MARKET OUTLOOK
November 24

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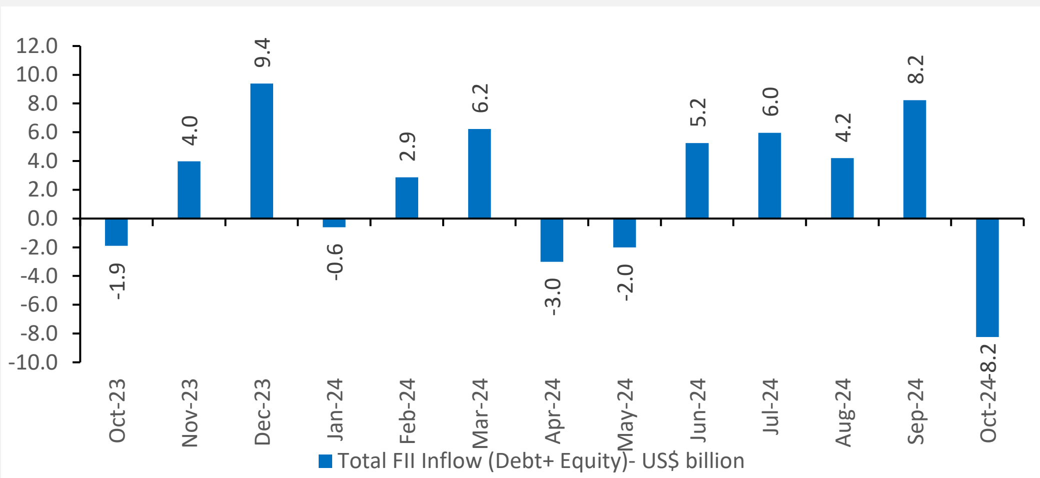
Relatively stronger data and uncertainty surrounding the US election outcome has led to benchmark US 10Y yields moving up by around 70 bps since the rate cut in Sep24. While the outcome and the impact of the US elections are awaited, the fact remains that the global risk-free benchmark asset continues to remain a source of ongoing volatility across most other asset classes. The other factor impacting domestic markets last month was the stimulus measures undertaken by China, leading to portfolio flows back into Chinese assets and possibly some rotation out of India.

Chart 1: FIIs pull money out of India in Oct 24



Source: Bloomberg, SBIFM Research

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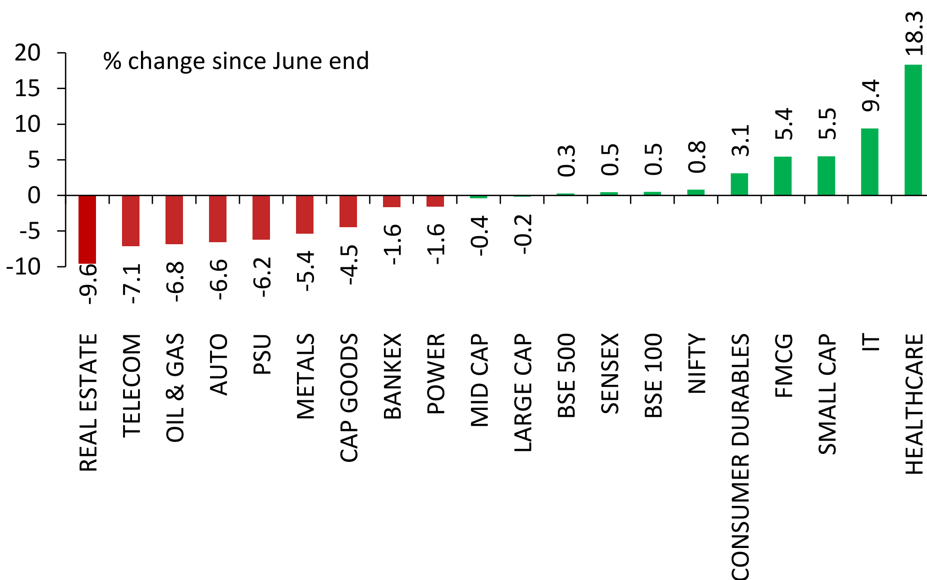
EQUITY

Mean reversion has been at work in financial markets for the past few weeks and continued to work its way through in the month of October as well. Indian equities that have been amongst the best performing asset classes over the past few years, significantly underperformed. Similarly, US bonds plummeted as long end yields surged despite a rate cut by the US Federal Reserve. On the other hand, some of the laggard assets such as Emerging Market (EM) equities, especially Chinese equities, has started to outperform as have global commodity stocks.

