Weekly Market update

13 December 2020

US Equities : Consolidation

- The week was a relatively quiet one on economic and financial fronts but snapped a weekly winning streak.
- Wall Street was chasing unicorns as share prices of home-sharing Airbnb and food-delivery DoorDash apps surged in their first days of trading.
- Congress passed a stopgap spending bill to avert a shutdown of the federal government. However, dampened expectations of a U.S fiscal deal and a Brexit trade deal kept sentiment lower, overshadowing lingering vaccine optimism.
- The market however has been largely focused on the prospects of a brighter outlook driven by vaccine rollouts, even as recent coronavirus trends continue to worsen and restrictions in activity are re-imposed. A predicted post-Thanksgiving surge sent hospitalizations to new highs - daily virus related U.S. deaths crossed 3,000 for the first time.
- To this point, the S&P 500 has hit 30 new all-times highs in 2020, 17 of them recorded after the late-February pandemic-induced bear market, and four of them recorded the last two weeks
- The pendulum of investor sentiment has clearly swung from fear of losses, to fear of missing out, and this could trigger near-term disappointments.

US Economy : Harsh Winter

- CPI inflation rose 0.2% in November, despite softness in food, housing and medical care. Discretionary items drove much of the increase, although many of these categories remain down year-over-year.
- Core inflation also rose 0.2%, despite the weakest print for primary shelter (shelter ex-lodging away from home) since 2010. While inflation is unlikely to meet the FOMC's criteria of "moderately above 2% for some time" (measured against the core PCE deflator), the underlying trend is expected to firm over the course of the year
- Consumer sentiment, however, has held up in early December rising to the second-highest level since March. Sentiment was likely boosted by vaccine hopes and the glimpse of a possible end to the pandemic, with both current conditions and expectations improving
- Further, an additional 853K workers, up 137K from the week prior and representing the highest weekly increase since March, filed an initial claim for unemployment insurance last week. Although job openings have improved, they remain about 5% lower than February. It's not just decreased demand for labour that continues to constrain the jobs recovery, but also supply. The labour force has fallen by a whopping 4.1M workers since February as childcare and health concerns have stopped millions from looking for jobs
- Optimism of small business owners has also recently wavered as the Small Business Optimism Index subsiding in November

FOMC : Non event

- Fed believes fiscal policy is the best way to support the economy in the face of a second wave of the pandemic, but there is a school of thought that believes the Fed should do more themselves.
- On December 16, FOMC will likely steer clear of more stimulus and ramp up its dovish rhetoric.
- Given what FOMC participants have said in public they are likely to focus on forward guidance in December linking it to the recently adopted strategy of flexible average inflation targeting .
- FOMC might make decisions on the parameters of the asset purchase programme in January, when the dust has settled in the political arena and there is more clarity on fiscal policy.
- However, if the FOMC has given up hope on Congress in recent days we may see a change.
- Yield curve will steepen further in this environment with 10Y set to test 1.5% in 2021. Should it rise swiftly, Fed may adopt the Bank of Canada’s strategy

Global Equity – Rebalancing risk

- The global wave of liquidity continues to be the headwind for Global equities – reiteration came from ECB in this week.
- At the core of the high global risk appetite that has lifted stock prices and commodities over the last few weeks is a perception that Roll-out of vaccines would spur the revival in business and consumer sentiment while trade policies could become less uncertain with Joe Biden assuming office , which would also serve as a tailwind.
- Year to date equity market top performer is S&P 500 with a gain of 14.27%. Nikkei 225 is in second with a gain of 12.22% and in third is China's Shanghai with a gain of 12.0%. Coming in last is London's FTSE 100 with a loss of 13.09%.
- With stock indices around the world scaling new records, the equity corpus of large funds has swelled disproportionately, which may force money managers to sell equity holdings in order to stick to their asset allocation mandate.
- Quarter-end rebalancing by funds may trigger $300 bln worth of selling in global equities by the end of 2020.
- Balanced mutual funds, estimated to have $7 trln in assets globally, may have to sell equities worth around $160 bln of shares to meet their target allocation of 60%,

ECB Stimulus – of no avail ?

