Debt Market Commentary

Indiabulls MUTUAL FUND

November 2016

30th November	Month Opening	Intra Month High	Intra Month Low	Month Closing
Overnight Rate (NSE MIBOR)	6.25	6.75	6.08	6.51
10 year Gsec	6.82	6.84	6.18	6.24
3 month CDs	6.62	6.62	5.85	6.00
6M CDs	6.85	6.85	6.25	6.30
12 month CDs	6.90	6.90	6.25	6.35
Currency	66.72	68.76	66.43	68.39
10 Year US Treasury	1.83	2.37	1.79	2.37

Inflation

Retail inflation as measured by CPI (consumer price index) for October 2016 witnessed moderation and came at 4.20% as compared to 4.31% of September. This number is a one year low inflation. Steep fall in food prices caused such a sharp fall in inflation. According to Consumer Price Index (CPI) data released by the Central Statistics Office (CSO), the fall in retail inflation was mainly due to a drop in the annual food inflation, from 3.96% in September to 3.32% in October. Prices of vegetables fell the most, they plunged by 5.74%. Wholesale Price Index (WPI)-based inflation fell to a four-month low of 3.39% in October 2016 from 3.57% in the previous month.

Macros

India’s trade deficit was $10.2 billion in October, as compared to September 2016 number of $ 8.3 billion deficit. This was on back of a rebound in imports, which more than offset faster exports growth. Imports totalled $ 33.7 billion in October, which represented an 8.1% increase y-o-y (September 2016: -2.5% y-o-y) and marked the highest result since December 2015. Meanwhile, exports growth picked up steam, rising to 9.6% y-o-y (from September’s 4.6%). India’s export totalled $ 23.5 billion, which represented the largest amount since March 2015. Exports witnessed healthy growth in shipments of jewellery and engineering products. India's fiscal deficit-difference between revenue and expenditure during April-October 2016 touched 79.3% of the budgeted figure or Rs 4.24 lakh crore, as per the figures released by the Controller General of Accounts (CGA). This is as against the budget estimates of Rs 5.34 lakh crore for the 2016-17 fiscal.

Liquidity and Rates

It has been an extremely eventful month with the demonetisation drive being at the centre of everything. With 500 and 1000 rupee notes getting demonetised, banking system was flush with deposits made by everybody of the non-legal tender. Inter-bank call money rates remained below the repo rate for most of the month mainly owing to comfortable liquidity in the system. RBI conducted reverse repos to suck out excess liquidity to prevent excess volatility in money market/overnight rates- this led to a bit of pressure on rates albeit to bring them to upper end of the operating rate. At the end of the month as a one of measure to suck out huge surplus cash, RBI announced an incremental cash reserve ratio (CRR) of 100% on deposits with banks between September 16 and November 11. This led to a spike in overnight rates. Gilts had a great run with yields dropping sharply-10-year benchmark – the 6.97%, 2026 paper closed at 6.24% November 30, 2016, compared with 6.80% on October 28, 2016. This rapid fall was primarily due to demonetised notes getting out of circulation and coming to banks, which resulted in significant improvement in systemic liquidity. This led to an increase in demand for gilts for regulatory purpose. Growing expectations that the MPC will vote to cut interest rates at its two-day meeting beginning December 6 further increased the appetite for bonds. Continuing selling of FIIs in both equity and debt led to fall in rupee versus the dollar. It fell to 39-month low levels at 68.76 per dollar before closing the month at 68.38 on November 30, 2016 compared with 66.79 per dollar on October 28, 2016.

