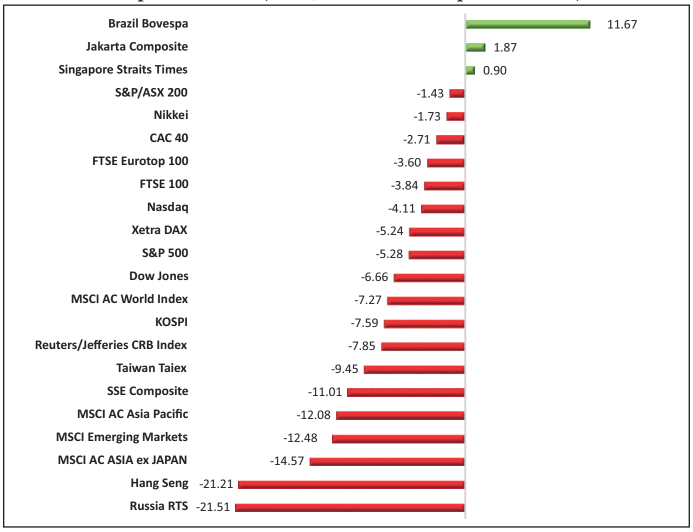
Market Review & Outlook

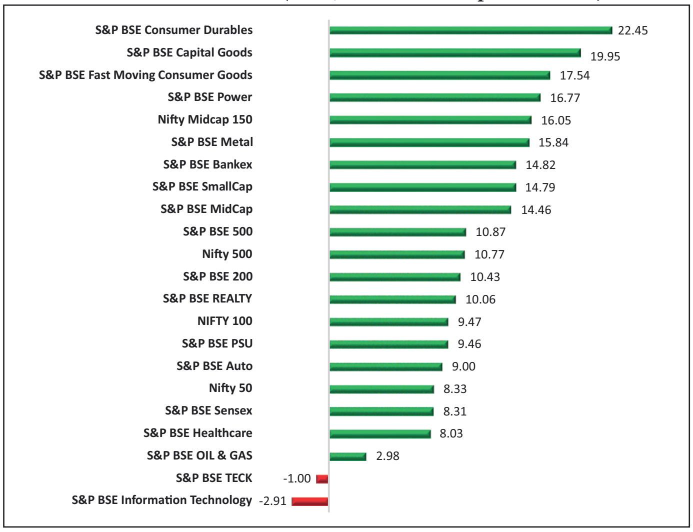
October 2022

Global market performance (For Quarter ended September 2022)



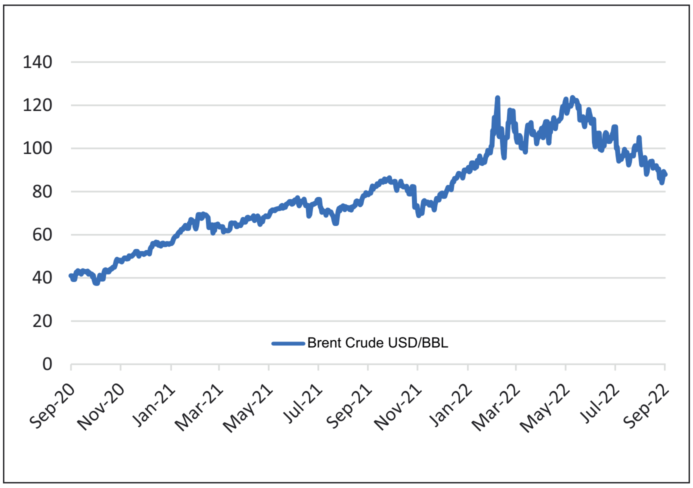
Global markets remained under pressure during the quarter, as sticky inflationary conditions remained persistent, and the resultant stance of global central banks continued with rate hikes to address inflationary fears. The developed markets corrected during the quarter as major economies, including the United States and the eurozone, acknowledged the concerns around global recession and the energy crisis in the eurozone. EM equities reported negative returns for the quarter. India remained an outperformer relative to global emerging markets.

