Monthly Strategy Report

June 03, 2022

HDFC securities
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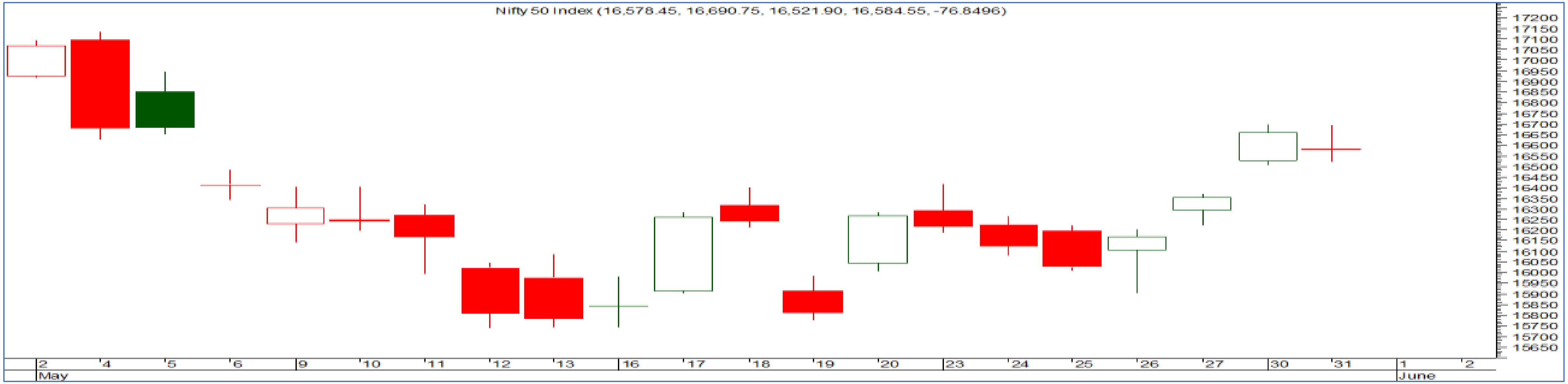
Nifty Chart for May 2022



The Month Gone By

Indian indices declined sharply in May with both the Sensex and Nifty plunging over 2.6% and 3.0% respectively as investors dumped riskier assets on fears that soaring inflation would hurt corporate earnings and spark an economic slowdown. High crude prices and foreign fund outflows further ruined already sluggish market sentiments. Profit-booking at higher dragged the benchmark indices. With corporate earning seasons nearing an end, traders have started hunting for new clues to drive the market and also a lot of shift in portfolios seems happening.

The incessant selling by foreign portfolio investors in India reached new heights in May as monthly net outflows touched Rs 37,663 crore, the second biggest single-month outflow since March 2020. In March 2020, when the COVID-19 pandemic triggered a nation-wide lockdown, foreign investors net sold domestic stocks worth Rs 61,973 crore. May also marks the eighth consecutive month of net selling from foreign investors in Indian stocks, also one of the longest ever streaks of selling seen on record. The sharp selling from foreign investors saw the benchmark Nifty 50 and BSE-Sensex index fall 2.6-3 percent in the month, which made it the worst performance from the indices in May since 2012. The selling from foreign investors comes amid rising bets of US Federal Reserve raising interest rates too aggressively to contain inflation and risking a recession in the US economy. Further, the ongoing war in Eastern Europe and lockdowns in China have aggravated global supply chain issues.

Key Positives during the Month

- The S&P Global India Manufacturing Purchasing Managers' Index (PMI) declined marginally in May to 54.6 from 54.7 a month back. The 11th consecutive 50+ print for the manufacturing PMI "pointed to a sustained recovery" and was "consistent with a solid improvement in operating conditions".
- India S&P Global India Services Purchasing Managers' Index rose to 57.9 in Apr 2022 from 53.6 in Mar 2022.
- India's labor force saw a significant increase in Apr 2022 compared to the previous month, with 88 lakh people joining the workforce, bringing the total to 4.37 crore.
- India witnessed the highest ever annual FDI (foreign direct investment) inflow of $83.57 billion in FY22 compared with $81.97 billion in FY21. FDI equity inflow in manufacturing sectors rose 76% YoY in FY22 to $21.34 billion.
- GST revenue for May stood at nearly Rs 1.41 lakh crore, a 44 per cent increase over the same month last year. Bucking the month-on-month increasing trend of the last two months, the Goods and Services Tax (GST) revenues came in lower than the record high collection in April at Rs 1.68 lakh crore.
- Production growth of eight infrastructure sectors rose to a six-month high of 8.4 per cent in April, up from 4.9 per cent growth in March, on the back of better performance by coal, refinery products and electricity segments.
- Domestic air passenger traffic in April increased by 1.7 percent on a month-on-month basis to 108.80 lakh.
- India's major ports moved 64.96 million metric tonne (mmt) of traffic in April’22, recording a growth of 5.48 per cent from the previous year.
- On a year-on-year (y-o-y) basis, non-food bank credit registered a growth of 11.3 per cent in April 2022 as compared with 4.7 per cent a year ago.
- Fiscal deficit for 2021-22 worked out to be 6.71 per cent of the gross domestic product (GDP), lower than 6.9 per cent projected by the Finance Ministry in the revised Budget Estimates.

Key Negatives during the Month

- India’s Index of industrial output (IIP) grew 1.9% YoY in Mar 2022 as against 24.2% rise in Mar 2021.
- India’s unemployment rate rose to 7.83% in Apr 2022 from 7.60% in Mar 2022. The urban unemployment rate rose to 9.22% in Apr from 8.28% in Mar, while the rural unemployment rate slipped to 7.18% in Apr from 7.29% in Mar.

- India’s consumer price index-based inflation (CPI) rose to 7.79% in Apr 2022 as against 6.95% in Mar 2022.
- India’s merchandise exports rose 30.70% to $40.19 billion in Apr 2022 on account of healthy performance by sectors such as petroleum products, electronic goods and chemicals. Similarly, imports grew 30.97% to $60.30 billion in Apr 2022. Thus, trade deficit widened to $20.11 billion in Apr 2022 as against trade deficit of $15.29 billion in Apr 2021.
- India’s Wholesale price index-based inflation (WPI) rose to 15.08% YoY in Apr 2022 from 14.55% in Mar 2022.
- A Global Rating agency lowered India’s growth forecast to 7.3% from 7.8% for FY23 on rising inflationary pressure and longer-than-expected Russia-Ukraine war.
- The Monetary Policy Committee (MPC) of Reserve Bank of India announced an unscheduled hike of 40 and 50 basis points in policy rate and the Cash Reserve Ratio (CRR) respectively in a move to contain raging inflation.
- India’s economy slowed down for the third consecutive quarter in the January to March period to grow at 4.1%, while the National Statistical Office pared down overall growth forecast for FY22 a tad to 8.7% from 8.8% estimated in January.
- Passenger vehicle dispatches to the dealers by manufacturers fell 3.84% in April to 251,581 units amid ongoing supply-related challenge.

