The Shifting Tides

18th Nov'24

There are times when the uncertainty around an event leads to even higher uncertainty after the event takes place. The US Presidential elections, one of the pivotal events for the year, is poised to tread a similar path after Donald Trump was sworn in as the 47th President, for a second term. Markets are pricing in a slew of measures from the Republican party, with Trump at the helm of affairs, including an increase in tariffs on imports, corporate tax cuts, and tighter immigration laws with a view to 'Make America Great Again', a stance which is being viewed as inflationary and fiscally draining for the economy. However, the market tends to swing on extremes, and the path to the above changes envisaged by the Republican party (which has started getting priced in already) isn't expected to be smooth sailing especially with the US economy staring at record-high fiscal deficit and only recently having gained some control on spiraling inflation. Trump's stance on Russia-Ukraine and Israel-Palestine standoff will be a key monitorable as will China's reaction to steeper tariffs (if enacted). The Fed's policy stance amidst the current US economic and political backdrop will emerge as a key catalyst impacting risk assets both domestically and globally.

Indian equities and to a lesser extent Indian fixed income yields have witnessed a surge in volatility over the past month primarily led by record Foreign Portfolio Investment (FPI) outflows (primarily in equities) in Oct'24 which continues till date with the US and Chinese equities emerging as relatively attractive allocation plays. The spike in US longer-term yields increases the demand for risk premia amidst an underwhelming Q2 earnings release from Indian corporates owing to reduced consumer and Government spending. However Indian macroeconomic landscape remains robust and there are increasing expectations of increased US-India collaboration which can boost the Indian manufacturing segment as a China+1 alternative.

Will the Federal Reserve (Fed) Continue to Act?

Post the US Fed's 50 Bps rate cut in Sep'24, the markets had priced in at least 175-200 bps by CY'25. This has undergone a material shift currently. While the Fed delivered on a 25-bps cut this month, the path ahead remains uncertain with Fed Fund Futures assigning a probability of only 3-4 additional rate cuts (cumulatively 75-100 bps) starting Dec'24 till the end of CY'25. A quick take on key US economic data is as follows:-

- Non-farm payrolls for Oct'24 expanded by only 12,000, significantly lower than market expectations of 100,000. However, this is being viewed as a one-off with multiple hurricanes and a labor strike at Boeing being the key reason.
- Hourly earnings rose by 0.4% for the month, making for a 4% YoY gain
- Unemployment rate remained at 4.1% in Oct'24, unchanged from the previous month.
- US Consumer Price Index (CPI) for Oct'24 increased by 0.2% MoM and 2.6% YoY both meeting expectations. Core CPI ticked higher by 0.3% MoM and 3.3% YoY again in line with street forecasts.

Global Markets Round-Up:

- US yields with tenors exceeding 2-year maturities witnessed sharp spikes between 30-40 bps on a 1-month basis, as markets price in a steeper inflation glide path ahead, curbing the probability of Fed rate cuts. The USD Index moved higher from 103 to 106 handle while Gold emerged marginally weaker and is currently trading around US$2627/oz, down from US$2657 levels a month back.
- US equities capped off a positive month led by Russel 2000 (+5.4%), NASDAQ (+2.8%) and S&P 500 (+2.0%). Asian equities endured a weak month, with all major indices including Kospi, Nikkei, Nifty, and Hangseng declining 6-8%, the sole exception being CSI 300 (+4.9%).

Global Central Bank Policy Snapshot

We had several major global central bank monetary policy decisions over the past month. Most of them announced a reduction in interest rates, led by the Bank of Canada (BoC) with a 50 bps cut, with the US Fed, Bank of England (BoE), and European Central Bank (ECB) reducing rates by 25 bps each, while the Reserve Bank of India (RBI) and Reserve Bank of Australia (RBA) maintained status quo on rates. Markets will be keenly awaiting the monetary policy stimulus roadmap from the Chinese central bank as well as the US Fed's future policy glide path, which is anticipated to have a significant impact on risk assets globally.

