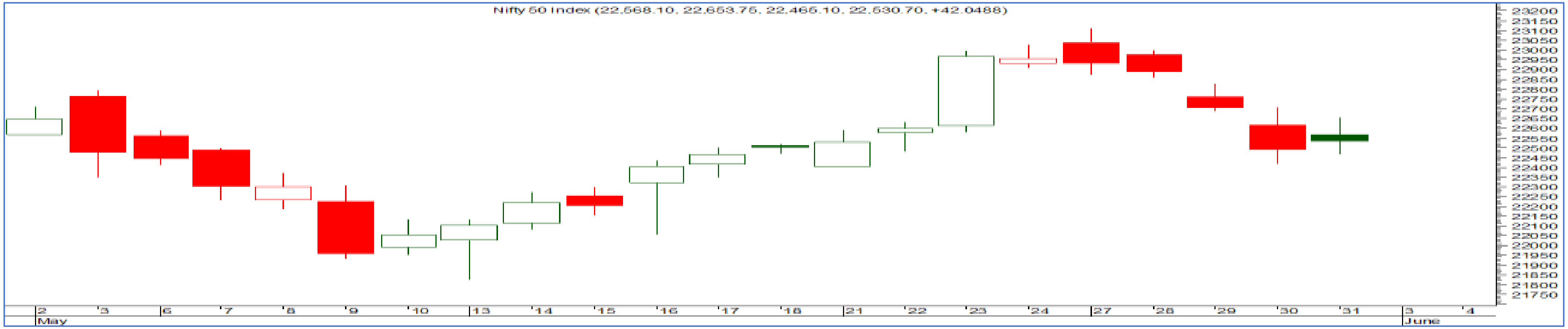
MONTHLY STRATEGY REPORT

04th June 2024

Nifty Chart for May 2024



The Month Gone By

The benchmark Nifty ended May with a decline of 0.3 per cent, snapping its three-month winning streak, amid heightened volatility. The Nifty Smallcap 100 index fell 1.85 per cent, while the Nifty Midcap 100 index managed to eke out a gain of 1.65 per cent. The Sensex ended with a loss of 0.7 per cent. However, during the month all key indices made fresh highs, propelling India's market capitalisation to $5 trillion.

Election uncertainty and the uncertain US rate cut outlook sent the India VIX soaring by 104 per cent to a two-year high of 26.2. FII selling, bounce back in the US dollar rate, hawkish US Fed fuelling treasury yields, unimpressive Q4 results 2024 season and rising India VIX Index are some of the primary reasons that dragged the Indian stock market downwards. Market sentiment was also impacted by escalating tensions in West Asia and investor anxiety ahead of general election results.

During the month, foreign portfolio investors pulled out around Rs 25,260 cr. The outflows were offset by Rs 47,666 inflows from Mutual funds. This was the 13th straight month of positive flows from Mutual funds. Since May 2023, they have pumped in Rs 2.86 trillion into domestic stocks, of which Rs 1.68 trillion have come during this calendar year.

Key Positives during the Month

- Goods & Services Tax (GST) collections during the month of May 2024 came in at Rs 1.73 lakh crore, recording a growth of 10 per cent on-year.

- India's petrol and diesel consumption broke all records in May 2024, aided by higher demand for auto fuels due to campaigning and voting in the ongoing Lok Sabha elections. Diesel usage rose by 2.4 per cent Y-o-Y and 6.3 per cent M-o-M in May to 8.4 MT, while petrol consumption was up 3 per cent Y-o-Y and 6 per cent M-o-M to 3.5 MT.

- The unemployment rate for people aged 15 years and above in urban areas declined to 6.7 per cent in the January-March period from 6.8 per cent a year ago.

- India's retail inflation slightly decreased to reach an 11-month low of 4.83 percent on an annual basis in April, compared to 4.85 percent recorded in the previous month.

- Industrial output in India rose by 4.9% on an annual basis in March 2024, slightly below market expectations of a 5.1% growth. Manufacturing output which accounts for nearly 78% of total industrial production, expanded by 5.2%.

- Total passenger vehicle sales in India grew 1.2% from a year earlier to 287,746 in April 2024, easing sharply from an 8.9% surge in the previous month.

- Domestic air passenger traffic rose by 3.88 per cent YoY to 1.32 crore in April.

- The government's fiscal deficit for 2023-24 stood at 5.63 per cent of the GDP, marginally better than the 5.8 per cent estimated in the interim Union Budget.

- India's infrastructure output in April rose 6.2% year-on-year, compared with a revised 6% growth in March. Coal production grew 7.5%, while electricity generation rose 9.4%.

- On a year-on-year (y-o-y) basis, non-food bank credit grew 15.3 per cent in April, compared to a growth of 16.2 per cent a year ago.

- The India Meteorological Department (IMD) has retained its outlook of an ‘above normal’ monsoon this year. In April, the agency had forecast June-September rainfall to be 6% above the normal of 87 cm.

- India's power consumption surged by 15% to 156.31 BU in May 2024 due to scorching heat, leading to increased use of cooling appliances. Peak power demand hit a record high of 250.07 GW, surpassing the previous peak of 243.27 GW.

- India’s gross domestic product (GDP) grew 7.8 per cent y-o-y during the January-March 2024 quarter (Q4 FY24) as compared with the 6.2 per cent growth recorded a year ago. For the full financial year 2023-24, India’s GDP growth rate stood at 8.2 per cent as against 7 per cent in FY23.

- India's eight core sectors posted a growth of 6.2 percent in April, backed by strong electricity and steel output. This growth has risen from a revised 6 percent recorded in the previous month.

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Key Negatives during the Month

- The HSBC India Manufacturing PMI came in at 57.5 in May 2024, below preliminary estimates of 58.4, and down from 58.8 in the previous month.
- The HSBC India Services PMI was revised lower to 60.8 in April 2024 from 61.7 in the preliminary estimates and after a final 61.2 a month earlier. It was the 33rd straight month of growth in services activity.
- India's wholesale prices increased by 1.26% year-on-year in April 2024, accelerating from a 0.53% rise in the previous month. Monthly, wholesale prices were up 0.79%, following a 0.40% gain in March.
- India's merchandise trade deficit was at $19.1 billion in April of 2024, widening sharply from the 11-month low of $15.6 billion in the earlier month. Imports soared by 10.3% from a year earlier to $57.28 billion in April. In the meantime, exports increased by a softer 1.1% to $34.99 billion.

