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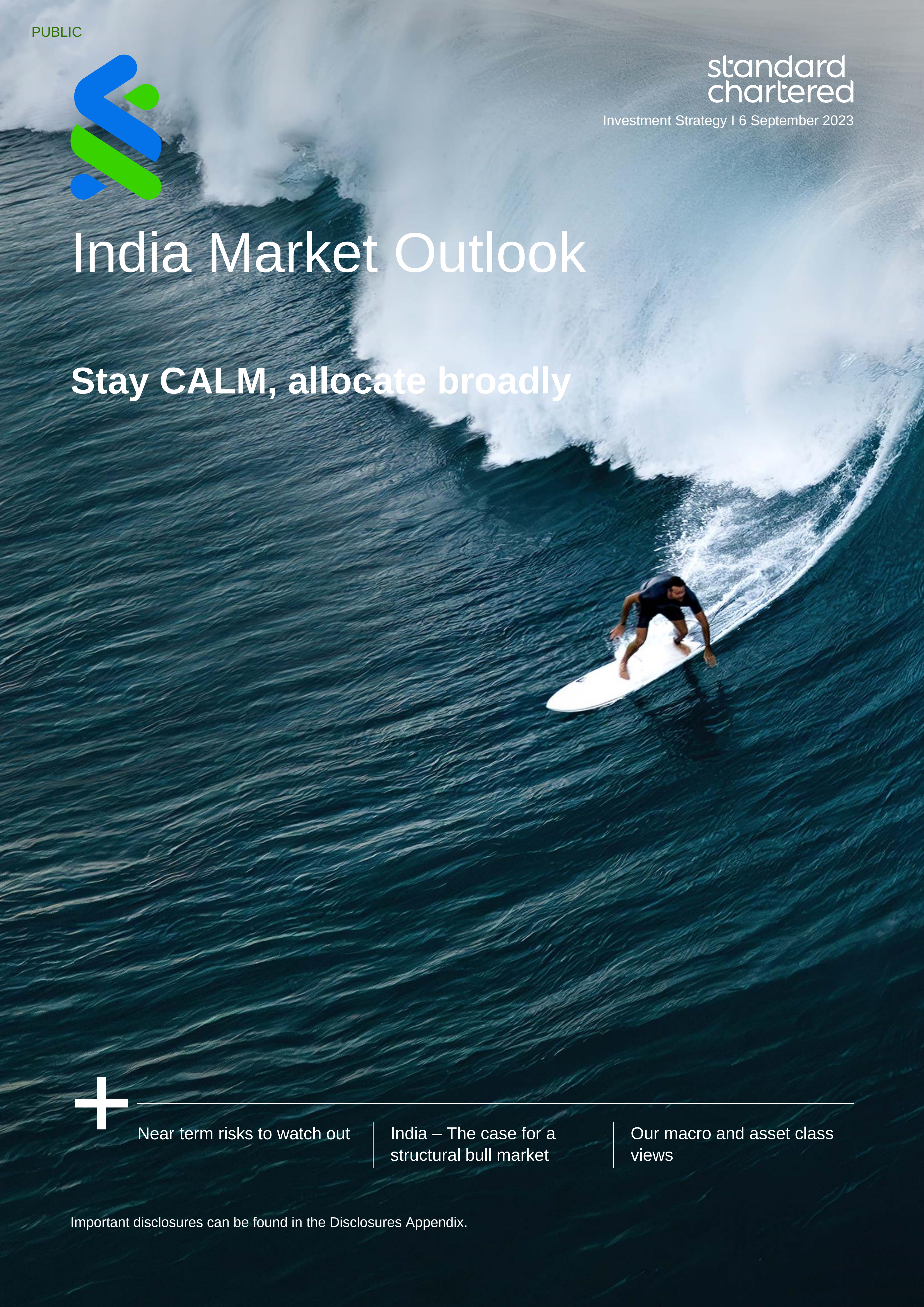


standard chartered

Investment Strategy I 6 September 2023

India Market Outlook

Stay CALM, allocate broadly

Near term risks to watch out | India – The case for a structural bull market | Our macro and asset class views

Investment strategy and key themes

Implications for investors

- We have a balanced asset class outlook.
- *In equities:* Overweight Mid-cap and Small-cap equities
- *In bonds:* Overweight Medium and Long maturity bonds.
- Gold a portfolio hedge.

