Dear Friends,

The month of May 2017 saw the benchmark indices S&P BSE Sensex and Nifty 50 gain around 4.1% and 3.4% respectively. However, the Mid-cap index, Nifty Free Float Mid-cap 100 shed around 3.2 % during the same period.

On the global front, the US employment report in May was weaker than expected as the Non-farm payrolls (NFP) increased by a modest 138,000 and the April NFP saw a meaningful downward revision. It is expected that the weak US employment data would have to be factored in by the US Federal Reserve (Fed) in its FOMC meet in June eventhough the minutes of the prior FOMC meet had indicated that most members felt that, if economic data came in broadly in line with expectations, it would soon be appropriate to nudge rates higher.

The OPEC decided to extend its production cuts by nine months till March 2018 even as they expressed confidence that the extension would bring down the oil surplus and return oil inventories to long-run averages. However, the US oil production has been increasing since the start of the year led by a steep increase in the number of oil rigs and this had resulted in downward pressures in oil prices.

On the domestic front, the real GVA growth for FY 2017 clocked 6.6% even as the GDP growth printed 7.1%. GVA growth for the fourth quarter of FY 2017 was at a modest 5.6% year on year showing the lag impact of the demonetization, which happened in the third quarter. However agriculture sector maintained its growth momentum at 5.2% in the fourth quarter FY17 even as manufacturing growth slowed to 5.3% and construction reported a contraction of 3.7% in the fourth quarter FY 2017. Within services, financial, real estate & professional services grew by just 2.2% while the services sector was buoyed by significant government spending as it surged 17% in the fourth quarter FY 2017.

The Indian meteriological department (IMD) expects the south west monsoon at 98% of Long period average (LPA) against its earlier estimate of 96% released in April. The IMD estimates a 50% probability of normal rainfall and expects the sowing season to experience normal rainfall with July rainfall at 96% of LPA and August rainfall at 99% of LPA. The spatial distribution forecasts were satisfactory with rainfall in north-west India expected at 96% of LPA, north-east India at 96% of LPA, central India at 100% of LPA, and southern peninsula at 99% of LPA.

The Goods and Service Tax (GST) council finalized the tax rate structure under the new GST regime with the essential items mainly exempt from tax while the remaining items taxed in brackets of 5%, 12%, 18% and 28% with additional cesses on certain product categories. The announcement of the itemised tax rates mark a significant milestone in rolling out GST by July 1st. The announced rates signal that GST will be broadly neutral on inflation as the GST council kept the tax incidence for a majority of goods & services closer or marginally lower than the current tax regime to mitigate the inflationary impact. They expect any revenue loss arising from the lower tax rate would be compensated by higher degree of tax compliance.

The fiscal deficit in FY2017 stood at 3.5% in line with earlier estimates. The gross tax collections registered a growth of 18%, higher than 17% growth expected in FY2017 revised estimates with the indirect tax collections growing by 21.6% and direct taxes growing by 16.9%. The excise duty collections grew 32.7% while customs duty and services tax grew 7.4% and 20.4% respectively. Corporate tax collections grew by a modest 7% and income tax collections grew by a robust 24.7%. Total expenditure increased 10.3% with capital expenditure growth at 14.7% while revenue expenditure grew 9.5%.

India's trade deficit in April was at USD 13.2 bn, higher than USD 10.4 bn in March. The exports in April stood at USD 24.6 bn as it grew at 19.8% against 27.6% in March while the imports were at USD37.9 bn as it grew 49.1% in April against 45.3% in March. The imports growth was robust across sectors led by gold, capital goods and ores & minerals. The exports growth was on the back of impressive growth in petroleum and engineering sements.

The Consumer Price Index (CPI) inflation for April 2017 came in at 3%, lower than the market expectation of around 3.4% and lower than the 3.9% registered in the prior month. CPI inflation ex. food and ex. fuel, a proxy to core CPI inflation in April registered 4.5% year on year, as against 4.9% in the prior month with broad based fall in inflation in health, recreation and household requisites. Some market experts expect the core inflation to nudge higher in the next few months on the back of the hike in HRA allowances for government employees as part of the 7th pay commission as well as from the implementation of GST. Wholesale Price Index (WPI) inflation for April 2017 printed 3.9% on a year on year basis, lower than the 5.3% registered in the prior month.

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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DEBT MARKET OUTLOOK

Debt market in the month of May 2017 saw the new benchmark 10 year Government security (G-sec) close the month at 6.66% even as the 30 year G-sec eased by 12 bps during the same period. On the corporate bond side, the 10 year AAA corporate bond closed the month at around 7.64%, easing by 13 bps over the month. The Foreign Portfolio Investors (FPIs) remained buyers of Indian debt over the month.The Indian fixed income yields eased across the board in May as the CPI inflation print for the month of April was below market expectations.

In its second bi-monthly monetary policy review for fiscal FY 2018, the Monetary policy committee (MPC) of the RBI held the repo rate at 6.25%,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 MPC noted the abrupt and significant retreat of inflation in April from the firming trajectory that was developing in the months of February and March and felt it appropriate to assess if the unusually low momentum in the inflation print for April would endure. They highlighted the supply glut in pulses caused by a record output and imports leading to a sharp fall in prices and expected policy interventions to arrest the slump in prices. They opined that the easing of inflation excluding food and fuel might be transient in view of its underlying stickiness in a backdrop of rising rural wage growth and strong consumption demand. On the inflation front the MPC believed that the April CPI inflation print had imparted considerable uncertainty to the evolving inflation trajectory, especially in the near term.

