Market Outlook & Investment Strategy

December 2018

Index

Investment Strategy - Equity

Equity View	Limited Upside to Our Sensex Target – Time to remain Selective
Performance	Sensex gained 5% during the month. Year-to-date (YTD), the index is up by 6.2%. Nifty Mid Cap index gained 1.8% in November (YTD -17%) and Nifty Small Cap delivered 2.5% (YTD -31%).
Earnings and Valuation	Q2FY19 earnings season witnessed strong sales growth being announced by most companies, but the margin pressure was evident for the broader universe and earnings breadth seems to be deteriorating. Input cost pressure is being increasingly absorbed by companies as the demand environment in weakening. This could be an early sign of an impending slowdown and warrants close monitoring. On a 12m forward basis, Sensex continues to trade over average @20x forward P/E. India's premium with EM is at 69%, higher than historical average of 41%.
Outlook and Strategy	▪ In our opinion there are a few key market drivers that would determine the trajectory over the next 12m – Earnings, Policy, Crude, Trade, Tightening and Flows ▪ Large corrections to the excess in valuations that were seen in October seem to have partially reversed. Degree of over-valuation at an aggregate level still remains (partly due to earnings downgrades). ▪ Over last few weeks, crude price has corrected by over $20/bbl. Further softening of crude (for any reason) would make India the largest beneficiary ▪ While the crude price fall led to some alleviation in inflation, external and INR risks, the recent growth prints (Q2 FY19 GDP softened to 7.1% vs. 8.2% in Q1) coupled with challenges in the NBFC sector underscores some headwinds to Indian growth. ▪ Markets have for now priced moderation in growth, but would gyrate to the tune of political news. ▪ Staggered investments over 6m is recommended. Bottom-up stock picking would be key.

Source:- Bloomberg, Note: Performance data updated up to 30th Nov 2018

Investment Strategy – Fixed Income

Fixed Income View	Positive on accrual oriented strategies with a quality bias
Performance	Duration trade outperformed in the last 1 month as yields eased across maturities and credit spectrum. However, over a 3yr timeframe, accruals products continue to deliver superior returns.
Monetary Policy and Inflation	RBI kept the policy rates and stance unchanged in the Dec policy while it drastically reduced headline CPI projections to ~4% and lower upto H1FY2020. Bond market yields came off post the policy as the markets seem to be reacting to downward revision to RBI's CPI projections. RBI also announced reduction in SLR over next 6 quarters to 18% from 19.5% currently. This could mean durable supply of government bonds in the market (due to selling by banks), which would counterbalance demand for these securities (coming from OMOs till March). Globally too, as advanced economy central banks continue with the tightening program (inspite of initial signs of slowing growth), pressure on yields would be maintained.
Outlook and Strategy	We don't see a secular rally in bonds as expectations as various global and domestic developments would continue to influence rates. We see 10yr G-sec yields to trade between 7.50% - 7.75%. We recommend debt Investors to: ▪ Avoid fresh allocation to duration trade / book profits on their existing allocations to longer end. ▪ Opportunities at short end of the curve as banking liquidity is being well managed by RBI OMOs. ▪ Pick strategies combining allocation to 1-3 years duration basket, with exposure to a mix of quality credits. ▪ Actively look at building yield in the debt portfolio: a) Credit accrual funds focusing on judicious mix of credit quality b) 3 year FMPs and preference shares with higher yields, c) Yield enhancement Structured Products. d) Direct bonds

Source:- Bloomberg, Note: Performance data updated up to 30th Nov 2018

Investment Strategy – Alternates and Other Asset Classes

Currency	INR: Expected to remain steady A USD: Positive	With receding global headwinds investors are optimistic about lower current account deficit and higher capital inflows. There is uncertainty over the RBI's response function to a BoP surplus though. Unsterilized FX intervention is going to help the liquidity situation and the FX reserves would be replenished. We marginally temper our trading range on the Rupee to 70 – 73 in the near term.
Commodities	Gold: Negative	Prices of precious metals, including gold and silver, moved slightly higher in the domestic market on the back of safe haven demand amid volatility in stocks .However, owing to liquidity crunch demand for gold seems to remain muted this festive season. Gold demand in India is expected to remain muted for the year.
Alternates	Real Estate: Positive on Commercial; Neutral / Selective on Residential	With introduction of RERA, Benami Property (Prohibition) Act and Bankruptcy and Insolvency Act, Indian Real Estate sector has seen bounce back with confidence in the market. Commercial properties has shown positive sentiments for H1 2018. Residential and retail market is seeing fresh lease of life with sales and investments making a comeback with decline in unsold inventory.
	AIFs	Positive on Rental yield funds in commercial space, Consumption theme in long only equity, long-short strategies to counter volatile markets

Source:- Bloomberg,

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Model Asset Allocation – Large Cap biased in equities; Accruals in Debt

Aggressive

ASSET CLASS	SA	TA
Equity	60.0%	60.0%
Large / Multi Cap	20.0%	30.0%
Mid / Small Cap	40.0%	30.0%
Hybrid	0.0%	0.0%
Fixed Income	10.0%	10.0%
Liquid / Arbitrage	0.0%	0.0%
Accrual / Credit	5.0%	10.0%
Dynamic / HTM	5.0%	0.0%
Equity Savings	0.0%	0.0%
Alternate	30.0%	30.0%
Listed & Unlisted Equity	10.0%	10.0%
High Yielding	10.0%	10.0%
Long - Short	10.0%	10.0%

Balanced

ASSET CLASS	SA	TA
Equity	35.0%	35.0%
Large / Multi Cap	15.0%	15.0%
Mid / Small Cap	5.0%	0.0%
Hybrid	15.0%	20.0%
Fixed Income	50.0%	50.0%
Liquid / Arbitrage	5.0%	5.0%
Accrual / Credit	35.0%	40.0%
Dynamic / HTM	0.0%	0.0%
Equity Savings	10.0%	5.0%
Alternate	15.0%	15.0%
Listed & Unlisted Equity	0.0%	0.0%
High Yielding	10.0%	10.0%
Long - Short	5.0%	5.0%

