Mutual Fund

2019
INDIA MARKET OUTLOOK

Permanent Innovator Mirae Asset

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One for the present, the other for the future.

If you continue investing & innovating you can make a better future.
This is how Mirae Asset aspires to change the future with investment.

Executive Summary

The Indian economy faced some challenging macro headwinds for the better part of 2018 such as high volatility in crude oil prices, sharp depreciation of the INR, liquidity crunch in the NBFC sector, FII outflows, the US-China trade war and quantitative tightening by the US Fed. However, towards 2018-end, these macro-economic conditions have turned supportive.

- Brent crude prices have declined to USD54/bbl from the year's high of USD86/bbl (YTD 14% correction).
- The INR has appreciated to 70.1 v/s the USD from an all-time low of 74.39.
- Liquidity situation has improved, thanks to intervention from the Government and the RBI.
- There are expectations that the US Fed is near the neutral rate.
- CPI Inflation is well within the RBI's policy threshold.

The table below highlights the economic impact of various parameters on the Indian economy in 2018.

Table 1: Economic impact of various parameters

The Good	The Not so Good	The Bad
Domestic Inflows	FII outflows	Currency
Inflation	GST Collection	Crude price volatility
GDP Growth	High Real Interest Rates	Tight Liquidity

Source: Mirae Asset

We expect India's macro-economic conditions to be fairly stable through CY2019. Global growth is softening, but is still above the 10-year average; India stands out with >7% GDP growth. India's favorable demographics should support growth from a long-term perspective. The recent oil price fall augurs well for India as it reduces pressure on the Current Account Deficit (CAD), and provides potential for INR appreciation. We expect the INR to trade in a narrow range after the sharp correction in 2018.

India's 17th Lok Sabha (Lower House) elections will be held around April-May 2019 and will remain a focus area for investors around the world. Based on previous four election studies, growth is generally seen improving during the election period.

We believe earnings revival will take center-stage in CY 2019, despite several local and global noises. With supportive macro-economic conditions and strong expected earning growth valuations seem reasonable.

As macro-headwinds of 2018 appear to be turning into tailwinds, the outlook for Fixed income in 2019 appears bright, especially at the beginning of the year.

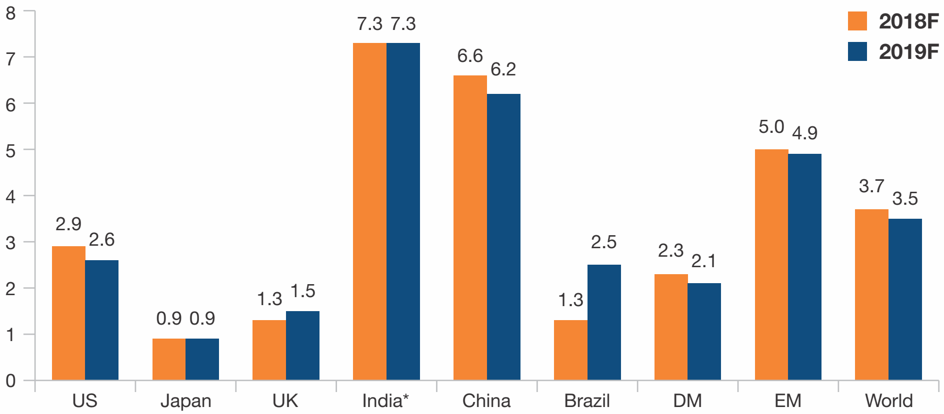
Key risks to the Indian economy could be a spike in oil prices (> $ 70/bbl), heightened trade war fears impacting emerging market currencies and a fractured mandate post-elections.

Economy Outlook

GDP Growth

In 1QFY19 and 2QFY19, GDP grew by 8.2% and 7.1%, respectively. The cyclical recovery in 1H2019 was due to a low base of 1H2018. Despite fears of emerging market contagion and the US-China trade war rhetoric, India is expected to grow at 7.3% in FY2018-19 (Chart 1). India's favorable demographics continue to support growth from a long-term perspective with India remaining one of the fastest growing economies in the world.

Chart 1: GDP Forecast (% YoY)



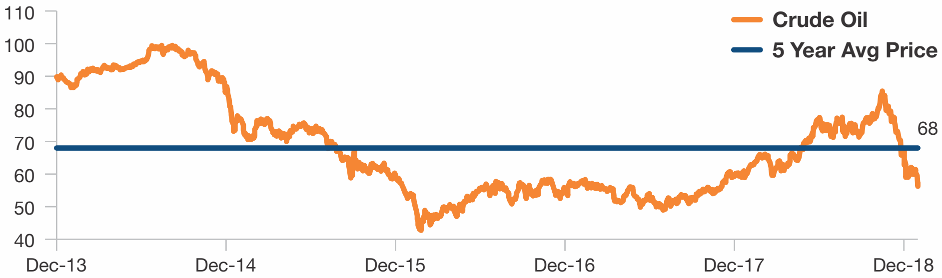
Source: Bloomberg, as on 26th December 2018. *GDP forecast for India is for 2018-19 & 2019-20 Fiscal Year. For the remaining geographies GDP forecast is for the calendar year.

