FIRST Insights

Global Political Developments to takes Center Stage

As prospects of weaker growth scenarios become more tangible, concerns about global economic recovery have dominated the global risk sentiment. The downside risks have become more apparent amidst subdued global trade, weak PMI readings globally and volatility in commodity prices. The momentum of manufacturing globally remains dogged by insufficient demand and excess supply. Global Manufacturing PMI fell further to 50.1 in April, (from 50.6 in March) amidst weakness observed in both developed and emerging markets indices underscoring the weakness in industrial sector.

Notwithstanding negative interest rates in both Europe and Japan, the euro and the yen have appreciated against the dollar. While the US Fed delivered a dovish tone in its latest FOMC meeting in Apr-16, the BoJ fell short of market expectations to provide additional stimulus thereby causing some disappointment. Financial market volatility is expected to increase with upcoming UK's vote on Brexit on June 23 and political developments in US. Continued concerns on slowdown in China are expected to add further pressure amidst a sharp contraction in imports and weak exports demand observed in April-led by lower shipments to US, Asia and EU. The outlook was further dimmed by lower than expected April PMI manufacturing print driven by stagnation in new orders and a sharp fall in new export work.

On the domestic front lead indicators suggest a moderate recovery, capped by sluggish external and subdued domestic investment demand. India's manufacturing PMI fell to a 4-month low in Apr-16 amid moderation in pace of output and new orders. Softer expansion in private sector output was also confirmed by moderation in April PMI services following a 3 year high registered in March. However, momentum in PMI services continues to remain strong. Meanwhile credit growth moderated in March after improving for the previous 4 months

Mar-16 core sector expanded at a 16 month high of 6.4%YoY on back of a strong 5.7% growth in Feb-16 driven by (1) strong favorable base, (2) development spending ahead of state elections (3) fertilizer demand following projection of good monsoon (4) traction in road construction and (5) surge in power supply in response to rising demand amidst soaring mercury levels. Additionally, in a reflection of gradual uptick in economic activity, auto sales continued to post strong numbers especially in commercial vehicle and two wheeler segment. Moreover, Q4FY16 earning reports have also indicated a gradual traction with 63% of the firms (according to media reports) beating market expectations for net sales. While low commodity prices continue to underpin profit margins, increase in net sales points towards an encouraging trend.

Going forward in FY17, India's economic recovery is expected to gain traction. Recovery in rural demand given government's focus on rural spending and projected normal monsoon, Pay Commission and OROP payouts and continuing focus on reviving investment demand through improvement in ease of doing business, and emphasis on public capex should allow recovery to acquire a more sustained character. The improvement in government's legislative business through passage of Mines and Minerals Bill 2015, passage of 'The Insolvency and Bankruptcy Code' in lower house of parliament and Amendment to the Companies Act 2013 would be additionally supportive.

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Global Macro Developments

- US ISM rose at a more moderate pace in April (50.8, Previous: 51.8), below market expectations, though a rise in export orders to almost a 1-1/2 year high offered hope for the otherwise weak manufacturing sector.
- US economy added the least jobs in 7-months in April (+160k, Previous: +208k, Forecast: +202k), in a sign that labor market strength could be taking a breather; growth in wage earnings remained muted at 0.3%.
- Markit Euro zone manufacturing PMI for April was recorded a tad higher from previous month (51.7, Previous: 51.6). While production and new orders slowed, job creation gained strength and deflation pressures eased.
- ECB President Draghi said that low rates are "the symptom of an underlying problem" on the fiscal side, with specific reference to Germany.
- Japanese authorities could intervene in the currency market if the "one-sided" trend in JPY persists, though there no plans to manipulate currency moves on a long-term basis, as per Finance Minister.
- Caixin Manufacturing China PMI moved further into contraction zone in April (49.4, Previous: 49.7, Forecast: 49.9), led by a fall in new orders.

