House View, November 2018

Global Market Update

The US Q3, 2018 GDP growth at 3.4% was better than expected and moreover on the back of robust growth of more than 4% in previous quarter. The US FED is expected to increase interest rates by 25bps one more time in 2018 however expectations for aggressive hikes in 2019 are tempered. Meanwhile inflation is crossing FED target of 2% on the back of higher consumer spending, increased wages and higher crude prices which may force FED to go with hike. The US equity markets weakened during the month on the back of rising interest rates and elevated commodity prices which may put corporate profitability under pressure with some investments moving towards debt with better yields.

Index	28-Sep-18	31-Oct-18	% Change
Dow Jones	26458.31	25117.22	-5.34
Nasdaq	8,046.35	7,305.90	-10.13
FTSE	7510.20	7128.10	-5.36
CAC	5,493.49	5,093.44	-7.85
DAX	12246.73	11447.51	-6.98
Nikkei	24,142.50	21,920.46	-10.14
Hang Seng	27788.52	24979.69	-11.24
Strait Times	3,257.05	3,018.80	-7.89
Shanghai Comp	2821.35	2602.78	-8.40
KOSPI	2,343.07	2,029.69	-15.44

Euro zone is still under pressure with growth yet to pick pace and high debt and rising inflation may again trip the economy. Moreover the Germany Chancellor Angela Merkel may get out of power after 18 years after poor showing by her party in recent elections as she was considered one of the strongest leader and votary of strong Euro zone. The Euro Central bank may be forced to continue with accommodating monetary stance for some more time. Br-exit deal is yet to be finalized which may put further pressure on the UK economy. The no deal exit will be serious risk for UK economy. The trade issues between US, China and many other countries are keenly watched by the markets and can hamper the world growth seriously as US threaten to impose additional tariff on rest of imports from China and tariff may be hiked further to 25% from January onwards. The trade war with volatile currency markets and higher crude prices may force FED to move towards more accommodative monetary policy in case these risks play out in real time. The strengthening dollar with rising interest rates is also expected to disrupt the fund flows to emerging and other global markets as we are already witnessing substantial outflows from the emerging markets including India with weakening global currencies against US dollar.

The Chinese economy is slowing down considerably on the back of internal restructuring, deleveraging of the economy and any escalation in trade war will have serious impact on its growth. This can also spill over the currency markets as many emerging market currencies including China have already depreciated more than 10% in the current year and can pose substantial risk to global trade if situation goes out of hand and reconciliatory measures are not taken soon by the parties involved. Japan expected to continue monetary stimulus as still lot of ground is to be covered with slow growth recovery. It is clear that era for enormous quantity of cheap money is over and Central bankers will find it difficult to manage volatility in their currency market movements with rising interest rates and trade war threat globally. Further higher crude prices on the back of forthcoming Iran sanctions kicking in from 4th November as announced by US is major risk need to be managed by world economies. Although crude prices has moderated from its high during October still the higher crude prices remain substantial risk the future trend is dependent on global growth, production ramp up by OPEC & non-OPEC members and US shale gas production. It remains big concern for India if any untoward supply disruption happens as imports constitute more than 80% of our crude oil needs.

Domestic Markets

The Nifty ended at 10386 in October compared to 10931 for September down by 5% during the month. The market was highly volatile during the month as debt default by ILFS group continued to weigh on the financial sector and in turn resulted into negative sentiment in the market. Although market was already considered to be overvalued but default by high credential NBFC provided the trigger for steep downside. The midcap and small cap space was down by 25-50% in case of many stocks with broader indices down by more than 15%. The IT and Pharma sector stand out in the market on the back of depreciating rupee and reasonable valuations. The GST September month collections in October at INR 101,000 Cr are substantially higher compared to previous month and crossed Rs. 1 lakh Cr second time in this financial year since April as consumption demand is picking up during festival season and compliance increases on the back of recently introduced measures. This should provide some respite to the government on fiscal front as first half collections fell short from its target of 1 lakh crore per month. It is expected that second half should result into better collection as the new eco system goes under stabilization GST is expected to be a game changer and should add significant momentum to GDP growth with informal sector expected to contract while formal sector will expand. GST along with productivity gain in medium to long term may result into low cost economy with transparent and efficient system in place to operate for the businesses. The real estate sector along with mission of housing for all backed by RERA introduction should also provide momentum to the economy in future.

