NETRA

Early Signals Through Charts

December 2024

DSP

Section 1

US Federal Debt Spiral – Love or Hate, But Don’t Ignore

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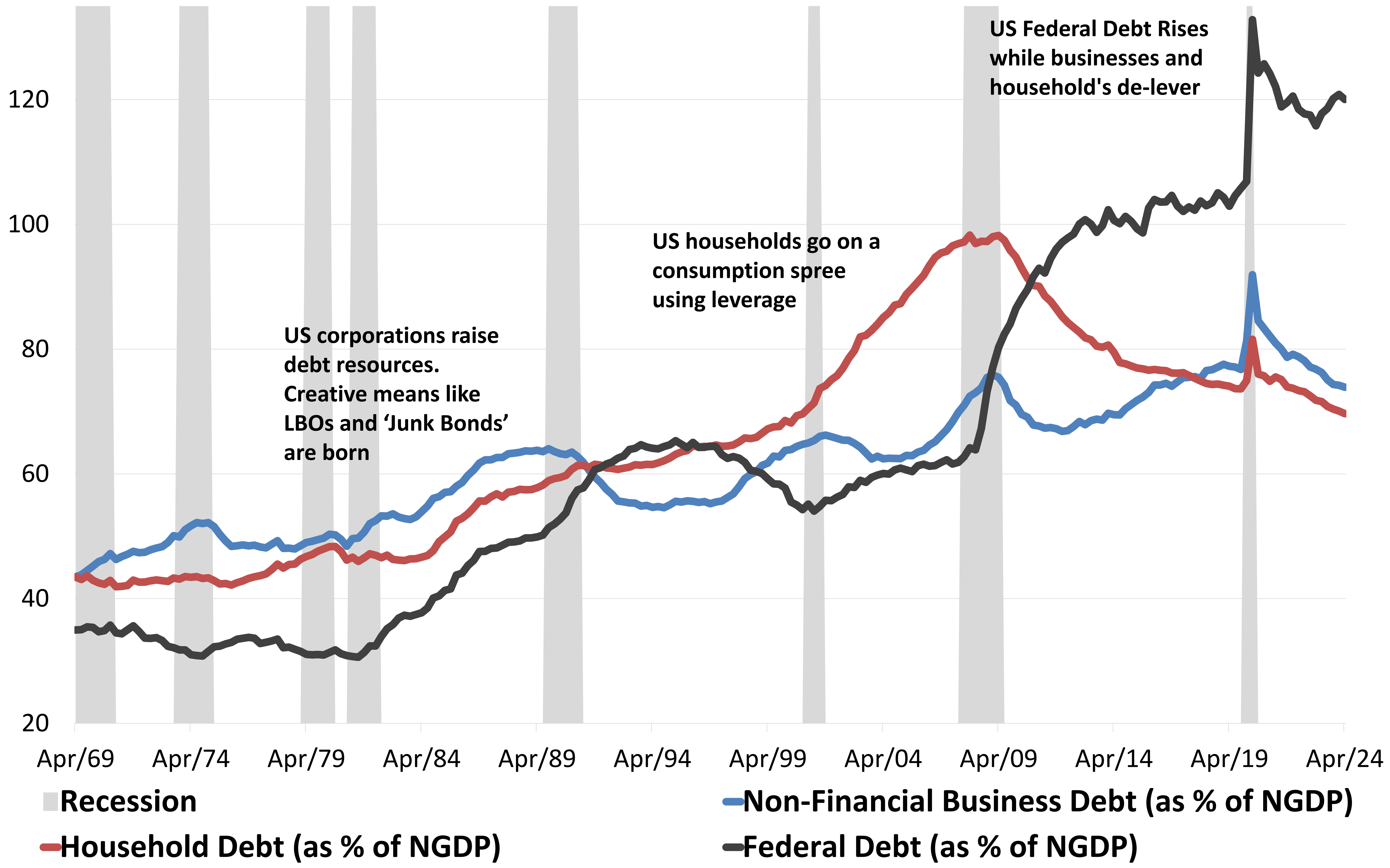
US Federal Debt Is The Epicenter of This Cycle's Leverage, And Its Likely Reversal

Leverage & Bull markets are fast friends. If you find one, the other is likely lurking around. In each of the past cycles, one of the three agents of growth, has borrowed heavily to reap rich rewards. The aftermath is always similar. A repetition of boom-and-bust cycle.

Bull markets often begin with excessive borrowing, driven by hubris that the cycle will last forever. But history tells a different story. The bust arrives with a sharp contraction in leverage, marking the cycle's painful end. The current U.S. cycle is unique. This time, the government has led the borrowing spree, relying on its ability to issue debt in the world's reserve currency, the U.S. Dollar. The assumption that unlimited borrowing is sustainable because of dollar printing defies basic financial principles.

As Walter Bagehot warned in Lombard Street: "Much of the present evil of the world comes from the fact that there is far too much confidence and far too little caution." Even for a sovereign, excessive debt breeds vulnerabilities. The biggest risk that US and global economy faces is a sudden and large drop in US spending or its ability to finance its spending. A fork in the road.



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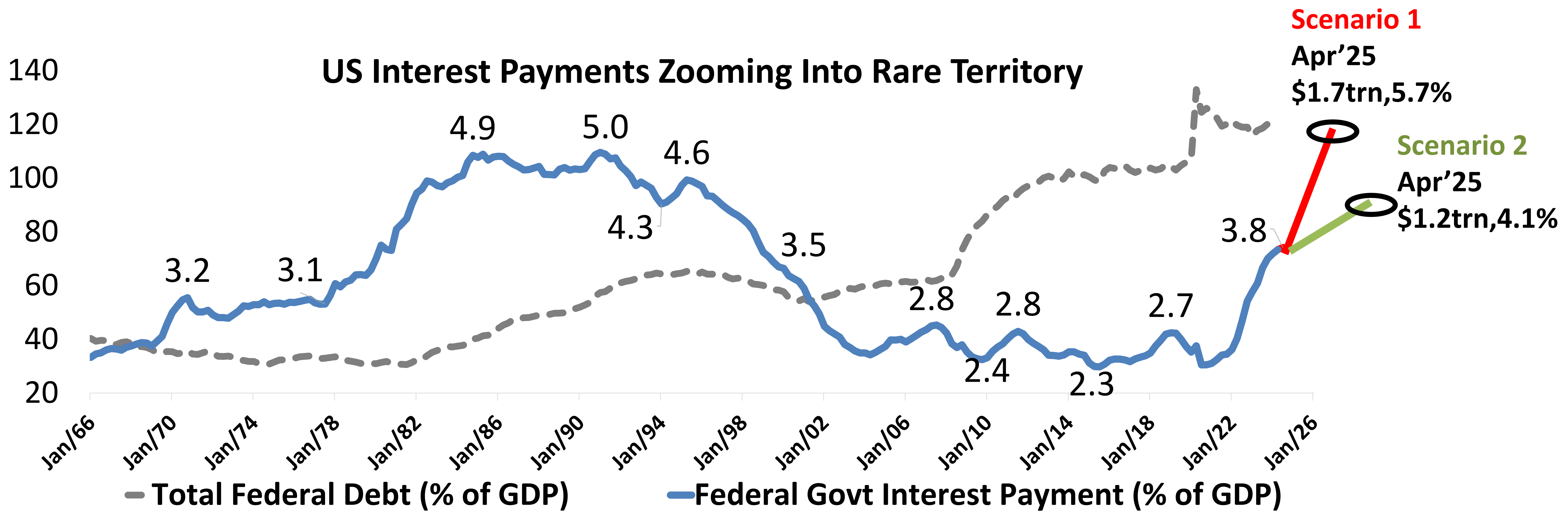
Source: St. Louis Fed Fred, DSP. Data as of Nov 2024

