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Global growth remains sluggish; India's momentum intact

As markets re-gained calm following the Brexit shock, the focus of the markets during the month of August was on the timing and magnitude of future rate hikes in the US. While robust US jobs data for June and July had raised expectations of a September rate hike by Fed, lower than expected job additions for August dampened such expectations.

August PMI readings globally signaled an improvement in manufacturing activity, albeit the improvement was uneven and failed to gain a broad based character. As such with the rate of global economic expansion remaining subdued overall, IMF hinted at another downgrade to global growth projection for 2016. Recall, in its latest economic outlook, the IMF had downgraded its global growth projections for 2016 and 2017 by 0.1% each versus April forecast.

Meanwhile in the Eurozone, while Britain's vote to leave the EU did not manifest into any adverse financial market shock, the pace of growth in Q2 moderated to slowest pace in two years and manifested divergent patterns within individual countries. For instance, while Italy and France's economy stagnated, improving labour market and booming tourism fueled economic activity in Spain.

On domestic front, although GDP growth for Q1FY17 came in lower than expected; sectoral activity as reflected in GVA suggested that economy continued to maintain momentum. Additionally, India's Aug-16 PMI readings showcased a solid expansion in business activity for both manufacturing and services sectors. Moreover, auto sales for August posted robust growth, reflecting a gradual uptick in domestic demand conditions.

On the downside, Jul-16 core sector growth witnessed a moderation led by weakness in steel, crude oil and electricity sector. This was also corroborated in the continued sluggishness in credit offtake to industrial sector. While growth in non-food credit offtake improved in Jul-16 relative to the previous month, it was led primarily by improvement in credit to services and continued robustness in personal loan segment. Lending to industry recorded a tepid growth of 0.6% YoY unchanged from the previous month.

Going forward, we expect India's economic recovery to gain traction led by improvement in consumption as increase in disposable incomes following 7th CPC implementation and recovery in rural incomes following satisfactory performance of monsoon amid benign inflation pave way for improved demand conditions. We expect FY17 GVA growth to improve to 7.8% from 7.2% in FY16.

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Global Macro Developments

- ✓ The US economy added another 151,000 jobs in August, according to the US Labor Department, while the unemployment rate stayed at 4.9%. The number of extra jobs was sharply down from an upwardly revised July figure of 275,000. It was also a smaller rise than the average monthly increase of 204,000 seen during the previous 12 months.
- ✓ European Central Bank maintained interest rates at existing levels, in line with market expectations, in its latest meeting. However, growth forecasts for 2017 and 2018 were trimmed by 10 bps each to 1.6% for both years. ECB President Draghi said that the bank was looking at monetary easing options, but maintained the March end-date for the plan.
- ✓ Bank of England Governor Carney said that the bank's "timely, comprehensive and concrete" measures thus far had helped the economy adjust to the post Brexit impact, while also saying that room was open for further rate cuts if required.
- ✓ Growth in Japan was revised up to 0.2% for the June quarter, compared to initial estimates of stagnation, and higher than the previous quarter, mainly boosted by private consumption and public investment.

Events and Data Calendar

Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
Japan	15/07/2016	JPY Gross Domestic Product Annualized	(2QP)	0.70%	0.20%	2.00%	↓
EU	30/08/2016	Consumer Price Index - Core (YoY)	(AUG)	0.90%	0.80%	0.90%	↓
	16/08/2016	ZEW Survey (Economic Sentiment)	(AUG)		4.6	-14.7	↑
US	02/09/2016	Change in Non-farm Payrolls	(AUG)	180k	151k	275k	↓
	01/09/2016	ISM Manufacturing	(AUG)	52.0	49.4	52.6	↓
	26/08/2016	Gross Domestic Product (Annualized)	(2QS)	1.10%	1.10%	1.20%	↓
	30/08/2016	Consumer Confidence	(AUG)	97.0	101.1	96.7	↑

