Sun Life Excel India Fund

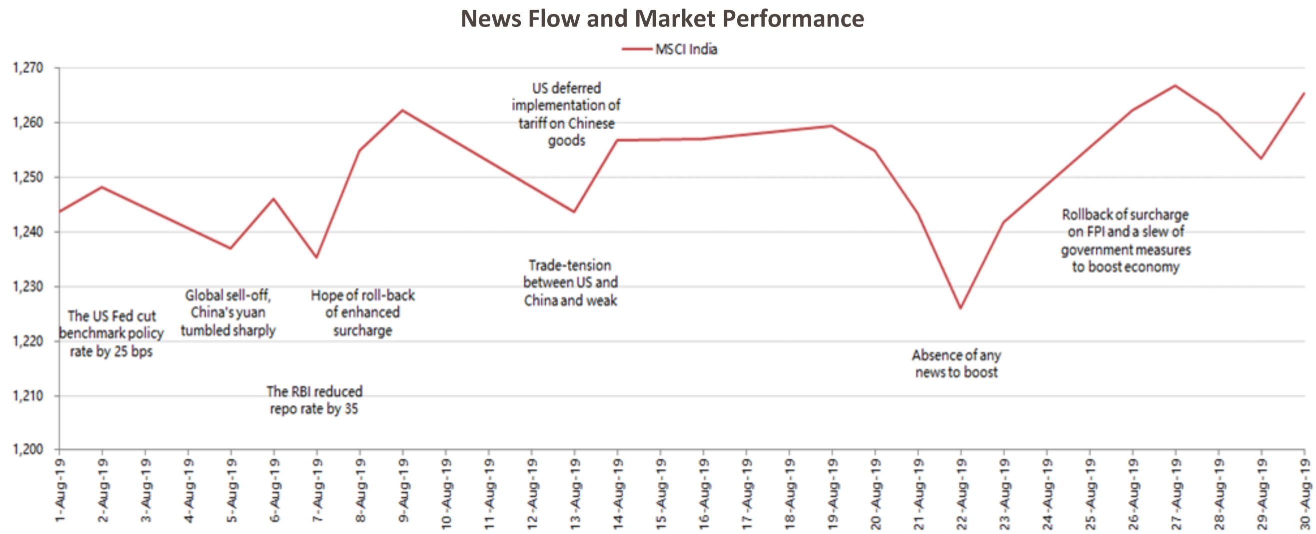
MONTHLY COMMENTARY

AUGUST 2019

Opinions and commentary provided by Aditya Birla Sun Life Asset Management.
(Note: In India, the Financial Year runs April 1 to March 31, so the current period is FY 2019-20)

Equity Market Recap and Outlook

MSCI India (US$) declined by 3.2% in August, but outperformed the MSCI Emerging Market Index (-5.1%) and the MSCI Asia Pacific (ex-Japan) Index (-4.7%). Performance was adversely impacted by a weakening currency as the rupee depreciated by 4%, despite a flat US Dollar (+0.4%). Mid-and-small-cap indices underperformed large-cap indices.



Source: Bloomberg, Kotak research

On the global front, equity markets witnessed a volatile month amid US-China trade disputes. On August 1, U.S. President Donald Trump imposed a 10% tariff on the remaining $300 billion of imports from China. Trade tensions intensified again on August 23, with China announcing additional tariffs on $75 billion of imported products from the U.S., and re-imposing tariffs on automobiles and auto parts imported from the U.S. starting on December 15. Meanwhile, Trump announced an increase in tariffs from 25% to 30% on $250 billion worth of Chinese imports. President Trump also tweeted that he had the “absolute right” to “order” U.S. companies to stop doing business with China.

Indian equities gained marginally in local currency terms but nevertheless endured a volatile month. The Finance Minister announced a series of measures during the month to address growth concerns. The surcharge on capital gains for both domestic and foreign investors announced in the Union Budget on July 5 was reversed. Around 40% of Foreign Portfolio Investments (FPIs), which follow the 'trust' route, were impacted by the surcharge. Other measures were also announced to address interest rate transmission, improve liquidity and credit flow and help with the auto sector slowdown. Late in the month, the government announced the amalgamation of ten public sector banks into four, leading to larger banks with bigger balance sheets. Benefits from merger synergies then helped credit growth in the economy.

