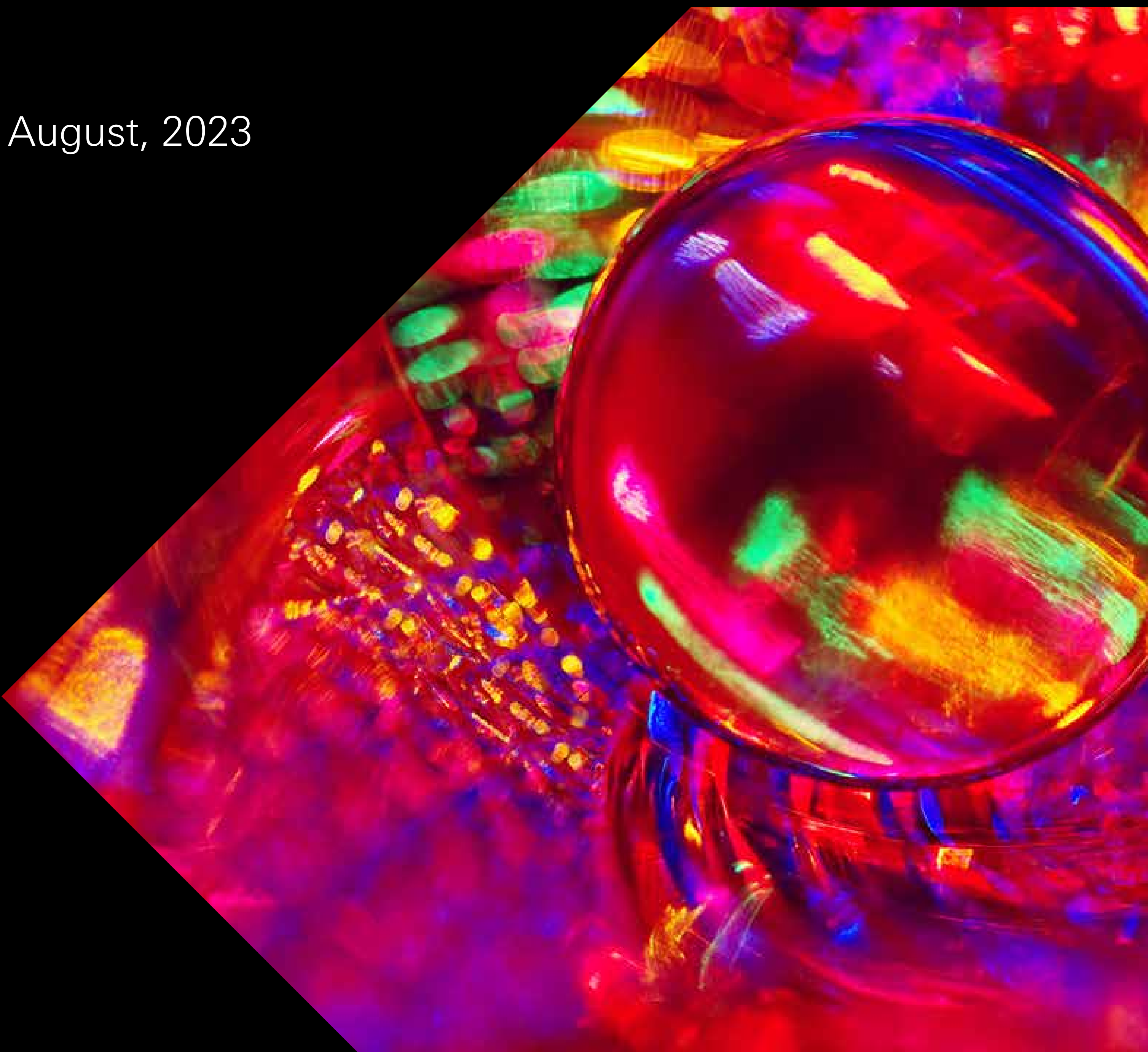
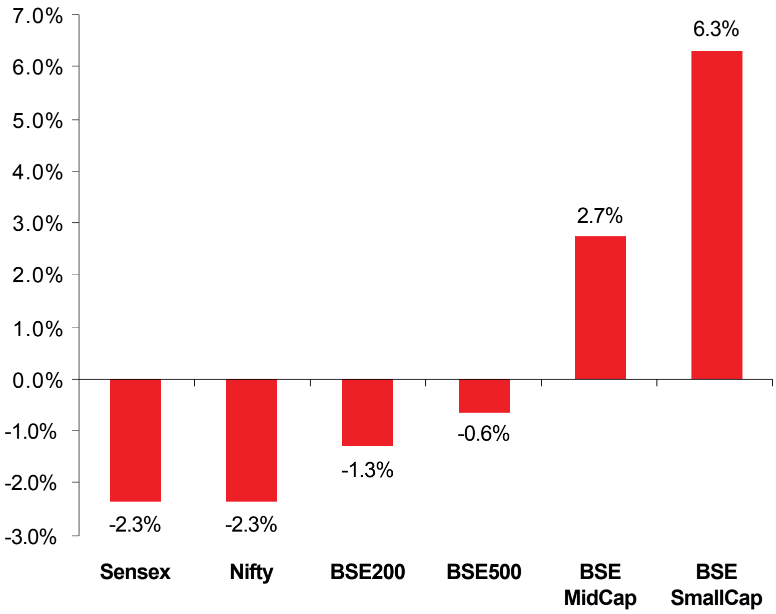
HSBC Mutual Fund

Equity Market Review

August, 2023



- In August, major Indian indices corrected in-line with other major global equity indices, however Small and Mid Cap indices performed well.
- While the S&P BSE Sensex and NSE Nifty indices both declined 2.3% during the month, the rally in Small and Mid Caps continued unabated as BSE Mid Cap / BSE Small Cap indices jumped up by 2.7% / 6.3%, respectively.
- Given, the domination of Large Caps, most sectoral indices also delivered flat to negative returns. IT was the best performing sectoral index followed by Capital Goods. Oil & Gas and Banks were the worst performing sectors for the month.



