The new normal

India Outlook - 2020

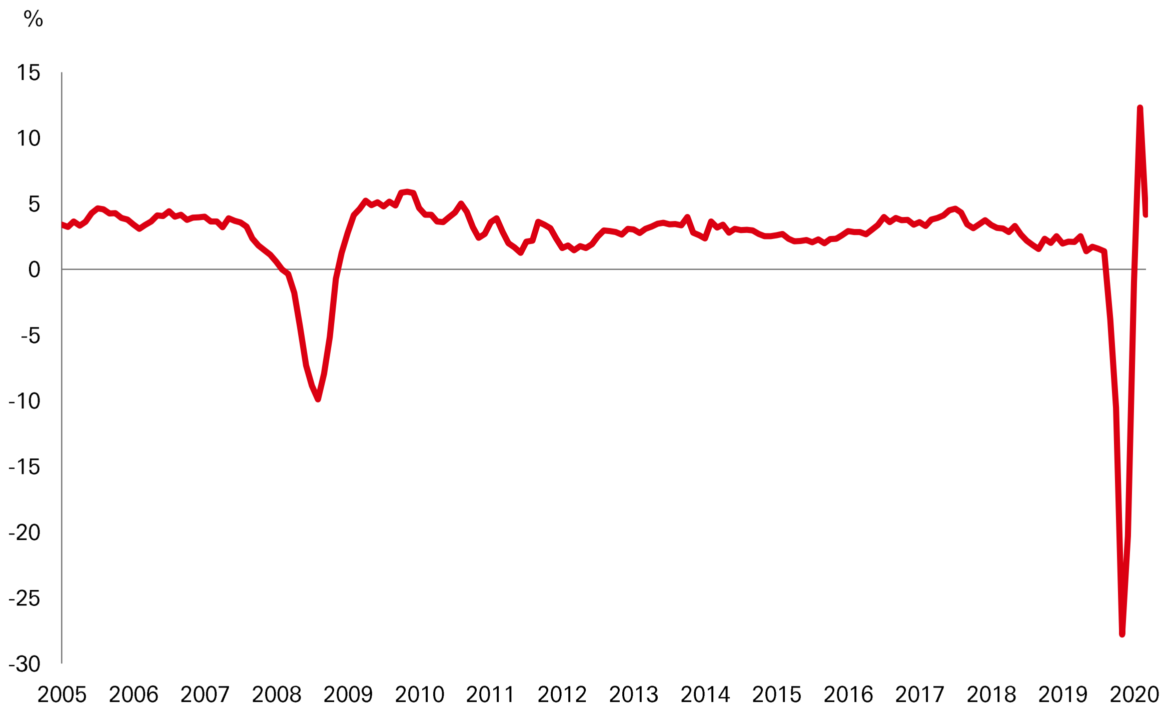
HSBC
Global Asset
Management

September 2020

The most historical year of the 21st century

- 2020 may go down as **the most historical year** with the **outbreak of COVID-19 and resultant lockdowns** across the globe and also in India, which saw one of the severest lockdowns since March ’20
  - Supply chain issue at the start of the year
  - Various industries grounded to a halt, such as travel and manufacturing
  - Plunge in oil prices, exacerbating stress in financial markets
- The **epicenter of the disease shifted** from China to Europe in April and then to US, Brazil and India
- This led to **significant contraction in economic output and volatility** in capital markets and widespread dislocation of markets and industries; consumption patterns took a deep dive; Cash flow in enterprises dropped and dislocation started in labour markets
- India economy virtually sputtered to a halt by April ‘20
- Following the **fastest bear market of all time came the fastest recovery**

Global Growth Nowcast (real-time GDP measure) - HSBC GAM

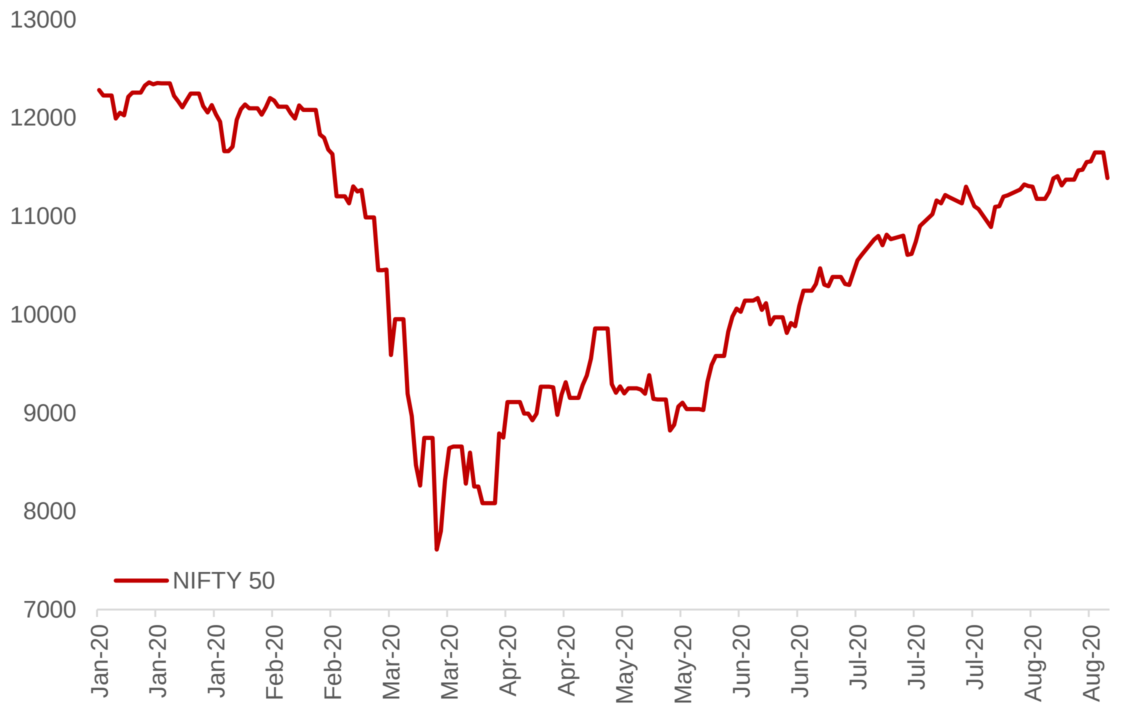


Covid-19 and measures to fight it have created one of the largest macro shocks in history

Fastest bear market of all time followed with the fastest recovery

- With improved FPI inflows India markets staged a rally to recover from March lows. This **rapid reversal has been labelled as “irrational”**, but this view is incorrect – the recovery since mid-March has been due to:
- **Markets being forward-looking**. A significant Global policy responses including from RBI and that coupled with global and Indian governments’ economic relief initiatives further supported in economic recovery since April ‘20 onwards
  - A reduction in extreme downside risks following **bold policy support -** Cutting of interest rates, providing funding to businesses and financial support for individuals. The **goal is to limit an inevitable recession** and try to stimulate faster recovery
  - **Asia as an indicator**: “back to work” dynamic in industrialised Asia
  - **Market drivers:** gains or stability in certain sectors
  - The extent of the **rebound has varied across asset classes and sectors**

India equity market performance (Nifty 50 : YTD - 2020)