Central Bank	Rate	Last Change	Next Meeting	Expectations
Bank of Canada	3.75%	23rd Oct 24, 50 bps Cut	11th Dec'24	Status Quo
Bank of England	4.75%	7th Nov'24, 25 bps Cut	19th Dec'24	Rate Cut
Bank of Japan	0.25%	31st Jul'24, 15 bps Hike	18th Dec'24	Status Quo
European Central Bank	3.25%	17th Oct'24, 25 bps Cut	12th Dec'24	Rate Cut
US Federal Reserve	4.75%	7th Nov'24, 25 bps Cut	12th Dec'24	Rate Cut
People's Bank of China	3.1%	21st Oct'24, 25 bps Cut		
Reserve Bank of Australia	4.35%	7th Nov'23, 25 bps Hike	10th Dec'24	Status Quo
Reserve Bank of India	6.50%	8th Feb'23, 25 bps Hike	6th Dec'24	Status Quo
Swiss National Bank	1.00%	26th Sep'24, 25 bps Cut	10th Dec'24	Status Quo

Gold and Silver Prices Correct

Gold is currently trading down around 5.5% for the month of November (as of 12th November), correcting nearly 7% from its October peak of around US$2800/oz. The precious metal has been under pressure lately amidst a stronger dollar and as markets absorb the implications of Donald Trump's victory and its potential impact on U.S. interest rate expectations. Trump's victory has fueled questions about whether the Fed may proceed to cut rates at a slower and smaller pace, given the former president's tariff policy.

A surge in the U.S. dollar index to a 4.5-month high, solidly lower crude oil prices, and rising U.S. Treasury yields are all bearish market elements working against gold prices. Technical selling pressure and profit-taking from shorter-term futures traders have also played a part in the recent correction.

Silver is trading down around 7.3% for the month of November (as of 12th November), approximately 13% lower than its October high. This is largely driven by the strengthening U.S. dollar and waning demand for silver in key sectors. The dollar's resilience, supported by optimism around President-elect Donald Trump's tax policy proposals, has made silver more expensive for international buyers, pushing prices lower. An additional factor in silver's recent dip has been a slowdown in demand from the solar industry, a critical sector for silver consumption. Seasonal changes as winter approaches typically reduce solar installations, impacting demand for silver in solar technology.

Crude Prices Weaken

Crude prices are down by around 0.7% in November (as of 12th Nov), down nearly 12% from their early October levels of US$78 per barrel (WTI benchmark). China's latest stimulus plan disappointed investors who were seeking demand growth in the world's second-biggest oil consumer, while supply looks set to rise in 2025.

The recent rise of the US dollar against other currencies has also contributed to the decline in oil prices. A stronger dollar makes commodities denominated in the U.S. currency, such as oil, more expensive for holders of other currencies and tends to weigh on prices.

Persistent concerns around oversupply have also continued to weigh on crude oil prices. According to Bank of America, non-OPEC crude supply was expected to grow by 1.4 million barrels per day (bpd) in 2025 and 900,000 bpd in 2026. Meaningful non-OPEC growth and an unconvincing Chinese stimulus package likely means that inventories will swell even without OPEC+ increases.

China: Uncertain Economic Outlook

China's consumer inflation rate slowed in October, official data showed recently, in a sign that demand remains sluggish in the world's second-biggest economy. The CPI, a key measure of inflation, rose 0.3% YoY in October, down from 0.4% in September. The persistence of near-zero inflation offers the latest evidence of China's domestic demand staying subdued despite Beijing's stimulus measures since late September that included interest-rate cuts, more cash for bank lending, and support for the stocks and property markets. Factory-gate prices also slid 2.9% year-on-year in October, compared to a decrease of 2.8% in September.

