Morning Insight

OCTOBER 1, 2018

	28-Sep	% Chg 1 Day	1 Mth	3 Mths
Indian Indices				
SENSEX Index	36,227	(0.3)	(6.9)	3.4
NIFTY Index	10,930	(0.4)	(6.9)	3.2
NSEBANK Index	25,120	0.3	(11.1)	(4.6)
NIFTY 500 Index	9,116	(0.9)	(8.7)	0.9
CNXMcap Index	17,154	(2.0)	(13.0)	(3.9)
BSESMCAP Index	14,431	(3.4)	(15.3)	(8.3)
World Indices				
Dow Jones	26,458	0.1	1.9	9.0
Nasdaq	8,046	0.1	(0.8)	7.1
FTSE	7,510	(0.5)	1.0	(1.7)
NIKKEI	24,120	1.4	6.1	8.8
Hangseng	24,120	1.4	6.1	8.8
Shanghai	27,716	(0.4)	(0.4)	(4.0)

Value traded (Rs cr)	28-Sep	% Chg Day
Cash BSE	3,490	29.2
Cash NSE	45,132	7.4
Derivatives	714,420	(62.3)

Net inflows (Rs cr)	27-Sep	MTD	YTD
FII	622	(8,546)	(13,985)
Mutual Fund	(917)	8,822	85,438

Nifty Gainers & Losers 28-Sep	Price (Rs)	Chg (%)	Vol (mn)
Gainers			
Axis Bank	613	2.2	16.8
Wipro	324	1.6	6.9
ITC	298	1.5	24.6
Losers			
Yes Bank	184	(9.6)	148.6
Indiabulls Housing	855	(9.0)	12.1
Hindalco Ind	230	(5.8)	11.6

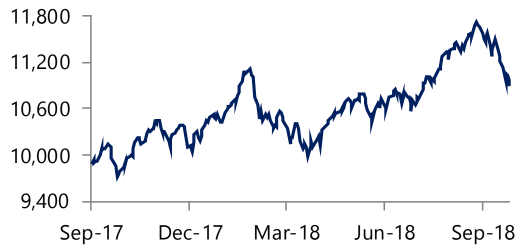
Advances / Declines (BSE)

28-Sep	A	B	T	Total	% total
Advances	77	129	25	231	100
Declines	353	880	125	1,358	588
Unchanged	2	12	10	24	10

Commodity	28-Sep	% Chg 1 Day	1 Mth	3 Mths
Crude (US$/BBL)	83.2	0.6	7.5	4.7
Gold (US$/OZ)	1,192.5	0.8	(1.0)	(5.1)
Silver (US$/OZ)	14.7	3.1	0.5	(9.3)

Debt / forex market	28-Sep	1 Day	1 Mth	3 Mths
10 yr G-Sec yield %	8.0	8.0	7.9	7.9
Re/US$	72.5	72.6	70.1	68.8

