IDFC FIRST Bank

Wealth Management
Investment Strategy Note

July 2024

IDFC FIRST Bank

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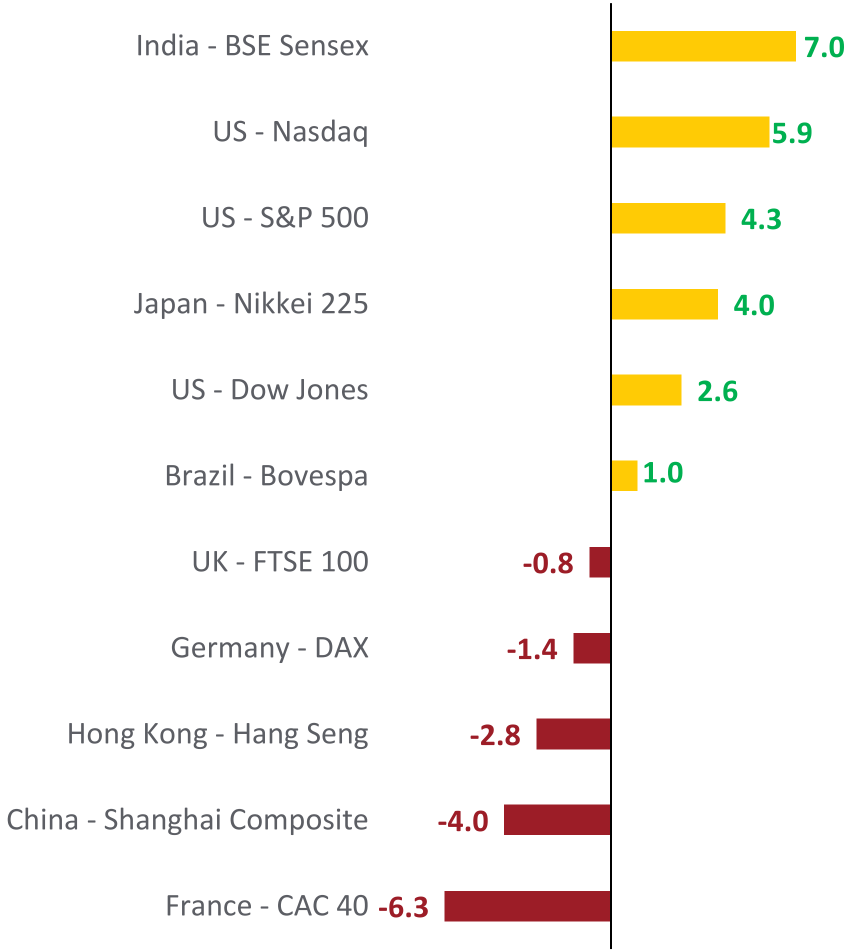
Global Update

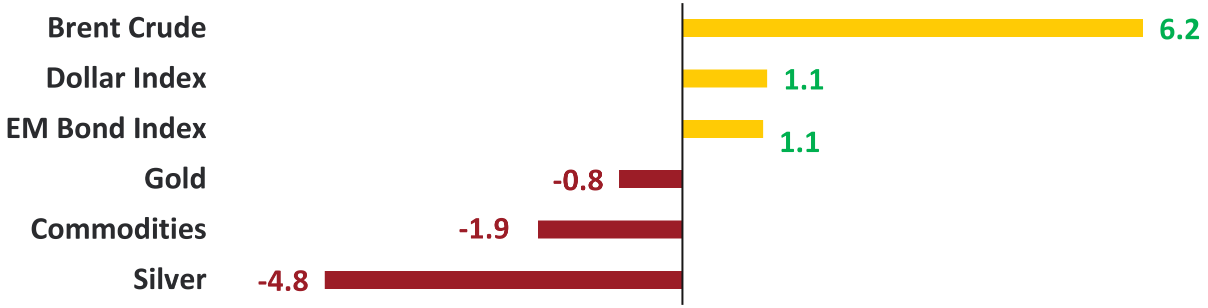
IDFC FIRST Bank

Indian Equities Make A Smart Comeback In June; Precious Metals Fell Amidst Stronger Dollar

Performance - June 2024



Other Asset Classes Performance (%) - 1 Month



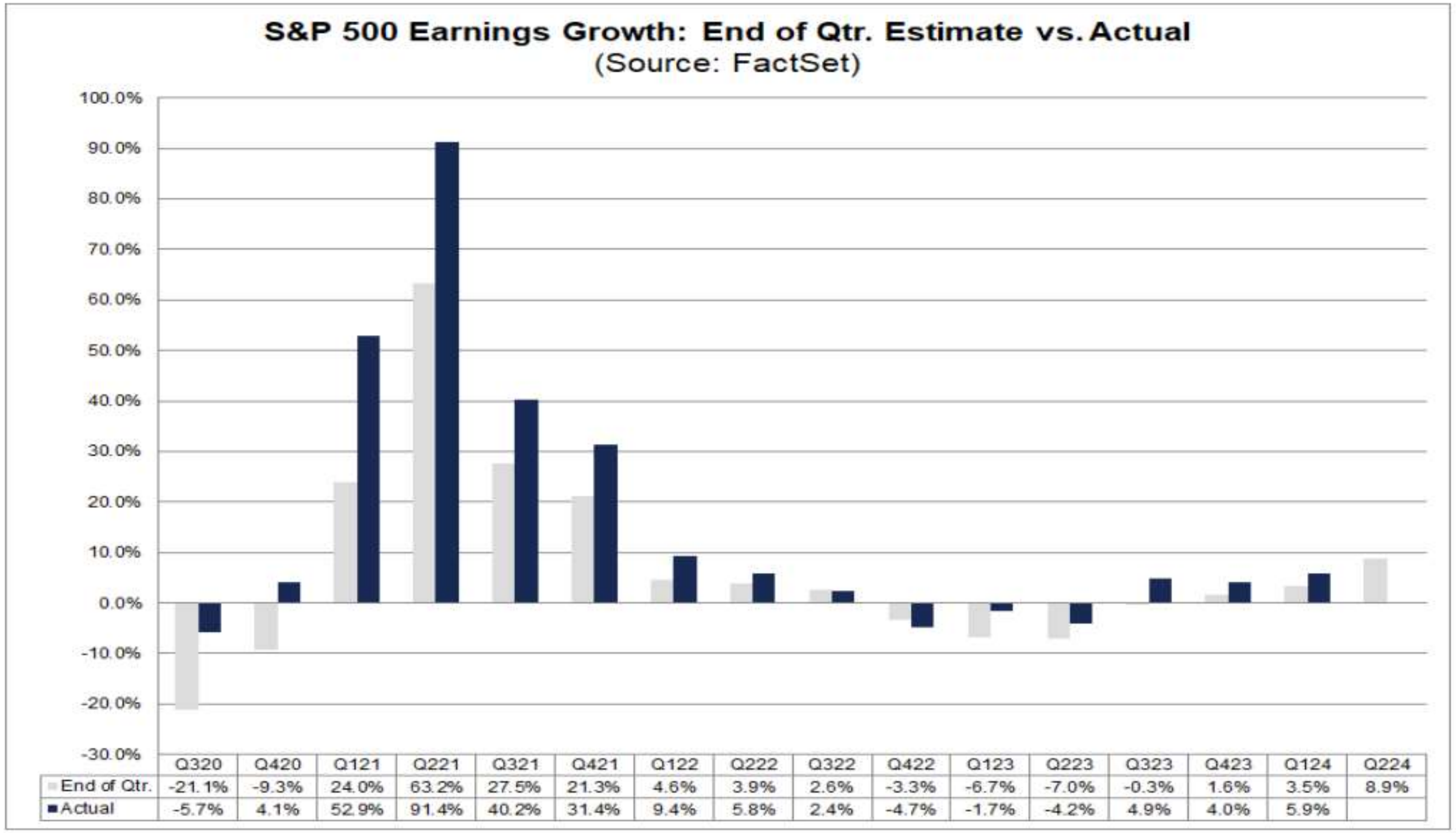
- **U.S.** – US stocks, especially tech stocks, surged to all-time highs. AI-exposed companies led the way with strong earnings. However, smaller rate-sensitive stocks and REITs faced challenges due to the prolonged higher interest rate environment