Recent factory activity and GDP data painted a more hopeful picture. China reported third-quarter GDP growth of 4.6%, slightly beating expectations of 4.5%. On a quarterly basis, the third quarter saw a 0.9% expansion, compared to 0.7% in the second quarter. China's official Purchasing Managers' Index (PMI) for October came in at 50.1, in expansionary territory for the first time since April. The statistics bureau's PMI for non-manufacturing activity rose to 50.2 in October. That was up from 50 in September but below August's 50.3 print.

China has recently unveiled new measures aimed at boosting its flagging economy, as it braces for a second Donald Trump presidency. The latest plan involves using an additional 6 trillion yuan (US$840 bn) from now until 2026 to bail out local governments which have piled up unsustainable levels of debt. Trump won the US election on a platform that promised steep import taxes, including tariffs as high as 60% on Chinese-made goods. This is likely to hinder Xi Jinping's plans to transform the country into a technology powerhouse and further strain relations between the world's two biggest economies.

Dollar Index Rises

The dollar index is up around 2% in November, trading at 106 levels (as of 13th November). The dollar keeps strengthening as investors seem to believe Trump's policies will support both growth and inflation, keeping interest rates relatively high. The same forces are driving treasury yields higher.

A Republican red sweep has triggered a revival of the 'Trump trade', fueling rallies across equities, bond yields, and the dollar. The Trump trade is the expectation that his proposed policies, including trade tariffs, would lead to higher inflation and prompt the Fed to cut interest rates by less than previously anticipated.

The rupee recently depreciated to a new intraday low of 84.41 per dollar as foreign portfolio investors continued selling domestic equities amid persisting demand for the greenback. The local currency has been touching new lows over the past few trading sessions as the dollar index has strengthened post-Donald Trump's election victory.

Indian Macro Update:

India's macro fundamentals remain robust led by resurgence in manufacturing and industrial activity in the months of Sep'24 and Oct'24. The GST collections remain robust while the fiscal deficit remains well anchored. Let's look at some of the key data points over the past month below:

Industry

- The index of the eight core industries rose by 2% in Sep'24 after contracting by 1.6% in August, according to provisional data. Five of the eight sectors - coal, steel, cement, fertilizers, and refinery products, reported an annual increase in production, with cement rising 7.1%. While the output of crude oil, electricity, and natural gas contracted by 3.9%, 0.5% and 1.3%, respectively.
- The Index of Industrial Production (IIP) growth rate for Sep'24 is 3.1%, up from 0.1% in Aug'24. Capital goods witnessed a reversal, clocking a gain of 2.8%. Consumer non-durables grew by 2%, while consumer durables climbed by 6.5%. The three major components of the IIP—Mining, Manufacturing, and Electricity - grew by 0.2%, 3.9%, and 0.5%, respectively.
- India's Manufacturing PMI rose to 57.5 in Oct'24 from 56.5 in Sep'24, driven by a faster increase in new orders and international sales, as well as further improvements in operating conditions. Meanwhile, input and output prices are both rising due to persistent inflationary pressures.
- India's Services PMI rebounded from a ten-month low in Sep'24 to reach 58.5 in Oct'24, sustaining a robust rate of output expansion. October also marked a significant increase in services employment, which reached a 26-month high. Input price inflation rose at its fastest pace in three months in Oct'24, although it remained well below its long-term average.