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

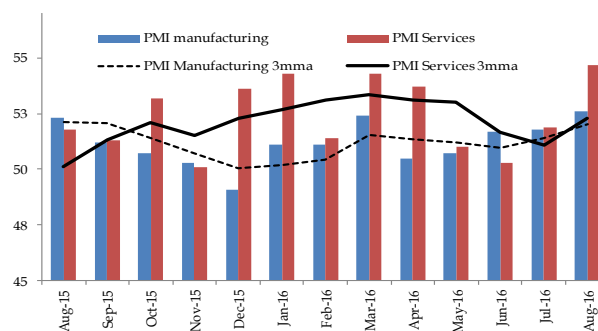
COMMODITY

- ✓ Gold prices contracted 0.10% in Aug-16 after expanding 4.9%MoM in Jul-16 as the dollar strengthened after hawkish statements from Fed Chair Yellen and comments from US Federal Reserve officials increased bets on a US rate hike this year.
- ✓ Brent prices contracted 0.15% in Aug-16, as compared to a decline of 7.4%MoM in Jul-16. While stronger dollar and expectations that Nigerian rebels may stop hampering oil production weighed on prices, the decline in US crude oil supplies according to data from American Petroleum and expectations of a possible agreement between OPEC and other major producers, lent support to prices.

Domestic Market Macro Economics

	Weight (%)	May-16	Jun-16	Jul-16	Apr-Jul FY16	Apr-Jul FY17
IIP	100	1.1	2	-2.4	3.5	-0.2
Sectoral Classification						
Mining	14.2	1.4	5.3	0.8	0.6	2
Manufacturing	75.5	0.6	0.7	-3.4	4	-1.4
Electricity	10.3	4.7	8.3	1.6	2.6	7.1
Use Based Classification						
Basic	45.7	3.8	5.8	2	4.8	4.1
Capital	8.8	-12.3	-16.3	-29.6	4.2	-21.3
Intermediate	15.7	3.9	5.7	3.4	1.7	3.8
Consumer	29.8	1	2.7	1.3	2.2	0.7
Durables	8.5	6	5.6	5.9	6	7.3
Non-Durables	21.3	-2.3	0.9	-1.7	0.2	-3.6

Headline IIP in July slipped into negative territory led by sharp de-growth in manufacturing index

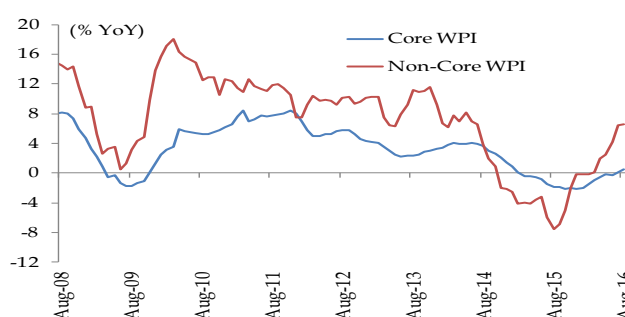


August PMI's signal robust pace of private sector activity

- ✓ GDP growth in Q1FY17 surprised on the lower side coming in at 7.1% compared to 7.5% in Q1FY16 led mainly by continued weakness in investment demand and some moderation in the pace of private consumption growth. On the activity side, while GVA growth surprised us on downside clocking a growth of 7.3% versus 7.2% growth in Q1FY16. While, services GVA growth was recorded at robust 9.6%.
- ✓ Reflecting solid improvement in the pace of growth of manufacturing sector, NIKKEI India Manufacturing PMI surged to a thirteen-month high in Aug at 52.6 (Previous: 51.8).
- ✓ NIKKEI India Services Business Activity Index increased to its highest level in over three-and-a-half years at 54.7 in August (Previous: 51.9).
- ✓ Output of eight core infrastructure industries moderated to 3.1%YoY in July compared to 5.3% in Jun-16. On FYTD (Apr-Jul) basis, output growth advanced to 4.9%YoY compared to 2.2%YoY during the same period in FY16.
- ✓ August CPI came in at a 5-month low of 5.05%, expectedly led by food price disinflation. Core CPI continued to remain range-bound in the 4.5-5.0% range.
- ✓ India's July IIP print contracted 2.4% YoY vis-à-vis a 2.0%YoY expansion in June; on back of a broad based moderation in all three sub-segments, namely-mining, manufacturing and electricity.

