China unnerves Global markets

Risk off sentiment gripped the markets in the beginning of the New Year. The catalyst was panic selling in Chinese equities ahead of the anticipated end to the 6 month ban on share sale by major institutional investors- a policy that was implemented to shore up markets following the rout in mid-2015. This amid signs of sluggishness in the economy drove Chinese Renminbi to its weakest level in five years, in turn unnerving the global financial markets. Even as the markets were worried about the extent of devaluation of the Renminbi and the consequent competitive devaluation that it could trigger, China's recent decision to guide its currency sharply stronger, in an apparent reversal of recent weakening trend added to market confusion on its policy.

Meanwhile, the weakness in global economy amid sharp buildup of US gasoline reserves saw oil prices plunge below USD 35/bl for the first time since 2004. The renewed tension between Saudi Arabia and Iran has cast doubts on the agreement to contain oil output. Even as US Fed hiked rates in December, minutes of the meeting released recently confirmed that the decision to hike rates was more cautious than was initially believed as some members within the FOMC said that the 'liftoff' was a close call.

The end of 2015 saw Euro zone recovery gaining further traction, with composite PMI registering a 4 month high print of 54.3 in December (vs. an estimate of 54.0) While the headline signaled an expansion for 30 consecutive months, growth in Q42015 as a whole was quickest in four-and-a-half years, suggesting an increase in pace of expansion. Just as the recovery in EU appears to be picking up pace, the downside risks have been exacerbated by concerns in China- 2nd largest export trading partner with the EU. Further with continued slide in crude oil prices, Euro area inflation remained unchanged in December at 0.2% yoy, (versus market expectations of 0.3%). While, additional ECB stimulus in December (extension of bond-buying program by 6 months to March 2017) is likely to somewhat cushion the impact on inflation, continued slide in commodity prices poses a concern.

On domestic front, broad message continued to remain consistent - that of a gradual and uneven improvement in growth. India's Dec-15 manufacturing PMI fell to sub 50 levels for the first time since October 2013 as output in industrial hub in South India was affected due to floods. Likewise, fewer working days due to Diwali along with excess capacity in electricity sector is likely to have impacted core sector activity which registered a contraction in November. That said, a sustained recovery in core sector will require government to revitalize private investment appetite by reviving PPP model in infra projects by adopting recommendations of the Kelkar panel. Despite, some near term loss in growth momentum, pockets of improvement continue to support sentiment. First, quality of fiscal adjustment has been improving over the last 8-months – amidst robust indirect tax collections. Two, India's external debt dynamics continue to remain comfortable. Third, PMI services accelerated to a 10-month high in Dec-15 driven by rise in new business index.

The forthcoming Budget session of the Parliament remains crucial for two reasons- visibility of progress of reforms and the path of fiscal consolidation. Subdued private investment calls for increasing public investment and as such we would keenly watch government's fiscal stance following 7th pay commission recommendations. With regards to reforms visibility, we expect government to remain focused on ease of doing business, and implementation of important economic reforms especially of Goods and Services Tax (GST) and Bankruptcy code. This in our view should allow recovery to acquire a more sustained character from FY17 onwards.

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Global Macro Developments

- World Bank has downgraded its global growth forecast for 2016 by 50 bps to 2.9% (2015: 2.4%), driven by expectation of a weaker performance from EMs and anemic growth from DMs.
- US Fed December FOMC minutes showed that policymakers raised rates in the meeting as they were reasonably confident of a rise in medium-term inflation, though some members said that the decision to raise rates was a close call due to still-low inflation.
- US ISM manufacturing PMI fell to 48.2 in December (November: 48.6, Forecast: 49.0), ISM non-manufacturing PMI registered at the lowest since April 2014 (55.3, November: 55.9); signaling continued weakness in both the manufacturing and services sector.
- China PMIs released showed continued contraction in manufacturing, with the Official PMI reading at 49.7 (Forecast: 49.7, Previous: 49.6) and Caixin PMI at 48.2 (Forecast: 49.0, Previous: 48.6).
- China's services PMI fell to a 17 month low of 50.2 from 51.2 in November in a further indication that China's economy may be losing steam. The index for December was the second lowest since data collection began in late 2005.

