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*Expert view: Volatility to continue in the short term; valuations of large caps reasonable, says Canara HSBC Life CIO*

*Expert view: Jyoti Vaswani, CIO of Canara HSBC Life Insurance, expects short-term volatility in the Indian stock market due to global factors, with the US Fed rate cut and the presidential election as key triggers.*



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Expert view: **Jyoti Vaswani**, the chief investment officer (CIO) of **Canara HSBC Life Insurance**, believes the Indian stock market may remain volatile in the short term, and global factors will dominate market sentiment due to the absence of domestic triggers. In an exclusive chat with Mint, Vaswani highlighted that the rate cut by the US Fed and the US Presidential Election are the two key triggers for the markets for the near future. Vaswani also shared her views on current market valuation, key triggers for the market and the outlook for the private banking and IT s

**Edited excerpts:**

*What is your short-term view of the market? What should be our strategy?*

Following the general elections and the formation of a stable coalition government, the markets settled down, expecting a continuation of policy focus on manufacturing and related reforms.

Of late, markets have been driven by global cues and events such as the reversal of yen carry trade post rate hike in Japan, weak economic data from the US and geopolitical tension in the Middle East

Post a superlative run over the past one year, the markets have witnessed a bout of profit booking recently. We believe that global factors will dominate in the near term due to the absence of incremental domestic cues.

Two key near-term events are lined up from the USA- the expected rate cut by the Federal Reserve in September and the presidential election in November.

We expect volatility in the Indian stock market to continue in the near term, resulting in bouts of profit booking in pockets of the market where valuations are stretched and stock price movement is not in sync with fundamentals.

While we prefer quality large-cap stocks at this point, one should look for an opportunity to buy into the correction, especially in domestic plays like industrials/PSU space, where earnings growth is robust for the next few years.

Global themes such as increased power demand + green energy transition, supply chain diversification, and the need for water conservation and waste reduction will provide additional impetus to India's manufacturing prospects and provide further thrust to the manufacturing theme in India.

*What are your expectations from the Fed and the RBI on the rate cut front? When can they start cutting rates?*

Over the past two years, consensus on the US economy had shifted from anticipating a 'hard landing' (that is, a recession) to a 'soft landing': that inflation would be contained without much of a growth sacrifice.

Market expectations of rate cuts by the US Fed rose significantly in July as July's labour data triggered the 'Sahm Rule'.

This rule states that a recession is probably underway if the average unemployment rate over the past three months has risen by half a per cent from its low point over the previous twelve months. Such fears seem premature as the US economy is slowing but is far from recessionary.

In fact, it is the only large economy where GDP is above its pre-pandemic path.

Consumption remains steady, wage growth is above inflation on average, home prices are still rising, layoffs have not

started yet, and even after the increase in July, the unemployment ratio is still below 'normal'.

Having said that, Inflation, on the other hand, has cooled significantly, with July 2024 CPI coming below the 3 per cent level, opening the door for rate cuts.

In its latest meeting, the FOMC (Federal Open Market Committee) maintained a balanced stance, as in the June policy, when the members had toned down the expectations to just one rate cut in 2025 from earlier projected three rate cuts.

However, the recent developments warrant a pickup in the cadence of Fed easing, and the Fed is expected to start easing from the September 2025 policy, starting with a 25bps cut, followed by at least one more cut by December 2025. India is a different story altogether, enjoying a stable macro environment.

While a deterioration in growth prospects drives the call for rate cuts in developed economies, India remains one of the fastest-growing economies in the world.

After growing by 8.2 per cent in FY24, India is expected to grow by nearly 7 per cent in FY25. CPI inflation, however, has seen some volatility, mainly driven by erratic food inflation.

While the core CPI inflation in the first four months of FY25 has averaged nearly 3.2 per cent, food inflation (nearly 46 per cent weight in the CPI basket) has averaged 7.3 per cent in the same period.

In the last meeting, MPC members raised concerns over this stickiness of food inflation and its possible implications for other components of CPI.

Amid this backdrop, food inflation has become the new core inflation, and its stickiness and volatility have brought in some uncertainty regarding the expected policy path from hereon. The above-normal rainfall with higher sowing should augur well for food inflation and provide some respite in the coming months.

However, in FY25, we do not rule out further preemptive macroprudential actions to keep financial instability at bay amid elevated growth in the personal loan segment, speculative activity in the equity markets, divergent paths of monetary policies globally, and the unwinding of yen carry trade and its ramifications on EM (emerging market) currencies and FII flows.

Accordingly, while the Fed is expected to start easing from September, MPC may choose to stay on the sidelines for now and may only start easing in December or Q4 of FY25, ceteris paribus.

