IDFC MUTUAL FUND

MARKET OUTLOOK

EQUITY MARKET

JANUARY 2019

WHAT WENT BY

The year when hero became zero

After a sunshine filled 2017, 2018 could be best described a bleary, windy winter for Indian investors, especially those investing through mutual funds. Across segments, out of the 180 odd open-ended equity funds only 20 open ended funds posted positive returns. Easily the lowest percentage in a decade. To add salt to injury, SENSEX (even in US$ terms) emerged as the #2 Index across the world. SENSEX outperformance was breathtaking, best performing index in Asia, outperforming MSCI emerging Market Index by a whopping 14%.

Most MF investors, unfortunately, were not celebrating this podium finish. Across MF categories, 20 funds (open ended diversified) reported positive returns with 10 of them reporting less than +1% return. Even in the large cap category, only 6 out of the 27 funds reported positive returns. No fund beat the SENSEX TRI and 2 funds beat the NIFTY TRI. No wonder, investors faced with the scale of underperformance across categories, renewed interest in Indexing/ETF investing. On the PMS/AIF front, where most of the investments were made in small and mid-caps, the story should have been more acute; small solace for the MF industry.

The key reason for the skewness in returns was the narrow contribution of stocks and sectors to returns. The largest 10 stocks in the NIFTY Index recorded a return of +15.0% as compared to 3.2% for the NIFTY Index. Only 3 sectors – IT Services, Private Banks and FMCG gave positive returns. The below tables depict the narrow distribution of returns

- At 34% of the total stocks, Large Caps had the highest proposition of positive returns followed by midcaps at 27% and small caps only 14%
- Most stocks and portfolios gave significant negative returns
- Only 21% of the BSE500 stocks gave positive returns
- 32% of Large Caps, 43% of Mid-Caps and 66% of Small Caps fell in excess of -20%

BSE500	Large Cap	Mid Cap	Small Cap	Total
>20%	16%	14%	6%	10%
0 to 20%	18%	13%	8%	11%
-20% to 0%	34%	30%	21%	27%
-40% to -20%	24%	30%	33%	30%
-60% to -40%	4%	10%	25%	16%
<-60%	4%	3%	8%	6%

Given the last two year's trend – 2017 was the year of small and mid-caps and 2018 belonged to the largest of the large caps. What augurs for investors going forward? While refraining from predicting, several issues need to be highlighted:

From the bottom of Sep'13 to the high of Jan'18, small caps were on a dream run. In the current fall, the excesses of small caps may have well endured a price correction, though markets could witness a reasonably long time correction. While price correction at the index level and individual stock level may be behind, the next few quarters will witness "Manthan" – churning of positions from older hands to newer - weaker to stronger. However, the concern on valuations, which on hindsight, appeared fairly straight forward in December 2017, is not any more the issue. While it is difficult to predict how long a time correction lasts, price destruction to a large extent is behind us.

Entwined with small caps is the debacle of "Cyclical" segment – Private sector corporate focused banks; PSU banks; Infrastructure related NBFCs; Cement; Commodities; Telecom; Power Utilities; Construction & Capital Goods. This was the other segment which was pummeled by the markets after a shiny 2017. Will this recover some of the lost sheen? Valuations appear to be in favour, though investor confidence may not be as supple as it was in 2017.

Politics will hold the center stage at least in the first half of 2019, and should reduce in relevance in the second half. This is based on the premise that the largest party in any coalition has over 180 seats and we have a modicum of a stable government.

Lastly, global markets are facing a headwind of "QT" Quantitative tightening, the reverse of QE. While the US Fed has already commenced the shrinkage of its balance sheet, down roughly $400bn and estimated to reduced further by $50bn per month. Tightening in Europe should be announced by the ECB in the second half of CY19. Japan, though, continues to maintain a loose monetary policy. China, given the slowdown, can hardly afford to tighten too quickly. In this context, a "non-US trained Economist" at the RBI's helm may be the much needed salve that Indian investors needed. We expect currencies to remain volatile.

