YES Prosperity

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PROSPERITY INSIGHTS

Focus shifts to Union Budget

Global financial markets have been unsettled since the start of 2016. Increased concerns on global growth, notably, the slowdown that is underway in China and the sharp decline in commodity prices - crude in particular, following a second round of surprise Yuan devaluation, appeared to have triggered the sell-off in markets. Meanwhile IMF recently revised down its 2016 GDP forecast by 20 bps to 3.4% further thereby validating concerns over global outlook.

In the mayhem that ensued, Central Bankers globally intervened with Bank of Japan introducing a negative interest rate and ECB promising more easing. While the actions and comments of Central Bankers calmed the markets to some extent, the risk-on sentiment was short lived as soft activity indices from US and China further fanned asset market volatility.

US jobless claims rose more than expected last week (2.25 Mn, Forecast: 2.24 Mn), suggesting labor market improvement may be taking a breather amid prolonged global slowdown. Further, US factory orders also fell more than anticipated to 2.9% (Forecast: -2.8%, Previous: -0.7%), as manufacturing firms continued to be impacted by slow overseas demand. Dollar strength- 'the flavor of 2015' waned as USD index fell sharply (Lowest since Nov-15) in February with investors turning cautious over the anticipated trajectory of US Fed rate hike. Meanwhile across the Atlantic, manufacturing data showed moderating growth in Euro zone (Jan PMI: 52.3 vs. December: 53.2) weighed down by faltering incoming orders. In a validation of the same, European Commission marked down Euro zone 2016 GDP growth by 1bps to 1.7%. Moderating growth and tepid inflation outlook amidst low oil prices are likely to weigh on ECB monetary policy stance when policy makers meet next month.

On domestic front, incremental data continued to underline a gradual recovery with a broader uptick weighed down by (1) moderation in industrial activity and (2) weak rural recovery. India's core growth remained tepid in Dec-15; with underlying seasonally adjusted momentum contracting by 1.2%MoM. Notwithstanding the marginal uptick in Dec-15, bank credit growth continued to remain tepid and skewed. On FYTD basis, half of incremental credit off take has been contributed by personal loans category alone.

More recent data from Jan-16 has been on a slightly positive note. PMI services posted a 19-month high print, underpinned by expansion of new business inflows. PMI Manufacturing too recovered sharply as the adverse impact from the heavy floods in Chennai receded. In our view, Q4FY16 is expected to see a recovery in manufacturing activity as is also evident from modest expansion in business situation in the sector, according to RBI industrial outlook survey. Further, Apr-Dec fiscal data continued to highlight government push for capex amidst robust revenue receipts and savings on petroleum subsidy bill (relative to FY15). Despite a 23% deficiency recorded in north-east monsoon season, only a slight deficiency in Rabi sowing at 3% YoY augurs well for inflation outlook. For now, Jan-16 inflation is likely to undershoot RBI target of 6.0% by ~40 bps amid ongoing seasonal correction in prices of fruits and vegetables.

For FY17, we expect GDP recovery to be gradual with incremental growth likely to be consumption-led amidst improving real incomes and implementation of 7th CPC recommendations. However investment recovery is likely to be moderate amid still subdued private capex amidst overleveraged balance sheets along with concerns on increasing number of stalled projects. In view of 7th CPC recommendations, we expect centre to set its fiscal deficit target higher by 20 bps target to 3.7% of GDP (vs. 3.5% targeted earlier). This in our view is likely to create additional fiscal space to drive public capex and help augment supply by crowding in private investment.