Conservative

ASSET CLASS	SA	TA
Equity	10.0%	10.0%
Large / Multi Cap	0.0%	0.0%
Mid / Small Cap	0.0%	0.0%
Hybrid	10.0%	10.0%
Fixed Income	80.0%	80.0%
Liquid / Arbitrage	5.0%	5.0%
Accrual / Credit	60.0%	65.0%
Dynamic / HTM	0.0%	0.0%
Equity Savings	15.0%	10.0%
Alternate	10.0%	10.0%
Listed & Unlisted Equity	0.0%	0.0%
High Yielding	0.0%	0.0%
Long - Short	10.0%	10.0%

SA: Strategic Allocation; TA: Tactical Allocation
Note: Please refer to the Product Compendium for recommendations under every asset class and product category

Tactical Allocation Rationale – Existing & New Money

Aggressive	Equity	▪ Allocate in a staggered manner through multi-cap strategies over pure large cap plays given reducing premium between mid and large caps and Sensex/Nifty trading at high PEs ▪ Pure mid cap funds might still see some correction, hence marginally underweight.
	Fixed Income	▪ Probable stress in NBFCs, higher MF exposure to NBFCs, expectations of rate hike makes us prefer quality accrual funds over funds taking excessive credit risk. Also, the spreads in AAA are attractive currently, reducing the need to move lower the credit spectrum. Negative duration.
	Alternate	▪ Neutral weight across alternate strategies for this profile
Balanced	Equity	▪ Pure mid cap funds might still see some correction, hence marginally underweight ▪ Given the client profile and expectations of volatile markets make us go overweight on hybrid category
	Fixed Income	▪ Probable stress in NBFCs, higher MF exposure to NBFCs, expectations of rate hike makes us prefer quality accrual funds over funds taking excessive credit risk. Also, the spreads in AAA are attractive currently, reducing the need to move lower the credit spectrum. Negative duration.
	Alternate	▪ Neutral weight across alternate strategies for this profile
Conservative	Equity	▪ Neutral weight across equity strategies for this profile
	Fixed Income	▪ Probable stress in NBFCs, higher MF exposure to NBFCs, expectations of rate hike makes us prefer quality accrual funds over funds taking excessive credit risk. Also, the spreads in AAA are attractive currently, reducing the need to move lower the credit spectrum. Negative duration.
	Alternate	▪ Neutral weight across alternate strategies for this profile

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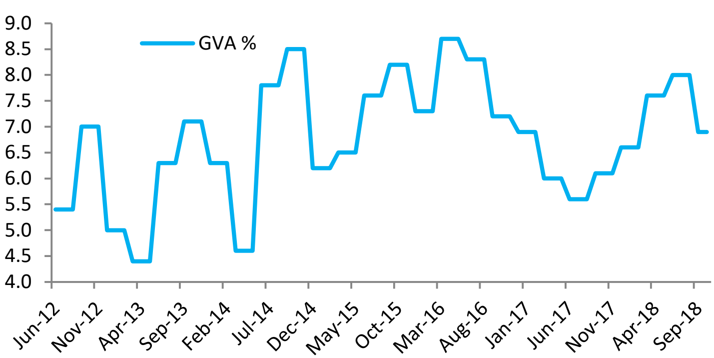
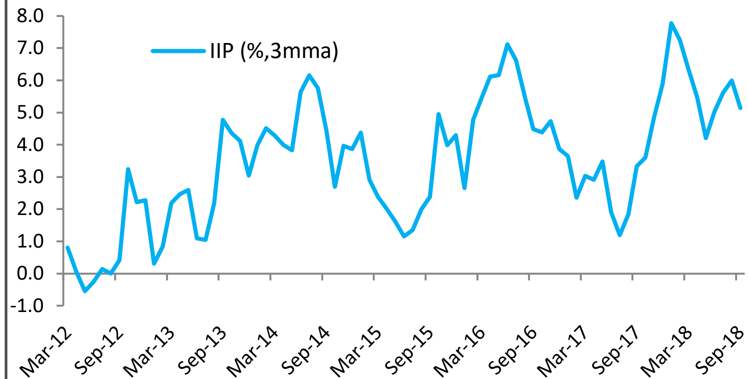
Growth – Pickup in momentum; IIP sluggish; Services strong

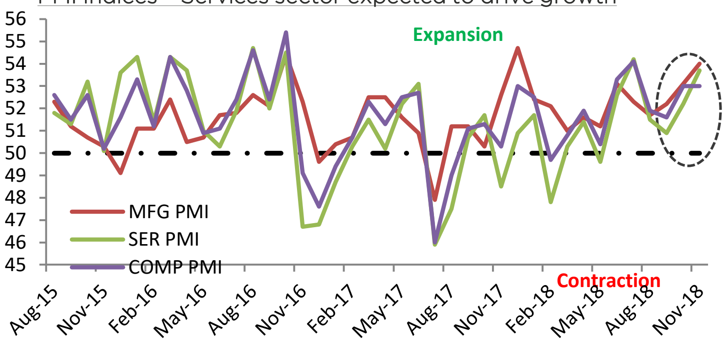
GDP Growth (%YoY) – Growth pick up has been consistent recently



