Dear Investor,

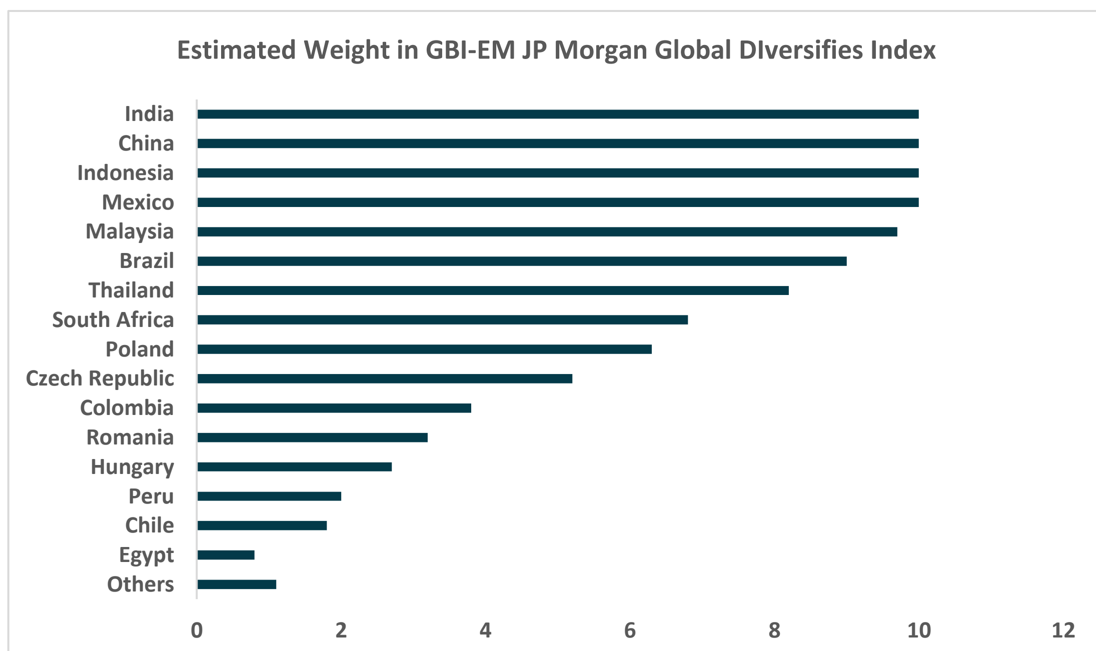
As we navigate through September, the global equity landscape has been marred by multiple headwinds - marking the second consecutive month of negative momentum globally. Key events driving markets during the month include:

- Central banks have maintained their stance on a 'higher for longer' interest rate narrative, while keeping rates unchanged. This has led to a cautious sentiment among investors;
- The 10-year US Treasury yields have skyrocketed to a 16-year high, adding another layer of uncertainty. The volatile macroeconomic environment has cast doubts over central bank policies and future risks;
- Supply constraints have pushed oil prices higher, adding inflationary pressure to the global economy.

Against this backdrop, the MSCI World and MSCI Europe have declined 4.5% and 4.0% respectively in USD terms in September. Interestingly, emerging markets have shown relative resilience, with the MSCI EM down just 2.8%. India and Philippines stand out as the only major economies posting positive returns last month. In local currency, NIFTY 50 has gained 2.0% during the month. The Midcap segment continues to outperform, registering a 3.6% increase. Sector wise, PSU banks, Utilities, and Energy have led the gains, while FMCG and IT have lagged. (Source: Bloomberg)

Important event during the month has been inclusion of Indian Government bond in JP Morgan Emerging Market Bond Index. Inclusion is slated to commence on June 28th, 2024, in a staggered manner. From the date of commencement, 1 percent weight will be added to the index every month for the next 10 months to take the overall weightage to 10% by March'25. This comes post the exclusion of Russia from the index and will take the overall exposure in Asian subcontinent in the index close to 50%.

With this inclusion, investors will be able to diversify their portfolios and allocate money to a high yielding market in the world's first-largest economy by GDP. On the yield front, among those Asian economies which are part of JP Morgan Emerging market bond Index, India has one of the highest yields currently and will also have a higher relative weight.



Source: Bloomberg, ASK IM Research

For the country, this is an opportunity to tap into a larger pool of liquidity to meet the growing finance need. India is expected to witness inflow of over USD 20 bn in the Indian bond markets. This would bring diversity in the Indian debt ownership and deepen Indian bond market. Overseas ownership is less than 2% of the total outstanding debt in India. Indian bond market has been larger than many of the other bond markets and its inclusion in global indices has been long due.

This inflow will help finance the country's current account deficit. Currently India's credit rating is BBB-/Baa3, last in the investment grade band. Inclusion in the index is expected to also bring down the country's risk premium attached to it in the global financial markets. This should also lead to lower cost of funding and thereby cost of capital and consequently a positive effect on the overall equity valuations. The decision by JP Morgan can also lead to domino effect for Indian markets as other competing global EM bond benchmarks might end up taking a similar decision. With this inflow of funds in next financial year, it is expected to see a positive effect on the Indian forex reserve along with stability in the currency market.

