

Dear Friends,

The month of July 2017 saw the benchmark indices S&P BSE Sensex and Nifty 50 surge around 5.15% and 5.84% respectively. The Mid-cap index, Nifty Free Float Mid-cap 100 gained around 4.43% during the same period.

On the global front, the FOMC of the US Federal reserve (Fed) kept the US Fed Fund rate unchanged in its July meeting, on expected lines. However, the Fed changed the starting point for the adjustment of its USD 4.5 tn balance sheet from “this year” to “relatively soon” which has increased expectations that the adjustment could start in the month of September itself. The policy statement was generally considered by the market experts to be more dovish as the committee acknowledged more directly that the inflation rate was running below 2%. Meanwhile, the European central bank (ECB) kept the policy rates unchanged as expected and made no change in the quantity and duration of EUR60 bn per month asset purchase program. It expected the asset purchases to continue until end of December 2017 or beyond if needed until inflation path had been sustainably adjusted.

On the domestic front, the RBI's Monetary Policy Committee (MPC) in its third Bi-Monthly monetary policy reduced the policy repo rate under the liquidity adjustment facility (LAF) by 25 bps from 6.25% to 6.00% while continuing to maintain its neutral stance.

India's central government fiscal deficit in the first quarter FY 2018 reached an elevated 80.8% of the full year target, much higher than the 61.1% in the same period last year. The total expenditure was up around 27% year on year in the first quarter, reflecting a frontloading of expenditure by the government. The tax revenue collection has been better compared to last year with gross tax collections up 15.2% year on year.

Trade deficit in the month of June was at USD 13 bn, a tad below the USD 13.8 bn in the prior month. The exports in June was at USD 23.6 bn, registering a growth of 4.4% year on year, as against 8.3% growth in May. Imports in June were at USD 36.5 bn, growing 19% year on year, against 33.1% in May. Oil imports were at USD 8.1 bn in June, while non-oil imports were at USD 28.4 bn with gold imports at USD 2.5 bn.

The Consumer Price Index (CPI) inflation for June 2017 came in at 1.5%, lower than the market expectation of around 1.7% and lower than the 2.2% registered in the prior month. Overall, food inflation contracted by 1.2% on a year on year basis in the month of June as against a contraction of 0.2% in the prior month, on account of lower levels of inflation in certain food components such as vegetables and pulses. Wholesale Price Index (WPI) inflation for June 2017 printed 0.9% on a year on year basis, lower than the 2.2% registered in the prior month.

The cumulative rainfall as of July 26th was at around 5% above normal with most of India receiving normal to excess rainfall though parts of south India saw deficient rains. Out of the 36 sub-divisions across India, 7 had received excess rainfall, 26 had received normal rainfall, and 3 had received deficient rainfall.

As of July 28th, 2017, the total Kharif (summer crop) acreage was 3.3% higher than the same period last year. The sowing acreage for rice was 2.4% higher and pulse acreage was 6.9% higher even as the oilseed acreage was 9.2% lower than last year's. Higher sowing acreages were seen in coarse cereals, sugarcane and cotton.

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 July 2017 saw the new benchmark 10 year Government security (G-sec) close the month at 6.47%, easing by 4 bps over the month. The 30 year G-sec eased by 2 bps over the month to close at 7.10%. On the corporate bond side, the 10 year AAA corporate bond closed the month at around 7.31%, easing by 11 bps over the month. In the month of July, the Foreign Portfolio Investors (FPIs) remained buyers of Indian debt. The Indian fixed income yields eased across the board in July as the June CPI inflation print remained below market expectations.

The RBI's Monetary Policy Committee (MPC) in its third Bi-Monthly monetary policy reduced the policy repo rate under the liquidity adjustment facility (LAF) by 25 bps from 6.25% to 6.00%. The decision of the MPC was consistent with a neutral stance of monetary policy in consonance with the objective of achieving the medium-term target for CPI inflation of 4% within a band of +/- 2%, while supporting growth.

The RBI took comfort from a normal and well-distributed south-west monsoon improving the prospects of agricultural and allied activities supporting rural demand as around 84% of the country's geographical area received excess to normal rainfall as of August 1st. The RBI expects the achievement of the robust crop production target set for FY 2018 and noted that the procurement operations in respect of rice and wheat during the rabi (winter crop) marketing season had been stepped up to record levels at 36.1 mn tonnes in April-June 2017 and the stocks had risen to 1.5 times the buffer norm for the quarter ending September.

