



# PGIM India Market Outlook

March 2024



## Executive Summary

- Global macro is weak – economies slowing down, interest rates increasing, fiscal pressure growing, inflation cooling off
  - India – oasis of green. Growth is strong, inflation cooling, stable currency, stable bond market. India Elections short term material event.
  - Long term returns are driven by earnings growth – higher growth leads to better returns and vice versa.
  - Small and midcaps significantly outperformed large caps
  - Trend since March 2020, which has accelerated since 1<sup>st</sup> April, 2023 – poor RoE and weak growth companies outperformed their stronger counterparts.
  - Possible reason could be longer duration for high growth stocks v/s low growth. Sharp interest rate increase caused longer duration to underperform shorter duration.
  - Another reason for this trend to continue – FII are net sellers in last 9 months, while DII are net buyers in last 9 months.
  - Valuations – Large Caps attractive, Mid Cap and Small Caps expensive
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## **Chapter – I**

# **What is the macro outlook**

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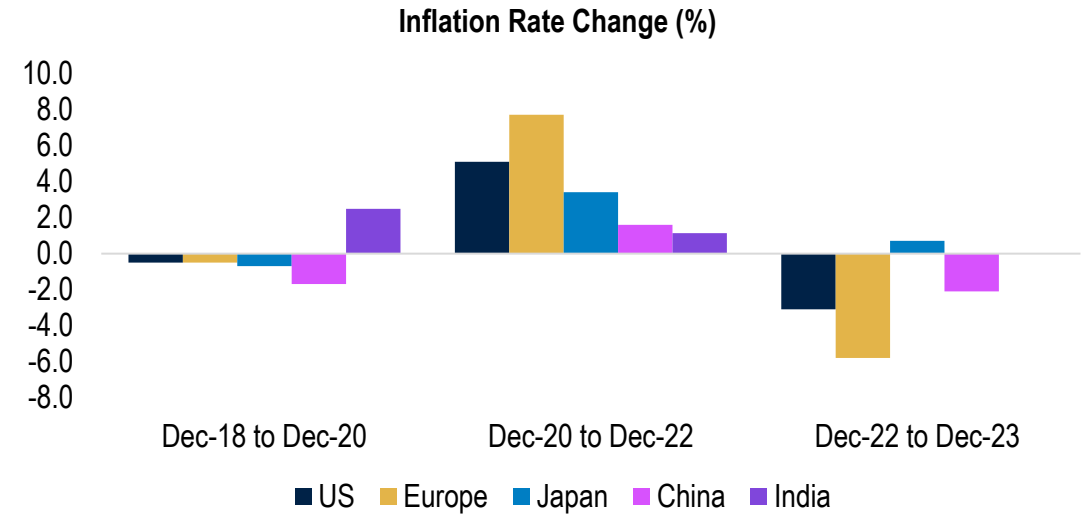
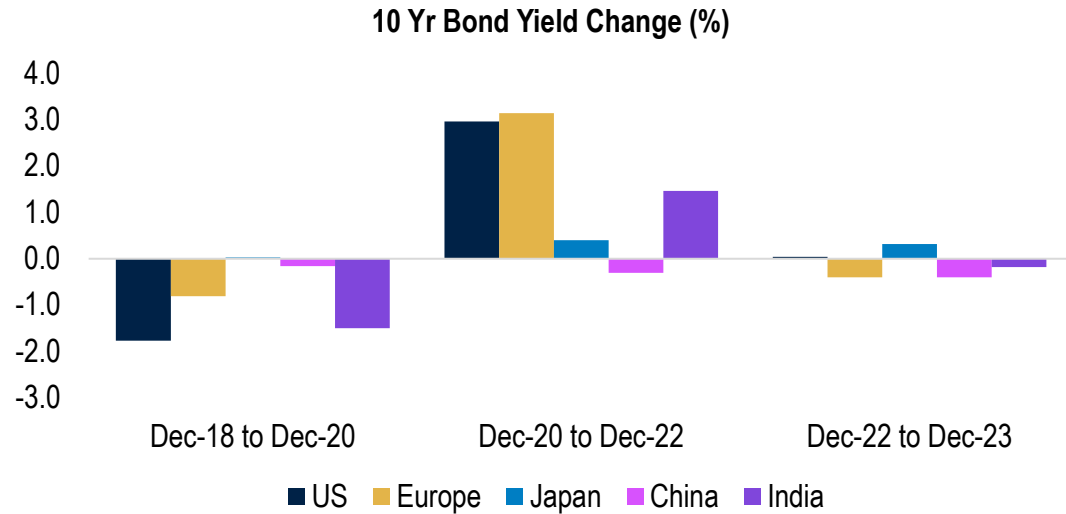
# Global market outlook: Global growth to be steady

