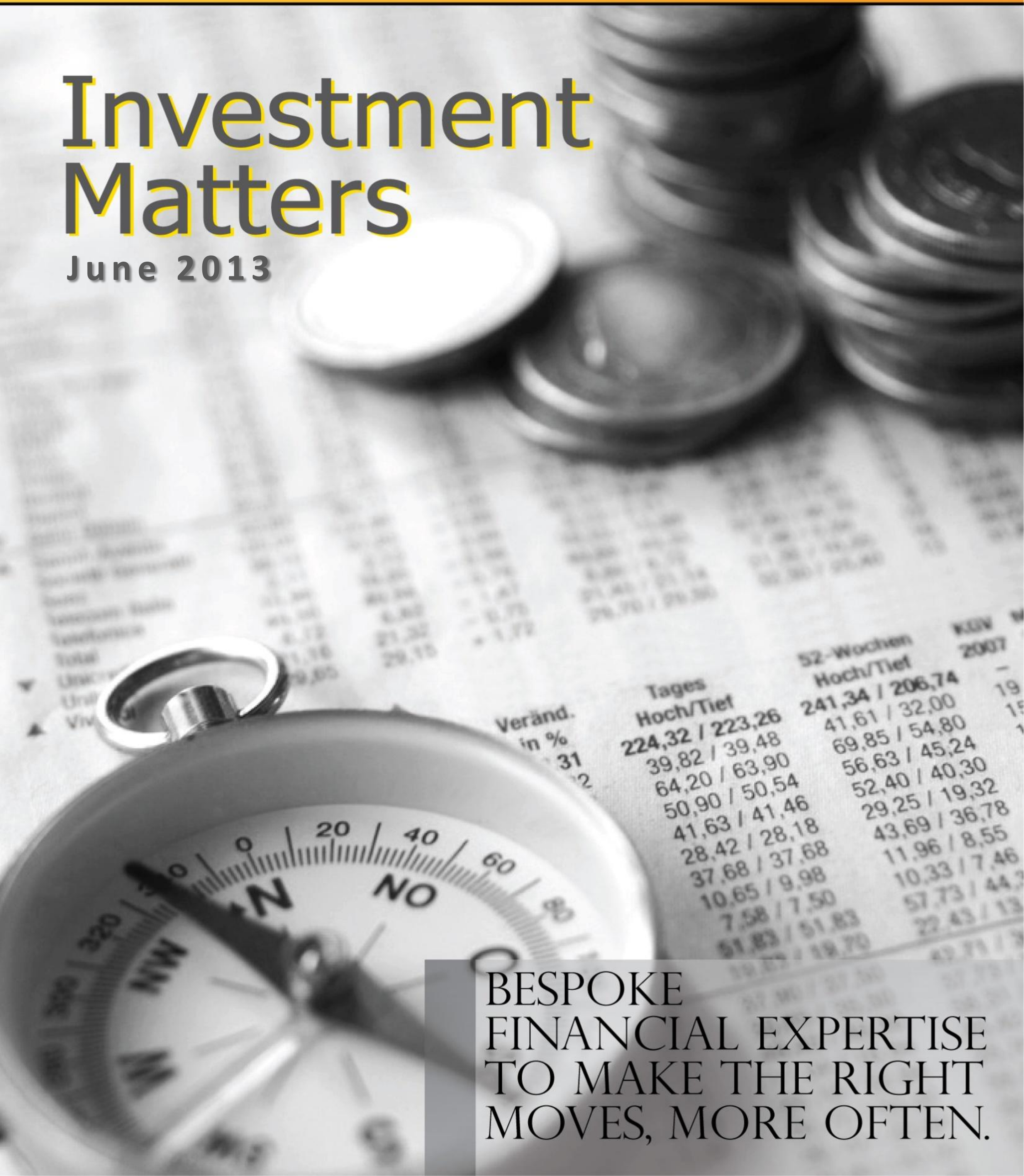
ALCHEMY
PRIVATE WEALTH

Investment Matters

June 2013



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

EQUITY OUTLOOK FROM CIO'S DESK

Rupee at 57, Gold imports at 160 tonnes during April 2013, Diesel price hike by oil marketing companies, RBI cut repo rate by 25 bps, GDP growth and fiscal deficit at 4.8% for Q4/FY13 respectively were some of the headlines for India macro during the month of May 2013. Some headline numbers continue to be negative. The rupee depreciated further responding to higher CAD, but also in line with other EM currencies which have weakened against a strengthening dollar. Meanwhile on the positive side, the oil marketing companies continued diesel price hike for the 5th successive month thereby lowering oil subsidies. The government has still a lot to do on correcting the structural problems faced by India – High fiscal deficit on the back of subsidies on fuel, food and fertilizers, Fuel supply issues for the power sector, Land Acquisition issues for infrastructure projects, Corruption allegations at all levels of the government etc – however a good beginning has been made with diesel/petrol subsidy being targeted to be brought down to zero in FY14. The more the stress in the near term, the greater the probability of remedial action where possible!

