Prabhudas Lilladher
POWERING YOUR FINANCIAL GROWTH

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Economy & Market Updates

Domestic & global drivers for Indian equity markets in the medium term

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Shadow of Bihar poll results to loom large over India's legislative agenda: Bipartisanship need of the hour

Indian equity markets were closely watching two key domestic events- the election results from the politically crucial Hindi heartland state of Bihar and 2Q FY 2015-16 corporate earnings. The shrill campaign for the bitterly contested polls stretched over five phases and nearly a month. The Grand Alliance of RJD, JD (U) & Congress decisively trounced BJP-led alliance due to its superior caste arithmetic, lack of anti-incumbency against the Chief Minister, success in convincing electorate about developmental track record of the Chief Minister and above all a very high index of opposition that ensured that the votes of those who are opposed to the BJP remain together. The Grand Alliance's success has galvanised Opposition parties to consider forming similar alliances in other poll bound states. These results are bound to find an echo in the upcoming Winter Session of Parliament with an aggressive Opposition throwing down the gauntlet at the government. With the last session (Monsoon) of Parliament not conducting any meaningful business due to repeated disruptions by a section of the Opposition, the government will have to adopt an extremely conciliatory stance by reaching out to them to get some of the crucial pending legislative bills like the GST, Bankruptcy Bill, Whistleblowers Bill, amendments to the Prevention of Corruption Bill etc. cleared especially in the Upper House (Rajya Sabha) where it lacks majority. Both the treasury and opposition benches need to display a spirit of bipartisanship keeping in mind the nation's interest by ensuring that India's economic juggernaut keeps on rolling at a brisk pace to generate employment opportunities for millions of youth who are joining the jobs market every year.

Government pushing the pedal decisively on reforms through executive action

Even if the legislative agenda of the government were to face an onslaught of emboldened Opposition, it can unveil many reforms through executive action. Last fortnight saw two significant moves on this count- first an ambitious measure to rescue the almost-bankrupt State government owned power distribution companies (discoms) and a bold move to increase FDI participation in many sectors by increasing the upper limit for investments and routing most of the investments through automatic route instead of government approval.

'UDAY': A comprehensive package to resuscitate almost bankrupt power distribution companies

The Ujjwal Discom Assurance Yojana (UDAY) is likely to prove a comprehensive game-changer for discoms with four-pronged approach to bring them on a path of sustainable growth. First is reduction in interest costs by transferring 75% of discoms' debt of Rs 4.3

lakh crores to the balance-sheets of State governments (50% in FY16 and 25% in FY17) and asking the State governments to pay back lenders by issuing State government bonds. As State governments typically borrow at 8-9% vis-à-vis 12-13% for discoms this would lead to an annual savings of around Rs 15000 crores. Second is reduction in cost of power through coal swapping. Third is time-bound loss reduction by ensuring quarterly fuel cost adjustment and annual tariff increase that would ensure that tariffs are brought in line with costs by FY19 and also by reducing distribution losses from 22% currently to 15% by FY19 through upgradation of transformers & meters. Lastly by embedding a structure that aligns the financial interests of State governments with discoms. This will be achieved by ensuring that if the discoms incur any losses after FY18 then the losses will be part of those State government's FRBM limits. As an additional incentive, those discoms that adhere to the plan will get additional funding in centrally sponsored schemes like Integrated Power Development Scheme, Deendayal Upadhayaya Gram Jyoti Yojana, Power System Development Fund etc while those that fail to meet the plan would be liable to forfeit their claims on these grants.

FDI reforms in 15 sectors: A crucial macro-economic structural reform to ease & rationalise foreign investments

A crucial macro-economic structural reform was unveiled by the government to ease, rationalise and simplify the process of foreign direct investment in India in 15 sectors including construction, broadcasting, defence, agro-plantations, civil aviation, retail trade etc. with the intention to put more & more FDI proposals on automatic route instead of government route where time & energy of investors is wasted. The reform entails opening up of the manufacturing sector for wholesale, retail and e-commerce so that industries are motivated to Make in India to sell it to customers here instead of importing from overseas. Reforms include enhancing the approval limit by Foreign Investment Promotion Board (FIPB) from Rs 3000 cr to Rs 5000 cr and contain many other long pending corrections including those being felt by limited liability partnerships and NRI owned companies who seem to be motivated to invest in India. To attract more foreign direct investment sectoral caps have been raised for many sectors and full fungibility has been permitted for investments in private sector banks.

