Kotak Mahindra Bank

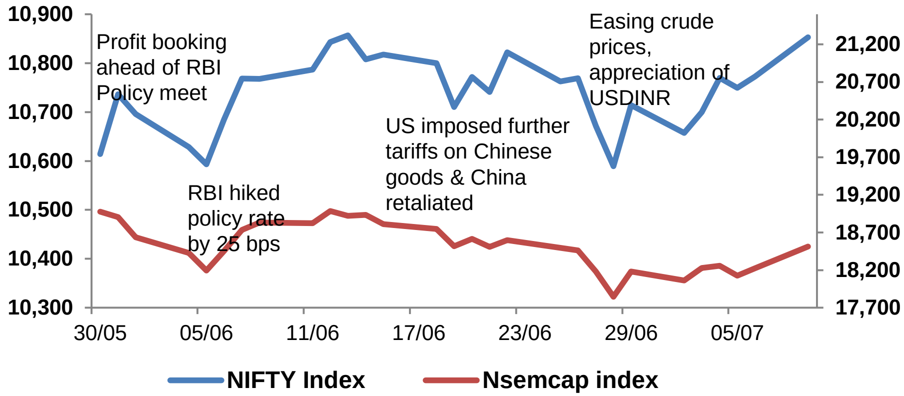
Equity & Debt Strategy

Mid July – Aug’ 2018

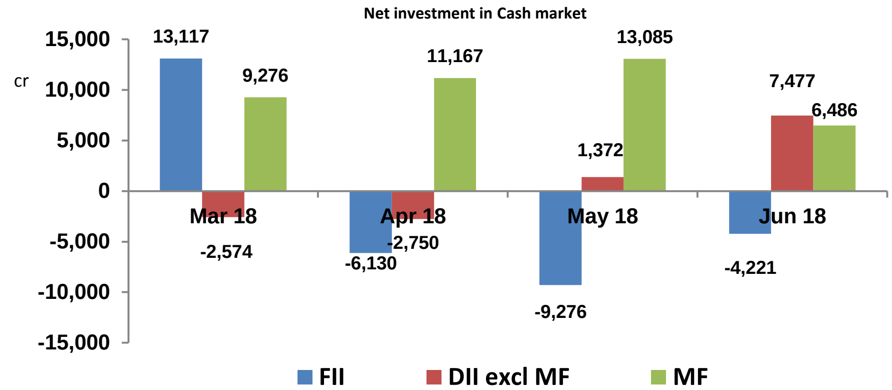
Equity Market Update
&
Equity MF Strategy

Wide divergence in Large Cap and Mid Cap index performance continue. Reliance and TCS lift Nifty50

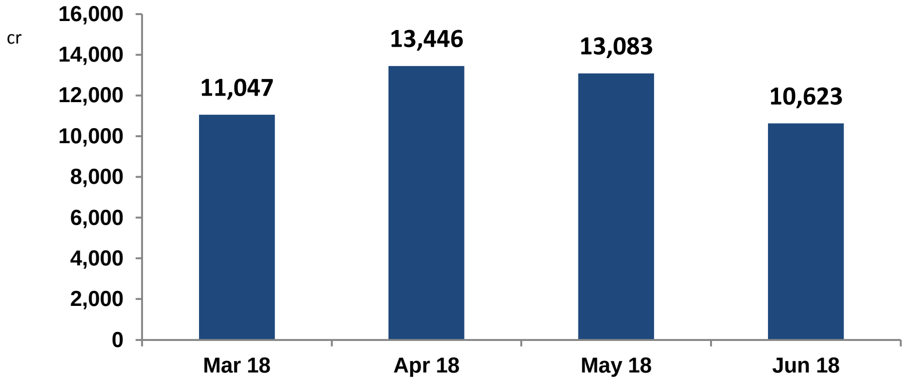
Crude and US-china kept market range bound with downward pressure



