Investment Snapshot

For the Quarter Ended September 2018

Indian Markets: A long-term opportunity for growth

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Dear **Valued Policyholder**,

Fiscal year 2019 is panning out to be an eventful one with several regulatory reforms causing significant volatility for both Debt and Equity markets. The reclassification by SEBI of mutual fund schemes, RBI's Feb Circular on NPA recognition and SEBI's imposition of Additional Solvency Margins affected the stock markets in the first half of the year. In the quarter gone by, Indian equity indices scaled fresh life highs at the start of the quarter propped by encouraging Q1 FY19 corporate earnings results, positive economic indicators and recovery in monsoon trends. However, this was followed by correction towards fag end of the quarter, as Indian equities fell on concerns over depreciating rupee, surging global crude oil prices and escalating global trade conflicts. While the default by a leading NBFC caused significant concern in the money markets, quick action from the government and strong liquidity measures from RBI, helped ease the situation. Besides, the key solace was the pace of domestic inflows into equity markets, which has provided support to the headline indices, while their foreign counterparts have been selling.

There has been a significant divergence in the performance of NIFTY stocks and the broader markets in the quarter, with NIFTY gaining 2%, while the broader markets such as Small cap and Midcap indices corrected sharply during the same period. This was largely due to a few large cap stocks continuing to rally and higher share of export revenues in the NIFTY stocks (i.e. IT and Pharma stocks).

On the Macro front, despite the global crude prices being on an up move along with continued rupee depreciation, India's trade deficit narrowed during the month of August and September from its high in July, aided by buoyancy in exports. Besides, strong Q1 FY19 GDP growth at 8.2% has aided the Indian markets from not losing its sheen versus its EM counterparts, as economic recovery of the country is now conspicuous. Both wholesale and retail inflation prints have been trending lower amid rising crude and depreciating rupee, largely due to benign food inflation. GST revenues have also remained range bound and is slated to pick up in the coming months, with the increasing formalization of the economy and economic activity catching up gears.

On the Debt market front, markets have been volatile with the 10-year treasury yield touching a high of ~8.25% in September, largely due to rising US 10 year, sharply depreciating INR and spike in crude oil prices. However, if the INR depreciation is looked at from a three-year perspective, then the depreciation is ~4% pa, as the rupee did not depreciate in the last two years. Hence, normalization towards real effective exchange rate is quite natural. The government has tried to stem the incumbent concerns over impact of rising crude oil and rupee on CAD and fiscal deficit and IL&FS issue, by a slew of measures such as reducing duties on petrol and diesel, increasing tariffs on non-essential imports, easing ECB borrowings and abolishing withholding tax on Masala bonds and intervening in the IL&FS issue. Besides, the much needed breather to the yields came in from the open market operation (OMO) buyback of Rs.36,000 crore by RBI and the government truncating its annual borrowing programme for FY19 by ₹70,000 crore.

While the near term concerns are well documented, the longer-term outlook for the markets looks very sanguine. India has been in the midst of a structurally high growth phase and remains the fastest growing economy in the world with IMF projecting 7.3% and 7.5% GDP growth rates for FY19 & FY20 respectively. As indicators such as credit growth, reducing output gap and private investments pick up & with some revival in the capex cycle albeit gradually, along with an improving global environment, GDP growth is expected to improve further. Besides, the benefits of structural reforms such as Goods & Services Tax (GST), Insolvency & Bankruptcy Code (IBC), RERA, and JAM (Jan Dhan, Aadhar, Mobility) will start manifesting in the growth numbers, by removing inefficiencies and formalizing the economy. Corporate earnings have also troughed out after a protracted period of low growth and are expected to grow in healthy double digits for FY19 and FY20. The earnings growth will be led by rebound in consumption, peaking of credit cost for the financials as the resolution happens under NCLT. Post the recent correction, the valuations have also become reasonable at 17x 1 year forward earnings, which are a slight premium over long term average multiple of 16.5x. Furthermore, India could also attract large inflows with its reasonably sound domestic fundamentals relative to its peers and the various initiatives taken by the government to boost investment and reduce the CAD.

