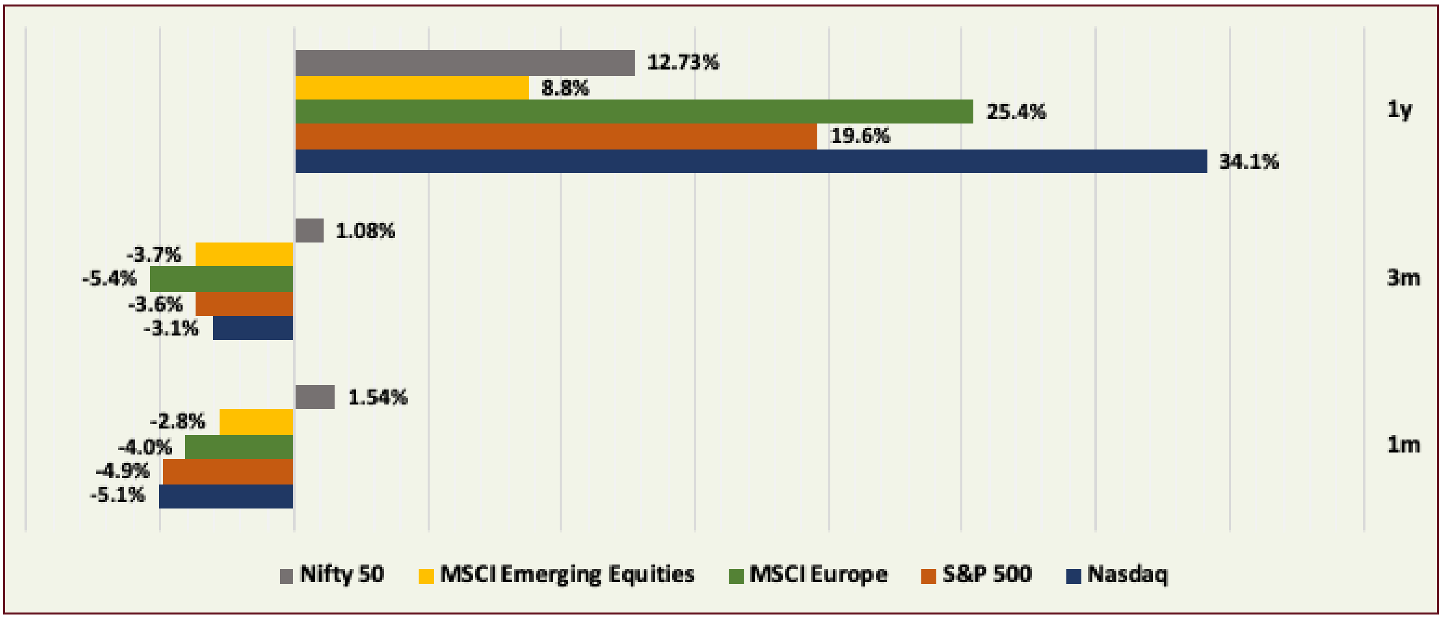
Global Equities (in USD terms)

