Global economy on a weaker turf

Despite the continued softening in global crude oil prices, IMF marked down it global growth forecast by 30 bps to 3.5% for 2015, highlighting investment weakness in many advanced and emerging market economies. While United States was the only economy whose estimates were revised upwards, recent slew of data releases suggest that economic growth may have lost momentum in recent days suggesting a downside risk to Q1 2015 GDP.

Concerned about persistent deflationary concerns, ECB announced EUR 1.1tn worth asset purchases to be carried out until end-September 2016. Under the program the ECB will not hold more than 33% of any issuer's debt and will not buy more than 25% of any issue. EU's 19 national central banks will make 80% of the purchases and take on any risk they carry. ECB projections show the announced measures should boost the euro area's inflation rate by 0.4% this year and 0.3% point in 2016.

Among Asian economies, Japan's economy is likely to continue towards a moderate recovery path as exports are expected to increase against the backdrop of recovery in US. However, the risk to this outlook arises from stubbornly low inflation. Excluding the impact of sales tax hike, December's inflation rate rose 0.5% vs. 0.7% in November, well below central bank target of 2%. Likewise, household spending dropped 3.4% YoY in Dec-14 as consumers continued to hold on to their cash in the wake of a 3% increase in sales tax in April.

China's economy continued to manifest weakness as suggested by manufacturing PMI which remained in the contractionary zone at 49.7 in Jan-15 compared with 49.6 in Dec-14 highlighting the need for more easing measures to support weak demand. In view of this, China's Central Bank reduced the reserve requirement by 50 bps to 19.50%, in order to boost liquidity amid slowdown and low inflation.

On the domestic front, recent data signaled incremental consolidation of economic activity. Growth in core sector output moderated in Dec-14 after two successive strong prints. Services sector output picked up pace in Jan-15 as PMI services came in at 52.4 vs. 51.1 in Dec-14. However, PMI Manufacturing expanded at a relatively slower pace (52.90 vs. 53.50 in Dec-14).

Meanwhile, in line with expectations, Reserve Bank of India kept the policy repo rate unchanged at 7.75% in its sixth bi-monthly monetary policy review highlighting lack of incremental data on inflation or fiscal outlook as its key policy rationale. Note that in an off-cycle move in mid-January, central bank had eased its key repo rate by 25 bps to 7.75%. Looking ahead, we expect upcoming budget to stick to fiscal consolidation roadmap while incorporating some expenditure reforms following recommendations of the Expenditure Reforms Commission. Expected fiscal consolidation, reform push and subdued commodity prices are likely to create space for front loaded 50 bps of monetary easing in FY16. However, if oil prices continue to remain soft leading to a faster pace of disinflation, room for another 25 bps rate cut could open up.

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YES FIRST

FIRST Insights

Global Macro Developments

- ✓ IMF lowered its forecast for global economic growth in 2015, and called for governments and central banks to pursue accommodative monetary policies and structural reforms to support growth. Global growth is now projected at 3.5% for 2015, lower than 3.8% projected earlier. Despite the downward revision in global growth projections, the IMF retained India's GDP growth projection of 6.3% for 2015-16.
- ✓ The Bank of Japan cut its inflation projection to 1% for the fiscal year starting April and kept its unprecedented monetary easing unchanged as tumbling oil prices handicap efforts to reflate the Japanese economy.
- ✓ Mario Draghi led the European Central Bank into a new era, committing to a quantitative easing program worth at least 1.1 trillion euros (USD 1.3 trn) to counter the threat of a deflationary spiral in eurozone
- ✓ China's manufacturing growth stalled for the second straight month in January (HSBC PMI at 49.8 vs. Dec's 49.6) and companies had to cut prices at a faster clip to win new business, adding to worries about growing deflationary pressures in the economy
- ✓ US GDP grew slower than expected in 4Q2014 (2.6% QoQ, Previous: 5%, Forecast: 3%) as weak business spending and a wider trade deficit offset the fastest pace of consumer spending since 2006.

Events and Data Calendar

Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
US	02/01/2015	ISM Manufacturing	(DEC)	57.5	55.5	58.7	↓
	06/01/2015	ISM Non- Manufacturing Composite	(DEC)	58	56.2	59.3	↓
	08/01/2015	Fed Releases Minutes from Its Dec. 16-17 FOMC Meeting	(DEC)				→
	09/01/2015	Change in Non-farm Payrolls	(DEC)	240K	252K	353K	↓
	14/01/2015	Advance Retail Sales	(DEC)	-0.10%	-0.90%	0.40%	↓
	16/01/2015	U. of Michigan Confidence	(JAN P)	94.1	98.2	93.6	↑
	16/01/2015	Consumer Price Index (YoY)	(DEC)	0.70%	0.80%	1.30%	↓
	29/01/2015	Federal Open Market Committee Rate Decision	(JAN 28)	0.25%	0.25%	0.25%	→
	30/01/2015	Gross Domestic Product (Annualized)	(4Q A)	3.00%	2.60%	5.00%	↓
UK	13/01/2015	Consumer Price Index (YoY)	(DEC)	0.70%	0.50%	1.00%	↓
	27/01/2015	Gross Domestic Product (YoY)	(4Q A)	2.80%	2.70%	2.60%	↑
Japan	30/01/2016	National Consumer Price Index (YoY)	(DEC)	2.30%	2.40%	2.40%	→
EU	22/01/2015	European Central Bank Rate Decision	(JAN 22)	0.05%	0.05%	0.05%	→

