Global developments | Uncertainty around the world

Further easing in Europe. The European Central Bank left deposit rates and interest rates at record lows of 0.2% and 0.3% respectively in the wake of an uncertain outlook for Europe and the world in general. Further, ECB chief Draghi hinted that "the degree of monetary policy accommodation will need to be re-examined at our December monetary policy meeting", indicating that their € 1.1 tr. ($1.2 trillion) bond-buying program could possibly expand to further strengthen economic impetus in the region. This dovish message, among other things, clearly point to the further downside potential of the Euro.

Some numbers from China. For the first time since the global financial crisis, GDP growth in China slipped below the psychological 7% mark as it reported a number of 6.9% for Q3-CY2015. This is significantly lower than the 7% in the first two quarters and its full year growth of 7.3% for the full year 2014. Going forward, China is shooting for an annual growth rate of "*about* 7%" which would be their lowest ever rate of growth in a quarter century. A multitude of measure spanning several reductions in bank's required reserves, a surprise devaluation of the Yuan, approval or several infra projects worth $280bn and most significantly, multiple rate cuts, including one this month reducing the main bank base rate to 4.35%, have failed to spawn growth. It is important to note in the same breadth that bank credit increased by 15.4% in the third quarter compared with the same period in 2014. Instead of deleveraging from the torrent of credit released to buoy the economy during the financial crisis, the system continues to coax the economy into further debt, further accelerating the possibility of systemic financial risk in the economy.

And meanwhile in the US, the clamor for a rate hike has increased as unemployment numbers fell to a seven & half year low of 5%. While the pause last time was on account of the global nervousness, caused mostly by Chinese actions, this time around given improvement across economic parameters, a rate hike may be imminent when the Fed meets again in the coming month.

Indian Market

In October, MSCI India was up 1.4% but underperformed MSCI EM by 5.6%. India's performance ranking slipped to 18th position from 3rd in September.

- The benchmark BSE Sensex returned 1.9% for the month of October 2015;
- BSE Midcap & Small cap were up 1.6% and 2.7% respectively.
- On the back of sustained redemptions in emerging market funds, FII's remained sellers for the second consecutive month (USD 894mn) in the cash market while domestic mutual funds remained buyers (USD 1.3bn) for the 17th month in a row.
- Year to date, FIIs have bought USD 3.6bn and USD 6.3bn in the cash and debt markets, respectively while DIIs have bought stock worth USD 8.2bn.

MSCI (in %)	India	Brazil	Russia	Korea	China	Japan	US	Australia	EM Index
MoM (in %)	1.39%	4.96%	6.06%	11.28%	9.06%	10.07%	8.12%	5.82%	7.04%
CY - YTD (in %)	-5.04%	-37.95%	11.42%	-1.80%	-5.64%	8.65%	1.00%	-16.47%	-11.34%

Monthly Macro Review | Inflation is moderate | IIP on expansion mode

Key inflation readings

- CPI for September 2015 inched up to 4.4% while WPI came in at -4.5%, in line with expectations
- CPI food inflation (CFPI) has marginally gone up to 3.8% given the rise in prices of onions & pulses and waning of the positive base effect.