Sector Moves/G-Sec Yield Moves Over the Month

BSE Indices	May-24	Apr-24	% chg
Sensex	73,961	74,483	-0.7
Smallcap	47,264	47,316	-0.1
Midcap	42,853	42,121	1.7
500	33,344	33,143	0.6
200	10,432	10,369	0.6
100	23,771	23,760	0.0
Auto	53,026	51,066	3.8
Bankex	55,772	55,998	-0.4
Capital Goods	70,056	63,025	11.2
Consumer Durables	54,915	55,198	-0.5
FMCG	19,529	19,612	-0.4

BSE Indices	May-24	Apr-24	% chg
Healthcare	34,890	35,406	-1.5
IT	33,199	34,095	-2.6
Metal	32,713	31,251	4.7
Oil & Gas	28,640	28,981	-1.2
Power	7,699	7,220	6.6
PSU	20,888	20,098	3.9
Realty	7,980	7,643	4.4
TECK	15,674	15,802	-0.8
G Sec Bond Yields	6.98	7.19	-20bps
Nifty	22,531	22,605	-0.3

Global Markets

Indices	May-24	Apr-24	%Chg
US - Dow Jones	38,686	37,816	2.3
US - Nasdaq	16,735	15,658	6.9
UK - FTSE	8,275	8,144	1.6
Singapore - Strait Times	3,337	3,293	1.3
Japan - Nikkei	38,496	38,406	0.2
Indonesia - Jakarta Composite	6,971	7,257	-3.9
India - Sensex	73,961	74,483	-0.7
India - Nifty	22,531	22,605	-0.3
Hong Kong – Hang Seng	18,080	17,763	1.8
Germany - DAX	18,498	17,922	3.2
Chinese - Shanghai composite	3,087	3,105	-0.6
Brazil - Bovespa	122,098	125,924	-3.0

- World markets ended the month of May on a mixed note. US - Nasdaq, Germany - DAX, US - Dow Jones, Hong Kong – Hang Seng, UK – FTSE, Singapore - Strait Times and Japan – Nikkei were up by 6.9%, 3.2%, 2.3%, 1.8%, 1.6%, 1.3% and 0.2%, respectively during the month while, Indonesia - Jakarta Composite, Brazil - Bovespa, India - Sensex, Chinese - Shanghai composite and India - Nifty were down by 3.9%, 3.0%,0.7%, 0.6% and 0.3% each respectively.

- U.S. stocks ended mostly higher with all three major stock indexes posting monthly gains. In May, the S&P 500 rose 4.8% for its best month since February while the technology-heavy Nasdaq climbed 6.9% for its biggest monthly gain since November. The Dow rose 2.3% in May for its strongest monthly performance since December as investors wrapped up a strong month after the Federal Reserve's preferred inflation measure came in largely around expectations. A slew of economic data pointed to a cooling U.S. labor market, raising expectations that the Fed will cut borrowing costs more than once this year. In May, companies shattered records with a surge in stock buybacks, suggesting strong corporate confidence in future earnings. A total of 154 companies announced $201 billion in planned buybacks, marking an all-time high.

- European shares rose after softer U.S. inflation data spurred hopes of interest rates cuts by the Federal Reserve, while June rate cut bets for the euro zone remained intact despite hotter than expected inflation figures from the region. Adding to the positive market sentiment, the UK announced that its economy grew by 0.6% in the first quarter of 2024, surpassing the anticipated 0.4% and effectively pulling out of a recession that began in the latter half of the previous year.

- Hang Seng Index advanced by 1.8% for the month. The better-than-expected manufacturing PMI numbers from China contributed to the gains. Hong Kong stocks rallied after data showed China's industrial profits resumed growth in April, marking a recovery following the biggest weekly loss since January. The Index gained after the securities regulator tightened rules on stake reductions by major shareholders.

- London's FTSE 100 hit yet another record high as investors cheered the dovish tone of the Bank of England, while the British economy grew better-than-expected in the first quarter this year. The Bank of England left interest rates unchanged at 5.25% but implied that a rate cut was coming soon, possibly by June.

- Japan's Nikkei rose to finish at more than a one-month high as technology stocks rallied after U.S. peer Nvidia's earnings delivered on sky-high expectations. The Index saw a slight increase despite caution over potential monetary tightening from the Bank of Japan.

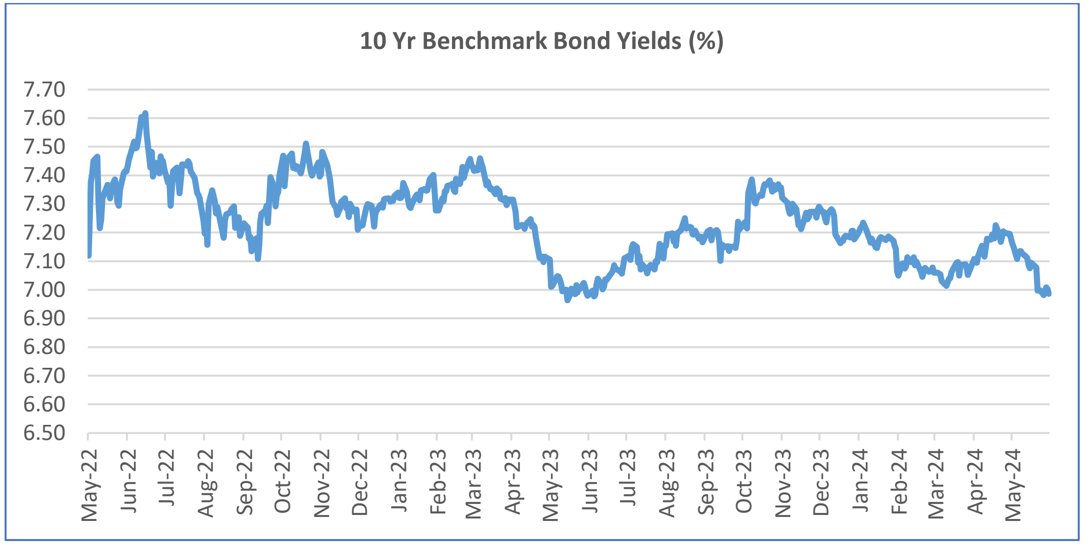
- The geopolitical tensions in the Middle East have significantly impacted the Indonesian stock market (IDX), causing the Jakarta Composite Index to decline. The index fell 3.9% in May. The Middle East factor has caused a market crash, affecting not only mediocre stocks but also large-cap stocks that support the index across sectors such as banking, energy, manufacturing, and telecommunications. The Index slumped with foreign investors exiting risky assets after parliamentary election results signalled possible formation of a weak government that will have limited ability to push for reforms needed to boost investments in the Southeast Asia's largest economy.