Events and Data Calendar

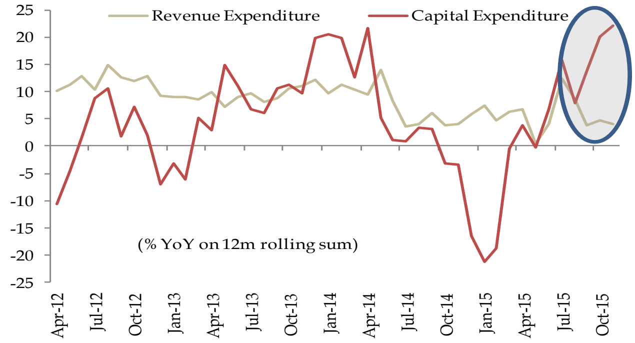
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
China	12/8/2015	Trade Balance	(NOV)	USD 54.1bn	USD64.1bn	USD61.6bn	⇧
	12/9/2015	Consumer Price Index (YoY)	(NOV)	1.50%	1.40%	1.30%	⇧
US	12/1/2015	ISM Manufacturing	(NOV)	48.6	50.5	50.1	⇧
	12/17/2015	Federal Open Market Committee Rate Decision	(DEC 16)	0.50%	0.50%	0.25%	⇧
	12/23/2015	Durable Goods Orders	(NOV P)	0.00%	-0.60%	2.90%	⇩
	12/23/2015	Personal Consumption Expenditure Core (YoY)	(NOV)	1.30%	1.30%	1.30%	⇨
	11/17/2015	ZEW Survey (Economic Sentiment)	(NOV)		28.3	30.1	⇩
	11/13/2015	Gross Domestic Product s.a. (YoY)	(3Q A)	1.7%	1.6%	1.5%	⇧
EU	12/8/2015	Gross Domestic Product s.a. (YoY)	(3Q P)	1.6%	1.6%	1.6%	⇨

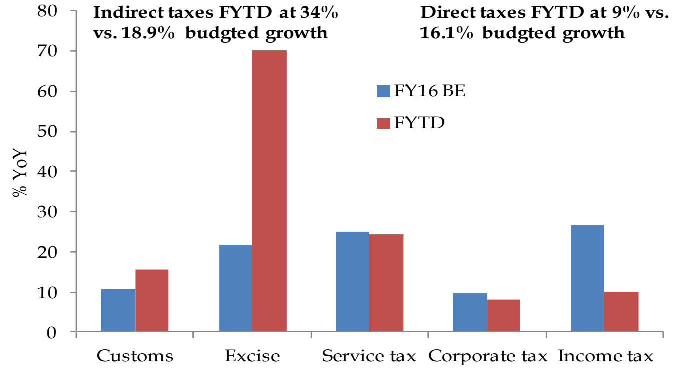
P* – Provisional Estimates F* - Final Estimates A* - Advanced Estimates T*- Third Estimates

COMMODITY

- Gold prices contracted 1.5% MoM in Dec-15 (following a 6.3% MoM contraction in Nov-15) amid reduced liquidity in markets. The decline was capped amid thin trading volumes as traders looked ahead to cues from US data for hints on pace of rate hikes.
- Brent prices contracted 16.9% MoM in Dec-15 (post contracting 7.8% MoM in Nov-15) sliding towards 11-year lows, after an unexpected build up in US stockpiles and news reports that the OPEC's high oil supply will be maintained.

