Global developments

The timing of the Federal Reserve's interest rate hike, which would be its first in nearly a decade, is unclear and for now policymakers are watching the recent weakness in data coming out of the U.S. economy along with hoping that it does not signal a more substantial slowdown. The jobs market data which had enthused everyone alike disappointed in March (much to the liking of global markets) as the addition of just 126,000 jobs was grossly below expectations of a gain of 245,000 jobs. But as a remainder, the Fed maintained that a hike would come as long as policy makers witness a sustained increase in the employment number and when they are confident that inflation will be around 2%. So going forward, the timing of normalization will be data dependent and remains uncertain because the future evolution of the economy cannot be fully anticipated and the path to rate hikes may be relatively shallow with no solid lead indicators pointing out when exactly the rate trigger is to be pulled. Cheap oil and the strong dollar are the key risks to the U.S GDP that is expected to grow at a more than 2% this year, with unemployment falling to close to 5% from 5.5% now, and wages rising.

The biggest global development coming out of this month was achieving breakthrough in the Iranian nuclear deal that will finally see Iran coming out of 36 years of sanctions that have crippled their economy and not seen them participate in much of the new global trade order. Though the finer details of the deal await further rounds of negotiations, it will certainly do its bit to bolster economic growth in the Asian region as they have a lot to catch up with. It was ironical that the world's 4th largest producer of crude was dependent on imported refined crude for its own domestic consumption.

And Europe's Greek troubles may not be over any time soon as Bank of Greece Governor Yannis Stournaras said that "further relief" on Greece's whopping debt burden is needed to boost their economic growth but it "doesn't have to translate into losses" for Eurozone lenders.

Indian Market

FIIs bought stock worth USD1.5bn in the cash market along with debt worth USD1.4bn for the month of March while Domestic Mutual Funds bought stock worth USD530mn. Insurance companies remained sellers of equities at USD566mn. Over all, in March, MSCI India underperformed the global indices for the second consecutive month. The performance ranking slipped further to 17th position from 15th position in the previous month. Year to date, India continues to be the fifth best-performing market. The benchmark BSE Sensex returned -4.78% for the month vs -4.28% of MSCI India. BSE Midcap and BSE Small cap returned, -2.02% and -3.34%.

MSCI (in %)	India	Brazil	Russia	Korea	China	Japan	US	Australia	EM Index
MoM (in %)	-4.28%	-11.49%	-2.67%	1.26%	2.40%	0.88%	-1.60%	-3.03%	-1.59%
CY - YTD (in %)	5.17%	-15.50%	18.61%	4.01%	8.12%	9.47%	0.86%	1.78%	1.91%

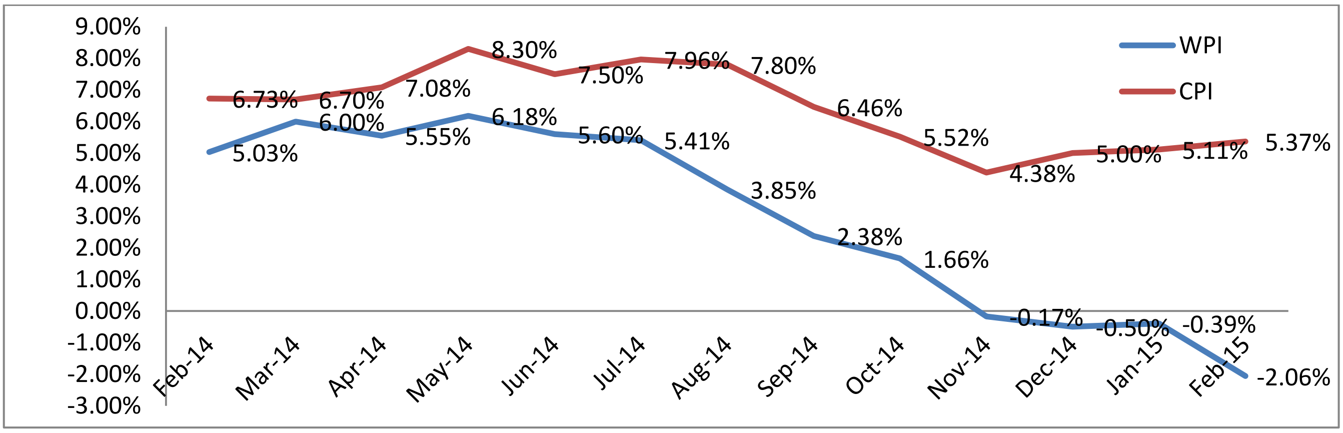
Monthly Macro Review | Inflation, over all in control | IIP Grows

