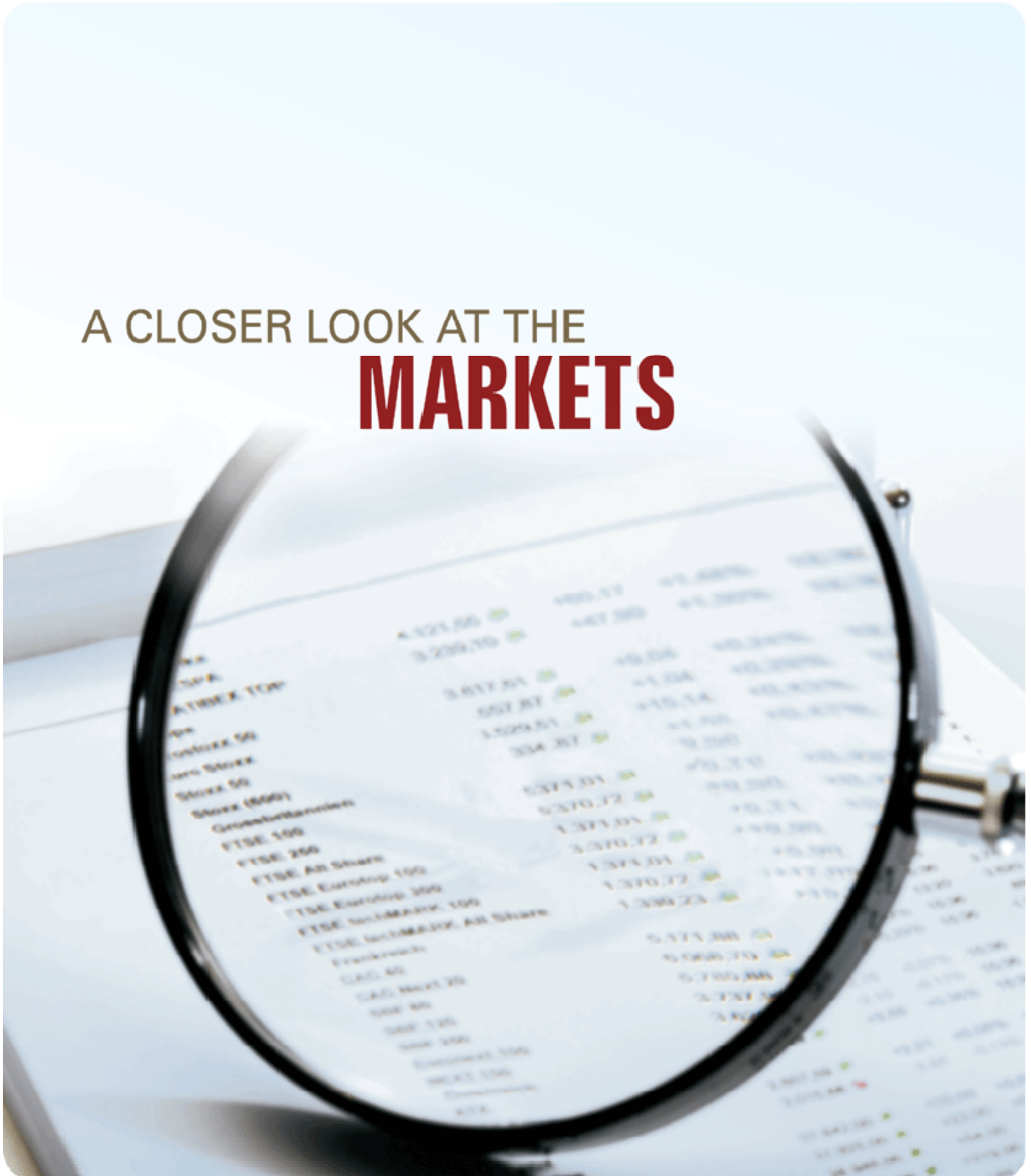


# A CLOSER LOOK AT THE **MARKETS**



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## House View

### Equity

- Domestically, the macro variables remain weak in terms of lower IIP numbers, lower guidance by many of the companies in terms of next year's profitability, inflation projection for FY13 at 6.5% (higher than comfort levels) and sustainability of higher global crude oil prices
- Although the sentiments remain weak, we do not expect the markets to fall significantly from current 5000 levels on the Nifty. However, lack of fresh positive trigger may prevent the markets from rising significantly. Therefore, markets are likely to trade in a range with stock specific movement depending on result outcome and news flows
- At 16500, the markets are trading at a P/E multiple of 13x FY13 EEPS of ₹ 1270, below its long term range of 14-16x. Therefore, it provides a margin of safety from a valuation perspective
- The investment strategy should be to start allocating some portion of the investible surplus at current levels while waiting for some clarity before deploying the remaining parts

### Debt

- The market would take cues from international developments and crude prices along with RBI intervention
- Yields on three month CDs fell by more than 200 bps from 11.5% to less than 9.5% while 12 month CD yields fell by 100 bps from 10.7% to 9.7%. Returns from ultra short term and short term debt funds are likely to moderate, going forward, but remain better placed from a risk-return trade-off perspective
- G-Sec yields are likely to provide trading opportunities since they have already moved significantly discounting the negatives. Dynamic bond funds with the flexibility to take some exposure to G-Sec should be considered by investors to capitalise on such opportunities

### Commodity

- In May the sharp correction in crude prices continued with crude prices falling by 5.7% from month to date from \$119.7 per barrel to \$112.8 per barrel. This slump in oil prices was due to weak jobs data in the US, weaker than expected trade data in China and political & economic developments in Europe
- An important event that would act as a trigger for crude oil prices in the near term would be the meeting between Iran and the west on May 23 that could help in diluting the premium attached to Brent crude because of geopolitical tensions. We expect crude prices to slump further if geo-political tensions subside and Euro Zone crisis revives
- As the demand for industrial metals is closely linked to world growth, going forward, the movement in the base metal prices is expected to be a function of global economic factors

### Gold

- Domestic gold prices touched an all-time high level on May 4, at ₹ 29580 surpassing the previous high set on November 16, 2011, on a declining rupee and buying support from central banks across the globe
- Two major important factors supporting gold prices are ultra-loose monetary policies of recent years that do not look like they are going to end any time soon and the problems in the Euro Zone that do not look like ending any time soon either
- International as well as domestic gold prices are likely to trade in a range as higher prices are keeping investors cautious while global macros are providing support

Downside risk looks limited from a valuation perspective. Therefore, investors should start allocating some portion of the investible surplus...

The debt markets remain attractive and offer a good investment opportunity due to a positive outlook...

Crude prices may slump further if geo-political tensions subside and on a revival of the Euro Zone crisis ...

Gold continues to provide an effective diversification to the portfolio although investors should avoid going overweight from an absolute returns perspective...

**Exhibit 1: Consolidated view and recommendation**

Equity		
	View	Recommendation
Short Term	<ul style="list-style-type: none"> <li>Markets are expected to take support at current levels</li> <li>News flows from European region (Greece and Spain) will have impact on the markets</li> </ul>	<ul style="list-style-type: none"> <li>High participation structures with auto call trigger to utilise upside potential</li> </ul>
Long Term	<ul style="list-style-type: none"> <li>Valuations looks reasonable and offer comfort in investing.</li> <li>Downside risk looks limited as compared to upside potential</li> </ul>	<ul style="list-style-type: none"> <li>Large cap and diversified equity mutual funds</li> <li>Our large cap direct equity stocks model portfolio</li> <li>PMS with a bias on stock picking since there would be very good buying opportunities available</li> </ul>

Debt		
	View	Recommendation
Short Term	<ul style="list-style-type: none"> <li>Range bound movement of yields at the shorter end of the curve after the recent sharprun up expected.</li> <li>G-Sec may provide trading opportunities as yields have already moved up sharply, however no secular rally expected</li> </ul>	<ul style="list-style-type: none"> <li>Aggressive investors may allocate part of the portfolio towards Dynamic bond funds</li> <li>Short-term debt mutual funds with good credit quality portfolio</li> </ul>
Long Term	<ul style="list-style-type: none"> <li>G-Sec yields are expected to be lower than current levels</li> <li>Shorter duration yields are also expected to come off from current elevated levels due to improved liquidity and lower inflation</li> </ul>	<ul style="list-style-type: none"> <li>Allocation to longer duration income and G-Sec funds with an investment horizon of one year and above in a phased manner</li> <li>Maintain investments in short-term debt mutual funds for better risk-reward trade-off</li> </ul>

