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'T' has not been the season of much gain

CY22 has been a tumultuous year. It started off on a shaky note with Ukraine Russia war, which impacted commodity prices. Inflation for major economies peaked. This led central banks globally to turn the tables. From ultra-low rates seen in the previous two years to support the economy from Covid induced slowdown; central banks shifted the gear to control inflation. Thus, central banks globally remained hawkish, raising policy rates. This coupled with Covid related restrictions in China, impinged on the global growth fundamentals. Concerns of recessions also emanated in Eurozone, UK. Even in the US, worries persisted over 'hard landing'.

In this environment it is interesting to see how various asset classes have fared over the year in terms of nominal returns. We have conducted a short exercise to see how in this uncertain environment returns have fared across different asset classes. The first fortnight of December for 2021 and 2022 have been averaged to calcualte the annual returns.

Table 1. Return across different asset classes

Asset Class	Return for the fortnight ending 16 Dec 2022
Natural Gas	63.1%
Oil	9.8%
Dollar	8.1%
Nifty	7.6%
-PSU bank index	60.6%
-FMCG index	21.7%
-Metal index	21.7%
Bank Term Deposit Rate >1 Year	5.3%
Housing: House price Index	4.5%
-Kochi index	11.1%
-Kolkata index	8.4%
-Delhi index	8.3%
364 days TBill	4.2%
Silver	2.7%
NSE-total return index on Gsec	1.5%
Gold	0.4%
Aluminium	-6.3%
Copper	-11.7%
Bitcoin	-72.8%

Source: Bloomberg, RBI, NSE, Bank of Baroda Research, Note: Return is compared taking the average for the fortnight ending 16 Dec 2022 compared to the same period of the previous year. For Natural gas: futures data have been taken, Oil: ICE Brent futures, Gold, Silver: Spot prices, Copper: Cash price from the end of LME day Final Evening Evaluations, House price index for Q2FY23 have been used and compared with the same period of previous year, total return index on Composite Gsec have been used from NSE.

The assumption made here is that an investor locked into investments during the first fortnight of December 2021 and then held on to the same until the first fortnight of December 2022, when it was sold. Hence an annual return has been derived. Optically this may seem at variance with conventional

belief where there was substantial volatility in commodity prices (including exchange rates) in the interim period. However there have been several price corrections by December 2022 with oil, metals and currencies gravitating to their equilibrium levels.

'T is not the season to cheer' as can be seen from the returns of major asset classes. If inflation which is averaging around 6.5-7% is also buffered in, the real returns would look even less impressive.

Amongst major ones, sharp drop in returns was seen for crypto with bitcoin being included in the table here. The hype over bitcoin has now been obscured with investors thinking twice before investing in them. This has been on account of regulatory concerns over security issues. Further, collapse of FTX, which used to be the fourth largest crypto exchange in the world along with the uncertain global environment and wobblier macro fundamentals, also led to falling returns in this segment. It fell as sharply as 72.8%.

The best return came from natural gas due to the war effect. This is also on account of major economies intention to shift away from oil and coal. Thus many had resorted to natural gas instead of coal for production of electricity. Apart from this, even supply issues concerning supplies from Russia also led to soaring natural gas prices and hence higher returns. Taking positions in the futures segment would have opened this door though admittedly this was not what could have been expected.

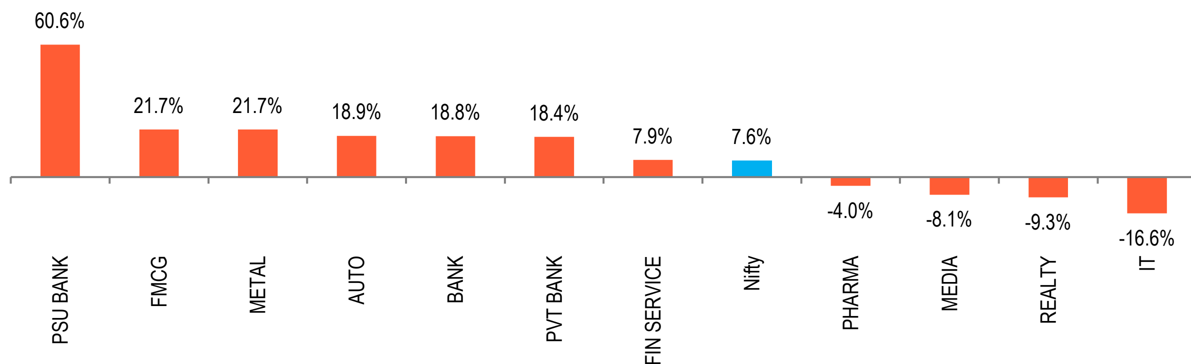
Oil remained volatile throughout the year with annualized average daily volatility rising to 46.3 % in CYTD22 from 32.2% in CY21. Further in CYTD22, oil traded in the range of US$ 76.1-128/bbl, against CY21's range of US$ 51.1-86.4/bbl. Return on oil thus edged up to 9.8% (on point to point basis) as most of the economies started running at full capacity post Covid. The return looks low compared to the peak prices witnessed in the interim period with the $ 125/barrel mark being touched.

The third best return came from currency and investments in the dollar would have given a return of around 8%. With the dollar strengthening for most of the months, the rupee went down in a scaled manner and was higher than the average of 3-4% which was witnessed in the past.

