Narnolia®

Market Perspective - Jan 2023

India Equity Outlook

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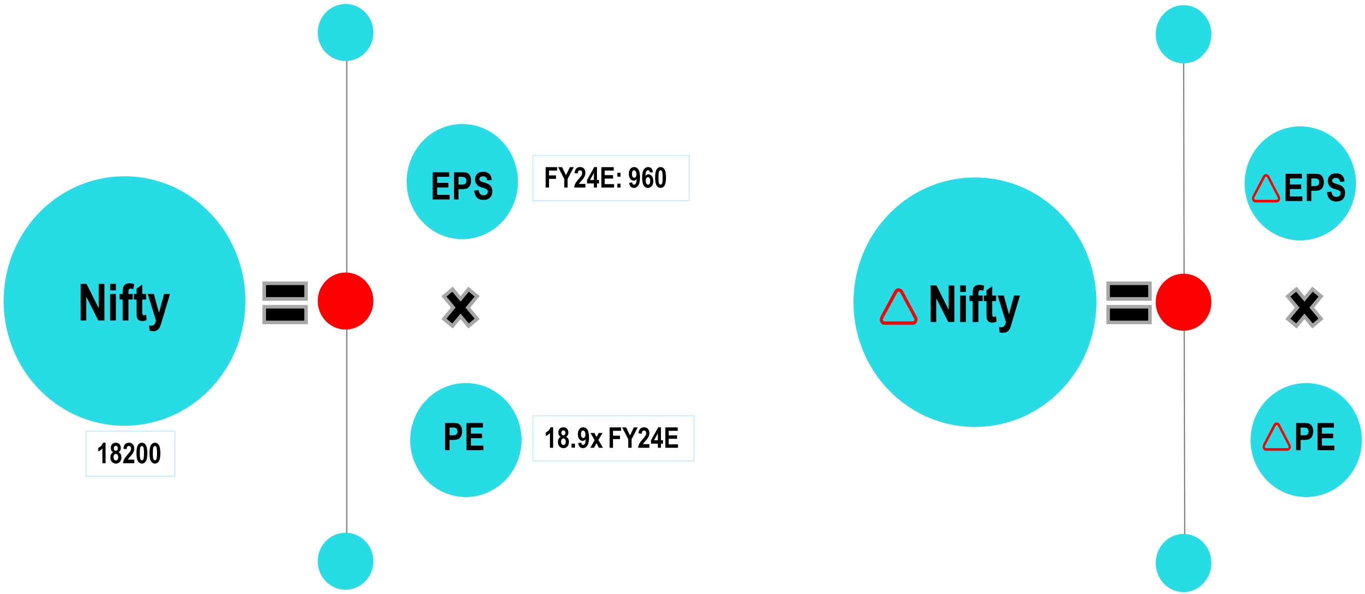
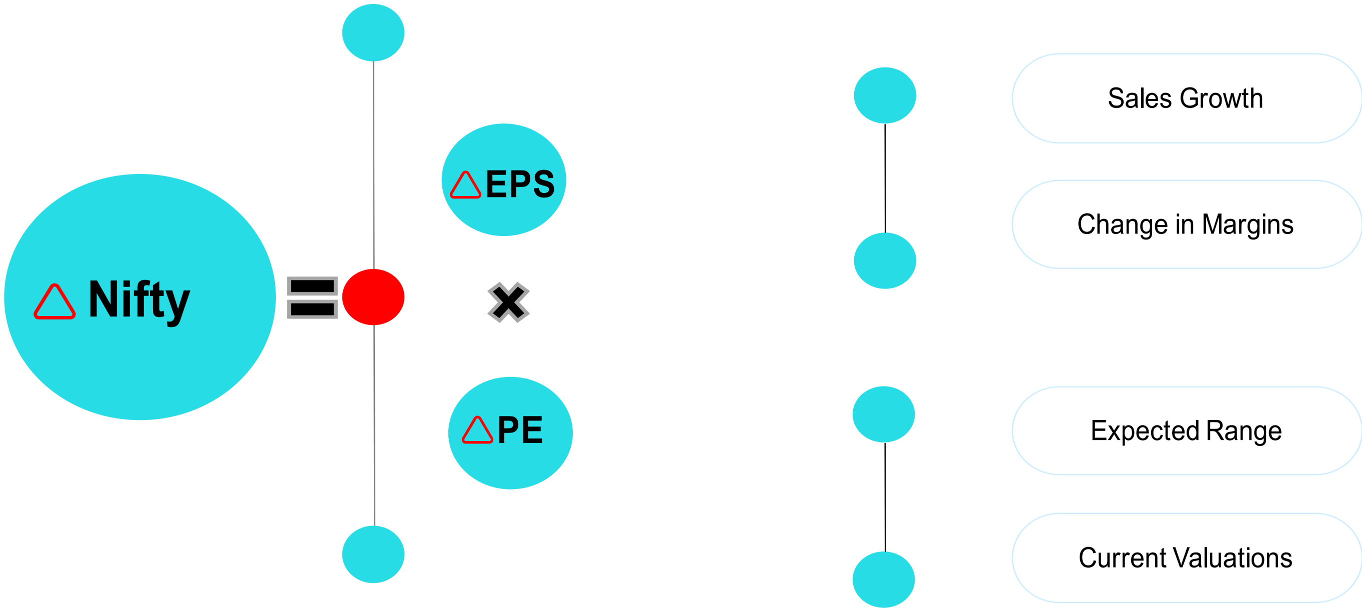
Source : Narnolia Financial Services Ltd | SEBI Registration No.- INH300006500