## GDP growth rate (y-y %)

	Year over Year			
	Estimate		Projections	
	2022	2023	2024	2025
<b>World Output</b>	3.5	3.1	3.1	3.2
<b>Advanced Economies</b>	2.6	1.6	1.5	1.8
United States	1.9	2.5	2.1	1.7
Euro Area	3.4	0.5	0.9	1.7
Germany	1.8	-0.3	0.5	1.6
France	2.5	0.8	1.0	1.7
Italy	3.7	0.7	0.7	1.1
Spain	5.8	2.4	1.5	2.1
Japan	1.0	1.9	0.9	0.8
United Kingdom	4.3	0.5	0.6	1.6
Canada	3.8	1.1	1.4	2.3
Other Advanced Economies	2.7	1.7	2.1	2.5
<b>Emerging Market and Developing Economies</b>	4.1	4.1	4.1	4.2
Emerging and Developing Asia	4.5	5.4	5.2	4.8
China	3.0	5.2	4.6	4.1
<b>India</b>	7.2	6.7	6.5	6.5

- IMF expects global growth to remain steady.
- Emerging Markets and Developing Economies are expected to grow at same pace of 4.1% in 2024.
- India's growth is expected at more than 2x that of global growth at 6.5% in 2024, similar to that in 2023.

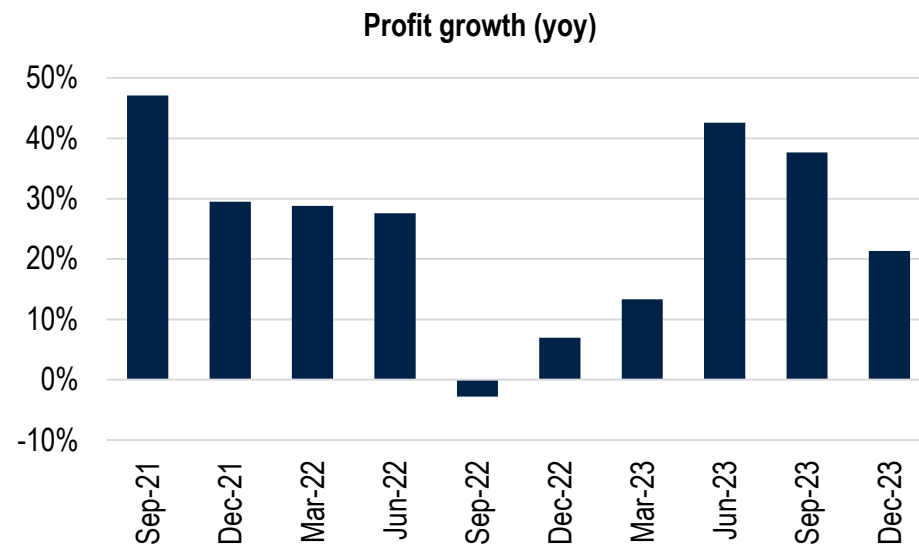
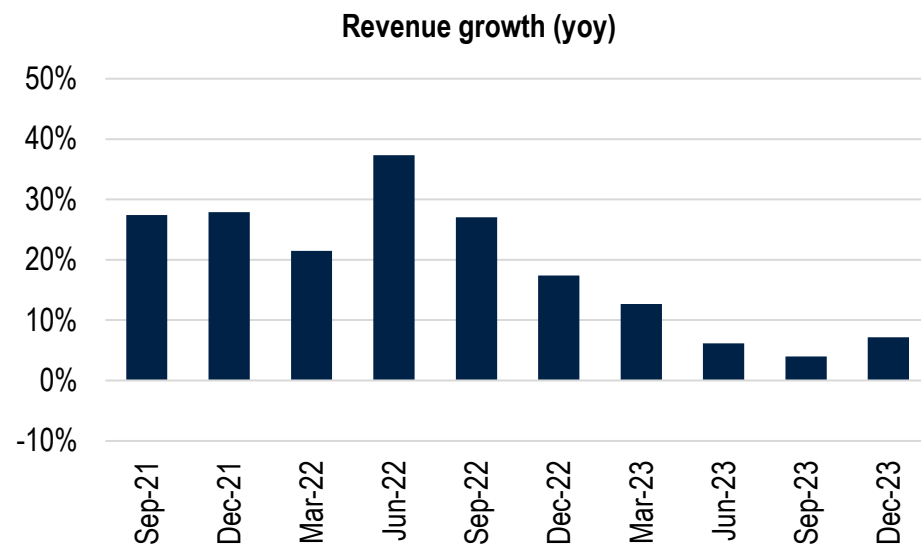
# Global Bond Yields and Inflation have Cooled



