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Economy & Market Updates

An imminent US Fed rate hike & fate of key economic legislations in Parliament to influence the course of Indian equities

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An almost certain rate rise by US Fed due to low jobless rate & brisk rise in hourly wages. US Inflation at 0.2% running well below the target of 2%.

US Federal Reserve (Fed) will almost certainly raise interest rates for the first time in seven years. In the wake of the global financial crisis, Fed has held its rates at lows of between 0% and 0.25% to stimulate aggregate demand by creating jobs to comply with its constitutionally-mandated objective to achieve full employment. With unemployment rate at 5%, a level below which it looks unlikely to sustain, even if it falls a bit further and average hourly pay rising by 2.8% on an annualized basis, it appears that slack in the labour market is fast diminishing and the Fed needs to start acting early so that it doesn't have to tighten at a rapid clip later in case inflationary risks were to overshoot their current expectations. Of course, any rate rise will have to be seen in the context of attendant risks. Labour participation rate among working age adults is at a two-decade low as a result of large number of workers withdrawing from the jobs market in the wake of severe recession. If they were to return back to the labour force in large numbers, it would then depress wage increases. Also, although Fed has set a 2% inflation target, its preferred inflation measure PCE (personal consumption expenditure) stands at a comfortable 0.2%. Even excluding the volatile food & fuel basket, core inflation stands at only 1.3%.

Strong Dollar due to pursuit of loose monetary policies by its trading partners complicating Fed's job. Glut in commodities from oil to industrial metals to continue

What is complicating Fed's move is the extraordinary strength of US Dollar, partly as a result of rout in commodity prices, thereby causing plunge in currencies of commodity exporting countries. Many of US' trading partners like EU, Japan, China, etc. are pursuing loose monetary policies through quantitative easing (QE), lowering of interest rates, reduction in reserve requirements for banks and/or loose fiscal policies to stimulate anaemic demand. The situation in commodity markets like oil & industrial metals is further complicated by weak global demand and refusal of key suppliers to match it with corresponding supply responses. What started as a tussle between Saudi Arabia & US based shale oil producers has increasingly mutated into a fight for geo-political dominance between Saudi Arabia-led sunni states & Iran-led shia states manifesting in refusal of either side to back down & cut production and further complicated by Saudi Arabia's fears of rapprochement between Iran and the West after signing of the deal on nuclear issue & lifting of sanctions on Iran. With significant fiscal pressures wreaking havoc on their economies, Russia & Venezuela too have refused to lower production, adding to global oil glut. The woes in other industrial

commodities like steel can primarily be attributed to China's indiscriminate dumping as a result of its huge build up of production capacities during good times and severe economic slowdown (both domestically & globally) necessitating it to export its increasing surpluses even below its cost of production.

We believe that global markets have already discounted impending rate rise, and all eyes will be on the accompanying commentary about the trajectory of further rate increases. The gradient of the rate rise in our view is unlikely to be as steep as the previous cycles, and in view of the structural slowdown in global economic cycle strongly holding down inflationary pressures the end-point after the rate increases would settle at a far lower level this time around.

The Indian economy & markets in particular stand on a stronger footing and will, in our view, weather any heightened volatility, should it occur, as a result of the rate increase by the Fed.

Weak economic recovery compels ECB to extend QE by 6 months and further push deposit rates in negative territory

In view of tepid economic recovery, the ECB in its last meeting extended QE program of monthly bond purchases of 60 billion Euros ($ 66 bn.) by six months till March 2017 with an assurance that the program would be extended further if necessary. ECB also pushed its deposit rate further into the negative territory to -0.3% from -0.2% to discourage banks from storing excess reserves with it and thus stimulate lending. EU's economic recovery lags US with unemployment rate remaining in double digits vis-à-vis 5% in the US and GDP growth in 2016 (as per IMF estimates) at just 1.9% versus 2.8% for the US. EU's growth worries are further compounded by the wobble experienced by emerging economies as it derives a much larger share of its GDP from exports vis-à-vis US.

Winter session of parliament - Repeated disruptions throttle debate and endanger crucial economic legislations slowing India's economic juggernaut at a time of tentative global recovery

The crucial winter session of parliament is underway. As of now, no significant business has been transacted in the Rajya Sabha due to repeated disruptions by some parties in the opposition. Despite vociferous attempts at disruption, the Lok Sabha has functioned relatively better due to an overwhelming majority by the ruling coalition. Many economic bills like the GST, Bankruptcy Bill, Real Estate Regulation Bill, etc. have been lying in limbo awaiting introduction, debate and eventual passage. The necessity to display an accommodative stance is wholly lacking in some opposition parties, who despite a conciliatory stance adopted by the government have been pursuing a policy of disruption, by amplifying issues that do not fall in the ambit of legislative business, thereby slowing the country's economic juggernaut, at a time when global economic engine is yet to pick-up steam, and strong macro-economic foundations are differentiating India vis-à-vis a miasma of gloom elsewhere.

