Sundaram Portfolio Managers - Market Outlook

October witnessed the Sensex grow by 4.1% to 39,614. The global narrative was dominated by the uncertainty in the run-up to the US elections, a rising 3rd wave of infections in the US, a string of lockdowns and restrictions across Europe, and GDP growth surprises. On the domestic front, the RBI's liquidity push / housing impetus, multi-year high PMI numbers and the government's fiscal package were the highlights of the month. FII inflows during the month stood strong at $3bn. The rupee witnessed a depreciation of 0.5%, while the dollar index (DXY) witnessed marginal strength of 0.1%.

Global

October was a month of weakness and volatility for developed economies on the back of surging infections in the western world. Europe experienced record infection spikes that eventually led to Germany, France and UK imposing moderate nation lockdowns and Italy, Spain, Belgium and Greece imposing various degrees of national restrictions. The US' 3rd wave surged and crossed the peak of its earlier 2nd wave. While European markets reflected the economic impact of restrictions, the US administration has consciously stayed away from controlling the pandemic. For this reason, the US markets remained focussed on the expectation of a protracted election season. The month also saw a brief pause in vaccine progress on account of untoward reactions in trials. In all this, emerging markets remained relatively unaffected and Indian markets continued to grow, despite market weakness globally. In the US, the pre-election highlights included a number of failed talks between the Democrats and the Republicans on the passing of the next stimulus package in the US. Tensions around US-China relations remained alive with commentary from the US on blacklisting China's Ant group, its fin-tech major. The US also targeted select Chinese companies that were allegedly using forced labour in the manufacture of their exports. China's GDP for the Q3 quarter continued to hold up and surprised estimates, while the US and Eurozone drew a sharp 'V'-shaped recovery, comfortably beating market expectations, on the back of strong consumption demand. In line with this, the IMF also upgraded global growth appreciably for select developed and emerging economies. Global manufacturing activity witnessed a pickup alongside strength in US manufacturing and services, reflected in their respective PMI prints. US consumer confidence touched multi-year highs alongside increasing strength in US housing and labour market positivity.

Central banks

The monetary policy space globally remained quiet with barely any rate actions witnessed. The market focus in the US was more on the narrative from the Federal Reserve officials on the need for another fiscal package, and expectation of policy action from the ECB. The ECB's monetary policy was a disappointment as the central bank did not announce any bond purchases. To the contrary, it was heard adding downside risks to growth on account of the rising infections curve in Europe.

Domestic

October saw a slew of positive macro numbers. Wholesale and retail inflation were seen inching up higher on vegetable prices. The positives seemed to outweigh the above with an 8 year high in manufacturing PMI and an above consensus services PMI. Into November, these were seen to have surged further. The GST collections for October reflected this momentum and was seen moving back to Feb'20 levels. The month also saw a pickup in core infrastructure growth, energy consumption, freight traffic increase across key commodities and continued strength in e-way bill generation. India's current account surplus recorded a 13 year high on falling imports. Macro data apart, the 42nd GST council meeting was held, and the council approved the extension of the tax surcharge on cars and tobacco products well into 2022. This was to help the states repay loans borrowed from the centre to bridge revenue shortfalls. The government launched a SVAMITVA scheme that aims at digitising rural land parcels using latest technology and help rural households borrow from banks using their land as collateral. On the monetary front, while the RBI stood pat on rates, the focus of the policy was continued liquidity infusion and an impetus for housing through rationalisation of its risk weights. On the fiscal front, India announced Rs.730bn of fiscal measures during the month totalling 0.4% GDP. The package was a set of four measures that included conditional tax free LTC vouchers for government employees, one time festival advance, interest free 50Y loans to states for capex and a top-up for the centre's own capex budget for the year. In order to ease burden for the states, the centre announced a borrowing of Rs.1.1tr from the markets that would eventually be used to meet the shortfall of the states. This would be added to the states' fiscal deficit, remaining neutral for the centres. The end of the month saw a sharp contraction in the centre's revenue and capex spending. However, on a closer analysis the spending seemed to be very focussed on agri and rural ministries. Given the strong narrative heard from the centre on more directed spending and capex, the ministry savings from this cut are likely to be redirected into another economic package in the coming months.

