Generational Capital
The Way Forward

GENERATIONAL CAPITAL

(A unit of Satwik and Ritwik Ventures Pvt. Ltd.)

MONTHLY MARKET OUTLOOK
February 2022

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MACROECONOMIC INDICATORS

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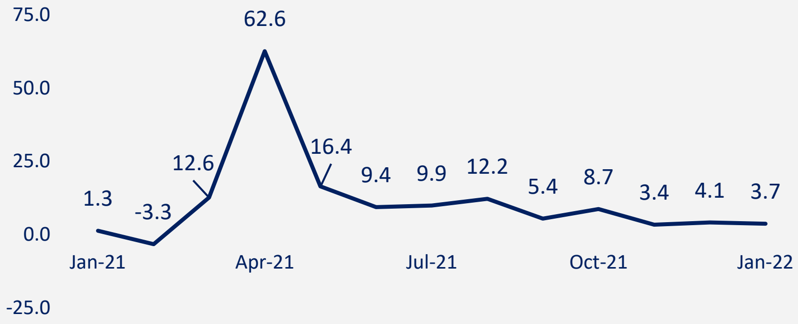
INDUSTRIAL PRODUCTION

The month on month performance of eight core industries eased marginally from the levels of 4.1% to 3.7% in the month of Jan-22 on account of disruption in economic activity led by the third COVID wave coupled with slightly positive base in Jan-21. Crude Oil production witnessed a contraction for the 50th month in a row in Jan-22. The production of Coal, Natural Gas, Refinery Products, Steel, Cement and Electricity industries increased in Jan-2022 over the corresponding period of last year.

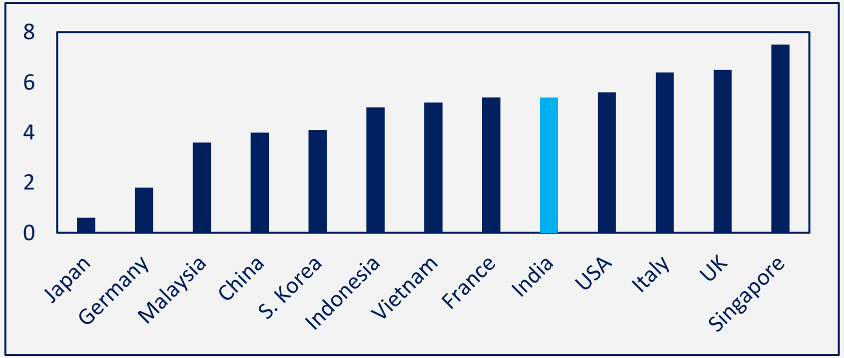
While India's economic growth may have slowed to 5.4% in Q3FY22, it was still higher than China, and continues to be one of the fastest growing economies of the world. Growth in agriculture tapered and the construction sector became negative, real GDP growth was supported by strong growth in the services sector and a pick up in consumption. The National Statistical Office (NSO) in its second advance estimates of national accounts pegged the country's growth for FY22 at 8.9%, slightly lower than the 9.2% estimated in it's first advance estimates.

Growth in Eight Core Industries
(Monthly movement, %)



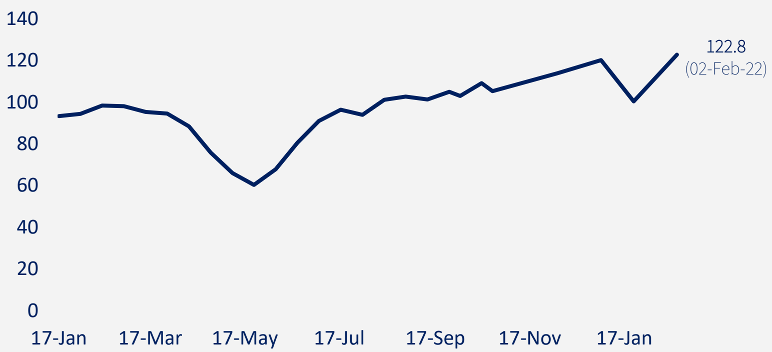
Source: Ministry of Commerce & Industry

India's GDP growth continues to be amongst the highest
Q4 CY21 Real GDP Growth Rate



Source: Kotak

Nomura India Business Resumption Index (NIBRI)



