

Change in conditions versus change in context



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In the past year, the markets have been debating the dynamics of price stability and economic growth. Due to a sharp rise in inflation in the last two years, major Central Banks across the world have been raising interest rates and tightening money supply aggressively. As expected, such sharp increase in cost of money impacted Economic growth rates which have been revised downwards. This in turn led to worries about credit and leverage. Market participants and credit rating agencies have been worried about leverage in Sovereign, Corporate as well as Household sectors and trying to price in the credit risk.

After one of the sharpest rate hikes in history, leading indicators finally started pointing towards lower inflation in the coming calendar year. It looked like Central Banks have successfully manoeuvred a soft-landing in the global economy while taming inflation. However, we believe it is going to be a rough ride forward. Even if some economies avoid a technical recession, growth is likely to be tepid and uneven and more 'recession-like'. On the inflation front too, there are likely to be sporadic period of spurts due to political and geo-political reasons.

We believe there will a change in the context in which markets discuss these issues. The focus of the investors will shift from economic issues to political and geo-political issues. As I am writing this, there has been an eruption of a new war between Israel and Hamas. This is likely to be a protracted war with possibility of some neighbouring countries also getting involved. Historically, conflicts in the Middle East have led to concerns on Crude Oil supplies, resulting in higher prices. We are likely to experience the same, atleast temporarily. This change in context however, will put central banks in a spot. Interest rates and monetary tools are blunt when it comes to handling geo-political situations.

Apart from Israel, there is long list of pressures building:

- The Russia-Ukraine conflict continues and has significant impact on the commodity trade. Russia is one of the largest producers of key commodities like Oil and Gas, Wheat, Metals and Fertilizers.
- Tensions between China and Taiwan continue as China claims Taiwan as its own territory.
- US and China are locked in a tit-for-tat trade restrictions; Protectionism is rising.
- US debt ceiling negotiations between the Republicans and the Democrats continue pushing the country repeatedly close to a government 'shutdown'.
- 2024 will see two large economies, India and the US going for elections. Typically, noise levels go up during such election

Clearly, looking at the list, we can be sure that market volatility will increase in the coming months. Add to this, the problems in the commercial real estate and financial sectors in many developed markets. If interest rates remain higher for longer, they will keep the foot on the brakes of economic growth. This in turn will increase the stress in these two sectors.

Indian macros and markets are relatively better placed compared to many developed and emerging economies. While India is not immune to global events, it is still better positioned to ride out the volatility. In the near term, global trade and hence Indian exports are likely to be negatively affected. And there is a possibility of an outflow of foreign funds from Indian markets. However, these concerns are likely to be of short-term nature.

A long term investor can use this volatility as an opportunity. Both, Indian fixed income as well as equity markets are poised to deliver healthy returns to investors who have an investment horizon of three years and above. Now, more than ever, investors should focus on their long term goals, stick to their asset allocation plans and follow their investment process with discipline.

Mutual Fund investments are subject to market risks, read all scheme related documents carefully.

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