Kotak Mahindra Bank

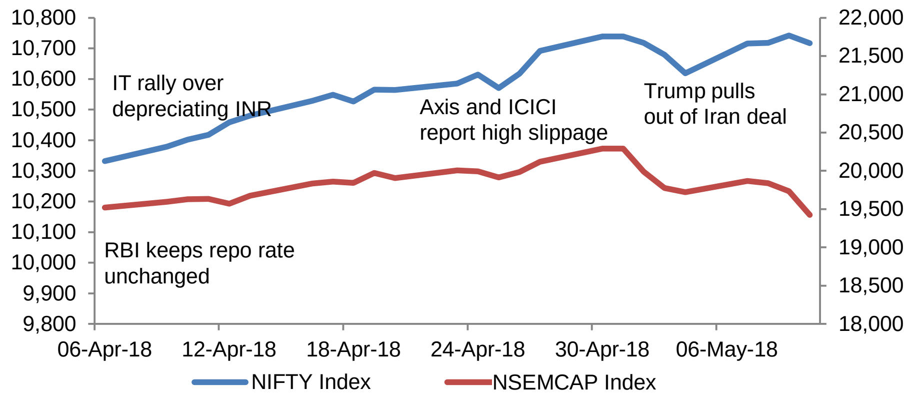
Equity & Debt Strategy

Mid May – Jun' 2018

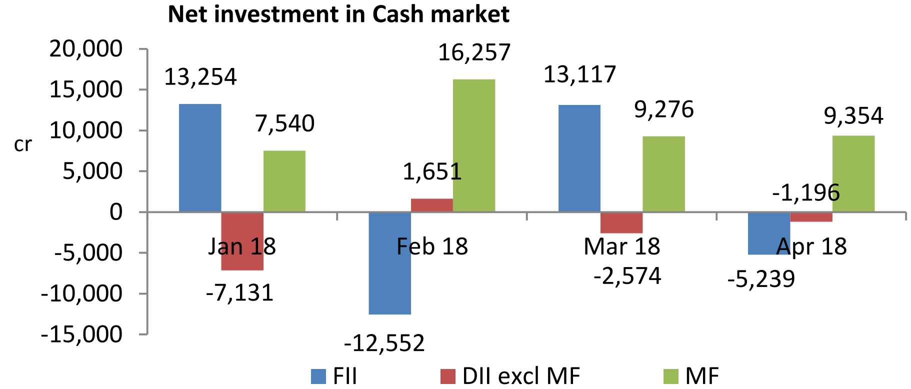
Equity Market Update
&
Equity MF Strategy

Equity markets bounce back, MF flows still below peak level

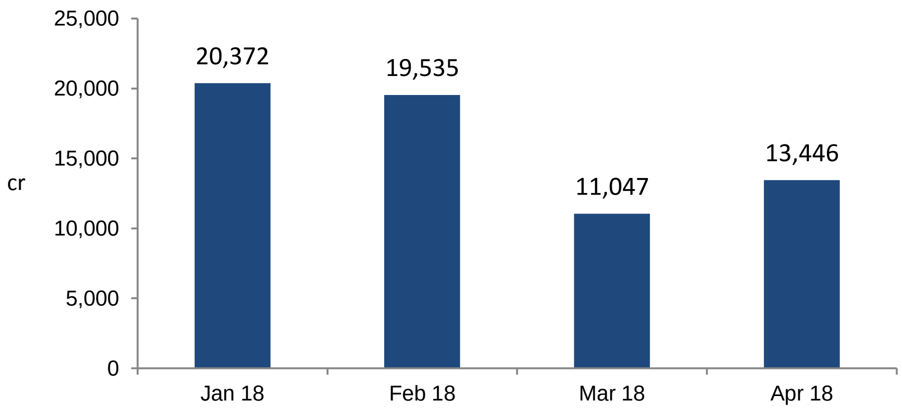
Nifty 50 and Midcap 100 up by 6.2% and 8.2% in Apr respectively



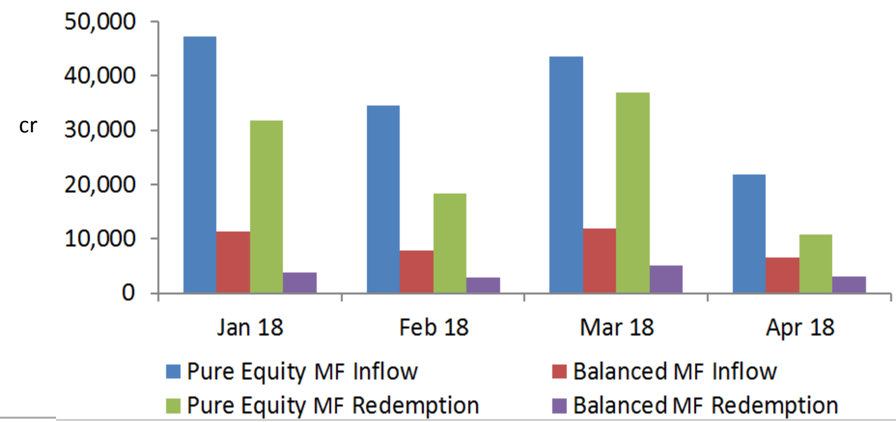
FII selling was balanced by Mutual Fund buying



Flows to Equity Mutual Funds still at lower levels compared to peak of Dec-Jan



March net inflows were lower due to higher redemptions. In April even gross inflows were low. Balanced Funds have been most impacted