Nifty



Source: Bloomberg

News Highlights

- The government has formed a Competition Law Review Committee to ensure that the legislation is in tune with the changing business environment. Among the panel's mandate is also to look into international best practices in the competition field with a thrust on anti-trust laws, merger guidelines and handling cross-border competition issues. (ET)
- Resolution professionals (RPs) handling various corporate insolvency resolution programmes under the insolvency and bankruptcy framework have reported a large number of fraudulent transactions. These transactions, reported in over 110 companies under resolution, are worth over Rs 400bn. (ET)
- Power tariff soars to a decade high of Rs 17.61/unit in spot market due to low hydro and wind energy production and coal shortage at thermal plants. (ET)
- The Ministry of Corporate Affairs has ordered an investigation into the the books of accounts of **Vakrangee** Accounts for a period of three financial years under the Companies Act. (ET)
- The Board of **Mahindra Lifespace Developers** has approved the appointment of Sangeeta Prasad, CEO - Mahindra Lifespaces as Managing Director & CEO of the company with effect from October 1, 2018. (ET)
- **IL&FS** to raise Rs 150bn, hike borrowing limit to Rs 350bn.It has appointed Alvarez & Marsal to devise a restructuring plan.
- **Engineers India Limited** bags Rs 50bn project of HPCL Rajasthan Refinery. The total awarded order value is more than Rs 50bn with a total project schedule of mechanical completion by October 2022. (ET)
- **Bandhan Bank** eyes options to cut promoter stake. Move comes after RBI pulled up bank for failing to cut promoters' stake. (Mint)
- With stagnant domestic yield, **IndiGo** bets on West Asia.It operates 60 daily return flights to West Asia, in addition to 4 daily return flights each to Sharjah, Muscat. (Mint)
- **Bharat Petroleum Corp Ltd** board has approved an investment of Rs 111.30 bn for setting up a petrochemical unit at its Kochi refinery in Kerala. Kochi refinery at its recent expansion to 15.5 million tonnes per annum capacity produces 5,00,000 tonnes of polymer grade propylene. (ET)
- Lenders to **Infrastructure Leasing & Financial Services (IL&FS)** have declined to provide additional loans of Rs 35bn to the term-lending institution unless a resolution plan explaining how debt will be repaid is put in place.(ET)
- **Nestle, Unilever** and Coca-Cola are among companies shortlisted by GlaxoSmith-Kline for the second round of bidding for its Indian nutrition business, which includes the prized Horlicks brand. (ET)

What's Inside

- **Market Strategy:** Monthly outlook for October 2018

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, IE = Indian Express, BL = Business Line, ToI: Times of India, BSE = Bombay Stock Exchange, MC = Moneycontrol

Market Strategy

Monthly Outlook for October 2018

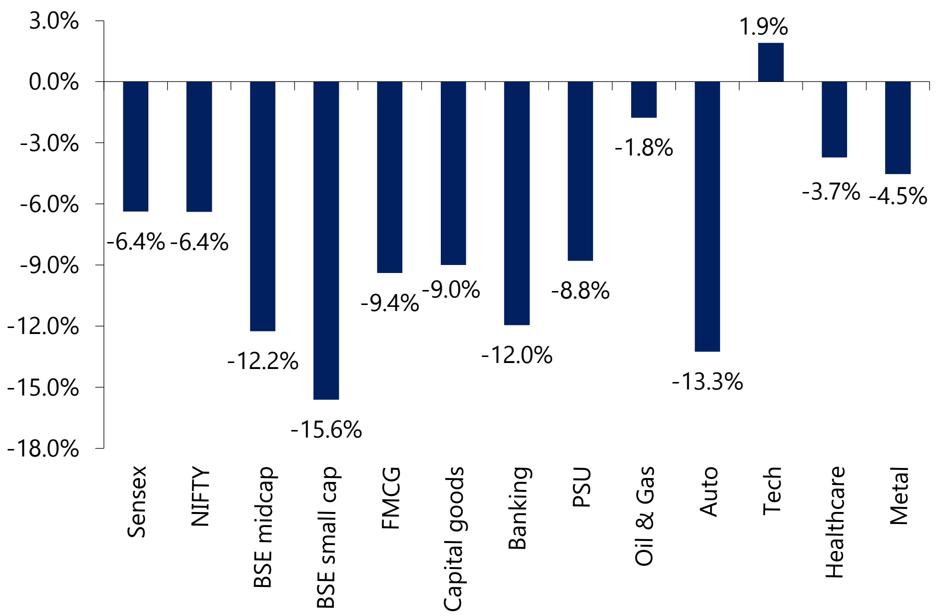
Return of volatility

September was a volatile month with domestic markets witnessing sharp correction led by continued rupee depreciation, higher crude prices, default from large financial institution IL&FS, higher yields and corresponding stress in NBFCs during the month. High valuation consumption related sectors also witnessed selling pressure owing to lesser risk reward ratio. Spike in bond yields, higher crude and depreciated currency has also resulted in valuation de-rating for sectors where earnings are likely to get impacted in near to medium term.

India is currently facing weaker macros with twin deficits and depreciated currency. Any slip on fiscal deficit given election year, higher inflation and rising crude can further pressurize INR in coming months, in our view. Under the given circumstances, we recommend investors to focus on companies that are capable of delivering strong earnings growth.