Source: Nomura Global Economics

Impact of a 10% rise in Crude Oil Prices

	GDP Growth (pp)	CPI Inflation (pp)	Current Account (% of GDP)
China	0.00	0.10	-0.20
Hong Kong	0.00	0.07	-0.07
India	-0.20	0.40	-0.30
Indonesia	0.05	0.10	-0.20
Malaysia	0.04	0.20	-0.03
Philippines	-0.07	0.40	-0.30
Singapore	-0.03	0.20	-0.70
South Korea	-0.05	0.20	-0.15
Thailand	-0.08	0.30	-0.50

Source: Nomura

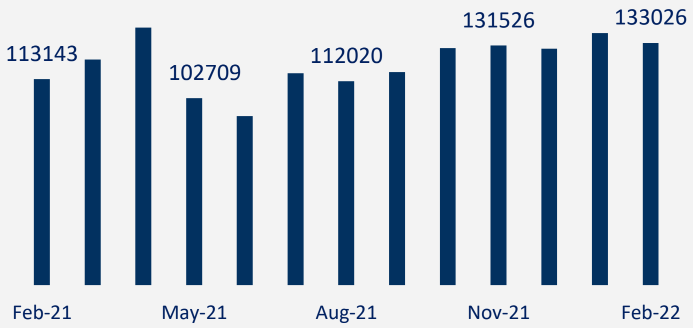
Improved resilience over the years

Brent Crude was > $100/barrel last in September 2014

Indicator	Then	Now
CAD (% of GDP)	1.30	1.60
Forex Reserves ($ Billion)	316	630
Forex reserves - Import Cover (in months)	7.30	10.60
CPI Inflation	6.46	6.00
GDP Growth	5.90	8.40

Source: Kotak

G.S.T. Collection (Figures in INR Crores)



Source: pib.gov.in

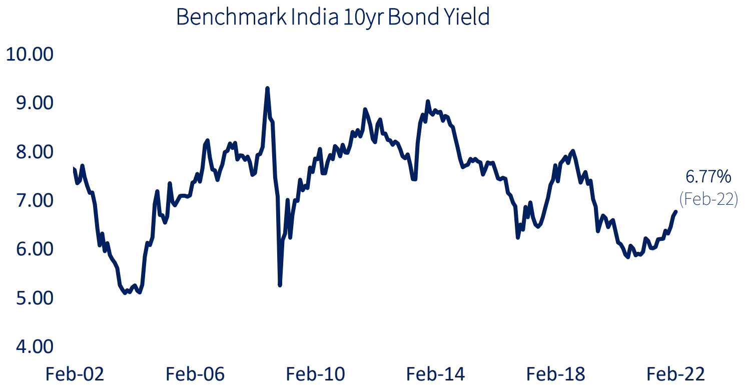
02

FIXED INCOME

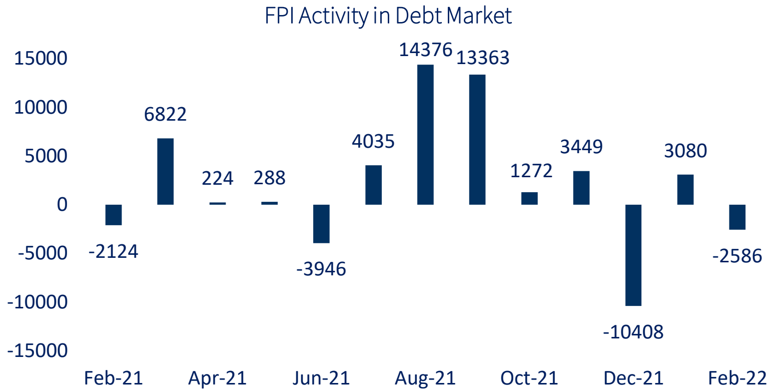
FIXED INCOME

The debt markets have witnessed a roller coaster ride so far in 2022 with the 10 year G-sec trading at 6.35% in December 2021 to spiking to around 6.95% in January and closing at 6.77% in February. The RBI may have provided some relief to the markets with its ultra dovish stance, however the chaos on the global front has overshadowed them significantly.

