FAITH & *PATIENCE*

September 30, 2020

For the month ended September 30, 2020, Nifty 50 index was down 1.23% over previous month's close. Mid and small caps continued to outperform large caps. NSE Midcap 100 Index was up 1.8% and NSE Small cap Index was up 4.2%. Within sectors, Information Technology was up 10.66%, healthcare was up 7.68%, consumer durables were up 6.68% whereas telecom and banking were down 0.79% and 0.62% respectively over previous month's close. Foreign funds (FII or FPI) were net sellers at USD731mn, whereas domestic funds net sellers at USD44mn. Foreign funds had deployed a relatively high USD6bn in August 2020 into Indian stocks but the higher proportion of the flows had gone into absorbing primary issuances. Compared to other EMs, which witnessed FPI outflows, India had outperformed in terms of inflows.

Fig: Flows

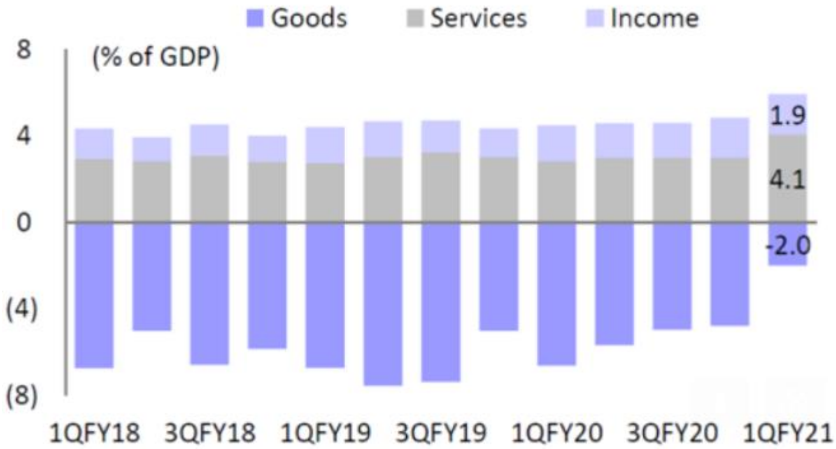
(USD mn)	Curr	MTD	CYTD
FII - Cash	(144)	(731)	4,076
DII - Cash	78	(44)	8,975
FII - Debt	(15)	569	(14,521)

Source: Bloomberg

India's current account posted a surplus of USD19.8bn (3.9% of GDP) in 1QFY2021, slightly better than the market consensus of USD19.5b. This is the highest surplus since FY2004 and follows a small surplus of USD0.6bn (0.1% of GDP) in the previous quarter. The economic lockdown and crash in crude oil prices helped narrow India's trade (goods) deficit in 1QFY2021, which came in at 15-year low of USD10bn (2% of GDP), as against USD35bn (4.8% of GDP) in the previous quarter and USD46.8bn (6.6% of GDP) in 1QFY2020. Note there has not been a single quarter of merchandise trade surplus since 1996 (since when the quarterly GDP data became available). Capital flows, on the other hand, reduced to almost negligible (USD0.5bn or 0.1% of GDP) in 1QFY2021 from USD17.3bn (2.4% of GDP) in 4QFY2020 and USD28.6bn (4% of GDP) in 1QFY2020. Net FDI outflows (of USD0.4bn) were witnessed for the first time in 14 years and are only the second on record since liberalization in 1991. Conversely, after the near-record outflows of USD13.7bn in portfolio investments in 4QFY20, there was marginal net inflow of USD0.6bn in 1QFY21.