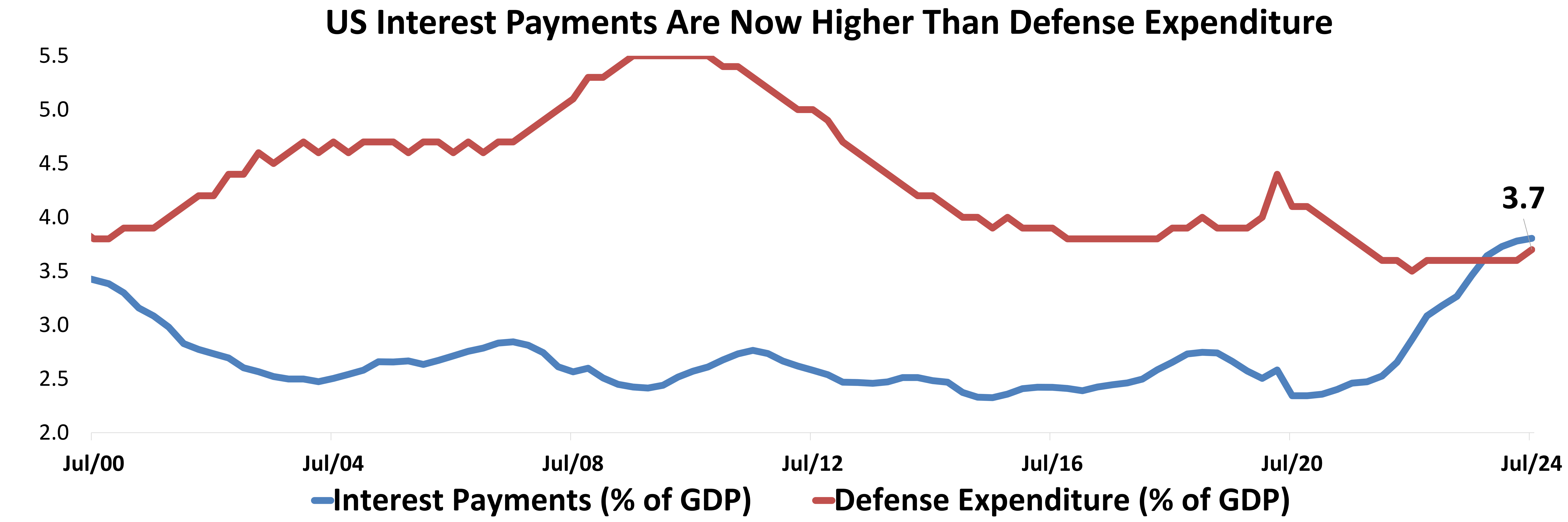
US Interest Payment: 'Smoke Signals'

Based on data from US Congressional Budgetary Office, if US Federal Reserve keeps the Fed Funds rate as it is over the next 12 months, the US interest payments expenditure will rise to an all time high of 5.7% of GDP at $1.7trn (see scenario 1 in the graph on the right). However, if the Fed embarks on another 75bps of interest rate cuts, the Federal Interest payment expense will rise to 4.1% of GDP, the highest levels in nearly 25 years (see scenario 2 in the graph on the right)

This means that US fiscal position is likely becoming more arduous as we get deeper into 2024. The ability of US treasury to continue its break-neck pace of borrowing will come into question at some point. It's not the absolute level of debt, but the annual fiscal deficit that is becoming a major worry.

Early signals from the incoming US administration are painting the 'inefficient' and 'highly indebted' US as a major point of change. If the incoming US administration opts to cut fiscal spending, it could pose a headwind for the US and the global economy. Watch out!





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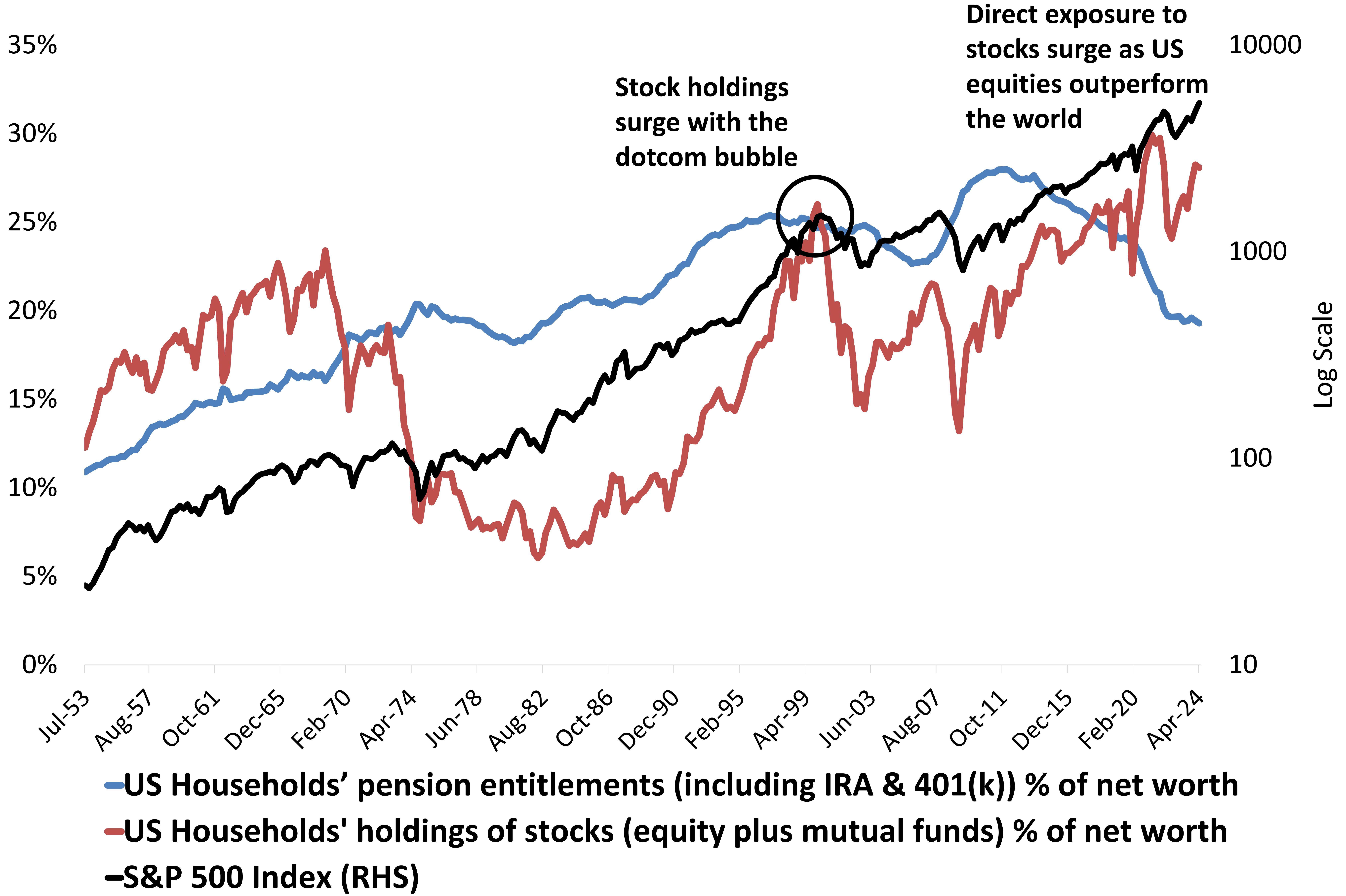
Source: CBO, DSP; Data as of Nov 2024.

US Stock Market Rally Changes The Complex of How Investors Participate

Two of the largest financial assets for U.S. households are pensions (like IRAs and 401(k)s) and direct stock holdings. Pensions, while offering tax benefits and employer contributions, are less liquid due to restrictions on converting them to cash. In contrast, direct stock holdings (corporate equity or mutual funds) are more liquid, allowing quicker access to cash. In the 1950s-60s, stock holdings exceeded pensions. From the 1970s, pensions surpassed stock holdings, remaining dominant for decades. Since the 1990s, stock holdings have risen steadily, peaking with the dotcom bubble. It took another 18 years for this peak to be reclaimed and exceeded.

This shift reflects factors like the rise of mutual funds, declining trading costs, and advancements in financial technology, such as app-based trading and micro-investing, which have made stock market participation more accessible.

It also reflects the dominant sentiment that making money is easier through direct investing and greater equity exposure. The mark-to-market gains reflected in the redline follows the trend in the general market direction which highlights the magnitude of vulnerability of households to market declines. Under-prepared.



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Source: Bloomberg, Fred, DSP. Data as of Nov 2024

Most Countries Running Higher Fiscal Deficits Without Worrying About Consequences

A high fiscal deficit, particularly in emerging markets, often triggers currency volatility, interest rate spikes, and investment outflows. When these threaten financial stability, governments must curb spending through austerity measures, leading to economic slowdowns. The U.S. fiscal deficit has reached unprecedented levels post-COVID, enabling other nations to boost growth without immediate consequences.

However, this dynamic could shift if the U.S. reduces its deficits. Countries like India, which leveraged this period for significant government-led investment, may struggle to maintain fiscal momentum. Thus, both the global and Indian economies remain sensitive to changes in U.S. fiscal policy, warranting close monitoring.

Additionally, the widely expected decline of the U.S. dollar may be mitigated by the relative financial strength of the US compared to other nations, which are grappling with slower growth, increased deficits, political instability, and aging populations.