Sector Overweights

- *Financials*
- *Industrials*
- *Healthcare*

Key Themes

- *Capitalise on market opportunities*
- *Allocate broadly*
- *Lean to Asia*
- *Manage volatility*

Stay CALM, allocate broadly

- The pullback in equities and spike in bond yields, is a reminder of the risks investors face after a strong rebound since April lows. Over the past month, the Nifty index closed flat, but outperformed MSCI Asia-ex-Japan (-2.2%) and MSCI Developed Markets (-0.4%). Broader markets continue to outperform large-cap equities, with the Nifty Midcap (+7.0%) and Nifty Smallcap (+8.2%) up sharply. The 10-year IGB yield rose 2bps to 7.20%, while the INR fell 0.2% against the USD.
- The pendulum continues to oscillate between “recession” and “goldilocks” for major developed economies. The two competing macro narratives - India's robust domestic macro fundamentals remains ahead of its major peers vs. high likelihood of a sharp growth slowdown in developed economies – is likely to remain the key driver for Indian assets, albeit increased near-term risks from higher oil prices and domestic inflationary pressures.
- Our **CALM** framework is a prudent approach to navigate current market conditions. The letter **A** in this framework, which stands for ‘Allocate broadly’ – maintaining a diversified and balanced foundation allocation, remains significant during such periods of uncertainty to help manage volatility.
- Within equities, we retain our overweight on mid-cap and small-cap equities given broadening growth momentum, improving earnings outlook and a likely peak in bond yields. Within bonds, we are overweight medium and long-maturity bonds and high-quality corporate bonds on attractive absolute yields.

Key Asset Class Views

Equities	◆
Developed Markets	◆
Emerging Markets	▲
Indian Equities	▲
Large Cap	◆
Mid/Small Cap	▲

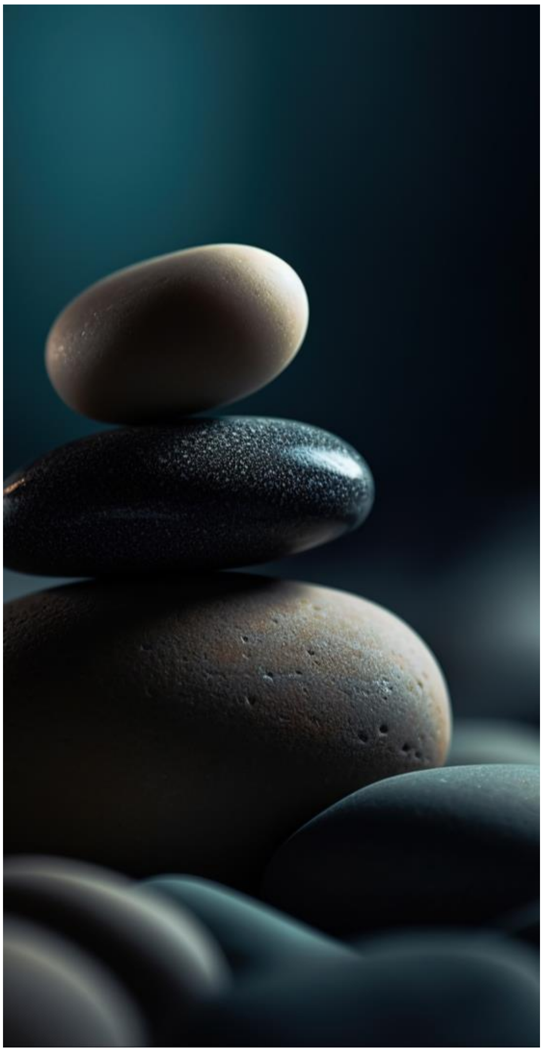
Bonds	◆
Short Maturity	◆
Medium/Long Maturity	▲

Gold	◆

Cash	◆

Legend: ▲ Overweight ◆ Neutral ▼ Underweight

Perspectives on key client questions



Are Indian assets attractive?

We highlighted in our previous outlook, possible downside risks to Indian assets in the near-term, following the strong rebound in Q2. Since hitting its peak in July, the Nifty index is down 2%. Nevertheless, momentum remains strong in broader markets, as they continue to outpace large-cap equities (Nifty Midcap index and Nifty Smallcap index is up 9% and 11% respectively). Yields have spiked, with short-maturity bonds (3M-3Y IGBs) up 10-16bps, while the 10-year IGB yield is up 11bps.

