HDFC Bank Research

Presentation

September 2019

Equity MF Strategy & Recommended Asset Allocation

- **Post budget selloff from the FPI has led to the markets correcting, while commitment of lower fiscal deficit has led to lower interest rates.**
- **The government came back with a slew of measures stem the deceleration and to revive the economy.**
- **Strong government response and easy liquidity regime is a potent combination for economic revival in the medium term.**
- **Macro indicators continued with mixed signals in near term as lower inflation, lower interest rate, improved domestic liquidity conditions, indications of steady volume growth continuing in many sectors seem to be offset by weak IIP and GDP on the other. Stagnation of consumer demand and lower corporate margins needs to reverse for stronger earnings growth to emerge.**
- **The GDP data for Q1FY20 showed further weakness on the back of deceleration in private consumption and investment demand. Markets are expecting that H2CY19 could be marked by improving investment demand and better corporate results.**
- **Rising government spending holds the key. We believe that in the next five years the government would accelerate the process of reforms and decision making to take advantage of the solid base that has been built over the past five years.**
- **From an Equity Mutual Fund perspective, investors should look at Large Cap and Multicap Funds for fresh investments and SIP into Midcap and Small caps funds can begin with a longer horizon (12-15 months), with an investment time horizon of 2-3 years. We maintain our investment strategy at 50% Lumpsum and rest 50% staggered over the next 3-4 months.**

	Aggressive	Moderate	Conservative
Equity Funds	75%	55%	25%
Debt Funds	20%	40%	70%
Gold	5%	5%	5%

Debt Mutual Fund Strategy

- Investments in Medium Duration Funds can be considered with a horizon of 15 months and above.

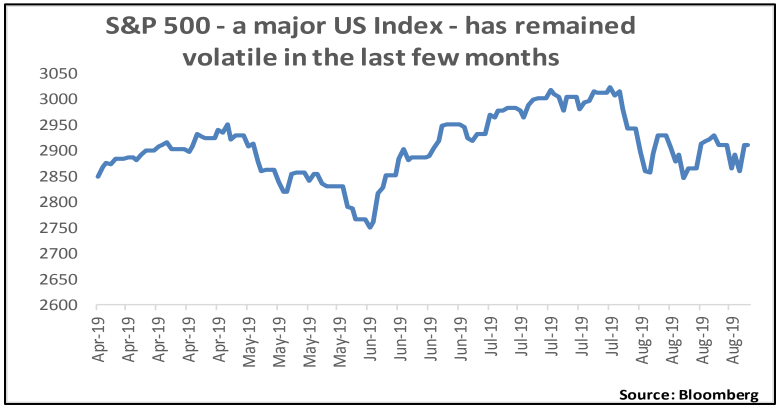
- Investments into Short Duration Funds can be considered with an investment horizon of 12 months and above.

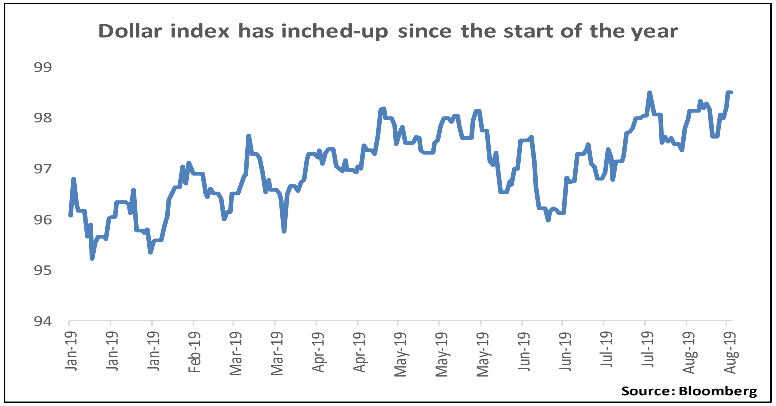
- Investors who are comfortable with intermittent volatility, can also look at strategies that have allocation to the longer end of the yield curve, through Dynamic Bond Funds with an investment horizon of 24 months and above.

- Investors looking to invest with a horizon of up to 3 months can consider Liquid Funds, while Ultra Short Duration Funds and Arbitrage can be considered for a horizon of 3 months and above.

Research Presentation – Contents September

Trump's tweets roil the markets…
… while Dollar Index continued to remain stronger at ~97-98 levels



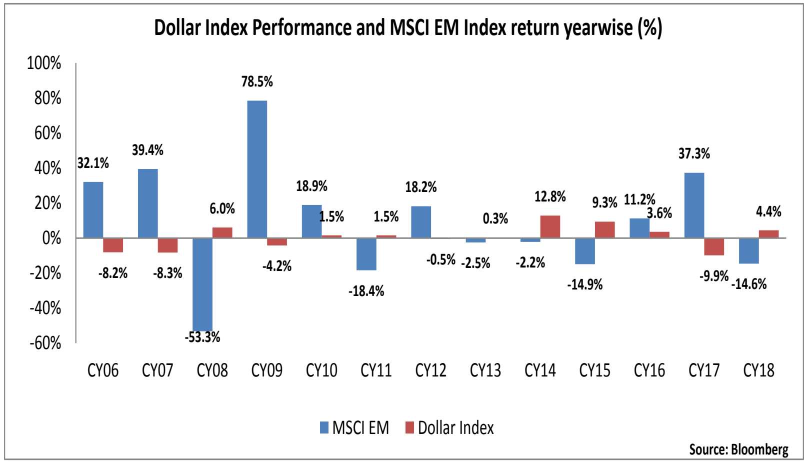


- Equity markets globally has seen volatility in the last one year, as ***series of tweets by US President Donald Trump on US-China trade war, US Fed policy actions on interest rates and currency and criticizing OPEC for oil production cuts*** have added to sharp volatility in the equity and currency markets world-wide.
- In a series of tweets recently (on Aug 23, 2019), ***Trump said that the United States would raise its existing tariffs on USD 250 bn worth of Chinese imports to 30% from the current 25% beginning on Oct. 1***. Trump's comments and tweets came after China unveiled its new tariffs on USD 75 bn worth of U.S. products, including autos.
- At the same time, ***Trump also tweeted about an increase in planned tariffs on the remaining USD 300 bn worth of Chinese goods to 15% from 10%,starting Sept. 1***, but tariffs on about half of those goods have been delayed until December 15.
- ***Trump has also ordered US companies to move their Chinese operations elsewhere***. These series of tweets on a single day led to sharp fall in US major equity indices. **The US major index, S&P 500 fell by ~2.3% in a single day on 23 Aug 2019.**
- On the other hand, Trump has been long demanding US Federal Reserve for higher interest rate cuts and a weaker dollar. However, given the global uncertainty, dollar has continued to remain stronger and US Fed's indication to be data dependent for any further rates cuts has helped in strengthening of USD.

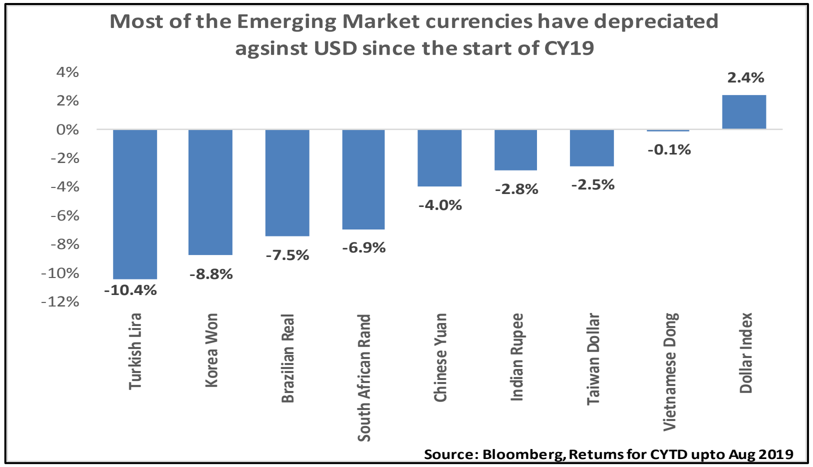
While, undoubtedly Trump's tweets have the ability to provide an abundance of short-term volatility to equity and currency markets all over the world; over the long term, resolution over the US China trade war is needed to improve the sentiments for the markets globally. On the other hand, the recent strengthening of US dollar is having a negative impact on the Emerging Markets assets as volatile and challenging global investment environment has resulted in increased demand for safer assets like the US dollar.

Stronger USD has had a negative impact on EMs Assets…

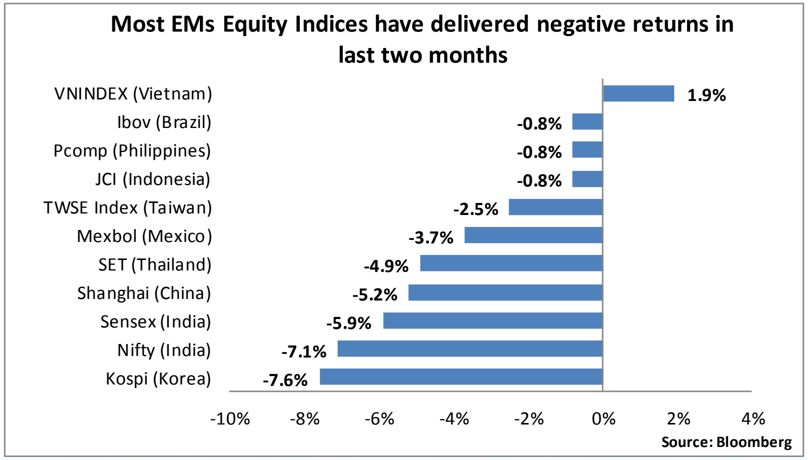
A stronger dollar, historically, has generally resulted in negative impact on EMs equities…



Demand for safe heavens have resulted in appreciation of dollar against most of EMs currencies, especially, in last few months…

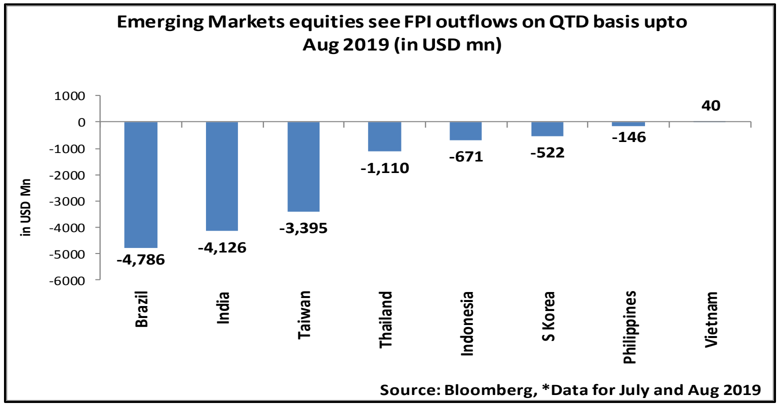


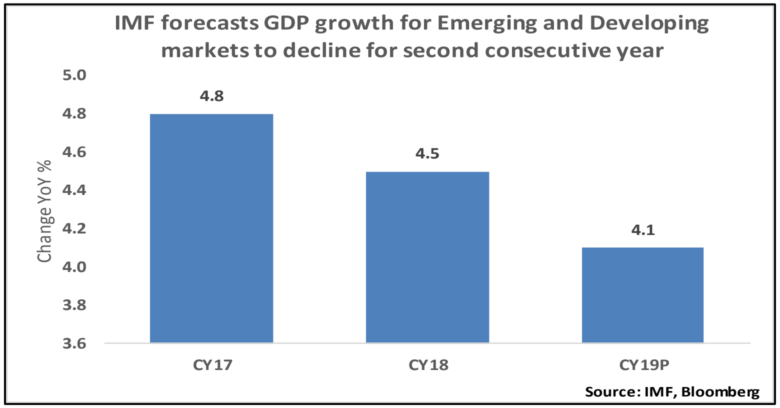
As a result, most of the EMs equity indices have turned negative in last few months…



- Demand for dollar has increased in the recent past as weak economic outlook, trade tension between US and China and Fed's mood to not cut rates going forward has resulted in increase in demand for safe assets like US dollar.
- As a result, most of the EMs currencies and equity indices saw sharp decline in the last few months.
- From India's perspective, Indian Rupee has depreciated by ~2.8% since the start of the year and by 4.8% in last two months.
- Moreover, given the sharp FPI outflow seen in the last few months, Indian major equity Indices, Nifty50 and S&P BSE Sensex are also down by 7.1% and 5.9% in the last two months.
- **Going ahead, any negative announcement by the US on its trade policies and global central banks monetary policy stance are likely to affect the sentiments for global equity indices and currencies.**