The Government has reacted to high gold imports by increasing import duties by another 200bps to 8% and forcing importers of Gold on consignment to put 100% cash margin for Letters of Credits. This is in response to 162 tons of Gold import in India, which are twice the normal imports. The surge in imports in May was due to fall in gold prices which coincided with Akshaya Tritaya falling on 13th May 2013 which is a very auspiciaous day for Hindu's to start a new venture. A sharp correction in gold prices led to a rush to buy more gold (typical human behavior of an asset class which corrects sharply post years of outperformance. While the surge in gold imports will hit 1QFY14 CAD, feedback from jewelers is that jewellery demand has already started tapering from 2H May and incremental government measures to dissuade gold purchases along with likely preponement of jewellery purchases on falling prices should mean gold demand will taper for the rest of the year.

Along with India's 4QFY13 GDP announcement which came at 4.8% & FY13 at 5.0%, India announced its FY13 fiscal deficit fell to 4.8% compared to initial estimates of 5.2%.

	Wt: Latest	FY12	1QFY13	2QFY13	3QFY13	4QFY13	FY13
GDP At Factor Cost	100.0	6.2	5.4	5.2	4.7	4.8	5.0
1. Agriculture	13.7	3.6	2.9	1.7	1.8	1.4	1.9
2. Industry	26.8	3.5	1.8	1.3	2.5	2.7	2.1
a. Mining	2.0	-0.6	0.4	1.7	-0.7	-3.1	1.4
b. Manufacturing	15.1	2.7	-1.0	0.1	2.5	2.6	1.0
c. Electricity, Gas & Water Supply	1.9	6.5	6.2	3.2	4.5	2.8	4.2
d. Construction	7.8	5.6	7.0	3.1	2.9	4.4	4.3
3. Services	59.5	8.2	7.7	7.6	6.7	6.6	7.1
a. Trade, Hotels, Transport & Communication	27.8	7.0	6.1	6.8	6.4	6.2	6.4
b. Finance, Real Estate & Business Services	18.7	11.7	9.3	8.3	7.8	9.1	8.6
c. Community, Social & Personal Services	13.0	6.0	8.9	8.4	5.6	4.0	6.6

EQUITY OUTLOOK FROM CIO'S DESK

The sharp reduction in fiscal deficit was due to compression in government spending (reported under 3c in the above table) which has affected GDP growth by 30-40bps in 3Q & 4Q. As we had highlighted in our earlier notes, since becoming Finance Minister, Mr. Chidambaram asked all ministries to curb spending plans to curb in the fiscal deficit, which had negatively affected some companies in our portfolio. Interestingly, now that we have achieved 4.8% Fiscal deficit in FY13, it now becomes easier to achieve the 4.8% forecasted number for FY14 given a) 10-11% nominal growth in GDP (b) lower oil subsidies (mainly on diesel) & (c) lower commodity prices, the government is asking various ministries to start spending their budgets faster. Typically ministries finalize their spending plans by September and spend a large part of it in 2H of the fiscal year. This year they have been asked to spend their budgets evenly throughout the year to support economic growth. We believe there is a high probability of a surge in government expenditure ahead of the election year which should improve both liquidity and demand conditions in the second half.

Q4FY13 earnings have come to a close with corporates delivering better than the already low expectation. BSE Sensex companies delivered a 8%+ growth in profits (adjusted ex energy) over the previous year compared to expectations of 3-5% growth. However, consensus has continued to lower expectations for FY14 growth in earnings on the back of slower GDP growth and elevated interest costs. FY14 earnings expectations have been revised downwards by 3-4% post the Q4 results season. Current consensus expecation for FY14 earnings growth stands in a range of 6%-12%. We expect earnings to remain muted for the 1HFY14 and are likely to pick up during the 2HFY14.

Monsoon will play an important role in the Agricultural output, food inflation and rural spending growth potential. Initial estimates suggest monsoon to be normal and farmers in anticipation of a strong monsoon seems to have started spending on essential example Tractor sales have over the past 2 months grown for the industry at high double digits and the industry players are now expecting growth to be strong for the remainder of the year as well. These are initial signs of a demand pick up and if these trends sustain then 2HFY14 may well turn out to be strong period for GDP growth and corporate earnings.

