

# CONTACT

## A Monthly Fund Update from JM Financial Mutual Fund

Details as on August 30, 2011

### Market Update - Equity

#### ECONOMY

India's 1st quarter of financial year 2011-2012 (1QFY12) GDP came largely in line with as consensus expectations, rising 7.7% vs. 7.8% in last quarter. 1QFY11 GDP was revised down from 9.3%YoY to 8.8%. The 7.7% growth in 1QFY12 was led by (1) Services up 10%, driven by trade, hotels and communication (+12.8%); financing/insurance (+9.1%) and community services (+5.6%); (2) Agriculture growth remained strong, up 3.9% due to higher production of rice, wheat, pulses and oilseeds; (3) Industry growth moderated to 5.1% from 6.1% last quarter with a deceleration mainly seen in construction (1.2%) and mining (+1.8% due to ongoing policy hurdles). India's Industrial Production for June surprised yet again, this time on the upside, rising 8.8% vs consensus at 5.8%. Consumer goods continued on its recent slowdown trend, while Capital Goods showed an uptick. Headline inflation showed some moderation but still remained elevated at 9.2%. Key now will be how Commodities behave amidst Global Growth concerns, as 60% of India's inflation is linked to Commodities, and Crude is yet to correct meaningfully. After the surprise 50bps rate hike in Jul, mkt is expecting another 25bps rate hike in the next policy meet on Sep 16 as the RBI's main bone of contention.

#### STOCK MARKET

For the month of August BSE fell by 8.8%, while the CNX Mid cap index fell 9%. FMCG and Auto index were the best performing sectors for the month, while Realty and IT were the worst performing sectors. The FIIs were net sellers to the tune of US\$ 2.1b for the month of August while Domestic Institutions were net buyers to the tune of US\$ 1.8b this month.

#### MARKET OUTLOOK

The markets have been affected by both global and domestic concerns. Commodities have corrected from their peaks but are still at high levels. US has been a consumption driven economy and with lesser job creation its difficult to maintain the pace of consumption. Hence, the growth may continue to elude US until the economy undergoes structural changes. European countries are trying to avoid default on the sovereign debt and new names are added to the existing list of Portugal, Italy, Greece and Spain (PIGS).

In India, the benefit of corrected crude oil price has not been passed on, as the prices were not increased then to fully bridge the gap between realization and cost. The govt. is still subsidizing diesel, LPG and Kerosene. Hence the cut in fuel prices may not be expected soon even if the crude falls further as govt has to keep its fiscal deficit under control. With increased subsidies on fertilisers and fuels, lower tax revenue and lowered GDP growth rate, the govt. may exceed the target of fiscal deficit of 4.6%.

Credit growth has been strong y-o-y and inflation has been sticky which may compel RBI to hike repo rates further by 25 to 50bps as this is the only tool available to RBI for control inflation. Interest rates are likely to plateau unless there is a sharp slow down in which case they may fall. Any monetary stimulus in west will provide a temporary boost to the stock markets and commodities. This will provide a good opportunity to sell off high beta stocks as higher commodity prices will further dent India's GDP or slow down the recovery. The market is likely to be range bound with a negative bias and there may be continued bouts of sell offs and pull backs. Q2FY12 results will make things clearer and determine the extent of slowdown.

### Market Update - Derivatives

Nifty August series settled around 12% below (at 4840) the July expiry level. The index traded within 750 points range in August series and traded below its 10 & 20 Day Moving Average throughout the series. Nifty rolls for the August series were at 70%, ~5% ahead of its three month average. Stock Futures rollover were at 82%, inline with its three month average. Overall rolls were at 76%, one percentage point ahead of its three month average. Weak rollovers were seen in Engineering, Fertiliser & Bank stocks whereas Telecom, Power, Financials & Metal stocks witnessed good rollovers. Most of our positions were rolled to the September series at lower levels as compared to the previous month. Volatility in the markets may help to churn the arbitrage portfolio and generate good returns.

