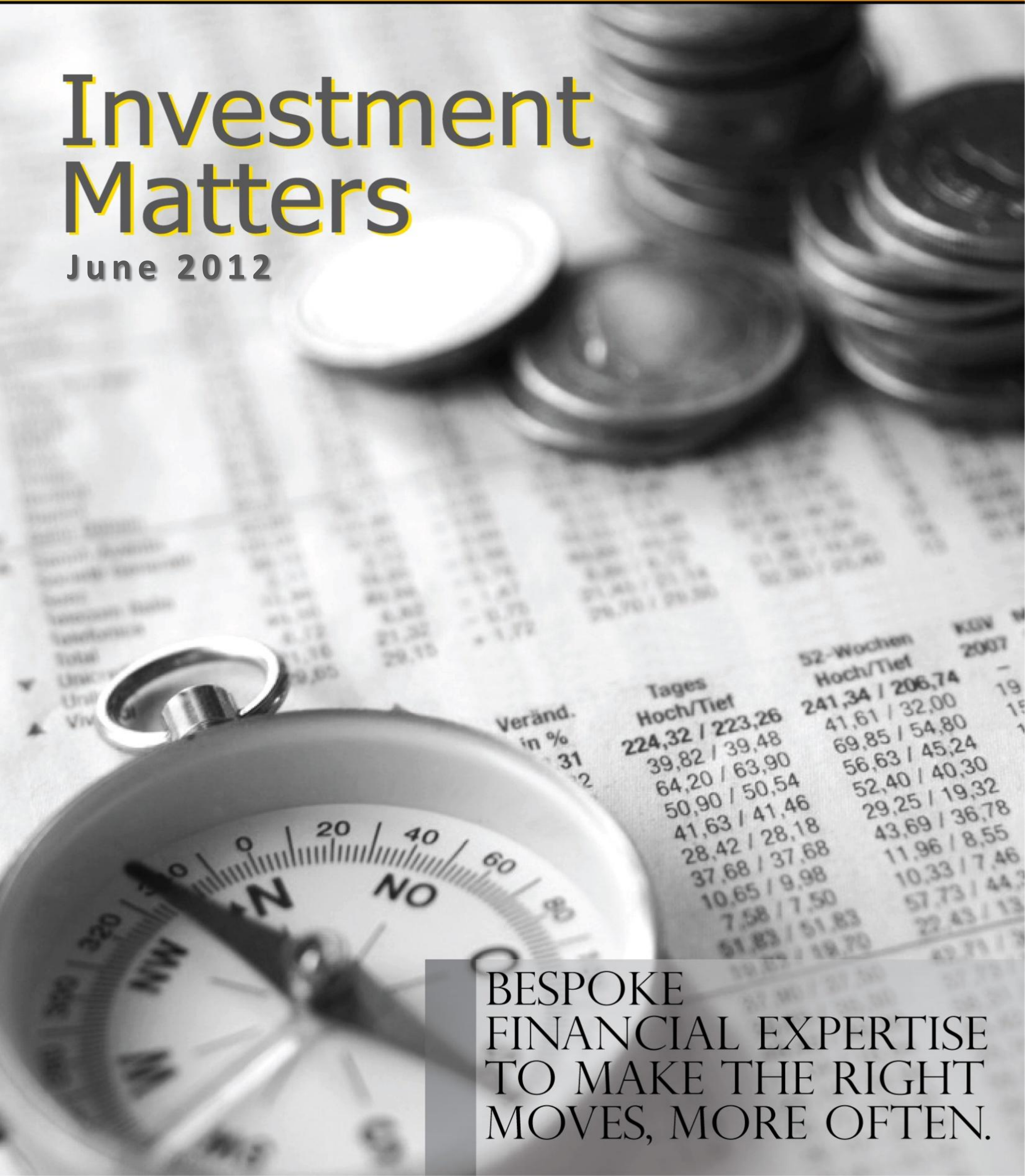
ALCHEMY
PRIVATE WEALTH



Investment Matters

June 2012

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

EQUITY OUTLOOK FROM CIO'S DESK

Indian Equity markets have faced significant headwinds due to Euro Zone crisis, high interest rates, rising fiscal and current account deficits. Marred with policy uncertainty and retrospective changes in the Financial Bill 2012-13 have eventually led to a sharp decline in capital inflows and a depreciating currency. BSE 500 and NIFTY corrected by 6.2 % during the month. FII flows continued to be negative with net selling of USD 63 million.

Negative economic data from two major economies, US and China led to a sharp fall in all asset and commodity classes across global markets. Crude Oil declined over 20% which is a very welcome development for India since it will help to ease inflationary pressures and arrest burgeoning CAD.

GDP growth at 5.3% for the 4Q FY12 was significantly lower than expectations and also record low for the last nine years. For the full year, FY12 GDP grew by 6.5% which was lower than RBI's estimate of 7%. GDP growth has been decelerated due to slowdown in Capex/Investments due to sharp decline in infrastructure and manufacturing activities – during the month of March IIP declined by 3.5% wherein manufacturing was down by -4.4% from 11% a year ago and infrastructure growth slowed down to 2% from 6% a year ago. With such a sharp decline in GDP and global commodities correcting sharply, RBI is expected to focus more on revival of economy than controlling inflation. We expect RBI to cut CRR in the upcoming policy meet boost demand, revive business confidence and also take corrective steps to improve liquidity in the system. These steps by RBI should help revive investor/business sentiment and aid in recovering growth back to 7% plus.

