



TM

India Economy & Strategy

30 June 2023

Markets sprint on contrived goldilocks, but for how long?

INDIA STRATEGY

	Last price	1 Wk	1 Mo	YTD	YoY
BSE Sensex 30	63702	0.8	1.7	5.1	20.5
Nifty 50	18908	0.8	2.0	4.8	20.1
Nifty Bank	44420	0.5	0.0	3.1	33.2
India 10-Year	7.07	0.0			
US 10-Year	3.77	-0.2			
US Dollar Index	102.5	0.5	-1.2	-0.5	-2.0
USD/INR	81.99	0.1	-0.6	-0.8	4.0
India VIX	10.8	1.0			
CBOE Vol	13.7	-1.4			

Source: Bloomberg, Systematix Institutional Research

Benign sentiment overriding hawkish CBs, dwarfing market risk premium: Markets are increasingly factoring in a hyper goldilocks' scenario which assumes that high inflation in the US & AE will glide back to normal without triggering a recession. Consequently, market risk premium has dipped to the lowest 1st quartile typically associated with an ultra-easy monetary policy. These presumptions have ratcheted up valuations and revived portfolio flows into EMs, including India which has underperformed due to rich valuations (YTD at 4-5%). These extrapolative assumptions can run out of fuel as latest data suggests that the overheated conditions in the US and AEs have not ebbed and central banks have voiced renewed hawkishness. Upside inflation surprises could be the key monitorable.

Projected Nifty EPS 70% higher than pre-COVID trend is untenable: Dwarfing risk-free premium has escalated valuations and forced extrapolation of the episodic bounce in earnings for FY22-23 into consensus earnings projection for FY24E-25E (15% average, 16.5% 5-year CAGR). Compared to the pre-covid trajectory the projected EPS has an average deviation of 70%, the highest ever!! Comparatively, for the US S&P 500 this deviation is a modest 7%; 2023 is expected to remain flat. Our comparative macro assessment indicates weaker degree of sustenance for India vs the US. Hence, we foresee substantial scope for downward revisions across most sectors. A combination of realistic EPS (INR 790, 15% cut in consensus) and an optimistic multiple (23x), the fair value for NIFTY 50 is flat.

Indian corporates on conservation mode, contrary to optimistic projections: Sharp deceleration in sales growth and declining profits, reflecting fading private demand, have prompted non-finance companies to adopt cost conservation to protect margins and market share. Reduced working capital requirements, and further deferring of capex, should also lead to a reduction in their interest cost burden. As a corollary this should mean lower interest income and spreads for lenders, primarily banks.

What is at risk, what is not? Given the large deviation in corporate earnings in FY23 from the pre-covid trend, earnings projection for FY24 can undergo sharper correction of about 15% compared to the 4% correction in FY23. The ongoing slowdown in private demand would imply downward reset in expectations across most sectors. Amongst these Banks, NBFCs, Autos, Cement and Logistics appear to be most optimistic. Sectors exposed to lower risks to downgrade are Consumers, IT, Insurance and Utilities. Our valuation assessment, incorporating "higher for longer global rate" scenario indicate lower valuation risks for Infra, Oil & gas, Utilities, Pharma and IT. Moderate to high risks would be in cap goods, FMCG, auto, Metals and Cement. The high-risk sectors would be Banks, Realty and Mid-caps.

Overall sectoral ranking: We give 60% weightage to earnings risk ranking and 40% to valuations risk. Accordingly, FMCG, O&G, IT, Pharma, Infra, Utilities qualify for positive view. Conversely, Banks, NBFCs, Metals, Realty, Cap goods, and Cement qualify for negative positioning. Autos also fall in this bucket largely due to Tata Motors, which is turning into profits now. Hence, we maintain our OW view on this sector.

Dhananjay Sinha
dhananjaysinha@systematixgroup.in
+91 22 6704 8095

Purvi Mundhra
purvimundhra@systematixgroup.in
+91 22 6704 8078

Why UW banks? Slowing cycle, diminishing pricing power, & rich valuations: Our macro cyclical view portends a) slower credit growth, b) weakening pricing power of banks due to reduced corporate lending that is pushing banks to rely on competitive retail lending, c) episodic rise in interest rate spreads have receded to pre-covid levels, d) rising cost of fund with declining share of CASA in bank deposits and the process of repricing, and e) bottoming out of the NPA cycle. Narrowing interest rate spreads and flattening G-sec yields are likely to reduce average net yield on assets. Behind the YTD underperformance of Bank Nifty valuation (3.9% YTD) is the higher valuation at 2.8x trailing P/B, 23% higher than 2.2x average of 2003-12 and 28% higher than 2014-19 average.

Our portfolio changes and assessment: Our portfolio has captured the market cycle well notwithstanding our conservative view on the economic cycle. Considering the changes in the index weights since our April note, what has worked are OWs on Consumer staples, Autos, Industrials (defence) and UWs on Financials specially Banks, and Metals. Things that went contrary are UWs on NBFC particularly on Chola mandalam Finance, equal weight on IT and zero weight on ports. Overall, our structural views on Banks, Metals, Autos, FMCG and Utilities, which comprise over 55% weight, have performed in line.

Our current structure maintains our key OWs on Agri, Auto, Consumption, Pharma and Utilities; UWs on Financials, Cement, Infra, Metals and Ports. The IT sector ranks positively in our composite risk assessment, but due to lack of immediate triggers we remain EW. We have also added insurance and increased allocation for the G-Sec.

Exhibit 1: Systematix model portfolio

	Sector weights			Systematix Financial portfolio	Stock weights
	Systematix	Nifty Index	OW/UW		
Agri Input & Chemicals	2.0	0.4	1.6	PI Industries	1.0
Auto & Auto Ancillaries	6.5	6.0	0.5	Coromandal International	1.0
				Hero Motocorp	2.0
				Maruti	1.5
				TVS	1.0
Cement	1.0	1.9	-0.9	Tata Motors	2.0
				Shree Cement	0.5
				UltraTech Cement	0.5
Consumer Durables	1.0	-		Bajaj Electricals	1.0
Consumer Staples & Retail	16.0	14.7	1.3	Nestle	3.0
				Britannia Industries	2.5
				Titan	2.0
				ITC	3.5
				Marico	2.0
				Asian Paints	3.0
				BEL	0.5
				HAL	0.5
				Larsen & Toubro	3.0
				HCL Tech	4.0
Industrials	1.0	-	1.0	Infosys	5.3
				Persistent Systems	2.3
Infrastructure/Construction	3.0	4.0	-1.0	LTI Mindtree	1.0
IT Services	12.5	12.2	0.3	Reliance Industries	9.0
				GAIL	2.0
				IGL	1.0
				Sun Pharma	3.5
Metals & Mining	-	3.5	-3.5	Indoco Remedies	1.0
				Balarampur Chini	1.0
Oil & Gas	12.0	13.3	-1.3	Bharti Airtel	3.0
				NTPC	2.0
				Financials	
Pharmaceuticals & Healthcare	4.5	4.0	0.5	HDFC Life	1.0
				Bajaj Finance	2.5
				Cholamandalam Finance	1.5
Ports & Logistics	-	0.7	-0.7	Muthoot Finance	2.5
Sugar	1.0	0.0	1.0	AXIS Bank	3.0
Telecom	3.0	2.5	0.5	HDFC Bank	10.0
Utilities	2.0	1.0	1.0	ICICI Bank	8.3
Financials	30.5	35.8	-5.3	State Bank of India	1.7
Insurance	1.0	1.5	-0.5		
NBFC	6.5	9.2	-2.7		
Banks	23.0	25.1	-2.1		
10 year Gsec @ 7.4%	4.0				4.0
	100.0	100.0		Total	100.0

Source: Systematix Research

Recent changes to the portfolio:

Autos: Removed Eicher, M&M, added Hero Motocorp, Tata Motors

NBFCs: Removed Mannapuram

Pharma: Removed Cipla & Ajanta Pharma, added Sun Pharma

Added insurance; HDFC Life

Increased Gsec allocation to 4% from 3.5%

Key OW: Agri, Autos, Consumption & Retail, Pharma, Utilities

Key UW: Financials, Cement, Infrastructure, Metals, Ports

Exhibit 2: Systematix top picks (see [here](#))

Company	Sector	Mcap (INR bn)	Company	Sector	Mcap (INR bn)
Apollo Pipes	Building Materials	27.9	Indraprastha Gas	Oil & Gas	331
Avenue Supermarts	Retail	2,256	Muthoot Finance	NBFCs	500
Balrampur Chini	Sugar	78	Nestle India	FMCG	2,190
CCL Products	FMCG	88	Prince Pipes	Plastic Pipes	73
Dodla Dairy	FMCG	35	Raymond	Retail	111
Greenpanel Industries	Building Materials	41	Stylam Industries	Building Materials	26.7
			Sun Pharma	Pharmaceuticals	2,453

Source: Systematix Research

Exhibit 3: Factors feeding into our portfolio

Sectors	Sector stance
Agri Input & Chemicals	Increased demand for agri produce and inputs, risk from El Nino effect, improved terms of trade
Cement	Peaking of urban housing cycle and government construction due to fiscal constraints; easing of cost pressure but demand momentum can weaken
Insurance	The sector has seen significant derating due to rising yields on G-Sec and the recently announced tax measures in the Union Budget 2023 relating to non-ULIP schemes. Significant underperformance of insurance companies since mid-2021 and YTD. At the current levels, the valuations are undemanding.
Metals & Mining	Enthusiasm around the China reopening has waned; China's housing sector woes are enduring in nature, declining exports, elevated local government debt problem likely to get worse; Multiple stimuli have failed to reverse China's down cycle. Global housing at risk due to synchronous slowdown in advanced economies,
NBFC	A rising proportion of retail and short-term lending, rising reliance on borrowings from banks; CV cycle is peaking, high retail lending could be a source of NPAs going forward; anticipated easing of rate cycle aligning with global sentiment has powered the recent rally in select stocks after a prolonged underperformance; we remain cautious as we foresee slowing business.
Oil & Gas	PSUs susceptible to elections-related risks; CGD companies better placed
Telecom	Digitization theme, tariff rate hikes, lesser industry competition now
Ports & Logistics	Susceptible to a slowdown in freight movement and global trade, spillover impact from the ongoing Adani-Hindenburg row is a risk
Consumer Staples & Retail	India will remain a large consumption story, both rural and urban, near-term cycle for urban is peaking out, rural demand to become critical; increased public spending. Rising share of essentials in urban consumption, improving terms of trade in the agri sector, organized retail, and digital platforms to substantially gain geographical spread; margin expansion to strengthen in FY24. Seasonal easing of milk prices after the steep up-cycle.
Banks	Rising proportion of retail and short-term lending, competition from fintech; gains from rising margins may peak out, and surge in credit growth from falling operating profits of NFCs has faded due to lower working capital requirement now and continued rise in the cost of funds; earnings upgrade due to episodic gains in 2Q-3QFY23 could reverse
Pharmaceutical & Healthcare	Sector at the lowest end of the cycle; healthcare spending needs to rise both in India and globally, Indian companies moving up the value chain, companies investing in R&D, and large compounding potential
Auto & Auto Ancillaries	Key drivers - volume recovery, premiumization, and margin expansion; volume momentum peaking out, especially for commercial vehicles (see our latest note here); margin expansion trigger still to play out fully.
Infrastructure/Construction	Housing to slow, government capex has been dominant in recent years, and may slow going forward
Utilities	Defensive
IT Services	Structural drivers for IT spending by companies in AEs are still relevant despite the near-term headwinds. Near-term outlook impacted by the recent banking sector debacles. Spending by large banks remains resilient. Constrained spending by US companies in the space of Hi-tech, mortgages, and telecom. In addition, Q1CY is generally a weak quarter. Tailwinds from retrenchment in US tech, improved utilization, lower retrenchment to improve efficiency performance.
Industrial and Cap goods	Driven by consumables, export orders, and government capex in railways and defense; major private sector capex is unlikely; See our note on why private capex is lagging here .

Source: Systematix Research

Markets factoring in a goldilocks' scenario controverting hawkish CBs

Benign sentiment overriding hawkish CBs, dwarfing market risk premium

The vacillating buoyancy in the risk markets since Oct'22 had assumed rate cuts amid fears of an impending recession. The recent liquidity and regulatory responses to the US banking debacle in Mar'23 appears to have reinforced markets assumption that the Fed would refrain from going far enough to trigger financial instability despite the continued hawkishness. This has rekindled pricing of a hyper goldilocks' scenario¹ which assumes that high inflation situation in the US & AE will glide back to normal without triggering a recession, either in the US or global. Despite the steepest inversion in the US yield curve (10 year – 3 months at -1.70%) since the 1970s signs of an over-heated economy linger.

As a result, the CBOE VIX, representing the market risk premium at 13-14 range has dipped to the lower 1st quartile around the 30-year average of 20. At these levels it is even lower than bottom attained in the aftermath of Fed cutting rates to zero, and the massive QE of USD 5tn in response to the COVID shock.

Hence, opposite to Fed's renewed commitment towards two more hikes after the premature pause in Jun'23 the markets are factoring in significant easing assuming the relapse to the pre-covid scenario (2009-19) when core inflation was less than 2% for 93% of the months. This phase was also characterized by 10 years of economic expansion and Fed trying hard to get inflation above its target of 2%.

Implicitly markets presumption of Fed's insurance against any market/financial instabilities, is pushing up valuations again.

In effect, the communication/actions of the US Fed and market presumptions have diluted the impact of rate tightening and quantitative tightening thus far.

Goldilocks presumption buoyed valuations, specially in Europe; India lagging: Our sample of global benchmark indices saw average valuation (PEx) rising by 15% since the US banking debacle in Mar'23. Thus, on YTD basis, Japan (28%) and Europe (+16%) outperformed while India (+3.6%) underperformed. Hence, the rebound in India indices is a part of the global triggers. India's underperformance is related to low global ranking on valuations, which is higher than the average by a good 40% ([Exhibit-4](#)).