Over the next 1-3 month, we expect volatility to remain elevated across Indian assets as below key drivers evolve:

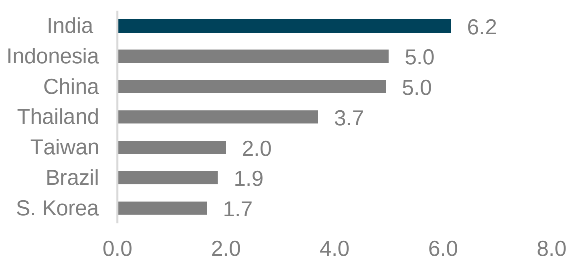
1) CPI inflation has moved above RBI's upper-bound target of 6% over the past two months, driven primarily by a sharp surge in food prices. Uneven rainfall distribution and rising crude oil prices (at 90$/bbl vs avg. of $77/bbl in May-July) poses upside risks to inflation. This has led to the RBI stepping up liquidity management operations since August policy.
2) Domestic bond yields have moved higher, responding to rising inflationary expectations, unwinding of policy easing expectations and likely heavy supply of government bonds in Q3 CY2023. The 1-year OIS spread suggests market expectations of no rate-cut by the RBI over the next 1-year.
3) The rebound in Indian equities was supported by strong foreign investor participation, with an average monthly inflow ~USD 4.5bn between May and July. August flows have slowed to~ USD 1.5bn as relative valuation premiums turn richer and prospects for other markets in the region improve.

Beyond the near-term risks, we see a structural bull case for Indian assets

We believe India has the potential to transition into an upper middle-income economy within the next two decades. This transition, which is underpinned by favourable demographics, policy reforms, infrastructure investments and technological improvements, would bring about transformative changes to the economic landscape and benefit Indian financial market assets.

Fig 1. GDP growth expected to stay ahead of EM peers

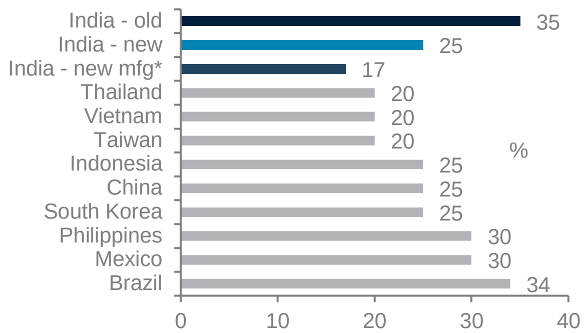
FY 2024 and FY 2025 avg. GDP growth estimates (%)



Source: Bloomberg, Standard Chartered.
For India, fiscal year (FY) considered (1 April – 31 March cycle) instead of calendar year (CY).

Fig 2. India's corporate tax rate for manufacturers remains the most competitive among market peers

Corporate tax rates (%)



Source: Bloomberg, Standard Chartered. *For new manufacturing companies commencing operations before March 2024

Reforms and policy initiatives focused on revival of the manufacturing sector

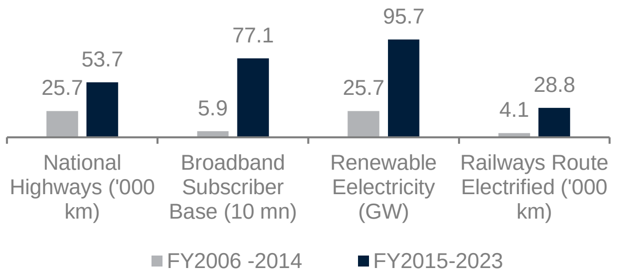
Over the past few years, the government has announced numerous structural reforms to address the ease of doing business and revive the domestic manufacturing sector. These include:

1. Reforms such as the Goods and Services tax (GST), the Insolvency and Bankruptcy Code (IBC), and corporate tax cuts (including a 15% tax rate for new manufacturing units set up before March 2024).
2. The government has also announced the production-linked incentive (PLI) scheme, which aims to make exports more competitive.
3. The government committed significant capex outlays during the pandemic to revive the investment cycle to support growth and crowd-in the private sector.

The PLI scheme aims to offer industry-specific incentives to raise value-add and create an ecosystem to lower imports, make exports highly competitive. The PLI scheme is expected to lead to investments of USD 58bn over the next five years across 660 entities (both Indian and Global) backed by an additional USD 33bn in government incentives over next 5-6 years (equivalent to 1.4% of government expenditure). Overall, PLIs not only have the potential to generate incremental revenue, but also the ability to boost job creation and support domestic consumption, which remains the largest contributor to GDP growth.