Fiscal

- Driven by festive demand and increased compliance, GST collections reached the second-highest figure of INR 1.87 Trn in Oct'24, marking an 8.9% rise from the previous month. On a YoY basis, a mere growth of 9.4% was recorded.
- Direct taxes, including both corporate and personal tax, grew by 21.20% to INR 15.02 Trn for FY 2024-25 as of Nov 10, 2024, while refunds issued increased by 53.07% to INR 2.92 Trn. This indicates robust tax collections, supporting the Centre in achieving its fiscal deficit target of 4.9% for FY 2025.
- India's fiscal deficit for Apr-Sep'24 stood at INR 4.75 Trn, or 29.4% of the overall budgeted estimates for FY'25. This is lower than the INR 7.02 Trn recorded in the previous year, owing to higher tax receipts, a record dividend from the RBI, and subdued government expenditure in the months leading up to and following the elections.
- Total receipts stood at INR 16.37 Trn, while total expenditure stood at INR 21.11 Trn for Apr-Sep'24. Revenue receipts stood at INR 16.22 Trn split between tax and non-tax revenue of INR 12.65 Trn and INR 3.57 Trn respectively for Apr-Sep'24, accounting for 49% and 65.5% of budgeted estimates.
- Capital expenditure stood at INR 4.15 Trn, while revenue expenditure totaled INR 16.97 Trn between Apr-Sep'24. The overall expenditure of INR 21.11 Trn accounted for 43.8% of the budgeted estimates for FY25.

Trade

- India's merchandise trade deficit in Oct'24 widened to US$27.14 Bn.
- In Oct'24, services exports were estimated at US$34.02 Bn, and imports at US$17 Bn against US$ 28.05 Bn and US$13.46 Bn, respectively, in the previous year.
- India's merchandise exports for the period Apr to Oct'24 reached US$252.28 Bn, a YoY growth of 3.18%. During the same period, total merchandise imports amounted to US$416.93 Bn, a YoY increase of 5.77%.
- Gold imports rose to US$7.13 Bn in Oct'24, up from US$4.39 Bn in the previous month, while crude oil imports rose to US$18.2 Bn from US$12.5 Bn.

Indian Equity Update :

Overview:

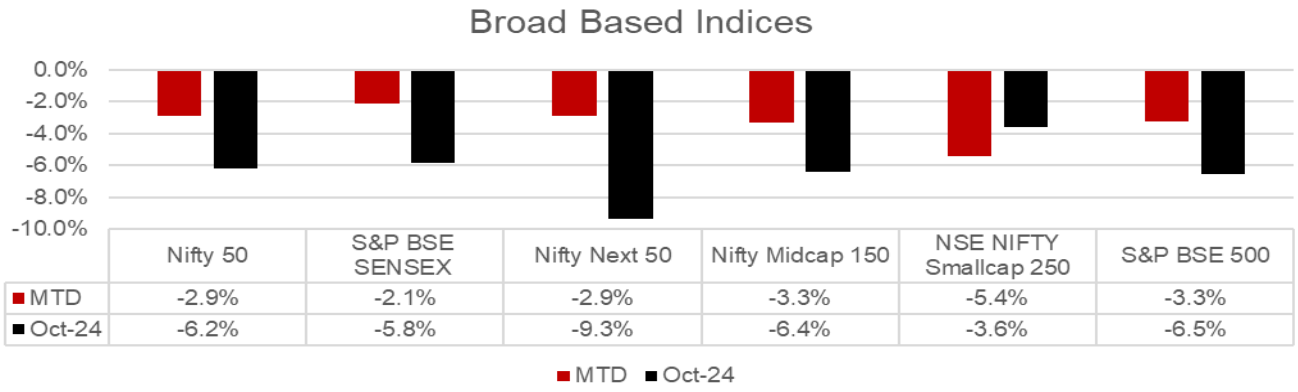
November has so far not offered any relief for Indian markets, as the selloff that began in October has persisted well into the current month. Weaker-than-expected Q2FY25 earnings for India Inc. along with global pressures triggered a sharp selloff in the equity markets, pushing frontline indices to multi-month lows in recent trading sessions.

Each time the frontline indices attempt a recovery, investors seize the uptick as an opportunity to sell stocks at higher levels, effectively halting any sustained rebound in the markets.

Sharp declines across major sectoral indices, coupled with heightened volatility have fueled investor caution about the market's direction. October recorded the steepest monthly drop for the Nifty 50 and Sensex since March 2020.