Goldilocks sentiments revive EM flows: As a corollary, while forward guidance of further rate hikes by the Fed and other major central banks should typically have negative influence on portfolio flows into Emerging Markets (EMs), but conversely the optimistic presumption of a goldilocks scenario is driving up flows into EMs. Hence, India has also seen an FII inflow of USD 11.4bn since Mar'23 (USD 7.6bn YTD), which is counterbalancing the decline in mutual fund flows ([Exhibits 13-14](#)).

Upside inflation surprises may challenge the Goldilocks presumptions: Unlike the earlier endogenous inflation cycles, current one is characterized by exogenous boom led inflation. Thus, unlike normal cycles, the combination of steepest curve inversion and the inadequate impact of Fed's tightening have failed to douse an overheated economy. A likely scenario of sticky and persistent high inflation reinforces our stance that Fed's normalization isn't over yet (see our Flowchart, [Exhibit 12](#)); at 79% of GDP, US M2/GDP is still 10ppt higher than pre-covid, US public debt/GDP at 118% is 10ppt

¹ A Goldilocks economy is an economy that is not too hot or cold, in other words sustains moderate economic growth, and that has low inflation, which allows a market-friendly monetary policy.

Opposite to Fed's renewed commitment towards two more hikes after the premature pause in Jun'23 the markets are factoring in significant easing assuming the relapse to the pre-covid scenario. Implicitly the markets are presuming Fed's insurance against any market/financial instabilities, which is pushing up valuations again. It has also revived portfolio flows into EMs, including India. Upside surprises in AE inflation can unsettle this complacency

Unlike earlier endogenous inflation cycles, the current one is characterised by exogenous boom led inflation. Thus, the combination of steepest curve inversion and the inadequate impact of Fed's tightening have failed to douse an overheated economy. A likely scenario of sticky and persistent high inflation reinforces our stance that Fed's normalization isn't over yet. Upside inflation surprises may need more hikes

higher than pre-Covid and consumption demand is 3-4% higher than the estimated post covid potential trend.

With current momentum (0.37% MoM rise core PCE) 2023 could end up at 4.5-4.7% core inflation vs FOMC's projection of 3.9% (revised upward from 3.6% earlier, 4.7% in Apr'23).

With recent reinforcement of Central Bank's consensus towards higher for longer including continued rate hikes by ECB, Bank of England, Bank of Canada, and commitment of two more hikes by the Fed after the latest pause, thus runs contrary to market's presumptions of hyper-goldilocks (see [CBs in consensus towards higher for longer](#)).

Latest US data indicating rebound of house prices, financial conditions turning accommodative again, and still tight labor market are suggestive of persistently high core inflation and warranting further rate hikes.

Possible risks to benign market outlook and inflated valuations:

- 1) Sticky and high inflation might persist for a prolonged period. Upside surprises in US inflation and labour market indicators.
- 2) Geo-political risks can intensify due to the reemergence of bipolar situation of Russia-China axis is weighing over feeble western axis championed by the US.
- 3) US-China-AE trade conflicts to continue in context of high public debt and protectionism

Exhibit 4: Global indices performance: YTD performance led by Japan, and Europe; India underperformed (+3.6%, bank Nifty flat)

		1 week	1 Month	YTD	1 Year
JAP	Nikkei 225	1.1	8.4	28.0	27.2
TAI	Taiwan Weighted	-0.2	6.2	21.6	9.3
UK	FTSE MIB	0.9	1.1	17.4	26.0
POL	WIG20	3.2	4.9	16.6	21.6
SKOR	KOSPI	-1.3	2.6	16.5	8.1
GER	DAX	-0.4	-0.7	16.1	21.6
SPA	IBEX 35	1.4	2.3	15.1	15.0
EUR	Euro Stoxx 50	0.4	-0.7	15.0	24.9
US	S&P 500	0.9	5.2	14.9	17.1
HUN	Budapest SE	-0.6	6.4	13.2	21.1
ITA	CAC 40	0.4	-2.3	13.1	22.7
BRA	Bovespa	2.7	8.2	9.2	20.2
RUS	RTSI	1.8	1.3	8.1	-24.0
CH	Shanghai	0.2	-1.3	4.9	-2.0
AUS	S&P/ASX 200	3.1	1.1	4.5	12.8
IN	BSE Sensex	-0.1	2.2	3.7	20.1
IN	Nifty 50	0.2	3.0	3.6	19.9
US	Dow Jones	0.3	2.6	3.5	12.3
CA	S&P/TSX	-0.3	-2.1	2.8	3.5
UK	FTSE 100	0.1	-2.0	2.0	6.3
IN	Nifty Bank	-1.3	-1.0	1.3	31.1
ISR	TA 35	-0.1	0.0	1.0	-1.3
AUST	ATX	-1.1	-0.3	0.8	2.6
HK	Hang Seng	0.6	0.9	-0.8	-9.0
BEL	BEL 20	-1.4	-3.7	-2.8	-3.7

Source: Bloomberg, Systematix Research

Exhibit 5: Indian sector indices: YTD led by Cap goods, Realty, FMCG, Autos; underperformance by Metals, PSU banks, O&G

Indices	1 Week	1 Month	YTD	1 Year	3 Years
BSE Capital Goods	1.5	9.1	20.3	61.2	214.5
Nifty Realty	-1.7	11.2	18.9	36.6	138.8
Nifty FMCG	0.6	6.2	17.9	40.9	80.4
Nifty Auto	0.8	6.6	17.4	36.1	120.0
Nifty Midcap 150	2.2	9.0	12.5	37.3	137.0
Nifty Smallcap 250	2.2	8.8	11.4	35.3	157.4
Nifty MNC	0.7	6.9	10.5	28.1	67.2
BSE Manufacturing	0.5	4.6	10.4	31.0	81.6
Nifty Consumption	0.6	6.5	8.7	26.7	74.0
Nifty Infra	0.8	5.6	8.6	27.7	86.3
Nifty Pharma	2.2	8.3	5.3	11.1	29.8
Sensex 30	0.4	2.4	4.3	22.5	81.8
Nifty 50	0.5	2.9	4.1	22.3	82.8
Nifty Fin Ser	1.1	1.3	3.4	28.6	84.1
Nifty Private Bank	-0.4	0.6	2.4	36.1	88.1
Nifty Commodities	0.0	4.8	2.2	25.5	108.5
Nifty Bank	-0.3	-0.1	2.0	33.6	102.1
Nifty IT	0.3	-0.2	1.2	5.3	100.2
Nifty Services	0.8	1.4	-1.9	16.9	78.0
Nifty Energy	0.6	3.7	-4.2	4.2	68.9
Nifty PSU Bank	1.4	3.2	-4.6	71.5	179.6
S&P BSE Power	1.1	7.5	-7.9	5.4	154.2
Nifty Metal	-0.4	6.8	-7.9	37.8	202.0
Nifty Media	-0.8	7.5	-10.2	-1.6	26.3
BSE O&G	-0.2	0.8	-10.3	6.3	40.8

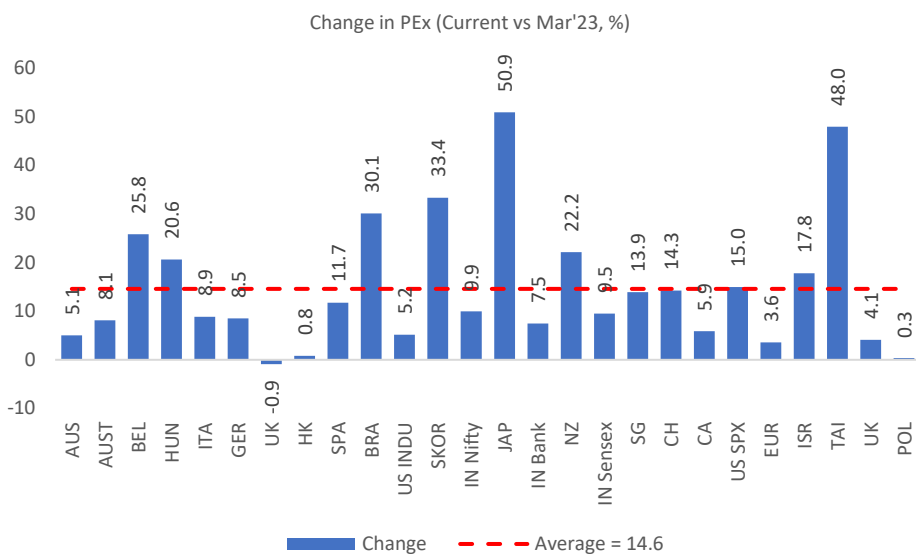
Source: Bloomberg, Systematix Research

Exhibit 6: Global composite ranking: India remains in the mid to high ranking despite low on value ranking due to optimistic earnings expectations; Europe and US have moved up due to upgrades in earnings since Apr'23

	Bloomberg index code	ROE (F1)	1 Month change in EPS (F1%)	PE (F1)	EPS growth (F1)	Premium (vs average)	Rank ROE	Rank change in EPS	Rank EPS growth	Rank valuation	Composite ranking: Current	Composite ranking: Apr'23
GER	DAX Index	11.5	1.3	11.5	6.9	-17	18	2	6	12	1	9
ITA	FTSEMIB Index	14.2	0.3	8.4	-5.0	-39	9	6	17	7	2	5
SPA	IBEX Index	11.5	1.1	10.4	6.4	-24	19	3	8	9	2	6
BRA	IBOV Index	17.0	0.0	8.3	-12.9	-40	4	9	22	5	4	18
EUR	SX5E Index	13.7	0.4	12.5	-1.0	-10	10	5	13	13	5	4
US	INDU Index	21.4	0.0	18.6	3.3	35	2	10	10	21	6	9
IN	NIFTY Index	15.1	-0.3	19.8	14.7	43	7	12	2	22	6	6
ISR	TA-35 Index	15.9	-2.3	8.3	5.9	-40	5	23	9	6	6	12
IN	SENSEX Index	15.1	-0.3	20.8	13.0	51	8	11	3	24	9	8
CH	SHCOMP Index	11.5	-0.6	11.3	26.0	-18	20	15	1	11	10	21
US	SPX Index	18.2	0.2	20.3	-2.3	47	3	7	14	23	10	16
POL	WIG20 Index	12.4	0.2	7.9	-14.5	-43	14	8	25	4	12	2
UK	UKX Index	15.2	-1.7	10.7	-10.6	-22	6	21	19	10	13	13
FRA	CAC Index	13.2	-0.4	12.8	-4.6	-7	12	14	16	14	13	17
AUS	AS51 Index	13.3	-1.4	14.7	0.6	7	11	18	12	16	15	13
HK	HSI Index	10.9	-2.7	10.0	12.4	-28	21	24	4	8	15	3
BEL	BEL20 Index	7.6	-0.4	15.6	6.8	13	25	13	7	18	17	22
SG	SET Index	9.1	-1.4	16.5	7.9	20	22	17	5	19	17	20
HUN	BUX Index	13.1	-3.6	6.5	-13.5	-53	13	25	24	2	19	15
AUST	ATX Index	12.3	-2.0	7.1	-23.1	-48	15	22	26	3	20	22
CA	SPTSX Index	11.8	-1.6	13.8	-3.5	0	16	20	15	15	20	18
NZ	NZDOW Index	8.2	1.9	29.3	-12.4	112	24	1	20	26	22	26
TAI	TWSE Index	11.8	-1.5	18.6	-10.4	35	17	19	18	20	23	24
JAP	NKY Index	8.8	0.4	26.2	-13.3	90	23	4	23	25	24	11
SKOR	KOSPI Index	6.3	-1.0	15.4	-12.9	12	26	16	21	17	25	25

Source: Bloomberg, Systematix Research

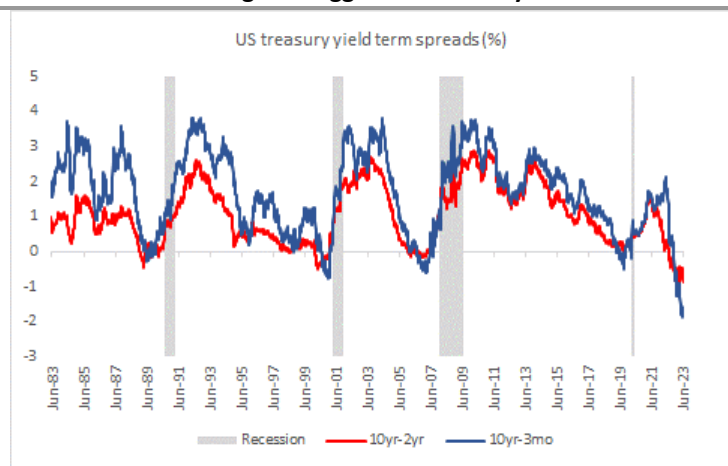
Exhibit 7: Relative to Mar'23 bottoms triggered by the US banking crisis average PE of global benchmarks have risen by 15%, India's PE moved up in line with a 10%



Source: Bloomberg, Systematix Research

Our sample of global benchmark indices saw average valuation (PEx) rising by 15% since the US banking debacle in Mar'23. Thus, on YTD basis Japan's benchmark index (+28%) and Europe (+16%) outperforming while India (+3.6%) underperformed. Hence, the rebound in India indices and gains in valuations are a part of the global triggers

Exhibit 8: Steepest inversion in US yield curve led by 500bp fed rate hike hasn't been enough to trigger a recession yet



