

ALPHA STRATEGIST

“Suit of Armour”



**WINNING PORTFOLIOS
POWERED BY KNOWLEDGE**

October 2024 | Issue No. 142

- As highlighted in our Sep'24 edition, “Goldilocks & Three Bears”, we are already seeing risks emerging from global events and expensive valuations being in play.
- Heightened geopolitical tensions have increased volatility leading to rising crude oil prices, bond yields – bringing back the fears of inflation & its impact on cutting of interest rates cycle.
- Valuations of Indian equities, especially small & mid-caps are trading at significant premium compared to long term averages, while the RoE profile has improved across the indices.
- However, the sustained inflows from DIIs & strong corporate fundamentals will act as a as a **“Suit of Armour”** and cushioning domestic equity market valuations in the wake of geopolitical events and FII outflows.
- Additionally after witnessing 4 years of double digit earnings growth, it seems appropriate to moderate the expectations on earnings growth.
- Considering current valuation levels and projected earnings growth, in our view, one could follow a staggered approach by investing in large & multi cap strategies over a 3 month period and in select mid & small-cap strategies over 6 to 12 months
- We still continue with our view to have a duration bias in the fixed income portfolio so as to capitalize on the likely softening of yields in the next 1-2 years





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Asset Class Performance – CYTD24

2019	2020	2021	2022	2023	1st Jan'24 to 4th Oct'24 (Abs basis)
NASDAQ 38.3%	NASDAQ 47.0%	Equity-IND 30.2%	Gold 13.9%	NASDAQ 46.0%	Equity-IND 24.8%
Equity-US 31.9%	Gold 28.0%	Equity-US 29.1%	Liquid 5.1%	Equity-IND 25.8%	Equity-US 21.4%
MSCI DM 28.1%	Equity-US 19.0%	NASDAQ 23.5%	Equity-IND 3.0%	Equity-US 25.7%	NASDAQ 21.3%
Gold 23.8%	MSCI EM 18.6%	MSCI DM 22.2%	Real Estate 2.8%	MSCI DM 22.3%	Gold 19.2%
MSCI EM 18.1%	MSCI DM 16.8%	Liquid 3.6%	Debt 2.5%	Gold 15.4%	MSCI DM 17.5%
Debt 10.7%	Equity-IND 16.7%	Debt 3.4%	MSCI DM -10.0%	MSCI EM 7.7%	MSCI EM 16.1%
Equity-IND 7.7%	Debt 12.3%	Real Estate 3.1%	Equity-US -10.7%	Debt 7.3%	Debt 9.5%
Liquid 6.9%	Liquid 4.6%	MSCI EM -2.9%	MSCI EM -13.5%	Liquid 7.1%	Liquid 7.4%
Real Estate 3.0%	Real Estate 2.2%	Gold -4.2%	NASDAQ -26.1%	Real Estate 2.0%	Real Estate 4.6%

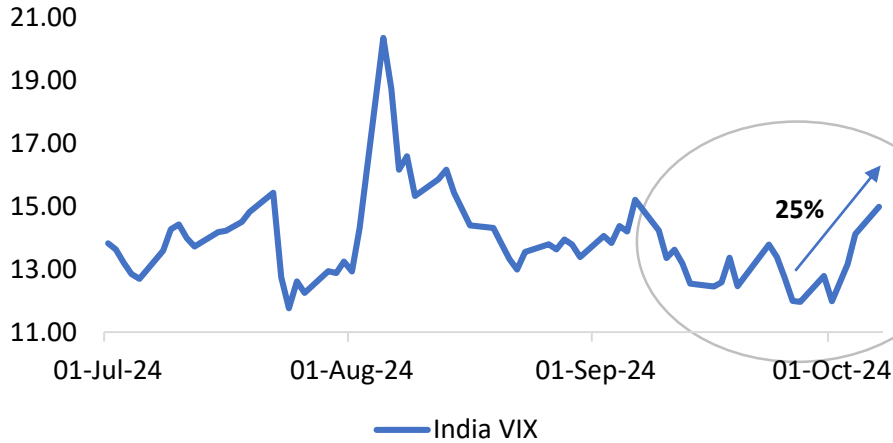
Note: Price Index values are being considered. Returns for Debt & Liquid are taken on Annualised basis, rest all are on absolute basis

Equity IND - Nifty 50, Equity US - S&P 500 INR, MSCI DM – MSCI World Index (Developed) INR, MSCI EM -MSCI Emerging Index INR, Gold - Gold INR, Debt - CRISIL Composite Bond Index, Liquid - CRISIL Liquid Index, NASDAQ - NASDAQ Composite index INR, Real Estate - RBI House Price Index (3 month returns for CY24 since data for this index is available only till end Jun'24)



Iran – Israel Tensions increasing volatility

India Volatility Index

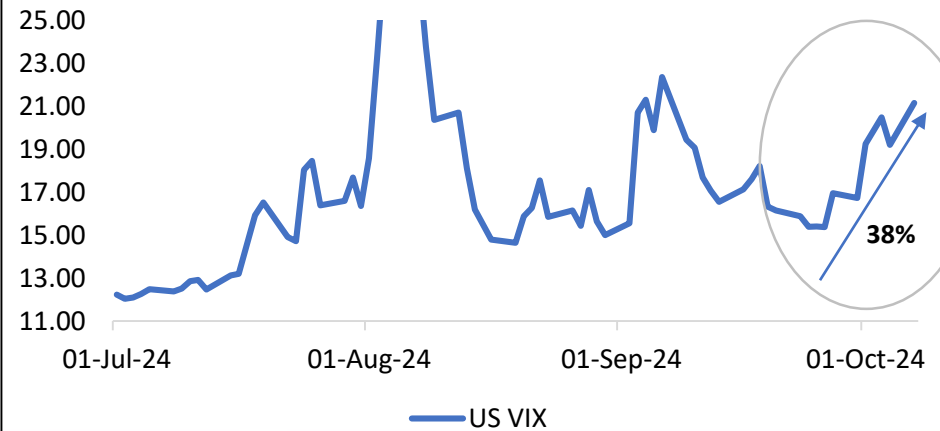


- India VIX increased by 25% from lows of 12 to 15 in a span of few days.

Data as on 7th October

- US VIX increased by 38% from lows of 15.4 to 21.2 in a span of few days.

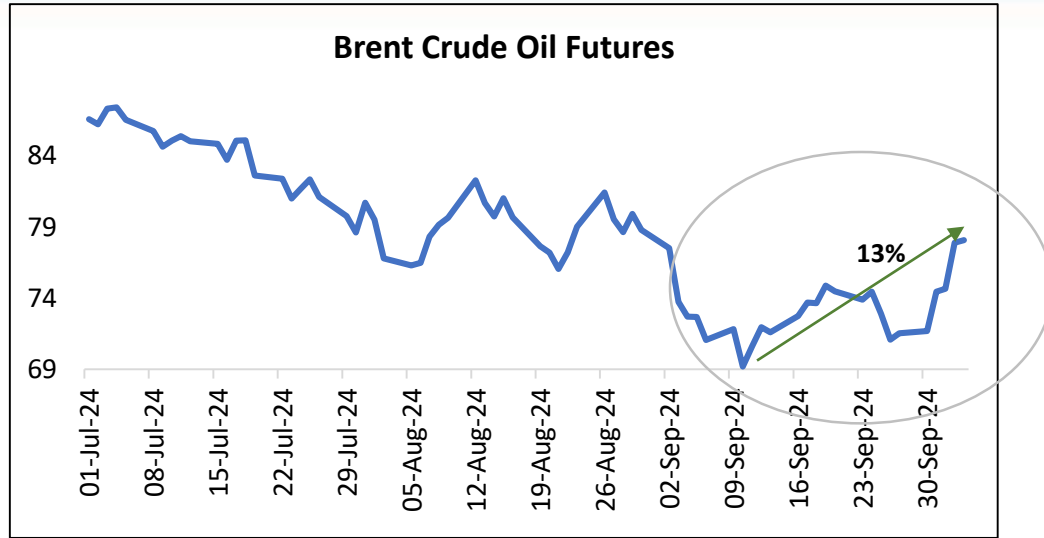
US Volatility Index



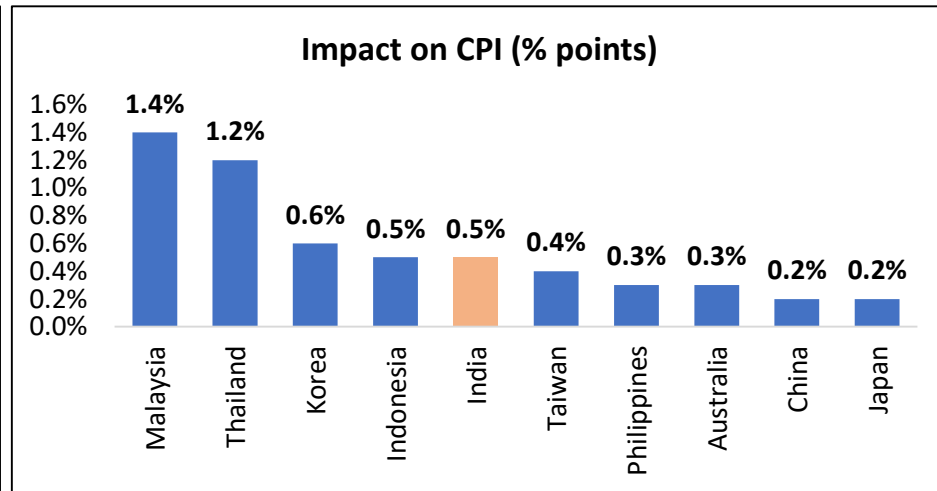
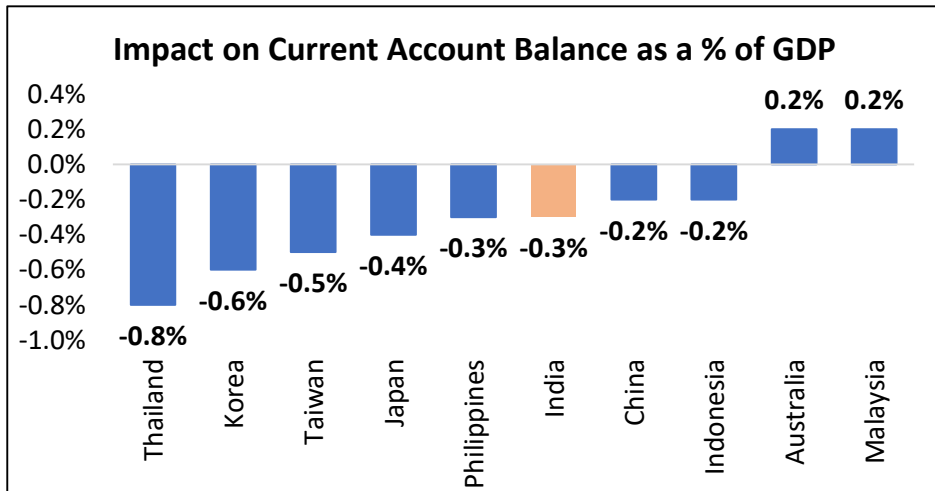
Data as on 7th October