Finally, for investors who are ruing their luck of not being in those 20 funds which registered positive returns, 10 funds were in the bottom quartile, 6 in Q3 and **only 3 were in the top two quartiles** in CY 2017.

Currencies and Commodities

The Dollar Index appreciated +4.4% in CY 18, causing most global currencies to depreciate. The INR (-9%) was in the middle of the pack. Most commodities fell in CY 18 led by Oil. Oil saw a sharp 20-25% fall in CY 18 after two previous positive years. Most metals fell in CY 18 on fears of global growth slowdown and increasing supply in China.

Currencies	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18
India	-2.0%	-4.9%	-2.7%	6.0%	-9.2%
Developed Markets					
US	12.8%	9.3%	3.6%	-9.9%	4.4%
UK	-5.9%	-5.4%	-16.1%	9.4%	-5.6%
EURO	-12.0%	-10.3%	-3.1%	14.1%	-4.5%
Japan	-12.0%	-0.3%	2.6%	3.8%	2.7%
Asia					
Indonesia	-2.1%	-10.3%	2.7%	-0.7%	-5.8%
Malaysia	-6.4%	-18.4%	-4.3%	10.5%	-1.8%
Pakistan	4.5%	-3.9%	0.5%	-5.5%	-20.5%
Philippines	-0.9%	-4.5%	-5.5%	-0.7%	-4.6%
South Korea	-3.8%	-7.0%	-2.6%	13.1%	-4.2%
Taiwan	-5.6%	-4.1%	2.4%	8.1%	-2.9%
China	-2.4%	-4.4%	-6.6%	6.8%	-5.4%
India	-2.0%	-4.9%	-2.7%	6.0%	-9.2%
Other BRICS					
Russia	-43.3%	-19.3%	16.7%	6.8%	-17.2%
Brazil	-10.8%	-33.2%	21.7%	-1.7%	-14.7%
South Africa	-9.3%	-25.3%	12.8%	10.9%	-13.7%
Europe					
Czech Republic	-13.1%	-8.1%	-3.1%	20.7%	-5.1%
Hungary	-17.3%	-10.0%	-1.2%	13.4%	-7.3%
Poland	-14.7%	-9.7%	-6.3%	20.2%	-6.6%
Turkey	-8.0%	-20.0%	-17.2%	-7.1%	-28.3%
Latin America					
Argentina	-23.0%	-34.5%	-18.5%	-14.7%	-50.6%
Chile	-13.4%	-14.4%	5.7%	9.0%	-11.3%
Colombia	-19.1%	-25.1%	5.8%	0.6%	-8.1%
Mexico	-11.6%	-14.2%	-17.0%	5.5%	0.0%

Commodities	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18
Oil & Gas					
WTI	-46%	-30%	45%	12%	-25%
Brent	-48%	-35%	52%	18%	-20%
Natural Gas	-32%	-19%	59%	-21%	0%
Metals					
Gold	-1%	-10%	8%	14%	-2%
Silver	-19%	-12%	15%	6%	-9%
Aluminium	3%	-19%	12%	34%	-19%
Copper	-14%	-25%	18%	31%	-18%
Zinc	6%	-26%	60%	29%	-26%
Steel	-16%	-36%	75%	22%	-18%
Agri					
Sugar	-12%	5%	28%	-22%	-21%
Cotton	-29%	5%	12%	11%	-8%
Rubber	-38%	-26%	84%	-19%	-14%
Coffee	50%	-24%	8%	-8%	-19%
Corn	-6%	-10%	-2%	0%	7%
Wheat	-3%	-20%	-13%	5%	18%