Market valuations have corrected in recent months and are trading at 20/17x FY19/20 estimated earnings but volatility is likely to remain owing to negative global cues as well as domestic factors such as elections, pressure on CAD and fiscal deficit from higher crude prices. Ideal approach is to use this volatility to add stocks that are likely to benefit from currency depreciation as well as healthy growth in respective domains (IT and Pharma), consumption growth as well as various defensives that have corrected in recent months and available at attractive valuations. Key risks to our recommendation would come from adverse outcome of further crunch in liquidity, state elections, further rise in oil prices & yields, shortfall in earnings or decline in liquidity from FIIs and domestic mutual funds.

Market performance – sector wise (September 2018)



Source: Bloomberg

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GLOBAL MARKETS

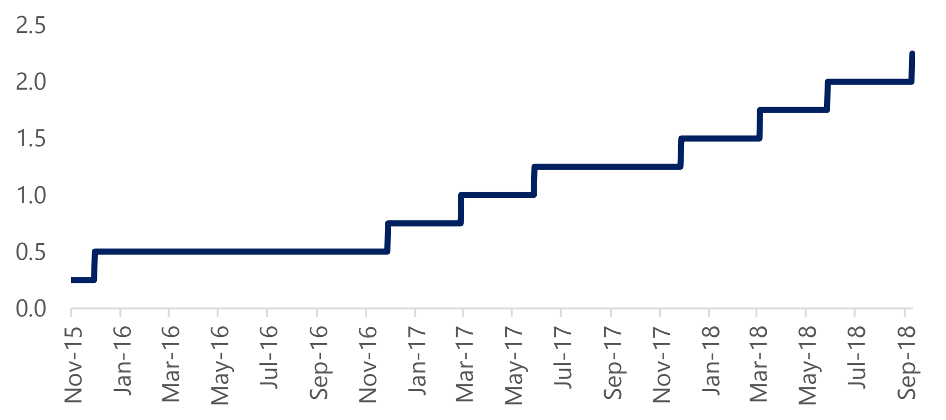
Global markets remained weak during the month amid heightened fears surrounding the state of trade between the U.S. and other major economies. Rising oil prices, higher yields in US, risks of currency contagion spreading to other emerging markets impacted markets negatively during the month.

US economy outlook strengthening but interest rate gap has widened with peers

US markets have moved up during the year till date due to front loading of tax reforms, economic recovery and higher government spending. However, during the month, markets remained volatile with trade war related concerns. US administration had imposed 10 percent tariffs on $200 billion worth of Chinese imports, which would rise to 25 percent by year-end. China also retaliated by announcing levies targeting over 5,000 American products worth $60 billion.

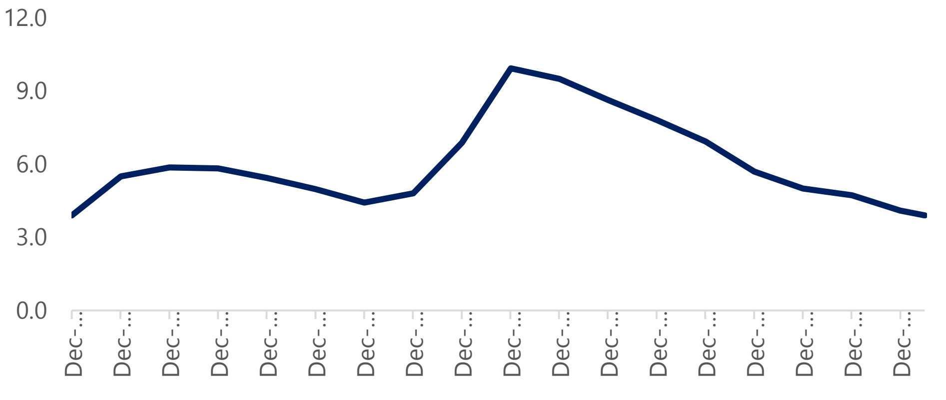
US Fed raised its target overnight rate to a range of 2 percent to 2.25 percent, up from 1.75 percent to 2 percent. This marks the central bank's eighth rate hike since 2015. Fed officials also upped their outlook for economic growth for this year and next. They now expect US economy to grow by 3.1 percent in 2018 from 2.8 percent earlier. They also see the economy expanding 2.5 percent in 2019, up from 2.4 percent. Fed rate hike has widened the gap with its peers as ECB still maintains a policy rate of -0.4 percent till June, 2019 and Bank of Japan is still sticking with its current rates till 2020. Thus, this hike can force the emerging markets to tighten their monetary policy to defend their currencies.

