HSBC Asset Management

Market Outlook

In Focus

Nov 2022

Nifty earnings have seen a marginal upgrade

Equity Market update

- Equity markets in India and developed markets rose sharply in October while Emerging markets (MSCI EM) declined largely on back of China. FII flows continue to remain volatile albeit with a net inflow in October.
- S&P BSE Sensex & NSE Nifty indices were up 5.9% / 5.5% respectively. Broader markets underperformed as BSE Midcap / BSE Smallcap indices were up 2.1% / 1.3% respectively. All sectoral indices closed positive, except for FMCG which was down 0.3%. Banks, Energy and Capital goods saw notable increase of 7.3%/6.6%/6.6% respectively.
- As of 31st October, 32 Nifty companies' saw the aggregate Sales & EBITDA rising 24% & 6% YoY respectively while PAT declined 2% YoY. The decline in profits was largely led by global cyclicals as excluding these profits have grown 25% YoY with major contribution from banks and financial services. In Financials, growth momentum has remained strong while outlook commentary from technology companies was stable despite weakening macro environment. Commentary from consumers' companies indicated resilience in urban and discretionary demand while rural demand remains weak.
- India's headline CPI accelerated to 5 month high of 7.41% in September due to higher food prices, compared to 7% in August. This is the 9th consecutive month that the CPI data has breached the RBIs upper margin of 6%. INR depreciated further by 1.8% against USD during the month. August IIP contracted by 0.8% compared with 2.2% in July.
- Other key developments during the month include – Gross GST revenue collected in october 2022 grew 16.6% YoY to Rs 1.52 tn. Government announced a one-time compensation of Rs 220 bn to three oil marketing companies for losses incurred on domestic LPG.
- Net institutional inflow was a positive USD 2.1 bn in October contributed by both FIIs & DIIs. FIIs were net buyers with inflows of USD 1.03 bn. FIIs' net sell of Indian equities stands at USD 26.3bn after peaking at USD 32.5 bn since the selling began in Oct 2021 (USD 21.5 bn of net outflows in 2022 so far). DIIs also contributed with net inflows of USD 1.1 bn largely led by MFs (+USD 0.77 bn). On a CYTD basis, the DIIs have net bought Indian equities worth ~USD 30 bn (~USD 22 bn by MF & ~USD 8 bn by Insurers).

Nifty continued with its up move in October increasing 5.4% resulting in higher valuations as earnings growth has remained largely intact. On a 10-year basis, Nifty is trading at +1 STD from its historic average valuations, while on a 5-year basis it is now trading above averages. Nifty is trading at 21.4x / 18.5x FY23 / FY24e. In the rising interest rate scenario, market returns may lag earnings growth given the probable moderation in valuation multiples.

Equity and other indicators

	Last Close	1 Month (Change)	CYTD 2021 (Change)
S&P BSE Sensex TR	91769	5.9%	5.6%
Nifty 50 TR	26182	5.5%	5.1%
S&P BSE 200 TR	9764	4.5%	5.5%
S&P BSE 500 TR	30509	4.1%	4.6%
S&P BSE Midcap TR	31357	2.1%	2.7%
S&P BSE Smallcap TR	35113	1.3%	-1.4%
NSE Large & Midcap 250 TR	12818	3.3%	4.3%
S&P BSE India Infrastructure Index TR	397	4.0%	10.6%
MSCI India USD	776	2.5%	-8.1%
MSCI India INR	2084	4.3%	2.3%
INR - USD	82.8	1.8%	11.4%
Crude Oil	95	7.8%	21.9%

Global market update

Major equity indices globally turned positive during the month with MSCI World index up 7.1%. US market (S&P 500) & MSCI Europe were up 8.0%/7.1% respectively while MSCI EM was down 3.2% largely on back of 16.8% decline in China. Crude oil prices saw a sharp increase of 7.8% MoM. US Fed's hawkish tone on interest rates and the fear of global recession are the key concerns among investors. An accelerated rate hike by US Fed, ongoing liquidity withdrawal process and a constrained US fiscal policy could drag global growth in the short term. As a result, equities are expected to remain volatile in the short term.

