US China trade tensions de-escalate: Mid-month geopolitical risks de-escalated, with the signalling of a partial deal between the US and China on trade. As part of the agreement, it is suggested that China will reportedly purchase USD 40-50bn of US agricultural products annually, strengthen intellectual property provisions, and issue new guidelines on how it manages its currency while the US would delay tariff increases for Chinese goods. Negotiations over “phase one” of a US-China trade deal are in progress and will likely be concluded by mid-November.

Brexit uncertainty reduces, though timelines stretched: Despite the UK Prime Minister reaching an agreement with the EU on the terms of a soft Brexit, Brexit got delayed for the third time as the UK Parliament asked for more time to vote on the Brexit deal. EU has granted a 3 month extension to the UK on Brexit. Prior to Brexit, UK general election will be conducted on 12th December.

US Fed signals a pause: US Real GDP growth at 1.9% QoQ in 3QCY19 came better-than-consensus estimates (1.6%). However, GDP growth has slowed down from previous quarters (3.0%/2.0% in 1QCY19/2QCY19). US Fed cut policy rate by 25bps in line with consensus expectations but signalled a pause in the easing cycle. S&P500 reached an all-time high of 3,050 on 30th October on the back of better-than-expected US GDP growth data and monetary policy easing by Fed.

Dollar weakens, boosting risk assets: US-dollar broke below the 200-day moving average (down 2% MoM), despite Fed calling a halt to its rate cut cycle. UK pound (+5.3% MoM) and Euro (+2.3% MoM) rallied on reduced probability of a no-deal Brexit. INR was stable (-0.6% MoM). Crude was flat with Brent closing at USD 60.23/barrel well within comfort levels for India. Most other metals were flat to positive. US 10Y-2Y yield curve continued to steepen, as long-dated treasuries underperformed. In India, the 10-Year G sec rallied 25bps in the month closing at 6.45%.

Equity markets rally: Global equity markets rallied during the month with MSCI Emerging Markets (+4.1% MoM) outperforming MSCI Developed Markets (+2.5% MoM). With USD return of 3.2%, India was in the middle of the pack; though at +21.4%, the SENSEX is one of the best performing global indices over the last 1 year. Japan was the best performing equity market for a second month in a row. Among sectors, global tech and auto sectors did well. Low-risk sectors such as utilities and staples underperformed the most, but energy and materials also failed to outperform.

Domestic Markets
In sync with global markets, Indian equities also rallied with the NIFTY, NSE Midcap 100 and NSE Smallcap 100 rising 3.5%, 4.9% and 2.7% MoM respectively. The broad index declined in the first week of the month on concerns around weak macroeconomic data. Performance picked up sharply in the later part of the month on the back of a global risk on rally. Sentiment was also boosted by a) companies reporting better-than-expected earnings (albeit of beaten down expectations) and b) media reports that the Government would consider investor friendly measures to boost equity investments including reducing / abolishing long term capital gains tax, dividend distribution tax and securities transaction tax. Auto (+13.0% MoM), Energy (+7.5% MoM) and Banks (+8.0% MoM) outperformed, while Telecom (-6.7% MoM), and IT (-1.8% MoM) underperformed during the month.
Sector Wise Returns

Performance of Stable and Cyclical across market cap
Cyclicals outperformed in the month, led by Large Cap Cyclicals – PSU Banks and Energy.

No clear majority in State election results: In recent state elections in Haryana and Maharashtra which were held on 21st October (results declared on 24th October), the performance of the ruling Bhartiya Janta Party (BJP) came below expectations. BJP emerged as the single largest party in both the states, but lost 17 seats in Maharashtra and 7 seats in Haryana and is dependent on allies to form the Government in both states.

RBI continues to be dovish: As expected, the RBI cut policy rates by 25bps in line with consensus expectations to 5.15% in its last MPC meeting on 4th October. RBI has cut policy rates by a cumulative 135bps since February of this year. The central bank also sharply reduced its FY20 GDP growth forecast from 6.9% to 6.1%.

Headline inflation rises, core benign: Headline CPI rose to 4.0% in September (vs. 3.2% last month) and came above consensus estimates (3.8%). The increase was primarily led by food prices which rose +1.3% MoM led by...
vegetable prices which were impacted by heavy rains and is likely to reverse in the coming months. WPI inflation for September at 0.3%ooya came in below consensus estimates (0.8%), and was the lowest print in the last 39 months.

**Growth uptick not visible yet:** Composite PMI for September shrunk to a 19-month low and fell into contraction phase at 49.8 (-2.8pts MoM). The decline in PMI was led by services which declined 3.7pts to 48.7 while the manufacturing PMI was flat at 51.4 in September. August IP came below expectations at -1.1% (consensus: +1.7%ooya) and printed a 7+ year low, although on a marginally upward-revised July print of 4.6%ooya (vs. 4.3% previously).

**Imports tepid, trade deficit under control:** India’s monthly trade deficit at USD 10.9bn narrowed sharply in September vs. last month (USD 13.5bn), and came below consensus expectations (USD 12.9bn). Merchandise exports were down -6.6%ooya while imports were down -13.8%ooya in September. Gold imports declined -50.8%ooya (vs. 62.5%ooya decline last month). Imports ex Oil and Gold declined -8.9%oya (vs. -9.3% decline last month), the 11th consecutive month of YoY decline.

