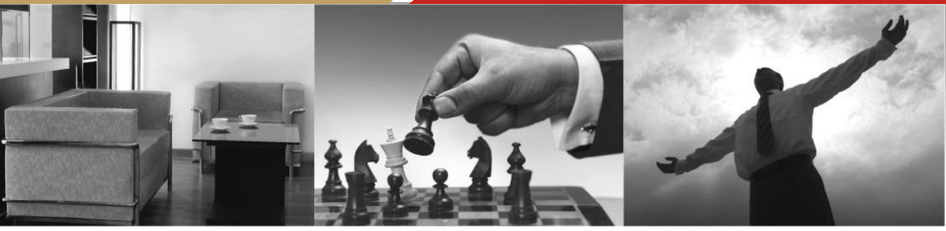


US Fed ends QE but Bank of Japan steps in

The global economic backdrop in the month of October was characterized by changing liquidity landscape. On one hand, US Federal Reserve ended its quantitative easing programme, on the other; Bank of Japan expanded its own bond buying programme by an additional JPY 30 tn, increasing its annual pace of purchase of Japanese bonds to JPY 80 tn.

Although European Central Bank has so far stayed away from large scale government bond purchases, it has started purchasing covered bonds under the new scheme and is soon likely to initiate purchase of asset backed securities.

The recent divergence in the monetary policy stance among central banks of US, EU and Japan reflects the uneven pace of economic growth in the world economy. The US economy continued to show strength with unemployment rate falling to 5.8% in Oct-14, lowest level since July-08 and economy growing by 3.5% in Q3 2014 exceeding market expectations of 3% growth.

However, recent economic data from Euro zone remained sluggish indicating insipid growth momentum. Retail sales contracted by 1.3%MoM in Sep-14 and remained flat in Q3-2015. The moderation in retail sales was indicative of subdued spending in euro zone which was corroborated by fall in core inflation to 0.7% in Oct-14 from 0.8% in Sept-14. The disinflationary trend amid weak growth momentum offer little comfort and suggest that ECB could consider unconventional measures to boost growth in coming months.

In China, consumer price inflation at 1.6% YoY in Oct-14 remained near 5 year low and manufacturing sector growth continued to remain sluggish. Manufacturing PMI moderated in Oct-14 to 50.8 from 51.2 previously. The continued softening of growth momentum in China has increased expectations that policy makers could take further action to stoke growth.

In India, growth indicators continued to show improvement albeit at a modest pace. Inflation metrics eased and retail inflation declined from its peak of 11.2%YoY in Nov-13 to 6.5% in Sep-14 supported by sharp correction in food inflation and pass-through benefits of steep fall in international crude oil prices. Price of Indian crude basket has declined by ~10% MoM in Oct-14 following ~5% decline in Sep-14.

With domestic and external environment expected to remain favorable in the near term, we have revised downward our average CPI estimate for FY15 to 6.9% from 7.8% earlier.

However, with RBI committed to Jan-16 inflation target of 6%, we expect the central bank to lean on the side of caution and maintain status quo for the remaining part of FY15.

Government measures to ease supply bottlenecks in infrastructure, agriculture and manufacturing amid persistence of softness in global commodity prices is likely to create room for monetary policy easing in Apr-15. We expect a cumulative of 50 bps cut in policy repo rate in FY 16.

Shubhada M. Rao
Chief Economist

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

FIRST Insights

Global Macro Developments

- ✓ The divergence in G-3 monetary policies took more definite shape in Oct -14. The Fed ended QE3, while the ECB has bought some EUR 4.8bn in covered bonds during the first two weeks of its program. Most spectacular was the Bank of Japan announcement on October 31 to increase Japan's monetary base from JPY60-70tn a year to JPY 80 tn annually by stepping up the buying of longer-term Japanese Government Bonds and a wider range of private-sector securities.
- ✓ The J.P Morgan Global Manufacturing PMI stood at 52.2 in October, unchanged from the September reading.
- ✓ At 50.6 in October, up from September's 14-month low of 50.3, the final seasonally adjusted Markit Eurozone Manufacturing PMI registered only marginally above the neutral 50.0 mark, highlighting the tepid growth.
- ✓ Meanwhile, the HSBC China Manufacturing PMI rose to 50.4 in the final reading for October, up from 50.2 in September; signaling only a fractional improvement in overall operating conditions.
- ✓ US ISM factory index stood at 59 in October (vs. 56.6 in September) indicating continued expansion catapulted by growth in New Orders, Production and Employment Indices

