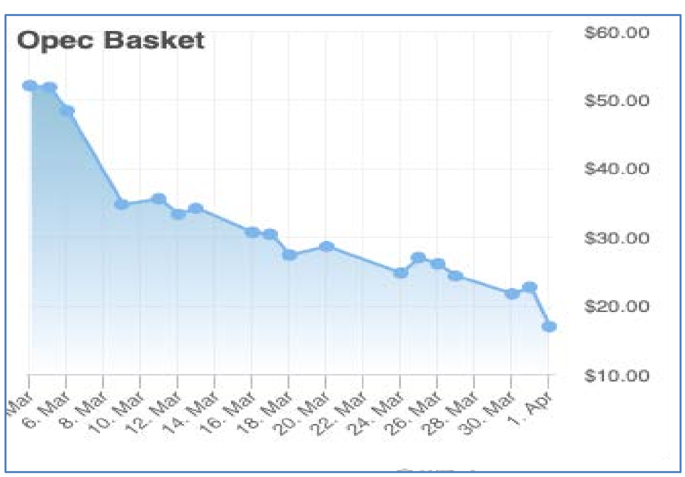
Capital League outlook

April'20

The Coronavirus pandemic has brought a sudden stop to economies around the world. This is unprecedented and the global markets across asset classes are trying to price in the various risks. Markets are reacting both to the lockdown, its economic fallout and the pandemic itself. Correia et al.(2020)'s study on non-pharmaceutical interventions (NPI) such as lockdowns during the 1918 Flu pandemic across the US found that cities that adopted lockdowns earlier and for longer time, not only had lower mortality, but also grew faster than others in the medium term. India therefore may have done the right thing by imposing a country wide lockdown earlier on. There will however be economic consequences as the world deals with triple shocks simultaneously – supply shock, demand shock and oil shock. Aggressive policy intervention across the globe will help in limiting damage.

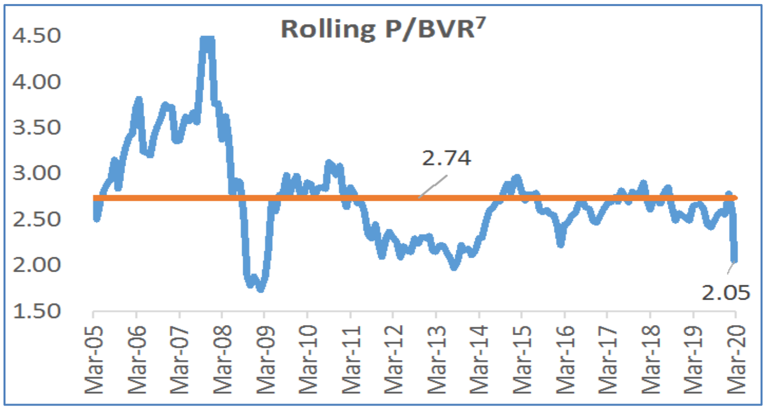
- **Uncertainty** about the future is leading to record daily volatility in all asset classes (except US treasuries). Equity markets around the world are highly correlated at this stage. Sell off is happening without regard to fundamentals. This volatility will reduce once we see the spread being contained or a credible medical solution emerging.
- **Global policy Response**: Central Banks around the world have taken swift policy action to counteract some of the effects of lockdowns.
  - Rate Cuts: US 150 bps, UK 50 bps, China 100 bps, EU 25 bps, Canada 100 bps.
  - CARES Act: US Govt's USD 2.2 trillion package to help businesses and individuals
  - ECB: Euro 750 Bn pandemic emergency purchase program
- **India's response:**
  - 21 day lock down. Sealing of international borders.
  - Relief Package of INR 1.7 lakh crore. Direct transfers, free fuel & food to the poor for 3 months.
  - RBI has reduced repo rate by 75 bps (higher than market expectation) and taken various liquidity inducing measures to tune of USD 50 billion.
- **India's Macroeconomics**: Macroeconomic situation is healthy.
  - Inflation: Inflation is under control at about 4%. Continued fall in food items and oil give RBI more scope to decrease rates.
  - Balance of Payment: India imports about 1.4 billion barrels of oil a year. Even a USD 1 fall in price saves us USD 1.4 billion. A fall in prices of over 50% can save upto 1% of GDP. A significant support for India's Balance of Payment.

