September saw the Sensex contract by 1.4% to 31,284. Geo-political tensions around North Korea, a hawkish Federal Reserve (Fed.), Trump tax reform blueprint and a crude price increase were the highlights of September globally. On the domestic front, speculation on a fiscal stimulus aside, the government's 'Saubhagya' scheme and PPP in housing were important focus points during the month. The Indian markets saw a net outflow of $1.64bn. The rupee saw a depreciation of 2.2% to 65.3 to the dollar as the dollar index strengthened by 0.4% during the month.

Global

Markets remained volatile through the month of September. Geo-political uncertainty around North Korea was the backdrop of the month. Crude price increase, Fed. assigning a start date to the balance sheet contraction, failure to repeal & replace Obamacare, Trump's new travel ban and his attempt to introduce tax reforms were the key events of September. Developed markets (DM) closed marginally positive, while emerging markets (EM) were a mixed lot as the crude price jump favourably impacted crude-dependent EMs. This was the first month of underperformance of Ems against DMs this year. DM macro prints remained positive with the Fed. and the European Central Bank (ECB) revising their 2017 growth estimates upwards and the Bank of Canada (BoC) acknowledging strong domestic growth. In addition the WTO increased their growth forecast range on the back of an increase in import demand from North America and Asia. The month also saw the US debt ceiling being postponed to December from September earlier.

Central banks

The central banking space was fairly active and started the month with a surprise hike from the BoC on growth and a cut from the Brazilian central bank on inflation. Indonesia, Russia and the Czech Republic also witnessed a cut in their respective policy rates. The Fed. and the ECB behaved in a similar fashion by pushing up their growth forecasts and bringing down their expectations on inflation. The Fed. set the start of the balance sheet taper for October, while the ECB indicated a continuation to its QE program. While DM central banks have clearly seen a shift in language towards better growth, they were seen thinking aloud on why inflation had not caught up with better growth. Yellen in her post policy commentary called undershooting inflation a "mystery". However, on rates, Yellen has communicated in clear terms that the Fed.'s strategy would be to continue raising rates and that she would not wait for inflation to touch its 2% target. This commentary from the Fed. had an impact on the longer end of the yield curve which reacted sharply upward, trickling into other DM yields as well. Rising global trade and increasing acknowledgement of growth by DM central banks raise the risk of yield slippage in global bond markets.

Domestic

September started with the markets feeling the overhang of weak Q1 GDP prints. This led to a general backdrop of market focus on the fiscal. Comments from Jaitley just after mid-month increased market speculation on a probable fiscal stimulus package from the government. While the government is likely to stick to broad fiscal prudence, there does appear a likelihood for the finance minister to tap into the escapes clause of up to 50bps introduced in this year's budget. Macro prints during the month were muted with an increase seen in wholesale and retail inflation. The current account deficit saw an increase, IIP inched lower on GST impact and crude oil prices rose globally on supply concerns. All of the above pushed up the clamor for a fiscal stimulus for the markets. On the positive side, PMI numbers witnessed a gradual increase during the month. Collections from GST were encouraging giving reasonable room to expect upward revisions in indirect tax receipts. The borrowing plan remained unchanged for the fiscal. On the policy front, the government introduced the 'Saubhagya' scheme, heavily subsidizing electrical connections. This would push power for all by 2018. The government also announced a new PPP policy for affordable housing which would help to achieve the 'Housing for all' target set for 2022.

Flows

September saw fund inflows continue into both the EM and DM space. Flows into EM fixed income remained positive with strong inflows into hard currencies relative to local currencies. EM equities witnessed marginally higher inflows from the previous month. Europe dominated inflows into the DM space. Japan saw lower inflows while the US witnessed reduced outflows. The broad monetary divergence between DM central banks looking to raise rates and EM central banks with a soft rate bias continue. Currency stability and relative performance that helped hold the structural EM differentiation story, was shaken a bit in September with dollar strength. September saw outflows from Indian equities to the tune of $1.8bn. and much reduced inflows into debt at $0.2bn.

Outlook

The Government's firm commitment to spur the infrastructure investment cycle is already reflecting in improved execution on the ground. Focus on rural incomes and spend is also helping broad-basing growth and serves as a long term driver of the consumption story. The stress in the banking system has seen more targeted addressing, as expected, with recognition, provision of bad loans, resolution and subsequent capitalisation commitments. The Govt. has been laying the foundations for the road to sustainable growth through broader reforms & efficient administration. While we continue to believe that all is well with the economy on a medium term perspective, there are some concerns on disruptions from GST implementation in the backdrop of weaker growth in 1q. GST transition impact though real in few quarters, we believe is a short term phenomenon and hence investors are advised to see it through patiently and have faith in the strong India growth story. Growth will be spurred by improved velocity of new currencies, rising rural incomes and improved demand going forward with the 1Q GDP print being the bottom. The uptrend in corporate results and earnings trend will gather steam into SH of FY18.

Softer inflation and better growth will gradually lead to a shift in the saving pattern of Indian households from physical to financial with a sharp bias towards equity. Mutual funds are well positioned to absorb this incremental shift. Corporate earnings are set to enter a double digit growth trajectory driven by the domestic recovery in this fiscal. Our funds are very well positioned to reap these benefits. Fed. is likely to move ahead gradually, keeping in mind not to pull down economic growth that has just seen some momentum. 2017 is likely to be the year of the fiscal with most governments acknowledging the need to create demand through fiscal spending. India will not be far behind in this move and will continue to remain prudent in such deficit spending. With the twin deficits reasonably contained, inflation well under control, bottomed out growth, a relatively stable currency and an extremely strong political mandate, India stands taller than the rest. While broader valuations, driven by domestic liquidity, indicate market discounting near term earnings, one will have to look beyond FY18 and look forward. Near term markets may undergo a time consolidation or be range bound, which could be a good time to get invested in a disciplined manner. Every bull market is interspersed with both time and value corrections while reasons could be varied. Every point of volatility would be an opportunity to buy India. With every turn of the markets, the India-differentiation story gathers more interest, momentum and conviction in that order. This would get louder in the coming quarters and a stable rupee would give comfort to the inflows. We continue to remain positive on our equity markets with a medium to long term outlook.

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