India Stock Market

OVERALL OUTLOOK POSITIVE, THOUGH VALUATION REMAINS A CONCERN

The overall outlook for the Indian stock market appears positive, although market appreciation from these levels would need major triggers. Hence, investors would do well to stay invested and avoid trading.

This is the time of the year when you start crystal gazing to see how markets will perform in 2023. The Indian stock market was a complete exception to global trends in 2022. The Indian benchmark indices (Sensex and Nifty) have hit life-time highs in a year marked by global meltdown. Nifty is up 6% for the year (till December 20) while all other markets including S&P 500, MSCI Emerging market index, etc. went through a tough bear market. India demonstrated efficient Covid management as it did not appear as draconian as in China which enabled broader economy to jump back swiftly. Also, the inward looking Indian economy with not much of export dependency (unlike China) saw to it that the economic engine continues to brim on the back of domestic consumer support. To top this, the strength of retail investors who have now embraced Systematic Investment Plan (SIP) in big measure made sure that the liquidity tap is kept open even in the aftermath of severe pulling out of funds by foreign investors. It is quite possible that these factors can explain the performance of Indian equity markets in 2022.

With this background, we can now focus on what is in store for 2023 in terms of expectations.

Of market drivers and signals

In my framework, I considered six key variables and rated them across positive/neural/negative to get a sense of the overall outlook.

1. **Economy**: There are many legs to the economy and I have identified seven to focus. Among these, let us first focus on the positives.

Market Drivers

	Positive	Neutral	Negative
Economy	☑	☐	☐
Earnings	☑	☐	☐
Valuation	☐	☐	☑
Foreign Investors	☐	☐	☑
Domestic Investors - Institutional	☑	☐	☐
Domestic Investors - Retail	☑	☐	☐
Overall	☑	☐	☐
Source: Author assessment			

At the broad level, the real gross domestic product (GDP) growth is expected to slow down a bit to 6.1% in 2023 from 6.8% in 2022 as per International Monetary Fund (IMF). Other global forecasts like Amundi (5.6%) and Barclays (5.1%) may be even a tad lower

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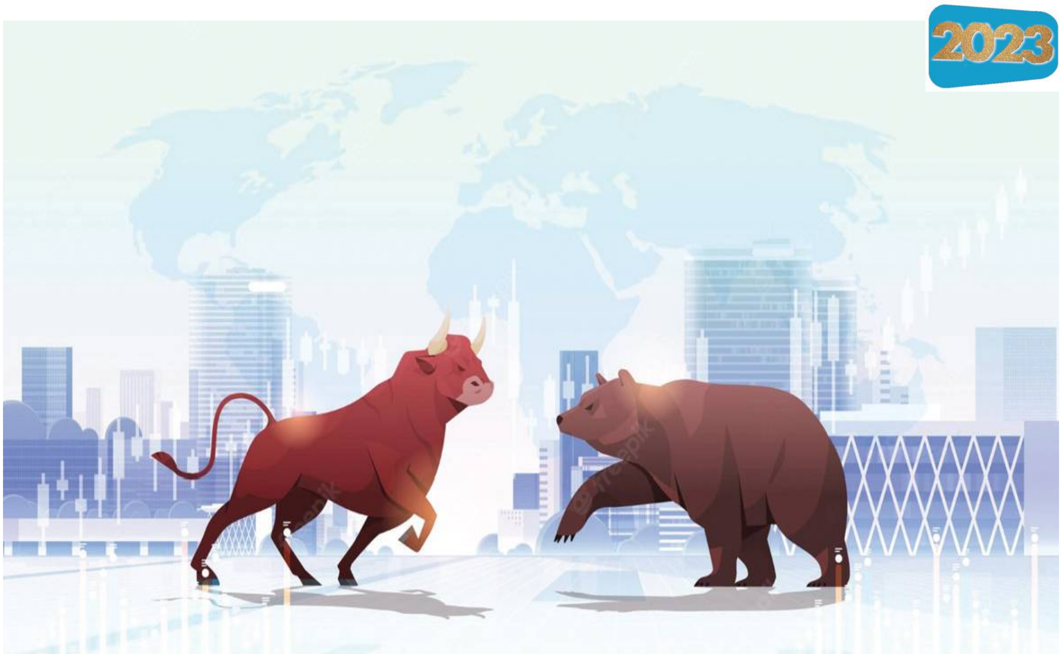
than IMF. However, in relative terms, the Indian growth appears better than other developed and developing markets. The current account worsened in 2022 (–3.5% of the GDP) on the back of high energy prices. However, India's deal with Russia saved the day to an extent and the current account is now expected to turn positive to 2.9% of GDP for the year 2023. The credit growth (a key measure of economic activity) exhibited good strength in 2022 at 14% and as per Fitch is expected to get better at 17% for 2023. Inflation is a hot topic for the world in 2022 and can count as the single spoiler of all equations. Advanced economies (read United States and Europe) inflation now looks more like emerging markets and Fed has to be its aggressive best to tame it. Eurozone inflation is expected to be 7% in 2023 while that of US is expected to come down to 4.1% in 2023 after clocking 8.1% in 2022. Consumer Price Index (CPI) estimates for India stand at 4.9% to 6.3% depending on where you look. But these numbers appear very reasonable given the global trends in inflation.

