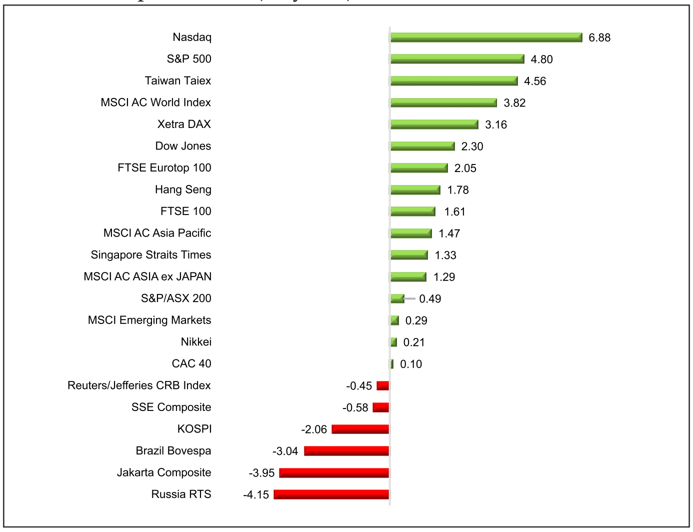
FRANKLIN TEMPLETON

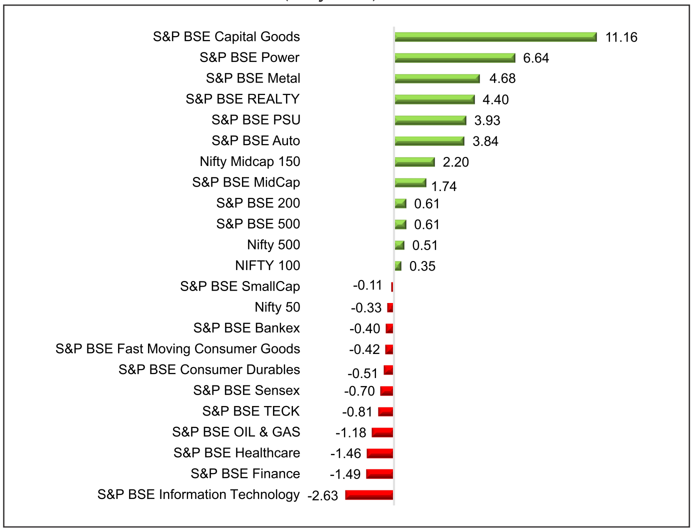
Market Review & Outlook
June 2024

Global market performance (May 2024)



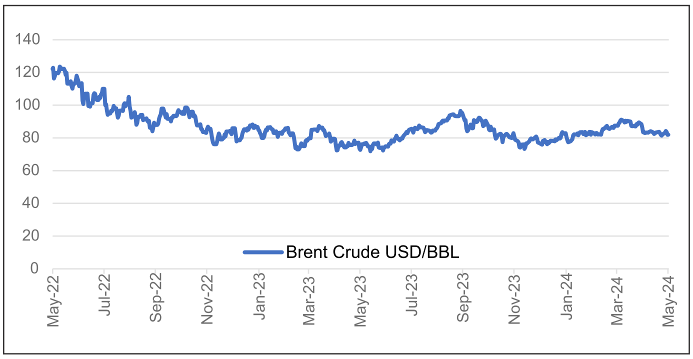
Global equity markets were overall positive for the month. Developed markets outperformed emerging markets. US equities were top performers led by investor optimism about robust corporate earnings results, expectations for interest rate cuts, and continued enthusiasm about artificial intelligence (“AI”). European markets were up on improved economic indicators, supported by the real estate and utilities sectors and financials. The Hang Seng Index has been up 9% over the last two months.