**India G sec yields continue to remain benign:** Yields on the newly issued 10-year bond are broadly unchanged since its issue on 4th October and is now trading at 6.45%. Yields have eased meaningfully YTD (- 92bps). This comes in the backdrop of policy easing by the RBI and fall in global yields.

**Strong FI inflows:** FIIs recorded net inflows of USD 1.8bn in Indian equities in the month of October. YTD, FIIs are net buyers of Indian equities at USD 9.9bn. FIIs recorded net inflows in debt markets at USD 564mn in October. YTD, FIIs remain net buyers at USD 4.5bn in debt markets. DIIs were net equity buyers at USD 750mn in October. YTD, DIIs are net buyers at USD 7.3bn inflows.

**Outlook:** Earnings have beaten expectations led by Autos and Financials with pre-tax profits up 13% YoY and 6% ahead of expectations. Note that the beat continues to be driven more by margins than topline with Revenues and EBITDA growth at 3%/9% YoY vs 5%/5% expectations.

Of the various factors needed for Cyclicals and Mid and small Cap outperformance, we believe that quite a few are in favour namely – a good and above expected monsoon, government and RBI attention to turn around the flagging economy, favourable valuations, crude prices closer to USD 60, yields below 6.5% and last but not the least a stable government at the centre.

The market, since Jan-18 has been clearly two tiered with 70-80 stocks out of BSE 500 generating positive returns. The focus on “High Quality, Consistent Earnings” has been the most successful play during this period. Valuation gap between the “haves” and the “have nots” is now at one of the widest levels. Given the slowdown in earnings growth even for the “High Quality Consistent Earnings” segment, a substantial part of the returns during the last 18 months has been derived from P/E re-rating. Is this P/E re-rating an endless exercise? The NSE Small Cap Index trades at 15.0x on Positive PE basis; 12.9x on FY20 estimate earnings and 0.8x Price to Book. NIFTY, trades at 21.0x positive PE; 17.1x FY20 earnings and 2.7x Price to Book.

Given that most forecast assume a slow though steady improvement in India’s GDP going forward, this could impact the earnings growth revival. Hence, the wait for a dramatic change in fundamentals may take longer than expected. However, market trends are not driven solely by improving Fundamentals. An uptrend could be initiated by a change in Sentiments driven by improving Liquidity and supported by moderate or cheap Valuations. At the current juncture, Sentiments could improve, driven by positive Government announcement (following on the previous month’s Corporate Tax cut) on the domestic front. Globally, sentiments could improve, if a comprehensive trade agreement between US-China, which could be perceived to reduce worries on the much forecasted US recession in 2020. Liquidity, the other “building block” for an upswing, is already being tackled domestically, with increased pressure on PSU banks to re-start lending to NBFCs, payments delayed by Government have also been speeded. The situation on liquidity is far more comfortable today (except for real estate and select HFCs) as compared to the position a few months back. Valuations, as mentioned earlier, are more modest for the broader market, approaching appetizing levels. What will be the trigger for the next upswing is not only difficult, perhaps impossible to predict. However, if these three building “blocks” converge (Sentiments, Liquidity and Valuation), a new upswing could commence. The folly, would be to wait for the Fundamentals, alone, as the most critical ingredient for any new upswing. The mood today, in a way, mirrors the pessimism which was prevalent in H1 2013. Smart investors, will recall, a new market upswing commenced within a couple of quarters!
Our Product Offerings

IDFC Core Equity Fund (Large & Mid Cap Fund - An open ended equity scheme investing in both large cap and mid cap stocks) is a diversified equity fund with a large cap bias currently. The focus of the fund is to build a portfolio of Quality companies while being cognizant of the relative valuation.

IDFC Sterling Value Fund (An open ended equity scheme following a value investment strategy) is a value oriented fund with the current focus on the mid and small cap segment*

IDFC Multi Cap Fund (Multi Cap Fund – An open ended equity scheme investing across large cap, mid cap, small cap stocks) is a multi-cap equity fund. It is a fund that encourages systematic investing.

IDFC Focused Equity Fund (An open ended equity scheme investing in maximum 30 stocks with multi cap focus): A concentrated portfolio of up to 30 stocks with the flexibility to invest across sectors and across market cap.

IDFC Large Cap Fund (Large Cap Fund - An open ended equity scheme predominantly investing in large cap stocks) is an equity oriented fund primarily focused on investing in large cap stocks.

IDFC Tax Advantage (ELSS) Fund (An open ended equity linked saving scheme with a statutory lock in of 3 years and tax benefit): An Equity Linked Savings Scheme (ELSS) that aims to generate long term capital growth from a diversified equity portfolio and enables investors to avail of a deduction from total income, as permitted under the Income Tax Act, 1961.

IDFC Hybrid Equity Fund (An open ended hybrid scheme investing predominantly in equity and equity related instruments) provides a combination of equity (between 65% and 80%) and debt (between 20% and 35%) so as to provide both relative stability of returns and potential of growth. Both equity and fixed income portions are actively managed.

IDFC Dynamic Equity Fund (An open ended dynamic asset allocation fund): An equity fund that ‘dynamically’ invests between equity and debt but buys less when markets are expensive and more when markets are cheap based on the model that tracks market valuation.

IDFC Infrastructure Fund (An open ended equity scheme investing in Infrastructure sector): A dedicated Infrastructure fund, that invests across the infrastructure value chain with exclusions like Banking, Autos, IT, Pharma and FMCG.

*Investors should consult their financial advisors if in doubt about whether the product is suitable for them.

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