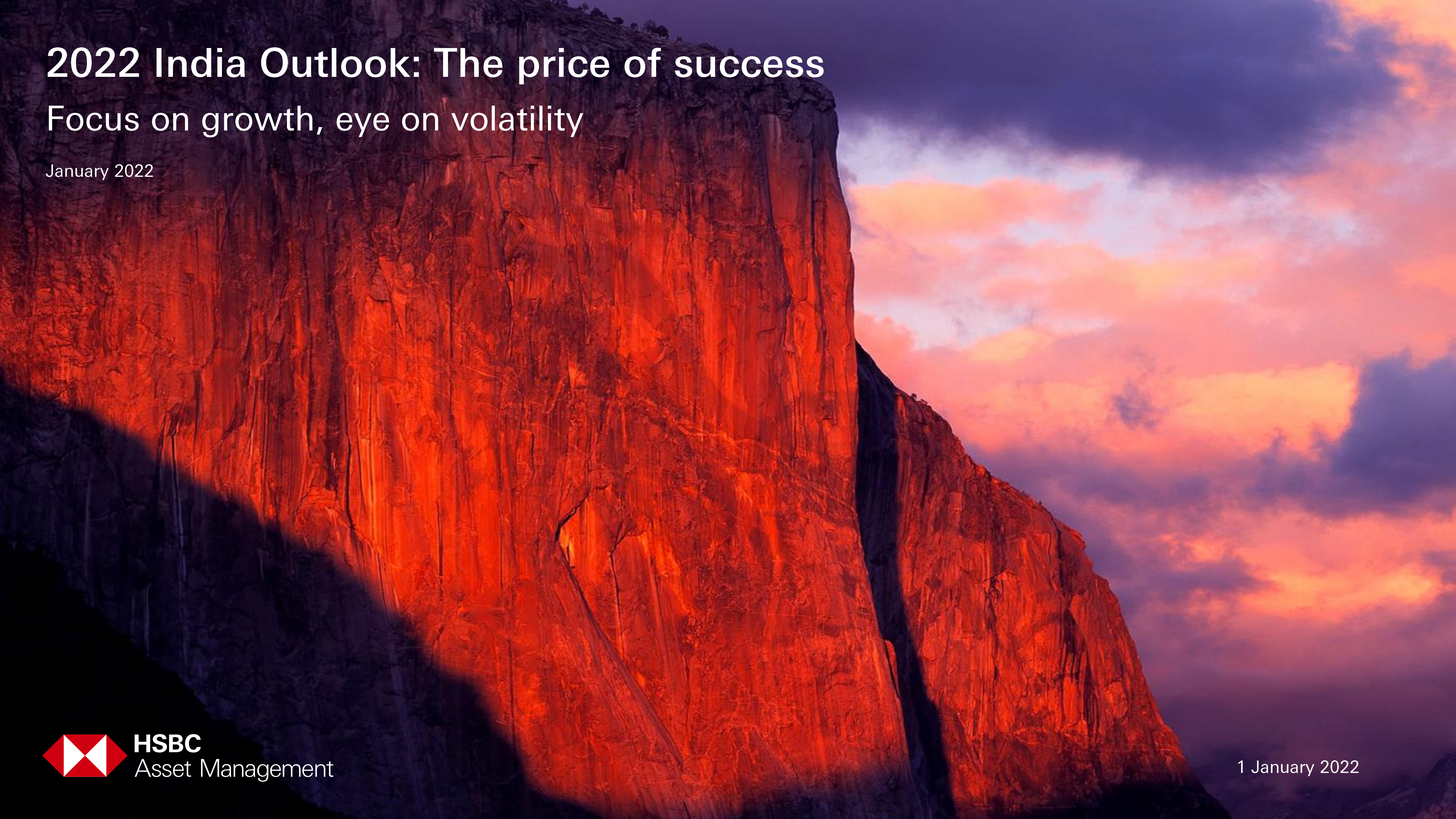


2022 India Outlook: The price of success

Focus on growth, eye on volatility

January 2022

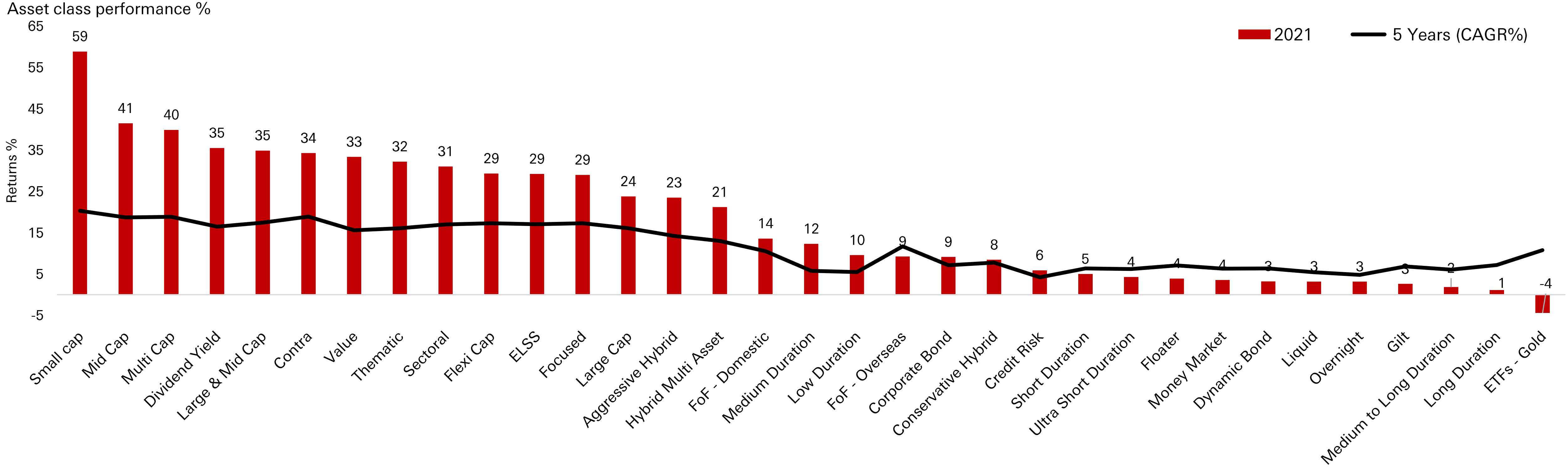
HSBC
Asset Management

1 January 2022

What do we mean by success?

Success in markets

A major follow-up rally in Indian equities in 2021 post recovery from COVID and lockdowns



Indian equities recovered in 2021 to take back a title of the best asset class post 2020 COVID led slump

Equity

Delivered relatively moderate to above average performance

Hybrid, Fixed Income & Multi-asset

Delivered relatively low - moderate performance

Fixed Income (FI)

Underperformed

Medium / Long duration FI & Gold

Equities have significantly outperformed other asset classes

Source: ICRA, Data as of 31 Dec 2021, Mutual Fund (MF) Categories: as per SEBI defined category fund list, MF category average returns, 5 year returns – CAGR as of 31 Dec '21. Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Asset Management India accepts no liability for any failure to meet such forecast, projection or target.

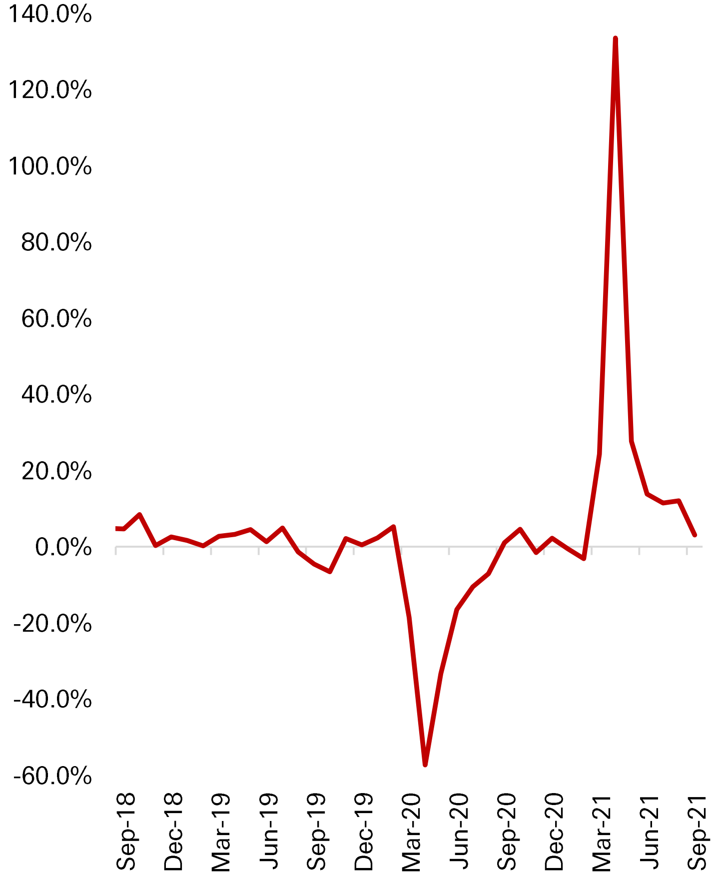
Success in macro

The Indian economy has bounced back from the Covid shock, aided by exceptional policy support

India PMI[1]

India Employment trend[2]

India Industrial production[3]



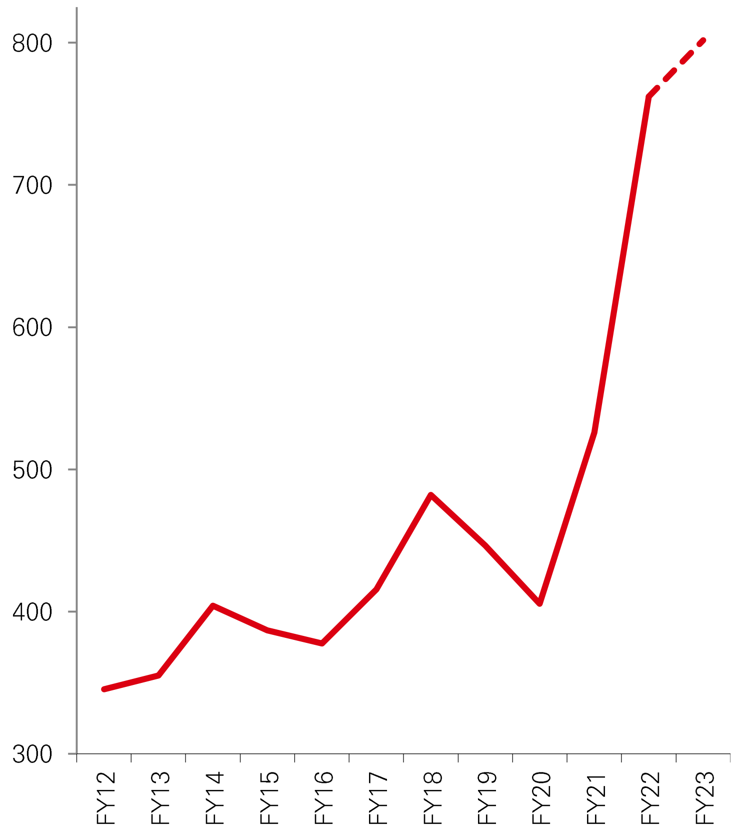
Macro factors showing signs of sustainable recovery ahead

Source: Morgan Stanley, Bloomberg, HSBC Asset Management, November 2021. 1. PMI - Manufacturing Purchasing Managers' Index 2. Employment trend – Naukri Job Speak, 3. IIP - Index of Industrial Production.
Past performance is not a reliable indicator of future performance. Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Asset Management India accepts no liability for any failure to meet such forecast, projection or target.

