FRANKLIN TEMPLETON INVESTMENTS

# Equity Market Snapshot

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## Global Markets

The year 2018 started on a positive note for the global equity markets with most of them advancing in January, backed by widespread positive macroeconomic data. Emerging markets were top gainers supported by strengthening global growth and trade. Brazilian equities (top performer) rallied on hopes of re-election of the current president, viewed to be favorable for equity markets. Persistent inflows from China buoyed the Hong Kong equity market. Strengthening of Yen and profit-booking in Japanese stocks capped gains in the Japanese equities during the month. US equities advanced on encouraging economic data, shrugging off the impact of the 3-day shutdown of the US Federal Government in January 2018. European equities also ended positive, though UK equities declined on strengthening of the Pound. Towards the end of the month, rising bond yields in the US, fueled by expectation that higher inflation would speed up the interest rate hikes by the US Federal Reserve, triggered a sell-off in the global equity markets thereby capping gains.

Brent crude oil prices advanced in January on concerns over potential supply disruptions in Iran amid anti-government protests and falling inventories in the US. After a robust rally seen in CY17, the base metal prices corrected during the month on rising stockpiles and rising output.

| Monthly Change for January 2018 (%) | |
|---|---|
| MSCI AC World Index | 5.6 |
| MSCI Emerging Markets | 8.3 |
| Dow Jones | 5.8 |
| Nasdaq | 7.4 |
| S&P 500 | 5.6 |
| FTSE Eurotop 100 | 1.3 |
| FTSE 100 | -2.0 |
| Hang Seng | 9.9 |
| Nikkei | 1.5 |
| Brent crude (USD/bbl) | 3.3 |
| Spot LME Aluminium USD/MT | -1.6 |
| Spot LME Copper USD/MT | -1.8 |
| Spot LME ZINC USD/MT | 7.7 |

| Monthly Change for January 2018 (%) | |
|---|---|
| S&P BSE Sensex | 5.6 |
| Nifty 50 | 4.7 |
| Nifty 500 | 2.2 |
| Nifty Free Float Midcap 100 | -1.6 |
| S&P BSE SmallCap | -2.7 |
| S&P BSE Finance | 5.9 |
| S&P BSE Auto | -3.0 |
| S&P BSE Information Technology | 11.3 |
| S&P BSE Fast Moving Consumer Goods | 0.2 |
| S&P BSE OIL & GAS | 0.5 |
| S&P BSE Capital Goods | 6.4 |
| S&P BSE Healthcare | -1.6 |
| S&P BSE Metal | 3.3 |

## Domestic Market

Indian markets surged in January supported by expectation of better corporate results for 3QFY18 and buoyant industrial growth data. The BSE Sensex index scaled life high towards the end of January post which investors turned cautious ahead of the union budget, thereby capping index gains at 5.6%. Broader indices (BSE 200 and BSE 500) gained between 2.3-2.8% outperforming mid and small cap indices which ended in the red. IT sector witnessed a sharp rally led by hopes of higher IT spends in the US post tax reforms. The banking sector advanced on positive 3QFY18 results along with news of mergers and capital being raised by some players. Metal sector rallied on volume and profitability growth of major companies in the sector. Oil & gas sector rose on gains made by key players during 3QFY18. Net FPI equity flows in January remained positive to the tune of USD 2.0 bn. The DIIs were also net buyers, bringing in USD ~63mn (INR 398.7 Crore) during the month.

**Macroeconomic Indicators:** Manufacturing PMI moderated to 52.4 in January (54.7 in December) as output and new order growth expanded at a slower rate. Services PMI expanded to 51.7 in January (50.9 in December) on new business growth. Index for industrial production (IIP) surged to 8.4%YoY in November (2.2%YoY in October) led by robust growth in the manufacturing sector. Strong pick up was seen in Capital goods, even as base effect contributed to an uptick in consumer nondurables and construction goods. Trade deficit (merchandise) widened in December to stand at USD 14.8bn from a year ago as imports grew 21.1%YoY offsetting the 12.3%YoY growth in exports. Rise in oil prices and a surge in gold imports added to the deficit. Non-oil and non-gold imports continued to grow at a healthy pace of 12.9%YoY. Fiscal deficit is estimated to stand at 3.5% of GDP for FY18 given the rise in government spending and relatively lower growth in tax revenue.

