

India equity playbook 2024: US pivot has finally happened; will D-St shine even more?

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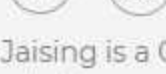
Synopsis

The US Federal Reserve has cut interest rates by 50 basis points to address rising unemployment and bolster demand. Historically, such cuts have led to market corrections, but current US GDP growth suggests a different outcome. Indian markets, with strong GDP growth and robust liquidity, may remain resilient despite global trends.



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The **US Fed** has finally cut its interest by 50 bps. Our analysis showcases that since the turn of the century the US has witnessed 3 instances of a pivot of 50 bps rate cut, which were driven by the need to reduce a recession. Excluding COVID, US markets corrected as much 24% to 28% one year post the first cut. Indian markets too followed suit, correcting 15% to 30% during these two instances.

However, this time US GDP is still growing at around 2% and fears of recession are lower.

Theoretically, falling interest rates in the longer run should revive demand, increase capex and

lower cost of capital and increase valuations and earnings of markets, especially if the economy is growing. India in our eyes falls under this basket of "growing economies with stable corporate earnings drivers". Surge in domestic liquidity led to belief the **equities** could delink from the world and US markets at least shunting any significant falls.

US finally has pivoted – Could the global markets correct

The **Fed** has cut its interest by 50 bps to 5% to arrest the rise in unemployment rates and bolster demand. This could lead to other economies following suit albeit not at the same pace. The cuts expected are another 150 bps by end 2025. This could call for a weakening of the US dollar specially against India. Our analysis showcases that since the turn of the century the US has witnessed 3 instances of a PIVOT of 50 bps rate cut, before the current Fed cut of 50 bps on September 18, 2024.

The dot-com bust and 9/11 led to 2001 being a year of recession - After the dot-com bubble of the late 1990s and 2000 came the dot-com bust of 2001. The frenzy of irrational exuberance saw massive amounts of money flow into ever less viable dot-com investments, leading to an inevitable stock market crash. The Nasdaq Composite peaked in February 2000 but wouldn't bottom out until September 2002. Along the way, the stock market meltdown spilled over into the real economy, driving a modest contraction in GDP in 2001 and higher unemployment levels. This led to an eight-month long recession.

The 9/11 terrorist attacks only exacerbated the problems in the economy. The first cut of 50 bps came in Jan 2001, and the Fed lowered interest rates by a total of 4.75 percentage points with a steady drumbeat of rate cuts throughout 2001, with the last cut coming Dec 2001 of 25 bps.

During this period the tech heavy NASDAQ fell by almost 80% from its peak by Oct 2002, even 10 months post the last cut.

The housing market crash 2007-2008 led to 2008 and H2009 being a period of recession

The Fed completed its 2005-2006 campaign for rate hikes in June 2006. By early 2007, the housing bubble was bursting and the unemployment rate started to rise. With the economy ailing, the FOMC started reducing rates in September 2007, eventually slashing rates by 2.75 percentage points in less than a year. "The substantial easing of monetary policy to date, combined with ongoing measures to foster market liquidity, should help to promote moderate growth over time and to mitigate risks to economic activity," the Fed said in an April 2008 statement. After the April 2008 rate cut, then Fed Chair Ben Bernanke hit pause to survey the impact of lower interest rates on the economy. Some analysts believed that higher inflation was afoot—and few realized how bad the coming global financial crisis would become.

The first cut of 50 bps came in Sept 2007, and the Fed lowered interest rates by a total of 4.75 percentage points in two cycles, with a steady drumbeat of rate cuts till April 2008 of 25 bps. The second cycle started in October 2008 again with 50 bps cuts.

Though the US markets (S&P 500) were stable for the first 90 days, it started falling thereafter and corrected 24% in a year.

The COVID pandemic of 2020 lead to a short lived recession in 1H2020

COVID being a black swan event, was well handled by most of the govts, by increasing fiscal deficit and cutting interest rates. Interest rates were cut aggressively by 50 bps and 100 bps in 1H2020 and so also 10% of fiscal spending in the year as a whole. During this period in the first quarter the markets corrected almost 20% but reverted back 50% of its fall in 3 months. Recession too was short lived lasting two quarters

The learnings to the 3 Fed PIVOTs of 50 bps has been it has come due to GDP contraction/recession and hence the markets reacted negatively

The current Fed cut of 50 bps has come more so to curb unemployment rates and jobless claims and indirectly to reduce the high interest burden on the debt. The US GHDP growth in Q22024 was 3% and not a contraction hence the past three analysis may not hold true of a possibility of a significant market correction

Will Indian equities de-link from the US and the world?