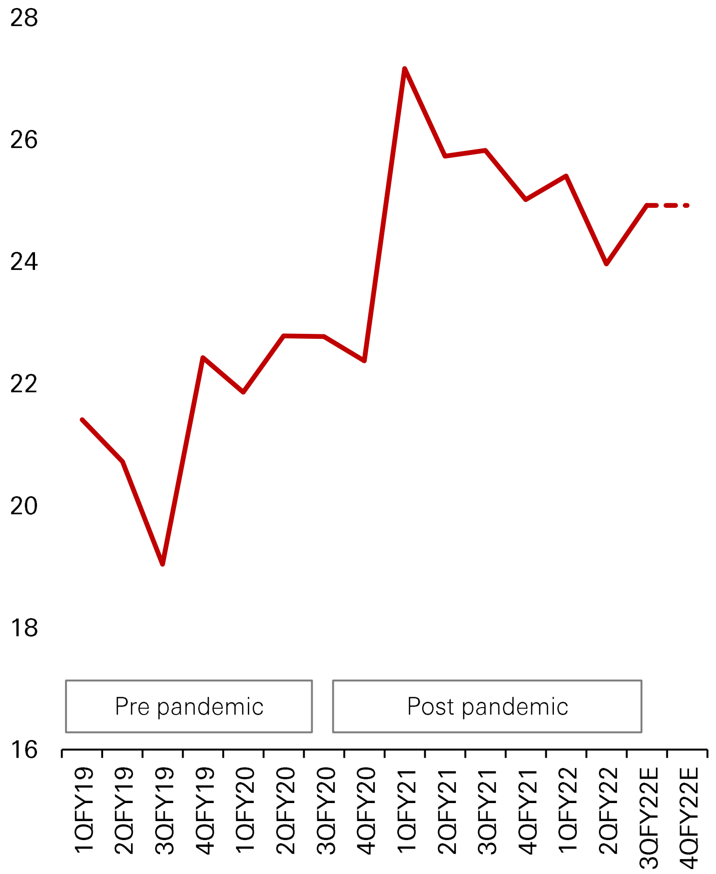
Success in corporate fundamentals

Policy support has also left corporate health in good shape

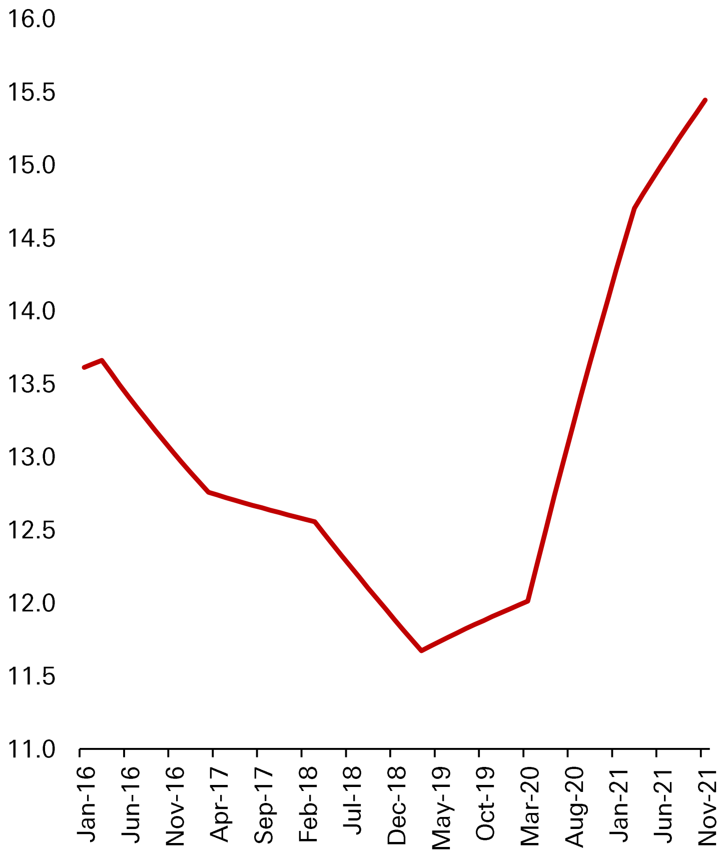
India Earnings trend[1]



Corporate Margins at healthy levels in India [2]



Indian equities: Return on Equity (RoE)



Corporate earnings, margins have shown significant improvement post COVID recovery

Source: MOSL, CRISIL, Bloomberg, HSBC Asset Management India, Data as at December 2021. 1. EPS – Earnings Per Share - (Nifty50). 2. EBIDTA Margin % (Nifty50).

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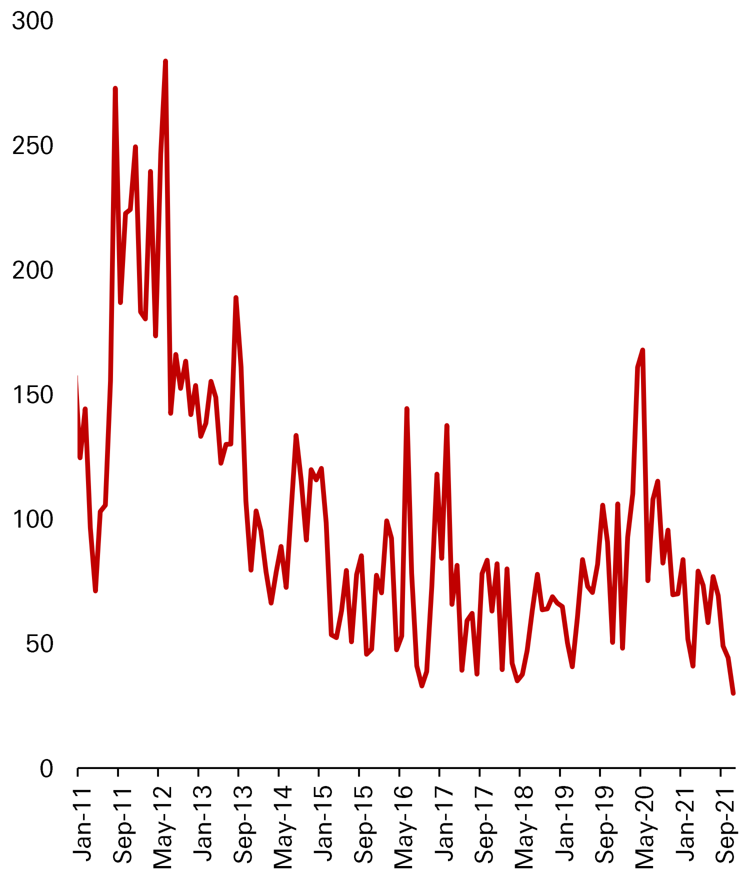
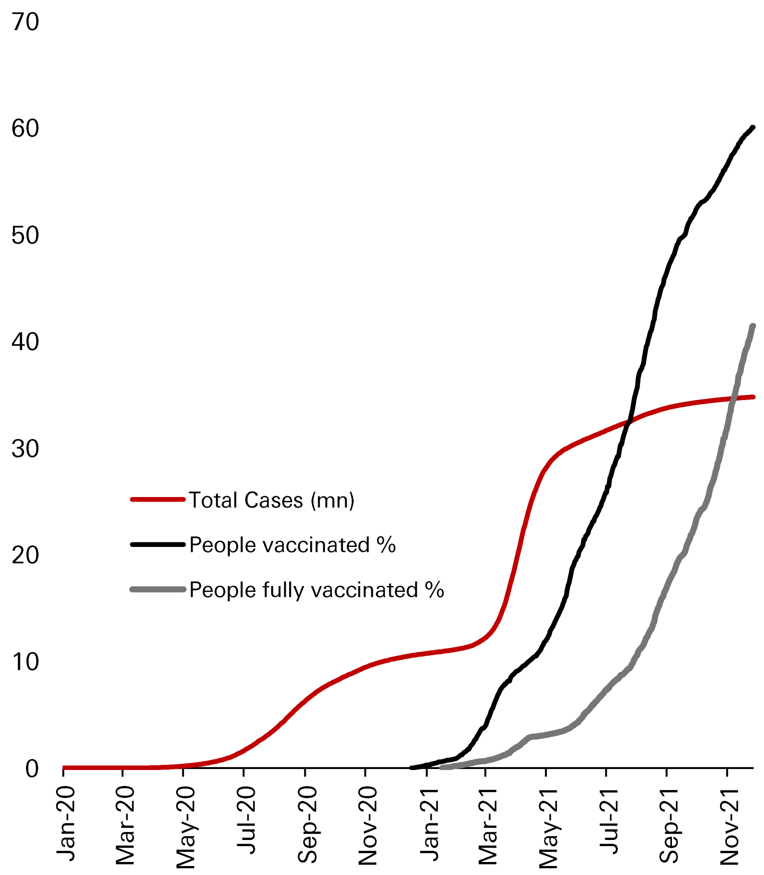
Success in the political economy

Policymakers too have demonstrated agility and force in their response to the pandemic

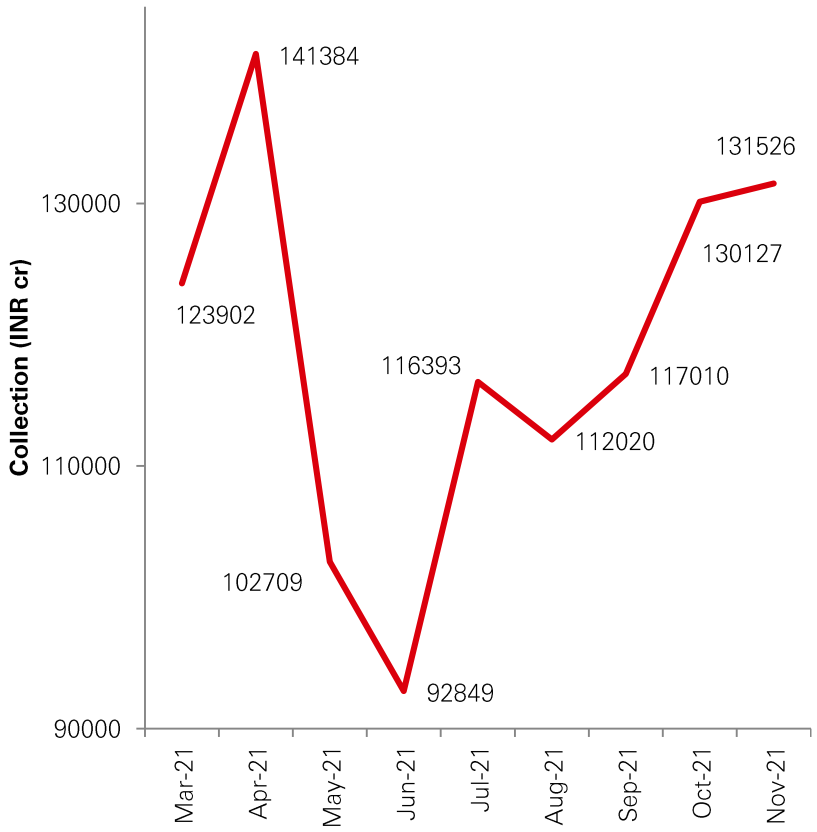
Policy uncertainty near its decade low in India [1]



Rapid vaccination in India [2]



Strong GST collections



Successful vaccination of large population expected to stop COVID recurrences

Source: Bloomberg, IMF, HSBC Asset Management, Data as at December 2021. 1. Policy Uncertainty Index - 'Measuring Economic Policy Uncertainty' by Scott Baker, Nicholas Bloom and Steven J. Davis at www.PolicyUncertainty.com. 2. Ourworldindata.org

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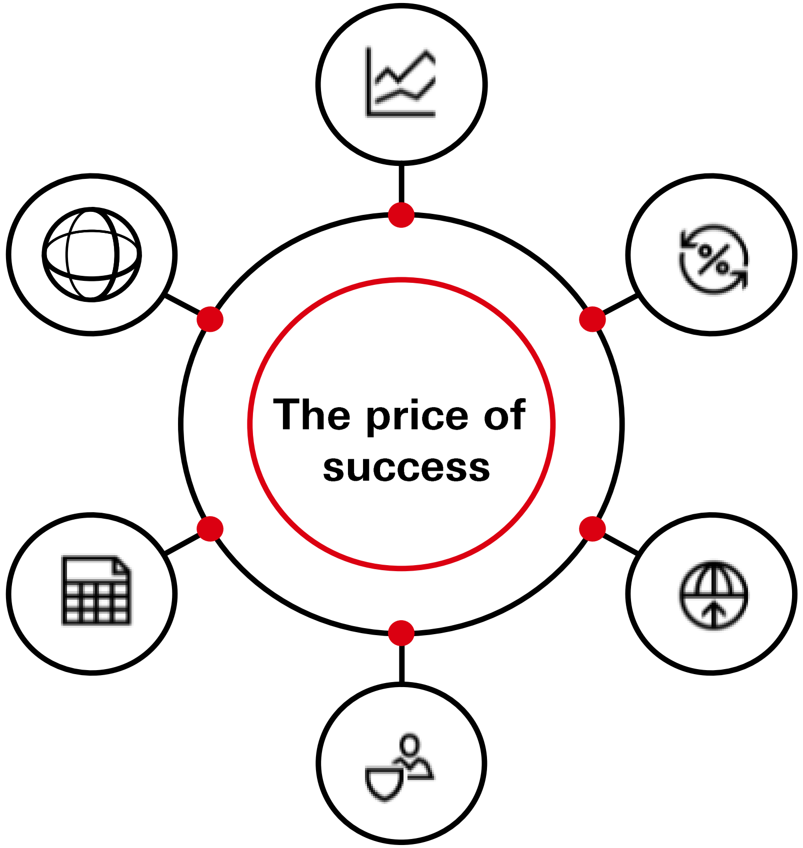
2022 outlook themes: the price of success