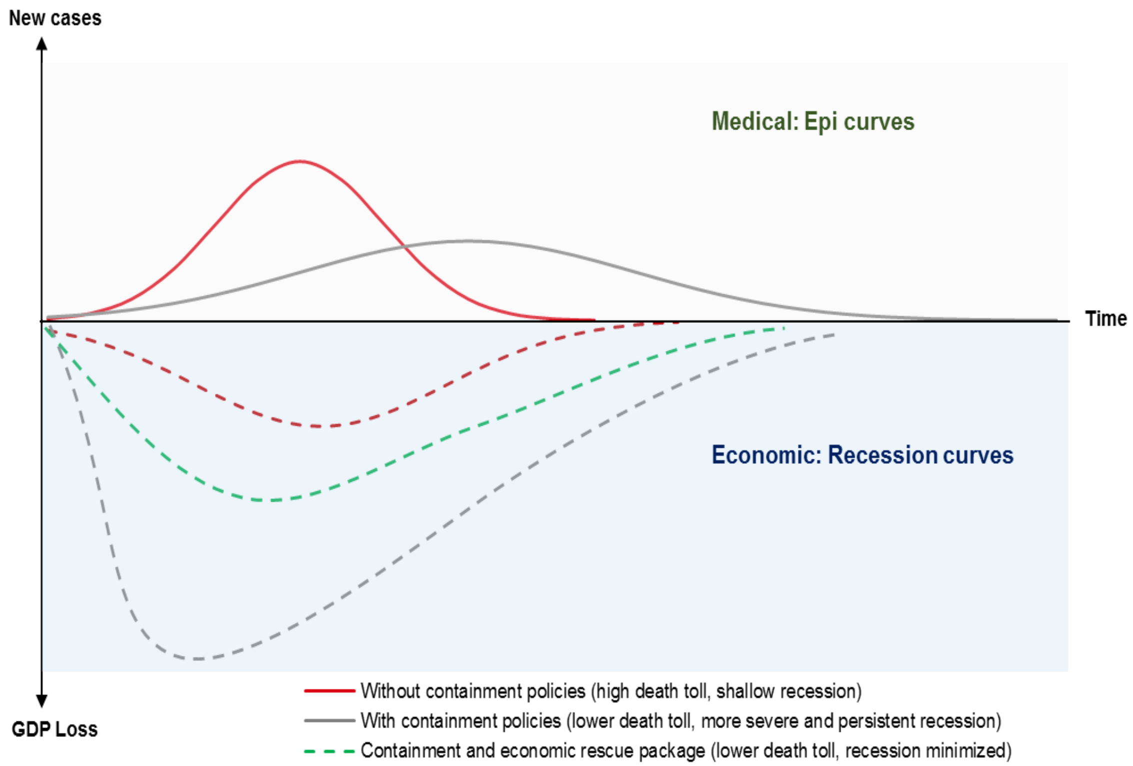


‘Irrational rapid reversal’ talks go away when we remember markets are forward looking

Flattening the curves – minimising lockdown effect

- India went in for one of the **severest lockdowns** since 22 March ’20. Complete lockdown was extended till May ‘20 across India.
- India continues to be in a **partial lockdown** situation which is now reviewed every month and some exemptions are allowed.
- The crisis has **frozen corporate paper market**
- **Credit markets spreads rocketed**
- While India remained in lockdown state, **Interest rates were slashed by the RBI** which led to a significant rally in the GOI bond markets
- With focus on liquidity **near term bond markets rallied significantly more than long term bonds**
- **India announced Economic Relief Package** to minimise expected damage to the economy

Economic: Recession curves



Health policies flatten the “epi curve” & economic policies flatten the “recession curve”

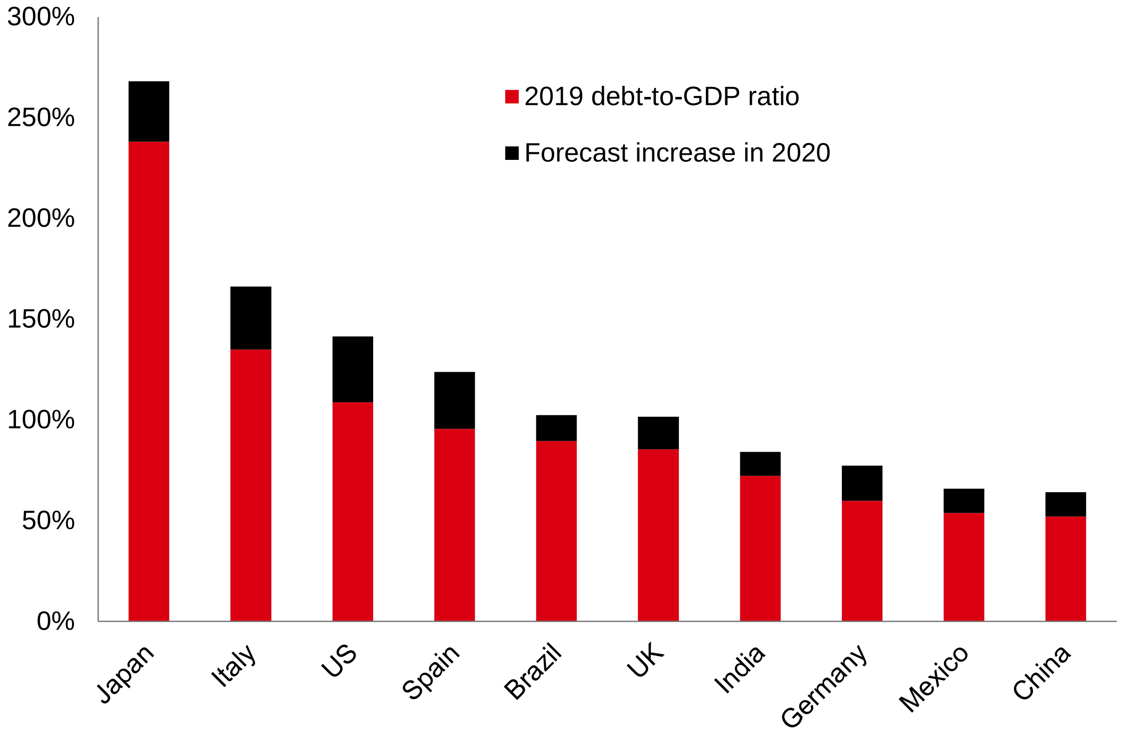
Source: HSBC Global Asset Management, research by Baldwin & Gourinchas at VoxEU,, Content as at August 2020

What triggered the global market recovery?

- Unprecedented (and timely) fiscal and monetary policy support coupled with signs that exponential growth rates of new Covid-19 cases were slowing helped reduce the "disaster risk premium" in risky asset classes

G20 public debt (% of GDP)

Gross government debt-to-GDP ratio



	US	EU	China	Japan	UK
Policy rates	150bp cut	Lower bound	30bp cut; RRR reduced	Lower bound	65bp cut
Asset purchases	Unlimited	EUR 1.35tn	Equity market support	ETF and JGB support	GBP 300bn
Short-term paper support	USD 1tn CPFF	✓	X	✓	Unlimited
Liquidity schemes	Swap lines	LTRO operations	CNY 800bn relending	✓	Term Funding Scheme
Lower capital buffers	✓	✓	?	x	✓

	Policy rates	RBI measures	GOI policies	India relief package
India*	Cumulative 155bp rate cut in CY20	~8 Lakh Cr (~3.8% - GDP)	~13 L Cr (~6.2% of GDP)	~21 Lakh Cr (~10% of GDP)

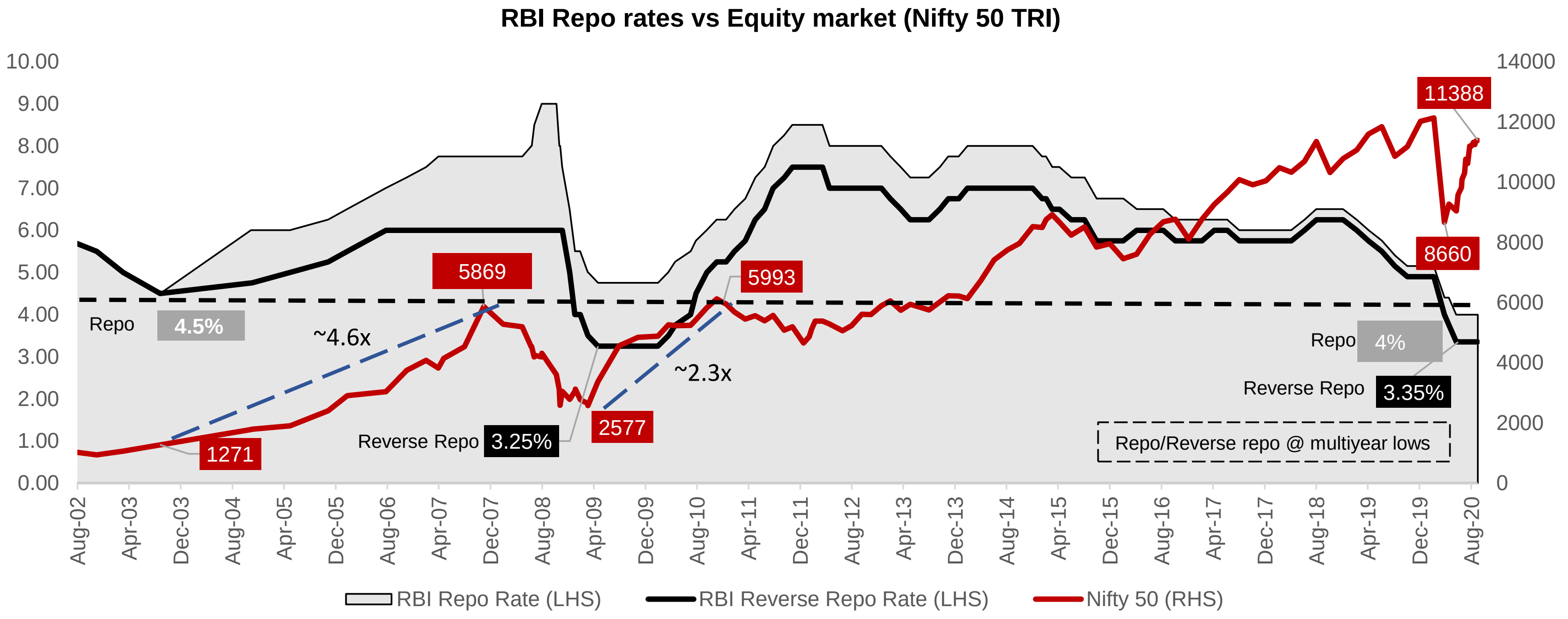
"Whatever it takes" moment for fiscal and monetary policymakers - Tail risk reduction