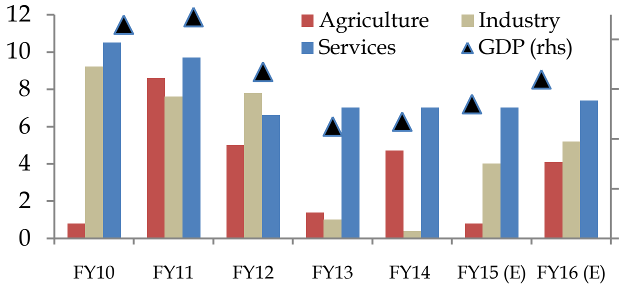
P* – Provisional Estimates F* - Final Estimates A*- Advanced Estimates T*- Third Estimates

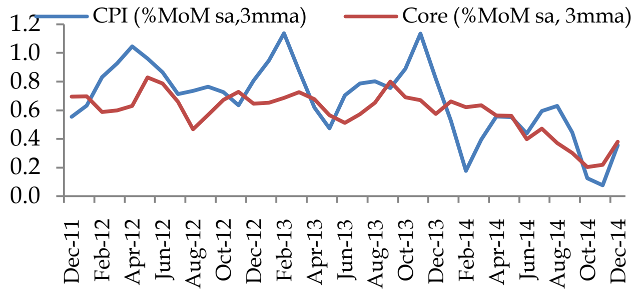
COMMODITY

- ✓ Gold increased 4.46% MoM in Jan-15, as compared to a 1.57% MoM in Dec-14; as safe haven demand got a boost, after Switzerland's unexpected currency move and US non-farm private employment data showed less than expected rise in January. Further, surprise move of China's central bank to cut reserve requirement ratios also boosted demand for bullion.

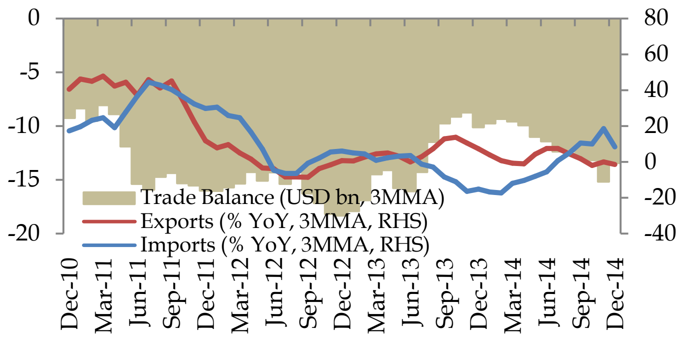
- ✓ WTI prices contracted 20% MoM in Jan-15, hovering near a 6-year low as the US Energy Information Administration reported a 14-year high US crude inventory number. However, the gains were capped after the death of King Abdullah of Saudi Arabia, the biggest producer in OPEC.