Quantitative Framework of Price



In a fundamental sense, to understand the Price movement, we need to understand the Earnings and the Valuation multiple as Price= EPS x PE. Currently Nifty level of 18200 is a product of Nifty FY24E EPS of 960 and fwd PE multiple of 18.9X.

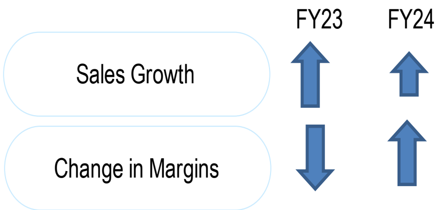
Bottom Up Factors affecting Changes in Price



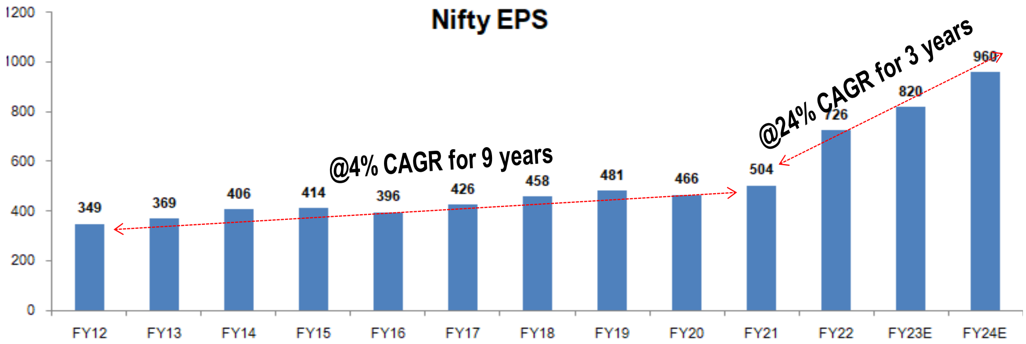
To know the forward earnings, it is important to predict the Sales Growth and Margins of the company.
Similarly, for knowing the future multiple, we need the current valuation and forecasted range of PE going forward.

