December 2018

Monthly Commentary

India update

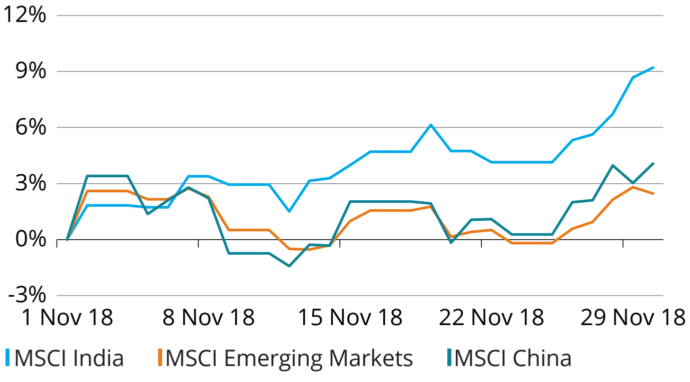
- Indian equities among the top gainers in emerging markets
- Lower oil price a boost to the economy
- Earnings growth remain stable

Market overview

Indian equities advanced in November and were one of the leading performers among emerging markets, as the oil price declined and the rupee firmed up against the dollar after the US Federal Reserve signaled that it would slow its pace of raising interest rates. Investors were further buoyed by steady corporate earnings and the Reserve Bank of India's intervention in the non-banking-financial-companies (NBFC) sector. Moreover, unlike other emerging markets, India stayed insulated from the US and China trade tensions, which provided investors with additional comfort.

September's GDP numbers missed expectations at 7.1%, as higher oil prices and a weaker rupee, weighed on growth. Notwithstanding the slowdown, India remained the fastest growing nation, globally.

India performed better than other EMs



Source: Bloomberg, November 2018

RBI to the rescue

The financial sector gained after the RBI infused liquidity into the system and relaxed the lending norms for NBFCs, to alleviate the pain caused by the IL&FS default. Investors rewarded well-capitalised companies with a solid funding base and robust balance sheet, that could navigate the these challenges. The private-sector lenders were a beneficiary of this distinction, as they gained market share from reduced competition from the NBFC consolidation amid tighter liquidity. The flight to quality boosted our core holding, **Housing Development Finance Corporation** (HDFC), which outperformed on good results. The lender reported solid growth in income and asset-under-management with stable asset quality. Moreover, the profits from the sale of HDFC Asset Management allowed the lender to set aside more for future contingencies. Investors also favoured quality private-sector leaders, such as **Kotak Mahindra Bank**.

Earnings growth remain steady

Overall, corporate earnings in the second-quarter met expectations. However, margins came under pressure as input costs rose. Growth continued to favour the consumer and energy sectors, while telecom and transportation was under pressure. Meanwhile, healthcare and real-estate trends turned positive.

Consumer staples faced margin pressures, although, some companies did better than others. **ITC**'s margins improved across all divisions, including cigarettes, as volumes grew and demand stabilised. Similarly, the fund's overweight position in **Hindustan Unilever**, a market leader in the fast-moving-consumer-goods sector, continued to see good momentum in volumes and results.

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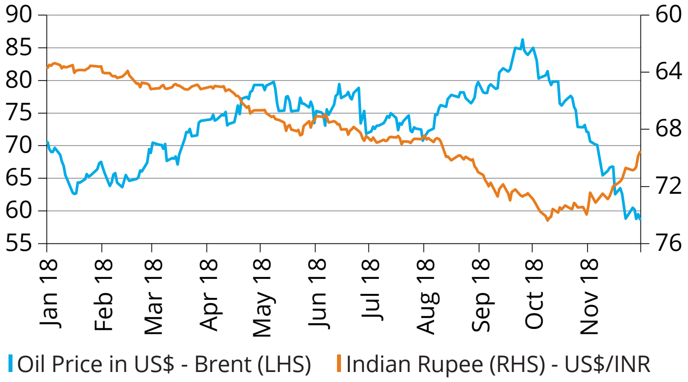
The recent roll-back in oil prices should also bode well for paint and cement companies by reducing costs and improving margins. In the previous period, however, its adverse effects were evident in recent results, which were muted. However, some companies fared better than others, as prudent cost optimisation, product mix and recovering pricing boosted operating margins.Notably, **Shree Cement** posted significant volume growth, whereas **Kansai Nerolac Paints** reported weak results.

Falling oil prices positive for the rupee and input costs



Source: Bloomberg, November 2018

What we've been up to...

In November, we raised our exposure in the IT services sector, adding to **TCS**, **Infosys and Mphasis**. Our holdings have continued to deliver solid results on the back of improving demand in their core US market and growth in digital services. They also benefited from a depreciating rupee, given that much of the revenues are in US dollar. Overall the sector's outlook remained positive.

Elsewhere, we added to **Kotak Mahindra Bank**; the lender is well positioned to take market share from the troubled public-sector banks and the NBFC sector. Against this, we took profits from **HDFC** after it rebounded from the NBFC sell-off.

Note: Any changes refer to those of our model portfolio, which is the basis for actual portfolios we manage that have similar investment objectives. However, there might be minor variations, so the comments may not apply to all portfolios.

Outlook

The outlook for Indian equities appears supported by macroeconomic factors. Its economy is the fastest growing, while remaining well insulated from the ill-effects of global trade tensions. Structurally, its large domestic economy is in a good position to withstand external shocks. Growth remains compelling, underpinned by structural positives of a young population and expanding middle class. Moreover, key local macroeconomic issues appear to be abating, thanks to the recent dip in oil prices and a pause in US rate hikes, as inflation remain benign. In addition, policymakers' efforts to infuse liquidity into the system have calmed the market. Also, in a pre-election year, government spending and policies should continue to support rural consumption.

That said, India remains vulnerable to oil price fluctuations and US-dollar strength. The rupee could face renewed pressure, given mounting concerns of an economic slowdown from tighter liquidity conditions and rising costs. Political noise could grow louder as the country enters the final stretch of the election season.

In such an environment, companies with pricing power and robust balance sheets will benefit. We remain positioned in companies that will continue to benefit from India's long-term consumption trends, as well as those that play into the strength of what the market has to offer in IT services and healthcare. We also view the current stress in the financial sector as an opportunity to build on our holdings in high-quality commercial banks with solid deposit franchises.

We hold the companies highlighted.

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