- **Japan** – Japanese equities saw gains driven by factors such as semiconductor stocks rebound, dividend reinvestment, the weak yen and positive sentiment regarding the performance of US equities

- **Hong Kong** – Stocks fell after official data showed China's imports slowed underscoring challenges to revive domestic demand. Inflation data signalled weak demand. Slowdown in industrial profits for Chinese companies, added concerns about corporate performance

***Source**: ACE MF, Investing.com. Data as on 30th June 2024.*

U.S. Q2CY24 Earnings Update



	Q320	Q420	Q121	Q221	Q321	Q421	Q122	Q222	Q322	Q422	Q123	Q223	Q323	Q423	Q124	Q224
End of Qtr.	-21.1%	-9.3%	24.0%	63.2%	27.5%	21.3%	4.6%	3.9%	2.6%	-3.3%	-6.7%	-7.0%	-0.3%	1.6%	3.5%	8.9%
Actual	-5.7%	4.1%	52.9%	91.4%	40.2%	31.4%	9.4%	5.8%	2.4%	-4.7%	-1.7%	-4.2%	4.9%	4.0%	5.9%	

Factset as on 30 June 2024

- **Earnings Scorecard:** For Q2 2024 (with **5% of S&P 500 companies reporting actual results**), 81% of S&P 500 companies have reported a positive EPS surprise and 56% of S&P 500 companies have reported a positive revenue surprise

- **The blended earnings growth rate for the second quarter is 9.3% (July 12)** compared to an earnings growth rate of 8.9% at the end of the second quarter (June 30)

- The **upward revisions to EPS estimates and positive EPS surprise reported by JPMorgan Chase**, partially offset by downward revisions to EPS estimates for companies in the Energy sector

- **Nine of the eleven sectors are reporting (or are projected to report) YoY growth.** Four of these eight sectors are reporting (or are predicted to report) **double-digit growth: Communication Services, Information Technology, Heath Care, and Financials.** Two sectors are reporting (or are predicted to report) a YoY decline in earnings, led by the Materials sector

- **Valuation:** The forward 12-month P/E ratio for the S&P 500 is 21.4. This P/E ratio is above the 5-year average (19.3) and above the 10-year average (17.9)

***Source**: Factset as on 12 July 2024*

Global Winners And Losers : The Benefits Of Diversification

Right asset allocation and diversification is a WIN-WIN situation in all market conditions

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	YTD 2024
Indian Equity	38.9	0.4	5.2	37.6	-1.8	9	18.4	31.6	4.8	26.5	16.7
US Equity	15.2	5.5	15.4	14.2	3.9	34.2	23.8	28	-10.3	27.2	14.3
Gold	0.5	-6.2	11.4	6.9	7	21.5	27.4	-1.8	11.1	14.1	13.2
Developed Markets Equity	7.8	4.7	11.4	15.8	-0.3	31	19	23.2	-8.6	24.3	11.4
Emerging Markets Equity	1.3	-9.1	14.2	27.9	-5	21.2	21.6	1.7	-8.7	12.6	7.9
India Fixed Income	17.5	7.4	15.6	2.4	8.3	11.8	13	2.2	2.6	7.8	6.5
European Equity	-4.7	3.6	3.4	19.4	-6.7	28.5	9.1	18.7	-8.4	21.1	6.4

Gold – In 2024, gold continued to perform due to continued central banks buying and surrounding geopolitical tensions. In July, the Federal Reserve's moderately dovish tone suggests a potential easing cycle later this year, which bodes well for gold.

Global markets – In 2024, the US stock market led returns, primarily driven by large-cap companies. AI-exposed firms continued to outperform.

India Equities – India stands out as a bright spot, showing strong economic growth driven by robust domestic demand and a thriving tech sector. Political continuity at Centre ensures continuity of reforms.

India Fixed Income – Returns in fixed income were primarily influenced by the central bank's "higher for longer" stance. The inclusion of the JP Morgan bond index and anticipated flows further support the Indian fixed income market.

__Source__: Morningstar Direct, in INR terms, *YTD till 30th June 2024. Performance of Indian Equities is represented by S&P BSE 500 TR Index, of Developed Market Equities by Morningstar Developed Market Index , of Emerging Market Equities by Morningstar Emerging Market Index, of U.S. Equities by Morningstar U.S. Market Index, of Europe by Morningstar Europe Index, of Gold by S&P GSCI Gold Spot Index and of India Fixed-Income by CCIL All Sovereign Bond Index. This is for illustrative purposes only and not indicative of any investment.

U.S. Macro Update

GDP

- **As per third and final estimate, the U.S. economy grew at an annualized rate of 1.4% from January through March** higher than the previous estimate of 1.3%
- **The GDPNow model estimate for real GDP growth (seasonally adjusted annual rate) in the second quarter of 2024 is 1.7% on July 1,** down from 2.2% on June 28
- **The FOMC estimate with 2024 (Q4) GDP growth kept unchanged at 2.1%**

U.S. Fed

- The higher-than-expected inflation prints in Q1 2024 has not given Fed 'greater confidence' that inflation will reduce on a sustainable basis towards the 2%-target
- The Fed Dot plot was more hawkish than expected with the median forecast showing just one rate cut (25bps) in 2024 from three cuts in the March projection
- **Given current conditions, the earliest the Fed rate cut cycle could start from is September 2024**

Inflation

- PCE price index flat in May; up 2.6% on year-on-year basis
- The flat reading in the personal consumption expenditures (PCE) price index last month followed an unrevised 0.3% gain in April
- The PCE price index is one of the inflation measures tracked by the U.S. central bank for its 2% target**. Monthly inflation readings of 0.2% over time are needed to bring inflation back to target**

USD

- The dollar strengthened as U.S. business activity surged in June, suggesting that the central bank will not be in a rush to kickstart its rate-cutting cycle
- **In the near-term dollar strength is likely to persist as other DM central banks diverge from the Fed, as their growth-inflation dynamics differ from the US**

