ICICI Investment Management

Investment Strategy

Executive Summary

Global / US

- Narrative is shifting from monetary tightening to probable growth scare. We present likely market scenarios if US recession risk were to materialize
- Equities remain vulnerable towards a growth slowdown
- Bonds – US Bond yields might have peaked out at recent highs – a good hedge against a potential slowdown, albeit with lot of volatility

India - Equities

- Nearly half of NIFTY EPS growth has been led by Metals / Mining, Petroleum Refining & Coal – a cyclical surge which can moderate going forward
- Given global factors, some moderation in forward EPS growth looks likely
- Indian valuations remain anchored to global / US valuations - susceptible to US recession
- Opportunities are likely to arise in H2-2022, but right sizing will make a meaningful difference

India – Fixed Income

- OIS curves indicate 200bps further tightening, alongside liquidity withdrawal
- Prefer 5year+ curve, 10year+ at yields above 7.75%+ levels
- Credit spreads remain low by historical standards

Gold

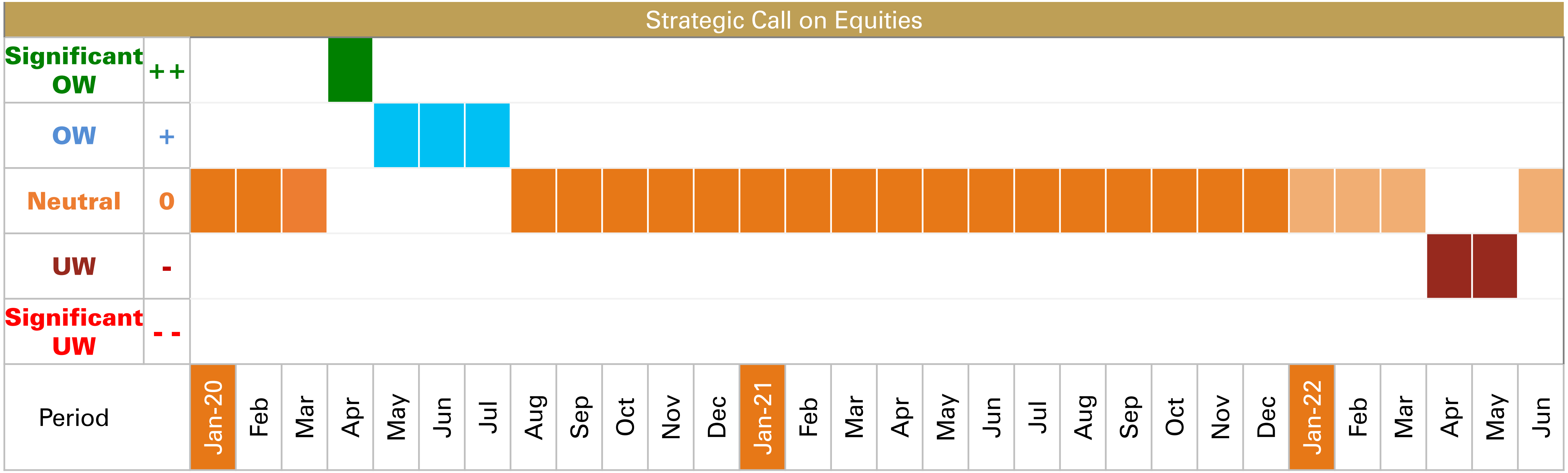
- Gold has underperformed as expected. Once speculative positions wind down somewhat, it may be appropriate to go Over Weight

Asset Allocation Positioning

Asset Class	Short Term					Medium Term				
	- -	-	0	+	++	- -	-	0	+	++
Equities		■					◆	■		
Large Cap & Diversified			■				◆	■		
Mid & Small Cap		■					■			
Global Equities			■				◆	■		
Debt			■					■		
Low Duration Debt			■					■		
Short & Medium Term			■						■	
Credit Fund			■					■		
Duration			■					■		
Gold			■					■		

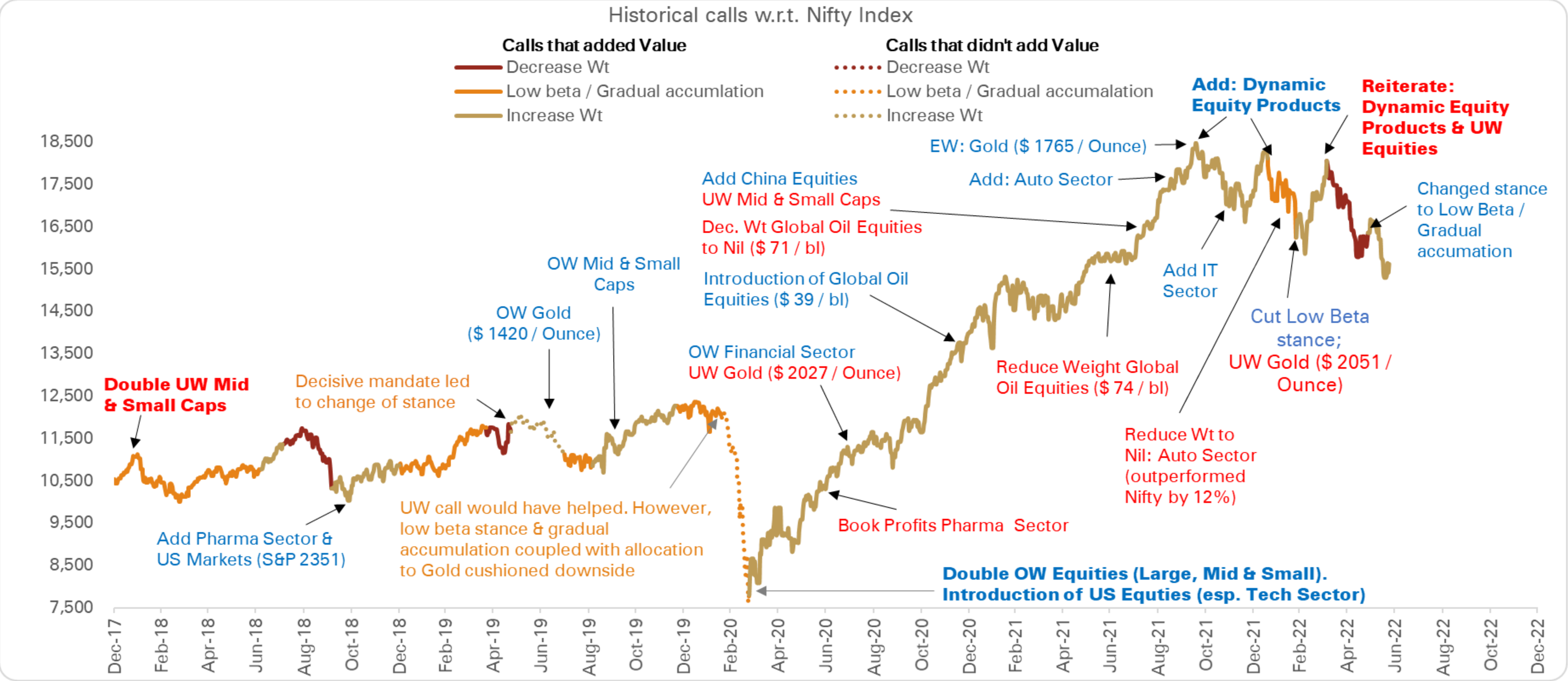
Legend	
++	Strong Overweight
+	Overweight
0	Equal weight
-	Underweight
- -	Strong Underweight
◆	Previous Position

