Introduction

The recent developments in the Indian markets, may be cause of concern for all of you. In this note we try to explain our asset allocation strategies which will help us whether this storm and also prime ourselves for the future, which in our view still remains uncertain atleast till the next general elections in India, which is May 2014. The reasons for this are both global and local, but we feel the impact of the latter is more pronounced currently.

Asset price performance

The recent fall in INR vs all major global currencies has had substantial impact on all rupee denominated assets, specifically Indian equities. The RBI adhoc measures to reign in the rupee has lead further loss of confidence, which has lead to steepening of interest rates- thus fall in bond prices. This means that all interest rate sensitive asset classes have taken beating. The table below reflects the damage which has played out.

The one sliver- lining amidst all this carnage has been gold prices. Gold prices have been a perfect hedge for the rupee depreciation, and it is also reacting increase in global tensions, mainly driven by news from Syria and possible war like situation likely to unfold. Even crude oil prices have reached multi-month highs in this aftermath.

Asset class Performance in recent past

	28/08/2013	1 month return		6 month return		2013 performance	
Sensex	17996	19675.21	-8.5%	18918	-4.9%	19714	-8.7%
NIFTY	5285	5867.32	-9.9%	5719.15	-7.6%	5993	-11.8%
Gold($)/oz	**1427.94**	**1330.12**	**7.4%**	**1600**	**-10.8%**	**1700**	**-16.0%**
Gold INR/gm	**3443**	**2550**	**35.0%**	**2750**	**25.2%**	**2950**	**16.7%**
INR	67.8	59.5	-13.9%	55	-23.3%	55	-22.8%
Bond yield*	8.89	8.13	-8.5%	7.87	-11.5%	8	-10.0%
Net performance adjusted for interest			-8%		-7%		-5%

*increase in bond yields is negative

What does this teach us

The current rapid price action in all asset classes is extremely difficult to predict. Although, one can argue that weak fundamentals of the Indian economy was known and you could have seen this coming. We agree, but the timing and brutality of the fall or rise of asset classes is something we believe is difficult if not impossible to predict. Hence, to prevent the downside, diversification and asset allocation is the key.

Our Asset Allocation Approach

We have been advocating the tripod strategy for sometime now, which in our view was the right allocation in such a scenario, which is unfolding now. Although defensive, but we believe this strategy has helped protect the downside to a reasonable extent across all our portfolios. The basis of this is that every portfolio will have investments in all three main asset classes, equity, fixed income and gold. The perfect tripod is 1/3rd allocation in all the three, but the percentage of this varies across asset portfolios depending on each individual risk assessment and liquidity needs.

Das Capital Portfolio Returns

Diversified Portfolio returns	1 month	6 months	2013 performance
Perfect Tripod (33% each in equity,debt, gold)	5.8%	3.4%	0.1%
Equity Skewed (50% equity, 30% debt, 20% gold)	-0.3%	-1.0%	-4.0%
Debt Skewed (30% equity, 50% debt, 20% gold)	0.1%	-1.0%	-2.5%
Equal weighted (40% each equity,debt, 20% gold)	-0.1%	-1.0%	-3.3%
High risk (50% equity, 40% debt, 10% gold)	-4.6%	-4.3%	-6.1%

Note: We do not recommend gold to be above 25-30% as it is not an income generating asset

This table captures all our portfolio asset allocation strategies across all our clients. This shows that with diversification we have protected downside risks of equity and debt, although sacrificing the full potential of the gold run. Infact, gold has almost mirrored the rupee depreciation in the exact opposite direction. We feel investing INR denominated gold will provide substantial security against rupee depreciation.

Market timing

We have also strictly followed the strategy of not timing the market, and we are prepared to even sacrifice part of the gains that accrue by timing the market, in order to protect the downside. This is particularly useful in equity , where we have followed the dollar cost averaging method (through SIP's and STP's) to invest in the market. But you could see that despite this, certain equity assets could be negative. This will happen in extreme market reactions like what we are seeing now, but we have seen that this strategy will help us in the long run as the cost of acquisition will keep going down in falling market, which will benefit us when the prices reverse their trend.

Outlook

Economy

We feel that the next 6-12 months will remain uncertain and volatile, as the incumbent government muddles through its remaining term in office by announcing a number of populist measures in the run up to the elections. This will put immense pressure on the fiscal deficit, monetary policy as well as the currency. This will force the next government to resort to aggressive reformist measures inorder to steer the economy and country from this precipice.

Equity

We do not expect growth to rebound till 2015 , which will effect corporate performance which is anyway reeling from the effects of the current high borrowing costs and depreciating currency. This will have an effect on the equity market in the short to medium term.

But a calibrated policy response, low base effect, aggressive interest rate cuts and improvement in sentiments (with a new government) should lead to recovery of growth in the domestic economy. This we believe will be a fillip to equity performance, because by then we expect markets to be cheap. We expect these developments to unfold by 2H2014. Markets discount ahead, so we do not rule out an equity market recovery earlier.

Portfolio strategy

Equity: Underweight , Debt: Overweight, Gold: Overweight

Equity

We believe that the current correction will present a huge opportunity to enter the markets towards the end of 2013. Portfolio should be overweight equity around the time of general elections. For the shor term we will look to book profits in equities, and wait on the sidelines for the current correction playout. We do not exiting equity completely, but will cut the current holdings in the portfolio and re allocate wherever possible. We believe that possibility to enter markets can present itself anytime over the next 6-8 months, since corrections tend to be fast and brutal.

Action: Book profits wherever possible- reallocate to debt and toe dip into equity subsequently. We remain positive on good quality cheap stocks which will benefit from the weak rupee.

Fixed Income

Once the currency pressure dissipates and growth slows, the central bank will be forced to cut interest rates aggressively, this will create opportunity for capital gains in debt funds, while locking into the current high yields for good interest incomes.

Action: Switch some part of equity to debt. Some into duration plays, some in liquid to re invest in equity

Gold

We believe gold prices will track the currency; we will remain overweight on gold as long as the currency depreciation persists. There is an additional upside in gold, if geo political risks with respect to war in Syria will escalate leading to high oil prices. We still maintain gold will act as value store against risks and we are not very positive in the long term.

Currency

Although there will be volatility in the Re in the near term, but we believe that it has immense value at these levels. We feel the current levels of Re/USD presents a rare opportunity to acquire INR denominated assets with a 3-5 year view. We can not only make money in the currency appreciation, we are confident that the underlying asset value also will go up. We can look to invest fresh proceeds in INR gold as a hedge.

Action: Stay invested , and add new money in gold to take advantage of the high dollar value, with a view to shift to debt and equity when things improve

All the actions suggested are with view to preserve the asset values, as we believe that it is

Better to be Safe than Sorry