Global bond yields surge high on volatility

Uncertainty and volatility guided the global markets as steep rise in yields and increase in international oil prices dominated the sentiment. Yields on 10-year German bonds rose to a peak of 0.70% in May versus an April low of less than 0.1%. The rout in German bond markets pushed yield on the US 10-year note to 2.3% from 1.96% since the end of March. The narrative was largely driven by first positive reading on inflation front in six months. Eurozone CPI in May rose by 0.3% YoY vs. 0.0% YoY in April) as its economy showed further signs of stability. GDP in the region rose 0.4% in Q1-2015 (vs. 0.3% in Q4-2014) driven by expansion in France and Italy. Meanwhile amid gradual improvement in the economy, European Central Bank left its benchmark rate at 0.05%.

After US revised its Q1 real GDP to a negative print, IMF downgraded its 2015 US GDP forecast to 2.5% from 3.5% earlier. Notwithstanding the weak print in the Q1, incoming data is suggestive of some stability ISM manufacturing index picked up in May to 52.8% from 51.5% in April despite strength in dollar. Additionally, May jobs data showed that economy added 280k payrolls compared to 221k in April and higher than 225k expected by market.

Driven by stronger pickup in business investment, Japan's Q1 GDP grew at an annualized 3.9%, more than the initial estimate of 2.4%. The economy is likely to maintain momentum in Q2 as highlighted by lead indicators. Industrial production rose to a seasonally adjusted 1.0% in April, from -0.8% in the preceding month. Meanwhile, Japan's retail sales rebounded in April by rising 5%YoY following a 9.7% drop in March. While strong print on retail sales strengthened Bank of Japan's assertion that consumer spending is reviving, marginal increase in Japan's core inflation to 0.3%YoY in April (vs. forecast of 0.2%) suggests that prices pressures remains subdued. With economic activity modest amid muted price pressures, Bank of Japan is expected to maintain its asset purchases to 80 trillion yen a year

On the other hand, economic growth momentum continued to remain weak in China. While manufacturing PMI marginally increased in May (49.2 vs. 48.9 in April), it remained below the crucial 50.0 mark and signaled a third successive monthly deterioration in factory activity. Meanwhile, imports declined 17.6% YoY in May, indicative of weak consumer spending. Amid sluggish factory activity and subdued domestic demand, monetary policy may need to be more accommodative to support the economy.

On the domestic side, we continue to find mixed evidence of economic recovery. While there was some improvement in the PMI Manufacturing print for May, it was offset by a contraction in the Services Index. Core sector posted a second consecutive contraction for the first time in the current series while incoming corporate earnings remained disappointing. Meanwhile, bank credit offtake continued to remain tepid on account of weak industrial growth and balance sheet stress for few corporates.

Despite some near term loss in growth momentum, pockets of improvement continue to support sentiment. First, urban consumption has been a beneficiary of the rapid decline in inflation. Second, quality of fiscal adjustment has been improving sequentially over the last 4-months – this is likely to get better as PSEs like railways build further capex momentum. Third, while monsoon continues to remain a key risk (after IMD downgraded its expectation for 2015 south-west monsoon to 88% from 93% earlier) , government action in the area of ensuring non-disruptive supply, crop insurance, use of price stabilization fund, strategic import preparedness, price administration among others could mitigate most of these risks.

Shubhada M. Rao
Chief Economist

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

Global Macro Developments

- ✓ ECB kept key rates steady in its monetary policy meeting, with Draghi also rejecting investors concerns that the recent rise in CPI would encourage bank to end its ongoing monetary stimulus program worth USD 1.2tn early.
- ✓ OECD slashed its global growth forecast from 3.7%YoY to 3.1% in 2015; 2016 forecasts were cut 10bps to 3.8%. As per the organization, pace of recovery remains weak and investment is yet to take off. US GDP
- ✓ The IMF confirmed that Greece will be bunching four debt repayments due June (worth ~1.5Bn), averting the possibility of a default when its first tranche of USD 338Mn is due on June 5.
- ✓ IMF has urged US Fed to delay its first rate hike until H12016, that is, until when there are signs of pickup in wages and inflation.

