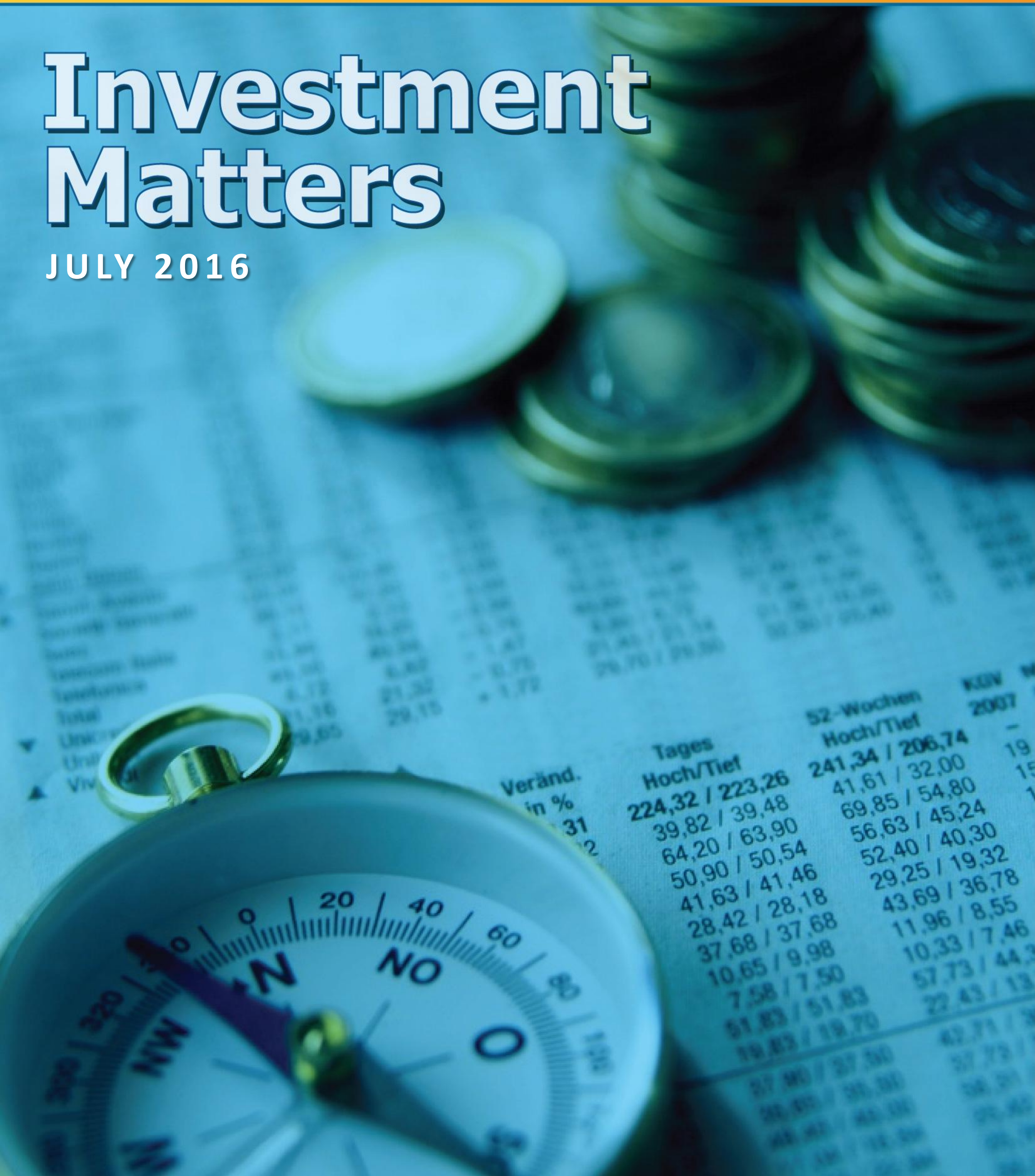
ALCHEMY
CAPITAL MANAGEMENT

Investment Matters

JULY 2016



EQUITY OUTLOOK

After a difficult start to the year, 2Q has been reasonably calm as markets have responded to a good Jan-March quarter earnings season, which was the final quarter for fiscal year end in India. It has been 2 years of near flat earnings for the major indices and early signs of a pick-up in earnings bode well for the future.

Despite fears over BREXIT the Indian markets have held up relatively well as domestic triggers are playing out well.

•Monsoon though delayed by a week is starting to progress well over most of the country. AS of 7th July, rainfall is 1% above normal with only north east of India showing rainfall deficit.
•The GST bill is likely to be tabled in the upcoming monsoon session of the parliament and there are renewed hopes it will be cleared in time to be implemented from 1st April 2017.
•The cabinet has cleared the 7th Pay commission (once in 5 year pay review) recommendations implying a 23.6% rise (0.7% of GDP) for central government employees and pensioners which should help boost consumption.