Outlook:

Globally, policy actions by central banks to tame inflation casts a shadow on equity asset class as they adversely impact both drivers of the equity performance viz valuations (given rising interest rates) and earnings growth (slowing demand & inflation). Moderation in global commodity prices from peak and stalemate in geopolitical situation has given some respite. Domestically, India seems to be more stable. Domestic demand so far has seen recovery to/higher than pre-covid levels. The rise in oil and other commodity prices which was the concerning factor earlier this year, seems to be receding.

International market indicators

Indices	Last Close	1 Month (Change)	CYTD 2021 (Change)
MSCI World	2,548	7.1%	-21.2%
Dow Jones	32,733	14.0%	-9.9%
S&P 500	3,872	8.0%	-18.8%
MSCI EM	848	-3.2%	-31.2%
MSCI Europe	1,558	7.1%	-25.6%
MSCI UK	979	5.9%	-16.7%
MSCI Japan	2,859	3.0%	-25.8%
MSCI China	47	-16.8%	-43.9%
MSCI Brazil	1,588	8.6%	10.7%

This should aid corporate earnings growth. Nifty earnings have seen a marginal upgrade so far in Q2 results largely due to banks and are expected to grow at 15% CAGR (consensus estimates) over FY22-24E. However, with valuations on a higher side, equity markets are likely to remain volatile in near term with a negative bias. Fall in crude prices, sharper decline in inflation and normalization of geopolitical situation would support the markets.

Valuations: Nifty continued with its up move in October increasing 5.4% resulting in higher valuations as earnings growth has remained largely intact. On a 10-year basis, Nifty is trading at +1 STD from its historic average valuations, while on a 5-year basis it is now trading above averages. Nifty is trading at 21.4x / 18.5x FY23 / FY24e. In the rising interest rate scenario, market returns may lag earnings growth given the probable moderation in valuation multiples.

Macro View: Our macro environment had deteriorated but still hasn't gone to worrisome levels. With RBI now having drawn down US$ 118 bn of FX reserves from the peak of US$ 640 bn over a year ago, India's ability to absorb further external shocks has reduced. Despite widening Current Account Deficit and Balance of Payments deficit, overall external situation is still on a stronger footing compared to 2013. RBI's policy actions so far indicate the urgency in taming inflationary pressures in the economy and more rate hikes are in the anvil. Though global commodities have seen moderation, Inflation is expected to remain elevated in the near term. The strong tax buoyancy (visible in both GST and direct taxes), could create more fiscal room than anticipated, providing ammunition for policy maneuvers during times of volatility. However, the incoming high frequency data need to be monitored closely. Fall in crude prices on back of global demand slowdown could support markets in the near term.

Portfolio Strategy and Update

- Our portfolio construction is through bottom-up stock selection with focus on fundamentals of the companies and their earnings growth trajectory. We prefer dominant businesses with scalable and sustainable earnings growth and available at reasonable valuations.
- We continue to run high conviction strategies, with a cyclical tilt to be well positioned for the earnings growth and macro recovery cycle, holding a medium to long term view.
- However, in the macro set up of rising rates, depreciating currency and slowing growth, corporate earnings would likely see a downward revision after second quarter results. On the other hand, valuation is elevated both in absolute and relative basis. In light of the above we have tamed our pro-cyclical bias slightly and increased our exposure in the defensive sectors to de-risk our portfolio.

Our positioning in the portfolio is

- Overweight to Domestic cyclical plays: Our highest active sector weight remains financials which would see credit cost normalization and earnings expansion, followed by Auto which is benefitting from cyclical recovery and real estate on improving residential affordability and industry consolidation;
- Small overweight to Capex oriented plays: Cement, industrials, and building materials – The capex push reiterated in the recent budget is a key positive for the sector.
- Equalweight to Global growth plays: We see Technology and Chemicals as structural plays – but have equal-weight position given near term growth concerns and valuations higher than historical averages; and
- We are underweight on consumption (especially rural consumption) and regulated businesses like utilities and energy

Key drivers for future:

On the headwinds, we have

- High and persistent inflation concerns (Global & Domestic)
- US Fed Policy: Accelerated rate hikes and balance sheet shrinking process could mean volatile equities.
- RBI Policy: RBI's hawkish stance of 'taming inflation' and liquidity withdrawal process.
- Geopolitical: Current impact is already in the base case, coupled with no escalation assumed from the current conflict.
- Moderating growth globally due to geopolitical headwinds and demand impact from sticky inflation.

