KICKSTARTING RECOVERY
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The Central Government's first quarter performance shows that it is well on the path to spending the entire budgeted expenditure for 2022-23 without deviating from its fiscal target. The government spent Rs.9.5 trillion, or 24 per cent of its annual budgeted expenditure from April-June 2022, which is 15.4 percent higher than the expenditure incurred during the previous period a year ago.

Out of the Rs.7.5 trillion capital expenditure budget for FY23, the government has spent Rs.1.8 trillion from April-June 2022, an increase of 57 percent compared to the same period a year ago, which is much needed to spur growth. Even on the revenue expenditure front, the government has used a fourth of its budgeted revenue expenditure in Q1FY23. It was majorly driven by interest payments and then by subsidies.

When it comes to revenue, the receipts saw a remarkable growth on the back of the highest ever tax revenue collected in Q1FY23. It has mobilised Rs. 5.1 trillion in the same quarter. It was majorly driven by a 40.7 per cent jump in income taxes, a 30 percent surge in corporation taxes & 24.8 percent increase in goods & services tax (GST). The government is in a position to absorb this additional subsidy burden owing to the buoyancy in its tax collections. It does not need to compromise on its major budgeted expenditures - revenue or capital. Hence we don’t expect any dent in the government’s budgeted numbers.
India’s external debt situation seems reasonably placed; short-term debt still a concern

- Of the total outstanding external debt, 43.1 per cent will mature in the next year. Almost 96-98 per cent of short-term debt by original maturity is trade-related credit raised by non-financial corporations. The 20 per cent increase in outstanding trade-related credit is due to the steep rise in India’s imports during 2021-22, led by the sharp increase in global commodity prices, including energy and food prices.

- The debt service ratio of interest payments and principal repayments to current receipts - dropped to an 11-year low of 5.2 per cent by end-March 2022. It is because of a sharp increase in current receipts to USD 798.7 billion during FY22.

- The ratio of foreign exchange reserves to total debt was 97.8 per cent by end-March 2022. A quicker increase in outstanding external debt compared to forex reserves is the critical reason for a lower ratio. The ratio will likely deteriorate further, given the drop in foreign exchange reserves.

- Most indicators determining external debt sustainability appear to align with the past trend. However, there are troubles regarding short-term debt; given the pressure, it can exert on the sharply depreciated rupee.
Trade deficit continues to expand

Trade Deficit
% of GDP

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<th>FY14</th>
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<td>-6.8</td>
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• India’s merchandise trade deficit rose rapidly and peaked at USD 70.8 billion during the quarter that ended June 2022. Half the deficit during the quarter was derived from trade in POL, and the other half from non-POL items. Imports rose at a faster clip than exports.

• The record high trade deficit has two macroeconomic implications for the Indian economy. Firstly, it results in the widening of the current account deficit (CAD), which along with the foreign portfolio investments (FPI) flight, is currently exerting pressure on the Indian rupee. The rupee depreciation increases the landed cost of imports, thereby adding to the domestic price inflation, which is presently ruling well above the RBI’s upper limit of tolerance of 6 per cent. Secondly, the merchandise trade deficit in 2022-23 is expected to amount to 7.9 per cent of GDP, thereby eating into the economy’s growth. It will be the highest pie of GDP eaten away by merchandise trade deficit in the last ten years.

• We expect India’s merchandise trade deficit to remain elevated in the next two quarters - those ending in September and December 2022. The deficit will likely ease in the March 2023 quarter following the decline of imports due to an expected easing of global commodity prices.
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FPIs hint a comeback; net buyers for the first time this calendar year

After nine months of rigorous selling, FPIs emerged as net buyers in July for the first time in 2022. The selling spree started in October 2021, and until June 2022, FPIs sold Rs. 2.5 lakh crore from the Indian capital market. FPI's buying in equities was neutral compared to the massive outflows in the previous months. They invested Rs. 4,988 crores in the Indian equity segment in July 2022, bringing some relief to the bear-hit stock market.

Softening dollar index & good corporate earnings were the key reasons for the inflows. Additionally, the commentary by the US chairman stating the country is not in a recession helped improve the sentiment globally. The recent correction in the Indian equity markets gave them an excellent opportunity to enter.

