Equity Market Review

Indian stock market continued to be weak in the month of October on the back of worries around liquidity tightening in the credit markets, fear of defaults and currency depreciation. Nifty and Sensex ended the month of October with (-5%) and (-4.9%) returns.

Global markets witnessed a sharp selloff on concerns of a global slowdown due to trade wars, mounting geopolitical tensions and uncertain oil markets. Worldwide Dow Jones and FTSE were top performer with (-5.1%) return, followed by Euro Stoxx (-5.9%) and Nikkei ended with (-9.1%) return. Hang Seng was the worst performer with (-10.1%) returns.

MSCI Emerging market underperformed Indian domestic market with (-8.8%) returns. MSCI AWI Index ended with (-7%) returns. BSE Mid cap and BSE Small cap indices both outperformed its larger peers. BSE Mid cap index ended with (-1%) and BSE Small cap index ended the month of October with (-1.6%) returns.

Sector Performance

Month of October was a mixed bag as majority of the sectors traded with a negative bias and ended in red. Capital Goods was the top performer with (+2.2%) return. Power (+1.5%), Banking (+1.3%), Real Estate (-1.4%), Healthcare (-2%) and Consumer Staples (-3.3%) outperformed Nifty. Metal (-5.7%), Information Technology (-7%) and Auto (-7.4%) underperformed Nifty. Oil & Gas (-10.8%) was the worst performer.

Institutional Activity

FII continued to be net sellers in month of October with $3.7 Bn of outflows during the month which took their YTD net outflow to $5.7 Bn. Domestic investors continued to be net buyers with net inflows of $3.5 Bn taking their YTD tally to $15.7 Bn. Mutual Fund continued to be net buyer for 27th straight month with net buying of $3 Bn in October. Insurance companies were also net buyers during the month with inflows of $558 Mn.

Macro-Economic Developments

IIP for the month of August came at 3 month low of 4.3% as mining sector output witnessed a sharp decline and capital goods saw a poor offtake. Out of 23 industry group 16 witnessed positive growth. Manufacturing output witnessed a 4.6% growth while capital goods production decelerated by 5% and mining contracted by 0.4%. CPI for the month of September remain unchanged at 3.8% despite a surge in global oil prices, sharp increase in MSP for winter crops and below normal monsoon. Food inflation came at 1.1% showing little impact of MSP price, while core inflation excluding transport remained elevated at 5.7%. WPI rose to 5.13% in month of September on back of hardening food & fuel prices. Trade deficit for the month of September moderated to $14 Bn lowest levels in last 5 months on back of deceleration in both exports and imports. Majority commodity group showed positive export growth with petroleum products (26.8%) & inorganic chemicals (16.9%) leading the pack. Contrary to market expectations, MPC kept policy rates on hold changing stance from "Neutral" to "Calibrated tightening". While CPI forecast had be lowered on lower food inflation but concerns over upside risk to inflation came from rising crude prices and depreciating rupee.

Outlook

Nifty has wiped out majority of its gains in the last two months led by escalating volatility on the back of unsupportive global and domestic events. We can expect volatility at elevated levels especially given the market concerns about a global trade war and uncertainty around oil. It looks likely that markets will continue to closely monitor election outcomes in few key states in run up to general elections. We expect the economy to recover as GST related disruption smoothens and consumption revives on back of improving farm income and implementation of pay commission. Q2FY19 earnings season has started well and management commentary sounds promising. After the recent correction valuations are now trading closer to long term averages and provide opportunity to invest in strong and able management. The liquidity concerns have improved over past few weeks as money market rates have been coming of its recent highs. We continue to remain positive on long term India story and stay invested in companies with earnings visibility and reasonable valuations.

Debt Market Review

Indian sovereign bond posted their first monthly decline in three by a drop of 20 bps to 7.83% vs 8.03% in September. The 10-year G-Sec yields cooled this month as the central bank bought debt to replenish liquidity

In October, the Reserve Bank of India (RBI) announced Rs 360 billion of open market operations (OMO) to buy bonds from the secondary market. In November, it plans to buy Rs 400 billion worth of secondary market bonds.

Market Performance

The 10-year benchmark G-sec yield closed at 7.83%, down by 20 bps from its previous close of 8.03% while that on the short-term 1-year bond ended 15 bps lower at 7.45%.

In the corporate bond segment, yields fell across the yield curve over the month. The 10-year AAA bond yield ended 10 bps higher at 8.75%, while the short-term 1-year AAA bond yield ended 5 bps down at 8.65%.

