Annual Equity Outlook – 2019

ADITYA BIRLA CAPITAL

PROTECTING INVESTING FINANCING ADVISING

On the Road to Recovery

Index

2018: A Year of Reversals

Globally, most asset classes were in the red in 2018 due to heightened volatility

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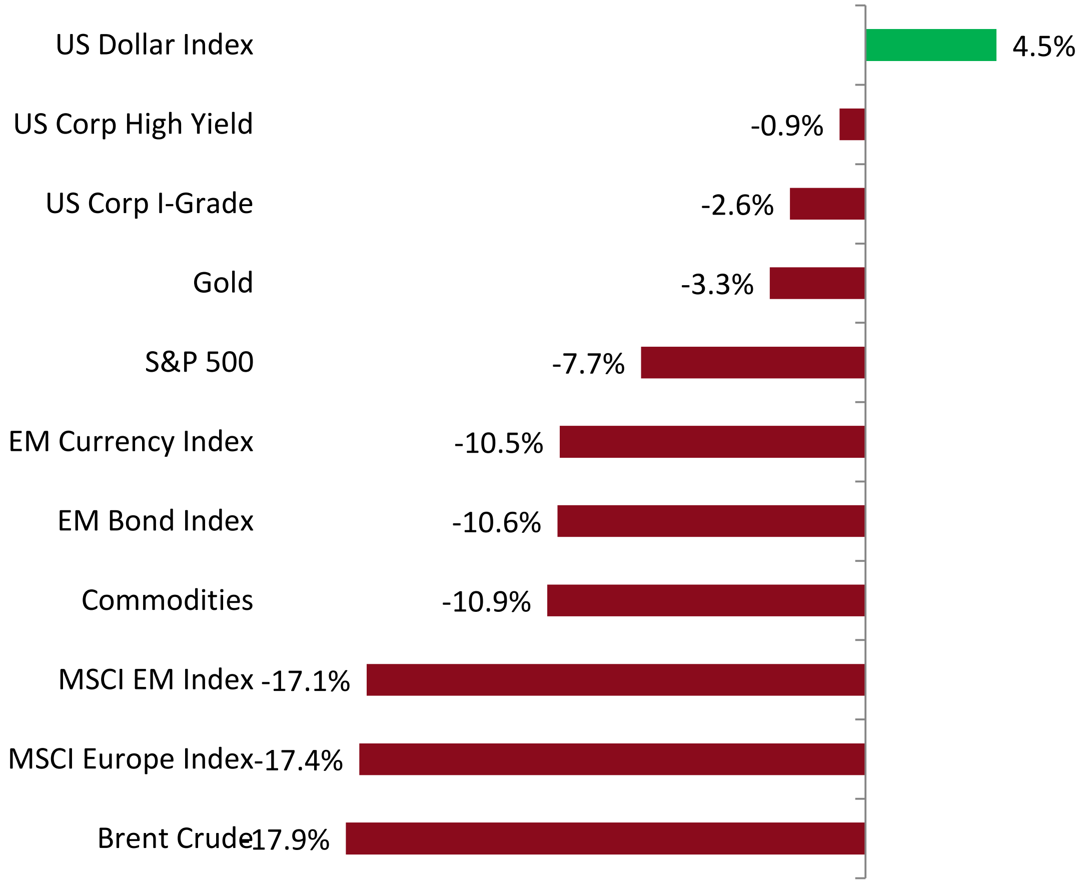
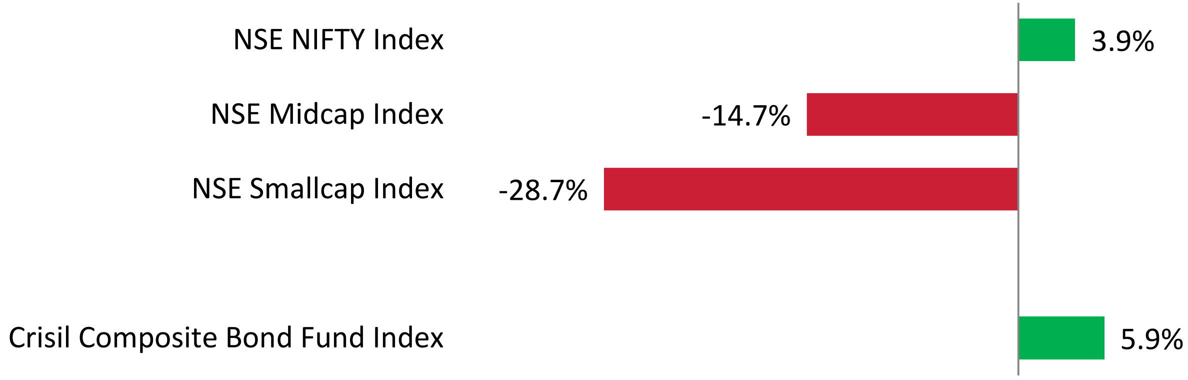
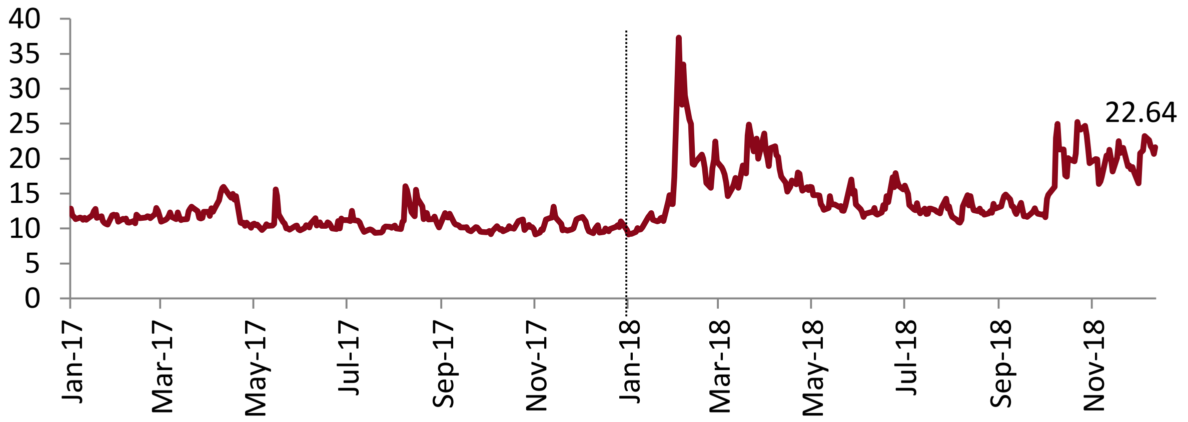
Performance of key asset classes globally in 2018 (in USD)



Performance of Key Asset Classes in India in 2018 (in INR)



VIX - Volatility Index



Volatile crude oil prices, strong USD and rising yields in the USA, and trade tensions kept investors on tenterhooks.

Source: Bloomberg, ABSLAMC Research

Secular growth of Equity markets in 2017 was followed by high volatility in 2018

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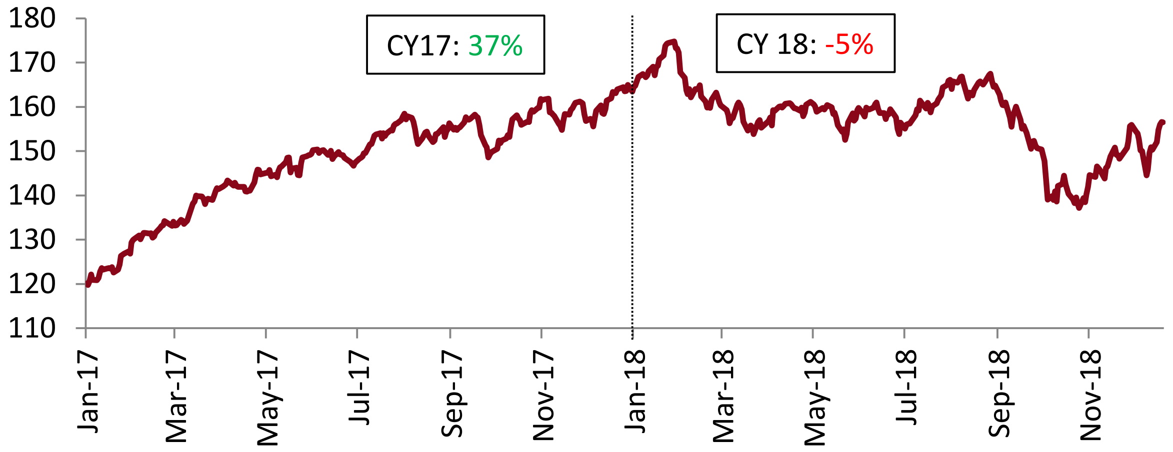
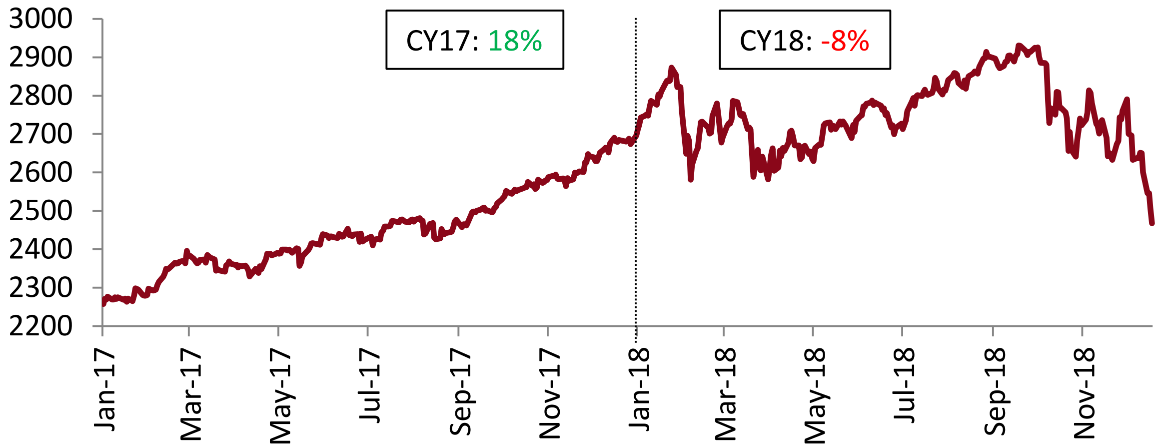
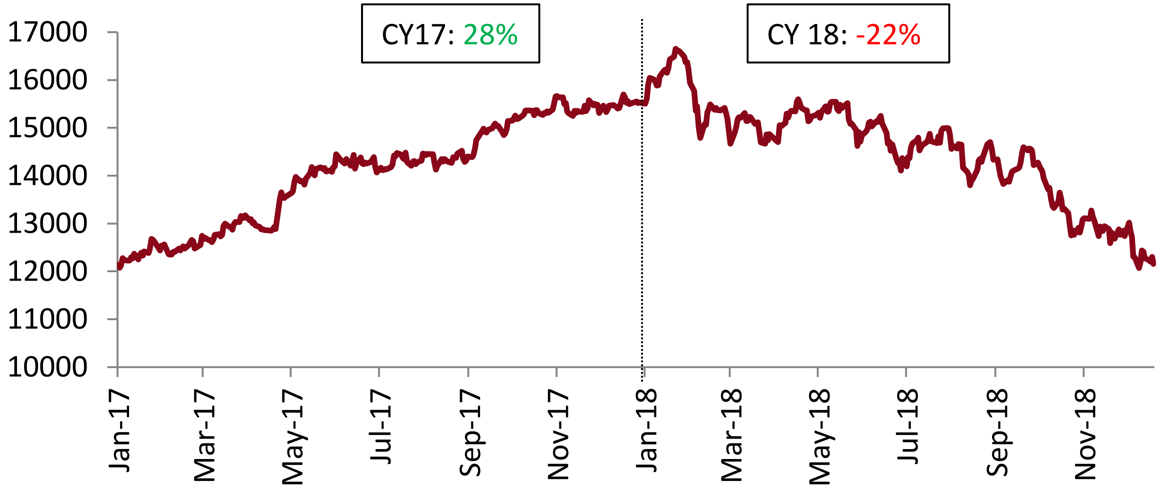
Nifty 50 – India (in USD)



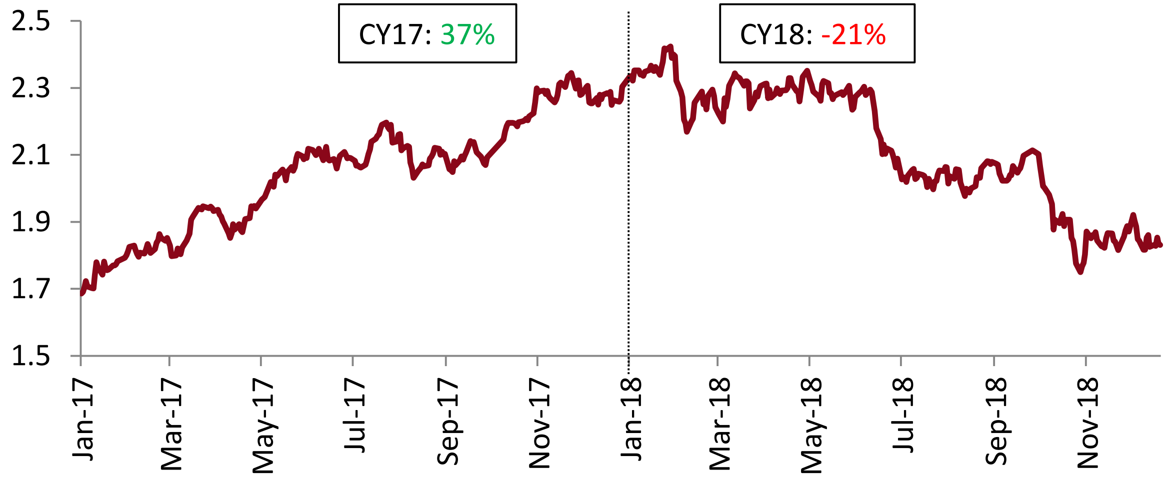
S&P 500 – US (in USD)



DAX – Germany (in USD)



Kospi - S. Korea (in USD)



Source: Bloomberg, ABSLAMC Research

After being supportive in 2017, Commodities and Currencies were unfavorable for most of 2018, but have improved in the last two months

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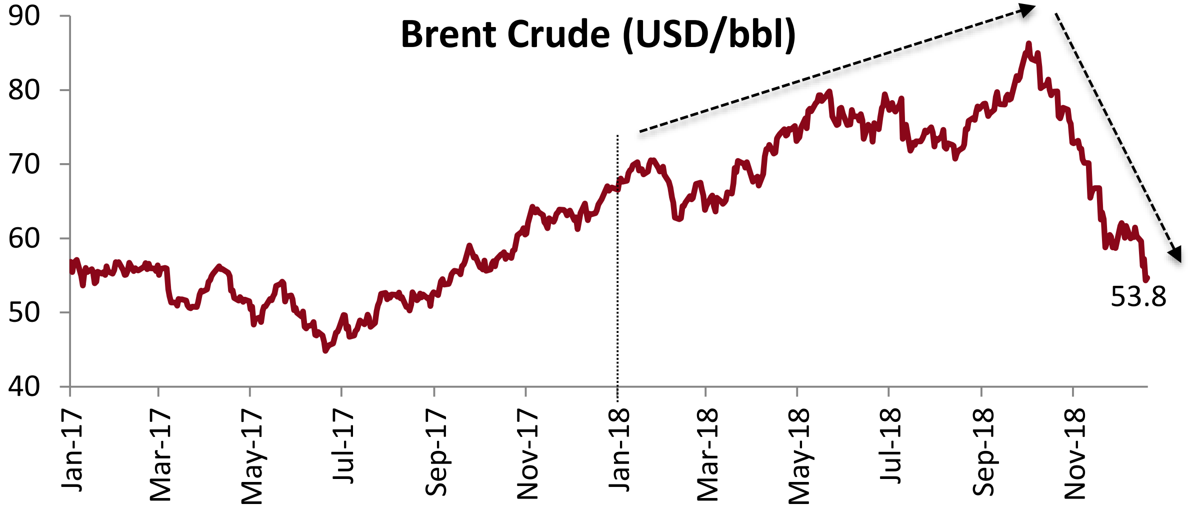
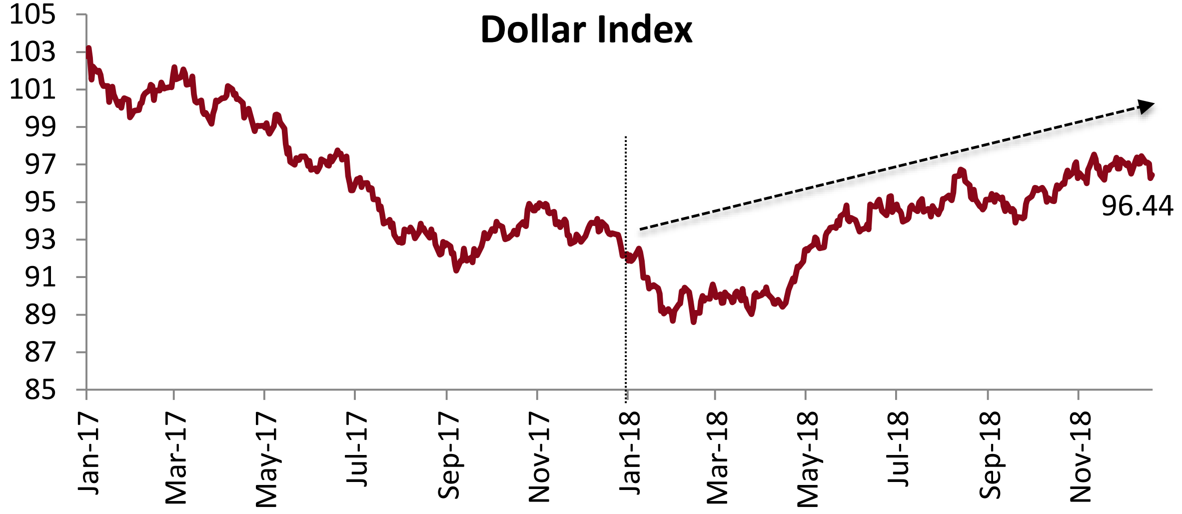
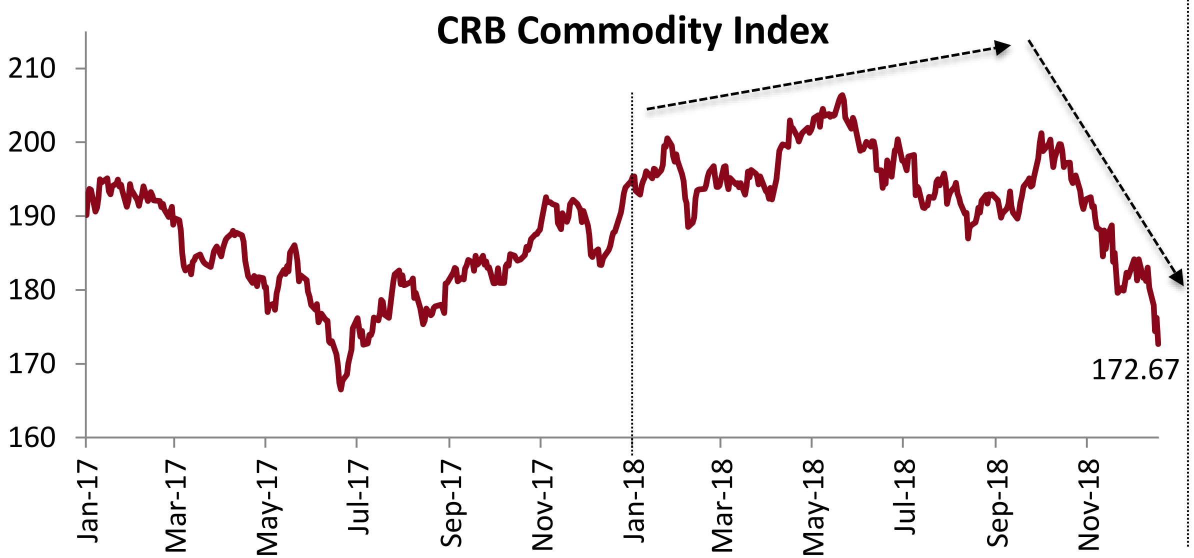
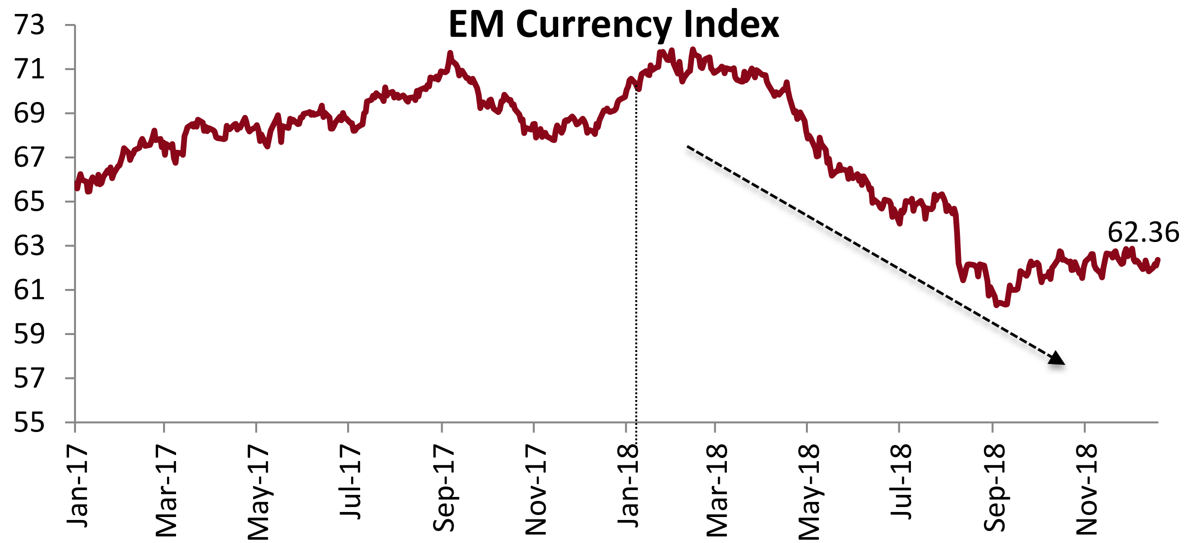








Source: Bloomberg, ABSLAMC Research

While 2017 was relatively calm, several geopolitical and economic events impacted markets in 2018

International

Trade Wars

- US and China imposed tariffs on each other. They have agreed to temporarily halt the imposition of new tariffs for 90 days, as they negotiate a lasting agreement.
- US renegotiated trade agreements with Mexico, Canada & South Korea. Tensions with Europe were de-escalated

Iran, North Korea

- US re-imposed a series of sanctions on Iran, which it had relaxed after the 2015 nuclear deal.
- After a long standoff, US and N. Korea signed an agreement to work towards de-nuclearization of the Korean peninsula.

Brexit, Italy

- Chaos surrounding the UK's scheduled departure from the EU, with a delay in the parliament vote on the Brexit deal.
- High leverage, weak banks, and an erratic government with populist spending plans raised alarms about Italy's solvency.

Domestic

NBFC issues

- Default by a large financial institution on some of its debt obligations led to a crisis of confidence resulting in tightening of liquidity.
- Cost of borrowing has gone up for NBFCs. There will be some moderation in growth and pressure on margins.