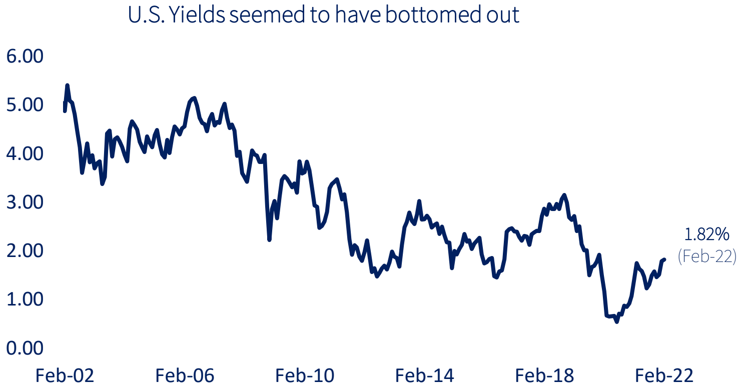
Foreign investors went on a selling spree in February taking away Rs 3073 cr but invested Rs 487cr through the VRR route. However, on a yearly basis, foreign investors have infused around Rs 30,000 cr (including VRR) in the debt markets. Given the dovish policy statement from the RBI and imminent rate hikes by the US Fed, with their tough stance on inflation, foreign investors' inflows can be muted as the US 10 year bond yield continues to move upwards.



Source: Investing.com



Source: NSDL (Figures in Crores)



Source: Investing.com

INFLATION (WPI, CPI, FOOD INFLATION)

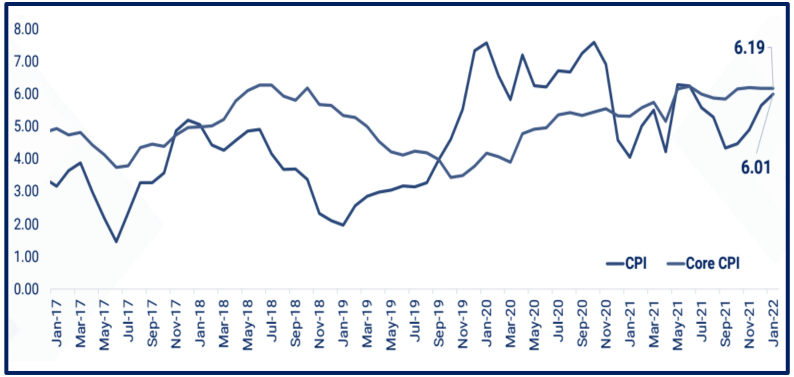
Retail price inflation rose sharply to 6.01% as against 5.59% in the previous month, to reach a 7-month high level. This elevated level can be attributed to a spike in food and clothing inflation coupled with a low base a year ago. The CPI inflation breached the RBIs target range of 2-6%. Regionally, the gap between rural and urban inflation has narrowed down.

RBI's Deputy Governor, Michael Patra, said in a statement that international crude oil prices present an overwhelming risk to inflation. He added that any spike in prices would be treated as a supply shock and the monetary policy will be supportive of economic growth.

"The annual rate of inflation is 12.96% (Provisional) for the month of January, 2022 (over January, 2021) as compared to 2.51% in January, 2021. The high rate of inflation in January, 2022 is primarily due to rise in prices of mineral oils, crude petroleum & natural gas, basic metals, chemicals and chemical products, food articles etc as compared the corresponding month of the previous year." – Ministry of Commerce & Industry

While the RBI focuses on CPI to decide the policy targets, high WPI inflation is witnessed as a precursor to higher consumer prices as producers often pass on these elevated price levels to their costumers. This is the 11th consecutive month in which WPI has been in double digits.

CPI and CORE CPI



Source: Kotak

Wholesale Price Index (YoY, %)

	Weight	Dec-21		Jan-22	
	(%)	Index	Inflation	Index	Inflation
All Commodities	100	142.4	13.56	142.9	12.96
I Primary Articles	22.62	167.8	13.38	165.0	13.87
II Fuel & Power	13.15	128.2	32.30	133.2	32.27
III Manufactured Pr.	64.23	136.4	10.62	137.1	9.42
Food Index	24.38	169.0	9.24	166.3	9.55