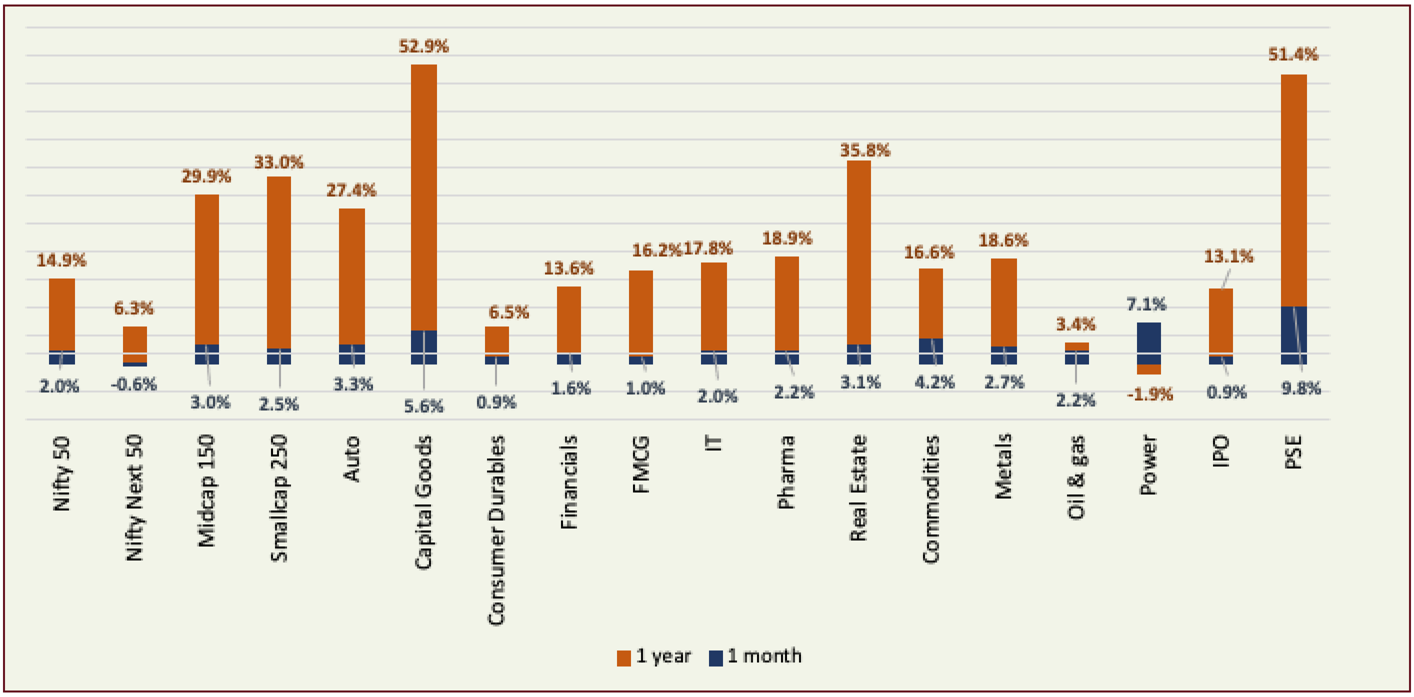
Developed market equities fell by -3.4% over the quarter, with YTD returns still strong at 11.6%. Value stocks turned out to be more resilient against their more growth counterparts, returning -1.7% and -4.9% over the quarter respectively.

S&P 500 corporate earnings are expected to be flat following three declining quarters. After the recent weakness the Nasdaq-100 stands +41% from its 52-week lows.

August and September have historically been "seasonally weak" as they are the two worst-performing months on average since 1970. In this regard, declines in all 3 major U.S. equity benchmarks was more or less expected, marking their first quarter in red since Q3 2022.



Domestic Equities



Indian equity indices ended lower in the last week of September on weak global equities markets amid fears of higher interest rates by the Federal Reserve (Fed) and surging crude prices.

Both Mid and small cap indices witnessed corrections in the 2nd half of September after scaling 52-week highs.

Capital Goods industry continues to generate higher returns while Power stocks and PSEs stole the limelight.

Almost all sectors generated positive returns over the month despite correction in the 2nd half of the month.

Commodities

Commodities	Returns		
	1m	3m	1y
Brent Crude	6.9%	22.4%	7.9%
Precious Metals			
Gold	-4.7%	-3.7%	11.3%
Silver	-9.3%	-2.6%	17.8%
Industrial Metals			
Steel	-1.6%	-2.5%	-10.0%
Iron Ore	1.7%	5.3%	18.3%
Aluminium	-0.5%	2.1%	-6.9%
Copper	-1.2%	-0.7%	8.6%
Zinc	8.8%	11.0%	-10.7%
Nickel	-8.2%	-9.4%	-12.2%
Lead	-2.1%	2.6%	17.2%

Crude rose 29% in Q3, or as much as 40%, from the final week in June to the late September highs. The announcement that Saudi Arabia and Russia will extend voluntary oil output cuts through to the end of the year was the major catalyst behind the move. It was also more concerning as it showed coordination between Russia and Saudi.

