kotak Mutual Fund

SECTORAL UPDATE

SEPTEMBER 2018

SECTORAL POSITION SUMMARY

Sectors Covered	Position	Reasoning
Banking & Finance	Pvt. Banks – Overweight PSU Banks – Underweight NBFCS/HFCs- Underweight	NBFC: Lower funding availability and higher cost of borrowings to impact growth and profitability Private banks gaining market share Balance sheet stress resolution is key
Energy	Largely Underweight	Margin risk due to high oil price Positive demand growth for gas utilities
Industrial Manufacturing	Largely Overweight	Recovery in demand growth
Pharmaceuticals	Largely Underweight; stock specific positions	Regulatory overhang remains Positive on domestic business
IT	Neutral	Demand outlook- initial signs of bottoming out INR to act as margin tailwind offsetting higher wage pressure and bottoming out of utilization gains

SECTORAL POSITION SUMMARY

Sectors Covered	Position	Reasoning
Auto	Neutral	Growth remains robust so far; could see near term pressure; Tightening of finance availability Higher commodity costs and competition; Profitability under pressure
Cement	Overweight	Proxy infrastructure play; Awaiting increase in pricing
Consumers	Discretionary- Overweight Staples- Underweight	Improving growth opportunity High valuations levels – a key risk Hike in MSP and below average monsoon to impact gross margins
Metals	Underweight	High cyclicality, global risks remain
Construction	Overweight	Strong Demand, valuations

BANKING AND FINANCIAL SERVICES

- NBFCs/HFCs face liquidity pressure; Likely to see lower growth; Private banks to gain

NBFCs/HFCs face liquidity pressures post IL&FS default; Pressure on growth and margins

- Post the IL&FS issue, NBFCs and HFCs have been facing liquidity pressures; Those running a large asset liability mismatch are at most risk
- Tight liquidity, selective lending by mutual funds and banks to NBFCs/HFCs and further elevation in borrowing rates could lead to sharply lower disbursements and pressure on margins for NBFCs; Sector awaiting new guidelines from RBI on ALM and liquidity requirements

Private sector banks likely to gain further market share

- Tight liquidity and higher cost of funds to shift credit demand from the wholesale markets to the banking system leading to higher bank credit growth
- Private sector banks to continue to gain market share in loans and deposits and grow faster than the system; lower growth envisaged for PSU banks and NBFCs. Private banks remain well capitalised with a robust liability franchise;
- change in top management at many banks key to watch out for

PSU Banks: Need for significant structural reforms; growth to remain elusive; consolidation begins in the sector

- Asset quality pains likely to linger with the removal of forbearance on restructuring; credit costs to stay elevated
- Additional capital infused would be used up in NPL provisions; growth capital remains unavailable
- Start of consolidation among PSU Banks to take up management bandwidth and focus away from near term growth and profitability
- Urgent need for structural reforms in PSU Banks in areas relating to HR, administration, IT, systems and processes

Corporate stress remains large; some early signs of resolution; provisioning to stay elevated; recognition phase nearing an end

- Need to arrive at final resolutions for cases under List 1 referred to the NCLT under the Bankruptcy Code; Resolution seen in a few cases
- The resolution for cases under the List 2 seems some time away; need to monitor haircuts in these cases
- Recognition phase for corporate NPLs nearing a peak; Slippages to stay elevated in the near term before stabilising and showing some moderation
- Corporate private sector banks better placed: Management issues now resolved; near term credit costs to stay elevated but are likely to normalise by H2FY20 resulting in improvement in return ratios

BANKING AND FINANCIAL SERVICES

-NBFCs face liquidity pressure; Likely to see lower growth; Private banks to gain

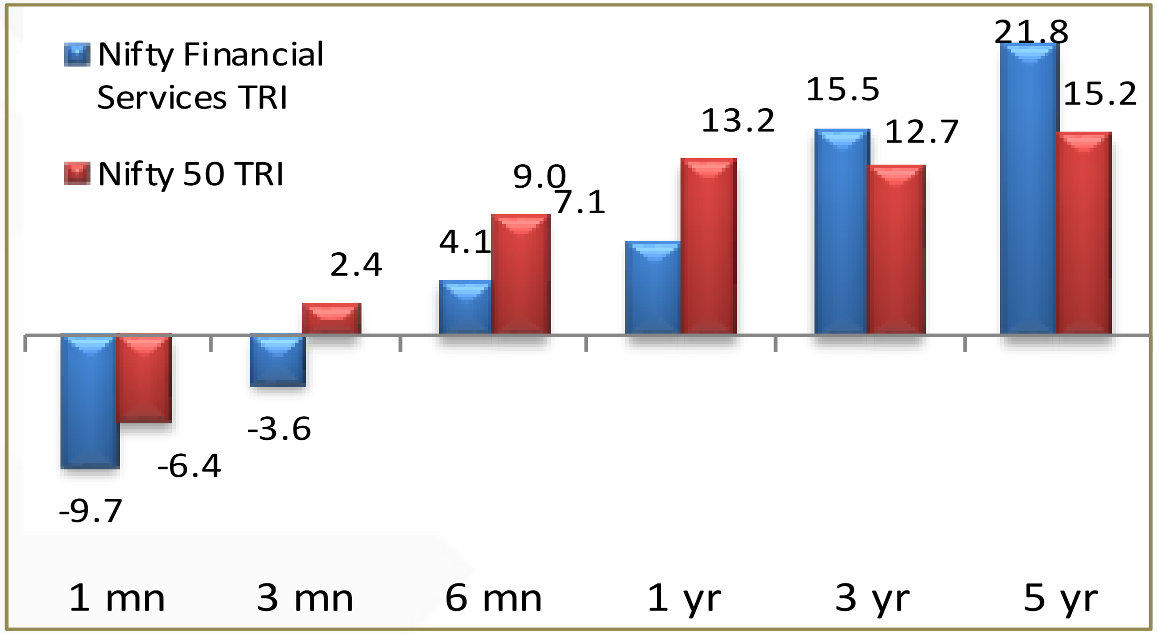
Headwinds

- Tight liquidity conditions and higher cost of wholesale borrowings to result in lower growth and margins pressures
- Loan growth for PSU banks & NBFCs to remain slow and could result in reduction of credit availability in the system
- Elevated credit costs on the back a large pool of stressed assets ; pace of recovery tepid
- Removal of all forbearance given earlier under various restructuring schemes of RBI
- Consolidation plan for PSU banks could lead to a period of uncertainty
- Need for further structural reforms in PSU Banks and additional capital over the next year