Fiscal Budget Balance as % of GDP

	2019	2020	2021	2022	2023	2024*
Netherlands	1.8	-3.7	-2.2	0.0	-0.4	-0.1
Korea, Rep.	1.0	-2.7	-0.3	-1.8	-1.9	-1.0
Canada	-0.6	-1.7	-12.4	-3.2	-1.2	-2.0
Germany	1.3	-4.4	-3.2	-2.1	-2.6	-2.5
Vietnam	2.7	-3.4	-3.4	-3.6	3.5	-4.1
Mexico	-1.6	-2.8	-2.8	-3.2	-3.3	-4.2
Japan	-3.0	-9.0	-6.2	-5.8	-5.2	-4.4
United Kingdom	-2.3	-13.0	-7.3	-4.2	-5.0	-4.5
China	-4.9	-6.2	-3.8	-4.7	-4.6	-5.0
India	-4.4	-6.0	-6.2	-6.9	-6.0	-5.0
France	-2.4	-8.9	-6.6	-4.7	-5.5	-5.6
United States	**-4.7**	**-15.2**	**-10.5**	**-5.4**	**-6.5**	**-5.7**

**2024 numbers are estimates for Canada, South Korea and China. For the rest of the countries, average of March and June quarters*

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Source: IMF, Bloomberg, DSP. Data as of Nov 2024

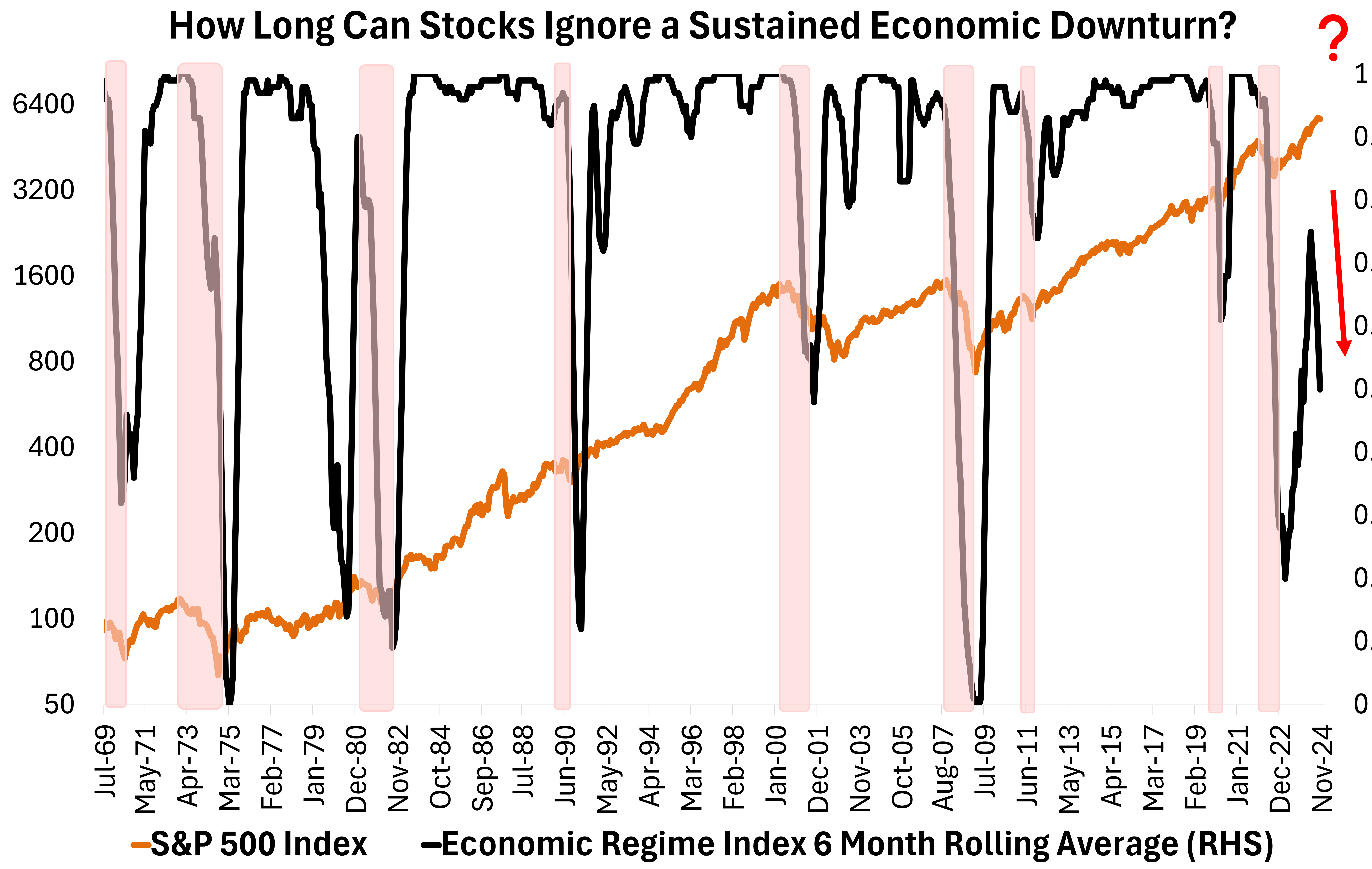
Can The Economy 'Catch-up' To Stocks, Or Will The Market 'Catch A Cold'?

The market appears to be disregarding a prolonged, sustained economic decline, raising questions about how long stocks can defy this trend given the lack of historical precedent. Historically, in all eight instances observed in the history, the S&P 500 experienced declines during periods when the six-month rolling average began to trend downward. However, the past six months represent a notable deviation from this pattern.

Since May, the six-month rolling average has been steadily decreasing, reaching a level of 0.5 in October while the S&P 500 has simultaneously risen by 11.7%. This period is particularly distinct, as the decline in the six-month average occurred without the typical precondition of a recovery phase.

A likely justification is the domination of the Tech sector which drives a large portion of earnings from exports and is less reliant on US economy. But it's only a justification, not a fact.

Are we setting up for a market downturn or this time it is different?



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Source: Bloomberg, DSP. Data as of Nov 2024

Section 2

Why Has India Outperformed?

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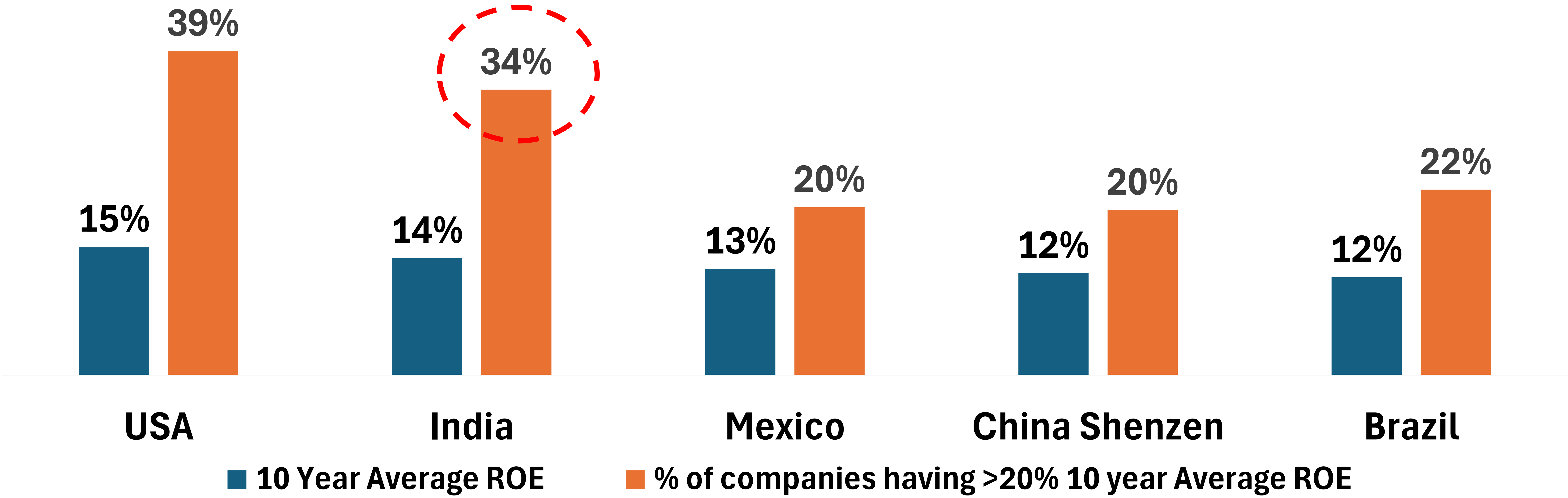
Why India Outperforms Over The Long Term? It's Not Flows, GDP Growth or The Story…

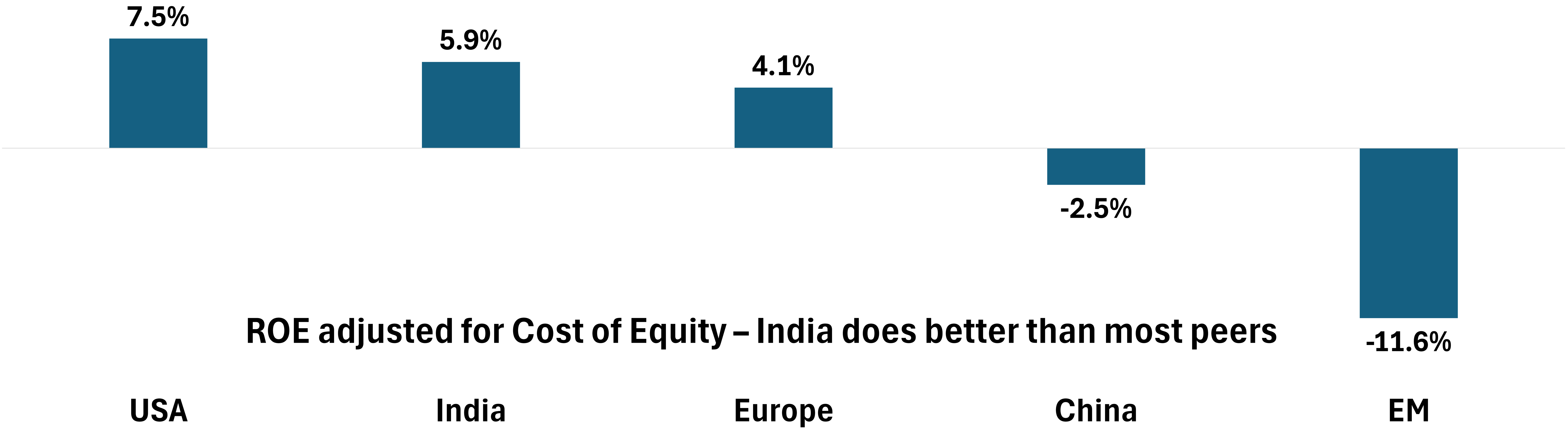
India's long-term outperformance is often attributed to narratives like domestic flows or high GDP growth, but these are merely surface-level explanations.

