NETRA

Early Warning & Signals Through Charts

JULY 2022

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A 6+6 Book On Global & Indian Trends

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US Housing Market – Staring At A Slowdown

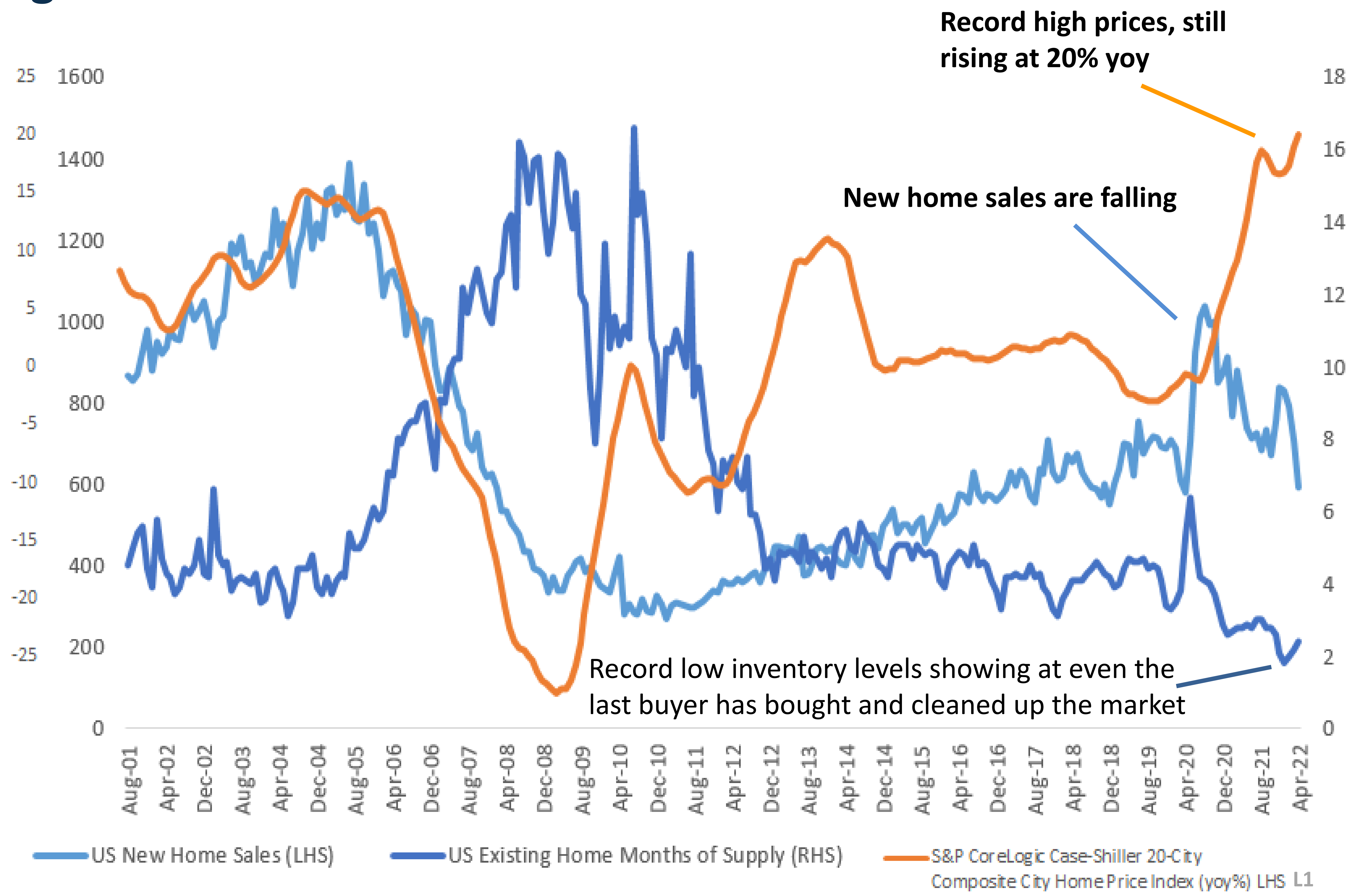
US Housing market was on a tear since COVID struck in 2020. As you can see in the chart on your right, housing prices have risen rapidly and are still rising 20% yoy.

The inventory of new homes have hit all time lows.

But there are two major changes that have occurred.

1. Mortgage rates in US have risen nearly 300bps in last one year and are now at 6%+. One of the highest levels in decades.
2. New home sales have begun to fall with housing affordability at its worst.

Prepare for sober times in US Housing ahead. This also means demand for many home building commodities like Copper, Lumber and aluminum will reduce and so will housing's contribution to inflation.



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Source: Bloomberg, Data As on June 2022

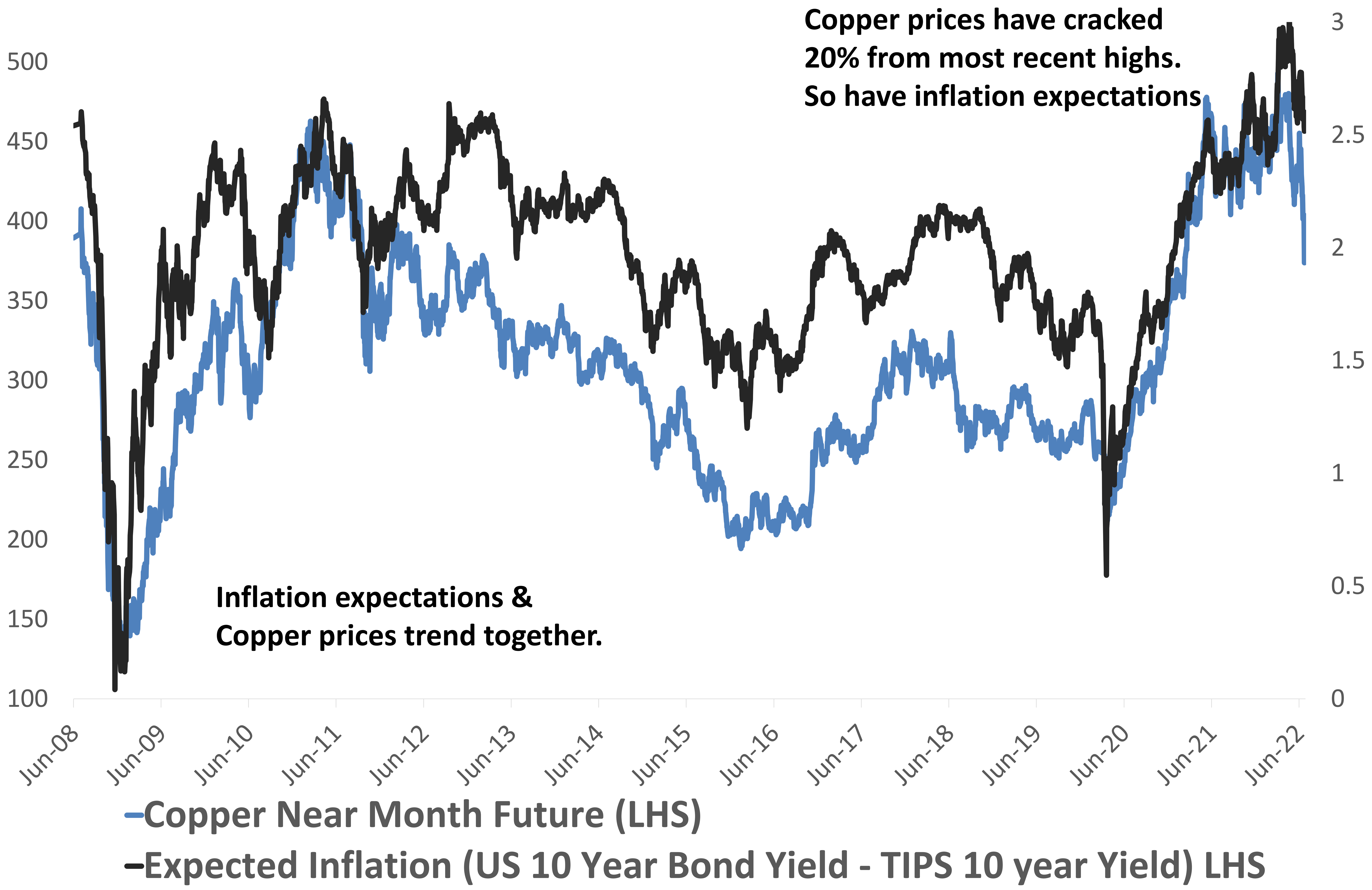
Dr. Copper Calling In Sick?