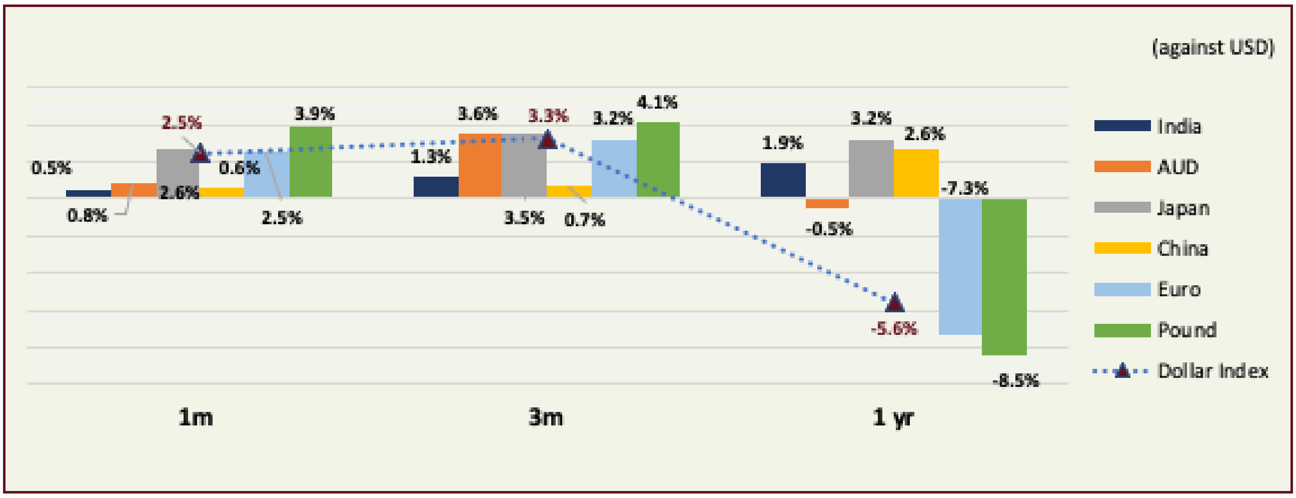
Rising energy prices tax consumers and corporations at the expense of future economic activity and reduce the likelihood of a soft landing.

Gas and heating oil rose 41% and 37%, respectively, while EU natural gas rose 13%.

A relentless surge in the dollar index towards a 10-month high, driven by growing concerns over persistently high interest rates in the US, exerted downward pressure on gold prices.

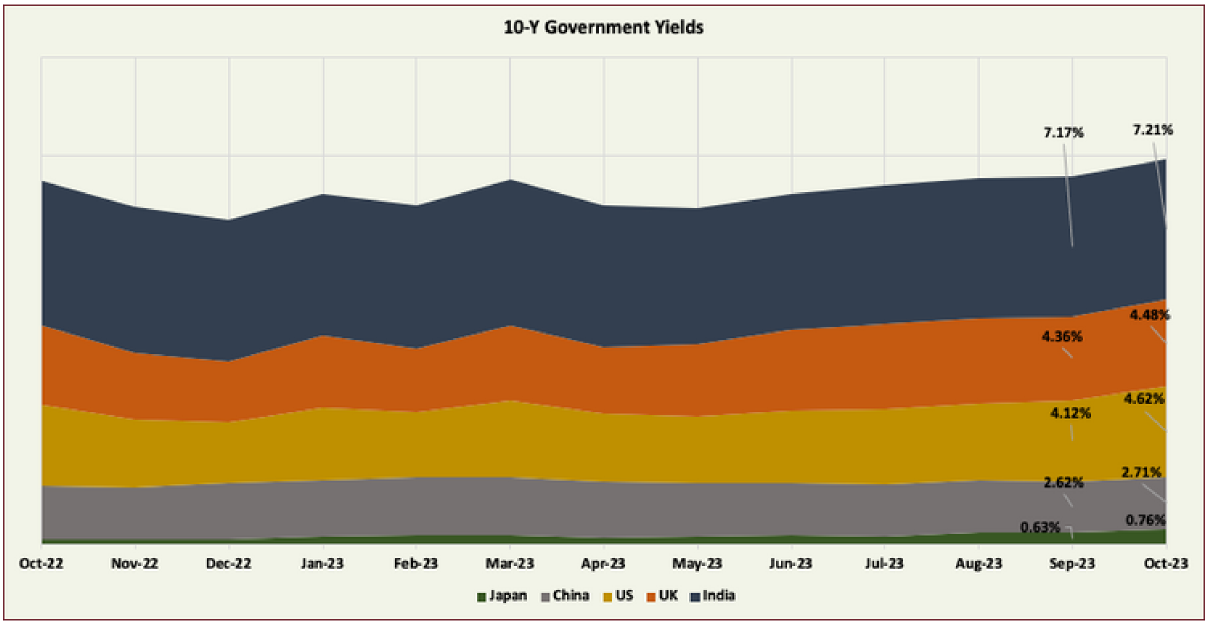
Currencies

(depreciation against USD)