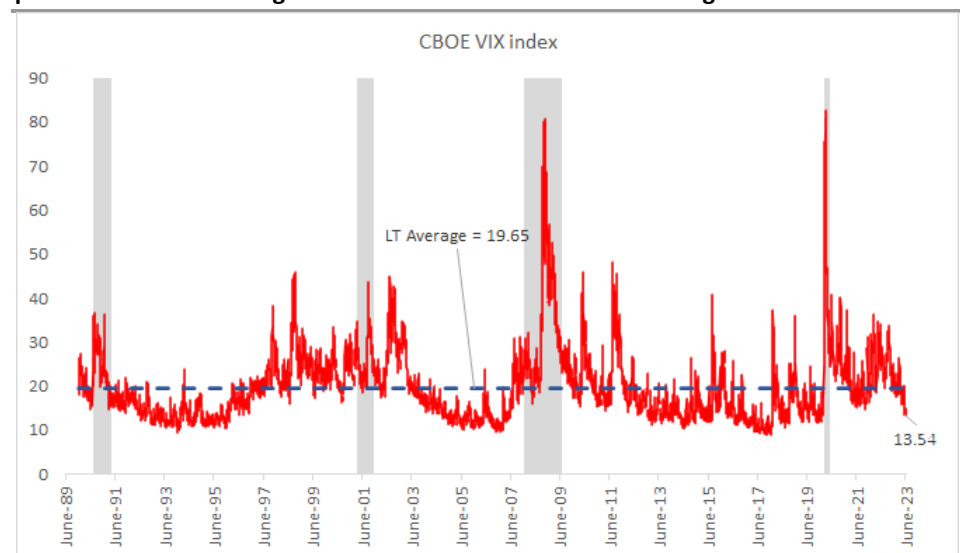
Source: Bloomberg, Systematix Research

Exhibit 9: UST yield curve biggest relative rise in US short term rate vs 10 years in five decades



Source: Bloomberg, Systematix Research

Exhibit 10: Market risk premium at post-covid lows, pricing in a goldilocks scenario that precludes both US-and global recession scenario and inflation glide down

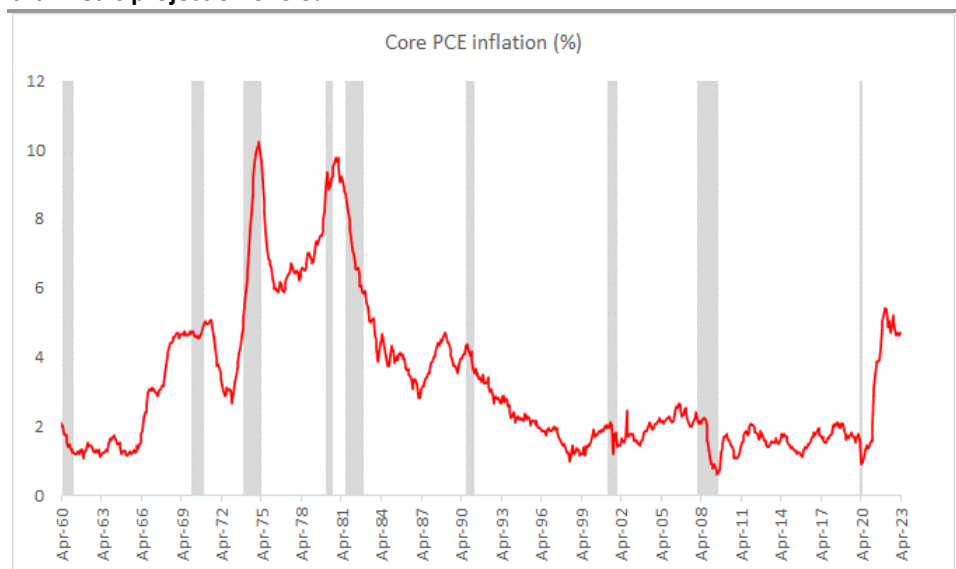


Source: Fred database, Systematix Research

The CBOE VIX, representing the market risk premium at 13-14 range is at the lower 1st quartile around the 30-year average of 20. At these levels it is even lower than lows attained in the aftermath of Fed cutting rates to zero, and the massive QE of USD 5tn in response to the COVID shock.

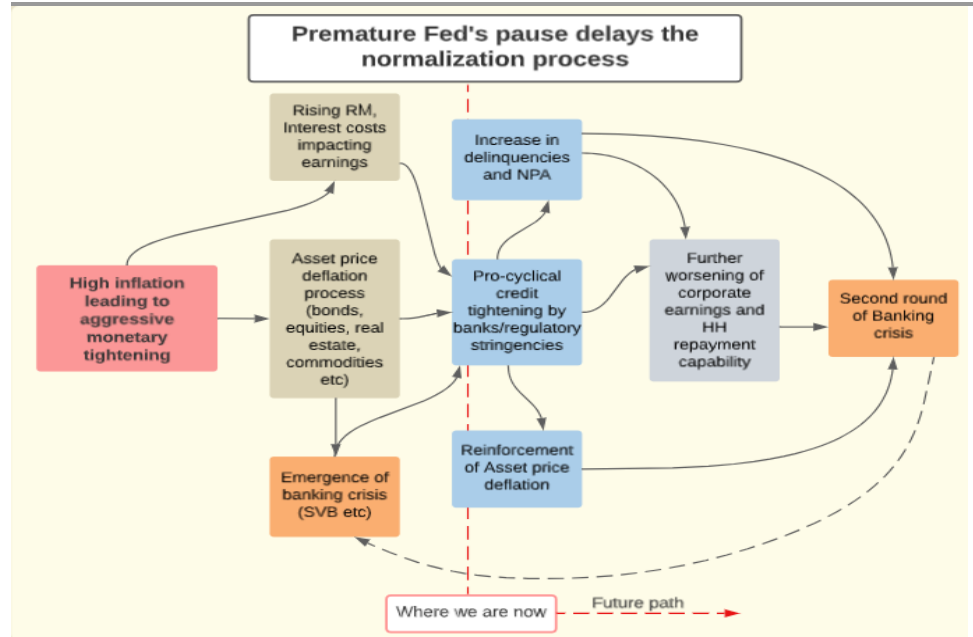
Hence, opposite to Fed's renewed commitment towards two more hikes after the premature pause in Jun'23 the markets are factoring in significant easing assuming the relapse to the pre-covid scenario (2009-19) when core inflation was less than 2% for 93% of the months. Such presumptions could be precarious as we think it will take a long while for US core inflation to decline to 2%

Exhibit 11: However, US continues to experience high & sticky inflation along with other AEs in Europe; at the current momentum it could end higher at 4.5-4.7% in 2023, higher than Fed's projection of 3.9%



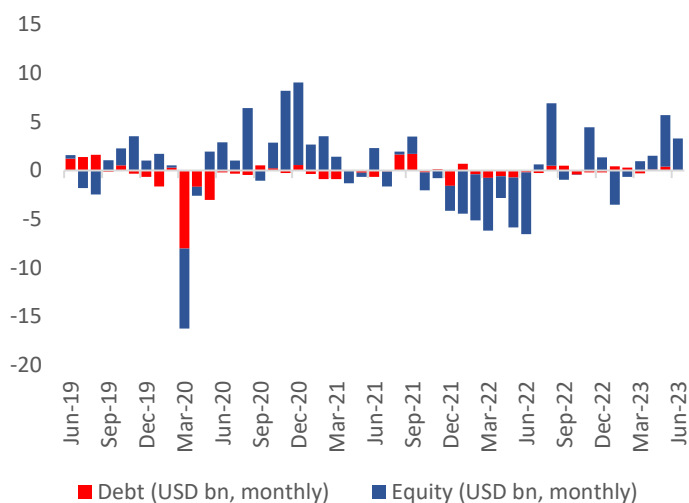
Source: Fred database, Systematix Research

Exhibit 12: US data show diluting impact of Fed's tightening thus far, creating risk of upward inflation surprises; normalization process partly reversed post the SVB episode



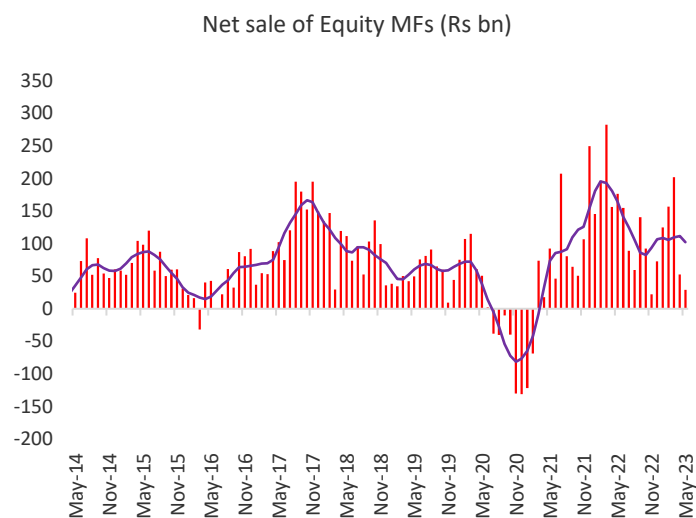
Source: Systematix Research

Exhibit 13: Monthly FII flows (USD bn)



Source: CMIE

Exhibit 14: Net investments in mutual funds



Source: CMIE

Projected Nifty EPS 70% higher than pre-COVID trend is untenable

The post covid bounties for Indian companies came through multiple impulses, predominantly led by higher sales growth aided by surge in commodity prices triggered by supply bottlenecks, spillovers from global stimulus on domestic and export-oriented businesses, gains in market share of large companies from smaller players, domestic stimulus, particularly lower interest costs and effective tax incidence.

All put together, from the FY21 lows, profits for BSE100 companies increased by 22% (FY21-FY23 CAGR, sales growth of 25%) from 3.3% during FY14-19. Comparatively, for NIFTY 50 companies' profits expanded by 20% CAGR during FY21-FY23 following an average of 4.6% during FY14-19.

Long term in Nifty 50 EPS indicate the post covid episodic bounties translated into 38% rise during FY22-FY23 over the pre-pandemic structural trend. Consensus projecting rise of 13-14% during FY24E-FY25E would expand this deviation to 70%! This is unprecedented. As the slowdown cycle get entrenched, a sharper cut in earnings expectations will ensue

Long term assessment of Nifty 50 EPS indicates that the post covid episodic bounties translated into 38% rise over the pre-pandemic structural trend that was growing at 3.5%, thereby translating into three-year CAGR of 15.2% (FY20-FY23). This is the highest deviation in the last 25 years, and it supersedes even the cyclical boom time EPS growth of 25% during FY04-08. Consensus estimates for NIFTY earnings converts into continued expansion with an average FY22-FY25E CAGR of 13-14% (16% in FY24E), translating into deviation from the pre-covid trend by a monumental 70% during FY24E-25E!

In our view the projected 70% deviation from the LT trend is hugely optimistic given the prospect of the cyclical downturn and the fact that the post pandemic private sector demand trend, including consumption and investment demand of Indian households and corporates have turned out to be weaker around 2% in 4QFY23 than pre-pandemic trends (see [The Chimeric Bounce In GDP Has Little To Cheer About](#)).

Secondly, the post covid bounties for Indian companies has been larger than even of the US which experienced the largest post covid fiscal and monetary stimulus. For S&P 500 the projected EPS for 2023-25 is 7%, which was higher than Nifty's pre-covid trend at 3.5%, growing annually at 5.7%. This corroborates the idiosyncratic rise in earnings growth in India, afforded by gaining market share of large companies.

Idiosyncratic surge in post pandemic profits for Indian cos is not sustainable

Following the 4QFY23 results, the earnings downgrade cycle has continued. FY23 earnings ended at 11%, significantly lower than 16% estimated at the start of 2022. The downgrade was contributed by the non-finance companies (NFCs, -9.2%), particularly the metals space. FY24E Nifty EPS estimate has also nudged lower by 0.9% translating into a growth of over 16%. Contrastingly for S&P 500, the projected EPS for 2023 is flat vs 2022 ([Exhibits 15-17](#)).

The contrasting trend between India and US earnings is the diverging macro trends which impels sustainability question on the large post-pandemic earnings deviations for Indian companies.

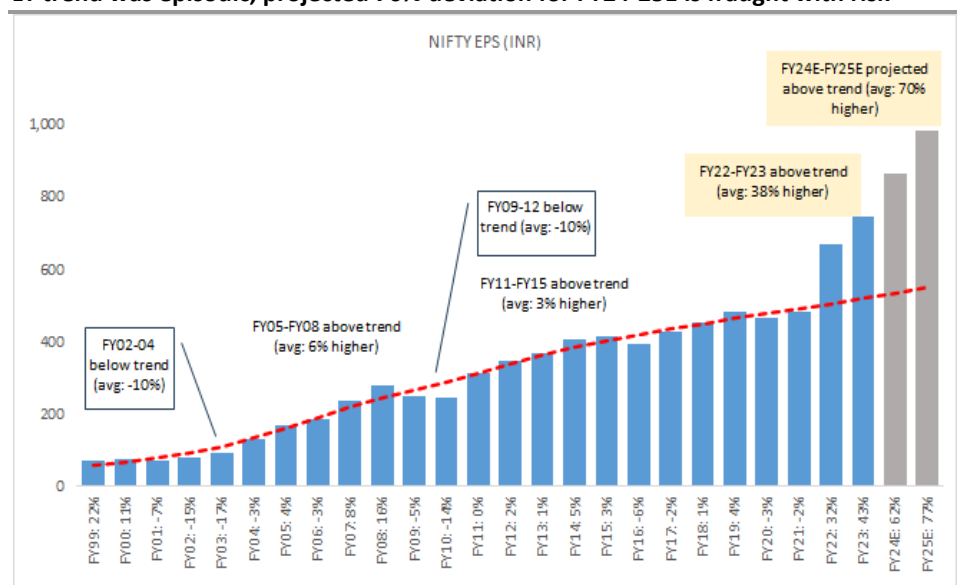
In the case of US, while the real GDP growth loss over pre-covid is -50bp (1.8% 3-year CAGR vs 2.3%), private consumption growth was higher (up 40bp at 2.7%). Thus, the rise in core inflation (180bp at 3.5% 3-year CAGR) has been driven by higher household income which resulted in sharp rise in S&P 500 EPS (3-year CAGR of 9.4% vs 5.7% pre-covid).

