MARKET OUTLOOK

May 2025

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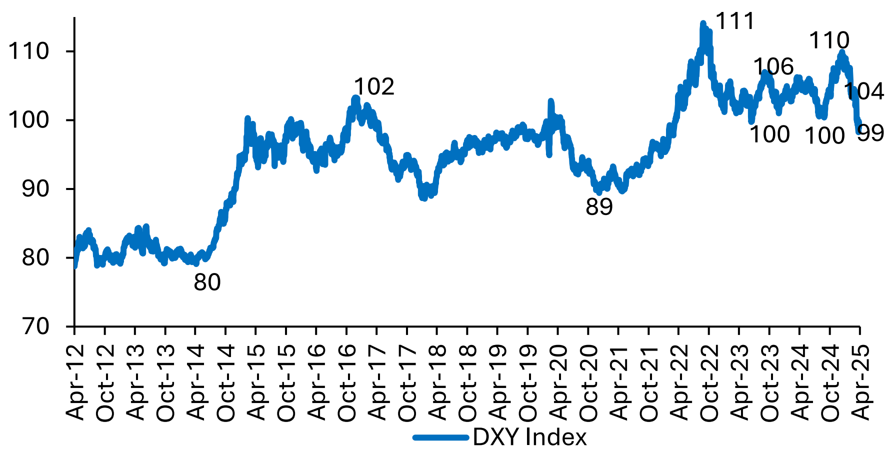
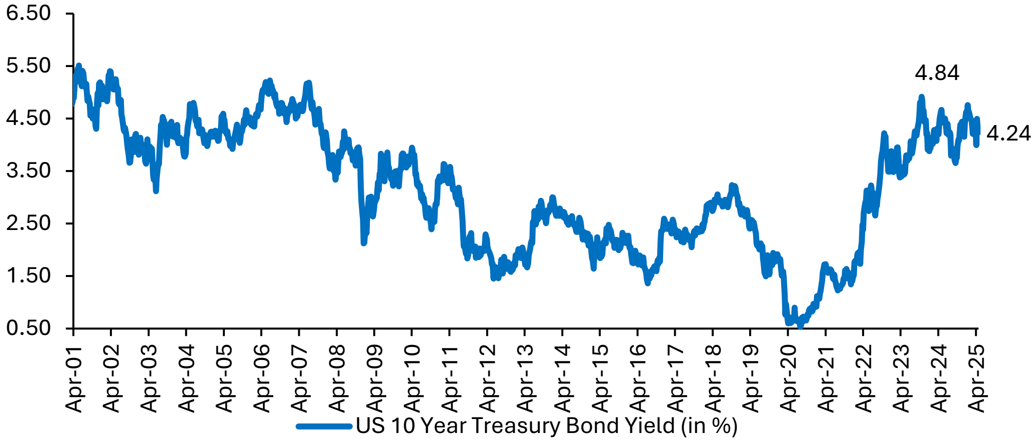
April was an eventful month for financial markets, Indian as well as global. The month started with the announcement of the much-anticipated reciprocal tariffs by the US, with the eventual tariff outcome being far worse than feared. However, shortly thereafter a 90-day breather was announced in implementation of these tariffs, beyond the initial 10% increase, for most countries except China. The tariff war between the US and China only intensified with neither of the two countries looking to back down. The net effect of the "Liberation Day" tariffs have been the changed outlook with financial market sentiments broadly converging to being liberated from the thesis of "US exceptionalism". This is reflected in weaker dollar, higher yields as well as steeper yield curve and possible diversification over time incrementally from US dollar assets.