IIP Growth (%YoY) – Sustained pickup **in investments yet to be seen**

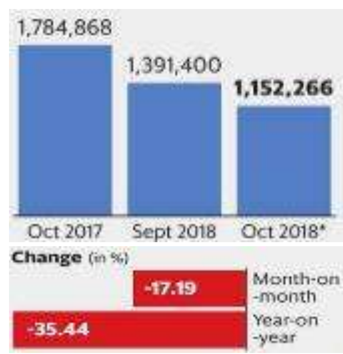


PMI Indices – Services sector expected to drive growth



Source:- Bloomberg, Vahan, MOSPI, Nikkei, RWML Research; *till 30th Nov 2018

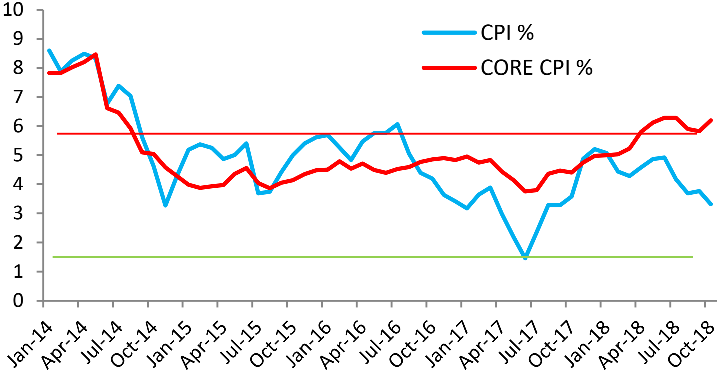
Auto Sales (%YoY) – Strong turnaround in FY18 seems to be fading



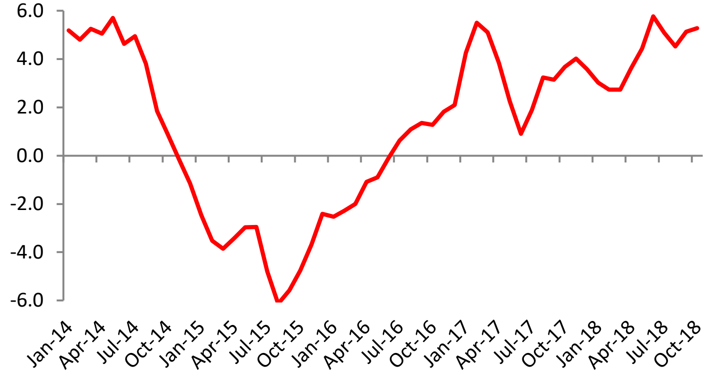
- Increase in insurance premiums and increased fuel prices seem to have impacted sales
- Sales of Cars, 2 wheelers and SUVs seem to have impacted
- SUV sales continue to be strong

Inflation – Headline in control; Core stable at current levels

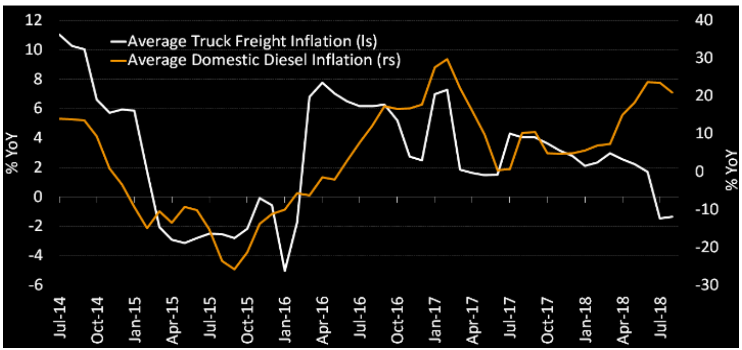
CPI (%YoY) – Below RBI's target; Core has remained firm



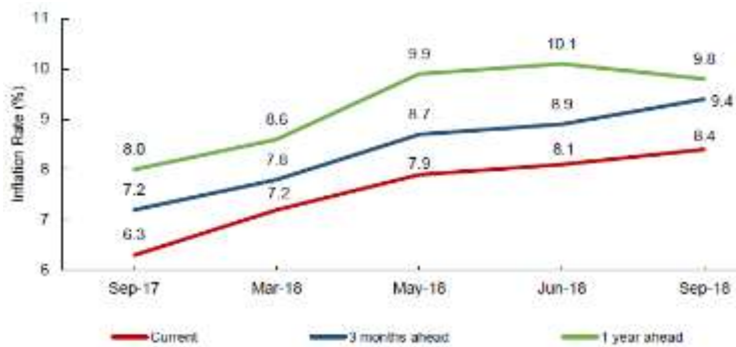
WPI (%YoY) – Continues to edge upwards



Truck Freight & Diesel Price led inflation seems to be in control



Inflationary expectations (%) - Near term has moved up; **1yr has tapered**

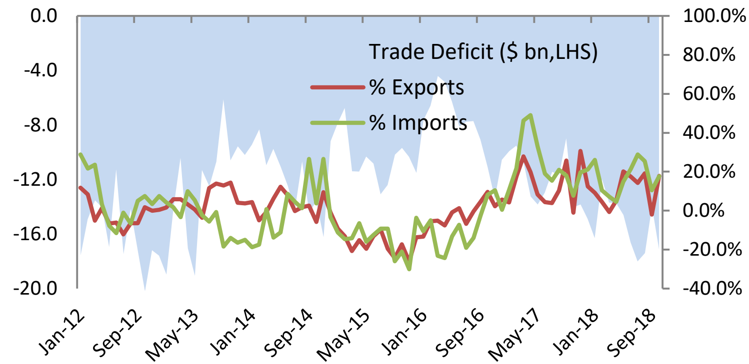


Source:- Bloomberg, RBI, MOSPI, RWML Research

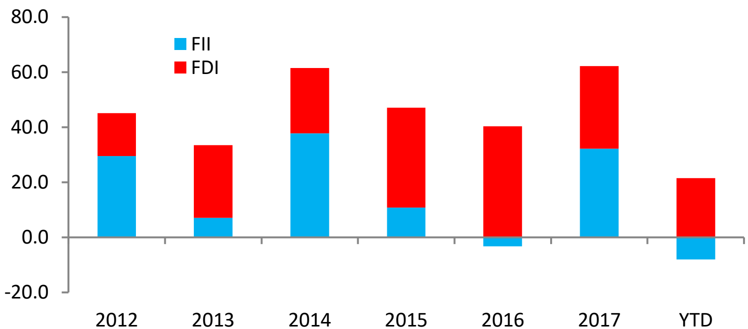
External Balance – Strong Reserves, CAD under pressure, Watch out for flows

