MONTHLY UPDATE
JULY 2019

HDFC Life

Sar utha ke jiyo!

July 2019

"However difficult life may seem, there is always something you can do and succeed at"

- *Stephen Hawking*

Equity markets

Indices	28th June 2019	31st July 2019	1 Month Return (%)	1 Year Return (%)
BSE Sensex	39,394.64	37,481.12	-4.86	-0.33
S&P CNX Nifty	11,788.85	11,118.00	-5.69	-2.10
BSE 100	11,909.67	11,210.78	-5.87	-3.57
BSE Mid Cap	14,808.34	13,643.38	-7.87	-14.80
BSE Small Cap	14,239.33	12,692.18	-10.87	-23.47

Source: Bloomberg

All the major domestic indices posted decline during July'19; Sensex was down 4.86% m-o-m in July'19 whereas Nifty declined 5.69%. Mid cap and Small cap indices underperformed the large cap indices as they declined 7.87% and 10.87% respectively during the month.

Performances of the major global equity indices were mixed during the month of July'19; ranging from -2.68% to 2.17%. Hangseng index declined the most while FTSE 100 gained the most.

For the month of July'19, except for IT sector (0.51% gains) all the other sectoral indices posted decline. Auto sector declined the most by 13.58% during the month.

FIIs were net sellers to the tune of Rs13,316cr of equities whereas DII's bought to the extent of Rs20,395cr. Among DIIs, Mutual funds bought Rs11,667cr. In debt markets FIIs were net buyers of Rs8,418cr during the month. YTD till July'19, FIIs have bought Rs14,214cr worth of equities and Rs14,615cr in debt markets. DIIs are net buyers of Rs25,135cr in equities YTD till July'19

The yield of benchmark 10-year G-sec moved to 6.37% at the end of July'19 from 6.88% as at the end of June'19.

Indian Rupee appreciated by 0.3% during Jul'19, as it closed at 68.8 vs. 69 at the end of Jun'19.

Commodities (USD)	1 Month Return (%)	One Year Return (%)
Gold	0.32	15.51
Silver	6.18	4.76
Crude Oil	-0.47	-12.23
Copper	-1.10	-5.92
Primary Aluminum	-0.06	-13.55
Lead	4.04	-6.71
Nickel	14.18	3.28
Tin	-8.02	-13.77
Zinc	-2.04	-6.90

Source: Bloomberg

The performances of all the major commodities were mixed during the month. Nickel gained the most by 14.18% while Tin declined the most by 8.02%. On a y-o-y basis, Gold gained the most while aluminum and Tin declined by ~13.5%.

Macro Economic Data

indicators	Apr'19	May'19	Jun'19	Jul'19	Comments
IIP	4%	3%	-	-	Industrial output growth has decelerated to 3.1% in May'19, from 4.3% in Apr'19, mainly led by the manufacturing output growth (2.5% in May'19 vs. 4% in Apr'19). Notably, electricity output grew by 7.4% in May'19, from 6% in Apr'19. Infrastructure goods output growth decelerated to 5.5% in May'19 vs. 7.2% in Apr'19.
Core Sector	6.30%	4.30%	0.20%	-	Core sector output growth fell sharply to 0.2% in Jun'19 from 4.3% in May'19, led by fall in refinery product output growth (-9.3% in Jun'19 vs. -1.5% in May'19) and cement output growth (-1.5% in Jun'19 vs. 2.8% in May'19).
RBI monetary policy (Repo Rate)	6%	6%	5.75%	-	In its second bi-monthly monetary policy of FY20, the RBI has cut the repo rate by 25bps to 5.75% in Jun'19 while the monetary policy stance has been changed to 'Accommodative'. Apart from that, RBI has cut GDP growth forecast for 1HFY20 to 6.4-6.7% and 7.2-7.5% for the 2HFY20.
CPI inflation	3%	3%	3.18%	-	CPI Inflation marginally up to 3.18% in Jun'19 from 3% in May'19. The notable point is that urban CPI has already crossed 4% (4.3% in Jun'19 vs. a low of 2.9% in Jan'19). The rural CPI, however, continued to be low at 2.2% in Jun'19. Core inflation remained unchanged at 4.1% in Jun'19
Trade Deficit	$15.3bn	$15.4bn	$15.3bn	-	In Jun'19, exports declined by 9.7%, the sharpest fall in the last 41 months, to $25bn, while Imports fell 9% (sharpest fall of 34 months) to $40.3bn. As a result, trade deficit remained high at $15.3bn in June'19 vs. $15.4bn in May'19. Gold imports rose by 13% to $2.7bn in Jun'19 from $4.8bn in May'19.
GST Collection	Rs. 1.12tn	Rs. 1.0tn	Rs. 0.99tn	Rs. 1.02tn	Total gross GST revenue collections in Jul'19 stood at Rs. 1.02tn, following Rs. 1tn collection in Jun'19. CGST stood at Rs. 179bn, SGST at Rs. 250bn, IGST at Rs. 506.1bn and GST cess at Rs. 85.5bn.
Exchange Rate	69.55	69.69	69	68.8	Indian Rupee appreciated by 0.3% during Jul'19, as it closed at 68.8 in the end of Jul'19 from 69 at the end of Jun'19 per dollar.
Monsoon	-	-	-32%	-7.30%	Delayed monsoon resulted in rainfall deficiency of 7.3% as of 5th Aug'19
Kharif Sowing	-	-	9.90%	6.60%	Kharif sowing is down 6.6% yoy in this season as of 2nd Aug'19, majorly led by the decline in sowing of pulses, coarse cereals and jute.