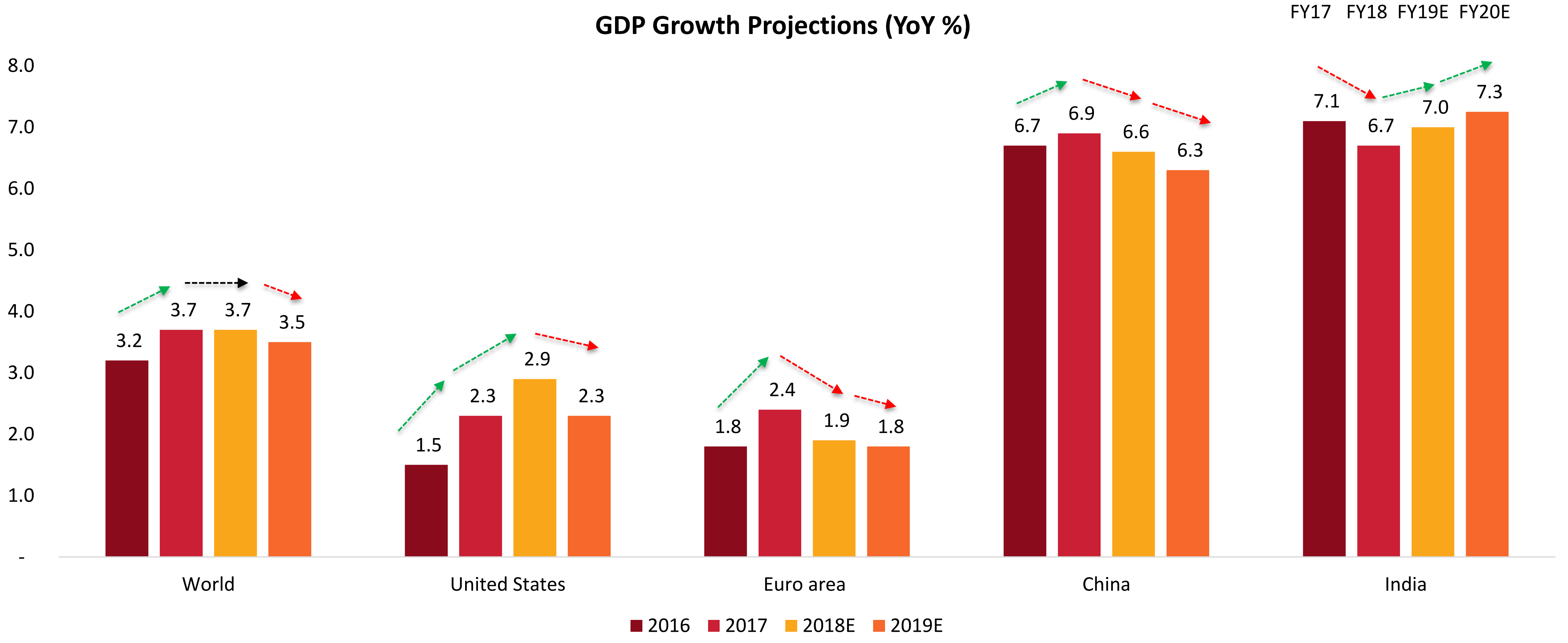
Elections

- Elections in 3 key states - Rajasthan, MP and Chhattisgarh saw the Congress winning against the incumbent BJP.
- The elections highlighted sharp rural distress which may impact the General elections in May'19

2019 – Outlook

World View

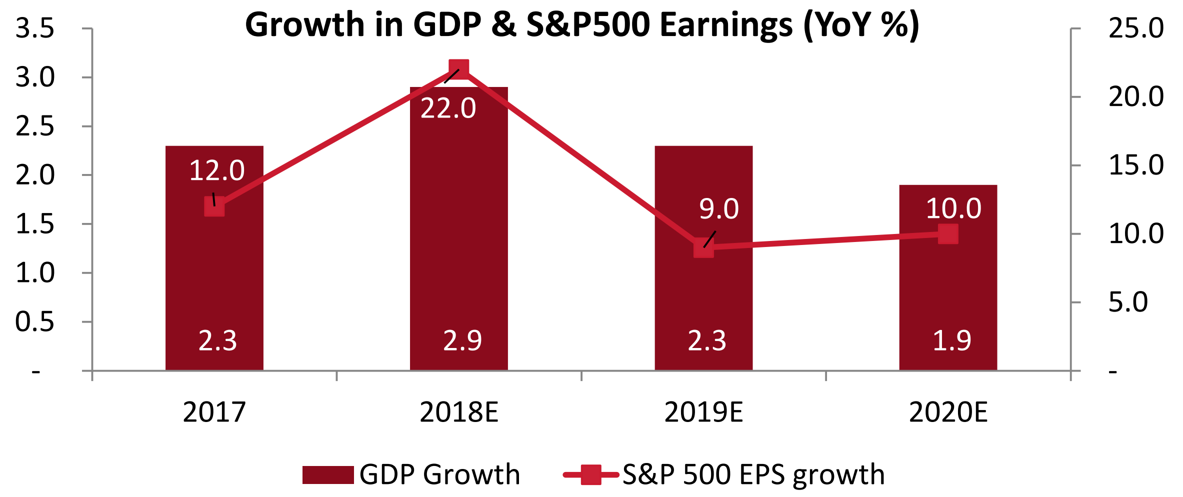
Global growth has peaked and will see a slight slowdown in 2019

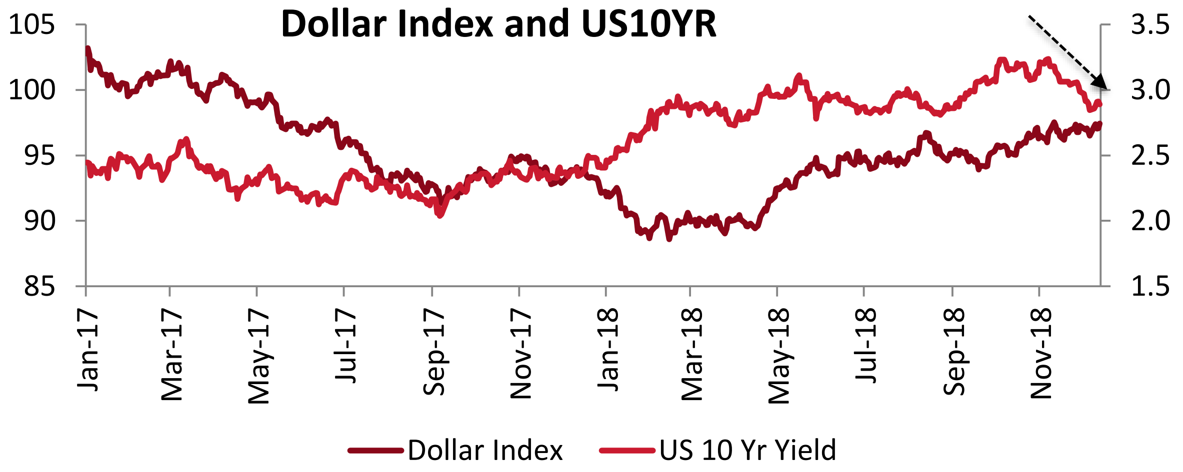


Synchronous global expansion of 2017 gave way to increased divergence in 2018. Synchronous slowdown seen in 2019.

Source: RBI, Fed, OECD, IMF, ABSLAMC Research

US to see soft landing as impact of fiscal stimulus starts fading



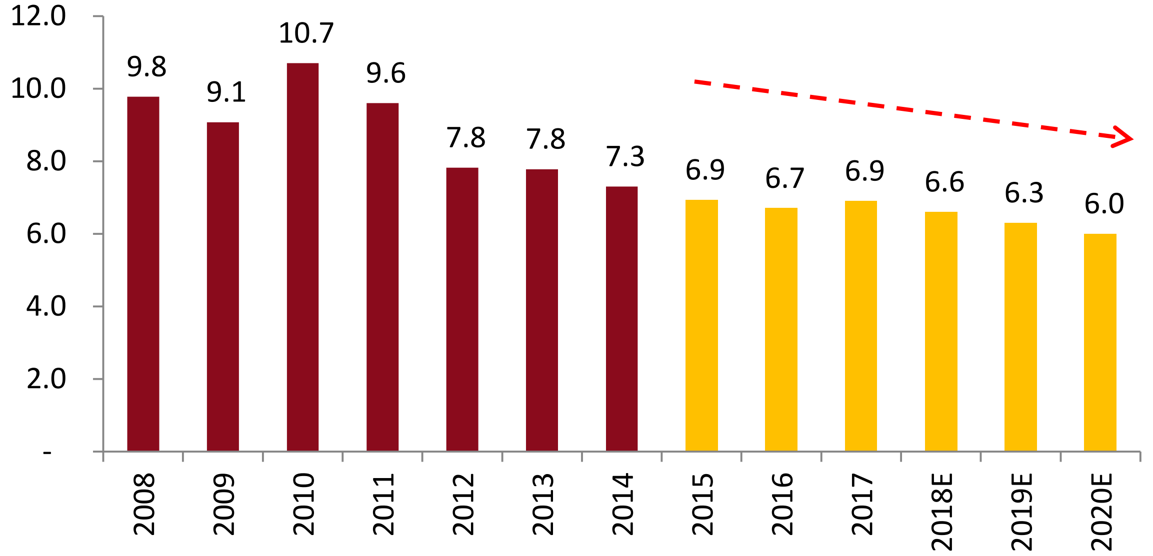


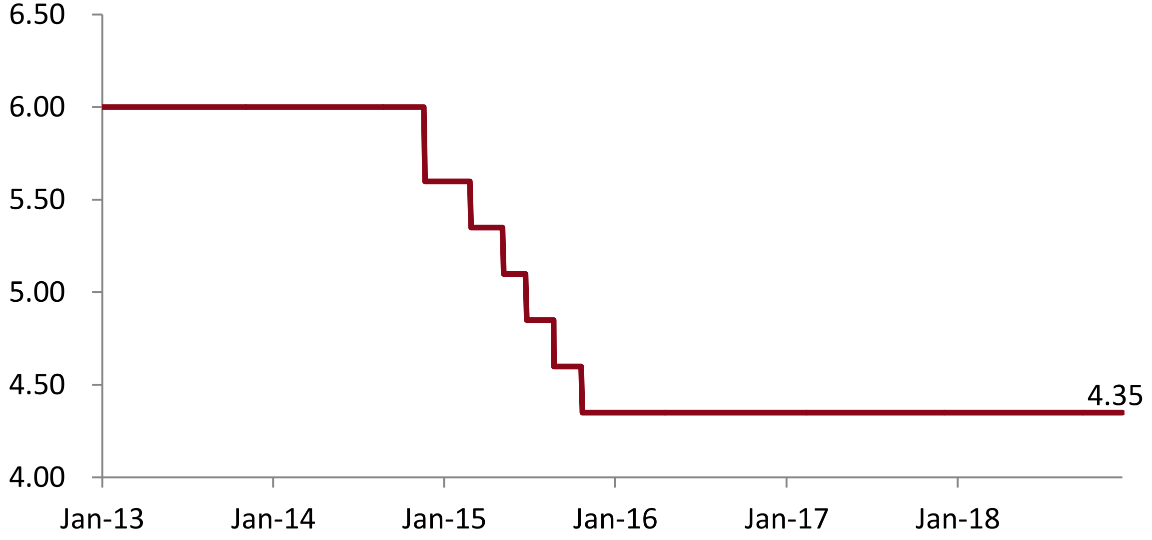
- US economy is posting solid GDP growth of ~3%. However, impact of fiscal stimulus will start fading and GDP growth will slow down to ~2.3% in 2019 and ~2% in 2020.
- Consensus CY2019 EPS growth forecast for S&P 500 is 9% due to expectations of a slowdown in economic growth.
- While Fed has projected 2 rate hikes in 2019, market is factoring only 1 rate hike. We believe that Fed is not on a preset course and evolution of US rates will be guided by upcoming US economic data.
- In our base case we would expect range-bound 10-Yr US yield centered in 2.60 to 3.00 range, but note that there are significant risk factors on both sides.
- Trump administration's fiscal policy is also likely to result in a widening of both the fiscal deficit and current account deficit which should also put a cap on USD strength.

Weaker US growth and lower rates will cap USD strength and ease the pressure on EM.

Source: Goldman Sachs, Morgan Stanley, JPMorgan, Bloomberg, ABSLAMC Research

China will see a calibrated slowdown due to slower credit growth and trade tensions





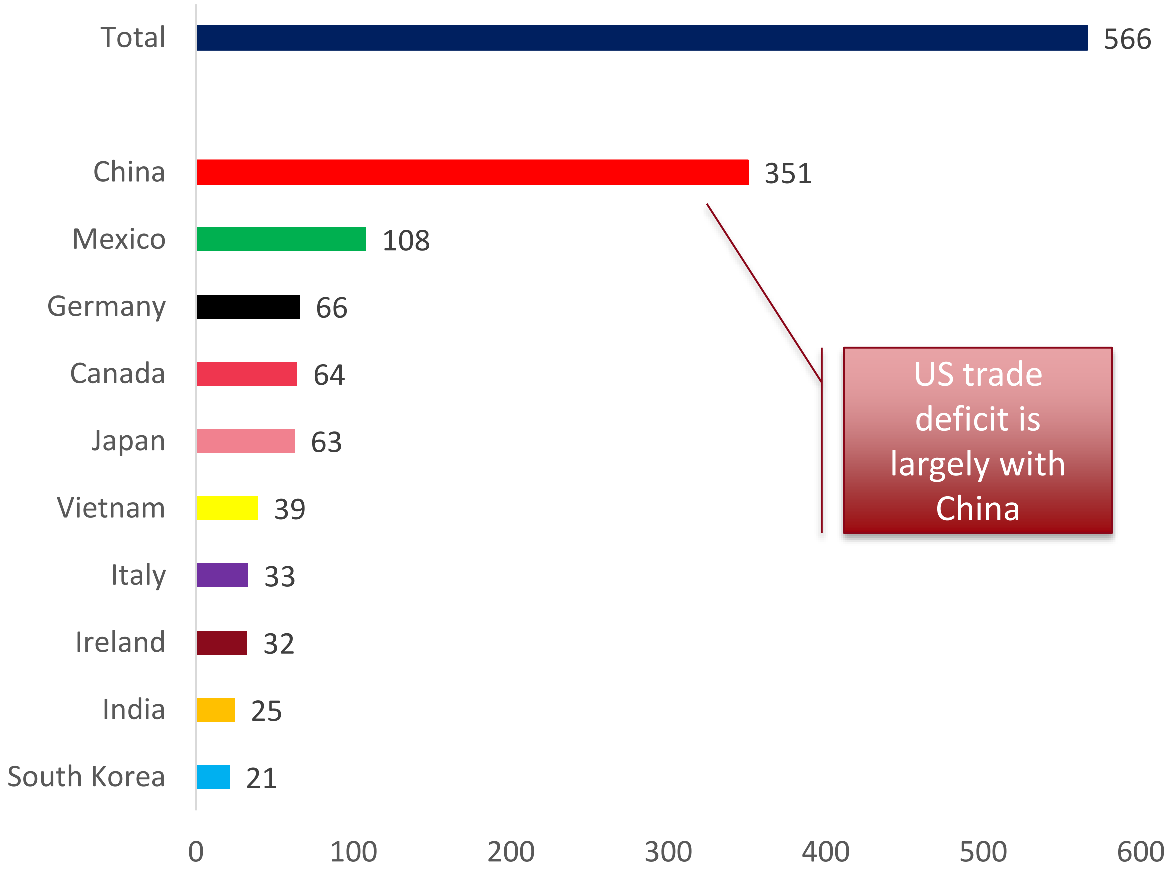
- Weakening in economic momentum due to slowdown in credit growth and likely slowdown in exports due to trade tensions.
- Government has launched fiscal and monetary stimulus to sustain growth, including tax cuts for corporates, easier credit for private sector, and investment in infrastructure projects.
- People’s Bank of China will also supply lower-cost liquidity at 3.15% for up to 3 years to banks willing to lend more to smaller companies.

Beijing deploying multiple levers to counter internal and external headwinds and sustain growth.

Source: IMF, OECD, HSBC, Bloomberg

Trade war: Trade deficit of US is largely with China

Trade Deficit of United States (USD Bn)



- Impact of US tariffs on China's GDP growth:
  - Currently announced tariffs on USD 250 Bn worth of Chinese imports: - 0.3%.
  - Potential additional tariffs on USD 267 billion worth of Chinese imports: - 0.3%.
- US and China have temporarily halted imposition of new tariffs for 90 days, as they negotiate a lasting agreement.

Further escalation can start impacting global growth.

Source: HSBC, Bloomberg, ABSLAMC Research

EM growth will sustain as global macro backdrop becomes supportive

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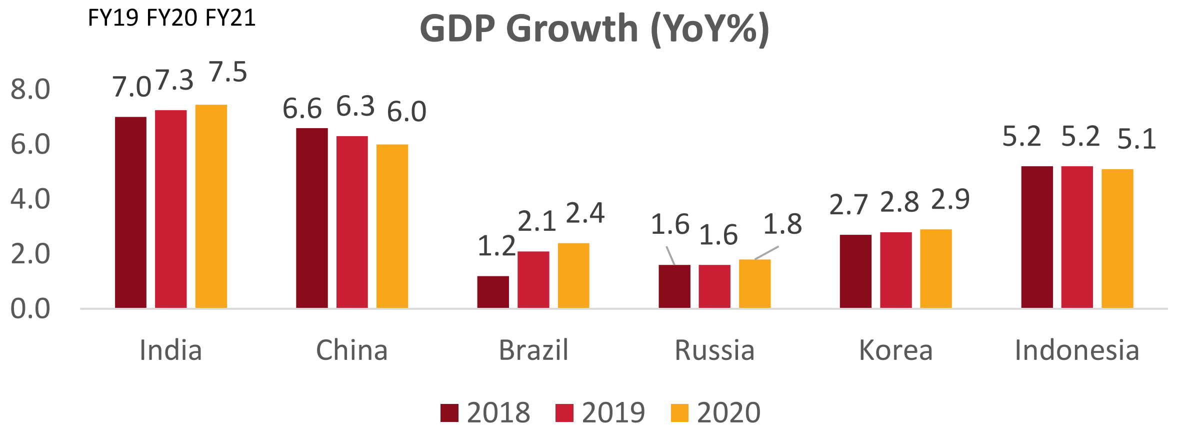
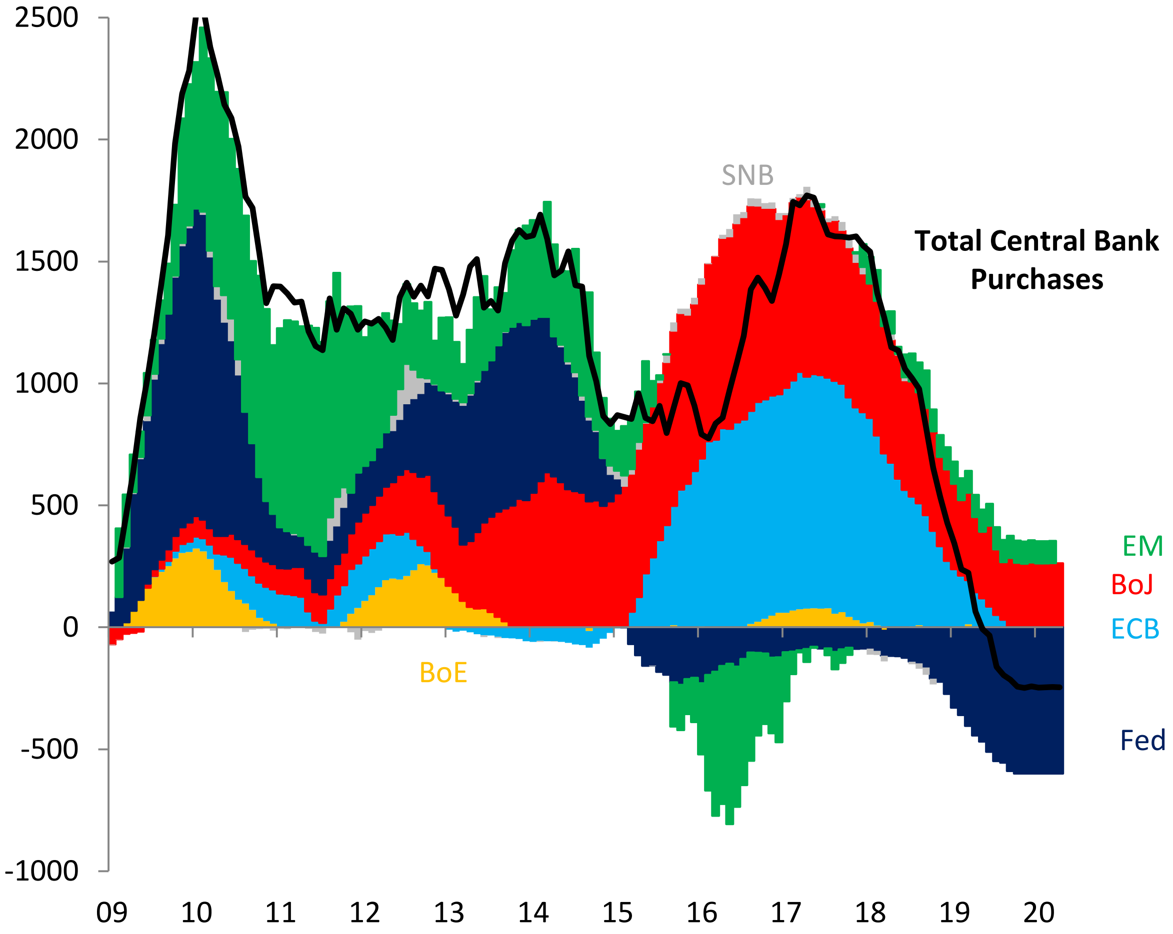


- With USD strength abating and softer oil prices, external headwinds will recede supporting EM growth momentum.
- Macro-stability indicators such as inflation and current account deficit have remained relatively contained.
- Most EMs have maintained a prudent policy mix and stayed on a path of fiscal consolidation to repair their balance sheet.
- EM listed corporate sector balance sheets are healthy and cash flows are strong.
- However, EMs still remain vulnerable to rising US rates and capital outflows and may be forced to tighten monetary policy in response to the US. Any slowdown in China will also weigh on EMs.

EM in a good position to benefit from favorable macro fundamentals.

Source: OECD, Goldman Sachs, Morgan Stanley, UBS, Nomura, ABSLAMC Research

Global Central Bank Securities Purchases, rolling 12m, USD Bn



Global Central Bank views on QE wind-down

US Fed

- The balance sheet run-off will continue on auto-pilot by up to USD 50 bn per month.
- Will use rate policy as the active tool of monetary policy.

ECB

- Will halt QE by the end of Dec, even though it was the driver of growth in the Euro zone
- Interest rates will stay unchanged until at least the summer of 2019 or longer if economic news warrants.
- Will maintain its stock of holdings and continue to reinvest the proceeds from maturing securities for an extended period of time past the date of initial interest rate rises.

BoJ

- Will continue to buy Japanese Government Bonds (JGBs) in "a flexible manner"

Quantitative tapering is likely to impact growth and asset prices globally.

Source: Citi, BAML

Crude oil prices will remain range-bound

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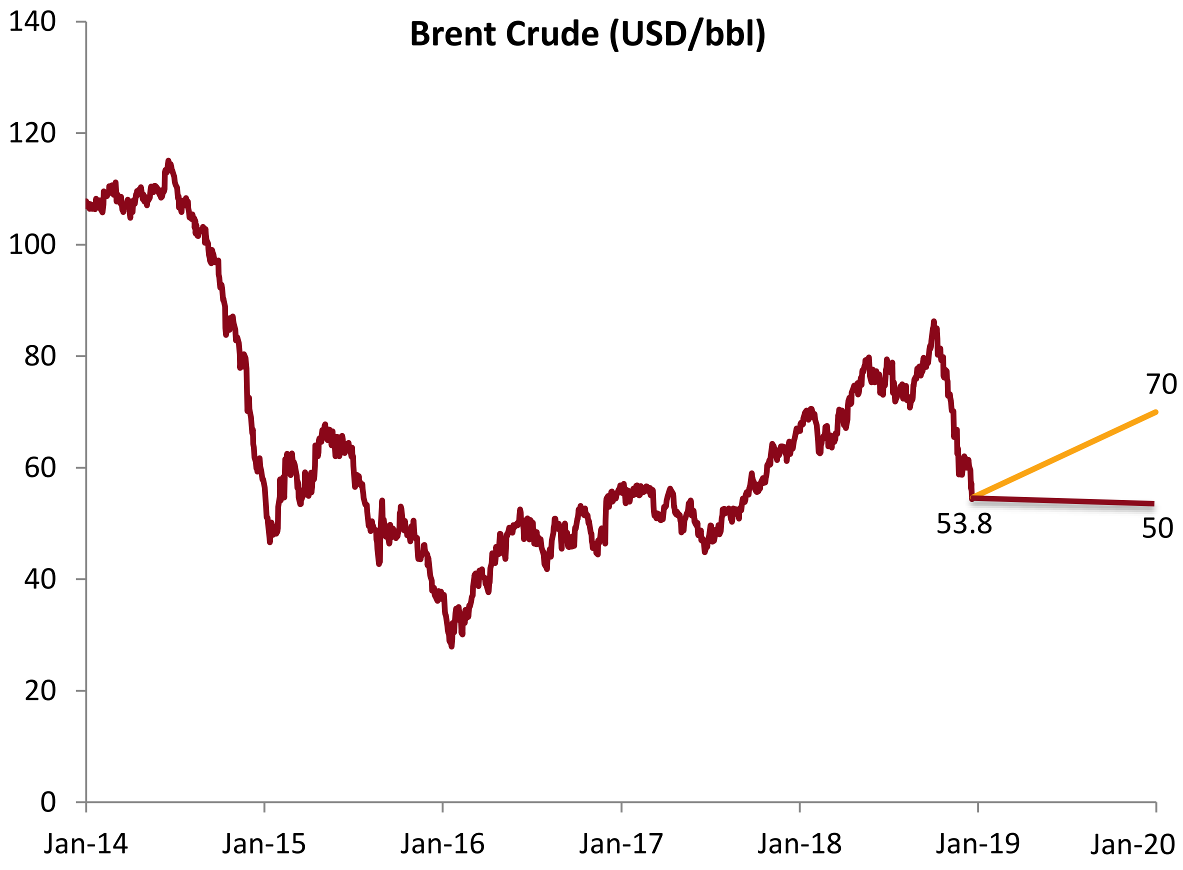


- After a sharp rise to USD 86+ per bbl, crude prices corrected 35%+ to ~USD 54/bbl due to over-supply (Saudi Arabia, US shale), concerns of a slowdown in global growth, and waiver from US sanctions on Iran to 8 countries for a limited period
- OPEC+ coalition has reached a deal to cut oil supplies by 1.2 mn bpd which should lead to moderate price growth. However, discipline of coalition members remains to be seen.
- Brent crude oil prices expected to be range-bound between USD 50-70/bbl.
- Demand-Supply will be in balance with ability to respond to any shocks since:
  - OPEC+ will have enough spare capacity post the supply cuts to respond to any sharp price rise
  - Decline below USD 55/bbl will start impacting US shale production

Stable crude oil prices will be positive for oil importing EMs, including India.

