Global developments | What growth?

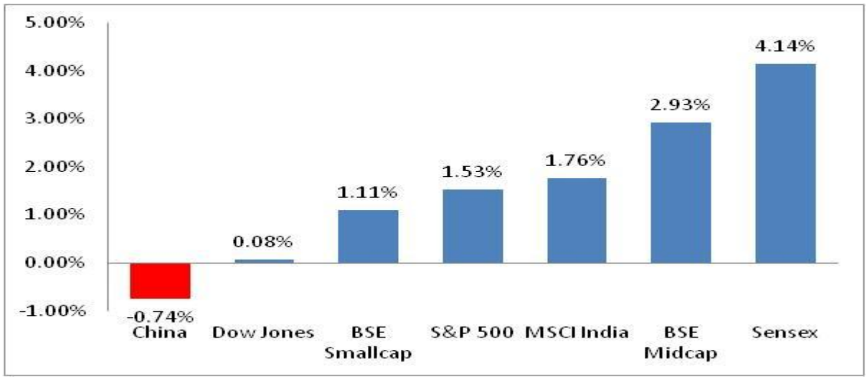
The EU region grew at 0.5% in Q1 of 2016, outpacing the US and the UK & probably pointing to a recovery in the region's economic prospects, but ECB chief Mario Draghi did not think so, cautioning that it may slow down again. As a result, the ECB left its key policy rates unchanged and added that it is likely to "remain at present or lower levels for an extended period of time, and well past the horizon of the net asset purchases". Earlier in March this year, the ECB went on the aggressive, cutting its benchmark refinancing rate by 5 basis points to zero, slashing deposit rates by 10 bps to -0.40bps, boosting its monthly asset purchases by €20bn Euro's to €80bn Euro's & widening its ambit of bond purchases to those issued by non-banks as well. So, it looks like the quantum of liquidity being injected into the system may well go up & remain elevated beyond the erstwhile date of Mar-2017.

Meanwhile, the adjusted American jobs report came in as a shocker, indicating an addition of a mere 72,000 jobs vs an average of 178,000 jobs for most of this year. The weakness was widespread with manufacturing & construction losing 10,000 & 15,000 jobs respectively. In fact, adjusting for seasonality, some analysis indicate a loss of about 4000 jobs. But what it does unanimously point to is some amount of slowdown in the US economy. In the wake of the US Fed priming the markets about a rise in interest rates, this does come as a bit of a chastening data point. The Fed will meet about a week from now over 14-15 June and it would really be an act of boldness that is out of line if they do go ahead with a rate hike.

But the biggest economic event to look forward to this month is Britain's tryst with 'to-be' or 'not-to-be' with the EU; a referendum for which is slotted for the 23rd of June, '16. An 'against' decision will significantly change the long term impact of trade in the region. While we don't have an opinion on the outcome, betting 'odds' suggest towards an eventual 'Brexit'. So much for economic co-operation. Ha!

For the really curious: Ladbrokes are offering odds of 3/10 for a Remain vote and 5/2 for a Leave.

A stable May

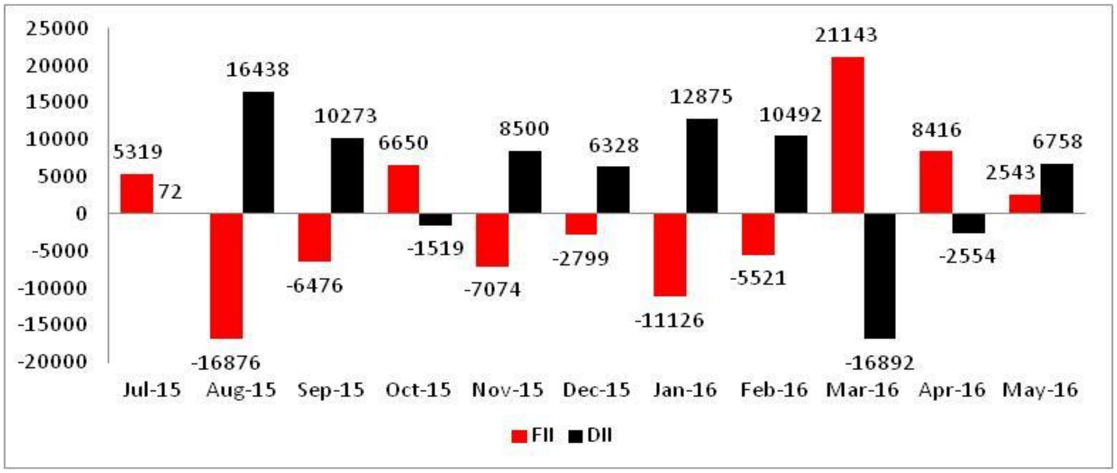


- Dow Jones was up 0.08%
- S&P 500 was up 1.53%
- Shanghai was down 0.74%

- BSE Sensex was up 4.14%
- BSE Mid-cap was up 2.93%
- BSE Small-cap was up 1.11%
- MSCI India was up 1.76%