Current Account- Deficit widens; expected to move up in the next year

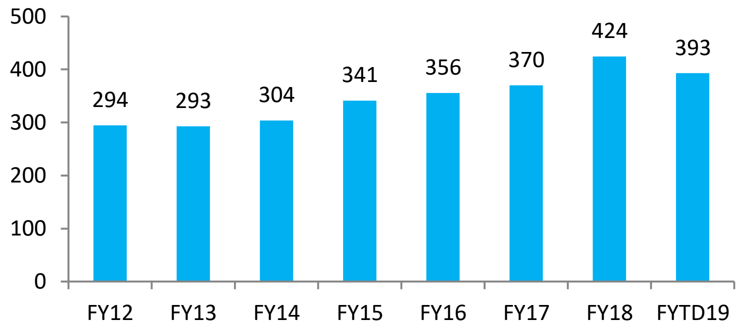
Trade Deficit- Around $17bn; Exports & Import growth bounced back



Foreign Flows ($ bn) – FDI support has been strong over last few years



Fx Reserves ($ bn) – Strong build up; Recent fall due to RBI intervention



Source:- Bloomberg, Commerce Ministry, RBI, RWML Research

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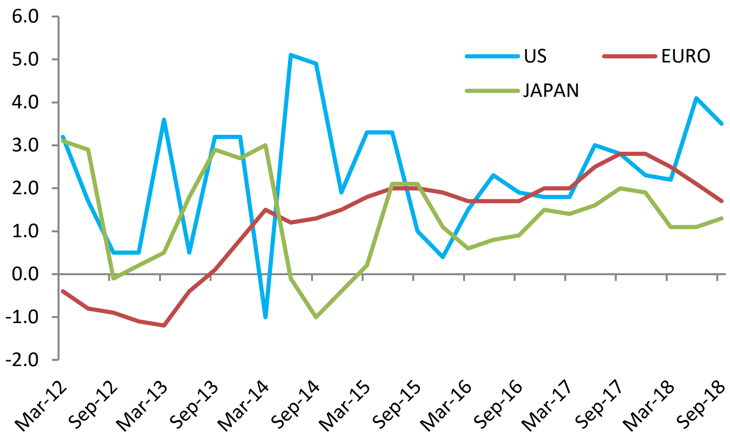
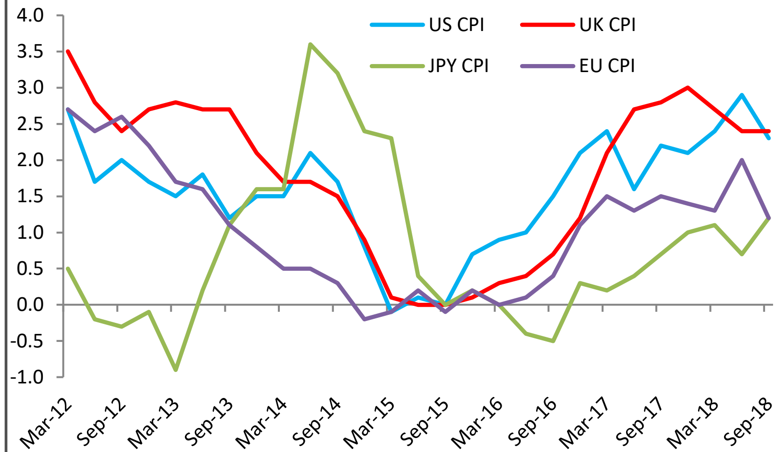
Steady growth, Pick up in prices- Central bank tightening to continue

GDP Growth (%) – Key Developed Markets (DM)



Headline Inflation (%YoY) – US, EU show price rise; Japan and UK lag



- Fed Chair Powell provided some comfort to financial markets by saying Fed rates are near 'neutral' and markets are now pricing only one hike in 2019 versus two hikes in early October.
- Global growth remains fairly robust but dynamics diverging now
- Slower European growth, uncertainties about China's growth prospects, trade policies and bouts of financial turbulence have undermined business investment and unsettled markets
- After nearly a year of trade spat, US and China held cordial talks at their recent summit meeting following the G-20 leaders

Source:- Bloomberg, RWML Research

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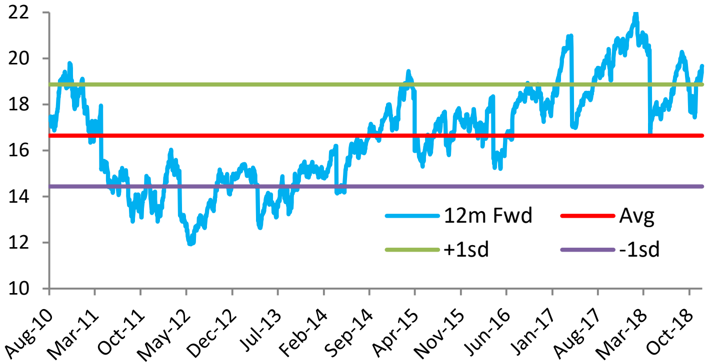
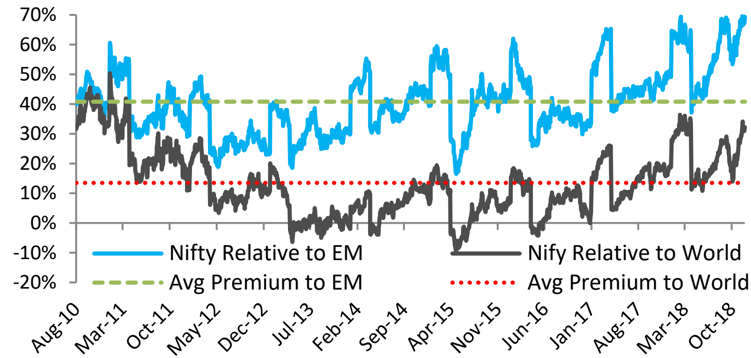
Earnings & Valuation – Multiple has risen with market upturn & EPS revisions

12M Fwd P/E(x) for Nifty has moved higher owing to EPS revisions



Nifty Premium to EM/World is higher than the average since 2010



Nifty EPS Growth (%) – Narrative hasn't changed much!

