

INDIAN MARKETS EMBRACING MODINOMICS 3.0



Quarter gone by for markets

The second quarter of CY24 can be characterised as a quarter of notable volatility for both global and Indian markets. Multitude of factors such as geopolitical tensions, softer economic indicators, central bank policies, and election results have shaped the market landscape, making this quarter particularly eventful. The narrative for the quarter began on a tepid note with escalating geopolitical tensions between Iran and Israel driving commodity prices higher. The scenario of higher than anticipated US inflation and resilient private demand in US prompted a recalibration of rate cut expectations. Soon the narrative for markets turned positive driven by the renewed investor optimism about the economic outlook. The momentum in markets sustained in 1QFY25 despite bouts of volatility. While US rate cut expectations have been pushed back, the market continues to draw comfort from the fact that the Fed will cut rates sooner than later.

On domestic side, the market narrative was heavily influenced by the general elections. The benchmark index experienced significant volatility, largely due to concerns of conflicting lower voter turnouts and positive exit poll results. Actual Election results were underwhelming, with the BJP securing fewer seats than anticipated, leading to market jitters. Despite these interim fluctuations, the Nifty50 index ended the month relatively flat, with broader markets slightly outperforming. India Equity & Bond markets went through a patch of volatility with incoming verdict of a fractured political mandate, but it more than recovered losses & scaled new highs with formation of a stable government & expectation of policy continuity. India outperformed global peers during the quarter. Nifty50 index was up 1.2% in April, down 0.3% in May and up 6.6% in June. Midcaps and Small caps outperformed by far.

Macro & Fixed Income outlook

India's macro-outlook is one of stable growth and corporate profitability augmented by receding fiscal deficit. RBI has pegged GDP growth for FY25 at 7.2% but many policy makers now believe that the potential non-inflationary rate of growth has moved up in India. High frequency indicators continue to show resilience and stability. The GDP growth continues to remain strong aided by lower subsidies, strong government capex and rebound in manufacturing. While a flare-up in geo-political tensions can play spoilsport, we remain constructive on the Indian economy.

The Indian economy is becoming more diverse and resilient in its performance, and global investors are now beginning to take note. India was included in the JP Morgan suite of global bond indices effective June 28, 2024. Besides, S&P raised India's rating outlook to positive from stable. S&P noted that the positive outlook reflects the view that continued policy stability, deepening economic reforms, and high infrastructure investment will sustain long-term growth prospects. That, along with cautious fiscal and monetary policy that diminishes the government's elevated debt and interest burden while bolstering economic resilience, could lead to a higher rating over the next 24 months.

The electoral outcome, though not in consensus with the market expectation, is not a very big negative outcome for the market. While the Government will indeed have to take allies on board for major decision making, we expect economic policy continuity. With core of the government remaining constant, we believe that the focus on Fiscal consolidation, CAPEX led nation building, manufacturing etc. to remain steadfast. We would anticipate more discussion and consensus building on political topics like One Nation One election, Uniform Civil Code, & land labour reforms which are contentious. However, this is not a major wall of worry for markets. Also, some reorientation of spending towards revenue expenditure with rural focus is quite a possibility. Political stability and policy continuity have now largely been factored in by markets.

Globally Interest rate hiking cycle has ended across economies (ex-Japan) and major central banks like ECB and Bank of Canada have embarked on rate cuts. In US, the last mile of disinflation has started showing positive progress and the labour market has started cooling off with unemployment rate inching up. However FOMC members would need some more prints showing downward trajectory in Inflation to get confidence that inflation is sustainably moving towards its 2% target. The market is now factoring in 1-2 rate cuts from the Fed in 2024. The Fed dot plot suggests one rate cut in 2024. While the US economy continues to be resilient, the labour market is on a slow grind down and pandemic era savings have been exhausted. Durable goods is already in deflation and services inflation has started is likely to trend down led by lower rent inflation. Consequently, we reckon it's just a matter of time and 2 rate cuts are imminent in 2024.