Source: Bloomberg, Morgan Stanley, ABSLAMC Research,

Summary: 2019 Outlook – World View

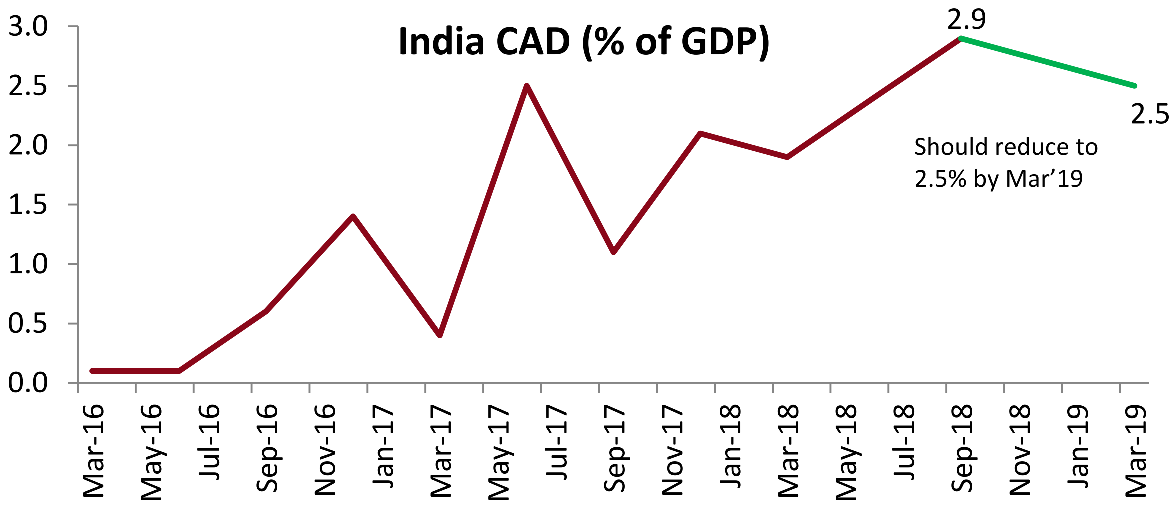
1. US to see soft landing as impact of fiscal stimulus fades. Weaker economic growth would lead to tempering of Fed rate hikes. USD strength will abate easing pressure on EMs.
2. China will see calibrated slowdown due to slower credit growth and trade tensions, offset by fiscal and monetary stimulus measures being deployed by Beijing.
3. EM growth will sustain as global macro backdrop becomes supportive. EMs have repaired their balance sheet with prudent policy measures. However, with QE wind-down, easy liquidity will end.
4. Global growth has peaked. 2019 will see a slight slowdown due to fading policy stimulus in the US, trade tensions, and QE wind-down.
5. Brent crude prices will be range-bound which will be positive for oil importing EMs, including India.

2019 – Outlook

India View

MACRO STABILITY

External stability will return as macro backdrop has improved



- CAD increased to 2.9% of GDP in Q2FY19, driven by India's growth differential with other economies and higher oil prices.
- With recent moderation in oil prices and stabilization of the Rupee, CAD is likely to moderate going forward to ~2.5% of GDP for FY19E and improve further to ~2.2% of GDP in FY20E if oil stabilizes around USD 60/bbl.
- Forex reserves are strong, and FPI outflows are expected to reverse, both in equity and debt.

Current Account / Balance of Payments Estimate in FY20E

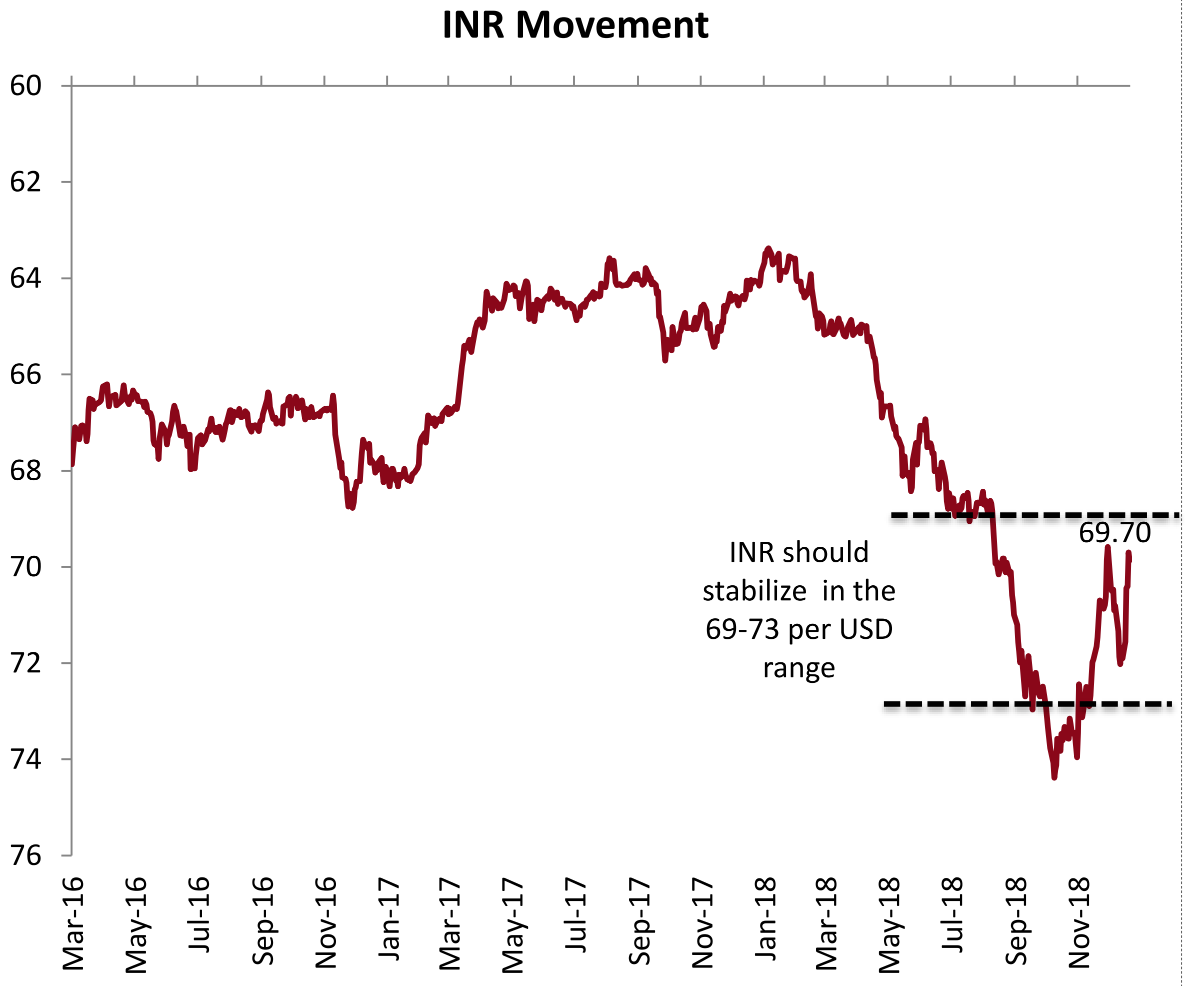
(US$ bn)	Crude @ $50/bbl	Crude @ $60/bbl	Crude @ $70/bbl
Total imports (a)	**550**	**560**	**570**
- Oil imports	118	128	138
- Gold imports	38	38	38
- Non-oil non-gold imports	394	394	394
Total Exports (b)	**364**	**368**	**372**
- Oil exports	44	48	52
- Non-oil exports	320	320	320
Trade balance (b-a) = i	**-186**	**-192**	**-198**
Invisibles (ii)	**128**	**128**	**128**
- Software exports	83	83	83
- Remittances	76	76	76
- Income	-31	-31	-31
CAD (i+ii) = a	**-58**	**-64**	**-70**
CAD (% of GDP)	**-2.0**	**-2.2**	**-2.4**

Foreign Direct Investment	32	32	32
Portfolio Investment	10	10	10
Others	24	24	24
Capital account (b)	66	66	66

Balance of Payment (a+b)	8	2	-4

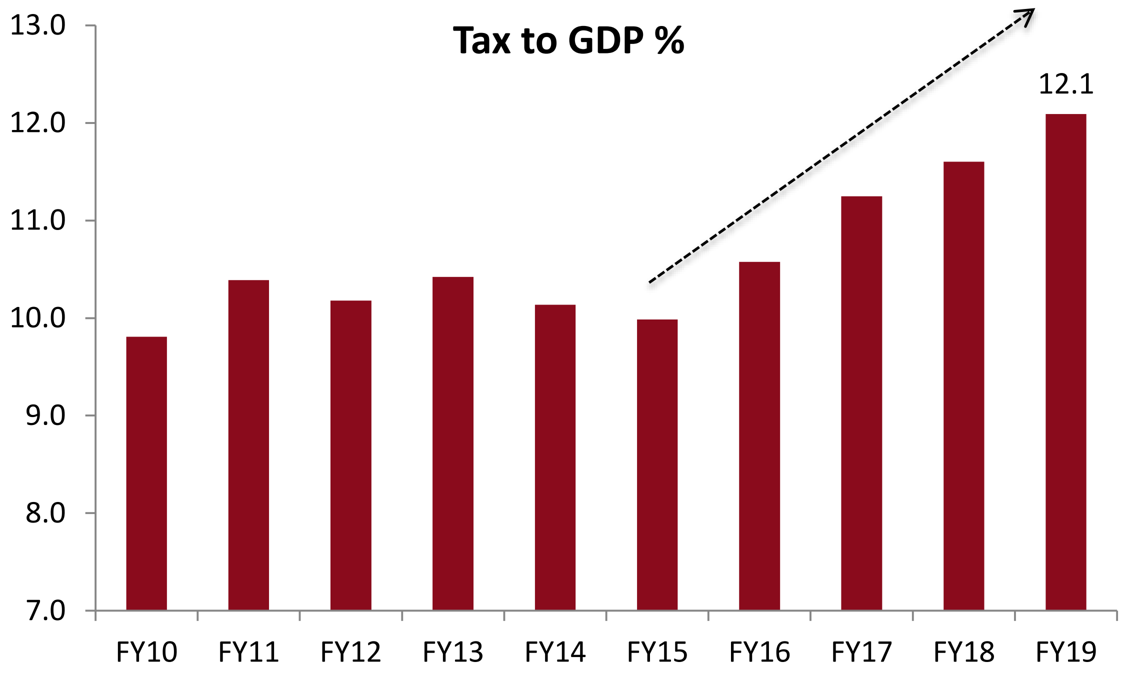
External vulnerability is less of a concern now as global macro backdrop has improved.

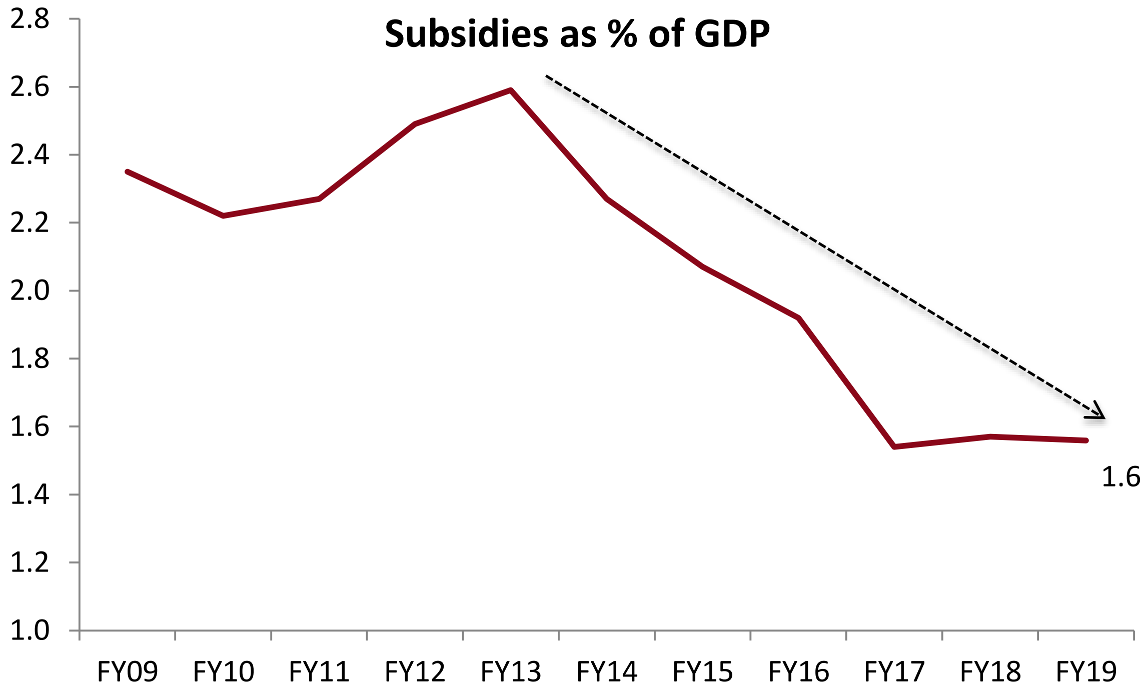
Source: Axis Capital, Bloomberg, ABSLAMC Research



- Sharp INR depreciation in 2018 on the back of widening of CAD due to higher oil prices, interest rate differential with the US as the US Fed hiked rates, and FPI outflows.
- With a pull-back in oil prices, CAD will improve and the BoP will be in balance. FPI flows will also reverse on the back of macro stability.
- Consequently, the Rupee has appreciated to levels of 70 INR per USD.
- In terms of real effective exchange rate (REER) also, Rupee overvaluation has corrected and it has reached the historic avg.
- We believe the Rupee will stabilize in the 69 – 73 INR per USD range if oil prices remain range-bound.

Source: Bloomberg, ABSLAMC Research



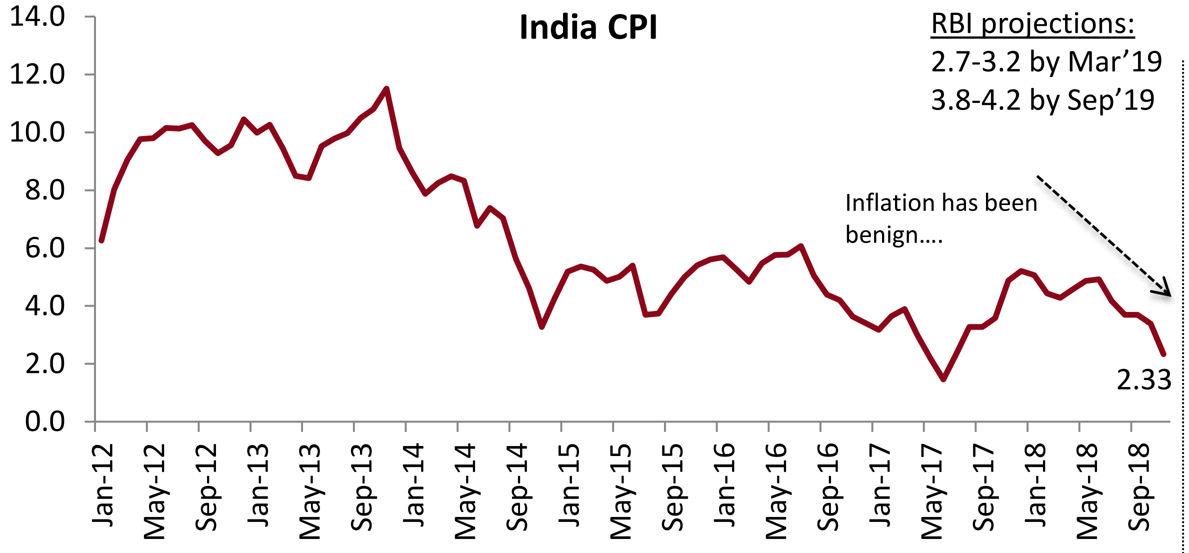


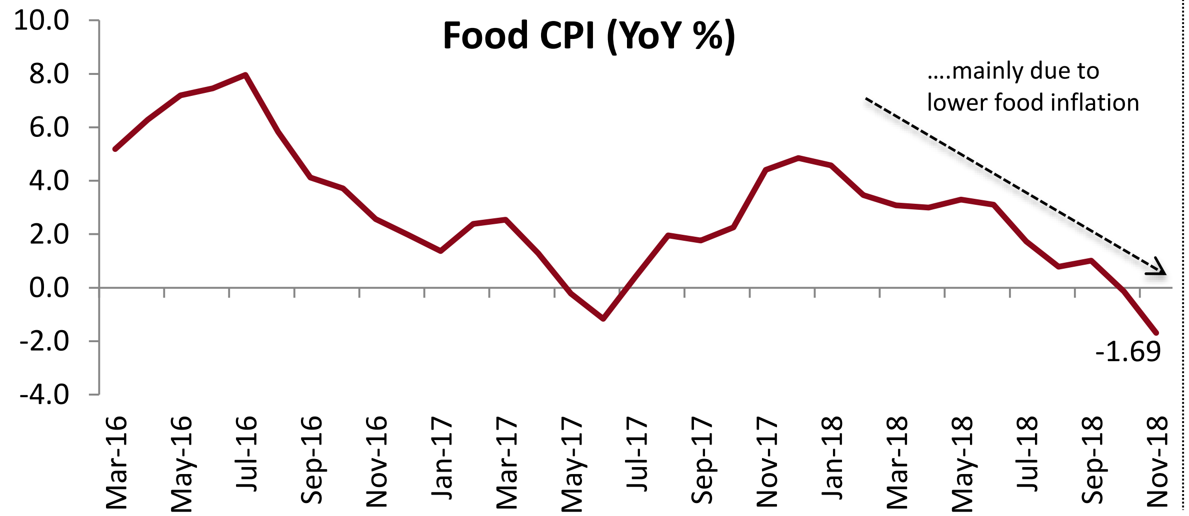
- Meeting the fiscal deficit target of 3.3% of GDP for FY19E is likely to be challenging due to lower GST collections and lower divestments.
- Government is managing fiscal deficit through various measures such as market-linked reforms resulting in a decline in subsidy payments and off-balance-sheet funding for infra projects e.g. NHAI bonds.

Government spending will be constrained due to fiscal pressure.

Source: CMIE, Antique, ABSLAMC Research

Inflation will remain benign over longer term due to structural drivers

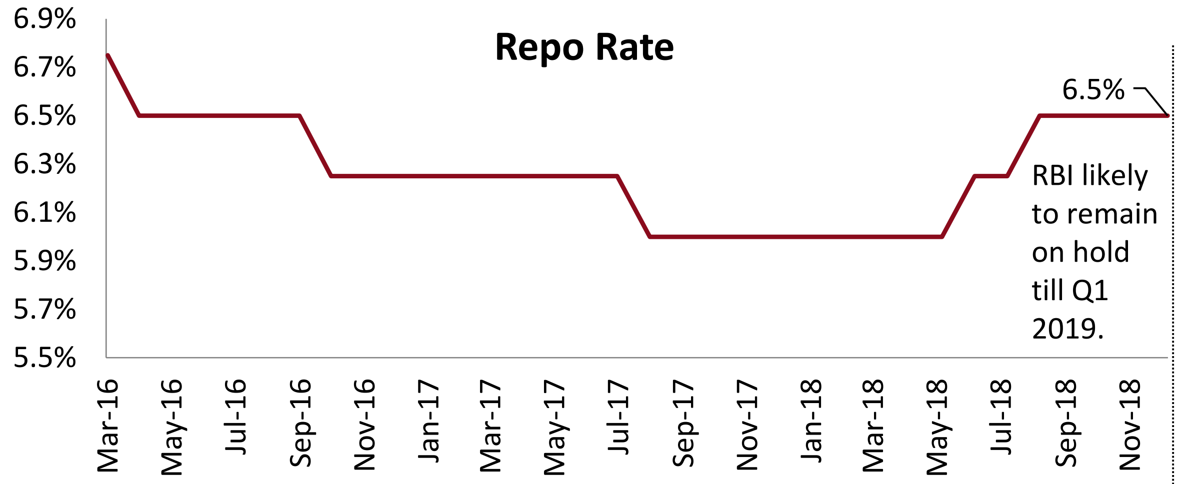


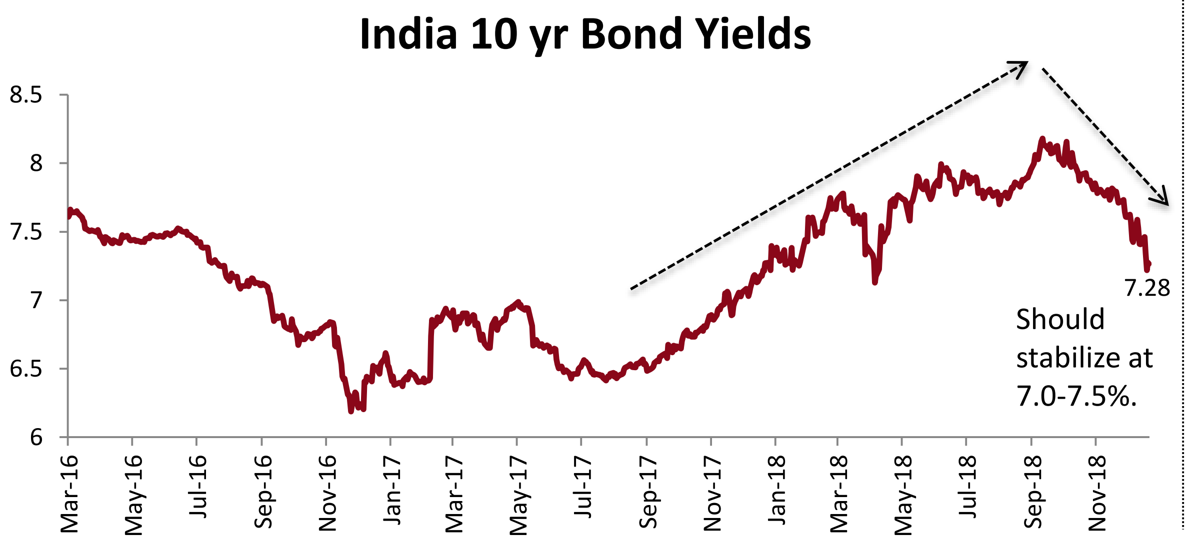


- CPI has moderated to 2.3%. Inflation has been consistently undershooting estimates due to benign food prices.
- Inflation expected to normalize towards 4% level and remain within RBI's comfort zone. RBI's projection for CPI inflation is 2.7-3.2 by Mar'19 and 3.8-4.2 by Sep'19.
- With food constituting 46% of the basket, the large and continuing downside surprises to food inflation has dramatically altered the CPI inflation trajectory.
- The sustained and dramatic food disinflation is due to some combination of improved supply and surpluses in some crops, and benign global prices. Food prices have continued to soften to the downside despite generous increases in minimum support prices (MSPs).