Nifty Revenues have grown at a sharp pace in Q1FY19

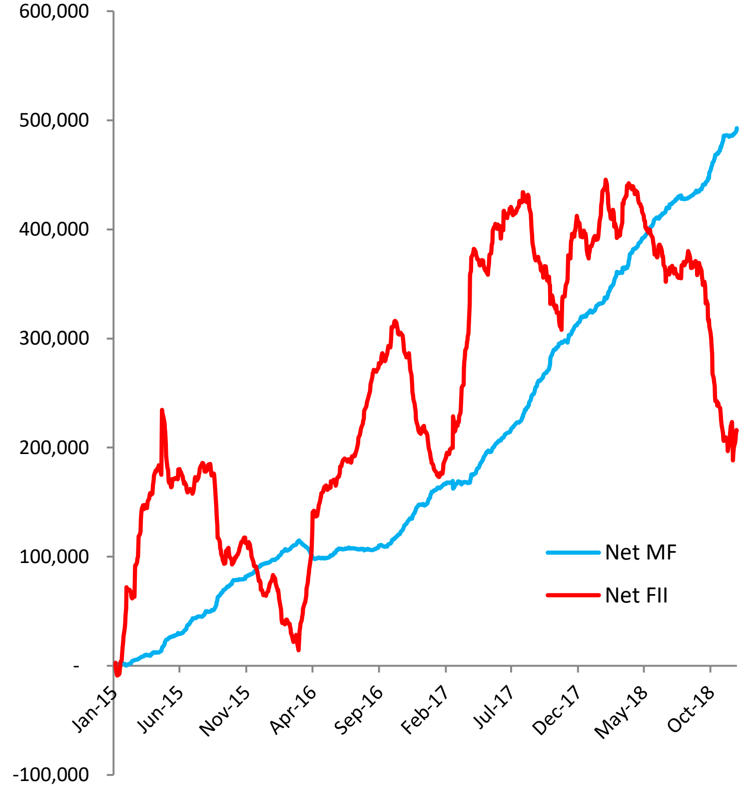
Source:- Bloomberg, Capitaline, RWML Research

Flows – FPIs v/s MFs

Historical Equity Market Flows ($ mn)

CY	FII	MF
CY2005	10901	3034
CY2006	8337.7	3379
CY2007	18517.8	1390
CY2008	-12918.3	3253
CY2009	17639.2	-1154
CY2010	29320.8	-5939
CY2011	-511.8	129
CY2012	24547.7	-3805
CY2013	19754.3	-3780
CY2014	16161.9	4944
CY2015	3274.1	10806
CY2016	2902.89	6600
CY2017	8014.48	19750
CYTD2018	-6556.83	17897

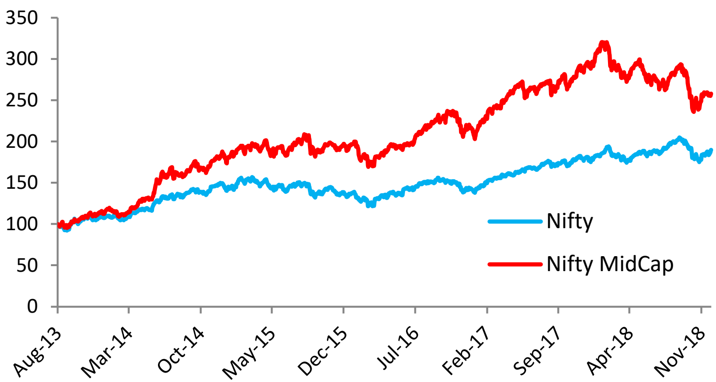
Cumulative Net Equity Flows Since Jan 2015: Sharp fall in FIIs; MFs hold



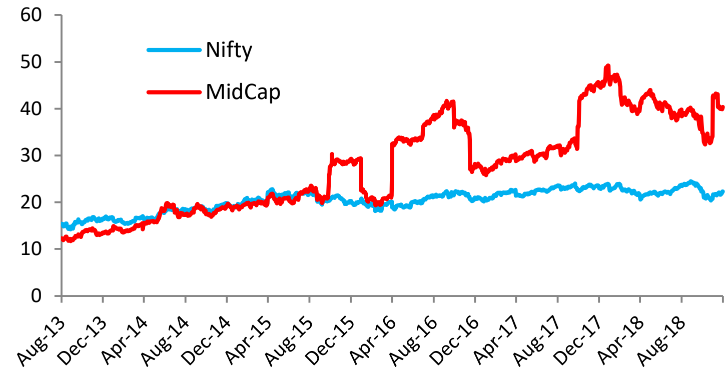
Source:- Bloomberg, NSDL, SEBI, RWML Research; Data as on 29th Oct 2018

