FIRST Insights

China sets off global gyrations

The month of August was dominated by gyrations in the global financial markets. China's devaluation of Yuan marked the point of set off, with the currency depreciating by close to 3.0% in August. The surprise move to align Yuan to "market forces" followed by easing of policy rates and additional stimulus, have raised questions on the strength of China's economic growth. These has triggered global risk aversion and sent world equity markets, commodities and currencies in a commotion.

The safe heaven currencies such as yen and euro rose on risk off trade and US Treasury's yields tumbled to 4 month low as investors rushed to low risk assets amid growing uncertainty. Global growth dynamics also turned precarious especially of emerging economies, (which have close trade ties with China) and those driven by commodity exports. The continued weakness in data suggests challenges facing China remain daunting as highlighted by China's manufacturing PMI which fell to its lowest in 77 months (47.1 in August vs. 47.8 in July).

Meanwhile amid a relatively dovish July US Fed minutes and global volatility due to China, rate hike expectations in US took a backseat, only to resurface later on positive data surprises. Revised US Q2-2015 data showed that US grew faster than initial estimates (3.7% vs. the first estimate of 2.3%). Meanwhile first set of Q3 data also offered signs of economic recovery gaining traction with US durable goods posting a surprise increase in July (+2.0%, Forecast: -0.4%). Amid a dimmed inflation outlook and improving growth, September FOMC meeting will be closely watched for cues on timing of US Fed's interest rate rise.

Across the Atlantic, ECB president Mario Draghi eased some conditions of quantitative easing by raising the shares of bonds that ECB can buy to 33% of each issue from 25% earlier. More so, it remained dovish as it trimmed down outlook on growth and inflation.

Meanwhile, Bank of Japan refrained from expanding its stimulus programme at its latest meeting. However with consumer prices (Latest +0.2% YoY) remaining well below the official 2% target, further easing measures may be warranted going forward, especially amid muted commodity prices.

On the domestic front, strength of incremental economic data waned amid softer improvements in both foreign and domestic demand. PMI manufacturing eased marginally in August to 52.3 from 52.7 due to slower expansion in output and new orders, but on a brighter side input prices dipped to the lowest level since 2009, finally reflecting the lagged pass-through of lower commodity prices. Further, core sector growth dipped to a 3 month low of 1.1% in July, giving up gains accumulated during Q1FY16. While recently released Q1 GDP data indicated a slowdown in growth to 7.0% from 7.5% in earlier quarter, it masked the sharp improvement on GVA basis to the tune of 100 bps. Meanwhile, August ended with a higher than anticipated monsoon deficit of 22%, taking the season's deficit up to 12% of Long period average and as such government measures (such as imports of perishables) would remain crucial to contain spillover effects, if any. As such, we continue to expect CPI inflation to undershoot the 6% target for January by 40-50 bps. In the absence of any major inflationary risks, we continue to expect an RBI rate cut of 25 bps in the September meeting.

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Global Macro Developments

- Global PMIs expanded at the weakest pace in two years, with JP Morgan Global Manufacturing PMI falling to 50.7 from July's 51.0.
- ECB kept interest rates and its QE program unchanged in its monetary policy meeting, while explicitly signaling possible expansion of the latter if required.
- US Services ISM slowed to 59 in August (July: 60.3), though 15/18 industries reported an expansion- the most since October.
- UK Services PMI expanded at the slowest rate in more than two years in August (55.6m July: 57.4), as growth of business activity moderated.
- Eurozone retail sales rose less than expected in July (0.4%, Forecast: 0.6%, June: -0.2%), underscoring concerns over the region's economic outlook.
- China manufacturing PMI fell at 49.7 fell to a three year low amid sustained signs of slowdown in the economy