Crude Oil

By Oct'18, crude appreciated ~36% and hit a near 4-year high of USD86/bbl due to rising concerns regarding sanction on Iranian oil exports by the US with many analysts projecting a possible flirt with the USD100/bbl mark. However, the last couple of months saw a very sharp 40% correction in crude prices due to fears of weak global demand (Chart 2).

Higher crude prices for most part of 2018 adversely impacted the CAD and put pressure on the INR. The recent oil price fall augurs well for India, as it reduces pressure on CAD and provides potential for INR appreciation. **Due to increased supply and softening demand, we expect crude oil prices to remain subdued in 2019.**

Chart 2: Crude oil Prices (USD per bbl.)



Source: Bloomberg, as on 26th December 2018

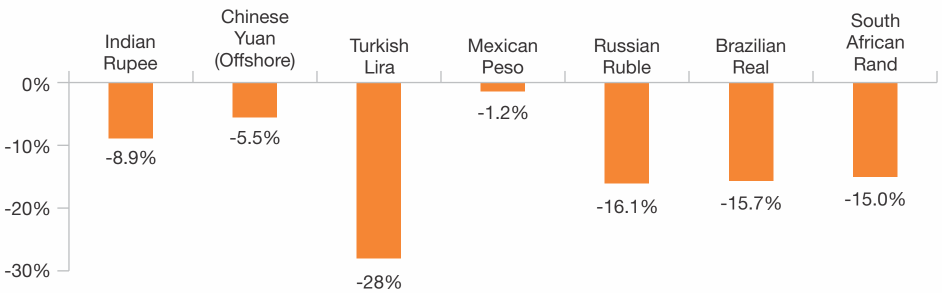
Indian Rupee (INR)

The INR was one of the better performing emerging market currencies in 2017 and started 2018 on a firm footing, but quantitative tightening by the US Fed, FII outflows, emerging market currency weakness and higher crude prices (and CAD) led to a weak INR throughout 2018.

The INR fell sharply to an all-time low of 74.39 v/s the USD by mid Oct'18 (16% depreciation), but smartly recovered by 5% in the last two months, which coincided with the sharp fall in crude oil prices.

The fall in the INR should be seen in context of the performance of other emerging market currencies (Chart 3).

Chart 3: Emerging Market currencies (vs USD) (% CYTD 2018)

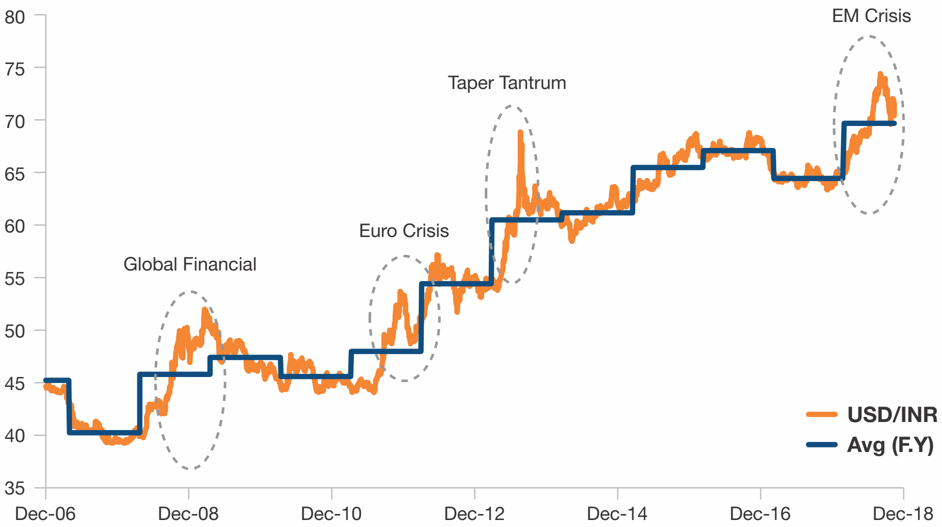


Source: Bloomberg, as on 26th December 2018

Historically, over the past 15 years the INR has witnessed long periods of overvaluation and short periods of sharp corrections (Chart 4).