Going forward, we expect FPI inflows to continue in August on the expectation of cooling in oil prices, strong earnings, and rangebound rupee depreciation.
India received the highest ever FDI inflows in FY22

Foreign Direct Investment To India
In USD Million

- India received the highest annual Foreign direct investment (FDI) inflows of almost $56 million in FY22. India is rapidly becoming a preferred country for FDI in the manufacturing sector. FDI Equity inflow in Manufacturing Sectors increased 76% in FY22 compared to FY21.

- Computer software & hardware, services sector, and automobiles were the top sectors that received the highest FDI inflows. As per the UNCTAD World Investment Report (WIR) 2022, in its analysis of the global trends in FDI inflows, India has moved to 7th rank among the top 20 host economies for 2021. Among the states, Karnataka & Maharashtra received the highest FDI flows.

- The government has, in recent years, implemented an investor-friendly policy, wherein most sectors, except specific strategically essential sectors, were opened for 100% FDI under the automatic route. Even in this challenging time, this is a good signal that the economy is doing well and resilient to global disturbances.
Domestic Institutions seem exhausted after a long string of heavy buying; still net buyers

**Equity: Net Purchases by DII**

In Crores

- Domestic inflows moderated in July 2022. They have infused Rs.10,546 crore after consistently buying Rs.30,000 crore since November 2021. The mutual fund is the most significant contributor, which has invested Rs. 4,712 crores this month. Both passive & active funds see a moderation in the flows.

- The AMFI numbers for July were weak, and we had seen that investors get worried whenever they start seeing negative trailing returns & when the trailing 12-month returns begin to go into the negative territory. We think we are hitting that point now and may see some moderation in the inflows in the near term.

- Along with this, we have also seen strong demand for physical properties; hence, some flows shift from equity markets to the property market. It may also impact the DII's flows.
Forex reserves remain at comfortable levels; pace of decline a cause of concern

The country’s foreign exchange reserves fell by ~Rs. 1 Tn to Rs.45.5 Tn in July 2022. India’s forex reserves nearly doubled till September 2021 since 2013 Fed tapering but have been falling since then.

The decrease in forex reserve was due to the decline in foreign currency assets which is a significant component of overall resources. A strong dollar, capital outflows triggered by the rise in inflation and rate hikes by the US lead to declining forex reserves. FPIs have sold Rs.2.12 Tn from January this year till July end, which has exerted pressure on the currency and the forex kitty. Also, an increase in import bills & short-term debt servicing requirements added further pressure on the reserves. RBI has been supplying US dollars to the market to ensure adequate forex liquidity.

We would have witnessed large outflows without RBI’s intervention and heavy accumulation done in the past. Forex reserves may shrink further if RBI doesn’t roll over some of its short-term debt maturing this year and commodity prices don’t cool further.
## Indian Economy

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India’s eight core industries expanded to a thirteen-month high

- The leap in YoY number was led by the low-base effect of the last year. India’s eight core industries expanded to a 13-month high to 18.1% in May’22 from 9.3% in Apr’22.

- This was led by broad-based improvement across the sectors with refinery (16.7% from 9.2% in Apr’22), steel (15% from 2.2%), cement (26.3% from 7.4%), electricity (22% from 11.8% in Apr’22) and fertilizers (22.8% against 8.7%) each clocking double-digit growth in May’22. However, Coal output moderated marginally but remained robust at 25.1% compared with a growth of 28.8% in Apr’22. On an FYTD basis, growth in eight core industries improved by 13.6% against the growth of 36.3% last year.

- We expect the growth to moderate as the base effect wanes.
India’s manufacturing activity in July bounced to 56.4, the highest in the past eight months. It is also the 13th consecutive month where manufacturing activity has remained in the expansionary zone.

Per the survey, there was positive news on the price front, as inflation rates of both input and output costs subsided to some extent. Also, the uptick in manufacturing resulted from the uptick in the broad-based sub-sector, led by investment goods.

The Indian economy has fairly remained resilient, despite various concerns like an increase in interest rates, consistent outflows by foreign investors, a depreciating rupee and a much-anticipated slowdown in the US. We expect the manufacturing PMI to remain in the expansionary zone going forward.
India’s Services activity in July declined to 55.5 at a four-month low, from 59.2 in June 2022. However, the July reading indicates a healthy service activity expansion.