Sources - HSBC Global Asset Management, RBI and GOI announcements, Data as at August 2020

Note - based on the headline announcements, however the actual outlay especially on the fiscal measures are estimated to be lower

Policy measures by the Indian government and RBI to support recovery

- RBI delivered overall 155bps rate cuts since February 2020 to bring repo rates to multiyear lows of 4%
- RBI continues maintained accommodative stance
- Also RBI announced additional liquidity measures and debt moratorium option which was also extended for another quarter
- The Economic Relief Package had proposed quantum of INR 21 Lakh Cr which is as big as ~10% of India's GDP



Encouraging economic relief package - 10% of GDP

Source: RBI, Bloomberg, Repo, Reverse Repo, Nifty 50 data, as at August 2020.
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Tracking the recovery

Composite PMIs

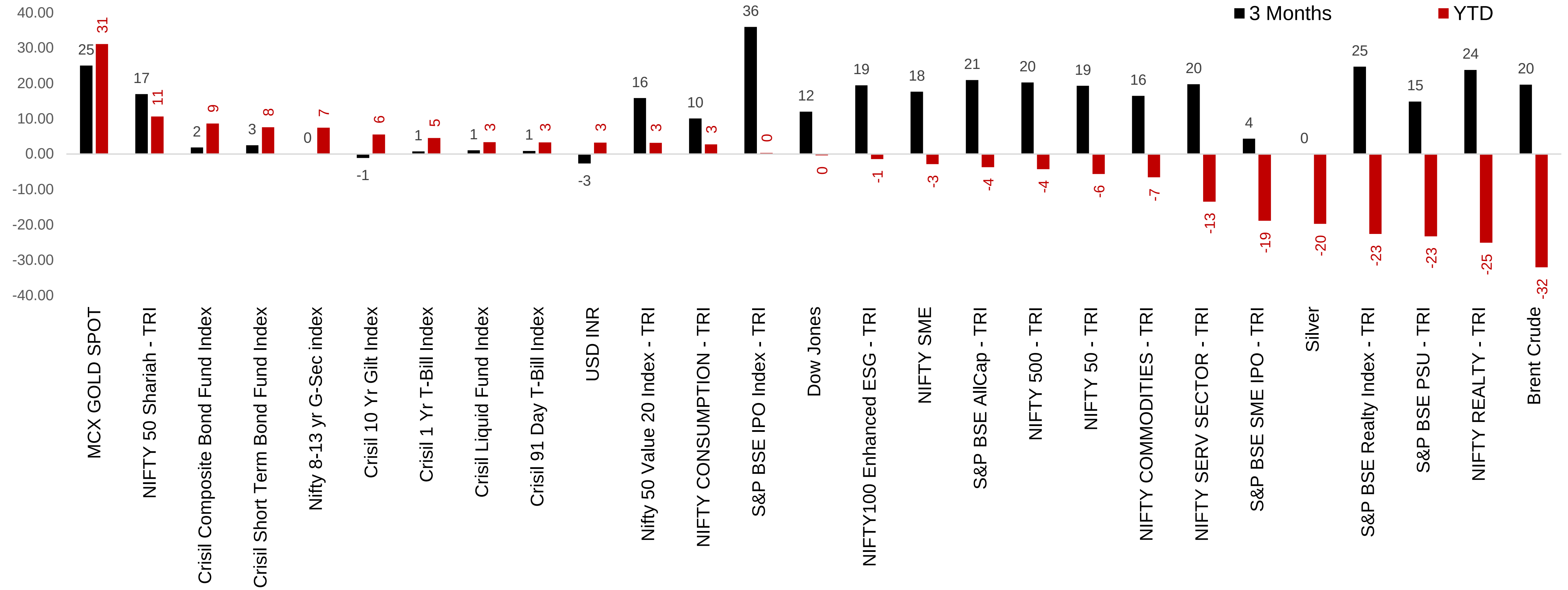
	Sep-19	Oct-19	Nov-19	Dec-19	Jan-20	Feb-20	Mar-20	Apr-20	May-20	Jun-20	Jul-20	Aug-20
World	51.1	50.8	51.4	51.5	52.1	46.1	39.2	26.2	36.3	47.8	50.8	--
Developed Markets	50.7	50.3	50.8	51.2	52.1	49.5	36.4	22.2	33.2	46.9	51.1	--
Emerging Markets	51.8	51.8	52.6	52.1	52.2	38.9	44.9	34.6	42.7	49.7	50.8	--
United States	51.0	50.9	52.0	52.7	53.3	49.6	40.9	27.0	37.0	47.9	50.3	54.7
United Kingdom	49.3	50.0	49.3	49.3	53.3	53.0	36.0	13.8	30.0	47.7	57.0	60.3
Eurozone	50.1	50.6	50.6	50.9	51.3	51.6	29.7	13.6	31.9	48.5	54.9	51.6
Germany	48.5	48.9	49.4	50.2	51.2	50.7	35.0	17.4	32.3	47.0	55.3	53.7
France	50.8	52.6	52.1	52.0	51.1	52.0	28.9	11.1	32.1	51.7	57.3	51.7
Italy	50.6	50.8	49.6	49.3	50.4	50.7	20.2	10.9	33.9	47.6	52.5	--
Spain	51.7	51.2	51.9	52.7	51.5	51.8	26.7	9.2	29.2	49.7	52.8	--
Ireland	51.0	50.6	52.0	53.0	54.7	56.7	37.3	17.3	25.7	44.3	55.9	--
Japan	51.5	49.1	49.8	48.6	50.1	47.0	36.2	25.8	27.8	40.8	44.9	44.9
China	51.9	52.0	53.2	52.6	51.9	27.5	46.7	47.6	54.5	55.7	54.5	--
India	49.8	49.6	52.7	53.7	56.3	57.6	50.6	7.2	14.8	37.8	37.2	--
Brazil	52.5	51.8	51.8	50.9	52.2	50.9	37.6	26.5	28.1	40.5	47.3	--

Dip in PMI looks like following up with reasonable recovery

Source: HSBC Global Asset Management, Macrobond, August 2020.

Significant recovery across asset classes in India post COVID-19 led market correction

