YES FIRST

FIRST Insights

Commodities meltdown amid China growth worries

Global commodity prices continued to downtrend in July with Reuters CRB commodity index slipping by more than 5% MoM. Key industrial commodities ranging from nickel, copper, iron ore, aluminum, oil, gold among others sank to multi year lows amid bullish outlook on dollar, growth concerns in China and supply glut in commodities like oil.

US Fed meanwhile offered a relatively positive outlook on economic recovery in FOMC meeting on back of modest growth in household spending and gradual improvement in labour markets conditions. Nonfarm payroll additions for July were recorded at 215k and the job additions for the previous two months were revised upward. Encouragingly, hourly wages grew by 0.2% MoM following a flat reading in the previous month. While the pace of growth in the US manufacturing sector slowed in July (ISM manufacturing moderated to 52.7 from 53.5 in June), services sector showed robust growth with ISM service sector index rising sharply to 60.3 (vs. an expectation of 56.2). In this context, US Fed's September meeting will be closely watched for cues on the eventual timing of first rate hike.

Among other key developments, the Bank of England at its recent meeting decided to remain on hold with respect to rates. However, ahead of the meeting, the anticipation was for an increasingly hawkish stance by the BoE amid a gradually improving economic growth in UK. However, the voting pattern offered a surprise with just one of the nine members (against the consensus expectations for a 7-2 split) dissenting in favor of a rate hike, thereby raising prospects of a longer period of low interest rates on slow pickup in inflation amid subdued global oil prices.

Meanwhile recovery in the broader eurozone continued as bank lending to households picked up on continued ECB's stimulus and low energy prices. Amid a weaker euro, eurozone manufacturing sector continued to expand at a steady pace despite lingering concerns in Greece and China.

China's stock markets remained volatile even as the government initiated measures to stem the fall amid an intensifying moderation in the economy. July PMI manufacturing indicated the downturn in China sharpened on renewed fall in new export orders and total new works. (47.8 in July vs. 49.4 in June). In order to support growth, China's central bank devalued its currency by 1.9% against the US Dollar.

On domestic front, data showed India's economy gained some traction. Q1FY16 fiscal data exhibited a broad improvement on healthy tax collections and advancement in quality of spending. July PMIs also exhibited some expansion. While manufacturing PMI surged to a 6 month high, services PMI moved into expansion following 2 months of contraction. While, June core sector data exhibited some moderation though incremental momentum remained healthy.

In line with our expectations, the RBI maintained status quo on monetary policy in August meeting after a 25 bps rate cut in June. While the RBI retained its GVA growth estimate of 7.6% for FY16, the estimate for inflation was revised lower by 20 bps. We continue to expect CPI inflation to undershoot RBI's 6% target for Jan-16 by 40-50 bps supported by government's supply management efforts, improvement in spending mix and moderation in global commodity prices. This in our opinion will open up space for another 25 bps of monetary easing in H2 FY16

Shubhada M. Rao
Chief Economist

Kanwar Vivek
Senior President and Head
Wealth Management & Global Indian Banking

FIRST Insights

Global Macro Developments

- The IMF in its US Article IV consultation report has said that economy had bounced back from its temporary loss of momentum during 1Q2015, and 2015 growth rate is expected at 2.5%, from 2.4% in 2014. The phase of steady growth rate is expected to last for at least four years, before it starts to slow down to 2% by 2020.
- In its July FOMC meeting Fed sounded relatively optimistic with respect to economic recovery highlighting that the slack in the labour market had diminished and the risks to economy and job market looked nearly balanced.
- China devalued its currency by nearly 2% after recent data showed continued fall in exports and weak manufacturing sector growth.
- Greece has struck a deal with creditors to receive its third bailout after series of talks in Athens

Events and Data Calendar

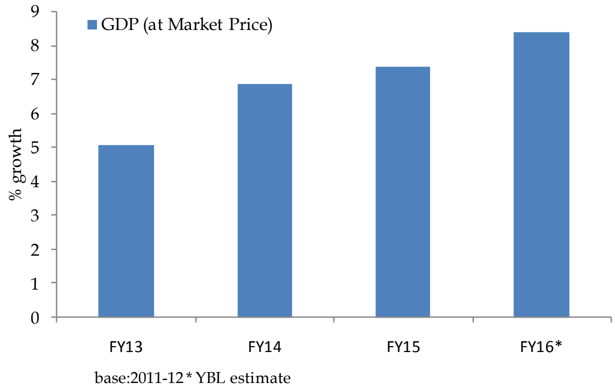
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
US	06/07/2015	ISM Non-Manufacturing Composite	(JUN)	56.4	56	55.7	↑
	14/07/2015	Advance Retail Sales	(JUN)	0.3%	-0.3%	1.0%	↓
	30/07/2015	Gross Domestic Product (Annualized)	(2Q A)	0.6%	2.3%	2.5%	↓
EU	28/07/2015	UK Gross Domestic Product (QoQ)	(2Q A)	0.7%	0.7%	0.4%	↑
	14/07/2015	UK Consumer Price Index (YoY)	(JUN)	0.0%	0.0%	0.1%	↓
	16/07/2015	European Central Bank Rate Decision	(JUL 16)	0.1%	0.1%	0.1%	→
	14/07/2015	Euro-Zone ZEW Survey (Economic Sentiment)	(JUL)		42.7	53.7	↓
	31/07/2015	Euro-Zone Consumer Price Index - Core (YoY)	(JUL A)	0.8%	1.0%	0.8%	↑