Conversely for India, the real GDP growth loss is higher (-230bp at 3.3% 3-year CAGR), and private consumption growth is also lower (-140bp at 4.5%). This implies that the rise in EPS for Nifty 50 (and corporate profits in general), in the context of nearly equivalent rise in core inflation (+160bp at 5.6%) has come at the cost of slower household real income growth. Thus, as the post-COVID recovery matures multiple indicators show that household consumption is slowing, even as private sector capex continues to remain elusive. While the 4QFY23 real GDP growth print of 6.1% has surprised positively, it masks exogenous support from government spending even as the underlying private sector demand is slowing, which is growing merely 2% in real terms.

While the post pandemic GDP growth loss for India has been higher than for the US, inflation deviations has been similar. But while the US household consumption growth trend is higher than pre-pandemic, for India it slowed sharply. These imply that the elevated profits/earnings trajectory for Indian companies is aided by substantial rise in market power and at the cost of household real income. It is quite the opposite for the US; higher consumption led to higher earnings. These trends sharpens the sustainability question

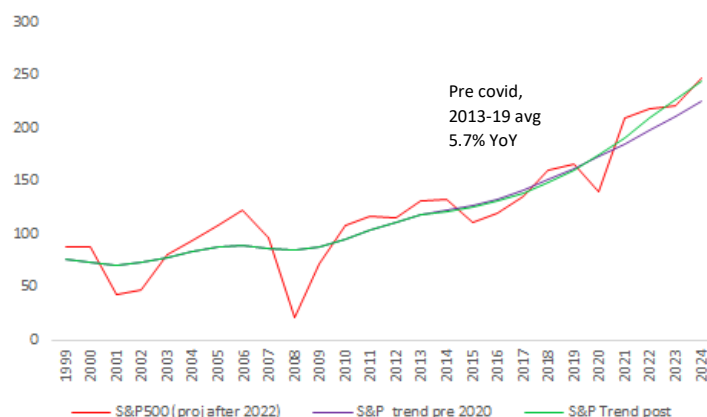
The above divergent macro and corporate earnings cycles on the one hand and continued tightening in the interest rate cycle in the AEs would further narrow the growth differential between the US and India. This will make the 70% divergence in EPS trajectory for Nifty50 increasingly untenable, creating significant scope for projected earnings downgrade for FY24 and FY25; in the past, the slowdown phases of FY02-FY03 and FY09-FY10 saw below trend Nifty EPS of the order of -10% each and a near flat trajectory during FY14 to FY20.

Exhibit 15: Extraordinary surge in post pandemic Nifty EPS, 38% higher than pre-covid LT trend was episodic, projected 70% deviation for FY24-25E is fraught with risk



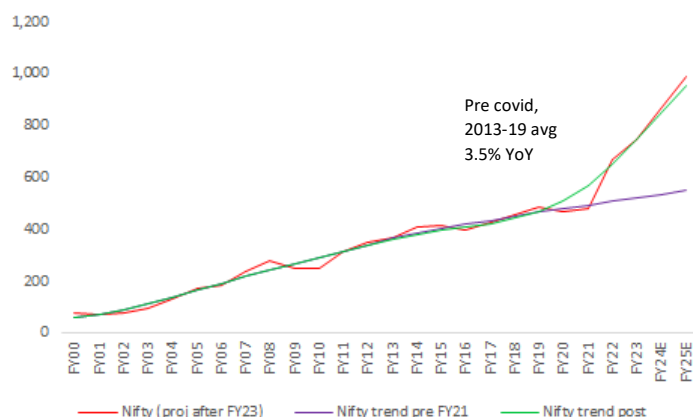
Source: Bloomberg, Systematix Research; * Dashed line represents pre-covid trend

Exhibit 16: US S&P EPS (2023E-24E) above pre-covid trend by 7%, average growth of 6.5% YoY vs 3-year CAGR of 9.4%



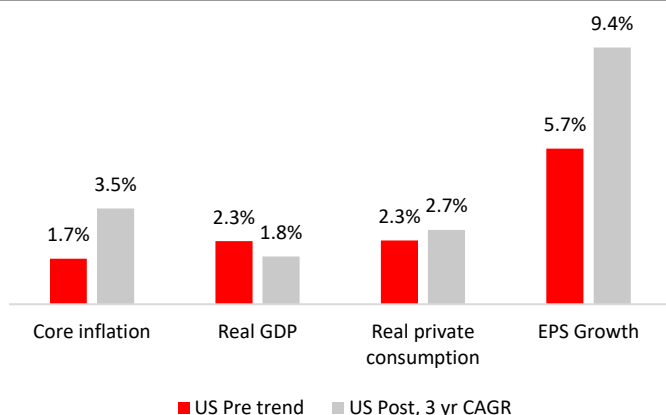
Source: Bloomberg, Systematix Research

Exhibit 17: Nifty EPS (2023E-24E) above pre-covid trend by 70%, average growth of 15% YoY vs 3-year CAGR of 15%



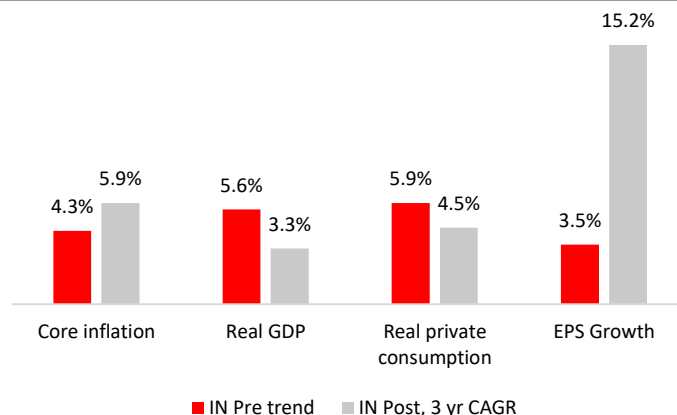
Source: Bloomberg, Systematix Research

Exhibit 18: US: Lower post covid GDP YoY (-50bp), higher consumption (+40bp), & inflation (+180bp) => Higher EPS (370bp)



Source: Bloomberg, Systematix Research; Pre covid, EPS 2013-19 avg 5.7% YoY

Exhibit 19: IN-Lower post covid GDP YoY (-230bp), lower consumption (-140), & inflation (+160bp) => Higher EPS (1117bp)



Source: Bloomberg, Systematix Research; Pre covid, EPS 2013-19 avg 3.5% YoY

What will drive future earnings growth?

Indian firms on cost optimization mode to conserve margins, capex remains elusive

The trend towards cost economization to preserve profitability and price discounts to retain market share should also lead to a reduction in their interest cost burden and as a corollary should mean lower interest income and spreads for lenders, primarily banks. Reduced working capital requirement to preclude prospects of private capex cycle in the near term

Contrasting the wide divergence in the expected corporate performance trajectory, the sales growth for the NFCs (ex IT and BFSI) has flattened to 6.7% in 4QFY23 from 12% in 3QFY23 and around 50% in 2QFY23. In reciprocation, companies have started economizing on the overall cost with total expenditure decelerating from 56% in 2QFY23 to 7.3% in 4QFY23. Raw material costs growth decelerated to 3.3% in 4QFY23 from 37.2% in 2QFY23. Employee cost growth, however, accelerated from 5.5% in 3QFY23 to 8.4% in 4QFY23 translating into FY23 average at 7.6%. Still, employee cost/total cost has declined from 6.5-7% to around 5% currently.

The APAT growth of 4.5% YoY in 4QFY23 compared to -19% in 3QFY23, translating into full year FY23 at -7% compared to +15% 4-year CAGR.

With a clear trend of companies heading into a cost optimization mode and offering product discounts to retain market share, the working capital has been decelerating too, which precludes prospects of private capex cycle in the near term. Hence, the trend towards cost economization to preserve profitability should also lead to a reduction in their interest cost burden and as a corollary should mean lower interest income and spreads for lenders, primarily banks.

What is at risk, what is not?

In a most likely scenario FY24 (and FY25) earnings projections can undergo a sharper correction of 15% than 4% for FY23

Given the backdrop that both the domestic and global bounties are ebbing, reflected in a sharp deceleration in sales growth of non-financial companies (NFCs) to 7-8% in 4QFY23 and the large deviation in corporate earnings during FY22-23 from the pre-covid trend, in a most likely scenario FY24 (and FY25) earnings projection can undergo a sharper correction of the order of 15% compared to the 4% correction for FY23, when banks benefited from the fag-end cyclical clustering of working capital led credit demand from industries. But that has also ebbed with the deceleration in credit growth.

Consensus earnings projection for FY24E implies a 16.3%, higher than 11% in FY23 in a slowing economy ([Exhibits 21-23](#)).

- Within the 16.3% growth for FY24E, the contribution from BFSI is expected to fall significantly to 5.8% from 9% out of 11.4% in FY23.
- A higher contribution is expected from Oil & Gas (2.3% in FY24E) and Autos (3.2% in FY24).
- The contribution from the metals sector is expected to flatten after -5.4% in FY23.
- IT is expected to increase from 1.1% out of 11.4% in FY23 to 1.5% out of 16.3% in FY24E.
- Consumers are also going to be lesser (0.9% in FY24E, 1.2% in FY23)

Considering the profile of earnings downgrade for FY23 we expect more companies to undergo downgrades of a higher magnitude.

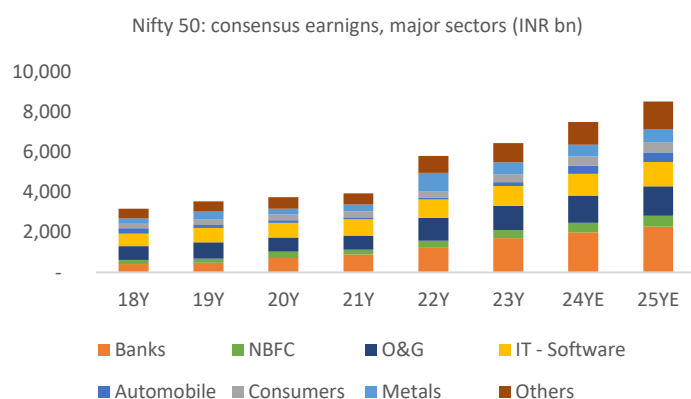
- There have been significant downgrades of over 5% in the consensus estimates for FY23 and FY24E for 29-30 companies since the beginning of 2022. This is especially coming from the material sector (Metals and Cement), Healthcare and Autos ([Exhibits 24-25](#)).

The ongoing slowdown in private demand would imply downward reset in expectations across most sectors. Amongst these, banks, NBFCs, Autos, Cement and Logistics appear to be most optimistic. Sectors exposed to lesser downgrade risk are Consumers, IT, Insurance and Utilities.

- Modest downgrade has happened for IT companies, and FMCG companies.
- Upgrades in FY24 were seen for financials (SBI, Axis, Kotak and Bajaj Finserv). Some consumer (Titan, ITC, Britannia) and auto names (M&M) also saw an upgrade.
- BPCL in the utilities space, Coal India and Grasim in the materials space have also seen an upgrade.
- 16-17 companies have seen an upgrade from their minimum levels since Feb'22. Some companies have seen continued expansion while some have seen an upgrade after a substantial fall (Tata Motors for instance).

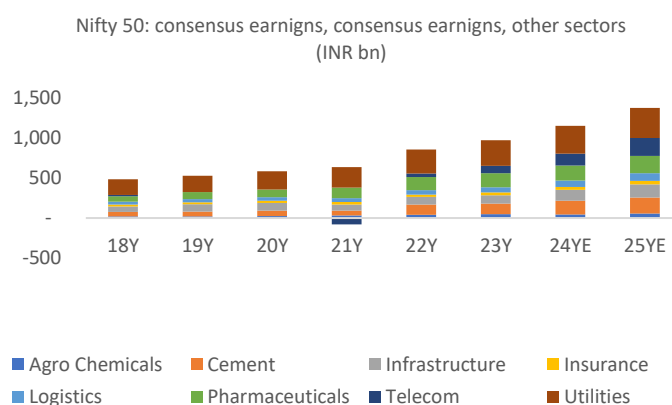
Given the backdrop of the 70% upside deviation of projected Nifty earnings compared to the pre-covid trajectory, even if we consider that the post covid pricing power is higher for large companies, the ongoing slowdown in private demand would imply downward reset in expectations across most sectors. **Amongst these, banks, NBFCs, Autos, Cement and Logistics appear to be most optimistic. Sectors exposed to lesser downgrade risk are Consumers, IT, Insurance and Utilities.**

Exhibit 20: Major divergence vs pre-covid trends in earnings from BFSI, Autos, O&G; metal's to diminish but still elevated



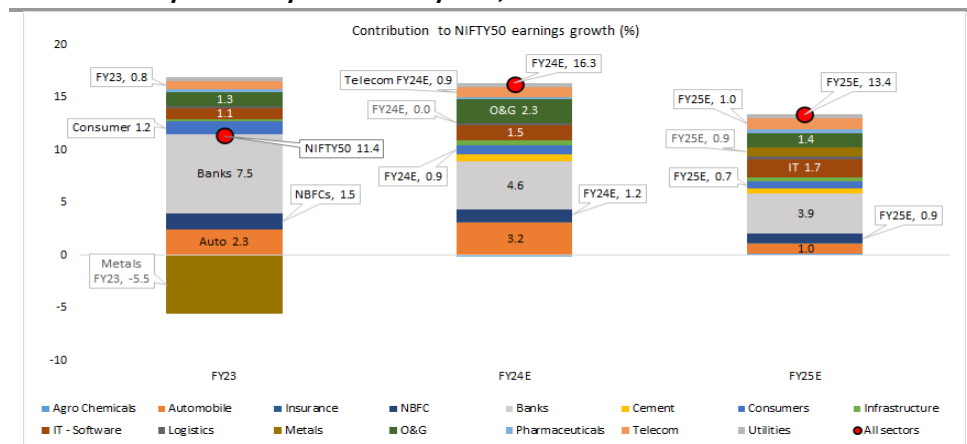
Source: Bloomberg, Systematix Research

Exhibit 21: Cement and utilities also driving post covid deviation from the trend



