April 22, 2019

Equity Market

Update

After remaining under pressure in the last six months, the Indian markets regained momentum in March. Midcap and small caps outshone large caps in the current rebound as investors started finding value in beaten down midcap stocks.

Market sentiments witnessed a turnaround with foreign investors turning significant net buyers after many months. FPIs bought equities worth ₹ 32000 crore. Sentiments were lifted on the back of increased expectation of the incumbent government getting a majority in the upcoming general elections along with positive global markets.

Foreign investors had been on the sidelines and were net sellers. India has received the least amount of inflows among its emerging market peers. However, this trend seems to be changing as February and March witnessed net inflows.

We believe that historically elections have largely been positive for equity markets as clarity over the next five years is achieved paving the way for positive momentum. Last three elections years witnessed robust equity returns (~13% - 2004, 81% - 2009, and 20% - 2014) while none of the election years in the last 30 years (except in 1998 (index down 16% given a weak coalition government) have resulted in negative returns for equities.

Outlook

Overall, we expect the earnings momentum to continue in Q4FY19E. This, coupled with stable currency amid increase in crude price, softening system interest rates (controlled inflation) and resolution of stressed asset is expected to lead to healthy 20%+ earnings CAGR in FY19-21E.

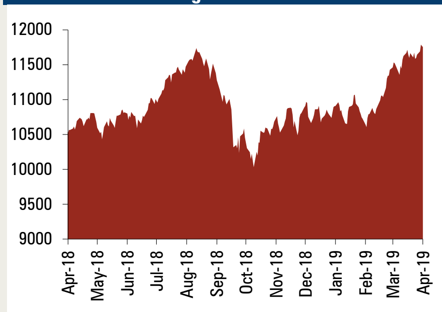
The global macro set-up (dovish outlook by Fed & range bound crude) as well as domestic macroeconomic indicator such as RBI rate cut (possibility of further rate cuts) driven by benign inflation and stable currency levels are key driver of our positive outlook on markets. While there is uncertainty ahead of elections, historically equity markets have largely been positive as clarity over the next five years emerges.

Going ahead, underlying macroeconomic growth coupled with corporate earnings growth momentum is likely to remain a key catalyst for the market movement for the next three to five years. The resilient corporate earnings growth across most pockets is a positive.

Volatility is expected to remain elevated in the run up to general election 2019, which should be capitalised on as an incremental buying opportunity. We believe that banking and infrastructure sectors and, consequently, these thematic funds may be considered for thematic allocation.

Markets went into the policy with the expectation of a 25 bps cut aided by a softer policy tone as well as an outside chance of a change in MPC stance from 'neutral' to 'accommodative'. This would have enabled monetary transmission as it completes the purpose of lower (repo) rates seeping into the economy via easier liquidity conditions. While the rate cut was largely in line with market expectations, the market reaction was subdued as yields moved up slightly on no major announcement on liquidity measures.

Markets at all time high



Source: Bloomberg

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Debt Market

Update

Bond yields across market segments remained range bound during March as markets awaited RBI's monetary policy decision.

Markets went into the policy with the expectation of a 25 bps cut aided by a softer policy tone, as well as an outside chance of a change in MPC stance from 'neutral' to 'accommodative'. This would have enabled monetary transmission as it completes the purpose of lower (repo) rates seeping into the economy via easier liquidity conditions. While the rate cut was largely in line with market expectations, the market reaction was subdued as yields moved up slightly on no major announcement on liquidity measures.

The Indian debt market since the start of calendar year 2019 has been range bound, particularly G-Sec yields that are trading in a narrow range, at around 7.3% on a 10 year paper despite macro variables incrementally turning favourable. Since the start of the year, global markets have witnessed significant correction in bond yields with US 10 year declining around 40 bps to 2.5%. Domestic inflation continued to undershoot RBI's projection with latest print at 2.6%, below RBI's own expectation for the period and rate cut by RBI of 25 bps, including today's 25 bps cut.

G-Sec yield trading in narrow range since start of year 2019

Source: Bloomberg

Outlook

The higher government borrowing along with lower buying interest from foreign investors and banking system prevented any fall in yields despite a favourable environment. However, foreign investors inflows turned positive in March 2019 (₹ 6500 crore) after continuous net outflow for the previous 13 months. FPI inflows are likely to continue on the back of benign US bond yields with dovish stance adopted by US Federal reserve, attractive real rates and stable currency.

RBI has cut the benchmark repo rate by 50 bps since the start of 2019 (including April 25 bps cut). It has further reduced its inflation forecast to 2.4% from 2.8% earlier for Q4FY19, to 2.9-3.0% from 3.2-3.4% for H1FY20 and now estimates H2FY20 at 3.5-3.8%. The reduced forecast opens up further scope for a rate cut by another 25-50 bps if no major trend deviation occurs from monsoon or global crude oil prices.

Overall, the macro environment is supportive in terms of growth-inflation dynamics (lower inflation, further rate cut expectation and weak economic growth as reflected by recent lower GDP numbers) and supportive global environment with dovish US Federal Reserve. However, the demand supply dynamic is unfavourable with record government borrowing in FY20 and expectation of lower OMOs by RBI.

Assuming there is no negative surprise then the current low food inflation will give RBI room to cut rates by at least another 25 bps. The rate cut is likely to have a positive effect on bonds having short duration papers, which may also benefit from easing liquidity in the next financial year. Meanwhile, 10-year bonds may not benefit much from the rate cut due to the supply side constraints that is PSUs sitting on excess SLR investments and high government borrowing to meet fiscal deficit numbers.