Strategic Indian Equity Allocation (recent history)



Maintain defensive bias towards Equity allocation – very gradual accumulation

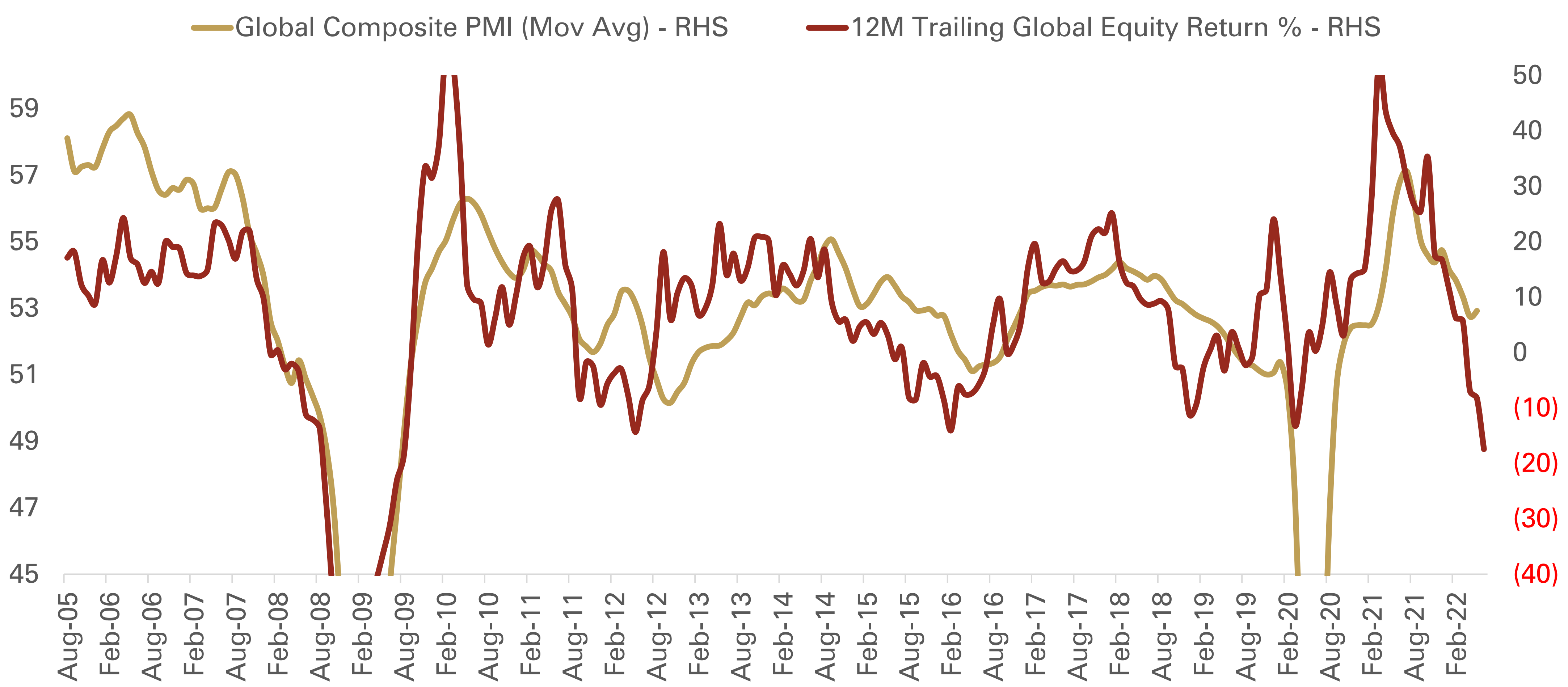
Historical Calls - Equity



UW - Underweight; OW – Overweight; Wt. – Weight; Inc. – Increase; Dec. – Decrease;
Double OW or UW are highlighted in Bold; Increase weight in Blue; Reduce weight in Red; Calls that didn't add value in Orange;

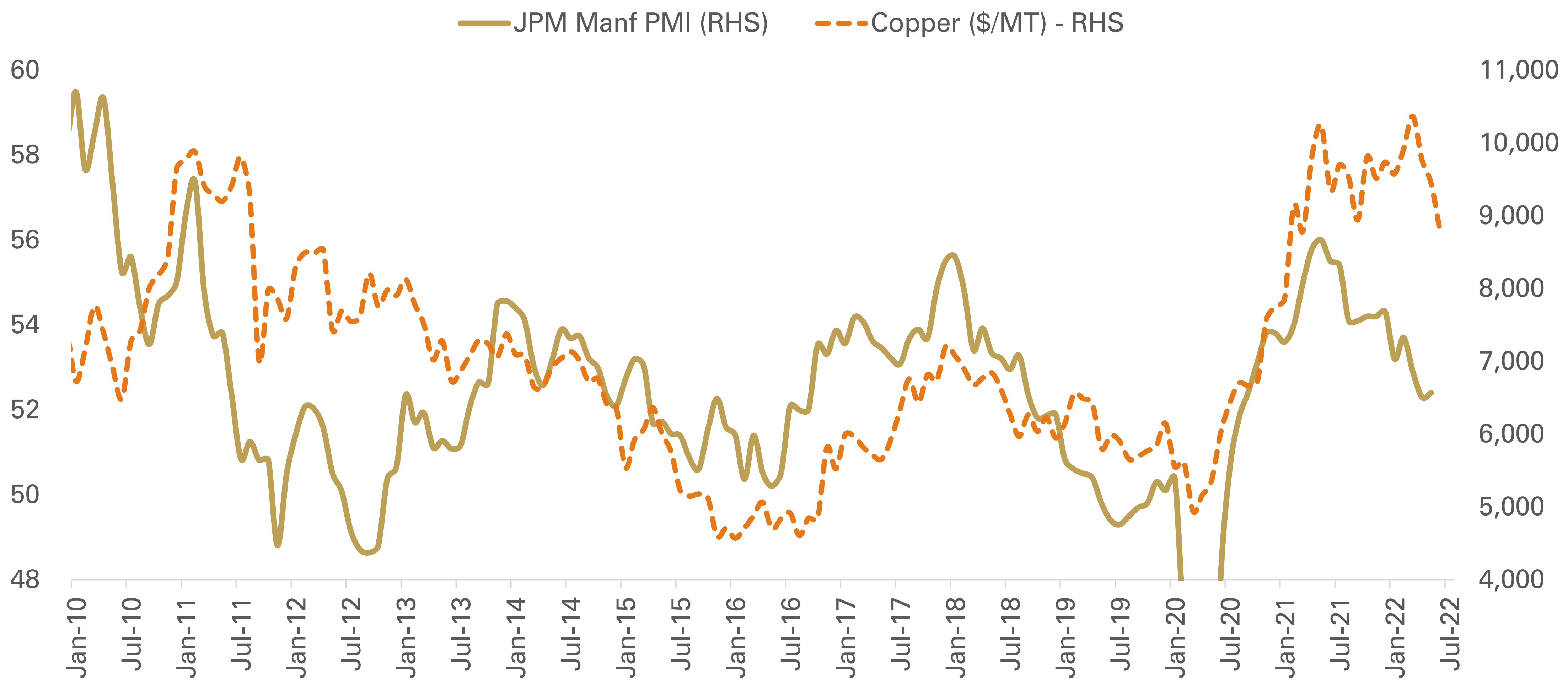
Narrative changing from inflation control to potential growth slowdown

