EQUITY MARKET REVIEW

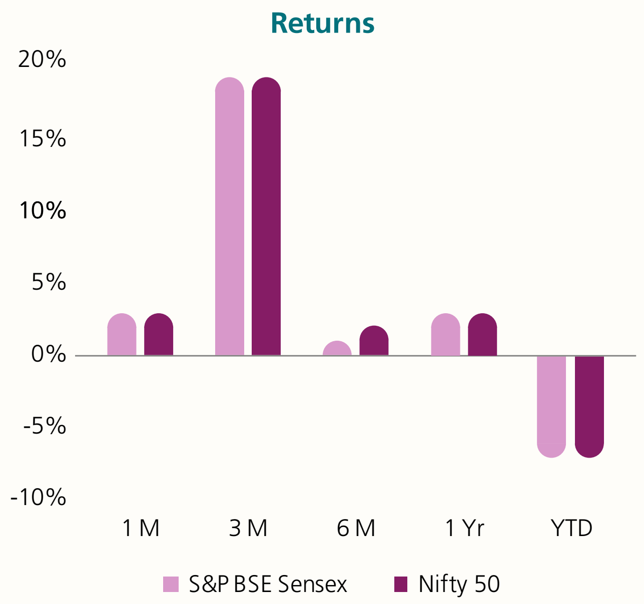
AUGUST, 2020

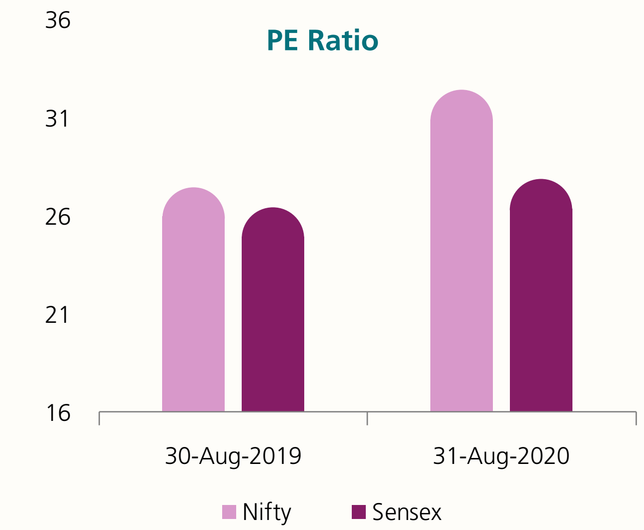
L&T Financial Services
Mutual Fund

The Indian equity market continued to move higher tracking global cues, even as India continues to see a sharp increase in daily new COVID-19 cases. India's volatility index moderated for the fifth consecutive month and declined 5.6% in August. Delivered earnings by companies in Q1FY21 are amongst the weakest they have been for the last several years. Yet, Q1FY21 is also amongst the best (in recent times) in terms of an earnings beat.

MSCI India (US$) rose 3.4% in August and performed in-line with MSCI APxJ (+3.6%) but outperformed MSCI Emerging Market (EM) (+2.1%). YTD, MSCI India (-6.0%) is meaningfully underperforming peers, MSCI EM (-1.2%) and MSCI APxJ (+3.4%). Nifty 50 and S&P BSE Sensex ended the month of August with 2.8% and 2.7% returns, respectively.

Indian domestic market outperformed the peer group MSCI EM (-0.2%). MSCI AWI Index ended with 3.8% returns. Among broader markets, the Midcap index outperformed the Largecap index by 380 bps while the Smallcap index outperformed the Largecap index by 740 bps. BSE Midcap and BSE Smallcap indices ended the month of August with 6.6% and 10.1% returns, respectively.





GLOBAL MARKETS

Global equity markets continued their rally in August with S&P500 up 7%. S&P500 crossed the pre-pandemic peak of February and is up 8.3% YTD. The US Fed formally moved its monetary policy strategy from flexible inflation targeting to average inflation targeting.

Worldwide, major indices saw positive trends. Dow Jones was the outperformer with 7.6% returns, followed by Nikkei (6.6%), Euro Stoxx (3.1%), and Hang Seng (2.4%). FTSE100 was the worst performer with 1.1% returns.