- ECB largely delivered on expectations for additional monetary policy relief.
- ECB increased purchases under its Pandemic Emergency Purchase Program (PEPP) by €500 billion, taking the size of the PEPP to €1.85 trillion .
- It also extended the duration of those purchases through at least March 2022 and pushed the reinvestment period of maturing PEPP securities through at least the end of 2023.
- In addition, terms for the third series of TLTRO operations were recalibrated while three additional operations will now be conducted in the second half of 2021.
- But while any port in a storm will be welcome for the ailing Eurozone economy, the monetary measures are not expected to make any positive impact , mainly because Eurozone household disposable income fell 2.9% year-over-year in Q2, and was likely flat in Q3.
- There is less dry powder on the household side…

No deal Brexit ?

- Although Britain technically left the EU on Jan 31, its relationship with EU remains the same until the end of the transition
- As it stands, the Government does not have a deal and has not requested an extension of the deadline. Legally speaking another extension could happen if all EU countries, including the UK, agree to it.
- Johnson's attempts to negotiate directly with Angela Merkel and Emmanuel Macron have been rebuffed three times in a week, prompting him to warn a no-deal outcome to Brexit talks is now "very, very likely".
- Fishing has always been an emotional issue in the UK's relationship with EU -that it is one of the final outstanding issues in the post-Brexit trade talks. EU boats catch about £600m of fish in UK waters every year, and the UK wants more than half of that catch back.
- The self-destructive and humiliating consequences of Brexit are finally coming into sharp focus. The emerging picture is worse than its most pessimistic opponents feared. The consequent devastating chain reaction will touch every corner of UK.
- The ensuing downturn, as per LSE models will slash GDP by 8% over a decade.

Europe : Landmark breakthrough

- EU unlocked funds from the EUR 1.8 trillion package after reaching a compromise with Poland and Hungary.
- While the rule of law mechanism remains in place, it seems that Hungary's PM Orban and his Polish counterpart Morawiecki received sufficient reassurances and guarantees from other European leaders that this tool will not be used for political purposes and for interference in their domestic agendas.
- The compromise still ties EU disbursements from the budget and recovery package to a mechanism that insists on respect for the rule of law, but such sanctions cannot now be triggered until the European Court of Justice has ruled on the legality of the mechanism, a process that could take more than a year to complete.
- The clash over the rule-of-law scheme also revealed deepening divisions within the EU over its fundamental values, which threaten to widen in the months and years ahead.
- The draft deal still needs to be accepted by European Parliament, which is scheduled to vote on the agreement this week.

China : Robust momentum

- China is ending 2020 on a strong note economically. PMI indicators for both manufacturing and services are at high levels.
- Since China emerged from the coronavirus lockdown in June, it has regained its reputation as the world's factory
- China's exports hit an all-time monthly high in November , climbing 21.1 % y/y to USD 268.1 billion, while imports grew by 4.5 % to USD 192.7 billion in the same period. This helped to widen the trade surplus by 102.9 % to USD 75.4 billion
- With exporters scrambling to meet delivery schedules and commitments, freight rates from China have surged by 300 % since March.
- With imports in China falling way short of exports, container vessels leaving overseas ports have not been able to reach full capacity. Uneven distribution of containers at major ports around the world is causing a major headache for Chinese exporters . The question is whether the booming exports and surging shipping demand will last.
- CNY has continued to strengthen against the USD, but it is as much a story about USD weakness as CNY strength.
- Lately CNY weakened a bit against EUR and the trade weighted CNY is less than two percent above the average of the past five years