Events and Data Calendar

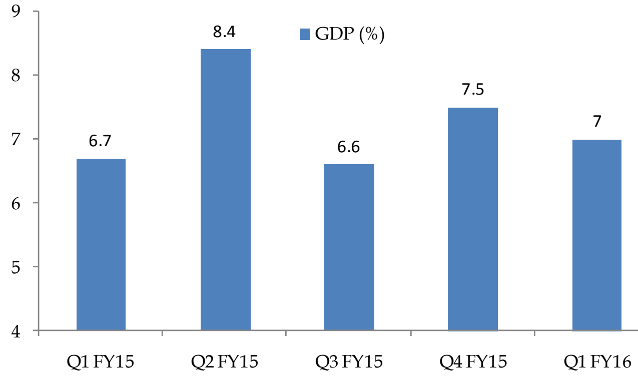
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
US	03/08/2015	ISM Manufacturing	(JUL)	53.5	53.5	52.7	↑
	26/08/2015	Durable Goods Orders	(JUL)	-0.4%	2.0%	4.3%	↓
	27/08/2015	Gross Domestic Product Price Index	(2Q S)	2.0%	2.1%	2.0%	↑
EU & UK	06/08/2015	UK Bank of England Rate Decision	(AUG 6)	0.5%	0.5%	0.5%	→
	18/08/2015	UK Core Consumer Price Index (YoY)	(JUL)	0.9%	1.2%	0.8%	↑
	14/08/2015	Euro-Zone Gross Domestic Product s.a. (YoY)	(2Q A)	1.3%	1.2%	1.0%	↑
	31/08/2015	Consumer Price Index - Core (YoY)	(AUG A)	0.009	0.01	0.01	→
China	11/08/2015	New Yuan loans(bn)	July	750.0	1480.0	1279.0	↑
	01/09/2015	Mfg PMI	Aug	49.7	49.7	50	↓

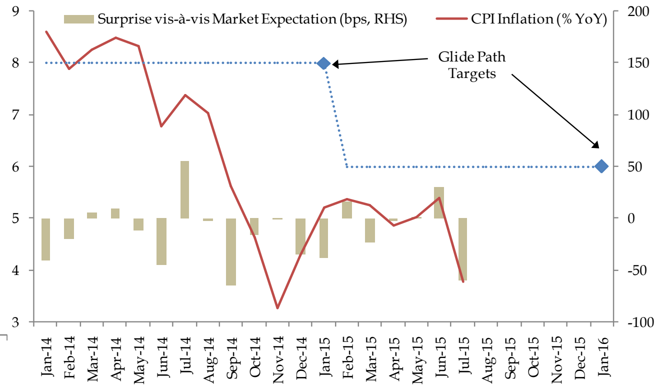
P* – Provisional Estimates F* - Final Estimates A*- Advanced Estimates T*- Third Estimates

COMMODITY

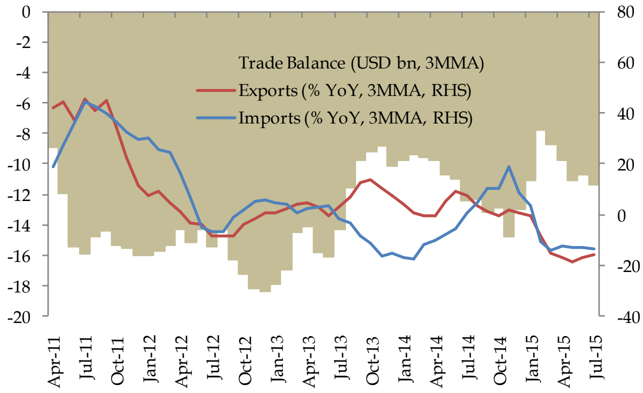
- Gold prices fell 0.9% MoM in Aug-15 compared to 4.4% MoM contraction in Jul-15, as investors digested the comments from Fed's Stanley Fischer on an increased possibility of September rate hike, and dollar too remained ranged. Further, China equity crisis and Jackson Hole summit of the US Fed remained in focus. Lower volatility in Asia and upbeat US economic reports capped heavy gains.
- Brent prices declined sharply 15.6% MoM in Aug-15 (compared to 12.1% MoM contraction in July) amid continued concerns over China, falling equity markets, and a global supply glut