Events and Data Calendar

Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
US	05/01/2015	ISM Manufacturing	(APR)	52	51.5	51.5	→
	05/08/2015	Change in Non-farm Payrolls (APR)	(APR)	228K	223K	85K	↑
	05/08/2015	US Unemployment Rate (APR)	(MAR 18)	5.40%	5.40%	5.50%	↓
	13/05/2015	USD Advance Retail Sales (APR)	(FEB)	0.20%	0.00%	1.10%	↓
	15/05/2015	University of Michigan Confidence	(MAY P)	95.9	88.6	95.9	↓
	22/05/2015	US Consumer Price Index (YoY)	(APR)	-0.20%	-0.20%	-0.10%	↓
	29/05/2015	Gross Domestic Product (Annualized)	(1Q S)	-0.90%	-0.70%	0.20%	↓
UK	05/07/2015	Bank of England Rate Decision	(MAY 11)	0.50%	0.50%	0.50%	→
	19/05/2015	Consumer Price Index (YoY)	(APR)	0.00%	-0.10%	0.00%	↓
EU	13/05/2015	Euro-Zone Gross Domestic Product s.a. (YoY)	(1Q A)	1.00%	1.00%	0.90%	↑

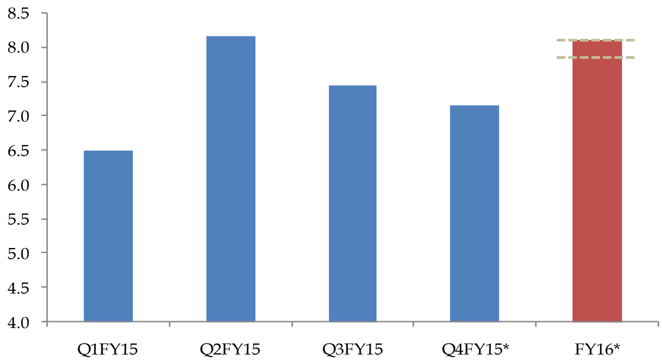
P* – Provisional Estimates F* - Final Estimates A*- Advanced Estimates T*- Third Estimates

COMMODITY

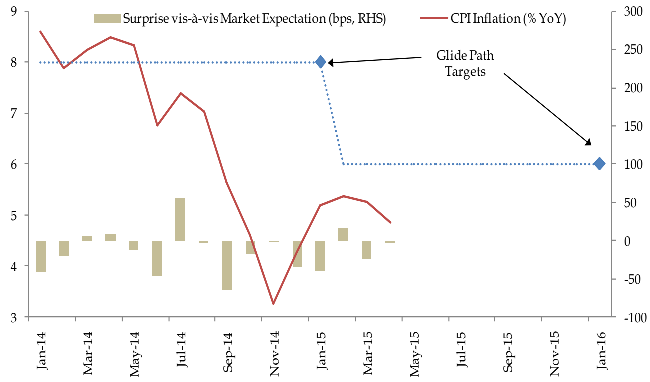
- ✓ Gold registered a 0.08% MoM contraction in May as compared to 1.74% MoM expansion in April-15 as positive news flow from the US, pushed the USD to its highest level in four weeks in May end; weighing on bullion sentiment.

- ✓ WTI increased 5.8% MoM in May (vs. 9.3% MoM in April-15) on news that crude stocks fell for a fourth week, suggesting some amount of rebalancing post a supply-glut. EIA data showed crude oil inventories fell by 2.8mn barrels, as against expectations for a decrease of 857k barrels.

