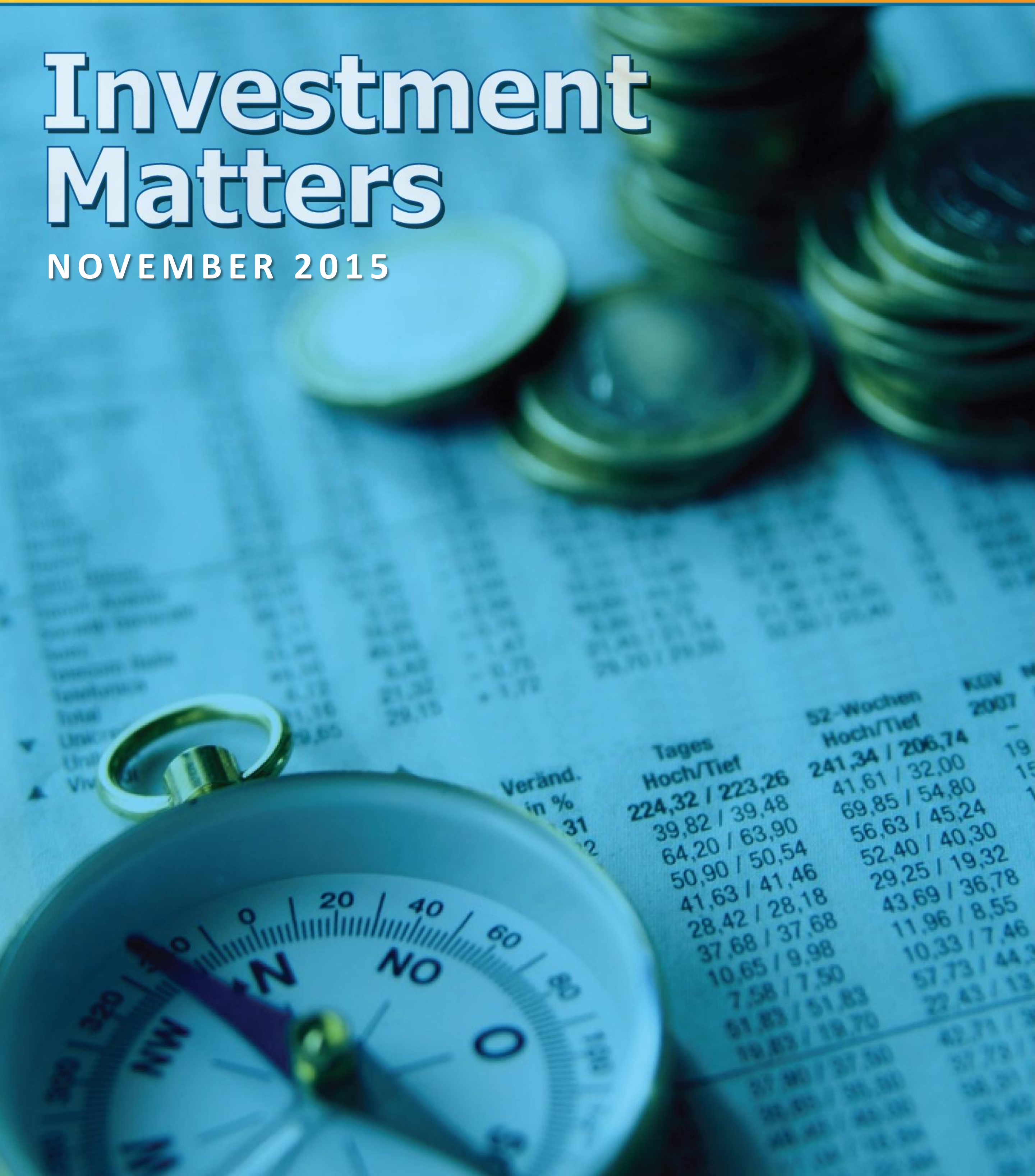
ALCHEMY
CAPITAL MANAGEMENT

Investment Matters

NOVEMBER 2015



EQUITY OUTLOOK

October 2015, a month of 2 halves – start being very positive +4.8%, however the month ended with only 1.47% gain on the Nifty and 1.65% on the BSE 500. FII flows turned positive during the month with net buying worth $1bn while DIIs sold net -$0.2 bn – within DII mutual funds remained net buyers worth $0.2 bn and Insurance companies net sellers worth -$0.4 bn. India during the month was a relative underperformer during the month primarily on account of a late sell off which capped overall positive performance. US S&P 500 up 8.4%, Stoxx600 up 8.1%, Nikkei up 9.7% and Hang Seng gaining +8.8% were the key outperforming markets during the month.

