

Dear Investor,

## Equity market – Global markets surge despite recession fears

The equity markets continued their upward trajectory as we head to the midway point of an eventful 2023 buoyed by upbeat sentiments. The decision by the US House of Representatives to suspend the \$31.4 trillion debt ceiling until January 2025 provided a notable relief, while the Federal Reserve's pause on rate hikes after 10 consecutive months has added an element of predictability, despite continued quantitative tightening and hints at another hike of total 50 bps by year-end. However, the monetary policies show divergence globally, with the

- RBI holding its policy rate steady at 6.5% for the second time,
- Europe, Australia, and New Zealand increasing its policy rates to tackle sticky inflation, and
- the People's Bank of China cutting its policy rate to stimulate economic recovery.

The sentiments however has been somewhat hit as the fallout from the rate hikes has started to manifest with Eurozone and New Zealand falling into recession and manufacturing activity globally seeing continued deceleration, 1) in US composite Purchasing Manager's Index (PMI) decreased from 54.3 to 53.0 missing consensus by expectations of 53.5; 2) in Europe, the composite PMIs for the UK and Euro area decreased to 52.8 and 50.3, respectively, both also missing consensus expectations.

*Source: Bloomberg*

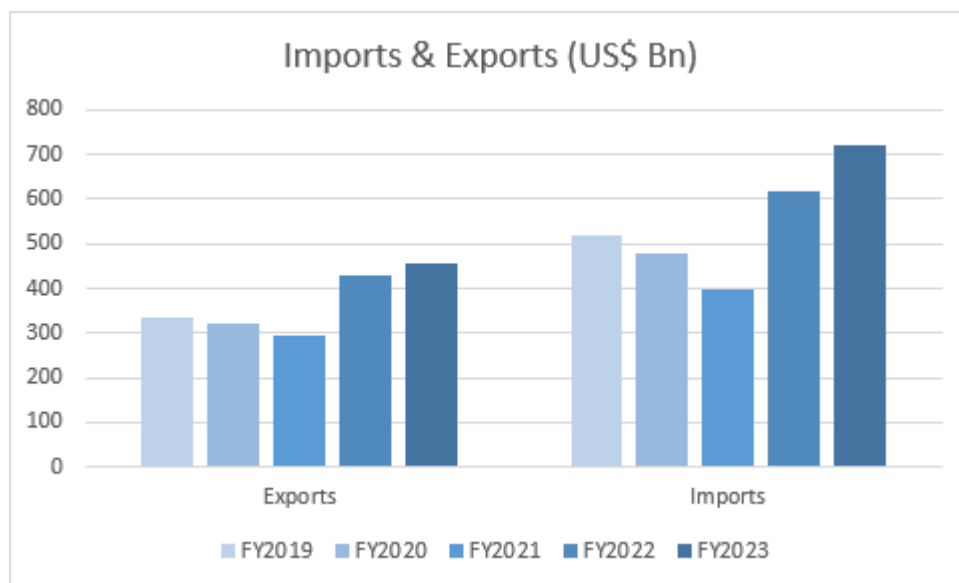
This combination of divergent monetary policies and the ongoing global events have played out interestingly in equity markets, with the MSCI Emerging Markets (EM) and MSCI World indices posting gains of 3.2% and 5.9% respectively in June in USD terms. Most of the developed markets reported strong gains in June. Asia displayed a mixed picture, with the Hang Seng index leading the pack with a 3.7% gain, while Nifty 50 closed with a gain of 4.4%, in USD terms.

Majority of Indian indices touched all-time highs in June buoyed by positive market sentiments. Nifty50 was up 3.5% for the month while NSE 500 performed slightly better with a 4.2% gain, in INR terms. Midcap and Small cap Indices outperformed the broader markets, posting returns of 6.2% (BSE Midcap) and 6.8% (BSE SmallCap) respectively till date. Real estate continued its positive momentum in June, rising 8.6% on the back of Reserve Bank of India's (RBI's) policy rate pause and expected uptick in housing sales. Capital goods also posted modest gains of 9.4% followed by Healthcare and Utilities which were up 9.1% and 6.1% respectively. IT after rising 2.4% CYTD May, was subdued with index up by 1.8% for the month, relatively underperforming Nifty50.

All time high in markets has been backed by the relative earnings resilience of India Inc in a very volatile global macro environment, supported by improving macroeconomic indicators and strong Foreign Portfolio Investors (FPI) flows. Markets have come a long way in last few months, when macro pressures were evident, for e.g. Current Account Deficit (CAD) reached 3.7% in Q2 FY23, forex reserves dipped to USD 533bn from its highs of 639bn in Q2 FY22.

