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India Investment Strategy
14 May 2024

India Market Outlook

Looking through Volatility

How to navigate the near-term challenges? | Key asset class views | Performance update

Important disclosures can be found in the Disclosures Appendix

Investment strategy and key themes

Our top preferences

(12-month outlook)

Foundation overweights

- Equities
- *In equities:* Large-cap equities
- *In bonds:* Medium and Long-maturity bonds

Sector overweights

- Industrials
- Consumer Discretionary
- Healthcare

Looking through volatility

- Indian equities have witnessed a pullback post scaling new all-time highs, as a resurgence of inflationary pressures in developed economies, delayed monetary policy easing and escalating geopolitical tensions in the Middle East has soured risk sentiment. Over the past month, the Nifty index fell 3%, trailing peers (MSCI World flat and MSCI Asia-ex-Japan up 2.0%). Broader markets have also corrected, with the Nifty Midcap index down 1.6% and Nifty Small cap Index down 2.8% respectively. The 10-year IGB yield fell 2bps to 7.13%, while gold is down 0.5%. The INR fell 0.2% against the USD.
- We expect volatility to remain elevated in the near-term given significant event risks. A well-diversified portfolio is key to navigating the near-term challenges, by lowering portfolio risk (*see page 3 for more*).
- Within equities we remain overweight large-cap equities given a higher margin of safety in terms of earnings and valuations and stronger balance sheets to cushion the impact of tighter financial conditions. We retain our preference for value-style equities and investment theme – manufacturing and infrastructure.
- We expect bonds to outperform cash over 6-12 month as the government sticking to the fiscal consolidation path, improving bond demand-supply balance and receding domestic inflationary pressures are key supports. We are overweight medium and long-maturity bonds and high-quality corporate bonds on attractive absolute yields. Gold remains a key portfolio hedge.

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

How to navigate an uncertain market environment?

Equity markets have hit a rough patch after scaling new all-time highs last month. Volatility (measured through NSE Volatility index) has risen to a 16-month high as investors turn cautious ahead of the Lok Sabha poll results, successive higher inflation readings in the US that has pushed back expectations of Fed policy rate cuts and escalating geopolitical tensions in the Middle East. Domestic bond yields have also risen alongside the pullback in equities, raising investor concerns that there could be limited places for investors to seek refuge. In the face of significant near-term event risks, how should investors navigate the shifting and volatile environment ahead? Our views are as follow:

- It is important to recognise that it is normal for equity markets to experience bouts of volatility. Stay calm and do not resort to panic selling.
- A well-diversified portfolio is key to navigating the volatility ahead, as it lowers portfolio risks and outperforms a balanced (60/40 stock-bond) portfolio in most inflation/growth regimes.
- While there is a risk of a pullback in gold prices, the precious metal's role in the portfolio as a hedge against geopolitical and inflation risks remains compelling.

Stay calm and do not resort to panic selling

It is important to recognise that it is normal for equity markets to experience bouts of volatility. History has shown that the worst days in equity markets have tended to be followed by its best days. Therefore, panic selling during period of declines and heightened volatility can significantly lower returns over the long-term for investors. Drawdowns in the Nifty index have rarely exceeded 10-15% outside of global shocks and recessions. We expect further downsides in the Nifty index to be limited, given robust domestic macro fundamentals and our view of a soft-landing in the US.

A well-diversified portfolio is key to navigating the uncertainties ahead

A well-diversified portfolio that allocates across a range of asset classes with varying characteristics, performs differently under diverse market conditions, is key to navigating the uncertainties ahead.