Nifty EPS- FY23E & FY24E

	FY22A	FY23E	FY24E
- Topline Growth %		17%-19%	6%-8%
- EPS Growth %		12%-14%	15%-20%
Nifty EPS	726	815-835	950-1003
Private Consumption	1292	1987	2636

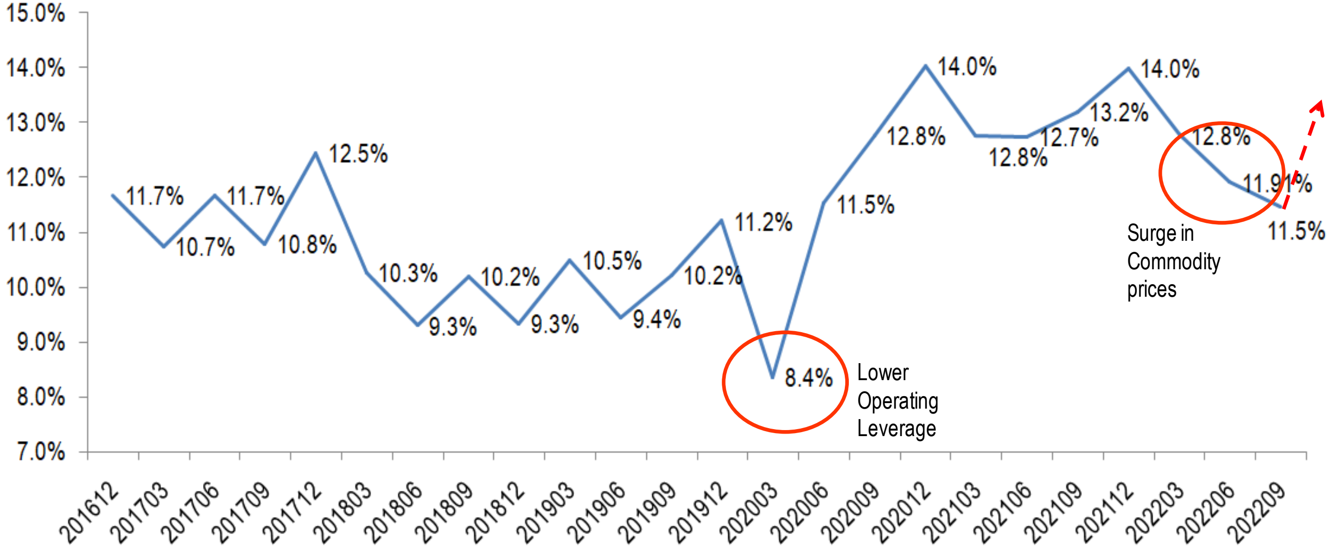


We are confident of FY23E 820 & FY24E as 960



In FY23, expected topline growth is 17-19% and profit growth is 12-14% implying that margins are falling. In FY24, Sales growth is expected to be low around 6-8% owing to factoring in recession and also base effect of increase in prices etc, but margins of FY24E is expected to increase as Profit growth is expected to be high in the range of 15-20%

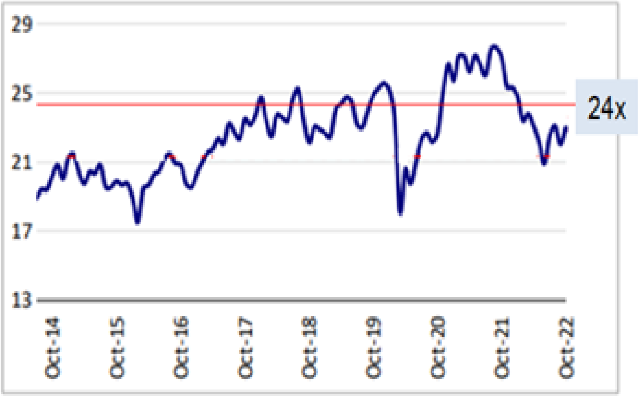
Net Profit Margin of NIFTY 500 to get better in coming quarters



