



August 5, 2022

Investment Strategy

Put pivot

The US FOMC meeting was the highlight of July 2022, where the US Fed chair, Jerome Powell, emphatically denied that the US was in a recession despite two successive quarters of GDP contraction. The Fed raised rates by 75 bps, in line with market expectations, and guided that they would be data-dependent for future hikes. The Fed appears committed to hiking through into 2023, although they could potentially reduce the magnitude of each hike in the future. While the markets are pricing in rate cuts as early as Feb 2023, the Fed playbook may not mirror that from 2009-21. Inflation is the Fed's top concern, and the Fed will trade growth for it until inflation is firmly closer to the target rate.

The jury on whether this is a technical or an actual recession is still out since unemployment levels are quite low. However, unemployment is a lagging indicator. Employment data is softening (although nowhere near weak). Amazon, the third highest employer in the US after the government and Walmart, has been reducing its headcount.



Source: Amazon

Microsoft, Apple, and Facebook, among others, have warned about slower hiring/hiring freezes in the future.

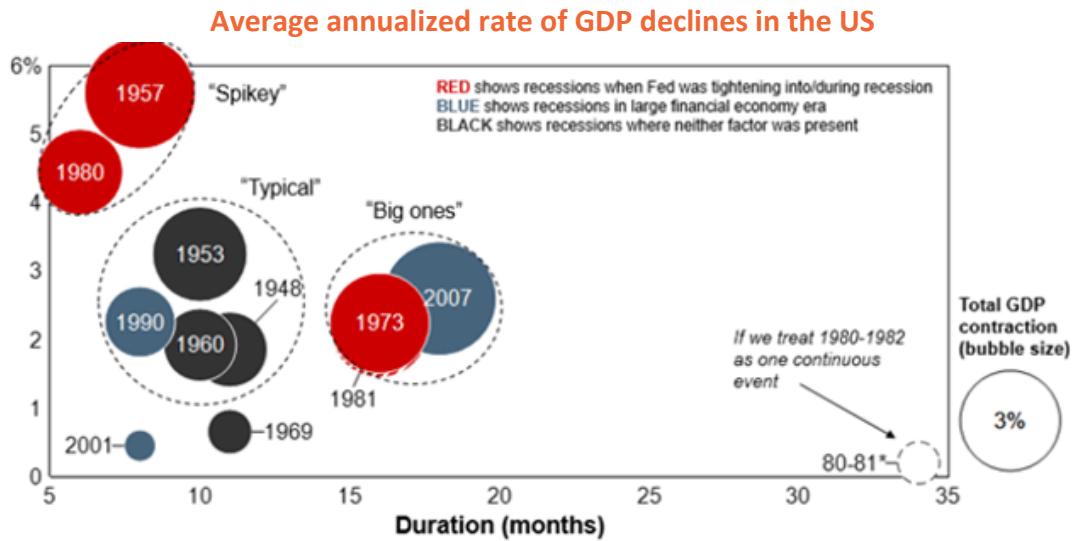
We mentioned in our previous commentary that assessing the recession's depth and the length is the next essential step. In these early stages, lower unemployment is cushioning demand destruction. But Walmart's earnings, a bellwether of retail spending, show that people are spending more on fuel and food and lower on discretionary items to deal with inflation.

Nominal vs real grocery consumption



Source: MorganStanley

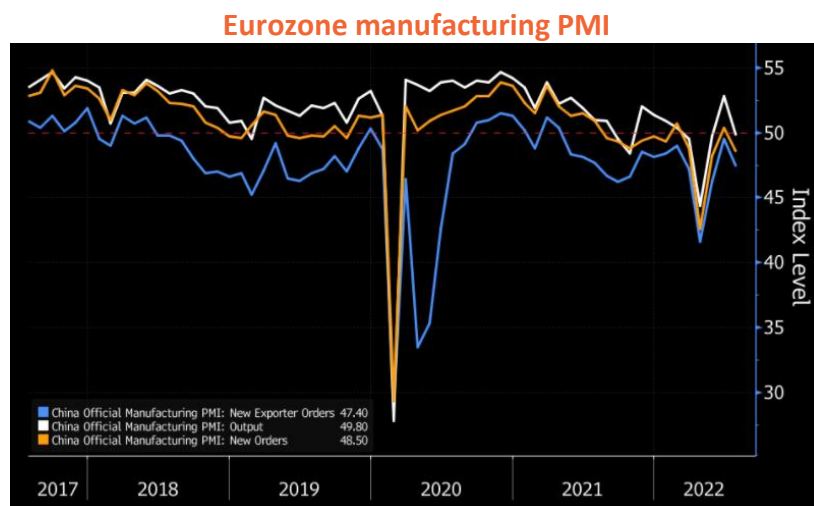
For a consumer-driven economy such as the US, eroding wealth effect as equities and housing markets correct, lower spending power as wage increases fall short of inflation, and interest rate hikes could mean a deeper recession.



Source: Bain Macro Trends Group, Mauldin economics

China shocked the world with a manufacturing PMI contraction. There were expectations of a rebound post the opening up after the latest covid wave but clearly, the zero covid policy continues to dissuade firms from investing, borrowing or hiring. A deepening property slump and weakening economic activity trend don't bode well for China's GDP growth.