Market performance & Global PMI



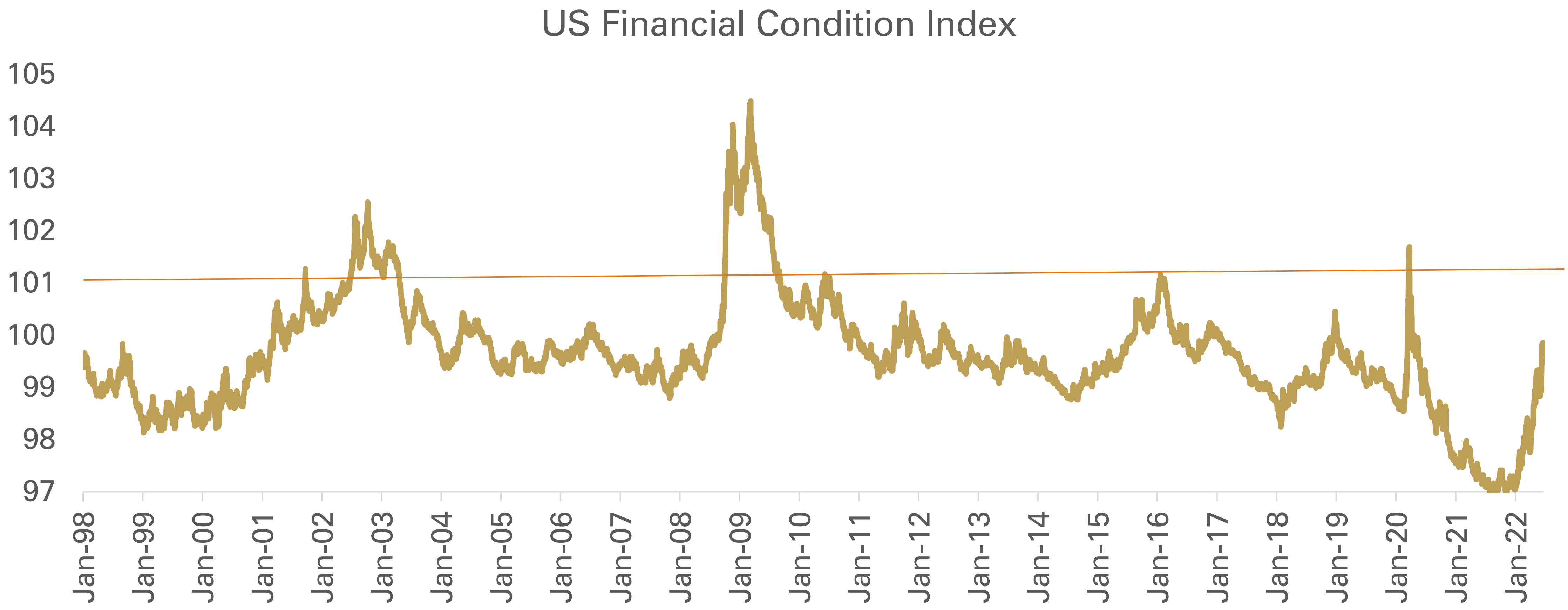
PMIs are lead indicators of economic momentum. A sharp fall in equities is indicative of potential further decline in PMIs which remain in 'expansionary' territory

Industrial Metals remain vulnerable



"Dr" Copper has been flat-lining after peaking simultaneously with peak PMIs. Industrial metals have already corrected and remain vulnerable to slowdown

US Financial Conditions



Financial conditions in US are at the tightest in two years, driven by soaring energy prices, challenges facing global supply chains due to Ukraine-Russia conflict and persistent high inflation leading to central banks turning hawkish. Financial conditions are yet to move towards a level consistent with 'mild recessionary' lows.

'US Recession' – a 'known unknown' or 'known known' now?

FINANCIAL TIMES

Jay Powell warns US recession is 'certainly a possibility'

Fed chair says economy is resilient but factors beyond his control raise risk of inflation surprises

THE WALL STREET JOURNAL.