Foreign Institutional Investors (FIIs) recorded net outflows of US$2.3 billion in Indian equities in the month of August compared to US$1.9 billion of outflows in July. Year to date, FIIs are net buyers at US$7.1 billion in Indian equities.

In terms of debt, FIIs recorded net inflows at US$1.5 billion in August (the consecutive month of US$1 billion+ net inflows). Year to date, FIIs remain net buyers at US$4.2 billion in debt markets.

Domestic investors (DIIs) were net equity buyers at US$2.7 billion in August compared to net inflows of US$3.0 billion in July. Year to date, DIIs are net buyers at US$4.6 billion of inflows. Mutual funds bought US$2.4 billion of equities in August compared to inflows of US$2.1 billion in July. Insurance funds bought US$314 million in August compared to inflows of US$851 million in July. Year to date, mutual funds are net equity buyers at US$5.7 billion while insurance funds remain net equity sellers at US$1.1 billion.

Sector and stock returns (%, INR)

Ranked sector returns				Top and bottom five MSCI India stocks			
One month		Three months		One month		Three months	
Energy	3.3	IT	4.4	Hdfc Life Insurance	12.9	Hdfc Life Insurance	26.2
IT	2.9	Consumer staples	0.8	Petronet L N G	12.9	Avenue Supermarts	18.8
Consumer staples	2.8	Healthcare	(4.1)	Piramal Enterpirses	12.3	Asian Paints	14.8
Consumer disc.	2.3	Communication services	(6.4)	Maruti Suzuki India	12.0	Unitied Spirits	13.4
Communication services	1.4	Financials	(9.8)	Pidilite Industries	11.1	Dabur India	13.4
Healthcare	1.0	Utilities	(9.8)				
Industrials	(1.6)	Material	(10.3)	Yes Bank	(34.3)	Vodafone Idea	(61.7)
Financials	(1.9)	Energy	(10.8)	Vodafone Idea	(21.9)	Yes Bank	(59.4)
Utlitilies	(3.5)	Industrials	(12.2)	Tata Steel	(20.2)	Indiabulls Housing Fin	(42.1)
Material	(4.4)	Consumer disc.	(14.4)	Lic Housing Finance	(17.9)	Tata Motors	(32.4)
MSCI India	0.5	MSCI India	(6.7)	State Bank of India	(17.6)	Glenmark Pharmaceuticals	(29.5)

Source: MSCI, Datastream, Bloomberg, *Dll and FII Info is as of August 30, 2019

Over the month, energy, IT services and consumer staples were key outperformers, while materials, utilities and financials were notable laggards.

Market Outlook

Indian equity markets had touched all-time highs after elections. However, post the Union Budget, the large cap index is down roughly 8% while the mid cap and small cap indices are down 12-14%. There seems to be heightened pessimism in the market mainly due to:

- Concerns regarding a continuing slowdown in consumption, especially in the Auto sector. The government has not announced any direct short-term measures to boost consumption so far which seems to have impacted market sentiment.
- Lack of money flow in the broader economy which is stifling growth. Although various measures have been announced to boost system liquidity, risk aversion towards Non-Banking Financial Companies (NBFCs) remains high leading to high credit spreads. NBFC issues are also leading to continuing stress in the real estate sector.
- Globally, there is an element of caution as the trade talks between the U.S. and China are not progressing as smoothly as expected.

