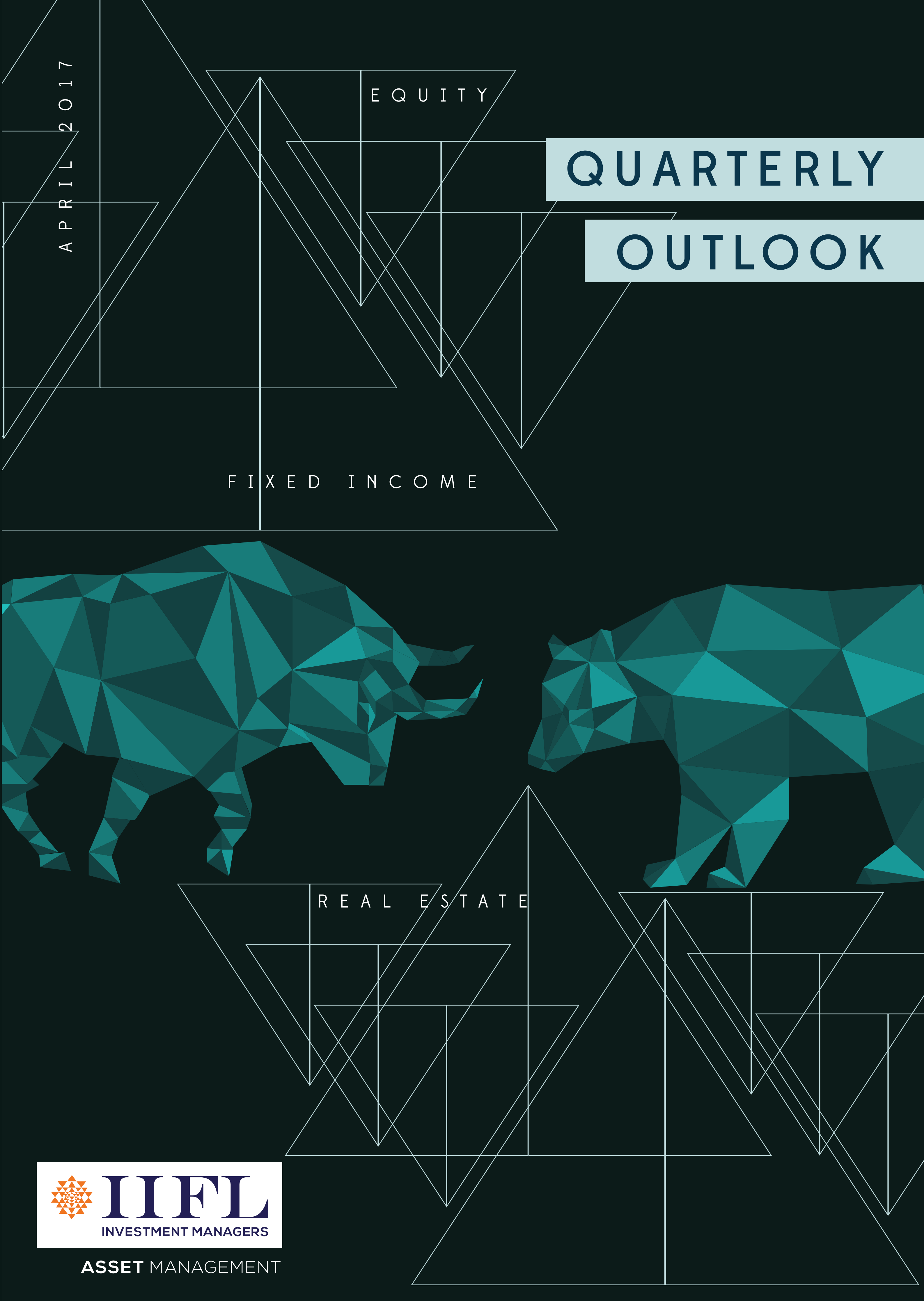

APRIL 2017
QUARTERLY
OUTLOOK
EQUITY
FIXED INCOME
REAL ESTATE
IIFL
INVESTMENT MANAGERS
ASSET MANAGEMENT

GREAT EXPECTATIONS! TIME TO BE CAUTIOUS

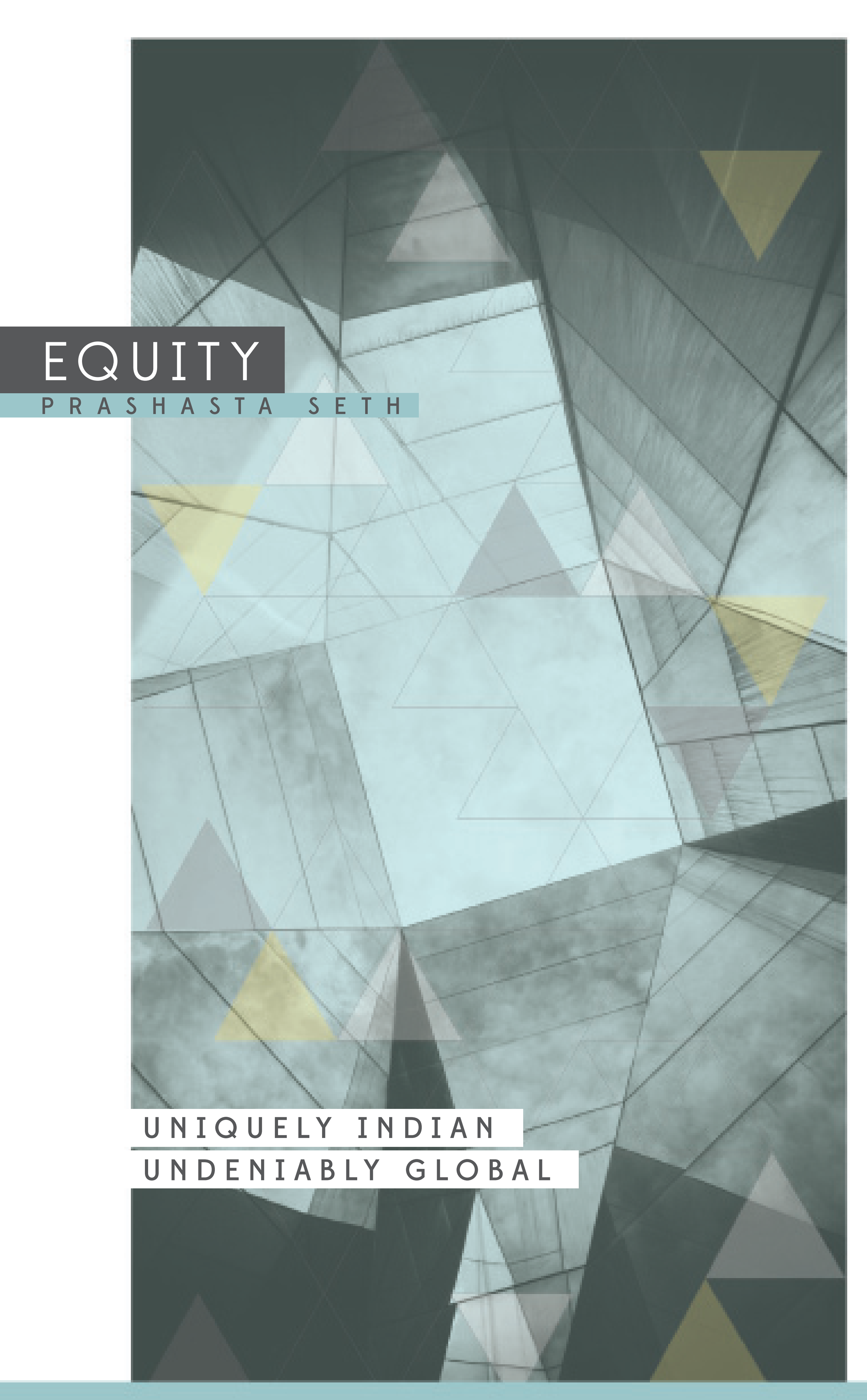
Most fears at the start of the year proved to be short-lived as the rally in equity markets continued unabated. Mutual funds received the highest net inflows in over a decade with US$52.89 bn entering various schemes; nearly US$6.78 bn came in via Systematic Investment Plans (SIPs) in FY17. With around US$0.21 mn active SIP accounts in the country, expect the inflows here to rise steadily in the coming quarters. FIIs returned with a vengeance in February after being net sellers during October-January. In March alone, FIIs pumped in over US$8.68 mn into the Indian market; some inflows were to take advantage of the grandfathering clause ahead of the implementation of the General Anti-Avoidance Rules (GAAR). We had a rare situation where foreign and domestic investors were net buyers for most days, taking the benchmark indices to all-time highs.

