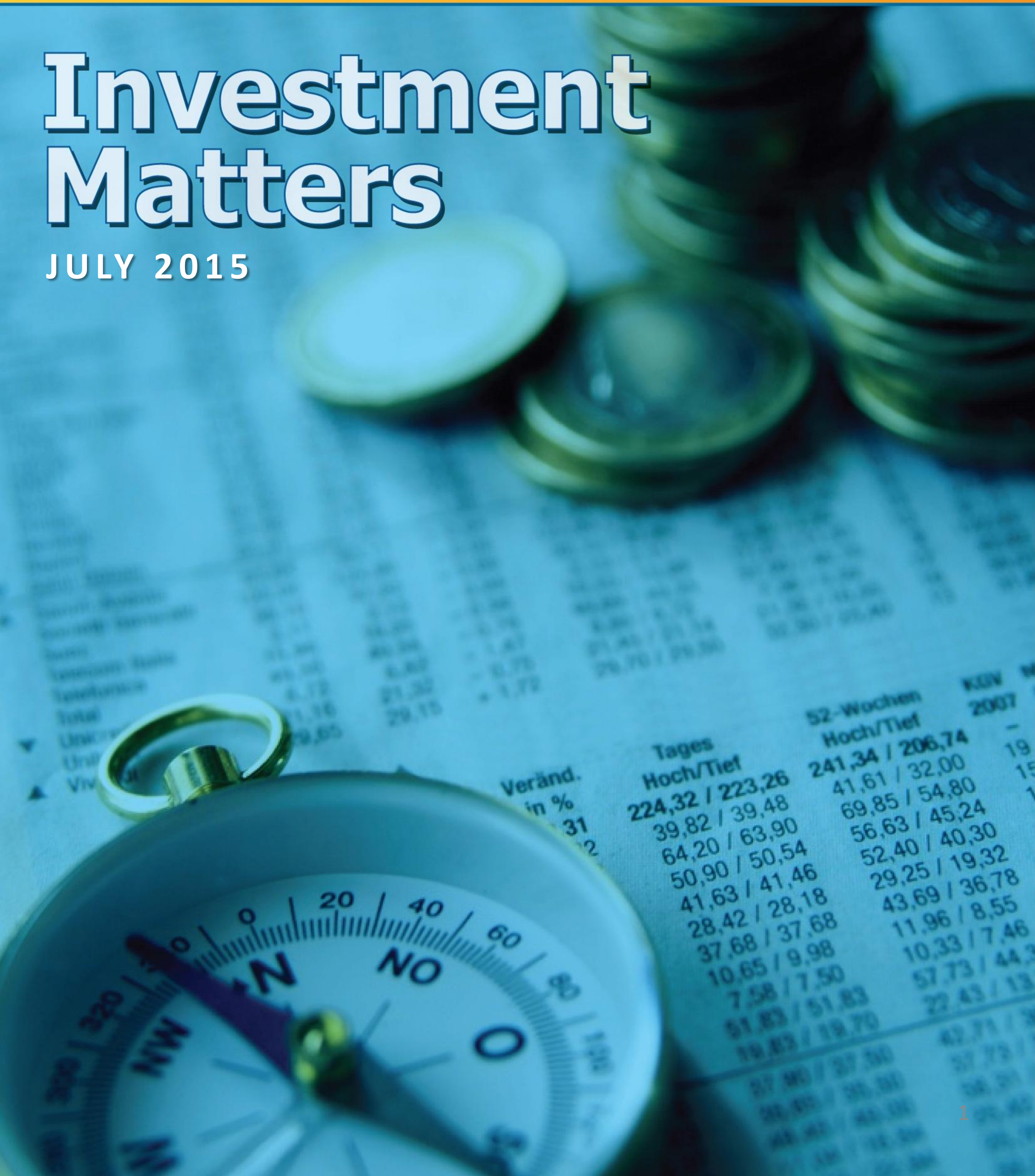
ALCHEMY

CAPITAL MANAGEMENT

Investment Matters

JULY 2015



EQUITY OUTLOOK

Global economic uncertainties around Greece and the repercussions it may have on other EU countries specially Italy, Portugal and Spain which are closer to elections in the next 9 months were the latest topics of discussion last month. Greece is small in the overall scheme of things with around Euro320bn of debt, the real danger to the EU may be on account of Italy/Spain/Portugal with much larger debt on their balance sheets. Italy alone has a debt in excess of Euro 2.4 tn. However, the recent bailout of Greece should come as a big relief for the markets.

Greece aside, China A share market is another point of discussion with extreme volatility. Shanghai Composite Index has now corrected by 24% + from its recent high. The Chinese government along with the central bank is trying to support the markets with rate cuts and market stabilisation fund. News flow around China will remain a focus area over the next few weeks.

