

# TWIN EVENTS IMPACTING INDIAN MARKETS

- Demonetization of ₹
- US Presidential Election 2016

## FIXED INCOME MARKET

The positive Inflation print in the month of October'16 helped support market sentiment and resulted in the 10 year benchmark yield to drop from 6.82% at the start of the month to 6.67% in a couple of trading sessions. However, yields went up on back of global bond market weakness and profit booking, closing at 6.79% on 28<sup>th</sup> Oct'16. FPIs also sold, resulting in the outflows to the tune of ₹6000 Cr as against an inflow of over ₹9800 Cr in the previous month.

However, things changed yesterday and the twin factors affected the Indian markets; demonetization of higher denomination notes by government and Donald Trump becoming the President of the USA. The government further clarified that the decision taken move would help in curbing financing of terrorism and eliminate black money in the country. Though in short term, it may cause inconvenience to the citizens and have a deflationary effect, in the long run it is likely to improve the system liquidity. From a bond market perspective, the liquidity impact would be a significant positive. Over the longer term, both the moves towards non cash economy and the introduction of GST may give a strong message to the FII that India is on the reform path.

FI Indicators	30-Sep-16	28-Oct-16
G-Sec (10 yrs - old)	6.82%	6.79% ↓
Inflation(CPI)	4.31% (September 2016)	
GDP	7.10% (June 2016)	
Call Money	6.50%	6.20% ↓
10 Year US Treasury	1.59%	1.84% ↑
Brent Crude (\$)	50.75	50.68 ↓
3 Month CD	6.55%	6.58% ↑
1 Year CD	7.06%	6.93% ↓
5 year AAA PSU	7.42%	7.34% ↓
10 year AAA PSU	7.50%	7.52% ↑

Source: Bloomberg

Just when the market participants had come to terms with the news of demonetization, the unexpected win of Donald Trump took the market by surprise. The market expects Trump to bring in tax-cuts to help boost spending in the economy which in turn would give room to the Fed to hike rates sooner. The US 10 year Treasury Yield went up from 1.8547% on 8th Nov'16 to 1.8942% today, though Fed rate hike / Trumps plan for fiscal stimulus, may dampen global bond sentiment in the short term, the local factors are likely to overshadow global malaise and impact on bond market is likely to be positive.

Indian bond markets however, saw softening of yields on possibility of further rate cuts by the RBI helped by the disinflationary impact of demonetisation. The 10 year benchmark fell by 13bps from 6.798% on 8th Nov'16 to 6.666% today.

### OUTLOOK

- Over the next 2-3 years, the demonetisation move, along with implementation of GST, should have a positive impact on the economy by way of curtailing the unorganised sector (shift to the organised sector due to GST benefits along with fear of legal hurdles), higher financial inclusion, higher tax collections for the government, and higher GDP
- Due to higher deposits and limits on withdrawals, liquidity with banks is expected to rise, which, in the absence of credit off take, would be invested in government securities.
- Though the economic data coming from the US was positive, the election of new president reduces the possibility of a rate hike in December'16 FOMC meeting.
- Based on the current market scenario, we expect the new 10 year to trade between 6.60 - 6.80% in the near term, in absence of any external factor or event.

## EQUITY MARKET

The move of the government of India to withdraw Rs. 500 and Rs. 1,000 notes from circulation from the midnight of 9<sup>th</sup> Sept'16 surprised the Indian market participants. The effect of the move, on a country driven by cash economy, is to be observed in the coming times. In the shorter term, citizens face inconvenience in the day to day operations; the longer term effect of the move is expected to be, amongst other things, a pickup in the bank deposit growth & improvement in the system liquidity.

While the markets did observe knee jerk reaction to the domestic events, the focus soon shifted towards the result of the US election outcome. Donald Trump emerged victorious over Hillary Clinton in a close fought race to become the President of the United States. Markets plummeted as investors were seen moving to safer havens such as gold and bonds. The US dollar dropped ~ 2% against other major currencies while the price of gold – seen as a safe haven in times of crisis – rose 3.5%.

Indices	30-Sept-16	28-Oct-16	% Change
S&P BSE Sensex	27,865.96	27,941.51	0.27%
Nifty 50	8,611.15	8,638.00	0.31%
S&P BSE Mid – Cap	13,166.68	13,408.27	1.83%
S&P BSE Small – Cap	12,780.80	13,454.03	5.27%
Dow Jones	18,308.15	18,161.19	-0.80%
FTSE 100	6,899.33	6,996.26	1.40%
Nikkei	16,449.84	17,446.41	6.06%
Hang Seng	23,297.15	22,954.81	-1.47%
Strait Times	2,869.47	2,816.26	-1.85%

Source: Bloomberg & ICRA, MFI Explorer

October'16 started on a positive note with the newly constituted monetary policy committee (MPC) announcing 25 bps rate cut on back of lowering CPI, weak global environment. The month marked the beginning of 2QFY17 corporate result announcements which were broadly lacklustre. Globally, ECB kept policy rates unchanged; however, they indicated that they were open for new stimulus to boost inflation in the economy. Crude oil prices also surged to a one year high of USD 53. This upswing was post Russia's announcement of joining the OPEC's effort to reduce oil supply. In the month of Oct'16, Indian bellwether indices viz. Nifty 50 and S&P BSE Sensex closed at 8625.7 and 27930.21 gaining

0.17% and 0.23% respectively after the customary Muhurat trading on 30<sup>th</sup> October'16.