Fig. 1 **Staying invested through downturns tends to generate better returns than trying to time the market**

Nifty returns, including after leaving out the best 'up' days*

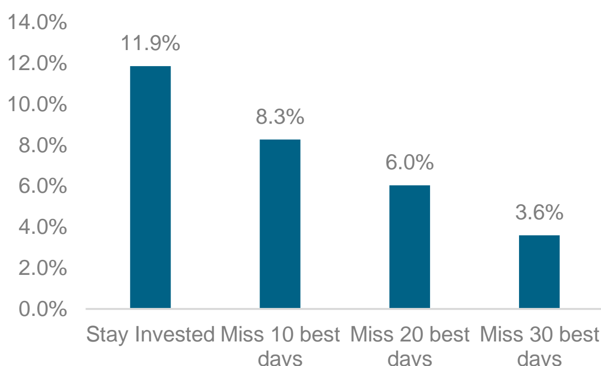
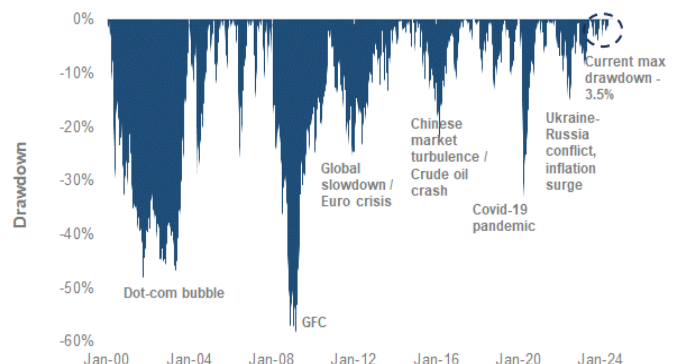


Fig. 2 **The drawdown in the Nifty index has thus far been relatively minor**

Drawdown of the Nifty index



Source: Bloomberg, Standard Chartered. *Data dating back to 2000.

Investors need to maintain an allocation to equities to benefit from the upside should economic conditions remain resilient. While Indian equities have witnessed a pullback lately, we believe the medium-term outlook remains supported by strong positive drivers including robust domestic macro fundamentals, strong corporate earnings cycle, and gradual improvement in private consumption. On the other hand, allocation to Bonds can serve as a hedge against the risk of a domestic slowdown and give a steady source of income in the portfolio. The recent surge in domestic bond yields has improved the risk-reward for the asset class. We believe this presents investors an opportunity lock in still-attractive yields, especially in high-quality corporate and medium-and-long term bonds, given our view of a likely peak in interest rates in the current cycle. Investors also need to maintain an allocation to gold to protect the portfolio against the risk of inflation. Further, an allocation to cash and liquid alternatives provides a source of less correlated returns. Cash allocations serve as the dry powder, to take advantage of short-term pullback.

Fig. 3 A diversified portfolio outperforms a 60/40 portfolio in most growth/inflation regimes

Risk-adjusted returns of 60/40 vs a diversified portfolio*

60/40 portfolio

		Real GDP growth		
		<5%	5 - 7%	>7%
Inflation	<4%	0.28	0.37	0.30
	4 - 6%	-0.03	0.51	0.34
	>6%	0.31	0.03	0.30

Diversified portfolio

		Real GDP growth		
		<5%	5 - 7%	>7%
Inflation	<4%	0.34	0.40	0.32
	4 - 6%	-0.01	0.56	0.35
	>6%	0.33	0.06	0.33

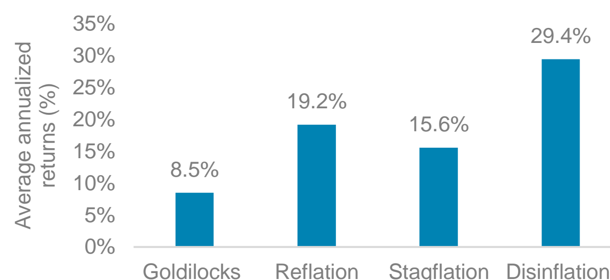
Source: Bloomberg, Standard Chartered. *Diversified portfolio defined as a 55% allocation to equities, 35% to bonds, 5% to gold and 5% to cash. Data since Q1 2010.

Gold's role in the portfolio remains compelling, even as the risk of a pullback remains high

In India, gold enjoys strong domestic tailwinds amid resilient household demand for jewellery and as a traditional store of wealth that passes on for generations. This in part, explains the resilience of domestic gold prices and its lower sensitivity to shifts in global macros. More recently, gold has decoupled from historical fundamental drivers such as real rates and the USD to rally to a fresh record high. Though, we remain neutral on the asset class, gold's role in the portfolio as a hedge against geopolitical tensions and inflation remains compelling. Gold has shown the tendency to be an all-weather asset with the ability to provide positive returns during any growth and inflation regimes (Chart 4).