Companies within the service sector witnessed ongoing improvement in sales. However, as the pandemic-led uptick in activity normalizes, price pressures and US dollar strength reportedly curbed the rise in sales.

Domestic demand remained a key driver for growth in sales of services companies as the international market took a backseat. The easing of input cost pressures was at a 5-month low, which was also in favour of services companies struggling to preserve margins and contributed to a moderate rise in prices charged.
Kharif sowing activity sluggish in the second half of July 2022

- Area sown under Kharif crops dwindled y-o-y by 2.2 per cent to 82.3 million hectares by 29 July 2022. The deficient rains in the northern plains of Haryana, Uttar Pradesh and the eastern regions of Bihar, Jharkhand, Odisha and West Bengal have affected rice sowings in these states. Rice is the primary Kharif crop cultivated in these states.

- The prospects of other Kharif crops are better. The area under cultivation of Kharif crops, other than rice, has increased by three per cent by July 2022.

- The current scenario of lower Kharif acreage and intermittent monsoon has raised concerns over its implication for food inflation, but we expect the deficit to narrow down as there has been some respite in monsoon showers since the first week of August, and that will benefit the sowings.
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Q1FY23 corporate profit margins succumb to pressure

- Net profit margins consistently have been more than 8.5 per cent for each of the last seven quarters but have marginally gone down to 7.0 per cent for Q1FY23. Margins had peaked at 10.1 in the quarter that ended September 2021. In the ongoing earning season, downward surprises have outnumbered the upside surprises.

- The increase in commodity prices inflated sales and pressed margins. The overall earnings drove by the BFSI sector, which has gone 124% of incremental YoY earnings growth. Oil & Gas, automobiles, metal and cement industries posted weak earnings.

- With correction in global commodity prices, indications of recovery in the corporate Capex cycle, relatively resilient domestic demand, and companies focus on profitability, we expect earnings to improve in FY23 and FY24.
Investment momentum kickstarted; private capex leads

- Investment momentum has picked up in Q1FY23. Despite global headwinds, monetary tightening by global central banks & increase in commodity and raw material prices, a YoY growth of 30% has been witnessed in a new investment project announced by both government & private companies.

- A notable thing was the per cent share of Indian private companies in total projects announced. It went up to 82% in Q1FY23 compared to 56% in Q4FY22. On the other hand, new project announcements by the foreign private sector declined in June 2022 quarter as compared to the previous quarter as caution prevailed owing to the ongoing geopolitical tensions.

- Completion of Capex projects has recovered to reach its pre-lockdown level. But, it hasn’t yet, surpassed levels of completions seen in previous years. It is rare that the private sector contributed more to the completions than the government. The reason for it was the growth in the manufacturing industry. The share of manufacturing sector projects shot up to 25 per cent. This is large because of the PLI scheme under which three Apple iPhone manufacturing units were commissioned during the quarter. These were by Wistron Infocomm (Rs.29 billion), FIH India (Rs.25 billion) and Pegatron Corporation. (Rs.11 billion).
Merger, acquisitions & primary activities in equity markets lose steam

- Merger & acquisition activities slowed as investors became cautious with rising interest rates and rupee depreciation. As per Barclays, Billionaires Gautam Adani and Mukesh Ambani will continue to drive mergers and acquisitions in India as the country’s wealthiest people are hunting for targets to diversify their businesses. The overall deal momentum in the second half is undoubtedly slowing down, which would affect the overall deal activity.

- Equity primary markets have been out of favour for the last few months, and there is not much noise around any issues hitting the street in the near term. We have seen traction in primary fundraising of debt instruments as long-term benchmark yields have shown more resilience in the last few months.

- We expect primary activities in equity markets and even merger acquisition activities to moderate till some clarity emerges around the current macro environment.
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Despite growing concerns around inflation & rising interest rates, motor vehicle registrations have increased by 6% YoY & saw the highest wholesale deliveries in July 2022.

Though we have seen some improvement in CY2022 registrations, the numbers are still 30-35% away from the pre-pandemic numbers. The rise in wholesale deliveries was mainly driven by an increase in demand for SUVs and the revival of personal mobility.