Note: April excludes Arbitrage Funds

Source: Bloomberg, KIE, AMFI

As of 10th May , 2018

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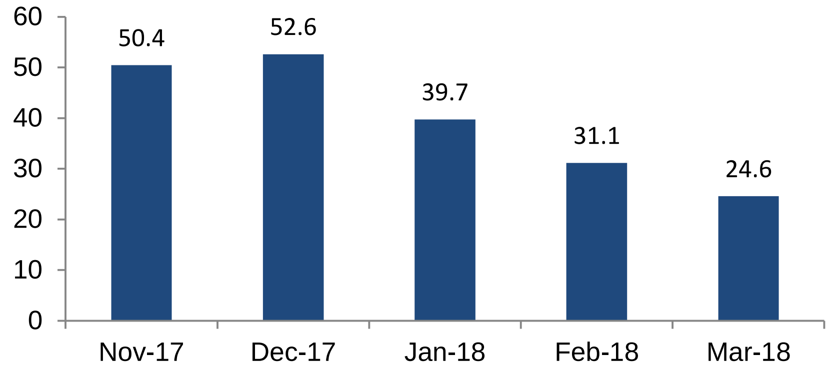
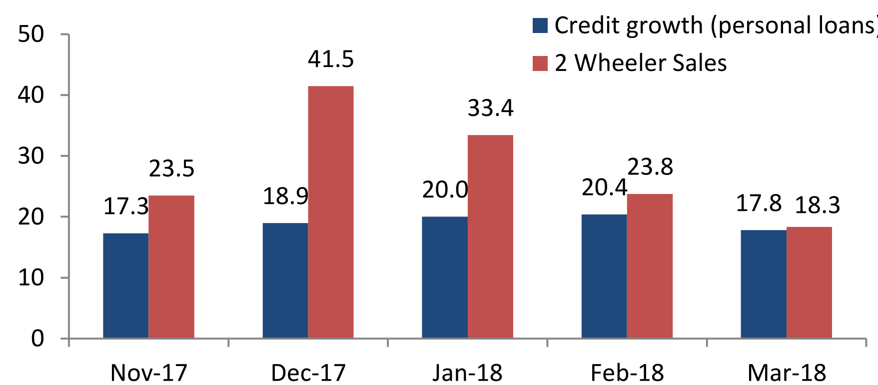
Domestic Economy showing greenshoots in both Consumption and Capital Goods linked sectors

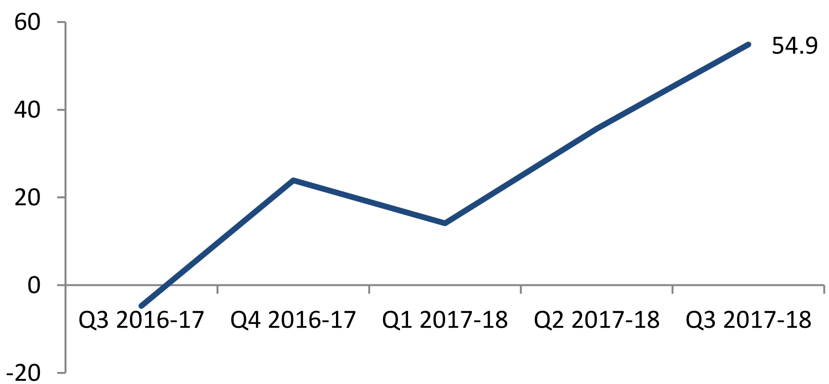
Auto/Industrials - Commercial Vehicles which are generally a lead indicator of industrial recovery have seen strong YoY growth in sales



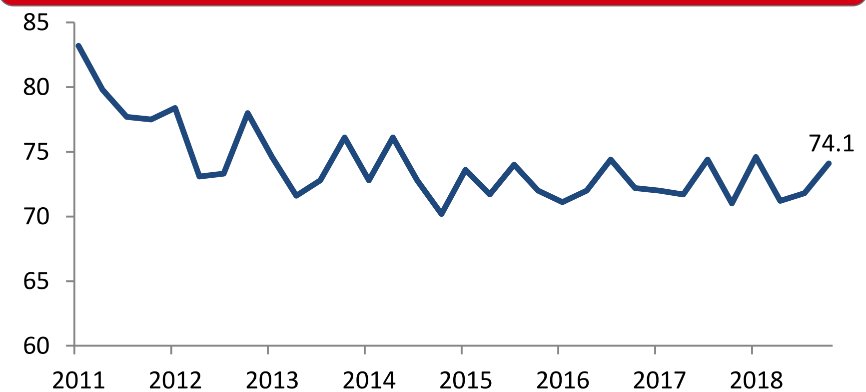
Consumption - Most Consumer linked indicators are growing at ~20% rate yoy



Capital Goods - Sectors related to infra and Auto have seen significant jump in new order inflows



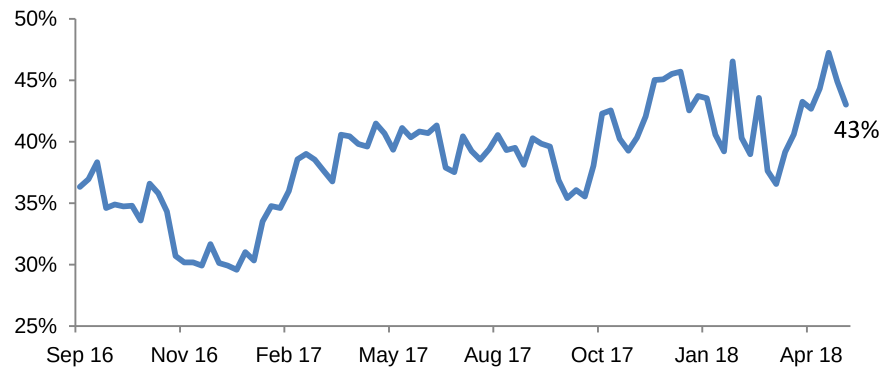
Manufacturing – Capacity utilization is showing signs of bottoming out