Fig. 4 Gold stands out as an all-weather asset, providing returns in any inflation/growth regimes

Gold's average annualised returns in various growth/inflation regimes since Q1 2000*

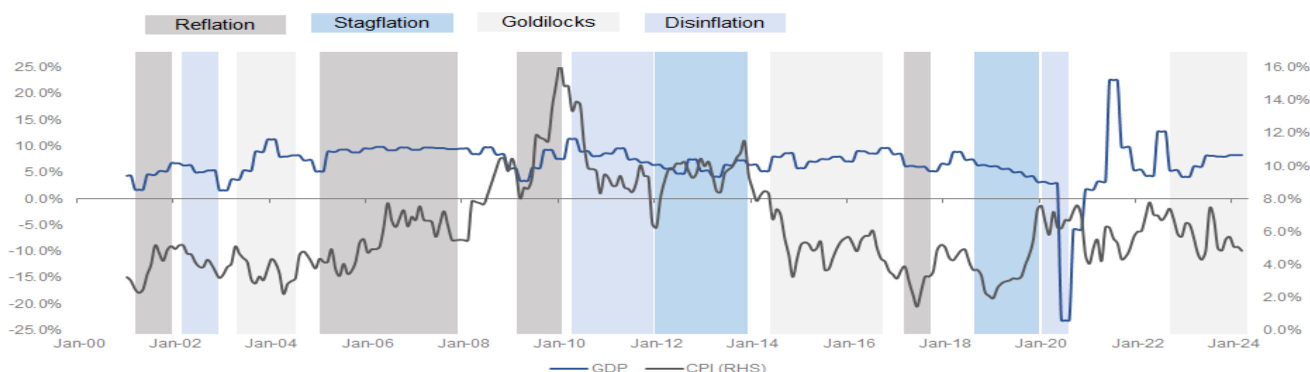


Source: Bloomberg, Standard Chartered. *Goldilocks: Deceleration in inflation, acceleration in growth. Reflation: Acceleration in growth and inflation. Stagflation: Acceleration in inflation, deceleration in growth. Disinflation: Deceleration in inflation and growth

Opportunistic allocations to buffer risk-adjusted returns. Investors can buffer their foundation allocations with opportunistic allocations to improve overall portfolio performance. Within equities, we continue to see value in manufacturing and infrastructure, with multi-year structural drivers still in place for these sectors. We prefer a barbell approach on sectors through an overweight on domestic cyclicals, like Industrials and Consumer Discretionary along with a defensive overlay through an overweight on Healthcare. Within bonds, we see attractive risk-reward in corporate bonds, especially in high quality (AAA), given cyclically high yield spreads (over government bonds) and their lower sensitivity to changes in interest rates.

Fig. 5 Growth-inflation regimes have stabilized in India post adoption of Inflation targeting framework in 2013

GDP growth (% y/y) and CPI (% y/y) across various time periods in India



Source: Bloomberg, Standard Chartered.

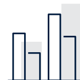
Macro overview – at a glance

Key themes

We expect India's economic growth to stay above its long-term trend and ahead of its major peers in 2024. Resilient domestic demand, supportive government policies and continued focus on capex are tailwinds for growth. Further, pre-election spending could support weak consumption demand. In our view, CPI inflation is likely to trend lower in 2024 and track within the RBI's inflation target range of 2%-6% on disinflationary pressures from previous policy tightening and lower food and commodity prices with likely government policy interventions to manage supply side concerns.

In our assessment, fiscal policy remains the key driver for growth in 2024, as financial conditions are likely to be tighter than normal. Measures undertaken by the government in the last few years including (i) greater public capex spend, (ii) structural reforms and (iii) incentives to boost manufacturing and infrastructure, is likely to support India's medium-term growth outlook. In our view, given underlying strong growth and contained inflationary pressures, the RBI is likely to keep policy rates on hold in H1 2024. We expect the RBI to cut rates later in the year as inflation declines closer to the medium-term target of 4% or growth impulses start to slow. However, the quantum of easing in this cycle is likely to be shallow.