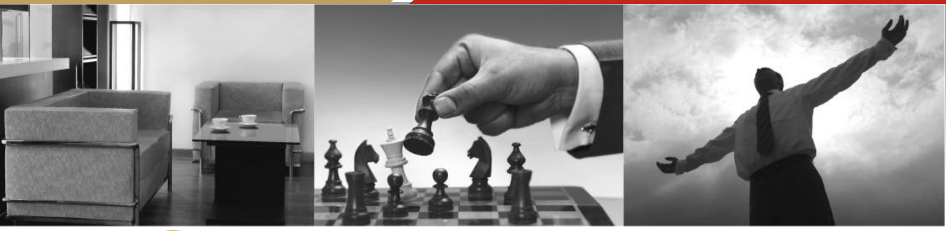
Events and Data Calendar

Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
US	10/01/2014	ISM Manufacturing	Sept	58.5	56.6	59	↓
	10/03/2014	Unemployment Rate (MoM)	Sept	6.10%	5.90%	6.10%	↓
	10/03/2014	ISM Non-Manufacturing Composite (SEP)	Sept	58.5	58.6	59.6	↓
	10/15/2014	USD Advance Retail Sales	Sept	-0.10%	-0.30%	0.30%	↓
	10/17/2014	U. of Michigan Confidence	(Oct P)	84	86.4	84.6	↑
	10/29/2014	US Consumer Confidence (OCT)	Oct	87	94.5	89	↑
	10/30/2014	Federal Open Market Committee Rate Decision (OCT 29)	Oct	0.25%	0.25%	0.25%	→
	10/30/2014	US Gross Domestic Product (Annualized)	(3Q A)	3.00%	3.50%	4.60%	↓
UK	10/14/2014	Core Consumer Price Index (YoY)	Sept	1.80%	1.50%	1.90%	↓
	10/24/2014	Gross Domestic Product (YoY)	(3Q A)	3.00%	3.00%	3.20%	↓
Japan	10/31/2014	National Consumer Price Index (YoY)	Sept	3.20%	3.20%	3.30%	↓
EU	10/14/2014	German ZEW Survey (Economic Sentiment)	Oct	0	-3.6	6.9	↓
	10/28/2014	ECB Announces Covered Bond Purchase	Oct	-	-	-	→
	10/30/2014	German Unemployment Rate s.a. (OCT)	May	6.70%	6.70%	6.70%	→
	10/31/2014	Consumer Price Index Estimate (YoY)	Oct	0.40%	0.40%	0.30%	↑

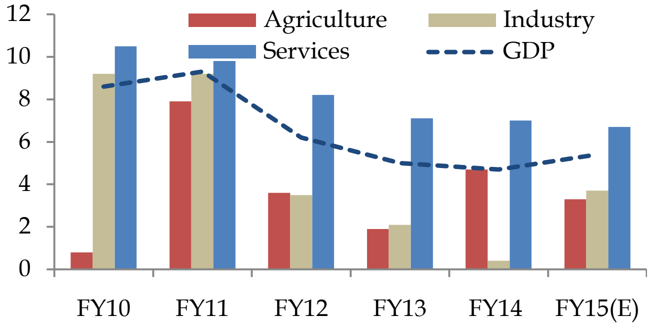
P* – Provisional Estimates F* - Final Estimates A*- Advanced Estimates T*- Third Estimates