Inflation: CPI and WPI continue to moderate:

On a revised base, CPI for February 2015 came in at 5.37%, higher than consensus expectation of 5.25% while WPI deflated faster than expected at -2.06% vs a moderation of -0.4%. This is the fourth consecutive monthly decline in the WPI index; the current month decline is -1.4% MoM.

While the rise in CPI was majorly contributed by the food basket wherein inflation rose 6.8% YoY, WPI's deceleration at -2.06% was majorly driven by the decline in the fuel group index that fell 14.7% YoY. The divergence between the CPI and the WPI reading for February 2015 is primarily due to a difference in weight of food components, where a seasonal decline in prices has moderated. Under CPI, food has higher weight of 45% vs a mere 14% weight in WPI. Hence, while CPI inched up, the effect was not too sharp in WPI.

Going forward, increase in indirect taxes in the Union Budget 2015-16 and the recent increase in petrol and diesel prices (up 5%), CPI may marginally inch up from the current levels of 5.37%. However, it will still remain below the 6% mark. The government has taken a number of steps to curb inflation, particularly food inflation. Some of the major steps taken by the government are: higher allocation of rice under public distribution system (PDS) and higher allocation of wheat under Open Market Sales Scheme, moderation in increases in minimum support prices, and advisory to the states to allow free movement of fruits and vegetables by delisting them from the Agricultural Produce Market Committee (APMC) Act. This should structurally prevent price shocks in perishable items, although volatile swings in crude prices may imbalance the numbers otherwise.



IIP – Good January, 2.6% growth YoY

The IIP for January came in at a growth of 2.6% YoY which was well above consensus expectations of 0.7%, implying the overcoming of an adverse base.

Mining slipped into negative territory (-2.8%) for the second successive month after a long spell of 13 months of positive growth averaging 2.2%. Electricity growth also slowed down to 2.7%, the lowest growth in 15 months.

However, in spite of this, manufacturing sector continued to display momentum which grew for the third consecutive month, at 3.3% for January.

While the overall number seems positive, it continues to be a mixed bag internally. While it was heartening to witness the core capital goods sector grow at 12.8%, after a gap of three months, intermediate goods registered a de-growth (-0.8%) after two months of positive growth along with Consumer sector goods industry slipped back into de-growth again (-1.9%) pulled down by de-growth in durables (-5.3%) and non-durables (-0.1%).

Over all, YTD-FY15 IIP inches up to 2.5%. This shows that broadly industrial production is on a steadier course of recovery. Also at 2.5%, YTDFY15 IIP exhibits a fair bit if momentum versus the nearly no growth of 0.1% during YTDFY14.

Table 1: IIP, January, YoY, 2014-15

Year on Year in %	**Weight**	**Nov - 2014**	**Dec - 2014**	**Jan - 2015**	**YTDFY14**	**YTDFY15**	**FY13**	**FY14**	**FY15E**
Classification by Economic activity									
Over all	**100**	**3.9**	**3.2**	**2.6**	**0.1**	**2.5**	**1.2**	**-0.1**	**2.5**
Mining	14	3.9	-2.1	-2.8	-1.0	1.3	-2.2	-0.6	4.5
Manufacturing	76	3.1	3.8	3.3	-0.4	1.8	1.3	-0.7	0.8
Electricity	10	10.0	4.8	2.7	5.7	9.3	4.0	6.1	11.1
Classification by use									
Basic Goods	46	7.1	5.7	4.5	1.6	7.4	2.5	2.1	9.0
Capital Goods	9	6.6	5.3	12.8	-0.8	5.7	-5.6	-3.6	5.2
Intermediate Goods	16	4.5	1.0	-0.8	3.2	1.5	1.7	3.1	1.8
Consumer Goods	30	-2.1	0.3	-1.9	-2.6	-4.7	2.6	-2.7	-5.7

Interest Rates

The Reserve Bank of India on 7th April, 2015 decided to leave interest rates unchanged when it met for a bi-monthly review, after effecting two out-of-cycle rate cuts earlier this year for 25 basis points each. This was more or less expected given the small uptick in CPI as well as the erratic vagaries of the monsoons which has marginally dampened the agricultural sector for the past few months. The RBI would want to witness further evidence of sustained lower inflation as well as data on monsoons before deciding on the timing if the next cut. Even otherwise, there is scope for a downward transmission in the system before the next round of cuts begins.

