kotak
Kotak Mahindra Bank

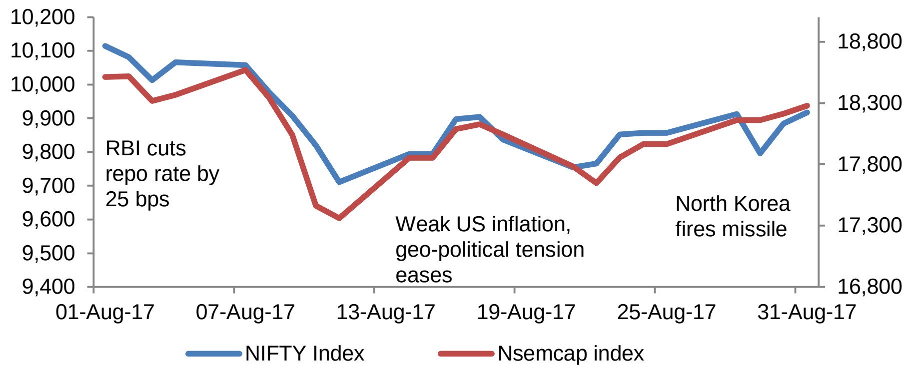
Equity & Debt Strategy

Mid Sept – Oct' 2017

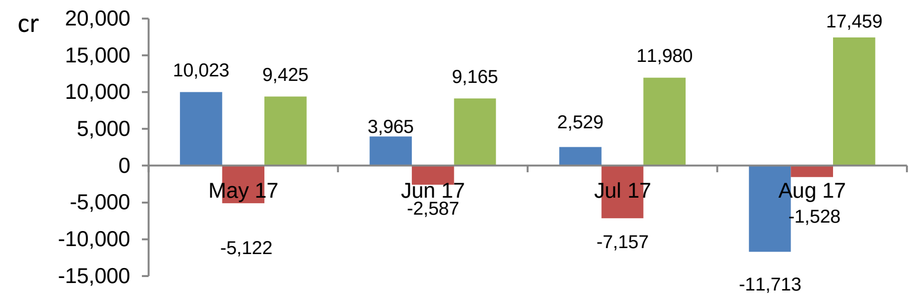
Equity Market Update
&
Equity MF Strategy

Equity market fell in Aug after disappointing earnings season and heightened geo-political tension

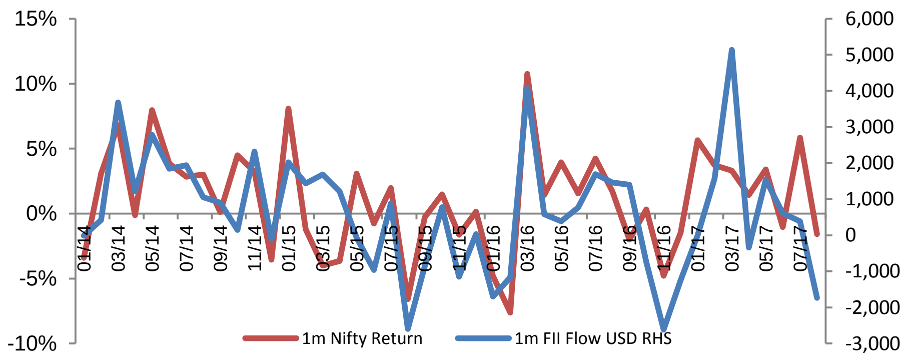
Both Large Cap and Mid Cap corrected over Geo-political tension



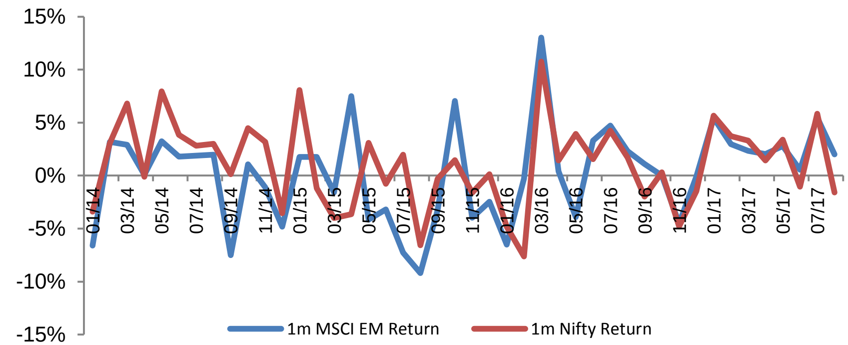
FII took out money after 3 months, market fell even after strong Domestic MF flows



Despite strong MF inflow since 2014, Nifty returns are still correlated to FII flows



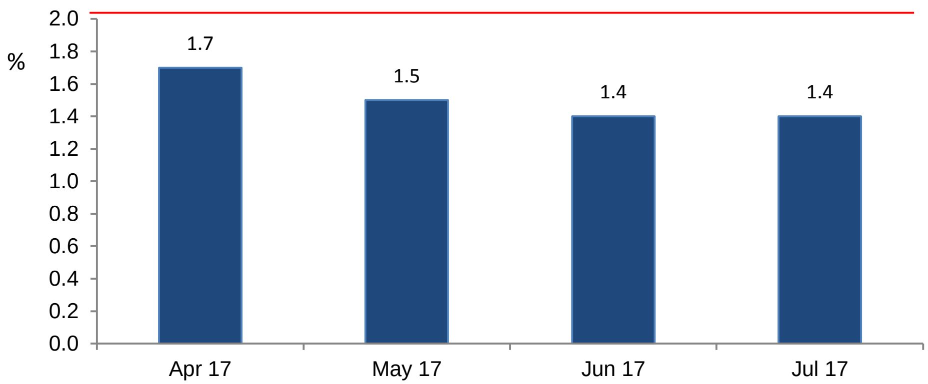
Similarly Indian markets have been broadly following the Emerging market returns even in 2017