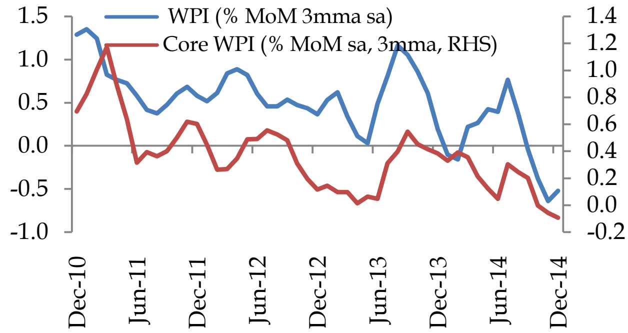
Domestic Market Macro Economics





- Industrial production growth rebounded in Nov-14 to 3.8%YoY following a sharp decline of 4.1% in Oct-14. On FYTD basis, growth was recorded at 2.2%YoY as compared to a near stagnation in Apr- Nov 2013.
- Dec-14 trade deficit improved sharply to USD 10.2 USD (vs. USD 16.9bn in Nov-14), its lowest in the past 9 months as the dynamics of relaxed export momentum and augmentation in Non-Oil Non-Gold imports was more than counteracted by a deceleration in Gold demand and a sharp contraction in India's crude imports
- Dec-14 CPI came in at 5.0% YoY led by a solid 41 bps sequential decline. The sequential softening (first since Feb-14) was led by slump in food prices as sequential rise in other components largely followed the trend.
- Dec-14 WPI inflation remained muted at 0.11%YoY as compared to 0.00% in Nov-14 as the disinflationary impulses from the global commodity price slump and domestic food price correction continued to manifest. Core inflation moderated further to 1.58% YoY, from 2.20% in November.
- India's FY14 GDP growth estimate was revised upwards 6.9% from 4.7%earlier on account of base revision to 2011-12 from 2004-05 earlier.
- Reserve bank kept the policy repo rate unchanged at 7.75% in the sixth bi-monthly monetary policy review, after announcing a 25 bps cut in the repo rate in an off cycle move in mid-January.



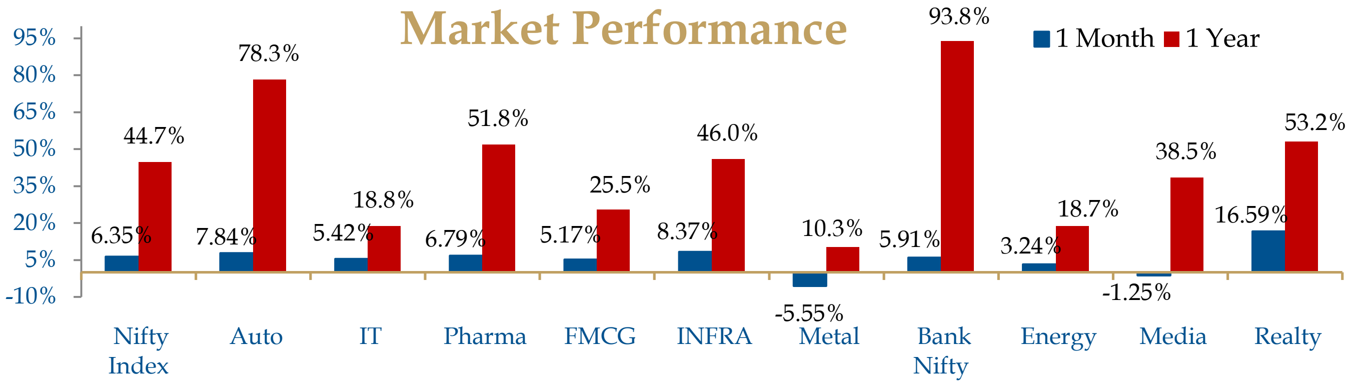


We expect:

- We hold on to our FY15 growth estimate of 5.4%(on old base) and expect growth in FY16 to improve by 100 bps to 6.4% on account of benign commodity prices, easing interest rate cycle and policy impetus by the government.
- We continue to expect CPI inflation to average close to 5.9% in FY16 with Q4 inflation now likely to undershoot RBI's target of 6% by 10-20 bps. If the current softness in global commodity prices persists well within FY16, we could see downward bias to our avg CPI expectation of 5.9%.
- We expect the RBI to ease monetary policy by a cumulative of 50 bps in FY16. Although if oil prices continue to remain soft to allow a faster pace of disinflation, the potential incremental easing could expand to 75 bps.
- We expect FY15 CAD to shrink to ~USD 24bn (-1.2% of GDP) vs. earlier expectation of USD 35bn (-1.6%) as compared to USD 32bn (-1.7% of GDP) in FY14.
- We maintain our call of 63.00 for the last quarter of FY15. This is because, we expect the RBI to stick to its reserve building strategy, amidst overvaluation of rupee (basis CPI-REER index) and robust FII inflows. For FY16 we expect Rupee to broadly trade in the range of 63-64.
- We continue to expect 10Y g-sec yield to drift lower towards 7.35% before the end of FY16. While monetary policy normalization by the Fed and BoE could provide volatility to rates, persistent softness in commodity prices could provide downside risks that could take 10Y yield down to 7.15% levels.

Equity Market Insights

- The month of January saw the Indian stock markets close on an upbeat note. The benchmark BSE SENSEX closed at 29,183, up 6.12% for the month while the Nifty closed at 8,809, up by 6.35% during the same period. The CNX Mid-Cap and CNX Small-cap indices relatively underperformed with returns of 4.3% and 3.6% respectively during the month.
- The hope of a recovery in economic growth combined with a surprise rate cut by the Reserve Bank of India has led to a continued interest from institutional investors as they were net buyers by~ $2.85bn in equities during January. DII's were also net buyers and ~ $0.04bn during the same period.



