Model Portfolio Update

HSec LARGECAP Portfolio*

Portfolio Return	NIFTY Return
46.96%	35.32%
OPF : 1,164 bps	

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(Domestic) value to the fore!

We are tactically tilting our Model Portfolio towards (relatively cheap) domestic cyclicals and correspondingly away from (relatively expensive) global stories. This is based on two key arguments: weak global macros (external) and government policy initiatives (internal). We must confess that the foundations for this shift have been around for a while now (the regime change in May-14, softer commodity prices).

However, our stance was further emboldened by recent events (namely Chinese tremors, the Fed's reluctance to raise rates and Governor Rajan's bold 50 bps repo rate cut) which are likely to ease liquidity (inflows into India) and trigger policy initiatives. Given India's relatively stable macros within the EMs pack and evidence that Government is leading the revival of the capex cycle, a tilt towards domestic cyclicals is called for.

- We are adding **ICICI Bank and SBI**, in the belief that pragmatic policy reforms and government spend on infra buildout (Plan capex is up 38% YoY so far in FY16) will help revive asset quality (and credit growth) in stressed sectors such as construction and steel. Both banks are adequately capitalised, and available at a significant discount to historic valuations (**ICICI Bank** is under 1.6x FY17 ABV while **SBI** is ~ 1x, both net of subs).

- Our BUY call on **Bank of Baroda** is faith-based, where we think the new CEO P S Jayakumar's term may lead to a re-rating in line with other stressed PSBs. We think this is undeserved, given the strong corporate lending franchise of the bank which can sync nicely with a macro revival. A charismatic private banker such as Mr Jayakumar may be just the right leader in the right bank at the right time.

- We are reducing our **Indusind Bank** position to EW after posting ~130% returns over two years purely on valuations (over 2.8x FY17e ABV), which lends credence to our preference for cyclical bets in the sector such as ICICI Bank, BoB and SBI.

- Recent government actions on the beleaguered power sector indicate that a transformational change may be in the offing. Fiscal devolution to the states is likely to be linked to their achievements in reforming power distribution. This augurs well for the regulated entities **NTPC and Powergrid**, which offer high confidence on business continuity, capex outlay, asset commissioning and (hence) visibility on growth. Also, as interest rates fall, we see rising P/BV multiples for both entities. We introduce **NTPC** at 160 bps OW (2.5%) and increase **Powergrid** to ~250 bpws OW (3.5%) in our Model Portfolio.

- We sense a near term bottom for oil prices, led by the weakening dollar driven by lack of macro traction in the US. Tightening supplies of shale oil will help. This drives prospects for beaten down upstream cos in India such as **ONGC** (retains upsides upto $60/bbl on domestic output). Overseas operations can break even at ~$65. Our TP for ONGC is Rs 375 at $70/bbl, which we will review post this quarter. We are increasing **ONGC** to 230 bpw OW in our Model Portfolio. The axe, naturally, falls on **HPCL** where we are admittedly late in EXITing. We see lower refining margins, inventory losses and most of the rerating post subsidy reduction having played out already.

- **IT services, FMCG and Pharmaceuticals are natural REDUCE/SELL targets of our pro-cyclicals stance.** We, however, maintain our OW on **ITC** (where we see strong relative value) and believe that Asian Paints and Pidilite offer refreshingly different stories (and, hence, stock trajectory) versus traditional FMCG. We expect weak commodities and construction/home-building revival to help both stocks diverge from the rest of the FMCG pack.

- In IT services, we are booking part-profits on our huge OW on **Infosys, which still remains OW**. Here, the macro-led demand environment poses a sentimental challenge to the longer term story of revival under the transformational leadership of Vishal Sikka. Our **HCL Tech** call has hurt (down ~11%), but we prefer to maintain faith for now in view of its unique business mix which is skewed towards infrastructure management services.

- Like IT services, Pharmaceuticals is another space where Indian companies have made giant global strides. We see increased regulatory challenges and competition, though speciality pockets of pricing power persist. We have more than doubled our money in **Lupin** and can foresee rising integration/execution challenges post the Gavis acquisition. Valuations are stiff at ~29x consensus FY17E EPS. Meanwhile, our **Sun Pharma** exposure has delivered 29%. The promise of successful integration of RBXY is very much intact, but near term pain will have to be first absorbed. Again, valuations are not exactly in favour at ~27x FY17E consensus EPS. **Our pro-value stance compels us to exit both these Pharma positions.**

- A similar EXIT argument applies at **Zee** despite structural tailwinds. While we continue to like the prospect of rising TV ad spends, improving monetisability of viewership in the BARC era and Phase III and IV of the CAS buildout, we feel **Zee**'s current valuation of ~30x FY17E EPS (adj for Rs 22/sh pref payout) is not quite the stuff that characterises margin of safety.

