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Focus shifts to Union Budget

Global financial markets have been unsettled since the start of 2016. Increased concerns on global growth, notably, the slowdown that is underway in China and the sharp decline in commodity prices - crude in particular, following a second round of surprise Yuan devaluation, appeared to have triggered the sell-off in markets. Meanwhile IMF recently revised down its 2016 GDP forecast by 20 bps to 3.4% further thereby validating concerns over global outlook.

In the mayhem that ensued, Central Bankers globally intervened with Bank of Japan introducing a negative interest rate and ECB promising more easing. While the actions and comments of Central Bankers calmed the markets to some extent, the risk-on sentiment was short lived as soft activity indices from US and China further fanned asset market volatility.

US jobless claims rose more than expected last week (2.25 Mn, Forecast: 2.24 Mn), suggesting labor market improvement may be taking a breather amid prolonged global slowdown. Further, US factory orders also fell more than anticipated to 2.9% (Forecast: -2.8%, Previous: -0.7%), as manufacturing firms continued to be impacted by slow overseas demand. Dollar strength- 'the flavor of 2015' waned as USD index fell sharply (Lowest since Nov-15) in February with investors turning cautious over the anticipated trajectory of US Fed rate hike. Meanwhile across the Atlantic, manufacturing data showed moderating growth in Euro zone (Jan PMI: 52.3 vs. December: 53.2) weighed down by faltering incoming orders. In a validation of the same, European Commission marked down Euro zone 2016 GDP growth by 1bps to 1.7%. Moderating growth and tepid inflation outlook amidst low oil prices are likely to weigh on ECB monetary policy stance when policy makers meet next month.

On domestic front, incremental data continued to underline a gradual recovery with a broader uptick weighed down by (1) moderation in industrial activity and (2) weak rural recovery. India's core growth remained tepid in Dec-15; with underlying seasonally adjusted momentum contracting by 1.2%MoM. Notwithstanding the marginal uptick in Dec-15, bank credit growth continued to remain tepid and skewed. On FYTD basis, half of incremental credit off take has been contributed by personal loans category alone.

More recent data from Jan-16 has been on a slightly positive note. PMI services posted a 19-month high print, underpinned by expansion of new business inflows. PMI Manufacturing too recovered sharply as the adverse impact from the heavy floods in Chennai receded. In our view, Q4FY16 is expected to see a recovery in manufacturing activity as is also evident from modest expansion in business situation in the sector, according to RBI industrial outlook survey. Further, Apr-Dec fiscal data continued to highlight government push for capex amidst robust revenue receipts and savings on petroleum subsidy bill (relative to FY15). Despite a 23% deficiency recorded in north-east monsoon season, only a slight deficiency in Rabi sowing at 3% YoY augurs well for inflation outlook. For now, Jan-16 inflation is likely to undershoot RBI target of 6.0% by ~40 bps amid ongoing seasonal correction in prices of fruits and vegetables.

For FY17, we expect GDP recovery to be gradual with incremental growth likely to be consumption-led amidst improving real incomes and implementation of 7th CPC recommendations. However investment recovery is likely to be moderate amid still subdued private capex amidst overleveraged balance sheets along with concerns on increasing number of stalled projects. In view of 7th CPC recommendations, we expect centre to set its fiscal deficit target higher by 20 bps target to 3.7% of GDP (vs. 3.5% targeted earlier). This in our view is likely to create additional fiscal space to drive public capex and help augment supply by crowding in private investment.

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Global Macro Developments

- ✓ US 4Q2015 GDP slowed more than expected (0.7%; Forecast: 0.8%; Previous: 2%), as both consumers and producers cut back on spending and US exports were hurt by the global slowdown.
- ✓ US factory orders fell more-than-expected 2.9% (Forecast: -2.8%, Previous: -0.7%), as manufacturing firms continued to be impacted by slow overseas demand and strong greenback.
- ✓ US ISM manufacturing PMI came in at 48.2 for January (December: 48.0), recording the fourth month of contraction as employment sub-index declined.
- ✓ The ECB will not “surrender” to low inflation, and the risks of acting (on monetary policy) too late are higher than risks of acting too early, as per ECB’s Draghi, reinforcing his case for monetary policy action in the March meeting next month.
- ✓ Euro-zone manufacturing PMI fell to 52.3 from December’s 53.2 as incoming orders failed to show any meaningful increase, despite companies cutting prices at the sharpest pace for a year.
- ✓ Bank of England kept interest rates on hold in its monetary policy meeting, while cutting 2016 growth forecasts to 2.2% from 2.5%, and inflation forecast to 0.8%, climbing to 2% target only in 2018.
- ✓ China’s Official Manufacturing PMI disappointed (49.4, Forecast: 49.6, Previous: 49.7), as sub-indices of output, new orders slowed.