Q2FY16 earnings season for Nifty companies (33 companies reported out of 50 till date) is turning out to be a mixed bag with a few sectors/companies performing better while many delivering below expected earnings. Key takeaways from the quarter remain more or less the same ie demand growth across sectors remain on the weaker side with even the consumer facing brand companies reporting low single digit volume growth with outlook for the immediate future not looking any better. Commodity prices continue on a downward trend with the CRB index falling another 4.9% during the month of October 2015. The resultant impact is that sales for Nifty companies continue to degrow and stands at -4.6% for the quarter till date. A positive aspect of lower/falling commodity prices is that EBIDTA margins are now running at fairly high levels – margins have moved up by >300 bps during the quarter, however one key point of concern which needs monitoring is the fact that interest cost is still not falling and infact has risen by 17% during the quarter.

Among our portfolio companies Q2FY16 was a good quarter for many companies with few notables ones outperforming expectations ie Bajaj Finance, Cadila Healthcare, Maruti Suzuki, Inox Wind, Grasim Industries, Sundram Fasteners, Sterlite Technologies, Tata Elxsi and Essel Propack. Alongside there were a few disappointment as well where we are in discussions with the respective management teams to understand what went wrong and more importantly can the business perform better in the future – our take post our initial interactions is that all of these companies did face certain specific issues during the quarter and more likely they are expected to report better numbers going ahead – key among them were – Federal Bank (Weak growth along with higher NPA), Ipca Labs (Delay in USFDA approval), L&T (weak ordering activity), Container Corporation (Weak container movement), Praj Industries (Delays in execution of orderbook), Everest Industries (Forex Loss) and Thomas Cook (New acquisition in the HR space contributing to losses). We will continue to monitor closely the performance of these companies and take corrective actions if required.

Initial feedback from consumer facing companies suggest that the festive season this year is likely to be on the positive side with demand pick up being reported in many sectors key among them being Auto (Read - Passenger Cars), Consumer Durables etc. Another segment where we have been highlighting improving trends is government capex on infrastructure specially Roads, Railways, Defence, Metro (Urban Infra). We expect execution on the ground to start reflecting in numbers over the next 6-12 months driving positive demand and sentiment. We continue to be optimistic on the long term potential in equity markets in terms of delivering positive returns going ahead.

Chandraprakash Padiyar

Portfolio Manager
Alchemy Capital Management Pvt. Ltd

DEBT OUTLOOK

Wishing you all a very Happy Diwali and Prosperous New Year!

October 2015 was comparatively stable month from fixed income prospective. Post surprise 50 bps cut from RBI in September yields fell initially but gave up all the gains and again moved back to 7.6% levels. Focus is changed towards global developments. China's central bank cut its deposit, lending and cash reserve rates once again after its first sub-7% quarterly GDP reading since 2009. There are increased speculations that European central bank (ECB) and Bank of Japan (BoJ) would opt for further accommodative measures to support their economies. US Fed in its latest policy meet kept the rates unchanged, while sounding more hawkish than before despite mixed US economic data over the month. This has put the possibility of rate hike in the December policy meet back into play. US GDP for the third quarter of 2015 came in at 1.5% as compared to 3.9% in Q2, mainly on account of slower inventory accumulation. However, other components of GDP like the consumer demand and business spending on equipments remained strong .

RBI in its policy allowed Foreign Portfolio Investors (FPIs) to hold 5% of the outstanding stock of government bonds in phased manner. The new limits opened in October as part of this phased opening were taken up very quickly, thereby indicating the strong underlying appetite for Indian bonds. The government for the first time issued a new 40-year tenure government bond, which was also fully subscribed. These long tenure bonds help institutions like insurance firms and provident funds effectively hedge their long term liabilities, and also help build the yield curve at the longer end as in line with the international markets. Helped by a strong growth in revenue receipts, the fiscal deficit for the first half of FY 2016 (April to September) came in at 68.1% of the full year budget estimate (BE), better than last year's 82.6% of the BE. With government focusing on capital spending, the Plan Expenditure rose to 54.6% of the full year BE as against 42.8% last year's BE. The government is expected to meet the fiscal deficit target of 3.9% of GDP, in spite of the underachievement of the disinvestment target.

