The Alpha Investor

Issue #11, Sep 2020

finpeg®

What lies ahead?

INSIDE THIS ISSUE

Dear Investor,

The month of September finally saw the long-awaited correction in global Equity markets. But the real question is, are we done?

In this issue, we discuss what lies ahead? We touch upon key themes that will impact returns in the coming few months.

US presidential elections and the trajectory of COVID-19 are the two top themes on our list.

Expect elevated volatility and turbulence as uncertainty prevails. Stay nimble!

Happy reading!

Shubham Satyarth

Co-founder, Finpeg

Smart solutions for smart money

What's Inside?

What lies ahead?

The month of September saw some bit of sanity return to global equities. Indian benchmark NIFTY 50 corrected by 1.45% during the month. US benchmark S&P 500 was down 9.6% as of September 30th from its all-time high of 3581 (on 2nd September).

The correction is even more pronounced in US tech index NASDAQ which was down 11.8% from its all-time high of 12,056. This is not surprising given that Tech had run up much more than all other sectors. The recent correction has hit the tech names the most (refer our issue which specifically highlighted the overvaluation in tech names - History doesn't repeat, but it often rhymes.

Our stance on equities remains clear. We continue to be pretty bearish on the equities as we believe that risk-reward ratio is far from favourable at these levels. And we have covered the reasons for our bearish stance in detail in our previous issues: Markets are pricing in perfection, History doesn't repeat, but it often rhymes, Let's talk Economy.

We have talked about elevated valuations, euphoric sentiment (and retail mania), over bullish positioning, rising volatility, and deteriorating fundamentals. All of which pointed to a correction (perhaps significant) in the equity markets. September seems to have validated our thesis. Not completely, but to an extent. We believe that there is still significant downside left.

In this issue's cover story, we will focus on what lies ahead? We will touch on key themes that will likely impact equity returns for the rest of this year. And obviously, we will close with valuations (how can we not?).

Let's talk US elections

Perhaps the most significant event that will decide the course of the markets over the next couple of months is the US presidential elections.

US goes to polls on 3rd November 2020. By the night of November 3rd, we will know the winner between incumbent Donald Trump and Democrat challenger Joe Biden.

Or will we?

Here lies the real uncertainty which could lead to huge amount of volatility in the markets. In general, the bulk of voting happens through in-person voting and the result on the election night is the final outcome.

However, a record number of US citizens are likely to opt for mail-in ballots due to COVID-19 risk. And hence, the actual results might appear a few days after the election day.

Whichever side loses will likely allege the election to be "stolen" and claim fraud. Consider a scenario – Mr. Trump wins on election night but the results are reversed when mail-in ballots are counted. That will not go down well with Mr. Trump and the republicans.

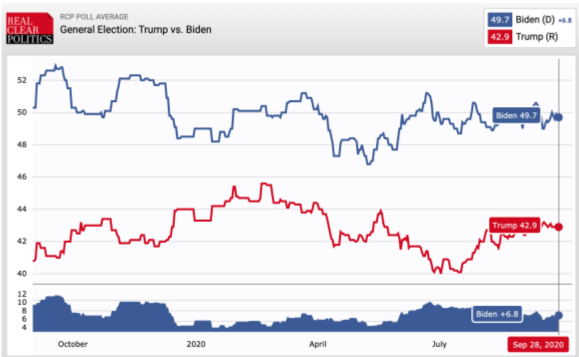
It is this uncertainty that will keep the markets volatile not just in the run up to elections but also post elections. And in an event of a full-blown civil unrest (a tail risk), all bets are off and we could see a big crash.

Leaving this uncertainty aside, how will the actual result impact the markets? Well, there are differing views on this. Some believe (including Mr. Trump himself) that if Joe Biden wins, equity markets will crash. Others argue that if Democrats win, it would mean a bigger fiscal stimulus and hence should see a sharp rally.

In our view, the actual result will not have a sustained impact on the markets. Markets would adjust to the new President fairly quickly and will then again be guided by other (and more important) factors including monetary policy stance. This is not to say that a USD 5 trillion (or maybe 10, who knows?) stimulus by Democrats will not move the markets. But only for a while before other factors take over.

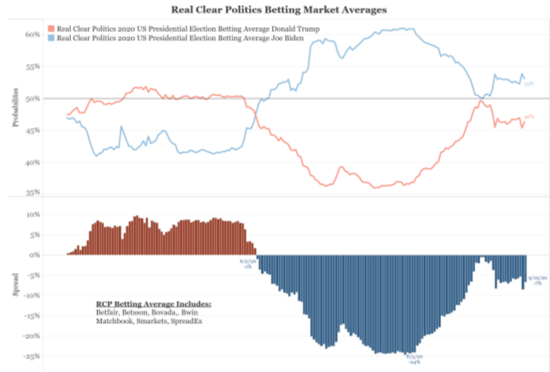
As of now, polls suggest a big advantage for Joe Biden while betting markets have the odds fairly close.

Exhibit 1: National average polls give a 6.8 percentage point lead to Joe Biden



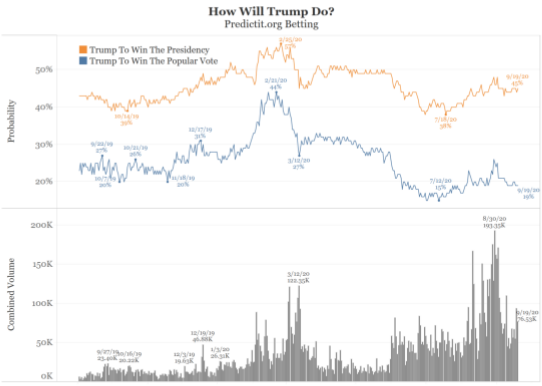
Source: Real Clear Politics

Exhibit 2: Betting markets suggest a much closer fight than polls



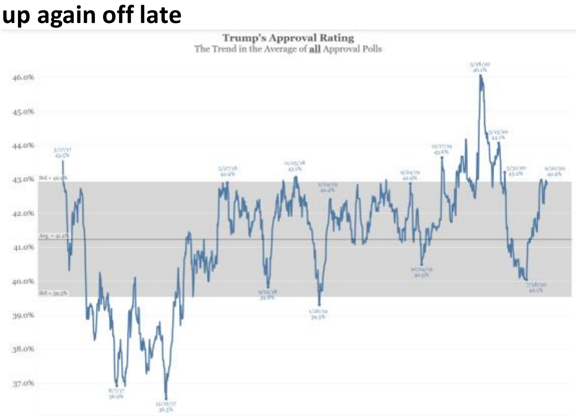
Source: Real Clear Politics

Exhibit 3: Another betting market puts a 45% chance for Trump winning Presidency



Source: Bianco Research, Predicit

Exhibit 4: Trump approval rating has been inching up again off late



Source: Five ThirtyEight Blog

Apart from stance on Stimulus and taxes, other big thing to watch out for will be the stance on tackling COVID-19. Mr. Trump has been fairly clear that he wants the Economy completely open. Democrats might have a different take.

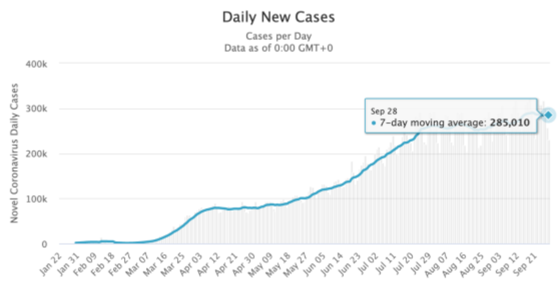
We discuss this next.

COVID-19 second wave

Well, it's is clear now that Europe is having its second wave of infections with cases surging in UK, Spain and France. Cases in US seems to be increasing again after coming down significantly in August. Chances are that with winter approaching, the cases will surge again to new highs.

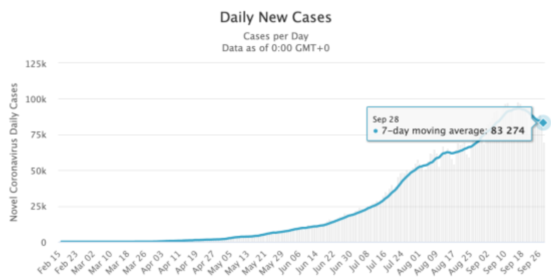
And in India, we never got out of our first wave. Daily new cases seem to have stabilized around 80,000 – 90,000 per day. See Exhibit 5-10 track the status of COVID-19 worldwide and in some key countries.

