December saw the Sensex rise by 2.7% to 34,057. Rate hike by the Federal Reserve (Fed.), US tax reform proposal passage in both houses and EM outperformance were the highlights of December globally. On the domestic front, all accused being acquitted in the 2G scam case and BJP's win in Gujarat and Himachal Pradesh were key focus points during the month. The markets saw a net outflow of $(0.4)bn. The rupee saw an appreciation of 0.9% to 63.9 to the dollar as the dollar index (DXY) weakened by 1% during the month.

Global

Global market returns were broadly positive in December, with the Emerging markets clearly outperforming Developed markets. The global macro space continued to remain positive with both the Fed. and the European Central Bank (ECB) raising their growth forecasts for 2018. While the Fed. inflation forecasts remain unchanged, ECB expects an inflation pickup in 2018. The global manufacturing space witnessed growth from end 2016 and through 2017. This is expected to continue into 2018 as well. The pickup in manufacturing appears to be fairly synchronised and not just being limited to the developed economies. Strong Eurozone growth is translating into a strong Euro and this is likely to keep the DXY range bound in 2018. Further, the lack of any fiscal or infrastructure push from the Trump government is likely to keep the DXY contained. The DXY remains a good proxy of market confidence in the Trump administration and reforms. December news flows continued to be dominated by Trump administration related news. The month saw a long awaited US tax reform proposal being passed in both the houses. A sharp cut in corporate tax rates, a drop in the repatriation tax, accelerated depreciation and a shift to a territorial tax regime appear to be some of the key features of this bill. The decision on sustainably increasing the debt ceiling was postponed a couple of times during the month and is expected to come up for discussion in January. The month also witnessed OPEC and Russia agree to continue output cuts, Saudi Arabia announce a stimulus package to boost private sector growth, agreement on the Brexit divorce bill and the Catalonian parliament legally vote for independence from Spain.

Central banks

The central banking space remained fairly active during the month with a number of central banks reviewing their monetary policy stance. The Fed. remained in focus, delivering an expected 25bps hike and guiding for 3 hikes in 2018. We would like to reiterate here that rate hikes must be seen as a positive; as it reflects the economy's resilience to withstand such increases. The ECB left rates on hold and kept the pace of asset purchases unchanged at Eur 30bn. per month. Developed economies have seen a pickup in inflation while emerging economies are seeing a near bottoming out of the same. 2017 witnessed large developed economies raise rates, while many emerging economies saw space to cut rates. With room for accommodation closing for the emerging economies, their central banks have gradually started raising rates.

Domestic

The month of December was filled with significant political and economic developments. BJP's electoral win in Gujarat and Himachal Pradesh were key positives. The BJP was the preferred choice in urban areas, but faced a close fight in rural areas. Soon after, a special court acquitted all accused in the 2G scam on the prosecution's inability to prove the charges. The macro prints in December were on the weaker side. Industrial production growth saw a drop from previous levels and inflation saw a sharp increase on the back of rise in the prices of vegetables. The RBI left all policy rates unchanged with its focus likely to shift to policy transmission. Favourable output gap dynamics and seasonal food prices appeared to offset the incremental risks. We seem set for an extended pause into 2018 and the budget will now decide the future course of inflation. While there is no room for cuts, there isn't any scope for a hike either, given the nascent growth recovery underway. Central government fiscal numbers were in focus with rising expenditure growth and apparent GST revenue shortfalls. The centre also announced an additional borrowing that could push up the fiscal deficit for FY18 by ~0.3%GDP. These news flows and the inflation prints drove the Indian 10 year consistently higher during the month.

Flows

December saw continued fund inflows into both Emerging equities and debt. The Developed markets saw outflows from US and Europe. It was surprising to see that the passing of the US tax reform plan led to an increase in redemptions across asset classes. Currency stability, relative performance and the structural differentiation story continues to hold for India. The month saw marginal outflows from equities to the tune of $(0.7)bn. and marginal inflows into debt of $0.4bn. Debt has seen an inflow of $18bn. since the start of April this fiscal and $23bn. in CY17.

Outlook

The Government's firm commitment to spur the infrastructure investment cycle is already reflecting in improved execution on the ground. Focus on rural incomes and spend is also helping broad-basing growth and serves as a long term driver of the consumption story. The stress in the banking system has seen significant & targeted addressing, as expected, with recognition, provision of bad loans, resolution and subsequent capitalisation commitments. The Govt. has been laying the foundations for the road to sustainable growth through broader reforms & efficient administration. GST transition impact though real in few quarters, we believe is a short term phenomenon and hence investors are advised to see it through patiently and have faith in the strong India growth story. Growth will be spurred by strong infra related spend, urban consumption, rising rural incomes and improved demand going forward with the 1Q GDP print being the bottom. The uptrend in corporate results and earnings trend will gather steam into SH of FY18.

Softer than historic inflation and better growth will gradually lead to a shift in the saving pattern of Indian households from physical to financial with a sharp bias towards equity. Mutual funds are well positioned to absorb this incremental shift. Corporate earnings are set to enter a double digit growth trajectory driven by the domestic recovery in this fiscal. Our funds are very well positioned to reap these benefits. Fed. is likely to move ahead gradually, keeping in mind not to pull down economic growth that has just seen some momentum. FY18 is an year of the fiscal with most governments acknowledging the need to create demand through fiscal spending. India is not be far behind in this move and will continue to remain prudent in such deficit spending. With the twin deficits reasonably contained, inflation well under control, bottomed out growth, a relatively stable currency and an extremely strong political mandate, India stands taller than the rest. While broader valuations, driven by domestic liquidity, indicate market discounting near term earnings, one will have to look into FY19 and beyond. The impending budget could hold the key in terms of fiscal, growth stimulus and employment generation. Strengthening dollar may spell some short term weakness in EMs and few other asset classes. Near term Indian markets may undergo a time consolidation or be range bound, which could be a good time to get invested in a disciplined manner. Every bull market is interspersed with both time and value corrections while reasons could be varied. Every point of volatility would be an opportunity to buy India. With every turn of the markets, the India-differentiation story gathers more interest, momentum and conviction in that order. This would get louder in the coming quarters and a stable rupee would give comfort to the inflows. We continue to remain positive on our equity markets with a medium to long term outlook.