Short-term debt funds or lower duration funds are better placed over the next few months. We maintain our cautious stance on credit risk funds or funds with higher credit risk. Corporate bond fund category is best placed for long term debt allocation. Conservative investors may consider overnight funds as an alternative to liquid funds.

Industry Synopsis

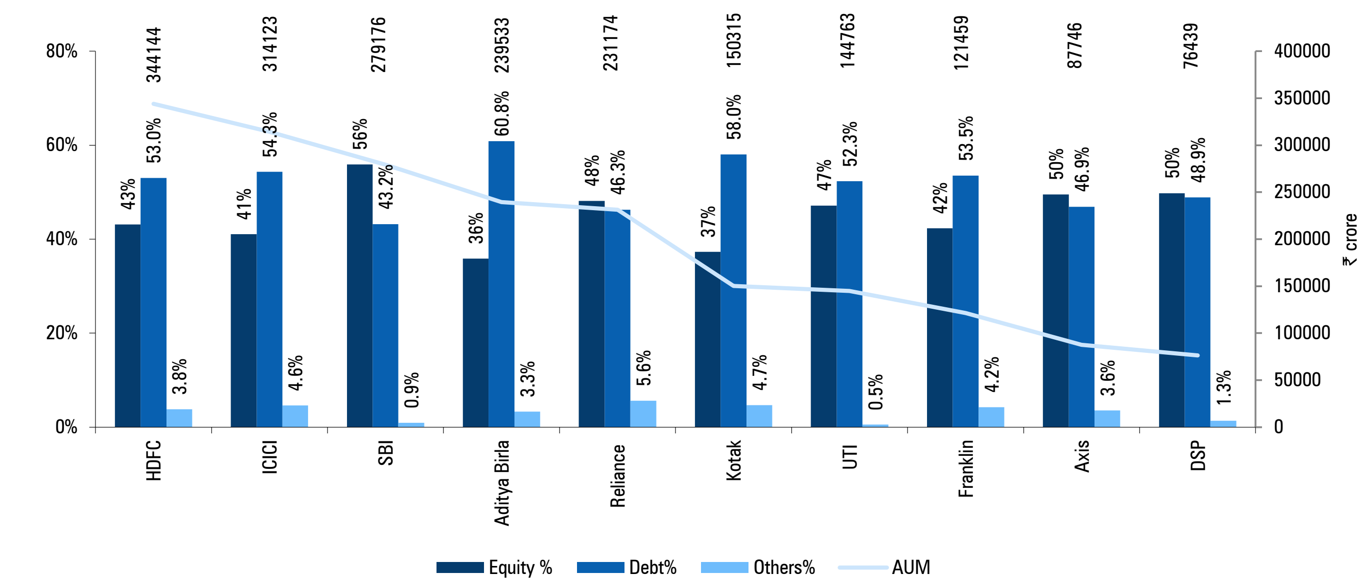
The MF industry AUM rose ~2.7% in March to ~₹ 23.8 lakh crore on the back of inflows and mark to market gain in equity holdings. Of the total AUM, ~49% was held in equity oriented funds (equity, balanced, ELSS and ETFs), a similar 49% was held in debt funds (income, money market funds) and the remaining in arbitrage, gold and others.

During March 2019, net inflows into equity and equity oriented funds (i.e. equity, balanced, ELSS, ETFs) witnessed a sharp increase at ~₹ 19000 crore against ₹ 9300 crore in February 2019.

Inflows into pure equity funds were at ₹ 9000 crore, ETFs were at ₹ 10500 crore while ELSS was at ₹ 2700 crore. Balanced funds continued to witness net outflows for a third consecutive month at ~₹ 3200 crore.

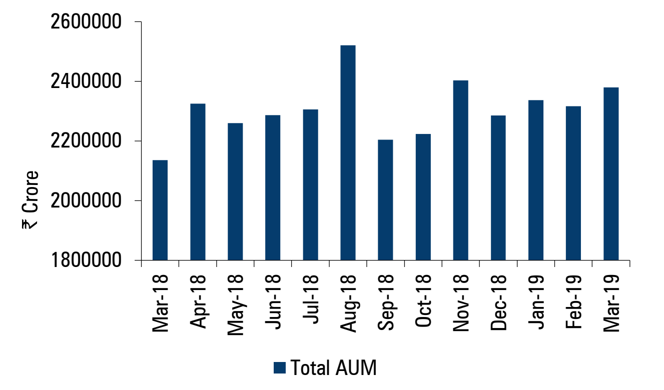
SIP flows, however, continue to remain encouraging. According to Amfi data, SIP inflows for March 2019 continue to be above ₹ 8000 crore at ₹ 8055 crore.