Additionally, FPIs have been steadily pulling out of Indian markets since late September, which has put sustained pressure on the Indian rupee, driving it to new record lows.

Performances of some of the key market indices for the month of October & MTD (as of 19th Nov'24) are given below:



	Nifty 50	S&P BSE SENSEX	Nifty Next 50	Nifty Midcap 150	NSE NIFTY Smallcap 250	S&P BSE 500
MTD	-2.9%	-2.1%	-2.9%	-3.3%	-5.4%	-3.3%
Oct-24	-6.2%	-5.8%	-9.3%	-6.4%	-3.6%	-6.5%

Valuations of Select Indices:

With the recent correction in equity markets, valuations for some of the indices have also come down significantly. A summary of trailing price to earnings ratios for these indices is given below:

Nifty 50



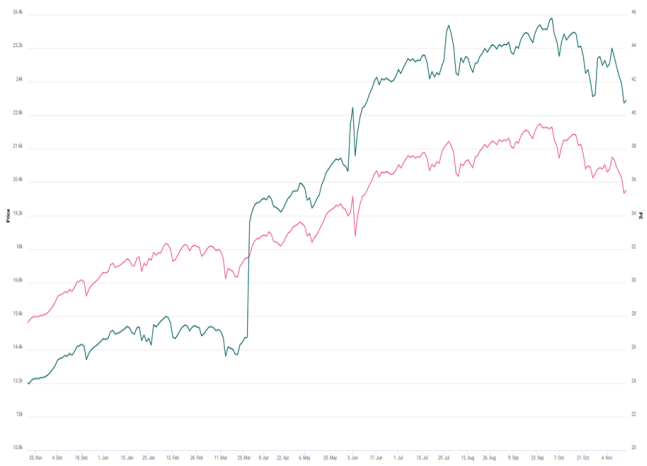
Nifty Next 50



Particulars	Nifty 50	Nifty Next 50
Current	21.65	21.54
High	24.38	27.65
3 yr Median	22.10	24.70

Lighthouse Canton Research, Trendlyne, Screener

Nifty MidCap 150



Nifty SmallCap 250



Particulars	Nifty MidCap 150	Nifty SmallCap 250
Current	40.90	30.85
High	45.80	33.71
3 yr Median	26.50	24.70

Lighthouse Canton Research, Trendlyne, Screener

From the above data, it appears that while valuations for Large Cap Companies have come down and are now trading near their long-term averages, the Mid & Small Cap Companies continue to remain expensive as they still trade significantly above their median historical levels.

Weak Q2FY25 Earnings

The July-September quarter (Q2FY25) consolidated earnings of NIFTY50 companies largely fell below expectations, showing single-digit growth in both Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) and Profit After Tax (PAT), which points to a broad-based economic slowdown in India.

The overall weak Q2 earnings were due to the decrease in urban consumption and higher operating expenses, which further impacted the companies' margins. The government spending during the quarter was moderate, restricting the second quarter's performance. Urban demand also was subdued and reflected in the FMCG, retail, and automotive sectors, which saw a decline in volume. The chemicals and consumer durables sectors have also experienced a decrease in demand. NBFCs reported stress in their unsecured lending portfolios.

To date, 47 companies forming part of the NIFTY50 index have declared their Q2FY25 earnings. Out of them, 28 have posted positive profit growth, 15 posted negative profit growth while the rest remained flat.

On an aggregate basis in Q2FY25, NIFTY50 companies (currently 47 announced their results — Eicher Motors, Hero Motocorp, and Grasim have yet to announce their results) showed modest growth in both the top line and bottom line. The index has posted 6.5% YoY revenue growth, and EBITDA has shown single-digit year-on-year growth of 9.6%. The operating profit of NIFTY50 stocks has logged 5.4% year-on-year growth.