Impact of Iran – Israel tensions – spurt in crude oil prices



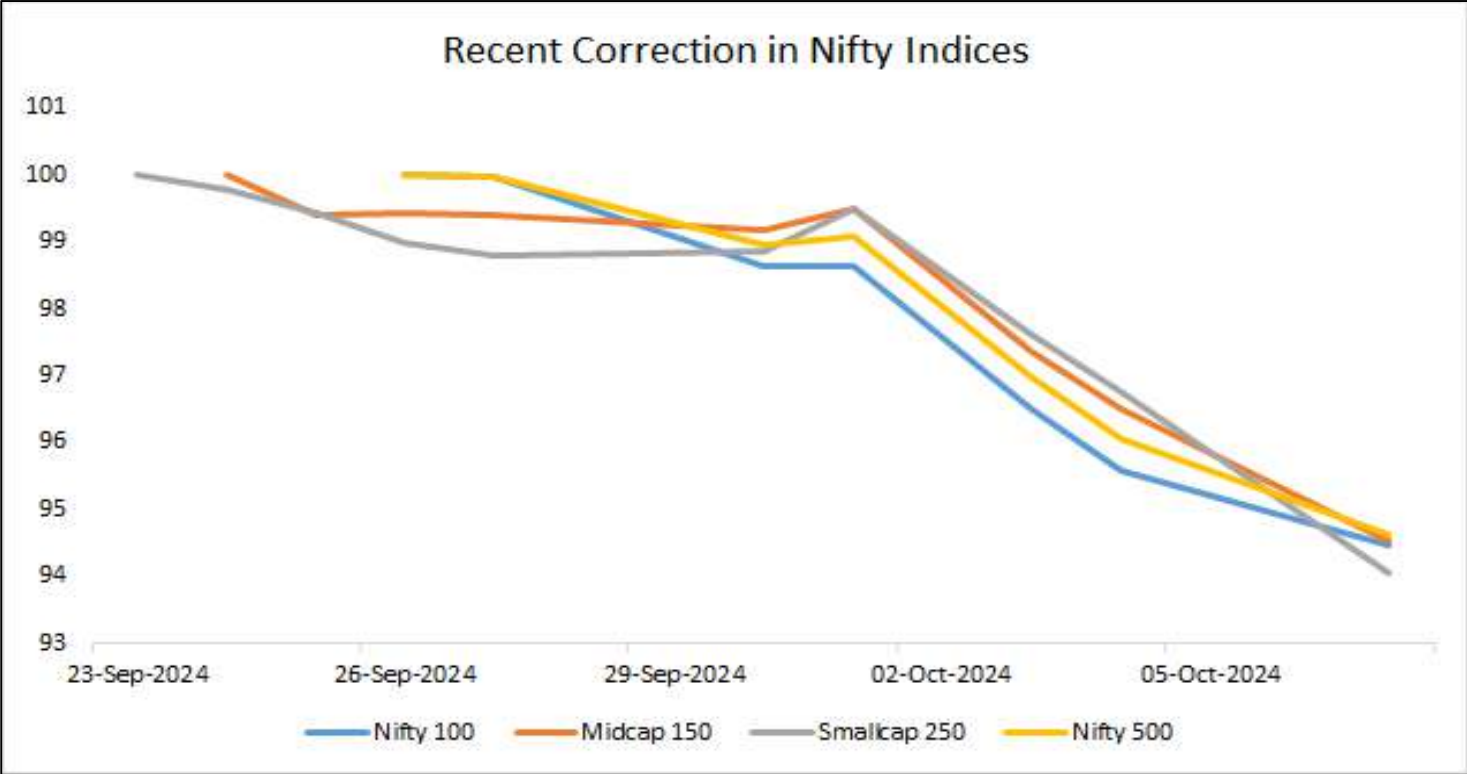
How sensitive are Asian economies to a \$10 rise in Oil Prices



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Recent correction in Nifty Indices



Index	Performance
Nifty 100	-5.5%
Midcap 150	-5.5%
Smallcap 250	-6.0%
Nifty 500	-5.4%



Nifty Indices – Valuation, Returns profile & expected growth

Index	Trailing PE			Return on Equity		
	Current*	Avg from 2018	Premium	Current*	Avg from 2018	Diff
Nifty 100	25.1	23.6	6.4%	16.4%	13.5%	2.8%
Nifty Midcap 150	45.7	34.0	34.7%	12.6%	9.4%	3.1%
Nifty Smallcap 250	33.6	24.3	38.3%	14.0%	8.4%	5.5%
Nifty 500	27.8	26.2	6.2%	15.6%	12.3%	3.3%

* Current PE are as on 7th Oct 2024 and ROE numbers are as on 30th Sept 2024

- Nifty Smallcap 250 and Nifty Midcap 150 are trading at significant premium compared to long term average
- RoE profile has improved across different Nifty Indices and the expected earnings growth also looks decent



Sector	PE (x)		
	Current	10 Yr Avg	Prem/Disc (%)
Auto	26.7	27.4	-2.7
Banks - Private	16.5	21.1	-21.7
Banks - PSU	7.2	10.2	-28.8
NBFC	17.2	17.2	0.0
Capital Goods	43.6	28.7	52.0
Cons. Durables	56.6	32.7	73.1
Cement	35.5	27.0	31.7
Consumer	49.5	41.3	19.8
Consumer Ex ITC	58.7	51.3	14.5
Healthcare	34.6	26.7	29.4
Infrastructure	25.8	11.4	126.1
Logistics	28.8	21.1	36.1
Media	21.4	25.3	-15.5
Metals	12.5	10.9	14.9
Oil & Gas	15.3	12.3	24.7
Oil & Gas Ex RIL	9.6	8.6	12.5
Sp. Chemicals	38.3	24.0	59.9
Real Estate	48.7	28.7	69.4
Retail	92.9	81.4	14.1
Technology	28.5	20.7	38.0
Telecom	Loss	46.3	-
Utilities	15.3	7.8	95.1



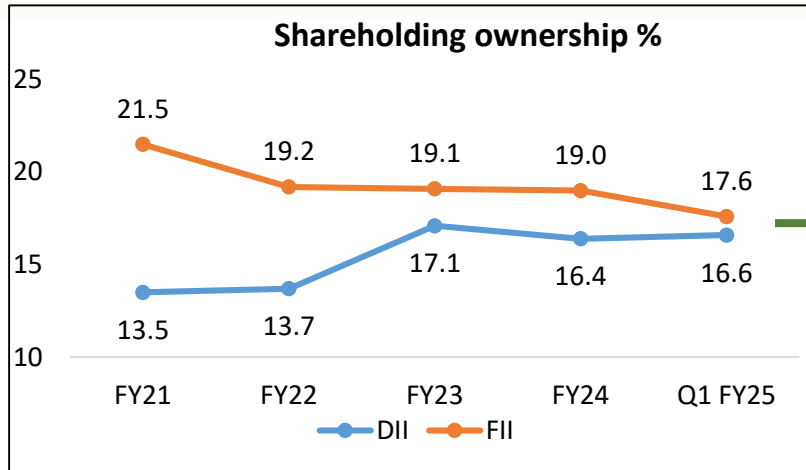
- Currently, Banks (Private and PSU) are trading at a discount to their long-term 10 yr. avg. by 22% and 29% respectively.
- Banks haven't become overheated in terms of price performance and provide a margin of safety, especially when the broader market is trading at a premium valuation.