Outlook

Water water everywhere but not a drop to drink is the popular adage- similarly system is flush with liquidity but how much of that liquidity is expected to remain to have a meaningful impact i.e. a further fall in money markets rates is a cryptic puzzle which needs to be decoded. Additionally CMBS/MSS will be used to prevent the temporary liquidity overwhelming the system. The overhanging cloud of demonetisation and its effects thereon is going to be the biggest factor that needs to be kept in mind while making any investment/ divestment decision. Multiple moving parts in the equation and frequent changes in operation guidelines will keep the markets volatile. Basis this, long maturity funds will be suitable for those who can withstand extreme volatility. So even though from medium term perspective we continue to expect rate cuts and resulting sharp fall in yields, the ride is going to be volatile and not bound by predefined timelines. For new investors short term fund offers a wonderful vehicle to earn high constant accrual. Benefit in terms of constant high accrual and effective vehicle as compared to bank fixed deposit (in light of lower and lower rates of FDs in banks) make short term fund a very attractive fund. Liquid and ultra-short term fund, as always will be vehicles for smart utilisation of temporary surpluses.

Malay Shah
Head – Fixed Income

Equity Market Commentary

Indiabulls MUTUAL FUND

November 2016

Key Domestic News

* Government announced the demonetization of Rs.500 & Rs.1000 currency note with aim to rein in corruption, black money, parallel economy, hawala & terrorist financing. Over medium to long term this bold step is structurally positive for Indian macros and can strengthen the India growth story materially. However, over short term it is causing squeeze in domestic consumption and would lead to slowdown in economic growth. We believe this squeeze is transient in nature and consumption should bounce back in next few months.
* In a surprise move, the monetary policy committee kept the policy repo rate unchanged at 6.25% against consensus expectation of a 25bps rate cut, while maintaining an accommodative stance. RBI reduced its FY17 GVA estimate to 7.1% from 7.6%, highlighted that growth is weakening across segments, and stated that inflation could fall by 10-15 bps due to demonetisation. The RBI also announced that the incremental CRR of 100% will stand withdrawn from 10 December.
* With the objective of 'Housing for All by 2022', government approved a scheme to construct 10mn houses in next three years. If properly funded and implemented, this scheme can have significant cascading effect on the economy.

Key Domestic Economic Data

* India's GDP growth came in at 7.3% y-o-y in Q2FY17, better than 7.1% in Q1, but below consensus expectations of 7.5%. GVA growth moderated to 7.1% from 7.3% in Q2, below expectations of 7.3%. Growth was largely consumption led, investments still weak and non-agriculture sectors slowing down.
* India's Manufacturing PMI moderated sharply to 52.3 in November, from 54.4 in October, reflecting the effect of cash squeeze due to demonetization.
* India's Services PMI fell to 46.7 in November, from 54.5 in October, indicating that demonetisation hit services much more than manufacturing, as expected. However, the future activity index rose to 60.5 from 57.2, suggesting that the sharp moderation is temporary and services sector are likely to bounce back once the cash circulation is back to normal.
* India's CPI inflation moderated to 4.2% y-o-y in October from 4.4% in September, in line with consensus expectations. This moderation was led by food articles (especially pulses).

Key Global Events

* In one of the most shocking U.S. elections, Donald Trump defeated Hillary Clinton. With his election, focus would shift from monetary policy to fiscal as he has promised aggressive infrastructure spending and tax cuts during the campaigns. However, still there is significant bit of uncertainty around the economic policies to be pursued by him.
* Minutes of US FOMC meeting in November suggest that Fed sees further improvement in labor markets and inflation, with most members agreeing that a rate hike is coming "relatively soon."
* Mario Draghi sent a strong signal that the ECB may extend its €1.7T bond-purchase program next month, warning that the Eurozone's weak economy remains clouded by risks and heavily reliant on the central bank's stimulus.

Outlook

* Over short term, we are cautious on the markets due to short term effects of demonetization, uncertainty around US economic policies, ECB's decion on extending QE & US fed rate hike in December.
* We strongly believe that demonetization is only a short term pain, and accrues significant long term gains for Indian economy. Shrinking of parallel economy, higher tax revenue, lower fiscal deficit, higher financial savings, lower cost of capital are some of the key long term benefits likely from demonetization. Currency demonetization makes India story stronger and more compelling over medium to long term.

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