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Investment Matters

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

EQUITY OUTLOOK

A historic victory by the BJP led by PM Mr Narendra Modi has raised the expectation of reforms in the country. The Prime Minister himself, both during the course of the poll rally and post forming the government, talked of the need for a step change in the thought process in running the country and make India a fast growing economy with higher standard of living. The first 100 days of the government needs to be evaluated in this backdrop. The government has largely focused on enhancing the work efficiency of the bureaucracy, controlling the menace of inflation and making India the most favored destination for capital investment. While investors may be disappointed at the lack of big-bang policy announcements, there have been plenty of small policy actions to address policy bottlenecks and to get the investment cycle moving. In short, we could interpret that the government is trying to pluck the low hanging fruits before embarking on the more structural and challenging tasks. It is our earnest hope that is more a strategic call than a lack of will.

The Rajasthan government, a BJP ruled state, has been proactive in introducing bold reforms when compared to the central government, most importantly by amending its labour laws. It seems a case of testing waters for the central government, wanting to see the level of acceptance of reforms at the state level prior to introducing the same at the centre. Similarly, Rajasthan is attempting a change in Land acquisition rules with flexibility in pricing and enhancing the role of the state government – a major change compared to the central Land Acquisition Bill approved a few months back in Parliament. The government wants to bring similar changes in the Land Acquisition Bill albeit after evolving a broad consensus.

The initial 100 days of this government has been especially pro-active and responsive to foreign policy matters. The PM's attempts to improve foreign relations are evident in his visits to Nepal, Bhutan, BRICS, Australia and Japan. Upcoming visits to the US and visits from China will also be aimed more at economic issues. PM is focusing on countries like Japan which has traditionally been a large lender for infra projects in the country like the Dedicated Freight Corridor and has shown willingness to fund future projects in the infrastructure space.

With these in mind, let me take you through some of the key initiatives taken by the government in various fields.

Governance

- Smaller size of cabinet and combining related ministries under common minister to ensure faster decision making
    - Power and Coal under Mr. Piyush Goyal, Road, Rural development, Shipping under Mr. Nitin Gadkari, Commerce minister also reporting to the Finance Minister.
- Abolishment of GOMs and EGOMs
    - Norm during UPA that resulted in delays in decision making
- Cabinet reconstruction – 6 critical committees reconstituted, CCEA being one of them
- Due diligence of right technocrats and bureaucrats (no allegiance to UPA) for ministerial and advisory roles being conducted
- Railways for coal linking: Railways and Power & Coal Ministries hold joint meeting to put three critical coal connectivity projects on fast track
- Multi Disciplinary Project Monitoring Unit is also being formed for better coordination.
- New institution to replace Planning Commission

Fiscal reforms

➢Diesel & Petrol subsidy close to nil through monthly price hikes. A saving of >Rs 80K cr compared to FY14

➢Hike in railway fares: Fares of all classes are set to rise by 14.2%, while the freight rates will go up by 6.5% - fuel adjustment built in calculation – helps reduce railway subsidy by Rs.69 bn.

➢Fiscal deficit target of 4.1% for FY15 going down to 3% to GDP by FY17

Doing Business, Approvals, Clearances, Investments – 'Come, Make in India'

➢Parliament – works harder and smarter – More sittings with Fewer interruptions
- Key bills cleared by parliament
  - Securities Laws (Amendment) Bill, 2014 – strengthens SEBI to act against frauds
  - Judicial Appointment Commission Bill – to improve judicial accountability
  - Factories (Amendment) Bill, 2014 and Apprentices (Amendment) Bill, 2014 – to improve labor laws

➢Transparency – Digitisation of government records and approval process – All ministries are working to implement online access by FY15 end

Financial market reforms

➢Definition of FDI and FII: Government has now accepted the definition of FDI and FII advanced by the Committee, whereby in line with the international practices, where an investor has a stake of 10% or less in a company, it will be treated as FII and, where an investor has a stake of more than 10%, it will be treated as FDI.

➢NBFC fund raising: allows Infra finance companies and infra debt funds from NBFCs to issue secured debentures for a period of 30 years. Similarly, HFCs to relax terms for maintaining debenture redemption reserve on similar lines

➢Lowered regulatory requirements on long term infra financing (no minimum CRR, SLR, PSL requirements on these loans)

➢Outbound investment eased: RBI restored the limit on their overseas direct investments (ODIs) under the automatic route to 400% of net worth. The limit was cut by 3/4th to 100% in August, 2013 after the rupee touched all-time low

➢"Pradhanmantri Jan-Dhan Yojana" to provide for a bank account, a debit card and an insurance amount of INR100,000 for the poor

Agenda for the future – Post harvesting the low hanging fruits, it's time for the government to focus on measures which have the potential to improve the confidence in economy and repairing the investment cycle. We would focus on the government implementing the following key agenda which has the potential to kick start the economic growth going ahead.

