Security market scenario in India

The second term of NDA Government saw Sensex reaching a lifetime high of 40,267 on 1st June 2019. The majority government brought a new sliver line of hope for India. Several global and domestic factors including trade wars, sanctions, rating downgrades, global slowdown, sluggish domestic demand, etc. On the international front, China's slowdown has been major contributing factor for the global slowdown. The tariff imposition by US has further exacerbated the domestic situation in China along with sluggish internal demand (Reference to Apple sales index, whereby the company for the first time saw reduction in demand from the previous years in China). These factors are bound to impact markets in developed and developing economies in the form of fall in indices, currency depreciation and inversion of bond yield curves.

On the domestic front, the indices have been regularly volatile due to both domestic reforms and global dynamics. The recent post-budgetary announcement of surcharge on FPIs and tax regime for super-rich led to a continuous 5-day fall in Sensex of around 1186 point and 387 points in Nifty and major withdrawal of FPIs from the markets. Sensing the negative response to the decision, the government rolled back the surcharge and the indices rose again. The acceptance of transfer of surplus funds from RBI to the government also lifted the market's spirits significantly. Such measures have had tentative impact on markets. However, for a sustained rally in the market, appropriate valuations, good corporate earnings and sustainable growth is necessary. The volatility in the markets may be attributed to the correction in such valuations. In 2018, Mid-cap stocks faced a sharp correction after a consistent performance in 3 years post-election of NDA government. Sensex went on to perform in ranges of 28k in 2015 to 33k in 2018. The FPIs were regular investors in this period. Low crude oil prices and rupee prices also worked in market's favor. However, in 2018, the mid-caps saw a sharp correction. Also, on macroeconomic side, crude oil prices shot up to 85 USD/barrel and Rupee saw a low of 74.6/ USD.

In August 2018, it fell sharply on account of revelation of IL&FS crisis. Some of the key reasons for such fall of mid-caps were overvaluation, NBFC liquidity crisis and mutual fund reclassification imposed by SEBI. The mutual fund reclassification required the mutual funds to reclassify their equity schemes into small, mid and large cap. This led to a huge withdrawal from the mid-cap and small caps.

Coming to 2019, the macros have slightly turned to favor the markets with inflation, fiscal deficit and CAD under control. While FPIs had been net sellers in 2018, in contrast in 2019 - from February to June, FPIs had been net buyers in Indian markets.

The Indian indices remain reasonably valued. The Indian indices are trading just near around their 10-year historical averages. Nifty is trading at about 17 times (which has traded at multiples of 21-22 times in 2016 and 2017), just above its historical average of 16 times. Weak corporate earnings for the June-quarter may have been a key reason for such valuations. Also, as mentioned earlier, sluggish demand is affecting auto and banking businesses, which has in turn impacted the respective indices severely. The auto sector (along with supporting industry like steel and ancillaries) are facing production cuts, high inventory at dealer level, working capital issues and delayed capex. Auto companies have resorted to discounts to lure customers. The government has also sensed such glut and plans to introduce reforms such as tax cuts in these sectors to encourage growth. In case of banks, the provisioning coverage ratio (ratio of provisioning to gross non-performing assets) has also gone up owing to IBC resolution processes, which has impacted the earnings significantly. The RBI sensing the slowdown, has softened the provisioning. The major private sector banks sense the loan growth to stabilize, leading to greater NIMs and lower slippages. NBFCs have also been granted breathers including opening up of External commercial borrowing route (ECB) for funding.

IT, insurance and certain private sector banks and retail companies have performed in line with expectations for q1. However, for IT industry certain factors to look forward to impacting EBIT margins include cross-currency headwinds, wage-hike, increased sub-contracting and higher visa cost.

Quarter 1 results for manufacturing and banking sector have been quite gloomy for 2019. However, we must not forget cyclical nature of markets. While q1 still glares at weak demand, we have better than average monsoons and festive season to look forward to, for increase in capital goods demand. With inflation under control, RBI has been continuously reducing repo rate, thereby reducing corporate borrowing costs, which shall help in further working capital infusion.

Like an ideal developing economy, Indian security markets have always stuck to their volatile nature. Macroeconomic factors like reduction in demand and consumption have been responsible for lower demand in manufacturing sectors, with rural demand being directly affected. The NBFC crisis had impacted the markets to a great extent, leading to several prompt policy measures by RBI and the government. The capital stimulus by RBI, easing ECB norms for NBFCs, rollback of surcharge on FPIs and introduction of direct-retail FDI norms shall go a long-way in attracting foreign investments in India. Also, in light of tariffs imposed on China, its time India showcases itself as an attractive alternative manufacturing destination.