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ISL – Portfolio Positioning

There has been a liquidity scare in the Indian financial system recently, driven by a few events which led to a spike in yields and related panic in equity markets. We see this as more of an isolated event rather than a systemic risk issue.

- Liquidity conditions have been tightening in India for the past 6-12 months
- IL&FS downgrade led to some debt investors turning risk averse
- One large institutional investor subsequently tried to sell commercial paper of an NBFC (Dewan Housing) at a discount for liquidity reasons

What happened with IL&FS

Earlier in September, IL&FS defaulted on a repayment of inter corporate deposits (unsecured) to SIDBI. This was followed by a sharp downgrade of its long term credit rating by ICRA from AA+ to BB (on 8th September 2018) and then a further downgrade to D (on 17th September). One of the key issues for IL&FS was liquidity mismatch as it was borrowing at the shorter end and lending at the long end.

IL&FS faces credit stress primarily due to delayed receivables on its road and infrastructure projects. This is a known area of stress for the market (infrastructure) in our view and not a new area (Housing / Auto). If we look at overall liquidity, it is still at a manageable level; however, the excess liquidity period post demonetization is now behind us.



IL&FS, is a core investment company (CIC) and serves as the holding company of the IL&FS group, which is involved in infrastructure development, finance, etc., with most business operations carried out by separate companies (~180 subsidiaries / associates / joint ventures). As of March 2018, it had standalone debt of ~Rs160bn and consolidated debt of ~Rs910bn (USD 12 bn approx.).

IL&FS is backed by strong shareholders, LIC (quasi-sovereign) and other reputable names.

Response from various stake holders

RBI and SEBI have issued a joint statement saying that they are 'closely monitoring recent developments in financial markets and are ready to take appropriate action, if necessary'. This is an unprecedented move where two regulators have come together to give a joint statement to assure the markets that they are going to step in if required.

To that effect, RBI has already announced open market

operations (injecting liquidity) worth Rs100 bn.

Key shareholders of IL&FS (LIC and Orix) say they are ready to inject equity into IL&FS which would keep the company afloat; IL&FS has said that it is planning to raise from promoter group (Rs45bn) as well as doing some non-core asset sales (Rs300bn).

Impact of the response

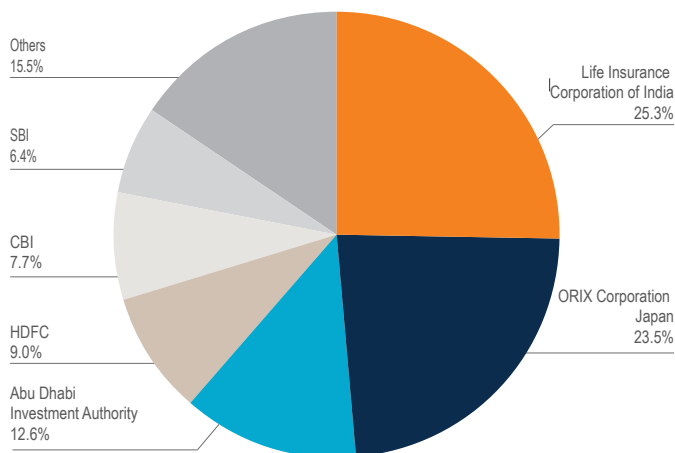
Bond markets have calmed and we have seen new issuances by NBFC's in the market. There is clear differentiation between good and bad quality NBFC's and in our view, this will continue to be the case.

Currency

There has been some investor concern around YTD Rupee depreciation. The YTD depreciation is more of a correction of the past appreciation. Historically, we have seen that post sharp depreciation in short period of time, Rupee has exhibited stability much more than other EM's currencies.

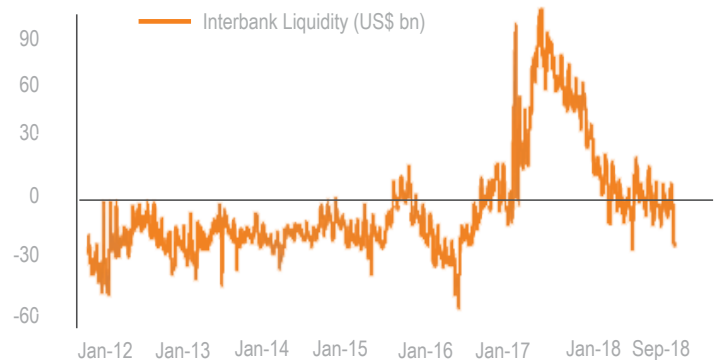
IL&FS Shareholding as of March 2018

Source: ICRA Report, Morgan Stanley, as of 31 Mar 2018.