- Global Bond Yields, led by US and Eurozone had increased substantially during December 2020 to December 2022 period.
- However, the rate of interest rate increase across markets has reduced
- This is in response to significant declines witnessed in inflation.
- However, the current inflation rate remains higher than the respective monetary authorities' targets, due to which rates may be expected to remain stable for next 6 months

## 3QFY24 Corporate Results – Strong but margin led

### BSE500: Headline Performance



Source: ACE Equity, Company Reports

- In 3QFY24, overall earnings growth was strong led primarily by margin expansion due to commodity price deflation
- Revenue growth was anaemic for a third quarter running that may eventually catch up with earnings growth as well
- Auto, capital goods and cement led revenue growth while chemicals and IT was weak

## **Chapter – II**

# **What is our Market View**

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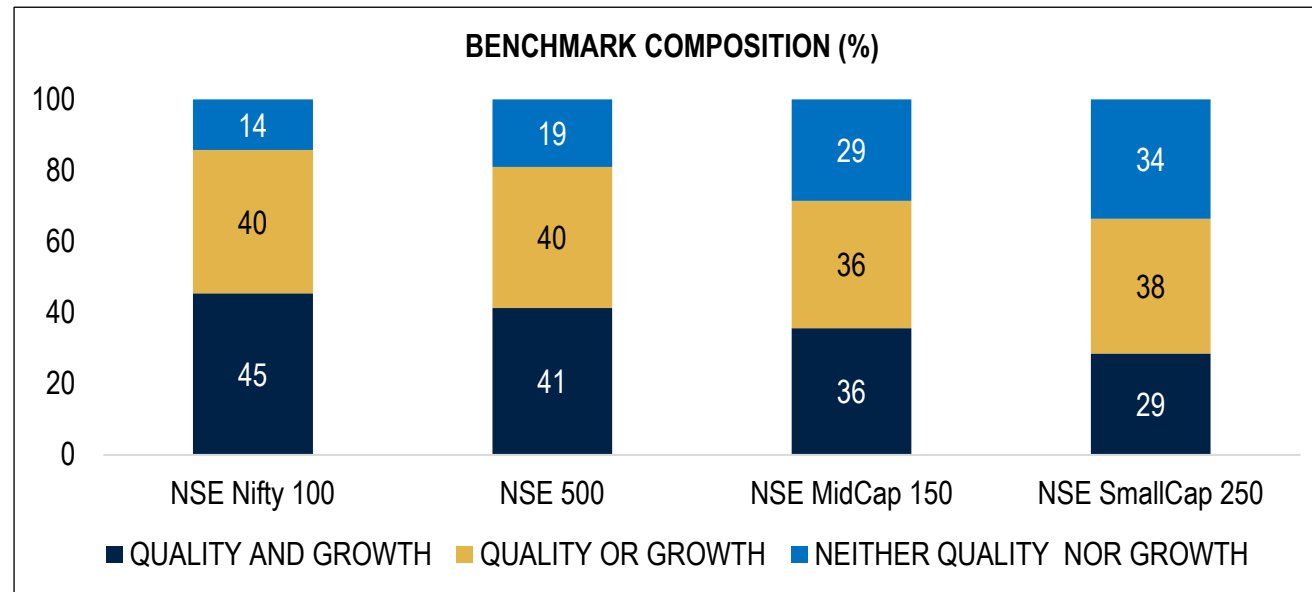
# Strong companies have outperformed long term but underperformed near term