Equity market gave a relatively satisfactory return of 7.6%. In real terms however once adjusted for inflation would come down further to just about 1%. However, sectoral indices showed variation.

- PSU banks gave a return of 60.6%. Better financial performance in Q2FY23, driven by rising interest income in the rate hike cycle and pick up in credit demand contributed towards the same. Private Banks index gave a return of 18.4%. Even return of FMCG shares have been fairly high at 21.7%, with pent up demand materializing and also higher inflation contributing to rising nominal value.
- Metal stocks have also been an outperformer, giving 21.7% return. A possible explanation could be government's initiative to cut the export duty on steel products and iron ore to nil with effect from 19 Nov 2022 -- 6 months after its imposition on 21 May 2022. Post this, metal stocks have gained by 12.6%. Also, in terms of financial performance, net sales of these companies remained stable in Q2FY23.
- Auto also gave a return of 18.9% with festive demand and cheer for high end product segments and supply constraints mitigating towards the later part of the year. The stocks which have fallen the most has been IT, on account of inflation and worries over geopolitical tension worldwide.

Figure 1: Returns of different sectoral indices

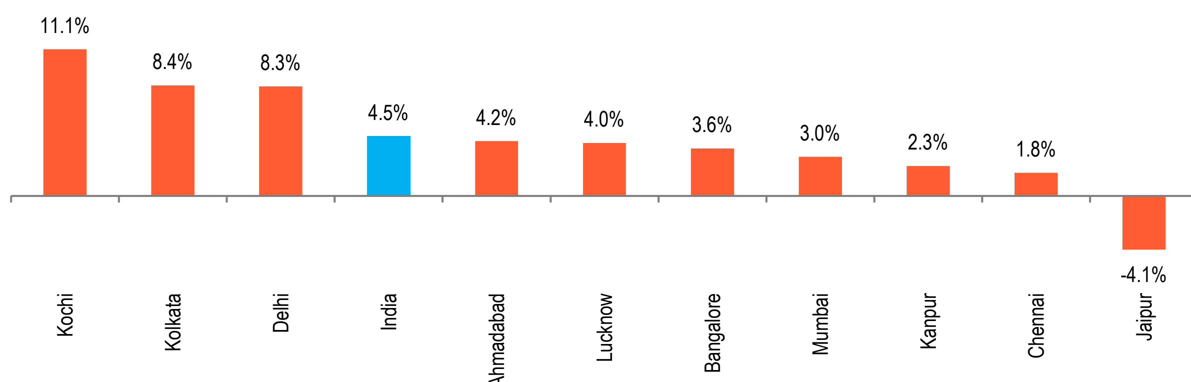


Source: Bloomberg, Bank of Baroda Research Note: Return is compared taking the average for the fortnight ending 16 Dec 2022 compared to the same period of the previous year.

Conventional avenues were not favourable for savers which when adjusted for inflation gave negative returns. Among investment options, Bank deposits >1 year, gave a return of 5.3%, higher than return on 364 days TBill which gave a return of 4.2%. Currently the situation has reversed completely, return on Bank deposits >1 year are running at 6.7% whereas for 364 days TBill it is 6.9%. This is because liquidity conditions have driven the TBill rates while bank deposit rates have moved up in specific maturity brackets. Notably, return on government bonds have been just 1.5%.

Housing gave a return of 4.5%, with maximum return increasing for cities such as Kochi (11.1%), Kolkata (8.4%) and Delhi (8.3%). However, for other metros such as Bangalore (3.6%), Mumbai (3%) and Chennai (1.8%), it remained below the All India level. Even on a rising rate cycle, the return from housing is expected to be stable in the medium to near term as these are long interest cycle loans which get balanced out during the tenure.

Figure 2: House price index across different cities



Source: RBI, Bank of Baroda Research Note: The current YoY data for Sep'22 quarter has been used

Bullion was an underperformer this year as the dollar was strong and China remained in a semi-closed state. The returns of precious metals have been moderate. Gold gave a return of just 0.4%. This is on account of rising DXY, which in the same period has risen by ~9%. Since gold is dollar denominated so there lies an inverse relation between gold prices and DXY, ceteris paribus. Physical demand too was affected by the lockdown in China.

Other than this, fall in commodity prices owing to concerns of muted demand especially from economies such as China, has led to falling returns of commodities such as copper, aluminum, which

is the major intermediate input of electronic components. For copper the return fell by 11.7% and for aluminum, it fell by 6.3%. Interestingly these prices had spiraled after the war but got corrected by June-July.

Conclusions:

- CY22 has been a volatile year in terms of macro dynamics of the global as well as Indian economy. This has impacted returns across major asset classes.
- Return of majority of asset classes have not even crossed 10%.
- Except natural gas which is an outlier (on account of focus towards cleaner fuel), returns have remained muted.
- Yet equity market continued to post a stable nominal return compared to other financial savings avenues such as Bank term deposit.
- Going ahead, conventional bank deposits may become a more attractive as RBI takes a call on the repo rate.
- Rising policy rate impacted return on government securities as rising rates caused fall in prices and hence the total returns index showed minimal returns. .
- Gold continued to give virtually nil returns to rising DXY and even in the coming year. With the dollar declining in value of late, there can be an upside to gold in 2023.
- The buzz of crypto seems to be fading on account of security and regulatory issues.

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