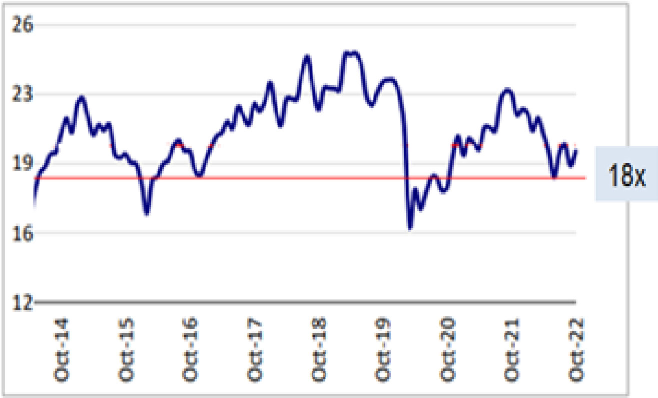
In Mar 2020, margins of companies fell down due to lower operating leverage. As sales shrunk and fixed costs remained elevated, there was a contraction in margins. This was however shortlived and as Sales revived margins continued with their upward trajectory movement. Towards end of FY21, margins made a peak of 14% and has fallen after that owing to Russia–Ukraine led commodity price increase. However, as commodity prices have cooled off, we expect margins to bounce back from hereon.

Nifty Valuations Range over the last 8 years

Upper Range - Trailing 24X



Lower Range - Forward 18X



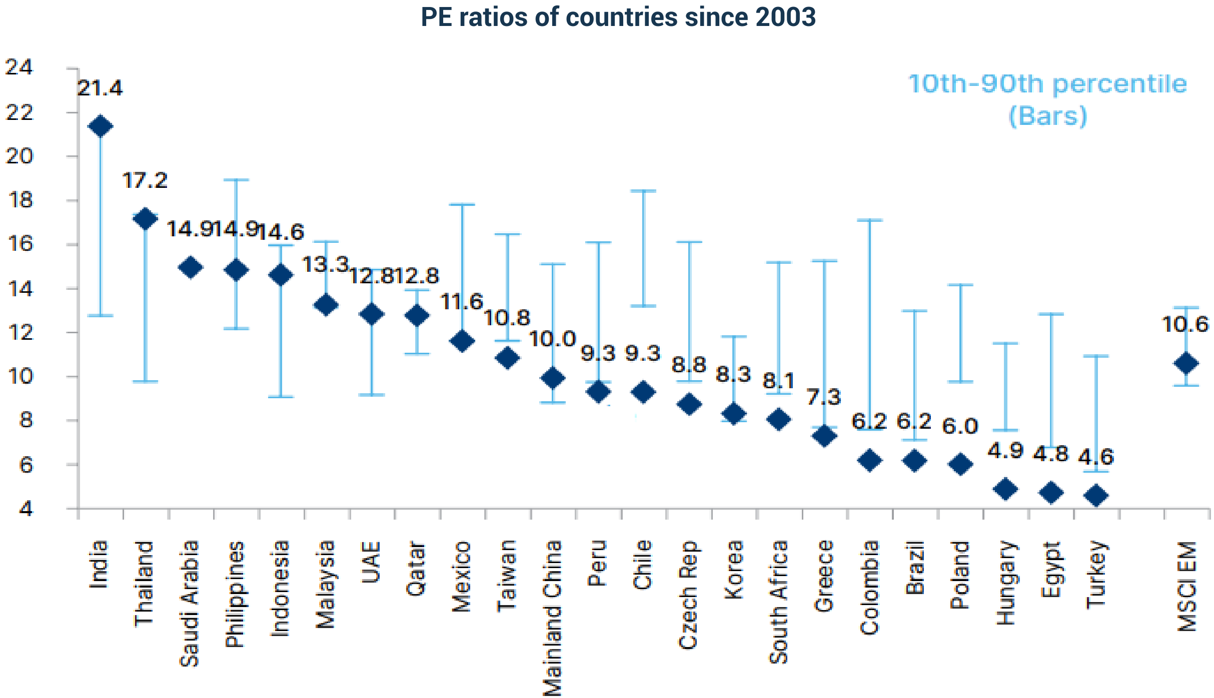
The above chart displays trailing and forward PE trend. As we entered the Modi Government regime, PE chart since 2014 gives a clear picture of market movement. Since 2014, PE upper range is of 24x on trailing earnings basis and lower range of 18x on forward earning basis. Nifty has usually risen from the level attained at 18 times one year forward EPS.