Events and Data Calendar

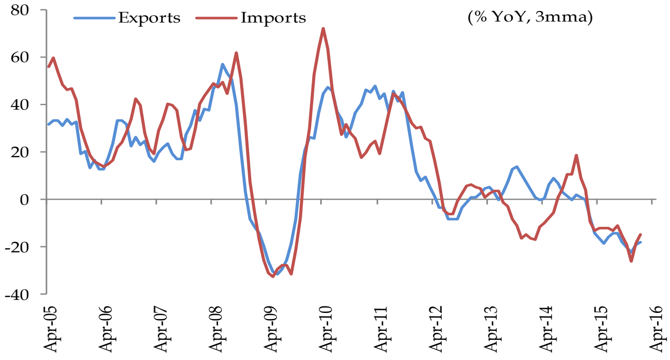
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
China	4/13/2016	Trade Balance CNY	(MAR)	203.65bn	194.60bn	209.50bn	⇩
Japan	4/28/2016	National Consumer Price Index (YoY)	(MAR)	0.00%	-0.10%	0.30%	⇩
US	4/26/2016	Durable Goods Orders	(MAR P)	1.90%	0.80%	-3.00%	⇧
	4/27/2016	Federal Open Market Committee Rate Decision	(APR 27)	0.50%	0.50%	0.50%	⇨
	4/28/2016	Gross Domestic Product (Annualized)	(1Q A)	0.70%	0.50%	1.40%	⇩
EU	4/29/2016	Consumer Price Index Estimate (YoY)	(APR)	-0.10%	-0.20%	-0.10%	⇩
	4/29/2016	Gross Domestic Product s.a. (YoY)	(1Q A)	1.40%	1.60%	1.60%	⇨
UK	4/27/2016	Gross Domestic Product (YoY)	(1Q A)	2.00%	2.10%	2.10%	⇨

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

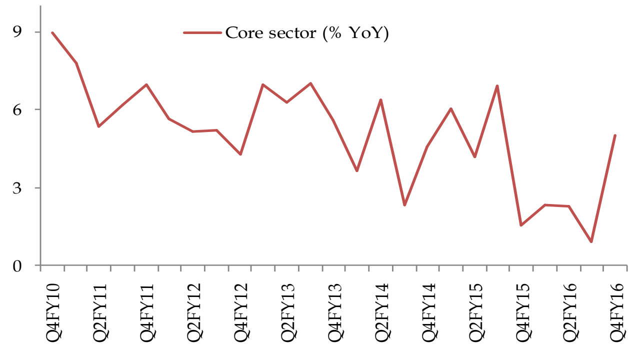
COMMODITY

- Gold prices remained steady in April, following a 3.5% MoM expansion in Mar-16; on back of global weakness in the greenback after the US Fed and the Bank of Japan's policy statements buoyed the price of the dollar-denominated precious metal
- Brent prices expanded 5.7%MoM in Apr-16, after expanding 14.8% MoM in Mar-16, as a seventh consecutive weekly decline in US crude production and a weak dollar boosted the price of the commodity.