We believe INR levels in 2019 will primarily depend on three factors - CPI, crude prices and global yields. Our base case scenario is that CPI Inflation, oil prices and global yields will sustain at current levels, in which case we believe the INR will be range-bound within (+/-) 3-5% from the current level.

Chart 4: INR Movement v/s USD



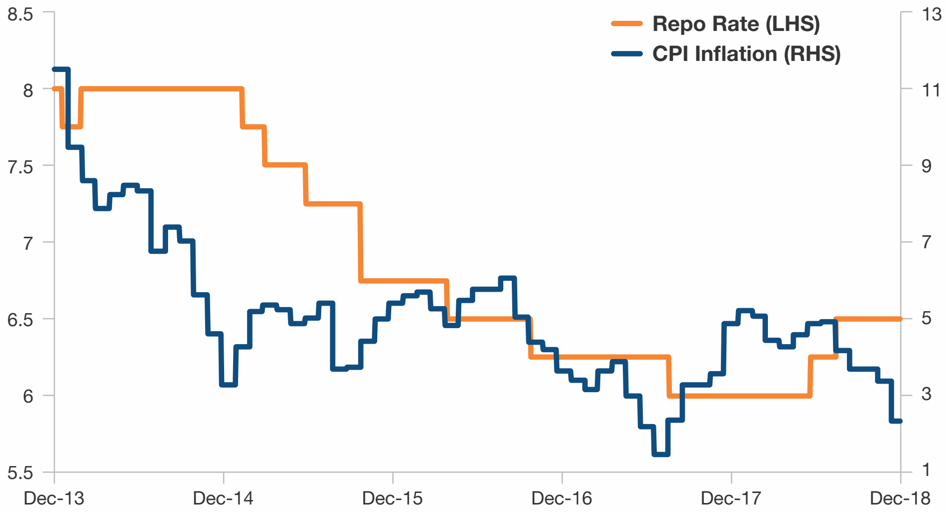
Source: Bloomberg, as on 26th December 2018

CPI Inflation & RBI policy

CPI Inflation was 5.07% at the start of 2018, while it declined sharply to 2.33% by Nov'18 (Chart 5), much below the medium-term target of 4% by the RBI, mainly due to continued deflation in food prices and the recent fall in crude oil prices. The RBI has projected inflation at 2.7-3.2% in the 2HFY19 and 3.8-4.2% in 1HFY20. We expect CPI Inflation to be under control with food prices remaining benign, however, core Inflation is likely to remain elevated for the next few months and glide down gradually later on.

Repo rate was at 6% in the beginning of 2018. The RBI hiked the repo rate twice by 25bps (in June and August) due to expectations of higher inflationary pressures (Chart 5). The RBI changed its stance to "calibrated tightening" in its October monetary policy and has maintained the stance, keeping the repo rate unchanged. The market expects the new RBI Governor to take a more accommodative stance with respect to (1) relaxation in certain regulations for the banking sector (higher liquidity, relaxation of PCA framework, dilution of promoter ownership rules), and (2) a more liberal monetary policy (possibility of a rate cut based on RBI's recent dovish stance).

Chart 5: Repo Rate and CPI Inflation (%) movement



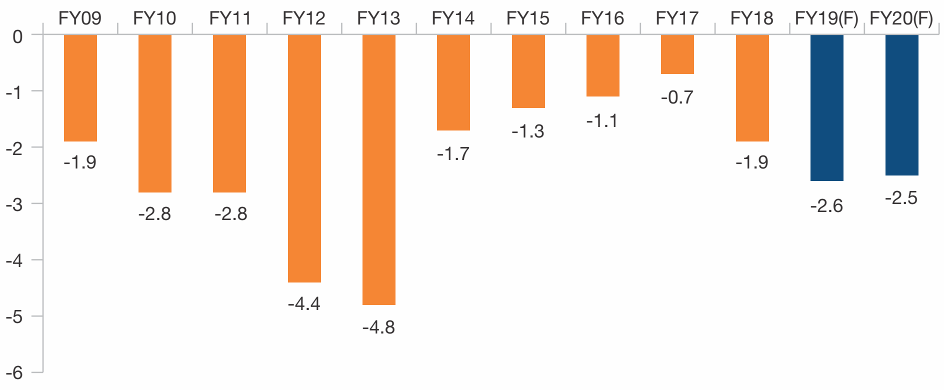
Source: Bloomberg, as on 26th December 2018

Current Account Deficit (CAD)

In FY18, the CAD increased to 1.9% of GDP from 0.7% in FY17. In 1HFY19, the CAD increased to 2.7% of GDP from 1.8% in 1HFY18, both on the back of trade deficit widening (Chart 6).

The external sector should continue to be a headwind for the Indian economy in CY2019. While softening crude oil prices will provide the fillip, there are some structural factors like lack of strong export growth and uncertainty of capital flows, which will pressurize the external sector.

