



Inching forward despite uncertainty

Speculation regarding the tapering of quantitative easing by Federal Reserve dominated the sentiments of global markets in May. With increasing apprehension that Fed may be open to calibrate its policy stance based on the strength of economic recovery, equity & currency markets across the globe remained volatile.

Data flow from US remained encouraging throughout the month with employment as well as housing market indicators pointing towards continued recovery in US economic fundamentals. The Thomson Reuters/University of Michigan's index on consumer sentiment in US rose to its highest level since July 2007 to 84.5 from 76.4 in April and sales of existing homes sales climbed to its highest level since November 2009. The continuing improvement in US economy along with rising expectations that Fed may taper its asset purchases program led to strengthening of US Dollar and consequent weakness in major emerging market currencies and global commodity prices. Gold continued to witness selling with prices falling for eight consecutive month as investors shunned the precious metal in favor of equities.

While US economy witnessed greater signs of consolidation, economic fundamentals in the Eurozone remained fragile. Euro area GDP contracted by 0.2%QoQ in Q12013, marking the sixth consecutive quarter of contraction. High unemployment, fiscal austerity and absence of large scale quantitative easing amid lack of coordination between fiscal and monetary policies continue to derail the prospects of revival in the Euro zone.

Among the Asian economies, solid recovery in China remained elusive with manufacturing sector showing fresh signs of weakness. Manufacturing PMI moved to a contraction zone for first time in seven months reflecting slower domestic demand and ongoing external headwinds. Japan, on the other hand continued to reap the benefits of ultra loose monetary policy as it grew by 0.9% QoQ in Q1 2013- significantly higher than 0.3% in Q4 2012.

On the domestic front, fresh concerns emerged on growth revival as HSBC Manufacturing PMI fell to a 50 month low of 50.1 in May-13 as compared to 51 in Apr-13. GDP data release showed that Q4 FY13 GDP growth was recorded at 4.8%- marking second consecutive quarter of sub 5% growth since FY03. In order to address growth concerns, RBI eased rates by 25 bps in its Annual Policy review on May-3 but given the unsustainable levels of CAD and high retail inflation, its guidance remained cautious. However, recent data has pointed towards increasing concerns on growth amid greater signs of moderating inflation as corroborated by sharp decline in output index and input and output sub indices within PMI. As such, we expect RBI to ease monetary policy by another 25 bps in July policy review. The expected high trade deficit in May-13 on the back of higher gold imports of 162 tons may limit RBI's action in June. Moreover, by July greater clarity is likely to emerge on the progress of monsoon and consequently on the outlook for food inflation, offering greater comfort for RBI to respond to weakening growth. Further rate cuts will be contingent upon government's ability to revive investment sentiments and address supply side constraints.

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FIRST Insights

Global Macro Developments

US

- ✓ The Thomson Reuters/University of Michigan's reading on the overall index on consumer sentiment in US rose to 84.5 from 76.4 in April, topping economists' expectations for 78. Highest reading in nearly six years.
- ✓ US payrolls expanded by 165k in April following a revised 138k increase in March that was larger than 88k that was first estimated. The revisions to the data for February and March added a total of 114k jobs to the counts. The jobless rate fell to 7.5%
- ✓ Sales of previously owned U.S. homes climbed in April increased 0.6% to an annual rate of 4.97 million, the most since November 2009.
- ✓ Industrial production in US declined by 0.5%MoM in April, as weaker than expected manufacturing output weighed on the headline.
- ✓ US retail sales unexpectedly advanced in April, helping ease concerns of a sustained pullback in consumer spending. The 0.1% gain in April followed a 0.5% decrease in March.
- ✓ Foreclosure activity in US fell in April to its lowest level since February 2007 as it fell 5% from March, and 23% from a year earlier signaling that the recovery in the housing market is on track.
- ✓ As per the Fed minutes released on May 22, 2013, a number of officials said they were willing to taper bond buying as early as the next meeting on June 18-19 if economic reports show "evidence of sufficiently strong and sustained growth" While Fed Chairman's testimony to the Joint Economic Committee of the Congress on May 22 was dovish, there were some indications that Fed may consider tapering bond purchases if the incoming economic data remained strong. These two events have increased the market expectations of partial withdrawal of QE.