Domestic Market Performance (May 2024)



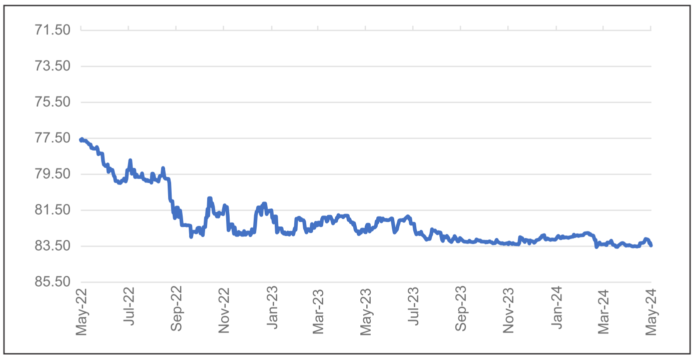
The frontline Nifty 50 index marginally declined by -0.3% for the month. Markets were volatile, especially in the first half of the month, on account of nervousness related to the election outcome and geopolitical tensions. However, markets saw a recovery in the second half as the RBI announced a substantial Rs 2.1 lakh crore dividend for the government for fiscal 2024. Optimism around corporate earnings and S&P Global's upgraded outlook for the Indian economy to 'positive' from stable also aided the markets. Midcap outperformed large cap and small cap indices. The Nifty Midcap 150 Index rose 2%, whereas the Nifty Small Cap 250 slid 1.3% in May 2024. On the sectoral front, capital goods, power, and metal were among the top gainers for the month.

Crude oil prices – Brent



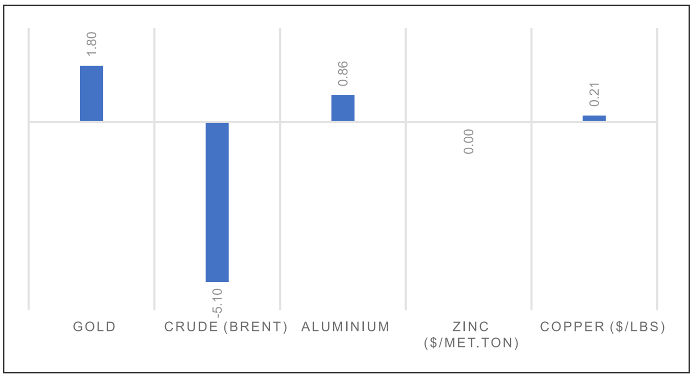
Macroeconomic indicators:

USD INR



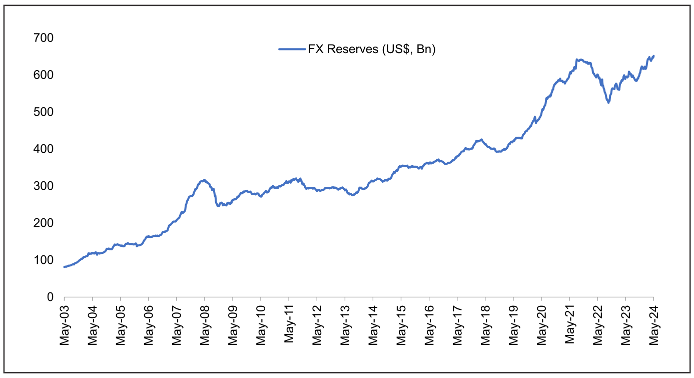
From the closing level of the previous month, the rupee marginally depreciated by a modest 0.02%to close at USD/INR 83.46. In the month of May 2024, the Dollar Index (DXY) lost (-1.5%).

Commodity price trend



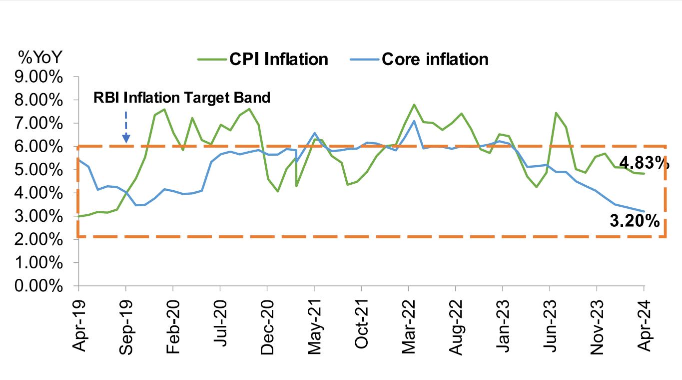
Brent crude oil saw a drawdown for the month as looser supply-and-demand dynamics quelled oil prices as a seasonal increase in inventories, signs of consumer stress and excess capacity within OPEC+ kept investor sentiment in check. Crude oil has been in a broad range of $70-95/bbl over the last year and ended May close to $82/bbl.