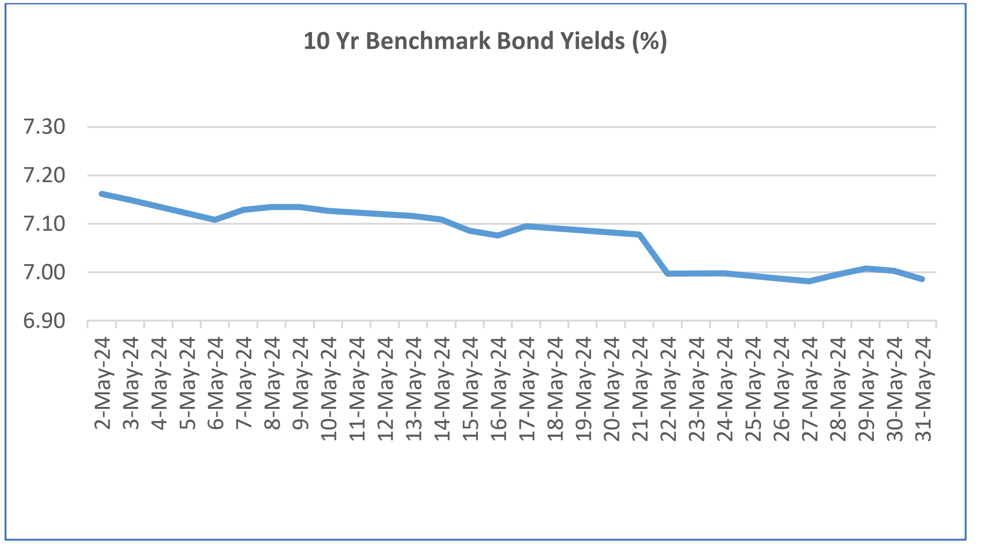
- Brazil's markets fell after the central bank cut rates in a split decision that saw appointees of the current government advocating for a larger reduction, sparking concerns of a forthcoming dovish monetary policy influenced by politics.

- Mainland China's market finished lower amid signs of escalations in Sino-U.S. trade tensions after U.S. President Joe Biden's decision to levy fresh tariffs on Chinese goods. Index saw selloff after the Washington moved to increase levies on a range of Chinese imports, triggering a pledge from Beijing it would take necessary action.

G Sec Market:

- Indian G-Sec yields fell by 20 bps during May 2024, to end the month at 6.98%. Bond yields declined in tandem with a significant drop in U.S. Treasury yields as a result of weaker-than-expected employment data in Apr 2024. The unexpected announcement of the Indian government's bond buyback resulted in further gains. Yields decreased as the Indian government decided to continue pumping money into the banking system in the upcoming weeks after reducing the supply of Treasury bills. Gains were extended after the RBI approved a record surplus transfer of Rs. 2.11 lakh crore to the government for the fiscal year ended on Mar 31, 2024.





Fund Activities

	Net Buy / Sell May-24	Net Buy / Sell April-24	Open Interest May-24	Open Interest April-24	Remarks
FII Activity (Rs in Cr)					FII Activity (Rs in Cr)
Equities (Cash)	-25259.7	-6820.3		-	FIIs were large net sellers in May-24
Index Futures	-8791.5	-6859.1	28199.7	24834.7	FIIs were net sellers with a rise in open interest
Index Options	-360652.1	166947.2	358225.5	299118.7	FIIs were net sellers with a rise in open interest
Stock Futures	6505.6	-6096.6	268857.8	276485.2	FIIs were net buyers with a fall in open interest
Stock Options	1920.1	289.2	16390.4	17824.6	FIIs were net buyers with a fall in open interest
MF Activity (Rs in Cr)					MF Activity (Rs in Cr)
Equities (Cash)	47666.3	32823.7	-	-	MFs were large net buyers in May-24

- FIIs were net buyers in the debt market, buying a net amount of Rs 8367.5 in May 2024 as compared to net selling of debt worth of Rs 9625.5 cr in April 2024. Mutual funds were net sellers of debt papers, selling Rs 44066.2 cr in May 2024 as against Rs 14528.9 cr of net buying in April 2024.
- The average daily volume on the BSE in May 2024 rose by 11.01% MoM. NSE's daily average volume rose by 16.4% MoM. The average daily derivatives' volume on the NSE rose by 1.3% MoM to Rs 33,211,922 cr in May 2024.

Commodities

- In May 2024, the Reuters/Jefferies CRB Index of 19 raw materials fell by 0.4% to close at 290. The fall was due to decrease in Cocoa (down 7.5%), Crude Oil (down 6.0%), Sugar (down 5.8%) and Cotton (down 2.4%). However, Natural gas, Wheat, Silver, Orange Juice, Nickel, Soybeans, Lean Hogs, Aluminium, Corn, Gold, Live Cattle, Coffee and Copper were up by 30.3%, 16.7%, 15.7%, 15.7%, 4.4%, 4.2%, 3.0%, 2.9%, 2.7%, 1.9%, 1.7%, 1.7% and 1.5% respectively.

Commodity	May-24	Apr-24	% Chg
Gold	2345.8	2302.9	1.86
Crude Oil	77.0	81.9	-6.03
Aluminium	2652.5	2577.5	2.91
Copper	10040.0	9895.5	1.46
Zinc	2969.5	2881.0	3.07
Nickel	19710.0	18879.0	4.40
Tin	33042.0	30603.0	7.97
Lead	2273.0	2180.0	4.27

- Gold prices edged up buoyed by a weaker dollar and declining bond yields following the release of US consumer inflation data and after a report showed consumer inflation slowed in April, lifting hopes the Federal Reserve may cut interest rates, which would be bullish for gold.
- Tin has gained 31% this year and 8% for the month, making it the best performing base metal, on funds flowing into the sector to hedge against inflation and as hopes of rate cuts grow. Tin's gains have exceeded those of investor favourite copper.
- Nickel prices surged to their highest levels in eight months, boosted by funds inflow, supply disruption concerns in New Caledonia and China's latest rollout of support measures. Nickel jumped more than 4% - the most in a month as unrest in New Caledonia raised concerns about further disruption to supplies from the French territory.
- Zinc prices rose driven by China's recent stimulus measures aimed at boosting future construction demand.
- Copper prices were buoyed by positive developments in China, including property stimulus measures and better-than-expected industrial output data. The rise was also supported by systematic buying, with funds betting on a shortage of copper due to the metal's critical role in the transition to a green economy. Prices saw a notable rise driven by expectations of global interest rate cuts and a weaker dollar.
- Aluminium prices surged buoyed by widespread gains in main base metals following China's announcement of fresh support for its struggling property sector. Prices also surged driven by supply constraints and increased buying interest from funds shifting from copper and by a strong rally in key raw material alumina and robust demand.
- Oil prices fell following data published by the American Petroleum Institute showing inventory growth of 2.5 million barrels and concerns over high US interest rates. The fall in crude oil prices comes despite the ongoing geopolitical tensions and ahead of the meeting of the Organization of the Petroleum Exporting Countries and its affiliates,

together known as OPEC+ on supply. Oil prices fell and settled at multi-month lows as the prospect of higher-for-longer U.S. interest rates raised worries around demand growth in the world's biggest oil market.

