Risk aversion sentiment returns

The global economy is in grip of risk off sentiment right now. Sharp decline in crude oil prices and geopolitical concerns in some economies has created uncertainties. Fears of financial crisis in Russia, economic vulnerability in other oil exporting countries, deflation in Euro zone, worries over possible exit of Greece from the Euro zone and weakness in emerging market currencies in the wake of US Dollar strength has dominated the macroeconomic landscape over last one month.

Brent crude price fell to less than USD 50/barrel translating into a shocking 56% decline over last six months. This dramatic decline in oil prices has brought back the concerns of deflation in advanced economies of Japan and Euro zone accentuating the slowdown worries. As such, investors now seem to be focusing on the adverse impact of global growth slowdown amid deflationary concerns rather than the benefits of a commodity price decline.

Emerging data from Eurozone highlights this peculiar situation. Consumer inflation fell by 0.2%YoY in December turning negative for the first time since 2009 financial crisis. The deflationary conditions have added to the fears of economic stagnation in the Euro zone. Growth in the Eurozone continues to remain sluggish as reflected by Purchasing Manager's Index. Composite PMI for December fell to 51.4 from a preliminary estimate of 51.7. Although deflationary conditions amid weak growth have increased probability of quantitative easing by ECB, political uncertainty in Greece is delaying possible action by ECB.

Likewise, in Japan, weak demand amid slump in international crude prices has depressed consumer prices. Consumer prices have remained in the negative territory in Oct-Nov with December print expected to slip further into negative territory.

While Japan and Eurozone are reeling under concerns on economic stagnation, subdued inflationary pressures are giving a boost to US consumption. GDP growth for Q3 was revised upwards to 5.0% from 3.9% largely on the back of upward revision to private consumption to 3.2% from 2.5%. Traction in economic activity in US despite weakening global growth suggests that Fed policy is likely to diverge from that of other Central Banks in 2015.

On the contrary, although consumer inflation in China eased to a five year low of 1.4% in Nov-14 reflecting lower commodity prices, domestic demand struggled to gain momentum. China's manufacturing PMI dropped to 49.6 in Dec-14 from 50.0 previously with new orders index contracting for the first time since April 2014.

On the domestic front, recent data indicates that recovery in the economy is gradually gaining pace with concerns on inflation taking a backseat on the back of slump in the commodity prices. Private sector output surged in Dec-14 led by strong reading on PMI manufacturing (54.5 vs. 53.3 in Nov). Likewise output in core industries rose to a 5 month high of 6.7% in Nov-14 following 6.3% in Oct-14, led mainly by double digit growth in key sectors such as coal, cement and electricity.

Meanwhile, in line with expectations, Reserve Bank of India kept the policy repo rate unchanged at 8% in its fifth bi-monthly monetary policy review, although it signaled a change in monetary policy stance if trajectory of inflation remained supportive. We continue to expect RBI to announce its first rate cut in Feb-15 with a cumulative of 75 bps cut during the course of 2015.

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YES FIRST

FIRST Insights

Global Macro Developments

- On the global front, at 51.6 in December, (51.8 in November) J.P. Morgan Global Manufacturing PMI posted its lowest level since August 2013.North America remained the prime driver of the global expansion, as growth stayed relatively muted in both the Eurozone and Asia.
- The US economy recorded its biggest expansion in more than a decade. GDP data released for Q3 showed that the economy grew by 5% annualized rate, up from a previously estimated 3.9%. This was considerably higher than the consensus expectation of 4.3%.
- China official PMI fell to 49.6 in December from 50 previously, outlining the growth challenges facing manufacturers in terms of rising costs and softening demand.
- Japan approved a reduction in corporate taxes by about 2.5% in the upcoming fiscal year, marking the latest measure by Prime Minster Abe to fuel growth in the world's third-largest economy.
- The Bank of Japan maintained unprecedented stimulus, as Governor Haruhiko Kuroda's bid to stoke inflation faces increasing challenges from the tumble in oil prices.
- Russian GDP showed a contraction of 0.5% for November compared to the same month last year, its first drop since October 2009. With oil exports forming the backbone of the economy and Western sanctions imposed over Moscow's rule in the Ukraine crisis, the contraction is expected to worsen going further.