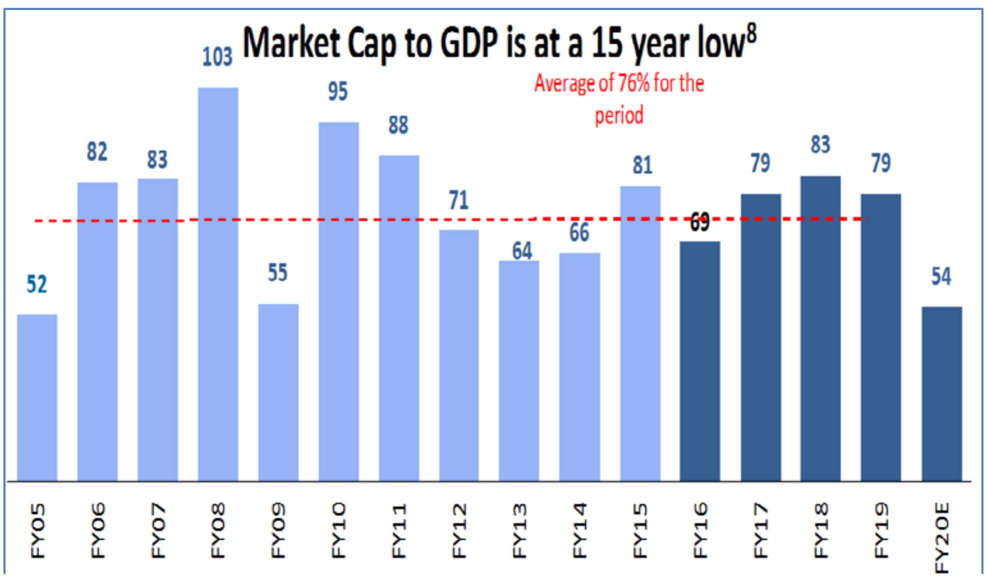


- Forex Reserves: India has healthy forex reserves of USD 480 billion approx. as of Feb'20. This gives RBI some flexibility is trying to protect Rupee. In the recent turmoil, depreciation of the Rupee against the dollar has been less than other emerging market currencies.

- **Equity Market Overview:**
  - Valuations are at one of the lowest in last two decades in terms of Price to Earnings (P/E), Price to Book (P/B) and Market Cap to GDP ratio.

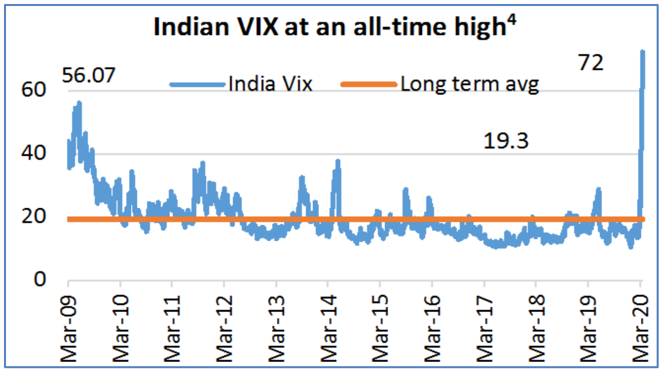
	Dec-07	May-13	Mar-20
Valuations			
Trailing P/E Nifty 50	27.6	18.0	16.2
Trailing P/B Nifty 50	6.4	3.2	2.1





Source: Graph 7-NSE, 12 month trailing data from 31-March'05 to 31-March'20,
Graph 8- Motilal Oswal Securities Ltd., 31-March'05 to 31-March'2020(E)

  - Volatility: Volatility as measured by India VIX, is at an all time high- higher than the levels seen during global financial crisis. This indicates that **sentiment** is at all time low. VIX measures the degree of volatility of fluctuation that active traders expect in the NIFTY50 over the next 30 days.



- <u>Yield Gap</u>: Widening yield gap is making equities cheaper to bonds. The NIFTY earnings yield – the inverse of the price-earnings multiple - has increased by over 131 basis points over the bond yield for the first time since May 2009. The spread had averaged 92 basis points for the last 15 years. Bond yields have fallen to record levels, thereby widening the yield gap. A rising yield gap suggests that equities are undervalued. Historically, when earnings yield exceeded bond yield during the Taper tantrum in 2013 and demonetisation in 2016, the equity indices gained in the next 12 months.
- **<u>Outlook & Way Forward</u>**: Valuations and market sentiment is at all time low. Volatility will continue in near term as investors keep an eye on developments of Covid-19 and the policy responses. However valuations such as market-cap to GDP and long term earnings based yield spread are near all time lows suggesting attractive entry points for long term investors.