The spread between 1-year and 10-year AAA bond narrowed. Within the short term segment, yield on 3-month commercial paper (CP) was up 25 bps to 8.50% while 1-year CP yield was up 30 bps at 9.40%.

Macroeconomic Highlights

The Reserve Bank of India in its fourth Monetary Policy Committee meeting of FY19 kept the repo rate unchanged at 6.50%.

The Nikkei India Manufacturing Purchasing Managers' Index rose to 52.2 in September from 51.7 in August on the back of stronger gains in new orders, output and employment.

Services sector touched 50.9 in September, down from 51.5 recorded in August as higher fuel costs and stronger US dollar made imported goods expensive.

Industrial production growth slipped to a 3-month low of 4.3% in August vs 6.6% in July mainly due to a sharp decline in the mining sector output and poor offtake of capital goods.

Retail inflation rose marginally in September to 3.77% vs 3.69% in August, nudged up by food and fuel prices. wholesale price inflation (WPI) surged to 5.13% in September from 4.53% in August.

Trade deficit narrowed to a 5-month low at $13.98 billion in September. Exports contracted 2.15% in September while imports grew 10.45% in dollar terms.

Outlook

October has clearly been a tale of two extreme halves. The first half of October saw the peak of market jitters, with oil hitting a high of USD 86 / barrel, INR hitting a low of 74.48 / USD, 10 year government bond yield at a high of 8.16% and credit worries around solvency of NBFC/HFCs threatening to unleash a systemic panic attack. Nervousness spread to the equity markets too, with sharp falls across segments but especially in NBFCs/HFCs due to the credit issue overhang.

However, each of these parameters started turning around in the second half of October.

- Oil, after hitting a peak of USD 86/barrel, collapsed by almost USD 10 by month end. INR too reversed course with a sharp rally, driven not just by oil, but also broad EM currency strength seen across other hitherto vulnerable currencies such as BRL and TRY.
- With RBI proactively announcing its calendar of OMOs (Rs. 36000cr for October, followed by Rs. 40,000cr for November – the demand supply situation in gilt markets has clearly turned around with hardly any net gsec supply for the markets to absorb. With momentum swinging around, FPI selling in bond markets abated, and traders got back into action on the long side after a protracted period of neutral to short positions.
- Finally, with various NBFCs/HFCs taking drastic measures such as loan selldown, stopping incremental disbursements, raising funds at high interest rates – gradually worries around another default in the cond / CP market started abating, and primary fund raising deals at least in the short end (2-3 month CPs) for a few NBFCs/HFCs started getting done, thereby gradually unfreezing the markets for such borrowers.

Having said that, some of these factors such as oil, global risk sentiment, FX weakness could come back just as fast, and hence investors need to be vigilant about these risks. The on-going war of words between the RBI and the Government could also take an ugly turn, if not handled properly by both sides and hopefully – professionalism and a pragmatic approach towards problem solving will get the two parties back on the same path. If not, markets could see a sudden rise in volatility and risk aversion as well.

As pointed out earlier, we have moved from a cautious, short duration stance across our various funds, to a neutral (in a few funds- overweight) duration approach. Cash levels, which were running high in anticipation of further sell-off, are gradually being deployed back by us, into specific segments where we believe the sell-off provides attractive carry while still keeping risks limited.

The 2-5 year G-Sec segment appears attractive, so also does the 1-3 year AAA corporate bond segment. The L&T MF approach of keeping high quality funds such as L&T Ultrashort Term, L&T Short Term Bond fund, L&T Banking and PSU Fund invested only in the top quality AAA papers ensures that credit risks in these funds are kept at a minimum, and we would advise investors to start looking at these segments gradually, given the attractive carry they offer.

As pointed out in our earlier outlooks as well, while we are cautious in our outlook for yields over the next 1-2 quarters, from a longer term perspective however, we believe interest rates are nearing the upper end of the range, and price in a majority of the negative factors currently at play. From a 3-5 year perspective, we believe investors who can absorb near term volatility, could gradually allocate a portion of their long term savings (by spreading out investments over the next 2 quarters) to debt products which invest in the longer end of the AAA corporate bond curve such as the L&T Triple Ace Bond Fund. We believe such a strategy should do quite well, especially compared to investing in tax free bonds or long term FDs where current yields are quite unattractive.

Source: Bloomberg

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