The fundamental question is why stock investors should expect higher returns than those offered by bonds. The extra return that stocks can provide stems from the ability of management to generate returns exceeding their cost of capital. Therefore, the primary driver of stock prices over the long term is the returns that shareholders earn on their capital. Companies with superior return on equity (ROE) are more likely to deliver higher returns compared to their peers. Adjusted for the difference in cost of capital, India does better than most peers.

India ranks second only to the U.S. in the number of firms consistently achieving an ROE of over 20% for more than a decade. This strong performance in ROE is the true engine behind India's superior stock market results, suggesting that the underlying fundamentals are what truly matter, rather than the popular narratives surrounding market performance.

Nearly one third of companies in India have recorded an ROE of more than 20% consistently





ROE adjusted for Cost of Equity – India does better than most peers

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Source: Bloomberg, DSP. Data as of Oct 2024. Large cap indices are considered for all countries. USA – S&P 500, India – Nifty 50, Mexico - S&P/BMV IPC (MEXBOL) Index, China Shenzen – CSI300, Brazil – IBOV Index. For ROE adjusted for Cost of Equity; Source: Aswath Damodaran , DSP. For this chart, ROE of the full market is considered.

'Poor Managements Produce Poor Market Prices, Superior Managements Produce Superlative Market Prices'

One of the key factors contributing to the outperformance of Indian markets is the consistent growth in the book value of underlying companies. A steady increase in book value reflects a company's ability to create long-term shareholder value, as well as strong financial health and efficient management practices.

Indian companies have demonstrated remarkable stability and consistent growth over time. Over the long term, more than three-fourths of companies have shown positive growth in their book value. Notably, in the 20 years, 7 out of 39 companies with positive growth in book value have achieved growth in each of those 20 years, even amidst global challenges such as the GFC and the COVID-19 pandemic, highlighting the stability of these businesses.

Same is the case with the broader Indian market (Nifty 500) which shows their sustained performance and relevance in the Indian markets.

Nifty 50 Companies showing growth in Book Value per share over 20 years

Change in Book Value Over The Last 20 Years	No. of Companies	No. of Companies which had growth every year	% of Companies
Growth	39	7	78%
Contraction	7		14%
Merged/Delisted	4		8%

Nifty 500 Companies showing growth in Book Value per share over 20 years

Change in Book Value Over The Last 20 Years	No. of Companies	No. of Companies which had growth every year	% of Companies
Growth	309	49	62%
Contraction	64		13%
Merged/Delisted	123		25%

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Source: Capitaline, DSP. Data as of Nov 2024.

Indian Businesses Have Been More Rewarding, Consistently

Indian businesses have delivered higher shareholder returns in ten of the fourteen major sectors over the past 20 years. Based on earnings, Indian businesses have showcased one the best per share earnings growth over the last 20 years.

Economic growth, political stability, funds flows, demographics and (insert any other narrative) is easily falsifiable. Meaning, despite these triggers, many other countries do not have businesses which have delivered these numbers consistently.

The reason could be, (as we are also shooting in the dark), the ability of Indian entrepreneur to navigate challenges across cycles and yet deliver superior results. This data also highlights an unspoken dynamic. Indian entrepreneurs are laser focused on costs, and their ability to minimize inputs costs (such as labour costs and raw material costs) is a large contributor to superior profitability outcomes.

Next time you think about India, think about the enterprising entrepreneur before any narratives.

Sectors	India Leader	Global Leader	Indian Leader 20 Year Average ROE	Global Leader 20 Year Average ROE	Indian Leader 20 Year EPS CAGR	Global Leader 20 Year EPS CAGR
Aerospace & Defence	Bharat Electronics Ltd	RTX Corp	21.2	16.4	14%	-1%
Pharmaceuticals & Biotech	Sun Pharmaceuticals	Johnson & Johnson	20.7	24.9	16%	9%
Banks	HDFC Bank Ltd	JPMorgan Chase & Co	17.9	11.1	21%	12%
Automobiles	Tata Motors Ltd	Volkswagen AG	17.4	11.5	15%	15%
IT - Software	Tata Consultancy Services	Microsoft Corp	43.5	33.5	18%	15%
Ferrous Metals	Tata Steel Ltd	Glencore PLC	14.8	5.0	-1%	-6%
Cement & Cement Products	Ultratech Cement Ltd	CRH PLC	18.0	10.7	29%	4%
Oil	ONGC	EXXON Mobil Corp	17.6	19.5	9%	4%
Construction	Larsen & Toubro Ltd	China State Construction	19.5	18.4	10%	15%
FMCG	Hindustan Unilever Ltd	Nestle SA-REG	69.3	19.7	11%	5%
Healthcare Services	Apollo Hospitals	Tenet Healthcare Corp	10.5	-5.8	15%	4%
Telecom - Services	Bharti Airtel Ltd	Verizon Communications	11.1	30.0	12%	0%
Power	NTPC Ltd	ENEL SPA	10.9	12.0	7%	-1%
Insurance	Life Insurance Corp	PING AN Insurance Group	22.8	17.2	98%	15%

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Source: Bloomberg, DSP. Data as of Nov 2024

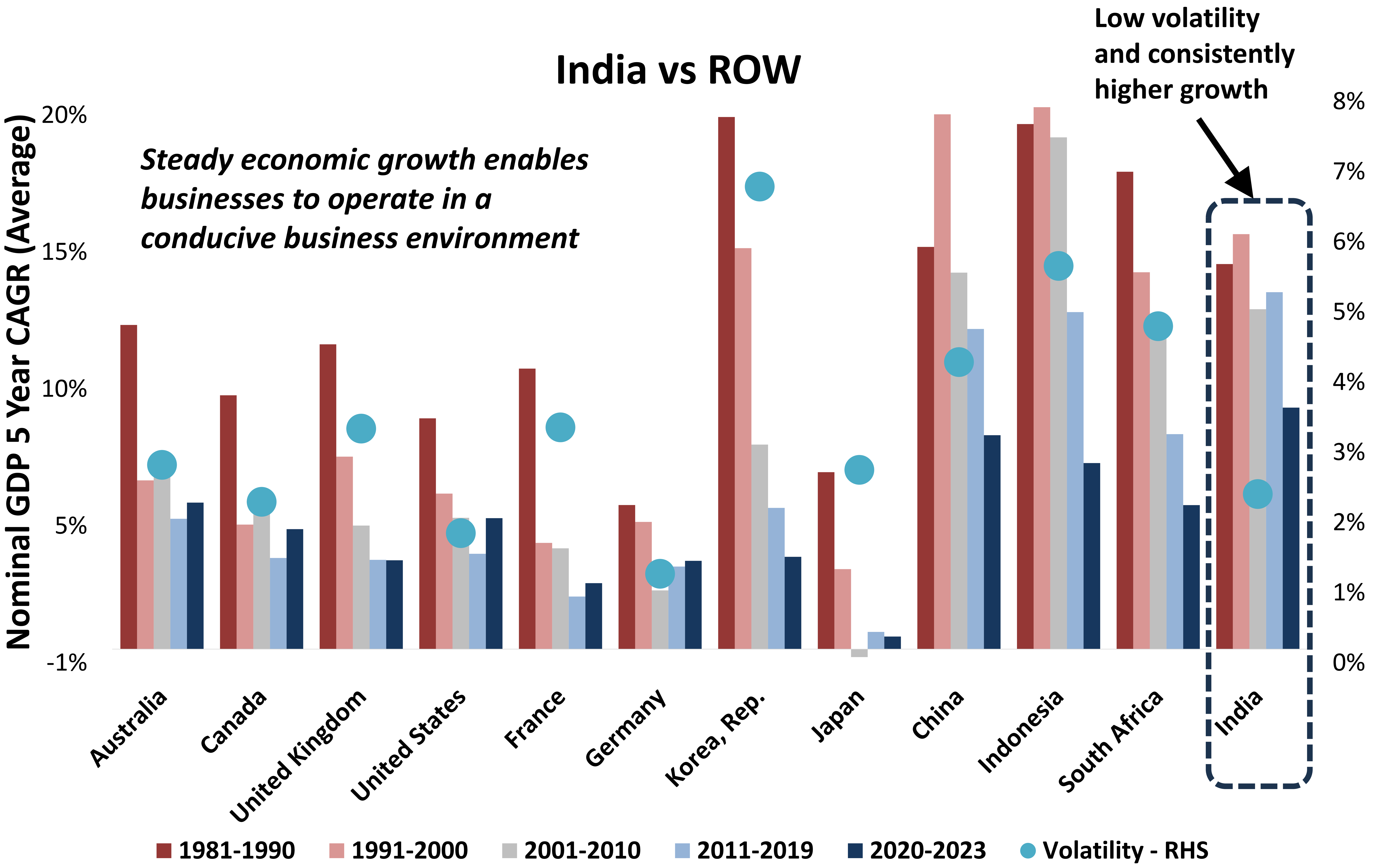
India Growth Looks Chaotic But Is Steadier Than Most Peers