Domestic Market Performance (For Quarter ended September 2022)



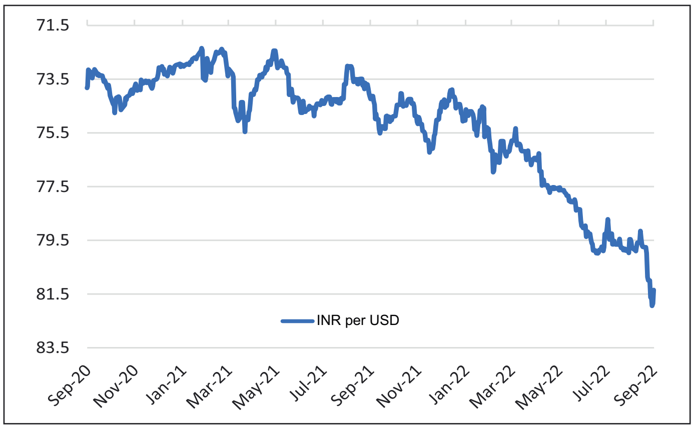
Domestic markets ended on a positive note for the quarter despite the volatility in global markets. However, the month of September concluded on a negative note due to the sell-off that was observed in the last few days due to worries over global growth and recessionary risks as a result of the hawkish stance of global central banks. The midcap segment was the top gainer, followed by small caps and large caps.

Crude oil prices – Brent



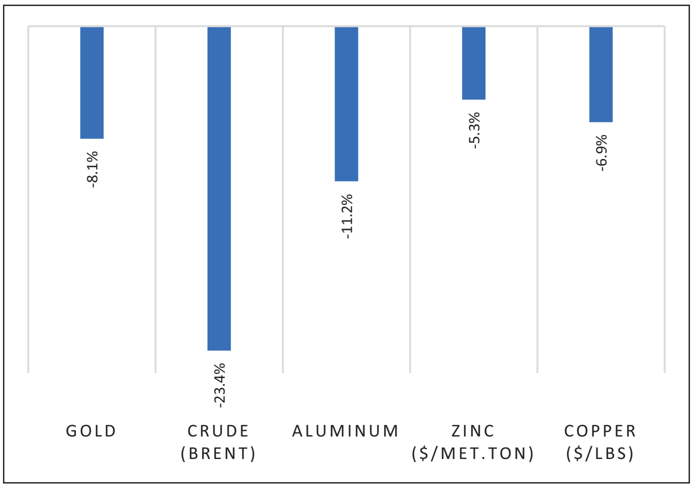
Macroeconomic indicators:

USD INR



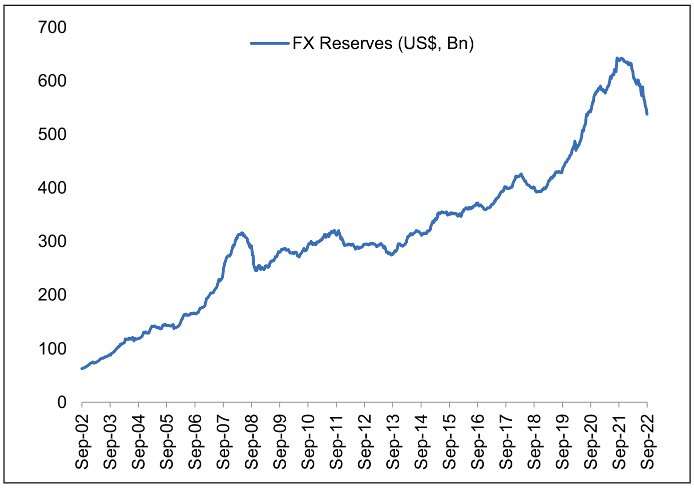
In September 2022, the INR depreciated by 2.21% against the USD. The INR depreciated close to 7% against the USD on a YTD basis. It traded in the range of 79.80 to 81.34per USD on a daily closing basis in September 2022.