Copper prices trend with economic growth and inflation. That's why Copper is also called Dr. Copper in macroeconomic parlance. It signals the strength of aggregate demand in the economy.

Lately, not just copper but most industrial metals have seen a sharp correction highlighting the slowing down of economic growth. This slowdown is more pronounced in three biggest economic blocs – US, EU and China.

Historically, weaker copper prices have coincided with downward trend in inflation. Even market driven inflation expectations are falling along with copper.

Prepare for a softening in inflation readings in H2 of 2022. This is the prognosis from Dr. Copper.



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Source: Bloomberg, Data As on June 2022

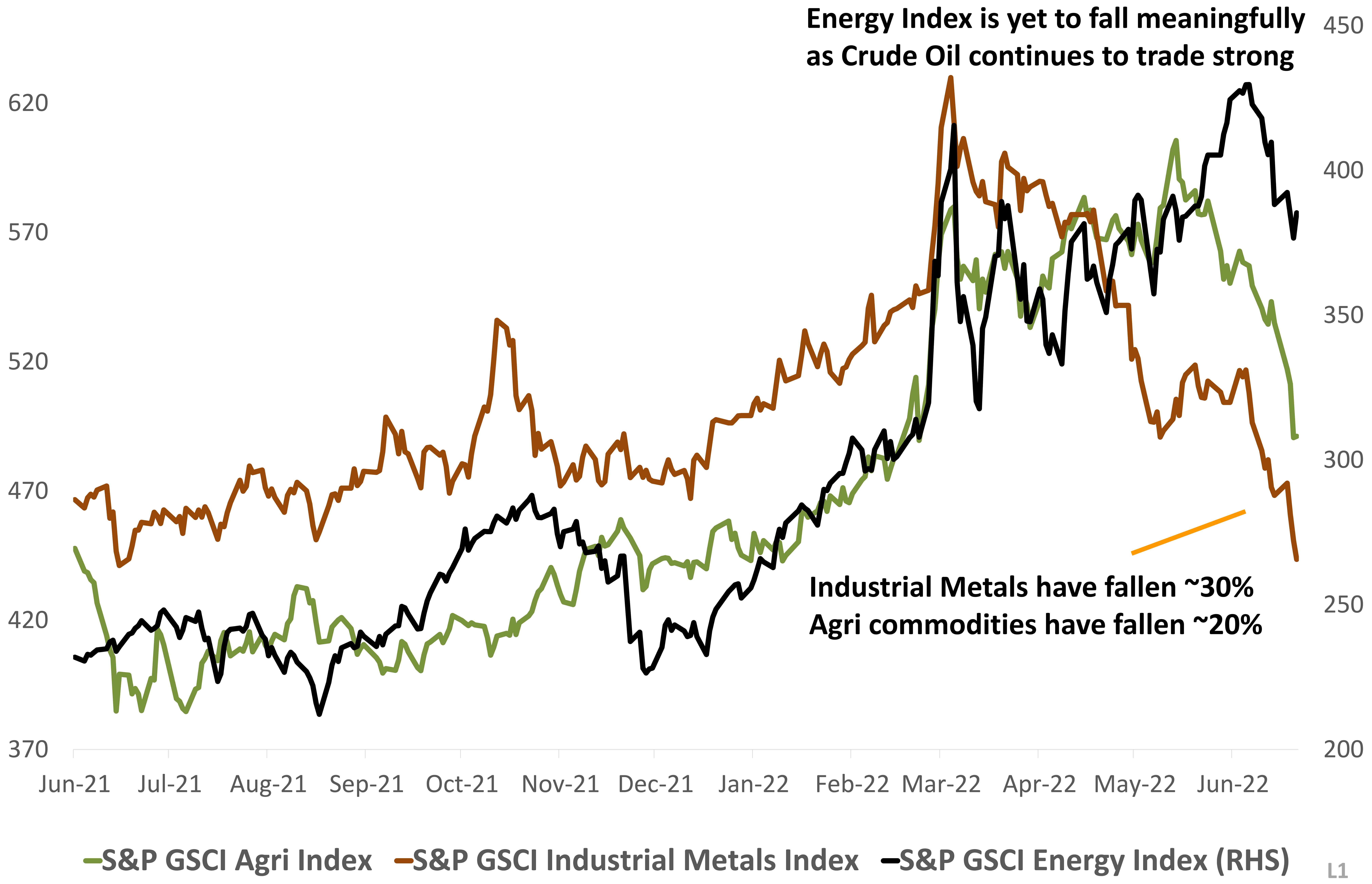
Will Oil Follow Its Commodity Cousins?

Industrial metals and agricultural commodities have seen a sharp decline over the last 3 months. Key industrial metals like Copper (-20%), Aluminum (-37%) and soft commodities like Wheat (-20%) which are closely linked to inflationary trends have faced price erosion.

However, the biggest weight in commodity prices, energy especially Crude Oil, is yet to witness a meaningful decline. It is hovering about 10% lower from recent highs.

Historically, most commodity prices move together. The outliers do not outperform for a long period.

It is quite likely that Oil prices will ease in H2 of 2022 thereby leading to a change in inflation trajectory in next 6 months.



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Source: Bloomberg, Data As on June 2022

Who Drove Demand For Oil In The 21st Century & Can It Continue At The Same Pace?

Oil Demand Dynamics	World	OECD	US	Europe	China	India	India + China
Crude Oil Demand (2019, MBPD)	97.7	46.1	19.4	14.8	14.3	5.1	19.5
World Oil Demand Increase Between 2000 to 2019	21.2	-2.5	-0.2	-1.3	9.7	2.9	12.5
CAGR (2000 to 2019)	1.2%	-0.3%	0.0%	-0.4%	5.8%	4.1%	5.3%
Contribution to World Oil Demand Growth		-11.6%	-0.8%	-6.4%	45.5%	13.5%	59.0%
Avg GDP Growth (2000 to 2019)	3.1%	2.0%	2.1%	1.6%	9.0%	6.5%	7.7%
GDP Growth - Oil Demand Growth	1.9%	2.2%	2.1%	2.0%	3.2%	2.3%	2.5%

MBPD: Million Barrels Per Day

If the world demand for Crude Oil de-grows, do we really need a lot of growth CAPEX for Oil production?

China & India's oil demand growth was higher than any large country across any period

59% of incremental demand was driven by India & China

China and India GDP grew at a much higher pace than the world and peers. In the next 10 years the growth rate for both these countries is likely to be lower than last 20 years.

