

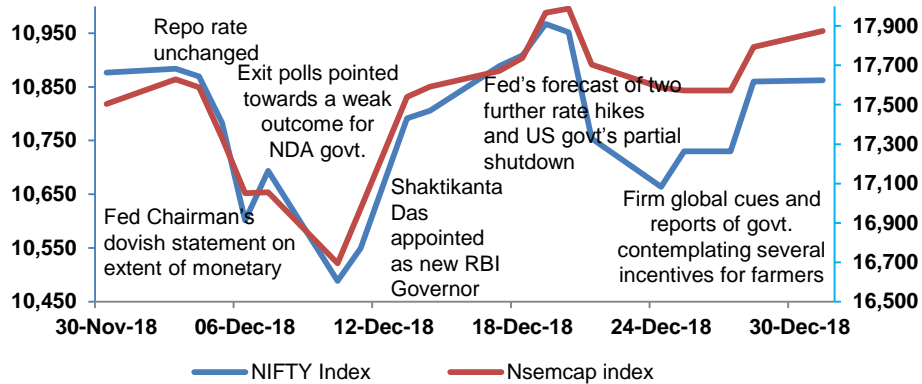
# Equity & Debt Strategy

Mid Jan – Feb' 2019

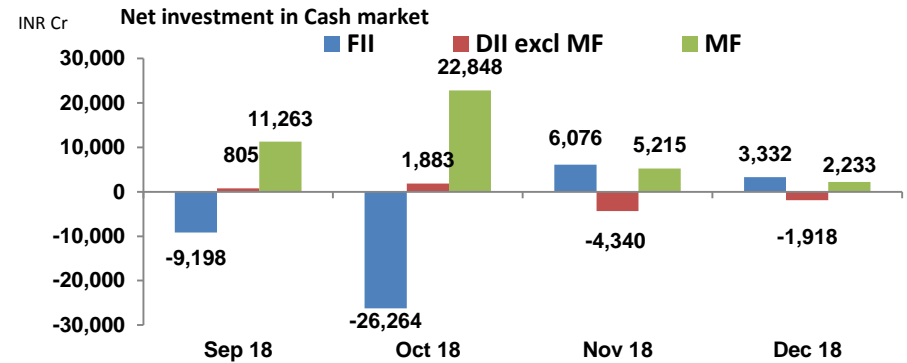
**Equity Market Update  
&  
Equity MF Strategy**

# Nifty 50 was flat in December (-0.13%) while Midcap Index posted gains of 2.12%

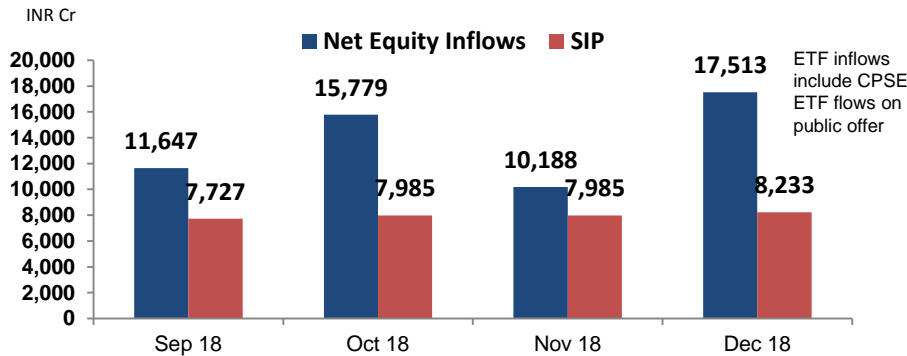
Nifty witnessed a volatile month falling 5.0% and then rebounding 6.3% to end flattish with Midcaps outperforming



Trend reversal for the past two months – FII buying, DII selling; MF buying however reduced significantly

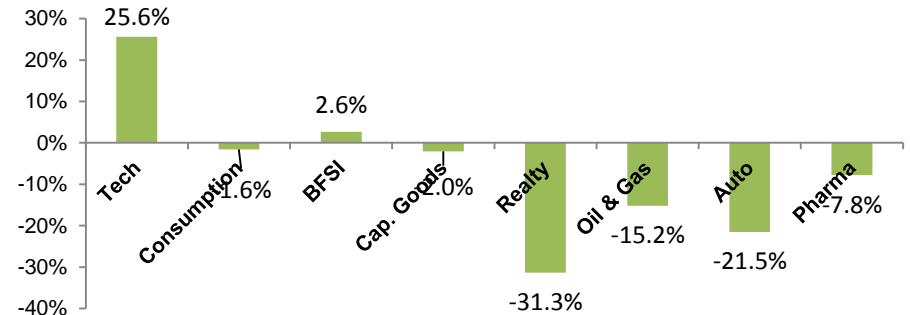


Net Flows to Equity Mutual Funds/ETF surged to 17.5k Cr due to surge in ETF inflows to ~ 11k Cr, strong SIP flows continued

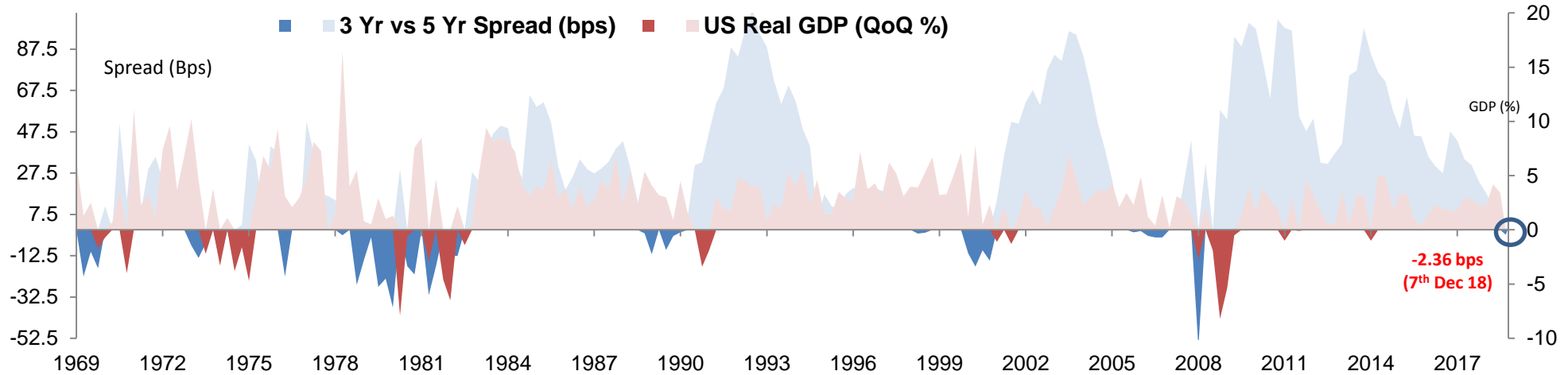


Note: Amount excludes Arbitrage Funds, assumes 65% equity flow from Balanced

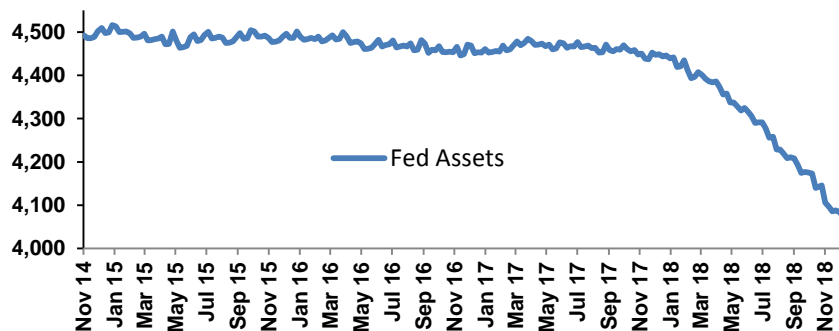
Technology sector benefited from depreciated INR in CY18