Total No. of Stocks in MOFSL Universe: 281

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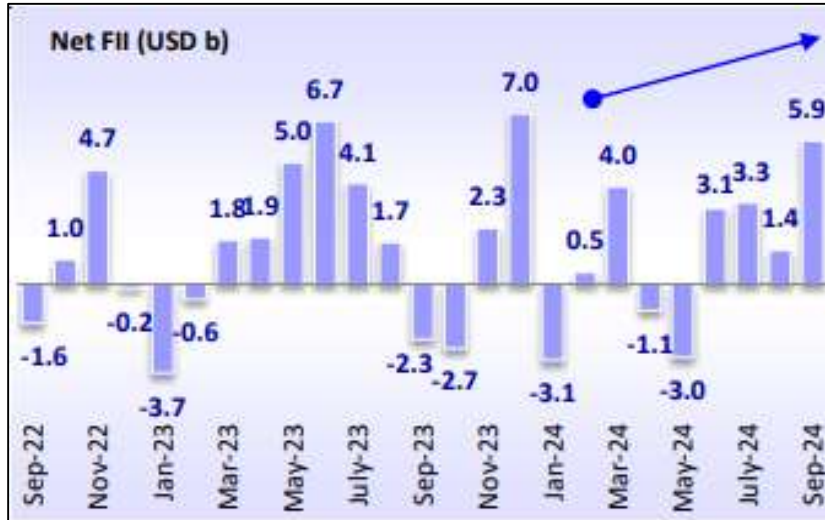


FII and DII Equity Ownership and Flows

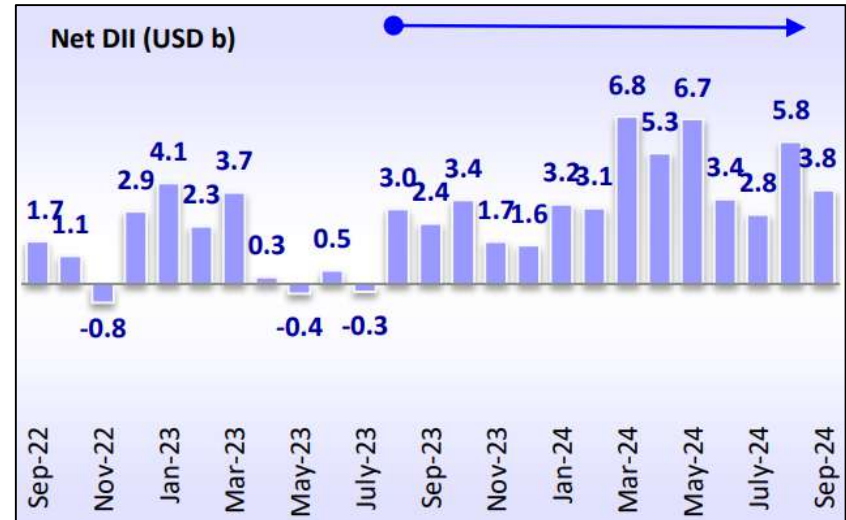


FII and DII equity ownership is converging showcasing that the FIIs hold on the Indian markets is being balanced by the equally strong DII ownership.

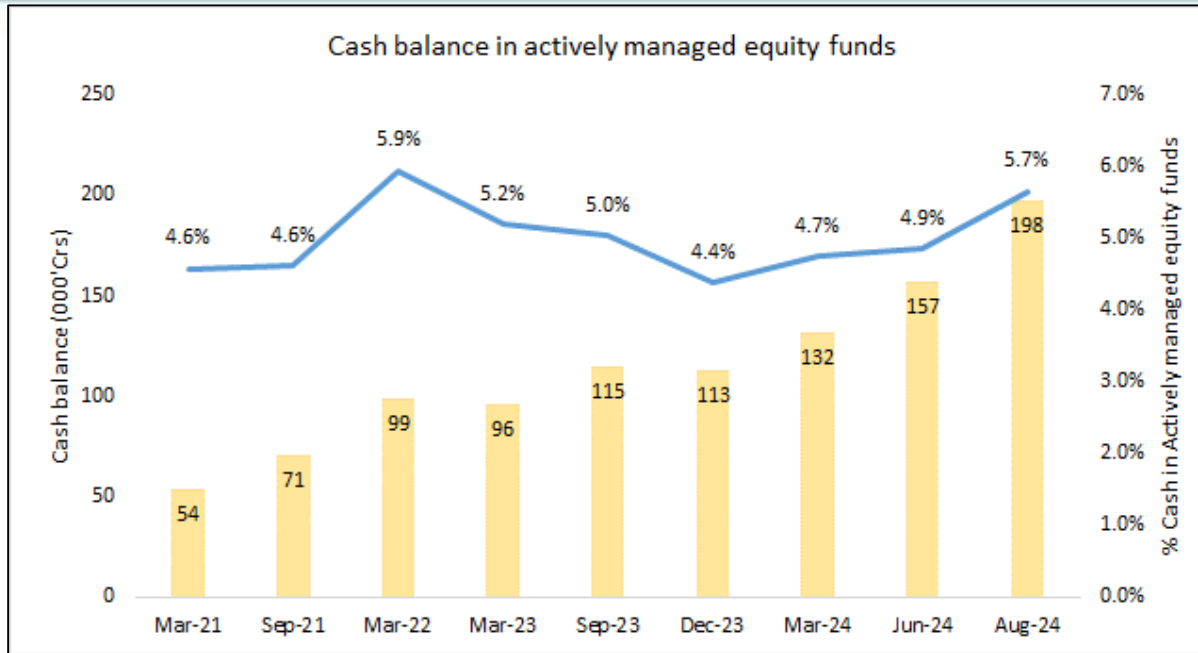
Largest net FII flows in equities observed post Dec'23



DII flows have been robust since the last 14 months



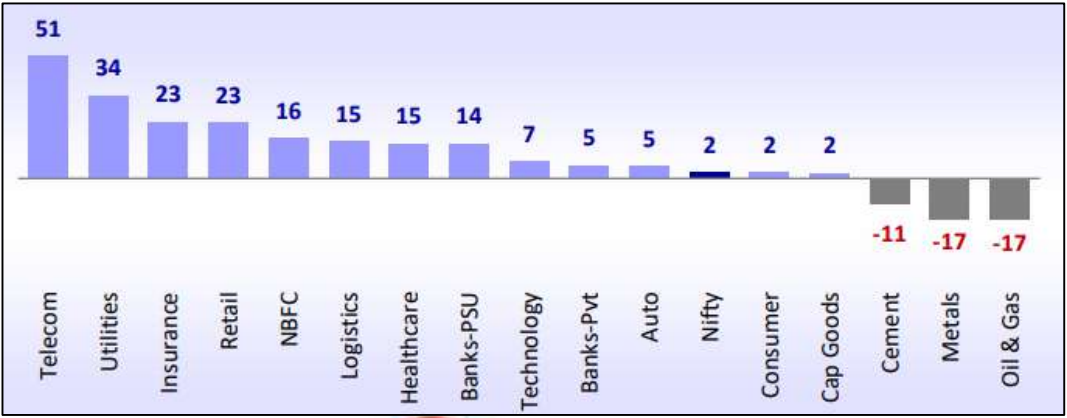
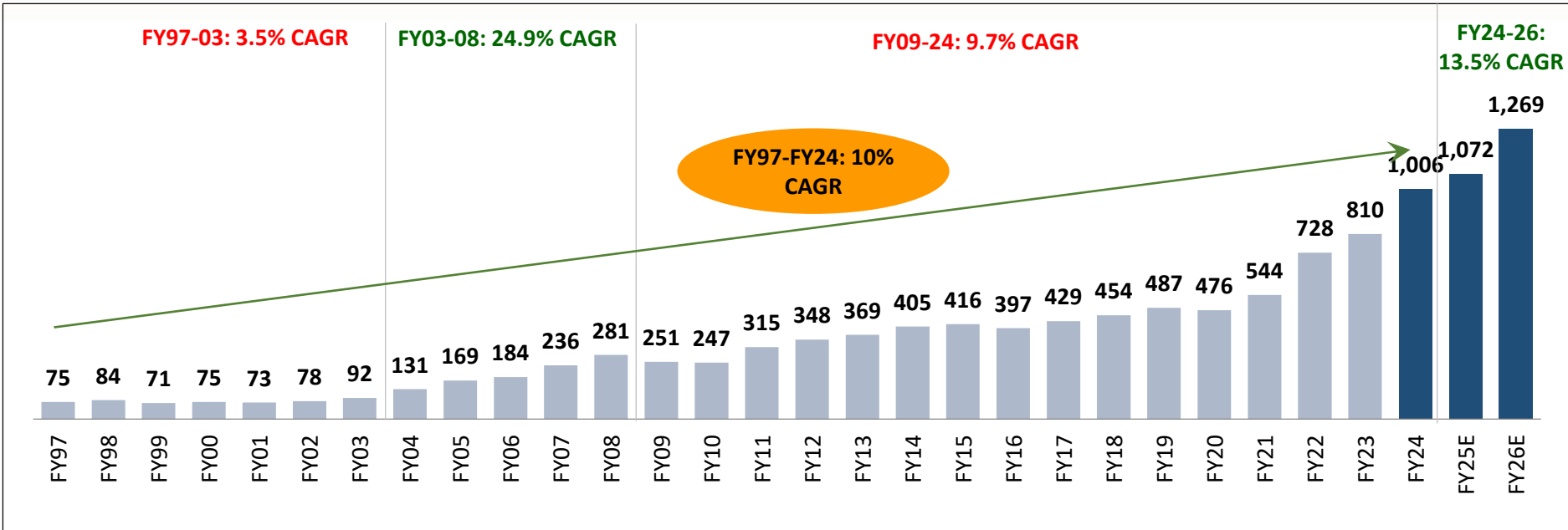
As per provisional estimates as on 7th October, FII net flows has been **negative at -4.6 USD b** and DII net flows has been positive at **4.7 USD b**.



- The cash balance in actively managed equity funds (including Aggressive Funds & Balanced Advantage funds)
- In addition to this, monthly SIP allocations are at ~23,500 Cr (on gross basis, as of Aug'24)
- EPFO allocation into equity (through ETFs) also is another source of inflows into the market



Nifty 50 - Earnings Growth Outlook



- Nifty EPS is estimated to grow by 7% at 1,072 for FY25 and by 18% at 1,269 for FY26.
- Earnings growth is anticipated to be driven by **Financials, Telecom and Utilities** and to be dragged down by **Cement, Metals, Oil and Gas**.

