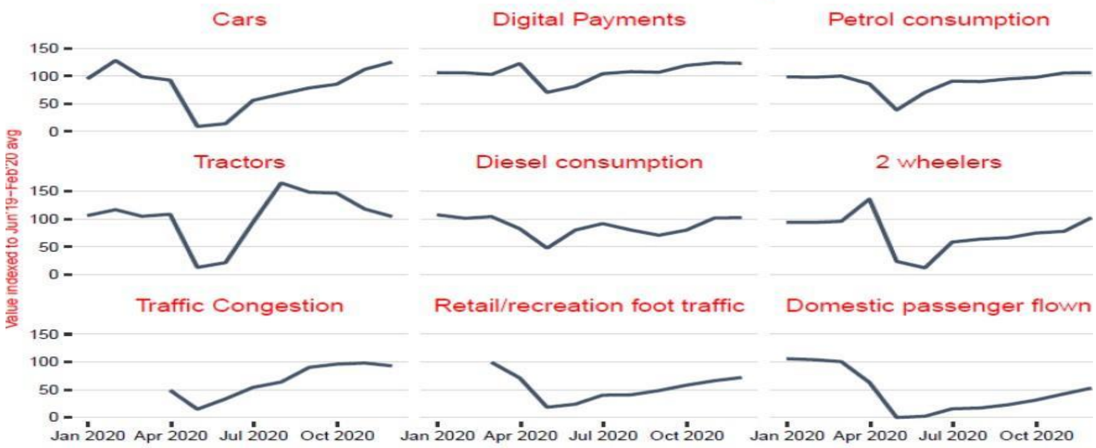
2020: Year end

Indian Economy

- 2020 has been amongst the most unpredictable years. Despite this, India has ended the year on a strong note.
- **Demand Side** indicators showing pick up:



- **Supply Side** Indicators – Coal production, E-Way bill, Rail cargo, Steel production, Port traffic, Cement production etc. are all showing upward trend.
- Economic recovery is broad based with everything from auto sales to electricity production showing uptrend.
- PMI index for both Manufacturing and Services are showing recovery and growth.
- GST Collection for Dec'20 was highest ever at 1.15 Lacs Crore. Third consecutive month of over Rs 1 Lac Crore collection.
- Real Estate Sector is showing signs of recovery and should support economic revival. Affordability is high and mortgage rates have fallen to the lowest level in the last decade.
- Central government spending in 2H21 is projected to be good (approx.5% GDP).
- Rural sector remains strong on two back to back good monsoons; Rabi season sowing has been good.

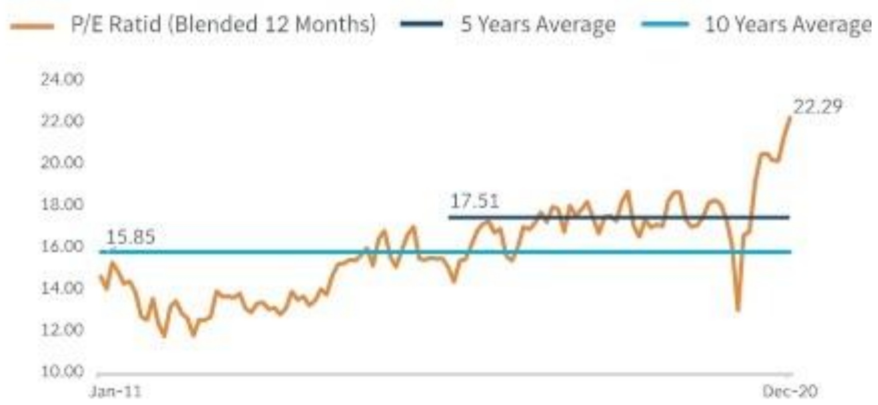
- FY21 GDP growth is expected to be -6% y-o-y as compared to 6.2% growth in FY20 finally rebounding to 13% y-o-y in FY22.
- The three key macro factors which will help in the rebound are – a) low interest rates b) stable currency and c) oil prices – are currently in a favourable zone.
- Equity market corrected ~38% (NIFTY50) in Mar'20 from its high in Feb'20 and later rose 84% to record highs by Dec'20 growing by 14.9% for CY20.

Indices	% Change in Indices CY 2020 (USD terms)
China (SSEC)	22
Japan (NIKKEI 225)	22
Emerging markets (MSCI)	16
United States (S&P 500)	16
India (Nifty 50)	**12**
Russia (RTS)	-10
UK (FTSE 100)	-12
Brazil (BVSP)	-20

- Healthcare and Technology Sectors have been outperformers. Mid-cap and small-cap indices too grew by 22% and 21% in CY20.
- Move from Unorganised to Organised is underway. Consolidation is leading to big getting bigger. These trends are providing opportunity for active fund managers.