Outlook

Global equities witnessed divergent trends. Developed markets outperformed led by US while EM underperformed as the USD rallied meaningfully. Global equities were buoyed by US-China trade truce and central banks continuing to shift towards a more dovish stance as economic data deteriorated. US Fed cut interest rate by 25bp and signaled that future policy decisions will be more data dependent. The future policy signaling was construed as more hawkish than the market was anticipating.

Indian equities corrected post the Union Budget announcement triggered by the uncertainty emanating from proposals like: 1) increase in tax surcharge for higher income bracket. FPIs (which follow a Trust structure) will be impacted due to the proposed change in tax. The effective income tax rate for taxable income of Rs.20-50mn will go up from 35.88 % to 39% and for those above Rs.50mn would go up to 42.7%.and 2) Supply side pressures for equity markets via increase in free float requirement from 25% to 35% coupled with relaxation on minimum threshold of 51% Government ownership for a PSU and include shareholding of Government controlled institutions such as LIC. We estimate the potential increase in equity supply due to these proposals. The big positive of the budget was maintaining fiscal deficit target at 3.3% of GDP for FY20 which was better than the 3.4% target previously announced and better than market expectation of slippage in target.

A consumer slowdown has impacted the 1QFY20 results season with FY20 earnings downgrades exceeding upgrades. On the positive side, the large auto sector volume declines were not seen in other consumer segments. Companies' guidance going forward have been on cautious side. Corporate banks did see improved profitability but not to the extent hoped for.

While monetary stimulus is likely to continue with RBI cutting benchmark rates and providing liquidity economic recovery will be gradual considering limited ability of the government to give fiscal stimulus. Indian equity markets have corrected sharply from the recent highs led by economic slowdown, weak earnings growth and certain policy decisions in the Budget. Also, tepid commentaries from corporate also suggest that recovery will be gradual and festive season is key to watch out for. Our portfolio strategy remains premised on earnings visibility and valuation comfort. The valuations of the broad market are now more reasonable at 19x relative to historical valuations and bond yields. However given uncertainty of slowing growth and expectation of further earnings downgrade, we expect markets to remain volatile in short term.

July 2019

Fixed Income Market

Fixed Income Market Review –

The bond market rally of the previous two months accelerated in July. The Union Budget presented by the newly elected Government, at the beginning of July triggered the sharp rally during the month.

The Government presented the final Budget for the current financial year, projecting a fiscal deficit of just 3.3% of GDP, belying the widespread expectations of a widening of the deficit. After the strong win in the elections, the markets expected the Government to announce sops for key sections of the economy, as also to step up spending to counter the slowdown in economic growth. The Government eschewed populist expenditure in favour of conservative estimates for spending, which positively surprised the markets.

In addition to the fiscal consolidation, the Government also announced plans to diversify its sources of borrowing and issue foreign currency sovereign bonds. The fund raising from external sources during the current year, would reduce the domestic borrowing to a similar extent. The reduction of the domestic Government bond supply was another positive factor for the bond markets.

Inflation data released during the month continued their benign trends. CPI inflation for June inched up slightly to 3.18% from 3.05% in the previous month, due to a pick-up in food inflation, while the core inflation stayed benign at 4.1%. The soft inflation trends increased expectations of further interest rate easing by RBI in its monetary policy meeting in August.

Over the course of the month, the 10-year bond yield eased significantly to 6.37% from the previous month's close of 6.88%.