# US Treasury Yield curve inverts after a decade; historically, it has been a precursor for a recession



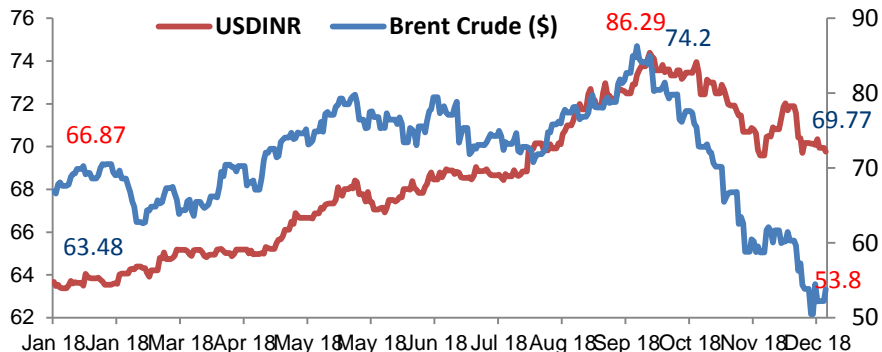
**Fed shows no sign of easing its stealth tightening; Balance sheet leaner by \$368 Bn in the last year**



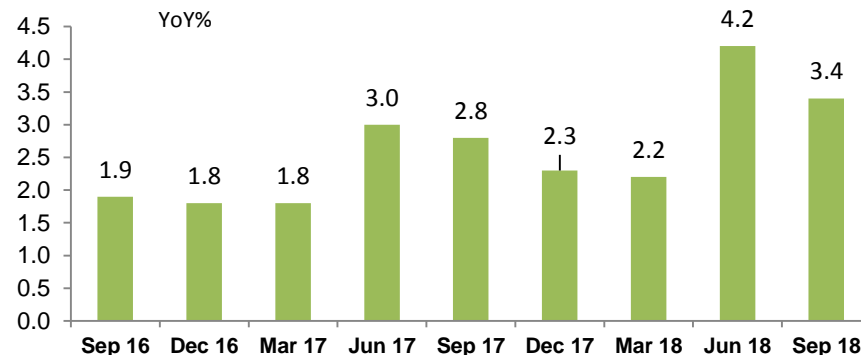
- Spread between short- and long-term treasury yields has dropped below zero ahead of each of the past 7 recessions
- However, the timeline is not instantaneous; historically, 15 – 28 months have passed between the yield curve inversion and a recession
- In almost every single instance of this occurring, short term rates have risen because central banks have hit the brakes on money either in response to higher inflation or an overheated economy
- Fed has hiked rates 8 times since the beginning of the tightening cycle in 2015 along with reduction in Balance sheet size

# 2018 was a tumultuous year for crude oil and the rupee; 2019 could see a rate hike pause by the US Federal Reserve

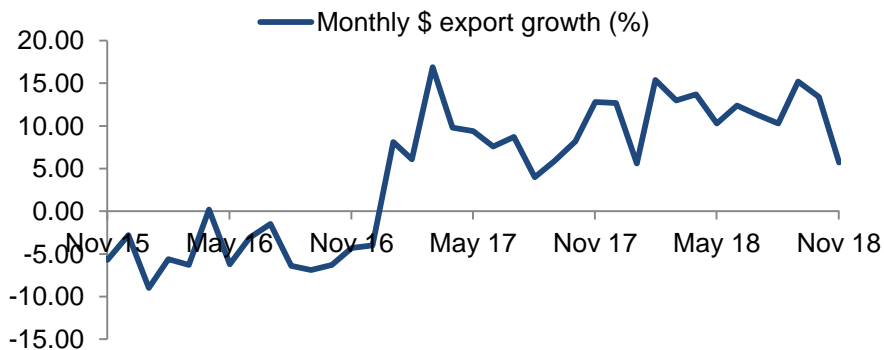
INR fell to an all-time low when Crude reached 4-year high in Oct-18, crude prices have since corrected sharply by 42% helping INR recover



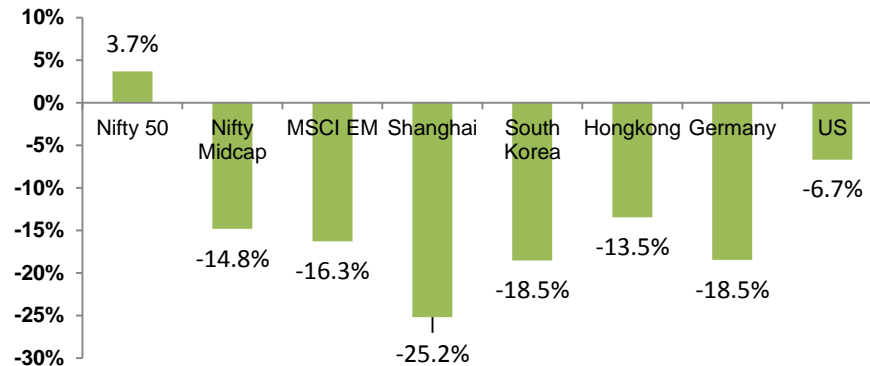
US economy has continued to record strong growth



While Chinese monthly exports growth has dipped significantly in Nov-18, impact of trade war with the US not conspicuous

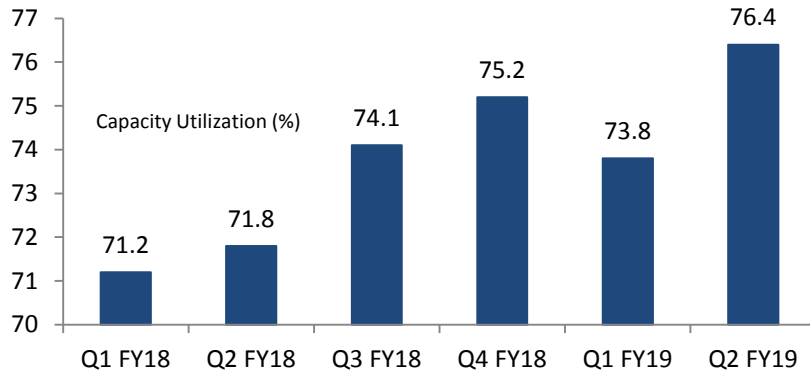


Emerging markets have corrected by 16% in CY2018, Nifty 50 has been an outlier

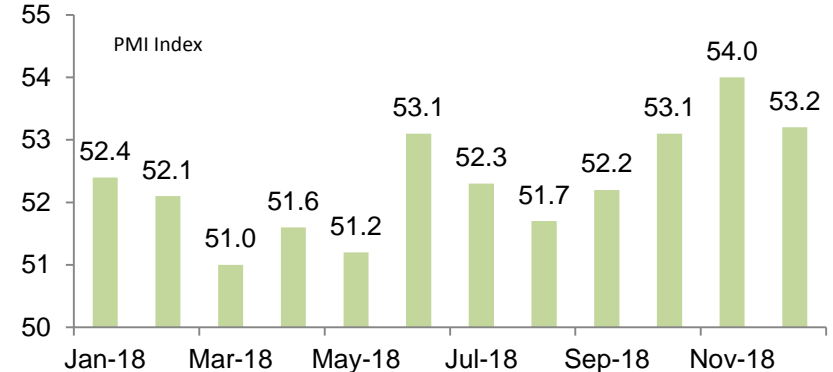


# Domestic Highlights

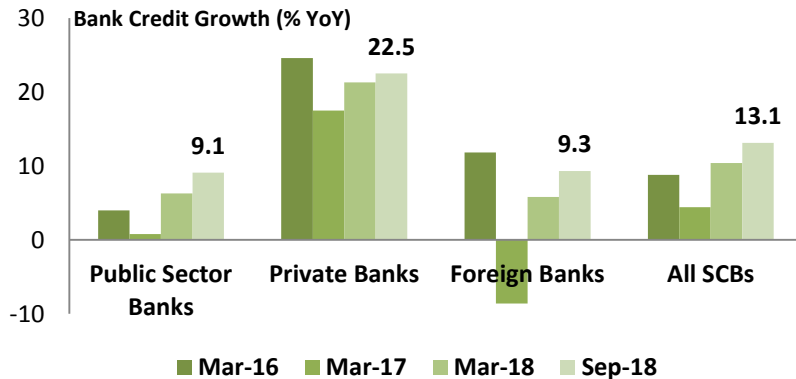
**Capacity Utilization reached a 4-year high in the quarter ended 30<sup>th</sup> September 2018**