United Nations World Economic Situations & Prospects (WESP) forecasts India to be the fastest growing economy in 2016 and 2017 amidst volatile global financial conditions

India's 2Q FY16 GDP grew at 7.4% (vis-à-vis 7% in 1Q FY16 and 8.4% in 2Q FY15), led by transport/communication/broadcasting services at 10.6%, financial / real estate / insurance / professional services growing at 9.7%, and manufacturing growing at 9.3% (vis-à-vis 7.2% in 1Q FY16 and 7.9% in 2Q FY15). The weak spots were agriculture/forestry/fishing at 2.2% & construction at 2.6% (vis-à-vis 6.9% in 1Q FY16 and 8.7% in 2Q FY15). WESP has forecast that India's economy will grow at 7.3% in 2016 & 7.5% in 2017 and India will continue to be the fastest growing economy in the world in 2016 and 2017 amidst volatile global financial conditions that will see diminished trade flows and stagnant investment.

October IIP grew strongly at 9.8% in October 2015 mainly due to a robust 10.6% growth in manufacturing sector.

RBI keeps repo rate unchanged at 6.75%, shift to marginal cost of funds to help better transmission of policy rates to lending rates, banks fear squeeze in NIMs

In response to weak domestic & global demand that was impeding investments, RBI had frontloaded a hefty 0.5% reduction in repo rate in its last bi-monthly monetary policy in September 2015. CPI increased for the third successive month in October 2015 at 5% (vis-à-vis 4.4% last month) as anticipated by RBI driven by food inflation (especially pulses), education & health services. RBI has kept the repo rate unchanged at 6.75% in its December 2015 monetary policy. Since the start of the rate reduction cycle in January 2015 repo rates have been eased by 125 basis points while the median base lending rates of banks have gone down by only 60 basis points. RBI has decided that base rate must be determined on the marginal cost of funds which it believes will help faster and higher transmission of policy rates into lending rates. Banks though feel that it would further squeeze their net interest margins (NIM) and impact pre-provisioning profits at a time when they are grappling with the burgeoning stressed assets problem.

Outlook for agriculture subdued as both kharif & rabi prospects being hit by monsoon vagaries

Outlook for agriculture remains subdued due to both rabi & kharif prospects being hit by monsoon vagaries. Strong North East monsoon has wrecked havoc on the Malabar Coast, further denting the prospects of rabi production. Total area sown under Rabi crops till 11th December, 2015 was down 9.1% YoY at 442.33 lakh hectares versus 486.69 lakh hectares. Among the major crops, wheat at 202.38 lakh hectartes has witnessed a 16.4% YoY drop while pulses at 114.51 lakh hectares is down just 0.7% YoY, oilseeds down by 7.7% YoY at 65.68 lakh hectares, and coarse cereals up 7.7% YoY at 48.92 lakh hectares.

After strong inflows in Indian equities till April 2015, FIIs turn net sellers later but end up with ₹9665 cr. of net purchases in CY2015 till date. Record equity inflows in domestic MFs lead to investments of a mammoth ₹67,726 in CY2015 till date. FIIs continue to repose faith in India's strong macro-economic fundamentals with ₹52,385 cr. of debt inflows in CY2015 till date

FIIs have sold equities worth ₹3185 cr. from 1st December till 9th December, 2015 after being net sellers of ₹7629 cr. in November 2015. From 1st January 2015 till 9th December 2015, FIIs have bought equities worth ₹9665 cr. with heavy buying from January to April 2015 and heavy selling in August, September and November 2015. On the other hand, FIIs have pumped in ₹52,385 cr. in debt from 1st January 2015 till 9th December 2015, and have been marginal sellers in debt over the last couple of months. Indian MFs have seen strong inflows in 2015 and have invested ₹67,726 cr. in equities from 1st January 2015 till 9th December 2015. Indian MFs continue to remain buyers in December with ₹1271 cr. being invested till 9th December, 2015 and ₹6548 cr. in November 2015.

Valuations are broadly in line with long term providing comfort. Interest rate sensitives, Pharma & IT preferred over global cyclical sectors.

At 7600 levels, Nifty is trading at 15.9x, 1 year forward earnings of ₹477.9 (Dec 2016) and is trading at 10% discount to last 10 year's average of 17.7x. MSCI India's premium to MSCI Asia (ex-Japan) at 28% is in line with last 10 year's average premium of 29%. With an uptick in earnings momentum expected from FY17, we believe valuations should hold. Our portfolio would continue to emphasise allocations towards interest rate sensitive sectors like Banks & NBFCs, Auto & Auto Ancillaries, select plays in investment revival like roads, engines, etc., as well as some fundamentally strong pharmaceutical & IT companies. We remain wary of global cyclical sectors.

PMS Strategy Wise Performance

Performance as on 10-12-2015

	Multi Strategy Portfolio (%)	Equigrow Strategy Portfolio (%)	Sensex (%)	Nifty (%)
Post New Investment Team#	85.9	102.8	38.6	42.6
Two Yearly	59.9	70.7	19.2	21.7
Yearly	8.9	11.5	-9.2	-8.0
Half Yearly	7.4	9.9	-5.9	-5.4
Quarterly	4.6	5.1	-1.4	-1.3
Monthly	-0.7	-0.8	-1.9	-1.3

#Since 19th August 2013

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Note: The above strategy returns are of model clients as on 10th December, 2015. Returns of individual clients may differ depending on time of entry in the strategy. Past performance may or may not be sustained in the future and should not be used as basis for comparison with other investments. Strategy returns shown above are post fees and expenses.

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