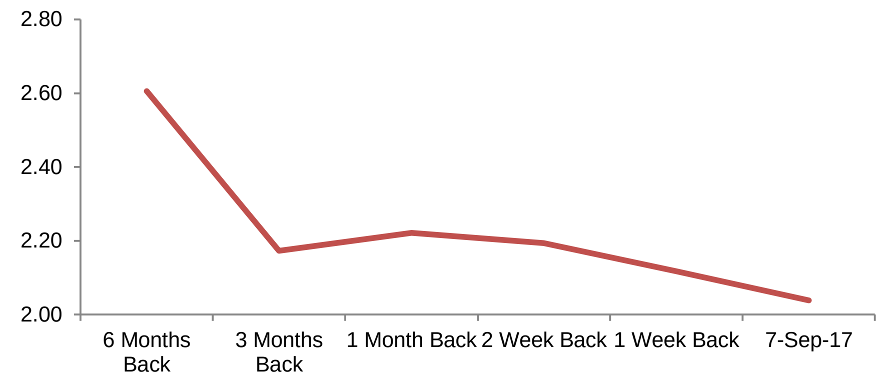
Source: Bloomberg

US inflation still reclusive, Gold rises on US – North Korea situation

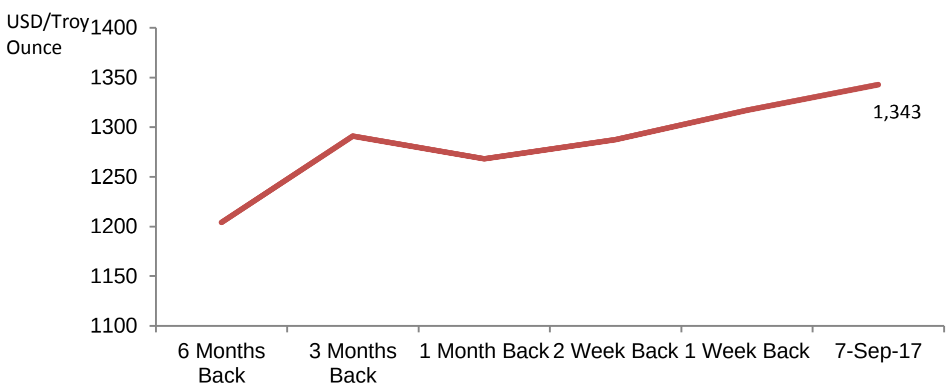
USA Inflation at 1.4% below 2% target



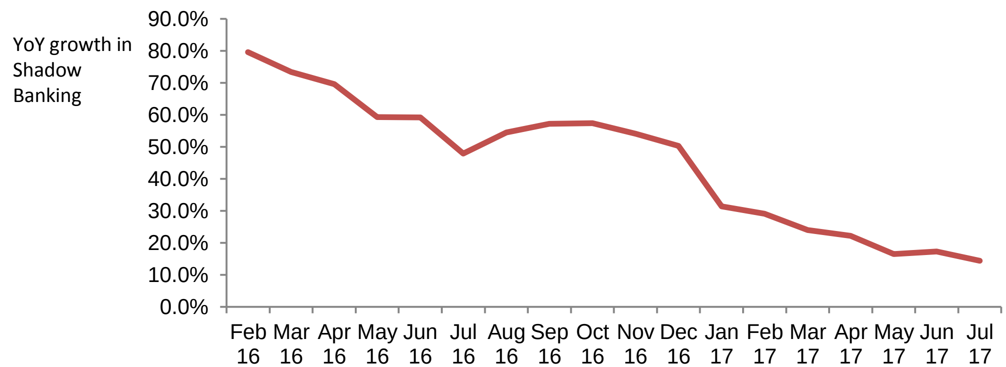
US yields have fallen to close to 2% level, reflecting loss of faith in US tax reforms and growth



Gold has gained 6% in last 1 month from rising Geo-political tension



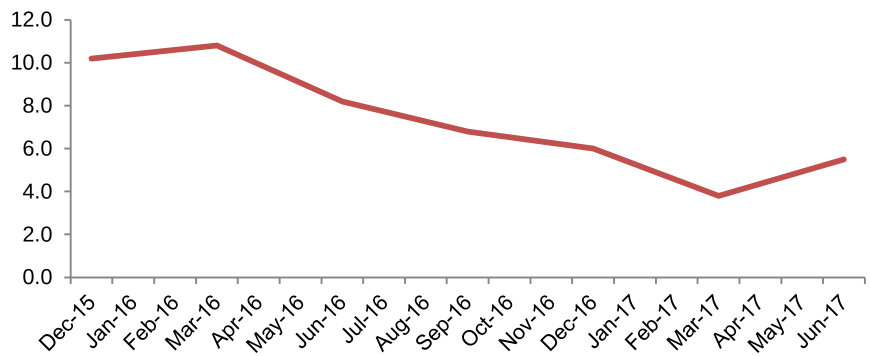
Chinese Govt's squeeze on Shadow Banking, P2P lending, NPAs is showing results



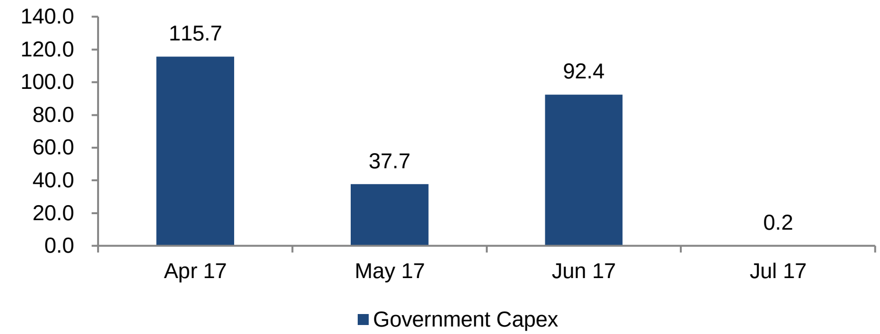
Source: Bloomberg

Domestic Economy struggling reflected from the recent GDP figure of 5.7% in Q1FY18

