September saw the Sensex grow by 3.6% to 38,667. Improving US-China trade relations, continued global growth softness and the Fed's second rate cut for the year were the highlights of August globally. On the domestic front, weak macro prints, contained inflation and the government's move to slash corporate taxes, were the events in focus. The markets saw a net inflow of $0.7billion in September. The rupee saw an appreciation of 0.8% to 70.9 to the dollar on improving sentiment, while the dollar index (DXY) strengthened by 0.5% during the month.

Global

The global economic environment continued to remain relatively weak with OECD cutting its global growth forecast for 2019 to 2.9% from 3.2%. The geopolitical situation in the middle-east also kept markets on edge after drone attacks on Saudi oil facilities saw crude jump 20% in intra-day trade. The attacks knocked out nearly 5% of global oil supply and 50% of Saudi Arabia's oil production capacity. Saudi Arabia however managed to minimise disruption and almost restored global supplies by drawing from its huge oil. The US-China trade war narrative also witnessed incremental positivity last month, with US delaying tariff increases on $250billion of China imports by 15 days to October 15th. China reciprocated the goodwill gesture by exempting 16 US products from additional retaliatory tariffs, ahead of high-level trade negotiations scheduled in October. US and Japan also appear to have reached an initial trade deal. The deal is expected to ease access for $7.2billion of agricultural goods. US-Japan trade has witnessed progress over the last year with the US having withdrawn its threat of imposing automobile tariffs on Japan. Markets now expect a near comprehensive deal to be signed between the US and Japan in the near future. US short frequency indicators paint a mixed picture of the US economy during the month. While ISM manufacturing index entered into the contraction zone for the first time in three years, manufacturing PMI increased to its highest level in five months. US consumer spending continued to remain robust, despite US non-farm payrolls suggesting a weakening labour market at the margin. The slump in Eurozone's manufacturing continues to worsen after the manufacturing PMI dropped to its lowest level in over seven years. Manufacturing PMI of China, however, pointed at a marginal improvement. Domestic demand however appeared to be subdued in China with total auto sales contracting for a 14th consecutive month. As Chinese economy continues to slow further, markets expect the government ramp up stimulus measures to support the economy.

Central banks

The central banking space remained quite active in September. The Fed cut its rates for a second time this year by 25bps to 1.75-2%. The policy language remained broadly unchanged except for acknowledging the strong pace of rise in household spending and the weak state of exports. The Fed mentioned that the rate cuts were to "provide insurance against ongoing risks". Powell was of the opinion that a moderate monetary policy would be enough to sustain the US' expansion and would be open to an "extensive sequences of cuts". The ECB also joined the Fed in easing its monetary policy. The ECB cut its deposit rates for the first time since March 2016, by 10bps to -0.5% and also announced resuming its Asset Purchase Programme (APP) or QE at a monthly pace of EUR20billion starting November. Do note here that the ECB had ended QE in December last year, tapering it to zero from a monthly pace of EUR15billion. The ECB has also extended the maturity period on loans given under the Targeted Longer-Term Refinancing Operations (TLTRO III) to three years from two years. To offset the cost of negative deposit rates, ECB also introduced a two-tiered deposit rate system, under which a part of banks' holdings of excess liquidity would be exempt from the negative deposit facility rate. Following its developed economy peers, China's PBoC also cut its Reserve Requirement Ration (RRR) by 50bps to 13% in a bid to spur growth in its slowing economy. It is estimated that the cut would release Yuan900billion ($126billion) of additional liquidity in the economy. Several EME central banks also cut rates last month. Out of 35+ EME central banks, September witnessed a net of fourteen rate cuts; the largest number since the GFC of 2008.

Domestic

Short frequency indicators appeared to paint somewhat of a weaker picture of the Indian economy. The manufacturing PMI remained unchanged at 51.4 in September but continued to remain below its historical average. Indian automobile industry continued to remain in stress, with total automobile sales contracting for a 9th consecutive month in August and passenger vehicle sales, for a 14th consecutive month. Retail inflation broadly remained contained and inched up only marginally; remaining well below the RBI's target. The corporate income tax cut appeared to be at the forefront of domestic policy developments last month. The government slashed the effective corporate tax rate to 25.17%, inclusive of all cess and surcharge, for domestic companies (from 34.9% at present), subject to the condition that companies would not avail any other incentive or exemptions available under IT. Further, new manufacturing companies that are incorporated after 1st Oct, 2019 would be taxed at a substantially lower rate of 17.01%, without deductions, subject to the condition that they commence production on or before 31st Mar 2023. The revenue forgone from this move is pegged at Rs.1.45trillion. However, we feel that the real impact is likely to be much lower than this quoted figure. Further on the fiscal deficit; we are confident that the centre stick to its consolidation with a slippage, if any, to be well contained under 30bps.

Flows

September witnessed continued outflows from global equities, with continued stress in long-only funds and a sharp increase in the pace of ETF inflows. The Developed Markets pack saw inflows with the large flows of funds into the US greatly offsetting Eurozone outflows. The Emerging Markets pack outflows continued with a marginal bias towards China. In India, September saw equity inflows to the tune of $1billion., while debt outflows stood at $0.3billion. While global markets continue to grapple with global growth slowdown concerns, India appears to be focused on reviving domestic growth through a combination of rate cuts and fiscal measures.

Outlook

The slowdown in the economy has been continuing over the last five quarters and is hurting. The broader segments of housing, finance companies, auto and auto component sectors remain weak impacting the economy at large. The uncertainty over the corporate stress and labour markets are also adding to the worries. The weakness in the rest of the world is also not helping either, though monetary policies are in full swing to reverse it.

The NDA Government, in its second term, continues 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, though elongated in timelines, as expected, with recognition, provision of bad loans, resolution and subsequent capitalization. The NBFC sector is slowly emerging from high cost of funds and liquidity tightness thanks to efforts of efforts of Government. & RBI. We expect more action here in order to bring back confidence in the asset quality of the book.

The major policy reform from the Government. in the form of the corporate tax rate cut and incentivisation of a low 15% rate for new manufacturing companies is a game changer to kick start the next big corporate capex cycle. We expect a fairly huge FDI acceleration as India positions itself as a major alternative to China. Another big step is the privatisation and or strategic divestment program of the Government., something that again is a bold step in the right direction, necessitated by the deteriorating fiscal condition.

The Govt. continues on the path of sustainable growth through broader reforms & efficient administration. Monsson progress has improved significantly and is not a worry any longer this year. We expect the economic growth will be steadily improve from now and accelerate in the next fiscal, 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 sustain sufficient domestic liquidity, soft rates, enable strong rate cut transmission and provide confidence in the financial market stability. The recent results have halted the uptrend in corporate results and earnings trend that gathered steam in FY19 but we expect the tax cut to boost the earnings in FY20 too.

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.

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 long term corporate growth, stands taller than the rest of the EM pack.

In the near term, the markets have taken a beating with FIIs also turning sellers, driven by growth scare which we think is more temporary and transient. Foreign equity outflows 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 which are reasonable. The noises on the trade wars, local growth scare and loan defaults 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.