ALCHEMY
PRIVATE WEALTH

Investment Matters

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

EQUITY OUTLOOK FROM CIO'S DESK

Slow GDP growth, High Inflation, High Current Account Deficit, High Fiscal Deficit – these are the key macro highlights of India which define how investors need to position their overall asset allocation and within that Equity investments. FY12 and FY13 has been one of the most challenging economic environment for India – GDP growth has slowed from an average of 8%+ to 5% expected for FY13, Inflation has consistently hovered close to 10%, Current account deficit has reached a new high of 4% of GDP and sustained around these levels and finally high government subsidies towards Oil & Gas, Food, Fertilisers have meant that fiscal deficit remains at >5.3%. A combination of all these negative factors have meant that the liquidity scenario in the country has been extremely tight, corporate have not yet seen the benefit of interest rates falling which normally is seen during a slow growth environment and new investments have been stuck on account of weak sentiment along with other issues like fuel supply, land acquisition, environmental clearance and financing. In a way, whatever bad could happen has taken place for India over the past 2 years.

Out of the 4 negative factors mentioned above, we expect a few to start turning gradually for India going ahead in FY14 and most indicators to turn positive starting FY15. GDP growth is likely to have bottomed out in FY13 and we expect growth to pick up albeit at a slow pace from FY14. Inflation has already started to come down and now stands at closer to 7% out of which core inflation ex food has now come down to 4% levels. The government has shown some resolve to tackle high fiscal deficit recently and have taken some concrete steps to improve on this number – recently the government has increased railway fares by 15-20% - an important step to reduce the budget imbalances and surprisingly the rail fare hike has not seen any opposition (possibly first time in history) – another major decision taken by the government which can have very large positive implication for India is to raise retail Diesel price by 40-50 paise per month starting with 50 paise during the month of January 2013. The government currently subsidises Diesel by around Rs 10 per litre with an annual subsidy amount >Rs 94,000 crore. Surprisingly again, the government has faced very little opposition from political parties till date on diesel price hike. This is potentially the biggest reform move that UPA II has undertaken if taken to its logical end and has the biggest impact on the fundamentals for India. The key challenge for the government on this topic remains various state elections on the horizon in FY14 and ultimately the general elections in FY15. Historically the ruling government's chances of winning elections have got impacted negatively on such moves. We will keep a close watch on the government's resolve to hike diesel prices.

Equity markets are witnessing a lot of churn with Mid cap and small cap indices showing deep corrections in the beginning of CY13. CNX Mid Cap Index has corrected by 5.7% from its highs in Jan 2013 while the BSE Small Cap index has corrected by a higher 7.6%. Interestingly out of BSE 200 stocks, 60% of stocks have reported negative returns for the month of January compared to CNX Nifty/Sensex which have delivered a positive gain during the month. The market gains are extremely narrow and only a few sectors/stocks have contributed to this gain – IT, Oil & Gas and Telecom being the standouts. It is important to note that FIIs have continued to be large buyers of Indian stocks with net inflow of $4bn in Jan 2013 and $24 bn in CY12, however domestic mutual funds and insurance companies have been large sellers of stocks with $3.24 bn net selling in Jan 2013 and $10bn for CY12. At Alchemy, currently we have a very limited exposure to the Oil & Gas, IT and Telecom sectors. As discussed in our past updates, we continue to focus on select sustainable high growth opportunities in our portfolios. We continue to believe that better stock selection will play a major role in creating better return for investors going ahead and remain focused to identify and invest in the right companies for the long term and not be guided by short term sectoral performances to churn our portfolios.

EQUITY OUTLOOK FROM CIO'S DESK

Meanwhile, leaving you with some key takeways from the Finance Minister's recent global roadshows (Courtesy: BoAML).

Fiscal Deficit: The FM was confident of keeping the fiscal deficit for this year at 5.3%. This would be done mostly through crunching EXPENDITURE & AUSTERITY measures and NOT through TAXES. Longer term FD would be CUT by 0.6% EVERY YEAR to bring it to 3% by FY17 through cost cuts as well as enhanced revenue (but no tax increase).

Current Account deficit: acknowledged this was a PROBLEM which is difficult to curtail near term. They have tried to raise import duty on gold to slow imports. But overall, confident of getting CAPTAL FLOWS to fully meet the current account deficit.

GDP growth targets: He expects GDP growth to be between 6 to 7% for next year and hopes to reach 8% by FY15.

