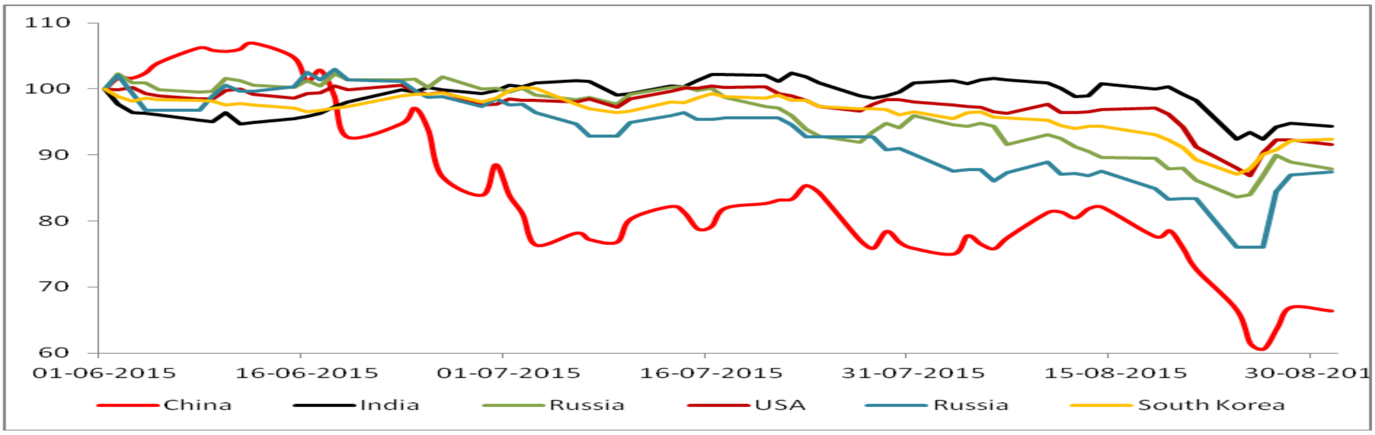
**Global developments | Xīng xīng zhī huǒ, kě yǐ liáo yuán**

*There's a Chinese saying: a single spark can start a prairie fire.* The following chart should make this adequately clear.




After decades of seeing an upward trajectory in all economic metrics pertaining to China, everyone led by the Chinese have panicked at the flow of data that has lifted the veil on its economic troubles. Among others, a 77 month low in manufacturing activity and 25 year low revised GDP target of 7% have caused immense worry for global growth prospects. While a 7% growth in absolute numbers is not bad, but just benign, it is the fact that Chinese policy making has been so divorced from market reality, that it has had a telling effect on the markets. On the back of their failure to prop up the markets with a series of anti-free market measures such as criminal investigation against short sellers, banning share sales by entities holding > 5% of a stock, jailing traders, etc., the credibility of Chinese policy makers to find a sustainable solution to their problems has accentuated the distress. Hence, when without anticipation, China devalued the Yuan on August 11, it riled world markets which then went into panic mode fearing the start of a global "currency war", with each EM taking it upon themselves to support their export competitiveness. Naturally, almost every EM currency depreciated simultaneously stressing an already stressed state of being. Which brings us to another reason for short term pain; will the Fed hike interest rates in September? It is widely believed that China's currency devaluation has been seen as a way to hedge against Fed's tightening apart from of course supporting its flagging exports.

American jobs data, a key parameter in the Fed's decision that came out for August indicated an unemployment rate of 5.1%, which was better than most expectations. Now, all eyes are on the mid-September Fed meeting to see what actually happens and it is fair to expect a bit of volatility leading upto the event. Higher interest rates would presumably increase the value of the dollar, which would also lift the greenback-linked yuan, making China's products more expensive to foreign buyers. Should China and other EM's then continue to devalue its currency, it will feed deflation around the world, and the US would then face a tougher time hitting its 2% inflation target.