Sector Moves/G-Sec Yield Moves Over the Month

BSE Indices	May-22	Apr-22	% chg
Sensex	55,566	57,061	-2.6
Smallcap	26,371	28,612	-7.8
Midcap	23,144	24,418	-5.2
500	22,498	23,552	-4.5
200	7,176	7,486	-4.1
100	16,888	17,575	-3.9
Auto	26,454	25,210	4.9
Bankex	40,907	41,534	-1.5
Capital Goods	27,145	27,371	-0.8
Consumer Durables	37,999	42,667	-10.9
FMCG	14,167	14,082	0.6

BSE Indices	May-22	Apr-22	% chg
Healthcare	22,467	24,341	-7.7
IT	30,129	31,990	-5.8
Metal	18,100	21,655	-16.4
Oil & Gas	18,607	19,498	-4.6
Power	4,226	4,776	-11.5
PSU	8,483	8,849	-4.1
Realty	3,278	3,529	-7.1
TECK	13,629	14,339	-4.9
G Sec Bond Yields	7.42	7.14	28bps
Nifty	16,585	17,103	-3.0

Global Markets

Indices	May-22	Apr-22	%Chg
US - Dow Jones	32,992	32,979	0.0
US - Nasdaq	12,081	12,335	-2.1
UK - FTSE	7,608	7,545	0.8
Singapore - Strait Times	3,232	3,357	-3.7
Japan - Nikkei	27,280	26,848	1.6
Indonesia - Jakarta Composite	7,149	7,229	-1.1
India - Sensex	55,566	57,061	-2.6
India - Nifty	16,585	17,103	-3.0
Hong Kong – Hang Seng	21,415	21,089	1.5
Germany - DAX	14,388	14,098	2.1
Chinese - Shanghai composite	3,186	3,047	4.6
Brazil - Bovespa	111,351	107,876	3.2

Global Markets

- World markets ended on a mixed note in the month of May 2022. Singapore - Strait Times, India - Nifty & Sensex, US – Nasdaq and Indonesia - Jakarta Composite were down by 3.7%, 3.0%, 2.6%, 2.1% and 1.1% respectively while Chinese - Shanghai composite, Brazil – Bovespa, Germany – DAX, Japan – Nikkei, Hong Kong – Hang Seng and UK – FTSE were up by 4.6%, 3.2%, 2.7%, 2.1%, 1.6%, 1.5% and 0.8% respectively.

- US Indices dropped as investors grappled with signs that high inflation will stick around, though both the Dow and the S&P 500 closed out a volatile roller coaster month of trading flat. The Nasdaq lost about 2.1% on the month. Rising oil and a record high in eurozone prices renewed inflation concerns, which sent the 10-year Treasury yield surging. Stocks tumbled shortly after May began and continued falling amid a slew of earnings and economic data that came in worse than expected. Throughout the month, profit warnings from companies ranging from Snap to Target to Walmart intensified worries about the lingering impact of inflation, and spurred investors to dump shares across several industries. By mid-May, it seemed the S&P 500 was bound to close in a bear market, defined as a drop of 20% or more from a recent high, before a late-month rally sent stocks higher. The S&P 500 ended the month down about 14% from its January high. Concerns about an economic slowdown in China and sustained supply-chain disruptions due to the pandemic and the war in Ukraine have continued to weigh on investors' minds.

- The Singapore - Strait Times finished lower following mixed performances from the financial shares, property stocks and industrial issues.

- The Mainland China market finished higher on economic growth optimism as Shanghai inched closer to a planned end to a two-month coronavirus lockdown. The Beijing and Shanghai reopening narrative has boosted risk sentiment. Shanghai authorities aimed to exit a two-month COVID lockdown conditions and will allow businesses to resume work from 1 June 2022. Risk appetite was also supported by stimulus measures announced by Shanghai authorities to support the economy. Chinese Index closed at five-week highs led by a rally in consumer and high-tech stocks, as the market witnessed its highest foreign inflows for this year ahead of Shanghai's imminent reopening of its economy and easing of COVID-19 curbs.

- Brazilian stocks rose in May despite fears over October's presidential vote tarnish the outlook for the second half and double-digit interest rates prompt a switch to deposit accounts

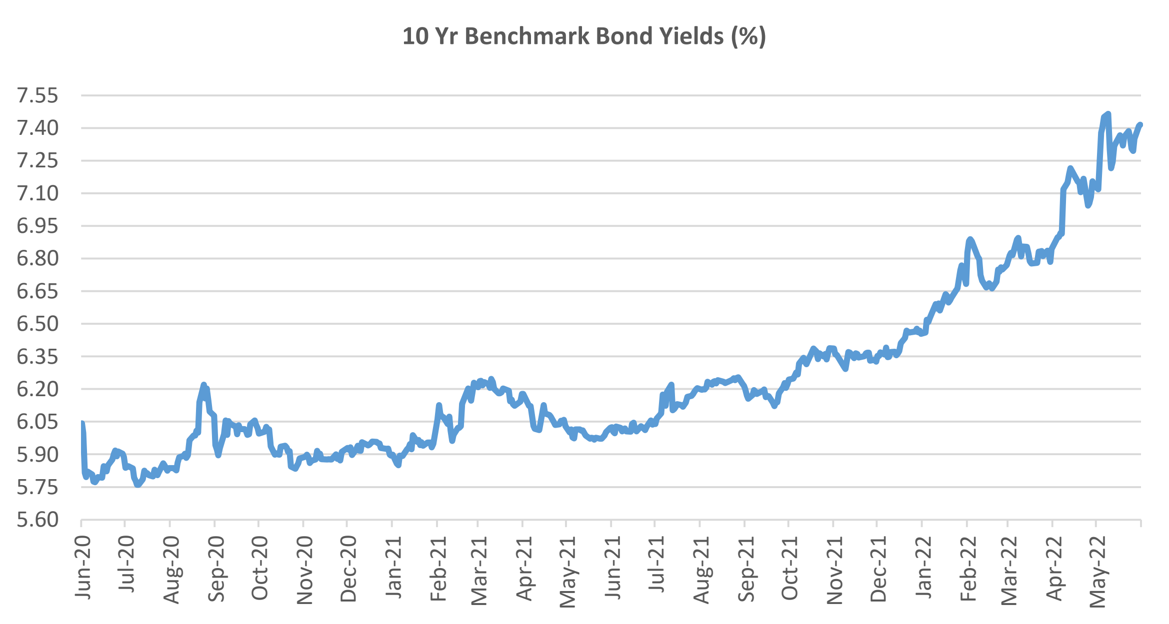
- European shares touched their highest level in almost a month, with optimism buoyed by China's easing of COVID-19 restrictions and adding of new stimulus. European stocks rose as upbeat U.S. consumer sentiment data, signs of peaking inflation and clarity on the Federal Reserve's plan had calmed markets. Britain's FTSE 100 edged higher, as an easing of China's COVID-19 curbs lifted spirits across global markets. Most European markets rose, taking heart from a Wall Street rally after the Federal Reserve minutes suggested it could pause its rapid rate hikes later this year.

