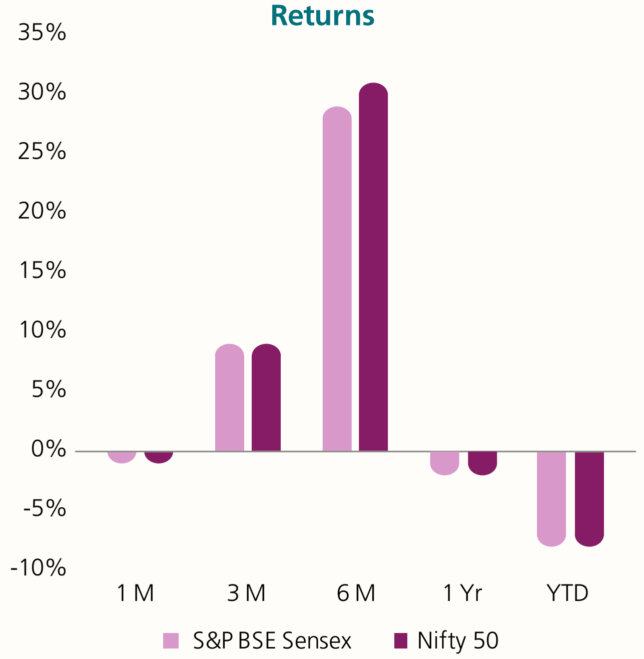
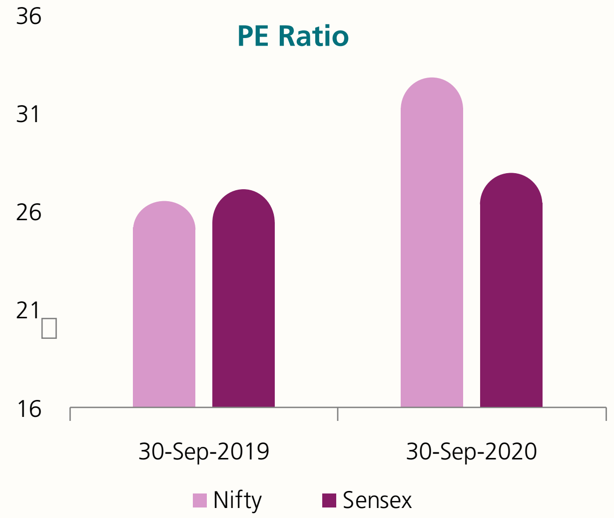
In line with global equities, Indian equity markets saw correction during the second half of September but were able to reverse some of the declines by the end of the month. Exports sector, IT and Healthcare benefitted from the strength in the US$.

MSCI India (US$) rose 0.6% in September and outperformed peers MSCI APxJ (-2.5%) and MSCI EM (-2.9%). However, YTD MSCI India (-5.5%) is meaningfully underperforming peers, MSCI EM (-2.9%) and MSCI APxJ (+0.8%). Nifty50 and S&P BSE Sensex ended the month of September with (-1.2%) and (-1.5%) returns, respectively.

Indian domestic market outperformed the peer group MSCI Emerging market (-1.8%). MSCI AWI Index ended with -2.9% returns. Among broader markets, the Midcap index outperformed the Largecap index by 170 bps while the Smallcap index outperformed the Largecap index by 520 bps. BSE Midcap and BSE Smallcap indices ended the month of September with 0.3% and 3.7% returns, respectively.





GLOBAL MARKETS

Global equity markets had a volatile month and witnessed a loss in momentum, with S&P500 and MSCI DM down 3.9% and 3.6%, respectively. This was the first monthly decline in DM equities after 5 consecutive months of gains. The decline in global equities was led by a tech correction. Several other developments – stalled US fiscal negotiations, drop in European PMIs, and rising virus count in Europe impacted on investor sentiment. Investors are also concerned about the upcoming US election and UK/EU Brexit negotiations.

Worldwide, major indices saw negative trends. Nikkei was out-performer with 0.2% returns, followed by FTSE100 (-1.6%), Dow Jones (-2.3%), and Euro Stoxx (-2.4%). Hang Seng was the worst performer, falling by 6.8%.

