NETRA Early Warning & Signals Through Charts

November 2022

DSP

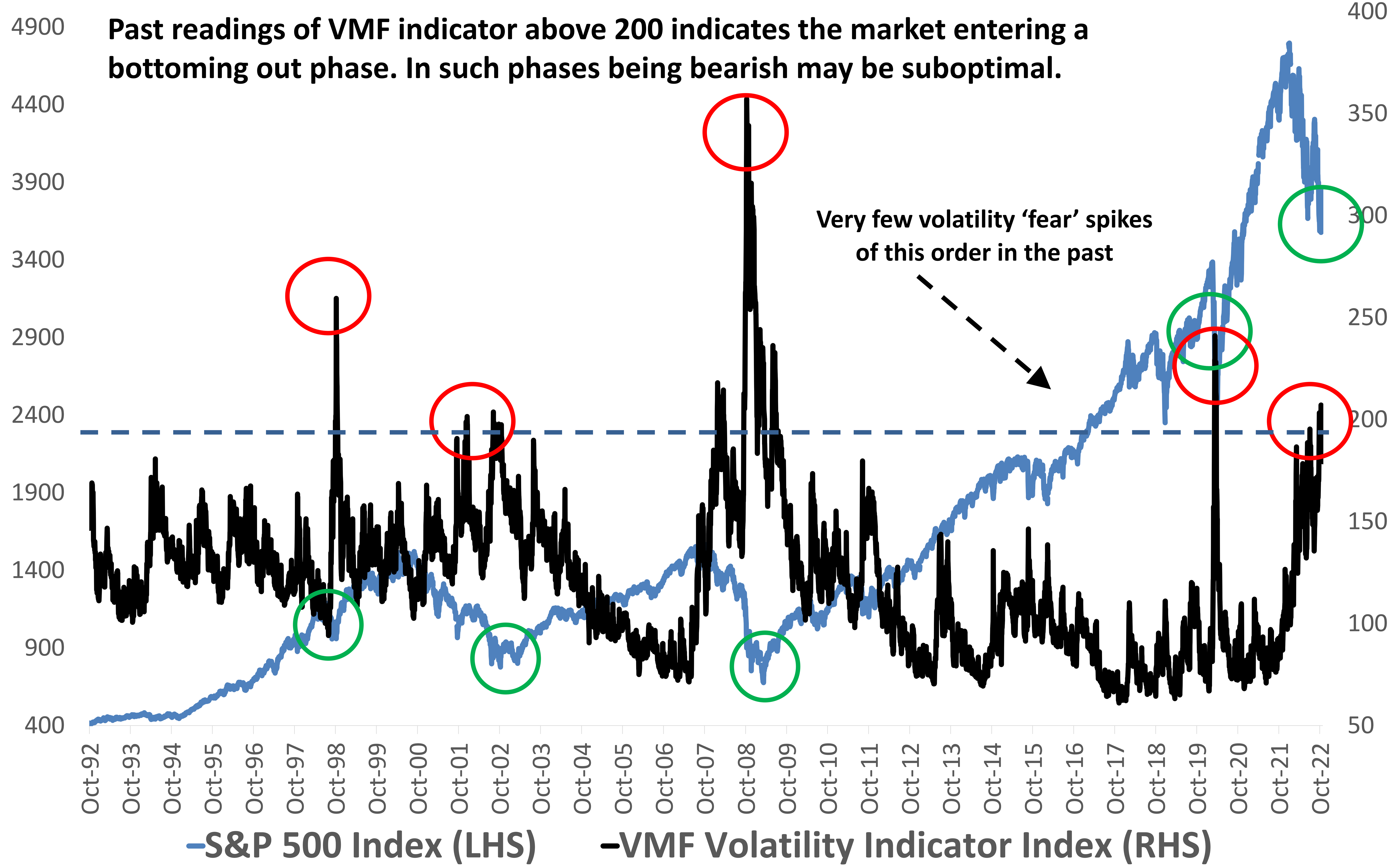
Risk Indicator Check

‘Volatility Gauge’ Shows The Extremity of Fear In Markets

VMF(VIX, MOVE and FX volatility index) indicator is our in-house indicator which measures the combined volatility in stocks, bonds & currency markets. Elevated readings in this indicator means that all three asset classes are under stress at the same time.

Currently, we are witnessing heightened readings across all the three underlying indices of these asset classes. In the first week of Oct’22, this indicator reached a level which signalled the possibility of the bottoming out process in markets. The ‘Risk-off’ has run too far.

The indicator suggests that the worst of FX & bond moves may be behind us now. This means equity markets may enjoy a less volatile period ahead.



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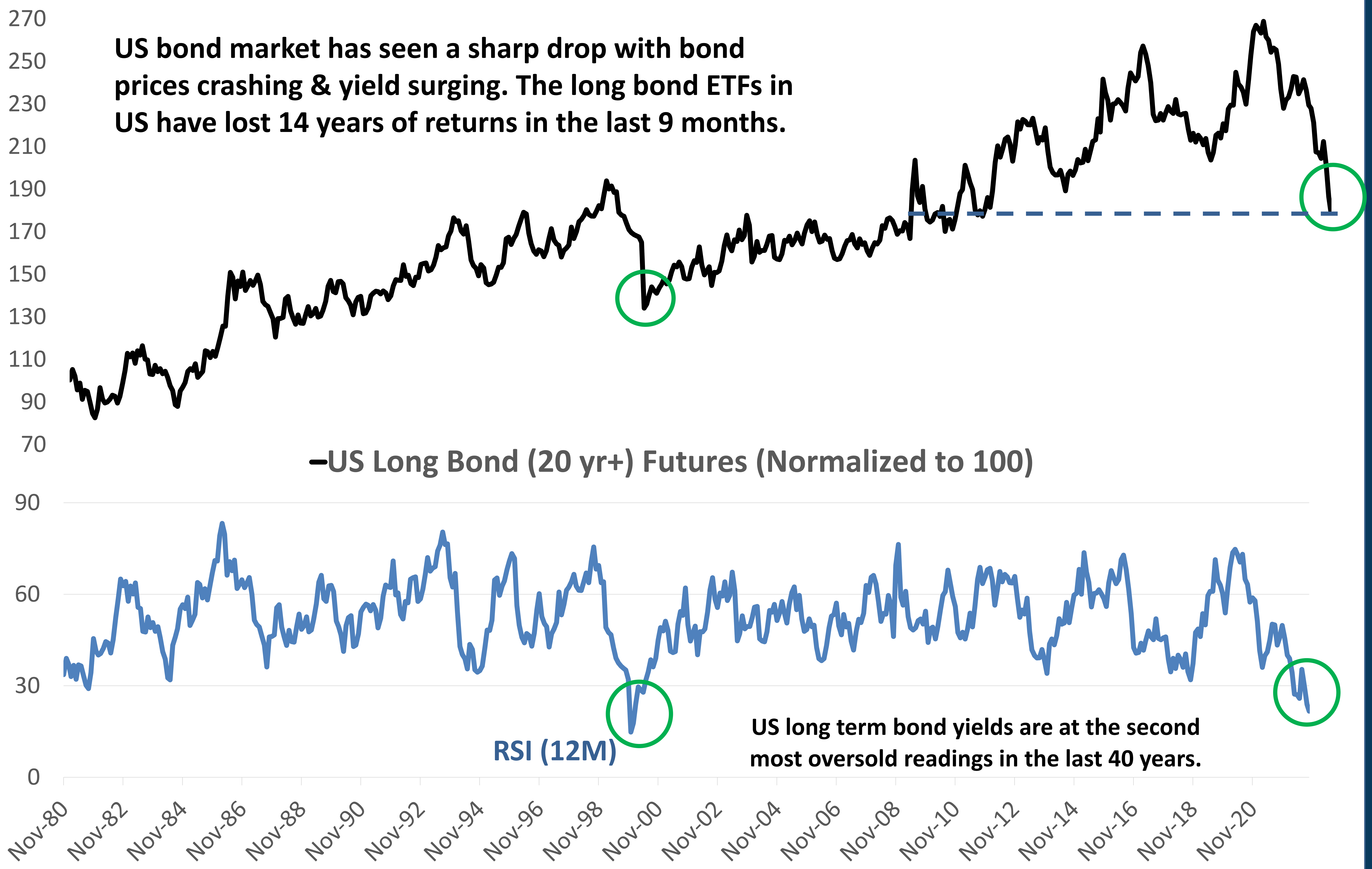
Source: Bloomberg, DSP As on Oct 2022