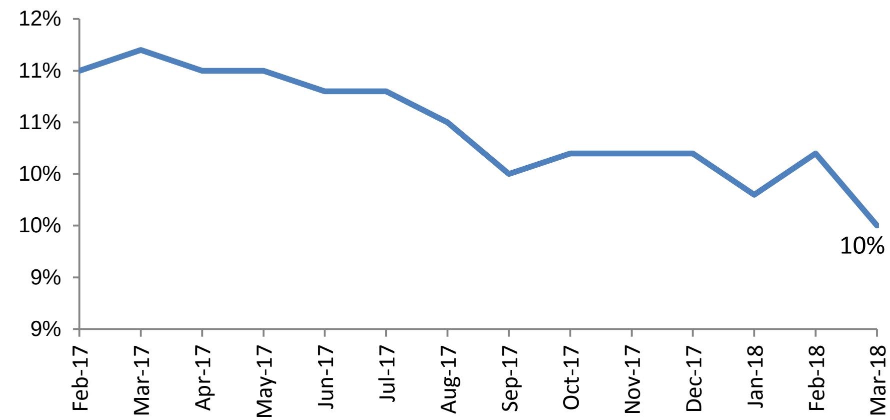
Source: DB, KIE, RBI
YoY% growth

Emerging Markets under pressure as monetary tightening is in motion, India protected till now due to strong Domestic flows

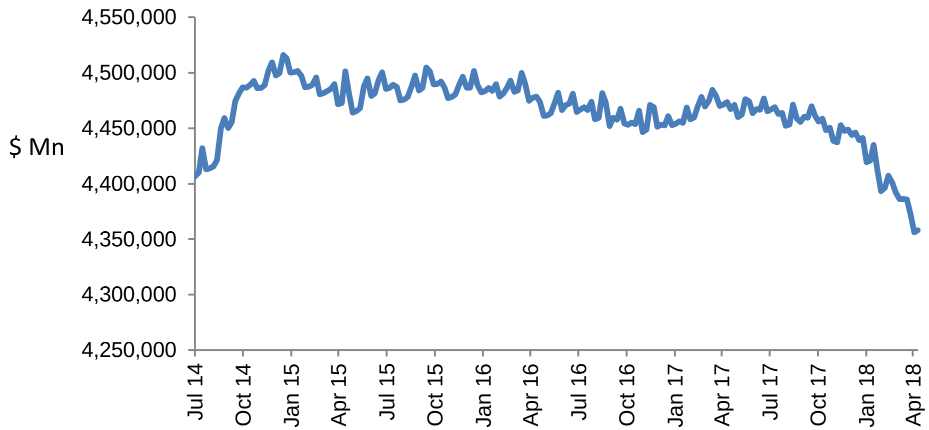
India PE Premium over Emerging Markets has increased in last 1-2 Years



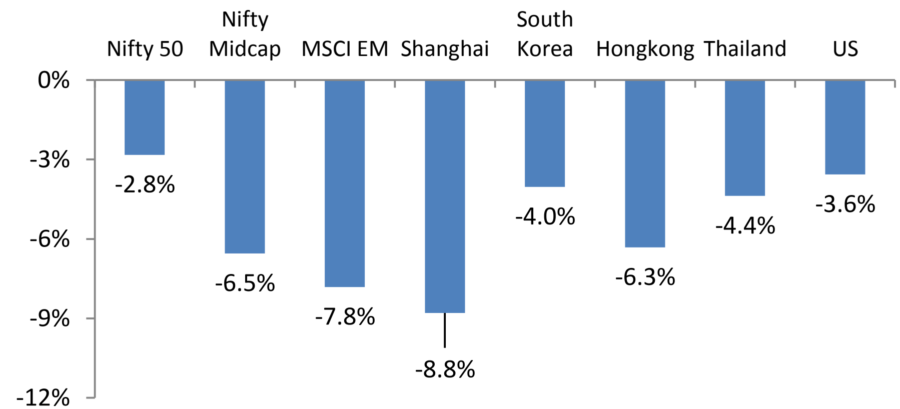
India allocation In Growth & Emerging Market (GEM) funds has been declining due to rich valuations



QE Unwind program is gaining pace , Fed Balance sheet leaner by $112 bn in last 1 Year



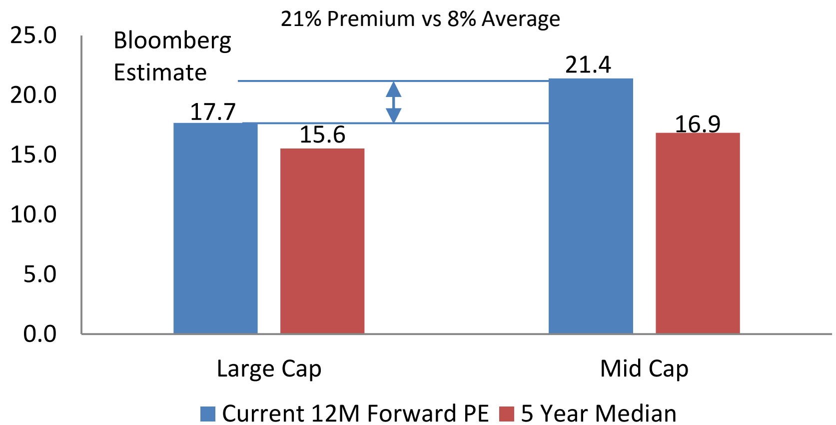
Since 31st Jan, Emerging markets have corrected by 7.8% , Nifty 50 has sustained due to Domestic flows