Interbank Liquidity stayed close to neutral

Source: Bloomberg, Morgan Stanley Research, as of 30 Sep 2018.





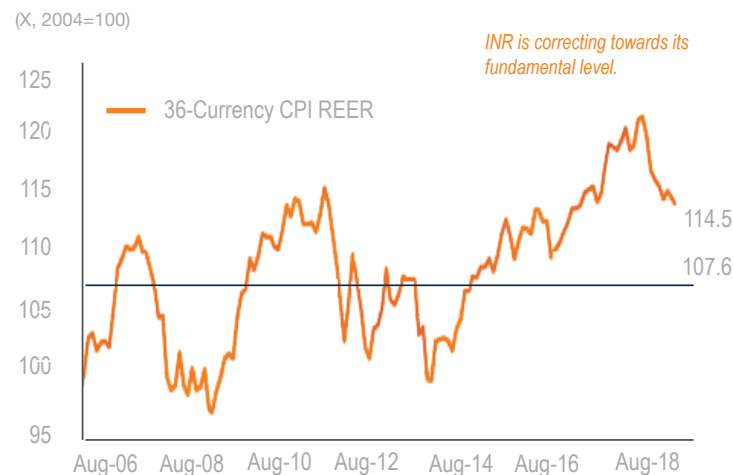
Exchange Rate Change vs USD

Source: Bloomberg, as of 30 Sep 2018.

EXCHANGE RATE CHANGE VS USD					
		1M CHG	3 M CHG	YTD CHG	12 M CHG
CN	6.87	0.6	-3.8	-9.3	-3.3
IN	72.7	-2.4	-6.2	-14.3	-11.4
KR	1,117	-0.4	-0.2	-4.7	2.4
TW	30.7	0.2	-0.6	-5.2	-1.1
ID	14,938	-1.5	-4.2	-11.6	-10.9
TH	32.5	0.9	1.7	-3.6	2.5
MY	4.14	-0.7	-2.5	-6.2	1.9
PH	54.2	-1.3	-1.6	-5.7	-6.7
SG	1.37	0.5	-0.2	-4.1	-0.6
HK	7.82	0.4	0.4	0.1	-0.1
AU	0.73	1.2	-1.8	9.7	-7.1

Real Effective Exchange Rate of Indian Currency

Source: CEIC, RBI, Kotak, as of 31 Aug 2018.

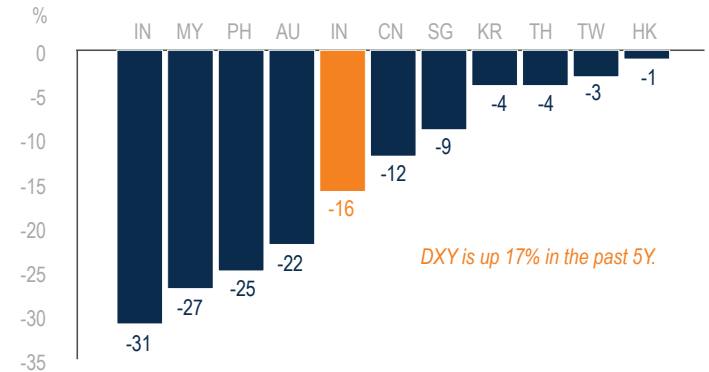


The Rupee (INR) is down 14% YTD, the weakest amongst Asian peers. However, it is more of a correction which was overdue as INR had appreciated on REER terms by 20% since the middle of 2013. This appreciation should not have happened in the first place and it is a natural correction where the Rupee is heading towards its fundamental level.

We see INR settling between 72-75 vs the USD, where it would

5 Year Change vs USD

Source: Bloomberg, as of 30 Sep 2018.



be close to its long term average levels. The below REER is up to August and INR has further depreciated by 2.5% in last month, so we are getting close to mean levels on a REER basis.

Despite INR being the worst performer YTD relative to Asian peers, on a 5-year basis, it is in the middle of the pack and still the best amongst current account deficit countries in Asia. Over 5 years, it is down 16%, which is in line with the 17% appreciation in the US Dollar Index (DXY) during the same period.