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Global Equity Markets

	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Comments
India	27%	-9%	-1%	36%	-3%	India - Sensex Returns in USD
World	2%	-4%	6%	22%	-11%	
Developed Markets	3%	-3%	5%	20%	-10%	
Emerging Markets	-5%	-17%	9%	34%	-17%	Indian Market beat MSCI EM by 14% and MSCI DM by 7%
Developed Markets						
US	11%	-1%	10%	19%	-6%	US Market fell 6%, most other DMs fell much more
UK	-8%	-10%	-4%	18%	-18%	
Germany	-10%	-2%	3%	28%	-22%	
Japan	-6%	8%	4%	23%	-10%	
Brics						
India	27%	-9%	-1%	36%	-3%	India the 2nd best performing BRIC after Brazil
Russia	-45%	-4%	52%	0%		
Brazil	-13%	-42%	69%	25%	-2%	
South Africa	-2%	-24%	13%	30%	-24%	
China	49%	5%	-18%	14%	-29%	
Asia						
Indonesia	20%	-21%	18%	20%	-9%	
Malaysia	-12%	-22%	-7%	21%	-8%	
Pakistan	33%	-2%	46%	-20%	-27%	India was the best performing Asian markets
Philippines	22%	-8%	-7%	24%	-17%	
South Korea	-8%	-5%	1%	37%	-21%	
Taiwan	2%	-14%	13%	26%	-11%	
China	49%	5%	-18%	14%	-29%	
India	27%	-9%	-1%	36%	-3%	
Eastern Europe						
Czech Republic	-17%	-7%	-7%	41%	-14%	
Hungary	-26%	30%	31%	40%	-9%	
Poland	-14%	-18%	4%	48%	-16%	
Turkey	16%	-33%	-10%	37%	-43%	
Latin America						
Argentina	21%	-10%	18%	52%	-50%	
Chile	-10%	-18%	19%	46%	-19%	
Colombia	-24%	-43%	24%	13%	-20%	
Mexico	-10%	-15%	-11%	13%	-16%	

Domestic Markets

Indian Market Snapshot	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Comments
USD INR	-2.0%	-4.9%	-2.7%	6.0%	-9.2%	After a strong CY 17, INR witnessed a sharp depreciation, before recovering towards the year-end to close 9.2% below
Broad Market						
S&P BSE 500 IDX	37%	-1%	4%	36%	-3%	
Market Cap Wise						
Nifty 50	31%	-4%	3%	29%	3%	Small Caps underperformed NIFTY by a greater amount (-32%) as compared to their outperformance (+28%) in CY 17. NIFTY and SENSEX were positive but the broader markets were negative
NIFTY Midcap 100	56%	6%	7%	47%	-15%	
NIFTY Smallcap 100	55%	7%	2%	57%	-29%	

Sector Wise					
SPBSEPrivBINR	67%	-5%	10%	42%	7%
S&P BSE PSU	39%	-17%	13%	19%	-21%
S&P BSE Finance	59%	-6%	7%	43%	2%
S&P BSE FastMovConsGoods	19%	2%	3%	32%	11%
S&P BSE AUTO	52%	-1%	9%	32%	-22%
S&P BSE ConsDisGoods&Svc	54%	8%	5%	54%	-16%
S&P BSE CONSUMER DURAB	66%	24%	-6%	102%	-9%
S&P BSE Healthcare	48%	15%	-13%	0%	-6%
S&P BSE Information Tech	18%	4%	-8%	11%	25%
S&P BSE Telecom	9%	3%	-21%	49%	-41%
S&P BSE Utilities	20%	-4%	10%	30%	-15%
S&P BSE CAPITAL GOODS	50%	-9%	-3%	40%	-2%
S&P BSE India Infrastr		-9%	12%	35%	-21%
S&P BSE Industrials	55%	-6%	1%	38%	-19%
S&P BSE India Manufac	31%	-1%	4%	31%	-5%
S&P BSE Basic Materials	28%	-14%	32%	56%	-19%
S&P BSE OIL & GAS	12%	-3%	27%	34%	-16%
S&P BSE METAL	8%	-31%	37%	48%	-21%