Exhibit 1: HDFC MF retains top spot in terms of total AUM



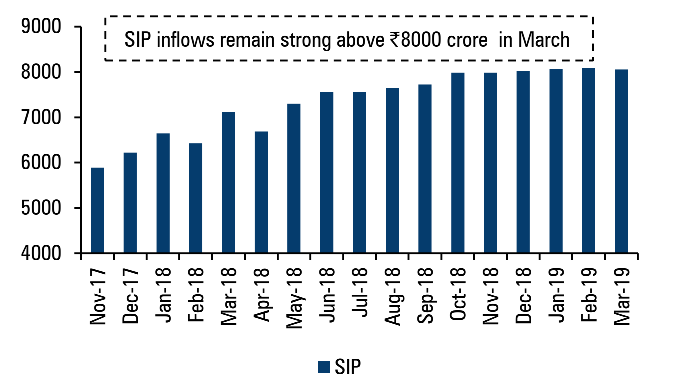
Source: ACE MF

Exhibit 2: Total AUM increases MoM on strong equity inflows, market gain



Source: ACE MF

Exhibit 3: Consistent strong SIP inflows continue to provide strong support to markets

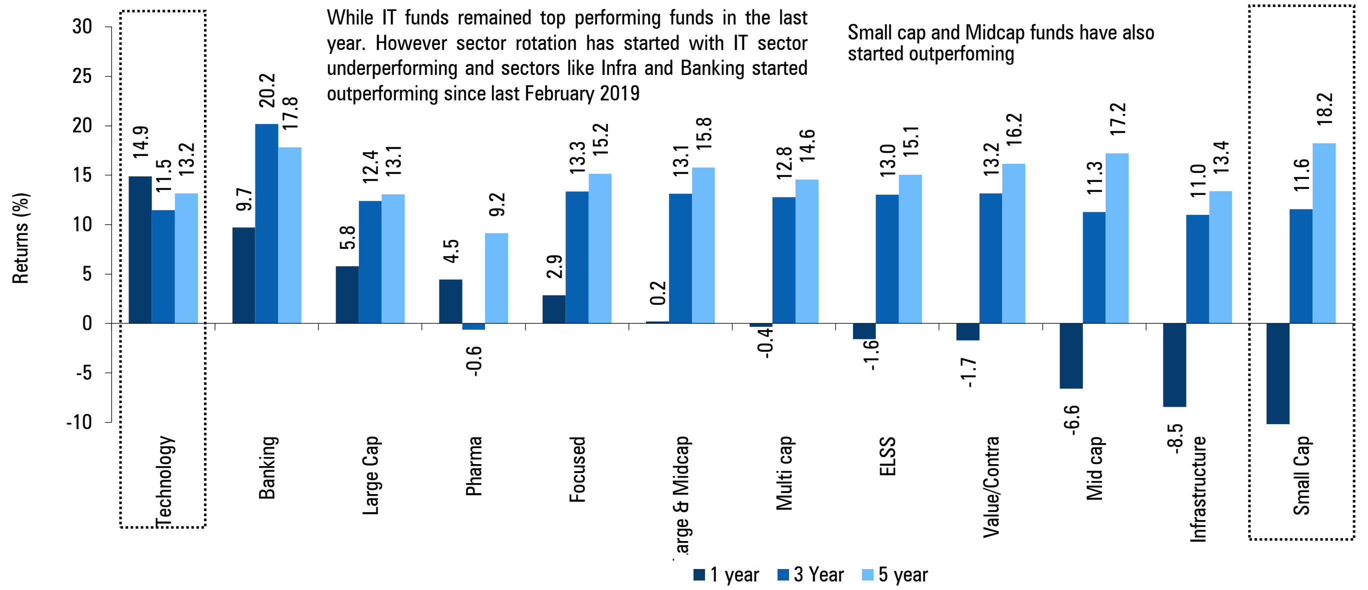


Source: ACE MF

Category Analysis

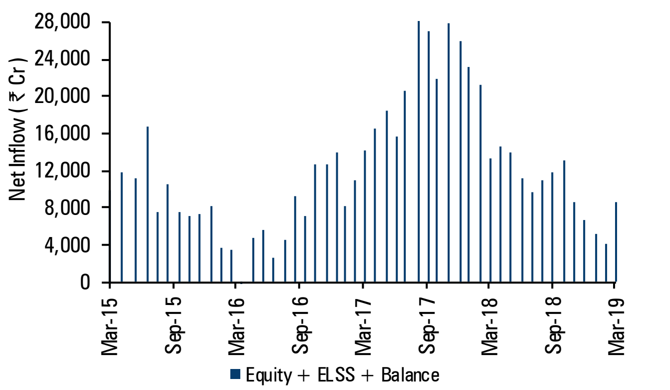
Equity Funds

Exhibit 4: IT remains best performing category over last year but shift in sector performance witnessed since February 2019 as banking, infra outperform in recent rally



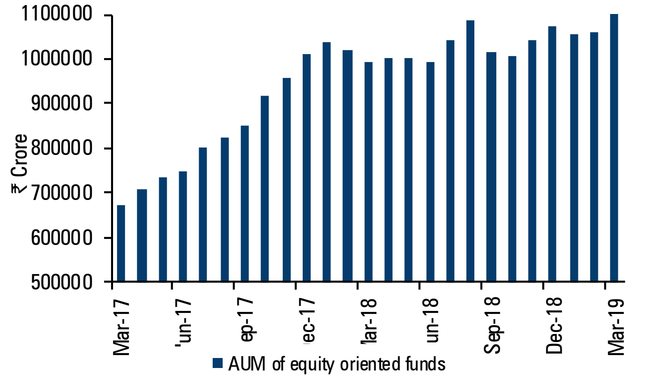
Source: CRISIL. Category average annualised returns as on April 18, 2019