The U.S. Dollar Index (DXY) closed out with a streak of eleven consecutive weekly gains, its 2nd longest streak in 50+ years and reaching fresh 2023 highs. The dollar rose against nine of ten G10 currencies, as well as most EM currencies. USD INR closed at 83.05 with the currency depreciating only 0.5% against USD.

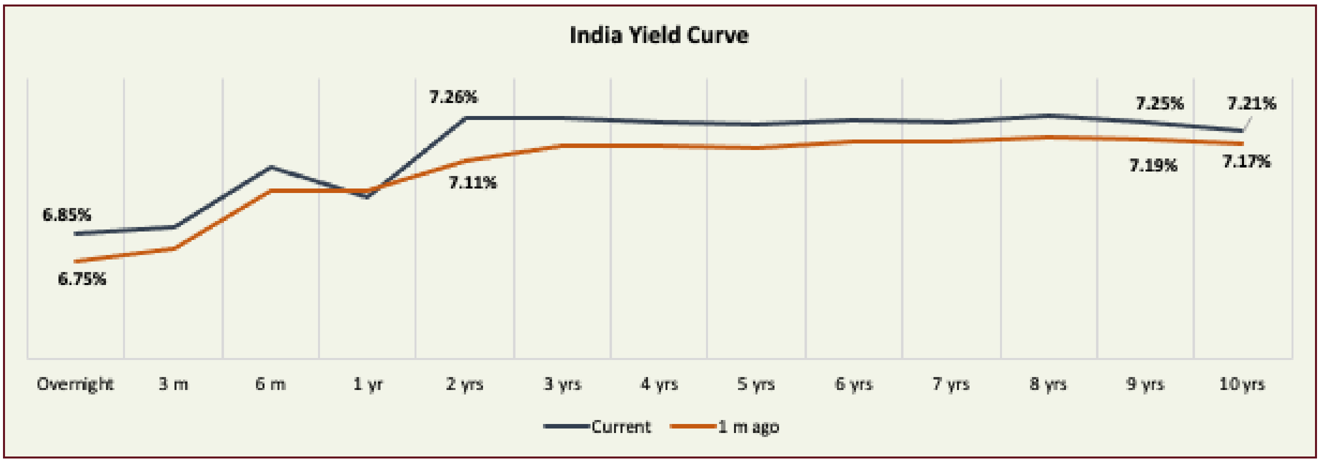
Yield Trends



Global Yields

The 10Y Treasury Yield advanced 74bps in the quarter, touching a 16-year high of 4.69%. With the Fed approaching the end of its rate hike cycle, the shorter-end the 2Y yield rose a modest 15bps. Accordingly, a bearish steepening is witnessed all through the month. After bottoming at -108bps in March - June, the 10Y-2Y spread has since been steepening. In the last seven sessions following the September 20th FOMC, the spread steepened an additional 30bps to close the quarter at -47bps.

In govt. bond returns, UK Gilts remain the major laggard YTD, but did enjoy relatively better few months, returning -0.7% over the quarter. Weaker growth data forced investors to dial down their expectations for where interest rates will peak in this hiking cycle. The US Fed is indicating a restrictive monetary policy for some time as the debate over another rate hike is ongoing. Markets are pricing in a 35% probability for one additional rate hike this cycle.



India Yield Curve

RBI kept the policy rates unchanged at 6.5% in today's monetary policy, while maintaining withdrawal of accommodation stance. Inflation (at 5.4%) and GDP growth (at 6.5%) forecast for FY24 were kept unchanged compared to August policy. Debt markets reacted negatively - 10Y G-sec yield went up by 9 bps. Stance of 'Withdrawal of accommodation' was expected to change to 'Neutral'. This would have meant being open to rate cut at some point over the next few months.