US Bonds Are Deeply Oversold

US long bond yield (20 yr+) has risen 250 basis points (2.5%) in the last 9 months. This is one of the sharpest rises but is still lower than the ~400 bps increase in short term (3 month) rates in the US. That's because short term rates are closely linked to actions of the central banks, the US Fed in this case.

The oversold readings on bonds indicate that long term bond yields in the US are in a process of topping out. Our inflation readings indicate a decline in inflation ahead . Additionally, oversold conditions in the bond market indicates that **both data and markets will push the US Fed to tone down its hawkish stance in the next two meetings.**

This is another 'risk-off' indicator in the current context which suggests that the worst sell-off in bonds may be behind us.



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Source: Bloomberg, DSP As on Oct 2022

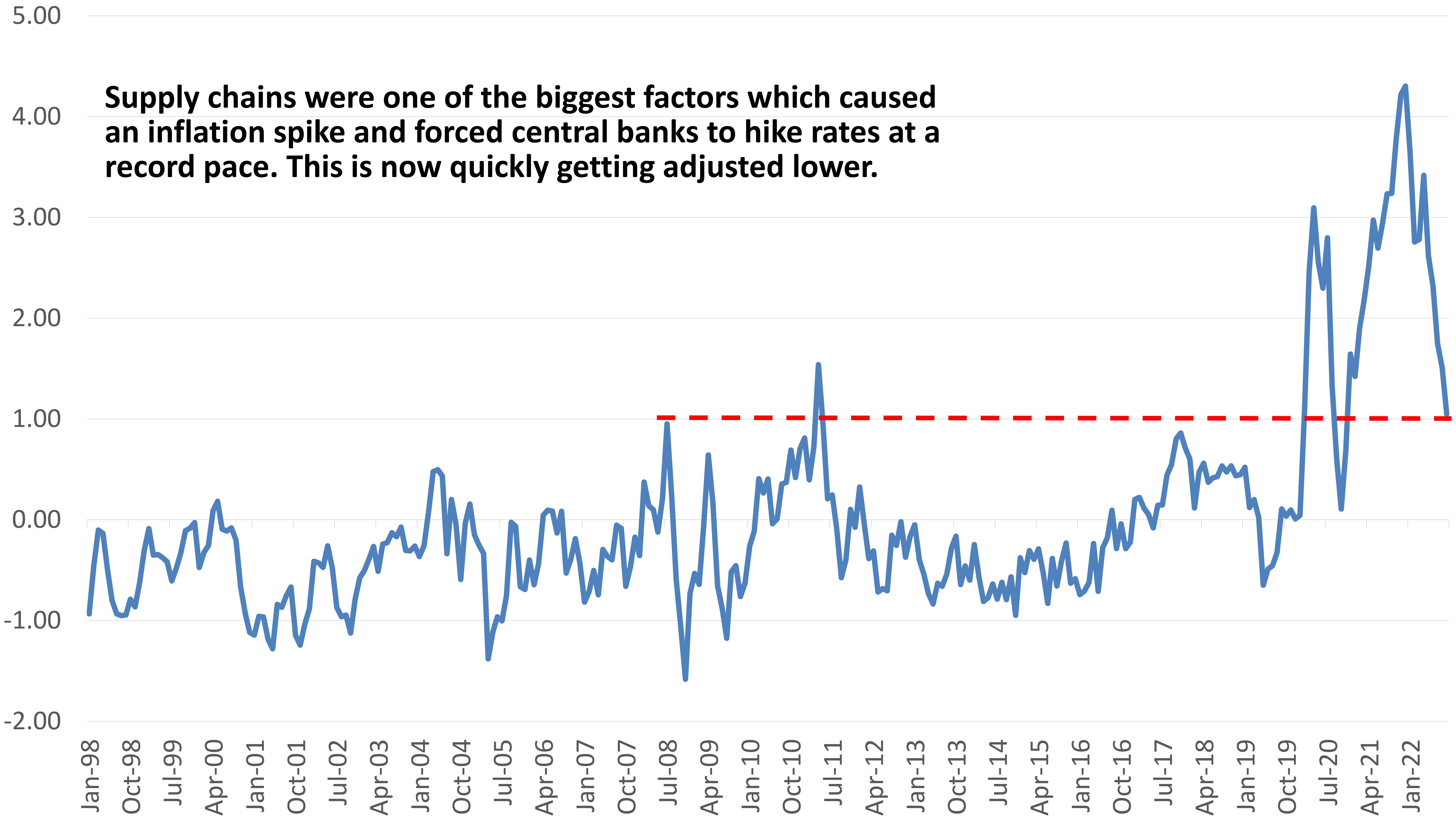
Supply Chain Pressures Are Easing

The worldwide market for container ships and freight containers were one of the biggest source of a surge in input price pressures. In the last few months, this trend has reversed and has seen an eye watering decline.