Source: Bloomberg, ABSLAMC Research

With inflation in the RBI's comfort zone, interest rates are likely to be supportive

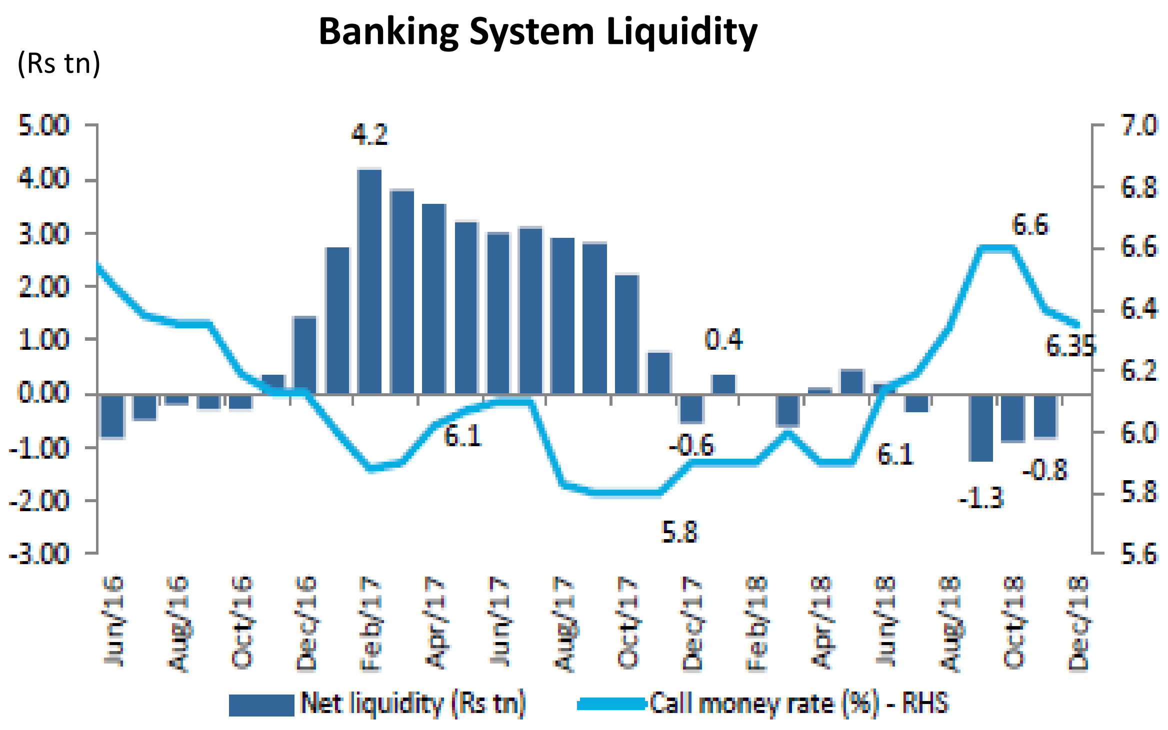




- With inflation consistently undershooting estimates due to benign food prices, and the significant improvement in the macro backdrop, the RBI has maintained its policy rate at 6.5% and lowered its inflation forecasts for next year.
- We believe RBI will remain on hold till Q1 2019, with a possibility of a change in stance if inflation remains subdued.
- Bond markets have calmed down meaningfully in response to policy makers' announcements on keeping the economy well supplied with liquidity.
- Yield on the benchmark 10-Yr Government Bond has declined from 8.2% to ~7.4%. We expect it to stabilize in the 7.0-7.5% range.

Source: Bloomberg, ABSLAMC Research

Tight liquidity situation has eased off



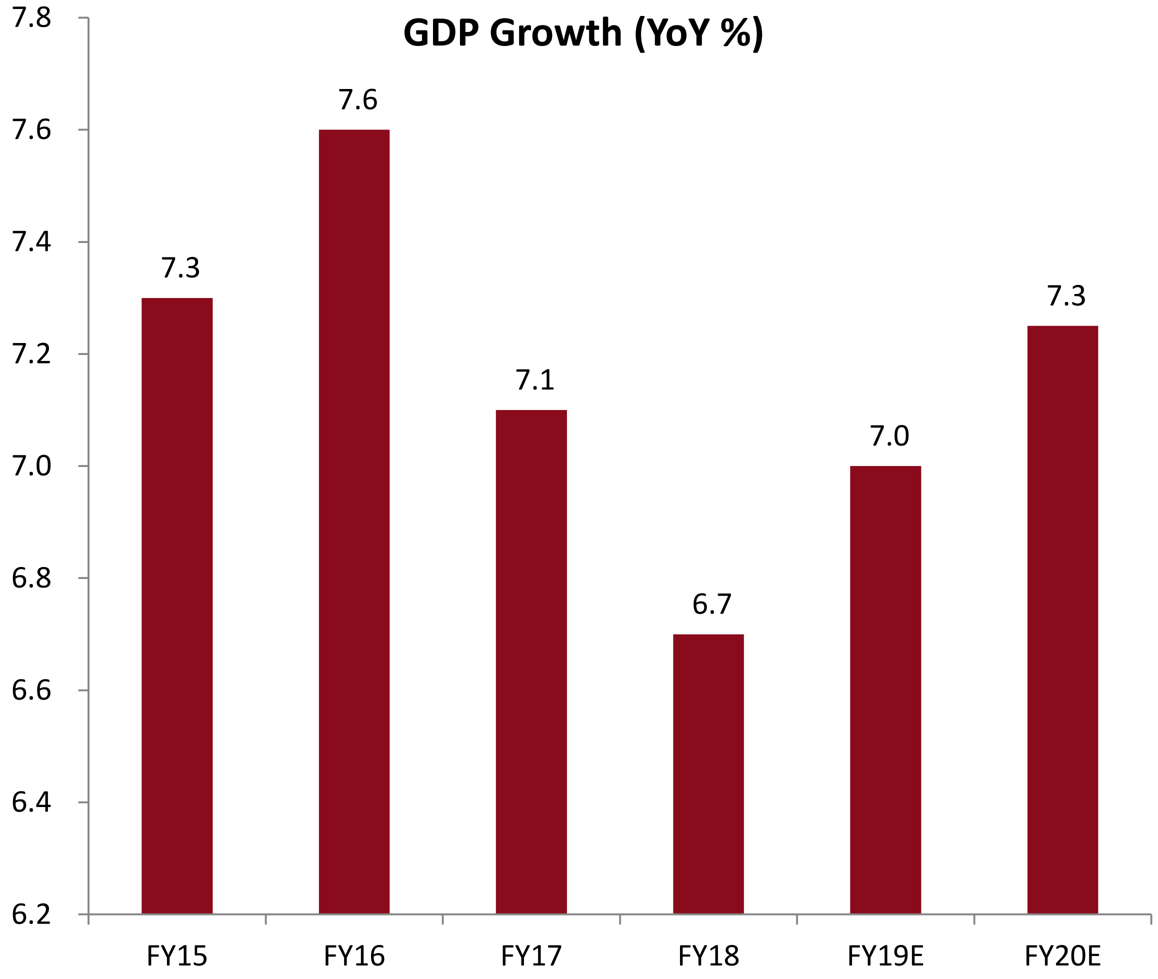
- Overnight banking liquidity in the system has eased to Rs. 0.03 tn deficit from Rs. 1.2 tn deficit in Sep'18.
- Liquidity will return to neutral by Mar'19 due to:
  - FX intervention by RBI: A decline in the CAD as a result of lower oil prices will lead to positive BoP and accumulation of FX reserves by RBI which increases Rupee liquidity
  - Higher OMOs i.e. bond purchases by the RBI
- Commercial Paper (CP) market activity has been better than expected with rollover of 80% amounting to Rs 1.3 tn in Nov
- However, corporate spreads have widened to 110-140 bps, reflecting some risk aversion in the system

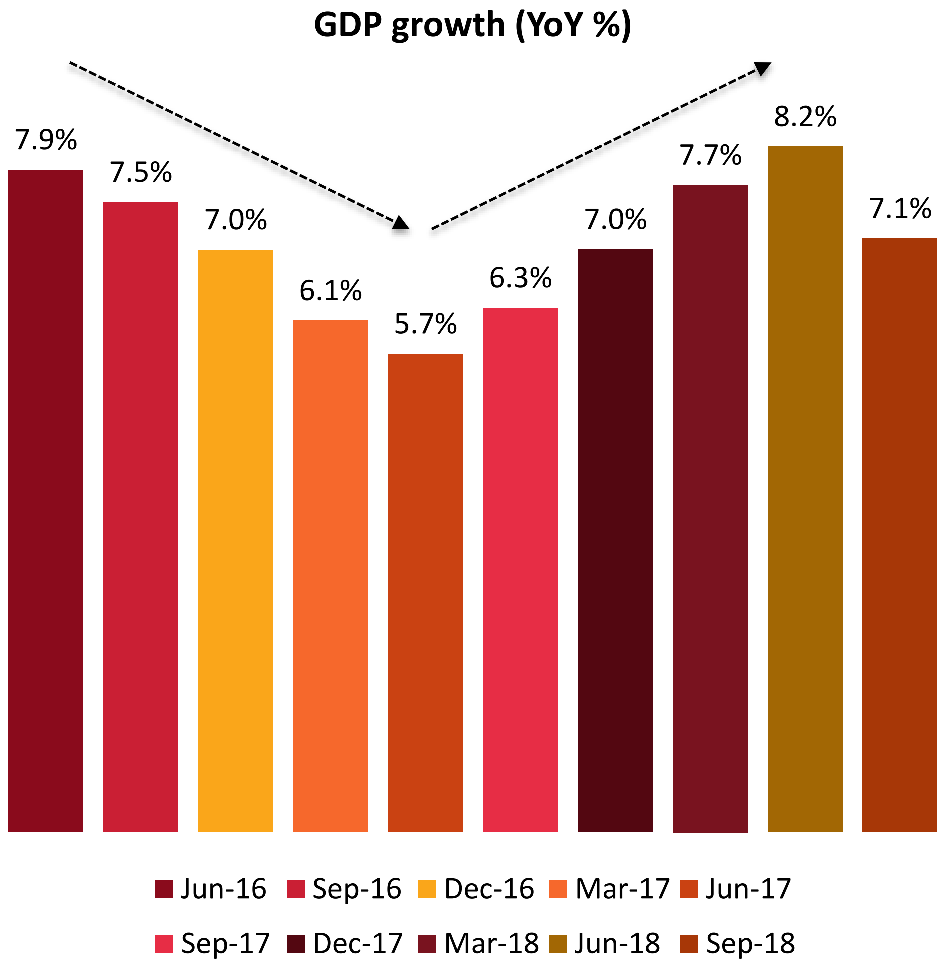
System liquidity will return to neutral by Mar'19.

Source: Spark Capital, Edelweiss, ABSLAMC Research

GDP GROWTH DRIVERS

India GDP growth will continue to be steady with marginal improvement



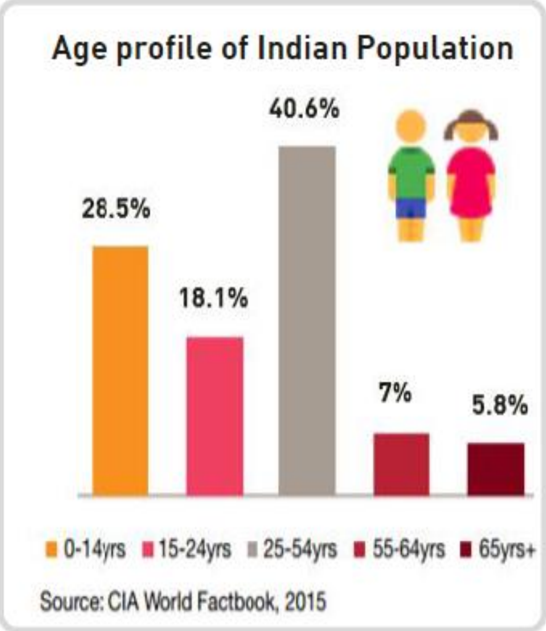


Key drivers will be steady growth in private consumption, supported by investment in infrastructure.

Source: RBI, OECD, Goldman Sachs, Morgan Stanley, UBS

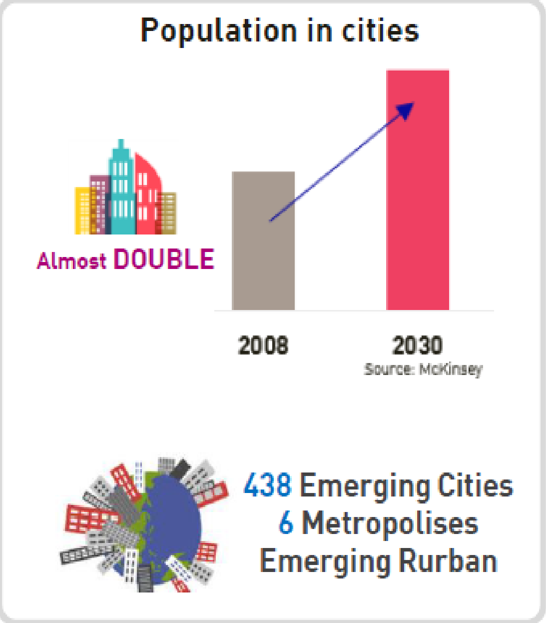
Large middle Class & growing affluent class to drive steady growth in Private Consumption

Demographics



Huge youth population (65% pop less than 40 years)

Urbanization

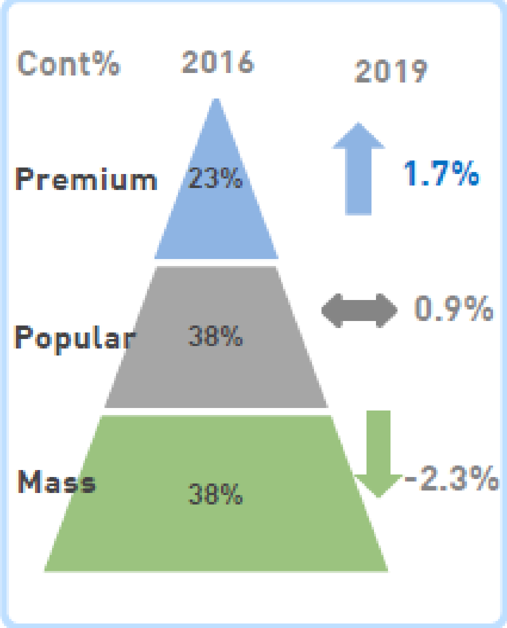


Growing at 4-5%; changing attitude & aspirations; more female consumers

Shift from unorganized

GST will help to make the process faster

Premiumization



Per capita income improving

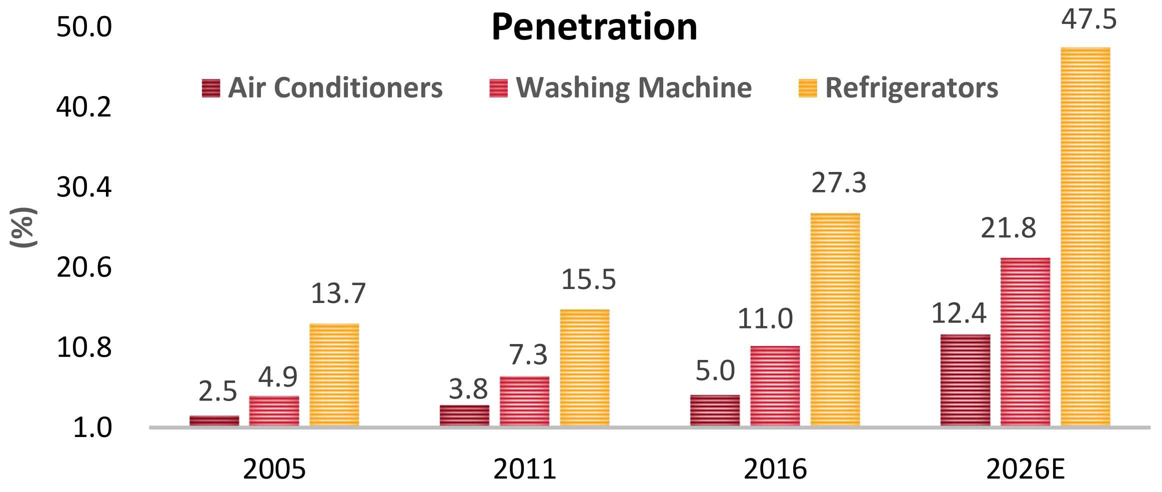
Besides rising per capita income, decline in crude prices, and good agri harvest will also support spending.

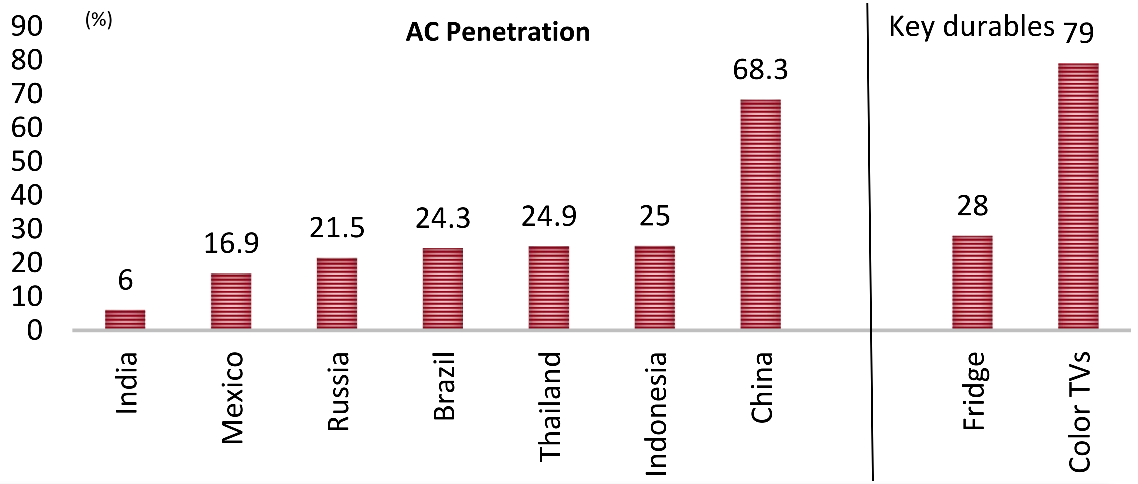
Source: Credit Suisse, ABSLAMC Research

Increased electrification - All inhabited villages have been electrified

Electrification

State	Electrified as on Oct'17 (%)	Current level of electrification (%)
Uttar Pradesh	59.7	83.1
Maharashtra	97.1	100.0
West Bengal	94.5	100.0
Bihar	76.3	100.0
Madhya Pradesh	83.4	100.0
Gujarat	99.7	100.0
Andhra Pradesh	99.0	100.0
Rajasthan	82.9	95.4
Tamil Nadu	100.0	100.0
Karnataka	94.5	97.9
Kerala	100.0	100.0
Odisha	72.3	96.4
Telangana	93.5	100.0
Assam	63.9	86.6
Jharkhand	62.3	91.9
Chhattisgarh	84.2	99.2
Punjab	100.0	100.0
Haryana	99.3	99.7
Uttarakhand	82.1	100.0
Tripura	81.3	100.0
Meghalaya	61.8	78.4
Manipur	74.4	99.2
Nagaland	74.7	87.1
Arunachal Pradesh	75.0	84.8
Mizoram	91.6	100.0

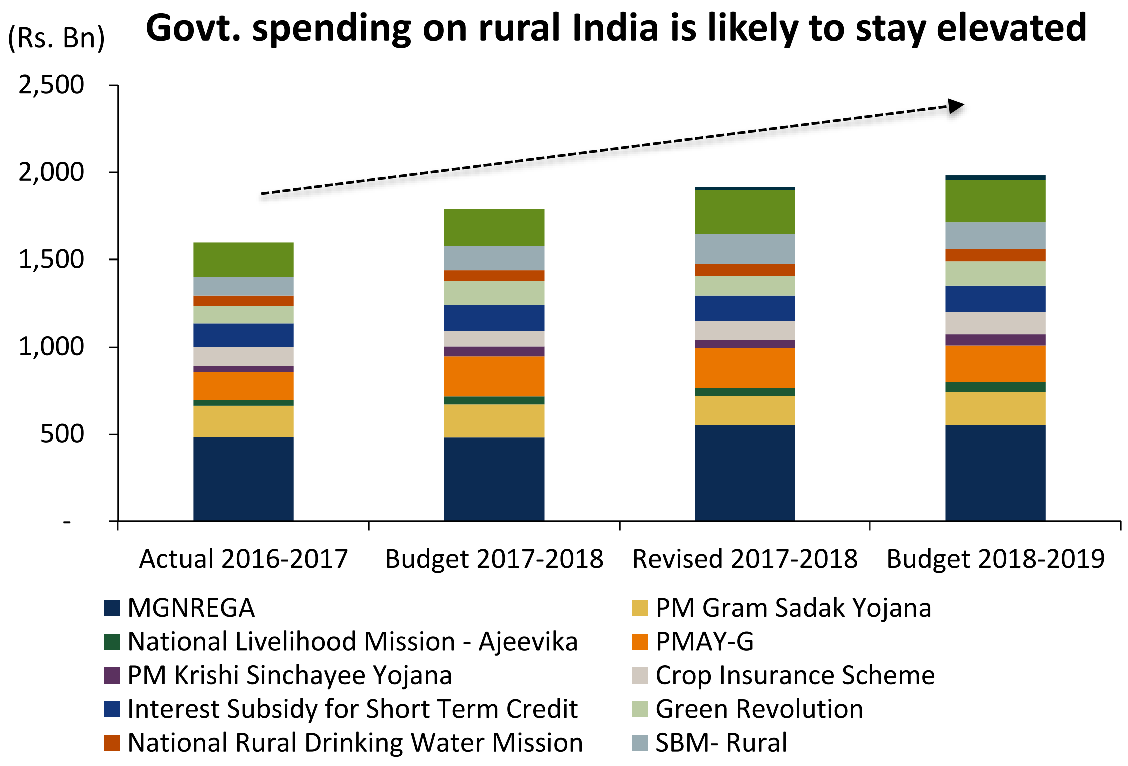


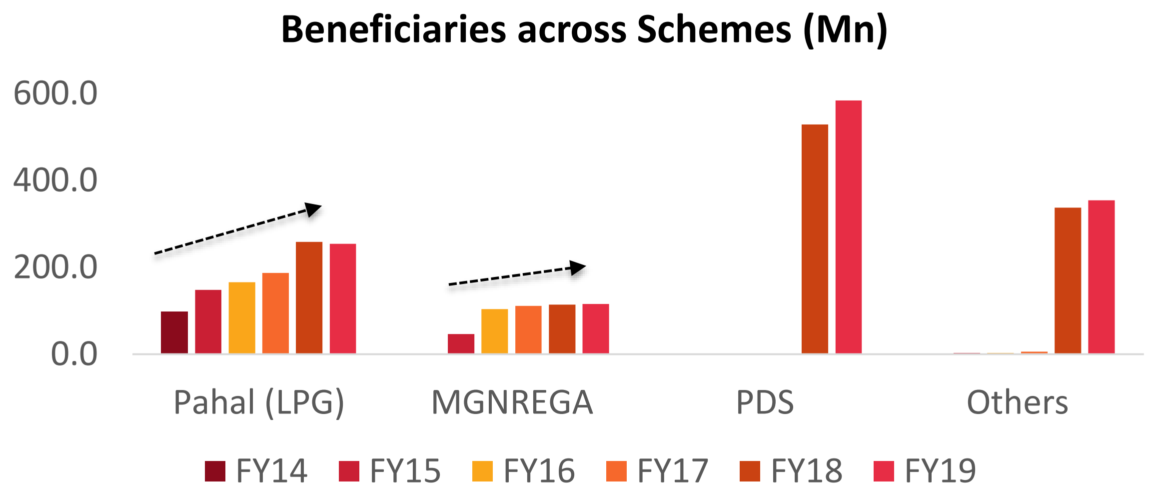


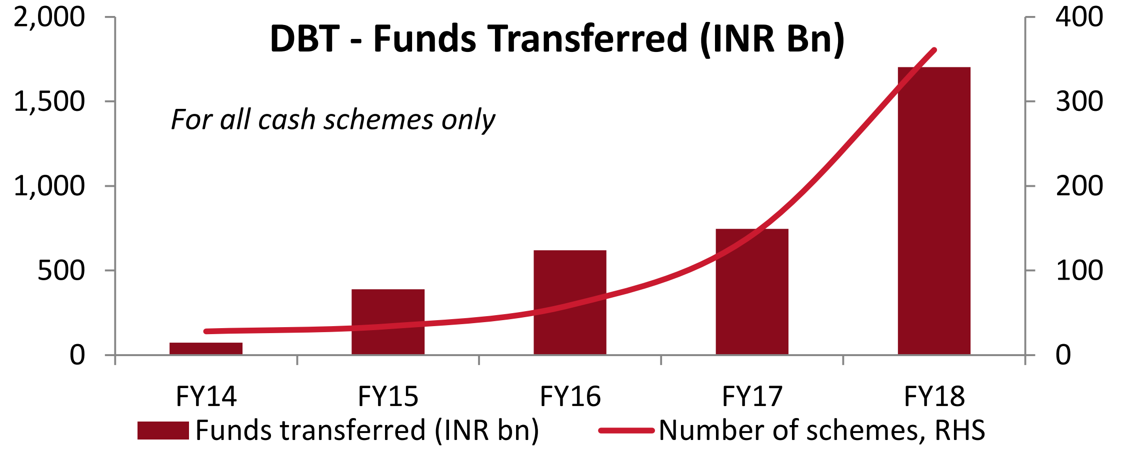
Discretionary spending to increase going forward.

