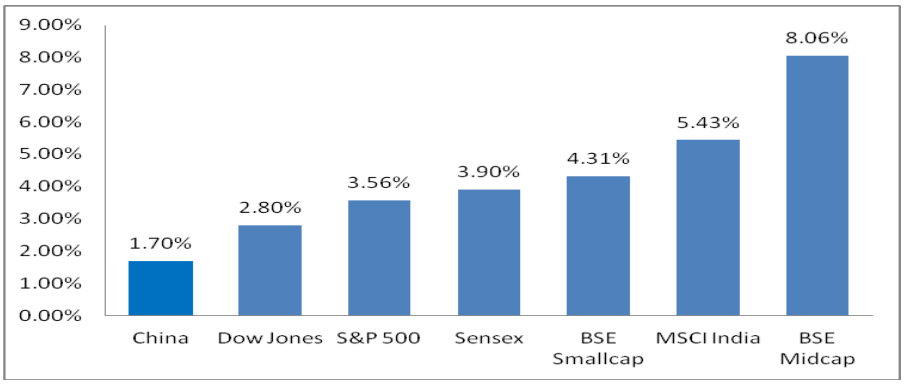
Global developments | Fed defers again | UK & Japan ease again

The pace of economic growth in the US strengthened to an annualized rate of 1.2% for Q2-CY2016 after expanding at 0.8% for the first quarter. All the key economic parameters that count have been doing well: payroll additions from April to July have been at 147,000/month, new home sales have been the best since 2008, and unemployment has been low at 4.9%. By most accounts, they are doing well, yet, the Federal Reserve in its 5th consecutive meeting since the initial hike, opted to hold interest rates @ 0.25%. One reason behind the hesitation could be the current rates of inflation, which at 0.9% is below the Fed's target of 2%. This begs the question: if the sustained period of loosening has only done so much for (low) inflation, *is the monetary policy really stimulatory?* And then there is the entire question of productivity; with a demographic curve* that is bent towards seniority *(a la Japan)*, and thus reducing the capacity of the economy to produce, is there a case for stagnation to be secular, and not just an economic phenomenon? Difficult questions. So while the Fed takes its time on the rates, it may be due to reasons far below the usual peripheries, notwithstanding the implications of Black Swans that now seem to occur with a degree of regularity. Meanwhile the Bank of England for the first time in 7 years, cut interest rates by 0.25% *to* 0.25%, doing its bit to boost a post-Brexit recession and added that they could be reduced further as the economic implication of the exit becomes clearer. While the implications on borrowers may be positive, we are increasingly intrigued about what such low rates do to the savings infrastructure of a country. Is this explaining the massive flow of equities to EM's? Japan also continued to ease, unveiling a $265bn stimulus package, likely to be a mix of national and local government expenditure in addition to loan programs and will constitute roughly 5-6% of the size of their economy. The Government also indicated a 3% hike in minimum wages in a bid to boost consumption while holding onto its negative rates at -0.1%. Given that the global markets are now accustomed to such sizes of 'packages', it remains to be seen how long they will continue to sway the markets with its promise of liquidity.