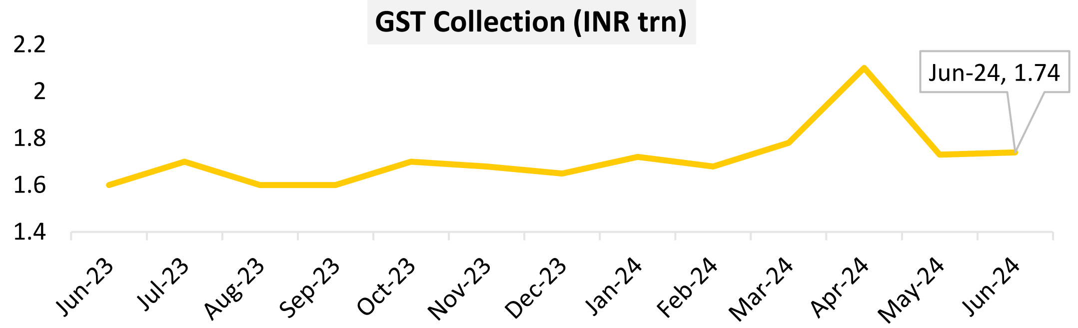
***Source**: IDFC First Bank Economic Research As on 3rd July 2024*

India Macro Update

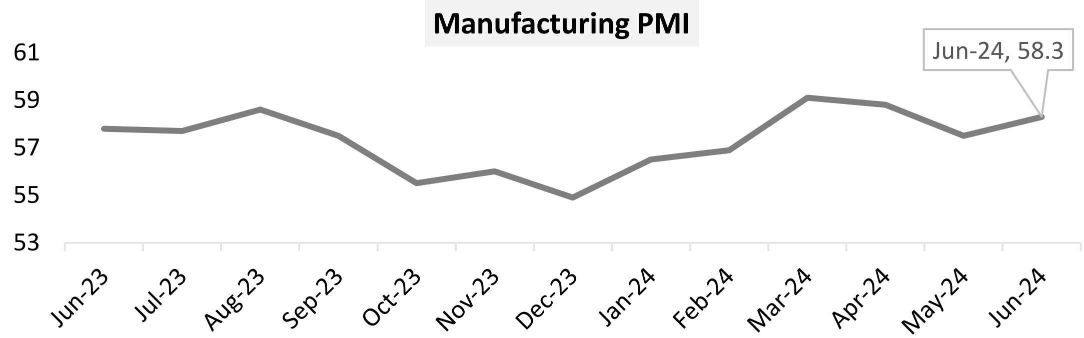
IDFC FIRST Bank

Key Macro Trends Observed

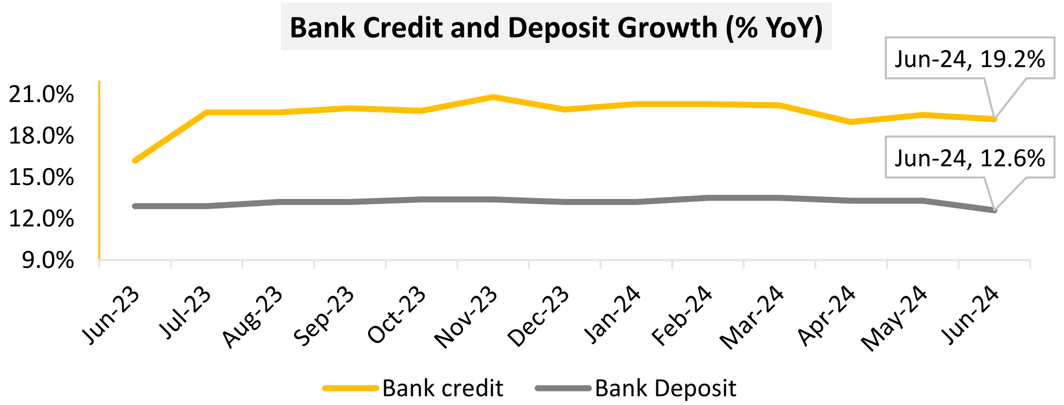
The **GST collection for June 2024 stood at Rs 1.74 trillion, marking 7.7% Y-o-Y growth**. This reinstates consistency in growth of the economy; however, it is notably less than the 12.4% and 10% increases recorded in April and May, respectively.



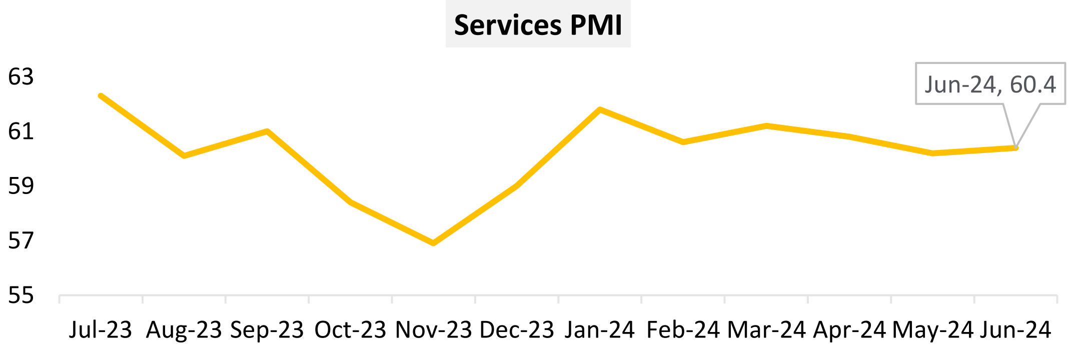
The India Manufacturing PMI increased to 58.3 in June 2024 from May's three-month low of 57.5. This indicates a faster expansion in the country's manufacturing sector due to stronger growth in output and new orders.



Credit off-take continued its upward trend, growing by 19.2% YoY to reach Rs. 167.1 lakh crore by the fortnight ending June 14, 2024. This growth is largely attributed to the impact of HDFC's merger with HDFC Bank and the increasing demand for personal loans.



The India Services PMI edged up to 60.5 in June 2024 from 60.2 in the previous month. This marked the 35th consecutive month of growth in services activity, supported by a further rise in new orders.