In their developing phase, nations often experience a broader scope for growth compared to their developed counterparts.

This phase, while presenting opportunities, is also marked by inherent growth volatility, as emerging markets navigate structural transitions, infrastructure development, and policy overhauls. The relative instability in their growth trajectories stems precisely from this dynamic—there is greater room for expansion but also heightened vulnerability to external and internal shocks.

India's economic journey, however, has managed to defy certain norms of this developmental curve. Over the past four decades, the country has demonstrated a consistent growth trajectory, maintained high single-digit to mid-teen growth rates while it kept volatility in check—a characteristic more commonly associated with advanced economies.

This steady growth may appear chaotic but is consistent and highlights the compounding effect in force.



Source: WDI, DSP. Data as of Nov 2024. (ROW: Rest of the World, selected countries)

Section 3

Early Signals

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Get Over FIIs, Even Foreign Direct Investors (FDIs) Are Selling

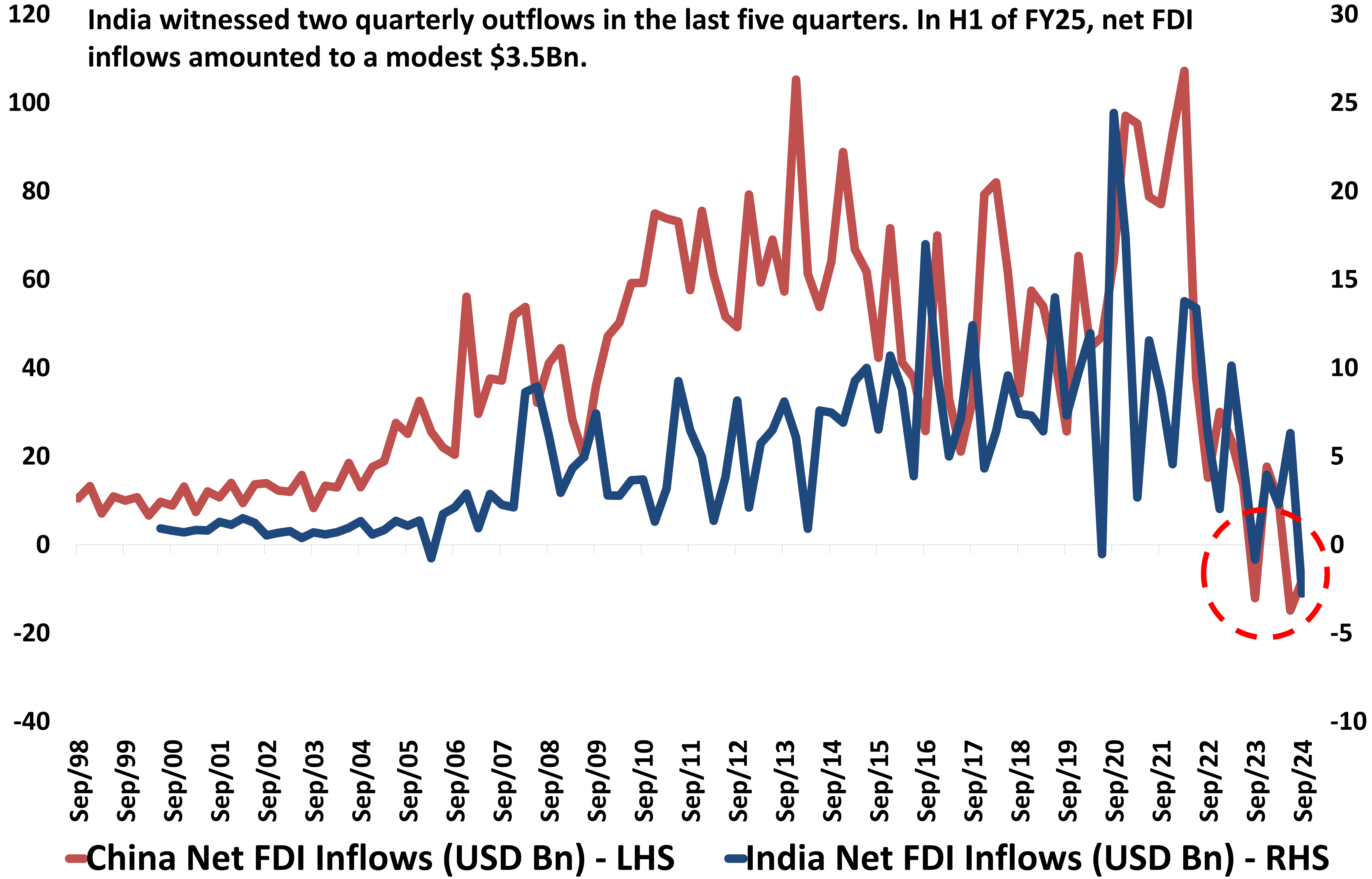
Global FDI Is Scared & Scarce.

China recorded Net FDI outflow for the 2nd consecutive quarter, cumulating to $23 Bn (Jun'24 and Sep'24). The synchronicity in flows continues.

Net FDI into India in Sep'24 quarter also fell (outflow of $2.75Bn). This marks the 4th quarterly outflow since data became available for India in 2000 (the first was in Mar'06 quarter, the second in Jun'20 quarter and the third was Sep'23 quarter).

Over the past few years, Indian economy has demonstrated steady GDP growth, a stable currency, a robust policy environment, no credit accidents, a more stable balance of payments than ever before, and the best corporate earnings growth. Yet, foreign investors are selling both in the secondary equity market and the typically more stable direct investment route.

One possible driver is the high valuations offered by Indian markets, which contrasts with the low valuation multiples available anywhere else in the world.



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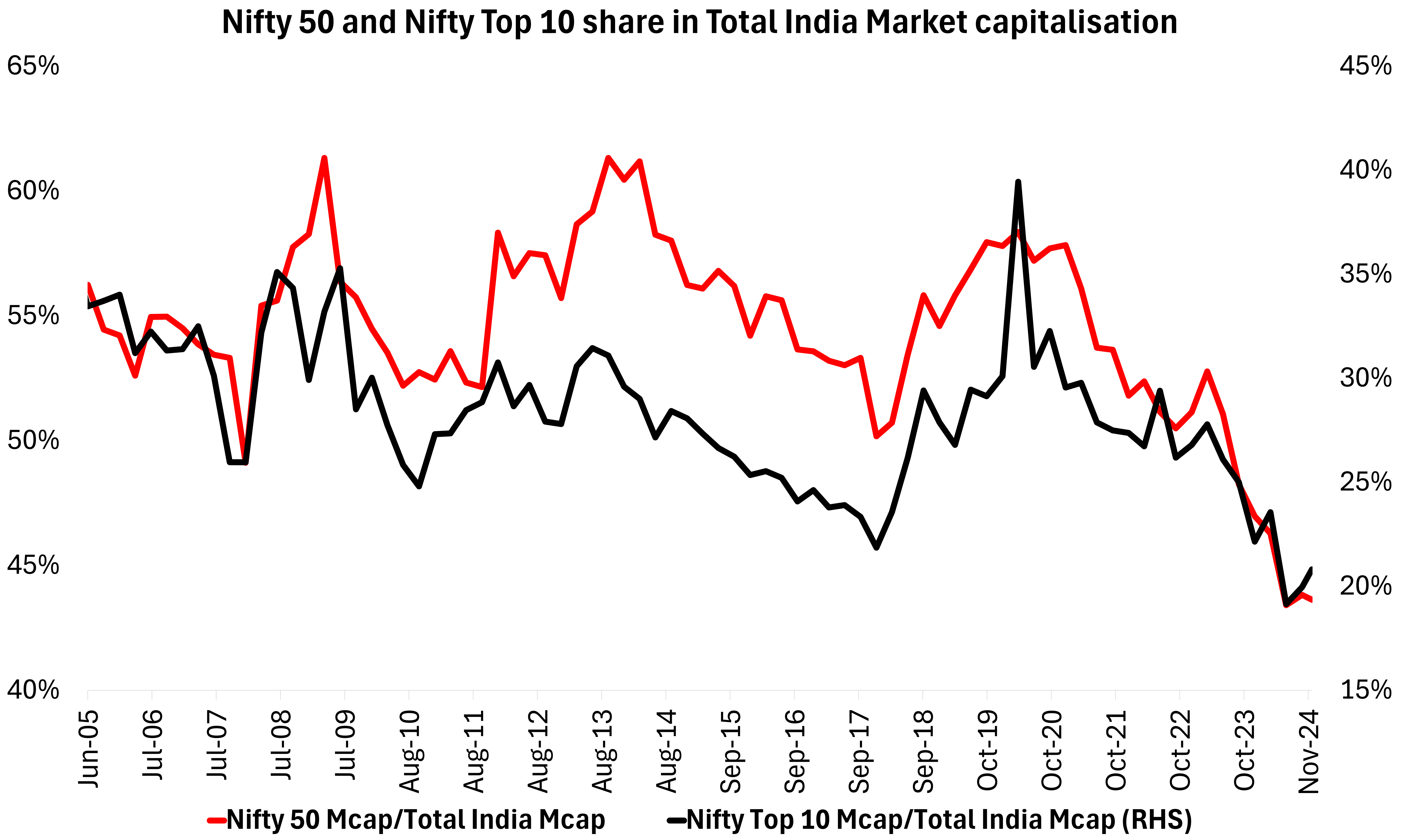
Source: Bloomberg, DSP; Data as of Nov 2024