**Age group of 60+ is 19% of America's population while the productive group of 20-60 is 54%*

A strong July

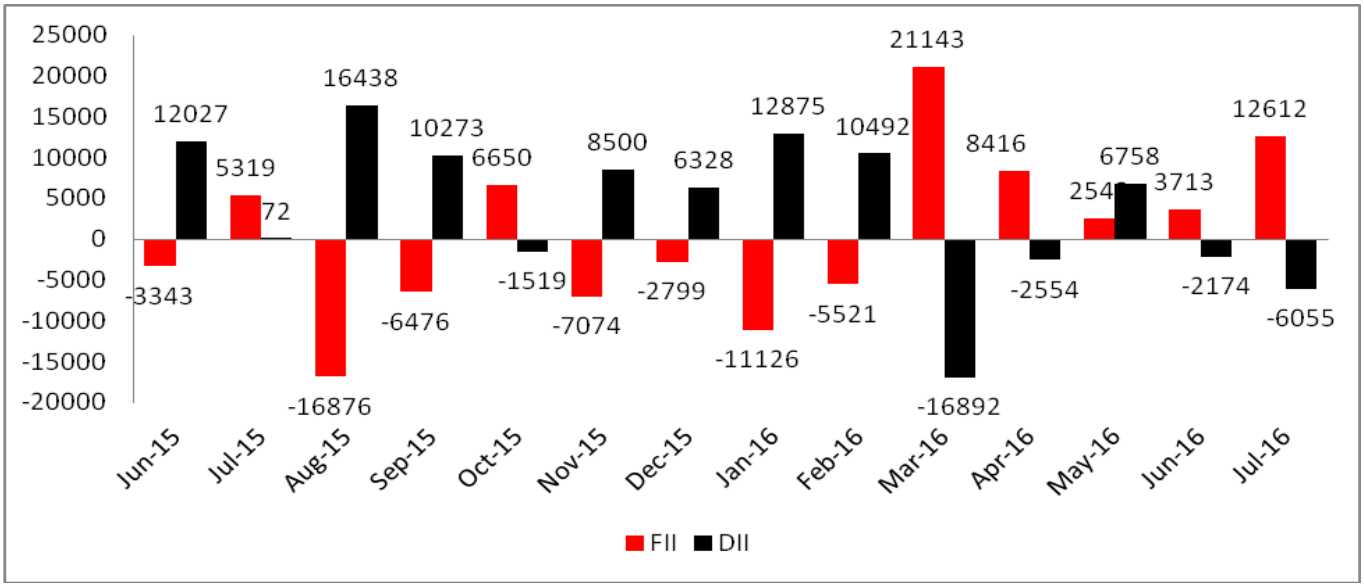


- Dow Jones was up 2.80%
- S&P 500 was up 3.56%
- Shanghai was up 1.70%

- BSE Sensex was up 3.90%
- BSE Mid-cap was up 8.06%
- BSE Small-cap was up 4.31%
- MSCI India was up 5.43%

MSCI (in %)	India	Brazil	Russia	Korea	China	Japan	US	Australia	EM Index	MSCI World
MoM (in %)	5.43%	9.82%	-0.41%	6.12%	3.33%	6.48%	3.67%	8.16%	4.72%	4.15%
CY - YTD (in %)	5.76%	58.48%	18.95%	9.77%	-3.33%	-0.45%	6.21%	8.48%	9.99%	3.55%

Foreign Institutional investors continue to increase their exposure to India with the YTD-FY17 witnessing inflows of USD 4bn already. What is driving this size of traction? We have tried to reason this later on in this note.



Monthly Macro Review

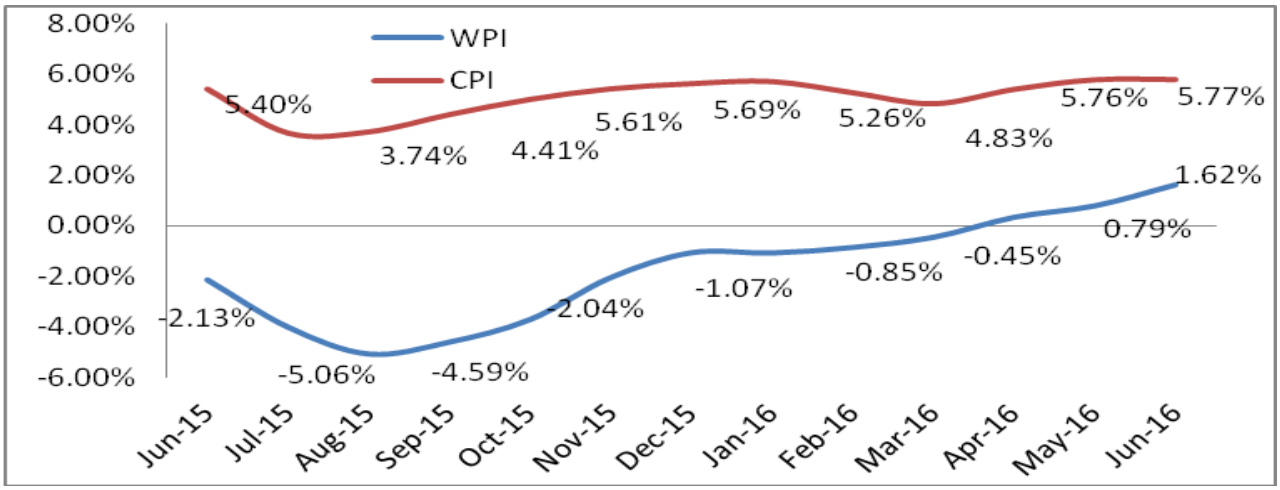
Inflation | CPI stable @ 5.77% vs 5.76% MoM | WPI @ 1.62% vs 0.79%

After an uptick in inflation for the months of April and May, June was more or less stable with most baskets witnessing a cooling down in prices. Food inflation came in at a modest 4.3% vs 21% and 18% in the months prior, while overall CPI came in almost flat at 5.77% vs 5.76% MoM. Pulses, the key culprit in India's higher consumer inflation has come off well and the entire food basket will continue to ease as the bountiful monsoons delivers a good produce.