***Source*: RBI, GST Council, S&P Global**

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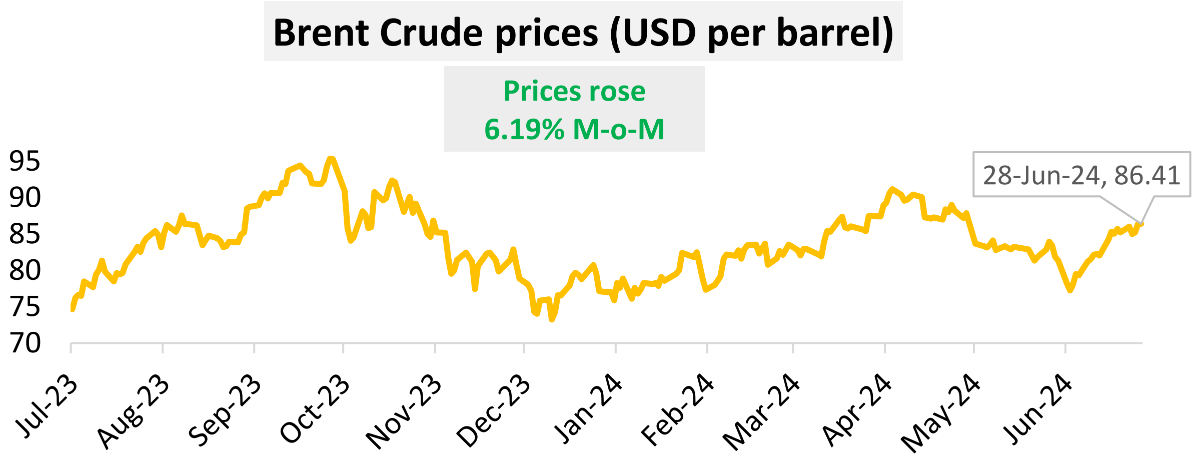
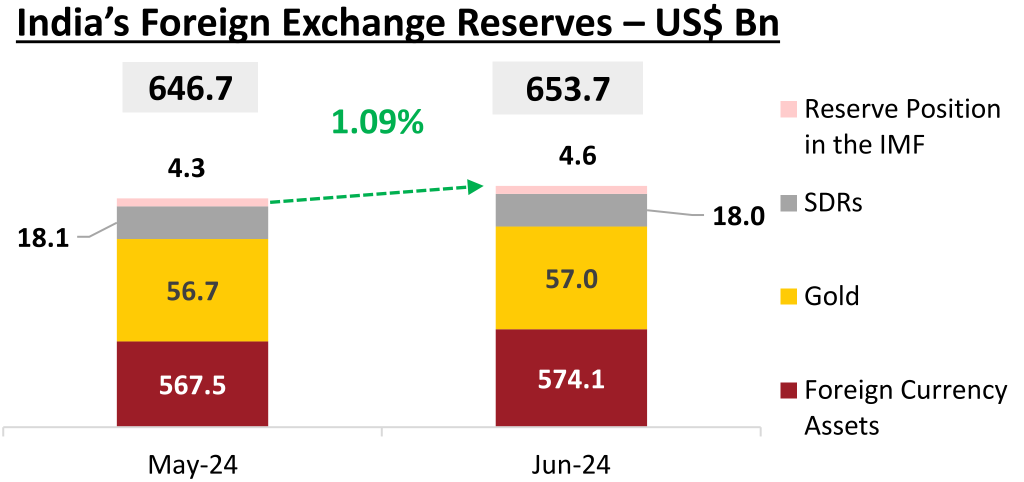
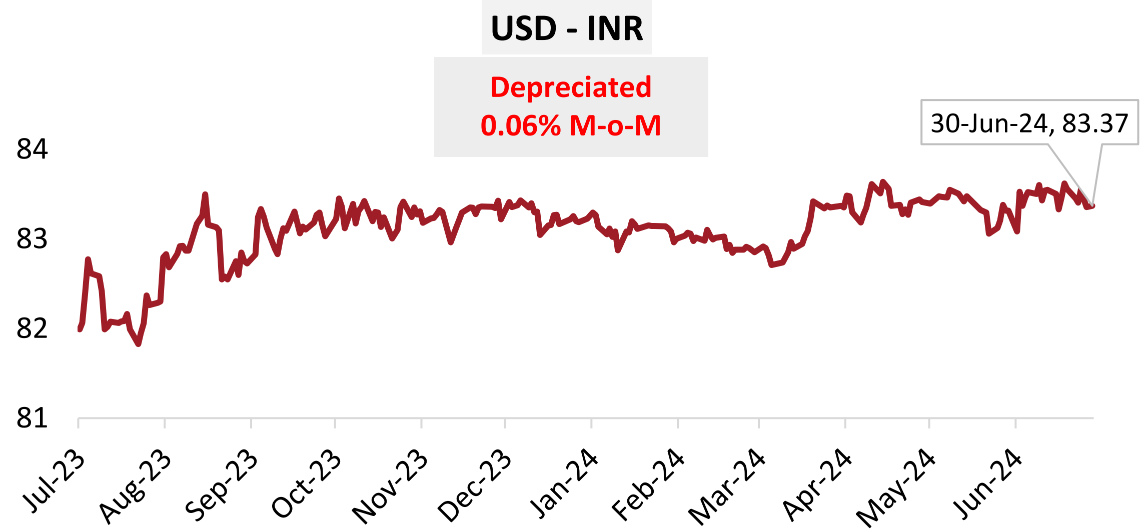
Crude Surges Due To Geopolitical Tensions And OPEC+ Extension Of Production Cuts; USD Strengthens







- **Crude Oil** – Crude rose as OPEC+ decided to extend the production cut deal. Crude further bolstered driven by conflict between Israel and Lebanon, renewed geopolitical risks as Ukraine amplified its drone attacks on Russian refineries and Yemen's Houthi militants ramped up hostilities

- **USD/INR** – Greenback gained broadly across all the currencies in the dollar index. Calls for snap elections in France also led investors to flock to the dollar, reflecting its continued safe-haven appeal. This shift in the Fed's stance from three rate cuts earlier to just one this year has led to an increase in the greenback

- **Forex Reserves** – Increased by 1.09% over the last month. Inflows by FIIs in equity and debt helped boost foreign currency assets

__Source__: Investing.com – Data as on 30th June 2024, RBI – Forex Reserves as on 21st June 2024

Domestic Macro Outlook

GDP growth

- FY25 GDP growth estimate is retained at 6.5% (with upside risk)
- **Consumption growth will be supported by rural demand** which is expected to revive, aided by better distributed monsoon
- The **support to the capex cycle from government is expected to continue**

RBI Monetary Policy

- Strong domestic growth conditions provide RBI monetary policy space to remain on hold, till there is further clarity on food inflation risks and Fed policy
- The key change was the voting pattern with two external members (Dr. Goyal and Prof. Varma) voting for 25bps cut and change in stance in June v/s one member (Prof. Varma) in April policy
- **RBI rate cut cycle is expected to start from is October (at the earliest), provided the Fed rate cut cycle starts from September**

Inflation

- CPI inflation was lower than expected at 4.75% in May 2024 v/s 4.83% in April 2024
- **Supportive base effects could result in headline inflation dipping to 3.5% in Q2FY25 and then rise to 4.6% in H2FY25**
- The outlook for inflation remains favourable with monsoon supported by development of La Nina conditions

