# MONTHLY UPDATE
# JULY 2021

20 YEARS
Protecting India with Pride

HDFC Life
Sar utha ke jiyo!

Jul, 2021

"Chains of habit are too light to be felt until they are too heavy to be broken."

- *Warren Buffet*

## Equity markets

| Indices | 30th Jul 2021 | 30th Jun 2021 | 1 Month Return (%) | 1 Year Return (%) |
|---|---|---|---|---|
| BSE Sensex | 52,587 | 52,483 | 0.2% | 51% |
| S&P CNX Nifty | 15,763 | 15,722 | 0.3% | 53% |
| BSE 100 | 16,108 | 16,010 | 0.6% | 55% |
| BSE Mid Cap | 23,087 | 22,536 | 2.4% | 77% |
| BSE Small Cap | 26,787 | 25,232 | 6.2% | 116% |

*Source: Bloomberg*

During Jul'21, domestic equity indices had a mixed performance - large cap indices were up ~0.2%-0.6% while the mid and small cap indices outperformed with BSE Mid Cap and Small Cap Index up 2%/6% respectively. On a 1-year basis, the mid and small cap index have outperformed the large cap indices. Over the past one year, Sensex and Nifty were up 51% and 53% respectively while mid cap and small cap index were up 77% and 116% respectively.

During Jul'21, performance across the sector indices was mixed. The performance ranged from -5% to +16%. Realty and Metals sector gained the most; up 16% and 13% respectively while Auto and Power sector fell the most; down 5% each. On a 1-year basis, Metal sector is the best performing sector gaining 191% followed by IT and Realty sector respectively. FMCG followed by Oil & gas are the bottom two sectors; up 20% and 22% respectively.

The yield of benchmark 10-year G-sec moved to 6.20% at the end of Jul'21 from 6.05% at the end of Jun'21.

Major global equity indices had a mixed performance – Hang Seng was down 10% during the month and Nikkei and Shanghai Composite were down 5% each. S&P 500 along with CAC Index gained the most up 2%. On a 1 year basis, Nasdaq has gained the most; up 46%.

| Commodities (USD) | 1 Month Return (%) | One Year Return (%) |
|---|---|---|
| Gold | 3% | 2% |
| Silver | -2% | 40% |
| Crude Oil | 1% | 25% |
| Copper | 4% | 11% |
| Primary Aluminum | 3% | 60% |
| Lead | 5% | 34% |
| Nickel | 7% | 53% |
| Tin | 11% | 107% |
| Zinc | 2% | 48% |

Most of major commodities saw an uptick during Jul'21 except Silver. Tin rose the most, up 11% during the month.

On a YoY basis, all the major commodities have posted YoY gains. Tin has appreciated the most.