DXY Weakens





Equity

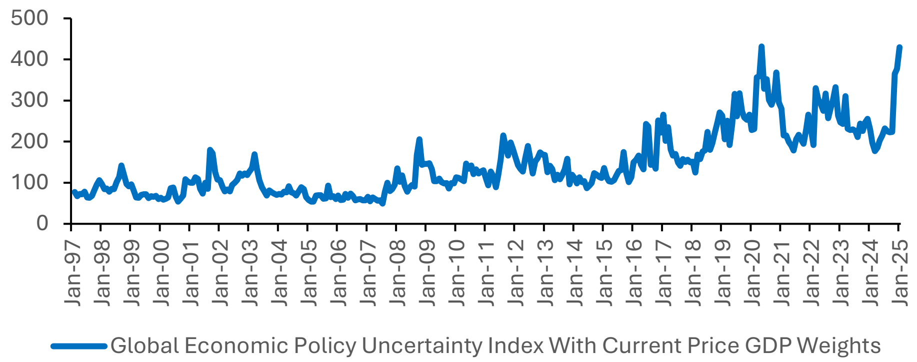
Amidst the to and fro on tariffs, Indian equities gained for the month with the Nifty and the Sensex rising 3.5% and 3.7% respectively. This wasn't however without significant volatility with the Nifty first dipping over 7.5% intra month before staging a nearly 12% recovery from those lows. On one hand, there is hope that India and the US will negotiate a mutually beneficial trade deal, on the other the RBI has been aggressive on its triple easing on rates, liquidity and regulation to support growth, bolstered by easing inflation. Amidst these positives however, the big question mark on global growth and its impact on the Indian economy remain. Global economic uncertainty has soared and may impact corporate capex plans going forward putting a ceiling on Indian growth even as potential market share gains in the event of a successful trade with the US as well as RBI actions act to put a floor.

Amidst this background, Foreign Portfolio Investors turned buyers of Indian equities, even as overall market breadth continued to weaken. On sector performance, outward facing sectors underperformed.

On our allocation framework, the significant decline in Indian 10-year bond yields along with a derating on price to earnings multiples over the past few months had led to valuations turning more modest on our preferred gauge of earnings yield to bond yields spread, versus the rich valuations of the past year. Similarly, the continued weakness in market internals has meant that the readings on our proprietary Equity Sentiment Index have continued to dip below zero suggesting more fear than greed. This is in stark contrast to the extreme exuberance of the past year. We see both these as welcome changes and from a contrarian standpoint, these developments have led us to turn neutral on equities versus the underweight stance of the past year. That said, neither valuations nor sentiment are at pessimistic extremes to warrant an overweight on equities yet even as we think these are better entry points for long term investors versus last year.

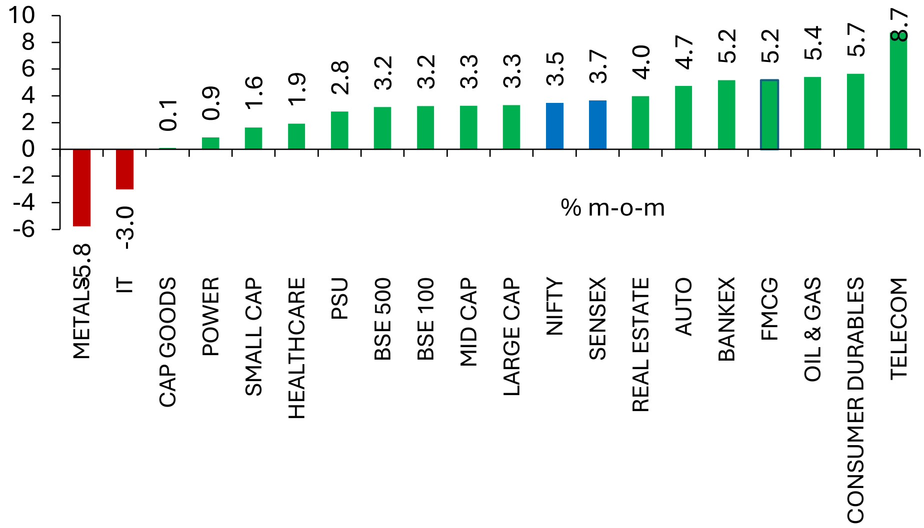
Finally, on portfolio positioning we continue to think that amidst the ongoing macro uncertainty and heightened market volatility, market action is likely to turn more stock specific now versus the indiscriminate rally of the past year. Quality and long-term fundamentals will start getting rewarded versus narrative based and to some extent speculative price action of the past year, in our view.

