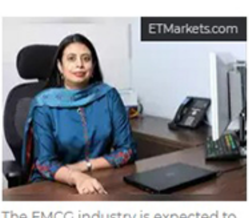
ETMarkets Smart Talk: Why FMCG & BFSI are likely to continue their outperformance in 2023, Reshma Banda explains

Synopsis
While there is an anticipated global growth slowdown, India's macroeconomic condition is comparatively stronger. Although India's growth is also expected to slow down to some extent in FY24.



The FMCG industry is expected to post double-digit earnings growth in FY24, driven by revenue expansion and cost reduction.

"The FMCG industry is expected to post double-digit earnings growth in FY24, driven by revenue expansion and cost reduction," says Reshma Banda, ***Head –Equity & EVP, Investments, Bajaj Allianz Life.***

In an interview with ETMarkets, Banda said: "Private Banks are well placed and should benefit from the operating environment's continued strong credit growth and benign asset quality trends" Edited excerpts:

Sectoral indices are hitting fresh record highs which suggests that Nifty, Sensex could soon follow suit. What is fuelling the rally and way ahead? Fresh peak for Nifty soon?
While there is an anticipated global growth slowdown, India's macroeconomic condition is comparatively stronger. Although India's growth is also expected to slow down to some extent in FY24.

However, it remains one of the fastest-growing major economies globally. One positive factor is that inflation in India has started to moderate and is currently lower than the threshold band set by the Reserve Bank of India (RBI).

This favorable inflation scenario keeps India distant from advanced and other emerging economies where inflation is at multi-decade highs (However, started moderating).

Additionally, the expectation of a normal monsoon season across the country is likely to help in controlling food inflation levels, which is positive for the overall economy.

Lately, we have also witnessed a return of foreign portfolio investor (FPI) equity inflows into India, contributing to a healthy rally in the equity markets.

Quite a few global central banks are nearing the end of the rate hike cycle and that is also contributing to foreign flows and some return of risk appetite.

Corporate earnings in India of Q4FY23 have been in line with our expectations, and we anticipate double-digit earnings growth for this fiscal year.

Currently, the Indian equity markets are trading at valuations that are slightly higher than the long-term averages due to the recent market rally.

Despite these valuations, we maintain a constructive view of the domestic markets. India is in a much better position compared to other markets, and we expect relatively healthier returns for the year.

Considering India's stronger macroeconomic conditions, moderating inflation, potential growth opportunities, and favorable monsoon expectations, we believe that the Indian market offers attractive investment prospects in the current global economic landscape.

Which sectors are you overweight and underweight on and why?
Some sectors like FMCG & BFSI have done well over the past year and we expect that these sectors should continue their outperformance in 2023 as well.

We have been quite positive on BFSI & Capital Goods for a while, due to a pick up in investment & manufacturing activities.

Private Banks are well placed and should benefit from the operating environment's continued strong credit growth and benign asset quality trends.

In terms of valuations, pharma appears attractive, but most of the negatives pertaining to weakness in the US generic market seems to be priced in.

Though the IT sector earnings outlook appears a bit cloudy due to the expectation of global growth slowing down, but valuations are now looking reasonable on a select basis.

We have a positive outlook on Auto and Auto Ancillary space as the supply side challenges are easing out and demand to sustain rural recovery; but likely to be selective on some stocks particularly due to the recent run-up in the valuation.

As things around us are changing rapidly like consumption patterns and rebound in discretionary spends should benefit companies in QSR & Hotels (Quick Service Restaurant) segments.

Commentary from the RBI suggests that India is on track for robust growth and further rate action will be data-dependent which is comforting the bulls. But, what can ruin a bull party on D-St? Anything that investors should watch out for?
The Indian economy remained resilient despite the global growth slowdown in 2022-23. However, thanks to strong macroeconomic policies, lower commodity prices, a robust financial sector, healthy corporate earnings, and a focus on quality government spending, India's growth is expected to continue in 2023-24.

India's GDP growth stood at 7.2% for FY23 above then the street estimates, conversely to the major global economies have been experiencing a GDP slowdown.

This positive outlook is further supported by new growth opportunities arising from the global realignment of supply chains. Despite these encouraging factors, there are potential risks to growth.

Slower global economic growth, prolonged geopolitical tensions, and the possibility of increased volatility in the financial markets due to new stress events in the global financial system could pose a downside risk to India's growth trajectory.