Hard yards in the growth cycle

In India, the easy gains from re-opening are now close to peak. In the expansion phase, we are close to peak of GDP and profits, while policy is normalising, relatively higher valuations



Transition

The transition to new normal could weigh on market performance but there is silver lining with the emergence of stronger Digital economy, increasing acceptance of ESG themes in India

Price pressures

Many of the temporary factors that are boosting inflation now should peak in 2022. Inflation is expected to decline thereafter as supply chains repair and consumption rebalances from goods to services

Lower future returns

The strength in markets over the past 18 months has compressed yields and risk premia, reducing future returns. Equity markets are likely to outperform with a cyclical revival on the horizon

World spillovers

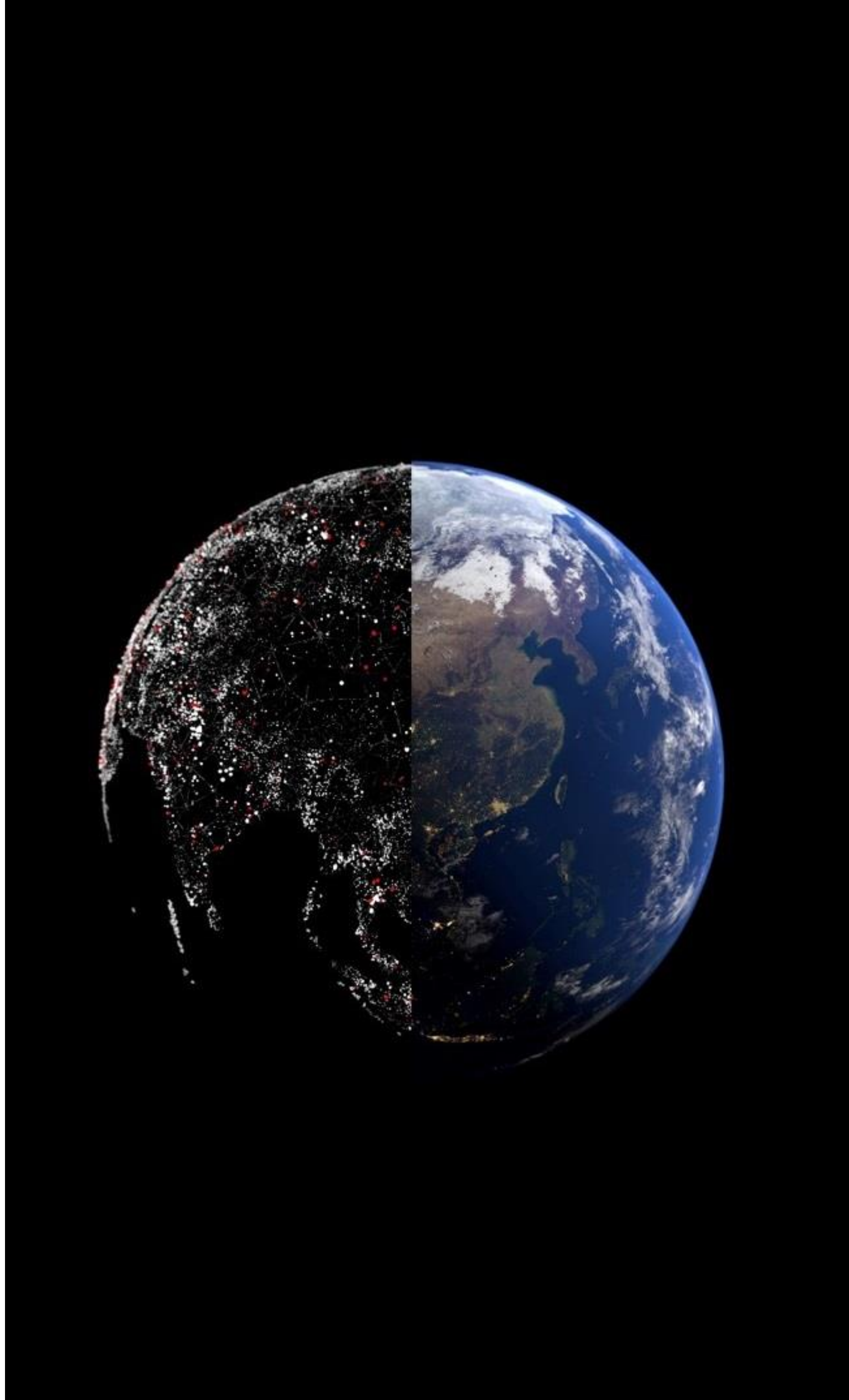
China's economy has slowed under the headwinds of a property sector downturn, power shortages, and past policy tightening. Flexible policymaking limits further downside. Global tapering is expected to have short to medium term impact on Indian economy. India is likely to benfit from the China +1 / global diversification theme.

Fast cycle means more uncertainty

The warp-speed recovery has created uncertinties in the macro system. Investors need to be prepared for this

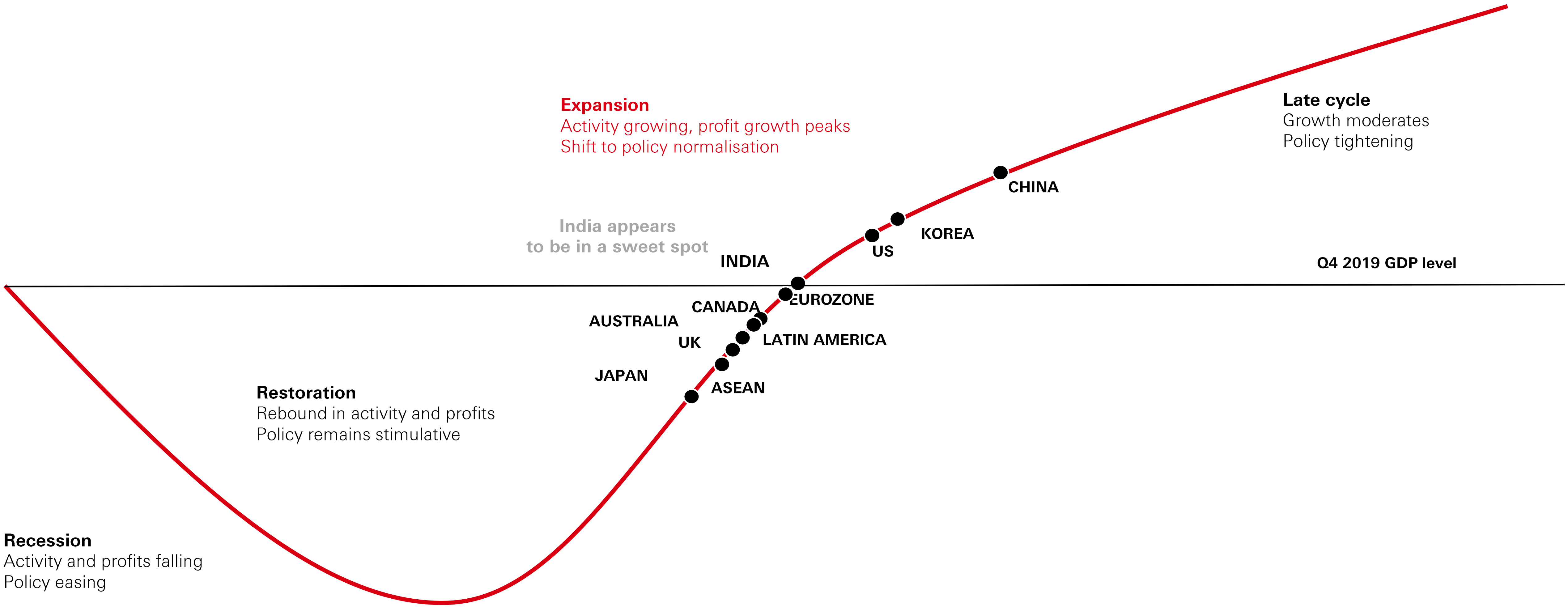
Source: HSBC Asset Management, December 2021. Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Asset Management India accepts no liability for any failure to meet such forecast, projection or target.

Hard yards in the growth cycle



Economies heading into the "expansion phase" of the cycle

India past peak policy stimulus, sustainable growth is on the horizon

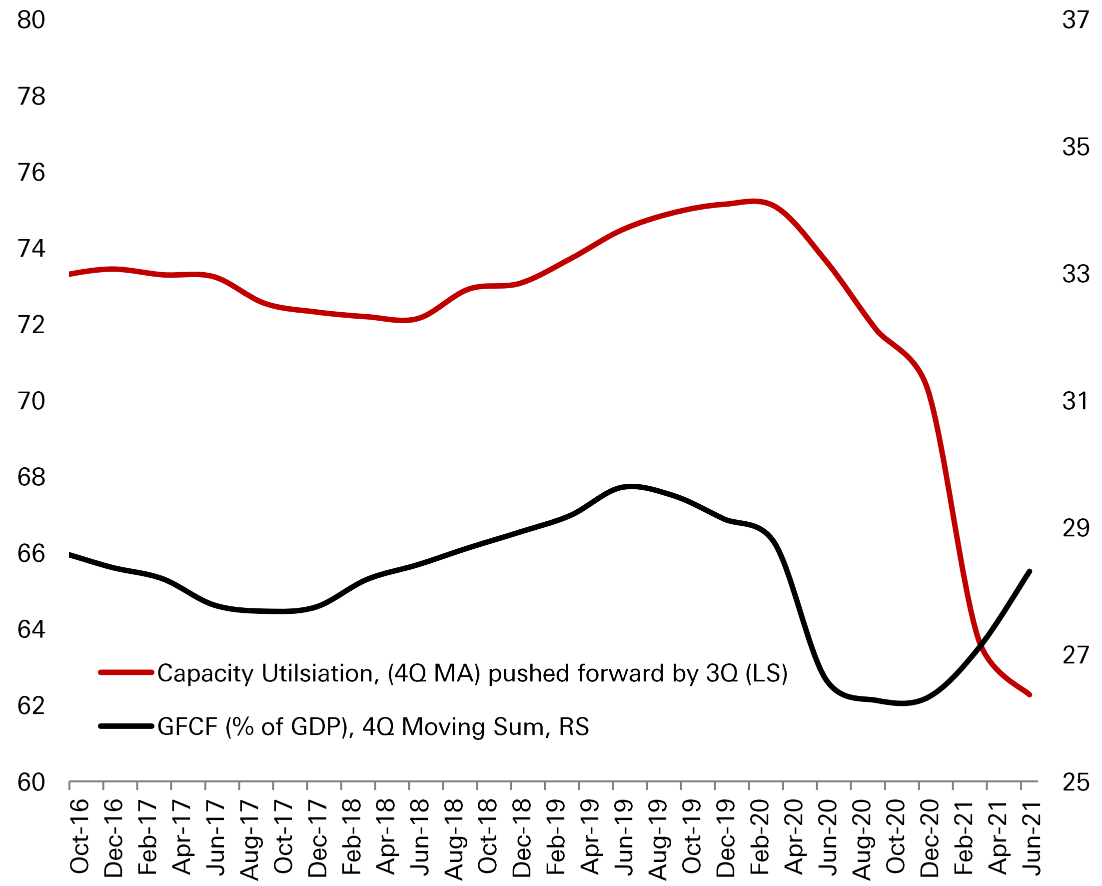


Source: HSBC Asset Management, Bloomberg, November 2021. Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Asset Management India accepts no liability for any failure to meet such forecast, projection or target.

