ALCHEMY
PRIVATE WEALTH

Investment Matters

OCTOBER 2014

BESPOKE FINANCIAL EXPERTISE TO MAKE THE RIGHT MOVES, MORE OFTEN.

EQUITY OUTLOOK

Indian equity markets have performed reasonably well in September despite the increased volatility in several pockets of global markets; equities, bonds, currencies and commodities. A key reason for India's recent outperformance is that it is a big beneficiary of the fall in global commodity prices, especially crude oil which has fallen by almost 15.0% (US$17.7/barrel) in Q3.

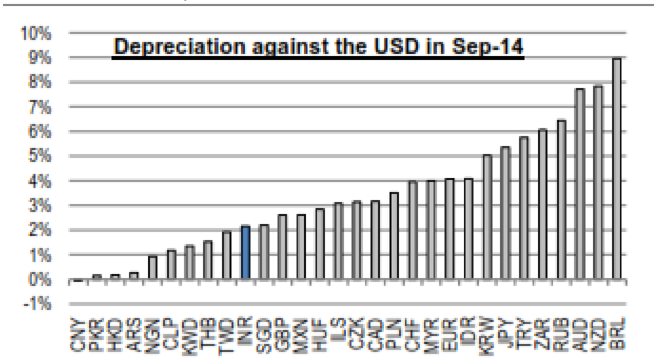
India consumes 3.7m barrels of oil a day, of which 80% is imported and the fall has big positive impact on Current Account Deficit, Inflation & Fiscal Deficit. For every US$10 fall in crude prices

-Current Account Deficit would fall by 40-50bps
-Wholesale Inflation would fall by 80-100bps
-Oil Subsidy and thus Fiscal Deficit would be lower by 20bps in FY15.

The fall in Gold & Coal prices also bode positively as their imports account for about 2% of GDP.

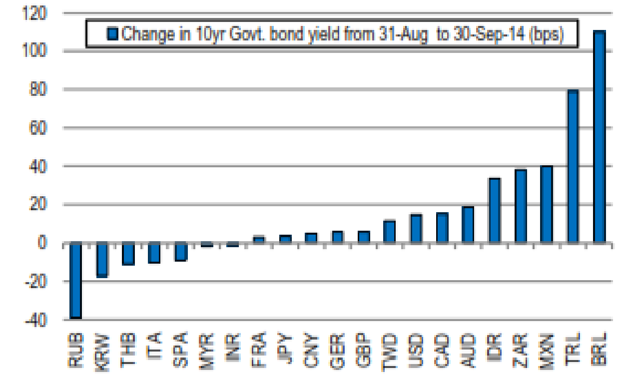
Hence it is no surprise that not only equities but Indian Bonds and Currency have held up well in September as seen from the tables below. In fact our Singapore fixed income desk tells us that earlier in the month of September there has been some large scale buying of Indian Government Bonds by foreigners without hedging the underlying currency, that seems like a first in a long time.

Chart 1. INR Depreciated about 2%



Source: Bloomberg, Credit Suisse estimates.

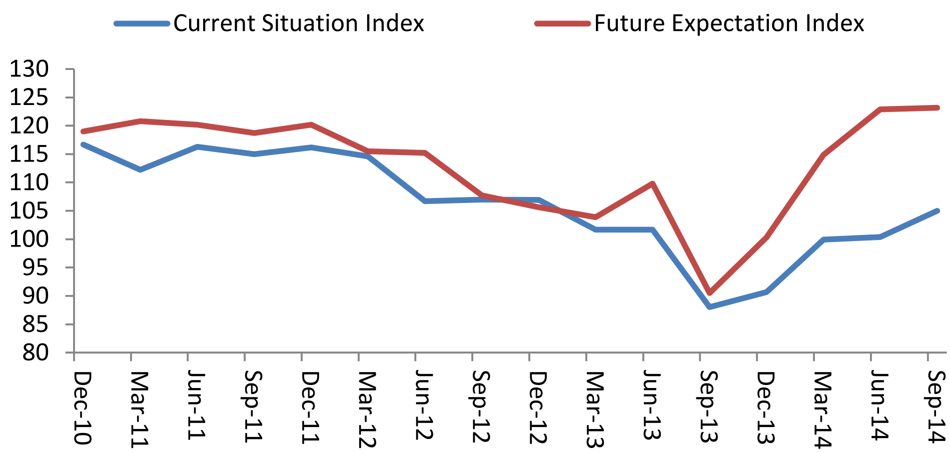
Chart2. Yields see minor decline



Source: Bloomberg, Credit Suisse estimates.

