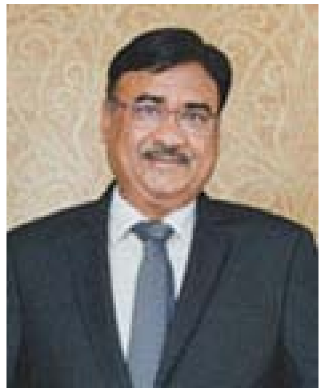

Mr. Ashok Ajmera, CMD & CEO

Mr. Ajmera's column as on 5th November, 2016

Nifty hits 4 months low; US Presidential elections result to drive market direction..

Domestic bourses performance

Nifty hit 4 months low of 8,400 during the week; ends at 8,433 losing 2.2% for the week. Major losers during the week were Pharmaceuticals and Textiles. Volatility (VIX) is rising steadily ahead of US Presidential Elections suggest bearishness for equity markets. The selling spree continues by FII (Foreign Institution Investors). Since October, FII have sold approx Rs.7000crs indicating they are light ahead of US Election.

GST update

The Goods and Services Tax (GST) Council on Thursday decided upon a four-slab tax structure of 5%, 12%, 18% and 28%, with lower rates for essential items and the highest for luxury and de-merits goods, many of which would also attract an additional cess.

India moved a step closer to creating a national sales tax but a deal on rates reached on Thursday will hit some businesses harder than others, while its complexity will dilute any boost to growth and undermine its reliability as a revenue generator. The Goods and Services Tax (GST), due to be rolled out from April 1, 2017, had been billed as the one reform that could help Prime Minister Narendra Modi deliver on his jobs and growth agenda. In a key Modi win, parliament amended the constitution in August to clear the way for the GST, which would unify Asia's third-largest economy into a common market for the first time. But Thursday's bargain between Finance Minister Arun Jaitley and his counterparts from India's 27 state governments has exposed the difficulties of dealing with so many stakeholders. The GST Council, set up to oversee the tax, agreed on a more steeply progressive structure for goods than earlier foreseen with rates of 5, 12, 18 and 28 percent, depending on the kind of product involved. The top rate, Jaitley said, would apply to the kind of goods bought by middle-class Indians. On top of that, essentials like grains that make up half the consumer price index would not be taxed at all. Finally, a "cess" - a separate central tax - would be added to the top 28 percent GST rate on luxury cars and harmful products like tobacco and fizzy drinks.

PSU Banks results under pressure

Quarterly results reported by state-run lenders on Friday show that asset quality issues continue to plague the banking system. Slow credit growth is making the pain only worse for the lenders.

Country's second largest public sector lender Punjab National Bank (PNB) has reported a 11.5 percent degrowth in second quarter profit at Rs 549.4 crore, impacted by higher provisions and lower NII but it was ahead of estimates due to treasury income. Asset quality also improved during the quarter but credit growth was muted. Net interest income, the difference between interest earned and interest expended, fell by 10.2 percent year-on-year to Rs 3,879.85 crore in July-September quarter due to muted credit growth. Other income or non-interest income during the quarter grew by 76 percent to Rs 2,387.91 crore and operating profit increased 12.7 percent to Rs 3,312.04 crore compared with year-ago period. Asset quality has seen an improvement in the quarter gone by as gross non-performing assets (NPA) as a percentage of gross advances dropped 12 basis points to 13.63 percent and net NPAs declined 6 bps to 9.10 percent on sequential basis. In absolute terms also, gross NPAs fell 0.3 percent quarter-on-quarter to Rs 56,465.63 crore and net NPAs slipped 0.02 percent to Rs 35,722.32 crore in the quarter ended September 2016. Capital adequacy ratio during the quarter, too, improved from 11.58 percent in June quarter to 11.65 percent in September quarter. Provisions jumped 34.6 percent year-on-year to Rs 2,533.8 crore in July-September quarter of FY17 but sequentially declined 7.5 percent.

Mumbai-based Union Bank of India and Kolkata-based Allahabad Bank reported second-quarter net profit of Rs176.67 crore and Rs 65 crore respectively. Central Bank of India reported a large loss of Rs 642 crore.