In terms of negatives for the economy, I would flag the sharply reducing forex reserves and fiscal deficit. On the forex reserves, we have seen a depletion of more than $100 bn in 2022 and the reserves stand now at $564 bn compared to $635 bn in 2021. That is the price Reserve Bank of India (RBI) has to pay to defend the currency which depreciated by 11% in 2022, still better than other emerging market currency depreciations. Morgan Stanley now expects Rupee to appreciate by 6% in 2023. The rapid fall in forex reserves is indeed a negative for an economy like India. However, the performance of Rupee can be categorized as neural. The other negative is the outsized fiscal deficit that the country is going through. After clocking nearly 10% of deficit in 2022, 2023 appears no different with a projected deficit of 9% of the GDP. In normal times, such high levels of deficit would have warranted serious credit rating actions but in Covid and war times, all are forgiven. However, the uncontrollable fiscal deficit is a serious negative.

My overall assessment of the economic potential of India for 2023 is POSITIVE.

2. **Earnings:** In the long run the only thing that matters for stock market is the earnings growth. Due to Covid, earnings per share (EPS) growth showed very high volatility (–15.4% in 2020 followed by +98% in 2021). However, EPS growth stabilized to 16% in 2022 and Citi's forecast for 2023 stands at 16.4% and 28.2 % for 2024. This makes me to believe that assessment for earnings growth is POSITIVE.
3. **Valuation**: India's P/E ratio stands at 22 in 2022 though down from 24 in 2021. However, global P/E ratios all appear very reasonable after the bear market meltdown and in that context India's P/E ratio appear very excessive. The forecast by Citi is that it is likely to moderate to 18.9 in 2023 and to 8.8 for 2024 given the strong EPS growth. While the outlook for 2024 appears very reasonable, the outlook on valuation for 2023 looks expensive and therefore the assessment is NEGATIVE.
4. **Foreign Portfolio Investors (FPIs)**: FPIs found immense value in United States and Europe after the bear markets and therefore money got pulled out of markets like India. Though towards the end some money found its way back to the market, generally throughout 2022, foreign investors were mainly sellers in India. FPI showed a negative balance of ₹133,963 cr in 2022 as against a

Economy	Positive	Neutral	Negative
Real GDP Growth	☑	☐	☐
Current Account	☑	☐	☐
Fiscal Deficit	☐	☐	☑
Forex reserve	☐	☐	☑
Rupee	☐	☑	☐
Credit Growth	☑	☐	☐
Infaltion	☑	☐	☐
Source: Author Assessment			



positive flow of ₹50,089 cr in 2021. FPIs own nearly 19% of shares in Indian companies. Given the expected volatility in global markets, I see the same trend for 2023. The assessment therefore on this count is NEGATIVE.

5. **Domestic Institutional Investors (DII's)**: Institutional investors in India like LIC, mutual funds, etc., are indeed active and contribute to the overall strength. However, their asset allocation favors more of debt except for equity mutual funds. To compensate for the outflow from FPIs, DIIs invested ₹251,000 cr in 2022 and were instrumental in holding up of the market. They hold nearly 20% of shares in Indian companies something very similar to FPIs. The role of domestic institutional investors largely remains POSITIVE for now.
6. **Domestic Retail Investors**: The biggest surprise for Indian capital market continues to be the growing retail investors who embraced active trading during Covid lock down in 2020 and 2021 and now turned to long-term investors primarily through SIPs which guarantee regular liquidity regardless of market conditions. Retail investors account for 7.3% in terms of share ownership in Indian companies and I expect that to grow significantly over time. The continuous presence of retail investors in the market is a huge POSITIVE for market outlook.

What do the indicators suggest?

In conclusion, given the fact that 4 out of 6 factors are positive with one neutral, the overall outlook for Indian stock market in 2023 appears positive. Market appreciation from these levels when indices have reached historic highs can be tricky. Such an appreciation can come mainly through market cap expansion triggered by earnings expansion. The scope for upward P/E rerating appears low and therefore earnings expansion seems to be the key. Any negative surprises on this can induce a great deal of volatility.

Global opinion about Indian equity market prospects are sharply divided with Citi predicting Nifty to end at 17,700, while Goldman Sachs expects Nifty to end at 20,500. I would expect Nifty to close anywhere between 21,000 and 23,000 as a base case scenario. Within this, sectors like banking, financial services, capital goods and IT can be favored.

In any case, equity asset class is characterized by high volatility and one can beat this risk only by constantly investing in the market at periodic intervals. The key would be to stay invested and avoid trading. ■

Reference # 20M-2023-01-06-01