

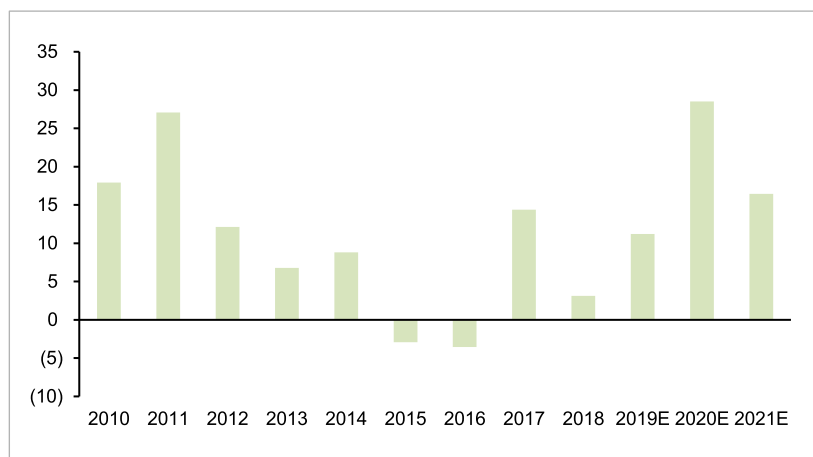
2019 – The Middle Overs



Outlining the full year outlook is challenging for most years but 2019 is particularly so with adequate sprinkling of domestic and global risk factors. The year 2019 feels like, to borrow from the cricket parlance, the middle overs. After a rousing start in 2017 and a mini-batting collapse in 2018, equity investors will have to respect risk-reward i.e. take the singles, rotate the strike and play the percentage game to be able to stay in the game.

First, the good news. Market earnings growth (as measured by Nifty 50) estimates for FY20 are now ranging in the mid 20s with some estimates forecasting as high as 30%. Some of this growth acceleration might be optical as corporate banks recovery appears to be on a firm footing even as core earnings support from consumption related sectors continues. However, Nifty forward PER at around 18x is at a premium to 10-year average and is the only emerging market to trade at a premium to history. Thus assuming we get the earnings acceleration in FY20, some of that seems to be factored in which means market returns might significantly lag the earnings growth. In a way, its payback time for earnings in 2019 (FY20) as valuations have sustained in the expectation of a pick-up that has been elusive over the last few years.

Nifty EPS growth, March fiscal year-ends, 2010-21E (%)



Source: Companies, Kotak Institutional Equities

The moderate return outlook in 2019 for equities has to be weighed against the risks. We focus below on the risks that are more immediate and can be monitored and leave the discussion on elections for a later date.

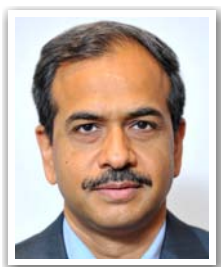
1. The one domestic risk (before elections) that is a worry in the immediate term is the fiscal slippage. GST collections have lagged targets and there is a risk of pre-elections sops making the fiscal deficit target of 3.3% for FY19 difficult to achieve. So while low inflation prints (ignoring the sticky core inflation) gives room for rate cuts, the rate markets will also pay attention to the fiscal. There are some options for the government to raise revenues (SUUTI stake sale, higher excise on auto fuels, RBI dividend), but time seems to be running out.
2. Gradual global slowdown, moderation of Fed rate hikes and weaker dollar will help India but resumption of equity inflows might await election results. Thus, 2019 could also turn out to be a tale of two halves. However, in case of a sharp slowdown with recessionary risks, there could be a global risk-off affecting equities as an asset class. The probability of the latter appears low as of now but cannot be completely ruled out.

In the above backdrop, we continue to watch and back five trends that will drive portfolios through next 12-15 months.

1. **Corporate banks placed well:** Banks seem to be benefiting not only from the normalisation of credit costs (in the case of corporate lenders) but pricing power and credit growth also bodes well for the core income growth. The dislocation in the financial markets in the last quarter of 2018 has stabilised a bit but 2019 could remain a year of growth reset for the NBFCs as capita conservation remains a priority.
2. **Capex cycle green shoots:** Infrastructure and construction sector, is attractive on valuations and companies have stocked up on order books. However, election related risks and prospects of a weak government at centre is the key risk to contend with for the sector. This is especially true for segments leveraged to the public capex cycle. Meanwhile, private capex cycle has seen some green shoots although nowhere near the boom period as power generation and metals still lag. However, there seems to be just enough tailwinds now in the capital goods space for it to at least stay in the reckoning in 2019. Cement, which has been a proxy to infrastructure exposure, has seen robust demand growth but is witnessing subdued pricing and the potential capacity additions need to be watched in the medium term.
3. **Consumption – short term hiccups? :** Consumption in FMCG and discretionary revived after the disruptions of GST but the ensuing liquidity squeeze could be one of the reasons that impacted the discretionary consumption (esp. Autos) in the 2018 festival season. Lower fuel prices and stability in interest rates can arrest this slide as the inventory seems to have normalised. Meanwhile the CV/tractor cycle is in its 2nd year of up cycle and has tailwinds for FY20 as well. However, the any agri boost pre-elections and trends in capex will be critical to sustain the cycle in 2019.
4. **FMCG – high valuations but lack of alternatives:** FMCG valuation leaves little room for error but growth tailwinds remain strong and some margin levers are either intact or still unfolding. Given that other defensive sectors (IT/Pharma) are going through their own set of concerns, FMCG sector performance seems to be more a function of availability (or lack thereof) of alternate investment opportunities.
5. **IT – watch the risks:** Higher US rates and trade policies have raised risks of an economic slowdown which could affect corporate IT spends. We believe that the structural drivers of IT spends and outsourcing could help see through any cyclical dip and thus avert a major slowdown in earnings. Hence, there is a case or the relatively inexpensive large cap IT stocks to fare better amidst this uncertainty even though the sector-level returns could be moderate.

In summary, earnings growth may not necessarily result in equivalent returns in the year 2019 although on balance the slight upward bias should continue. However, the real story as always will be in the relative timing and spacing of the various evolving domestic and global macro risk factors during the year. In such a backdrop, priority should be to get through to the other end of the wicket safely!

Happy Reading!



Rahul Singh

Chief Investment Officer (CIO) – Equities

Disclaimer: The views expressed in this article are personal in nature and in no way trying to predict the markets or to time them. The views expressed are for information purpose only and do not construe to be any investment, legal or taxation advice. Any action taken by you on the basis of the information contained herein is your responsibility alone and Tata Asset Management will not be liable in any manner for the consequences of such action taken by you. Please consult your Financial/Investment Adviser before investing. The views expressed in this article may not reflect in the scheme portfolios of Tata Mutual Fund. This is for information only and is not to be considered as sales literature. Not to be used for solicitation of business in schemes of Tata Mutual Fund.