Bullion		
	View	Recommendation
Short Term	<ul style="list-style-type: none"> <li>The outlook remains positive due to uncertainty surrounding management of high debt of European nations</li> <li>Volatile global currencies are also positive</li> </ul>	<ul style="list-style-type: none"> <li>Allocate part of the portfolio to gold to provide hedge to the overall portfolio</li> <li>ETFs are a better option for investment</li> </ul>
Long Term	<ul style="list-style-type: none"> <li>Neutral stance due to a sharp rally and significant outperformance in recent times</li> <li>Once the current uncertain economic scenario settles down, gold may underperform other asset classes</li> </ul>	<ul style="list-style-type: none"> <li>Avoid overweight position</li> <li>Maintain asset allocation</li> </ul>

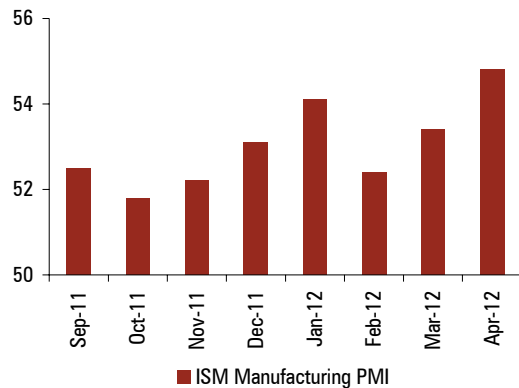
US and European policy makers are taking all unconventional liquidity easing measures to avoid any immediate shock to their own as well as global economy. However, individual governments are finding it difficult to carry out austerity measures to meet the European Union target due to social unrest against such programmes...

## Global economy

### European crises continue to haunt investor's sentiments...

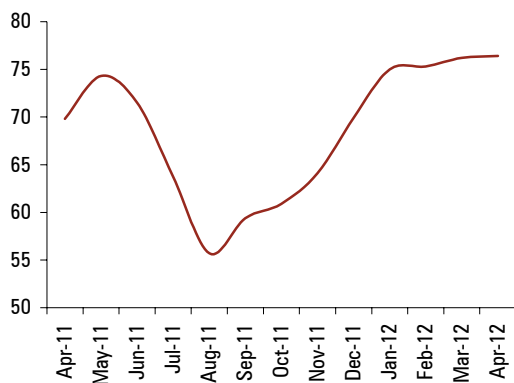
- The International Monetary Fund has raised its global growth forecast in April for the first time in more than a year to 3.5% for 2012 as compared to 3.3% projected in January this year. It sees growth of 4.1% in 2013 up from the earlier projection of 4.0%. The IMF has stated that it is seeing improvements in the global economy although that remains "very fragile."
- Global economic growth slipped in March, according to PMI surveys. However, the first quarter still saw the strongest expansion for a year. US, UK and Japanese upturns in Q1 contrasted with signs of recession in the Euro Zone and growth hitting a three-year low in China
- The upturn is also feeding through to the labour market, with March seeing the strongest worldwide payroll growth for a year, though job gains have been largely focused in the US. Despite higher oil prices, global price pressures remained far weaker than a year ago due to weak demand, boding well for inflation
- European crises have again attracted investor's attention with a sharp rise in yields of Spain and Italian government bond yields (rose almost 100 bps in the last month). Although ECB's three year LTRO had helped normalise market conditions, individual governments are finding it difficult to carry out austerity measures to meet the European Union target due to social unrest against such programmes
- Elevated levels of global crude oil prices have started to pinch almost all major economies, which has started to reflect in their inflation data points and policy maker's comments

### US ISM manufacturing PMI: Continues to grow proving comfort about stable recovery...



Source: Bloomberg

### University of Michigan consumer sentiments continue to improve...

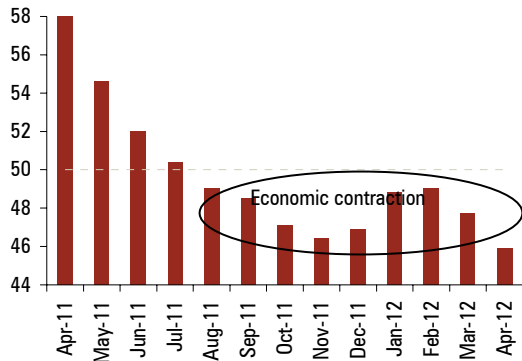


Source: Bloomberg

### US economy: Better than expected results and mixed economic data improving economic outlook...

- The January-March quarterly results in the US have been encouraging. According to Factset, of the 403 companies that have reported earnings for Q1 2012 to date, 72% have reported earnings above the mean estimate
- Retail sales in the US rose more than forecast by 0.8% in March and followed a 1% advance in February showing consumers are weathering the jump in gasoline prices heading into the second quarter
- US GDP growth eased to 2.2% QoQ (annualised) in the first quarter of 2012 from 3.0% QoQ gain in the prior quarter and compared to market expectations of 2.5%
- The Federal Open Market Committee (FOMC) left the target range for federal funds rate unchanged at 0-0.25% and made no change to its bonds purchase programme. The committee maintained its guidance on rate, stating "economic conditions are likely to warrant exceptionally low levels for rates at least through late 2014"
- The Institute for Supply Management's factory index, which indicates manufacturing activity, rose to 54.8 last in April 2012, more than expected

**Euro zone manufacturing PMI: Below 50 for a ninth consecutive month in March indicating economic contraction**

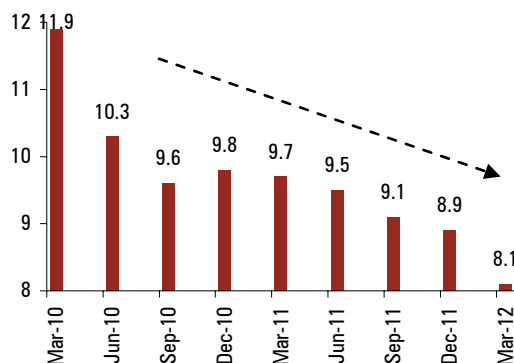


Source: Bloomberg

**Euro Zone: No clear visible solution to manage austerity and growth...**

- The ECB in its monetary policy meeting continue to adopt a wait-and-watch approach and maintained its policy rate at 1.0%, in line with market expectations. The ECB also left its deposit rate unchanged at 0.25% and the marginal lending rate unchanged at 1.75%
- In France, Françoise Hollande defeated President Nicolas Sarkozy to become the first Socialist President in 17 years. He pledged to push for less austerity and more growth in the region. Sarkozy is the latest victim of a wave of voter anger over spending cuts in Europe that has ousted governments and leaders in the past couple of years
- The election results in Greece indicate that Greek voters have spurned the ruling coalition government and voted in favour of anti-bailout parties, calling into question the country's ability to impose the austerity measures needed to ensure bailout funds. Greece in June is supposed to chalk out plans as to how they would be able to achieve €11.6 billion of savings for 2013 and 2014 to secure the terms of the €130 billion (\$169 billion) bailout from the European Union and International Monetary Fund. The results of the Greek election have added to the uncertainty and increases speculation that Greece may ultimately default given strong opposition to austerity measures demanded by EU and IMF
- Spain's economy plunged into recession in the first quarter of 2012, shrinking by an estimated 0.4%. It was the second straight decline in economic output after a 0.3% contraction in the previous quarter. Standard & Poor's downgraded its sovereign credit rating to BBB+ from A. Spain's short-term rating was lowered to A-2 from A-1 while the outlook on the long-term rating is negative. Concerns have risen that Spain will have to provide further fiscal support to the banking sector as the economy contracts
- The UK slid back into recession in the first quarter of 2012 as its economy contracted in the second consecutive quarter. Its GDP shrank 0.2% in the January-March quarter from the final quarter of 2011, when GDP declined 0.3%