Mid v/s Large: Select mid/small caps & multi-cap oriented portfolio is advised

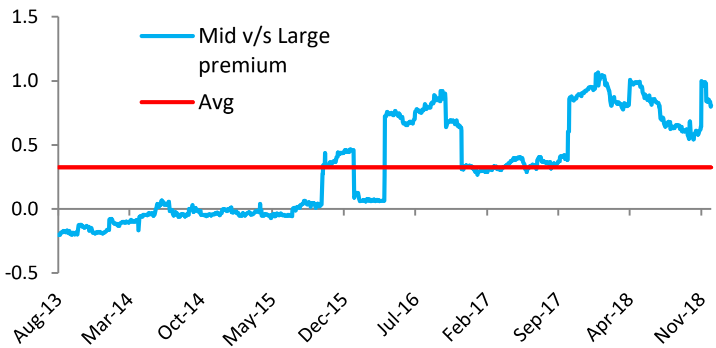
5yr performance by the two segments



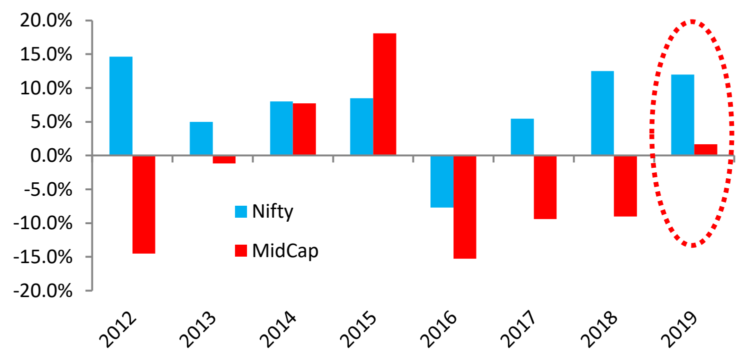
Mid Caps v/s Large Caps – 12M Fwd P/E(x)



Mid Caps v/s Large Caps – Premium (x)



Mid Caps v/s Large Caps- EPS Growth (% YoY): Some revival in Midcaps



Source:- Bloomberg, RWML Research; Data as on 30th Nov 2018

Sensex Index: Earnings Estimates and P/E Valuations

- Global uncertainties (trade war, crude, flows) and uncertain domestic political scenario until May 2019 continues
- Q2FY19 earnings season witnessed strong sales growth being announced by most companies, but the margin pressure was evident for the broader universe and earnings breadth seems to be deteriorating.
- Input cost pressure is being increasingly absorbed by companies as the demand environment in weakening. This could be an early sign of an impending slowdown and warrants close monitoring.
- For the overall market, volatility could continue near term, given above average valuations and risks of some moderation in growth in certain segments

Equity Outlook

Fiscal Year -->		FY18	FY19E	FY20E	FY21E
EPS Growth -->		4.0%	16.0%	18.0%	12.0%
Sensex EPS -->		1,525	1,769	2,087	2,338
PE Multiple	17	25,925	30,073	35,486	39,744
	18	27,450	31,842	37,574	42,082
	19	28,975	33,611	39,661	44,420
	20	30,500	35,380	41,748	46,758

- Our Sensex earnings growth estimates for FY19 is 16% (YoY). Bloomberg consensus estimates are down to ~15% (from 23%) earlier.
- Markets have witnessed a relief rally in November due to which valuations are back at 1sd over mean of 17x; 69% premium to EM.
- At an average 1yr forward P/E of 17x, we expect Sensex levels closer to 40,000 by Mar'20 (12% upside from current Sensex levels).
- We maintain neutral allocation towards equities amidst prevailing uncertainties. Recommend being selective in stock picks.