CPI headline inflation moved up to 4.41%YoY in September from 3.74%YoY in the previous month as the base effect began to reverse. Food inflation accelerated on account of a sharp uptick in the prices of pulses and a slight increase in protein-based items. Core inflation (ex food and fuel) also edged up to 4.3%YoY in September 2015 from 4.2%YoY in the previous month. Meanwhile, Wholesale price index (WPI) inflation remained in deflation territory and recorded -4.54%YoY in September 2015 vs - 4.95%YoY in the previous month.

Asset allocation plays an important role in generating optimal returns. We advise existing investors to hold on to their duration portfolio and wait for further reduction in the yields. For new fixed income investments we suggest to invest larger allocation of 50% in short term funds, small allocation of 25% in duration funds to generate capital gains and another 25% allocation in accrual strategy to get benefit of current high yield available in the market to generate consistent returns.

Advisory Team

Alchemy Capital Management Pvt. Ltd

DEBT OUTLOOK

The RBI cut interest rates by 50bps, The US Federal Reserve (Fed) delayed its decision to hike interest rates and the European Central Bank (ECB) has lowered the euro zone's growth and inflation forecast, due to a weaker-than-expected pace of economic recovery. These all auger well for bond markets in India. Debt markets were choppy since last 4-5 months but September brought much need enthusiasm to lift over all sentiments.

RBI surprised markets at the fourth bi-monthly meeting, with a larger than expected 50 bps policy cut. Additionally, this was followed through with a highly 'dovish' stance, with the RBI reiterating that it would remain in 'accommodative mode' beyond the 50 bps cut. This was the fourth rate cut by RBI in calendar year 2015, taking the cumulative rate cut to 125 bps. RBI clarified front-loading of the rate cut, as most of the pre-conditions set at the previous policy meeting were met satisfactorily. The dovish tone was underpinned by the emphasis on headwinds to growth particularly in emerging markets. This in RBI's view could drive commodities lower and help in disinflation the economy in the coming quarters. The cut was also premised on the basis that investment could respond more strongly if there was adequate visibility of monetary stimulus even if the transmission was slow. Even as it went further than expected on policy easing, RBI re-iterated its resolve to continue battling inflation and to anchor CPI at 5% by 2017 and 4% by March 2018. RBI also lowered its growth forecast for FY 16 by 20 bps to 4.4%, given the sluggish investment cycle, slowing trade, anemic global growth and subdued business confidence. However growth forecast for FY 17 was upped to 8%, while inflation guidance was lowered to 4.8%. RBI also announced a much larger than expected expansion of limits for foreign investment in Indian bonds. This would be increased in phases to 5% of the outstanding G-Sec by March 2018 and would give FPIs the room to invest an additional Rs 1,200 billion in central government securities.

Markets rallied quite strongly post the policy. There was a sharp up-move in the prices of both G secs and bonds. The benchmark 10 year G sec rallied to sub 7.60% from over 7.70% pre-policy. Benchmark AAA bonds also rallied by 20-25 bps post the policy.

Given the sharp rate reduction in the September policy, it will probably be expected that the RBI may not effect another rate reduction before the beginning of the next financial year. We reserve our outlook on the same, but feel positive on further rate reductions given the change in RBI's attitude and its focus on demand revival and comfort on inflation. Given the continued external headwinds from weak global growth, which may possibly intensify in the coming months and which could also pull retail inflation below the central bank's forecast, we believe that further monetary easing cannot be ruled out and more policy rate cuts could follow. While in the immediate term, we see the G-Sec market to be range bound, we continue to remain positive on the medium term outlook of long term bonds and gilts.

We advise investors to hold on their duration portfolio and wait for further reduction in the yields. For new fixed income investment strategy now we suggest to invest larger allocation in short term funds, small allocation in duration funds to generate capital gains and part in accrual strategy to get benefit of current high yield available in the market to generate consistent returns.

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