Large Cap Stocks At Their Smallest Share of Market Capitalization

A source of relative attractiveness can be found in the largecap universe of stocks (because on absolute basis largecaps aren't cheap).

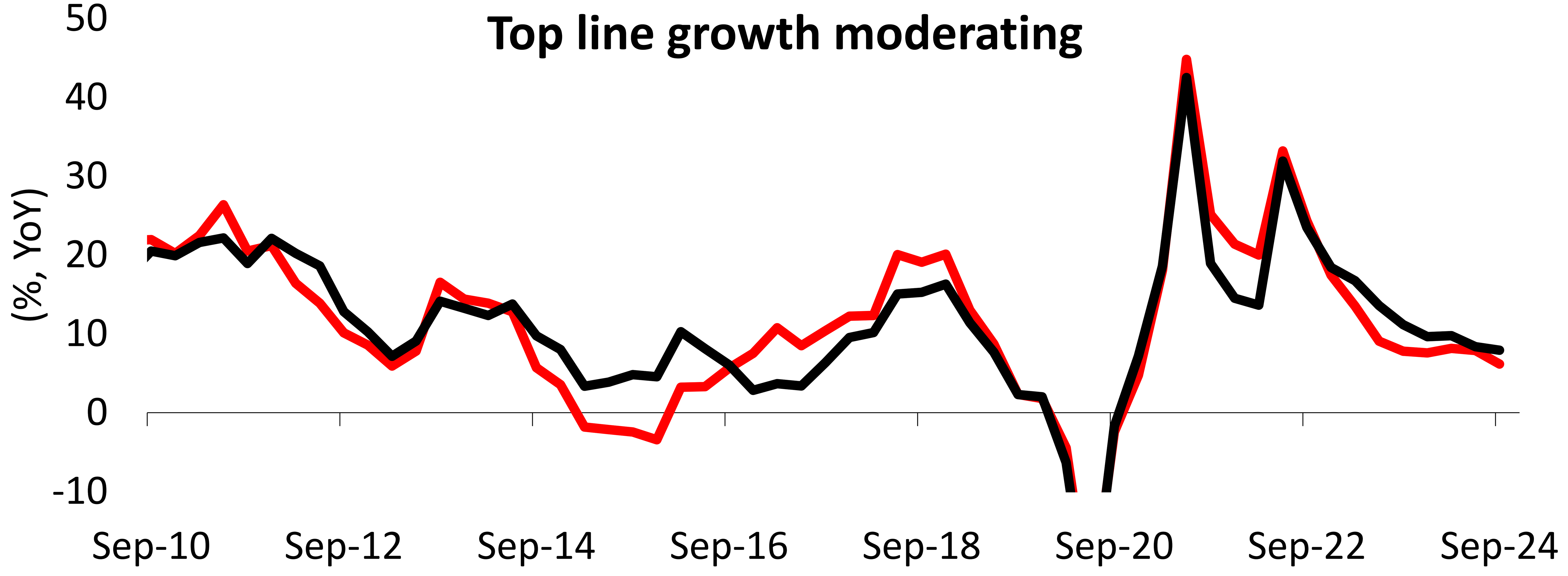
The share of top 50 or top 10 stocks relative to the total market capitalization is hovering near all-time lows. These readings are hard to decipher in real-time, and harder to take advantage of. Considering the large excess returns delivered by the non-largecap universe and the narrative that 'domestic flows' would not allow non-largecap universe to 'fall', it is not easy to use this rare occurrence to advantage.

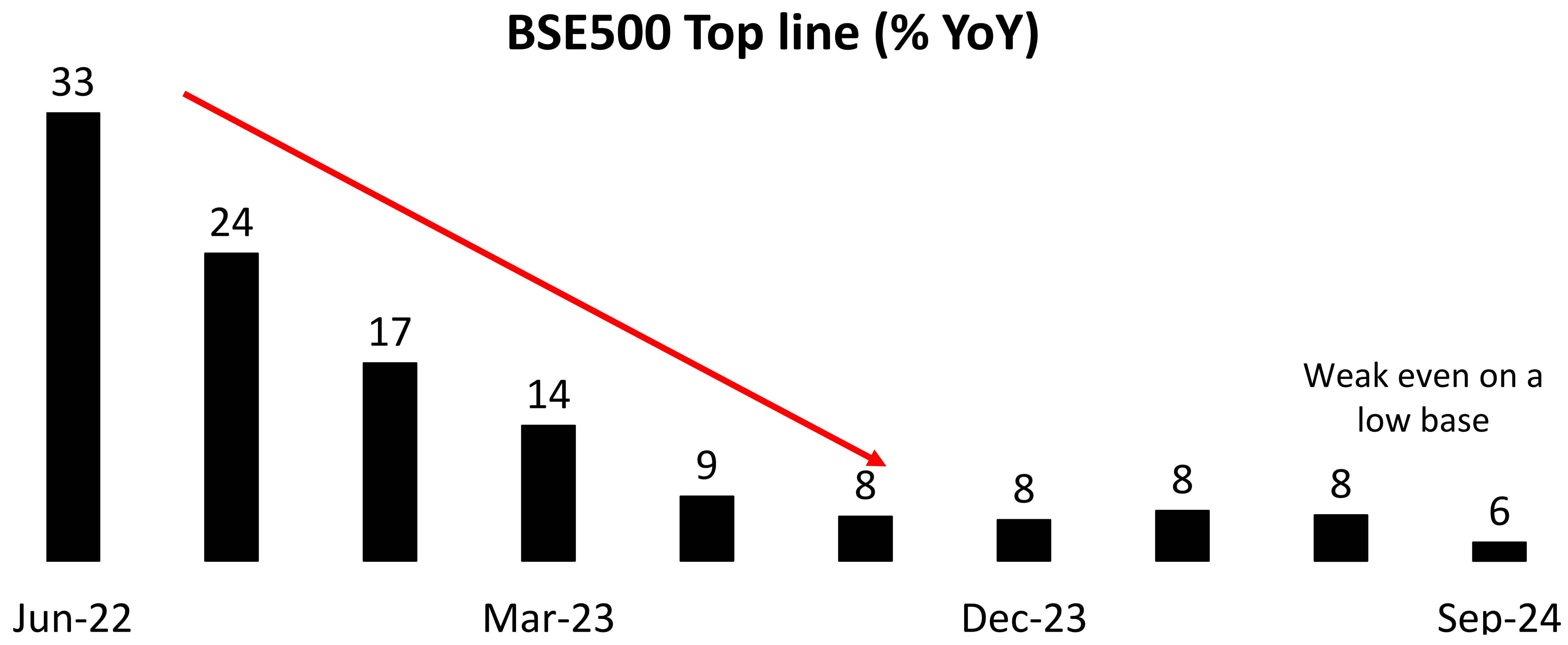
This is the precise reason why a focus on largecap universe could be a hiding place from the virus of volatility which has infected the market in the last quarter of 2024. Although the symptoms are mild, and mostly non-existent, but the incubation period of volatility is always uncertain and unpredictable. Therefore, it would be prudent to be conservative and choose protection over aggression for non-largecap universe.