NSE 500 COMPANIES - CAGR RETURNS	10yr	5yr	3yr	1yr	FYTD
QUALITY AND GROWTH	30%	22%	34%	26%	36%
QUALITY OR GROWTH	22%	15%	36%	33%	46%
NEITHER QUALITY NOR GROWTH	18%	15%	45%	59%	65%
<b>EQUAL WEGHTED UNIVERSE AVERAGE</b>	<b>23%</b>	<b>17%</b>	<b>37%</b>	<b>42%</b>	<b>47%</b>
NSE 500 COMPANIES - CAGR RETURNS	10yr	5yr	3yr	1yr	FYTD
QUALITY AND GROWTH	7%	4%	-3%	-16%	-11%
QUALITY OR GROWTH	-1%	-2%	-1%	-9%	-1%
NEITHER QUALITY NOR GROWTH	-5%	-3%	8%	17%	18%

- We analysed top 500 companies forming part of NSE 500 Index and separated them into 3 baskets based on fundamental parameters  
1) high quality AND high growth, 2) high quality OR high growth, and 3) poor quality AND weak growth
- We concluded that stronger companies (good quality and high growth), have delivered strong performance over a 10 year and 5-year period.
- However, near term (FYTD24), weaker companies have delivered 65% returns on average, compared to just 36% by their stronger counterparts.



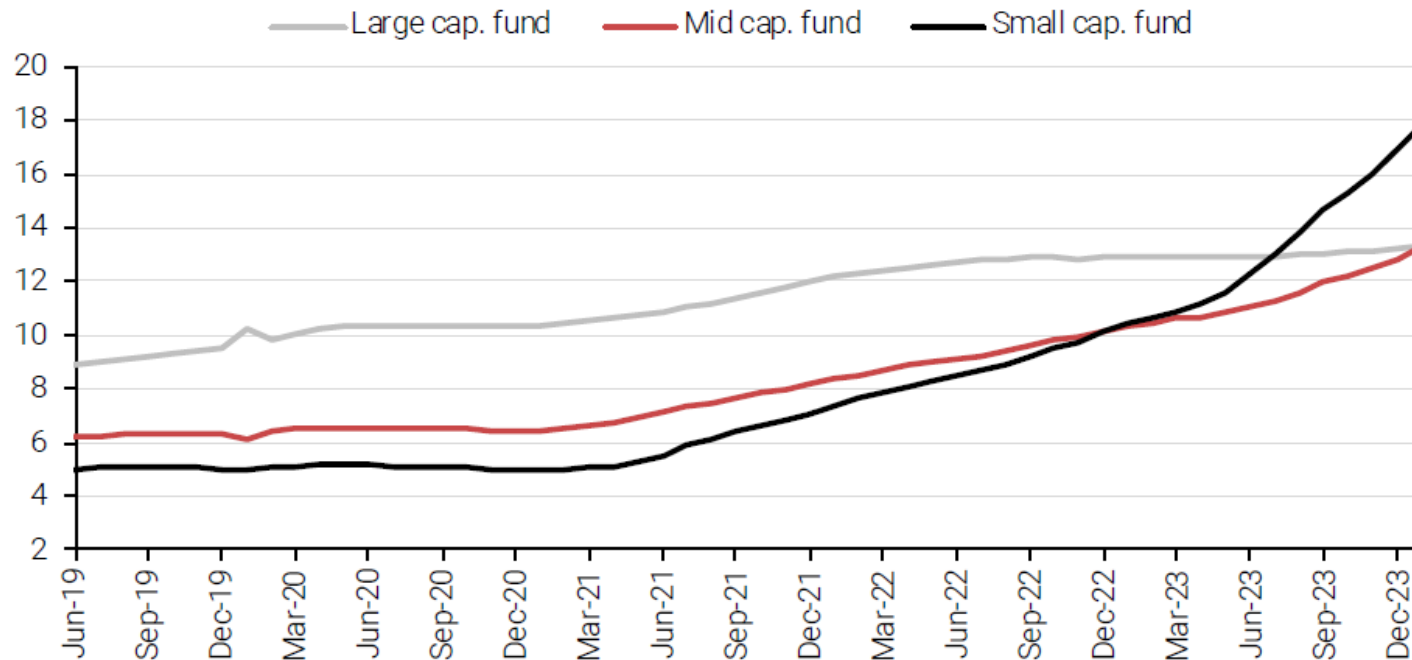
# Benchmarks – Small and Mid cap Indices have larger share of weaker companies



