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Macro-economic developments

- On the global front, Non-farm payrolls in the United States rose by 213,000 in June 2018, higher than market expectations of around 195,000. Also, the unemployment rate rose marginally to 4% from 3.8% in the previous month.
- The US Fed kept rates unchanged in its August beginning meeting, and signalled 2 more rate hikes this year. The Fed said that the labour market has continued to strengthen, and that economic activity has been rising at a strong rate. The US 10 year yield closed the month of July up 10 bps at 2.96%.
- The European Central Bank (ECB) kept policy rates unchanged in its late July meeting, and reaffirmed its plan to end its bond buying programme by end of Dec 2018.
- The Index of Industrial Production (IIP) growth dropped to 3.2%YoY in May 2018 from 4.9%YoY in the previous month—led by Manufacturing sector (78% weight in index), where growth fell to 2.8%YoY in May 2018.
- The Nikkei India Manufacturing Purchasing Managers Index (PMI) fell to 52.3 in July 2018 from 53.1 in the previous month, on the back of softer gains in output and new orders.
- CPI headline inflation continued to rise to 5.0%YoY in June 2018, primarily due to rise in core inflation, and also contributed by rise in fuel, and housing inflation. Food inflation, which has the highest weight in CPI inflation, remained benign at 2.9%YoY in June 2018. Core inflation (ex food & fuel) rose to a multi-year high of 6.4%YoY in June 2018. It was ~5.2% at the end of March 2018.
- As promised in the budget, the govt. hiked minimum support price (MSP) for kharif (summer) crops to at least 1.5 times the production cost in order to boost farm incomes. Paddy (which has the highest weightage of 4.7% in CPI inflation) saw its MSP registering a 12.9% hike in FY19. On a weighted average basis, MSPs were hiked by ~15%YoY in FY19 versus 6%YoY in FY18.
- Crude oil prices corrected in July, with Libya opening up its ports & increasing production, and with Saudi Arabia & Russia promising to increase output. Brent crude price closed the month at USD 74.25/barrel – down 6.5%.
- INR strengthened in the second half of the month after breaching the 69/USD mark intra-month, on the back of correction in crude oil prices, recovery in foreign flows and intervention by the RBI. It finally closed the month at 68.55 / USD.

Equity market developments and Outlook

- Indian markets fared well in the month of July, helped by easing crude oil prices, recovering foreign inflows, GST rate cuts, and positive corporate earnings. The benchmark Nifty index closed the month up 6%, while the Nifty Midcap 50 and Nifty Smallcap 100 indices closed the month with gains of 3.0% and 4.0% respectively. Sectors which outperformed in July were oil & gas (BSE Oil & gas index up 10%),--with crude oil prices correcting, and FMCG (BSE FMCG index up 7.1%)—with some major FMCG companies positing strong volume growth in Q1FY19 results. Metals sector was the biggest underperformer during the month, with the BSE Metal index down 3%.
- Foreign portfolio investors (FPIs) registered inflows for the first month since March 2018. Net inflow was ₹ 1,429 crore in the month of July 2018 compared to a net outflow of ₹ 2,577 crore in the previous month.
- Domestic Institutional Investors (DIIs) registered a slowdown in flows, with a net inflow of around ₹ 4,200 crore in the month of July, compared to ₹14,146 crore in previous month.
- Global markets also closed on a positive note during the month. The MSCI World index returned 3.1%, while the MSCI Emerging Market index returned 1.7%. India was among the top performing markets during the month.
- In the US, the S&P 500 index closed with a gain of 3.6%. Major European markets also registered decent gains in July. Within Asia, Thailand was one of the top performers with the benchmark SET index up 7.6%, followed by India and Malaysia. Amongst emerging markets, Brazil's benchmark Bovespa index was one of the top performers—rising almost 9% in July.
- Quarterly Q1 FY19 corporate earnings have broadly been good so far, and helped to drive up the markets. Consumer sector has seen pick up volumes, IT has benefited from a depreciating rupee, and financials have mostly delivered results in-line or better than expectations—benefiting from the pick-up in credit growth. We are presently positive on these sectors, and also feel that the pharma sector may also have bottomed out, with large part of the FDA related issues behind us now, and with a weaker rupee aiding the sector.
- We continue to expect strong earnings growth in FY19 and FY20, and that should drive the trajectory of markets. Broad macro-economic data and high-frequency data point to a recovery in economic growth. However, some macro headwinds remain--like elevated and rising crude oil prices and its impact on the twin deficits, rising interest rates and inflation. Global uncertainty on escalating trade war, tightening of monetary policy by major central banks, and global risk aversion in EM markets/currencies, also remain.
- YTD in 2018, it has been quite a narrow market, with only a handful of stocks contributing most of the gain for the benchmark Nifty index. Meanwhile, the mid / small-cap space has seen a substantial correction YTD in 2018, as a result of which the market breadth has been largely negative. So stock picking has played an important role so far this year in generating returns / alpha, and we believe that it will continue to be the case, going forward as well.

Fixed Income market developments and Outlook

- Bond yields eased during the month, supported by easing crude oil prices, recovering rupee, reversal of foreign outflows from debt markets, and OMO purchase. The 10 year yield closed the month at 7.77%--down 13 bps.
- On 1st August 2018, RBI announced its monetary policy review, in which it hiked the policy rate by 25 bps, but maintained its 'neutral' monetary policy stance. This is the second consecutive rate hike after the June 2018 policy. RBI revised the CPI headline inflation forecast marginally upwards for H2 FY19 to 4.8% (from the earlier forecast of 4.7% in June policy review), and forecasted Q1 FY20 inflation at 5%—with risks evenly balanced. On the economic front, the central bank retained the GDP forecast of 7.4% for FY19 (with risks evenly balanced), and projected Q1 FY20 GDP growth at 7.5%.
- RBI policy action was broadly along expected lines. What has probably been read favourably by the market (and led to some respite in bond yields after the policy announcement) is that CPI headline inflation forecast for H2 FY19 has hardly been changed from the earlier monetary policy (only revised upwards by 10 bps), despite the MSP hikes. However, the RBI maintained that uncertainty still remains on the inflation front and it needs to be monitored closely.
- With the RBI retaining a neutral stance, we feel that future monetary policy action will continue to be data dependent.
- India's fiscal deficit for FYTD 19 (upto June) reached 68.7% of the budgeted full year target, compared to 80.8% in the year ago period. This was supported by higher tax revenue and lower expenditure.
- Foreign Portfolio Investors (FPIs) in debt markets saw a reversal in flows, and registered a net inflow of ₹ 718 crore in July, after recording outflows since the month of Feb 2018--cumulating to around a net ₹ 50,000 crore.
- With the yield curve being flattish, we continue to prefer the shorter end of the yield curve.