Indian manufacturers enjoyed yet another month of improving operating conditions. With demand from the external markets picking up, Nikkei India Manufacturing PMI rose from 52.1 in Sept'16 to 54.4 in Oct'16. Similar surge was seen in Nikkei India Services PMI which was seen at 54.5 in Oct'16 from 52.4 in Sept'16. The trade deficit of the country was seen to be at ~ 8.339 Billion USD.

Indicators	Value	Date & Month
GDP <sup>^</sup>	7.1%	Q1 - FY17
IIP <sup>^</sup>	-0.7%	Aug'16
Nikkei India Manufacturing PMI <sup>*</sup>	54.4	Oct'16
Nikkei India Services PMI <sup>*</sup>	54.5	Oct'16
India's Trade Deficit <sup>##</sup>	\$8.34bn	Sept'16

Source: <sup>^</sup>mospi.nic.in; <sup>##</sup> Ministry of commerce, <sup>\*</sup>markiteconomics.com

Net Flows	Oct'16	CY-2016
FPI/FII	-4,306	38,397
MF	9,128	21,305

Source: ICRA, MFI Explorer, Values in INR Cr

Oct'16 saw reversal in FPI (Foreign Portfolio Investor) flows. From investing close to Rs. 10,443 Crs in Indian equities in September'16; FPIs withdrew around Rs. 4,306 Crs. from Indian equities in the month gone by. The outflow of funds could be attributed to profit booking. This was also the first time that the FIIs have turned net sellers in Indian Equities in the current FY.

### OUTLOOK

- With new developments domestically as well as globally, Indian equity and currency markets are expected to experience heightened volatility in the near future.
- The short term effects resulted by the demonetization of the Rs.500 & Rs.1000 denomination Indian Currency could be shaky, the bigger picture may be in the favor of the Indian economy. Banks are expected to be the biggest beneficiary of the collective move by RBI & government. Other sectors like Cement, NBFCs & Micro-Finance and Materials are expected to be negatively affected by the move. Sectors like Health care and Pharma are expected to have least impact.
- The election of Donald Trump as the US President could have an adverse impact on the emerging market economies including India; the full impact of which has to be observed in the times to come. With improved fundamentals, good monsoons, inflation under check & good progress on reforms, India offers itself as a bright spot for global investors to invest.
- Despite the near-term challenges, the long term potential of Indian economy remains intact. We continue to be constructive on equities and hence, in our opinion, we see merit in increasing allocation to equities in a staggered manner to even out the market volatility.

➤ Gold prices edged lower by almost 3% in the month of October 2016 as the US Dollar Index gained some more momentum over the rising chances of a rate hike by the Federal Reserve. The yellow metal closed at \$1275.5 per troy ounce while US Dollar index gained 3.0% to close at 98.3. The domestic price of Gold dropped by 3.6% to close at Rs. 30,049 per 10 grams as import discounts narrowed on the back of festive season.

Indices	30-Sep-16	28-Oct-16
Gold (\$) p/oz	1315.8	1275.5
Gold (€) p/oz	1170.5	1161.2
DXY Index	95.5	98.3
Rupee v/s Dollar	66.6	66.8
EUR USD	1.123	1.10
Silver (\$) p/oz	19.2	17.8

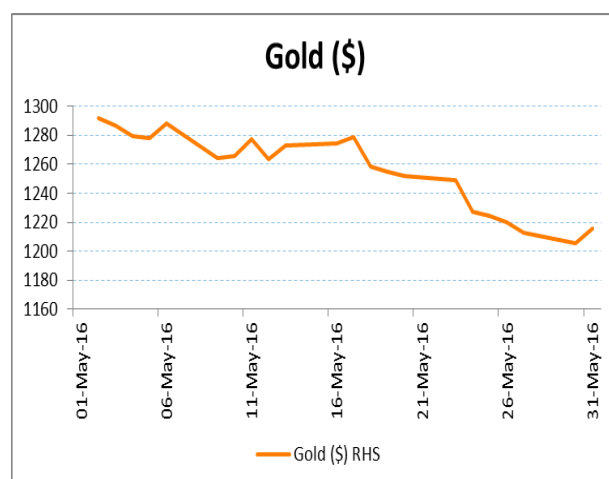
Source: Bloomberg

- Gold prices however regained lost ground at the start of November on account of Donald Trump defeating Hillary Clinton in the race for White House to become the 45<sup>th</sup> President. Gold prices rallied around 5% globally and domestically after the outcome as investors factored in market uncertainty on back of an unexpected verdict. The domestic markets also were struggling to understand the implications of the sudden measures by the government to curb black money usage in the country by declaring Rs.500 and Rs.1000 as illegal tender and kept banks closed across the country.
- The economic data on labor and inflation front were supportive during the month of October with the unemployment rate dropping below 5% in the October labor report.

### OUTLOOK

- Gold prices are expected to remain supported on the back of uncertainty around President Trump's policies. Political uncertainties in Europe and Britain are also expected to add to the overall crisis hedge demand for gold.
- Gold prices however, could face some correction in the near term due to higher probability for a December rate hike on account of positive economic data in US. Also, with President Trump being against lower interest rates, the Fed may be pushed to go ahead with a rate hike action.
- Any disappointing labour or inflation data however could negatively impact the chances of a rate hike.

Gold (\$) Weekly Price Movement



Source: Bloomberg

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