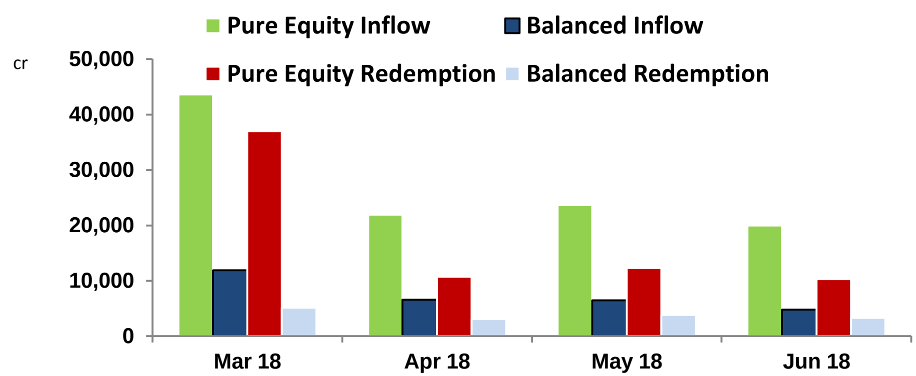
FII selling and MF buying continues



Net Flows to Equity Mutual Funds fell this month to 10k cr



Balanced Fund inflows have decreased substantially

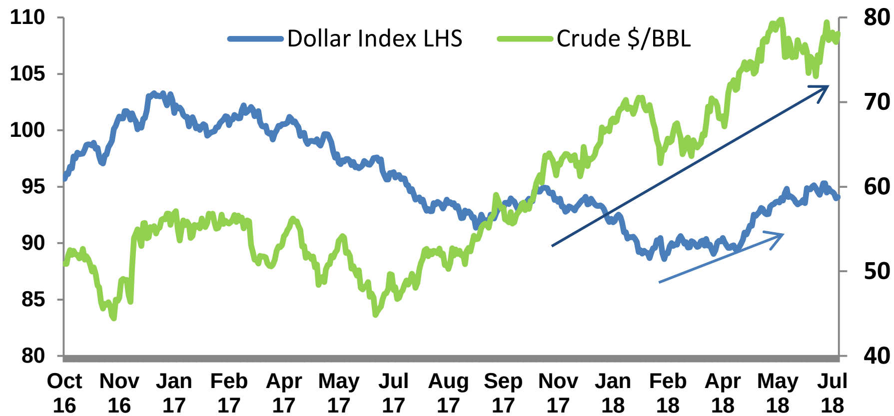


Source: Bloomberg, KIE, AMFI
As of 10th July, 2018

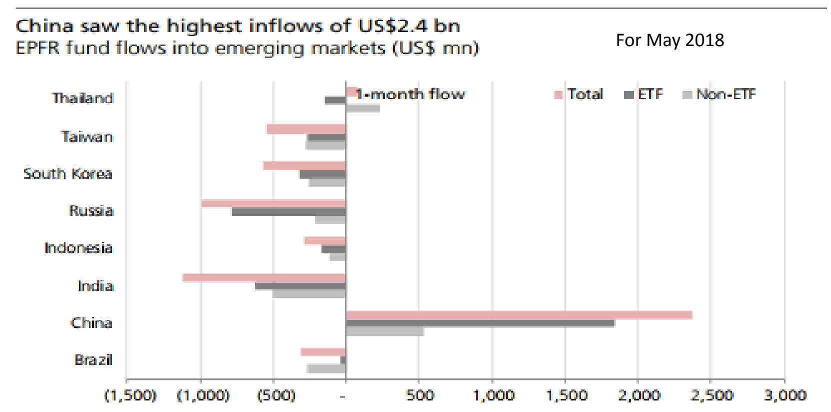
Note: April excludes Arbitrage Funds

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

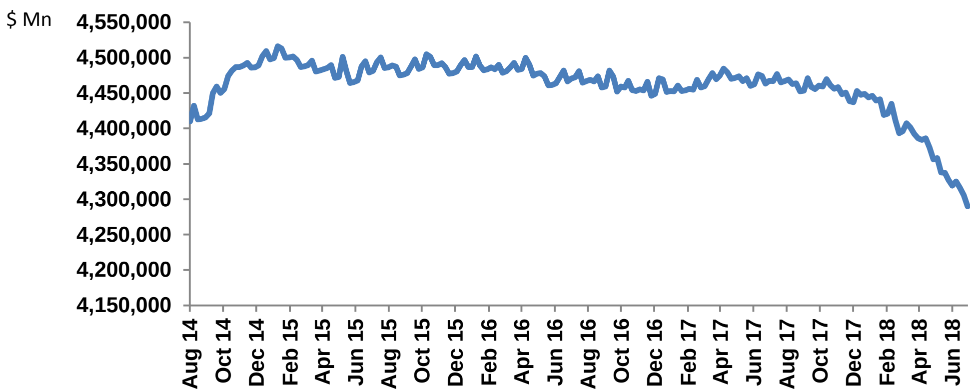
Rising Crude prices and Dollar strength is impacting India outlook for FIIs



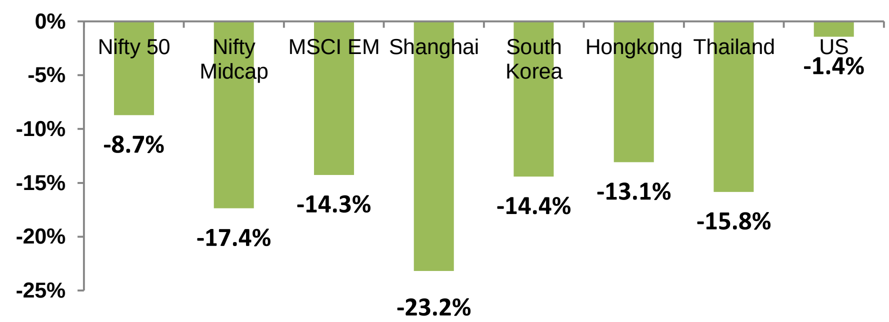
Most EMs especially India and Russia witnessed heavy selling from FII in Equity market



QE Unwind program is gaining pace, Fed's Balance sheet leaner by $178 bn in last 1 Year



Since 31st Jan, In Dollar terms Emerging markets have corrected by 14%, Nifty 50 has still fared better



