July saw the Sensex rise by 6.2% to 37,607. Escalation of the trade war narrative and China trying to support domestic growth was the focus of the month globally. On the domestic front, favourable macro backdrop with crude softness, softer than expected retail inflation, MSP hikes as promised, cuts in GST rates and a no-confidence motion win by the Modi led government were the key domestic notables. The markets saw a net inflow of $0.3bn. in July. The rupee saw a depreciation of 0.1% to 68.6 to the dollar, the same extent to which the DXY strengthened during the month.

Global

Markets were broadly positive in July but varied in their return profiles. India, as always continued to tag the US markets for a good part of the month, as did most EMs. The narrative around the US-China trade wars continued to dominate a great part of the markets' mind space. The first week of July saw the US impose its earlier proposed tariffs on China, prompting China to retaliate in equal measure. This triggered the US to impose a second round of proposed tariffs, details of which were released well ahead of market expectations. The US has made it clear in their language that they intent to exert maximum pressure on China and coerce them till they reform their ways and come to the table for talks. Hinting that the US was in this trade spat for the longer haul, Trump announced a $12bn aid package for US farmers, keeping the option open to extend aid further to other industries. Subtle non-tariff action was seen by China with English language cartoons on soybeans. This highlighted the risk US farmers had because of tariff imposition on imports from China. China pressure on US companies was also witnessed. Indicating that they would not be backing down in the face of tariff threats, China relaxed and tweaked its policies to shore up growth through tax cuts, boosting liquidity, loosening credit etc. Our base case on the trade war narrative is that of a die-down post the November mid-term elections. We attach only a low probability of a trade war blow-out post November. However, developments in July call for us to revisit this as it indicates intent from both the US and China towards an indefinite timeline on trade resolution.

Central banks

The central banking space was fairly quiet during the month with nearly all central banks on hold. The Bank of Canada was the only significant central bank that acted to raise rates, hinting at more. Developed market Central banks look to normalise rates and respond to domestic inflation and growth momentum in their respective economies. However, the broad trade war narrative and protectionist concerns are creating a flutter in the minds of Central bankers. They increasingly notice businesses responding to the uncertainty in the environment, holding back business plans to an extent. Central bankers appear a bit unsure about how much of hesitancy, they must factor into their rate decisions. Unless there is clarity on the trade narrative, Global Central banks would refrain from giving unambiguous forward guidance, leaving markets hanging in balance.

Domestic

July saw mixed macro prints. Retail inflation grew slower than expected at 5% against a higher consensus that helped ease the trajectory of inflation into FY19. Wholesale inflation on the other hand saw an increase on the back of manufacturing and fuel inflation. Industrial production remained soft on the back of a drag from non-durables and infrastructure. The PMI number however was at its highest since demonetisation and is likely to reflect in next month's Industrial production prints; on account of their one-half month lag in reporting. The monsoon deficit narrowed in July on the back of better rains in Central and Southern India. During the month, the Government fulfilled its budget promise and increased the minimum support prices for select kharif agricultural crops. The increase was at 1.5x the cost of production and more than that for some select crops while the weighted average hike is about 15%. The inflationary impact of this increase is not likely to be substantial as market prices for most crops are well below their current MSPs. Further, market prices moving up would mostly be linked to a ramp-up in procurement by the government; that is yet to be meaningful. There was a big relief in GST for consumer durables given in July which is expected to improve demand. Alongside this compliance around GST filing was also eased. The fiscal deficit for the quarter ending June was seen lower than for the same period last year. On the political front, July was a positive for the Modi led government as they won a no-confidence motion by a wide majority 325/126.

The earnings season has been good with fairly strong revenue and operating profit growth cross most sectors, in the mid to high teens range. The Corporate stress seems to be peaking off and expect improvement in performance of Corporate Banks over the year.

Flows

July saw net inflows into global equities. Long only funds as a category however continued to see outflows. The DM space saw equity outflows from Europe, but inflows into US and Japan more than compensated for this. EM equity outflows appeared fairly broad-based with a sell-off seen in both actives and passives. EM bonds however seemed to hold with marginal inflows in both bonds and bond ETFs. Indian equity markets witnessed positive net inflows after three consecutive months of significant outflows. July witnessed marginal inflows into equity to the tune of $0.2bn and $0.1bn inflow into debt. The last few months have seen FII outflows dominated by debt and this appeared to have stemmed considerably in July. With a rate hike by the RBI in August, the rupee is likely to stabilize a bit more and reduce the incentive for bond holders to move out of India bonds. India continues to see relatively lower twin deficits with its reform story intact.

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 and 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 and 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 second half 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. 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. With the ongoing correction in the broad markets - more severe in small and midcaps - valuations are getting more comfortable than before. Domestic liquidity continues to be strong and we would keep faith in the corporate earnings recovery and look ahead into forward valuations of FY19 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 stable rupee would give comfort to the inflows. We continue to remain positive on our equity markets with a medium to long term outlook.