Among the tailwinds were the resounding victory by the BJP in most state elections, especially the landslide victory in UP, which boosted confidence of political stability in the country and raised hopes of accelerated reforms including timely implementation of the Goods and Services Tax. This also strengthened the Indian rupee, which had an inspiring run underpinned by a clear indication of an end to monetary easing cycle and narrowing inflation differentials between India and developed countries. On the debt side, the market has been sniffing for incremental bad news for the high yields to sustain. A few factors like rising probability of El Nino impacting the southwest monsoon, farm loan waiver and implementation of GST could keep inflation higher.

The IPO market has seen record-breaking gains and FY18 could be one of the best years in India's IPO history as over 50 companies could tap the capital market; the money being talked about is in the range of US$6.17 bn - US$9.25 bn and this could sterilize some of the FII inflows.

While there are reasons to be cautious, asset management companies, have seen a five-fold growth in the last decade and industry reports project it could touch US$308.4 bn this calendar year. Our strategy would be to scout for domestic stories with valuation comfort where the market isn't pricing in an aggressive recovery as yet. While earnings are likely to show improvement, the street seems to be overestimating the extent of recovery.

AMIT SHAH


EQUITY
PRASHASTA SETH
UNIQUELY INDIAN
UNDENIABLY GLOBAL

We have historically constructed our portfolios with focus on domestic consumption and have been underweight on industrials and private sector capex recovery for quite some time now. Our portfolios were focused on Autos, Retail-focused Private Banks and in sectors like IT & Pharma, which we felt, offer a margin of safety in a market where valuations look extremely stretched.

This strategy worked very well for majority of last year, but has seen a big reversal in the month of March'17 with cyclically-focused domestic sectors outperforming defensives by a wide margin. This has led to some marginal under-performance in the portfolio in the last one month.

There are few reasons that have led to this sharp up-move. First and foremost is liquidity, which is chasing few stocks. FIIs are known to be frantic buyers and they are buying in the market now. In March, not only India, but also other emerging markets received strong inflow of foreign money. India received ~US$5 bn in equities during March'17 alone, which was more than what was received in the previous 11 months.

Most of this money is coming through Exchange Traded Funds (ETFs) and not India-specific / emerging market-dedicated funds. This is not long term money, and can return quickly as well.

Additionally, post demonetization, the domestic liquidity environment is also looking exceptionally strong with mutual funds receiving inflows worth US$7.71 bn in the last few months with a monthly Systematic Investment Plan (SIP) of US$0.77 bn - US$0.93 bn.

The other factor that is helping the market now is the perception that one can safely play this market with a two-year, five-year kind of horizon.

Political stability translates into a lot of economic gains down the road. This is what the market has started discounting: political stability leading to a lot of continuity of economic policy. The third factor that is helping the market is expectations of economic turnaround given the visibility of green shoots in the global economy and better numbers seen in forward looking indicators like PMI.

We, however, continue to remain cautious; not because we don't think there will be a better environment for earnings going forward (second half of FY18), but because we think that just like the last few years, markets are overestimating the extent of recovery and are again likely to get disappointed. We have few reasons to be cautious:

a) **The economy is still not out of the woods –** The impact of demonetization on the economy has been mixed. Although some sectors such as passenger and commercial vehicles have hardly seen any impact, others such as two-wheelers and tractors have seen a sharp slowdown. However, credit growth remains very weak.

   While consumer sentiment has taken a hit, surprisingly, unemployment has fallen and wage growth in rural areas has ticked up. Foreign trade is seeing an uptick with export traffic at major ports at a five-year high. Government policies are helping the steel sector, with import substitution underway.

b) **Global markets are underestimating the political risks in US –** Since the failure of the Trump health care bill on March 24, the stock market has been positive, indicating 'the market' may term this to be a non-event. In light of the failure to repeal and replace the "Obamacare" healthcare bill, a negative momentum seems to be growing.

   The continuing pattern of weak US nominal GDP growth and the related weakness in corporate revenues is a reminder that the S&P500 should not be where it is unless the promised tax cutting policies

are implemented. Profit margins, and therefore corporate profits, are now under pressure after so many years of cost cutting, in part because wages are finally rising.

A decline in corporate profits is likely to lead to retrenchment in capital spending, or the opposite of what markets have of late been hoping for.

c) **Earnings downgrade cycle might still continue –** Despite an improvement in the economy after the demonetization shock, the earnings downgrade cycle has continued. In the past month, consensus Nifty EPS for FY18 has seen 6% downgrade and that for the wider BSE100 has seen 5% downgrade. Commodity sector companies have seen the highest upgrades whereas the large downgrades were concentrated in sectors such as banks, telecom, and consumer discretionary.

   Consensus estimates still imply doubling of profit growth (ex-PSU banks and metals) to 15% in FY18, which looks optimistic to us, given limited scope for margin expansion. We don't foresee such sharp earnings upgrades, and on the contrary believe downgrades might happen in the recent quarter.

   Markets aren't pricing in the risks that might come in that period due to a big global sell-off, possibility of a poor monsoon (as predicted by Skymet) and farm loan waivers by multiple states, which have the potential to derail the improvement in fiscal situation that we have seen improving so far.

Given significant uncertainty over growth, we believe stocks with rich valuation multiples are vulnerable from both, earnings and valuation perspectives.

Thus, we prefer stocks and sectors with low earnings and valuation risks. Indian valuations at 23x trailing are +2SD from the mean and are indicating caution. We have been looking to progressively reduce risks from our portfolio and invest into stocks where earnings risk and valuation risks aren't high.

As a result, we continue to maintain sectors like IT, utilities where markets are not pricing in any substantial recovery. At the same time, we are looking for domestic stories where the markets aren't pricing in an aggressive recovery and which offer valuation comfort.

As a whole, we think the domestic-focused stocks are extremely overpriced. We do see some reasonably priced stocks in sectors like power and roads where we have strong visibility on growth going forward. We are looking to selectively increase our exposure in such counters.

FIXED INCOME
RITESH JAIN
UNAFRAID TO BE
UNCONVENTIONAL

The year 2017 did not begin on a very strong footing for the Indian debt market with yields still being a matter of concern. Market was looking for incremental bad news for the high yields to sustain. However, its absence led to short squeeze in beginning of March. India's fiscal deficit in the April-February period of the FY17 touched US$93.45 bn or 113.4 % of Budget Estimates for FY17 – as against 107.1 % of Budget in the same period of last year, government data showed. India's current account deficit stood at US$7.9 bn (1.4% of GDP) in the third quarter of FY17.

That was higher than US$7.1 bn (1.4% of GDP) in the year-ago quarter and US$3.4 bn (0.6% of GDP) in the preceding quarter.

The CPI inflation increased for the first time in seven months to 3.65% in February 2017 from 3.17% a month earlier, which was led by an increase in the inflation for food & beverages and fuel & light.