Even though we expect registration to go up on the back of the upcoming festive season, the industry may face challenges delivering the same to retail investors due to supply-side challenges. The industry currently has a bloated waiting list of six lakh units that still need to be delivered to retail investors.
Consumer sentiments improved dramatically in July 2022. It came after four months of significant weakening of the pace of its growth. It grew by 6.7% in July. Rural India drives the sentiments where the index rose by 7.3 per cent. These hinterlands have not seen such growth in the ICS for long. The increase in ICS in urban India was relatively modest but still a respectable 4.8 per cent.

The recovery of consumer sentiments in rural India in July is likely primarily a reflection of the improved economic prospects of the agricultural sector. While the smart improvement in consumer sentiments in July is encouraging, the fall in the index in recent weeks is somewhat disturbing. It is because the falls in the last two weeks, one that ended on July 31 and another on August 7, were steep.

All components of consumer sentiments in rural and urban India declined sharply during these two weeks. The decline was more pronounced in rural India than urban regions, and the ICC suffered more than the ICE. Rains, for now, appear to hold the key to supporting the improvement in consumer sentiments seen in July.
Non-farm employment dips as the farms reflect promise of higher employment

- Labour statistics for July reflect recovery in rural India. But, this has turned out to be grossly insufficient. Employment grew only by 6.3 million in July compared to a 13 million fall in June. All the comeback in July is in rural India and notably in agriculture. The transitory nature of the fall in employment in June is true. Yet, the recovery expectations turned out to be only partly true.

- The employment rate has been declining gradually. The urban employment rate fell from 34 per cent in June to 33.8 per cent in July. It is the lowest urban employment rate in a year. It may not be a labour migration from urban to rural regions. The labour participation rate in metropolitan India increased slightly in July, and the unemployment rate increased. If labour were migrating, then the LPR would have dropped. But, this is not the case.

- The lacklustre performance of the non-farm sectors and the urban regions leaves labour seriously vulnerable to monsoon failure.
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Transportation activity eases from peak

- Transportation contributes about 5 per cent to India's GDP directly. Besides, it is an enabler of economic activity and a facilitator of international trade, making it a lead indicator and a good gauge of the economy's direction.

- Transportation activity in India could not sustain its record levels in the initial part of 2022-23. The slowdown in transportation activity was due to a combination of contraction in foreign trade and mellowing of domestic demand. The transportation industry in India has possibly started feeling the heat of rising inflation and global slowdown. It could also indicate an impending slowdown in the growth momentum of the Indian economy.

- We expect transportation activity on both railways and roadways to remain mellowed for some time due to weakening export demand and uncertainty around domestic demand due to the unpredictable monsoon. It may regain momentum and surpass its first quarter level towards the end of 2022-23 if inflation eases and domestic demand picks up.
Second highest GST collection since introduction

GST Collections
In Trillion Rupees

- GST collections rose 28% to 1.5 Tn in July, making it the second highest monthly collection since the inception of the new regime. The total revenue of the Centre and the States in July 2022 after the regular settlement is ₹ 58,116 crores for CGST and ₹ 59,581 crores for the SGST. Buoyant imports mainly strengthened the GST collections. Collections from imports increased by 48% compared to a 22% growth from domestic sources.

- This is a clear impact of various measures taken by the Council in the past to ensure better compliance. Better reporting coupled with economic recovery has been having a positive effect on the GST revenues consistently.

- The consistent high collection signifies a comeback from the pandemic hit and can also be attributed to inflation and tight check and balances implemented by the government. We expect collections to exceed the budget estimates and may provide much-needed fiscal comfort to the centre as well as the states.
EQUITIES ROUNDPUP
Even as Indian indices gain momentum, global counterparts trail closely. The NIFTY50 and SENSEX30 packs delivered 8.7% and 8.6% respectively in Jul’22. The uptick across the indices have been broad-based. A decline in crude oil prices, an expectation of ease in inflation, and net buying by foreign institutional investors contributed to upbeat sentiments.

After a challenging ride in H1CY2022, U.S. indices ended the month on a high note while outperforming most global peers. Easing anticipations of a steep interest rate hike along with stable earnings from several significant technology and energy companies were key contributors to the movement.