As of 10th July 2018
Source: Bloomberg

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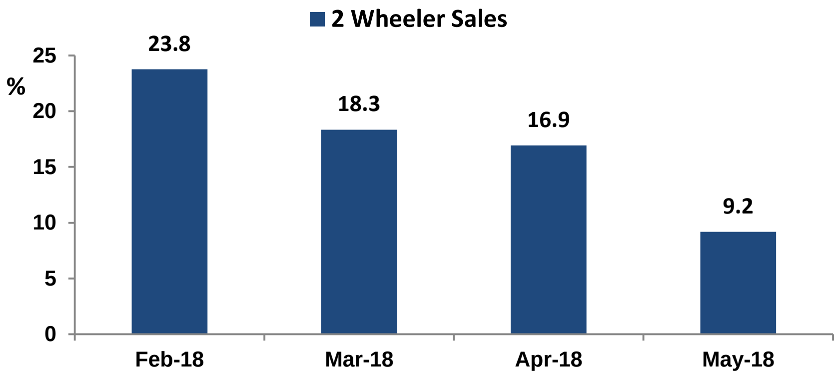
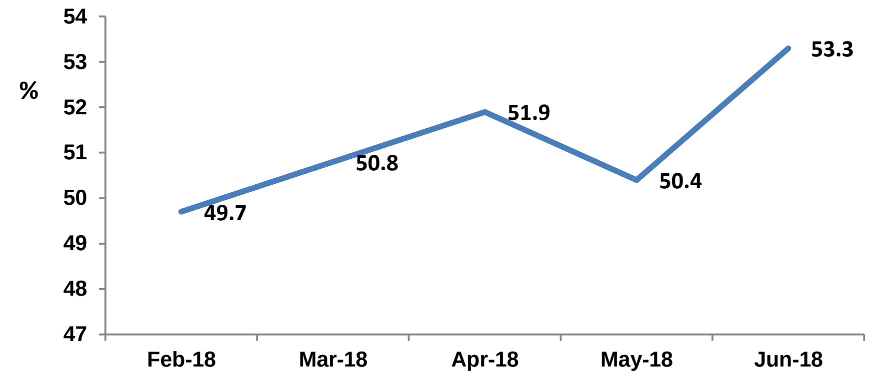
Domestic Economy showing greenshoots in both Consumption and Manufacturing , Credit also picking up

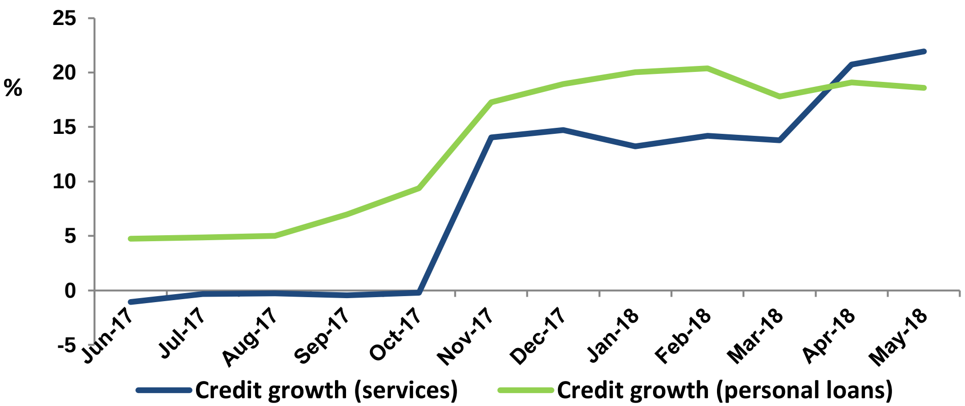
Strong 2 Wheeler Sales indicate rural economy recovering



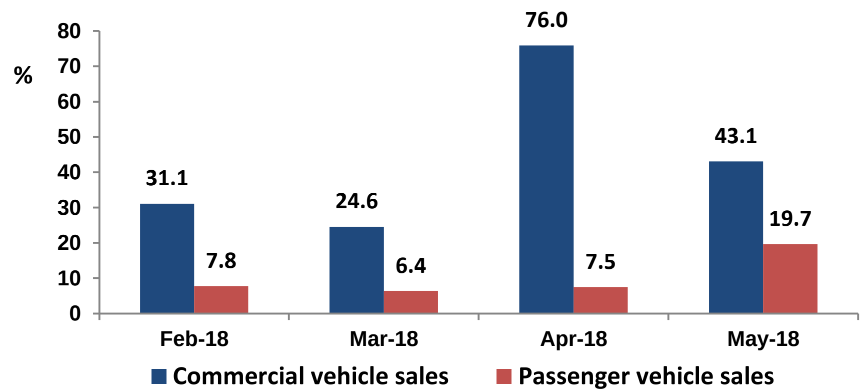
PMI rises to 53.1, Manufacturing strong, orders from overseas increasing



Credit Growth has started to pick up, higher bond yields also helping



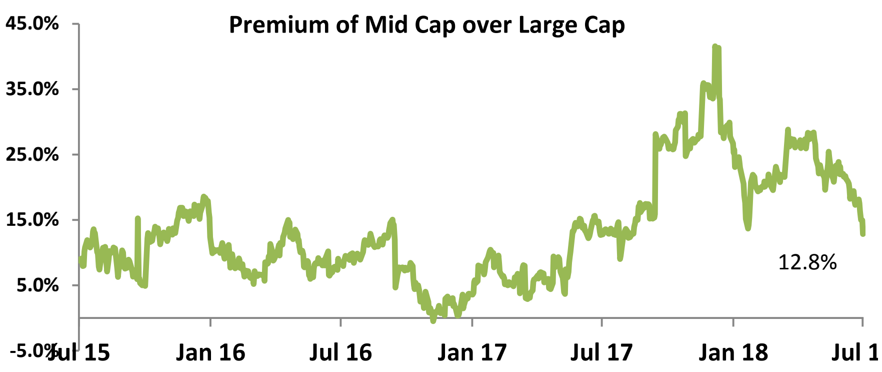
Commercial Vehicle Sales (an early indicator of industrial growth) showing impressive growth



