rates in India are perceived to have more room to fall than to rise.

WCA Outlook Equities

Since April of the current year, Indian equities have been on an upward trajectory, and the Indian IT sector mirrors this trend. The puzzling question is: why is Indian IT outperforming when the sectors it serves in the US are grappling with higher interest rates and economic uncertainties?

- The US banking system is facing challenges, and there are issues in the US housing and telecom sectors and even the previously strong retail sector is showing signs of deterioration.
- The majority of US citizens have depleted the monetary relief they received during the COVID lockdown, leaving only 20% with meaningful savings in their accounts.
- Notably, the home loan rate in the US is approximately 8%, subject to individual risk profiles, leading to fresh challenges for home builders. Furthermore, the US housing market is experiencing a cessation in the initiation of new residential construction projects.
- While the strength of the Dollar Index may provide some insulation, the uncertainties in the global economic landscape make it crucial for investors and industry observers to carefully monitor the situation.

Finally, it's essential to acknowledge the risks on the horizon. Higher US bond yields, rising crude oil prices, and a stronger Dollar Index are not an ideal scenario for risk-on sentiment in equities. These macroeconomic factors can create headwinds for both US and global markets, including the Indian IT sector.

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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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