Dear Friends,

The month of April 2017 saw the benchmark indices S&P BSE Sensex and Nifty 50 gain around 1% and 1.4% respectively. The Mid-cap index, Nifty Free Float Mid-cap 100 surged around 5.2% during the same period.

On the global front, the US administration unveiled the broad framework of its tax plan proposing reducing the individual tax brackets, repealing some taxes, reducing corporate tax rates and levying the onetime tax on overseas profits. Meanwhile, the European central bank (ECB) kept its key policy rates unchanged and reduced its monthly bond purchases to EUR60 bn from April onwards expecting to continue the quantitative easing program at least till December. ECB highlighted that the downside risks to growth had further diminished as the recovery was broadbased.

On the domestic front, the committee set up to recommend the fiscal roadmap for India proposed a framework pegging the general government debt to GDP at 60% by FY2023 with 40% for centre and 20% for states. The fiscal deficit to GDP will be the key operational metric which would have to be reduced to 2.5% by FY2023. The committee recommended the usage of escape clauses to permit a deviation to the extent of +/- 0.5% fiscal deficit to GDP under certain extraordinary circumstances as well as the formation of a fiscal council to ensure an independent assessment of the adherence to the fiscal framework.

The GST rollout seems to be firmly on track as the final amended draft rules are expected to be taken up in the next GST Council meeting on 18th-19th May even as the category classification under the GST rate structure is expected to be finalized by the rate fitment committee shortly. The GST network is expected to be ready by July and would act as the IT backbone of the GST. Most states are expected to pass the SGST bill by May end.

The Indian Meteorological Department (IMD) forecast the southwest monsoon at 96% of Long Period Average (LPA) with a model error of +/- 5% even as the IMD saw a 38% probability of near-normal monsoon. However, the IMD flagged off the possibility of weak El Nino conditions in the latter part of the monsoon season. Further clarity of the evolving monsoon would be from the second update from the IMD in June when the spatial and temporal distribution of the monsoon would be available.

India's trade deficit in March 2017 was at USD 10.4 bn, higher than USD 8.9 bn in the prior month. The exports in March stood at USD 29.2 bn, up 27.6% on a year on year basis against 17.5% in the prior month while the imports were at USD 39.7 bn, up 45.3% on a year on year basis in March against 21.8% in the prior month. For fiscal FY2017, export growth was at 5% at USD 275.5 bn while import growth was at an anaemic 0.4% to reach USD 382.4 bn and trade deficit stood at USD106.9 bn as against USD118.7 bn in the prior fiscal.

The Consumer Price Index (CPI) inflation for March 2017 accelerated to 3.81% as compared to 3.65% registered in the prior month, even as food inflation remained contained at around 2.5%. The core inflation inched marginally higher to 4.9% from 4.8% in February. Meanwhile, headline WPI inflation printed 5.7%, in March 2017 compared with 6.6% in the prior month as fuel inflation dropped from 21% in February 2017 to 18.2% in March 2017 on the back of decline in international oil prices. The divergence between the elevated WPI inflation and the still moderate CPI inflation is to the extent of almost 2% as on March 2017, led by higher WPI, owing to higher commodity prices, albeit lower than the divergence of 3% in the prior month. This is in sharp contrast to the huge gap of 9% between the CPI inflation and WPI inflation registered in September 2015 when WPI inflation was firmly in negative territory.

With key macroeconomic indicators looking robust in the backdrop of the positive impact of far reaching reforms, we believe that the equity market offers a reasonable entry point for a long-term investor with a 3-5 year view.

Team Investment

DEBT MARKET OUTLOOK

Debt market in the month of April 2017 saw the benchmark 10 year Government security (G-sec) close the month at 6.96%, hardening by 26 bps over the month even as the 30 year G-sec hardened by 11 bps during the same period. On the corporate bond side, the 10 year AAA corporate bond closed the month at around 7.77%, hardening by 12 bps over the month. In the month of April, the Foreign Portfolio Investors (FPIs) remained buyers of Indian debt.

The month of April 2017 saw the Indian yields inch up as commentary by the RBI was more hawkish than market expectations. The fixed income market took note of the possible upside risks to inflation as highlighted by the RBI which could play out over the medium term. Moreover, the liquidity absorption stance of the RBI was an overhang imparting upward pressure to the bond yields.

The minutes of the Monetary policy committee (MPC) of the RBI in its first bi-monthly monetary policy review for fiscal 2018 reiterated MPC's concerns on upside risk to inflation. The MPC had unanimously voted to keep the repo rate unchanged while it increased the reverse repo rate by narrowing the LAF corridor.