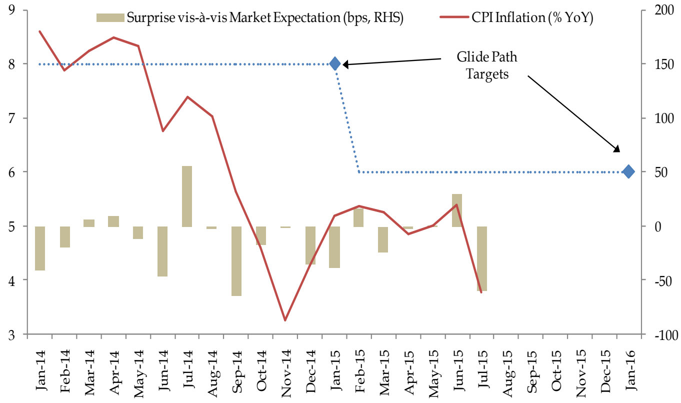
P* – Provisional Estimates   F* - Final Estimates   A*- Advanced Estimates   T*- Third Estimates

COMMODITY

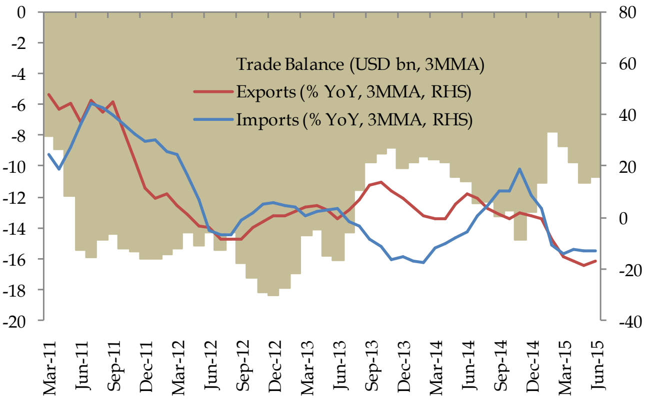
- Gold prices fell 4.4% MoM in July-15 (vs. 1.4% MoM contraction in June-15) as US Dollar continued to strengthen amid improving economic fundamentals and expectations of rate hike
- Brent prices declined sharply by 12.1% MoM in July following a decline of 3.3% in June owing to surprise resilience of US shale output in the face of lower prices as well as nuclear deal with Iran.

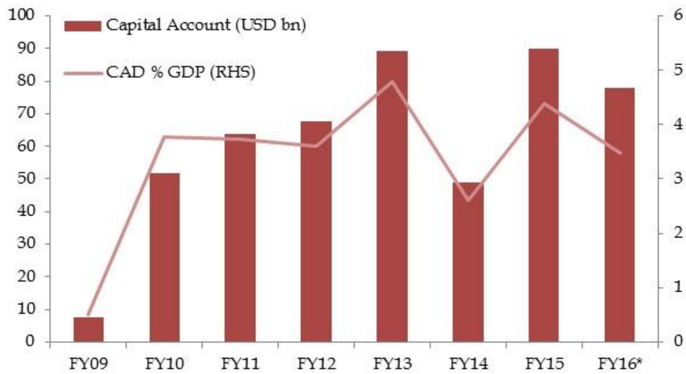
Domestic Market Macro Economics





- ✓ In line with expectations, the RBI maintained status quo on key policy rates at the third bi-monthly policy review
- ✓ RBI retained its GVA growth estimate of 7.6% for FY16, though the estimate for inflation for Jan-16 was revised lower by 20 bps.
- ✓ June CPI inflation rose to a 9 month high of 5.40%YoY from 5.01% in May (YBL expectation: 5.06%, Bloomberg consensus: 5.10%). The sharp uptick in the headline index was nearly broad based, with the exception of housing prices.
- ✓ India's merchandise trade deficit for Jun-15 registered a mild increase to USD 10.8bn. Q1 FY16 trade deficit improved marginally to USD 32.2 bn (vs. USD 33.1 previously). Exports contracted by 16.8% YoY vis-à-vis a 12.6% contraction for imports.
- ✓ Nikkei Services Business Activity Index rose to 50.8 in July from 47.7 in June on back of renewed increase in new business, amid a gradually strengthening demand conditions
- ✓ Nikkei India Manufacturing Purchasing Managers' Index rose to a 6 month high of 52.7 in July from 51.2 in June.)