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

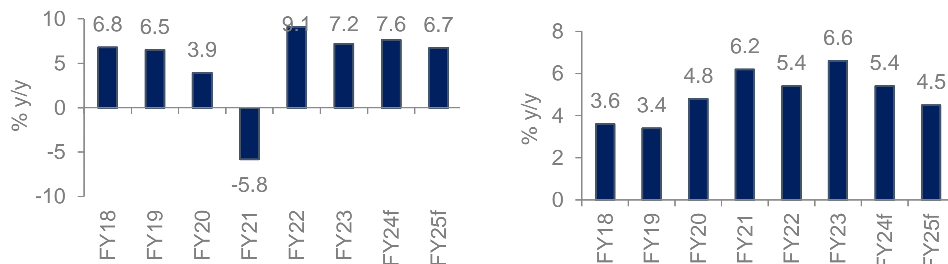


Key chart

For FY2025, India's GDP is expected to grow at 6.7% and CPI is expected to average 4.5%.

Fig. 6 India's growth-inflation dynamics stronger than peers

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



Source: Bloomberg, Standard Chartered

Macro views at a glance

Factors	View	Comments
Economic growth	◑	**Economic activity remained strong in April 2024.** Manufacturing PMI eased to 58.8 in April 2024 while Services PMI eased to 60.8. Industrial production grew 5.7% y/y in February 2024, higher than a 3.8% growth recorded in the previous month.
Inflation	◓	**India's consumer price inflation moderated to 4.8% in March 2024**, driven by muted growth in food article prices. Core inflation declined to an all-time low of 3.3% in March 2024.
Fiscal deficit	◓	**The government prioritized fiscal consolidation while supporting growth in the latest budget.** FY 2025 fiscal deficit is estimated at 5.1% of GDP vs revised target of 5.8% in FY2024. GST collections rose to all time high of INR 2.1trn in April 2024, up 12.4% y/y on strong growth in domestic transactions and imports.
External	◓	**India's trade deficit fell to USD 15.6 bn in March 2024.** Imports fell by 4.5% y/y to USD 57.3bn, while exports fell 0.7% y/y to USD 41.7bn. India's current account deficit widened to USD 10.5bn or 1.2% of GDP compared to USD 8.3bn or 1% of GDP in Q2 FY2024. The widening was driven by a rise in merchandise trade deficit even as net services surplus improved sequentially.
Monetary Policy	◓	**The RBI kept the policy repo rate unchanged at 6.5% in its April 2024 policy review for the seventh consecutive meeting.** The RBI retained its monetary stance of 'withdrawal of accommodation' and indicated flexible liquidity management through two-way actions. Further, the RBI retained its average inflation forecast for FY 2025 at 4.5% y/y and real GDP growth forecast for FY 2025 at 7.0% 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 are neutral on bonds, as attractive absolute and real yields are counterbalanced by below-average yield premiums and stretched medium-term fiscal position. Nonetheless, improving bond demand-supply balance on lower than-expected government borrowing and India bonds' recent inclusion in the global bond index are tailwinds for bonds. We are overweight medium and long-maturity bonds given their attractive carry and potential for higher price gains as yields fall. We prefer corporate bonds (i.e. bonds that offer a yield premium over government bonds), especially high-quality (AAA-rated) corporates.

In our view, the RBI's prolonged pause on policy rates, indicates the likelihood that bond yields have peaked. We expect 10-year IGB yield to trade in the range of 6.75%-7.00% over the next 6-12 months. In our assessment, high quality (AAA) corporate bonds offer a better risk-reward amid attractive spreads and improving corporate fundamentals. In addition, India's nominal bond yields are higher compared to most Emerging Market (EM) peers.