Source: Bloomberg, Systematix Research

Exhibit 22: FY24E NIFTY earnings driven by IT, Autos, and Oil & Gas; the combined contribution by BFSI likely to decline by 39%, Consumers to narrow as well



Source: Bloomberg, Consensus estimates

Exhibit 23: Consensus earnings growth for FY24E, and FY25E are optimistic, BFSI at max risk

Sectors	FY23	FY24E	FY25E
Agro Chemicals	0.1	-0.0	0.1
Automobile	2.3	3.2	1.0
Banks	7.5	4.6	3.9
Cement	0.0	0.6	0.4
Consumers	1.2	0.9	0.7
Infrastructure	0.2	0.4	0.4
Insurance	0.1	0.1	0.1
IT - Software	1.1	1.5	1.7
Logistics	0.2	0.2	0.2
Metals	-5.5	0.0	0.9
NBFC	1.5	1.2	0.9
O&G	1.3	2.3	1.4
Pharmaceuticals	0.3	0.2	0.4
Telecom	0.8	0.9	1.0
Utilities	0.3	0.4	0.4
All sectors	11.4	16.3	13.4
Non BFSI	2.3	10.5	8.6
Metals ex Coal India	-7.7	0.9	1.0
Nonbank cos ex metals & Coal India	10.0	9.6	7.6
BFSI	9.1	5.8	4.8

Source: Bloomberg, Consensus estimates

Exhibit 24: NIFTY earnings consensus estimates: Downgrade for FY24E can intensify, FY22-25E CAGR at 14% is too optimistic given weak private demand and global headwinds; margin expansion and market power to be the key drivers

	23Y	24Y	25Y	23Y	23Y	24Y	24Y	25Y	25Y	FY22- FY25E
				Old^	Latest	Old^	Latest	Old^	Latest	
	Change (%)			%YoY	%YoY	%YoY	%YoY	%YoY	%YoY	% CAGR
Agro Chemicals	-1.4	-15.4	-14.3	20.6	18.9	15.4	-1.0	19.5	21.1	12.5
Automobile	-36.7	21.6	-3.1	362.2	192.5	4.4	100.6	48.6	18.5	90.8
Banks	11.1	6.5	41.2	20.7	34.1	22.4	17.3	-13.7	14.6	21.7
Cement	-18.0	-6.2	-4.8	23.3	1.2	14.0	30.3	15.6	17.3	15.7
Consumers	-3.5	5.4	1.6	25.9	21.5	5.6	15.4	16.4	12.2	16.3
Infrastructure	-13.7	-9.3	1.3	32.9	14.7	18.3	24.3	10.0	22.8	20.5
Insurance	-24.0	-28.4	-8.7	46.1	11.0	19.5	12.7	-10.7	13.8	12.5
IT - Software	-7.6	-10.5	-2.9	15.6	6.8	13.1	9.6	3.1	11.9	9.4
Logistics	-16.6	-15.5	-5.3	40.0	16.7	17.4	19.0	7.3	20.3	18.7
Metals	-18.1	-15.0	-7.2	-21.0	-35.3	-3.4	0.3	2.1	11.5	-10.3
NBFC	1.1	4.3	-2.7	27.6	29.0	15.4	19.1	21.9	13.7	20.4
O&G	0.2	3.7	-1.0	6.5	6.7	8.2	12.0	12.6	7.6	8.7
Pharmaceuticals	-3.8	-11.3	-7.2	13.6	9.3	16.9	7.8	10.0	15.0	10.7
Telecom	-25.9	-20.5	-6.3	177.8	105.8	52.9	64.0	27.6	50.4	71.9
Utilities	0.6	1.0	5.4	5.9	6.5	6.6	7.1	4.1	8.6	7.4
All sectors	-4.1	-0.9	6.3	16.1	11.4	12.6	16.3	5.8	13.4	13.7
Non BFSI	-9.2	-3.7	-2.5	13.7	3.2	9.1	15.7	11.5	12.9	10.5
Metals ex CIL	-45.7	-31.4	-12.5	-26.9	-60.3	-4.5	20.7	-4.4	21.9	-16.4
Nonbank ex metals & Coal	-4.5	-0.7	-1.6	22.4	16.9	10.9	15.3	13.3	12.3	14.8

Source: Bloomberg, Change since Jan'22 (^Old), Change* since Dec'22

Exhibit 25: 42 of NIFT50 companies saw earnings downgrades in FY23 (29 larger than -5%); FY24E also saw downgrades for 42 companies (31 larger than -5%); Slowing growth could imply more downgrades for FY24E

Downgrades in FY23 earnings (current vs peak since Jan'22)				Downgrades post 4Q FY23 results			
	FY23*	FY24E	FY25E		FY23		FY24E
Tata Motors	-110.1	-23.3	-24.7	JSW Steel	-7.5	UPL	-18.5
JSW Steel	-77.1	-35.2	-10.1	Axis Bank	-5.1	HDFC Life	-13.8
Tata Steel	-56.5	-46.4	-23.6	Tata Steel	-4.4	Bajaj Finserv	-13.2
BPCL	-54.8	-10.5	-3.7	Divi's Labs	-2.9	Cipla	-8.9
UltraTech	-38.9	-27.2	-19.0	HDFC Life	-2.0	Hindalco	-8.5
Divi's Labs	-37.7	-45.0	-39.0	Grasim	-1.7	Tata Steel	-8.2
Apollo Hospitals	-35.6	-27.6	-3.3	IndusInd Bank	-1.4	Infosys	-7.6
Hindalco	-33.4	-29.6	-11.3	Reliance Industries	-1.3	Tech Mahindra	-7.4
Bharti Airtel	-29.2	-23.6	-13.7	Sun Pharmaceutical	-1.0	JSW Steel	-6.9
Hero MotoCorp	-26.8	-20.4	-8.3	UltraTech	-1.0	Sun Pharmaceutical	-6.8
SBI Life	-26.2	-27.0	-17.0	Kotak Mahindra Bank	-0.9	Apollo Hospitals	-6.1
Tech Mahindra	-20.3	-23.6	-16.1	Hindalco	-0.6	Wipro	-5.9
HDFC Life	-19.1	-29.1	-36.1	Tech Mahindra	-0.5	Divi's Labs	-5.8
Wipro	-18.1	-21.1	-19.0	Cipla	-0.5	Maruti Suzuki	-4.7
Adani Ports & SEZ	-17.1	-16.0	-22.6	Eicher Motors	-0.3	ONGC	-4.1
Reliance Industries	-16.8	-14.5	-29.2	Larsen & Toubro	-0.2	HCL Technologies	-3.7
ONGC	-16.3	-6.9	-4.1	Hindustan Unilever	-0.2	Bharti Airtel	-3.6
Tata Consumer	-15.5	-10.2	-16.0	HDFC	-0.2	NTPC	-3.2
Larsen & Toubro	-13.9	-9.9	-15.0	Bajaj Auto	-0.2	Reliance Industries	-2.9
Asian Paints	-10.0	-5.9	-6.6	Titan Co	-0.2	UltraTech	-2.9
Cipla	-9.5	-15.0	-24.6	Britannia	-0.2	IndusInd Bank	-2.6
Maruti Suzuki	-7.3	-17.3	-17.6	Infosys	-0.2	Larsen & Toubro	-2.5
Infosys	-7.3	-13.5	-9.1	Power Grid	-0.1	TCS	-2.3
IndusInd Bank	-7.1	-9.6	-7.8	Asian Paints	-0.1	Hindustan Unilever	-1.7
Bajaj Auto	-6.3	-5.7	-5.1	TCS	-0.1	Adani Ports & SEZ	-1.5
Grasim	-6.0	-9.8	-28.8			Kotak Mahindra Bank	-1.2
Hindustan Unilever	-6.0	-4.6	-3.9			Hero MotoCorp	-0.7
Bajaj Finserv	-5.7	-13.2	-17.3			Dr Reddy's	-0.3
Axis Bank	-5.4	0.0	0.0			Mahindra & Mahindra	-0.3

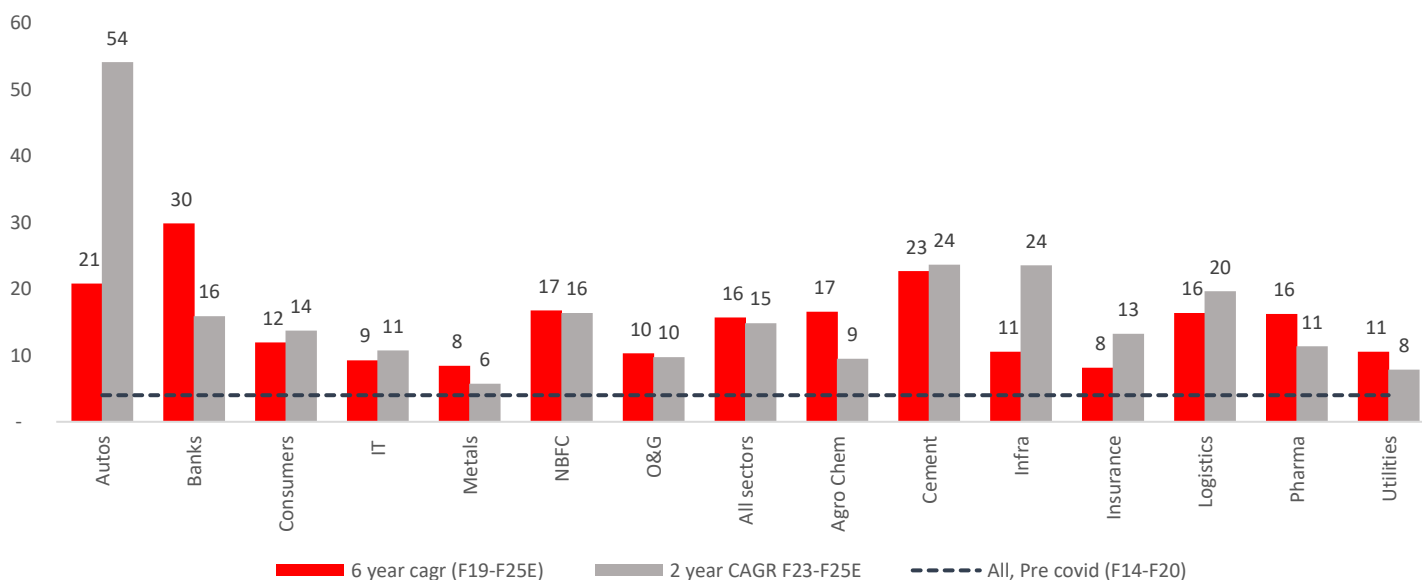
Source: Bloomberg, Systematix Research; consensus estimates; * declines greater than 5%

Exhibit 26: 16 cos in Nifty50 saw upgrades (>5%) from their bottoms for FY23E and 17 for FY24E; Sectoral distribution: FY24/ FY23- BFSI 5/6, Autos 4/2, Consumer 3/3, O&G 2/2, material 2/2; BFSI, O&G and materials could be at risk, Cement can retain gains

Upgrades in FY24 earnings (current vs lows since Jan'22)			Upgrades in FY23 earnings (current vs lows since Jan'22)	
	Current vs minimum	Change post 4Q results		Current vs minimum
Bajaj Finserv	54.7	2.9	BPCL	129.0
M&M	50.1	-0.3	Coal India	69.1
Coal India	33.5	-4.7	M&M	29.1
ONGC	24.3	0.9	Bajaj Finserv	26.9
Tata Motors	22.6	22.6	ONGC	26.4
Axis Bank	21.1	1.7	Dr Reddy's	26.3
Grasim	20.3	1.9	Titan Co	23.0
BPCL	17.4	15.8	Axis Bank	20.2
Titan Co	15.0	-4.1	ICICI Bank	18.2
ITC	14.8	3.7	SBI	17.1
ICICI Bank	13.9	-13.2	Britannia	14.0
Dr Reddy's	13.1	3.9	Grasim	13.7
SBI	12.5	-1.2	ITC	11.2
Eicher Motors	11.4	0.0	Bajaj Finance	10.0
Britannia	9.4	-0.3	Kotak Bank	5.6
Kotak Bank	7.4	3.2	Eicher Motors	5.3
Maruti Suzuki	6.3	7.8		

Source: Bloomberg, Systematix Research; consensus estimates; Note: the sample for downgrades (Exhibit 25) and upgrades (Exhibit 26) are not mutually exclusive; filter used-upgrades greater than 5%

Exhibit 27: Nifty sector earnings growth (6, 2 year CAGR) vs pre-COVID average for all sectors (%)



Source: Bloomberg, Systematix Research

Global ranking: India ranks high due to optimistic earnings, but performance lags

Relative to the Mar'23 lows, the rise in valuations for Nifty (PE) has been about 10% which is majorly driven by the global rebound; global average has been around 14.6%. On a trailing basis, the Nifty index has moved up to 22x whereas PE (1-yr forward) is at 19.8x, 43% higher than the global average of 14x, which makes it a low ranking on the relative valuation component.

However, India's composite ranking is higher with Nifty at 6th and Sensex at 8th out of 25 global indices, due to higher-than-average forward earnings growth projections of 14-15% and return ratio (15%) over the next two FY24E-FY25E.

The outperforming European indices (up 20-25% from Mar'23 lows, and Japan) remains at the top because of higher upgrades in EPS in the last two months. Relatively due to the rich valuations India has underperformed with a YTD return of 4% compared to the global average of 10%.

This performance has largely come from Realty, Cap goods, FMCG and Autos which has given returns in the range of 18-20%. Whereas, the underperformance has largely come from IT, Services, PSU Banks, Power, Metals and Oil & Gas.