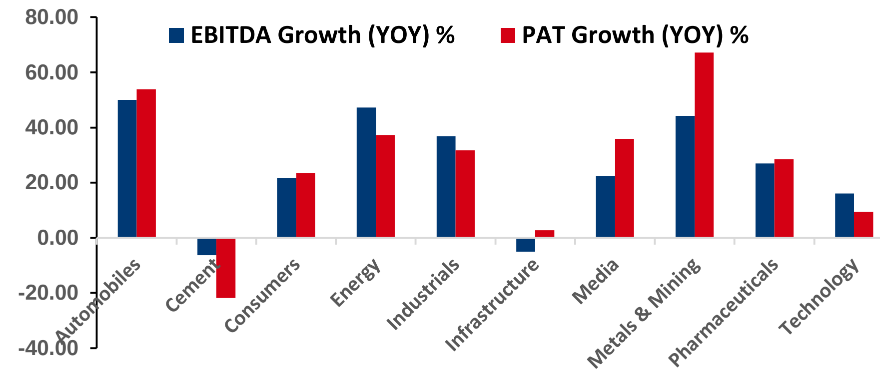
Source: KIE, Nomura
YoY% growth

Earnings and Valuation

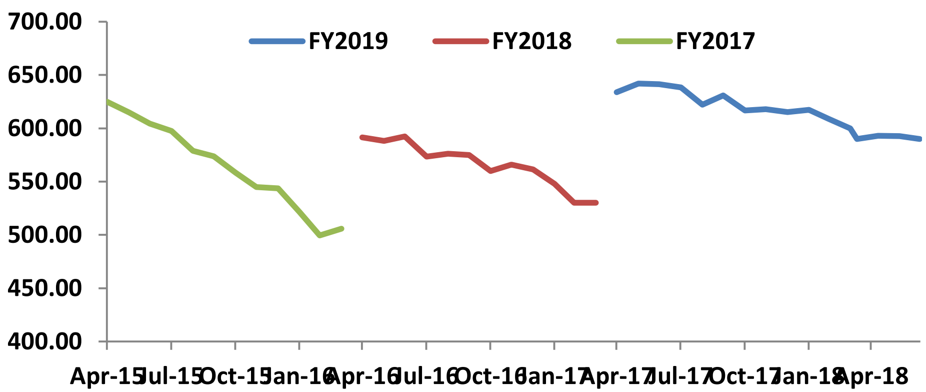
Post recent correction, Mid Caps still at a 13% premium over large caps



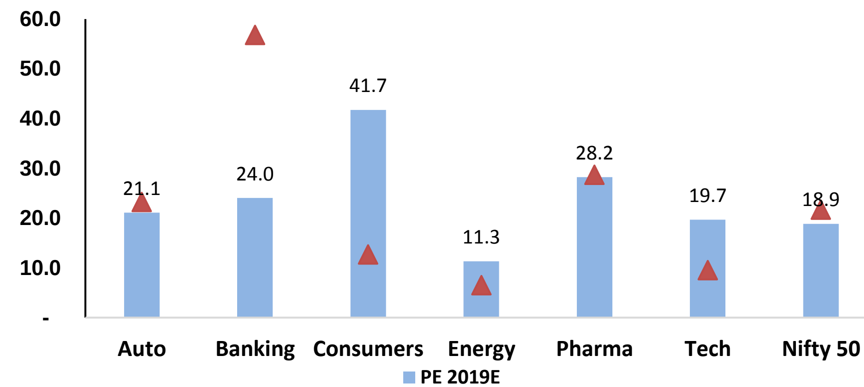
We expect 26% EBITDA growth in Q1FY19 from our KIE universe companies



Post stable outlook in the beginning, FY19 earrings expectation has also started to taper off



KIE expects 23% and 20% Nifty 50 Earnings growth for FY19 and FY20



Source: Bloomberg, KIE * Based on KIE Estimates on free float basis.
Better if Actual vs Expected >5%, Worse if Actual vs Expected <-5%
As of 11th July 2018

Key Triggers

Positive Triggers

- **Global Economic data :** World economy improving
- **Resolution of NPA:** Effective addressal of NCLT lists
- **Weaker Rupee:** To benefit IT and Pharma
- **Monsoon/Rural recovery:** Government focus on rural economy including increase of MSP could benefit rural consumption

Risks

- **FII Outflow from EM:** US tax reforms and rising global rates could trigger capital flight from Emerging Markets like India
- **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 and strict enforcement of Iran sanctions
- **Monetary Policy:** Faster than expected monetary tightening in Europe and US
- **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
- **Elections:** A combined opposition can be threat to BJP in next elections

India Equities: Valuations & Strategy – Maintain Neutral Stance

Nifty was flat for the month of June for the second consecutive month. However the midcap index once again saw a huge divergence and lost ~4%. The month was driven by depreciation seen in INR which is down ~8% for 2018 and currently stands at 69/USD. Crude stood at $78/barrel much higher than comfort zone of $68/barrel. FIIs flows remained negative for the third month in a row, however this was compensated by positive DII flows.