Exhibit 5: Daily new cases worldwide continue to hover around 300,000 per day



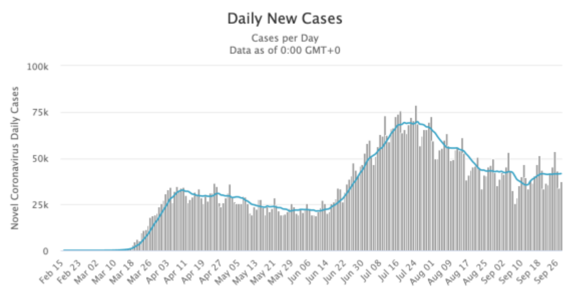
Source: Worldometers.info

Exhibit 6: Cases in India have shown signs of peaking but still remain stubbornly high



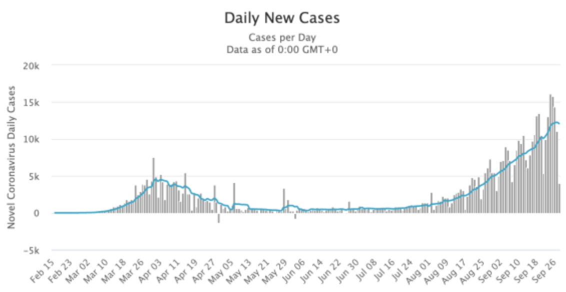
Source: Worldometers.info

Exhibit 7: Daily new cases in US on the rise again in September



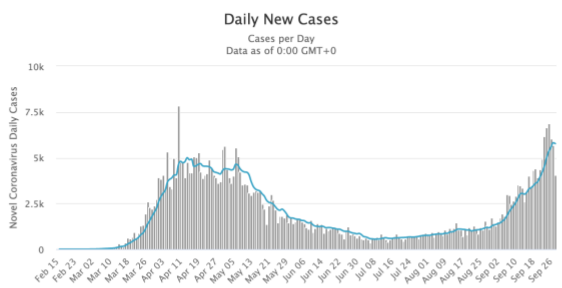
Source: Worldometers.info

Exhibit 8: Daily new cases in France clearly on the rise



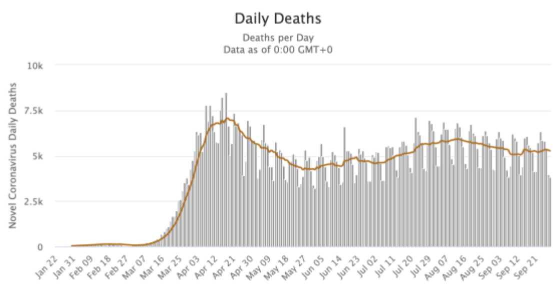
Source: Worldometers.info

Exhibit 9: Daily new cases in UK is surging leading to new sets of restrictions



Source: Worldometers.info

Exhibit 10: Daily worldwide deaths remain stubbornly high at around 5,000



Source: Worldometers.info

The world has moved beyond March. Rising cases don't alarm us anymore. Nor do authorities resort to draconian lockdowns that were imposed in March and April. People have realized that Economic cost of lockdown is way too high.

However, rising cases will lead to localized lockdowns. We are already seeing that happening in Europe. A lot of countries have postponed their full reopening plans and new sets of restrictions have been imposed. More importantly, rising cases lead to change in consumer behavior. Normal consumption and spending just cannot return unless the virus is totally in control.

Remember, even if the activities return to 90% of levels seen in January 2020, we are talking about one of the deepest recessions in living memory. And the longer the virus lingers along, more prolonged will be the recession.

Which brings us to our next question – where are we on vaccine?

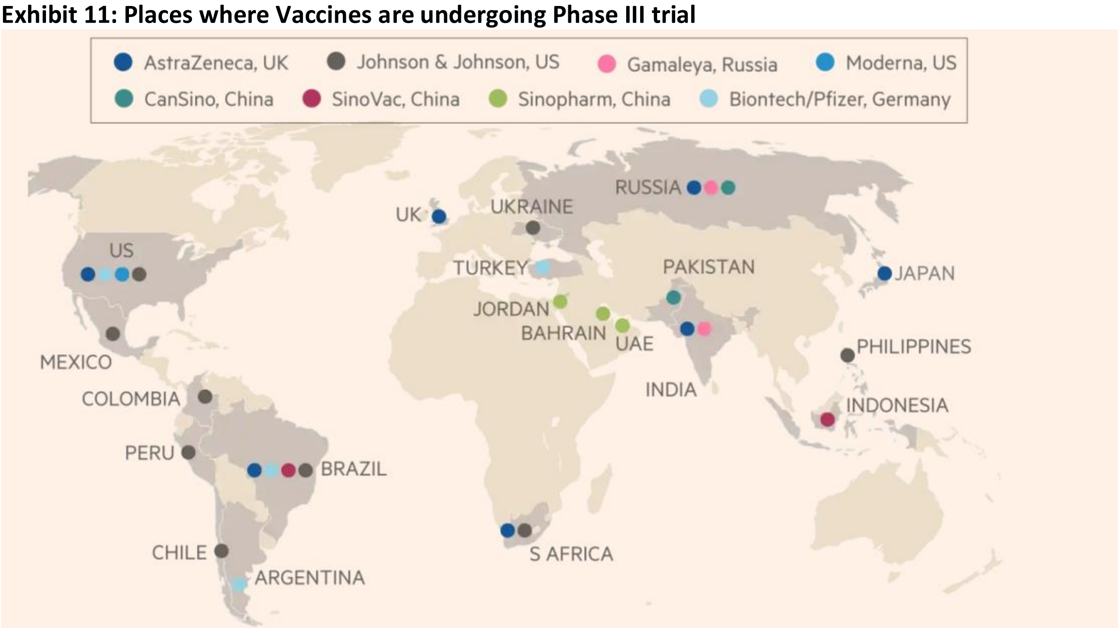
Where are we on Vaccine?

Well, if we are to believe the Governments, a vaccine is likely to be available by end of this year. But that seems highly unlikely. Moreover, even if we do have a "decently" effective vaccine by year end (a highly optimistic scenario), we are unlikely to be able to produce enough dosage to effectively curb the virus.

As of now, out of 300 vaccine candidates, nine are in phase 3 trials, with some hoping for emergency use approval this year. Scientists' forecasts for when the first vaccine could present positive phase 3 trial results range from October this year, at the most optimistic, to mid-2021 at the most pessimistic.

Moreover, most of the Vaccines being worked upon are being done to prevent symptoms rather than infection itself (a case with most strains of influenza virus). This means that unless a major chunk of population is not vaccinated, the spread is unlikely to stop. And now imagine a country like India and the task of vaccinating over 1.3 bn people. Even if achieved by end 2021, it would be a miracle.

Exhibit 11: Places where Vaccines are undergoing Phase III trial



Source: FT

Bottom line is that a "return to normalcy" doesn't look likely before mid 2021 (even in the optimistic case). This implies that the economic pain is likely to linger on.

And this economic pain will be compounded further once we encounter a wave of bankruptcies and defaults. This is a fairly high probability event both in India and in the US. No wonder that Credit spreads have started to rise again in anticipation of this. We talk about this next.

Watch out for Credit Spreads

In April, Federal Reserve (FED) came out with a plan to buy Corporate bonds (including Junk bonds) and ETFs. This calmed the credit markets and effectively put a ceiling on credit spreads. Since then spreads have fallen consistently with high yield spreads falling from March highs of 8.77 to 5.02 in August.

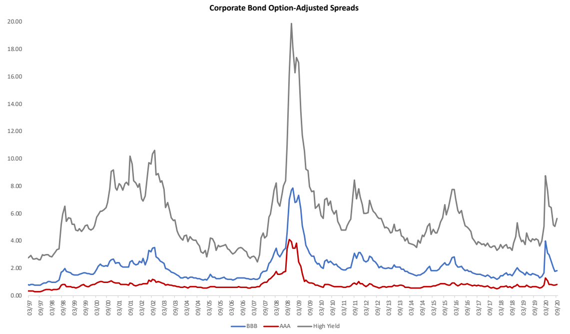
However, spreads have been inching up again with latest reading of 5.64 (62 bps increase in September). This is a clear sign of stress building up in the credit markets. As Economic recovery falters and COVID-19 cases surge, credit markets are signaling stress.

Another important point to note is that the high-yield spreads (or AAA and BBB spreads) are way above levels seen in 2019 and Jan 2020. And they never came down despite the Fed backstop. High-yield spreads are a good 200 bps above Jan 2020 levels.