**China GDP: Global slowdown impacting the export oriented Asian giant as well...**



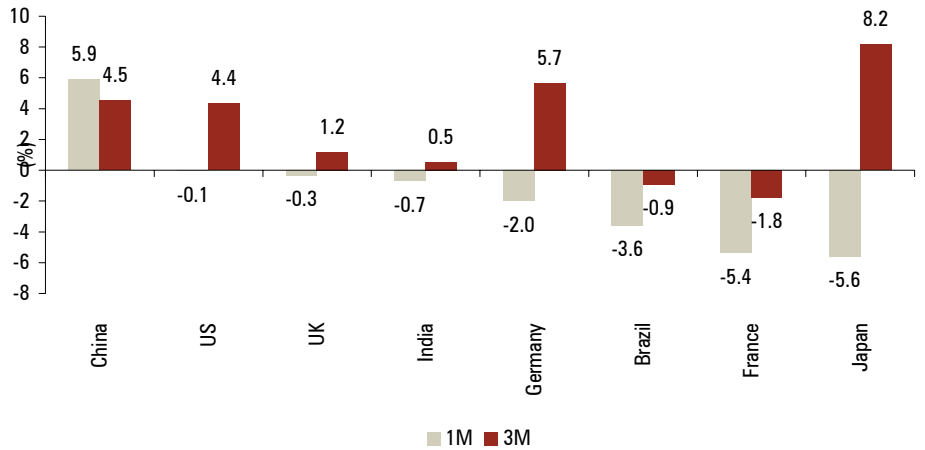
**China: Mixed economic data...**

- The HSBC Markit China manufacturing (PMI) hit a two-month high of 49.1 in April, up slightly from 48.3 in March. However, it still remains below the 50 level indicating contraction remains. Its official PMI rose to a 13-month high in April 2012 to 53.3 from 53.1 in March
- The Chinese economy grew at a slower than expected rate of 8.1% in the first quarter of 2012 from the 8.9% rate of growth in the December 2011 quarter
- In the January-March quarter, total retail sales of consumer goods grew 15.2% YoY indicating resilience among consumers

## Global equity markets: European concerns loom on global markets...

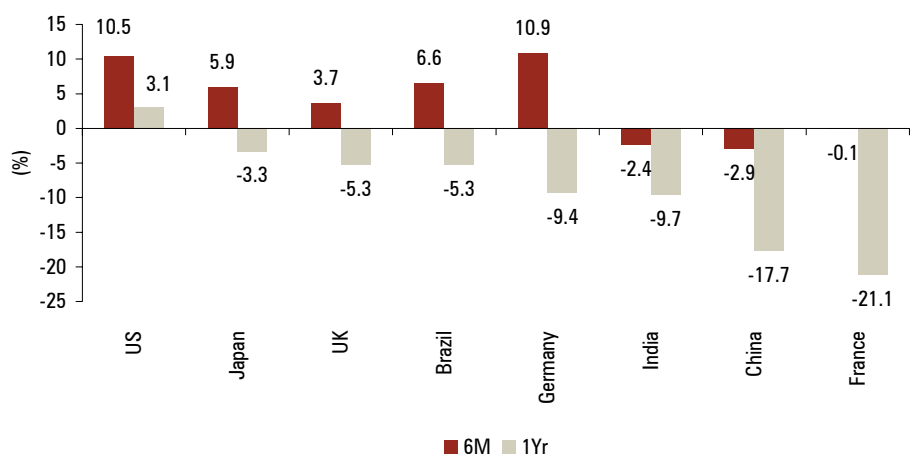
- Negative news flows from Europe and mixed data from the US and China kept global equity markets under pressure
- Japan underperformed on profit booking after the continued recent outperformance
- China outperformed as the market bounced back from recent lows after central bank intervention and hopes of slower-than-expected slowdown
- The US remained one of the best performing markets as better than expected results and improving economic data points helped it to attract investor's interest

**Exhibit 2: Easing global liquidity fuels equity market rally**



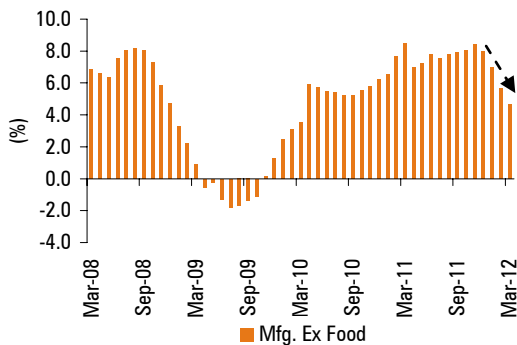
Source: Bloomberg, Returns as on Apr 30, 2012

**Exhibit 3: China remained major underperforming market due to policy tightening measures...**



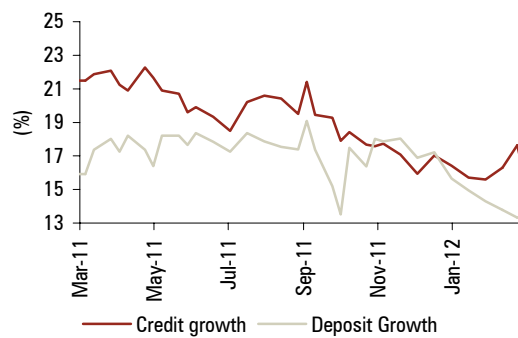
Source: Bloomberg, Returns as on Apr 30, 2012

**Fall in core inflation led to rate by RBI...**



Source: Bloomberg

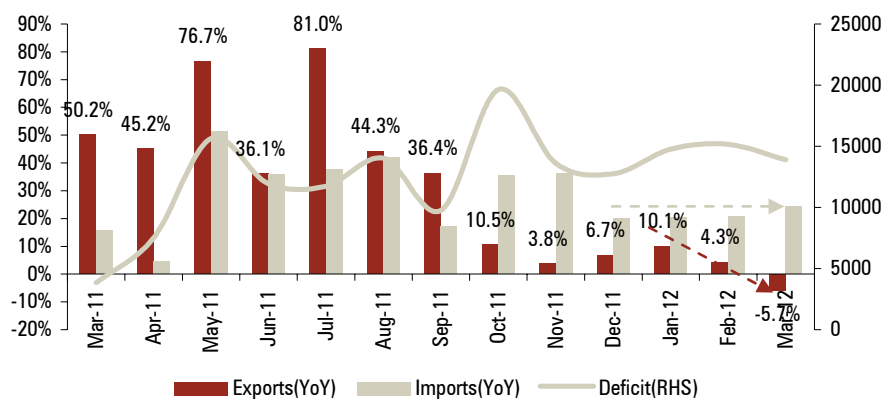
**Deposit growth (13.3% YoY) declines from the lowest level in FY12 ...**



**India: Weak exports growth leads to widening of trade deficit...**

- S&P, while retaining India's 'investment grade' rating, revised its outlook from 'stable' to 'negative' due to worsening fiscal numbers. It's a veiled threat that the sovereign rating may be downgraded from BBB-, which is the lowest-rung investment grade, to speculative grade. However, Moody's livened hopes as it said there was some reason for optimism due to interest rate cuts and prospects of a good monsoon. India's economy is "now growing below potential as a combination of bad luck and poor economic management weighs on sentiment", said Moody's
- The Wholesale Price Index (WPI) moderated to 6.89% in March 2012 from 9.68% in March 2011. Manufactured goods inflation, which has the highest weightage (64.97%), came down sharply to 4.87% while primary articles inflation started rising from -0.5% to 9.62%. Consumer Price Index (CPI), rose to 9.47% in March 2012 from 9.47% in February because of higher prices of milk, vegetables, protein-based items and edible oil products
- Bank deposits mobilisation grew 13.3% YoY while credit (loan) grew by 17.7% YoY as on April 20, 2012. We believe deposit growth is the key concern for the banks in FY13E, which remains at the lowest level (13.3%). It is observed that banks are reluctant to cut base rates by 50 bps (50 bps repo rate cut by the RBI on April 17) as deposits rate should also be cut by 50 bps to maintain margins, which would impact deposit growth negatively
- The crucial southwest monsoon is likely to be normal this year, as per the Indian Meteorological Dept (IMD). The same may be beneficial in containing primary article inflation
- India's exports in March fell 5.7%, the first fall since the 2009 global financial crisis as demand weakened in the US and Europe while imports of oil and gold remain high. The trade deficit for 2011-12 came in at US\$184.9 billion. The deterioration in the current account deficit is expected to further pile pressure on the rupee

**Exhibit 4: Negative exports growth having repercussions on deficit as well on currency...**



Source: Bloomberg

## RBI surprises with 50 bps rate cut but future cuts?

### Key policy statements....

- The RBI surprised us with a repo rate cut of 50 bps to 8%. However, it has indicated that future rate cuts may be limited due to upside risk in inflation
- The central bank has kept the CRR unchanged 4.75%
- Marginal standing facility (MSF) borrowing limit has been raised by 100 bps to 2% of NDTL while the MSF rate has been changed to 9.0%
- GDP growth target for FY13 has been projected at 7.3%. Also, FY12 growth is expected to be 7%
- M3 growth for FY13 is projected at 15% whereas it has fallen to 13% as on March 2012
- The path of inflation in FY13 could remain sticky around current levels due to high oil prices, large suppressed inflation and exchange rate pass-through, impact of freight and tax hikes, wage pressure and structural impediments to supply response. Inflation is expected to be 6.5% for FY13
- Growth in non-food credit of SCBs is projected at 17%. FY12 credit growth of 19.3% came way above the RBI's projection of 16%, thanks to the last 20 days lending in March 2012
- Aggregate deposits of SCBs are projected to grow by 16 %