We believe these along with spending on infra, especially roads railways and defence form the bedrock of a broad based recovery and our positioning is likewise tilting to these domestic themes.

We were disappointed that Reserve Bank of India (RBI) Governor Rajan did not get an extension considering the good work he has done. However, personalities are important when institutions are weak, which we believe is not the case with RBI.

Rajan has set high standards with his legacy, which would be difficult to reverse. For e.g. the Finance Minister did not abandon fiscal deficit targets of his predecessor. Similarly the new incumbent is not expected to abandon inflation targeting. It would be suicidal politically if inflation is allowed to go up and Prime Minister Modi wouldn't want to give opposition fodder ahead of important upcoming state elections and general elections in 2019.

One thing is certain though that the lack of public support that Rajan got from the ruling government while he was criticized by the party fringe means this government will find it difficult to attract outside talent to work for it.

While global macro may keep headline markets constrained, there is an increased confidence on growth visibility for domestic focussed companies. This is clearly evident with the CNX Midcap Index at its all time high.

Hiren Ved

Chief Investment Officer
Alchemy Capital Management Pvt. Ltd

DEBT OUTLOOK

June 2016 was a crazy month. Two big events happened, first Brexit and other Rexit. Everybody expected markets to be very volatile and there would be out flow of money from bond markets as well. But Markets surprisingly rallied after these events on expectations of a relatively dovish RBI governor & global central bank stimulus. The ten year benchmark bond yield closed the month 3bps lower at 7.45%.

For the first time ever, nearly $13 trillion worth of government bonds worldwide — representing more than a third of all government debt — have negative interest rates. Returns or yields on bonds drop as their prices rise following an increase in demand. Demand for bonds and gold has soared as central banks kept interest rates down and investors rushed to safe haven investments following Brexit, or UK's vote to leave the European Union. The yield on 10-year US treasuries fell to an all-time low of 1.34% while the yield on a 30-year bond fell to 2.15%. In the UK, the 10-year yield fell to less than one percentage point to 0.77%. In Japan, almost 90% of the sovereign debt is trading at negative yields. In Switzerland, the return on even 50-year bonds is negative. Taking clues from global central banks bond investors decided to put more money in India. We saw a good rally in fixed income markets since 24th june 2016.

Globally central banks are keeping very low interest rates to stimulate their economies since 2008 but are not successful in boosting economic growth. World is struggling with very low growth. In developed countries debt to GDP ratio is keep on increasing and it is worry some. We saw huge money went in US treasuries as a safe haven and this has caused US 10 year to fall instead of fed talking to increase the rates. With Brexit happening many economists are of view that world growth will further go down and hence we saw commodity prices are on free fall expect gold. People have invested in gold as gold is a safe haven whenever there are big global uncertainties. Amid all these India is expected to grow better. FPI investors prefer India as interest rate differential is still very high and there is clear sign of economic activities picking up. We expect this will drive the sentiments going forward.

The Reserve bank of India kept the rates unchanged at 6.5% in its June monetary policy meeting. The central bank also retained its newly adopted liquidity framework. While there was increased confidence on growth, there was a hint of concern of concern on inflation. We sense that higher than seasonal spurt in April inflation print and an expectation of yet another high CPI inflation in May made the RBI more circumspect. RBI may now want to look at the actual spatial and temporal distribution of rainfall before going in for yet another rate cut. It may also want to see further evidence of transmission of its cumulative rate cut of 150 bps by the banking system especially in the backdrop of new base rate guidelines and its latest liquidity management moves enunciated in the April policy.

We have been consistently advising our investors to follow asset allocation under debt and invest in short term, accrual and long term strategies. We expect RBI to hold interest rates at these levels for next 2 -3 quarters before acting on it. Inflation is one of the most important parameter and we are keeping a close track on it. We advise to investors to follow following allocation.

Short term debt: 35%, Accrual Strategy: 35% and long term debt through dynamic funds:20% and income funds :10%. We expect with better growth credit profile of big corporate will improve and there could be some gains due to rerating of papers. We also want to alert our investors that returns from liquid funds may down from these levels. We suggest transferring some funds to ultra short term funds with minimum 60 days horizon period to generate better returns then liquid funds.

Advisory Team

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Edited by: Naman Dhamija(Ph: +91-22-66171773)
Alchemy Capital Management Pvt. Ltd., B-4, Amerchand Mansion, 16 Madame Cama Road, Mumbai 400 001. Ph: +91-22-66171700
CIN- U67120MH1999PTC119811, Email ID: contactus@alchemycapital.com