Source: CMIE, Credit Suisse, ABSLAMC Research

Rural income growth will benefit from higher MSP, farm loan waivers, increased government spending on rural schemes, and Direct Benefit Transfer (DBT)





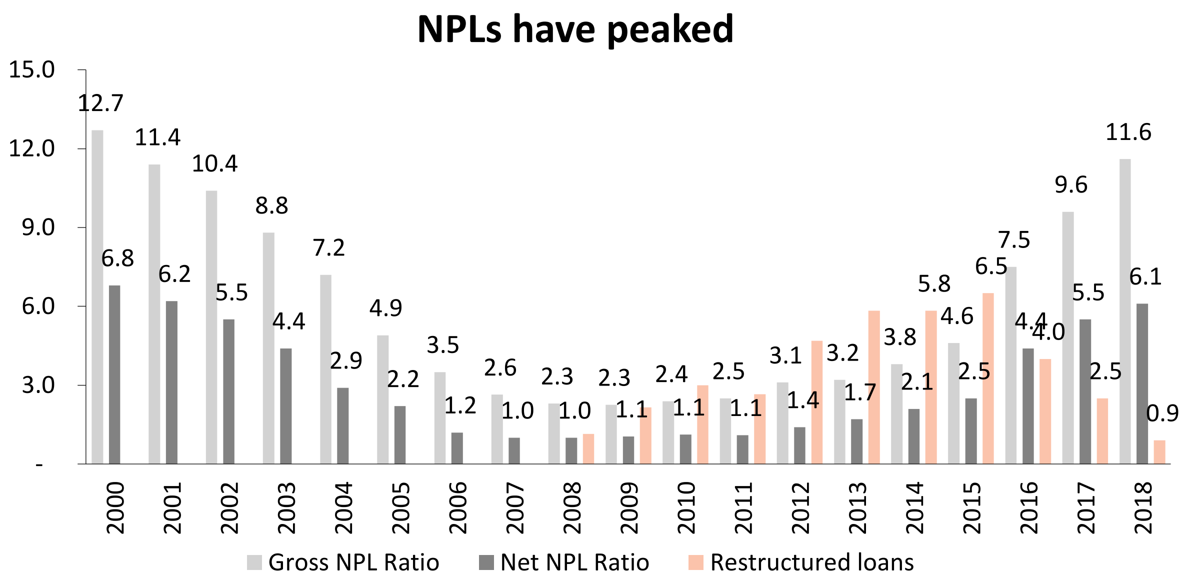


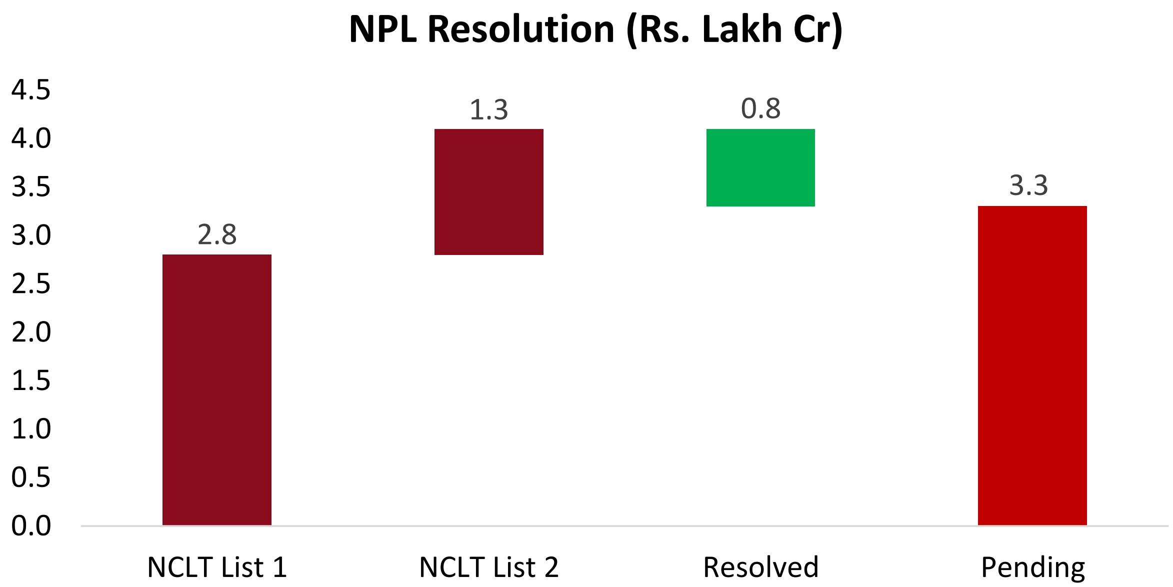
- Farm loan waivers announced by State Govt. in MP (Rs 50,000 Cr), Rajasthan (Rs 18,000) and Chhattisgarh (Rs 6,100 Cr)
- Total farm loan waivers announced by state governments since 2014 is Rs more than 2.2 lakh Cr (equal to PSU bank recap)

Government stimulus in an election year, including farm loan waivers, will give a boost to rural consumption.

Source: BAML, CMIE, Antique

Bank balance sheets are getting repaired



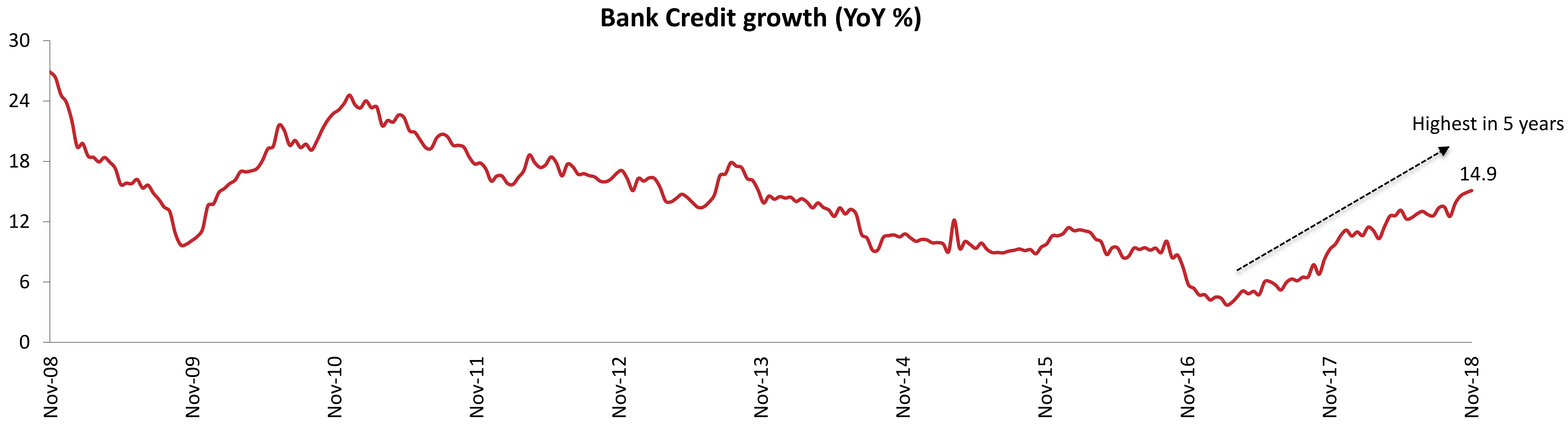


- GNPLs have peaked. There appears to be no significant stress arising from any new sectors, except standalone cases.
- NPL resolution in progress under NCLT with IBC setting time-bound limits for resolution. Cases resolved via liquidations (~55% till 2QFY19) gradually seeing a rise while average haircut has been high at 45%.
- Banks will likely gain from corporate recoveries going ahead in FY19/20E.

NPLS to see a declining trend. NPL resolutions in progress under IBC.

Source: Kotak, CLSA, ABSLAMC Research

Credit growth will continue to remain strong as banks step in for NBFCs

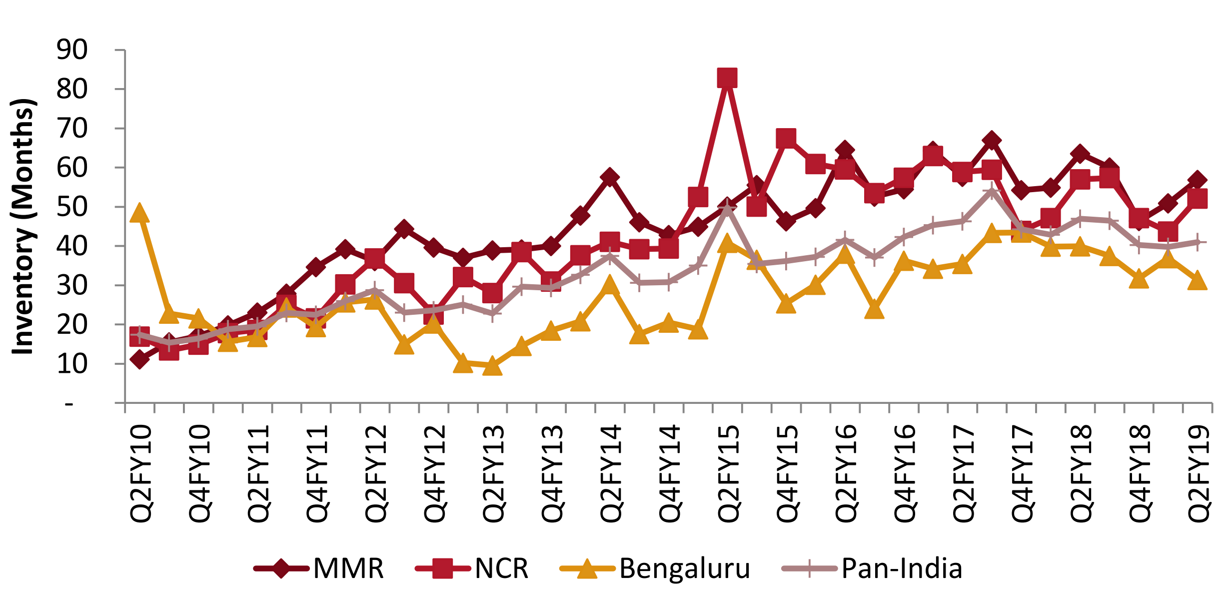


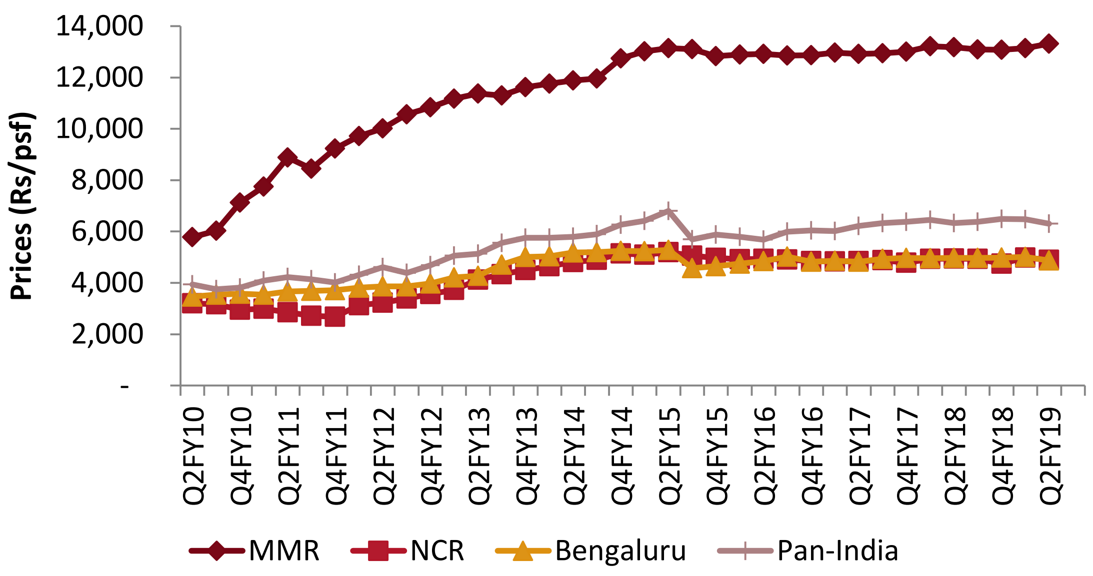
- In addition to recoveries due to NPL resolution, banks are receiving capital infusion from the government and are also benefiting from gains due to decline in bond yields.
- This will enable Corporate banks to put the past issues behind and focus on growth going forward.
- With NBFCs facing moderation in growth and pressure on margins due to tightened liquidity, banks will start taking share from NBFCs

Credit growth has seen strong traction driven by retail, MFI and MSME loans.

Source: Kotak, ABSLAMC Research

Housing: Buyers have delayed their purchase decision due to lack of funding from NBFCs





- At a pan-India level, inventory levels have stabilized at ~40 months and residential property prices have remained flat in CY18
- With developers focusing on completing and selling ongoing projects, inventory levels may trend downwards in CY19.
- Forced asset sales by developers who are unable to get funding due to the NBFC stress will lead to a price correction in CY19

Housing inventory stabilized at ~40 months; Correction in prices expected in CY19

Source: Liases Foras Research, Isec., ABSLAMC Research

RERA and Affordable Housing will be key drivers for Household capex over next few years

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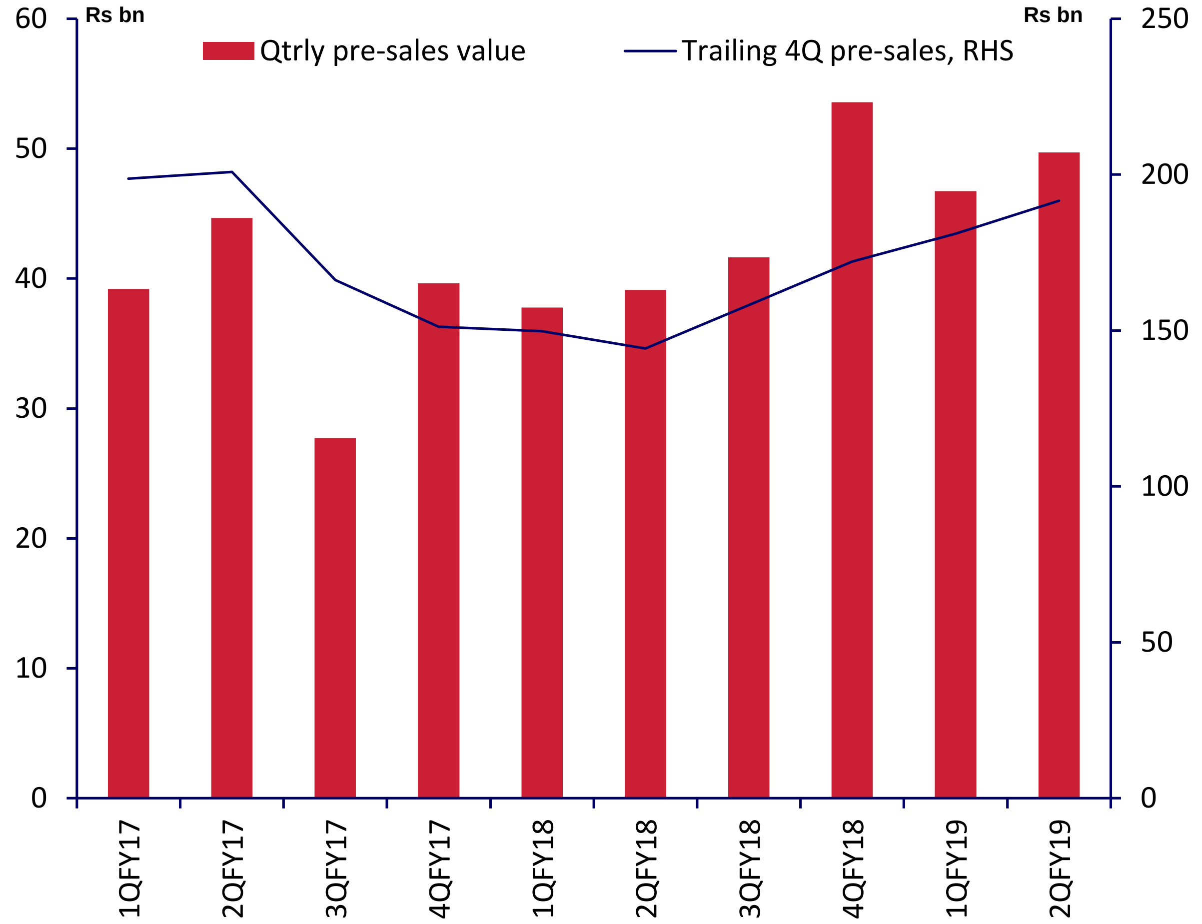
Confidence in property coming back



- The Real Estate sector faced challenges in 2018. However, a good foundation has been laid for the next few years which along with the sustained demand for housing in a growing country like India will help to revive the sector
  - Reforms such as RERA enable an organized funding mechanism and ensure that cash flows are contained with a proper escrow mechanism. RERA will cause a shift from smaller, unorganized developers to larger organized developers
  - Focus on Affordable Housing which was an untapped segment earlier and has become attractive for large developers now
  - Potential GST rate cut for housing
  - Interest rates will ease off due to outlook on inflation being benign
  - Price correction expected in 2019

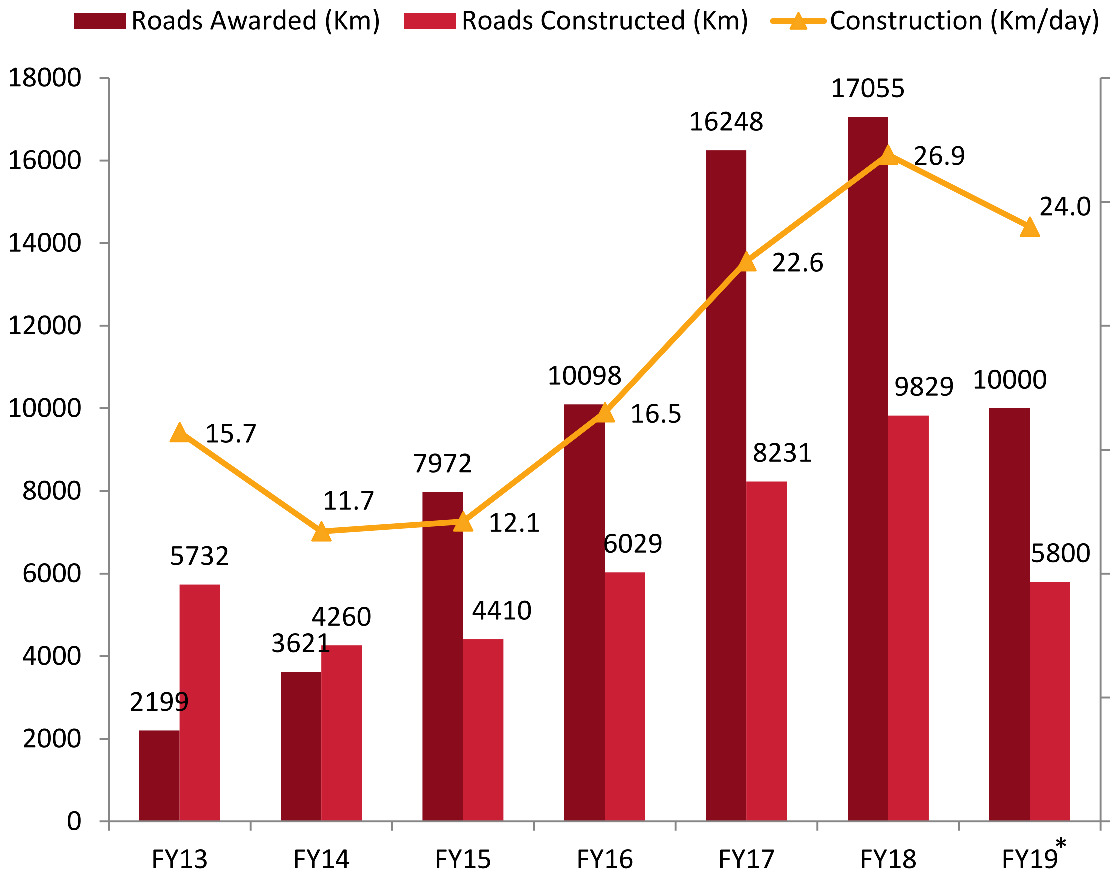
Although the transition will be painful in the short-term, it will provide a good platform for growth of the sector in the long-term

Source: CLSA, ABSLAMC Research

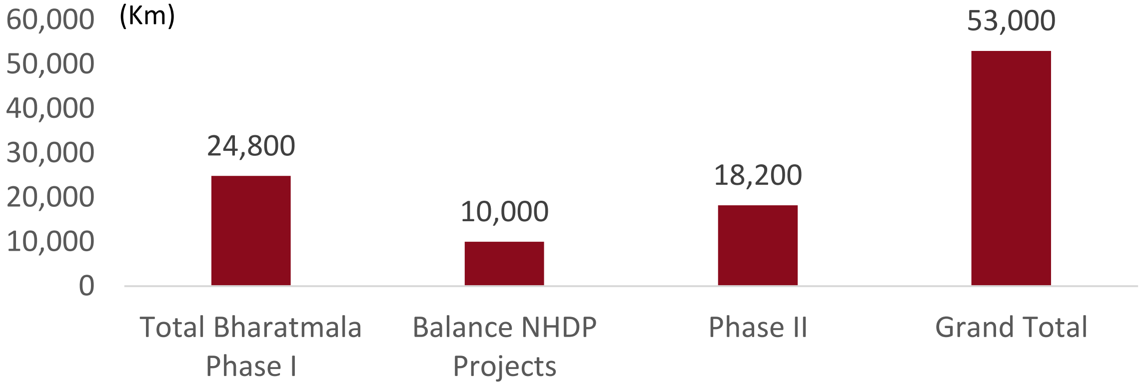
Investment in Roads set to deliver substantial improvement in highway network

ADITYA BIRLA CAPITAL

Highway Construction



Bharatmala Pariyojana – The Way Forward

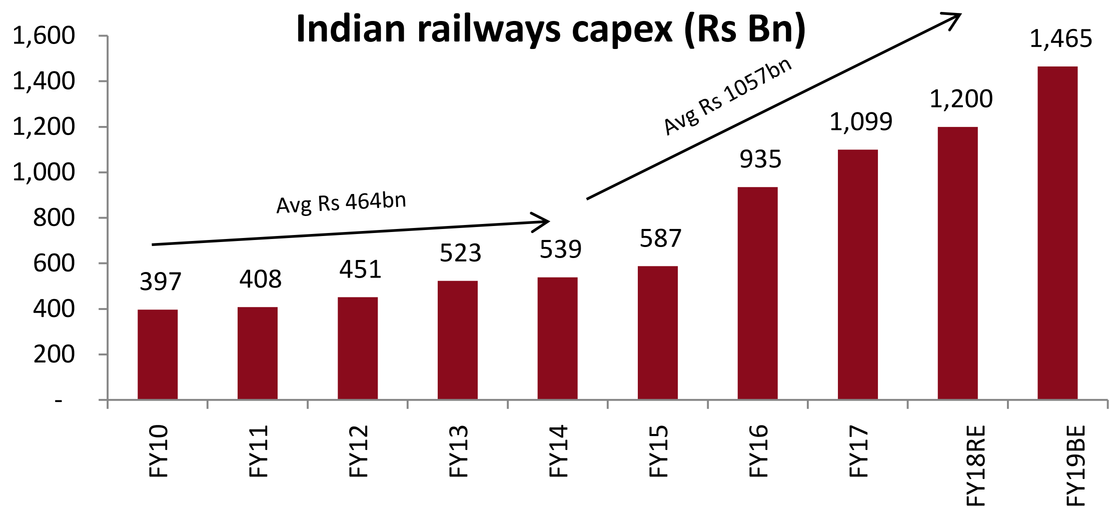


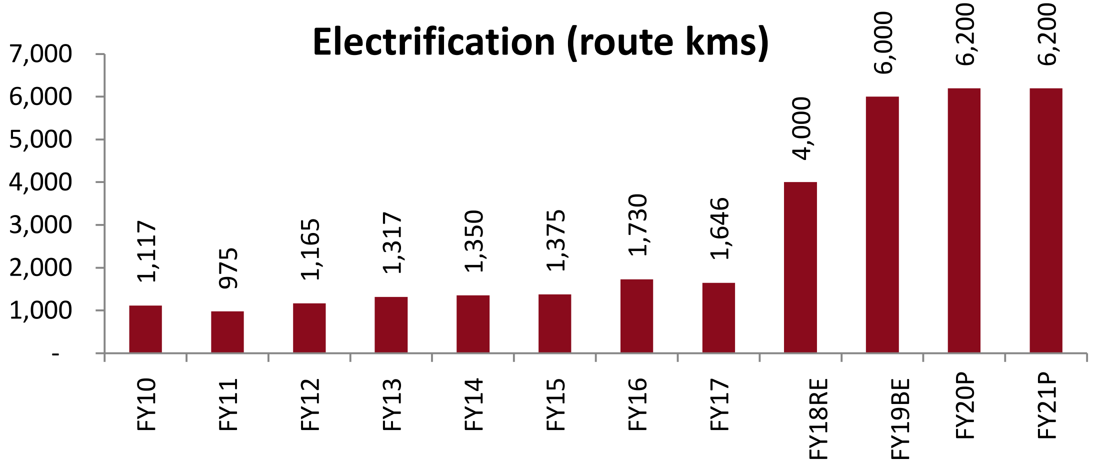
From		To
Six Corridors (GQ, NS-EQ)	→	Fifty Corridors
40% freight on National Highways	→	70-80% freight on National Highways
~300 districts connected by 4+ Lane Highways	→	~550 districts connected by 4+ Lane Highways

Pace of execution expected to increase in 2019 as financial closure has been achieved for many projects.

