DEZERV

Markets Down by 10% from the Peak: What Lies Ahead?

20th Nov 2024

Executive summary

Current market situation:

The market (Nifty 50) reached an all-time high on 26th September 2024 and has been going down continuously. The correction of roughly 10% in the market over the last 45 days is primarily due to the following two reasons -

- Indian companies' earnings slowed compared to expectations. This quarter was the slowest in the last four years.
- FIIs continue to sell their Indian equity positions aggressively. Over the last 45 days, we have seen outflows of $15 billion.

Long-term outlook - Bullish:

We believe that the slow earnings growth is a temporary phenomenon as macro factors of the Indian economy remain strong:

- Factors like forex reserves, current account deficit and fiscal deficit look favourable along with potential for rate cut
- Resumption of government led Capex spending which saw a temporary dip due to general elections
- The long-term consumption trends show discretionary spending increasing across urban, semi-urban and rural areas, even though there may be small pockets of stress in urban markets.

Given the strength of the macro-economy and consumption, we remain bullish on the mid and long-term prospects.

Short-term outlook - Cautious:

In the short-term, we should expect volatility, even a further correction in the markets, due to the following significant reasons:

- The uncertainties around the timing and extent of rate cuts by RBI and FED
- Uncertainty around policy changes in the upcoming budget
- The US Dollar may perform strongly against the Rupee under the new Trump administration.

As these factors play out in the next few months, we expect the market to provide multiple investment opportunities at favourable entry valuations.

Dezerv's View

Given the current market scenario, here are our views:

A. Equity portfolio managed by Dezerv PMS

Dezerv's equity portfolio is positioned well to be resilient, and you need to stay invested to generate outperformance in the long run. Over the last year, we have aligned our portfolio to be large-cap heavy due to reasonable valuations. Large-cap indices are now trading at ~ 8% discount compared to their 5-year historic P/E, while mid and small-cap indices are trading at a significant premium to their 5-year historic median levels. We will monitor the markets actively and switch across market caps whenever the right opportunity arises from a valuation perspective.

B. External portfolio

We recommend that clients review their external portfolio holdings and move to segments of the markets where valuations are reasonable. You may contact your Client Financial Partner to execute this.