We thus expect the flows to remain robust going forward, as even the real interest rates remain positive (2.5% to 3%) , which drives away investments from physical assets such as real estate and gold.

From the debt market standpoint, the market is currently providing a great opportunity to lock in the current high yield. The current environment is more of a perception freezing over reality and we believe this environment shall not go on forever. We reckon that the current high interest rate scenario is only transient and would eventually ease out, as and when the global growth and inflation starts fading and the incumbent resultant problem of rising crude wanes out. Such times can only be deemed as a good opportunity to invest. We reminisce, when G-sec yields had touched a high of 9% in 2013, it almost fell to 6.5% in a span of two years and commensurately during the period the average return of income funds was upwards of 10%. Hence, we believe it is time to build a portfolio of high quality credit papers and wait for atleast ~3 years to start reaping the benefits from reversal of interest rate cycle.

With regard to Equity markets, volatility is an inherent feature of equity markets, especially after a year of good performance. We know that markets come back from every correction and eventually make new highs and the best way to partake in these times is to invest, and stay invested. As long-term investors, we understand the importance of investing in equities and the criticality of staying invested through these corrections, as these short term gains come with enticing long-term rewards. Equity is an asset class that has historically returned a very healthy premium over inflation - 7% on an average over the long term - and remains the best way to increase the purchasing power. This premium will continue, and in order to reap this, we need to stay invested in Equity. Going forward, as Indian markets continue to tide over volatility on domestic and global fronts; we have always strived to achieve good risk adjusted return for our funds across categories in Life, Pension as well as Group funds over the long term. In addition, we have been declaring good bonuses to our Traditional Policyholders. Insurance being long-term investment tool, it is advisable to remain invested and complete the term of the policy to optimize returns.

As Insurance is a vehicle to touch upon the lives of many by means of providing protection and savings, we would like to take this opportunity to thank you for entrusting your hard earned savings with us and look forward to your unflinching faith and continued support in future. We remain committed towards offering best-in-class products and services to our valued customers.

Regards,

Jyoti Vaswani
Chief Investment Officer

Global Economy

Global central banks remain in spotlight.

The US economy registered strong growth in the September quarter on the back of strong momentum in business investments and exports. The Federal Open Market Committee raised its GDP growth forecast for 2018 to 3.1% from its April forecast of 2.8%. It has forecast GDP growth of 2.5% for 2019 and 2% for 2020. The US Federal Reserve (Fed) raised its benchmark interest rate by a quarter percentage point to a range of 2-2.25%, marking its third increase this year.

The International Monetary Fund (IMF) lowered the UK's growth projection for 2018 from 1.3% to 1.1% on Brexit uncertainty. The Bank of England raised the interest rate to 0.75% from 0.50% in its August meeting. The European Central Bank (ECB) left interest rates unchanged, but reiterated its plan to scale down the size of its bond-buying programme in October and to end purchases in December. The ECB cautioned that although the Euro zone economy continues to expand, Brexit-related uncertainties could hamper growth.

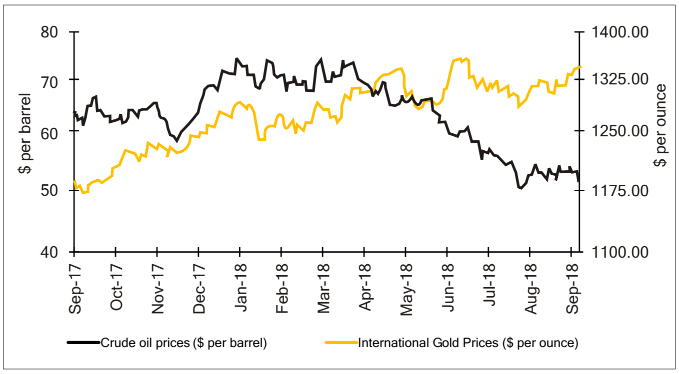
The Bank of Japan (BoJ) kept its monetary policy steady by maintaining its short-term interest rate target at minus 0.1% and its 10-year government bond yield target at 0%. BoJ Governor Haruhiko Kuroda added that the Central Bank is unlikely to raise interest rates for quite some time. The Chinese Central Bank, meanwhile, cut the reserve requirement ratio (RRR) by 100 basis points (bps) from 15.5% for large institutions and from 13.5% for smaller banks with effect from October 15 to spur growth amid the trade tussle with the US.

