Macro, Markets & Strategy review

2018

May

UNIFI INVESTMENT MANAGEMENT

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Global developments | Oil on the Boil

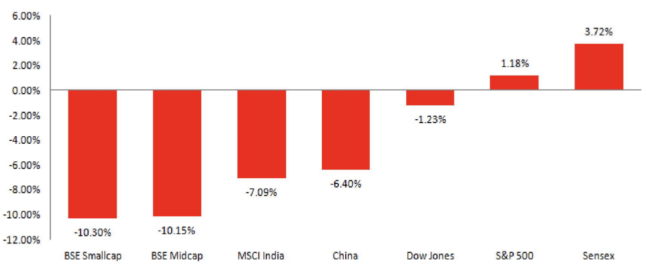
The economic data for the US economy continued to be strong with consumer confidence rising to 128 in May, a 17-year high while the Manufacturing PMI index came in at 56.6, second strongest improvement since September 2014. The US job growth accelerated in May with unemployment dropping to an 18 year low of 3.8%. The positive effects from the growth and the tax cuts announced by the Trump administration translated to a strong Q1 earnings season for the US companies. The S&P 500 saw its EPS grow by 24% YoY with revenue growth of 8% YoY and over ¾th of the companies reported better earnings than market forecasts. The strong show across economic indicators is expected to lead to an interest rate hike when the Federal reserve meets in mid-June. However, the market's fears over an aggressive tightening cycle have eased thanks to the dovish stance of the recent statements made by Fed officials. The US two-year yield fell by 6 bps over the month while the ten-year yield was lower by 9 bps.

Oil on the other hand, hit a new high of $80 per barrel for the first time since 2014. The rise was due to strong global demand, supply reduction from OPEC and geo-political factors. Contrary to his accommodative stance with respect to North Korea, President Trump withdrew from the Iran nuclear deal which led to heightened geo-political tensions and aided a spurt in Oil prices. The political and economic uncertainty prevailing in Venezuela, a major petroleum exporting country, is not helping matters. All eyes would be on the upcoming OPEC meeting on June 22nd wherein member countries will be deciding on the way forward in terms of daily crude output targets. The Indian macros have deteriorated off late given the pressure from crude and this will be a closely watched affair. The upcoming Fed rate hikes coupled with higher oil prices have turned the near term macro environment into a challenging one for emerging economies as risk averse capital moves back to the US.

World Markets

May was a month of negative returns for most of the markets with emerging market indices witnessing a sharp correction. US markets moved higher on the back of good earnings in Q1.

MSCI (in %)	India	Brazil	Russia	Korea	China	Japan	US	Australia	EM Index	MSCI World
MoM (in %)	-3.72%	-16.53%	0.99%	-5.24%	1.45%	-1.05%	2.20%	0.72%	-3.75%	0.31%
CY-YTD (in %)	-7.09%	-11.05%	2.19%	-3.57%	3.24%	-0.38%	1.38%	-4.38%	-3.26%	-0.50%

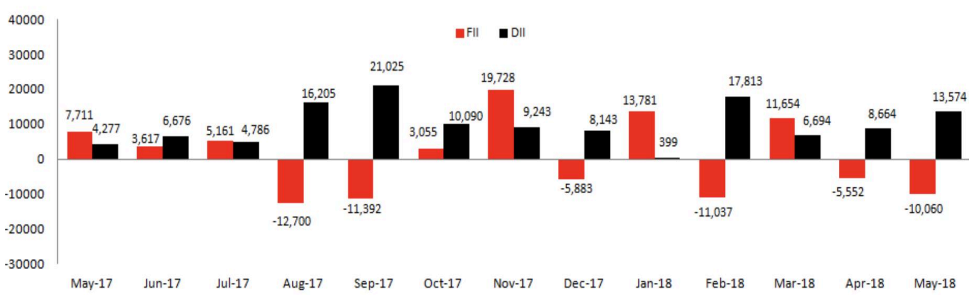


CY-YTD Returns

- BSE Smallcap was down 10.30%
- BSE Midcap was down 10.15%
- MSCI India was down 7.09%
- China was down 6.40%
- Dow Jones was down 1.23%
- S&P 500 was up 1.18%
- BSE Sensex was up 3.72%

Liquidities flow in India

FII fund outflows stronger| FII outflows were stronger in May compared to the previous month as fears of a Fed rate hike made investors pull back capital from Emerging markets. However, the DII inflows were stronger as domestic funds started deploying aggressively.