Events and Data Calendar

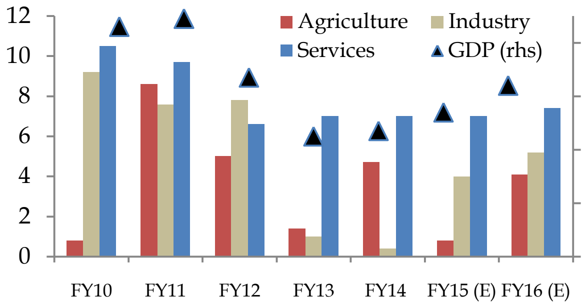
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
US	12/01/2014	US ISM Manufacturing	(NOV)	58	58.7	59	↓
	12/02/2014	US ISM Non-Manufacturing Composite	(NOV)	57.5	59.3	57.1	↑
	12/05/2014	US Unemployment Rate	(NOV)	5.80%	5.80%	5.80%	→
	12/11/2014	US Advance Retail Sales	(NOV)	0.40%	0.70%	0.50%	↑
	17/12/2014	US Consumer Price Index (YoY)	(NOV)	1.40%	1.30%	1.70%	↓
	12/28/2014	USD Federal Open Market Committee Rate Decision	(DEC17)	0.25%	0.25%	0.25%	→
	12/24/2014	USD Durable Goods Orders	(NOV)	3.00%	-0.70%	0.30%	↓
	12/04/2014	UK BOE Asset Purchase Target	(DEC)	375B	375B	375B	→
	12/16/2014	UK Core Consumer Price Index (YoY)	(NOV)	1.50%	1.20%	1.50%	↓
Japan	12/26/2014	JPY National CPI (YoY)	(NOV)	2.50%	2.40%	2.90%	↓
EU	12/04/2014	EU European Central Bank Rate Decision	(DEC 4)	0.05%	0.05%	0.05%	→
	12/05/2014	Euro-Zone Gross Domestic Product s.a. (YoY)	(3Q P)	0.80%	0.80%	0.80%	→
	12/16/2014	EU German ZEW Survey (Economic Sentiment)	(DEC)	20	34.9	11.5	↑

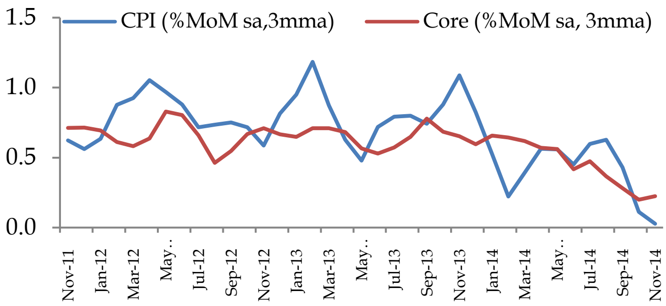
P* – Provisional Estimates F* - Final Estimates A*- Advanced Estimates T*- Third Estimates

COMMODITY

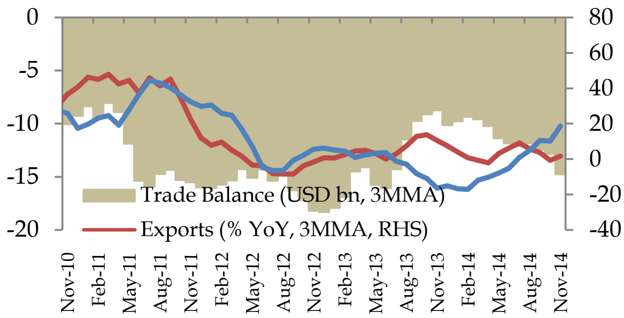
- Gold increased 1.8% MoM in December after a contraction of 3.7% MoM in November, as end-of-year caution, Greek tensions and heightening global growth worries increased the metal's safe haven appeal. Further, speculation that China (world's biggest consumer) would take more measures to bolster the economy increased gold demand as a store of value.
- WTI contracted 21.59% MoM in December following 8.6% MoM decline in November, as strengthening dollar- and supply glut from US; negated worries of falling production from Libya. Additionally, global manufacturing growth stagnated in December with a slowdown in Europe and China; indicating a fall in future demand.