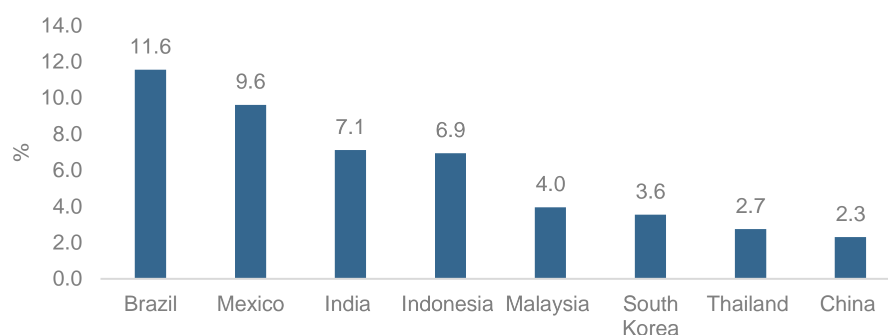
However, three factors for bonds remain unfavorable: 1) High fiscal deficit over the medium-term, 2) Tight banking system liquidity and a lack of outright support from the RBI, and 3) Above-average inflation is likely to keep bond yields elevated.

Key chart

India's stable nominal yield is better than most peers.

Fig. 7 **India's nominal yield is better than most peers**

10-year government bond yields (%)



Source: Bloomberg, Standard Chartered.

Bond views at a glance

Factors	Views	Comments
Real Yields	◑	**India's inflation-adjusted yield is lower than other Emerging Markets**. The 10-year IGB real yield at 2.3% is below the average real yield of 3% for other major EMs.
Supply dynamics	◐	**Government bond supply dynamics have turned favorable**. The government pegged its gross borrowing for FY 2025 at about INR 14.8trn compared to INR 15.4tn in FY2024. Both, FY 2025 fiscal deficit and government borrowing target was lower than market expectations.
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 stay on hold over the next 12 months.
Liquidity	◓	**The RBI's focus remains on withdrawal of excess liquidity**. The banking system liquidity has fallen to a deficit of INR 1.7trn in early May since hitting a surplus of INR 1.4trn in April. Increased currency leakage ahead of general elections, could keep banking system liquidity tight in H1 2024.
Demand dynamics	◐	**Demand dynamics have improved**. Foreign investor inflows remain positive YTD 2024 and is likely to stay robust given India's bond inclusion in global indices. Demand from domestic institutional investors (banks, insurers, and mutual funds) will be a key determinant of bond yields in 2024.
Yield premiums	◓	**Yield premiums trade below-average**. The spread between 10-year IGB yield and repo rate is at 64bps vs. 5yr avg. of 158bps. High-quality (AAA) bonds have turned attractive with the yield spread between 3Y AAA rated bond and 3Y G-sec rising to 61bps, higher than 43bps in Oct 2023 and close to 10Y avg. of 69bps.

Source: Bloomberg, Standard Chartered India Investment Committee

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

Equity - at a glance

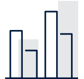
Key themes

We are overweight Indian equities. India's strong domestic growth momentum, up-trending earnings cycle and robust fund inflows are likely to off-set above-average valuation premiums. Further, expectations of government and policy continuity in the ensuing general elections are tailwinds for equities. Within equities, we are overweight large-cap equities given higher margin of safety in terms of earnings and valuation. We prefer value-style equities.

In our view, Indian equities is likely to be supported in H1 2024, by below positive drivers: 1) GDP growth and earnings outlook remains robust and continues to outpace its major peers. 2) Despite the strong performance in CY 2023, absolute valuation for Indian equities is lower compared to previous peaks amid strong earnings delivery. Though, relative valuations are above average, they are lower than previous peaks. 3) Stable inflows from domestic investors driven by inflows into systematic investment plans. 4) Pace of foreign investor inflows have improved amid reasonable valuations, strong earnings delivery, 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.