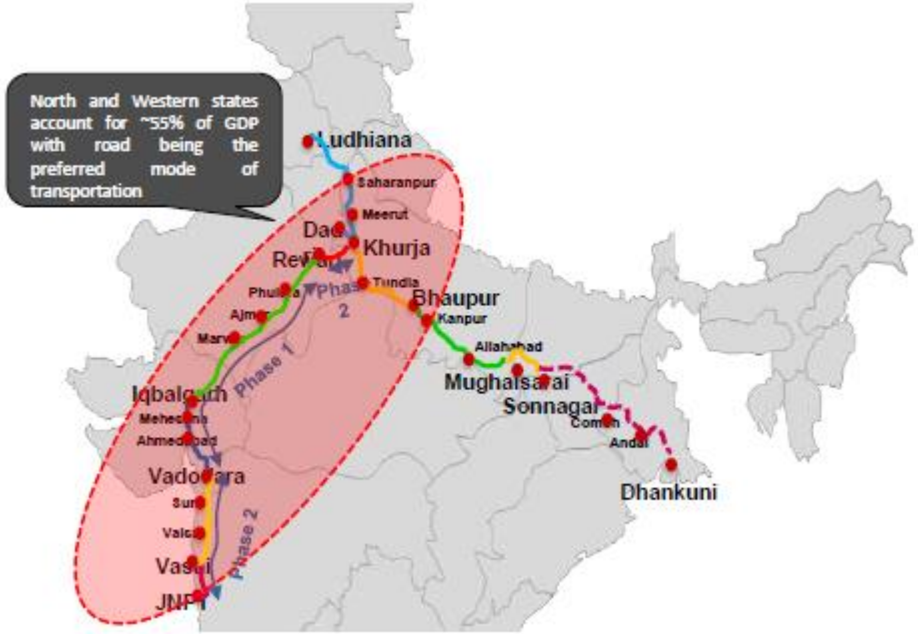
* Roads awarded is target for the year. Roads constructed and Construction (km/day) is actual till Nov'18

Source: SBICapSec, Elara Securities





Dedicated Freight Corridor (DFC)



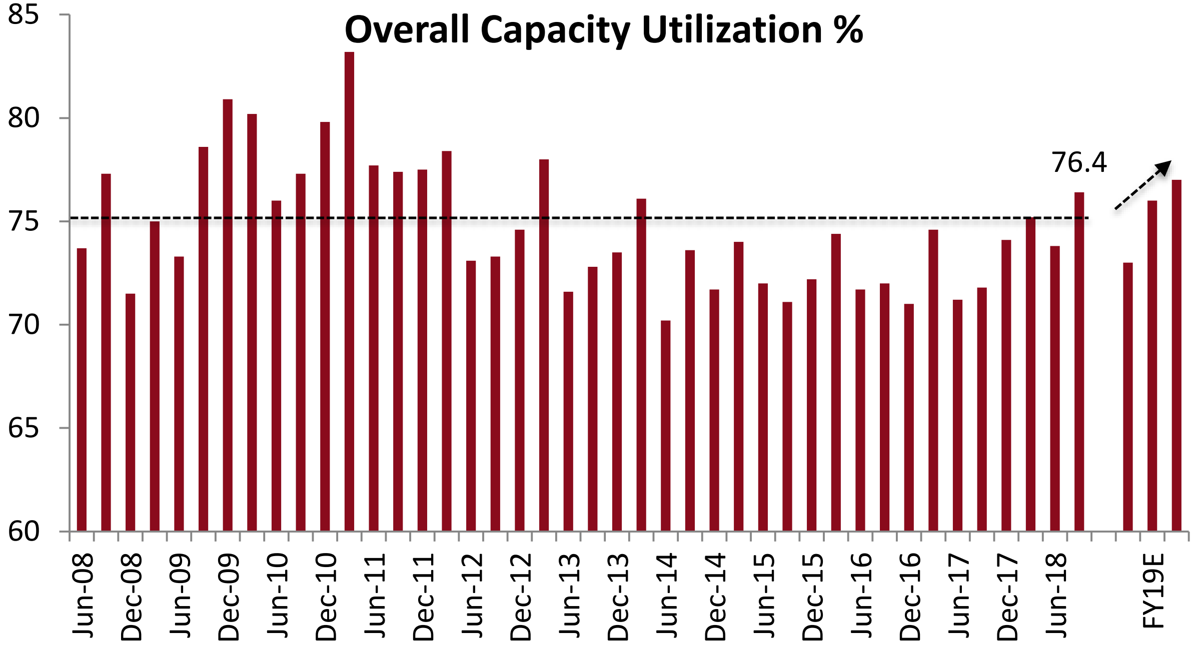
- East & West DFCs (FY21) will add 1 bn tonnes of capacity (eq. to current capacity of railways). Total cost of Rs ~80,000 Cr
- Bullet Train: High speed train corridor between Ahmedabad and Mumbai with a total length of 508 kms and total cost of Rs 1.1 lakh cr

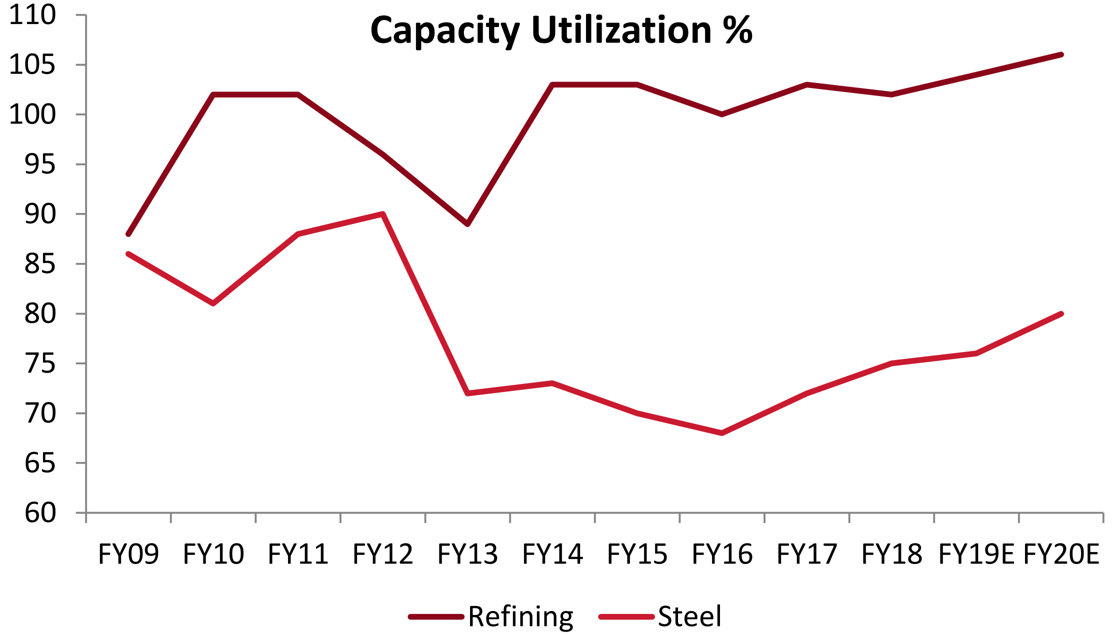
Post DFC, by FY22, rail's share is expected to go up to 40-45% in the total transport sector from less than 20% currently.

Map of India is used for illustrative purpose alone. And is not a political map of India.

Source: JPMorgan, Phillip Capital, Elara Securities

Green shoots of recovery visible in industrial capex as Capacity Utilization has risen to 75%+





<u>Key drivers of Private Capex:</u>

- Oil & Gas: BS-VI emission norm-related upgrades and brownfield/greenfield refinery expansions by state-owned oil marketing companies.
- Metals: With protection of import tariffs, Metals companies are announcing capacity additions

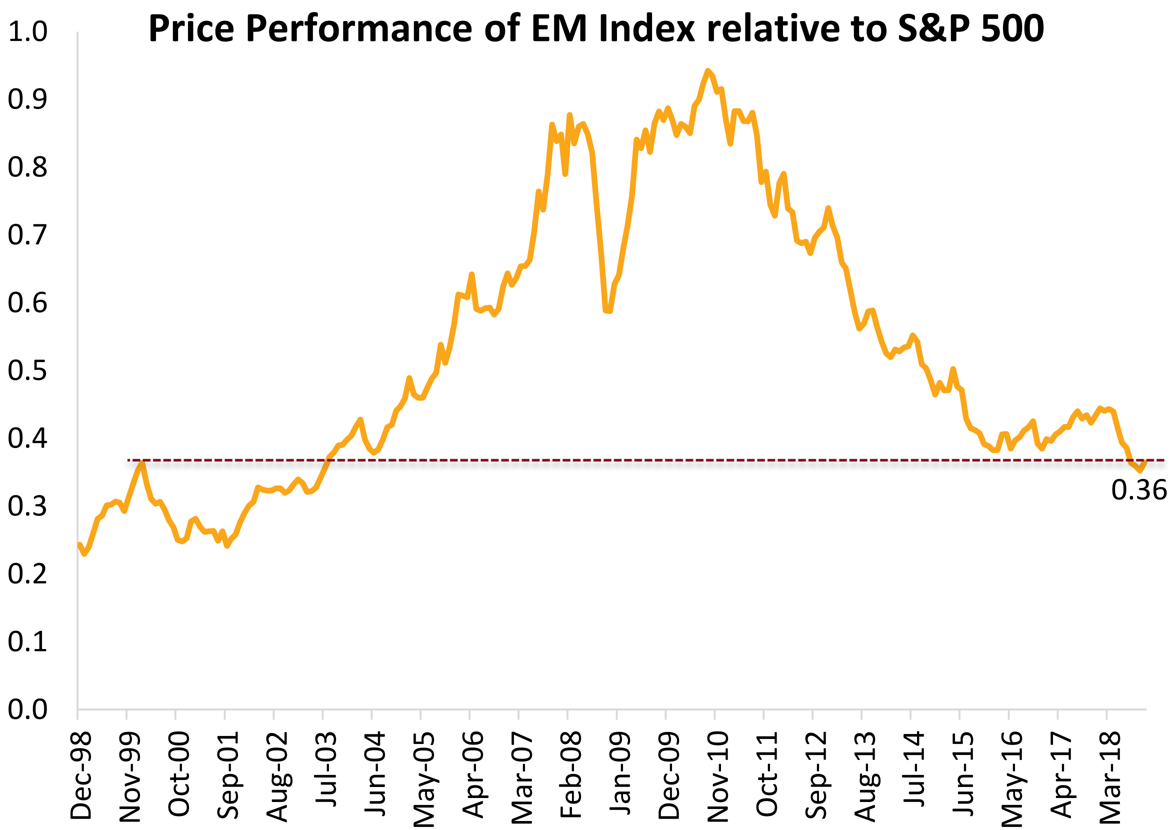
With utilizations for key sectors on an uptrend and steady demand growth, we are in the early stages of a capex cycle.

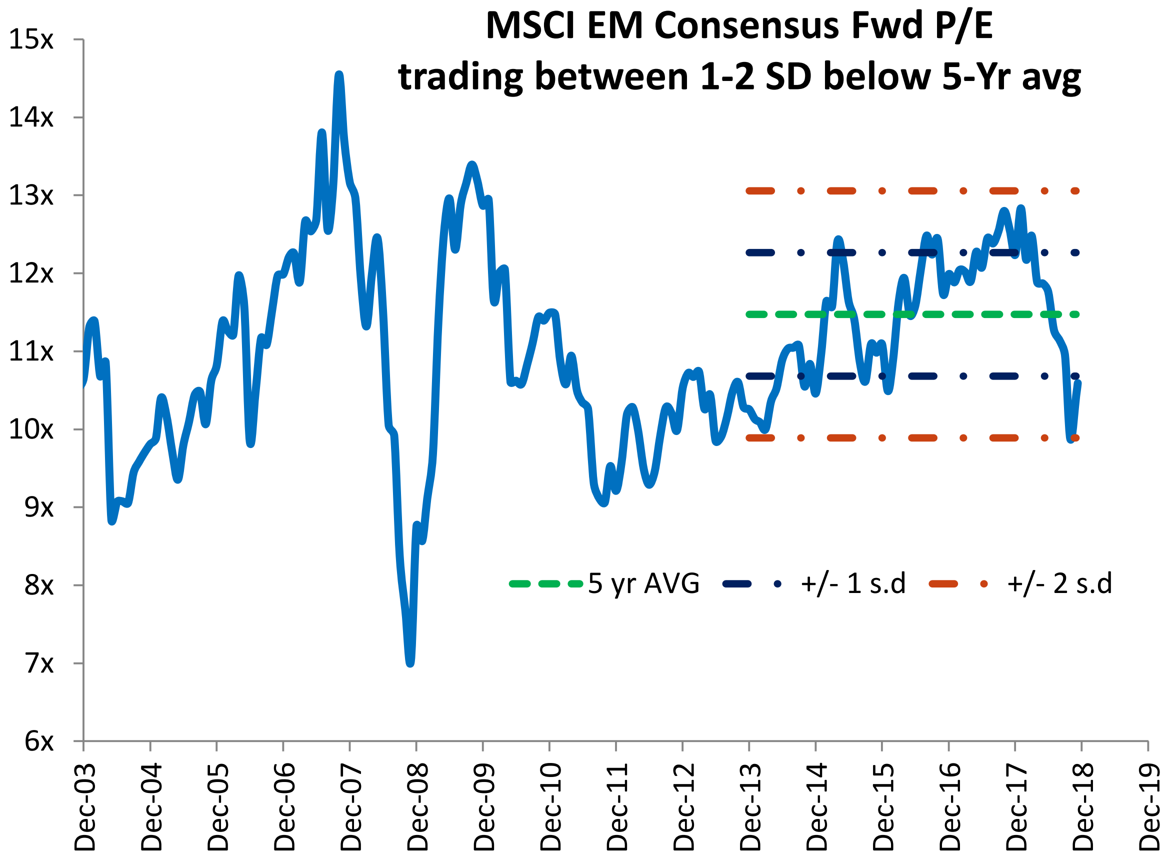
Source: CMIE, Credit Suisse, MOSL., ABSLAMC Research

FPI AND DOMESTIC EQUITY FLOWS

EM has underperformed DM; EM valuations are attractive

Price performance of EM index relative to S&P 500 (proxy for developed markets) has reached a ~20-year low. EM valuation is also between 1-2 std dev below 5-yr average.

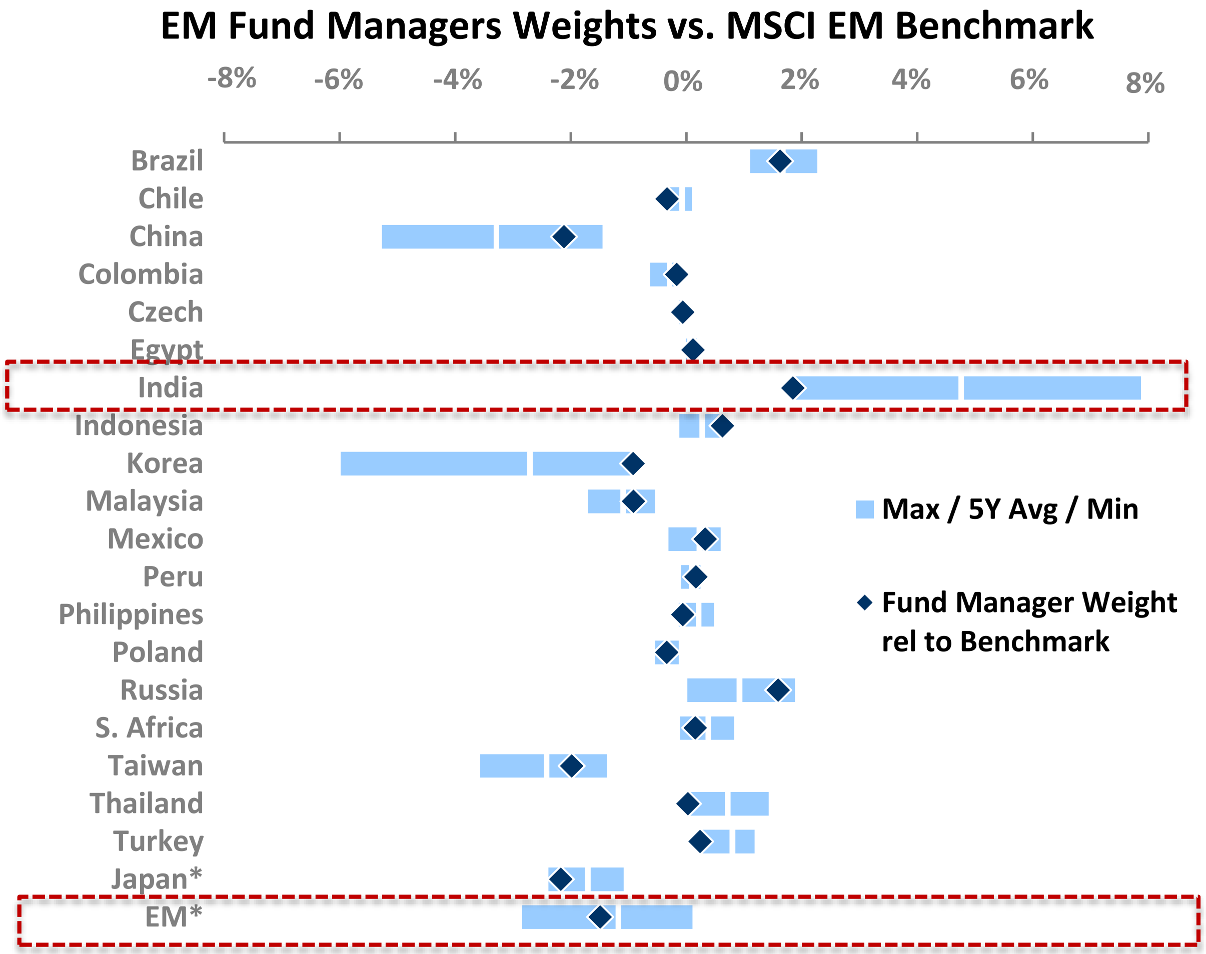




EM valuation has undershot and can re-rate from here

Source: Morgan Stanley, Bloomberg, ABSLAMC Research

Global equity investors' positioning in EM equities is low relative to historical average



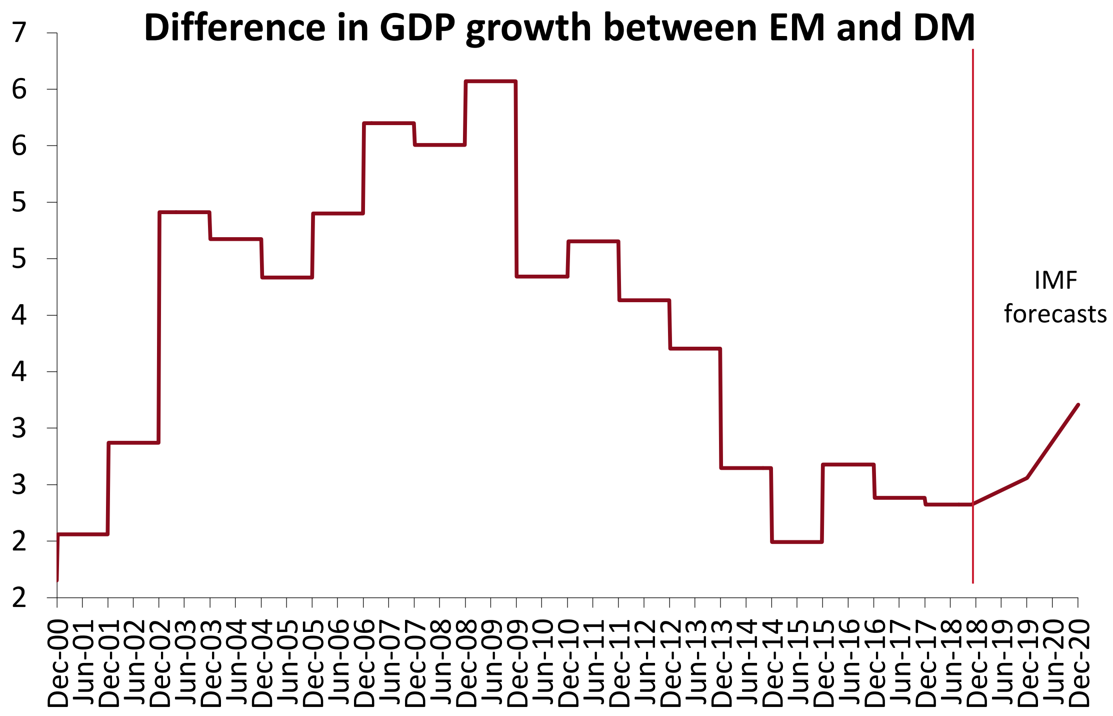
Data as of October 2018. *Japan and EM fund weights in global funds.

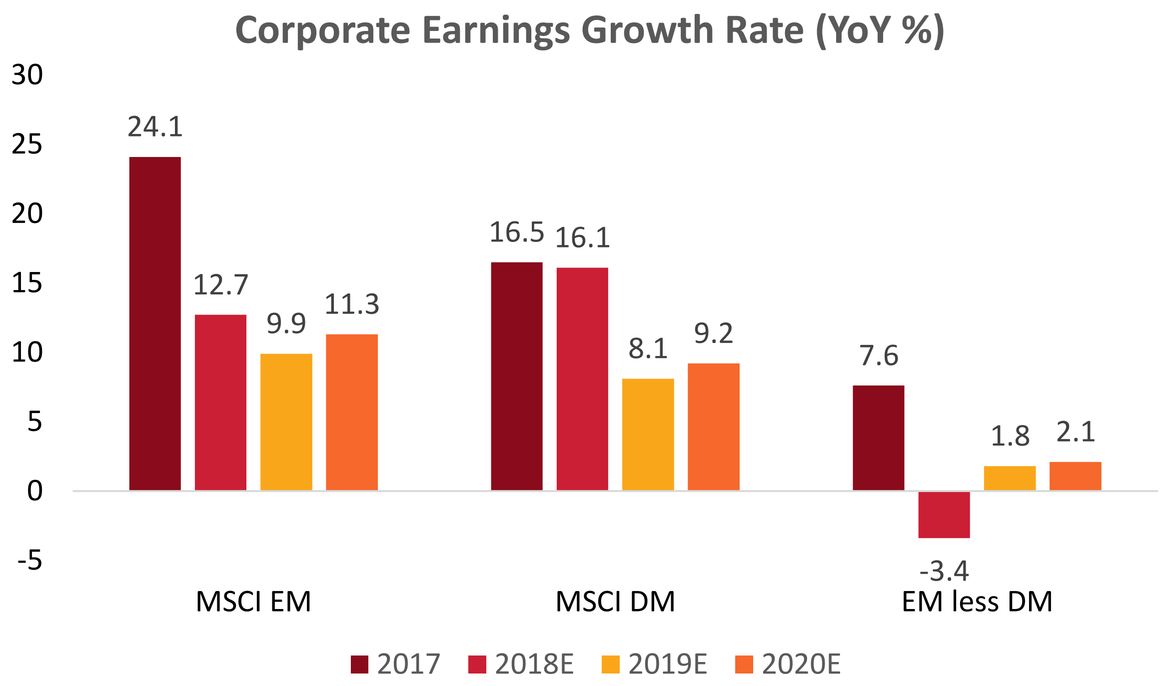
- Fund managers are currently under-weight on EMs. Asian EMs (excl. China) saw an outflow of USD 35 Bn in 2018.

- India has a high weight in the MSCI EM index. However, India is under-owned by EM Funds compared to the historical range.

As FPI outflows from EMs reverse, India should also see FPI flows coming back.