Summary of Portfolio Changes

BUY	SELL
BOB (new)	HPCL (exit)
SBI (add)	IndusInd Bank (reduce)
ICICI Bank (add)	Infosys (reduce)
NTPC (new)	Lupin (exit)
Power Grid (add)	Sun Pharma (exit)
	Zee (exit)

HDFC sec MODEL PORTFOLIO

Sector	CMP	Stock	NIFTY wt (%)	Portfolio wt (%)	OW/(UW) bps
FINANCIALS			**31.1%**	**34.5%**	**347**
	278	ICICI Bank	5.6%	10.0%	442
	243	State Bank Of India	2.6%	10.0%	740
	491	Axis Bank	2.9%	6.6%	377
	186	Bank of Baroda	0.6%	3.5%	290
	65	Federal Bank		2.8%	
	946	IndusInd Bank	1.6%	1.6%	0
IT SERVICES			**16.5%**	**11.8%**	**-469**
	1,132	Infosys	7.8%	8.6%	80
	828	HCL Tech	1.6%	3.2%	166
FMCG			**9.9%**	**13.2%**	**325**
	339	ITC	6.6%	7.9%	138
	875	Asian Paints	1.4%	2.7%	133
	574	Pidilite		2.5%	
AUTOMOBILES			**9.1%**	**11.3%**	**213**
	343	Tata Motors	2.2%	3.6%	134
	4,354	Maruti	2.0%	2.9%	96
	2,540	Hero Motocorp	1.1%	2.5%	147
	931	Bharat Forge		2.2%	
OIL & GAS			**8.2%**	**9.2%**	**100**
	889	RIL	5.1%	5.3%	28
	258	ONGC	1.6%	3.9%	230
INDUSTRIALS & UTILITIES			**8.3%**	**12.4%**	**411**
	1,534	L&T	4.3%	6.4%	210
	132	Power Grid Corporation Of India	1.0%	3.5%	249
	126	NTPC	0.9%	2.5%	160
MATERIALS & COMMODITIES			**5.6%**	**4.7%**	**-88**
	346	Coal India	1.5%	2.9%	138
	914	JSW Steel		1.8%	
PHARMACEUTICALS			**8.2%**	**0.0%**	**-818**
TELECOM & OTHERS			**3.0%**	**1.9%**	**-106**
	410	Bharti Infratel		1.9%	
Cash				**0.8%**	**84**
TOTAL			**100%**	**100%**	

Portfolio Return	NIFTY Return
46.96%	**35.32%**
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BoB (NEW), SBI (ADD), ICICI Bank (ADD), IndusInd (REDUCE)

Infosys (REDUCE)

HPCL (EXIT), ONGC (ADD)

NTPC (NEW), Power Grid (ADD)

Lupin (EXIT), Sun Pharma (EXIT)

ZEE (EXIT)

Alpha idea

Big OW vs NIFTY

Big UW vs NIFTY

HDFC sec MODEL PORTFOLIO : STOCK RETURNS

Stock	CMP	*Returns*	Portfolio wt
IndusInd Bank	946	**130%**	1.6%
Pidilite	574	**115%**	2.5%
Federal Bank	65	**44%**	2.8%
Axis Bank	491	**38%**	6.6%
Coal India	346	**36%**	2.9%
Infosys	1,132	**33%**	8.6%
L&T	1,534	**28%**	6.4%
ICICI Bank	278	**25%**	10.0%
Maruti	4,354	**17%**	2.9%
State Bank Of India	243	**13%**	10.0%
Power Grid Corporation of India	132	**9%**	3.5%
Hero Motocorp	2,540	**6%**	2.5%
RIL	889	**4%**	5.3%
ITC	339	**4%**	7.9%
Asian Paints	875	**2%**	2.7%
Bank of Baroda	186	**0%**	3.5%
NTPC	126	**0%**	2.5%
ONGC	258	**-6%**	3.9%
Bharti Infratel	410	**-7%**	1.9%
HCL Tech	828	**-11%**	3.2%
JSW Steel	914	**-13%**	1.8%
Bharat Forge	931	**-16%**	2.2%
Tata Motors	343	**-17%**	3.6%

Rating Definitions

BUY	:	Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL	:	Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL	:	Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

Disclosure:
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