Expected Nifty Movement Range

	Dec 2023	Dec 2024
Lower Range (18x fwd 1 yr EPS)	19200	21200
Upper Range (24x trailing EPS)	21500	23500

Currently the Nifty trades at 18200. Considering EPS of 820 in FY23 and 960 in Fy24 and valuation range of 24x trailing EPS and 18x forward EPS, we can arrive at the range of Nifty movement by Dec 2023 and Dec 2024.

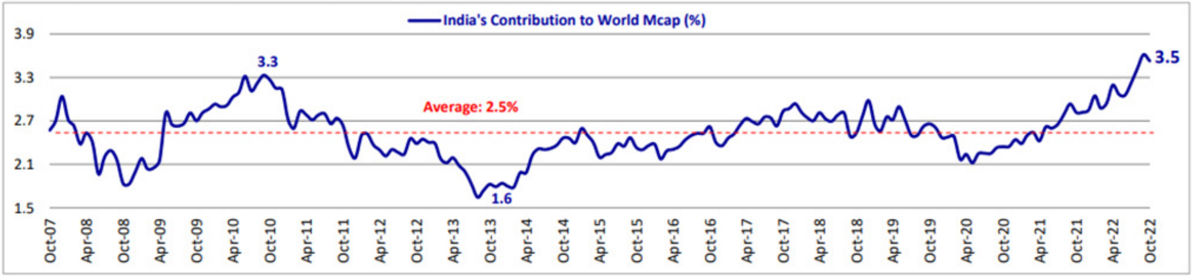
India Valuation Puzzle-Bottom up Perspective

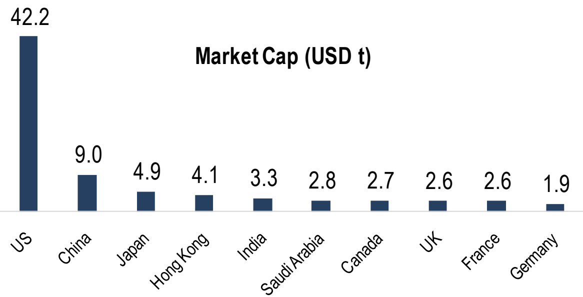


Considering indexes movements across globe, India may appear costly vis a vis other important stock markets of the world. Since 2003, India's PE has ranged from 12.5 to 21.4 and is the highest amongst major economies of the world.

Are the Valuations expensive?-Size Perspective

Trend in India's contribution to world m-cap (%) – at its all-time high





India GDP ~ 3.28% of World GDP BY 2030 at 7-8 trillion $ we will be 6.5-7% of world GDP

India Population ~ 17.7% of World's Population

India to World GDP currently is at 3.28% and India to World Market Cap is 3.5%. Considering the world GDP to grow at 2% and India GDP at $7 trillion in next 10 years, India as a % of World GDP will be ~6.5%. The Indian market will command a higher share in Market cap of the world, say 6%.

Risk-Inverted Yield Curve in US- An anomaly that cannot last forever

As on 19th Dec 22	Fed Rate	1 Yr	2 Yr	5 Yr	10 Yr
Bond Yields	4.25%-4.50%	4.62%	4.18%	3.64%	3.52%

Inverting Yield Curve meaning say a 2 Yr Bond Yield higher than a 10 Yr Bond Yield is a sign of recession. Currently also the Yield Curve in US has inverted signaling recession going ahead. However, we assume that it is an anomaly that cannot last forever. This will correct, depend on either FED rate goes down or 10Year Bond Yield goes up

Who will Blink First?