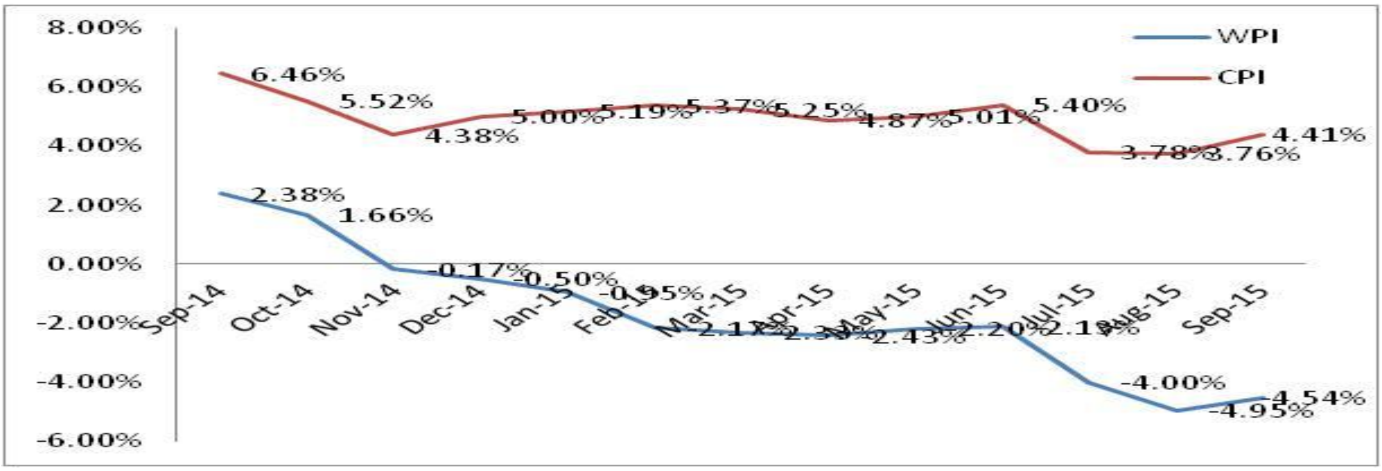
WPI: Continues in negative zone

- WPI September 2015 was still in the red at -4.54% for the eleventh consecutive month.
- Core WPI at -1.86 signifies slack in demand for input commodities CPI: Rises due to waning
- The global commodity index (CRB index) was down 30% YoY, supporting a continuous decline in raw material prices across sectors. Sequentially, WPI was flat as decline in the minerals index and fuel & power index partially offset by increase in pulses and onion index

Inflation to stay within RBI's projected trajectory

Going ahead, a waning base effect may pull CPI inflation upwards to 5% from current 4.4%. However, it is broadly expected to remain well within RBI's target of 5.8% CPI January 2016. Muted global commodity prices and proactive supply side management by the government (especially of food articles), along with muted global as well as domestic growth give us comfort that inflation is likely to stay in the 4.5-5.5% range for the next year. Post the front loaded rate-cut (50 bps) in the fourth bi-monthly policy on September 29, 2015, the RBI may now shift focus on bringing inflation to around 5% by end of 2016-17.

India's steep inflation correction over the past year has been as follows



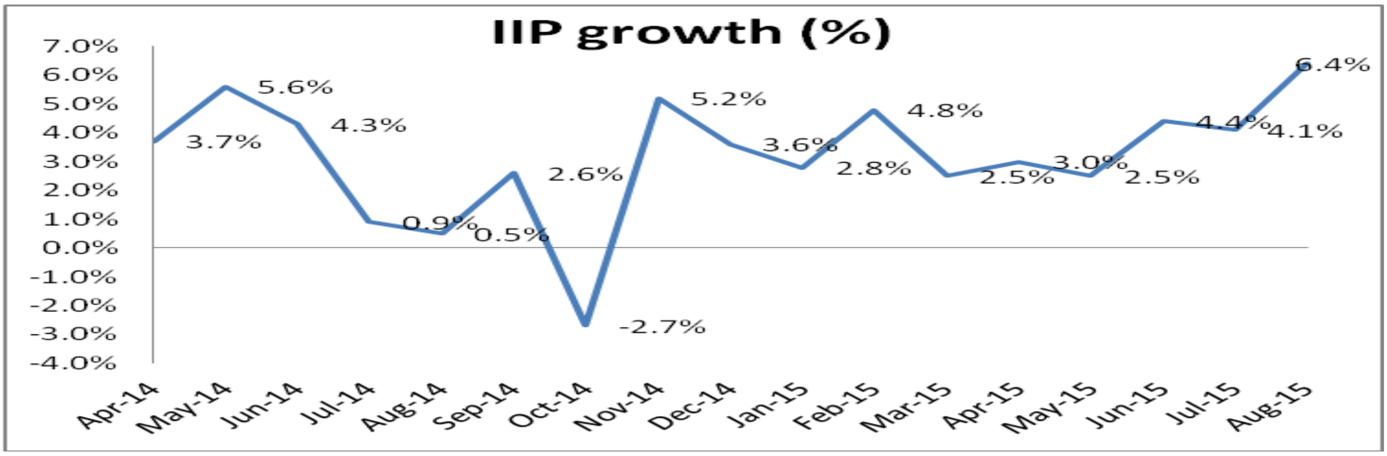
Index on Industrial Production zooms

IIP growth for August 2015 zoomed to 6.4%, much higher than the consensus estimate of around 4.5-5%.

Capital Goods key driver

- All three sub-groups of the industry: manufacturing, mining and electricity, performed well in Aug'15.
- As per user based classification, the capital goods sector was the key driver while also remaining the sole reason for high volatility in the index, falling 16% YoY last year and zooming up 22% YoY this year.
- Basic goods production rose by 3.4% while that of intermediate goods 2.6%.
- Consumer durables/non-durables recorded growth rates of 17%/0.4%, with overall growth in consumer goods coming in at 6.8%
- FYTD IIP growth is lower at 3.5% vs. 3.6% last year.

While IIP growth for FYTD (Apr-Aug'16) now stands at a respectable 4.1% YoY, it needs to sustain above an average 5% for industrial recovery to find firm footing. Deficient monsoons have led to weak rural demand and delayed the scope of substantial pick-up in industrial output. Going ahead, any improvement will only be slow and gradual.



