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India Investment Strategy
5 June 2024

India Market Outlook

Positioning for higher volatility

How should investors position for higher volatility? | 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 allocation

- Prefer a diversified asset allocation
- *In equities:* Large-cap equities
- *In bonds:* Medium and Long-maturity bonds

Sector overweights

- Industrials
- Consumer Discretionary
- Healthcare

Positioning for higher volatility

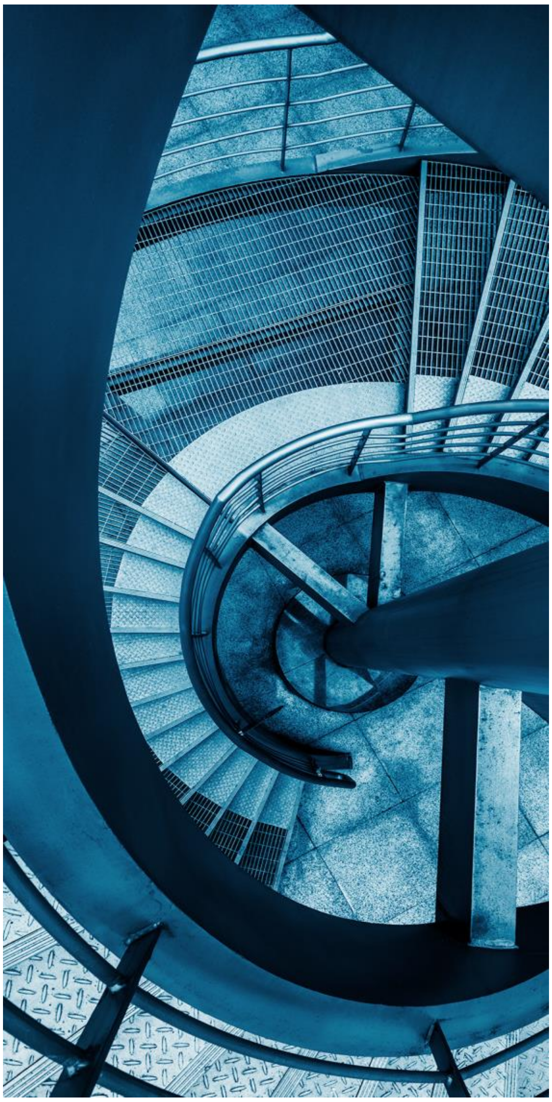
- India's national elections indicates the incumbent BJP led NDA coalition likely to return to power albeit with a smaller majority. Market volatility surged on result day with Nifty index down 6% and 10yr IGB yield up 9bps to 7.04%. Over the past month, the Nifty index (down 2.6%) has trailing its peers (MSCI World up 2.7% and MSCI Asia-ex-Japan up 1.8%). Broader markets witnessed a sharper pull-back, with the Nifty Midcap and Nifty Smallcap index down 3.5% and 7.3%, respectively.
- Within our Foundation allocations, we dial down risk and downgrade equities to neutral given near-term uncertainty on the new government formation and stretched relative valuations to bonds and major peers. We upgrade cash to neutral as a source of dry powder for tactical opportunities.
- Within equities, we remain overweight large-cap equities given a higher margin of safety in terms of earnings and valuations along with stronger balance sheets to cushion the impact of tighter financial conditions.
- We see an improved risk-reward for bonds amid positive supply-demand balance given India's inclusion in global bond index, the government sticking to the fiscal consolidation path and lower borrowing pressure. 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	◆	Bonds	◆	Gold	◆	Cash	◆
Developed Markets	▲	Short Maturity	◆				
Emerging Markets	◆	Medium/Long Maturity	▲				
Indian Equities	◆						
Large Cap	▲						
Mid/Small Cap	▼						

Legend: ▲ Overweight ◆ Neutral ▼ Underweight

Perspectives on key client questions



How should investors position their investments in a post-election market backdrop?

The latest electoral verdict is the weakest for the ruling BJP-led alliance since it came into power a decade ago. In the previous two terms, the BJP alone commanded a majority, which gave the party the political mandate to push through wide-ranging reforms. Over the last decade, India has implemented multiple reforms focused on bringing efficiency in governance, rationalizing tax structure, providing incentive schemes to boost domestic manufacturing and a significant step up in government capex.

