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MARKET OUTLOOK FOR OCTOBER 2021

Time in the market is more crucial than market timing

The Nifty-50 Index gained around 3% in September 2021 and around 19% in H1FY2022. It reached a new all-time high in September 2021. Indian markets continued to price higher growth potential, while global investors perked up as they pinned new hope on the regional containment of the crisis in China's real estate market.

Rising tide lifts all boats. A big factor in enthusiasm is sector specific performance. Nifty Media gave highest return of 33.5%, followed by Nifty Realty 33% in September 2021. Sector-specific corporate announcements and actions provided a boost to these sectors. Nifty midcap 100 index gave astonishing ~7% return in September 2021. The silver lining from the pandemic is that many midcap and large-cap firms have become operationally efficient.

Now more importantly, investors needs to focus on three key market drivers' 1) fundamentals, 2) sentiment and 3) flows.

On the fundamental side, in FY2022, we expect earnings growth for the listed companies to remain healthy underpinned by pent-up demand, cost optimization and shift from un-organised to organised sector. In the near term, the market will focus on quarterly results and management guidance.

As reflected in the sharp revival in high frequency economic data, the impact of the second wave on activity and tax collections has been rather muted. Given the likely upside to the budgeted tax collections and RBI dividend, we are optimistic on the center's fiscal health. We expect FY2022 GFD (Gross Fiscal Deficit)/GDP (Gross Domestic Product) at 6.4%.

Second, overall sentiment is boosted with the controlled Covid cases in India and the improvement in the number of vaccines administered. However, the key near term risk is that of any third Covid wave.

In September 2021, FIIs have been net buyers in cash equity markets as against net seller in the last five months.

We do understand that volatility is part and parcel of investing journey. As a smart investor, what is needed for long term wealth creation is discipline and patience. Interestingly, those who took the pain in March 2020 and remain invested enjoyed the rally. We suggest investors to focus on companies with good margin of safety on valuations, strong corporate governance matrix and excellent growth opportunity.

We have noticed in few sectors that surging raw material prices led by meaningful rise in global commodity prices and subdued domestic consumer demand can be a two-headed monster that ails the bottom lines of companies in that sector.

We see no material change in India's macroeconomic position at current levels of oil prices. India's CAD (Current Account Deficit) and BoP (Balance of Payment) look quite reasonable at US$75/bbl. A US$10/bbl change impacts India's CAD by ~US$1500 crore or 0.5% of GDP.

The sharp increase in global energy prices and prospects of elevated prices may pose another source of risk to global and domestic inflation. Energy does not have a large direct weight in India's CPI (Consumer Price Index) inflation but higher energy prices may feed into overall goods and services inflation. Notably, every US$10/bbl increase in oil price impacts CPI inflation by 40-45 bps (direct impact).

The external sector is likely to remain favorable in FY2022E but H2FY2022 will be subjected to significant frictions from widening trade deficit amid demand pickup, supply disruptions, higher energy prices, and onset of DM policy normalization. We estimate FY2022E CAD (Current account deficit)/GDP at (-)1.1% at current crude prices along with BOP (Balance of payment) surplus of around US$4400 crore. Notably, USD-INR is likely to be in the range of 73-75 in the near term.

On the global front, we expect several Developed markets (DM) and Emerging Markets (EM) central banks to start tapering over the next few months. They will follow different approaches with (1) DM central banks likely to reduce the amount of their extant bond buyback programs and (2) EM central banks likely to raise interest rates further to fight inflation and reduce current high negative real interest rates. India is likely to follow a 'middle' path with a staggered reduction in bond purchases over time and likely rate increase in H2CY2022. We do not see rate hikes over the next few months given manageable inflation.

The benchmark 10-year Treasury yield has soared above 1.5%, climbing to its highest level since June, in the wake of Federal Reserve policy-setting meeting. This rise has increased the pressure on stock valuations, especially for those with poor short-term cash flow.

Crude oil: Brent crude oil price is trading ~US$77/bbl rising on concerns of a global supply crunch and as demand picks up with the easing of Covid-19 pandemic restrictions.

Outlook and Valuation

Equity markets in India have been buoyant underpinned by multiple factors including expectation of higher corporate earnings growth, strong GDP growth, global liquidity, rising retail participation, etc. We estimate India's GDP growth at 9% in FY2022 and at 6.5% in FY2023. We expect earnings of the Nifty-50 Index to grow by 31% in FY2022 to Rs.718, by 14.3% in FY2023 to Rs.822 and by 19.1% in FY2024 to Rs.930.

