ALCHEMY
PRIVATE WEALTH

Investment Matters

June 2011

BESPOKE
FINANCIAL EXPERTISE
TO MAKE THE RIGHT
MOVES, MORE OFTEN.

EQUITY OUTLOOK FROM CIO'S DESK

Global equity markets corrected during the month of May for a variety of reasons, the foremost being the rebound in the US dollar (the dollar index rose +2.2% during the month). We also saw a sharp correction in commodity markets early on in the month on the back of comments from ECB's Trichet.

Asia outperformed in this fall with the MSCI AC Asia ex-Japan index falling -1.7% compared to the -2.5% fall in the MSCI AC World Index and a -3% fall in the MSCI EM Index. The Dow fell -1.9% during the month. India, however, underperformed global indices for a second consecutive month and is now the fourth worst performing EM (out of 21) YTD.

In India, the mid-cap index outperformed the narrow market for a second consecutive month and the BSE Midcap Index fell -2.6%, compared to the -3.3% fall in the Nifty & Sensex and a -5.5% fall in the BSE Small Cap Index. The BSE500 Index fell -2.6%. Market activity continued to be poor with the cash market turnover now at a 27-month low of US$65bn. The futures market saw a 9% MoM improvement in activity to US$580bn.

Five state elections came to an end and the ruling party at the centre i.e. Congress (and its allies) won three out of the five. In West Bengal, a state ruled by communists for 37 years, we saw a rout of the left government by Ms Mamata Banerjee, Railway Minister in the central cabinet). She won a landslide 226 seats (out of a total 294 seats) while the ruling left government garnered only 60 seats.
Tired of the bad economic policies of the ruling leftist government and seeing the progress made by the rest of India, this demonstrates why politics in India is slowly taking an economic dimension. One of the most important positive trend is that the anti-incumbency factor is no longer working where the party in power has delivered on development and governance (recent example Bihar) and is working very ferociously where there has been lack of any progress or governance (west Bengal and TN in the recent assembly elections). Governments which will have understood the trend of voters are seeking "politics of aspiration" will make it. If you are a keen follower of politics, I would recommend you read Indian express editor Shekhar Gupta's article post the recent elections (http://www.indianexpress.com/news/jantar-chhu-mantar/790720/0). It also demonstrates the success of India's democratic system which sees the exit and entry of governments at both the local and central level without any violence. While the process of democracy leads to slow decision making, it empowers the people: something many countries in Asia do not enjoy.

Inflation continues to be the riding concern across EMs and in India in particular. The central bank, RBI, raised policy rates 50bps to 7.25% on 03 May and has now turned hawkish. We do not rule out another 25bps-50bps hike in the coming meeting on 16 June.

Local elections in five states ended mid-May and the government oil companies immediately acted, as expected, to raise petrol prices by 8% (or by Rs5/litre) to Rs68/litre (it now costs US$100 to fill a 65-litre petrol tank of a mid-size car like a Honda Accord, which will last you for 500km in a crowded city like Mumbai). This hike in petrol prices will directly impact inflation by ~10bps in June. Oil companies continue to lose money on petrol, so another hike cannot be ruled out if crude (Brent) prices remain at US$115/bbl for any longer.

Inflation for the month of April came in marginally lower at 8.66% vs 9.04% in March (and February's 9.54%, which has now been revised up by 123bps from 8.31%). However, it is largely expected that a hike in diesel prices (oil companies have to get the government nod to hike diesel prices, which are still controlled) will take place by July, which, again, will add to the pressure on inflation. The large base effect will keep the YoY inflation number in check, but inflation is expected to remain at elevated levels for a few more months.

Foreign institutional investors (FIIs) turned sellers and sold -US$1.2bn of equities in the cash market. YTD they have turned net sellers and have sold -US$240mn of equities. Domestic MFs continued buying and bought US$97mn of equities. YTD they have bought US$445mn in equities.

The March 2011 quarter (4QFY11) earnings season has come to an end. The Sensex-30 companies saw only a 4% YoY increase in net income (the consensus estimated a 19% growth). This has to be seen in light of the 'miss' by India's largest bank, SBI and of the largest oil company, ONGC. Both these index heavyweights missed for one-off reasons. The broader market did reasonably well and posted a 18% earnings growth for the quarter, in line with expectations. For FY11, the Sensex has grown earnings by 20.5%. The consensus expects the Sensex to deliver a 19% EPS growth in FY12. Based on this, the Sensex trades at 14.5x FY12 earnings, around its historic average.

We see downside risks to earnings and therefore continue to believe the upside for the narrow market is capped. However, for the broader market, we see that valuations continue to be attractive and we see several bottom-up stock picking opportunities. We believe that seeking out returns from a secular rise in the markets in the medium term is a difficult proposition and that the limited money will chase companies that can deliver earnings growth with quality.

The monsoon session of Parliament will commence in July. We hope that the government will act decisively to enact several pending important legislations in this session. That is the only countercyclical measure that can work for the markets.