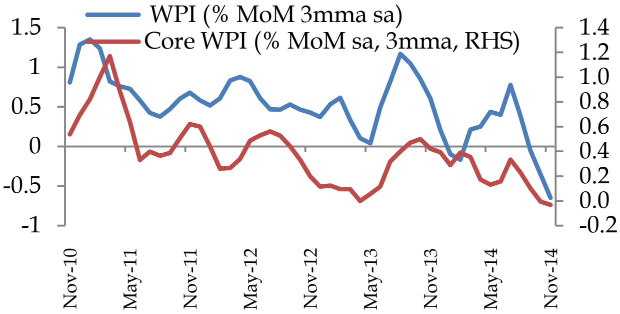
Domestic Market Macro Economics





- India's Q2FY15 GDP growth moderated to 5.3%YoY from 5.7%YoY recorded in Q1FY15 as industrial growth moderated to 2.2%YoY from 4.2%YoY in Q1FY15
- HSBC manufacturing PMI rose to a 2 year high of 54.4 in Dec-14 from 53.3 in Nov-14 as new orders index surged. While, HSBC PMI Services Business activity index moderated to 51.1 in Dec-14 from 52.6 in Nov-14.
- Core sector output during Nov-14 rose to 6.7%YoY from 6.3%YoY in Oct-14, as coal, cement and electricity sectors registered double digit growth.
- Nov-14 trade deficit widened to USD 16.9 USD (vs. USD 13.2 bn in Oct-14) as imports grew at 26.6%YoY in Nov-14 (vs. 3.6% in Oct-14) on the back of surge in gold imports to 18 month high of USD 5.6 bn.
- CPI inflation for the month of Nov-14 declined to a series low of 4.38%YoY as compared to 5.52%YoY previously, aided by moderation in food and fuel inflation and additionally supported by favorable base.
- Nov-14 WPI inflation fell to a 64 month low of 0%YoY from 1.77% in the previous month. Core inflation declined to a 59 month low of 2.22%YoY from 2.55% in the previous month.
- Reserve bank kept the policy repo rate unchanged at 8% in the fifth bi-monthly monetary policy review, while signaling that room for monetary easing may open up in early 2015 if the current moderation in inflation continues.



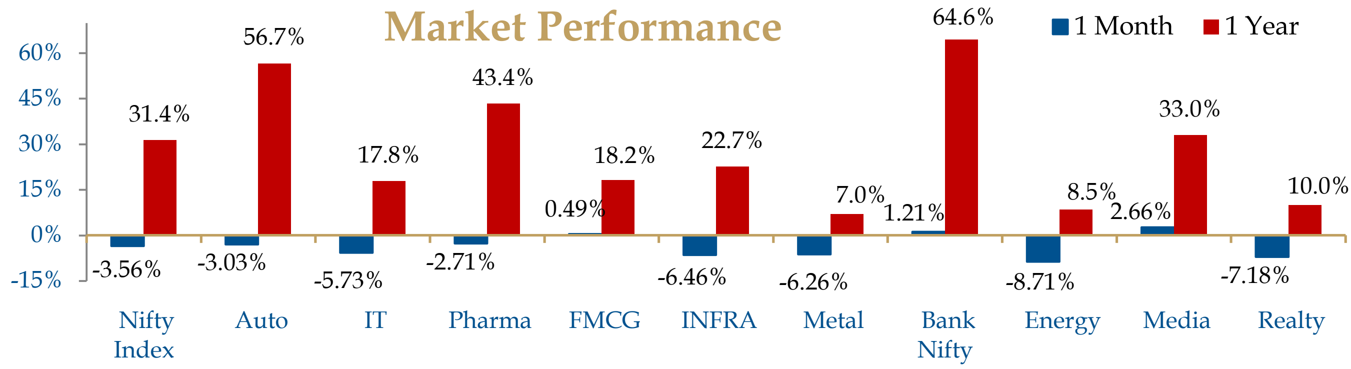


We expect:

- We expect Q3FY15 growth to slip to ~ 5% from 5.3% in Q2FY15 dragged by weak agriculture growth on account of sub-normal monsoon. Thereafter a gradual recovery in industrial sector amid moderate expansion in services sector would steer full year growth toward our target of 5.4% for FY15
- We expect growth in FY16 to improve by 100 bps to 6.4% supported by confluence of three factors-policy reforms, favorable commodity cycle and easing interest rate cycle
- On the back of sharp decline in crude prices and moderation in food inflation, we expect FY15 average CPI inflation to come at 6.7%. We expect Jan-15 CPI inflation to undershot RBI's target by 150 bps. For FY16, we have revised our estimate lower to 5.9% from 6.4% earlier.
- We expect CAD in FY15 to moderate to USD 33 bn on back of decline in global commodity prices. We expect marginal uptick in CAD in FY16 to about USD 40 bn.
- We believe this risk-off scenario is likely to be temporary and overtime markets are likely to gain confidence from improving macroeconomic fundamentals of India. As such, while we expect rupee weakness in the near term (~64-64.50 levels June-Dec-15), we are confident that rupee sentiment should turn positive on account of improved BOP dynamics, leading INR to consolidate around 63 levels in Mar-16.
- We expect the RBI to ease monetary policy by a cumulative of 75 bps during the course of 2015 with first cut being announced in Feb-15.