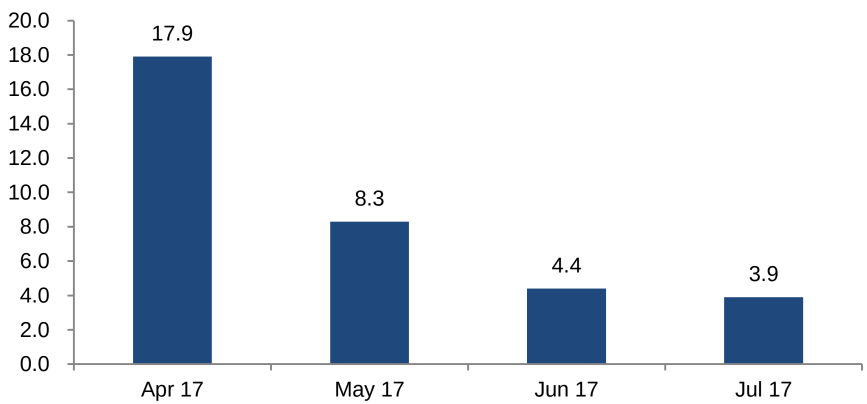
GVA growth exAgri & exGovt has fallen from upwards of 10% levels



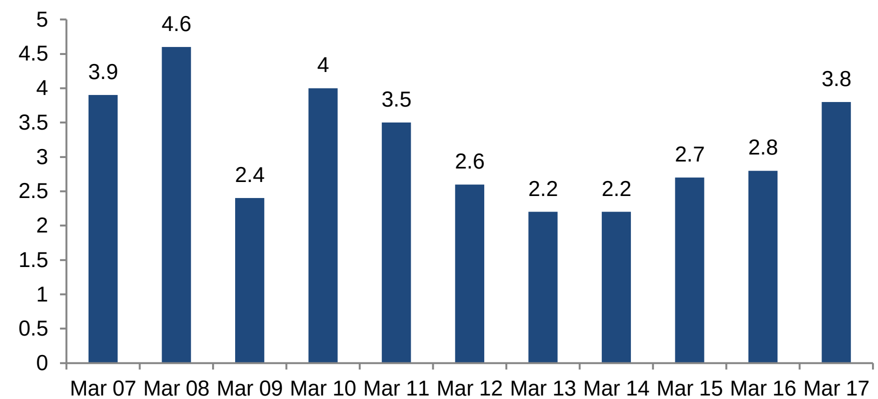
Government capex might slow down for rest of Fiscal Year due to front ended spending, Fiscal Deficit already 92% of target level for FY18



Exports have been hurt by Strong Rupee and GST disruption



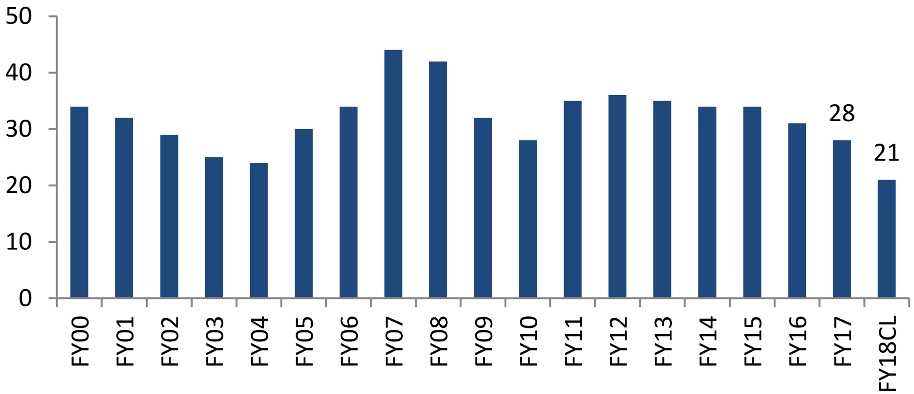
Equity Holdings as proportion of Total Household savings has increased substantially in last 1 Year but still below peak levels



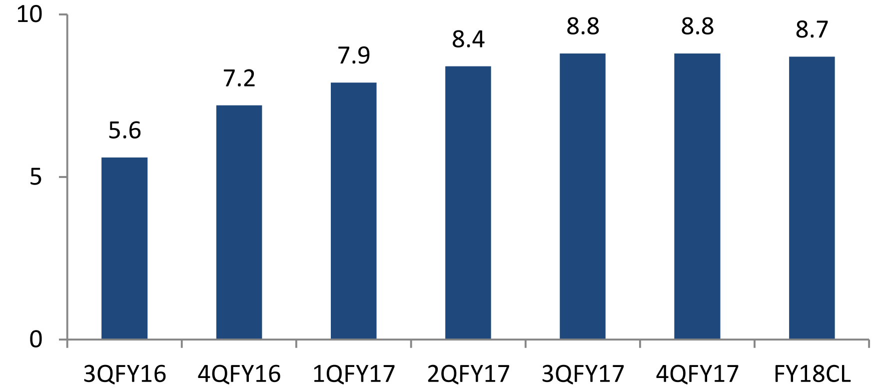
Source: Bloomberg, KIE, Nomura
YoY% unless specified

