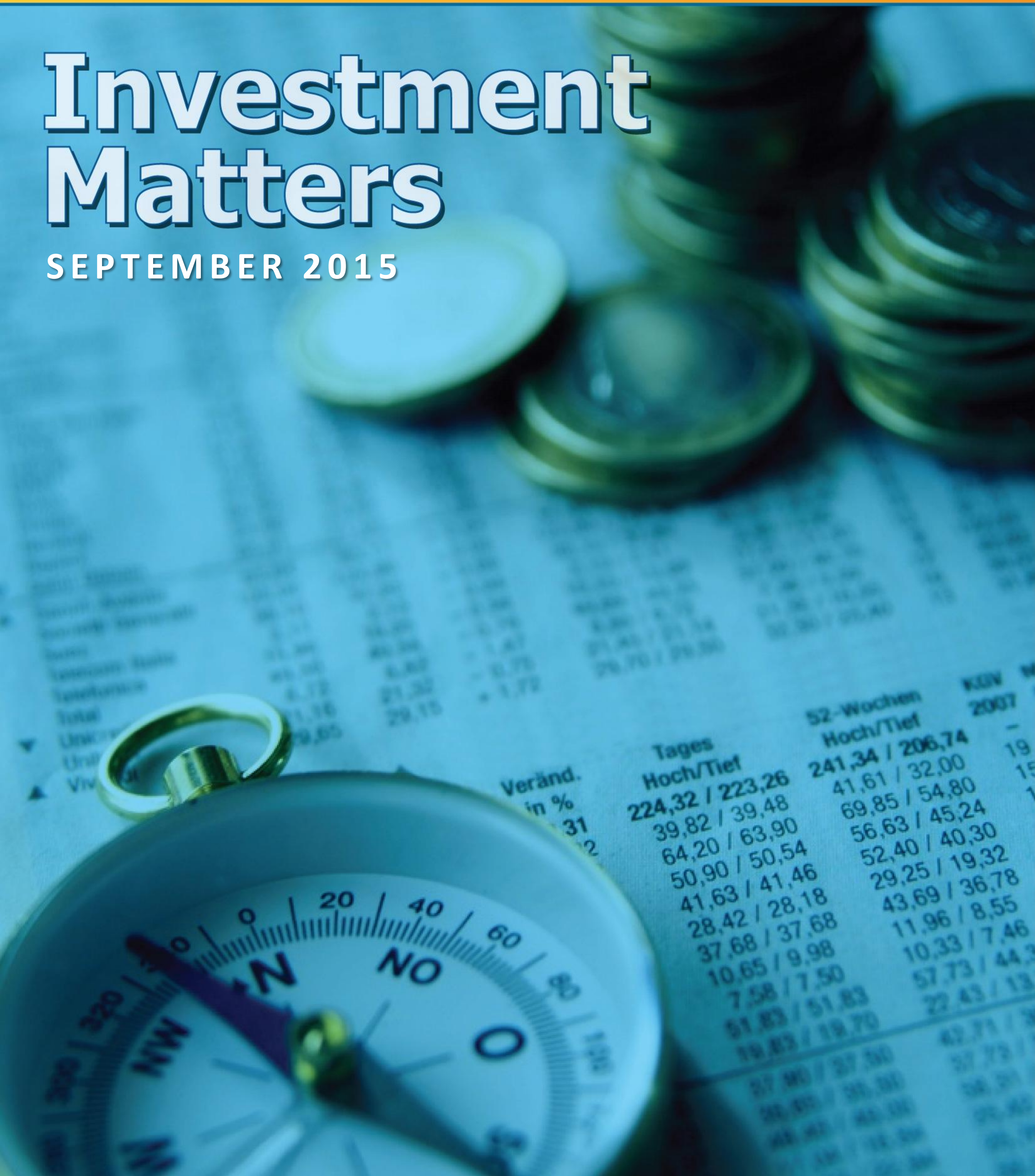
ALCHEMY

CAPITAL MANAGEMENT

Investment Matters

SEPTEMBER 2015



EQUITY OUTLOOK

Last Month the markets faced several headwinds. The principal trigger for the sharp correction was the sharp retracement of the Chinese stock markets and fear of a continued slowdown in China. That the Chinese economy was slowing down is not surprising, the significant global attention was because of the unsuccessful attempt by Chinese authorities to shore up and subsequently sustain the manufactured boom in their markets. The overall slowdown and challenges faced by EM's have led to record outflows from GEM Funds and hence the consequent outflows by FII's from India. These outflows have been accentuated by the need to rebalance global portfolio's by underweighting EM's in the wake of the impending US rate hike. Data shows that the outflows from EM's in 2015 have already exceeded in comparison to similar outflows during 2008. A continued weakness in commodity prices continues to instil fears of deflation around the world and the subsequent impact on world trade growth.