Union Bank’s provisions against bad loans rose to Rs1,596.21 crore, up 73% year-on-year, from Rs924 crore a year earlier. Central Bank’s provisions more than doubled to Rs1,661.21 crore, from Rs645.44 crore a year ago. he state-owned lender had reported a net profit worth Rs112.87 crore in the same quarter a year ago. The loss would have been bigger but for a Rs164.5 crore writeback on tax provisions. In the same quarter last year, Central Bank of India had provided Rs89.29 crore for tax. Provisions against bad loans rose sharply to Rs1,161.21 crore from Rs645.44 crore last year. Gross non-performing assets (NPAs) rose 2.4% from the preceding quarter to Rs25,718 crore. Gross NPAs made up 13.7% of the loan book, up from 13.52% in the June quarter. Net NPAs were stable sequentially at 8.17% of the loan book. Net Income Income (NII), or the difference between interest earned on loans and those paid on deposits, came in at Rs1,693.4 crore, down 11.5% from a year ago. Non-interest income rose to Rs776.64 crore from Rs473.25 crore a year ago.

In October last year, the Reserve Bank of India (RBI) conducted an asset quality review (AQR) wherein it made a list of accounts that continued to be classified as standard assets despite inherent weakness. RBI asked banks to reclassify some of these accounts as NPAs, or make higher provisions against them. The banks were given time until 31 March 2016 to do this.

While the impact of these bad loans had been expected to fade by 31 March, state-owned banks and some large private sector lenders have continued to make higher provisions in the first two quarters of this financial year. Incremental NPAs, however, are much lower than what they were in the October-March period of the last fiscal year.

Global Markets

The S&P 500 ended lower on Friday for a ninth straight day, the longest losing streak for the benchmark index in more than 35 years, as investors stayed on edge ahead of an uncertain US election. The tech-heavy Nasdaq also ended lower for a ninth-consecutive session, while the Dow industrials closed down for a seventh straight day. Investors have been unnerved by signs of a tightening presidential race between Democrat Hillary Clinton and Republican Donald Trump. Clinton had been thought to have a clear lead until the re-emergence last week of a controversy over her use of a private email server while secretary of state. "Investors are uncertain about the outcome of the election, and they have grown more uncertain since last Friday.

The Dow Jones industrial average fell 42.39 points, or 0.24 percent, to 17,888.28, the S&P 500 lost 3.48 points, or 0.17 percent, to 2,085.18 and the Nasdaq Composite dropped 12.04 points, or 0.24 percent, to 5,046.37.

Despite the historic run, the S&P has pulled back by only about 3.1 percent over that time. For the year, the index is up 2 percent. It was the 14th time since 1928 that the S&P 500 had declined for nine sessions in a row, according to S&P Dow Jones Indices. On Friday, Wall Street had posted solid gains as of the afternoon, spurred by a strong US employment report, but then lost steam and sold off into the close.

Week ahead and Ajcon's view:

We believe markets will take cue from the outcome of the US Presidential elections; corporate earnings growth in India; commodity prices, especially crude oil; and the progress on reforms, including tackling geopolitical concerns are the five key factors, will have a bearing on the markets . However, we don't rule out market volatility. At present, corporate profit to GDP is 4 percent, inflation is 4-5 percent, investment to GDP is 29 percent, savings is 33 percent We believe as savings and savings rate go up, investment to GDP is going to go up, inflation is low, consumer demand is also reviving. Hence we are bullish on the markets from a long term perspective. At current levels, markets will test investor's patience and conviction.

At current valuations, we advise investors to remain stock specific and use the buy – on – dips strategy to make most of this bull market. At current levels, we believe value is still left in both midcaps and smallcaps. Large caps look expensive but in sectors like IT and Pharma value picks are still available in large cap space. Intermediate corrections are part of any bull market and investors should not be scared of investing when the markets drift lower. The domestic economy grew at its slowest pace in five quarters in the April – June period falling below expectations but it still grew 7 percent which is still fastest in the world.

CA Ashok Ajmera

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For research related queries contact:

Mr. Akash Jain – Vice President (Research) at research@ajcon.net

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Website: www.ajcononline.com

Corporate and Broking Division : 408 – (4th Floor), Express Zone, "A" Wing, Cello – Sonal Realty, Near Oberoi Mall and Patel's, Western Express Highway, Malad (East), Mumbai – 400063. Tel: 91-22-67160400, Fax: 022-28722062

Registered Office: 101, Samarth, Off. Hinduja Hospital, 151 Lt. P.N. Kotnis Road, Mahim (West), Mumbai – 400016. Tel: 022-24460335/36/40

ASHOK KUMAR AJMERA

Digitally signed by ASHOK KUMAR AJMERA
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