Sanctum View

April 05, 2018

Market & Monetary Policy Update

The Fed Giveth

Before we get to the Monetary Policy, equities rallied strongly as investors gained comfort that the U.S. President, the new Fed Chairman, and their aides are likely to follow in the path of their predecessors, staying keenly focused on preserving the health of the U.S. economy - and by extension - the stock market, or vice versa.

The President, the commerce secretary and the Fed displayed their preferences quite clearly yesterday. President Trump chose to preserve the economic expansion, and equity markets, over a prolonged and painful escalation in trade sanctions with China. Wilbur Ross downplayed the President's remarks and attempted to defuse tensions.

Equally importantly, St. Louis Fed President Bullard made comments that the Fed may be close to interest rate neutral, and may no longer need to hike rates for the rest of this year. It was off to the races for equities.

The U.S. President is keenly focused on business and isn't that different from his predecessors in that regard. Ditto the Fed Chairman. The Powell Fed also appears set to follow in the footsteps of Bernanke and Yellen, and pursuing the policies and strategies of its predecessors.

Key highlights of the RBI's Monetary Policy

Repo Rate and Policy Tone Maintained at 6% and Neutral Respectively

The Reserve Bank of India today decided to keep the policy repo rate unchanged at 6% in a 5-to-1 vote. Dr. Michael Patra voted for a 25bps hike. The MPC **maintained its neutral stance** on monetary policy and commitment to achieving a medium-term target for CPI of 4% ± 2%, while supporting growth.

With 61/61 analysts polled by Bloomberg expecting a status quo stance, the Monetary Policy was a non-event in most ways.

Rosy picture for the global economy

The Monetary Policy Committee noted that advanced economies are showing economic strength. The U.S. has bounced back in Q1CY18, the Euro area remains buoyant overall, and Japan registered eight straight quarters of growth till Q4CY17 with available data for 2018 showing a slight moderation in growth.

Emerging economies remained robust in Q1CY18. China exhibited strong consumption, Brazil gained on higher commodities and Russia on recovering industrial production.

Overall, world trade volume growth was robust in Q1CY18 on better container trade throughput, air freight and export orders. Inflation remains below target in many economies world over.

Indian economy evergreen

The MPC noted that the domestic economy remained buoyant notwithstanding the transient adverse effects of GST implementation. Private consumption growth moderated in H2FY18 though Government expenditure provided sustained support to aggregate demand, with a pick-up in pace in the second half.

Fixed Capital formation turning around

Gross fixed capital formation turned around in Q2FY18 and accelerated in the second half. For Q4FY18 as well, the economy remains steady with improving private consumption, capital goods production and better housing loan uptake for banks.

Inflation likely cooling off

CPI fell from 5.1% in Jan-18 to 4.4% in Feb-18 mainly due to a 120bps decline in Food, and a decline in LPG in-line with international price movements. CPI ex-food and fuel remained sticky at 5.2% for the third consecutive month in Feb-18. Actual inflation outcomes in Jan-Feb-18 averaged 4.8%, largely reflecting the sharp decline in vegetable prices and significant moderation in fuel group inflation.

Households' inflation expectations, measured by the Mar-18 RBI's Survey of Households, edged up for both three-month and one-year ahead horizons. Manufacturing firms covered in the RBI's Industrial Outlook Survey reported input price pressures and an increase in selling prices in Q4FY18, which are expected to continue in Q1FY19.

Market Reactions

Ten-year yields **declined intra-day on the RBI announcement to 7.19%** (down -10bps) at the time of this writing. Over the last couple of weeks, the yields have tapered off on the Government's reduced borrowing plans for H1FY19. Today's RBI's expectation of CPI at:

- 4.4% for H2FY19 (vs. 4.5-4.6% as at Feb-18),
- 4.7-5.1% for H1FY19 (vs. 5.1-5.6% earlier) and

- 4.5% for Mar-18 (vs. 5.1% earlier),

has likely led to near term support for bond market prices.

The benchmark NIFTY50 index closed the day up nearly 2% as equity markets cheered global cues, and the central bank's softened CPI outlook, and the marginally better growth outlook for FY18 (FY18e real GDP growth now pegged at 6.6% vs. CSO's 6.5% in Jan-18).

The committee believes the following for its lowered inflation outlook:

- Sharp moderation in food prices in Feb-Mar-18 with inflation trajectory expected to soften vs. its Feb-18 outlook in H1FY19 on the assumption of normal monsoon and effective supply management by the Government.
- Increase in shale production is likely to keep Crude prices in check.
- Sustained strong Indian domestic demand and the impact of an increase in HRA for central government employees under the 7th CPC will continue till mid-CY18, and gradually dissipate thereafter.

Outlook

It's a Central Banker's world, and investors live in it. On Monday, we had written that it was around these times of rising fear and uncertainty that the Fed would announce a QE package and markets would roar higher. We wondered if we were likely to see a repeat. Unfortunately, there's no way to predict or act on Fed actions with reliability.

In the course of a couple days, trade war fears have been allayed, at least temporarily. Fed hike fears have been allayed, at least temporarily. The domestic bond market has rallied, and Crude looks manageable at $68 with oncoming shale production.

Unfortunately, valuations at the index level remain above 25 times, and bad loans continue to remain an issue that is being addressed, but not yet resolved. So, it remains reasonable to assume forward returns at the index level will remain muted, while stock selection and manager selection will be critical to portfolio returns.

In the face of wildly gyrating markets, pendulating between fear and euphoria on a weekly basis, we continue to prefer the positioning we've advised and adhered to as a prudent option. Protection on the downside with exposure to the upside.

Dispersion in stock performance is likely to be wide, and quality, predictability, and stability in growth will be rewarded.

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