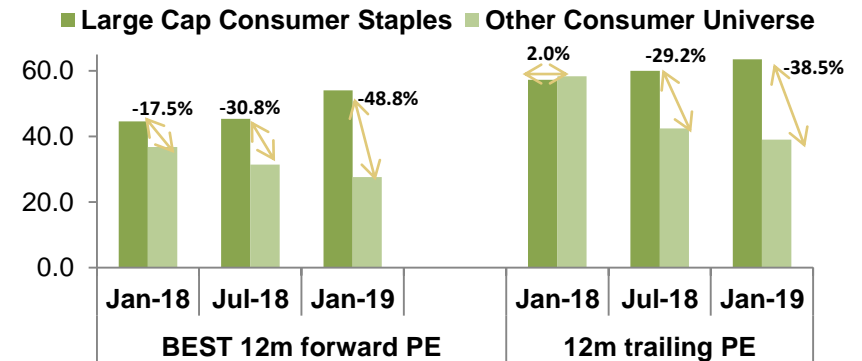
**Manufacturing PMI slipped marginally ending the year on a high**



**Over last 3 years private banks have led the credit growth, with public banks showing recovery in H1FY19**

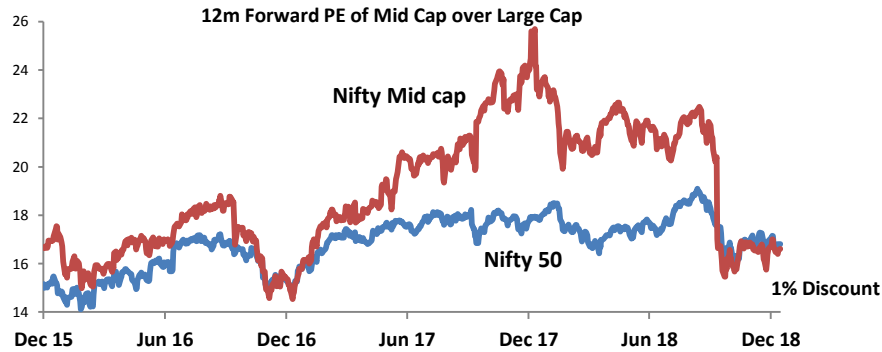


**Select large cap consumer staples contribute to the high PE of consumption basket; gap widening from rest of consumer universe**

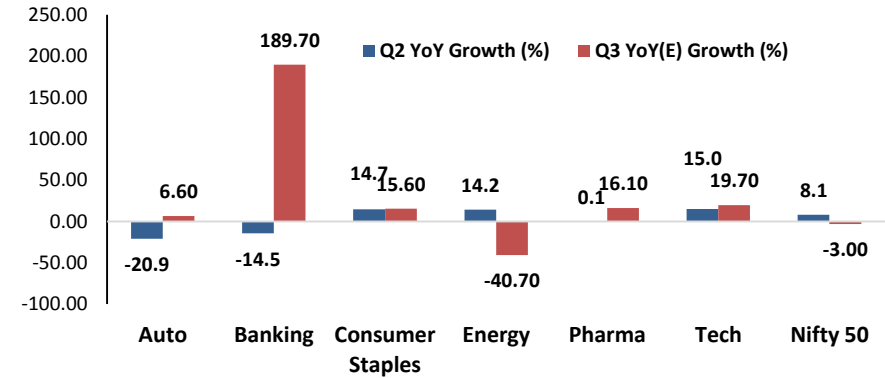


# Earnings and Valuation

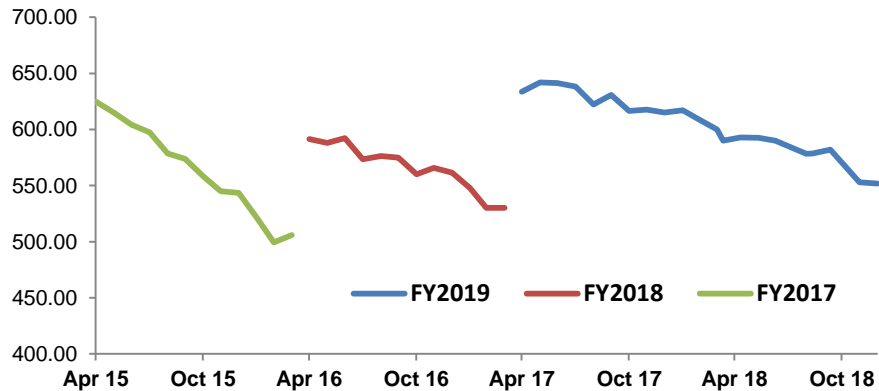
Broad market based recovery has resulted in Midcap discount to Largecap at 1% from 6% in Oct-18



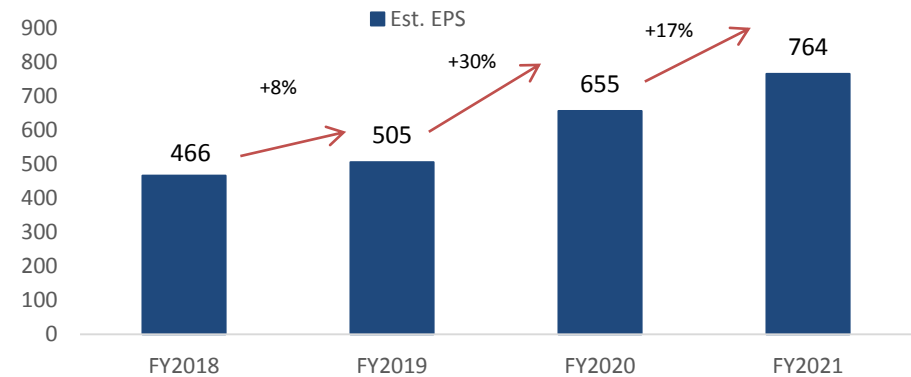
Q3FY2019 PAT for our universe is expected to be lower by 3% on the back of stress in the energy sector