Forex reserves



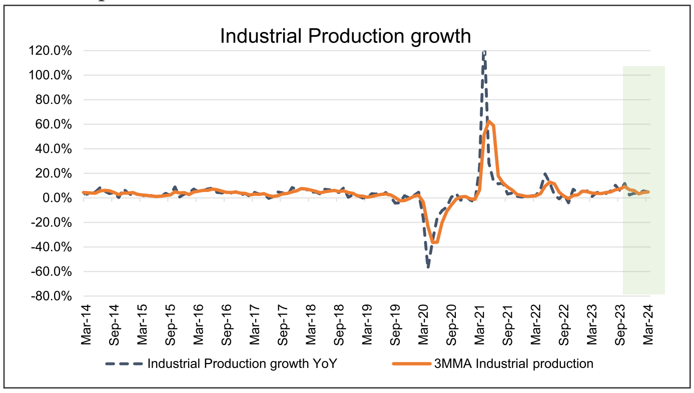
Foreign exchange reserves reached a historical high of US$ 651.5 billion as on May 31, 2024, adding 2.1% to the previous month end.

Inflation



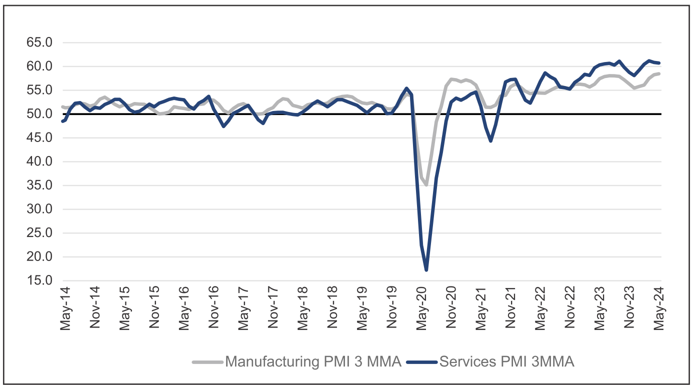
The Consumer Price Index ("CPI") on a YoY basis further eased slightly to 4.8% in April 2024. The moderation was driven by core components which slid further to 3.2% in April 2024, the number is the lowest in current CPI series.

Industrial production



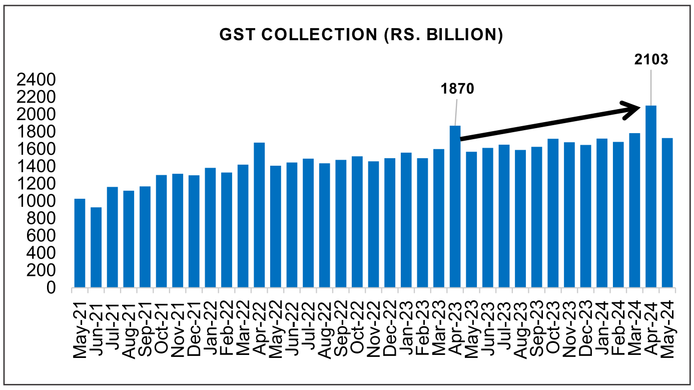
Industrial production decreased for the month, as it came in at 4.9% (YoY) in March, due to a slowdown in mining output.