Tailwinds

- Real GDP growth is expected to revive at a moderate pace in FY19E
- Private sector banks gain market share in deposits and assets ; Retail asset growth and asset quality still healthy
- Most large private sector banks have a strong liability franchise with high percentage of low cost deposits
- Referral of cases under the IBC (Indian Bankruptcy Code) could set a precedence for resolution of corporate stressed assets

FINANCIAL SERVICES – PORTFOLIO POSITION



Financial Services				
Funds	**Fund Weight**	**Index Weight**	**OW/UW Sept 18**	**OW/UW June 18**
Kotak Bluechip Fund	28.0%	34.7%	-6.7%	-5.8%
Kotak Equity Opportunities Fund	27.6%	31.6%	-4.0%	-5.3%
Kotak Standard Multicap Fund_AI	35.4%	31.6%	3.8%	0.2%
Kotak Smallcap Fund	16.1%	25.8%	-9.7%	-14.8%
Kotak Emerging Equity Scheme	22.1%	26.5%	-4.4%	-6.7%
Kotak India EQ Contra Fund	19.2%	32.3%	-13.1%	-13.2%
Kotak Tax Saver Scheme	25.9%	30.4%	-4.4%	-4.0%
Kotak Equity Hybrid 99(EQ)	41.0%	34.7%	6.4%	-3.8%

Data: As of 28th Sept 2018. Source: Valuefy

- While we are positive on private sector retail lenders, we remain cautious on PSU banks and NBFCs and HFCs. We are keenly focused on the asset quality and the valuations that we at invested at. We may have acquired some investments at lucrative opportunities in the recent correction.
- Corporate focussed private banks with a strong liability franchise and which are adequately capitalised trade at attractive valuations.
- In the near term however, there may be some volatility on account of higher possible slippages and credit costs
- High interest rates could impact NIMs (net interest Margins) and lead to marked to market losses in the near term

Note: Index performance data as on 28th Sept 2018. Source: ICRA.

INFORMATION TECHNOLOGY

Demand likely bottoming out; Signs of improvement in BFSI and retail verticals

Structural shift in demand from traditional to digital and consulting; companies investing in new capabilities to emerge stronger

- High proportion of application development related revenues of Indian IT companies at risk; Companies which have built capabilities in new age digital related technologies to gain market share
- New projects are focussed on digital, cloud migration and analytics and are typically much smaller in size
- Many niche players are also competing for the same digital projects as some of the larger players

Demand likely to have bottomed out; Spend by large US banks is the key

- IT spend to see some degree of stability in FY19/20E; client budgets to focus on new areas of spend in digital; Signs of revival in large verticals such as BFSI and retail hold the key
- Growth outlook appears better in Europe
- Insourcing in large banks now at last stages; shift to captives still on in a few cases

Sector revenue growth likely to see some improvement in FY19E/FY20E

- Companies with higher digital and consulting capabilities to fare better
- Competition increasing from niche IT companies and mid tier companies in digital

Room for margin improvement limited; utilization levers are fully expended; INR to be a tailwind

- Pricing pressure and higher onsite costs remain the key margin headwinds; INR depreciation and improving revenue growth could offset some of the pressure
- Benefits of automation yet to flow through; levers to reduce costs close to being fully squeezed

Currency movements need to be closely monitored

- INR depreciation to help offset some of the margin pressure
- Cross currency headwinds to impact reported USD revenue growth; Constant currency growth in Q2 to remain strong given seasonal trends

INFORMATION TECHNOLOGY

Demand likely bottoming out; Signs of improvement in BFSI and retail verticals

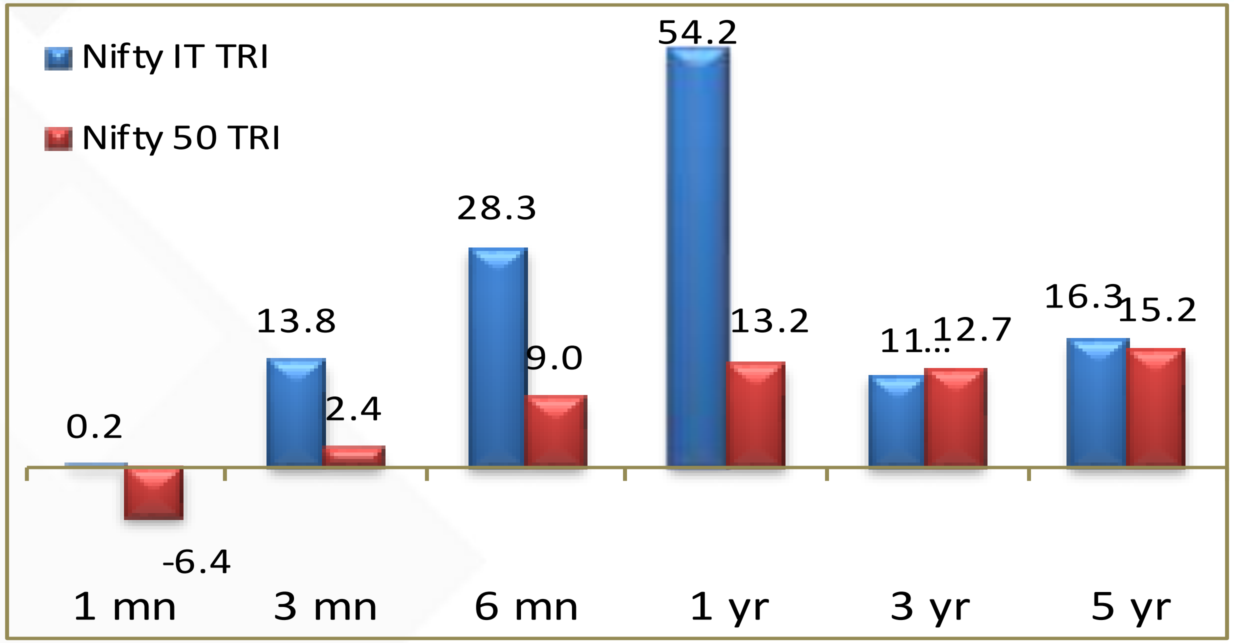
Headwinds

- Growth in new technologies putting pressure on traditional application management deals
- Growing fears of protectionism in the US; Change in visa regulations forcing IT companies to hire more local resources and adopt an onsite pyramid structure
- Competition increasing in the digital space along with some further shift in business towards captives
- Deal sizes on the digital space showing improvement still much small than traditional deals