From a domestic standpoint, we don't expect RBI to embark on an aggressive rate cut cycle, given that growth outlook remains strong and inflation trajectory is well on track to be in RBI's target range. While core inflation is benign at 3%+ levels, food inflation continues to remain elevated with heatwaves adding to volatility particularly in vegetable prices. Consequently, RBI is likely to continue with its 'wait and watch' approach.

While a favorable base is likely to support lower inflation points particularly in the months of July and August, RBI is likely to look through this patch of 'soft inflation'. Although the RBI has indicated that domestic monetary policy is independent of the Fed, we reckon RBI is unlikely to cut rates ahead of the Fed as the favorable domestic backdrop gives the requisite leg room to wait and watch. Overall, with the likely pivot from central banks, we expect RBI to follow suit, although the rate cut cycle in India is likely to be a shallow one of 50 bps with rate cuts beginning in late 2024.

India Government Bond (IGB) yields have seen less volatility compared to the advanced economies. Tight liquidity has also led to a flat yield curve on the back of elevated short-term rates. Going ahead with likely pivot from global central banks and shift to neutral stance, we expect domestic liquidity to improve with the curve likely to steepen over the next few quarters. Indian bond yields have been supported by expectations of continued fiscal consolidation aided by a higher RBI dividend and prospects of an eventual rating upgrade over time, and sustained FPI flows on the back of inclusion in global indices such as the JP Morgan suite of indices. Although India's bond inclusion in FTSE Emerging Market Government Bond Index (EMGBI) has been deferred, they continue to acknowledge the progress in India and has kept the country on watch list for an upgrade and possible inclusion. The fractured election mandate suggests some reorientation of spending towards schemes targeting the 'rural' and 'bottom of the pyramid' populace, however the capex spend is likely to be maintained with the fiscal deficit at 5.1% of GDP. We do not anticipate any change in government borrowings. With most of the supply being in the belly and duration of the curve, our view of steepening gets further credence.

Going forward, we believe the continuance of fiscal consolidation path by the new coalition government coupled with tailwind from passive FII flows with Global index bond inclusion in end of June 24, should keep the bond yields supported. Besides, the goldilocks domestic macro set up with contained inflation readings, lower CAD, robust GDP growth and expectation of government sticking to its fiscal consolidation path, should keep the bond yields range bound with a downward bias.

Equity market outlook

Clearly the stupendous rally seen in the domestic Equity markets in 2023 was reflecting the exuberance of having policy continuity, goldilocks macro (strong economic growth, contained inflation, stable rupee & structural capex push) and impending Fed rate cuts in the fag-end of 2024. In FY25, we believe that post the formation of the government at the helm, near term election related

volatility is indeed a thing of the past. However, we do not rule out volatility and consolidation in the interim, as markets will start focussing on other crucial events such as upcoming Union Budget, Earnings performance, US inflation trajectory and its ramification on monetary policy path, US elections and the geopolitical landscape. Union Budget is expected to have its sustained focus on infrastructure, capex, and manufacturing. The government is also likely to partly utilize windfall from the RBI dividend to provide impetus on consumption and address rural distress. While the market valuations are indeed rich compared to historical averages, it must be seen from the prism of significantly improved macro-economic backdrop in India. We reckon the long-term outlook for Indian markets remains intact and markets will eventually be driven by its strong fundamentals such as high single-digit GDP growth, stable currency, and robust corporate earnings growth. Hence while there may be bouts of volatility, we do not see a major correction on the anvil. If at all any correction were to happen, it would be largely driven by global factors, and as a portfolio strategy, we would be ardent buyers in such corrections and partake in India's long term growth story.

We are cautiously optimistic on Indian Equity markets. We believe the backdrop for Indian equities is conducive with strong GDP growth and strong earnings performance. We continue to be bullish on domestic facing sectors/themes given that we expect policy continuity and political stability to be at the helm. With no major deviation from the normal expected in the upcoming budget, several domestic focussed sectors are poised to perform well under the new regime, such as Infrastructure, Construction & allied sectors, Cement & Auto. Banking & Financials will continue to be in an attractive zone, as it's a sector that is still at reasonable valuations, despite the strong growth and pristine asset quality that the sector is delivering. Consumption is another space which is expected to benefit from any increase in rural spending and consumption-focused initiatives along with favourable monsoon.