Fig 3 **Infrastructure has received a strong boost from the government's focus over the past eight years**

Pace of infrastructure developments



Source: Mins. of Road, Transp. & Highways (India), RBI, TRAI

Indian assets to remain on a strong footing

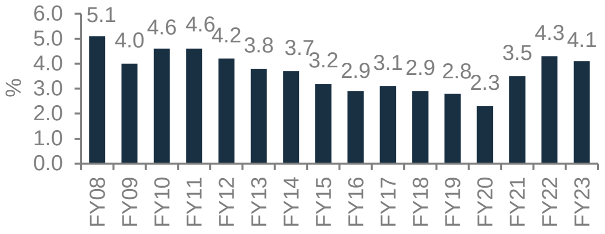
In our view, India's macroeconomic backdrop sets Indian financial market assets up to perform well on a multi-year horizon. These include: 1) A high rate of economic growth, with well-managed inflation and external stability risks. 2) sustainable corporate profit cycle, 3) Fiscal consolidation and improving quality of spend - government's shift towards capex is likely to raise the investment rate, key to sustaining growth.

Equities best positioned to benefit

Indian equities remain poised to benefit from several strong multi-year structural drivers including: a) a diversified economy with robust domestic macro fundamentals, b) healthy corporate balance sheets and strong financial sector health, c) lower foreign exchange risks, d) a sustained corporate earnings growth cycle driven by increased formalization, improving capacity utilization and efficiency gains from technological improvements and e) lower reliance on foreign investor inflows. We expect the current equity cycle to be analogous to the 2003-2008 bull cycle when output growth rose sharply, inflation stayed stable and improvements in productivity drove a rise in investments.

Fig 4 **India's corporate profit share of GDP has recovered closer to pre-pandemic levels**

NSE 500 index profit as % of India's GDP



Source: Bloomberg, Standard Chartered

Fixed income to provide a stable yield

India's government bond yields have risen from pre-pandemic lows as monetary policy turned less accommodative. Given the focus on investment-led growth and containing inflation, domestic bond yields are likely to remain well anchored for the next few years. A stable inflation and currency outlook are additional support factors for bond investors. The RBI's strong FX reserves (~USD 600bn), a level deemed more than adequate by the IMF relative to imports and external debt, should also help manage INR volatility.

Private markets to provide long-term alpha

India's private markets have evolved significantly over the past decade, with investments increasing five-fold and the investor base rising four-fold. The industry has received support from a favourable regulatory landscape, notable strides in digital infrastructure and deepening maturity of founders. In 2022, India's private markets demonstrated resilience in the face of global headwinds, with India's share of PE-VC investments in Asia-Pacific rising to about 20%, from 15% only a few years ago. In our view, private markets interest is likely to remain strong, supported by a positive economic outlook and structural enablers such as large consumption opportunity and best-in class digital infrastructure. We expect sustained demand from major PE/VC capital in India's Healthcare, Manufacturing, Tech, NBFCs, Fintech and ESG-aligned investments like EV and Green energy. Together, this suggests the asset class is likely to offer potential for long-term alpha over listed assets.

Macro Overview

Key themes

We expect India's economic growth to track above its long-term trend and stay ahead of its major peers in H2 2023 with India's growth likely to be resilient to weakening global growth given supportive government policies, sustained revival in services and a pick-up in private capex. Further, a likely peak in RBI's policy rate could boost consumption demand. In our view, CPI inflation is likely to trend lower in 2023, tracking within the RBI's medium-term target range of 2%-6% given high base effect, easing commodity prices and lagged impact of monetary policy.

In our assessment, fiscal policy is likely to be the key driver for growth in 2023, as financial conditions remain tighter than normal. The past measures undertaken by the government including (i) greater public capex spend, (ii) long-standing reforms related to taxation and labour and (iii) providing incentives to boost manufacturing and infrastructure, is likely to boost India's medium-term growth outlook. In our view, the RBI's decision to keep policy rates unchanged in its past three policy meetings, despite the recent surge in inflation prints, likely signals an end to the tightening cycle.

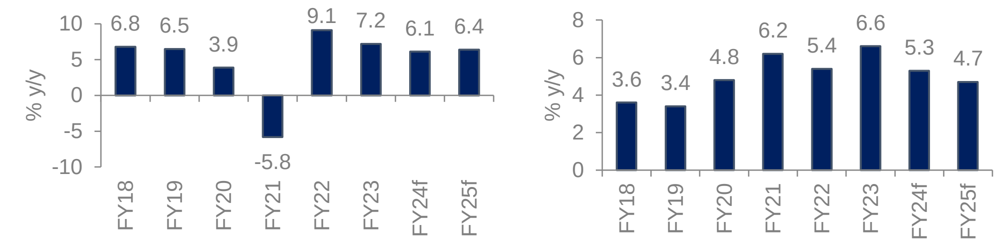
Key risks to our macro-outlook are: 1) Global growth slowdown, 2) Persistent high inflation, 3) Escalating geo-political tensions.