Also, while Inflation projection maintained at 5.4%, they have mentioned key risks to inflation like Kharif outcome, level of reservoirs and global macro. This means inflation and in turn interest rates could remain elevated for longer periods.
To manage surplus liquidity. RBI may conduct OMO sales from time to time.

India Macro Trends

Month Gone By

India's GDP is expected to grow 6.2% in FY24, being the fastest-growing major economy in the world according to a Reuters poll.

India's core sectors has seen a whopping growth of 12.1% in Sep 2023, highest in 14 months. Power, Coal, Cement, Steel and Natural gas contributed to over 10% growth.

Fiscal Deficit has widened to 6.43 lakh crore, while the deficit in August is down 81% YoY.

	FIIs	DIIs	FII Debt
Apr-23	11,631	2,217	806
May-23	43,838	-3,306	396
Jun-23	47,148	4,458	9,178
Jul-23	46,618	-1,184	3,726
Aug-23	12,262	4,383	3,276
Sep-23	-14,768	2,751	938

Inflation, Manufacturing & Liquidity

CPI data	
Month	Inflation
Mar-23	5.66
Apr-23	4.70
May-23	4.31
Jun-23	4.87
Jul-23	7.44
Aug-23	6.83

8.2% decline MoM

PMI		
Month	Manufacturing	Services
May-23	58.70	61.20
Jun-23	57.80	58.50
Jul-23	57.70	62.30
Aug-23	58.60	60.10
Sep-23	57.50	59.0 (Exp)

Manufacturing PMI at 3-month low

Surplus Liquidity (in crore)	
Month	Inflow
Apr-23	79,885
May-23	89,697
Jun-23	2,84,219
Jul-23	3,67,517
Aug-23	3,60,558
Sep-23	2,36,206

Liquidity down

Other Trends

Corporate Bond Issues: 14751 crore

Core Sector Growth: 12.1% in Aug 2023

GST Collection: 1.63 lakh crore (slowed to 10.2% increase YoY from a previous 10.8%)

Time to Sell Small Caps?

Most Investors get attracted by the high rates of return numbers displayed across the funds in Mid and Small cap categories. While determining the consistency of returns is important, it is equally important to understand the sustainability of such high returns over the long term.

For example, the table below shows the returns comparison across MF categories in the last 20 year period. Specifically, each period of 5-6 years has been considered from 2003, under which periods between peaks and troughs are again compared. For instance, of the Sep '03 - Mar '09 (5.5 year) period, returns between the trough (Jan '08) and the peak (Mar '09) are also compared.

Date	Nifty 50	BSE 200	BSE MIDCAP	BSE SMALLCAP	Remark
Sep '03 - Mar '09	12.8%	11.2%	10.0%	12.3%	Overall
Sep '03 - Jan'08	41.2%	43.1%	52.4%	63.9%	Uptrend
Jan '08 - Mar '09	-51.0%	-56.4%	-67.2%	-72.4%	Downtrend
Mar '09 - Mar '14	18.4%	19.5%	19.4%	16.1%	Overall
Mar '09 - Nov '10	64.2%	75.2%	98.0%	112.5%	Uptrend
Nov '10 - Mar '14	0.5%	-1.3%	-7.3%	-14.1%	Downtrend
Mar'14 - Apr '20	4.8%	5.8%	7.7%	6.6%	Overall
Mar '14 -Jan '18	14.4%	17.9%	29.6%	33.0%	Uptrend
Jan '18 - Apr'20	-9.9%	-12.1%	-21.3%	-27.0%	Downtrend
Apr '20 - Sep '23	28.1%	29.5%	38.5%	48.1%	Uptrend
Sep '23 - ??	?	?	?	?	?

Historically, there have been phases of sharp out-performance or under-performance by Small caps compared to Nifty. But as can be seen, over longer periods also (Sept 2003 to Jan 2020), the returns of small caps have been almost the same as Nifty, albeit with more volatility.

We have seen sharp-outperformance by Small caps over the last 3.5 years (20% difference on CAGR basis) and extent of such out-performance is difficult to sustain. Also currently, Small cap index is trading at 25 PE compared to 22 PE for Nifty. So unless the profit growth for small caps remains at higher levels for longer periods, there is case for mean reversion.