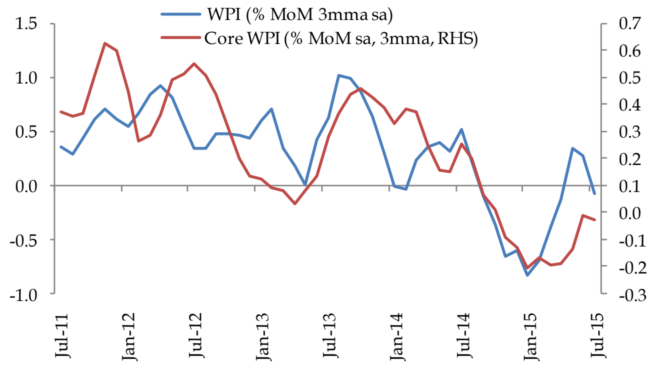
Domestic Market Macro Economics





- India's GDP growth for Q1FY16 came in line with our estimates at 7%, (Bloomberg 7.4%) although GVA surprised on the upside 7.1% (YBL 6%; Bloomberg 6.4%) as the value addition in agriculture and industry was reported higher
- April-July FY16 fiscal data remained robust and continued to provide incremental comfort on two front (i) continued robust tax collections and (ii) connected improvement in the quality of spending on back of higher capex
- Retail inflation fell to eight month low of 3.78% YoY in July (vs. 5.40% in June) on favorable and lower than expected reading for food. (Bloomberg: 4.40%, YBL Estimate: 4.11%)
- WPI inflation slipped further into negative territory in July and was recorded a series low of -4.05% compared to -2.40% in June (YBL expectation: -3.46%, Bloomberg consensus: -2.90%).
- July trade deficit rose to USD 12.8 Bn, in line with expectations of an increase vis-a-vis June. While exports posted an increase over the last month (USD 23.1 bn vs. USD 22.3 bn), an across-the-board increase in import sub-components led to the deterioration in the deficit.
- The Nikkei India PMI Manufacturing moderated to 52.3 in August from July's six-month high of 52.7 while the seasonally adjusted Nikkei Services Business Activity Index rose from 50.8 in July to 51.8 in August





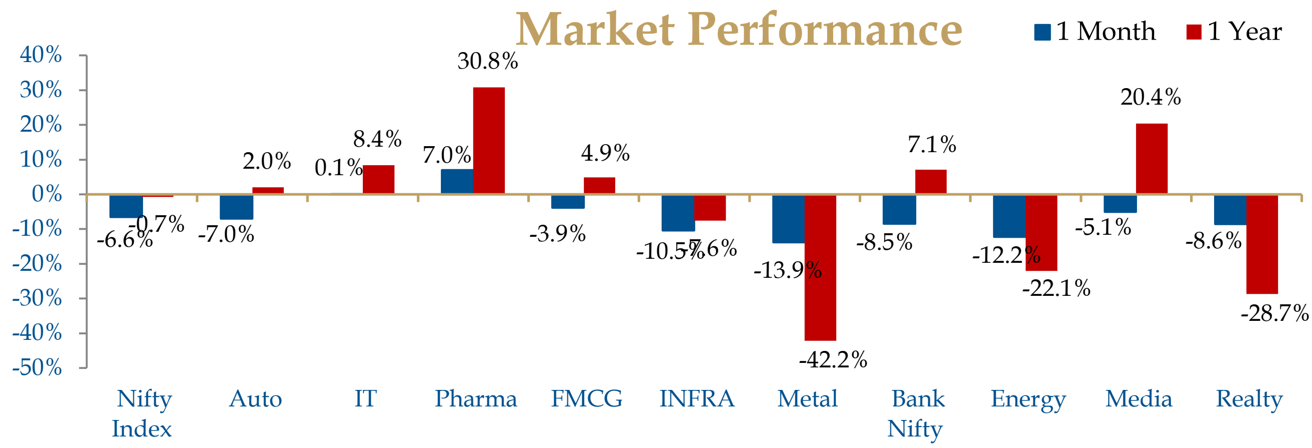
We expect:

- We expect FY16 growth to improve moderately to 7.8% from 7.3% in FY15, albeit nearly 20-70 bps below its potential (8%-8.5% as per RBI), On the positive side, continued moderation in inflation amid lagged impact of lower interest rates and government's capex boost is expected to have a positive impact on consumption demand over coming quarters. On the downside, weakness in global demand led by China is likely to have a dampening effect on export demand.
- In our baseline scenario of near normal monsoon and ranged commodity price, we expect CPI inflation to undershoot the 6% target for January by 40-50 bps.
- We continue to expect an RBI rate cut of 25 bps in the September meeting.
- USDINR has been trading above 66 levels, last noted during 2013 with the surprise devaluation of yuan being the main contributor