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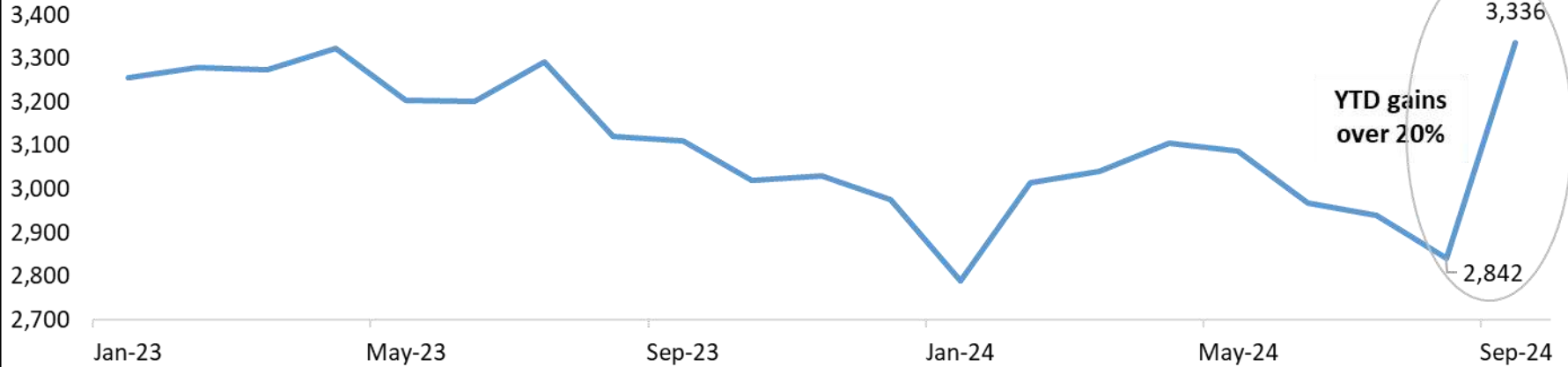
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Shanghai Stock Exchange Composite Index Value



Steps	Implications
50bps cut to the Reserve Requirement Ratio (RRR)	This can lead to infusion of approximately 1 trillion yuan (around \$142 billion) into the financial system
50bps cut in existing mortgage rates	Likely to save household approx. \$20-21 billion in a year in interest expenses.
Raised financing ratio from 60% to 100% for \$43 billion housing inventory digestion scheme	This can accelerate the process of cutting home inventory and encourage banks to facilitate land transactions
Plans to inject \$1 trillion in yuan into six major state banks	May provide stimulus to banking sector
Regulators specified that management fee and custodian fee of newly registered active equity and equity hybrid funds shall not exceed 1.2% and 0.2% respectively	This may provide support to capital markets

China and India as a Percentage of MSCI Emerging Markets Index



As on August'24

India's increased weight in the MSCI EM Index not only enhances its **attractiveness as an investment destination** but also facilitates significant capital inflows driven by **passive investment strategies** (index-tracking funds) and a **favourable economic outlook** compared to its regional competitors.



India Consumption story: Potential for Expansion

Products	India	China	USA
Auto	4%	15%	81%
Outbound Trips	6%	9%	42%
Air Conditioners	8%	60%	90%
Refrigerators	18%	94%	100%
Smartphone Users	37%	54%	83%
Internet Users	58%	60%	95%

Source: Morgan Stanley & CLSA Research

ZERODHA

Economic profile of Indian will transform consumption



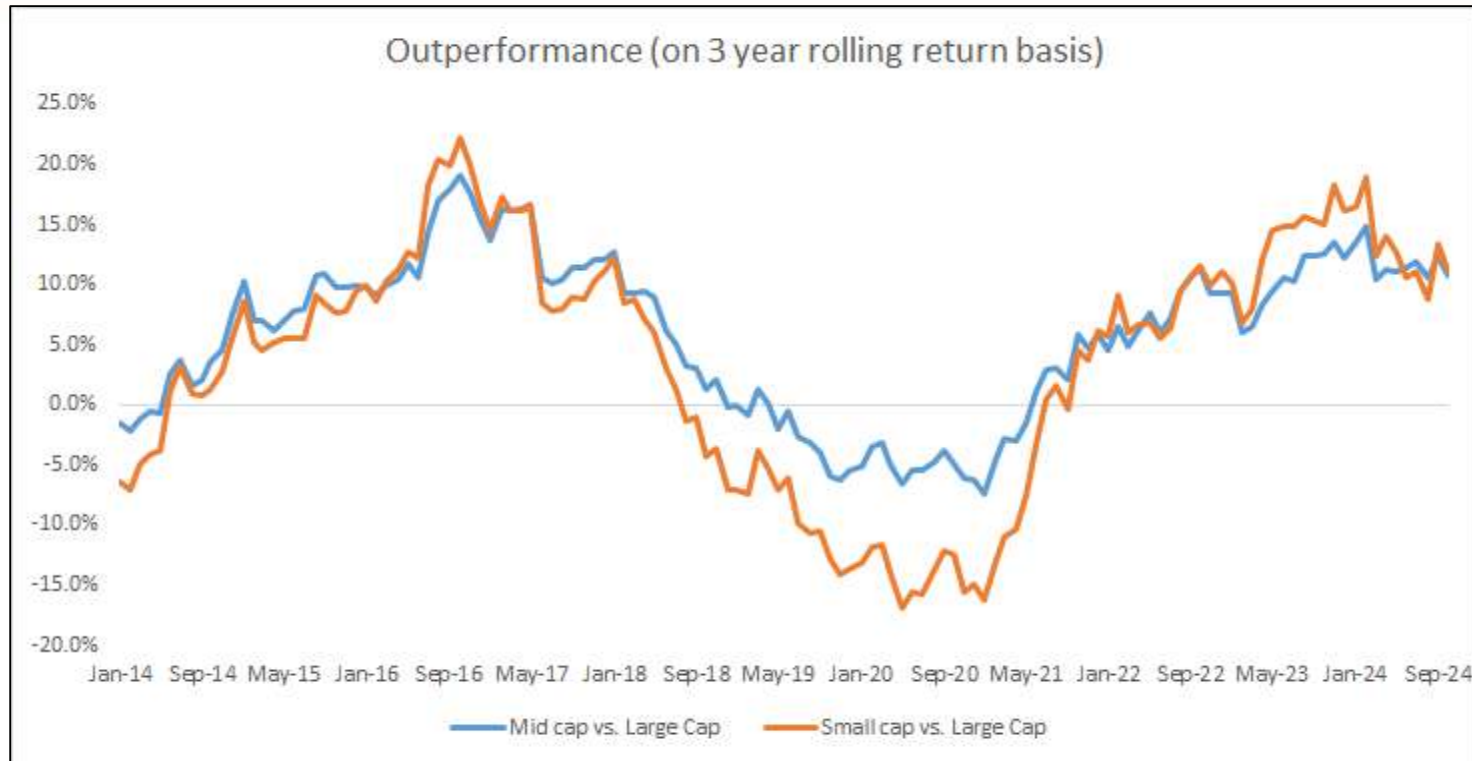
Source: Zerodha, Carnelian - WEF, PRICE projections based on ICE 360 surveys (2014, 2016, 2018), Bain, Future of consumption in Fast-Growth Consumer Market: INDIA, F-Forecast

Disclaimer: The above data is for informational purpose. Past performance may or may not be sustained in future

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Out/underperformance of Mid Cap and Small Cap vs Large Cap



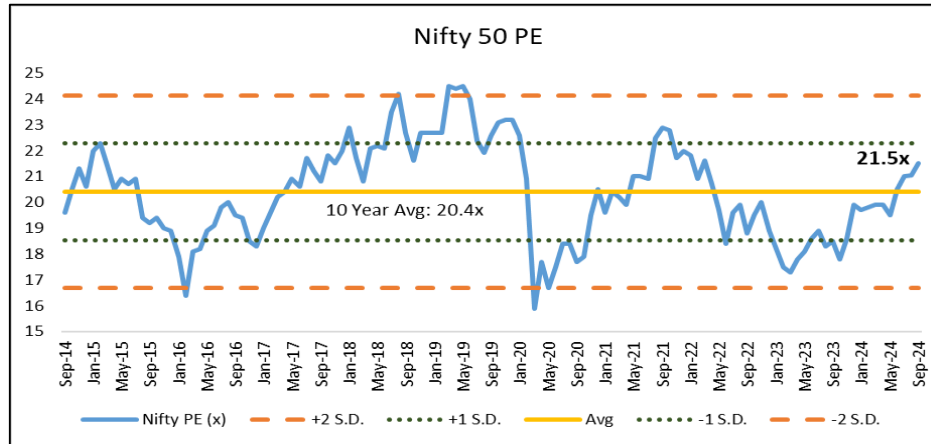
Nifty Midcap 150 TRI is used as proxy for Mid cap, Nifty Small cap 250 TRI is used as proxy for Small cap and Nifty 50 TRI is used as proxy for Large Cap

- Since Oct-21, both Mid cap and Small cap have outperformed the Large cap index on a 3 year rolling return basis.