**Corporate Earnings:** 3QFY18 corporate results till now indicate gradual improvement of growth on top of favorable low base same period last year, which was impacted by demonetization. Fading impact of GST-led destocking combined with some revival in rural consumption (normal monsoons) suggest demand growth acceleration in the coming quarters. Sectors impacted by demonetization including FMCG, Auto, Cement, Retail and Consumer Durables should see a resurgence growth in going forward. Strong uptick in commodity prices and a healthy volume growth are likely to drive the Metal sector profits. NBFC and corporate-oriented banks are expected to post a broad-based growth on improving asset quality trends and progress in IBC/ NCTL process. Technology is expected to report a moderate quarter but with an improved outlook due to reviving tech spend in US and other developed markets. Telecom and healthcare sectors may continue to report muted results as they continue to face headwinds on the domestic and global front, respectively.

**Valuation:** Bloomberg consensus estimate growth for FY18 EPS stands at 6.7% while estimated EPS growth for FY19 is 25.8%. FY18 forward PE for Sensex stands at 23.0x (based on Bloomberg consensus earnings estimate) and indicates a premium to long-period average.

## Budget 2018-19

Treading the tightrope between leaning towards populist measures and maintaining fiscal prudence, Union Budget 2018-19 places emphasis on social sector and at the same time, commendably shows a resolute intention to follow the fiscal consolidation path. In the backdrop of rising crude oil prices, vulnerable fiscal and current account situation and nascent recovery in the domestic growth, the budget strives to achieve an equilibrium between growth and social sector spending by reiterating its focus on rural income push to spur consumption. The budget delivers on road, railway and social sectors along with a focus on fiscal consolidation. MSP at 1.5x of input costs in the farm may lead to some meaningful hikes in food prices and can engender inflationary risks driven by higher food prices. Quality of spending remains moderate and includes a healthy growth of 20.8% in the total infrastructure outlay and a 9.9% rise in capital expenditure. Tax revenue growth target of 16.7% appears ambitious, unless helped by the GST tailwinds. Through continued thrust on affordable housing, the finance minister reiterates emphasis on achieving double objective of high growth multiplier through housing sector along with high employment generation capacity. Effort to widen the coverage of health insurance scheme to include 10 crore poor and vulnerable households is a positive long term trend.

## Outlook

Economic Survey projects GDP growth rate of 6.75% in FY18 and 7-7.5% in FY19 with normalization post GST and demonetization. Investment to GDP ratios are yet to improve from their lows due to sluggishness in construction sector and insipid demand for new houses from urban consumers. The introduction of long term capital gain (LTCG) tax for listed equity shares and equity oriented mutual funds should lead to moderation in asset prices as the market factors in a lower level of realized post-tax returns. Issuance of recapitalization bonds, though cash-neutral and fiscal deficit-neutral, may lead to a rise in public debt/GDP ratio by 0.8% of GDP post the issuance of recapitalization bonds of INR 880bn this year and INR 550bn next year. Even as this budget refrains from overtly populist measures and shows lower divergence from the path of fiscal consolidation, it falls short of providing a significant boost to improve Investments to GDP ratio and set the economy on a structurally higher growth path.

While the upward revision to fiscal deficit target (3.5% for FY18RE and 3.3% for FY19BE), widening of trade deficit and a rise in inflation pose concerns for the economy, some of the high frequency indicators including two-wheelers sales, commercial vehicle sales, steel and cement production, exports growth, credit offtake, port freight volumes and industrial production show meaningful sequential acceleration. This should bode well for growth going forward. With incremental focus on spurring the rural farm and non-farm income, we may expect the rise in aggregate demand to aid improvement in capacity utilization and support stronger corporate revenue growth. This should further augment a private capex recovery in 2018.

However, any further hardening of crude oil prices could dent the government's fiscal balance. Expectation of speedier tightening of interest rate by the US Federal Reserve on account of improving US economic growth and imposition of protectionist policies by the US could heighten global risk aversion sentiments which could impact capital flows to emerging markets. That said, Indian economy projects structural strength and the domestic equity markets continue to be well-supported by domestic capital flows. This should minimize the impact of any global market turmoil on Indian equities.

From an investment perspective, diversified equity funds with core exposure to large caps and prudent risk-taking in mid/small cap space may be well positioned to capture medium to long term opportunity presented by the equity market. We look to brace ourselves for some volatility in 2018 and investors too should chalk out a strategy for that.



Mutual Fund investments are subject to market risks, read all scheme related documents carefully.