Asset classes and themes - indices performance%



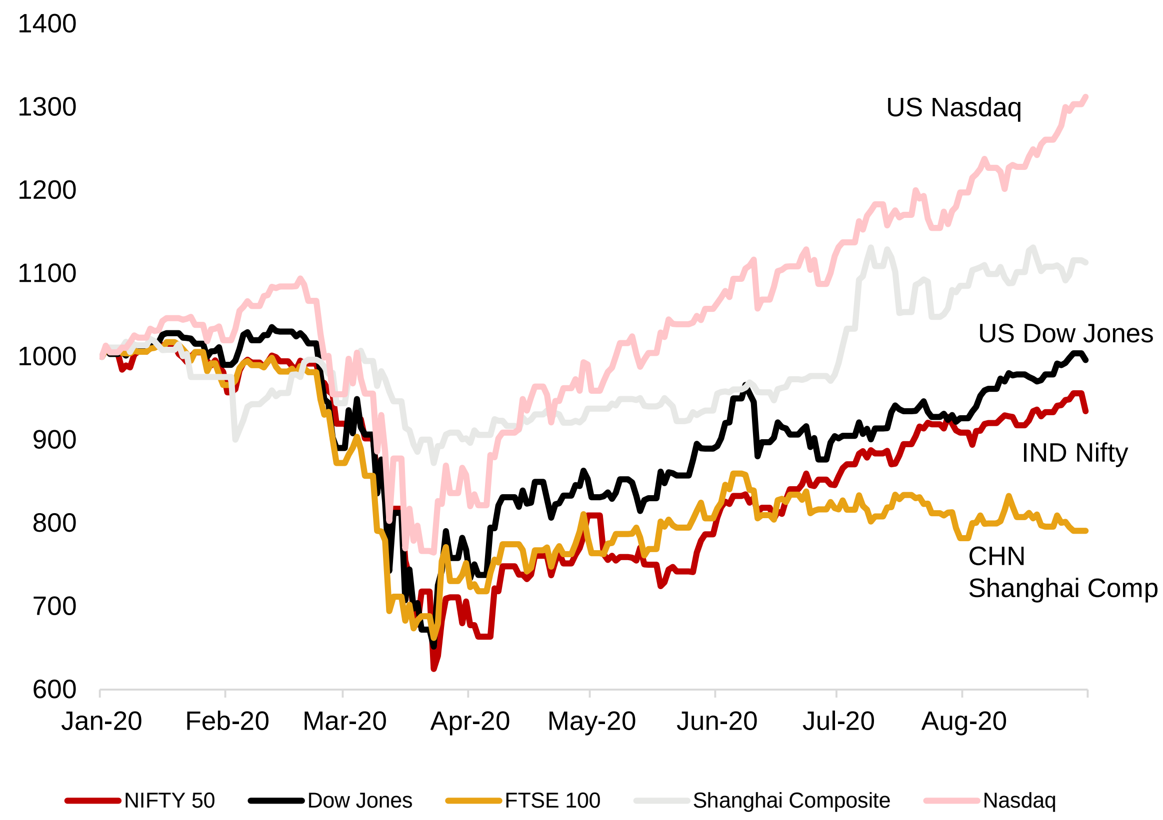
Post lockdown (past 3 months) most asset classes showed reversal in significant downward trend

Source: Ace MF, Indices performance, Data as at August 2020

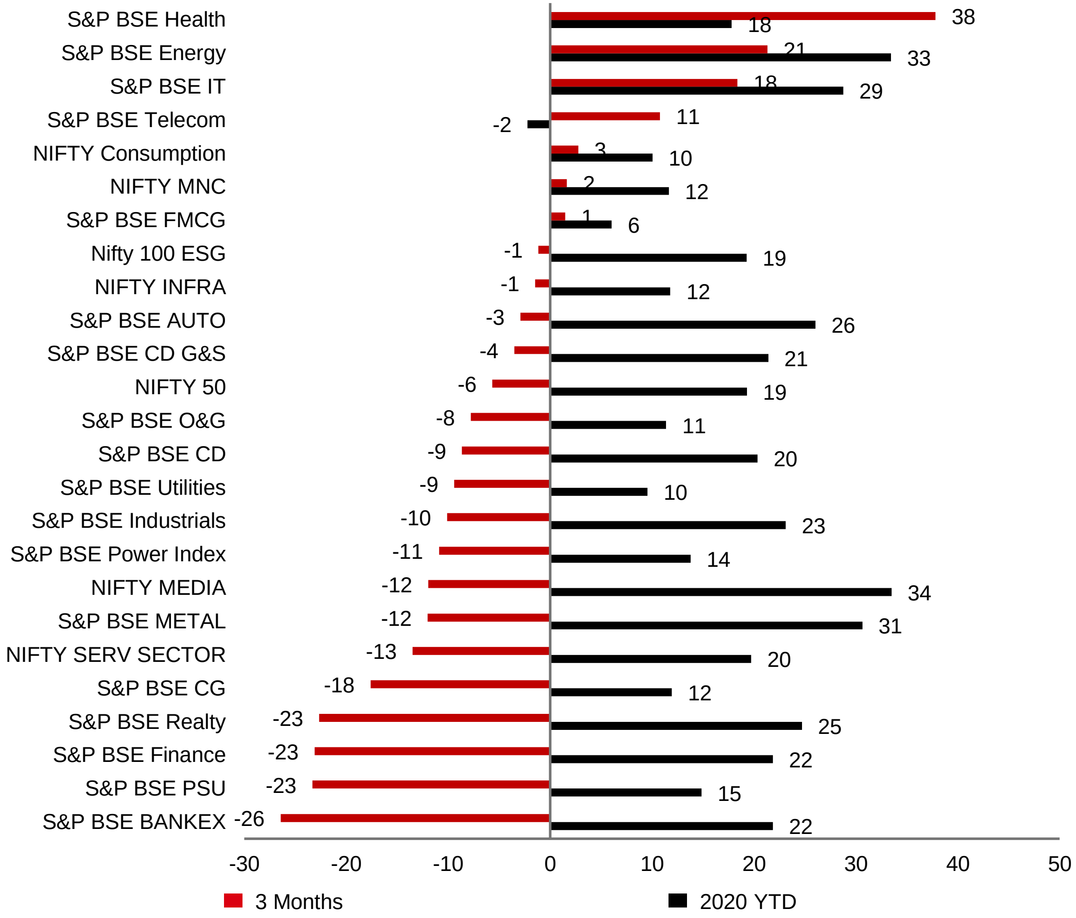
Mutual fund investments are subject to market risks, read all scheme related documents carefully. Past performance is not a reliable indicator of future performance

The stock market is not the same as the economy, sector effects matter

India markets vs others in 2020



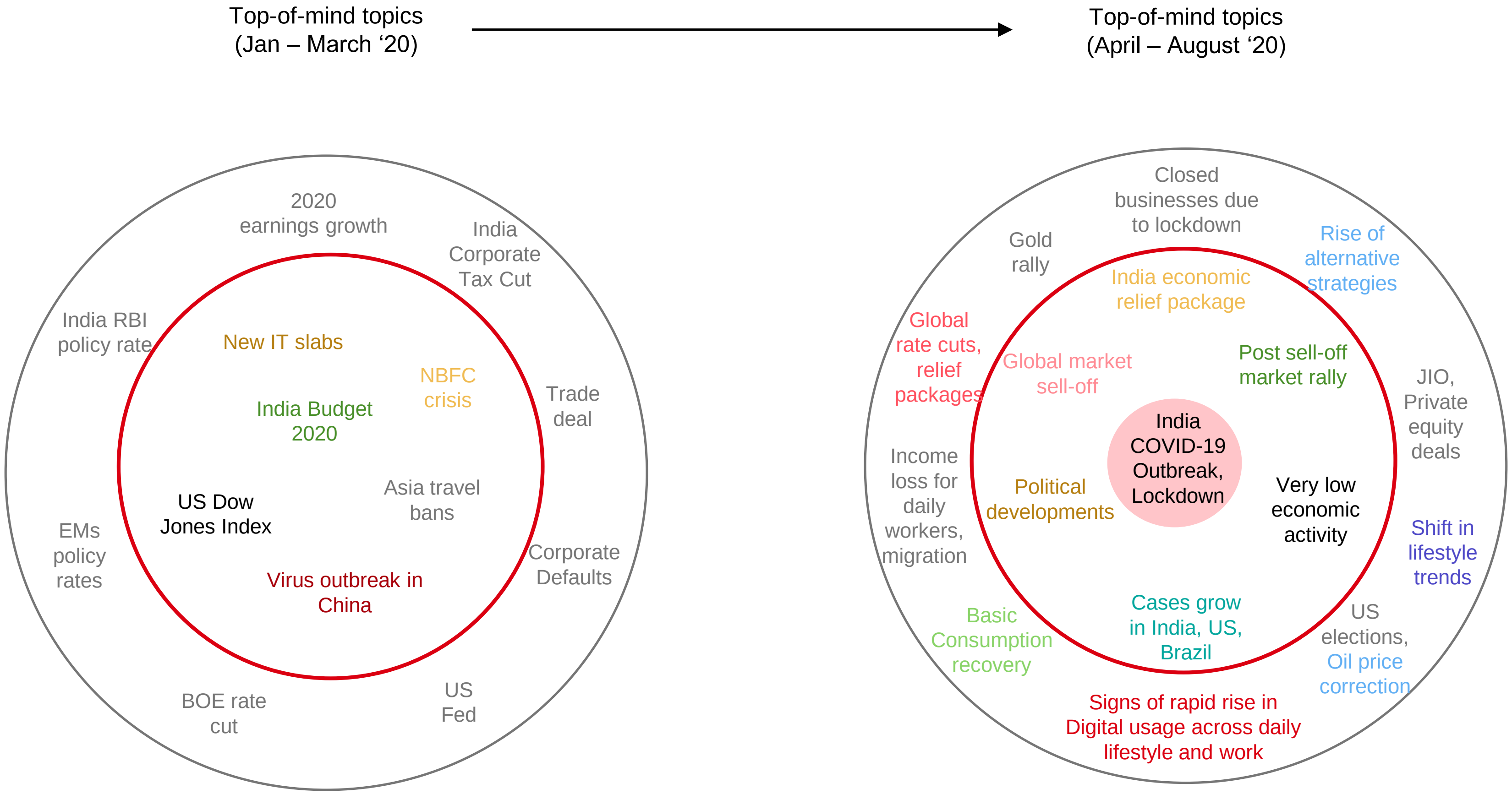
India - Sector and major themes performance in 2020