Market Outlook –

The fundamental outlook for the bond markets continues to be one of sustaining the softer yields. Inflation outlook is benign and the current trends suggest that the inflation is likely to stay within the RBI's projections for the year. The soft core inflation provides greater comfort for RBI to continue the soft bias to its monetary policy. With inflation concerns receding, the RBI is also expected to take further measures to support growth revival in the economy. The soft inflation affords RBI room to cut interest rates further. Moreover, in line with the 'accommodative' stance of the policy, the liquidity in the system has improved significantly helping support bonds.

Global factors, too, have turned favorable as the outlook for global growth has dimmed further over the course of the past few months. The lower growth outlook has led to sharply lower bond yields across most large economies, with a significant portion of the developed economies' sovereign yields trading in negative yields. The subdued growth outlook also helps keep commodity prices soft. Oil prices, notably, have softened, despite the OPEC production cap, and would have softened further, but for the increase in hostilities between the US and Iran. These developments do support lower bond yields.

Risks to the outlook arise from these same factors. An increase in hostilities between the US and Iran have the potential to push oil prices higher, negating the positive fundamental outlook. Secondly, a delay or a roll-back of the proposal to issue a foreign currency sovereign bond could also potentially affect the markets, as the yields have largely priced in the reduction in the domestic bond supply.

Third Bi-monthly Monetary Policy, August 2019

RBI Monetary Policy Committee reduced the policy repo rate under LAF, by an unprecedented 35 bps, to 5.40% from 5.75%, the Reverse Repo rate to 5.15% and the MSF reduced to 5.65%.
The MPC maintained the stance of the policy at 'accommodative'.
There was no change in the CRR or the SLR.

Key Takeaways

Inflation:

"*CPI inflation excluding food and fuel fell by 50 basis points to 4.1 per cent in May from 4.6 per cent in April, and remained unchanged in June. The softness in inflation in this category was broad-based across clothing and footwear; household goods and services; transport and communication; and recreation and amusement. Housing inflation remained unchanged over the last three months.*"

"Inflation expectations of households remained unchanged in the July 2019 round of the Reserve Bank's survey for the three months ahead horizon as compared with the previous round, but they moderated by 20 basis points for the one year ahead horizon. Input cost pressures from prices of agricultural and industrial raw materials continued to ease in May and June. Nominal growth in rural wages was muted, while growth in staff costs in the manufacturing sector eased in Q1. Manufacturing firms participating in the Reserve Bank's industrial outlook survey expect input cost pressures to soften on account of lower raw material costs in Q2."

"..the outlook for CPI inflation excluding food and fuel remains soft."

"..the path of CPI inflation is projected at 3.1 per cent for Q2:2019-20 and 3.5-3.7 per cent for H2:2019-20, with risks evenly balanced. CPI inflation for Q1:2020-21 is projected at 3.6 per cent."

Growth:

"*Industrial growth .. moderated in May 2019, pulled down by manufacturing and mining even as electricity generation picked up on strong demand."*

"High frequency indicators of services sector activity for May-June present a mixed picture.

"Tractor and motorcycle sales – indicators of rural demand – continued to contract. Amongst indicators of urban demand, passenger vehicle sales contracted for the eighth consecutive month in June; however, domestic air passenger traffic growth turned positive in June after three consecutive months of contraction. Commercial vehicle sales slowed down even after adjusting for base effects. Construction activity indicators slackened, with contraction in cement production and slower growth in finished steel consumption in June. Import of capital goods – a key indicator of investment activity – contracted in June. The services PMI expanded to 53.8 in July from 49.6 in June on increase in new business activity, new export orders and employment."

"..real GDP growth for 2019-20 is revised downwards from 7.0 per cent in the June policy to 6.9 per cent – in the range of 5.8-6.6 per cent for H1:2019-20 and 7.3-7.5 per cent for H2 – with risks somewhat tilted to the downside; GDP growth for Q1:2020-21 is projected at 7.4 per cent."

Outlook

The policy outcome was largely in line with the optimistic expectations. However, after 110 bps of rate cuts over four consecutive policy meetings, the markets expect RBI to focus on transmission of the rate cuts and assess the impact of the rate cuts on activity. While the favorable global environment will continue to support soft bond yields, expectations from RBI are likely to get toned down. The path of bond yields, henceforth, are likely to be influenced by developments on domestic inflation, growth and global factors like Developed market bond yields, large Central banks' monetary policies as well as path of commodities, notably oil. These factors are likely to increase the near term volatility in bond yields.