Inflation risks rise| RBI obliges

After sliding for three consecutive months, the Retail Inflation for the month of April came in at 4.58%, a tad higher than what the economists were expecting. More importantly, the core inflation, which strips the impact of food & fuel, hit a new 44 month high of 5.9%. A spike of 12% in the Indian crude basket, significant rise in households' inflation expectations in RBI's survey and staggered impact from the HRA revisions by various state governments forced the RBI's hand in increasing the repo rate by 25 bps to 6.25%.The Central bank now expects the CPI inflation to be at about 4.8- 4.9% in H1 and 4.7% in H2 of FY 19. The bank reiterates its neutral stance of monetary policy with the objective of reining in the CPI inflation at 4% within a +/- 2% band. The market has taken the rate hike in its stride with the neutral stance of the bank being seen in positive light. Nevertheless, the bond markets continued their upward trend with the 10 year yield poised to break the 8% levels.

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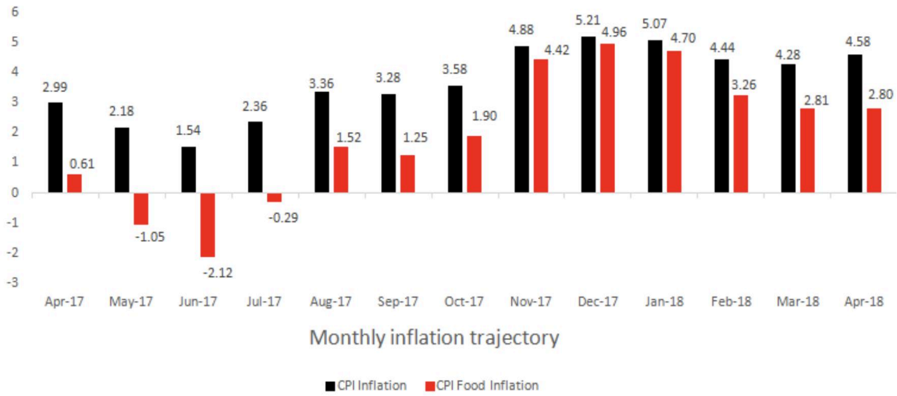

Unifi Strategy | Sticking to basics

It is a fact that the near-term macro environment has turned challenging for the Indian economy. Higher crude prices, weakening rupee against the dollar and higher bond yields have posed new road blocks for the fiscal deficit roadmap set by the incumbent government. The increasing political uncertainty as the country approaches the 2019 general elections magnifies these risks.

However, if one were to put things in perspective, the economy is recovering gradually post the Demonetization and GST related shocks that it went through over the last 2 years. It clocked an impressive GDP growth rate of 7.7% in Q4 of FY 18. This was on the back of a strong performance in the Manufacturing and Construction sectors. The manufacturing GVA grew by 9.1% YoY while construction GVA grew by 11.5% YoY. Investments also grew by 14.4% YoY as the government loosened its purse strings and awarded infrastructure projects on a large scale. The meteorological department has forecasted normal monsoons in FY19 with signs of an early onset. This should augur well for rural growth and related consumption demand. A steady month on month demand trajectory in automobiles, commercial vehicles and tractors points to early signs of the same. The much-awaited rollout of e-way bill will pave way to more formalization of the economy thereby leading to higher tax collections for the exchequer. The Q4 earnings season witnessed good earnings from consumption and commodity-based sectors though corporate banks continued to be a drag. The street is now forecasting a Nifty EPS growth rate of about 20-25% for FY 19 and FY 20. Overall, inspite of the near-term macro challenges, the economy looks to be on a stronger wicket as far as medium and long-term growth prospects are concerned.

We continue to look for companies which would benefit from the above themes while meeting our internal criteria on growth, capital efficiency and valuations. After a long time, the Indian equity markets are witnessing high volatility in price movements. We would use such opportunities to build long term positions in firms where we feel that the riskreward ratio is attractive. As they say in investing, one needs to be fearful when others are greedy and needs to be greedy when others are fearful. We believe that it is in volatile times like these that one needs to be patient and stick to the basic tenet of long term investing which is buying good companies at fair valuations and sticking with them over the long term.

Risk: Key risks to our portfolio would come from geo-political concerns globally, materially high foreign outflows, sharp currency movements, American and Fed policy 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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