Chart 6: Current Account Deficit (CAD) (as a % of GDP)



Source: Bloomberg, as on 26th December 2018

Elections

India's 17th Lok Sabha (Lower House) elections, will be held in and around April-May 2019, and will remain a focus area for investors around the world. The market expects the BJP-led NDA to assume power again (with a lesser mandate). An analysis of leading party manifestos suggest that a consensus exists on several main policies, such as affordable housing, farmer welfare, job creation and infrastructure. Current positive trends in housing and rural recovery should play out irrespective of the election outcome. Also based on past history, we note that previous coalition governments have been a success, which we believe bodes well for the India story.

Based on previous four election studies, generally there is an improvement in growth during the election period.

Table 2: Sensex Returns from one election to next

Government Type		Date		Sensex returns from one election to next[#1]	Absolute Sensex returns in 1 year after elections
Party	Coalition	From	To		
Congress	N	Jan-80	Oct-84	18%	24%
Congress	N	Oct-84	Dec-89	21%	78%
Janta Dal	Y	Dec-89	Nov-90	96%	68%
Samajwadi Janta Party	Y	Nov-90	Jun-91	-4%	37%
Congress	N	Jun-91	May-96	24%	135%
BJP	Y	May-96	Jun-96	-2%	-1%
Janta Dal	Y	Jun-96	Apr-97	-1%	1%
Janta Dal	Y	Apr-97	Mar-98	3%	13%
BJP	Y	Mar-98	May-4	4%	-4%
Congress	Y	May-04	May-9	23%	31%
Congress	Y	May-09	May-14	12%	20%
BJP	N	May-14	Nov-18	9%	13%

Source: Bloomberg. #1 Returns for period >1 year is CAGR return, returns for period <1 year is Absolute return.

Debt Outlook

Review 2018

2018 started on a challenging note for the fixed income markets in India. While on the domestic front, extra market borrowings due to a miss in fiscal deficit target for FY18 and a sticky core inflation weighed on the market sentiments, strong global macro headwinds by the way of rate tightening by the US Fed (raising key rate by 25bp each on four occasions aggregating 100bp) and rising crude prices further added to the adversity.

While not initiating any rate action yet, the RBI talked up the market yields, possibly to prepare the street for any further adverse escalation in macros while still assessing the sustainability of such developments. Resultantly, benchmark India 10-year yields approached near 8% mark. Subsequently, fresh turbulence in emerging markets led by the US-China trade war tensions and currency depreciation in Turkey, Mexico and Argentina had a cascading impact on India with FPI flows turning negative.

FPIs withdrew about USD 15b (including equity and debt) during the year until October 2018 after which flows turned marginally positive (Table 3). Due to rising concerns on sanction of Iranian oil exports by the US, oil prices hit a near 4-year high mark of USD86/bbl with many analysts projecting a possible flirt with USD100/bbl mark.

Consequently, the INR also suffered massive depreciation of nearly 15%, hitting an all-time low mark of 74 before settling down to around 70, adding to the bond market's woes. These developments spiked bond investors taking India 10-year yield to the yearly high of 8.25% (Chart 7).

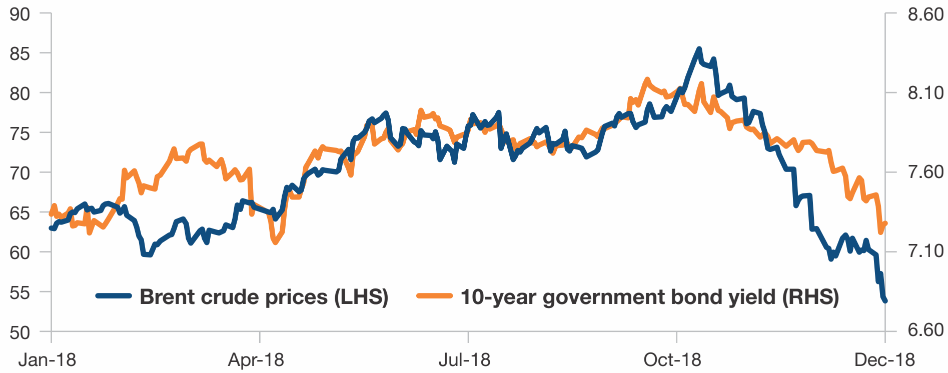
There was virtually a situation of credit freeze towards end-3QCY18 following default by IL&FS until the RBI and the Government intervened strongly. Then followed a possibly better time for fixed income markets with CPI inflation sliding dramatically, led by a sharp decline in food inflation. Brent crude prices declined swiftly by nearly 40% from the year's high to below USD55/bbl by the year-end on increased supplies and expectations of lower demand as global economy showed early signs of a slowdown. In a favorable development, the Fed also indicated that it was near the neutral policy rate. With a change in Governor following a public spate, market started pricing in an imminent change in policy stance to an accommodative one by the RBI. India's 10-year yield moved rapidly to settle near the 7.26% mark by the year-end, a mark which it pretty much started out the year at.