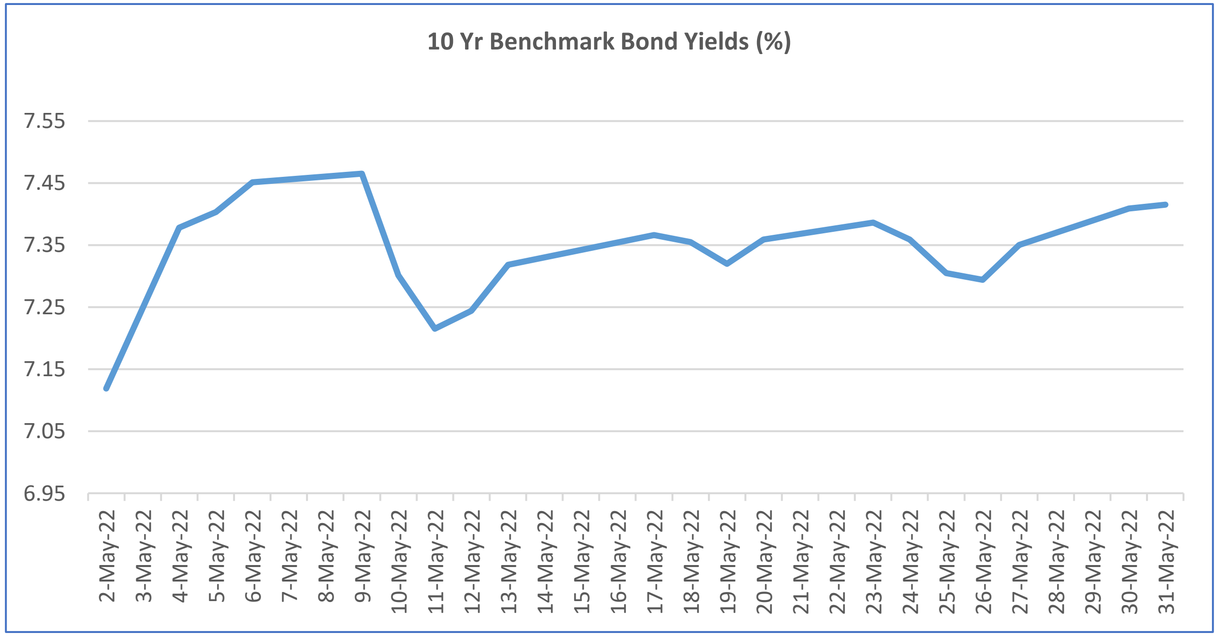
- Japan's Nikkei reversed its course to settle higher, as investors snapped up shares on hopes for solid corporate earnings, despite a sell-off in broader Asian markets amid concerns over China's earlier reinforcement of its zero-COVID policy. Index rose to its highest level in more than one month, led by machinery and technology stocks, as Shanghai's stimulus measures and decision to ease COVID-19 curbs later in the month tempered fears of a sharp slowdown in the world's second-largest economy.

- Hong Kong Index finished on the front foot again, building on a recent rally as traders were cheered by data indicating improvement in China's factory activity.

G-Sec Market:

- G-Sec yields rose by 28 bps during May 2022, to end the month at 7.42%. Bond yields surged and witnessed the biggest rise in over five years after the Monetary Policy Committee unexpectedly kicked off its rate hike cycle to put a check on rise in domestic inflationary pressures. Reports that the government is in discussion with the Reserve Bank of India (RBI) to either buy back government bonds or conduct open market operations in the next fortnight to put a check on rising bond yields resulted in some respite. A fall in U.S. Treasury yields too boosted market sentiments. However, gains were restricted after consumer inflation in Apr 2022 reached to a near 8-year high, which increased probability of aggressive rate hikes ahead. Yields rose after the minutes of the latest monetary policy meeting held in May 2022 hinted at more frontloading of policy rate hikes by the Monetary Policy Committee in the months ahead. Increase in global crude oil prices further dampened market sentiments.





Fund Activities

	Net Buy / Sell May-22	Net Buy / Sell April-22	Open Interest May-22	Open Interest April-22	Remarks
		FII Activity (Rs in Cr)			FII Activity
Equities (Cash)	-37663.4	-20468.3			FIIs were net sellers in May-22
Index Futures	279.6	-9898.2	12733.2	9210.1	FIIs were net buyers with a rise in open interest
Index Options	46701.9	41681.6	103738.5	116285.0	FIIs were net buyers with a fall in open interest
Stock Futures	20003.5	-5618.1	150682.5	137703.0	FIIs were net buyers with a rise in open interest
Stock Options	252.8	207.7	5728.5	5339.4	FIIs were net buyers with a fall in open interest
		MF Activity (Rs in Cr)			MF Activity
Equities (Cash)	27360.3	22371.2	-	-	MFs were net buyers in May-22 (till 30th May)

- FIIs were net sellers in the debt market, selling a net amount of Rs 5378.0 cr in May-2022 as compared to net sellers of debt worth of Rs 4161.0 cr in April-2022. Mutual funds were net sellers of debt papers worth Rs 13326.1 cr in May-22 (till 30th) as against Rs 6825.1 cr of net buying in April 22.

- The average daily volume on the BSE in May 22 fell by 21.0% MoM. NSE's daily average volume fell by 19.6% MoM. The average daily derivatives' volume on the NSE fell by 0.3% MoM to Rs 1,04,10,860 cr in May 2022.