At current levels of approx. 11,008 (17th July 2018), Nifty is trading at a 1 year forward PE of 18.8X. 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 Funds					
ICICI Prudential Bluechip Fund (erstwhile ICICI Prudential Focused Bluechip Equity Fund)	17,496	6.40	12.46	9.53	All Risk Profiles except Secure
Large & Mid Cap Funds					
Aditya Birla Sun Life Equity Advantage Fund (erstwhile Aditya Birla Sun Life Advantage Fund)	5,948	2.35	10.29	22.22	All Risk Profiles except Secure
Multi Cap Funds (Multi Cap/ Value/ Focused/ Dividend Yield/ Contra)					
Axis Focused 25 Fund	4,724	19.49	14.98	19.43	All Risk Profiles except Secure
Franklin India Equity Fund (erstwhile Franklin India Prima Plus Fund)	11,470	3.79	7.74	18.59	All Risk Profiles except Secure
Kotak Standard Multicap Fund (erstwhile Kotak Select Focus Fund)	19,827	5.32	11.72	21.05	All Risk Profiles except Secure
L&T India Value Fund	7,648	-1.95	11.26	24.05	All Risk Profiles except Secure
Mirae Asset India Equity Fund (erstwhile Mirae Asset India Opportunities Fund)	7,945	6.38	11.31	20.88	All Risk Profiles except Secure
Motilal Oswal Multicap 35 Fund	13,016	6.30	12.45	-	All Risk Profiles except Secure
Mid & Small Cap Funds (Mid Cap/Small Cap)					
Aditya Birla Sun Life Small Cap Fund (erstwhile Aditya Birla Sun Life Small & Midcap Fund)	2,182	-2.95	13.50	24.58	All Risk Profiles except Secure
HDFC Small Cap Fund	4,143	11.51	17.20	22.86	All Risk Profiles except Secure
Kotak Emerging Equity Scheme	3,163	0.59	11.49	26.42	All Risk Profiles except Secure
L&T Midcap Fund	2,808	0.96	14.72	28.47	All Risk Profiles except Secure
Aggressive Hybrid Funds					
Aditya Birla Sun Life Equity Hybrid '95 (erstwhile Aditya Birla Sun Life Balanced 95)	14,484	1.57	8.49	16.65	All Risk Profiles except Secure
HDFC Hybrid Equity Fund (erstwhile HDFC Balanced Fund)	21,961	1.44	9.60	18.72	All Risk Profiles except Secure
L&T Hybrid Equity Fund (erstwhile L&T India Prudence Fund)	10,570	3.20	9.50	17.97	All Risk Profiles except Secure
SBI Equity Hybrid Fund (erstwhile SBI Magnum Balanced Fund)	24,959	6.43	8.68	16.95	All Risk Profiles except Secure
Balanced Advantage Funds (Balanced Advantage OR Dynamic Asset Allocation)					
ICICI Prudential Balanced Advantage Fund	27,877	6.00	8.44	14.25	All Risk Profiles except Secure
Indices					
Nifty		10.56	8.30	12.92	

Source: MFI Explorer

Returns are CAGR as on July 16, 2018 and for Regular Plans with Growth option. Corpus size is as on June 29, 2018.

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Debt Market Update
&
Debt MF Strategy

Debt Market: Key Variables

Indicators

Policy Action
- Rate hiked by 25bps to 6.25%
- Tone remained cautious with focus on upside inflation risks
- We now expect another 25 bps rate hike in August

Inflation
- CPI was at 5.0% in June 2018 was below expectation
- RBI increased expectation of 2HFY19 to 4.7% from earlier 4.4%
- We expect March 2019 CPI at 4.6% vs RBI's 4.7%

10 Year G-Sec Benchmark Yield
- G-Sec segment expected to be volatile
- We expect that this will be a shallow rate hike cycle

INR
- FII outflows and CAD put pressure on INR, RBI expected to support INR
- Broad range of 66-68 to hold

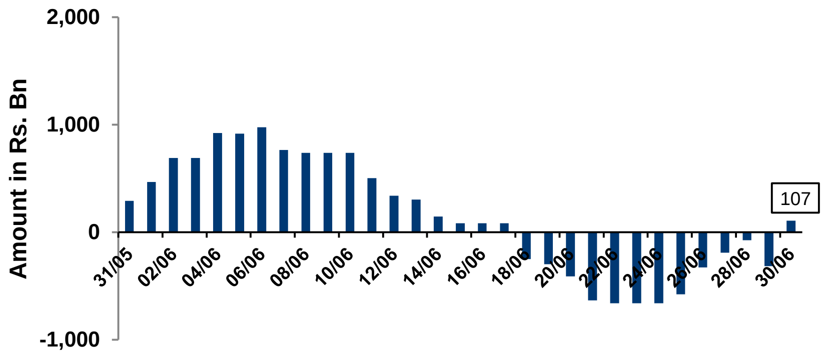
Liquidity
- Liquidity at neutral level
- Given the increased allowance in SLR for LCR, Bank's CD issuance should reduce

G-Sec Supply
- RBI has done 2 OMO of 10,000 cr
- Still weak demand sentiment and low volumes

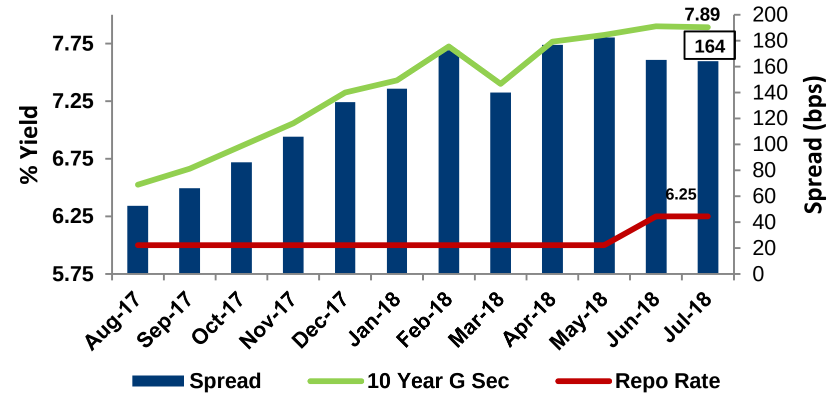
Key Risks
- Global monetary tightening
- Increase in Inflation expectation
- Crude Prices
- Impact of GST revenues and spending on Fiscal Deficit
- Adverse Monsoons