Table 3: Monthly FPI/FII Net Investments (CY18)

Calendar Year	Flows (in ₹ 1,000 crore)		
	Equity	Debt	Total
January	13.8	8.5	22.3
February	(11.4)	(0.3)	(11.7)
March	11.7	(9)	2.7
April	(5.6)	(10)	(15.6)
May	(10.1)	(19.7)	(29.8)
June	(4.8)	(11)	(15.8)
July	2.3	0	2.3
August	1.8	3.4	5.1
September	(10.8)	(10.2)	(21)
October	(28.9)	(10)	(38.9)
November	6	5.6	11.6
December*	1.9	5.3	7.3
Total	**(34.2)**	**(47.2)**	**(81.5)**

Source: NSDL, *December data up to 26th December, 2018

Chart 7: Crude oil prices (USD per bbl) & 10 year G-Sec yield



Source: Bloomberg, as on 26th December 2018

Table 4: Money market and 10 year G-Sec yields (%)

Fixed Income - Rates	26th Dec'2018	29th Jun'2018	29th Dec'2017
Call Money	6.65	6.15	6.1
CBLO	6.56	6.01	5.82
3 Month CD	7.08	6.93	6.38
3 Month CP	7.45	7.75	7.06
1 Year CD	8.08	8.07	6.75
1 Month CP	8.95	8.6	7.53
G-Sec (10 Yrs)	7.26	7.9	7.33

Source: Bloomberg, as on 26th December 2018

Debt Market Outlook 2019

While 2018 turned out to be a wash-out for fixed income, outlook for 2019 appears much brighter at the start of the year. Even as macro headwinds remain strong, the momentum seems to be turning decisively positive, though major headwinds of 2018 seem to be turning into tailwinds.

In the last few months, three key swing factors namely inflation, global macro and oil prices have turned favorable for fixed income. Market is now beginning to price in a likely shift of monetary policy stance back to accommodative. Given these positive developments, possibility of another 50-75bp decline in benchmark India10-year G-Sec rates to 6.50-6.75% has increased significantly, especially as OMO operations by the RBI are now expected to be of nearly the same magnitude (INR 3.6 tn) as the net borrowing program of Central government. Following the credit freeze due to a shocking default by IL&FS, corporate bond spreads widened nearly 50bp from 70bp to 120bp across the curve. These wider-than-average spreads are also expected to narrow going forward, as the massive liquidity injection by the RBI should help create conducive environment for corporate issuers.

Revenue collections on the GST front have not shown the expected buoyancy. Average monthly collections of GST till Nov'18 are around INR 0.97 tn against budgeted figures of INR 1.10 tn. The required run rate to achieve the budgeted targets keeps climbing by the month. Oil prices have also gyrated violently. The underlying risk to our positive view are (1) a move to cut daily oil production by OPEC, (2) a below normal monsoon, and (3) an indecisive general election verdict, which may trigger fresh FPI outflows or currency volatility.

At this moment, barring any severely negative development, 2019 promises to be a re-bound year for fixed income markets in India. As always, one needs to carefully watch fresh development on these fronts and be prepared to recast the outlook as appropriate.

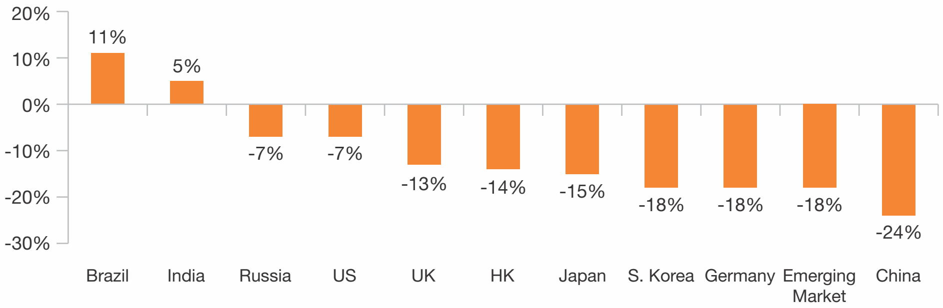
Equity Outlook

2018 Recap

After a strong 2017, 2018 turned out to be challenging for the markets as macros turned into headwinds led by oil price, the INR and trade war for most part of the year.