Domestic Market Macro Economics

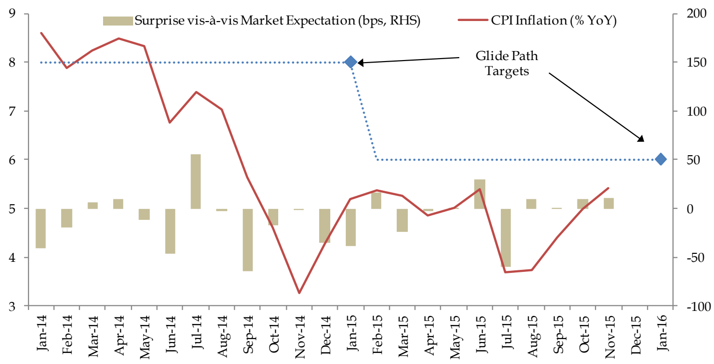


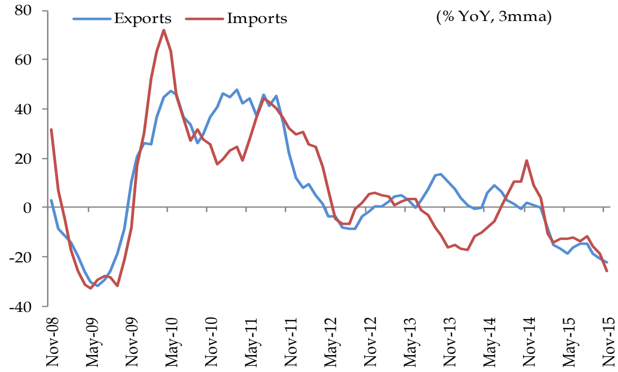


Improvement in quality of fiscal spending in FY16

Indirect tax run rate remains robust during April-Nov FY16

- India's fiscal deficit during April-Nov FY16 stood at 87.0% of Budget estimate (BE) as compared to 98.9% of BE in FY15 on the back of buoyancy in non-tax revenues and indirect tax collections.
- Non-food credit growth in Nov-15 improved marginally to 8.8% YoY vs. 8.3% in October, largely driven by personal loans category. Industry and services credit continued to remain subdued.
- As per latest data, India's external debt as of Sep-15 stood at USD 483.2 bn, recording an increase of 1.7% from the Mar-15 levels and a YoY increase of 5.9%.
- The Nikkei India PMI Manufacturing moved into contraction zone in Dec-15, coming in at 49.1 (two-year low), compared to 50.3 in November as floods in Chennai kept the output index muted.
- India November CPI rose to a 14-month high of 5.41%YoY, coming in above market expectations of 5.30% (YBL expectation at 5.25%) and previous month's 5.00%.
- India's merchandise trade deficit for Nov-15 remained unchanged at USD 9.8 bn (Bloomberg consensus: USD 10.2 bn; YBL expectation: USD 10.5 bn).





CPI: Continue to remain well below RBI's Jan-2016 target

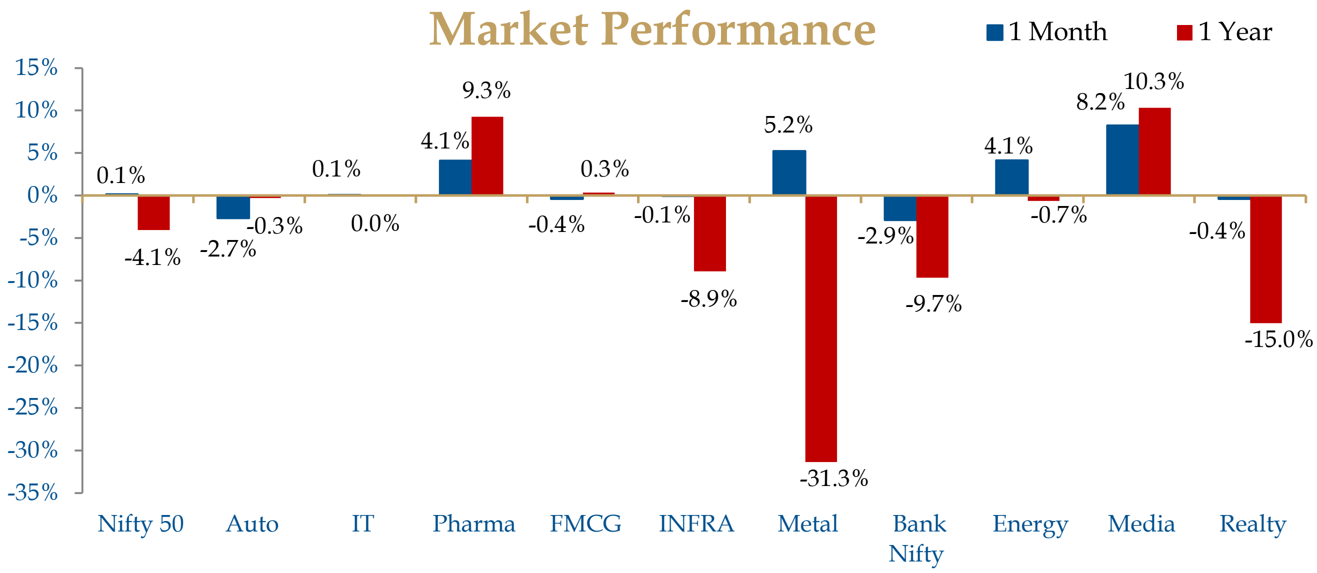
India's trade metrics weak on trend

We expect:

- From a global perspective, even as emerging markets are likely to slowdown collectively, growth prospects for India appear to be relatively bright. Compared to average growth of 4.0% for emerging economies (IMF 2015), we continue to expect the Indian economy to clock 7.5% in FY16. In this regard, gradual implementation of structural reforms, subdued inflation, superior quality of fiscal spending, and lagged response to policy rate cuts are likely to be important growth boosters for India, going forward.
- We expect average CPI inflation to come at 5.1% in FY16 from 6.0% in FY15 amidst softening global commodity prices especially oil, slowdown in global growth prospects and quickened pace of policy transmission led by deposit rate cut; juxtaposed with the delay in closing of the domestic output gap. We see Jan-16 CPI undershooting RBI's estimate of 5.8% by at least 50 bps.
- We expect RBI to ease policy repo rate by 25 bps in Q4 FY16. We see the possibility of another 25 bps rate cut thereafter up to Sept-16 contingent on - global commodity prices, pace of domestic output gap closure especially in the context of 7th CPC payouts and Government policy reforms.