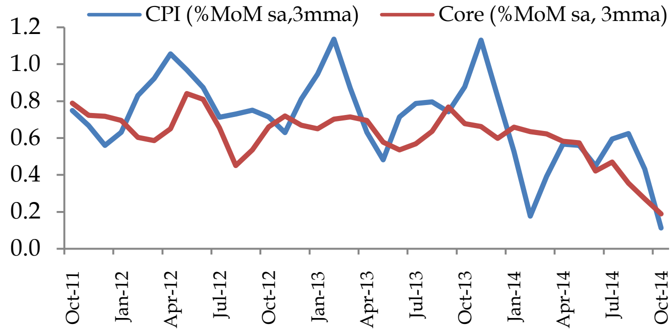
COMMODITY

- ✓ The pace of decline in Gold prices slowed to 1.2% MoM in October as compared to 4.4% MoM decline in September as IMF trimmed its forecast for global growth and weak data from Euro Zone and China bolstered the metal's safe haven appeal. However, fears of imminent hike in US interest rates kept the gains capped.
- ✓ WTI declined 8.7% MoM in October as compared to 2.6% MoM decline in September as OPEC output rose to a 14-month high in October and at the same time global demand momentum showed signs of deceleration. The OPEC signaled that it was comfortable with lower crude oil prices, but was more concerned about preserving its market share in global oil market.

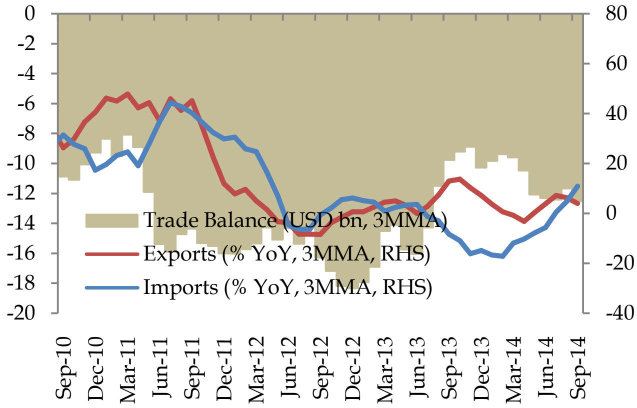


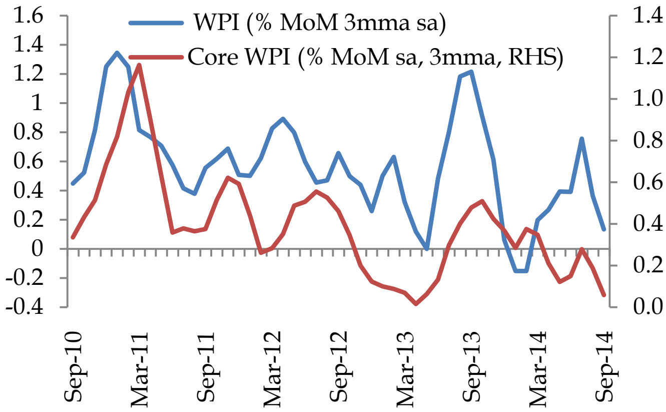
Domestic Market Macro Economics





- India's trade balance during Sept-14 rose to USD 14.2bn from USD 10.8bn in Aug-14 on account of rise in commodity imports following a sharp fall in the global commodity prices.
- CPI inflation for the month of Sept-14 fell to 6.46%YoY as compared to 7.73%YoY on account steep fall in food inflation. Core CPI also fell sharply to 5.90%YoY in Sept-14 from 6.82%YoY previously.
- WPI inflation eased to 2.38%YoY in Sept-14 as compared to 3.74%YoY in Aug-14 supported by favorable base and sharp fall in commodity prices. Encouragingly, core WPI moderated to 2.81%YoY in Sept-14 from 3.45%YoY previously.
- Core sector output growth during Sept-14 moderated to 1.9%YoY from 5.8%YoY in Aug-14; although key sectors such as cement, electricity and coal continued to show strength, on trend.
- HSBC manufacturing PMI ticked higher to 51.6 in Oct-14 from 51.0 in Sept-14 while HSBC PMI Services Business activity index moderated to 50.0 in Oct-14 from 51.6 in Sept-14
- Reserve bank of India kept the repo rate unchanged at 8% in the third bi-monthly monetary policy review



