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Global Equity markets continued their rally in July. India was up 8.4% in USD terms, and was amongst the best-performing markets after Brazil and China. But we still have room to catch up.

Looking forward, key macro factors are in balance; Economic recovery is being seen globally although resurgence in COVID cases is a dampener.

Globally, economies are seeing a recovery with indicators like PMI showing an improvement although resurgence of the virus is being seen in a few countries. US economy was on a recovery path but is showing signs of flattening amid resurgence of the virus in a few states. The Chinese economy is also rebounding but still has some way to go before reaching pre-COVID levels. Globally, fiscal and monetary policy will remain highly accommodative and liquidity will remain high, which should continue to support the economic recovery.

In India, we are still seeing a rising trend in number of COVID cases although fatality rate remains low. There are signs of reflation in the economy – pent up demand is seen in the form of higher vehicle registrations and rising air travel - although it remains to be seen if this will sustain. Key high frequency indicators such as electricity consumption, petrol and diesel consumption, rail freight, toll collections and E-way bill generation are showing improvement although some are flattening out. Capacity utilization levels for Oil & Gas, steel, and tractors are at par with pre-COVID levels while those for 2-wheelers, cement, and power are catching up. Rural economy is a bright spot with normal monsoon and Kharif sowing higher YoY. Rural demand has been resilient and is being seen in various sectors such as consumer staples, paints, cement, and auto (2-wheelers and tractors). In addition, global macro factors such as low oil prices and stable currency also continue to be in India's favour.

Regarding earnings, Q1 FY21 earnings are expected to be weak and further earnings downgrades can be expected. However, corporate earnings should bottom out in FY21. A recovery is projected in FY22 and economy and earnings are expected to normalize by FY23. Also, companies are re-designing business processes to take advantage of technology, remove inefficiencies, and reduce costs which may lead to faster recovery in earnings and ROE.

Valuations are reasonable with Nifty Trailing P/B ~13% below its LTA. Mid-and-smallcaps are at relatively attractive valuations. Low interest rates and high liquidity can justify higher equity valuations going forward.

USD has entered a bear market and a weaker USD boosts EM flows and assets. Consequently, India continued to see strong FII inflows in July. However, domestic flows have turned negative even though SIP flows have been steady.

## View on the Market

We have a cautious stance in near-term but are bullish over medium-to-long term.

Global equity markets are expected to remain volatile due to resurgence of the virus in a few countries. However, accommodative fiscal and monetary policy and high liquidity should provide a supportive backdrop for stocks. As we have seen, US markets are already back to their pre-COVID levels and the tech-heavy Nasdaq has hit all-time highs.

Abundant liquidity, global as well as domestically provided by RBI, and stimulus measures by the government will support the Indian economy and can drive a bull market in Indian Equity markets in medium-to-long term.

In the short-term (3 months), market volatility is expected to continue. From a very near-term perspective, we are cautious and would not be aggressive. There is a huge supply of paper (~USD 7 Bn) in the form of fund raise, mainly in the BFSI space, coming in over the next one month which may cap the upside. A correction is possible in case of global weakness. But it may be limited to 10-12% in the base case due to the liquidity available in the market.

In the medium-term (1 year), valuations are reasonable with Nifty Trailing P/B ~13% below its LTA which is a better indicator than P/E in the current environment. Mid-and-smallcap are at relatively attractive valuations. Market can rise close to previous peak implying ~10-12% upside from current levels.

In the current environment, it would be best to take a longer-term 3-year view as the economy and earnings would have normalized by then. Over a 3-year timeframe, we can expect a return CAGR higher than the long-term average of 12.5% for the Nifty. Indicators like Market Cap-to-GDP and Market Cap-to-Broad Money Supply indicate that the market has sufficient room to rise from current levels. Low interest rates and high liquidity justify higher valuations. We are positive on Banking & Financials, Consumption (Low-ticket Consumer Discretionary, Retail, Auto), and Technology/Digital.

Investors should stay invested, continue their SIPs, and definitely buy into any dip. Lump-sum investments can be spread over the next couple of months.

Source: Bloomberg, ABSLAMC Research

(PMI – Purchasing Managers Index, LTA – Long Term Average)