Fed Chair Jerome Powell Says Higher Interest Rates Could Cause a Recession

'It is essential that we bring inflation down,' he tells Congress

By Nick Timiraos Follow

Updated June 22, 2022 5:15 pm ET

Bloomberg

Musk, Roubini and Goldman Warn of Rising US Recession Risk

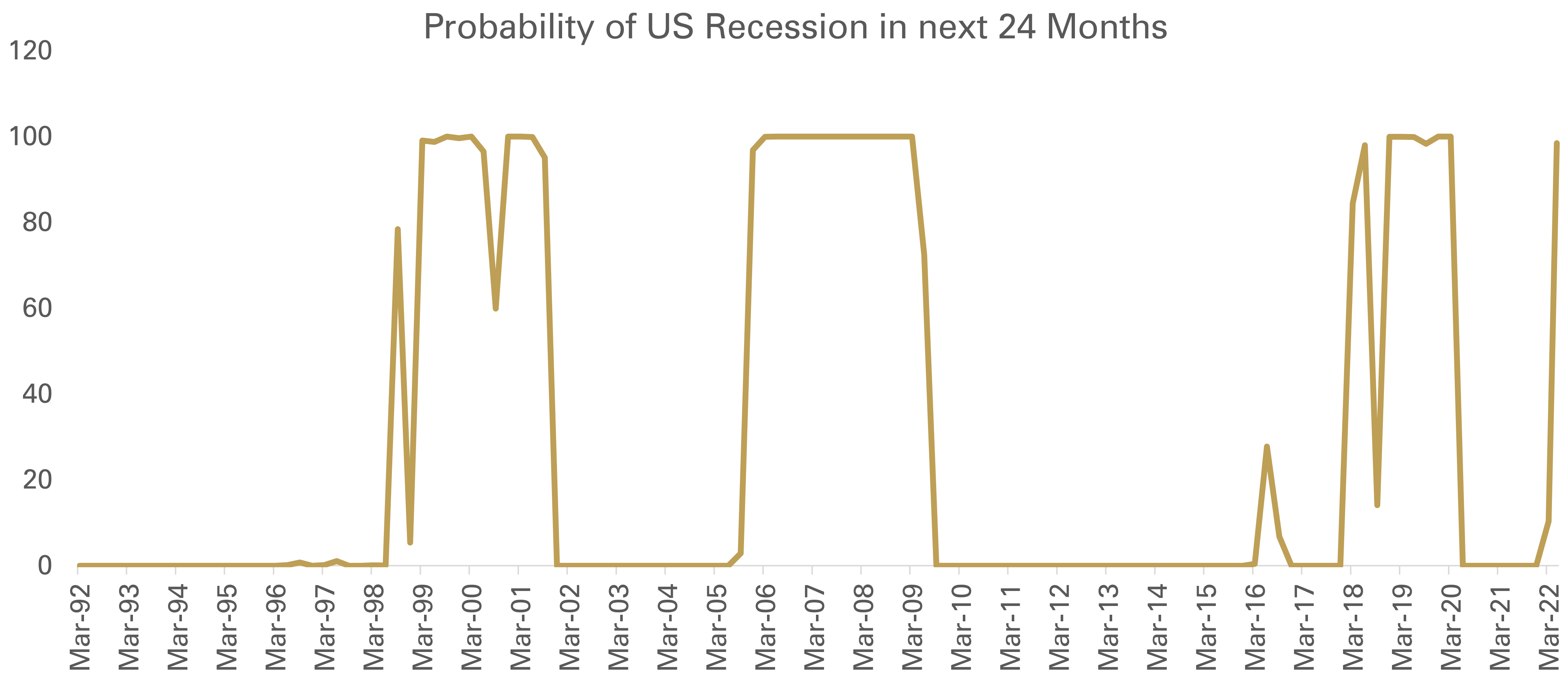
- Warnings come as rising interest rates fuel hard landing fears

Investing.com

U.S. recession fears darken outlook for global growth

Potential US recession is now moving towards being a near consensus view, from just being a tail risk till last month

Probability of recession has risen meaningfully



Risk of recession is at highest levels as per Bloomberg Economic models

Equity Index simulation & stress testing to assess potential downside & ensuing upside as recovery sets in

US - Stress testing S&P500 basis historical valuations parameters

Date Mkt Bottom	EY - BY	P/E	EV / EBITDA	P / Sales	P/B	Mcap to Money Supply	Days	Index Bottom Avg.	Downside (%)	2Yr Frwd CAGR	Avg. Target 2 Yr
Jul-10	3.2	13.5	8.1	1.1	1.9	110.3	70	2,449	(37)	34	3,270
Oct-11	4.9	11.5	7.3	1.1	1.8	107.7	157	2,224	(43)	53	3,396
Aug-15	2.7	16.2	10.9	1.7	2.5	141.4	96	3,115	(20)	31	4,075
Feb-16	2.5	16.4	11.2	1.6	2.5	133.2	100	3,104	(21)	43	4,445
Dec-18	2.1	15.8	11.1	1.8	2.8	143.8	95	3,251	(17)	58	5,120
Mar-20	2.5	14.3	10.0	1.6	2.4	125.1	33	2,905	(26)	99	5,786
Jun-22	0.7	18.4	12.7	2.3	3.8	152.1	171	3,912			
Probable Market Performance if a recession does occur								2,841	(27)	11	4,349

Table above simulates likely Index levels if US market was to bottom at valuation levels as observed in last few bear markets. Feb 2016 presents a reasonable base line (slowdown without a recession)

Interestingly, all market bottoms have followed a massive recovery in next two years

NSE500 - Stress testing basis historical valuations parameters

Date Mkt Bottom	EY - BY	P/E	EV / EBITDA	P / Sales	P/B	Mcap / Money Supply	Days	Index Bottom Avg.	Downside (%)	2Yr Frwd Return	Avg. Target 2 Yr
Dec-11	(1.0)	12.2	9.7	1.3	1.9	68.7	405	9,069	(32)	33	12,030
Aug-13	(2.1)	12.1	9.8	1.2	1.8	61.5	103	9,081	(32)	65	15,019
Feb-16	(2.6)	16.5	11.3	1.6	2.1	67.3	359	10,851	(19)	59	17,259
Dec-16	(2.3)	18.8	11.5	1.8	2.3	77.4	109	11,595	(13)	34	15,591
Oct-18	(3.7)	19.4	11.1	1.9	2.5	85.2	56	12,801	(4)	15	14,673
Aug-19	(2.7)	20.0	11.5	1.7	2.3	82.0	80	11,911	(11)	60	19,049
Mar-20	(0.1)	13.3	8.9	1.2	1.8	57.8	66	8,465	(36)	135	19,926
Jun-22	(2.5)	19.2	12.7	2.2	2.8	104.0	157	13,323			
Probable Market Performance if a recession does occur								10,539	(21)	22	16,221

Interestingly, all market bottoms have followed a massive recovery in next two years

More the downside, higher tends to be the upside

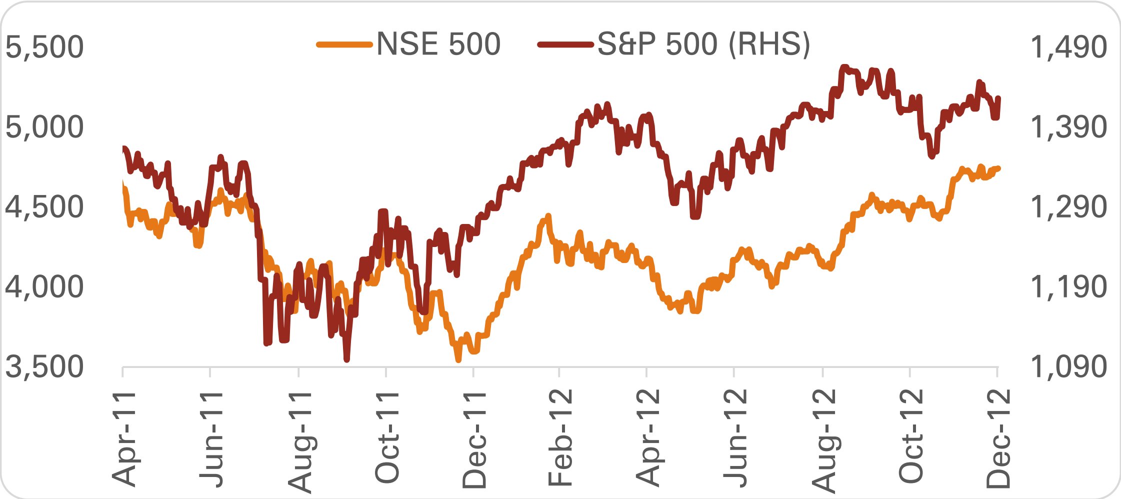
MF Flows during market bottom – Possible to time the market?