Unifi Strategy

"Eat a live frog first thing in the morning and nothing worse will happen to you the rest of the day." – Mark Twain

Stepping into the results season, expectations were so low that the eventual disappointments did not really surprise the street. A broad summary of the results for Q2-FY2016 from the BSE-100 universe would be: revenue growth of 5%, EBITDA growth of 4% and PAT growth of a mere 3% *(simple average of companies in the BSE-100 that have announced results; broadly indicative of the trends in revenue and earnings momentum).* Within this, should one exclude a handful of good performers, the numbers would be even dire. While revenues were largely muted, lower raw material prices and non operating reasons shielded a bit of the weakness.

- This trend was visible among consumer plays (FMCG, Auto) where revenues continue to signify weakness in underlying demand, but the weak commodity prices (namely crude derivates & metals) saw them deliver reasonable earnings.
- The IT sector was a mixed bag with the industry as such continuing to showcase weak near term prospects. Clearly on a large enough base (in USD terms) they are having to run more to maintain a degree of momentum expected of them and they are clearly panting
- The take away from the banking sector was the usual: PSU banks continued to battle poor asset quality with no near term end to the same in sight while private banks continue to perform on the back of growing their retail books with select stress from the utilities and commodity sectors.
- Metals & commodities: fundamentally, the less said the better. However this sector witnessed a, what we call, 'dead cat bounce' after an elongated period of weakness

A quick look at some other macro data points

- ✓ Fiscal deficit declined in September: GoI's fiscal deficit contracted for the second consecutive month (on a YoY basis) due to an increase in receipts and a drop in total expenditure. The deficit fell 77.3% YoY in Sep-15 vs. a decline of 121.7% YoY in Aug-15. On a 12-month trailing basis, the deficit reduced to 3.4% of GDP vs. 3.6% of GDP in Aug-15, tracking below the budget deficit target of 3.9% for the second consecutive month.
- ✓ Expenditure growth contracted for the second month in a row, off 5.8% YoY in Sep-15 after falling 22.3% YoY in Aug-15. The decline in September expenditure was due to a contraction in revenue expenditure, while capital expenditure accelerated. Capital expenditure has been expanding on a YoY basis since Feb-15 (except for Aug-15), underlining the government's intent to support capex.
- ✓ Gross tax revenue collection grew 19.4% YoY in Sep-15 from 42.2% YoY in Aug-15: The moderation is reflective of the health of corporate P/L following which direct taxes as well as indirect tax have moderated.

So what is next? Should the second half of FY2016 be any better? On the ground, we don't see any telling reason for a sharp improvement in corporate performance for the remainder of the year. Which leaves us almost in complete anticipation of green shoots to broad based growth coming only in mid 2016 (i.e., FY2017).

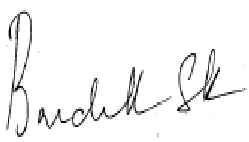
Going forward into the next financial year, the two broad drivers of economic growth will be 'good' monsoons and heavy cap-ex related spending. While expectations of a good monsoons year will be a binary event, there has to be heavy lifting by the Government on the cap-ex front. Overall, Government: PSU: Private corporate spending today in the ratio of 56:24:20. Given weakness in the global commodity cycle and domestic real estate cycle, there is little avenue for the private sector to increase its share of spends. Given that the PSU's will do what they have to, it puts the ball entirely in the Governments court to act. We like what we are seeing today on the Government led cap-ex front clearly but more can be done and needs to be done. Also, rapid off take in the "Make in India" program can give growth an impetus.

The Government continues to do its bit on policy reforms, with the latest directives on the power sector, providing a direction to State Electricity Boards to one time clean up of its house. Also, movement on GST reforms will be key to provide a base for broad based growth. In this context, the set back the central Government suffered in the recently concluded elections of Bihar could be an irritant; the opposition will be empowered to stall bills and prevent active passage of important legislations.

In the very short term (the next 6 months), the drivers will be a good Rabi cropping season and the 7th pay commission. As a repetition of what we have been saying, the drop in commodity prices are aiding corporate margins, they are not influencing consumption due to limited pass through of benefits. Our portfolio is aligned with companies that are able to deliver above average earnings and have the construct of continue doing so in the near to medium term.

Risk: Key risks to our portfolio would come from geo-political concerns globally, decline in foreign inflows, sharp currency movements, spike in commodity prices and a prolonged delay in fiscal reforms. Global re-allocation of equity, which is not India centric will continue to happen and may result in turbulence from time to time. Indian markets as well as the INR will continue to remain vulnerable to global events, however unrelated to India. Interest rate hikes in the U.S may be a huge event risk and affect liquidity conditions domestically. NPA in banking system and new IPO's may also hamper liquidity in the market.

Please do let us know if you'd like any clarifications regarding your Portfolio account with us. Thank you for placing your trust in Unifi



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