Crude oil surges & global bond sell off dominate the market

April witnessed resurgence in crude oil prices, which soared by as much as 13% driven by factors such as fluctuating Libyan oil production and Saudi Arabia's military intervention in Yemen amid first weekly decline in the US oil inventories as oil rig count in US continued to decline. The oil price rally came despite the sobering growth data in China and US.

Apart from rise in oil prices, over last few days global financial markets have seen significant volatility led by sharp rise in bond yields especially in the advanced economies. The US 10 yr yield rose by 38 bps to a high of 2.24% on May 6, 2015 in 14 trading sessions. During the same period, yield on German 10 Yr Bunds rose by 51 bps. The expectation of rise in interest rate in US amid rise in oil prices seem to have been cited as main reasons for the recent sell off in the bonds. A faster rise in oil prices will lead to quicker rise in inflation levels in the West which in turn could prompt Fed to raise rates sooner even as the incoming data in US continued to remain soft. US first quarter GDP expanded at 0.2% much below the expectation of 1.1% growth. Consistent with GDP report, April FOMC statement downgraded its assessment of economic conditions. Weaker economic activity was in part contributed by temporary factors such as harsh weather and stronger dollar.

Meanwhile, macroeconomic data from the Eurozone suggests modest recovery was underway as tailwinds in form of central bank's stimulus and favorable currency continued to support mild cyclical upswing. In line with the improving outlook, European commission upgraded its growth forecast for Eurozone by 20 bps to 1.5% for 2015 from its earlier forecast in February.

Data from China showed its economy expanded by 7.0% in Q12015, slowest since 2009. Exacerbating concerns of slowdown in China, the manufacturing Purchasing Managers' Index (PMI) fell to 48.9 in April (vs. 49.6 in March), the lowest level since April 2014. In response to the weak growth conditions, China cut interest rates by 25 bps - the third cut in six months.

On domestic front, data release in March-April indicated that pace of economic recovery eased somewhat. On the upside, monthly credit offtake improved for the 4th straight month in March, although it continued to lag on YoY basis. Core sector posted a flat reading in Mar-15, with key sectors such as cement and steel posting negative growth and coal and electricity sector growth fell sharply. Private sector output also moderated in April with PMI services and manufacturing remaining in lower gear relative to previous month. PMI manufacturing growth moderated after a solid expansion in Mar-15 on account of softness in domestic demand.

The recent unseasonal rains and India Meteorological Department's (IMD's) below normal monsoon forecast (93% of long period average) has further clouded the outlook, particularly for rural demand. Nevertheless we believe its early days and as such we await IMD's 2nd forecast in June before assessing the likely impact. In addition, the recent firming up of crude oil prices precipitated by geopolitical unrest poses potential short term headwinds. Going ahead, we believe, gradual progress on structural policy and administrative reforms by government will hold key towards a sustained revival in the economy.

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FIRST Insights

Global Macro Developments

- US GDP expanded at a 0.2% seasonally adjusted annual rate in Q12015 (vs. consensus estimate of 1.1%) as businesses slashed investment, exports declined and consumers showed signs of caution.
- US non-farm payrolls rose by a seasonally adjusted 223k in April in line with expectations compared to downward revised 85k in Mar-15.
- US Fed Chair Janet Yellen said high equity valuations could pose potential dangers but that stability risks across the US financial system remained in check.
- Japan's industrial output fell slightly in March for the second straight month of decline as the nation struggles to grow despite lower oil prices and a booming stock market. The 0.3% fall was much smaller than a consensus estimate of 2.3%.