Back home, India monsoon started on a very strong note with June 2015 seeing 16% above long term average rainfall with spatial distribution being on the positive side. July will be an important month to gain a better understanding on the impact on crops this year. There are conflicting views with the government agency IMD predicting 8-10% below normal rainfall during the month while the private agency Skymet predicting a normal monsoon month. The first week of July has been quite weak and hence monsoon till date stands at normal levels compared to 16% above normal at the end of June.

Q1FY16 results season is expected to be another weak quarter for India with consensus expecting -2% to +5% profit growth. Given weak economic environment and gradual pickup in government capex along with sharp correction in commodity prices, sales growth is likely to be on the weaker side, however profit margins will remain healthy with improvement continuing. 2HFY16 is likely to see base improving on low commodity prices and hence on a like to like basis earnings growth is expected to pick up, also government capex is expected to grow in a larger manner supporting earnings growth.

The government is pushing for the passage of The GST bill and The Land Acquisition Bill in the monsoon session of parliament starting July 21, 2015. However, with the congress and other opposition parties demanding resignation of the External Affairs Minister and the Chief Minister of Rajasthan over the Lalit Modi episode, it remains to be seen whether any meaningful business is able to be transacted during the session.

With several headwinds as articulated above as a backdrop it is unlikely that markets will report any meaningful positive performance in the near term. Stock selection will remain the key and most likely growth as a theme will continue to deliver above average performance. For our portfolio companies we continue to expect healthy double digit profit growth of >20% during the quarter and are optimistic on overall growth as we progress towards the end of the current calendar year.

Hiren Ved

Chief Investment Officer
Alchemy Capital Management Pvt. Ltd

DEBT OUTLOOK

Events are fast unfolding then is expected. This has created high volatility in the market. Both global as well as domestic factors are impacting the market like never before. The month of June 2015 was very volatile for global markets due to Greece Exit concerns in Europe and the rise in bond yields in developed economies on back of better economic data. Indian bond markets were also volatile. The 10 year bond yield went up by 22 bps points during the month closing at 7.86% from 7.64% at the beginning of the month.

RBI in its policy meeting on 2nd June 2015 cut the policy rates by 25bps and kept all other rates unchanged. Though RBI cut the policy rates by 25bps, the yields went up due to the hawkish commentary by RBI. Currency remained stable with INR /USD ending the month at 63.65 from 63.70 at the start of the month. On the macro front, the outlook for inflation has improved in recent weeks due to the strong start to monsoon season. Rains have been 16% above normal in June 2015, resulting in an improvement in sowing patterns for major crops (pulses and oilseeds).

May CPI inflation rose as expected to 5.0% y-o-y (from 4.9% in April 2015) led by higher crude. Meanwhile, core CPI (ex. food & fuel) picked up (4.7% y-o-y vs. 4.2% in April). Brent crude remained range bound for the month which helped INR stay in a tight range for the month.

The fiscal deficit (central government) contracted 36.3% YoY in May-15 versus an increase of 12.4% YoY in April 2015. May trade deficit narrowed to USD 10.4 bn vs. prior month's deficit of USD 11.0 bn, aided by a fall in gold imports. Imports growth contracted by 16.5% YoY in May, compared to prior month's contraction of 7.5%. Meanwhile, the oil import bill increased to USD 8.5 bn from USD 7.4 bn recorded in April. Exports growth contracted for the sixth consecutive month, by 20.1% YoYin May 2015. The risks to further policy easing arise from deficient monsoon, higher oil prices and emerging market selloff post Greece exit, if any. Going forward we continue to expect RBI to cut the policy rates further by 25 bps during the Sept - Dec 2015 quarter. Though RBI remains data dependent, we expect that inflation will undershoot RBI's target opening up further room for monetary easing.

World is facing low growth across the globe and as a result we see accommodative policies from large economies. Currently, our nominal policy rates are actually higher than other countries with similar macro-dynamics and thus fixed income flows into the country have been substantial over the last year. This has resulted in rupee appreciating against virtually every other major currency in the year so far. In the absence of accompanying productivity improvements, this renders our exports incrementally uncompetitive. If major trading peers ease their monetary policy further and we don't, then on the margin this pressure via the currency channel becomes even more accentuated.

Given above challenges and RBI’s focus on targeting CPI around 4%, immediate interest rate cut seems to be postponed. We believe RBI will take in account the monsoon factor and its impact on food prices before further rate cuts. We are bullish on bond prices and except interest rates to eventually fall in next 12 months. As a fixed income investment strategy we suggest to invest part allocation in duration funds to generate capital gains and part in accrual strategy to get benefit of current high yield available in the market to generate consistent returns.

Advisory Team

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