Key chart

India is expected to grow at 6.1% in FY24, faster than its peers. Inflation is expected to track below the RBI's upper-bound target of 6%.

Fig. 5 India's growth-inflation dynamics stronger than peers

GDP Growth (Y/Y) and CPI Inflation (Year average) – Bloomberg consensus estimate *



Macro views at a glance

Factors	View	Comments
Economic growth		**Economic activity remained strong in August 2023.** Manufacturing PMI rose to a three-month high of 58.6 while Services PMI eased marginally to 60.1 in August 2023. Industrial production eased to 3.7% y/y in June 2023. India's GDP grew 7.8% y/y in Q1 FY2024, higher than the growth of 6.1% y/y recorded in Q4 FY2023.
Inflation		**India's consumer price inflation rose to a fifteen-month high 7.4% y/y in July 2023,** driven by a sharp surge in food article prices. Core inflation eased to 5% from 5.2% over the previous month.
Fiscal deficit		**The government balanced its growth priorities with fiscal consolidation in the latest budget.** FY 2024 fiscal deficit is estimated at 5.9% of GDP while FY 2023 fiscal deficit was retained at 6.4% of GDP. India's GST collections rose 11% y/y to INR 1.59trn in August 2023, tracking below the CYTD23 average collections of INR 1.62trn.
External		**Trade deficit widened to USD 20.7bn in July 2023.** Imports fell by 17% y/y to USD 52.9bn, while exports fell by 15.9% y/y to USD 32.3bn. India's current account deficit fell to USD 1.3bn or 0.2% of GDP in Q4 FY23 after reaching an all-time quarterly high of USD 36.4bn (4.4% of GDP) in Q2 FY23. The moderation was driven by a narrowing of merchandise trade deficit (USD 56.2bn from 71.3bn in Q3 FY23) and robust services surplus.
Monetary Policy		**The RBI kept the policy repo rate unchanged at 6.5% in its August 2023 policy review.** The RBI cumulatively hiked policy rates by 250 bps in FY 2023. The RBI retained its monetary stance of 'withdrawal of accommodation' and imposed an incremental CRR of 10% on scheduled banks' deposits on deposits made between May 19 and July 28, 2023. Further, the RBI revised its average inflation forecast for FY24 higher by 30bps to 5.4% and kept the real GDP growth forecast for FY24 unchanged at 6.5% y/y.

Source: Bloomberg, Standard Chartered India Investment Committee

Legend: Not supportive Somewhat supportive Balanced Supportive Very supportive

Bonds at a glance

Key themes

We maintain our neutral stance on bonds, as we expect attractive absolute yields to be counterbalanced by below average yield premiums, stretched medium-term fiscal position and weak government bond demand-supply balance. We see an opportunity to lock-in attractive yields post the rise in August, with a likely peak in bond yields given the RBI's pause on policy rates. We are Overweight medium and long-maturity bonds. We have a preference for corporate bonds (i.e. bonds that offer a yield premium over government bonds).

In our view, the RBI's decision to keep policy rates unchanged in the latest monetary policy, indicates the likelihood of bond yields being closer to the peak. We expect the 10-year IGB yield to likely trade in the range of 6.75%-7.00%. In our assessment, corporate bonds offer a better risk-reward amid attractive spreads and improving corporate fundamentals. In addition, higher absolute bond yields and lower currency volatility, provide a stable carry relative to their Emerging Market (EM) peers.

