PINC

July 2022

Market Commentary

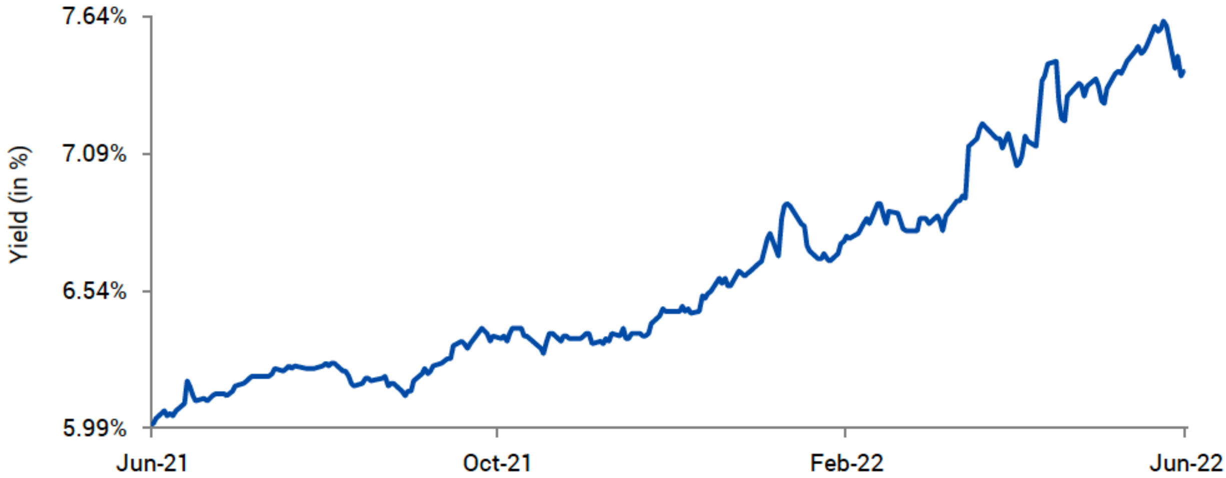
PIONEER WEALTH MANAGEMENT

Volatility, uncertainty, and unpredictability have been go-to words for writers and analysts tasked with writing about markets in the past few months. Last week's economic data has market watchers thinking that the Fed's terminal rate, where it will be reasonably sure inflation will not cross its comfort level, may be set lower than expected. Signals that the economy is slowing and prices are falling (or that the price rise is slowing) are giving rise to this 'feeling' that's finding takers in the market. Flash PMIs are indicating deceleration in the US economy and commodity prices have fallen sharply from their peaks. Inflation expectations have come lower than expected. If the slide stays in place, then some of the Fed's concerns could get addressed even without crushing rate hikes, goes the hope.

A whiff of change wafted through the markets this month. The focus shifted from worrying over inflation to concerns about growth. The advance Purchasing Managers Indices (PMIs) for the current month for the US and the Eurozone showed slowing growth, but while they indicated inflation was cooling in the US, it continued to rise relentlessly in the Eurozone. They also reflected stalling demand and falling business confidence. UK consumer confidence hit a record low. In China, housing starts and property transactions reached extreme lows.