The MPC noted the sticky behavior of core inflation and the possible mean reversion of food inflation as the key concerns. There was a range of opinions across the spectrum by the MPC members ranging from inflation risks requiring a preemptive 25 bps rate hike in order to avoid the need for back-loaded policy action later on one extreme to noting comfortable inflation dynamics through FY2018 on the other extreme. The MPC highlighted the upside to inflationary risks from a range of factors such as the remonetisation, rising rural wages, the implementation of the 7th pay commission HRA increase, the rollout of the GST, possibility of El Nino conditions impacting the Indian southwest monsoon, higher global commodity prices, and exchange rate volatility.

The RBI has absorbed liquidity from the banking system by issuing Market stabilization scheme (MSS) bonds and Cash management bills (CMB) to the extent of ₹700bn resulting in a fall in surplus liquidity with the commercial banks. The average liquidity in the banking system was to the extent of ₹3.5 tn for the week ending 28th April 2017 compared with ₹4.2trn for the week ending 21st April 2017. The surplus liquidity has also declined due to the increase in money in circulation as consumers have been withdrawing excess cash deposited with the banks.

The Indian metereological department (IMD) has forecast a normal monsoon which could ease price pressures in the food components. The spatial and temporal distribution of the monsoon needs to be monitored for assessing the impact on food prices. However, if the south west monsoon were to be impacted by the possible El nino conditions, the government's response through proactive supply side initiatives and price management policies would be the key to contain food inflation.

Going forward, the fixed income market is bracing for a long pause from the RBI as it assesses the upside risks to inflation and monitors the onset and progress of the south west monsoons. In the near term, the inflation prints in the first half of FY 2018 as against the RBI's projected trajectory of an average of 4.5% would be the key data point to shape the trajectory of the fixed income yields .

EQUITY MARKET OUTLOOK

The month of April 2017 saw the benchmark indices S&P BSE Sensex and Nifty 50 gain around 1% and 1.4% respectively. The Mid-cap index, Nifty Free Float Mid-cap 100 surged around 5.2% during the same period. The FIIs were net sellers in the month of April while the DII's were net buyers.

The month of April saw the Indian equity market reacting to global cues such as elevated geopolitical concerns regarding Syria and North Korea. However, the market sentiment saw a positive turnaround on the back of early signals of a favorable French presidential election result post the first round of French elections. The IMD's forecast of a normal south west monsoon was an added positive.

On the domestic front, the fourth quarter earnings season got off to a mixed start with the early results indicating continued asset quality pressures and high credit costs in the financial sector even as some companies in the housing finance space saw robust earnings. The results of the IT sector has been tepid, on expected lines, even as some companies in the cement sector seem to have shrugged off the demonetization concerns to report strong growth in volumes.

The passenger vehicle segment reported a strong growth in volumes in April even as the two wheeler segment rebounded after a weak fourth quarter on the back of demonetization. However, the commercial vehicle segment saw a sharp decline in volumes on the back of an increase in prices post implementation of the BS IV norms.

The RBI announced the revised guidelines for the Prompt Corrective Action (PCA) framework for banks wherein, the regulator would proactively take corrective action if a bank breaches any of the specified limits on capital, asset quality, profitability and leverage under the framework. The bank would be classified in risk threshold ranging from 1 to 3, depending on the degree of the breach. The corrective action would be through measures ranging from restrictions on dividend distribution to identifying the bank as a potential merger candidate.

The data on the deployment of bank credit across sectors reflect an uptick in retail loan growth and trade finance in March. The retail loan growth of a robust 16.7% year on year in March was on the back of an impressive growth in housing loans. The trade finance picked up to 12.3% year on year after being weak in the prior months post demonetization. The growth in industry loans is still tepid on the back of a large decline in the mid-size and large corporate segment.

The Real Estate Regulatory Act (RERA), effective from May 1st 2017, could be a key pro-consumer legislation which could increase transparency in the real estate sector by reducing information asymmetry and increasing accountability. It is expected to put in place an effective regulatory oversight mechanism to enforce contracts thereby increasing the consumer's confidence in the sector. In the long term, RERA has the potential to catalyze the consolidation of the unorganized market and increase the scale of the established players and help rationalize prices.

The high frequency indicators relating to air passenger traffic, foreign tourist arrivals, hotel occupancy rates and passenger car sales have registered buoyancy and the manufacturing PMI is firmly in the expansion mode.

With key macroeconomic indicators looking robust in the backdrop of the positive impact of far reaching reforms, we believe that the equity market offers a reasonable entry point for a long-term investor with a 3-5 year view.

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