Commodities

- In May 2022, the Reuters/Jefferies CRB Index of 19 raw materials rose by 2.7% to close at 316.5. The rise was led by an increase in prices of Natural Gas (up 12.4%), Crude Oil (up 9.9%), Coffee (up 3.7%), Lean Hogs (up 3.1%) Wheat (up 2.1%), Soybeans (up 1.1%) and Sugar (up 0.3%). However, Nickel, Aluminum, Silver, Corn, Cotton, Cocoa, Gold, Copper and Orange Juice were down by 10.6%, 8.7%, 5.7%, 4.7%, 4.6%, 3.9%, 3.8%, 3.3% and 2.8% respectively..

Commodities

Commodity	May-22	Apr-22	% Chg
Gold	1838.9	1911.7	-3.81
Crude Oil	115.1	104.7	9.91
Aluminum	2787.0	3052.5	-8.70
Copper	9447.5	9769.5	-3.30
Zinc	3913.5	4107.0	-4.71
Nickel	28392.0	31771.0	-10.64
Tin	34670.0	40259.0	-13.88
Lead	2182.0	2260.5	-3.47

- Oil prices surged after EU leaders reached an agreement to ban 90% of Russian crude by the end of the year. Prices drew support from strong worldwide demand for fuel, with both gasoline and heating oil futures outpacing crude this year. Oil also rose as China started moving out of its lockdowns, which will also lead to more demand in the coming months.

- Copper and aluminum prices fell on worries that higher interest rates globally and COVID-19 lockdowns in top metals consumer China will hurt global economic growth and metals demand. Copper prices fell to their lowest in nearly five months, as tightening lockdowns in top metals consumer China stoked worries about demand, with a stronger dollar further weighing on the market.

- Nickel prices declined due to the declining mainstream transaction prices and the weak demand. The current supply of pure nickel was tight, but the continuous weakening of demand made the current upward trend of nickel prices lack of motive power.

- Aluminium prices fell to four-month lows as concerns about demand created by a slowdown in manufacturing activity, particularly in China, the world's top consumer, were reinforced by a strong dollar. Prices of the metal used widely in the power, construction and packaging industries saw a drop of about 30% since early March and the lowest level since Jan. 5. Slowing global manufacturing growth, Fed rate hikes and broader inflationary pressure on economic activity also weighed on the metal.

- Zinc prices settled down as concerns grew that the global economy may plunge into a recession and dampen demand for metals.

- Gold prices slipped as the U.S. Federal Reserve's aggressive monetary policy tightening plan dimmed the metal's appeal, with additional pressure from a rebound in equities. However, investors are also concerned about a potential recession caused by monetary tightening, with many investors priced in two half-point interest rate hikes in June and July. Gold's performance in May has been disappointing overall, showing immediate weakness at the first sign of dollar strength while being unable to trace out material gains on USD weakness or lower U.S. bond yields. Gold slid below $1,900 an ounce as the dollar surged to two-decade highs.

Currencies

Given below is a table that shows the depreciation (-)/appreciation (+) of the US Dollar against various currencies in May 2022. The U.S. dollar edged higher, helped by higher Treasury yields as the focus turned once more towards soaring global inflation.

USD to:	May-22	Apr-22	% chg
Pakistani rupee	198.70	185.40	7.2
Hong Kong dollar	7.85	7.85	0.0
Chinese yuan	6.67	6.61	1.0
Indian rupee	77.60	76.52	1.4
Taiwan dollar	29.03	29.44	-1.4
Singapore dollar	1.37	1.38	-1.0
Argentine peso	120.19	115.31	4.2
Euro	0.93	0.95	-1.8
Thai baht	34.30	34.24	0.2
Malaysian ringgit	4.38	4.35	0.6
Indonesian rupiah	14580.00	14495.00	0.6
Japanese yen	128.68	129.83	-0.9
Brazilian real	4.73	4.92	-3.9
South Korean won	1242.74	1263.48	-1.6
Russian Rouble	61.50	70.96	-13.3
Turkish Lira	16.40	14.84	10.5
South African Rand	15.63	15.81	-1.2

- The rouble firmed sharply reversing heavy losses as it retained support from capital controls and Russia's strong trade account. The rouble briefly reached its highest level against the dollar since March 2020, supported by capital controls, as the market watched developments around possible new sanctions against Moscow.

- The Brazilian real rose as the country's jobless rate dropped to its lowest level in nearly six years, while currency headed for their fourth month of gains this year. The real also rose after Chinese authorities set out more plans for exiting the city-wide COVID-19 lockdown in Shanghai.

- The euro held onto most of their gains as hopes of easing lockdowns in China and rising retail sales in the US pushed investors towards riskier assets and hurt the safe haven dollar.

- Korean won hit 5-week high against U.S. dollar. South Korea’s won jumped as a rally in regional stocks lifted sentiment.

- The Turkish lira fell against the US dollar. Turkey is suffering from a debilitating economic crisis. Turkey's lira slid beyond 16.4 against the dollar to its weakest level since the depths of a December crisis, as analysts questioned authorities' ability to continue steadying it without new sources of foreign currency.

- The Pakistani rupee continued its month-long run of devaluation, with the currency trading at its all-time low of Rs 200 against the US dollar. The Pakistani rupee (PKR) continues to slide in line with the predictions of analysts who fear more losses ahead as the country remains mired in political and economic instability.

- The rupiah risks weakening to its lowest level in almost two years as Indonesia’s ban on palm oil exports adds to headwinds from interest rate hikes in the US. The currency fell to a one-year low despite an assurance from the central bank that it would stabilize the currency.

- The Indian rupee weakened sharply against the US dollar, as weak economic data from China stoked fears of a global recession, eroding appetite for riskier emerging market currencies. Risk aversion in global markets, persistent selling by Foreign institutional investors (FIIs) also weighed on the domestic currency. The Rupee also fell as weakness in global equities on concerns over the economic outlook and rising bond yields weighed on sentiments. Intervention from the Reserve Bank of India (RBI) restricted the losses.

- China's yuan fell against the US dollar to its lowest point in 18 months as strict Covid lockdown policies imposed by Beijing weigh on economic growth prospects. The yuan's price slipped against the dollar to the worst exchange rate since November 2020, continuing a sell-off that saw the Chinese currency tumble 4% in April. The currency depreciated as a hawkish Federal Reserve sends bond yields in the US above those in China, while fresh data showed export growth slowing. Additionally, sentiment has been weighed down because state-owned banks haven't sold off dollar holdings

- The Malaysian ringgit is playing catch up to the US dollar as surging global interest in the greenback increases its demand and value tremendously. The sharp increase in the US dollar has resulted in the ringgit depreciating against the US dollar. Strong demand for the US dollar continued to hurt the ringgit’s performance, and steady crude oil prices, which currently stood at above US$110 per barrel, were unable to support the local note.

