Market Outlook

Birla Sun Life
Mutual Fund

Equity Investment Outlook

Indian equity markets continued with gains with benchmark indices, the S&P BSE Sensex and the CNX Nifty, registering gains of 4.9% and 5.3% respectively. These levels were recorded monthly closing for the markets. On the sectoral front, stocks from consumer durables sector emerged as top gainers, followed by healthcare, IT, Capital Goods, Real Estate, Power and Metals. Durables rose 15%, healthcare by 11%, IT by 10.5%, Capital Goods by 10%, Power and Metals by 6.5% each. On the other side, FMCG (-2.7%), Oil & Gas (2.7%) and Banks (3%) remained laggard. (*Source: Bloomberg)*

India continued to attract flows with FIIs deploying a further $2.0bn in India in Jun'14 – albeit a significant portion of this would have been through primary markets. YTD, FII net buying stands at an impressive $10bn. Domestic Institutional Investors on the other hand remained net sellers to the tune of $775mn during the month – which took their YTD sell total to $5.1bn. Within the DIIs, mutual funds actually bought $457mn in Jun'14, meaning that insurance funds sold around $1.2bn. Indian Rupee though retreated 2%, as the Iraq crisis led to Crude prices spiking (Brent Crude up ~2.7% in Jun'14). (*Source: Bloomberg)*

Trends in industrial production improved, for a change, with Apr' 14 IIP at +3.4% vs -0.5% in Mar' 14. This was the highest reading in 13 months. The turnaround was most in Manufacturing and Capital Goods. On inflation front, May 14 CPI moderated to 8.3% vs 8.6% Month on Month, as we head into a favorable base effect from Jun 14. Core CPI also declined marginally to 7.7% as on July '2014-. WPI on the other hand rose unexpectedly to 6.0% vs 5.2% Month on Month. The difference was fuel inflation and core WPI that rose to 3.8% from 3.4% in Apr 14 (*Source: Citi Research)*

There were some policy related announcements that look encouraging. For instance (a) Railway Fare hike – 14% for passenger, and 6% for freight, (b) Extension of excise duty cut for Autos announced in interim Budget, to 2nd Half of the Calendar Year 14, (c) Low MSP price increases for the 2nd consecutive year, (d) Speedy redressal of Orissa mining ban and (e) de-licensing a number of dual use items in defence list.

The next key macro catalyst we feel for the market is the Union Budget on Jul 10, 2014. Investors' focus will probably turn from Fiscal Consolidation to growth enhancing measures. Modifications in the Land Acquisition Bill, timelines for GST and DTC, PSU Divestment Target, Tax sops to encourage retail investments, will be some of the things to watch out for.

In the near term, the ongoing monsoon assumes greater significance. The South-West monsoon in 2014 is off to a poor start, delaying sowing activity across all key crop categories in the country. The country is looking for a revival in the monsoon between now and July 15th, which is considered the outer limit for salvaging the kharif cropping season. This is supported by forecasts for improved rainfall in coming days and by a hundred years of history, which show that a very dry June is usually followed by a normal July.

There are structural drivers in place for sustained economic growth. Ongoing cyclical recovery would act as catalyst to capitalize on structural opportunities. However, volatility is nature of equity markets. And there are bound to be some hiccups along the way. In this journey, investors should take long-term view and allocate savings with appropriate time horizon to benefit from the opportunity.

Debt Investment Outlook

Macro Outlook

While elections in the one of the world's largest democracy brought a big sigh of relief to every stakeholder in the economy at the beginning of June, parched monsoon in June and militants strike in Iraq led to worries on both fiscal and inflation front.

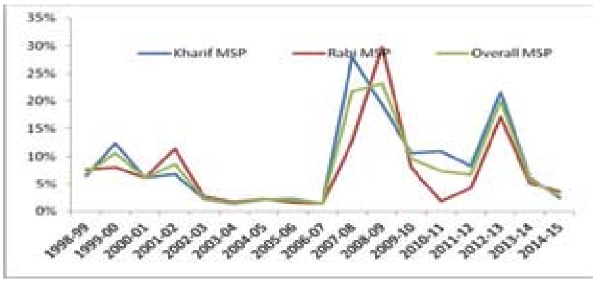
On the macro front, core industries growth came lower at 2.4% (CSO) for the month of May 2014, largely contributed by the base effect.