Global policy uncertainty has surged sharply, may dampen corporate investment plans



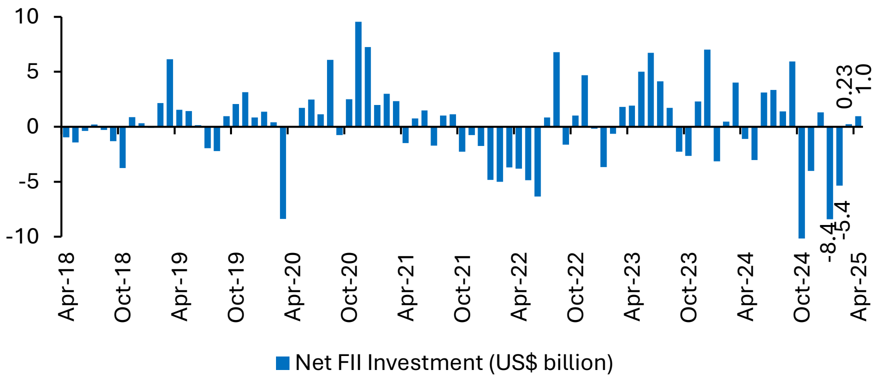
Source: Bloomberg, SBIFM Research

Outward facing sectors underperformed in April



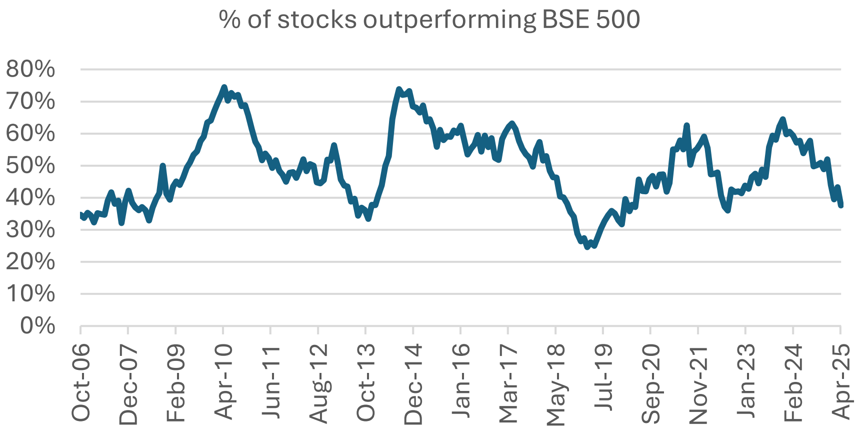
Source: Bloomberg, SBIFM Research

FPIs turned buyers in April



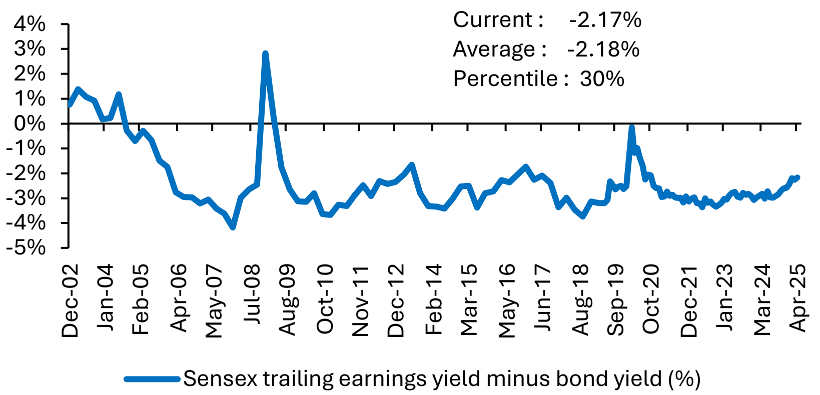
Source: Bloomberg, SBIFM Research

Market breadth still weakening



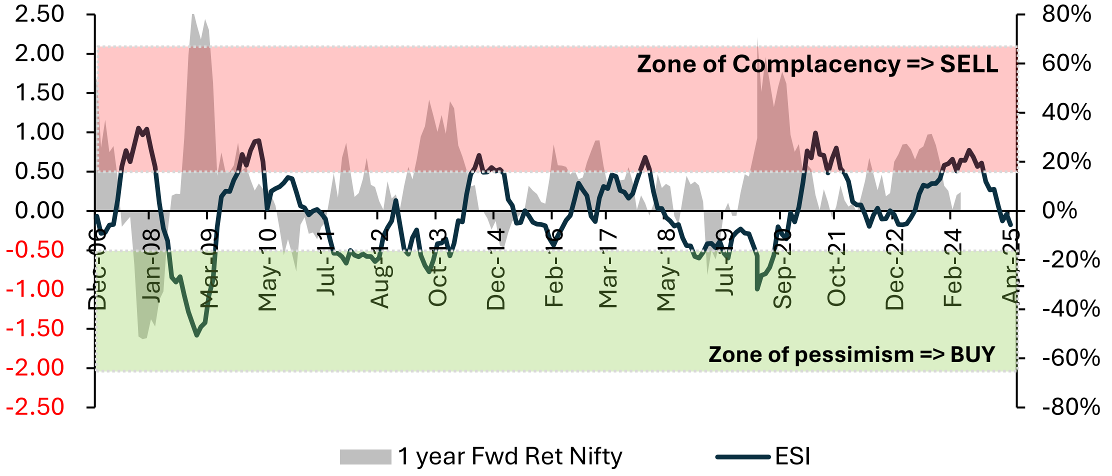
Source: Bloomberg, SBIFM Research

Valuations have moderated on earnings yield to bond yield spread



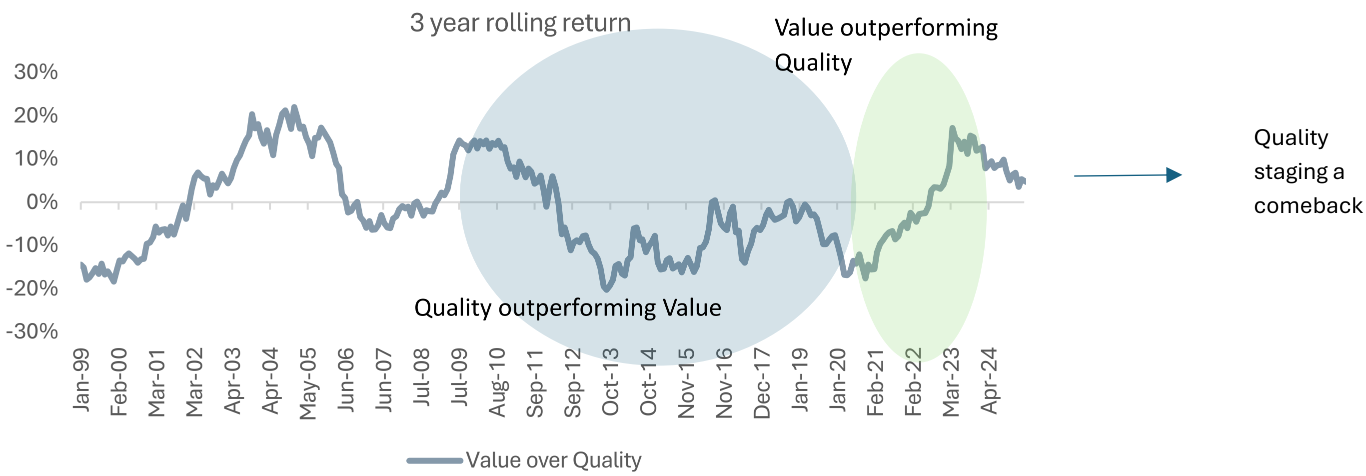
Source: Bloomberg, SBIFM Research

Equity Sentiment Index firmly below zero suggesting more fear than greed



Source: Bloomberg, FactSet, SBIFM Research; Note: ESI stands for Equity Sentiment Index, our proprietary equity market sentiment measure.

Prefer Quality on portfolio positioning



Source: FactSet, SBIFM Research. Returns are the difference in rolling 3-year CAGR returns of the average of top 2 quintiles on the two styles. The classification into quintiles is based on SBIFM's definition of the respective style/factor. A falling line indicates Quality's performance improving versus Value and vice versa.