Events and Data Calendar

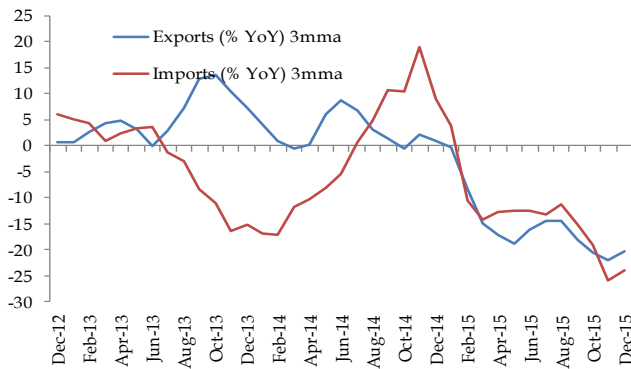
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
China	1/19/2016	GDP (YoY)	(4Q)	6.90%	6.80%	6.90%	↓
US	1/29/2016	Gross Domestic Product (Annualized)	(4Q A)	0.80%	0.70%	2.00%	↓
	1/28/2016	Federal Open Market Committee Rate Decision	(JAN 27)	0.50%	0.50%	0.50%	↔
	1/28/2016	Durable Goods Orders	(DECP)	-0.70%	-5.10%	-0.50%	↓
	1/15/2016	U. of Michigan Confidence	(JAN P)	92.6	93.3	92.6	↑
	1/15/2016	Advance Retail Sales	(DEC)	-0.10%	-0.10%	0.40%	↓
EU	1/21/2016	European Central Bank Rate Decision	(JAN 21)	0.05%	0.05%	0.05%	↔
	1/29/2016	Consumer Price Index Estimate (YoY)	(JAN)	0.4%	0.4%	0.2%	↑

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

COMMODITY

- ✓ Gold prices increased 2.9% MoM in Jan-16 after contracting 1.5% MoM in Dec-15 on a sharp decline in China equities, exacerbating worries of a potential global slowdown.
- ✓ Brent prices contracted 18.9% in Jan-16 (post a 16.9% MoM decline in Dec-15) as the weakening bias for the commodity continued following the report released by IEA, which stated that the oil market is likely to remain over supplied in 2016