Sectors which are expected to do well

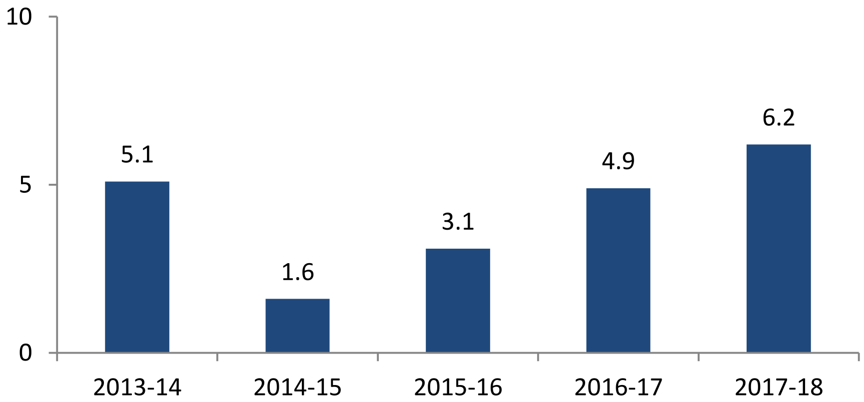
Mortgage Payment to Post Tax Income Ratio at one of the lowest level which should give a boost to affordable housing program



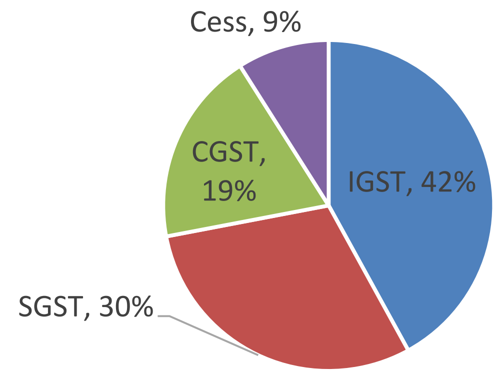
Consolidated Gross NPL ratio showing signs of peaking out



Growth in MSP for Kharif crops has been highest in past 5 Years



GST off to a smooth start, input credit remains an unknown



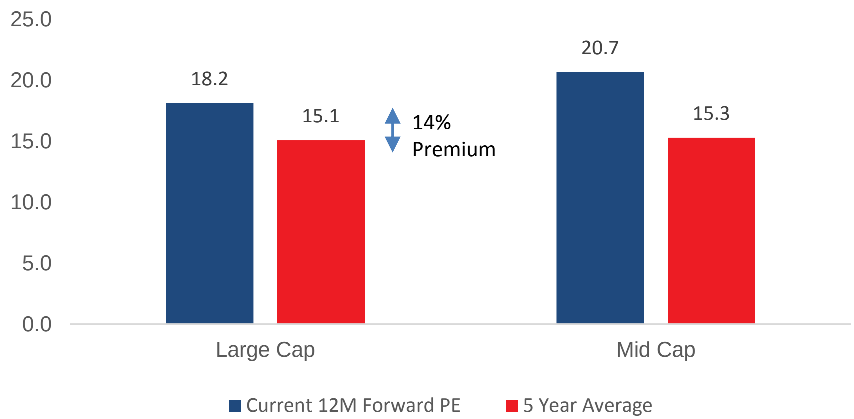
Tax Collection in July:
Rs. 92,300 cr vs Rs. 91,000 target

Source CLSA, Motilal Oswal
YoY% unless specified

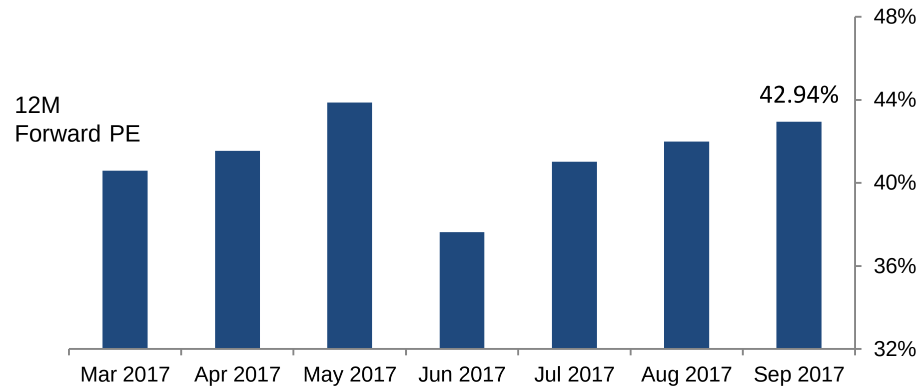
Earnings and Valuation –

Liquidity and Hope of strong Earnings growth has led to slightly expensive valuations

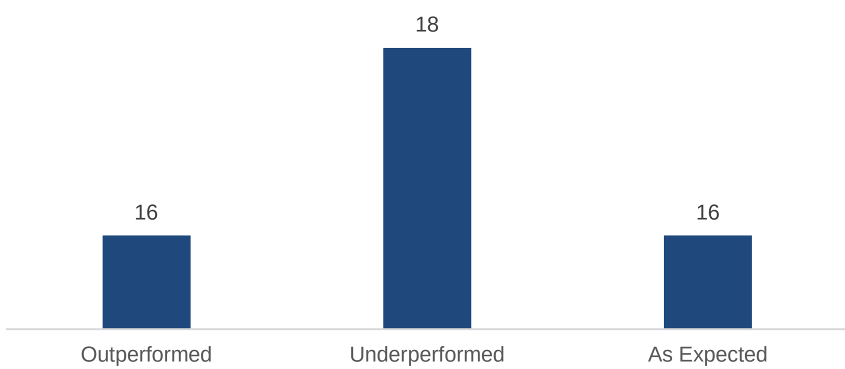
Nifty @ 10,006 trading at 18.2x one year forward Bloomberg earnings and 19.2x KIE estimate