However, what matters the most is the earnings growth and its sustainability

- Corporate earnings growth: Nifty earnings have seen a marginal upgrade post Q2 so far largely driven by banks.
- Domestic macro: Domestic macro has been stable and that will support future corporate earnings growth.
- Other factors / risks: Impact of elevated energy prices on inflation, current account balance and fiscal deficit. Faster than anticipated reversal in commodity prices (especially crude oil), would be positive from an inflation and corporate margins perspective.

Source: HSBC Asset Management, India (HSBC AMC), Bloomberg, MOSL, Data as at Oct '22 unless otherwise given.
Returns mentioned in the report are the Total Return or TR variants of the respective domestic indices. USD return for global indices.

Fixed Income update

Market Summary for the month

- The month of October started on a volatile note post RBI policy in end September, volatility seen in crude prices and disappointment on non-inclusion of Indian bonds in global bond indices. However, markets subsequently settled into a range of 7.35-7.55 and remained resilient to a reasonable extent to upward pressure seen in yields in global bond markets.
- 2H borrowing calendar was largely on expected lines at INR 5.92 trillion. The borrowing, similar to 1H FY 23, is concentrated at the belly and the longer end the curve. Around INR 160 bn is proposed to be raised through "green bonds". The SDL borrowing calendar indicated INR 2.53 of state borrowings during Q3, however it may be noted that SDL borrowing in 1Q and 2Q has been much lower than in the indicative borrowing calendar.
- Macro data released during the month were a mixed bag. Industrial production for August contracted while September CPI inflation inched higher. Fiscal trends remained on expected lines with September GST collections (collected for sales made in the month of August) seeing a marginal uptick, in line with seasonality. Data released in early November indicated a trend of continued growth uptick- uptick in PMIs, robust growth in core industries and improvement in October GST collections,
- September trade deficit reduced marginally from the highs but remained elevated at ~ USD 26 bn. The flows from foreign portfolio investors were a mixed bag with an uptick in the second half of the month on the equity side. Despite improvement in portfolio flows, rupee traded weak for most part and briefly touched 83 towards the end of the month before mildly recovering.
- The MPC minutes released in the second half of the month provided a fillip to bond markets as the views of some of the external members were on the dovish side with these members indicating a preference for a terminal rate lower than market expectations. This lead to a reasonable rally, especially at the shorter end of the G-Sec curve. Overall, 10 yr closed October 5 bps higher at 7.50 v/s 7.4 in September. 14 yr closed at 7.50 v/s 7.46 in September.5 yr (2027) also closed 5 bps higher at 7.37 v/s 7.32 in the previous month. 3 yr closed at 7.19 v/s 7.10 in September On the corporate bond side, we saw some uptick in issuances at the shorter end of the curve, while dovish MPC minutes later in the month led to some demand for corporate bonds coming in especially in the 3-5 yr segment. These lead to some volatility in corporate bond spreads/ yields at the shorter end of the curve. Meanwhile spreads at the longer end of the curve continued to remain tight.
- Liquidity surplus continued to moderate on account of increase in currency in circulation and decrease in FX reserves and liquidity turned into deficit mode in the later part of the month. Average LAF O/s declined to just ~INR 36 bn for the month of October v/s INR 1.0 trn in September from INR 1.2 trn in August and INR 1.9 trn in the month of July.

Outlook

Given that RBI has already front loaded rate hikes over the past few months and some moderation in inflation is expected in the medium term, further rate hikes may happen in a much more calibrated manner and the tone of the MPC minutes appears to vindicate this view. At the same time, RBI is expected to factor in actions taken by global central banks and keep in mind the movement in the currency and external accounts. Inflation is also expected to remain above the target band of RBI atleast in the near term.

Overall yields are expected to continued to trade range-bound with a slight negative bias, given the above backdrop and be influenced by global cues. The short to medium part of the curve which has moved up sharply higher in yield terms since March, may present opportunities for carry and roll-down going forward. Bulk of the bond supply is also towards the duration segment, and hence the longer end of the curve may remain more volatile

Fiscal deficit and GST collections:

GST collections for the month of October (for sales in the month of September) remained at INR 1.52 trn v/s INR 1.48 trn in the previous month, with uptick in line with seasonality and given the improved production in the run up to the festive season.