EUROPE

- ✓ Euro area GDP contracted by 0.2%QoQ in Q12013, marking the sixth consecutive quarter of GDP contraction. The downside surprise came from Germany, which expanded by 0.1%QoQ only.
- ✓ Eurozone industrial production rose 1.0% in March from February, the strongest month-to-month increase since July 2011. Output was down 1.7% year-to-year, the smallest contraction since August 2012.
- ✓ Composite PMI in Euro area rose to 47.7 from 46.9 in April exceeding market expectations of 47.2. Preliminary estimates show that May composite PMI rose to 47.7.
- ✓ Cyprus received the first tranche of EUR 2bn and will get as much as EUR1bn more in June as a part of EUR 10 bn aid package that was recently approved by Trioka
- ✓ European Central Bank President Mario Draghi said policy makers are ready to cut interest rates again if needed after reducing them to a record low last week.

UK

- ✓ The Bank of England left its stimulus program unchanged at GBP 375 bn as officials assess recent signs of strength in the economy after it returned to growth in the first quarter
- ✓ In its inflation report released last month, Bank of England upped its GDP forecast for 2013 to 1.2% from 0.9% and its 2014 GDP forecast to 1.9% from 1.8% previously.

JAPAN AND CHINA

- ✓ Gross domestic product in Japan grew 0.9% in the three months to March compared to market expectations of 0.7%, translating to an annualised rate of 3.5%.
- ✓ Japanese core machinery orders jumped a bigger-than-expected 14.2% in March, the quickest monthly pace in eight years, in a sign a weaker yen and surging stock prices are making companies more confident about investing in equipment
- ✓ Yield on 10 yr JGB has more than doubled since April 4, when it touched a low of 0.44% raising concerns on the health of Japanese banks who are huge investors in Japanese debt.
- ✓ China's manufacturing contracted in May for the first time in seven months as PMI was reported at 49.2 as compared to 50.4 in April
- ✓ China's consumer inflation in April increased by 2.4% vs. market expectations of 2.3% and 2.1% in March.
- ✓ China's fixed-asset investment in the first 4 months of the year increased 20.6% compared with 20.9% in Q1.



COMMODITIES

Crude

- ✓ While prices of Brent fell marginally by -0.1%, the WTI crude oil prices rose by 2.6%
- ✓ US economic growth recovery and persistent geo political tensions in Syria kept the downside in crude oil prices even as US Dollar appreciated.

Gold

- ✓ Gold prices continued to fall recording eight consecutive month of decline as outflows from ETFs continued even as retail demand from China and India remained intact.
- ✓ Gold prices fell by 4.6% MoM on the back of 6.8% fall in April.



Domestic Market Macro Economics

- ✓ India's HSBC Manufacturing PMI fell to a 50 month low of 50.1 in May as against 51.0 in April. Falling for third consecutive month, Manufacturing PMI is now significantly below its long period average of 55.5.
- ✓ India services PMI rose to 53.6 in May-13 from the April level of 50.7 driven by rise in new business services and business confidence sub-indices.
- ✓ Core sector growth expanded by 2.3% YoY in April 2013 as against growth of 3.2% YoY in Mar-13 and 5.7% in Apr-12.
 - April WPI inflation for April at 4.89% YoY was the lowest recorded inflation since November 2009
 - Core inflation softened for the eight consecutive month, easing to a 39 month low of 2.74% YoY compared to 3.41% in March
 - Manufacturing inflation continued its downward trajectory coming at 3.41% YoY vs. 4.07% in Mar.
- ✓ CPI inflation for Apr-13 continued to show moderation as it fell to a 13-month low of 9.39% YoY (vs. market expectation of 9.74%) from 10.39% YoY in Mar-13. Core CPI inflation (CPI ex food & fuel components) bucked the increasing trend seen over the last four months and moderated marginally to 8.13% YoY from 8.52% YoY in Mar-13.
- ✓ March IIP growth rose by 2.5% YoY as against our expectation of a 1.0% YoY and consensus expectation of 2.4% YoY led by a surge in the capital goods production.
- ✓ Driven by resurgence in gold import demand and a sharp decline in exports, the trade deficit in April rose by more than USD 7bn MoM to a three month high of USD 17.8 bn. Gold imports in April 2013 were recorded at a staggering USD 7.5 bn translating into a growth of 138% YoY

