

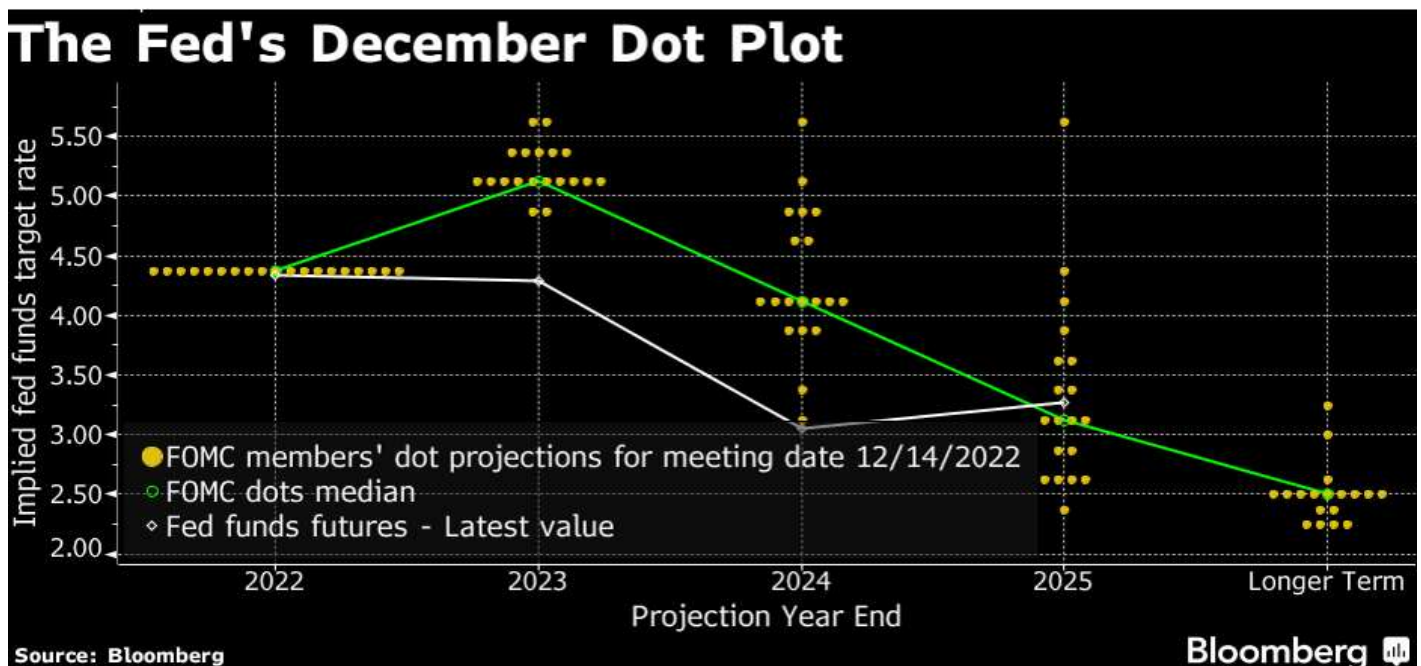
# Higher For Longer

19<sup>th</sup> Dec 2022

As predicted in last month's commentary titled 'Key Narratives', the US Fed hiked rates by 50 bps which was the lowest quantum of a rate hike post a series of 75 bps rate hikes delivered across four consecutive meetings. US headline CPI meanwhile continued its downtrend, falling to 7.1% in Nov'22 from 7.7% in the previous month. However, US Jobs, wages and unemployment levels continued to post robust growth. US Non-Farm payrolls witnessed new job additions at 2,63,000 (against expectations of 2,00,000 job additions) while wages grew by 5.1% (against expectations of 4.6%). US unemployment numbers remained flat at 3.7%, same as last month. Core CPI also posted a marginal decline from 6.3% in Oct'22 to 6% in Nov'22 (forecast 6.1%).