Commodity price trend



The Brent crude declined 23% during the quarter on concerns of global economic recession dampening demand outlook. Gold price corrected during the quarter on strengthening USD and expected rise in interest rates. Metal prices slipped during the quarter amid a general drop in global commodity prices.

Forex reserves



India's Foreign exchange reserves stood at USD 537.5 bn in September (561.04 billion in August).

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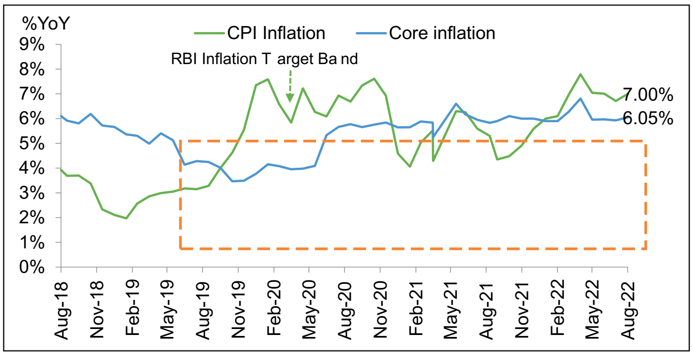
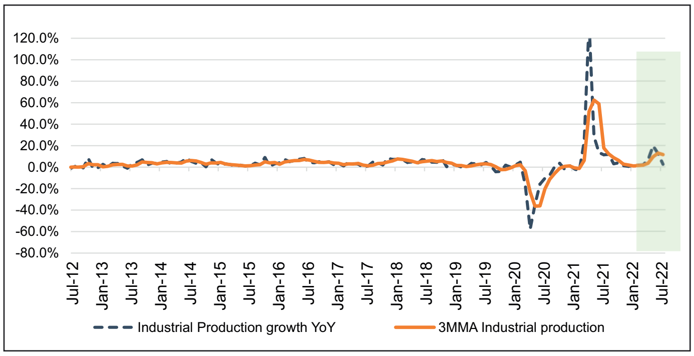
Inflation



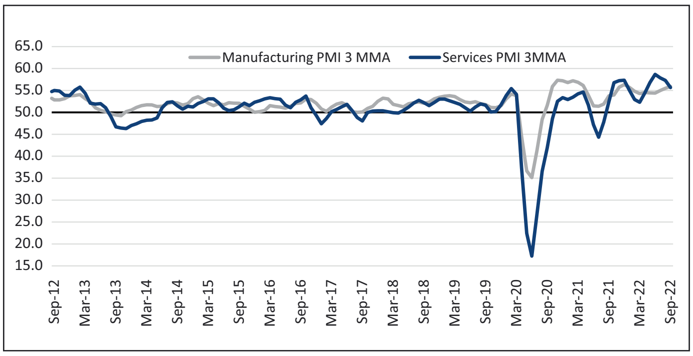
CPI Inflation rose to 7% for August 2022 following a moderation in July (6.7%). RBI maintained its projection of annual inflation to 6.7% for FY23.

Industrial production



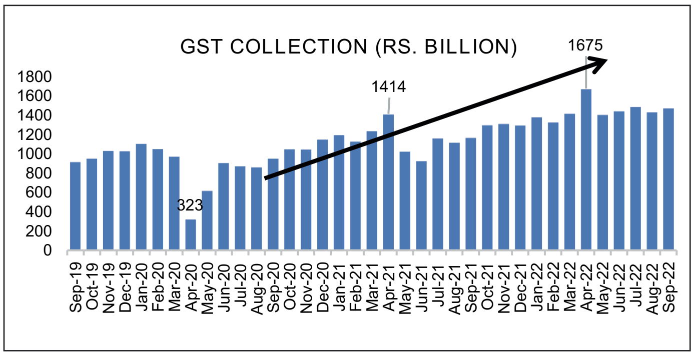
After sharp increases in the initial months of the quarter, industrial production growth moderated (2.4% YoY in July) due to a slowdown in the manufacturing and electrical sectors.