The RBI was concerned that the industrial performance had weakened in April-May 2017 reflecting a broad-based loss of speed in manufacturing. Moreover, the weakness in the capex cycle was also evident in the number of new investment announcements falling to a 12 year low in the first quarter, the lack of traction in the implementation of stalled projects, the deceleration in the output of infrastructure goods, and the ongoing deleveraging in the corporate sector. In July, the Purchasing manager's index (PMI's) for India contracted, reflecting the roll out of the GST.

On the inflation front, the MPC observed that while inflation had fallen to a historic low, a conclusive segregation of transitory and structural factors driving the disinflation was still elusive. The MPC noted the price spikes with respect to the inflation-sensitive vegetables even as excess supply conditions continued to push down prices of pulses and kept the prices of cereals in check.

The MPC noted that some of the upside risks to inflation had either reduced or had not materialized. The MPC opined that the baseline path of headline inflation excluding the HRA impact had fallen below the projection made in June to a little above 4% by the fourth quarter and the inflation excluding food and fuel had fallen significantly over the past three months. Moreover, they stated that the roll-out of the GST had been smooth and the monsoon normal. The MPC concluded that consequently, some space had opened up for the monetary policy accommodation, given the dynamics of the output gap resulting in a 25 bps reduction in the policy repo rate. However, the MPC expected the trajectory of inflation in the baseline projection to rise from current lows and therefore the MPC decided to keep the policy stance neutral and to watch incoming data.

The MPC highlighted the surplus liquidity conditions exacerbated by front-loading of budgetary spending by the government even as there was some moderation in the pace of increase in currency in circulation during the months of June and July. Surplus liquidity of ₹1 tn was absorbed through issuance of treasury bills under the market stabilisation scheme (MSS) and ₹1.3 tn through cash management bills on a cumulative basis thus far this financial year. The RBI had opted for outright open market sales of ₹100 bn each on two occasions in June and July and has announced another auction of an equivalent amount to be conducted on August 10th, 2017.

Going forward, the fixed income market will brace for a pause in interest rates in the near term as the CPI inflation prints are expected to be higher than the record lows registered in the month of June. Some market experts are of the view that the RBI has limited monetary space in the near term as the CPI inflation prints are expected to be broadly in line with the first half of FY 2018 projection in the range of 2-3.5%.

EQUITY MARKET OUTLOOK

The month of July 2017 saw the benchmark indices S&P BSE Sensex and Nifty 50 surge around 5.15% and 5.84% respectively. The Mid-cap index, Nifty Free Float Mid-cap 100 gained around 4.43% during the same period.

The Indian equity markets in July were buoyant due to favourable global markets momentum on the back of dovish monetary policy from the major global central banks, a relatively seamless transition to GST in India, a significant softening of CPI inflation and higher than normal monsoon raising expectations of a recovery in rural demand. The FII's and DII's were buyers in the month of July taking their CYTD total net inflows to around USD 9.1bn and USD 4bn respectively.

The first quarter FY 2018 earnings growth was at acceptable levels for the companies making up the Nifty universe thus far, despite companies in many sectors running down inventories ahead of the GST rollout. A slew of companies in sectors such as financials, telecom and cement have surprised positively while many companies in the healthcare sector have delivered subpar earnings. In the near term, corporate earnings might be impacted by the possible issues and implementation challenges pertaining to the GST even as there could be some respite due the restocking over the next few quarters.

The government has confirmed that subsidised LPG prices would be raised by ₹4 per cylinder per month hereon as against ₹2 per cylinder per month earlier till March 2018 or till subsidies were fully removed, whichever was earlier. The fortnightly price hikes for kerosene, meanwhile, continue at ₹0.2/litre. This should further reduce the subsidy overhang for the upstream oil companies while also being a positive for the Oil marketing companies (OMCs) as it would reduce their dependence on subsidy compensation from the government and improve their working capital dynamics.

There has been some high frequency indicators indicating robust economic activity such as air freight carriage, commercial vehicles, recent uptick in the sales of passenger cars and two-wheelers, strong and sustained growth in the subscriber base of voice and data services, robust growth of foreign tourist arrivals and air passenger traffic. An expectation of a good Kharif (summer crop) harvest and higher budgetary allocation to housing in rural areas is expected to shore up rural demand. Moreover, the significant step-up in the budgetary allocation for roads and bridges and the growth-enhancing effects of the GST would support economic activity in the medium term.

The RBI has been of the view that there was an urgent need to reinvigorate private investment, remove infrastructure bottlenecks and provide a major thrust to the PMAY for housing needs of all through speedier clearance of projects by the states. The government and the RBI are working in close coordination to resolve large stressed corporate borrowers and recapitalize public sector banks within the fiscal deficit target to help restart credit flows to the productive sectors of the economy as the demand revives.

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