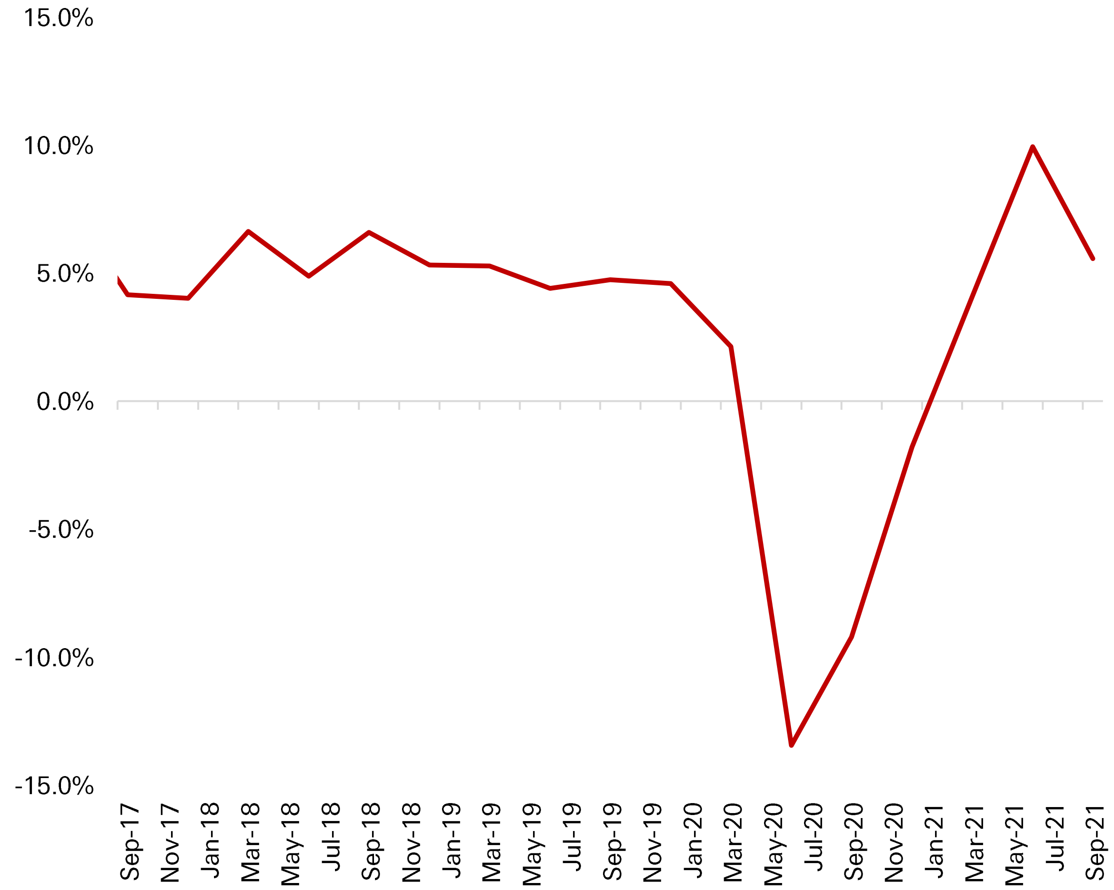
Supply-demand remains volatile in India

Above-trend consumption has created short term blockages

Capacity utilisation remains low in India



Consumption remains high in India



Source: Morgan Stanley, Bloomberg, HSBC Asset Management India, November 2021. Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Asset Management India accepts no liability for any failure to meet such forecast, projection or target.

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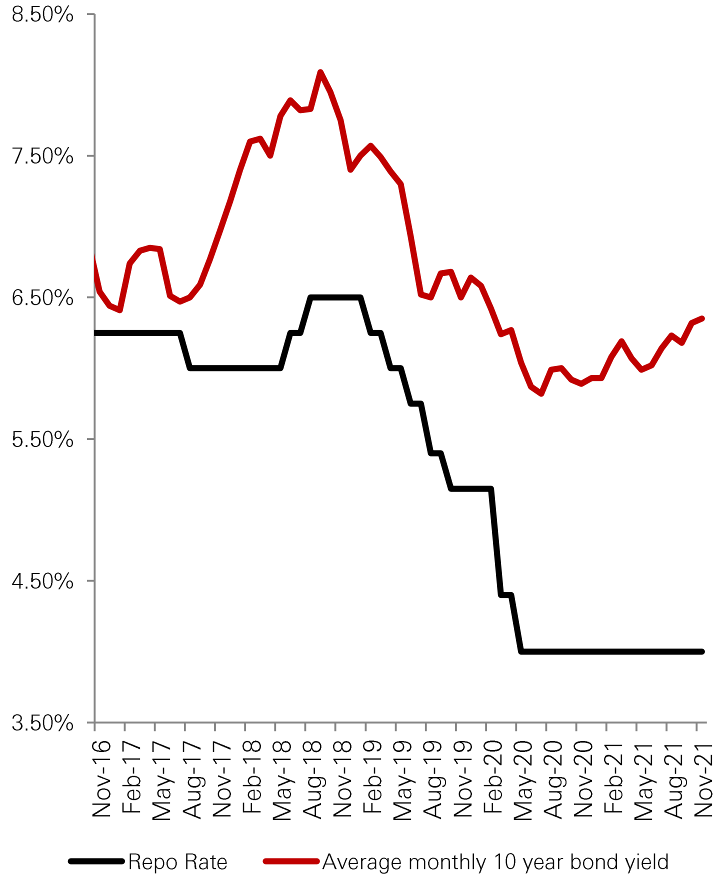
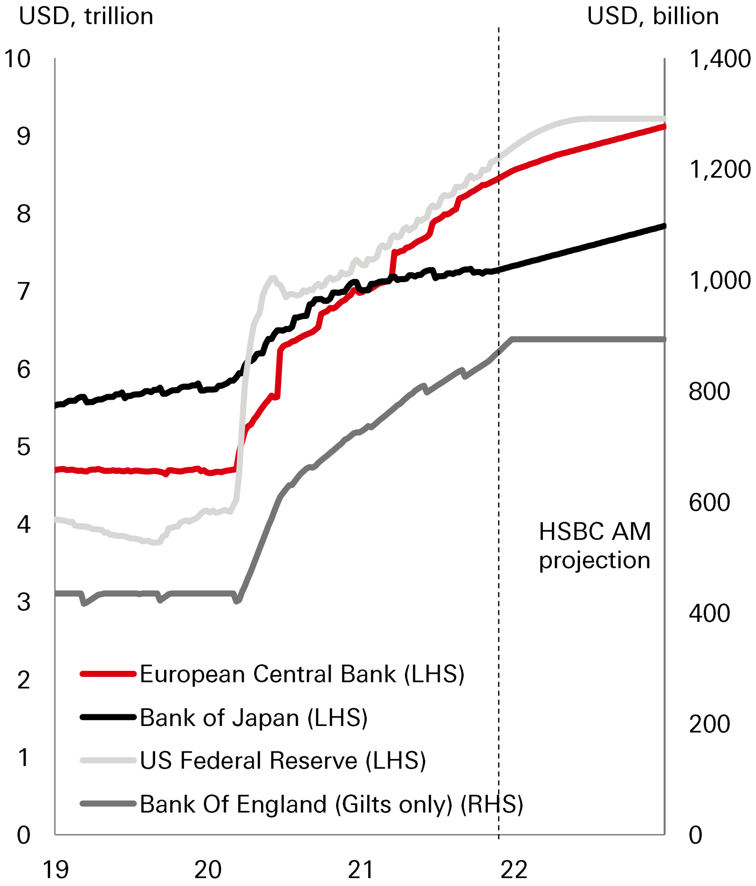
India continues with accommodative policy while DMs look to tapering

Globally policy support is being withdrawn following economic restoration

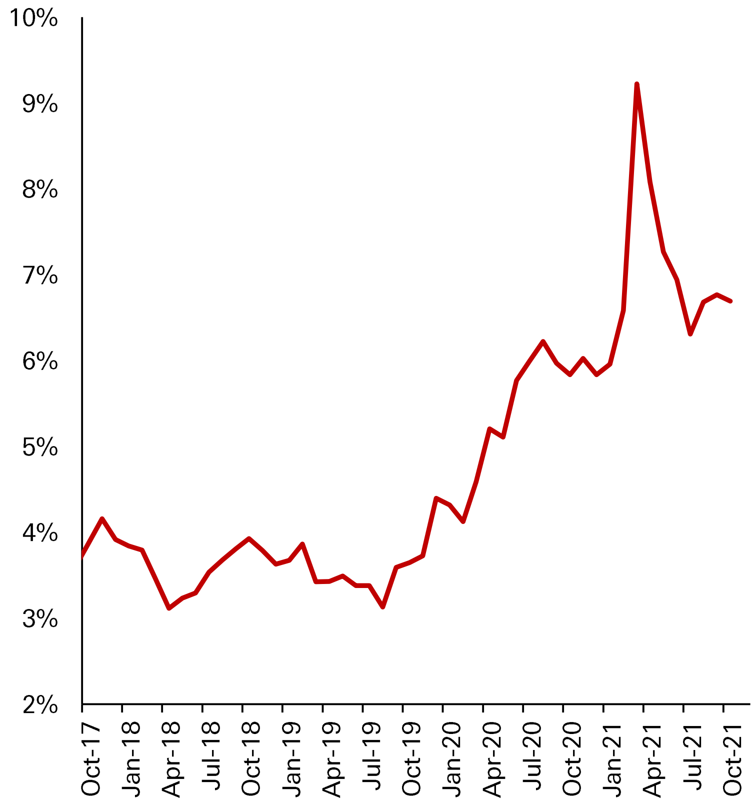
Low rates in India, no rate cuts since 20 months



DM central banks look to tapering



Fiscal policy a drag on India growth[1]



Source: Bloomberg, RBI, Morgan Stanley, The Hutchins Center - Monetary Policy, HSBC Asset Management, November 2021. 1. Fiscal Deficit of India - 12M Trailing Sum (% GDP)), Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Asset Management India accepts no liability for any failure to meet such forecast, projection or target. Past performance is not a reliable indicator of future performance.

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Important nuances between regions

UK

Near-term **growth** faces headwinds from higher inflation and BoE tightening. Positively, however, goods shortages should ease over 2022

The **BoE** is likely to lead other major central banks in lifting rates given higher inflation expectations and structural supply-side impediments due to Brexit

The UK's **fiscal stance** remains more hawkish than in the US and eurozone, with Chancellor Sunak emphasising the requirement to put the public finances back on a sustainable footing

China

China's growth headwinds may ease in 2022 as energy shortages are addressed, and policy is eased. Global inventory restocking supports exports prospects. However, there is uncertainty over the government's future Covid policy and thus the outlook for domestic demand

Beijing is likely to introduce targeted easing measures and a more gradualist approach to regulatory tightening. Aggressive stimulus is unlikely, however, with quantitative controls on lending keeping a lid on credit growth

Local **government bond issuance** could be speeded up, and is likely to do the heavy lifting in terms of policy support

US

GDP headwinds are easing amid an improving health situation, although supply-side constraints are expected to linger. A rotation toward services spending should help ease goods shortages, while inventory restocking will also support growth

FOMC remains accommodative as it focuses on full employment goal, with tapering in 2022 and first rate hike in Q1 2023. More persistent-than-expected inflation or faster employment recovery risks earlier lift-off

Fiscal policy is now acting as a drag on US growth. Looking ahead, the bipartisan infrastructure deal is unlikely to provide a significant boost to the economy in the short-term, while other spending is likely to be largely offset by tax increases