Outflows from EMs continue to happen…

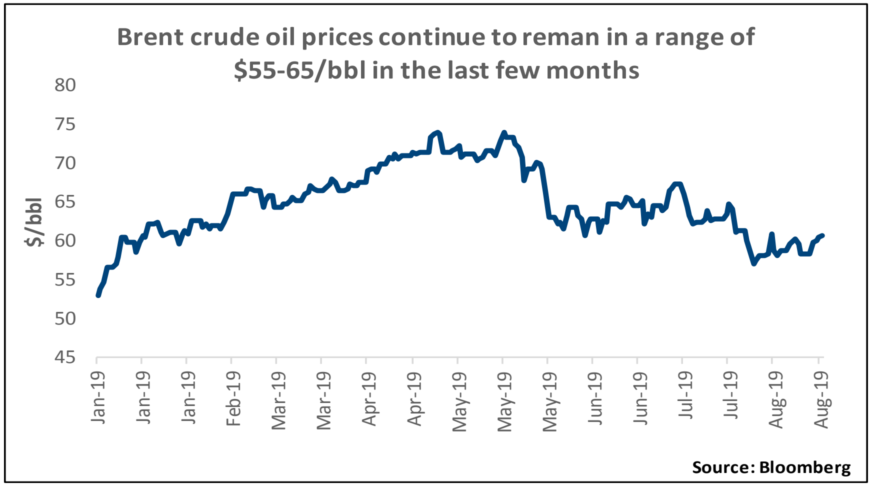


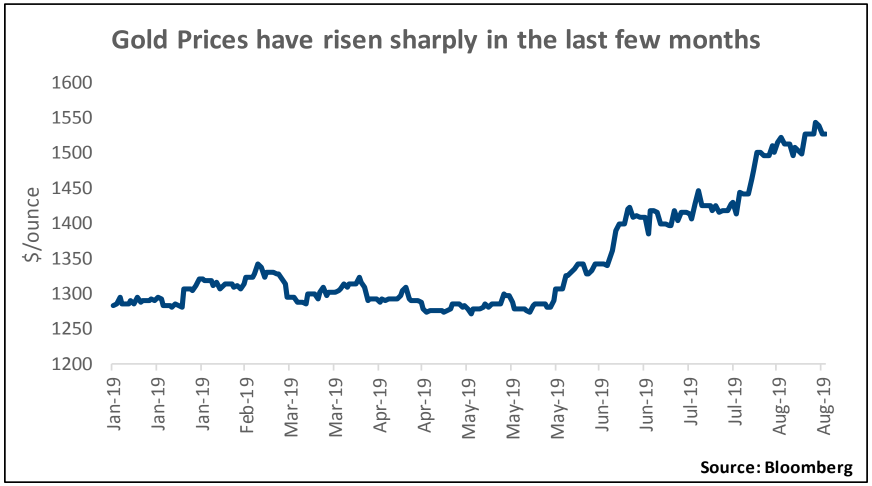


- Most of the Emerging economies' equity markets, after seeing a positive inflow during the start of the year, are now seeing FPI outflows in the last few months.
- Many factors like global growth challenges and stronger dollar has resulted in money flowing out from Emerging economies to safer assets like US dollar and other USD denominated assets.
- As per IMF, growth in Emerging Markets (EMs) is likely to decline in CY19 to 4.1% YoY from 4.5% YoY in CY18. This is the second consecutive year of lower growth for the EMs and has led to weak investment sentiment in these economies.
- From India's perspective, apart from the weak global sentiments, higher FPI surcharge announced in the Union Budget in July 2019 also contributed to sharp FPI outflows from the Indian equity markets. However, recent announcement by Finance Minister to roll the same is expected to give markets some breather.
- Amongst the EMs Brazil, India, Taiwan and Thailand has seen maximum FPI outflow of USD 4786 mn, USD 4126 mn, USD 3395 mn and USD 1110 mn respectively in the last two months.

Going ahead, any worsening of global macros are likely to drive demand for safe heavens like dollar and this in turn may further result in FPI outflow from EMs equity markets.

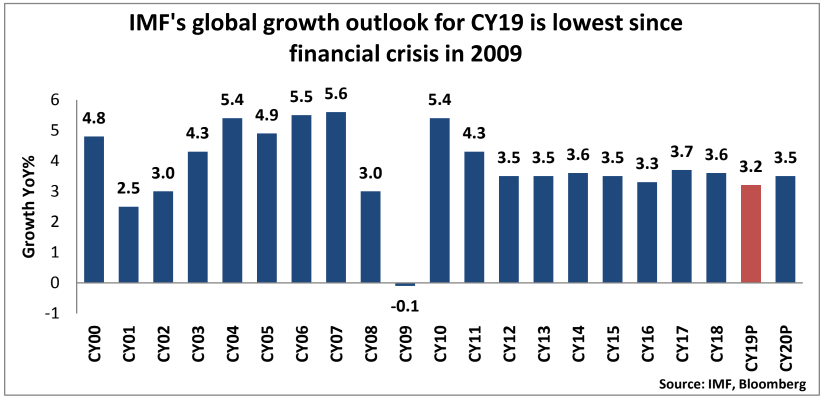
Output cut on one side and demand slowdown on other keeps crude in a range…while demand for safe haven pushed demand for gold

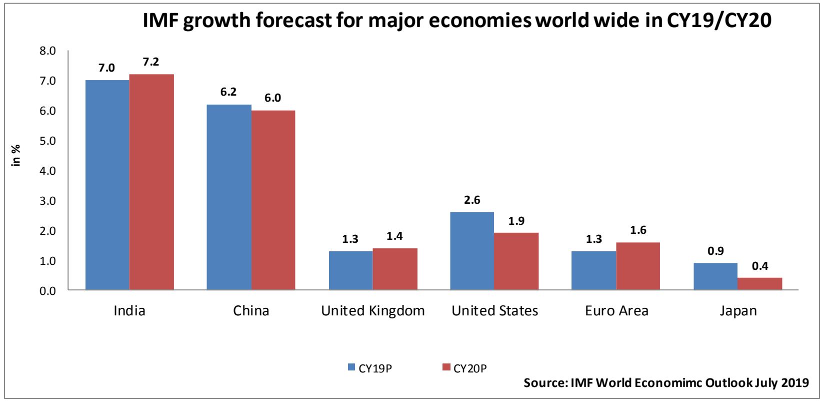




- The Brent crude oil prices have largely remained in a range of USD 55-65/bbl over the last few months as the concerns over global growth and rise in American oil exports have kept the crude prices under check and on the other hand concerns over Geo-political tension in Middle East (major oil supplier) and rising tension in the Persian Gulf have only given Brent crude prices a relatively smaller boost.
- Adding to the global factors, Donald Trump's tweets on OPEC for artificially keeping crude prices higher in the recent past has also helped in keeping oil prices lower
- The International Energy Agency has also cut its CY19 forecast for global oil-demand growth owing to muted global growth expectation. This has also resulted in softening of Brent crude prices.
- On the other hand, gold prices have surged significantly in the last few months as weak global market outlook, volatile equity markets and buying by central banks world wide have contributed to the sharp rise in price and demand for safe asset like gold.
- Gold prices are currently near a five year high of $1526 per ounce (as on 30 August 2019) as it has rallied by 19% on YTD basis.
- **Going ahead, oil supply by OPEC and Non OPEC member nations and political conditions in Middle East on one hand and global growth trajectory and U.S. Shale gas production and export on the other are likely to direct the crude oil prices in the near to medium term. Also, uncertain economic outlook world wide, easing monetary policies and global growth challenges may result in continued demand for gold, going ahead.**

IMF warns of continued weakness in global trade…

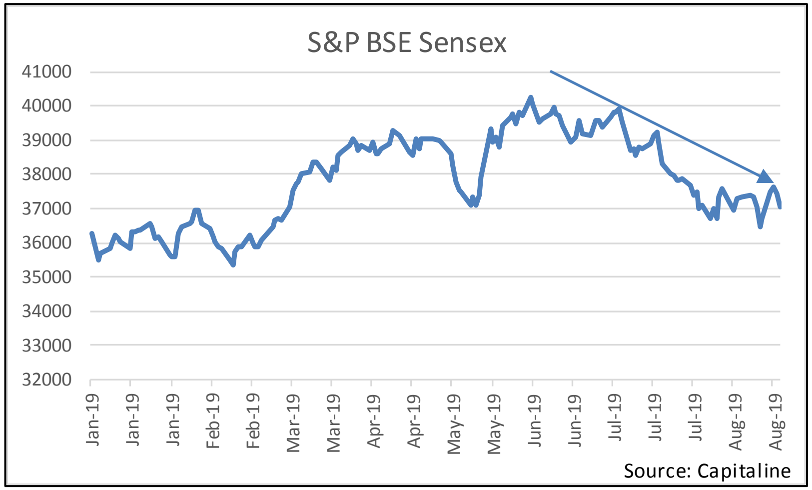




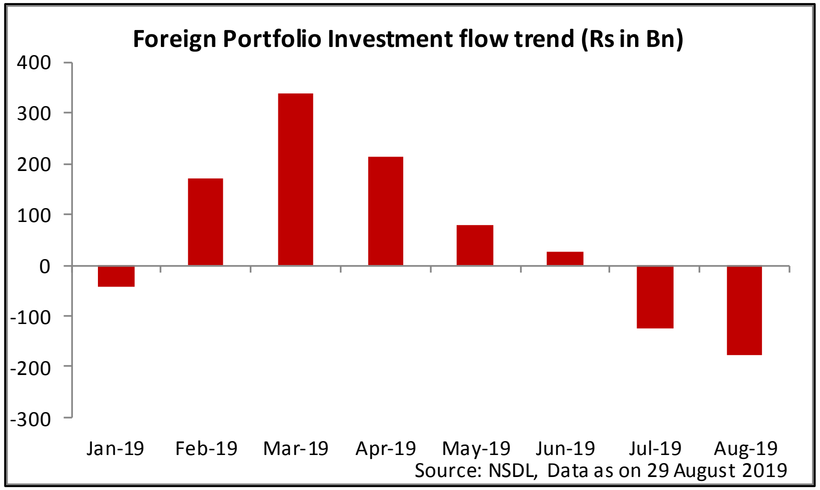
- The International Monetary Fund (IMF) has warned the United States that escalating trade disputes and an abrupt downturn in financial markets could pose substantial risks for the US economy.
- The IMF has also criticized the Trump administration's efforts to overhaul global trade relationships by raising tariffs and said it is essential to resolve a trade dispute with China. It further added that such moves are counterproductive, won't achieve the desired results, and will weaken the global economy.
- IMF said that such actions are likely to harm both domestic and global growth by sapping business and investment confidence and also disrupts global supply chains, while raising costs for producers and consumers.
- The IMF also raised concerns that the US financial system was increasingly vulnerable to a reversal in easy financial market conditions, saying that corporate leverage was historically high and underwriting standards are weakening.
- The International Monetary Fund (IMF) has again cut its global growth forecasts as trade tensions between the US and its trading partners have started to hit economic activity worldwide.
- IMF also warned that even a countervailing bilateral tariff aimed at offsetting an undervalued currency is unlikely to reduce aggregate trade imbalances as it is likely to divert trade to other countries.
- **In the wake of rising trade tension and global challenges, in July 2019, IMF had cut its forecasts for global economy to 3.2% YoY in CY19 vs earlier forecast of 3.3% YoY and by 3.5% YoY in CY20 vs earlier forecast of 3.6% YoY.**

Indian markets remained volatile with weakening economy and FPI selling dragging the markets lower…. Steady DII flow keeping the losses under check

Sensex continued to fall for second consecutive month…

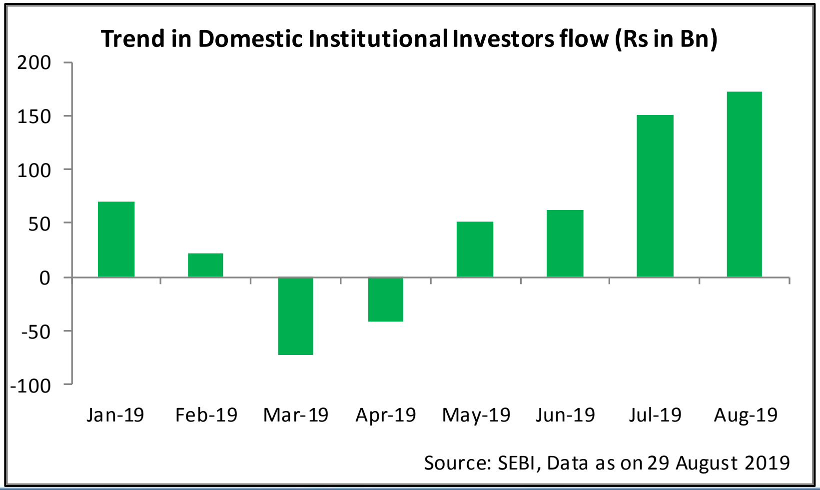


… FPI outflow continues post budget announcement on taxation

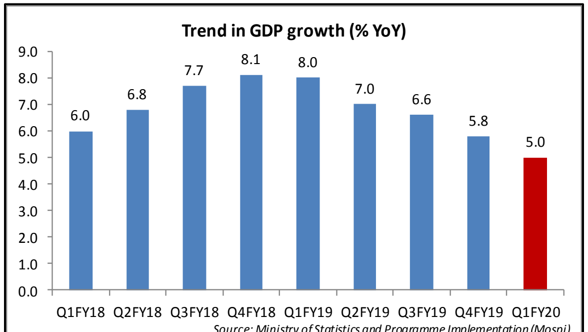


- Indian markets remained volatile during the month of August and ended on a negative note.
- Weakness in domestic economy with Q1FY20 GDP growth at six year low coupled with continuous outflow by the FPI post budget continued to impact the market sentiments.
- However, DIIs continued its strong buying, which has helped in reducing some of the losses on indices during the month.