However, on the positive side:

- We are in an environment of easier monetary policy which may aid an economic recovery in the medium term. The RBI cuts its policy rate by 35 basis points last month resulting in cumulative 110 bps of rate cuts in CYTD19 (Calendar Year to Date 2019).
- The progress of the monsoon has been strong and should provide some relief to the rural economy, thereby improving consumer sentiment.
- The government seems to have realized the magnitude of the stress in the economy with the RBI also reducing its growth forecast for FY20. The government is evaluating measures to address the concerns of various sectors as well as the FPIs and the capital markets.
- Globally, central banks are dovish and the U.S. Fed also reduced its policy rate by 25 bps. Brent crude prices have fallen below $60 per barrel which is beneficial for India's CAD. The Rupee has depreciated slightly below INR 70/USD in line with the depreciation of the Chinese Renminbi.
- GDP growth, and by extension earnings growth, is likely to be muted in the first half of FY20. However, as the easier monetary policy and various government measures start having an impact, and due to a favourable base, we could see a recovery in the second half of FY20. While our GDP growth expectation for FY20 is less than 6.5%, the policy reforms implemented thus far (GST, IBC, PSU Bank recap, etc.), as well as those in the works (labor regulation, land acquisition, legal reforms, etc.), should drive the country towards higher sustainable growth rates in the medium-to-long term. Higher earnings growth should follow.

Q2 earnings season is ongoing and of the 38 NIFTY (top 50 companies on India's stock exchange) companies that have reported results, 60% have come in above / In-line vs. estimates. Currently, the yield gap ratio for the NIFTY stands at 0.84 compared to the long-term average of 0.78. At 18x 1-Yr forward P/E multiple for the Nifty, valuations are close to the long-term average. Both metrics indicate that Equities are in a relatively attractive zone. India's structural growth story remains intact and has been reinforced by the progressive reforms initiated by the government. We remain generally optimistic on the Indian equity market outlook from a medium to long term view.

Fixed income recap and outlook

Growth indicators

Growth remained poor with Q1FY20 (April to June 2019) GDP growth coming at a disappointing 5.0%, the lowest growth rate since March 2013. This slowdown was broad based and not driven by idiosyncratic factors like government expenditure or agriculture. Private consumption, which has so far been the most resilient part of GDP, plunged and so did imports.

Gross Fixed Capital Formation (GFCF) remained weak and exports growth halved. Government expenditure held on while nominal GDP growth plunged to an 8.0% increase year over year. Real Growth Value Added (GVA) also came at its lowest since Mar 2013 at 4.9% with a decline across every segment except for electricity and public administration. Auto sales have continued to decrease and the Index of Industrial Production (IIP) declined 2% in June, with only 8 out of 23 manufacturing groups showing growth. Composite PMI for August also declined to 52.6 from 53.9 in July, with both manufacturing and services PMI declining. The global environment and equity market remains weak, which has soured market sentiment.

Fiscal

Despite aggressive rate cuts, the weighted average lending rate has not fallen significantly. There are thus headwinds to a quick growth revival and we expect FY 2020 (April 2019 to March 2020) to have sub-6% growth compared to the RBI's estimates of 6.90%.

External sector

The July trade deficit declined to its lowest in 4 months, due to lower gold and oil imports and an overall increase in exports (especially machinery, electronics and chemicals).

We expect the Balance of Payments (BoP) to remain favourable in FY20 with a healthy surplus aided by a low CAD and moderate foreign capital inflows, particularly coming from foreign direct investment (FDI). The main risks are a broad-based global risk-off that could result in massive EM outflows or a large increase in crude oil prices due to geo political risks.

Inflation

July inflation came broadly in line with expectations at 3.15%. On a month over month basis, the CPI increase remained India's lowest in three years. Overall inflation numbers have broadly met expectations and should not interfere with monetary easing.

Portfolio Positioning

The risk to achieve fiscal targets are increasing due to the global and local growth outlook remaining cloudy, meaning monetary policy will have to do more lifting to boost growth. Liquidity has already moved to surplus levels; however, a large part of this is because of the seasonal movement of economic variables.

The RBI indicated in their June policy that they would like to revise their liquidity framework. We expect that in order to facilitate better transmission, the stance should be accommodative. The liquidity premium in the short end is still too high and does not correspond to the current macro and RBI stance.

The portfolio modified duration stands at 4.72 years compared to the benchmark duration of 5.02 years. The portfolio continues to earn a higher carry of 7.73% compared to the benchmark carry of 7.40%.

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