On the ground, the consumer demand is witnessing a nascent recovery. Consumer discretionary categories like Two-Wheelers, Passenger Cars and White & Brown Goods are showing good growth though there is some amount of channel push given upcoming festival season. Our recent company meetings with Titan, amongst others, confirmed that consumers are back and they are witnessing good demand for premium watches and jewellery. The RBI quarterly Consumer Confidence Survey too points to similar improving trend in consumer confidence over the last 4 quarters.

Chart 3. RBI Quarterly Consumer Confidence Survey



The one thing most investors are focused on is the revival in investment demand which is a key to medium to long term sustainable growth. While the government has taken the right steps in easing environment clearances and settling disputes to de-clog existing stalled projects, the impact of which will be seen in the next 12-18 months, on ground feedback from Industrial companies is still not very encouraging and there is more hope than actual movement on the ground.

The recent decision by the Supreme Court to cancel 214 out of 218 coal block licenses issued since 1993 terming the issuance arbitrary and non-transparent because it granted licenses without competitive bidding is also a setback to investment revival. However, it does provide the new government with six months to put a transparent policy in place and enrich it's coffers by about US$15bn when it auctions these mines which can be used to invest in future projects.

We got an opportunity to meet several senior bureaucrats in Delhi a couple of weeks ago from some important ministries and we came away with a feeling that the bureaucracy is extremely energized to work and deliver. There was new found enthusiasm in them and they felt empowered and were keen to be part of the change to turnaround the economy. Being a closed door interaction some of them were quite forthright with their views and one of the senior bureaucrats mentioned that *"Modiji has told us that we should take (quick) decisions and that if they are within the laid down rules and bonafide, I will back you to the hilt"*. So we came away with the feeling that the immediate focus is to improve the speed of decisions, improve co-ordination and get the stuck projects off the ground and to bring in large amounts of transparency in the process by going digital. On asked about initiatives on hard structural reforms (land acquisition, labour reforms) – most felt that the government was seized of the issues but they would want to do it more tactfully and after some level of consensus emerged giving the impression that this government is still cautious about spending its new found political capital to resolve contentious issues and that other than GST, which was a clear priority, the rest would happen in a more calibrated fashion.

EQUITY OUTLOOK

The upcoming 2QFY15 results should provide a lot of commentary for developments in various sectors/companies but the important event for markets is the upcoming state elections in Maharashtra & Haryana. Both are important industrial states and winning these elections is important as:-

1. All new legislation in India has to be approved by both houses of parliament. However, BJP and its allies only control 62 / 250 seats in the Rajya Sabha (Upper House). Hence passing the bills in the upper house is a challenge. The members of the Rajya Sabha are elected by members of legislative assembly of each state; hence the only way to increase the tally in the upper house is to win state elections.
2. India is a federal state where under the constitution states have significant powers of legislation on key economic issues (states have exclusive authority to legislate on several key economic matters including water and joint authority on land labour and electricity). For contentious reforms like labour and land where national consensus is difficult to arrive at present some BJP governed states like Rajasthan & Madhya Pradesh are taking the lead in reforming at the state level and are positioning to attract big investments. The BJP currently governs only 7 out of the 29 states in the country and Maharashtra & Haryana would be welcome additions here.

Early indications for the 15th October state polls are that the BJP would be the single largest party in both states but would fall short of absolute majority. Markets would take it positively as long as BJP is the senior partner in the coalition running the state government.