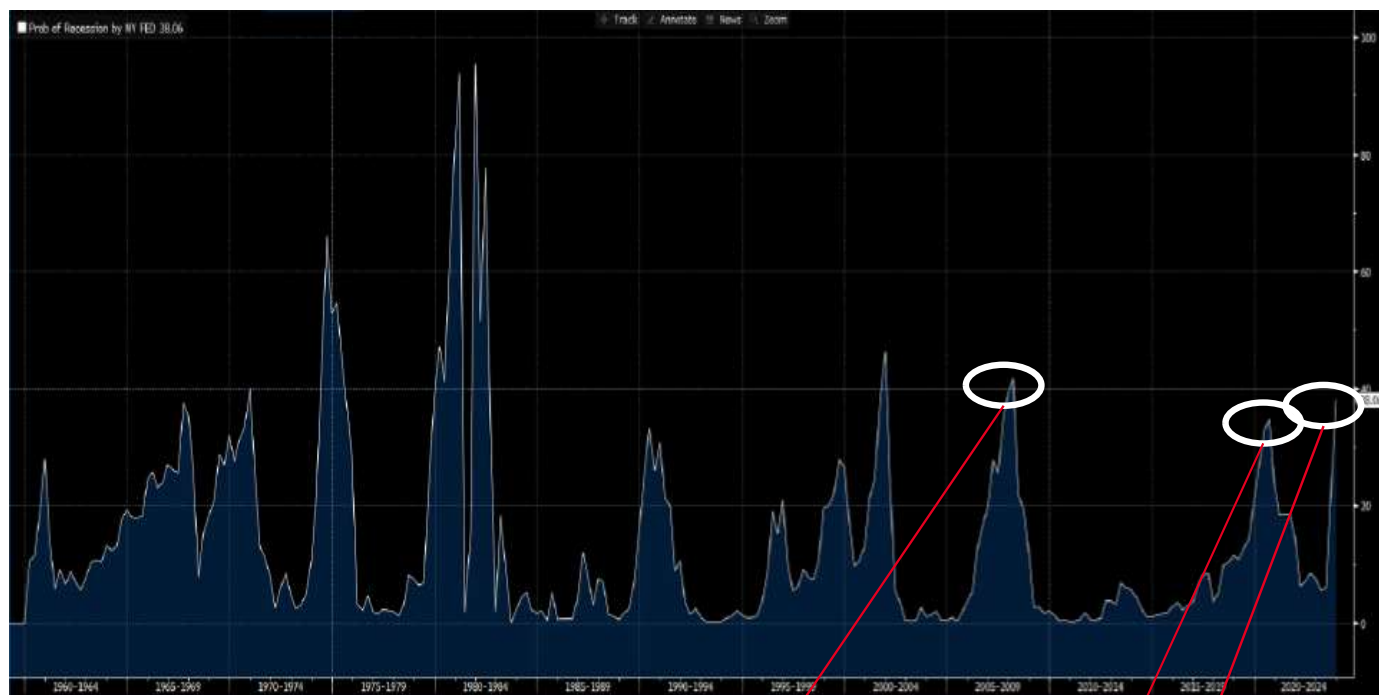
The overall data release failed to dent the US Fed's view on interest rates, and they continued to uphold their stance on reigning in inflation '**within the target range of 2%**'. The much awaited 'Dot Plot' (shown below) highlighted the terminal rates inching higher to 5.1% as compared to September's projections of 4.6%, with rate cuts anticipated only in 2024.

**Resultant Impact:** Bond market participants expect the US FED to be unable to hold on to their hawkish rhetoric with both US 2-Year and US 10-Year bonds witnessing decline in yields by 6 and 7 bps, respectively. Risk assets however seem to concur with the US FED's stance with Dow Jones and S&P 500 down 4.2% and 4.9% respectively.



## US Recession Fears

As highlighted above, US Bond market participants expect the US FED to 'pivot' sooner than the dot plot indicates. The chart below may tell us why:



Recession probability as of 2008

Recession probability as of 2020  
and as on Dec'22

Source : Bloomberg, Lighthouse Canton

As the chart above highlights, the probability of a recession in the US has surpassed the peak seen during Covid'19 and is almost near the previous peak witnessed during the Global Financial Crisis back in 2008.

## Precious Metals Back in Reckoning

With recession fears gaining ground, precious metals especially Gold have recovered sharply over the past month and in USD terms has gained nearly 12% (from the lows of 3<sup>rd</sup> Nov'22) while Silver prices in USD terms has gained by almost 21% during the same period. We anticipate current recessionary backdrop aiding Gold prices. Silver prices meanwhile will be closely tracking developments with respect to the reopening of the Chinese economy to further gain momentum after the recent sharp uptick in prices.