While we expect private capex to see gradual recovery, the best seems to be priced in. Moreover, private capex recovery beyond a point must be supported by a recovery in domestic consumption, particularly at the bottom of the pyramid. Consequently, we expect some sector rotation towards the consumption themes aided by government policy and anticipated rural recovery (assuming a normal monsoon). Sectors like affordable housing are likely to receive a push. Exports are rebounding as monetary tightening has eased in developed economies. If the US cuts rates in the near future, we are likely to see a softish landing which bodes well for demand recovery in sectors like IT. Liquidity is expected to remain extremely strong aided by India's increased weights in major global equity indices and strong & consistent domestic inflows.

Our caution, however, stems from the sharp run up in Indian Small & Midcap stocks which has created certain pockets of exuberance which may lead to some correction in the broader markets. The sharp outperformance by mid and small caps compared to large caps in Fiscal year 2024 has set the stage for a reversion to mean in fiscal year 2025. We therefore find relative comfort in large cap names and remain selective in our portfolio construction. Thus, Indian Equity markets present an attractive opportunity given the favorable domestic macro backdrop and we expect Indian equities to continue to command better valuation premium compared to EM peers. Given this construct, we remain constructive on equities as an asset class and history has exemplified that we should be believers in the ability of Equities to compound wealth over long period of time. We advise investors to partake in long-term potential of India and stay on course to leverage any dips, as an opportunity to buy.

Snapshot of Macro Indicators

Indicators	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24	Q4FY24
Real GDP % YoY	21.6	9.1	5.2	4.0	13.1	6.2	4.5	6.2	8.2	8.1	8.6	7.8
Real GVA % YoY	20.3	9.3	4.7	3.9	12.0	5.4	4.7	6.0	8.3	7.7	6.8	6.3
Agriculture	3.4	4.8	2.3	4.1	2.4	2.5	4.7	7.6	3.7	1.7	0.4	0.6
Industry	49.1	8.1	1.6	2.3	9.4	-0.6	2.3	3.4	6	13.6	10.5	8.4
Services	12.5	11.1	7.6	4.9	16.3	9.4	6.1	7.2	10.7	6	7.1	6.7
Export Growth %	85.9	38.6	41.0	29.5	26.6	7.8	-2.1	-2.5	-14.0	-3.0	1.0	4.9
Import Growth %	107.5	62.7	50.7	30.4	44.4	28.2	5.5	-3.7	-12.7	-9.9	-1.0	2.0
Trade balance \$ bn	-31.5	-44.7	-60.2	-54.6	-62.6	-78.3	-71.5	-52.6	-56.7	-64.5	-69.9	-50.9
Current account balance \$ bn	6.6	-9.7	-22.2	-13.4	-17.9	-30.9	-16.8	-1.3	-8.9	-11.2	-8.7	5.7
CAD as % of GDP	0.9	-1.3	-2.7	-1.6	-2.1	-3.8	-2.0	-0.2	-1.0	-1.3	-1.0	0.6

