Sundaram Portfolio Managers - Market Outlook

September witnessed a drop in the Sensex by 1.5% to 38,068, after three consecutive months of strong returns. The global narrative was dominated by a rise in infections in the US / Europe, positive macro data in the US / China, Fed's indication of continued accommodation and the chaotic first US presidential debate. On the domestic front, the passing of the agri bills, labour laws, expected expansion of the PLI scheme into other sectors and the announcement of Unlock 5.0 were the highlights of the month. FII outflows during the month were seen at $(0.4) bn. The rupee witnessed a depreciation of 0.2% even while the dollar index (DXY) strengthened by 1.9%.

Global

September was a month of market correction for both developed and emerging markets. However, the Indian market correction appeared to be much more contained in measure to their developed market peers. The start of the month was key for the US from an infection standpoint. Right from the first week of the month, daily infections in the US witnessed an increase coinciding with a rise in infections in Europe, extending its second wave of infections. Some market commentators related this to the start of fall/winter in the western world where the flu season appears to have started. While US continues to largely remain open for business, Europe witnessed increasing policy deliberations on more restrictions to contain the pandemic. Infections apart, the narrative for the month was dominated by continued positive macro prints in the US, improvement in its PMI indices and labour market positivity through a sharp, near 2% drop in its unemployment to 8.4%. While this is well above the pre-COVID levels, the pace of pickup in activity was seen to be appreciable. Chinese macro data also witnessed continued growth with higher PMI indices, an increase in industrial production, a drop in urban unemployment and retail sales turning positive after more than two quarters in the negative. While US-China tensions remained active in the backdrop, Trump's expected ban of TikTok and WeChat and it being subsequently shot down by a federal court caught the attention of the markets. The month was filled with short market triggers in the form of Chinese military videos on simulated US base bombings, money laundering reports on banks, US postmaster general DeJoy's involvement in an alleged attempt to disrupt mail-in voting and finally ending in the first Trump-Biden presidential debate. The debate ended in chaos and name calling with many commentators calling this the worst presidential debate ever.

Central banks

The central banking space remained fairly quiet in September, especially after the landmark shift to average inflation targeting by the Fed ending August. All key central banks were on a rate pause with the Fed, ECB and BoE reiterating a hold on their respective monetary policies. The dominant focus of the markets was on the Fed's economic projections released during the month. The Fed's dot plot indicated that the central bank expected its rates to stay low till 2023 and added that rate normalisation would not take place until the US got back to maximum employment and 2% inflation. The

Fed revised its projection on growth in 2020, well above its projections made in June, and forecast a sharp rise in inflation for the current year. The ECB saw a continued reiteration of its accommodating monetary policy and expressed concerns around the growth impact of the ongoing second wave of infections in Europe. The Bank of England reiterated a similar message of extended accommodation, but also added that it explored negative interest rates as a tool in its policy kit.

Domestic

Macro data in September continued to grow more positive, with infections inching closer to pre-COVID levels in many segments. The GDP numbers for Q1 helped the markets anchor their forecasts around this with a clear sense that the worst was behind us. Industrial production numbers continued its pace of improvement. The manufacturing PMI numbers witnessed a sharp increase in August and moved into the expansionary zone. This pace was seen to have continued into September as well. Inflation remained contained and stayed flat. With COVID-disruption and global factors dominating the CPI, we continue to expect the RBI to pause on rates in its October policy, wait for inflation headlines to ease, before delivering the last set of rate cuts in early 2021. On the fiscal numbers, while July witnessed the government's pace of expenditure to be broadly in line with what it had budgeted, August saw a drop in this pace of expenditure growth. With the government committed to hold up expenditure in the face of weak revenues, we expect this to pick up and move closer to budgeted run rates in the months ahead. The passing of agri bills by the Rajya Sabha and labour laws by the Lok Sabha were keenly watched by the markets, as there was increased agitation around the same. The agri bills are set to give more choices to the farmer and does away with the inter-state and intra-state restrictions imposed earlier on agri produce. The labour laws passed have been appreciated by the business community as it gives them the flexibility to hire / fire without compulsory notification to the government and facilitates the ease of doing business. The month also saw the government announce MSP hikes for six rabi crops, ahead of schedule. On manufacturing, with the success of the PLI scheme in pharmaceuticals and mobile phones, the government is expected to expand this to other sectors as well and attract manufacturing companies to set up shop. The month ended with the government announcing new guidelines for Unlock 5.0 that allows limits to be removed on outdoor gatherings, re-opening of schools from mid-October and allowing multiplexes / cinemas to open with 50% capacity.

Flows

The month of September saw a sharp drop in the inflows into money markets. The YTD money market inflows have now gone back to the levels seen during the start of April. This is also reflected in the move away from gold that saw a sharp drop during the month. One must recollect here that it was during the month of March and April that there was a significant inflow into money market funds on increasing uncertainties. While money market outflows remain a highlight positive for the month, the inflows into other asset classes like bonds and equities have not seen much of a significant shift; and the flow bias into equity ETFs continue. The flow of money out of money market funds remain reflective of the easing concerns around dollar liquidity and market liquidity in general. India saw equity outflows to the tune of \$(0.8) bn, a probable normalisation of the near record inflows of $6.1 bn seen in August. Inflows into debt turned positive to $0.4bn, from $(0.6) bn seen in August. With the US elections focus for November, flows are likely to remain volatile during the current month.