**Indian Market**

August was one of the most volatile months in Indian markets since the 2008 meltdown. The benchmark BSE Sensex returned -6.5% for the month vs -8.8% of MSCI India. BSE Midcap and BSE Small cap returned, -4.8% and -7.3% respectively for the month.

| MSCI (in %) | India | Brazil | Russia | Korea | China | Japan | US | Australia | EM Index |
|---|---|---|---|---|---|---|---|---|---|
| MoM (in %) | -8.87% | -14.46% | -5.61% | -5.76% | -11.70% | -5.83% | -6.28% | -12.22% | -9.20% |
| CY - YTD (in %) | -6.71% | -32.74% | 10.08% | -13.28% | -11.40% | 6.59% | -3.87% | -17.09% | -14.39% |

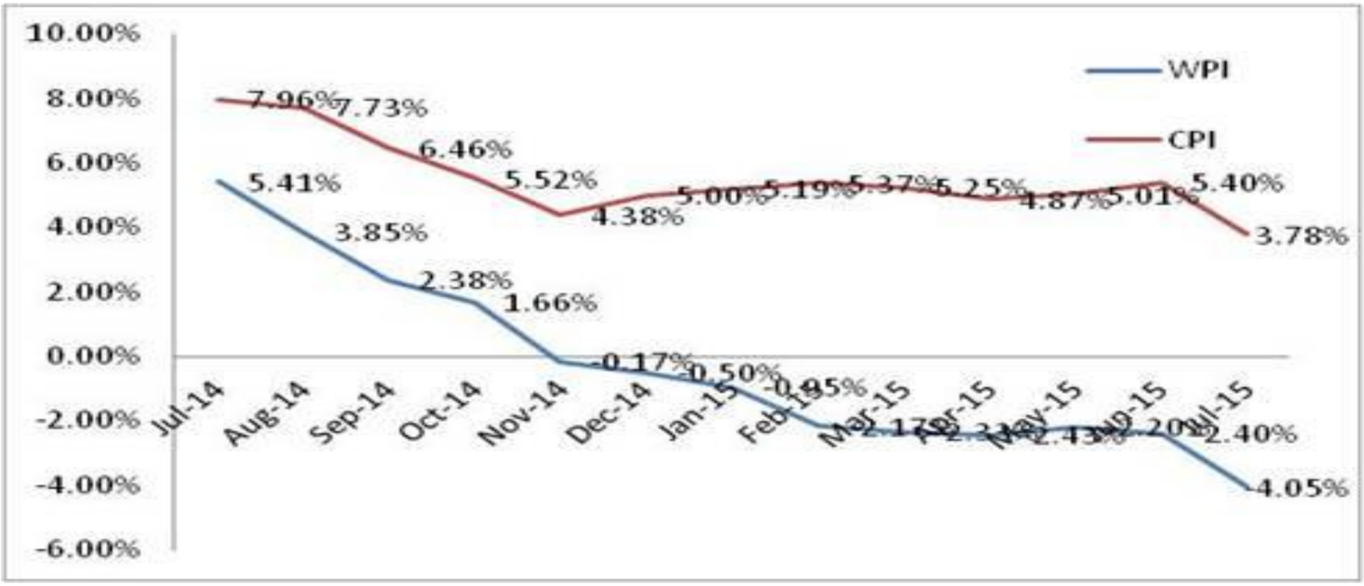
**Monthly Macro Review** | Inflation in control | IIP on expansion mode | GDP update

***Inflation reading***

CPI for July 2015 slipped to an eight-month low of 3.78% while WPI continued on its deflationary trend for the tenth month running, coming in at -4.05%.

- Core CPI, a measure of demand pressure in the economy, fell 52 bps to 4.1%. The decline was mainly led by a fall in personal care & effects and the continuing fall in Crude.
- WPI for July 2015 stayed in the negative territory at -4.05% for the ninth consecutive month. Core WPI at -1.39 signified slack demand for input commodities
- Wholesale prices of all food articles, primary articles and manufactured products have seen a continued decline, dragging WPI down to -4.05% YoY. The global commodity index (CRB index) was down 29% YoY, which led to a decline in input costs across sectors

As a summary, both CPI and WPI cooled off faster-than-expected on the back of a moderate increase in seasonal food inflation and positive impact of a glut in global commodity prices. It is now expected that CPI will mostly undershoot the RBI's target of 6% by January 2016, thereby creating room for a rate cut. With an expected real return of 1.5% and inflation expected to ease further going forward, it looks like there is sufficient room for a rate cut later this month. While the risk to inflation accelerating remains lower on the back of benign global commodity price outlook, any change could reduce the quantum of the rate cut. RBI meets for its next bi-monthly policy due on September 29, 2015 before which there will be another inflation reading further guiding the pace of disinflation.




***Index on Industrial Production - IIP update***

IIP growth for June 2015 was at 3.8% vs. 2.5% last month and 4.3% a year ago.