We expect:

- ✓ GDP growth to improve to 5.9% in FY14 from 5.0% in FY13. The growth will be driven by improvement in the agriculture and the industrial sector. The 3.5% estimate for agriculture sector growth is based on the expectation of normal monsoon. The higher growth in industrial sector in FY 14 would be both, on account of improved prospects for manufacturing & mining sector and favorable base effect.
- ✓ WPI inflation to average around 6.4% in FY14 from an average of 7.4% in FY13, as we anticipate the Rupee and global commodity prices to remain ranged and the pricing power of firms to remain muted. The recent moderation in commodity prices offers an added advantage.
- ✓ Weight of oil related items and gold in the WPI basket is at 9.4% and 0.4% respectively. If we assume an average price of Brent at USD 100 pb and average gold price at USD 1400/oz for FY14 along with an average USDINR rate of 53.50 (vis-à-vis an average of 54.45 in FY13), then average WPI inflation could potentially moderate by 100 bps from our expectation of 6.4% and come at 5.4%
- ✓ We expect Q4FY13 CAD to improve close to 4.5% of GDP, but remain elevated at 5.0% of GDP for FY13. For FY 14 we expect CAD to moderate to 4.1% of GDP supported by improved export performance and lower growth in gold and oil imports.
- ✓ We expect RBI to ease policy rates by a further of 25 bps in July Policy. Further rate cuts would be contingent on government's actions to address supply side issues and revive investment demand.
- ✓ We expect USDINR to broadly trade in the range 53.00-56.00 in FY14 (against our earlier expectation of 52-55), with a move towards 53.00 by Mar-14.



Equity Market Insights

- ✓ Markets closed on a positive note in May, despite a sharp decline in markets on the last trading day of the month, with BSE SENSEX, CNX Nifty and CNX Mid-cap Indexes closing up 1.31%, 0.94% and 0.04% respectively. The reasons for sharp decline were:
 - Negative comments by Subbarao post the release of weak GDP Data.
 - Increased volatility as traders rolling over their positions from May to June series.
- ✓ Equities witnessed further FIIs net inflows of ~ \$2.6Bn in May'13 while, DII's continue to be net sellers by ~ \$2.1Bn for May'13.
- ✓ Corporate results for Q4'13 show that sales revenue growth has come at the slowest pace in 14 quarters with 45 of the 50 Nifty companies growing at a mere 3.30%.
- ✓ An analysis of Q4 earnings of nearly 1,300 companies (excluding oil companies) showed that the aggregate net profits of these companies fell 14.6% on a y-o-y basis to Rs.62,244 cr. For FY13 too, the combined net profits of these companies fell 5% to about Rs.2.72 lakh cr. This is the first time since the global financial crisis year of 2008-09 that the yearly profits showed a decline.
- ✓ Quarterly earnings were at a new low due to pressure on demand, high interest costs and relatively weak bargaining power of the companies in raising prices.
- ✓ In the month of May, CNX IT (7.02%↑), CNX FMCG (4.12%↑), CNX Auto (2.95%↑), and CNX Pharma (2.73%↑) were positive. While CNX Realty (11.40%↓), CNX Infrastructure (3.63%↓), CNX Metal (2.01%↓), CNX Energy(1.05%↓), and CNX Bank Nifty (0.68%↓) were negative.
- ✓ CNX IT bounced back on positive economic data in the US and on value buying after the recent sell-off.