PMI Indicators



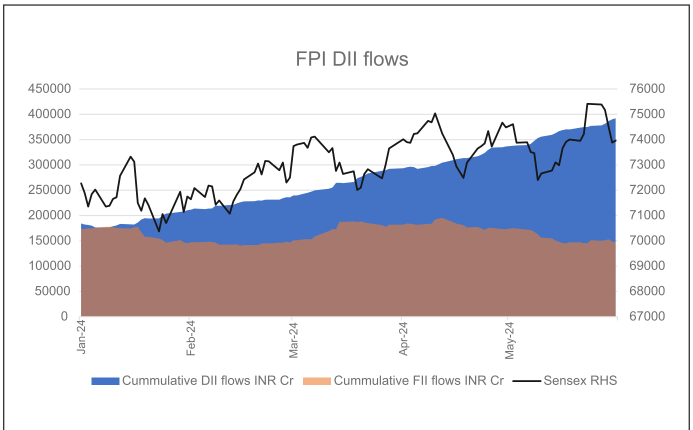
The manufacturing Purchasing Managers Index ("PMI"), an indicator of business activity, moderated nominally for the month due to softer growth in output and new orders, but demand remained strong from international markets. India's manufacturing PMI is among the strongest globally. Services PMI continued to remain resilient, as the uptick in new business from international and domestic markets was steady.

GST Collection



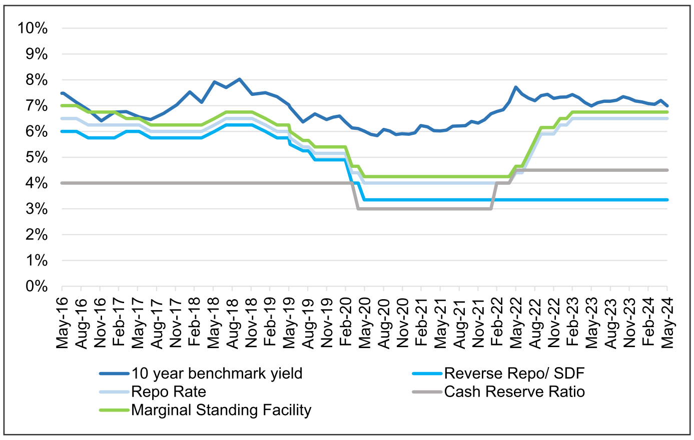
GST collections for May 2024 stood at INR 1.73 trn. up nearly 10% YoY.

FII/DII equity flows



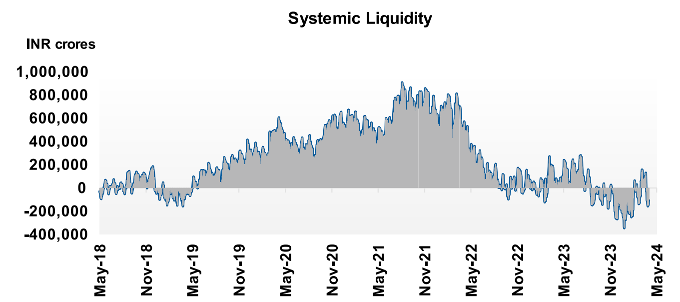
DIIs were the net buyers for the month.

Domestic Interest rate trend



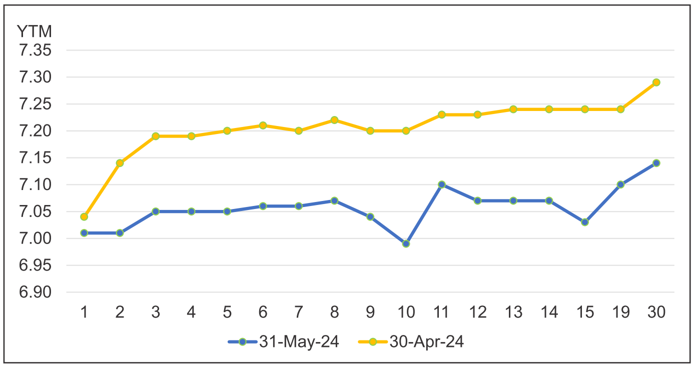
RBI kept policy rates unchanged at 6.50% and decided to remain focused on withdrawal of accommodation while ensuring that inflation aligns with the target while supporting growth. The decision to hold rates and the monetary policy stance was backed by 4 out of 6 members. Both, Prof. Jayanth R. Varma and Dr. Ashima Goyal voted to reduce the policy repo rate by 25bps and the policy stance to neutral.