%YoY	June	July	August	Apr-Aug FY16	Apr-Aug FY17
CPI	5.77	6.07	5.05	4.54	5.62
Food	7.5	8	5.8	4.4	6.9
Pan & Tobacco	7.4	6.8	6.9	9.6	7.3
Clothing	5	5.2	5.2	6	5.3
Housing	5.5	5.4	5.3	4.6	5.4
Fuel	2.9	2.7	2.5	5.7	2.8
Misc	3.8	4	4.2	3.6	4.1
Core	4.6	4.6	4.7	4.4	4.7

Aug CPI came in at a 5-month low, led by food price disinflation



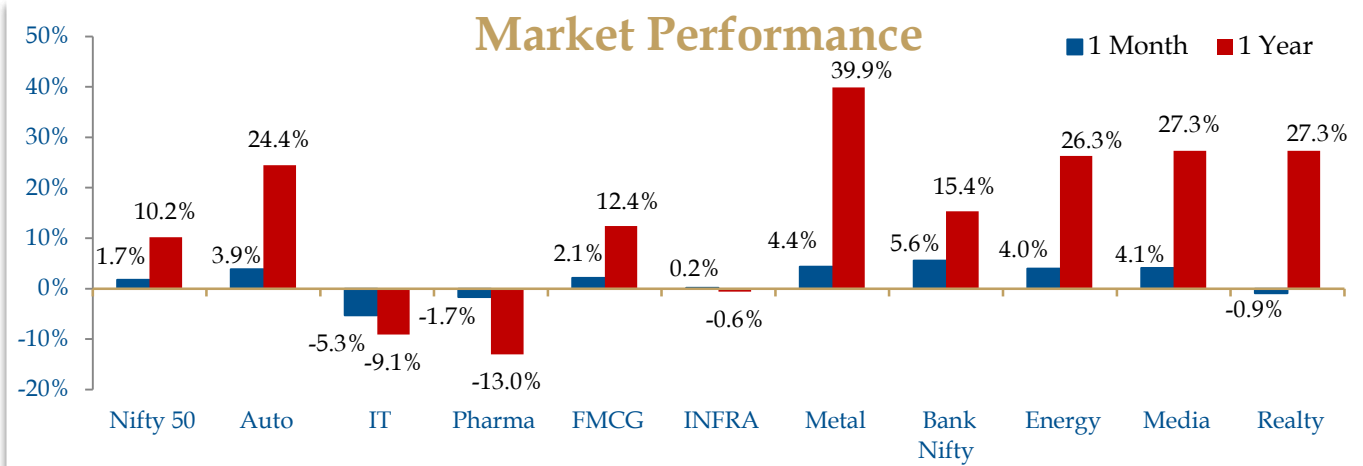
Return of inflation seen in Core WPI in August

We expect:

- ✓ We continue to expect GVA growth to improve to 7.8% from 7.2% in FY16. We expect FY17 growth to be led mainly by recovery in consumption on the back of improved prospects for revival in rural. A recovery in consumption demand however is unlikely to support a robust revival in investment demand given the still prevalent excess capacity in manufacturing sector and leveraged balance sheet of some corporates.
- ✓ We expect USDINR to remain in the range 67-69 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. As such, passage of GST and Bankruptcy code remains supportive.

Equity Market Insights

- ✓ The month of August saw Indian markets rally upwards. However, midcaps were the stars of the month with the Nifty free float Midcap 100 Index moving up by 4.05% during the month. BSE Sensex closed at 28,452, higher by 1.4% for the month while the Nifty closed at 8,786; up by 1.7% during the same period. The Nifty free float Smallcap 100 Index was up 1.4% during the month.
- ✓ During August, foreign investors pumped in USD 1.27 bn in the Indian equity markets but remained net sellers in the debt markets, which consequently saw an outflow of USD 0.31 bn taking the total tally to a net inflow of USD 0.96 bn. DII's were net seller in equity with outflow of USD 0.67 bn during the same period.



Factors to Watch

- ✓ Indian markets have been on an upward trajectory over the past months. This has been driven by expectations of economic revival and a flow of foreign institutional funds. The recently concluded June quarter earnings were a mixed bag. For the Nifty companies (excluding BFSI), top line was up 3% YoY while adjusted profits were up ~7% YoY (due to strict cost control).
- ✓ The next trigger for the domestic market would be the festive season. We expect consumption related stocks to outperform in the medium term given expected revival in rural demand on the back of healthy monsoons and Pay Commission related payouts. However, in the near term, in the absence of any major domestic trigger, our markets too would take cues from the global markets.
- ✓ Fundamentally, India still continues to remain attractive on the global stage on account of (i) Economy on an upward trajectory (ii) pro reform focus of the Government (iii) Government's continued emphasis on reviving manufacturing sector through structural steps (iv) easing monetary policy (v) better monsoons expected to lead to a pickup in consumption (vi) 7th Pay Commission hike to give a further fillip to consumption led growth.
- ✓ Geopolitical developments across the world.