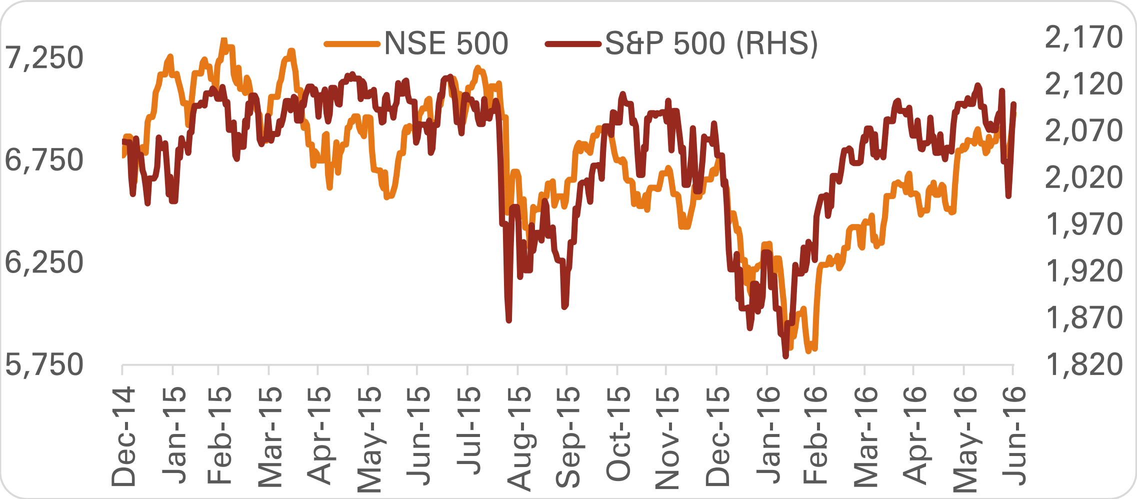
Period	Feb, 16	Dec, 16	Oct, 18	Aug, 19	Mar, 20	Jun, 22	Total	% Share
- 3 Months	129	222	278	212	232	629	1,702	28
Month 0	25	101	148	92	117		483	8
+ 3 Months	78	196	203	139	117		733	12
+ - 6 Months	534	895	1,126	845	533		3,934	65
Total MF Flows Rs 6,072 bn								

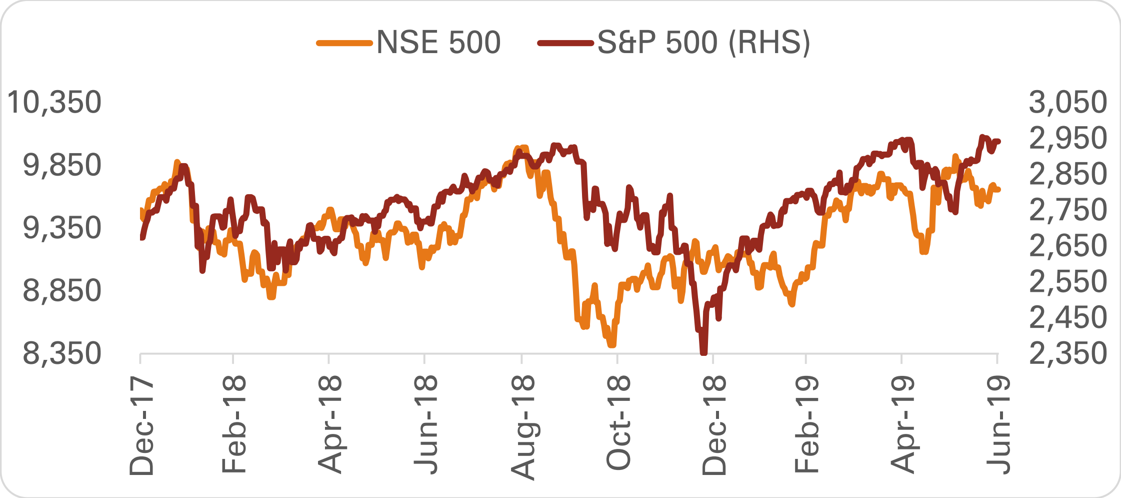
- Only 8% of the Net MF Flows have been observed in the month when market has bottomed out – around the bottom it would be miniscule
- Flows pre market bottom (3 months prior) have been higher than flows post market bottom (3 months later), indicating that as market rises after a bottom, investors usually perceive it to be temporary

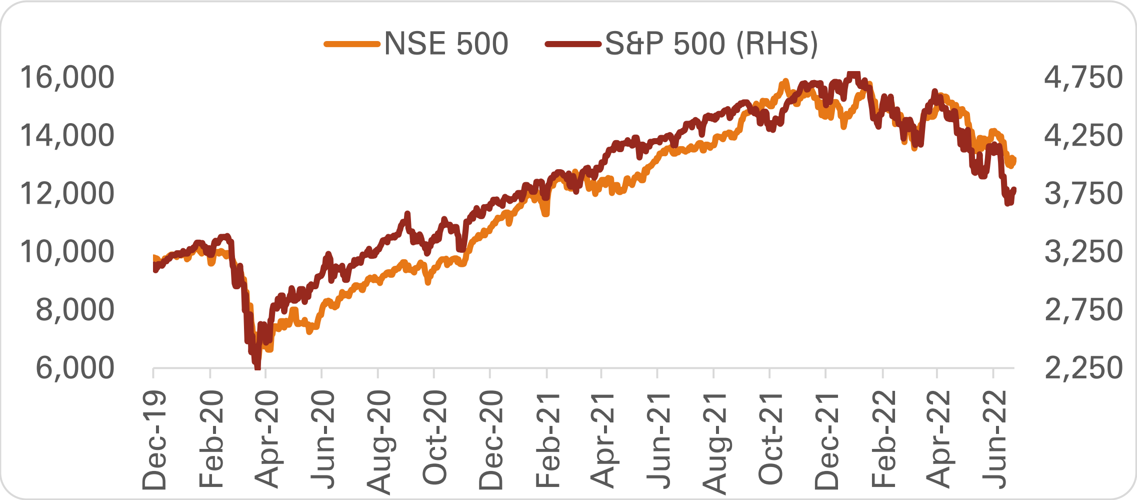
Thus, more than timing, right sizing is the biggest challenge