India's wholesale price index (WPI)-based inflation flared up to a two-and-a-half year high of 6.55% in February from 5.25% in January mainly due to a spurt in mineral and fuel prices while food prices started rising following rapid remonetisation. There are some upside risks to inflation in the coming quarter. These would be mainly due to the following:

- **Monsoon:** Rising probability of El Nino impacting the southwest monsoon and thereby food inflation. However, better supply management and record production in FY2017 would help in controlling food prices.
- **Increase in Housing Rent Allowance (HRA) under 7th Central Pay Commission (CPC):** Implementation of the HRA under the 7th CPC in FY2018 would raise the baseline inflation trajectory by 100-150bps over the 12-18 months. However, the Reserve Bank of India (RBI) has mentioned earlier that it will see through the impact of HRA implementation as transitory
- **Farm loan waiver:** The fiscal deficit of the state governments is expected to be impacted by the implementation of the farm loan waivers.
- **Implementation of GST:** With the Goods and Services Tax (GST) regime expected to be rolled out by July 1, 2017, the initial impact is expected to be a bit inflationary (especially in the case of service tax).

In its recent policy meet, RBI maintained the neutral stance of monetary policy by keeping the key policy rate unchanged. This was in line with expectations. However, the RBI surprised the markets by narrowing the LAF corridor by 25bps (from 50bps earlier).

The objective was to bring the overnight money market rates in finer alignment with the policy rate. Accordingly, the reverse repo was raised by 25bps to 6% and the rate under the Marginal Standing Facility was narrowed by 25bps to 6.50%.

The RBI has re-iterated its neutral policy stance. It has clearly preferred to adopt a "wait and watch" approach in the latest meeting and stated that further rate actions will hinge on upcoming data.

While the upside risks to inflation remain balanced at the current juncture, pick-up in rural wage growth, an adverse base effect, uncertainty around southwest monsoon and narrowing of the output gap could have a bearing on headline inflation.

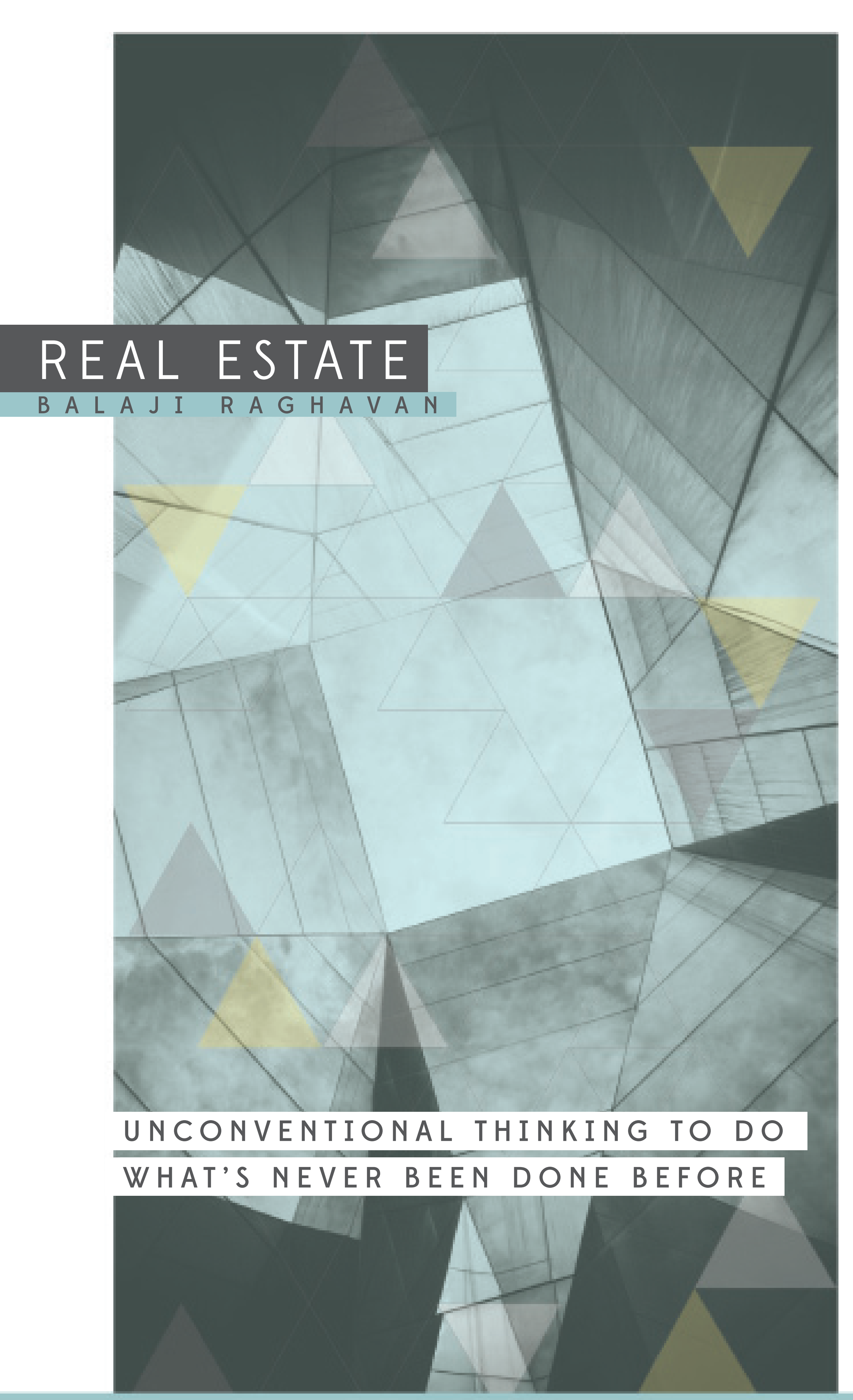
We are also seeing FII investors returning back to India in flocks, after RBI reiterated its commitment to maintain CPI inflation at 4% in the medium term. We had seen an exodus of FII money post the US elections, when hopes of

a strong recovery in US economy was expected. However, the Trump administration's ability to push reforms is being tested and the US Fed seems to be patient in hiking rates even after achieving the CPI inflation target of 2% and unemployment rate of 4.5%.

We believe liquidity will continue to remain easy for the next four quarters due to RBI forex intervention and with the economy becoming less cash-dependent.

This should make the short end of the yield curve steady and investors will get the benefit of roll down by buying papers following a steep yield curve. The rise in upgrade-to-downgrade ratio suggests an improvement in the credit environment.

This, along with the existing surplus liquidity could bode well for the shorter end of the yield curve. With resumption of new auction calendar supply along with high issuance of State Development Loans (SDLs) and (Ujwal Discom Assurance Yojana) UDAY Bonds, the medium and longer end of the yield-curve could continue to remain under stress.



REAL ESTATE

BALAJI RAGHAVAN

UNCONVENTIONAL THINKING TO DO WHAT'S NEVER BEEN DONE BEFORE

The recently released government data indicates that the demonetization exercise had a contained impact on economic growth. With that backdrop, most developers are reporting a slow recovery in sales. Developers across the country have been quick to launch schemes addressing the market situation. The maximum traction is reported in affordable or mass-affluent housing projects, where end-users have also been buoyed by the easy availability of cheaper housing loans. On the other hand, inventories continue to increase in the premium and luxury segments, with some markets witnessing price corrections.

The main urban centres continue to grow with renewed demand impetus for good commercial real estate space. The government has also notified revised norms for Real Estate Investment Trusts (REITs). Many industry players, including large domestic and foreign funds have stepped up exposure to this segment, or launched funds to address this opportunity. This has laid the foundation for a good secondary market in this space. The government has taken the challenge of urban housing shortage head-on, and emphasized the need for affordable housing to support this growth. It has announced incentives for timely launch and completion of affordable housing projects. It has also accorded "infrastructure" status to such projects to provide them access to cheap capital. The government has also removed most Foreign Direct Investment (FDI) restrictions in a bid to attract capital into the sector.

The industry is now gearing up for the fundamental change that the introduction of Real Estate Regulations (and Development) Act [RERA] will bring. The focus is on re-establishing consumer rights and bringing transparency into the entire buying experience. The Act lays down an operating mechanism to monitor cash flow, ensure timely completion of projects, and enforce adherence to local development rules. States are following up with notification of local RERA guidelines and the setting up of local real estate regulators, as well as appellate tribunals. The Act is forward looking, far reaching and encompasses all industry players including developers and brokers. The industry is reconfiguring to change all aspects – from design to construction, sale, delivery and asset ownership experience.