Valuation assessment:

Our overall sector ranking considers assessment of earnings & valuations risks across sectors. Considering the outlook of "higher for longer global rate scenario" our valuation comparison overlooks the phase of 2014-19 which was characterized by higher average valuations (Nifty at 24x), lower earnings growth (3.5%) and low global rates.

Thus, we compare the current valuations with the period prior to the 2014-19 period.

- Accordingly, the valuation risk would be lower in Infra, Oil & gas, Utilities, Pharma and IT.
- Moderate to high risks would be in cap goods, FMCG, auto, Metals and Cement.
- The high-risk sectors would be Banks, Realty and the Mid cap segments.

Earning risk assessment based on the cyclical deviations discussed earlier:

- Earnings risk would be lower in Insurance, Utilities, FMCG, IT and Oil & gas;
- Moderate to high in Metals, Infrastructure, Capital goods, Consumers and Pharma.
- High risks in cement, banks, NBFCs and realty.

Overall sectoral ranking:

We give 60% weightage to earnings risk ranking and 40% to valuations risk ranking, thereby arriving at an overall risk ranking based on 90% of the overall sectoral average ([Exhibits 28-30](#)). Accordingly, FMCG, O&G, IT, Pharma, Infra, Utilities qualify for positive view. Conversely, Banks, NBFCs, Metals, Realty, Cap goods, and Cement qualify for negative positioning. Autos also fall in this bucket largely due to Tata Motors, which is turning into profits now. Hence, we maintain our OW view on the sector.

India's composite ranking is higher with Nifty at 6th and Sensex at 8th ranks out of 25 global indices, due to higher-than-average forward earnings growth projections. But still it has underperformed due to rich valuation; 4% YTD vs 10% global

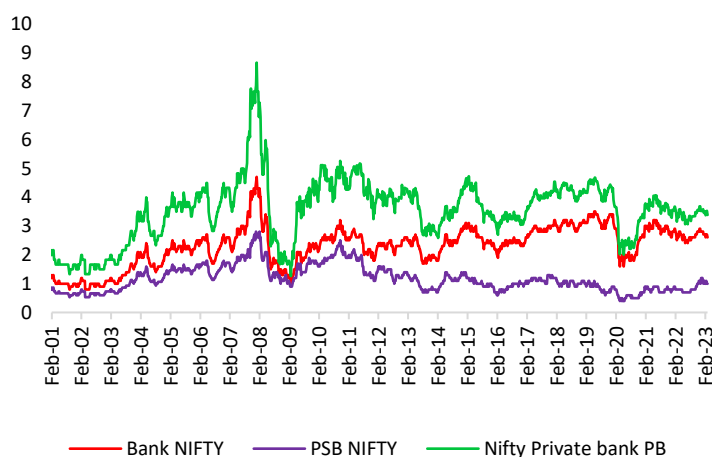
In our composite assessment FMCG, O&G, IT, Pharma, Infra, Utilities qualify for a positive view. Conversely, Banks, NBFCs, Metals, Realty, Cap goods, and Cement qualify for negative positioning. Autos also fall in this bucket largely due to Tata Motors, which is turning into profits now. Hence, we maintain our OW view on the sector

Exhibit 28: Valuations of various sectors indices relative to earlier phases

Indices	Index price-to-earnings (P/E) ratio:				c/a (%)	d/a (%)	c/b (%)	d/b (%)
	2003-2008	2003-2012	2014-2019	Jun-23				
	a	b	c	d				
Nifty Next 50	17.7	16.3	30.6	29.0	173	164	188	178
Nifty 500	18.6	18.3	26.6	23.1	143	124	146	126
Nifty 50	19.2	19.3	24.0	21.8	125	114	124	113
FMCG	36.7	37.1	39.6	44.9	108	122	107	121
IT	31.2	25.2	20.0	25.0	64	80	79	99
Bank (P/B)	2.2	2.2	2.7	2.8	123	128	123	127
Auto	20.3	19.6	34.9	29.8	172	147	178	152
Pharma	47.3	44.2	44.9	29.0	95	61	102	66
Nifty 100	19.0	18.8	24.6	22.8	129	120	131	121
Services Sector	18.8	21.4	24.0	20.3	128	108	113	95
PSE	11.3	12.5	11.8	9.5	104	84	94	76
Energy	12.4	13.8	13.5	12.8	109	104	97	93
Infrastructure	26.7	24.5	30.6	22.9	115	86	125	93
Realty	35.6	29.5	46.3	48.7	130	137	157	165
Midcap 50	17.4	16.0	39.1	23.5	225	135	245	147
Dividend Opportunities 50	14.7	14.9	15.9	16.5	108	112	107	111
India Consumption	26.3	24.3	38.9	41.5	148	158	160	171
Metal	12.4	12.9	16.7	17.1	136	138	130	133
Nifty 200	19.1	18.8	25.4	23.0	133	121	135	123
Low Volatility 50	23.1	24.6	24.7	29.5	107	128	101	120
Capital Goods	44.4	32.5	37.7	35.4	85	80	116	109

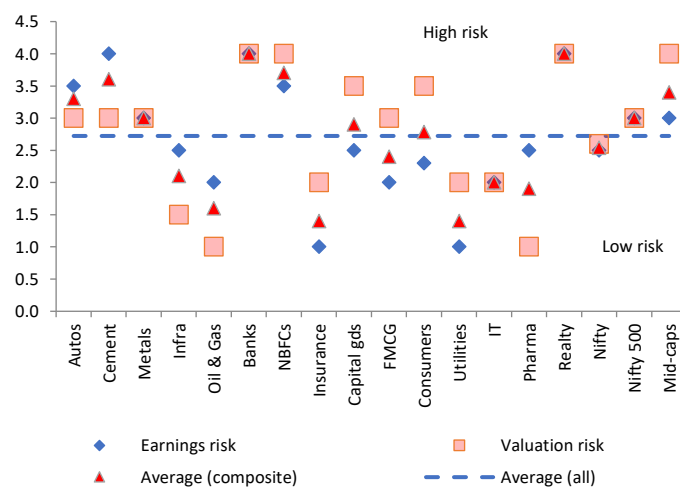
Source: Bloomberg, Systematix Research

Exhibit 29: Banking sector valuation (PB trailing, x)



Source: CMIE, Systematix Research

Exhibit 30: Composite risk scaling across sector: Earnings and Valuations



Source: Bloomberg, Systematix Research, risks ranked from low (1) to high (4); earnings risk derived from magnitude of deviation from pre-covid trends; Valuation risks assessed vs 2003-2012 averages

Why UW banks? Slowing cycle, diminishing pricing power, & rich valuations

Behind the YTD underperformance of Bank Nifty Valuations (3.9% YTD) is the higher valuation at 2.8x trailing P/B, 23% higher than 2.2x average of 2003-12 and 28% higher than 2014-19 average. This difference is largely because of the re-rating of PSU banks and the ICICI Bank. Conversely, private bank valuations at 3.5x is lower than 2013-14 average of 4.2x, largely driven by derating of HDFC bank and Kotak Bank.

Bank Nifty underperformed YTD and is expected to continue going forward:

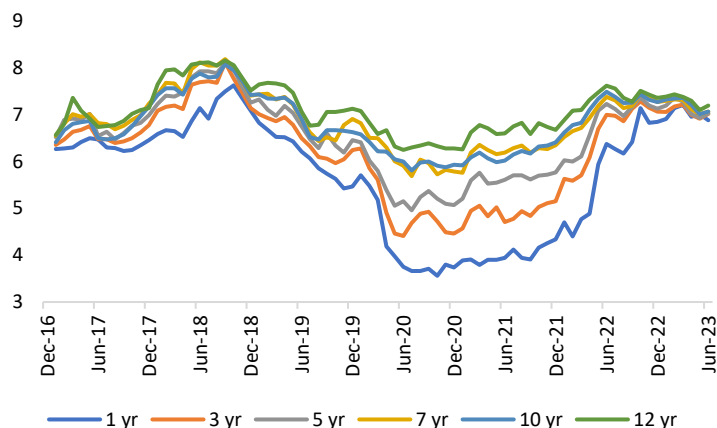
- Credit growth is expected to slow because of reduced lending, lack of capex intent and waning of working capital requirement of the NFCs; Credit growth has slowed to 15.4% from the peak of 17.4% in Dec'23 and industrial lending growth has decelerated to 7% (Apr'23, 13.6% in Oct'22). The industry has guided for further deceleration to 12-13% in FY24E; we think it can decelerate closer to 10% in response to further slowing of sales growth for NFC (7-8% in 4QFY23) and peaking out of retail lending momentum.
- While the banks have continued to focus on retail lending for overall credit growth, the reduction in the proportion of industrial lending, rising cost of funds and lowering of CASA proportion in deposits are translating into lower margins. RBI's latest financial stability report estimates CASA growth decelerating to 5.4% YoY in FY23 from 11% in FY22. Conversely, the term deposit growth has risen to 13% from 6%.
- Since Apr'22, the average term deposit rates have increased by 120 bps to 6.3% from 5.1%, while the average lending rates have increased lesser by 110bp from 8.7% to 9.8%.
- Rising interest rates translated into higher spreads (yields-term deposit rates) on advances till mid FY22. But it has declined by 50bp from the peak of 3.9% since then as industrial lending decelerated. Thus, while retail lending remains elevated at 20% YoY, contributed by non-mortgage, uncollateralized lending, and decelerating mortgage lending, it has come at lower margins.
- Compared to the pre-covid levels (4QFY20), the current spread for SCBs at 348bp is lower than 360 lower (-12). From their respective peaks, PSBs at 289bp are lower by 11bp and PVB at 436bp are higher by 16bp. Hence, the differential between private and public has widened to 147bp from 120bp pre-covid.
- The declining spreads of banks in a high interest rate scenario depicts fading pricing power in response to slowing corporate lending. And at the end of the post-covid recovery cycle PSBs have seen greater erosion in pricing power.
- RBI has continued to remain hawkish (see [here](#)) with a view to attain the long-term inflation target of 4% along with an implied flattening of the yield curve spread between the 1-10 years by 30bps approx. This also implies that the demand for long term fund and project lending is not evident.
- Reduction in lending rates of fresh loans and lowering of G-sec yield would imply lower yield on assets for the sector in general and particularly for the PSU banks.
- We had already highlighted in our previous themes that lower lending growth and slowing economy would imply bottoming out of the credit cost cycle (See [Paradoxical retail lending exuberance amid rising ruralisation](#)). RBI's latest Financial Stability Report (Jun'23) estimates systemic GNPA ratio declining to 3.9% in FY23, which is higher than our projection of 3.5%. And following the larger than

Ebbing of the episodic bounties for non-finance companies is now getting transmitted into the banking sector, reflecting on slackening in corporate credit demand, interest rate spreads declining lower than pre-pandemic levels and diminishing pricing power. The aggressive push for retail lending is not aiding margins even as we foresee the possibility of rising credit risk. In addition, we think the valuations are rich

projected provisioning drawdown (Actual at 2.9% of advances vs our estimates of 2.5%), the NNPA ratio at 1% is same as our estimate of FY23.

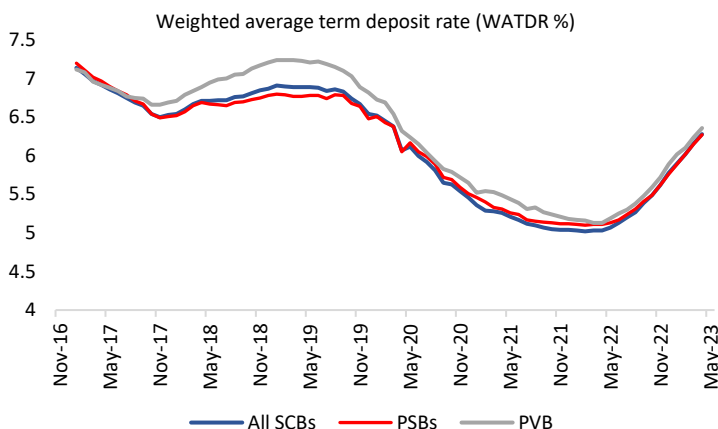
- These arguments reinforce our underweight on banking and financials in general.

