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From the Desk of Rakesh Rathod - Head Domestic Institutions Clients Group 01

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Dear Patrons,

2017 was a year of reckoning for Indian Equity Markets in general and fund Management industry in particular. A sustainable flow of large Domestic money from both Retail and HNIs has attracted the best minds in the industry to come up with some innovative solutions, when it comes to Investing. Several Fund Managers from mutual funds, brokerages and research analysts from brokerages, have been keen to seize this opportunity and set out their journey of setting up Alternative Investment Funds (AIF). Edelweiss Prime Brokerage Services has been at the forefront by offering the one stop solution to setup AIFs.

The Growth in all categories has been explosive. Scalability of strategy & desire to build a client business are the primary considerations to get into asset management.

Regulatory and policy changes has left a positive impact on the foreign investors and provided more reasons to both Domestic & Foreign investors to consider India as one of the most favoured investment destination.

Edelweiss Custodial Services Limited (ECSL) was rated as a Leading India Custodian - both in the Global Custodian (GC) Indian Domestic Survey 2017 and also in the Global Custodian (GC) Agent Banks Emerging Market survey 2017 with clients rating us highly in relationship management, knowledge of market intricacies, process and legal structures, value delivered and asset servicing. While we celebrate this success and thank all our stakeholders for their faith and trust in us, we also acknowledge that this recognition is a big responsibility and drives us further to constantly work towards enhancing customer experience through our products, platforms and services.

We also see a lot of new trends which are emerging in the space.

- Increasingly Mutual Funds are launching more AIFs considering micro regulations in Mutual funds and more flexibility on product innovation
- Family offices and Ultra HNIs looking to setup funds or invest in alternatives.
- SME Focused Funds & Distressed assets Fund are on the rise

With the rise in investment capital in India, the on-going bullish equity market and increasing FPI and FDI investments, the outlook for the AIF sector is very positive.

Warm Regards
Rakesh Rathod
The bond markets witnessed significant volatility in April as the euphoria at the beginning of the month gave way in a short period of time. The reduction of FY19 borrowing at the end of March and increase in FPI debt limits in early April raised hopes of a sentiment revival and the benchmark yield dropped to almost 7.10%. However, the markets were back in a bearish grip as both crude prices and US treasury yields resumed a sharp upward trajectory. The possibility of a hawkish monetary policy resurfaced with inflationary concerns and gilts too felt the pressure with the 10Y benchmark yield approaching 7.80% towards the end of April. The sentiment revival proved to be short-lived and we are back to a state of weak demand and appetite from both domestic and global investors.
**FOREX**

**DXY**

Dollar index surged to its highest level since December 2017 at around 93.5 amidst breakout in oil prices and the U.S. Treasury yields breaching important psychological level of 3%. The U.S. president Donald Trump’s decision to leave international nuclear agreement with Iran and impose pre-agreement sanctions pushed oil prices above $75 per barrel levels. Further, economic data coming from US, indicated that economy is well on track to recovery which lent support to the currency.

**EURUSD**

EURUSD erased its gains as ECB chief Mr. Mario Draghi kept his tone dovish in his monetary policy speech. Further, the recent data from Eurozone shows that Europe’s spectacular growth in last couple of years is losing its steam. On inflation front, core CPI data slipped to 0.7% from 1% previously and 0.9% expected. Following soft growth and inflation readings, EURUSD breached important support level of 1.20 and made low of 1.1821 before bouncing off to 1.1980 levels.

**GBPUSD**

GBPUSD corrected from 1.43 levels following disappointing growth data which led to pull back in rate hike expectations. Further sharp drop in inflation number to 2.5% also added to the pressure on currency. Subsequently, Bank of England kept interest rate unchanged at 0.5%. However it surprised markets on its growth forecast, which was trimmed down to 1.4% vs 1.8% forecast in February.
**USDJPY**

In April, JPY witnessed some appreciating pressure due to risk-off sentiments, as speculators turned net long for first time since November 2016. However, the currency failed to hold on to its gains as dollar rallied sharply against basket of currencies. USDJPY surged from low of 106.85 and rallied one way towards 110 levels on account of rising yield differentials between Japan and the US.

**USDINR**

Since the beginning of April, Rupee came under deprecating pressure against dollar as oil prices rose to $75 per barrel and US yields touched 3% levels. Firming up of crude prices added to concerns over India’s macro-economic fundamentals (Current account, Inflation and Fiscal Deficit) which led to consistent selling off by FPIs. Over last one month, FPIs offloaded $2.6bn of debt papers and $1bn of equities. USDINR was trading at 64.80 levels which were breached in mid-April and the pair gathered sharp upward momentum towards current levels of 67.50.
EQUITY

After sluggish performance of equity markets in March’18 equities have regained their momentum. Nifty was up 7%, while the midcap index was up 8%. However, strong market performance was not sufficient to attract foreign flows back to India and FII’s were net seller in the market and reduced their exposure by around USD 1Bn.