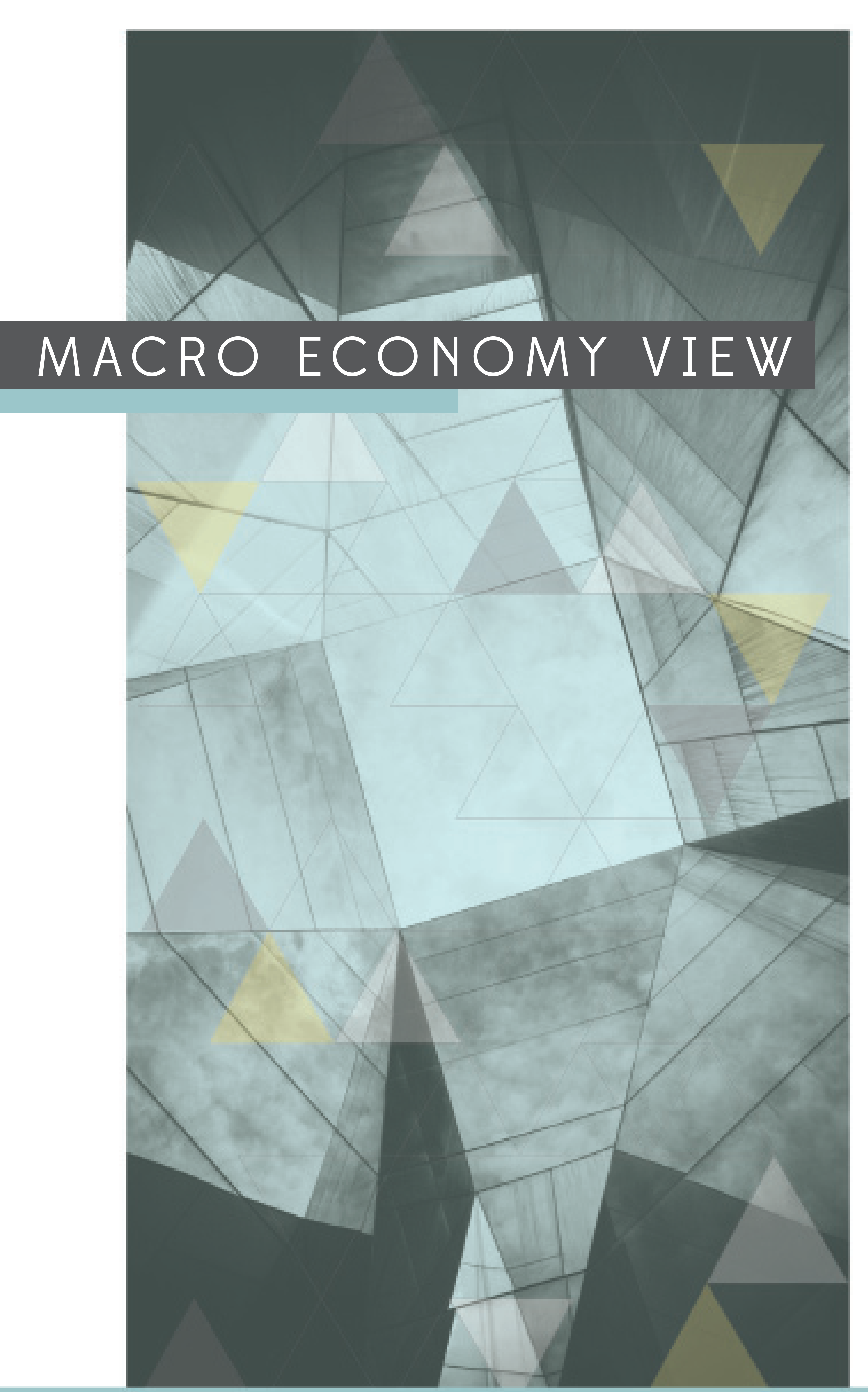
The Lower House of India's Parliament has cleared four bills in preparation of the upcoming rollout of the Goods and Services Tax (GST) regime. As widely reported, the Central GST (CGST) bill states that any tenancy, lease, license to occupy land, or easement will be considered as supply of service. Any lease or letting out of a residential, industrial or commercial building for commercial purposes – wholly or partly – will also constitute a supply of services. Simultaneously, the sale of land or building (except the sale of under-construction buildings) will not be treated as either supply of goods or services. The sale of land and buildings will be out of the purview of GST, and such transactions will continue to attract stamp duty. Therefore, once GST comes into effect from July, the leasing of land and buildings - as well as home loan EMIs paid by those who purchase under-construction apartments - will attract the applicable tax rate. Depending upon the tax rate that gets announced for real estate, the effect could be higher or lower than today. According to reports, the Ministry of Housing and Urban Poverty Alleviation (MHUPA) has suggested to the finance ministry that the current exemption of service tax on affordable housing should continue even under the GST regime. A decision on the same is expected before July.

Given the government's goal of 'Housing for All by 2022', this exemption is likely to continue under the new tax regime. MHUPA has also requested the states and union territories to consider waiver or rationalization of stamp duty on affordable housing projects.

In the long term, these structural changes will bring in many positives for the industry. End users can look forward to a more assured asset ownership experience, and domestic as well as foreign investors can look forward to dealing with a more mature and a better governed industry.

We will continue to keep you updated with emerging trends as the industry embarks on this transition.

MACRO ECONOMY VIEW



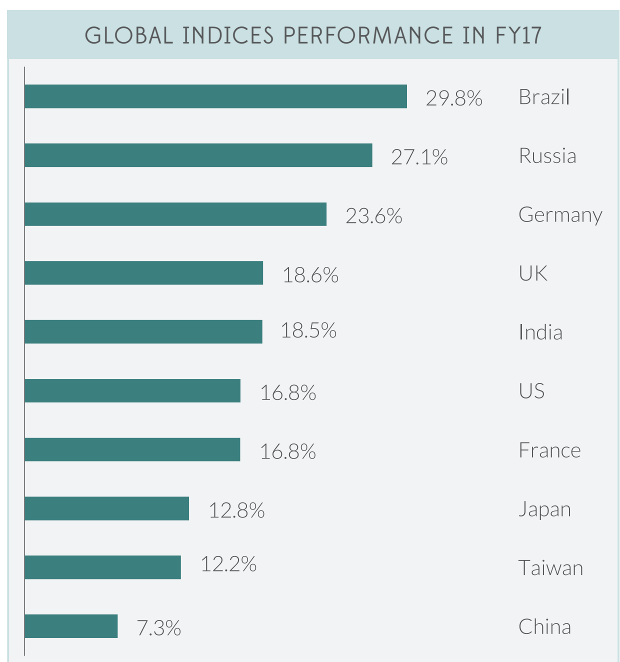
LOOKING BACK

"Only those who risk going too far can possibly find out how far one can go." ***– T. S Elliot***

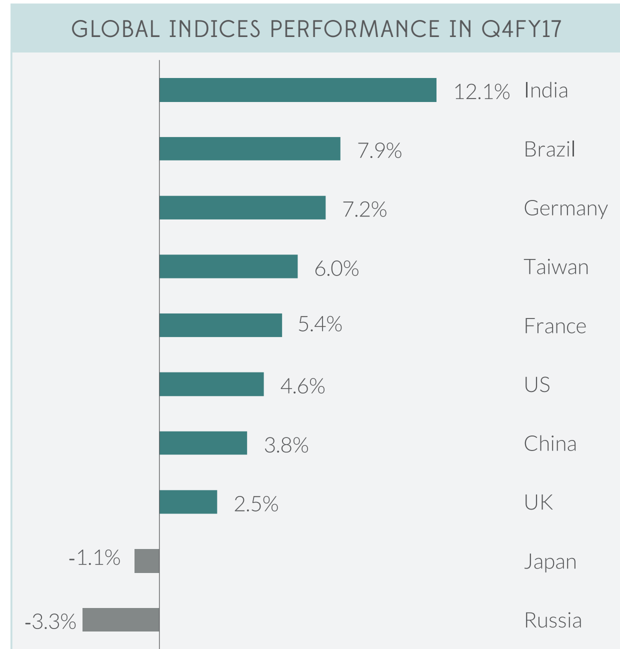
Scaling new heights and unchartered territory can be filled with fear and hope. The above famous quote of T.S Elliot was tested, as investors brazed new all-time highs in the Indian market. The Indian market started the calendar year 2017 on a fearful note having just been bitten by the demonetization bug. We had highlighted in our last quarterly newsletter in January that market valuations look reasonable after the correction seen in Nov-Dec'16 post demonetization and Trump's victory. We believe markets have not disappointed most investors who took the opportunity to deploy fresh capital during the last quarter. The Indian market was the best performing market globally in Q4FY17 (Q1CY17) as two of the major events - political outcome in the four state elections and Budget 2017 - played in our favour. In our previous newsletter, we had highlighted that these events would be the key driver of markets in the near term.