For the quarter ending September 2024, among Nifty50 companies that showed the most revenue growth were SBI Life Insurance Company (39.90%), Trent (39.40%), Bajaj FinServ (29.50%), Bajaj Finance (27.70%), and HDFC Life Insurance Company (23.10%). On the other hand, JSW Steel (-11.00%), Coal India (-6.40%), and Asian Paints (-5.30%) posted negative revenue growth in the same period.

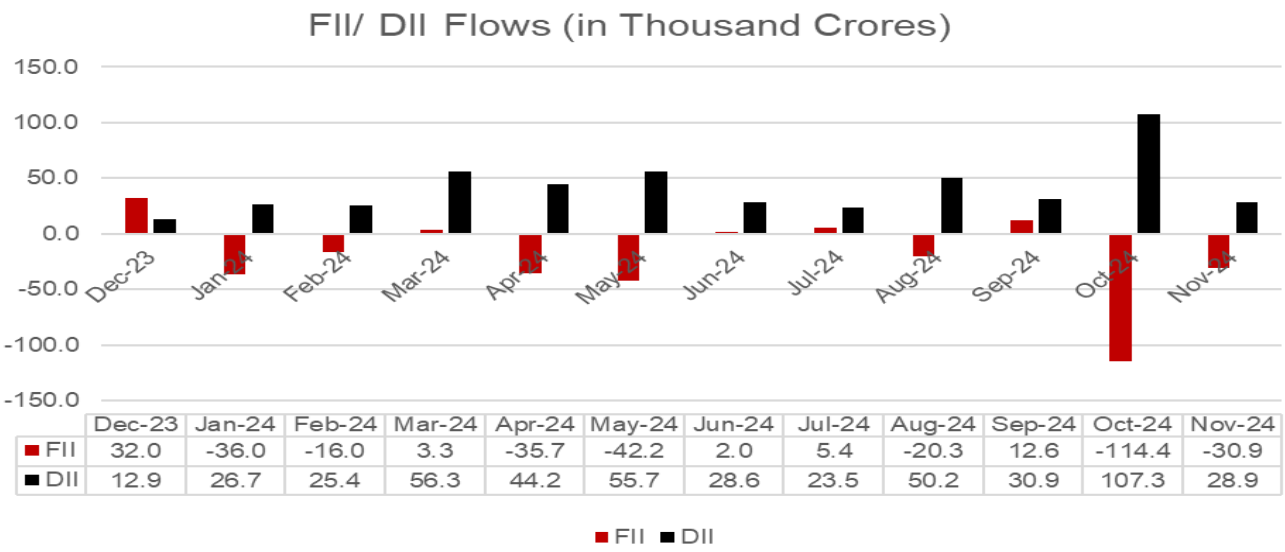
Among the NIFTY50 constituents, the top 4 stocks that showcased triple-digit net profit growth, with an impressive performance were Adani Enterprises (664.50%), Bharti Airtel 168%, Tech Mahindra (153.10%) and Tata Steel (113.50%). On the flip side, Asian Paints (-42.40%), Bharat Petroleum Corporation (-72.10%), and JSW Steel (-84.10%) disappointed investors with negative profit growth.

FII DII Flows

Foreign institutional investors (FIIs) continue their selling spree in Indian markets with total outflows worth INR 1,14,446 crore in Oct'24 & INR 30,937 crore in November (as of 18th Nov'24).

On the other hand, the domestic institutional investors (DIIs) were net buyers and invested INR. 1,07,255 crore in Oct'24 & INR 28,853 crore in November (as of 18th Nov'24).