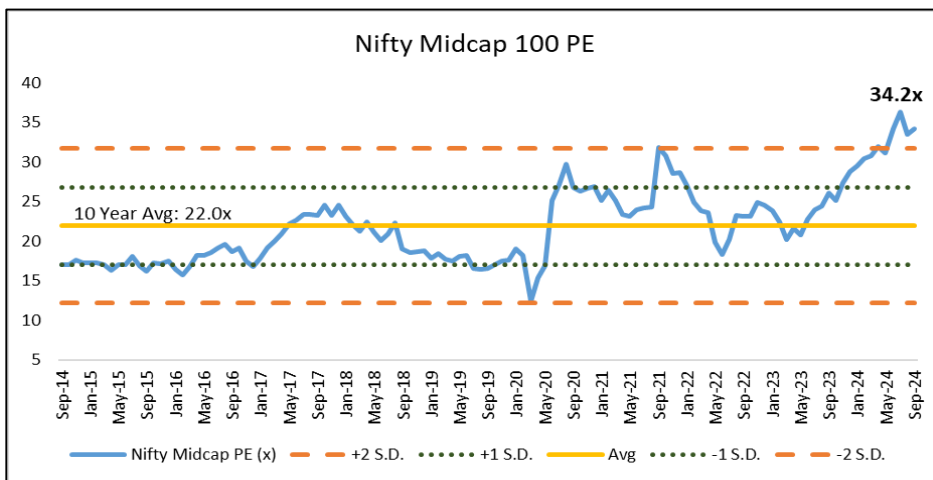


Market Indices Valuations Based on Forward Earnings

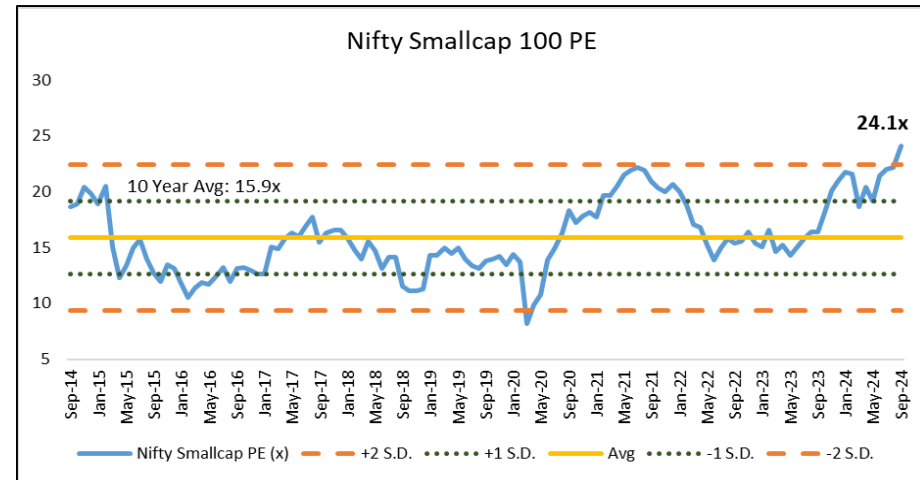
Nifty 50 PE 1 Year Forward - (10 Year Period)



Nifty Midcap 100 PE 1 Year Forward - (10 Year Period)



Nifty Smallcap 100 PE 1 Year Forward - (10 Year Period)



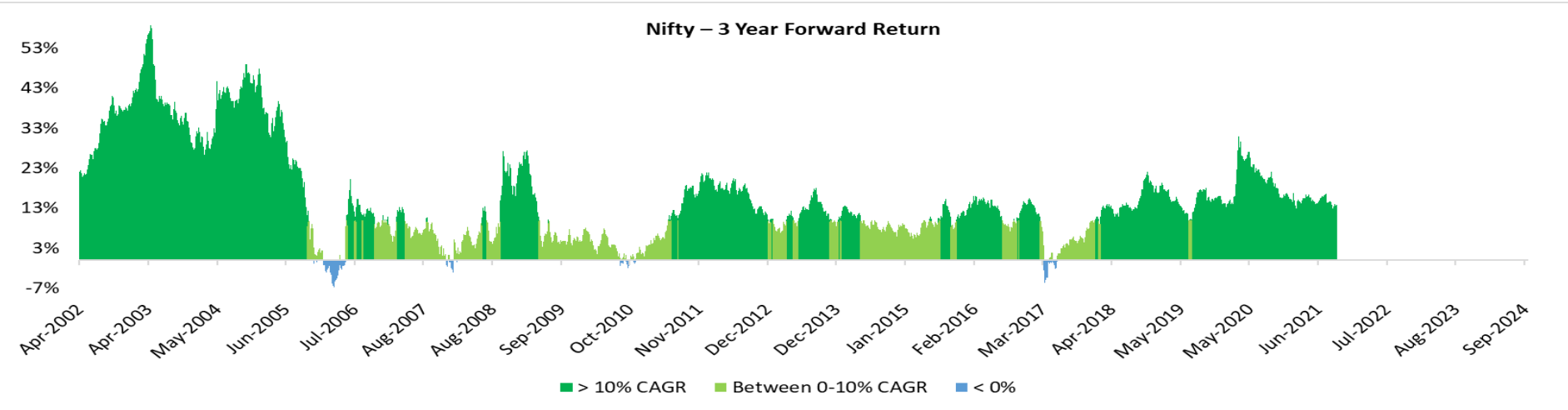
- Nifty Midcap forward PE & Nifty Smallcap forward PE are trading significantly higher compared to their respective long-term average.



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Temperature Gauge Index

- Temperature Gauge Index is an equally weighted index of EY-BY and MOVI Index
- It incorporates PE Ratio, PB Ratio, Div. Yield and G-sec Yield, and hence is a useful valuation metric.



Data as on 30th September'24
 Source: Capital Line, Bloomberg Internal Research
 Disclaimer: The above graph is for informational purpose. Past performance may or may not be sustained in future.

Temperature Gauge Index – Sensitivity Analysis

Temperature Gauge Index - Sensitivity Analysis					
Nifty50/10 Yr Gsec	6.47%	6.67%	6.87%	7.07%	7.27%
24560	113	114	115	116	117
24810	114	115	116	117	118
25060	114	115	116	117	118
25310	114	115	116	117	118
25560	115	116	117	118	119
25810	115	116	117	118	119
26060	115	116	117	118	120
26310	116	117	118	119	120
26560	116	117	118	119	120
26810	116	117	118	120	121
27060	117	118	119	120	121
27310	117	118	119	120	121
27560	117	118	119	121	122

Pink cell Indicates Current Level of Nifty 50 and 10 yr G-sec levels. Data as on 30th September'24



3 Yr Forward Returns Of Nifty At Different Levels Of Temperature Gauge Index

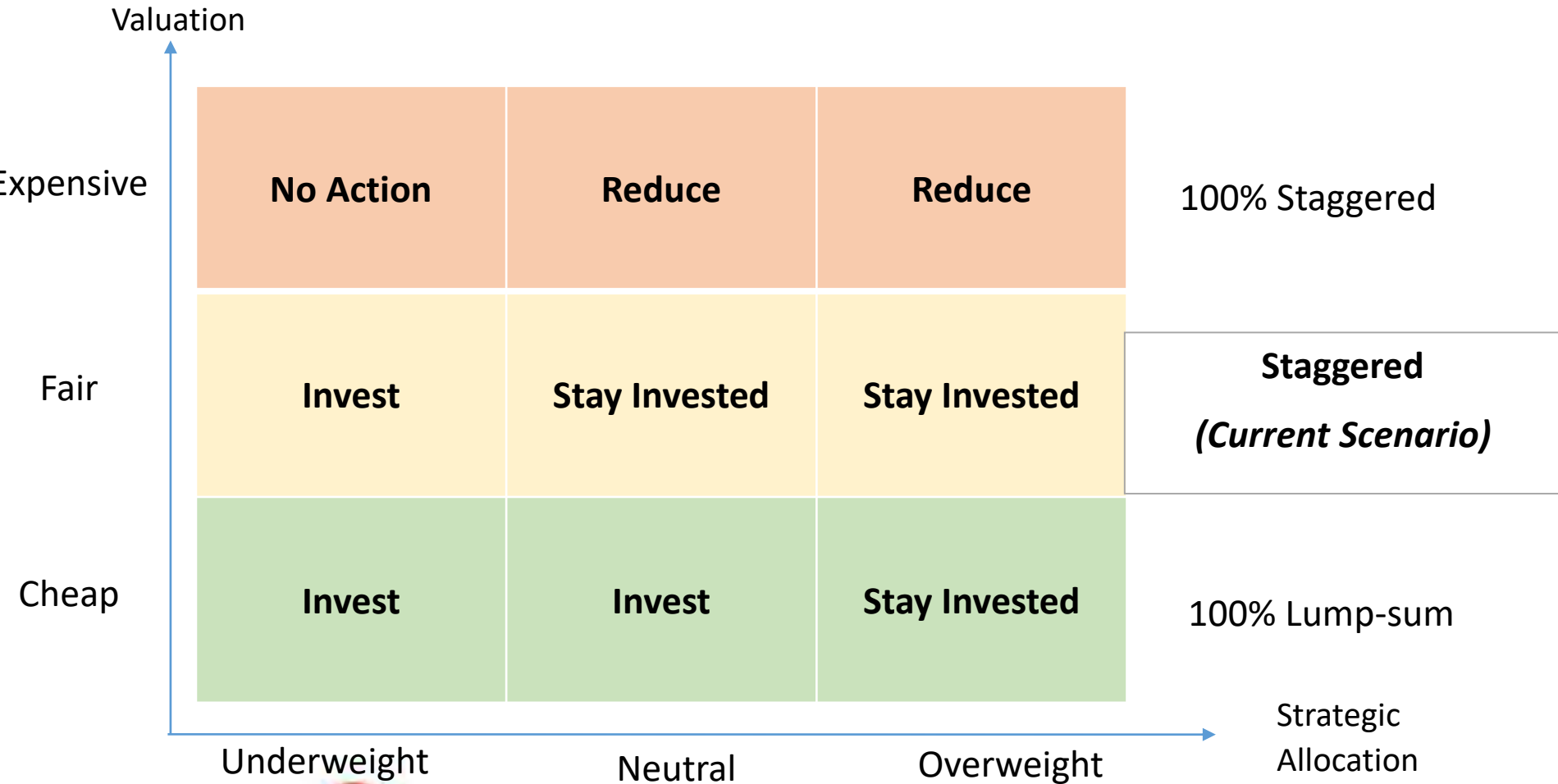
Nifty 50		No. of Observations	% of Observations	3 Yr Return CAGR			% Times Positive	% Times in CAGR range	
Index in Range	Min			Max	Average	6% to 10%		>=10%	
65	70	60	1%	24%	57%	43%	100.0%	0%	100%
70	75	202	2%	15%	51%	32%	100.0%	0%	100%
75	80	285	3%	14%	45%	37%	100.0%	0%	100%
80	85	168	2%	15%	43%	34%	100.0%	0%	100%
85	90	207	3%	12%	49%	33%	100.0%	0%	100%
90	95	539	7%	2%	47%	27%	100.0%	2%	97%
95	100	832	10%	1%	44%	18%	100.0%	8%	91%
100	105	714	9%	-2%	30%	13%	98.7%	20%	71%
105	110	810	10%	-4%	22%	10%	83.1%	15%	56%
110	115	1797	22%	-7%	22%	9%	64.5%	28%	22%
115	120	1606	19%	-4%	21%	8%	72.9%	21%	22%
120	125	804	10%	-2%	18%	10%	85.7%	7%	57%
125	130	135	2%	0%	16%	12%	93.3%	4%	74%
130	135	84	1%	-2%	15%	6%	91.7%	0%	36%
135	140	28	0%	-3%	0%	-1%	10.7%	0%	0%

