Global developments | The Fed blinks to uncertainty

Rarely in the world's recent economic history has so much capital been invested on a single signal; the Fed's interest rate. After months of exaggerated posturing leading up to the day (Sept 17th) and after all markets and portfolios were set up for a hike, the Fed declined to raise rates amid concerns on multiple grounds. The Fed's apprehensions were led by slack in labor markets which along with the influence of lower energy prices and dollar appreciation has resulted in very low levels of inflation. As a reminder, US inflation as on date is around 0.2%, a far cry from Fed's goal post of 2% and an important parameter for considering a rate hike. Domestic issues apart, the Fed obviously took cognizance of China's economic turmoil that has had a cascading effect on global emerging markets and creating a crisis of confidence on a key driver of global economic growth. This has had a serious ripple effect in US markets as well that are now down 8% since August this year. The comfort of volatility from extraneous events was drawn upon to pause this time around and postponing a decision till December this year with the twin arguments that it is risky to tighten in the uncertain market environment and that, softness in emerging markets could take some froth out of the US economy. Going into December, the Fed could point to another set of events and adopt to "wait and see". However, Governor Yellen did mention *"I anticipate that it will likely be appropriate to raise the target range for the federal funds rate sometime later this year"*. Considering that the rate of hike will be 0.25%, even though the US economy is not in full growth mode, its pace is a respectable 2.2% or so and seems to be stable. The theory that markets digests all known information, and reflects the knowledge back in prices, suggests that whether the Fed moves today or sometime in December may not really matter significantly.

In other news, while China continued to weaken (markets down 4.8%), the central banks of Norway, Taiwan, Ukraine and India lowered interest rates to prop up domestic growth amid fears of a weak global and domestic growth cycle.

Indian Market

Notwithstanding global volatility, September was more or less a flat month for Indian equities. The benchmark BSE Sensex returned -0.5% vs 0.4% of MSCI India while BSE Midcap & Small cap were up 0.6% and 0.5% 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 US 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 %)	0.39%	-12.11%	-4.57%	1.76%	-2.34%	-7.40%	-2.82%	-4.79%	-3.26%
CY - YTD (in %)	-6.35%	-40.88%	5.06%	-11.76%	-13.48%	-1.30%	-6.58%	-21.06%	-17.18%

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

Interest rate cut | The RBI front loads with a 50bps cut

The RBI surprised consensus again, but this time on the upside, cutting its benchmark repo rate by a material 50bps to 6.75%. Besides the frontloaded easing, the Governor made it adequately clear that should inflation further surprise on the downside, there would be further room for easing. One may interpret this commentary as a signal to the Government to keep up its good work on price management thus far and consolidate on the same on the back of a weaker than expected monsoons India just experienced. The RBI however seems to be concerned about the pace of economic recovery in India on the back of which it has cut down its GDP estimate for the year from 7.6%nto 7.4% for FY-2016.

But where is the transmission? Since Jan-2015, there has now been a cumulative 125bps of cuts, but this has seen less than encouraging transmission to borrowers till the end of September. While banks have held on to cheaper funds on the back of less than encouraging off take of quality credit, only now have they begun the process of passing on the cuts and going forward, we are likely to enter a period of lower absolute rates. This is also important from an inflation management perspective, as between now and the next few quarters as the favorable base effect of commodity prices reverses, the focus on the transmission mechanism will get all the more visible.

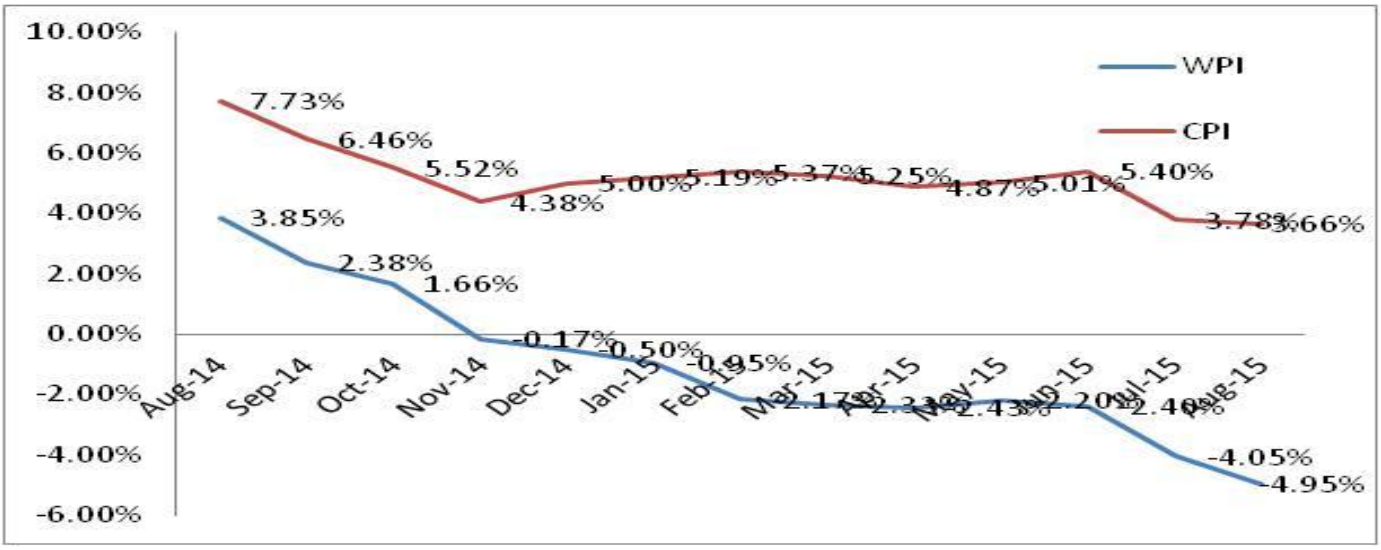
On another note, it is also important to be realistic about what exactly a rate cut translates to. For instance, on a home loan, a 50 basis points cut translates into a benefit of between Rs.32 and Rs.40 per Rs,100,000 depending on tenure. It is thus debatable if a cut alone will trigger a pent up demand for homes or cars. What cheaper capital should do is enable kick starting the broader investment cycle which should in turn feed consumption. It's a complex equation. However, it should be reiterated that the easing cycle is NOT over for the medium term. Once the headline CPI settles at 5.0% in 2016e, owing to benign pricing pressures in the economy, the RBI would be willing to provide for a further cut in rates in a rage of at least 1.0 - 1.5% in an upswing growth cycle.