Source: Ministry of Commerce & Industry

03

EQUITY

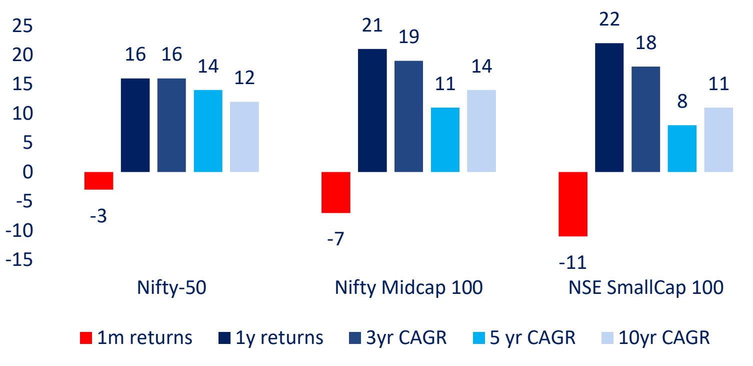
EQUITY

DOMESTIC & SECTORAL INDICES

The month of February started off on a positive note where markets stretched upwards majorly on account of the expectation of a non-populist and CAPEX focused budget coupled with pick-up in the global market sentiments. As the month approached the third weak, an increase in volatility was witnessed, majorly driven by soaring inflation and geo-political tensions. When such uncertainties cloud the skies, generally there is a shift in sector allocation from cyclicals to defensives. But this time, cyclicals like Nifty Auto, Metals, Energy outperformed defensives like Nifty FMCG, Nifty Pharma. As fear of tensions between Russia and Ukraine increased, the frontline index declined 3.58% in the last weak of February, with VIX touching the highest level since Jun'20.

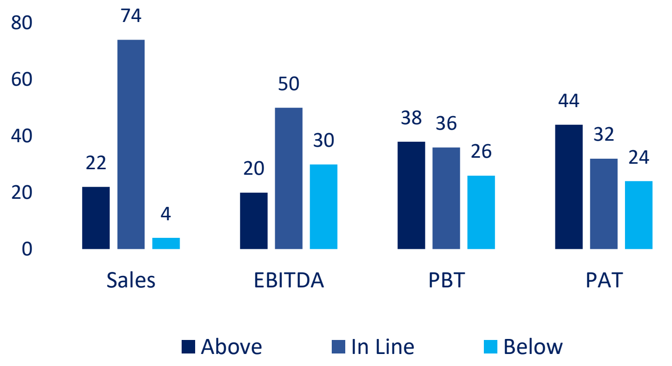
Earnings, which help gauge the strength of the market, witnessed more beats than misses, as is evident in the below chart.

Index Performance as on 28th February 2022 (% Returns)



Source: National Stock Exchange

BEATS > MISSES



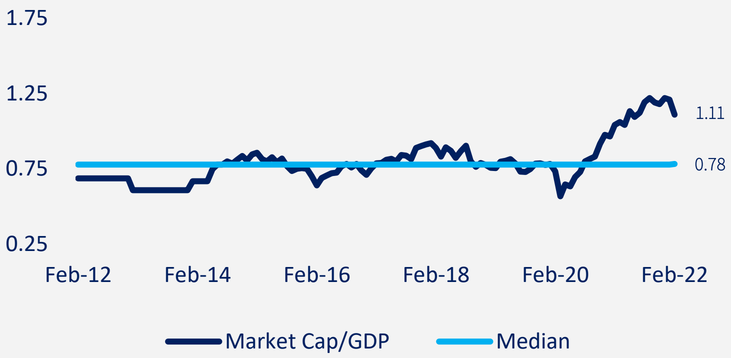
Source:: MOSL, Kotak

Rate hikes in a strong business cycle have proven to be positive for markets

Fed rate hike cycle		% Index returns from start to end of cycle			
START	END	S&P 500	NASDAQ	Dow Jones	Sensex
Feb-83	Aug-84	31.1	13.8	28.2	13.9
Mar-88	Mar-89	36.5	30.1	38.3	79.1
Dec-93	Apr-95	10.0	8.3	14.7	-6.4
Jan-99	Jun-00	19.5	66.4	17.4	43.2
Jun-04	Jul-06	13.1	3.2	8.4	124.0
Nov-15	Jan-19	38.6	51.9	50.4	38.7

