India's growth inflation dynamics continue to improve

Incoming data from US suggests that its economy is gearing for pick-up, notwithstanding the weather induced moderation in the first quarter. March manufacturing PMI indicated a buildup of momentum in manufacturing business conditions. While economic growth showed traction, weaker than expected non-farm payroll (126k in March vs. expectation of 247k) dimmed the expectations for June rate hike. Most market participants are penciling in first hike policy rate in September-15.

Data out of Eurozone suggests that economy is gradually emerging from stagnation, supported by lower oil prices, and weaker Euro following ECB's launch of stimulus programme. At 52.2 in March (vs. 51.0 in Fev-15), PMI manufacturing stood at its highest level in 10 months. While producers appeared to benefit from falling input costs, consumer spending moderated as highlighted by retail sales in Feb-15 which fell 0.2% (vs. 0.9% in Jan-15) following four months of rise. With unemployment falling and wages starting to pick up in some parts of Eurozone, consumer spending is expected to rise during 2015.

Recovery in Japan remained weak as Feb-15 industrial production declined 3.4% (vs. +3.7% rise in Jan-15) underscoring the slack in capital spending. On the other hand, consumer spending remained weak as highlighted by household spending, which declined by 2.9% in Feb-15. Meanwhile, BoJ decided to maintain its plan to expand the monetary base at an annual pace of JPY 80 trn.

China's CPI inflation stayed low in Mar-15 at 1.4% while producers' prices contracted 4.6% vs. an expectation of 4.8%. Additionally GDP grew at 7% in first quarter slowing from 7.3% in fourth quarter suggesting that economy continues to lose momentum and increasing the likelihood of additional monetary easing measures could be deployed to support domestic demand.

Meanwhile on domestic front, data release in March-April indicated the economic environment continued to improve at the margin. On the upside, HSBC PMI Manufacturing accelerated to 52.1 in Mar-15 (vs. 51.2 in Feb-15) and industrial production growth rose to 5% from 2.8% in previous month. IMF revised its India growth forecasts upwards to 7.5% in 2015 from 7.2% in 2014 on the back of recent policy initiatives, pick-up in investments and lower oil prices.

On the other hand, inflation metrics continued to suggest that risks to inflation remained subdued. Retail inflation eased has to 5.17% in Mar-15 from 5.37% in Feb-15 and WPI inflation continues to remain in the deflationary territory for the fifth consecutive month, coming in at -2.33% for Mar-15.

RBI maintained its key repo rate at 7.5% in its first bi-monthly policy in FY16 while emphasizing on following four factors to guide the course of further easing viz- transmission of policy rates, stability in food prices, government's supply responses and signs of monetary policy normalization in the US. We continue to expect policy easing of another 25 bps by Jun-15 with the possibility of a further 25 bps easing by Sep-15 conditional upon crude oil and food prices remaining subdued.

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FIRST Insights

Global Macro Developments

- China CPI stayed flat at 1.4% YoY in March (Previous: 1.4%, Consensus: 1.3%), while PPI fell slightly less than projected (-4.6% YoY, Previous, Consensus: -4.8%), keeping pressure on profit margins at Chinese corporations as the country struggles to stimulate growth.
- Mediocre economic growth could soon become a new norm with high debt and unemployment, unless policymakers act, as per IMF Chief Lagarde.
- Greece has been able to pay its USD 450 mn Euro loan installment to the IMF due April 9.
- Doubts about when Greece could repay the loan had raised concerns that the country may default and have to leave the Eurozone.
- US Fed's FOMC minutes showed that Bank officials are eager to get the rate hike process started, but could slow down once lift-off begins. Several participants said that June could be the right time, with a few saying that hikes would rather be postponed to next year.

