Dear Friends,

The month of March 2017 saw the benchmark indices S&P BSE Sensex and Nifty 50 gain around 3.05% and 3.31% respectively. The Mid-cap index, Nifty Free Float Mid-cap 100 surged 4.35% during the same period.

In the US, the FOMC of the US Federal Reserve raised interest rates by 25 bps on expected lines while reiterating its accommodative stance and guiding gradual rate increases in the future. Meanwhile, the ECB maintained its benchmark rate and indicated that the quantitative easing would run until inflation is on a sustainable path towards price target and can be increased in size and duration if the outlook worsens.

On the legislative front in India, the parliament passed four landmark bills namely Central GST bill, Integrated GST bill, Union territory GST bill, and GST compensation to states bill, in a significant move to enable the ushering in of the GST regime. The states have to now pass the State GST bill by May to meet the July 1st deadline for the nationwide rollout of the GST. Meanwhile, the rules dealing with GST have been broadly finalized and around 60% of existing businesses have already enrolled for the GST even as the tax department is likely to conduct outreach programs for small businesses to ensure a smooth rollout.

The Monetary policy committee (MPC) of the RBI in its first bi-monthly monetary policy review for fiscal 2018 kept the repo rate on hold on expected lines even as it narrowed the LAF corridor with the reverse repo rate under the LAF pegged at 6% and the marginal standing facility (MSF) rate at 6.5% and persevered with the neutral stance.

The Current account deficit (CAD) in the third quarter FY 2017 widened to USD 7.9 bn, higher than USD 3.4 bn in prior quarter led by higher trade deficit on the back of higher gold imports. The capital flows slowed to USD 6.2 bn against USD 12.8 bn in 2QFY17 due to net FPI outflows in equities and debt. Further, FCNR (B) redemption due in October-November led to net NRI deposits of a negative USD18.5 bn in 3QFY17. However, overall capital flows remained positive, largely on the back of net FDI flow of USD 9.8 bn. Overall, the balance of payments was at a negative USD 1.2 bn against USD 8.5 bn in 2QFY17. The current account deficit for the first three quarters of FY 2017 narrowed to 0.7% of GDP, half of its level a year ago. For the year as a whole, the RBI expects the current account deficit to remain muted at less than 1% of GDP. Foreign direct investment (FDI) has dominated net capital inflows during April-December 2016, with manufacturing, communication and financial services being the preferred sectors.

Trade deficit in February was at USD 8.9 bn; lower than USD 9.8 bn in January. February exports growth was at 17.5% year on year against 4.3% in January. The strong merchandise exports growth in February 2017 were broad-based, with major contributors being engineering goods, petroleum products, iron ore, rice and chemicals. Imports grew 21.8% year on year to USD 33.4 bn in February on a back of a recovery in gold imports against 10.7% year on year to USD 31.9 bn in January. Non-oil non-gold imports continued to grow at a modest pace, though capital goods imports remained sluggish. The export growth for the first eleven months of fiscal 2017, was at 2.7% while imports contracted by 3.1%.

The Consumer Price Index (CPI) inflation for February 2017 came in at 3.65%, broadly similar to the market expectation but higher than the 3.2% registered in the prior month. Wholesale Price Index (WPI) inflation for February 2017 increased sharply to 6.55%, broadly in line with the consensus estimate and higher than the 5.2% registered in the prior month. The divergence between the elevated WPI inflation and the still moderate CPI inflation was to the extent of almost 3% as on February 2017, led by higher WPI, owing to higher commodity prices and adverse base effects. This was 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.

Early forecasts of the monsoons indicate that India is likely to receive below-normal rainfall this year owing to an evolving El Niño situation. However, recent developments after the above forecasts offer some respite for the upcoming south west monsoon season.

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 March 2017 saw the benchmark 10 year Government security (G-sec) close the month at 6.70%, easing by 17bps over the month even as the 30 year G-sec eased by 7 bps during the same period. On the corporate bond side, the 10 year AAA corporate bond closed the month at around 7.65%, easing by 15 bps over the month. In the month of March, the Foreign Portfolio Investors (FPIs) remained buyers of Indian debt.

The Monetary policy committee (MPC) of the RBI in its first bi-monthly monetary policy review for fiscal 2018 kept the repo rate on hold on expected lines while it narrowed the LAF corridor pegging the reverse repo rate at 6% and the marginal standing facility (MSF) rate at 6.5% even as it persevered with a neutral monetary policy stance. The decision of the MPC was in consonance with the objective of achieving the medium-term target for consumer price index (CPI) inflation of 4 % within a band of +/- 2%, while supporting growth.

The MPC noted that the headline CPI inflation was set to undershoot the target of 5% for Q4 of 2016-17 and projected inflation at an average of 4.5 % in the first half of the FY 2018 and 5 % in the second half. The MPC opined that the risks to inflation were evenly balanced at the current juncture with upside risks stemming from the uncertainty surrounding the outcome of the south west monsoon in view of the rising probability of an El Niño event around July-August, and its implications for food inflation. They also noted upside risks to the inflation trajectory from managing the implementation of the allowances recommended by the 7th pay commission, the one-off effects of the GST, the possibility of higher general government deficit which is likely to be exacerbated by farm loan waivers, global commodity prices and geopolitical risks inducing global financial market volatility. The downside risks to inflation was expected from easing international crude prices and stepped-up procurement operations in the wake of the record production of food grains to rebuild buffer stocks.