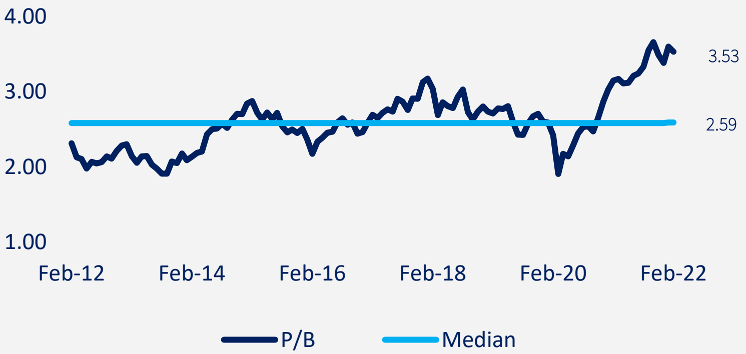
Source: Bloomberg, Kotak

BSE 500 MCAP / GDP Ratio



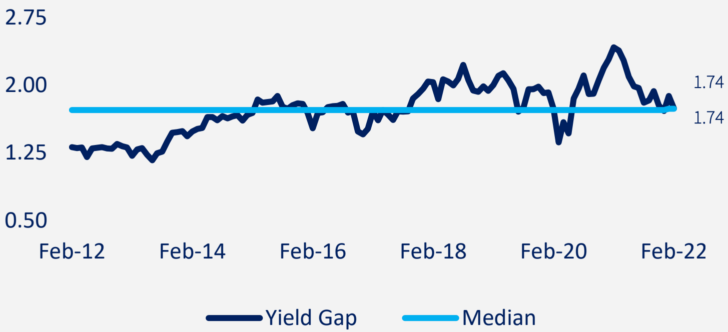
Source: Bombay Stock Exchange

BSE 500 P/B Ratio



Source: Bombay Stock Exchange

BSE 500 Yield Gap



Source: Bombay Stock Exchange

04

GLOBAL ECONOMY

ECONOMY

GLOBAL

The war has forced central banks around the world to asses the renewed supply change disruptions and the sudden inflation shock for several economies. However, the US Fed's impending rate hike is set to overshadow it. Other central banks are set to impose a range of policies to cope with the differing impacts of the war in economies that were already adjusting to increasing prices. While the hawkish Bank of England is expected to hike rates, the Bank of Japan is expected to continue with its easing stance. Prices of commodities such as brent crude have risen to their highest levels since 2013.

Buyers and shippers are increasingly avoiding Russian oil supplies, estimated at around 5 million barrels per day. European gas prices rose more than 120% to hit a record high.

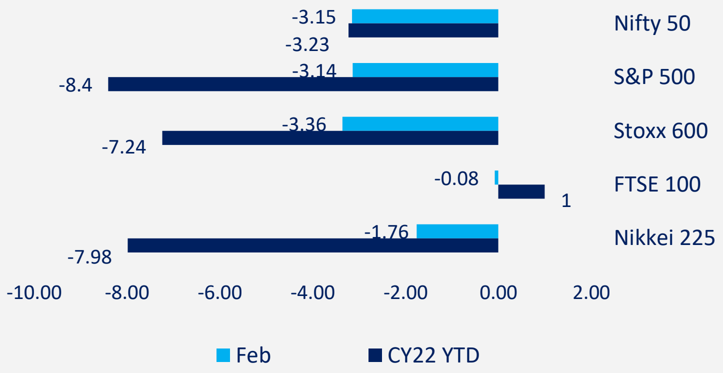
Prices of raw materials and metals too have surged. Russia and Ukraine happen to be two of the world's largest exporters of wheat. Russia is also a major supplier in metals as it supplies around 3.5% of world supplies. As we can see below, markets around the globe have not taken lightly to these developments.

Accelerating Global Inflation

Country	CPI (YoY%)	Country	CPI (YoY%)
Japan	1%	Germany	5%
China	1%	Canada	5%
Saudi Arabia	1%	UK	6%
Taiwan	3%	New Zealand	6%
France	3%	India	6%
South Korea	4%	US	8%
Singapore	4%	Russia	9%