Equity Market Insights

- The month of December saw the Indian stock markets come under pressure as profit booking led to consolidation. The benchmark BSE SENSEX closed at 27,499, down 4.16% for the month while the Nifty closed at 8,283, down by 3.56% during the same period. The CNX Mid-Cap and CNX Small-cap indices however outperformed and delivered returns of 1.6% and 5.7% respectively during the month.
- The hope of a recovery in economic growth has to a continued interest from institutional investors. However, FIIs seem to have preferred to book some profits in their equity portfolios that led to a $ 0.1bn outflow in equities during December. While, DII's were net buyers and ~ $1.14bn 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. During the month of December, the Government has approved Ordinance on the Coal Mines as well as the Insurance Bills. The Coal Mines Ordinance provides for the fresh auction of the coal blocks that were de-allocated by the Supreme Court in September 2014. The Insurance Bill on the other hand raises the cap on foreign investment in insurance companies to 49% from 26% currently.
- At the end of the year, the Government has also approved the Ordinance to amend the land acquisition law. 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 policy announcements in the Euro zone.

Outlook & Expectations

- In terms of valuations, the Sensex is trading at a trailing twelve month PE multiple of 18.8 times which is in line with its long term historic average of 18.2 times. On a forward earnings basis too (assuming an 11% growth in earnings), the Sensex is trading at a multiple of around 16.9 times, which suggests that valuations are not expensive even at these 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.
- 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.

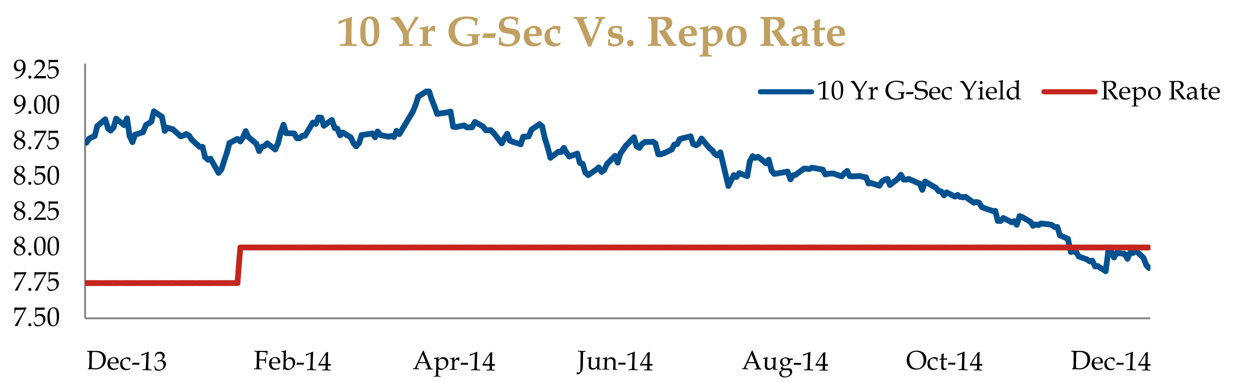
- From a longer term perspective, i.e. from a 2 to 3 years' horizon, investors could look at picking up stocks in sectors that stand to benefit from a revival in the economy. These would be consumer durables, infrastructure and banks.

Debt Market Insights

- The average systemic liquidity deficit in Dec rose to an average INR 877bn as compared to INR 429bn in Nov. The fall was due to advance tax outflows, higher currency leakage and RBI's forex intervention.
- Average 10 yr yield during Dec declined to 7.93% from 8.18% in Nov-14 as falling commodity prices increased expectations of a rate cut by RBI.
- In line with expectations, the Reserve Bank of India in its fifth bi-monthly review of monetary policy left repo rate unchanged at 8.00%. As such, the reverse repo and the MSF rates continue to remain at 7.00% and 9.00% respectively.
- Going forward, government's disinvestment program, spectrum auction amid expected cut in government spending could increase the liquidity deficit in the system.
- We continue to expect RBI to ease policy rate by a cumulative of 75 bps in 2015 with the first rate cut being announced in Feb-15.

Outlook and Expectations

- The 10 Yr G sec yields were ranged within 7.83% to 8.06% levels for the month of December.
- We expect RBI to announce its first rate cut in the Feb-15 policy review. Over the course of 2015, we stick to our call of cumulative monetary easing of 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 – January 2014

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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