Domestic Market Macro Economics

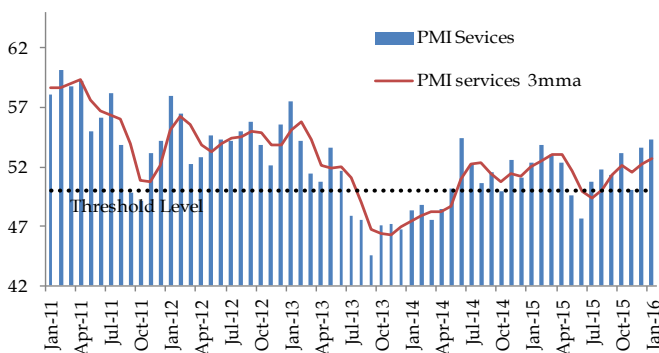


India's trade metrics weak on trend

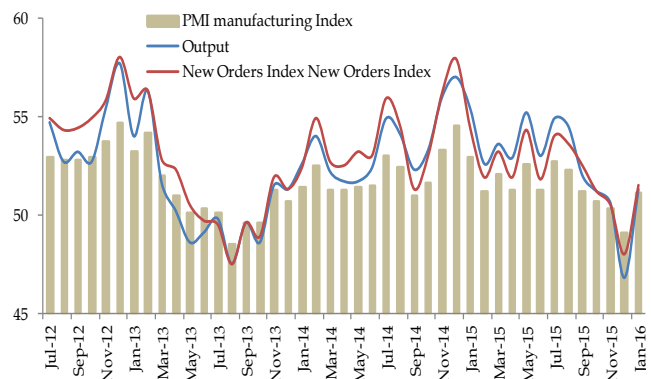
April-Dec	FY15	FY16	FY15	FY16
	%YoY		% of BE	
Gross Tax Revenue	7.0	21.1	58.3	66.5
Corporate Tax	6.6	10.1	61.6	64.9
Income Tax	8.4	11.7	58.6	56.8
Customs	9.4	17.6	67.2	76.6
Excise	0.2	68.3	49.2	74.6
Service Tax	8.5	24.5	48.7	62.4
Non-Tax Revenue	27.3	22.6	69.7	81.9
Non-Debt Capital	-24.0	115.0	13.8	27.4
Total Receipts	8.7	17.3	55.7	67.6
Non-Plan Expenditure	8.8	7.0	72.4	72.1
Plan Expenditure	0.4	-1.9	61.3	74.4
Revenue Expenditure	9.0	-4.6	69.9	68.1
Capital Expenditure	-11.2	33.5	62.1	77.8
Total Expenditure	6.2	8.2	68.9	75.3
Fiscal Deficit	3.1	-8.3	100.2	87.9

April Dec FY16 fiscal summary: Robust receipts; higher capex

- ✓ In line with our expectations, the RBI maintained status quo on key policy rates in its sixth bi-monthly policy review: For FY16, the RBI:
 - Continues to expect GVA growth at 7.4% with mild downside bias
 - Continues to expect Jan-16 CPI inflation target to be comfortably met
- ✓ For FY17, the RBI:
 - Expects GVA growth to improve moderately to 7.6%
 - Revised upwards its CPI inflation estimate to 5% for end FY17 from 4.8% provided earlier
- ✓ India's December trade deficit surprised significantly on the upside, rising to USD 11.7 Bn (Bloomberg consensus: USD 9.5 Bn; YBL forecast: USD 8.8 Bn; November: USD 9.8 Bn).
- ✓ Both exports and imports rose vis-à-vis the November reading. Over the year however, both exports and imports remained weak (exports: -14.7% YoY, imports: -3.9% YoY).
- ✓ India's fiscal deficit during Apr-Dec FY16 stood at 87.9% of Budget estimate (BE) as compared to 100.2% of BE in FY15 on the back of buoyancy in revenue receipts.
- ✓ NIKKEI India Manufacturing PMI accelerated to a four month high of 51.1 in January, post a contraction in December on back of a production disruption from the Chennai floods.
- ✓ India's Nikkei Services Business Activity Index accelerated to a 19-month high of 54.3 in Jan (vs. 53.6 in Dec) amid a stronger rise in new business index, indicating an improvement in year-ahead expectations.
- ✓ Output of core infrastructure industries expanded at a meager 0.9%YoY in Dec-15, after contracting 1.3%YoY in Nov-15



India's services PMI on strong footing



PMI Manufacturing rebounds, led by an uptick in output and new orders

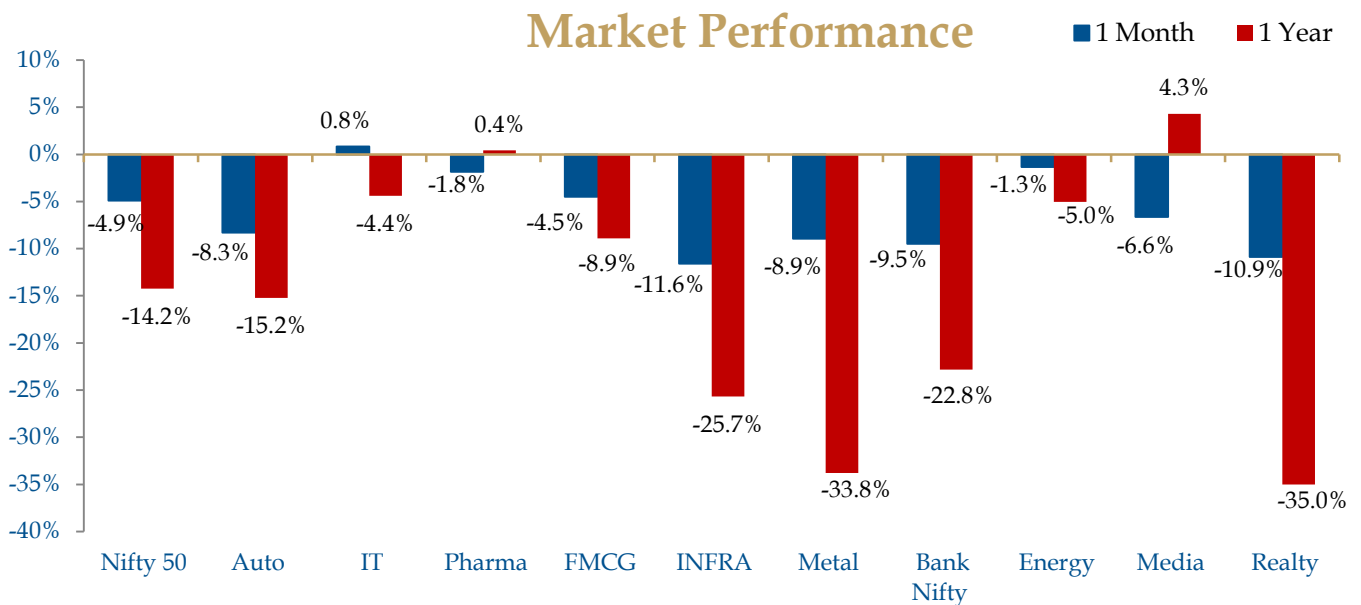
We expect:

- ✓ Our FY16 current account forecasts remain at a comfortable 1.1% GDP, 10 bps higher than our previous estimate, as exports slow but sharply lower commodity prices support. For FY17, we see a higher but still subdued CAD of 1.3% of GDP.
- ✓ We expect USDINR to remain weak in the range 67-69 (Previous: 67-68/USD), due to continued global headwinds such as monetary policy uncertainty from central bank actions and financial volatility; though strong domestic macros would keep sharp depreciation pressures contained. Medium-term INR direction would depend on the execution and pace of domestic reforms.



Equity Market Insights

- ✓ The Indian stock markets remained under pressure in January as global cues took the centre stage in the absence of any major domestic triggers. BSE Sensex closed at 24,871, lower by 4.8% for the month while the Nifty closed at 7,564; down by a similar 4.8% during the same period. The CNX Mid-Cap and CNX Small-cap indices relatively underperformed with losses of 6.9% and 11.0% respectively.
- ✓ During January, FPIs pulled out US\$ 1.57 bn from the equity markets but invested around US\$ 0.18 bn in debt markets thereby taking the total tally to an outflow of US\$ 1.39 bn during the month. The selloff was triggered off at a global scale with China's continued signs of weakness becoming a major factor responsible for the same. DII's were net buyers by \$1.98 bn during the same period.



Factors to Watch

- ✓ Global markets and consequently Indian markets are expected to remain under pressure and see increased volatility. Worries related to global growth slowdown triggered by the slew of weak data from China and sharp fall in commodity prices particularly that of oil and metals are the key reasons behind the meltdown in financial markets seen in recent times. These issues have increased the overall risk and volatility in the global markets as a result of which foreign investors have adopted a cautious approach towards all emerging markets including India.
- ✓ Unlike other emerging markets (largely commodity exporters) that are reeling under the pressure of falling commodity prices; India is a beneficiary of falling prices since it is a commodity importer. As such India is seeing a confluence of positive factors in the form of expected reforms, lower inflation and falling interest rates which reiterates our long term positive view on the markets. Therefore over a period of time investor interest will return to the country.
- ✓ On the domestic side two events would be closely tracked by the market participants. The first is the ongoing corporate earnings season. Till now no major surprises have come on the positive side. As such investors have shown very little tolerance towards any miss in estimates that have already been revised downwards.

- ✓ Though companies have started to see the benefit of lower commodity prices in the form of expanded margins and profitability; however the sluggish growth on the top line level suggests that demand is still lagging. In such a scenario, we believe that we could see more earnings downgrades coming in as the street would readjust their estimates to account for a longer than expected time for revival.
- ✓ The second event that investors would watch out for would be the Union Budget scheduled to be presented in the end of this month. Besides the usual wish list of tax rationalization and announcement/commitment towards major reforms, market and industry participants would also watch out for cuts in duties to boost domestic demand; incentives for boosting consumption which could help trigger investments from the private sector; cuts of service tax in exports to boost that segment; commitment to the domestic industry particularly metals through announcements of anti-dumping measures, etc.
- ✓ Investors would also be keeping a close eye on commodity prices particularly that of crude. Increasing geo-political tensions in the region would be a crucial factor guiding the prices of crude in the near term.

