

INDIAN MARKET OUTLOOK 2023 AND BEYOND





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INDIA: STANDING TALL AMIDST UNCERTAINTY

The year 2022 has been a rough ride, beginning with the Russian-Ukraine conflict, world inflation hitting the roof and forcing Central bankers to jack up rates, at a pace not seen in decades, massive currency swings, fall of several crypto companies and meltdown in platform business-based stocks. And yet, after a strong downward reaction by mid of the year, Indian equities have retested their previous high.

When we assess what lies ahead, in the present world situation, it is important to gauge the strength of the foundation, or the lack of it. This assessment tells you whether there is margin of safety from any further shocks or can we fall into a long depression and bear market. As we inch closer to the new year 2023, we draw reassuring comfort in the fact that the world isn't in a 2008-like global financial turmoil.

It is clear and evident that both in the US and in India, there is neither a banking bubble nor a property bubble. Moreover, Indian corporate balance sheets are extremely healthy. The foundations are robust enough in the absence of any excesses across the board. It is pertinent to note that demand is not an issue, we are rather witnessing a blockage of the existing supply.

The existing situation is nowhere near the stagflation that doomsday advocates are constantly predicting for India and the world. Unlike popular perception, we choose to see stagflation as a function of high inflation and high unemployment and not high inflation and no growth. Given that unemployment is extremely low across the globe, we see little reason for anxiety.

Talking of **world inflation**, we see it peak out for sure, but expect it to remain elevated for a couple of years. When we attended the LME conference in London this year, Chinese participants hinted at a positive surprise from China in 2023, following the end of strict Covid lockdowns. Consequently, a lot of supply can return from China and its market share in global trade will likely be reinstated. Supply will partly and gradually come onstream, which was blocked due to Covid-related disruption. US workers, for instance, are not yet back to pre-Covid. With them returning, inflation would be tamed further. Already, shipping rates are easing out.

In the US, rate hikes are helping tame inflation and inflation expectations. Since mortgage rates have moved up to 6.5%, housing prices are falling, and so are rental yields. US inflation will fall sharply next year as the Commercial rental Index shows a fall in housing rents, a major component of CPI. US goods inflation has peaked, and US cotton prices have plummeted. The second-hand car index has dropped, signalling the abating of supply-side pressures.

In the US, inflation is also up due to heavy travelling! This is a discretionary expense, which amply shows that internals are not weak. High base effect will further help upcoming inflation numbers. Fortunately, Europe may not have to endure a severe winter this time, and their energy inventory is now at 91% vs the seasonal average of 80%.

Global Agricultural prices are at pre-war levels; Industrial commodities are cooling down; Speculators are the least bullish on industrial commodities

Having said that, inflation will stay elevated for a couple of years given that new capacities will take a while to replace the old. Also, the Russia-Ukraine war will continue to disrupt the supply of select items like semiconductors, wheat, sunflower oil, fertilizer, and energy.

Coming to the much talked about **interest rate cycle**, we see central Banks take a pause on rates soon. Up until February 2022, the Fed was supporting its economy and didn't raise rates, even though inflation was rising. In our view, it is not overdoing the rate hike cycle but rather only 'right-doing' it. As inflation cools off, it will pause after another 50-75bps and start cutting rates in late 2023 or early 2024, to support its economy again. RBI will not necessarily raise rates to curb inflation, but more to partly match Fed raising rates; India's inflation internals are better placed. We see a 0-25 bps hike by RBI to 6.25-6.50% Repo level. China and Japan are supporting their economies with an easy monetary policy, and governments are offering stimuli through lower-than-planned QT, infrastructure spending, and loan guarantees, among others.

Talking of **FII flows to India**, we expect them to resume as Bonds and INR stabilize. We've already seen among the worst outflows by FIIs from India, as a percentage of market cap, by June of 2022. This magnitude of outflow was as close to the 2008 situation. India has been an outlier in the last 5 years with maximum FII inflow among all EMs, which is why it saw a higher outflow in 2022. We expect FIIs to return to India as bond markets and INR are stabilizing. Already, FIIs have started buying in fag-end 2022. We strongly believe that the Dollar index has peaked. With the rate hike cycle drawing to a close, the Fed's tapering will be offset by falling share in world transactions, China paring US treasuries and US's high budget deficit, and certain countries trying to conduct trade in their local currencies. The INR has also bottomed, as inflation is far more under control than in the US; real rates are better than in the US, and higher CAD is factored in these levels.

In what is clearly one of the most heartening attributes of India, **Indian equities have shown remarkable resilience.**

India's resilience to global turbulence is amply manifested in its outperformance. Notwithstanding near-term corrections, India's market structure appears attractive. Retail participation has moderated even as the market has risen, evident through a big YoY drop in Demat account openings in the last few months. This suggests that the market is not in an overheated zone. Heavyweight stocks like RIL, Banks and IT Services, look attractive. Though the gap between risk-free returns and equity-earnings yield has widened, the spread is confined within the historical average. Liquidity conditions remain strong, characterized by healthy retail inflows and more skin in the game by domestic institutions.

Our study suggests that Nifty tends to move to a new high over the next 12 months when prior all-time highs are breached, preceded by at least nine months of consolidation. Interestingly, the majority of such breakouts occur in November-December, and we are discernibly on the cusp of a Déjà vu. Markets tend to be sector-agnostic during such breakouts; however, mid-cap and small-caps tend to do much better than the Nifty.

India clearly holds a concrete advantage over other markets, in terms of higher GDP growth driven by government investments, a strong foundation of digital infra, energy transition, peaking inflation and superior inflation internals, strong balance sheets of corporate India, well-capitalized BFSI sector, and a stable property market.

Summing up, **India stands tall in an uncertain world.** While our manufacturing base will substantially gain from production-linked incentives and global re-shoring, we also expect Household Consumption to move up to Rs191trn by FY26, in what would be a remarkable 46% jump over FY22 levels. Needless to say, household savings at 19% of GDP will leave a sizable quantum of disposable income to be spent on consumption. All these markers point to the solidity, credibility, and sustainability of the India story going forward, which in turn will lift and sustain market sentiments in full measure.

Regards,

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