MARKET

Either
10Y Bond Yields which is market driven goes higher

This will impact Equities negatively causing PE de-rating

OR

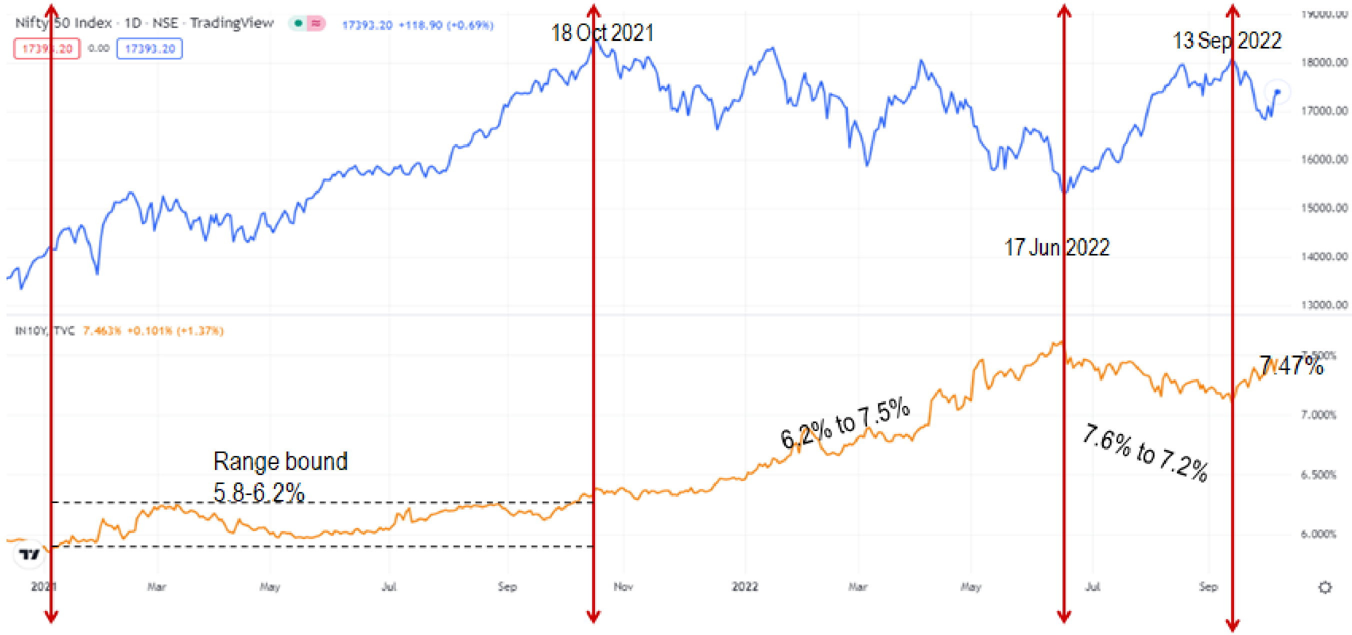
The FED will lower Interest rates

This will be done to support growth but will have adverse impact on Inflation

FED

We assume that market will correct itself resulting in 10Year Bond Yield going up. This will cause Equities to correct world wide for that period of time when the market adjusts its 10Y bond Yield. This will have a trickle down effect on Indian markets also.

Risk in 2023- 2-3 Months of Adjustment



Indian Equities in the past has taken signals from 10Year Bond yield movement. When the 10 year Bond Yield was rangebound, markets were rising, since Oct 2021 when the 10Y bond yield started rising, the markets corrected and as 10 year Bond yield fell post Jun 22, the markets have risen. As the rate adjustment takes place, it will cause some period of corrections in the market.

US Govt 10 year Bond yield

US Govt 10 year Bond yield over last 100 years

Above is 10 year bond Yield Chart for US since 1913. We can divide the chart in broad 2 periods:

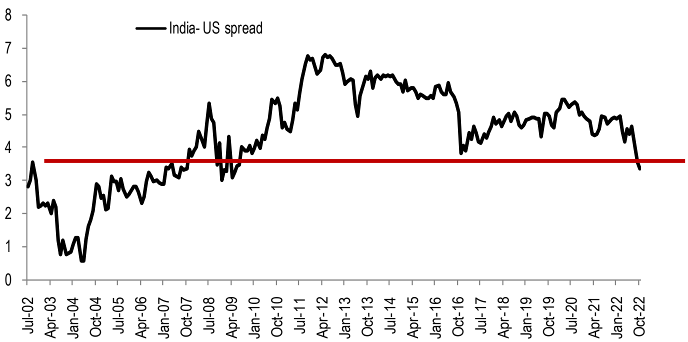
1941-1980- where US government Bond Yield went up from sub 2% to higher than 15%

1981-2020- where the yields fell all the way to 0.5%.