Tepid 2Q FY16 results, large 'slack' in Industrial sector to delay their capex cycle but large requirements in Infrastructure sector to lead India's capex cycle with government frontloading spends in roads & railways

Corporate results for 2Q FY16 continue to indicate a very sluggish recovery in demand. Net sales growth remains tepid with the spectre of falling commodity prices on a year-on-year basis constraining companies' pricing power ability. Volume growth remains sluggish especially weighed down by poor rural demand. With companies fighting to maintain their market share in volume terms amidst weak aggregate demand and lack of pricing power, net sales growth appears all the more tepid. However on the positive side the gross margins have expanded due to savings in raw material costs. With many industries like cement, steel & non-ferrous metals, industrial manufacturing, autos etc operating with considerable slack i.e. capacity utilization ranging at 60-70% the revival of capex cycle in the industrial side will take 1-1.5 years. The investment cycle on the infrastructure side, on the other hand, will lead the revival with the government frontloading massive spend in sectors like roads, railways, power transmission etc. 1H FY16 has seen roughly 5000 km of roads (out of yearly target of 10000 km) being tendered by NHAI & Ministry of Road Transport. Similarly, out of Rs 1 lakh crores of capital expenditure budgeted by the Indian Railways in FY16, Rs 37758.62 cr has already been spent in the period April to October 2015 vis-à-vis Rs 35338.82 cr in the same period last year.

Large boost expected to consumer discretionary sectors due to VII Pay Commission award & OROP

Consumer discretionary sectors like autos, housing, consumer durables etc will get boost with the likely implementation of VII Pay Commission award from 1st January 2016 and One-Rank-One-Pension (OROP). The Central government's salary expenditure is likely

to go up by 9.5% in FY16 to Rs 1 lakh cr, a hefty 15.79% in FY17 to Rs 1.16 lakh cr and Rs 1.28 lakh cr in FY 18 due to the Pay Commission award. OROP notification by the government would benefit around 25 lakh ex-servicemen & war widows by re-fixing their pension on the basis of the average of minimum and maximum pension of personnel retiring in 2013 in the same rank and same length of service. Benefit will be effective from 1st July 2014 and will be paid in four equal half-yearly instalments. Pension would be re-fixed every five years. Additional annual expenditure on account of OROP is expected to be around Rs 8000-10000 cr.

Global markets bracing for a December 2015 Fed rate rise

Global markets are keenly watching whether US Federal Reserve (Fed) raises interest rate in December 2015 especially as the October 2015 unemployment rate at 5% plunged to a 7.5 year showing that the domestic economy has gathered enough strength despite strong dollar impacting net exports and holding down GDP growth somewhat. The unemployment rate is now at a level many Fed officials see as consistent with full employment. The strong jobs data in October was supplemented by strong services sector, auto sales data and rise in average hourly earnings. In our view markets have discounted a 0.25% rise in Fed rate in December and are likely to focus on the accompanying commentary which should indicate a slow trajectory of further rate increases.

India's strong macro-economic fundamentals to provide a bulwark against any global volatility: In CY '15 till date FIIs pour Rs. 57052 cr. in debt & Rs. 19336 cr. in equities; DIIs invest Rs. 61791 cr. in equities

In the event of any rise in volatility in global markets as a result of rate action by the Fed we are confident that India's strong macro-economic variables would ensure that it easily weathers the storm. This is clearly evident in the strong surge in FIIs investments in debt securities since the beginning of CY 2015 despite an expectation of rise in US Fed rate and 2.25% fall in India's repo rate. Such a widening gap between the rates theoretically should have led to concerns of FII outflows in debt securities from India. However strong economic growth, well-anchored inflationary expectations, moderation in inflation, strong forex reserves, falling commodity prices aiding sharp contraction in current account deficit and government's falling subsidy bill helping it to put a lid on fiscal deficit have been the reason for FIIs pouring in Rs 57052 cr in debt securities from the start of CY 2015-till-date. Despite some large equity outflows in Aug-Sept 2015 by FIIs, from the start of CY 2015-till-date FIIs have been net buyers to the extent of Rs 19336 cr while strong inflows from retail investors in mutual funds have led to DIIs net buying of Rs 61791 cr.

Valuations broadly in-line with long term providing comfort: Interest rate sensitives, Pharma & IT preferred over global cyclicals

Nifty is currently trading at 16.9x 1 year forward earnings of Rs 459.9 (Oct 2016) and is trading at 4% discount to last 10-year average of 17.6x. MSCI India's premium to MSCI Asia (ex-Japan) at 30% 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 13-11-2015

	Multi Strategy Portfolio (%)	Equigrow Strategy Portfolio (%)	Sensex (%)	Nifty (%)
Post New Investment Team#	88.1	105.5	40.5	44.0
Two Yearly	70.0	82.5	27.3	30.0
Yearly	11.8	14.7	-8.3	-7.1
Half Yearly	9.7	12.2	-6.0	-5.7
Quarterly	0.2	1.5	-7.0	-7.1
Monthly	0.8	1.3	-4.6	-4.5

#Since 19th August 2013

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Note: The above strategy returns are of Model Clients as on 13th November 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 are shown above are post fees and expenses.

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