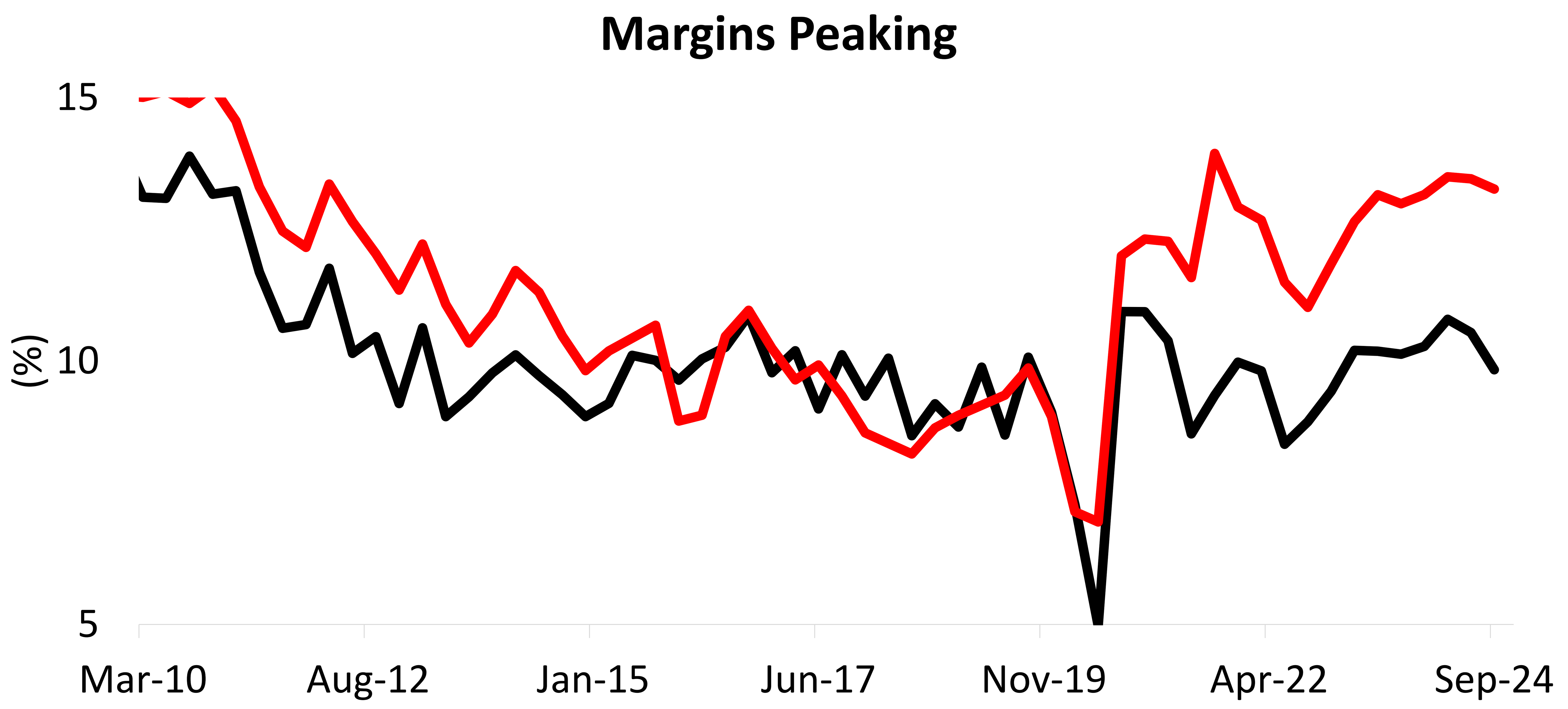


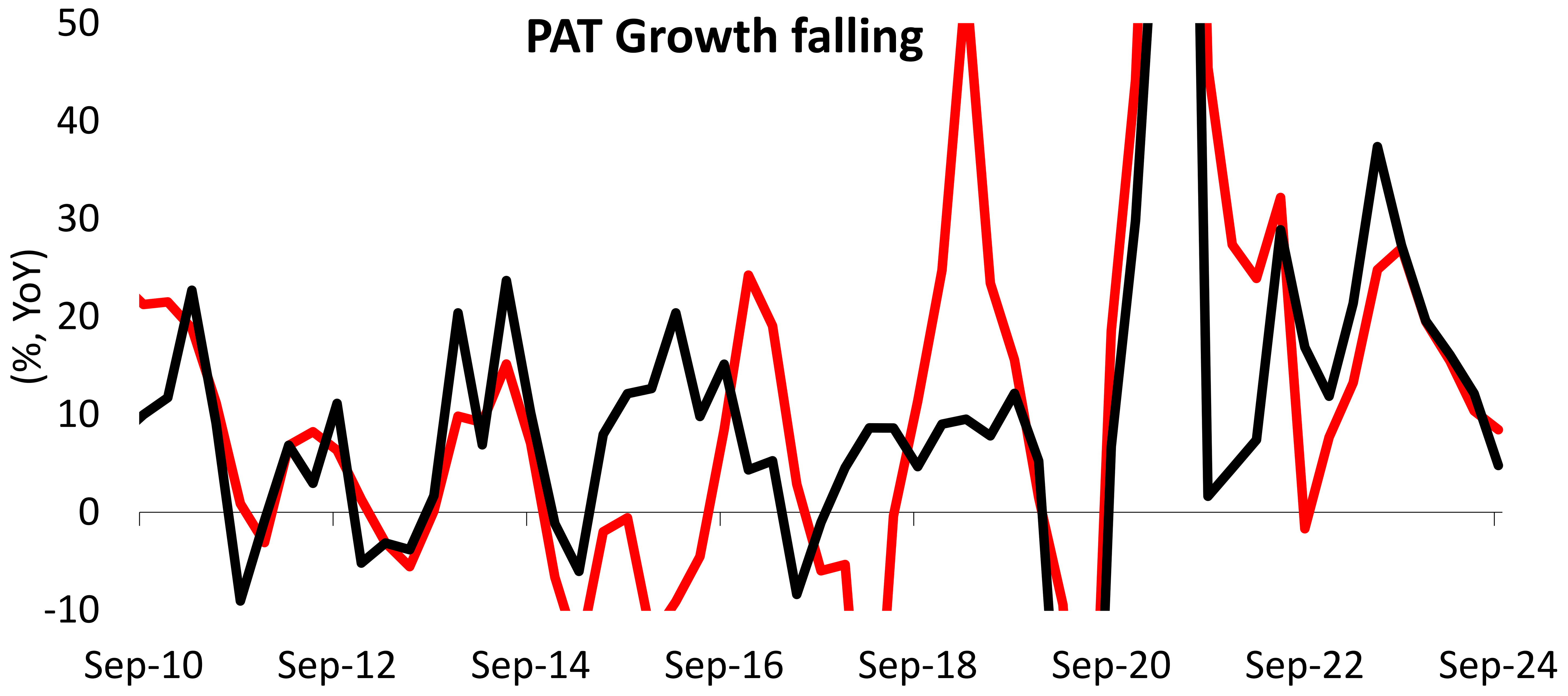
Source: Bloomberg, DSP. Data as of Nov 2024

High Valuations But Corporate Profitability In Slow Lane – Unhealthy Combination









BSE500 BSE500 (ex-BFSI and Commodities)