- Growth in mining came in at -0.3%, while manufacturing and electricity delivered 4.6% & 1.3% respectively;
- 6/22 industries (vs. 10/22 last month) recorded negative growth on an annual basis.
- Capital goods growth contracted by 3.6% due to strong base of 23% growth last year;

Going forward, there isn't any lead indicator suggesting a material pick up in the pace of industrial expansion.

***GDP – an update***

Statistically at least, expectations of favorable economic growth scenario gained traction with the GDP for Q1-FY16 coming in at 7%, higher than 6.7% YoY. The latest GDP growth numbers makes India one of the faster growing economies globally. As a beneficiary of the steep decline in global commodity prices, not only has India's inflation situation been contained, the greatly reduced subsidy has also helped growth numbers (the revised methodology for GDP calculation subtracts subsidy and adds taxes to the GVA to arrive at GDP).

Key takeaways from the construct of GDP growth:

- Growth was primarily driven by the services sector, i.e., trade, hotel, transport and communication services which grew at a healthy 13% while financials & professional services' grew at a healthy 9%
- The manufacturing & construction segments too recorded favorable growth of around 7% each
- However, there was a sharp decline of 6.9%, in the growth of the electricity, gas, water & utility services
- Likewise, the 'agriculture & allied sector' saw a decline with growth coming in 0.6% lower this fiscal
- The 'mining and quarrying' segment recorded 0.3% decline in growth

Overall, while the GDP numbers look good, the same is not reflected by sentiment on the ground as well as corporate earnings for the quarter (Q1FY16) that just went by. As the IIP data reflects, manufacturing activity is yet to take off meaningfully and the agriculture based rural economy remains subdued due to lower than expected monsoons on the back of which, going forward, it is difficult to estimate the multiplier effects of this on India's largely consumption based economy.

**Unifi Strategy**

Clearly everybody is worried about China and it is justified to an extent given how much of the world's major emerging markets (largely dependent on commodity exports) are dependent on them. And then their devaluing the currency once suggests they are not averse to this route of propping up growth should the need arise, which then could possibly trigger a replay of the 1997 Asian crisis. But thankfully in reality, the recalibration of all other EM currencies has been far higher than that of the Renminbi; for instance while India depreciated naturally, Vietnam did so at a policy level. So while China goes through this pace of internal reorientation of growth, one needs to wait and watch as to how they keep at reforms and deliver on their 7% GDP growth for the year.

From an earnings perspective for the quarter just gone by, there was nothing much to write home about. The aggregate revenues of the benchmark BSE-Sensex declined by 5% while earnings was flat. On the policy front, a political impasse saw the landmark Goods and Services Tax (GST) and Land Acquisition Bill being stalled. The absence of any development on this front added to the bearish sentiments in India given that they were looked up to as prime drivers for economic growth going forward. The only positive signal we can interpret among the lot in the continuing downward trajectory of inflation, reduction in Government's subsidy bills and its resultant hike in public expenditure. India is in a much better macro health than it has been in a while. Fiscal deficit even with increased government spending is under check at below 4 %. CAD and inflation are in comfort zones. Interest rates are at a level from where material downsides are possible while the benefits of increased government spending are yet to fully percolate to the economy. The recent depreciation of Rupee vs USD, Euro and Yen will bolster exports. Over all, there is no structural problem facing India unlike our EM peer's and the only issue we need to address in growth per se. In the medium term however, the effects of a lack lustre agricultural season may stress domestic demand in general.

Currently, valuations of benchmark BSE Sensex at 16.6x FY16 and 13.6x FY17 are not too undemanding given India's long term valuation average. Our preference stays with companies having strong balance sheets, good governance and those with product leadership within their industries. Key risks to our portfolio would come from geo-political concerns globally, decline in foreign inflows, sharp currency movements, spike in oil prices and a prolonged delay in fiscal reforms. A pulse on China and Fed's action on policy will continue to have its share of anxiety in the markets. Global re-assessment of equity allocation is creating a major turbulence in the market and we should remember that the correction is not India centric.

Till then, we'll leave you with another profound Chinese saying: **山 雨 欲 来 风 满 楼**, *Shān yǔ yù lái fēng mǎn lóu: the coming events cast their shadows long before them.*

**Risk:** Indian markets as well as the INR continue to remains vulnerable to global events, however unrelated to India. Sudden rises in global commodity prices may have a detrimental effect on the domestic macro. Interest rate hikes in 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

Yours truly
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