ALCHEMY
PRIVATE WEALTH

Investment Matters

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

EQUITY OUTLOOK

Indian Equity markets are trading at all time high levels with a big up move of 4.6% in the month of October 2014 post a short period of consolidation. The general tone of market participants suggest extreme optimism in GDP growth of India improving with inflation and thereby interest rate coming down and a stable currency against the US $ going ahead. A sharp correction in crude price and other major commodity prices are helping in this optimistic scenario. Also helping the mood is the fact that the government is promising a few major initiatives to be launched soon i.e GST implementation from April 2015, FDI liberalization upto 49% in Insurance and big spending on infrastructure projects like Roads, Metro, Railways etc.

On the ground, activity remains muted as of now, with both consumer and industrial demand remaining weak. Recent Q2FY15 corporate performance till date and our feedback from some of the relevant companies suggest that consumer demand post seeing a pickup just after the election verdict in May 2014 have once again started to look weaker than expected and on the industrial side investment scenario continues to be weak. On the investment cycle specifically we see certain green shoots developing on the back of increased award activity in the roads sector. The government/NHAI has recently come out with bids for more than 4000 km of road projects, the extent of projects is more than the combined ordering over the past 2.5 years, and importantly a large part of the ordering is in the EPC segment improving the profitability for the general construction sector.

Separately the government, post the Supreme Court verdict has decided to auction coal blocks for captive use within the next 6 months with a provision to allow merchant selling at a future date. Power sector issues largely remain unresolved till date with a large number of private sector plants running at low PLF due to lack of coal and lack of PPA at an economical rate with the SEBs. A coal auction is likely to be the first step in many required to bring the sector to a growth path. A positive beginning has been made which makes us optimistic for the future.

The RBI governor till date has done a commendable job in focusing on bringing inflation down by keeping interest rates higher and liquidity in the system tight. The governor has also successfully taken advantage of the FII flow post elections to take our reserve position > $350 bn thereby helping lower the volatility in the Rs/$ rate in a narrow band. With crude and commodity prices correcting sharply and food inflation trajectory in India coming down, expectations of a rate cut by the RBI are growing. The government is also making all the right moves in terms of targeting of lower fiscal deficit at 4.1% to GDP for FY15 going down to 3% by FY17. Credit growth for the banking system has come down to 10% only, while the deposit growth continues to be around 13-15%, implying that liquidity in the system is increasing allowing the banks to reduce deposit rates and cut base rate for lending. The likelihood of a rate cut by the RBI over the next 6 month is increasing and potentially can benefit the market trajectory going ahead.

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DEBT OUTLOOK

Debt market is slowly setting up a platform for next rally. We find a bullish trend looking at the CPI data, the global environment, views expressed by members of monetary policy advisory panel and actions by the government. The possibility of RBI softening its stance has gone up. RBI has announced open market sales of government bonds to suck out excess liquidity and maybe to tame the rally; however, underlying momentum remains bullish. With a subdued credit off-take and improved liquidity, banks' demand for government securities is likely to remain healthy in the near term.

The pressure is mounting on the Reserve Bank to soften its stance on monetary policy given the better-than - expected CPI reading, fall in global commodity prices particularly crude oil, poor credit growth and weaker manufacturing data. The government has been showing a commitment of doing its bit through marginal increase in minimum support prices, cut in diesel prices, pushing direct benefit transfers (DBT) and announcing fiscal austerity measures to keep deficit under check. The new government has stuck to giving low Minimum Support Price (MSP) hikes and keeping freebies in check. As against the 7% and 9% average MSP hikes for the last 5 and 10-year respectively, the government has announced a minimal 4% MSP hike this year. This augurs well for containing food inflation and subsidies.

Bond yields and swap levels have declined sharply with expectations of the RBI stance undergoing a change. The benchmark 10-year bond yield is trading at8.25% levels, lowest since September 2013. The yield curve has flattened substantially with long term bonds performing far better. Foreign investors have pumped in a record $ 22 billion in Indian bonds this year. With their limits for sovereign bonds getting exhausted, demand for corporate bonds has gone up resulting in credit spreads contracting to record lows. The global deflationary environment as reflected in ultra-low bond yields in the rest of the world has led to aggressive bidding by foreign investors. India offers a high carry with expectations of relatively stable currency and a positive turn in the monetary policy cycle.

Liquidity conditions in the economy are comfortable. The recent indirect tax collections show initial signs of pick up in the economy. Record RBI transfer of dividends to government and expectations of record divestments proceeds will help government easily achieve the fiscal deficit target. The Government has sufficient cash balances and if the trend continues, they might not borrow the additional INR 16,000crs which was reduced from the H1 FY15 borrowing calendar.

All these positives have led to 10 year G-Sec yields coming down from 8.70% July to 8.25% currently. Outlook Upgrade from leading international rating agencies like Moody's and S & P on India's rating will prove to be positive for Indian fixed income markets. All these macro developments are extremely positive for fixed income markets and are structurally building-up a case for lower interest rates in the near future. We believe, valuations in fixed income are reasonable and sentiments are negative, this makes a strong case for investing in fixed income today. We have been given bullish call since last 3 months and have been recommending investments in long duration funds. The shorter end of the curve is likely to remain supported as the outlook for liquidity remains comfortable. We suggest allocation in duration products to get the benefit when interest rates would fall.

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