Outlook & Expectations

- ✓ In terms of valuations, the Sensex is trading at a trailing twelve month PE multiple of 18.3 times which is close to its long term historic average of 18.2 times. On a forward earnings basis the Sensex is trading at a multiple of around 17.2 times, which suggests that markets are not expensive 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 auto stocks. From a medium term perspective, investors could also look at accumulating stocks in the technology space that are expected to benefit from the currency movements as well as a steady growth in demand pipeline. We would recommend investors to accumulate/build positions in these sectors/stocks post result announcements.



Debt Market Insights

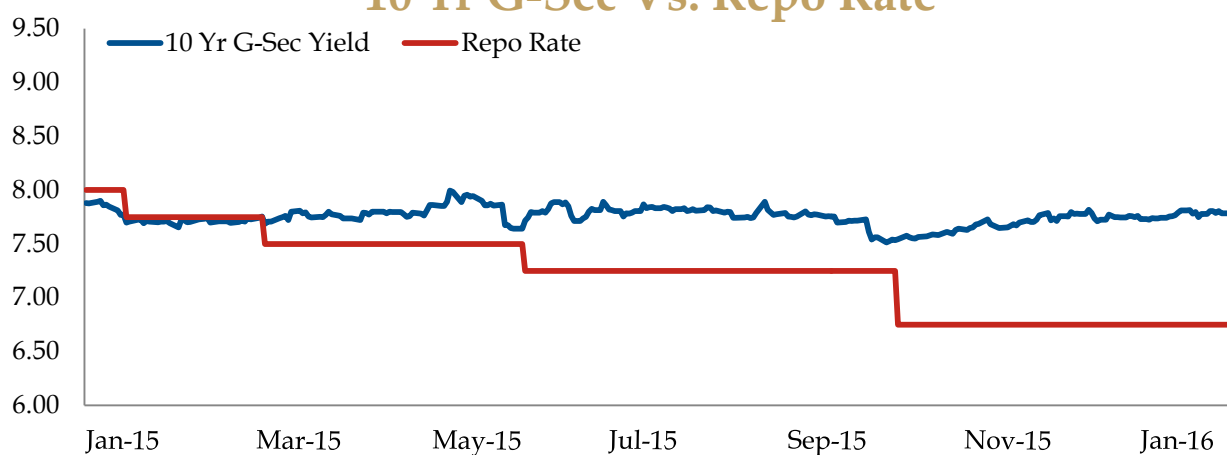
- ✓ The average systemic liquidity deficit in Jan-16 increased to an average INR 1340 bn compared to average INR 1114 bn in Dec-15 as currency leakages remained high and government cash balances with the RBI increased as it restrained spending.
- ✓ RBI auctioned new 10 year bond during Jan-16 with a cut off yield of 7.59%, 13 bps lower than the previous benchmark. Average 10 yr yield during Jan was 7.71%
- ✓ In line with our expectations, RBI maintained status quo on key policy rates in its sixth bi-monthly policy review
- ✓ Inflation for the month of December rose to a 15-month high of 5.61% (vs. 5.4% in November-2015). Marginally higher than expectations (YBL: 5.36%, Bloomberg: 5.53), the Food and Beverages category continued to be the key driver behind rising inflation.

Outlook and Expectations

- ✓ **We expect the RBI to cut repo rate by 25 bps post the announcement of the FY17 Budget as:**
 - With output gap remaining negative and the anticipated underlying inflation tracking its target, the real policy rate should get accommodative to the extent possible. We believe a real policy rate of ~1.5% would be ideal for the Indian economy at this juncture.

- The government has so far used its balance sheet for increasing public capex. For FY17, persistence on this path will help to augment supply by crowding in private investment. This will provide comfort to the RBI for considering incremental monetary accommodation.
- ✓ We expect average CPI (ex housing) inflation to moderate towards 5.0% in FY17 from our estimated level of 5.1% in FY16
- ✓ Our FY16 current account forecasts remain at a comfortable 1.1% GDP, 10 bps higher than our previous estimate, as exports slow but sharply lower commodity prices support. For FY17, we see a higher but still subdued CAD of 1.3% of GDP.

10 Yr G-Sec Vs. Repo Rate



Model Portfolios -February 2016

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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