Indian Manufacturing sector

- The manufacturing sector's gross value added grew 0.6% in Jul-Sep as against a massive contraction of 39.3% in the previous quarter. But IIP used to compute the GDP–fell 6.7% over the same period. Hence the gap between manufacturing GVA and IIP growth was 7.3 percentage points.
- The divergence between IIP manufacturing and manufacturing GVA is, however, not a new trend. In fact, the gap between the two has been larger several times in the past. In Q3 of 2015-16 the difference was as large as 11.7 percentage points and 10.2 percentage points in Q2. A 9.8-percentage-point gap was recorded in both Jul-Sep 2012 and Jan-Mar 2016.
- It is perhaps not a surprise that there is a gap between the two measures as they don't capture the same data- IIP measures the volume output. Whereas GVA measures volume and any improvement in efficiency. Manufacturing GVA is sourced from the Ministry of Corporate Affairs' MCA-21 database, while IIP, which is calculated via a survey of manufacturing units registered under the Factories Act, is used as a proxy for estimating GVA of quasi-corporate and unorganized sector.
- Message : The predominant view about the manufacturing recovery might be misplaced .

Bond Market –Caught in bind

- Bond yields rose because the RBI did not announce any open market operation resulting in tweak demand at the auction
- After the auction was completed, the central bank announced a special OMO which will be conducted next week.
- Market is caught in a bind right now - RBI has become conservative in coming out with more OMOs whereas the market is faced with heavy supply and inflation
- OIS rates ended higher ahead of the inflation data on Monday on view that inflation is expected to remain elevated
- Should retail inflation come in at 7.2%, as projected, it will be the 11th time in the last one year that inflation would have remained above the RBI 's upper tolerance bound of 6.0%.
- However the base effect continued to be favourable as prices had risen sharply in November last year. (The overall index had risen 0.95% on month in November last year. Retail inflation was 5.54% in November 2019).
- Separately WPI inflation is expected to have risen to a nine-month high of 1.7% in November from 1.48% a month ago,