- FII buying for the CY20 stood ~USD 23 Bn (INR 1,65,000 Crs) whereas DIIs sold USD 5 Bn. Based on research by ET Intelligence Group, bulk of these flows are of long term nature from Pension funds, Sovereign Wealth funds.
- 80% of FII inflows came in the last quarter of CY20 leading to markets rallying by nearly 20% during this time.
- Based on the consensus estimates, earnings for Nifty is expected to grow by 38% in FY22E led by Financials, Energy, Healthcare, and Telecom.

Source: Bloomberg, as on 31st Dec, 2020



Source: Bloomberg, as on 31st Dec, 2020

- Headline market valuation should be seen in the context of earnings being at cyclically low levels, mean reversion in earnings and interest rates at multi-year lows. While the key indices have more than recovered from their Mar'20 low; there are still large pockets of value as some sectors and most midcaps and small caps are yet to recover from the highs touched in Jan18.

Global Economy

- Large global economies have mostly recovered.
- Central Banks worldwide have massively expanded the size of their balance sheets by printing money thereby increasing liquidity. The top four central banks alone have pumped in nearly USD 8 Tn.
- China is the only major economy which is not expected to register de-growth in CY20.

	Market Price (USD)*	Change in price (%) CY20
Brent Crude (per barrel)	52	-21.5
Gold (per ounce)	1,898	25.1
Steel (per tonne)	4,575	19.0
Copper (per tonne)	7,742	25.8
Aluminium (per tonne)	1,974	10.8

*Market prices as on December 31, 2020;

- Metal prices witnessed a sharp rebound after easing of lockdowns. Prices are now higher than Pre-Covid-19 levels for base metals like Steel. Large stimulus, weak Dollar, near zero interest rates (USD 23 Tn worth bonds are quoting below zero) and Infrastructure spending have pushed the prices higher.
- The same factors are also resulting in huge liquidity flows to Emerging markets as investors hunt for better prospects and yields.

2021: The year ahead…

Outlook

- 2021 should see a transition at multiple levels:
  - **Virus to vaccine:** Infection rate, positivity rate and fatality rate on the decline. Multiple COVID vaccines developed and manufactured indigenously expected to be widely available in 2021
  - **From lockdown to reopening:** Data points indicate global economy back to pre-COVID levels
  - **From recession to recovery:** Upgrades to economic growth estimates
  - **From narrow rally to broad-based rotation:** Developed Markets to Emerging Markets, Largecap to Mid-and-Smallcap, Defensives to Cyclicals, Growth to Value
- **'GOLDILOCKS' macroeconomic backdrop (strong growth and low rates) for Equities** is driving **risk-on sentiment globally.** This should benefit Emerging Markets, including India. **Indian economy is at an inflection point**. COVID curve has flattened out. Economic activity is at nearly pre-COVID levels.
- **Rural economy** continues to be resilient and has been largely unaffected by the pandemic.
- **Turnaround in the Real Estate Sector**. Low interest rates, attractive pricing, incentives by govt, RERA, easing of stamp duty in Maharashtra has led to end user demand pick up. Further incentives can revive the real estate sector leading to job creation
- **Economic growth estimates are being upgraded for the first time after 23 consecutive quarters of downgrades.** From multi-year lows on the corporate profits to GDP ratio in India currently, there is room for catch-up in earnings on account of significant reforms announced by the government. **PLI Schemes across 10 sectors and likely to be expanded should attract FDI, Labour reforms, Agricultural reforms and Land reforms are all creating growth drivers for the long run.**
- Last few years of clean-up in Indian banks' balance sheets, healthier corporate balance sheets, leaner cost structures and lower corporate taxes have improved profit margins.

- These narratives can help frontload equity returns. Additionally, if the current efforts by global policy makers for a successful reflation do fructify, that may just do the trick for India's corporate profit cycle to revive.
- Oil price volatility, sustainability of inflation at higher levels, policy fatigue, and fiscal stress are the near term risks.
- **Valuation** – Absolute valuation is much higher than historical average (justified by low interest rates – lower discounting rate for future earning and reducing risk premium on equity) but **Indian valuation premium to US/Emerging Markets is at historical average.**
- **Long-term (3-year) view:** In the current environment, it would be best to take a 3-year view as the economy and earnings would have normalized by then.
  - From current levels, we can expect a 10-12% CAGR return for the Nifty.
  - During economic recovery, mid-and-smallcaps typically do well and could outperform large caps.
- **We are at the Cusp of a New Cycle.** Investors should stay invested, continue their SIPs, and buy into any dip as any correction is expected to be temporary and minor (i.e. 5-10%). Lump-sum investments can be spread out over next few months.
- **Diversification into US and Emerging markets** is likely to provide better risk adjusted returns both in the near and long term
- **Fixed Income as an asset class will likely give sub-par returns.** Bonds have become richly valued and given our view on growth and the rebound in inflationary expectations, we expect yields to have bottomed out and to inch upwards in latter half of 2021. **Allocation to fixed income will provide stability rather than contribute attractive returns to the portfolios.**