SELECTIVE LEGISLATION underway: CONFIDENT of passing the Insurance Bill (raising FDI limit in insurance to 49%) & the pension Bill in the budget session that starts in Feb. He acknowledged that beyond the noise, there was quiet NEGOTIATION with the BJP and some regional parties which has helped the REFORM process.

GAAR: Most of the ISSUES had been SORTED. There would be a panel to look into disputes that includes a judge of the Supreme Court, an outside scholar & a representative of the Income tax dept. There were no questions on GAAR.

Infrastructure: Agreed that there was a gap normally between the Plan & what we finally achieve. He highlighted 2 measures to bridge this:
a) Cabinet Committee on Investments (earlier NIB): is now OPERATIONAL and will meet before the end of this month. He hopes this will speed up inter-ministerial disputes that hold up projects.
b) TAKE-OUT FINANCING by Infrastructure Development Funds (IDFs) which would free up bank funds to provide money to the next round of projects.

Direct Benefit/Cash Transfer: He highlighted this as a major initiative to (a) make sure LEAKAGES are REDUCED in the system & (b) reduce subsidy: pilot projects have shown that the COST SAVINGS can be 20% to 60%.

Goods and Services Tax: is the major reform from his point of view. He is hoping to have the legislation approved by Dec of this year.

Disinvestment: confident of meeting his target of $5 bn. He said the companies & the time-table has already been announced. (US$3.7bn already achieved)

Debt investments: He mentioned that while the limit was $75bn, investors had wanted the sub-limits to be fungible. The regulatory authorities are trying to remove some of these sub-caps.

Within our portfolio's we have bought into select companies with a lot of emphasis on growth in earnings in FY14 and beyond. We are playing businesses which have a potential to deliver strong growth of 30%+ sustainably over the next 2-3 years along with strong balance sheets and high return ratios. We look forward to a rewarding FY14 based on the investment we have made in your portfolios.

Hiren Ved

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DEBT OUTLOOK

Much awaited event Third Quarter Monetary Policy was held on 29th Jan 2013. The RBI monetary review in January 2013 was widely anticipated to initiate the process of monetary easing after the pause since April 2012.

Highlights of the policy are as follows:

- Reserve Bank India in its Third Quarter Monetary Policy Review today has cut CRR by 25 bps and repo rate by 25 bps.
- Current repo rate under the liquidity adjustment facility (LAF) now stands at 7.75 per cent. Consequent to this, the reverse repo rate under the LAF, determined with a spread of 100 basis points below the repo rate, gets calibrated to 6.75 per cent. Similarly, the marginal standing facility (MSF) rate, determined with a spread of 100 basis points above the repo rate, and also the Bank Rate stand adjusted to 8.75 per cent.
- CRR of scheduled banks will be 4.0 per cent of their net demand and time liabilities (NDTL) effective the fortnight beginning February 9, 2013. This reduction in the CRR will inject primary liquidity of around Rs. 180 billion into the banking system.

Considerations for policy move:

- Both headline wholesale price inflation and its core component, non-food manufactured products inflation, have softened through the third quarter.
- Growth has decelerated significantly below trend through the last fiscal year and through this year so far, and overall economic activity remains subdued.
- Liquidity conditions have remained tight. Although the Reserve Bank lowered the cash reserve ratio, CRR, successively in September and October 2012, and carried out open market operations (OMO) injecting systemic liquidity of Rs. 470 billion during December and January to augment liquidity, the average net LAF borrowings at Rs. 910 billion in January have been above the Reserve Bank's comfort level. The structural deficit in the system provided a strong case for injecting permanent primary liquidity into the system.

RBI also made following changes in its macro-economic Projections:

- Projection of GDP growth for FY 13 reduced from 5.8% to 5.5%.
- WPI inflation projection for March 2013 reduced to 6.8% from 7.5%
- M3 growth expectation for FY 13 reduced to 13% from 14%
- Non food credit growth projection kept unchanged at 16%

We expect RBI to keep on supporting credit market by more OMOs in 2013. RBI will try to maintain liquidity in the system in order to support ongoing borrowing program and restrict the increase in benchmark yields. Overall, we believe that interest rates are going to fall in coming time, only matter is how much and by when. We expect interest rate to fall by 25-50bps in next 6months. The short end rates currently have come off their peaks and seem to have bottomed hence we suggest to reduce exposure to short term funds and increase allocation to income funds to take the benefit of higher accruals and yield contraction if interest rate falls from here. Longer end of the curve would react once there is clear sign of RBI indicating policy rate cuts and other policy measures to boost liquidity. Investors with higher risk appetite can invest a part of their portfolio in dynamic bond funds and income funds to play safe duration calls to generate better risk adjusted returns

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