PMI Indicators



The Manufacturing PMI was steady led by strong growth in output and new orders. Services PMI saw a drawdown due to sluggish demand.

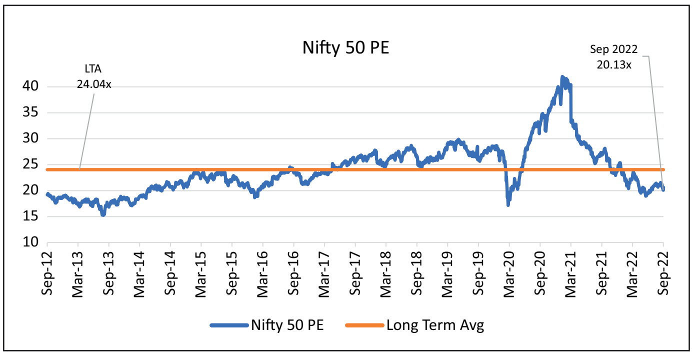
GST Collection/other HFI



GST collections for September rose to INR 1.47 trn.

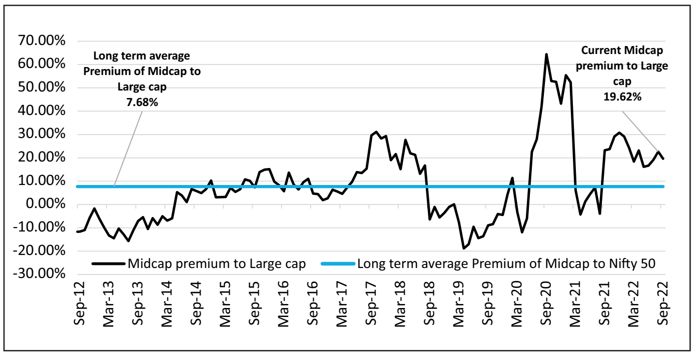
Domestic Valuation Trends

Nifty PE



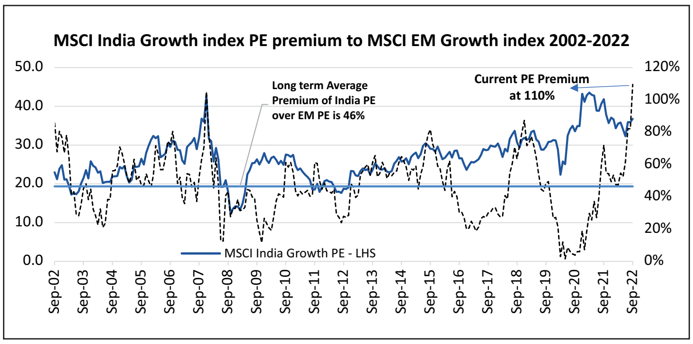
Frontline index Nifty 50 PE valuation indicates a drop below the long-term trend levels

Large cap to midcap



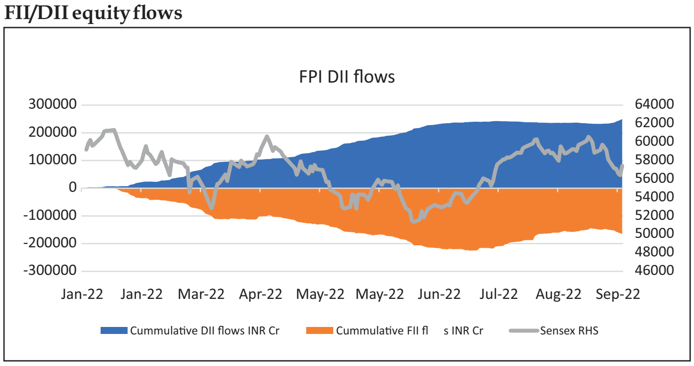
Midcap segment premium to Large cap segment in terms of PE based valuation indicator trends above long term average