Hong Kong indices underperformed most global indices. Investors seem worried about the continued clampdown on the technology sector after a Wall Street Journal report said Chinese billionaire Jack Ma planned to surrender control of behemoth financial technology firm Ant Financial Services.
Midcap and smallcap indices outpace bellwether indices

- Midcap & smallcap indices rebounded from their lows and outperformed the benchmark indices in July 2022.
- A lot of investor interest in the mid and smallcap segments follow a recent and steep decline across counters on the indices. As developed markets struggle for growth and domestic investment environment gains buoyancy, a clear transition into higher risk assets is observed.
- Besides, many mid-cap companies have achieved capacity expansions and are sitting on lean balance sheets, generating healthy cash flows, and trading at reasonable valuations after the correction. India’s economic growth & period of revival along with global macro environment will be crucial for the broader rally to sustain.
All sectors in green; commodity-sensitive sectors flourish on the back of a low base

**Sectoral Performance**

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<th>Performance (%)</th>
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<tr>
<td>Nifty Realty</td>
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<tr>
<td>Nifty Consumer Durables</td>
<td>13.2</td>
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<tr>
<td>Nifty FMCG</td>
<td>12.8</td>
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<td>Nifty Bankex</td>
<td>12.2</td>
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<td>Nifty Auto</td>
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<td>Nifty Healthcare</td>
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- All the sectoral indices delivered positive returns. Metal & realty posted exceptional returns of 17.7 percent & 17.0 percent respectively. Reduction in taxes on metals & expectation of faster than expected revival in China backed the outperformance. Reported robustness in sale of housing projects helped the realty sector.

- For the banking sector, advancement in corporate profits, healthy asset quality & lower credit cost helped grab investors’ attention. Robust pricing power, better top line, and pick up in rural & institutional sales contributed to the rally in consumer durables & FMCG.
Rupee continues depreciating even as RBI maintains prudent intervention policies

A widening trade deficit exerts pressure on the value of the Indian currency unit. India’s trade deficit increased to USD 31 billion in July 2022. The IMF cut India's FY23 GDP forecast to 7.4 per cent from 8.2 per cent in its previous estimate, which also weighed on the rupee.

As per reports, RBI’s strong defence by intervening in the forex market on the rupee breaching 80 per dollar in the spot market helped the rupee to settle below 80 at the end of the month. RBI sold dollars from its foreign reserves to shield the rupee. But these forex reserves may come under pressure as demand for dollars will increase since a high proportion (~43%) of short-term debt is coming up for redemption. Additionally, any upside risk to commodity inflation may worsen the situation further.
Prices of gold in the global market fell for the third consecutive month. They dipped by 5.3 per cent from USD 1,833.8 per troy ounce in June 2022 to USD 1,736.4 per troy ounce in July 2022. The price of gold in May was USD 1,848.3 per troy ounce. Steep depreciation in the Indian rupee still cushioned domestic gold prices to a certain extent.

The critical reason for the fall was the expectation of a rise in treasury yield and the U.S. dollar index amid sky-rocketing inflation in June. US consumer price index rose by 9.1 per cent in June.

However, disproportionate rate hikes are likely to worsen the growth outlook. It shall ignite the safe haven appeal of gold from a medium to long-term perspective, while lower levels will make it all the more attractive.
FIXED INCOME ROUNDDUP
Yields soften (almost) across the board

### Interest Rates

In %

<table>
<thead>
<tr>
<th></th>
<th>AAA 1 Year</th>
<th>AAA 5 Year</th>
<th>AAA 10 Year</th>
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**Change in interest rates**

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<th>Date</th>
<th>AAA 1 Year</th>
<th>AAA 5 Year</th>
<th>AAA 10 Year</th>
<th>AA 1 Year</th>
<th>AA 5 Year</th>
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<th>G Sec 1 Year</th>
<th>G Sec 5 Year</th>
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<tr>
<td>Yield Change Since June'22 (bps)</td>
<td>-7</td>
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<td>-25</td>
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<td>Yield Change Since May'22 (bps)</td>
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<td>-7</td>
<td>155</td>
<td>-40</td>
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</table>

Table: FisdomResearch • Source: CMIE • Created with Datawrapper
The Reserve Bank of India (RBI) hiked the policy repo rate by 50 basis points (bps) to 5.4 per cent in its third monetary policy statement of FY23. The standing deposit facility (SDF) is now at 5.15 per cent, and the Bank rate and marginal standing facility (MSF) now stand revised to 5.65 per cent. The RBI has stated that the policy of withdrawal of accommodation will continue “to ensure that inflation remains within the target in the future while supporting growth.”

