Sanctum Wealth

Sanctum View

May 15, 2024

Investment Strategy

- **Fed almost rules out a rate hike; the market still expects two rate cuts, starting September 2024.**
- **Geopolitical tensions escalated in the Middle East in April but now seem to have stabilized.**
- **India’s PMIs are near all-time high, underscoring its economic resilience.**
- **Q4FY24 earnings of Indian companies are broadly in line with expectations thus far.**
- **Gold can serve as a hedge against any resurgence of geopolitical tensions or inflation.**

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Back to Square One

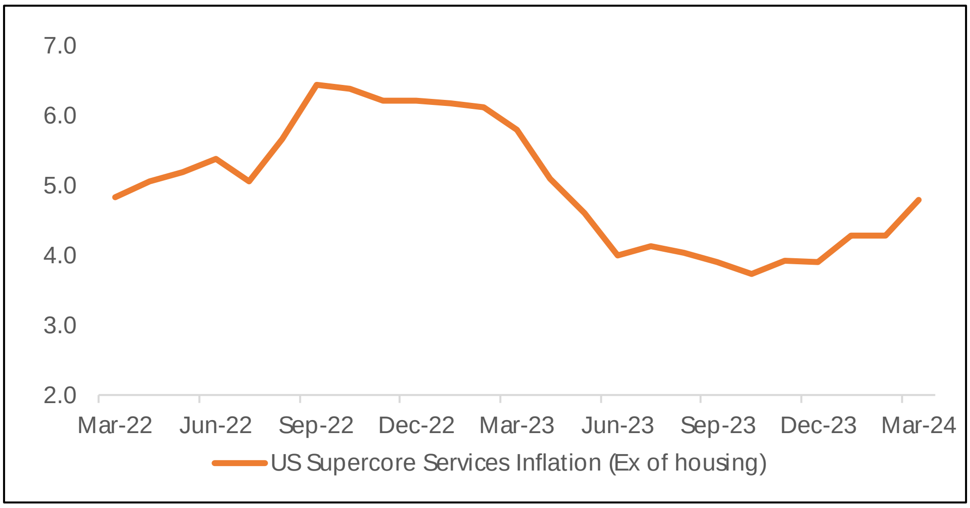
Last month, the world was on tenterhooks as geopolitical tensions in the Middle East flared up. Iran and Israel came very close to what could have been a messy conflict. However, it seems like both have taken the high road, and now the world can breathe again. Meanwhile, resilience in US inflation ignited fears of a possible rate hike; however, Fed comments and recent data suggest hikes seem highly unlikely. The market expects the Fed to cut rates later this year and foresees inflation cooling down to more comfortable levels soon. Whether it is wishful thinking or if the inflation concerns materialise, we will know soon.

The general election in India is being labelled as one of the most boring, with the outcome seemingly known. Whether it will indeed be a non-event or if there's a surprise in store will become evident on June 4th. Meanwhile, Indian continues to stand out as one of the strongest economies globally.

Global Macro Update

In the first quarter of 2024, several US inflation indicators exceeded expectations, triggering concerns about a potential rate hike. However, these concerns abated with the release of the recent employment report, which was weaker than anticipated. In April, only 175,000 new jobs were added to the US economy, falling short of the projected 240,000, and wage growth was also lower than anticipated. Additionally, following the recent FOMC meeting, Fed Chair Powell emphasized that the next policy rate move is unlikely to be a hike. However, he stressed the need for 'greater confidence' in inflation declining toward the 2% target before considering rate cuts.