Global container 40ft box freight rates are down 67% from the peak of last year and are approaching pre-Covid levels. The freight rates for container ships (as per HARPEX) is now down 68% from a peak index of $4586 to $1486.

The outlook from the industry body suggests that these rates are likely to fall below pre-Covid levels in the coming quarters.

This means that one of the biggest sources of supply side pressure which led to inflation and Central Bank hawkishness is already over.



Global Supply Chain Pressure Index (GSCPI)

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Source: Federal Reserve Bank of New York, Global Supply Chain Pressure Index

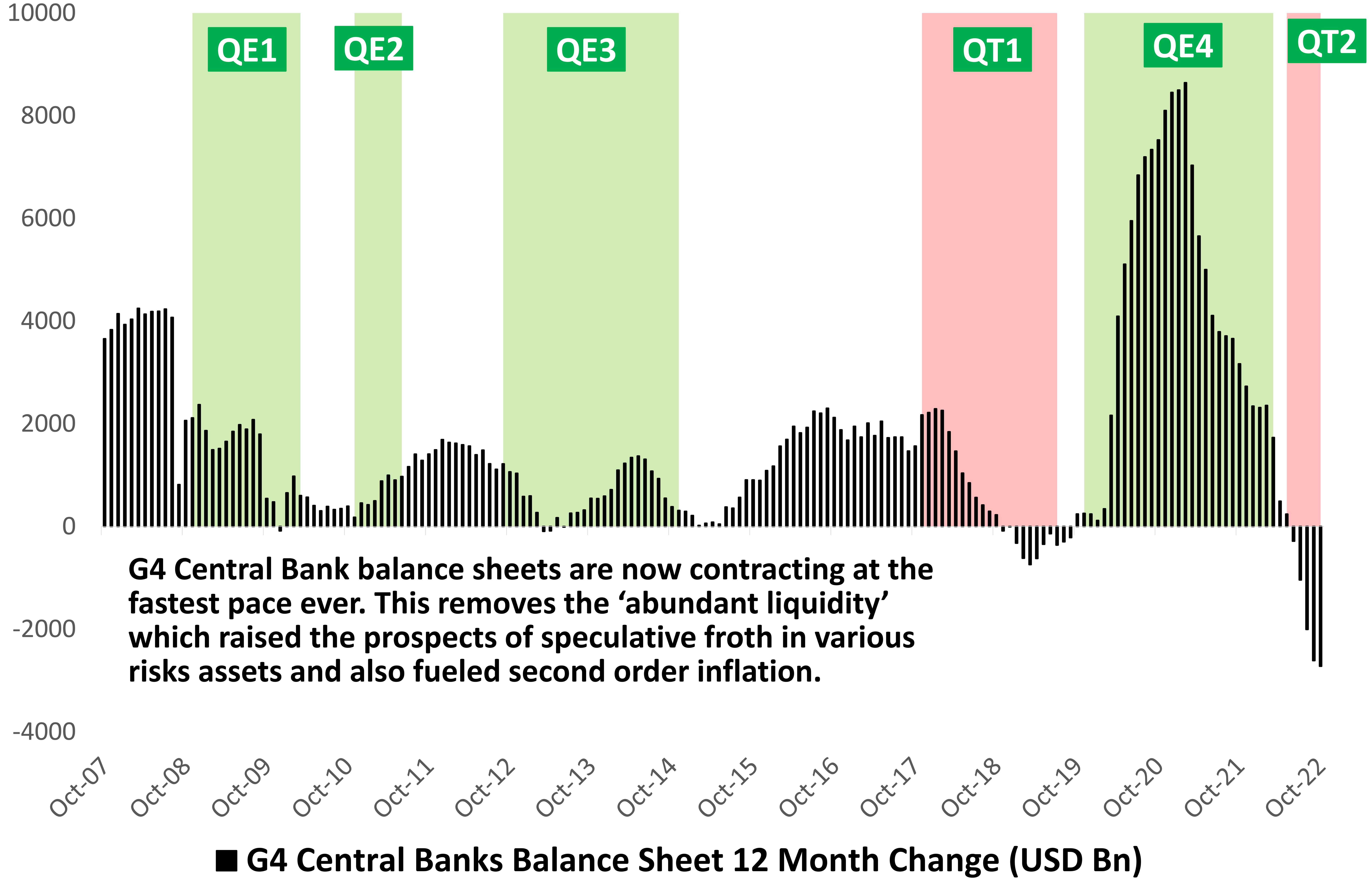
G4 Central Bank Not in Money Printing, But In Squeezing Mode

Asset purchases aka quantitative easing or what is colloquially called 'money printing' is over, for now. Central banks are no longer purchasing bonds but are either standing aside or selling them.

This is squeezing systemic liquidity which according to many market participants is one of the contributing factors of a spike in global inflation.

This means that both the 'Big' factors which caused inflation – supply squeeze and Quantitative easing – are in reverse gear.

Conclusion: The Risk-off caused by the inflation scare should get a respite from these developments.



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Source: St. Louis Fed, ECB, BOJ, BOE, DSP As on Oct 2022