Source:- Bloomberg, RWML Research and estimates; Data as on 1st Nov 2018

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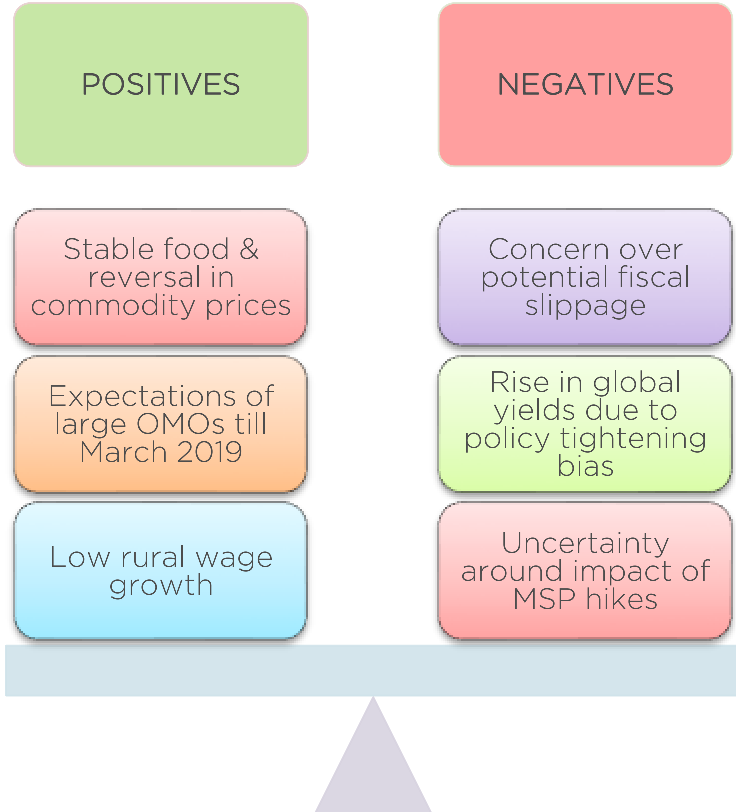
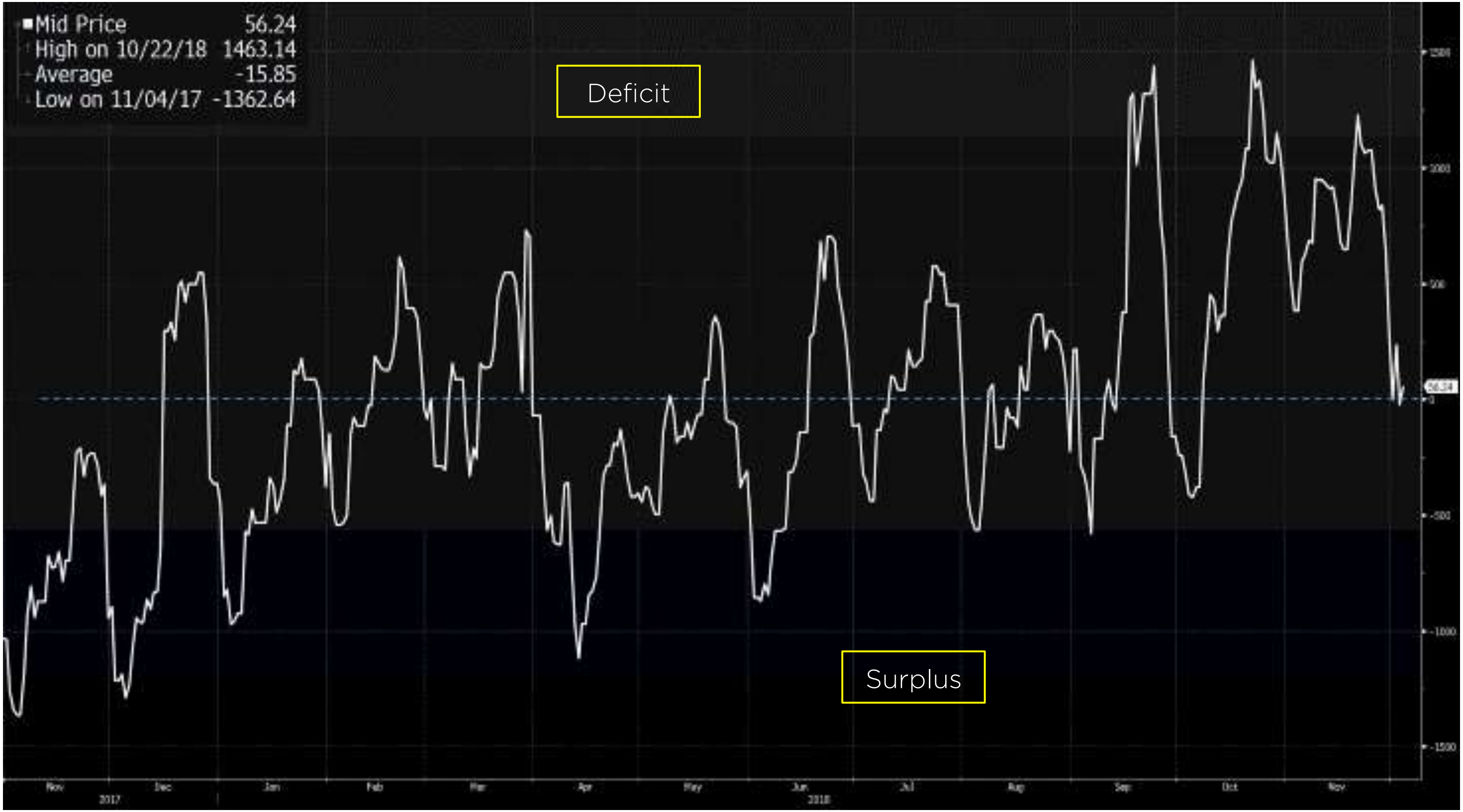
Factors affecting interest rates: Seem to be in balance; Yields to remain steady



Source:- Bloomberg, RWML Research

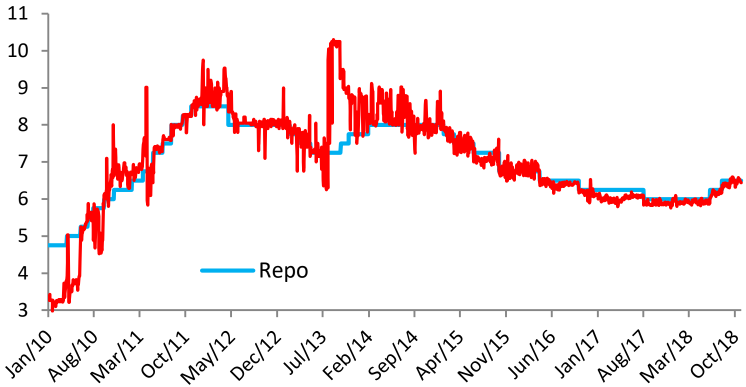
Liquidity Back to near Neutral; Recent OMOs seen to have eased the deficit



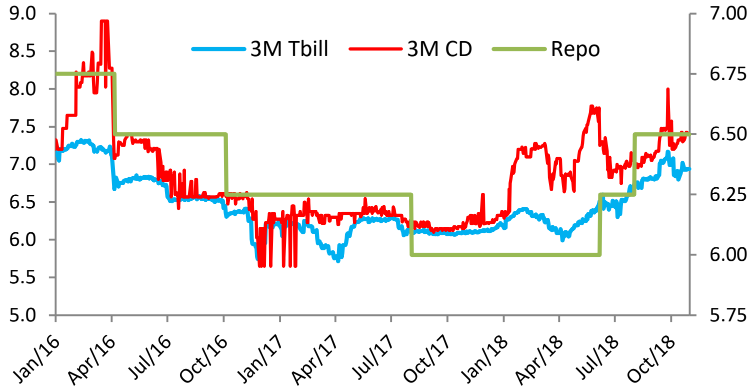
Source:- Bloomberg, RWML Research; Data as on 30th Nov 2018

Short Term Rates: Mirroring operative rate; Hike expectations close to nil

Call rates have moved in line with the Repo Rate so far



Other ST rates have reversed sharp uptick seen in Oct



Probability of rate hike by the RBI in Dec policy and post that has fallen substantially post the recent softness in crude prices and weak CPI prints