Data as on 22nd September'24

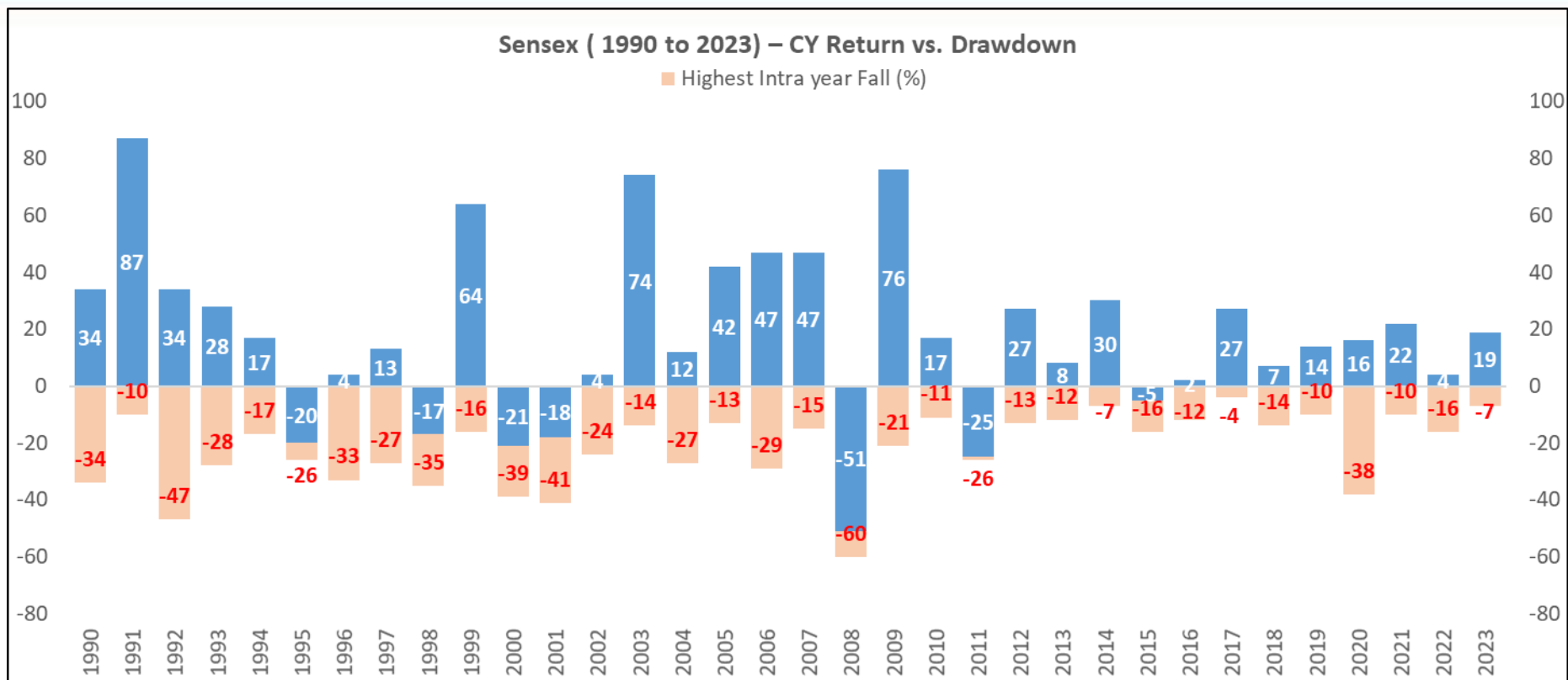


Equity Allocation & Deployment Grid

➤ Below grid is based on Temperature Gauge Index



Intra-year Corrections and Returns



Data as of 31st December 2023

- Out of 33 years, while markets always had an interim decline, only in 7 years did the market end the year with negative returns. In other words, for 26 out of 33 years, the markets ended in positive despite the temporary decline in between.
- Approximately, 10-20% temporary drawdown is almost a given every year.



- Equity market outlook continues to remain positive based on deleveraging of Corporate Balance Sheets, uptick in the Capex cycle and expected earnings to remain robust for the next two years.
- However, given the uncertainties in the global context and rich domestic valuations, it is advisable to tread with caution by adopting a strategy which is balanced and resilient.
- Based on their risk profile, investors having the appropriate level of Equity allocation can continue to remain invested
- If Equity allocation is lower than desired levels, investors can increase allocation by implementing a staggered investment strategy **over 3 months for large & multi-cap strategies** and **6 to 12 months for select mid & small-cap strategies** with accelerated deployment in the event of a meaningful correction.





1. [Highlights](#)

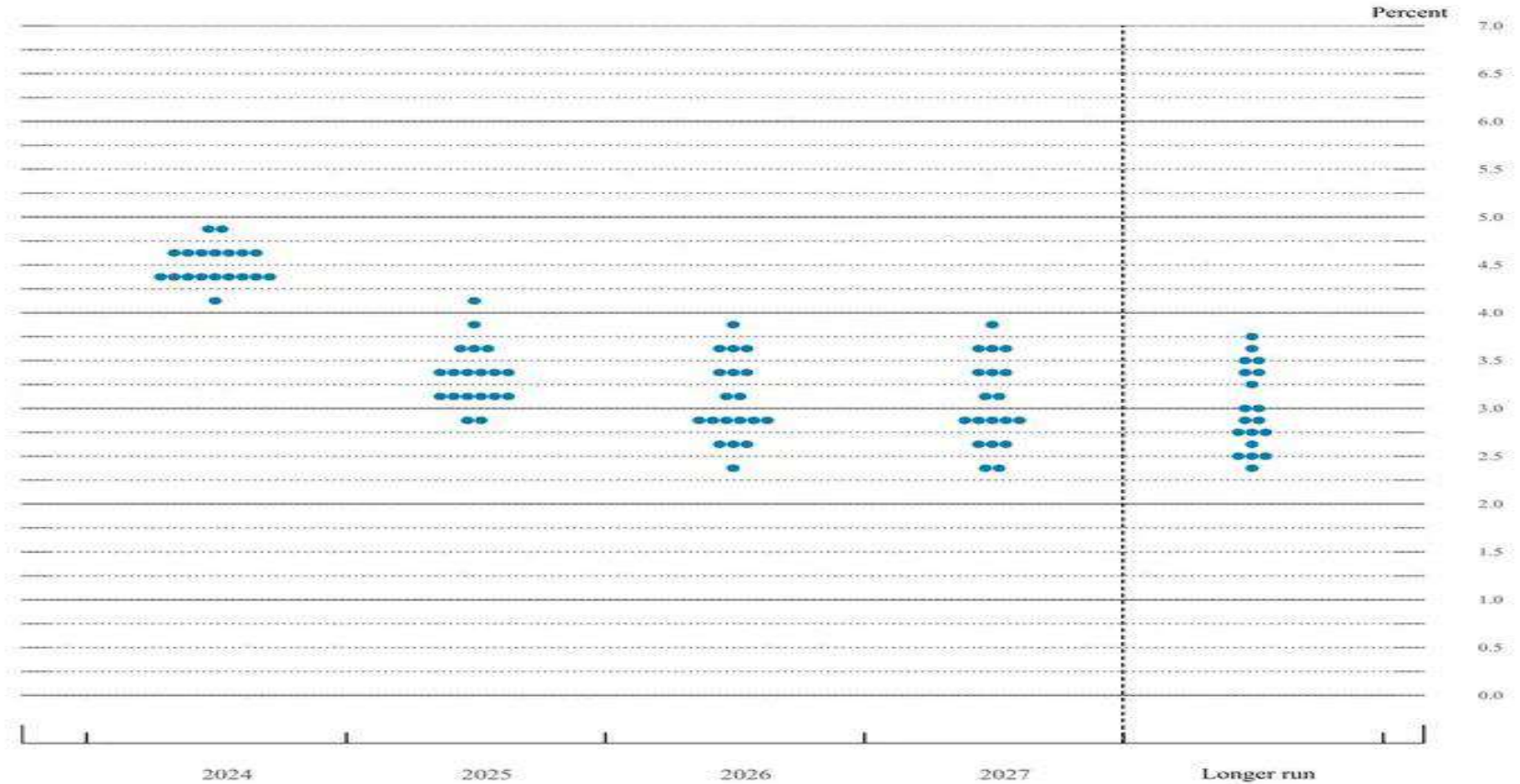
2. [Equity](#)