- Based on similar analysis, the composition of benchmarks was very different
- Large cap index (NSE 100) has least exposure to weak companies (low growth and poor quality), while the small cap index (NSE SmallCap 250) has the maximum exposure to weaker companies

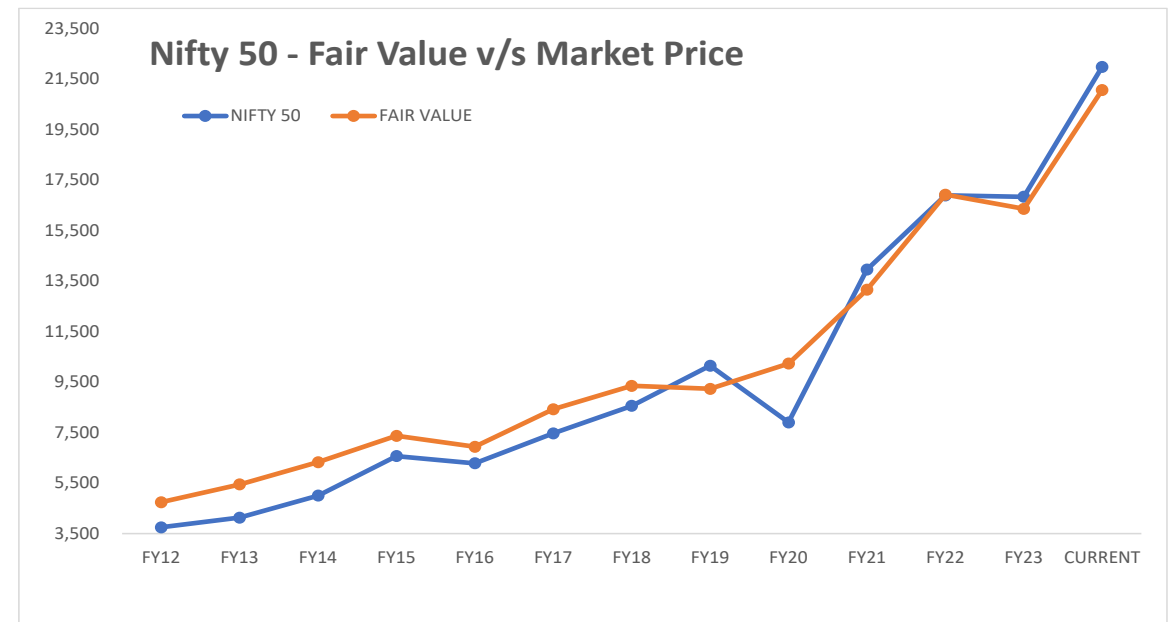
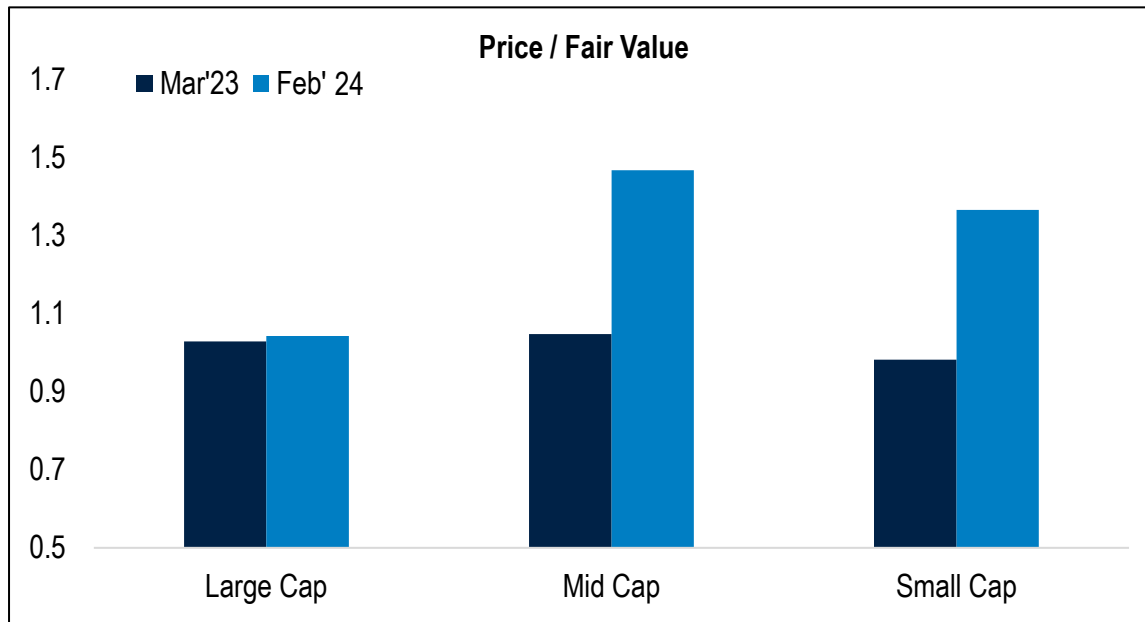
## Domestic flows surge in Small & Mid Cap category