India

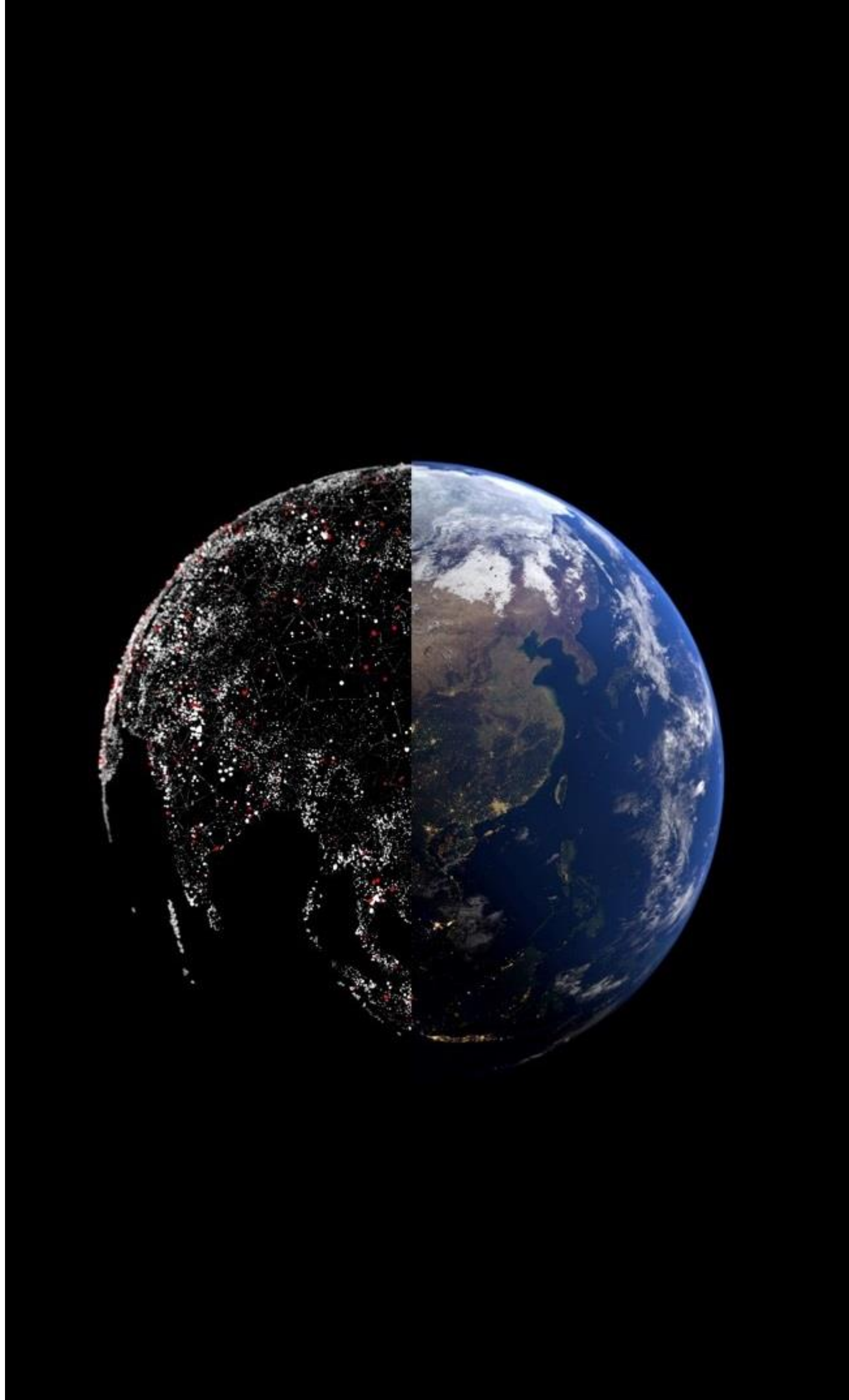
India appears to be in a sweet spot, while the global situation looks to slow down. Multiple tail winds starting from being a little behind on the restoration curve to policy response already moderating indicating it being slightly ahead of the curve offer some sustainable market environments.

Economic growth perspective: India should continue to see secular and sustained growth in the coming couple of financial years.

Inflation and interest rates continue to remain under pressure however a dramatic rise in either is not the base case. It is expected that government revenues on the back of robust GDP growth will not lead to additional borrowing and while there may be a gradual hardening of interest rates a certain portion of the same appears to be priced in.

Source: HSBC Asset Management, November 2021**.** Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Global Asset Management (UK) Limited accepts no liability for any failure to meet such forecast, projection or target.

Price pressures



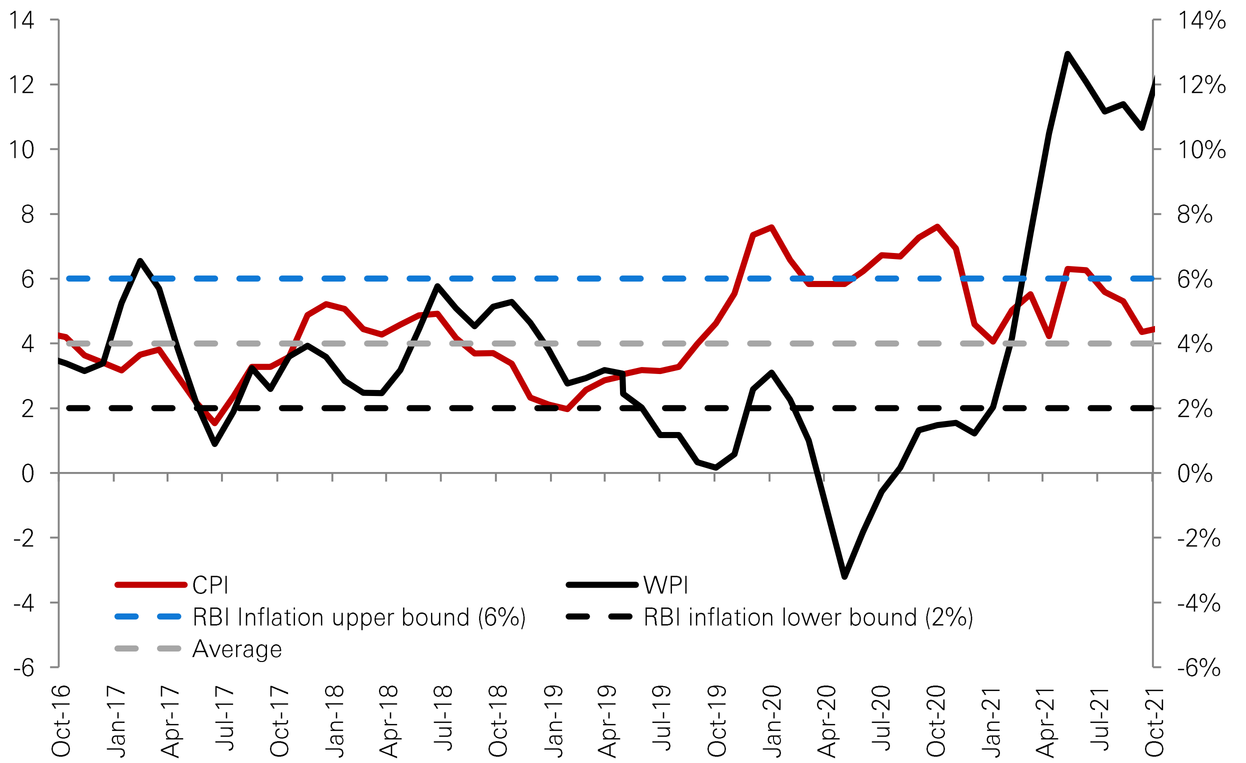
Transitory inflation remains our base case

Many of the temporary factors that are boosting inflation now expected to peak in early 2022

Our base case on the various sources of inflation

Goods demand	The surge in goods demand versus pre-pandemic levels has been more severe in the west compared to India
Covid policy response	Fiscal income support was less generous in India where savings support demand than in the US and most of the other countries,
Energy prices	Higher energy prices are expected to continue to impact inflation and rate outlook
Inflation outlook by RBI	Inflation estimates remain at 5.3% for FY22, with increase in estimate for Q3 FY22, and slight reduction in Q4 FY22 estimate compared to previous; H1FY 23 inflation estimated at 5.0%

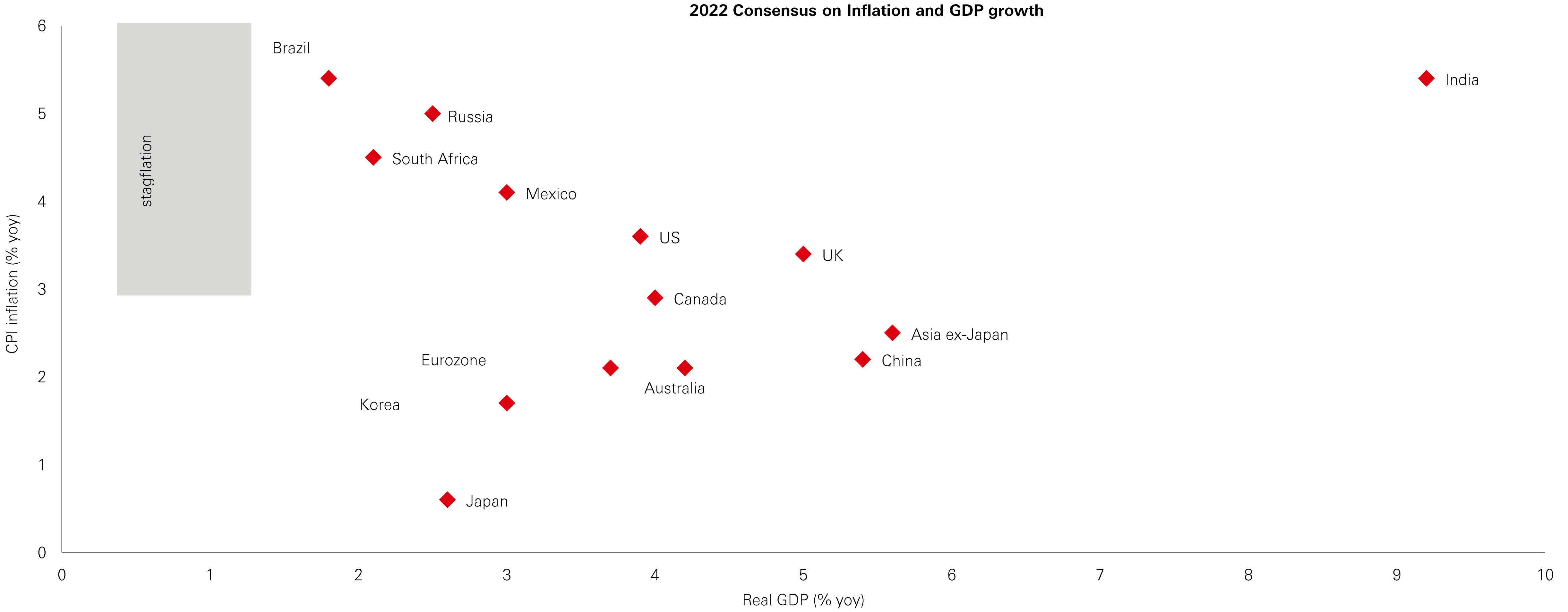
India inflation expected to fall back later in 2022



Past performance is not a reliable indicator of future performance. Source: Bloomberg, HSBC Asset Management, November 2021. Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Asset Management India accepts no liability for any failure to meet such forecast, projection or target.

India: Transitory Inflation with higher growth

Policymakers will keep a close eye on inflation expectations



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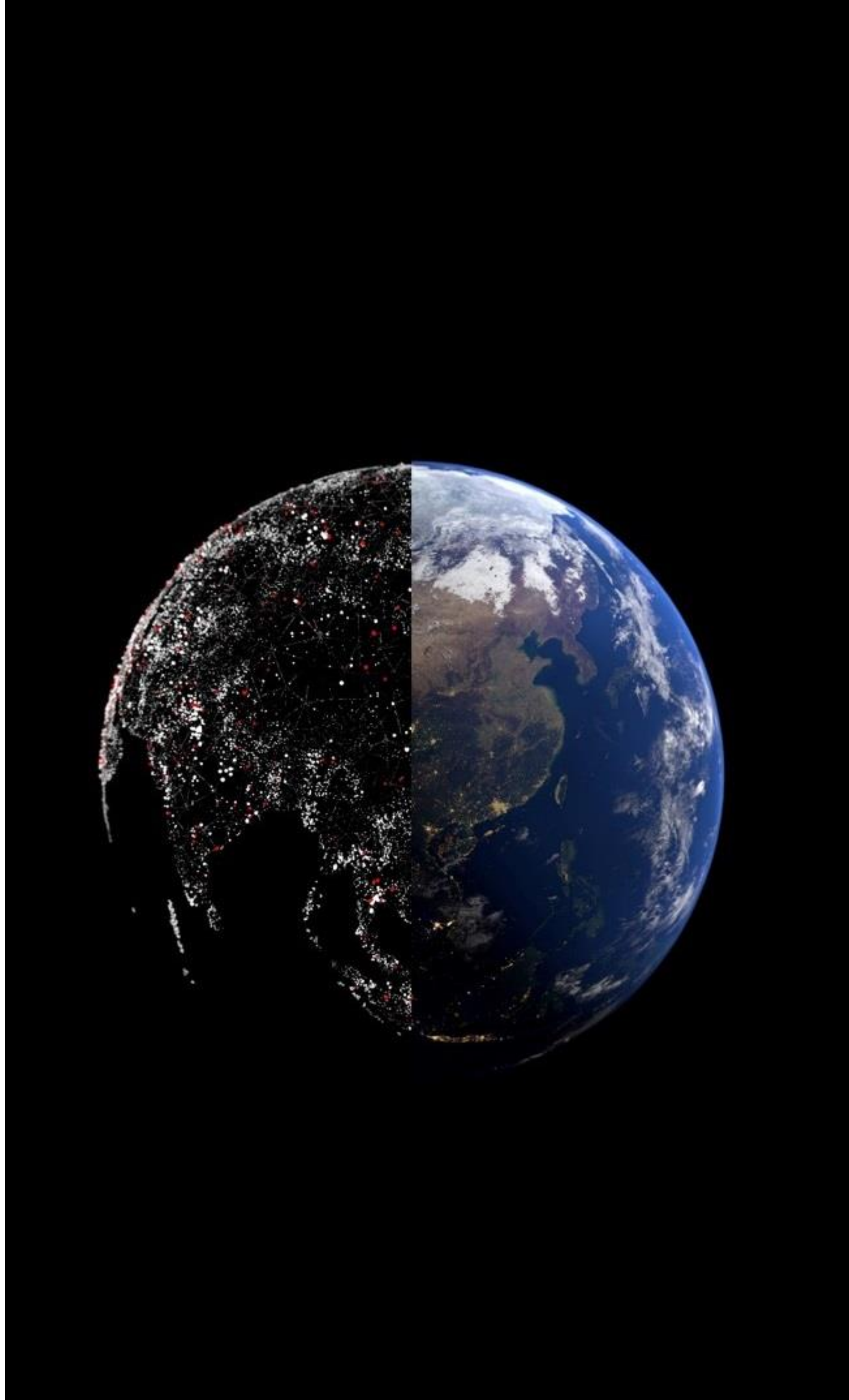
World spillovers