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DEBT OUTLOOK

May 2013 turned out to very good month for bonds. 10 year G-sec (8.15% GOI 2012) fell from 7.73% to the lows of 7.34% and closed at 7.44% and New 10 year G-sec (7.16 GOI 2013) launched on 20th May 2013 went down to 7.10% and closed at 7.24%. Bond prices were falling in early April due to concerns over High fiscal and current account deficit, sticky inflation, high government borrowings for this fiscal year; however the yields started to rally and have fallen more than 50bps YTD. Major reasons for the rally were improvement in incremental macro numbers. Inflation came down sharply as compared to Market expectation, Commodity prices particularly Gold and Oil started declining and IIP numbers were disappointing and suggesting subdued growth. Current rally is fuelled by market expectation of Rate cut in upcoming policy meeting of RBI on 17th June 2013.

In last week of May 2013 yield moved up by around 10bps and suggesting a halt in bond rally. Major reasons attributed for rise in yield are a rise in US yields and sharp depreciation of Rupee against US dollar led to yields moving up. The RBI Governor's comments, raising discomfort on high Consumer Price Index (CPI) inflation and high Current Account Deficit (CAD) also added to the bearish mood in the market ahead of the GDP number. The GDP for the 4th Quarter of FY13 came in at 4.80%, in line with market expectation. Further the fiscal deficit for 2012-13 was revised lower to 4.9% from budget estimate of 5.2%. However market reaction to the lower fiscal deficit for 2012-13 and the decade low GDP growth for FY13 at 5%, did not improve the market sentiments, as the market was more glued towards USD/Rupee movements, which has weakened by almost 5% in the last 1 month. The selloff in the sovereign bonds had its impact on the corporate bond market as well with yield moving up sharply. While the 5 year AAA PSU bond yields closed at 8.15%, up 12 bps, compared to previous week, the 10 year AAA PSU bond yield jumped by 14 bps. However, the credit spreads remained more or less unchanged. While the credit spreads on the 5 bonds remain unchanged at 64 bps, the spread on 10 year AAA PSU bonds rose marginally to 56 bps compared to 53 bps in the previous week.

The Wholesale Price Index-based (WPI) inflation stood at 4.89% for the month of April against the last month's reported figure of 5.96% (provisional) and the same period last year's figure of 7.50%. This is the lowest inflation figure in the last 41-months. WPI data for the month of February has been revised upward to 7.28% against provisional figure of 6.84%.vThe food articles inflation declined to 6.08% in April, after reaching the high of 12.35% in January. The fuel inflation eased to 8.84% for the month of April. In the previous month, it stood at 10.18% and in the same period last year at 12.10%. The manufacturing inflation continued with the falling trend and during the month under review, it stood at 3.41% against the previous month's reported figure of 4.07% and the same period last year's figure of 5.27%. CPI and WPI continued the downward trend. While Consumer Price Index stood at 9.39% in April from a year earlier, the Wholesale Price Index also stood lower at 4.89%. The food index for both CPI and WPI moved down to 10.61% and 6.08% against 12.42% and 8.73% recorded a month ago. India, so far, has the highest retail inflation among the BRICS group of emerging economies.

CSO has released the quarterly GDP numbers for 4QFY13 both at constant (2004-05) and current prices. Accordingly, the domestic economy has registered a growth of 4.8%, against the last quarter's revised figure of 4.7% and the same period previous year's figure of 5.1%. For the full fiscal year ending March 2013, India's GDP registered a decade-low growth of 5.0% against the last fiscal's reported figure of 6.2%.

DEBT OUTLOOK

Liquidity deficit as reflected by the Liquidity adjustment facility (LAF) numbers, eased during the week, on the back of G-sec maturities (Rs.115 Bn) during the week. RBI infused an average net liquidity of Rs. 869 Bn compared to Rs.1.01Tn in the previous week.RBI reiterated that it will continue to actively manage liquidity through various instruments, including open market operations (OMO), to ensure adequate flow of credit to productive sectors of the economy. Liquidity might tighten in June going forward on corporate advance tax outflow. RBI had already started OMO and will continue to ease liquidity through various instruments like CRR and OMO to ensure a pass through of previous rate cuts.

Given the current state of macros we believe that fixed income markets will be volatile in near future with downward biased. As market has witnessed more than 50bps rally in 10 year g-sec, some pull back was expected. We advise investors to keep patient and participate in fixed income market with 1-2 years of investment horizon. We continue to believe that interest rates are going to go down in this fiscal year and hence maintain overweight on duration products through dynamic and income funds. We also advise investor to allocate some part in accrual strategy portfolios to take care of reinvestment risk arising out of fall in interest rates over next 2-3 years.

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