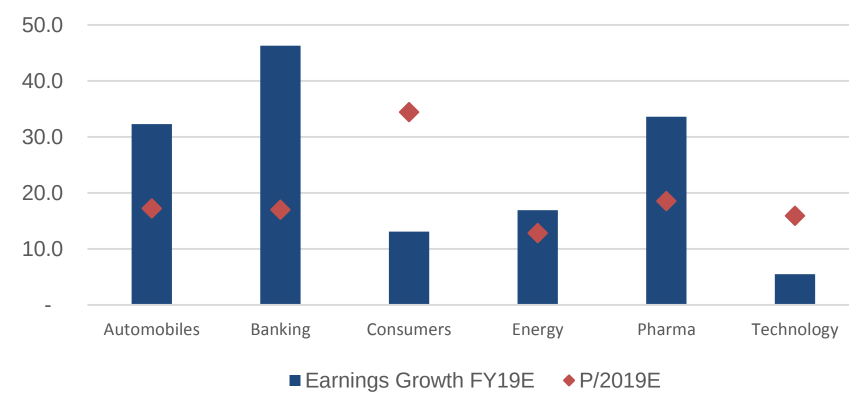
MSCI India P/E Premium over MSCI EM has been in the range of 38-43% this Year



Nifty Q1 FY18 EPS contracted both QoQ and YoY mostly due to Tata Motors and Refining stocks, Pharma results were lower than expected



Banking and Automobile sectors to lead Earnings growth in coming next 2 Fiscal Years



Source: Bloomberg, KIE Estimates Outperformed if PAT>1.05x Expected, Underperformed if PAT<0.95 of expected
YoY% unless specified ^ CY17-18

Key Triggers – GST Implementation and Monsoon

Positive Triggers

- **Global Economic data :** Better macro numbers from US
- **Credit Demand :** Better consumer demand from low rates
- **Resolution of NPA:** Effective addressal by government of NPA issue in Indian Banks
- **Monsoons:** Cumulative rainfall was only 3% deficit till Aug 30th, better crop output to support farm income

Risks

- **US Policies:** Tax reform in US could trigger outflows from EM to US
- **Earnings:** Consensus expected earnings growth for domestic equities is high at around 20%, any downgrade would make the valuations more expensive
- **GST implementation:** GST implementation could be disruptive in short term especially for small players
- **Geo-Political Risk:** Political uncertainty in UK, Germany, Netherland, North Korea
- **Monetary Policy:** Faster than expected monetary tightening in Europe and US

India Equities: Valuations & Strategy – Maintain Neutral Stance

Post a 2% correction for the month of August on account of geo political tensions, equity markets continue to rally to life time highs on the back of domestic liquidity. With monsoon on track, better crop output could lead to improved rural income. Additionally, allocation to equity as part of household savings over the last 1 year has substantially increased although it is below peak levels.

At current levels of approx. 10,006 (11th September, 2017), Nifty is trading at a 1 year forward PE of 19.2X. In the current scenario, **we continue to maintain a Neutral stance**.

Mutual Funds: As domestic liquidity continues to drive markets, we advise new investments in Mutual Funds to be deployed 25% in lumpsum and subsequent in tranches via SIPs/STPs.

Recommended allocation within equity mutual funds is as under:

- 100% Large Cap allocation (Prefer Large Caps due to relatively Favorable Valuations)
- This allocation to Large caps can also be taken through Opportunistic Funds which currently have a bias towards Large cap
- For investors who want equity exposure but have low appetite for volatility, they can take equity exposure through Balanced Funds. Balanced funds have around 25% to 30% of their portfolio into Debt instruments which provides cushion to the portfolio return during market volatility.

Source: EPS Estimates by KIE

Debt Market Update
&
Debt MF Strategy

Debt Market: Key Variables

Indicators

Policy Action
- We expect pause in rates in near term
- RBI to wait and watch.
- Rate action to depend on incoming data.

Inflation
- CPI has started inching up from the lows of June
- We expect CPI to be around 4% by Mar 18

10 Year G-Sec Benchmark Yield
- 10 Yr yield likely to remain in range

INR
- Stable around 64
- Likely to remain in a range

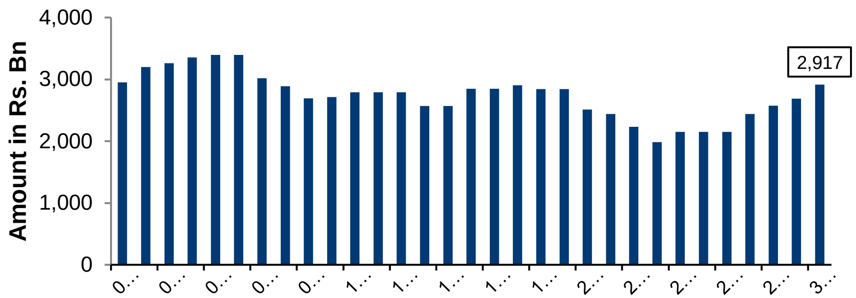
Liquidity
- Liquidity surplus to continue
- RBI to calibrate the timing of OMOs

G-Sec Supply
- The gross G-Sec supply to be Rs. 5.8 trn
- SDL issuance of Rs. ~4.5 trn+ expected