### Developmental steps announced...

- Banks cannot levy foreclosure charges/pre-payment penalties on home loans on a floating interest rate basis
- To issue the final guidelines on the implementation of Basel III capital regulations by end-April 2012
- To issue the final guidelines on liquidity risk management and Basel III framework on liquidity standards by end-May 2012, after taking into account the suggestions/ feedback received
- To check finance to NBFCs predominantly engaged in lending against gold via reduction of their regulatory exposure ceiling in a single NBFC, having gold loans to the extent of 50% or more of its total financial assets, from the existing 10% to 7.5% of bank's capital funds.
- To issue final guidelines on securitisation by end-April 2012
- To issue guidelines on licensing for setting up new urban cooperative banks (UCBs) by end June 2012. Also, in order to facilitate enhanced priority sector lending, the RBI has decided to permit UCBs to utilise the additional limit of 5% of their total assets for granting housing loans up to ₹ 25 lakh, which is covered under the priority sector.
- Banks should have a board approved transparent policy on pricing of liabilities and should also ensure that variation in interest rates on single term deposits of ₹ 15 lakh and above and other term deposits is minimal
- As a step towards implementing Unique Customer Identification Code (UCIC) for banks' customers in India, banks are advised to initiate steps to allot UCIC number to all their customers while entering into any new relationships in the case of all individual customers to begin with

Similarly, existing individual customers may also be allotted unique customer identification code by end-April 2013

- To mandate state level bankers' committees (SLBCs) to prepare a roadmap covering all unbanked villages of population less than 2,000 and notionally allot these villages to banks for providing banking services in a time-bound manner. Detailed guidelines in this regard will be issued separately by the RBI
- To set up a working group to assess the feasibility of introducing more long-term fixed interest rate loan products by bank

**As per RBI, the policy actions taken are expected to:**

- Stabilise growth around its current post-crisis trend;
- Contain risks of inflation and inflation expectations re-surfing and
- Enhance the liquidity cushion available to the system.

**Gold loan NBFCs to be impacted due to pressure on incremental funds**

The RBI has guided that a ceiling be placed on credit to NBFCs with gold loan exposure to the extent of 50% or more of its total financial assets. This ceiling has been reduced from the existing 10% to 7.5% of bank's capital funds. However, the exposure ceiling may go up by 5%, i.e., up to 12.5% of the bank's capital funds if the additional exposure is on account of funds on-lent by NBFCs to the infrastructure sector. Also, banks will have an internal sub-limit on their aggregate exposure to all such NBFCs, having gold loans to the extent of 50% or more of their total financial assets, taken together.

This exposure ceiling should impact rapidly growing gold loan NBFCs like Mannapuram Finance and Muthoot Finance limiting sources of funds from bank financing. It may also keep a tab on rapid lending against loan done by players like India Infoline where gold loan forms 32% of the loan book as on Q3FY12 as against 10% in Q1FY12.

We expect an impact on south based banks like Federal Bank, South Indian Bank, etc., with high gold credit to be limited as they mainly disburse gold loan directly rather than through gold loan NBFCs. Detailed guidelines in this regard will be issued separately.

**Our view**

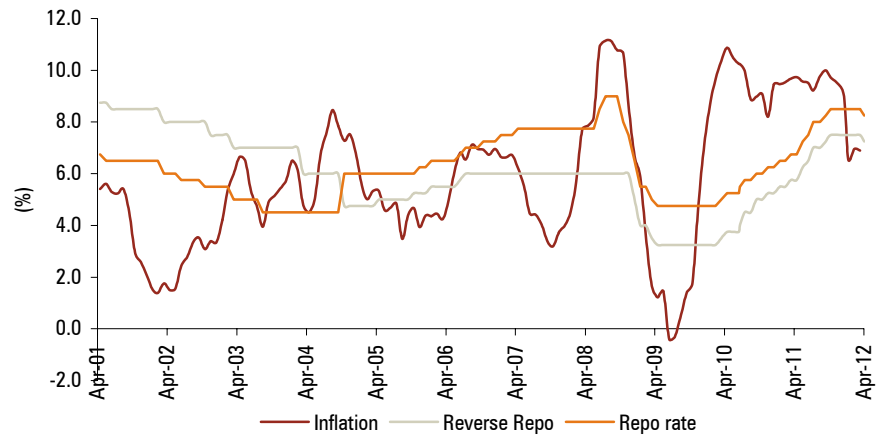
RBI's action makes it quite clear that it is changing its stance by moving towards growth faster than anticipated. As inflation has moderated from its peak to 6.89% in March 2012 with average full year inflation now standing at 8.85% for FY12 and LAF borrowing under control at ₹70000- 80000 crore, room for repo rate cut has been created.

Also, slowing IIP growth at just 3.5% on a YTD basis has dropped substantially. The deceleration in overall GDP growth is sharp and the recovery is seen hard; an aggravated rate cut can be justified.

Wholesale funded banks like Yes Bank, IDBI, and south based banks with lower CASA may benefit due to immediate easing in funding costs.

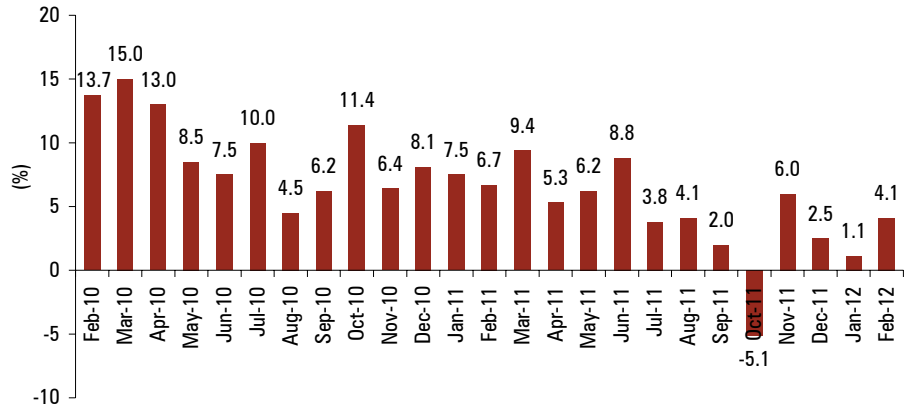
Overall, due to re-pricing of loans happening faster than deposit re-pricing, the NIM may contract in the near term for the banking sector. A slower first quarter may add to the woes. However, we expect credit growth to get a boost on account of increased demand from corporates undertaking capex. We expect banks to cut base rates by 25 bps but as base rates are a function of cost of funds, deposit rates and other borrowing costs should also decline for banks. However, the RBI has indicated that future rate cuts may be limited due to upside risk in inflation.

**Exhibit 5: First rate cut in three years...**



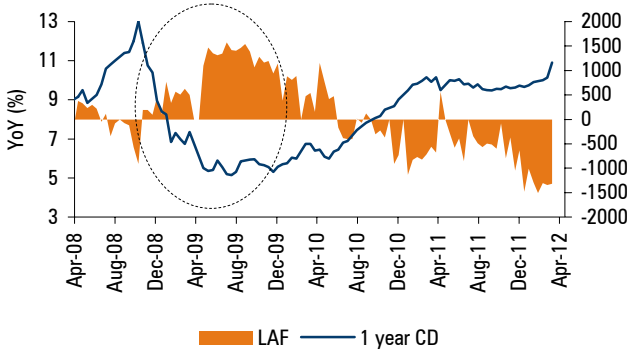
Source: RBI, ICICIdirect.com Research

**Exhibit 6: IIP contracting much faster – fostering need for cuts**



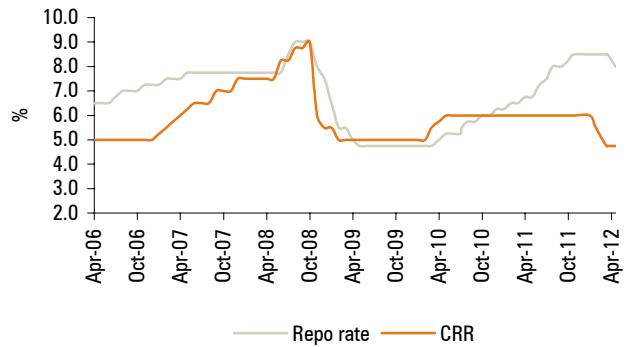
Source: Company, ICICIdirect.com Research