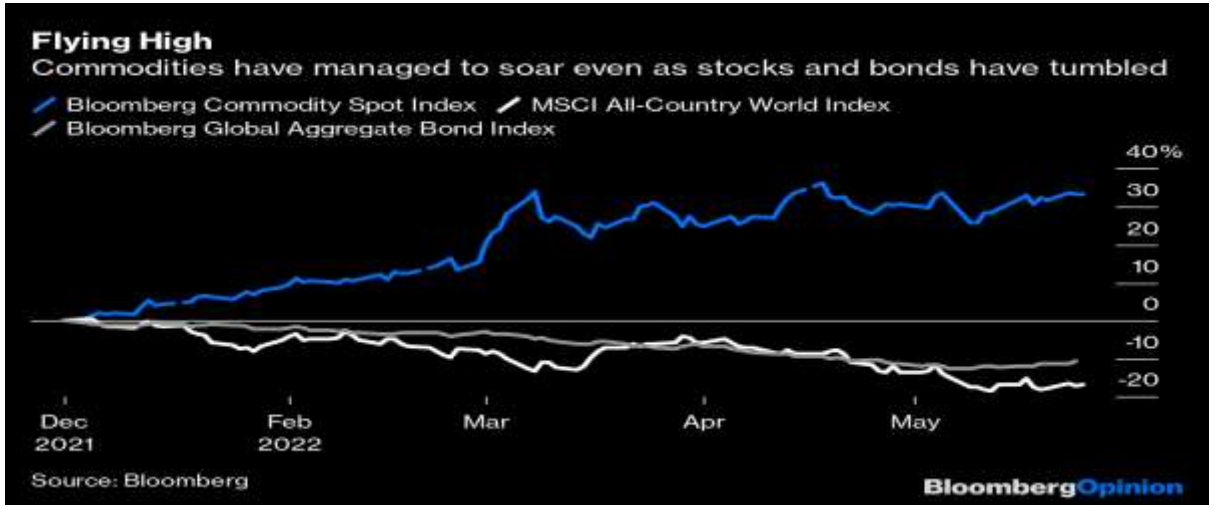
Outlook Going Forward

Q4FY22 corporate earnings ..still on good ground

- Corporate earnings continued to remain healthy in Q4FY22. However while the aggregate growth looked impressive, it was not broad-based and driven only by three sectors: Banks & Finance, Oil & Gas and Metals. Some sectors were adversely affected by rising raw material prices like Autos, Cement, FMCG, Consumer Durables, Chemicals etc while the three sectors mentioned earlier were not directly impacted/benefitted by rising prices. Topline growth in Q4FY22 remained healthy but lower than that in Dec 2021 quarter despite inflation remaining high and March being a peak season for most industries.
- The third wave of the pandemic had little impact on economic activity, unlike the second wave. Activity levels bounced back to pre-Covid levels across various segments, supported by effective policy measures. Better operating leverage protected India Inc from cost (input and wage) pressures in Q4 despite heightened worries on account of global monetary tightening and rising rates. Reopening sectors like hospitality, tourism, restaurants, multiplexes, QSR etc did well in Q4. However number of small and midcap companies that shocked investors were at a high being impacted by the cumulative effect of Covid, commodity inflation, rising rates and impacted demand. Some companies chose to account for most negatives in this quarterly number given the negative background which can be used to justify the weak numbers.
- Going ahead, June quarter is historically a dull quarter for most sectors. Developments on the geo political issues and on the Central Banks rate hike policies will decide the global risk sentiments and in turn consumer and capital spending ultimately impacting the corporate results.

Commodity uprun..not done yet?

- While all other markets are falling, commodities have been on a run. The Bloomberg Commodity Spot Index is up 33% this year, with energy, metals and agriculture prices all showing big gains. Investors, shocked by faster inflation, rising geopolitical risks and accumulating portfolio losses, are buying into commodity exchange-traded funds to hedge their portfolios. This year through April, $21.4 billion flowed into commodity ETFs in contrast to the $63 billion in outflows in the first four months of 2021.



- Covid-19 has led to continuing lockdowns in China, causing dramatic production cutbacks in the China, which accounts for 18.1% of global gross domestic product and 23.9% of manufacturing. The pain has spread to China's imports of commodities from countries such as Brazil, Chile and Australia of oil, copper and iron ore as well as manufacturing exporters like Germany, South Korea and Taiwan.
- Russia's invasion of Ukraine has also impacted global demand and the strong dollar has reduced demand for commodities by developing countries since their currencies have fallen 3% on average since April.

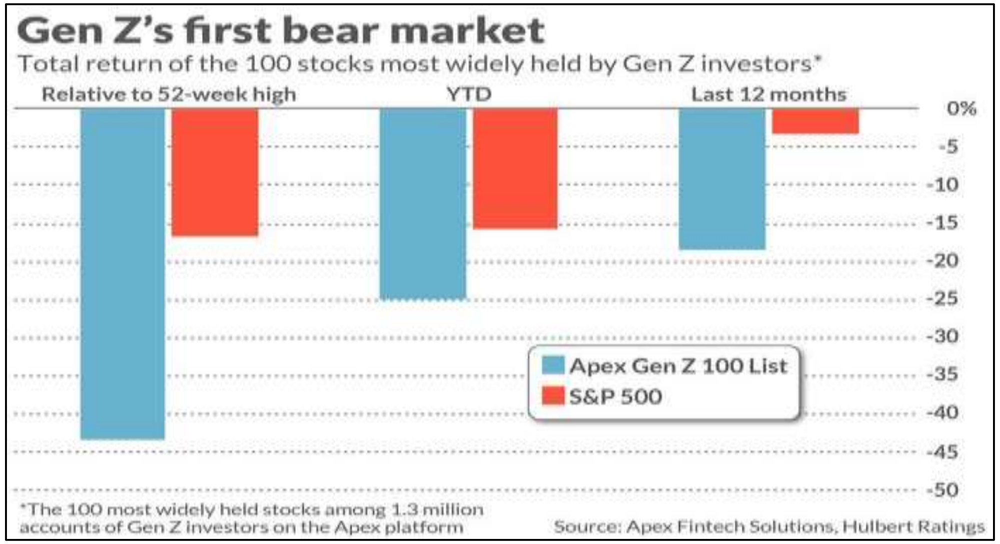
Asset volatility is making a dent in pension plans.