DIIs continued to support Indian markets



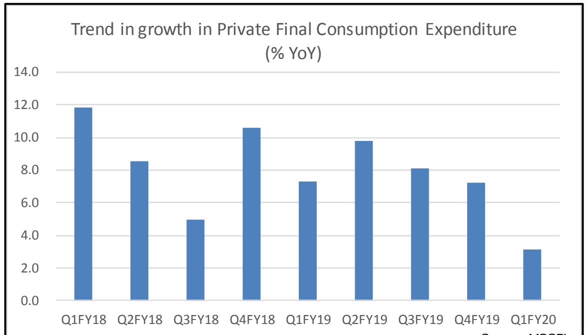
India GDP continued to decelerate in Q1FY20 as well … at six years low of 5.0% YoY, GVA at 4.9% YoY in Q1FY20



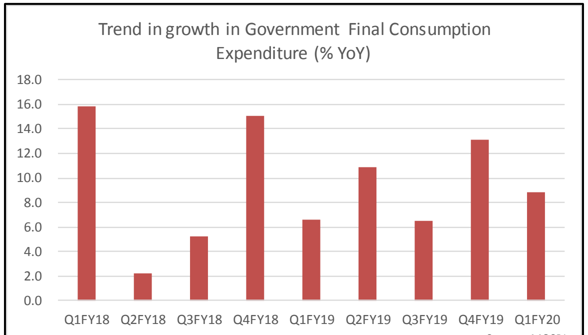
Source: Ministry of Statistics and Programme Implementation (Mospi)

Growth (% YoY) in Sectoral GVA at basic prices					
Industry	**Q1FY19**	**Q2FY19**	**Q3FY19**	**Q4FY19**	**Q1FY20**
Agriculture, Forestry & Fishing	5.1	4.9	2.8	(0.1)	2.0
Mining & quarrying	0.4	(2.2)	1.8	4.2	2.7
Manufacturing	12.1	6.9	6.4	3.1	0.6
Electricity, Gas, Water supply & other Utility	6.7	8.7	8.3	4.3	8.6
Construction	9.6	8.5	9.7	7.1	5.7
Trade, Hotel, Transport, Communication & Services Related To Broadcasting	7.8	6.9	6.9	6.0	7.1
Financial, Insurance, Real Estate & Professional services	6.5	7.0	7.2	9.5	5.9
Public administration, defence & other servi	7.5	8.6	7.5	10.7	8.5
GVA at Basic Price	**7.7**	**6.9**	**6.3**	**5.7**	**4.9**
Source: Mospi					

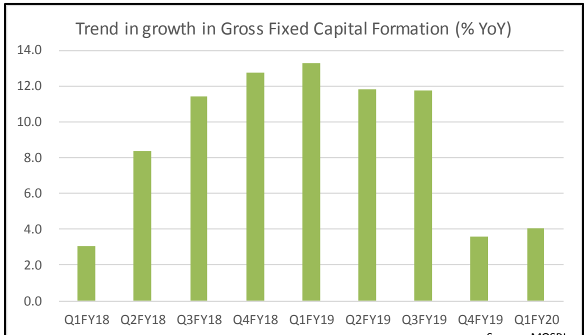
- India's GDP growth continued to decelerate in Q1FY20 and came in six years low at 5.0% YoY and Gross Value Added (GVA) stood at 4.9% YoY
- While GVA growth in "Agriculture, forestry and fishing", "Electricity, Gas, Water supply & other Utility Services" and "Trade, Hotel, Transport, Communication & Services Related To Broadcasting" saw sequential improvement.
- However, concerns in "Manufacturing", "Construction", "Mining & quarrying" continued to be there in Q1FY20 as these industries witnessed deceleration in growth rates.
- A downward pressure on the consumption demand was also visible during the quarter, with growth in Private Final Consumption Expenditure gets further suppressed in Q1FY20.
- Two consecutive quarters of subdued growth in Gross Fixed Capital Formation (GFCF) has emerged as one of the major concern from Q1FY20 data. Though a marginal improvement was seen on sequential basis but a sustainable improvement is one of the key lever for growth going ahead.
- **While the RBI is on a rate cutting spree to spur the growth in the economy, the government also seemed to have taken a cognizance of slowdown in consumption and has taken measures to revive the economy.**
- **Going ahead, the improvement in consumption growth rate hinges upon transmission of existing rate cuts announced by the RBI to the end consumers, normal monsoon rainfall and on impact of measures announced by the government.**
- **Investment demand seems to stalled due to slowdown in government spending. However, with the agenda of heavy infrastructure spending, the government is likely to once again take the lead in driving the investment demand and private players joining them once they see revival in demand and pricing scenario.**



Source: MOSPI



Source: MOSPI



Source: MOSPI

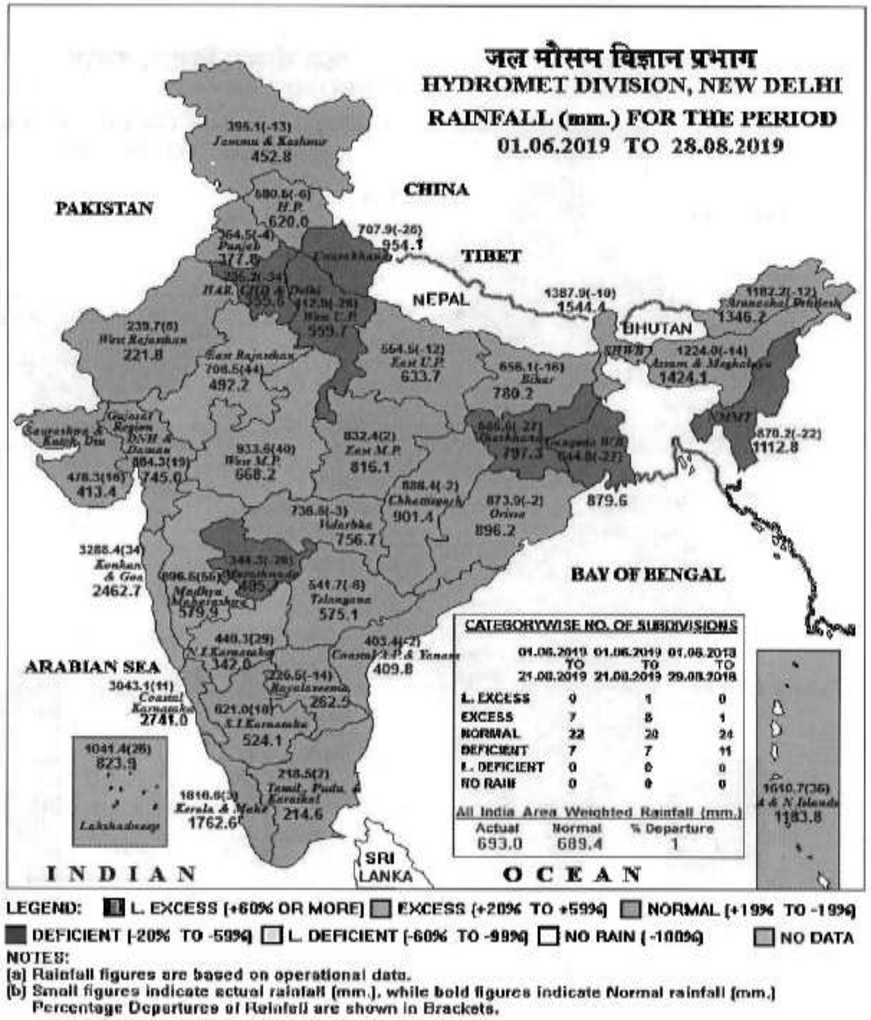
Government came up with the plan to control FPI outflow and stimulate growth…

- Post the budget announcements on hike in taxation for FPIs, Indian markets saw sharp outflow from FPIs. Taking the cognizance of the outflow and appeal from the FPIs community, **the government relooked at its tax proposal and withdrew enhanced surcharge levied on long/short term capital gains arising from**
  - transfer of Equity shares in a company,
  - Unit of an equity oriented fund,
  - Unit of a Business Trust; and
  - transfer of the derivatives (Future & options) only for Foreign Institutional Investors (FPI)
- The government also **withdrew Angel Tax provisions for Startups** registered with Department for Promotion of Industry and Internal Trade.
- The government also considered ongoing concerns of economic slowdown specially pertaining to few sectors to start with
  - **Automobile – Positive**
    - Bharat Stage-IV vehicle purchased till March 31, 2020 would remain operational for entire period of registration
    - Revision of one-time registration fees is being deferred till June 2020
    - Additional 15% depreciation on all vehicles, to increase it to 30% acquired during the period from now till March 31, 2020
    - focus will be on setting up of infrastructure for development of ancillaries/components including batteries
  - **Banks/Financials – Positive**
    - Upfront release of Rs.700 bn. capital to Public Sector Banks (PSBs)
    - Banks to launch Repo rate/external benchmark linked loan products
    - Additional liquidity support of Rs.200 bn to Housing Finance Companies (HFCs) by National Housing Bank (NHB)
    - Partial Credit Guarantee scheme for purchase of pooled assets of NBFCs/ HFCs upto Rs.1 trillion - to be monitored at highest level in each bank
    - to remove the requirement for creation of a Debenture Redemption Reserve (DRR) of outstanding debentures in respect of listed companies, NBFCs and for HFCs
    - To support decision making and to prevent harassment for genuine commercial decisions by bankers, CVC has issued directions that Internal Advisory Committee (IAC) in banks to classify cases as vigilance and non-vigilance.
    - Decision of the IAC and bank Chief Vigilance Officer (CVO)/ DA to be treated as final
  - **Capital Market – Positive**
    - More action on development of Credit Default Swap markets to be taken soon
    - The Depository Receipt Scheme 2014 to be operationalized soon by SEBI, to help Indian companies increased access to foreign funds through ADR/GDR.
    - Simplified KYC procedure to improve market access for foreign investors including FPIs
    - Ministry of Finance is working with RBI to introduce various measure to bring offshore Rupee market to domestic stock exchanges and permit trading of USD -INR derivatives in GIFT IFSC

..Stimulus measures for individual sectors…
…RBI surplus transfer also seems to have arrived at right time

- **Infrastructure – Steps in the right direction**
  - To establish an organisation to provide Credit Enhancement for infrastructure and housing projects
  - An inter-ministerial task force is being formed by Department of Economic Affairs to finalize the pipeline of infrastructure projects
  - Delayed payments from Government/ CPSEs to be monitored by Department of Expenditure and performance reviewed by Cabinet Secretariat
- **Medium, Small and Micro Enterprises (MSMEs) – Positive**
  - GST refund due to MSMEs
    - Pending refund shall be paid within 30 days
    - Future GST refunds shall be paid within 60 days from the date of application
  - TReDS to use GSTN system in medium term to enhance market for bill discounting for MSMEs
  - Amendment to MSME Act to move towards single definition to be considered
  - Single air and water clearance for MSMEs
  - Single consent to establish a factory by MSMEs
- **Real Estate**
  - **Many indirect measures expected to help real estate sector** like improving liquidity to HFCs, reduction in interest rate cut, etc
  - Upfront release of Rs.700 bn to create scope for Rs.5 trillion of additional credit to retail and other segments
  - Measures for reduction in MCLR to effect in the timely rate cuts by RBI and banks to launch repo rate/external benchmark-linked loan
  - Additional liquidity support of Rs.200 bn to Housing Finance Companies (HFCs)
- **The government seems to have an open mind to discuss and address the genuine problems faced by the economy. The announcement made by the government should be sentiment positive for the economy in the medium term.** The heartening part is, despite the strong majority that the government enjoys (thus it could have remained stuck to its stance taken in the Budget); it still went ahead and rolled back some provisions which were announced in the budget (just one and a half months back) to adress the genuine concern in the economy.
- **We think that the markets are likely to take this move positively and the announcements could also have a positive rub-off on the overall sentiments in the economy.**
- **The surplus transfer from the RBI also seems to be on a higher side as compared to the expectation, which is likely to lend a supporting hand to the government in order to increase the spending to stimulate the growth while maintaining fiscal prudence.**
  - The RBI decided to transfer a sum of ~Rs.1.76 trillion to the Government of India comprising of ~Rs.1.23 trillion of surplus for the FY19 and ~Rs.526.37 bn of excess provisions identified as per the revised Economic Capital Framework (ECF).
  - Of the Rs.1.23 trillion for FY9, an amount of Rs.280 bn has already been paid as interim dividend. Thus, the RBI would transfer the remaining amount of ~Rs.1.48 trillion during the current fiscal, which is higher than the earlier expectation of Rs.900 bn.

Improving monsoon and positive outlook given by tractor manufacturers… leading to rise in expectation for revival in rural demand



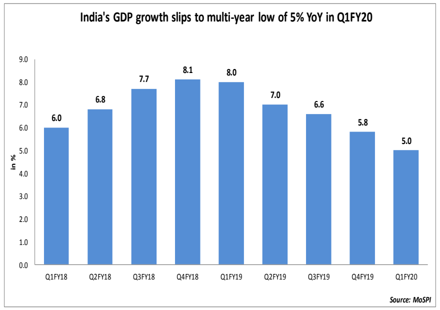
Source: IMD

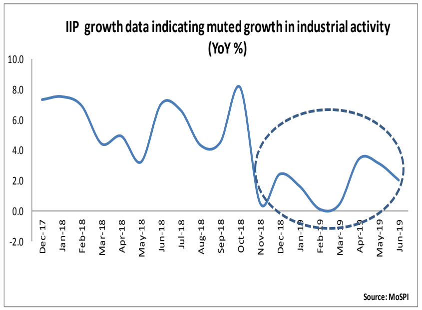
Kharif Crop Sowing			
Crop (Lakh hectar)	Area sown in FY20	Area sown in FY19	Growth (%)
Rice	354.8	372.4	-4.7
Pulses	128.0	131.5	-2.7
Coarse Cereals	171.7	171.7	0.0
Oilseeds	170.8	171.2	-0.2
Sugarcane	52.4	55.5	-5.5
Jute & Mesta	6.8	7.2	-5.0
Cotton	124.9	117.7	6.2
Total	**1009.5**	**1027.2**	**-1.7**
Source: Min. of Agriculture, data as on 30 August 2019			

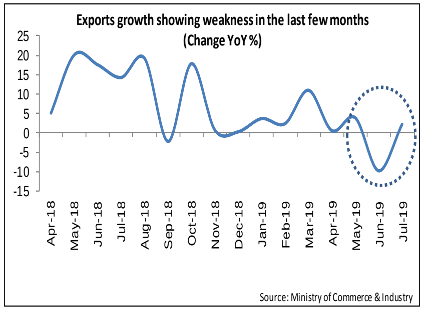
- Sharp revival to 1% above normal range for the monsoons, from a minor deficit in previous months has revived the hopes of improvement in rural demand.
- A sharp recovery in monsoon rainfall has also supported kharif crops sowing which improved from a deficit of 9.5% YoY till June 28, 2019, to a deficit of mere 1.7% YoY till August 30, according to the government data.
- The improvement seen in Water levels in the 107 major reservoirs of the country in July has continued in August as well. As per reservoir storage bulletin dated August 29, the content was 126.63 bn cubic metres (BCM), which is 111% of the live storage of corresponding period of last year and 125% of storage of average of last ten years.
- **Top tractor manufacturers have also given positive outlook in their quarterly earnings call for the growth in tractor sales in H2FY20.**
- **With the improvement in overall monsoon rainfall, Kharif sowing and water levels in reservoirs both have improved, which is a positive sign and may lead to recovery in consumption demand especially in rural areas if the trend continues going ahead.**