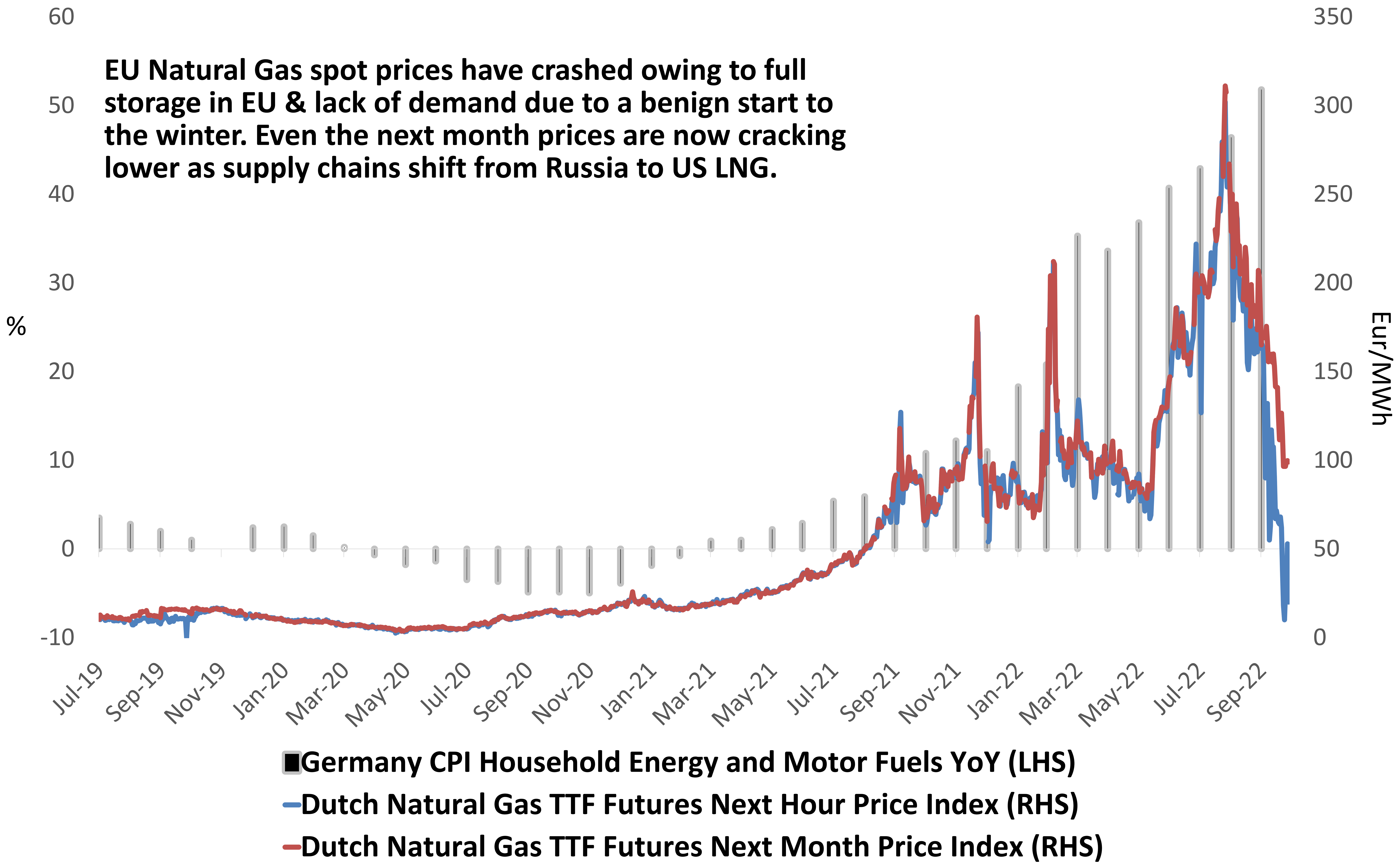
**QE dates highlighted above are only for US Federal Reserve implementation dates.*

Natural Gas: The Most Adversely Impacted Market Is Normalizing

The biggest spill over of the Russia-Ukraine war was on the European Natural Gas market. Russia used to account for 45% of EU gas imports before the conflict broke out. This led to a parabolic rise in European gas prices from 35 to 320 Euro/MWh.

This market represents one of the focal points of what has gone wrong in 2022. Over the last two months, prices have corrected significantly. Although prices are still more than double the pre-Covid levels, the demand-supply picture is improving significantly in favour of lower prices.

This should eventually reduce the inflation burden in Eurozone and abate the prevailing risk-off sentiment especially in EU countries.



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Source: Bloomberg, ECB, DSP As on Oct 2022

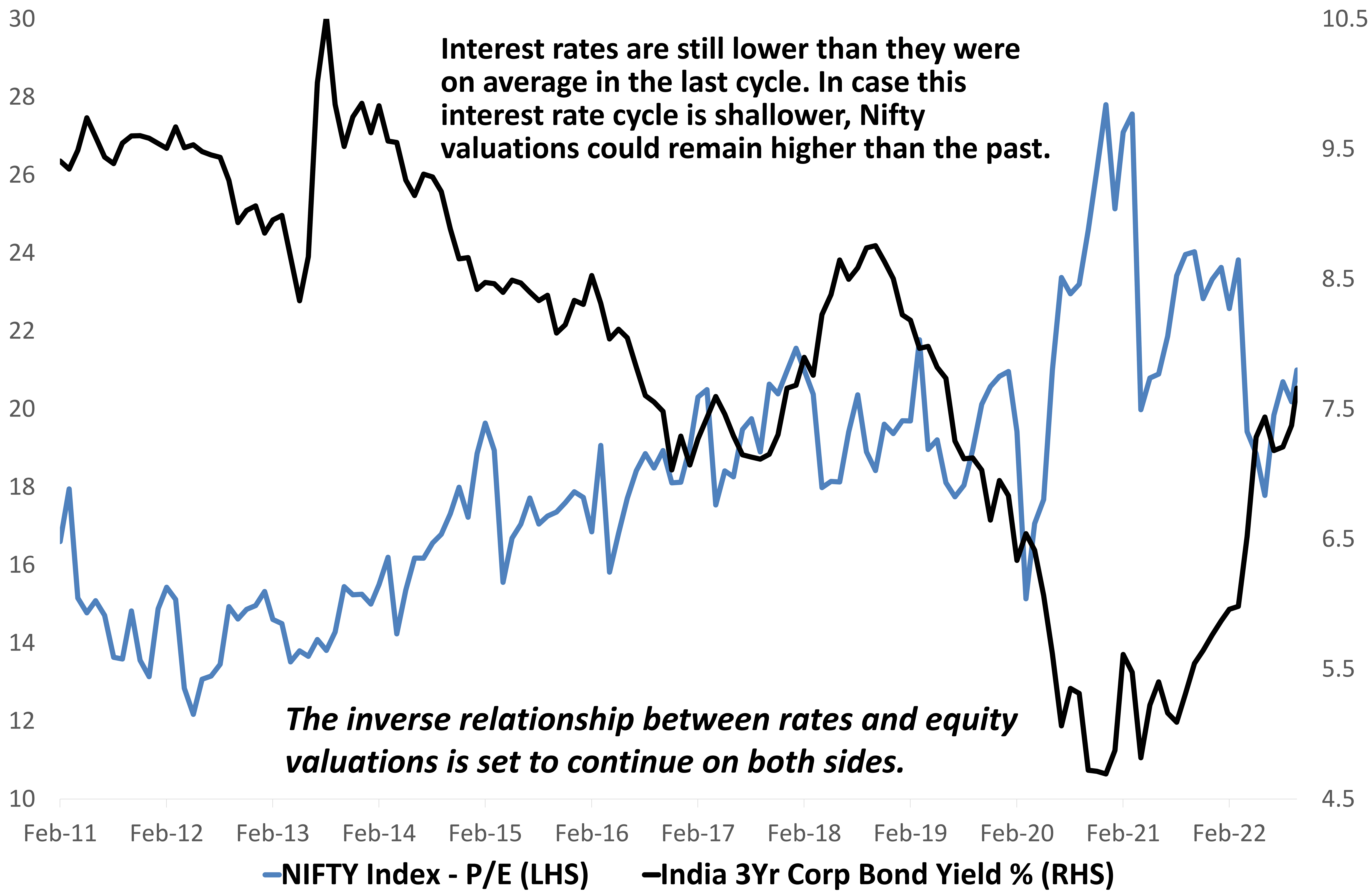
Valuation Froth Has Reduced Due To Rising Interest Rates

Ultra low interest rates have caused India equity valuation multiples to expand. Since the peak of 2013, India Corp Bond 3Yr Yield has declined from 10.5% to 4.6%, of which nearly 300bps happened during Covid monetary policy largesse.