Currencies

Given below is a table that shows the depreciation (-)/appreciation (+) of the US Dollar against various currencies in May 2024. The dollar fell after U.S. consumer prices increased less than expected in April, suggesting inflation has resumed a downward trend in the second quarter and that the Federal Reserve will cut interest rates in September.

USD to:	May-24	Apr-24	% chg
Pakistani rupee	278.32	278.13	0.1
Hong Kong dollar	7.82	7.82	-0.1
Chinese yuan	7.24	7.24	0.0
Indian rupee	83.42	83.45	0.0
Taiwan dollar	32.47	32.60	-0.4
Singapore dollar	1.35	1.37	-1.0
Argentine peso	895.50	876.50	2.2
Euro	0.92	0.94	-1.6
Thai baht	36.77	37.18	-1.1
Malaysian ringgit	4.70	4.77	-1.4
Indonesian rupiah	16245.00	16255.00	-0.1
Japanese yen	157.31	157.80	-0.3
Brazilian real	5.24	5.17	1.3
South Korean won	1381.68	1385.38	-0.3
Russian Rouble	90.10	93.05	-3.2
Turkish Lira	32.23	32.41	-0.6
South African Rand	18.81	18.76	0.3

- The Russian rouble firmed and climbed towards a near five-year high supported by continuing restrictions on currency trading. The rouble is the world's best-performing currency this year.

- Euro rose resuming gains and approaching two-month highs amid expectations of further advances above the $1.09 barrier due to interest rate outlook.

- The ringgit strengthened 1.4% against the greenback for the month. The strengthening ringgit came after action taken by the central bank three months ago to encourage government-linked companies (GLC) and government-linked investment companies (GLIC) to bring home income from foreign investments. The efforts also include increasing interactions with exporters to convert proceeds into the MYR, monitoring conversions of export and import proceeds, as well as strengthening the domestic economy and continuing promised fiscal reforms.

- The dollar nursed losses and the yen rose after US core inflation eased to its slowest pace in three years, pulling forward expectations for rate cuts in the world's biggest economy.

- The Brazilian real fell against a firm dollar, as softer inflation data exerted more pressure on the country's central bank to lower interest rates. The real slid to a three-week low after data showed that price pressures continued to slow down in early May, in a move that surprised markets.

- Argentina’s peso plunged on the black market after months of stability, creating a potential stumbling block for libertarian president Javier Milei’s plans to remove currency controls. The peso has fallen more than 15 per cent against the dollar to a record low on the black market, where Argentines go to sell their chronically depreciating pesos.

- The South African rand fell against the dollar as traders awaited Federal Reserve meeting minutes for hints on the interest rate path of the world's biggest economy. The Currency fell as early poll results showed the governing African National Congress was on course to lose its majority, a scenario that could lead to weeks of uncertainty as it tries to negotiate a coalition with one or more smaller parties.

- The Pakistani rupee ended slightly weaker as import demand for dollars surpassed the greenback's sales by exporters. The local currency fell from the mismatch between the supply and demand of the greenback in the market.

- The Indian rupee declined, pressured by month-end dollar demand from importers, with investors awaiting the outcome of the country's general elections for fresh cues. Dollar demand from importers and oil marketing companies (OMCs) also weighed on the rupee. However, foreign inflows in the bond markets ahead of inclusion on India's government bonds in global bond index cushioned the downside.

Outlook Going Forward

How will gold perform from here…

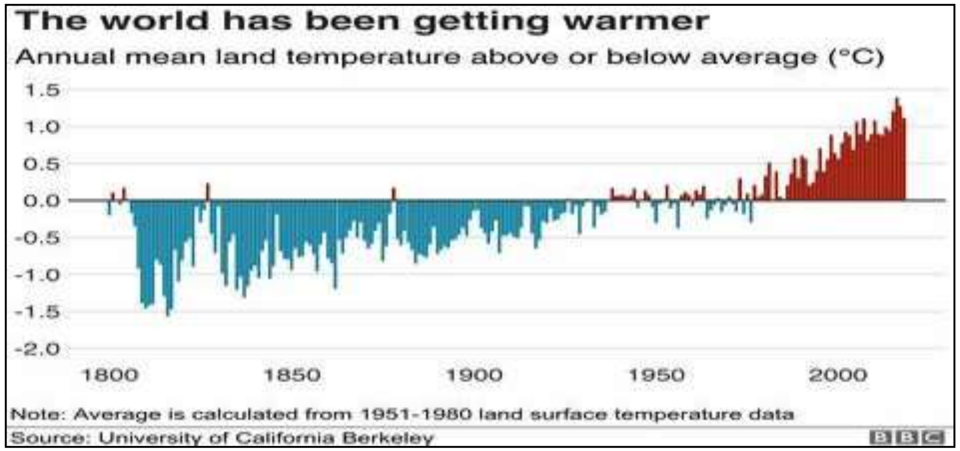
- Gold as an investment is likely to lag U.S. inflation by more than 7% a year over the next decade. That's the implication of new research titled "Is There Still a Golden Dilemma?" from Claude Erb, a former commodity-fund manager at TCW, and Campbell Harvey, a Duke University finance professor.

- Recently, gold's fortunes have changed. The yellow metal has shattered its previous all-time high, soaring above $2,400 an ounce. Yet according to the Erb/Harvey model, gold is as overvalued now as it was in 2012. The model is based on the ratio of gold's price to the U.S. consumer-price index. Erb and Harvey note that if gold were a perfect inflation hedge, this ratio would stay constant. If the CPI rose 10%, gold would too - and the ratio wouldn't change.

- Over the past five years, gold's real return has been 8% annualized and 12.5% before inflation. The S&P 500 is up 9.1% and 13.6%, respectively, over that time. On a 10-year comparison, there is no contest: Gold's real return is 3.1% and 6.1% before inflation, while the S&P 500 is up 9.5% and 12.6%, respectively.
- The oldest of rationales is that gold is an inflation hedge. But it's been evident for many years that inflation is unable to explain gold's bull and bear markets, and the past several years provide yet more evidence. Another widely cited narrative has been that gold's price had become a function of the bullion held by gold-owning exchange-traded funds. Gold's price's gyrations were closely correlated with changes in the holdings of gold-owning ETFs. This correlation has seriously broken down over the past couple of years. According to the World Gold Council, gold-owning ETFs collectively hold 21% less gold now than they did in October 2020, and yet the price of gold is more than 20% higher.
- A newer narrative that Erb and Harvey explore at some length is that the Chinese government is acquiring gold as part of its strategy to challenge the U.S. dollar's dominance. This narrative has some plausibility, since the gold reserves held by the Chinese central bank - at least what it reports to the International Monetary Fund - have been steadily increasing since late 2022.