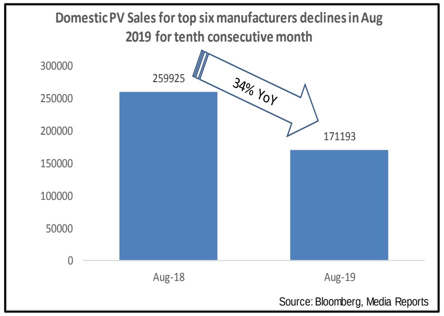
Macro indicators are showing mixed trend with a negative bias…

Many macro economic data like declining GDP, IIP and exports and auto sales are showing weakness

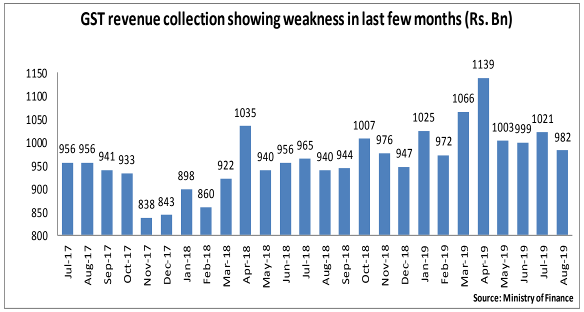


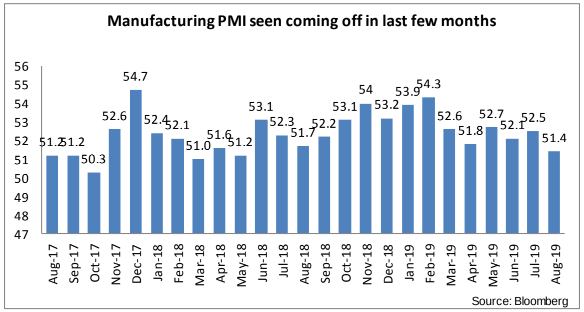


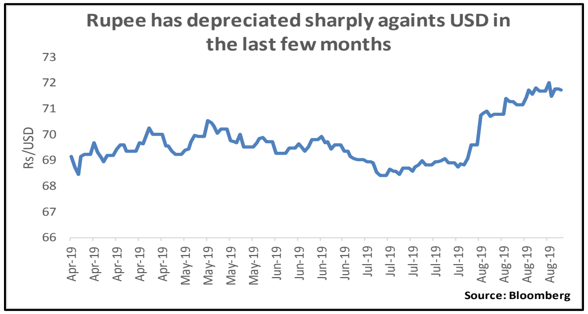




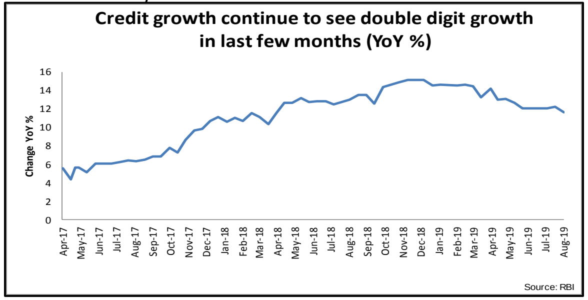
While tepid growth in GST collection and PMI data and recent depreciation of rupee are concerning

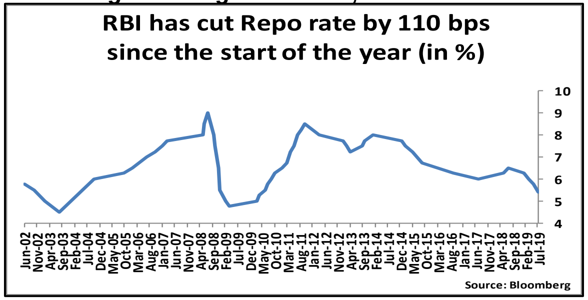


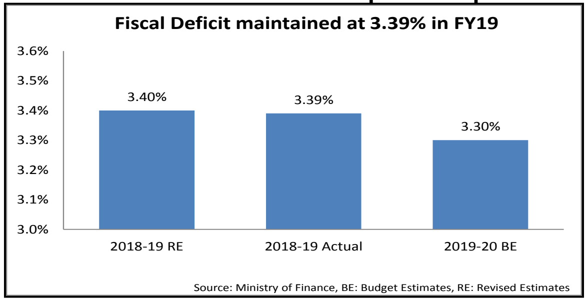




However, certain macro indicators like continued double digit credit growth data, lower interest rates and maintainence of Fiscal discipline are positive





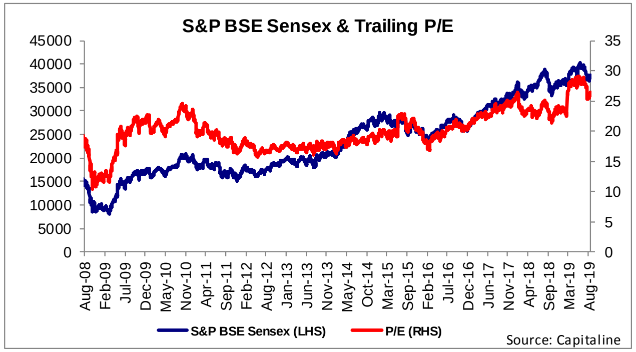


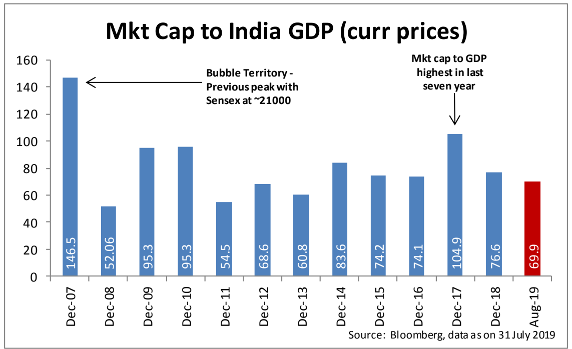
Q1FY20 saw mixed results … with Oil & Gas, Metal and reporting weak numbers, cement and banking cushioned the fall in profitability

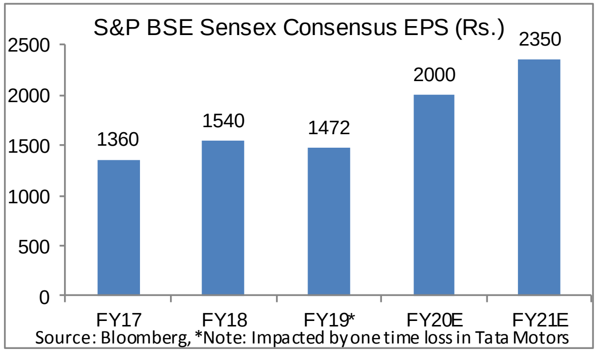
YoY Changes in %	Net sales			EBITDA			Reported PAT		
	Q1FY20	Q4FY19	Q1FY19	Q1FY20	Q4FY19	Q1FY19	Q1FY20	Q4FY19	Q1FY19
Air Transport Service	44.7	35.9	13.2	(22894.9)	564.4	(101.0)	4219.8	401.2	(96.6)
Auto & Auto Anc	(4.6)	0.2	18.3	(20.9)	(14.0)	18.1	(25.9)	(14.6)	(27.2)
BFSI	17.1	19.8	15.4	28.9	124.4	1.5	57.8	(162.9)	(25.0)
Capital Goods	(6.5)	9.9	24.4	(47.1)	9.3	159.4	(47.9)	16.0	157.9
Cement & Pdts	8.1	13.0	17.3	42.0	30.4	(3.1)	50.3	48.1	(20.4)
Chem & Fert	27.5	32.6	11.2	30.7	4.5	8.0	(29.2)	(48.9)	6.9
FMCG & Retail	3.0	(1.7)	0.3	17.7	11.7	20.0	11.2	24.7	20.5
Healthcare	13.6	13.9	15.8	31.8	26.2	38.5	27.0	(41.8)	65.1
Infrastructure	10.6	5.5	7.0	29.5	(19.2)	2.7	22.7	(41.4)	7.3
IT	11.7	17.3	13.7	9.3	17.8	17.1	5.7	16.1	14.3
Media & Ent	(11.3)	8.4	48.4	6.0	(98.9)	70.0	15.3	(222.3)	55.3
Metal & Mining	(1.3)	5.4	24.9	(12.3)	43.1	56.1	(24.3)	(47.9)	92.1
Miscellaneous	8.1	12.9	8.1	8.9	24.4	20.4	(24.0)	44.7	30.8
Oil & Gas	7.4	12.5	34.0	(14.7)	9.2	64.0	(19.5)	(0.1)	36.8
Power	12.4	6.6	1.7	13.9	(102.6)	(4.0)	(8.9)	(69.9)	13.9
Realty	(3.5)	18.5	16.5	(6.1)	54.0	(10.9)	(8.8)	25.9	97.1
Telecomm	23.3	25.1	(13.7)	35.4	(8.8)	(24.9)	(791.0)	1424.7	358.5
Textiles	12.2	21.0	65.6	27.9	48.8	79.2	13.6	58.2	25.7
Grand Total	**8.0**	**11.3**	**19.3**	**12.1**	**30.2**	**16.5**	**(3.0)**	**11.3**	**13.8**
Ex Metals & Oil&Gas	**9.7**	**11.7**	**12.5**	**21.5**	**34.5**	**5.9**	**7.2**	**58.2**	**(0.0)**
Source: Capitaline									

- The Q1FY20 aggregate corporate earnings announced were mixed but no major surprises were witnessed during the quarter.
- The net sales of companies in CNX 200 index grew by ~8% YoY. The EBITDA of these companies grew at ~12% YoY. This was mainly due to recent correction seen in commodity prices driving the margin improvement. However, Reported PAT was down by ~3% YoY in Q1FY20, owing to weakness in Oil & Gas, Automobile and Metal segment.
- Performance of Automobile segment was impacted by general economic slowdown and liquidity concern. While Metal companies were also impacted due to general slowdown and weakness in commodity prices, muted performance of the refining segment dragged the overall performance of Oil & Gas sector.
- On the positive side, improvement in realization resulted in better profitability in Cement sector, lower provisioning and a low base helped Banking sector to report sharp improvement in profitability and a steady volume growth was witnessed in FMCG sector.
- The overall management commentary had been mixed with FMCG companies being hopeful of improvement owing to upcoming festive season, banking companies remaining cautious on asset quality and Auto companies delivering muted commentary. **We believe upcoming festive season, improvement in monsoon rainfall, Kharif sowing, recent measures by the government and expected improvement in spending post RBI surplus transfer would be key levers for improvement in earnings going ahead.**

While markets remained volatile owing to FPI selling, valuation though lower, continue to remain rich… a lot depends on earnings trend





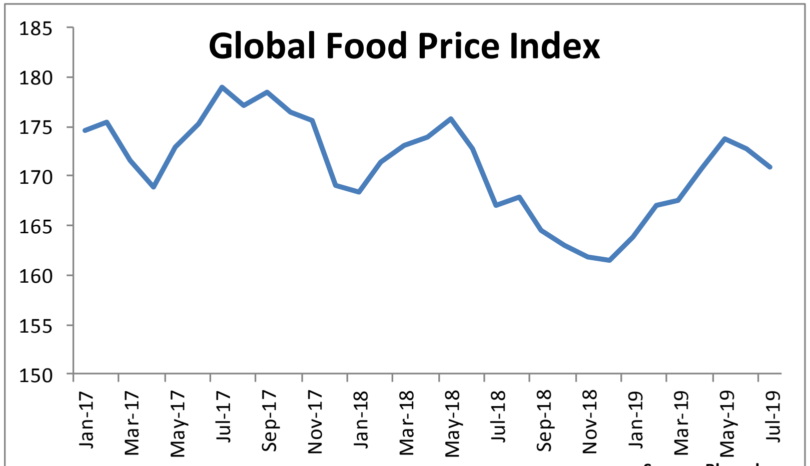


- Domestic indices remained volatile owing to mixed news flow and data points like mixed quarterly earnings, FPI selling, global volatility, steady DII buying and improvement in monsoon among others.
- Post the recent fall, the markets valuations, though lower, still remained rich with the S&P BSE Sensex trading at 18.7x FY20E Bloomberg consensus EPS of Rs.2000 and 15.9x FY21E Bloomberg consensus EPS of Rs.2350. (S&P BSE Sensex price as on 30.8.2019). **The Valuations of the Midcap indices have risen compared to large caps mainly due to lower earnings leading to rise in PE multiples of Mid Caps indices.**
- **However, considering the recent stimulus measures by the government and surplus transfer by the RBI coupled with hopes of better festive season, a lot more depends on earning recovery, which is expected to bunch up in H2FY20, to drive the markets and ease the pressure of high valuation going ahead.**
- The Market is also expecting a sharp recovery in earnings in both FY20 and FY21 on the back of policy continuity, accelerating decision making and reforms by the government, rising capacity utilization and ease of doing business.
- On the consumption demand, interest rate cuts and steady efforts to improve liquidity scenario by the RBI may give some impetus to consumption demand and if corporates are able to manage the cost then revenue and earnings growth should improve over the time.
- With improvement in earnings growth owing to the expected acceleration in growth in investment demand (especially after the budget impetus) and gradual recovery in consumption demand, market valuation should improve over the near to medium term.
- In addition, the trend of financialization of saving especially money channelized into mutual fund investment, as seen post the NDA government came into power for the first time, is expected to continue in future as well, which would augur well equity markets.

Key concerns to watch out ….