USD-INR

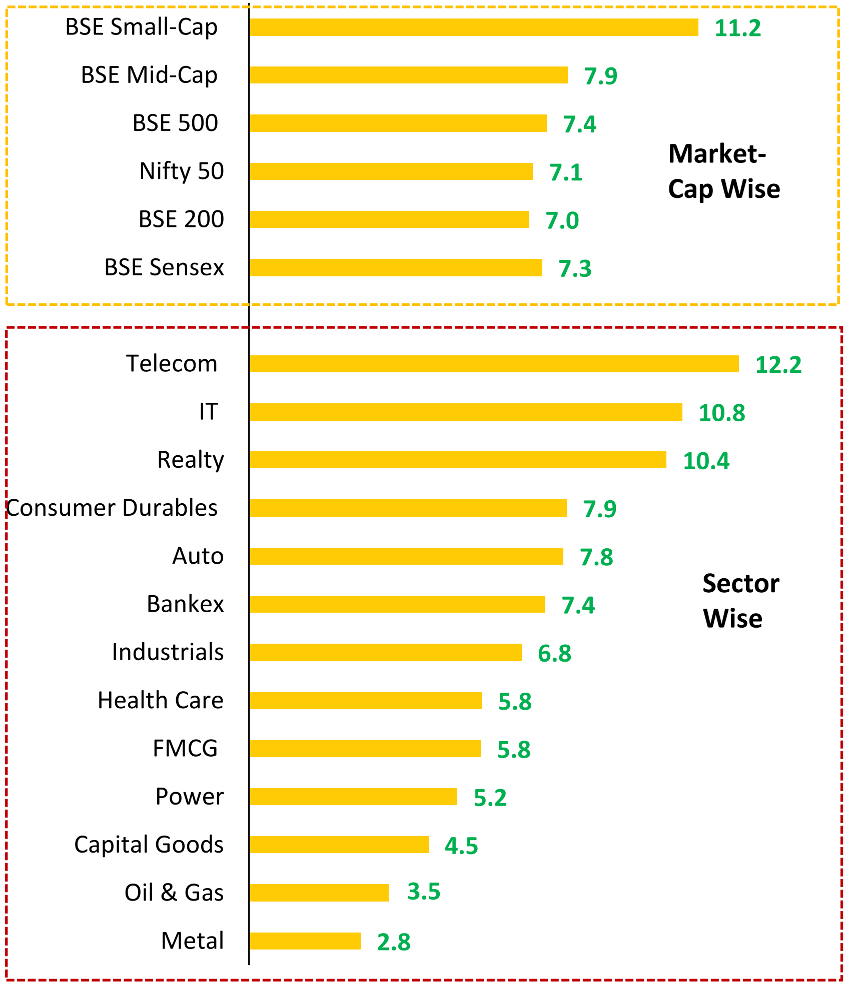
- Depreciation pressure is likely to persist on the INR in the near-term with dollar getting support from a hawkish Fed
- RBI intervention will focus on limiting USDINR volatility (on both sides)
- **USDINR H2 FY25 trading range is expected to be 83.5 to 82.5**

***Source**: IDFC FIRST Bank Economics Research As on 3rd July 2024*

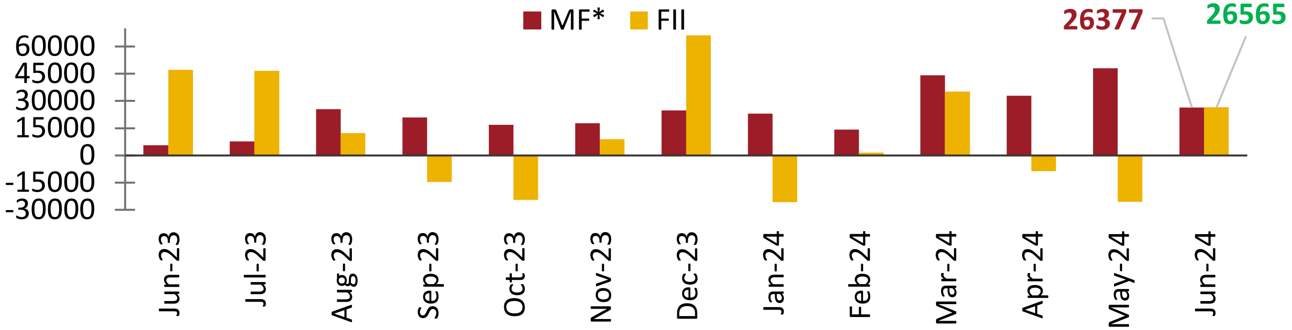
Equity Market

Market Rally: FIIs on a Post-Election Shopping Spree!

Performance (%) - June 2024



MF FII Trend (in INR Crores)



- **Benchmark Indices** – Shrugging off all worries related to elections, foreign institutional investors (FIIs) have ended up buying Indian stocks worth about Rs 26,565 crore in June - before the Union Budget and India's inclusion in JP Morgan's bond index
- **Telecom** – Telecom index grew the most by 12.2% for June 24. Tariff hikes by top telcos in FY25 are projected to significantly boost the industry's operating profit, leading to a 15% increase in blended ARPU. This increase will aid telcos in deleveraging, funding technology upgrades, and expanding networks while also improving debt levels post-June 2024 spectrum auction
- **IT** – IT stocks appear to be gaining from a weak rupee and hopes that the Fed rate cuts should bring back tech spending to normal levels
- **Realty** – Investors continue to bet on this sector as government policies continue after the same government comes into power

Source: ACE MF, TRI Returns. Data as on 30th June 2024.

FY25 Earnings : Key Sectors Expected To Drive The Growth

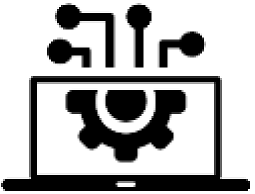
Banking

- Margins are nearing bottom, and most banks have guided NIMs to be range bound with a slight downward bias in the near term
- For 1QFY25, it is expected that NIMs will be stable with a slight downward bias for the sector. Credit quality for most banks has been robust, leading to controlled provisioning expenses
- Healthy loan growth along with benign credit costs would drive steady earnings and result in continued outperformance of the sector

Metals

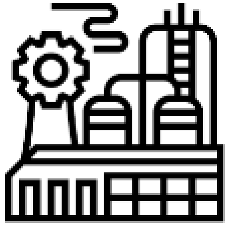
- Rise in industrial metal prices can be attributed to a combination of increased demand from growing business activity in major economies and ongoing supply disruptions due to heightened tensions in key metal-producing nations
- China's property support measures and better-than-expected industrial data have can spur momentum buying, driving base metal prices higher
- Domestic steel demand is expected to grow 8-10% in FY25 while the increase in the Indian steel prices could result in improved margins

Technology



- Demand environment has not significantly improved vs. the last quarter; discretionary spending remains under duress
- Do not expect any further draw down in discretionary projects
- Margins to remain range-bound with a positive bias; no significant wage hikes are expected, and currency movements should benefit the Indian IT services companies