CPI inflation for the month of May 14 came in lower than expected largely due to softening food inflation but core inflation too stayed lower. We feel the key thing is that, May 14 core inflation was just 0.2% month on month compared to historical movement of 0.6%. This shows significant softening of inflation build-up and potentially much lower core going forward.

New government has already started taking much needed measures to improve fiscal and tame inflation.

On 20th June, the Government hiked rail fares wherein it raised freight fares by 6.5% and passenger fares by an unprecedented 14.2% *(Source: Ministry of Railways).* Such bold and much needed decisions may help the government to bring fiscal back on track.

In order to keep tight leash on inflation, the government announced only 2.4%average increase for Kharif crops for FY15 crop season which comes out to be lowest registered since FY07 (see the chart below) *(Source: Ministry of Agriculture).*



Source: Ministry of Agriculture

This lower increase in MSP (Minimum Support Price) follows the first round of measures announced by the central government on June 17th to check inflation including the release of five million tonnes of rice from its buffer stocks through the states and advising states to delist fruits and vegetables from the Agricultural Produce Market Committee (APMC) Act etc among others *(Source: Ministry of food and Distribution)*. While the implementation of these measures involve providing a channel to farmers to market their produce in the open market largely rests with the respective state government, we believe it reflects the new government's commitment to take steps to check food inflation menace.

On the flip side some short term challenges emerged for the Government in the form of spiking crude prices in the international market on the news of militants' attack on certain cities in Iraq. Crude spiked with the fear that the militants could reach Southern Iraq which pumps out 80% of the country's oil production. While crude prices have receded from the peak now, but Iraq situation may stay on radar of the markets.

Another hurdle that may come in the way of the new Governments' efforts to kick-start the economy and tame inflation was parched monsoon in June 14. The monsoon in June 14 was one of the lowest registered in India over many decades as suggested by IMD, wherein June rainfall was 42% of the Long Period average (LPA) (IMD).

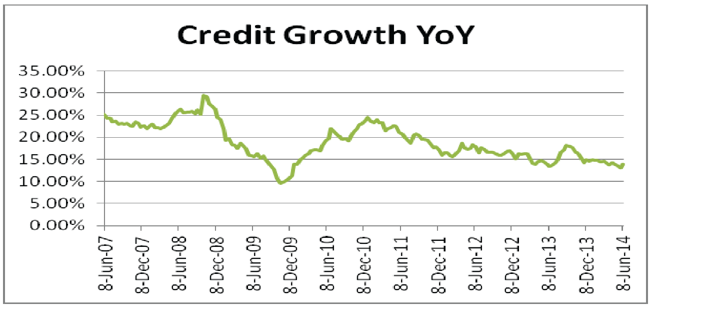
Government is set to announce its first budget on 10th July. This budget is going to be an important platform for the new government to show its fiscal resolve and unveil some reformist measures like a road map on GST or measures specific to infrastructure sector. Finance minister has already gone on record by mentioning that fiscal discipline is a must. In view of such comments bond markets is keenly watching the fiscal deficit to be announced by the budget and fiscal consolidation roadmap, if any.

Liquidity Outlook

As on June end (27th Jun), adjusted banking sector liquidity stood at INR 1.05 lac crore which was worse by about 35k crore over May end (31st May). This deterioration in banking system liquidity was chiefly due to advance tax payments to the government. RBI is micro-managing liquidity as it is using measures like reverse term repos, OMOs and buying dollars in forward market to make sure that the liquidity does not become too easy and overnight rates stay closer to 8% *(Source for all data: RBI).*

Credit Outlook

Credit growth's weak crawl continued in June 14 as well, with YoY growth at close to 13.9%. We believe as various policy initiatives being taken by the new government become visible, including a perceived focus on reviving investments, credit growth shall also start picking up. We are already seeing early signs of various companies accessing equity markets to raise capital; it not only helps some of the companies having over-leveraged balance sheets gain health, but also provides ammunition to companies looking to take advantage of the next round of growth.



Source: RBI, Bloomberg

In credit markets, supply from frequent issuers was relatively benign due to some of the guidelines under the new Companies Act, 2013. However, with some clarifications and concessions coming through, we expect supply of corporate bonds to start hitting the market.

Investor appetite in accruals funds has remained strong, which has enabled newer structures like CMBS (Commercial mortgage backed security) being absorbed in the market. We see this as a very positive development towards the overall development of corporate bond market in the country. Due to healthy appetite from funds, spreads between AAA and non-AAA corporate bonds have shrunk.