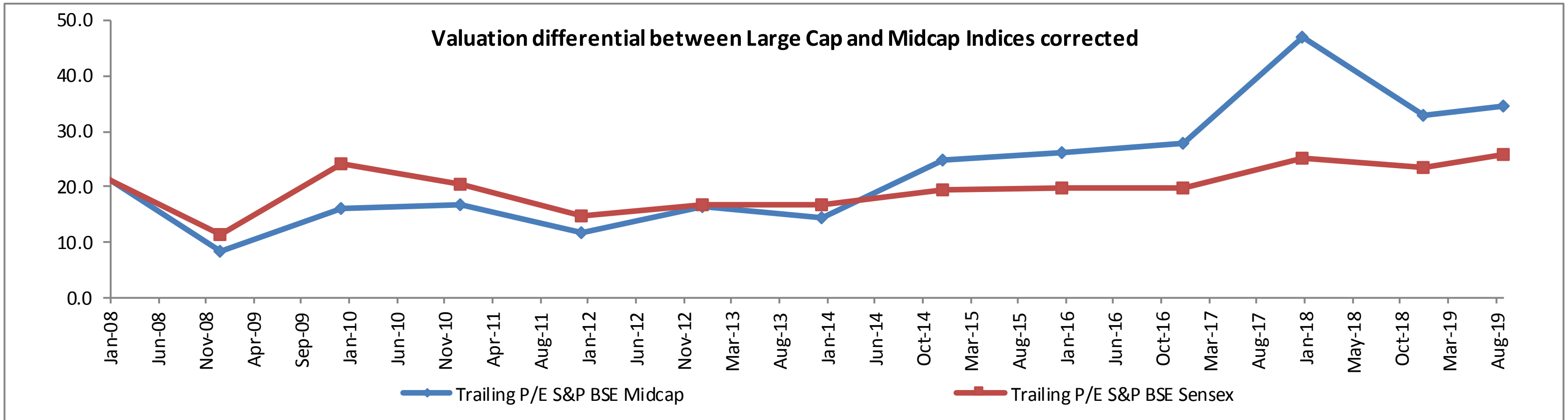
- **Domestic factors**
  - If **Rupee continues to depreciates** (so far 2.8% depreciation in CYTD Aug'19), then it may impact the country's twin deficit.
  - Tightening of **corporate credit cycle** may lead to delay in capex cycle due to funding requirement
  - **Delay in revival of domestic consumption demand**
  - **Lower government spending**

- **Global factors**
  - **Weak economic growth which trigger demand for safe haven assets**
  - **Rising trend of protectionism across economies** leading to trade war situation could pose a risk to overall global growth.
  - **Worsening in geo-political situations** (Brexit, trade wars, etc) **across globe.**
  - **Rise in volatility in commodity prices** could put pressure on the global financial markets.
  - **Rising global food prices** may lead to rise in food inflation.

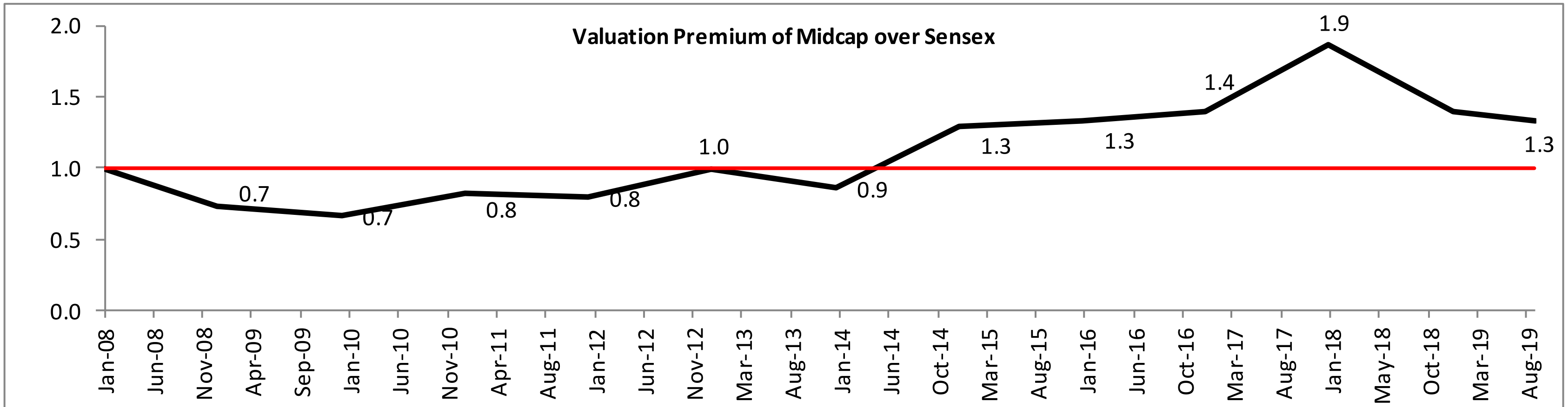


Source: Bloomberg

Large Cap and Midcap valuations widens, mainly on account of lower earnings driving the PE multiple for Mid cap companies

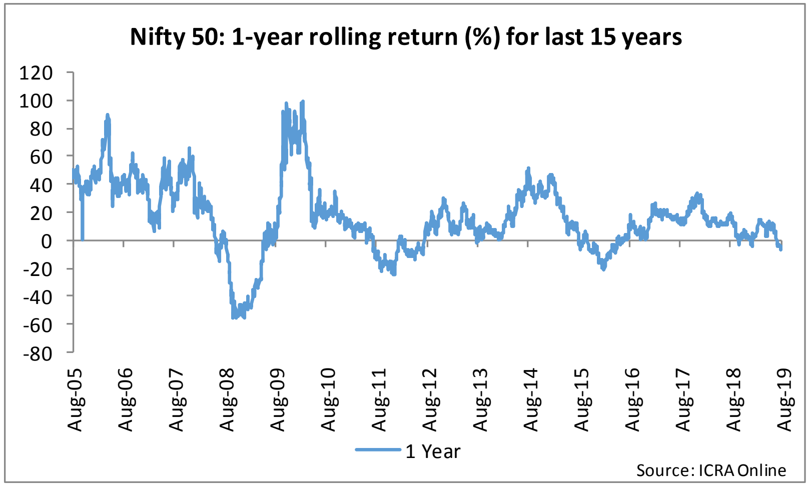


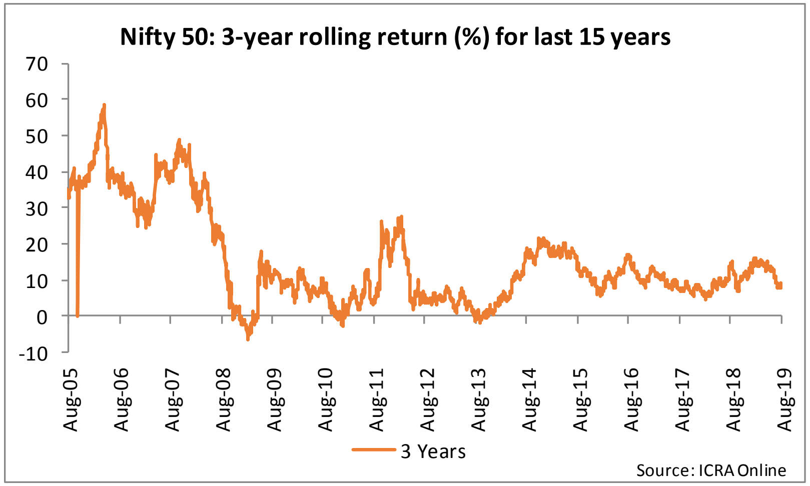
Source: Capitaline



Source: Capitaline

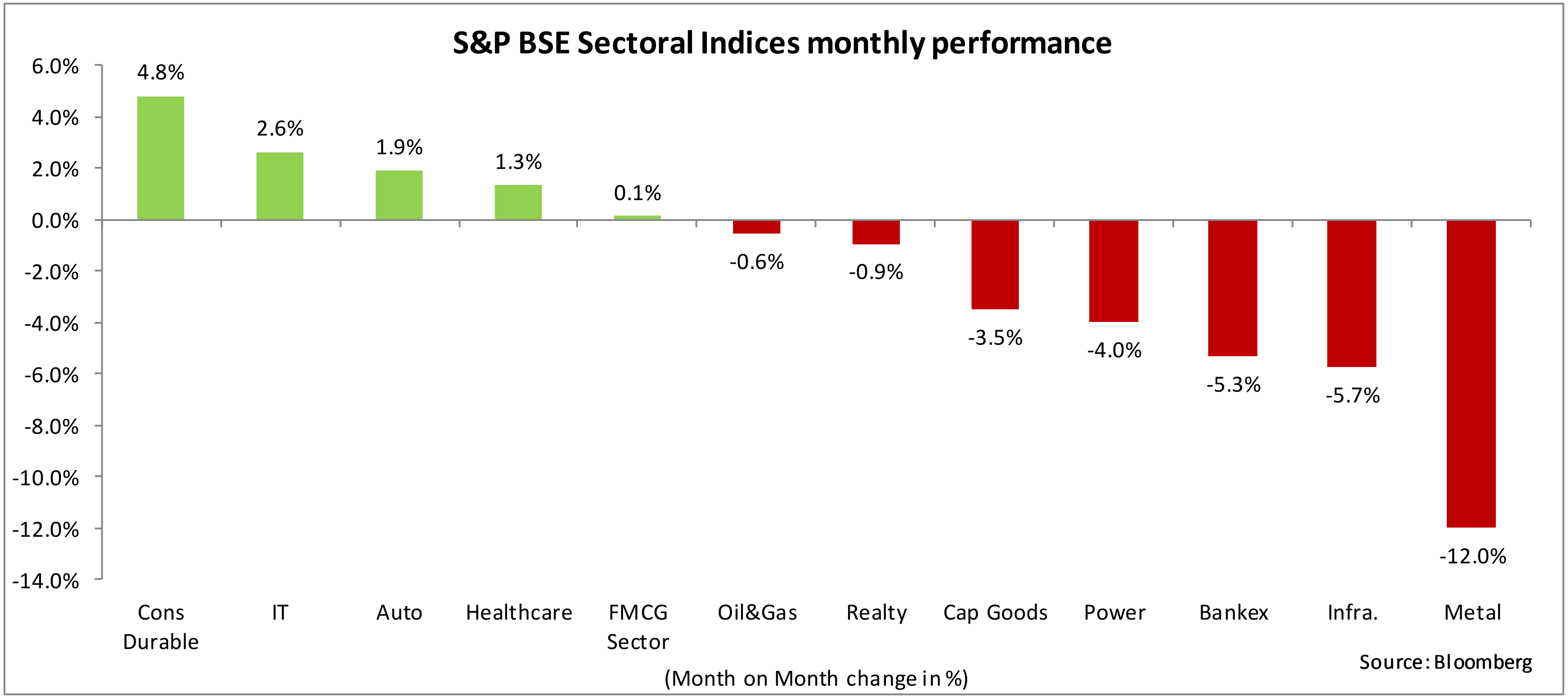
Nifty 50 rolling returns for last 15 years …





Source for entire data stated above is ICRA Online Ltd. (For Disclaimer of ICRA Online Ltd, refer http://www.icraonline.com/legal/standard-disclaimer.html)

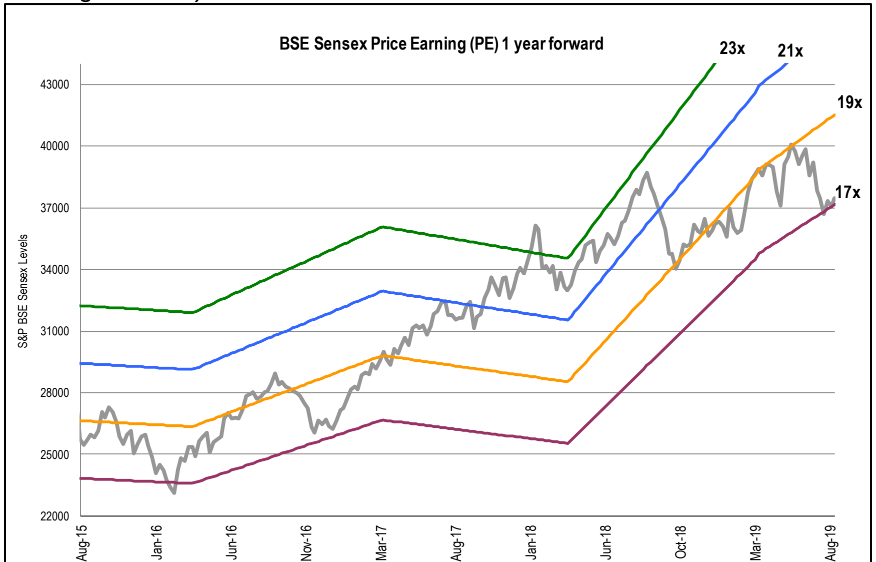
S&P BSE Sectoral Indices monthly performance for August 2019



Market Round Up – August 2019

- Indian equity markets were volatile and ended the month of August on a negative note with S&P BSE Sensex index and Nifty 50 index ending with the loss of 0.4% MoM and 0.9% MoM, respectively.
- The fall in S&P BSE Midcap index and the S&P BSE Smallcap index was even higher at 1.3% MoM and 1.2% MoM, respectively.
- On the sectoral indices front, S&P BSE Consumer Durable index and S&P BSE IT index were top two outperformers with a gain of 4.8% MoM and 2.6% MoM, respectively. The S&P BSE Metal index and S&P BSE Infra index were top two underperformers as they declined by 12.0% MoM and 5.7% MoM, respectively.
- During the month of August'19, Foreign Portfolio Investors (FPIs) were net sellers to the tune of ~Rs.176 bn while Domestic Institutional Investors (DIIs) were net buyers to the tune of ~Rs.172 bn (as of 29 August 2019).