Events and Data Calendar

Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
US	02/03/2015	US ISM Manufacturing	(FEB)	53	52.9	53.5	⇩
	06/03/2014	USD Change in Non-farm Payrolls	(FEB)	235K	295K	239K	⇧
	12/03/2014	USD Advance Retail Sales	(FEB)	0.30%	-0.60%	-0.80%	⇧
	18/03/2014	US Federal Open Market Committee Rate Decision	(MAR 18)	0.25%	0.25%	0.25%	⇨
	24/03/2014	US Consumer Price Index Ex Food & Energy (MoM)	(FEB)	0.10%	0.20%	0.20%	⇨
	25/03/2014	US Durable Goods Orders	(FEB)	0.20%	-1.40%	2.00%	⇩
EU	02/03/2015	Euro Zone Consumer Price Index - Core (YoY)	(FEB A)	0.60%	0.60%	0.60%	⇨
	30/03/2014	EU German Consumer Price Index (YoY)	(MAR P)	0.30%	0.30%	0.10%	⇧
UK	05/03/2014	UK Bank of England Rate Decision	(MAR 5)	0.50%	0.50%	0.50%	⇨

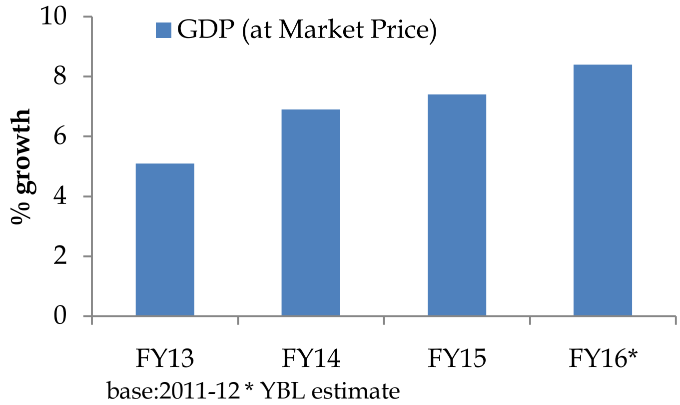
P* – Provisional Estimates F* - Final Estimates A*- Advanced Estimates T*- Third Estimates

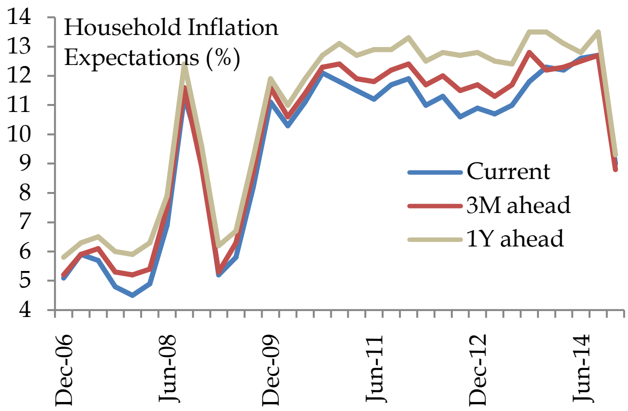
COMMODITY

- Gold registered a 3.8% MoM contraction in Mar-15 vs. a 1.96% MoM decline during Feb-15, as the strengthening dollar amid growing expectations for higher interest rates in the US later this year, reduced appeal for the precious metal.

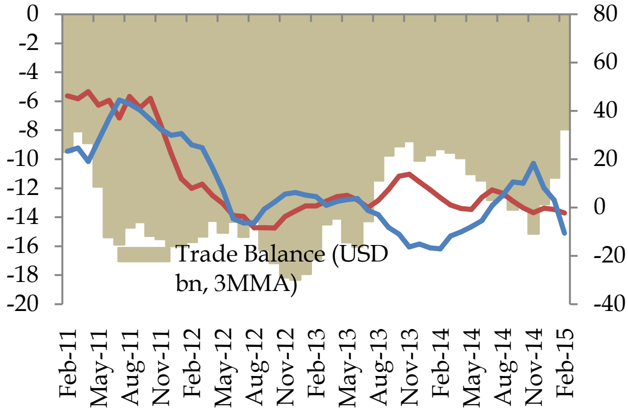
- WTI declined 6.8% MoM in Mar-15 as compared to a 7.1% MoM rise in Feb-15; after activity in China's factory sector fell to an 11-month low and as Saudi Arabia said its production was close to an all-time high.