Within Indian equities, defensive sectors such as Consumer, Healthcare and Technology have started to outperform their cyclical counterparts such as Defense, Real Estate, Industrials and PSUs. From a style standpoint, Quality has started to outperform Value. Also, market breadth that had been exceptionally strong with broader markets outperforming large cap indexes over the past many quarters, has started to narrow.

Chart 2: Defensive sectors have started to perform while cyclicals drag

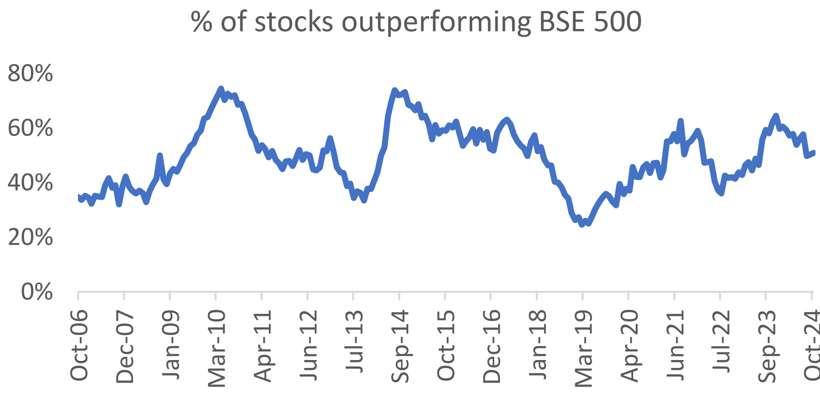


Source: Bloomberg, SBIFM Research

Chart 3: Quality has started to outperform…

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.

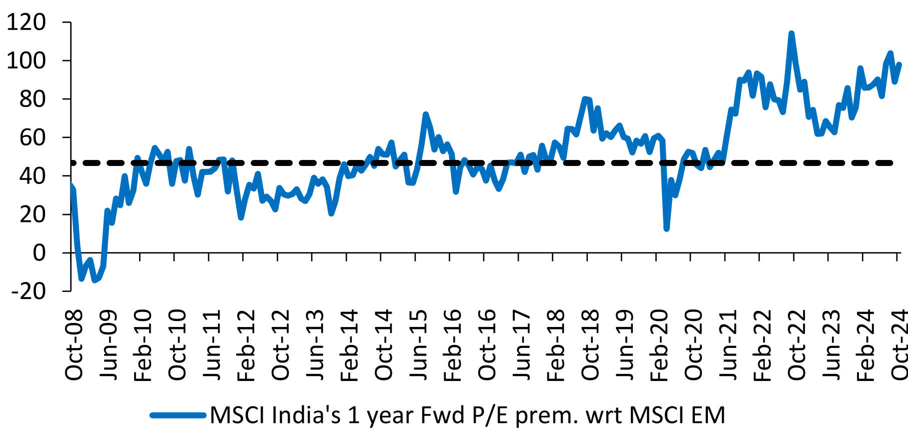
Chart 4: Market breadth has been narrowing for the past few months



Source: FactSet, SBIFM Research

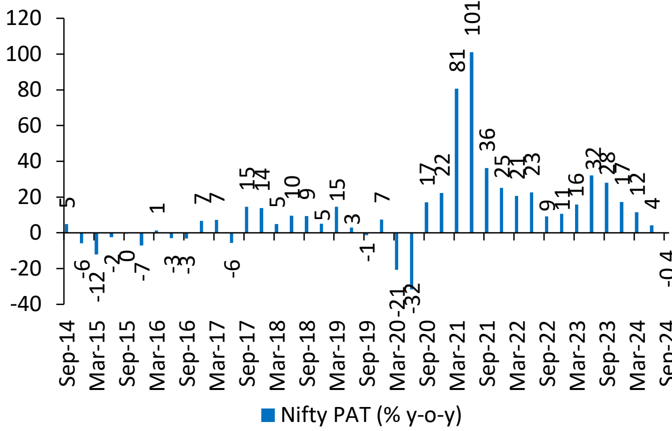
As we have maintained for a while now, there is a confluence of factors that is leading to this, in our view. One, valuations have been rich for Indian stocks both on an absolute basis as well as relative to EM peers. Two, near term earnings have been slowing down and earnings revisions suggests more stocks are seeing earnings downgrades than upgrades. Three, our measure of equity market sentiment had stayed extremely stretched- this works as a contrarian measure, suggesting markets were vulnerable to an abatement in speculative activity from such elevated readings and hence pullbacks. While there has been some moderation in valuations as well as equity market sentiment, we think there may be more room for the current market turbulence to run before we reach saner levels on both.