10 Year Benchmark close to 8% level , RBI sees upside risk to inflation

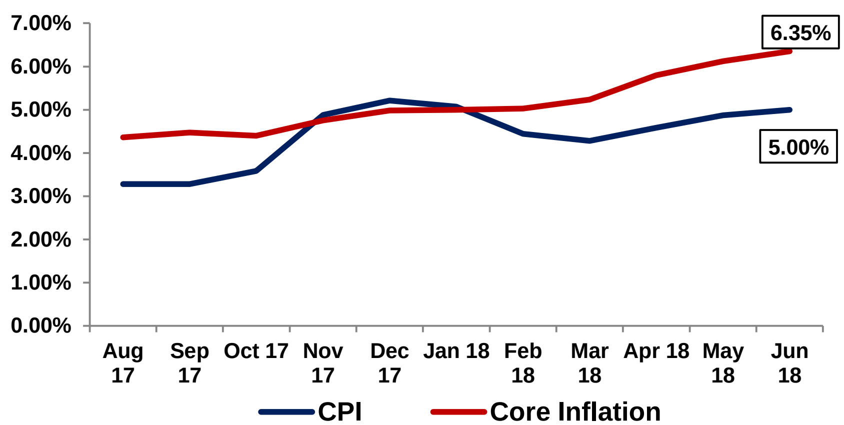
Liquidity maintained at surplus level



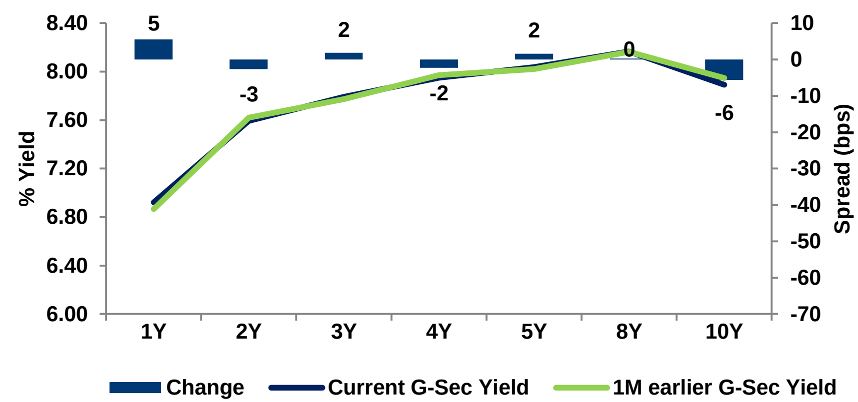
Despite rate hike, 10 Year spread over repo still at high level



Rising household inflation expectation and core inflation are a concern



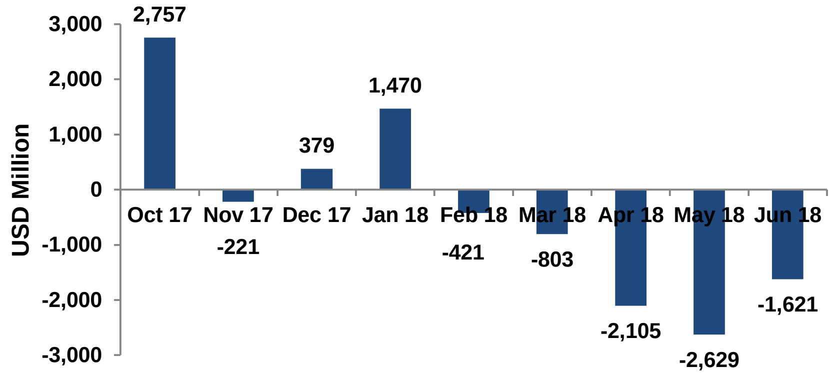
Yields have stabilized



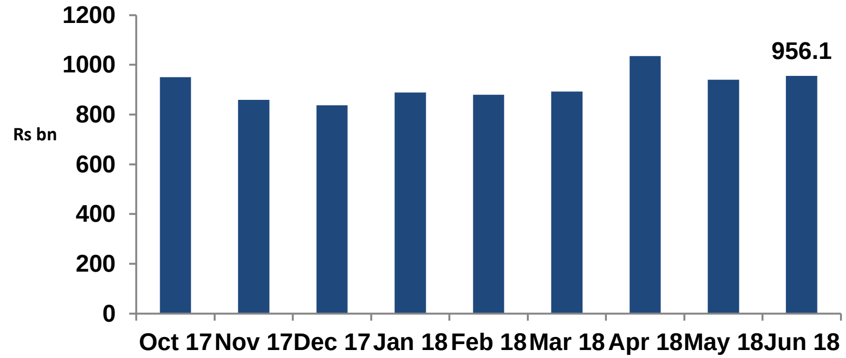
Note: As of 11th July 2018, Source Bloomberg