Exhibit 5: Equity market witnesses sharp rebound in inflows



Source: ACE MF

Exhibit 6: Equity AUM at all-time high at ₹11.55 lakh crore

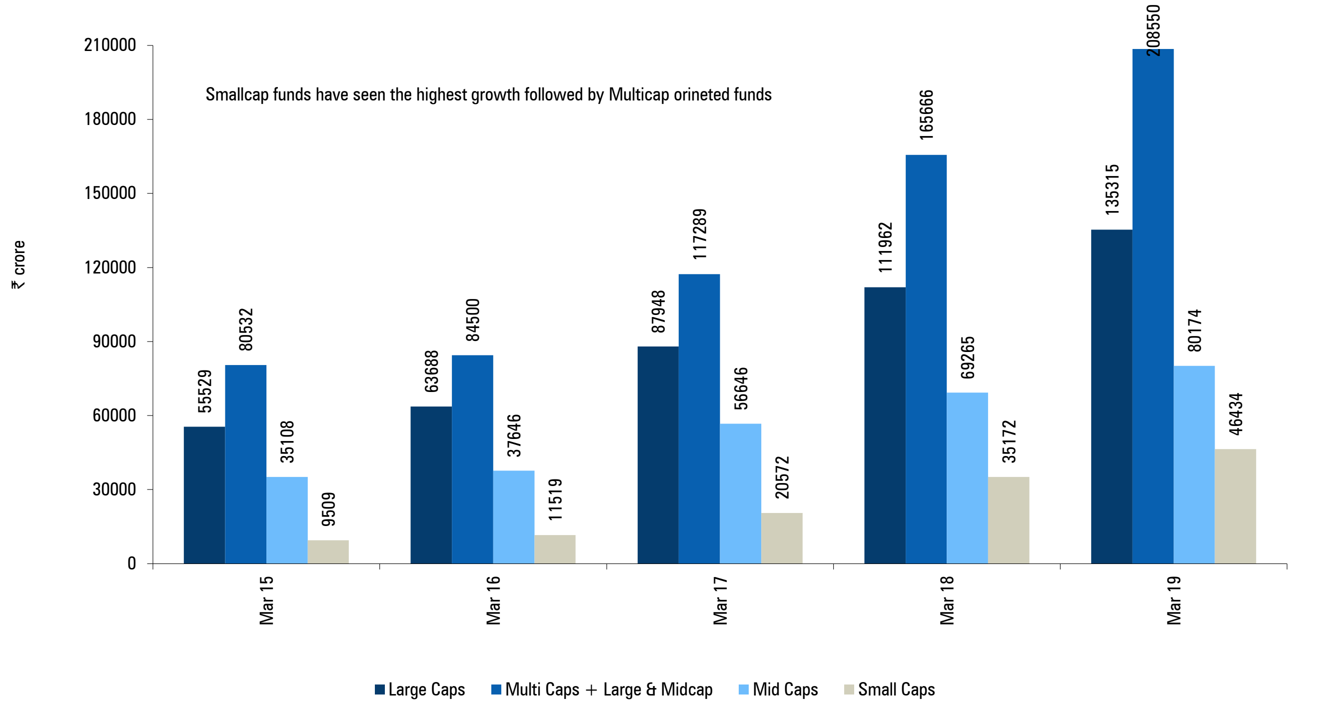


Source: ACE MF

Equity Diversified funds

Last year, midcaps, small caps corrected significantly offering an investment opportunity in select stocks. However, the many midcaps and small cap stocks had significantly outperformed prior to the recent correction. Therefore, an overweight position in small cap or midcap funds may still not be warranted. Multicap funds offer fund managers flexibility to allocate funds across all market segments and are, therefore, relatively better placed.

Exhibit 1: Multicap oriented funds remain largest category in terms of AUM



Source: ACE MF

Banking funds – In focus

Recommended Funds

ICICI Pru Banking & Fin Services Fund

Reliance Banking Fund

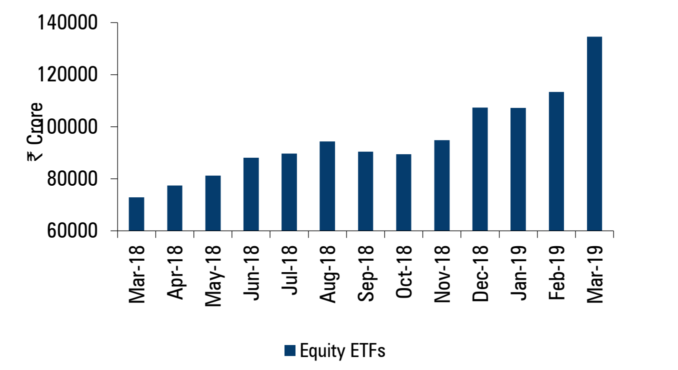
The banking sector is poised to benefit from multiple tailwinds in the form of a revival in credit growth, softness in bond yields and clarity over the PCA framework. We believe the banking sector may outperform and lead the next market rally. Investors may invest in banking funds as part of their thematic allocation with an investment horizon of more than two to three years.

Indian banks have outperformed with the Bank Nifty breaching life-time highs and becoming the best performing index providing ~10% returns in January-March 2019 (March alone - 11%). Expectations of a recovery in profit for large corporate banks, led by moderation in provision resulted in the recent rally in large private banks and public sector banks.

In our opinion, as challenges surrounding growth and asset quality have receded, we expect large banks to continue to benefit disproportionately on growth and thereby operating profit. We believe the banking sector will outperform and continue to lead the market rally over the next few quarters. Investors may invest in banking funds as part of their thematic allocation with an investment horizon of more than two to three years.

