Macro, Markets & Strategy review

2016

September

UNIFI INVESTMENT MANAGEMENT

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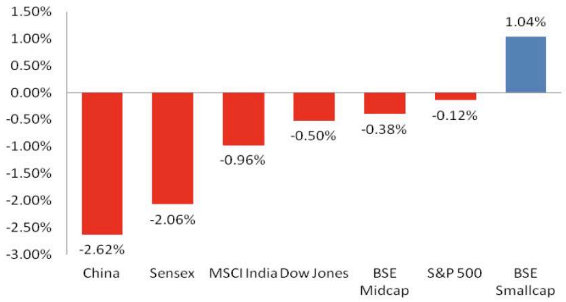
Global developments | Fed defers again | UK & Japan ease again

Hesitating once again to act out of line, the US federal reserve continued its dovish stand, and held on to rates, citing current data flow of less than expected growth on inflation and employment. However, to give itself room to maneuver later it added that "the case for an increase in the federal funds rate has strengthened but decided, for the time being, to wait for further evidence of continued progress toward its objectives." This probably means that December could see a rate hike coming, as the target rate for the FED is at 0.25-0.50 vs the 0.25% that they are at today. As a parallel, talks of tapering by the ECB are said to be taking shape which may be surprising as the pace of growth in the Euro area continues to fall with economic expansion expected at 1.7% for 2016 vs 2% in the previous year.

Interestingly, as global liquidity continues to ooze, the IMF in its new Fiscal Monitor report stated that the world is now under $152 trillion of total debt, and if economies can afford to, they should spend more! Global debt (both private and public) have now reached 225% of global economic output last year, up from about 200% in 2002. Pointing to a probable head wind, it added that as two-thirds of debt (about $100tn) is owed by the private sector, any deleveraging on a large scale could thwart the still recovering global economies. As things stand today, it is estimated that global growth in 2016 will rise at a pace of 3.2%, broadly in line with last year, with a slight increase of 3.4% for 2017. With easy money now the only panacea for absolute growth, it will be interesting to see how far the proverbial can of rates continues to be kicked down the road.

Absolute growth worries apart, the British Pound saw its weakest level in 30 years as the both Germany and France pushed for a tough line on Britain's exit from the union. The Pound is now down -14% since the referendum and a weaker currency isn't translating to growth any time soon for U.K as their growth is predicted to slow to 1.8% this year and to 1.1% in 2017, down from 2.2% last year.

A divergent September

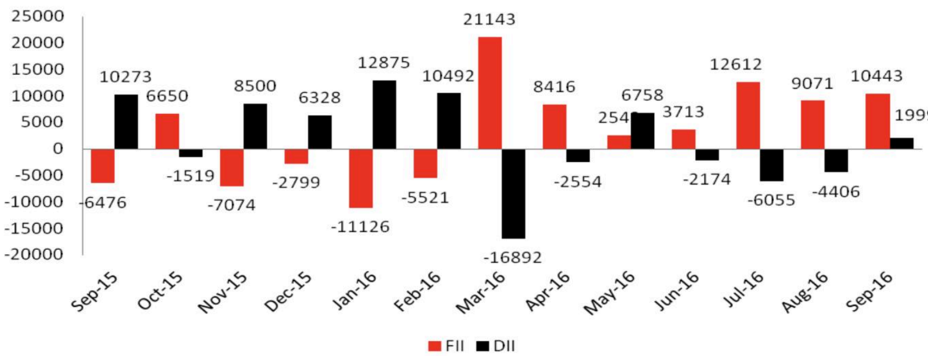


- Dow Jones was down 0.50%
- S&P 500 was down 0.12%
- Shanghai was down 2.62%

India saw a divergent trend in performance for the month as the benchmark Sensex and Mid-cap were down 2.06% & 0.38% while the BSE Small-cap index was up 1.04%. MSCI India was down 0.96% as well.

MSCI (in %)	India	Brazil	Russia	Korea	China	Japan	US	Australia	EM Index	MSCI World
MoM (in %)	-0.96%	0.27%	3.77%	1.37%	2.25%	0.84%	-0.04%	2.08%	1.10%	0.36%
CY - YTD (in %)	5.82%	59.78%	26.51%	14.81%	6.13%	0.74%	6.05%	7.01%	13.77%	3.78%

September witnessed inflows of Rs.12000cr of flows into India equities as easy global liquidity continues to translate to Foreign Institutional flows into India. Domestic flows from SIP's continue to be strong. For CY-2016, FII's have pumped in a total of USD7.5bn into India equities.