On sectoral performance side, Consumer staples, Information technology and Industrials were the best performers with ~10% return for April’18. However telecom continued to remain weak and was down 1% mainly due to ongoing pricing war in telecom industry.

On valuation side MSCI India is trading at 17.6x 12 months forward earnings, 47% premium to MSCI EM. This is slightly above the long term average of 40%.

With this going ahead, political events, global liquidity and earnings performance will be the key for market direction.

Source: Bloomberg
REGULATORY UPDATES

SEBI CIRCULARS

APR 05 2018
Monitoring of foreign Investment limits in Listed Indian Companies
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APR 09 2018
Measures to strengthen Algorithmic Trading and Co Location Proximity Hosting Framework
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APR 10 2018
Clarification on Clubbing of Investment Limits of Foreign Government Related Entities
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APR 12 2018
Investment by FPIs in Government and Corporate Debt Securities
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Amendment to SEBI Circular No. IMD/FPIC/CIR/P/2018/61 dated April 5, 2018 on Monitoring of Foreign Investment limits in listed Indian companies
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RBI CIRCULARS

APR 27 2018
Investment by Foreign Portfolio Investors in Debt - Review
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INTRODUCTION

Alternative investments have started to play a more prominent role in Indian investor portfolios in the last few years. For example, commitments to AIFs among domestic investors has grown at a 92.84% CAGR over the past 3 years and stands at Rs 1,41,120 cr (21.21 Bn USD) at the end of December 2017. This meteoric rise has also created a need for a simple framework to evaluate alternative investments that goes beyond wealth manager recommendations or face-to-face meetings with fund managers.

The law of financial gravity is a simple but powerful idea when used to evaluate any category of alternative investment. Stated simple, it is:

“No fund manager can deliver outperformance:
(a) consistently (b) at size (c) without tail risk (d) and do so legally”

Let’s look at each of the components of the law in the context of different alternative investments, to understand it better. Venture Capital & Private Equity can be done at size and can have large positive outcomes, but their returns can be lumpy and back-ended – they are not consistent on a monthly basis. High yield credit whether infrastructure, real estate credit or structured credit has monthly / quarterly consistency in terms of coupon income and can be done at size but involves tail risk if any of the borrowers default. Arbitrage strategies such as those in high frequency trading or commodity markets offer monthly consistency without tail risk but are capacity constrained because the opportunity is limited by the size of markets and regulatory limits. Long short trading often trades off consistency and size and can involve some tail risk if the manager is selling out of the money options.

History has taught us that ideas that offered consistency, size and the lack of tail risk were later found to be either frauds (National Spot Exchange scam) or violating regulatory norms (bit coin trading) or in the case of unregulated investments – outright Penza schemes.
The law of financial gravity is useful for investors and advisors because it prods them to ask managers four basic questions:

01 **How consistent will your strategy be?**
   The most successful strategies possess two distinct qualities; they are both consistent and agile. These two traits working in tandem push the Fund, to remain dedicated to their original philosophy which is strategic with the flexibility to adapt to ever-changing markets.

02 **What is the capacity of your strategy and how much of that is already absorbed?**
   It's only when an investment management process or the strategy be applied to a wide variety of market segments, then an increase in the fund size will improve its performance, else the size itself becomes the reason for under performance.

03 **Is everything that you are doing regulated and within the letter and spirit of the law?**
   Ensure the fund has a well planned investment management and not a person centric and is highly transparent and at times also ahead of regulations.

Alternative investments can be a powerful force in investor portfolios but every style has its own limitations. The law of financial gravity teaches us to embrace those limitations and diversify across styles and managers to deliver superior risk adjusted returns rather than looking for the Holy Grail.
Introducing the team from left to right: Rakesh Rathod (Head - Domestic Institutions Clients Group), Dipesh Shah (Head - PB & Custody), Vishal Ved (Deputy COO), Satish Jathan (Head - Custody & Clearing), Shweta Dasgupta (Head – Technology), Jyoti Rai (Head - Channel Partners and Alliances), Pradeep Khandelwal (Head - Domestic Brokerage Group), Pralhad Shinde (Financial Controller - Prime Broking), Udit Sureka (Head – Products), Atul Badkar (Head - International Institutional Clients Group).
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