Capital Goods

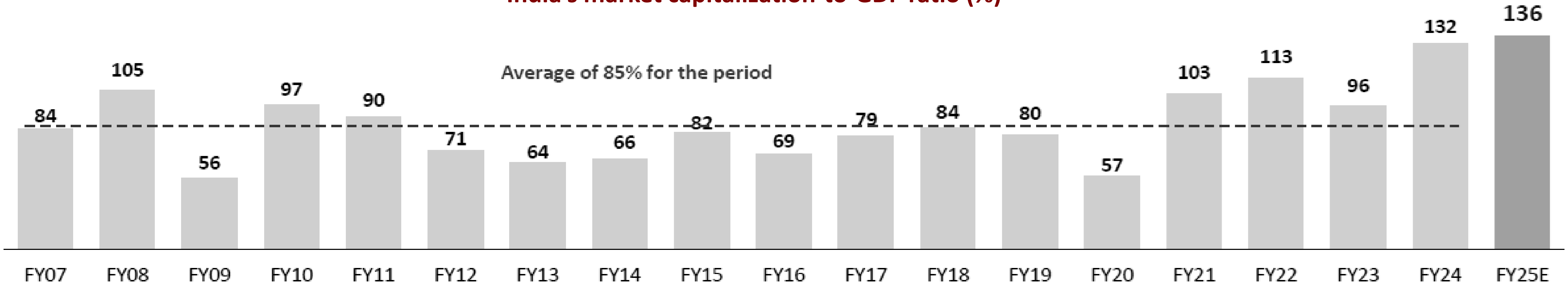


- The sector is witnessing a robust increase in order activity and further gain is likely as govt policy continuity prevails
- Moreover, companies remain confident of the long-term drivers. It is expected that the anticipation of strong capex from the central government, a resurgence in private capex, improvements in capacity utilization, higher budgetary allocation, and robust tax collections should boost the outlook of the overall sector

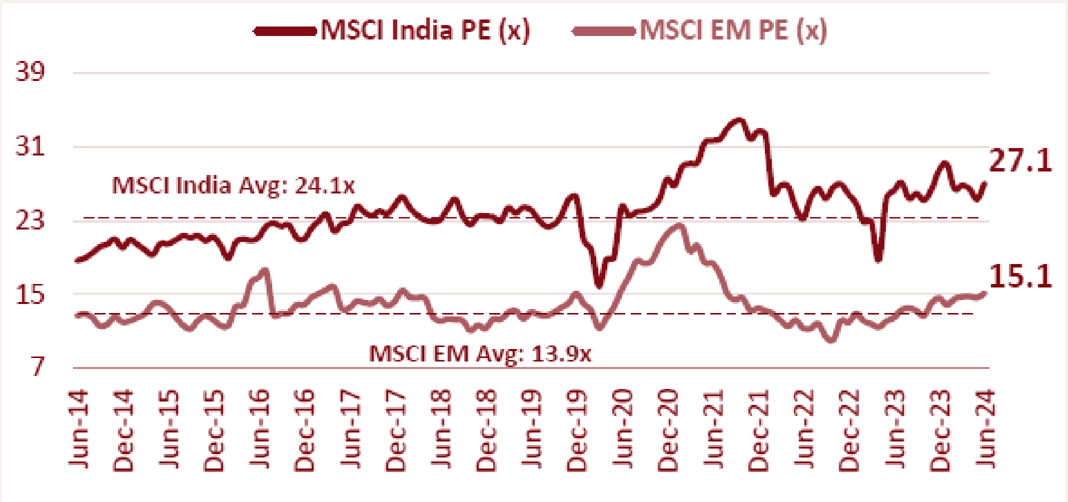
Source: Motilal Oswal

Indian Equities – Valuations (1/2)

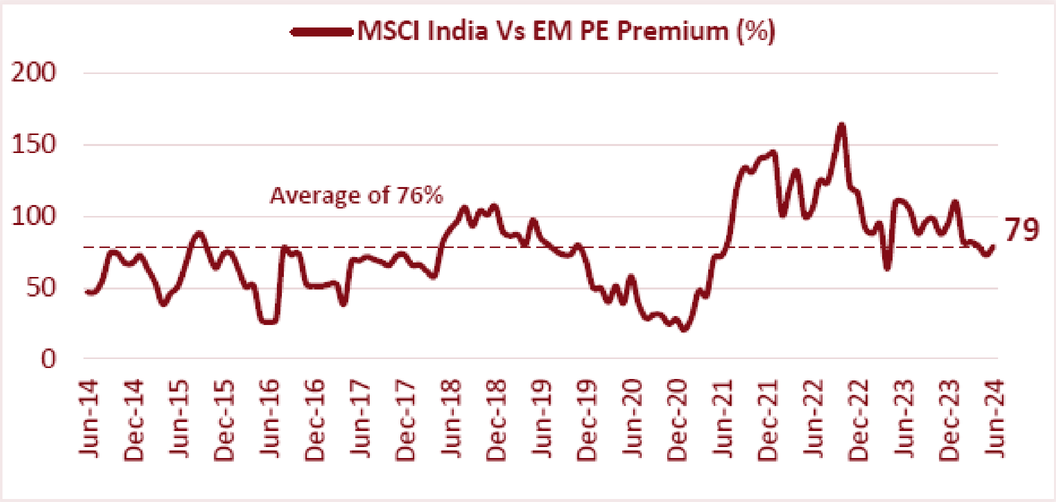
India's market capitalization-to-GDP ratio (%)



Trailing P/E ratio (x) for MSCI India vs. MSCI EM



In P/E terms, MSCI India trades at a premium (%) to MSCI EM



Source: *Motilal Oswal*

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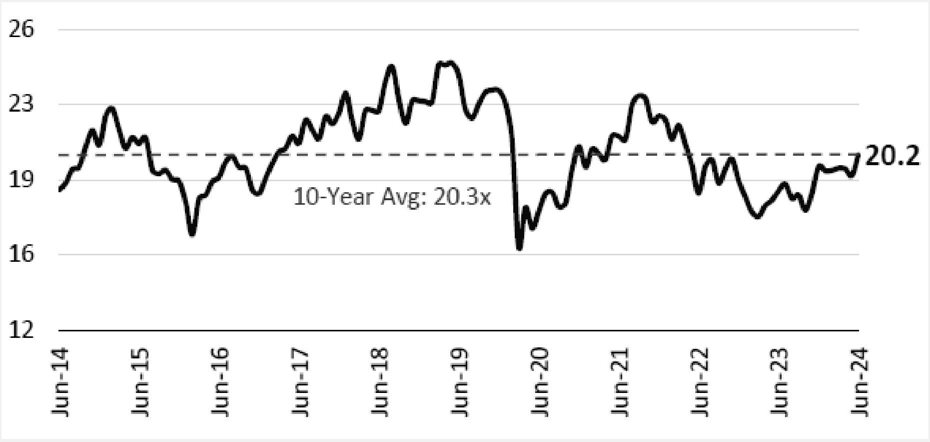
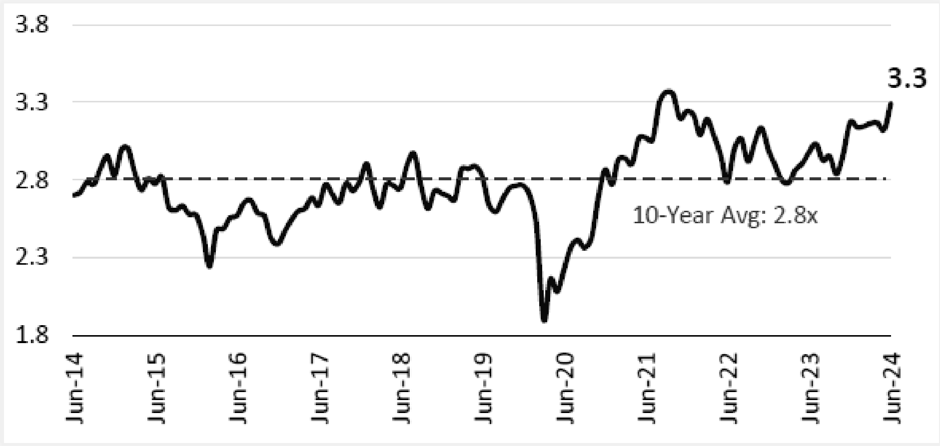
Indian Equities – Valuations (2/2)