MSCI India vs MSCI EM



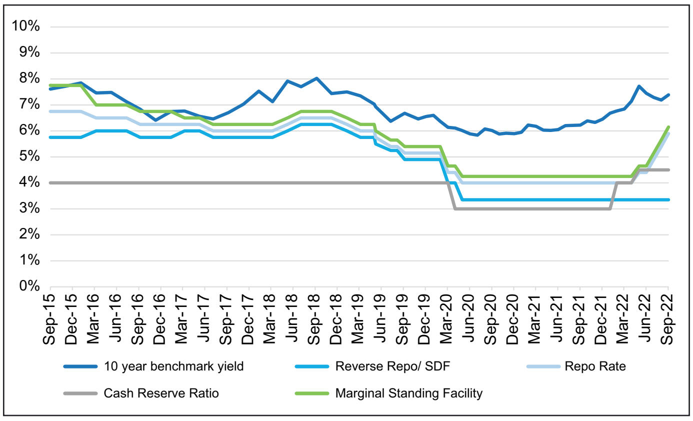
Indian equities have been one of the best performers in YTD 2022, yielding positive returns in contrast to most DMs and other EMs declining during the period and hence continue to trade at a premium valuation (above long-term average levels). This premiumization is supported by structural strength of the economy.

FII/DII equity flows



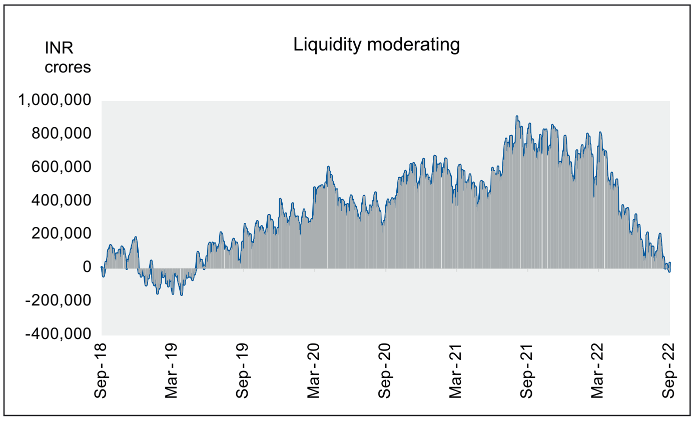
FPIs continued to remain net sellers during YTDCY2022. DIIs supported with net positive flows.

Domestic Interest rate trend



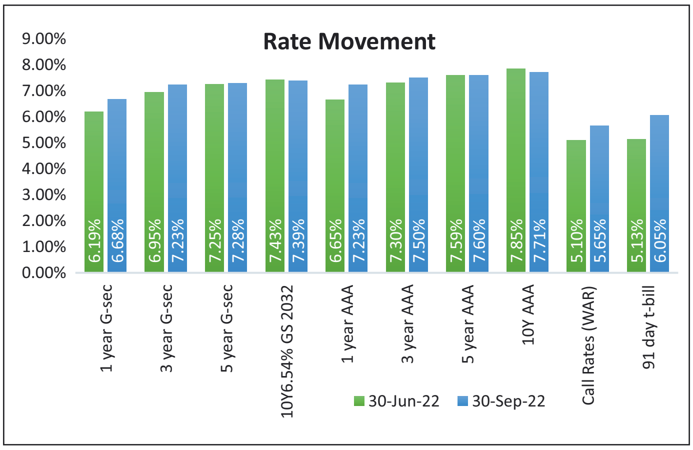
In view of sticky core inflation, ongoing improvement in domestic economic activity and expected support from festive season demand, Monetary Policy Committee (MPC) proactively continues to prioritize anchoring inflation expectations so as to avert likely second round effects of inflation. Accordingly, the MPC voted unanimously to increase the policy repo rate by 50bps to 5.9%. Consequently, the Standing Deposit Facility (SDF) rate stood at 5.65%. The Bank rate and Marginal Standing Facility (MSF) were at 6.15%. The committee remains focused on withdrawal of accommodation to steer inflation to be within target band as well as to support medium term growth.

