PROSPERITY INSIGHTS

China and Greece in focus

The month of June has been quite eventful for global markets. On one hand, Greece voted 'against austerity' in the public referendum post defaulting on its payment to IMF. Greece has now submitted a new three year bailout plan to creditors, which needs to be approved by the Troika to enable them to stay within the Eurozone and avoid collapse of its banking system. Meanwhile, a sharp slide in China's stock markets (~30% since mid-June) added to volatility in the global financial markets. In order to stem the crisis, regulators capped short-selling, pension funds pledged to buy more stocks, government suspended IPOs and brokers created fund to buy shares.

Against the backdrop of risks arising out of events in Greece and China and amid mixed economic data, June FOMC minutes indicated a more gradual pace of rate hike than earlier expected. US nonfarm payrolls grew by 223k in June vs. expectation of 233k, while payrolls for May were revised downwards. Although, Institute for Supply Management PMI index edged up to 53.5 (vs. 52.8 in May), US factory orders fell more than expected in May on account of weak demand for transportation and electrical equipment.

Data from Japan painted a somewhat positive picture for economic outlook. Japan machinery order came in at 19.3%YoY (vs. an expectation of 16.3%), growing for the third straight month, suggesting that capital spending continues to benefit from low energy cost amid range bound oil prices. Meanwhile, household spending increased by 4.8% in May, posting the first rise since sales taxes hike in April last year. Gradual improvement in domestic demand is likely to support still muted price pressures in the economy. Core inflation, excluding volatile fresh food prices, was up 0.1% well short of the Bank of Japan's 2% target.

Meanwhile, domestic lead indicators continued to signal mixed outlook for India's economic recovery. On the one hand, May fiscal data highlighted an improvement in government's capex expenditure, and core sector output registered abroad based improvement, after two months of contraction. On the other, June Manufacturing PMI moderated and services PMI contracted for the second straight month.

Monsoon which had recorded a surplus of 16% in June took a breather in July (4% below normal). With likelihood of deficient rainfall in July (as per IMD's forecast), government's policy has been focused at managing supply in the domestic market through import of oilseeds, pulses and wheat, curbs on exports and release of surplus foodgrain among others.

On monetary policy front, in line with expectations, the RBI eased repo rate by 25 bps to 7.25% in Jun-15, taking the cumulative monetary easing to 75 bps in the calendar year so far. Despite expected sub-normal performance of monsoon, government actions have been directed at mitigating any adverse impact on food prices easing expected risks to inflation and the recent risks emanating from Greece and China amid mixed data from US have pushed forward the expectation of US rate hike and as such we now expect 25bps rate cut during H2FY16.

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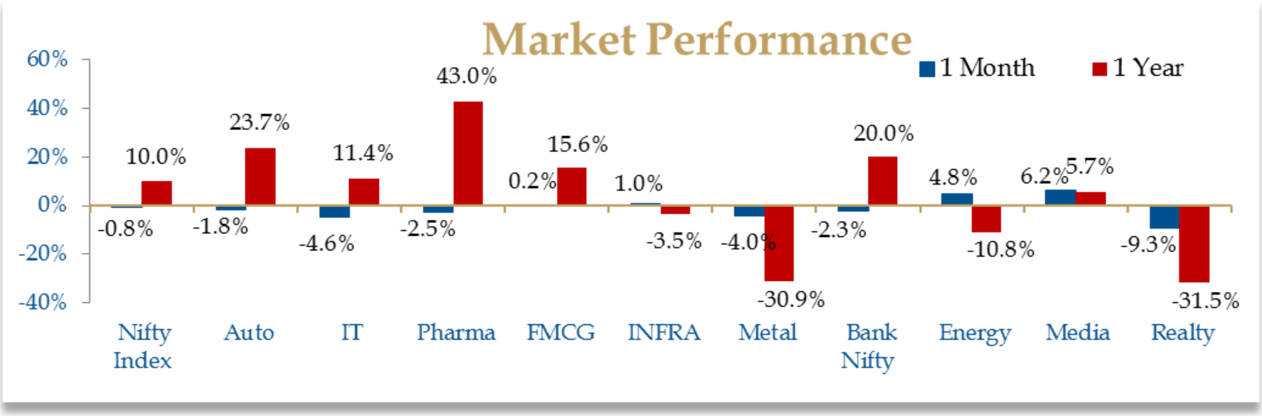
Equity Market Insights

- The month of June saw the Indian stock markets go through a volatile phase BSE Sensex closed at 27,781, lower by 0.17% for the month while the Nifty closed at 8,369; down by 0.77% during the same period. The CNX Mid-Cap and CNX Small-cap indices relatively underperformed with losses of 1.3% and 4.3% during the period.
- The FII pulled out about $ 0.5 bn from Indian equities and about $ 1.1 bn from debt markets during the month. DII's were net buyers and ~ $1.91bn during the same period.