US Fed rate (%)



Source: Bloomberg

US unemployment growth (%)



Source: Bloomberg

Trade war and impact on currencies

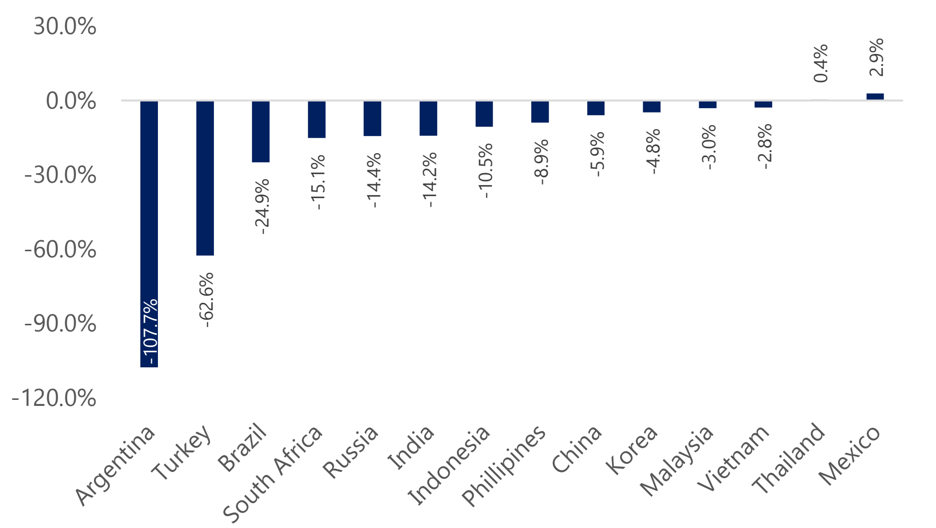
The trade war between US and China is resulting into a currency war among countries with sharp depreciation being witnessed in emerging market currencies.

US dollar has strengthened compared to other emerging market currencies on the back of continued strength in the US economy and subsequent rate hikes by the US Fed and trade war related concerns between US and China. The steps taken by the government on tax cuts and deregulation are promoting economic growth. However the interest rate differential between US and other regions is increasing and putting pressure on the exchange rates. Fed has been indicating faster policy normalization while the rate hikes in EU have been pushed to mid-2019. This divergence in monetary policy stance is resulting in strengthening of US dollar vis-à-vis emerging markets.

Apart from US dollar strengthening, adverse risk of trade war, escalating geopolitical tensions, political and economic uncertainties in Turkey, Argentina and Brazil have sparked the fears of contagion spreading to other emerging markets particularly the ones with current account deficit.

Indian rupee has depreciated by 14% since the beginning of 2018. The higher current account deficit due to higher crude prices, rising US Fed rates and a slowdown in FII inflows into the Indian capital market is already weakening the Indian currency. The trade war has further increased the woes of the Indian economy with rupee depreciating by 2% further in September month itself.

Emerging market currencies – Performance CYTD (%)



Source: Bloomberg

China market impacted by trade war

Chinese economy held up well during August 2018 despite escalating trade tensions with the United States. Industrial production expanded 6.1% annually while nominal retail sales grew 9.0% on an annual basis, a slight acceleration from the 8.8% expansion registered in July.