**Exhibit 7: Liquidity deficit in LAF window declining now...**



Source: Company, ICICIdirect.com Research

**Exhibit 8: Comfortable liquidity, dip in inflation offers room for rate cut**



Source: Company, ICICIdirect.com Research

## Equity investment strategy: Sentiments weak but start allocating some portion of the investible surplus...

- The overall results have, so far, been mixed but mainly in line with market expectation with no major disappointment
- The Indian markets have been underperforming the global markets due to uncertainty surrounding policy bottleneck and GAAR applicability
- Although the RBI's 50 bps rate cut is a positive development, expectation of no further rate cut in the near term is preventing the markets from breaking out of the range bound movement
- Domestically, the macro variables remain weak in terms of lower IIP numbers, lower guidance by many of the companies in terms of next year's profitability, inflation projection for FY13 at 6.5% (higher than comfort levels) and sustainability of higher global crude oil prices
- Although the sentiments remain weak, we do not expect the markets to fall significantly from current levels of 5000 on the Nifty. However, lack of fresh positive trigger may prevent the markets from rising significantly as well. Therefore, the markets are likely to trade in a range with stock specific movement depending on the result outcome and news flows
- At 16500, the markets trading at a PE multiple of 13.x FY13 EEPS of ₹ 1270, below its long term range of 14-16x, and, therefore, provides a margin of safety from a valuation perspective
- The investment strategy should be to start allocating some portion of the investible surplus at current levels while waiting for some clarity before deploying the remaining part

### Our Technical team's View

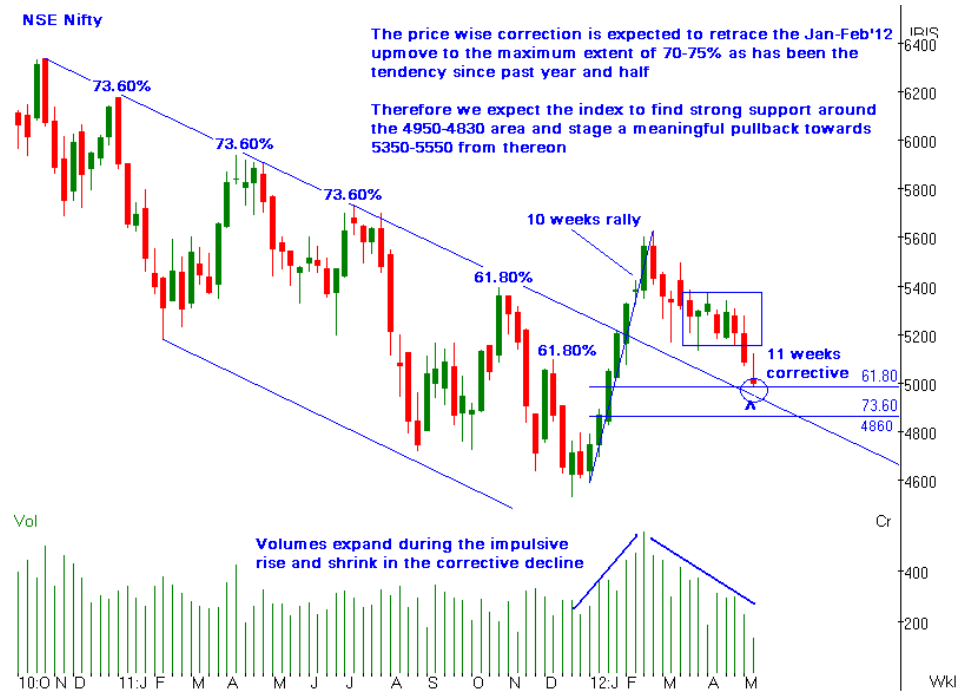
#### Key retracements likely to be turning points

The entire decline since the February 2012 highs appears to have the characteristics of a corrective leg of the impulsive rally witnessed during January-February 2012. On the volumes front also, the current decline is backed by receding volumes while the impulse move in January-February 2012 occurred with rising volumes. This clearly indicates the volume expansion during the break-out and lacklustre volumes during the corrective phase.

Over the past year and a half while indices remained in a downtrend, prices tended to offer ample of opportunities to get in and out of the pullback rallies and ensuing declines, respectively, as key retracement levels were duly respected. As highlighted in the adjoining Nifty weekly chart, majority of all pullbacks in the previous year's decline culminated precisely around the 70-75% retracement area, which is considered a critical reference point to determine the underlying trend.

The Nifty registered a break-out from the 14 month old declining channel on the back of a strong rally, which lasted for 10 weeks starting from the December 2011 lows. The current corrective leg has already surpassed the time wise correction of this rally while only retracing 61.80% of the up leg, which is placed at 4950 levels.

**Exhibit 1: Nifty Weekly Chart**



Source: Spider Software

Going by the evidence of the past year and half, we expect indices to follow a similar trend and respect the 70-75% retracement levels of the preceding rally, which also coincide with the major trend line supports placed around the 4950-4800 area, and post a meaningful pullback towards 5350-5500 in the medium term.

In the run-up towards 5350, the index may spend some time consolidating around the 5150 mark as the recent support region, which was a stronghold area for bulls for the past two months may prove a temporary resistance as weaker hands tend to get out of the rally at such important junctures.

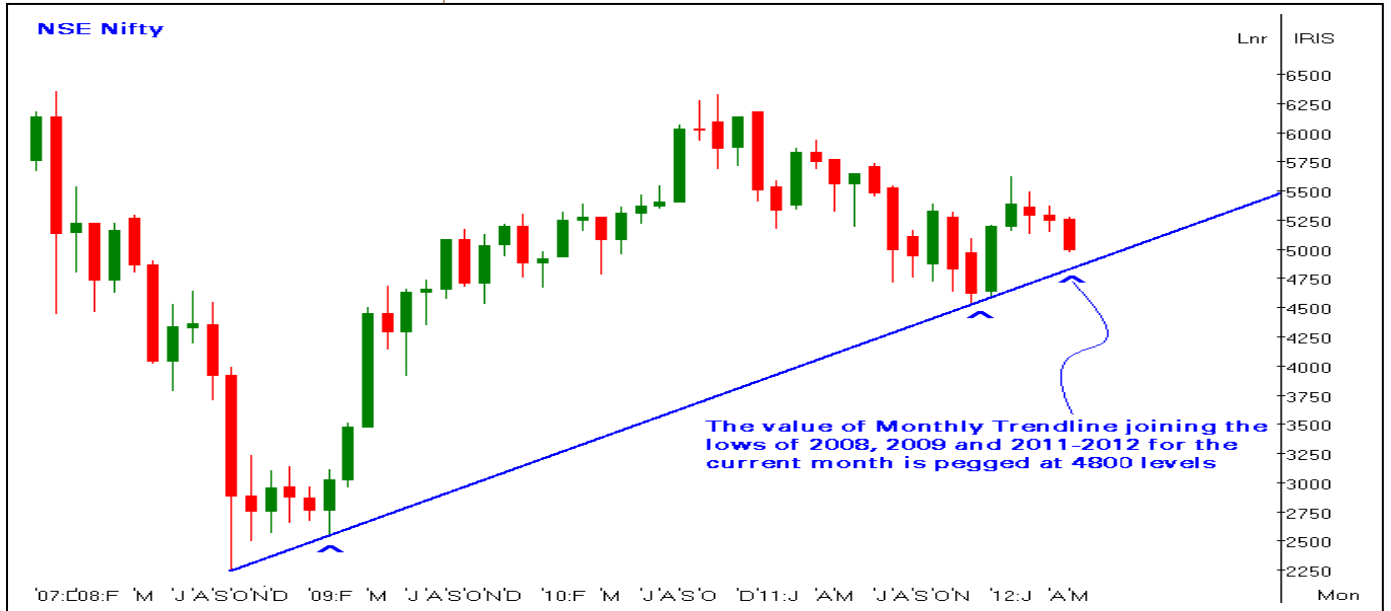
An eventual triumph over the 5150 level will infuse the necessary momentum to challenge the 5350 level, which is seen as a major hurdle in the near term, being the confluence of a Bearish Island reversal gap and the 61.8% retracement of the fall from February 2012 highs till date.

**Major supports identified in the range of 4950-4800**

- The 61.8% Fibonacci retracement of the entire rally from the December 2011 low (4531) to February 2012 high (5629) is placed at 4950 levels
- The upper band of the previous falling channel is also pegged around 4950. The upper band of the said channel, which had acted as a resistance in the entire decline of 2010-2011, is likely to reverse its role as a support as per the Change of polarity principle
- The key Fibonacci retracement, to the extent of 70-75% of the preceding rally, from the low of 4531 to a high of 5630 projects major support around 4860

- The value of the monthly trend line connecting the bottoms of 2008-2009 and 2011 is currently pegged around 4800 odd levels. Violation of this long term trend line would jeopardise the uptrend, leading to a re-test of the December 2011 lows

**Exhibit 2: Nifty Monthly Chart**



Source: Spider software

**Conclusion:**

After a breach of the two month old trading range, the index is likely to spend some time in the corrective phase. However, going by the evidence listed above, we believe the said corrective decline is likely to garner good buying support around the 4950-4800 region being the confluence of a major trend line supports and key retracement levels and head back towards the 5350-5500 levels in the medium term.

