Capital League outlook

March, 2019

Indian Economy

- Q3 FY19 corporate earnings outcome for NIFTY companies was broadly in line with market expectations. Revenue growth was at multi-year high at 23% but net profit growth was much lower at 6.4%. Operating profit margins were under pressure on account of high input costs.
- Autos, Metals and Oil & Gas were key sectors to see the margin decline. Corporate banks showed a sequential improvement in the asset quality trends.
- Nikkei's India Manufacturing Purchasing Managers' Index (PMI) rose to a 14-month high of 54.3 in Feb'19. Due to supportive government policies and strengthening demand conditions, inflows of new work orders continued to expand during February.
- PMI for services rose from 52.2 in Jan'19 as compared to 52.5 in Feb'19, showing acceleration in the growth rate. New business received by services companies rose to a great extent in February amid strengthening underlying demand.
- India's GDP grew 6.6% in the third quarter of FY19 compared with 7.0% in the second quarter of FY19. GDP growth during 2018-19 is estimated at 7% against 7.2% in 2017-18.
- The GST Council reduced the tax rate on under-construction properties from 12% to 5% and on affordable homes from 8% to 1%.
- Tight liquidity and stress in NBFC sector had visible impact on Real Estate and Auto sales. Banks, particularly the ones with strong liability franchise, are well positioned to regain market share from the NBFCs.
- The RBI merged three categories of NBFCs — Asset Finance, Loan Companies and Investment Companies — into one new category called NBFC-Investment and Credit Company (NBFC-ICC) to ease operational flexibility of these institutions.
- The Reserve Bank of India (RBI) is infusing Rs 12,500 crore into the financial system through open market operations. The RBI has absorbed close to 74% of net issuance by the government through OMOs in FY19. This has helped to off-set the weak demand of Government securities (G-Sec) from banks.
- Foreign Institutional Investors (FIIs) inflows to Indian markets have recovered in CY19 on account of US Fed commentary, expectations of a recovery in earnings and expectation of a stable government at the Centre. FIIs bought USD 2.37 Bn in equity in Feb'19, their biggest purchase since Nov'17. On YTD basis, FIIs have invested USD 4.23 Bn in equities.

Global Economy

- The US Fed’s shift to a more dovish stance and a likely truce between US and China on trade conflict has helped propel the global rally in risky assets.
- China’s exports fell 20.7% on account of slowdown both globally and locally in Feb’19. This is the largest drop in three years led by a large fall in trade with the United States.
- The Euro Zone's central bank slashed its growth forecast for 2019 to 1.1 % from an earlier forecast of 1.7% made in Dec’18 owing to the uncertainties related to geopolitical factors, the threat of trade protectionism and vulnerabilities in emerging markets.

Outlook

- Improving capacity utilisation, strengthening bank balance sheets and GST implementation tailwinds are likely to provide a conducive environment for investment growth to pick up from late FY20 onward.
- With the inflation concern subsiding for the RBI, further rate cuts are possible to aid the economic growth.
- The recent domestic geo-political developments have improved prospects for the ruling party in the upcoming elections. This has raised expectation of a stable Govt. As a result, FII sentiment has improved leading to higher flows in the last one month.
- In the last 15 months, the broader market had sharply corrected both in terms of price and time. As a result, valuations of Mid and Small cap stocks are now more reasonable though not cheap.
- All indices-Nifty, Next 50, Mid Cap, Small Cap etc. are up by 13 -15% from their 52-week lows. However, though Nifty is lower only by 3% from its 52-week high, Mid cap and Small Cap are still lagging by 10% and 19% respectively.
- Broader markets have rallied sharply in the last 2 weeks.
- We recommend clients should maintain their asset allocation and any tactical call on lower equity allocation should be restored.
- On the fixed income side we continue to focus on high credit quality Accrual funds, Fixed Maturity Plans (FMPs) and Tax-free bonds to lock-in better yields.