- As inflation and geopolitical uncertainties rattled the markets in the first quarter, U.S. pension funds posted their worst performance since the start of the pandemic, with a median loss of 5%, according to data released by analytics and data firm Investment Metrics, a Confluence company. The firm tracks performance and portfolios of over 4,000 institutional investors.

- The last time pension funds lost money was in the first quarter of 2020, when they posted a median loss of 12%. Before that, the group also saw negative returns in the last quarter of 2018 and the third quarter of 2015. Over the past five years, though, pension funds have managed to deliver a median return of more than 8%.

The new young investors are experiencing their first large correction, and that's a good thing.

- Until recently, a lot of new investors who have signed up in the past 2-4 years only experience of stock market investing was that stocks almost always go up. And that led to alarming levels of overconfidence, with dangerous consequences for both their own portfolios and the stock market as a whole.
- The stock market's recent decline has certainly reduced that overconfidence, if not eliminated it altogether. Take a look at the accompanying chart, which reports the performance of the 100 stocks that are mostly widely held by Gen Z investors, according to an analysis conducted by Apex Fintech Solutions. A bear market is traditionally defined as a loss of at least 20%.

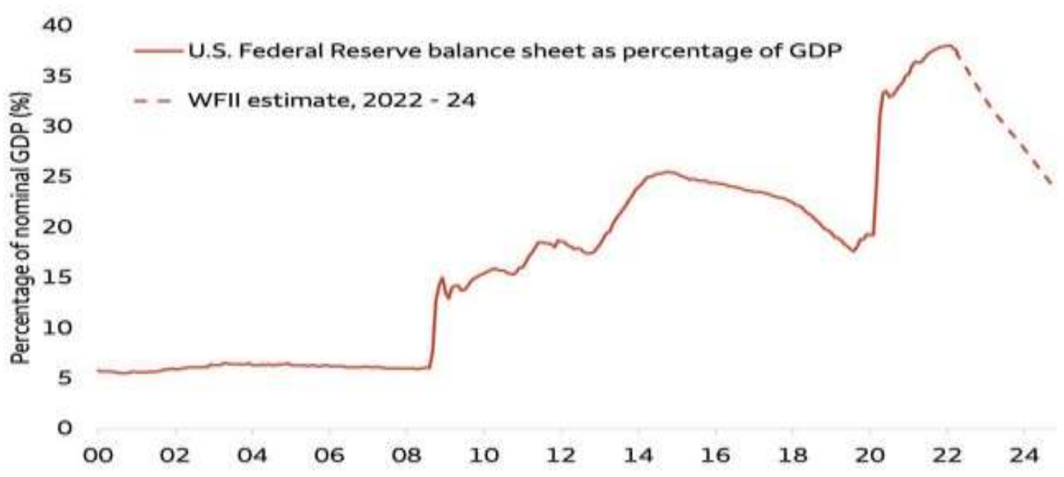


- All of us, at one point or another, have gone through a similar and painful process of becoming older and wiser through experiencing a bear market.
- The reason that it's a good thing to experience a bear market is that youthful investors' overconfidence becomes ever more dangerous the longer it takes for them to experience their first bear market. If it takes too long, these investors' arrogance will lead them to invest way more than they can afford to lose, and they therefore will lose intolerable amounts when the market eventually turns—as it inevitably will, sooner or later.
- Bear markets teach us an appreciation of valuations and risk, and that appreciation in turns supports the market being an efficient engine of economic growth, allocation of capital, and innovation. If the stock market were always to go up, then the riskiest, craziest, and most undeserving of new companies would gradually suck up the bulk of equity financing.

The bearish angle

- Global growth in factory activity slowed in May as China's strict coronavirus curbs and Russia's invasion of Ukraine unsettled supply chains and dampened demand, adding to woes for businesses already struggling with surging raw material prices.
- Manufacturing growth slowed in May in economies as diverse as France, Japan to Malaysia, business surveys showed, illustrating the challenge policy makers face in trying to combat inflation while not stifling anaemic economic activity.
- US inflation remains at a 40-year high. The Fed raised its benchmark overnight lending rate by half a percentage point last month, to a target range of between 0.75% and 1%, and plans further increases of the same size at its next two meetings in June and July.
- The latest US Fed Beige book revealed a disarrayed picture marked by waning business optimism and rising fears of a recession and little end in sight soon for price pressures or the tightness in the labor market to markedly ease.
- The US Federal Reserve has signaled it will reverse its emergency bond-buying programs and shrink its balance sheet. The so-called quantitative tightening, or QT, is scheduled to begin this month and will ramp up to $95 billion a month in reduced bond holdings. The Fed's balance sheet could shrink by almost $1.5 trillion by the end of 2023, taking it down to around $7.5 trillion. It is likely to drive up real or inflation-adjusted yields, which in turn makes stocks somewhat less attractive.

Balance sheet back to pre-COVID-19 size by 2025?



Sources: U.S. Federal Reserve, Bloomberg, and Wells Fargo Investment Institute (WFII). Latest data as of April 29, 2022. GDP = Gross domestic product. The Fed's balance sheet is defined as Reserve Bank Credit as a ratio of nominal GDP. Forward-looking nominal GDP estimates are derived from WFII estimates for real GDP growth and the GDP deflator.

- The Ukraine war and its impact on commodities, including food and fuel and consequently inflation is another worry. Some experts feel that Oil has to go up in price because of disruptions caused by the worst European conflict since World War II, potentially hitting $150-160 a barrel.
- Chinese order flow that drove the global surge in metals prices from mid-2020 through end-2021 has reversed since March, as recurring outbreaks of COVID-19 have triggered extended factory shutdowns. Lockdowns and movement restrictions have curtailed factory and construction activity just when it typically peaks, depriving metals producers of a key window to sell their products.
- A global recession is not imminent, but one has to brace for rising costs and slower growth. As the war in Ukraine and pandemic disruptions continue to wreak havoc on supply chains, stagflation — marked by low growth and high inflation — will stick around "for at least the next 12 months. Commodity prices will start to ease from next quarter, but will remain permanently higher than before the war in Ukraine for the simple reason that Russian supplies of many commodities will be permanently reduced.