- The US economy grew an upwardly revised 4.2% in Q2 2018, much higher than 2.2% growth clocked in Q1 2018.
- The UK's economy expanded at an annualised rate of 1.2% in Q2 2018 compared with 1.1% in Q1 2018.
- The Euro zone's GDP expanded 2.1% annually in Q2 2018 compared with 2.4% in Q1.
- Japan's economy grew at an annualised rate of 3% in Q2; the economy had contracted 0.9% in Q1.
- China's economy expanded 6.7% annually in Q2, lower than the 6.8% annual pace in Q1.

Crude oil prices rose after the US restored sanctions on Iran; gold prices fell after the US Fed raised interest rates.

International crude oil prices rose after US President Donald Trump signed an executive order restoring sanctions on Iran, rekindling fears of supply constraints. Prices advanced further after major oil producers refused to raise output. International gold prices fell owing to gains registered by the US dollar in the wake of the financial crisis in Turkey, and on the back of encouraging US economic indicators and after the US Fed hiked key interest rates.

Chart 1 - Crude oil versus gold prices



Source: NYMEX, LBMA

Global Equity

Table 1 - Global benchmark indices returns

Indices	28-Sep-18	Quarterly % Change	Yearly % Change
DJIA (USA)	26458	9.01	18.09
Nikkei 225 (Japan)	24120	8.14	18.49
Hang Seng (Hong Kong)	27789	-4.03	0.85
FTSE 100 (UK)	7510	-1.66	1.86
Shanghai Composite Index (China)	2821	-0.92	-15.75
DAX (Germany)	12247	-0.48	-4.54
iBovespa (Brazil)	79342	9.04	6.80
MICEX (Russia)	2475	7.81	19.25

Source: Yahoo Finance, Bloomberg, Moscow Exchange

Global equity indices ended mixed.

US equities surged by 9% in the quarter on the back of encouraging domestic economic data. Sentiment strengthened after US Fed Chief Jerome Powell said the US economy is robust enough to handle tighter monetary policy. Japan's Nikkei advanced 8% tracking upbeat US markets and aided by weakness in the Yen. China's Shanghai Composite Index declined 0.92% after being put under pressure owing to the ongoing trade war with the US. Hong Kong's Hang Seng declined 4% over Chinese economic health concerns.

Indian Economy

India clocked strong economic growth in Q1 FY19.

International agencies remained optimistic about the domestic economy, which expanded strongly in the June quarter on the back of strong performance in the manufacturing and construction sectors. The Central Bank hiked the repo rate to 6.50% in its August policy announcement, its second consecutive hike after June, noting inflationary concerns. The Apex Bank, however, surprised markets in its October policy announcement by opting to maintain interest rates. Meanwhile, the government hiked import duty on 19 items to curb a widening Current Account Deficit (CAD) and support the rupee.

Among key reforms, the Cabinet cleared an increase in the Minimum Support Price (MSP) for kharif crops for the 2018-19 seasons to support farmers. Further, the GST Council approved a pilot project to give incentives for digital payments and President Ram Nath Kovind gave his assent to the Insolvency and Bankruptcy Code (Second Amendment) Act 2018. Prime Minister Narendra Modi launched the India Post Payments Bank which offers basic banking services and promotes financial inclusion, and inaugurated the Ayushman Bharat-National Health Protection Mission to provide health cover for underprivileged families.

- India's Gross Domestic Product (GDP) rose to 8.2% in April-June of fiscal 2019 compared with 5.6% in the same quarter last year.
- The United Nations Conference on Trade and Development (UNCTAD) expects the Indian economy to grow at 7% in calendar year 2018 compared to 6.2% in 2017.
- IMF retains India's FY 2019 growth outlook at 7.3% and says the country will grow at 7.4% in FY 20.
- India's retail inflation fell to a 11-month low of 3.69% in August from 4.17% in July.
- India's Current Account Deficit (CAD) as a percentage of GDP declined marginally to 2.4% in the April-June quarter of 2018-19 against 2.5% in the year-ago period.