Domestic Liquidity trend



Average liquidity conditions turned deficit during the month of May 2024. Advance tax payments, build-up in government cash balances, payments of GST etc. added pressure to the liquidity in the system.

Yield Curve



Domestic yields were influenced by easing US treasury yields due to soft macro data and RBI surplus transfer to the government. Entire domestic G-sec yield curve saw a downward shift. The benchmark 10-year sovereign yield in India fell by 21 bps during the month. Given the liquidity dynamics, weighted average call rate (WACR) largely remained in the middle of the policy rates.

Domestic Macros Heatmap

Fiscal Year End	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	Latest*
GDP Growth (%)	7.2	7.9	7.9	7.3	6.1	4.2	-7.4	4.1	4.4	8.6	7.8
CPI Inflation (%)	5.9	4.9	3.8	3.6	3.4	5.8	5.5	7.0	5.7	4.9	4.8
Current Account (% of GDP)	-1.3	-1.1	-0.6	-1.9	-2.4	0.1	-0.2	-1.5	-2.2	-1.2	-1.2
Fiscal Deficit (% of GDP)	4.1	3.9	3.5	3.5	3.4	4.6	9.3	6.7	6.4	5.6^	5.6^
Crude Oil (USD/Barrel)	53	39	60	58	65	23	59	111	80	87	82
Currency (USD/INR)	63	66	65	65	70	75	73	76	82	83	83
Forex Reserves (USD bn)	342	356	370	424	413	490	579	606	579	646	652
GST Collections (INR billion)						1222	1239	1421	1601	1785	1727

*GDP data for Q4FY24, Fiscal Deficit data is as of FY24. ^Revised estimates for fiscal deficit, CPI data as on 30-April-2024, Crude oil, currency, forex Reserves and GST collections as on 31-May-2024.

Source: Bloomberg, RBI, MOSPI, Morgan Stanley

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Equity Market Snapshot

R. Janakiraman*, CIO – Franklin Equity

Corporate earnings

For Q4FY24, domestic cyclicals, such as Autos and Financials, along with Healthcare, Capital Goods, and Cement contributed to the earnings growth. Following were the key sectoral trends which aided strong performance in these sectors:

- Banks: Credit growth, asset quality improvement with lower provisioning;
- Autos: Volumes growth, operating leverage, strong demand in select segments;
- Capital goods: Healthy order flows and benign raw material costs;
- Cement: Rise in sales volumes, lower raw material costs offsetting lower pricing;
- Consumer durables: Strong revenue growth trend led by demand;
- Healthcare: Strong sales in the US and lower raw material costs; and
- Real estate: Strong pre-sales growth.

On the other hand, earnings trend in the global cyclicals (metals and oil & gas), consumer staples (muted volumes growth, moderate margin expansion), retail (weaker demand), technology (muted discretionary spending), telecom (modest tariff hikes) remained moderate. Incremental earnings for FY25E are expected to be contributed by industrials, financials, metals, telecom and energy sectors. The consensus estimate for Nifty 50 earnings growth stands at 12%/16% for FY25/26.

Outlook:

The Lok Sabha 2024 elections delivered a less decisive mandate. However, we expect the focus of the new government to stay on the path of infrastructure and investment capex driven growth. Rise in the government capital expenditure in the past 5 years by 3 times along with strong housing cycle for past 3+ years has helped revive the investment cycle. Going forward, strengthened balance sheets, higher capacity utilization levels along with support from the Production Linked Incentive ("PLI") schemes should drive corporate capex.

Post the electoral verdict, further factor market reforms (land, labor, capital) is likely to be a more time-consuming and consultative process for the new government. Some fiscal flexibility has been made available by the higher-than-expected dividend from the RBI and the lower-than-expected fiscal deficit for FY24 which came in at 5.6% vs the budget estimate of 5.8%. This flexibility may be utilized for welfare spends in the near term without compromising on capex plans and fiscal prudence targets. The current combination of robust real GDP growth and moderating inflation bodes well for growth expectation of 7.2% (RBI projection) in FY25.