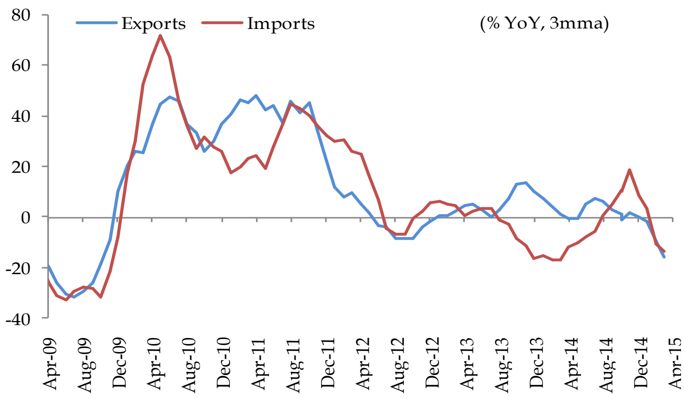
Domestic Market Macro Economics

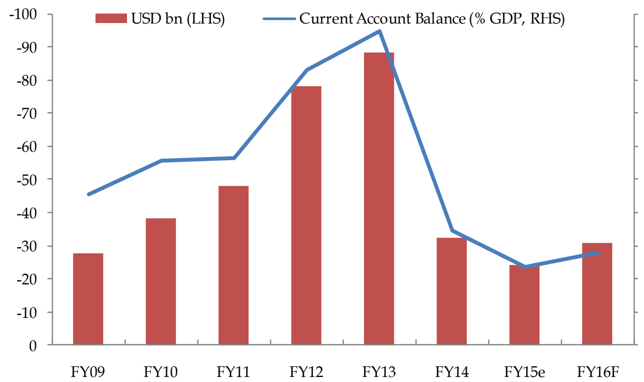


*YBL forecast



- ✓ In line with expectations, the RBI eased repo rate by 25 bps to 7.25% taking the cumulative monetary easing to 75 bps in the calendar year so far
- ✓ GDP growth for Q4FY15 posted above our and market expectations at 7.5%YoY. However, for FY15, growth at 7.3%YoY was in line with our expectation due to a strong downward revision to Q3 growth by 90 bps to 6.6%YoY on the basis of availability of incremental information
- ✓ In line with our expectation, headline CPI inflation for the month of Apr-15 moderated to 4.87% YoY (Bloomberg consensus: 4.90%; YBL estimate: 4.78%) from 5.25% in Mar-15 (revised upwards from 5.11%).
- ✓ HSBC PMI Manufacturing rose to 52.6 in May from 51.3 in April; accelerating to a four month high driven by output and new orders indices
- ✓ Registering 49.6 in May, from 52.4 in April, the seasonally adjusted HSBC India Services Business Activity Index stood in the contraction zone
- ✓ In FY15 CPI inflation registered a growth of 6%, much below the RBI's target of 8%.





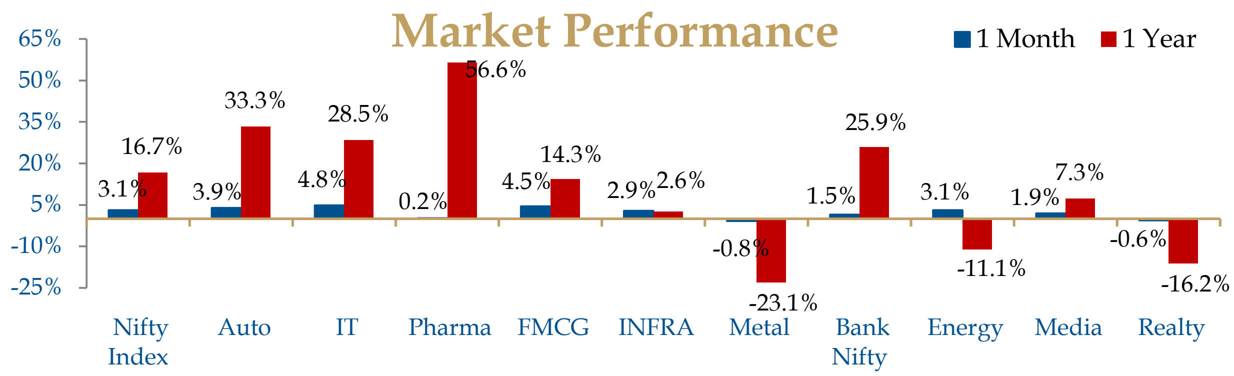
We expect:

- ✓ We expect GDP growth of ~ 7.6-7.8% for FY16 (lower than earlier expectation of 7.8%-8.1) on expectation of resilience in services and improvement in manufacturing GVA in the coming quarters as the cumulative impact of policy measures, lagged impact of lower interest rates, subdued inflation and a gradually improving global economic cycle plays out.
- ✓ Monsoon has emerged as the key risk for inflation going forward. Some of these risks can be attenuated by the government through efficient management of the food economy vis a vis 2014. In our baseline scenario, CPI inflation could undershoot 6% target for January by 50 bps. However, the extent of undershooting may shrink as per the severity of the monsoon shock.
- ✓ A final 25 bps cut cannot be ruled out in our baseline scenario although poor monsoon outturn will strengthen the case for caution and status quo on monetary policy for the rest of FY16.
- ✓ We expect 10Y g-sec yield to trade close to 7.35% by end of FY16 with an upside risk. Recent sell off in the global bond market and concerns of poor monsoon have increased the risks to the upside.
- ✓ We continue to expect USDINR to depreciate to 64.50 by Sept-15 in line with impending Fed rate hike. Eventually improvement in growth-inflation fundamentals could guide Rupee stronger. We expect USDINR

to trade at 63 by Mar-16. However, higher inflation amid continued strength of the US Dollar could exert some upside pressure.

Equity Market Insights

- The month of May saw the Indian stock markets go through a volatile phase. Despite the volatility, BSE SENSEX closed at 27,828, higher by 3.03% for the month while the Nifty closed at 8,434; up by 3.08% during the same period. The CNX Mid-Cap index relatively outperformed with gains of 3.87% during the period while CNX Small-cap index relatively underperformed with returns of 1.88%.
- The FII's have booked profits in Indian equities during the month which in turn led to an outflow of ~$ 0.8bn, while DII's were net buyers by ~ $0.7bn during the same period.