Tailwinds

- Industry growth to be driven by consulting, cloud migration and digital; Companies with higher digital /consulting and engineering capabilities to gain market share.
- Some early signs of cyclical revival in BFSI (spends by large US banks holds the key). Retail could be bottoming out
- Companies focused on automation can negate some of the margin pressures on the back of improved efficiency gains ; need for cost cutting and increased offshoring as a proportion of total revenues
- Companies continue to generate significant free cash flow. Efficient capital allocation through buybacks and dividend pay-outs to support downside in stocks especially at current valuations

INFORMATION TECHNOLOGY – PORTFOLIO POSITION



Information Technology				
Funds	**Fund Weight**	**Index Weight**	**OW/UW Sept 18**	**OW/UW June 18**
Kotak Bluechip Fund	13.7%	15.1%	-1.4%	-4.8%
Kotak Equity Opportunities Fund	10.8%	12.6%	-1.7%	-1.8%
Kotak Standard Multicap Fund_AI	8.1%	12.6%	-4.5%	-3.9%
Kotak Smallcap Fund	1.8%	14.7%	-12.9%	-4.6%
Kotak Emerging Equity Scheme	1.0%	7.0%	-6.0%	-4.0%
Kotak India EQ Contra Fund	16.2%	13.3%	2.9%	2.7%
Kotak Tax Saver Scheme	10.7%	11.9%	-1.2%	-2.1%
Kotak Equity Hybrid 99(EQ)	9.0%	15.1%	-6.0%	-6.4%

Data: As of 28th Sept 2018. Source: Valuefy

- Demand outlook to show some improvement in FY19/FY20 led by signs of improvement in spends in large US banks
- Pace of large deal wins showing some initial signs of improvement
- The opportunities in the sector are stock specific. Mid cap IT services companies may grow faster than large caps. However, valuations in most cases reflecting the growth differential

Note: Index performance data as on 28th Sept 2018. Source: ICRA.

ENERGY

- Run-up in oil price have increased risks

Oil price jump upto US$ 85/bbl on geopolitical worries

- Above US$70-75/bbl risks are perceived to be higher for OMCs. In wake of upcoming Elections in key states, maintaining refining and marketing margins will be difficult for OMCs. Upstream cos.' earnings improve with higher oil price.

Partial backtracking of fuel price reforms

- Govt.'s action asking OMCs to sacrifice Rs 1 per litre margin on auto-fuels was disappointing which is perceived by the street as reverting to price control apart from cut in earnings estimates for OMCs.
- Intervention by the Govt. brings in uncertainty on any future action by the Govt. if oil prices were to rise further. Busy election calendar over next 3-9 months elevates this risk.

INR depreciation adds to worries

- Sharp depreciation in INR against USD hits OMCs through forex loss as crude oil purchases are in USD. Need to raise retail price to offset the impact.

Steady gross refining margins but high oil price can slow demand

- Demand can get impacted with higher oil price. While regional crack spreads are steady, higher fuel & cost will negatively impact margins.

Gas prices cheaper options vs petroleum fuels

- Domestic gas price increase for H2FY19 is not substantial to impact demand. Cost price increase has been passed on by CGD companies while upstream cos. will gain from higher realization. Natural gas, when brought under GST in future, will be significant positive for demand.

ENERGY –

Backtracking on pricing reforms has brought back uncertainty on sector

kotak Mutual Fund

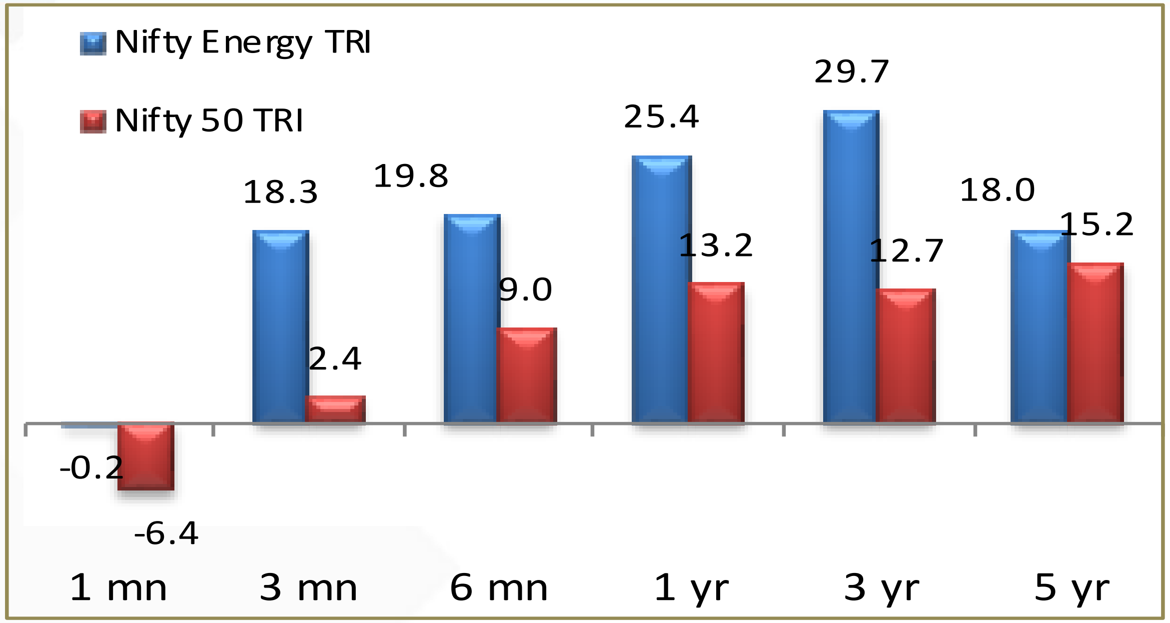
HEADWINDS

- Govt. buckled under pressure as fuel pricing reforms were partly rolled back by asking oil cos. to bear burden.
- Due to its strategic importance, sector dynamics are subject to geopolitical risks and policies of Govt. of oil producing nations. Current tensions between US and Iran has put risk premium on oil price.
- Risk of rollback of pricing reforms due to political compulsions materialized – faith on Govt. sticking to reforms has gone.
- Petroleum and natural gas kept out of GST is slightly negative but intent is there to bring them under GST in future, particularly natural gas.
- Limited options available with Govt. to manage fiscal situation means less scope to further reduce excise duty on fuels and hence, risk of putting burden on upstream cos. is now a strong possibility if oil prices rise further.
- INR depreciation against USD putting further upward pressure on final retail prices.