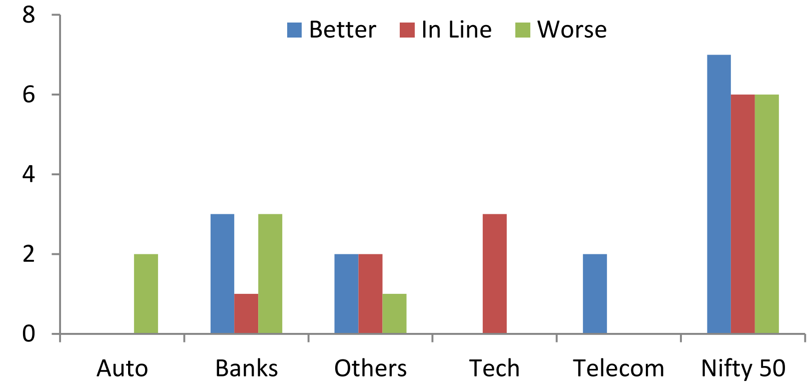
As of 10th May 2018
Source: DB, Bloomberg, CLSA

Earnings and Valuation

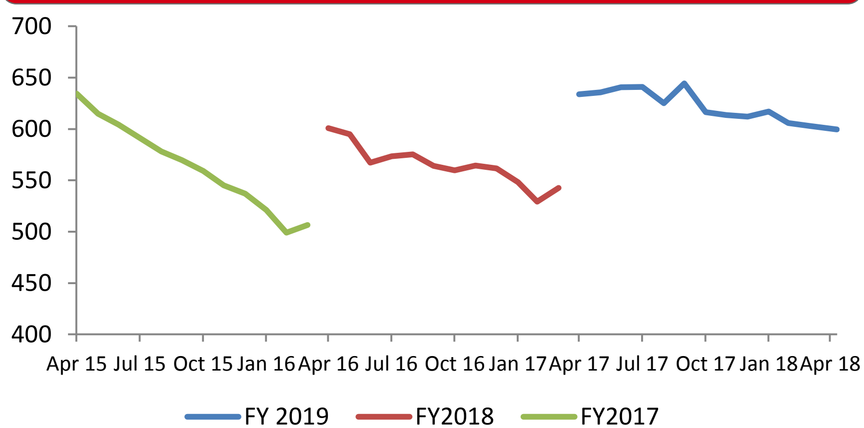
Mid Cap Index premium over large cap still above median



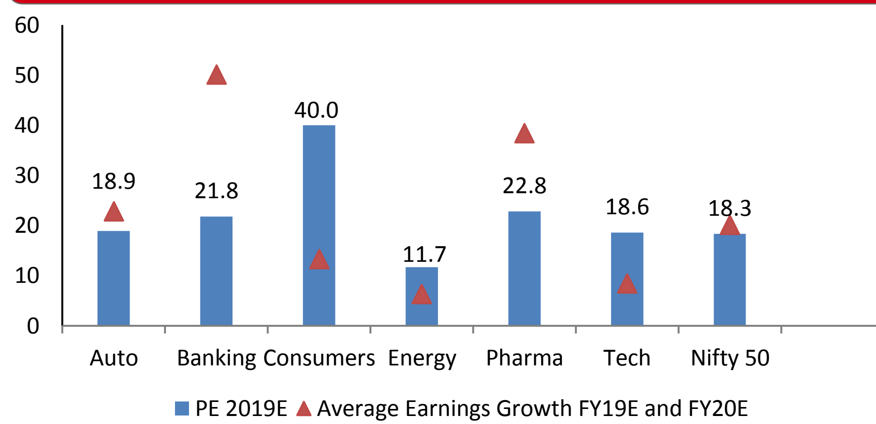
4QFY18 Nifty 50 results have been in line with expectation, ICICI and Axis major disappointments, Yes bank surprised with better than estimates



Consensus Earnings expectation of FY 2019 has been relatively stable compared to previous Fiscals



Valuation of Consumption oriented and IT companies have become richer*



Source: Bloomberg, KIE * Based on KIE Estimates on free float basis
As of 10th May 2018

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Key Triggers

Positive Triggers

- **Global Economic data :** World GDP growth rate improving
- **Commodity Prices:** Sustained high prices are expected to lead to high earnings growth in Steel/Oil sector
- **Resolution of NPA:** Effective addressal of NCLT lists
- **Weaker Rupee:** To benefit IT and Pharma
- **Normal Monsoon/Rural recovery:** Government focus on rural economy including increase of MSP could benefit rural consumption

Risks

- **Outflow from EM:** US tax reforms and rising global rates could trigger capital flight from Emerging Markets like India
- **Monetary Policy:** Faster than expected monetary tightening in Europe and US
- **Earnings:** Consensus expected earnings growth for domestic equities is high at around 22% for FY19, any downgrade would make the valuations more expensive
- **Trade Wars:** Further tariffs imposed by US/China
- **Weaker Macro:** Higher crude prices and low GST collection could lead to de-rating of Equity valuations
- **Higher Provisioning :** Due to recent RBI rule and continued slippages, Banks could show high provisioning this FY also thus impacting Nifty EPS
- **Slowdown in Retail Flows:** Redemption pressure post 10% LTCG. 10-15% correction in markets is possible.
- **State Elections:** Elections in some of the major states are expected to be closely contested

India Equities: Valuations & Strategy – Maintain Neutral Stance

Domestic equity markets bounced back in the month of April after two consecutive months of decline. The Nifty ended the month up by ~6%. FII flows into equity markets turned negative in April, but was balanced by net buying from domestic mutual funds.

At current levels of approx. 10,682 (17th May 2018), Nifty is trading at a 1 year forward PE of 18.5X. In the current scenario, **we continue to maintain a Neutral stance.**.