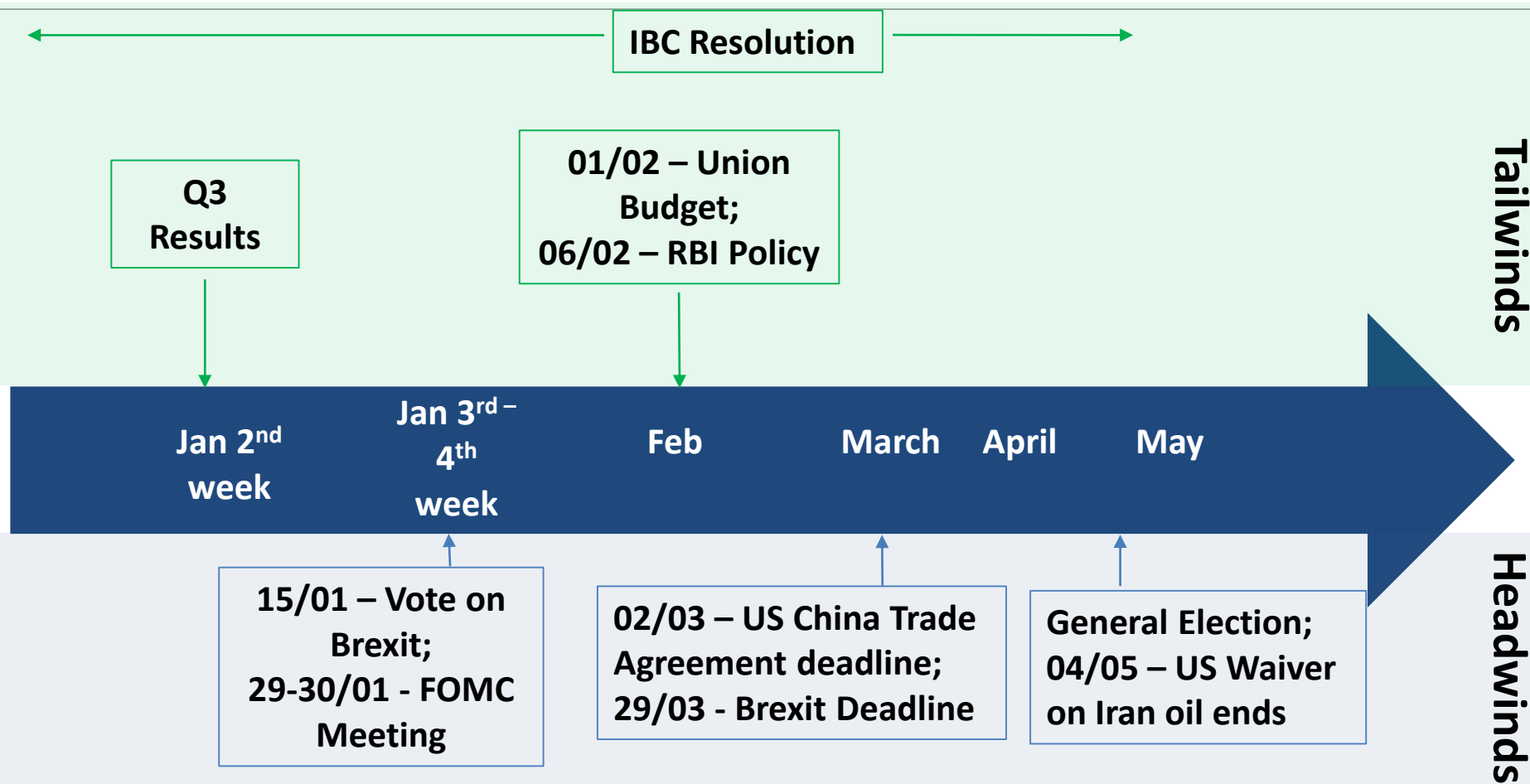
FY19 earnings outlook dampened after Q2FY19 results



We expect 18% Nifty 50 Earnings growth for FY19 and FY2



# Key Events in next few months



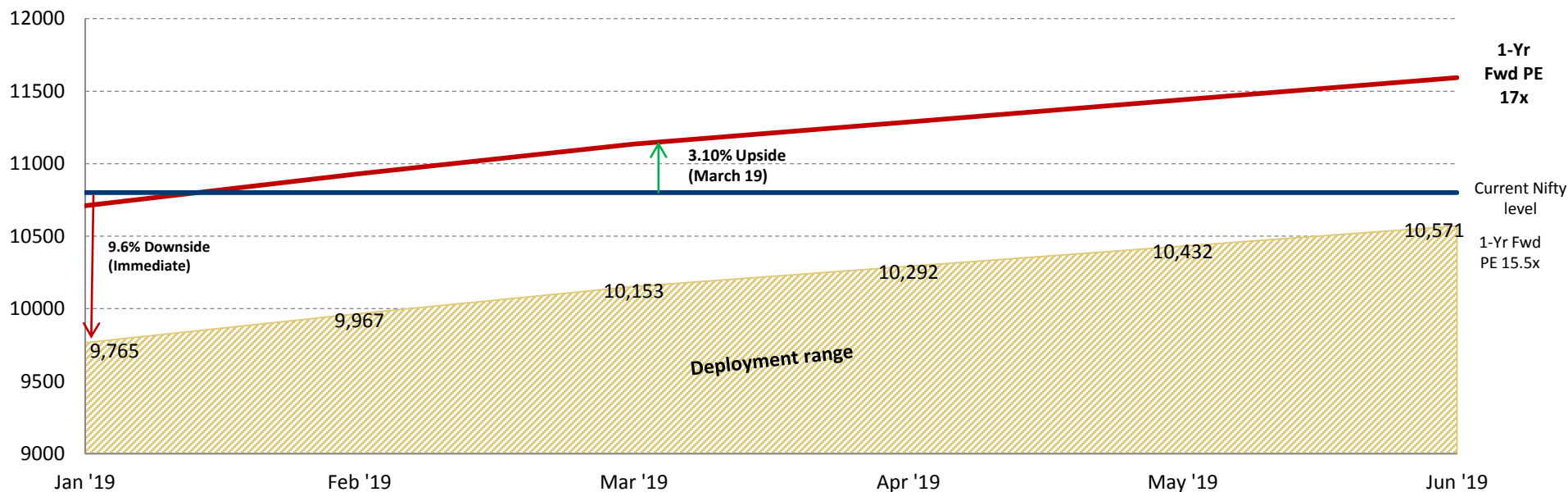
**General elections, US-China Trade negotiations and Brexit outcome will be important to monitor**



# Equity Deployment Strategy

20% underweight on equities to hold in cash, 80% to be deployed in staggered manner

Risk-Reward ratio unfavourable at current Nifty level with equity market sentiments in risk-off mode, recent volatility remains amidst upcoming general elections and global events. We therefore continue to maintain "20% Underweight" stance



Equity allocation of INR 100	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Total
<ul style="list-style-type: none"> <li>Staggered deployment of INR 80</li> <li>Hold INR 20 in cash; deployment basis market level &amp; outlook</li> </ul>	16.0	16.0	16.0	16.0	16.0	<b>80.00</b>

# India Equities: Valuations & Strategy – Continue 20% Underweight

Nifty was volatile for the month of December, 2018. This has been on account of global and domestic concerns which include status quo by RBI, sudden resignation of RBI governor, Lok Sabha elections anxiety, US Fed increasing rates, US shutdown amongst others.

General elections, US-China trade negotiations and Brexit outcome are key events which are likely to drive markets in the short term. **Therefore we continue to be “20% Underweight” on equities** and see the current rally as an opportune time for fully built portfolios to create some cash position. For fresh corpus, we recommend staggering 80% deployment in next 6 months while keeping 20% as dry powder for deploying opportunistically.

**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 Cap stocks over Mid cap since Mid cap valuations are still above historical levels)
- 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 Aggressive Hybrid Funds. Such funds have around 25% to 30% of their portfolio into Debt instruments which provides cushion to the portfolio return during market volatility.