Oil demand growth trails GDP growth by about 2% to 2.5%. ***Assuming China and India growth to slow to 6% & 5% respectively for the next 10 years, Oil demand growth is likely to de-grow as well. Therefore, even maintenance of CAPEX could be a threat to prices.***

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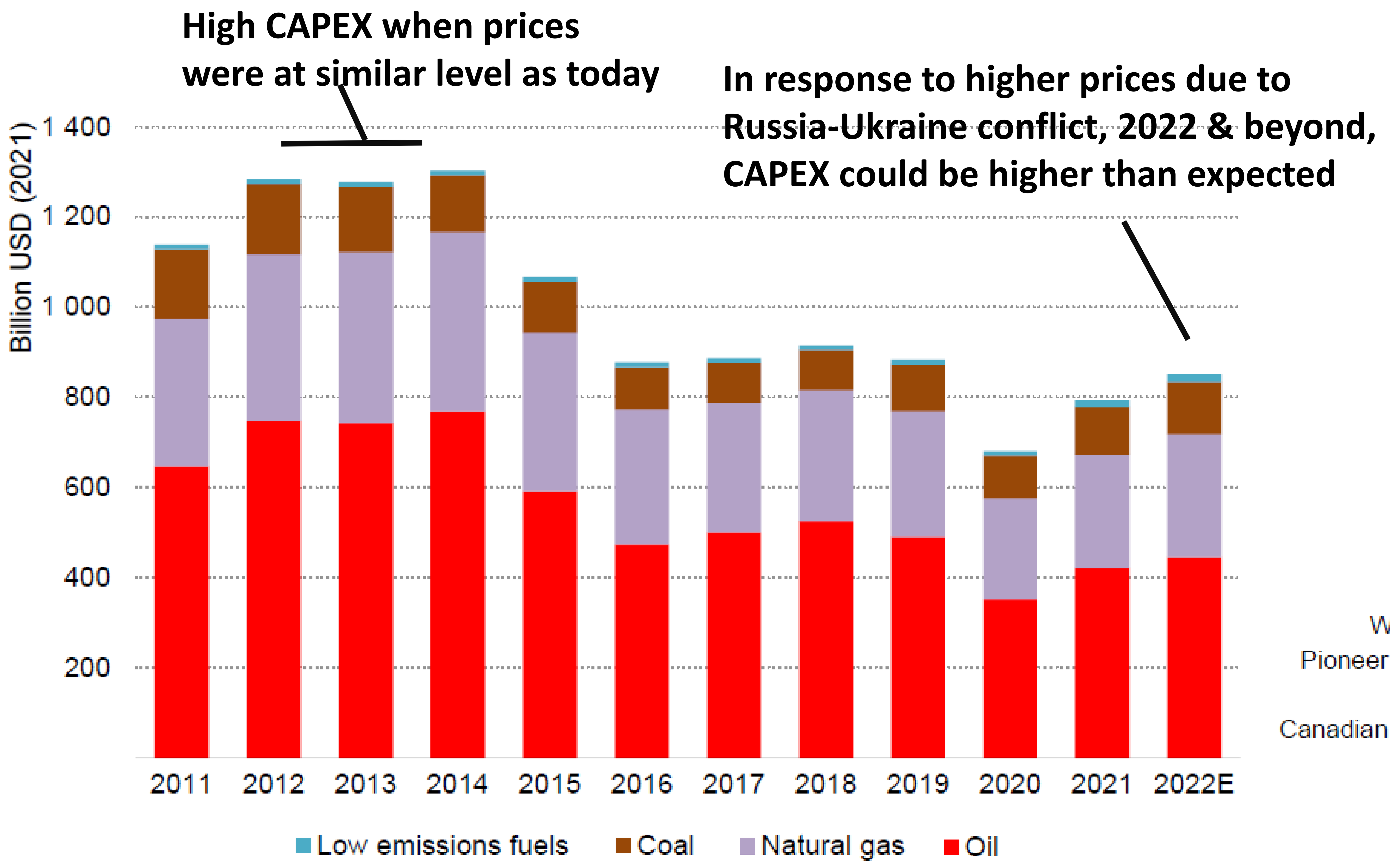
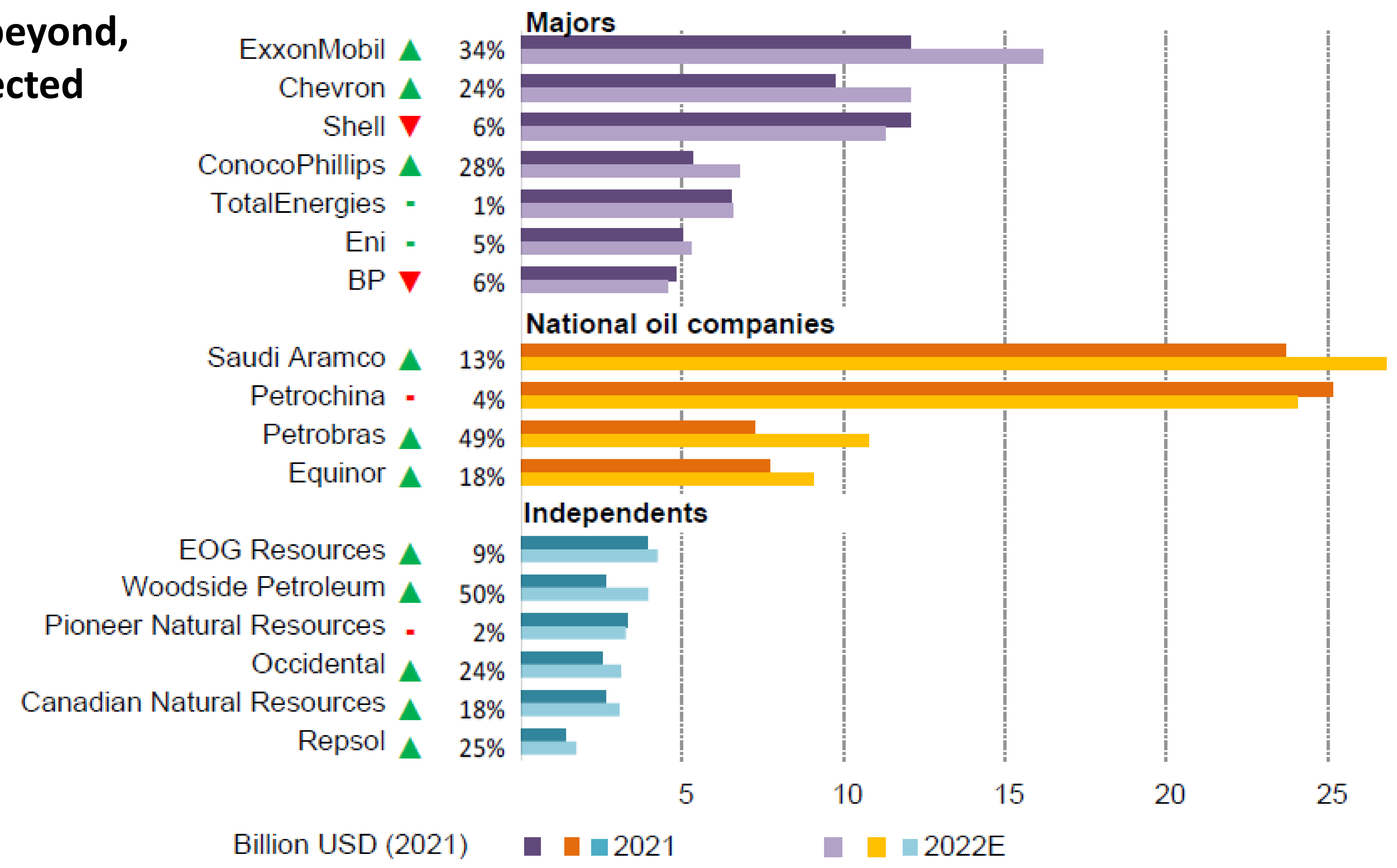
Source: BP Energy Outlook, IMF, Bloomberg Data As on June 2022

While The Demand Slows, Energy CAPEX Is Coming Back

Energy CAPEX Is Rising Again Driven By Coal & LNG



CAPEX By Major Oil And Gas Companies



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Source: IEA World Energy Investment 2022

