Sampath Reddy, CFA
CIO, Bajaj Allianz Life Insurance

Macro-economic developments

- The Non-farm payrolls in the United States rose by a strong 312,000 in December 2018, much higher than market expectations of around 176,000. The unemployment rate moved up from a record low of 3.7% in November to 3.9% in December.
- The US Fed hiked rates by 25 bps (as expected) in its December 2018 policy review, making it the fourth rate hike in CY2018. However, the Fed turned a bit dovish, by toning down its future interest rate projection for 2019 to 2 rate hikes (from 3 rate hikes earlier), and also cut the median target rate for 2020 and 2021. It also cut US GDP growth forecast for 2019 to 2.9% (from Sep 2018 projection of 3.1%) and for 2020 to 3.1% (from Sep 2018 projection of 3.4%).
- Trade deficit for the month of November 2018 came in at $16.7 billion, compared to $17.1 billion in the previous month. Export growth fell sharply to 0.8%YoY in November from 17.9% in October, primarily owing to the high base effect. Import growth also moderated to 4.3%YoY from 17.6% in October.
- The Index of Industrial Production (IIP) growth picked up to 8.1%YoY in October 2018, from 4.5%YoY in the previous month. The pick-up in IIP in October was helped by a favorable base effect, and manufacturing sector (78% weight in IIP) growth rose to 7.9%YoY, from 4.5%YoY in the previous month. Mining sector growth also picked up strongly to 7.0%YoY from 0.2%YoY in the previous month. For FYTD19 (upto October) IIP growth was stronger at 5.6%YoY, compared to just 2.5%YoY in the corresponding period, a year ago.
- Consumer Price Index (CPI) headline inflation came in below expectations, falling to a 17-month low of 2.3%YoY in November 2018. This was primarily led by food inflation (biggest component of CPI), which fell to -2.6%YoY in November, from -0.9% in the previous month. Core inflation (ex food & fuel) also fell to 5.8%YoY from 6.3%YoY in the previous month. Fuel inflation still remained a bit elevated at 7.4%YoY, compared to 8.5%YoY in the previous month.
- Crude prices continued to fall, after the sharp decline in the month of November. Brent crude closed the month down around 8%, near the $54/bbl mark. It has fallen sharply from its peak of ~$86/bbl in early October, on the back of easing sanctions on Iran, unwinding of long speculative positions, significant increase in crude production particularly from the US, and expectation of some slowdown in global growth.
- The Index of Industrial Production (IIP) growth slowed down a bit to 4.5%YoY in Sep 2018, from 4.7%YoY in the previous month. Manufacturing sector (which has 78% weight in index) saw growth slowdown to 4.6%YoY in Sep 2018 from 5.1%YoY in the previous month. However, IIP growth for FYTD 19 (upto Sep) was higher at 5.2%YoY, versus 2.6%YoY in the year ago period.
- Consumer Price Index (CPI) headline inflation continued to moderate and came in below expectations at 3.3%YoY in Oct 2018, compare to 3.7%YoY in the previous month. The fall in headline inflation was helped primarily by fall in food inflation (has highest weightage in CPI), which fell to -0.9%YoY in Oct 2018 from 0.5%YoY in the previous month. However, core inflation (ex food & fuel) rose a bit to 6.1%YoY in Oct 2018, from 5.8%YoY in the previous month.
- Crude prices fell sharply in the month of November, with Iran sanction concerns easing, global crude production and inventories rising. Brent crude closed the month at $57.8/bbl—down by a massive 22%.
- The rupee depreciated in the first half of the month, after the surprise resignation of Dr. Urjit Patel as RBI governor, but then recovered to close the month on a flat note at 69.8/US dollar. The rupee has strengthened significantly, after touching life-time lows of ~74.5/US dollar in early October. The appreciation in the rupee over the past few months has been on the back of sharp fall in crude oil prices, reversal in foreign outflows, and a general recovery in most emerging market currencies.

