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Daily Voice: Near-term headwinds for corporate earnings could impact equity markets for a while, says CIO Jyoti Vaswani

Near-term headwinds for corporate earnings could impact equity markets for a while, according to Jyoti Vaswani of Canara HSBC Life Insurance, though she believes medium-term earnings trajectory of Indian market remains robust.

After registering strong double-digit earnings growth over past few years, of late, there have been some concerns (fuelled by weak demand in auto sector, slowdown in credit growth by banks, absence of pick up in volume growth for FMCG companies) over sustainability of this earnings growth over next few quarters, said the chief investment officer with more than 25 years of experience in the mutual fund and life insurance industry.

On the IT space, she believes most IT companies are currently trading at higher than historical average valuation which indicates most of the turnaround story for the sector has been already captured in stock price. She broadly prefers largecap IT names over mid cap at this stage.

Are you bullish on mid-cap IT companies compared to large-cap IT names?

The sharp run up in the IT sector over past few months has made the sector valuation expensive. We are currently witnessing revival in demand environment especially for BFSI clients which could lead to tangible improvement in revenue growth for the sector in FY26. 50 bps rate cut by US Fed in September and optimism for a soft landing in US economy has created a tailwind for Indian IT companies.

However, most IT companies are currently trading at higher than historical average valuation which indicates most of the turnaround story for the sector has been already captured in stock price. On this backdrop, we are very selective in our stock picks from the mid-cap IT space, and we broadly prefer largecap IT names over mid cap at this stage.

Do you strongly believe that domestic liquidity remains unstoppable?

Equity as an asset has increasingly found a place in domestic investors' mind as shown in higher percentage of equity investment within retail financial savings in India. SIP investments in equity market has found favour and has resulted in mutual fund monthly gross SIP figure crossing Rs 24,000 crore in September 2024. This is a positive sign for Indian economy and development of equity market as market participation is getting broad based.

We believe this is a structural change for our markets and this trend of increasing retail participation is likely to continue for next few years. However, there will be intermittent volatility in the domestic liquidity situation especially if markets go through a phase of consolidation or correction. In a negative equity market cycle, it is natural to see some drawdown in retail investor flows into the market.

Given the rising competition, do you see the auto industry growing at best in single digits from here on?

Automobile sector witnessed a bout of robust growth in FY24 with two-wheeler and passenger vehicles doing well on the back of product launches. This year volume growth for the sector has started on a muted note especially for passenger vehicle segment with rising inventory and falling demand. Electric vehicle sales have also fallen with phasing out of government incentives. Festive season demand so far has remained mixed with all eyes on upcoming Diwali week. We believe auto sector may have muted volume growth in FY25 with passenger vehicle (PV) segment registering slower growth versus last year and two-wheeler segment doing better than PVs.

Is the equity market more concerned about earnings growth than global risk factors?

While equity markets get affected by global factors in near term, earnings growth determine market returns over medium to long term. Various global factors like geopolitical tension in Middle East, probable economic slowdown in USA and stimulus in China have impacted Indian markets adversely over last few months. However, impact of global events on Indian markets are cushioned by robust domestic inflows which counters FII outflows.

After registering strong double-digit earnings growth over past few years, of late, there have been some concerns over sustainability of this earnings growth over next few quarters. These concerns are fuelled by weak demand in auto sector, slowdown in credit growth by banks amidst race to raise more deposits, absence of pick up in volume growth for FMCG companies etc. While we believe medium term earnings trajectory of Indian market remain robust, these near term headwinds for earnings could impact markets for a while.

Is it better to invest in the consumer discretionary space rather than traditional FMCG stocks?

FMCG stocks have been struggling with revenue growth for past many quarters on the back of issues like rural slowdown, high inflation, increasing competition etc. We do not see material improvement in growth rates in near term as indicated by Q2FY25 results so far by consumer companies. On top of slower growth, stocks are trading at extremely high valuation thus limiting upside. On the other hand, within consumer discretionary space, pockets such as retail, jewellery, aviation, cables, alcohol beverage, white goods are posting better growth amidst strong demand. Some of the stocks in this space are also available at reasonable valuation too. Thus, we currently prefer consumer discretionary stocks over FMCG.

Do you rule out telecom tariff hikes at least for the next 2-3 years? Should one remain invested in the telecom stocks?

Private telecom companies took a round of tariff hikes between 10-25 percent in July this year after a long wait of 10 quarters. The quantum of hike is relatively large and should have significant impact on profitability of the companies. Also, subscriber churn could play out over next few quarters. We expect the telecom companies will wait for at least a year or so before taking any material tariff hike.

For telecom companies, due to operating leverage benefits, tariff hike improves profit margin and cashflow materially. Being a few players market, we remain positive on the sector and companies where viability of debt servicing is not in question. We believe structurally these stocks will generate decent return ratios and sustainable cashflow over long term as telecom tariff rate keeps improving.

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