Indices	30 Aug 2019	31 July 2019	Chg %
S&P BSE Sensex	37,333	37,481	(0.4)
S&P BSE Mid Cap	13,468	13,643	(1.3)
S&P BSE Small Cap	12,535	12,692	(1.2)
S&P BSE 100	11,140	11,211	(0.6)
S&P BSE 500	14,234	14,324	(0.6)



Source: Bloomberg

Net Flow (Rs. Bn)	FPI	DII
CY19*	486	413
CY18	(340)	1204
CY17	513	1188
CY16	151	475

Source: BSE, NSDL (CY19 FPI data and DII data as on 29 August 2019)

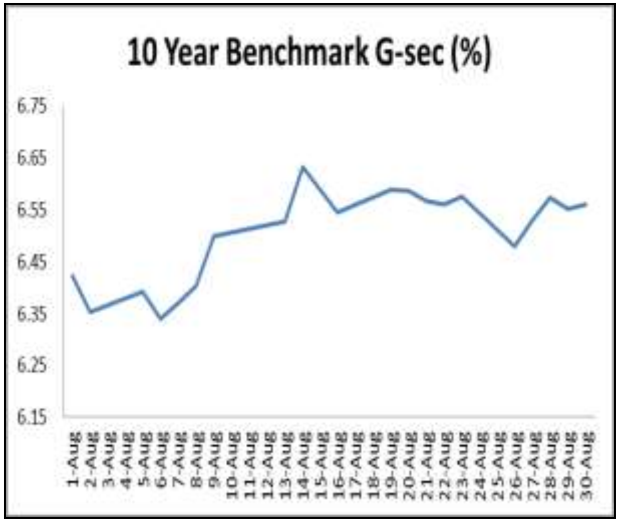
Market Outlook

- In global market, US President Trump's tweets roiled the market, especially US and resulted in sharp volatility in US indices. However, Dollar index continued to remain strong
- While a demand for safer assets led to a stronger USD, which in turn had impacted the EM assets negatively and also led to FPI outflow from EMs in recent past.
- On the commodity front, slowing economies across the globe has resulted into higher demand for safer assets like Gold. However, crude oil continued to remain range bound due to slowdown in economic growth and output cut by the OPEC nations.
- The ongoing trade war had led multilateral agencies to cut their global growth forecast. IMF has warned the United States that escalating trade disputes and an abrupt downturn in financial markets could pose substantial risks for the US economy.
- In the domestic market, equity indices remained volatile with weakening economy and FPI selling dragging it down, while steady DII flow kept the losses on indices under check.
- India GDP continued to decelerate in Q1FY20 as well and came in at six-year low at 5.0% YoY and GVA came in at 4.9% YoY in Q1FY20.
- However, the government came up with the plan to control FPI outflow and stimulate growth. The surplus transfer from RBI also seems to be arrived at right time as it may help in pushing the government spending in coming times to stimulate the growth while maintaining fiscal prudence.
- Improving monsoon rainfall and positive outlook given by Tractor manufacturers are indicating a revival in rural demand in near term.
- Macro-economic indicators are showing a mixed trend with negative bias, where declining GDP, IIP and exports and auto sales are showing weakness, data pertaining to credit growth (double-digit growth), fiscal deficit (maintained at 3.4%) and interest rates (at lower levels) are giving soothing effects in otherwise a gloomy scenario.
- Q1FY20 earnings saw mixed outcome, where Auto, Metal and Oil & Gas dragging the overall profitability, while cement and banking cushioned the fall in profitability.
- Domestic indices remained volatile owing to mixed news flow and data points like mixed quarterly earnings, FPI selling, global volatility, steady DII buying and improvement in monsoon among others.
- Post the recent fall, the markets valuations, though lower, still remained rich with the S&P BSE Sensex trading at 18.7x FY20E Bloomberg consensus EPS of Rs.2000 and 15.9x FY21E Bloomberg consensus EPS of Rs.2350. (S&P BSE Sensex price as on 30.8.2019).
- However, considering the recent stimulus measures by the government and surplus transfer by the RBI coupled with hopes of better festive season, a lot more depends on earning recovery, which is expected to bunch up in H2FY20, to drive the markets and ease the pressure of high valuation going ahead.
- In long term, India is likely to see a steady growth on the back of improvement in Rural economy, higher urbanization, rising government expenditure, revival of private capex and higher disposable income in the hands of consumers. With strong demographic dividend that India is seeing, we expect the economic growth and demand conditions in the country to remain strong for a long period. This is likely to augur well for investment in equities. Hence, investors should use any major volatility in the equity markets as an opportunity to adding into their exposure in line with their risk profile with a 2-3 years investment horizon.
- Some of the key global events like Rising demand for safer assets, Rising trend of protectionism across economies, Slowdown in global growth, Rising food prices and Rise in volatility in commodity prices amongst few other reason would be key to watch out for in CY19. Certain domestic events like Rupee movement, Corporate credit cycle tightening, Lower government spending and Weakening of discretionary consumption demand are key to watch out for in near term.
- The government's focus on giving a strong fillip to the rural economy, create more jobs and recent measures to address the concern of some of the key sectors is likely to drive the growth in the capital formation and improve demand conditions in the economy. From here on the Indian equity markets are likely to move on the back of improved corporate earnings and upcoming macro-economic data points. We remain positive on the Indian equity markets over the medium term and maintain our investment strategy of 50% lumpsum and rest 50% to be staggered over the next 3-4 monthsFrom an Equity Mutual Fund perspective, investors should look at Large Cap and Multicap Funds for fresh investments and SIP into Midcap and Small caps funds can begin with a longer horizon (12-15 months), with an investment time horizon of 2-3 years. We maintain our investment strategy at 50% Lumpsum and rest 50% staggered over the next 3-4 months.

Fixed Income

G-secs turn volatile in August 2019…

…tracking fiscal deficit fears, Rupee movement & uncertainty over Govt. overseas sovereign bond issue



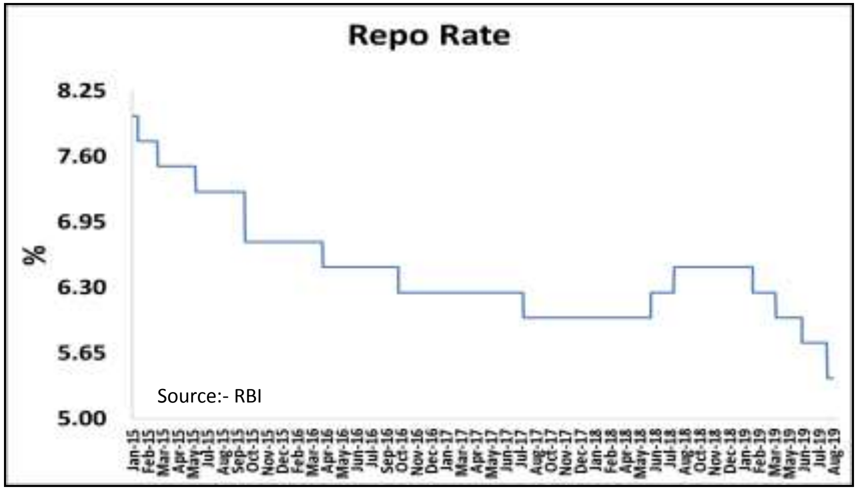
- Domestic G-secs turned volatile during August 2019, wherein yield on the benchmark 10 year 7.26% G-sec 2029 closed at 6.56% on 30 August 2019 compared to 6.37% on 31 July 2019.
- G-secs started the month on a positive note tracking decline in crude oil prices on account of escalation of trade tensions between the US and China and as hopes of interest rate cut by the RBI in August 2019 were rekindled.
- However, post the RBI's monetary policy the longer end yields rose tracking,
  - Fears of fiscal stimulus by the government for economic growth recovery.
  - Lack of clarity on future interest rate trajectory.
  - Depreciation in the value of Rupee against the USD due to US and China trade tensions.
  - Rise in Core CPI inflation in July 2019.
- Towards the later part of the month yields declined marginally tracking dovish minutes of monetary policy meeting of the RBI, dovish comments by Federal Reserve Chairman's at Jackson Hole Speech, and government's commitment on maintain fiscal discipline despite announcing measures to bolster the economy.
- Another positive was the announcement of higher surplus transfer by the RBI to the government.

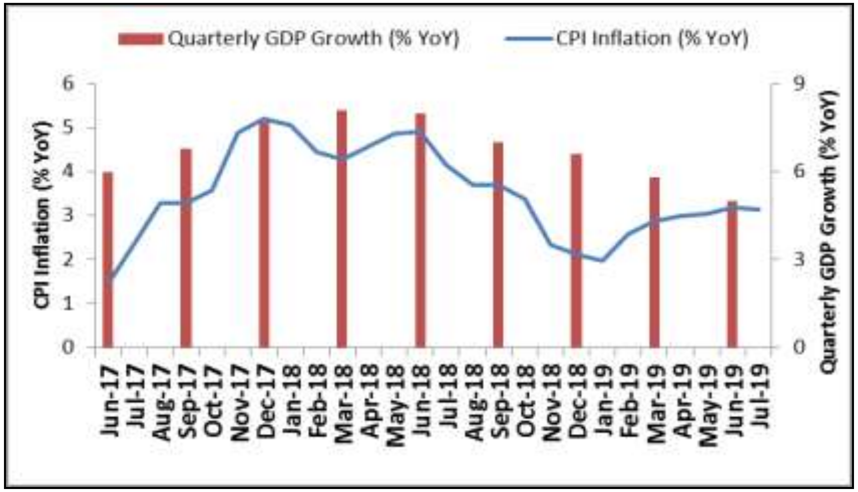
Third Bi-Monthly Monetary Policy…
…RBI delivers more than expectations

- The RBI reduced Repo Rate by 35 basis points (bps) from 5.75% to 5.40% with immediate effect.
- Thus, the Reverse Repo rate was revised to 5.15%.
- The monetary policy stance was also maintained as accommodative.
- The Repo rate cut of 35 bps came in as a bonus, as the market participants were largely expecting a 25 bps cut.

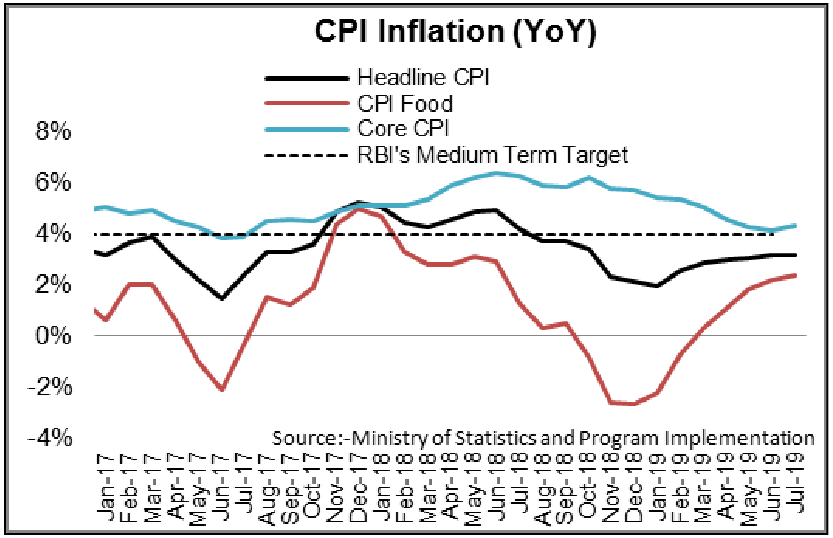
While reducing the Repo rate, the RBI's policy stated, "Addressing growth concerns by boosting aggregate demand, especially private investment, assumes the highest priority at this juncture while remaining consistent with the inflation mandate."

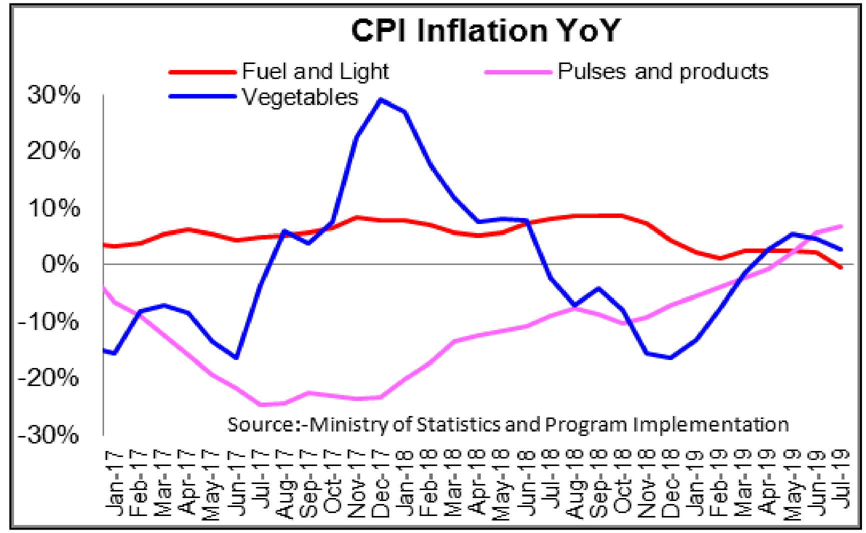
- Though the inflation projection for Q2FY20 was retained at 3.1%, that for H2FY20 was increased very marginally to 3.5%-3.7% from 3.4%-3.7% projected in June 2019 monetary policy. The inflation projection for Q1FY21 was kept below the 4% mark at 3.6%.
- The FY20 GDP growth was projected downward to 6.9% (5.8%-6.6% for H1FY20 and 7.3%-7.5% for H2FY20) from 7% (6.4%-6.7% for H1FY20 and 7.2%-7.5% for H2FY20 projected in June 2019. GDP growth for Q1FY21 is projected at 7.4%.
- While revising the growth projections, the RBI stated that the risks are now 'somewhat tilted to the downside', instead of 'risks evenly balanced' mentioned in the June 2019 monetary policy.
- The monetary policy seemed quite dovish, not only because the RBI chose to cut the repo rate by more than expected but also 25 bps, but also because the governor spoke about the RBI's liquidity stance.
- On liquidity, the RBI governor said that the RBI will use the liquidity tools available with it to ensure that the day-to-day and durable liquidity needs of the system are met.