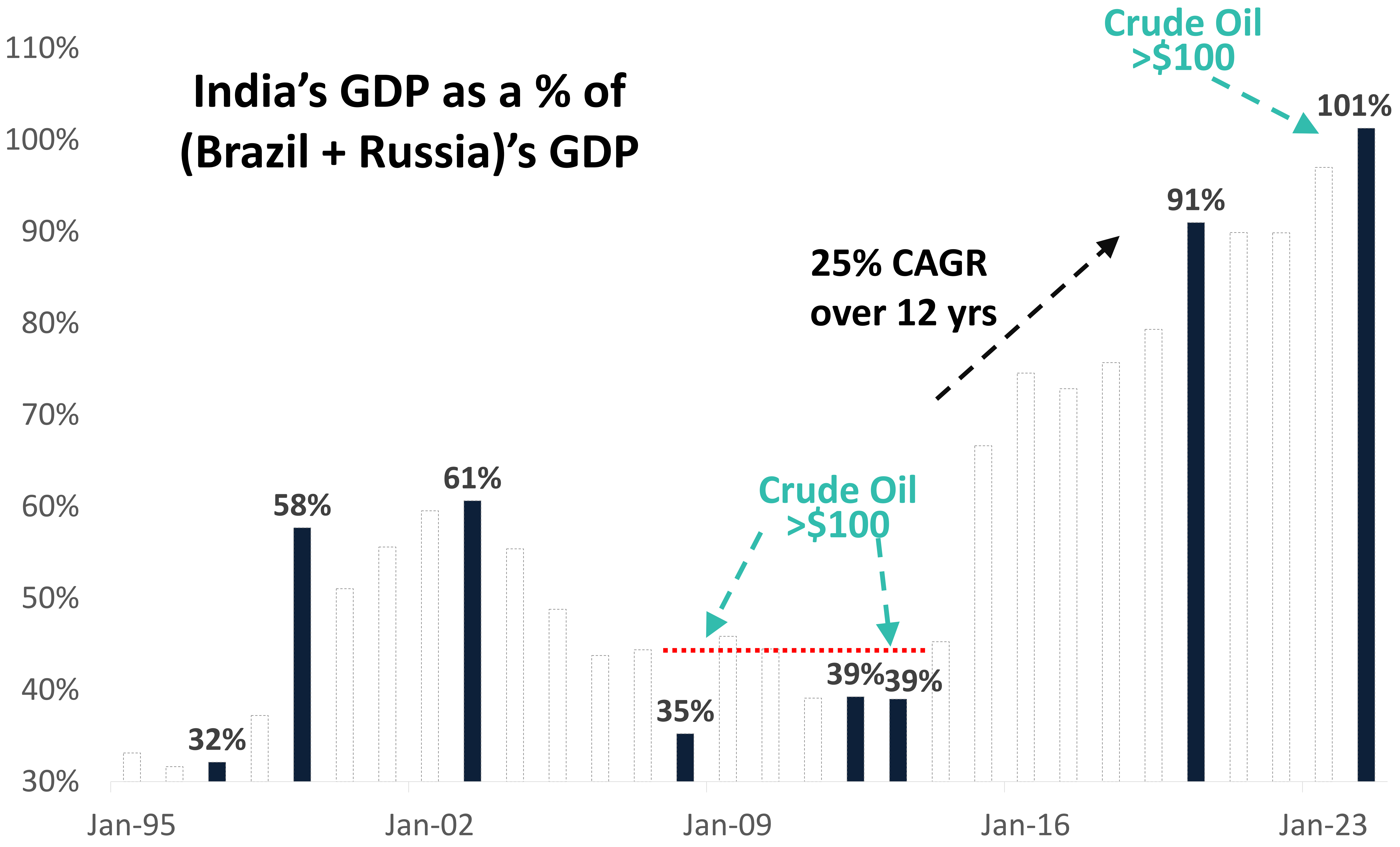
India's Energy Problems Are Tapering As Size of The Economy Rises

Indian economy faced debilitating effects from higher oil prices in the past. On two occasions when Crude oil prices went past $100, the Indian economy slowed appreciably, Rupee depreciated and bond yields rose.

However, over the years the size of Indian economy has risen swiftly. It is now as large as the two biggest commodity exporters combined (Russia + Brazil).

This means Oil prices needs to rise a lot more to impact the Indian economy the way it did in earlier two cases in 2008 and 2011-14.

The trouble for India: price of Oil at this time is beyond $125 / barrel for Brent crude.



Source: Bloomberg, Data As on June 2022

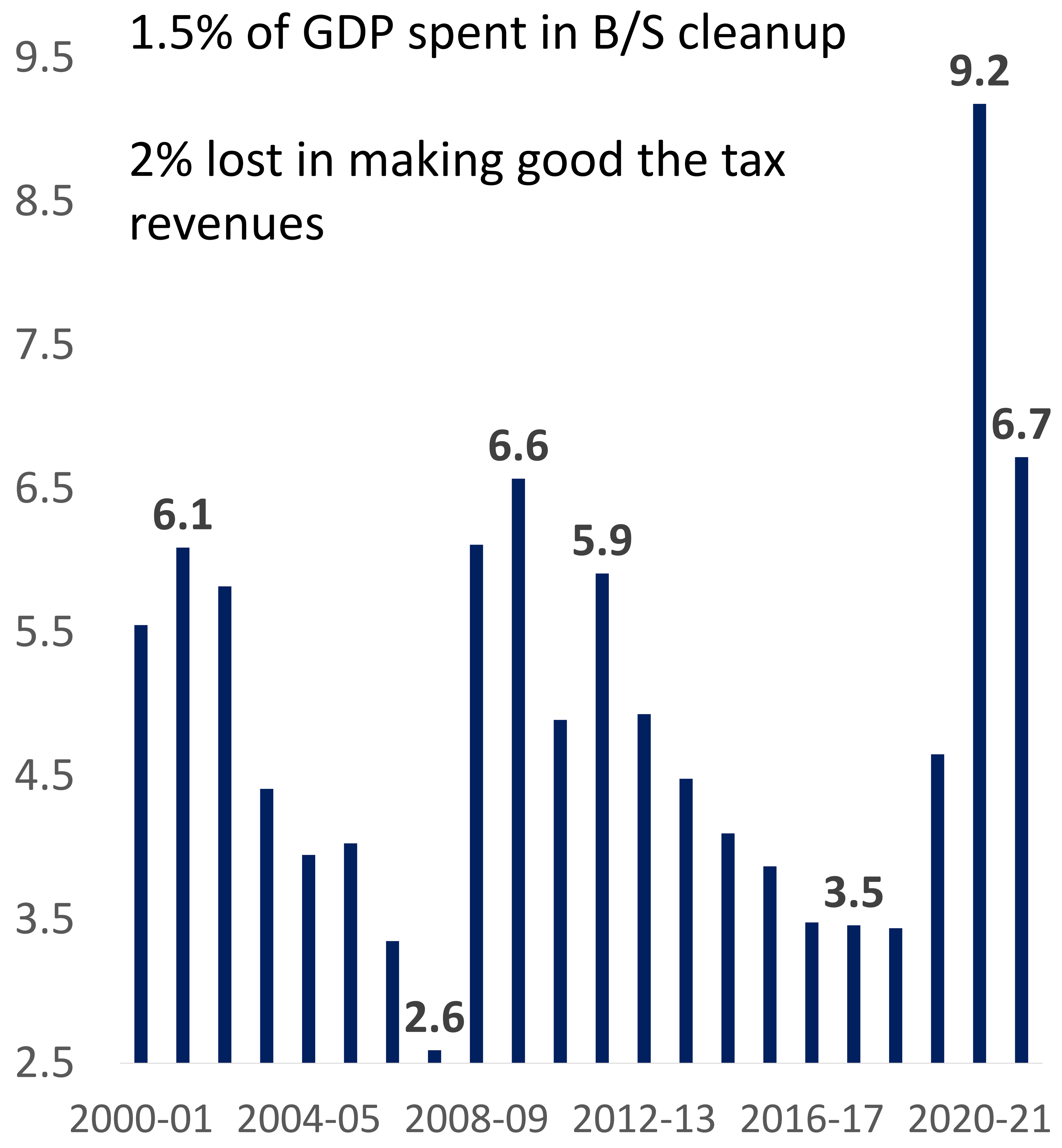
Is There A Stimulus By Central Govt. No One Is Talking About?

There is an excess Rs. 4 trillion government expenditure over and above the long term trend. In the last two financial years most of this expenditure was utilized in paying higher subsidies & general government expenditure because Govt. revenues were not growing.