- For almost all economies of Asia, a recession is fairly unlikely. Even if the global economy is at risk of a recession, many consumers have ample savings and have stocked up on household durables. The longer inflation stays high the more investment markets worry that central banks will not be able to tame it without bringing on recession.
- The latest wave of Omicron and the widespread lockdowns in place since mid-March have resulted in a sharp contraction in Chinese government revenue, including land sales revenue. Premier Li Keqiang said during a rare nationwide meeting last week that in some respects, the difficulties were greater than in 2020. This will restrict China's options to push economic growth beyond a point. China's economy won't be snapping back quickly from the latest Covid outbreak, and instead, it could see a slow recovery ahead. When the pandemic first hit in 2020, China bounced back from a first-quarter contraction to grow in the second quarter. This year, the country faces a far more transmissible virus variant, overall weaker growth and less government stimulus.
- Historically, midterm election years are tough for markets. U.S. stocks have lost more than 17% on average peak-to-trough. On average, the market bottoms during these years occur later in the year.
- Over the past month fund managers have increased their cash position by 5%, reaching the highest level in 20 years in May.
- U.S. company earnings revisions are "deteriorating quickly," threatening to deepen the stock-market's losses so far this year, according to a note from Morgan Stanley's wealth-management division.
- Negative earnings revisions and negative economic surprises could produce another 5% to 10% decline in the S&P 500. With the last two years a period of significant 'overearning,' reversion to the mean now makes U.S. earnings revision downgrades the worst among all regions.
- Despite the extensive losses seen for stock markets so far this year, it's not over until it's over — and investors should keep selling into any big rebounds higher. That's the advice from a team of strategists at Bank of America. In focus for the bank is increasing debate about whether the market has capitulated, which refers to investors basically giving up on trying to recapture lost gains. Some strategists view capitulation as a sign the market has bottomed and a good time to buy stocks. However, even the falls in Dow, S&P and Nasdaq hasn't convinced everyone the selling is over.
- Stagflation is making a comeback, according to former Morgan Stanley Asia chairman Stephen Roach. He warns the U.S. is on a dangerous path that leads to higher prices coupled with slower growth.
- The markets are not even close to discounting the full extent of what's going to be required to bring the demand side under control. Roach calls stagflation his base case and the peak inflation debate absurd. The Fed has a massive amount of tightening to do. Roach expects inflation to stay above 5% through the end of the year. At the current pace of interest rate hikes, the Fed wouldn't meet that level.

The bullish angle

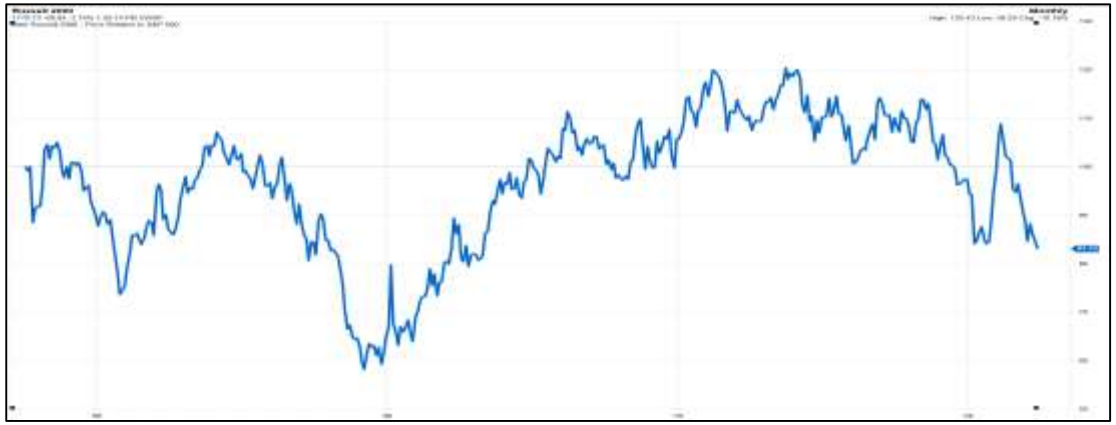
- Global economy is now on the cusp of regaining momentum. Beijing has unveiled a series of measures from cuts to benchmark lending rates to allowing delays to loan repayments to soften the blow from the economic slowdown, but its commitment to a zero-COVID policy has precluded more direct steps to revitalise economic activity.
- Another bullish reason could be the potential for massive month- and quarter-end rebalancing flows that could trigger a sustained rebound in stocks. The team of JPMorgan equity quants feels more than $250 billion could flow into stocks by the end of June as American mutual funds and pension funds, along with foreign pensions and sovereign-wealth funds, "rebalance" by buying stocks and selling bonds to compensate for the latest drop in stocks.

- The Biden administration is considering "all options" as it reviews potential changes to U.S. duties on Chinese imports, including tariff relief and new trade investigations in a shift of focus to strategic concerns with Beijing. It could move towards addressing long-term challenges from China and "getting a tariff structure that really makes sense."
- U.S. President Joe Biden has said he is considering removing some of the tariffs imposed on hundreds of billions of dollars’ worth of Chinese goods by predecessor Donald Trump in 2018 and 2019 amid a bitter trade war between the world's two largest economies. His administration is seeking ways to cool inflation, and industry groups have called for tariff cuts to reduce costs for businesses and consumers.
- The U.S. State Department has updated its fact sheet on Taiwan again, to reinstate a line about not supporting formal independence for the Chinese-claimed, democratically-governed island. Last month the State Department changed the wording on its website on Taiwan, removing wording both on not supporting Taiwan independence and on acknowledging Beijing's position that Taiwan is part of China, to anger in Beijing.
- These two developments suggest that US could get softer with China and the global trade sentiments could gradually improve over the next few months.
- There were measured comments from Federal Reserve officials – most notably Atlanta Fed chief Raphael Bostic – who raised the possibility of a “pause” in the central bank’s plan for rapidly hiking interest rates.
- Then there was the encouraging commentary from megabank CEOs, who sounded much more sanguine about the outlook for the U.S. economy.
- And finally, corporate buybacks kicked in post earnings while the rebalancing of fixed weight portfolios helped drive equities higher heading into the end of the month. All of this was helped by a vicious short squeeze that helped spur the strongest comeback in U.S. stocks in more than a year.
- The market is already stretched to the down side, there simply isn’t room for stocks to move substantially lower. Even in the most brutal of bear markets, you get sharp, counter-trend rallies.

If one is a long-term investors, what should one be buying?