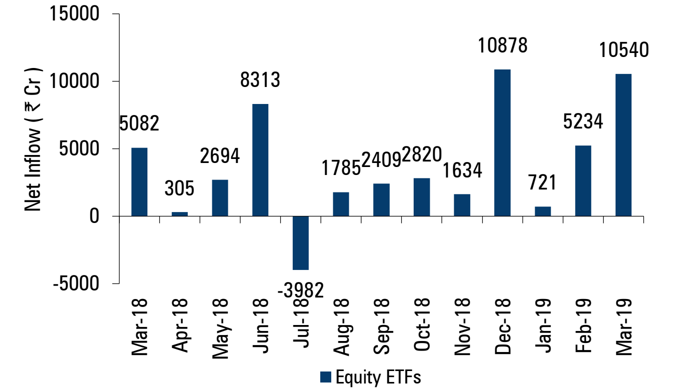
Exchange Traded Funds (ETFs)

Exhibit 2: ETF AUM rising significantly on back of institutional money from EPFO into Sensex/Nifty ETF



Source: AMFI

Exhibit 3: Flows into equity ETFs remain volatile. Inflows during March rise significantly



Source: AMFI

ETFs as a category is gaining popularity. Apart from Sensex or Nifty ETFs, many other equity oriented ETFs are now available tracking various indices across market cap and sectors.

Exhibit 4: There are around 15 categories of ETFs available

Nos.	Types of ETFs	Name of ETF
I	**Largecap oriented ETFs**	
1	Nifty 50 ETF	Most AMCs
2	Sensex ETF	Most AMCs
3	BSE 100 ETF	SBI-ETF BSE 100
4	Nifty 100 ETF	ICICI Pru Nifty 100 ETF
		LIC MF ETF-Nifty 100
		Reliance ETF Nifty 100
5	Nifty 100 Quality 30 ETF	Edelweiss ETF - Nifty 100 Quality 30
6	Nifty Low Vol 30 ETF	ICICI Pru Nifty Low Vol 30 ETF
7	Nifty Next 50 ETF	Aditya Birla SL Nifty Next 50 ETF
		ICICI Pru Nifty Next 50 ETF
		SBI-ETF Nifty Next 50
		UTI-Nifty Next 50 ETF
8	Sensex Next 50 ETF	SBI-ETF Sensex Next 50
		UTI S&P BSE Sensex Next 50 ETF
9	NV 20 ETF	ICICI Pru NV20 ETF
		Kotak NV 20 ETF
		Reliance ETF NV20
II	**Midcap Oriented ETFs**	
10	Midcap 100 ETF	Motilal Oswal Midcap 100 ETF
11	Nifty Midcap 150	Reliance ETF Nifty Midcap 150
12	Midcap Select ETF	ICICI Prudential Midcap Select ETF
III	**ETF in Multicap segment**	
13	S&P BSE 500 ETF	ICICI Pru S&P BSE 500 ETF
IV	**ETFs based on sectors/Themes**	
14	Banking ETF	Edelweiss ETF - Nifty Bank
		Kotak Banking ETF
		SBI-ETF Nifty Bank
15	PSU Bank ETF	Kotak PSU Bank ETF
		Reliance ETF PSU Bank BeES

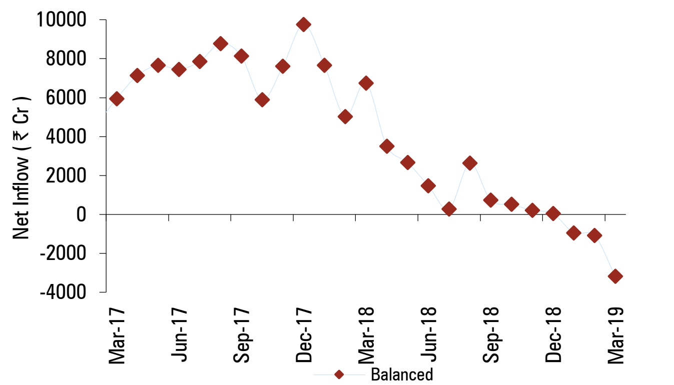
Source: ACE MF

Aggressive hybrid funds

Inflows into balanced funds have shown a consistent decline over the last few months. March 2019 witnessed a third continuous decline at ~₹ 3200 crore. Volatile equity markets resulting in negative returns for the category while imposition of dividend distribution tax (DDT) on equity mutual funds in the last Budget have dampened investor sentiments considerably in balanced funds.

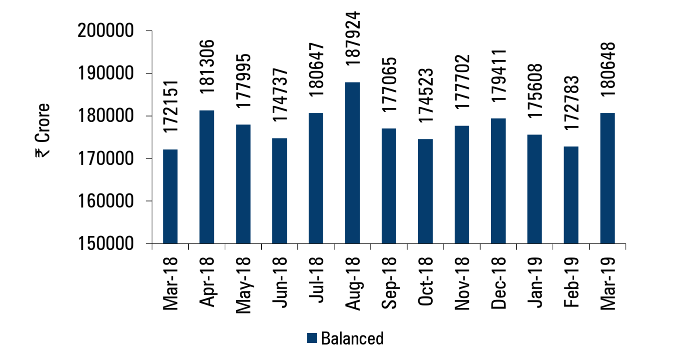
Average net monthly inflow in H1CY18 was ~₹ 4500 crore. In H2CY18, it was ₹ 740 crore. In CY17, it was ₹ 7000 crore. It has turned negative for the first three months of calendar year 2019.