The strong performance by BJP in all the states and mainly the landslide victory in Uttar Pradesh (UP), has raised the confidence of political stability in the country over the longer term and market pundits believe that a second term for the Modi government has become stronger. This has led to a strong surge in Foreign Portfolio Investors' (FPIs) flows in recent months. FPIs bought Indian stocks worth US$4.63 bn in March 2017, as against US$3.08 bn in the preceding 11 months of the year.

It would be interesting to note that the Indian market gave a return of 18.5% for FY17 out of which 12.1% came in the last quarter itself as markets looked relatively attractive compared to its peers. Most other global markets gave



Source: Bloomberg, IIFL Research; data as on 31st March 2017

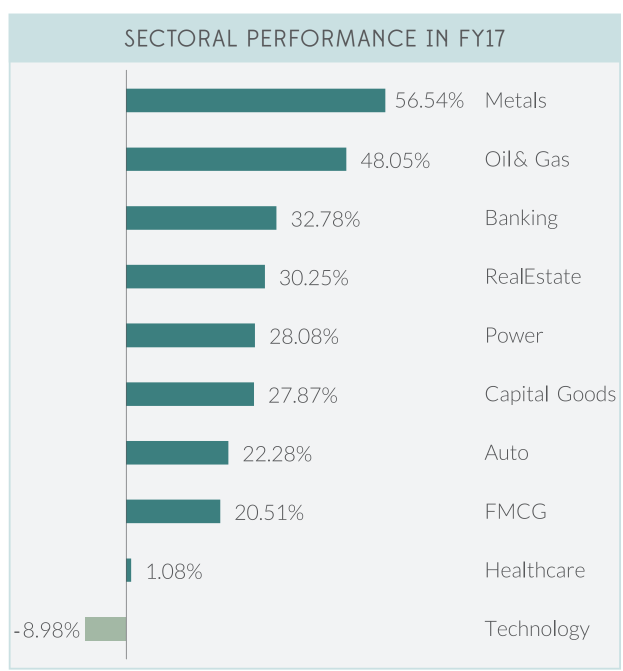


Source: Bloomberg, IIFL Research; data as on 31st March 2017

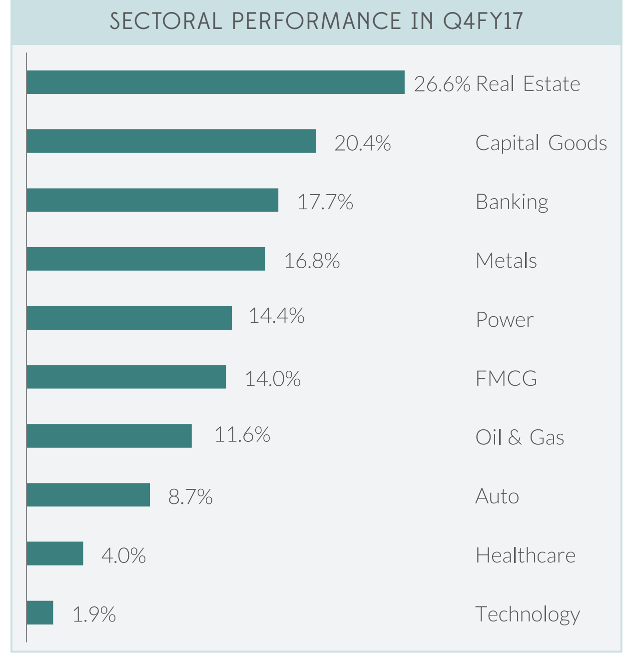
double digit returns in FY17, with Brazil and Russia being the best performing emerging markets. The developed markets did not lag much behind as Germany, the UK and the US gave strong double digit returns during the year, backed by improving macro-economic indicators and pick-up in economic activity.

There are few reasons that have led to this sharp up-move in Indian markets in recent quarter. First and foremost is liquidity, which is chasing few stocks. FIIs are known to be frantic buyers and that is happening in the market now. In March, not only India but also other emerging markets received good inflow of foreign money. India received ~US$ 5bn in equities in March'17 alone, which was more than what it received in the previous 11 months. However, one needs to note that majority of this money is coming through Exchange-Traded Funds (ETFs) and not India specific / emerging market dedicated funds. However, this also means that this money is not here for long term and can go back quickly as well. Additionally, post demonetization the domestic liquidity environment is also looking exceptionally strong with mutual funds receiving inflows worth US$7.71 bn in the last few months with a monthly SIP of US$0.77 bn - US$0.93 bn.

The Indian market like its global counterparts was in Risk-On mode and this was evident from the sectoral performances during the last financial year and the recent quarter. During FY17, Metals was the best performing sector as a sharp rally in global commodities took place post Donald Trump's victory, on the back of his announcement of making large infrastructure development projects in America. Some recovery in Chinese economy also added to the commodity rally. Following the commodity rally, Oil & Gas too saw sharp movement and was the second best performing sector during the year.



Source: Bloomberg, IIFL Research



Source: Bloomberg, IIFL Research

Real estate as a sector, which had seen major sell-off in Nov-Dec'16 post the demonetization announcement, saw a major pickup as the valuations became attractive and fears of a complete rout in the sector was overdone. Two sectors, which dragged most of our portfolios in the last quarter were Healthcare and Technology. Both these sectors were plagued with uncertainties from US markets. Pharma companies exporting to the US faced headwinds of drug pricing investigations, while technology companies faced H1B visa restriction issues.

We would want to highlight three key trends/ developments in recent times, which we believe will lead to long lasting impact on the markets and economy:

Changing rule book in politics – The recent political mandate that the people gave in the four states and most importantly in UP, showed that the age-old rule of caste-based and appeasement politics was out of the window. People wanted real reforms and were willing to accept the reforms agenda set by PM Modi for the nation as a whole. The landslide victory of BJP was also a vindication of the demonetization drive, which market pundits had otherwise believed would be suicidal for the Modi government. It seems to have worked better than expected, with the common man. What impact demonetization would actually have is a matter of discussion otherwise.

Domestic Institutional Investors (DIIs) and not Foreign Institutional Investors (FIIs) decide the direction of the markets – Domestic institutional flows are increasingly turning out to be the primary driver of market direction, displacing the FII flows as the price-setter. With monthly SIPs in excess of US$0.77 bn and increased equity allocation from LIC and EPFO, we could see DIIs only getting stronger balance for the volatile FIIs. This has been very obvious in recent months due to extraordinary demonetization factors. However, notwithstanding the short-term reasons, there is a strong secular trend that is likely to make DIIs a consistently growing force in the marketplace over the next decade or so. It would not be outlandish to forecast that DII ownership and trading volumes could surpass those of FIIs in early 2020s.

Financial instruments seeing increased acceptance - Equity investment culture is on the rise and is also shaping up into a more formal and collective investment form. This trend is increasing post-demonetization, after the traditional investments of gold and real estate turned less attractive. There are multiple reasons why it is logical to expect an ever higher proportion of savings to channel towards equities in the decades to come:

- Rising per capita income and hence rising saving levels, at a rate higher than GDP growth. Add to this, rising middle class affluence and hence larger appetite for risk.
- With more fiscal discipline, lower interest rates and appetite for diversification away from deposits.
- Declining attraction for traditional saving tools like gold due to difficulty in using cash for buying gold and silver.
- Consistent long-term return generating history of stock markets.