Index	28-Sep-18	31-Oct-18	% Change
BSE Sensex	36227.14	34442.05	-5.18
NIFTY 50	10930.45	10386.60	-5.24
NIFTY MIDCAP 100	17154.35	17189.15	0.20
NIFTY 100	11126.40	10604.60	-4.92
NIFTY IT	15838.05	14940.10	-6.01
NIFTY BANK	25119.85	25153.25	0.13
BSE Small Cap	14430.68	14201.37	-1.61
BSE FMCG	11502.75	11127.84	-3.37
BSE METAL	13278.79	12524.55	-6.02
BSE POWER	1929.43	1958.13	1.47

The public sector banks which are under pressure this quarter on account of dual provision required on Bond Investments due to higher yield and additional provision on stressed assets. Although most of stress assets are already identified under NPA but additional provision requirement may put pressure on further capital requirements of these banks. The stressed assets problem seems to be near its peak and next few quarters will be watched for their resolution whether under IBC or otherwise. The RBI laying road map for default resolution under new guidelines will result into early identification of stress and proper follow up to protect the lenders interest with time bound actions which shall be good in medium to long term for banking sector as a whole. The majority of first 12 large accounts identified by RBI initially and moved for resolution under new IBC laws are expected to get resolved in next 2-3 months. As most of other stressed accounts are recognized we expect to see substantial improvement in banks performance during second half of FY19 with more and more stressed accounts resolved under evolving IBC laws interpreted by the judicial system in the country. As crude prices are softening with currency stabilizing and bond yield declining from its peak should result some respite on provisioning in next quarters. We expect with time IBC will become more robust, transparent for faster resolution mechanism as new legislative amendments are added based on experience and precedents. The Government and RBI actions clearly demonstrate message to promoters and lenders to take forward time bound resolution and transparency in processes. We expect that NPA situation to show meaningful improvement by the end of FY20. NPA early identification and resolution going forward should result into further lending which is expected to spur further investments in the economy.

The industrial output at 4.3% in August was lower compared to 6.6% in July on the back of Kerala floods in monsoon. The industrial output on average is still hovering around mid single digit since last several months and expected to take some more time to recover towards higher single digit or double digit post twin structural reforms of demonetization and GST as growth for 2018-19 expected to be better on the back of restoration and normalization of supply lines. The demand in the economy is expected to go up with higher bank lending seen in recent months. As the capacity utilization is going up the private investments have also seen some green shoots however these are still slow to come and may take some more time for the industrial production to turn on higher trajectory. The government's focus on infrastructure, social and rural spending in current year with wide spread monsoon may further push the overall demand in the economy and should provide further trigger to the private investments.

The trade deficit for September at USD 13.98bn was substantially lower compared to USD 17.4bn in August a big respite on external front but risk remains high on the back of rising crude prices and higher non oil imports with improved economic activity. The exports although in positive territory still remain a concern which is expected to improve with better global growth and depreciating currency this year. The current account deficit in FY19 is estimated to be above 2.5% of GDP compared to 1.9% in 2017-18 and remains a concern due to higher crude prices. The currency touched all time low near 74 against US dollar on the back of strengthening dollar index, rising inflation and widening trade and current account deficit. The depreciating rupee can prove to be good for exports in short to medium term as it was earlier considered overvalued but may result into higher imported inflation and uncertainty on external inflows if volatility continues. The foreign exchange reserves at USD 394bn declines sharply due to FPI outflows and widening current account deficit but seem sufficient for any untoward event presently.