Mutual Funds: As domestic liquidity continues to drive markets, we advise new investments to be staggered in Mutual Funds via SIPs/STPs.

Recommended allocation within equity mutual funds is as under:

- 50% Large Cap allocation (Prefer Large Caps due to relatively Favorable Valuations)
- 50% Multi Cap allocation (such funds currently have a bias toward 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

Recommended Large Cap, Multi Cap & Balanced Fund Performances

Scheme Name	Corpus (In crs.)	1 Year	3 Years	5 Years	Investor Suitability
Large Cap Fund					
Axis Focused 25 Fund	3714	17.87	16.29	17.36	All Risk Profiles except Secure
Franklin India Prima Plus Fund	11848	8.22	10.12	18.29	All Risk Profiles except Secure
ICICI Prudential Focused Bluechip Equity Fund	17142	14.02	11.98	16.41	All Risk Profiles except Secure
Kotak Select Focus Fund	19228	8.62	13.91	20.14	All Risk Profiles except Secure
Mirae Asset India Equity Fund	7479	12.76	14.13	20.03	All Risk Profiles except Secure
Index					
Nifty 50	--	14.36	9.34	11.93	
Multi Cap Fund					
Aditya Birla Sun Life Advantage Fund	6184	7.92	13.09	21.85	All Risk Profiles except Secure
DSP BlackRock Equity Opportunities Fund	5560	10.16	14.97	19.45	All Risk Profiles except Secure
L&T India Value Fund	8073	7.56	16.45	24.93	All Risk Profiles except Secure
Motilal Oswal Multicap 35 Fund	13131	11.91	16.92	--	All Risk Profiles except Secure
Index					
S&P BSE 200	--	12.80	10.51	13.58	
Balanced Fund					
Aditya Birla Sun Life Balanced 95 Fund	14662	7.73	11.15	16.33	All Risk Profiles except Secure
HDFC Balanced Fund	21779	9.84	11.89	18.72	All Risk Profiles except Secure
ICICI Prudential Balanced Advantage Fund	27123	8.55	9.71	13.96	All Risk Profiles except Secure
L&T Hybrid Equity Fund (Erstwhile L&T India Prudence Fund)	10572	9.13	11.88	18.29	All Risk Profiles except Secure
SBI Equity Hybrid Fund (Erstwhile SBI Magnum Balanced Fund)	23581	12.58	9.90	16.82	All Risk Profiles except Secure
Index					
CRISIL Hybrid 35+65 - Aggressive Index	--	10.19	10.65	12.62	

Source: MFI Explorer

Returns are CAGR as on May 15, 2018 and for Regular Plans with Growth option. Corpus size is as on Apr 30, 2018.

Debt Market Update
&
Debt MF Strategy

Debt Market: Key Variables

Indicators

Policy Action
- Short end rates pricing-in rate hikes
- The latest minutes captures hawkish commentary from MPS
- We expect repo rate to be unchanged as a base case in next policy

Inflation
- April headline CPI was higher than expectations at 4.58% YoY.
- We expect CPI averaging around 4.3% for FY2019

10 Year G-Sec Benchmark Yield
- G-Sec segment expected to be volatile
- 10 Year Yield should hold in 7.60 to 7.90 range

INR
- Concerns over CAD and FII outflow put pressure on INR
- Witnessed sharp depreciation towards 67.30
- Expect range of 66-68 to hold in near term

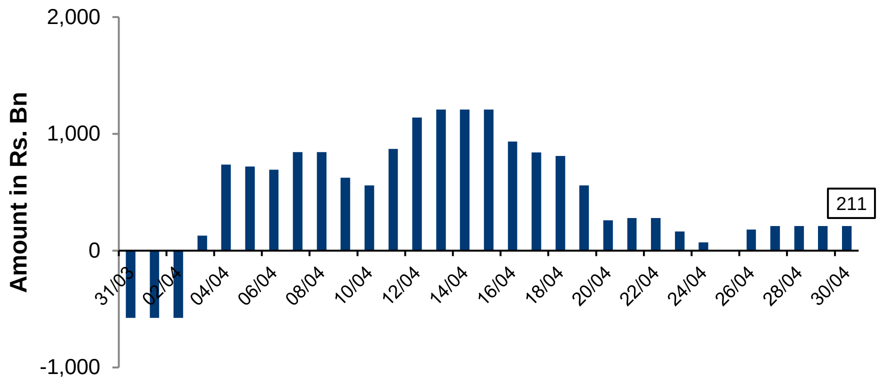
Liquidity
- Liquidity is close to neutral
- OMO Purchase for Rs.10000 Crs announced

G-Sec Supply
- Four consequent G-Sec auction got devolved.
- SDL auction are also being cancelled.
- Weak demand sentiment amid low volumes

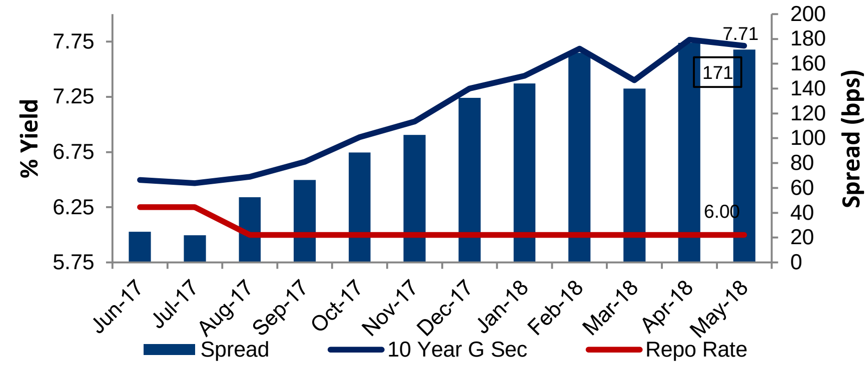
Key Risks
- Global monetary tightening
- Crude Prices
- Impact of GST revenues and spending on Fiscal Deficit
- Growth Recovery