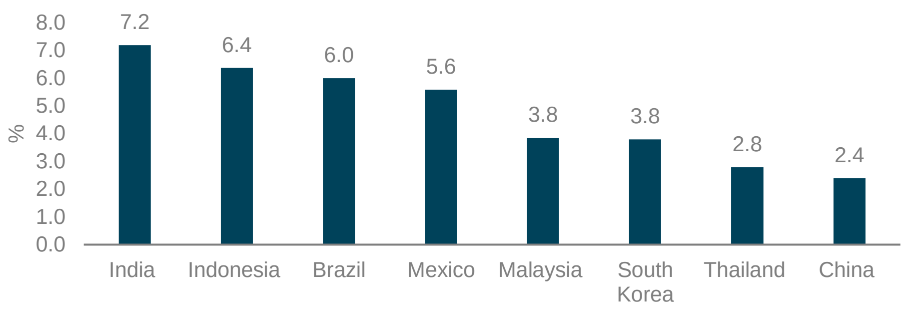
However, three factors for bonds remain unfavourable: 1) Fiscal deficit is likely to remain high over the medium-term, 2) Worsening government bond supply balance given high supply of government bonds amid a lack of support from the RBI, and 3) Higher-than-expected inflation could keep bond yields elevated as the RBI maintains a prolonged pause on policy rates.

Key chart

India's absolute yield is better than most peers

Fig. 6 **India's absolute yield is better than most peers**

10-year government bond yields (%)



Source: Bloomberg, Standard Chartered. Data as of 5 September 2023.

Bond views at a glance

Factors	Views	Comments
Real Yields	◓	**India's inflation-adjusted yield is lower compared to other Emerging Markets.** The 10-year IGB real yield at -0.2% is lower than the average real yield of 2% for other major EMs.
Supply dynamics	◐	**High bond sales is a key risk**. The government pegged its net borrowing for FY 2024 at about INR 11.8trn. Sustained demand from domestic investors and improvement in institutional investors' participation especially by foreign investors and OMOs by the RBI will be key to address supply concerns.
Monetary policy	◓	**Market expects no rate cuts by the RBI in the near-term.** 1-year Overnight Indexed Swap (OIS) spread suggests market participants expects the RBI to no rate cuts over the next 12 months.
Liquidity	◐	**The RBI's focus remains on withdrawal of excess liquidity.** The RBI has drained INR 11trn of system liquidity via variable rate reverse-repo (VRRR) so far in FY 2024. The banking system liquidity improved to a surplus of INR 1.6trn compared to a deficit of INR 0.26trn in 21 August 2023.
Demand dynamics	◐	**Demand dynamics have been stable** given lower issuances by States. CYTD 2023, foreign investor flows into bonds remain positive. Demand from institutional investors (banks, insurers, and mutual funds) will be a key determinant of bond yields in H2 2023, given a lack of RBI OMO plans so far in FY2024.
Yield premiums	◓	**Yield premiums trade below average.** The spread between 10-year IGB yield and repo rate is at 70bps vs. 5yr avg. of 165bps. High-quality (AAA) bonds have turned attractive with the yield spread between 3YAAA rated bond and 3Y G-sec trading at 52bps compared to 30bps in March 2022 and 5Y avg. of 66bps.

Legend: ○ Not supportive ◐ Somewhat supportive ◓ Balanced ◑ Supportive ● Very supportive

Equity at a glance

Key themes

We remain neutral on Indian equities, as robust domestic growth and strong corporate earnings cycle is counterbalanced by stretched valuation premiums, both absolute and relative to peers. Within equities, we are Overweight mid-cap and small-cap equities given broadening growth momentum, improving earnings outlook and a likely peak in bond yields. We prefer value-style equities.

In our view, Indian equities are supported by the following drivers: 1) Economic growth and earnings outlook remains robust and continues to outpace its major peers. 2) Indian equities underperformance in Q1 2023 amid strong earnings delivery has turned valuations more reasonable 3) Stable inflows from domestic investors driven by inflows into systematic investment plans is a key support for the market. 4) Positive foreign investor inflows amid reasonable valuations, robust fundamentals, and low foreign investor positioning in Indian equities.

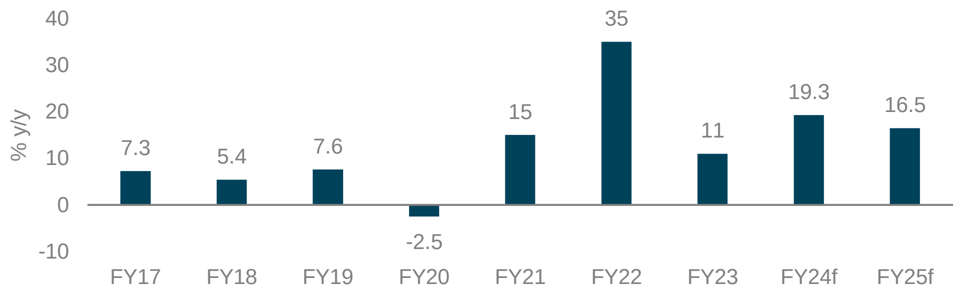
Risks to our positive equity view are: 1) Global growth slowdown and probable downgrades of earnings expectations, 2) Above-average equity valuations, both absolute and relative to peers, 3) Foreign investor selling amid slowing domestic investor flows.