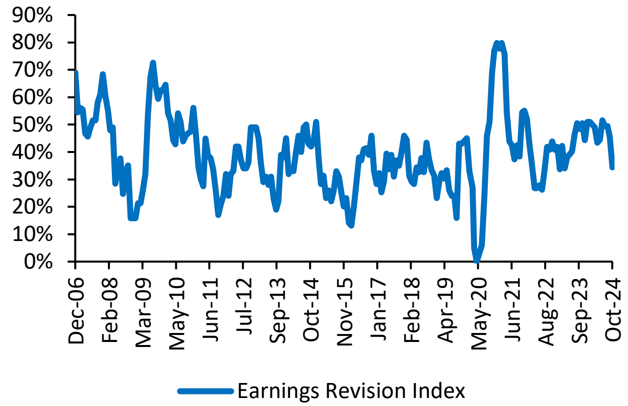
Chart 5: Indian equities stay at elevated premium to the EM index on valuations



Source: Bloomberg, SBIFM Research

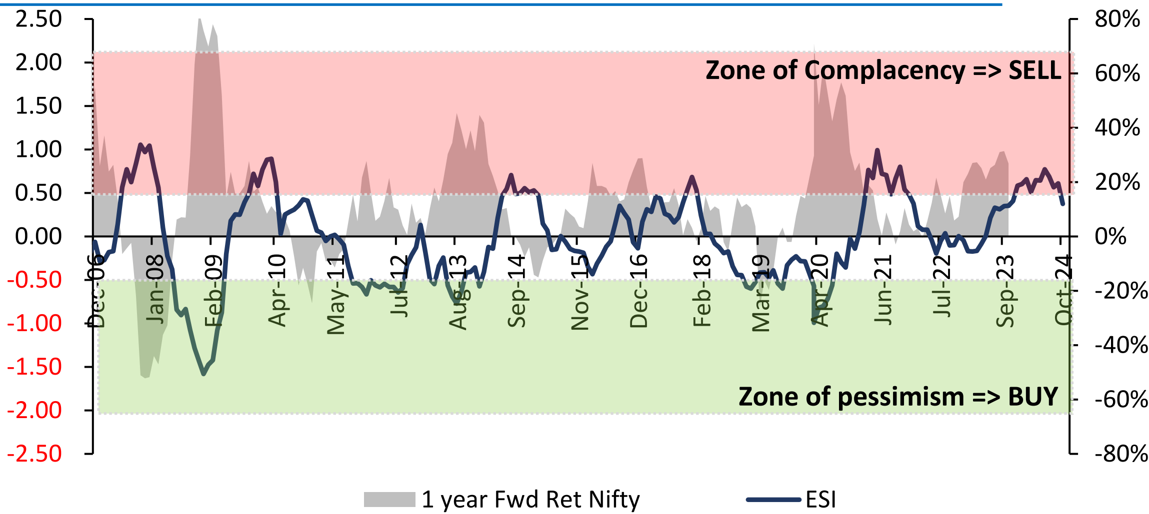
Chart 6: Earnings in slow lane near-term; more downgrades than upgrades in earnings revisions too





Source: FactSet, MOSL, Bloomberg, SBIFM Research. Results released for 33 Nifty companies for Sep 24 quarter, historical data is for all Nifty 50 companies.

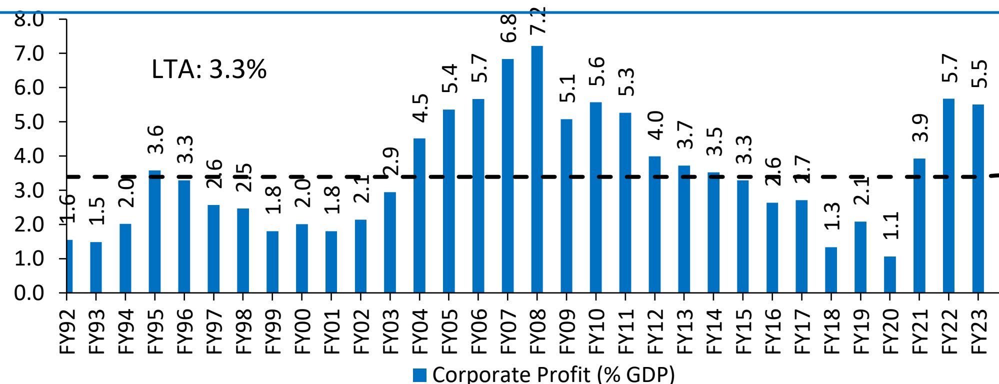
Chart 7: Complacency stays high as Equity Sentiment stays stretched even with some moderation of late