SECTOR PERFORMANCE

Indian equity markets outperformed MSCI Emerging Market Index. IT was the best performing sector with 10.7% returns outperforming Sensex by 12.1%. Healthcare (7.7%), Consumer Durables (6.7%), Tech (5.9%), Auto (1.1%), Capital Goods (0.7%) and Power (-1%) also outperformed Sensex. FMCG (-2.6%), Realty (-4.9%) and Metal (-6%) underperformed Sensex. Oil & Gas and Bank were the worst-performing sectors, down 6.4%, and 9.7%, respectively.

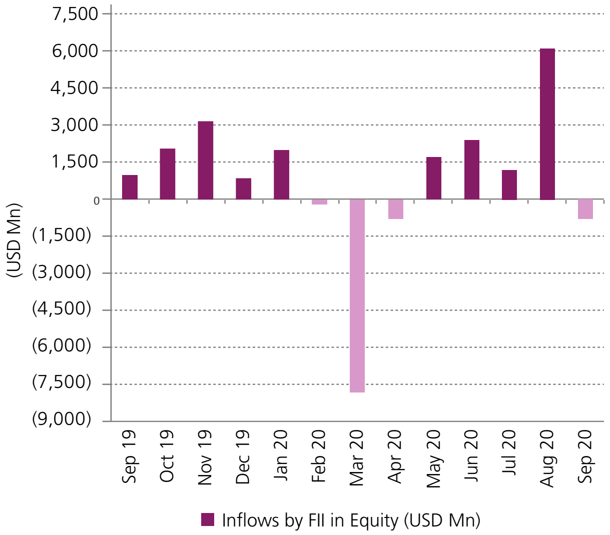
INSTITUTIONAL ACTIVITY

After recording monthly net inflows in August, FII's turned net sellers in September with outflows of $0.73 bn vs. inflows of $6.1 bn in Aug'20 taking FY21 net inflows to $10.8 bn. DIIs were marginal net equity buyers of US$15 mn in Sep post outflows of $1.5 bn in Aug taking FY21 tally of outflows to $1.1 bn.

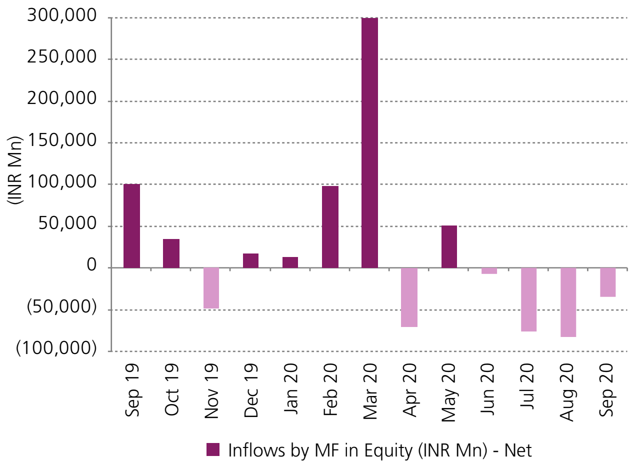
Within DIIs, Insurance funds turned net buyers in September, mutual funds remained net sellers. Mutual funds were net equity sellers at $0.64 bn while insurance funds bought $0.52 mn of equities in Sep.

(Mutual fund and insurance fund flow data is as of September 28, 2020).

Inflows by FII in Equity (USD Mn) - Net



Inflows by MF in Equity (INR Mn) - Net



MACRO-ECONOMIC DEVELOPMENTS

Headline CPI for Aug at 6.7% was lower than the market expectations. Despite the recent softening of momentum, however, core-core inflation was sticky printing at 5.4% (YoY) in both July and August. August food inflation at

8.3% (YoY) came marginally below the July print (8.5%). Monsoon and sowing are above normal, augurs well for food inflation.

After plateauing in July, the Composite PMI gained 8.8 pt (MoM) to 46.0 in Aug. India's services PMI improved to 41.8 in August (+7.6 pt MoM) while the Manufacturing PMI printed at 52.0 in August (+6.0 pt MoM). Within the forward-looking demand indicators recovery was seen in Composite PMI new orders which came at 45.4 (+7.6 pt) and Composite PMI new export orders at 40.2 (+4.6 pt).

