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Economy & Market Updates

Confluence of global & domestic factors propel a surge in Indian equities. Upward bias to remain intact.

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Indian equities surge post-Budget

A pall of gloom had enveloped the Indian equity markets before the announcement of the Union Budget 2016 with a confluence of global & domestic headwinds threatening to scupper the sentiment with pessimists outdoing each other in predicting that Nifty which was precariously perched at that time at around 6800 levels would breach 6500 or even 6000 levels. We have come a long way since those gloomy times with a swift 1000 point upsurge in Nifty underpinned by a reversal in most of those perceived headwinds.

Expected gradual trajectory in US rate increases in 2016 quells concerns and propels risk-on trade

One of the principal factors that aided risk-on trade globally was the US Federal Reserve's (Fed) admission in its monetary policy release that 'economic conditions will evolve in a manner that will warrant only gradual increases in the federal funds rate and that the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the long run'. Although the labour market conditions in the US have improved with jobless claims falling to a 42-year low & unemployment rate below 5%; inflation at 1.6% has continued to run below the Fed's target of 2% due to decline in energy prices & falling prices of non-energy imports. 1Q CY16 GDP growth has come to a crawl at 0.5% due to softer personal consumption despite low fuel prices, low interest rates, low unemployment rate and warmer than usual winter, as well as the sharpest drop in business investment since 2Q CY09 mainly led by 86% precipitous drop in investments in upstream oil & gas sector but also due to weak overseas & domestic demand. Markets are now expecting Fed to raise rate, if at all, only once towards the end of 2016 as against a widely held belief in December 2015 of 2 to 3 more rate increases. This expected gradual trajectory of US rate increases in 2016 has quelled concerns about large scale capital flight out of emerging markets into the US and lowered risk-aversion leading to sharp surge in global equities.

Fears of tipping into recession & plunging into dreaded deflationary spiral spur ECB & BOJ to continue with massive bond buying

Weak growth prospects, worries of tipping into recession and fears of getting caught in the dreaded deflationary spiral have compelled both the ECB and BOJ to experiment with negative interest rates & aggressive monetary accommodation in the form of massive bond buying programs. ECB increased its monthly bond purchases from Euros 60 billion (bn) to Euros 80 bn (app. $ 91 bn) in April 2016 while BOJ is continuing with its policy of 80 trillion yen ($740 bn.) of annual bond buying program, negative interest rate of 0.1% for banks that wish to deposit excess cash with BOJ and a program to buy riskier assets including stocks.

IMF warns that global growth is too slow for too long. Financial turbulence & rising tide of protectionism identified as 2 biggest risks to global economy

In its semi-annual review of World Economy, IMF has warned that 'global growth continues but at an increasingly disappointing pace leaving the world economy more exposed to negative risks with growth being too slow for too long'. Although it predicts a slight acceleration in growth from 3.1% in 2015 to 3.2% this year and 3.5% in 2017, it acknowledges that its predictions are getting progressively

less optimistic over time. IMF has pointed out two major risks that could stall global economic recovery. First is the danger of growing financial turbulence characterized by sell-off of risky assets, heightened risk aversion, spikes in EM sovereign spreads and sharp falls in oil & other commodity prices. Second is the rising tide of protectionism, backlash against free trade as well as inward-looking & nationalistic policies engulfing many countries in the EU as also the United States evident in the shrill, jingoistic, anti-globalisation tenor of the campaign of leading Presidential candidates. With sectarian strife destabilising many countries in the Middle East, millions of refugees poured into Europe. A few incidents of terrorism, anaemic economic growth post the Financial Crisis in 2008, lack of wage growth & rising inequality is bringing decades-old consensus of open borders under increasing strain in Europe.

In view of the low real borrowing rates, IMF recommends continued monetary accommodation, especially in those countries where deflationary trends are on the rise & output gaps exist. Additionally it recommends investments in infrastructure assets to address supply-side bottlenecks, fiscal support to R&D and balanced budget tax reforms to support growth, address problems of income inequality & foster social cohesion.