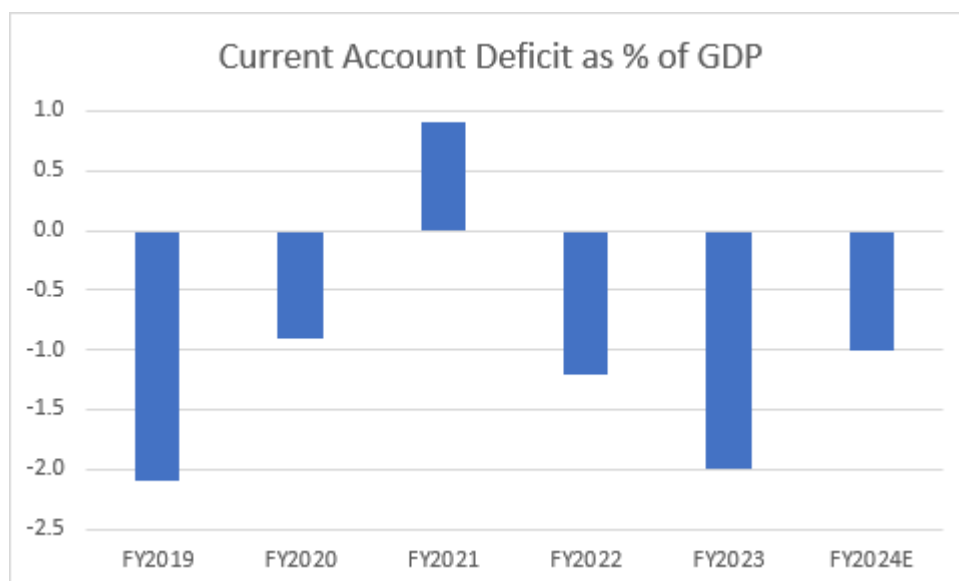
## The worst of Current Account Deficit (CAD) is likely behind us

The sharp rise in energy and commodity prices between Feb-2022 to September-2022 has had a big impact on the CAD of the country (India imports about 85% of its energy requirements). CAD deteriorated sharply from -1.6% in Q4FY22 to -2.1% in Q1FY23 and then to -3.7% in Q2FY23. It seemed at that time that CAD for the full year FY2023 will be as high as about -4% of GDP- led by a big increase in imports, while export growth would be moderate.



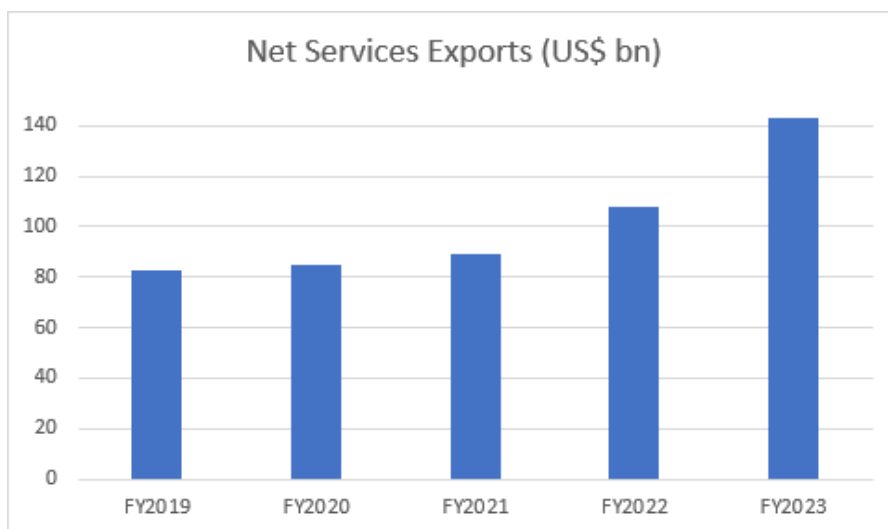
Source: Bloomberg; ASK IM Research

From that situation at the end of Q2FY23, there was a very sharp turn, due to the considerable decline in energy and commodity prices. Q3FY23 CAD improved to -2.0% of GDP from -3.8% in the previous quarter and the recently released data for Q4FY23 shows that the CAD in the quarter was -0.2%. The quarter-on-quarter improvement in Q4FY23 was led by the lower trade deficit (led by a decline in imports) and a continued strong performance in services exports. For the full year FY23, CAD was at -2.0% of GDP, which though higher than the previous two years of -1.2% of GDP in FY2022 and surplus of +0.9% in FY2021, is far better than the expectations at the end of Q2FY23. The forecasted CAD in FY24 is about 1.0% of GDP.



