June saw the Sensex contract marginally by 0.8% to 39,395. US-China trade war strains followed by resumption of trade talks in the G20 meet, World Bank downgrade of global growth and soft central policy language led by the Fed were the highlights globally. On the domestic front, positive macro prints and strained US-India relations were the key domestic notables. The markets saw a marginal net inflow of $2.0bn during the month. The rupee saw a depreciation of 1% to 69 to the dollar, while the DXY weakened by 1.7% during the month.

Global

The pessimism induced due to escalation of US-China trade war in May continued to overshadow market sentiment in June. The World Bank also reflected this broad sentiment and cut its global growth forecasts by 30bps to 2.6% on the back of increasing trade tensions. The above developments were reflected in global yields moving down, touching record lows. Markets pinned their hopes on a resumption of trade talks between the US and China in the G20 meet that took place end June. The G20 witnessed a plan to resume trade talks between the US and China, to prevent further escalation of their trade conflict. Trump also agreed not to impose tariffs on $300bn of Chinese imports while the negotiations were underway. Existing tariffs on China however would remain in place. Trump agreed to allow Huawei continue purchasing US goods and technology that did not pose any national security risks to the US. The month also saw its share of geo-political uncertainties with Iran shooting down a US military drone that allegedly had violated the Iranian airspace. Crude oil saw a sharp rise post this development and remained elevated for the rest of the month. US macro prints displayed some weakness, with non-farm payrolls increasing at a much slower pace, PMIs inched down and consumer sentiment touched record lows. The Eurozone economy appeared to worsen further with industrial production dropping for a second consecutive month. The German economy remained under pressure due to cooling domestic demand and a weak global trade environment. Macro weakness in China persisted with industrial production growing at its slowest pace since 2002 and auto sales falling for a 11th consecutive month. In the UK, Prime Minister Theresa May stepped down from her position after failing to get her Brexit deal passed in the British parliament. Boris Johnson, the face of the official 2016 Brexit campaign appears to be the most likely candidate to replace May.

Central banks

Increasing global headwinds led to softening in the language of developed central banks. The Fed in its June policy left rates unchanged, dropped "patient" from its policy. The June dot plot for 2019 showed more members expecting at least one rate cut by the end of 2019. The markets appear to have read this as a clear indication of rate cuts round the corner. The Fed also stressed on its intent to "sustain the expansion" of the US economy. ECB left its rates unchanged and delayed its rate hike at least until H1 2020. ECB also appears to have eased the terms of its third Targeted Longer-Term Refinancing Operation (TLTRO III), allowing banks to borrow from the central bank at 10 basis points above zero. In addition, banks whose net lending exceeds ECB's benchmarks would be allowed to borrow at upto 10 basis points below the average deposit rate; effectively paying certain banks to borrow from them. Draghi also indicated that ECB would ease the monetary policy further if it did not see inflation in Eurozone return to its target on a sustainable basis. Bank of Japan also left its policy rate unchanged. Like the Fed and ECB the BoJ Governor Haruhiko Kuroda sounded incrementally dovish mentioning that the BoJ could combine interest rate cuts with bigger asset buying if needed, to keep the economy on track to achieve its 2% inflation target. Domestically, RBI cut its rate consecutively for a third time on the back of an increasing output gap and the need to assuage an investment slowdown. Policy language appears to show a clear indication of more rate cuts down the road.

Domestic

Retail inflation marginally inched up while wholesale inflation appeared to soften and India's manufacturing PMI showed signs of improvement. On the RBI front, Dr.Viral Acharya resigned from his post of the Deputy Governor, six months before the completion of his term citing personal reasons. This did not have much of an impact on the markets as they were broadly priced in. India's trade relations with US became tensed after US withdrew India's trade benefits it received under the Generalised System of Preferences (GSP) scheme. Over 2000 Indian goods amounting to about $5.6bn will be impacted by this move. In retaliation India imposed higher retaliatory tariffs on 28 US imports products that is expected to strain bilateral trade relations. Indian tariffs targeted Iron and steel products, flat rolled products of stainless steel, tube and pipe fitting, boric acid, certain dry fruits, apples and lentils. Specifically almond and apple would be affected the most by this decision as Indian imports accounted for more than half of US exports of these products in 2018.

Flows

The month of June witnessed positive outflows from global emerging markets and inflows into developed markets. Developed market equity inflows appeared to be led by positive flows into the US and Japan, while Europe saw outflows. Another interesting observation was an outflow from long-only funds and a near triple inflow into ETFs. The inflows into the US and Japan can be read to be directly related to a flight into safe haven assets like the US and Japanese yields. India equity witnessed a drop in inflows to a marginal $0.2bn, while debt saw an increase in inflows to $1.2bn in June. A continued backdrop of soft global rates, would greatly benefit India, by creating a very conducive atmosphere for the RBI to deliver continued rate cuts in FY20.

Outlook

We expect the NDA Govt. to the sustain its push to spur the infrastructure investment cycle, focus on rural incomes and spend to help broad-based growth and serve 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 private sector capex cycle seems to be seeing an uptick across many sectors. The Govt. continues on the path of 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. Recent softness in commodity prices and enhanced political capital should provide adequate levers for the Government to deal with economic challenges without compromising on macro stability. We expect RBI to improve the domestic liquidity, drop rates, enable strong rate cut transmission and provide confidence in the financial market stability. 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 has chosen to pause on rates while also calibrating the tightening of its balance sheet given the emerging softness in growth, amidst uncertainties. ECB has moved to induce more targeted liquidity in the backdrop of softening growth too. We expect the US$ to remain soft with yields also more range bound. This scenario coupled with benign inflationary trends is quite positive for emerging markets and provides space for central banks here to cut rates and provide growth stimulus alongside with a fiscal equivalent. We expect continued fii flows into EMs.

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 a global risk on trade towards EMs coupled with reasonable valuations across broader markets, there has been a reversal of the weakness in the markets. Foreign inflows have turned up sharply while domestic liquidity continues to be reasonable. We would keep faith in the corporate earnings recovery and look ahead into forward valuations of FY20 and beyond. The noises on the trade wars, weaker monsoons and crude prices could create some short-term volatility in markets. Investors should continue to get invested in a disciplined manner without trying to time the markets. Valuations look reasonable across broad markets and we continue to remain positive on our equity markets with a medium to long term outlook.