Market Outlook

February 2021

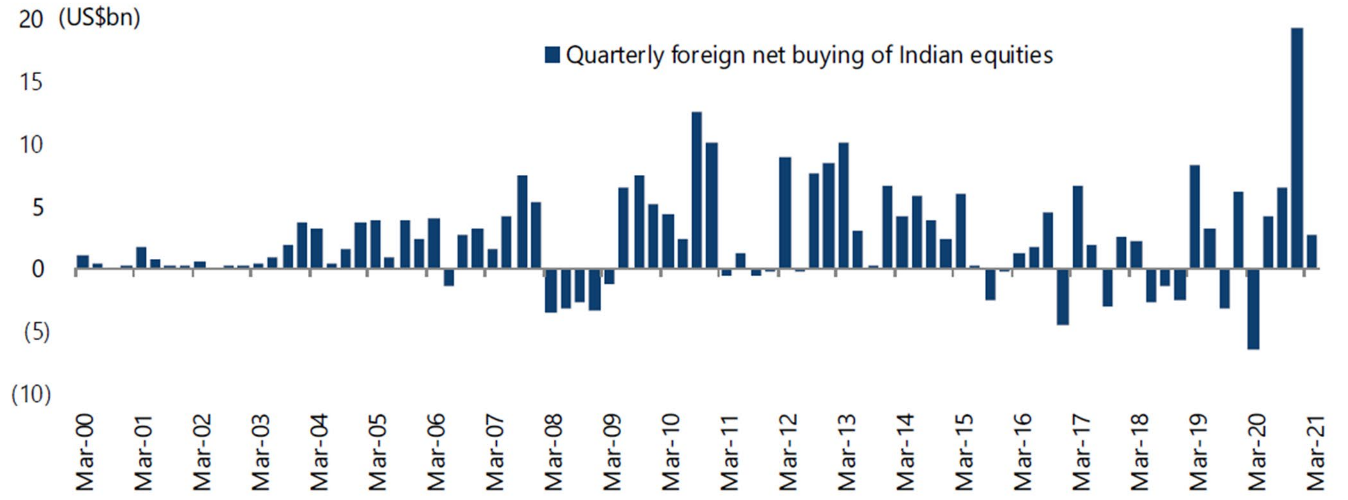
Key takeaway from this commentary

We are extremely confident of a strong cyclical recovery in India which would primarily benefit India's financial sector. Almost all the constituents to make this happen are in place including:

- Extremely low interest rates
- RBI's continued accommodative stance to support growth by keeping rates low
- Abundant liquidity in the global markets represented by the 5-year high level of FPI holding of Indian Equities
- US Government and Fed combined continuing to inject fiscal stimulus of around $3 trillion in 2021 at a level equivalent to 2020
- The bottoming out of the housing cycle and the best-ever affordability levels
- A landmark budget indicating willingness to fund infrastructure growth by keeping high fiscal deficits etc.

Liquidity is boosting stock prices

Quarterly foreign net buying of Indian equities

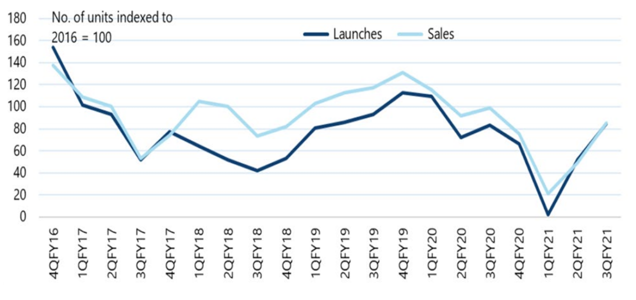


Note: Data upto 19 January 2021. Source: Jefferies

Even though all markets are witnessing a positive liquidity effect, India has received the highest ever inflows of $19 bn in a quarter in over 20 years. Foreign Investors are quite enthused by the prospect of strong GDP recovery with the Nominal GDP growth expected to around 15% and the earnings growth of over 30% in FY22.

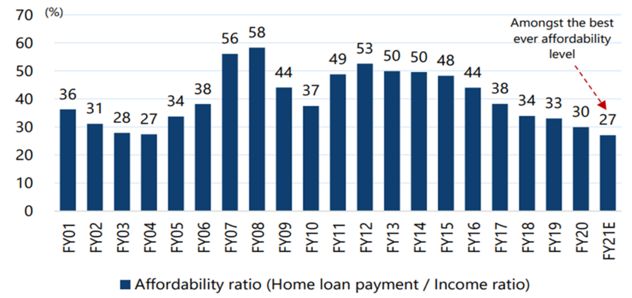
Housing Cycle is in a upswing after 8 years

India residential unit sales (indexed) in top 7 cities



Source: Jefferies. January 2021

Affordability (home-loan payment to income ratio) ratio trend



Source: Jefferies. January 2021

The residential property sales are expected to double and even then, the prices will be 30% below the 2013 highs. After such a long downturn the upturn could also be a long one and with the housing affordability at its best in India it is expected that a strong housing recovery will strongly contribute to the bounce in GDP.

Financial Sector would be a major beneficiary

Financial services businesses are beneficiaries of a cyclical upturn. In particular, lenders with strong balance sheets are very favourably placed to take advantage of the capital expenditure needs of viable projects and also of the booming retail demand for housing and consumption goods.

In this context, a few private sector lenders amongst banks, NBFCs, HFCs are set to win market shares from their public sector counterparts that are short on capital.

Our portfolio attempts to pick such businesses and we remain convinced that "while a rising sea will lift all boats, some boats will lift higher."

Many of these stocks are still reasonably valued when compared to those in certain other sectors and a combination of valuation re-rating and compounding of earnings will drive the stock prices higher.

India Banks: Stock returns during past cycle; growth matters

	Absolute Performance				
	F2004	F2005	F2006	F2007	F2004-07
Nominal GDP Growth	**12%**	**14%**	**14%**	**17%**	**71%**
Bankex	**119%**	**29%**	**37%**	**24%**	**378%**
Sensex	**83%**	**16%**	**74%**	**16%**	**329%**
Large Private Banks					
Axis	275%	60%	48%	38%	1125%
HDBK	65%	42%	43%	23%	313%
ICBK	125%	31%	51%	45%	546%
Mid-sized Private Banks					
Kotak	150%	70%	106%	71%	1400%
Federal	350%	33%	25%	13%	750%
SOE Banks					
BOB	188%	-10%	5%	-7%	153%
BOI	55%	76%	29%	25%	342%
Canara	104%	38%	33%	-27%	174%
PNB	235%	18%	19%	1%	375%
SBI	128%	9%	47%	3%	276%

Source: Morgan Stanley, February 2021

Much of the foreign capital is coming into these stocks and it is important not to miss this opportunity that was last seen in the 2004-2007 cycle.

Risk to the Market Outlook

The main risk to the market outlook is a sustained increase in inflationary pressures due to the pick-up in growth and the resultant withdrawal of policy support by global central banks including RBI. We see the possibility of this not being high in the context of the recent monetary policy commentaries where the central banks have indicated their willingness to tolerate overshooting of inflation beyond their indicated range of comfort.