INR under pressure due to higher crude prices and FII outflows

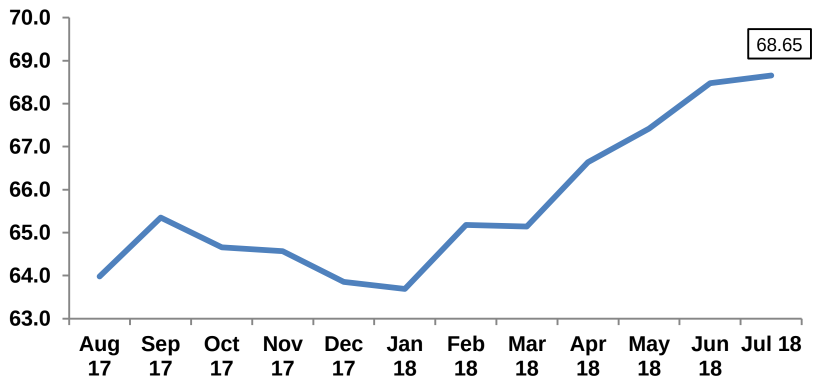
FIIs have sold ~7.6 bn USD since 31st Jan 2018



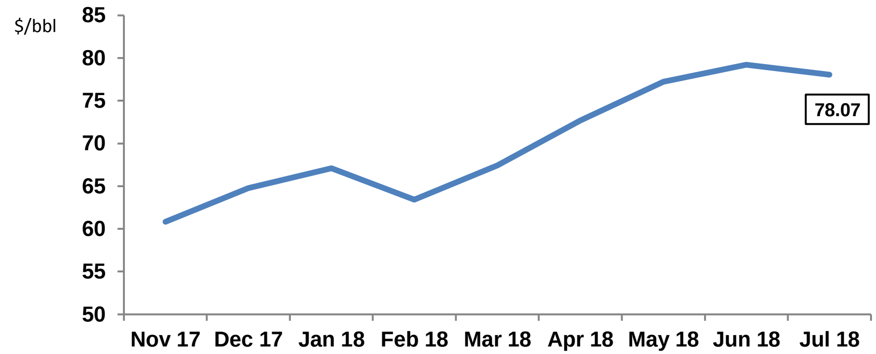
GST collections improve but could be due to seasonality effect



Indian currency has depreciated by ~ 8% in 2018 reaching a low of INR 69/USD



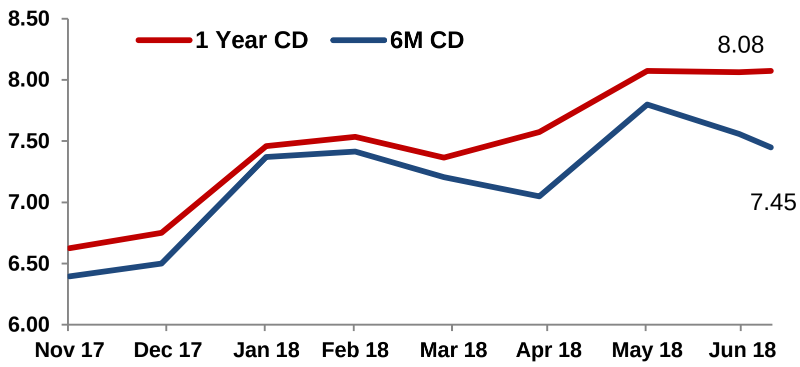
Brent at $78/bbl is above Fiscal estimates based on $68/bbl



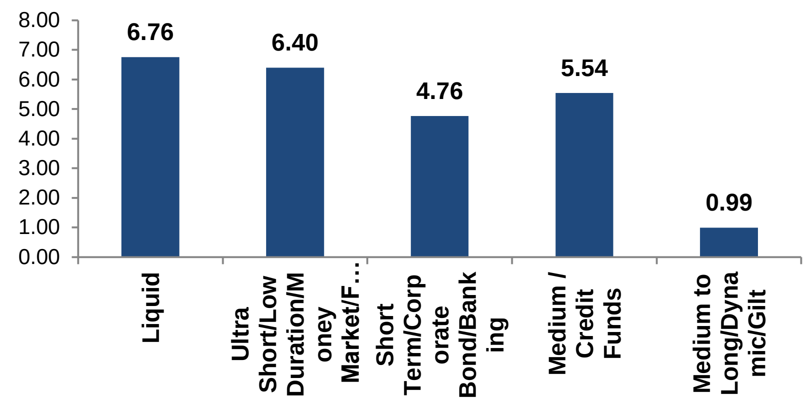
Note: As of 10th July 2018, Source Bloomberg, Nomura

Debt Market Trends

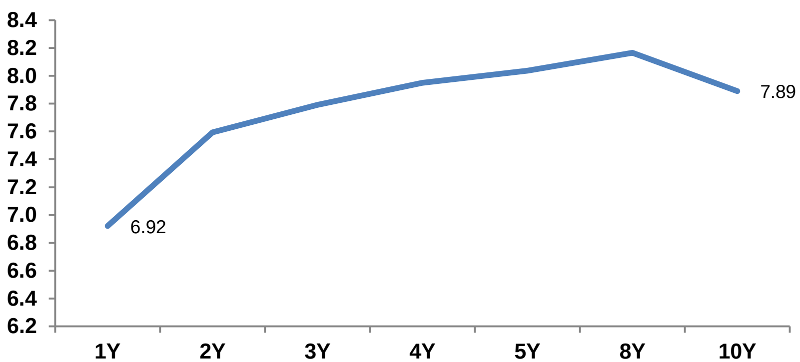
6 Month and 1 Year rate still at attractive level