No. of folios under large-cap, mid-cap and small-cap funds, 2020-24 (mn)



- There has been a significant divergence in the performance across different segments of the markets.
- Small Cap and Mid Cap companies have significantly outperformed their Large Cap counterparts.
- One of the reasons could be accelerated flows in the midcap and small cap categories over the last 2 years.

# Valuations – Likely running ahead of fundamentals in Small and Mid cap Segment



- Large Cap companies are trading at a reasonable valuation
- Mid Cap and Small Cap companies are trading at significantly higher valuations than their Fair Values.

## Valuations – Likely running ahead of fundamentals in Small and Mid cap Segment

<b>NSE 100 Index</b>	<b>FY18-23</b>	<b>FYTD'24</b>	<b>FY23 – 25E</b>
Index Returns	11%	45%	
Profit Growth	11%	27%	20%
<b>Nifty MidCap 150 Index</b>	<b>FY18-23</b>	<b>FYTD'24</b>	<b>FY23 – 25E</b>
Index Returns	9%	57%	
Profit Growth	9%	21%	19%
<b>Nifty Small Cap 250 Index</b>	<b>FY18-23</b>	<b>FYTD' 24</b>	<b>FY23 – 25E</b>
Index Returns	7%	70%	
Profit Growth	8%	25%	23%

- Indices representing all sub-segments of the market, Large Cap (Nifty 100), Mid Cap (Nifty MidCap 150) and Small Cap (Nifty Small Cap 250) have delivered returns in line with their underlying constituents' profit growth in the FY18 – FY23 period.
- However, in FYTD24, Mid Cap and Small Cap Index returns have significantly exceeded their underlying constituents' profit growth, hinting towards valuation excesses.

Source: Bloomberg, PGIM AMC Internal Analysis, as on 29<sup>th</sup> February 2024, FY23 – FY25E – Bloomberg consensus estimates

Index Returns: Returns of Aggregate Market Cap of included Index Stocks

Profit Growth: Aggregate Profit growth of included Index Stocks

Exclusions:

a) Excludes all companies making losses as on FY18

b) Excludes all companies having no reported numbers as on FY18

c) Excludes all companies having no FY24 estimates in Bloomberg

## Valuations – Micro bubbles brewing

INDEX	10 Yr Returns	4Yr Returns	1Yr Returns	2 Months Returns
	CY12 To CY 2022	CY2019 To CY2022	CY23	CY24 YTD
S&P BSE Mid Cap 150	16%	17%	41%	6%
S&P BSE Small Cap 250	15%	18%	48%	6%
S&P BSE IPO	3%	8%	55%	18%
S&P BSE PSU	13%	21%	69%	5%
S&P BSE INDUSTRIALS	17%	19%	41%	10%
S&P BSE REALTY INDEX	5%	18%	79%	16%

Micro bubbles are visible in following segments of the market :

1. Weak (low growth + low quality) Mid Caps,
2. Weak (low growth + low quality) Small Caps,
3. Newly listed IPO companies,
4. Public Sector Enterprises,
5. Industrials & Capital Goods Sector
6. Real Estate
7. Micro Caps