*Source: Bloomberg*

## Macro Economic Data

| Indicators | Apr-21 | May-21 | Jun-21 | Jul-21 | Comments |
|---|---|---|---|---|---|
| **IIP (yoy, %)** | 134.6% | 29.3% | | | Industrial output declined by 14% in May'21 (over May'19) vs. flat in Apr'21 (over Apr'19), mainly led by the declined in mining output (-2% in May'21) and manufacturing output (-14% in May'21) |
| **Core Sector (yoy, %)** | 60.9% | 16.3% | 8.9% | | Core sector output declined by 4.7% in Jun'21 (over Jun'19) led by the fall in Coal (-9.3% in May'21 over May'19), steel (-4% in May'21 over May'19), electricty (-3.6% in May'21 over May'19) and cement output (-2.8% in May'21 over May'19) |
| **RBI monetary policy (Repo Rate) (%)** | 4.00 | 4.00 | 4.00 | 4.00 | RBI kept repo rate unchanged at 4% as on Jun'21. |
| **CPI inflation (%)** | 4.2% | 6.3% | 6.3% | | CPI inflation dipped by 4 bps to 6.26% in Jun'21 from 6.3% in May'21 led by the moderation in Core inflation from 6.6% in May'21 to 6.1% in Jun'21 |
| **Trade Deficit ($, bn)** | -15.1 | -6.3 | -9.4 | | In Jun'21, exports grew by 48.3% to $32.5bn, while imports grew by 98.3% to $41.9bn, as a result trade deficit widened to $9.4bn in Jun'21 vs. $6.3bn in May'21. |
| **GST Collection ($, bn)** | 1414 | 1027 | 928 | 1164 | Total gross GST revenue collections in Jul'21 stood at Rs. 1,164bn, following Rs. 928bn collection in Jun'21. |
| **FII Flows-Equity ($, bn)** | -1.29 | -0.39 | 2.36 | -1.51 | On equity side, FPIs sold $1.51bn in Jul'21, following an inflow of 2.36bn in Jun'21. On debt side, FII sold $0.11bn in Jul'21, following an outflow of $0.66bn in Jun'21. |
| **FII Flows-Debt ($, bn)** | -0.02 | -0.24 | -0.66 | -0.11 | |
| **Exchange Rate (INR/USD)** | 74.02 | 72.52 | 74.35 | | Indian Rupee depreciated by 2.5% during Jul'21, as it closed at 74.35 in the end of Jul'21 from 72.52 at the end of Jun'21 per dollar. |
| **GDP (%)** | | | | | Real GDP grew by 1.6% in Q4 FY21 vs. 0.5% growth in Q3 FY21 led by the sharp jump in investment (13.8% in Q4FY21 vs. 3% Q3 FY21)and Govt. expenditure (28.3% in Q4FY21 vs. -1% in Q3 FY21) |

## Outlook

Global equity markets had a mixed July. Among developed markets, UK and Germany were flat while France and the US were up between 1.2-2.3%. Japan was an outlier with return of -5.2%. Hong Kong and China markets continued to feel the heat because of the crackdown by Chinese authorities on their "Big tech" companies which has engulfed companies in Fintech, Rideshare, Food delivery and now EdTech space. These markets were down 9.9% and 5.4%, respectively.

Most of the hard metals had a strong rally in July with Tin and Nickel being star performers with appreciation of 10.9% and 7.3%, respectively; other metals were up between 1.8-4.7%. Crude oil price hovered around $74 per barrel with the rally halted for the moment after the announcement by OPEC+ to increase the overall supply by 0.4 mn b/d per month over Aug-Dec21, thereby adding 2mn b/d of supply by end-CY21.

Economic data in most developed countries, especially the ones that have managed to vaccinate faster like the US, has continued to improve. Pace of economic recovery and inflation are key monitorables as they have a direct bearing on interest rate increases and tapering of stimuli by Global Central Banks.

Active caseload of Covid cases continued to moderate in July with the number standing at 0.4mn at July end while the cumulative number of confirmed cases stood at 31.6mn. Pace of vaccination, though better than earlier, is yet to show a material improvement. A total of 501mn vaccine doses have been administered till Aug 6 (390mn first doses and 111mn second doses).

All the high frequency indicators have shown a good sequential improvement in July with an improvement in the covid situation and subsequent opening up of the economy. However, the ongoing Q1FY22 results did show a significant impact of the second wave on the reported financials of all the domestic facing companies across most sectors. The impact was also visible in the asset quality of financial companies which bore a brunt of collections being meaningfully lower in April and May. There was also an additional hit at the gross margin level due to high commodity prices and inability of companies to take sufficient price hikes. Most of the export oriented sectors like IT and Pharma, on the other hand, expectedly performed quite well.

FII sold nearly $1.3bn worth of Equities in cash markets during July. DIIs on the other hand were net buyers to the extent of $2.1bn. For the calendar year, both FIIs and DIIs have been net buyers worth $6.7bn and $1.6bn, respectively. July was the fifth straight month of net equity inflows for mutual funds with equity schemes seeing inflows of Rs.225.8bn during the month.

Nifty earnings have been revised downwards during ongoing results season and are now expected to grow at a CAGR of 22% from FY21-23. While there is a reasonable chance of further downgrade in near term earnings especially if we get a third wave, there should be a commensurate acceleration from FY23 onwards on a then revised low base of FY22, also given the fiscal expansion and government's focus on growth revival through continuous reforms. After the recent run-up, markets are trading at nearly 19.1x FY23 earnings, resulting in valuations being higher than long period averages and making us cautious in the short term. However, we would be optimistic from a medium to long term point of view as we expect a cyclical recovery in the economy and earnings after several years of sub-par growth.