However, stocks faced selling pressure owing to trade war related concerns. With the latest round of tariffs on $200 billion worth of Chinese imports to the U.S. at a 10 percent rate before rising to 25 percent, the GDP growth of the country is likely to be impacted adversely as the economy is already reeling under high debt, slowdown in property market and potential corporate defaults. The BATs – Baidu, Alibaba and Tencent – which had become a proxy for the Chinese economy have underperformed the FANG stocks – Facebook, Amazon, Netflix and Alphabet (parent of Google) owing to concerns of slowdown in economy, high valuations as well as trade issues between US and China. Chinese authorities had been trying to rein in the country's rising debt but as the trade war drags on, China appears to be using investments to boost the economy again.

Oil prices continue to move up

Oil prices rose sharply during the month as reserves' drawdown in the US and supply disruptions from Venezuela and Iran pushed prices higher. During the month President Trump urged OPEC members to lower the prices. OPEC and allies have ruled out any immediate additional increase in crude supply to offset a shortage of Iran supplies due to US sanctions which are set to take effect in November. Once these sanctions are in place from November 2018, there is a possibility of further increase in brent crude prices if OPEC countries fail to increase supplies in the market.

As per our analysis, every $10 increase in per barrel price of crude has the potential to increase our import bill by $11.3 bn per annum and erode 40 bps of GDP. Higher crude prices would also increase raw material cost, working capital requirements and operating cost for user industries such as lubricant manufacturer, chemicals industry including consumer staples and paints.

Brent Crude (US$/barrel)

Source: Bloomberg

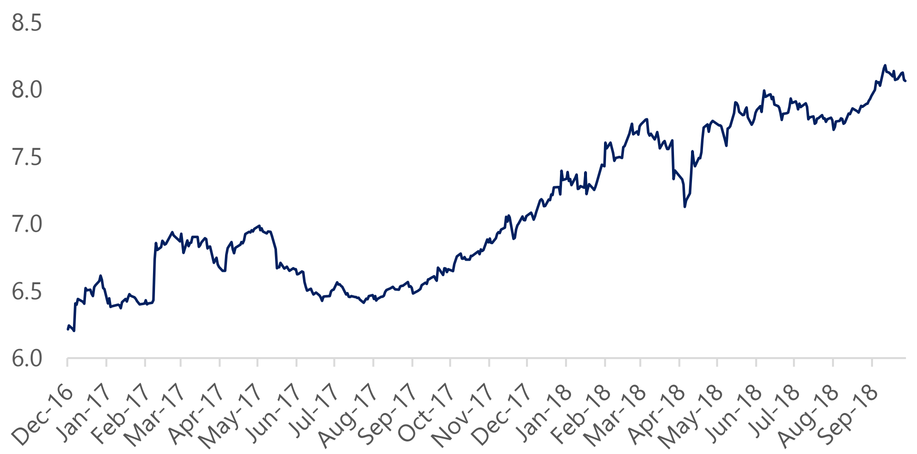
DOMESTIC MARKETS

September was an eventful month with domestic markets witnessing sharp correction led by continued rupee depreciation, higher crude prices, default from large financial institution IL&FS, higher yields and corresponding stress in NBFCs during the month. High valuation consumption related sectors also witnessed selling pressure owing to lesser risk reward ratio. Spike in bond yields, higher crude and depreciated currency has also resulted in valuation de-rating for sectors where earnings are likely to get impacted in near to medium term.

Bond market crisis impacted equity markets too

After the defaults by IL&FS in the past month, liquidity crisis fears started gripping the debt market which had its adverse impact on equity markets too. There are concerns being raised of a contagion impact of further defaults in case of more cash worries in the market, especially when the yields on bonds are rising. The distress selling in DHFL bonds at higher yields sparked concerns of liquidity crisis over likely further defaults in the bond market, especially after IL&FS had been unable to make repayments on two of its bond maturities.

10-year GSec yield (%)



Source: Bloomberg

10-year GSec Bond yields have moved up to 8.2% - led by liquidity crunch, advance tax outflows in second half of the month and government's borrowing plan in H2FY19. Sharp spike in GSec yields has now moved up the cost of capital thereby impacting valuations. Recent spike in the bond yields now calls for rate hike in October meeting from RBI despite sub-5% inflation and expectation of moderation of growth in H2FY19.