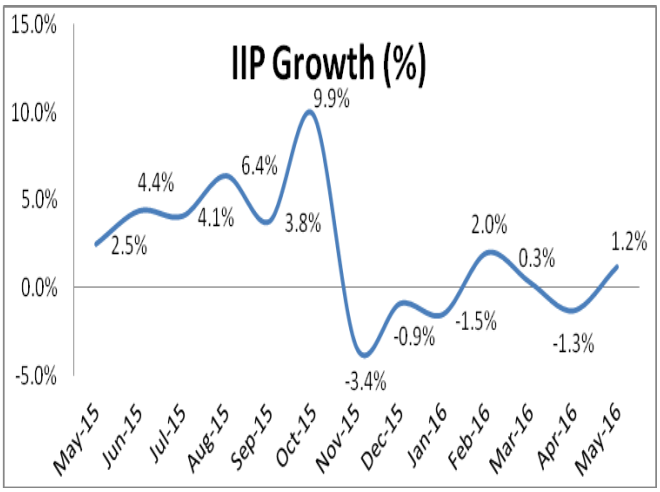
Weight	CPI	Feb-16	Mar-16	Apr-16	May-16	Jun-16	MoM
45.9%	*Foods & Beverages*	*5.52*	5.27	6.21	7.20	7.38	2.5%
2.4%	*Pan, Tobacco & Intoxicants*	*8.39*	8.51	7.96	7.82	7.82	-6.9%
6.5%	*Clothing n Footwear*	*5.52*	5.5	5.56	5.37	5.01	-6.7%
10.1%	*Housing*	*5.33*	5.31	5.37	5.35	5.46	2.1%
6.8%	*Fuel n Light*	*4.59*	3.38	3.03	2.94	2.92	-0.7%
28.3%	*Miscellaneous*	*4.38*	4.01	4.34	3.96	3.85	-2.8%
100.0%	*CPI -Inflation*	*5.18*	*4.83*	*5.39*	5.76	5.77	0.2%
	CPI Food	*5.30*	*5.21*	*6.32*	7.47	7.79	4.28%

Also, the deflationary trend in WPI continued to be broken with help from food as well as non-food items, coming in at 1.62% vs 0.79% MoM. The temporary surge in commodity prices was largely responsible for this move and we don't believe this to be a sustained uptrend as both crude and Iron Ore have softened considerably off late.

We don't think there are serious risks to RBI's CPI target of 5% by March 2017 unless there is a sharp reversal in commodity prices.



Index of industrial production (IIP) | Surprised positively up 1.2%



IIP for May surprised positively on the upside, coming in at 1.2% YoY, driven entirely by higher manufacturing output. IIP growth had averaged at -0.9% in the last six months. While the May print signals some improvement, it remains to be seen if the pickup is sustainable.

Manufacturing growth touched a seven-month high of 0.7% YoY in May'16 after declining in five of the last six months (Nov'15-Apr'16: -2.3%).

The pickup was broad-based, with growth in 16 of the 22 industries.

GST… biggest reforms since 1991?

While market valuations no doubt warrant an element of caution, the timing has coincided with the passage of the much needed GST Bill. It has been a tiring and decade-long wait to unify the maze of indirect taxes into one; a development that has the potential to transform India into 'a single common market', bringing with it huge efficiency gains.

Among others, the most important advantages of the GST regime will be to transform India into a common national production centre as against clusters today that were set up on the basis of duty benefits at a State level. The doing away of the negative protection must see a balanced growth in manufacturing capabilities around India.
And then of course, it helps in widening the tax net. As each person in the value chain who gets input tax credit has an incentive to ensure that the previous person has paid taxes, the GST mechanism can lead to better tax compliance and a broadening of the tax base.

Over all, GST has the potential to add materially to the GDP of the country by a combination of raising tax buoyancy, assisting the organized sector in widening their base and encouraging foreign inflows due to a simplified fiscal environment. It is difficult to quantify a number to this development, but our interactions with organized players lead us to believe that the reform will most certainly widen the addressable market in India for them and that no doubt is a key development.

Unifi Strategy

What is really driving equities?

