ANDBANK
Private Bankers

Alex Fusté
@AlexfusteAlex
alex.fuste@andbank.com

The India equity market still appeals to me. Here are my reasons

Significant boost in the state elections for the market friendly BJP party ahead of the scheduled central government elections.

The results of the state elections were more favorable for the BJP than anticipated, indicating a stronger pre-election position. The BJP secured a decisive victory in 3 out of 4 states (Madhya Pradesh, Rajasthan, and Chhattisgarh), while the Congress party emerged victorious in Telangana. These state election results provide a significant momentum for the BJP before the central government elections scheduled for April-May 2024. With the BJP's strong position in key states such as Madhya Pradesh, Rajasthan, Gujarat, and Uttar Pradesh, an improvement in the market's mood is expected, supported by continuity in policies, reform agenda, development and economic growth. The BJP can now focus more on welfare plans ahead of the state elections.

Economy: India's economic strengths are evident from various key indicators.

Real GDP growth was 7.7% in the first half of fiscal year 2024, driven by robust dynamics in manufacturing and investment sectors, partly due to impressive corporate profits of the Nifty in 1HFY2024.

Industrial production in India (IIP) climbed to 10.3% YoY in Aug 2023, the highest since June last year, as compared to 6.0% rise in Jul 2023. Production in the manufacturing industry increased by 9.3%, in mining by 12.3% and in electricity by 15.3%. Positive trends continued in the latter part of 2023, as seen in high-frequency data such as GST collections, automobile sales, energy demand, and PMI figures. Globally, favorable conditions, such as stabilized interest rates, Brent crude oil prices and steady bond yields, further support India's economic outlook. The Manufacturing Purchasing Managers' Index growth slowed in Oct 2023 to 55.5 (from 57.5 in Sep 2023), reflecting a slower increase in total new orders, but still at a reasonable expansionary level. Meanwhile, Services PMI also fell but remains at an impressive 58.4 in Oct. According to the government data, the combined Index of Eight Core Industries increased by 8.1% in Sep 2023 as compared to 8.3% in Sep 2022. The production of all Eight Core Industries recorded positive growth except crude oil which contracted by 0.4% in Sep 2023.

CPI-based inflation dropped to 5.02% in Sep 2023, compared to 6.83% in Aug 2023. The rate fell within the RBI's upper tolerance level and due to a significant slowdown in food inflation.

Equity Market momentum to continue positive until elections.

The profits for the first half of fiscal year 2024 (which began in April) were impressive, showing a year-on-year increase of 30%. We anticipate that the growth rate will stabilize at 20% year-on-year in the second half. Looking ahead to the next twelve months, and with a slightly expansion in PE multiple (from 20x to 21x) due to the inclusion of expectations for a political victory for the BJP and the continuation of the pro-market agenda, we believe that the Sensex India index should trade between 78,000-80,000 points in the coming 12 months (today at 73,000). Also, the clarity in U.S. interest rates and strong second-quarter GDP data for India (with updated GDP forecasts for fiscal year 2024) have resulted in a positive outlook for Indian stocks. The peak of global interest rates is also expected to positively impact foreign investor flows into India.

Since the financial results were announced on December 3, markets have already risen by 8-9% (as of January 15, 2024), and I believe that market momentum could continue to be positive until the general elections in April-May 2024.

How to invest? Medium and small-cap companies have significantly outperformed large-cap companies over the past year. Small & mid caps returned 24% and 30%, respectively, compared to ~4.5% for large companies over the past year. The superior performance is attributed to attractive valuations during the pandemic and expectations that medium and small-sized companies will benefit more from strong economic growth. While valuations in small and mid caps may be deemed expensive by some, I consider the country's reality vastly different from that of 10 years ago, and thus, such historical analyses should be given less significance. That being said, the current valuation of the mid-cap index is 21.8x compared to its long-term average valuation of 15.8x, representing a premium of ~38%. Similarly, the current valuation of the small-cap index is 18.4x compared to its long-term average valuation of 14.1x, representing a premium of ~30%. All said, the long-term growth potential for medium and small-cap companies still remains strong, though admittedly, the margin of safety has been reduced due to higher valuations. Short-term returns may be moderate in these sectors. It seems that now is the time to shift the investment portfolio in India towards larger capitalization positions. We will identify the vehicle that aligns with this objective to expose ourselves to this market in our discretionary mandates.

Central Bank RBI kept policy repo rate unchanged at 6.50%: Stability in domestic monetary conditions, coupled with falling interest rates abroad, makes for a favorable "cocktail" for the domestic equity market.

The Monetary Policy Committee (MPC) in its fourth bi-monthly monetary policy review of FY24 kept key policy repo rate unchanged at 6.50% for the fourth consecutive time. The standing deposit facility (SDF) rate also remained unchanged at 6.25%. All six members unanimously voted to keep the policy repo rate unchanged. The MPC also remained focused on withdrawal of accommodation to ensure that inflation progressively aligns with the target, while supporting growth.

Market outlook – Recommendations & Targets from fundamental analysis

Equities – SENSEX: OVERWEIGHT

Bonds – Govies: OVERWEIGHT (Target yield 6.5%)

Bonds – Corporates: OVERWEIGHT

Forex – INR/USD: NEUTRAL (Target 82)