Headline Inflation surprises on the downside in July 2019…
…Core inflation inched up

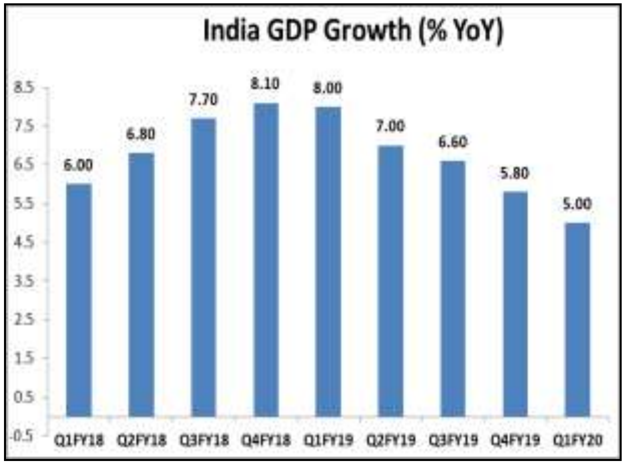




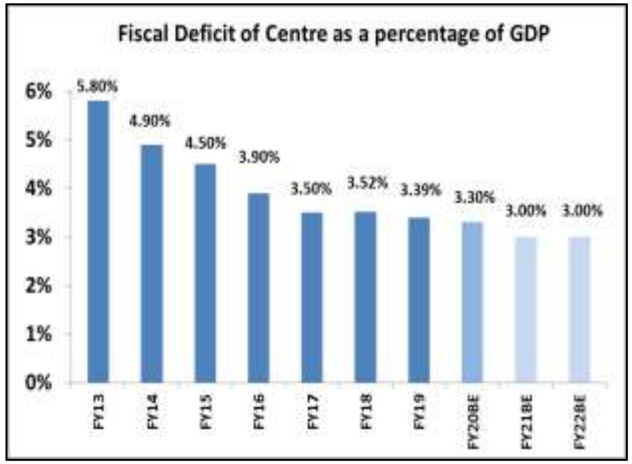
- CPI inflation for July 2019 came in at 3.15% YoY compared with 3.18% YoY in June 2019.
- The general markets expectation on the headline inflation was of ~3.20% YoY. While headline inflation declined after rising for five consecutive months; Core CPI inflation (ex Food and Fuel) rose after declining for eight months in a row.
- Inflation in the food basket however, continued to follow the rising trend and came in at 2.36% YoY in July 2019 compared to 2.25% YoY in June 2019.
- Core inflation on the other hand rose in July 2019 and came in at 4.30% YoY compared to 4.16% YoY in June 2019.
- Most of the internals of Core inflation witnessed a broad based rise in inflation.

Going forward, given that we are approaching the winter months, food inflation may continue to remain contained. Monsoon progress has improved recently which is also likely to be positive for food inflation. While core inflation inched up in July 2019, we may not see any meaningful rise, at least in the near term, as demand conditions may remain subdued for some more time. Thus, overall the inflation trajectory seems to be comfortable at this juncture.

Govt. announces measures to bolster economic growth…
…Fiscal Discipline maintained



Source:- Bloomberg



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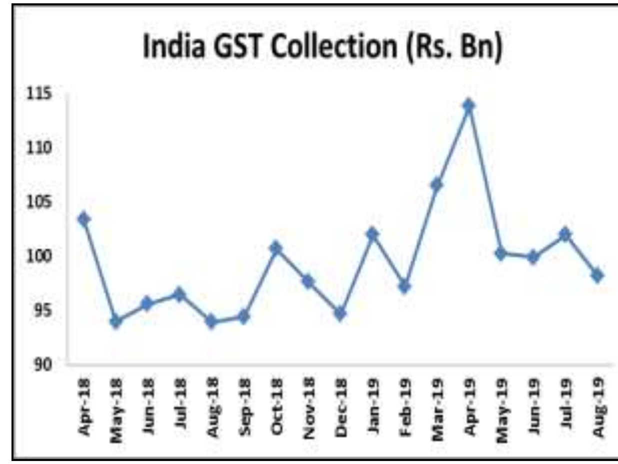
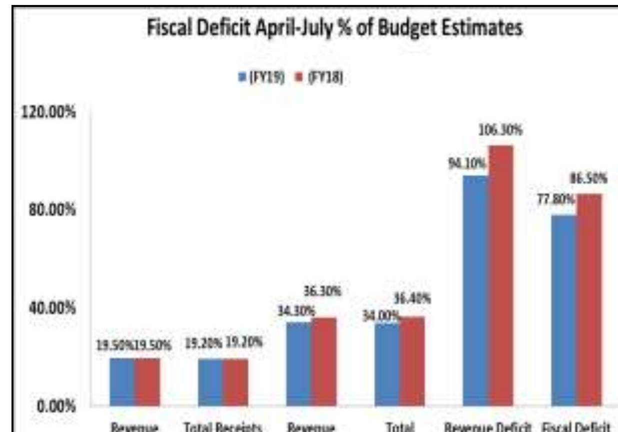


Source:- pib.gov.in

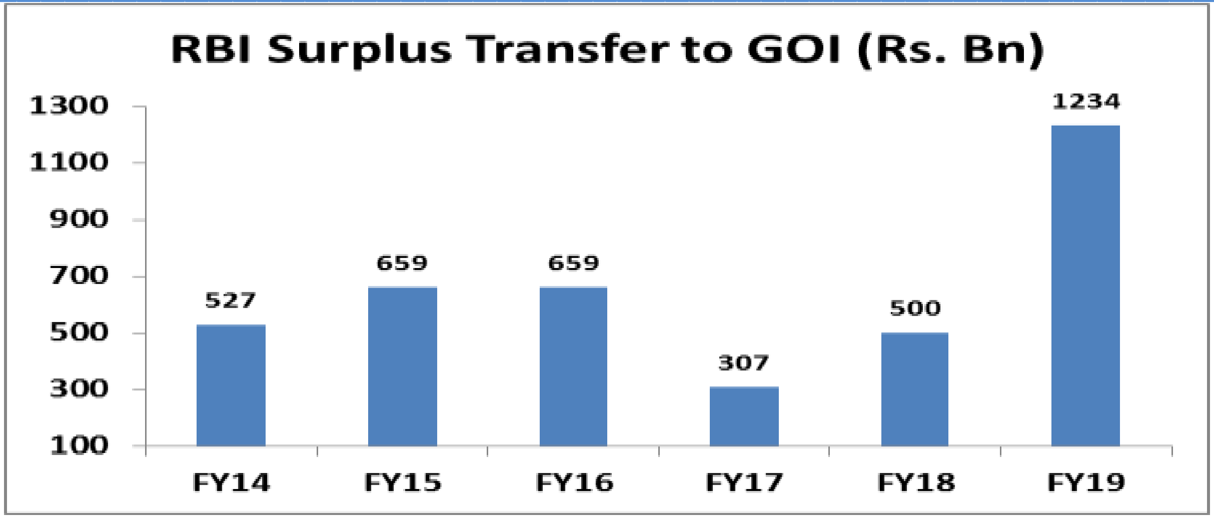
- India's GDP growth for Q1FY20, stood at 5% YoY compared to 5.8% YoY for Q4FY19 and 8% YoY in Q1FY19.
- Given the heightened fears of further economic growth slowdown, the government announced measures during the month.
- While the market was expecting measures from the government, it was also accompanied with expectations of fiscal expansion, which was leading to caution in the debt markets.
- However, the government stuck to its fiscal discipline. The government is targeting fiscal deficit 3.3% of GDP for FY20.
- For the period April-July 2019 the fiscal deficit stood at 77.8% of the budgeted target for FY20.
- While in FY20, the monthly GST collection trend has been better than FY19, given the slowdown the same may not sustain.
- To counter the challenges on the revenue front, the RBI's higher surplus transfer to the government is likely to come in handy.



Source:- cga.nic.in

Thus, the government has so far balanced the act between ensuring sovereign strength (by maintaining fiscal discipline) and efforts in reviving economic growth.

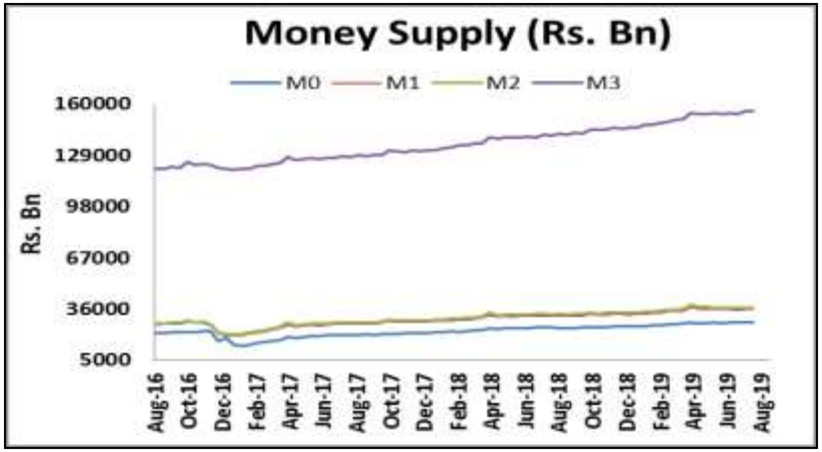
RBI announces a higher surplus transfer to the Govt….
…a much needed respite for the fiscal situation



- The RBI accepted all the recommendations of the Expert Committee to Review the Extant Economic Capital Framework of the Reserve Bank of India (Chairman: Dr. Bimal Jalan).
- Accordingly the RBI decided to transfer a sum of ~Rs.1.76 trillion to the Government of India comprising of ~Rs.1.23 trillion of surplus for the FY19 and ~Rs.526.37 bn of excess provisions identified as per the revised Economic Capital Framework (ECF).
- Of the Rs.1.23 trillion for FY9, an amount of Rs.280 bn has already been paid as interim dividend in previous fiscal.
- Thus, the RBI would transfer the remaining amount of ~Rs.1.48 trillion during the current fiscal.
- In the Union Budget for FY20, the government had estimated the transfer from RBI and financial institutions to the tune of ~Rs.1.06 trillion, of which the interim dividend of Rs.280 bn has been paid already.
- Thus, the additional surplus, after yesterday's announcement would now amount to ~Rs.420 bn (Rs.1.76 trillion, less budgeted estimated of Rs.1.06 trillion, less Rs.280 bn already transferred).

The higher surplus is likely to help the government stick to its fiscal deficit while still being able to support the economic growth. This could also mean that, the government may not resort to additional borrowings which would leave space for private sector in the debt markets and prevent crowding out. This move is also positive from system liquidity perspective. The liquidity support through the surplus transfer would be higher than that was budgeted by the government in July 2019 Union Budget. Additionally this event could create more room for the RBI to reduce interest rates in the near term as the fears of fiscal expansion fuelling inflation are now alleviated.

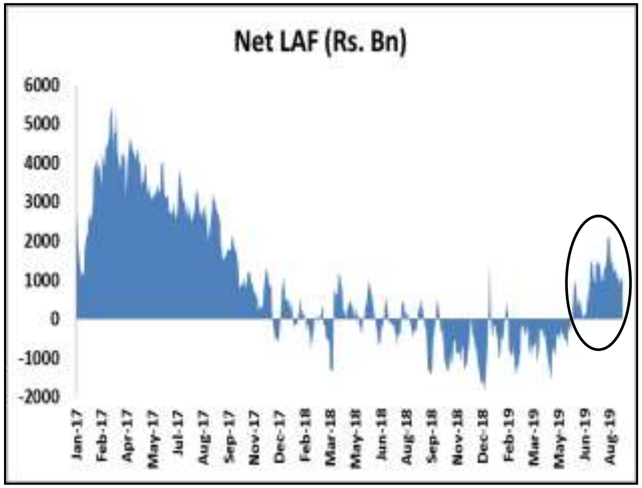
Money Supply growth at lower levels...
…limited scope for fiscal expansion



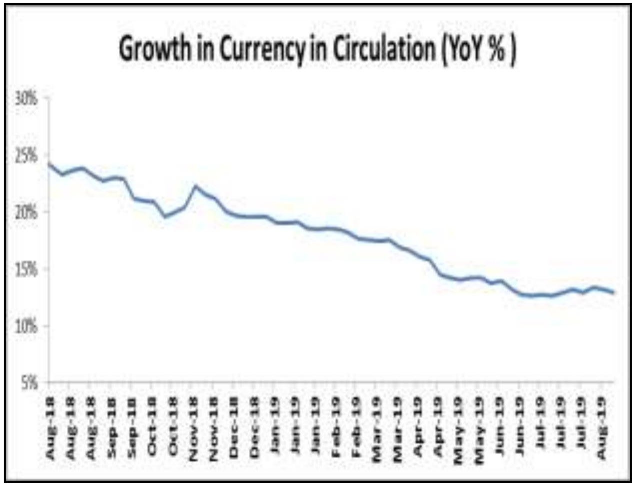
- The domestic M3 (broader money supply) YoY growth over the past about 17 years has been at ~14.5%; minimum being at ~5.50% and maximum at ~24.5% (including the demonetization period of 2016).
- As on 20 July 2019 the YoY M3 growth stood at 10.20%, indicating that M3 growth has been on closer to the lower side of the above range.
- It is important to track the M3 growth, as it can give an insight into the space available for fiscal expansion, lending rates and availability of credit to private sector of the economy.
- Government being the largest borrower in the Indian debt markets, any increase in the government's fiscal deficit can potentially lead to increase in government's market borrowings and thus crowd out the debt markets, leaving limited space for private sector to borrow.
- Additionally it can push up the yields and also prevent the lending rates to come down given availabilities to lesser money in the system.

The government seems to be well cognizant of this fact and thus has maintained its deficit target for FY20 and has also stuck to fiscal consolidation. This is important for bond markets as this could mean that any major fiscal expansion may not be an option available to the economy at this juncture.