Hiren Ved
Chief Investment Officer
Alchemy Capital Management Pvt. Ltd

DEBT OUTLOOK

RBI's unexpected policy rate hike of 50bps in its 3rd May 2011 meeting sent some hard signals to the markets. The monetary policy's stance was to maintain an interest rate environment that moderates inflation and anchors inflation expectations. The long-term interest rate measured by a 10-year G-sec yield went up to 8.47% during the month. The RBI monetary policy actions, which focused on an inflationary stance, delivered a larger than expected rate action of 50bps, compared to the market consensus of 25bps. The latest hike was the ninth increase since the RBI began hiking rates in early 2010, which has effectively raised policy rates by a total of 400bp. The 50bp is the first of that magnitude in the current tightening cycle and the tone of the policy statement remains hawkish. The RBI acknowledged that the monetary tightening so far has being effective in checking aggregate demand, but rightly appears ready to sacrifice some near-term growth for stronger sustainable medium-term growth in a lower inflation setting.

The continuous rise in policy rates along with the weekly supply of bonds in an environment of resurgence of inflationary concerns led to an upwards move in bond yields over the month. The government cash balances with the RBI have moved from large surplus positions until March 2011 to huge borrowing under Ways and Mean Advances (WMA) in the current financial year so far. Huge tax refunds and the draw down by states have resulted in government borrowing under WMA staying above the limits. This has resulted in the government resorting to issuing Cash Management Bills, and higher issue of regular Treasury bills. We expect that the liquidity situation will remain tight on the basis of higher issue of T-bills and the regular Gilt auctions. This could result in short-term yields remaining elevated and having an upside bias in the near term.

Inflation remains the primary concern at the moment. WPI inflation for April 2011 stood at 8.66%, marginally lower than 9.04% in March 2011 but significantly higher than analyst estimates of 8.30%. In the near term we expect inflation to hover around 8.60%. The monsoon is the key to curtailing food inflation in the coming months.

We are monitoring four factors at our end to estimate the upcoming interest rate scenario. The first is the incremental GDP growth numbers, the second, general demand in the economy, third are the crude prices and fiscal deficit number and lastly, inflation. If growth tempers, with the result of a fall in demand, inflation will automatically come down. We expect interest rates to be at elevated levels for the next three to four months. Shorter duration rates will reach the peak of March 2011 in June 2011.

We believe that RBI will further increase the policy rates by 25bps and as a result short-term rates are expected to breach the 10% mark in early June 2010. Long-term rates are expected to be range bound between 8.25% and 8.50%. Weekly supply will keep putting pressure on long-duration bonds. We advise investors to invest in ultra short-term funds for short-term investments. FMPs are the most efficient investment avenue as carry in the portfolio is high due to high short-term rates.

Rupesh Nagda
Head – Investments & Products
Alchemy Capital Management Pvt. Ltd

DISCLAIMER

General Risk factors

All investment products attract various kinds of risks. Please read the relevant Disclosure Document/ Investment Agreement carefully before investing.

General Disclaimers

The information and opinions contained in this report/ presentation have been obtained from sources believed to be reliable, but no representation or warranty, express or implied, is made that such information is accurate or complete.

Information and opinions contained in the report/ presentation are disseminated for the information of authorized recipients only, and are not to be relied upon as advisory or authoritative or taken in substitution for the exercise of due diligence and judgement by any recipient.

The information and opinions are not, and should not be construed as, an offer or solicitation to buy or sell any securities or make any investments.

Nothing contained herein, including past performance, shall constitute any representation or warranty as to future performance.

The services related to Mutual funds, Insurance, Real Estate, Art, Commodity etc. may merely be a referral / advisory services in nature. Such third party investment products or services do attract the general and specific risk factors unique to those respective products or services, which would be mentioned by the manufactures of those products in the respective product documentation. The prospective investors in such third party products are advised to read and understand those risk factors & disclaimers, in addition to what has been stated herein. Alchemy Capital Management Pvt. Ltd., its Group or affiliates have not verified and do not take any responsibility for any statements, numbers or claims made, omitted to be made or implied in any documentation, presentations etc. which have been created by the manufacturers of such third party products or services.

The client is solely responsible for consulting his/her/its own independent advisors as to the legal, tax, accounting and related matters concerning investments and nothing in this document or in any communication shall constitutes such advice.

The client is expected to understand the risk factors associated with investment & act on the information solely on his/her/its own risk. As a condition for providing this information, the client agrees that Alchemy Capital Management Pvt. Ltd., its Group or affiliates makes no representation and shall have no liability in any way arising to them or any other entity for any loss or damage, direct or indirect, arising from the use of this information.

Edited by: Rupesh Nagda (Ph: +91-22-66171785), Ambrish Jamodkar (Ph: +91-22-66171772) Copy editor: Lucy Bharadwaj
Alchemy Capital Management Pvt. Ltd., B-4, Amerchand Mansion, 16 Madame Cama Road, Mumbai 400 001. Ph: +91-22-66171700