The MPC reiterated its commitment to bringing headline inflation closer to 4% on a durable basis in a calibrated manner. Accordingly, the MPC was keen to monitor inflation related developments closely and wanted the food price pressures to be in check so that inflation expectations can be re-anchored. The MPC stated that the future course of monetary policy would largely depend on incoming data on how macroeconomic conditions would evolve.

The RBI noted that the banks had reduced lending rates, although further scope for a more complete transmission of policy impulses remained. The RBI provided greater clarity about liquidity management, even as it steadily drained out the surplus liquidity. The RBI was determined to put the resolution of banks' stressed assets on a firm footing and create congenial conditions for bank credit to revive and flow to productive sectors of the economy.

Meanwhile, the central government's borrowing calendar for the first half of FY 2018 pegged the gross borrowing at ₹3.72 tn, making up 64.1% of its gross borrowing program for FY2018BE, higher than 61% in the first half FY17 and an average of 60.9% in the past four years. The weekly dated securities auction size was at ₹150-₹180 bn with the tenor concentrated in the 10-14-year bucket

The Indian fixed income market saw a sharp selloff post the February RBI policy on the back of the change in stance of the RBI from accommodative to neutral. Subsequently, the bond market has rallied in the month of March on the back of robust inflows from FPIs and falling oil prices.

Going forward, the market expects the RBI to be in a long pause as it monitors the onset and progress of south west monsoon, the rollout of the GST and the allowances of the 7th pay commission. CPI inflation is likely to have bottomed out and is headed higher over the fiscal 2018. The immediate trigger for the fixed income market is the liquidity management tools that the RBI is expected to use to remove liquidity overhang in the system to align with its neutral monetary policy stance.

EQUITY MARKET OUTLOOK

The month of March 2017 saw the benchmark indices S&P BSE Sensex and Nifty 50 gain around 3.05% and 3.31% respectively. The Mid-cap index, Nifty Free Float Mid-cap 100 surged 4.35% during the same period. The FIIs were net buyers to the tune of USD 5.1 bn in the month of March while DII's were net sellers.

The month of March also saw the continuation of the stellar equity market performance on the back of strong FPI flows as the concerns of a faster trajectory of rate hike from the US Federal reserve abated. The results of the state elections in India, passage of four key GST bills in the parliament, the accommodative stance of the global central banks such as ECB and BoJ as well as the still benign CPI inflation were positive factors for the Indian equity market.

The fourth quarter earnings could see a net income growth of around 9% on a year on year basis for companies making up the BSE Sensex on the back of expectations of a strong performance of the banking sector due to the low base effects. Some sectors could report tepid earnings on the back of weak demand, higher raw material prices and increase in discounts.

The RBI, in its assessment report on impact of demonetization on the Indian economy noted the resilience of the organized sector even as some labour intensive manufacturing segment and services segments were adversely affected. The demonetization period saw a sharp increase in CASA deposits of banks even as surplus liquidity with banks was expected to decline going forward. Exports of sectors such as gems and jewellery, leather and leather products as well as meat, dairy and poultry products contracted significantly and gold demand declined sharply in December and January.

The RBI expects the GVA growth to strengthen to 7.4% in FY 2018 from 6.7% in FY 2017, with risks evenly balanced on the back of a rebound on discretionary consumer spending due to rapid remonetization and restoration of activity in cash-intensive retail trade, hotels & restaurants, transportation and unorganized segments. Additionally, significant improvement in transmission of past policy rate reductions into banks' lending rates post demonetization should further encourage both consumption and investment demand. Moreover, the Union Budget is expected to stimulate capital expenditure, rural demand and social & physical infrastructure. Structural reforms in the form of the roll-out of the GST, the institution of the Insolvency and Bankruptcy Code and the abolition of the Foreign Investment Promotion Board is expected to boost investor confidence and bring in efficiency gains.

The expansion in the manufacturing PMIs on the back of growth of new orders and output, the improvement in the Q1 FY 2018 overall business sentiment in the RBI's industrial outlook survey on the back of a sharp pick up in both domestic and external demand, coincident indicators such as exports and non-oil non-gold imports indicate higher economic activity even as the sizable underutilization of capacity in several industries could operate as a drag on investment.

Overall, high frequency indicators relating to railway traffic, telephone subscribers, foreign tourist arrivals, passenger car and commercial vehicles are regaining pace, thereby positioning the services sector on a rising trajectory. After three consecutive months of contraction, the services PMI for February and March emerged into the expansion zone on improvement in new business. However, rural demand remains depressed as reflected in lower sales of two and three-wheelers and fertilizer. The domestic capex cycle is gradually recovering on the back of government capex led by the spending from states. The capex cycle is expected to be led by new projects in infrastructure, defense, railways, roads, power and oil & gas.

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