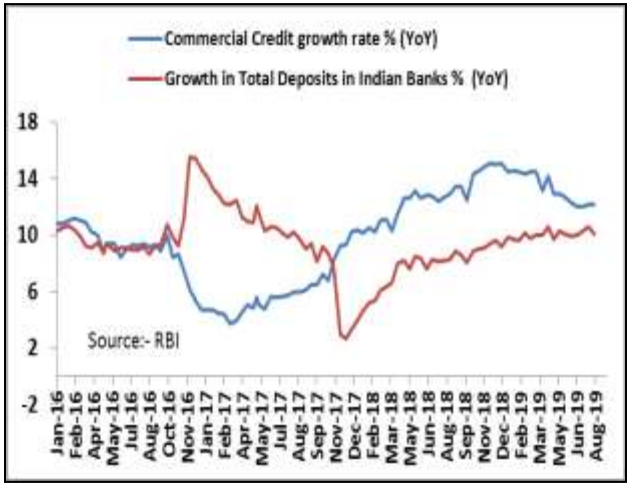
Liquidity conditions remained comfortable in August 2019…



Source - RBI



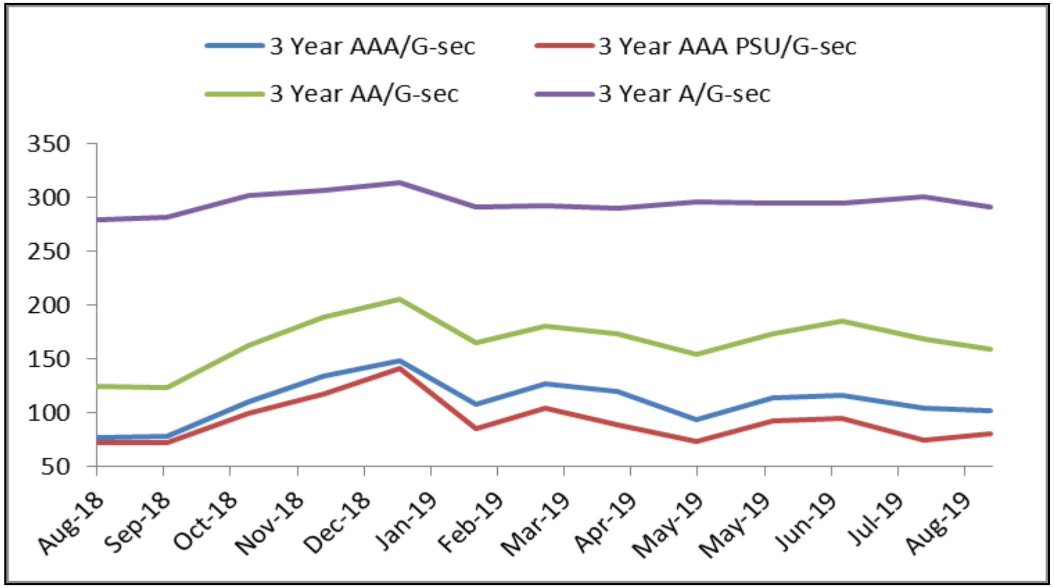
Source - RBI



Source - RBI

- Domestic system liquidity continued to remain comfortable during August 2019; wherein Liquidity as measured by the RBI's Liquidity Adjustment Facility (LAF) stood at a daily average surplus of ~Rs.1.32 trillion, compared to a daily average surplus of ~Rs.1.26 trillion during July 2019.
- Growth in Currency in Circulation (CIC) is also slowing down, which could also be adding to the comfortable liquidity conditions.
- CIC grew at a slower pace of 12.88%YoY as on 23 August 2019 compared with 23.88% YoY around the same period last year.
- Commercial Credit growth stood at 12.18% YoY as on 2 August 2019 as against 12.7% YoY as on 3 August 2018. It had risen to 15.11% YoY in December 2018.
- Growth in Total Deposits in Indian Banks stood at 10.08% YoY as on 2 August 2018 compared with 8.21% YoY during the same period last year.

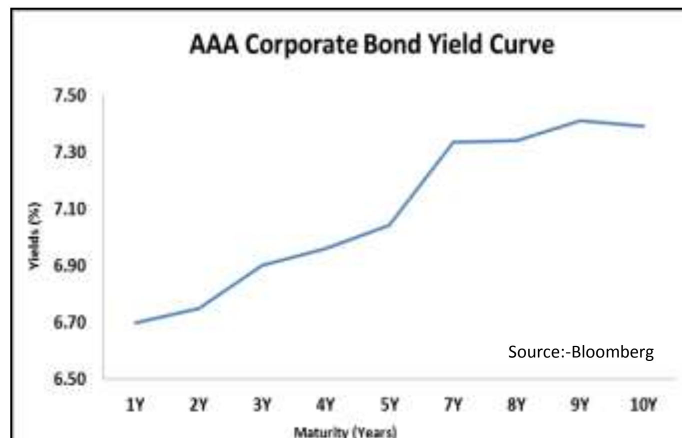
Bond spreads – An Update



Spread between AAA corporate bonds and G-secs of similar tenure as on 26 August 2019.
Source:- Bloomberg and Reliance MF

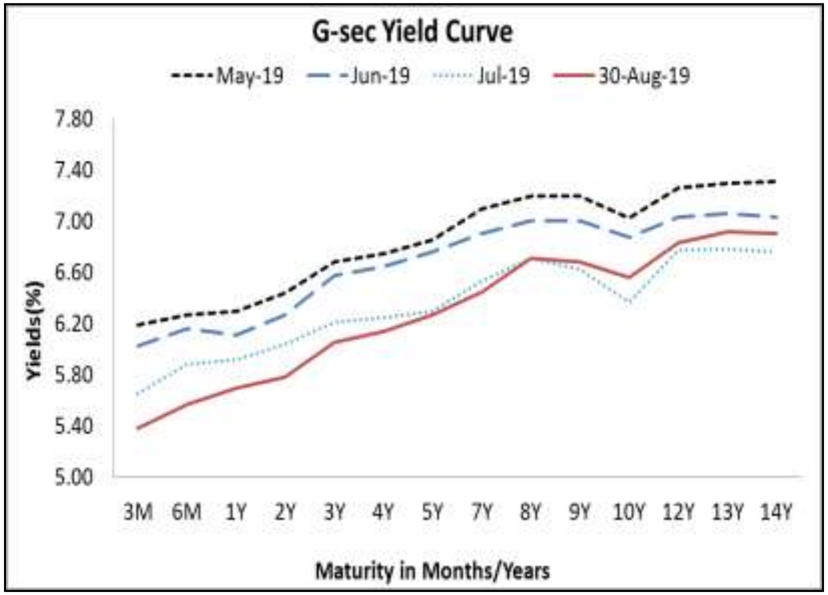
Credit Spreads in Bps

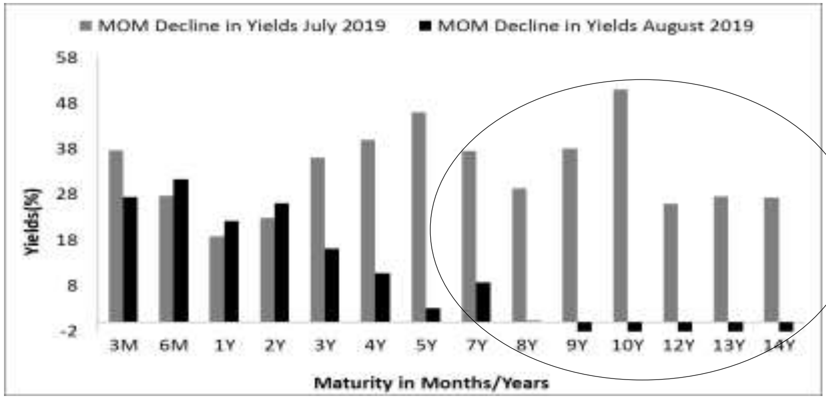
Date	3 Year AAA/G-sec	3 Year AAA PSU/G-sec	3 Year AA/G-sec	3 Year A/G-sec
Aug-18	77	72	124	279
Sep-18	78	72	123	281
Oct-18	111	100	163	303
Nov-18	134	117	189	307
Dec-18	149	142	205	314
Jan-19	108	85	165	291
Feb-19	127	105	181	292
Mar-19	119	89	173	291
Apr-19	93	73	154	297
May-19	114	92	173	295
Jun-19	116	94	185	295
Jul-19	104	74	168	301
Aug-19	102	80	159	292



- The credit spreads on are currently higher than the pre-September 2018 period tracking heightened caution in the corporate bond market.
- Increase in the spreads on AAA rated corporate bonds has been higher than those rated lower, as can be seen from the table above.
- Thus, while risk and caution in the lower rated debt securities has increased, the increase in the spreads does not seem commensurate.
- Thus, from a risk reward perspective, the corporate bonds with higher credit rating still look attractive at this juncture.

While shorter end of the yield curve declined tracking rate cut and surplus liquidity… …the longer end rose due to fiscal concerns





G-sec Term Spreads

Term Spreads	May-19	Jun-19	Jul-19	Aug-19
1-5 Years	66	73	65	89
1-10 Years	73	77	45	86
5-10 Years	18	12	7	29

Source:- IDFC Mutual Fund

- While the shorter end of the yield curve has been reacting well to the interest rate as well as monetary easing, the longer end has been reluctant lately even after various positive events announcements both from government and the RBI.
- This is largely on account of caution on bond supply absorption as the government's overseas sovereign bond issue seems to be on a back burner at this juncture. Also, lack of clarity on the quantum of RBI's OMO purchases seems to be adding to the caution.
- Additionally, for market participants, the proof of pudding is in eating; thus, on the fiscal deficit front, they remain cautious and would want to wait for further clarity to emerge, on how the government plans to spend the surplus received from the RBI.

Fixed Income Outlook

- System liquidity conditions typically tighten in the second half of the financial year, given the demand from festival season and later the last quarter demand for funds at the end of the financial year. Thus liquidity surplus could decline in H2FY20. However, with the RBI's positive liquidity stance, it is likely to keep liquidity in the surplus mode in order to 1.) lead to effective transmission of rate cuts; 2.) to keep liquidity available for the key sectors of the economy. Thus, the overall outlook on liquidity seems to be comfortable at this point.
- While monsoon progress was good in July 2019, August 2019 has seen erratic patches for monsoon. Cumulative rainfall on an overall basis, from June to August 2019 has been near normal. However, the impact of the uneven distribution and erratic behavior in some parts of the country on Kharif crop production, needs to be tracked very closely. That said any meaningful spike in the food inflation is unlikely as the food prices globally are at lower levels, and government's buffer stocks are at robust levels.
- While core inflation saw a rise in July 2019, given the subdued demand conditions, it is also likely to remain muted in the near to medium term. Thus, the overall trajectory of inflation at this point seems to be confortable in the near to medium term. Crude oil prices have also been muted tracking muted global economic growth scenario, which also gives comfort on the impact on domestic inflation.
- The government not only announced measures to revive economic growth, but also stuck to the fiscal deficit target for FY20. While generation of the estimated tax revenues could still be challenging given the economic slowdown, the higher surplus transfer by the RBI, could give respite to the fiscal situation of the government and any shortfall in the tax revenues could be made up by the additional surplus. This could help the government in sticking to its fiscal deficit target.
- With the Federal Reserve's interest rate cut and ECB being very close to interest rate cuts as well as possible further monetary easing, the global outlook for interest rates remains to be on the declining side. This is likely to give more comfort to the RBI while taking its interest rate decisions. With the domestic Q1FY20 GDP data being muted and below expectations, government so far maintaining fiscal deficit, inflation remaining muted and global mood of lowering interest rate and monetary easing, there could still be more room for further interest rate cuts in India.
- The decline in the short term rates continued, given sustained liquidity surplus and interest rate cuts by the RBI. The decline in the short term rates may continue given RBI's stance of keeping liquidity in the surplus mode. Thus, the shorter end of the yield curve is better placed from risk reward perspective. The steepness between the short to medium term segments of the yield curve, keeps the medium term segment also attractive at this juncture. The longer end of the yield curve may remain volatile tracking concerns on higher supply of bonds, volatility in Rupee and markets still worrying about the government's fiscal deficit position. However, with a lower inflation coupled with muted economic growth and hopes of interest rate cuts by the RBI, the longer end of the yield curve may also decline.
- Thus, we recommend investments in Medium Duration Funds can be considered with a horizon of 15 months and above.
- Investments into Short Duration Funds can be considered with an investment horizon of 12 months and above.
- Investors who are comfortable with intermittent volatility, can also look at strategies that have allocation to the longer end of the yield curve, through Dynamic Bond Funds.
- Investors looking to invest with a horizon of up to 3 months can consider Liquid Funds, while Ultra Short Duration Funds and Arbitrage can be considered for a horizon of 3 months and above.

Investment Strategy

- **We recommend investors to rebalance/realign the portfolios according to the recommended asset allocation**
- **On Equity Funds:**
  - Post budget selloff from the FPI has led to the markets correcting, while commitment of lower fiscal deficit has led to lower interest rates.
  - The government came back with a slew of measures stem the deceleration and to revive the economy.
  - Strong government response and easy liquidity regime is a potent combination for economic revival in the medium term.
  - Macro indicators continued with mixed signals in near term as lower inflation, lower interest rate, improved domestic liquidity conditions, indications of steady volume growth continuing in many sectors seem to be offset by weak IIP and GDP on the other. Stagnation of consumer demand and lower corporate margins needs to reverse for stronger earnings growth to emerge.
  - The GDP data for Q1FY20 showed further weakness on the back of deceleration in private consumption and investment demand. Markets are expecting that H2CY19 could be marked by improving investment demand and better corporate results.
  - Rising government spending holds the key. We believe that in the next five years the government would accelerate the process of reforms and decision making to take advantage of the solid base that has been built over the past five years.
  - From an Equity Mutual Fund perspective, investors should look at Large Cap and Multicap Funds for fresh investments and SIP into Midcap and Small caps funds can begin with a longer horizon (12-15 months), with an investment time horizon of 2-3 years. We maintain our investment strategy at 50% Lumpsum and rest 50% staggered over the next 3-4 months.

On Fixed Income Funds:

- Investments in Medium Duration Funds can be considered with a horizon of 15 months and above.
- Investments into Short Duration Funds can be considered with an investment horizon of 12 months and above.
- Investors who are comfortable with intermittent volatility, can also look at strategies that have allocation to the longer end of the yield curve, through Dynamic Bond Funds with an investment horizon of 24 months and above.
- Investors looking to invest with a horizon of up to 3 months can consider Liquid Funds, while Ultra Short Duration Funds and Arbitrage can be considered for a horizon of 3 months and above.

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