

# FAITH & *PATIENCE*



June 30, 2020

For the month ended June 30, 2020, NIFTY 50 index was up 7.53% over previous month's close. Mid and small caps continued to rally. NSE Midcap 100 Index was up 10.78% and NSE Smallcap Index was up 15.29%. Within sectors, realty was up 12.52%, banking was up 10.74%, energy up 10.23% whereas pharma and consumer durables were relatively weak and up 2.22% and 2.62% respectively. Foreign funds were net buyers at USD2.73bn whereas domestic funds net buys amounted to 319mn. However, for the calendar year 2020, foreign funds are net sells in equities amount to USD2.18bn and in debt market amount to USD14.28bn. Which means gross sales as on June 30, 2020 for calendar year 2020 by foreign funds - equity and debt are about USD19bn. Despite this India's foreign exchange reserves touched an all-time high of USD507.64bn on June 12, 2020 and are at USD506.84bn currently.

For the quarter ended March 2020 India's current account recorded a surplus of USD600mn, higher than market estimate of USD0.2bn surplus and USD2.6bn deficit in previous quarter. Trade deficit for the quarter came in at USD35bn versus USD36bn in previous quarter, while invisibles surplus was recorded at USD35.2bn versus USD33.4bn in previous quarter. The capital account surplus was at USD17bn in March quarter versus USD24bn in previous quarter despite USD13bn in portfolio outflows, USD4.6bn banking capital outflow and USD1bn trade credit outflow. These outflows were offset by large inflows in FDI USD12bn and commercial borrowing USD10bn and other capital USD 13.8bn. Other capital includes ADR/GDR investments abroad, ECB held abroad etc.

With trade deficit already much lower than expected in Q1 FY20 due to weaker domestic demand, the upbeat market sentiments are due to portfolio flows and FDI due to corporate deleveraging. The dichotomy between the real economy and market sentiments will likely be reflected in larger current account plus capital account surpluses in the coming quarters.

Quarter four financial year 2020 (4QFY20) corporate earnings were weak. For companies in Nifty 50 index (Nifty), sales declined 5.1% YoY while EBITDA/PBT/PAT declined by 4.8%/28.6%/20.1% YoY respectively. Nifty EBITDA decline of 4.8% YoY was the first decline in 11 quarters. Nifty profit after tax (PAT) declined 20% YoY. PAT was dragged by autos, oil and gas, metals, private banks and NBFCs while select public sector companies like Gail, SBI and Power Grid provided some support. One-third of the Nifty 50 companies' EBITDA came in below expectations and half of the Nifty 50 companies' PAT was below expectations. 6 out of the 49 Nifty companies which reported 4QFY20 results saw earnings upgrades greater than 5% for FY2021 EPS, while 30 companies saw downgrades of greater than 5%.

We are not surprised by the rally in mid and small stocks with the respective indices strongly outperforming the narrow markets i.e. Nifty 50 or BSE Sensex. This we believe is a classic function of domestic funds playing catch up to the rally in large caps led primarily by foreign funds. We are mindful of the fact that broad markets have significantly underperformed the narrow markets over last 1year and 3years.

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If we look at commentaries and here, we will specifically refer to big names like Nestle Ltd. The MD & CEO of Nestle India said predicting demand is tough over next two quarters and that there were newer consumption trends emerging - one, down trading and two, affordable consumption. "...people want to conserve the last Rs.10/- as a future hedge." He also said direct cash in the hands of people i.e., economic stimulus, would have helped small businesses and economy revive faster.

Given that we still have a lockdown in India, and quite a severe one at that compared to the rest of world till July 31, an economic stimulus when supply-side challenges remain would have an inflationary effect on the economy. Which means we have to wait for COVID-19 cases to peak-out and decline for lockdown to be lifted fully. This also means economic stimulus and hence economic recovery will be pushed back. Apart from COVID-19, India is also facing multiple challenges on its border with Pakistan, China and Nepal. News flow related to this also impacts markets occasionally.

This rally is led by a global surge in liquidity as can also be seen global markets, in the recent net inflows from foreign portfolio investors and also foreign direct investment into India even in June 2020 which caused the foreign exchange reserves to soar to an all-time high of USD507.64bn and also INR appreciating versus USD.

There is no doubt in our mind that Indian economy is best positioned to revive faster than others given the investment focus of Government of India and low penetration levels in virtually all consumer sectors including financial services.

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Best,

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