Yields are likely to remain high owing to rising crude prices, rate hikes by central banks, trade war tensions, uptick in core inflation, pass through of MSPs and possibility of fiscal slippage at the centre or state level.

As per our currency team, the bear handshake between credit and equity markets is an ominous development for Rupee. Rising oil prices, elevated levels of yields in DM and EM had caused an outflow from the markets and now the funding squeeze in the under developed debt market in India can cause further damage to Rupee and we could see Rupee depreciating towards 75.00 levels on spot. Any slip on fiscal deficit given election year, higher inflation and rising crude can further pressurize INR in coming months, in our view.

Currency depreciation coupled with higher crude prices to impact sectors in Q2FY19

Impact of INR depreciation and its corresponding impact on overall cost is likely to be reflected on sectors during Q2FY19/H2FY19 with sectors like IT/Pharma/textile/speciality chemicals/steel/upstream companies getting positively impacted and negative impact is likely to be seen for aviation, downstream companies, cement, tiles, selective FMCG companies/power sector.

IT companies would enjoy both translation and margin gains in the near term but we believe it will be short lived and eventually companies will pass on the currency benefits to clients over time.

Pharma sector is also likely to benefit positively as nearly 40% of revenues for most of the leading players come from US and over 70% revenues are generated outside India (dollar bills), hence rupee depreciation is also expected to benefit and cushion the earnings growth this year.

For Steel sector, rupee depreciation has lifted import parity price, thereby giving room to the domestic steel manufacturers to hike prices. We expect, domestic steel prices to stay firm in the near term. Margins of domestic players are expected to remain strong in 2HF19, supported by weaker Rupee and strong demand. Downstream oil and gas sector which includes refining companies like IOC, BPCL and HPCL are negatively impacted due to higher crude oil prices and depreciated INR as their raw material cost, operating cost, working capital and interest cost increases. On the top of it, market is concerned about pricing freedom of these companies especially during election heavy year. Upstream companies like ONGC and Oil India are getting benefited with higher crude oil price and weaker rupee. Additionally, from 1st Oct'18, domestic gas prices are expected to rise which will be positive for these companies but will be negative for city gas distribution companies if they fail to pass on.

However, the rise in gas prices along with rupee depreciation is expected to be negative for building material companies like tiles as companies would find it difficult to pass on the cost pressures of higher power cost due to lower than expected demand growth. For cement, aviation, power etc the cost pressures are going to increase with rupee depreciation and higher imported coal prices or higher ATF prices.

Despite moderation in inflation, RBI likely to hike rates in October

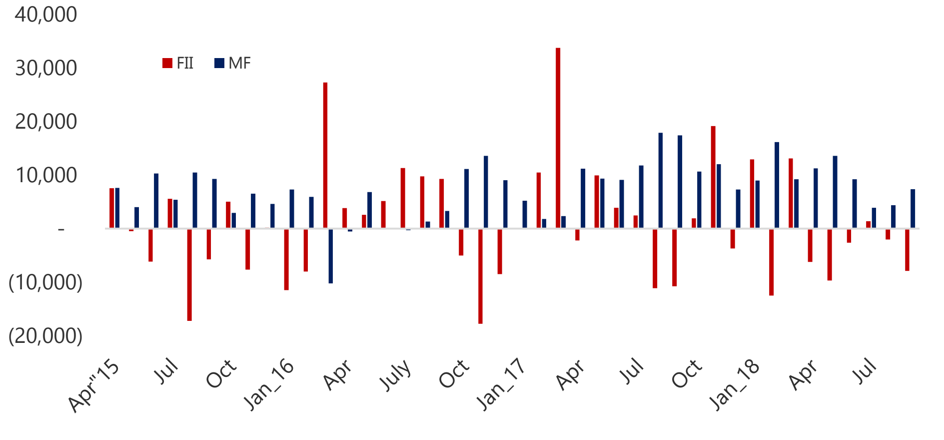
CPI inflation moderated to 3.69% in August compared to 4.17% in July led by softer food and core inflation. However, the food inflation is likely to inch up higher led by MSP increases for the Kharif output. Core inflation (including petrol and diesel) moderated to 6% in August from 6.2% in July. Even as the fading of adverse base effect will continue to moderate core inflation lower, our economist estimates average core inflation at 5.7% in FY19.

