February saw the Sensex contract by 1.1% to 35,867. Trump's declaration of emergency to fund the border wall, incremental positive developments on US-China trade talks and market expectations of a Fed pause through 2019 were the highlights of the month globally. On the domestic front, escalation in India-Pakistan tensions triggered by the Pulwama attacks and India's airstrike retaliation on the same was significant while a fiscally conservative budget, an RBI rate cut, and a new electronics policy were the other key domestic notables. The markets saw a net inflow of $1.1bn. in February. The rupee saw a depreciation of 0.5% to 70.8 to the dollar, while the DXY strengthened by 0.6% during the month.

Global

Global markets remained fairly positive through the month of February, with the Indian markets remaining divergent for most part. While the second half of the month saw a sharp pickup, the weakness and divergence of the first half dragged down the monthly returns that remained in the negative. February saw the Senate pass the funding bill that averted another partial US government shutdown. The bill however allocated $1.4bn of funds for the wall, much lesser than Trump's demand of $5.7bn. Subsequently, Trump declared a national emergency, bypassing the congress to acquire funding for the wall. 16 US states have sued Trump administration over this and the House has launched investigations against Trump for abuse of presidential powers. The month saw increasing positivity over US-China trade talks with two high level talks first with negotiations that covered some of the most contentious topics of forced technology transfers, IP protection, non-tariff barriers, agriculture and trade balance. Trump has also delayed the proposed tariff increases on Chinese good on the back of progress made in these talks. While the US-China trade narrative witnessed positivity, signs of friction were seen emerging between the US and EU, ahead of trade talks around the corner. On the macro front, weak prints and waning fiscal tax-stimulus in the US, brought back concerns over the US economy losing steam. Although the Fed's commentary on US growth remained largely positive, the weak macro prints have led the markets expecting the Fed to extend its rate pause through 2019. Europe's economy also remained under pressure with its largest economy Germany, narrowly avoiding a technical recession in Q4 2018. The Eurozone has also cut its growth forecast for 2019 to 1.3%y/y from an earlier forecast of 1.9%. Moving to China, various types of fiscal stimuli were announced to support its slowing economy that included announced tax breaks for small businesses run by recent graduates and low-income workers with more announcements.

Central banks

Central banking language especially in developed markets have seen a clear shift towards incremental accommodation. With likely global softening round the corner, this accommodative stance appears likely to continue through this year with emerging central banks likely following suit. The Fed indicated 'patience' in January and providing forward guidance to the markets on a possible stop to its balance sheet run-off. A large segment of the markets are expecting no hikes in 2019 with some even considering the possibility of a rate cut. While the Fed remained largely positive on domestic growth, in its semi-annual monetary policy report to the Congress, it acknowledged weakening in consumer and business spending. It also flagged "softer global and economic conditions" as one of the reasons behind its decision of pausing the rate hike cycle last month. After holding its rates in January, the ECB continued to remain soft on Eurozone growth. With Eurozone economies under stress, the ECB is expected to push its rate normalisation cycle well into 2020. Markets also expect TLTROs or Targeted Long Term Refinancing Operations to make a comeback soon. The TLTROs this time are expected to be of shorter term with variable rates that track ECB's main refinancing operation. Markets await more details to be released in the March or June ECB meetings. On the domestic monetary policy front, RBI under its new Governor, Mr. Shaktikanta Das cut rates by 25 bps bringing the repo rate to 6.25%. The rate cut was on the back of an opening that the RBI saw in the output gap, the need to boost private investment and the sharp downward revisions it observes in households' inflation expectations.

Domestic

Apart from the India-Pakistan related tensions over the Pulwama attacks and India's retaliation on the same; the domestic front in February saw the interim budget presented in the parliament. FY20 Budget saw the fiscal deficit remain flat at 3.4%GDP, after a 10bps slip in FY19RE. The budget was an overall positive with focus was from the bottom of the pyramid up to the middle classes. Farmers received direct investment support scheme, rural households were targeted with higher interest subvention, unorganized labourers received a social security pension blanket and middle classes with upto Rs.5 lakh of taxable income got full tax rebate. Retail inflation continued to ease further in January, indicating that inflation had not bottomed out yet as markets had originally expected. Wholesale inflation also continued to ease in February. The RBI board approved a transfer of Rs.280bn for its half year ending Dec'18 to the government. The total surplus transfer to the govt. now stood at Rs. 680bn. February saw RBI cut rates by 25 bps. The justification for this could be found in RBI's minutes that showed MPC members take a relatively dovish stance on inflation. All members without exception appeared to appreciate and take cognisance of the shift in inflationary expectations. The month also saw the Union Cabinet approve a new electronics policy that aimed at creating 10 million jobs, a scheme to build 19.5 million houses for the rural poor, a Rs.300bn rapid transport system for the National Capital Region and policy changes to make oil exploration more attractive. In additions to the above, the Cabinet Committee on Economic Affairs also allowed captive coal mines to sell up to 25% of their output in the open market, 40,000 MW of new rooftop solar projects, a new solar power scheme for farmers and the extension of key schemes for three more years. The Cabinet also approved an additional dearness allowance (DA) of 3% over the existing rate of 9% for government employees and pensioners, effective from January 1st 2019.

Flows

Developed market flows saw continued outflows from equity markets with a clear rise in outflows in Europe and the US, in that order. The Emerging markets however appear to have seen a return of fortunes with an pickup in inflows in 2019. In India, equity witnessed inflows of $2.4bn and debt saw an outflow of $1.3bn. The Fed.'s sharp shift in language and the market expectation of ECB's TLTROs, indicate incremental monetary policy accommodation that would be positive for the EMs as a whole. The EM economies therefore have a great amount of uncertainty pushed away from the sidelines. With an expectation of muted moves in commodities, a renewed EM differentiation can be expected round the corner. The equity inflows of $2.4bn is an inflow level not seen in the last ten months; despite the weakness in the equity markets in February. One could see this as an indication of better times of improved differentiation ahead.

Outlook

The Government's sustained push to spur the infrastructure investment cycle, focus on rural incomes and spend is 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 pause on 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.