TAILWINDS

- Though Govt. made OMCs cut their margins, now after the price cut, OMCs have continued with daily revision of prices of petrol and diesel.
- Direct Benefit Transfer for LPG and similar framework for kerosene has controlled leakage in subsidy disbursed.
- Govt's push to increase domestic oil & gas production
- Increased focus on pollution control in big cities and Govt's push to increase share of gas in India's energy basket will spur domestic gas demand. Low prices of contracted and spot LNG vs. alternate petroleum fuels will support this further.

ENERGY : PORTFOLIO POSITION



Energy				
Funds	**Fund Weight**	**Index Weight**	**OW/UW Sept 18**	**OW/UW June 18**
Kotak Bluechip Fund	12.9%	15.9%	-2.9%	-3.2%
Kotak Equity Opportunities Fund	13.8%	13.6%	0.2%	0.1%
Kotak Standard Multicap Fund_AI	13.9%	13.6%	0.3%	-0.7%
Kotak Smallcap Fund	1.6%	1.2%	0.4%	0.4%
Kotak Emerging Equity Scheme	2.5%	7.7%	-5.3%	-6.1%
Kotak India EQ Contra Fund	10.8%	14.4%	-3.6%	-4.5%
Kotak Tax Saver Scheme	13.7%	12.6%	1.1%	0.7%
Kotak Equity Hybrid 99(EQ)	8.7%	15.9%	-7.2%	-7.4%

Data: As of 28th Sept 2018. Source: Valuefy

- **Our Funds largely have an *neutral to underweight view on the sector*.**
- Our allocations prefer gas utilities companies which have significant scope for volume growth as share of natural gas in India's energy basket increases.
- Pricing reforms were positive for earnings of refining and marketing companies. However, this has received setback due to recent Govt. action.
- We have an underweight position in upstream as well as downstream cos. as we expect earnings weakness due to lack of clarity on realization due to possible sharing of under-recovery on fuels.

Note: Index performance data as on 28th Sept 2018. Source: ICRA.

METALS & MINING –

- China dependent but domestic demand could be up this year

China's supply side reforms

- Over last 1-2 years, China has closed down illegal and polluting capacities which has become game changer for the industry as China is significantly dominant producer in steel and non-ferrous metals. Steel market has shifted from oversupply to now a balanced market.

Duty protection and trade barriers

- Anti-dumping and safeguard duties for steel producers in India protects realizations in case of weak global prices. Recent series of events related to trade barriers by US and China can potentially weaken the market.

Global demand

- Demand at global level is mixed but showing improvement. Europe and North America are low growth but improving while China is high growth but slowed down in recent years.

Domestic demand

- Steel demand in India has been weak and in low single digits for last 4 years but this year can pick up to high single digit growth due to faster execution of infrastructure and housing projects.

METALS & MINING –
China dependent but domestic demand could be up this year

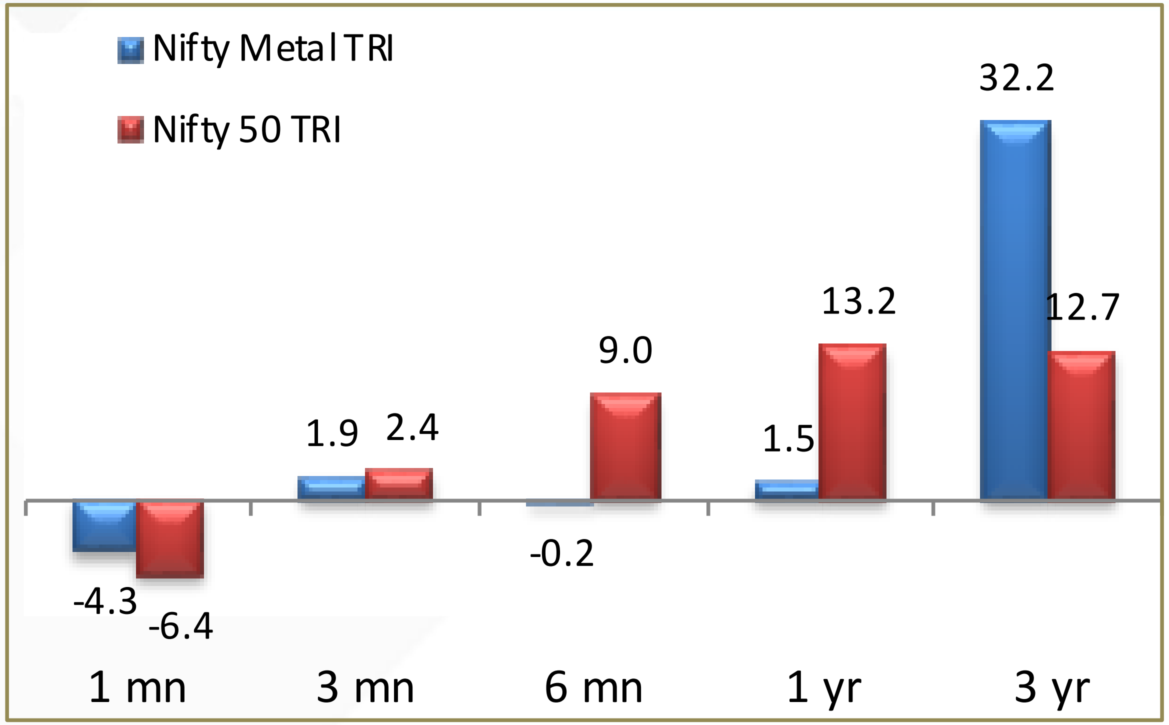
HEADWINDS

- High volatility in earnings and outlook for the same which is driven by external factor, mainly Govt. policies and economic conditions in China.
- Global economic growth rate, though improving, is still not robust.
- Globally, while non-ferrous industry is fairly consolidated, steel sector is highly fragmented.
- Rising global interest rates, US Fed balance sheet and strong USD or DXY is negative for non-ferrous commodity prices
- Trade wars can have direct (duty rates, quota) as well as indirect impact (slow manufacturing growth, supply disruptions)
- High leverage balance sheet of most companies in the sector.