During this phase the Price to Earnings multiple on Nifty expanded from 14x at the bottom to ~27x at its peak on a trailing 12-month EPS basis. For a 600bps contraction in borrowing costs, the PE multiple expanded by 1300bps even when earnings growth was lower than the preceding 10 years.

In the last 18 months, interest rates have risen by nearly 300bps and the Nifty PE multiple has contracted by nearly 800bps.

Interest rates and valuations have an inverse relationship, all else remaining same.



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Source: St. Louis Fed, ECB, BOJ, BOE, DSP As on Oct 2022

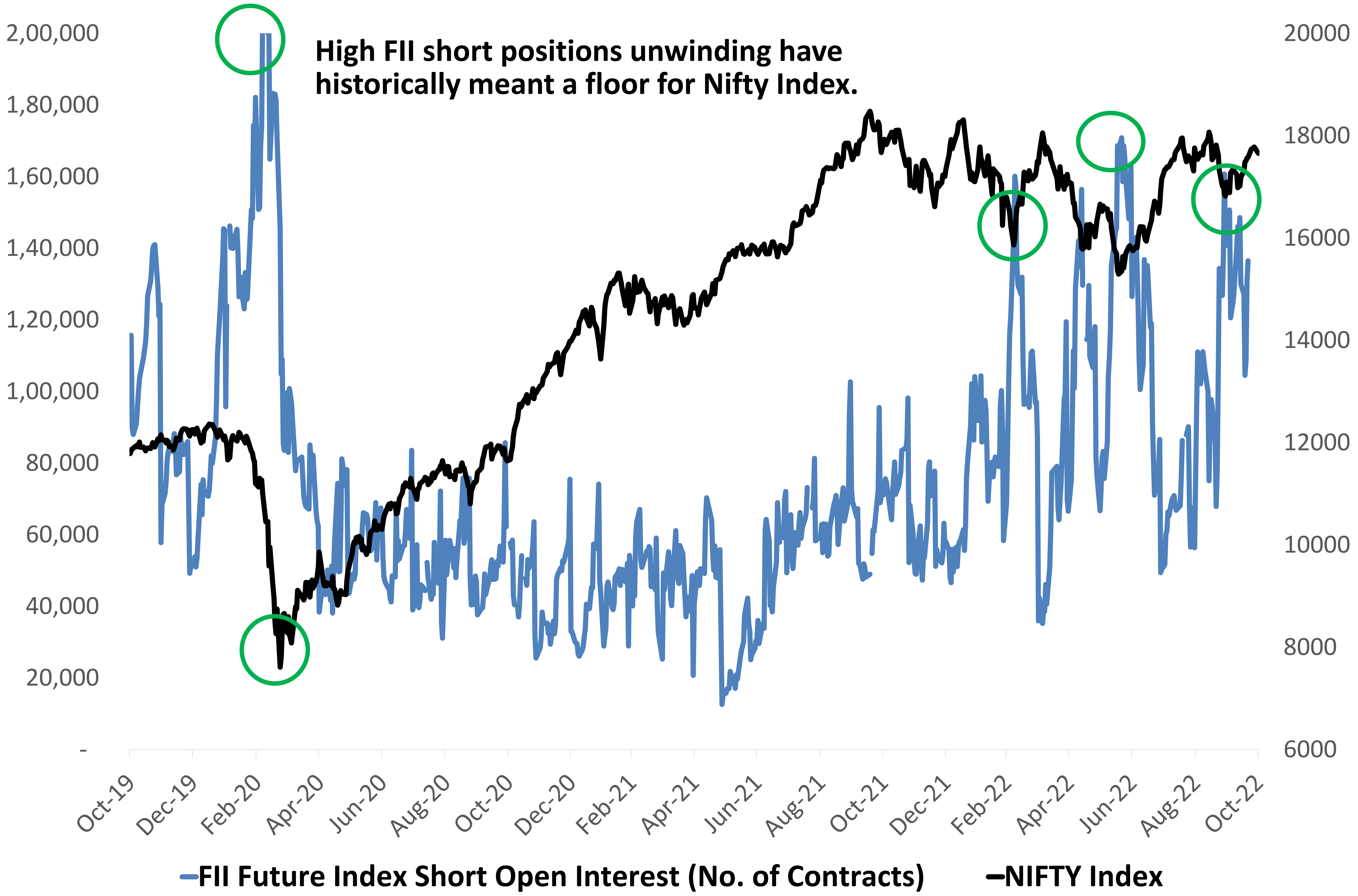
FII's Short Position Indicates A Floor For Nifty

FIIs have been net sellers of Indian equities in Sep & Oct 2022. In October they also amassed more than 1,00,000 contracts in Nifty futures as a short position.

Historically, when such a high short position in Nifty futures reverses, the corresponding move is usually on the upside.

During the same period the Nifty Index 'Put Call Ratio' had also fallen below 0.75, another indicator which shows that the market was oversold. Consequently the market approached the range to increase equity allocation highlighted in our report The Navigator .

Combine this further with 3 of the top 20 major equity indices hitting oversold conditions in October 2022- this shows that global equity markets have recovered from deeply oversold readings, suggestive of a significant price bottom.



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Source: NSE, DSP As on Oct 2022

Sector Musings

What Should Be Valued More: Higher Growth, Scale or Both?

TCS has delivered a higher Profit growth and higher EBITDA growth over a 10-year period than Asian Paints. This is at a scale which is 11x higher (TCS FY22 EBITDA is 11 times that of Asian Paints).

Cash Flow conversion (CFO/ EBITDA) is also better for TCS.

Yet Asian Paints continues to trade at 3x Price to Earnings Multiple of TCS. This is often explained by higher "potential" growth.

There are multiple similar examples for companies in the consumption segment that have seen significant rerating over the last 10 years (in 2010 TCS/ Asian Paints were trading at similar multiples).

What valuation differential is "enough"?