12-month forward Nifty P/E ratio (x)

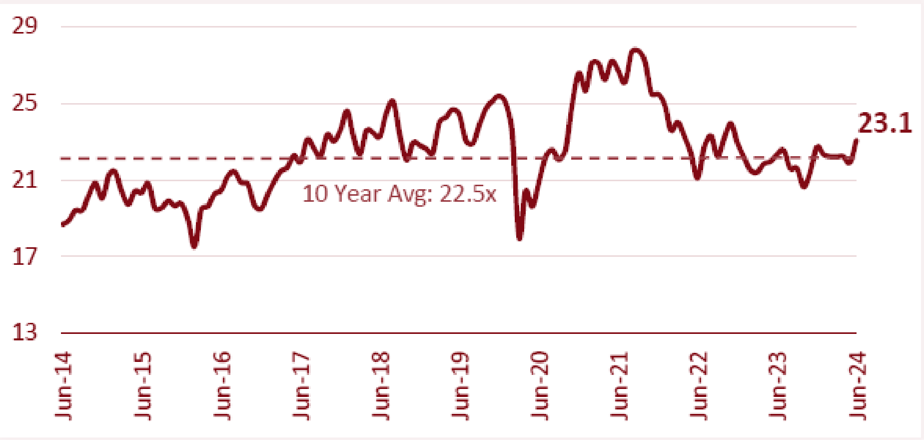


12-month forward Nifty P/B ratio (x)

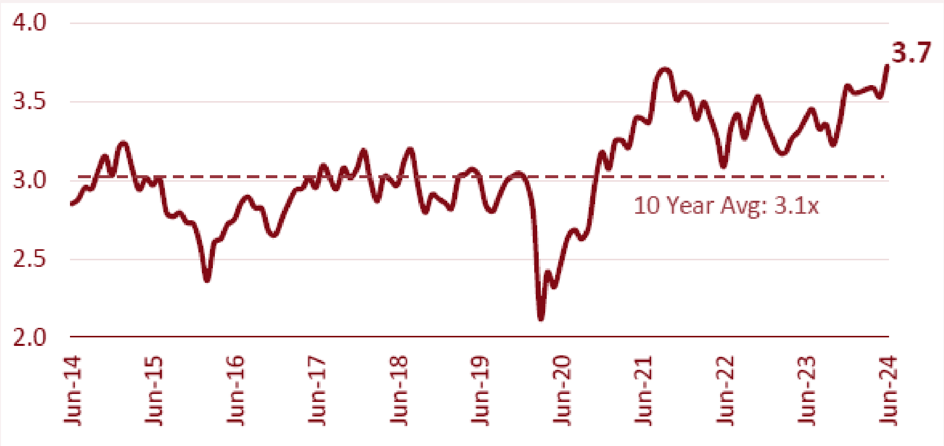


The Nifty is trading at a 12-month forward P/E ratio of 20.2x, near its LPA of 20.3x (at a 1% discount). Conversely, its P/B ratio of 3.3x represents an 18% premium to its historical average of 2.8x

Trailing Nifty P/E ratio (x)



Trailing Nifty P/B ratio (x)



The 12-month trailing P/E for the Nifty, at 23.1x, is above its LPA of 22.5x (at a 3% premium). At 3.7x, the 12-month trailing P/B ratio for the Nifty is above its historical average of 3.1x (at a 22% premium).

Equity Market Outlook

1 Valuations	Neutral	▪ Nifty's 12-month forward PE is at 20.7x vs current PE of 23x, Nifty Midcap 100's 12-month forward PE is at 32.5x vs current PE of 42.2x, Nifty Smallcap 100's 12-month forward PE is at 21.6x vs current PE of 29.7x ***(As on 1st July 2024).*** ▪ **From a Valuation perspective – Large cap is most attractive, followed by small cap and then mid cap**
2 Earnings	Neutral	▪ **High-frequency data** (GST collections, Auto monthly numbers, Power demand, PMI data, et al.) **indicates that earnings momentum will continue to remain intact going forward as well** ▪ **Nifty EPS for FY25E/FY26E also experienced upward revisions of 0.8% each to INR1,142/INR1,327. We now expect Nifty EPS to rise ~14%/16% YoY in FY25/FY26** ▪ The **Metals, Banks, and Technology sectors are projected to be the key growth drivers.** They are likely to contribute 65% to the earnings growth in FY25E
3 Volatility	Neutral	▪ **Nifty VIX ended at 13.8 (as on 1st July) as against 24.6 (as on 31st May 2024)** ▪ **Domestic and global macroeconomic data, geopolitics, crude oil prices, global yields and upcoming election results** to drive the volatility index going ahead

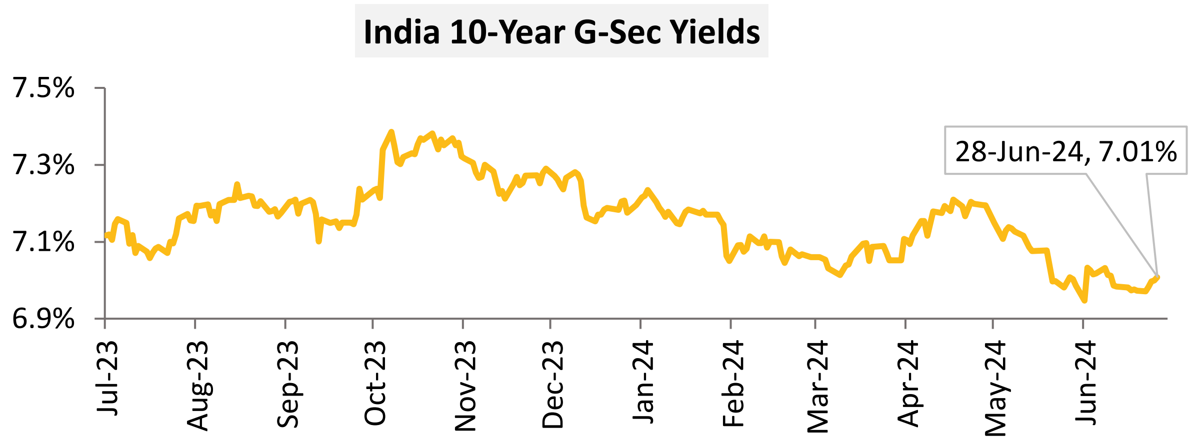
Source- Bloomberg, NSE, Motilal Oswal Commentary

