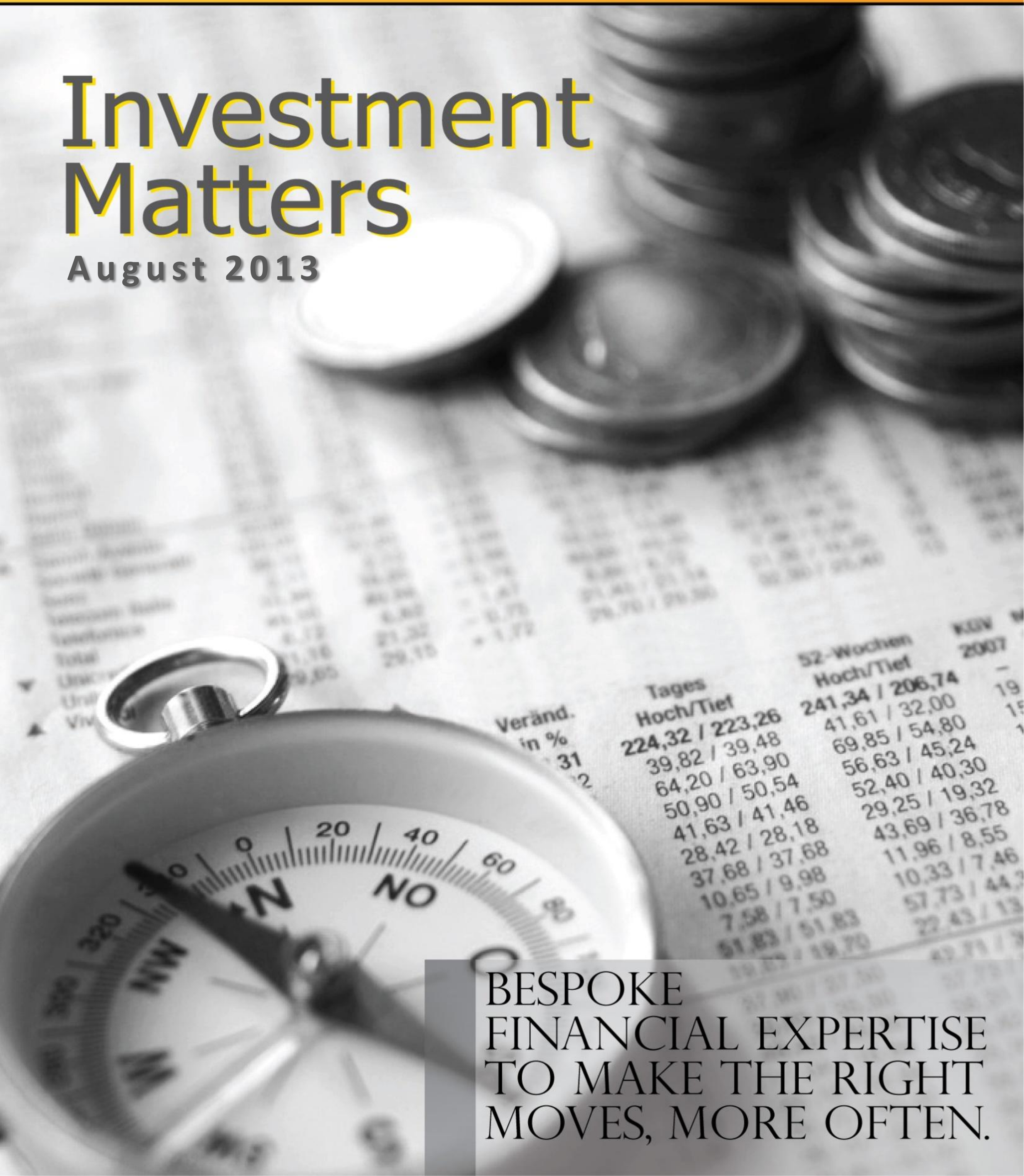
ALCHEMY PRIVATE WEALTH

Investment Matters

August 2013



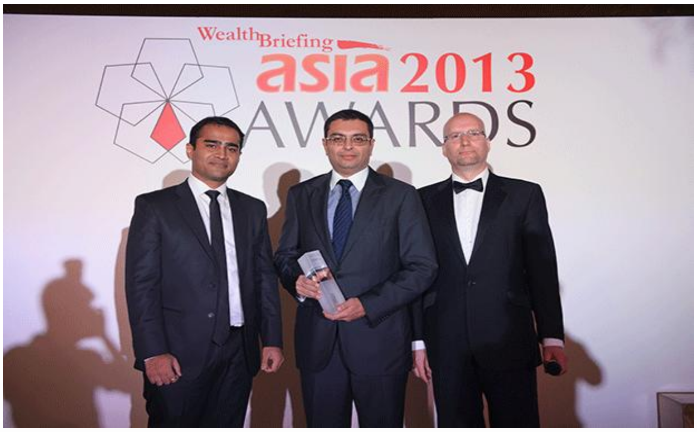
BESPOKE FINANCIAL EXPERTISE TO MAKE THE RIGHT MOVES, MORE OFTEN.