Source: Bloomberg; ASK IM Research

The greater part of the improvement in FY24 will come from lower global commodity prices, especially oil. The weaker than expected recovery in China is likely to keep a lid on commodity prices. Though the services trade surplus, which played a key role in containing CAD last year, is likely to moderate, it will continue to offset the trade deficit on the goods side. On the other hand, services exports have played a very important role in boosting external flows, especially during a time when goods exports have been impacted by the demand slowdown in the US and Europe.



Source: Bloomberg; ASK IM Research

Over the medium to long term, the efforts towards import substitution and increasing proportion of renewables and electric vehicles could aid in keeping a lid on the growth of imported goods. On the other hand, India increasingly being integrated in global supply chains should help in boosting exports.

The tough patch of poor CAD now seems to be behind us. The improvement in CAD bodes well for the macro-economic stability of the country with a positive impact on multiple aspects. For example, though capital flows will play an important part, the improvement in CAD is likely to help manage the impacts on the exchange rate in an uncertain global environment. No wonder Indian Currency has behaved well in past few months.

## Valuations and Flows

Continuing with the trend of the past three months, Foreign Institutional Investors (FII) flows in the Indian markets remained strong at about USD 5.7 bn in the month of June. This is despite the run-up in the stock markets in the recent period, which highlights the relative importance of India within the overall EM basket for these investors.

The Nifty's 12-month forward PE ratio at ~19x is at about fair value levels when compared to 10-year historical averages. Over the next few years, the market earnings are likely to grow at about low to mid-teens. A pause in interest rates hikes supported by a moderation in inflation is likely to result in less incremental erosion of spending power in the hands of consumers. This could support demand after a lag. The softness in commodity prices will aid margins and profit growth for corporate India. We remain watchful of the evolving monsoons situation in the country and the potential impact of El Nino, if any.

Our portfolios continue to comprise of companies with robust business models and strong long-term growth visibility. The strength in the superior quality of businesses that we own will be demonstrated as they gain greater market share in a growing economy. While our portfolios have bounced nicely in the last three months, valuations continue to remain lower than the peak achieved a few quarters back. Portfolio earnings growth has remained strong and expected to remain so, driven by a combination of revenue growth and margin expansion.

Happy investing!

Mr. Sumit Jain

Deputy CIO, ASK Investment Managers Ltd

## Investment Approach Update

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### Market backdrop

Global markets remained on the uptrend in the month of June gaining anywhere between 1-3% on the back of Federal Open Market Committee (FOMC's) decision to hold rates in its scheduled meeting in June. While inflation showed signs of cooling off in the US, it continues to remain elevated in the UK and other European economies. The Bank of England responded with a surprise 50bps rate increase as the inflation point continued to remain sticky. On the domestic front, RBI in its monetary policy meet decided to hold rates and monitor incremental data before deciding the next course of action. INR appreciated against US dollar by 1% to 82 while 10-year government bond yield increased to 7.11% at end Jun 23 (vs 7% at end May 23).

The Q1FY24 results are around the corner, and we expect earnings growth to be driven by normalization in margins for most of our businesses while volume growth is expected to remain tepid. In the near term, we will be monitoring inflation and the volume growth trajectory closely as we believe that acceleration in earning growth in FY24 will be driven by a combination of normalization in margins and acceleration in underlying volume growth.

Over the medium to long term, we believe that various regulatory/fiscal initiatives taken in the past few years coupled with structural transition in the manufacturing sector (favorable policy environment coupled with opportunities from shift in global supply chain) will translate into acceleration in GDP growth.

### Portfolio impact

On the portfolio performance front, the portfolio underperformed its benchmark BSE500-TRI which delivered 4.3%. In consumer space, Patanjali Foods, Astral and Titan increased by 13%/9%/8% respectively while Radico Khaitan, Polycab and Berger Paints increased by 3-4% each. Page Industries declined by 3% in last 1 month. In Financial services space, Cholamandalam, HDFC and Bajaj Finserv increased by 9%/7%/5% respectively. Bajaj Finance increased by 2% while ICICI Bank and AU Bank declined by 2-3% in last 1 month. Among the other names, APL Apollo and Divi's increased by 15%/4% respectively. Infosys, Reliance, and Bharti increased by 1-3% each. Navin Fluorine, SONA BLW and SRF underperformed with a 3-9% decline in last 1 month. We have exited Aarti Industries as operating performance has been below expectations.

### Conclusion

We are invested in high quality businesses which are likely to come out stronger post crisis and, therefore, medium to long term growth prospects remain largely unchanged for our portfolio companies.

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