UK - 'To be or not to be' in the EU is the question. Brexit can hurtle markets into bouts of heightened volatility

A referendum is due in the UK in June 2016 to consider whether to exit or remain in the EU (Brexit). It is primarily centred on the issue of large scale influx from Eastern European countries replacing jobs from locals & depressing wage growth, fears of open borders being used by economic migrants & militants masquerading as refugees as also necessity to claw-back sovereignty from the much-maligned Brussels-based EU bureaucracy that is being depicted as slothful & slowing UK's economic engine. In case Brexit were to materialize global economy & markets would hurtle into heightened volatility as many trade & investment relationships built over decades would get damaged and any attempt to fashion a new architecture would take years.

IMF lauds India as a bright spot in an otherwise bleak global economy

IMF has predicted that Indian economy will clock the highest growth rate among large world economies at 7.5% in FY17 ahead of China and called the Indian economy as 'a bright spot in an otherwise bleak global economy'. The growth would be driven by private consumption as a result of low energy prices & higher real incomes and further bolstered by pick-up in investment demand & revival of sentiment. It has endorsed the government's adherence to fiscal prudence, advised ushering in labour market reforms & dismantling of supply-side bottlenecks, especially in power sector. An unfavourable monsoon & fiscal pressures due to a rising wage bill as a result of acceptance of VII Pay Commission & OROP have been flagged off as risks that need to be navigated deftly.

Fiscal prudence, focus on rural sector, investments in roads/railways and fillip to consumer demand due to VII Pay Award & OROP drive Indian equities post-Budget

A fiscally-prudent Budget with its triple booster dose of relieving rural distress as a consequence of two successive monsoon failures through a large Rs. 87,000 cr. allocation to rural infrastructure like roads, electricity & irrigation; continuance of massive public investments in roads & railways (Rs. 2.21 lakh cr. in FY17 on top of nearly Rs. 2 lakh cr. in FY16) to ease supply-side bottlenecks & propel aggregate demand as also subsequently crowd-in private sector investment and expected boost to consumption-led demand due to nearly Rs. 1.1 lakh cr. of VII Pay Commission award to Central government employees and Rs. 10,000 cr. payment to retired defence personnel as OROP has been welcomed by markets. Adherence to medium-term fiscal consolidation plan and lower than expected market borrowing program has led to softening of bond yields.

IMD brings glad tidings: Monsoon to be above normal

Although only 15% of India's GDP is contributed by agriculture, nearly 50% of its population is still dependent on agri & allied activities. Two successive monsoon failures has led to a drought-like situation in many parts of the country. This coupled with low rise in MSPs and a fall in global commodity prices had tamped down rural demand. Hence, an above-normal monsoon forecast (106% of long period average) by the IMD has injected a sense of optimism in sectors dependant on rural demand like 2-wheelers, passenger vehicles, tractors, consumer durables, consumer finance, agri-inputs like seeds, pesticides, etc.

RBI brings in seminal change after 6 years in its liquidity management policy by moving the system from deficit to neutral. To lead to faster transmission of rates.

RBI in its April monetary policy, cut repo rate by 0.25% to 6.5%, reduced the daily maintenance of CRR from 95% to 90% of the requirement and narrowed the policy rate corridor from +/- 100 basis points (bps) to +/- 50 bps by reducing Marginal Standing Facility (MSF) rate by 75 bps to 7% and reverse repo rate by 50 bps to 6% with a view to better align weighted average call rate to repo rate.

A seminal change was introduced by RBI in its liquidity management policy. For the last 6 years, RBI had kept the managed liquidity in such a manner that there was a deficit of 1% of net demand and time liability (NDTL) in the system. This was done in response to high inflationary environment prevalent in the economy and it acted as a restraint on banks from excessive lending. RBI has mentioned that the system would now be neutral. As a result, daily borrowing by banks from RBI of roughly Rs. 1 lakh cr. as a result of deficit would vanish. RBI would provide liquidity through open market operations (OMO) and purchase of forex inflows. This seminal shift in liquidity management would lead to faster transmission of rates from banks to borrowers & risk-averseness of banks to lend would reduce due to easy liquidity & less pressure in managing daily CRR balances.