It is important to keep an eye on the credit spreads. As we keep highlighting, Bond markets generally get a whiff of reality much sooner than Equity markets. And the current signal is ominous.

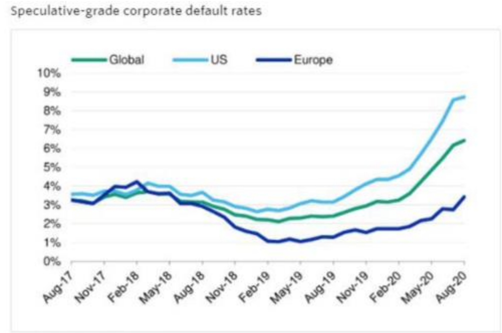
Exhibit 13 shows how speculative grade default rates have now edged up to 6.4% (globally, much higher in US), highest levels seen in a decade.

Exhibit 12: Credit spreads have been inching up again as economic recovery falters



Source: FRED

Exhibit 13: Meanwhile, speculative-grade default rate edged up to 6.4%



Source: Moody's

Rich valuations at elevated volatility. What could possibly go wrong?

We cannot close the discussion without relooking at valuations. They still remain staggeringly high. Notwithstanding the recent correction and notwithstanding the high-valuation "justifiers", the current valuations do not point to a favorable risk-reward ratio for equities.

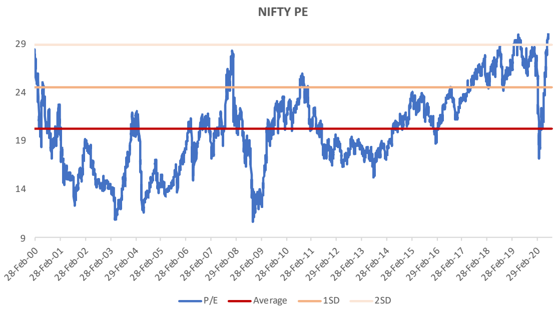
NIFTY is trading at a PE (trailing twelve month) of 32.69, which is 2 standard deviations above its historical average and in the top 0.5 percentile. Similarly, S&P 500 is trading at historically high valuations – levels seen only during dot-com bubble in 1999. US market cap to GDP ratio continues to be at an all-time high.

Definitely not a cheap market. Not in US. Not in India.

Another important point that we mentioned in our [last issue] was volatility. We specifically said that despite rising markets, volatility had started rising again, especially in S&P 500. Even as we speak, volatility remains at an elevated level of 27. Again, we believe that volatility is like to remain elevated in run up to US elections and possibly beyond that.

And when these stretched (fairly rich) valuations are juxtaposed with the underlying economic fundamentals, gloomy prospects (getting gloomier) and elevated volatility, we prefer to be extremely cautious when it comes to owning Equity as an asset class.

Exhibit 14: NIFTY PE (TTM) continues to be 2 SD above historical average



Source: NSE

Exhibit 15: S&P 500 forward PE continues to be elevated and below only 1999-2000 levels

Source: Yardeni Research

Exhibit 16: US Market Cap to GDP remains the highest ever

Source: GuruFocus

Exhibit 17: Meanwhile, Volatility remains elevated above 27 levels

Source: Google

Indian Markets – Weak month for Large Caps

1. Equity Market wrap for the month

Table 1: Index Returns as of 30th September, 2020

	1 Month	3 Months	6 Months	1 Year	Year to date
NIFTY	-1.45%	8.93%	30.53%	-2.20%	-7.77%
NIFTY Mid Cap	1.74%	15.44%	45.03%	5.91%	-0.75%
BSE Small Cap	3.66%	20.03%	54.66%	12.83%	8.48%
NIFTY Auto	1.08%	17.95%	67.51%	5.77%	-3.92%
NIFTY Bank	-9.86%	0.19%	11.84%	-26.43%	-33.43%
NIFTY FMCG	-3.79%	-2.09%	7.74%	-5.46%	-2.28%
NIFTY IT	10.61%	34.41%	55.38%	27.62%	26.70%
NIFTY Pharma	5.68%	17.27%	63.16%	55.14%	45.64%

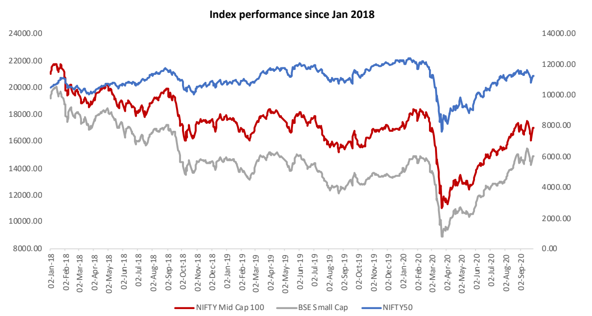
Mid and small caps continue their outperformance

As can be seen from table above, mid and small caps continue to outperform the large cap index. In-fact while NIFTY was down 1.45% during the month, both mid and small cap indices were up 1.74% and 3.66% respectively. Small cap index is now up 8.48% year-to-date.

September was yet another bad month for Banks with NIFTY Bank down 9.86% (down 33.4% year-to-date) as fear of bankruptcies (that we have talked about) continue to loom large.

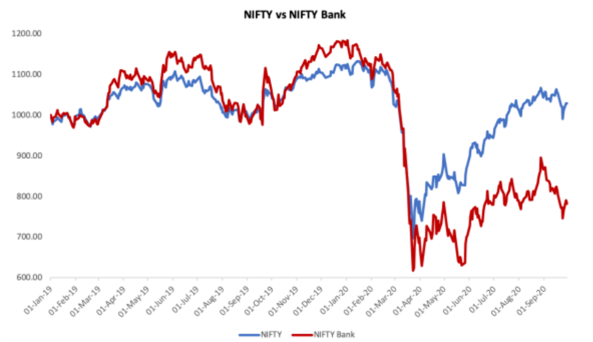
Pharma and IT have been the best performing sectors this year yielding 45.6% and 26.7% respectively year-to-date. Both these sectors continued their outperformance during the month.

Exhibit 18: Mid and small caps continue their outperformance



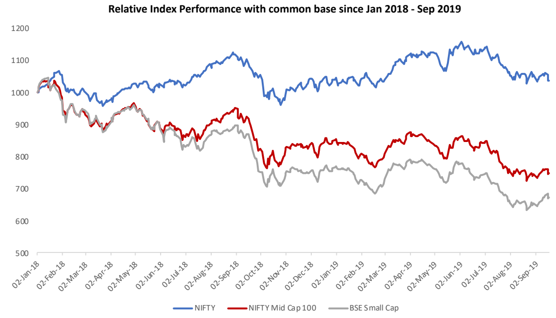
Source: BSE and NSE

Exhibit 19: Banking Index continues to severely underperform the broader market



Source: NSE

Exhibit 20: Mid and small caps continue their outperformance



Source: BSE and NSE

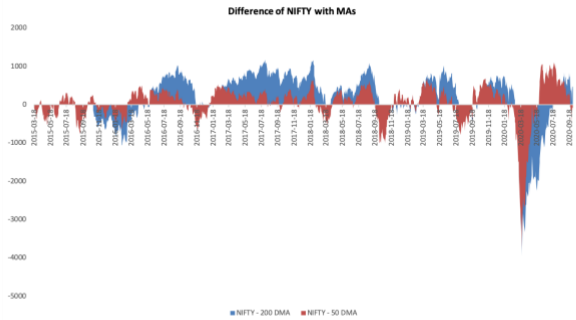
Exhibit 21: Index performance with common base from 1st January 2020

Source: BSE and NSE

The correction in September ensured that NIFTY breached its 50-day moving average rebounded after almost testing 200 DMA levels.

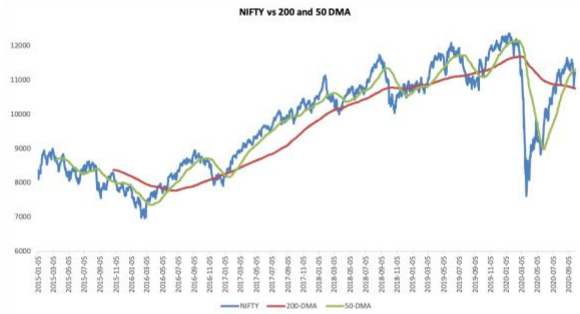
Also, the gap between current NIFTY and 200 DMA which had grown to highs of 827 has now narrowed down to 471 levels.