Current Implied Probabilities — 3) Add/Remove Rates

Dates: Meeting / Calculation — Calculated 11/02/2018 — Based on rate 6.50

Meeting	Hike Prob	Cut Prob	6.5	6.75	Fwd Rate
12/05/2018	30.2%	0.0%	69.8%	30.2%	6.66

Current Implied Probabilities — 3) Add/Remove Rates

Dates: Meeting / Calculation — Calculated 12/05/2018 — Based on rate 6.50

Meeting	Hike Prob	Cut Prob	6.25	6.5	6.75	Fwd Rate
12/05/2018	48.8%	0.0%	0.0%	51.2%	48.8%	6.63
02/06/2019	35.5%	14.0%	14.0%	50.5%	35.5%	6.56

Source:- Bloomberg, RWML Research; Data as on 4th Dec 2018

OIS Curve: Markets are practically not pricing in rate hikes any more

- 3m forward swaps have started factoring in a near term pause by the RBI in the upcoming policies.

Source:- Bloomberg, RWML Research; Data as on 1st Dec 2018

India 10yr: Spreads vs. US 10yr continue to hover around long term averages

Source:- Bloomberg, RWML Research

India 10yr: Spreads vs Repo Rate fallen closer to last 10 year average

Source:- Bloomberg, RWML Research

Yield Curve Movement and Spread Analysis

India Sovereign Yield Curve (across maturities) as of today, 1m ago and 1y ago

	Curve Id	3M	6M	1Y	2Y	3Y	5Y	10Y
11)	I180 Last	6.720	6.950	7.107	7.200	7.286	7.442	7.559
12)	I180 1M	6.890	7.120	7.374	7.495	7.487	7.722	7.808
13)	I180 12/05/17	6.134	6.221		6.382	6.588	6.876	7.060
14)	I180 (Last-1M)	-17.0	-17.0	-26.7	-29.5	-20.1	-28.0	-24.9
15)	I180 (Last-12/05/17)	58.6	72.9		81.7	69.8	56.5	49.9

- Yields have eased across maturities / tenors over the last 1 month, but they are higher than their 1yr ago levels. 3M paper has seen yields easing by 17bps with maximum fall seen in the 2yr paper (30bps). The 10yr paper has seen yields ease by 25bps.
- The recent cooling off in the yields can be attributed towards a status quo by the RBI in Oct and Dec 2018 policy coupled with softer CPI data prints, downward revision of CPI forecasts by the RBI and also easing of global brent crude prices.
- Corporate bond curve (across maturities and credit ratings) have also moved in a similar range vis-à-vis their traded yields in the last 1m and 1year periods.
- While the overall bearishness in the bond market might have subsided (tilting towards mild dovishness), we continue to advocate fresh exposure to funds / bonds with residual maturities of up to 3years as expecting an aggressive easing stance from the RBI seems premature at this stage.
- From a credit point of view, the AAA and AA & equivalent segment continues to offer attractive yields / accruals thus limiting the need to aggressively allocate towards credit risk funds where allocations to A & equivalent (or lower rated papers) would be higher.

Source:- RWML Research

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Currency and Commodities

INR appreciation can be seen over last 3 months

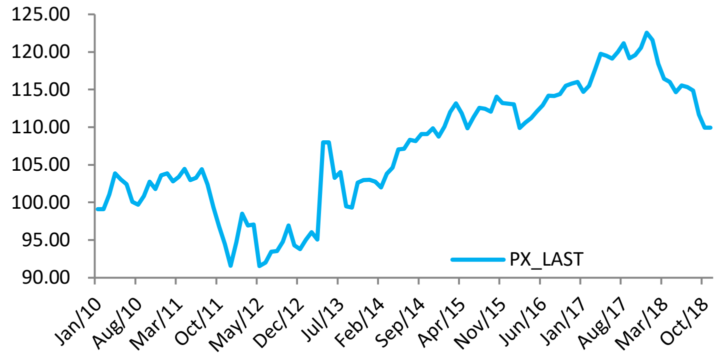
Country	% Change		
	3m	6m	1y
China	-1.9%	-8.4%	-5.3%
Indonesia	2.8%	-2.9%	-5.7%
India	2.0%	-3.8%	-7.9%
Russia	0.6%	-7.8%	-14.8%
Brazil	4.6%	-2.7%	-18.3%
Japan	-2.3%	-3.7%	-0.9%
US	-2.2%	-3.3%	-4.5%

Oil prices have seen a massive correction over the last 3 months

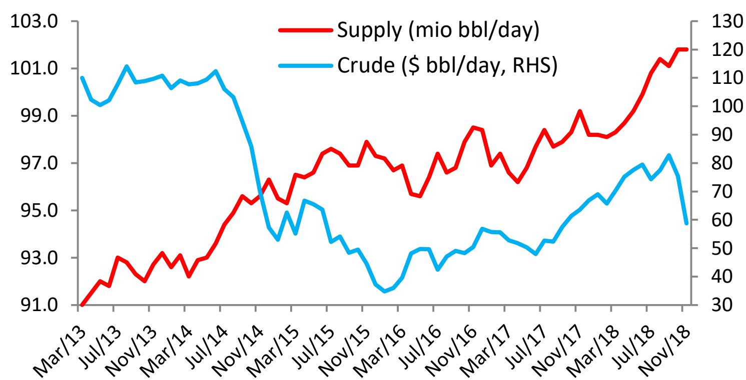
Commodity	% Change		
	3m	6m	1y
Gold	1.6%	-5.6%	-4.3%
Brent	-24.2%	-23.5%	-7.6%
Zinc	7.9%	-14.4%	-16.4%
Wheat	-0.5%	-1.4%	26.0%

Source:- Bloomberg, RWML Research

INR overvalued on a Trade Wtd. basis: Reason for RBI not panicking



Oil: Announcement of additional supply has led to price cooling off



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Email: relianceprivateclient.service@relianceada.com Website: www.reliancewealth.in