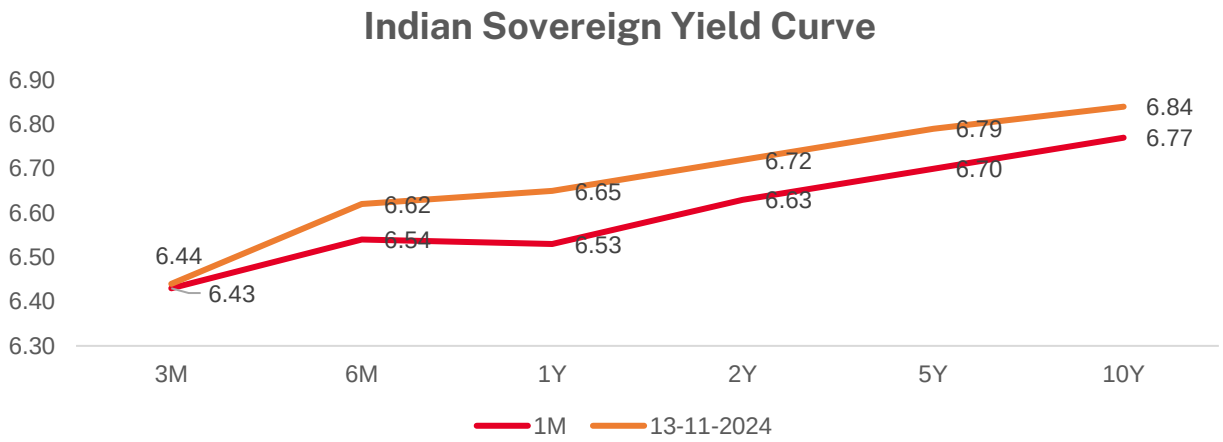
A summary of monthly Inflows & Outflows for FIIs & DII over the last 12 months is given below:



	Dec-23	Jan-24	Feb-24	Mar-24	Apr-24	May-24	Jun-24	Jul-24	Aug-24	Sep-24	Oct-24	Nov-24
FII	32.0	-36.0	-16.0	3.3	-35.7	-42.2	2.0	5.4	-20.3	12.6	-114.4	-30.9
DII	12.9	26.7	25.4	56.3	44.2	55.7	28.6	23.5	50.2	30.9	107.3	28.9

India Fixed Income Update :

Indian sovereign bond yields rose across all tenors in Oct'24 due to a gamut of factors. The increase in U.S. Treasury yields, selling by foreign portfolio investors (FPIs), and high domestic inflation data contributed to the rise, pushing yields back to levels like those seen in Sep'24. The Chart below highlights the surge in yields across tenors:



Highlighted a few key existing and probable factors that are already impacting, or are expected to further impact Indian fixed Income yields below:-

- **US Yields Spikes:** US treasury yields (2 years and above) witnessed significant spikes in Oct and Nov'24 as the market started factoring in Trump's victory and his potentially inflationary policies. US 10-year yields surged to 4.28 in Oct'24 and to 4.44 as of 18th Nov'24. Tapering interest rate differential between the Indian and U.S. yields can potentially impact FPI flows into Indian fixed-income instruments.

- **System liquidity continues in surplus territory:** Indian system liquidity continued to be in surplus in the month of Oct'24 and MTD Nov'24. The average daily liquidity surplus amounted to INR 1.5 Trn in Oct'24. For Nov'24 (MTD 13th), the average daily system liquidity surplus stood at INR 2.2 Trn. This had a positive impact on shorter-tenor yields.

- **FPIs on a selling trend:** India saw FPI outflows of US$ 0.4 Bn in the month of Oct'24. The current month saw a similar trend with a marginally positive inflow of USD 0.02 Bn. The FPI holdings through the Fully Accessible Route (FAR) also saw outflows of USD 0.2Bn in MTD Nov'24 (13th Nov'24), and marginal inflows of USD 0.08 Bn in Oct'24, well below the levels seen in the previous month.

- **Oct'24 headline CPI crosses RBI's tolerance levels:** India's headline inflation surged to 6.21% in Oct'24, up from 5.49% in Sep'24. This marks the second consecutive month of significant CPI increase, with the latest figure exceeding the RBI's tolerance range of 4-6%. The spike was largely driven by a sharp rise in food inflation, which jumped to 10.87% in October (vs 9.24% in Sep'24). Essential items like vegetables, fruits, and oils & fats were the key contributors to this uptick. With the RBI reiterating its cautious stance on food inflation, the higher Oct'24 inflation print may potentially delay expectations of any interest rate easing in the near future.