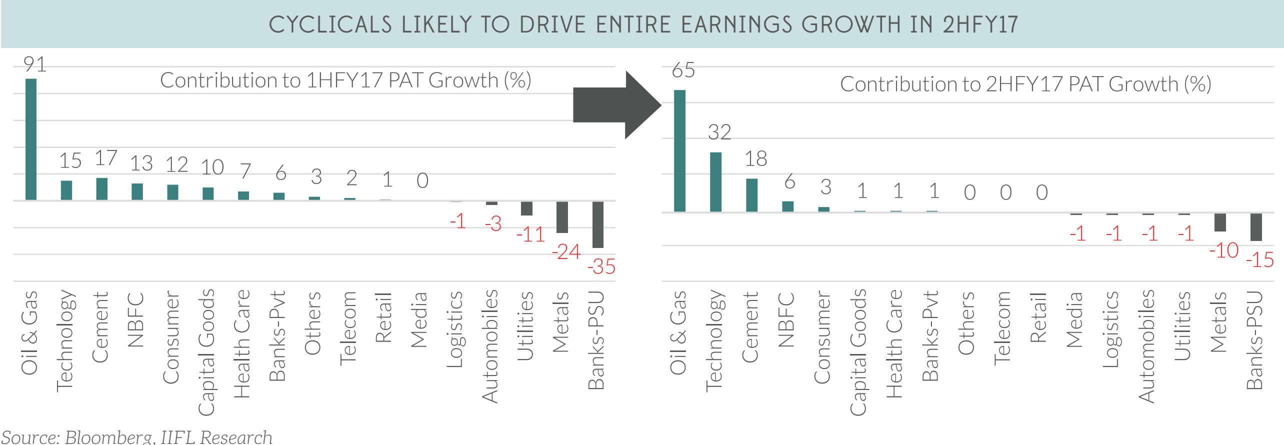
SHOW ME THE EARNINGS...MARKET LOOKING FORWARD WITH HOPE

While we cheer the market's new highs, the fact remains that they have moved faster than fundamentals and there are no visible signs of a significant recovery in earnings. Q4FY17 performance may be boosted by the depressed bases for some cyclical sectors, but that aside, the broader earnings picture appears subdued. FY17 began with hopes of an ever-elusive earnings recovery, backed by expectations of a good monsoon, 7th Pay Commission awards and macro buoyancy. However, continued weakness in private capex cycle, absence of broader consumption pick-up and sluggish asset quality trends in financials played spoilsport. Additionally, events like demonetization changed the setting mid-way, leading to a flattish earnings performance. As we look ahead, there are several unknowns emerging on the horizon – currency appreciation, GST implementation and progress of monsoon. While the impact of currency appreciation is still quantifiable, that of GST implementation and monsoon on near-term earnings is difficult to predict.

We believe cyclicals would be driving growth in the coming quarters on the back of a weak base. Given the disappointments over the past few years, skepticism remains around the ~18% consensus Nifty earnings growth expectation for FY18 estimates. We believe there would be small pockets of outperformance on a bottom-up basis, but top-down growth would be elusive.

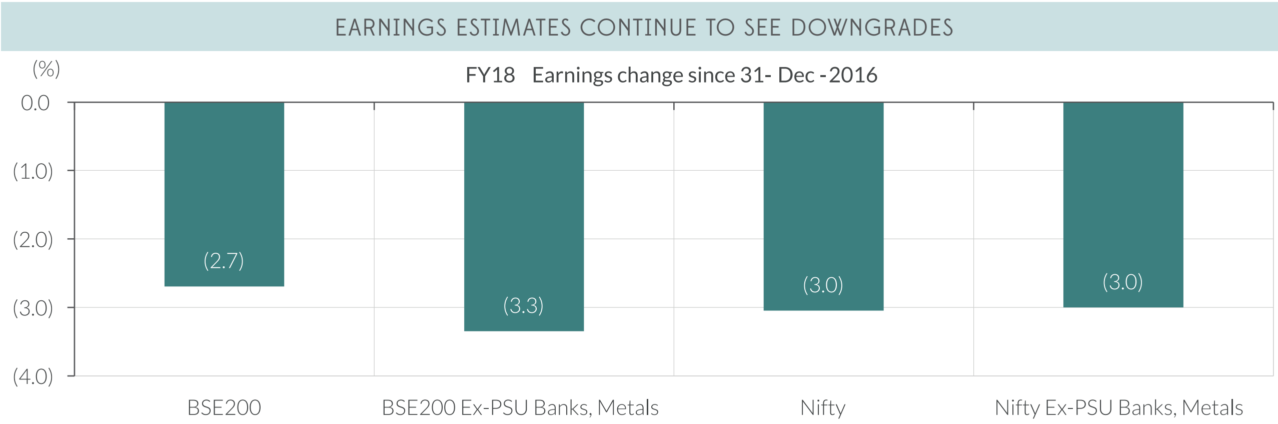
Despite economic growth likely to surprise our expectations at the start of the year, corporate earnings have continued to see downgrades, as we expected. And this is despite the general perception that results for the December quarter were by and large better than

CYCLICALS LIKELY TO DRIVE ENTIRE EARNINGS GROWTH IN 2HFY17



Source: Bloomberg, IIFL Research

EARNINGS ESTIMATES CONTINUE TO SEE DOWNGRADES



Source: Bloomberg, IIFL Research

expected. Thus, consensus expectation of aggregate BSE200 PAT has seen a 3% downgrade since the start of the year. The downgrades for the more widely tracked but narrow Nifty Index are 4.5%.

BSE200 Earnings Growth (YoY%)	FY16	FY17E	FY18E
Consumer Discretionary	9.9	(2.1)	31.0
Consumer Staples	12.9	6.9	16.0
Energy	13.6	19.6	6.1
Financials	(25.4)	41.0	27.7
Health Care	19.6	15.1	16.9
Industrials	41.1	9.2	19.9
Information Technology	8.6	5.2	8.0
Materials	(39.1)	88.4	41.6
Real Estate	1.7	25.6	12.6
Telecommunication Services	(10.1)	(32.1)	(20.4)
Utilities	17.4	7.8	19.1
BSE2001ndex	(1.0)	19.2	18.7
BSE200 Ex-PSU Banks, Metals	12.5	8.5	14.5

Source: Bloomberg, IIFL Research

Although at a headline level, consensus expectation is for earnings growth to be slightly moderate in FY18, this is, in large parts, due to higher earnings growth for the volatile metals companies and PSU banks. Excluding these, consensus expectation is for a sharp acceleration in profit growth to 14% in FY18, almost 6ppt higher than in FY17 estimates. In particular, the domestic consumer and cyclical sectors are expected to see a sharp acceleration in earnings in FY18.

IMPACT OF POLICY CHANGES

The noticeable feature of the recent past has been big policy changes which, while structurally positive in the long term, have impacted earnings in the near term; demonetization in FY17 being a case in point. As we make our estimates, we note that FY18 will be characterized by the implementation of GST - the most significant taxation reform since independence. GST, while a big structural positive, may induce uncertainty and earnings volatility owing to trade adjustment of the inventory pipeline and potential teething troubles in the initial stages of implementation. This could impact our earnings estimates of FY18.

Apart from these big policy reforms, we also note that several other policy changes viz. ban on selling of liquor within 500m of proximity of state and national highways, judicial pronouncements pertaining to BS-III to BS-IV switchover for Auto sector have also added to element of uncertainty in earnings forecast. Exogenous factors like progress of monsoons bring in their own set of unique challenges. Overall, the pace, frequency and magnitude of policy changes have clouded the earnings predictability at the margin.