Events and Data Calendar

Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
US	06/04/2015	ISM Non-Manufacturing Composite	(MAR)	56.5	56.5	56.9	↓
	14/04/2015	Advance Retail Sales	(MAR)	1.10%	0.90%	-0.50%	↑
	17/04/2015	Consumer Price Index (YoY)	(MAR)	0.00%	-0.10%	0.00%	↓
	24/04/2015	Durable Goods Orders	(MAR)	0.60%	4.00%	-1.40%	↑
	28/04/2015	US Consumer Confidence	(APR)	102.5	95.2	101.4	↓
	30/04/2015	Personal Consumption Expenditure Core (YoY)	(MAR)	1.40%	1.30%	1.30%	→
EU	24/04/2015	German ZEW Survey (Economic Sentiment)	(APR)	55.3	53.3	54.8	↓
	30/04/2015	Consumer Price Index - Core (YoY)	(APR A)	0.60%	0.60%	0.60%	→
Japan	03/04/2015	Markit/JMMA Japan Composite PMI	(MAR)		49.4	50	↓

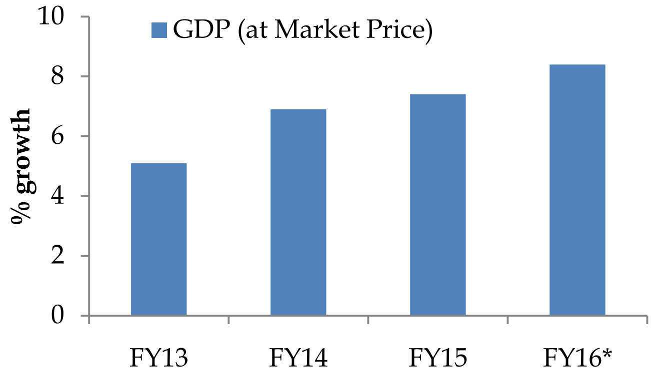
P* – Provisional Estimates F* - Final Estimates A*- Advanced Estimates T*- Third Estimates

COMMODITY

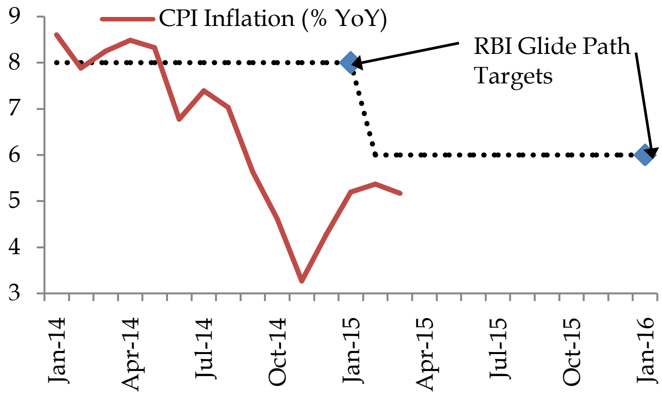
- Gold registered a 1.74% MoM expansion in April-15 as compared to a 3.8% MoM contraction in Mar-15, as weak economic data in the US, continuing debt concerns in Greece, and fall in global stock markets increased demand for the precious metal.

- WTI increased 9.3% MoM in April-15 compared to a 6.8% MoM decline in Mar-15 on renewed concerns of geo-political tensions in Yemen and as the Chinese central bank announced a bank reserve ratio cut in an attempt to inject liquidity into the economy.