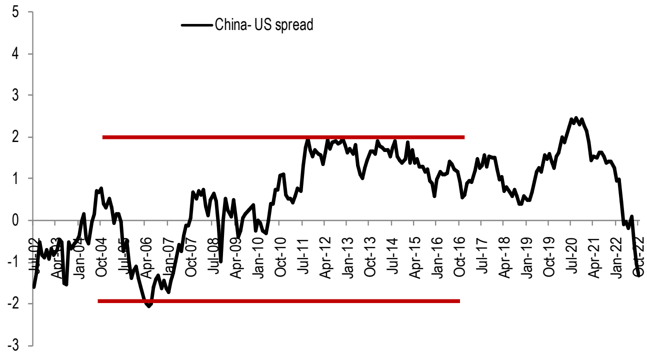
The fall can again be seen in two parts- first where the interest rates were falling in 2008 which can be attributed to lower inflation due to globalization where manufacturing was getting shifted to lower cost geographies; and second, a more severe fall from 3% to close to 0% on the basis of huge liquidity infusion by central bankers.

2021 onward-**Not necessarily a sharp rising trend but more like an elevation and then long period of sideways movement**

India-US I0 year Bond Yield Spread



Source: investing.com

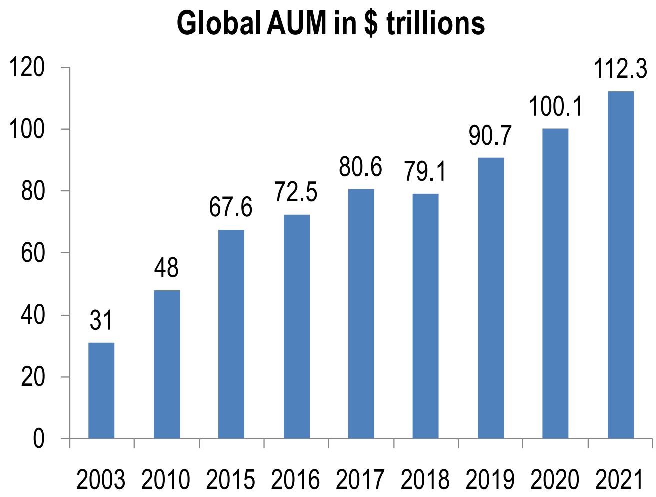


Source: investing.com

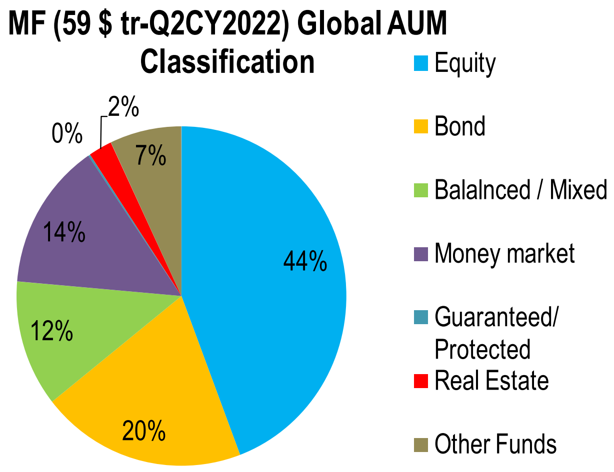
Rising Fed rate or say rising US 10 year Government bond yield will impact India bond yield movement as well. The India – US spread in 10 year Govt bond yield has been in the range of 3-6%, which means the current Bond yield In India may range from 6-9%. Bond Yield rally from current 7.6% to 9% will mean damage to Indian macros and hence stock markets.

We assume India will take guidance from China – US spread going further as the macro construct at this point of time is similar to what China had some 20 years ago. This implies bond yield spread to range in -2% to 2% implying Indian average peak Bond Yield to remain around 8%.