Equity Market Insights

- The month of December saw the Indian stock markets continue on a bumpy ride. The BSE Sensex closed at 26,117.54, lower by 0.11% for the month while the Nifty closed at 7,946.35; up by 0.14% during the same period. The CNX Mid-Cap and CNX Small-cap indices relatively outperformed with gains of 1.12% and 1.93% respectively.
- During December, FIIs interest remained subdued with regards to the capital markets. There was a net outflow of US$ 0.1 bn from equity markets and US$ 0.9 bn from debt markets taking the total tally to an outflow of US$ 1.03 bn from capital markets. DII's were net buyers and ~ $2.4bn during the same period.



Factors to Watch

- Markets are expected to remain volatile due to geopolitical reasons related to China and commodity prices. As signs of slowdown intensify for China, the markets there have remained under pressure which in turn has led most Asian and consequently global markets to trade in the red. This is expected to continue for the coming weeks as well. Furthermore the recent depreciation of the currency by China has also added pressure on the currency side. Together these issues could lead to sharp selloffs in the markets in coming weeks.
- 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.
- Earnings outlook for India: On the domestic front, the markets would be tracking the earnings announcements for the quarter ended December 2015. While we do believe that the earnings have bottomed out; however growth may still remain subdued with no signs of recovery for most sectors. The major issue for most sectors remains the lack of growth in demand which would contain the benefit of softer commodity prices and easing interest rates in earnings growth.

Outlook & Expectations

- In terms of valuations, the Sensex is trading at a trailing twelve month PE multiple of 18.8 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 16.9 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 auto stocks. We would recommend investors to accumulate/build positions in these sectors/stocks post result announcements.

Debt Market Insights

- The average systemic liquidity deficit in Dec-15 rose to Rs. 1,114bn compared to Rs 758bn in Nov on account of currency leakage, RBI's fx intervention and build-up of government balance.
- RBI announced OMO purchase worth Rs 100 bn in Dec- 15 to shore up liquidity
- Average 10 yr yield during Dec rose to 7.76% from 7.69% in previous month as liquidity deficit rose, concerns on food inflation increased and FIIs remained net sellers.
- The probability of government relaxing the path of fiscal consolidation also added to further worries. Government has indicated that given the still fragile state of private investment, it may consider relaxing the fiscal deficit target by 20-40 bps next year as well as pushing forward the path of fiscal consolidation as set out in the Budget FY16

Outlook and Expectations

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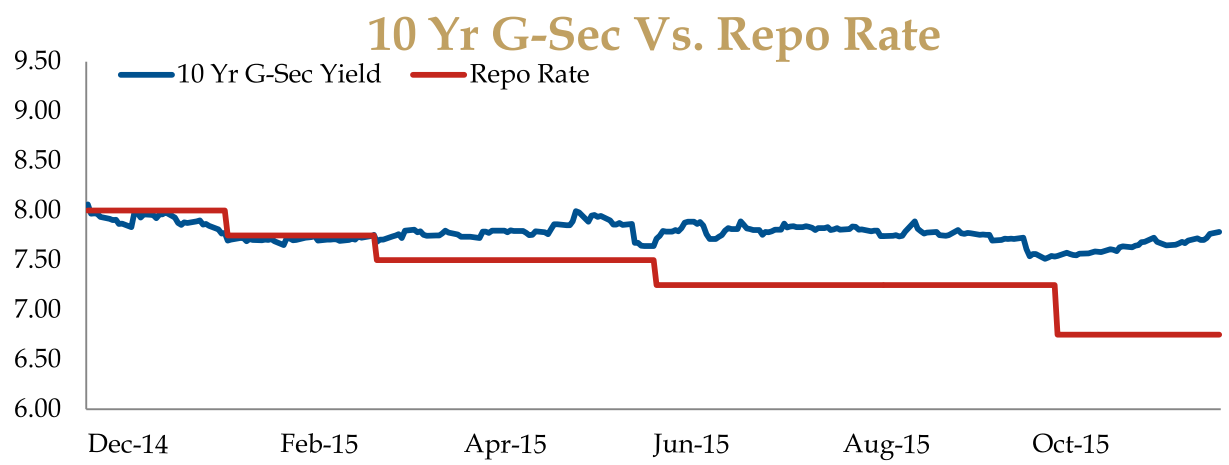

Model Portfolios – January 2016

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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