Exhibit 31: Flattening of Gsec yield since mid-2022 due to slowing bank credit demand, specially from industries (%)



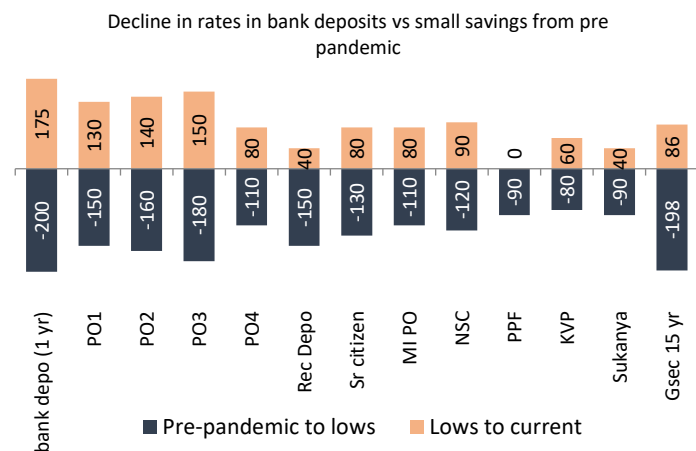
Source: CMIE, Systematix Research

Exhibit 32: Synchronous rise in bank term deposit rates of PSBs and PVBs unlike 2018-19 due to stronger demand from PSBs



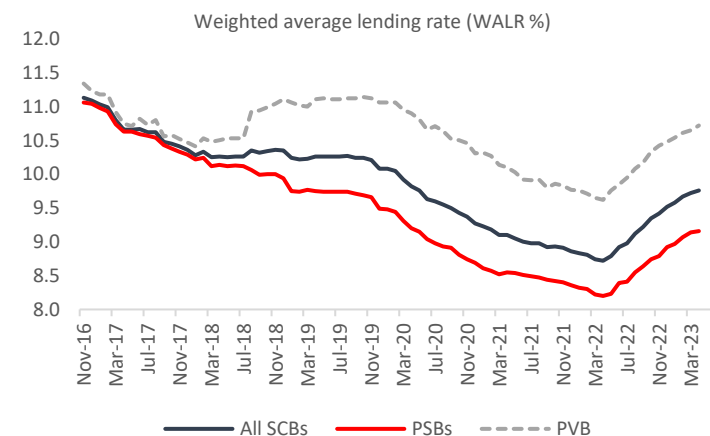
Source: CMIE, Systematix Research

Exhibit 33: Relative rise in bank deposit rate vs 15-year GSec yield higher than when it fell (0.9x vs 1.75x); reflecting falling in savings

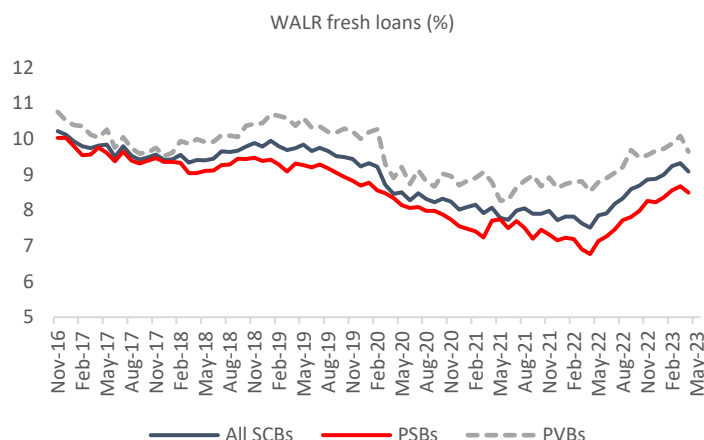


Source: CMIE, Systematix Research

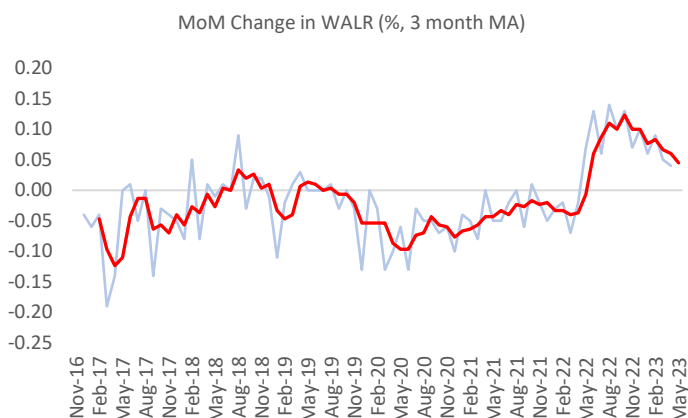
Exhibit 34: Slower rise in average lending rates, specially PSBs reflecting slowing credit demand



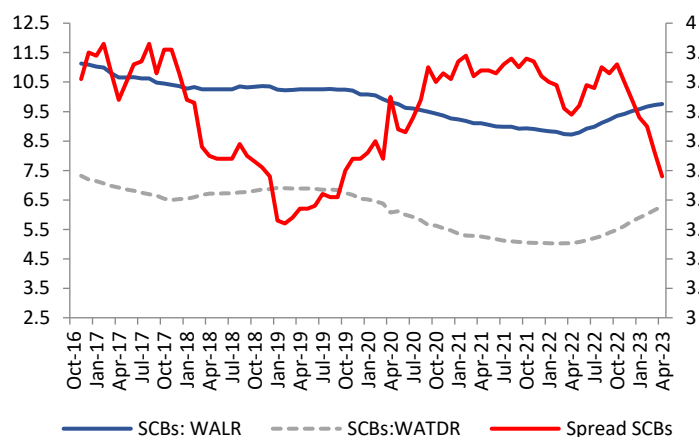
Source: CMIE, Systematix Research

Exhibit 35: Rates in fresh lending rate beginning to decline

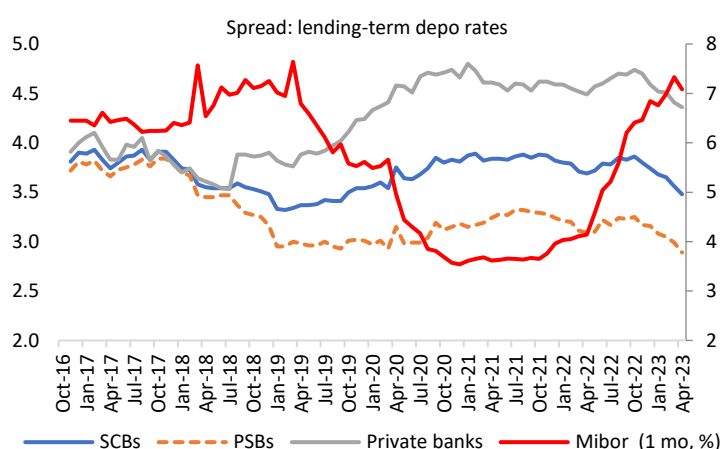
Source: CMIE, Systematix Research

Exhibit 36: Falling pace of lending rate rise since mid-2022 indicates a mix change toward lower-yielding loans

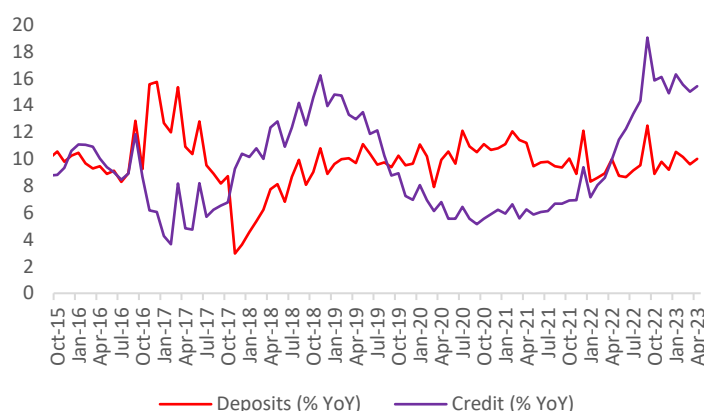
Source: RBI, Systematix Research, 3 mma in red

Exhibit 37: Falling bank spread as deposit rate rising faster than lending rates (%)

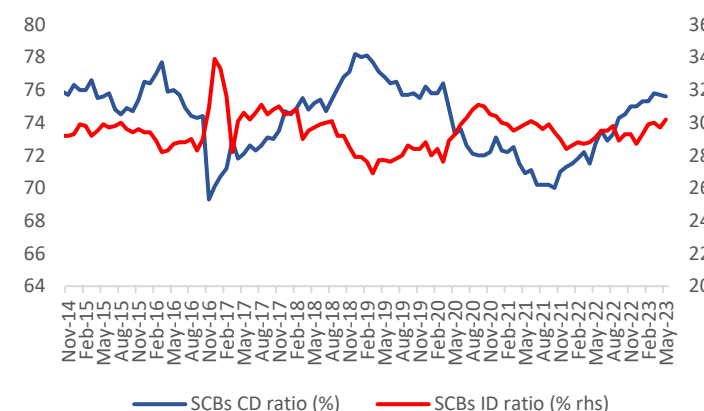
Source: CMIE, Systematix Research

Exhibit 38: Fall in spreads since mid-2022 despite higher market rates reflects weak pricing power; negative correlation prevailed

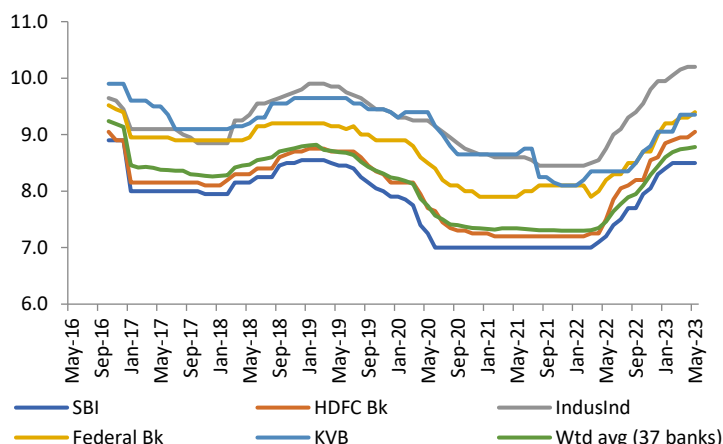
Source: CMIE, Systematix Research

Exhibit 39: Bank lending deceleration due to sharp decline in industrial, bank rebalancing it through competitive retail lending

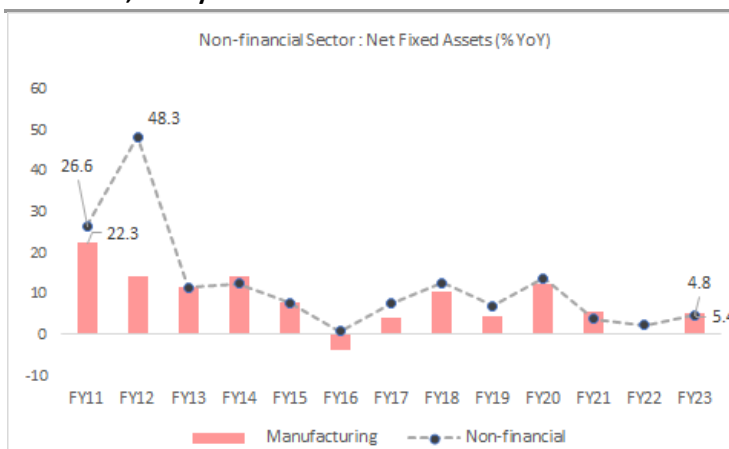
Source: CMIE, Systematix Research

Exhibit 40: Lesser recovery in bank CD ratio and higher ID ratio reflects the anemic economic recovery and demand for funds

Source: CMIE, Systematix Research

Exhibit 41: Bank-wise 1-year MCLR (%), stopped rising

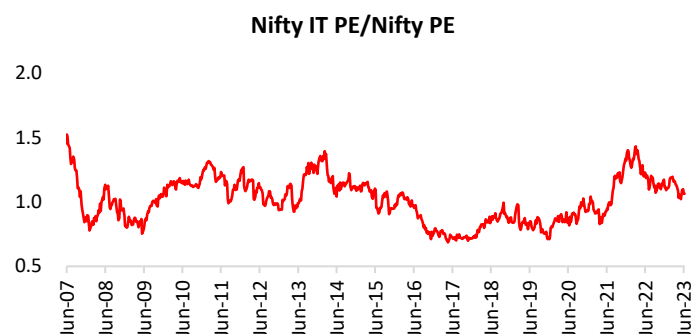
Source: CMIE, Systematix Research

Exhibit 42: Growth in net assets of non-finance companies at sub 5% in FY23, nearly zero in real terms

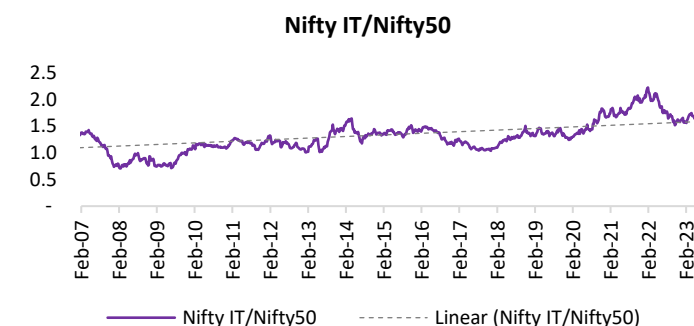
Source: CMIE, Systematix Research

IT Sector: Low earnings risk but triggers for large caps still lacking

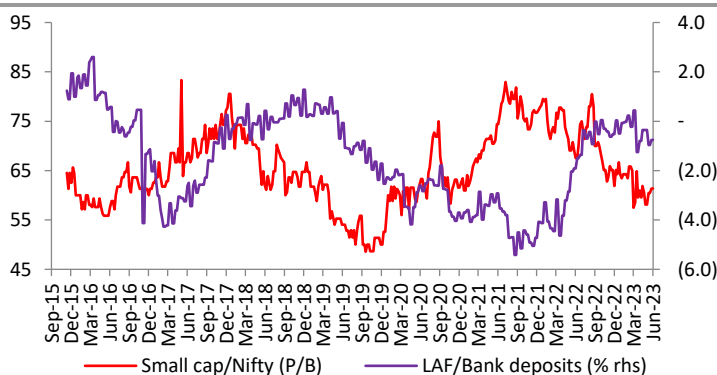
Relative to Nifty, the underperformance of the IT has brought down the relative valuations to 1.1x, equal to the levels seen during 2013-16. But continued concerns of on margins and slow revenue growth for large companies have implied lack of triggers for Tier 1 names. Mid-caps on the contrary are still demonstrating better traction.