Metric	Company	Mar 2022	Mar 2021	Mar 2020	Mar 2019	Mar 2018
PAT CAGR 10-yr	ASIANPAINT	11.9	14	12.5	18.4	17.4
PAT CAGR 10-yr	TCS	13.9	13.6	16.6	19.6	17.8
EBITDA CAGR 10-yr	ASIANPAINT	12.3	13.8	12.9	18.8	17.1
EBITDA CAGR 10-yr	TCS	14.3	15.5	17.4	20	19
PE Ratio	ASIANPAINT	97	87	59	66	55
PE Ratio	TCS	36	38	21	25	21

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Source: Internal DSP As on Oct 2022

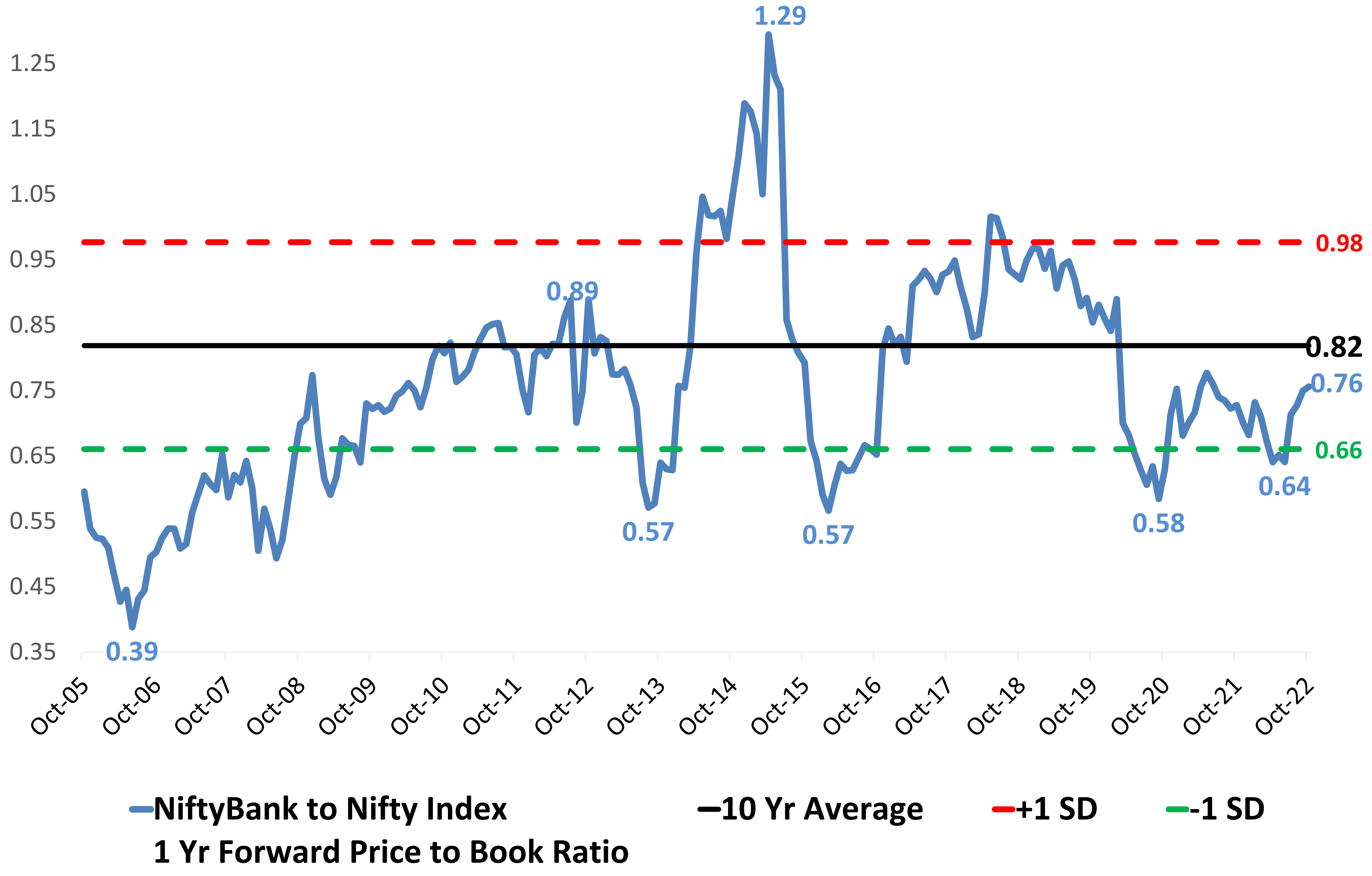
Banks Are Still Trading Below Average Valuations Relative to The Nifty Index

Nifty Bank Index has outperformed the Nifty Index by 13.5% in 2022 YTD (end Oct'22).

Yet relative valuations for the banking sector remain slightly below average on the whole. This means that lenders continue to remain at attractive valuations.

We also know that banking credit growth has climbed to ~18% YoY in the most recently released data from RBI. For some large banks Net NPL ratios have fallen to decade lows and bank balance sheets remain robust.

Over the next few years, the banking sector is likely to remain a market leader during equity market upturns. Stay the course.