## Indian Equity Update

Nifty continued its upward move in the month of Nov'22 as the index closed the month higher by 4.14% at 18,758. The Indian market performance has shown resilience in last few months and outperformed major global markets on the back of strong economic growth expectations and inflation prints not getting out of hand. In Nov'22, foreign institutional investors (FIIs) turned out marginal buyers with net purchases of INR 22,546 crs. On the other hand, Domestic institutional investors (DIIs) turned out sellers with net sales of INR 6,301 crs in Nov'22 (Source – Money control).

All sectoral indices closed on a positive note except Auto & Healthcare. The biggest recovery was seen in banking names, especially PSU banks which reported healthy loan growth, improvement in asset quality and strong NIMs.

With the recent upwards move, the Nifty 50 is trading at 12-month trailing PE of ~23 times (Source – Bloomberg), above the long-term averages. **Thus, we believe the current market levels may not in favour of an investor in terms of risk reward. We would continue to recommend a staggered or tactical deployment approach.**

## Indian Fixed Income Update

The RBI MPC meeting was scheduled in the first week of December. As we had pointed out in our commentary last month titled 'Key Narratives', the MPC delivered on a 35-bps rate hike, taking benchmark Repo rates to 6.25%. While the rate hike was in line with market expectations, the RBI Governor's stance on controlling inflation in times of resilient domestic growth led market participants to believe that the overall commentary was more hawkish than market expectations.

***We believe that the RBI may deliver another rate hike of 25 bps in their Feb'23 meeting (the last MPC meeting for FY'23) which perhaps could be the peak interest rate for the economy followed by a prolonged pause.***

*For a detailed take on RBI's monetary Policy decision, we request readers to kindly go through our RBI Policy Note released on 8<sup>th</sup> Dec'22*

Indian Bond yields declined over the past month and a half, buoyed by a fall in Indian and US CPIs, as well as fall in Crude and Commodity prices. The Indian 10Y benchmark 7.26% 2032 fell from 7.45% levels as on 31<sup>st</sup> Oct'22 to 7.22% levels as on 2<sup>nd</sup> Dec'22 before surrendering some of the gains post hawkish commentaries from US Fed and RBI MPC decisions and is currently trading at 7.29% levels (as on 19<sup>th</sup> Dec'22) . ***The spread between 5-yr. and 10-yr. sovereign bond yields continue to hover in the narrow band of 10-12 bps, making long duration trades relatively unattractive currently.***

## INVESTMENT OUTLOOK

Taking the cue from our previous publications, we would like to reiterate that investors are encouraged to adhere to 'Asset Allocation' and calibrate investment decisions by carefully monitoring the ever evolving economic and geopolitical data points. Marrying our inhouse Asset Allocation framework (comprising 4 quadrants -Asset Growth, Return Stability, Inflation Hedge and Volatility Hedge) with our current stance on markets (as explained above), we build an investment outlook as follows –

- We continue to have higher allocations to volatility hedges through market neutral strategies. Central bank policy making and developments on geopolitical front would be the foremost reasons for higher volatility in risk assets and we expect long short fund managers to benefit from dispersion in returns across sectors.
- On return stability quadrants, we continue to prefer allocations to short-term bond funds and/or roll down funds (match funds duration with the investment time horizon). As mentioned above, we believe the RBI may continue to hike rates towards 6.5% (repo rate currently stands at 6.25%). Short term bond funds have become attractive with the upward move in yields in recent months across the 1–3-year segment. Investors who are looking for visibility of returns could invest in high quality roll down strategies across a 3-5 years duration. Investors could also look to invest in well managed credit funds (on the AIF platform) where the focus is on capital preservation and current income.
- We continue to avoid lumpsum deployments in equities – part of the asset growth quadrant and we prefer a staggered approach.
- For long term investors who prefer to invest more tactically, we previously recommended a strategy in our July publication titled “Revalidate”, to deploy the first 1/3rd of the money in July on account of more reasonable valuations and improved macroeconomic condition in India. We would invest the remaining two tranches (1/3<sup>rd</sup> each) in the periods of Jan-Mar’23 and Q2-Q3 CY23.
- Funds which benefit from domestic growth led by government spending and policies and selective consumption and export opportunities could be considered as an investment opportunity. Allocation to the asset growth quadrant should be consistent with the risk profile of an investor.
- Allocation to gold which is a part of inflation hedge quadrant should be maintained in one’s portfolio. Gold has an inverse relationship with real rates and gold also acts as a good hedge against economic uncertainty, and it may even attract buying from central banks especially in times of de-dollarization.

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