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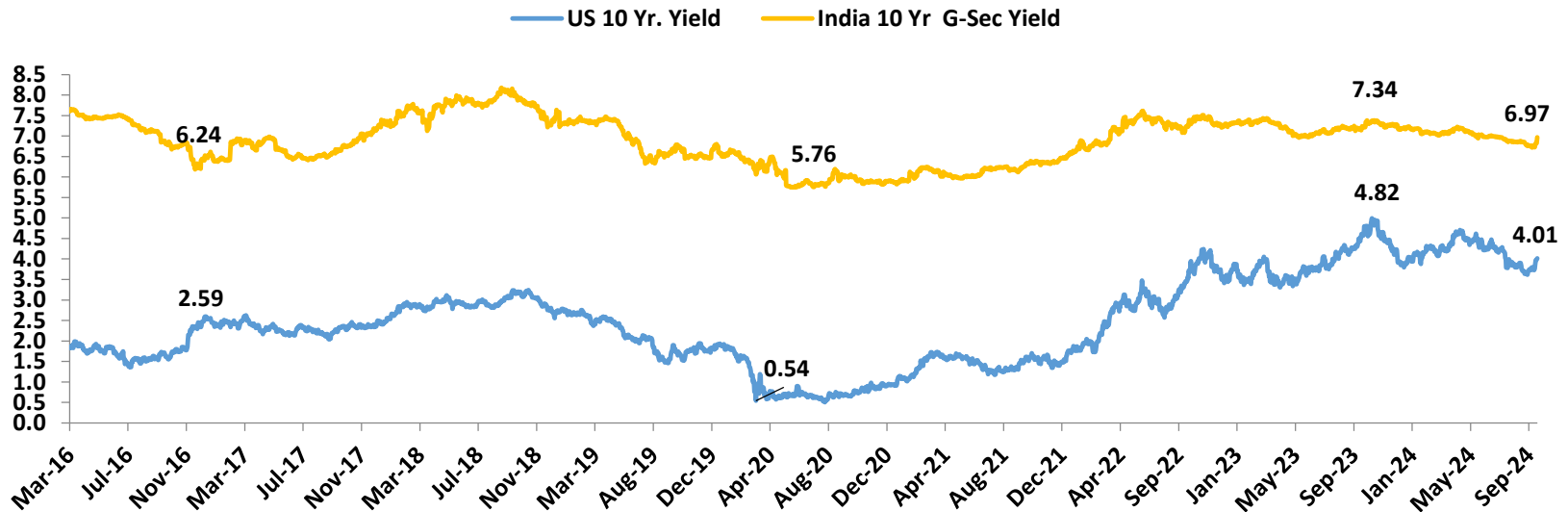
4. [Gold](#)

US Fed projections for Interest Rates

**Post a 50 bps Fed rate cut to 4.75% - 5.00%,
Federal Policy Rate Median Projection:
4.4% by 2024; 3.4% by 2025, 2.9% by 2026**



US & India 10 Yr G-Sec Curve

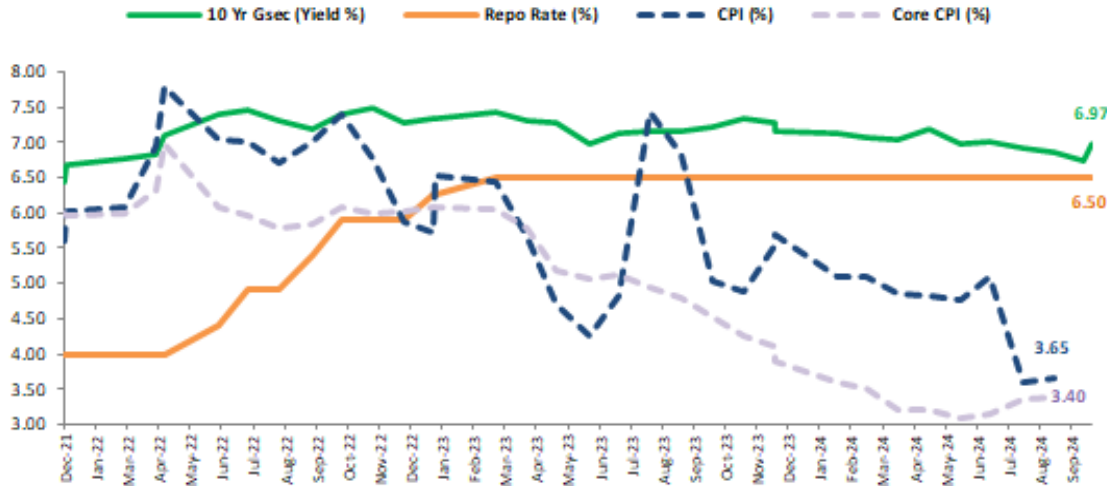


- Much of the impact of 50 bps Fed rate cut was factored in the movement of U.S. 10-Year Treasury yield which gradually softened in Sep to 3.71% level before increasing again to 4% levels.
- India's 10 year Gsec continued to remain guided by foreign inflows, strong domestic macros and US Treasury yields to some extent.
- However, recent geo - political tension & rise in crude oil prices remains an upside risk for the global yields.



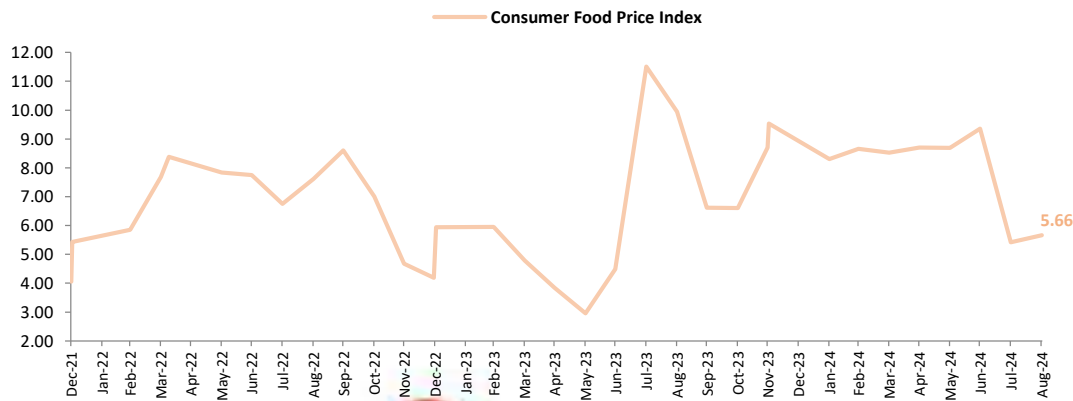
RBI Expected to Remain Status Quo on Policy Rate/Stance : To Take Cues from Domestic/Global Factors

India CPI and Core CPI Inflation is structurally trending downwards...



- RBI to prefer more clarity on trend/data to change guidance on policy rates and stance
 - Inflation & Growth dynamics
 - Global Central Bank Stance
 - Path of interest rates of developed economies

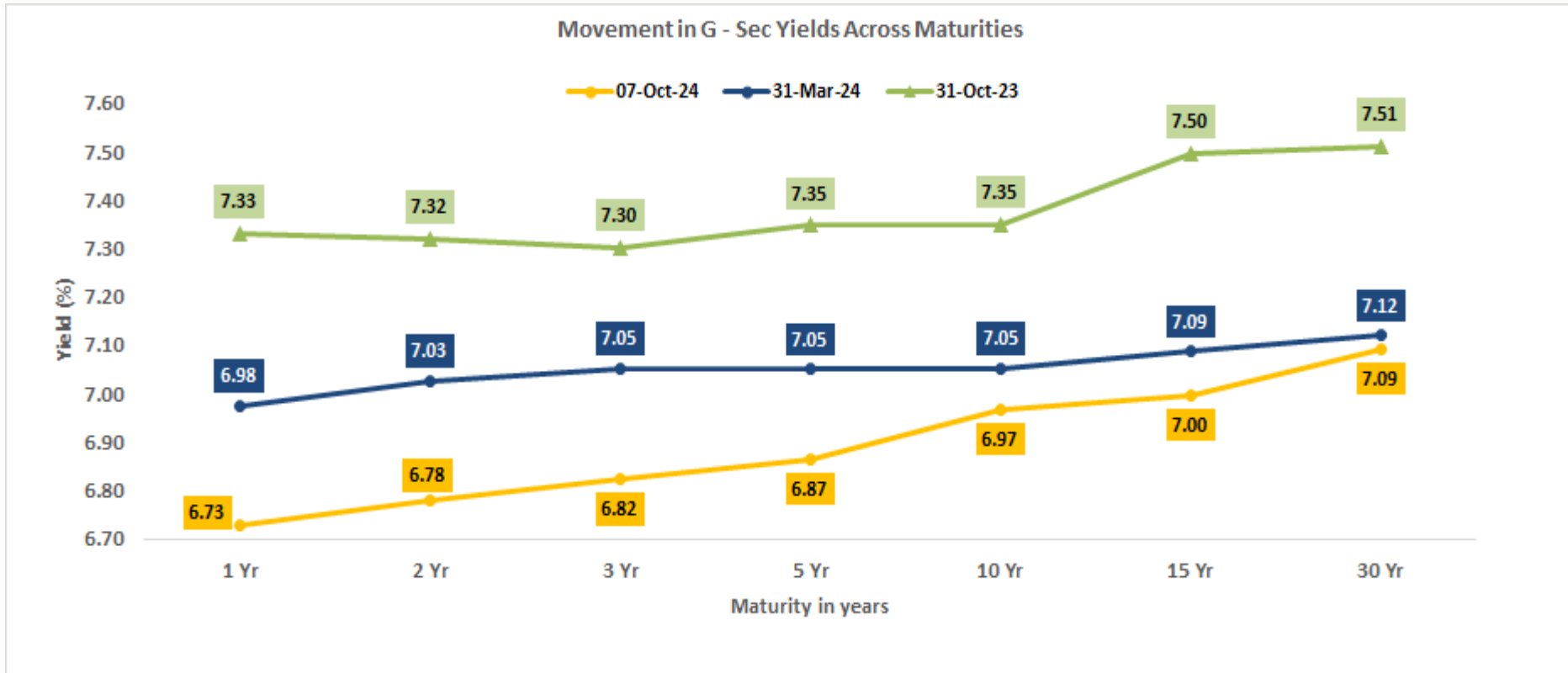
However, food inflation which is ~45% of the CPI index is still high