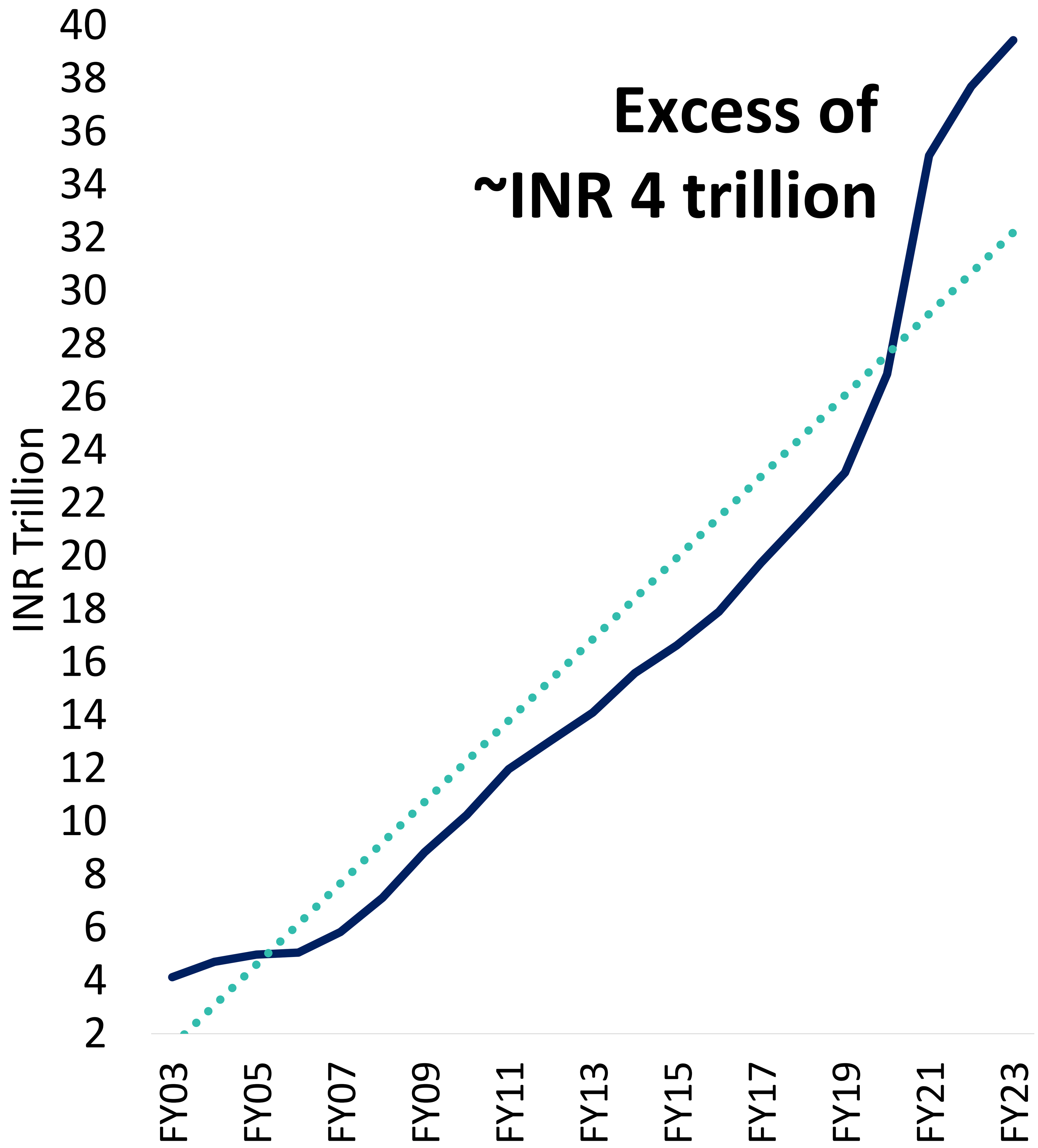
But in FY23, the income tax collection is running above average, indirect taxes like GST have improved and government is likely to meet its disinvestment target.

This means excess expenditure in FY23 and till FY25 can act as a economic stimulant to support growth.

At this time the street is focused & worried about financing of this deficit, but let's not forget what higher expenditure does. It can lead to stronger economic growth.



Fiscal Deficit as a % of GDP



Government Expenditure

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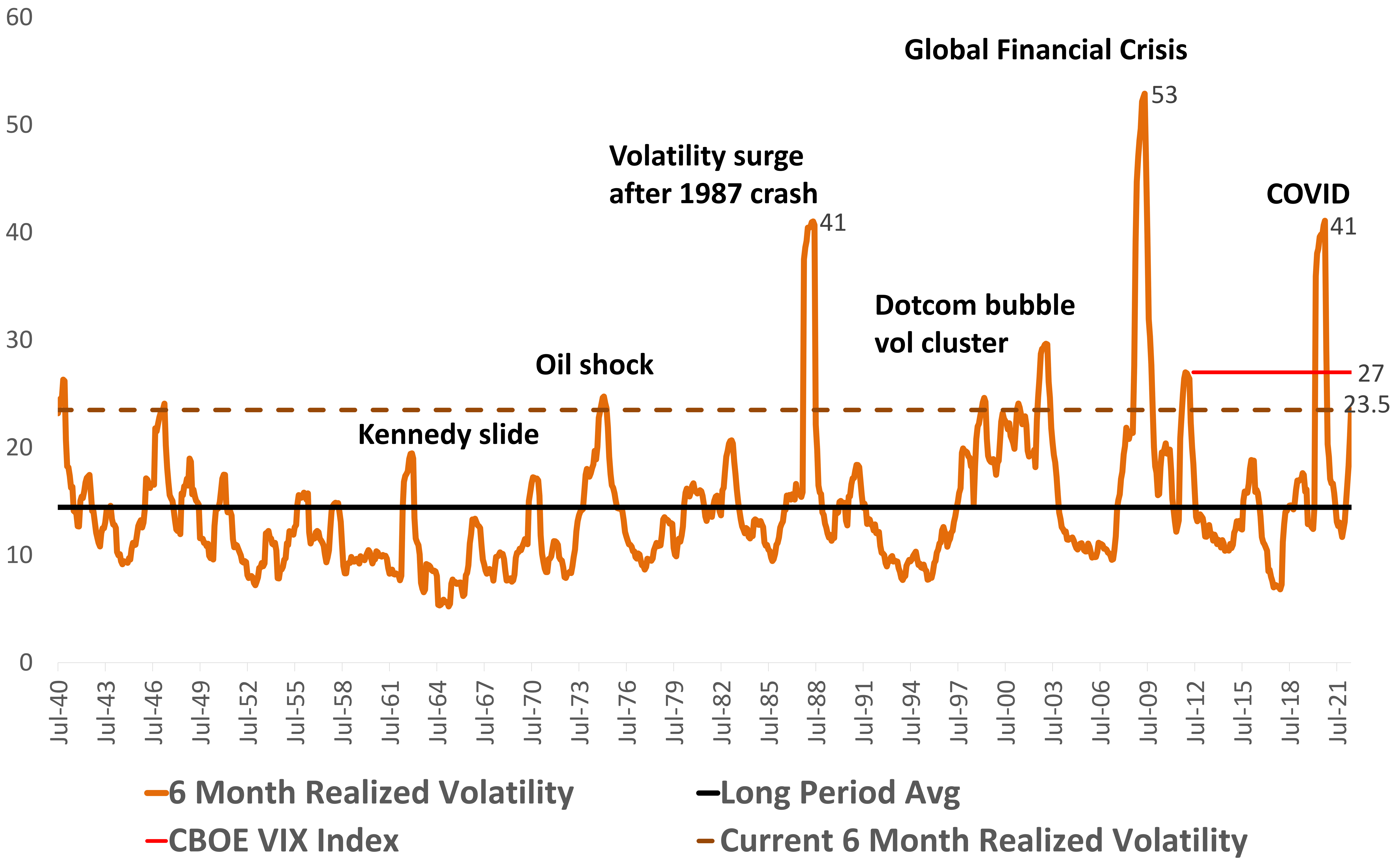
Source: CMIE, Data As on June 2022

US Stocks Volatility Is As High As It Can Be Without A Crash

The 6 month realized volatility is a measure of how much the stock market is fluctuating. In times of stress, crisis & crashes the volatility surges at a fast rate and rises to unprecedented levels. Volatility gauges are also called 'Fear' Index because they rise when market participants are fearful about the future outlook. At extremes they act as contrarian indicators. Higher the volatility, more are the chances that stock prices are currently lower & future returns better.