Factors to Watch

- Updates on reforms and/or measures to enable further reforms; investors would also be looking at the monsoon session of the Parliament. Passing of key Bills including those on land acquisition reforms and amendments related to GST are the major expectations of investors. Any delays/issues on these could be viewed as an immediate negative by 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 data on timing and quantum of interest rate hikes by the US Fed.

Outlook & Expectations

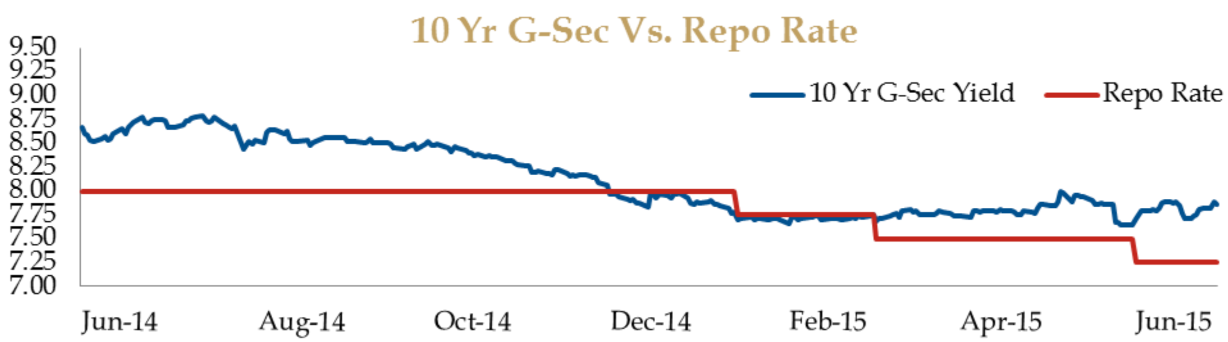
- Investors would be keeping a close eye on the corporate earnings announcements for the June quarter. Earnings are expected to remain muted although there could be a slight improvement as compared to the March quarter. Slowdown in rural earnings and consequently on rural demand could hurt the consumption driven sectors. However we do expect the urban demand to offset the impact of this to a large extent.
- Another factor that one would watch out for would be the monsoons and more importantly the geo-spatial distribution of rains. Even though the rains were better than expected in the month of June, the data for July would be crucial as this would have an impact on the agriculture and rural side of the economy.
- In terms of valuations, the Sensex is trading at a trailing twelve month PE multiple of 20.3 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 14.8 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, 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

- ✓ On monetary policy front, in line with expectations, the RBI eased repo rate by 25 bps to 7.25% in Jun-15, taking the cumulative monetary easing to 75 bps in the calendar year so far.
- ✓ For FY16, the RBI revised:
    - o GDP growth downward to 7.6% from 7.8% provided earlier in April
    - o January CPI inflation to 6% - somewhat higher than the levels provided in April
- ✓ The yield on new 10 yr bond eased to avg 7.80% in June from avg 7.85% in May.
- ✓ Basis our expectation of a 25 bps rate cut by the RBI, enhancement of demand for g-secs, liquidity improvement led progress in monetary transmission, and gradual quality fiscal consolidation, we now expect 10Y g-sec yield to move lower towards 7.50% in H2 FY16. This is somewhat higher than our earlier call of 7.35% as we've now incorporated emerging risks on account of global fixed income volatility.

<u>Outlook and Expectations</u>

- ✓ The 10 Yr G sec yields were ranged within 7.64% to 7.89% levels for the month of June.
- ✓ While we continue to expect 25 bps cut as our baseline scenario, poor monsoon outturn will strengthen the case for caution and 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 – July 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.

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About YES BANK

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