Source: EPFR Global, Morgan Stanley



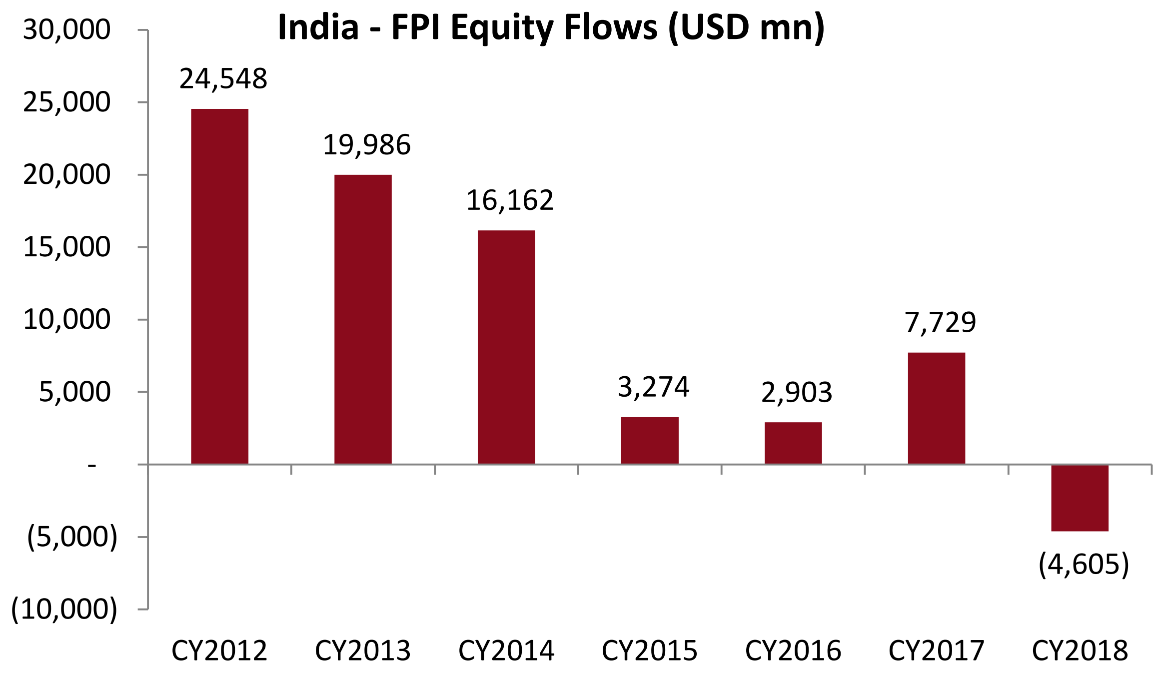


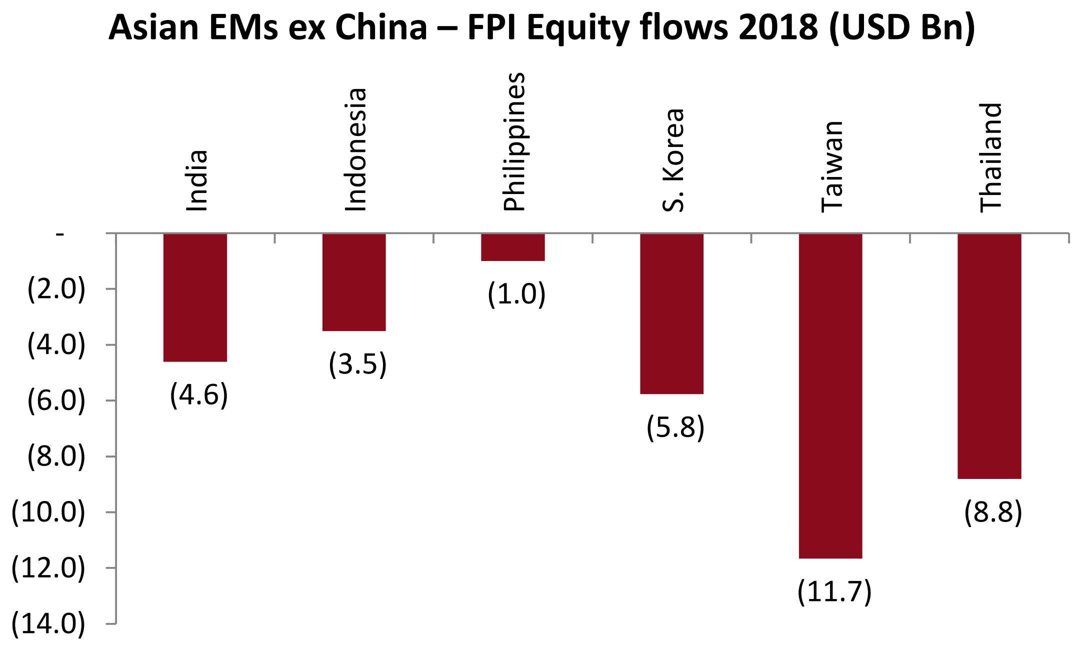
- Improving GDP growth differentials favour EM. The gap between EM and DM GDP growth is expected to widen in 2019 and 2020.
- Similarly, EM EPS growth rates are set to trump DM in 2019 and 2020 after lagging them in 2018.

Improving growth differentials, healthy balance sheets, investor positioning, and valuations suggest a favourable risk-reward for EMs.

Source: Morgan Stanley, Nomura

EMs, including India, will see a reversal of the FPI outflows seen in CY2018





- FPI Equity flows were negative in CY2018 in EMs, including India, due to Strong USD and increasing yields in the US, lower rate hikes in EMs, and high crude oil prices leading to widening deficits of oil importing countries such as India.
- Given the favorable risk-reward, EMs will see a reversal of the FPI outflow. However, with the QE wind-down, liquidity will be moderate and fund managers will be selective.

India can expect to see a reversal of the FPI outflow, given its steady high growth and stable macro fundamentals.

Source: Bloomberg, Kotak, ABSLAMC Research

Tremendous potential for domestic investor ownership to increase

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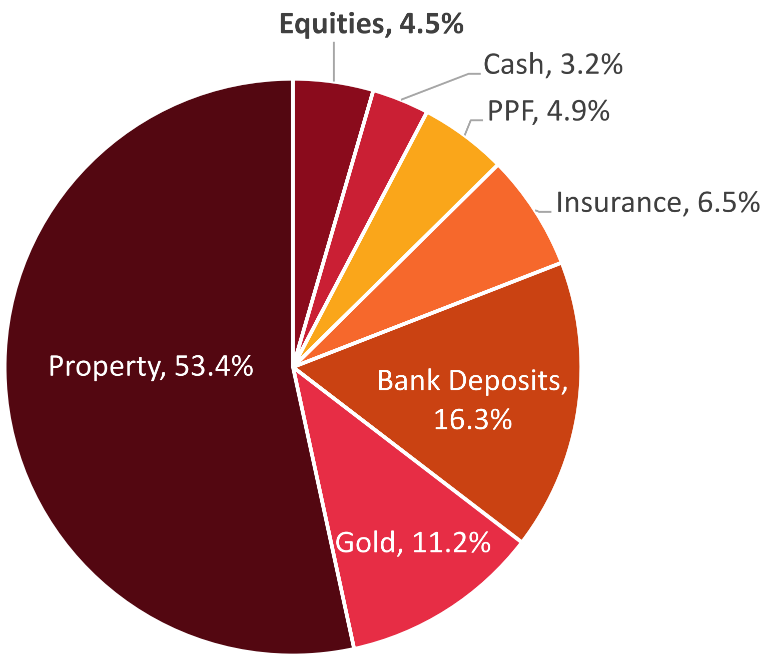
Household Asset Holding



Total Household Assets

Mar’18: Rs 575 Trn (USD 8.2 Trn)

- Equity ownership is low in Indian households even after demonetization
- However, financialization has unlocked household savings which were locked up in relatively less productive hard assets like gold and real estate.
- Flows to Mutual Funds (MF) should sustain as long as:
  - Further equity rally is driven by earnings growth
  - Non performance of Real Estate as an asset class
  - Gold remains weak – which is the case if global inflation behaves
- With the government’s push, the Employees’ Provident Fund Organization (EPFO) has invested up to 15% of investable assets i.e. INR 50,000 Cr in ETFs.
- Rs. 10,000+ crore of committed monthly inflow into market (7.5-8.0K - MF SIP, 2.0-2.5K – EPFO/NPS)

Financialization has unlocked household savings and will lead to increased equity ownership.

Source: Morgan Stanley, ABSLAMC Research

Domestic Equity inflows have sustained even as FIIs have been net sellers

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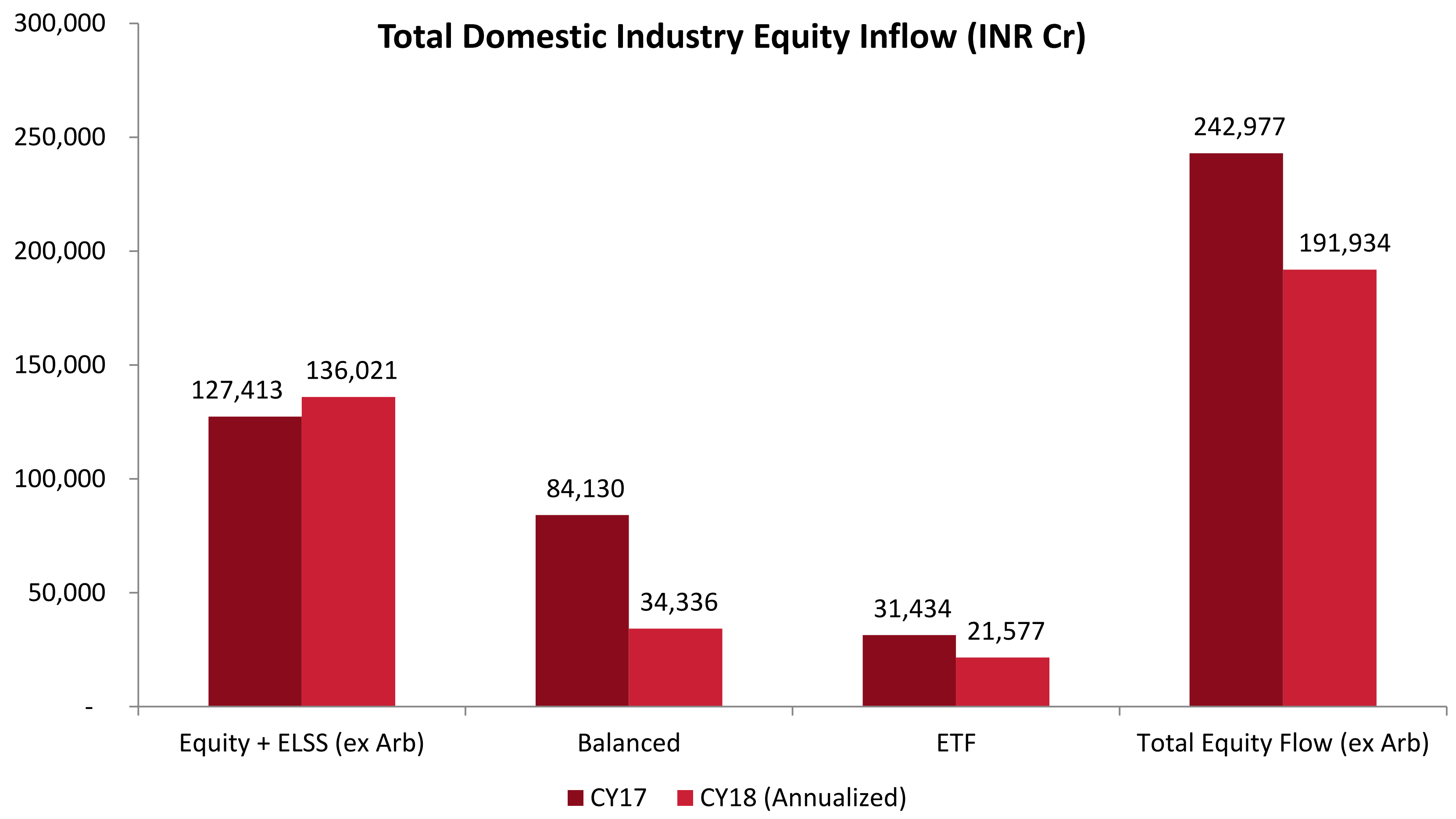

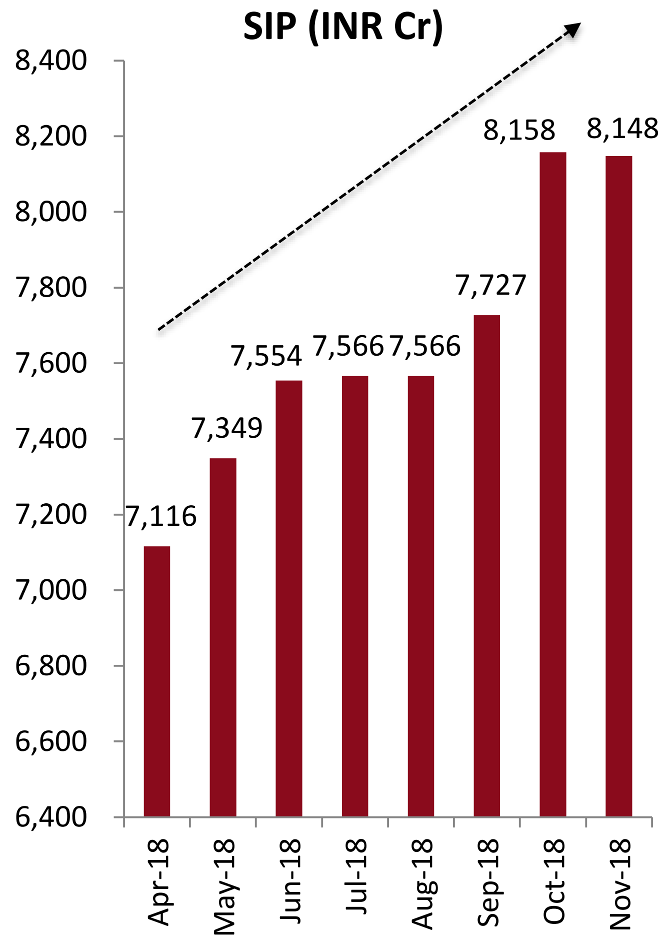

Industry Equity inflows will remain strong despite market volatility, on the back of a steady SIP book

Source: AMFI; ABSL Research

Summary: 2019 Outlook – India View

1. External stability will return with range-bound crude prices. CAD projected at ~2.5% for FY19. Rupee should also stabilize in the INR 69-73 per USD range if crude prices stabilize. Govt. spending may be constrained due to fiscal pressure.

2. Inflation expected to normalize towards 4% level and remain within RBI's comfort zone. RBI to remain on hold till Q1 2019 with a possible change in stance if inflation remains subdued. 10-Yr Gsec yield can be in the 7.00 – 7.50% range.

3. India GDP growth will continue to be steady with marginal improvement driven mainly by Private consumption and supported by investment in infrastructure. Bank NPLs having peaked and NPL resolutions are in progress. With banks stepping in for NBFCs, credit growth will remain strong.

4. RERA and Affordable Housing will be key drivers for Household capex in the future. Govt. will continue its push in infrastructure, especially Roads (Bharatmala) and Railways (Dedicated Freight Corridor). Green shoots of recovery visible in industrial capex as Capacity Utilization has risen to 75%+.

5. Favorable risk-reward for EM with improving growth differentials vs DM, supportive macro, healthy balance sheets, light investor positioning, and reasonable valuations. India and other EMs to see FPI inflows. Domestic liquidity to sustain with steady SIP flows.

2019 – Outlook

Market View

EARNINGS GROWTH AND VALUATION

Nifty50 Earnings Growth trajectory

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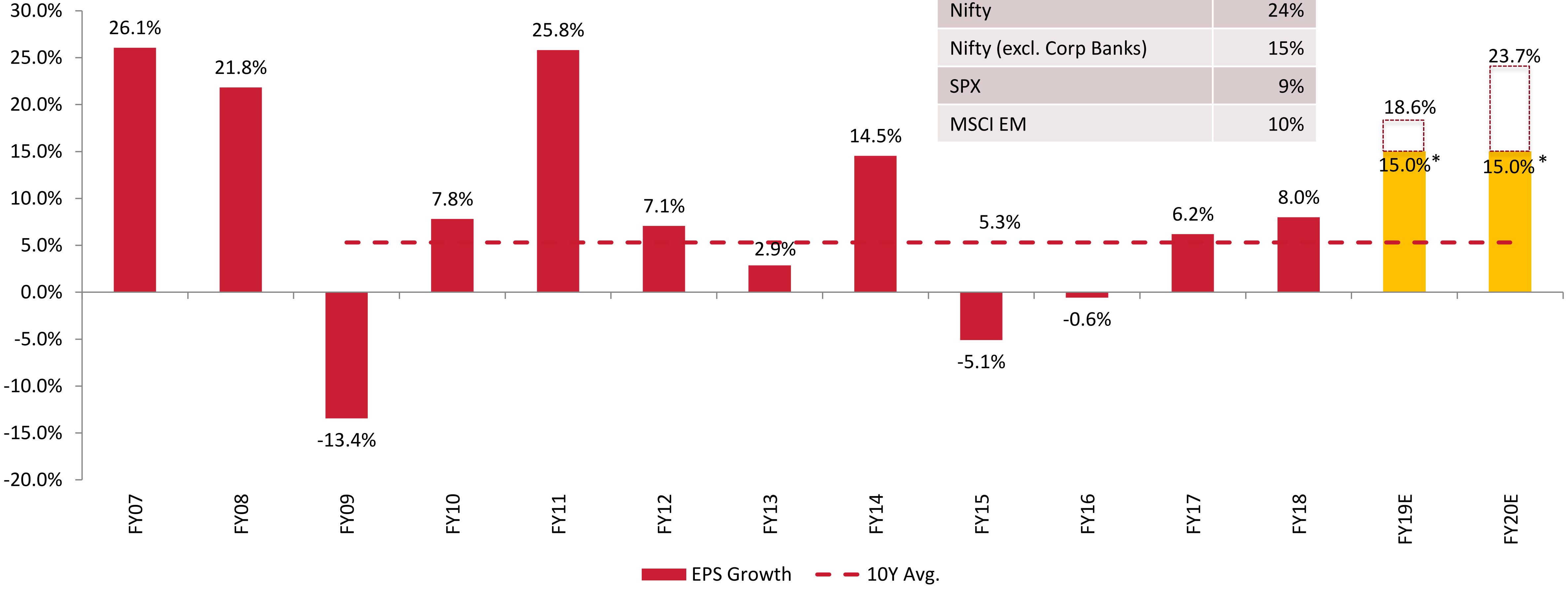
Nifty50 EPS Growth



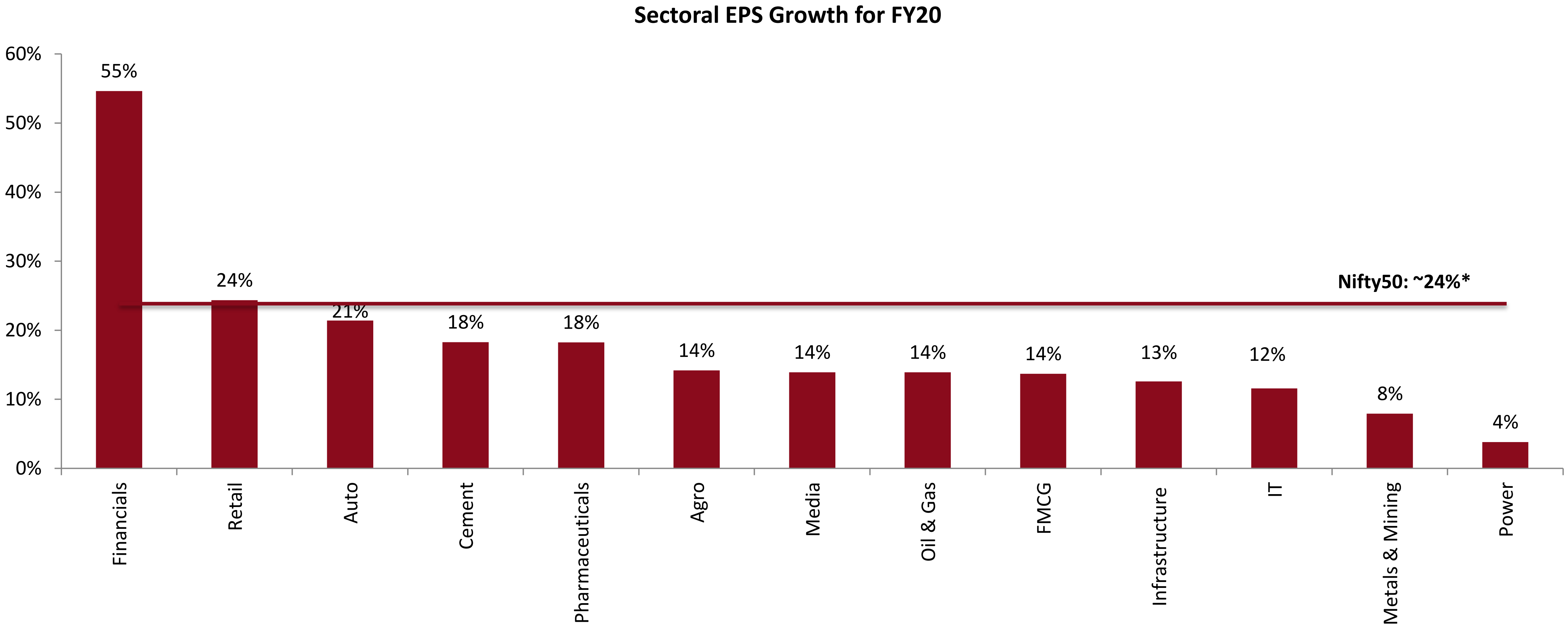
FY20E earnings growth	
Nifty	24%
Nifty (excl. Corp Banks)	15%
SPX	9%
MSCI EM	10%

With steady economic growth, earnings growth of ~24% for Nifty (15% excl. Corp Banks) in FY20 seems achievable.

* Excluding Corporate Banks (SBI, ICICI, Axis)

Source: ABSLAMC Research

Sectoral adjusted profit growth estimates



Broad based growth expected.

* FY20E earnings growth for Nifty excluding Corporate Banks (SBI, ICICI, Axis): 15%

Source: ABSLAMC Research

Corporate Profits are showing signs of having bottomed out

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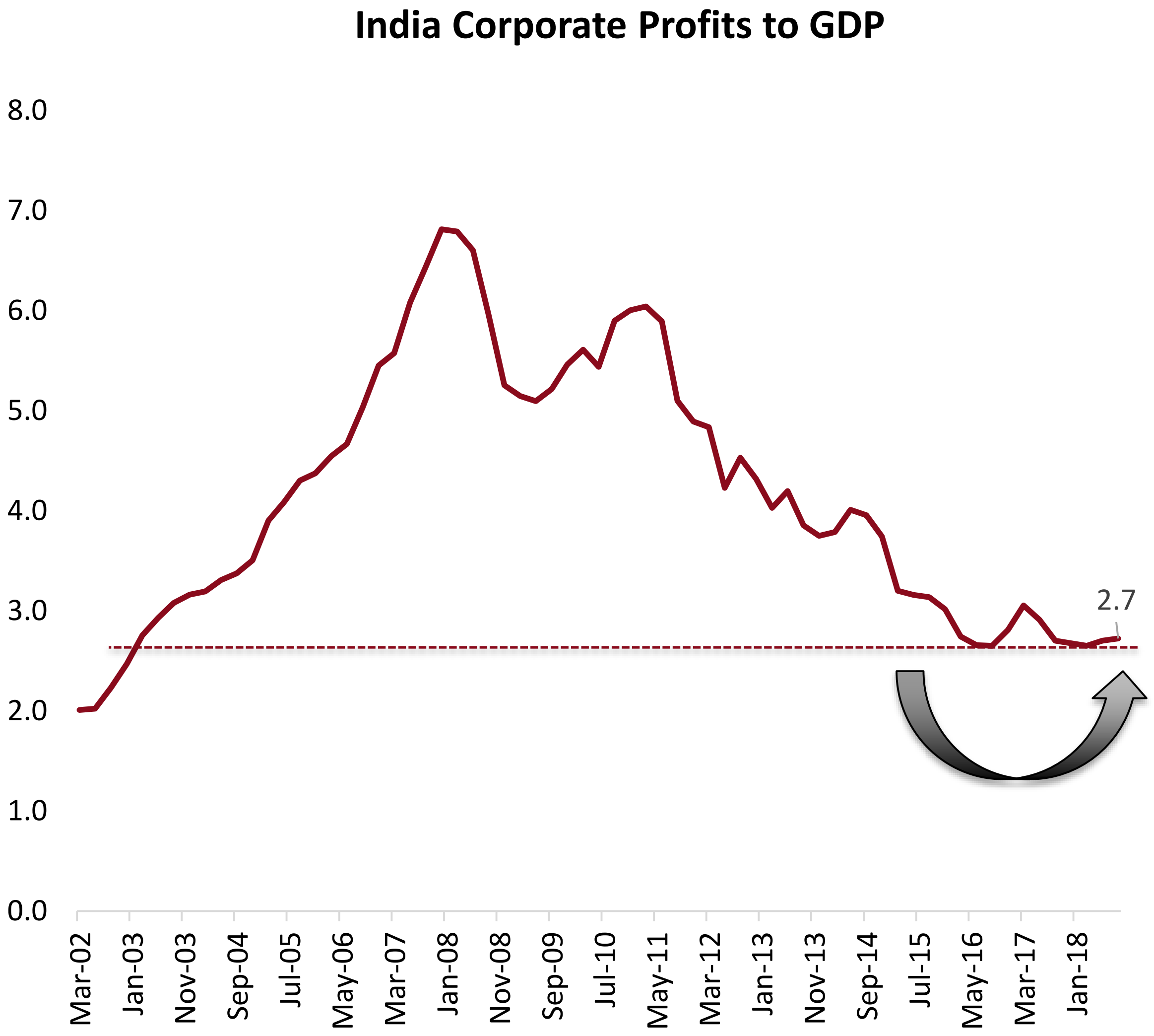

- Corporate profits had declined over the past decade to a 15-yr low due to factors such as slower economic growth, high leverage, implementation of Demonetization & GST, and NPLs in the Banking sector.
- There is a strong inverse correlation between the Corporate Profits-to-GDP ratio and next five-year earnings. A low ratio indicates the bottom of the corporate earnings cycle, which is followed by a strong earnings recovery.
- Currently the ratio is less than half of the level in 2007 and is showing signs of having bottomed out.
- Going forward, corporate profits should improve as businesses have adjusted to the policy changes, domestic consumption remains steady, and macro fundamentals are in place.