Exhibit 22: Difference between NIFTY current levels and its 50 and 200 DMAs



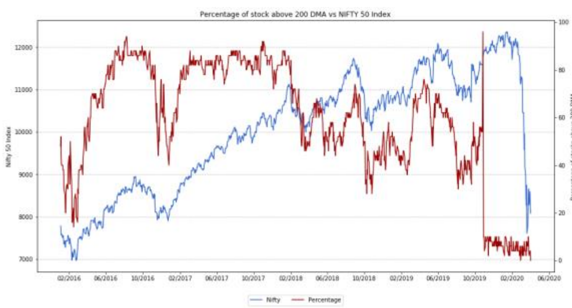
Source: NSE

Exhibit 23: NIFTY just rebounded from its 200-dma resistance levels



Source: NSE

Exhibit 24: NIFTY 50 vs percentage of stocks above their 200-day moving average



Source: NSE

Exhibit 25: NIFTY 50 vs percentage of stocks above their 50-day moving average

Source: NSE

2. Equity Market Valuations

We touched upon valuations in our cover story. At 32.69, NIFTY's trailing twelve-month PE is highest it has ever been (in the top 0.5 percentile).

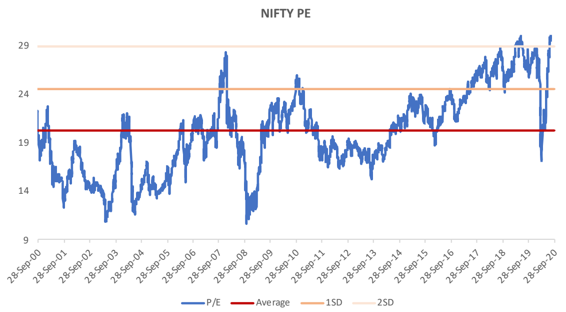
While the bullish argument is that that with ensuing earnings (EPS) growth in second half of FY21 and FY22, valuations will come back to fair levels. And well, markets are forward looking and the worst of earnings is behind us.

We have however discussed that given the tepid pace of economic recovery and yet-to-hit phase of insolvency and loan defaults, it is unlikely that we will see material growth in EPS and even if we were to use FY22 earnings, NIFTY would still look extremely expensive.

And it's not that only mega caps in NIFTY are expensive (like Jan 2020). Even NIFTY Equal Weight index is now 2 standard deviation above its historical average (Exhibit 27). So, the broader large-cap space is now pretty richly valued.

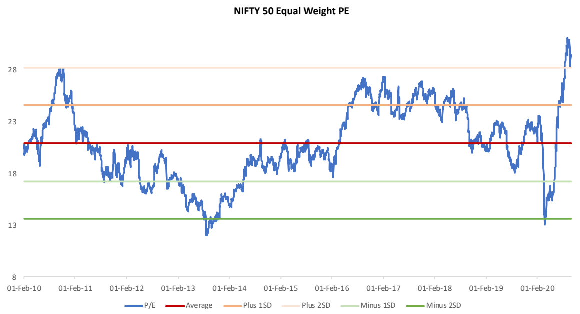
Mid caps are now at same valuation levels as Jan 2020 while small caps have overshot Jan 2020 levels. Overall, valuations are fairly stretched and unlike Jan 2020, overvaluation is spread across market cap segments. And with limited earnings growth in site, it is unlikely that earnings will catch up to elevated valuation levels.

Exhibit 26: NIFTY is trading 2 SD above its historical average PE (TTM)



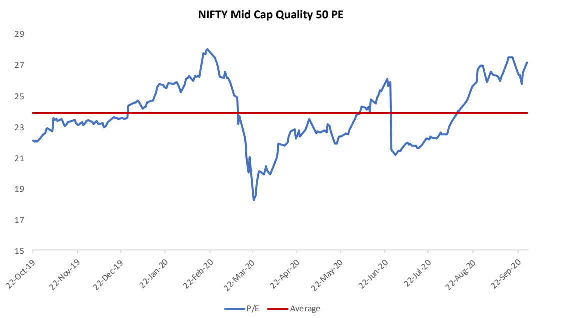
Source: NSE

Exhibit 27: NIFTY Equal Weight index is also 2 SD above historical average PE



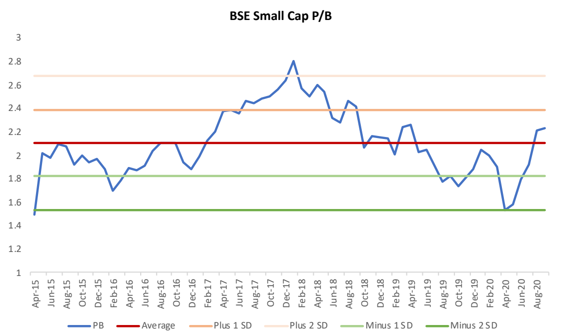
Source: NSE

Exhibit 28: Mid Cap valuations also appears to be rich on back of the recent outperformance



Source: NSE

Exhibit 29: Even small cap valuations have run up quite a bit



Source: BSE

3. Debt Market wrap for the month

10-year GSEC yields fell by 10bps in the month of September as Reserve Bank of India stepped in (again) to keep the longer-dated yields in check. However, there is a catch. If we remove the impact of 17bps drop on 1st September following RBI's big announcement on 31st August (discussed here), yields were actually up 7 bps during the month.

Reserve Bank of India (RBI) announced open market operation of Rs 20,000 crore to be conducted in 2 tranches on September 10th and September 24th. While the 10-year yields dropped to lows of 5.99%, failed OMO (RBI cancelled the purchase) on 24th resulted in a spike in the yields. However, yields then settled down to close the month at 6.02%.

While near-term inflationary pressure (driven by supply side constraints) could keep RBI from lower rates, we continue to believe that RBI will not let yields rise significantly since it would impact the borrowing cost of not just the Government but for the rest of the economy as well (since interest rate for everyone else is benchmarked to Government bond yields).

This, along with our thesis on moderate inflation (or disinflation) makes us bullish on longer-dated GSECs.

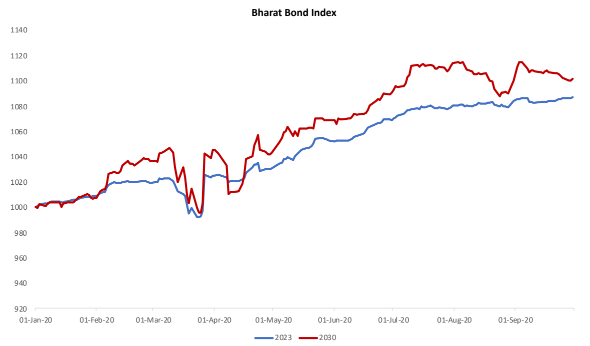
Table 2: Returns of Gilt and Medium to Long duration Funds

Scheme Name	1M	3M	6M	YTD	1Y
IDFC Bond Fund	0.21%	1.35%	5.39%	7.72%	9.88%
ICICI Prudential Bond Fund	-0.12%	1.63%	5.67%	8.76%	11.40%
HSBC Debt Fund	0.00%	-0.05%	3.53%	7.60%	7.49%
IDFC G Sec Fund	0.37%	0.34%	6.06%	10.47%	12.52%
DSP Govt Sec Fund	0.22%	0.69%	5.57%	10.33%	11.46%
Nippon India Gilt Securities Fund	-0.19%	0.09%	4.87%	8.67%	10.16%

Exhibit 30: 10-year GSEC yields fell in the month of March by 20bps

Source: Bloomberg

Exhibit 31: Outperformance of longer dated Bharat Bond ETF now converging



Source: NSE

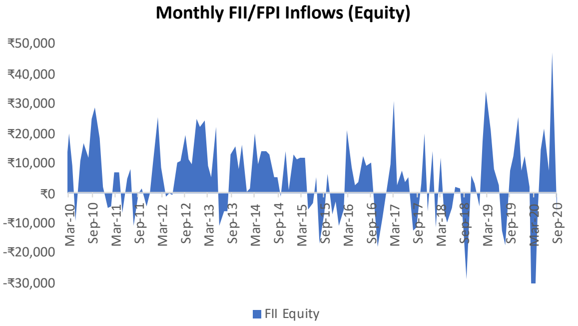
4. What is the "smart" money doing?

After record purchase of Rs 47,000 crore in August, FIIs turned net seller in India Equities selling Rs 7,783 crore in September. In the Debt segment, FIIs turned net buyers in September for the first time since February 2020 buying Rs 3,958 crore.

DIIs (Mutual Funds) were net sellers in Equity in September for the fourth consecutive month. DIIs sold Rs 3,468 crore (net) in September as against Rs 9,339 crore in August.

