Capital League outlook

September, 2018

Indian Economy

- India's GDP for Q1 FY18-19 grew at 8.2% on the back of strong core performance and a healthy base. Sectors that registered high growth include Manufacturing, Electricity, Gas, Construction, Public administration and Defence.
- India's manufacturing activity measured by Manufacturing PMI was at 51.7 in Aug'18 compared to 52.3 in Jul'18 reflecting slower gains in output and new orders. Manufacturing companies are also grappling with higher input costs due to Rupee depreciation.
- The July retail inflation has come at a nine-month low of 4.17% as compared to 4.92% in June'18. This decline is mainly on account of reduction in food prices.
- Sowing of Kharif crops has been nearly at par with last year amid pick up in rainfall as well as a shift in acreage towards more profitable crops.
- Corporate earnings for the Q1 FY18 have recovered sharply as compared to the last year. The aggregate results for 2830 companies for quarter ending 30th Jun'18 are :

	% Growth Y-O-Y Including financial and energy companies	**% Growth Y-O-Y Excluding financial and energy companies**
Net Sales	16	13
Net Profit	9	25

- On Mar'18 balance sheets, debt has come down for most companies in the Manufacturing sector. Capacity Utilisation has significantly improved leading to operating leverage for the sector.
- For more than 300 companies out of NSE 500 companies, Return on Investment has risen to high teens. Order books have also seen significant improvement especially backed by government spending in the election year.
- FIIs flow have resumed in Jul & Aug'18 on account of better corporate earnings and correction in the mid and small-cap stock prices. Net investment by FIIs in both equity and debt markets was INR 338 Crs in Aug'18 vs an outflow of INR 11,150 Crs during April-July'18.
- High oil prices along with a weakening rupee has widened the current account deficit (CAD) which is expected to cross 2% of GDP in Q1 FY19 against 1.9% in Q1 FY18.
- The Rupee has declined 3.3% in Aug'18 and nearly 10% YTD. This has provided a boost to export oriented companies.

Global Economy

- The trade war between the US and China has further accentuated with US imposing 25% tariff on USD 16 Bn worth of Chinese imports. China has also retaliated with fresh tariffs on a similar amount of additional imports from the U.S. including fuel, steel products, autos and medical equipment.
- Chinese Yuan has depreciated 8% since April and Chinese growth has weakened. Contrary to most other emerging markets, the People's Bank of China (PBOC) has eased the monetary policy by relaxing the lending quotas for banks.

Outlook

- The MSCI India index is currently trading at 19 X based on the next 1-year earnings. The Indian market is trading at 26% and 62% premium to developed markets and emerging markets respectively. The valuation appears to be the most expensive in the last decade. This not only reflects optimism from the expected growth but also seems accentuated on account of depressed earnings while Indian companies are coming out from the bottom of an economic cycle.
- The biggest risk to these valuations is from shortfall in projected earnings. Market has been unforgiving in the last six months on this account.
- The other key risks which may subject the equity markets to volatility are – global trade wars, higher global interest rates, volatility in crude oil prices, etc.
- Investment in equities should be done in a staggered manner over the next 6 -9 months and intermittent volatility should be utilized.
- Although the RBI has been sounding comfortable with the domestic growth trends, further interest rate hikes will depend on the inflation trajectory, concerns on global growth and the government's commitment towards fiscal discipline in the run-up to the 2019 election.
- Hence, on the fixed income side, investors should look to invest in Accrual funds, Short Duration funds and Fixed Maturity Plans (FMPs) for better yields.