Negative of current High Interest rate: Fall in Equity Allocation globally



Source: BCG Global Asset Management Market Sizing 2022



Source: https://www.ici.org/research/stats/worldwide

Rising interest rate will impact Incremental inflow of funds. The world AUM is $112 trillion and $60 trillion in Mutual Funds and out of this 44% is in Equity and 20% in Debt. Rising Interest rate will result in increase in % allocation to debt funds from current 20%. It will happen through higher allocation among incremental inflows and less on account of churning out from current allocation.

US Recession Risk. Is It?

Year	Inflation%	Real GDP Growth%	Nominal GDP Growth
2001	2.80%	1.00%	3.80%
2002	1.60%	1.70%	3.30%
2003	2.30%	2.80%	5.10%
2004	2.70%	3.90%	6.50%
2005	3.40%	3.50%	6.90%
2006	3.20%	2.80%	6.00%
2007	2.90%	2.00%	4.90%
2008	3.80%	0.10%	4.00%
2009	-0.40%	-2.60%	-3.00%
2010	1.60%	2.70%	4.40%
2011	3.20%	1.60%	4.70%
2012	2.10%	2.30%	4.40%
2013	1.50%	1.80%	3.30%
2014	1.60%	2.30%	3.90%
2015	0.10%	2.70%	2.80%
2016	1.30%	1.70%	2.90%
2017	2.10%	2.30%	4.40%
2018	2.40%	2.90%	5.40%
2019	1.80%	2.30%	4.10%

Recession is considered on Real GDP. US Real GDP is expected to contract leading to recession.

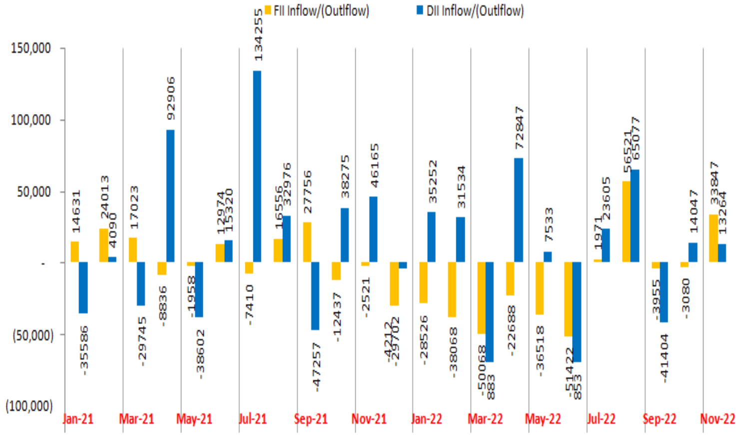
Recession is a fear for India as it will impact our external trade that is expected to come down.

However, external trades are part of nominal GDP meaning Real GDP + Inflation. As we expect that nominal GDP will remain around 4% for US (near the average of last 20 years of 4.1%), fear of recession will not be a very big impact on our economy.

Last 20 years Average Nominal GDP Growth rate is 4.1%

In 2023, even when Growth is-ve, Nominal GDP Growth rate will be at ~ 4%

FII Behavior If Recession



Allocations to India Have Room to Rise Further

Investor Category/ Investment in India public markets in USD Billion	Equity	Debt	Hybrid	Total	India Investment as a % of global Total AUM
Central Bank/ Sovereign Wealth Funds/ Governments	82.8	11.6	1.3	95.7	1.20%
Pension Funds	51.3	2.6	0.2	54.1	0.10%
Endoments/ Foundation	2.6	0	0	2.6	0.30%
Insurance	7.7	1.3	0	9.0	0.00%
Investment Advisors/ Asset Managers/ Funds and other	449.8	34.7	2.3	486.8	0.30%
Total	594.2	50.2	3.8	648.2	0.20%

Source: NSDL Data, Global AUM data: PWC, OCED, Towers Watson, Quantum Analysis and Assumptions

» The anomaly is that In terms of GDP we are 3.5% of the world but in terms of Investments only 0.2% of the world

» This ratio should get better in coming years as India will be amongst very few countries (less than 10 out of 200 countries for which data is available) growing at great than 5% in terms of GDP.