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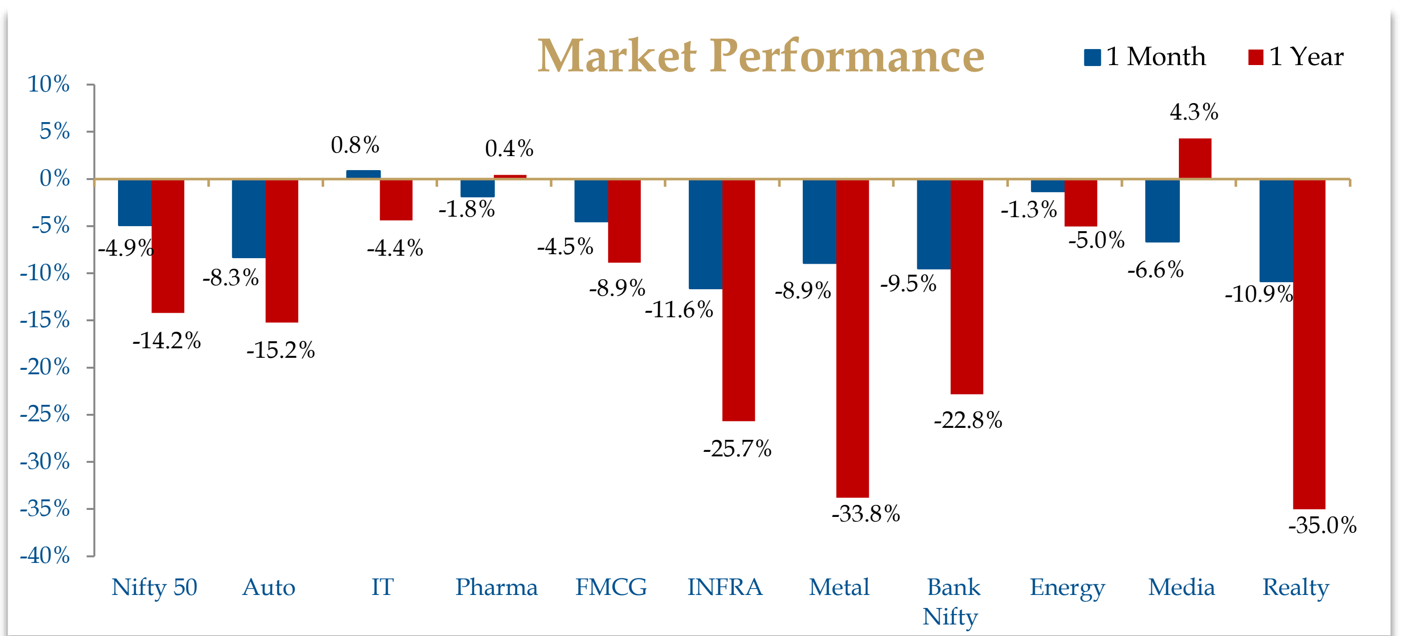
Equity Market Insights

- The Indian stock markets remained under pressure in January as global cues took the centre stage in the absence of any major domestic triggers. BSE Sensex closed at 24,871, lower by 4.8% for the month while the Nifty closed at 7,564; down by a similar 4.8% during the same period. The CNX Mid-Cap and CNX Small-cap indices relatively underperformed with losses of 6.9% and 11.0% respectively.
- During January, FPIs pulled out US$ 1.57 bn from the equity markets but invested around US$ 0.18 bn in debt markets thereby taking the total tally to an outflow of US$ 1.39 bn during the month. The selloff was triggered off at a global scale with China's continued signs of weakness becoming a major factor responsible for the same. DII's were net buyers by $1.98 bn during the same period.



Factors to Watch

- Global markets and consequently Indian markets are expected to remain under pressure and see increased volatility. Worries related to global growth slowdown triggered by the slew of weak data from China and sharp fall in commodity prices particularly that of oil and metals are the key reasons behind the meltdown in financial markets seen in recent times. These issues have increased the overall risk and volatility in the global markets as a result of which foreign investors have adopted a cautious approach towards all emerging markets including India.
- Unlike other emerging markets (largely commodity exporters) that are reeling under the pressure of falling commodity prices; India is a beneficiary of falling prices since it is a commodity importer. As such India is seeing a confluence of positive factors in the form of expected reforms, lower inflation and falling interest rates which reiterates our long term positive view on the markets. Therefore over a period of time investor interest will return to the country.
- On the domestic side two events would be closely tracked by the market participants. The first is the ongoing corporate earnings season. Till now no major surprises have come on the positive side. As such investors have shown very little tolerance towards any miss in estimates that have already been revised downwards.
- Though companies have started to see the benefit of lower commodity prices in the form of expanded margins and profitability; however the sluggish growth on the top line level suggests that demand is still lagging. In such a scenario, we believe that we could see more earnings downgrades coming in as the street would readjust their estimates to account for a longer than expected time for revival.