Reeling under huge subsidy burden, the government took a welcome step by raising the price of petrol by Rs7.5/lt. However to reduce subsidy burden significantly it becomes essential to increase the prices of other fuels like Diesel/LPG/Kerosene. We continue to believe that recurring subsidy levels have gone beyond what can be sustained in the budget and government will have no option but to tackle it by increasing/deregulating price of fuels and fertilizers.

INR plummeted 6.9% during the month to new lows of over Rs.56/USD due to mounting concerns over twin deficits and flight to safety to Greenback. This would partially take away benefits of commodity fall but over a long term a weak currency will help exports and curtail imports leading to improvement in Current Account Deficit (CAD).

Most of the weather forecasting agencies including Indian MET Department are predicting a Normal monsoon this year. The current state of economy is not strong enough to absorb any adverse shock of unfavorable monsoon. Given the slowdown in economy, it is very critical to have a normal monsoon to support consumption demand and revive sentiments.

Earnings season for the March quarter just got over, a review of which highlights sluggish growth and continued stress in margins. Five out of the ten sectors have reported compression in margins. Financials witnessed the most margin expansion whereas Materials saw the most contraction. However, on the brighter side, overall earnings were ahead of expectations.

At the current levels, the stock market is trading at lower band of historical valuation multiples which imply that the most of the headwinds are already priced in.

EQUITY OUTLOOK FROM CIO'S DESK

This provides investors with a good opportunity to invest for long term as empirically it is proven time and again that investments made during difficult macro environment lead to superior above average returns when things turnaround. As we have maintained in the past we will focus on investing in companies which have a better ability to manage the current volatile and uncertain environment and grow profitably. Hopefully the 5.3% GDP print will lay the basis for some constructive policy initiatives soon, as time and again it has been proven that we generally tend to respond only during times of distress. This pain may well have come as a blessing in disguise!

Hiren Ved

Chief Investment Officer
Alchemy Capital Management Pvt. Ltd

DEBT OUTLOOK

Bond market sentiments improved significantly during last week of May on following developments:

- Sharp correction in global asset and commodity markets which saw decline in global crude prices.
- Dismal GDP numbers. Q4 GDP growth reported at 5.3% much below the market expectation.

May month witnessed stumbling key economic indicators listed below:

- Annual Inflation for the month of April came at 7.23 % as compared with 6.89% for the previous month. Core inflation rose to 4.85% from 4.66%.
- IIP for March contracted by -3.5% against 9.4% growth previous year mainly due to volatile capital goods index which contracted by -21.3% against expectation of marginal fall.
- The rupee continued to decline during the month with a sharp fall of about 6.9% and finally closing at 56.42 against USD as compared to 52.52 levels previous month.
- GDP growth of 6.5 per cent for 2011-12 came below against the Reserve Bank's baseline projection of 7.0 per cent. Jan-Mar'12 GDP growth was at 5.3% as a result of declining growth in almost all segments of the economy, including agriculture, manufacturing, mining and construction.

The weak GDP numbers nevertheless had positive implications on the bond markets which saw 10 year benchmark G-Sec yields sharply get lowered to 8.37% levels. With increased downside risks, growth in the next few quarters can continue to remain subdued prompting RBI to easy monetary policy further. RBI in its last policy had reduced the repo rate under the liquidity adjustment facility (LAF) by 50 basis points, much more than expected. With worrisome GDP numbers, speculation of another round of rate cut seems very likely. Fall in the crude prices in spite of weakening rupee, expectation of a normal monsoon which can provide some cushion to food price related inflation are lot more comforting to the policy makers who are grappling with dithering growth and sticky inflation.

Domestic systemic liquidity continues to show signs of improvement backed by CRR cut and OMO from RBI. RBI had already stepped up efforts on liquidity and has bought almost INR 55,000 crores of bonds since start of the current financial year. Liquidity deficit is likely to remain at around Rs.850-900 billion, till the tax outflows scheduled during second half of June. Moreover with the volatility seen in Rupee, RBI can intervene in forex market hence affecting rupee liquidity.

We believe the longer end of the yield curve is expected to remain volatile given projected high fiscal deficit and government borrowing programme this fiscal. With sharp rally in sovereign bonds the credit spread has widened with corporate bonds. Short term rates have come off from their higher levels but are likely to remain range bound with an upward bias given the stressed liquidity.

DEBT OUTLOOK

Going forward we expect the yield curve to steepen bullishly (short end rates falling faster than long rates) over the next 2 – 3 months. The short end rates currently are still high hence we suggest short term funds with low average maturity and high carry in the portfolio as a superior investment option. Longer end of the curve would react once there is clear sign of RBI indicating policy rate cuts. Investors with higher risk appetite can invest a part of their portfolio in dynamic bond funds to play safe duration calls to generate better risk adjusted returns.

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