World temperatures – getting hotter

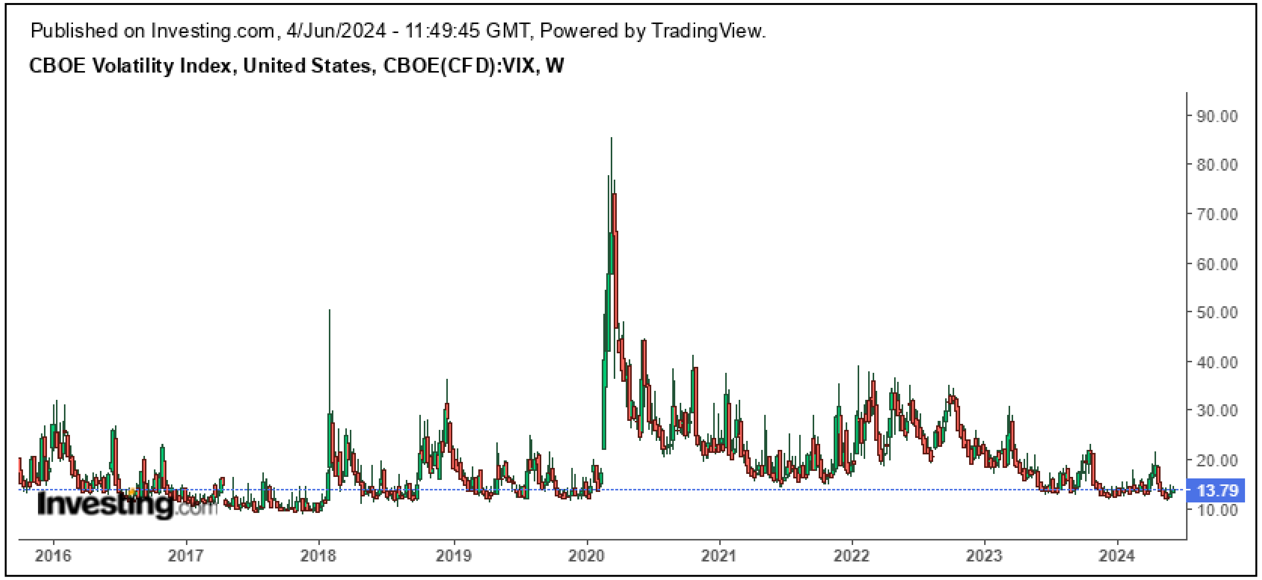
- The world just experienced its hottest April on record, extending an 11-month streak in which every month set a temperature record, the European Union's climate change monitoring service said. Each month since June 2023 has ranked as the planet's hottest on record, compared with the corresponding month in previous years, the Copernicus Climate Change Service (C3S) said in a monthly bulletin. C3S' dataset goes back to 1940, which the scientists cross-checked with other data to confirm that last month was the hottest April since the pre-industrial period.
- Including April, the world's average temperature was the highest on record for a 12-month period - 1.61 degrees Celsius above the average in the 1850-1900 pre-industrial period.



- Greenhouse gas emissions from burning fossil fuels are the main cause of climate change. In recent months, the natural El Nino phenomenon, which warms the surface waters in the eastern Pacific Ocean, has also raised temperatures.
- Hayley Fowler, a climate scientist at Newcastle University, said the data showed the world is perilously close to breaching the 2015 Paris Agreement's goal to cap global warming at 1.5 degrees Celsius. Countries agreed the 1.5C goal at a U.N. climate summit in 2015. It is the level scientists say would avoid the most disastrous consequences of warming, like fatal heat, flooding and the irreversible loss of ecosystems.
- Technically, the 1.5C target has not yet been missed, as it refers to an average global temperature over decades. But some scientists have said the goal can no longer realistically be met and have urged governments to cut CO_2 emissions faster to limit overshoot of the target.
- The intense northern hemisphere summer heat that drove wildfires across the Mediterranean, buckled roads in Texas and strained power grids in China last year made it not just the warmest summer on record - but the warmest in some 2,000 years, new research suggests.
- New work published in the journal Nature suggests the 2023 heat eclipsed temperatures over a far longer timeline - a finding established by looking at meteorological records dating to the mid-1800s and temperature data based on the analysis of tree rings across nine northern sites.

VIX is low as it is supposed to be so

- Forget the conspiracy theories about the Vix being 'broken'. The real reason why the index is so low is because that's exactly where stocks put it
- April’s stock-market selloff ended seemingly as quickly as it arrived. And as one might expect, a short-lived pop in Wall Street's "fear gauge" quickly faded as well.
- The swift decline in the Cboe Volatility Index VIX, better known as the Vix, has helped revive chatter on Wall Street that the volatility gauge is "broken." Some critics have blamed the growing popularity of so-called zero-days-to-expiry, or ODTE, options. Others have blamed the rise of exchange-traded funds that regularly sell options as part of a strategy to generate income.
- But according to DataTrek's Nicholas Colas, there's a simpler explanation: The gauge of implied volatility is actually trading exactly where it should be, based on how calm stocks have been over the past 100 trading sessions.
- The standard deviation of daily S&P 500 SPX returns over the last 100 days is 0.7%, compared with its average of 1% between 2010 and the present day. That's a difference of roughly 30%. Over the same period, the average level of the Vix has been 18.5. The index stands at 13.6, meaning the fear gauge is about 28% below its average from the past 14 years.



- Even though VIX is a gauge of implied volatility, it is not designed to anticipate what comes next, Colas noted. Rather, it merely reflects what has been happening recently in the stock market. This also happens to be the most important factor in the pricing of one-month S&P 500 index options - and the level of the Vix is determined based on trading activity in these contracts.

History shows the S&P 500 tends to do well when the Federal Reserve leaves rates on hold

- History may offer relief to stock-market bulls worried about the Federal Reserve's continued reluctance to begin cutting interest rates.
- It's been more than 310 days since the Fed last moved its benchmark policy rate, marking the second-longest pause in modern market history. The silver lining, however, is that data show such long pauses are often accompanied by solid gains for equities.
- "As the Federal Reserve extends the timeline for interest-rate cuts, historical data shows that longer Fed pauses often correlate with better equity returns," said Mark Hackett, chief of investment research at Nationwide, in a note.
- "In fact, in periods where the pause is greater than 100 days, the stock market has historically moved higher by an average of 13%. This should give investors reasons to be optimistic," he wrote.
- Jeff Buchbinder, chief equity strategist at LPL Financial, noted that over the past 50 years, the S&P 500 has gained 6% on average during such pauses. It’s record is even stronger in the six pauses since 1989, which have tended to be longer and when it has posted an average gain of 13.1%, he said in a note.