WEALTHBRIEFINGASIA AWARDS 2013

Alchemy Capital Management Pvt. Ltd voted as Best Boutique Wealth Management Company in India at "WEALTHBRIEFINGASIA AWARDS 2013"

We are delighted to have been voted the winner of this prestigious award by "Wealth Briefing Asia" at Singapore on 6th June 2013. It is a great honour to be recognised in these inaugural awards, and testament to the hard work that the Team Alchemy has put in over the last 12 months. We stand committed in our mission to deliver the highest level of service to our clients.

We take this opportunity to thank all our clients and stake holders for the faith they continue to repose in us. Assuring best services at all times



Yours Sincerely,

Mohit Batra
Group CEO-Alchemy Capital Management Pvt. Ltd

EQUITY OUTLOOK FROM CIO'S DESK

Indian markets were jolted by the recent Reserve Bank of India's (RBI) action to put a liquidity squeeze to protect the INR from depreciation. At the beginning of the month, the RBI (i) Limited the liquidity available at the Repo Window (Liquidity Adjustment Facility) to Rs750bn (US$12.5bn) or 1% of Net Demand & Time Liabilities (ii) For funding beyond LAF, rates for the Marginal Standing Facility (MSF) were raised from 100bps to 300bps & (iii) the government announced Open Market Sales of Government Securities to drain Rs12bn (US$2bn) from the system.

Subsequently, the RBI further tightened liquidity by reducing the LAF facility to 0.5% of NDTL and tinkered with the way Banks maintain Cash Reserve Requirements with RBI. RBI's concern stem from the rapid depreciation of the INR (-9.2%) post the tapering talk by the US Fed on 22nd May 2013. India's high Current Account Deficit (CAD) and reliance on short term portfolio flows makes the INR susceptible to external risks. RBI was worried that the currency was open to speculative attack given the self fulfilling expectations of currency depreciation were building up. Currency depreciation beyond a point would be counterproductive as it would impair sentiment of foreign investors, increase stress on the banking system due to overseas corporate borrowing (US$50bn over past 4 years), increase government's oil and fertiliser subsidy burden further and have an overall inflationary impact on currency pass through of imports (10% depreciation of currency impacts inflation by 1.2% as per RBI). Thus RBI's intent of inverting the yield curve is to stabilise the currency by making onshore speculation in the currency expensive. The move makes it attractive for exporters to bring money back into the country as well as make Indian debt more attractive to foreigners such that it slows immediate outflows and probably brings in inflows when the currency stabilises.

DAILY INR Chart – Bigger Candles & Gap Openings Post Fed Taper Talk.

EQUITY OUTLOOK FROM CIO'S DESK

India's actions are similar to China in respect to squeezing liquidity as opposed to increasing policy rates as other countries like Brazil or Indonesia have opted for. However, what has left investors jolted is that China was already on a slow tightening path whereas in India investors were positioned for an easing bias to help kick start the economy. RBI has not tinkered with policy rates yet as it does not want to completely reverse the growth inflation trade off of its monetary stance. In fact in the policy meeting post these measures, RBI has downgraded both its growth and inflation outlook downwards probably leaning towards an easing bias once these temporary measures are reversed.

Therefore the key question for investors is (i) how long is the tightening episode going to last. RBI maintains these measures will stay in place till the INR stabilises (Remember, the RBI governor retires in September) & (ii) the tail risk – How far will RBI go in squeezing liquidity or using other policy tools if it fails to stabilise the INR. RBI Governor's recent statement during his April 2013 speech at the IMF on Capital Account Management in this regard is putting investors on an edge as liquidity squeeze will definitely hurt economic growth as well as burden the banking system with higher non-performing assets. We reproduce the relevant paragraph below:-

There is one other important issue relating to forex intervention. Both currency appreciation and currency depreciation, quite unrelated to fundamentals, are complex problems. But there is a significant asymmetry between intervention for fighting appreciation and intervention for fighting depreciation. When you are fighting currency appreciation, you are intervening in your own currency. Your capacity to do so is, at least in theory, unlimited, quite simply because you can print your own currency. But when you are fighting currency depreciation, you are intervening in a hard currency. Your capacity to intervene is, therefore, limited by the size of your forex reserves. What complicates the dilemma is that the market is aware of this. So, there is the real danger that by intervening in the forex market, you could end up losing forex reserves, and not gaining on the currency. The lower your reserves dip, the more vulnerable you become. And the vulnerability can become quite serious if your reserves go below the level markets perceive as necessary to regain market access. It should also be clear that a failed defence of the exchange rate is worse than no defence at all. So, when you are intervening in the forex market, it is important to make sure that your intervention is successful.

