



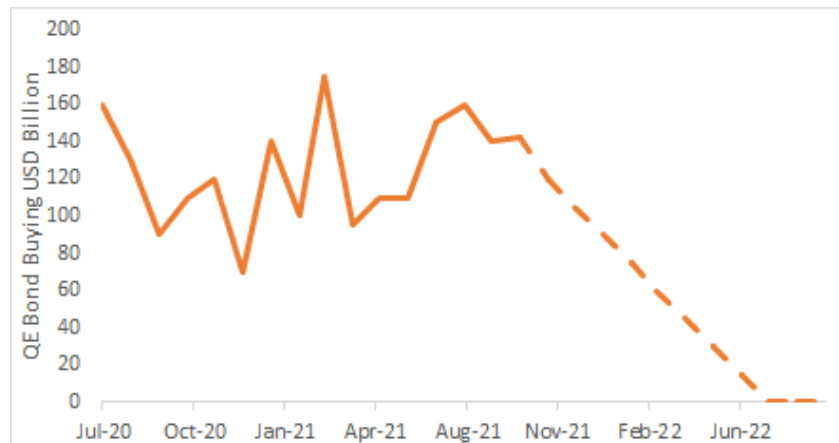
November 11, 2021

Investment Strategy

Normalization Post Covid

Finally, the US Fed has turned towards the normalization of its economy. To stimulate the economy after the Covid outbreak, the US had increased the money supply by roughly 30% in less than two years. In its latest meeting, the Fed announced tapering of quantitative easing (QE) by USD 15 billion a month. At that pace, QE would completely end by June 2022. Needless, to mention that the Fed retains the flexibility to adjust the pace should it so require.

Fed to taper at a rate of USD 15mn per month by end of the year



Source: Federal Reserve, Microbond Financial, Danske Bank illustration

The new USD 1.2 trillion infrastructure bill passed last week, is expected to further the investment cycle underway. While the positive aspect is that implementation is expected to create 2 million, the flipside is concerns around the increase in either US national debt or higher corporate taxes.

Supply chain disruptions continue to hinder recovery/growth around the world. Stories of long queues outside fuel stations in the UK is a symbol of that. These supply disruptions are not straightforward to resolve. Rationing of energy in China, port disruptions, tight labour supply in various parts of the globe, geopolitical dynamics is contributing to the supply jams.

Global Manufacturing PMI: Backlogs of work & Suppliers' delivery times

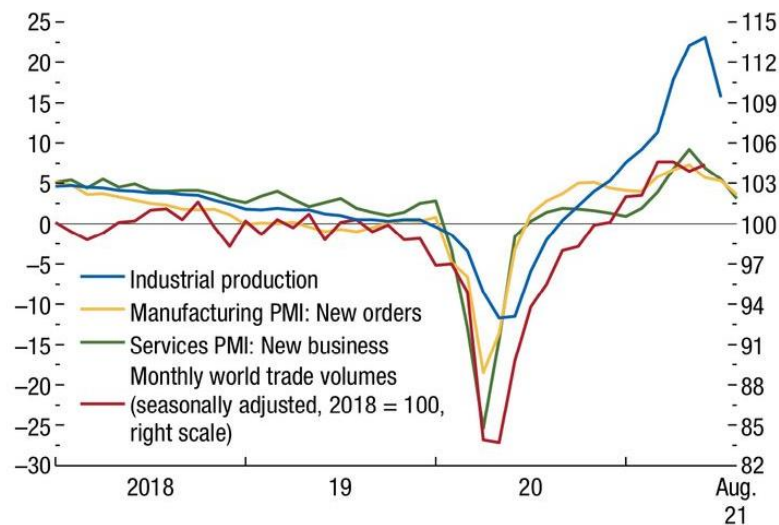


Source: Capitaleconomics.com

We could see some amount of easing in the supply-demand imbalance as short-term demand tapers a little in the US – the world's largest consumer. The extra unemployment benefits in the US have ended and the infrastructure spending won't start for a few months. But that's the wrong side of the equation contributing to the correction of the imbalance.

On the one hand, economists including those at the IMF are revising growth projections downwards on account of the supply chain disruptions, third covid wave, lagging pace of vaccinations in emerging economies and the debt deleveraging cycle in China.