Along with positive news on Bond inclusion, **rainfall also saw some improvement during the month**. Cumulative rainfall (till Sept 22) was now 6% below long period average. On a cumulative basis, rainfall was normal in north-west and central India, while relatively weaker in east and north-east, and southern India. Interestingly, though rainfall has a major impact on total agricultural output of the country, the overall impact has been reducing as there has been a structural shift in contribution of crops to agriculture Gross Value Added (GVA), a drop from 63% to 52% in last 10 years. Furthermore, there has been a change in the constituents within the crops as there has been a significant increase in horticulture which has overtaken cereals. Also, gradually India is also increasing irrigation leading to gradual reduction in dependence on rainfall.

When it comes to sowing status, it is in line with last year, which is on a positive note looking at the inflationary pressure on the current food and vegetables basket. By the end of third week of September, in this season, total kharif, rice and coarse cereal sowing was 0.3%, 2.7% and 1.3% higher respectively. On the other hand, pulse and oilseeds were at 4.6% and 1.6% lower respectively, compared to last year.

However, Brent crude oil prices has shot up recently to over $90/bbl vs April - August'23 average cost of crude imported for India was USD 80.2/bl. Compared to FY24 bottom reached in Jun-23, Brent crude is up by ~30% primarily due to supply constraints as Saudi Arabia extended production cuts and Russia reduced export which, in OPEC's view can lead to a shortfall of 3.3mn barrels/day in 4Q23. One of the key positive developments is steady geopolitical risks – incremental negative developments between Russia and Ukraine has not surfaced and bilateral talks between US and China keeps tension contained in Taiwan. The Geopolitical Risk Index eased to 98.3 in Aug-23 – lowest since the end of 2021.

On the demand side, policy support from Chinese government and People's Bank of China has added to the bullish sentiment for crude. Although China's industrial sector remains muted, impacted by sluggish property sector, services sector is showing resilience post removal of Covid restrictions. Robust Indian economy too is adding to the firming up of crude prices – being a net importer, India imported 102mn tonnes of petroleum and crude products in Apr-July FY24 reporting a growth of 12.5% YoY vs same period last Financial Year.

Firming crude oil prices also has led to negative sentiment among the FIIs leading to recent net sell numbers in the equity markets during the month. After six months of robust FII inflows totaling USD 23bn since Mar'23, the Indian equity market experienced a slight reversal with outflows of USD 1.9bn in September 2023. However, DIIs have continued to remain net buyers.

Firming crude oil prices may remain a key headwind for Indian economy in the near term. There are three major ramifications:

- **Current Account Deficit (CAD):** Every USD 10/bl increase in crude oil prices, India's net imports rise by USD 16 bn. With the outlook for global crude oil prices remaining elevated, India's Current Account Balance may see upward revision. While this year, the flows remain comfortable, and non-IT Services inflows remain buoyant, funding may not be a stress. CAD is expected to be around 1.5% of GDP in FY24. This can have a resulting effect on the currency. CYTD Rupee has remained in range so far this calendar year.

- **Inflation concerns:** Every USD 10/bl of increase in crude oil prices impacts CPI inflation by ~30-40 bps directly and by a similar magnitude indirectly. This however assumes that there is a 100% passthrough of the global crude oil prices to the local pump prices. However, in the current scenario, the pump prices are being controlled and the pass-through is not only lagged but also incomplete. However, even if the government doesn't allow the complete passthrough of global oil prices to petrol and diesel, the elevated oil prices are likely to push forward the expectation of a cut in petrol and diesel prices which would have otherwise had a salutary impact on inflation both directly and indirectly.

- **Oil led margin compression:** Rising oil prices are also likely to remain a key concern for key sectors such as aviation, cement, paints, tires among others, albeit in the short term. The indirect impact of the rising crude oil prices is likely to reflect on the industrial sector in general as it will also likely push ahead the expectations of a cut in pump price cut which would have been a positive across all sectors driving lower cost of transportation.

However, over last few years, India has reduced salience of crude in overall GDP. The share of net crude import to GDP has fallen from 8.3% in 2010 to 4.6% in FY23. Also, our net IT services exports today are significantly more than net crude imports. Also, a sharp rise in services exports should further reduce external macro vulnerability.

Overall, markets have been buoyant in the last few months. The Nifty 50/Mid Cap Index/Small Cap Index has moved up by 13.1%/35.0%/41.7% in the last 6 months. We believe markets from hereon will be more driven by bottom-up ideation. Those businesses that deliver on superior earnings backed by solid capital efficiency should perform distinctly better than the others.

Earnings season is round the corner. We will closely look for the incoming commentary on volumes as we approach the crucial festive season. The current quarter will continue to witness capex driven businesses performing well on the earnings front. Global linked businesses like chemicals and IT will continue to report muted results while pharma is expected to be a mixed bag with domestic growth being slower while US based pharma businesses should perform well.

Happy investing!

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