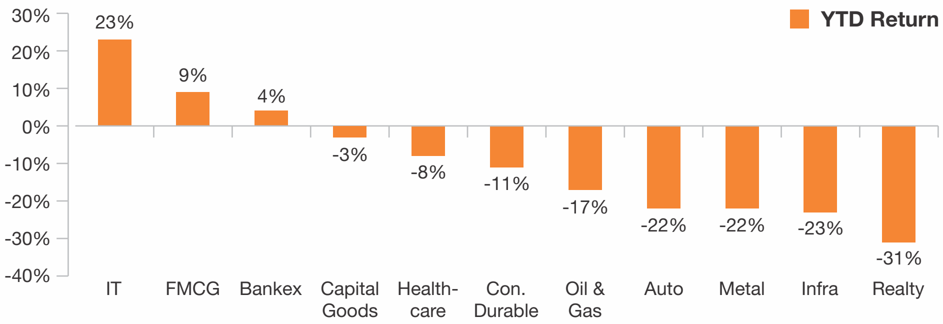
Among the major global indices, only India (+5% YoY) and Brazil (+11% YoY) were positive in 2018. US Dow Jones ended 7% lower on account of a poor second half after starting the year with strong gains, while MSCI Emerging Markets Index ended the year 18% lower (Chart 8).

Chart 8: Performance of global indices in CY18 (%)



Source: Bloomberg, as on 26th December 2018

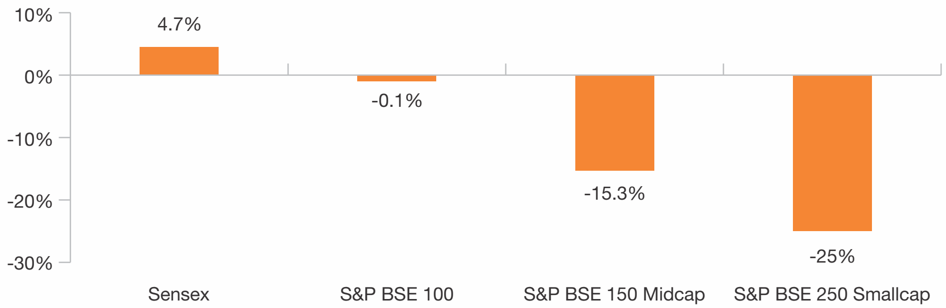
Chart 9: Performance of sectoral indices in CY18 (%)



Source: Bloomberg, as on 26th December 2018

In major sectors, Bank, FMCG and IT gave positive returns with IT being an outperformer (aided by sharp depreciation in the INR) by giving an alpha of ~18% over the Sensex in YTD 2018. Major laggards were Realty (down by over 30%), Infra, Auto, and Metals (down by more than 20%) (Chart 9).

Chart 10: Market cap wise performance in CY18 (%)



Source: Bloomberg, as on 26th December 2018

S&P BSE 150 Midcap and S&P BSE 250 Small cap index fell by 15.3% and 25.8%, respectively, whereas the Sensex gave positive return of 4.7% (Chart 10). Overall in 2018, market has been narrow with only 111 stocks from the BSE 500 index giving positive returns (Table 5) .

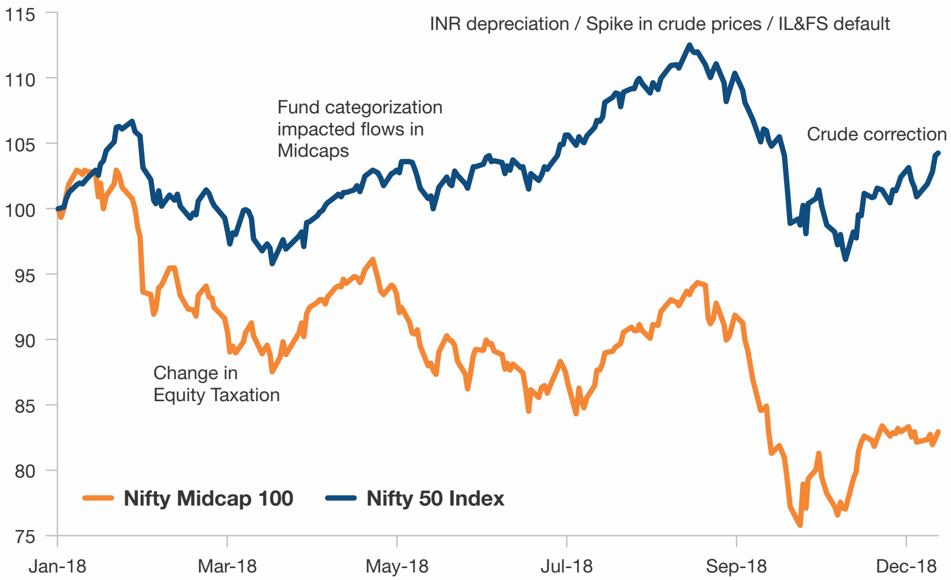
Table 5: Stock returns in BSE 500 Index in CY 18 (%)

Stock Return in 2018	Weight
More than 10%	76
0 to 10%	35
0 to - 10%	57
-10% to - 30%	148
-30% to - 50%	125
More than - 50%	51

Source: Bloomberg, as on 26th December 2018

In NIFTY 50, performance was again lopsided, with top-5 and top-10 stocks contributing 58% and 86% of the NIFTY 50 returns respectively. 33 stocks gave negative returns.