SECTOR PERFORMANCE

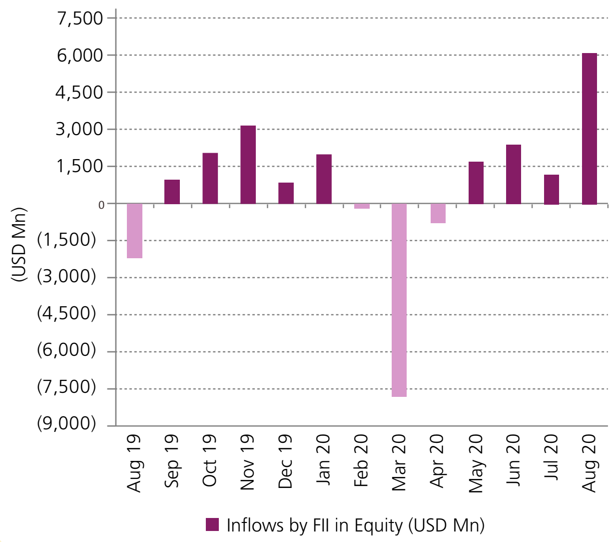
The Indian equity market outperformed the MSCI EM Index. Metal was the best performing sector with 12.9% returns outperforming Sensex by 10.2%. Realty (11.6%), Banks (9.6%), Power (8.5%), Capital Goods (7.9%), Auto (7.3%) and Consumer Durables (6%) also outperformed Sensex. Healthcare (0.6%), Oil & Gas (-0.7%) and FMCG (-0.8%) underperformed Sensex. IT and Tech were the worst performing sectors with (-1.1%), and (-1.5%) returns, respectively.

INSTITUTIONAL ACTIVITY

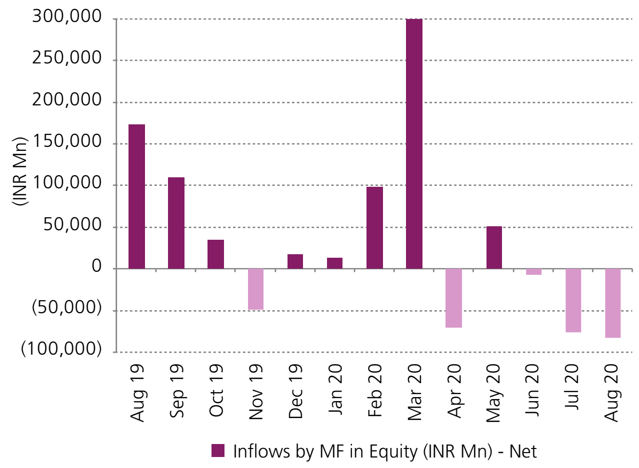
FII recorded the highest ever monthly net inflows of $6.4 bn into Indian Equities in August vs inflows of $1.2 bn in July 2020 taking FY21 net inflows to $11.8 bn. August is the fourth consecutive month of net FII inflows. DIIs continued to be net equity sellers of US$1.5 bn in August post outflows of $1.3 bn in July taking FY21 tally of outflows to $1.1 bn.

Within DIIs, both Mutual funds and insurance funds were net equity sellers in August. Mutual funds were net equity sellers at $1.2 bn while insurance funds sold $324 mn of equities in August. *(Mutual fund and insurance fund flow data is as of August 28, 2020).*

Inflows by FII in Equity (USD Mn) - Net



Inflows by MF in Equity (INR Mn) - Net



MACRO-ECONOMIC DEVELOPMENTS

Headline CPI for July at 6.9% was higher than the market expectations. Core-core inflation increased from 5.3% in June to 5.6% in July, at a 17-month high. Food inflation at 9.6% in July has increased from 8.7% in June.

After strong recovery seen in May and June following a single-digit print in April, July composite PMI plateaued at 37.2 vs. 37.8 in June. India's services PMI improved to 34.2 in July (vs 33.7 in June). Similarly, the Manufacturing PMI printed at 46.0 in July down from 47.2 in June. Forward-looking demand indicators printed sharp recovery with new orders came at 45.6 and new export orders were up 4.4 pts to 43.3 (MoM).

Jun IIP contracted by 16.6% (YoY). Consumer non-durables jumped to 115% of its pre-pandemic levels and registered a healthy 14% growth (YoY). Although the output of consumer durables doubled between May and June, it was still at just 68% of its pre-pandemic levels.

India's monthly merchandise trade balance normalized and moved back into a modest deficit of $4.8 bn in July vs. a one-time monthly surplus of $790 mn in 18 years in June. Merchandise exports were down 10% (YoY) in July (vs. 12% decline in June) and imports were down 28% (YoY) in July (vs 48% decline in Jun). Imports ex Oil and Gold declined 29% (YoY) vs. 41% decline in June, the 18th consecutive month of declines (YoY).