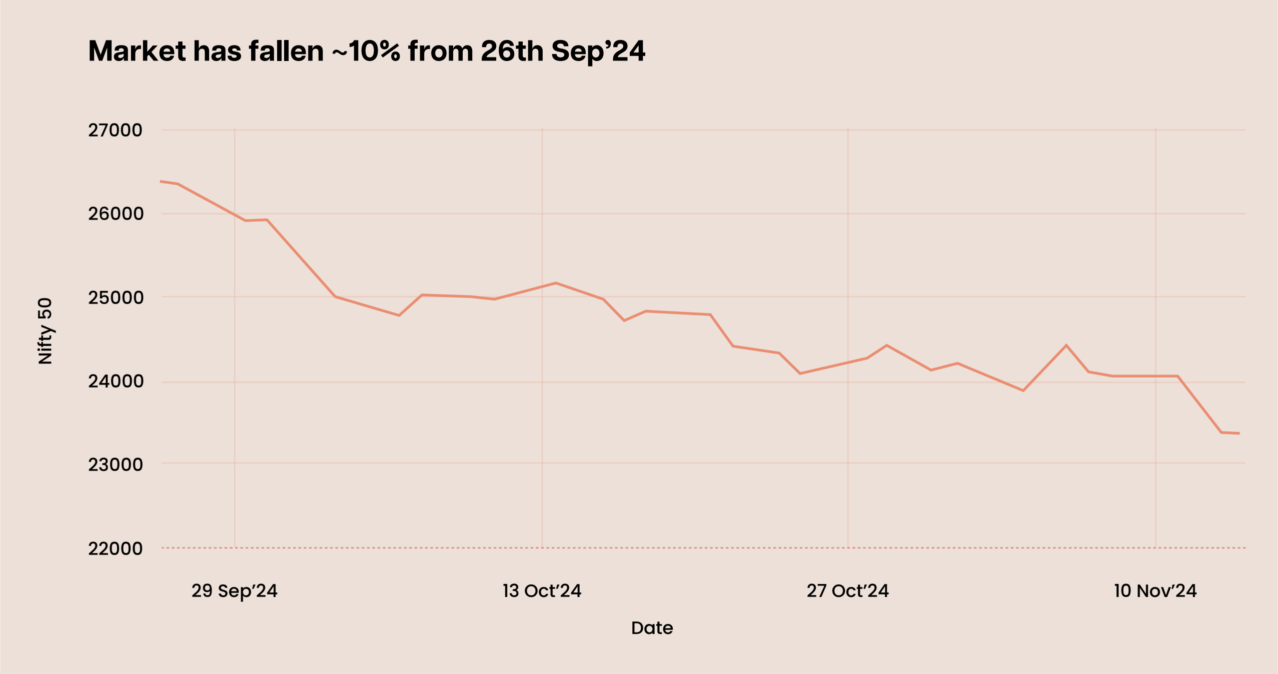
C. New cash deployment

Given the recent dip in the market in combination with the uncertainty around the results of the US elections being behind us, we recommend investors deploy 40% of lumpsum investment (instead of the earlier recommendation of 25% lumpsum) and stagger the balance in 8 instalments over 4 months so that we can take advantage of volatility. In addition, you should look at increasing SIP or starting SIP in an Equity Portfolio to take advantage of the down cycle in the market.

In the following note, we will provide a detailed analysis of the long-term and short-term factors impacting the market and substantiate our view.

SECTION 1

Current market scenario



Last month, our markets experienced their sharpest decline in over 30 months. In our note dated 27 October 2024, we addressed this correction with our views on how investors should react. Since then, the markets have fallen further by ~ 2.5% across all key indices. This adds up to ~ 10% correction in the last 2 months. Broadly, the fall has been due to 2 key factors that we covered in our previous note:

- The slowdown in corporate earnings marked the slowest growth rate observed in the past 16 quarters
- FII outflows of $15 billion over the last 45 days.

SECTION 2

Short-term outlook - Cautious

Given the current market environment, the Indian markets may fall in the short term (4-6 months) because of the following factors:

A. Uncertainty around policies of the Trump administration

Uncertainty surrounds the new Trump administration's economic and trade policies, tax reforms, and foreign policy stances. Markets may react sharply, especially to policy announcements impacting global trade or diplomatic relations.

B. Budget expectations

There is growing anticipation around policy and tax decisions in the next budget. Any changes, especially in taxes, will impact the markets in the short term.

C. Delays in interest rate cut

Inflation has crossed the RBI's upper limit of 6%, which may delay rate cuts. Since investors have been anticipating a rate cut for a long time, delayed interest rate cuts could lead to a temporary market fall.

D. Sharp Rupee depreciation

The Indian Rupee has depreciated approximately 2% in the past month, hitting an all-time low. This is primarily driven by global dollar strength, foreign fund outflows, and trade imbalances. A weaker Rupee could discourage foreign investors, slow equity inflows, and dampen market performance.

SECTION 3

Long-term outlook - Bullish

Despite recent market volatility, India's macroeconomic fundamentals remain resilient. Here are a few factors that will ensure market stability in the long term.

A. Government capex focused towards the second half of the year

Due to the general elections in the first half of the year, there was a slowdown in government spending, and we expect a more significant portion of government spending to occur in the second half of the year.

Only 44% of the INR 11.11 lakh crore allocated for capex was utilised by September, compared to over 50% last year. The government remains confident of achieving its full-year target.