Domestic Liquidity trend



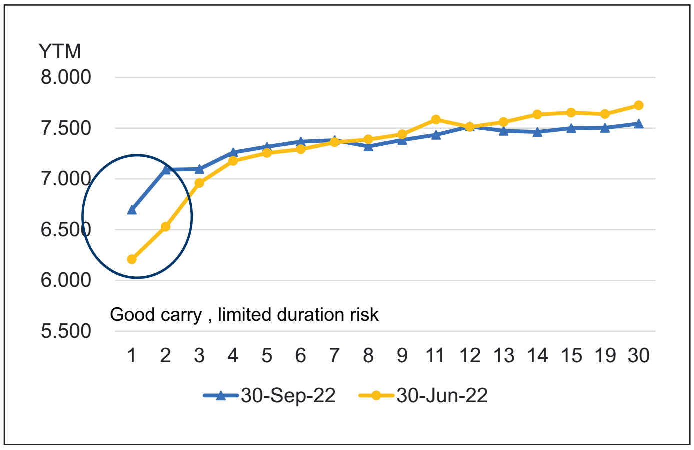
The overall system liquidity continued to moderate, with average daily absorption under the LAF at INR 1.2 lakh crore during Jul-September.

Domestic rate movement:



In September 2022, the 91-day treasury bill yield curve rose to 6.05% adding 92bps while the 10-year government securities yield declined by 4 bps.

Yield Curve



The G-sec yield curve continues to remain steep in the short end up to 2-year maturity bucket while the longer end of the yield curve has mostly remained flat in September.

Domestic Macros Heatmap

Fiscal Year End	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	Latest*
GDP Growth (%)	5.6	6.6	7.2	7.9	7.9	7.3	6.1	4.2	-7.4	4.1	4.1
CPI Inflation (%)	10.2	9.5	5.9	4.9	3.8	3.6	3.4	5.8	5.5	7	7
Current Account (% of GDP)	-4.8	-1.7	-1.3	-1.1	-0.6	-1.9	-2.4	0.1	-0.2	-1.5	-1.5
Fiscal Deficit (% of GDP)	4.9	4.5	4.1	3.9	3.5	3.5	3.4	4.6	9.3	6.7	6.7
Crude Oil (USD/Barrel)	109	107	53	39	60	58	65	23	59	111	87.96
Currency (USD/INR)	54	60	63	66	65	65	70	75	73	76	81.35
Forex Reserves (USD bn)	292	304	342	356	370	424	413	490	579	606	537.5
GST Collections (INR billion)								1222	1239	1421	1476

*GDP data for Q1FY23, Fiscal Deficit data is as of FY22, CPI data as on 31-Aug-2022, Crude oil, currency, forex Reserves and GST collections as on 30-Sep-2022.

Source: Bloomberg, RBI, MOSPI, Morgan Stanley

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Equity Market Snapshot

Anand Radhakrishnan, CIO – Franklin Equity

Corporate earnings

For Q2FY23, Banking sector earnings growth is expected to stay healthy led by higher business growth, NIM expansion, and a sustained reduction in credit cost. Slippages and credit costs could remain controlled. The Auto sector margins could improve in Q2FY23 driven by volume recovery, price hikes and operating leverage, despite the residual impact of an increase in raw material cost. Consumer sector could recover on account of price hikes. However, the recent declines in commodity prices could likely be passed on to consumers to boost volume growth. Though recovery in rural demand is likely to be gradual, premiumization in urban India could support staples sector growth. Strong demand is expected to aid earnings trend in discretionary sector. Tech sector could see a moderation in earnings trend led by lower tech spends from 2HFY23 and leading to deal-win moderation for IT vendors.