2016 began on a remarkably bearish mood. Commodities tumbled, the Chinese devalued, and the combined fear was of deflation exporting itself around the world; just the anathema any capital market loathed. Fast forward just a few months, including a Brexit thrown in, and there seems to be no indication whatsoever of any geo-economic stress around the world. The MSCI global index is up 6.1%, China is up 4.1%, Dow jones, NYSE, US is up 5.2%, and even Britain is up 8.3% post Brexit!

Neither commodities, and nor has China reversed. After a brief period of consolidation, Oil sunk almost 20% in July, all the way down to $40 a barrel. This is of concern as the quantum of supply expected to hit the market will be significant in the coming months with post-sanctions Iran stepping up production, the US adding drill rigs in July and Libya expecting to boost exports by 900,000 barrels a day by the end of the year. And on China, a gentle slowdown is obviously underway. So, with a more or less mediocre global macro-economic set up, what really explains a bullish frame of mind? It has to be loose monetary policy. With ultra-low to non-existent bond and cash yields, investors aren't really spoilt for choices when it comes to asset allocation. Given falling or already low yields in much of the developed world and global developments pushing rates down further, Equities have been the only asset class with a promise of better yields and the outlook needs to be absolutely poor for allocation not to come to Equities.

Here is a sample of yields in key global markets:

10 YR BOND

SWISS	-0.55%
GERMANY	-0.09%
FRANCE	0.13%
USA	1.49%
UK	0.64%
CANADA	1.04%
AUSTRALIA	1.87%

For the adventurous, Venezuela offers 31.2%

As per ratings major Fitch, it is estimated that there is a whopping $10 trillion in total negative-yielding sovereign bonds outstanding worldwide. This dynamic has also trickled into the corporate sector, where there are more than $300 million worth of negative-yielding bonds. This is a source of concern not just from a money management perspective, but from the point of view of providing an absolute sense of financial security to scores around the world.

As a result, the allocation is naturally gravitating to equities and within that to emerging economies such as India that promise long periods of core growth in fundamentals as well as earnings.

What's moving India?

India's bench mark indices, led by better earnings and the legislative ground work for increasing the quality of earnings, delivered between 15-18% for the first 4 months of this financial year.

The earnings season of Q1-FY17 has been incrementally much stronger, with revenue and earnings recording a much better performance vs the same time YoY. The benchmark Nifty (ex-Banking) witnessed revenue growth of 9% vs 1% YoY while earnings growth came in at 21% vs 7% YoY. Of course, the quality of revenue growth must be seen in the context of lower commodity prices in general while earnings are a better indicator of fundamentals.

Nifty 50 – ex BFSI		
YoY	Q1 FY16	Q1 FY17
Sales	1%	9%
PAT	7%	21%

While the above is just a snapshot of the broader indices, the acceleration in earnings is broadly representative of the companies that we hold in our portfolios today, and, the growth estimates based on which we had initially taken exposure to, broadly hold. Importantly, the qualitative commentary on business per se has been encouraging. While May was a broadly risk-on trade following an abrupt global weakness led sell off in February, the markets broadly priced in the Monsoons in June, while July priced in the passage of GST apart from rebound in earnings. We believe the journey from here on will be strictly led by stock specific and bottom up fundamentals.

Bouts of speculative titillation are a challenging period for fund managers. As markets pout and all and sundry rise, the need for focusing closely on risk to reward on a stock specific basis is greater than ever. 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. For instance, we have increased our allocation to the BFSI space after several years as the sector witnesses improving industry tailwinds over all. We continue to like select names in chemicals, auto and agri and are closely monitoring the near as well as mid to long term potential of their fundamentals in making portfolio decisions. Like we have been saying, we are cognizant of the fact that bulk of the upsides in a *risk on* market is by means of valuation expansion but at the same time it is important to maintain a balanced fundamental approach as given the extent of global liquidity that has driven the Indian markets, a reversal could be prolonged and painful. 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.

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
Baidik Sarkar
Head - Research

CHENNAI:
11, Kakani Towers
15 Khader Nawaz Khan Road
Nungambakkam High Road
Chennai - 600 006. INDIA
Ph: +91-44-3022 4466, 2833 1556
Fax: +91-44-2833 2732

HYDERABAD:
H No. 6-3-346/1, Road No. 1
Banjara Hills
Scotia Bank Building
Hyderabad – 500 034. INDIA
Ph: +91-40-6675 2622/23

BANGALORE:
511, Barton Centre
84, M.G. Road
Bangalore - 560 001. INDIA
Ph: +91-80-255 9418/19

MUMBAI:
Shiv Sagar Estate,
A-Block, 8th Floor,
Dr. Annie Besant Road
Worli, Mumbai - 400 0018.
INDIA