PRANITYA

Pranitya Wealth LLP
Market Outlook
February 2024 | Volume 45

Overview

We aimed to cover Budget 2024 and hence are reaching out to you post the event this month. Our update will encompass key points to keep you informed, and we'll conclude by sharing our insights.

Interim Budget

- It adhered to the tagline of "reform, transform, and perform," emphasizing fiscal prudence and a focus on infrastructure.
- 17% year on year higher spend on Capex and reduction in freebees is positive. Capex is expected to be Rs.11.1 lakh crores.
- Gross borrowing came down to Rs. 15.43 trillion, a good 8% down from the last fiscal
- Divestment target at Rs. 50000 crore is digestible and more realistic. We feel we can achieve more if planned well.
- GDP growth expected at 7.3% as against the expectation of many other agencies of around 6.5%
- Making India a seven trillion-dollar economy by 2030 was emphasized in the Budget.
- Achieve status of developed country by 2046
- 10 million households to get 300 units of electricity through rooftop solarization.
- Lower food and fertilizer subsidy in FY 2025. Modest allocation hike in railway, road and related infra spend.
- 20 million homes planned under rural housing scheme.
- Government plan to give Rs. 2 lakhs in place of Rs.1.2 lakhs per rural home under its Pradhan Mantri Aawas Yojana.
- Tax to GDP is expected to improve and is expected to reach a 25-year high level
- The fiscal deficit in challenging times is planned to be brought down to 5.8% of the GDP lower than the estimate. It is now well on track to reach 4.5% by 2026-27. Debt to GDP ratio expected at 57.2%, down from 61.5%.

In general, it was commendable to present such a budget in the election year. It also takes care of the country's rating which is crucial for raising funds at cheaper cost and inclusion of securities in the Global bond index.

Q3 Earnings Take Away

Results confirmed a K-shaped recovery in the economy where most of the results are on expected lines. The market has factored most of the good news and growth in the price already. Thus, you may have also seen prices of stocks correcting even after posting in-line results.

IT sector clearly seen under margin pressure barring a couple of mid-tier companies. The only positive is that the AI budget spend is expected to be USD 306 billion in 2024.

The hiring scenario is also weak. It all boils down to how the Indian IT sector can leverage the anticipated 15% Compound Annual Growth Rate (CAGR) in AI business that is expected to reach USD 740 billion by 2030.

The FMCG sector is grappling with challenges in achieving volume growth, attributed to constraints in spending among the lower-middle-class and middle-class demographics. In contrast, the high-end vehicles and white goods market are witnessing a notable boom.

The banking sector was worst hit in terms of indices. Large banks in the private sector are seen growing at 15 to 16% from 25% per annum. PSU Banks have put up good show and they are likely to book good gains on their treasury portfolio apart from business gains which is not factored in by the market. So, we are still bullish on PSU banks even after the recent rally. Over ownership of HDFC Bank post-merger led to correction in the banking sector. However, net interest margins face pressure as the cost of funds is higher, necessitating a reconsideration moving forward.

The pharma sector is experiencing a notable upturn after a prolonged wait. Over the last 10 months, a majority of pharmaceutical companies have witnessed a rise of 20-40%. This positive trend is expected to persist in the future.

The manufacturing sector has received a substantial boost following initiatives such as FAME, PLI, and various other schemes, contributing to the overall strength of companies. The share of manufacturing is anticipated to increase over time. In light of these developments, overall results are promising, and the markets seem poised to stabilize at current levels.

Fed Review

All eyes were on the US Fed on its latest stance on the market. Fed has kept rates steady for the 4th straight time at 5.25% - 5.5% as of 1st Feb meet. US Bond yields went up from 3.8% to 4.2% last week and now again came back to 3.8% yesterday. Domestic 10-year yield is at 7.06% and has seen volatility in the last week. Inflation in the US is coming down slowly, but Fed will take some more time to cut rates. It was announced on 1st Feb in their FOMC meet that they will only cut rates when they have greater confidence that inflation is moving sustainably towards 2%. Thus, rate cut expectations in 2024 may get delayed. Some economists are engaged in a debate regarding the possibility of a soft landing for the economy, considering recent developments.

GDP growth

GDP growth is an important factor for the market. As of now we are all factoring in 6.5% growth as predicted by global agencies like IMF, World Bank, and some rating agencies. In the current year 2023-24 we will end up with 7.2% GDP growth. But RBI and government interim economics survey expects GDP growth at 7.4% for 2024-25

This development is poised to catch the market by surprise and potentially lead to further gains. We expected this kind of growth many times in the past but faltered due to many reasons. This time you feel it is achievable due to many factors.

Equity Tailwinds

The manufacturing sector has shown good pick up, exports are up, oil is under check, government spending in the absence of private sector (we call it heavy lifting) kept manufacturing and Infra sector supported. Real estate, Pharma, Banking Finance, with select IT will do well. Government PLI, China plus one, helped capacity built up and Exports.
Employment situation is good with unemployment rate falling to 10.2% in 2023 from 17.8% in 2018.
The banking system is strong and private capex and investments are on the rise. IPOs and debt fund raising helped capital build up.
The influx of Foreign Direct Investment (FDI) and capital inflows from the Debt Market by Foreign Portfolio Investors (FPIs) has positively impacted the forex situation, leading to stability in the value of the rupee.
Interest rates are likely to come down, which helps corporate profitability and their ability to invest and spend.
General boost to Infra, housing, solar power and green energy will lead to growth in most of the sectors.
The support to MSME and different sector will lead to huge growth. We have seen MSME is playing vital role as they employee 40% of Indian workforce. These 63 million MSME contribute to 30% of India's GDP and 45% of countries output.