Outlook:

Globally, commodity prices have considerably cooled down, though still above pandemic levels. IMF growth estimate for India GDP stands at 6.1% (2023) versus 3.9% for EMDE and compared to 1.4% for DMs (July 2022 forecast). Indian domestic demand shows relatively healthy growth trend supported by private consumption growth, which remained resilient on a 3Y CAGR basis. Incrementally we view the contribution from exports to lower on account of weakness in external demand. Domestic demand will likely continue to provide a partial offset to slower external demand. Moderation in global commodity prices also bodes well for near-term inflation and margin outlook. Domestically, Indian economy could experience the impact of global demand slowdown over the next few quarters driven by weakness in exports and rub-off effect on other sectors. From the near-term perspective, tightening liquidity conditions, any spike in commodity prices could pose risk to domestic growth trend.

That said, macroeconomic strength continues to manifest in the form of improving high frequency consumption and industrial indicators. An improving trend is seen in corporate and financial sector balance sheets coupled with policy reform initiatives. Corporate debt to GDP is at a 15-year low while banking sector impaired loans are at a 10-year low. Ratio corporate of profits to GDP is likely to increase in the coming years. The private capex cycle could be supported by the following factors. (i) Cyclical improvement in demand and capacity utilization, (ii) Cleaner corporate and financial sector balance sheets, (iii) Structural reforms such as corporate tax rate reduction, implementation of PLI schemes, and focus on infrastructure, and (iv) Global supply chain diversification in favor of India. This backdrop of healthy balance sheets and rising corporate confidence bodes well for the outlook for business investment.

Indian equities have been one of the best performers in YTD 2022, yielding positive returns in contrast to most DMs and other EMs declining during the period and hence continue to trade at a premium valuation (above long-term average levels). This premiumization is supported by structural strength of the economy.

Investors may participate in a staggered manner and invest systematically for the long term. We focus on three key themes in our portfolios including (i) focus on domestic cyclical sectors which are early beneficiaries of uptick in the economic cycles (ii) Consolidation in various industries led by shift from unorganized to organized sector (iii) identifying beneficiaries of tech-led disruption which exhibit long term sustainable of their unique proposition.

Fixed Income Market Snapshot

Santosh Kamath, CIO - Fixed Income

Outlook:

The Repo rate hike of 50 bps announced in September's monetary policy review is in line with market expectations. Current increase takes the total post covid Repo rate hike to 190 bps. System liquidity surplus levels have considerably lowered from around INR 8 trn in January 2022 to INR 1.2 trn in September 2022. Slowing global growth, tighter liquidity conditions hampering global demand and resultant impact on domestic exports, among other factors have led the MPC to lower GDP growth estimates for FY23 (7%). Inflation projection is unchanged for FY23. The policy highlights concerns arising from uncertainty around global growth trend and persistent inflationary pressures. As the global central banks try to make up for the slower start to policy tightening measures, their intent to firmly stay the course of hiking rates at the current pace highlights their resolve to anchor inflation expectations. Franklin Templeton (reference article* Paradigm shift) expects the FOMC terminal rates to reach a minimum level of 4.5% with a likelihood of scaling 5%-5.25% on the upside. As a spillover effect, this in turn could necessitate higher expected terminal rates domestically. We revise the terminal Repo rate projection higher from 6.0%-6.25% to 6.25%-6.5% for FY23.

We remain neutral on the market borrowing numbers since the marginal drop in the central borrowing in H2FY23 is being offset by a rise in the state borrowings. The likely rise in fertilizer and food subsidies could potentially warrant an adjustment to the borrowing numbers towards the close of the year.

The G-sec yield curve continues to remain steep in the short end up to 2-year maturity bucket while the longer end of the yield curve has mostly remained flat during the month. Post policy announcement, 2-year G-sec yield rose 11 bps and the 10-year G-sec yield hardened 7 bps (1-day movement). Yields in the 13- and 14-year maturity buckets marginally slipped and the 30-year G-sec yield hardened by 4 bps during the day. For the month, the 1-year G-sec rates have risen by ~35 bps while the 10-year G-sec was up by ~21bps for the month.

Led by expected rate hikes and tighter liquidity conditions, we continue to favour the low-to-moderate maturity segments while identifying tactical opportunities in the longer maturity segments. Investors may consider shorter maturity funds and floating rate funds as they provide a hedge against a rise in interest rates.