India on the other hand is seeing growth in its GDP estimates of ~7%, a strong PMI expansion both in services and manufacturing; as well a swelling Forex reserve which currently stands at US\$ 690 bn. This is clearly a contrast of what is prevailing in rest of the world, making it a safer haven to its global peers however valuations of indices are 10% above their 5-year averages, 100% above EMs and 25% above global comps

The thing driving the equity markets is the resilient flows both domestic and FII. Post-election both domestic and FII have invested over US\$ ~13 Bn each into the market. Domestic flows have been over US\$ ~25 bn FYTD the fourth highest India has witnessed in a year as a whole. FIIs overall ownership levels in the Indian market to around 16.3% the lowest in 12 years and we expect this to improve substantially in the future. Domestic MF are sitting on Rs 1.9 lakh Crores or 6.4% of their AUM on cash and this will further cushion any major fall. The themes we would like to be invested in the current environment are largely domestic facing sectors as against global, especially since we having a 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.

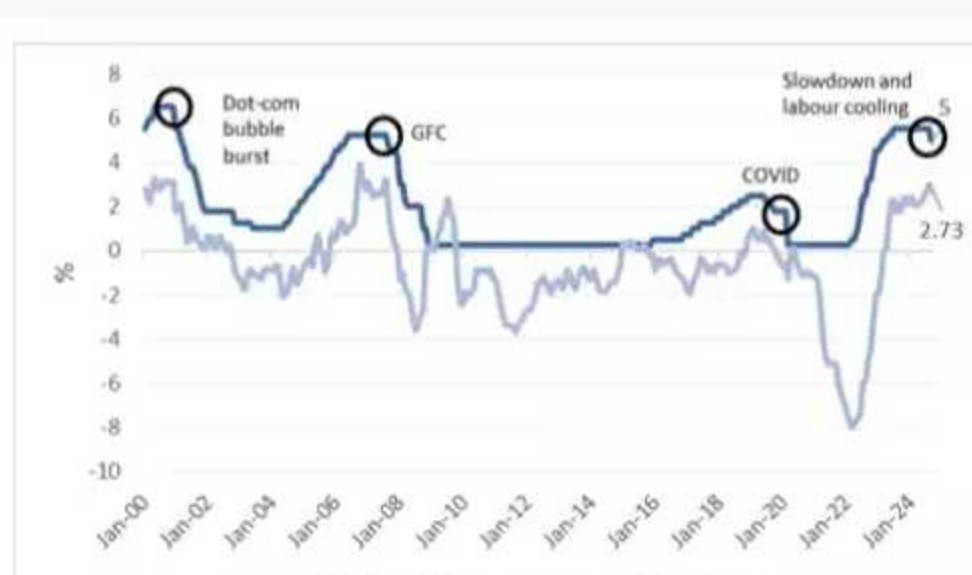


Figure 1 - US Federal Funds and Real Federal Funds rates

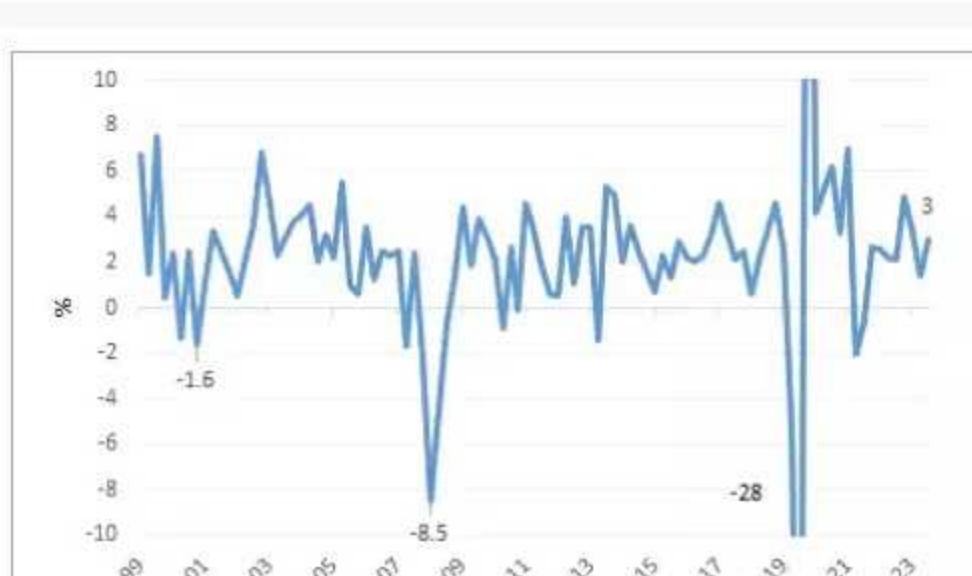


Figure 2 - US Real GDP Growth Rate YoY

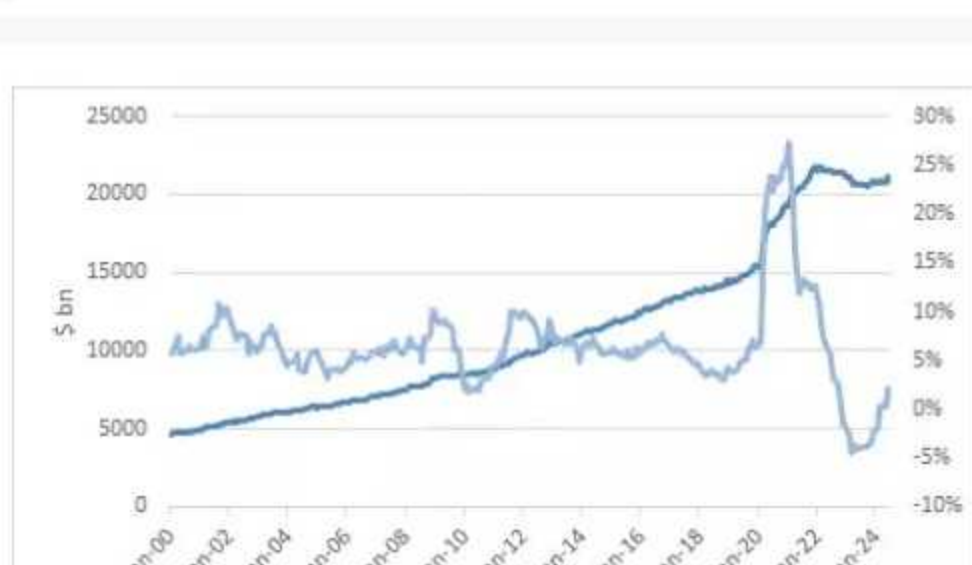


Figure 3 - USD Bn and YoY (LHS)

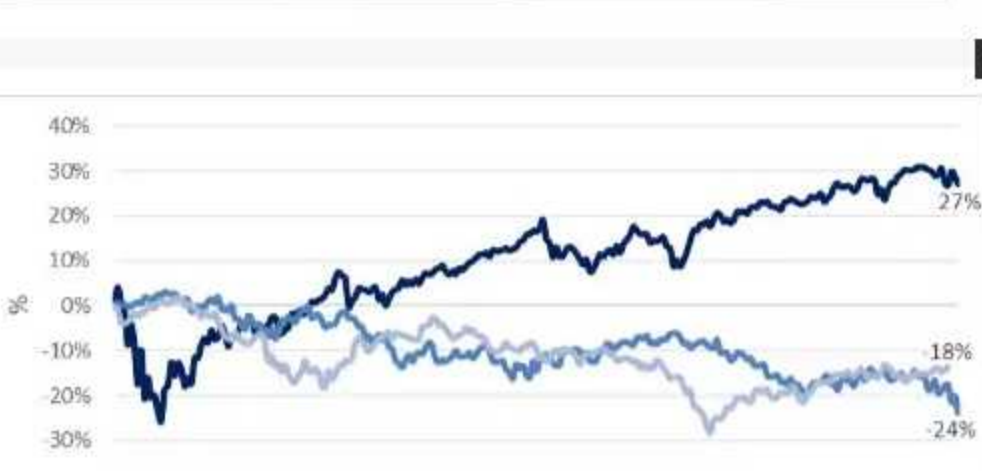


Figure 4 - S&P500 movement post Fed cut

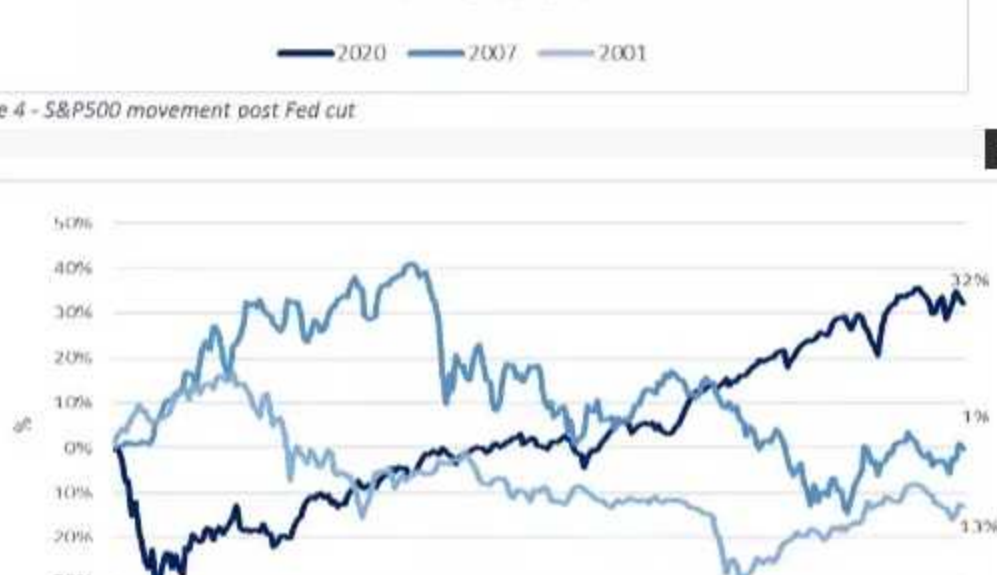


Figure 5 - NIFTY 50 movement post Fed cut

(Source – Bloomberg)