However, stocks keep fluctuating. When there is no apparent crisis or crash the volatility surge is usually contained at levels below 22.

At this time the 6 month realized volatility is at 23.5 and options market implied volatility is even higher at 27. This indicates that there is an elevated level of 'Fear' in the market. This is a bullish reading for stocks.



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Source: Bloomberg, Data As on June 2022

India Banking Credit Growth Is Recovering, After A Long Time

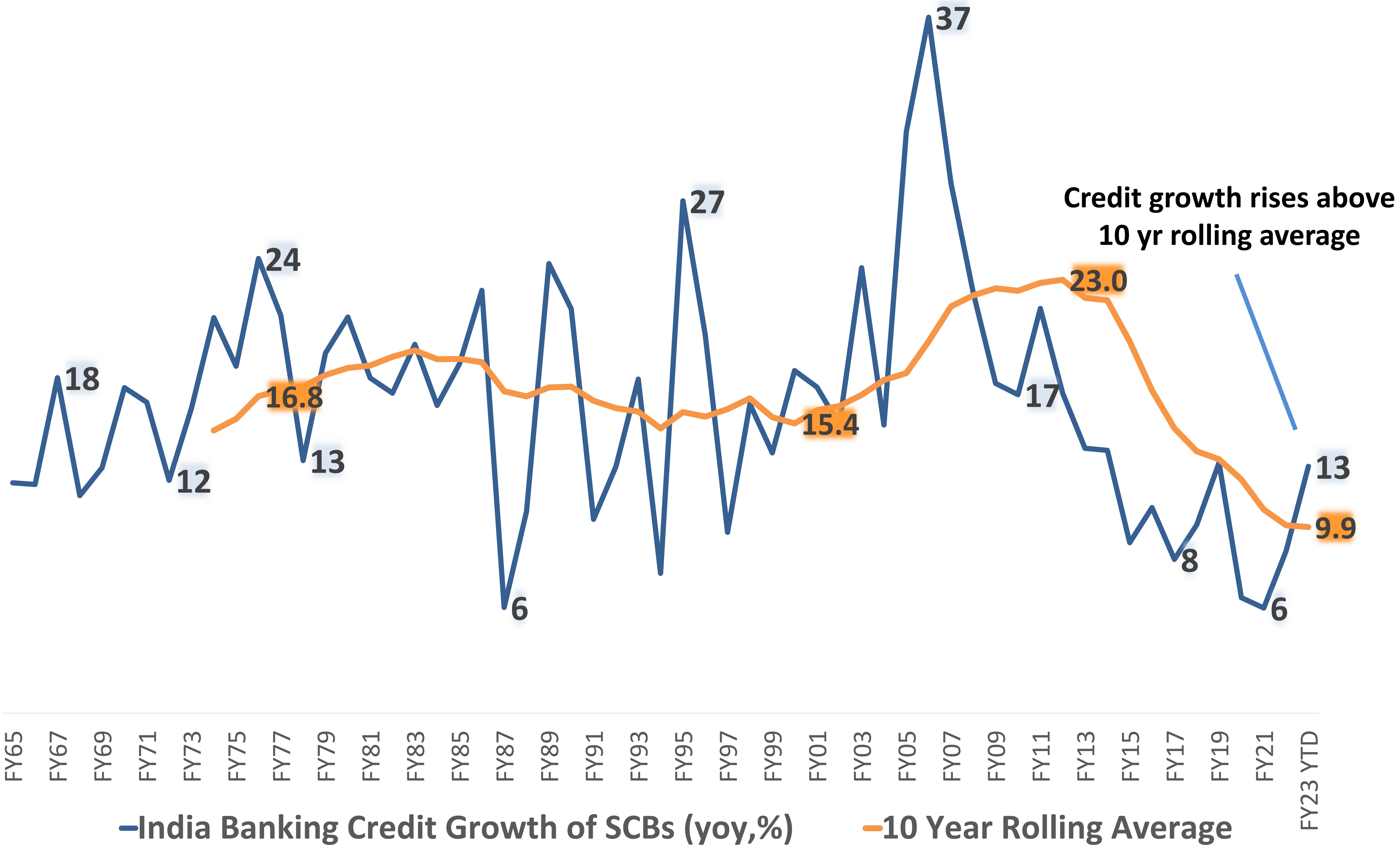
India's banking sector has faced multiple headwinds since the global financial crisis. The go go years of credit growth post the GFC of 2008 resulted in huge Non Performing Assets (NPAs) which took years to get resolved.

The introduction of demonetization, GST, IBC and then the COVID shock delayed the banking sector clean up & recovery.

At this time most of these are accounted for. As per RBI estimates the Banking sector will have one of the lowest GNPA ratio in over 2 decades in FY23.

What's interesting is credit growth revival and cleaner bank balance sheets are available at a time when banking sector stocks haven't done well.

A bullish setup for banking sector stocks.



Source: CMIE, DSP Data As on June 2022

What Happens When You Invest In Indian Banks Below 2X P/B

Banking sector stocks have not performed over the last 3 years. At the same time the valuations have gone through a churn.

As measured by Price to Book Value ratio (P/B) the bank Nifty traded below 2X P/B in June 2022. Historically, if you were to keep investment in Bank Nifty in periods when it is below 2X P/B value it deliver exciting returns over the next few years.

We don't know what will happen in next few years, but history says Buy Banking Sector Stocks whey they are cheap. And they are!

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Source: Bloomberg, Data as on June 2022

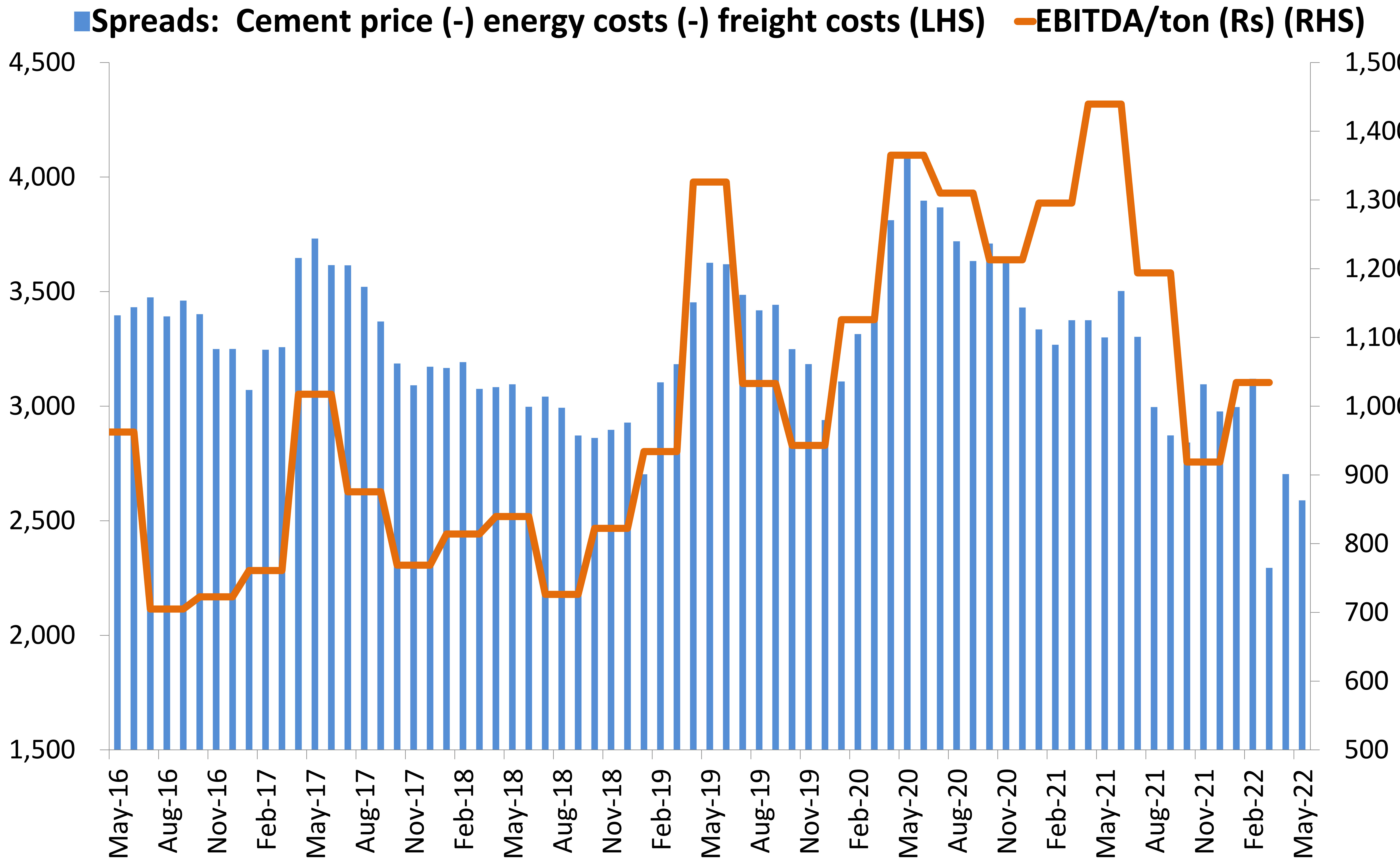
Cement Sector Stocks Are Cheap But In Distress