To mitigate these risks and ensure sustained economic progress, it is crucial to maintain structural reforms that enhance India's long-term growth potential.

We have gone through time correction, but we (India) are no longer cheap. FIIs have started to pour money into the markets. Is it macro stability or earnings growth which is fuelling optimism?
After a heavy bout of FPI selling, FPI equity flows have turned quite positive in the month of March & April 23. The inflation and interest rate cycle are relatively better placed in India compared to the developed economies where the situation is relatively more challenging.

As most of the central banks are nearing the rate hike cycle, triggering foreign portfolio investors to return. Therefore, we believe that much of the inflation pressure and RBI rate hikes are behind us now and we may continue to see a pause of the rate hike cycle in India.

Also, with the Indian economy being more domestic-focused, it is relatively better placed, though short-term hiccups cannot be ruled out.

What about recession or economic slowdown in developed countries say USA or other parts of the world? How will that impact sectors here in India?
The possibility of a recession in the U.S. and other parts of the world has been a topic of concern, with factors such as rising interest rates, high inflation, an inverted yield curve, and a recent regional banking crisis.

However, despite these warnings, the U.S. economy has shown resilience over the past nine months, with a strong labour market and ongoing consumer spending.

The potential economic recession or slowdown in developed countries may have a significant impact on export-oriented sectors in India.

For instance, a slowdown in the US and other parts in the globe could lead to lower demand for Indian exports, such as pharmaceuticals and IT services (But with the recent correction in these two sectors, valuation is started looking attractive on a selective basis).

This could lead to moderation in new job creation and may dampen economic growth in India to some extent. Additionally, a recession in developed countries could lead to a decline in foreign investment in India.

This could further dampen economic growth and make it slightly difficult for Indian businesses to access foreign capital. Overall, a recession or economic slowdown in developed countries is a potential risk to the Indian economy.

However, macroeconomic condition in India is better placed than other emerging economies and peers hence we believe that the adverse impact of possible global growth slowdown on the Indian economy will be limited.

The withdrawal of Rs 2000 note – is there any deep impact you foresee on the economy?
The withdrawal of Rs 2000 note is likely to have a limited impact on the economy. The denomination accounts for only 10.8% of the total currency in circulation.

The withdrawal is likely to lead to a temporary increase in demand for smaller denomination notes, but this demand is expected to be met by the RBI. The withdrawal of Rs. 2000 possibly lead to a decrease in the use of cash for transactions, as more and more people will tend to switch to digital payments.

This shift to digital payments is potentially beneficial for the economy, as it likely to improve tax buoyancy. Overall, the withdrawal of Rs 2000 note is not expected to have a significant impact on the economy. The impact is likely to be limited and temporary.

How do you pick stocks for your portfolio? What are the filters you use?
We have a disciplined investment philosophy and focus on Growth at Reasonable Price (GARP) strategy. We follow a bottom-up research process, which helps us to identify the best ideas across sectors, and in superior stock selection—which is the key contributor to alpha generated over the long term.

We look for companies with a strong competitive advantage in terms of brand, distribution reach, cost advantage and barriers to entry. We also prefer companies with good corporate governance and a competent management team.

What is your take on FMCG stocks? Recently, price action has increased in his space? What is leading the rally?
The FMCG sector is witnessing a modest improvement in demand trends across rural and urban markets. With a growing population and increasing disposable incomes, the demand for FMCG products is expected to remain robust.

Urban markets, especially in the premium category, are projected to experience resilient demand and positive volume growth. The ongoing decrease in headline inflation bodes well for overall consumption, particularly in rural areas, as it enhances affordability and purchasing power.

As inflation moderates, FMCG companies may witness enhanced margins and reduced cost pressures.

The outlook for rural demand is anticipated to improve with increased government spending and the positive impact of an expected normal monsoon on the rural economy.

These factors indicate a gradual recovery in volumes, expected to grow at a low to mid-single-digit rate in the medium term.

The margins are expected to improve due to factors like lower raw material prices, cost optimization measures, and potential volume growth. Most FMCG companies are projected to experience sequential and year-on-year improvements in gross margins in the coming quarters.

The FMCG industry is expected to post double-digit earnings growth in FY24, driven by revenue expansion and cost reduction.

Major FMCG companies' valuations have moderated and are now below historical averages. Within the next 12 months, it is anticipated that valuations will return to mean levels as volume growth and profitability potential increase.