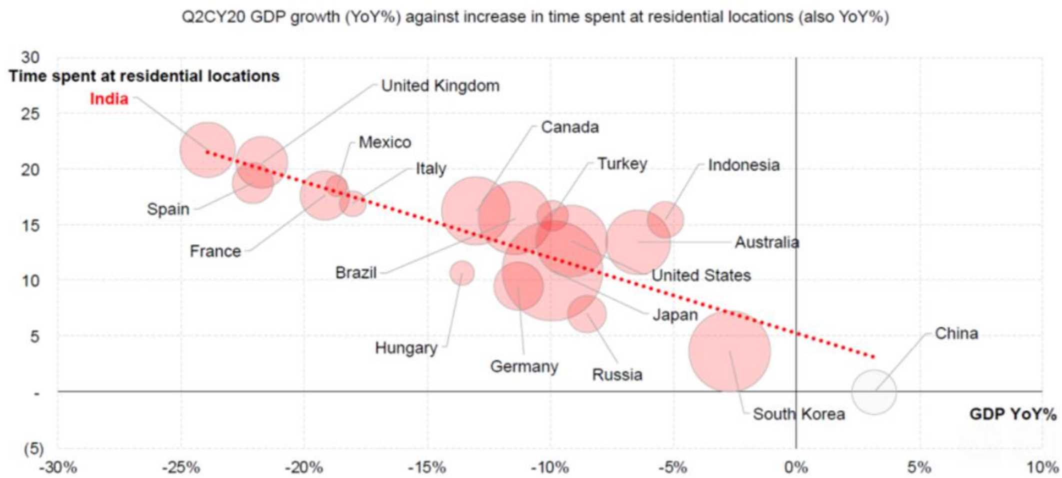
Based on monthly data, India's trade deficit has increased from USD9.2bn in 1QFY2021 to USD11.6bn in July-August 2020. Accordingly, India's current account surplus is expected to reduce to USD9bn (or ~1.4% of GDP) in 2QFY2021. In fact, current account is expected to remain in surplus in all four quarters of FY2021 and record a surplus of ~2% of GDP for the full-year FY2021.

Fig: India's current account at 16-year highest surplus led by 15-year lowest trade deficit



Source: RBI

India Q1FY2021 (Q2CY2020) GDP growth was the weakest among G20 peers - partly on account of the stringency of the lockdown as measured by mobility - explaining weak consumption and investments. Time spent at residential locations, correlated strongly with GDP, has plateaued at around 10%-15% above pre-COVID levels. The expectation for GDP growth for FY2021 is now around -8%.



Source: Bloomberg, Google Mobility

September 2020 was a historic month as far as India is concerned as Government implemented reforms related to education, agriculture and labour laws.

In the current monsoon session, the Parliament passed two key bills related to agriculture that addresses key issues faced by farmers. We believe the two bills are structurally positive for farmers, agriculture sector and overall economy over the long term. These bills are hailed as events which finally granted "independence" to farmers from the shackles of traders or red tape or "system" and like GST which created "ONE INDIA, ONE TAX" this will create "ONE INDIA, ONE AGRI MARKET."

First, Farmers' Produce Trade and Commerce Bill, 2020 (now Act) seeks to provide the creation of an ecosystem for farmers and traders, wherein both parties could enjoy freedom of choice relating to sale and purchase of farmers' produce. The Act would facilitate remunerative prices through competitive alternative trading channels to promote efficient, transparent and barrier-free inter-state/intra-state trade and commerce of farmers' produce outside physical premises of markets or deemed markets notified under various State Agricultural Produce Market Legislations. It would also provide a facilitative framework for electronic trading and for matters connected therewith or incidental thereto.

This act was required as farmers in India faced several restrictions in marketing their produce. Farmers were restricted from selling their Agri-produce outside the notified APMC market yards. Also, they had to sell the produce to only registered licensees of the State governments. Further, barriers existed in free flow of agriculture produce between various States owing to the prevalence of multiple APMC legislations enacted by the State governments.

