FAITH & *PATIENCE*

December 31, 2020

For the month ended December 31, 2020, Nifty 50 index was up 7.81% over previous month's close and 14.9% over previous calendar year. Midcaps underperformed large caps whereas small caps were in line with large caps. NSE Midcap 100 Index was up 5.72% and NSE small cap 100 index was up 7.82%. Within sectors, realty, technology and pharma outperformed Nifty 50 index whereas banks, infrastructure and energy underperformed. Foreign investors (FII or FPI) were net buyers again at USD8.4bn in December 2020 and the total for the calendar year stands at net USD23bn (includes secondary and primary market. Source: FPI.NSDL.CO.IN).

India has seen ~USD8bn of net buying by foreign investors in equities in both months of November and December. This net purchase of USD23bn for the calendar year 2020 does not give the complete picture as foreign investors had pulled out close to ~USD 8.5 bn from Indian markets during March-April 2020 due to COVID-19 outbreak. This net inflow of USD23bn part of the reason why there was the sharp rise of 15.8% (Bse Sensex) in the markets despite COVID-19 pandemic.

CY2020 was quite unprecedented year for the global economy as well as the equity markets. From despair to hope, the year ended on a strong positive note as the fight with the pandemic seems nearing an end with the beginning of vaccination. Indian equities were no different from global equity markets as they staged a heroic recovery of ~84% from the lows (~16% return for CY20) after the disastrous fall of ~39% in February-March, 2020.

The health of the Indian manufacturing sector continued to strengthen in December with manufacturers stepping up production and input buying amid efforts to rebuild their inventories following business closures earlier in the year. While firms were able to lift input stocks, and did so at the quickest rate in nearly a decade, holdings of finished goods decreased sharply due to ongoing increases in new work. The seasonal adjusted IHS Markit India Manufacturing Purchasing Managers Index (PMI) was at 56.4 in December, a tick higher than November's reading of 56.3 and above the critical 50.0 threshold for the fifth straight month. The latest figure was consistent with a marked improvement in business conditions across the sector.

Total government spending grew at an eight-month high of 48.3% YoY in November 2020. Government's spending during April - November 2020 now stands at INR19.1trillion. The high growth in spending in November 2020 was led by a sharp growth (248.5% YoY) in capital spending, while revenue spending too grew 31.8% YoY (after three consecutive declines) last month. Growth in Government's interest payment has once again moderated to 12.2% YoY during April - November 2020. Growth in government receipts jumped to a 31-month high of 57.6% YoY in November 2020 (v/s 46.8% YoY in October 2020), driven by a sharp growth (23% YoY) in gross tax revenue last month. Both direct as well as indirect taxes supported growth in total gross tax revenue. Direct taxes grew 14% YoY, buoyed by a 15-month high in personal income tax collections, even as corporate tax collections continued to decline for the seventh consecutive month in November 2020. Indirect tax collections rose 27.2% YoY in November 2020 on account of better Goods & Services Tax (GST) collections. With better-than-expected

GDP growth in 2QFY2021, street has revised its FY2021 fiscal deficit forecast downwards to 7% of GDP. With only four months remaining for the fiscal to come to an end, the question of whether or not the government carries on with its spending spree (of the last two months) in order to support a sustained economic recovery remains.

Given the sharp up move, particularly in the last few months, led by foreign fund flows, reopening of the economy, better than expected quarterly results and commencement of vaccination process, we will not be surprised if broader market participation continues as domestic investors turns increasingly positive. "Buy on dips" seems to be the consensus investment strategy among retail investors and that should push flows into domestic funds.

However, we believe that after a "V-shaped" recovery and a flush of liquidity in the capital markets in CY2020, the economic recovery path ahead is likely to be uneven. Furthermore, rising commodity price led inflation and new strain led risk of restrictions and lockdowns, also persist. Households have remained conservative and have preferred to save over consuming in CY2020. This also needs to be watched closely hereon.

Policy reforms by the government towards making India attractive as a global manufacturing hub (lower taxes, labour reforms, ease of doing business, digitalisation) are improving the long-term demand outlook. Production-Linked Incentives (PLI) are a meaningful change in India's industrial policy where INR2trilliontn of incentives over 5 years for 13 sectors with 5-10% of revenues if output targets are met.

PLI is designed to make India competitive and also take advantage of the drop in China's industrial labour force. Mobile, Autos, Textiles and Food Processing are among the most promising sectors or beneficiaries of PLI. The general expectations are -

a. Production of mobiles could rise from 350mn to 600mn, value-add from 15% to 30%.
b. In autos with largest allocation, may incentivize i) Electric Vehicles ii) Passenger Vehicle exports and iii) component import substitution.
c. Textiles is another important sector and focus likely on man-made fabrics and to make India compete in all four seasons.
d. Food processing: ready-to-eat/ready-to-cook, marine, processed fruits and vegetables. It has large local value-add.

PLI has the potential to add 2.2mn jobs, USD144bn to FY2027 sales and USD70bn to GDP; net exports USD55bn higher. Industry response enthusiastic so far.

Themes for CY2021 to look at:

- PLI scheme boost for textile/electronics/specialty steel and benefits of import substitution
- Food processing to utilise excess farm output for value addition
- CRAMS - Significant capex hints at growing visible opportunities
- Cloud based opportunities in the IT sector
- Insurance on the cusp of sustained structural growth
- Product based capital goods companies as they would likely benefit from capex upcycle
- Roads and Highways - Resilient segment within infrastructure

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Best,

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