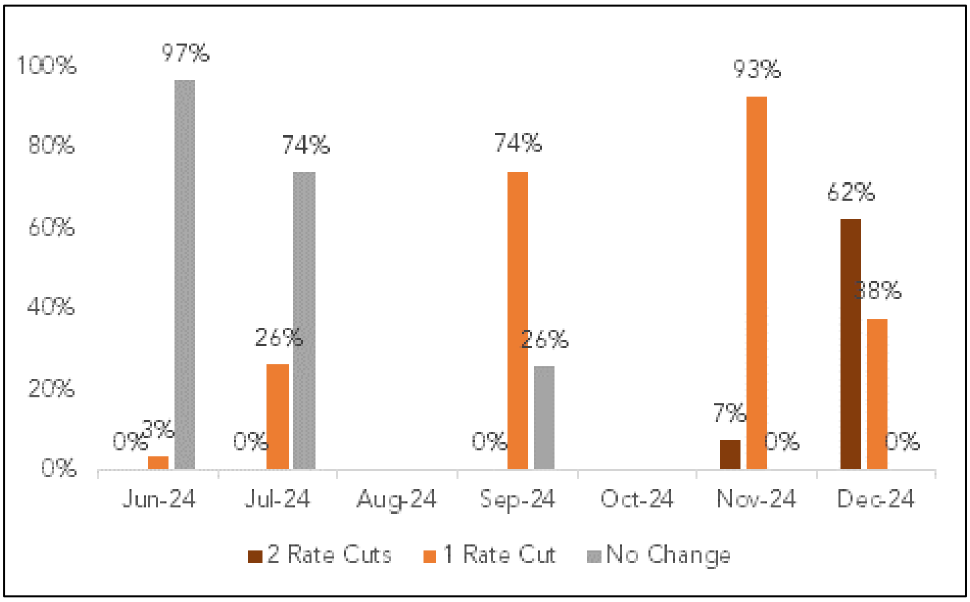
US Supercore services inflation on the rise



Source: Bloomberg, Sanctum Wealth

Consensus forecasts suggest that inflation may be beginning to taper off again after the rebound seen in Q1. Consequently, the market is still pricing in two potential rate cuts for this year, but now starting in September 2024 rather than July 2024. The April inflation data are likely to be closely monitored to confirm the trend of moderating inflation.

Fed Rate Cut Expectations



Source: CME FedWatch Tool, Sanctum Wealth

In the past few years, consumption has been the primary driver of economic activity in the US. However, recent indicators such as an increase in initial jobless claims, slower growth in average hourly earnings, and a moderation in manufacturing and services PMI, coupled with the weaker-than-expected employment report, suggest a potential slowdown in US consumption. This slowdown was further evident in the disappointing Q1 2024 US GDP growth, which stood at 1.6% compared to market estimates of 3%. Lower government spending also contributed to this reduced GDP growth, alongside slower household spending. While it's important not to assess these data points in isolation, we will monitor them closely for emerging trends.

US growth and inflation outlook remain murky, with no distinct trends visible. However, they remain pivotal, not only in shaping US Fed policy path but also in influencing the global market outlook. Currently, the market is pricing in a “Goldilocks” environment where growth is steady, and inflation is moderate. A surprise in either area could have significant implications for the market.

China’s GDP growth in Q1 2024 rebounded to 5.3%, exceeding analyst expectations. It appears that a slew of policy measures implemented over the past year are starting to bear fruit. However, March retail sales and industrial output were lower than anticipated, suggesting that the recovery is still very nascent. Challenges persist in the property sector, with concerns over rising local debt and sluggish consumer spending weighing on the Chinese economy. As highlighted previously, the recovery is likely to be gradual and arduous, requiring continuous support from policymakers.

Growth remains below trend in Europe while inflation is slowing down. High interest rates and tight lending conditions are key headwinds for the region. The German economy, the largest in Europe, is headed for a technical recession amid subdued industrial production. Higher energy cost and the transition to green energy are also structural factors impacting German economy. The French economy is flat, while Italy is barely positive. With slow growth, inflation is likely to cool further, thus paving the way for ECB to cut rates, probably before the Fed.