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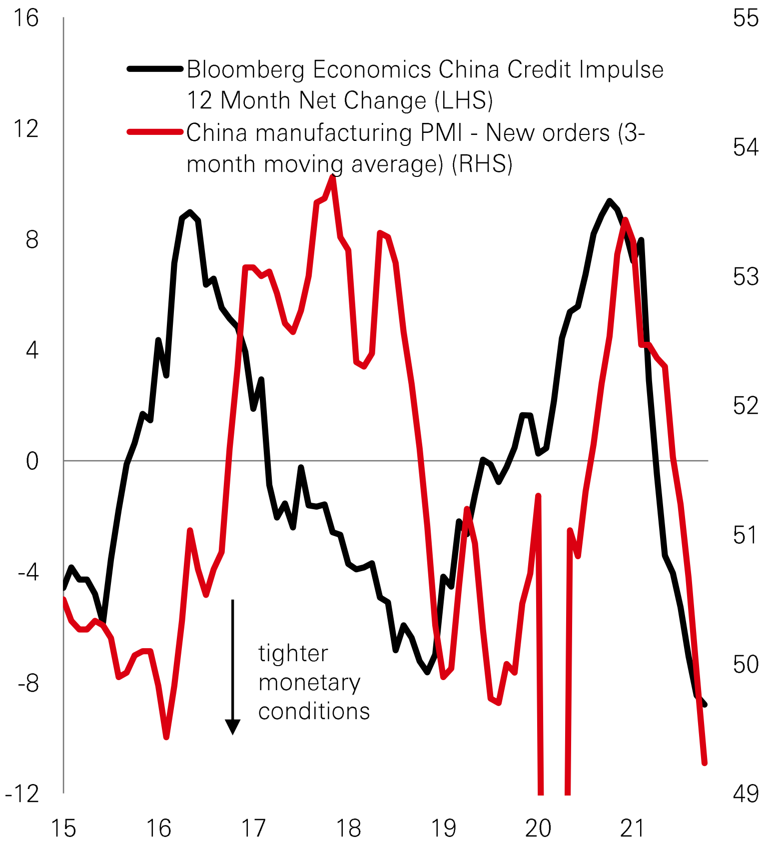
China slowdown and global diversification theme to benefit India

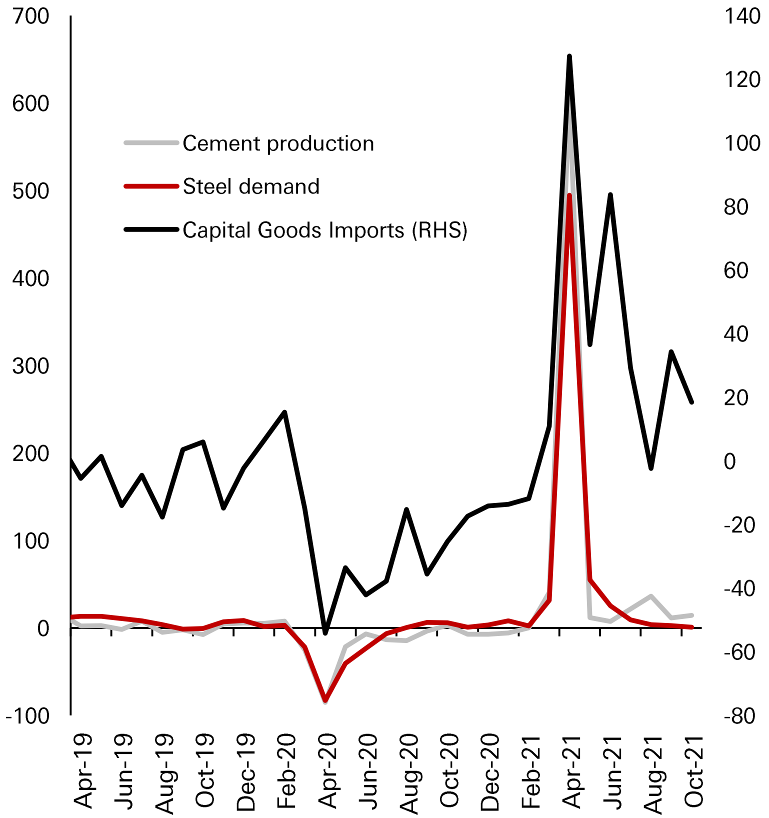
India's accommodative policy feeding in to strong activity while China growth under pressure

China's past policy tightening feeding into weaker activity



China Real estate downturn amid financing regulations

India cyclical revival on the horizon

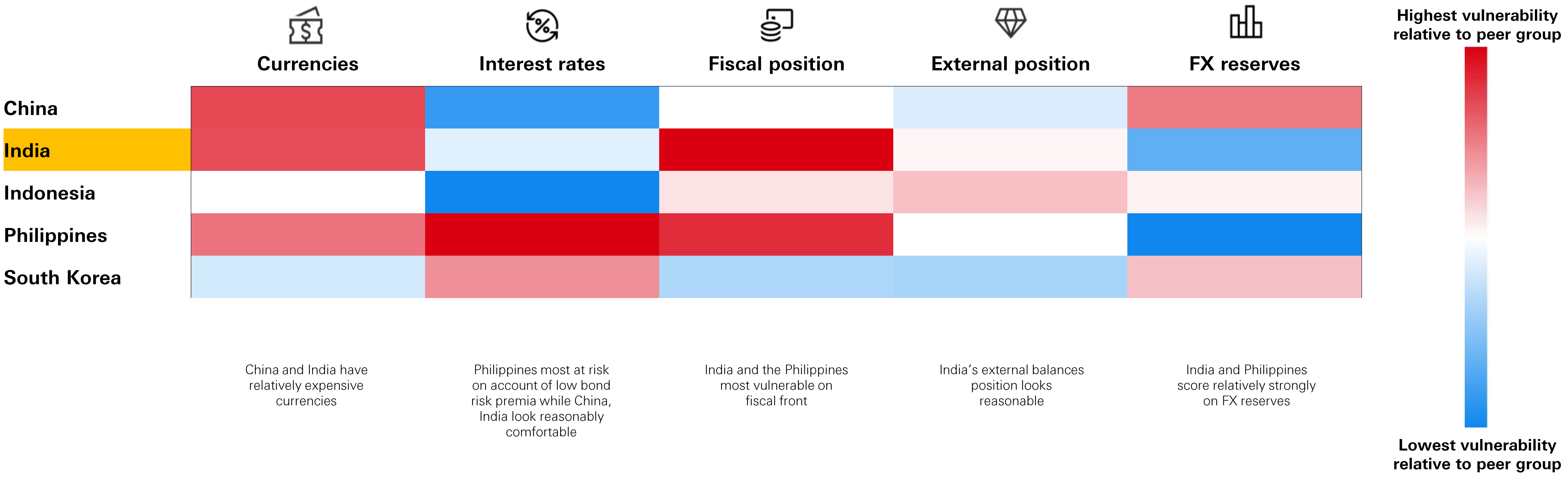


Past performance is not a reliable indicator of future performance. Source: Bloomberg, China National Bureau of Statistics (NBS), Macrobond, HSBC Asset Management, November 2021. Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Global Asset Management (UK) Limited accepts no liability for any failure to meet such forecast, projection or target.

Indian economic outlook on major parameters

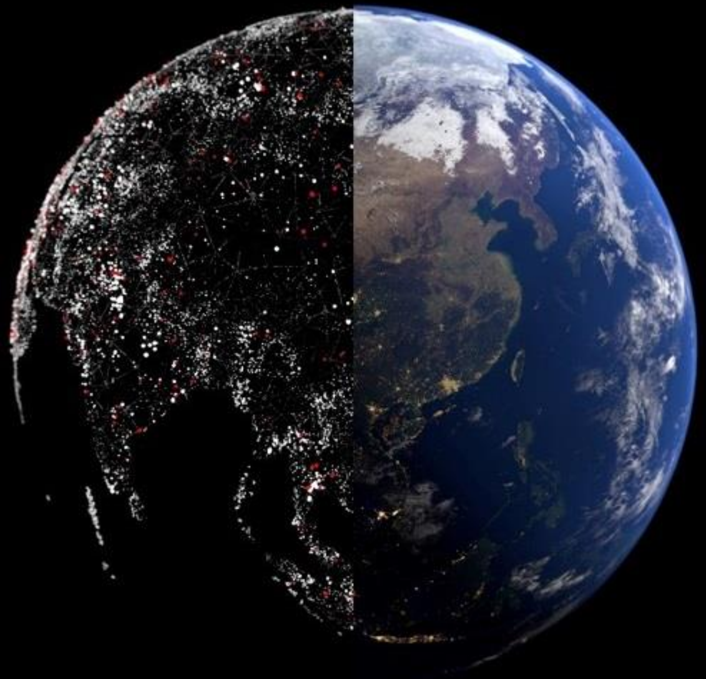
Large fiscal deficits pervasive, external balances less of a headwind than in the past

Heat map for some EM Asian countries for financial vulnerability metrics (position relative to last 10-year average and peer group)



Source: Macrobond, HSBC Asset Management, November 2021. Notes: Currencies: FX Valuations are calculated using REER deviations from their 10 year averages. Interest rates: Deviations of 10y real yields differentials from their 10-year averages (real yields relative to CPI inflation). Fiscal position: calculated as % of GDP. External position: (current account + foreign direct investment) as a % of GDP. FX reserves to short term external debt. Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Asset Management accepts no liability for any failure to meet such forecast, projection or target. Past performance is not a reliable indicator of future performance.

Fast cycle means more uncertainty



Central scenario and risks

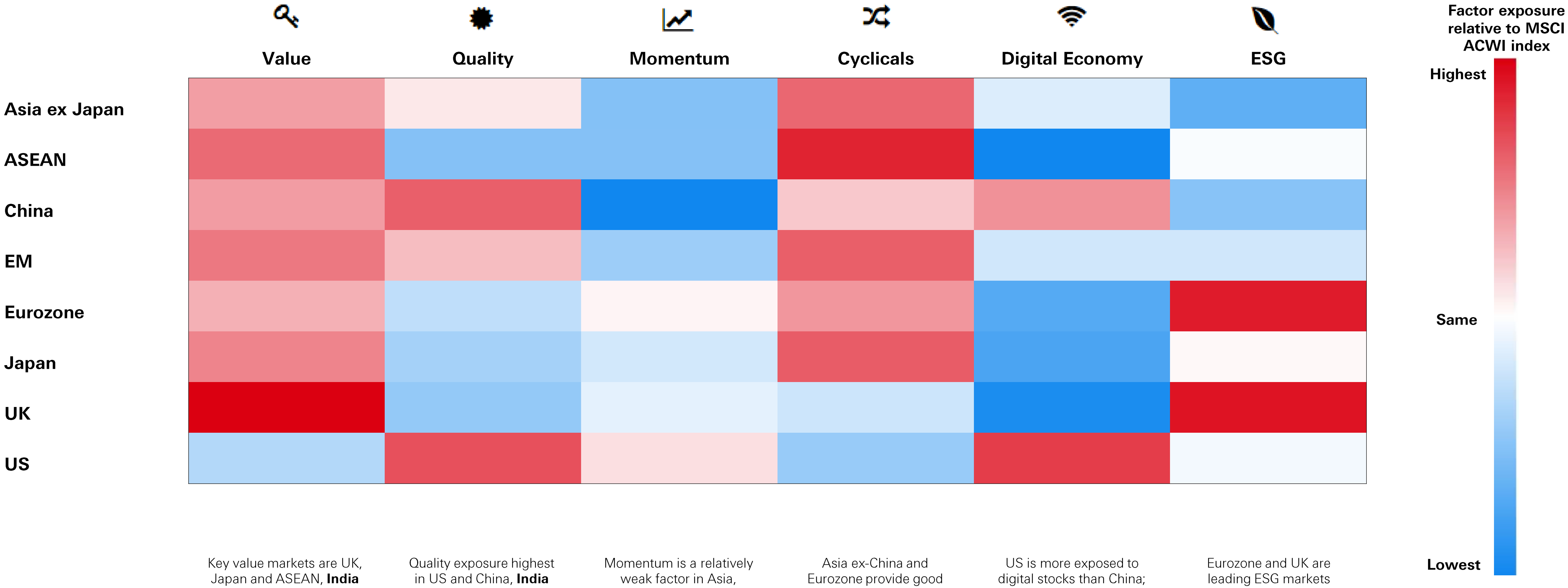
Uncertainty around interplay between demand and supply in expansion phase

	Stalling Growth	Expansion Economy (CENTRAL SCENARIO)	Sticky Inflation
Macro	**Demand** shocks (covid, policy, confidence) GDP trajectory stalls Eventual policy support, but limited in scope	Post-covid recovery continues Inflation shock transitory Gradual policy normalisation	**Supply-side** impairment Inflation is persistent and meaningful Faster policy normalisation
Market	Bond hedge limited due to fiscal action Cyclical equity markets struggle Defensive factors (quality, ESG) outperform USD rallies versus EM FX	Stocks > bonds amid falling unemployment Late cycle equities catch-up EM performs amid weaker USD	Inflation shock = ↑ nominal and real yields Equities de-rate despite neutral ERP Quality, defensive growth, and inflation-linked equities outperform

Source: Bloomberg, HSBC Asset Management, November 2021. Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Asset Management India accepts no liability for any failure to meet such forecast, projection or target.