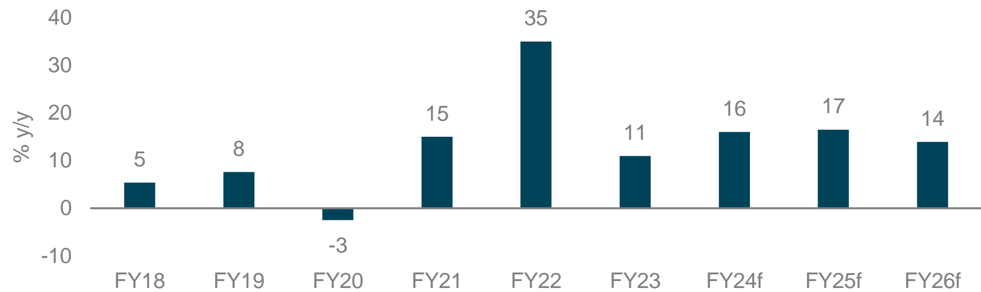
Key chart



Bloomberg Consensus expectation is for Nifty earnings to rise by 16% and 17% in FY 2024 and FY 2025.

Fig. 8 **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 real income levels and broadening growth momentum is likely to support corporate profitability. Rising food article prices amid skewed rainfall distribution on possible EL-Nino related weather disruptions, remains a key risk.
Earnings growth	◑	**Earnings growth expectations are robust.** Nifty index earnings is expected to deliver 16% growth for FY 2024. Bloomberg consensus earnings growth expectations for the Nifty Index for FY 2025 and FY 2026 stands at 16% and 14% respectively. EPS estimates for large-cap equities (Nifty index) have seen positive revisions over the past six months.
Valuations	◓	**Valuations have moderated**. Nifty 12-month forward P/E trades at 19.5x, is below its peak of 23x, but higher than its long-term average of 17.7x. Price-to-book value ratio (P/B) at 3.8x and Market cap to GDP ratio at ~134%, are above long-term averages. Nifty Mid-cap 12-month forward P/E trades at 47% premium to large caps, higher than its 10-year average premium of 17%.
Flows	◓	**Foreign investors have turned Sellers in May 2024.** YTD 2024, foreign investors have sold about USD 0.6bn worth of equities compared to USD 21bn inflows in CY 2023. **Domestic institutional investors remain buyers in 2024**. YTD 2024, domestic institutional investor inflows are at USD 19.7bn compared to USD 22.3bn inflows in CY 2023.

Source: Bloomberg, Standard Chartered India Investment Committee

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

Foundation: Asset allocation summary

Summary			View vs. SAA	Conservative	Moderate	Moderately Aggressive	Aggressive	Very Aggressive
Cash			▼	14.5	1.9	1.8	1.7	0.0
Fixed Income			◆	57.7	49.0	33.7	20.0	11.2
Equity			▲	22.5	44.6	60.2	74.3	85.1
Commodities			◆	5.2	4.5	4.2	4.0	3.7
Level 1	**Level 2**	**Level 3**						
Cash & Cash Equivalents			◆	14.5	1.9	1.8	1.7	0.0
Fixed Income	Short-term Bonds		◆	37.6	27.0	20.9	12.0	6.5
	Mid/Long-term Bonds		▲	20.1	22.0	12.8	8.0	4.7
Equity	DM Equity		▲	3.8	6.4	9.2	11.6	13.5
	Asia Ex-Japan / Other EM Equity		◆	2.1	3.5	5.0	6.4	7.5
	Indian Equities ▲	Large-cap equities	▲	13.8	29.0	38.5	47.1	53.7
		Mid/small-cap equities	▼	2.7	5.6	7.5	9.2	10.5
Commodities (INR Gold)			◆	5.2	4.5	4.2	4.0	3.7
				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