B. Favourable macros: rising forex reserves, stable current account deficit, and improving fiscal management

I. India’s forex reserves soar to a peak

India's forex reserves stood at $675.7 billion as of November 8, 2024, 40% higher than pre-COVID levels. These reserves strengthen India's resilience to global shocks, support currency stability, and enhance long-term economic growth potential.

II. Current account deficit:

The Current Account Deficit (CAD) shows no signs of stress and has stayed within a stable range. The CAD has remained close to its long-term average, indicating that external sector pressures are manageable.

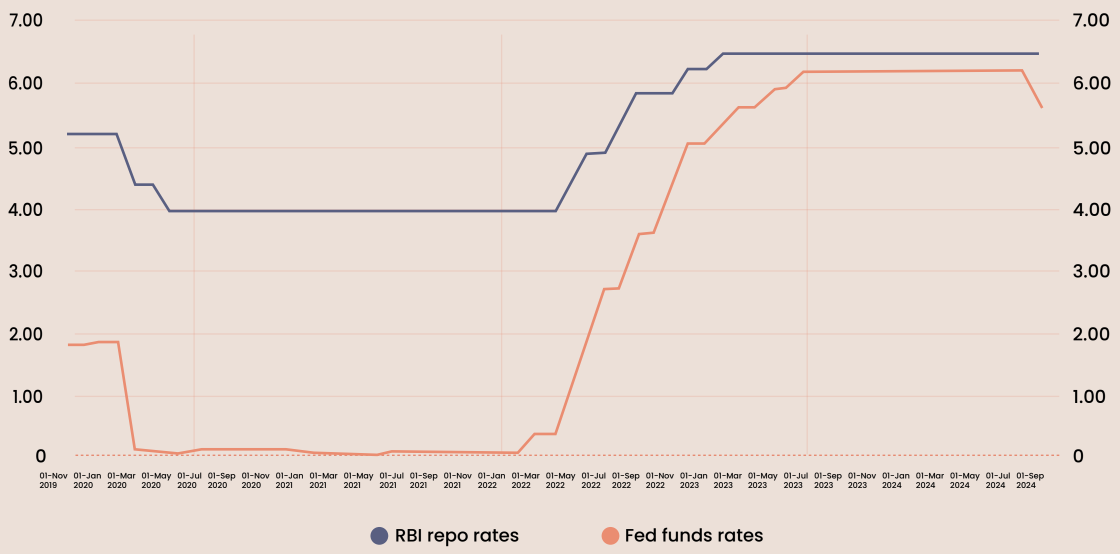
III. Fiscal deficit as a percentage of GDP

The fiscal deficit for FY 2023-24 was 5.63% of GDP, slightly lower than the revised estimate of 5.8%. The central government's fiscal deficit target is 4.9% of GDP for 2024-25. A lower fiscal deficit indicates disciplined spending, reduces inflationary pressures, and supports private investment, fostering long-term economic growth.

C. Room for interest rate cut; timing hinges on inflation

With the recent Fed rate cut, a rate cut in India is also inevitable, positively impacting equity markets. However, the RBI may delay interest rate cuts due to high inflation.

Similar trend in rates set by Fed and RBI



D. Rural consumption growth seems evident post-monsoon [1, 2, 3]

This year's rainfall reached 109% of the long-period average, the third-highest since 1994, boosting Kharif crop production and rural consumption as food inflation eases.