OIS Curve Remains Inverted Although The Gap Between 1 Y And 5Y Curve Narrows:

The Indian Overnight Indexed Swap (OIS) Curve is normally taken as a lead indicator for the future interest rate trajectory. Compared to the 1-year OIS level of 6.43 and 5-year OIS level of 6.18 as of 14th Oct'24, they stood at 6.56 and 6.30 respectively as of 13th Nov'24. The inversion between the 1-year and 5-year tenors persists, with yields moving higher across all tenors. Currently, the spread between the 1-year and 5-year OIS stands at 26 basis points.

Investment Outlook:

As mentioned earlier in this newsletter, the interplay between multiple global events is expected to aid volatility in risk assets globally. The FPI selloff, which led to a decline in the Indian indices in Oct'24 and continues into the current month, highlights that Indian markets wouldn't remain unaffected. While we believe resilient domestic flows and a robust domestic economic framework will act as crucial supports, investors need to brace for headwinds in the coming months as record-high valuations will be assessed in conjunction with the earnings growth trajectory. The Q2 earnings growth has been below expectations and markets would be pinning on festive demand and rural consumption-led recoveries in Q3'FY 25, adding another layer of uncertainty in addition to the global factor stated earlier.

Indian fixed income continues to be attractively poised basis a favorable demand-supply scenario although the recent surge in inflation may delay the RBI interest rate pivot from Dec'24 to Q4FY'25/Q1FY'26. Also, the spike in the US yields and the resultant compression in yield differentials between the US and Indian sovereigns is expected to reign in Indian yields at current levels with an upward bias in the near future.

The anticipated surge in volatility and green shoots with respect to sector rotation makes for attractive opportunities in the market-neutral category as an asset class. The lineup of global events reinforces the need for a portfolio and asset class hedge at all points in time.

Deployment Overview:

We encourage investors to adhere to 'Asset Allocation' and calibrate investment decisions by carefully monitoring the ever-evolving economic and geopolitical data points. Marrying our in-house Asset Allocation framework with our current stance on markets (as explained above), the below points can be kept in mind –

Equities: Over the past three years, the Indian equity performance has been primarily driven by the Value and Momentum style of investing, with quality investing taking a breather. We believe that going forward, earnings will play a key role in driving stock prices as the exuberance around valuation re-rating dissipates. Stock selection, hence, is expected to play an increasingly important role, and managers with a proven track record in bottom-up stock picking with a keen eye on valuations and displaying requisite agility with respect to portfolio reorientation may continue to outperform their peers.

Fixed Income: Our investment positioning should be able to benefit from further yield compression in the longer end as well as the shorter end of the yield curve. We believe while allocation to duration is well poised, expectations of a delayed and shallower rate-cut cycle warrant tactical positioning. Hence, we prefer allocations to Short Term Funds, positioning for a decline in the shorter end of the yield curve, with some duration build-up, and Dynamic Bond Funds, which are judiciously positioned to benefit from declines in the longer end yield curve, with an aim to revert to reduced exposures as and when the terminal rates are attained. Corporate yields in the 2–5-year bucket meanwhile remain attractive and selective credit opportunities may be considered via pooled vehicles like AIF.

Precious Metals/ Inflation Hedge: Our view on maintaining a steady allocation to Gold and Silver has reaped steady returns for investment portfolios over the past year and we continue to be bullish on these commodities as a vital asset allocation tool, especially in the current economic and geopolitical backdrop.

Market Neutral and Volatility Hedge: As we have stated earlier in this newsletter, volatility can witness sudden spikes driven by events both globally as well as locally. Hence, Volatility Hedge strategies primarily played out through a judicious mix of market neutral and select long-short strategies need to be considered in the current scenario.

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