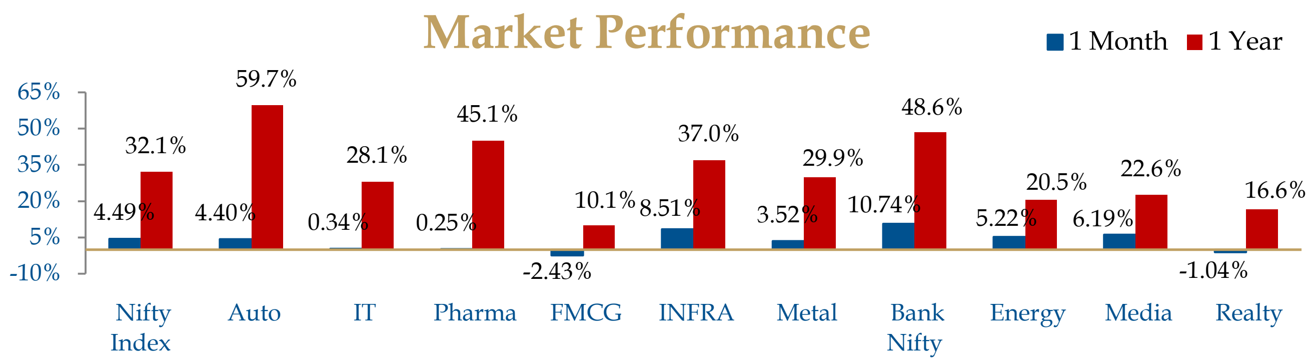


We expect:

- We expect Indian economy to grow by 5.4% in FY15 led primarily by improvement in industrial sector which is estimated to grow at 4.0% in FY15 as compared to 0.4% in FY14. Although weak monsoon is likely to drag agriculture growth lower, improvement in sowing suggests that growth may remain in positive zone. We expect agriculture to grow by 0.8% in FY15 as compared to 3.3% expected earlier and 4.7% in FY14.
- We have revised downward our average CPI estimate for FY15 to 6.9% from 7.8% earlier amid supply side initiatives by government and steep correction in global crude oil prices.
- We expect CAD to increase marginally to 2% in FY15 from 1.7% (of GDP) in FY14 assuming merchandise exports grow by 7-8 % and imports clock a growth of 8.0%. In absolute terms, CAD is expected to go up marginally from USD 32bn in FY14 to USD 42bn in FY15
- With RBI committed to Jan-16 inflation target of 6%, we expect the central bank to lean on the side of caution and maintain status quo for the remaining part of FY15.
- We expect RBI to start easing from April-15, as the visibility of the 6% inflation target will be enhanced by government's expected supply side steps and greater clarity emerging on global trends. We expect a cumulative of 50 bps rate cut in FY16.
- In line with the recent strengthening of US Dollar, we now expect there to be a depreciation bias to our USD-INR call of 59 by Mar-15.

Equity Market Insights

- The month of October saw the Indian stock markets resume their uptrend. The benchmark BSE SENSEX closed at 27,866, up 4.64% for the month while the Nifty closed at 8,322, up by 4.49% during the same period. The CNX Mid-Cap and CNX Small-cap indices too delivered robust returns of 3.7% and 4.1% respectively during the month.
- The hope of a recovery in economic growth has seen continued interest from institutional investors.
- However, FIIs seem to have preferred to book some profits in their equity portfolios that led to a $0.2bn outflow in equities, while the DII's continued to be net buyers of ~ $1.0bn during October.



Factors to Watch

- A key event that is being tracked closely by the markets would be announcements on policy measures by the Government which would strengthen the faith in an impending economic recovery.
- Quarterly earnings: The September quarter earnings season kick started in the second week of October and will continue through most part of November as well. Trends seem to suggest that the earnings for most companies have bottomed out and many companies are now reporting a better set of numbers.
- Other key events that would be watched closely especially by the FIIs would be the geo-political events surrounding Ukraine, growth in the Eurozone, domestic political developments and commodity prices.