- To impact inflation and the exchange rate adversely

- The central bank spelt out the upside risks to inflation, such as revisions in electricity tariffs across many states, high animal feed costs, persistently high crude oil prices and continuing trade and supply chain bottlenecks.

- A mixture of international and domestic factors seem poised to adversely impact inflation and the exchange rate. It will maintain pressure on RBI to hike rates in its forthcoming policy reviews.
Surplus liquidity in the system has dropped sharply. Large capital outflows and continuous liquidity absorption actions by the RBI will likely have sucked out liquidity from the system.

Apart from the central bank’s rupee defence, which has resulted in the sucking out of some liquidity, a months-long trend of deposit growth undershooting credit growth is also contributing to liquidity tightness.

Liquidity surplus would decline further since the MPC has suggested continuing a calibrated withdrawal of accommodation.
Meaningful real rate spread reins in FPI interest in domestic bond markets

• The US Federal Reserve has announced steeper rate increases but is still grappling with higher negative interest rates, but India has a positive real rate spread over the US. It has helped limit the FPI outflows from the Indian bond market. India is the highest-yielding sovereign security in the Asia-Pacific region, barring Pakistan, enticing investors to invest in local debt paper.

• India’s sovereign credit perception risk diminished following the rupee's comeback after striking its lifetime low and decline in oil prices, improving the likelihood of overseas betting on domestic debt. Even India’s low inflation compared to other countries contributed to the widening real rate spread.
Medium to long term yield curve looks attractive

Five to seven-year tenure government securities look attractive on the yield curve.
MUTUAL FUND ROUNDUP
All the categories received net inflows but the pace of it got moderated except for smallcap & multi-asset category, none of the categories received positive inflows over the earlier month.

### Net Inflow(+) & Net Outflow(-): Equity Categories

<table>
<thead>
<tr>
<th>Category name</th>
<th>Jan-22</th>
<th>Feb-22</th>
<th>Mar-22</th>
<th>Apr-22</th>
<th>May-22</th>
<th>Jun-22</th>
<th>Jul-22</th>
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<td>Value Fund/Contra Fund</td>
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<td>Sectoral/Thematic Funds</td>
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<td>Multi Cap Fund</td>
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<td>Multi Asset Allocation Fund</td>
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<td>Mid Cap Fund</td>
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<td>GOLD ETF</td>
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<td>Aggressive Hybrid Fund</td>
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<td>701</td>
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<td>1K</td>
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</table>

Table: Fisdom Research • Source: ACE MF • Created with Datawrapper
Ultra short-term & money market categories received decent net inflows

<table>
<thead>
<tr>
<th>Net Inflow(+) &amp; Net Outflow(-): Debt Categories</th>
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<tr>
<td>In Crore</td>
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<tr>
<td>Category name</td>
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<tr>
<td>Jan-22</td>
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<tr>
<td>Liquid Fund</td>
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<td>Ultra Short Duration Fund</td>
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<td>Low Duration Fund</td>
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<td>Money Market Fund</td>
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<td>Medium to Long Duration Fund</td>
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<td>Credit Risk Fund</td>
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<td>Banking and PSU Fund</td>
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<td>Gilt Fund</td>
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<td>Gilt Fund with 10 year constant duration</td>
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<td>Floater Fund</td>
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</table>

Table: Fidcom Research • Source: ACE MF • Created with Datavizr
Investor
Actionable
Way Ahead: Possible Scenarios

Optimistic Scenario
- Inflation remains in RBI’s threshold limit
- Growth holds up
- Robust corporate earnings
- Policy normalization on autopilot but flexible
- Supply chain normalization by H2 FY23

Base Case Scenario
- Inflation nears RBI’s upper target band
- Stable corporate earnings
- Policy normalization on autopilot
- Supply chain normalization by H1FY24

Difficult Scenario
- Inflation above RBI’s threshold limit
- Rate hikes
- Prolonged supply chain difficulties
- Lower than expected corporate earnings

Equity MFs with exposure to cyclical & value stocks
- Equity MFs with exposure to growth stocks & Mild cyclical stocks
- Quality Bonds, i.e. with high SOV & carry strategies
- Gold & EM Currencies
- Gold & Safe-haven currencies

High Yield Bonds & EM Currencies
- Equity MFs with exposure to Defensive stocks
- Quality Bonds, i.e. with high SOV
- Gold & EM Currencies
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