Key chart

Bloomberg Consensus expectation is for Nifty earnings to rise by 19.3% and 16.5% in FY 2024 and FY 2025.

Fig. 7 **Indian equities earnings growth expectations remain robust**

Consensus estimates for Indian equities (Nifty index) earnings per share growth



Source: Bloomberg, Standard Chartered

Equity views at a glance

Factors	Views	Comments
Economic environment	◑	**Growth-inflation dynamics are supportive of equities**. Growth focused fiscal policy, improving income levels, early signs of improving rural demand and broadening growth momentum is likely to support corporate profitability. Rising food article prices amid skewed rainfall distribution and possible EL-Nino related weather disruptions, remains a key risk.
Earnings growth	◑	**Earnings growth expectations are robust.** Nifty index earnings grew 11% in FY 2023. Bloomberg consensus earnings growth expectations for the Nifty Index for FY 2024 and FY 2025 stands at 19.3% and 16.5% respectively. EPS estimates for Nifty Mid-cap and Nifty Small-cap indices have seen significant upward revisions since the start of 2023, outpacing earnings estimates for the Nifty index.
Valuations	◓	**Valuations have moderated but remain stretched**. Nifty 12-month forward P/E trades at 18.1x, is below its peak of 23x, but higher than its long-term average of 17.5x. Price to book value ratio (P/B) at 2.9x and Market cap to GDP ratio at ~105%, are above long-term averages.
Flows	◓	**Foreign investors have turned net buyers since March 2023.** YTD 2023, foreign investors have bought USD 17bn worth of equities compared to USD 17bn outflows in CY 2022. **Domestic institutional investors remain buyers in 2023**. YTD 2023, domestic institutional investor inflows are at USD 13.5bn compared to USD 36bn inflows in CY 2022.

Source: Bloomberg, Standard Chartered India Investment Committee

Legend: ○ Not supportive ◐ Somewhat supportive ◓ Balanced ◑ Supportive ● Very supportive

Asset allocation summary

Tactical Asset Allocation - (12m). All figures are in percentages.

Summary			View vs. SAA	Conservative	Moderate	Moderately Aggressive	Aggressive	Very Aggressive
Cash			◆	25.0	5.0	5.0	5.0	0.0
Fixed Income			◆	55.0	55.0	40.0	25.0	15.0
Equity			◆	15.0	35.0	50.0	65.0	80.0
Commodities			◆	5.0	5.0	5.0	5.0	5.0
Level 1	**Level 2**	**Level 3**						
Cash & Cash Equivalents			◆	25.0	5.0	5.0	5.0	0.0
Fixed Income	Short-term Bonds		◆	36.3	30.8	25.2	15.2	8.9
	Mid/Long-term Bonds		▲	18.7	24.2	14.8	9.8	6.1
Equity	DM Equity		◆	2.3	4.5	6.7	9.0	11.3
	Asia Ex-Japan / Other EM Equity		▲	2.0	3.9	5.9	7.9	9.9
	Indian Equities	Large-cap equities	◆	6.9	17.1	24.1	31.0	37.9
	▲	Mid/small-cap equities	▲	3.8	9.5	13.3	17.1	20.9
Commodities (INR Gold)			◆	5.0	5.0	5.0	5.0	5.0
				100	**100**	**100**	**100**	**100**

▼ Underweight ◆ Neutral ▲ Overweight

Source: Bloomberg, Standard Chartered

All INR converted exposure. For illustrative purposes only. Please refer to the disclosure appendix at the end of the document

Performance of our calls

	Open calls	Open date	Close date	Absolute	Relative
Bonds	Indian mid- and long- maturity bonds to outperform short-maturity bonds	30-Jun-23	Open		✗
Equities	Indian mid-cap and small-cap equities to outperform large-cap equities	30-Jun-23	Open		✓