Source: Bloomberg, FactSet, SBIFM Research; Note: ESI stands for Equity Sentiment Index

From a longer-term standpoint, however, the Indian equity story continues to be underpinned by earnings upcycle, short term slowdown notwithstanding. India's corporate profits as a proportion of GDP have reverted higher over the past 4 years after secularly declining for 12 years between 2008-2020. We believe a revival in manufacturing, rising per capita GDP and an overall recovery in global Emerging Market economies should be tailwinds to continue supporting a constructive earnings growth outlook over the mid-long term. The current turbulence, however, should bring the focus back on fundamentals. We remain of the view that increasingly the market will become more discerning and move back towards companies which have strong business models, long-term earnings growth visibility and sustainable cashflows.

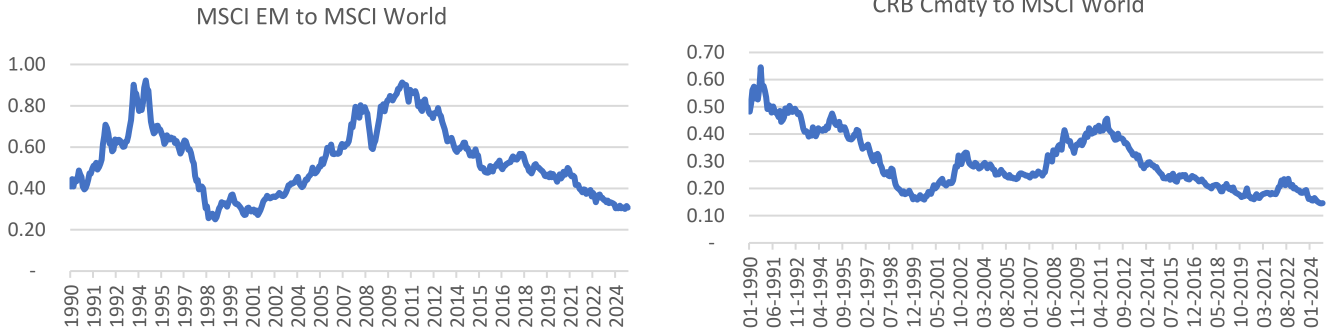
Chart 8: Longer term earnings upcycle stays the base case; augurs well for long term investors



FY92-FY23 data is based on a sample of ~30,000 listed unlisted companies in CMIE (includes both financial and non financial companies)

Source: CMIE Economic Outlook, Bloomberg, SBIFM Research

Chart 9: A revival of EM equities as an asset class after years of underperformance should augur well eventually, short-term portfolio readjustments led outflows notwithstanding



Source: Bloomberg, SBIFM Research. A declining ratio means that the asset in the numerator is underperforming the asset in the denominator.

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FIXED INCOME

Bond yields broadly mirrored the directional trend of rising UST yields and had the added headwind of FPI outflows after a long stretch of positive flows. While there remains increasing appetite for Indian sovereign bonds from offshore investors, recurring volatility and upside bias in US yields would continue to impact the pace of ongoing flows.

Gsec	30-Sep-24	31-Oct-24	Change
3-year G Sec	6.66%	6.74%	0.08%
4-year G Sec	6.68%	6.77%	0.09%
5-year G Sec	6.67%	6.78%	0.11%
7-year G Sec	6.69%	6.81%	0.12%
10-year G Sec	6.75%	6.85%	0.10%
15-year G Sec	6.79%	6.87%	0.08%
30-year G Sec	6.89%	6.98%	0.09%
AAA- PFC			
1Y AAA	7.67%	7.60%	-0.07%
2Y AAA	7.56%	7.52%	-0.04%
3Y AAA	7.41%	7.42%	0.01%
5Y AAA	7.28%	7.32%	0.04%
10Y AAA	7.20%	7.25%	0.05%
INR/USD	83.8013	84.08	-0.33%
DXY	100.779	103.976	3.17%
UST	3.75%	4.29%	0.54%
Brent	72.900	73.160	0.36%
Swaps			
1Y	6.39%	6.55%	0.16%
3Y	6.03%	6.30%	0.27%
5Y	6.03%	6.30%	0.27%

RBI Policy- October 24:

A change in the Policy stance was effectively a validation of the operating stance being adopted by the RBI in recent months. Effectively the prevalence of surplus liquidity has anchored the overnight rates around the policy rate off late. In the above context, a change in stance was probably a live event over the coming months. In having shifted the stance to neutral in the October review, the RBI has effectively enabled itself to have more flexibility to address evolving macro-economic challenges.