'Long- term returns are birthed in the depths of such dire circumstances. It is once in a decade type of opportunity.'

Stay invested and continue SIPs/ STPs. Investors with surplus consider adding in small bits spread over 6-8 months with a 3-4 yr time frame. We are now focusing on large cap funds.

Nifty50 Performance (%)

Date (MM-YY)	Peak	Trough	Peak to Trough	+1M	+3M	+6M	+12M
Jun 96 -Dec 96	13/06/1996	04/12/1996	-33%	18%	42%	35%	28%
Aug97-Jan 98	05/08/1997	29/01/1998	-26%	13%	22%	-3%	3%
Apr98-Nov 98	02/04/1998	28/11/1998	-30%	9%	16%	35%	73%
Feb 00-May 2000	11/02/2000	23/05/2000	-30%	22%	12%	1%	-4%
Feb 01-Sep 01	15/02/2001	21/09/2001	-40%	14%	24%	35%	14%
Jan04-May 04	14/01/2004	17/05/2004	-30%	8%	15%	35%	43%
May06-June 06	10/05/2006	14/06/2006	-30%	19%	29%	46%	58%
Jan 08-Oct 08	08/01/2008	27/10/2008	-60%	9%	6%	38%	92%
Nov 10-Dec 11	05/11/2010	20/12/2011	-28%	10%	16%	13%	30%
May- Aug 2013	17/05/2013	28/08/2013	-15%	10%	15%	17%	51%
Mar 15 to Feb 16	03/03/2015	25/02/2016	-23%	11%	14%	24%	28%
Aug 18 to Oct 18	28/08/2018	26/10/2018	-15%	5%	8%	17%	15%
Jan 20 to Mar 20	14/01/2020	31/03/2020	-30%	?	?	?	?

Source: Motilal Oswal & Internal analysis

In the last major economic downturn, the global financial crisis, those who stayed invested made much higher returns than those who tried to time and missed even a few months of the recovery. No one knows for sure when we will hit the bottom, but we believe that staying invested and disciplined pays off. Given the mix of robust macroeconomic backdrop, fearful sentiments and attractive valuations, every Rupee invested at current levels could have a favourable reward for long term investors.

- <u>Debt Market Overview</u>:
  - Yields have fallen globally. RBI has been bold with deep rate cuts. Lower interest rates will support both corporates & individual borrowers.

	Dec-07	May-13	Mar-20
10-Yrear Govt Bond Yield			
India	7.8%	7.2%	6.1%
USA	4.0%	2.1%	0.7%
Japan	1.5%	0.9%	0.0%
Europe	4.3%	1.5%	-0.5%
China	4.5%	3.4%	2.6%

- Liquidity: RBI's liquidity injection into the economy works out to approx. 3.2% of GDP. The government will have to provide support to the economy through various financial tools. There will be worries on debt levels, but it is important to note that debt to GDP typically rises in any crisis. Growing the economy out of trouble will take care of this ratio.
- A step towards India's inclusion in Global Bond Indices.

Measures To Attract FPI Investment	Implication
RBI has opened a new window "Fully Accessible Route" wherein **specified govt. securities shall be eligible for investment by foreign investors** **Increased FPI Limit For Corporate Bonds** • Increased FPI limits for corporate bonds to 15% from 9% for 2020-21	• **This will ease access of foreign investors to the Indian Bond Market and facilitate inclusion in global bond indices** • **Indian Bond Market has a huge scope of incremental flows by FPIs. This will have a downward pressure on interest rates**

- **Outlook & Way Forward :**
  a. RBI policy measures have been strong
  b. Falling commodity prices (especially Oil) and the bond rally globally will help lower Indian interest rates.
  c. Large liquidity infusion & rate cut to help lower short term rates.
  d. Cut in small savings rate & low deposit rates may lead to search for higher yields. Corporate bonds likely to outperform government bonds.

Stay invested. Lower interest rates lead to higher NAVs of debt funds. For surplus to be invested in debt we continue to focus on high quality ultra short term, short term, corporate bond funds and banking & PSU funds based on investment horizon.