The government's continuity, led by Prime Minister Modi, is likely to allay market concerns over policy reversals. The depleted mandate could even nudge the new government to prioritize policies directed towards boosting consumption and supporting the rural economy, supporting growth.

Beyond the near-term uncertainty, stay focused on the big picture.

We dial down risk in our Foundation Portfolio given near-term uncertainty on the government formation and stretched valuation premiums.

Nevertheless, **the medium-term prospects for Indian equities remain supported by strong positive drivers**, including 1) robust economic growth momentum, 2) resilient corporate earnings cycle, and 3) robust domestic investor inflows amid improving financialisaton of savings and systematic investment plans. Within equities, we maintain our OW on 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 see an attractive opportunity for bond investors to lock in still-attractive yields, especially in medium-and-long maturity bonds, given the outlook for interest rate cuts, improving demand for onshore bonds from June following India's inclusion in global bond index and lower government borrowing amid the government sticking to the fiscal consolidation path and robust tax collections.

The Indian rupee (INR) was relatively stable after the election results. The INR has been among the least volatile Emerging Market currencies over the past year. We expect the currency stability to continue amid political and policy continuity. A stable INR is likely to provide further support for INR government bonds over the medium term.

Fig. 1 **Broader markets are trading at cyclically high valuation premiums compared to large caps**

12-month forward PE premium (Nifty midcap, Nifty index)

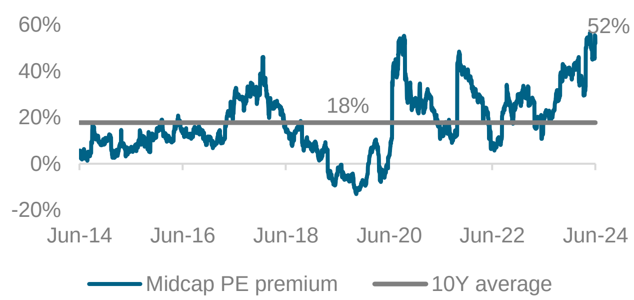
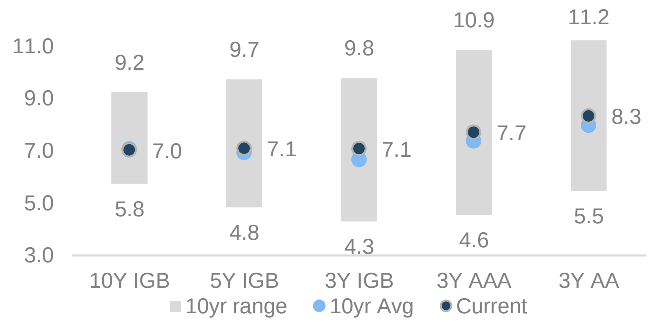


Fig. 2 **Bonds offer attractive yields, trading marginally higher to long-term averages**

Bond yields (%) across government and corporates segment



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 focus on capex are tailwinds for growth. In our view, CPI inflation is likely to trend lower 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 6.8% and CPI is expected to average 4.5%.

Fig. 3 **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 moderated in May 2024.** Manufacturing PMI eased to 57.5 in April 2024. Industrial production grew 4.9% y/y in March 2024, lower than a 5.6% growth recorded in the previous month. India's GDP recorded a growth of 7.8% in Q4 FY2024 and 8.2% in for the full FY2024.
Inflation	◓	**India's consumer price inflation moderated to 4.83% in April 2024**, driven by muted growth in food article prices. Core inflation declined to an all-time low of 3.25% in April 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 for May 2024, stood at INR 1.74trn, up 10% y/y on strong growth in domestic transactions.
External	◓	**India's trade deficit rose to USD 19.1bn in April 2024.** Imports rose by 10.3% y/y to USD 57.3bn, while exports rose 1.1% y/y to USD 35bn. India's current account deficit widened to USD 10.5bn or 1.2% of GDP in Q3 FY2024 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 yields are counterbalanced by below-average yield premiums. Further, 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 6.50%-6.75% 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.