A surge in input costs have led to a squeeze on margins for cement sector companies. Coal & diesel cost inflation continues to remain a key area of concern for the sector.

Over the last many quarters the realizations have not grown and EBITDA/ton for the sector has declined.

However, the sector may see a reduction in headwinds if & when input prices ease. The cement stocks have seen large price correction recently and are still very volatile.

This could be a sector to watch out in H2 of 2022 with a focus on input price pressures and demand recovery for cement. Watch out!



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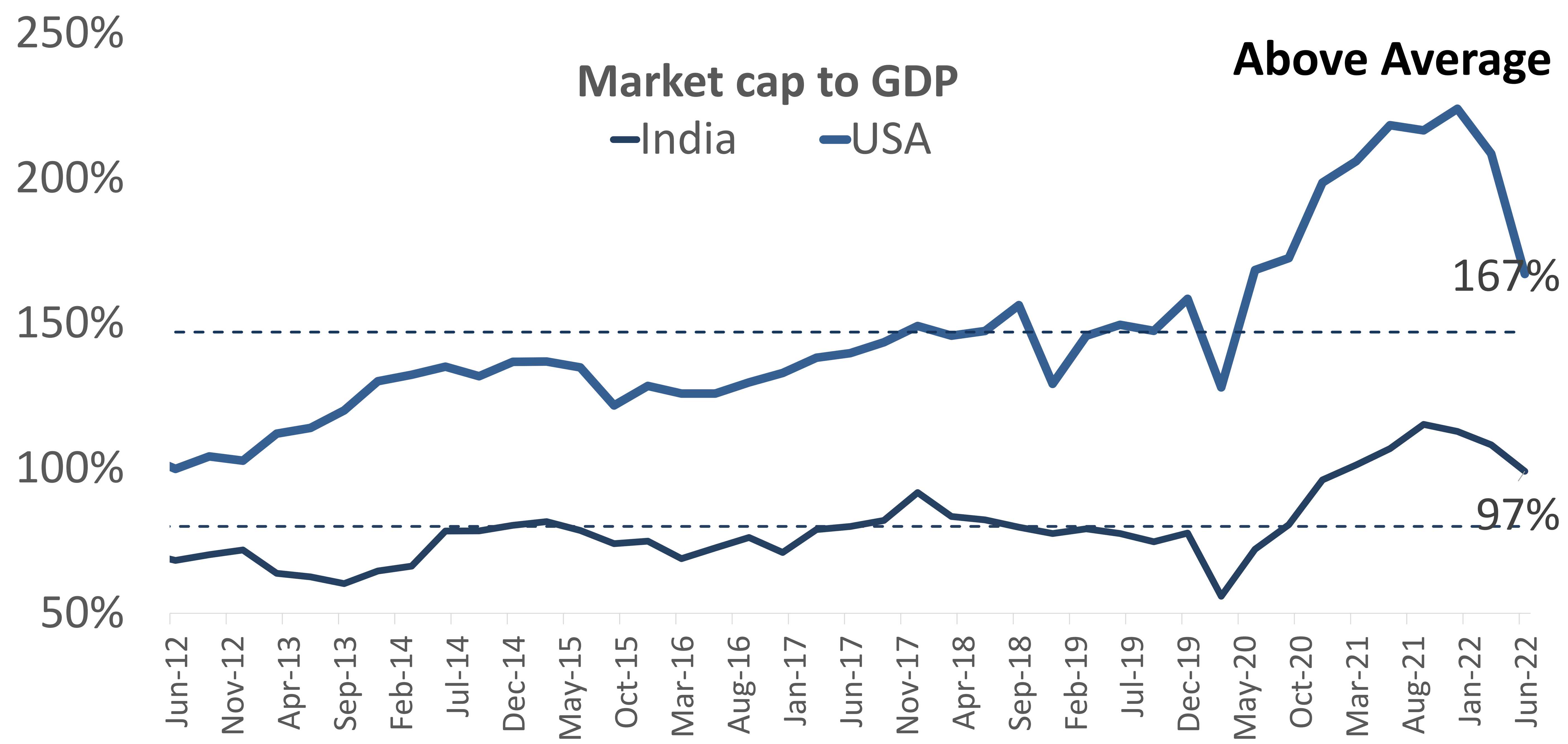
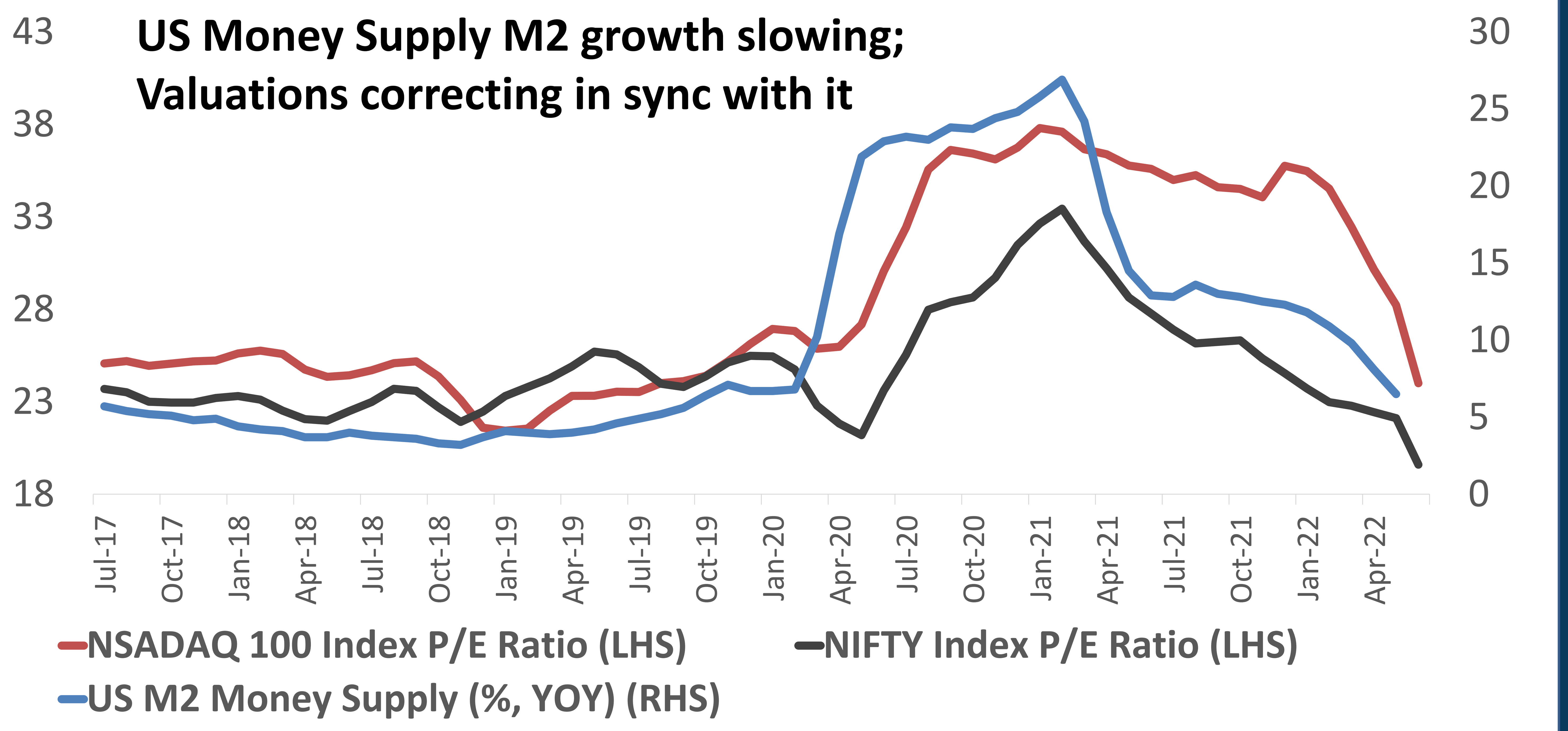
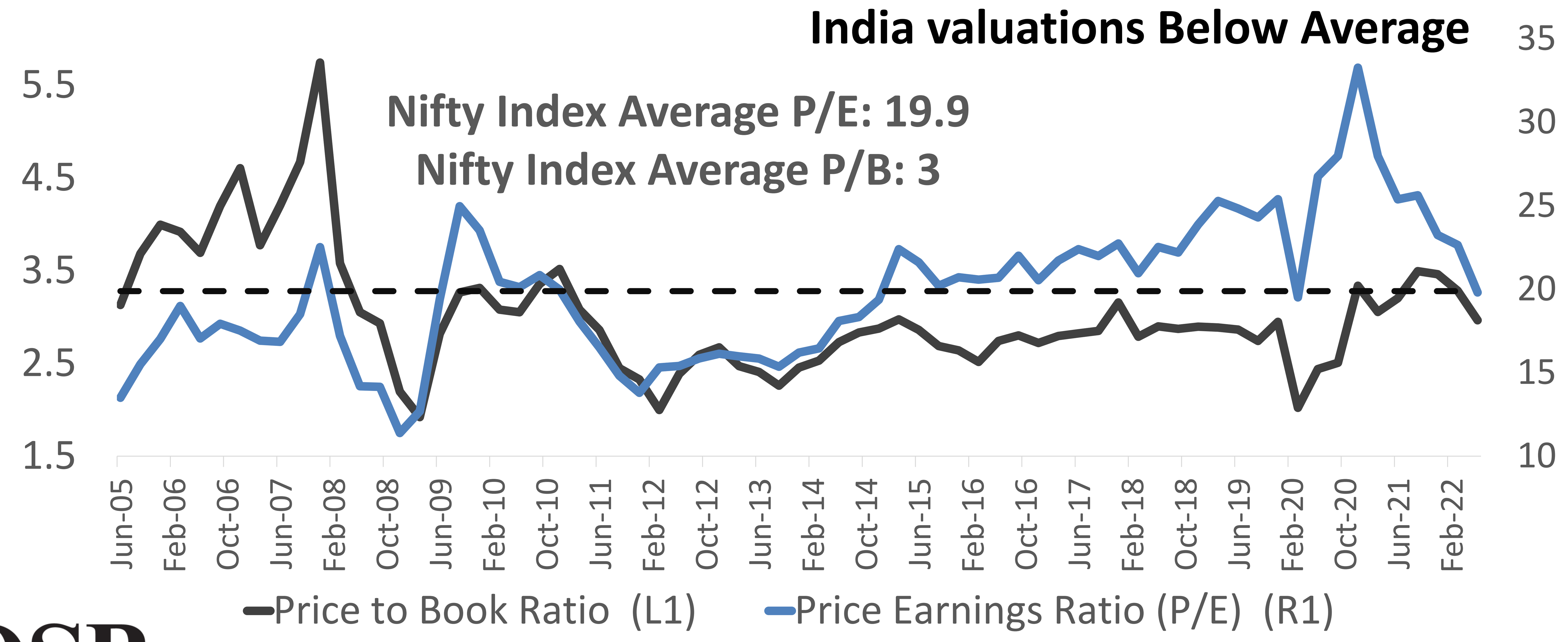
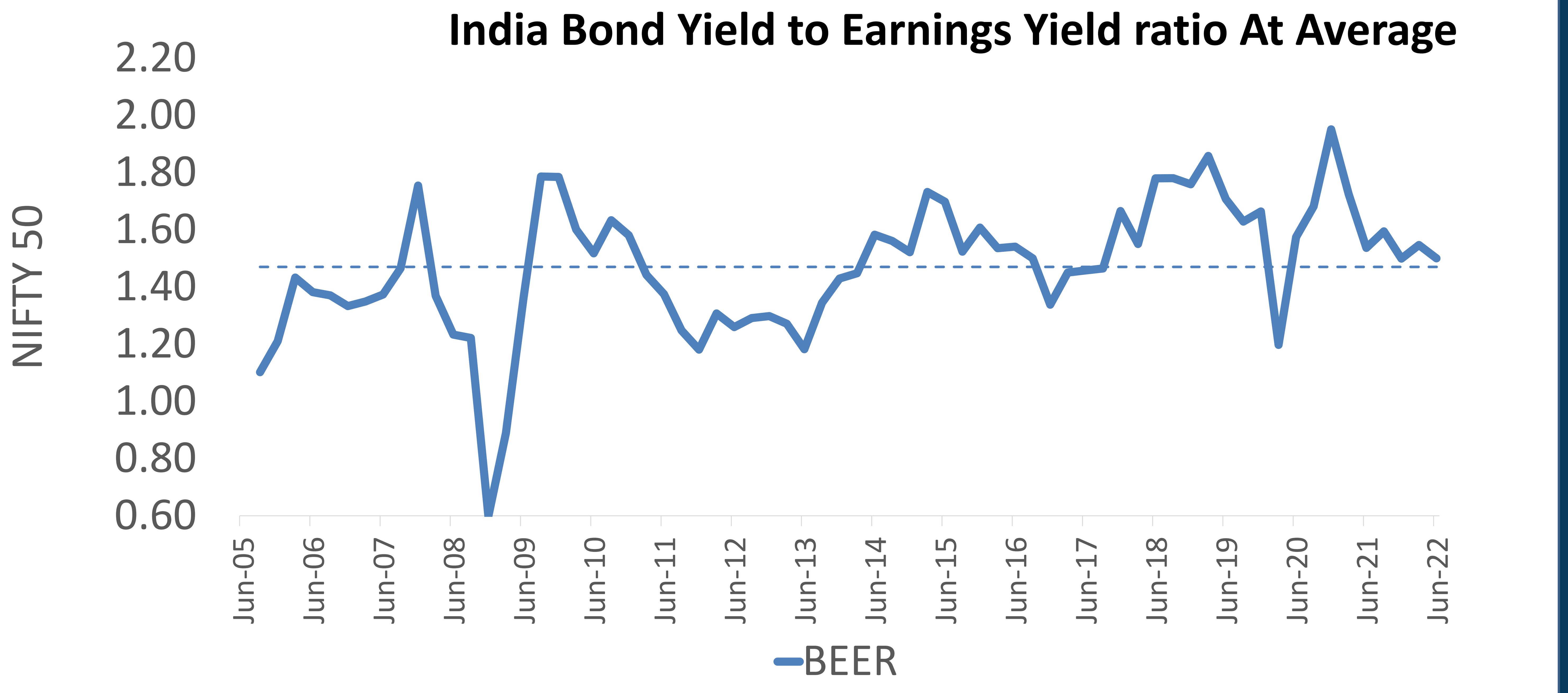
Source: Kotak Securities IE Research, Data as on June 2022

Valuations Reach Historical Averages









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Source: Bloomberg on 30th June 2022

Losses Are A Part Of The Gains

If you abhor losses more than you enjoy gains, you may end up holding on to losers and cutting winners early.

Beware!

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