Monthly Macro Review

Inflation | CPI stable @ 5.05% vs 6.07% MoM | WPI @ 3.74% vs 3.55%

After 4 months of rising inflation, where headline CPI moved from 4.83% in March to as much as 6.07% in July, the numbers for August witnessed a cool down to levels of 5.05%, led by a 29% fall in food inflation. The predominant driver was a fall in the prices of Vegetable and Pulses prices and as can be seen below, the magnitude of their fall has driven absolute food inflation down from 8.35% to 5.91%, down -29% month on month.

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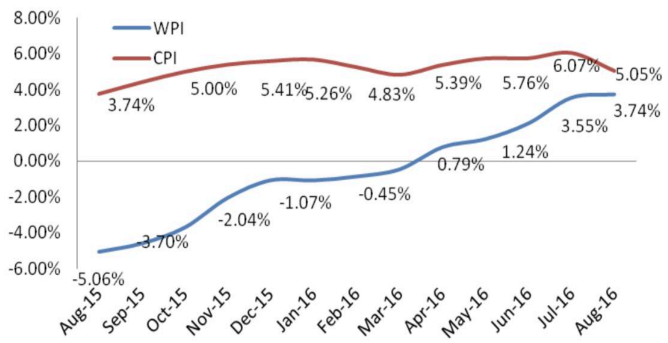
Weight	CPI	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16	MoM
6.04%	Vegs	4.63	6.39	0.70	0.54	4.82	10.77	14.74	14.06	1.02	-92.7
2.38%	Pulses	45.92	43.32	38.30	34.15	34.13	31.57	26.86	27.53	22.01	-20.1%
CFPI			**6.8%**	**5.3%**	**5.2%**	**6.3%**	**7.5%**	**7.8%**	**8.3%**	**5.9%**	

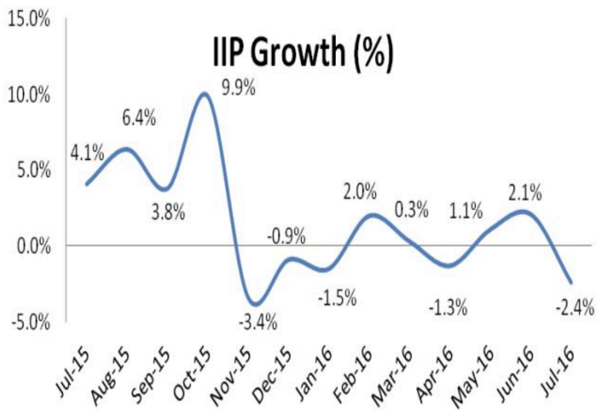
As the produce from the on-going season hits the markets, there is sufficient head room for the overall headline CPI number to remain close to RBIs benchmark of 5% for the year.

Weight	CPI	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16	MoM-16
45.9%	Foods & Beverages	6.66	5.52	5.27	6.21	7.20	7.38	7.96	5.83	-26.8%
2.4%	Pan, Tobacco etc	9.03	8.39	8.51	7.96	7.82	7.28	6.83	6.86	0.4%
6.5%	Clothing n Footwear	5.85	5.52	5.5	5.56	5.37	5.01	5.23	5.21	-0.4%
10.1%	Housing	4.86	5.33	5.31	5.37	5.35	5.46	5.42	5.29	-2.4%
6.8%	Fuel n Light	5.32	4.59	3.38	3.03	2.94	2.92	2.75	2.49	-9.5%
28.3%	Miscell	3.95	4.38	4.01	4.34	3.96	3.85	4.01	4.18	4.2%
100.0%	CPI – Inflation	5.69	5.18	4.83	5.39	5.76	5.77	6.07	5.05	-16.8%



WPI continued to spike as well driven by food and non-food inflation, coming in at 3.74% vs 3.55% MoM which is at a 24-month high. Disinflation was seen in fuel and food MoM, whereas 9/12 manufacturing industries recorded higher prices.