Exhibit 43: IT index valuation, stabilization after a significant correction

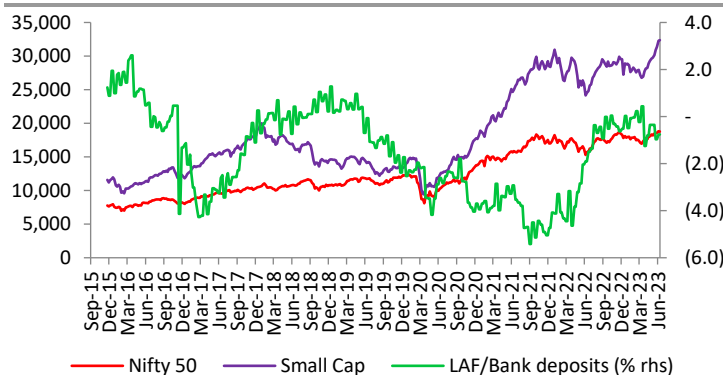
Source: CMIE, Systematix Research

Exhibit 44: IT sector relative performance has corrected sharply along the long term out performance

Source: CMIE, Systematix Research

Exhibit 45: Small caps valuation recovery dependent on endurance of surplus liquidity; earnings outlook could be at risk

Source: Bloomberg, Systematix Research; LAF/bank depo<0 is surplus, LAF/bank depo>0 is deficit

Exhibit 46: Small caps compensating for 2 years of underperformance; due to rate cut expectations & easing liquidity

Source: Bloomberg, Systematix Research

Institutional Equities Team

Nikhil Khandelwal	Managing Director	+91-22-6704 8001	nikhil@systematixgroup.in
--------------------------	--------------------------	-------------------------	----------------------------------

Equity Research

Analysts	Industry Sectors	Desk-Phone	E-mail
Dhananjay Sinha	Co Head of Equities & Head of Research - Strategy & Economics	+91-22-6704 8095	dhananjaysinha@systematixgroup.in
Ashish Poddar	Consumer Durables, Building Materials, Small & Midcaps	+91-22-6704 8039	ashishpoddar@systematixgroup.in
Himanshu Nayyar	Consumer Staples & Discretionary	+91-22-6704 8079	himanshunayyar@systematixgroup.in
Manjith Nair	Banking, Insurance	+91-22-6704 8065	manjithnair@systematixgroup.in
Pradeep Agrawal	NBFCs & Diversified Financials	+91-22-6704 8024	pradeepagrawal@systematixgroup.in
Pratik Tholiya	Specialty & Agro Chem, Fertilisers, Sugar, Textiles and Select Midcaps	+91-22-6704 8028	pratiktholiya@systematixgroup.in
Rahul Jain	Metals & Mining	+91-22-6704 8066	rahuljain@systematixgroup.in
Sudeep Anand	Oil & Gas, Logistics, Cement	+91-22-6704 8085	sudeepanand@systematixgroup.in
Vishal Manchanda	Pharmaceuticals and Healthcare	+91-22-6704 8064	vishalmanchanda@systematixgroup.in
Aniket Shah	Banking, Insurance	+91-22-6704 8034	aniketshah@systematixgroup.in
Bezad Deboo	Pharmaceuticals and Healthcare	+91-22-6704 8046	bezaddeboo@systematixgroup.in
Chetan Mahadik	Consumer Staples & Discretionary	+91-22-6704 8091	chetanmahadik@systematixgroup.in
Hena Vora	NBFCs & Diversified Financials	+91-22-6704 8045	henavora@systematixgroup.in
Pranay Shah	Consumer Durables, Building Materials, Small & Midcaps	+91-22-6704 8017	pranayshah@systematixgroup.in
Pratik Oza	Midcaps	+91-22-6704 8036	pratikoza@systematixgroup.in
Prathmesh Kamath	Oil & Gas, Logistics, Cement	+91-22-6704 8022	prathmeshkamath@systematixgroup.in
Purvi Mundhra	Macro-Strategy	+91-22-6704 8078	purvimundhra@systematixgroup.in
Rajesh Mudaliar	Consumer Staples & Discretionary	+91-22-6704 8084	rajeshmudaliar@systematixgroup.in
Shraddha Kapadia	Consumer Durables, Building Materials, Small & Midcaps	+91-22-6704 8019	shraddhakapadia@systematixgroup.in
Shweta Dikshit	Metals & Mining	+91-22-6704 8042	shwetadikshit@systematixgroup.in
Varun Gajaria	Midcaps	+91-22-6704 8081	varungajaria@systematixgroup.in

Equity Sales & Trading

Name		Desk-Phone	E-mail
Vipul Sanghvi	Co Head of Equities & Head of Sales	+91-22-6704 8062	vipulsanghvi@systematixgroup.in
Sidharth Agrawal	Sales	+91-22-6704 8090	sidharthagrawal@systematixgroup.in
Chintan Shah	Sales	+91-22-6704 8061	chintanshah@systematixgroup.in
Pawan Sharma	Director and Head - Sales Trading	+91-22-6704 8067	pawansharma@systematixgroup.in
Mukesh Chaturvedi	Vice President and Co Head - Sales Trading	+91-22-6704 8074	mukeshchaturvedi@systematixgroup.in
Vinod Bhuwad	Sales Trading	+91-22-6704 8051	vinodbhuwad@systematixgroup.in
Rashmi Solanki	Sales Trading	+91-22-6704 8097	rashmisolanki@systematixgroup.in
Karan Damani	Sales Trading	+91-22-6704 8053	karandamani@systematixgroup.in
Vipul Chheda	Dealer	+91-22-6704 8087	vipulchheda@systematixgroup.in
Paras Shah	Dealer	+91-22-6704 8047	parasshah@systematixgroup.in
Rahul Singh	Dealer	+91-22-6704 8054	rahulsingh@systematixgroup.in

Corporate Access

Pearl Pillay	Sr. Associate	+91-22-6704 8088	pearlpillay@systematixgroup.in
--------------	---------------	------------------	--------------------------------

Production

Madhu Narayanan	Editor	+91-22-6704 8071	madhunarayanan@systematixgroup.in
Mrunali Pagdhare	Production	+91-22-6704 8057	mrunalip@systematixgroup.in
Vijayendra Achrekar	Production	+91-22-6704 8089	vijayendraachrekar@systematixgroup.in

Operations

Sachin Malusare	Vice President	+91-22-6704 8055	sachinmalusare@systematixgroup.in
Jignesh Mistry	Manager	+91-22-6704 8049	jigneshmistry@systematixgroup.in
Sushant Chavan	Manager	+91-22-6704 8056	sushantchavan@systematixgroup.in

DISCLOSURES/APPENDIX**I. ANALYST CERTIFICATION**

I, **Dhananjay Sinha Purvi Mundhra**, hereby certify that (1) views expressed in this research report accurately reflect my/our personal views about any or all of the subject securities or issuers referred to in this research report, (2) no part of my/our compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this research report by **Systematix Shares and Stocks (India) Limited (SSSIL)** or its group/associate companies, (3) reasonable care is taken to achieve and maintain independence and objectivity in making any recommendations.

Disclosure of Interest Statement	Update
Analyst holding in the stock	No
Served as an officer, director or employee	No

II. ISSUER SPECIFIC REGULATORY DISCLOSURES, unless specifically mentioned in point no. 9 below:

- The research analyst(s), SSSIL, associates or relatives do not have any financial interest in the company(ies) covered in this report.
- The research analyst(s), SSSIL, associates or relatives collectively do not hold more than 1% of the securities of the company(ies) covered in this report as of the end of the month immediately preceding the distribution of the research report.
- The research analyst(s), SSSIL, associates or relatives did not have any other material conflict of interest at the time of publication of this research report.
- The research analyst, SSSIL and its associates have not received compensation for investment banking or merchant banking or brokerage services or any other products or services from the company(ies) covered in this report in the past twelve months.
- The research analyst, SSSIL or its associates have not managed or co-managed a private or public offering of securities for the company(ies) covered in this report in the previous twelve months.
- SSSIL or its associates have not received compensation or other benefits from the company(ies) covered in this report or from any third party in connection with this research report.
- The research analyst has not served as an officer, director or employee of the company(ies) covered in this research report.
- The research analyst and SSSIL have not been engaged in market making activity for the company(ies) covered in this research report.
- Details of SSSIL, research analyst and its associates pertaining to the companies covered in this research report:

Sr. No.	Particulars	Yes / No.
1	Whether compensation was received from the company(ies) covered in the research report in the past 12 months for investment banking transaction by SSSIL.	No
2	Whether research analyst, SSSIL or its associates and relatives collectively hold more than 1% of the company(ies) covered in the research report.	No
3	Whether compensation has been received by SSSIL or its associates from the company(ies) covered in the research report.	No
4	Whether SSSIL or its affiliates have managed or co-managed a private or public offering of securities for the company(ies) covered in the research report in the previous twelve months.	No
5	Whether research analyst, SSSIL or associates have received compensation for investment banking or merchant banking or brokerage services or any other products or services from the company(ies) covered in the research report in the last twelve months.	No

- There is no material disciplinary action taken by any regulatory authority that impacts the equity research analysis activities.

STOCK RATINGS

BUY (B): The stock's total return is expected to exceed 15% over the next 12 months.

HOLD (H): The stock's total return is expected to be within -15% to +15% over the next 12 months.

SELL (S): The stock's total return is expected to give negative returns of more than 15% over the next 12 months.

NOT RATED (NR): The analyst has no recommendation on the stock under review.

INDUSTRY VIEWS

ATTRACTIVE (AT): Fundamentals/valuations of the sector are expected to be attractive over the next 12-18 months.

NEUTRAL (NL): Fundamentals/valuations of the sector are expected to neither improve nor deteriorate over the next 12-18 months.

CAUTIOUS (CS): Fundamentals/valuations of the sector are expected to deteriorate over the next 12-18 months.

III. DISCLAIMER

The information and opinions contained herein have been compiled or arrived at based on the information obtained in good faith from sources believed to be reliable. Such information has not been independently verified and no guaranty, representation of warranty, express or implied, is made as to its accuracy completeness or correctness.

This document is for information purposes only. This report is based on information that we consider reliable; we do not represent that it is accurate or complete and one should exercise due caution while acting on it. Description of any company(ies) or its/their securities mentioned herein are not complete and this document is not and should not be construed as an offer or solicitation of an offer to buy or sell any securities or other financial instruments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. All opinions, projections and estimates constitute the judgment of the author as on the date of the report and these, plus any other information contained in the report, are subject to change without notice. Prices and availability of financial instruments are also subject to change without notice. This report is intended for distribution to institutional investors.

This report is not directed to or intended for display, downloading, printing, reproducing or for distribution to or use by, any person or entity that is a citizen or resident or located in any locality, state, country or other jurisdiction where such distribution, publication, reproduction, availability or use would be contrary to law or regulation or what would subject to SSSIL or its affiliates to any registration or licensing requirement within such jurisdiction. If this report is inadvertently sent or has reached any individual in such country, especially USA, the same may be ignored and brought to the attention of the sender. Neither this document nor any copy of it may be taken or transmitted into the United States (to U.S. persons), Canada, or Japan or distributed, directly or indirectly, in the United States or Canada or distributed or redistributed in Japan or to any resident thereof. Any unauthorized use, duplication, redistribution

or disclosure of this report including, but not limited to, redistribution by electronic mail, posting of the report on a website or page, and/or providing to a third party a link, is prohibited by law and will result in prosecution. The information contained in the report is intended solely for the recipient and may not be further distributed by the recipient to any third party.

SSSIL generally prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, SSSIL generally prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that they cover. Our salespeople, traders, and other professionals or affiliates may provide oral or written market commentary or trading strategies to our clients that reflect opinions that are contrary to the opinions expressed herein. Our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. The views expressed in this research report reflect the personal views of the analyst(s) about the subject securities or issues and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations and views expressed by research analyst(s) in this report. The compensation of the analyst who prepared this document is determined exclusively by SSSIL; however, compensation may relate to the revenues of the Systematix Group as a whole, of which investment banking, sales and trading are a part. Research analysts and sales persons of SSSIL may provide important inputs to its affiliated company(ies).

Foreign currencies denominated securities, wherever mentioned, are subject to exchange rate fluctuations which could have an adverse effect on their value or price or the income derived from them. In addition, investors in securities such as ADRs, the values of which are influenced by foreign currencies, effectively assume currency risk. SSSIL, its directors, analysts or employees do not take any responsibility, financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on the basis of this report including but not restricted to fluctuation in the prices of shares and bonds, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, etc.

SSSIL and its affiliates, officers, directors, and employees subject to the information given in the disclosures may: (a) from time to time, have long or short positions in, and buy or sell, the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation (financial interest) or act as a market maker in the financial instruments of the company (ies) discussed herein or act as advisor or lender / borrower to such company (ies) or have other potential material conflict of interest with respect to any recommendation and related information and opinions. The views expressed are those of the analyst and the company may or may not subscribe to the views expressed therein.

SSSIL, its affiliates and any third party involved in, or related to, computing or compiling the information hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any of this information. Without limiting any of the foregoing, in no event shall SSSIL, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind. The company accepts no liability whatsoever for the actions of third parties. The report may provide the addresses of, or contain hyperlinks to, websites. Except to the extent to which the report refers to website material of the company, the company has not reviewed the linked site. Accessing such website or following such link through the report or the website of the company shall be at your own risk and the company shall have no liability arising out of, or in connection with, any such referenced website.

SSSIL will not be liable for any delay or any other interruption which may occur in presenting the data due to any technical glitch to present the data. In no event shall SSSIL be liable for any damages, including without limitation, direct or indirect, special, incidental, or consequential damages, losses or expenses arising in connection with the data presented by SSSIL through this presentation.

SSSIL or any of its other group companies or associates will not be responsible for any decisions taken on the basis of this report. Investors are advised to consult their investment and tax consultants before taking any investment decisions based on this report.



Systematix Shares and Stocks (India) Limited:

Registered and Corporate address: The Capital, A-wing, No. 603 – 606, 6th Floor, Plot No. C-70, G Block, Bandra Kurla Complex, Bandra (East), Mumbai – 400 051

CIN - U65993MH1995PLC268414 | BSE SEBI Reg. No.: INZ000171134 (Member Code: 182) | NSE SEBI Reg. No.: INZ000171134 (Member Code: 11327) | MCX SEBI Reg. No.: INZ000171134 (Member Code: 56625) | NCDEX SEBI Reg. No.: INZ000171134 (Member Code: 1281) | Depository Participant SEBI Reg. No.: IN-DP-480-2020 (DP Id: 34600) | PMS SEBI Reg. No.: INP000002692 | Research Analyst SEBI Reg. No.: INH200000840 | Investment Advisor SEBI Reg. No.: INA000010414 | AMFI : ARN - 64917