Vulnerability to Rising Oil Prices

India, being a trade deficit economy and an importer of a large amount of its crude oil requirements, is seen as more vulnerable to higher crude oil prices. Sensitivity shows oil at USD 80/barrel increases trade deficit by USD 20bn (0.6% of GDP) vs base case of USD 70/barrel for the year.

Both the government and RBI have been taking lot of proactive measures to ensure currency stability on a trade weighted basis. **Unlike vulnerable countries such as Turkey or Argentina, India by virtue of a closed account has a low 24% short term debt to reserves. It is highly likely that RBI may do a dollar bond raise of USD 30-35 bn to defend currency to approx. Rs 73-75 levels.**



High Levels of Short-term External Debt Relative to Reserves Implies a Weaker Currency - Turkey, Malaysia and Argentina at Risk

Source: BofA Merrill Lynch Global Research, IIF, World Bank, CEIC, as of 30/09/18.

COUNTRY	12/31/2007	12/31/2017	CHANGE (%)
Turkey	58.8	139.9	81.2
Malaysia	22.9	86.9	64.1
Argentina	98.1	146.9	48.8
China	15.4	34.8	19.4
India	15.3	23.3	8.0
Indonesia	33.9	38.6	4.7
Mexico	32.1	34.4	2.4
Russia	21.0	15.8	-5.2
Brazil	21.6	14.6	-7.1
Thailand	39.6	30.7	-8.9
South Africa	81.3	72.3	-9.0
Philippines	32.5	19.5	-13.0
Chile	67.9	53.9	-14.0
Poland	72.1	46.3	-25.7
Korea	63.3	30.2	-33.1
Emerging Markets	26.0	35.1	9.1
Emerging Markets ex China	35.1	35.5	0.4

Political Uncertainty

Political uncertainty along with current account deficit is another concern on investor's minds. The base case scenario is that the Modi government returns to power though with a lower majority. Initiatives such as electrification, rural infrastructure build-out, financial inclusion and large scale public health program should resonate well with semi urban/rural voters. Lack of a credible alternative and absence of unity in the opposition should work to Modi government's advantage while seeking re-election.

Mirae Asset India Sector Leader Equity Fund – Portfolio Positioning

The overall positioning of the portfolio is geared toward a more defensive stance given the more volatile market environment in recent months. We have taken opportunities in the past few months to reduce our exposure to consumer discretionary and financials and added exposure to utilities (e.g. GAIL) as well as select healthcare (e.g. Cipla) and IT names (e.g. Infosys, Cognizant Technologies) which stand to benefit more from the weaker Rupee.

ISL Sector Allocations

Source: Mirae Asset, as of 30 Sep 2018.

PORTFOLIO WEIGHT	9/28/2018	
Consumer Discretionary	11.90	↓
Consumer Staples	7.07	
Energy	10.06	
Financials	25.32	↓
Health Care	7.60	↑
Industrials	0.50	
Information Technology	17.29	↑
Materials	8.74	
Real Estate	1.63	
Telecommunication Services	1.14	
Utilities	6.02	↑
Cash & Others	2.72	
Total	100.0	

Although some concerns on currency depreciation and political uncertainty may weigh on investor sentiment in the near term, **the medium-long term outlook for India remains very positive.** Key macro indicators point to robust domestic economic conditions; GDP grew 8.2% YoY for 2Q18, the highest pace in nine-quarters. Latest earnings season points to a broad-



based recovery in corporate earnings, NPL formation has peaked and higher corporate confidence sets up the case for a capex recovery. Furthermore, India should remain more of a **safe haven amidst global trade tensions** given domestic demand is the key driver of growth.

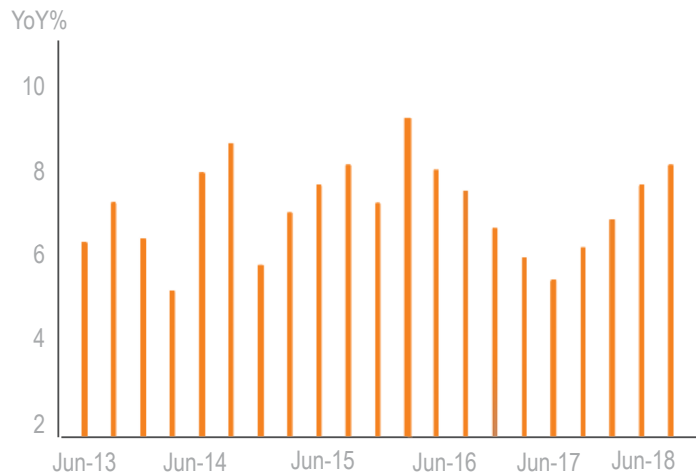
We believe the high valuation of in Indian consumer staples and

consumer-focused finance companies is being corrected now and the next 6-9 months should provide a good opportunity to shift back into domestic demand plays with reasonable expectations.