Factors to Watch

- In the coming months we expect more announcements to be made which would provide more clarity to the broad themes and measures that were announced during the Budget. These measures would help revive earnings growth for corporate, however we expect signs of a turnaround to become visible only after 2 to 3 quarters. A crucial point which most market participants are watching out for is the development surrounding the Land Bill. Any progress on this front could be viewed as a re-rating trigger for 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 in Greece and further policy as well as political announcements in the Euro zone and US. 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 March quarter earnings growth for CNX-100 and Nifty alike was one of the lowest in about 20 quarters. It clearly reflects the impact of the slowdown in the economy that we have seen till now (based on old series GDP data) on the corporate earnings. We believe that earnings should turnaround going forward. Our belief is based on the following: 1. Government's focus and commitment towards improving infrastructure. 2) Pro-reform attitude which should lead to better execution. 3) Improvement in economic growth which would lead to a growth in demand and investments. 4) Lower commodity prices which would aid margin expansion for companies. 5) Lower interest rates leading to lower interest outflow thereby leading to higher earnings. And finally a benefit in corporate taxes which the government has announced during the Budget speech. All these factors combined should lead to better earnings growth going forward.
- In terms of valuations, the SENSEX is trading at a trailing twelve month PE multiple of 19.9 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 15.1 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. However based on technical's, 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.

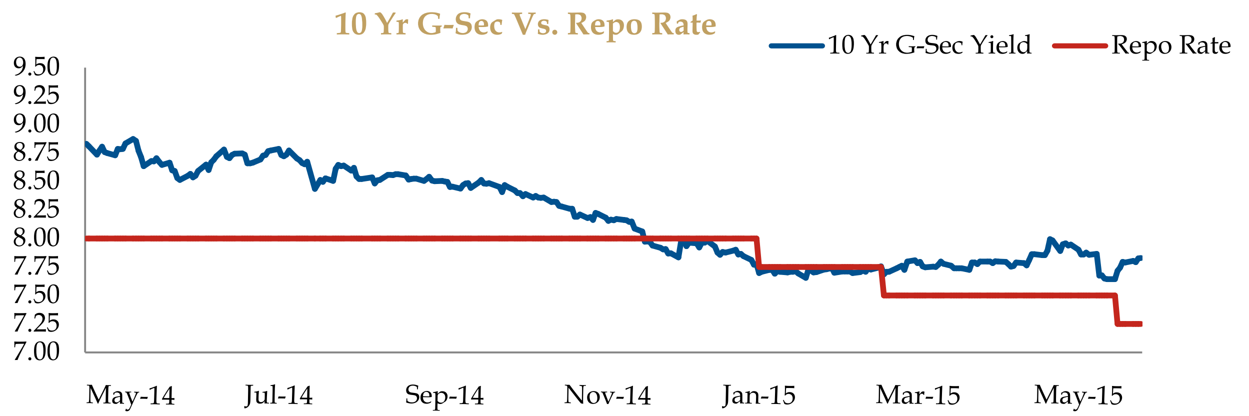
- From a long term perspective we continue to remain positive on companies in infrastructure, capital goods and private sector banks. Investors could also look at investing in select stocks in the auto and auto ancillary space.

Debt Market Insights

- The average systemic liquidity deficit in May rose to an avg INR 1023tn from INR 796bn in April
- Average 10 yr yield during May rose to 7.85% from 7.77% in April. Lack of visibility of further rate cuts given RBI's concern on monsoon and global bond market sell-off were the two main factors for the rise in yields.
- In line with expectations, the RBI eased repo rate by 25 bps to 7.25% taking the cumulative monetary easing to 75 bps in the calendar year so far
- For FY16, the RBI revised:
  - GDP growth downward to 7.6% from 7.8% estimated earlier
  - CPI inflation to 6% - somewhat higher than the levels provided in April
- We expect 10Y g-sec yield to trade close to 7.35% by end of FY16, while we believe impending interest rate hike in the US in 2015 could provide some volatility.

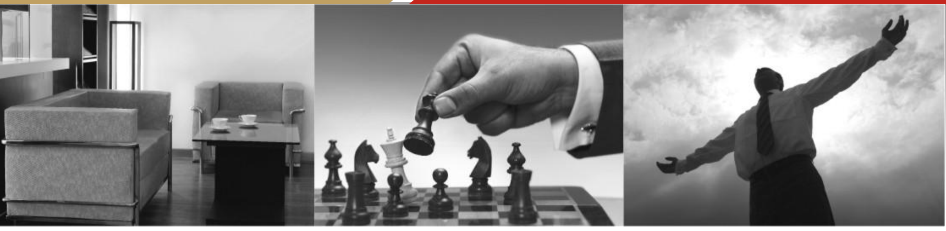
Outlook and Expectations

- The 10 Yr G sec yields were ranged within 7.64% to 8.00% levels for the month of May.
- While we continue to expect 25 bps cut as our baseline scenario, poor monsoon outturn will strengthen the case for caution and 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 – June 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.

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