

Market Outlook

July 2021

Equity Market

Mid and small caps see rally

The market that was

As in June 2021, while broader markets were largely range-bound in July 2021 and closed marginally higher (NIFTY +0.4%) they saw a strong surge in the midcaps (+3.2%) and small caps (+8.2%) segments. Realty, Metals and Cement sectors were the outperformers while Auto, Utilities and Energy underperformed. The Covid situation seems to be stabilizing. However, there are concerns about the third wave in India and newer variants globally.

June CPI was little changed at 6.3% in June, lower than market estimates. India Wholesale prices rose 12.1% YoY in June – a second straight month of 12%+ seen for the first time in 2 decades. On a 2-yr CAGR basis, WPI inflation was 4.9% vs. 4.5% in May – highest since August 2014.

IMF cut India's FY22 GDP growth forecast to 9.5% (from 12.5%) due to Covid-related concerns. The vaccination pace has picked up with about 5 Mn doses per day in July, and the target to vaccinate all adults by the end of CY2021 looks achievable. India witnessed normal monsoon over large parts of the country, and overall, IMD expects rainfall to be within long-period averages.

GST collection picked up as activity normalized. July GST collections came in at a 4-month high of Rs1.16 tn. Gross GST collections in 4MFY22 was at Rs 4.5 Tn — 9% higher than 4MFY20 (66% higher than 4MFY21).

Given the regulatory action, the Chinese tech and education sectors saw a sell-off leading to outflows from most EMs. FIIs were net sellers in July to the tune of US\$1.7bn – the highest net sale since March 2020. DIIs continued their buying to the tune of US\$2.5bn – the highest net buy since March 2020. YTD FII/DII inflows stand at +US\$6.4bn/-US\$2bn respectively.

Going Forward

From an earnings perspective, Q1FY22 so far has been broadly in line though optically better, benefitting from the lower base of Q1FY21, as lockdowns in Q1FY22 were localized and less stringent v/s Q1FY21. Management commentaries across the board suggest an improved demand environment post-June '21, led by easing restrictions, lower active Covid-19 cases, and a pickup in vaccinations. However, the impact of rising commodity costs and, in general, higher inflation is reflected in the P&L. At the time of writing, 34 out of Nifty 50 companies (with 86% weightage) had reported numbers. The weighted average earnings growth came in at 32% - in line with estimates.

Globally, as China saw outflows, particularly in its tech-related sectors, one may have expected India to be a beneficiary of the same; however, that has not played out yet. India is one of the well-placed markets from an EM perspective, with Covid third wave/newer variants being the only concern (though not only India specific).

After a strong upmove in the last 16 months, we reckon markets are likely to be more earnings-driven with little room for further valuation rerating. Heightened activity from retail investors and frenzy in IPO markets are key concerns. We remain positive on equities and India as solid earnings growth is ahead of us with the economy opening up and economic activity gathering momentum. We continue to stick to quality names with strong cash flow profiles and healthy growth prospects to play the India growth story.

Debt Market

Demand-led inflation

Inflation

After printing at a record high of 6.3% in May 2021, CPI for June 2021 (released in July) came in marginally lower at 6.26%. Notably, this was the second successive month with an over 6% print, being the upper end of RBI's tolerance band for CPI.

Food inflation, while remaining high, moderated with the sequential month-on-month print at 1.17% as against 1.71% in May 21 (over April 21). Some categories of food softened in the month helping the reduction. Delayed monsoon in some parts has played a part in food inflation taking time to cool-off.

Core inflation rose to a 7-year high of 6.30% in June (6.17% in May), even as the monthly sequential pace moderated. Crude, metals, commodities also caused the rise; however, some elements such as housing, clothing and miscellaneous products, declined.

Rates and liquidity

Liquidity, already in a surplus, increased even further in July with daily average LAF balances in excess of INR 5.7 trillion (INR 4.8 trillion in June). Govt cash balances continued to build further from levels at the start of the fiscal. In a bid to ease the distortion in the forward premiums, the RBI opting to

take delivery (USD) in spot rather than roll-over as in the past, also added to money market liquidity. Durable liquidity as a result, was closer to INR 9 trillion, pushing money market yields down sharply.