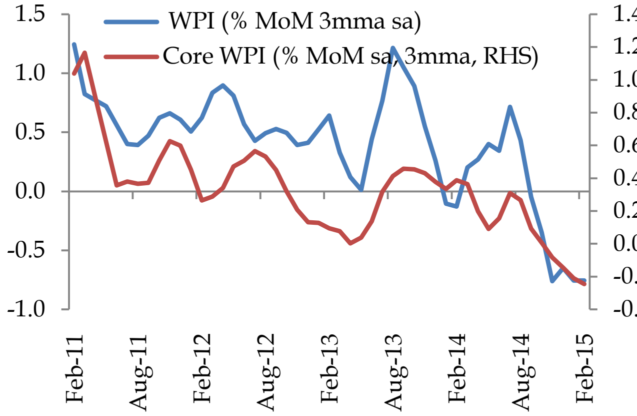
Domestic Market Macro Economics





- ✓ In line with our expectations, the RBI maintained status quo on monetary policy after the pre-emptive rate cut in March
- ✓ For FY16, the RBI estimates GDP growth to improve moderately to 7.8% from 7.5% in FY15 while CPI inflation to move towards 5.8% in Mar-16, somewhat lower than the 6% target
- ✓ Core sector output moderated to 1.4%YoY in Feb-15 (vs. 1.9% in Jan-15) driven lower by unfavorable base
- ✓ India's trade deficit declined to a 17-month low of USD 6.8bn in Feb-15 (vs. USD 8.3bn in Jan-15), primarily as lagged impact of low oil prices led to improvement in trade deficit
- ✓ Retail inflation has eased to 5.17% in Mar-15 from 5.37% in Feb-15 and WPI inflation continues to remain in the deflationary territory for the fifth consecutive month, coming in at -2.33% for Mar-15.
- ✓ HSBC PMI Manufacturing accelerated to 52.1 in Mar-15 from 51.2 in Feb-15; highlighting moderate improvement in India's manufacturing activity
- ✓ India HSBC PMI Services index eased from 53.9 in Feb-15 to 53.0 in Mar-15, indicating a moderate rate of expansion. Overall, Q4FY15 proved to be the strongest quarter for service sector.



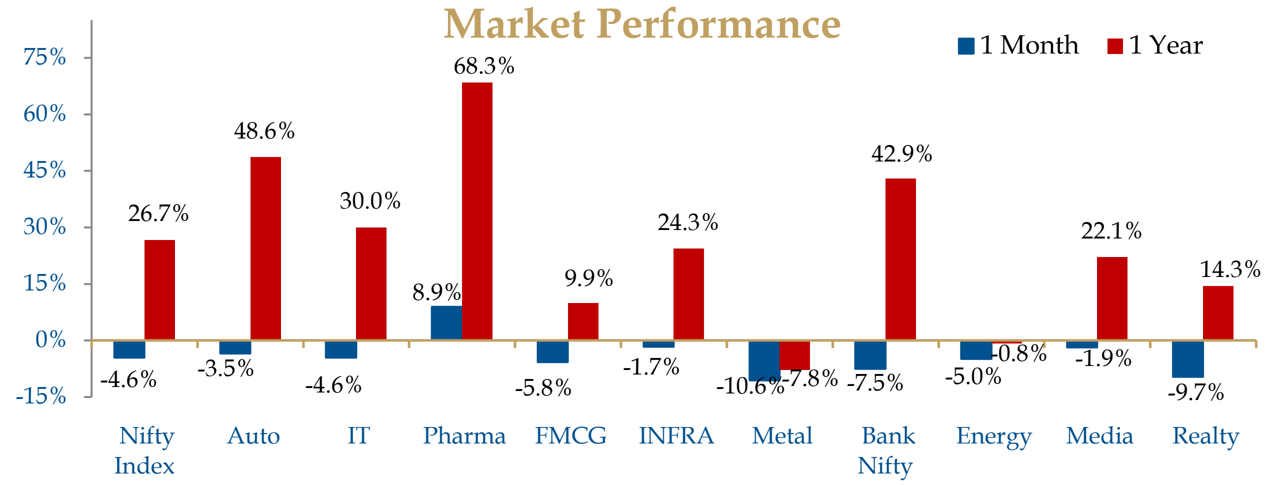


We expect:

- ✓ FY16 GDP growth is expected to improve by 80-100 bps over the FY15 growth of 7.4%
- ✓ We continue to expect CPI inflation to undershoot the Jan-16 target of 6% by as much as 50 bps on the back of subdued commodity prices, restrained MSP adjustments, and a favorable monsoon outturn, all amidst gradual legislative and administrative progress in debottlenecking of supply side constraints
- ✓ We continue to stick to our baseline call of another 25 bps repo rate cut by Jun-15 with the possibility of a further 25 bps easing by Sep-15 conditional upon crude oil and food prices remaining soft
- ✓ We expect 10Y g-sec yield to trade close to 7.35% by end of FY16. While we believe impending interest rate hike in the US in 2015 could provide some volatility, downside risks could guide 10Y g-sec yield potentially to 7.15%.
- ✓ We continue to expect USDINR to depreciate to 64.50 by Sept-15 in line with impending Fed rate hike. Eventually improvement in growth-inflation fundamentals could guide Rupee stronger. We expect USDINR to trade at 63 by Mar-16.

Equity Market Insights

- The month of March saw the Indian stock markets enter a phase of consolidation. The benchmark BSE SENSEX closed at 27,957, down 4.78% for the month while the Nifty closed at 8,491, down by 4.62% during the same period. The CNX Mid-Cap and CNX Small-Cap indices relatively outperformed with returns of –0.89% (13001) and -1.16% (5,623) respectively during the month.
- The FII continued to remain optimistic about Indian equities during the month which in turn led to an inflow of $ 1.5bn during the month, while DII's were also net buyers and ~ $0.6bn during the same period.



Factors to Watch

- In the coming months we expect more announcements to be made which would provide more clarity to the broad themes and measures announced during the Budget. These measures would help revive earnings growth for corporate, however we expect signs of a turnaround to become visible only after 2 to 3 quarters.
- Market participants would also keep a close eye on the global commodity prices particularly that of crude, which has come down sharply in recent times.
- Other key events that would be watched closely especially by the FIIs would be the geo-political events in Greece and further policy as well as political announcements in the Euro zone and US. With regards to US in particular, the global investors would be awaiting more clarity on timing and quantum of interest rate hikes by the US Fed.

Outlook & Expectations

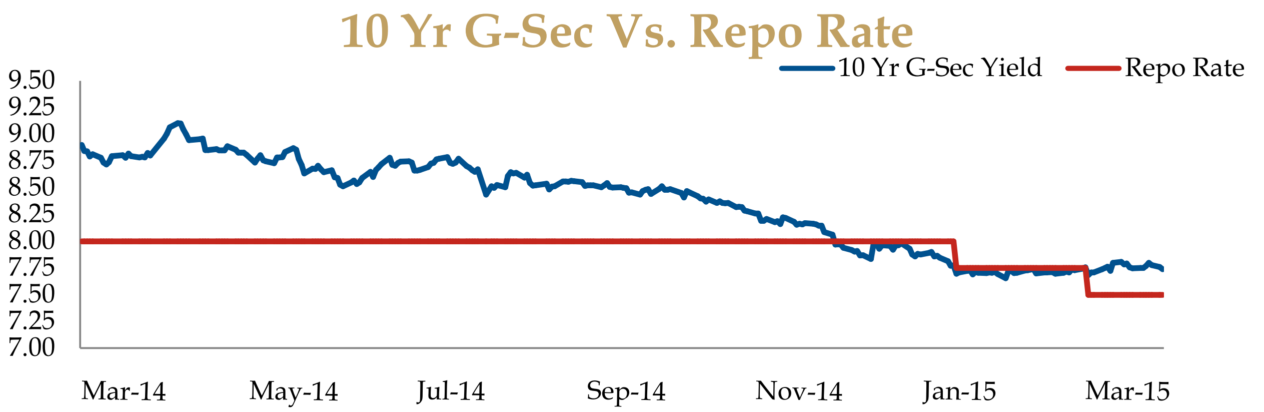
- In terms of valuations, the SENSEX is trading at a trailing twelve month PE multiple of 19.1 times which is slightly higher than its long term historic average of 18.2 times. On a forward earnings basis the SENSEX is trading at a multiple of around 16.9 times, which suggests that markets are not expensive but fairly valued at current levels. However based on technicals, we could see some near term consolidation in the markets. We believe that any correction in the market should be viewed as an ideal time to pick up quality stocks.
- We recommend equity investments through a Systematic Transfer route with a minimum investment horizon of 36 months.
- From a long term perspective we continue to remain positive on companies in infrastructure, consumer durables and private sector banks. Investors could also look at investing in select stocks in the auto and auto ancillary space.
- From a longer term perspective, i.e. from a 2 to 3 years' horizon, investors could look at picking up stocks in sectors that stand to benefit from a revival in the economy. These would be consumer durables, infrastructure and banks.