China – haunted by old issues. when will it show signs of revival?

- China is actively seeking foreign investment to boost its slowing growth, but that very sluggishness is weighing on company plans to grow their businesses in the world's second largest economy, an annual survey of more than 500 European companies has found.
- The slowing economy is now the dominant concern of respondents to the European Chamber of Commerce in China survey. China still ranks high as a place to invest, but the share of companies considering an expansion of their operations in the country this year fell to 42%, the lowest ever recorded.
- The economic worries are layered on top of long-running complaints about regulations and practices that companies say favor their Chinese competitors or are unclear, creating uncertainty for businesses and their employees. Others including the American Chamber in China have expressed similar concerns.
- Those older issues are now compounded by the weaker economy, eroding business confidence, said Jens Eskelund, the president of the European Chamber.
- The government is launching programs to boost consumer spending but confidence remains low because of a weak job market. Economic growth came in at a faster than expected 5.3% annual pace in the first three months of the year, but much of the GDP growth came from government spending on infrastructure and investment in factories and equipment. China's manufacturing activity in May grew at the fastest pace in about two years with strong production and new orders, indicating the sector remains robust amid supportive industrial policies.
- Massive investment in industries such as solar power panels and electric cars has created intense price competition, squeezing profits. More than a third of the survey respondents said they have observed overcapacity in their industry. For 15% of the companies, their China operations finished 2023 in the red. Foreign companies need growth in domestic demand, not manufacturing capacity, Eskelund said.
- Close to 40% of companies said they have moved or are considering moving future investments out of China. Southeast Asia and Europe are the biggest beneficiaries, followed by India and North America.
- The Shanghai composite Index’s 18% gain since a February low mostly reflects a rotational play on cheap valuations, and Chinese earnings are yet to convince, according to Lombard Odier, Pictet Asset Management, and Fidelity International.
- The latest rally since February has surprised many, with Goldman Sachs Group Inc.’s analysts saying it had evoked a fear of losing out among traders. Rotation from markets like the US, Japan and India, where stocks have soared to highs or near-records, compared with low valuations in China, was a catalyst. Overseas investors bought onshore stocks via trading links with Hong Kong for a third straight month in April, the longest such stretch in a year.
- There will be continued rotation into Chinese tech firms from their global peers, particularly from the US, said David Mudd, founder and chief investment officer of PegasusAsia, a hedge fund.
- The other driver for the recent gains lies in signs of more policy support from Beijing, in particular a desire to clear unsold homes in the depressed property sector. At the same time, the likelihood of US policy rates staying higher for longer has turned Chinese stocks into an alternative, with its tech names benefiting.

High inflation and need to save more affecting spending power of consumers?

- Over the past few years, companies have been increasing prices to claw back rising costs and were largely getting away with it. While corporate profits alone are not responsible for inflation, they have grown by 41% since the end of 2019, while prices have gone up 17% in that time, the Wall Street Journal reported last month.

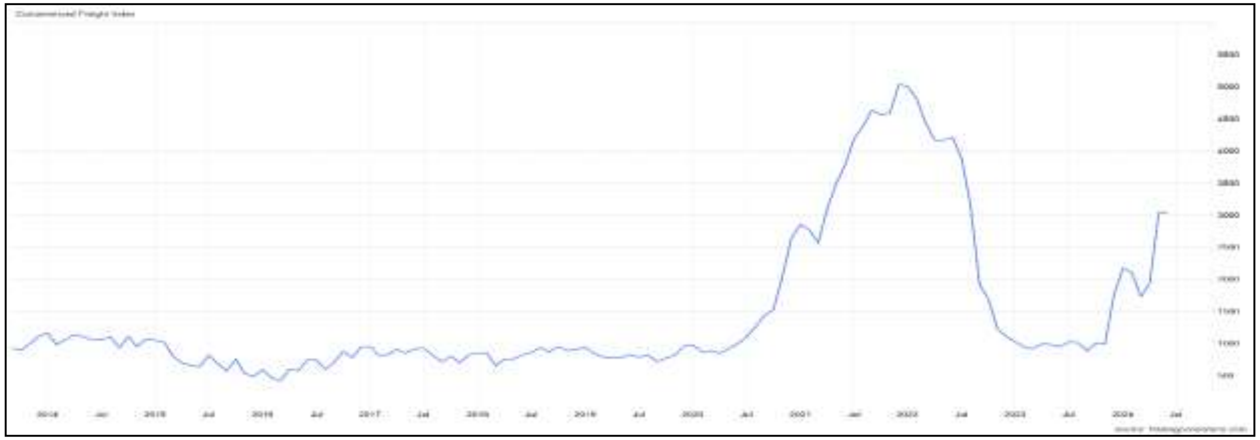
- Mike Wilson, chief U.S. equity strategist at Morgan Stanley, recently noted that mentions of “value” by executives during discretionary-goods companies’ earnings calls have been historically elevated.
- Chad Lusk, a managing director in the consumer and retail group at the consulting firm Alvarez & Marsal (A&M), called companies’ renewed focus on value “a small victory” for consumers who have needed “some give” in a high-cost environment for some time. “There appears to be some give happening right now,” he said.
- Low-income consumers are especially sensitive to high prices, but A&M’s latest consumer survey found that households across the income spectrum now intend to cut back on spending. Households earning $150,000 to $200,000 reported the highest rates of planning to pare back purchases.
- Downbeat consumers across income levels told A&M’s researchers that they are preparing for prices to stay high, they believe the U.S. is heading toward a recession, and they don’t expect their personal financial situation to improve in the next six months. In this climate, they intend to pull back spending in many areas: jewelry, alcohol, beauty products, electronics, entertainment, sports, prepared food, shoes, apparel and home improvement. Meanwhile, they said they expect to spend more on necessities like groceries and personal-care items.
- The personal-savings rate, which measures the share of income that households save after covering expenses, fell to 3.2% in March, down from 5.2% the previous year. Saving money appears to be a growing priority for many people. In an American Express survey from October, growing savings was the No. 1 financial goal (59%) for millennials and Gen Z in 2024, followed by paying off debt (42%) and sticking to a budget (41%).