Global Market Update

Major equity indices globally saw a correction in August weighed down by the negative economic news flow from China plus rising US bond yields. MSCI World index declined 2.6% as the US market (S&P 500) corrected 1.8% and MSCI Europe lost 4.2%. MSCI EM declined 6.4% pressurized by the 9% decline in China and 9.3% in Brazil. Crude oil price continued to move up (2.1%) in August, following a rise of 14.2% in July.

International Indices (in USD)	Last Close	1 Month (Change)	CYTD 23 (Change)
MSCI World	2,986	-2.6%	14.7%
Dow Jones	34,722	-2.4%	4.8%
S&P 500	4,508	-1.8%	17.4%
MSCI EM	980	-6.4%	2.5%
MSCI Europe	1,902	-4.2%	9.8%
MSCI UK	1,119	-5.0%	4.2%
MSCI Japan	3,523	-2.4%	12.2%
MSCI China	60	-9.0%	-6.5%
MSCI Brazil	1,555	-9.3%	6.6%

- FIIs continued to be buyers of Indian equities in August to the tune of US$1.3 bn slowing from the inflow of US$15 bn in the prior three months. DIIs again turned strong buyers with investments of US$3 bn in August after effectively no net investment in the first four months of the year.
- India's GDP growth surprised positively for Q1FY24 at 7.8% (YoY) vs 6.1% (YoY) in Q4FY23. RBI expects 6.5% (YoY) GDP growth for FY24. Strong growth in Q1 was driven by an increase in government investment.
- India's July CPI inflation came in at 7.4% (YoY) rising from 4.9% in June on the back of sharp increase in vegetable prices. On the positive side, core-core inflation (i.e., core inflation ex petrol and diesel) eased to 5.1% (YoY) in July from 5.4% in June.
- June 2023 Industrial production growth (IIP) growth slowed to 3.7% (YoY) from 5.2% (YoY) in May.

- INR depreciated over the month (down 0.6% MoM) and ended the month at 82.79/USD in August. India's FX reserves came in at $595 bn. FX reserves have declined by US$9.0 bn in the past four weeks.
- Other key developments during the month include – Gross GST revenue collection in the month of August 2023 stood at Rs 1.59 tn, up 11% (YoY).

Valuations

Nifty FY24/25 consensus earnings have seen a 1%/0% upgrade over the last 1 month. As a result, Nifty continues to trade on 19.0x 1-year forward PE. On a 10-year basis, Nifty is still trading ~10% above its historic average valuation but is now trading slightly below its 5-year average. However, in a higher interest rate environment, market returns may lag earnings growth due to moderation in valuation multiples.

Macro View

In our view, the macro environment remains challenging with heightened global geo-political and economic uncertainties. The Fed remains hawkish and has continued to tighten policy rates despite signs of moderation in inflation. For India, growth has been strong in Q1FY24 at 7.8% (YoY) driven by strong government spending and resilient private consumption. Strong infrastructure thrust of the government as announced in the Union Budget is visible in order flow and demand for various industries and should support the domestic economy. However, inflationary pressures remain a key factor to watch given the sharp jump in crude prices and uptick in food inflation in July/August. Recovery in monsoon in the month of September will be key for both rural consumption and inflation outlook.

Outlook

We believe lagged impact of sharp interest rate increase cycle could result in negative growth surprises for the global economy going forward. However, at the margin things are turning more positive for India, with low a likelihood of further interest rate increases. FY24Q1 GDP growth has surprised positively indicating that the domestic economy remains more resilient despite global pressures. While we expect India's economic growth to be slower in FY24 and expect downside to consensus earnings growth forecast, we remain positively biased towards domestic cyclicals and constructive on Indian equities longer term supported by the more robust medium term growth outlook with government focus on infrastructure and support to manufacturing.

Key Drivers For Future

On the headwinds, we have

- **US Fed Policy:** Fed remains hawkish even as core inflation is starting to soften. Higher interest rates and balance sheet shrinking process could mean volatile equities.
- **Moderating global and domestic growth** due to higher interest rates is likely to weigh on demand going forward.
- **Global commodity prices:** Decline in crude oil and fertilizers is a positive for India from inflation, fiscal deficit and corporate margins perspective. However, crude has bounced back over the last two months. Any further increase is likely to be a headwind for the Indian markets, in our view.
- **Monsoon trends:** An extremely weak August has now led monsoon to be below trend. If monsoon doesn't recover in Sep, it will be a headwind for rural demand and food price inflation, in our view.

We see the following positives for the Indian market:

- **Government infrastructure spending:** Strong government thrust on infrastructure spending is clearly supporting the economy and has been one of the big positive contributors to Q1FY24 GDP growth.
- **Recovery in private capex and real estate cycle:** Industry capacity utilization based on RBI survey data is at a reasonably high level and indicates potential for increase in private capex going forward. Also, continued expansion of the Production Linked Incentive (PLI) scheme is likely to further increase private investments in targeted sectors.
- **Other factors / risks:** High current account and fiscal deficit.

Past performance is not an indicator of future returns. *Returns mentioned in the report are the Total Return or TR variants of the respective domestic indices. USD return for global indices. (Source: Bloomberg, MOSL & HSBC MF estimates as on August 2023 end).

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