Market driven by gains / stability in select sectors

Past performance is not a reliable indicator of future performance.
Source: ACE MF, India Market vs others data as at August 2020

A shift in the structure of beliefs

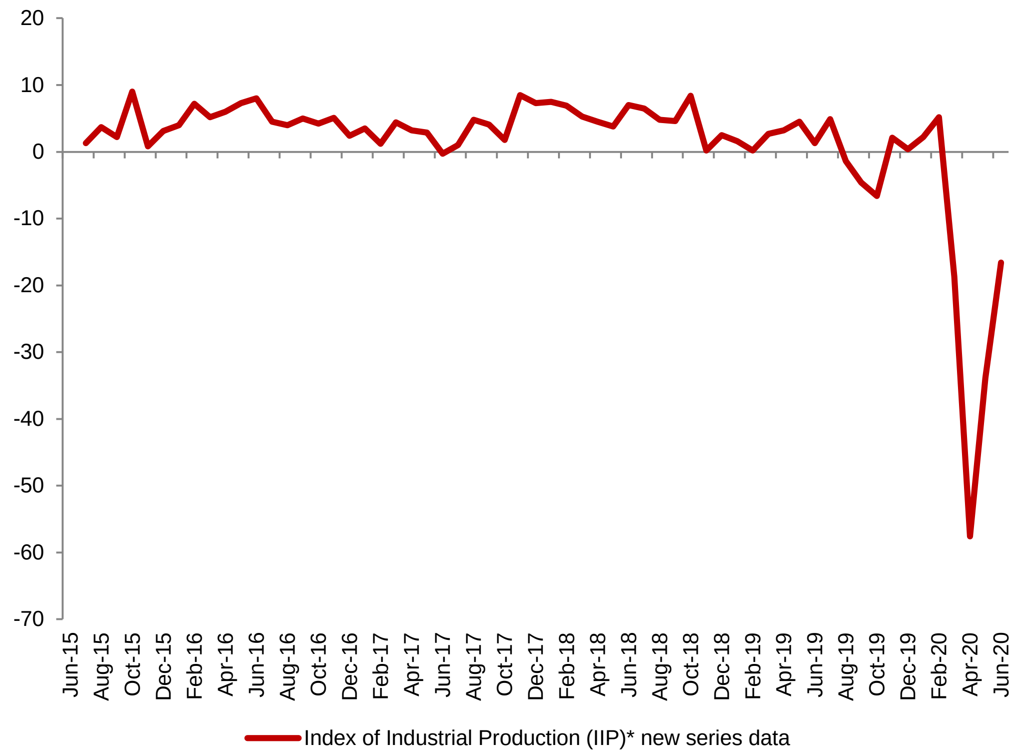


Source: HSBC Asset Management, India, Data as at August 2020.

Economic indicators vs coronavirus spread

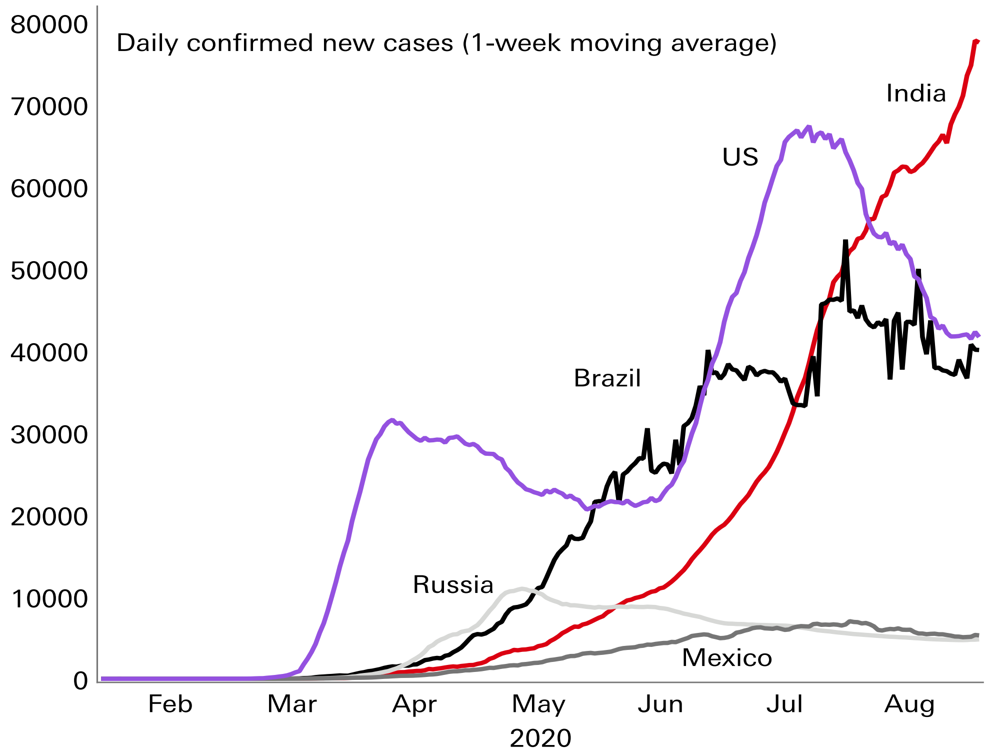
With relaxation in lockdown we may have already seen the lowest levels of IIP numbers

Index of Industrial Production (IIP)



…But virus risk remains

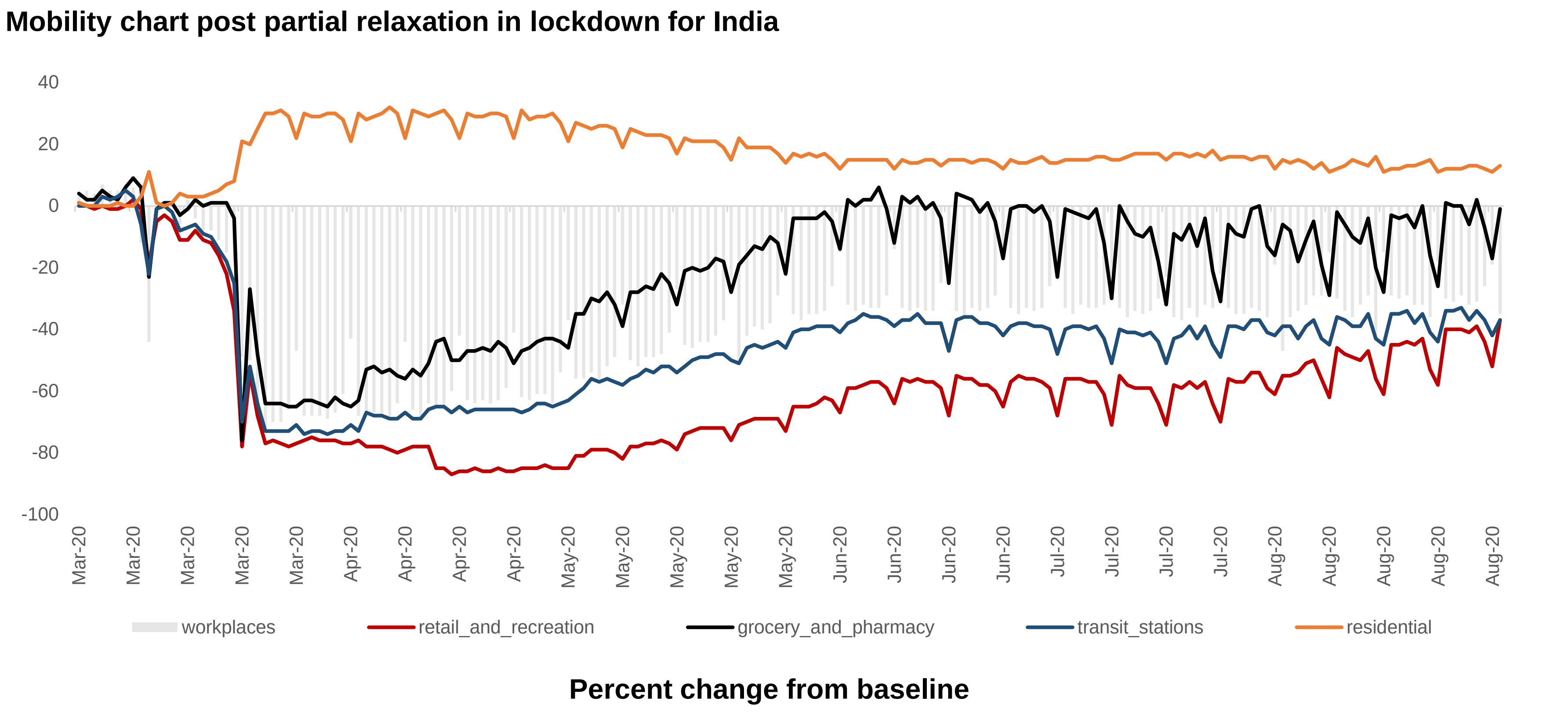
Daily confirmed new cases (5-day moving average)



