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India equity playbook 2024: Japan carry trade, rate cuts and US elections taking centre stage

By Vinay Jaising, ET CONTRIBUTORS • Last Updated: Sep 02, 2024, 02:05:00 PM IST

Synopsis
US economic indicators, like rising unemployment and mortgage delinquencies, point towards a global economic slowdown, potentially leading to interest rate cuts. The upcoming US elections in Q4 2024 could further fuel market volatility. Comparatively, India's economy is robust, and with elections and the Budget behind us, it's well-positioned for continued outperformance, particularly given the ample domestic liquidity. However, despite its strong fundamentals, the Indian market may still be influenced by global trends, especially given its current high valuations.

Global and **Indian markets** have been shining so far in 2024 with MSCI world up 13%, MSCI India increasing an impressive 21%, and small and midcap Indian indices almost 30%. For the remaining part of the year, global events would take centre stage as to how the **equity market** performs globally and headwinds seem more than tailwinds. Japan was a low-cost capital country for certain investors who were investing Japanese money into global assets, which is currently reversing, with the appreciating Yen.

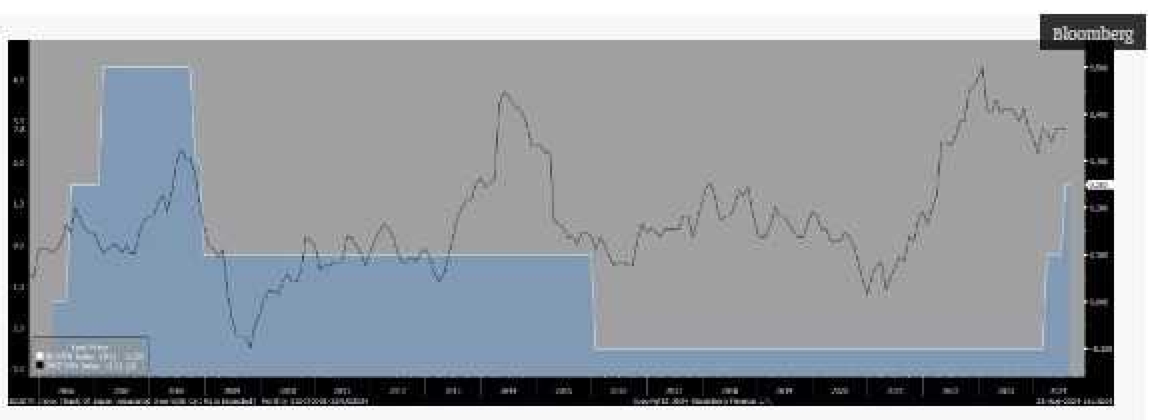
US economic data, be it unemployment rates or mortgage delinquencies, is all hinting towards a global slowdown and interest **rate cuts** seem imminent. **US elections** too are in Q42024, which could add to volatility. India, on a relative basis, has a much stronger economy, and with the Indian elections and Budget behind us, should continue to outperform, especially given domestic liquidity being the highest ever. On an absolute basis, however, Indian markets could be a function of how **global markets** perform, since valuations are rich.

Japan has moved from a negative inflation and depreciating currency Country to the opposite

Japan has always been a low-to-negative inflation country for the last 30 years, with its **interest rates** being sub 0.5% since Oct'08. Its currency too has depreciated by ~60% since then and had hit a 34-year low of ~160 versus the dollar in Apr'24.

However, since Apr'22 the inflation rate inched up to over 2% and now stands at 2.8%. This has led to interest rates for the 10-year bond from 0.15% in Jan 2022 to almost 1% now and the Japanese government last month also increased the bank lending rates by 15bps. This has led to the currency appreciating from a peak of 160 versus the dollar by ~15% to 140 levels, currently.

Earlier, investors from the US would borrow in Japanese currency at virtually no interest and invest in global markets. In the US if one had borrowed in 2010 and repaid back in 2024 Feb, pure currency deprecation would have given him ~40% return and add to that the return say of NASDAQ of ~860% would have earned ~900%. But with the appreciating Yen, this carry trade of borrowing in Japan and investing in the US is now behind us.



Source – **Bloomberg**)