Equity market developments and Outlook

- Indian markets closed the month on a flattish note, despite the volatility and correction in global markets. The benchmark Nifty index returned -0.1%, while the mid/small-cap segment outperformed, with the Nifty Midcap 50 index and Nifty Small-cap 100 index returning 3.2% and 3.8% respectively in December. Sectors that outperformed during the month included power, utilities, banking and FMCG. Meanwhile, the bottom performing sectors during the month were pharma and IT.
- Global markets witnessed correction during the month, led by developed markets—due to some concerns of global growth slowdown. The MSCI World index fell 7.7% during the month, while the MSCI Emerging Markets index fell 2.9%. .
- In the US, the S&P 500 index fell by a sharp 9.2% in December. Most European markets also ended in the red, with the benchmark indices of Germany, France and UK down 6.2%, 5.5% and 3.6% respectively during the month. Within Asia, Japan (-10.5%) and China (-3.6%) were among the bottom performers, while markets like Indonesia, Malaysia and India were relative outperformers.
- Foreign portfolio investors (FPIs) continued to buy, registering a net inflow of ₹ 2,299 crore in December, compared to a net inflow of ₹ 6,200 crore in the previous month.
- Domestic Institutional Investor's (DIIs) net investment in equities continued to slow down in December to ₹ 376 crore, from ₹ 800 crore in the previous month.
- We believe that earnings growth will accelerate in H2 FY19 and particularly in FY20, and this should be the key driver for markets in 2019. Earnings growth over the past years was primarily driven by domestic consumption sectors; but we expect that growth will be more broad-based in 2019, and also that the capex cycle (which has been the drag earlier) has now bottomed out.
- In the equity markets, we have been preferring the large-cap segment since the beginning of 2018, on a relative valuation basis. Although we still like the large-cap segment; with the recent correction in the small and midcap segment, there are some good selective bottom-up opportunities also emerging in this space.
- Investors should continue to invest in a staggered manner in equities, and could look to add positions on any large market dips.

Fixed Income market developments and Outlook

- Bond yields continued to soften during the month on the back of fall in crude oil price, RBI turning dovish on inflation, liquidity infusion by RBI via OMOs, reversal of foreign outflows, and a stable rupee. The benchmark 10 year bond yield closed the month at 7.37%--down 24 bps for the month. The 10 year yield has softened significantly from its recent peak of above 8.2% in early October.
- RBI continued to infuse liquidity through OMO purchases. It increased the OMO purchase amount for December to ₹ 50,000 crore, from ₹ 40,000 earlier. It also announced OMO purchases of ₹ 50,000 crs for January 2019, and that infusion via OMOs would continue for remainder of FY19—intending to bring liquidity back to neutral.
- In its December 5, 2018 policy review, the RBI kept the policy repo rate and stance unchanged, as expected. CPI headline inflation forecast for H2 FY19 was cut from 3.9-4.5% in October policy to 2.7-3.2% in December policy, and for H1 FY20 to 3.8-4.2% (compared to forecast of 4.8% for Q1 FY20 in the October policy). The central bank also indicated that if upside risks to inflation (mentioned in the policy) do not materialize, then it could open up space for future policy action—therefore keeping it data dependent.
- GDP growth forecast for FY19 was retained at 7.4%. RBI also announced SLR cut by 25 bps from beginning of 2019 to 19.25%, followed by progressive cuts every quarter until the SLR comes to 18%.
- India's fiscal deficit for FYTD 19 (upto November) reached 115% of the budgeted full year target, compared to 112% in the year ago period. The fiscal deficit was elevated, primarily due to lower GST collections and lower than budgeted divestment proceeds.
- Foreign Portfolio Investors (FPIs) in debt markets continued to register a net inflow of ₹ 5,805 crore in December, compared to a net inflow of ₹ 6,468 crore in the previous month.
- With bond yields coming down substantially, we feel that a large part of the rally is behind us now. We expect the debt markets to be range-bound-providing steady returns. Presently, we are positive on the short to medium term part of the yield curve.

Ver: Dec 2018