September saw the Sensex drop by 6.3% to 36,227. Increased market volatility, US tariffs, China retaliation, the new NAFTA and Fed rate hikes were the highlights of the month globally. On the domestic front, launching of Aayushman Bharat, PSU Bank mergers, IL&FS defaults and Rupee measures were the key domestic notables. The markets saw a net outflow of $2.8bn. in September. The rupee saw a depreciation of 2.1% to 72.5 to the dollar, though the DXY remained flat during the month with a spell of weakness for most part.

Global

Markets were volatile with India seen breaking off its tagging of the S&P. DXY strength alongside a sharp increase in the price of crude appeared to reflect unfavourably in Indian markets. A large part of the weakness in India appears to be attributed to the second half of the month. Emerging markets and currencies were seen under pressure; Asian and Latam countries in particular. US macro prints remained strong and the Fed was seen reiterating their stance on rate hikes for 2018 and 2019. This appeared to set the backdrop for market volatility to hit markets in October. The month saw US imposing tariffs on $200bn of China imports and indicate that another $267bn of China imports could be targeted. China retaliated to US tariffs with their own imposition of $60bn on US imports alongside continued filing of complaints with the WTO on US tariffs. While China was seen retaliating to US tariffs on one hand, on the other, it continued with its opening up narrative. China cut tariffs on a number of items like machinery equipment, electrical equipment, textile production etc. The tariffs apply to nearly 1500 products that would mostly lead to lower costs for US consumers. The average tariffs appear to drop to the 7% handle from an earlier high 9% handle. After many rounds of talks, US, Canada and Mexico were seen finally agreeing to sign the new NAFTA, to be called the USMCA (US Mexico-Canada Agreement). The month was not devoid of Trump news flows that focussed on oil, geo-politics, Brett Kavanaugh and the US mid-term elections. Trump also accused China of meddling in the US mid-term elections through propaganda advertisements in US newspapers.

Central banks

The Central banking space was replete with rate hikes in Europe and Asia that were raised on the back of inflation in a few, as a currency tool in some and Fed rate hikes in others. The Fed raised rates by 25bps, taking the Fed rate upper range to 2.25%. In Europe, Norway, Czech Republic, Russia, Ukraine and Turkey raised rates alongside Indonesia and Philippines in Asia. US macro prints remain strong and the Fed raised rates a third time this year, on the back of this. The policy reaffirmed the December rate rise with an increase in its dot plot to 18 (from 12) members indicating a hike. 2019 continues to see 3 rate hikes. US growth forecasts were raised for both 2018 (3.1% from 2.8%) and 2019 (2.5% from 2.4%). On tariffs, the Fed is yet to see the numbers reflect impact. This positivity from the Fed appears to keep EM central banks at the edge of their seats deliberating if they must raise rates when their economies are experiencing a nascent recovery of sorts. September also saw PBoC surprise markets with a $39bn injection to its financial institutions through its 1 year medium term lending facility (MLF). This is seen to support small and medium companies from the impact of the on-going tariff war between the US and China.

Domestic

The month of September was mixed on the macro front. While both wholesale and retail inflation prints were seen easing, industrial production and manufacturing PMIs saw a drop during the month. GST collections remained relatively range bound. Global crude prices were on an up move along with continued rupee depreciation. This increased market concerns around the inflation outlook and RBI's actions to stem these risks. On the positive side, India launched a payments bank system targeting the unbanked in India. This is expected to offer financial services to the poor in rural unbanked areas of India. India also launched Ayushman Bharat which is set to provide health cover to 100mn families or 500mn poor people. This would provide a health cover of 5lakh rupees per year for the treatment of serious bodily ailments. The government announced measures to shore up the rupee and further measures to reduce non-essential imports of goods. The government's H2 borrowing was sharply brought down with a commitment to stick to its said fiscal deficit target for FY19. Also announced was the procurement policy for Kharif crops through MSP, price deficit and private players. On the banking side, the month witnessed announcement of the merger of BoB, Dena and Vijaya banks to address bad loans and to revive credit growth in the economy. While the IL&FS defaults triggered a scare in the money markets, quick action from the Govt. and strong liquidity measures from RBI helped ease the situation.

Flows

September saw an increased focus on EM outflows from both equity and debt. The EM asset class is fairly sensitive to the currencies to which it takes first exposure. Therefore it is fairly understandable to see market volatility around sharp currency moves. Indian equity markets witnessed outflows from both equity and debt. Equity witnessed outflows to the tune of $1.3bn, while debt saw outflows to the extent of $1.5bn. Despite the turmoil in the currency space, within the EM pack, India will stand out as soon as the volatility subsides. 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. Our funds are very well positioned to reap these benefits.

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. While we believe that the twin deficits will be reasonably contained, the current elevated levels of crude and the sustained USD strength has created concerns about the deficits and triggered weakness in our markets, accentuated by the scare in money markets & NBFC space. 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 FY19/20 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.