India's fiscal deficit in the first half of the financial year through September rose to INR 6.2 trn from INR 5.27 trn a year earlier. Fiscal deficit for the April to September period touched 37.3% of BE. Center's gross tax revenue in 1HFY23 was at 51% of FY2023BE (growth of 17.6%) while net tax revenues was at 52% of FY2023BE (growth of 9.9%). Direct tax collection was at 52% and indirect tax collection was at 49% of FY2023BE, respectively, driven by income tax and GST collections. Total expenditure in 1HFY23 was at 46% of FY2023BE (growth of 12.2%) with revenue expenditure growth of 6% and capital expenditure growth of 50%

Source: HSBC Asset Management, India (HSBC AMC), Bloomberg, Data as at Oct '22 unless otherwise given

Fixed Income update

PMIs: October PMI see an uptick

India Manufacturing PMI improved to 55.3 from 55.1 in the previous month. The upward movement in the October headline figure largely reflected stronger increases in employment and stocks of purchases. Similarly, Services PMI improved to 55.1 in October from 54.3 in September. As a result, Composite PMI improved to 55.5 from 55.1

Trade deficit: Remains elevated in September;

India's merchandise trade deficit widened to USD 25.7 bn in September 2022, as against USD 22.5 bn in September 2021, albeit declining from the highs of USD 28 bn in August and USD 32 bn in July. Exports rose only 4.82 per cent to USD 35.4 bn from USD 33.8 bn in the same month last year. On the other hand, India's imports rose 8.66 per cent to USD 61.16 bn in September from USD 56.29 bn in the same period last year.

IIP: August IIP moved into contraction

August IIP contracted by -0.8% as compared to growth of 2.2% in July. On a sectoral basis, manufacturing activity fell by -0.7% (July: growth of 3%), and mining activity fell by -3.9% ((-)3.3% in July). As per the use-based classification, consumer goods production contracted sharply over last August levels while all other sectors registered positive growth

Inflation: CPI inflation increases to 7.4% on increase in food prices; WPI moderates slightly

September CPI inflation printed at 7.4%, marginally higher than consensus and higher than previous month number of 7.0%. Food inflation inched to 8.4% v/s 7.6% in the previous month while core inflation inched to 6.1% v/s 5.9%. Part of the rise in both food and core was due to base effects. The rise in food inflation was led by cereals and pulses yet again while the usually volatile vegetable prices saw a muted increase yet again on a m-o-m basis. Inflation is expected to remain elevated above the RBI target range of 4% +/-2% in coming months.

WPI inflation moderated to an 18-month low of 10.7% in September 2022 from 12.4% in August 2022 on account of a broad-based correction in inflation for all segments, with their respective inflation prints touching multi-month lows. The core WPI inflation dipped to a 19-month low of 7.0% in September 2022, driven by the softening in commodity prices amid global slowdown concerns. Moreover, the WPI-food inflation declined to a 10-month low of 8.1% in September 2022 from 9.9% in August 2022

External Factors – UST yields sharply higher, currency continues to face pressure

Oil: Crude prices stayed highly volatile during the month, albeit and after reaching as high as USD 98/bl Brent Crude closed October at ~USD 94.8/bl v/s USD 88.4/bl in September

US Treasury yields: UST 10 yr yields inched sharply higher during the month, continuing the uptrend, closing October at 4.23 v/s September at 3.80 (August at 3.13 and 2.64 in July)

Currency: Rupee traded with a depreciating bias through the month and despite a mild recovery after touching 83.0, USD INR closed October at 82.77 v/s 81.51 in the previous month

Indicators	Current month (October)	Prev month (September)
Repo rate	5.90	5.90
1Y OIS	7.00	6.90
5Y OIS	6.91	6.91
3M T-Bill	6.25	6.00
1Y G-Sec	6.81	6.70
3Y G-Sec	7.19	7.10
5Y G-Sec (2027)	7.37	7.32
10Y G-sec (6.54 GS 2032)	7.45	7.40
AAA 5Yr Corp Bond (2027)	7.55-7.65	7.50-60
AAA 10yr Corp Bond PSU	7.65-7.75	7.65-7.75
USDINR	82.8	81.5
Brent Oil (USD Per Barrel)	94.8	88.4

Source: HSBC Asset Management, India (HSBC AMC), Bloomberg, Data as at Oct '22 unless otherwise given.

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