Fixed Income

The RBI policy review and subsequent liquidity actions indicate a clear bias towards accommodating growth concerns. A shift to accommodative stance, notwithstanding the earlier reference to global uncertainties has been the key takeaway apart from the 25bps cut in the repo rate. The policy guidance also has affirmed that in the absence of any material shocks, the direction of monetary policy going forward is biased towards further cuts or a pause. Effectively the key message was the unambiguous focus on domestic growth and the confidence that forward looking inflation is likely to be aligned closer to the policy target of 4%. Alongside the demonstrated commitment to address liquidity dynamics, the policy stance clearly opens the likelihood of additional rate cuts in this cycle. This has been enabled by projections of softer growth than anticipated as well as visibility of forward-looking inflation aligning closer to 4% on a 12mth basis.

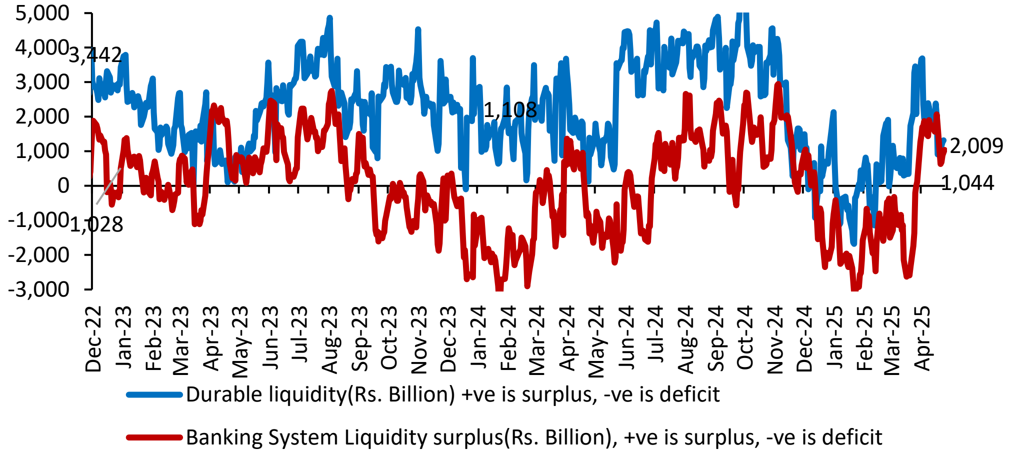
RBI has revised its FY26 growth and inflation projections downward by 20bps each, lowering the growth forecast from 6.7% to 6.5% and inflation from 4.2% to 4.0%. The evolving global landscape clearly provides downside risks to the growth estimates.

Apart from the stance, the central bank has followed up with further liquidity infusion measures through OMO purchases and longer term VRR (43 days). Cumulatively the additional OMO's announced included Rs 80,000 crs for April and additional Rs 1,25,000 crs to be conducted till May 19th.

The cumulative impact has been a steepening of the curve even as broad market rates have eased across the curve.

G sec	28-Mar-25	30-Apr-25	Apr change
3-year G Sec	6.43%	6.05%	-0.38%
5-year G Sec	6.48%	6.11%	-0.37%
10-year G Sec	6.58%	6.36%	-0.22%
15-year G Sec	6.69%	6.45%	-0.24%
30-year G Sec	6.90%	6.78%	-0.12%
slope 3x30y	0.47%	0.73%	
SDL			
10-12Y	6.95%	6.73%	
AAA- PFC			
1Y AAA	7.40%	6.84%	-0.56%
2Y AAA	7.24%	6.82%	-0.42%
3Y AAA	7.24%	6.84%	-0.40%
5Y AAA	7.20%	6.87%	-0.33%
10Y AAA	7.10%	6.94%	-0.16%
Slope 1x10y	-0.30%	0.10%	