Indication of bottoming out of economic indicators, but subject to some control over virus spread

Source – Bloomberg for IIP - data with a lag and subject to further revision, Source – HSBC Global Asset Management – Macrobond, Data as at August 2020

India - attempting to go back to The New Normal post partial relaxation in lockdown



Consumption (grocery-pharmacy)
-1%

Workplaces
-35%

Public transport (Transit stations)
-37%

Discretionary spend (Retail & recreation)
-37%

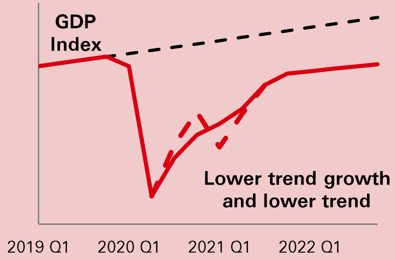
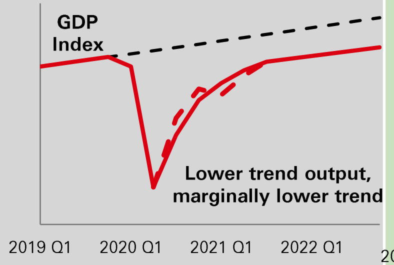
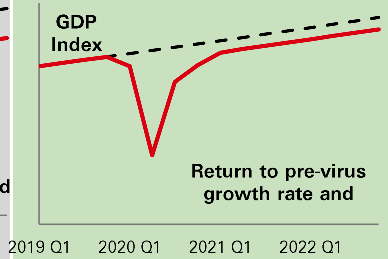
Residential (Places of residence)
+13%

Workplace activity recovered to about -35% at the end of Aug ‘20 vs -61% average in Apr ‘20

Source: Google mobility report India, Data as at August 2020.

Outlook - Possible global market recovery scenarios

- Looking ahead, our baseline **global growth** scenario is for a "**swoosh recovery**" where growth rebounds strongly before moderating to eventually restore the bulk of lost output
- In practice, however, there are **downside risks**. The risk of a second-wave of the virus looms large, the potential for fiscal policy "under delivery" is high, plus there is a likelihood of long-term economic damage to trade flows or labour markets
- **Different economies have different capacities to absorb the shocks**, and regional dynamics could look quite different.
- Meanwhile, global **government bonds offer very low future returns** even as fiscal policy support is becoming more important. This means we need to think harder about how to achieve diversification
- In India spread continue to harden and increased bond supply is expected to keep **bond rates anchored in the longer term**
- Finally, environmental and social issues are likely to move to the top of the agenda in a society more focussed with sustainability. This elevates the importance of **sustainable investment** considerations
- Overall, these developments create **selective opportunities** for investors with a greater emphasis on regional allocation, styles and sectors

	Stagnation (25%)	Recovery (60%)	Rapid recovery (15%)
All scenarios see abrupt fall in activity	**Slow and partial recovery** 	**"Swoosh"** 	**Partial V** 
Pandemic assumptions	➢ **Vaccine:** Start of 2022 ➢ **Renewed outbreaks:** Second wave Q1 2021 ➢ **Restrictions: Completely removed from Q4 2021**	➢ **Vaccine:** Mid-2021 ➢ **Renewed outbreaks:** Isolated, contained ➢ **Restrictions: Completely removed by mid-2021**	➢ **Vaccine:** Start of 2021 ➢ **Renewed outbreaks:** Minimal ➢ **Restrictions: Completely removed from start of 2021**
Macro assumptions	➢ **Support policies:** Cannot prevent significant reduction in the level of potential output and its growth rate ➢ **Activity:** Modest recovery from mid-2020, but output remains well below previous trend.	➢ **Support policies:** Pre-virus trend growth rate is broadly maintained ➢ **Activity:** Recovery starts mid-Q2. Economy reverts to its new lower trend by Q42021	➢ **Support policies:** Pre-virus trend growth rate is fully maintained ➢ **Activity:** Recovery starts mid-Q2. Economy reverts to its new, lower, trend in H12021

Spread of the virus ⟵ TENSION BETWEEN TWO FORCES ⟶ **Policy effectiveness**

Sources - HSBC Global Asset Management, HSBC Asset Management, India, Data as at May 2020, Note: Dashed red lines in charts indicate the scenarios are consistent with different paths for activity; the scenarios describe the broad trends