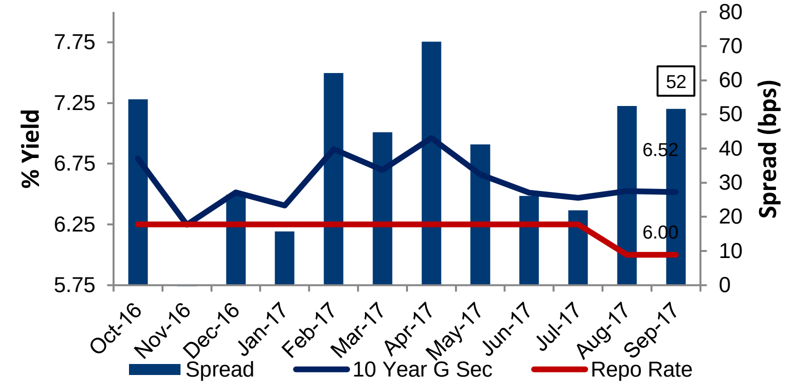
Key Risks
- Fed hikes; Global monetary tightening
- Impact of 7CPC allowance implementation on CPI
- Farm loan waivers can impact fiscal deficit by 1.0 to 1.3% of GDP

Yields remain flat

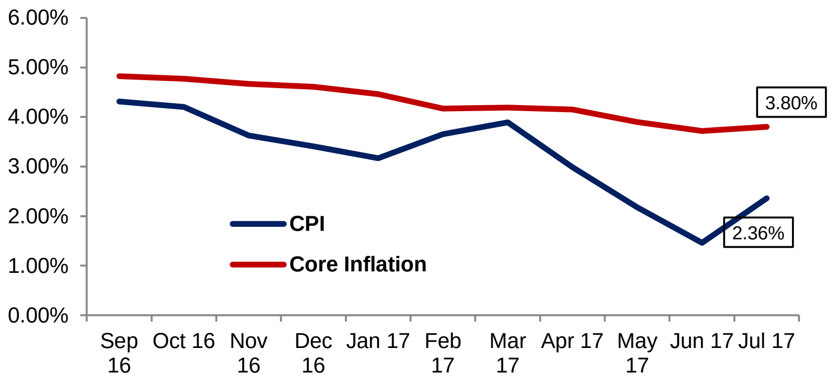
Liquidity continues to be around 3000bn



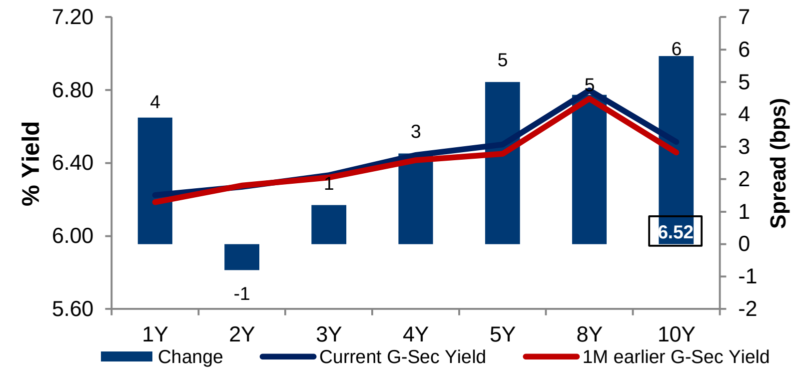
G Sec Spread over Repo now closer to long term average



Small pick up in inflation due to lower base, expect CPI to reach 4% in H2



Longer Duration yields have gradually increased by 5-6 bps

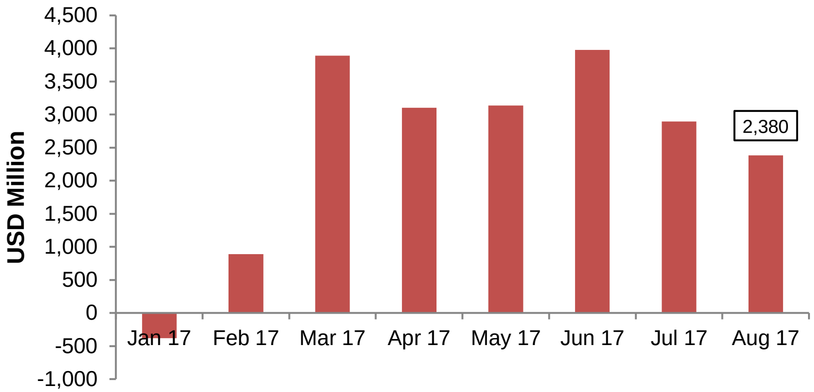


Note: As of 7th Sep 2017, Source Bloomberg

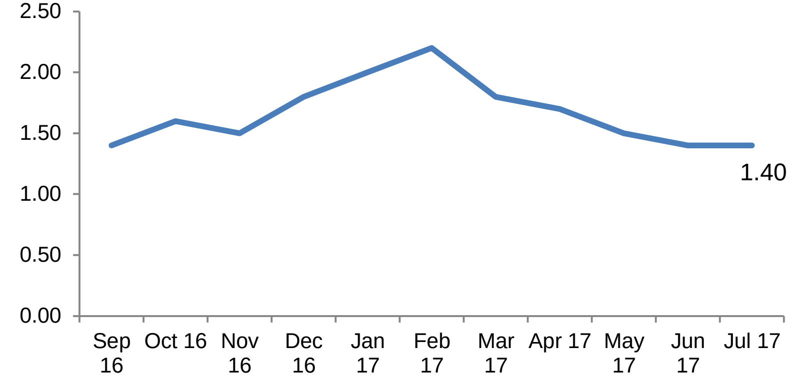
kotak
Kotak Mahindra Bank

Strong macros and low inflation driving FII Flows

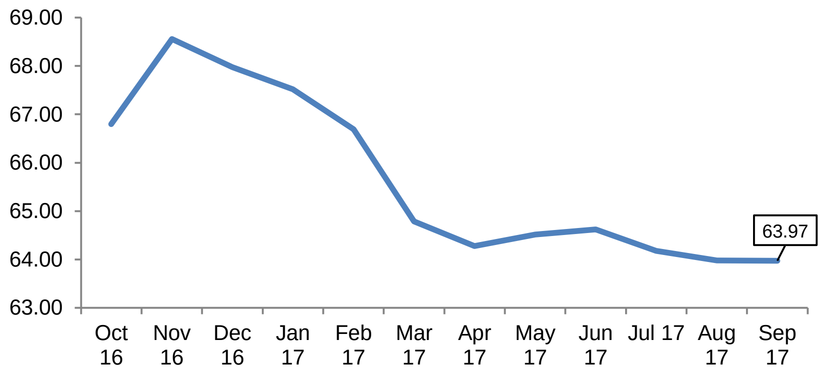
Strong FIIs buying continue, CYTD $20bn inflow from FIIs