- The second event that investors would watch out for would be the Union Budget scheduled to be presented in the end of this month. Besides the usual wish list of tax rationalization and announcement/commitment towards major reforms, market and industry participants would also watch out for cuts in duties to boost domestic demand; incentives for boosting consumption which could help trigger investments from the private sector; cuts of service tax in exports to boost that segment; commitment to the domestic industry particularly metals through announcements of anti-dumping measures, etc.
- Investors would also be keeping a close eye on commodity prices particularly that of crude. Increasing geo-political tensions in the region would be a crucial factor guiding the prices of crude in the near term.

Outlook & Expectations

- In terms of valuations, the Sensex is trading at a trailing twelve month PE multiple of 18.3 times which is close to its long term historic average of 18.2 times. On a forward earnings basis the Sensex is trading at a multiple of around 17.2 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. 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 auto stocks. From a medium term perspective, investors could also look at accumulating stocks in the technology space that are expected to benefit from the currency movements as well as a steady growth in demand pipeline. We would recommend investors to accumulate/build positions in these sectors/stocks post result announcements.

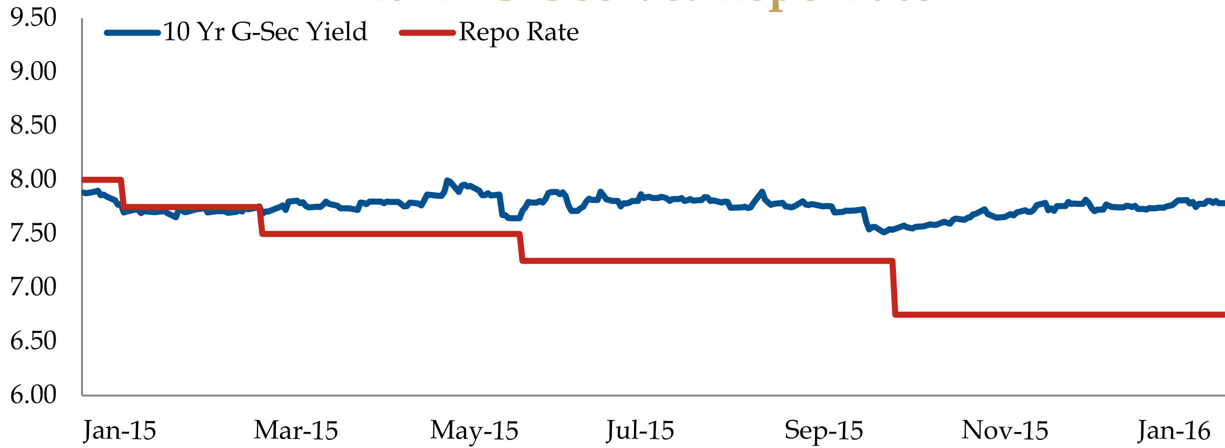
Debt Market Insights

- The average systemic liquidity deficit in Jan-16 increased to an average INR 1340 bn compared to average INR 1114 bn in Dec-15 as currency leakages remained high and government cash balances with the RBI increased as it restrained spending.
- RBI auctioned new 10 year bond during Jan-16 with a cut off yield of 7.59%, 13 bps lower than the previous benchmark. Average 10 yr yield during Jan was 7.71%
- In line with our expectations, RBI maintained status quo on key policy rates in its sixth bi-monthly policy review
- Inflation for the month of December rose to a 15-month high of 5.61% (vs. 5.4% in November-2015). Marginally higher than expectations (YBL: 5.36%, Bloomberg: 5.53), the Food and Beverages category continued to be the key driver behind rising inflation.

Outlook and Expectations

- **We expect the RBI to cut repo rate by 25 bps post the announcement of the FY17 Budget as:**
  - With output gap remaining negative and the anticipated underlying inflation tracking its target, the real policy rate should get accommodative to the extent possible. We believe a real policy rate of ~1.5% would be ideal for the Indian economy at this juncture.
  - The government has so far used its balance sheet for increasing public capex. For FY17, persistence on this path will help to augment supply by crowding in private investment. This will provide comfort to the RBI for considering incremental monetary accommodation.
- We expect average CPI (ex housing) inflation to moderate towards 5.0% in FY17 from our estimated level of 5.1% in FY16

- Our FY16 current account 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.



Model Portfolios – February 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.

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