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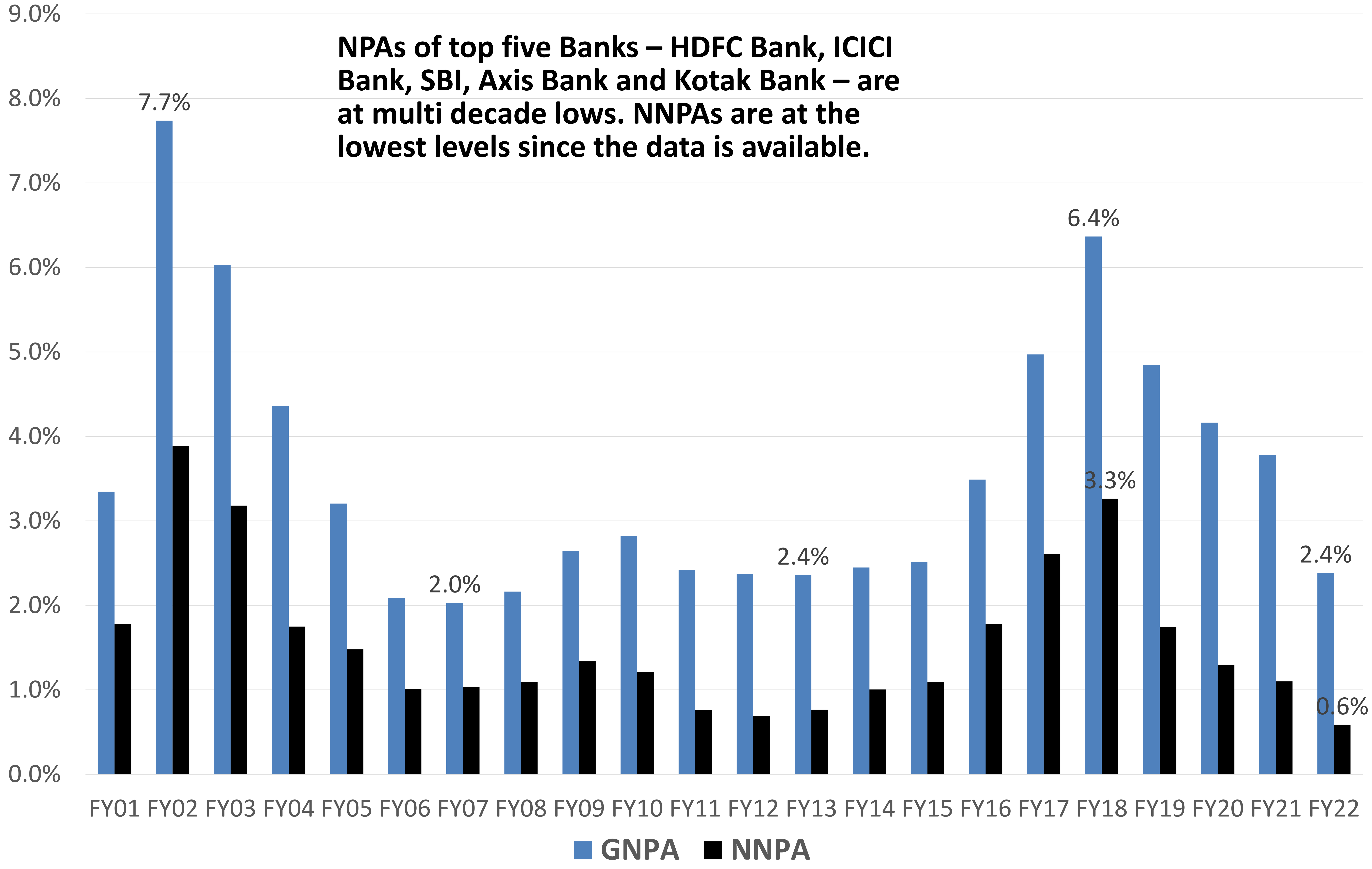
Source: Bloomberg, DSP As on Oct 2022

Non-Performing Loans of Banks At Multi Decade Lows

Non Performing Loans for the entire banking sector had hit record levels in FY18. At an aggregate level, the GNPA ratio had reached early teens depicting severe stress in the banking sector.

Aggressive recognition & provisioning and consequently equity dilution turned the cycle around. However, banking sector profitability and quality improves the most during strong credit growth supported by underlying economic growth.

Currently, the top 5 Banks are witnessing strong credit growth at a time when asset quality is progressing in the right direction. This trend historically hasn't been ephemeral. There are reasons to believe that better prospects for lenders are still ahead and there are enough opportunities for investors. Bullish on lenders.



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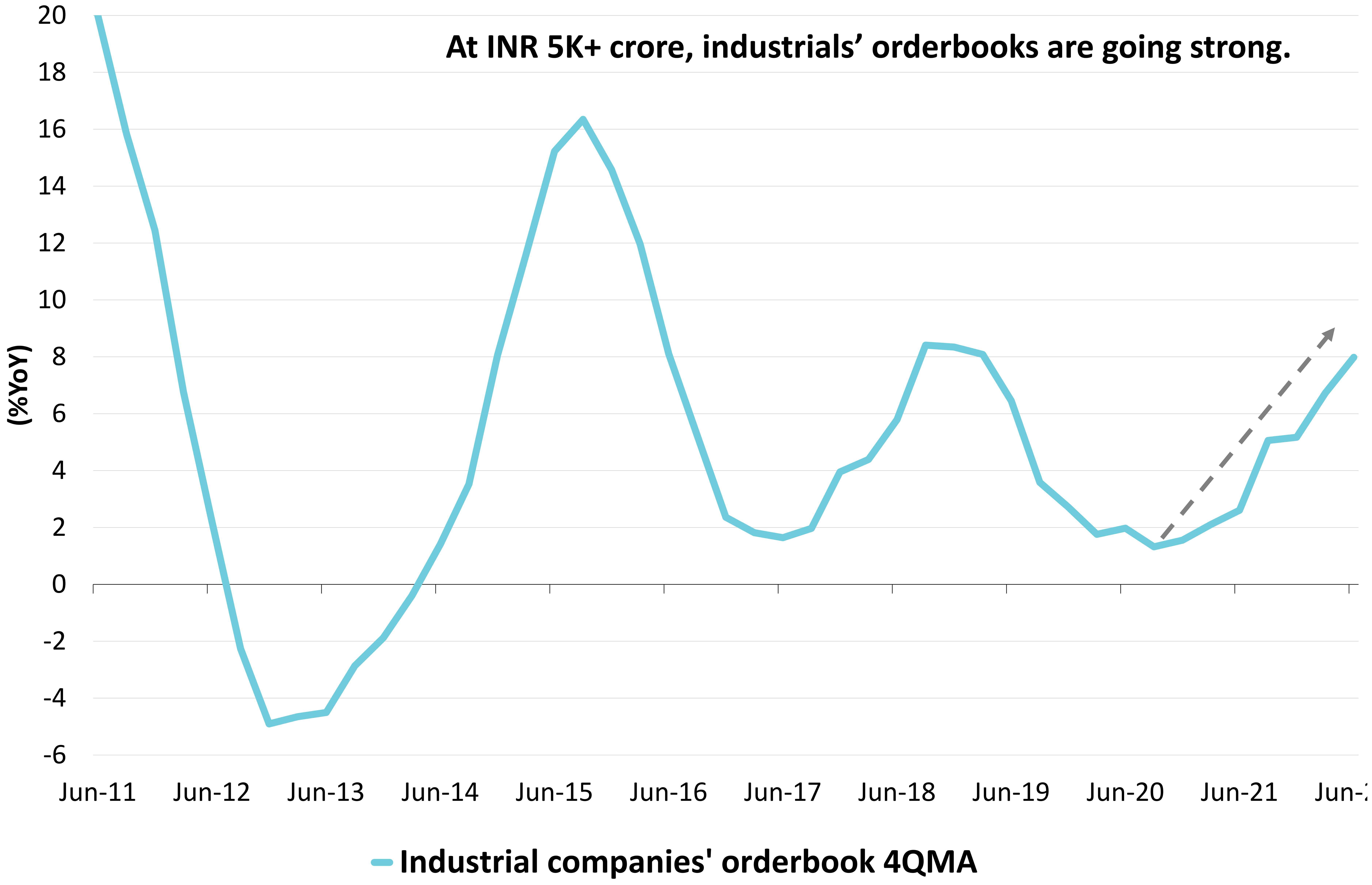
Source: Bloomberg, DSP As on Oct 2022

The Lead Indicator For Industrials Shows Strength

Industrial companies' orderbooks continue to improve.