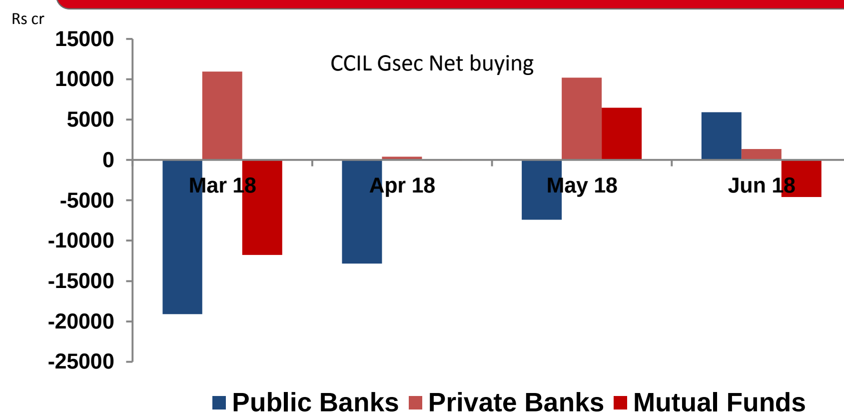
In Last 1 Year , Liquid Funds have outperformed other Debt categories due to marked to market impact



Gsec Yield curve is steep till 4 Year and then almost flattish, hence it better to stay at the short end



After consecutive months of selling, PSU Banks were net buyers in June 2018



Note: As of 11th July 2018, Source Bloomberg, MFI

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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 1-3 yrs (Corporate Bond/ Banking & PSU/Short Duration)					
Aditya Birla Sun Life Corporate Bond Fund (erstwhile Aditya Birla Sun Life Short Term Fund)	15,654	3.16	5.14	7.03	All Risk Profiles except Secure
Axis Banking & PSU Debt Fund	816	3.62	6.04	6.93	All Risk Profiles
Edelweiss Corporate Bond Fund	338	-0.07	4.05	6.45	All Risk Profiles except Secure
IDFC Corporate Bond Fund	11,170	2.56	4.79	6.94	All Risk Profiles
HDFC Banking and PSU Debt Fund	3,218	0.43	4.22	6.74	All Risk Profiles except Secure
ICICI Prudential Banking & PSU Debt Fund	5,590	2.01	3.92	7.12	All Risk Profiles except Secure
Kotak Banking and PSU Debt Fund	1,022	2.31	4.53	6.88	All Risk Profiles except Secure
Sundaram Corporate Bond Fund (erstwhile Sundaram Flexible Fund - Flexible Income)	382	-2.75	2.04	5.90	All Risk Profiles
Medium & Credit Risk Funds (Medium Duration/Credit Risk)					
Aditya Birla Sun Life Credit Risk Fund (erstwhile Aditya Birla Sun Life Corporate Bond Fund)	7,409	4.50	5.75	8.40	All Risk Profiles except Secure
BOI AXA Credit Risk Fund	1,602	6.07	7.55	9.28	All Risk Profiles except Secure & Conservative
ICICI Prudential Credit Risk Fund (erstwhile ICICI Prudential Regular Savings Fund)	10,886	4.54	5.67	7.60	All Risk Profiles except Secure
Kotak Credit Risk Fund (erstwhile Kotak Income Opportunities Fund)	5,191	3.59	5.40	7.38	All Risk Profiles except Secure
L&T Credit Risk Fund (erstwhile L&T Income Opportunities Fund)	3,798	1.95	4.87	7.28	All Risk Profiles except Secure
UTI Credit Risk Fund (erstwhile UTI Income Opportunities Fund)	5,090	1.97	5.01	7.24	All Risk Profiles except Secure
Dynamic Debt (Medium to Long Duration/ Dynamic Bond/Gilt)					
Aditya Birla Sun Life Dynamic Bond Fund	6,502	1.10	-0.41	4.52	All Risk Profiles except Secure
HDFC Income Fund	1,108	-2.32	-1.25	3.88	All Risk Profiles except Secure
ICICI Prudential All Seasons Bond Fund (erstwhile ICICI Prudential Long Term Plan)	2,103	1.50	2.58	7.74	All Risk Profiles except Secure
ICICI Prudential Bond Fund (erstwhile ICICI Prudential Income Opportunities Fund)	3,298	-1.59	1.94	5.83	All Risk Profiles
ICICI Prudential Gilt Fund (erstwhile ICICI Prudential Long Term Gilt Fund)	1,192	-1.79	0.29	6.53	All Risk Profiles except Secure
LIC MF Bond Fund	313	-1.55	0.25	4.71	All Risk Profiles
SBI Magnum Gilt Fund (erstwhile SBI Magnum Gilt Long Term Plan)	2,141	-1.03	-0.65	6.82	All Risk Profiles except Secure
SBI Magnum Income Fund	1,676	-0.42	1.99	6.81	All Risk Profiles except Secure
UTI Dynamic Bond Fund	1,307	0.07	1.50	7.22	All Risk Profiles except Secure

Source: MFI Explorer

Scheme Returns are as on July 16, 2018 and for Regular Plans with Growth option. Crisil indices returns are as on July 15, 2018. Returns are CAGR. Corpus size is as on June 29, 2018.

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