Indian markets are aligned to move in global markets esp. US





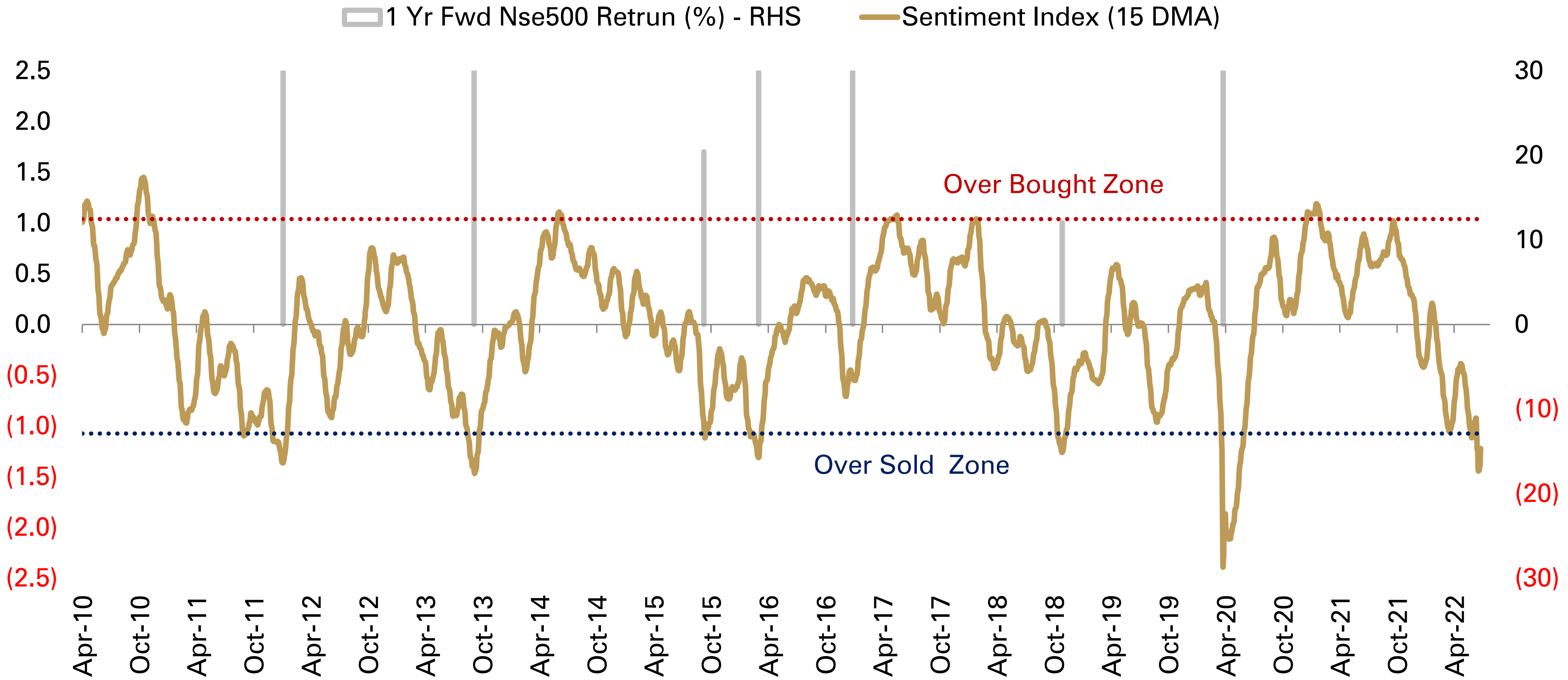




Despite Indian fundamentals being superior to world, Indian markets are always heavily influenced by global market movements, including bottoms & peaks

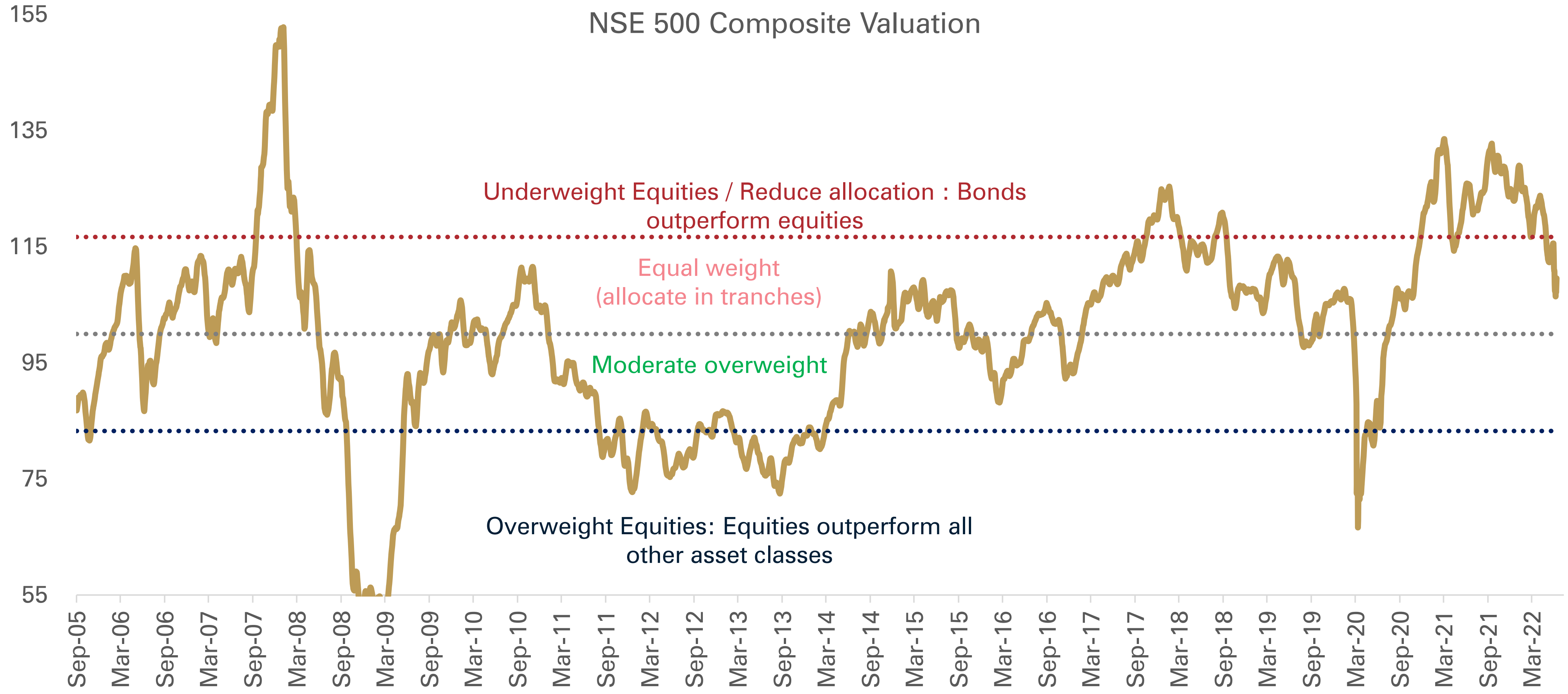
Equity Strategy & Valuations

Indian equity sentiment indicator



Sentiment index indicates a possible short term technical bounce back

Composite Valuation: Still above long term averages



Valuations have now moderated to more reasonable levels, yet not outright cheap

Summary: Equity Strategy

External risks remain elevated

- As economic data shows moderation, quite likely market may bottom much ahead of any potential recession

- Market valuations have already corrected, though not cheap. Therefore, an Equal Weight stance with a defensive bias seems appropriate – if it is widely believed that there can be a recession in US, actual damage may not be that outsized.