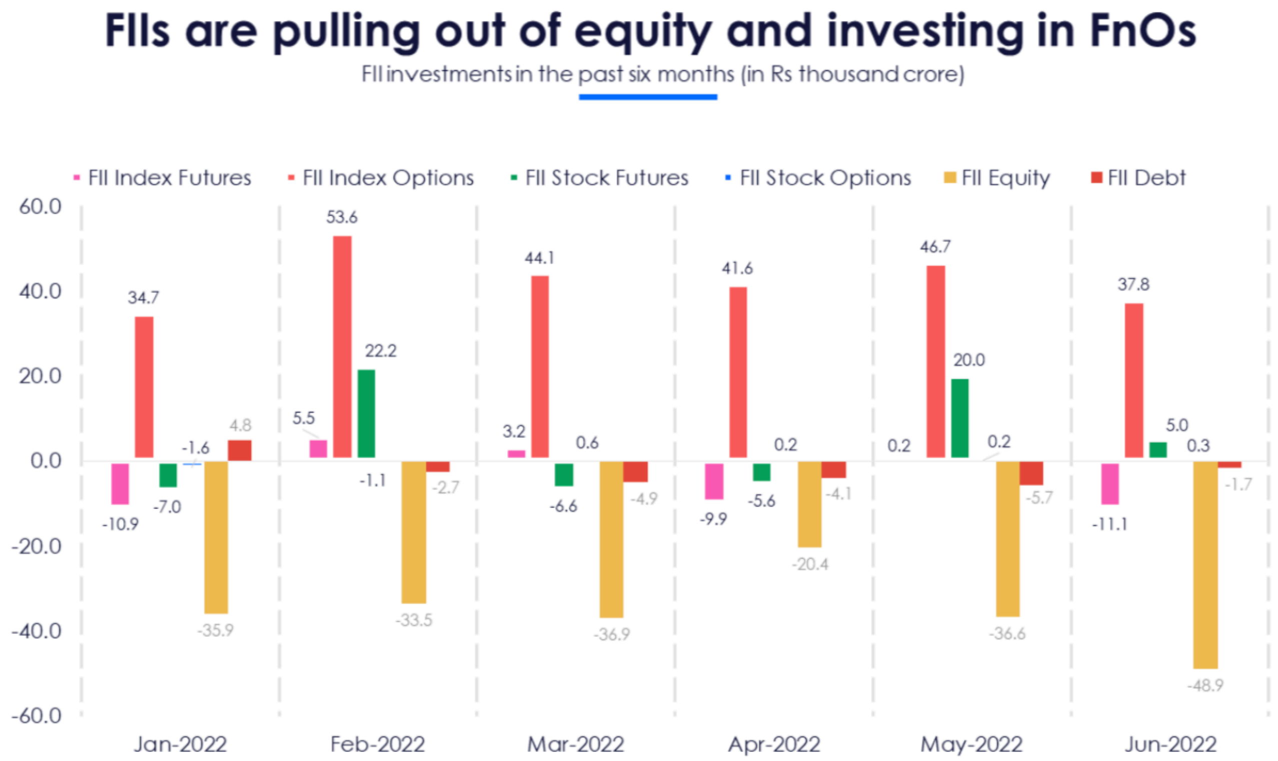
The worries over an imminent recession in the US, the UK and the Eurozone sent commodity prices sharply lower. Copper prices have moved down dramatically. Crude oil prices too fell. That dissipated some of the inflationary fears. The markets are now pricing in the Fed Funds rate at 325-350 basis points by year end, a lower estimate than a week ago. The 2-year Treasury yield has come off sharply. German 10-year yields dropped from 1.9 percent to 1.4 percent in five days. Domestic bond rates plunged as well however gains were capped as market participants booked profits after a sharp fall in yields. Yield on the 10 year benchmark paper (6.54% GS 2032) fell 11 bps to close at 7.44% as compared to the previous week's close of 7.55%.

10 - Year benchmark G-Sec Movement



On the Macro front India's current account deficit (CAD) decreased to US $13.4billion (1.5% of GDP) in Q4 of FY22 from US $22.2billion (2.6% of GDP) in Q3 of FY22. The sequential decline in CAD in Q4 of FY22 was mainly on account of a moderation in trade deficit and lower net outlay of primary income.The current account balance recorded a deficit of 1.2% of GDP in FY22 as against a surplus of 0.9% in FY21 as the trade deficit widened to US $189.5 billion in FY22 from US $102.2 billion in FY22.

