General elections-2024

Negative electoral results would lead to valuation correction

What has happened? Contrary to all exit poll projections, the BJP did not secure a clear majority in the Lok Sabha in the General Elections of 2024, which came as a negative surprise. This outcome implies that coalition politics have returned after a ten-year gap, alarming the equity markets and causing frontline indices to correct by 5-8% today. This needs to be considered in light of YTD performances, though, as most index returns in CY24 are still positive following a strong CY23. Further, sharper corrections were observed in domestic cyclicals. This was more pronounced in the recent outperformers, which were the industrial, PSU, power, and real estate sectors. In comparison to other sectors, defensive sectors like IT, pharmaceuticals, and staples fared relatively better, given the risk-off.

What does it mean for markets? We expect this corrective phase to continue as valuations in domestic cyclicals are stretched compared to historical levels, making risk-reward unattractive, particularly in light of the election outcome. While we expect that the NDA forming government and delivering a pro-growth budget will soothe investors' nerves and help stabilise markets in the near term, any disappointment could result in a further sharp correction.

What lies ahead for the economy? Considering that the NDA forms the government, we believe it will pursue a balanced economic growth model which could mean equal emphasis on investment and consumption growth. It must be highlighted that this approach would be in contrast to the government's earlier stance, which was primarily focused on infrastructure development. In our view, the government would remain fiscally prudent and not resort to any major populist measures, which the market would consider positively. We believe that the thrust on infrastructure creation and reforms will continue, albeit at a slower pace, given the dynamics of coalition politics. Some reallocations of expenditure to social schemes should be expected in the upcoming budget. In addition, we may witness a slowdown in private capex as companies may postpone large investments in case of any political uncertainty at the centre.

What lies ahead for markets? As highlighted in our note '**Valuation of Indices**', we believe the margin of safety in the valuation of key benchmarks was very low after the last 12-month retail liquidity-driven rally. This overvaluation of indices was already unsustainable, and the election results only acted as a trigger for them to correct. Having mentioned this, we don't expect any significant earnings downgrade due to this election outcome as India has historically been able to grow real GDP by ~6-8% under coalition governments as well. However, it could lead to a contraction in PE multiples, given the high PE premium enjoyed so far by Indian markets due to political stability and continuity. Nifty valuations at ~18.7x FY26 PE still don't offer much upside for ~12% earnings CAGR over FY24-26. Mid and small-cap indices are trading even at a premium to the Nifty, which could keep the broader market under pressure in the near term. Retail flows into equity markets need to be monitored over the next 3-6 months as they could witness some slowdown, which we believe would be positive for the markets' long-term health.

HSIE view on markets: We advise caution and bottom-up stock picking to ride through the volatility. We remain positive on financials which offer the best risk-reward amongst large domestic sectors and are perhaps the only domestic cyclical sector with reasonable valuations. Consumer staples, IT and pharma also look reasonably valued for their quality of earnings and growth. We expect industrials and select PSUs to witness a contraction of multiples.

**As per election results declared (leading and won, both included) till 10PM on 4th June 24.*

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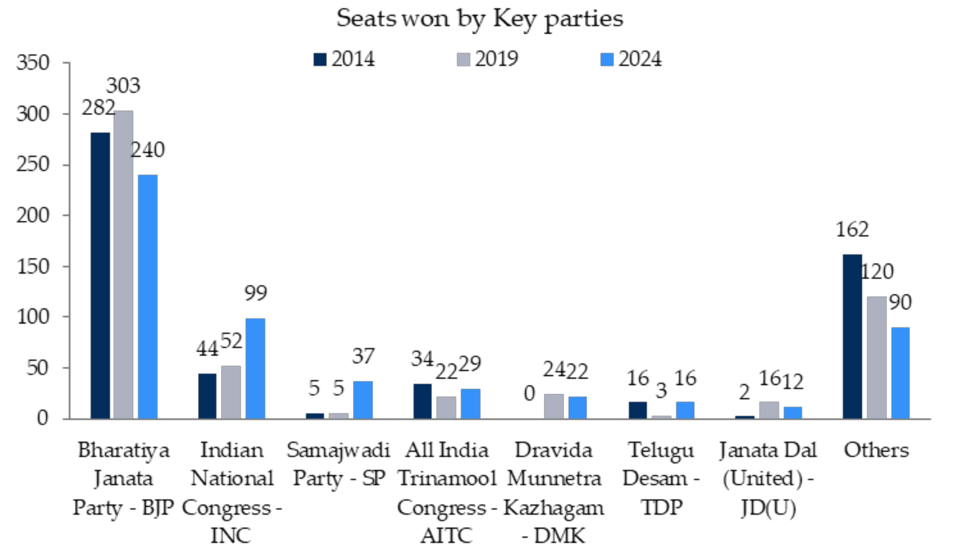
Nifty 50: Nifty currently trades at 18.7xFY26 EPS (consensus), factoring in 12% EPS CAGR for the next two years. In our view, this doesn't offer much margin of safety and leaves a low single-digit upside in the next twelve months.