Source: Morgan Stanley

Nifty valuation has risen as earnings have been depressed over the past couple of years

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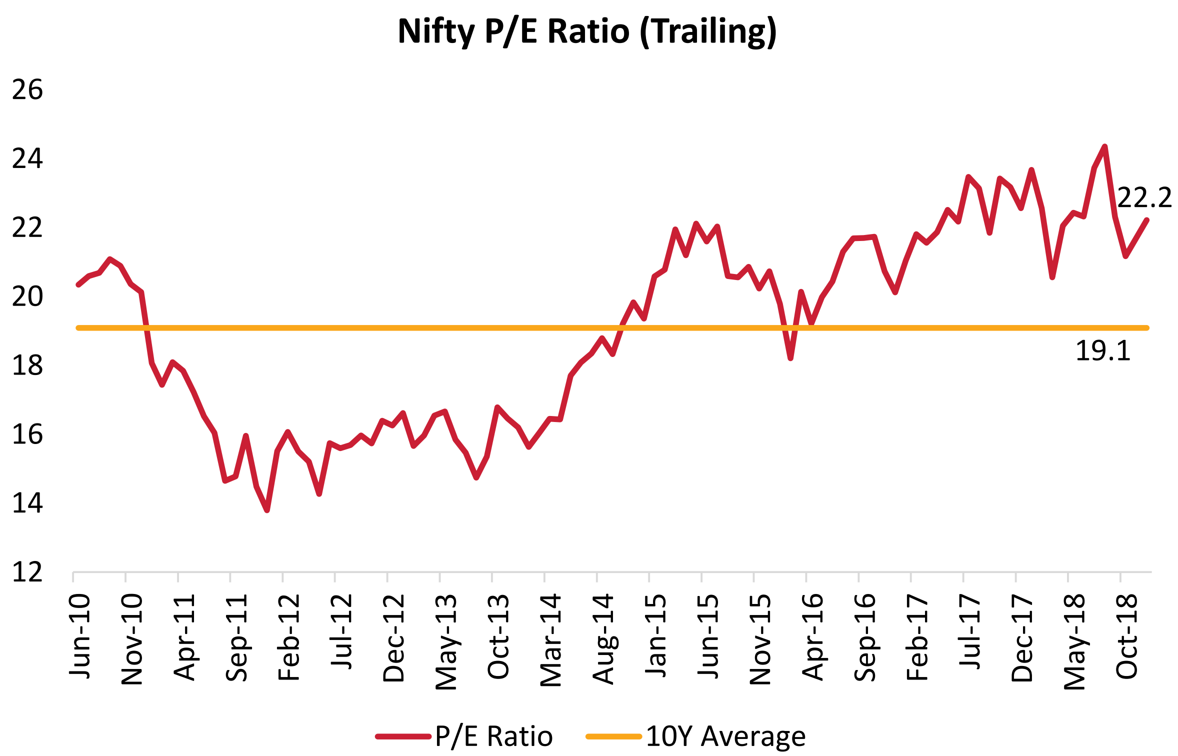
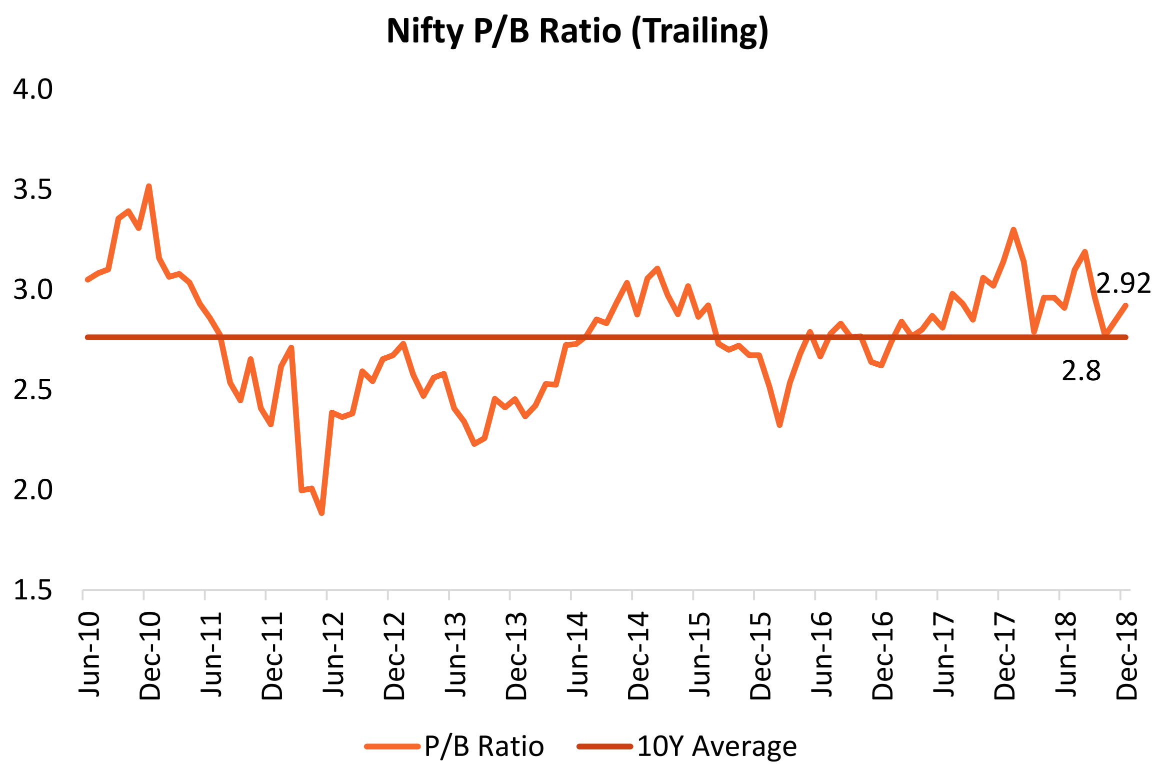
Nifty trailing P/E Ratio is trading higher than its 10-Yr average



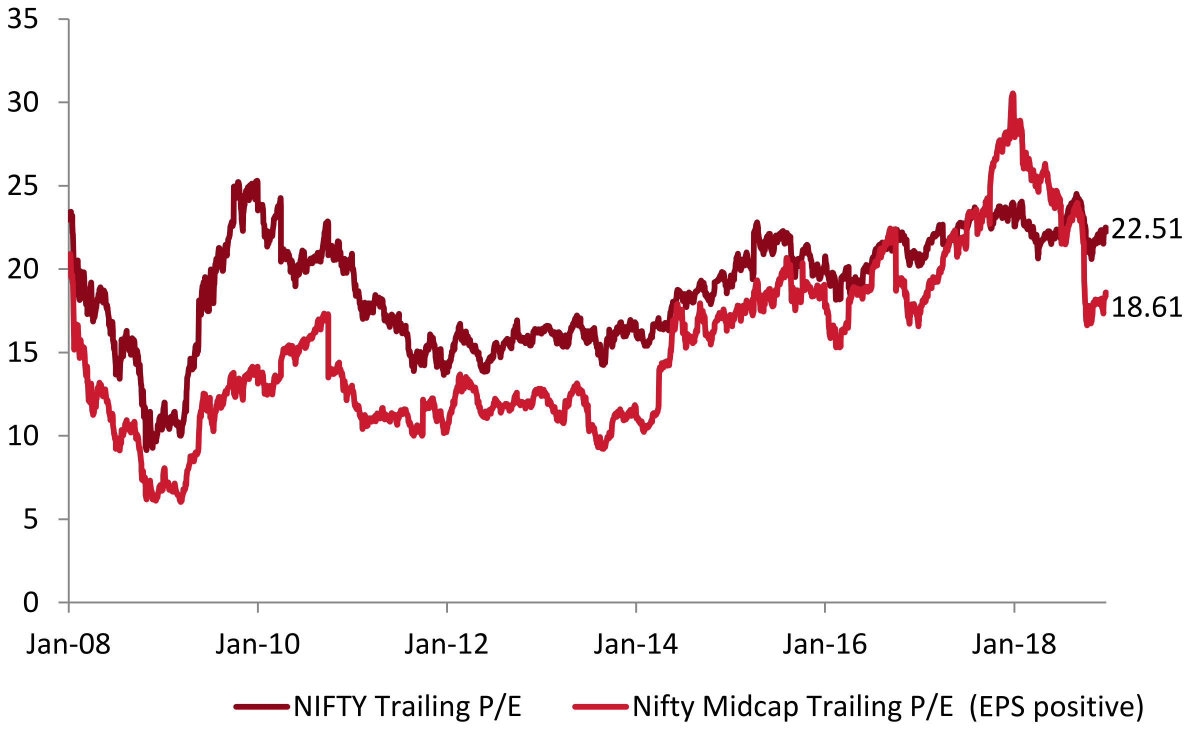
Nifty trailing P/B Ratio is trading close to its 10-Yr average



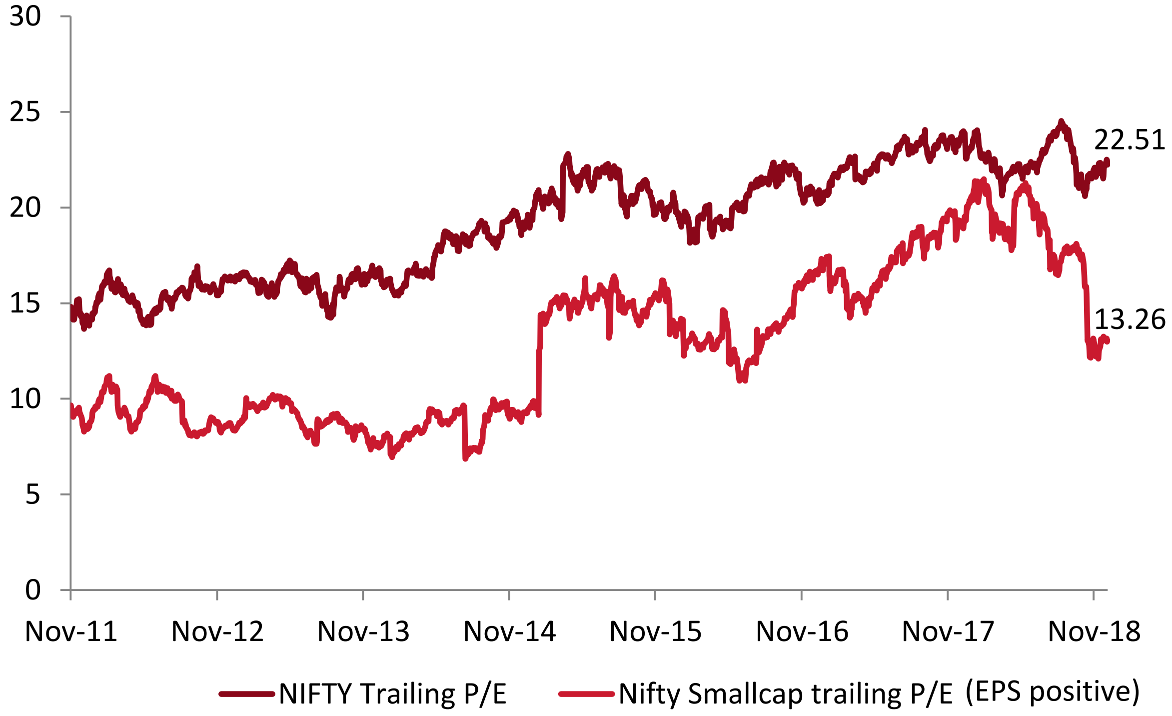
2018 was a year of consolidation and earnings have caught up with markets.

Source: Bloomberg, ABSLAMC Research

Midcap index is currently at a discount to the Nifty index



Smallcap index is currently at a large discount to the Nifty index



Source: Bloomberg, ABSLAMC Research

KEY RISKS

Key Risks

Global Macro

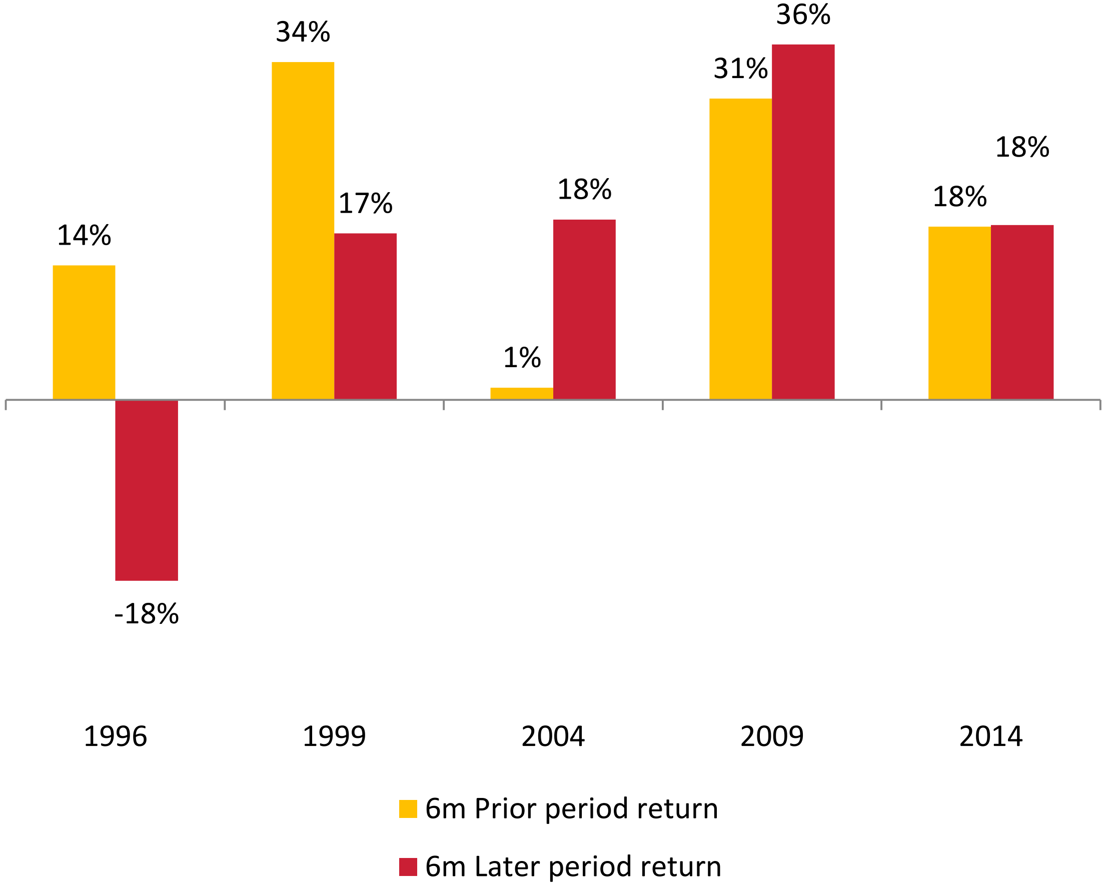
Higher oil prices due to supply cuts while global demand remains strong.

Escalation of trade war and hard landing in China, which will impact other economies also.

Domestic Factors

General Elections in May'19 clouds economic and market outlook. Government focus may shift away from development and tilt towards populism.

Returns around elections have been mostly positive



- The General Election scheduled this year clouds the economic and market outlook. However, the uncertainty will be over by H1CY19.
- Analysis of market performance around past General Elections shows that returns in the 6-month period both before and after elections have been mostly positive.
- Also, FPI flows have generally picked up after election uncertainty is over.
- While elections can lead to short-term blips, the market reverts to fundamentals shortly thereafter, and market performance is driven mainly by the strength of the economy.

Every election seems important for markets; However, market performance has no correlation with political outcomes.

Source: ABSLAMC Research

SECTOR-WISE OUTLOOK

Key Sectors Outlook (1/4)

Automobiles	Neutral
✓ As expected, sales of 2W and 4W were tepid during the festive season, and we expect the softness in demand to continue in the near term on account of overall higher cost of purchase ✓ In CVs also, we may see some impact on sales in the near term due to liquidity issues faced by NBFCs	

Banking & Financials	Positive
✓ Corporate Banks will see normalization in FY19 but pain on provisioning to continue, for PSU banks (except SBI, Bank of Baroda) capital continues to remain issue ✓ Select private sector banks and select NBFCs continue to show good growth outlook, profitability & capital ratios ✓ Interest rates/liquidity scenario and slower NPL resolutions remain key risks ✓ Life Insurance and General Insurance companies offer promising opportunities due to high growth driven by low penetration and increasing financialization of savings	

The Scheme(s) may or may not have any present or future positions in these Sectors and should not be construed as promise, guarantee on or a forecast of any minimum returns

Source: ABSLAMC Research

Oil & Gas	Neutral
✓ Moderation in refining margins and government interference in petroleum product pricing would cap the upside in the sector ✓ Good business model, high quality earnings growth, and utility nature of the business will drive market cap of Gas stocks	

Metals	Positive
✓ Low inventories and lack of supply growth to support metal prices ✓ Balance sheets have been strengthened though acquisition could restrict cash return to shareholders. ✓ Valuations are reasonable & risk-reward is evenly balanced	

Infrastructure, Capital Goods & Construction	Positive
✓ Road and railways remain the area of focus, Road has strong ordering pipeline under Bharatmala of 65000 Km for the next 4-5 years and Railways has plans to electrify 15,000 Km in next 3 years ✓ On Private industrial capex we are seeing some sign of greenshoots as announcement of capex from Cement and Metal companies have gathered pace ✓ Currently the base order (short cycle) are growing >20% reflecting the thrust of government expenditure on ground	

The Scheme(s) may or may not have any present or future positions in these Sectors and should not be construed as promise, guarantee on or a forecast of any minimum returns

Source: ABSLAMC Research

Key Sectors Outlook (3/4)

Consumer Durables	Positive

- ✓ Lower penetration across categories and improving affordability makes for a structural investment case for the sector. Rural electrification & rural growth which will lead to increase in demand
- ✓ Valuations have corrected meaningfully due to broad market sell off and stocks look attractive at current levels

Consumer Non-Durables	Neutral

- ✓ Government focus on rural growth and election spending will help accelerate rural demand
- ✓ GST lead savings due will continue which will help maintain margin
- ✓ Good monsoon augers well for demand
- ✓ Valuation at elevated levels

Information Technology	Neutral

- ✓ Increased investments in front end, UI, and cloud migration driving better demand for companies
- ✓ Weaker INR already factored in the earnings and unlikely to see further upgrades
- ✓ Uncertainty due to Brexit and concerns of slowdown in US economy can impact technology spending going into CY19

The Scheme(s) may or may not have any present or future positions in these Sectors and should not be construed as promise, guarantee on or a forecast of any minimum returns

Source: ABSLAMC Research

Telecom	Negative
✓ Competitive intensity remains high and incumbent's balance sheet remain stressed. Reliance JIO continues to be aggressive in the market and tariffs are unlikely to increase until it achieves disproportionate subscriber and revenue market share	
Pharmaceuticals	**Neutral**
✓ Challenges in US generics market continue. Expect companies to report muted revenue growth in FY19 and most of the companies are undertaking imminent costs control which would help earnings recover to FY17 base ✓ Indian market, accounting for 25-50% of revenues, look attractive with 12-14% CAGR growth for the next 3 years ✓ Earnings multiple continue to be rich compared to global peers	
Cement	**Negative**
✓ Improving volume growth trend and rising utilization to trigger operating leverage benefits ✓ Valuations already factoring in large of part of growth hypothesis	

Source: ABSLAMC Research

Summary: 2019 Outlook – Market View

1. With fall in crude prices, stable currency, and steady economic growth, we should see earnings growth of ~24% for the Nifty (15% excl. Corporate banks) in FY20E. Broad-based growth will remain supportive of markets.
2. 2018 was a year of consolidation. With earnings catching up, valuations have corrected. Nifty index valuation at 17-18x one year forward earnings multiple is ~10% higher than long-term average. However, considering better earnings visibility, valuations are reasonable. Midcap and smallcap valuations are at attractive levels.
3. An improving growth outlook should drive markets to scale new highs in 2019. We should see returns in the low teens.
4. Key risks which cloud the economic and market outlook are higher crude oil prices, escalation of the trade war and a hard landing in China, and political uncertainty due to General Elections in May’19.
5. Themes of Interest are Financials (Private banks, Corporate banks and select NBFCs) and Consumption (Consumer and Consumer Discretionary).

Call to Action! Investors should continue to build equity exposure for long term. Investment through SIPs/STPs recommended for the next 6 months. It would be prudent to allocate 20% of corpus to mid-and-small cap funds.

2019 – Outlook

Summary

World View

- Slight slowdown in global growth with soft landing in US, calibrated slowdown in China, and sustained growth in EM.
- Supportive macro backdrop with dovish Fed, capped USD strength, and range-bound oil prices.
- EM in good shape with favorable growth differential vs DM, receding external headwinds & repaired balance sheets.

With a revival on the cards, risk-reward will become favorable for EM.

India View

- Steady GDP growth driven by private consumption and supported by investment in infrastructure.
- Macro stability with favorable oil prices, stable INR, benign inflation, and manageable twin deficits.
- EM, including India, will see FPI inflows. Domestic liquidity will sustain with steady SIP flows.

Underperformance will bottom out and India will see a recovery along with other EMs.

Market View

- Earnings growth of ~24% for Nifty (15% excl. Corp Banks) in FY20E, With Nifty forward P/E at 17-18x, valuations are reasonable.
- Key risks are higher oil prices, escalation of trade war and hard landing in China, Elections in May'19.
- Themes: Financials (Private banks, Corporate banks, select NBFCs), Consumption (Consumer and Cons. Discretionary)

We should see returns in the low teens. Midcap and smallcap valuations are attractive.

Abbreviations

Abbreviation	Description	Abbreviation	Description
GDP	Gross Domestic Product	FII	Foreign Institutional Investors
GST	Goods and Services Tax	DII	Domestic Institutional Investors
IBC	Insolvency and Bankruptcy Code	SIP	Systematic Investment Plan
RERA	Real Estate Regulation Act	EFPO	Employees' Provident Fund Organization
PSU	Public Sector Undertakings	NPS	National Pension Scheme
USD	United States Dollar	CPI	Consumer Price Index
CY	Calendar Year	WPI	Wholesale Price Index
FY	Fiscal Year	CAB	Current Account Balance
DM	Developing Markets	CAD	Current Account Deficit
EM	Emerging Markets	IMF	International Monetary Fund
FPI	Foreign Portfolio Investors	BoJ	Bank of Japan
GFCF	Gross Fixed Capital Formation	ECB	European Central Bank
NCLT	National Company Law Tribunal	Fed	Federal Reserve
IRR	Internal Rate of Return	BoE	Bank of England
FCF	Free Cash Flow	OPEC	Organization of the Petroleum Exporting Countries
IRAC	Income Recognition Asset Classification	EPS	Earnings per Share
CLS	Credit Linked Subsidy	ERR	Earnings Revision Ratio
EWS	Economically Weaker Section	FMCG	Fast Moving Consumer Goods
LIG	Low Income Group	RoE	Return on Equity
MIG	Medium Income Group	NBFC	Non-Banking Financial Company
PMAY	Pradhan Mantri Awas Yojana	FRDI	Financial Resolution and Deposit Insurance
MSP	Minimum Support Price	NHAI	National Highways Authority of India
IGST	Integrated Goods and Services Tax	MoRTH	Ministry of Road Transport and Highways
IIP	Index of Industrial Production	ARPU	Average Revenue per User
PMI	Purchasing Managers' Index	bbl	Barrel

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