TAILWINDS

- Supply side reforms in China due to pollution curbs have brought in balance in the market from oversupply earlier, particularly in steel which has given strength to underlying product prices.
- Due to improvement in the commodity prices there is better operating cashflow and in some cases, free cashflow which is reducing balance sheet risk.
- In pre-election year, domestic metal demand, particularly long steel, is expected to be stronger due to faster project executions.
- Govt.'s supportive policy incentivising higher domestic production and usage; duty protection in downturn.

METALS & MINING : PORTFOLIO POSITION



Metals				
Funds	**Fund Weight**	**Index Weight**	**OW/UW Sept 18**	**OW/UW June 18**
Kotak Bluechip Fund	2.1%	4.5%	-2.4%	0.5%
Kotak Equity Opportunities Fund	1.9%	4.1%	-2.3%	-3.5%
Kotak Standard Multicap Fund_AI	1.1%	4.1%	-3.1%	-3.1%
Kotak Smallcap Fund	4.8%	2.2%	2.5%	4.5%
Kotak Emerging Equity Scheme	2.7%	2.0%	0.7%	-4.8%
Kotak India EQ Contra Fund	3.3%	4.4%	-1.1%	-1.6%
Kotak Tax Saver Scheme	3.7%	3.9%	-0.2%	-2.2%
Kotak Equity Hybrid 99(EQ)	2.8%	4.5%	-1.7%	0.4%

Data: As of 28th Sept 2018. Source: Valuefy

- We maintain a largely underweight allocation in this sector. Our allocation in the smallcap and emerging equity fund is driven by availability of attractive valuation opportunities for quality businesses
- Overall, the present valuations levels may be relatively high vis-à-vis the historical levels. At that, the sector is given to high cyclicality, low margin, trade policies and excess capacity.
- Thus we are present in select stocks and allocation is based on the company’s volume growth prospect, ability to prudently utilize capital and create cost efficiencies.

Note: Index performance data as on 28th Sept 2018. Source: ICRA.

CEMENT & CEMENT PRODUCTS

-Resuming a multiyear uptrend in volumes and profitability

Improving sector capacity utilization levels

- Utilization levels have shown improvement in FY18 v/s FY17
- New capacity announcements are lower than incremental demand expected in next five years

Strong Demand Drivers – low single digit growth behind

- Public capex spend likely to result in allocation towards infrastructure, specifically roads, affordable housing and irrigation. Sand mining issues moving towards resolution would support volume growth
- Rural demand for cement to get boost from increase in farm income and better agriculture growth

Sector consolidation underway

- Around 40% of India's capacity between 3 groups now
- New players are facing higher cost curve which will bring back the pricing discipline across regions.
- Stressed assets are being acquired by existing players leading to further consolidation

CEMENT & CEMENT PRODUCTS

-Resuming a multiyear uptrend in volumes and profitability

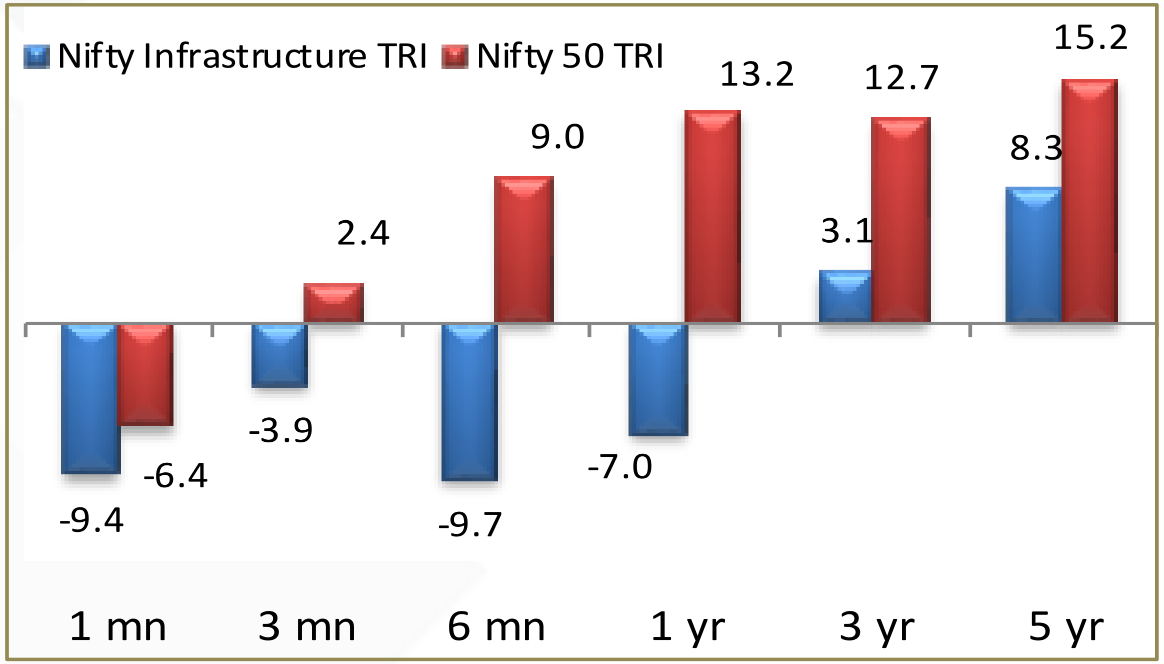
HEADWINDS

- Government intervention on pricing for cement in government projects.
- Strength in global energy prices leading to higher pet coke coal and diesel prices.
- Ban on cost efficient fuel like Pet coke.