A change in view would be warranted if prices violate the long term trend line support of 4800 on a closing basis, which may lead to a re-test of the December 2011 lows.

## Direct Equity Model Portfolio

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Our model portfolio has been designed keeping in view the varied risk-return profile of different investors. Before constructing a portfolio, an investor should go through a self appraisal so that one can finally decide the contours of the portfolio that needs to be built in order to deliver reasonable risk-adjusted returns.

Our model portfolio contains a well balanced mix of large cap and quality midcap stocks, which, in our view, have the ability to deliver superior returns over a three to five year time frame.

Keeping our varied investor interest in mind, we have selected 35 quality companies and segregated them into 20 large cap stocks and 15 midcap stocks. These stocks belong to the BSE 200 universe as they provide a better representation of steady, matured and emerging businesses. The constituents of the BSE 200 index have been screened based on the quality of the management and several business parameters to arrive at a core list of around 35 stocks, which fall in the I-direct coverage universe so that continuous monitoring can be done.

After stock selection, we have further taken our exercise forward to bifurcate the above stocks into the three following portfolios:

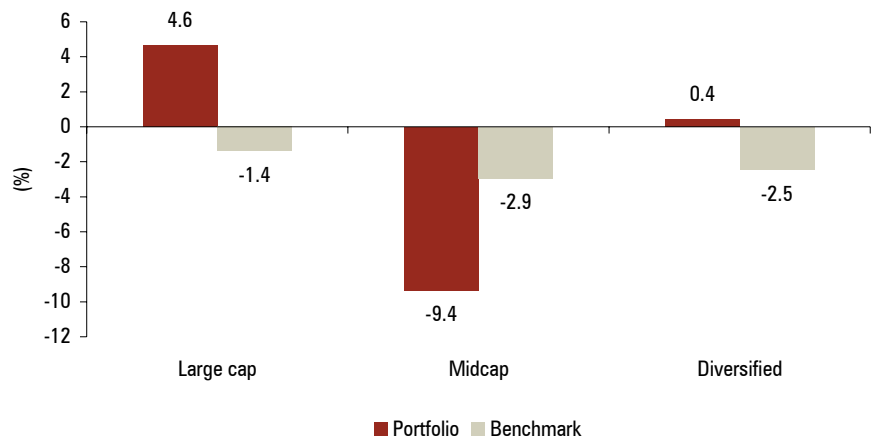
- Large cap portfolio (stable, consistent, low volatility)
- Midcap portfolio (high growth, relatively more volatile)
- Diversified portfolio (a blend of large and midcap portfolio)

On the basis of risk tolerance, return expectation and time horizon, one can mimic any of the above three portfolios, which we believe will cater to investors of all kinds.

**Model portfolio**

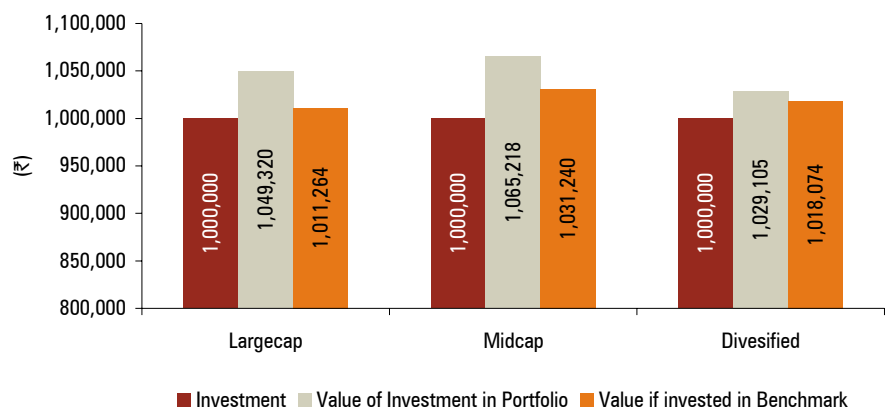
Name of the company	Model Portfolio(%)		
	Largecap	Midcap	Diversified
<b>Largecap Stocks</b>			
<b>Auto</b>	7	-	4.9
Maruti Suzuki	3	-	2.1
Tata Motors	4	-	2.8
<b>Bank</b>	24	-	16.8
HDFC	8	-	5.6
HDFC Bank	8	-	5.6
SBI	8	-	5.6
<b>Capital Goods</b>	8	-	5.6
L & T	8	-	5.6
<b>Cement</b>	3	-	2.1
ACC	3	-	2.1
<b>FMCG</b>	9	-	6.3
Asian Paints	3	-	2.1
ITC	6	-	4.2
<b>Metals</b>	12	-	8.4
Coal India	6	-	4.2
Hindalco	3	-	2.1
Tata Steel	3	-	2.1
<b>Oil and Gas</b>	13	-	9.1
Gail India	3	-	2.1
ONGC	4	-	2.8
Reliance	6	-	4.2
<b>Pharma</b>	4	-	2.8
Lupin	4	-	2.8
<b>Power</b>	3	-	2.1
NTPC	3	-	2.1
<b>IT</b>	14	-	9.8
Infosys	6	-	4.2
TCS	8	-	5.6
<b>Telecom</b>	3	-	2.1
Bharti Airtel	3	-	2.1
<b>Midcap Stocks</b>			
<b>Auto</b>	-	8	2.4
Exide Ind.	-	8	2.4
<b>Aviation</b>	-	6	1.8
Jet Airways	-	6	1.8
<b>Bank</b>	-	20	6.0
Federal Bank	-	8	2.4
Oriental Bank of Comm	-	6	1.8
Yes Bank	-	6	1.8
<b>Construction</b>	-	6	1.8
JP Associate	-	6	1.8
<b>FMCG</b>	-	6	1.8
Dabur India	-	6	1.8
<b>Oil and Gas</b>	-	6	1.8
GSPL	-	6	1.8
<b>Pharma</b>	-	14	4.2
Biocon	-	6	1.8
Glenmark	-	8	2.4
<b>Power</b>	-	8	2.4
PTC	-	8	2.4
<b>Realty</b>	-	6	1.8
Oberoi	-	6	1.8
<b>Retail</b>	-	6	1.8
Shoppers Stop	-	6	1.8
<b>IT</b>	-	6	1.8
Mahindra Satyam	-	6	1.8
<b>Media</b>	-	8	2.4
Dish TV	-	8	2.4
<b>Total</b>	100	100	100

**Exhibit 9: Equity portfolio performance since inception**



Source: Bloomberg  
Returns are as on April 30, 2012  
Date of inception of portfolios: June 21, 2011

**Exhibit 10: SIP performance in our Equity portfolios since inception**

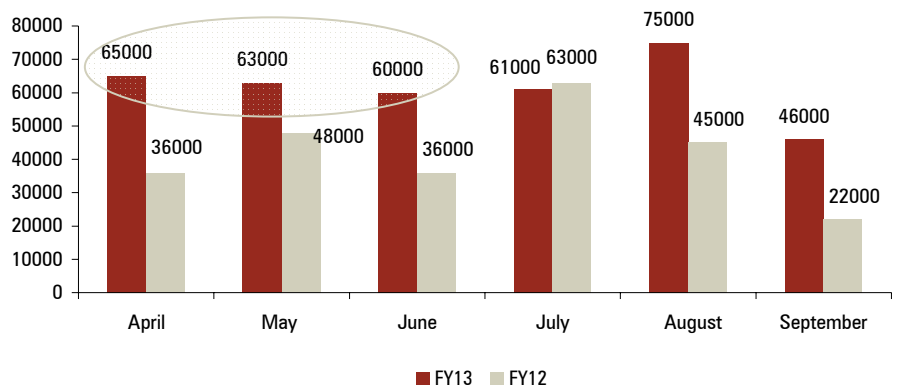


Source: Bloomberg  
Returns are as on April 30, 2012  
Date of inception of portfolios: June 21, 2011