# Recommended Large Cap, Multi Cap & Balanced Fund Performances

Scheme Name	Corpus (In crs.)	1 Year	3 Years	5 Years	Investor Suitability
<b>Large Cap Funds</b>					
Aditya Birla Sun Life Frontline Equity Fund	21,175	-4.22	13.40	15.04	All Risk Profiles except Secure
Axis Bluechip Fund	3,737	5.34	15.07	14.79	All Risk Profiles except Secure
ICICI Prudential Bluechip Fund (erstwhile ICICI Prudential Focused Bluechip Equity Fund)	20,115	-2.71	15.06	14.84	All Risk Profiles except Secure
SBI Bluechip Fund	20,611	-5.94	11.75	15.67	All Risk Profiles except Secure
UTI Nifty Next 50 Index Fund	304	-	-	-	All Risk Profiles except Secure
<b>Large &amp; Mid Cap Funds</b>					
Aditya Birla Sun Life Equity Advantage Fund (erstwhile Aditya Birla Sun Life Advantage Fund)	5,654	-13.36	12.62	17.45	All Risk Profiles except Secure
IDFC Core Equity Fund (erstwhile IDFC Classic Equity Fund)	2,926	-8.47	14.62	13.52	All Risk Profiles except Secure
Invesco India Growth Opportunities Fund (erstwhile Invesco India Growth Fund)	1,017	-2.38	15.36	16.38	All Risk Profiles except Secure
Kotak Equity Opportunities Fund (erstwhile Kotak Opportunities Fund)	2,373	-6.02	15.07	16.84	All Risk Profiles except Secure
Mirae Asset Emerging Bluechip Fund	6,340	-5.91	20.00	27.22	All Risk Profiles except Secure
<b>Multi Cap Funds (Multi Cap/ Value/ Focused/ Dividend Yield/ Contra)</b>					
Axis Focused 25 Fund	6,723	-4.42	17.13	16.32	All Risk Profiles except Secure
Kotak Standard Multicap Fund (erstwhile Kotak Select Focus Fund)	21,718	-2.39	16.25	18.93	All Risk Profiles except Secure
L&T India Value Fund	7,979	-13.29	13.78	21.79	All Risk Profiles except Secure
Mirae Asset India Equity Fund (erstwhile Mirae Asset India Opportunities Fund)	10,128	-2.62	17.33	18.92	All Risk Profiles except Secure
Motilal Oswal Multicap 35 Fund	13,180	-10.08	14.88	-	All Risk Profiles except Secure
<b>Mid &amp; Small Cap Funds (Mid Cap/Small Cap)</b>					
Aditya Birla Sun Life Small Cap Fund (erstwhile Aditya Birla Sun Life Small & Midcap Fund )	2,232	-24.32	13.49	20.13	All Risk Profiles except Secure
HDFC Small Cap Fund	6,013	-9.51	20.76	20.24	All Risk Profiles except Secure
Kotak Emerging Equity Scheme	3,494	-12.03	15.59	23.48	All Risk Profiles except Secure
L&T Midcap Fund	3,685	-13.85	16.92	24.42	All Risk Profiles except Secure
<b>Aggressive Hybrid Funds</b>					
Aditya Birla Sun Life Equity Hybrid '95 (erstwhile Aditya Birla Sun Life Balanced 95)	13,839	-5.34	11.10	14.95	All Risk Profiles except Secure
L&T Hybrid Equity Fund (erstwhile L&T India Prudence Fund)	10,081	-6.91	10.20	15.16	All Risk Profiles except Secure
Reliance Equity Hybrid Fund	13,171	-6.75	11.04	15.11	All Risk Profiles except Secure
SBI Equity Hybrid Fund (erstwhile SBI Magnum Balanced Fund)	28,635	-1.63	11.72	15.35	All Risk Profiles except Secure
<b>Balanced Advantage Funds (Balanced Advantage OR Dynamic Asset Allocation)</b>					
ICICI Prudential Balanced Advantage Fund	29,292	1.94	11.37	12.53	All Risk Profiles except Secure
Kotak Balanced Advantage Fund	2,379	-	-	-	All Risk Profiles except Secure
<b>Indices</b>					
Nifty	-	0.83	14.04	11.72	

Source: MFI Explorer

Returns are CAGR as on Jan 18, 2019 and for Regular Plans with Growth option. Corpus size is as on Dec, 2018.

**Debt Market Update  
&  
Debt MF Strategy**

# Debt Market: Key Variables

## Indicators



### Policy Action

- RBI kept rate hike on hold in December with downward surprise to inflation estimate
- Change in stance to “neutral” likely in next policy. We expect RBI to cut rates by 50 bps over next 6-9 months



### Corporate and G-Sec Benchmark Yield

- New 10 Yr G-Sec auctioned at 7.26% vs 7.50% on old benchmark
- Expectation of monetary easing and continuation of OMO purchases, even if, at a slower pace should shift the new 10-year benchmark yield towards 7.0-7.5% in the near term



### Liquidity

- Liquidity has improved significantly but remains in negative.
- RBI continues to conduct OMO Purchases actively
- Expect liquidity to remain tight till March 2019



### Global Trends

- US 10 Year yields at ~2.7%
- Markets are now pricing only one rate hike by Fed in 2019 with 30% probability of a rate cut in 2020
- Softness in USD in 2019 could provide a more sustained gain in non-Dollar DM currencies



### Inflation

- December CPI inflation moderated further to 2.2% from 2.3% in Nov
- Core inflation remains firm at 5.6%
- We expect CPI inflation at average 3.6% in FY19 and 4.3% in FY20



### INR

- INR has witnessed large swings in recent months in tandem with crude oil price trajectory
- We see USD/INR trading in 68.50 – 71.25 range in Q4FY19



### G-Sec Supply

- RBI has done INR 2,08,000 cr of OMO this FY, expected to continue for rest of this fiscal
- 82% of Gross G-Sec borrowing completed. ~ 1L Cr if gross supply remaining. However, net of redemptions and OMO purchases, it remains negative.

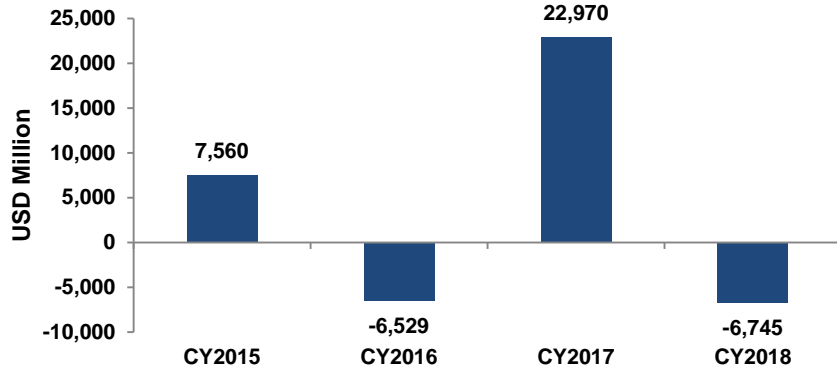


### Fiscal Policy

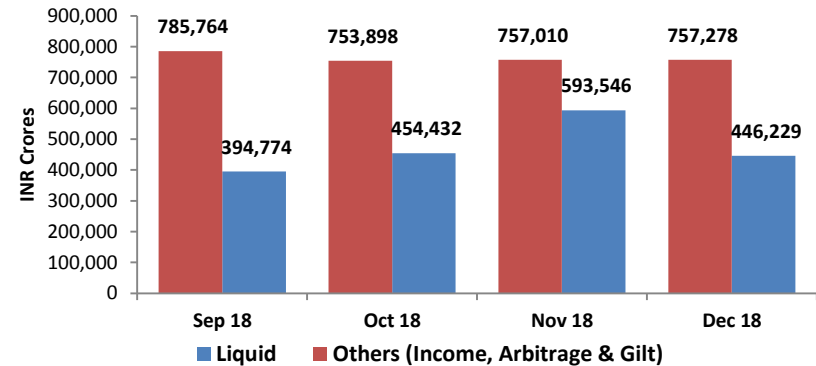
- Fiscal deficit had touched 114.8% of target by November end.
- We believe that the government will have to use the levers like expenditure rollovers along with extra RBI interim dividend to achieve the FY2019 budgeted fiscal target of 3.3%