Yields over Feb end levels due to concerns on rising crude prices

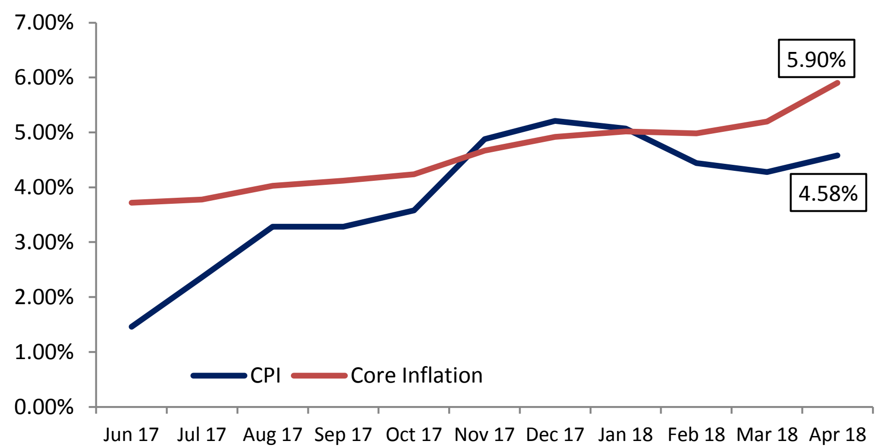
Liquidity back to surplus levels post March end



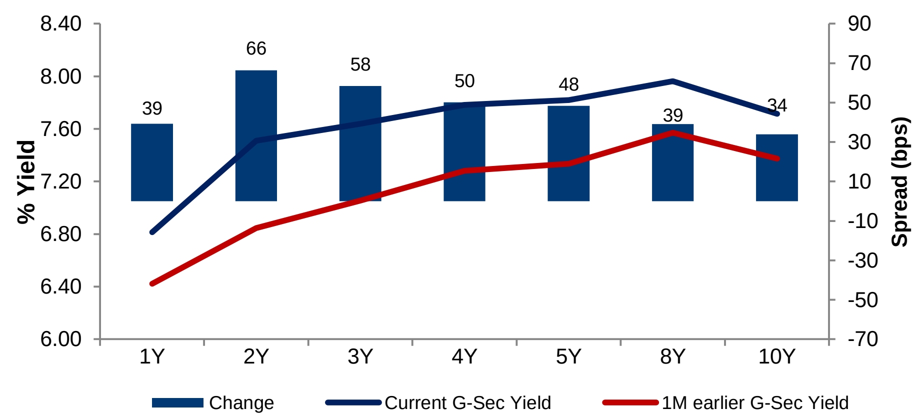
G Sec Spread over Repo has fallen from peak of 170 bps to 113 bps



April Inflation rose due to rise in crude prices, Core CPI also inched higher



10 Year papers rallied the most in April, but have inched higher than the Feb-end levels.



Note: As of 10th May 2018, Source Bloomberg

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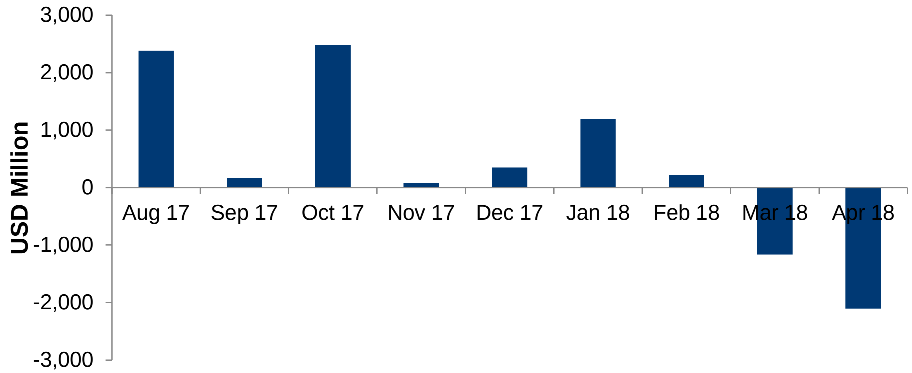
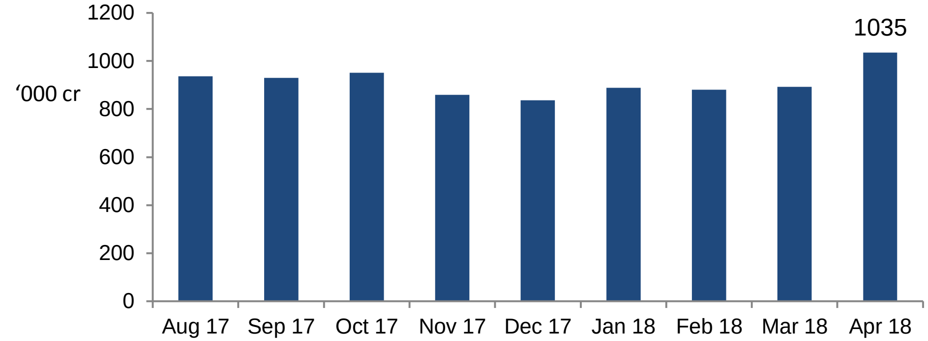
Despite announced increase in FII limit, FIIs have stayed away from Indian Bond market