- **Best strategy is to keep buying on dips / accumulate over 9 to 12 months to capture bulk of any potential downside – this is the only way of appropriately sizing equity allocation**

- Large cap & diversified equity space remains preferred bet

Fixed Income

RBI hikes rates by 50 bps in line with expectations

RBI expectedly hikes rates by 50 bps: In line with market expectations, the RBI MPC decided to raise policy rates by 50 bps. The decision to raise rates was unanimous. Furthermore, the RBI increased its full-year 2022-23 CPI forecast by a full 100 bps from 5.7% to 6.7%,

Looking forward, the MPC statement explicitly noted the Committee remains ***"focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth."*** The MPC changed its stance from neutral to accommodative in June 2019 when it cut policy rates from 6% to 5.75%. A withdrawal of accommodation would therefore imply taking policy rates back towards 6%, close to our policy rate forecasts.

Inflation projection revised to 6.7% and growth projection retained: RBI revised its inflation forecast from 5.7% to 6.7% at average crude oil price at USD 105/ barrel. CPI inflation is expected at 7.5% in Q1, 7.4% in Q2, 6.2% in Q3 and 5.8% in Q4.

While there are some positives by way of 1) a normal monsoon (despite it being 37% below LPA in first week of June), 2) reduction in taxes on petrol and diesel, 3) tweak in export and custom duties along with ban on wheat exports to reduce domestic prices and 4) decline in global metal prices, inflation risks remain on the higher side given higher oil and food prices. RBI maintained its growth forecast for FY23 at 7.2%

Central Banks have embarked on policy normalization

Policy Rate (in %)	Dec-19	Dec-20	Dec-21	June-22
China	4.15	4.15	3.8	3.7
India	5.15	4	4.0	4.9
South Korea	1.25	0.5	1.0	1.75
Taiwan	1.38	1.13	1.13	1.37
Thailand	1.25	0.5	0.50	0.50
Malaysia	3	1.75	1.75	2.0
Philippines	4	2	2	2.25
Russia	6.25	4.25	8.5	11.0
Turkey	12	17	14.0	14.0
South Africa	6.5	3.5	3.75	4.75
Brazil	4.5	2	9.25	12.75
Mexico	7.25	4.25	5.50	7.0
Colombia	4.25	1.75	3.0	6.0
Chile	1.75	0.5	4.0	8.25
US	1.75	0.25	0.25	1.75
Eurozone	0	0	0.0	0.0
UK	0.75	0.1	0.25	1.0
Japan	0.1	0.1	0.10	0.10

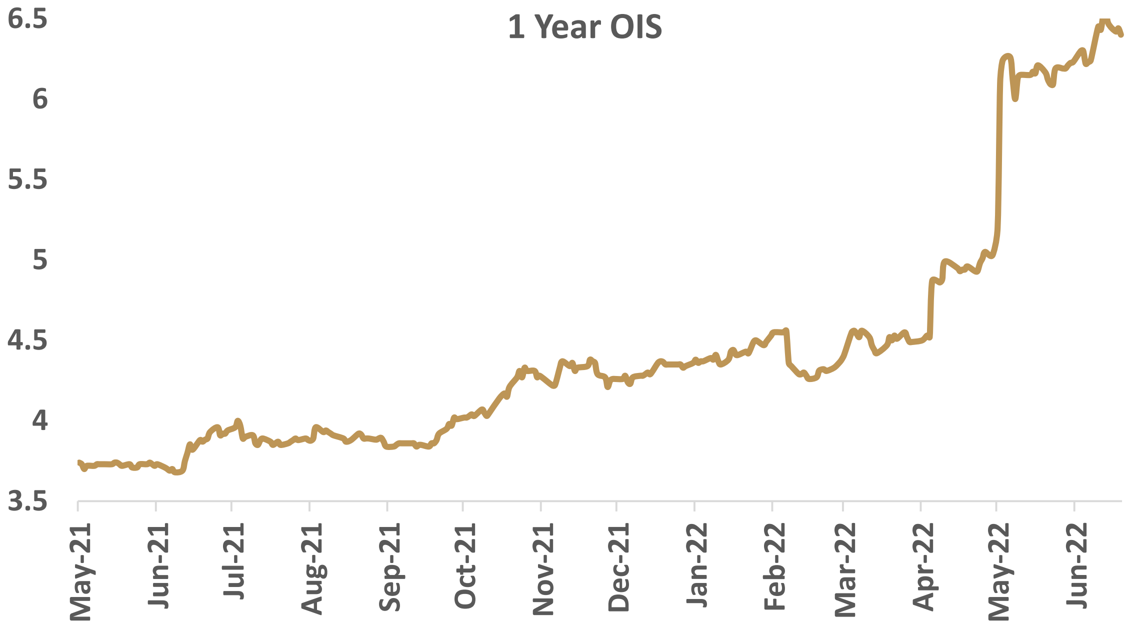
With increase in inflation globally, most of central banks are frontloading rate hikes. Developed markets also have embarked on policy normalization, however at this point, policymakers obviously face even more uncertainty regarding the growth outlook, the immediate risk from the rise in energy prices and near-term inflation outlook

Rising Global Bond Yields

10 Year Gsec Yield (% mth end)	2020 end	Mar-21	Dec-21	Feb-22	22-June-22	YTD change (in bps)
Developed market						
US	0.91	1.74	1.51	1.83	3.22	171
Germany	-0.57	-0.29	-0.18	0.14	1.66	184
Italy	0.54	0.67	1.17	1.71	3.72	255
Japan	0.02	0.1	0.07	0.19	0.24	17
Spain	0.05	0.34	0.57	1.12	2.76	219
UK	0.2	0.85	0.97	1.41	2.55	158
Emerging Market						
Brazil	6.91	9.28	10.84	11.56	12.78	194
China	3.15	3.19	2.78	2.79	2.79	1
India	5.87	6.17	6.45	6.77	7.40	95
Indonesia	5.86	6.76	6.36	6.5	7.60	124
Malaysia	2.65	3.27	3.58	3.67	4.47	89
Russia	5.92	7.04	8.45	15.99	8.91	46
Thailand	1.32	1.97	1.89	2.14	2.94	105
Turkey	12.9	18.86	24.32	21.99	19.77	-455
Mexico	5.55	6.84	7.57	7.95	9.56	199
Poland	1.24	1.57	3.67	4.1	7.24	357
South Africa	8.75	9.5	9.81	9.85	10.19	38
Colombia	5.39	6.97	8.19	9.53	11.99	380
Hungary	2.08	2.71	4.51	5.24	8.56	405

Inflationary pressures & increasingly hawkish monetary stances by major central banks across the globe resulted in higher bond yields.