Index of industrial production (IIP) | Down to -2.4%



IIP for July fell to -2.4% vs 2.1% last month and 4.1% a year ago. Growth was muted across all segments with mining (0.8%), manufacturing (-3.4%) and electricity (1.6%) remaining weak. FYTD, IIP growth is at -0.2% vs 3.5% last year.

Consumer non-durables again turned negative at -1.7% led by food products. Capital goods remained in red and worsened to -30%.

Negative growth was recorded in 12/22 industries vs 4/22 industries last month.

A surprise rate cut | Repo now at 6.25% - 6 year low

This was Dr.Urjit Patel's first monetary policy meeting and as the architect of the RBI's inflation targeting framework, he surprised a few by effecting a 25bps cut to 6.25% now. But of course the decision was taken by the Monetary Policy Committee (MPC), a new 6-member panel which along with the Governor will henceforth decide on rates. Incidentally, this is the lowest level India has seen interest rates at since November 2010.

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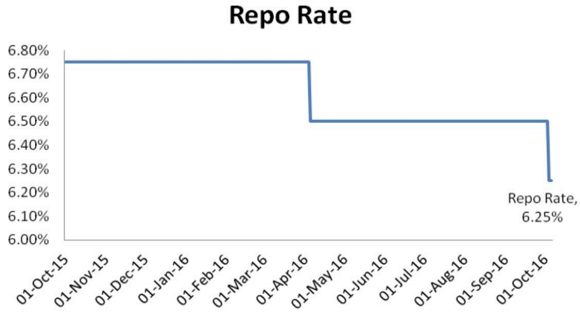


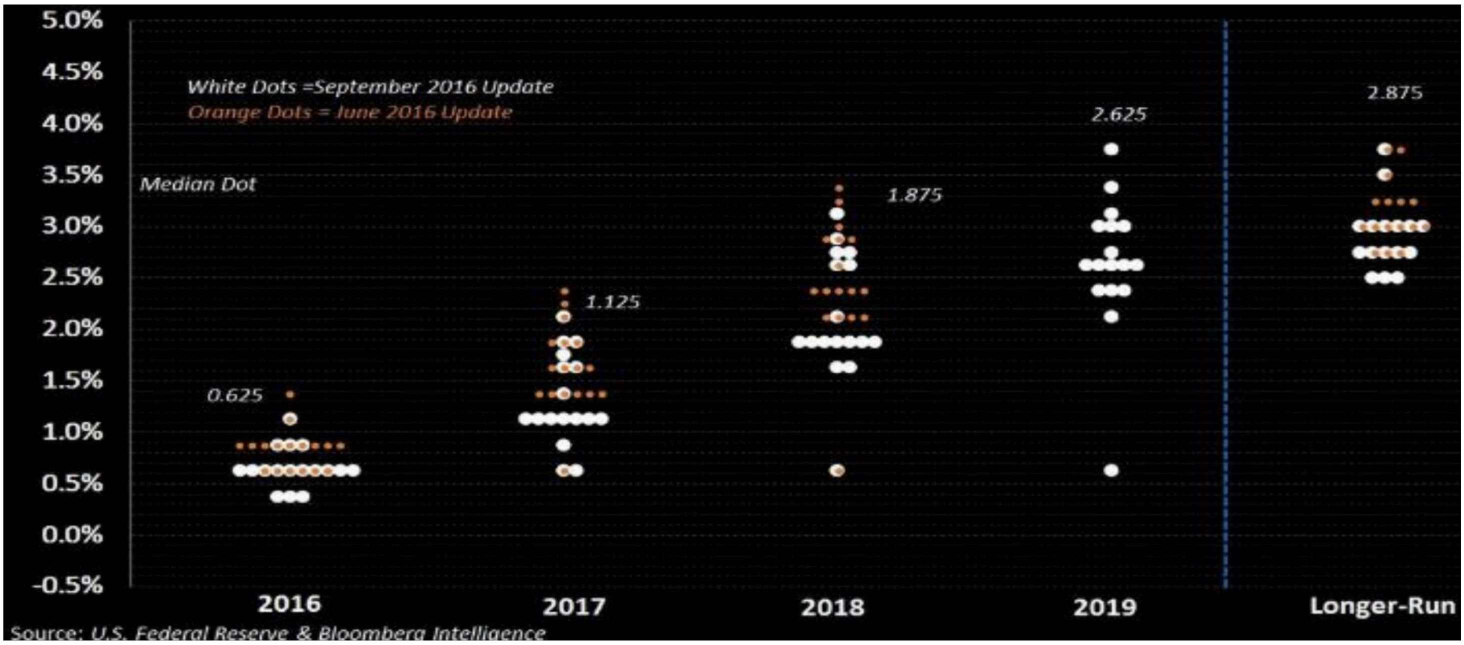
RBI's outlook on the domestic economy is positive with many of its high frequency indicators showing positive trends though global economic weakness will keep GDP growth at 7.6%. The fall in current headline CPI numbers to acceptable levels along with expectations of sustenance of the same at current levels led to the RBIs call on a rate cut, notwithstanding the fact the RBI expects a short term hike in inflation as the effect of new wage legislations and new minimum support prices for agri-commodities settle in. The MPC's target CPI inflation is at 4% with +/- 2% leeway for the year after and the near term benchmark of 5% for March 2017.