We believe investors would be quite risk averse over the next couple of months as any talk of fed taper would mean currency depreciating, bond yields spiking and sell-off in interest rate sensitive's. The broader markets ie BSE 500, BSE Mid Cap Index or the CNX Mid Cap Index have seen large sell off YTD and present an attractive entry point for investors who can withstand volatility in the markets and have a long term investment perspective. We continue to focus on growth opportunities with strong balance sheets at reasonable valuations and believe that there are pockets of prosperity in the market even in this environment and if invested at the right time can pay rich dividend to investors over the long term.

Hiren Ved

Chief Investment Officer
Alchemy Capital Management Pvt. Ltd

DEBT OUTLOOK

Fixed income market is passing through a very rough patch. After a good start at the beginning of financial year, July month proved to be a worst month in this financial year. Bond markets were rattled during the month. Yields moved up by more than 100bps from its lows in the month of may 2013.

During the month RBI announced series of measures to stabilized INR volatility and depreciation. On 15 July 2013, RBI announced following measures:

i. The Marginal Standing Facility (MSF) rate is recalibrated with immediate effect to be 300 basis points above the policy repo rate under the Liquidity Adjustment Facility (LAF). Consequently, the **MSF rate will now be 10.25 per cent.**
ii. Accordingly, the **Bank Rate also stands adjusted to 10.25 per cent with immediate effect**.
iii. **The overall allocation of funds under the LAF will be limited to 1.0 per cent of the Net Demand and Time Liabilities (NDTL) of the banking system, reckoned as Rs.75,000 crore for this purpose.** The allocation to individual banks will be made in proportion to their bids, subject to the overall ceiling. This change in LAF will come into effect from July 17, 2013.
iv. The Reserve Bank will conduct Open Market Sales of Government of India Securities of Rs.12,000 crore on July 18, 2013. Details of the securities included for the **OMO sale** auction will be announced through a separate press release tomorrow.

On 23rd July 2013, RBI announced more measures to supplement earlier measures:

I. Access to repo window restricted for each bank at 0.5% of net demand and time liabilities (NDTL) for that bank. This is effective immediately. To recollect, RBI had last week restricted repo drawdown to 1% of NDTL or INR 75,000 crores. Although, the RBI hasn't mentioned a number against this, the new limit will stand at INR 37,500 crores for the system as a whole. However, each bank will have to borrow within its own cap of 0.5% of NDTL.
II. Effective first day of next reporting fortnight (July 27th), banks will have to maintain minimum daily CRR at 99% of requirement. Minimum required was 70% so far.
III. Announced cash management bill (CMB) of INR 6,000 crores to drain liquidity

RBI wanted to squeeze liquidity in the system to stabilize the currency. 10 year G-sec moved up and closed at 8.21%, almost 100bps higher than the lows it touched in the month of May 2013. Yields across the curve have risen. The intent of measures taken was to take overnight rates higher towards 10.25% (which is the new MSF penalty rate at which banks borrows). However, the RBI chose to tighten liquidity via doing OMO sales to the market. Subsequently, the central bank failed to absorb enough under the OMO sales; because it did not want to sell securities at very 'disruptive' yields Combined with cancellation of treasury bill auction.

DEBT OUTLOOK

On 30th July 2013, RBI had first quarterly policy meeting. In line with market expectation, the RBI left all the key rates unchanged, however the undertone in the policy seemed much more dovish than market was expecting. As mentioned in the policy document, the monetary policy stance in the last two years has been shaped by the growth- inflation dynamics. However, in the current situation, while wholesale price inflation has been moderating and growth decelerating, RBI had to forfeit monetary policy discretion to address the external sector concerns. RBI once again states, that recent tightening measures will be rolled back in a calibrated manner as stability is restored in the forex market enabling monetary policy to revert to supporting growth.

Considering above measures, we believe that bond markets will be volatile in coming times. As yields across the curve have risen, FMPs have become attractive. Conservative investors can lock in these high yielding through FMPs. Investors with 1-2 years of time horizon and can ride the volatility should look at adding duration products systematically over 1-2 months. August is a good month to do so since net government bond supply for the month is very heavy at Rs. 67,000crores and should provide a good entry point. Key risk to interest rates is widening CAD and depreciating INR. We recommend investors to diversify the portfolio between FMPs, short term products and duration production depending upon their liquidity requirement and risk profile.

Rupesh Nagda

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