The MPC projected the headline inflation in the range of 2.0-3.5 % in the first half of FY 2018 and 3.5-4.5 % in the second half if the configurations evident in April were to sustain in the absence of policy interventions. They expected the risks to be evenly balanced, although the spatial and temporal distribution of the monsoon and the government staying the course through effective food management would play a critical role in the evolution of risks.

The MPC expressed caution regarding the rising risk of fiscal slippages, with inflationary spillovers, from the announcements of large farm loan waivers. The MPC also flagged off global political and financial risks materialising into imported inflation as well as the disbursement of allowances under the 7th central pay commission's award as upside risks to inflation. The MPC did not expect any material impact on overall inflation from the implementation of the GST.

The MPC noted that the incoming data suggested that the transitory effects of demonetisation in prices of food items had lingerted, entangled with excess supply conditions with respect to fruits and vegetables, pulses and cereals. At the same time, the MPC opined that the CSO's latest data on GDP and industrial production point to the sector specific and transient impact of demonetisation on the broader economy and the resilience of private consumption. The MPC stated that it was difficult to isolate these factors or to judge the strength of their persistence while it would continue to monitor the underlying inflation pressures, especially input costs, wages and imported inflation.

The MPC, while noting that inflation had fallen below 4% only since November 2016, remained focused on its commitment to keeping headline inflation close to 4% on a durable basis keeping in mind the output gap. The MPC wanted to avoid any premature action at this stage and risk disruptive policy reversals later which could result in the loss of its credibility.

Going forward, the fixed income market should take some comfort from the RBI's projection of a significantly lower inflationary trajectory as well as less hawkish stance in the monetary policy and expect some monetary space to open up for the RBI to nudge rates downwards provided the south west monsoons were normal and the food inflation contained. In the near term, the inflation prints in the first half of FY 2018 in the range of 2.0-3.5% in line with RBI's revised projected trajectory would be the key data point to shape the trajectory of the fixed income yields.

EQUITY MARKET OUTLOOK

The month of May 2017 saw the benchmark indices S&P BSE Sensex and Nifty 50 gain around 4.1% and 3.4% respectively. However, the Mid-cap index, Nifty Free Float Mid-cap 100 shed around 3.2 % during the same period.The FIIs and DIIs were net buyers over the month.

The month of May saw the Indian equity market reacting to domestic cues such as a significant momentum in achieving GST milestones such as finalizing GST rates, the expectations of a normal monsoon, sustained strong macro-economic data and a reasonable fourth quarter FY 2017 earnings season.

The net profits for the fourth quarter FY 2017 of the companies comprising the Nifty Index grew 23% on a year on year basis, on the back of a favourable base in sectors such as financials and metals. The net interest income growth of financials recovered from a low base while metals benefited from stabilizing global commodity prices and government policy support. The telecom sector revenues continued the downward trend as incumbents faced pricing pressures which offset any volume increase. Some companies in the IT Services and health care sector saw headwinds from adverse exchange rate and regulatory uncertainties. Some companies in the consumer goods space reported subdued revenue growth momentum as demonetization effect lingered on even as higher commodity prices adversely impacted their margins.

In an effort to enable speedy resolution of stressed assets in the banking system, the Government modified the Banking Regulation Act to give the RBI greater powers to address the NPL issue. The RBI is now mandated to direct banks to initiate insolvency proceedings in case of default under the insolvency code as well as issue specific instructions to banks for resolution of stressed loans and appointment of authorities to advice banks on resolution related issues. The expectation of more oversight committees (OCs) under the aegis of RBI as well as the expanding the role of OCs was another key development to speed up the resolution process.

On the economic activity front, the high frequency real indicators of activity such as freight carriage by air and rail gathered momentum even as the passenger car sales accelerated on the back of sustained strength of urban demand. However, the sale of commercial vehicles and three-wheelers contracted, reflecting in part the effects of new emission norms and technology changes even as the two-wheeler sales remained depressed, indicating still subdued rural demand.

In the communication sub-sector, there was a strong growth in the subscriber base of voice and data services. The sustained growth of foreign tourist arrivals and air passenger traffic, both domestic and international, supported activity in the hotels, restaurants and the hospitality sub-sector. However, both steel consumption and cement production were sluggish, pointing to continuing weakness in construction activity. The services PMI for May rose to its highest reading since November 2016, with an expansion in new business reflecting improving underlying demand conditions, alongside optimism on employment.

In the near term, the continuing re-monetization should enable an up-tick in discretionary consumer spending, especially in the cash-intensive segments of the economy. Additionally, the reduction in banks' lending rates post-demonetization is expected to support both consumption and investment demand of households and stress-free corporates. Moreover, the Government spending continues to be robust, cushioning the impact of a slowdown in other constituents. Meanwhile, the business expectations index of the RBI's Industrial Outlook Survey in April reflected optimism in the manufacturing sector in Q2 FY 2018, driven by expectations of rising rural demand going forward, higher exports growth and profit margins.

In the medium term, the Indian equity market is expected to benefit from structural initiatives such as the GST rollout, a less-cash economy, increased direct tax compliance and digitization which should accelerate the transition toward the organized sector in a slew of sectors. Moreover, India's corporate earnings could see some tailwinds from stable global commodity prices, signs of global growth stabilization and lower domestic interest rate.

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