Indian Equity

Table 2 - Indian benchmark indices returns

Sector Indices	28-Sep-18	Quarterly % Change	Yearly % Change
Nifty 50	10930	2.02	11.67
S&P BSE Sensex	36227	2.27	15.80
S&P BSE IT	15629	12.28	57.13
S&P BSE Oil & Gas	14855	8.76	0.09
S&P BSE Healthcare	15025	7.30	11.40
S&P BSE FMCG	11503	2.58	17.70
S&P BSE Metal	13279	1.64	-2.10
S&P BSE Power	1929	-0.88	-12.55
S&P BSE CG	17109	-2.17	-0.37
S&P BSE BANKEX	27992	-4.30	3.58
S&P BSE CD	19134	-5.31	9.00
S&P BSE Auto	21477	-9.91	-11.18
S&P BSE Realty	1703	-17.87	-17.55

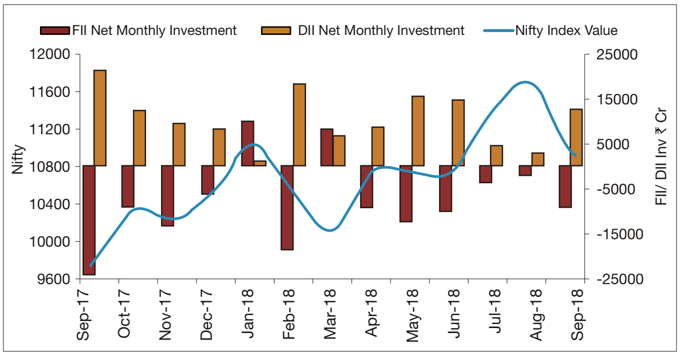
Source: BSE, NSE

Indian equities ended in the green aided by encouraging earnings announcements.

Indian equity benchmarks NIFTY 50 and S&P BSE advanced over 2% each in the September quarter aided by encouraging quarterly earnings announcements by index heavyweights, cooling in domestic inflation, and reduction in the GST rates on more than 50 items. Intermittent purchases by FIIs and DIIs provided support to equities.

Worries that the global trade war between US-China would hamper global economic growth dented investor confidence and triggered outflows sporadically. The market also fell after opposition parties tabled a no-confidence motion against the government in the Lok Sabha; the government won the motion. A massive sell-off in financial firms on liquidity concerns, rising crude oil prices, and nervousness about likely foreign investor outflows amid proposed changes in KYC norms for Foreign Portfolio Investments (FPIs) erased some gains. Turmoil in global equities amid the US Fed's decision to raise interest rates in September and rising uncertainty over Brexit negotiations between the UK and the European Union also pulled down the local indices. The RBI's interest rate hike by 25 bps citing inflationary concerns in August, the currency crisis in Turkey, and a sharp fall in Argentina's Peso after its Central Bank raised the interest rate to 60% prompted more selling in domestic equities.

Chart 2 - FII, DII versus Nifty movement



Source: NSE

- S&P BSE information technology advanced at 12.28% in the September quarter as the rupee's weakness aided IT exports.