However, India stands to be a net beneficiary in the long run given its large import of Oil. We believe that government is rightly focusing on a few sectors within the infrastructure space i.e Roads, Railways, Defence, Power T&D, Urban Infra and Irrigation. Roads and Railways are two segments where we are seeing improvement in capex trends while in the other segments capex is likely to be back ended towards 2HFY17. Earnings growth for the broad markets continue to be in negative territory given the challenge of revenue growth in a low inflation environment. For example for the latest quarter i.e Q1FY16 Nifty companies on a reported basis showed a -3.4% decline in sales over same quarter last year and the BSE 500 companies reported a -3.3% decline. However, EBIDTA margins as expected continue to show better trajectory with improvement of around 300 bps and hence inspite of decline in Sales, EBIDTA has grown by 7.7% for the Nifty companies and 8.7% for the BSE 500 companies. Incrementally for the companies to deliver positive earnings, it will be important for revenues to grow since there is a limit to which margins can improve. A significant jump in government capex as highlighted earlier can act as a potential trigger to change the direction of sales growth in the economy driving earnings growth and hence the market returns. We are optimistic that government capex will pick up meaningfully over the next 12-18 months and are positioned well in our portfolios to take advantage of the earnings growth pickup going forward.

Chandraprakash Padiyar

Portfolio Manager
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DEBT OUTLOOK

August month was another volatile month for fixed income market. Through the 10 year yield ended flat at 7.79% but market volatility was high in line with global markets. Forex markets across the globe were impacted by intervention of Chinese central bank to reset the peg to US dollar. The depreciation in Yuan caused fall in all major currencies especially of emerging market. INR fell by around 3.7%. First quarter GDP decelerated to 7% YOY Vs. 7.5% last quarter. Weak Monsoon prevailed in August 2015 as deficit remained 11% as per meteorological dept. of India. This could impact the production of Kharif crops. Headline CPI drops to 3.8% in July 2015. July trade deficit widened to $12.8 bn. Vs. 10.8 bn. in June 2015.

In its bi-monthly policy review, the RBI has kept the repo rate unchanged at 7.25%, CRR at 4% and SLR at 21.5%. The rationale for the pause was higher than expected inflation in past couple of months, especially core CPI which moved up by around 50bps since last policy. It is noteworthy that around 30bps out of 50bps is contributed by fuel inflation, which is likely to reverse in coming months, given the correction in crude oil prices. The RBI also noted that near-term inflation expectations have moved up. On the guidance front, it sounded moderately dovish stating that there are several mitigating forces – decline in crude prices, the government's proactive food supply management, higher sowing of pulses, oilseeds, etc. Hence, the risks to the Jan'16, 6% inflation target are now balanced (versus upside risks cited in the last policy).

The RBI mentioned 4 key factors that needs to be monitored for further policy action - fuller transmission by banks, developments in food prices, de-bottlenecking of supply-side issues such as power, land, etc., and normalisation of US monetary policy. Going forward, given the liquidity scenario and government's capital infusion plans, there should be further transmission by banks. Also, food prices should be in check even if monsoon is sub-par here on, given the government's pro-active food supply management and benign international food prices (down 15% YoY). The key source of uncertainty remains normalisation of US monetary policy.

Currently macro factors like low inflation, low trade deficit, lower commodity prices better liquidity are favourable for fixed income markets in India. We have being giving constructive views on fixed income products and strongly suggest having patience and hold on to your duration funds. Interest rates will come off from these levels. We expect 60-75bps reduction in Interest rates in next 12 months. RBI governor is holding back the rates as earlier rate cuts are not transmitted and to prepare for any big global sell off. We also strongly advocate diversifying the portfolio between different strategies like short term, accrual and duration.

Advisory Team

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