As per the latest PMI release, "Anecdotal evidence pointed to greater demand from domestic and international clients. Indeed, new export orders rose further in September. The increase was the sixth in consecutive months and the fastest since May."

The rise in orderbook for industrials bodes well for capital goods. Plus, capacity utilisation is gaining momentum. Credit growth is increasing. New investments have improved. With all good omens in place, do you own capital goods in your portfolio?



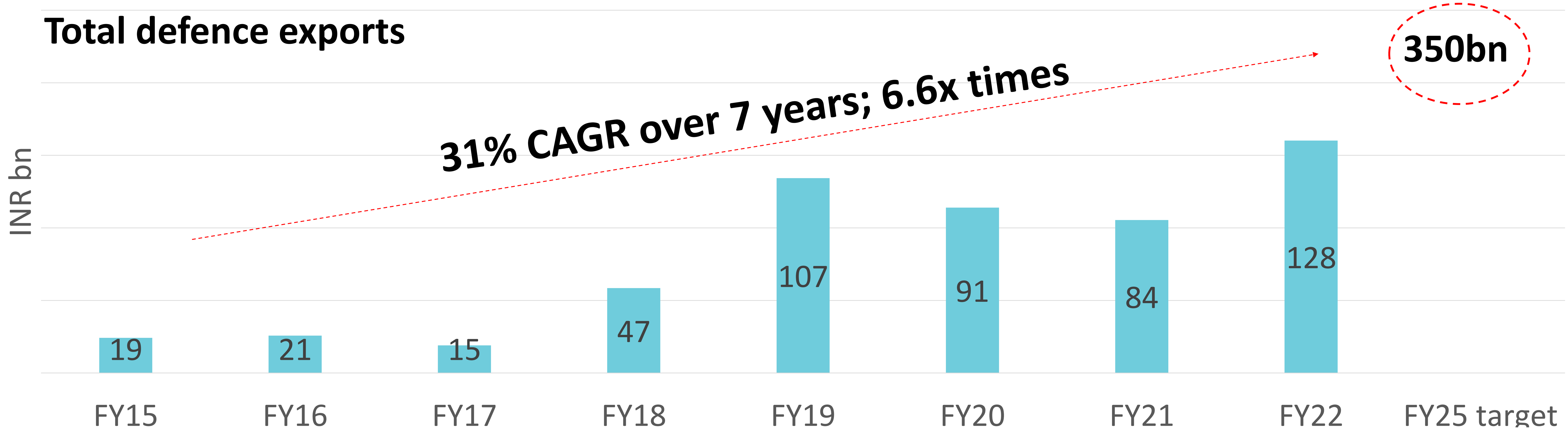
Source: Bloomberg, Nuvama Research, DSP As on Oct 2022

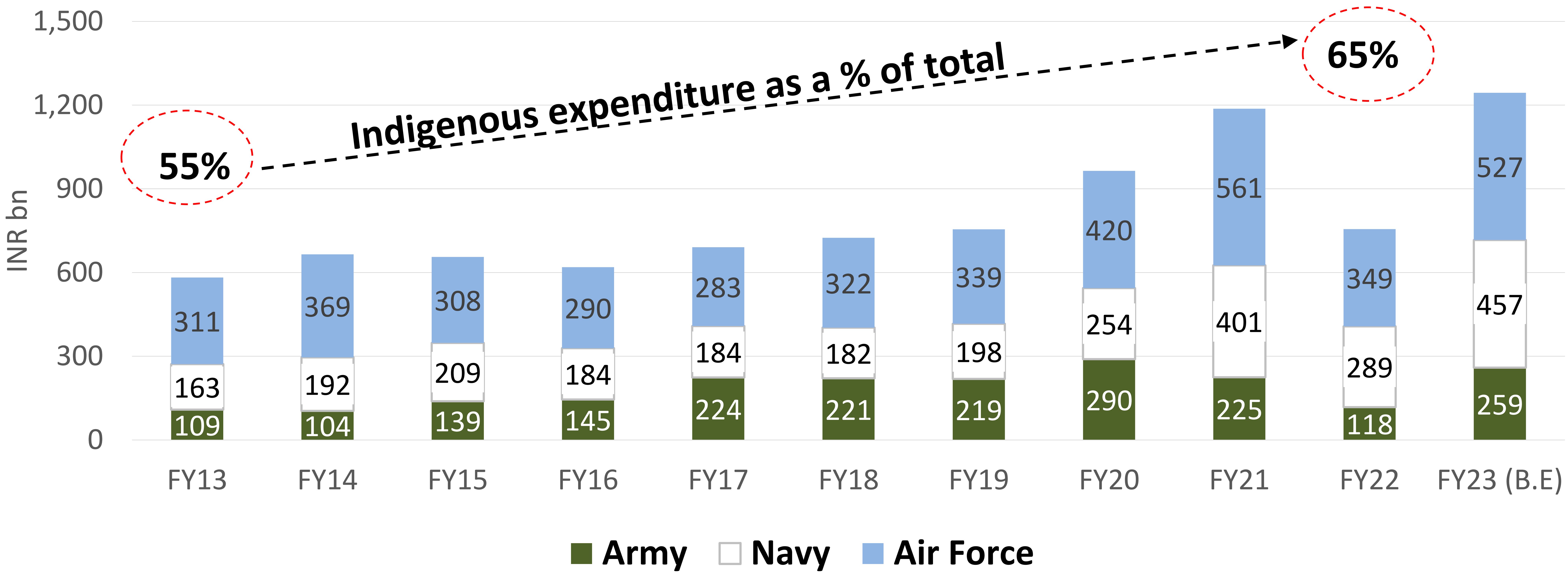
Defence Is the New Offence?

India's defence sector is coming of age. The Government's focus to cut import dependence is creating a large market opportunity for Defence PSUs (DPSUs).

DPSUs have a quasi monopoly in the sector as it takes years, if not decades, to get an approved defence product from ideation to launch stage.

India's defence capex (actuals) has expanded at a 3Y CAGR of 13.3%. However, as a % of GDP, it is far lower than many developed/ large countries. Indigenization, large orderbooks and lack of competition is likely to keep this sector bubbling with opportunities. With a mindful blend of respectable valuations and thoughtful earnings, investors can reap benefits from this sector.





Source: Nuvama Group As on Oct 2022

Invest With Purpose

There Is Little Merit In Outperforming Your Peers But Not reaching Your Goal

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