July IIP contracted by -10.4% (YoY) vs. 15.8% contraction in June and 33.9% contraction in May. Seasonally adjusted IP was still at about 89% of its pre-pandemic levels in July, up from 83% in June. Consumer non-durables eased to 110% of the pre-pandemic level in July from 115% in June. Capital goods production also rose in July, taking it to 79% of pre-pandemic levels. Infrastructure goods, which are more linked to government investment policies and spending than to the private business cycle, are recovering faster and rose to 89% of pre-pandemic levels.

India's monthly merchandise trade balance at US$6.8bn in August widened from US$4.8 bn in July. Merchandise exports were down 13% (YoY) in Aug (vs. 10% decline in July) and imports were down 26% (YoY) in Aug (vs 28% decline in July). Imports ex Oil and Gold declined 30% YoY (vs. 29% decline in June), the 19th consecutive month of (YoY) declines. India's FX reserves are close to their all-time peak at $545 bn as of September 18. INR depreciated by 0.2% and ended the month at 73.77/$ in September.

Benchmark 10-year treasury yields averaged at 6% in Sep (4 bps higher vs. August 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 0.68% (-98 bps over the last 1 year).

Brent oil price declined 7.7% (MoM) in September to end the month at US$41.0/bbl following a 3.7% (MoM) gain in August. YTD, oil prices are still 38% down.

Fiscal deficit for Apr-Aug came at INR 8.7 tn or 109% of the budgeted FY21 deficit (INR 8.0 tn). This compares to 79% reached during the same time frame in FY20. The central government has retained its market borrowing target of INR 12 tn for FY21. The government will borrow INR 4.34 tn (36% of the budgeted borrowing) in 2HFY20.

Cumulative rainfall is tracking +9% ahead of the long-period average (LPA) levels on an aggregate basis (over June 1 – September 30, 2020). North West India (-16% vs LPA) is lagging while Southern Peninsula (+29% vs LPA) and Central India (+15% vs LPA) and Eastern India (+6% vs LPA) have received higher than normal rainfall.

OUTLOOK

Indian equities market outperformed Emerging Markets for the second month running mainly on account of decline in active COVID cases and improvement in economic activity as reflected by high-frequency indicators. COVID case addition rate at 83k/day is down 11% from its mid-September peak. Daily fatality rate at ~1k/day, is still high, though off-peak.

The economy is responding positively to the reopening process. The continued reopening of the economy and preparation for the upcoming festive season has driven continuous improvement in the high-frequency indicators. Late-September data shows improvement in e-way bill generation (up to Feb'20 peak run-rate levels), E-toll collections (3% above pre-COVID levels), rail freight, and electricity consumption. Car/2W registration data is also strong on a MoM basis.

Unemployment data continues to improve and is now back to pre- COVID levels. Petrol and Diesel consumption are now 2% & -6% (YoY), respectively. Further, Sep'20 GST data shows that broader economic activities (in value terms) recovered to +4% (YoY), a first positive month since Mar'20.

The government passed key agriculture reforms to deregulate agriculture commodities and liberalize agriculture marketing. The government has now deregulated key commodities (including cereals, edible oils, oilseeds, pulses, onions, and potatoes). This will enable adequate choice for farmers to sell their products and allow barrier-free interstate trade in agriculture commodities. Currently, farmers are bound by a monopsony. The government has also introduced legislation that provides for a farming agreement between farmers and buyers prior to the production or rearing of any farm produce. On a Pan-India basis, this reform is another step to boost the Indian rural economy.

Further, monsoon trends continued to be positive as cumulative rainfall is now +9% ahead of the long-period average (LPA) levels on an aggregate basis (over June 1, 2020 – September 30, 2020). This augurs well for the farmers' income and thus rural economy and demand.

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 93% of the pre-COVID levels. Further, the good progress of monsoon bodes well for both the rural economy and the overall demand. Additionally, the Government's continuous focus on Agri & labor reforms is highly positive. India's long-standing ambition to succeed in manufacturing is seeing a renewed push. The focus is on import substitution.

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. The economic developments are 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.

Large cap index underperformed the broader market for the second month running and thus the stocks selection within mid and small cap segments has become incredibly important for higher performance. We continue to stick to the companies having core competitive advantage, strong balance sheet and having the ability to generate sustainable cash flows.

Source: Bloomberg, MSCI