*Is valuation still a concern after healthy correction?*

Market valuations are a major function of earnings growth. While the Indian stock market's valuation multiples look higher than the historical average, expansion in valuation multiples has coincided with strong earnings growth over the last couple of years.

Looking ahead, the question is whether the momentum in earnings growth will continue over the next two to three years to support the current valuations.

We believe that earnings growth may slow down a little going ahead. However, there are no concerning signs at this time. Earnings growth will likely be in double digits for the next couple of years, supporting market valuation. However, while the valuations on the large caps seem reasonable, valuations on the mid and small-cap sides do appear stretched and warrant a cautious approach.

The other factor contributing to India's high valuation multiple is the stable domestic flow, both institutional and retail. India has not seen significant foreign fund inflows over the past three years.

The main driver has been a deluge of domestic liquidity driven by the financialization of savings. Cumulative net equity fund flows FY22-25 till date were nearly \$70 billion for domestic mutual funds.

The valuations remain supported by deepening local liquidity with a long latent runway.

If the financialization of savings increases just 500bps over the next five years (from 50 per cent to 55 per cent), then this alone would mean roughly a 3.5-4 times increase in flow to equity markets—a powerful sponge to absorb market drawdowns.

*Does this market lack fresh triggers? What key factors will drive the stock market for the next few months?*

While many positives, such as robust domestic macro, sustained earnings growth, and political stability, have already been factored into current Indian market valuations, strong retail participation in Indian markets—directly and via mutual funds—with SIP figures crossing 20,000 crore continues to act as a positive trigger for our markets.

If we look at US markets, the beginning of the rate cut cycle is expected in September, which may continue over the next 12-24 months.

If economic conditions in the USA and political stability remain stable for the next few quarters, a declining interest rate cycle could present a goldilocks scenario for risky assets and emerging market flows.

In this case, FII inflows into India, which have been uneven for the past few years, could see an uptrend, resulting in an up-move for Indian equities.

*What are the key challenges that can impact the market significantly?*

We have seen negative global cues periodically impact Indian markets and flows.

Weak economic growth in the USA, escalation in prevailing geopolitical tensions, volatility in commodity prices, and yen carry trade unwinds are a few global factors that are hard to predict and could create risk-off sentiment globally, impacting Indian markets, too.

Domestically, our banking system has had a benign credit cycle for the past two to three years. Credit costs have been quite low, while credit growth has stayed strong at around 15 per cent.

At some point, the credit cycle will turn, impacting the banking system and the overall economy and markets. While there has been some rise in delinquency in small-ticket loans and the finance segment recently, this weakness has not spread to the overall banking system. We will keep a close eye on the development on this front.

*Do you see some value in the private banking space? What stocks are your preferred picks from the sector?*

While credit growth could slow down compared to the robust growth seen in the last few years, the large private banks are currently well-placed to take advantage of the credit opportunities available in the Indian economy, given that their capital adequacy levels (particularly tier-1 capital) are very strong and comfortably above the central bank's regulatory requirement.

In addition, loan loss provisions of private banks are expected to be manageable, given (1) the RBI's proactive monitoring and control of risky unsecured lending, (2) the improved credit monitoring frameworks and high NPA coverage of private banks and (3) the benign asset quality cycle of the overall banking / NBFC sector.

While competitive intensity may see some amount of compression in lending spreads, the overall profitability of private banks would be led by credit growth opportunities across corporate/SME/retail, better operating leverage of existing branches/employees and stable NPA provisions.

Hence, our preferred picks from the sector would be banks with a relatively (a) high and sticky low-cost deposit base to manage the lending spread compression ahead and (b) high capital adequacy (tier-1 capital) to take advantage of growth opportunities without the need for equity dilution.

*Should investors consider betting on midcap IT firms? Is the worst behind for the sector?*

With US inflation coming off and the unemployment rate going up, a rate cut by the US Fed in the near term is more likely than before.

This has been reflected in the recent rally in IT stocks, which factored in a cut in interest rates in the US even though there has been no material change in US corporate IT spending outlooks or revenue guidance by Indian IT companies.

While the worst seems to be behind us for the sector as order wins have started picking up and discretionary spending is witnessing some green shoots, we are cautious on the sector owing to the high valuation multiple for most of the IT stocks post the recent rally.

We are more constructive on the large-cap [IT space](#), and midcap IT stocks can be added selectively depending on the expectation of a revenue turnaround over the next few quarters.

**Link:** <https://www.livemint.com/market/stock-market-news/expert-view-volatility-to-continue-in-the-short-term- valuations-of-large-caps-reasonable-says-canara-hsbc-life-cio-11724302772426.html>