Outlook

Indian markets continue to tag the developed markets that had sharply turned positive after the large fiscal and monetary announcements from global central government and central banks. The significant flow of liquidity has held global equity markets on a continued spell of positivity. From the global equity market bottom of 23rd March'20, the Sensex has clocked a dash above 50%, exactly in line with the S&P 500. This has also brought in $9bn+ of FII money flows into Indian equity for the same period.

While the second wave in the US was easing all along, the start of September witnessed a gradual increase in infections, as the second wave progress in Europe witnessed some stalling. While there are no restrictions on activity in the US around the pandemic, this time around, Europe is much more cognisant of the economic impact of lockdowns and is being very selective and specific with the tightening of restrictions. Our longstanding expectations of India peaking on infections appear to have finally transpired and daily infections clearly peaked mid-September with two weeks of data confirming the same. Steady and continued daily testing appears to validate this drop in daily infections. It is interesting to note here that as we stand today, most of the states driving infections are seeing daily recoveries to be higher than daily infections. This effectively leads to a tapering of active cases in the respective states.

With the first wave in India having peaked, will we see a second wave like in the western economies? We believe not and for good reasons. To start with India's lockdown was the strictest in the world and has greatly helped in containing the raging infections early on. Added to this, India has also started unlocking its economy from the stringent phase witnessed in March and April and is currently rolling out Unlock 5.0. As a result, activity on the ground has resumed near normalcy at 85-90%, with just select sectors to be opened up. This is likely to ensure that there would not be any more surge in cases. It is important to note here that India's relatively low mortality rate at 72 per million, works in its favour, when compared to the high mortality rates witnessed in western economies such as the US (642), UK (621), France (490) and the like.

As a result, the 'V' shaped recovery we have been writing about is already underway, with the worst quarter Q1 already behind us. With the infections curve having peaked, the quarters ahead are likely to see a bout of normalcy and positivity. Of the Rs.3 tr of targeted loans to MSMEs, the finance ministry has sanctioned around Rs.1.6 tr of loans, under the credit guarantee schemes. Further, inquiry volumes for home and auto loans for the July-Aug'20 period are back to the levels seen for the same period in 2019. The RBI's resolution framework is now set to unfold in a calibrated manner, easing the system into further normalcy by greatly easing the financial stress in the system.

The RBI's resolution framework is a near medium term positive and is set to ease the debt burden of borrowers. It would also greatly increase the credibility of the resolution exercise, making sure that the participants are both accountable and responsible. The recommendations of the Kamath committee for 26 key sectors look at a one-time restructuring of both personal and corporate loans. Studies indicate that this is likely to benefit 66% of the pool of rated companies.

On the agricultural and labour front, India has taken long strides in the direction of progress. The Rajya Sabha's passage of key farm bills is set to empower the entire farm community in India. The bills passed will now allow the intra-state and inter-state trade of farmer produce, well beyond the areas of APMC control. Further, the bills give buyers the freedom to purchase farmer produce outside of APMCs, without having to pay any fees. The bills help in challenging the monopoly of APMCs and reduce crony capitalism at the local mandi level. It must be noted here that the bills are a move towards the market determination of India's production pattern; in the country that is heavily skewed towards excess cereal production. In short, the agri reforms must be read as India's attempt to open up its agricultural sector and its farmers to the free markets. On labour, the codes passed are expected to lead to an increase in the formalisation of India's work force and lead to an increase in both productivity and manufacturing. These are set to make hire/fire decisions smoother for businesses and provide social security benefits to cover all unorganised workers in India. The passing of the labour codes comes at an appropriate time when the government is moving ahead to replicate the success seen in its initial PLI schemes and broad basing this manufacturing / import-substituting impetus across sectors. Consumer appliances, solar panels and autos are three key segments among others that are broadly expected to witness announcements. These sectors appear to be strategically aligned to benefit from the China+1 strategy that is being considered by many global companies.

In the medium term, given the supply-side focus of this pandemic and the significant policy measures adopted, we see India’s core strengths and growth potential to remain uncompromised. The recently announced reforms are likely to give a boost to both sentiment and activity on the ground. As always, India continues to see the silver lining in this pandemic. India has seen improved competitiveness on corporate taxes, accommodative monetary policy, ample skilled labour supply, stable currency and is the most improved over the last five years on the ease of doing business. Global manufacturing companies are therefore increasingly considering India as an investment destination to relocate a part of their China operations.

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 that investors must be cognisant of the short-term volatility ahead. Apart from the ongoing second wave of infections in the western world, upside risks to crude, geo-political tensions, trade tariffs, US-China relations 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.

Trying times present great opportunities to invest at great prices. Historically, equity market returns have been quite good post decadal events like Global Financial Crisis, demonetisation, or Covid-19. Global liquidity, low interest rates with a weaker USD are quite supportive of flows into riskier asset classes and provide near term tailwind. Valuation metrics are reasonable and provide comfort to invest for the long term.

Source: In-house