Domestic Market Macro Economics

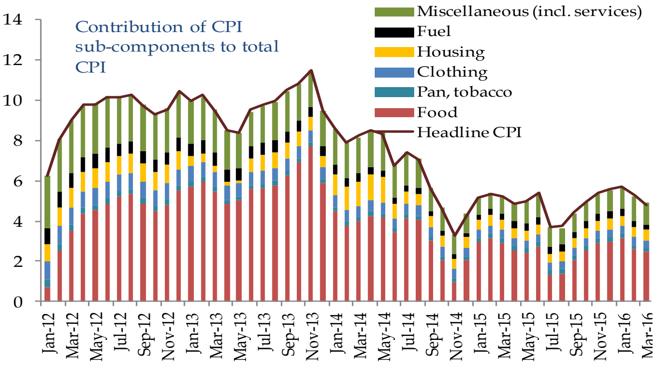


India's Merchandise trade performance remained weak in FY16

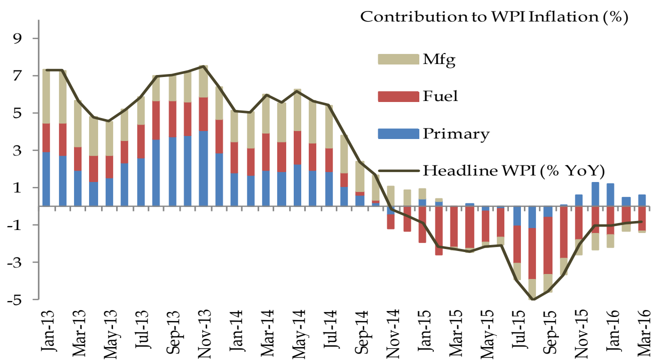


India's core sector output recovered in Q4FY16

- ✓ As per government's advanced estimates, GDP growth is estimated to improve to 7.6% in FY16 from 7.2% in FY15. GVA growth is estimated to improve to 7.3% in FY16 from 7.1% in FY15. On a full year basis, this will record the highest real economic growth in the new national account series beginning FY12
- ✓ India's Manufacturing PMI fell to a 4-month low of 50.5 in Apr-16 from 52.4 in Mar-16 driven by moderation in pace of output and new orders.
- ✓ Growth in core sector expanded to a 16 month high of 6.4%YoY in Mar-16 led by sharp uptick in Fertilizers, Cement, and Electricity and Refinery Products segments.
- ✓ India's merchandise trade deficit for Mar-16 narrowed to USD 5.1 bn (Bloomberg consensus: USD 6.7 bn; YBL expectation: USD -7.0 bn), the lowest in last five years. The improvement in trade deficit was driven predominantly by weakness in imports with annualized rate of contraction at 21.6% while the annualized rate of contraction for exports moderated to its lowest level of 5.5% in FY16. For FY16, both exports and imports contracted between 15-16%.
- ✓ After 3 consecutive negative prints, India's IIP registered an expansion of 2.0% YoY in the month of Feb-16 (YBL estimate: 3.0%; Prior; -1.5%). However production momentum is still lower than what was implied by some of the lead indicators like the core sector index, automobile production, and external trade data.



Across the board comfort on Headline CPI in FY16



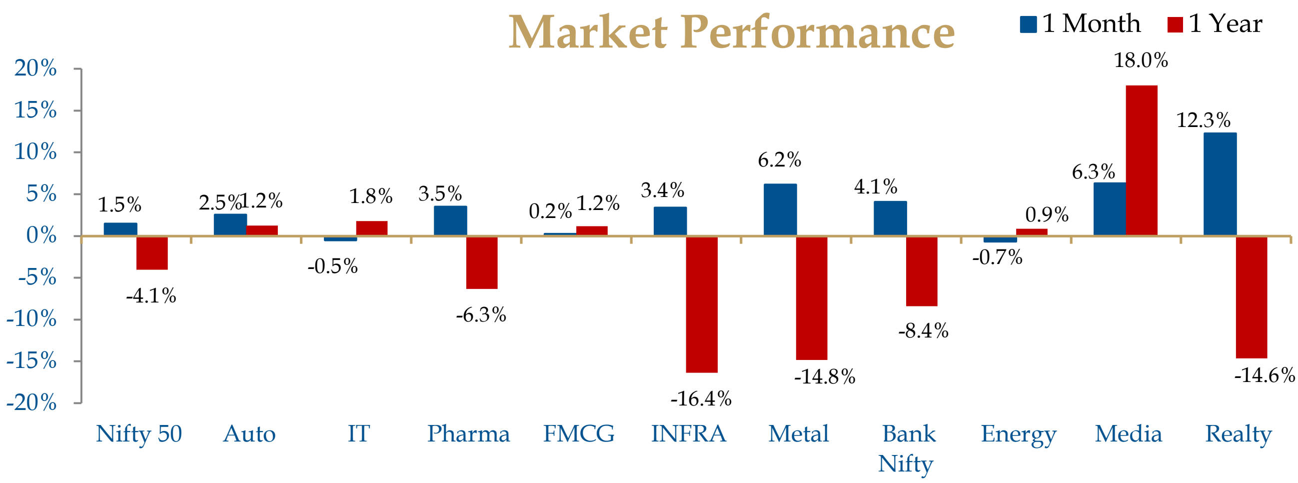
India's WPI remained in deflationary zone in FY16 on lower fuel and manufacturing inflation

We expect:

- ✓ Our FY16 CAD 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.
- ✓ For FY17, we continue to stick to our GDP growth forecast of 7.8% assuming a normal monsoon outturn, lagged impact of monetary easing, government's infrastructure push and the boost to consumption from revision in wages for government employees.
- ✓ We expect USDINR to remain 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

- Forecasts on the monsoons lent a cheer to the Indian stock markets during the month of April. BSE Sensex closed at 25,607, higher by 1.04% for the month while the Nifty closed at 7,850; up by 1.44% during the same period. The CNX Mid-Cap and CNX Small-cap indices outperformed with returns of 3.47% and 6.48% respectively during the month.
- During April, FPI flows continued on a positive note. There was an inflow of US$ 0.5 bn in the equity markets and of US$ 0.3 bn in the debt markets taking the total tally to a net inflow of US$ 0.8 bn during the month. DII's were net seller and there was an outflow of $0.40 bn during the same period.