MSCI (in %)	India	Brazil	Russia	Korea	China	Japan	US	Australia	EM Index	MSCI World
MoM (in %)	1.76%	-13.82%	-5.80%	-4.69%	-1.01%	-1.02%	1.57%	-3.14%	-3.90%	0.23%
CY - YTD (in %)	-0.72%	20.92%	17.42%	-0.54%	-5.96%	-4.01%	2.35%	0.41%	1.68%	0.71%

Domestic Institutional Investors continued to support the markets this month as sentiments improved over all. As you can see below, the 'blacks', after 3 months, have made a comeback.



Monthly Macro Review

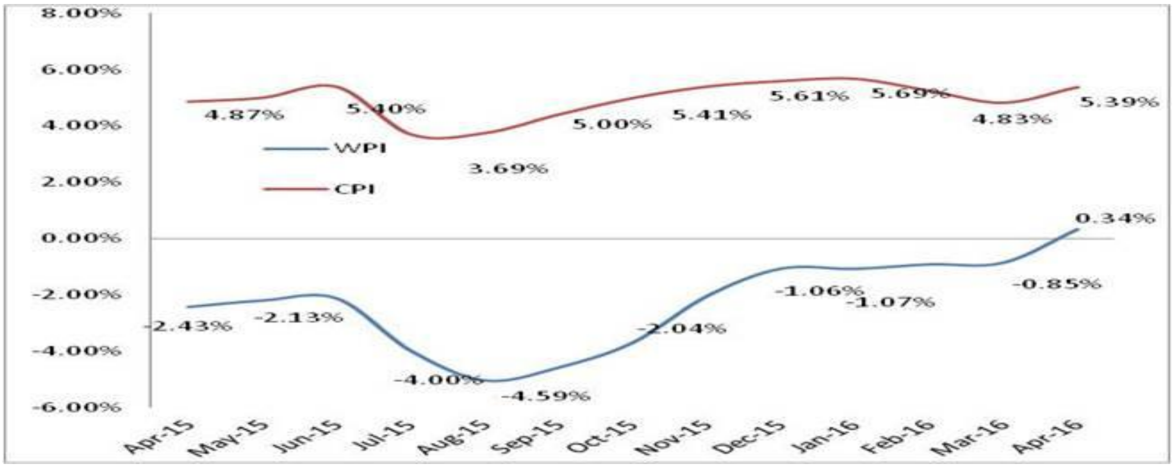
Inflation | CPI @ 5.39% vs 4.83% MoM | WPI rebounds finally to 0.34% vs -0.85%

After dipping sub 5% last month, CPI inflation reversed to 5.39%, mainly led by a sharp uptick in prices of fruits & vegetables, and to a lesser extent by Sugar prices, which is more a global phenomenon. Barring that, most of the food constituents were in control, with scope for falling further as they have a large disinflationary driver just around the corner - good monsoons.

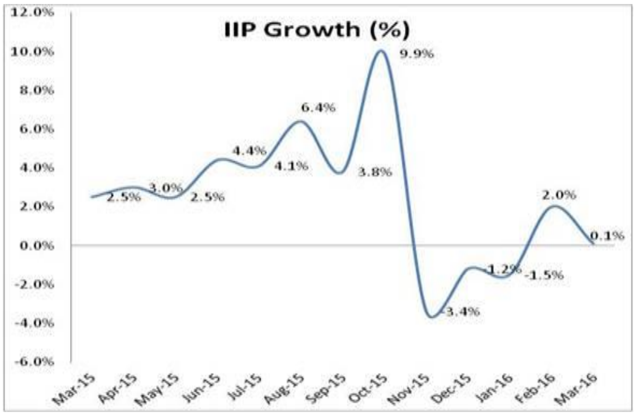
Weight	CPI	Jan-16	Feb-16	Mar-16	Apr-16	MoM
45.9%	*Foods & Beverages*	*6.66*	*5.52*	5.27	6.21	17.8%
2.4%	*Pan, Tobacco & Intoxicants*	*9.03*	*8.39*	8.51	7.96	-6.5%
6.5%	*Clothing n Footwear*	*5.85*	*5.52*	5.5	5.56	1.1%
10.1%	*Housing*	*4.86*	*5.33*	5.31	5.37	1.1%
6.8%	*Fuel n Light*	*5.32*	*4.59*	3.38	3.03	-10.4%
28.3%	*Miscll*	*3.95*	*4.38*	4.01	4.34	8.2%
100.0%	*CPI -Inflation*	*5.69*	*5.18*	*4.83*	*5.39*	*11.6%*
	CPI Food	*6.85*	*5.30*	*5.21*	*6.32*	*21.3%*