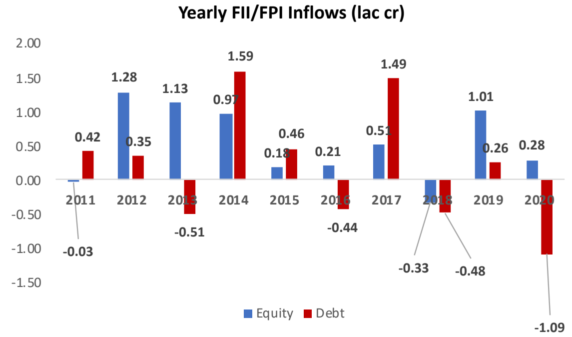
If we look at year-to-date data, both DII and FIIs are net buyers buying Rs 7,622 crore and Rs 28,347 crore respectively.

Exhibit 32: Monthly FII/FPI inflows in India Equity markets



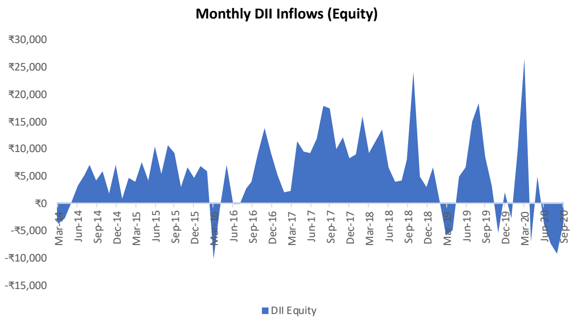
Source: NSDL

Exhibit 33: Calendar year FII inflows in Equity and Debt markets



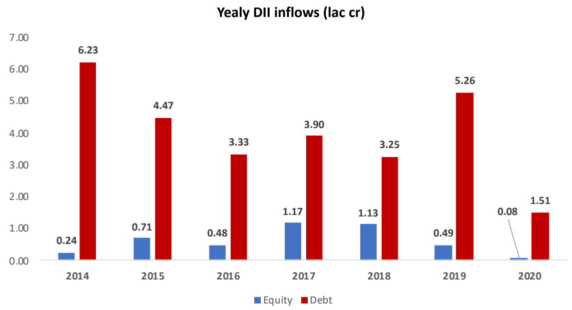
Source: NSDL

Exhibit 34: Monthly Domestic Institutional Investors (MF) inflows in Equity markets



Source: Moneycontrol

Exhibit 35: Calendar year DII inflows in Equity and Debt markets



Source: Moneycontrol

Economy – Green shoots emerging, but still early days

1. Summary and Outlook

A lot of good news for the Economy in September with clear signs of recovery picking up pace. For starters, Manufacturing PMI jumped to 56.8 suggesting a sharp pick up in manufacturing activity from August.

Most of high frequency indicators show not just recovery in September, but recovery at an accelerated pace.

Maruti Car Sales (largest market share in passenger vehicles) was up 31% yoy and Bajaj Auto saw 24% yoy growth in 2-wheeler sales. While some of this growth can be attributed to pent-up demand, these numbers are still very impressive and signal a strong revival in demand.

On similar lines, GST revenue collection registered a positive 3.9% yoy growth in September. Rail Freight was up 15% yoy and Power Consumption was up 5.6% yoy.

So, is the Economy out of the woods? We don't think so. While we are seeing good news (finally!), we believe that a big portion of this growth is pent-up demand and simply a return to normalcy. It is important to note that true reopening came about only in September when GoI clearly instructed State Governments to (1) not impose any local lockdowns and (2) not impose any restrictions on movement of people or goods. And therefore, September witnessed these impressive numbers.

On the flip side, Services remain in contraction as indicated by a Service PMI reading of 44.3. Unemployment (especially Urban) remains high and we are yet to fully see the second and third order impact in terms of defaults and bankruptcies.

We don't yet have a handle on how many businesses will shut down forever and how many will default. But it is likely to be big. And for any true recovery, we need credit growth to pick up. Given the backdrop of defaults ahead of us, we believe that it will be very difficult for Financial Institutions to unleash credit growth, the kind required for a big recovery. Unless, there is a big Fiscal intervention by the Government.

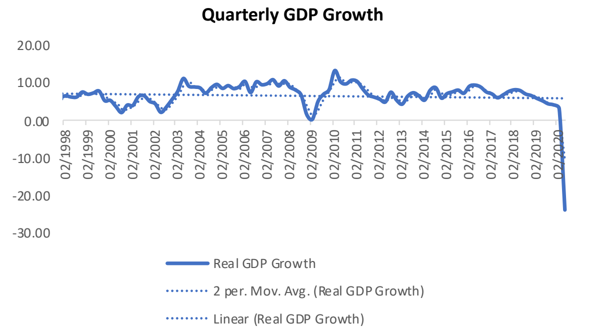
It is in this context that we believe that equity markets have run ahead of the underlying fundamentals. Despite markets being forward looking (the common rhetoric), nothing justifies a trailing PE of over 32 given that earnings growth in next 1 year looks fairly shaky.

We would like to end this section by talking about some reforms that were introduced in the recently concluded Monsoon session of the parliament. Introduction of new Labor Code, Agricultural reform bills and Amendment in Companies Act are 3 big reforms that stand out. While Agricultural reforms are truly game changing, Labor reforms, although not game changing yet, are steps in the right direction.

We believe that with these structural reforms along with eventual stabilization of GST regime (and rationalization of GST rates) and rationalization of direct taxes (corporate already done), India is setting up for a big decade. And this makes us very bullish on Indian equities in this decade.

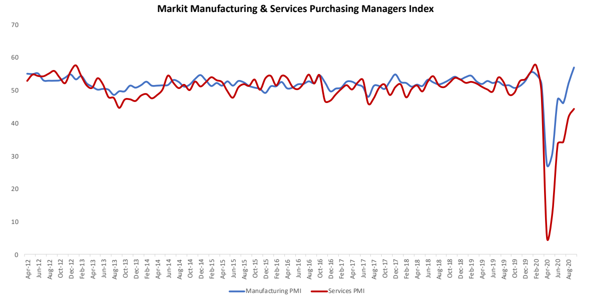
2. Economy through charts and indicators

Exhibit 36: India witnessed a historic contraction in GDP in the June quarter



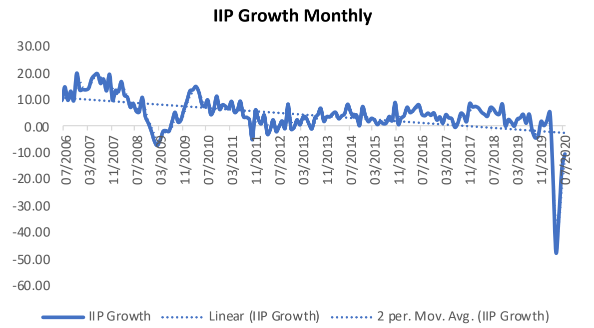
Source: MOSPI

Exhibit 37: Services PMI remained in contraction zone in September even as manufacturing surged