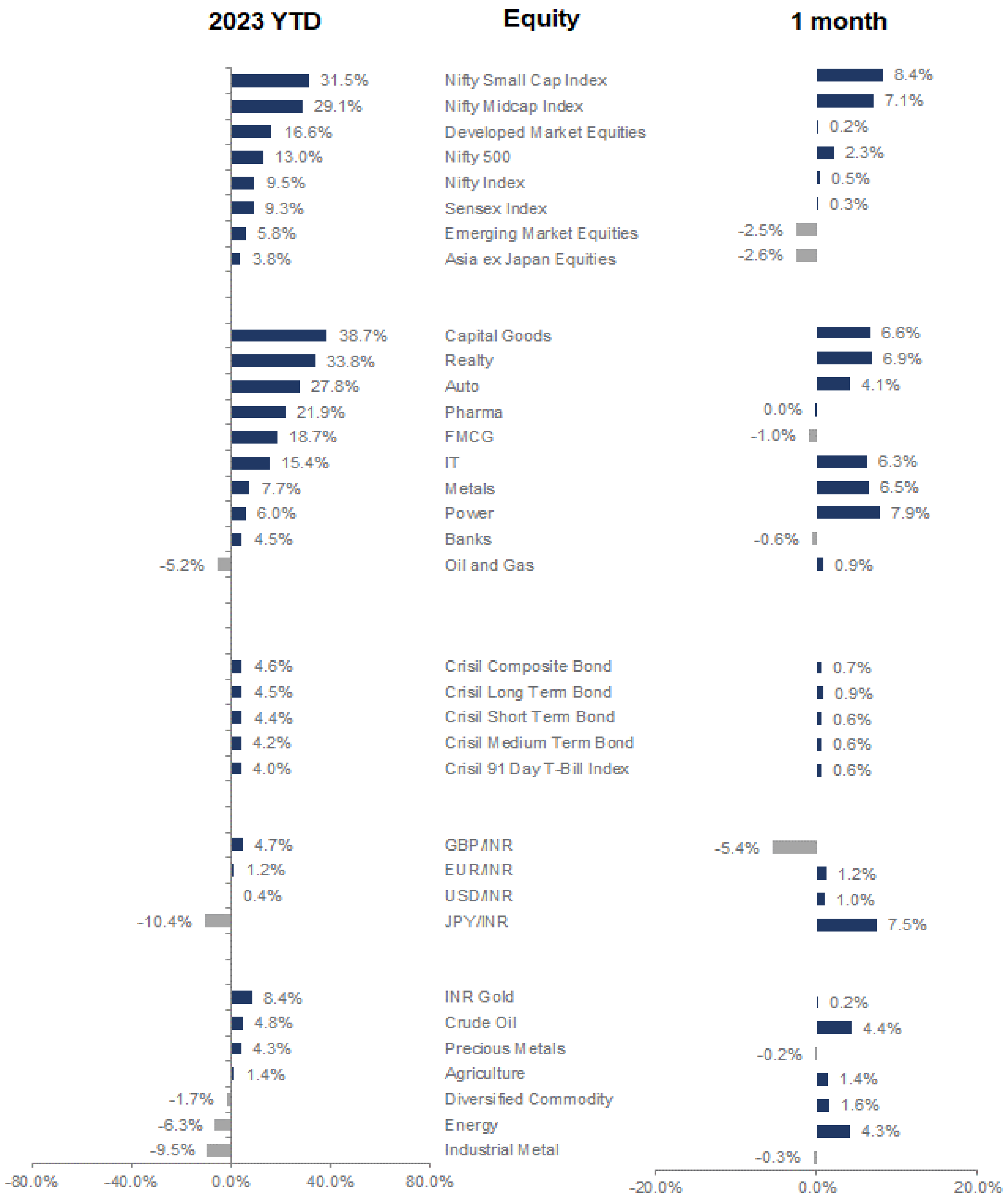
	Closed calls	Open date	Close date	Absolute	Relative
Bonds	Indian short-maturity bonds to outperform mid- and long- maturity bonds	19-Dec-22	30-Jun-23		✗
Equities	Indian large-cap equities to outperform mid-cap and small-cap equities	19-Dec-22	30-Jun-23		✗

Source: Bloomberg, Standard Chartered. Performance measured from 19 December 2022 (release date of our 2023 Outlook) to 5 September 2023 or when the view was closed.

Legend: ✓– Correct call; ✗ – Missed call; n/a – Not Applicable.

Past performance is not an indication of future performance. There is no assurance, representation or prediction given as to any results or returns that would actually be achieved in a transaction based on any historical data.

Market performance summary*



Source: MSCI, NSE, S&P BSE, Crisil, Bloomberg, Standard Chartered
*2023 YTD period from 31 December 2022 to 5 September 2023. 1-month period from 5 August 2023 to 5 September 2023.

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