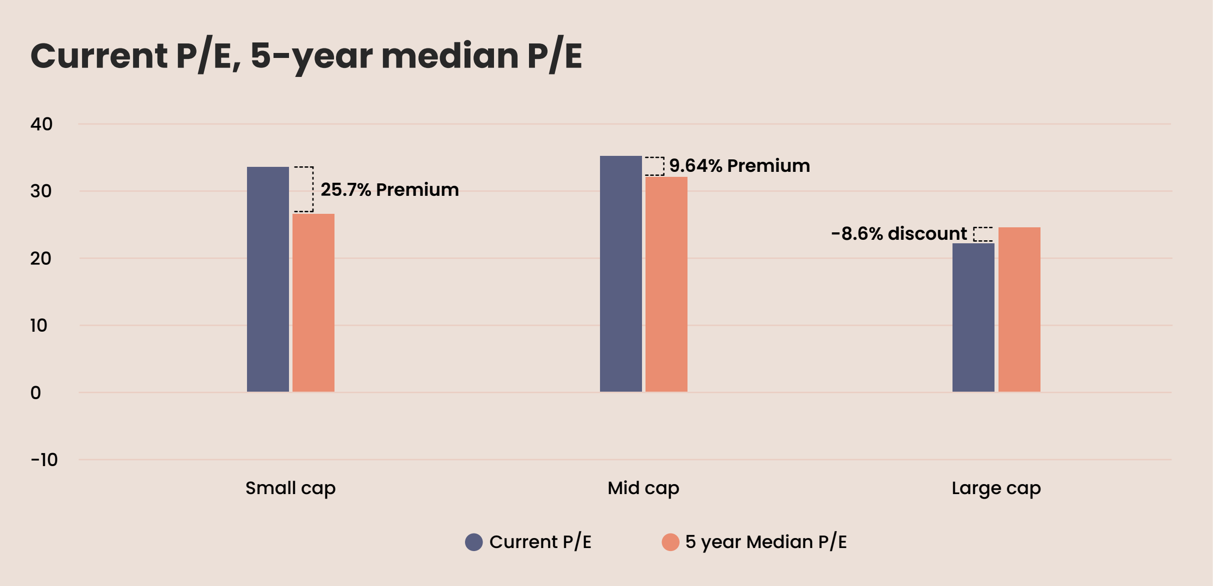
This uptick is reflected in festive spending, with Amazon India reporting 70% of Prime shoppers from Tier II and III cities and Meesho seeing a 45% rise in first-time e-commerce users during its recent festive sale.

Beyond this, as mentioned in a **report published by Deloitte**, demand in the non-food segment is increasing for both rural and urban India. Within the food segment, demand has also been shifting more towards premium food segments, i.e., protein-based diets, processed foods, etc. This is a clear indicator of higher spending power.

SECTION 4

Recommendations for our clients

01 Equity portfolio managed by Dezerv



Valuation comfort in large cap vs small and mid-cap:

Given elevated valuations in small and mid-cap space, we have gradually reduced our allocation to these stocks over the last year. In contrast, large-cap space is trading at a discount to its historical average.

In lieu of valuation across different market caps, we have been aligning heavily towards large caps over the last year through active large funds and indirect exposure through other large-cap heavy mutual fund categories. We currently have a ~ 66% allocation in large-cap stocks at an overall portfolio level.

Owing to the focus on valuations, we have also been able to curtail drawdown in October. While the Nifty 500 had fallen 7.31% from its peak, Equity Revival Strategy had fallen ~ 6.39%.

02 Fresh cash deployment in equities

While the market's recent decline presents challenges, it also offers long-term opportunities for disciplined investors. Staying focused on fundamentals and avoiding impulsive reactions is essential during this period of heightened market volatility.

Lumpsum:

Given that the markets have fallen ~2.5% since our previous communication and the uncertainty around the US elections and corporate earnings is behind us, we recommend that investors with fresh capital invest 40% upfront and stagger the rest over 4 months in 8 tranches spread apart by 15 days to take advantage of volatility

SIP:

The market correction provides an excellent opportunity to start a Systematic Investment Plan (SIP) as you can take advantage of lower costs.

03 Fixed income investors

Already invested in fixed income:

In our communication last month, we reassured investors that the factors impacting the equity markets have no impact on the fixed income space. Our view remains the same even in the current market scenario, and we recommend that investors who have invested before March 2023 remain invested until maturity.

Investing fresh capital in fixed income:

If you are considering investing in fixed-income instruments, you should invest now to lock in yields.