US elections in November and its impact on US fiscal situation and interest rates

- Hedge-fund billionaire Ray Dalio argues the U.S. election, scheduled for November, will be a test for democracy. “Will there be an acceptance of the rules and an ability to work well under those rules?” he asked.
- “Trump will follow more rightist, nationalistic, isolationist, protectionist, nonregulatory policies — and more aggressive policies to fight enemies internally and externally, including political enemies,” Dalio said.
- “Biden, and even more so the Democratic Party without Biden, will be more the opposite, though they, too, will play political hardball,” Dalio added, who held back from pledging his support for any particular candidate.
- He suggested investors consider moving money into foreign markets, pointing to countries including India, Singapore, Indonesia, Malaysia and Vietnam, alongside some Gulf states. “Countries that earn more than they spend and have great balance sheets, have internal order and are neutral in the geopolitical conflicts … look attractive,” he said.
- Donald Trump's tax and spending plans for his would-be second term in office imply a willingness to see the federal budget deficit rise to truly unprecedented levels. The former president plans to spend more than $5 trillion over 10 years to slash corporate taxes yet again from 21% to 15%, and make the individual tax cuts Republicans implemented in 2017 permanent. But less attention has been paid to the potentially enormous fiscal costs of his plans for the mass deportation of unauthorized immigrants.
- Trump has promised to institute "the largest domestic deportation operation in American history," and said in a recent interview that he would target all of the nearly 15 million undocumented immigrants estimated to be in the country as of March.
- The social impact of such a policy would be enormous, but investors should also be aware that mass deportation would put an enormous strain on the federal budget: The vast majority of unauthorized immigrants work and pay taxes, but receive very little in federal benefits. In addition to undocumented immigrants paying income and payroll taxes, they contribute to a growing population of consumers supporting businesses, whose corporate taxes also fill federal coffers.

- The effects would be particularly hard on regional economies like California and Texas, where immigrants compose upwards of 10% of the labor force.
- The CBO projects the U.S. federal deficit will grow to 6% of GDP in 2033 from 5.6% this year. Debt held by the public will increase to 114% of GDP from 99% and continue rising.
- President Joe Biden's proposed budget would effectively repeal the benefits for families with incomes over $400,000, raise taxes on the wealthy and boost the federal corporate rate to 28% from 21%. Most of Biden's tax increases are unlikely without the Democrats winning control of Congress; the Senate electoral map is more favorable to Republicans this year.
- If former President Donald Trump is elected again, it would raise the debt held by the public to far more than the CBO forecast of 114% of GDP by 2033. Borrowing costs would soar. Last July, the Treasury announced a substantial increase in its borrowing requirements to rebuild cash balances after the budget ceiling standoff in Congress. That instigated a full percentage-point jump in the 10-year Treasury rate (TY00) to nearly 5% by late October.
- This could trigger a flight from Treasurys in international markets - effectively, a vote of no-confidence in the U.S. dollar as the global reserve currency and boosting the prominence of the Chinese yuan.
- At that point, either the Federal Reserve would have to allow interest rates to rise, limiting investment and growth, or it would print money to purchase Treasurys. That printing would trigger significant inflation that would act as a tax on Americans' living standards in order to fund the government.
- Furthermore, Trump has proposed a 60% tariff on imports from China and a 10% tariff on all other imports. Important in all this, the price elasticity of export demand for Chinese goods appears quite low. Additional tariffs won't lower the volume of U.S. purchases much.
- Higher tariffs would be partially paid by foreign producers, but most of the cost would be borne by consumers.

Shipping container crunch and freight rates soaring…



- A perfect storm in global trade is creating a shipping container capacity crunch, fueling a sudden and surprise spike in ocean freight rates.
- The beginning of peak shipping season, coupled with the longer transits to avoid the Red Sea, and bad weather in Asia, have hit the flow of trade on key routes. Ocean carriers are skipping ports or decreasing their time at port, and not picking up empty containers, in an effort to keep vessels on track for delivery.
- The supply chain cost issues come at a time when consumer goods for back to school and the holidays are set to be moved on the water.
- “From the Far East into the U.S. West Coast, it is likely spot rates will surpass the level seen at the height of the Red Sea crisis earlier this year, which demonstrates how dramatic the recent increases have been,” said Emily Stausbøll, senior shipping analyst at Xeneta.
- Xeneta ocean freight rates show the rallying spot market and the widening spread between spot and long-term rates. “The bigger the spread between long and short term rates, the greater the risk of cargo being rolled, which we know is already happening,” she said.
- Spot rates had fallen after the sharp rise triggered by Red Sea tensions in early 2024, but since the end of April they began spiking by as much as $1,500, on average, on routes to the U.S. coasts, and now some of the highest contract rates charged by shippers are over double the rates of just a month ago.
- Stausbøll said this will bring back memories of the chaos caused by lack of available capacity during the Covid-19 pandemic. “Similarly to back then, some freight forwarders are now being pushed to premium rates to secure space guarantees,” she said.
- Early Xeneta data suggests rates will increase further at the start of June. DHL has been warning about about a container crunch since January because of the longer routes needed to avoid the Red Sea since the Houthi attacks began. Containers are out on the water longer and as a result not available to be reloaded. The availability of containers has been slowed even further by the bad weather impacting port operations in China, Malaysia, and Singapore.
- The latest round of soaring ocean freight rates comes after a previous high earlier in the year during which an “elevator floor” characterized by Levine of $3,000-$5,000 a container was set. At that time, prices compared to a year ago were double.
- Logistics price increases are ultimately passed onto the consumer and the dizzying freight rates during the pandemic were among factors cited by the Federal Reserve as a cause of inflation. In a series of customer alerts, logistics providers are warning shippers around the world, such as major retailers, of the container shortage.
- According to an Honour Lane Shipping note to clients, the “huge rate increases” could push the market to a new post-pandemic high. ”While spot rates continue to soar, capacity out of Asia continues to tighten,” HLS wrote to clients, and that has allowed carriers to implement a “diamond rate ... played during pandemic period,” it added.
- Citing the re-routing of ships around the Horn of Africa due to the Red Sea issues accounts for 17% of global container shipping capacity, and HLS warned the cancellation or blanking of ships will only add to the pressure of soaring freight rates.
- “Carriers have plenty of room to manipulate capacity,” wrote HLS, noting that blank sailings increased in May and June.
- Maritime shipping research firm Drewry has reported a total 17 sailings canceled on the Transpacific route between weeks 20 (this week) and week 24 on the shipping calendar, and it has tracked space available contracting “seriously” to the U.S. East Coast.
- HLS said the headwinds will not improve any time soon with the U.S. consumer economy still healthy. With 2024 retail sales in the U.S. forecast at an increase between 2.5% and 3.5%, it expects the current market trend and space situation will continue through June at least.
- “Regardless of what headlines about the economy might say, consumers are shopping and retailers are making sure they have merchandise on hand to meet demand,” said Jonathan Gold, vice president for supply chain and customs policy at NRF. “Re-stocking may have just started,” he wrote.