Which markets offer us the right factor exposure?

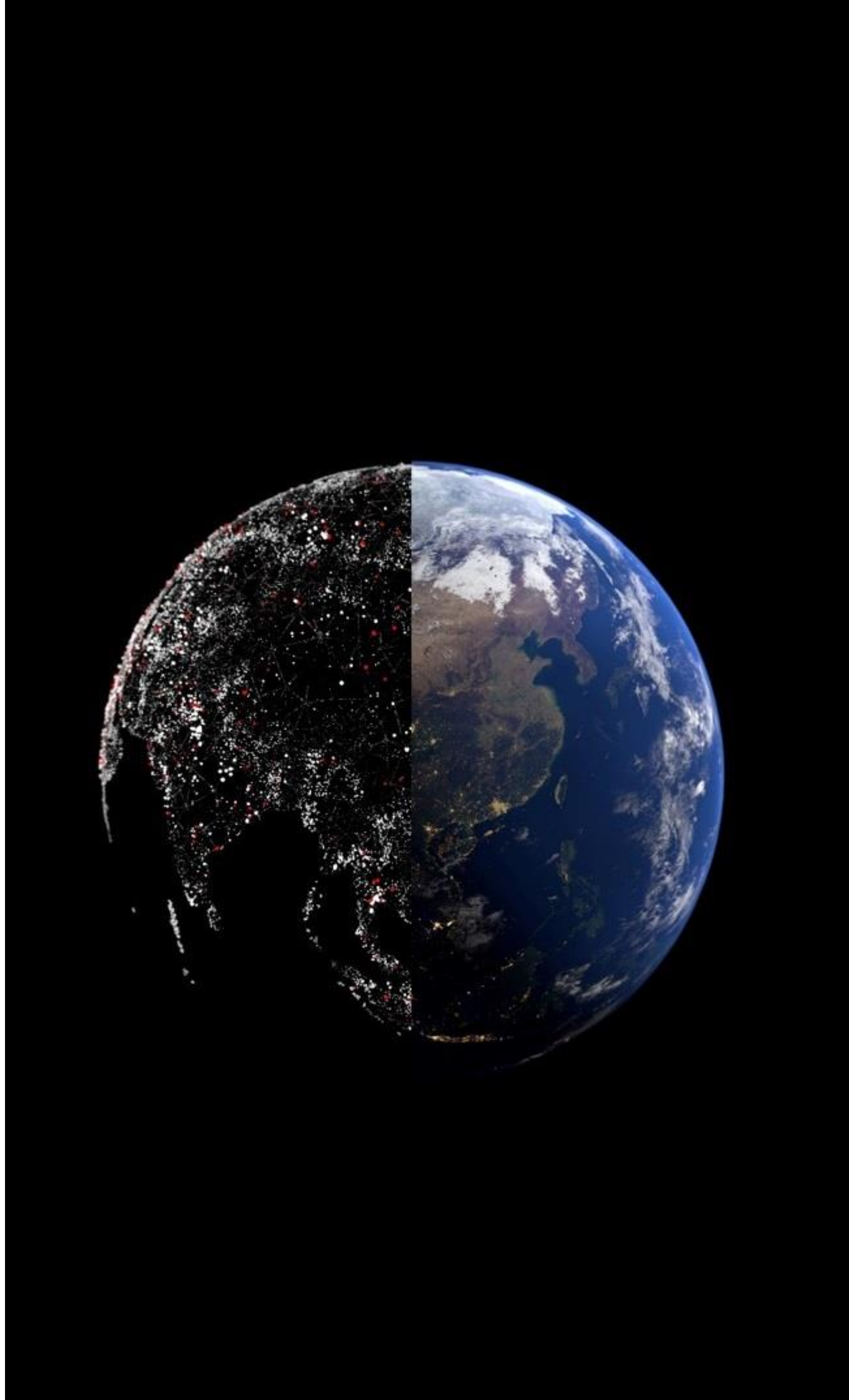
Value and cyclical factors can do well in the current environment, while risks support exposure to quality and ESG



Value	Quality	Momentum	Cyclicals	Digital Economy	ESG
Key value markets are UK, Japan and ASEAN, **India also offers select value buying opportunities**	Quality exposure highest in US and China, **India has quality corporates across traditional sectors.**	Momentum is a relatively weak factor in Asia, especially China but **India is doing reasonably well on this front**	Asia ex-China and Eurozone provide good cyclicals exposure, **India's cyclical revival offers significant opportunity**	US is more exposed to digital stocks than China; **Select opportunities are available in India now from this segment.**	Eurozone and UK are leading ESG markets

Source: Bloomberg, HSBC Asset Management, November 2021. Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Asset Management India accepts no liability for any failure to meet such forecast, projection or target.

Lower future returns

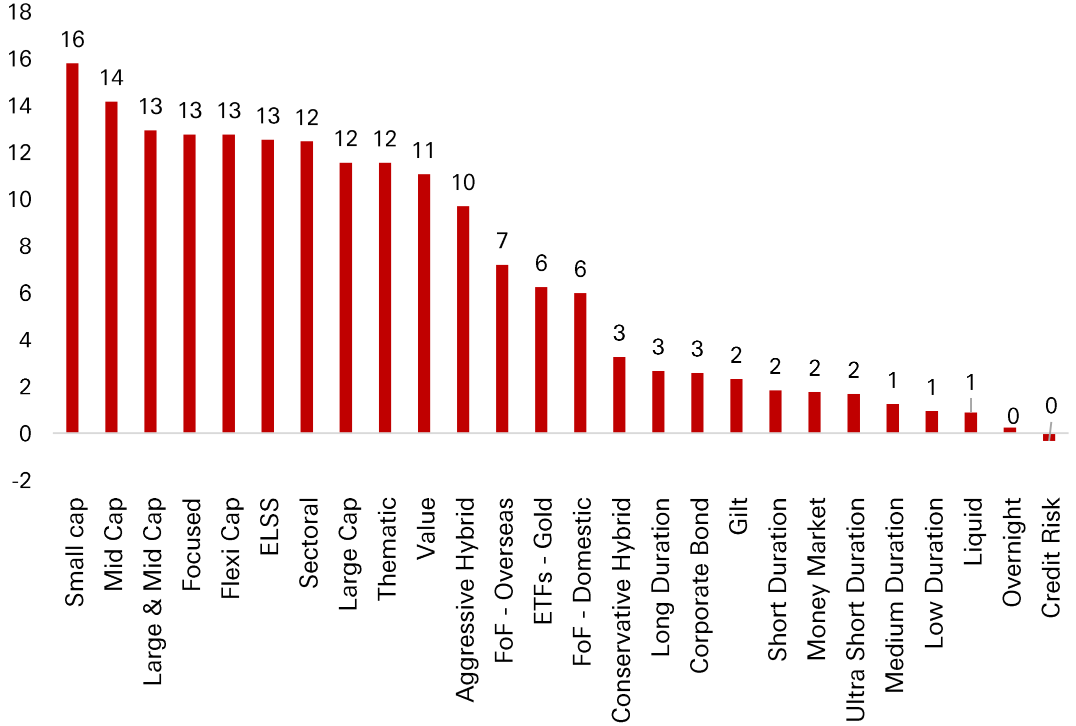


Strong market performance has borrowed returns from the future

Where to find inflation protection?

Target asset classes that have potential to deliver above inflation performance diaries

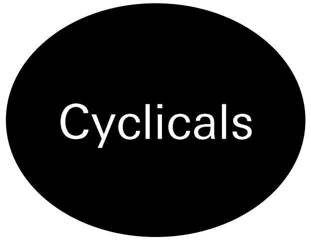
Inflation adjusted Asset class performance over the last 5 years



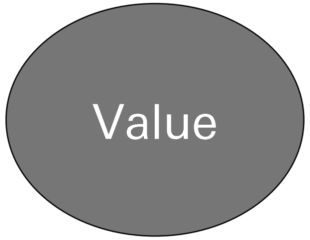
Equity factors, new innovative and current world relevant themes can add portfolio resilience

Dominant themes and quality corporates with sustainable profitability and pricing power have better potential

Transitions risks can be managed through exposure in ESG, Climate Change and Sustainable themes



Cyclical and consumer discretionary companies are seeing order growth at unprecedented levels

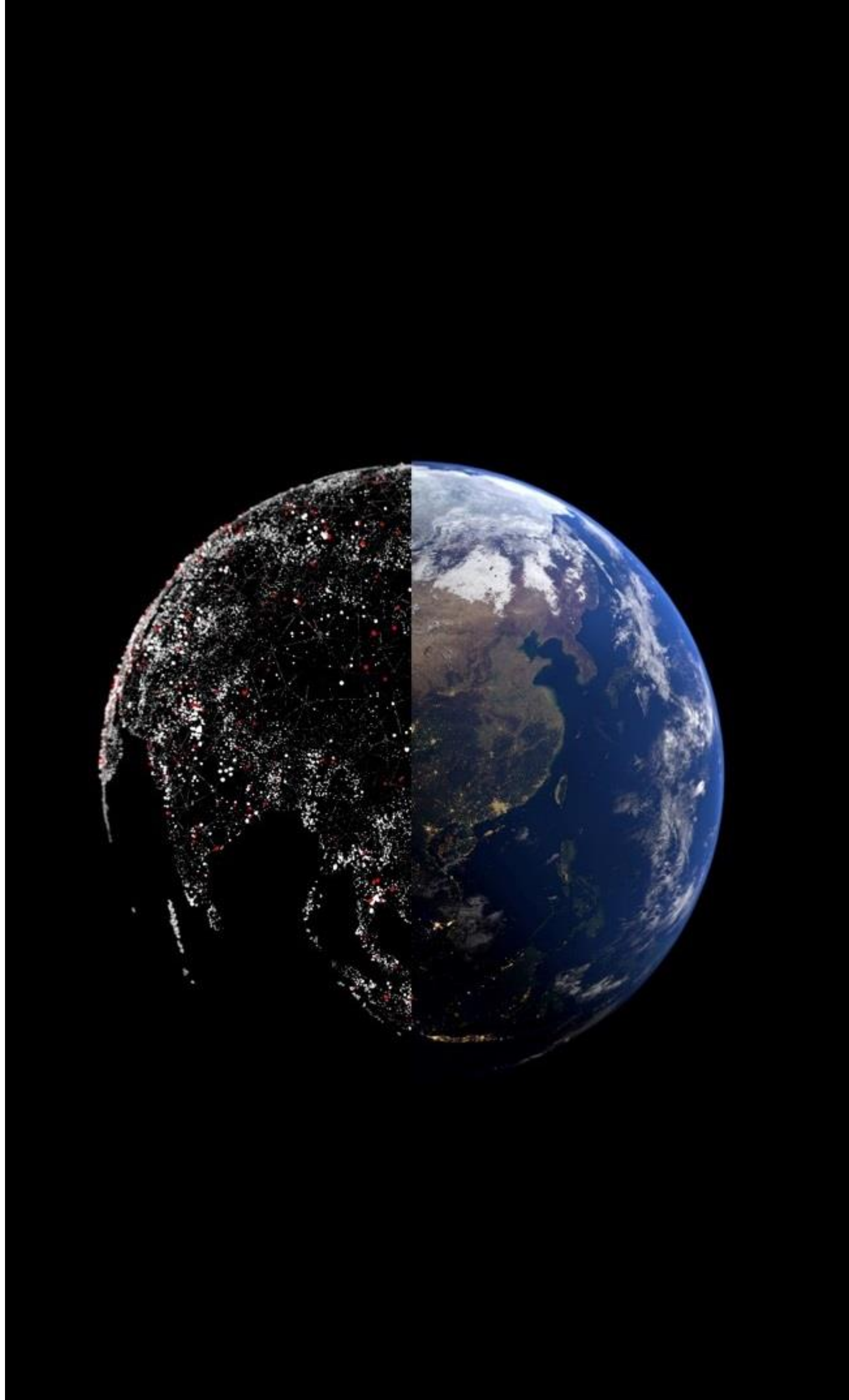


Relatively cheap companies offer decent margin of safety and are in sectors that could benefit (i.e. financials)

Interest rates are expected to remain low and active fixed income investors could exploit the steepness of the curve at the forward end as it gradually flattens

Source: ICRA, Data as at December 2021, as per SEBI defined mutual fund category - average returns CAGR%, Compounded Annualised Returns. Inflation – 5 years CPI average (4.5%) Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Asset Management India accepts no liability for any failure to meet such forecast, projection or target. Past performance is not a reliable indicator of future performance.