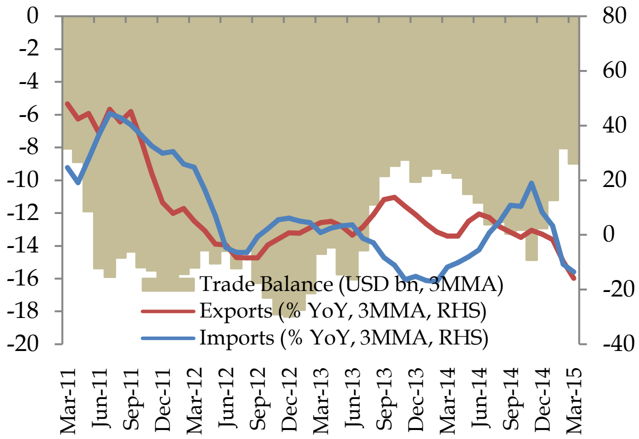
Domestic Market Macro Economics

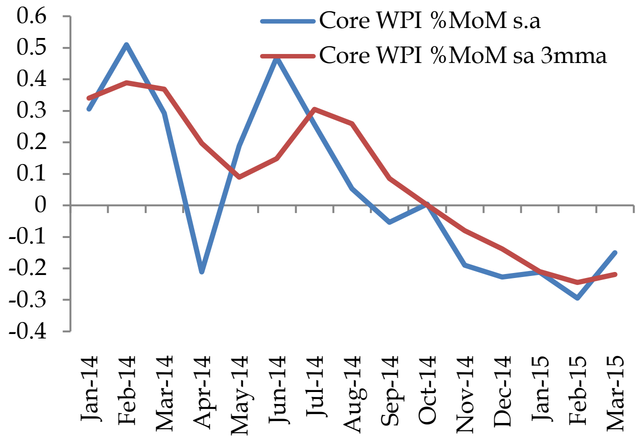


base:2011-12 * YBL estimate



- ✓ In line with our expectations, the RBI maintained status quo in April monetary policy after the pre-emptive rate cut in March
- ✓ For FY16, the RBI estimates GDP growth to improve moderately to 7.8% from 7.5% in FY15 while CPI inflation to move towards 5.8% in Mar-16, somewhat lower than the 6% target
- ✓ Core sector output posted a flat reading of -0.1%YoY in Mar-15 (vs. 1.4% in Feb-15), taking the full year growth to 3.6% in FY15, lower than 4.2%YoY in FY14
- ✓ India's FY15 trade deficit declined to USD 140bn (vs. USD 147bn in FY14) as imports contracted more than exports. Exports contracted 2.2% while imports contracted by 8%. The decline in imports was driven by 23% contraction in oil imports on account of decline in international crude oil prices.
- ✓ In line with our expectation, headline CPI inflation for the month of Mar-15 moderated to 5.17% YoY from 5.37% in Feb-15 driven by favorable base. However, the sequential gains in the headline index, increased by 0.33% MoM, the highest in the 7 months.
- ✓ In FY15 CPI inflation registered a growth of 6%, much below the RBI's target of 8%.
- ✓ HSBC PMI Manufacturing moderated to 51.3 in Apr-15 from 52.1 Mar-15; driven lower by softness in domestic demand.





We expect:

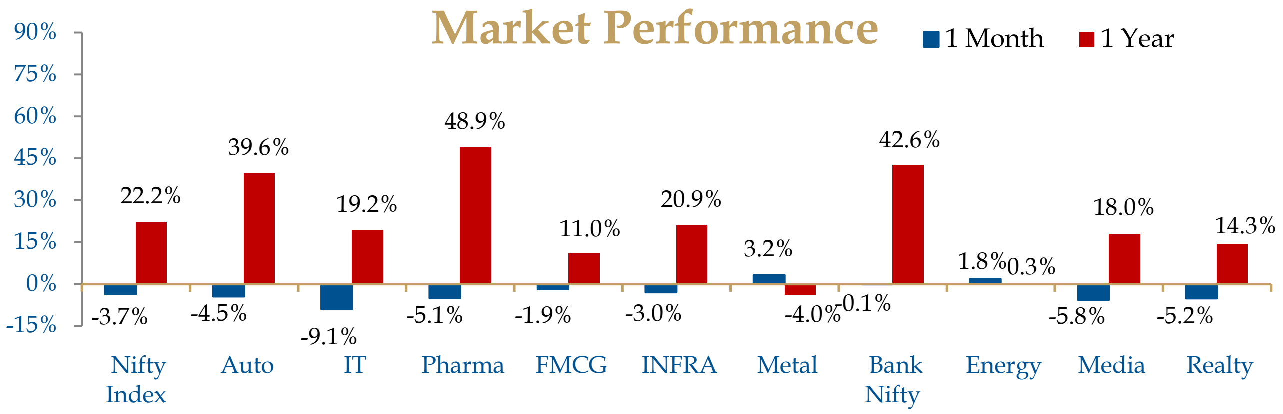
- ✓ FY16 GDP growth is expected to improve by 80-100 bps over the FY15 growth of 7.4%
- ✓ We continue to expect a further moderation in CPI inflation to an average level of 5.5% in FY16 from 6.0% in FY15 on back of restrained MSP adjustments amidst gradual legislative and administrative progress in debottlenecking of supply side constraints.
- ✓ While IMD's has predicted a below normal monsoon (93% of LPA) in its preliminary forecast, we would await IMD's second forecast in June before assessing the likely impact on retail inflation and growth.
- ✓ We continue to stick to our baseline call of another 25 bps repo rate cut by Jun-15 with the possibility of a further 25 bps easing by Sep-15 conditional upon crude oil and food prices remaining soft

- 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, downside risks could guide 10Y g-sec yield potentially to 7.15%.
- 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.