STRONGER RUPEE AND ITS PAINS

The INR has appreciated 4.5% against the USD from December 2016 to March 2017, as against consensus of moderate depreciation. This has been the fastest quarterly currency appreciation since September 2012. The enormity of the currency appreciation is underscored by the fact that only in four previous occasions, the currency has appreciated by more than 4.5% in a quarter in the last 27 years. Some factors that drove this appreciation are:

a) Strong control of twin deficits (CAD, FD)

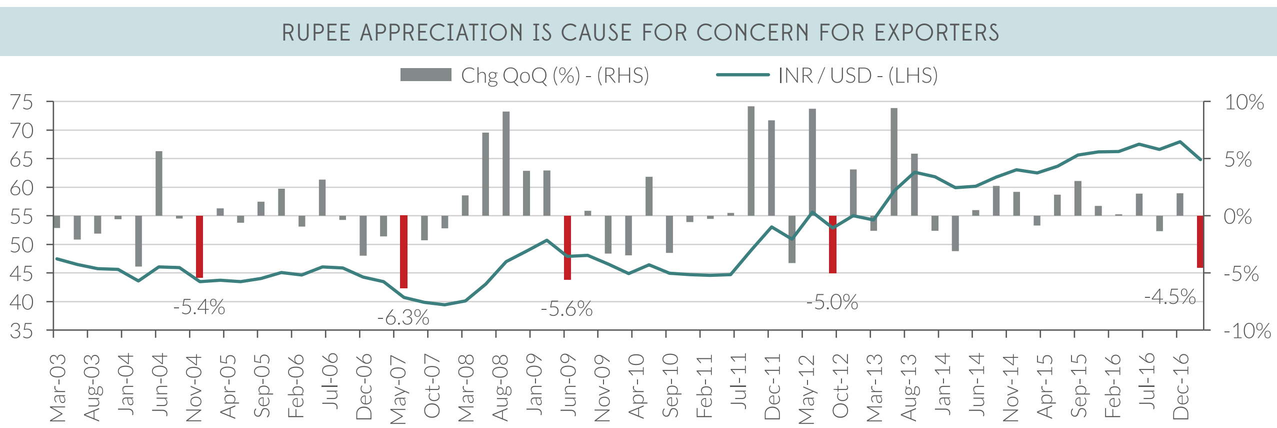
b) Strong FII flows of USD11bn in 4QFY17 and

c) Expectations of continued reform momentum post the BJP's massive UP election victory. We believe a strong Rupee is here to stay and could be an added pain point for sectors like IT and Pharma which are anyways reeling under other macro events.

MONSOON JITTERS TO BE SEEN IN NEAR TERM

Skymet has predicted a below-normal monsoon for 2017 (95% of Long Period Average) on a potential El Nino return in late-July. At the same time the Indian Meteorological Department (IMD) has predicted a normal monsoon with around 96-97% of Long Period Average, giving rise to expectations of 3-4% farm gross domestic product (GDP)

RUPEE APPRECIATION IS CAUSE FOR CONCERN FOR EXPORTERS



Source: Bloomberg, IIFL Research

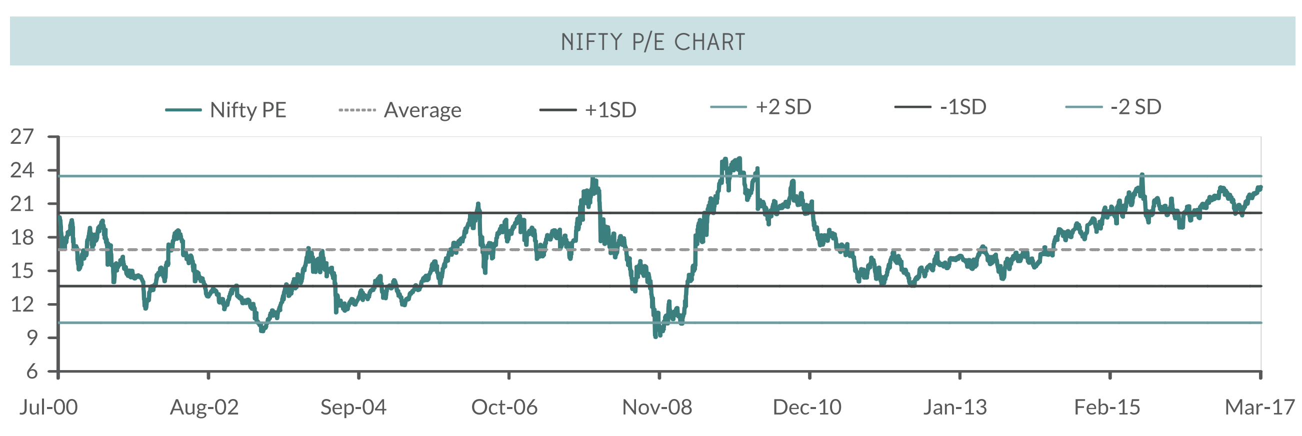
growth, which would fuel rural demand and ease food inflation. While, of late, shocks of a poor monsoon to rural GDP have become less pronounced, the impact on inflation is still worrisome. Our analysis indicates that from 2000 to 2015, India experienced below-normal monsoon in eight out of 16 years with average agri GDP growth at 0.4% (vs. 2.9% average agri GDP), while CPI was 5.8%. An assessment of the specific impact of the monsoon on the economy would have to wait a while, as the timing of the monsoon arrival and its distribution would be key.

VALUATIONS NO LONGER CHEAP; NEED EARNINGS SUPPORT

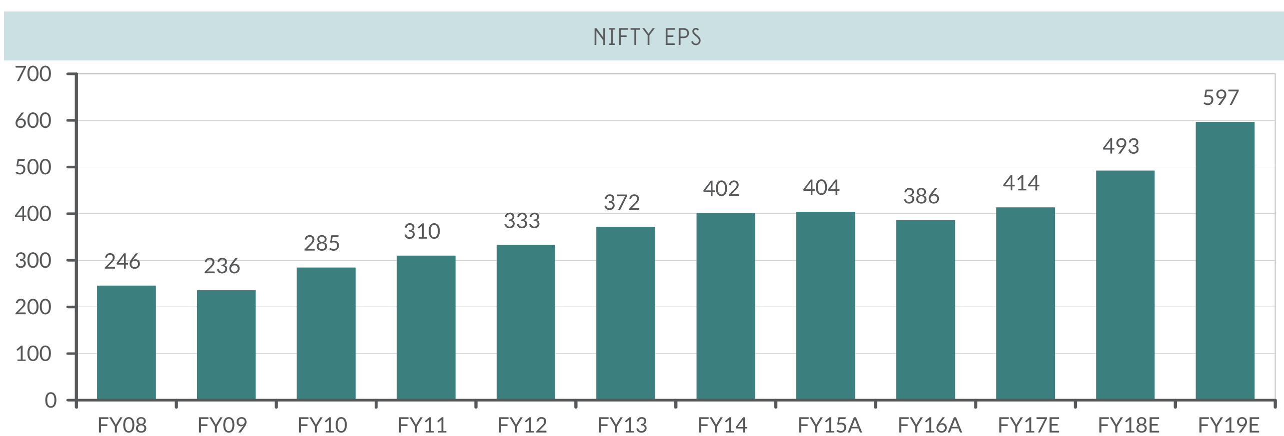
The rally seen in the last 3 months has taken markets to dizzy heights where it has become reasonably expensive and has little room for any negative surprise. We have to concede that local and global factors together contain enough force to create an outright valuation bubble that is inconsistent with historical bands and current news flow/fundamentals. Yet, this cannot mask our opinion that markets are severely mispricing risks emanating from earnings disappointment, geo-political events, poor monsoon and government drive to bring more tax reforms and black money under surveillance. The issue for the market, though, is this – given the strong liquidity flows, do valuations matter?

MSCI India trades at a ~40% premium to the MSCI EM, not too different from the ~36% average premium at which it has traded over the past 10 years. However, valuations in absolute terms are not cheap – trading at close to 2SD above the mean. Earnings growth remains the key – any disappointment on that front would take the market lower. India remains middle of the pack, both on growth rates and ROEs and one could argue that valuations are relatively high. Investor interactions do

NIFTY P/E CHART



Source: Bloomberg, IIFL Research



Source: Bloomberg, IIFL Research

suggest that diversity in the market (multiple sectors with reasonably high weights) and a large number of investible companies with decent corporate governance tend to result in this premium, which could sustain if earnings growth accelerates, as is being factored in currently.