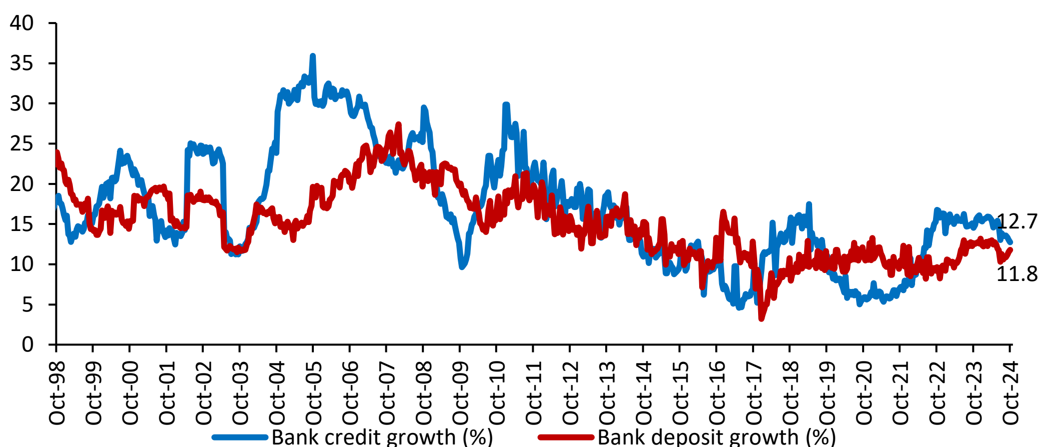
With a change in stance to neutral, market expectation would eventually consider the timing and extent of policy easing. However, given the challenges in terms of incomplete passthrough of better liquidity into various segments of the money market, thereby hindering transmission, fixing this possibly would need to be prioritized. With higher CD issuances and bulk deposits being offered at higher rates, the full transmission of easier liquidity and potentially of any rate actions in the future also would remain constrained. The prevalence of larger Government balances on an average outside the banking system also may require ex ante tolerance of higher system liquidity.

Expectations on RBI policy:

In this context, RBI actions on liquidity could possibly take the form of unsterilized forex intervention apart from the ongoing refinancing operations that target frictional tightness. With capital flows subject to external headwinds and seasonality in currency leakage in H2, maintaining a more durable surplus in core liquidity could possibly warrant additional measures including tweaks in CRR maintenance if needed.

Given the current estimates of FY25 real GDP growth at 7.2% and CPI at 4.50%, the RBI would quite possibly keep policy rates stable over the coming quarter at least. Emerging trends on the growth outlook would possibly determine the timing and extent of any policy easing. With near term CPI numbers likely to stay elevated, it's premature to consider expectations on any easing in the December review. However, high frequency data do validate a softness in growth data on an incremental basis. Given the anticipated aligning of CPI closer to the target over H2, a shallow easing if any can be a reasonable possibility over H1 of CY 25.

Chart 10: **Better alignment between credit and deposit growth rates in recent quarter**



Source: Bloomberg, SBIFM Research

The challenges of the banking system clearly has kept a floor on short term rates. Recent data however shows a much-needed alignment between credit and deposit growth, helped by better growth in Term deposits and some slowdown in lending to certain segments. These trends if sustained could lead to a softening bias on short term rates over time.

Portfolio strategy:

With visibility emerging on the liquidity dynamics, the elevated levels at the front end of the curve should settle lower over the coming months. This should enable a better risk- reward equation for incremental investments at the shorter segment (up to 5y) of the curve. As seen in earlier cycles, as the market starts to price in policy easing, we could potentially see the benchmark yields aligning closer to the policy rates. Given the overall positive tailwind both in terms of strong demand and ongoing fiscal improvements, this scenario is likely to play out over H2 FY25.

Portfolio positioning is aligned towards a higher duration stance that seeks to benefit from the anticipated softening in market yields over the coming months. At the same time, given evolving external headwinds, portfolio stance needs to be continuously reassessed.

Mutual Fund investments are subject to market risks, read all scheme related documents carefully.