Exhibit 5: Balanced funds see outflows for the third consecutive month



Source: AMFI

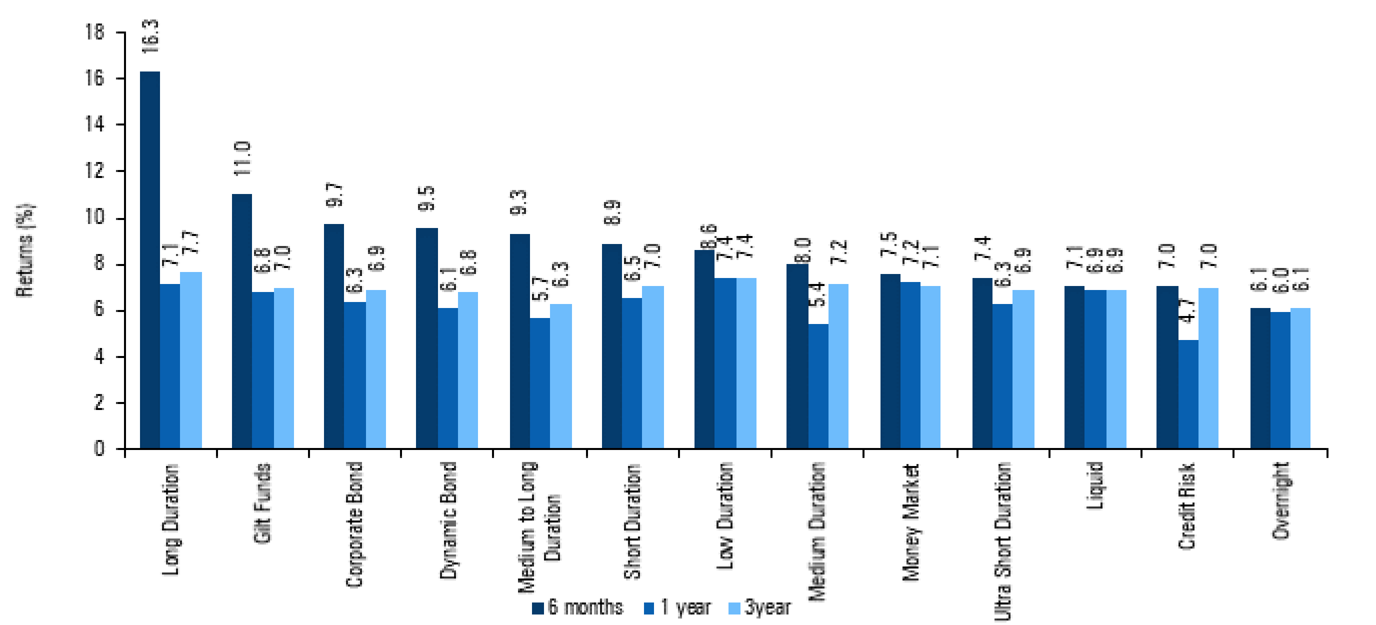
Exhibit 6: AUM of balanced funds rise in march due to mark to market gains



Source: AMFI

Debt Funds

Exhibit 7: Fall in G-Sec yields lead to duration/gilt funds outperforming in last six month. Credit funds average shift lower due to negative return in few funds



Source: CRISIL. Category average annualised returns as on April 16, 2019

Short-term debt allocation (investment horizon of less than a year)

We believe ultra-short term funds and low duration fund categories offer a relatively better investment opportunity

Ultra short-term bond funds and low duration funds are an ideal option to park money temporarily compared to overnight or liquid fund categories. They offer higher return potential by investing a higher proportion in a mix of corporate bonds and commercial papers compared to overnight/liquid funds. At the same time, most funds in these categories do not have exit load restrictions, thereby making them liquid from an investors' perspective.

Money market funds are also a worthwhile option from a liquidity and credit quality perspective, particularly for conservative investors. However, the return potential may be lower compared to ultra-short/low duration categories

Ultra short term funds and low duration funds with optimal mix of credit quality are better option to invest for investment horizon of less one year

Long term debt allocation (investment horizon of more than a year)

We believe medium duration funds and credit risk funds categories offer a relatively better investment opportunity based on risk profile of investors. Short-term funds are also a worthwhile option for conservative investors. However, the return potential may be lower compared to medium duration and credit risk categories due to higher credit quality.

In the medium duration category, many funds offer an optimum mix of credit quality along with higher return potential. Credit quality in this category is lower than short duration funds but higher than credit risk category.

Credit funds should be avoided in current weak credit environment. Corporate bond fund category is best suited for long term debt allocation

We are cautious on credit risk funds as a category especially in the current weak credit environment. Credit risk fund category is only suitable for aggressive investors who want to invest for long term (more than three years).

Categorisation of debt funds

Exhibit 8: Ultra short/low duration for short-term and corporate bond for long term should in general be preferred category

Category	Comment
Investment Horizon: Less than one year	
Overnight funds	Maturity up to 1 day
Liquid funds	Maturity up to 91 days
Ultra short funds	Maturity between 3-6 months
Low duration funds	Maturity between 6-12 months
Money market funds	Money market securities with maturity up to 1 year
Investment Horizon: More than one year	
Short duration	Maturity between 1-3 years
Medium duration	Maturity between 1-4 years
Medium to long duration	Maturity between 4-7 years
Long duration	Maturity of more than 7 years
Dynamic bond funds	Across duration
Corporate bond funds	High rated instruments (AA+ and AAA)
Credit risk funds	Below high rated instruments (below AA+)
Gilt funds	G-Secs across maturity

Source: ICICI Direct Research

Gold: Multiple factors favour positive outlook

After gaining around 5.0% since the start of 2019, gold prices witnessed some correction eliminating all gains accrued since the start of the year.