# Both Domestic and Foreign Bond market flows have been impacted this year

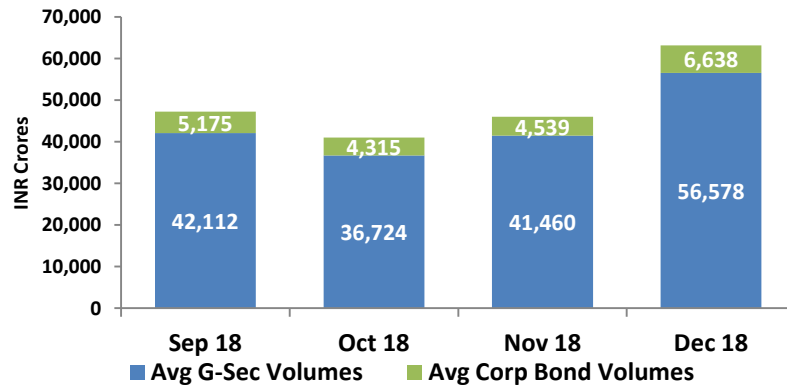
FII money has flown out in 2018 due to rising US rates leading to pressure on INR and yields, Oct-Dec has seen some reversal



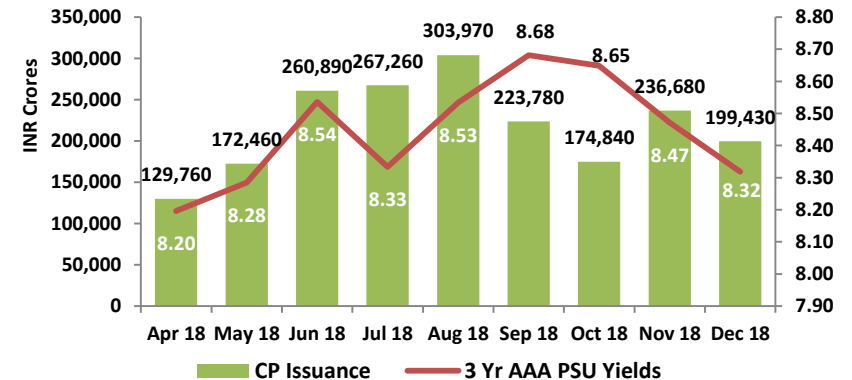
Impact on Debt & Liquid funds AUM post IL&FS issue has started to reverse with some ease in liquidity concerns



Trading activity in Gsec market and Corporate market have improved since September

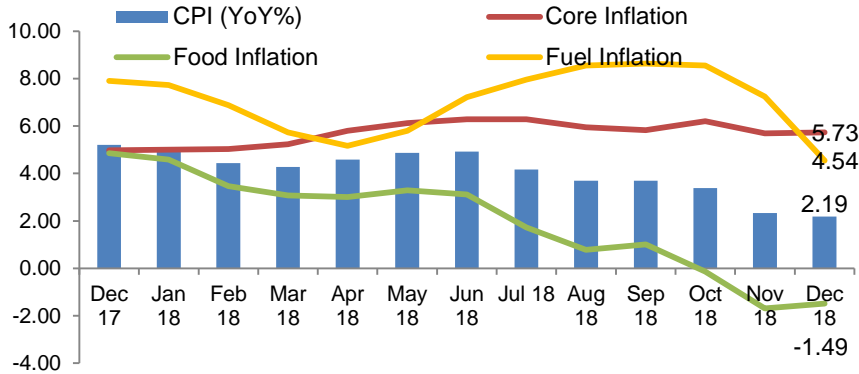


CP issuances have slowed drastically post September

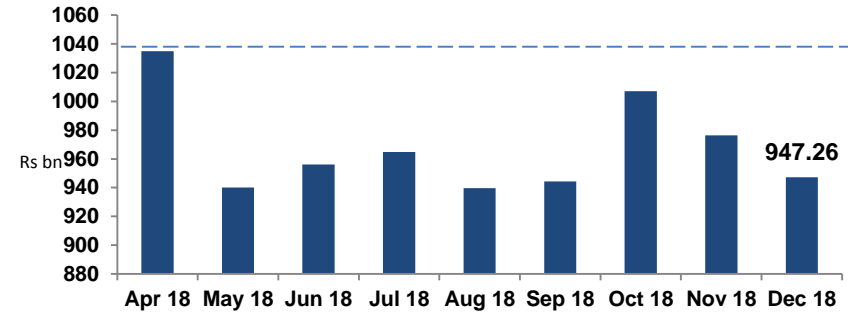


# Macros start to improve with lower crude, stable INR but risk of overshooting fiscal target remains as GST collections below estimates

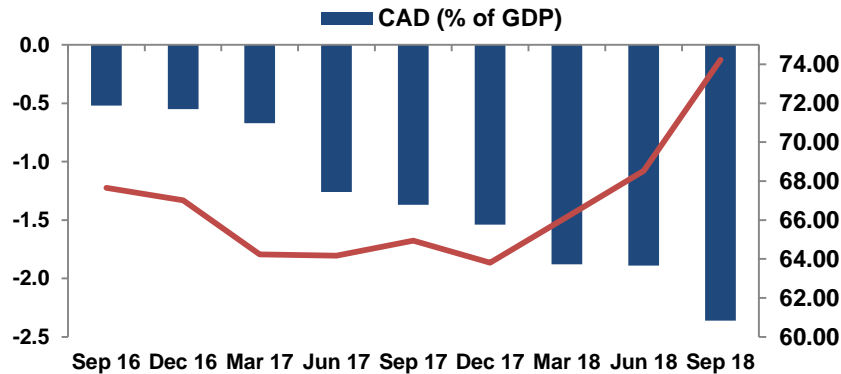
**Inflation further softened due to falling crude prices coupled with low food inflation**



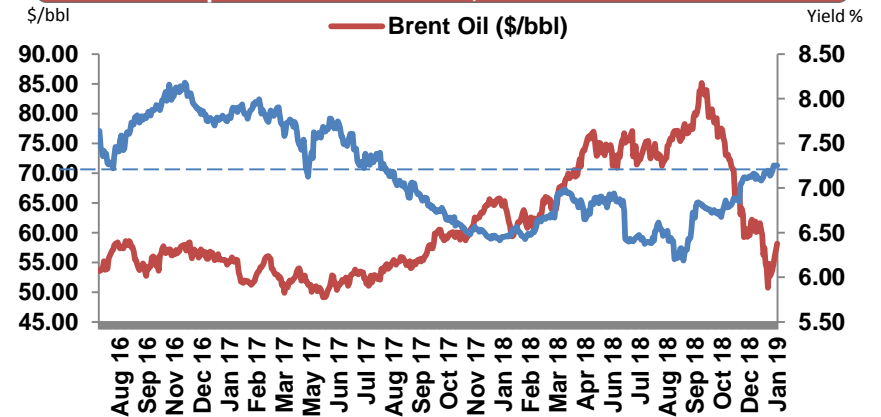
**GST collections continue to remain below estimates**



**CAD has widened from 1% to ~2.5% of GDP due to higher import bill through Crude, Gold and Electronic items**



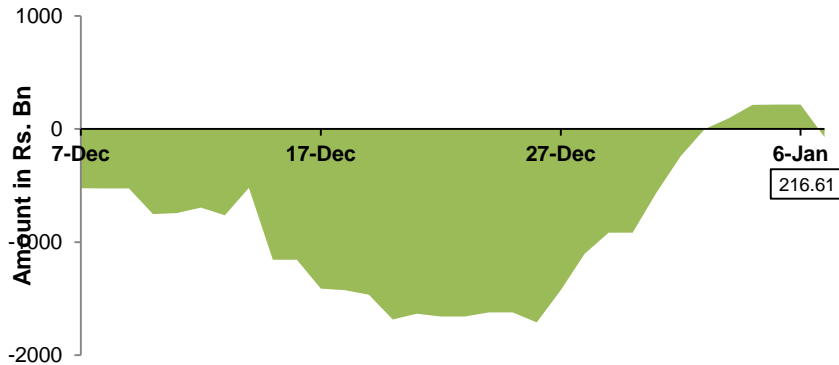
**Crude below budgeted \$65/bbl reducing concern on its impact on Fiscal Deficit, CAD and inflation**