Inflation continues to cool

In what has now become a constant, both consumer as well as whole sale price inflation continued to ease.

- CPI for August 2015 slipped to a nine-month low of 3.66% while WPI came in at -4.95%
- CPI food inflation (CFPI) came in low at 2.20% YoY with core WPI came in at -1.86%
- WPI for August is now in the red for the tenth consecutive month signifying slack demand for input commodities

Core CPI, a measure of demand pressure in the economy, fell 19 bps to 3.86% YoY. The decline was mainly led by a fall in personal care & effects, which was down 66 bps and transport that declined 63 bps YoY. This was mainly led by a fall in crude prices (Brent crude) by 12% in the month. The fuel and light index increase was flat at 5.70% YoY in August. Over all, the global commodity index (CRB index) was down 36% YoY, supporting a continuous decline in raw material prices across sectors.



As per the IMD, the June-September 2015 monsoon season may end with a deficit of 12-14%, which would make it the driest monsoon seasons in several years, barring the drought years of 2002 (-19%) and 2009 (-22%). This may lead prices of certain agriculture commodities to shoot up. However, the government has put in the necessary measures (timely imports etc) to ensure parity in prices. Additionally, the disinflation in global commodity prices remains supportive. Hence, inflation is expected to undershoot the RBI's projected trajectory (CPI January 2016 at 6%). This factor has is no small measure led to RBI cutting rates last month.

Index on Industrial Production - IIP update

IIP growth for July 2015 came in at 4.2% vs. 4.4% last month and 0.9% a year ago.

- Growth in mining was weak at 1.3%, while manufacturing and electricity delivered 4.7% & 3.5% respectively;
- FYTD IIP growth is lower at 3.5% vs. 3.6% last year.

Number of industries recording negative growth increased despite the benefit of low base effect (10/22 vs. 6/22 last month, annual basis).

Overall industrial data is reflecting a stable momentum in industrial activity. Deficient monsoons should worsen rural demand and delay the scope of substantial pick-up in industrial output. While drop in commodity prices are aiding corporate margins, they are not influencing consumption due to limited pass through of benefits. Going ahead, any improvement will only be slow and gradual.

Unifi Strategy

Before we present a synopsis on the state of affairs in India, here is a look at how growth is panning our around the world. (Source: IMF)

Countries	GDP Projections	
	2015	2016
United States	2.6	2.8
Euro Area	1.5	1.6
Japan	0.6	1.0
Russia	-3.8	-0.6
China	6.8	6.3
India	7.3	7.5
Brazil	-3.0	-1.0
South Africa	1.4	1.3

Relatively, there is no doubting the stress world over. In the context of this, India's 7.3% growth outlook and valuation at 14.5x FY2017e seems, reasonable. We are not saying this is good, but it isn't bad either and it needs to be seen in the context of what is happening structurally within the economy. As a domestic consumption led economy, the single biggest driver of sustainable growth will be demand creation and the enablers for that are in a phase of gradual transmission, being, the 7th pay commission, rate cuts, better policy for infrastructure creation and improved social spending. Each of these factors is work in progress and as they fructify, things will look better on the ground.

The Government has focussed hard on administrative reforms and its commitment on moving through with GST, proposed restructuring of state power utilities, etc are steps in the right direction. Also, the Government's fiscal discipline has been commendable; it has shown remarkable restraint in not passing over the entire benefit of crude prices which would have been a good populist measure. It has instead used the resources to augment spending in roadways and railways. And then of course is the entire international push for manufacturing in India which if executed well will be a structural economic multiplier. It needs to be understood that neither of these initiatives will help private consumption in the very short term. For the very short term, the drivers will be a good Rabi cropping season and the 7th pay commission. The macroeconomic position as such led by CAD, fiscal deficit and inflation continue to look good.

As we enter the earnings season for Q2FY16, expectations are grounded and realistic. Hopefully, with GDP numbers looking not all that bad, the pace of earnings will only improve going forward and H2-FY2016 will be a much better time period. Barring negativity in PSU banks, infrastructure and the commodity sector, there is no other sector that is in dire straits as such. Over the last few months, the markets have been volatile on the back of global news flows, emerging market capital redemptions, and domestic political issues. These events will continue to do its bit for volatility going forward. The coming month will see elections in the all important Indian state of Bihar and a negative outcome for the ruling party at the centre may lead to a bit of volatility as well.

Currently, valuations of benchmark BSE Sensex at 17.5x FY16 and 14.5x 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. This is necessarily combined with the risk reward in terms of valuation being in our favour, as demonstrated by its price earnings multiple being lower than the rate of earnings growth, adjusted for its scale.

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

Yours truly
Baidik Sarkar
Research