Unifi Strategy

After exiting CY2014 with a bang, the first quarter of the year (Q4FY15/Q1CY15) saw the markets returning a much reserved performance as the euphoria following the Union Budget and two rate cuts subsided along with jittery expectations that the cost of capital may move up in the US impacting flows to India. Also, murmurs of building in more realistic expectations around the execution of policy and translation of that into earnings has set in, building in tepid expectations from the market in the short term. On the back of that, focus is now on the upcoming Q4 earnings season and revisions to FY16E earnings estimates which could possibly set the tone for the next leg of directional moves in the market.

For the immediate term, a few variables that the markets will take cue from will be a mix of

(a) *Fed move:* There have been heightened apprehensions that a likely pickup in domestic growth could coincide with the US Fed raising its interest rates. International fund flows will continue to drive volatility in the Indian equities, which is expected to be higher than in the past 12 months as the cost of capital increase in the US. This is bound to cause some stress in domestic liquidity and lead to increased market volatility;

(b) *Acceleration in Government spending & legislation support:* The government is targeting a 30 per cent increase in investment spending in FY2016. This is the most crucial driver for India’s growth in the coming months and will provide the base for the multiplier effect coming and supporting all macroeconomic numbers that the street takes comfort in. Also, the land bill and landmark GST bill will be up or approval in April. As communicated earlier, the new indirect tax regime can add up to 1% to India’s GDP helped by efficiencies in the organized sector over the informal sector and this will provide for another multiplier effect;

(c) *Rate cut, and translation:* The base has already been set for translation of borrowing costs to the end user; out of the 50bps that has been cut so far, banks have not yet begun to pass on the savings, but as and when this happens this should provide a fillip to earnings as well as cap-ex.

Over the past few months, the markets have been struggling to associate a timeline with actual policy execution and earnings delivery. This combined with the fact that Q4 earnings could remain muted as government expenditure has possibly been cut substantially, with the fiscal deficit breaching the estimates in late February, has kept the street in check for some time and it may continue to be this way unless sustained green shoots in earnings emerge. While margins may provide some support with low commodity prices, comfort will actually set in from the sustainability of healthy volume growth. The forecast for FY16 earnings were cut by around 4% following Q3 earnings and it remains to be seen how they pan out after this quarter.

Strategy

Prima facie, the valuation looks reasonable on a top down basis at FY16e EPS of Rs.1703, translating to a market PE of 16.7x. However the valuations of good quality high growth stocks are expensive and some of these names are not free from underlying risks. We believe the market will continue to reward high quality names and we shall continue to focus on bottom up fundamental names with good return ratios. Accordingly, across sectors, we are invested in businesses that are benefitting from sustainable growth in consumption supported by Indian demographics as well as their market positioning. As we have been saying, an impending upturn in the earnings cycle and falling interest rates is likely to support valuations. However huge supply of paper in terms of disinvestment, IPOs's and FPO's can make the market volatile in the short term.

Risk: Indian markets as well as the INR continue to remains vulnerable to the end of QE and consequent movement of asset allocation to the U.S. Sudden rises in global commodity prices may have a detrimental effect on the domestic macro. Interest rate hikes in U.S may be a huge event risk and affect liquidity conditions domestically. Market may turn volatile in parts due to challenges in passing reform bill in upper house (due to minority of the ruling Government), possible increase NPA in banking system and geo political issues.

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
M. Ravvichandran

This is neither an offer to sell nor a solicitation of any offer to buy any securities in any fund managed by us. Any offering is made only pursuant to the relevant information memorandum, together with the current financial statements of the relevant fund, if available, and the relevant subscription application, all of which must be read in their entirely. No offer to purchase securities will be made or accepted prior to receipt by the offeree of these documents and the completion of the appropriate documentation. Please refer to the Private placement memorandum before making a decision.

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