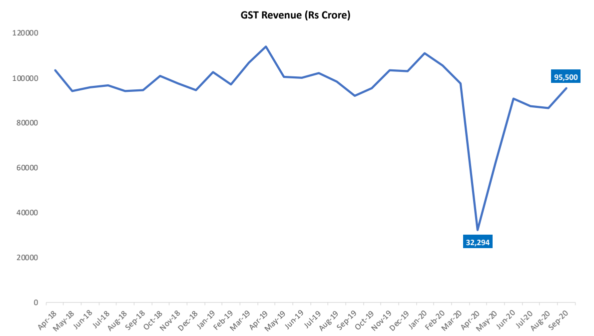
Source:Investing.com

Exhibit 38: IIP growth is recovering but remained in contraction in July



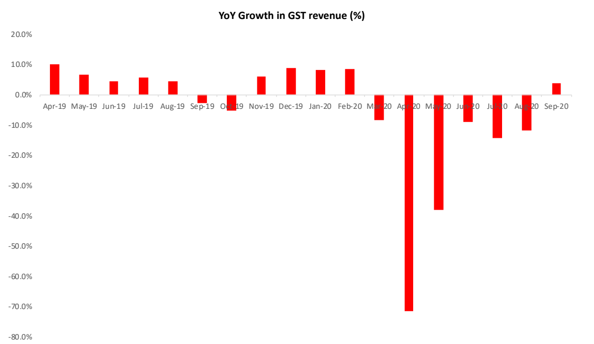
Source:MOSPI

Exhibit 39: GST revenue collection in September registered positive yoy growth



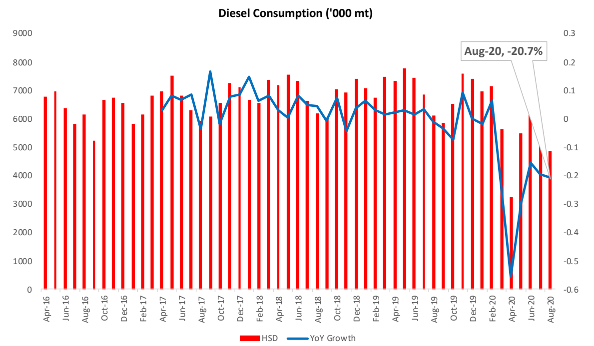
Source:GST Council

Exhibit 40: YoY growth in GST revenue turned positive in September



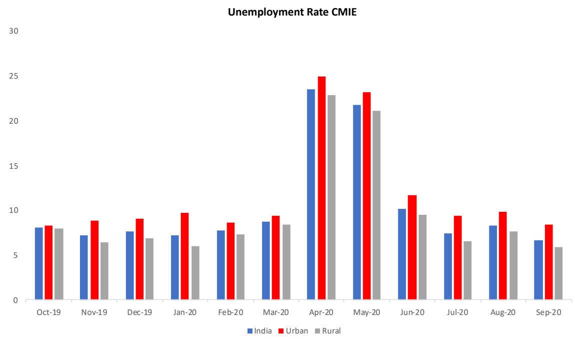
Source:GST Council

Exhibit 41: Diesel consumption in August was 20.7% below August 2019 levels



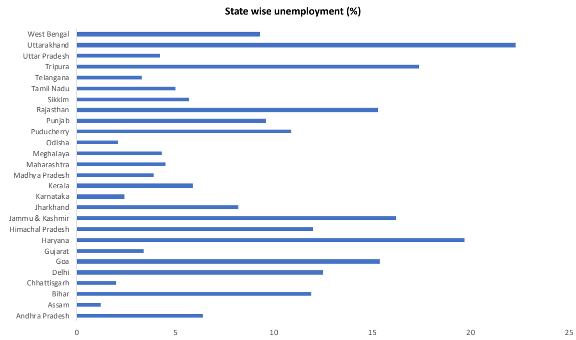
Source:MOSPI

Exhibit 42: Unemployment rate came down to 6.67% in September but urban unemployment high



Source: CMIE

Exhibit 43: State wise unemployment levels as of 30th September



Source: CMIE

3. Inflation and monetary policy

India's retail inflation (CPI) was 6.69% in the month of August. Wholesale price index increased from August and moved into slightly positive territory at 0.16%.

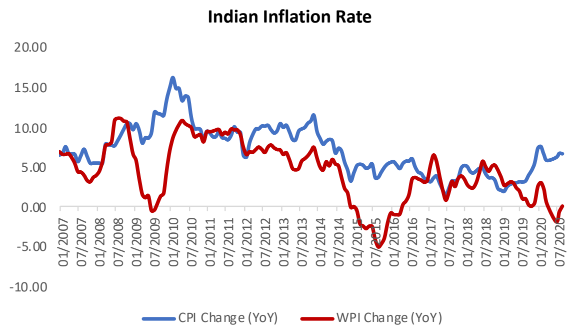
Higher inflation led to RBI holding onto policy rates in its August meeting thus putting an end to consecutive series of rate reductions. The inflation narrative is fueled by following reasons: (1) Unprecedented monetary and fiscal stimulus, (2) disruption in supply chain owing to COVID-19 and trade war and (3) inflation in commodity prices.

We however believe that the inflationary pressure is short term (driven by supply chain disruption and rising energy and commodity prices) and we will soon start seeing disinflation.

If we look at commodities index (Exhibit 46), it is now flattening after rising sharply from its April lows. The index was down 2.8% in September after inflating almost 40% from its April lows. Even crude prices are now falling – down 6.8% in September.

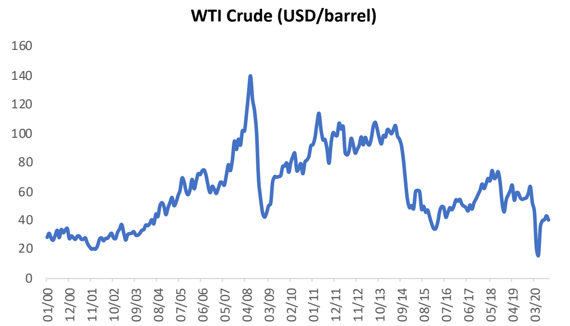
Price action in crude and commodities and the unprecedented demand shock reinforces our belief that current inflationary pressure is a transitory phenomenon, likely to give way to disinflation.

Exhibit 44: Deflationary pressure remains in the wholesale index



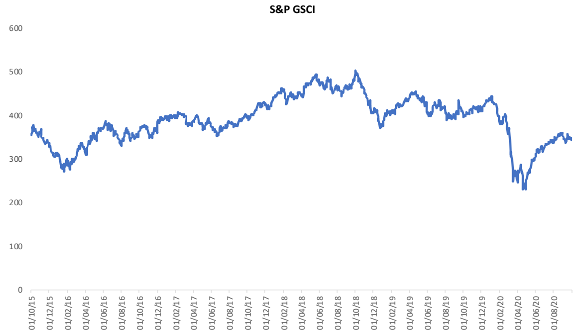
Source: Trading Economic

Exhibit 45: Oil prices have started to trend down in September



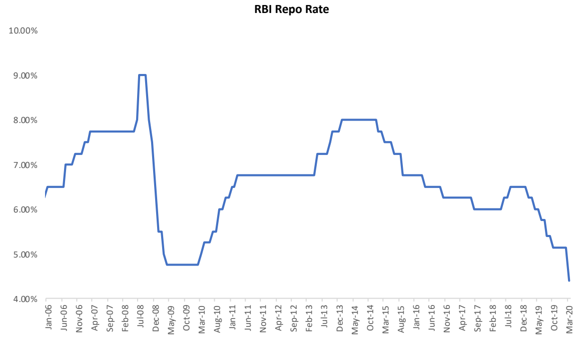
Source: MacroTrends

Exhibit 46: Commodity prices are now cooling off after a sharp run post April



Source: NASDAQ

Exhibit 47: REPO rate stands at 4%, lowest in 15 years



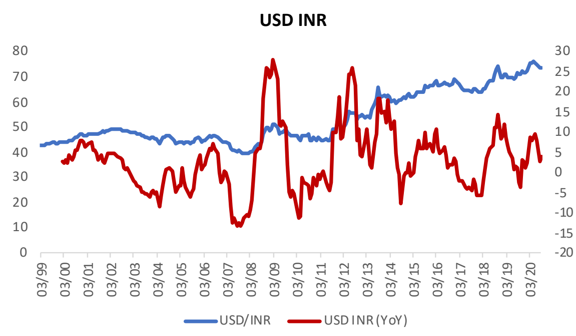
Source: RBI

4. Exchange Rate – INR continues to be strong

INR appreciated by 0.5% in the month of September on back of global dollar weakness and India's own current account surplus for second quarter in a row.

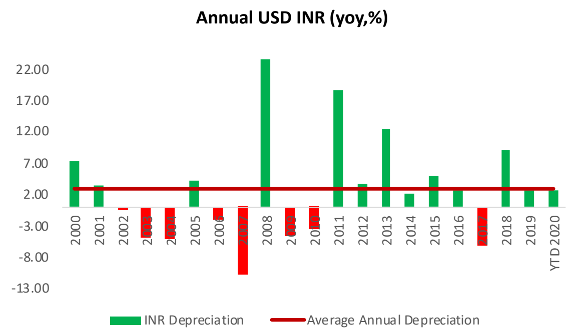
It is worthwhile to note that the Rupee would have likely appreciated sharply had it not been for the RBI. India's current account went into surplus in Q4FY20 and remained in surplus in Q1FY21 (Exhibit 51). Coupled with bumper portfolio flows (reversed somewhat in September), INR has been under strong pressure to appreciate. However, RBI, with its intervention in Forex market has so far avoided a strong appreciation leading up to record build up in Forex reserves (Exhibit 50)

Exhibit 48: INR appreciated by 0.5% during the September



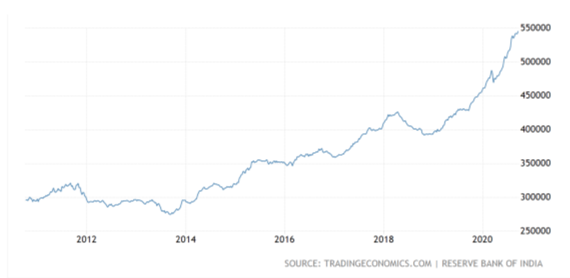
Source: NASDAQ

Exhibit 49: Rupee has been depreciated by 2.6% YTD in 2020



Source: MacroTrends

Exhibit 50: RBIs Forex reserve continue to make new record highs



Source: Trading Economics

Exhibit 51: India recorded current account surplus for the second consecutive quarter

Source: Trading Economics

Global Markets – Correction sets in

1. Global Equity Markets

In our last issue we had mentioned the following:

> *In our view, equity returns are likely to remain negative (or low) over the next 6 - 12 months. In fact, at these levels, there is a high probability of sharp correction (or even a crash).*

Well, September saw global markets correcting from their highs. US benchmark index S&P 500 was down 3.9% in September. In fact, the total correction from peak (3581 on 2nd September) to trough (3236 on 23rd September) was 9.6%.