India's FX reserves are close to their all-time peak at $537.5 bn (as of August 21). INR appreciated by 1.6% and ended the month at 73.62/$ in August.

Benchmark 10-year treasury yields averaged at 5.96% in Aug (15 bps higher vs. July avg.). Global yields have eased meaningfully as central banks globally have cut policy rates aggressively and have announced large QE programs, to counter the negative impact on global growth from the COVID-19 outbreak. US 10Y yields are at 0.71% (-79 bps over the last 1 year).

Brent oil price gained 3.7% (MoM) in Aug to end the month at US$44.4/bbl following a 4.7% (MoM) gain in July. YTD, oil prices are still 33% down.

India's Q1FY21 GDP contraction at 23.9% (YoY) came worse than consensus expectations of -18%. Core GVA (GDP minus agriculture and public administration) contracted almost 30% (YoY). Agriculture grew 3.4% (YoY).

In its last policy meeting, RBI kept policy rates on hold while maintaining its accommodative stance. MPC stated to use available space and cut rates if it is convinced of a durable reduction in inflation.

OUTLOOK

The Indian equities market continues to inch upwards led by broad-based improvement in economic activity as reflected by high-frequency indicators. With economy unlocking, economic activity improvement in August is broad-based led by a steady uptick in urban indicators.

Late-August data shows improvement in Rail freight and E-way bill generation, which are particularly strong. Other improvements include Congestion levels, Realty portal traffic, Auto portal traffic and Hotel & Travel web traffic. Car/2W registration data is also strong on month-on-month basis.

Unemployment data continues to remain stagnated near the pre-COVID levels. Exports (ex-oil) are nearly back to pre-COVID levels. Petrol and Diesel consumption are now only -6% & -23% (YoY), respectively. Further, the latest GST data shows that broader economic activities (in value terms) recovered to c.85% of pre COVID during the month of July.

Monsoon trends continued to be positive as cumulative rainfall is now 10% ahead of long-period average (LPA) levels on an aggregate basis (over June 1, 2020 – August 30, 2020). Out of the 36 meteorological subdivisions, rainfall has so far been excess/normal in 33 meteorological subdivisions and deficient in 3. There has been an improvement over the last month in terms of lesser deficient areas. Summer crop sowing has done quite well with 108% planting done and +7% (YoY). This augurs well for the farmers' income and thus rural economy and demand.

Despite the near-term economic challenges, India's long-standing ambition to succeed in manufacturing is seeing a renewed push. The focus is on import substitution. Chances of success appear higher now with several favorable factors like targeted incentives, import restrictions, favorable global disruption, tax cuts & improvement in India's ease of doing business rankings.

In April 2020, Government launched the flagship manufacturing boosting scheme i.e. the Production Linked Incentive (PLI) scheme for mobile phones/components segment. More measures followed like:

(a) PLI scheme for bulk-drugs & medical devices in July 2020

(b) Time-linked domestic manufacturing defense goods in August 2020

(c) Higher domestic supplier preference in govt. contracts from June 2020

(d) Licensing of imports of TV sets in July 2020 manufacturing incentives are being built-upon calibrated custom duty hikes (electronics chain, solar cells, AC compressors, etc.)

Indian Government is actively focusing on *Atmanirbhar Bharat* and *Make in India* as many global companies are in the process to re-structure their supply chain to reduce the geographical risk of high dependency on China.

Overall, the Indian economy is on the path of normalization as the high-frequency economic activity indicators and GST collection data suggests that the economy has already reached 85% of the pre-COVID levels. Further, the good progress of monsoon bodes well for both the rural economy and the overall demand. Although total COVID cases have now risen to 3.7 mn infections, the doubling rate has increased now to 35 days from ~30 days a week ago. Daily recovery rate appears to be plateauing out at 62k recoveries per day. This is highly encouraging supporting our view that FY21 will be a year of two halves given the COVID-19 disruptions in the first 3-5 months and expected gradual recovery in the remaining months of the fiscal year.

The current market conditions exhibit high correlation among stocks in different sectors and thus the stock selection is incredibly important for higher performance in the long term. We continue to stick to companies having core competitive advantage, a strong balance sheet and the ability to generate sustainable cash flows.

Source: Bloomberg, MSCI