Debt Market Insights

- The average systemic liquidity deficit in March was reported at an average INR 898bn as compared to an average INR 920bn in Feb.
- Average 10 yr yield during March rose marginally to 7.75% from 7.71% in Feb.
- After the surprise rate cut on March 4th, RBI kept benchmark policy rate unchanged in its first bi-monthly monetary policy on April 7th.
- Going forward, while the accommodative stance will be maintained, incremental policy action will be data dependent and also conditioned upon improvement in fiscal and legislative space.
- We continue to expect CPI inflation to undershoot the Jan-16 target of 6% by as much as 40 bps on the back of subdued commodity prices, restrained MSP adjustments, and a favorable monsoon outturn - all amidst gradual legislative and administrative progress in debottlenecking of supply side constraints.

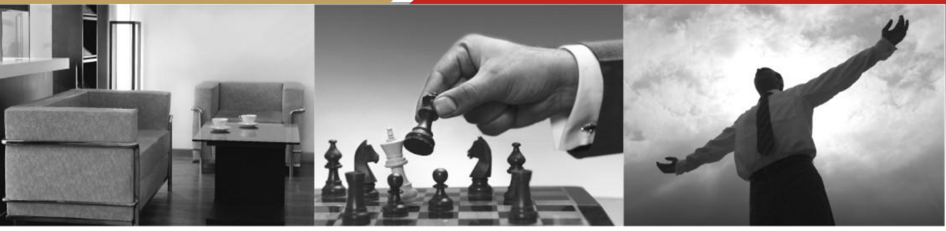
Outlook and Expectations

- The 10 Yr G sec yields were ranged within 7.69% to 7.81% levels for the month of March.
- As such, we continue to stick to our baseline call of another 25 bps repo rate cut by Jun-15 with the possibility of a further 25 bps easing by Sep-15 conditional upon crude oil prices remaining soft.
- We continue to believe that short term rates are attractive at current levels and suggest investing in short term funds and dynamic bond funds for an investment horizon of 12 to 18 months and for certain aggressive clients strategic allocation in long term income / gilt funds.



Model Portfolios – April 2015

Asset Class	Conservative	Cautious	Moderate	Growth	High Growth
I) Debt (%)	95	70	50	25	10
Ultra Short Term Funds	20	15	15	5	-
Dynamic /Income Funds	35	30	20	15	5
NCD/ Bank Deposit	40	25	15	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**



Glossary:

- **Consumer Price Index (CPI):** A measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care.
- **Wholesale Price Index (WPI):** An index that measures and tracks the changes in price of goods in the stages before the retail level.
- **Open Market Operations (OMO's):** is the buying and selling of government securities in the open market in order to expand or contract the amount of money in the banking system. Purchases inject money into the banking system and stimulate growth while sales of securities do the opposite.
- **Cash Management Bills (CMB):** A short-term security sold by RBI to meet any temporary shortfalls.
- **Purchasing Managers Index (PMI)** is based on surveys on private sector service /manufacturing companies. An index level of 50 denotes no change since the previous month, while a level above 50 signals an increase or improvement and below 50 indicates a decrease or deterioration.
- **Net Demand and Time Liabilities (NDTL):** It is the sum of demand and time liabilities (deposits) of banks with public and other banks wherein assets with other banks is subtracted to get net liability of other banks.
- **Current Account Deficit (CAD):** A measurement of a country's trade in which the value of goods and services it imports exceeds the value of goods and services it exports. A current account deficit represents negative net sales abroad. A country can reduce its current account deficit by increasing the value of its exports relative to the value of imports.
- **West Texas Intermediate (WTI):** also known as **Texas light sweet**, is a grade of crude oil used as a benchmark in oil pricing. This grade is described as light because of its relatively low density, and sweet because of its low sulfur content.

For Further Information on Model Portfolios, Kindly contact your Relationship Manager.

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