TAILWINDS

- Volume share fight among industry leaders receding which will lead to pricing recovery
- Improving demand supply to drive capacity utilization over next 2 years.
- Sector consolidation over last five years.
- Improved demand outlook visible in volume growth on the back of various Policy & Budget announcements.

CEMENT & CEMENT PRODUCTS – PORTFOLIO POSITION



Cement & Cement Products				
Funds	**Fund Weight**	**Index Weight**	**OW/UW Sept 18**	**OW/UW June 18**
Kotak Bluechip Fund	3.5%	1.9%	1.6%	1.5%
Kotak Equity Opportunities Fund	7.4%	2.6%	4.8%	4.5%
Kotak Standard Multicap Fund_AI	5.9%	2.6%	3.4%	3.5%
Kotak Smallcap Fund	5.1%	2.7%	2.4%	1.5%
Kotak Emerging Equity Scheme	3.6%	2.0%	1.6%	0.8%
Kotak India EQ Contra Fund	2.9%	2.7%	0.3%	-1.7%
Kotak Tax Saver Scheme	8.0%	2.5%	5.5%	5.5%
Kotak Equity Hybrid 99(EQ)	8.2%	1.9%	6.3%	6.3%

Data: As of 28th Sept 2018. Source: Valuefy

- We believe that cements sector is a good proxy play for infrastructure led growth theme.
- Corporate balance sheets in the sector are better compared to what it was a decade ago.
- Moreover, the boost in spend on infrastructure and housing would also see acceleration in demand.
- Increased pricing power in the hands of cement companies, as sector consolidates
- **As a consequence, we are bullish on the sector**.

Note: Index performance data as on 28th Sept 2018. Source: ICRA.

INDUSTRIAL MANUFACTURING –
Macro favourable, Recovery visible in light engineering goods

Macro in place for capex recovery

- The government over last three years made serious efforts to solve the issues and kickstart investments in the power, coal, roads and railways. We are seeing strong growth in demand for wires and cables, abrasives and consumables which is a lead indicator for improvement in demand for capital goods in subsequent quarters
- Order books for almost all companies EPC companies have shown strong growth over last 1 year
- Progress in resolution of NPAs would kickstart investment in some of the stalled projects.
- Recent depreciation in Rupee compared to USD would improve the competitiveness of Indian manufacturers

Govt. focus on promoting manufacturing in India

- Government is actively supporting increase of manufacturing in India. Government has rolled out phased manufacturing plan in electronics and put duties to promote domestic companies. Similar measures are expected in other sectors as well.
- Increase in custom duty on electronic goods to promote domestic manufacturing.
- Reduction in GST rate on most of the consumer durables from 28% to 18% would boost demand and promote manufacturing.

INDUSTRIAL MANUFACTURING –

Macro favourable, Awaiting recovery

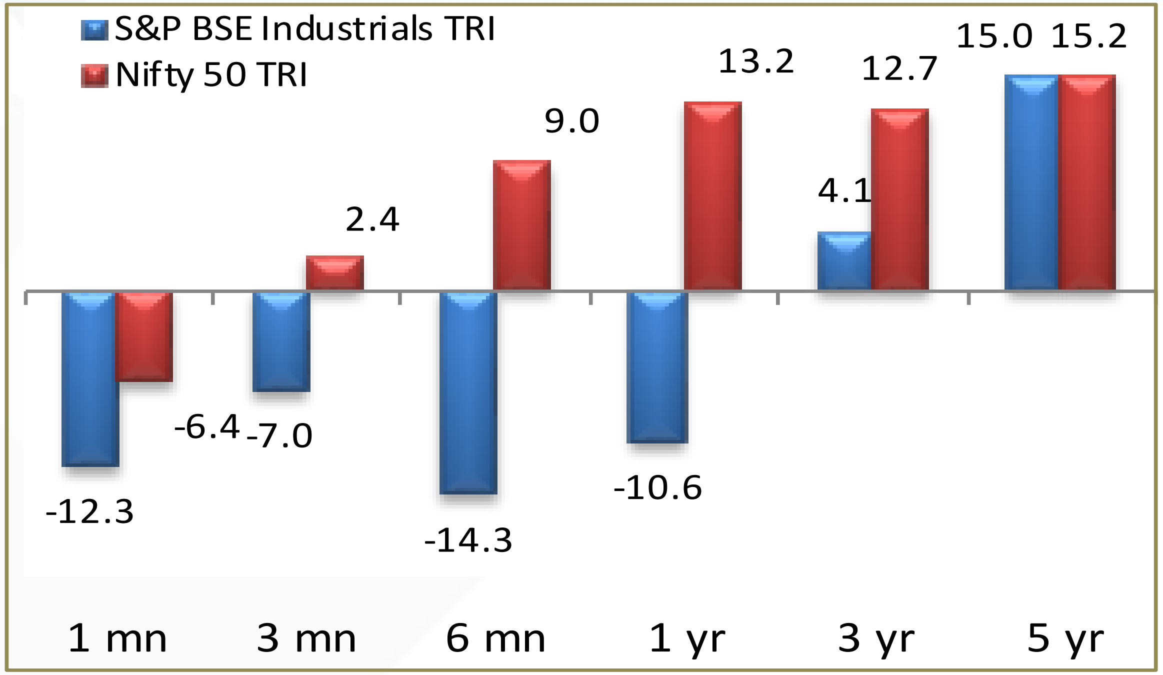
HEADWINDS

- Low utilisation levels of currently installed capacities is leading to slower decision making for new investment.
- Weak global outlook in key commodities is leading to delay in new investment.
- Weak balance sheets of private players, delaying announcement of new capex

TAILWINDS

- Investment cycle is poised to recover from the decline on the back of more favourable macroeconomic conditions and policy direction. Several indicators suggest the investment cycle is already building up after having bottomed
- Resolution of NPAs in steel, power and cement sectors should kickstart investment in many of the stalled projects
- Ordering by railways, NHAI, SEBs is gathering steam once again.
- Smaller projects in manufacturing, commercial and residential real estate likely to pick up in the near term.