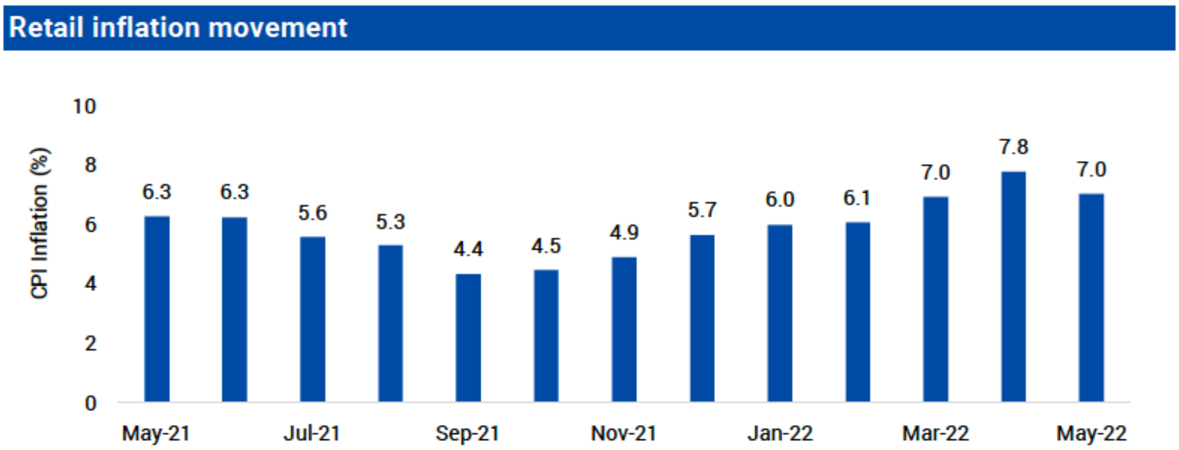
However foreign investors have been withdrawing funds relentlessly from Indian markets with withdrawals touching record numbers. The FII's sold a record Rs 58,112 Crores in the month of June 2022. The surpasses the Rs 55,000 Crores sold in May 2022. June marked the ninth consecutive month of the relentless selling spree by FII's. The FII's have sold nearly 3.5 Lakh Crore in domestic equites since October 2021 to June 2022. Although interestingly FII's are pulling out of equity and investing in FnO's. Index Options seem to be the go to choice for foreign investors in the past 6 months. The chart below illustrates the same.



Significantly this has lead to the rupee touching a new low against a resilient dollar which is showing strength against most currencies despite a weakening US economy. The rupee on Wednesday breached the 79 mark to the dollar for the first time on offshore derivative platforms. Even the Clearing Corporation of India reported trades above Rs 79 to a dollar. Despite regular RBI intervention, the rupee continues to be one of the worst performing currencies in Asia. Coinciding with the fall in the rupee is the fall in the equity markets. From its peak in mid-October 2021, the benchmark Nifty has fallen from 18,604 to the present levels of 15780, a drop of nearly 17 percent. During the same time rupee has dropped from 75.34 to 79 levels, a depreciation of 4.86 percent.

There is a clear explanation to the strong correlation between the fall in rupee and that of the market. Foreign investors have been withdrawing funds relentlessly from Indian markets with withdrawals touching record numbers. A fall in the equity markets, especially the sharper ones, have almost always coincided with a weak rupee. But when the market moves up or is flat the relationship is not as clearly defined. A question that comes to mind is whether the correlation is only defined by foreign investor flows or do fundamentals matters.

Around 40 percent of Nifty is comprised of stocks from the financial sector which is not directly affected by the currency. IT and pharmaceutical sectors benefit from a weak rupee while Indian companies which import their raw materials get negatively affected. However, these commodity based companies also export their final product and thus have an inbuilt natural hedge against currency fluctuations. On a net level Nifty50 companies are exporters, thus a weak rupee should benefit their performance. Why foreign investor do not like a depreciating rupee is because their investments have to work harder for them to break even.



For now, as the minutes of the Monetary Policy Committee meeting indicate, growth momentum in India remains robust and the focus remains on containing inflation. The Economic Recovery Tracker shows improving consumer sentiment and employment. The Monsoon Watch indicator shows the aggregate rainfall deficit is down to 2 percent, which augurs well for the kharif crop. We think the idea of waiting for the bottom is a terrible idea. Assets could get cheaper than current valuations, in which case we'll buy more.