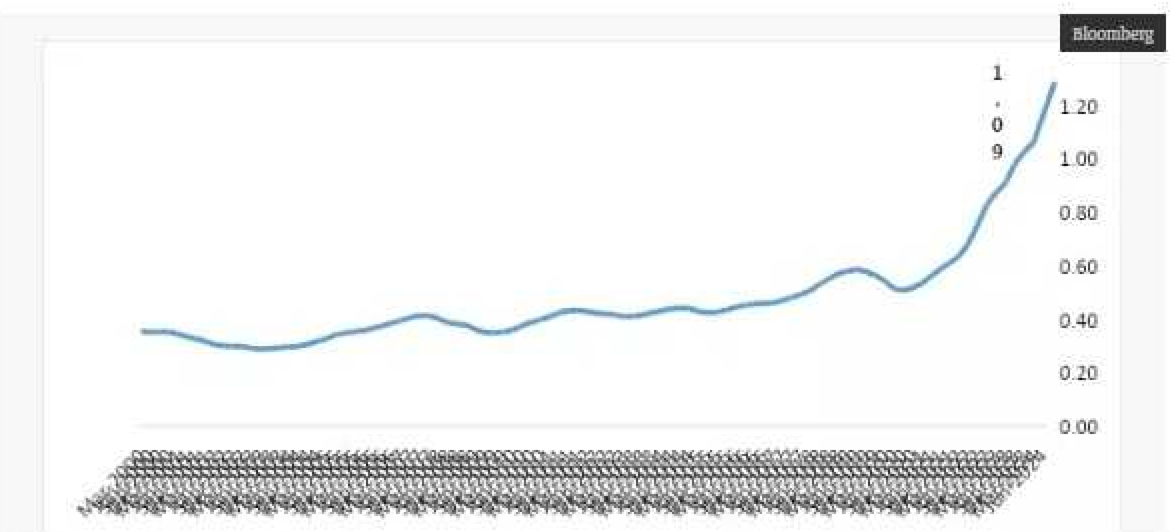
US rate cuts imminent

The US government cut rates to US 0.25% during COVID times in March 2020. However, since then, its rates have increased by 500 bps to 5.25% - 5.5%, currently. This has led to a ballooning interest cost of as much as US$ 1 trillion on the government debt and US$ 600 billion in mortgage debt paid by retail US and a similar number paid by retail US on other debt taken by them. This has led to a consumption slowdown. Mortgage applications were extremely slow, similar to 2008 levels, mortgage delinquencies slipped close to COVID levels and credit card delinquencies were reported closer to the GFC crisis at ~11%.

Unemployment rates have increased from 3.4% in January 2023 to 4.3% currently; jobless claims are at 11-month highs and non-farm payrolls are weak. The manufacturing PMI is sub 50, suggesting shrinkage. **GDP** growth in 2024 so far has grown less than the growth in absolute US govt.

Debt

The US 2-year and 10-year charts have fallen from a peak of 5% and 4% in April 2024, respectively, to 3.9% and 3.8%, suggesting a rate cut is on its way. The rate cut should help stabilise the economy and could be as much as 75 bps in the next two months. The good news is inflation though sticky has fallen below 3% after 2 years making it conducive for a rate cut. This suggests tailwinds for the equity markets globally in the shorter term.



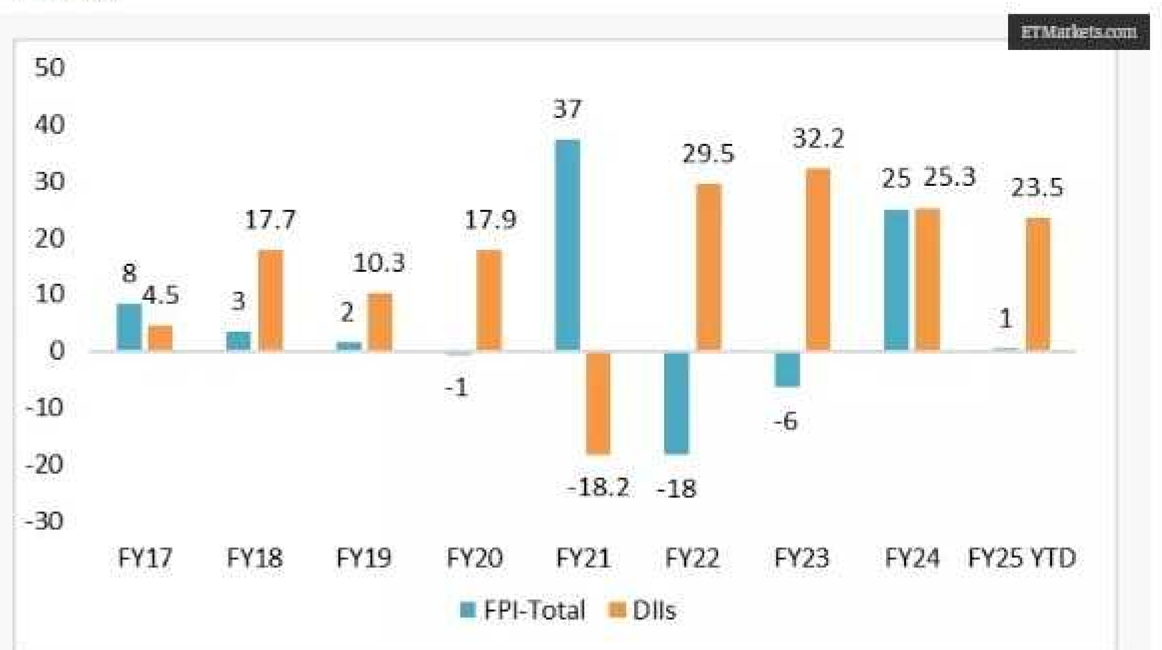
(Source – **Bloomberg**)

Can Indian Equities be de-aligned from the US and the world?

Indian manufacturing and GDP growth are in an expansionary mode, making it a safer haven to its global peers. However, valuations of indices are close to their 5-year averages. The thing driving the equity markets is the resilient domestic flows of US$ 4 billion in August itself and over US$ 23 bn FYTD the fourth highest India has witnessed in a year as a whole.

FIIs have been net neutral to the market FYTD and this should have got their overall ownership levels in the Indian market to around 16% the lowest in 12 years. Domestic MFs are sitting on Rs 1.5 lakh crore or 5% of their AUM in cash, and this will further cushion any major fall.

The themes we would like to be invested in in the current environment are largely domestic facing sectors as against global, especially since we have strong economic tailwinds and global headwinds for slowdown in growth. In the global facing sector, we would like to be invested in India's outsourcing stories.



*(Source – **Bloomberg, JM Financial**)*