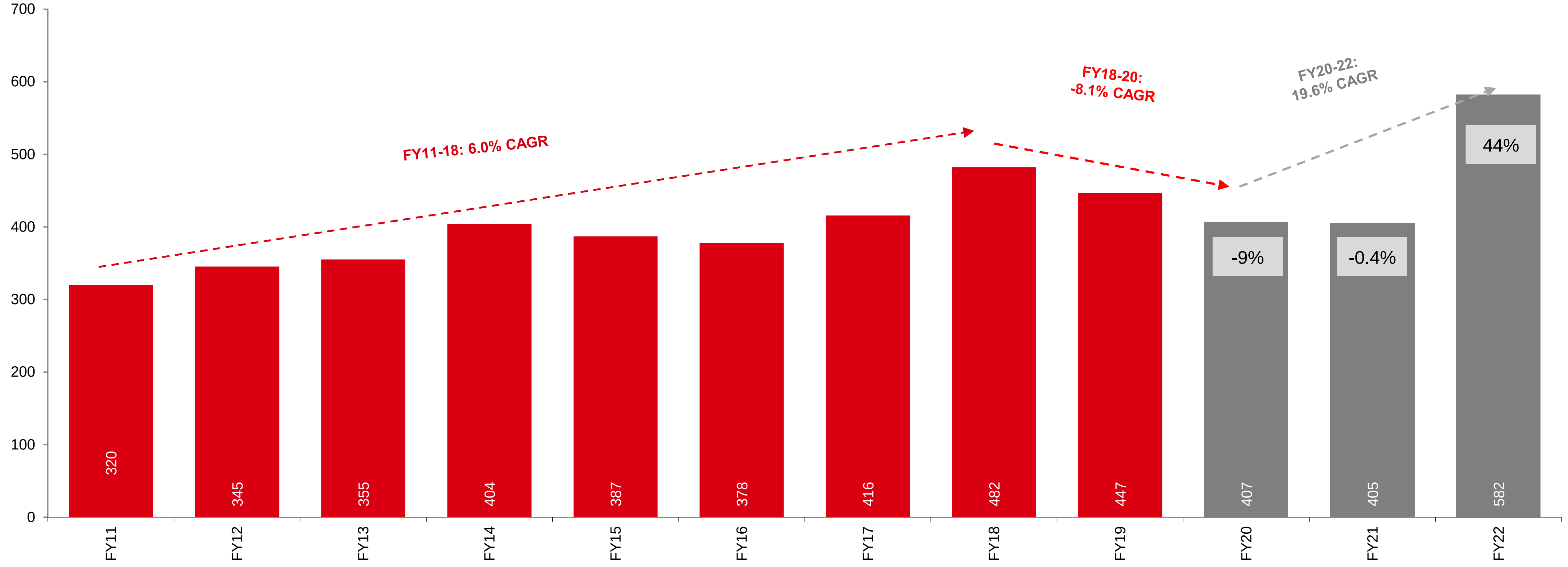
Region wise outlook

	Comment	Stagnation	Recovery	Rapid recovery
US	The lockdowns adopted to suppress COVID-19 have driven US unemployment to post-WWII highs. Consumers have retrenched with a record increase the saving rate. However, the US monetary and fiscal response has been among the most forceful globally which should support a recovery as lockdowns are eased			
Eurozone	Many eurozone countries have been hard hit by the virus and thus have implemented relatively stringent lockdown measures. The national level fiscal response has been significant, with job retention schemes important in limiting the rise in unemployment. But coordinated fiscal policy remains hamstrung by political constraints, while the ECB is pushing against the limits of it mandate			
UK	The UK's economic policy response to the crisis has been timely and robust and should support a solid rebound in output once lockdowns are lifted. Nevertheless, problems with developing adequate test-and- tracing infrastructure increases the risks of a second wave of infections. A disruptive hard Brexit at the end of 2020 is also possible			
China	China has seen a notable recovery from supply-side disruptions with improvements in the industrial, construction, real estate, tech and auto sectors, but the path is uneven and selective consumer (services) sectors are lagging. A return to pre-COVID-19 lives in the near future is unlikely and external (trade) risks loom large. Policy support is strengthening, despite lingering financial stability/debt concerns			
Japan/ developed Asia	Many industrial Asian economies have relaxed containment measures amid lower infection rates and appear better prepared for exit given their testing and contact tracing capacity. They look to lead in activity normalisation, amid strong policy support (many have sufficient fiscal space), though a degree of restrictions and behavioural caution will persist and income losses and weak external demand are risks			
EM Asia	Parts of ASEAN and India face a more difficult policy trade off between public health cost and the economic loss from containment, particularly those with limited fiscal space to offset the income loss. Most have started to reopen the economy and increased policy support, allowing gradual activity normalisation, but some lack strong health resources or infrastructure. The region faces external trade and financing risks			

Source: HSBC Global Asset Management, May 2020.

Equity markets move with earnings

Earnings per share for Nifty 50



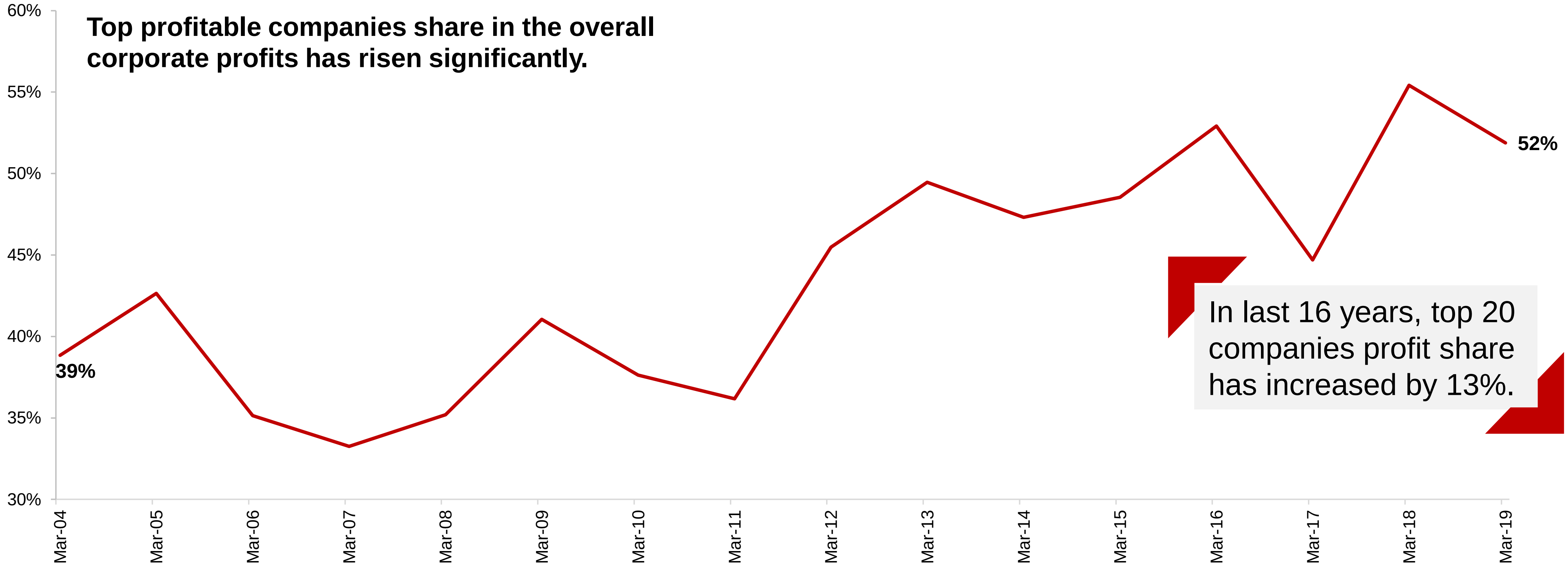
Earnings recovery expected by FY2022

Source: CRISIL, Bloomberg, Data as at August 2020, FY20 to FY22 - Estimates,

Past performance is not indicative of future performance, past performance may or may not be sustained in the future

Profitability of companies is getting concentrated among few players

Ratio of Top 20 Indian profitable companies' profit to the Total corporate profit

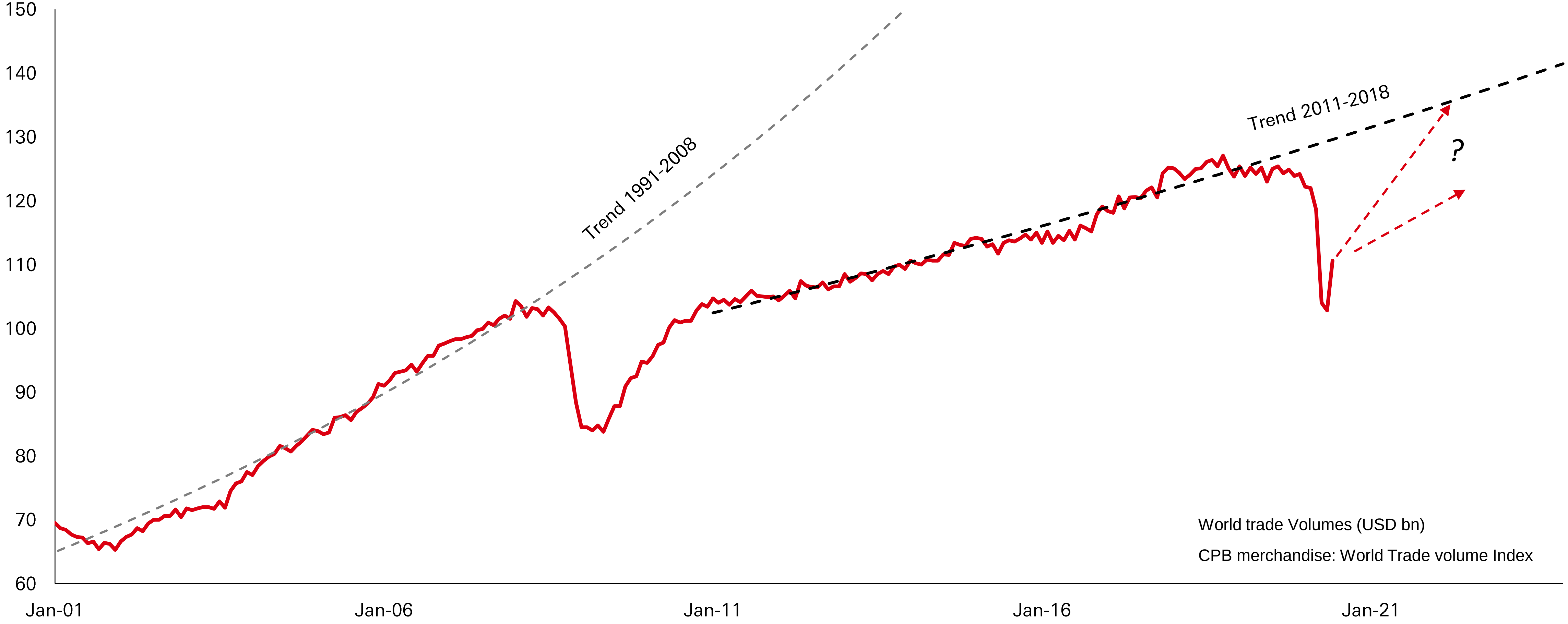


Focused strategies can help in the current market environment

Source: Bloomberg, MOSL, Data as at March 2019, For illustration purposes only
Profit of 20 most profitable listed companies in India to the total profit of India's listed companies

A retreat of hyper-globalisation

Global trade volumes, what happens next?