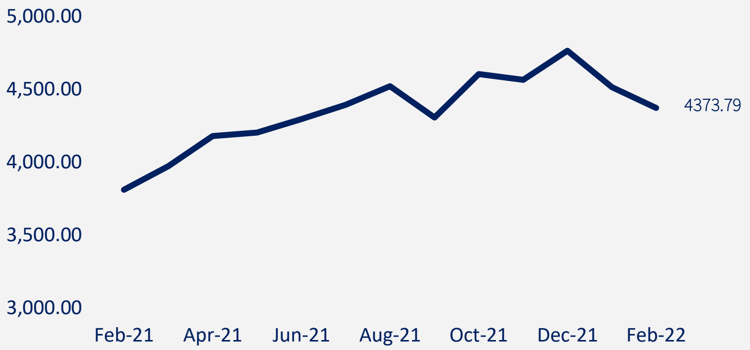
Source: Bloomberg, Kotak

Correcting Global Equities



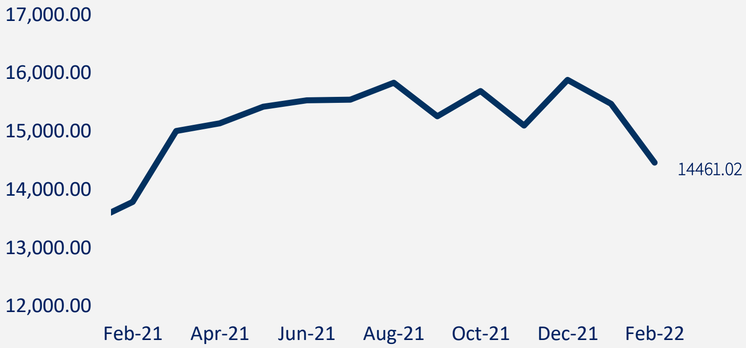
Source: Investing.com

S&P 500 Monthly Performance (U.S.)



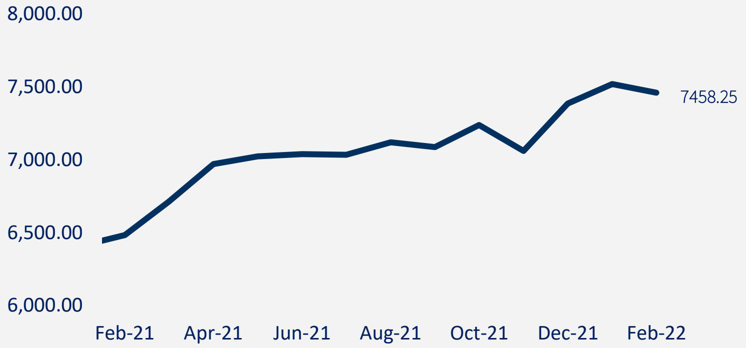
Source: Investing.com

DAX Monthly Performance (Germany)



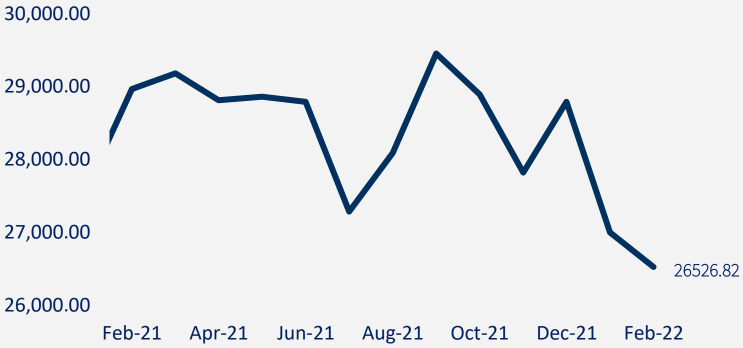
Source: Investing.com

FTSE 100 Monthly Performance (U.K.)



Source: Investing.com

NIKKEI 225 Monthly Performance (Japan)



Source: Investing.com

05

ASSET ALLOCATION DESK’S VIEWS

DESK VIEW

EQUITY

While we had cautioned investors at the start of the year of an impending correction, the war has come as a shock to the markets. FPI selling as well might have been higher than expected and the rise of commodity prices only added to the volatility. In the midst of this, investors looking from a 3-5 year perspective will only see this as an opportunity. A correction in the markets only comes along with negative news and given the market is a leading indicator, the dip can disappear before you react.

The Indian economy is on path to be the fastest growing economy despite its revised estimates and we continue to witness companies report results beating estimates. While FPIs may be pulling out, the markets have been supported by DIIs and retail investors with SIP flow being stable.

The gravy train we have been riding for the last year and a half came to a screeching halt. The importance of asset allocation and investing with the best fund managers who have a stable framework and sound risk management is the best way to generate alpha in such markets. The suspension on international funds should not reduce investments, but should be diverted towards domestic investments.

DEBT

India imports more than 85% of its total crude oil consumption and thus makes the economy and the bond markets vulnerable to oil price shocks like the one we are currently witnessing. Russia happens to the largest exporter of oil accounting for around 8% of the world's oil supply. Hence a prolonged war will continue to put pressure on the current account balance which in turn will fuel inflation and dent the government's balance sheet. The RBI's continuing accommodative stance will not be maintainable if crude prices sustain at these levels. Elevated market borrowings by the government will only add fuel to the fire.

With yields expected to rise our recommendation is to have a longer holding period to stay invested through any sporadic turbulence in the markets. Investors can look at their core allocation tilted towards liquid and money market funds or short term debt and dynamic funds with low credit risks. However, we have always recommended diversification through MLDs, Venture debt and even debt PMSs adhering to their asset allocation policies and expected returns.

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