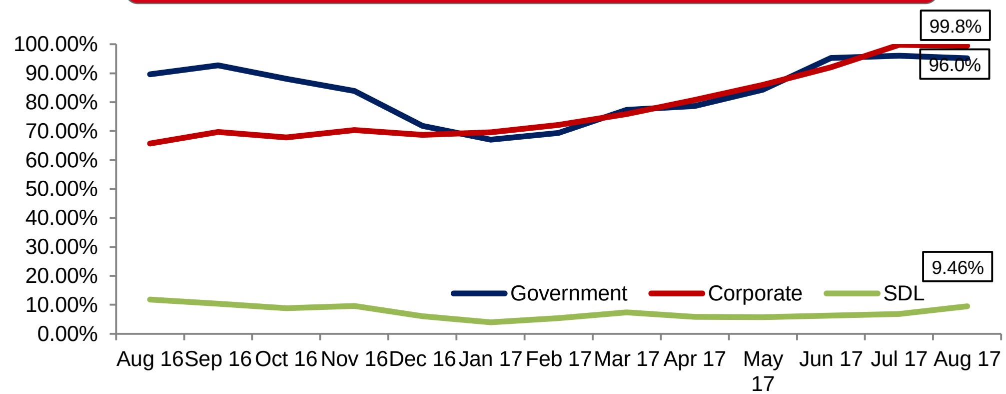
US Core PCE Inflation has fallen below 2% Fed target which can result in delay in the next Fed hike



INR remains stable around strong 64 level



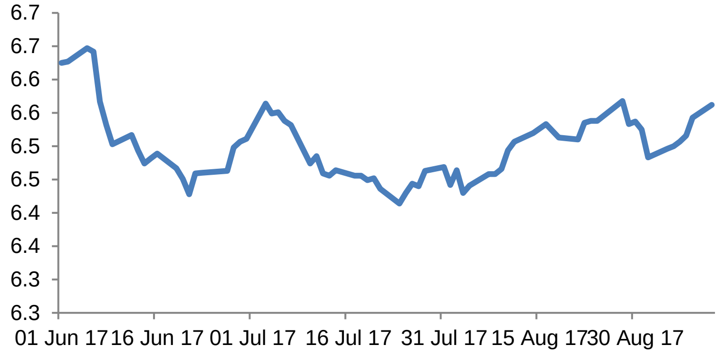
FII Debt Utilization in GSecs and Corporate at 100%, low interest in SDLs



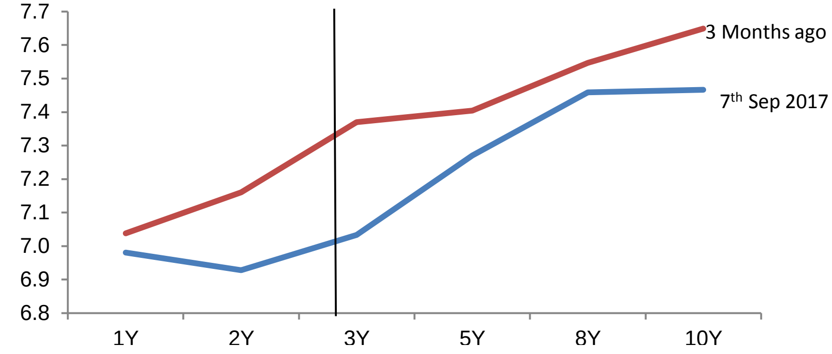
Source Bloomberg, NSDL

Market Trends

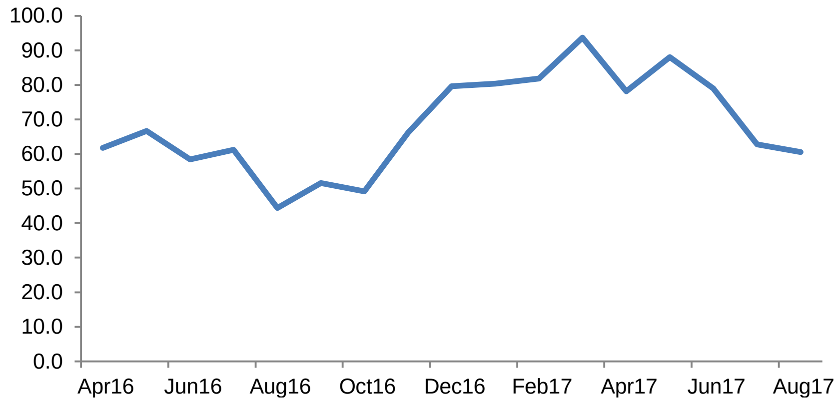
Benchmark Yield has been trading in a narrow range since June