Outlook & Expectations

- ✓ In terms of valuations, the Sensex is trading at a trailing twelve month PE multiple of 21.3 times which is higher than its long term historic average. However, given the expectations of recovery in demand due to factors mentioned above, earnings are expected to improve towards the second half of the year. Building an assumption of a robust improvement in earnings in FY17, we believe that the markets are still attractive from a medium to longer term perspective, i.e. for 2 to 3 years.
- ✓ Going forward, we believe revival of the rural economy would have a multiplier effect on sectors that are driven by consumption. This includes consumer goods, FMCG, autos (2 wheelers in particular), etc. Revival in rural demand would eventually translate to revival in private capex as well. We recommend investments in quality stocks in infrastructure, consumption and agri sectors.
- ✓ We recommend equity investments through a Systematic Transfer route with a minimum investment horizon of 36 months.



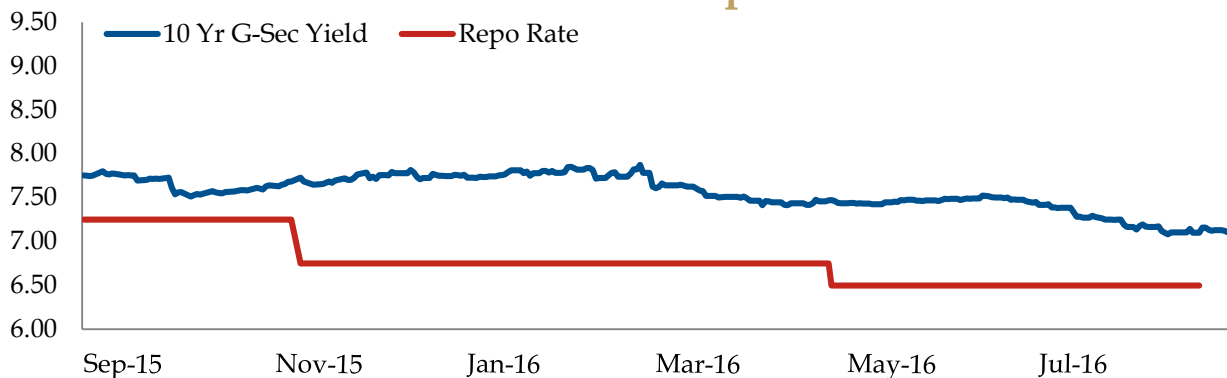
Debt Market Insights

- ✓ The average systemic liquidity in the banking system improved to a surplus of INR 305 bn from INR 139 bn in July 2016. Government's spending, RBI's dividend payment and continued purchase of Gsecs by RBI through OMOs helped create durable liquidity surplus.
- ✓ Average 10 yr yield during Aug declined to 7.13% from 7.30% amid comfortable liquidity conditions and expectations of a continued accommodative stance of RBI.
- ✓ OMO purchase worth INR 100 bn was conducted by RBI during the month. RBI transferred INR 658 bn surplus as dividend to Government this fiscal, unchanged from last year.
- ✓ The new 10 year benchmark security that was issued this month saw a cut off of 6.97%- lowest since 2009- and 15 bps lower than the prevailing 10 year security yield.

Outlook and Expectations

- ✓ We now see a downside risk to our CPI forecast of 5.1% for the year, with the number more likely to average below 5% for FY17 compared to 4.9% in FY16. We maintain our expectation of a 25 bps repo rate cut by the RBI during Q3FY17, with RBI now likely to remove its reference to "upside risks to inflation", on the back of a comfortable inflation trajectory from here on.
- ✓ We also anticipate the provision of comfortable liquidity to maximize the impact of the current accommodative monetary policy stance.

10 Yr G-Sec Vs. Repo Rate



Model Portfolios - September 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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