- A number of market strategists say that at this point there is one area of the market that is looking particularly cheap, especially in relation to everything else. Especially boring, higher-quality, so-called “value” small companies.
- The broad Russell 2000 small cap index has already plunged 25% since its peak last November. This is one of the sharpest, biggest falls on record. And it’s left them cheap.
- On a price-to-earnings (PE) basis small-cap stocks remain ‘on sale’ in relation to large cap,” reports Will Nasgovitz, portfolio manager of Heartland Value Fund, a value-oriented stock fund. “This is only the third time in the last 42 years small-caps have sold at this large of a discount.” Within small-caps, he adds, “value seems to be at a decided advantage over small-cap growth.”
- The following chart, shows the Russell 2000 index in relation to the S&P 500 going back to 1987. This is a comparative chart, showing one divided by the other. As you can see, over the long term they have tended in the same direction, but at different points in time one was more in fashion than the other. The smart play seemed to be to bet on whichever was cheaper.

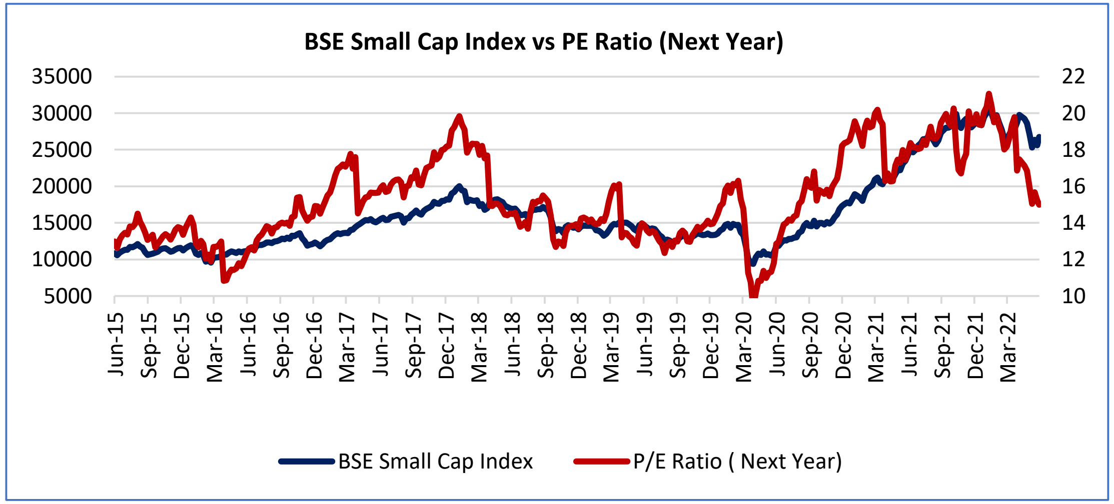
One however needs to remember that small-cap stocks are usually more volatile than large-company stocks (though not always and that probably won't help you in the short term.



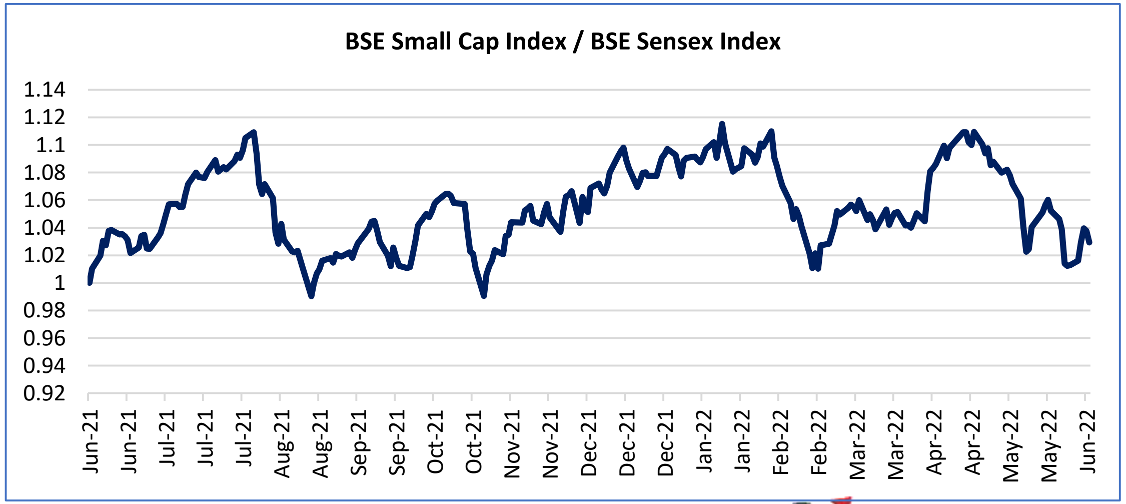
Russell 2000 vs S&P 500 (price only), 35 years

FACTSET

In India, the valuation of smallcap stocks have corrected quite a bit as is clear from the chart below.



Even relative to the Sensex, the smallcap valuations have come back to normal levels and now deserves a look-in.



To conclude

- Asian equities continued to witness foreign outflows for a fifth consecutive month in May, hit by concerns over monetary tightening measures by major central banks and supply chain disruptions due to strict lockdowns in China.
- Overseas investors withdrew $3.69 billion out of Asian equities, data from stock exchanges in Taiwan, India, South Korea, the Philippines, Vietnam, Indonesia and Thailand showed. However, the outflows were the smallest in the last five months.
- Foreigners offloaded Indian equities worth $5.18 billion, the biggest amount since March 2020, amid concerns over a weakening rupee and rising oil prices. Countries like Thailand, Indonesia and to some extent Vietnam are benefiting from a supply-chain rerouting as markets try to diversify away from dependence on China, both in the wake of trade tensions and Covid-related issues
- Off late we have seen macro data from India, most of which is encouraging despite adverse conditions. India's eight core sectors grew 8.4 percent in April, quickening from a revised 4.9 percent in March. Output in six of the eight core sectors grew in April. These sectors were coal, electricity, refinery products, fertilizers, cement, and natural gas. The government’s fiscal deficit for FY22 has come in at 6.7 percent of the Gross Domestic Product (GDP), skidding off the revised target of 6.9 percent. India's GDP is estimated to have grown by 8.7 percent in FY22 after growth slid to 4.1 percent in January-March quarter (Q4FY22). Growth likely slowed down in the first quarter of the calendar year 2022 because of the hit to activity from the Omicron variant-led third COVID-19 wave and the Russia-Ukraine war.
- We think the fears in the market are adequately discounted for the time being (though the second order effects could create a second round of fall a few months down the line). Sanity seems to be returning to the political leadership globally as inflation and interest rates are proving to be stubborn and the general population needs to be comforted about the effectiveness of the steps taken in this regard.
- A bounce from oversold levels across the globe can be expected and Indian markets can also participate in this. In this upmove Nifty can rise to 16950 and then 17130-17430 band. However investors need to do a big portfolio restructuring and take advantage of this upmove to trim their holdings and also raise some cash.

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