India: OIS pricing in front loading of rate hikes



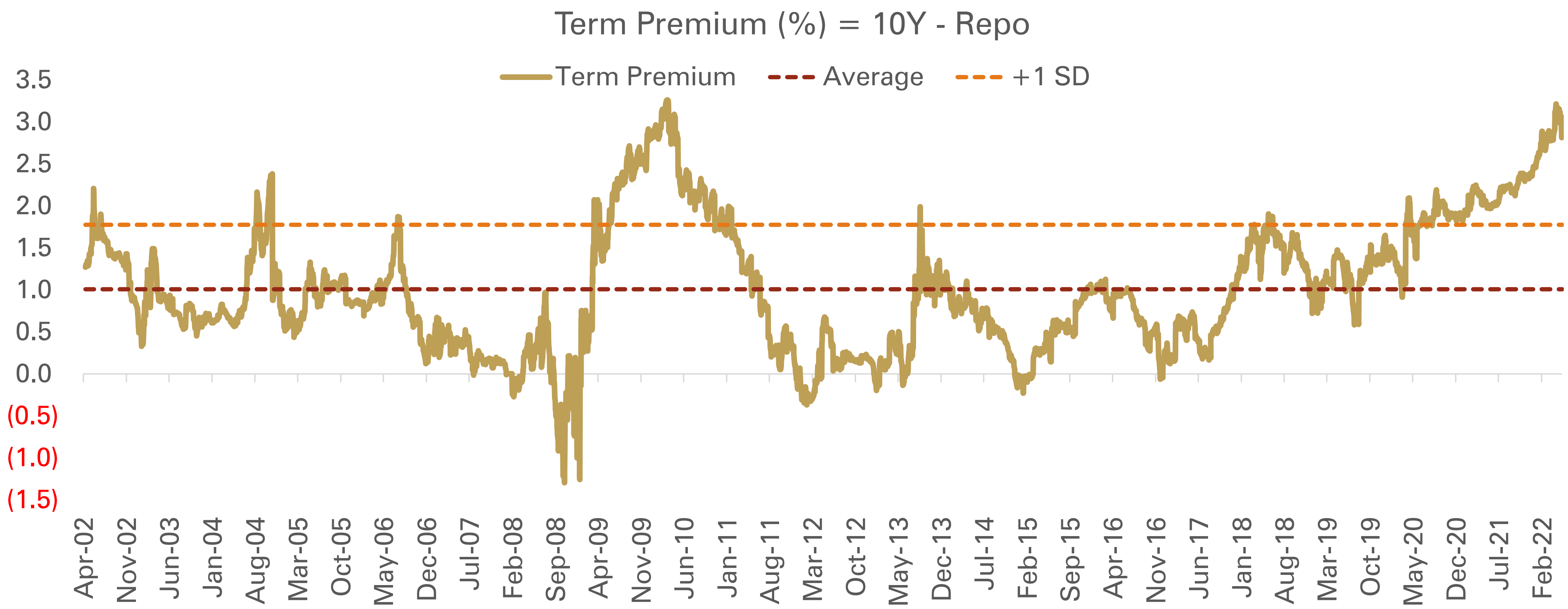
OIS markets are already pricing in 150 bps of rate hike in 1 year and more than 200 bps rate hike over 2 year period.

Rates across have gone up on anticipation of frontloading of rate hikes

Particulars	1-Jan-21	31-Dec-21	31-Mar-22	22-June-22	Change YTD Inc/ (Dec)
Call Rate	3.05	3.35	3	3.7	70
Repo	4	4	4	4.9	90
Short Duration					
3M T-Bill	3.01	3.61	3.78	5.04	126
6M CD	3.5	4.2	4.3	6.0	170
6M CP	3.8	4.7	4.8	6.5	170
G-Sec					
1 Year Gilt	3.5	4.4	4.35	6.2	185
2 Year Gilt	4.25	4.9	5.3	6.6	130
5 Year Gilt	4.99	5.87	6.1	7.3	120
10 Year Gilt	5.83	6.47	6.82	7.4	58
10 Year SDL	6.43	6.9	6.99	7.8	81
Corp Bonds					
1 Year AAA	3.9	4.79	5	6.70	170
3 Year AAA	4.68	5.62	5.8	7.35	155
5 Year AAA	5.5	6.2	6.29	7.64	135
1 Year AA	6.7	7.1	7.13	8.82	169
3 Year AA	7.44	7.87	7.92	9.47	155

With inflation above RBI tolerance and action by global central banks, RBI might frontload rate hikes which is partially getting priced in by the markets

Long Duration (10Y): Offers value at above 7.5 levels



At G-Sec level of 7.75 and above, it will price in terminal repo of 6.0 (overall rate increase of 200 bps) and spread of 175 bps.

At 7.50% - 7.75%, one can start building duration exposure (10 year and above maturity) with a 3+ year plus view

Fixed Income Strategy

The MPC statements in last policy saw a tweak with "**remain accommodative**" being removed while focus on withdrawal of accommodation retained. This should be construed as a step towards moving to neutral stance, which is defined as overnight rates hugging the repo rate. We see another greater than 25bps rate hike in August policy with inflation remaining elevated. We retain our view of 6% terminal repo to be reached in Q4FY23.

Incrementally the evolution of actual inflation and liquidity management will drive market trajectory.

The Governor's statement did indicate that the RBI will "***also remain focused on orderly completion of the government's borrowing program."*** We therefore expect that as the MPC hikes rates at the short end, the RBI could deploy operations to contain any significant movement in longer end of the curve.

Given expectation of gradual upward movement in yields over time, short term investors should continue to consider products with duration lower than investment horizon. Following is preferred strategy:

For investment horizon upto 3 months: Prefer liquid funds, money market funds. Individual investors can consider bank savings upto 3 months as other categories can be volatile.

For longer investment horizon (upto 1 Yr): investors can consider Ultra Short Term Funds, Arbitrage Funds & Deposits

Horizon of more than 3+ years –

- Consider 4-6 year AAA roll down strategies, for investors with horizon of more than 4 years
- At 10 Year G-Sec above 7.75%, long term investors can start building long duration exposure with 5+ year view

Thank you

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