October saw the Sensex drop by 4.9% to 34,442. Global market weakness, continued Trump trade talk and China fiscal measures were the highlights of the month globally. On the domestic front, MSP hikes, RBI pause and RBI-govt disagreements were the key domestic notables. The markets saw a net outflow of $5.1bn. in October. The rupee saw a depreciation of another 2% to 74 to the dollar and the DXY strengthened by 2.1% during the month.

Global

The month of October saw the markets in a secular down move for most part, before it appeared to near bottom out by the end of the month. Indian markets clearly tagged their global peers, especially the S&P 500. Dollar strength led to an equal magnitude of rupee weakness and with large outflows from the EM pack, EM currencies were clearly seen under pressure. The underlying thread of market concern remained the trade spat emerging from the Trump administration. US-China trade friction continued with Trump reiterating that he would impose another round of tariffs on China. The US earnings season witnessed a strong narrative of how the trade tariffs were pushing up company input costs and leading to price rises. Trump created a string of concerns in the markets with his direct comments on the Fed chairman Jerome Powell on his handling of monetary policy. Trump raised concerns on the geo-political space with his decision to withdraw from a nuclear treaty signed with Russia in 1987. By the end of the month three unfortunate instances of violent attacks in the US on racial, religious and political grounds saw Trump's popularity drop sharply by 4% to 44%. US growth continued to remain strong with increased tightness in the labour market, drop in unemployment, rise in wage growth and the average hourly wage. China remained in the news as their fixed asset project approvals witnessed a significant rise. China took a number of initiatives to support its economy through rate cuts and fiscal incentives through tax cuts and widening tax exemptions. It also urged lenders to prevent forced liquidation of pledged shares; attempting to stabilise its economy that is seeing pressure from tariffs. The month of November is very important for the markets with the US mid-term elections being held. The results are potent enough to change the course of the Trump presidency for the rest of his term.

Central banks

October was relatively quiet on the monetary policy front compared to September which was replete with rate hikes in Europe and Asia. US growth continued to remain strong increasing the probability of continued Fed rate hikes. Powell does not see an overheating labour market. He mentioned that the economy was immune to the runaway inflation seen in the 60's. He also sees the US with below 4% unemployment for two more years and modest inflation. The Fed minutes released during the month showed a clear consensus on rate hikes with all central bankers choosing to hike rates in September. On the trade wars, the Fed released a report where 60 per cent of the businesses said that the tariffs announced/implemented during the year increased their input costs. Nevertheless, so far, none of the tariffs have found its way and dampened the Fed's forecast of the economy. The bank of Canada raised rates as they saw their economy running full capacity and hinted at more hikes to comes. The ECB overlooked the current softness in growth and attributed the same to 'idiosyncratic' factors. In India, the RBI was in the news for holding on to policy rates and shifting its stance to 'calibrated tightening'. The MPC minutes appear to indicate a pause in December as well. The RBI was also in the news for a perceived rift it has with the government, on various issues including npa regulations, easing credit flow, etc.

Domestic

The month of October was mixed on the macro front. While wholesale inflation inched up, retail inflation continued to ease indicating more easing for the months to come. Industrial production, adjusted for its restocking base of last year stood unchanged and positive from the previous month. The fiscal accounts witnessed expenditure containment while receipts saw a shortfall, leading to pressure on the fiscal deficit in H2FY19. Going forward, we see broadly three avenues open for the government to offset this GST shortfall: direct tax revenue pickup, non-tax revenue pickup, and a sharp cut in capex spending. The government announced MSP prices for the Rabi crop that was an encouraging average growth of 6.1%. The government also cut the prices of petrol and diesel by Rs.1.5 each and directed the OMCs to follow this up with an incremental cut of Rs1. As expected, crude has softened considerably since the middle of the month, discounting the effect of Iran sanctions, while simultaneously the concerns on rising CAD receded bringing relief to the INR too which came off 3% from the highs. The liquidity and rate scare experienced in the bond markets, particularly by nbfcs, too receded with supportive action by the Govt. and RBI. The earnings season thus far has been more or less on track with a double-digit aggregate growth, except for some weakness in consumer discretionary spaces which we think is transitory.

Flows

Focus on EM outflows continued in the month of October. The weakness in the US markets appeared to have a strong impact on EM outflows. The news flows around credit cycle issues in India's NBFC segment worked to deepen the outflows briefly. Indian equity markets witnessed outflows from both equity and debt. Equity witnessed outflows to the tune of $3.8bn, while debt saw outflows to the extent of $1.4bn. The currency volatility appeared to have subsided by the end of the month and November saw relative rupee strength on the back of a drop in the price of crude. As the turmoil in the currency space subsides, within the EM pack, India will gradually stand out. This would bring about the well needed 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 since the SH of FY18.

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 moving into a double digit growth trajectory driven by the domestic recovery.

Fed. is likely to move ahead on raising rates while also tightening its balance sheet given the stable growth scenario. FY18 was a year of the fiscal with most governments acknowledging the need to create demand through fiscal spending. India was not behind in this move but continues to remain prudent in such deficit spending. 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 strong and we would keep faith in the corporate earnings recovery and look ahead into forward valuations of FY20 and beyond. State election 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 fairly valued stable rupee would give comfort to the inflows. We continue to remain positive on our equity markets with a medium to long term outlook.