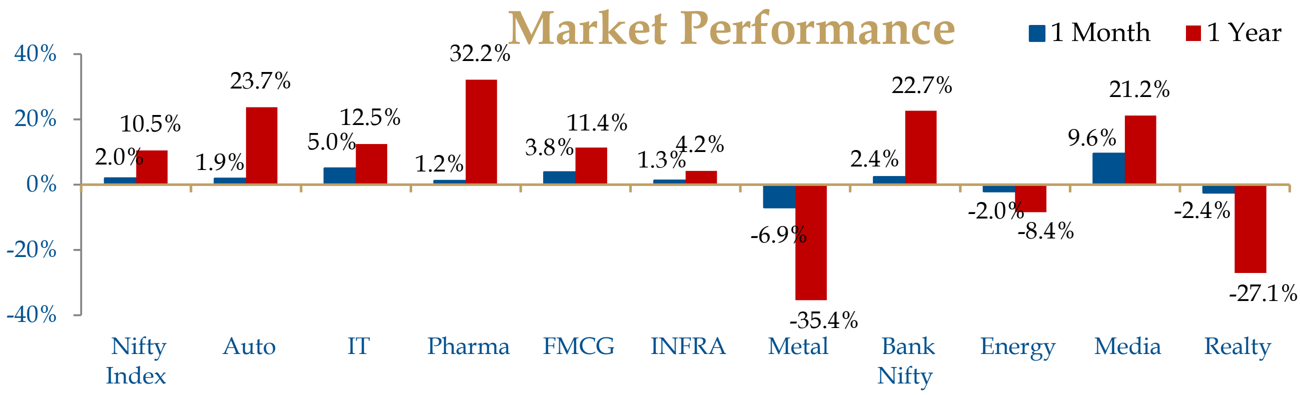
We expect:

- ✓ We expect FY16 GDP growth to improve moderately to 7.8% from 7.3% in FY15, albeit nearly 20-70 bps below its potential (8%-8.5% as per RBI), given the limited ability of private sector to support revival in capex on account of overleveraged balance sheets, moderation in rural dispensation and the stress of impaired loans on bank balance sheet
- ✓ In our baseline scenario of near normal monsoon and ranged commodity price, we expect CPI inflation to undershoot the 6% target for January by 40-50 bps.
- ✓ G-sec yields are likely to remain ranged with a moderate downward bias for major part of the year on the back of mild support from domestic factors amid few global headwinds We now expect 10Y g-sec yield to move lower towards 7.50% in H2 FY16 vis-à-vis our earlier call of 7.35%
- ✓ We expect rupee levels to hit a bottom in 3Q-FY16 instead of an earlier expectation 2Q-FY16. Due to higher volatility in the global financial markets, we now expect a slightly higher level of depreciation. In our view,

though the currency can overrun to 65.50 levels during the phase of extreme volatility, for most part of the year we expect it to trade between 63 and 65 levels

Equity Market Insights

- The month of July saw the Indian stock markets close on a positive note. BSE Sensex closed at 28,115, up by 1.2% for the month while the Nifty closed at 8,533; up by 1.96% during the same period. The CNX Mid-Cap and CNX Small-cap indices relatively outperformed with gains of 5.5% and 7.5% respectively during the period.
- The FII pulled out about $ 0.5 bn from Indian equities and about $ 1.1 bn from debt markets during the month. DII's were net buyers of ~ $ 0.72bn during the same period.



Factors to Watch

- Updates on reforms and/or measures to enable further reforms: investors would also be looking at the monsoon session of the Parliament. Passing of key Bills including those on land acquisition reforms and amendments related to GST are the major expectations of investors. Any delays/issues on these could be viewed as an immediate negative by the markets.
- 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. With regards to US in particular, the global investors would be awaiting more color on timing and quantum of interest rate hikes by the US Fed.

