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Macro-economic developments

- US non-farm payrolls rose by lower than expected 661,000 in the month of September compared to 1.5 million in the previous month. Unemployment rate fell to 7.9% in September vs 8.4% in August, and a record high of 14.7% in April.
- Economic activity improved globally, and Global Manufacturing PMI rose to a 29-month high of 53.0 in October from 52.4 in September. PMI data below 50 means contraction in activity.
- US GDP grew at a record 33.1% QoQ (annualized) in Q3 CY20, after contracting by 31.4% QoQ (annualized) in Q2 CY20. In YoY terms, US GDP contracted 2.9%YoY in Q3 CY20 vs contraction of 9.0%YoY in Q2 CY20. Strong growth in Q3 was primarily helped by surge in personal consumption (accounting for ~68% of US GDP), which grew by a strong 40.7% QoQ (annualized) and gross private investment which surged by 83% QoQ (annualized).
- As per IMF's World Economic Outlook Update (as of October 2020), global GDP growth is now projected to contract by 4.4% in CY2020 Vs earlier projection of 5.2% contraction (as per June 2020 forecast). This is being helped by healthy economic recovery in developed economies, especially the US--where GDP is now expected to contract 4.3% in CY20 vs earlier projection of 8.0% contraction. Healthy recovery of 5.2% in global GDP growth is projected for CY2021. IMF downgraded India's GDP growth forecast to -10.3% in FY21 from earlier projection of -4.5% (in June 2020 forecast). However, India's GDP growth is expected to recover by a healthy 8.8% in FY22 (helped to some extent by base effect). India's central bank (RBI) projects the country's GDP to contract by 9.5% in FY21.
- High-frequency economic indicators point to a healthy recovery in India's economy, and various economic/business activity indices indicate that activity is back to ~85-95% of pre-covid levels, and the festive season will also be an important indicator. In India we have seen new daily Covid cases seeing a healthy moderation (from the peak in September), and recovery rate has been high (~90% at national level)—leading to significant reduction in active cases, and mortality rate has also been controlled at ~1.5% at national level.
- The Indian government announced some consumption measures in the month of October, ahead of festive season (through leave travel concession and festival advance schemes for govt. employees). It also announced some investment stimulus through interest free loans to states and additional capex by the centre. However, the fiscal impact of these measures is limited at ~0.2% of GDP, with limited fiscal space available for the government.
- India Manufacturing PMI surged to 58.9 in October (strongest in over a decade) from 56.8 in September. India Services PMI rose sharply to 54.1 in October vs 49.8 in September, making it the first time it has been in expansion territory in eight months. PMI lower than 50 indicates contraction in activity.
- Consumer price inflation (CPI) data for the month of Sep 2020 rose to 7.3%YoY from 6.7%YoY in the previous month. Food inflation (which has 39% weight in the CPI index) rose to 10.7%YoY in September versus 9.1%YoY in the previous month. However, core inflation (ex food and fuel) moderated marginally to 5.6%YoY in September from 5.7%YoY in the previous month.
- Crude prices corrected due to global risk aversion as a result of a second wave of Covid cases in Europe (with lock-downs / restrictions being re-imposed in certain countries), escalating Covid cases in the US, and OPEC increasing production for the fourth consecutive month in October. Brent crude price fell 8.5% in October, to close at $37.5/bbl.
- The rupee closed the month down by 0.5% at INR 74.11/USD.