# Big Picture - What has worked in Investing in India - a 20yr perspective

## Year-wise alpha generation by different Factor Combinations

MEDIAN	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Quality AND Growth	11%	-15%	9%	10%	33%	0%	6%	25%	24%	27%	12%	13%	-14%	4%	13%	29%
Quality OR Growth	12%	-16%	9%	11%	23%	-6%	-3%	14%	17%	26%	15%	8%	-22%	-3%	14%	41%
NEITHER Quality NOR Growth	10%	-21%	7%	8%	23%	-9%	-7%	12%	18%	24%	15%	6%	-25%	-6%	13%	42%
Universe	12%	-15%	9%	11%	29%	-4%	-1%	17%	20%	26%	13%	9%	-19%	0%	14%	37%
ALPHA																
Quality AND Growth	-0.7%	0.2%	-0.2%	-0.7%	4.2%	4.5%	6.3%	8.5%	4.2%	1.1%	-1.9%	4.4%	5.7%	4.3%	-0.3%	-7.3%
Quality OR Growth	0.2%	-0.6%	0.4%	0.1%	-5.9%	-1.9%	-2.0%	-3.2%	-2.9%	-0.2%	1.7%	-1.3%	-2.4%	-2.5%	0.1%	4.1%
NEITHER Quality NOR Growth	-1.5%	-5.6%	-1.7%	-3.0%	-6.2%	-4.6%	-6.3%	-4.6%	-2.2%	-1.8%	1.7%	-2.9%	-5.7%	-5.2%	-0.5%	5.2%

SUMMARY	RETURNS	NO. OF COS.	ALPHA	BATTING AVG
Quality AND Growth	11.8%	375	2.0%	63%
Quality OR Growth	8.8%	672	-1.0%	38%
NEITHER Quality NOR Growth	7.0%	270	-2.8%	13%
Universe	9.8%	1047		

- Investment in a combination of High Growth AND Good Quality is an evergreen strategy.
- It has outperformed in 10 out of 16 rolling 3-year period observations
- It has delivered 20% higher returns than average over this period

Growth – Companies with Higher than average 3-Year CAGR Sales Growth

Quality – Companies with Higher than average 3-Year Return on Equity

Universe – All companies in NSE 500 Index from 2002 to 2022

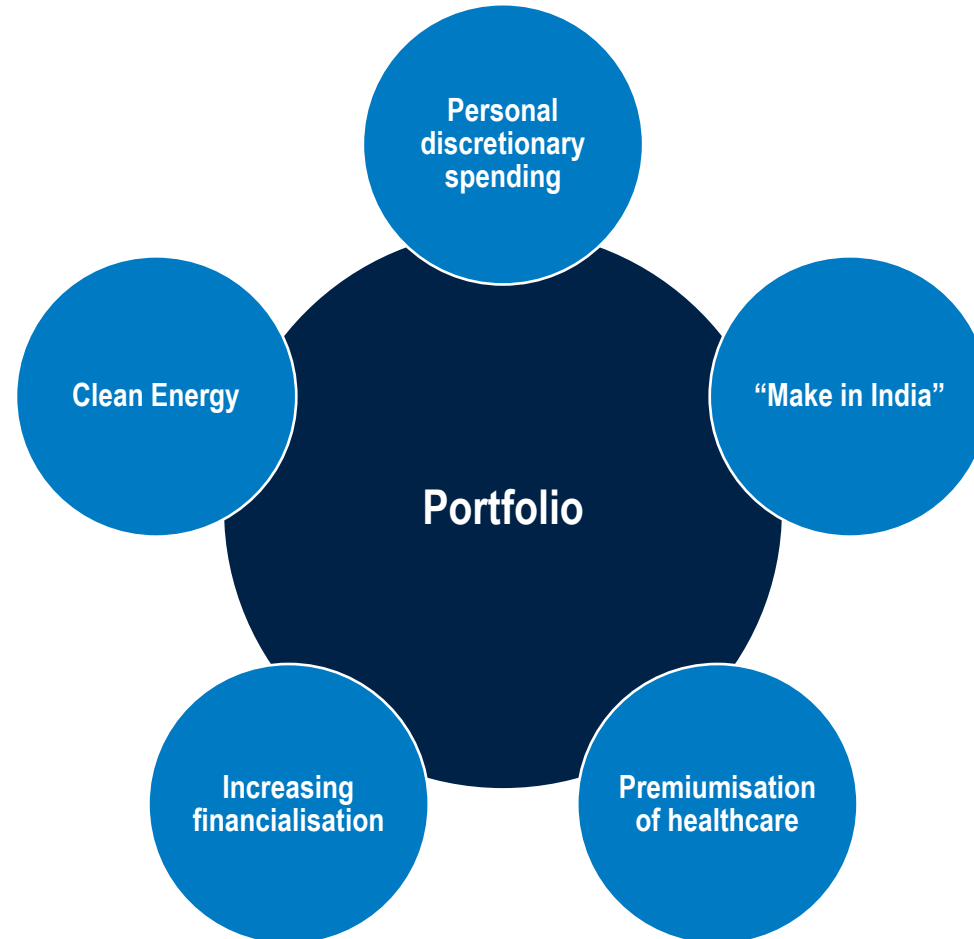
Source: Bloomberg, PGIM AMC Internal Analysis, as on 31<sup>st</sup> March, 2023