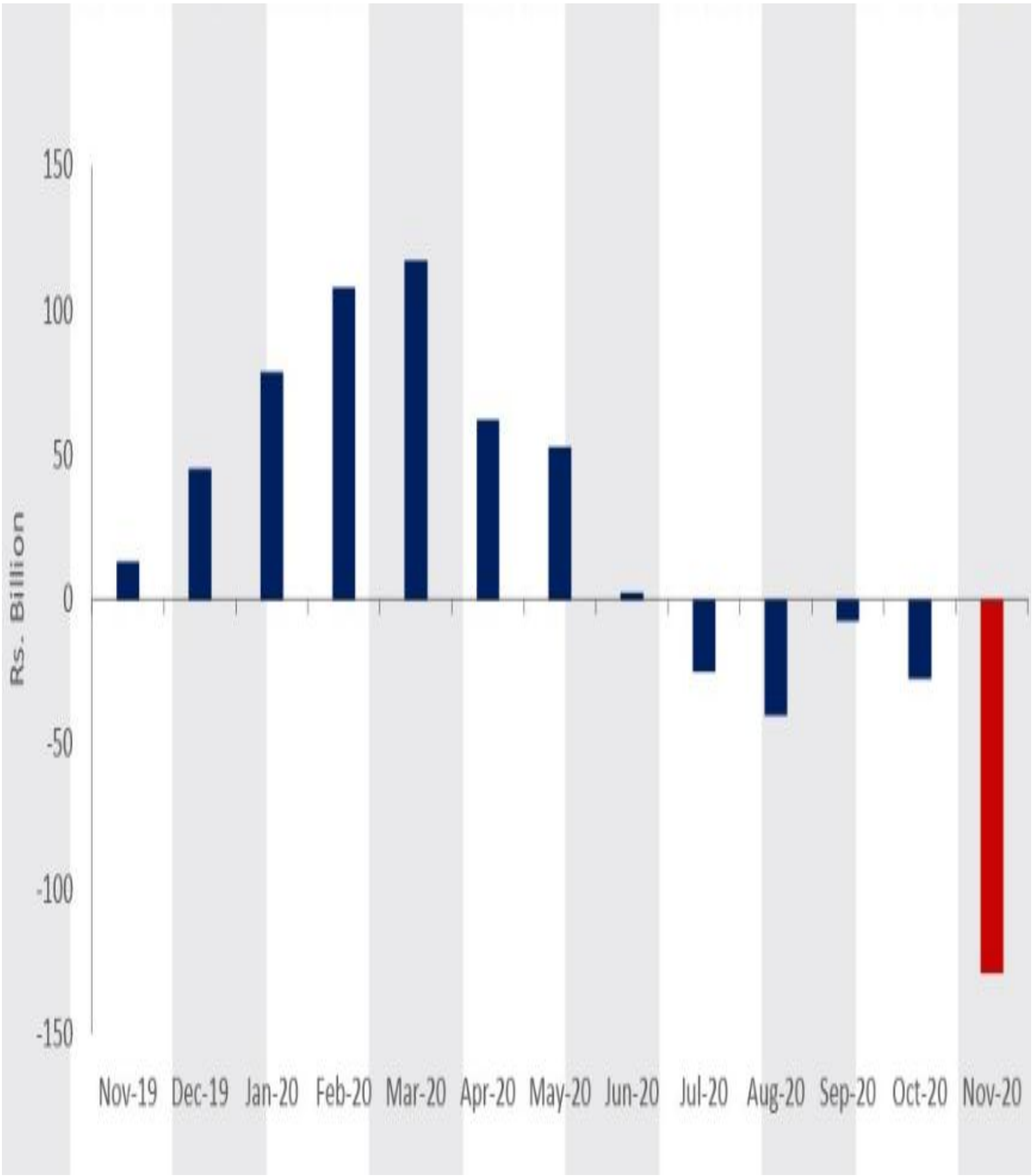
Corporate Bonds – Insipid activity

- Fundraising through corporate bonds in November declined 15% from a month ago as companies had frontloaded their borrowings for the current financial year, while overall demand is seen modest because of the ongoing economic slowdown.
- In November, companies raised 518 bln rupees by issuing 184 bonds, compared with 611 bln rupees raised through 134 bonds in October.
- Potential issuers of tier-II bonds faced setback after RBI asked Lakshmi Vilas Bank to write down Rs 3.18 bln rupees worth of such papers with loss-absorption feature. The unprecedented move is likely to hurt investor appetite for tier-II bonds and, in turn, push up borrowing costs for weaker banks.
- Moreover, the RBI's action came at a time when sentiment towards bonds issued by banks had already soured due to write-down of YES Bank's tier-I bonds in March

Indian Equity Markets

- The week further strengthened bulls with Nifty50 crossing 13500 levels for the first time in history.
- However, towards the latter half there was mild profit booking but this surely did not alter the sixth consecutive weekly gains.
- The markets continue to see contradictory stance put up by FPIs and DIIs since the past few months wherein the former has been consistently buying while the latter continues to be selling.
- Monthly equity mutual funds statistics are witnessing an outflow for the 5th straight month in November as redemptions intensified on profit-booking in spite of benchmark indices scaling lifetime highs.

Equity Mutual Fund Outflows



Nifty – Softer Undertone

- The Uptrend is too matured now and into the year end , it is likely that the Index would ideally retreat towards 12168 – Previous yearly close .
- The strong support is however seen at 12763.
- On the upside , a break past 13570 on a weekly close is seen as a negation trigger for this bearish view.

Bank Nifty- Weakness

- Bank Nifty has rallied nearly 50% from its lows it visited in the last week of September 2020 .
- An interesting observation has been spotted on the Bank Nifty–despite a rank outperformer across all other indices in the past 2 months domestically–Bank Nifty ‘failed’ to close above its March highs on a monthly closing basis which stood at 29792.
- Nifty 50 managed to do so back in October monthly closing itself.
- This opens up for a possibility of a trading-based correction on the Bank Nifty as well as it is likely to underperform the benchmark Nifty from hereon.
- Purely on the price action front–Bank Nifty could start a move downward after it closes below 28720