The risk on trade globally since the later part of February with equity markets rising and bond yields rising, led investors to shy away from the safe haven gold.

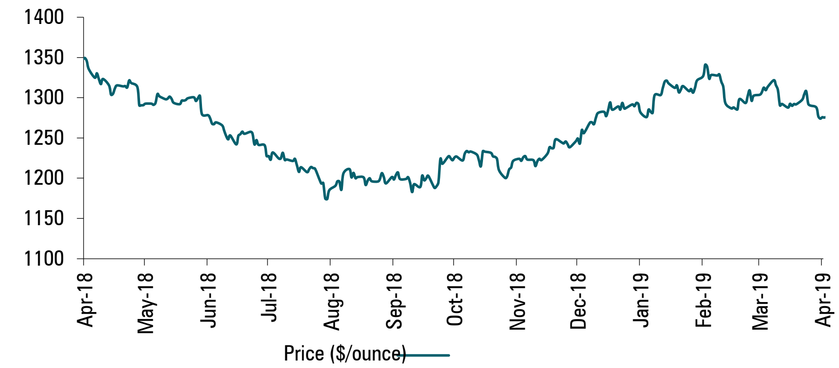
Gold prices in the near term may find support due to concerns on trade war and higher volatility in capital markets. The medium term outlook, however, remains benign given the rising global interest rate trajectory and reducing monetary stimulus

Many central bankers have bought gold in the last year including the Reserve Bank of India. Investor demand in global gold ETF is also witnessing some interest with the holding increasing.

Gold prices have been supported by a weakness in the US dollar in the beginning of 2019, lower economic growth in the country, the continued trade tension between the US and China and more importantly volatility in equity and currency markets.

Historically, the performance of gold is not structural. It generally performs in specific short periods of time, especially during capital market meltdown or global recession or geopolitical tension, etc. Therefore, it may not be an ideal long term asset class.

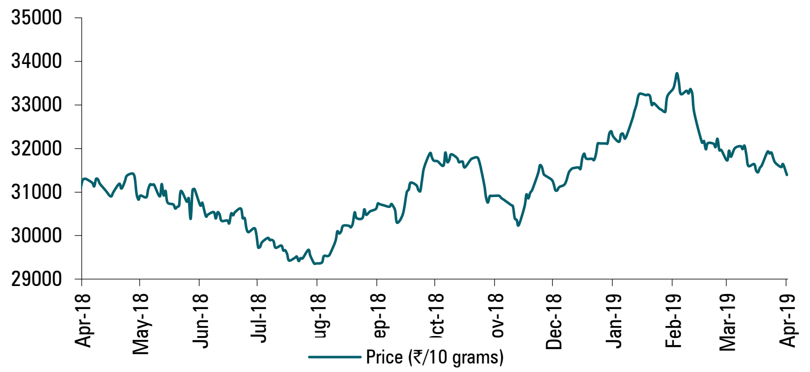
Exhibit 9: Gold prices US dollar terms



Source: Bloomberg

Global prices have corrected by around 3.8% from its recent highs in February 2019 while Indian prices are down 6.3% from similar corresponding levels

Exhibit 10: Gold prices in Indian rupee terms



Source: Bloomberg

Model Portfolio: Equity

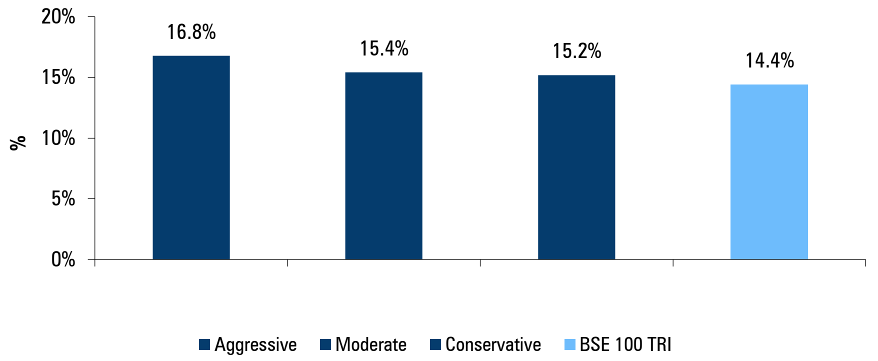
Investors who are wary of investing directly into equities can still get returns almost as good as equity markets through the mutual fund route. We have designed three mutual fund model portfolios, viz. conservative, moderate and aggressive mutual fund portfolios. These portfolios have been designed keeping in mind various key parameters like investment horizon, investment objective, scheme ratings, and fund management

Exhibit 11: Equity Model Portfolio

Particulars	Aggressive	Moderate	Conservative
Risk Return	High Risk- High Return	Medium Risk - Medium Return	Low Risk - Low Return
Funds Allocation			% Allocation
Franklin India Focused Equity Fund	20	-	-
Principal Emerging Bluechip Fund	-	20	20
HDFC Smallcap Fund	20	20	-
HDFC Equity Fund	-	-	20
L&T India Value Fund	20	-	-
L&T Midcap Fund	20	20	-
Mirae Asset India Equity Fund	20	20	20
ICICI Prudential Bluechip Fund	-	20	20
Reliance Large Cap Fund	-	-	20
Total	100	100	100