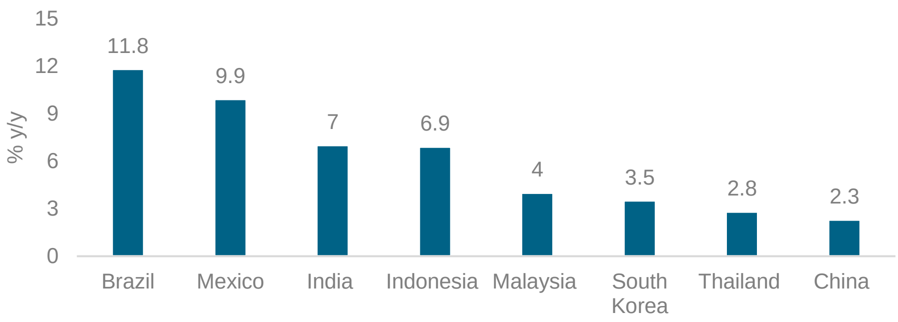
However, three factors for bonds remain unfavorable: 1) High fiscal deficit over the medium-term, 2) Tight banking system liquidity and a lack of outright support from the RBI, and 3) Above-average inflation is likely to keep bond yields elevated.

Key chart

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

Fig. 4 **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 3.6% 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 risen to a surplus of INR 436bnr in early June since hitting a deficit of INR 2.15trn in May. Lower government spending till the new government formation, 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 54bps vs. 5yr avg. of 157bps. High-quality (AAA) bonds have turned attractive with the yield spread between 3Y AAA rated bond and 3Y G-sec rising to 72bps, higher than 43bps in Oct 2023 and 10Y avg. of 70bps.

Source: Bloomberg, Standard Chartered India Investment Committee

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

Equity - at a glance

Key themes

We downgrade Indian equities to neutral. India's strong domestic growth momentum, up-trending earnings cycle and robust domestic investor inflows are counter balanced by above above-average valuation premiums, both on absolute and relative to peers. Further, we expect volatility to remain elevated over the near term on uncertainty regarding the formation of new government and policy directions. 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 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 and relative valuation for Indian equities is lower compared to previous peaks amid strong earnings delivery. 3) Stable inflows from domestic investors driven by inflows into systematic investment plans. 4) Pace of foreign investor inflows could improve amid more reasonable valuations, strong earnings delivery, and low foreign investor positioning in Indian equities.

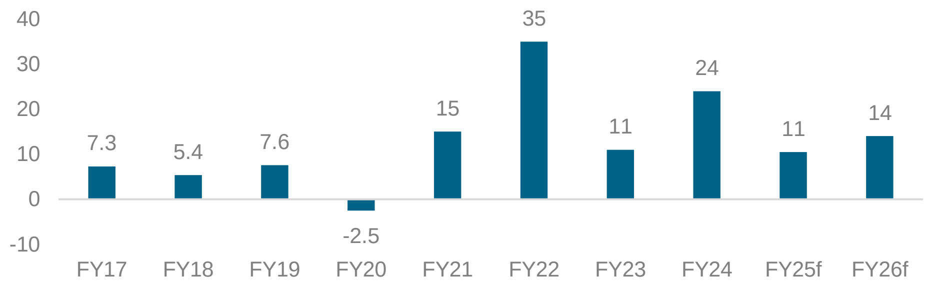
Risks to our positive equity view are: 1) Global growth slowdown and probable downgrades of earnings expectations, 2) Above-average equity valuations, both absolute and relative to peers, 3) Foreign investor selling amid slowing domestic investor flows.

Key chart

Bloomberg Consensus expectation is for Nifty earnings to rise by 11% and 14% in FY 2025 and FY 2026.

Fig. 5 **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 delivered an earnings growth of 24% in FY 2024, ahead of initial estimates. Bloomberg consensus earnings growth expectations for the Nifty Index for FY 2025 and FY 2026 stands at 11% 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 19x, is below its peak of 23x, but higher than its long-term average of 17.7x. Price-to-book value ratio (P/B) at 3.6x and Market cap to GDP ratio at ~131%, are above long-term averages. Nifty Mid-cap 12-month forward P/E trades at 52% premium to large caps, significantly higher than its 10-year average premium of 18%.
Flows	◒	**Foreign investors have turned sellers in May 2024.** YTD 2024, foreign investors have sold about USD 1.9bn 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 24.9bn 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			▼	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		◆	36.4	30.9	25.3	15.2	8.9
	Mid/Long-term Bonds		▲	18.6	24.1	14.7	9.8	6.1
Equity	DM Equity		▲	2.6	5.0	7.6	10.2	12.7
	Asia Ex-Japan / Other EM Equity		◆	1.4	2.8	4.2	5.6	7.0
	Indian Equities ▲	Large-cap equities	▲	9.2	22.7	32.0	41.2	50.4
		Mid/small-cap equities	▼	1.8	4.4	6.2	8.0	9.8
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
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			✓

Source: Bloomberg, Standard Chartered. Performance measured from 18 December 2023 (release date of our 2024 Outlook) to 4 June 2024 or when the view was closed.