Outlook & Expectations

- The ongoing June quarter result seasons is almost drawing to a close. However the numbers have been tepid and have either just met or have failed to meet street expectations, which in turn were already toned down post the March quarter announcements. Given the sluggish outlook presented for consumption and project execution status in the economy, further earnings downgrades are expected which would lead to pressures in the stock markets in the near term.
- Another factor that one would watch out for would be the monsoons and more importantly the geo-spatial distribution of rains. Shortfall in rains has a bearing on inflation (due to food inflation), rural incomes and sentiment. Rural income growth in particular has already been sluggish in recent times and this in turn has hurt the demand for companies/sectors that have a consumption focus
- Parliament session – The ongoing Parliament session is closely watched by investors for developments related to key bills particularly the GST bill and the Land Acquisition Bill. Both of them are critical for improving business sentiment and aiding economic/investment recovery in the country. Delays/negative news related to these would be viewed as a near term negative.
- In terms of valuations, the Sensex is trading at a trailing twelve month PE multiple of 21.8 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 15.4 times, which suggests that markets are not expensive but fairly valued at current levels. Building an assumption of a robust improvement in earnings in FY17, we believe that the markets are still attractive from a longer term perspective, i.e. for 2 to 3 years. We believe that any correction in the market should be viewed as an ideal time to pick up quality stocks.

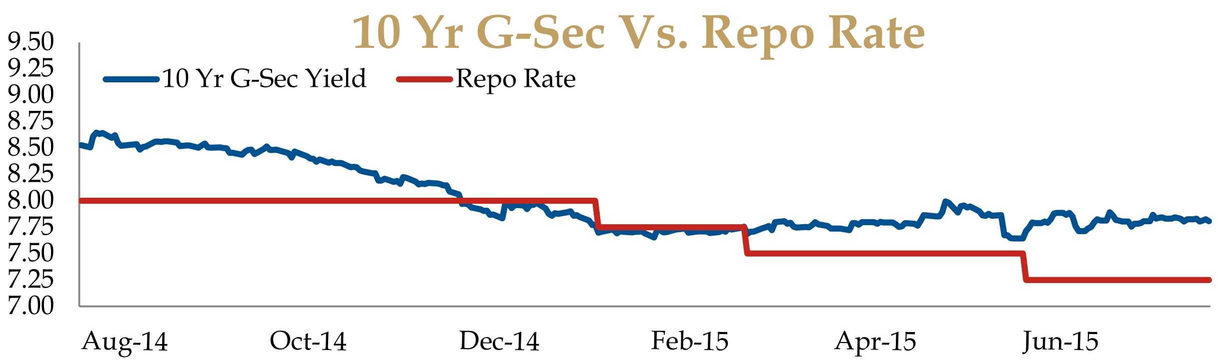
- We recommend equity investments through a Systematic Transfer route with a minimum investment horizon of 36 months.
- From a long term perspective we continue to remain positive on companies in infrastructure, capital goods and private sector banks. Investors could also look at investing in select stocks in the auto and auto ancillary space.

Debt Market Insights

- The average systemic liquidity deficit in July moved into surplus of Rs 130 bn as compared to a deficit of Rs 490 bn in June aided by RBI's forex intervention and increased government spending.
- Average 10 yr yield during July hardened marginally to 7.82% as compared to 7.80% in June
- RBI absorbed Rs 827 bn worth liquidity from the system by conducting OMO sales
- In line with expectations, the Reserve Bank of India left key policy rates unchanged at 7.25% at the third bi-monthly policy review.
- With the domestic environment being characterized by tight money supply growth, low pricing power, and gradual improvement in quality of fiscal adjustment, we continue to expect CPI inflation to undershoot RBI's 6% target for Jan-16 by 40-50 bps
- This in our opinion will open up space for another 25 bps of incremental monetary easing in H2 FY16.

Outlook and Expectations

- The yield on new 10 yr bond in July remained similar to average of 7.80% in June
- While we continue to expect 25 bps cut as our baseline scenario, However Monsoon remains a big concerns. Shortfall in rains has a bearing on inflation which could strengthen case for status quo on monetary policy for the rest of FY16
- 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 – August 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**

YES FIRST

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.

YES BANK Limited

Regd. & Corporate Office: Nehru Centre, 9th Floor, Discovery of India, Worli, Mumbai 400018. | Tel: + 91 22 6669 9000 Fax: + 91 22 6669 9018
Northern Regional Corporate Office: 48 Nyaya Marg, Chanakyapuri, New Delhi 110 021. |Tel: + 91 11 5556 9000 Fax: +91 11 5168 0144

Contact Details

Garima Kapoor
Economist
garima.kapoor@yesbank.in

Shubhada M. Rao
Chief Economist
shubhada.rao@yesbank.in

Kanwar Vivek
Senior President and Head
Wealth Management & Global Indian Banking
kanwar.vivek@yesbank.in