Source: Bloomberg, Reuters & FG Research

Indicators	Yearly Data										
	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24
GDP Growth %	6.4	7.4	8.0	8.3	6.8	6.5	3.9	-5.8	9.7	7.0	8.2
GVA growth %	6.1	7.2	8.0	8.0	6.2	5.8	3.9	-4.2	9.4	6.7	7.2
CPI Inflation Avg	9.4	5.9	4.9	4.5	3.6	3.4	4.8	6.3	5.5	6.7	5.4
Exports (US\$bn)	314.9	310.1	262.2	275.7	303.6	330.2	313.2	291.0	422.3	450.6	441.0
Imports (US\$bn)	448.8	447.6	380.4	384.2	465.6	514.3	474.2	393.0	613.6	715.3	675.5
Trade Deficit (US\$bn)	-134.0	-137.5	-118.2	-108.5	-162.1	-184.1	-161.0	-102.0	-191.3	-264.8	-242.0
Trade Deficit (%of GDP)	-7.2	-6.7	-5.6	-4.7	-6.1	-6.8	-5.7	-3.8	-6.1	-7.8	-6.8
Brent Crude oil prices Y/E	107.0	53.3	38.7	52.7	69.1	70.3	21.5	62.4	106.6	79.8	82.9
Oil Import USD Bn	164.9	137.8	82.6	86.9	108.7	141.1	130.5	82.4	162.1	209.3	179.7
CAD \$ Bn	-32.4	-26.7	-22.1	-15.2	-48.7	-57.2	-24.6	24.0	-38.7	-67.0	-23.2
CAD (% of GDP)	-1.7	-1.3	-1.1	-0.6	-1.8	-2.1	-0.9	0.9	-1.2	-2.0	-0.7
Capital account balance (US\$bn)	0.66	0.09	0.04	0.15	-0.03	-0.16	-1.09	-1.08	-0.20	-0.12	-0.09
FDI (US\$bn)	21.6	31.3	36.0	35.6	30.3	30.7	43.0	44.0	38.6	28.0	10.9
FII (US\$bn)	4.8	42.2	-4.1	7.6	22.1	-0.6	1.4	36.1	-16.8	-5.2	44.0
Fiscal Deficit %	-4.5	-4.1	-3.9	-3.5	-3.5	-3.4	-4.7	-9.2	-6.7	-6.4	5.6
Foreign Reserves (US\$bn)	303.7	341.4	355.6	370.0	424.4	411.9	475.6	579.3	617.6	578.4	645.6
Rupee (INR/\$) Average	60.9	61.2	65.7	67.1	64.5	69.9	71.0	74.2	74.4	80.3	82.8
Repo Rate year ending	8.0	7.5	6.8	6.3	6.0	6.3	4.4	4.4	4.0	6.5	6.5
US-10 year end	2.7	1.9	1.8	2.4	2.7	2.4	0.7	1.7	2.3	3.5	4.3
GIND-10 year end	8.9	7.8	7.4	7.1	7.4	7.4	6.1	6.2	6.8	7.3	7.2

Source: Bloomberg, Reuters & FG Research

Market Performance

Performance of Indian Equities across Market Caps and Debt benchmarks as on June 30, 2024

Sector	7 year CAGR	5 year CAGR	3 year CAGR	1 year	6 months	3 months
Nifty	14.1%	15.3%	15.2%	25.1%	10.5%	7.5%
Sensex	15.1%	15.4%	16.9%	34.0%	20.1%	9.4%
Nifty Midcap Index	17.8%	25.9%	27.4%	55.9%	20.7%	15.9%
Nifty Smallcap Index	14.0%	24.2%	23.5%	69.0%	21.0%	20.0%
NIFTY Composite Debt Index	6.9%	7.6%	6.3%	11.0%	7.2%	4.9%

Source: Bloomberg, Reuters & FG Research

Global Indices Performance (%)

Sector	7 year CAGR	5 year CAGR	3 year CAGR	1 year	6 months	3 months
Dow Jones Index (USA)	9.0%	8.0%	4.3%	13.7%	3.8%	-1.7%
S&P 500 (USA)	12.3%	13.2%	8.3%	22.7%	14.5%	3.9%
Nikkei 225 (Japan)	11.1%	13.3%	10.7%	41.2%	24.2%	18.3%
Hang Seng (Hong Kong)	-5.2%	-9.1%	-15.0%	-6.3%	3.9%	7.1%
FTSE 100 (UK)	1.6%	1.9%	5.1%	8.4%	5.6%	2.7%
Shanghai Composite Index (China)	-1.0%	-0.1%	-6.2%	-7.3%	-0.3%	-2.4%
DAX (Germany)	5.8%	8.0%	5.5%	12.9%	8.9%	-1.4%
iBovespa (Brazil)	10.2%	4.2%	-0.8%	4.9%	-7.7%	-3.3%

Source: Bloomberg, Reuters & FG Research

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