The RBI is its latest policy meet reaffirmed its CPI target of 5% by March 2017; reaching this number does not call for too many structural adjustments as we are close to that anyway and barring a sharp reversal in commodity prices, there may not be a risk to achieving that number.

The deflationary trend in WPI, which was in the negative for 17 continuous, has finally broken into +be territory on the back of sharp reversals in crude, coming in at 0.34% vs -0.85% MoM.



Index of industrial production (IIP) | Down to 0.1%



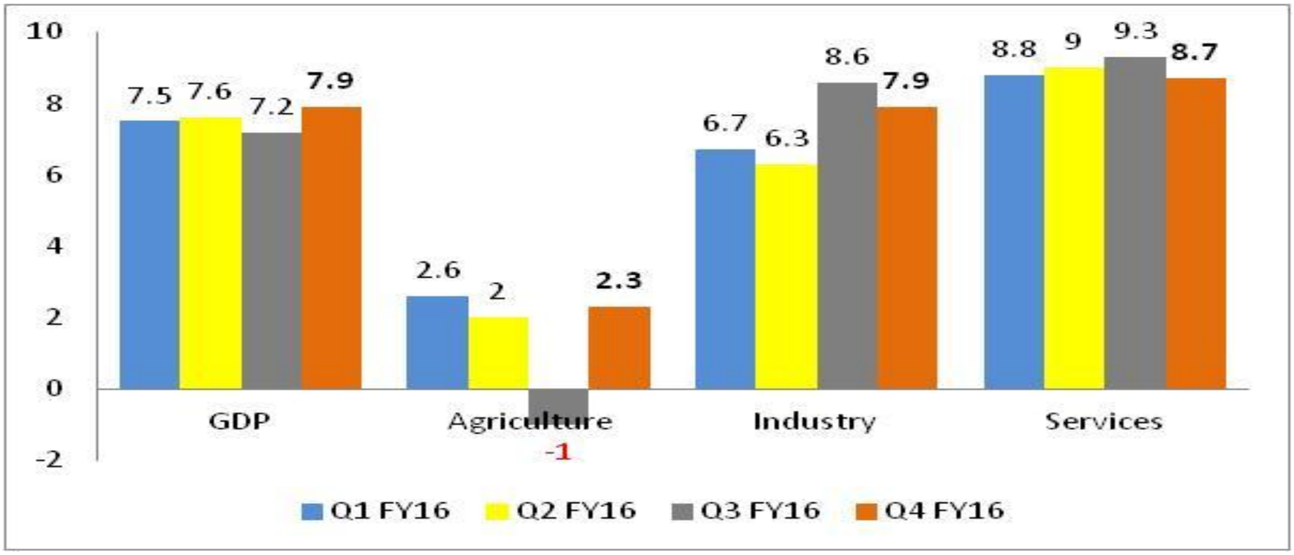
After a reasonable 2% growth in IIP for February, the growth for March fell again to 0.1%.

Manufacturing output declined 1.2% YoY with 10 / 22 industries posting lower output YoY. Manufacturing activity has declined in 4 of the last 5 months. This sustained weakness is worrisome and reflects the ongoing slump in private capex.

For the full year FY-2016, IIP recorded a growth of 2.4% vs 2.8% YoY. Electricity generation for the full year dropped to 5.6% (vs 8.4%) due to poor demand overall. Mining activity was the only bright spot, touching a 5 year high of 2.2%.

GDP – semblance of recovery

GDP for Q4FY2016 accelerated sharply to 7.9% YoY from 7.2% in the previous quarter. In fact, this was the highest growth in six quarters, driven by higher consumption. Real gross value added (GVA), which is nothing but production, the basis on which GDP is calculated, grew at 7.4%, again at the fastest pace in six quarters. {GDP is the sum of GVA and indirect taxes less subsidies}. The key driver of growth was 'agriculture', as industry & services sector activities eased slightly in Q4FY16. We were surprised as well, at the resilience of Agriculture, given how much stress the sector has seen this year.