UBS Global Wealth sees 10% upside in a broader commodity index over the next six to 12 months.

- Commodity prices still have room to rally, with rising demand and deepening supply shortages in oil and copper likely to keep prices well-supported over the next six to 12 months, according to UBS Global Wealth Management.
- Commodities have taken center stage in 2024 with gold, silver and copper prices reaching historic levels, while oil remains volatile amid geopolitical conflicts.
- With the UBS CMCI Composite Index up nearly 11% so far this year, Marcelli and her team foresee an additional 10% upside for the broad commodity index over the next six to 12 months.
- Copper prices have been soaring since the beginning of this year, buoyed by diminishing U.S. recession concerns amid a resilient labor market and rosy corporate earnings. Additionally, signs of an economic resurgence in China, which accounts for 50% of global copper consumption, have bolstered the demand for the industrial metal. The UBS analysts said the physical market tightness should continue to drive price gains in the red metal.
- Global central banks' purchases should keep gold well-supported for the rest of 2024, while demand for the yellow metal as hedges should remain "healthy" amid geopolitical uncertainties in the Middle East and between the U.S. and China, said UBS analysts. Meanwhile, the potential start of the Federal Reserve's easing cycle later this year should also drive more inflows into gold ETFs. Marcelli and her team recently raised their year-end price forecast for gold to $2,600 per ounce, and they recommended investors to buy on dips at around $2,300 an ounce or below.

3 reasons why risk of domestic fund flow reversing is rising - Jefferies

- The risk of domestic fund flow reversing is rising, with share of equity flows in financial savings rising way above a decadal average and with 'predictable' flows to equities segment contributing less than half to this, said Jefferies in a recent report.
- The global brokerage also pointed to regulatory action on derivatives as a trigger for reversal of fund flows.
- In the report titled "Is $7 bn/month sustainable?", the analysts pointed out that the domestic equity inflows during 2024 are a "staggering" $7 billion a month, which would be twice what they were in the previous high and more than 3x as compared to a year ago.
- In calendar year 2024, equity flows are likely to account for 20 percent of the financial savings of an Indian household, the analysts estimated. This is much higher than the average of 6 percent (share of the total savings) seen over the past decade.
- This was arrived at by taking FY24's financial savings of Indians--an estimated $375 billion--and assuming a 10 percent growth in equity flows in 2024. This would mean $85 billion in equity flows in 2024. In this massive equity fund flow, the 'predictable' portion is about half, wrote the analysts.
- The brokerage broke the inflows down into four categories: a) Direct retail trading in the stock market during CYTD saw net retail flows (via NSE) into direct equities at $8.8bn; b) Discretionary flows into MFs (i.e., inflows into MFs ex-SIP) at $5.8bn; c) Flows into MFs via SIPs at $9.3bn; and d) Flows via other sources such as equity component of insurance, etc. at $6.4bn.
- "Of these four sources of flows to domestic equity highlighted above, the former two are market sentiment–driven and thus highly volatile. The latter two are based on sustainable sources / part of broader shift to financial savings, and we evaluate the size of the more predictable flows (SIPs, equity portion of pension schemes, i.e., EPFO & NPS, equity component of Insurance) at a total $40 bn/annum, or slightly under half of the current pace of domestic flows," the report pointed out.

- The report also elaborated on the regulatory risk. There has been a sharp jump in futures and options (F&O) turnover recently, with daily notional trade of $5.3 trillion, which is greater than 100 percent turnover of the Indian mcap; and three times the FY23 average, according to the brokerage's calculations.
- Premiums (option prices) paid is much lower at $8.1 bn/day but it is still 20x what it was pre-Covid and is a high number on an absolute basis, the report pointed out.
- "Regulators appear concerned on this heightened derivatives activity and any action can cause derivatives volumes to come off potentially impacting smid-cap stocks also," wrote the analysts.

India election outcome and markets:

- Initial outcome of election results suggest that the incumbent Bhartiya Janata Party might be reliant on alliance partners to return to power for a third time. This is in sharp contrast to exit polls, which predicted the BJP-led National Democratic Alliance would return to power with a thumping majority.
- If the NDA ends up with lower than last time seats (353) which seems likely, then it does not reflect well on the leadership of the PM who had fought the elections single handedly seeking approval of his policies. Respect for him within the party and the coalition could get impacted. His reading of voting patterns in key states has come under challenge.
- As the BJP by itself may not win more than 272 seats (last time 303 seats) and it needs the support of its partners to form the Govt, then the Govt may be unstable (going by history of low tenure coalition Govts under Chandrasekhar, IK Gujral and Devegowda) and BJP could face a lot of interference in policy making and could be forced to be more welfare oriented, impacting the fiscal deficit path. The regional parties supporting PM Modi may want their pound of flesh in terms of fiscal support to the respective states. PM Modi may find it difficult to keep the flock under control and prevent partners from switching sides. In this circumstance, PM Modi could get even more Hindutva leaning over time and may want to hold another election soon hoping on the regrouping of voter choices and a bigger majority for the BJP.
- As far as the Indian markets are concerned, the NDA Govt with BJP dependence on partners may not be good news in the short term. The reform thrust may get diluted under pressure of opposition and partners. Though the Indian story is intact, there may now be doubts about the corporate earnings growth and the valuations that India may get atleast till the new Govt starts delivering on reforms and stirring economic growth.
- Focus could now shift to formation of the Union cabinet and choice of ministers that may give first indications of PM Modi’s style of handling coalition pressure. If the street sees a strong, unchanged style in this and in the policy announcements over the first 100 days, then markets may get reassured. But the sharp rerating of the markets may not happen in a hurry given the fact that the valuation of Indian markets is anyway not cheap going by historical standards and compared to other markets.
- Stocks with large leverage to the Government’s economic program - Infra, Capital Goods, Defence, Rail etc have delivered remarkable returns in the past few quarters. We think the new Govt could focus on investment-led growth, enabled with the recent large transfer of the RBI surplus. We feel that the new Government will also continue its focus on key areas such as affordable healthcare and housing, renewable energy, manufacturing etc. Although a lot of reform measures in these areas have already been taken by the previous NDA Govt., a renewed thrust and tweaking of measures for better efficacy could be in the offing.
- Having said this, welfare measures may be back with a bang and noises on measures to enable equitable distribution of income and wealth may be made going forward. Fiscal prudence may get a back seat for the time being and some reforms of the past may be partly reversed and/or halted (especially in the case of a non NDA Govt). Also, corporate earnings growth will have to be better and more evenly spread for higher valuations to sustain. FMCG and Private Banks may come back in favour given their attractive relative valuations.

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