At current levels, Nifty-50 is trading at around 24.5x on FY2022E and around 21.4x on FY2023E. Generally, the Indian economy has done better in the second half of the financial year supported by multiple festivals which boost demand.

If we look at the rich valuations of the Indian market and of most sectors then one can raise the prospects of a pullback in the market and/or modest returns for a 'longish' period of time. **However, we would rule out a severe correction in the market as potential bad news in the form of earnings downgrades (from global factors) and/or higher bond yields may not be bad enough.** However, investors should be selective in stock picks and should avoid over valued stocks.

We do not see any change to India's medium-term narratives including favorable demographics and likely multi-year investment cycle led by corporate and household capital expenditure.

Key Risk

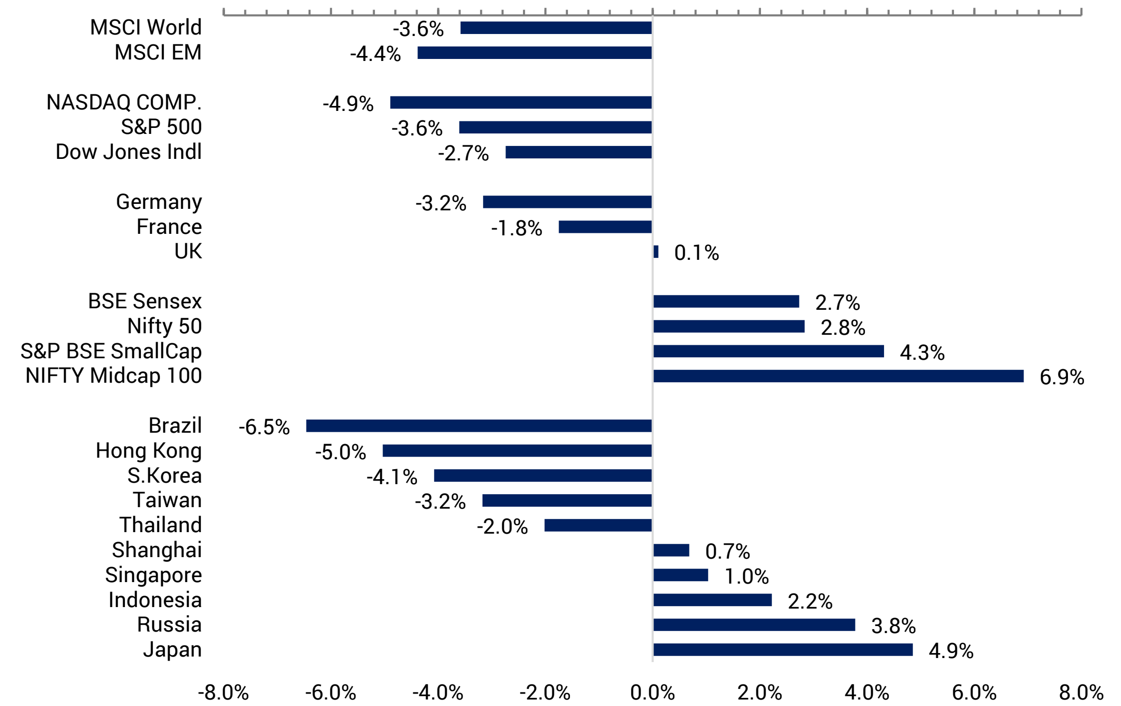
- Potential risk of third wave of Covid pandemic which can impact economy and earnings growth projections
- Rising inflation could lead to Central Banks rethinking their easy monetary policy
- Elevated commodity prices continue to put cost pressure and risk to earnings largely in manufacturing sector
- Increase in crude oil prices could impact economy and corporate earnings.

