

## Equity Market Outlook

The global environment remains adverse, though inflation might have peaked, based on the latest inflation data in US. The latest comments from Fed about possible slowing pace of increase in the interest rates is comforting (but indication on longer period of inflated rates is discomfoting). The short term interest rates are likely to remain at elevated level of ~5.5%, till inflation shows serious moderation. Terminal interest rates in US have clearly moved up by 50bps to 5.25-5.75%. Combination of slowing growth but yet sticky inflation is an outcome of elevated energy prices and challenged supply chains in China/Energy, which are taking time to correct itself. Geopolitical tensions are taking time to abate and are only getting complex. Given these tensions, supply chains and global trade has become vulnerable to new dimension in 2023, missing till 2022.

In our worldview, 1) the Liquidity, 2) Growth and 3) Inflation surfaced post monetary and fiscal expansion in 2020 in that order and they will reverse in the same order during CY22/23. We are already witnessing liquidity reversal since last few quarters; growth has started receding lately (Europe is already in recession, US is slowing) and inflation will be the last one to moderate. We have seen an initial downtick in inflation. Inflation is taking more time than usual to recede given healthy household savings, elevated energy prices, tight labor markets and challenged supply chains in China. In-turn, further interest rate increases become imperative - expect additional 25-50bps increase through next 6months to 5.25%-5.75% in US – and remain there for some time.

Equity market domestically were focused on the earnings (season) growth and cost of capital (interest rate outlook globally). We think, both these factors are neutral to negative for India from near term perspective and thus market will continue to consolidate till we get visibility on earnings upgrades or substantial decline in interest rates (Inflation globally/locally) to change multiples. The result didn't throw any surprises, the earnings growth in tracking FY23 expected numbers well although helped predominantly by financials during 3QFY23. The internals of the earnings are not very healthy expect in financials, auto and industrials. India trades at premium to other EMs and thankfully that is correcting with the consolidation over last 1.5 year. Indian equity market trades at 18.5x FY24 earnings – with earnings CAGR of 13-14% over FY23-25E – in a fair valuation zone from near term perspective. We will watch out for one year forward (Earnings yield – Gsec yield) gap to compress to ~150bps for getting more constructive in near term.

Having said this on near term earnings /market context, we believe that Indian economy is in a structural upcycle which will come to fore as global macroeconomic challenges recede over next few quarters. Our belief on domestic economic up-cycle stems from the fact that the enabling factor are in place viz. 1) Corporate and bank balance sheets are in best possible shape to drive capex and credit respectively, 2) Consumer spending remains resilient through cycle given our demographics, 3) Govt is focused on growth through direct investments in budget as well as through reforms like GST (increasing tax to GDP), lower corporate tax and ease of doing business (attracting private capex), PLIs (private capital through incentives for import substitution or export ecosystem creation) and 4) Accentuated benefits to India due to global supply chain re-alignments due to geopolitics. This makes us very constructive on India equities with 3-5years view.

Source: ICRA MFI Explorer

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