Risks to growth, but opportunities available for India if able to adapt

Source: Bloomberg, HSBC Global Asset Management, Data as at June 2020

 World trade volumes index (seasonally adjusted)

Structural shift to accelerate - Time to re-write the India rule book

Post COVID – 19, expectations on India's further journey

- Thrust on domestic manufacturing with incremental policy initiatives for businesses on this front to spur economic growth
- Revamp of health policy and medical infrastructure
- Strengthening of the digital ecosystem and Infrastructure – For efficient & targeted policy delivery and growth of the new age businesses
- Growth oriented agenda of government and RBI
- Accommodative monetary policy
- Fiscal policy discipline –sticking to the FRBM framework over the medium term
- Plugging the wastage – DBT and redirecting subsidies to productive use
- Benefits of tax reforms to flow through – higher revenues and the broadening of the tax base
- Further liberalisation of FDI norms
- Privatisation and improving the productivity of state entities

MAKE IN INDIA

Source: Bloomberg, HSBC Global Asset Management, India, PMJDY, UID – Aadhaar, India, Make in India logo, Data as at August 2020

Core investment strategy themes

Multiple equilibria

- Economic uncertainty in the short term is very high. There are “multiple equilibria” or possible outcomes
- Our baseline scenario is for a “swoosh recovery”
- Economic outlook and earnings will remain challenged for the entire financial year
- Valuation upsides possible where earnings appear sustainable and market share gains are visible

Great rebalancing

- A return to normalcy in the next few months should see a gradual recovery by 2HFY21.
- We aim to focus on assets such as high-quality corporate bonds and quality stocks considering ‘big will get better’ trend
- FY22 is likely to see a favourable base and with economy normalising, the earnings growth trajectory is likely to see a meaningful improvement.

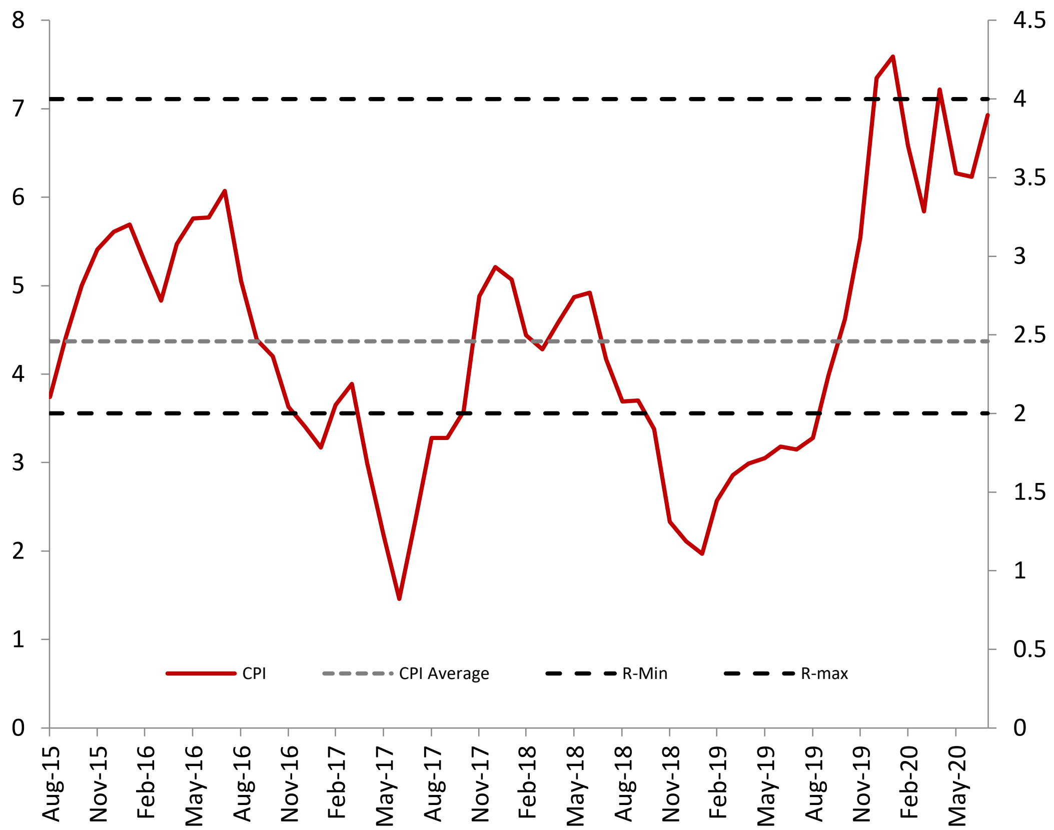
Structural shifts accelerate

- The crisis has accelerated a number of structural trends which were already underway
- These changes in globalisation and trade, populism, and environmental and social issues can no longer be ignored by investors
- A narrow select group of companies will continue to thrive in an otherwise uncertain near term

Fixed Income outlook and strategy

- While there have been divergent India rating actions in June ‘20, overall rating actions **did not have any significant impact** on the markets.
- While the **contraction in IIP and other data is a representation of lockdown impact**, prospectively we would expect data to improve as the lockdown has been easing in many pockets of the economy.
- While **supply side uncertainty continues** to linger, positive sowing data and **a normal monsoon should keep the food inflation contained**.
- Until there is a strong recovery in demand, **pressure from core inflation may not arise**. Therefore, inflation trajectory while uncertain, does not seem to be a serious concern for the near term.
- In the current backdrop of a **weak fiscal condition**, we expect RBI (and government) to not lift the pedal off the accelerator until the economy begins to revive.
- We expect **RBI to continue maintaining its accommodative stance** with measures aiming at rates and other policy measures supporting, growth, credit offtake and liquidity.
- Longer end of the curve, while not having any major positive triggers, is currently supported by RBI actions (OMOs, increase in HTM) and slowdown in credit offtake for banks
- In the corporate space, spread movement was in line with G-sec at the longer end. While shorter end remained supported by liquidity. Also corporate borrowing saw some pick up
- We are constructive at the low to medium term where there could be attractive carry opportunities

Inflation retreats to the RBI’s max target range



Source – HSBC Asset Management, India, Data and views as at August 2020. Note: Any views expressed were held at the time of preparation and are subject to change without notice. Any forecast, projection or target contained in this presentation is for information purposes only and is not guaranteed in any way. HSBC accepts no liability for any failure to meet such forecasts, projections or targets.

Equity outlook and strategy

- The Indian equity markets have rallied over 50% from the March lows with the broader markets catching up during the past month (after the sharp rally in August, smallcap indices are now outperforming in the market recovery phase).
- Analyzing the equity market performance, the recovery phases can be divided into two legs.
- The first leg recovery (i.e. last week of March till first week of May), was driven by attractive valuations led by sectors that were assessed to do relatively better in an uncertain environment. During the lockdown phase, the market was gyrating to supply shock initially and later to potential demand contraction.
- The second leg of the rally (which started from about third week of May and continuing till date), is characterized by broad market participation, sector rotation and catching up by laggards. The second leg of the rally is driven by optimism around the reopening of the economy, pent-up demand and rebound in economic activity indicators.
- The market has made distinction between sectors and industries which were minimally impacted and the sectors which faced major impact. The former segments have recovered faster and almost fully in most cases. Market has also made distinction between sectors and industries having temporary disruption and those with having longer lasting impact.
- 1QFY21 has witnessed a meaningful impact due to lockdown and a gradual recovery path would mean that FY21 earnings could also be at the risk for some further downgrades.
- Current market valuations are trending above historical averages.
- Our philosophy has been to invest in dominant businesses having scalable potential and that have reasonable valuations.
- Over the past few years, we’ve witnessed a trend of profit pool consolidating with the dominant players in respective sectors/industries. We believe that the trend will accelerate as the current disruption has higher magnitude as well as it encompasses more sectors.
- We also believe that, in the short term, growth will be scarce and the balance sheet strength would come under test. Therefore, we are positively disposed towards companies that have higher earnings resilience and have stronger balance sheet.

Market volatility can provide opportunities to buy growth assets

Source: HSBC Asset Management India, Data and views as at August 2020. Earnings based on Bloomberg estimates

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