T-bill yields moved down by 15-20 bps in the last fortnight of July, helped by excess liquidity. At the longer end, yields on the 10-year benchmark moved higher, both on the latest issuance (6.10% coupon) and the outgoing benchmark (5.85% benchmark). With the 6 % level no longer being defended by RBI, yields moved up sharply once it breached the 6% level.

Outlook

Micro-frequency data, led by mobility indicators such as electricity consumption, IIP prints, infra orders, crude demand etc., is now either nearing pre-covid levels or has crossed over in a few cases. Auto dispatches in July, for instance, have recorded a good jump not only over July last year (when the lockdown was still in force), but also sequentially over June 2021. Were it not for the acute chip shortages severely hampering sales of certain models, dispatches would have been even higher. Electricity consumption – all India at 125 billion units per unit is also higher than the all-time high of 116 billion units / month recorded in the pre-covid era.

As the second wave recedes gradually, and the pace of vaccination rises, there is certainly more optimism on recovery and a more robust Q2. However, it is important that there is no third wave or it is a muted one if there is one.

There is a fear that with rising inflation, excess liquidity and pick-up in activity, the pro-growth stance projected by the MPC may have to undergo a change. The upcoming policy in August will be closely monitored for the action, stance and commentary. We expect RBI to remain on an extended pause on rates and retain its accommodative stance, keeping liquidity well in surplus mode, though initializing liquidity normalization soon.

Given the mixed environment wherein bond supply remains high, inflation is still over 6% but the revenue collections are showing strength in April – July period, we prefer the Short / mid end products such as the Corporate bond (PGIM India Premier Bond Fund) and PGIM India Banking & PSU Debt Fund. PGIM India Dynamic Bond Fund is an option for investors with an ability to handle some volatility seeking duration gains.

Investors with a shorter time horizon of up to 6 months should also look at the PGIM Ultra Short Term Fund, a high quality fund that invests in predominantly in the 3-12 month segment to maintain duration under 6 months.

Fixed Income Market

	June 2021	July 2021	Change (in bps)
Overnight rate (NSE MIBOR)	3.36%	3.39%	3.00
1 yr CD	4.16%	4.02%	-14.00
10 yr GOI Yield	6.05%	6.20%	15.00
USD/INR	74.33	74.42	9 paise
IIP (Monthly with 2 month lag)	134.60%	29.30%	-10530.00
CPI (Monthly with 1 month lag)	6.30%	6.26%	-4.00
5 Yr AAA PSU spread (bps)	20	15	-5.00
5 Yr OIS	5.40%	5.22%	-18.00
US 10 Yr yield	1.45%	1.23%	-22.00
CRR	4.00%	4.00%	0.00
Reverse REPO	3.35%	3.35%	0.00
REPO	4.00%	4.00%	0.00

Source: RBI Weekly Statistical Supplement & Bloomberg

Note: IIP has been revised higher for the previous reading. CPI has been revised lower for the previous reading.

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Riskometer

This product is suitable for investors who are seeking*:

PGIM India Premier Bond Fund (An open ended debt scheme predominantly investing in AA+ and above rated corporate bonds)

- Income over the medium term
- Investments predominantly in AA+ and above rated corporate bonds including bonds
- Degree of risk – MODERATE



Investors understand that their principal will be at moderate risk

PGIM India Banking and PSU Debt Fund (An open ended debt scheme predominantly investing in Debt instruments of banks, Public Sector Undertakings, Public Financial Institutions and Municipal Bonds)

- Income over the short term
- Investment in debt instruments issued by Banks and Public Sector Undertakings, Public Financial institutions and Municipal Bonds
- Degree of risk – MODERATE



Investors understand that their principal will be at moderate risk

PGIM India Ultra Short Term Fund (An open ended ultra-short term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 3 months to 6 months)

- Income over the short term
- Investment in short term debt and money market instruments
- Degree of risk – LOW TO MODERATE



Investors understand that their principal will be at low to moderate risk

PGIM India Dynamic Bond Fund (An open ended dynamic debt scheme investing across duration)

- Regular income for short term
- To generate returns through active management of a portfolio of debt and money market instruments
- Degree of risk – MODERATE

*Investors should consult their financial advisers if in doubt about whether the product is suitable for them.

Source: BSE, RBI & Bloomberg

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