# Fixed Income Market

**Fixed Income Market Review –**

Bond yields rose during the month on account of multiple reasons. RBI did not buy liquid papers in its GSAP purchases which led to an uptick in yields. RBI accepting higher yield cut off in the weekly auctions did not help. The old 10yr benchmark bond rose sharply higher to 6.23% from its previous close of 6.05% as RBI issued a new 10yr benchmark bond at 6.10% during the month. The new 10yr benchmark bond also closed higher at 6.20%. On the positive side , in a surprise move the Central Government paid Rs 0.75 trn to states for the shortfall in the compensation cess without resorting to market borrowing. The additional borrowing plans for H1 have also been cancelled by the government.

During the month, the 10yr UST yield fell sharply to 1.23% from 1.47% and Brent Crude Oil prices rose to close at USD 76.3 per barrel higher compared to its previous close of USD 74.6 per barrel.

Among data releases, India's CPI inflation remained high at 6.26% in June-21 staying above the upper tolerance band of 6%, on account of a broad based spike in almost all index items. Food inflation printed at 5.6% on a y-o-y basis, as compared to 5.2% in May 2021. Core inflation (CPI Ex-Food Ex-Fuel) moderated to 6.2% from the previous month's print of 6.6%. Headline WPI inflation came marginally lower at 12.1% YoY in June 2021 lower than its all time high of 12.9% YoY in May 20. The high WPI indicates rising input cost pressure on manufacturers raising fears that these hikes are likely to be passed on to consumers thereby fueling CPI inflation in the coming months.

India's trade deficit rose to USD 11.2bn in July-21 from USD 9.4bn in June-21 led by increase in imports amidst gradual improvement in demand and increase in commodity prices. Among other economic data, IIP growth for May 2021 printed at 29.3% as against the revised reading of 134.6% in April 2021 as gradual waning of favorable statistical base led to moderation. The sequential momentum was weak across the board (contracted 8% MoM). Goods and Services Tax (GST) revenue collection for July came at Rs 1,16,393 cr. India's Nikkei Markit Manufacturing PMI rose to 55.3 in July 2021, against 48.1 in the previous month, and the Services PMI improved to 45.4 in July of 2021 from 41.2 in the previous month. Composite PMI also improved to 49.2 in July vs 43.1 in June.

**RBI Monetary measures and Bi-monthly Monetary Policy meeting**

In the August MPC meeting, the RBI kept policy rates unchanged and five members voted for retaining stance at "accommodative". One member (Prof. Jayanth Varma) voted against it. RBI increased its quantum of variable rate reverse repo (VRRR) of 14-day tenor to Rs4 tn by September 24 in a staggered way from the current Rs2 tn. MPC cut its GDP growth forecast for the next 3 quarters and revised its headline CPI inflation projection to 5.7% for FY2022 from 5.1% earlier. The MPC believes that the rise in inflation is temporary and hence any action against it will hurt the nascent recovery of economy.

**Market Outlook –**

Despite the elevated CPI and WPI inflation coupled with high global crude prices, RBI governor's comment on the high inflation as transitory and RBI's intention on prioritising growth has provided some respite to the markets. While, RBI is expected to continue to conduct GSAP to temper the rise in yields, the huge supply of bonds amid fear of rising inflation is expected to keep the markets on tenterhooks. Secondly, the increase in the VRRR amounts is seen as an initial signal of the start of the process of reversing the large monetary accommodation provided by RBI. The yield curve is expected to reflect the rise in short term yields as the surplus liquidity gets progressively absorbed by RBI. Yields may then harden further, as is being witnessed in other economies that are recovering from the second / third waves of Covid infections. The timing and extent of RBI’s support is likely to be key going forward.

Although large developed economies are on a firm recovery trajectory witnessed by uptick in growth and inflation, the recent spike in cases of delta variant across a number of countries, has stoked fear of another wave of infection. Rise in infections across major economies and concerns on growth, have led to fall in UST yields, providing some temporary respite to Indian bond markets.