Flows

The month of October witnessed a drop in equity inflows, led distinctly by outflows from Europe and the US. Most of the US outflows are likely to have been on the back of expectations of election-related volatility. Europe on the other hand saw outflows on its rising infections curve. These layers of concerns witnessed an increase in bond inflows and more gradual money market outflows. Emerging markets saw inflows and appeared to resist tagging global weakness to a large extent. India saw equity inflows to the tune of $2.5bn and debt inflows to the tune of $0.5bn. With rising COVID infections in Europe and election-related concerns in the US, the month of November could see volatile inflows if the US election results are contested / delayed.

Outlook

The month of October witnessed Indian markets decouple with global markets in a significant way. While the US and European markets delivered sharp negative returns, the Indian markets remained resilient and delivered strong positive returns in line with other key emerging markets. It appears likely that post the US election volatility and easing of the European infections curve, developed markets could stabilise / reflect outlook. From the global equity market bottom of 23rd March'20, the Sensex has clocked north of 52% and has witnessed $12bn+ of FII money flows into Indian equities. The western world continues to see a rising infections curve. The US entered its 3rd wave at the start of September with a pickup in momentum in October, reaching record highs. However, like we mentioned last month, this has not had any significant impact on economic activity in the US on the absence of any restrictions from the government. The Trump administration remains consistent in not wanting to control the epidemic and negatively impact businesses. As a result, US macro data continues to remain strong with particular focus on the labour market revival and evident strength in housing. Europe on the other hand has witnessed weakness in macros as a result of the various lockdowns and restrictions across its major countries of Germany, France, Italy, Spain and the UK. In India, we clearly peaked on infections in September and October saw India's infections curve ease considerably with steady rates of testing and near 90% recovery rates.

It is important to acknowledge here that the third wave in the US and the surge in Europe's second wave are on the back of the onset of fall/winter in the western world. These climatic conditions are very conducive for the spread of the virus that is flu-like and respiratory in nature. A second reason for the rise in infections globally has been the pickup in activity post the phases of restrictions. From an India stand-point a second wave seems unlikely. This is because, activity on the group in India picked up months before and there are very few segments that need to see incremental relaxations. Secondly, India does not experience a flu season like witnessed in the west. Therefore, from where we are today, we do not expect any appreciable pickup in infections or the onset of a second wave of any kind.

The 'V' shaped recovery we have been writing about is currently playing out and would gain strength in India very similar to how it has in other emerging and developed economies. The results season over the last few months have maintained a consistent beat over consensus estimates across sectors and market segments. The strong earning upgrades are quite visible in sectors like consumption, cement, industrials, autos, metals and financials. This pickup in activity appears evident in a jump up in GST collections and the multi-year highs recorded in manufacturing and services PMIs. It seems evident now that the estimates of GDP contraction in FY21 are likely to be revised upwards in the coming months on better than expected growth rates in Q2 and Q3 FY21. Continued government support and targeted spending in specific ministries are likely to stem from savings across other ministries, which would be repackaged in the form of more measures in the months ahead. This would work to contain the fiscal deficit as well, improving credibility of the sovereign from the eyes of rating agencies.

All the above positives are likely to see a pickup in momentum, aided by the RBI's resolution framework that is set to ease the debt burden of borrowers. The recent measures taken by the RBI on letting its liquidity engine run and the rationalisation of risk weights in individual housing are added positives. It seems likely that the combination of policy tweaks in the housing space and near record low interest rates could trigger the housing engine in India which would have a multiplier effect across sectors. The previously announced PLI scheme has been made less restrictive and has done away with the criteria of minimum investment (changed to committed investment) alongside removing the exclusion on exports (from only domestic sales). This is expected to work towards strengthening the scheme further by making it more accommodative. The months ahead are set to see the PLI scheme spread into other sectors, well aligned to benefit from the China+1 strategy considered by many global companies.

We remain constructive on India and equities as an asset class. Equities are a long-term asset class and require patience from investors to reap the benefits of the long-term compounding stories we invest in. Like all investments, we reiterate the short-term volatility ahead that investors must be cognisant of. Apart from the ongoing next wave of infections in the western world, geo-political tensions, and the volatility around an expected delay in arriving at election results in the US are key events we would watch for. There have been significant developments around the COVID-19 vaccine with most contenders in the phase 3 stage of development. We continue to reiterate that a medical solution could make the current growth constraints insignificant.

Historically equity market returns have been quite good post decadal events like Global Financial Crisis or demonetisation. Global liquidity, low interest rates with a weaker USD are quite supportive of flows into riskier asset classes and provide near-term tailwinds. Valuation metrics are reasonable and provide comfort to invest for the long-term.

Source: In-house