## Fixed income investment strategy: Heavy borrowing to weigh on yields... RBI action keenly watched

- The primary market issuances under CDs during April were seen around Rs 6,663 crore, which was sharply lower than ₹ 1,03,864 crore worth of issuances made in March. The primary market issuances under CPs during April were seen around ₹ 18,500 crore, which was significantly higher than ₹ 750 crore worth of issuances made in March. The same reflects that supply from banks were significantly high and once that supply side pressure eased, CD rates eased off significantly by 100-200 bps
- Yield on government securities remained under pressure on account of macroeconomic concerns (fiscal deficit, trade deficit), sustained oversupply of and depreciating currency. Expectations of new 10 year benchmark also led traders to exit from the existing 10 year benchmark 8.79% 2021
- S&P revising its outlook on India from stable to negative weighed down on the sentiments adding pressure to the market. With LAF figures again crossing the one lakh mark market participants were anticipating OMO. However, with no fresh cues traders were refraining from building fresh positions
- The market would take cues from international developments and crude prices along with RBI intervention
- Yields on three month CDs fell by more than 200 bps from 11.5% to less than 9.5% while 12 month CD yields fell by 100 bps from 10.7% to 9.7%. Returns from ultra short term and short term debt funds are likely to moderate, going forward, but remain better placed from risk return trade off perspective
- G-Sec yields are likely to provide trading opportunities since they have already moved significantly discounting the negatives. Dynamic bond funds with the flexibility to take some exposure to G-Sec should be considered by investors to capitalise on such opportunities

**Exhibit 11: Supply pressure to continue to weigh on sentiments but higher G-Sec yields to provide trading opportunity**



Source: Bloomberg

[View](#)  
Positive

[View](#)  
Ultra-short term:  
Positive  
Short-term: Positive

[View](#)  
Neutral

## Category View

### Liquid funds

- The yield on short-term money market instruments has eased as liquidity pressure and supply eases after year end pressures
- Liquid funds continue to enjoy higher accrual income due to higher yields
- Short-term yields are currently offering a good investment opportunity. Therefore, investors should utilise it for parking their short-term surplus funds

### Income funds

- The yields of three months CD/CPs has eased considerably by around 200 bps aiding the returns of most of the ultra short-term funds
- The yields of 12 months CD/CP have also moderated by around 100 bps and has, therefore, resulted in better returns for most of the short term funds
- The corporate bond yields have also moderated taking cues from the ease in liquidity pressure. The same is expected to ease further. Therefore, ultra short-term and short term funds remain attractive
- The corporate bond spread in the one to three year segment is favourable. A lot of short-term funds have a significant exposure to this segment
- Investors should choose the highest possible duration depending on the investment horizon and risk appetite
- The longer duration corporate bond papers will take cues from G-Sec yields, which are expected to remain under pressure. Therefore, only aggressive investors may consider deploying some part of the portfolio towards longer term income with an investment horizon of more than one year

### Gilt funds

- Government borrowings are budgeted at ₹ 5.69 lakh crore (net ₹ 4.79 lakh crore) as against ₹ 5.10 lakh crore (net ₹ 4.36 lakh crore) in FY12RE
- Unless the RBI resorts to interest rate cuts or continues to conduct OMOs (which it did last year), G-sec yields will remain under pressure
- We have seen G-Sec yields moving lower whenever there is an RBI OMO announcement. Otherwise, it remained under pressure reflecting a supply overhang
- G-Sec yields are expected to provide trading opportunities as it has already risen sharply discounting the negatives. However, to capture the through G-Sec funds would be difficult

## Commodity: To remain subdued on weak economic recovery...

---

- Brent crude oil prices declined 4.7% MoM moving from \$125.6 per barrel to \$119.7 per barrel in April. Crude prices corrected sharply on account of renewed talks between Iran and the west (UN members) about Tehran's nuclear programme. Both parties agreed to have further talks, which led to hopes of easing of tension between Iran and the western powers. Crude prices also lost ground on account of a rise in crude inventory, which points to a slack in energy demand
  - In May, the sharp correction in crude prices continued with crude prices falling by 5.7% in month to date from \$119.7 per barrel to \$112.8 per barrel. This slump in oil prices was due to weak jobs data in the US, weaker than expected trade data in China and political & economic developments in Europe. An important event that would act as a trigger for crude oil prices in the near term would be the meeting between Iran and the west on May 23 that could help in diluting the premium attached to Brent crude because of geopolitical tensions. We expect crude prices to slump further if geo-political tensions subside and the Euro Zone crisis revives
  - Global steel production for March 2012 stood at ~132 million tonnes (MT), an increase of ~2% YoY and ~10% MoM. Production for the first quarter of 2012 was 377 MT, 1.1% higher than the first quarter of 2011 and higher by ~5.6% as compared to Q4CY11. Global capacity utilisation for the month under review stood at 81.1% indicating an improvement of ~1040 bps in the last three months (steel capacity utilisation ratio of 70.7% in December 2011). Chinese steel production increased ~3.9% YoY while production growth in South Korea was ~3.2%
  - In April 2012, steel prices (global HRC) remained flattish MoM at \$711/tonne. However, prices of key inputs such as iron ore have seen an increase on a sequential basis. China import Indian iron ore - 62% Fe grade (CFR) prices have increased marginally by ~1.3% MoM to ~US\$151 per tonne
  - On an MoM basis, April 2012 was a mixed bag for base metals, in general. On a sequential basis MoM, prices of lead and zinc increased ~5.7% and ~3.0%, respectively while copper and aluminium prices remained flat
  - As the demand for industrial metals is closely linked to world growth, going forward, the movement in base metal prices is expected to be a function of global economic factors
-

## Bullion: Weakening currency leads to gold rising to all time high levels...

- Domestic gold prices touched an all-time high level on May 4, at ₹ 29580 surpassing the previous high set on November 16, 2011, on a declining rupee and buying support from central banks across the globe
- Two major important factors supporting gold prices are ultra-loose monetary policies of recent years that do not look like ending any time soon and problems in the Euro Zone that do not look like they are going to end any time soon as well
- The government, on Monday, withdrew the 1% central excise duty levied on unbranded jewellery with effect from March 17. It also withdrew the duty levied on branded jewellery in 2011-12
- Mainland China's gold imports from Hong Kong surged more than six fold in the first quarter. Imports from Hong Kong were 135,529 kg (135.53 metric tons) between January and March, from 19,729 kg in the year-earlier period. Demand has climbed in the world's second-largest economy as rising incomes and curbs on property speculation boosted purchases. China may become the biggest user annually this year, according to a forecast from the producer-funded World Gold Council
- International as well as domestic gold prices are likely to trade in a range as higher prices are keeping investors cautious while global macros are providing support
- Allocation to gold from an absolute return perspective should be avoided. It should form only a small part of the overall portfolio from a diversification purpose

Global prices remain continue to remain subdued...

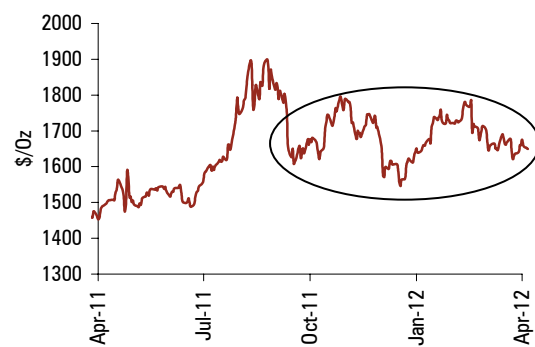


Exhibit 12: Indian gold prices touch all-time high level on May 4, at ₹ 29580...



Source: Bloomberg

Multicap portfolio with a bias towards high growth midcap stocks. High risk, high return allocation in the investment portfolio.

Group Management comprises of renowned stock pickers in the industry. The CIO is the founder of the asset management business since 1999 and the Fund Manager has been at the helm of the portfolio since 2007, bringing consistency in the fund strategy and management.

## Product ideas

### Portfolio Management Schemes (PMS)

#### Alchemy PMS – High Growth Strategy

The Alchemy High Growth Strategy is a multicap portfolio with a bottom-up stock selection strategy. The strategy was inception in 2002 and has consistently beaten its benchmark, BSE-500 in 9 out of the 10 years since then. The strategy is focussed on the India growth story and has a midcap bias - with the right stock picks; it has delivered a compounded, annual return of 28.3% against 18.7% given by the benchmark. The strategy has also delivered significant outperformance in the short term with 1-yr return at 2.4% v/s negative return of 9.8% for the index.