We believe that India should be viewed as a safe haven in light of ongoing trade tensions between US and China in coming years.

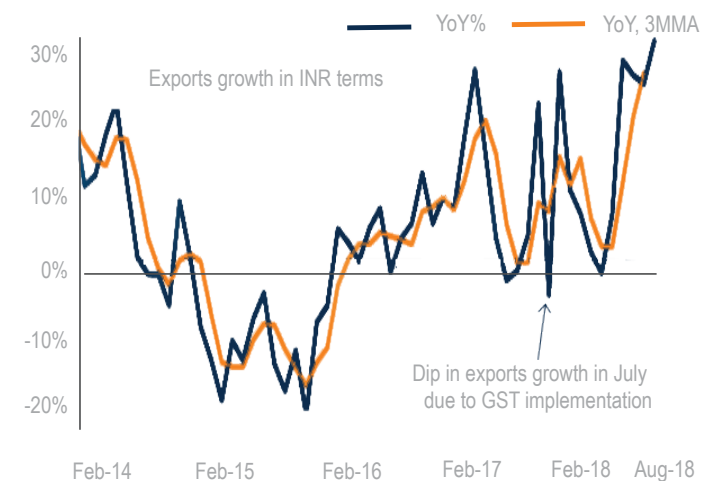
India Real GDP Growth

Source: CEIC, CLSA, as of 30 Jun 2018.



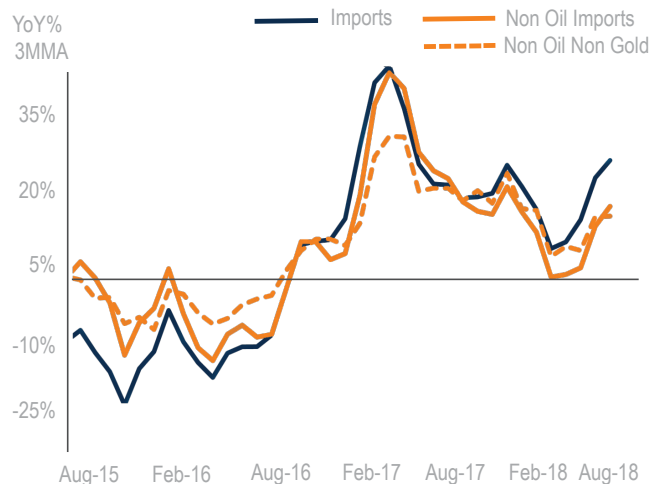
India Exports Growth Picking Up with Depreciating Rupee

Source: CEIC, Morgan Stanley Research, as of 31 Aug 2018.



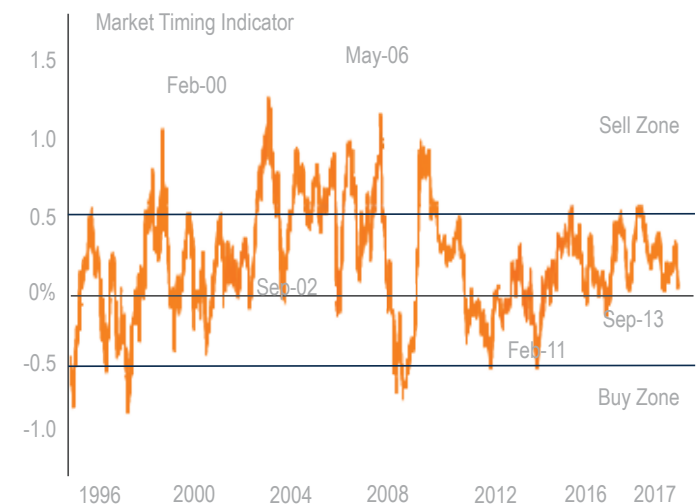
Imports Indicate Robust Underlying Demand

Source: Ministry of Commerce, CEIC, Morgan Stanley Research, as of 31 Aug 2018.



Market Timing Indicator at Buy Level

Source: RIMES, Bloomberg, AMFL, SEBI, Morgan Stanley Research, as of 30/09/18.





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