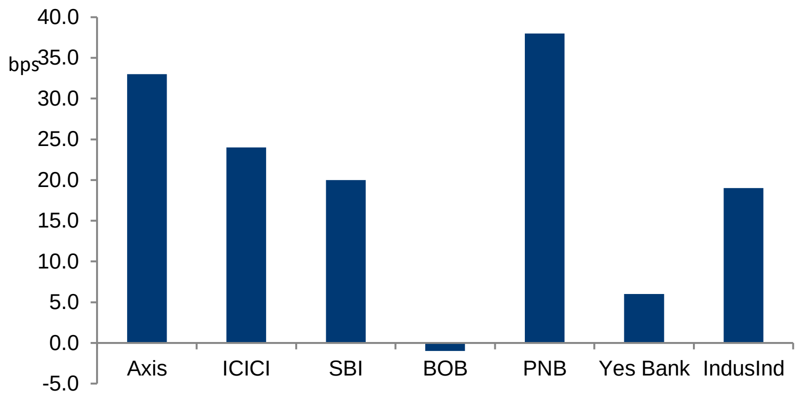
AAA Corporate Curve has become less steep in the short end



SDL spread over 10 Year Gsec has reduced from peak level



Most Tier 1 Perpetual Bonds have seen spread compression since 31st Mar 2017*



Note: As of 7th Sep 2017, Source Bloomberg, CCIL

*Indicative as of 21st July 2017

kotak
Kotak Mahindra Bank

India Fixed Income: Strategy

Substantial part of the portfolio should to be played through a mix of high rated and credit accrual strategies. Exit from duration funds only for investors who have completed 3 years and can deploy with another 3 years view.

Investment Focus:

Passive Accrual-Oriented Debt funds

- High quality portfolios (~100% AAA / Sovereign)
- Portfolio is run on a passive accrual basis i.e buying a bond and holding it till maturity thereby earning from the accruing of interest
- Higher predictability of return, lower volatility & lower interest rate risk

High Yield Credit-Oriented Funds

- Low volatility on account of maturity of portfolio between 3 – 5 years, attractive and stable accrual yields
- Experienced teams to carefully evaluate and tightly monitor high yielding debt instruments

Short Term Bond Funds

- Actively managed to run a low avg. maturity of 2-3 years, attractive risk-reward
- Lower volatility and interest rate risk than Dynamic Bond Funds, better suited from a risk-adjusted basis in volatile markets

Continue to recommend ultra short term relative to liquid funds (up to 3 Months)
For short term parking of funds for a minimum of 6 months, Arbitrage funds preferred over ultra short term funds on back of better tax adjusted returns

Source : AMCs, other Financial websites

Disclaimer

The aforesaid is for information purposes only and should not be construed to be investment advice under SEBI (Investment Advisory) Regulations.

In the preparation of the material contained in this document, Kotak Mahindra Bank has used information that is publicly available, including information developed in-house. Some of the material used in the document may have been obtained from members/persons other than the Kotak Mahindra Bank and/or its affiliates and which may have been made available to Kotak Mahindra Bank and/or its affiliates. Information gathered & material used in this document is believed to be from reliable sources. Kotak Mahindra Bank however does not warrant the accuracy, reasonableness and/or completeness of any information. For data reference to any third party in this material no such party will assume any liability for the same. Kotak Mahindra Bank and/or any affiliate of Kotak Mahindra Bank does not in any way through this material solicit any offer for purchase, sale or any financial transaction/commodities/products of any financial instrument dealt in this material. All recipients of this material should before dealing and or transacting in any of the products referred to in this material make their own investigation, seek appropriate professional advice

We have included statements/opinions/recommendations in this document which contain words or phrases such as "will", "expect" "should" and similar expressions or variations of such expressions, that are "forward looking statements". Actual results may differ materially from those suggested by the forward looking statements due to risks or uncertainties associated with our expectations with respect to, but not limited to, exposure to market risks, general economic and political conditions in India and other countries globally, which have an impact on our services and / or investments, the monetary and interest policies of India, inflation, deflation, unanticipated turbulence in interest rates, foreign exchange rates, equity prices or other rates or prices, the performance of the financial markets in India and globally, changes in domestic and foreign laws, regulations and taxes and changes in competition in the industry. By their nature, certain market risk disclosures are only estimates and could be materially different from what actually occurs in the future. As a result, actual future gains or losses could materially differ from those that have been estimated

Kotak Mahindra Bank (including its affiliates) and any of its officers directors, personnel and employees, shall not liable for any loss, damage of any nature, including but not limited to direct, indirect, punitive, special, exemplary, consequential, as also any loss of profit in any way arising from the use of this material in any manner. The recipient alone shall be fully responsible/ are liable for any decision taken on the basis of this material. The investments discussed in this material may not be suitable for all investors. Any person subscribing to or investing in any product/financial instruments should do so on the basis of and after verifying the terms attached to such product/financial instrument. Financial products and instruments are subject to market risks and yields may fluctuate depending on various factors affecting capital/debt markets. Please note that past performance of the financial products and instruments does not necessarily indicate the future prospects and performance thereof. Such past performance mayor may not be sustained in future. Kotak Mahindra Bank (including its affiliates) or its officers, directors, personnel and employees, including persons involved in the preparation or issuance of this material may; (a) from time to time, have long or short positions in, and buy or sell the securities mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation in the financial instruments/products/commodities discussed herein or act as advisor or lender / borrower in respect of such securities/financial instruments/products/commodities or have other potential conflict of interest with respect to any recommendation and related information and opinions. The said persons may have acted upon and/or in a manner contradictory with the information contained here. No part of this material may be duplicated in whole or in part in any form and or redistributed without the prior written consent of Kotak Mahindra Bank. This material is strictly confidential to the recipient and should not be reproduced or disseminated to anyone else

This material is not a research report as per the SEBI (Research Analyst) Regulations, 2014.

Mutual Fund investments are subject to market risks, read all scheme related documents carefully.

kotak®
Kotak Mahindra Bank