Given these circumstances, we believe India is poised to enter a new growth trajectory, and the prospect of achieving a GDP growth rate of over 7% appears quite feasible.

Will Market Correct

We consistently face this question, and at times, there is a demand to secure profits due to perceived high valuations.

We had called the Nifty50 levels at 18000, 20000, and now 22000 as high at different junctures. However, it's essential to recognize that these are just numerical indicators and may not summarize the complete market narrative.
While historically we are trading at elevated valuation levels, the full context is crucial for a broader understanding.

We use the thumb rule - GDP to market capitalization, where current market cap is at 1.24 times of GDP. Normally GDP to market cap ratio is 1:1. Thus, from this parameter we may look 24% expensive just probably market can correct 10% if not 24%. Again, this is a thumb rule and not necessary following a strict pattern.

Market correction and our reaction is relative concept. Someone will look at selling now and expect to buy on some correction. This may or may not work as equity markets are always imperfect.

If you are investing for the very long term and only investing in passive products (mutual funds), then the best way is to look at long term perspective of the economy. If you are actively managing part of your portfolio, then you may look at booking part of the profits where prices have started discounting 2026 earnings. Simply because there is always a gap between the cup and the lip. Booking some part of the profit with due justification to valuation is not a bad idea and it helps to better your IRR of the portfolio. For example, HDFC Bank, ITC, Bajaj Finance, RIL and ICICI Bank are among the greatest companies but in the last two years they have been a big drag when it comes to "return" part of your portfolio.

With 27-billion-dollar withdrawal by FPI in just one month of Jan 2024 our market would have completely collapsed but with the support of local investment it remained cushioned and even went up. The weightage of stocks also matters, and the last leg of the **index rally** simply belonged to one stock called Reliance Industries. It's worth noting that several large-cap stocks have yet to reach their 52-week highs, indicating that not all segments of the market have experienced the same level of upward movement though the market rally is broad-based.

When 90% of India's top 500 stocks trade above 200 DMA. Technically speaking Nifty is 200 DMA at 19672 and we are currently trading at 21853 so it's more than 10% above the 200 DMA. Historically, when such situations have occurred, there tends to be a correction, with values reverting to their mean.

Simply put, market me or may not oblige us with a correction this time around. Even if correction happens it will be about 10% and not more than that. Hence, waiting for correction may lead to loss of a big long-term opportunity.

Equity market

We have covered most of it in the above discussion. Going by interim economic review and circumstances, we feel Indian equity in a sweet spot.

Valuation reasonable if not cheap. Currently trailing Nifty PE is at 22, price to book is 3.81 and market cap to GDP is 1.24. Last year Nifty gave 23% return. Capacity utilization is at 74% and credit growth has been picking up and is now at 16%. Corporate earnings have grown by 20% and are expected to grow by 20% next year. This will drive our market further up.

India expects consumption and demographics benefit to continue. With a strong bank balance sheet, especially PSU banks, lending ability has improved to support any credit growth post capitalization.

FPI will come back to stabilize forex reserves. FDI will help more investments and job creation. Government is clearly focused on self-reliance, and they know if we can't attract 100 billion dollars of FDI then they have come up with means to save USD out flow in many ways such as -

- Putting TCS on LRS
- PLI Scheme for electronics
- Defense equipment source locally
- Use of Indian cars appealed by PM.
- Developing local tourism
- Investing in airports medical tourism
- Political diplomacy to keep oil bill under control.

This will save billions of dollars except for gold bond scheme has not made the desired impact.

Fixed income

Inflation is definitely going towards 4.2% over the next year or so. The last reported number of CPI was 5.2%. Globally food prices are at a multi-year low ,this might put pressure on domestic prices. Demand from lower middle class and rural areas is yet to pick up. The finance minister has placed entering budget with the lot of fiscal prudence. The fiscal deficit is planned to be brought down to 5.1% in 2025. For 2024 the government will achieve the estimate of 5.9% where the actual deficit came to 5.8%. On the other hand, revenue deficit will be brought down to 2% by 2024.
Most interestingly government borrowings came lower than last year. Gross borrowings were rupees 14.3 lakh crores as against 15.43 lakh crores. Net borrowings are at Rs. 11.75 lakh crores, lower by Rs.5275 crores. This was cheered by the market and 10-year G-sec went down from 7.29% to 7.06%. This will help G-sec and duration funds as discussed in last month's note.
Lower borrowing and likely lower cost of funds in 2025 for government, will help private sector to bring down their cost of funds.
In the US, 10-year yield dropped to 3.8% and came back to 4.05% in the last 3-4 days with huge volatility as a result of Fed's verbal intervention. The Fed may delay cuts and some doubts have been raised about its ability to make cuts in 2024 as they have now announced their careful intentions of sustainably bringing down inflation levels to 2%.We expect in India rates on both ends of the curve to start moderating soon.

Conclusion

FY 2024 being an election year, the market will start factoring in the May election. Results of Assembly elections of 3 states and changed equation in Bihar lent support to the market recently. We feel the market will remain cautious and not complacent. The geo-political situation is worsening further leading to delays in logistics for goods transport may bring global trade down. Superior valuations and quarter three results have led to no scope for further rerating. Ideally the market should remain supported around the 20,000 level and upside of 24,000 in the coming month.