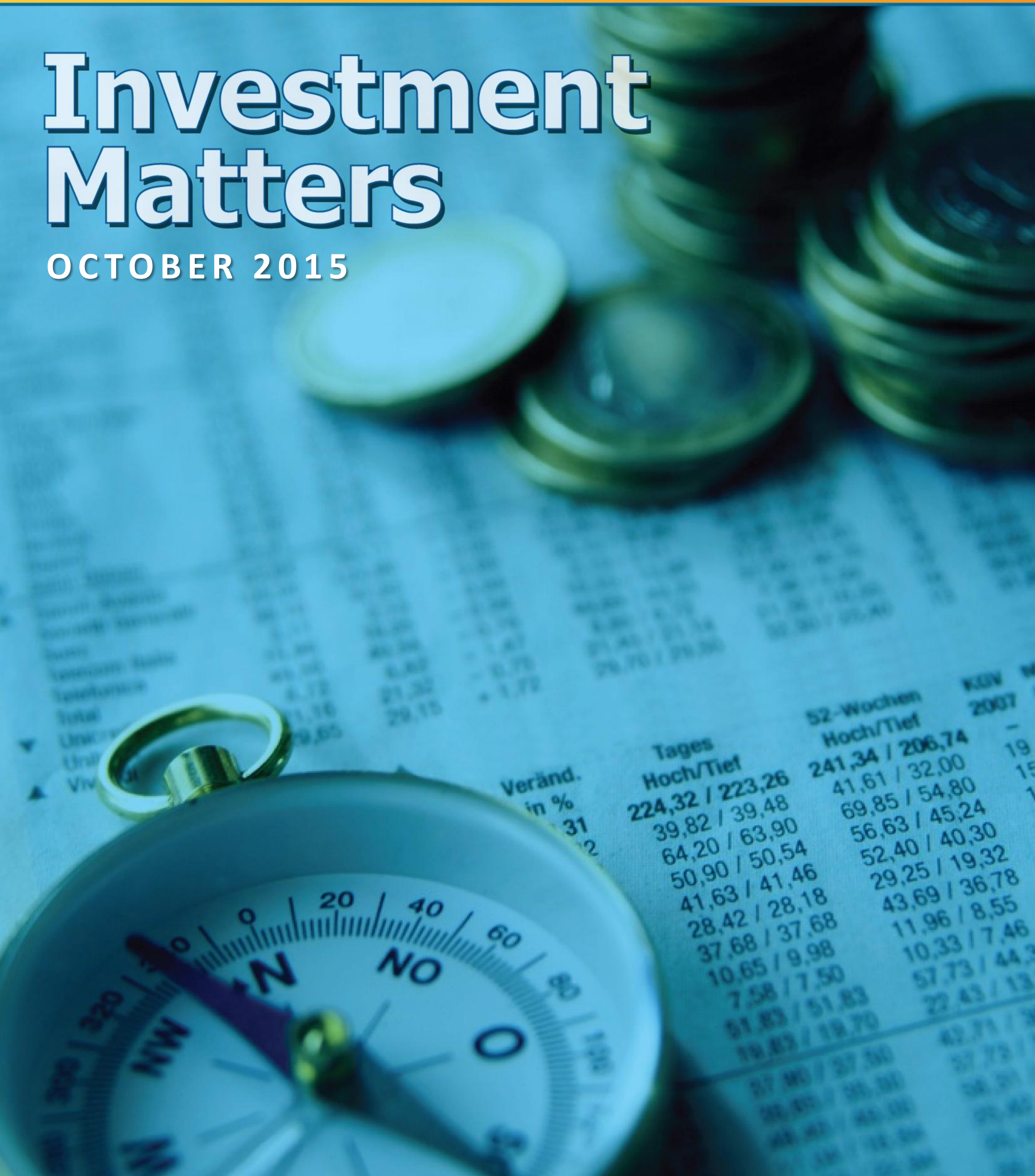
CAPITAL MANAGEMENT

Investment Matters

OCTOBER 2015



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EQUITY OUTLOOK

September turned out to be a month of consolidation with heightened volatility. BSE Sensex corrected by -0.5% while the BSE 500 ended down -0.4% during the month. FIIs remained net sellers for second consecutive month, selling stocks worth -$894 mn and DIIs remained net buyers to the extent of $1.58 bn continuing their trend of increasing their equity allocations.

Finally, towards the end of the month the RBI governor obliged by cutting rates by 50 bps surprising the markets positively. Clearly turning more growth focussed now that inflation is well under the central banks comfort level, he did re-iterate that the cut was frontloaded. Hence an above consensus cut from a person who now enjoys enormous credibility came as a substantial relief for investors and could help improve consumer sentiment just ahead of the festive season. We can now say that with a cumulative 125 bps cut in repo in CY 2015 signals that the cost of capital is on its way down on a sustainable basis and could help sustain market PE’s in the near term till earnings recover meaningfully.

We are seeing incremental movement by the government towards awarding contracts in the infrastructure space, specifically roads. Two new metro projects in Mumbai have been bid out and several infra companies have won orders. We expect further momentum to follow through in roads/railways and eventually in defence in terms of new orders. The strong growth of 36.5% in indirect tax revenues in the first 5 months bode well for enhanced government spending for the remainder of the year.

Q2FY16 earnings season will begin in a few days, BSE Sensex companies are expected to report another quarter of weak earnings growth of around -3% to -5% on the back of low commodity prices, low volume growth, global slowdown & gradual capex recovery from the government. Our belief is that if commodity prices stabilise over the next few months, earnings growth should return to double digits from Q4FY2016 as the base in the corresponding quarter was quite poor.

Hiren Ved

Chief Investment Officer
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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.

Advisory Team

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