Chart 11: Indian market performance & key events in 2018



Source: Bloomberg, as on 26th December 2018

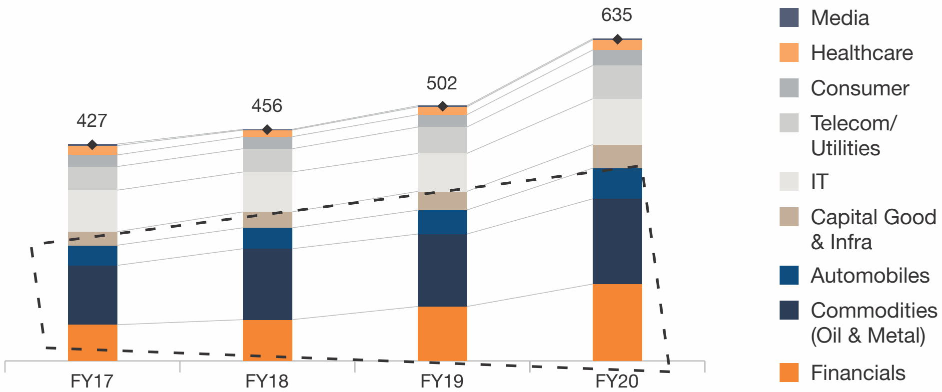
- **The key variables for 2019 from the equity markets perspective could be**

1. **Earnings revival will take centre stage to handle noises:** We believe that the earnings revival will be the most important driver for the markets during CY2019, despite several global and local events. As per consensus estimate, net profit of the Nifty 50 index is estimated to grow at 26% in CY20. Steady earnings revival could face noises from India's general elections in April-May 2019, China-US trade negotiations, etc. Robust growth in earnings should primarily be driven by normalisation of profits in the corporate banking sector (Chart 12).

2. **Global growth:** As global growth expansion enters its tenth year, there are many concerns arising from reversal in the monetary policy, trade tension, etc. According to estimates, overall growth should shift slightly down. The end of monetary stimulus and perhaps peaking of fiscal stimulus in 2019 should lead to the re-alignment of growth to lower levels. India stands out with > 7% GDP growth and favorable demographics can support growth from long term perspective.

3. **Elections:** Elections, typically can add to market volatility, however in the longer run earnings trajectory determine the performance of markets. India's 17th Lok Sabha (Lower House) elections will be held around April-May 2019, and will remain a focus area for investors around the world. Based on previous four election studies, it's been noticed that growth generally improves during the election period.

Chart 12: Sector breakup of NIFTY EPS (INR)



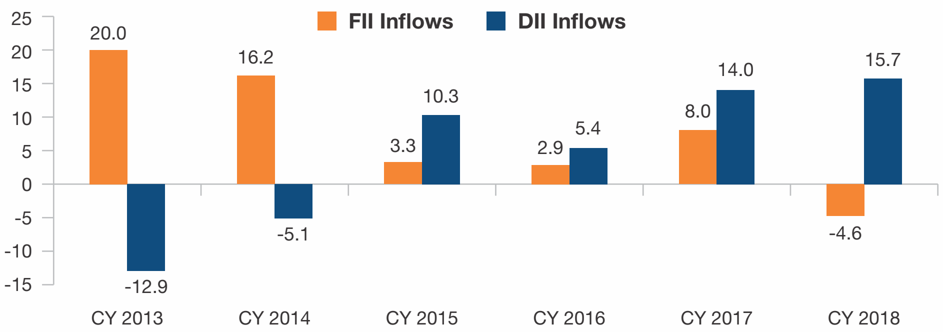
Source: Bloomberg, as on 26th December 2018

4. **Supportive macroeconomic conditions in CY2019:** We expect macroeconomic conditions to be supportive of the market in CY2019 with low inflation, manageable CAD and continued strong GDP growth at 7.3% for FY2020. We do note that growth generally improves during the election period. The fall in crude oil prices is a boon for India as it will soon lead to current account surplus. with inflation under check, rate of interest is expected to remain benign in 2019. India's growth momentum is expected to improve to about 7.3% in FY20 from 6.7% in FY18.