Eurozone woes continue to deepen as they are now receiving 53% less gas from Russia than it averaged before the start of the war. Manufacturing PMI slowed to a recessionary 49.8 in July vs 52.1 in June. The ECB delivered a surprise hike of 50 bps, the first in 11 years, as they too attempt to rein in inflation.



Source: NBS

In contrast to the economic news flow, global equity markets rallied in July. Over 250 S&P 500 companies have reported earnings, of which more than half have beaten earnings estimates. These results, combined with the hope of rate cuts in 2023, helped markets rally.

Data as of 31 st July 2022	1 Week	1 Month	CY 2022	1 Year
NSE Nifty 50 Index	2.6%	8.9%	-0.2%	10.2%
MSCI Emerging Markets Index	-0.4%	-0.3%	-14.0%	-17.2%
S&P 500 INDEX	3.5%	9.6%	-6.8%	1.6%
NASDAQ Composite Index	3.9%	12.8%	-15.2%	-9.4%

Source: Morningstar, Sanctum Wealth

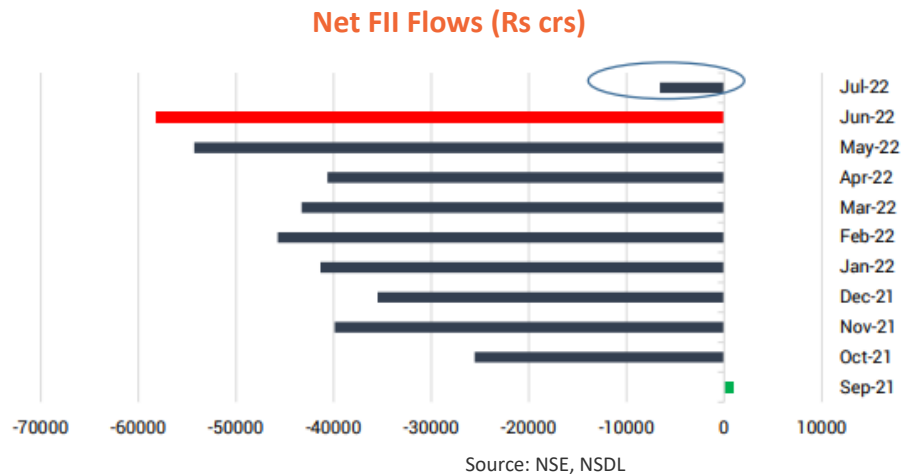
Please note the above returns are total returns in INR terms.

India

India continues to surprise positively. A correction in commodity (soft and hard excluding oil) has been a relief. The latest release of GST collections came in at the second highest ever, and this is the fifth consecutive month of GST collections over Rs 1.40 lakh crores. Bank credit offtake is picking up across segments (industry, services, retail and agriculture), and credit disbursement to the industry has been the highest in seven years. Manufacturing PMI for July is at an 8-month high, and new order intake also remains strong. Unlike some of its Asian peers, India appears to be holding up well in the face of a slowing global economy and a weaker currency.

Corporate earnings season is underway, and thus far, the results have largely been in line with expectations. About 230 out of the NSE 500 index have declared their results. Topline growth remains robust, with almost 80% of the companies that have reported results thus far beating Bloomberg consensus estimates of net sales. On average, Net sales for these companies grew close to 40% YoY. However, as expected, margins have been under pressure, and more than half the companies have seen a YoY decline in EBITDA margin. This margin compression has resulted in companies delivering lower than expected profits after tax. Only about 55% of companies have beaten Bloomberg consensus estimates of profit after tax. With input costs softening, margins should improve in a couple of quarters in our view. Management commentaries have been somewhat cautious with an optimistic slant. A higher base effect will kick in the next quarter, but estimates should factor it.

Indian equities taking cues from global markets, rallied sharply – the nifty delivering over 8% gains. FIIs selling receded the most in 10 months.



Fixed Income

In line with market expectation and sync with global rate cycle, the MPC (monetary policy committee) raised repo rates by another 50bps to 5.4% in the August 2022 monetary policy. The RBI kept both inflation and growth forecasts for FY23 unchanged at 6.7% and 7.2%, respectively. It also re-iterated its focus on withdrawal of accommodation and normalization of monetary policy. The RBI highlighted that India is better placed relative to the rest of the world and the Indian currency has been resilient compared to other Asian peers even as it had depreciated relative to the US dollar. The 10-year government bond yield was up about 9bps to 7.25% at the time of writing this report. We believe this could be the last/penultimate 50bps rate hike in the current cycle.

Outlook

As mentioned above and highlighted in our previous commentaries, India is better placed compared to the rest of the world but is not immune to volatility emanating from global factors. We think this could create opportunities for local investors. In our July commentary, we mentioned investors should add equity exposure in small steps of 50bps over the next three months. We suggest investors continue with this for now.

The RBI policy was in line with our expectations and hence our fixed income remains unchanged. We continue to like the 4–6-year part of the yield curve. But would like to take this exposure via SDLs and government securities as corporate bond spreads are very narrow.

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