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

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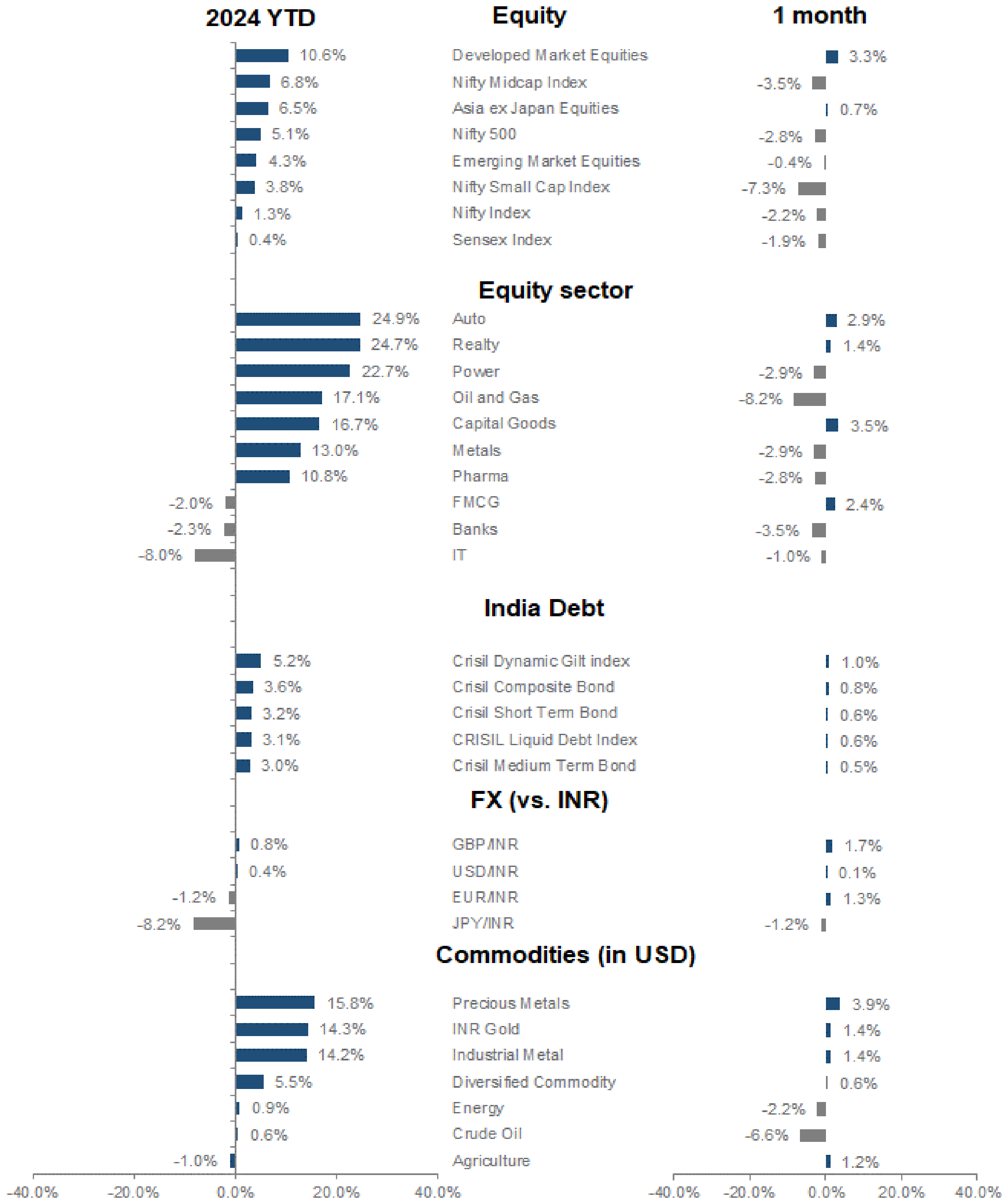
Market performance summary*



Source: MSCI, NSE, S&P BSE, Crisil, Bloomberg, Standard Chartered

*2024 YTD period from 31 December 2023 to 4 June 2024. 1-month period from 4 May 2024 to 4 June 2024.

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