We remain watchful of the INR depreciation and higher crude prices as it increases the risk of imported inflation in the near to medium term. Though a sub 5% inflation and expectation of moderation in growth in 2HFY19 would have provided some room for the MPC to remain on hold, our economist believes that the MPC will deliver a 25 bps of repo rate hike in the October policy, possibly with a tweak in the policy stance to take into account the forex and crude price risks.

FII's remained net sellers for the month

FIIs remained net sellers for the month due to trade war fears, rise in US yields coupled with rupee depreciation and sold stocks worth Rs79 bn (till 25th Sep). Buying from mutual funds has come down and stood at Rs.74 bn (till 25th Sep). For CYTD, FII's remained net sellers to the tune of Rs.133 bn and MFs remained net buyers to the tune of Rs.843 bn.

FII & Mutual Fund investment (Rs cr)



Source: Bloomberg

Recommendation

Market valuations have corrected in recent months and are trading at 20/17x FY19/20 estimated earnings but volatility is likely to remain high owing to negative global cues as well as domestic factors such as elections, pressure on CAD and fiscal deficit from higher crude prices. Ideal approach is to use this volatility to add stocks that are likely to benefit from currency depreciation as well as healthy growth in respective domains (IT and Pharma), consumption growth as well as various defensives that have corrected in recent months and available at attractive valuations. Key risks to our recommendation would come from adverse outcome of further crunch in liquidity, state elections, further rise in oil prices & yields, shortfall in earnings or decline in liquidity from FIIs and domestic mutual funds.

Preferred picks

Domestic Cyclicals / Investment oriented sectors

Sector	Stocks
Automobiles	Maruti Suzuki
Building Material	Kajaria Ceramics, Century Plyboards, Shankara Building Products
Capital Goods, Engineering	Genus Power Infra, L&T, Voltamp, Bharat Electronics
Construction	Dilip Buildcon, Nagarjuna Construction, PNC Infratech
Consumer durables	Amber Enterprises
Metals & Mining	Jindal Stainless (Hisar), MOIL Ltd, National Aluminium
Oil & Gas	Petronet LNG
Others	CDSL, Mold-tek Packing Ltd, Insecticides India, Mahindra Holidays & Resorts India, VIP Industries, Wonderla Holidays and Carborundum Universal, Maharashtra Seamless Ltd, Essel Propack, Quess Corp
Real Estate	Phoenix Mills, Arvind Ltd
Transportation	Adani Port, Container Corp, VRL Logistics and Cochin Shipyard

Source: Kotak Securities - Private Client Research

Export oriented / Defensive sectors

Sector	Stocks
FMCG	ITC, Marico
IT	Cyient Ltd, Persistent Systems
Paints	Akzo Nobel India, Kansai Nerolac Paints Ltd

Source: Kotak Securities - Private Client Research

RATING SCALE

Definitions of ratings

BUY	–	We expect the stock to deliver more than 12% returns over the next 12 months
ACCUMULATE	–	We expect the stock to deliver 5% - 12% returns over the next 12 months
REDUCE	–	We expect the stock to deliver 0% - 5% returns over the next 12 months
SELL	–	We expect the stock to deliver negative returns over the next 12 months
NR	–	**Not Rated.** Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
SUBSCRIBE	-	We advise investor to subscribe to the IPO.
RS	–	**Rating Suspended.** Kotak Securities has suspended the investment rating and price target for this stock, either because there is not a Sufficient fundamental basis for determining, or there are legal, regulatory or policy constraints around publishing, an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon.
NA	–	**Not Available or Not Applicable.** The information is not available for display or is not applicable
NM	–	**Not Meaningful.** The information is not meaningful and is therefore excluded.
NOTE	–	Our target prices are with a 12-month perspective. Returns stated in the rating scale are our internal benchmark.

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