The tech index NASDAQ was down 11.8% from peak to trough (down 5.2% for the month). We had warned about impending tech correction in our issue - History doesn't repeat, but it often rhymes.

China and HK also witnessed big correction of 5.2% and 6.8% respectively in September.

Is the correction overdone? Well, in the short-term, maybe. But we still feel that global equity markets still have one more leg down from here. When will it materialize is anyone's guess? It could be in the run up to US election or we could see another big rally up (on stimulus hopes or actual stimulus) and then a correction post US election.

Table 4: Performance of major indices across the world

Indices	1M	3M	6M	12M	YTD
S&P 500	-3.92%	8.47%	30.12%	12.98%	4.09%
Nasdaq	-5.16%	11.02%	45.03%	39.61%	24.46%
Russel 2000	-3.47%	4.60%	30.75%	-1.03%	-9.64%
FTSE	0.07%	-4.92%	3.42%	-20.82%	-22.23%
DAX	-1.43%	3.65%	28.43%	2.68%	-3.69%
Stoxx 600	-1.48%	0.21%	12.82%	-8.15%	-13.17%
Nikkei 225	0.20%	4.02%	22.56%	6.57%	-1.99%
Shanghai Composite	-5.23%	7.82%	17.01%	10.77%	5.51%
Hang Seng	-6.82%	-3.96%	-0.61%	-10.09%	-16.78%
NIFTY	-1.45%	8.93%	30.53%	-2.20%	-7.77%

Source: Bloomberg, Finpeg Research

2. Global Debt Markets

US 10-year bond yields continue to trade in a narrow range of 0.6% to 0.7% not being able to break out in either direction. In the process, volatility in the bond market has gone down to its lowest levels ever (Exhibit 54). Similar story of range bound yields is playing out in other markets as well including India.

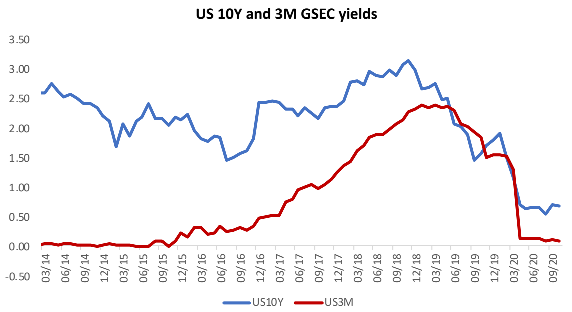
Despite FED's repeated assurances and guidance to stoke inflation, bond market is simply not buying it. At the same time, absence of a significant risk-off event has meant that yields have not collapsed either (in risk-off, investors pile on to safer government securities thus pushing the yields down).

But we feel that former is more important from point of view of equity markets. Bond market is simply not buying the narrative of a V-shaped economic recovery and inflation.

As we had highlighted in one of our previous issues, bond yields rose significantly after the beginning of QE1 in Dec 2008 and corresponded with a secular bull run in Equities as well. In contrast, this time, we have had a sharp rebound in Equities, but the bond yields are simply stuck.

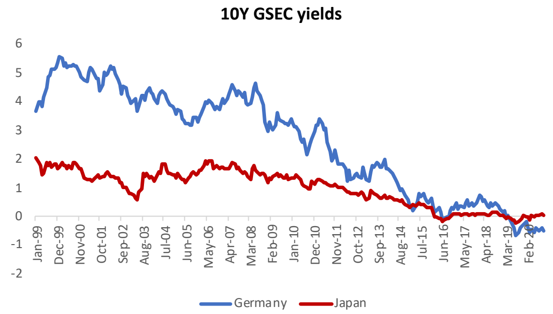
We should listen to the bond market!

Exhibit 52: US 10-year yields continue to trade in a narrow range



Source: Bloomberg

Exhibit 53: German and Japanese bonds are also trading in a narrow range

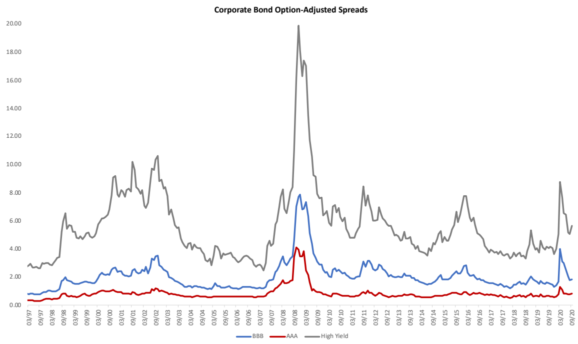


Source: Bllomberg

Exhibit 54: Bond volatility (as tracked by MOVE index) is now at its lowest level

Source: Google

Exhibit 55: Corporate Bond Spread in US over 10Y Treasury



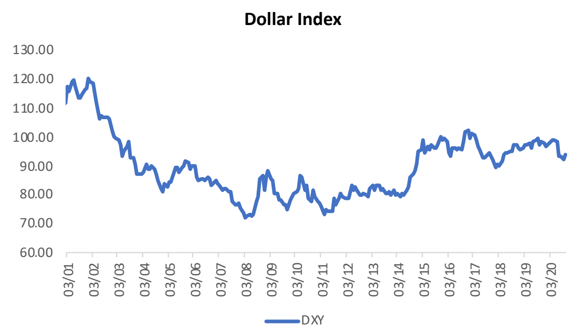
Source: FRED

3. Dollar and Gold

Months of July and August witnessed one of the sharpest corrections in dollar in last 4-5 years as dollar index (DXY) lost 6.3% in 2 months. The same period corresponded with a bumper rally in equity markets across the world.

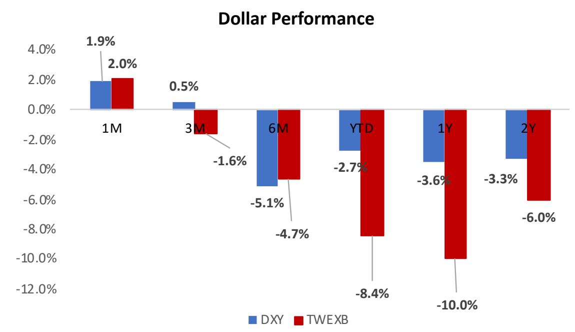
September saw a reversal in trend for both dollar and equities. Dollar was up (1.9%) while equities were down. Our regular readers would know that we continue to believe that there is one big leg up left for the dollar just like there is one leg down for the Equities before we are done with this cycle.

Exhibit 56: Dollar index (DXY) was up by just 1.9% during the month



Source: FRED, Bloomberg

Exhibit 57: Dollar index is down 2.7% year-to-date but was up in September



Source: Bloomberg

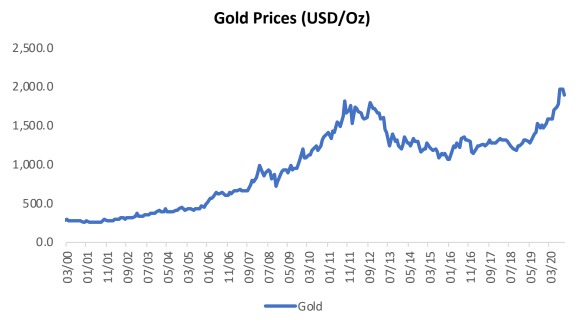
Gold witnesses a "healthy" pullback

In our previous issue, we had highlighted that Gold was overbought and in the short-term, Gold could see some selling pressure which could coincide with risk-off events. Turns out, that is exactly what happened in September.