Banking system liquidity remained in ~1tn surplus through most of April



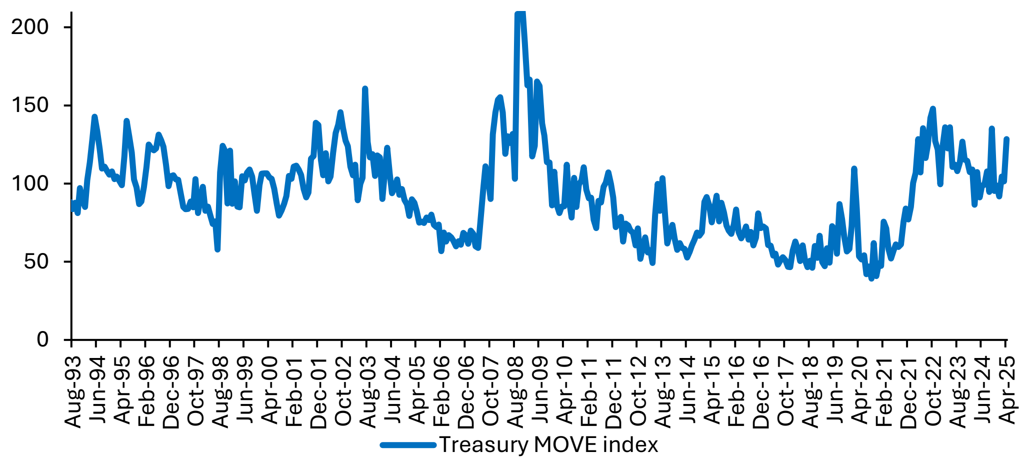
Source: Bloomberg, SBIFM Research

Even as the domestic monetary policy direction has shifted over the course of the second half of last fiscal year, the shift in liquidity operation clearly has been more prominent. This shift has a large bearing on the likely evolution of market rates.

Global landscape and impact:

The RBI policy stance has clearly shifted, rightly so in line with the evolving growth- inflation matrix domestically. While this has impacted the domestic yield trajectory positively, the same has coincided with a phase of extreme volatility in rates markets and financial markets globally. To the extent that recent policy changes in the US question the thesis of "US exceptionalism", emerging markets with better policy stability and relative macro strength should benefit from reorientation of global capital flows. Higher nominal yields on hard currency global sovereign bonds could constrain incremental debt inflows in the near term. At the same time, the relative macro strength and real yield visibility alongside capital gains opportunities should ensure a stable environment over the medium term with respect to the stock of offshore bond holdings.

Increasing volatility in US Treasuries



Source: Bloomberg, SBIFM Research

Liquidity actions:

The impact of liquidity actions, with a cumulative liquidity injection of Rs 10.8 trillion (Including CRR, OMO's, Forex Swaps and long tenor VRR operations) since Dec 24 has clearly led to better transmission and would continue to be relevant going forward. In the near term, the RBI dividend transfer would be an additional positive factor on liquidity. Interestingly the post policy press conference did indicate the RBI's preference for a liquidity surplus of around 1% of NDTL. While this could well be a moving target, the formal liquidity operations review being undertaken could possibly indicate a similar tolerance range on liquidity conditions.

Visibility on rate easing/ Policy Stance:

The RBI is widely expected to ease policy rates further in the upcoming months given the recent guidance. With a directional view on positive durable liquidity in the system, the recent transmission into market interest rates is expected to be sustained. Incremental RBI actions have clearly been toward aligning system rates lower in line with the prevailing monetary policy signalling rate. Even as the terminal rate debates could keep emerging with varying estimates of additional easing, we anticipate that the cumulative easing incrementally could be at least 50 bps. The anticipated view on additional easing, unlike our earlier view of policy rates settling around 6% has emerged basis the evolving growth- inflation scenario and assessment of RBI' s stance. The anticipated near-term additional liquidity infusion (helped by RBI dividend) could effectively result in periods where the effective overnight rate settings stay below the Policy repo rate.

Spreads on high grade bonds at the shorter end remain attractive. Given the anticipated external volatility and its likely resetting of market expectations, strategies on duration would incrementally be subject to ongoing review and would require to be nimble. A directionally softer rates environment outlook over the coming year provides a near term visibility to maintain a higher duration stance.

Short tenor high grade bond funds continue to provide higher accrual, wider spreads as well as an optimum risk/ reward that provide opportunities over the coming months as well as into the coming year. Credit/ carry focused strategies also would emerge as attractive proposition for investor with credit and liquidity risk tolerance. The vagaries of equity market volatility also make hybrid products more relevant in the current market context.