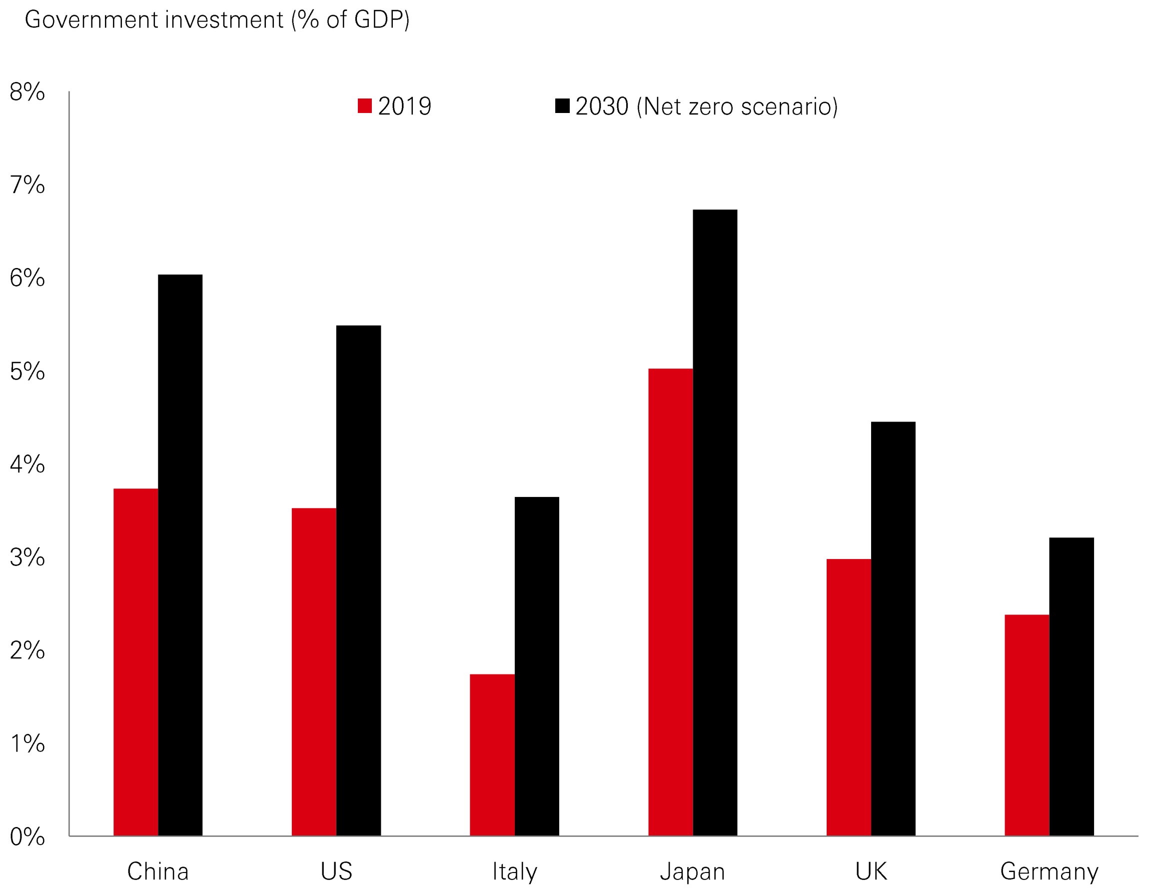
Transition to new normal



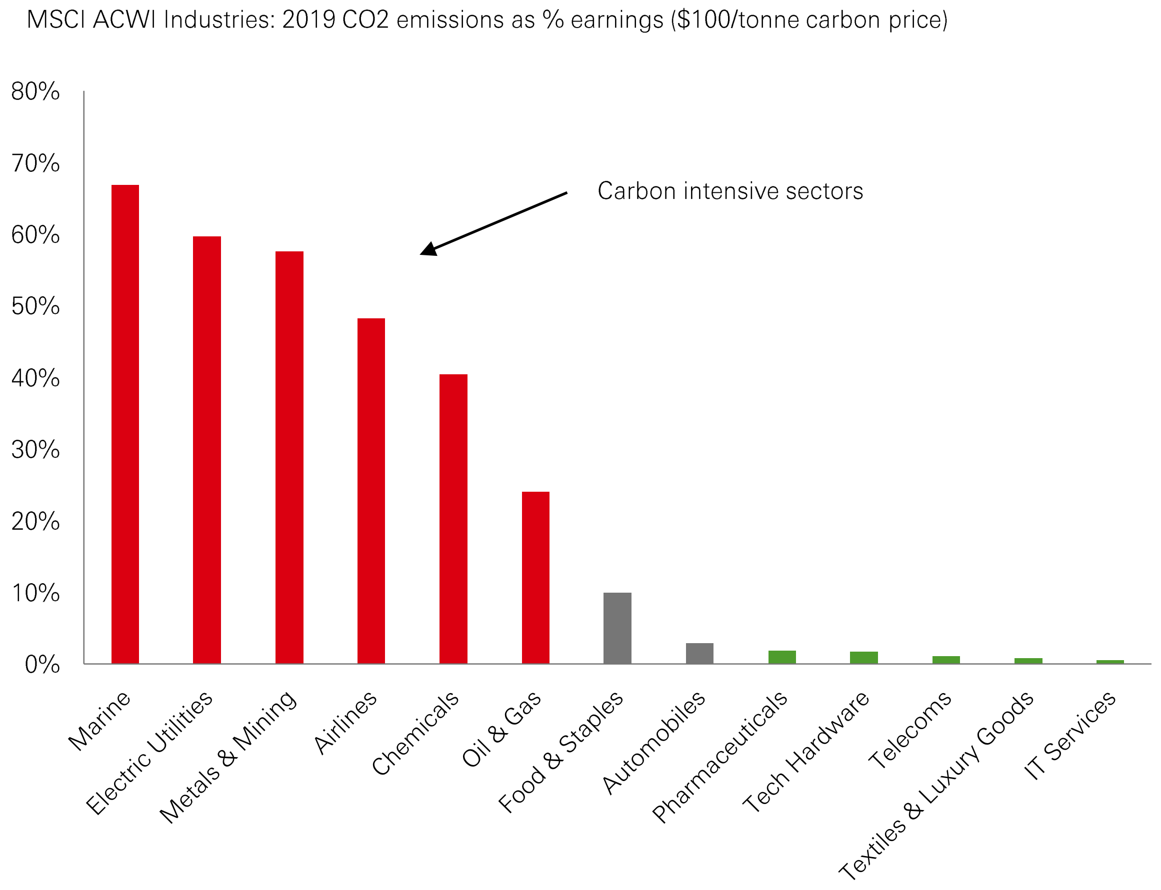
Strategies need to be adjusted for world trends such as climate change, transition to net zero

Sensible to hold assets that are guarding against risks, or are set to benefit from, the net zero transition

So far countries fall short of ambition of net zero



Risks to carbon intensive sectors



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India: benefiting from the new normal with digitisation progress

Opportunities from digital economy across sectors

Theme	Opportunity
Innovative Disruption & New age businesses	◆ India: ambitious target of a **$1 trillion digital economy** by 2025[1] ◆ Opportunities from **JAM** based digital economy ◆ **Digital adoption**: significant economic value addition ◆ New age digital businesses are expected to grow at **~30% to 50% CAGR**^

Leading disruptors / themes

- **Food delivery apps**
- **Innovative mobility services**
- Make in India
- New age sectors:
  - **Ed-tech start ups**
  - **Renewable Energy**,
  - Advanced Infrastructure,
  - Inventory management, **Delivery solutions**
  - Cloud solutions
  - **Omni channel Retail**

Emerging opportunities

Market opportunity	FY2021 (US$ bn)	FY2026 (US$ bn)	CAGR %
E-grocery	3.7	22-27	43-49%
Online Food Delivery	2.7-3	13-14	36%
Online Gaming	2.8	12-13	34% - 36%
E-tail	41	140-160	28% - 31%
India Advertising [3]	9.3	20-25	20%
Travel Ticketing [1]	36	60	~9%
Film Ticketing [1 2]	2.6	3.5	5%

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1. Travel ticketing and film ticketing for the period FY 2020, Includes ticketing from major organized and unorganized players, India advertising data for the period CY2020 and CY2025, , Details/information is provided for illustration purposes only

Source – Bloomberg, ^Paytm DRHP, July 2021, ^FY21 to FY26, Make in India (GOI), [1] Ministry of Electronics and Information Technology (MeitY), 1. These GOI schemes subject to other conditions, refer MakeinIndia website for more details.

The above information are for illustrative purpose only and it should not be considered as investment research, investment recommendation or advice to any reader of this content to buy or sell investments.

(JAM-Jandhan, Aadhaar, Mobile). The above themes are as per current view of the investment team and this is subject to change without any notice. Past performance may or may not sustain and doesn't guarantee the future performance. The Fund may or may not have any future position in these stocks. ^^HMF can not invest in unlisted companies. Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Asset Management accepts no liability for any failure to meet such forecast, projection or target. Past performance is not a reliable indicator of future performance.

Summary of investment views

Macro Outlook

- While many economies such as the US and China in the **expansion phase of the economic cycle**, global growth is expected to slow in the coming quarters amid policy normalisation. **India to continue with sustainable recovery and growth trend.**
- India a little behind on the restoration curve while policy response already moderating indicating it being slightly ahead of the curve **offer some sustainable market environments**.
- In India Inflation volatility likely to continue in the near-term but in the medium-term inflation is **likely to remain contained**.

Policy Outlook

- The combination of higher growth and higher inflation in India but sustainable growth is a challenge for RBI. **RBI policy is likely to remain supportive** as they prioritise economic recovery and sustainability.
- **Inflation and interest rates continue to remain under pressure** however a dramatic rise in either is not the base case.
- The government revenues on the back of robust GDP growth **will not lead to additional borrowing** and while there may be a **gradual hardening of interest rates** a certain portion of the same appears to be priced in.

Investment Views

- **In India equity valuations continue to remain elevated** compared to various parameters but the **earnings momentum continues to remain strong in India**.
- **Equities to perform better** than other asset classes in the coming year based on robust earnings expectation and benign interest rate regime.
- Interest rates will remain low and **active fixed income investors could exploit the steepness of the curve at the forward end** as it gradually flattens.
- Commodity markets are expected to be volatile and with rising interest rate expectations emerging in the US, **developing markets may see weaker currencies**.
- **Climate change and sustainable themes will continue to attract responsible capital**. An exposure to these themes can provide a much needed inflation buffer.
- **Mid caps tend to grow faster** in the expansionary theme which is current trend

Key Risks

Sticky inflation	More persistent prices pressures (mainly in the US) trigger a bond market tantrum, hitting risk asset performance
Pandemic developments	The pandemic drags on amid the impact of variants, slow vaccine rollout in some parts and waning immunity
Policy tightening	Vaccine complacency or stimulus fatigue could mean premature policy withdrawal. Lack of policy space a risk for many EMs, while China's credit cycle is turning

Source: HSBC Asset Management, December 2021. Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC GAsset Management India accepts no liability for any failure to meet such forecast, projection or target.

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