Equity market developments and Outlook

- Indian equity markets fared better than most other global markets during the month of October, helped by sharp decline in active Covid-19 cases, further recovery in the economy, and strong foreign portfolio inflows.
- The benchmark Nifty 50 index returned +3.5% during the month. The broader markets underperformed, with the Nifty Midcap 50 index and the Nifty Smallcap 100 index returning -0.01% and -0.07% respectively in October.
- The sectors that outperformed during the month of October were banking, realty and IT. The sectors that underperformed during the month were pharma, auto and metals.
- Global markets saw some volatility during the month with a second wave of Covid-19 cases being seen in certain major European countries (with lock-downs / restrictions being re-imposed in some), with Covid cases escalating in the US and also on account of uncertainty ahead of the US elections. Developed markets underperformed Emerging & Asian markets during the month of October. The MSCI World index returned -3.1% in October, while the MSCI Emerging Markets index and MSCI Asia ex-Japan index returned +2.0% and +2.8% respectively.
- For the US markets, the benchmark S&P 500 index returned -2.8% during the month. Major European markets like France, UK and Germany registered a healthy correction in October with a second wave of Covid cases being seen within the region. Within Asia—Indonesia, India and Hong Kong outperformed during the month, while Thailand, South Korea and Malaysia underperformed.
- Foreign portfolio investors (FPIs) registered a strong net equity inflow ₹18,400 crore in the month of October, compared to net equity outflow of ₹5,690 crore in the previous month.
- Domestic Institutional Investors (DIIs) registered a large net outflow of ₹17,318 crore in the month of October, compared to a marginal net inflow of ₹110 crore in the previous month.
- Q2 FY21 earnings so far have largely been coming in better than expected, and we expect earnings to gradually recover through the rest of the fiscal year. For FY21 we estimate Nifty EPS growth flattish at around 2% and for FY21 we estimate a strong recovery in Nifty EPS growth to around 30%.
- The Nifty index is currently trading at 19-20x of one-year forward earnings (which is above pre-pandemic levels), but the forward PE valuation based on FY22 earnings is quite reasonable (factoring-in the healthy recovery in corporate earnings). Markets seem to be focusing more on the latter.
- We recommend that long term investors should continue to systematically invest in equities. There is a possibility that we may see some volatility in the short term due to some major upcoming events. Investors can also use any large market corrections/dips to make lumpsum investment in equities.
- From a market-cap perspective, we prefer the large cap segment and advise higher allocation to the same. Macro fundamentals still remain a bit challenged and therefore large caps may see relatively less volatility compared to mid/small caps.

Fixed Income market developments and Outlook

- Bond yields softened during the month on the back of a dovish RBI policy, fall in global crude oil prices, and comfortable liquidity. Even though the RBI kept rates unchanged in its October monetary policy review—it announced various liquidity and credit enhancing measures, which helped to support the bond markets. The benchmark 10 year G-Sec yield closed the month at 5.88%--down 14 bps. Bond yields fell more at the shorter end of the yield curve.
- In mid-October, the government announced that central government borrowing in H2 FY21 will increase by ₹1.1 trln to ₹5.44 trln to help states meet the shortfall arising from GST. All of the additional borrowing is coming from additional issuance of 5-year bonds and introduction of 3-year bonds. The borrowing calendar has also been extended from January 2021 end to mid-March 2021.
- India's fiscal deficit for first six months of the fiscal year (April 2020 to September 2020) has already breached the full fiscal year target and stood at 115% of the budgeted estimate, compared to 93% of the annual target in the corresponding period in the previous fiscal year. The high fiscal deficit has been due to sharp drop in non-tax revenue & tax revenue collections—with total receipts (upto September) at only 25% of the budgeted estimate so far, compared to 40% in corresponding period of previous fiscal year. However, government spending (upto September) was at 49% of the budgeted estimate vs 53% in the corresponding period of previous fiscal year. The sharp fall in receipts, while maintaining government expenditure at somewhat similar levels has caused the large shortfall/deficit.
- Finance Ministry data showed that GST collections in October continued to rise to ₹1.05 lakh crore (highest since the lockdown in March) from ₹95,480 crore in the month of September.
- Foreign Portfolio Investors (FPIs) registered a net debt inflow of ₹3,297 crore in the month of October, compared to a net inflow of ₹3,009 crore in the previous month.
- The RBI monetary policy had a dovish undertone and it has been quite supportive of growth with abundant liquidity measures and mention of accommodative policy stance into next fiscal year. Commentary from the central bank indicates there is space for further rate cuts going forward, if inflation moderates as per the projected territory.
- However, current elevated inflation and concerns of fiscal slippage continue to be a bit of an overhang on bond markets still and have capped the fall in bond yields--especially at the longer end. From an investment perspective on the fixed income side, we continue to prefer the medium-term part of the yield curve.