Unifi Strategy

The times are changin'?

…. and H1 of FY-2017 is done with. While we need to wait and see how the earnings begin to come in, but if anecdotal evidence is anything to go by, sector leaders should witness a season of reasonably good earning's growth. The entire Automobiles pack, a reasonable indictor of consumer sentiment, has had a good second quarter with average volumes for the industry up by a good 16% for the quarter. Of course, a lot has to do with the seasonality of festivals but even by that yard stick the level of inventory stocking points to a reasonably good demand sentiment on the ground. Higher up the value chain, Maruti, which commands c.48% of the Indian 4-wheeler space saw volume growth of 18% this quarter. The price growth in FMCG companies, a sector that was lacklustre in the previous five quarters, has started witnessing positive traction as the industry has pulled back on promotional offers and even taken selective price that is likely to result in healthy top-line growth for the quarter. Over all, strong discretionary demand, aided by some push from the disbursals of the Seventh Pay Commission and pick up in rural incomes given the normal monsoon are expected to result in good consumer discretionary volumes. Elsewhere, pockets of opportunities in sectors such a chemicals, and smaller b2b firms in engineering and manufacturing continue to evolve due to their efforts at the firm level and we continue to track them at a micro level to regress what the future may look like for such select names. The optimism is however not all pervasive. The IT sector for instance continues to battle immense headwinds and the pointers from most of the tier-1 names point to an average (or less than average) season ahead. Coming to PSU Banks, asset quality woes are expected to persist (rising GNPA + restructured book) and a structural U-turn continues to look elusive.

As active fund managers, we continue to monitor the above trends for opportunities in the downstream value chain. The Governments fillip on infrastructure continues to be good and then of course there is GST that will see organized players consolidate. In all, there are pockets of macro opportunities available apart from individual players continuing to consolidate their scope of operations. Given the rally in the broader markets, valuation excesses are only heading north and that is something we monitor at a close level. But that is an over whelming feeling not just in India but around the world as liquidity continues to chase yields. A major risk to that now is applicable to markets the world over is the probability of capital flight back to its sources once interest rates begin to harden. The US Fed for instance has now come out with a dot plot on how they see rates panning out in the next few years



We continue to monitor our exposures and portfolios accordingly and have not hesitated to book profits where situations merit or look at new sectors as the core of the economy witnesses a change. We continue to like select names in chemicals, auto, etc., and are closely monitoring the near as well as mid to long term potential of their fundamentals in making portfolio decisions. We continue to maintain an eye on a favourable risk reward in terms of valuation, as demonstrated by its price earnings multiple being lower than the rate of earnings growth, adjusted for its scale, and not hesitating to book profits where valuations have exceeded its margin of safety.

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Risk: Key risks to our portfolio would come from geo-political concerns globally, decline in foreign inflows, sharp currency movements, Fed announcements, steeper Chinese devaluation, spike in commodity prices and a prolonged delay in fiscal reforms. Global re-allocation of equity, which is not India centric will continue to happen and may result in turbulence from time to time. Indian markets as well as the INR will continue to remain vulnerable to global events, however unrelated to India. Interest rate hikes in the U.S may be a huge event risk and affect liquidity conditions domestically. NPA in the banking system and new IPO's may also hamper liquidity in the market.

Please do let us know if you'd like any clarifications regarding your Portfolio account with us. Thank you for placing your trust in Unifi.

Yours truly

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