INDUSTRIAL MANUFACTURING – PORTFOLIO POSITION



Industrial Manufacturing				
Funds	**Fund Weight**	**Index Weight**	**OW/UW Sept 18**	**OW/UW June 18**
Kotak Bluechip Fund	2.0%	0.0%	2.0%	2.9%
Kotak Equity Opportunities Fund	6.9%	1.2%	5.7%	5.5%
Kotak Standard Multicap Fund_AI	1.8%	1.2%	0.6%	0.9%
Kotak Smallcap Fund	14.0%	7.1%	7.0%	0.6%
Kotak Emerging Equity Scheme	17.2%	5.8%	11.4%	14.2%
Kotak India EQ Contra Fund	0.7%	0.6%	0.1%	-0.8%
Kotak Tax Saver Scheme	6.0%	2.5%	3.5%	3.7%
Kotak Equity Hybrid 99(EQ)	7.1%	0.0%	7.1%	8.9%

Data: As of 28th Sept 2018. Source: Valuefy

- Our outlook is largely positive on the sector.
- Led by government spending, we expect this sector to benefit, as lot of these companies are sitting on unused capacities and therefore will be large beneficiaries of operating leverage.
- We are more positive on the stocks with exposure to government spending, consumer durables, renewable energy and engineering consumables as we expect robust growth in demand.

Note: Index performance data as on 28th Sept 2018. Source: ICRA.

PHARMACEUTICALS –

Gradual pickup in growth going ahead

Sector to see bottoming out of US growth in FY19 as pricing pressure in US abates

- Leading players in US generics market are looking to exit products where profitability is down significantly due to competition. This should help stabilise pricing pressure and lead to bottoming out US growth for Indian pharma companies.
- Depreciation in INR to help margins in the near to medium term.

Approvals of complex and specialty products for Indian players in US to pick up in FY19

- Number of complex and specialty launches by Indian generic players in US is expected to pick up meaningfully from FY19. Complex and Specialty products are key for next leg of growth and improvement in profitability for the sector as simple generics are under pressure.

Growth in India to recover

- IPM *(Indian Pharma Market*) growth which was muted in FY17 due to impact of NLEM (*National List of Medicines*) and FDC (*Fixed Dosage Combination)* ban, has started recovering and growth in FY19 is expected to be back to about 12-13% level.

PHARMACEUTICALS –
Growth to pickup in H2FY18

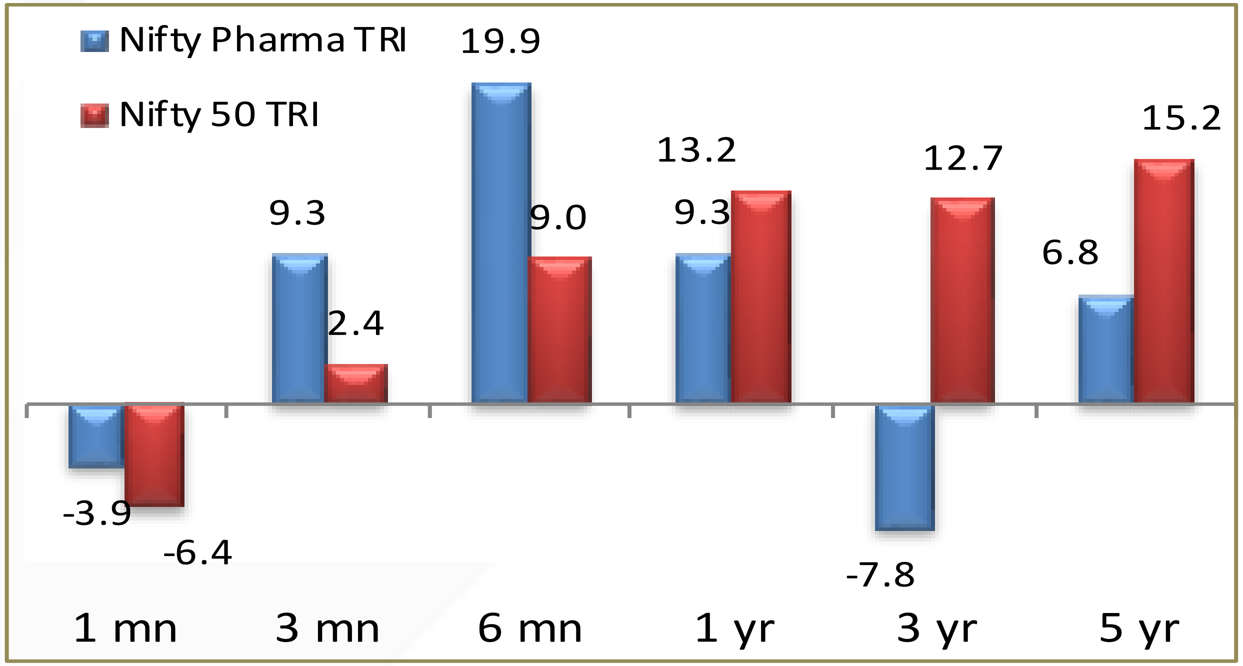
HEADWINDS

- USFDA has become more strict in ensuring compliance to manufacturing standards, this is leading to higher chances to adverse regulatory action on Indian companies
- Price erosion on the existing US base portfolio is now structurally high due to concentration among buyers.
- Government push to promote generic-generic drugs can reduce overall market size for branded generics.

TAILWINDS

- Faster approval by USFDA will lead to more opportunities for Indian companies in low competition products. Particularly helpful for players which have a small US portfolio.
- Key facilities of large Indian players which have received warning letters from USFDA are expected to be cleared in FY19. This would lead to approval of pending (New Drug applications) ANDAs, held up due to the warning letters.
- Commercialisation of ANDA pipeline acquired through acquisitions. Start of commercialisation of the complex/branded portfolio in the US market.
- After disruption in domestic market due to GST, growth is recovering. We expect that domestic pharma market growth would be in low double digits in the medium term.