For the year ahead, it is broadly estimated that GDP will grow closer to 7.8% vs 7.6% in FY16 and 7.2% in FY15.

In its latest review (7/6/16), the RBI announced a pause on key policy rates, and, accordingly retained repo at 6.50% and CRR at 4%. Any further cut in rates would largely be drawn from the comfort of the inflation trajectory going forward.

Unifi Strategy

Zeus has arrived | …. and so will earnings

About 17% of India's GDP and 50% of India's population still depends on agriculture and of that less than 40% have access to reliable irrigation. When you simplistically add that up, you can imagine the importance of rains and why we have been drawing as much reference to it as we have. Thank fully this year, the Indian MET has promised all of us a lot of rains. In fact, by the time most of you in India read this, the monsoons will have arrived, and you can well smell the moist mud. But the markets as usual did the sniffing well in advance just given the pent up 'demand for performance'. While the benchmark Sensex was up 4%, any stock resembling to benefit from the monsoons have rallied well. Over all, this is probably the most optimistic we have been on the markets in a while now.

Our positivity is mainly driven by the emergence of good set of numbers post Q4FY16 (finally!). Big surprises among the blue chips came in majorly from long time laggards such as Tata Motors and L&T, while barring the usual stressed set of Banking names, all NBFC's reported good numbers, implying good off take of consumer durables, home loans and auto's. Moreover, strong movement in Commercial Vehicle sales (HCY, MHCV, LCV) and Cement sales (over all strong realizations and volume growth) has generated excitement about the return of core industrial growth which is what the requirement really is. News from most of the other sectors were also good - Oil Marketing companies benefitted from inventory gains while Telecom sector reported over all lower S&M costs and better earnings. While overall earnings were impacted negatively by higher provisioning in the financials space, earnings (ex-financials) came in well above expectations.

A few of the other factors (relative to the past few quarters) that point to better on the ground economics and will possibly reflect on earnings down the line are:

SECTOR	MAR-16	DEC-15	SEP-15	JUN-15	MAR-15
CV SALES	20%	11%	10%	4%	5%
2W SALES	9%	4%	-1%	1%	0%
TRACTOR SALES	8%	-2%	-25%	-16%	-30%
AIR TRAFFIC	19%	17%	17%	16%	17%
CARGO TRAFFIC	8%	1%	4%	5%	4%
CREDIT	11%	9%	9%	10%	10%
DIESEL	11%	8%	9%	4%	3%

The Sensex (ex-financials) earnings witnessed 18% YoY growth (well above the 6% expectations). Over all, for the full year FY-2016, Sensex earnings growth was approximately 8% and as things stand today, they could return in excess of 15% for FY-2017e.

In addition to the above, like we have been saying, the increase of money supply in the economy (7^{th} pay commission) and rolling in of GST will continue to aid the overall economy. As a result, the markets are building in a strong recovery, across sectors. And as it happens more often than not, valuation expansion often precedes actual earnings expansion.

On the international macro front, the resurgent commodity prices of April did not give up their gains, with WTI Crude moving 7% for the month on the back of a 20% climb in April. While this is not good news for India's fiscal health, it bodes well for kick starting the international energy dependent cap-ex cycle and Indian corporate are a reasonable participant in the same. The metal basket however gave away its gains of April, falling heavily for the month: Aluminium down 6.5%, Iron Ore down 8% and Copper down 4%.

While we are closely taking cues from the macros, our strategy continues to be that of a sector agnostic, focused, bottom up approach and alignment with companies that exhibit strength at a firm level, with strong earnings growth outlook for the short to medium term while maintaining balance sheet discipline.

We continue to like the specialty chemicals basket, with alignment being strictly bottom up. In cases where we have seen valuations run ahead of fundamentals, we have not hesitated to book profits. We continue to be positive on the Auto space given the resurgence of broad based demand in the sector along with select names in the mid cap agri, pharma, etc. We continue to maintain an eye on a favourable risk reward in terms of valuation, as demonstrated by its price earnings multiple being lower than the rate of earnings growth, adjusted for its scale, and not hesitating to book profits where valuations have exceeded its margin of safety.

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
Head - Research

Risk: Key risks to our portfolio would come from geo-political concerns globally, decline in foreign inflows, sharp currency movements, Fed announcements, steeper Chinese devaluation, 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 the banking system and new IPO's may also hamper liquidity in the market.

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