Breadth of positive return sectors was very narrow - 3 to be precise.
IT Services which was one of the laggards of CY 17, outperformed significantly in CY 18
FMCG (+11%) and Private Banks (+7%) were the only two other sectors to post positive returns for the year

Key cyclical sectors - PSU Banks ,Industrials, Cap Goods, Infrastructure, Telecom, Utilities Metals and Oil all posted negative returns
PSU Bank Index fell 21% after the sharp rally seen in Oct-2017 as this was negated by a series of scandals
Industrials, Construction and Caps Goods saw a sharp PE derating despite reporting good numbers and strong order books
Metal stocks corrected as global commodity prices corrected on concerns of increasing supply in China
Oil stocks corrected as the government asked PSU oil companies to absorb increasing oil prices
The sustained price war in Telecom continued unabated with aggregate industry revenues falling

India Valuation

	Dec-07	Dec-13	Dec-16	Dec-17	Dec-18	Jan-18	Dec-18	Correction	5Yr Avg	% Prem	10Yr Avg	% Prem
PE Ratio												
NIFTY INDEX	22.5	16.2	20.9	23.9	22.2	23.8	22.2	-6.9%	20.8	6%	19.1	16%
NSEMCAP INDEX	21.5	13.5	27.2	45.0	44.4	43.3	44.4	2.6%	29.1	53%	21.7	105%
Difference with NIFTY	*-1.0*	*-2.7*	*6.2*	*21.1*	*22.3*	*19.5*	*22.3*		*8.3*		*2.5*	
NSESMCP Index		44.8		129.4	73.6	670.6	73.6	-89.0%	110.1	-33%	75.7	-3%
Difference with NIFTY		*28.6*		*105.5*	*51.4*	*646.8*	*51.4*					
Positive PE Ratio												
NIFTY INDEX	22.2	15.5	19.7	23.9	21.0	23.1	21.0	-9.4%	20.1	4%	18.3	14%
NSEMCAP INDEX	19.9	11.3	17.3	29.6	18.4	27.6	18.4	-33.4%	19.6	-6%	15.8	17%
Difference with NIFTY	*-2.3*	*-4.3*	*-2.4*	*5.7*	*-2.6*	*4.5*	*-2.6*		*-0.5*		*-2.5*	
NSESMCP Index		9.3	15.2	21.4	13.5	19.9	13.5	-32.1%	15.1	-10%	13.2	2%
Difference with NIFTY		*-6.2*	*-4.5*	*-2.5*	*-7.4*	*-3.2*	*-7.4*		*-5.0*		*-5.1*	

Comments

NIFTY PE has seen a correction of 6.9% from the peak in Jan but it is still at a premium to the 5 and 10 Year average

The Trailing PE for Mid and Small Cap Indices is not meaningful as these indices have large loss making companies - mainly PSU banks. Positive PE - which excludes these loss making companies makes more sense.

The positive PE has seen a significant correction for both the Mid and Small Cap indices. The small cap Index PE is below the 5 year average and in line with the 10 year average