In April, tensions surged in the Middle East as Iran accused Israel of bombing its embassy in Damascus, Syria. This accusation was followed by Iran's missile and drone attacks on Israel, prompting Israel to retaliate with its own strike on Iran. Fortunately, Iran downplayed the severity of Israel's response, which helped to ease tensions. As of now, the situation appears to be stabilized. However, this incident clearly highlights how quickly geopolitical tensions can escalate. Geopolitical instability remains a significant concern, especially given the ongoing conflicts in Israel-Hamas and Russia-Ukraine.

Global Market Update

Global equity momentum moderated in April after a strong first quarter, primarily driven by concerns about higher-for-longer rates. However, with the expectation of a return to a “Goldilocks” scenario, global equity markets rallied in the first week of May. Therefore, the trend in inflation is likely to be a key driver of equity markets in the near-term.

Performance as of 30-Apr-24	1 Month	CYTD	1 Year
Nifty 50 Index	1.2%	4.0%	25.1%
S&P 500 Index	-4.2%	5.6%	20.8%
Nasdaq 100 Index	-4.5%	3.7%	31.7%
Nikkei 225 Index	-4.9%	14.8%	33.1%
Shanghai Composite	2.1%	4.4%	-6.6%
MSCI ACWI Index	-3.4%	4.1%	15.5%
MSCI EM Index	0.3%	2.2%	7.1%
Gold (USD/Oz)	2.5%	10.8%	14.9%
DXY (Dollar) Index	1.7%	4.8%	4.5%
US 10 Yr Benchmark Yield	11.4%	20.6%	36.8%

Source: Bloomberg, Sanctum Wealth
Above returns are price returns in local currency terms

Chinese equities outperformed global markets driven by record inflows from foreign investors in April. Most investors are significantly underweight China, and research firms are only just beginning to recommend Chinese equities. Valuations are at a discount to the long-term average. Further, Chinese companies are increasing share buybacks and dividends to improve cash return to shareholders. Hence, with signs of some stability in the economy, the attractiveness of Chinese equities to global investors could increase.

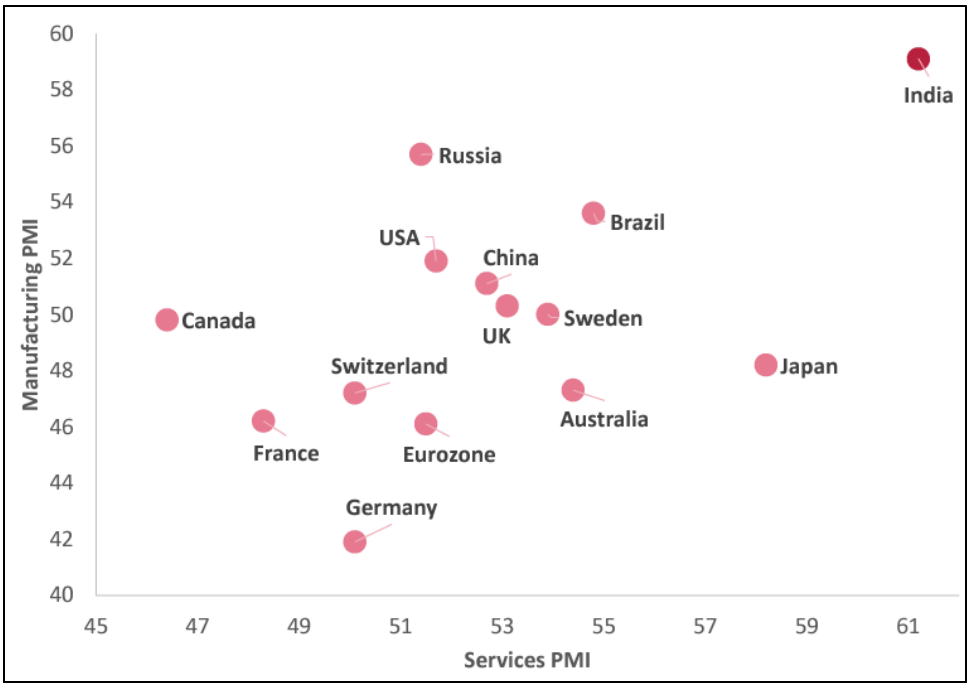
Chinese equities just starting to get traction