Debt

The RBI held the rates in its monetary policy announcement on 5th October however changed the stance to calibrated tightening ruling out any rate cut in near future at least. The yields for 10 year benchmark bond ended at 7.88% declining slightly on the back of stabilizing currency and softening crude prices. A combination of factors including the Reserve Bank of India's bond purchases from investors, aversion to buy short term corporate securities, and softer crude oil prices have triggered a much-awaited rally in the sovereign bond market. The consumer price inflation for September at 3.77% compared to 3.69% in August was lower than expectation on the back of declining food and vegetable prices. However higher crude and rising raw material prices reflected through higher core inflation in manufacturing remains concern going forward as one year forward inflation is estimated on the higher side near 5%. The wholesale price inflation at 5.13% was also higher compared to 4.53% in August reflecting higher crude and other commodity prices. The higher inflation with rising input prices on the back of depreciating currency and hardening crude prices remains a big concern as RBI closely monitoring the price situation to benchmark its monetary policy accordingly and may be forced further hike in current year if higher inflation expectations persist in the economy.

Currencies

As an eventful month ends rupee stands to gain from both global and domestic factors in particular from softer crude oil prices which has corrected by more than 20% on account of global demand concern and increased supply from OPEC. Dollar too has started to peak out, which means there is some respite for Asian currencies which has benefited rupee to a larger extent. Off late, globally there is concentrated effort to dump dollar and do bilateral traded in respective currencies. Rupee was supported by better than expected trade deficit which came in at 5 months low due to better import management because of government initiatives. India also signed a $75 billion currency swap agreement with Japan to aid currency stability. In October our GST collection crosses Rs. 1lk cr which will help India's fiscal numbers. Rupee did face a brief set back when there were reports over growing rift between RBI and Government over RBI's autonomy, but this was quickly settled when Finance Ministry issued a statement that the autonomy for the central bank, within the framework of the RBI Act, is an essential and accepted governance requirement. On the global front, both EUR & GBP remained under pressure due to ongoing negotiations over brexit deal. Moreover EUR was also trading soft due to Italian budget which was rejected by European council as it breached the fiscal deficit target set by EU. ECB, BOJ and BOE all kept their interest rate on hold even as FED reaffirmed further interest rate hike in near future. BOJ and ECB sounded cautious over the growth while BOE suggested for interest rate hikes in future if brexit negotiations goes as planned. Currency swap deals were the flavour of the month with China – Japan and China – Philippines entering in such deals. Venezuelan government also switched to EURO for all international traded dumping dollars. Going forward, with great deal of positivity around and easing of trade tension between China and U.S, rupee is likely to further appreciate to levels of 71.50 – 72.00 in the month of November.

Currencies	30-Sep-18	31-Oct-18	Change (%)
EUR-USD	1.1609	1.1312	-2.56%
GBP-USD	1.3031	1.2766	-2.03%
USD-JPY	113.69	112.94	-0.66%
USD-INR	72.51	73.96	2.00%
AUD-USD	0.723	0.7074	-2.16%

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Commodities

In the month of Oct, crude oil prices traded sharply lower after Saudi Arabia's pledge to raise production to a record high; two weeks before US sanctions potentially choke off Iranian supplies. On the one side crude oil has been supported by reports that Iranian crude exports may be falling faster than expected deadline of Nov 4, the date U.S. sanctions on the commodity are due to start. While on the other hand, fall in global stock markets can cap the upside. Overall it managed to hover in range of $65.33-76.90 in NYMEX and 4819-5669 in MCX. Russian Government reported that is it's no longer capping oil output increases by local producers, signaling that Moscow's supply-restraint pact with OPEC has effectively expired for now. Natural gas traded on upside path on higher demand. Overall it traded in range of $3.01-3.36 in NYMEX and 219.70-250.80 in MCX in the month of October. Recently natural gas got support on forecasts for more heating demand over the next two weeks than previously expected.