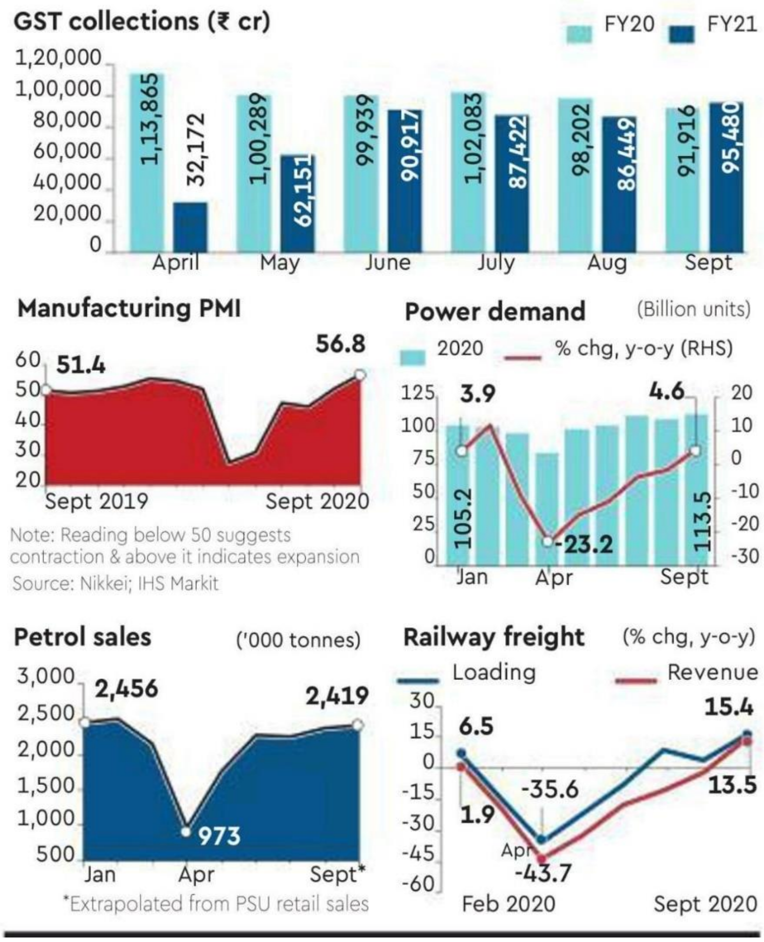
Second, Farmers (Empowerment and Protection) Agreement of Price Assurance and Farm Services Bill, 2020 seeks to provide a national framework on farming agreements that would protect and empower farmers to engage with agri-business firms, processors, wholesalers, exporters or large retailers for farm services and sale of future farming produce. This would be done at a mutually agreed remunerative pricing framework in a fair and transparent manner and for matters connected therewith or incidental thereto.

This act was required as Indian Agriculture is characterized by fragmentation due to small holding sizes and has certain weaknesses such as weather dependence, production uncertainties and market unpredictability. These factors make agriculture risky and inefficient in respect of both input and output management. This act would transfer the risk of market unpredictability from the farmer to the sponsor and also enable the farmer to access modern technology and better inputs. It would reduce cost of marketing and improve income of farmers. The legislation would act as a catalyst to attract private sector investment to build supply chains for Indian farm produce (for national and global markets), and for agricultural infrastructure. Farmers would get access to technology, advice for high-value agriculture and ready markets for such produce. Farmers would engage in direct marketing, thereby eliminating intermediaries, thus, resulting in them getting full price realization. The act also provides farmers adequate protection for their land as sale, lease or mortgage of farmers' land is totally prohibited and is also protected against any recovery. Effective dispute resolution mechanism has been provided for with clear time lines for redressal.

3 historic labour codes - (a) Code on Industrial Relations, 2020, (b) Code on Social Security, 2020, and (c) Code on Occupational Safety, Health and Working Conditions, 2020 were passed by both houses of the Parliament in September 2020. The Government has stated that there are over 100 state and 40 central laws regulating various aspects of labour such as resolution of industrial disputes, working conditions, social security and wages. To improve ease of compliance and ensure uniformity in labour laws, the Center had recommended consolidation of these complex labour laws into broader groups of (a) industrial relations, (b) wages, (c) social security, (d) safety, and (e) welfare and working conditions.

While the Wages Code was passed in the Parliament in August 2019, Government of India, tabled the remaining 3 codes in the Parliament and passed in September 2020. Out of the 40 labour laws, many got repealed and many got subsumed into 4 labour codes (3 passed last week and the Wages Code passed in Aug'19). As a result, 2,300 sections have now reduced to just 460 sections and nearly 1,000 central compliances have decreased to around 250 compliances. These codes are important as they would bring about more formalization of jobs in the country.

We have been maintaining a cautiously optimistic view for some time now and it remains unchanged. While incremental data related to exports, power consumption, freight, GST collection, petrol consumption, etc is positive and encouraging but it was expected as lockdown has been systematically relaxed and normalcy fast returns, of course along with COVID-19 cases. The recent policy reforms related to education, labour and agriculture particularly labour and Agri reforms are quite encouraging from India's economy and markets perspective. Disintermediation or freedom from "rent-seekers" has been the relentless effort of this Government and we are encouraged by their long-term positive impact on the overall economy.



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While auto sales numbers for September are encouraging but a closer look shows they are more wholesale numbers and not retail. They are related to inventory build-up at the dealerships in anticipation of two big Indian festivals in the this and next month - 'Dasera' and 'Diwali'. We will be closely monitoring these festive sales.

While foreign funds have been net sellers in markets through September, incremental flows into domestic mutual funds have not been encouraging. Channel checks also tell us that large wealth managers, advisers and distributors have been advising domestic mutual fund investors to increase debt allocation over equity.

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Best,

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