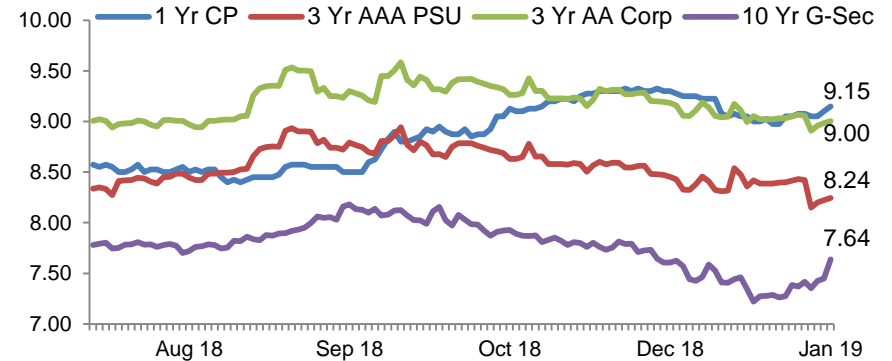
Note: As of 14th January 2019, Source: Bloomberg, PTI

# RBI continued to infuse liquidity through OMO Purchases

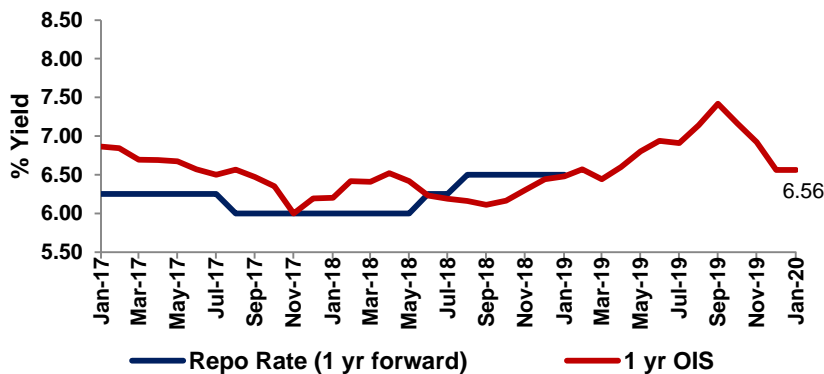
December faced liquidity deficit, easing towards the end with RBI OMOs of 50k cr in the month



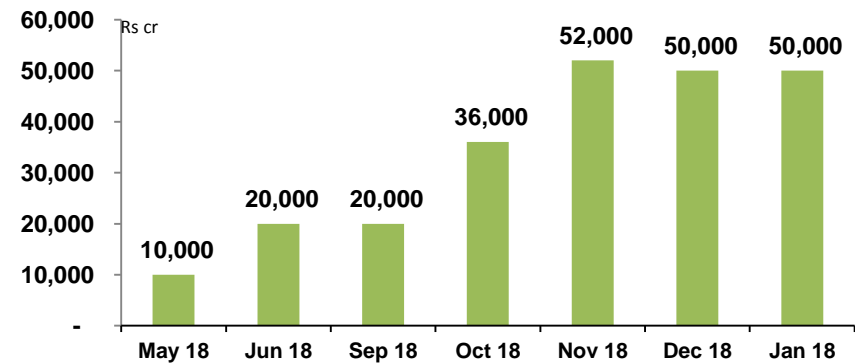
Rates have softened across the curve



Market Expectation of rate action as reflected from 1 Year OIS



RBI aggressively infusing liquidity post September with INR 2.08 lac cr OMO till date and further 40k cr announced



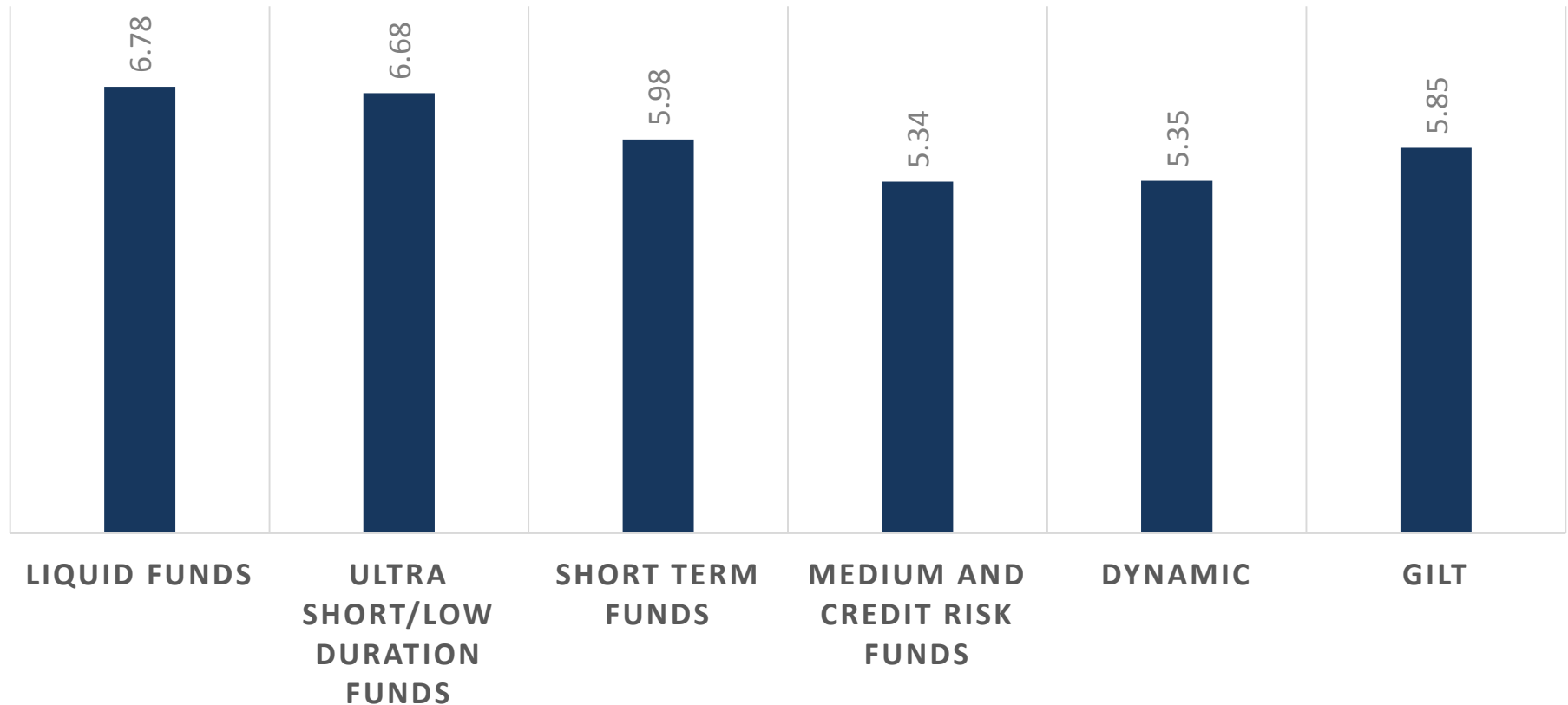
Jan 19 OMO INR 50k cr based on RBI's announced target for the month



# Debt Funds Performance – Last 1 Year

Dynamic & Gilt fund returns rose with rally in G-sec yields; liquid funds continued to out-perform