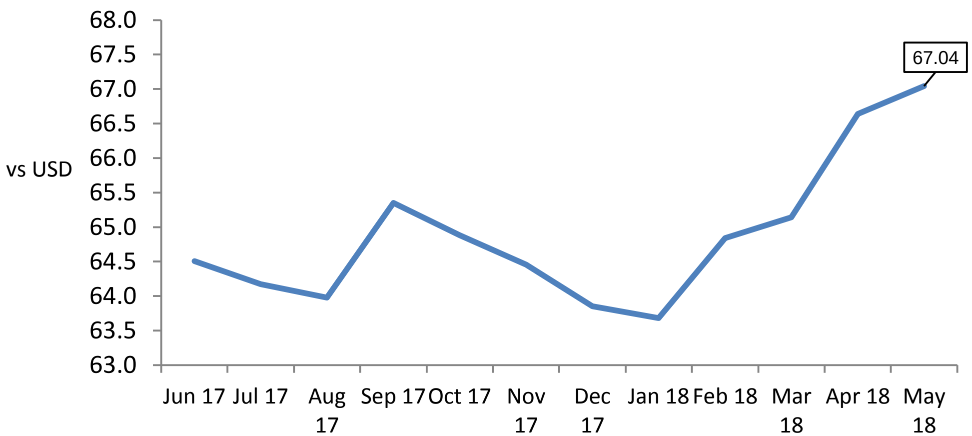
FIIs buying slowing down due to rising global rates and weaker INR



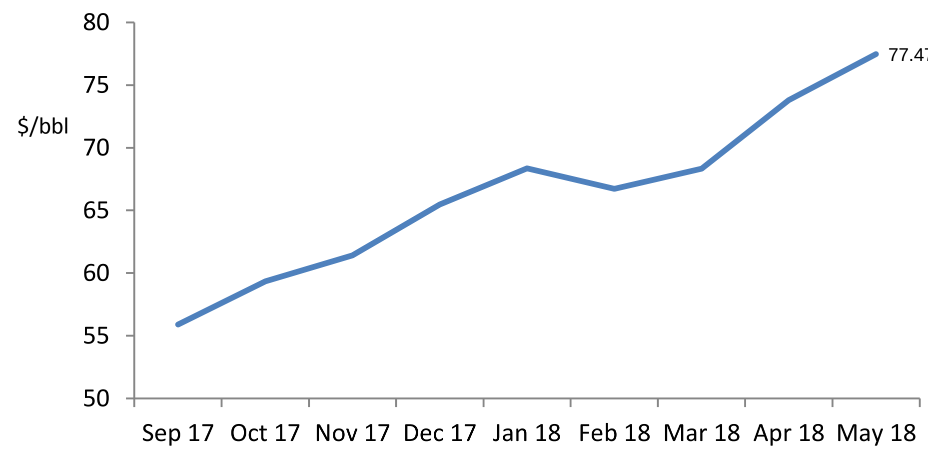
GST collections improve but could be due to seasonality effect



Indian currency has depreciated by ~ 5% in 2018



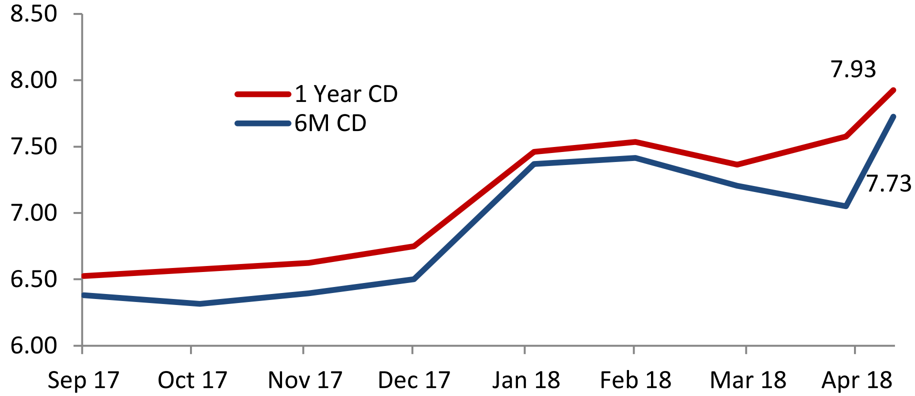
Brent at $78/bbl is above Fiscal estimates based on $68/bbl



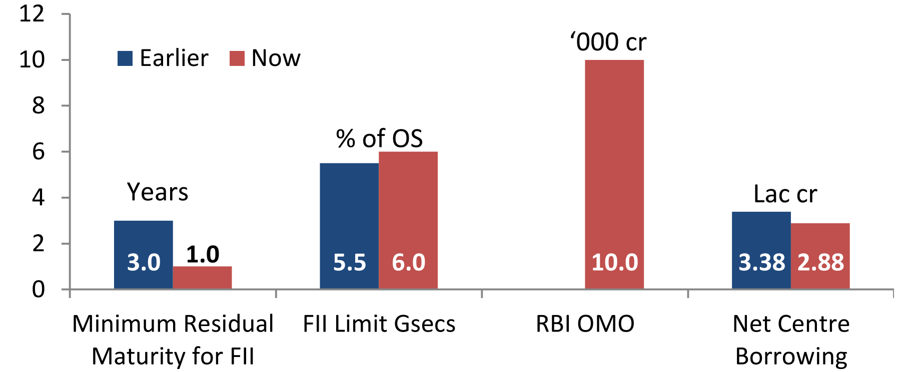
Note: As 10th May 2018, Source Bloomberg, Nomura