TOP INVESTMENT IDEAS

Company	Rating	Price (Rs)*	Fair Value (Rs)	Upside (%)	Mkt cap. (Rs Cr)	EPS (Rs) FY22E	EPS (Rs) FY23E	EPS growth (%) FY22E	EPS growth (%) FY23E	P/E (x) FY22E	P/E (x) FY23E	P/BV (x) FY22E	P/BV (x) FY23E	RoE (%) FY22E	RoE (%) FY23E
Aarti Industries	BUY	930	1,080	17.2	33,707	18.9	27.2	26.1	43.6	49.1	34.2	6.4	5.3	15.7	17.0
Hindustan Unilever	ADD	2,702	2,950	9.2	6,34,813	38.9	47.3	14.9	21.5	69.4	57.1	13.4	12.9	19.3	22.9
LIC Housing Finance	BUY	427	600	40.5	23,490	51.0	68.8	(5.8)	34.9	8.4	6.2	1.4	1.2	12.3	14.1
National Aluminium Co.	BUY	93	100	7.5	17,145	11.2	11.9	58.1	6.5	8.3	7.8	1.4	1.3	18.1	17.2
PVR	BUY	1,599	1,700	6.3	9,719	(32.5)	45.3	70.3	239.3	NM	35.3	3.8	3.5	NM	10.3
TCS	ADD	3,776	4,200	11.2	13,96,595	106.5	121.7	19.2	14.3	35.4	31.0	13.4	12.3	40.9	41.4

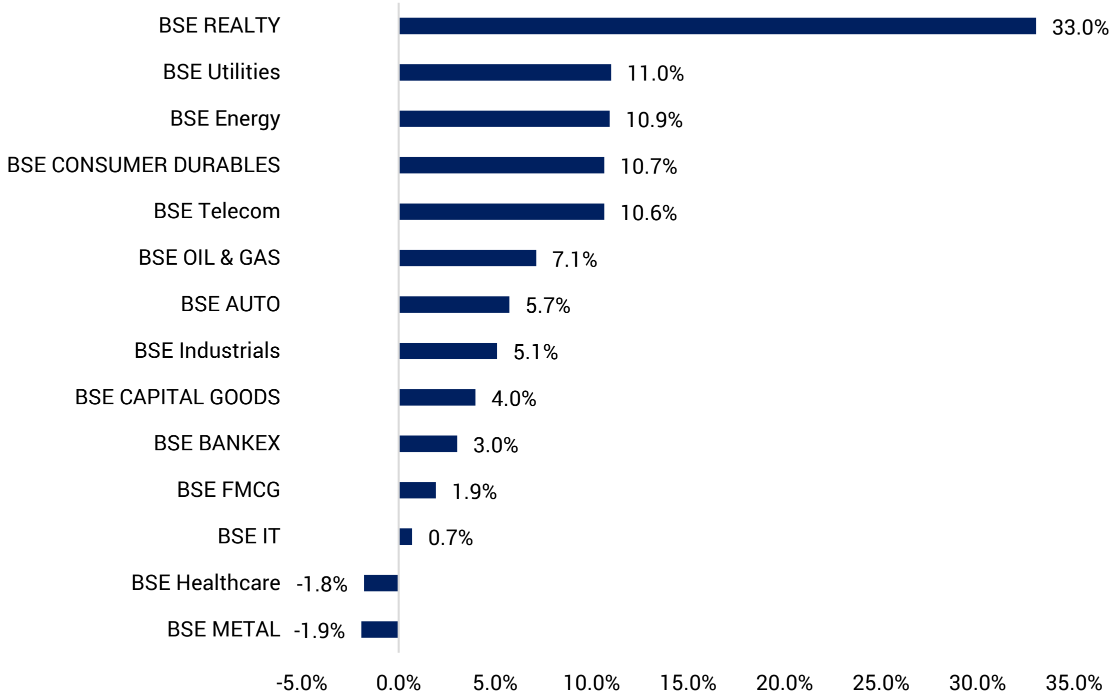
*Source: Kotak Institutional Equitites Research; Kotak Securities - PCG; *The above valuation summary is based on prices as on 30th September 2021.*

Global Indices Performance - for Month of September 2021



Source: Bloomberg

Sectoral Indices: % Chg in the month of September 2021



Source: Bloomberg

Rating Scale (Kotak Securities – Private Client Group) / Kotak Institutional Equities

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BUY	–	We expect the stock to deliver more than 15% returns over the next 12 months
ADD	–	We expect the stock to deliver 5% - 15% returns over the next 12 months
REDUCE	–	We expect the stock to deliver -5% - +5% returns over the next 12 months
SELL	–	We expect the stock to deliver < -5% returns over the next 12 months
NR	–	**Not Rated.** Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
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NA	–	**Not Available or Not Applicable.** The information is not available for display or is not applicable
NM	–	**Not Meaningful.** The information is not meaningful and is therefore excluded.
NOTE	–	Our target prices are with a 12-month perspective. Returns stated in the rating scale are our internal benchmark.

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