Factors to Watch

- As the result season continues, the month of May is likely to see an increase in volatility in the Indian stock markets. The results announced so far have been a mixed bag with indications that recovery in a meaningful manner is still a while off. One thing that has emerged is that investors clearly do not have the appetite for companies that are missing estimates in any way. It must be kept in mind that the estimates have already been revised downwards over the past one year. With most companies (that have reported results) giving indications that demand is either stable or subdued, we could see more downgrades in the near future.
- While headline numbers are yet to pick up for companies, indicators on the ground seem to suggest that things are improving and that it is just a matter of time that earnings growth comes back in a meaningful way. We base the assumption of recovery on 3 important factors – 1. Monsoons: As of now the estimates and indications as given by both Skymet as well as IMD are that the monsoons this year would be better. This in turn would have a positive impact on the rural economy and therefore on the rural driven consumption. 2. Project clearance and orders data: The data on projects getting cleared and awarding of orders has gone up in recent times. For instance there is traction on awarding orders on the metro side. 3. Pick up in industrial activity: The data on core industry growth has been positive with core industry growth increasing to 6.4% in March, a 16 month high.
- Investors would also be keeping a close eye on commodity prices particularly that of crude. In the near term, global issues are the major risk to Indian stock markets particularly from the point of view of foreign fund flows.

Outlook & Expectations

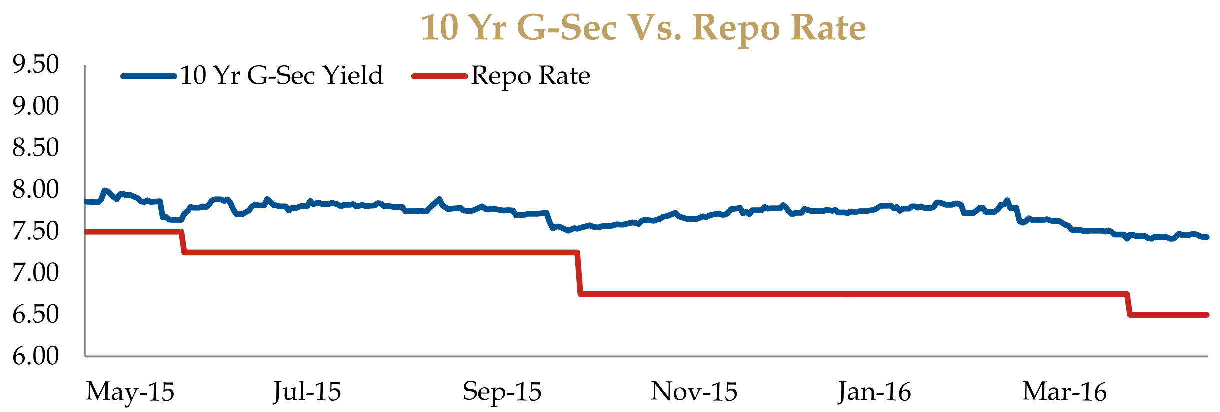
- In terms of valuations, the Sensex is trading at a trailing twelve month PE multiple of 19.3 times which is slightly above its long term historic average of 18.2 times. On a forward earnings basis the Sensex is trading at a multiple of around 15.8 times, which suggests that markets are not expensive 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.
- Going forward, we continue to remain optimistic on the agri sector. Revival of the rural economy would have a multiplier effect on sectors that are driven by consumption.

Debt Market Insights

- ✓ The average systemic liquidity deficit in Apr-16 reduced to an average INR 1,021 bn as compared to INR 1,889 bn in Mar-16 on the back of government spending. On a fortnightly basis, government's surplus cash balance (with the RBI) declined from INR 1,140 bn in Mar-16 to avg of INR 384 bn in Apr-16.
- ✓ Average 10 yr yield during Apr-16 eased to 7.44% from 7.57% in Mar-16.
- ✓ RBI conducted OMO purchases worth INR 30k cr to boost primary liquidity in the month of April. This amid projection of normal monsoon by IMD raised the expectations of rate cut by RBI.
- ✓ Mar-16 CPI inflation slowed to a six-month low of 4.83% YoY from 5.26% in February lower than our and market forecasts. The biggest downside surprise on the headline inflation came from 'fuel & light' index where prices declined by 0.65% MoM, marking first sequential decline since Sept-15
- ✓ WPI inflation in March fell marginally to -0.85%YoY (vs. -0.91% in Feb-16), in line with our expectations to mark the 17th consecutive negative print. Imparting some downside to WPI momentum, primary articles price continued to decline in March, albeit at a slower pace

Outlook and Expectations

- ✓ We continue to expect RBI to ease policy rate by 25 bps in its policy review in Jun-16 amidst government's continued commitment towards fiscal consolidation along with concerted focus on alleviating supply side bottlenecks. Additional space for monetary easing is likely to be supported as:
  - ➢ While RBI is expected to look through the first round impact of house rent allowance under Pay Commission, the second round impact too is likely to be subdued given restrained global commodity prices, low capacity utilization and sluggish recovery in demand leading to weak pricing power.
  - ➢ IMD's initial forecast for monsoon at 106% of LPA for 2016 is reassuring and is expected to keep the momentum on food prices contained.



Model Portfolios – May 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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