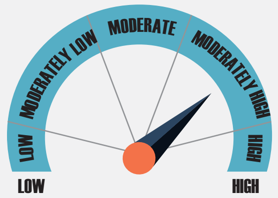
Source of data: Bloomberg

IDFC MUTUAL FUND

Our Product Offerings

- **IDFC Core Equity Fund** (Large & Mid Cap Fund - An open ended equity scheme investing in both large cap and mid cap stocks) is a diversified equity fund with a large cap bias currently. The focus of the fund is to build a portfolio of Quality companies while being cognizant of the relative valuation.
- **IDFC Sterling Value Fund** (An open ended equity scheme following a value investment strategy) is a value cap fund that focuses on active stock selection strategy.
- **IDFC Multi Cap Fund** (Multi Cap Fund – An open ended equity scheme investing across large cap, mid cap, small cap stocks) is a multi-cap Equity Fund. It is a fund that encourages systematic investing.
- **IDFC Focused Equity Fund** (An open ended equity scheme investing in maximum 30 stocks with multi cap focus): A concentrated portfolio of up to 30 stocks with the flexibility to invest across sectors and across market cap.
- **IDFC Large Cap Fund** (Large Cap Fund - An open ended equity scheme predominantly investing in large cap stocks) is an equity oriented fund primarily focused on investing in large cap stocks
- **IDFC Tax Advantage (ELSS) Fund** (An open ended equity linked saving scheme with a statutory lock in of 3 years and tax benefit): An Equity Linked Savings Scheme (ELSS) that aims to generate long term capital growth from a diversified equity portfolio and enables investors to avail of a deduction from total income, as permitted under the Income Tax Act, 1961.
- **IDFC Hybrid Equity Fund** (An open ended hybrid scheme investing predominantly in equity and equity related instruments) provides a combination of equity (between 65% and 80%) and debt (between 20% and 35%) so as to provide both relative stability of returns and potential of growth. Both equity and fixed income portions are actively managed. Both equity and fixed income portions are actively managed.
- **IDFC Dynamic Equity Fund** (An open ended dynamic asset allocation fund): 'Dynamically' invests between Equity and Debt and an Equity fund that buys less when markets are expensive and more when markets are cheap; based on the model that tracks market valuation.
- **IDFC Infrastructure Fund** (An open ended equity scheme investing in Infrastructure sector): A dedicated Infrastructure fund, that invests across the infrastructure value chain with exclusions like Banking, Autos, IT, Pharma and FMCG.

RISKOMETER



Investors understand that their principal will be at moderately high risk

IDFC Core Equity Fund

This product is suitable for investors who are seeking*:
- To create wealth over long term.
- Investment predominantly in equity and equity related instruments in large and mid-cap companies.

IDFC Sterling Value Fund

This product is suitable for investors who are seeking*:
- To create wealth over long term.
- Investment predominantly in equity and equity related instruments following a value investment strategy.

IDFC Multi Cap Fund

This product is suitable for investors who are seeking*:
- To create wealth over long term.
- Investment predominantly in equity and equity related instruments across market capitalisation.

IDFC Focused Equity Fund

This product is suitable for investors who are seeking*:
- To create wealth over long term.
- Investment in a concentrated portfolio of equity and equity related instruments of up to 30 companies.

IDFC Large Cap Fund

This product is suitable for investors who are seeking*:
- To create wealth over long term.
- Investment predominantly in equity and equity related instruments of the large cap companies.

IDFC Tax Advantage (ELSS) Fund

This product is suitable for investors who are seeking*:
- To create wealth over long term.
- Investment predominantly in Equity and Equity related securities with income tax benefit u/s 80C and 3 years lock-in.

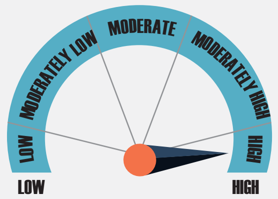
IDFC Hybrid Equity Fund

This product is suitable for investors who are seeking*:
- To create wealth over long term.
- Investment predominantly in equity and equity related securities and balance exposure in debt and money market instruments.

IDFC Dynamic Equity Fund

This product is suitable for investors who are seeking*:
- To create wealth over long term.
- Dynamic allocation towards equity, derivatives,debt and money market instruments.

RISKOMETER



Investors understand that their principal will be at high risk

IDFC Infrastructure Fund

This product is suitable for investors who are seeking*:
- To create wealth over long term.
- Investment predominantly in equity and equity related instruments of companies that areparticipating in and benefiting from growth in Indian infrastructure and infrastructural related activities.

*Investors should consult their financial advisors if in doubt about whether the product is suitable for them.

Disclaimer:

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

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