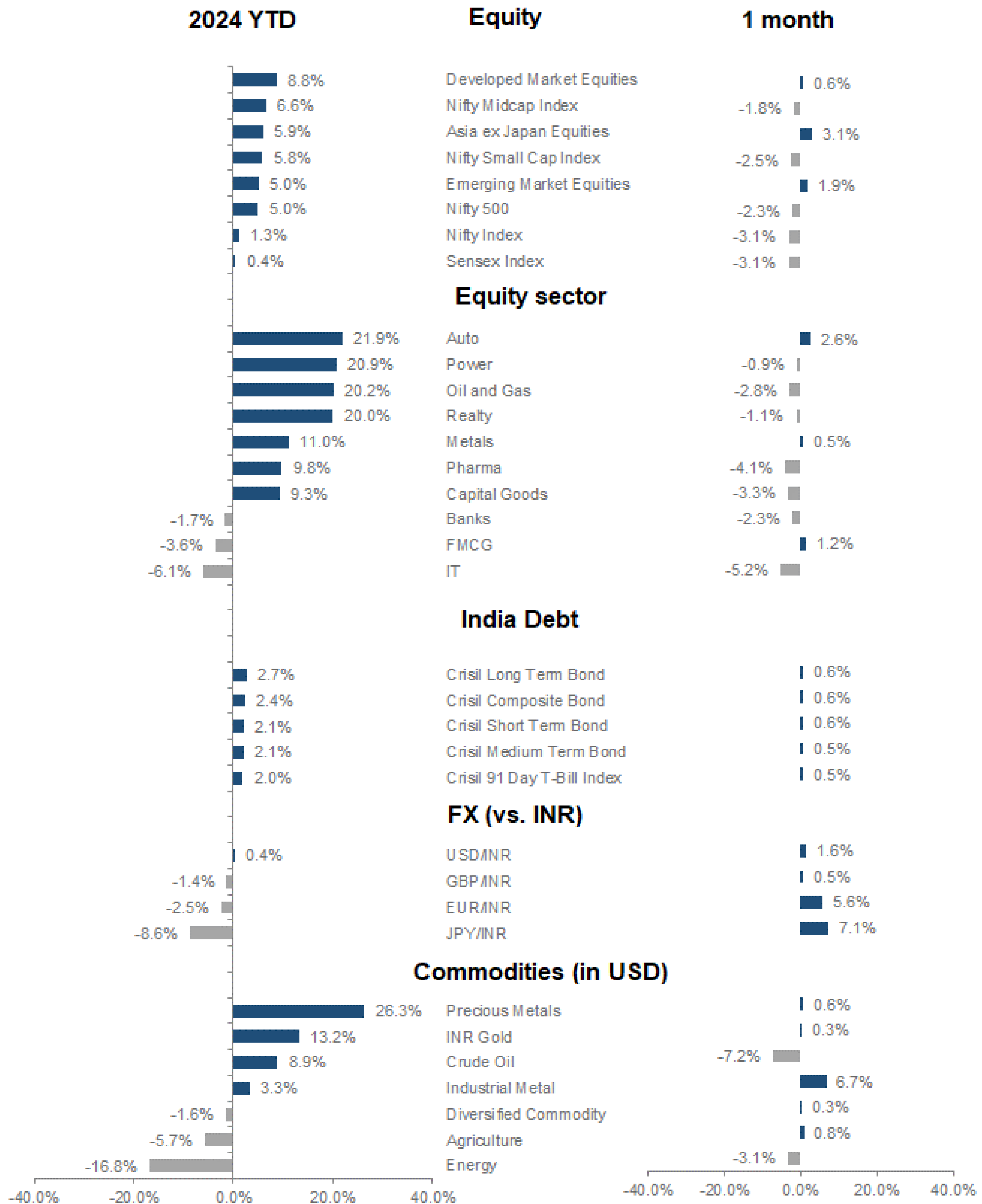
	Open calls	Open date	Close date	Absolute	Relative
Equities	Indian equities to outperform all other asset classes	18-Dec-23			✗
Equities	Indian large-cap equities to outperform mid-cap and small-cap equities	18-Dec-23			✗
Bonds	Indian mid-and long- maturity bonds to outperform short-maturity bonds	18-Dec-23			✓
Thematic	Indian corporate bonds to government bonds	18-Dec-23			✗
	Indian Investment sectors to outperform Indian equities	18-Dec-23			✓
	India Value equities to outperform Indian equities	18-Dec-23			✓
Sectors	India Industrial Sector to outperform Indian Equities	18-Dec-23			✓
	India Healthcare Sector to outperform Indian Equities	18-Dec-23			✓
	India Consumer Discretionary Sector to outperform Indian Equities	18-Dec-23			✓

Source: Bloomberg, Standard Chartered. Performance measured from 18 December 2023 (release date of our 2024 Outlook) to 9 May 2024 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

*2024 YTD period from 31 December 2023 to 9 May 2024. 1-month period from 9 April 2024 to 9 May 2024.

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