December saw the Sensex contract marginally by 0.3% to 36,068. A partial US shutdown, market volatility, a conciliatory China on trade and diplomatic tensions between China and Canada were the highlights of the month globally. On the domestic front, a spate of positive macro prints, the resignation of Urjit Patel as RBI governor and the BJP's state assembly loss in three key states were the key domestic notables. The markets saw a net inflow of $1.2bn. in December. The rupee saw an appreciation of 0.3% to 69.8 to the dollar, while the DXY weakened 1.1% during the month.

Global

The month of December was very mixed and volatile for the markets as a whole. However, India outperformed the developed markets and key emerging markets during the month. India appeared to resist for most part, the extreme volatility witnessed in global markets. The underlying thread behind global market weakness was that of global growth concerns that emanated from a possible hard landing for China, increasing concerns around trade war, concerns that more Fed rate hikes could sow the seeds of a recession etc. Apple's suppliers continued to sound out negative news around their earnings that was indicative of both China and global growth softening. Note here that the markets see Apple as a bellwether of global growth. On the trade war front, while the US continued to ramp up its anti-China rhetoric, China was seen slashing tariffs, opening up its earlier closed rice market to the US and release a draft foreign investment law proposing to ban forced technology transfer. In short, on trade China was heard as fairly conciliatory in its narrative. The month also witnessed extended war of words in the US between Trump and the Democrats on passing the spending bill with money for Trump's border wall. Trump refused to sign the spending bills without money for the wall and led the US into a partial shutdown that continued to run into Jan.'19. The month closed broadly negative for the developed markets especially the US, with concerns of a possible inverting of the yield curve that is seen as indicative of a recession into the future.

Central banks

Some select EMs saw rate hikes in December; but, the focus of the month was the rate hike by the Federal Reserve and the commentary around the same. Fed raised rates for the fourth time in December taking the Fed rate range up 25bps to 2.25-2.50%. The Fed dot plot indicated 2 rate hikes in 2019 from an earlier expectation of 3. While the rate rise was broadly expected, just ahead of the policy, the markets were increasingly factoring a December pause and some forward guidance on rate softness into 2019. While the dot plot moved lower, Fed language did not indicate any softness leading to market concerns on continued rate hikes into 2019. On economic projections, the Fed saw a very avoidable flip-flop. The Fed revised downwards is growth projection for 2018 and 2019 after raising it in its last policy. This volatility in its own projections were mainly on account of its delay in accepting the evident softness in global growth. It's forecasts were revised downward for both headline and core inflation as well.

Domestic

The month of December was entirely positive for macro data prints. While wholesale inflation saw an increase, retail inflation continued to ease, industrial production saw strength, PMI numbers rose and the trade deficit contracted. The RBI paused rates and indicated an increase in its OMO purchase, boosting system liquidity. December saw the RBI governor Urjit Patel step down from his governorship of the RBI before term completion, for personal reasons, His post was near immediately filled with the announcement of Shaktikanta Das, a retired IAS officer of Tamil Nadu cadre. Among a host of prestigious positions, Mr.Das has served as India's Economic Affairs Secretary and Revenue Secretary; bringing with him rich experience. The RBI initiated a committee on the Economic Capital Framework (ECF) headed by former governor Bimal Jalanduring the month. The government announced that they would infuse public sector banks with Rs.410bn of capital. Results of the state elections in December saw the BJP lose Chhattisgarh, Madhya Pradesh and Rajasthan to the Congress and won Mizoram. From a markets stand point, this is seen as a setback for the government in the run up to the 2019 elections.

Flows

The softening of the Fed's stance in comments outside the Fed policy has given a silver lining to the EM asset class. Flows into 2019 are likely to be more positive than what was witnessed in the last few quarters of 2018. December saw outflows from EM bonds and inflows into EM equities. Total EM equity flows remained positive for 2018, while total DM flows remained deep in the red. Equity witnessed inflows to the tune of $0.3bn, while debt saw inflows to the extent of $0.8bn. With the markets expecting lesser rate hikes from the Fed into 2019, the dollar index is likely to remain subdued. With muted commodity moves, this could translate into a more stable and range-bound rupee; giving impetus to a renewed differentiation.

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 significant & targeted addressing, as expected, with recognition, provision of bad loans, resolution and subsequent capitalization. The Govt. has been laying the foundations for the road to sustainable growth through broader reforms & efficient administration. Growth will be spurred by strong infra related spend, urban consumption, rising rural incomes and improved demand going forward with the bottom behind us clearly. The uptrend in corporate results and earnings trend has seen gathering steam over the last 12 months.

Softer than historic 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 into a double-digit growth trajectory driven by the domestic recovery.

Fed. is likely to slow its pace of raising rates while also calibrating the tightening of its balance sheet given the emerging softness in growth, amidst uncertainties. India continues to remain prudent in managing its fiscal while providing stimulus to sustain growth, a fairly well-balanced act. In the medium term, India, with its twin deficits reasonably managed, lower base levels of inflation, improving corporate growth, stands taller than the rest of the EM pack.

With the ongoing correction in the broad markets - more severe in small and midcaps - valuations are getting more comfortable than before with PE multiples tending to long term averages and lower. Domestic liquidity continues to be reasonably strong and we would keep faith in the corporate earnings recovery and look ahead into forward valuations of FY20 and beyond. The run up to the central elections & outcomes could create some short-term weakness in markets as also the noises on the trade war front. Near term Indian 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.