

'Market returns may moderate in the near term given slightly elevated valuations'

Tête-à-tête with Bajaj Allianz Life Insurance chief investment officer Sampath Reddy



By Nachiket Kelkar | Updated: August 22, 2023 14:50 IST



Bajaj Allianz Life Insurance Chief Investment Officer Sampath Reddy

Indian equity market rallied this year on the back of strong foreign institutional investor inflows and continued domestic retail investments through systematic investment plans of mutual funds. Post the rally, while the markets are starting to look a bit expensive in some pockets, India remains better placed from a macro-economic perspective and stronger corporate balance sheets, says Sampath Reddy, chief investment officer at Bajaj Allianz Life Insurance. In an interview with THE WEEK, Reddy shares his views on factors that will continue to drive stock market, sectors he is betting on and outlook on interest rates.

Strong flows from domestic as well as foreign investors drove the equity market rally. Do you expect the momentum to continue through 2023 and perhaps 2024?

The equity market rally this year has primarily been driven by FPI equity flows, which have picked up to around \$15 billion CYTD (calendar year-to-date) in 2023 compared to a net outflow of \$16.5 billion in entire calendar year 2022. This is due to India's relatively better macro-economic fundamentals within emerging market peers – with stable growth and benign inflation.

Also, some macro slowdown in China and recent signs of deflation, could have diverted some foreign flows from China to India.

A rate cut cycle by the US Federal Reserve in CY2024 could contribute to foreign flows increasing to emerging markets, and India is likely to benefit from that because it is relatively more attractive within emerging markets (EM) peer group. India's weight in the MSCI EM index has gone up from around 8 per cent three years ago, to 14-15 per cent presently (the highest weight increase in EM index), and that could attract more EM flows to India. Also, the rupee remains relatively stable, which further provides comfort to foreign portfolio investors.

DII flows have relatively moderated this year, primarily due to some slowdown in lumpsum mutual fund equity flows. But SIP flows remain robust and touch record highs every month.

What are going to be the key factors that could help sustain the market rally?

India is relatively better placed from a macro-economic perspective, and inflation and monetary policy remains broadly in control (compared to the developed economies). Corporate earnings in India have also been a strong positive surprise, especially during the pandemic, which has helped the markets to outperform over the past few years by a significant margin.

Nifty 50 index aggregate Profit After Tax (PAT) has almost doubled from Rs. 3.3 trillion in FY20 to Rs 6.2 trillion in FY23. Although corporate earnings growth is normalizing now, we expect Nifty earnings growth of 12 per cent in FY24 and 14 per cent in FY25—which is still healthy. Corporate deleveraging cycle in India also makes corporate balance sheets to be better positioned to deal with any possible growth slowdown.

Which are the sectors you feel confident investing in this bull cycle and could deliver strong returns over a medium term?

We have been positive on sectors like private banks, industrials and pharma for a while and their outperformance have helped our equity portfolios. Private banks are in a favourable operating environment with good credit growth, strong margins and benign asset quality – resulting in all-time high ROA/ROE for most players. Most banks are well capitalized, and valuations are in-line with historical averages.

Industrials and capital equipment are seeing good order inflows from railway, defence, and other government spending. With the domestic economy picking up, we could also see some revival of private capex cycle. Within pharma sector, domestic business is steady while US generic business is showing signs of bottoming out. Valuations are attractive on selective basis within the pharmaceutical sector.

We are also positive on some emerging / niche themes like railways and defence capex plays, quick service restaurants (QSR) – due to changing consumption pattern, and electric vehicles segment.

In bull markets like we are in, are valuations increasingly becoming a concern or are there still value opportunities to chase?

With Indian equity markets outperforming, valuations have picked up and are starting to look a bit expensive in certain pockets especially. Nifty index forward P/E ratio is above the long-term average, but still away from the peak seen in 2021.

However, India has a favourable GDP growth forecast of around 6.5 per cent for FY24, which makes it the fastest growing 'major' economy amid an expected global growth slowdown. Therefore, the relatively stronger macros and fundamentals for India could help it to sustain a valuation premium for some time. Market returns maybe more moderate in the near term (given the slightly elevated valuations), but the long-term India growth story still remains intact.

Bajaj Allianz launched a small-cap fund this year. Why now? Small-caps have already rallied, is there more steam left?

The launch of small cap fund was to further expand our ULIP (unit-linked insurance plan) fund offerings and plug any product gaps for investors. Given that ULIP is a long-term investment product, a small cap fund could be suitable for investors with a higher risk appetite for long-term wealth creation. We were the first to launch a small cap fund in the insurance industry, even though they have been around for a while in the mutual fund industry.

Given the strong performance of small-caps and robust fund flows, the valuations of small caps have become slightly expensive now. As per AMFI (Association of Mutual Funds in India) data, small cap fund category has seen the highest inflow in the equity MF segment over the past year, and even in the recent month of July 2023. We are currently advising investors having a longer investment horizon and higher risk appetite to invest in small cap fund using a systematic investment approach.

Would you choose mid and small caps over large caps?

With the strong rally in broader markets (mid/small caps) over the past year or so, and with relatively higher valuations, we presently recommend a higher allocation to large-caps in an investor's portfolio (from a risk-reward perspective).

What's your view on interest rates? Have rates peaked and in this backdrop what should the strategy be on debt investing?

We feel that interest rates are closer to the peak in India. The RBI continued to remain on pause in the August policy as expected, and increased the FY24 inflation forecast to 5.4 per cent from 5.1 per cent earlier. It introduced an ICRR to suck out some liquidity because of return of Rs 2,000 denomination notes to the banking system, but we feel this is a temporary liquidity tightening measure.

The July 2023 headline inflation print came in significantly above expectations at 7.4 per cent, compared to 4.9 per cent in June 2023. But almost the entire rise in inflation was contributed by a big spike in vegetable prices, because of which food inflation rose to 11.5 per cent. Core inflation continued to moderate to 4.9 per cent during the month.

We believe, given the recent inflationary pressures in India, elevated global monetary policy outlook, and RBI's commitment to bring down domestic inflation to 4 per cent; rate cut expectations have been further pushed back (with an extended pause expected), and will depend on evolving data. However, if inflation in India persists for longer and is more generalized, then the RBI may be forced to take some short-term monetary tightening measures. From a fixed income investment perspective, we presently prefer the medium to long term part of the yield curve.