Source: Bloomberg, Sanctum Wealth

India Macro Update

After achieving record PMIs in March, both India's Manufacturing and Services PMIs experienced a slight decline but maintained healthy levels, coming in at 58.8 and 60.8 respectively. Despite global PMIs moderating, India's PMIs have remained robust over the past year. While urban demand in India continued to show strength, there were concerns regarding rural demand. However, in a promising development, rural demand for consumer staples surpassed urban demand for the first time in five quarters last quarter. Additionally, auto sales were stronger in rural areas compared to urban areas. The monsoon outlook for this year also seems favourable with current projections of slightly above the long-term average rainfall with good spatial distribution. These trends suggest that a potential recovery in rural India may be underway following several sluggish quarters.

India's PMIs highlights the economy's resilience



Source: DSP's Tathya April 2024
PMI data as of March 2024

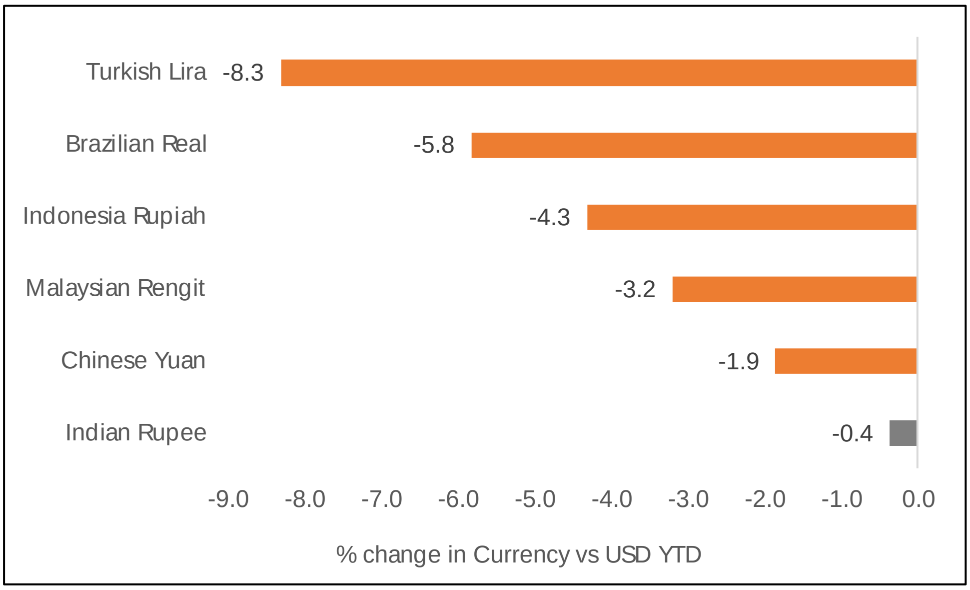
A significant contributor to Indian economic growth has been government capex. However, with fiscal deficit consolidation underway, the government may have limited headroom to further increase government capex. Hence, private capex needs to pick up the baton. The robust health of Indian corporations suggests that as demand increases and capacity utilization improves, private capex should naturally follow suit.

In India, inflation appears to be under control. Core inflation (excluding food and fuel) dropped to 3.27% in March 2024 and continues its downward trend. A year ago, core inflation was around 6%. However, food inflation saw a surge in March, driven by vegetable prices. The RBI typically overlooks food inflation as it tends to be temporary. While overall inflation is contained, as highlighted earlier, we believe the RBI is likely to cut interest rates primarily in response to the Fed's actions and to safeguard the INR. Therefore, any rate cuts might still be a few months away.

Crude oil prices have moderated as the geopolitical tensions in Middle East seems contained for now. However, any escalation in geopolitical tensions and subsequent impact on oil prices are key risks for the Indian economy.