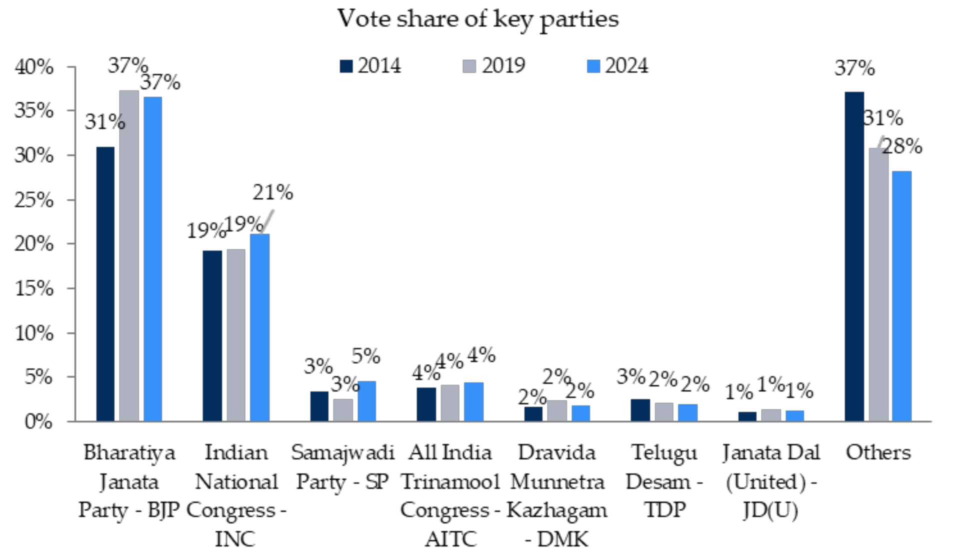
Sector-wise views

Sectors	Impact	Remarks
Defence		As government is expected to adopt a slightly more populist approach than earlier, expenditure on defence projects would be curtailed. It would result in derating of defence sector stocks as current steep prices have built in multiyear growth.
PSUs		This electoral verdict is expected to be detrimental to PSU stocks except large banking and utility PSUs. We continue to hold and like SBI, NTPC and PowerGrid in our model portfolio. Railway PSUs will witness pressure due to steep valuations and uncertainty over growth prospects.
Automobiles & auto ancillaries		A tilt towards a populist approach will aid rural recovery and boost consumption in the low- and mid-income groups. It will benefit the sales of compact cars, 100 cc bikes, and tractors. At the same time, sales of premium segment cars and two wheelers will face headwinds as discretionary spends come under pressure.
BFSI		While credit book of banks may witness sector reallocations, overall business of banks wouldn't face any major headwind, in our view. Given strong balance sheets and comfortable valuations, **we prefer BFSI over other sectors** at the current juncture.
Consumer staples		Increased government spends will help accelerate rural revival and boost consumption. This will be beneficial for FMCG and retail (apparel, grocery) players.
Infrastructure/capital goods		To maintain fiscal balance, government may need to prioritise "offering direct benefits to the masses" over "infra spends". It will adversely impact allocations towards infra-asset creation. This will be unfavourable to the ongoing capex cycle. Accordingly, infra and cap good companies will face headwinds.
Real estate		New launches are expected to be subdued as developers await policy stability. Further, lower discretionary spends will keep presales of properties under pressure.
Information technology		It would attract flows from investors as it is largely insulated from the domestic uncertainties and offers diversification to the portfolio.
Power		As renewable energy is a multiyear theme that will continue to be driven by market forces, we believe the current election's outcome won't derail RE asset creation program of large utility companies. We hold NTPC and PowerGrid in our model portfolio.
Pharma		Defensive nature of the sector will catch attention of the investors as pharma companies with global exposure will also offer portfolio diversification.

Seats won by key parties over last 3 elections



Vote percentages for key parties over last 3 elections



Disclosure:

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