From its high of USD 2070/oz on 6th August, Gold corrected by almost 10% by 25th September before rebounding again.

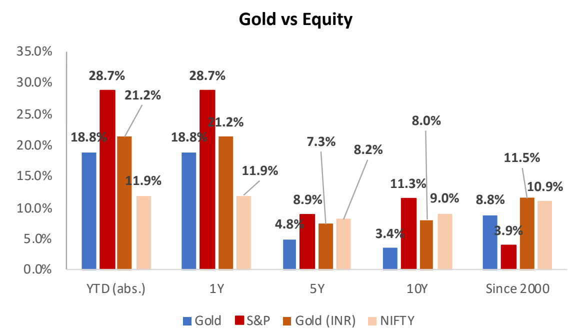
We continue to be bullish on gold from a medium-term perspective. In our view, rampant "debasement" of USD (as well as other major currencies) by Central Bank and large doses of Fiscal stimulus will makes gold very attractive w.r.t fiat currencies.

Exhibit 58: A healthy correction from overbought levels in September



Source: Goldprice.org

Exhibit 59: Gold has been the best performing asset class since 2000 both in INR and USD terms



Source: Bloomberg

Global Macro

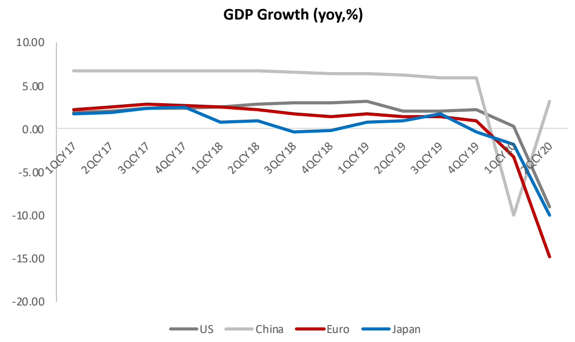
1. Global Macro Snapshot

Table 5: Overview of major and emerging economies

	US	Germany	Japan	UK	Euro
GDP (latest)	-9.00%	-11.3%	-9.90%	-21.5%	-14.7%
Inflation (latest)	1.30%	-0.20%	0.20%	0.20%	-0.30%
10Y Gsec (latest)	0.67%	-0.54%	0.02%	0.25%	0.14%
Central Bank Rates (latest)	0.25%	0.00%	-0.10%	0.10%	0.00%

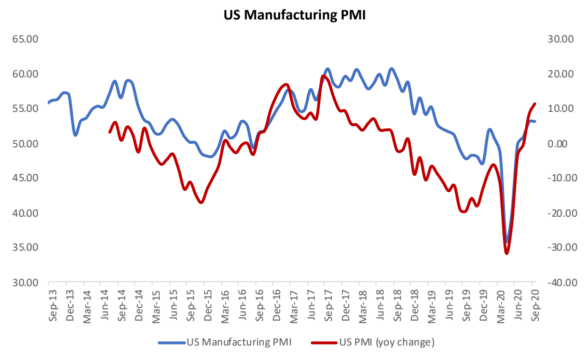
	China	Indonesia	Brazil
GDP (latest)	3.20%	-5.32%	-11.4%
Inflation (latest)	2.40%	1.42%	2.44%
10Y Gsec (latest)	3.23%	6.92%	7.38%
Central Bank Rates (latest)	3.85%	4.00%	2.00%

Exhibit 60: Sharp contraction in US and Euro zone in Q2 and a rebound in China



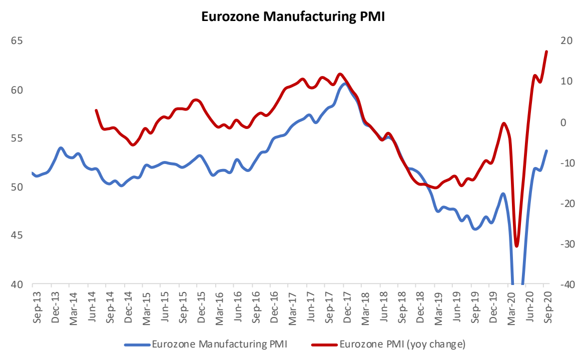
Source: TradingEconomics

Exhibit 61: US manufacturing PMI in expansion zone for the third month



Source: Investing.com

Exhibit 62: Sharp uptick in Eurozone manufacturing activity led by Germany



Source: Investing.com

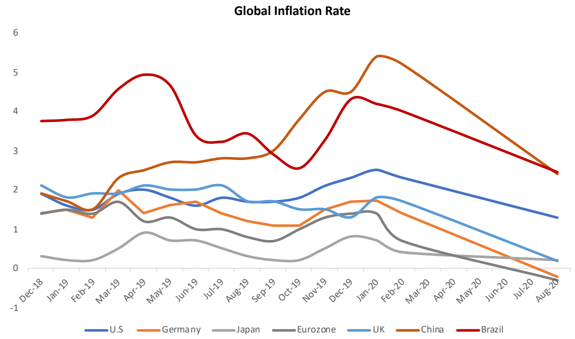
Exhibit 63: Chinese recovery slowing down as indicated by manufacturing PMI

Source: Investing.com

Inflation cooling off everywhere

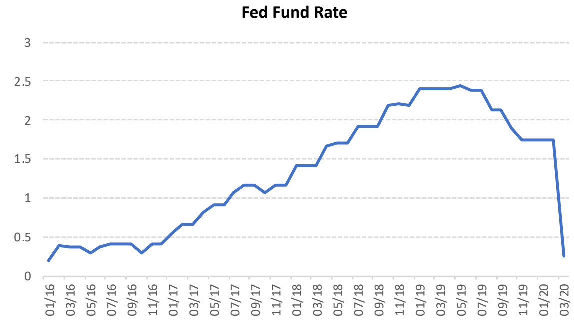
We have been constantly calling out for moderate inflation (or even deflation) in most of the developed world. While we saw a temporary spike in inflation, the same seems to have abated as inflation begins to cool off around the globe in line with falling crude prices and commodities. In fact, Eurozone has now entered into deflation territory with second consecutive month of negative inflation print.

Exhibit 64: Inflation headed lower across the world also corroborated by cooling oil and commodities



Source: Investing.com

Exhibit 65: US Fed brought the rates down by 150 bps in 2 back-to-back emergency cuts



Source: Bloomberg

Exhibit 66: 5-year inflation expectation came down sharply in September

Exhibit 67: Even 5-year forward inflation expectation has come down significantly

Source: FRED

Performance Data

1. Best performing Equity Mutual Funds in September 2020

Best Large Cap Funds	1M	YTD	1Y
IDFC Large Cap Fund	1.0%	-0.9%	3.8%
IDBI India Top 100 Equity Fund	0.5%	-4.2%	0.0%
Invesco India Largecap Fund	0.5%	-2.9%	2.0%

Best Multi Cap Funds	1M	YTD	1Y
UTI Equity Fund	2.3%	2.7%	10.1%
DHFL Pramerica Diversified Equity Fund	2.3%	10.6%	15.6%
Invesco India Multicap Fund	1.7%	-1.7%	2.6%

Best Mid Cap Funds	1M	YTD	1Y
DHFL Pramerica Midcap Opp Fund	6.4%	23.3%	31.5%
UTI Mid Cap Fund	4.2%	10.1%	15.0%
L&T Midcap Fund	4.1%	3.4%	8.0%

Best Small Cap Funds	1M	YTD	1Y
HSBC Small Cap Equity Fund	6.0%	7.4%	5.4%
Kotak Small Cap Fund	5.1%	9.1%	13.9%
L&T Emerging Businesses Fund	4.7%	-3.0%	-1.9%

Best Large & Mid Cap Fund	1M	YTD	1Y
Essel Large & Midcap Fund	3.3%	-6.8%	-4.1%
Invesco India Growth Opp Fund	2.9%	-3.4%	1.1%
Aditya Birla SL Equity Advantage Fund	2.6%	-4.9%	3.2%

Best Focused Fund	1M	YTD	1Y
IDFC Focused Equity Fund	1.6%	1.6%	8.9%
DSP Focus Fund	1.1%	-9.9%	-2.0%
IIFL Focused Equity Fund	0.4%	-0.1%	6.9%

Best ELSS Fund	1M	YTD	1Y
Canara Rob Equity Tax Saver Fund	4.0%	5.9%	10.6%
BOI AXA Tax Advantage Fund	3.3%	9.1%	16.2%
Kotak Tax Saver Scheme	2.1%	-3.6%	2.3%

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