Indicators	Current Month	Last Month	M-o-M Variation
Forex Reserves* USD Bln	318	317	1.42
Credit Off take* - Rs Crs	4,048,457	4,014,556	33901
Credit Deposit Ratio *	73.72	74.11	(0.39)
WPI Inflation*(%)	99.22%	9.44%	89.78%
10-Year Yield - India* (%)	8.32%	8.45%	(0.13%)
10-year Yield - USA* (%)	1.98%	2.74%	(0.76%)
Exchange Rate* USD/INR	45.86	44.19	1.67
Brent Crude per/bbl*	85.00	95.33	(10.33)
Reverse Repo-Daily Avg Rs Crs	1000	1300	(300.00)
Repo Average-Daily Avg Rs Crs	41700	37500	(4,200.00)

\* Data Reported as on month-end, Source RBI, WSS & Bloomberg.

Government bond yields eased on risk aversion on account of the ongoing global uncertainty. Rating agency S & P downgraded the sovereign rating for USA by a notch to AA+. S & P kept the outlook negative, suggesting that the S&P could downgrade to AA within the next two years. The short-term rating remained unchanged at A-1+, and the short-term and long-term rating was removed from credit watch, where they were placed on July 14 (due to uncertainty the debt-ceiling constraint). US downgrade triggered a big round of risk aversion. Metals including crude oil prices fell during the month.

Government bond yields fell by about 15-20 basis point on global risk aversion, however continues supply of bonds, strong macro data kept a lid on sharp drop in yields. IIP for the month of June 2011 was firm at 8.8% as against 5.9% and headline inflation for the month of July 2011 was 9.22%. Q1 FY12 GDP came above the market expectations at 7.7%. The yield on the 10-year government bond eased from 8.45% to 8.32%. Domestic liquidity situation continued to remain tight.

### Factor: Inflation

**Short Term: Negative**

**Medium Term: Negative**

Headline inflation eased but continued to remain firm. Food inflation, fuel index and manufactured index firmed up. The absolute index level was higher at 154 as against 153 the last month. Fuel index was higher at 165.60 as against 161.60 in the previous month. Primary article index was higher at 197.90 and manufacturing index higher at 137.70. The central bank estimates March 2012 inflation to moderate to 7%. RBI expects inflation to remain elevated at close to 9% till September and moderate only afterwards. The central bank has highlighted the suppressed component of inflation due to price controls on fuel, coal and electricity and its impact on the projected trajectory of inflation.

### Factor: Liquidity

**Short Term: Negative**

**Medium Term: Neutral**

System liquidity continued to remain tight. Tight liquidity conditions were evident as RBI received average daily bids of INR 41000 crore during the month in the daily repo auction. Inter bank call rates & CBLO remained around the repo rate on tight liquidity. Money market rates traded in a narrow range on tight liquidity situation. Going forward in the month of September 2011, it is expected that the liquidity situation will continue to remain negative on account of advance tax outflows. Money market rates are expected to remain volatile ahead of the important monetary policy review.

### Factor: Global interest rates

**Short Term: Neutral**

**Medium Term: Neutral**

US 10-year benchmark yield traded with a lower bias on continued economic slowdown in the US economy. Global risk aversion and continued weak data in the US led to gradual fall in the US treasury yields. The benchmark US treasury 10-year ended below 2% as compared to 2.74%. Rating agency S & P downgraded the sovereign rating for USA by a notch to AA+. The Federal Open Market Committee (FOMC) kept the target range for the federal funds rate at 0 to 1/4 percent. The Committee anticipated that economic conditions including low rates of resource utilization and a subdued outlook for inflation over the medium run are likely to warrant exceptionally low levels for the federal funds rate at least through mid-2013.

### OUTLOOK

Going forward, RBI's ability to tighten further would become challenging. With incipient signs of growth moderation emanating coupled with the ongoing global uncertainty, RBI will need to balance the near term growth correction with its medium term inflation objective. However, domestic inflation continues to remain a big worry for the central bank, which may make a remote case of another 25 basis points hike in the impending review of RBI policy. Government bond yields are expected to remain range bound with all eyes on the impending monetary policy and second half borrowing calendar. Undertone for Government bond continues to remain positive, as market expecting RBI to take a pause on hiking interest rates. Global economic slowdown and consequent fall in global commodity prices will keep a support for local bonds. We continue to remain positive on bonds with a medium term view.

Impending monetary policy and the calendar for dated securities for the second half for the financial year will be the next big triggers for the bond yields. Domestic liquidity situation likely to remain tight on advance tax outflows RBI stance to generate liquidity conditions consistent with more effective transmission of policy actions.