- In our view, on the back of these factors, INR could trade in the 65-66 range in the near-term. Favorable economic fundamentals, including ample forex reserves could keep the INR levels contained, unless markets move into an unchartered territory which signals a deeper and long-lasting global slowdown. We expect INR to trade in 67-68 range, as currencies of EM trading partners weaken, thereby evoking a similar response from INR

Equity Market Insights

- The month of August saw the Indian stock markets come under pressure with the BSE Sensex closing at 26,283, down by 5.1% for the month while the Nifty closed at 7,971; down by 6.6% during the same period. The CNX Mid-Cap and CNX Small-cap indices remained weak as well and ended with losses of 4.9% and 9.7% respectively during the period.
- The FII pulled out about $ 3.04 bn from Indian equities and. DII's were net buyers and ~ $2.53bn during the same period.



Factors to Watch

- Markets remained volatile with growing fears related to global growth. The fears were further exacerbated with data from China continuing to indicate that the economy is seeing signs of a slowdown.
- There are 2 major events that market participants would be keeping a close eye on in the coming month. The first is the outcome of the US Fed meeting. Though the expectation of an interest rate hike in the world's largest economy has come down in recent times, however the timing of the same would be something investors would watch out for. If US were to increase rates in the September meeting, then there would be an outflow of capital from emerging markets leading to a knee jerk reaction in India as well. The second event is the RBI meet scheduled for 29th of September where a decision related to interest rates in India would be taken. A rate cut would be viewed as a huge positive for the Indian markets.
- Market participants would also be keeping a close eye on monsoon data. As of now the same has been disappointing leading to fears of a continued slowdown in rural income and demand.
- Other events that investors would keep an eye on would be data related to China and other geo-political events.

Outlook & Expectations

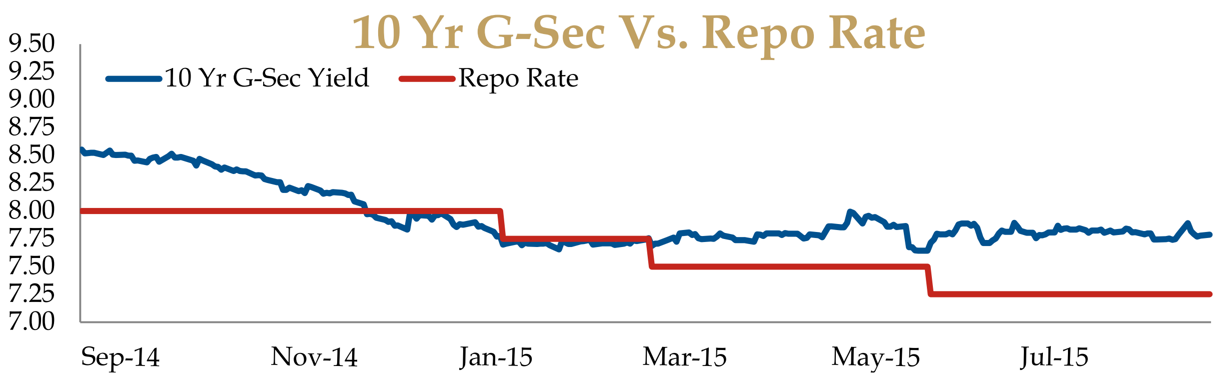
- In terms of valuations, the Sensex is trading at a trailing twelve month PE multiple of 20.8 times which is slightly higher than its long term historic average of 18.2 times. On a forward earnings basis the Sensex is trading at a multiple of around 15.7 times, which suggests that markets are not expensive 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 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 in Aug improved to a surplus of INR 286 bn from a surplus of average INR 130 bn in July supported by government spending and RBI intervention in the forex market
- ✓ Markets during Aug remained highly volatile amid China's yuan depreciation led movement in currencies.
- ✓ Sub-normal performance of monsoon also remained a worry. As per the IMD, the deficiency in south-west monsoon could be higher than the previous forecast of 12%
- ✓ Continued undershooting of inflation amid sharp fall in global commodity prices is expected to open up space for rate cut in Sept. We expect RBI to cut policy repo rate by 25 bps in Sept.

Outlook and Expectations

- ✓ Average 10 yr yield during Aug rose to 7.89% from 7.81% in previous month. FII participation in bond markets remained muted
- ✓ While we continue to expect 25 bps cut as our baseline scenario, However Monsoon remains a big concerns. Shortfall in rains has a bearing on inflation which could strengthen case for 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 – September 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.

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