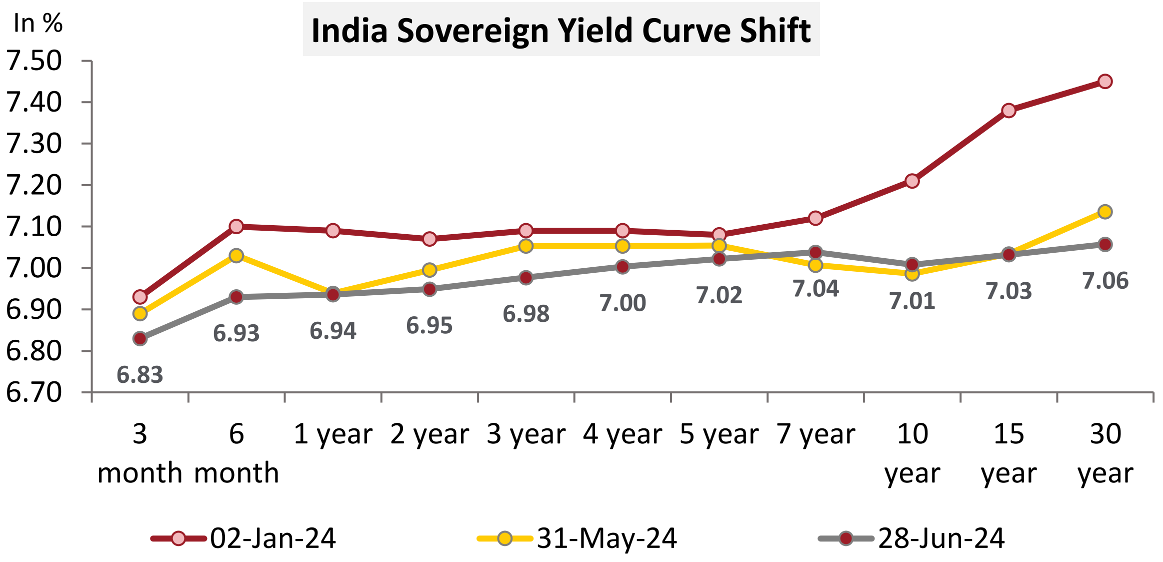
Our Equity Investment Strategy

- ‘Risk Mitigation’ of client portfolios has been our endeavor all through our journey – continued focus on end-to-end client engagement through our **VIN 2.0 process has helped us in safe-guarding client portfolios**
- While markets have touched new highs, **valuations are relatively reasonable considering both trailing and forward PE indicators in select market segments**. Amid the current uncertain environment, a large-cap tilted strategy may offer higher comfort and margin of safety vis-à-vis the broader market, while incremental allocation to equities can be staggered over a period of 3-6 months or look for incremental allocation during the upcoming events if markets provide that opportunity
- **Selective buying in diversified multi/flexi cap strategies** with blend (growth + value) investment styles is preferred
- **Select few small-cap biased strategies** aligning to pure **bottom-up, quality stock picking approaches** can also be looked at, provided the investment horizon is truly long-term
- **PMS/AIF platforms with a focus on cap-agnostic strategies** are ideal for long-term investments and strategies focusing on **domestic economy-focused themes** may be a good play there
- To mitigate market vagaries, **PE/VC funds from long-term perspective** and gaining early access in thriving themes/ sectors/companies
- A small allocation to global equities can be considered from a diversification point of view

Debt Market

Bond Yields Soften Across Major Economies; Global Index Inclusion Yet To Reflect On India G-Sec Yields





Global Bond yields (%)	30-Jun-24	31-May-24	1Y Ago
US 10 – Year	4.41	4.51	3.82
UK 10 – Year	4.18	4.32	4.39
Germany 10 – Year	2.49	2.65	2.39
Japan 10 - Year	1.06	1.08	0.40
India 10 – Year	7.01	6.99	7.11

- **U.S. Treasury yields:** Declined across the curve in June. Bond yields fell after the May CPI came in below expectations attributed to broad moderation in core services inflation
- **Euro zone:** The Bank of Canada and the European Central Bank both cut rates. The ECB cut its interest rate by 0.25% to 3.75% in its June meeting, its first cut in nearly five years. However, future decisions to be data dependent. While the Bank of England (BoE) has kept interest rates unchanged at 5.25%
- In **Japanese bond markets**, 10-year bond yield fell 2 bps to 1.06%. Prime Minister Kishida's declining approval ratings, and the Bank of Japan's decision to maintain its policy rate contributed to the volatility of the market. The yen depreciated, nearing its 34-year lows, as the BOJ was seen delaying normalizing its monetary policy
- **India 10 Yr sovereign bond** yield ended the month up 2 bps at 7.01%. Indian government bond yields largely remained flat ahead of expected inflows after domestic bonds are included in JPMorgan's emerging market debt index

__Source__: Investing.com, As on 30th June 2024

Debt Market Outlook

1 Interest Rates	Neutral	▪ In H1FY25, g-sec yields and INR is likely to remain volatile with uncertainty persisting on Fed policy outlook. We could see further upward pressure on g-sec yields and USDINR, if the Fed communication turns more hawkish ▪ The demand-supply dynamics remain favourable for g-secs, with net supply lower in FY25 (INR10.5tn in FY25 v/s INR11tn in FY24) and India's inclusion into JP Morgan EM bond index ▪ **Expectation of a shallow RBI rate cut cycle in H2FY25, will be an additional support. 10-yr g-sec yield is expected to ease towards 6.85% in H2FY25**
2 Liquidity	Neutral	▪ **Liquidity conditions eased in June 2024**, with system liquidity deficit averaging at INR0.5tn v/s deficit of INR1.45tn in May 2024. The improvement was led by higher government expenditure. ▪ **Liquidity conditions are expected to ease in H2FY25,** with BoP surplus is expected to rise, led by India's inclusion into JP Morgan EM bond index which started from June-end onwards ▪ **Majority of inflows are expected to come in H2FY25**. Other capital inflows are also expected to pick-up in H2FY25, once the Fed rate cut cycle starts
3 Credit Risk	Neutral	▪ **Spreads on offer versus additional risk taken are modest** – risk-reward doesn't favour taking credit risk via low rated category as a whole. However, selective buying can be rewarding ▪ **Markets are illiquid in low rated segment,** look at company specific opportunity

**IDFC FIRST Economics Research estimate as on 3rd July 2024*

Our Debt Investment Strategy

- Core part of portfolio in debt should be focused to **high quality investment products** –
  - **Actively managed strategies with duration upto 3 years**
  - **Long duration passively managed (roll down) strategies** to benefit from moderation in yields led by RBI rate cut cycle, moderation in inflation and favourable demand for g-sec supported by JP Morgan EM bond index inclusion
  - IDFC FIRST Bank Fixed Deposit
- Investors can selectively look at high coupon **perpetual bonds of only top-rated PSU banks (SBI, Canara, BOB) with a call option up to three to five years to earn carry return**
- **Exposure to credit opportunities can be taken via selective PMS & AIFs** with diversified holdings and investments across thoroughly researched companies
- **IDFC FIRST Bank Savings Account for tenure < 6 months** (Interest up to 7% p.a.) is still competitive with liquid funds
- **Tactical investments in select high yield NCDs and Bonds**
- **Satellite portfolio by adding duration via allocation to actively managed products - Dynamic Bond Funds/Medium to Long Duration funds/ Long Duration funds** as a tactical call to benefit from interest rate compression going ahead

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