INDIA EQUITY OUTLOOK

A roller-coaster 2022 year marked unique culmination of economic stress globally, driven by war-covid led supply chain pressures at the beginning of the year to higher inflation, tougher US Fed and sustained rise in interest rates throughout the year. The developed countries riding on easy money (liberal monetary policy of the past) faced the inevitable consequent music of rake hikes with possible economic and business contraction. Indian markets too witnessed a wild ride last year which tested the patience of investors.

As we step into 2023, we make an attempt at **probable scenarios in 2023** and India's likely business and investment outlook amidst ongoing global macro headwinds.

Easing of Inflation

Central banks are in a tightening zone. US Fed initiated its fight against inflation by interest rate hikes. US being the largest economy, any economic slowdown typically causes ripple effects across the globe, the most felt by exporters to US market. Going forward, it is quite likely that inflation will continue to ease in 2023, helping the US economy to escape recession narrowly. Lower oil, core goods and commodity prices are a reflection of the trend-down of inflation. On the other hand, given resilient consumers, low unemployment and strong economic data, there is higher probability of the US economy facing only a soft landing versus a sudden crash or a deep recession. India inflation is less of an issue with proactive RBI.

Emerging markets to find favour

Emerging markets (EM) are under owned asset class globally. Emerging markets (EM) have better growth, lower inflation and less sovereign debt.

Amongst many others, we expect India will be a favoured destination for global investors. The Indian economy is now witnessing multiple levers of a secular growth cycle. These include private capex, govt-backed PLI and sustainability of credit growth. The credit growth for public sector banks at 15% and for private banks at 20% reflect buoyancy in business and consumer lending. India's consumption driven nature of growth will partly shield against adverse export market conditions, if any, in the possible storm of global slowdown. India will emerge again as the fastest growing economy with perhaps limited macro volatility.

As a result, we expect a gradual flight of global risk capital from slowing developed markets to relative higher growth, stable currency emerging markets. While foreign investors have reduced their exposure in 2022, they still have faith in India's strong fundamentals and are expected to return to the market at more reasonable and corrected valuations. The Indian market is likely to eventually attract more global flows.

A come-back year of mid-small caps

Scratching the surface of how the market did last year, it doesn't look like a traditional upbeat market environment. Large caps outperformed mid/small caps in CY2022. Small mid-cap companies have historically tended to outperform large-cap companies over the long term as the segment has the potential to grow more quickly, which can lead to higher returns for investors. Though, as a category, small-mid-cap companies are also more volatile and less predictable in the short run. Assuming our probable scenario of receding inflation and interest rate concerns in CY2023, we expect small-mid cap companies could come back and outperform large caps as risk perception decreases.

A more disciplined investment environment

Reflecting back, 2022 was the year during which the private equity and new-age tech businesses finally experienced a long-overdue reset. As Warren Buffett rightly quoted, "you don't find out who's been swimming naked until the tide goes out". New-age tech companies that simply acquired revenues with cash burns, came with IPOs at illusory valuations. It was more an exit to private equity investors at the cost of retail public ! We see businesses lacking the real moat or positive unit economics or self-generating cash flows will continue to erode market caps with survival stress. 2023 will see the dawn of a more disciplined environment that moulds the core principles of investing in a sustainable cash-flow generating business.

Investment strategy and opportunities

India's export business is very much coupled with global economies. Hence our portfolio focus is more on domestic-centric businesses.

Themes like banking/financial services, travel & tourism, engineering & manufacturing are interesting opportunities. However, we shall keep a close watch on export oriented themes like IT and pharma that could come back and deliver returns as recession/slowdown fears would gradually disappear after 12 to 18 months.

Banking and financial services sector will sustain improved performance with higher credit growth, stable net interest margins, low credit costs and better return on assets.

Given India's urbanisation is quite low by global standards, formalisation of our economy is witnessing tremendous acceleration and presents opportunities in consumer categories like travel, retail and housing.

Rise of India's manufacturing – Indian manufacturing will move from the service sector's poor cousin to try to match it. The key drivers are seeded in place – PLI in 14 sectors with emphasis on Atma Nirbhar Bharat along with reduction in tax rates for new units. These, along with China + 1 (looking at supply alternatives to China) have provided the right enablers for potentially strong manufacturing growth in the years ahead.

The broad sentiment indicator currently suggests a lot more caution than a year ago, with many estimating a negative expected return for equities over the next 12 months. This negative consensus view will hopefully have the least outcome and lays the essential foundation for a prospective rally. Earnings of our portfolio companies continue to give us confidence in their respective business outlook.

The key to making money is to stay invested. - Suze Orman

HAPPY 2023,

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