As such, Nifty is likely to out-perform small cap index over the next 1 to 2 years. Thus small cap exposure at portfolio level should be reduced. This strategy should be relooked at, if the small index corrects or the performance differential between Nifty and Small caps reduces significantly.

SUMMARY

Oct 06, 2023

Key Takeaways

- Indian markets have witnessed increased volatility.
- Among different market segments, mid- and small-cap stocks have borne the brunt of this volatility, while large-cap stocks have remained relatively stable.
- The direct consequence of this volatility is increased selling pressure from FIIs and HNIs. The selling in India by foreign investors is collateral damage resulting from the adverse performance of global equity.
- However, the impact of FIIs' selling activity is cushioned by the positive inflows from DIIs and Retail investors. Net selling by FIIs is ₹16,026cr on 27th Sept while net inflow from DIIs is ₹14,230cr as on 21st Sept.

Key Events in Oct, 2023

Oct 11 - FOMC meeting minutes

Oct 12 - US CPI, India IIP and CPI

Quartertly GDP Data of most countries

Snippets

India

- Indian bonds were included in the JP Morgan Global EM bond Index which is seen to be a welcome move - the size of index is $250 bn, so expected 10% allocation should bring $25 bn flows to Indian markets over next 10 months or so. This led to limiting the rise in yields, compared to other markets, particularly the US.
- After inclusion into Emerging Bond Index, there have been positive developments with respect to inclusion into Bloomberg Global Bond Index, which would mean another $15 to 20 bn inflows.
- A weak trend in the domestic equity markets also weighed on the local currency while the losses were reduced on the back of RBI intervention.
- Nifty at 19500 is trading in expensive zone as per valuation.

Nifty Valuation Zones	
Above 18500	Expensive
14000-18500	Fair
12200-14000	Buy
Below 12200	Strong Buy

Global

- The S&P 500 continued, and increased, its downward trend in September, as the Fed's "higher for longer" theme started to sink in, with equities readjusting to the new perceived environment.
- The U.S. national debt reached USD 33 trillion for the first time (for reference, the S&P 500's market value is USD 36 trillion). Moody's Investor Service warned that a government shutdown could hurt the U.S. government's 'AAA' rating. The shutdown has been averted by passing. stop gap funding bill hours before the deadline.
- China's PMI expanded for the first time to 50.2, indicating the first growth in factory activity since March.
- Sluggish economy on the brink of high inflation and elevated bond yields is resulting in FII selling across emerging markets including India.
- Eurozone consumer confidence indicator came at -17.8 in September, from -16 in August.
- Asian markets closed lower amid fears that the US Fed's interest rates would stay high, dampening risk appetite, and because of a sell-off in chip-related, shipping and energy stocks. Japan industrial production decreased 3.8% in August, from 2.3% decline in July.

BEHAVIOURAL FINANCE

The Backfire Effect

If people were always rational, they would take time to evaluate any aspect closely when evidence is presented to challenge their beliefs. However, this is seldom the case in reality.

In fact, people often reject the evidence that should have caused them to doubt their beliefs in the first place. Moreover, their original belief grows stronger in the face of a contradicting evidence. This occurs due to a cognitive bias known as the backfire effect.

Efforts of debunking these beliefs often are ineffective as noted in the example shown here: A study which examined parents' intent to vaccinate their children, found that showing evidence on the negative effects of not vaccinating their children to parents who are against vaccination has in fact strengthened their belief that vaccination causes autism.

"Essentially, when a person encounters information which suggests that their current beliefs are wrong in some way, they feel threatened, which causes them to generate a variety of negative emotions. This is especially likely when the beliefs in question are crucial to their self-concept, which means that they represent an important part of that person's identity and ideology."

This theory could be applied to Investing as well. Investors give more strength to ideas that confirm their beliefs (confirmation bias) while rejecting those that oppose them. This, however, could prove costly and even result in significant losses. Investors should try to overcome their bias in order to give way to more rationality as opposed to emotion.

Read our Blogs here:

Someone will always be getting richer faster than you. This is not a tragedy.
-Charlie Munger

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