Commodity	28-Sep-18	31-Oct-18	% Change
WTI Crude	73.25	65.31	-10.84
Brent Crude	82.73	75.04	-9.30
Natural Gas	3.01	3.26	8.31

Bullion counter on domestic bourses traded on positive path as falling global stock markets prompted safe haven demand coupled with weakness in local currency rupee. Overall gold traded in range of 30370-32311 in MCX and $1186-1246 in COMEX. Silver traded in range of $14.24-14.88 in COMEX and 38055-39444 in MCX. Recently gold has rallied on safe haven demand as China locked in trade war with US and Italy trying to solve its budget issue without spill over risks to the Euro zone. Meanwhile US President Trump renewed attacks on the Fed's policy tightening have also highlighted the political pressure on the US Central bank.

Commodity	28-Sep-18	31-Oct-18	% Change
Gold	1196.20	1215.00	1.57
Silver	14.71	14.28	-2.92
Platinum	813.68	841.10	3.37
Copper (LME)	6180.00	6073.00	-1.73
Zinc (LME)	2573.00	2590.00	0.66
Lead (LME)	2002.00	1867.00	-6.74

Base metals traded on sideways path. China's factory gate inflation cooled for a third straight month in September amid ebbing domestic demand, pointing to more pressure on the world's second biggest economy as it remains locked in an intensifying trade war with the United States. Copper traded in range of 434.15-469.35. Chile's state copper miner, Codelco, has submitted an environmental impact assessment of its plans to overhaul its aging Salvador deposit that would sharply increase its production and extend its life by 40 years. China's unwrought copper imports surged to their highest in 2-1/2 years in September, while copper concentrate imports climbed to an all-time high as the worlds top copper consumer's crackdown on scrap leaves it needing other forms of the metal. Zinc also moved in range of 190.20-204.15. ShFE warehouse inventories showed that zinc arrivals jumped by 14,169 tonnes, or 48.5 percent, over the past two weeks to 43,373 tonnes. Battery metal Lead traded in range of 139.80-156.40. Aluminum prices moved on volatile path in range of 143.20-167.80. Aluminium prices corrected sharply lower after LME inventories saw a sudden build-up of more than 70000 tonnes. Nickel moved in range of 855.60-963.30 in MCX.

Market Outlook

Equities

The FPI sold equities worth more than INR 27,000Cr during October while domestic institutions were net buyer for INR 24,000Cr as market sentiments remain down. This year domestic investors turned out to be savior of the equity markets as they continued to invest in equities through systematic investment (SIP's) while real estate and gold provided either moderate or negative returns in last few years. FPI outflows from India are in line with the global developments on trade issues with rising US interest rate and strengthening dollar index as emerging markets across the world are witnessing fund outflows amid volatility and depreciating currencies. However FPI and domestic institutional investors continued to be bullish on India, we expect the inflows will resume as currency and market volatility stabilizes and India implements big reforms like GST, RERA, Bankruptcy laws and corporate performance improves going forward.

We expect the size of Indian formal economy to increase post demonetization and GST resulting into lower cost of production in medium to long term with moderate inflation and interest rates. The ease of doing business rank of India improved to 77 a jump of 23 from last year and of 65 points in last four years as more efficient & transparent processes are put in place this position should improve further resulting in higher FDI and domestic investments. The higher collection of direct and indirect taxes post GST should also result into more government spending in infrastructure and social sector which may create further demand in the economy providing better profitability to corporate with improved governance and compliance. The fiscal deficit being in election year remains a concern however higher tax collections with higher growth may take care of that. The domestic investors are expected to continue further investments in equities as it is expected to remain best performing asset class in next 3-4 years as other assets like gold and real estate are not performing currently.

The improved outlook for GDP growth and the corporate earnings should drive the market going forward and the market will be rerated accordingly. The midcap and small cap stocks corrections may provide attractive buying opportunities during the year which should be used for further investments as stocks move towards fair valuations and expected to resume upside trend after some consolidation with intermittent corrections amid higher volatility. The foreign investors continue to see India as better prospect among emerging economies as micros has started improving although in recent months some concerns on account of rising inflation, current account and fiscal deficit have emerged on macros which are still in reasonably good shape. The equity markets in India are expected to provide best returns among all assets classes on multiyear time frame and trigger will be healthy corporate earnings growth on the back of right policy announcements and quicker implementation by the government, ease of doing business, better compliance and tax collections under GST and all this resulting into higher inflows from domestic portfolio investors with FPI expected to resume inflows once global uncertainties abate.