- RBI may remain status quo on monetary policy for most part of 2024 with the possibility of a shallow rate easing cycle at end of FY25.
- Upside risks include spike in food inflation, geo political tension, impact on crude oil prices



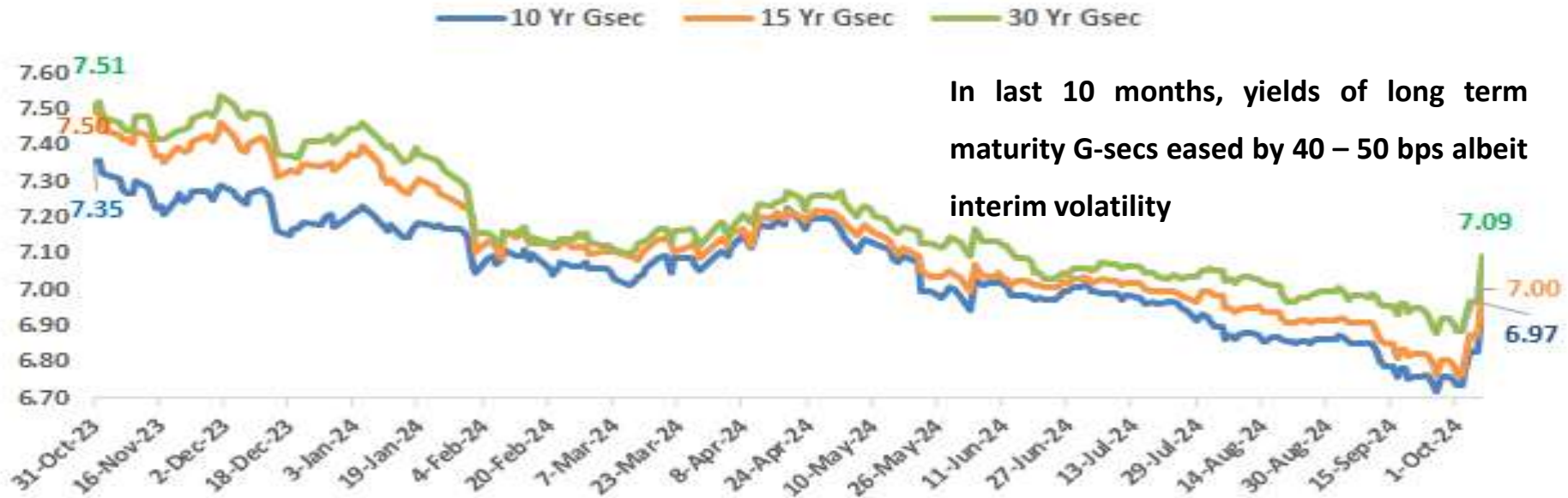
Movement in India's G-Sec Yield Curve



- ✓ Yields curve has shifted downwards and is gradually moving from a flat to a bull steepening on back of favourable demand supply dynamics and well-contained inflation
- ✓ **The short term yields are softening more than long term yields leading to increase in term spreads**



Movement in Long Maturity G Secs



Positive Factors :

- ✓ Stable Domestic Macros
- ✓ Path to Fiscal Consolidation
- ✓ Inclusion of Bonds in Global Indices
- ✓ Change in India’s Sovereign Outlook

Downside Risks :

- ✓ Rising Geopolitical tension
- ✓ Rise in Crude Oil Prices
- ✓ Mixed Global macro signals

Reiteration of our View :

- ✓ Duration bias in the fixed income portfolio so as to capitalize on the likely softening of yields in the next 1-2 years



Scenario Analysis for Investment in G –Sec MF

Net YTM	Yield movement over next 1-3 Yrs (A)	Probability	Avg Maturity (Yrs)	Modified Duration (Yrs) (B)	Capital Gain/Loss (A*B)	Accrual (Z)	Total pre tax return Z+(A*B)	Post Tax Absolute		
								39%	25%	17%
							Total post tax return (Individuals @39%)	Total post tax return (Corporates @25%)	Total post tax return (MAT Corporates @17%)	
6.97%	0.50%	Low	10.00	6.77	-3.4%	6.97%	3.59%	2.19%	2.69%	2.98%
6.97%	0.00%		10.00	6.77	0.0%	6.97%	6.97%	4.25%	5.23%	5.79%
6.97%	-0.50%	Reasonable	10.00	6.77	3.4%	6.97%	10.36%	6.32%	7.77%	8.59%
6.97%	-0.75%		10.00	6.77	5.1%	6.97%	12.05%	7.35%	9.04%	10.00%



We reiterate our view to have a duration bias in the fixed income portfolio so as to capitalize on the likely softening of yields in the next 1-2 years

- **30% of the portfolio can be invested in**
 - Actively managed duration funds to capitalize on evolving fixed income scenario
 - For passive duration allocation, one may invest in long term maturity G-sec papers to benefit from accrual income and potential MTM gains
- **30% - 35% of the portfolio can be allocated to Multi Asset Allocation funds & Equity Savings Funds**
 - These funds aim to generate enhanced returns than traditional fixed income with moderate volatility through a combination of Domestic Equity, Arbitrage, Fixed income, International Equity, Gold & other Commodities
- **To improve the overall portfolio yield, 30% – 35% of the overall fixed income portfolio** can be allocated to Private Credit strategies, REITs/InvITs & select high yield NCDs
- **For liquidity management,** investments can be made in Floating Rate (9 to 12 months) & Arbitrage Funds (3 to 6 months)





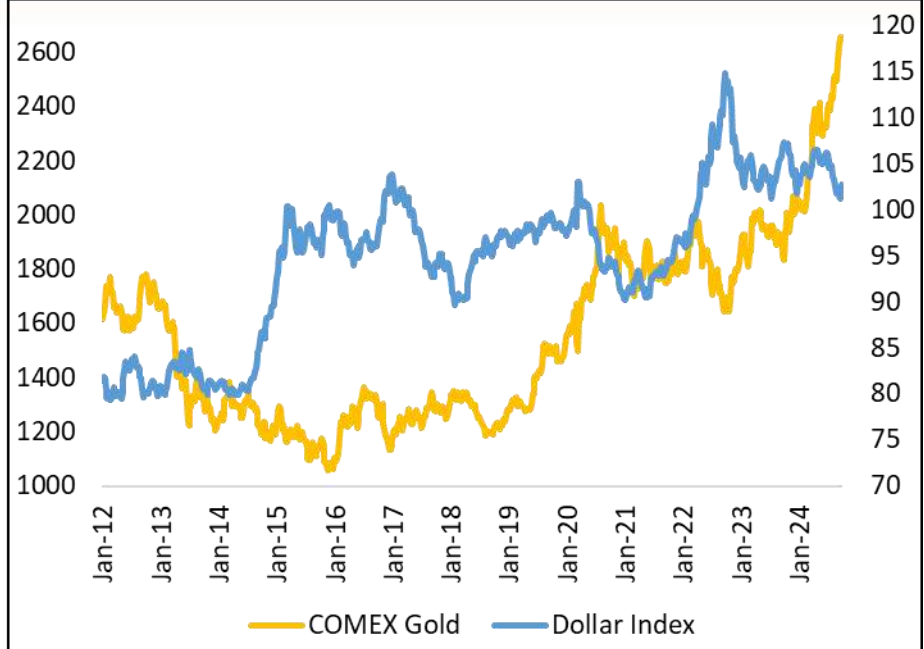
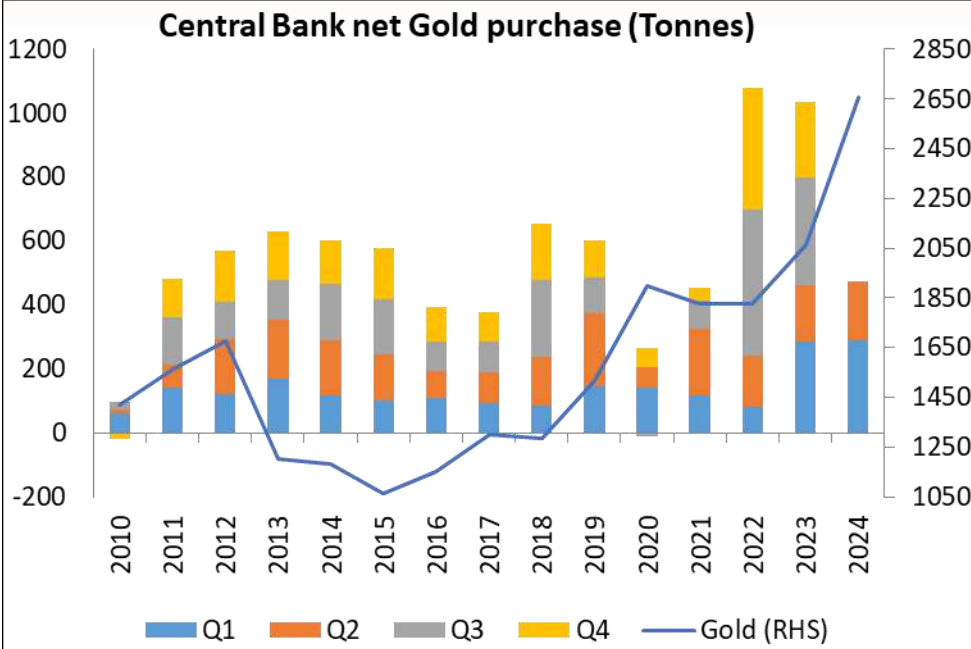
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Central Banks continue to add Gold



- Geopolitical tensions have added to the risk premium for gold, further escalating tensions could continue to boost safe haven appeal.
- Central bank buying, festive and wedding-related domestic demand could boost sentiments.
- Over the next 2 Years, gold could be on track to hit fresh highs in the next couple of years.



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