Factors to Watch

- ✓ Policy action by the government will be key factors some of the bills in line for approval are, the Forward Contracts (Regulation) Amendment Bill, 2010, the Pension Fund Regulator and Development Authority Bill, 2011, the Land Acquisition, Rehabilitation and Resettlement Bill, 2011, the National Food Security Bill, 2011 and the Insurance Laws (Amendment) Bill, 2008.
- ✓ Growing concerns on the twin issue of Current Account Deficit (CAD) and Fiscal Deficit could continue to weigh on the minds of investors, both foreign & domestic, and could come to the fore when the global risk appetite begins to fade.

Outlook & Recommendation

- ✓ We expect FY14 earnings growth estimate to be ranged between 8-11%.
- ✓ Domestic selling continues to offset the foreign inflows and we expect active policy action from the Government to continue supporting the market.
- ✓ We believe commodity prices, political developments and good monsoon season will be key triggers for the market going forward.
- ✓ We expect some consolidation within the banking sector in the near term due to PSB's weak asset quality & higher provisioning on restructured assets, however, we believe the private sector banks will continue to outperform over the long term horizon.
- ✓ We reiterate our recommendation of "Neutral" on Equities with a positive bias. However, in the near term the market is expected to consolidate due to economic and political uncertainties. The market will continue to be focused on the Govt. action in the pre election year.
 - Recommend equity investments through a Systematic Transfer route over 6 months with investment horizon of 18 to 24 months.
 - Continue to be positively biased towards a mix of consumers and interest rate-sensitive sectors like FMCG, Pharma, Infrastructure and Banking (Private Sector).

Debt Market Insights

- ✓ RBI in its Annual Review of Monetary policy on May 3 reduced the repo rate by 25 bps to 7.25%, while keeping CRR and SLR unchanged at 4% and 23% respectively. On account of persistent risks to CAD and upward pressures to inflation, it guided for limited policy action going forward.
- ✓ Total SLR securities held by banks in their Held to Maturity category were realigned from 25% to the existing SLR requirement of 23%. The HTM realignment would be effected by the way of at least 50 bps reduction each quarter with beginning of quarter ending June-13.



- ✓ The systemic liquidity deficit in May rose to Rs 960bn against an average of Rs 863bn in April. RBI announced OMO auction worth Rs 100bn which was conducted on May 7, 2013. RBI refrained from conducting any further OMOs during the month.
- ✓ The cut off on the new 10 yr stock that was auctioned came in at 7.16%
- ✓ We expect systemic liquidity deficit in June to remain around same levels as in May and 10Y G-Sec yields (on the new benchmark paper) to move towards 7.00% from 7.22% in H1FY 14.

Outlook and Recommendation

- ✓ We have witnessed a sharp correction in the 10yr Yields over the past one month with 8.15% GS 2022 paper moving towards 7.43 levels from 7.75 to 7.80 in the previous month.
- ✓ Most traders have rolled over their positions into the new paper 7.16% GS 2023 which is currently at 7.18 to 7.23 levels trading below the repo rate.
- ✓ Short Term and Dynamic Bond funds seem attractive in the near term and we recommend entering them with an investment horizon of 12 months plus.

 **Model Portfolios - June 2013**

Asset Class	Conservative	Cautious	Moderate	Growth	High Growth
I) Debt (%)	95	70	50	25	10
Ultra Short Term Funds	20	15	15	5	5
Dynamic /Income Funds	35	30	20	15	5
NCD/ Bank Deposit	40	25	10	5	5
II) Equity (%)	-	15	30	45	55
Large Cap	-	15	25	30	35
Mid cap	-	-	5	10	15
Sector/ Thematic	-	-	-	5	5
II) Alternate (%)	5	15	20	30	35
Gold ETF	5	5	10	10	10
Structured Products	-	10	10	10	10
PE/ Real Estate Funds	-	-	-	10	15
Total (%)	100	100	100	100	100

For Further Information on Model Portfolios, Kindly contact your Financial Advisor

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