The market is expected to remain volatile for some time in near future and will attract investors as valuations become fair. The September quarter results although lower than estimates till now still better than earlier despite depreciating currency, rising interest rates and higher crude prices as economic activity at micro level has improved compared to previous year. We see reasonable probability that market may provide 13-14% kind of annualized returns in next 3-4 years time frame however stock selection will be the key hence the dips in the market should be used by the long term investors to buy. The market is expected to provide good opportunities in large and midcaps stocks trading at attractive valuations. The IT, Pharma and other export focused sectors are expected to do well with weakening currency besides Infra, Agri, Auto and FMCG with large government spending and rural recovery post reasonably good monsoon. The public sector banks on the back of higher stressed assets remains a concern however renewed focus on NPA resolutions under recently enacted IBC legislation and RBI notified resolution framework should improve the health of these institutions in next 2-3 years. The NBFC will remain the concern on the back of recent debt defaults by high credential group and hardening interest rates.

However the fiscal deficit, inflation and current account deficit on the back of higher crude prices, weakening currency and muted private investments along with global volatility on the back of US protectionist policies under Mr. Trump, trade tensions, Britain exit, political uncertainty in Euro zone, geopolitical concerns in Middle East and China slowdown remains serious concerns. Moreover the US FED with contracting balance sheet amid rising interest rates shall keep the global markets on hook with some uncertainty and high volatility in monetary and currency markets.

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Debt

RBI is monitoring the inflation trajectory closely and if the expectations remain elevated on the back of higher crude and raw material prices with adverse impact of higher MSP it may opt for further interest hike during current financial year. The yield curve is near flat with near term liquidity concerns and elevated interest rates on short term maturity. The market liquidity is also tightening with FPI outflows and rising credit demand. The SBI and many other banks have already increased the MCLR with rising cost of deposits amid tight liquidity in last few months. It is clear that decade long period of global cheap money is over. The investors are advised to invest in short to medium term maturity debt for the time being under the current scenario however some allocation can be made to long term debt for lock-in purpose to avoid reinvestment risks.

Commodities

Energy: Crude oil prices may continue to remain downbeat as Saudi Arabia assured that markets would continue to meet customer demand for crude despite looming U.S. sanctions that are expected to reduce oil exports from Iran. Meanwhile, OPEC signaled that it may have to return to oil production cuts as global inventories rise that may further sour relations with U.S. President Donald Trump. Overall crude oil can move in range of 4750-5400 in the month of November.

Gold & Silver: Recently bullion counter has witnessed sharp rally amid falling stock markets but resurgent greenback and hawkish statements from fed members can lead to profit booking at higher levels in the month of November. The recent downtrend in the US stocks has increased safe-haven demand of gold to some extent. Movement of local currency will impact domestic prices as it can move in range of 72-75 in the month of November. Gold can trade in range of Rs 31000-32500 in MCX and $1200-1265 in COMEX. Silver can trade in range of 37000-40000 in MCX and $13.80-15.00 in COMEX. Physical demand in India can get boost as the most auspicious day of the year to buy gold is Dhanteras, which falls on November 5.

Base Metals: Base metals counter can trade with sideways bias. Recently concerns over the impact of a U.S.-China trade row on demand for industrial metals returned to focus. China's economic growth cooled to its weakest quarterly pace since the global financial crisis, with regulators moving quickly to calm nervous investors as a years-long campaign to tackle debt risks and the trade war with the United States began to bite. Copper may take support near 420 and can face resistance near 460 in MCX. Nickel can take support near 820 and can face resistance near 900. Lead can move in range of 138-155. Aluminium can trade on mixed path as it can take support near 138 and resistance near 155 in MCX.