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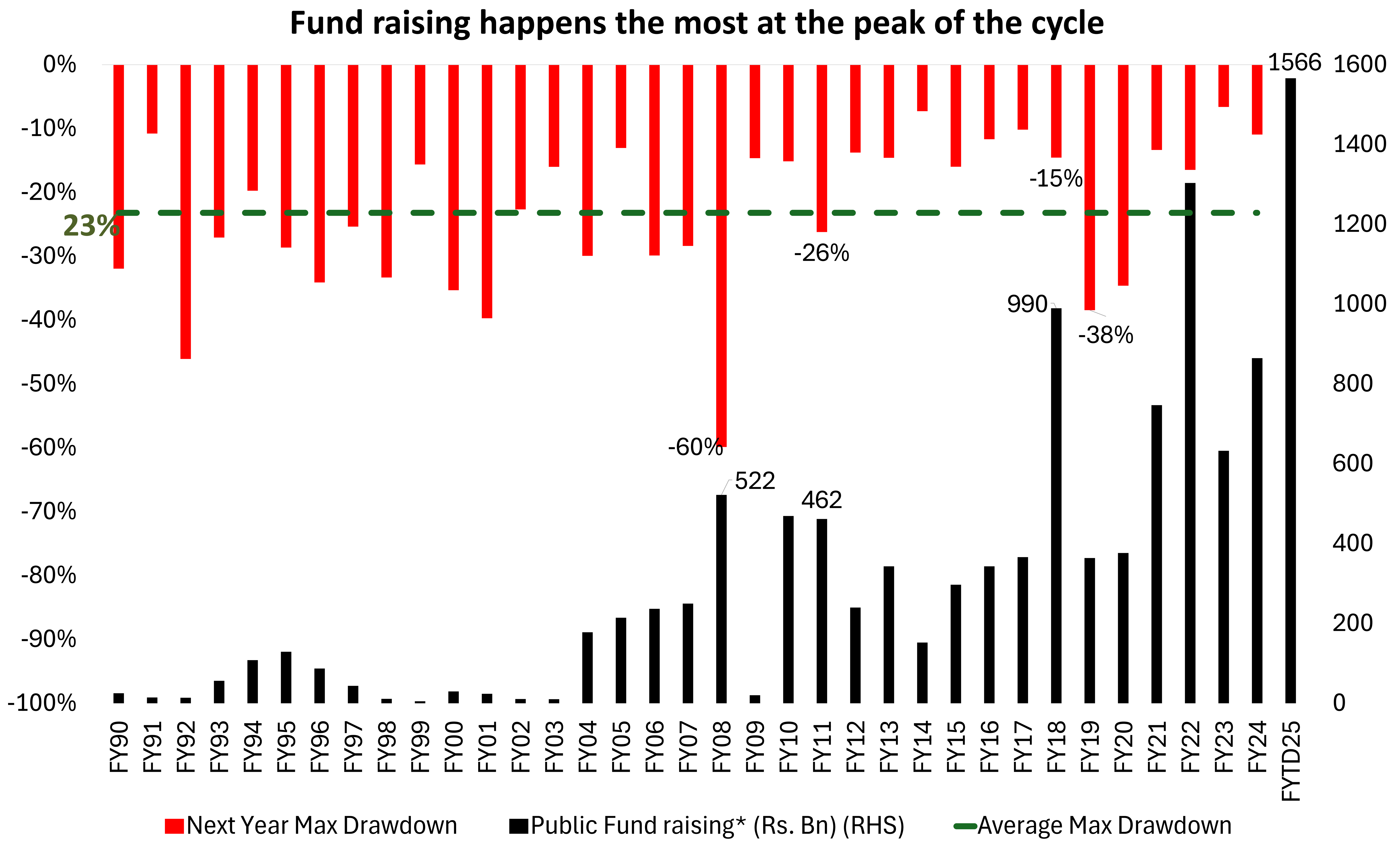
Source: Nuvama, DSP. Data as of Nov 2024. Note: OMCs and fertilizers are excluded from BSE500 sample space

‘Too Much Capital Availability Makes Money Flow To The Wrong Places’ – Howard Marks

During periods of market optimism and strong performance, substantial capital becomes readily available for both high-quality and speculative ventures. This environment often drives a surge in IPO activity, fueled by heightened investor confidence and an increased appetite for risk.

Historically, such fund-raising booms have signaled the late stages of market cycles. When capital flows abundantly, investors often overlook company fundamentals, leading to eventual market corrections as the exuberance fades.

In many of these cycles, companies issue more Offers for Sale (OFS) than fresh equity, indicating that promoters are cashing out rather than reinvesting in the business. Currently, we have already surpassed the previous fund-raising record of ₹1,304 billion set in FY22.



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Source: Prime Database, Bloomberg, DSP. Data as of Nov 2024. *Public Fund raising includes IPOs, FPOs and OFS

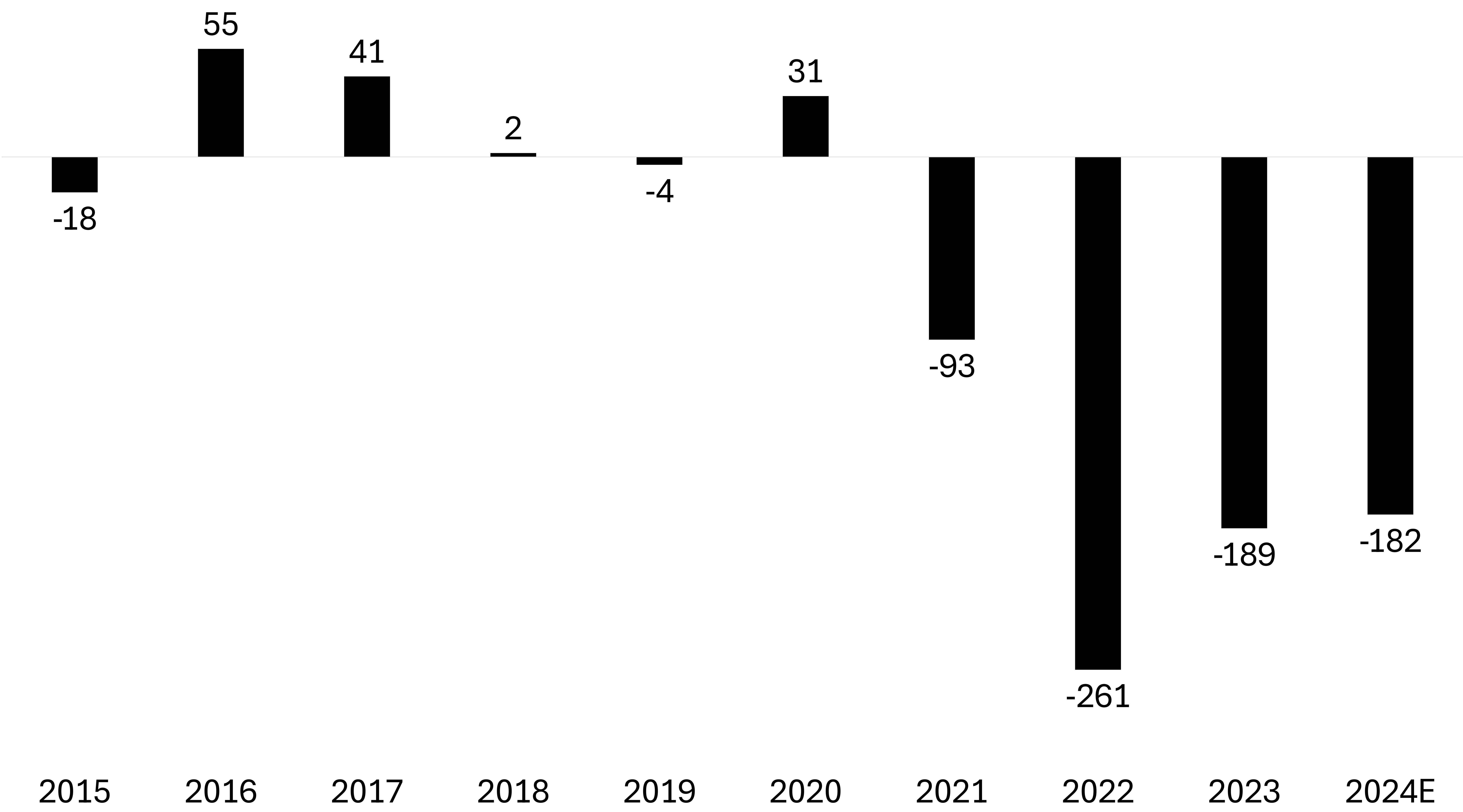
Silver Market Witnesses Fourth Consecutive Yearly Demand – Supply Mismatch

2024 has been favorable for both equity markets and precious metals, with gold and silver outperforming many global equity indices. Rising demand, driven by their diverse use-cases and applications, has fueled significant price appreciation.

Silver has seen strong, sustained demand since 2021, outpacing mine supply and creating a production deficit. Essential to industries like electronics, solar panels, jewelry, and investment, silver is expected to face its fourth consecutive annual shortage in 2024, according to the Silver Institute. Investor interest in silver ETFs is rising. Combined with a persistent supply deficit, these factors have driven silver prices up nearly 30% this year, positioning 2024 to be its best-performing year since 2020.

In the past, Silver has outperformed other precious metals during a precious metals bull market. Taking a cue from Gold, which has made multiples record highs, Silver prices could also benefit if the uptrend in precious metals sustain.

Silver Market Balance: Demand Minus Supply (Mn Oz)



Source: Bloomberg, Silver Institute, DSP. Data as of Nov 2024. Oz - Ounces

The Power of Compounding

When chess was presented to a king, the king offered the inventor any reward that he wanted. The inventor asked that a single grain of rice be placed on the first square of the chessboard. Then two grains on the second square, four grains on the third, and so on. Doubling each time.

He got more than 18 quintillion* of rice.

9.2	4.6	2.3	1.2 **Quintillion** [61]	576.5	288.2	144.1	72.06
281.5	562.9	1.1 **Quadrillion** [51]	2.3	4.5	9.0	18.0	36.03
140.7	70.4	35.2	17.6	8.8	4.4	2.2	1.1 **Trillion** [41]
4.3	8.6	17.2	34.4	68.7	137.4	274.9	549.8
2.1	1.1 **Billion** [31]	536.9	268.4	134.2	67.1	33.6	16.8
65,536	1,31,072	2,62,144	5,24,288	1.0 **Million** [21]	2.1	4.2	8.4
32,768	16,384	8,192	4,096	2,048	1,024	512	256
1	2	4	8	16	32	64	128

*1 quintillion means 1 billion billions or 10^{18}. Numbers written on the upper right of the box represents the No. of times it took to reach that milestone.

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


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