Debt Market Trends

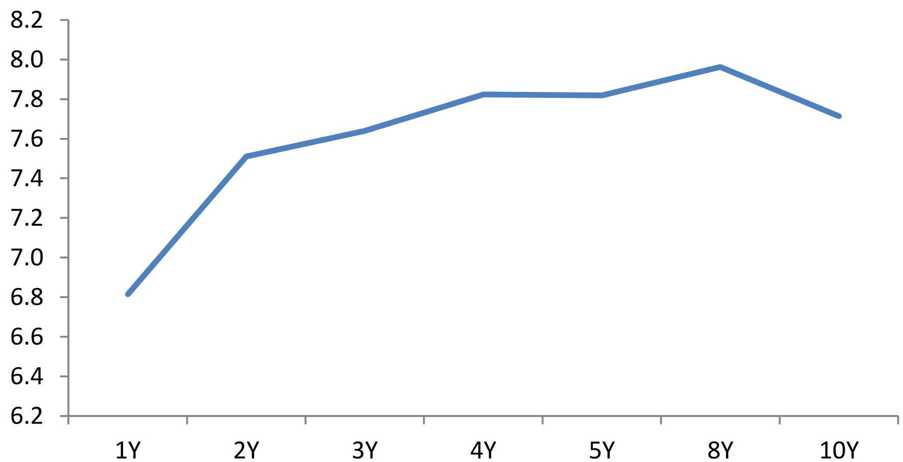
6 Month and 1 Yields have also increased to almost 8%



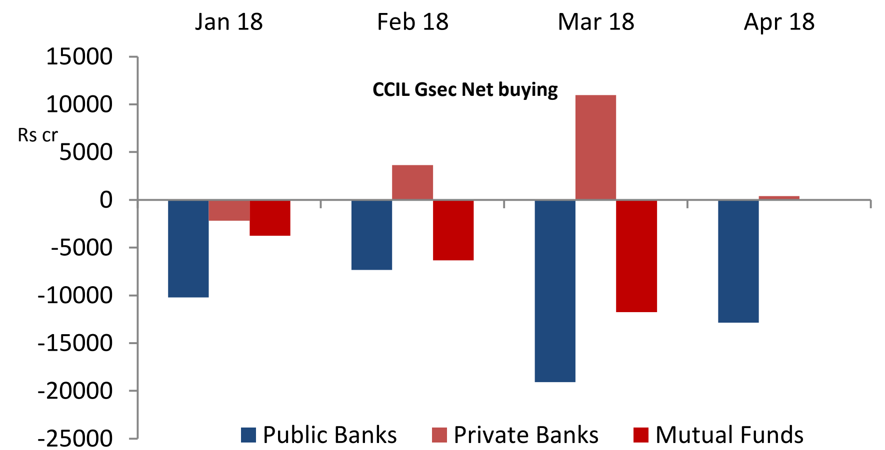
RBI and Govt. have announced sleuth of measures to control upward yields movement



Gsec Yield curve is steep till 3 Year and then almost flattish, hence it better to stay at the short end



Demand for Gsecs has been low across all Public/Private Banks and MFs especially PSU Banks



Note: As of 10th May 2018, Source Bloomberg, MFI

India Fixed Income: Strategy

Substantial part of the portfolio should be deployed 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

For investments up to 3 months, prefer Ultra Short Term Funds
For investments for atleast 6 months, prefer a mix of Ultra Short Term Funds and Arbitrage Funds.

Source : AMCs, other Financial websites

Recommended Short Term Bond, High Yield & Debt Others Performances

Scheme Name	Corpus (In crs.)	1 Year	3 Years	5 Years	Investor Suitability
Short Term Bond Fund					
Aditya Birla Sun Life Short Term Fund	17,330	5.61	7.95	8.39	All risk profiles except Secure
Edelweiss Corporate Bond Fund (Erstwhile Edelweiss Corporate Debt Opportunities Fund)	293	5.06	7.17	--	All risk profiles except Secure
HDFC Banking and PSU Debt Fund	3,631	4.62	7.76	--	All risk profiles except Secure
ICICI Prudential Banking & PSU Debt Fund	5,875	4.85	8.34	8.17	All risk profiles except Secure
Index					
CRISIL Short Term Bond Fund Index	--	5.08	7.53	8.12	
High Yield Fund					
Aditya Birla Sun Life Corporate Bond Fund	6,588	6.51	8.72	--	All risk profiles except Secure
BOI AXA Credit Risk Fund (Erstwhile BOI AXA Corporate Credit Spectrum Fund)	1,495	8.29	9.79	--	All risk profiles except Secure & Conservative
ICICI Prudential Regular Savings Fund	10,409	6.39	8.07	8.27	All risk profiles except Secure
Kotak Income Opportunities Fund	5,244	5.49	8.23	8.27	All risk profiles except Secure
L&T Credit Risk Fund (Erstwhile L&T Income Opportunities Fund)	3,773	5.67	8.23	8.43	All risk profiles except Secure
UTI Credit Risk Fund (Erstwhile UTI Income Opportunities Fund)	4,538	5.55	8.12	8.28	All risk profiles except Secure
Index					
CRISIL Short Term Bond Fund Index	--	5.08	7.53	8.12	
Other Debt					
ICICI Prudential Income Opportunities Fund	3,625	3.39	7.24	7.05	All risk profiles
LIC MF Bond Fund	322	1.32	5.61	6.05	All risk profiles
Sundaram Corporate Bond Fund (Erstwhile Sundaram Flexible Fund - Flexible Income)	362	3.31	7.41	7.13	All risk profiles
Index					
CRISIL Composite Bond Fund Index	--	2.58	7.52	7.29	

Source: MFI Explorerr
Scheme Returns are as on May 15, 2018 and for Regular Plans with Growth option. Crisil indices returns are as on May 14, 2018. Returns are CAGR. Corpus size is as on Apr 30, 2018.

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