High frequency indicators point to softening momentum



Source: CPB Netherlands Bureau for Economic Policy Analysis; Haver Analytics; Markit Economics and IMF staff calculations

On the other, inflation continues to be a worrying element. While sticking to the ‘transitory inflation’ line, the Fed chair Powell also acknowledged upside risks to inflation in the shorter term. An increasing number of market participants seem to be however recalibrating their view from inflation being transitory to durable.

Higher inflation and lower GDP growth is a dreaded situation for most central bankers. The easier part of the global recovery seems to be behind us. What lies ahead for the next few quarters, we expect, is a bumpy road.

India

Activity in India seems to be holding up fairly well even as global momentum is slowing down. The services PMI reading – a reflection of services activity as well as expectations came in at a robust 58.4 in October. Both Services and Composite PMI numbers stayed in the expansion territory for the third consecutive month. We also created jobs at the fastest pace in 21 months. For now, producers seem to be passing the higher cost burden to consumers, but this will have limitations in the months ahead. In the background of slowing global growth, we may still look relatively better in the quarters ahead.

The RBI has begun chalking the path to normalization of liquidity as well, as announced in the monetary policy in early October. This definitely serves as a pre-cursor to rate hikes next year. We have outlined our view in the [note](#) we published post the policy.

Markets

Stock markets, especially when flushed with liquidity, tend to discount good news well ahead and at a fast pace. Hence much of the optimism was built in the price. This result season has been about good volume growth but softer margins. We will cover that in detail in our upcoming portfolio management note. But it does seem that markets are increasingly worrying about inflation and hence after a strong rally of the past 18 months, there could be some meaningful profit taking. In fact, the market action of October is not reflected in the movement in the indices.

Outlook

We have maintained for the past few months that the phase of easy returns is well behind us, and one should be prepared for greater volatility ahead. We stated in our last note **“We are ourselves constructive on equities, but we would implore investors to commit capital only if they can stomach volatility. Both**

sentiment and liquidity can pivot away from equities rather quickly and oscillating behaviour can make temporary losses permanent.”

We indeed seem to be entering that phase of volatility now. That begs the question, is this time for going underweight equities now? On the contrary, our view is to increase weights in equity, should markets correct. The Indian economy as a whole and India Inc., in particular, has gone through a long period of clean up and deleveraging. Our fundamentals are very sound and make for a strong investment hypothesis. We concede that valuations are currently rich, but a market correction would address that issue to a certain extent. The magnitude and method (lumpsum/staggered approach) would be determined based on the extent and sharpness of the correction.

Technical Commentary

Ever since hitting an all-time high of 18,604 three weeks back, Nifty has been in a declining trend. The index has now moved below the 21-day exponential moving average and is trading below it. However, Nifty has maintained its trend of hitting higher highs and high lows since touching 17,250-17,450 in September. Currently, 18,000 and the 21-day exponential moving average is acting as the resistance zone. Nifty needs to break above this resistance for a rally towards 18,350 and 18,800 thereafter. On the downside 17,600 is a key support level.



Source: Falcon7

BSE Midcap index has formed a short-term base between 24,800 and 25,750 levels. A move above could lead to a rally towards 27,246 with 24,800 acting as a support level. Similarly, the BSE smallcap index has formed a short-term base between 3,772 and 3,943. A break on either side could suggest the next led of up or downtrend.

Internationally, the Dow Jones index has given a breakout on the upside after consolidating around 33,000 and 35,600. With this breakout 35,600 has now become a key support level. Nasdaq has also given a breakout above its previous high of 15,405.

Brent crude has seen some correction from the highs of USD 86/bbl. 80.25 is the next support level while 86 has become a key resistance level. Gold has been consolidating between 1,710 and 1,840 for the last 4-5 months. A break in either side could suggest the direction of the next move for Gold.

Indices	Next Resistance Level	Key Resistance Level	Current Market Price	Initial Support Level
Nifty Index	18,800	18,350	18,044	17,450
BSE Midcap Index	NA	27,246	26,520	24,800
BSE Small Cap 250 Index	NA	4,157	4,023	3,772
Nifty Bank Index	41,300	40,100	39,369	38,800
Nasdaq 100 Index	16,630	16,160	16,220	15,405
USD Gold	1,920	1,840	1,825	1,760

* Current Market Price as of 9th November 2021

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