Interest rates could likely stay steady in FY25 given the benign current account deficit supported by strength in services exports, stable currency and growth not being impacted by the current deflation cycle. Inflation has not yet reached RBI's stated 4% target yet. The timely start of the monsoons is heartening but its progress will need to be monitored for impact on food inflation.

Risks to global growth could emerge from (i) geopolitical conflict-led commodity price spikes (food, energy and transport related) that could hamper the ongoing deflation process and delay monetary policy easing, (ii) prolonged delay in Chinese economic recovery impeding on domestic demand and impacting global growth. On the domestic front, risks could arise from any unforeseen spike in inflation that could upset expectations of a shallow interest rate cut cycle.

The small and midcap segments have witnessed robust performance over the past two years. Earnings growth for these segments is expected to surpass large caps over the next two years. Although valuations are higher than historical averages and relative to large caps, strong earnings growth could still lead to respectable equity returns. However, equity returns may trail earnings growth. A long-term horizon and higher risk appetite is recommended while systematically investing in these segments.

Opportunities for investors:

While investors may continue to invest as per their specific risk appetite and investment goals, they may seek incremental diversification based on asset class, geographies, investment style and market capitalization segments for their portfolios. It is recommended to consider staggered investment in diversified fund categories.

Fixed Income Market Snapshot

Rahul Goswami, CIO - Fixed Income

Outlook:

RBI MPC review was along expected lines.

RBI took note of the fact that global growth has remained resilient in 2024, supported by rebound in global trade. Inflation is easing, but the final leg of this disinflation journey may be tough. Domestically, during 2024-25 so far, RBI noted that economic activity has maintained resilience and manufacturing activity continues to gain ground on the back of strengthening domestic demand. Private consumption, the mainstay of aggregate demand, is recovering, with steady discretionary spending in urban areas. Revival in rural demand is getting a fillip from improving farm sector activity.

Investment activity continues to gain traction, on the back of ongoing expansion in non-food bank credit. With trade deficit remaining moderate, strong services net export surplus, the current account deficit is expected to be well sustainable and less than 1.5% of GDP for the FY2025. Manufacturing activity continues strong on the back of strengthening domestic demand. The eight core industries posted healthy growth in April 2024. Purchasing managers' index (PMI) in manufacturing continued to exhibit strength in May 2024 and is the highest worldwide. PMI services remain strong at 60.2 in May 2024 indicating continued and robust expansion in services sector.

On the inflation side RBI took cognisance of the fact that Headline CPI is in disinflationary trajectory and monetary policy has played an important role in this process. The headline inflation declined by 2.3 percentage points between Q1: 2022-23 and Q4 of 2023-24. Supply side developments and government measures also contributed to this moderation of headline inflation. Repeated food price shocks, however, slowed down the overall disinflation process. RBI also highlighted risks emanating from double digit growth in industrial metal prices this year as well as higher global food prices. RBI cautioned that these trends, if sustained, could accentuate the recent uptick in input cost conditions for firms.

With an eye on the present growth – inflation milieu in mind RBI MPC decided to keep the rates as well as stance unchanged in the policy. We believe RBI will be vigilant of any inflation risks emanating from sub par monsoon or global commodity prices and even domestic demand conditions. The bar for cutting rates seems to be higher in such benign growth environment as governor reiterated in the press conference that RBI not only wants to reach 4% Inflation target but also stay there for some time before thinking of acting on rates.

RBI also gave a message on liquidity and rates, saying all the tools at its disposal will be utilized to keep market conditions consistent with its monetary policy stance and it will continue to be nimble and flexible in its liquidity management through main and fine-tuning operations in both repo and reverse repo. It will deploy an appropriate mix of instruments to modulate both frictional and durable liquidity so as to ensure that money market interest rates evolve in an orderly manner which preserves financial stability. We believe RBI will be proactive in its liquidity management when bond index inclusion inflows start coming into the country and may deploy OMO sales for taking out durable liquidity from the system. Excess liquidity can impede progress on RBI's disinflation path and dilute its monetary policy stance.

***R Janakiraman has been appointed as CIO - Franklin Equity, with effect from December 1, 2023.**