- Implementation of GST – Government talking of April 2016 as a realistic target for the implementation
- Modification of land acquisition act to make it more suitable for industries/infra projects – Likely to take some time to ensure political consensus
- FDI in insurance – May happen over the next 12 months
- Gas price hike - Indications of a price hike post September depending on the report by the select committee
- Auction of mineral resource ie Coal, Iron Ore, Bauxite etc – Subject to supreme court verdict by end September 2014

Chandraprakash Padiyar

Portfolio Manager
Alchemy Capital Management Pvt. Ltd

DEBT OUTLOOK

August 2014 was comparatively stable month back on stable macro developments. With improving macros and easing crude prices, the prospect of Indian Economy has improved significantly. Strong rebound in growth has been witnessed with GDP growth for 1QFY15 printing at 5.7%, highest in last 10 quarters. The rebound was led by turnaround in Industrial growth and stable growth in Services sector. Industrial Production (IP) also maintained its growth trajectory by posting 3.4% YoY growth in June 2014. Headline CPI inflation accelerated to 7.96% YoY in July from 7.5% in June, largely because of a spike in vegetable prices. However, core CPI inflation remained steady around the 7.4% mark. Wholesale prices (WPI) decelerated to 5.2% in July (5.4% in June), mainly due to high base effect even as food prices rose. Monsoon continued to improve during August 2014 with cumulative rainfall deficit (for the period June to Aug) improving to 18% from over 22% in July 2014. The trade deficit widened marginally in July 2014 to US$12.2bn (from US$ 11.8bn in June 2014) as export growth decelerated slightly. However, the overall trend remains in check.

New 10-year 8.40% 2024 paper ended at 8.56% on August 28, 2014 compared with 8.50% on July 31, 2014. Gilts were down earlier in August 2014 as the RBI's hawkish policy stance quelled hopes of an interest rate cut in the immediate future. Regular profit taking by participants pulled down the gilts further. Sentiments were also hit after data from the NSDL showed foreign investors had exhausted over 97% of the permitted gilt investment limits in the open category, amid concerns that the gilt investment limit for foreign investors might not be raised. Further decline in gilts was, however, restricted on the rupee's recovery against the dollar and with Govt. running high cash surplus, the RBI released a revised calendar for the August-September period, indicating total reduction of Rs. 16,000 cr of H1 borrowing through the sale of dated securities. Prices got further support on falling global crude oil prices amid easing tensions in Ukraine and on intermittent value buying.

Bond Markets are currently focusing more on inflation trends and perhaps all other positive macro developments are being overlooked. Real rates have turned positive after a long time and can enhance savings in the economy, Balance of Payment is in surplus, Current Account Deficit is likely to remain below 2% of GDP in current fiscal, Fiscal Deficit has improved from over 6% levels to 4.5% and is set to improve further to 3% levels in coming years, Inflation has come down from 11% levels to sub 8% and is headed for further deceleration. All these macro developments are extremely positive for fixed income markets and are structurally building-up a case for lower interest rates in the near future. We believe, valuations in fixed income are reasonable and sentiments are negative, this makes a strong case for investing in fixed income today.

We expect government bond yields to remain range-bound with a downward bias. There is possibility of headline CPI to ease going forward on account of improvement in sowing patters, better administration put in place by new government to counter spikes in food prices and easing oil prices. The timing of the rate cuts would continue to be largely data dependent as the RBI has also stated that they would not hold rates longer than necessary. The shorter end of the curve is likely to remain supported as the outlook for liquidity remains comfortable. We suggest looking at duration products as a part of debt allocation if one can digest some volatility.

Rupesh Nagda

Head – Investments & Products
Alchemy Capital Management Pvt. Ltd

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Edited by: Rupesh Nagda (Ph: +91-22-66171785), Sudeep Pai (Ph: +91-22-66171772)
Alchemy Capital Management Pvt. Ltd., B-4, Amerchand Mansion, 16 Madame Cama Road, Mumbai 400 001. Ph: +91-22-66171700
CIN- U67120MH1999PTC119811, Email ID: contactus@alchemycapital.com