Logjam over stalled Parliament resolved with passage of key economic legislations

The logjam over passage of key legislations in Parliament for the last 2 sessions was finally broken in the Budget session with two crucial economic bills Real Estate Regulation Bill and Aadhar being cleared. It is hoped that in the second half of the session some more bills like Bankruptcy Bill & Amendments to Mines & Minerals Bill would see light of the day.

4Q FY16 Earnings season underway: IT presents a cautious outlook in a US election year, Retail-focused private banks continue to march triumphantly, Corporate-focused private banks not yet out of the woods, FMCG crawls with tepid demand & weak pricing power, Cement shows sharp spike in volumes but weak realizations

We are in the midst of 4Q FY16 earnings season. Results announced till date present a mixed picture. IT majors have posted results in line with market expectations and have indicated a cautious outlook for FY17. Outsourcing of IT jobs to India at the cost of US workers is almost always played up in an election year in the US Presidential campaign and 2016 is no different. However IT outsourcing to India has moved from periphery to become mainstream for Corporate America & has helped enhance its competitiveness by improving productivity both through cost savings and innovation. We remain constructive on a few names in the IT sector.

Retail-focussed private sector banks have once again posted stellar performance both in terms of growth in profits and maintaining pristine asset quality in a challenging economic environment. Some corporate-focussed large private sector banks have chosen to set aside large provisions mainly towards exposures in stressed sectors like power, iron & steel, mining, cement, etc. With RBI's hawkish directives to clean up the balance sheets by end of FY17, we expect the credit costs for these banks to remain elevated in FY17. However, the government's focussed initiatives to lend a helping hand to the most-stressed sectors like steel, gas-based power plants, roads, etc has resulted in early signs of improvement in operating parameters in these sectors. We are hopeful that it should herald the beginning of the end of woes of these lenders. We would be watching their performance closely over the next few quarters.

A few FMCG companies that have declared results so far indicate that volume growth is modest with urban demand holding-up better than rural demand and lack of pricing power due to benign inflation as well as tepid end-product demand. With the government announcing that Pay Commission outlays would reach Central government employees by June-July 2016 and an expected above-normal rains leading to bountiful harvest, 2H FY17 could turn out to be the period that should see demand finally perking-up & return of some pricing power to FMCG companies.

Results of cement majors point towards strong uptick in volume growth on the back government's large public expenditure in roads. Pricing still remains under pressure due to low capacity utilization and lacklustre demand from the housing sector which should look-up post-monsoon. Results of companies in sectors like pharmaceuticals, public-sector banks, oil & gas are still awaited.

FII turn heavy buyers March 2016 onwards, DIIs turn sellers

After being net sellers for nearly a year, FIIs turned large buyers in March 2016 (Rs. 23620 cr.) and have bought shares worth Rs. 3670 cr. from the 1st to 27th April 2016. Domestic institutions on the other hand have sold shares worth Rs. 16892 cr. in March 2016 and Rs. 2554 cr. since 1st to 27th April 2016.

Markets to trade with an upward bias. Time ripe for large allocation to Indian equities with a medium-term perspective

After a near 1000 point rally over the last 2 months post-budget, we expect markets to be guided by the unfolding earnings season, passage of crucial economic legislations in Parliament, arrival & progress of monsoon, uptick in demand both consumption-led to start with followed by investment-led, alleviation of stress in the banking sector due to steady economic recovery aiding stressed sectors. Markets would trade with an upward bias and look poised for a steady upmove. Time is ripe towards large allocation in Indian equities with a medium-term perspective.

PMS Strategy-wise Performance

Performance as on 30-04-2016

	Multi Strategy Portfolio (%)	Equigrow Strategy Portfolio (%)	Sensex (%)	Nifty (%)
Post new investment team#	86.4	103.5	40.6	45.8
Two yearly	49.7	53.6	14.5	17.5
One and a half years	14.9	18.1	-8.1	-5.7
Yearly	7.3	9.6	-5.2	-4.1
Half yearly	-2.5	-2.3	-4.0	-2.7
Quarterly	5.1	4.9	3.0	3.8

#Since 19th August 2013

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Note: The above strategy returns are of model clients as on 30th April 2016. 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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