Outlook & Expectations

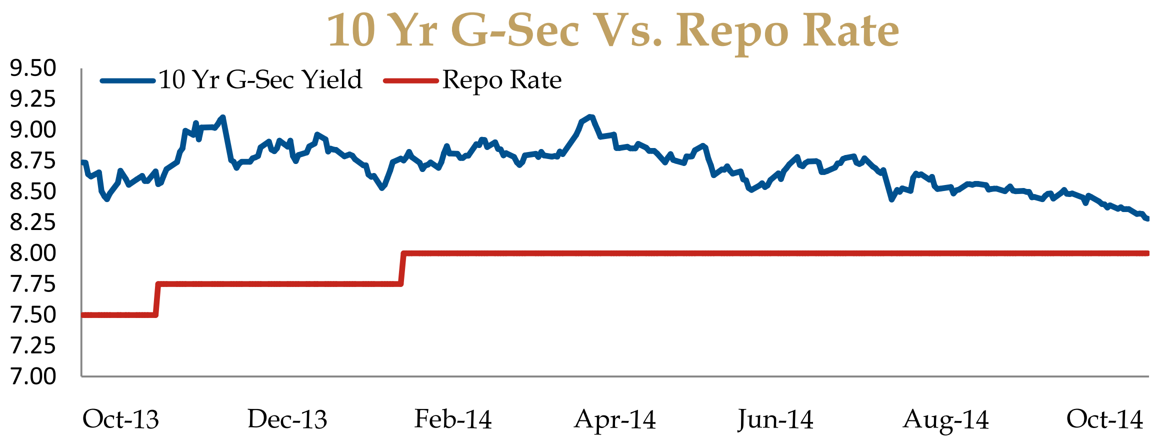
- With regards to the quarterly earnings season, quite a few companies have met street estimates with regards to revenue growth. However there were quite a few misses as well. One thing that seems to be coming out of the announcements is that earnings have bottomed out for most companies. Most of the management commentaries (with the exception of IT that sees a seasonal slowdown in the second half) have indicated that they expect their fortunes to revive. While quite a few companies have indicated that things are expected to improve, but even then they seem to be adopting a wait and watch approach with regards to Government announcements on policy reforms before committing huge investments on the CAPEX front.
- Rolling our earnings estimates to FY15, we had pegged the EPS growth to be around 11%. This is arrived at by applying a multiple of 2x (historic average) to the expected GDP growth rate for FY15. Using this estimate, the SENSEX is currently trading at a forward earnings multiple of 18.9 times which is higher than its 16 year historic average suggesting that despite the run up in prices, stocks are still available at reasonably attractive valuations.. We believe that any correction in the market should be viewed as an ideal time to pick up quality stocks.
- 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. We recommend equity investments through a Systematic Transfer route with a minimum investment horizon of 36 months

Debt Market Insights

- The average systemic liquidity deficit in Oct was recorded at 512bn compared to average Rs 536bn in Sept.
- Average 10 yr yield during October declined to 8.39% from 8.49% in September.
- The decline in yields during the month of October was led by sharp correction in global commodity prices in particular crude oil. Price of Brent declined by 10% MoM in Oct supporting moderation in inflation.
- Despite festive month leading to increase in currency in circulation, higher T-bill redemption and government spending contained the overall liquidity deficit in the banking system.
- On account of comfortable liquidity deficit situation, RBI conducted OMO sales of Rs 65.82 bn.
- Going forward, we expect improvement in the growth-inflation balance driven by complementary policy support from the government in the area of food management and facilitation of project clearances to create room for monetary easing in H1 FY16. We expect a cumulative of 50 bps repo rate reduction during the course of FY16.
- On G-Secs, S&P's India outlook upgrade, in conjunction with fiscal consolidation and expected moderation in inflation levels would help 10Y g-sec yield to drift lower towards 8.10% by Q4 FY15.

Outlook and Expectations

- The 10 Yr G sec yields were ranged within 8.28% to 8.49% levels for the month of October.
- We continue to expect RBI to ease policy rates in H1 FY16 with cumulative easing of 50 bps during the financial year with timing of rate cut guided by the sustainability of correction in global commodity prices.
- 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 – November 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**

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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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