## PERFORMANCE COMPARISON



Note: As of 4<sup>th</sup> January 2019, Source: MFI

# Credit Spreads

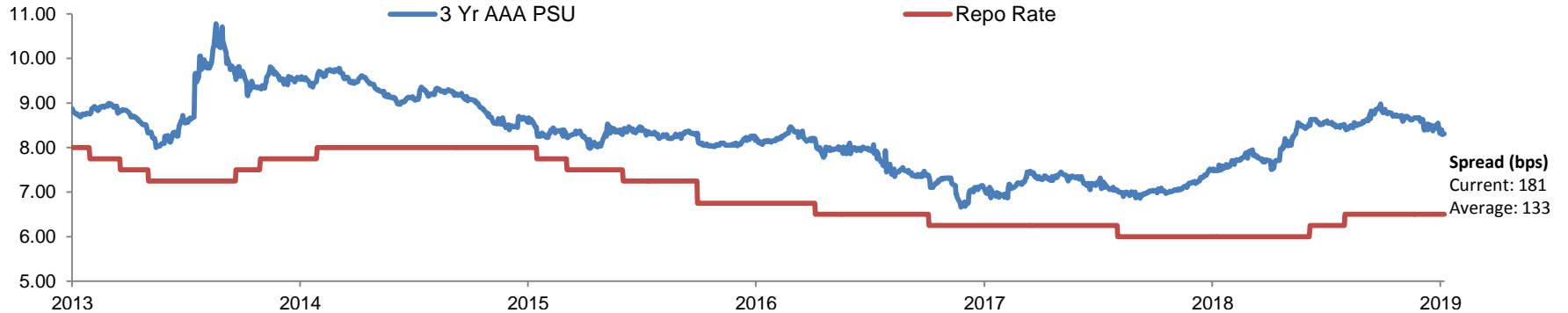
The current spreads call for high quality (AAA) in upto 5 year segment

Tenors	G-Sec	AAA - PSU	AAA- Corp	AA+	AA	AA-	A+
3M	6.11	7.29	7.45	7.82	8.05	8.52	8.97
6M	6.33	7.40	7.56	7.93	8.16	8.63	9.08
1Y	6.89	8.00	8.15	8.46	8.76	8.74	9.19
3Y	7.26	8.22	8.38	8.74	8.98	8.95	9.40
5Y	7.44	8.31	8.59	8.84	9.03	9.05	9.50
7Y	7.53	8.44	8.66	8.93	9.14	9.15	9.60
10Y	7.64	8.48	8.79	9.01	9.23	9.28	9.73
15Y	7.72	8.48	8.88	9.05	9.24	9.20	9.65

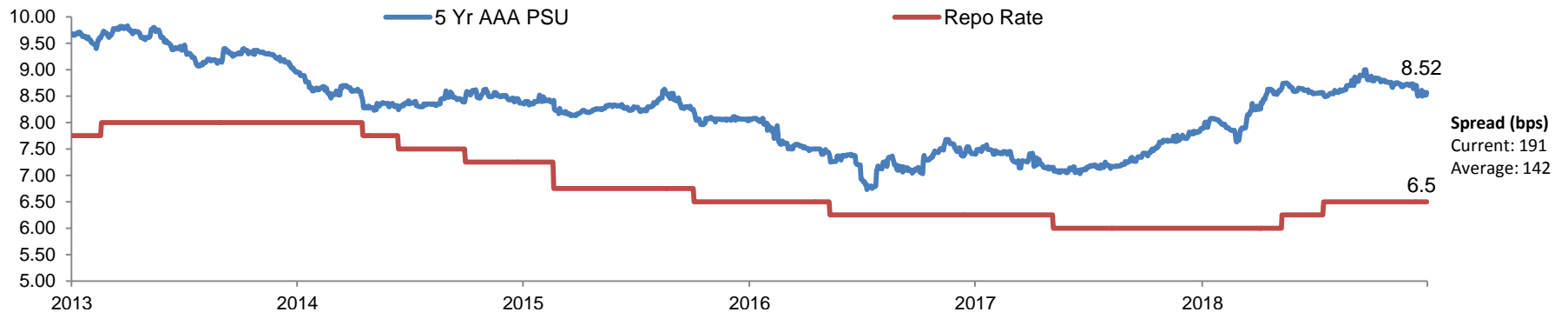
Note: As of 7<sup>th</sup> January 2019, Source: Bloomberg

# 3/5 Year AAA bonds still trades at attractive spreads, maintain overweight on this segment

3-Year PSU Bonds v. Repo Rate spread currently at 181 bps v. average of 133 bps



5-Year PSU Bonds v. Repo Rate spread currently at 191 bps v. average of 142 bps



Note: As of 7th January 2019, Source Bloomberg

# India Fixed Income: Strategy

The net spread Credit Funds over AAA is not attractive enough to prefer credit exposure. Moreover current environment calls for caution in credit space. **Therefore we recommend no allocation to “Credit Funds” and major allocation to AAA oriented Funds.** Due to Absolute high yields, we advice investors to allocate excess liquidity to Debt funds at current level via FMPs/Roll Down Strategy.

Due to absolute high yields, we advise investors to allocate excess liquidity to Debt funds at current level via FMPs & roll down strategies.

## Investment Focus:

Passive Accrual-Oriented Debt funds

- **Maintain overweight on short/medium term strategies.** Higher quality, 1 to 5 year corporate bonds remain preferred segment
- Substantial part of the portfolio should to be played through AAA rated FMP/Open ended Mutual Fund. Change recommendation of staggered deployment to instead, **lock-in at current levels**
- In money market, **upcoming seasonal liquidity tightness in Jan-Mar quarter** makes case for liquid funds, followed by UST funds and then low duration funds. However, for 4-6 months, ultra short term funds look appropriate
- Clients with a long investment horizon should also look to lock in yields for 10 Year in AAA segment

## Recommended Short Term Bond, High Yield & Debt Others Performances

Scheme Name	Corpus (In crs.)	6m	1Yr	2Yr	Investor Suitability
<b>Short Term 1-3 yrs (Corporate Bond/ Banking &amp; PSU/Short Duration)</b>					
<b>Tier I</b>					
Aditya Birla Sun Life Corporate Bond Fund	14,111	8.81	7.24	6.59	All risk profiles except secure
HDFC Short Term Debt Fund	8,985	8.15	7.24	6.70	All risk profiles except secure
ICICI Prudential Banking & PSU Debt Fund	4,853	6.60	5.89	5.45	All risk profiles except secure
ICICI Prudential Short Term Fund	7,168	7.22	6.07	5.69	All risk profiles except secure
<b>Tier II</b>					
Axis Banking & PSU Debt Fund	2,302	9.15	7.76	7.28	All risk profiles
IDFC Banking & PSU Debt Fund	1,870	9.43	7.60	6.51	All risk profiles
L&T Triple Ace Bond Fund	429	7.91	5.68	3.23	All risk profiles
Sundaram Corporate Bond Fund	358	8.50	5.27	4.86	All risk profiles
<b>Dynamic Debt (Medium to Long Duration/ Dynamic Bond/Gilt)</b>					
<b>Tier I</b>					
ICICI Prudential All Seasons Bond Fund	2,004	7.12	6.05	5.19	All risk profiles except secure
Reliance Gilt Securities Fund	897	10.68	7.65	4.91	All risk profiles except secure
SBI Magnum Gilt Fund	1,544	7.10	4.46	3.78	All risk profiles except secure
<b>Tier II</b>					
Aditya Birla Sun Life Active Debt Multi Manager FoF Scheme	14	6.69	4.17	7.98	All risk profiles except secure
ICICI Prudential Bond Fund	2,874	7.54	4.76	4.66	All risk profiles

Source: MFI Explorer

Returns are CAGR as on Jan 18, 2019 and for Regular Plans with Growth option. Corpus size is as on Dec, 2018.

# Disclaimer

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