Factors to Watch

- The markets are now focused on the Union Budget which is scheduled to be delivered in February. Close watch would be kept on policy measure announcements which would strengthen the faith in an impending economic recovery. Any policy measure announcements outside of the Budget would provide further impetus to the markets.
- The Government has shown their commitment towards the reforms, in recent times, however this has been done by taking the ordinance route. While Ordinances do support the Government's pro-reform image; however it cannot be used as a go-to solution for enacting reforms. Therefore it would have to find a way to get political support from opposition parties to carry out reforms thereby creating an environment that is conducive for growth, which is something most investors would be watching carefully.
- 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, developments in Japan and China and further policy & political announcements in the Euro zone.

Outlook & Expectations

- In terms of valuations, the Sensex is trading at a trailing twelve month PE multiple of 19.7 times which is slightly higher than its long term historic average of 18.2 times. On a forward earnings basis too (assuming a 13% 1 year forward growth in earnings), the Sensex is trading at a multiple of around 17.4 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 believe that the market participants would now be watching out for the Union Budget and would be closely watching announcements related to the fiscal targets, areas of Government spending and plans to revive the capex cycle which in turn would drive the economic growth. Given this, markets would be expected to remain volatile as any major announcement could lead to knee jerk reactions as we are already seeing on individual stock levels on the day of their earnings announcements.
- We recommend equity investments through a Systematic Transfer route with a minimum investment horizon of 36 months.
- We continue to have a positive view on the IT sector, though some of the top tier companies are trading close to the higher valuation bands. Therefore corrections could be viewed as good opportunities to buy into these stocks. Select stocks in the auto and auto ancillary space too would see their earnings grow based on a recovery in the domestic markets as well as better performance of the export markets.

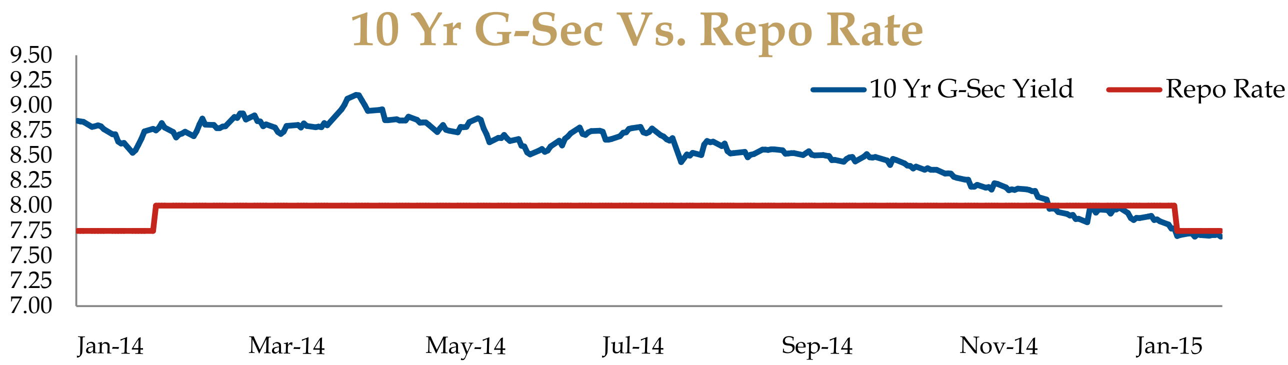
- From a longer term perspective, i.e. from a 2 to 3 years' horizon, investors could look at picking up stocks in sectors that stand to benefit from a revival in the economy. These would be consumer durables, infrastructure and banks.

Debt Market Insights

- The average systemic liquidity deficit in Jan remained largely unchanged at an average INR 867bn as compared to an average INR 877bn in Dec.
- Average 10 yr yield during Jan-15 declined to 7.77% from 7.93% in Dec-14 as RBI cut policy repo rate by 25 bps on Jan-15. However, in its 3rd Feb policy it maintained status quo while also retaining its guidance. Lack of new incremental information on inflation and fiscal outlook necessitated a continuation of the forward guidance provided in the Jan-15 policy statement.
- We continue to expect CPI inflation to moderate from 6.7% in FY15 to 5.9% in FY16 thereby creating space for incremental and front loaded 50 bps of monetary easing. However, if oil continues to remain subdued through FY16, then the potential incremental easing space could expand to 75 bps.
- We continue to expect 10Y g-sec yield to drift lower towards 7.35% before the end of FY16.
- While monetary policy normalization by the Fed and BoE could provide volatility to rates, persistent softness in commodity prices could provide downside risks that could take 10Y yield down to 7.15% levels.

Outlook and Expectations

- The 10 Yr G sec yields were ranged within 7.69% to 7.90% levels for the month of January.
- We expect the RBI to ease monetary policy by a cumulative of 50 bps in FY16. Although if oil prices continue to remain soft to allow a faster pace of disinflation, the potential incremental easing could expand to 75 bps.
- 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 – February 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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