Hiren Ved

Chief Investment Officer
Alchemy Capital Management Pvt. Ltd

DEBT OUTLOOK

The RBI, in its monetary policy review, has left the policy rates unchanged as expected. Similar to its August policy review, the RBI maintained that there are upside risks to its inflation target of 6% by Jan 2016, but acknowledged that such risks have moderated a bit. RBI’s projections for 2015-16 show CPI hitting ~7% by Q4FY16 (~100bps higher than target). The governor stated in the press conference that it is “appropriately set” to achieve its CPI target of 6%. In that sense, the RBI tried to make a distinction between its model-based projections and its overall assessment of inflation trajectory, and we presume that it is the latter which will guide its policy stance.

The G Sec market witnessed range bound trading with positive bias in September 2014. The market saw a lot of positive news flows from domestic as well as international front over the past one month. On the domestic front, there have been continuous FII inflows into the Indian debt market since the start of financial year on strong government at the Centre, policy initiatives and pickup in the economy. Monthly inflation numbers positively surprised the market and were better than market’s expectations. IIP growth remained positive. Trade Deficit in August narrowed to $10.8 billion indicating that while external demand remains stable, domestic demand is gaining momentum. On global front, international commodity prices especially crude oil and precious metals continued the bear run which indirectly aided the inflation number (both CPI & WPI) .The Brent crude has come down from high’s of 115$/bl by end June to 96$/bl currently, which is a big positive for Indian economy from fiscal and inflation point of view (High oil prices have been drag to Indian exchequer in recent years). Geo-political tensions have eased post US intervention in Iraq. The recent FED policy was also dovish. Finance minister has been reiterating time and again his commitment to adhere to the fiscal deficit target in current fiscal year and attain fiscal consolidation in medium term.

Liquidity conditions in the economy are comfortable. The recent indirect tax collections show initial signs of pick up in the economy. Record transfer of dividends from RBI to government and expectations of high divestments proceeds will help government easily achieve the fiscal deficit target. The Government has sufficient cash balances and if the trend continues, they might not borrow additional INR 16,000crs which was reduced from the H1 FY15 borrowing calendar.

All these positives have led to 10 year G-Sec yields coming down from 8.70% by mid –July to 8.45% currently. Outlook Upgrade from leading international rating agencies like Moody’s and S & P on India’s rating will prove to be positive for Indian fixed income markets. Overall, it appears that the RBI is in no hurry to reverse its monetary stance. After all, growth concerns which were pulling the RBI in the other direction have also receded a bit. Besides, the RBI acknowledged that Fed tightening reduces the elbow room to set the domestic policy rates. This suggests that the policy rates will be on hold for long, with chances of the first rate cut being pushed towards mid-2015.

Bond Markets are currently focusing more on inflation trends and perhaps all other positive macro developments are being overlooked. Real rates have turned positive after a long time and can enhance savings in the economy, Balance of Payment is in surplus, Current Account Deficit is likely to remain below 2% of GDP in current fiscal, Fiscal Deficit has improved from over 6% levels to 4.5% and is set to improve further to 3% levels in coming years, Inflation has come down from 11% levels to sub 8% and is headed for further deceleration. All these macro developments are extremely positive for fixed income markets and are structurally building-up a case for lower interest rates in the near future. We believe, valuations in fixed income are reasonable and sentiments are negative, this makes a strong case for investing in fixed income today.

DEBT OUTLOOK

We expect government bond yields to remain range-bound with a downward bias. There is possibility of headline CPI to ease going forward on account of improvement in sowing patters, better administration put in place by new government to counter spike in food prices and easing oil prices. The timing of the rate cuts would continue to be largely data dependent as the RBI has also stated that they would not hold rates longer than necessary. The shorter end of the curve is likely to remain supported as the outlook for liquidity remains comfortable. We Suggest Some allocation in duration products to get the benefits when interest rates would fall.

Rupesh Nagda

Head – Investments & Products
Alchemy Capital Management Pvt. Ltd

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Edited by: Rupesh Nagda (Ph: +91-22-66171785), Sudeep Pai (Ph: +91-22-66171772)
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