#### Portfolio Performance

as on 30.04.12	Alchemy High Growth	BSE 500	Outperformance
1 month	2.20%	-0.90%	3.10%
3 months	8.10%	2.30%	5.80%
6 months	4.30%	-1.00%	5.30%
9 months	1.20%	-5.80%	7.00%
1 year	2.40%	-9.80%	12.20%
2 years	3.40%	-2.50%	5.90%
3 years	21.10%	17.40%	3.70%
Since Inception	28.30%	18.70%	9.60%

Note: Performance is as on 30.04.12, performance is net of all expenses. Performance < 1yr is absolute, beyond 1 yr is CAGR

#### Key features

- The strategy aims at generating long term returns by investing in equities and equities related instrument across market capitalizations, with a Mid cap bias
- Alchemy was founded as a securities firm in 1992 by **Mr. Lashit Sanghvi** and **Mr. Ashwin Kedia**, who later co-founded Alchemy Stock broking with **Mr. Rakesh Jhunjunwala** in 1997; all three are experienced and successful investors in the Indian equity markets
- The asset management business was founded in 1999 and is headed by **Mr. Hiren Ved**, who is also the CIO and brings overall consistency in the investment philosophy of the firm. The High Growth Strategy is being managed by Mr. Chandraprakash Padiyar since 2007, who was earlier a fund manager with UTI AMC
- The portfolio allocation will be as follows:
  - Large cap >= 25%; to bring liquidity and stability to the portfolio
  - Midcap <= 75%; to participate in high-growth businesses
  - Smallcap <= 10%; to selectively pick multibaggers

- The investment and in-house research team focuses on selecting stocks by in-depth research that involves meeting more than 200 companies every year
- Portfolio monitoring is done continuously to enter, maintain and exit holdings, but stocks are bought from a buy-and-hold perspective, leading to low portfolio churn
- The portfolio has outperformed the benchmark in all calendar years from 2002 except for 2009 in which the portfolio underperformed due to a large cash allocation at the time of an unexpected and rapid market run up.

**Investment Rationale:**

- Long term outlook for equity, over a 3-yr horizon, remains positive in spite of the short term global and local macro-economic concerns and slowdown in growth
- Mid caps outperform large caps over a longer time horizon due to their high growth characteristics
- **Markets have corrected over the last 2 months from their early-year peaks and are trading at a discount to fair valuations, making it an attractive time to enter from a medium to long term perspective**
- PMS is an effective platform to take exposure to mid and small cap stocks in a portfolio due to fewer size and strategy constraints than an MF
- Alchemy High Growth PMS has delivered superior risk-adjusted returns in its past track record and the team is capable to outperform going forward also

**Investment Terms:**

Minimum Investment	Rs 25 lacs	Rs 50 lacs
Time period	Open ended	Open ended
Management Fee	2% P.A	2% P.A
Upfront Fee	2.25% of the subscription amount	1.75% of the subscription amount
Management Fee	Charged Quarterly	Charged Quarterly
Exit Load	1% Up to 12 months	1% Up to 12 months
Redemption	Daily	Daily

**Alternative Investments – Private Equity**

**TVS Shriram Growth Fund – Scheme 1B**

**Investment Strategy and Investment Team**

- The fund is the second scheme of the TVS Shriram Growth Fund after scheme 1A which was launched in 2008 and collected ~Rs.600 crore
- The fund seeks to generate attractive returns by investing in mid-sized, high-growth, consumer-driven companies. The fund will look to invest between Rs.50 – 80 crore in 8 – 10 companies
- The fund may take a stake in the company through a significant minority stake and PIPE (Private Investing in Public Equity)
- The fund will partner with the company in strategy, operational performance improvement and governance
- Target sectors:
  - Retail
  - Education
  - Healthcare
  - Food processing and FMCG
- Exit Strategy – Possible exit routes include secondary sale to another PE fund, strategic sale, listing, promoter buyback.
- **Senior management of the fund** has about 90+ years of experience in finance and operations.
  - a. The team is headed by **Gopal Srinivasan, a member of the TVS family who has founded 9 companies and has 25+ years of operational experience** in running companies on the ground
  - b. The fund also has on board, **D. Sundaram who is the ex-Vice Chairman and CFO of Hindustan Unilever** and brings with him a deep understanding of consumer businesses and corporate governance
  - c. **Manish Makharia, who was an Executive Director of Kotak investment banking** and set up the mid-market investment banking practice there has also joined the core fund management team recently
- The fund has already done a first close and has collected over Rs.400 cr. The first investment of the fund is expected to happen soon.

The team is headed by Mr. Gopal Srinivisan, who is a serial entrepreneur and is a member of the TVS family. Under him, the team had raised an Rs.600 crore fund in 2008 and is successfully managing the same

**Terms of the fund:**

Target corpus	₹ 500 crores, domestic fund including ₹100 crores greenshoe
Indicative <sup>1</sup> return	25% IRR
Sponsor Group Commitment	₹ 50 crores
Life of the fund	7 years (extendable for 2 years for exit + 1 yr by approval of Super majority)
Commitment period	4 years
Hurdle rate	10% p.a.
Carry	20% (catch-up after hurdle rate)
Management fees	2% p.a. of total capital commitment
Placement fees	1% of the capital commitment, if less than ₹ 5 crores
One time set up Fee	1% of the total capital commitment capped at ₹ 5 Crores
Operating Expenses	Actual capped at 1% p.a. of total capital commitment
Minimum Contribution	₹ 25 Lakhs
Notice period for capital calls	20 business days
Drawdown Schedule	<u>Initial Drawdown:</u> • 25% or ₹10 Lakhs whichever is higher <u>Balance drawdown:</u> • Upto ₹ 10 crores– On periodic basis in 4 to 6 installments • ₹10 crores and more– On deal by deal basis

1. Gross of tax, Not guaranteed

The first fund has invested across 9 deals in a span of 3 years

**Key strengths of the fund:**

- The senior fund team has over 90+ years of operational and investing experience. Gopal Srinivasan has founded 9 companies in the past and D. Sundaram is the ex-VC and CFO of Hindustan Unilever – they bring not just investing, but actual on-the-ground experience in running companies
- Direct origination of investment opportunities by the team – 5 out of 9 companies of scheme 1A were deals sourced directly and not through intermediaries, this implies better entry valuations and better relationships with the investee company
- Providing ‘Capability Capital’ to investee companies – high engagement involvement with investee companies in areas of operations, strategy, governance
- Track record of having committed 80% of Scheme 1A successfully in 9 deals in 3 years

**Investment Rationale:**

- The fund is a suitable opportunity to invest in a diversified private equity portfolio with an attractive risk-return profile
- The fund team has been running an existing fund and has strong senior management who are well-known and networked across industries and also have entrepreneurial experience

**Fixed Income: Corporate Bonds**

We are currently offering Tata Steel Perpetual Bonds along with other high yielding bonds and Rural Electrification Corporation Zero Coupon Bond to take advantage of the high yields currently available in the market. The Tax Free bonds of HUDCO & REC are also available in secondary market at attractive yields.

**Tata Steel Perpetual Bond**

**Key Features**

- Coupon at 11.80% semi annual
- Perpetual Bond with call option in the 10th year
- If call option not exercised by the issuer the distribution rate to be stepped up by 300 bps by Tata Steel
- Available in the ticket size of Rs.10 lakhs
- Credit Rating of AA

**Tax Free Papers of HUDCO/REC**

**Key Features**

- Interest Income on the bonds will be tax free
- Credit Rating of AAA/AA+
- Secured in Nature
- Bonds Issued by the Public Sector Units (quasi government companies)

**Indicative quotes**

The table gives the indicative level for the bonds offered, mentioning the rating, tenure, price, yield and quantum available. The availability and the price of these bonds can vary from day to day.

Issuer	Rating	Coupon	Maturity Date	Time to Maturity (Yrs)	Price	Yield (Ann)
Tata Steel Ltd	AA by CARE & BRWRK	11.80%	Perpetual (Call in 10 <sup>th</sup> Year)	Perpetual	110 -111	10.15% to 10.30%
REC ZCB	AAA CRISIL & CARE	0%	3-Feb-21	9.7	Dependent on trade date	8.40%-60% (pre-tax) & 7.80%-8.0% (post-tax)
Reliance Infra	AA+ CARE	10.70%	6-Jul-2026	6	104-104.5	10.20% to 10.30%
HUDCO Tax Free	AA+	8.20%	5-Mar-2027	15	100-101	8.10%-8.20%
REC Tax Free	AAA	8.12%	27-Mar-2027	15	101-102	7.89%-8.00%
Shriram City Union Finance	AA-, AA CARE	12.10%	25-Aug-2016	5	103-104	10.75%to 10.95%
Muthoot Finance	AA-	12.25%	13-Sep-2013	3	100-101	12.5%- 13.00%

**Investment Rationale**

- The tightening cycle started by the RBI to rein in the rising inflation has resulted in an increase in the interest rates across the yield curve
- Investors can use this opportunity to lock-in higher rates by investing in high yielding & high rated corporate bonds from a hold till maturity objective.
- The bonds can also give trading opportunities once the interest rate cycle reverses

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