A good budget, UP election results and progress on GST (GST panel recently finalized all central and state GST legislations – passage in the Parliament and State Assemblies to follow) have raised expectations that the reform momentum can kick into higher gear and may be supporting valuations. Valuations are also likely going to continue to find support from:

a) Macro strength (strong fiscal, stable currency, decent GDP growth etc.) and

b) Strong domestic flow trends.

Having said that, a number of factors may reverse this optimism:

1) Tightening interest rates in advanced economies may pressure EM equity flows which have remained strong thus far owing to a broader EM recovery aided by commodity price reflation.

2) There are still multiple challenges which need execution: resolution of PSU bank NPA/capitalization problem key among them.

IIFL MUTUAL FUNDS PERFORMANCE

PRODUCT LABELLING DISCLOSURES

Name of the scheme	This product is suitable for investors who are seeking	Riskometer
IIFL INDIA GROWTH FUND (An Open Ended Equity Scheme)	**This product is suitable for investors who are seeking*** • Capital appreciation over long term; • Investment predominantly in equity and equity related instruments. ** Investors should consult their financial advisers if in doubt about whether the product is suitable for them.*	LOW HIGH Investors understand that the principal will be at moderately high risk
IIFL LIQUID FUND (An Open Ended Liquid Scheme)	**This product is suitable for investors who are seeking*** • Income over short term horizon • Investments in money market and short term debt instruments, with maturity not exceeding 91 days ** Investors should consult their financial advisers if in doubt about whether the product is suitable for them.*	LOW HIGH Investors understand that the principal will be at low risk
IIFL DYNAMIC BOND FUND (An Open Ended Income Scheme)	**This product is suitable for investors who are seeking*** • Income and long term gains • Investment in a range of debt and money market instruments of various maturities ** Investors should consult their financial advisers if in doubt about whether the product is suitable for them.*	LOW HIGH Investors understand that the principal will be at moderate risk

Different plans shall have a different expense structure

MUTUAL FUNDS

IIFL India Growth Fund - EQUITY	30-Apr-16 to 28-Apr-17	PTP (₹)	Since Inception$	PTP (₹)
IIFL India Growth Fund - Regular Plan(G)	28.65%	12,856	12.53%	13,426
IIFL India Growth Fund - Direct Plan (G)	29.48%	12,939	13.67%	13,768
Benchmark*	18.58%	11,852	5.35%	11,389
Additional Benchmark**	16.89%	11,684	3.67%	10,941

*As on April 28, 2017; Point to Point (PTP) returns in ₹ is based on standard investment of ₹10,000; $ Inception date 30-Oct-2014; * Nifty 50; ** S&P BSE Sensex; Managed by Mr. Prashasta Seth since November 03, 2016; Scheme has been in existence for more than 1 year but less than 3 years*

IIFL Liquid Fund- FIXED INCOME	30-Apr-14 to 28-Apr-17	PTP (₹)	29-Apr-16 to 28-Apr-17	PTP (₹)	Since Inception$	PTP (₹)
IIFL Liquid Fund-Regular plan (G)	7.55%	12,438	6.64%	10,662	7.66%	12,907
IIFL Liquid Fund-Direct plan (G)	7.60%	12,455	6.69%	10,667	7.72%	12,932
Benchmark*	7.98%	12,587	7.06%	10,704	8.20%	13,132
Additional Benchmark**	7.72%	12,316	6.54%	10,654	7.93%	12,742

*As on April 28, 2017; * Crisil Liquid Fund Index, ** Crisil 91 Day T-Bill Index; Point to Point (PTP) returns in ₹ is based on standard investment of ₹10,000 made on the $ Inception date 13-Nov-2013; Scheme has been in existence for more than 3 years but less than 5 years; Effective March 08 2017, Mr. Ankur Parekh has been appointed as Fund Manager of the scheme. The Scheme was managed till March 07, 2017 by Mr Ritesh Jain*

IIFL Dynamic Bond Fund - FIXED INCOME	30-Apr-14 to 28-Apr-17	PTP (₹)	29-Apr-16 to 28-Apr-17	PTP (₹)	Since Inception$	PTP (₹)
IIFL Dynamic Bond Fund - Regular plan (G)	9.27%	13,044	6.38%	10,636	7.03%	12,987
IIFL Dynamic Bond Fund - Direct Plan (G)	9.82%	13,241	6.91%	10,689	7.57%	13,240
Benchmark*	10.93%	13,647	10.07%	11,004	8.98%	13,921
Additional Benchmark**	10.76%	13,584	9.64%	10,961	7.23%	13,080

*As on April 28, 2017; * Crisil Composite Bond Fund Index, ** Crisil 10yr Gilt Index; Point to Point (PTP) returns in ₹ is based on standard investment of ₹ 10,000 made on the inception date; $ Inception date 24-June-2013; Scheme has been in existence for more than 3 years but less than 5 years; Effective March 08 2017, Mr. Ankur Parekh has been appointed as Fund Manager of the scheme. The Scheme was managed till March 07, 2017 by Mr Ritesh Jain*

MUTUAL FUND INVESTMENTS ARE SUBJECT TO MARKET RISKS, READ ALL SCHEME RELATED DOCUMENTS CAREFULLY

I I F L   F U N D S   P E R F O R M A N C E

(as on March 31, 2017)

AIF FUNDS

EQUITY FUND	Region	AUM (in USD mn)	Returns (in %)		
			3 Months	YTD	3 years
IIFL NDA Fund	DOMESTIC	74.17	15.27	15.27	NA
IIFL Asset Revival Fund 2	DOMESTIC	76.18	13.02	13.02	NA
Nifty Index			12.07	18.55	11.02

ALTERNATE	Region	AUM (in USD mn)	Returns (in %)		
			3 Months	1 Year	3 years
IIFL Seed Ventures Fund (28th Feb'17)	DOMESTIC	58.19	16.26	42.97	NA

FIXED INCOME	Region	AUM (in USD mn)	Returns (in %)		
			3 Months	YTD	3 years
IIFL Cash Opportunities Fund	DOMESTIC	163.17	6.76	6.76	NA

REAL ESTATE	Region	AUM (in USD mn)	Returns (in %)		
			3 Months	YTD	1 year
IIFL RE Fund Domestic Series 4	DOMESTIC	58.75	12.39	12.39	NA
IIFL RE Fund Domestic Series 3	DOMESTIC	46.68	15.44	15.44	NA
IIFL RE Fund Domestic Series 2	DOMESTIC	163.07	13.27	13.27	13.13

AIF Schemes - Past performance may or may not be sustained in future. Returns greater than 1 year period are compounded annualized and less than 1 year period are on absolute basis. Distributions, if any are assumed to be reinvested.

AIF Schemes are governed by SEBI (Alternative Investment Funds) Regulations and can strictly solicit funds only through Private Placement. The performance of the Schemes stated herein is for information purpose only and should not be construed as an offer or solicitation to buy an Scheme(s).

PMS

IIFL Multi Cap Portfolio-EQUITY	Region	AUM (in USD mn)	Returns (in %)		
			3 Months	YTD	3 years
IIFL Multi Cap Portfolio-EQUITY	DOMESTIC	61.14	13.3	38.77	41.57

Returns below 1 year is absolute & above 1 year is CAGR

FEEDER FUNDS

ALTERNATE	Region	AUM (in USD mn)	Returns (in %)		
			3 Months	1 Year	3 years
IPEplus Fund	OFFSHORE	45.74	2.43	3.16	8.24
IIFL Global Bond Fund 2	OFFSHORE	18.98	4.43	4.43	NA

Returns below 1 year is absolute & above 1 year is CAGR. The expenses of the scheme will be over and above the expenses charged by the underlying schemes

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