5. **Valuations are reasonable:** Valuations for the broader market with Nifty 50 Index trading at 16.8x FY2020E 'EPS' may appear reasonable, especially when viewed against recent historical valuations (18-20x 12-month forward P/E) and bond yields (gap has closed with the recent sharp fall in the 10-year bond yields). However, we would note that valuations of 'quality' stocks are quite expensive while those of 'value' stocks are very inexpensive. Also, the reasonable multiples are based on estimated 26% growth in profits of the Nifty 50 Index in FY2020.

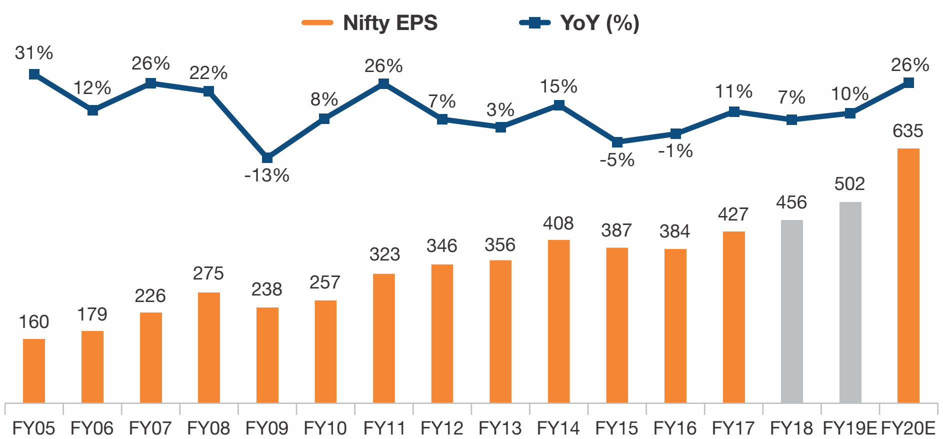
6. **Strong and sticky domestic flows:** Currently, domestic MF industry is attracting SIP inflows of ₹ 7,985 crs. (~USD 1.1bn per month) as on 30th November 2018. These inflows have exhibited maturity in terms of time periods and the mind-frame of investors as 2018 returns were marred by various factors like the SEBI reclassification, volatility in macros, etc.

Chart 13: DII Providing Strength to the markets (USD Bn.)



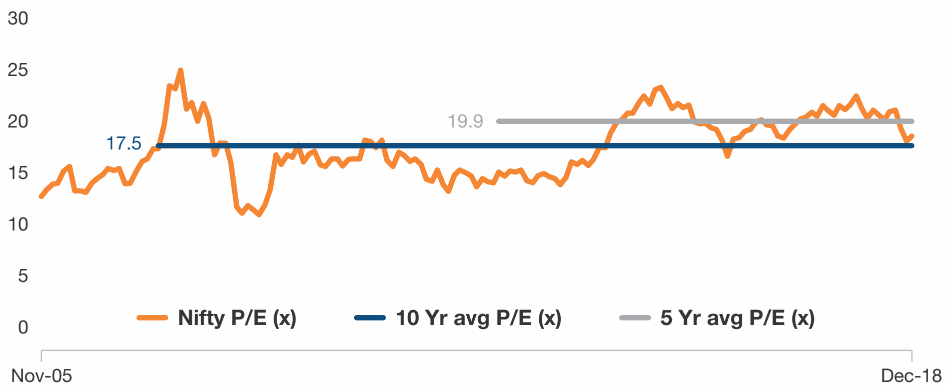
Source: NSE, NSDL

Chart 14: NIFTY Earnings per share (EPS) (INR)



Source: Bloomberg, as on 26th December 2018

Chart 15: NIFTY P/E: Historical movement



Source: Bloomberg, as on 26th December 2018

Equity Outlook 2019

Overall, we expect a much better 2019 and beyond. We expect decent returns from the Indian market in CY2019 on the back of supportive macro-economic variables, strong earnings growth and sticky domestic flows. Over the long term, the India growth story remains compelling, driven by favorable demographics. In the medium term, some of the structural reforms like GST, IBC, empowerment to rural masses with Direct Benefit Transfer (DBT), improvement of basic infrastructure in rural areas (power, cooking gas, housing, sanitation, etc.) along with the massive USD 5 tn infrastructure spending program should help maintain growth. Also, per capita income is set to double over the next decade as the economy moves towards being the third largest in the world by 2025 at about USD 5 tn.

Based on the above factors, we would advise investors to maintain committed allocation to equities as we believe that investors with a long-term horizon will be reasonably rewarded.

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