Equity Market Insights

- The month of April saw the Indian stock markets continue with the phase of consolidation. The benchmark BSE SENSEX closed at 27,011, down 3.45% for the month while the Nifty closed at 8,181, down by 3.66% during the same period. The CNX Mid-Cap and CNX Small-Cap indices relatively outperformed with returns of -1.93% (12,689) and -2.19% (5,461) respectively during the month.

- The FII continued to remain optimistic about Indian equities during the month which in turn led to an inflow of ~$ 1.8bn during the month, while DII's were also net buyers and ~ $0.6bn during the same period.



Factors to Watch

- Updates on reforms and/or measures to enable further reforms: 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

- In terms of valuations, the SENSEX is trading at a trailing twelve month PE multiple of 18.4 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 15.2 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 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.

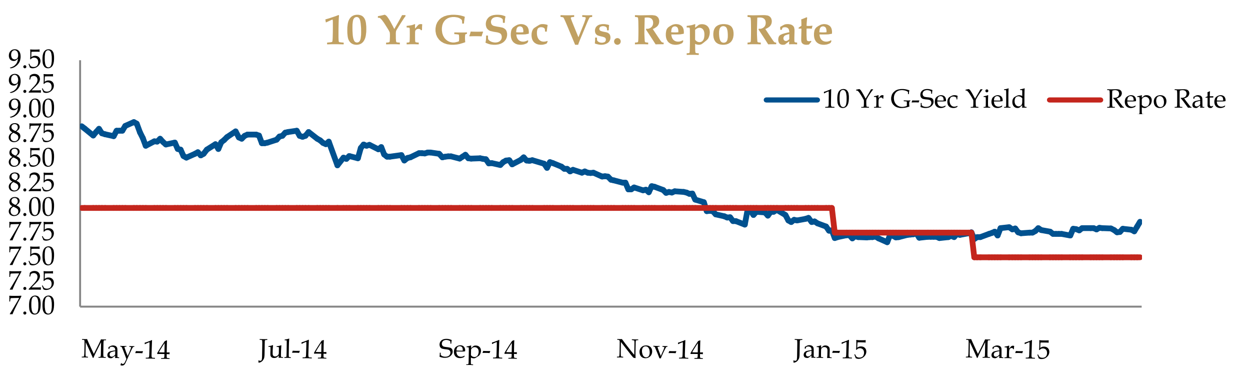
- From a long term perspective we continue to remain positive on companies in infrastructure, consumer durables and private sector banks. Investors could also look at investing in select stocks in the auto and auto ancillary space.
- From a longer term perspective, i.e. from a 2 to 3 years' horizon, 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 April remained largely unchanged as compared to March. Liquidity deficit in April reduced marginally to an average INR 861bn as compared to INR 898bn in March.
- Average 10 yr yield during April remained largely unchanged at 7.77% from 7.75% in March. However, a sharp rise in yields was witnessed during the end of the months. 10 yr yield rose to a high of 7.99% on May 7, 2015 from 7.75% on Apr 23, 2015 following a global sell off in government bonds.
- 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, downside risks could guide 10Y g-sec yield potentially to 7.15%.

Outlook and Expectations

- The 10 Yr G sec yields were ranged within 7.72% to 7.86% levels for the month of April.
- We continue to stick to our baseline call of another 25 bps repo rate cut by Jun-15 with the possibility of a further 25 bps easing by Sep-15 conditional upon crude oil prices remaining soft.
- 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 – May 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**

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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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