## **Chapter – III**

**What are our themes & our sector outlook.**

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## Key themes





## Our Sector stance Summary (1/2)

Sectors	PGIM Stance	Comments
Financials	Positive	Overweight in Private Sector Banks, NBFC and Select Non lending Financials.
		Good growth visibility at reasonable valuations; near term issues on deposit growth likely to smoothen out over the next financial year
		Lower credit costs, controlled opex. and improving non-interest income can drive healthy earnings growth.
Healthcare	Positive	Positive on the Indian hospital space and domestic branded formulations segments.
		Hospitals will see strong earnings momentum led by increase in occupancy, realization improvement per patient and operating leverage.
		Domestic branded formulations companies expected to see steady revenue growth and margin expansion
Consumer Discretionary	Positive	Sector has higher elasticity vs staples with respect to income levels leading to a J curve phenomenon in growth .
		Near term slowdown in consumption in select categories to even out as spending patterns normalise
		Opportunities available in a slew of subsectors such as retail, footwear, QSR, durables which are growing at a healthy pace with economics in place.
Communication services	Positive	Market structure enabling an improving return on capital for the incumbents and is likely to sustain
Consumer Staples	Neutral	While quality and size of companies in the sector is good, the sector is impacted due to consumption slowdown due to inflation.
		Valuations getting more reasonable on the back of a consumption slowdown

(The Fund Manager may change their stances on sector allocations depending upon market conditions)

## Our Sector stance Summary (2/2)

Sectors	PGIM Stance	Comments
Industrials	Cautious	<p>Manufacturing push, China+1 and policies such as PLI and Make In India resulting in strong growth</p> <p>While growth is favourable, a lot has already been baked in valuations, leaving no room for surprises and slowdown.</p> <p>We would evaluate our stance again in case of time/price correction.</p>
Information Technology	Cautious	<p>Global macro and demand environment continues to remain uncertain due to the risk of recession and elevated interest rates in developed markets.</p> <p>Deal bookings have remained healthy though customers have turned cautious, delaying revenue conversion.</p> <p>While we have reduced our underweight on IT, we still maintain our cautious view.</p>
Energy and Utilities	Cautious	<p>Sector is overly dependent / influenced by government polities/ action.</p> <p>We aim to avoid the cyclical energy companies and tend to be more positive on companies with structural growth.</p>
Materials	Cautious	<p>We are underweight on the deep cyclical industries in the Materials segment due to uncertain global economic environment</p> <p>Within the space we prefer speciality chemicals, domestic plays like cement and building materials over commoditised or globally exposed sectors</p>
Real estate	Cautious	<p>Demand is strong in urban residential real estate coupled with market share gains for branded developers</p> <p>However, valuations leave little room for negative surprises</p> <p>Real estate ancillary sectors may witness an acceleration going ahead</p>

(The Fund Manager may change their stances on sector allocations depending upon market conditions)

## Outlook

- India's economic growth likely to be steady and far ahead of its global peers.
  - Sector preferences:
    - Overweight on Consumer Discretionary (reasonable valuations, strong long-term growth), Financials (cheap valuations and high growth) and Healthcare (fair valuations but high growth).
    - Underweight on Materials (cheap valuations but low quality, weak growth) and IT (cheap valuations but low growth)
  - General elections could be a near term transient event risk.
  - Large caps are attractive and preferred.
  - Mid Caps and Small Caps in general are expensive. Weak (low growth + low quality) Mid Caps and Small Caps may be in bubble zone and caution is advised. Strong (high growth + high quality) Mid Caps and Small Caps may present opportunity for long term investors.
  - Optimistic on markets on medium to long term driven by strong economic growth.
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Document Number : C253/2023-24