Source: ICICI Direct Research

Exhibit 12: Model portfolio performance



Source: ACE MF. Since inception (May 2009) CAGR return as on March 31, 2019

Model Portfolio: Debt

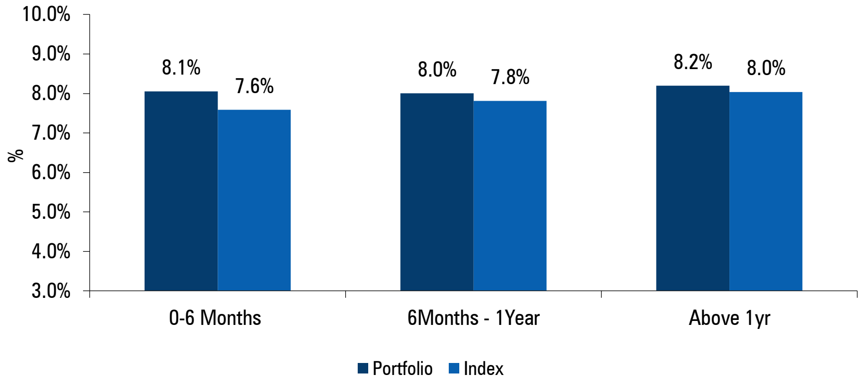
Investors who are wary of investing directly into equities can still get returns almost as good as equity markets through the mutual fund route. We have designed three mutual fund model portfolios, viz. conservative, moderate and aggressive mutual fund portfolios. These portfolios have been designed keeping in mind various key parameters like investment horizon, investment objective, scheme ratings, and fund management

Exhibit 13: Equity Model Portfolio

Objective	Liquidity	Liquidity with moderate return	Above FD
Funds Allocation			% Allocation
SBI Mag Ultra Short Duration	20	20	
ICICI Pru Savings Plan	20		
Kotak Savings Fund	20		
HDFC Medium Term Fund		20	20
IDFC Low Duration Fund	20	20	20
IDFC Corporate Bond Fund		20	20
L&T Ultra Short Term Fund	20	20	
HDFC Corporate Bond Fund			20
Aditya Birla SL Corporate Bond Fund			20
Total	**100**	**100**	**100**

Source: ICICI Direct Research

Exhibit 14: Model portfolio performance



Source: ACE MF. Since inception (May 2009) CAGR return as on March 31, 2019

Note: Index: 0-6 month's portfolio – Crisil Liquid Fund Index; six months-one year – Blended Index with 50% weight to Crisil Liquid Index, 50% weight to Crisil Short Term Bond Fund Index; Above 1 year: Crisil Short Term Bond Fund Index

Mutual Fund Recommendation

Exhibit 15: Equity Oriented Funds

Category wise top picks	
Largecaps	ICICI Pru Focused Bluechip Fund
	IDFC Large Cap Fund
	Reliance Large Cap Fund
Large and Midcaps	DSP Blackrock Equity Opportunities Fund
	IDFC Core Equity Fund
	Principal Emerging Bluechip Fund
Multicaps	HDFC Equity Fund
	L&T India Equity Fund
	Mirae Asset India Equity Fund
Midcaps	Invesco India Midcap Fund
	Kotak Emerging Equity Fund
	L&T Midcap Fund
Smallcaps	L&T Emerging Businesses Fund
	Reliance Small Cap Fund
	HDFC Small Cap Fund
Focused	ICICI Pru Focused Equity Fund
	Franklin India Focused Equity Fund
	Reliance Focused Equity Fund
ELSS	Aditya Birla Tax Relief 96 Fund
	DSP Blackrock Tax Saver Fund
	IDFC Tax Advantage Fund
Aggressive Hybrid	HDFC Hybrid Equity Fund
	ICICI Pru Equity & Debt Fund
	Principal Hybrid Equity Fund

Source: ICICI Direct Research

Exhibit 16: Debt Funds

Category wise top picks	
Category	**Fund**
Overnight / Liquid / Ultra Short Term	Kotak Savings Fund
	L&T Ultra Short Term Fund
	SBI Magnum Ultra Short Duration Fund
Low Duration / Money Market	DSP Low Duration Fund
	IDFC Low Duration Fund
	UTI Treasury Advantage Fund
Short Term	HDFC Short Term Debt Fund
	IDFC Bond Fund - Short Term
	L&T Short Term Bond Fund
Medium Term	HDFC Medium Term Debt Fund
	IDFC Bond Fund - Medium Term Plan
	SBI Magnum Medium Duration Fund
Medium to Long Term / Long Term	Aditya Birla SL Income Fund
	ICICI Pru Bond Fund
	Reliance Income Fund
Dynamic Bond Fund	DSP Strategic Bond Fund
	IDFC Dynamic Bond Fund
	Kotak Dynamic Bond Fund
Corporate Bond	Aditya Birla SL Corporate Bond Fund
	HDFC Corporate Bond Fund
	IDFC Corporate Bond Fund
Credit Risk	Axis Credit Risk Fund
	IDFC Credit Risk Fund
	SBI Credit Risk Fund
Gilt	IDFC G-Sec Fund - Investment Plan
	Reliance Gilt Securities Fund
	UTI Gilt Fund

Source: ICICI Direct Research

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