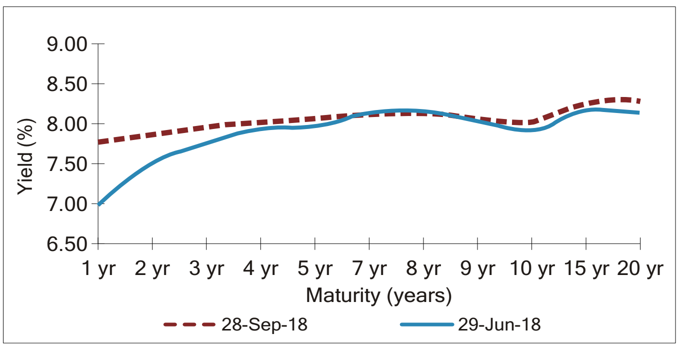
Equity Outlook

While the near term concerns are well documented, the longer-term outlook for the markets looks very sanguine. India has been in the midst of a structurally high growth phase and remains the fastest growing economy in the world with IMF projecting 7.5% GDP growth rates for FY19. Besides, the benefits of structural reforms such as GST, IBC, RERA, and JAM will start manifesting in the growth numbers, by removing inefficiencies and formalizing the economy. Corporate earnings have also troughed out after a protracted period of low growth and are expected to grow in healthy double digits for FY19 and FY20. The earnings growth will be led by rebound in consumption, peaking of credit cost for the financials as the resolution happens under NCLT. While one cannot rule out the volatility that may persist amid global and domestic concerns in the near term, Indian equity markets remain an attractive long-term bet for an investor.

- S&P BSE FMCG index rose to 2.58% aided by the Centre's decision to cut GST rates on more than 50 items.
- S&P BSE Realty declined to 17.87% as realty stocks witnessed a heavy sell-off after the Supreme Court imposed a ban on all construction activities in Madhya Pradesh, Maharashtra and Uttarakhand over their failure to deal with solid waste.
- S&P BSE Bankex index fell to 4.3% on liquidity concerns among banking and financial counters.
- FIIs sold Indian Equities worth ₹6785 crore in the September quarter vis-a-vis net sales of ₹20,443 crore in the previous quarter.

Indian Debt

Chart 3 - Domestic yield curve movement



Source: CRISIL Fixed Income database

Gilts fell on rupee weakness and strengthening crude oil prices.

Gilt prices weakened in the September quarter, with yield of the 10-year benchmark 7.17% 2028 paper closing at 8.02% on September 28, 2018 vis-a-vis 7.90% on June 29, 2018.

Prices declined because of the following reasons:

- The rupee declined sharply against the US dollar, hitting record lows, exacerbating fears of foreign investor outflows from the domestic financial markets.
- Global crude oil prices advanced, stoking fears of a widening in CAD and that the RBI would accelerate its interest rate hikes in the future, following the central bank's policy repo rate hike to 6.50% in August.
- Heavy supply of dated securities in the form of gilts and state development bonds put bonds under pressure.

Further losses were prevented by:

- Cooling in domestic inflation.
- The RBI's transfer of ₹50,000 crore as a surplus to the government, thereby soothing concerns over the government's fiscal situation.
- The RBI's announcement of bond purchase auctions through open market operations after monitoring systemic liquidity conditions and pledging to hold further OMO purchases through October.
- Reports that the RBI was mulling a special window through which oil companies can buy dollars directly from the Central Bank instead of the spot market.
- Expectations that the government may announce a lower borrowing target for the second half of this fiscal also propped up the prices. As expected, the government announced to borrow ₹2.47 lakh crore via bonds in the second half of the financial year, cutting the market borrowing by ₹70,000 crore.

On the regulatory front:

- The RBI surprised the market by holding interest rates steady in its October policy meeting. However, the Central Bank changed its stance to 'calibrated tightening' from 'neutral'.
- Further, the Central Bank proposed a Voluntary Retention Route (VRR) under which more flexibility will be accorded to foreign portfolio investors (FPI) in order to attract foreign investments. The RBI also said it will revise the asset-liability guidelines for non-banking financial companies (NBFCs).
- In addition, the RBI in its October policy review, projected GDP growth for 2018-19 at 7.4% with risks broadly balanced, ranging 7.3-7.4% in H2. GDP growth for Q1 FY20 is projected marginally lower at 7.4%. The banking regulator also lowered its retail inflation projection for the second half of the current fiscal to 3.9-4.5% mainly because of an unusually benign trend in food prices.

Debt Outlook

The 10 year G-sec yield has been rising amid concerns on rising US 10 year, sharply depreciating INR reflecting both domestic and global concerns and spike in crude oil prices. Nonetheless, going forward we expect the Indian bond yields to be range bound, given the pickup in indicators such as economic and credit growth led by reducing output gap, private investments pick up & some revival in the capex cycle albeit gradually, benign inflation, and initiatives taken by the government to ensure liquidity and solvency in the system and contain the widening current account deficit.

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