India's superior macroeconomic strength, along with large FX reserves, has helped the INR withstand dollar strength. INR volatility is the lowest amongst other EM peers. The INR has remained rangebound between 82-84 for a while now, even as the dollar index (DXY) has gained more than 3% this calendar year.

Indian Rupee has been one of the strongest currency in EM



Source: Bloomberg, Sanctum Wealth

India Market Outlook

Indian equities ended last month with modest gains despite a slowdown in global equity momentum. Although foreign investors were net sellers, DII buying more than offset FII selling. Mid and small-cap equities rebounded from their March lows and touched new all-time highs. Nearly all sectors, except healthcare and IT, yielded positive returns. The rally was led by the metals sector, with public sector banks and public sector enterprises (PSEs) maintaining robust momentum.

Performance as of 30-Apr-24	1 Month	CYTD
Nifty 50	1.20%	4.00%
Nifty Next 50	7.10%	21.70%
Nifty Midcap 100	5.80%	10.10%
Nifty Smallcap 100	11.40%	12.30%
Nifty Bank	4.80%	2.30%
Nifty PSU Bank	8.50%	33.10%
Nifty Metal	11.10%	15.00%
Nifty Healthcare	-0.70%	12.60%
Nifty IT	-4.90%	-6.50%

Source: Bloomberg, Sanctum Wealth
Above returns are price returns

More than half of Nifty companies have reported their Q4FY24 earnings results. Results have broadly been in line with expectations. Sales and PAT growth have both shown double-digit growth among the reporting companies. EPS forecasts for FY25 and FY26 remain stable. The auto and infrastructure/industrial sectors have seen upgrades, while the financial and IT sectors witnessed some downgrades.

General election voting has commenced, with many viewing this election as a 'done deal'. Consequently, any unexpected outcome where the incumbent BJP fails to secure a majority could significantly affect market sentiment.

Equity Outlook

In the near term, Indian equities are expected to be driven by global economic data and ongoing earnings results. While Indian economic strength and stability are well-known, equity valuations remain elevated. Large-cap stocks are trading slightly above long-term averages, while mid and small-cap stocks are trading at significant premiums. This reaffirms our preference for large-cap stocks over mid and small-caps. Additionally, inflows into mid and small-cap mutual funds have slowed down. Although there was a brief period of negative net flows into small-cap funds in March, the situation improved in April as small-cap stocks rebounded.

We re-iterate the importance of revisiting your long-term asset allocation, staggering fresh entry into equities, and overweighting large caps over mid and small caps.

Fixed Income Outlook

Indian bond yields continue to mimic global bond yields, albeit with much lower volatility compared to global peers. The actions of the Fed and global bond yield movements are likely to remain key drivers for Indian bond yields going forward as well. Despite FPI inflows resulting from bond index inclusion, a 2% dip in SLR (Statutory Liquidity Ratio) of banks has more than offset these gains. SLR represents the portion of assets banks must hold in liquid government bonds. Future reductions in SLR are likely to be constrained by regulatory requirements, while anticipated FPI inflows from bond inclusion are expected to be substantial.

Hence, we maintain a positive outlook on Indian bonds and suggest adding some duration to the portfolio, anticipating a decline in bond yields as interest rate cuts become more apparent. However, short-term volatility may persist, influenced by developments related to potential Fed actions.

Gold Outlook

INR gold prices touched new all-time highs amid escalating geopolitical tensions in the Middle East. Subsequently, as the situation in the region stabilized, gold prices have become range-bound. From a technical perspective, gold faces multiple resistance levels and hence may remain range-bound in the short term. However, gold remains a prudent option given its role as a portfolio hedge. INR gold serves as a hedge against both the potential escalation of geopolitical tensions and the resurgence of inflation, both of which pose significant risks to equity markets. Therefore, incorporating gold into portfolios can help protect against these uncertainties.

As always, following the conclusion of the earnings season, we will reevaluate our stance on various asset classes using our proprietary asset pair model.

Sanctum Wealth

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