PHARMACEUTICALS – PORTFOLIO POSITION



Pharma				
Funds	**Fund Weight**	**Index Weight**	**OW/UW Sept 18**	**OW/UW June 18**
Kotak Bluechip Fund	4.1%	3.0%	1.0%	0.5%
Kotak Equity Opportunities Fund	3.1%	5.0%	-1.9%	-3.5%
Kotak Standard Multicap Fund_AI	3.1%	5.0%	-1.9%	-3.1%
Kotak Smallcap Fund	4.8%	3.7%	1.1%	4.5%
Kotak Emerging Equity Scheme	6.6%	9.7%	-3.1%	-4.8%
Kotak India EQ Contra Fund	2.0%	4.4%	-2.4%	-1.6%
Kotak Tax Saver Scheme	4.7%	5.2%	-0.5%	-2.2%
Kotak Equity Hybrid 99(EQ)	3.1%	3.0%	0.0%	0.4%

Data: As of 28th Sept 2018. Source: Valuefy

- US generics business has become structurally less profitable leading to decline in return ratios for Indian pharma companies. Recovery would depend on Indian companies success in building a specialty portfolio. This is unlikely to happen in the near term.
- We are cautious on the sector as we believe the uncertainties in the sector can continue amidst still elevated expectations

Note: Index performance data as on 28th Sept 2018. Source: ICRA.

AUTO – RISE IN COST OF OWNERSHIP

NBFC Funded growth may take a breather

- The latest events in the credit market is likely to slow down the auto sales. High risk segments like 2W and pre owned vehicles may face some slowdown going ahead (around half of sales is leveraged)
- Interest rates hardening as well as non availability of finance may result in slower growth for the sector

Hike in insurance cost to weigh on two wheeler sales

- Increase in insurance cost on account of compulsory 5 year cover as also a 15 fold hike in sum assured for third party is likely to dent the lower end of the two wheeler industry
- One player wanting to gain share in the commuter segment by aggressive discounting is also likely to put pressure on margins.

AUTO – RISE IN COST OF OWNERSHIP

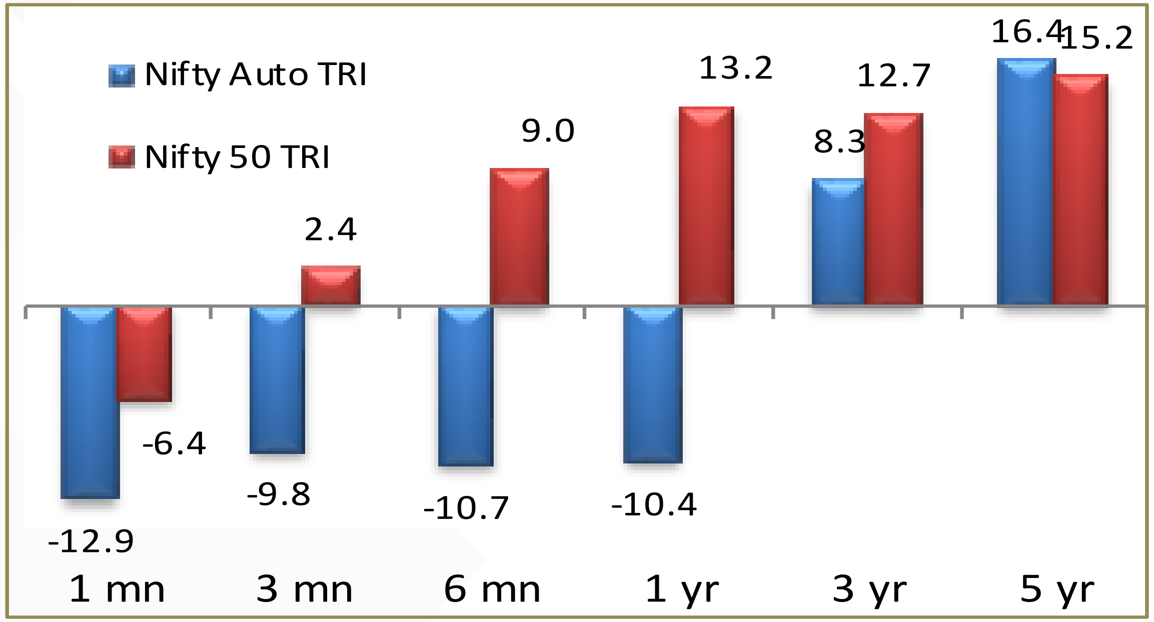
HEADWINDS

- High fuel cost may start impacting ownership cost
- Tightening of finance and increase in cost of borrowing to slow down growth
- Rising commodity cost to impact gross margins

TAILWINDS

- Increased spending by government to revive Rural India.
- MSP hikes also to result in higher purchasing power with farmers
- Increase in trade volumes resulting in better profitability for fleet operators

AUTO – PORTFOLIO POSITION



Automobile				
Funds	**Fund Weight**	**Index Weight**	**OW/UW Sept 18**	**OW/UW June 18**
Kotak Bluechip Fund	10.3%	7.5%	2.8%	2.1%
Kotak Equity Opportunities Fund	1.3%	8.0%	-6.8%	-4.7%
Kotak Standard Multicap Fund_AI	6.9%	8.0%	-1.2%	0.1%
Kotak Smallcap Fund	5.3%	2.0%	3.3%	-0.3%
Kotak Emerging Equity Scheme	7.2%	8.1%	-0.9%	-0.3%
Kotak India EQ Contra Fund	8.2%	8.0%	0.2%	3.1%
Kotak Tax Saver Scheme	3.2%	7.6%	-4.5%	-6.5%
Kotak Equity Hybrid 99(EQ)	11.3%	7.5%	3.8%	4.1%

Data: As of 28th Sept 2018. Source: Valuefy

- We are mostly neutral on the auto & ancillary sector.
- The allocation is largely spread out across OEMs and auto component manufacturers.
- Our exposure is dependent on the manufacturer's ability to manage pricing competition, market share dominance and multiple streams of revenues from product/geographical sub-segments.

Note: Index performance data as on 28th Sept 2018. Source: ICRA.

CONSUMER GOODS– RESURGENCE OF PRICING

- Commodity inflation amidst strong growth aiding price hikes

Crude led commodity inflation on a rise

- Key raw material linked to crude oil as well as freight cost are rising. Companies taking this as an opportunity to take price hikes

MSP Increase to add to inflation

- A below average monsoon along with sharp increase in MSP for both kharif and rabi crop to add to increase in raw material prices

Rural growth on the rise

- Rural growth is improving despite a poor monsoon. Hike in MSP as well as election led spending is likely to up the growth rates further.

Premiumisation continues

- Premiumisation of the portfolio continues as consumers are continuously upgrading at all levels.

CONSUMER GOODS – PRICING GROWTH BACK

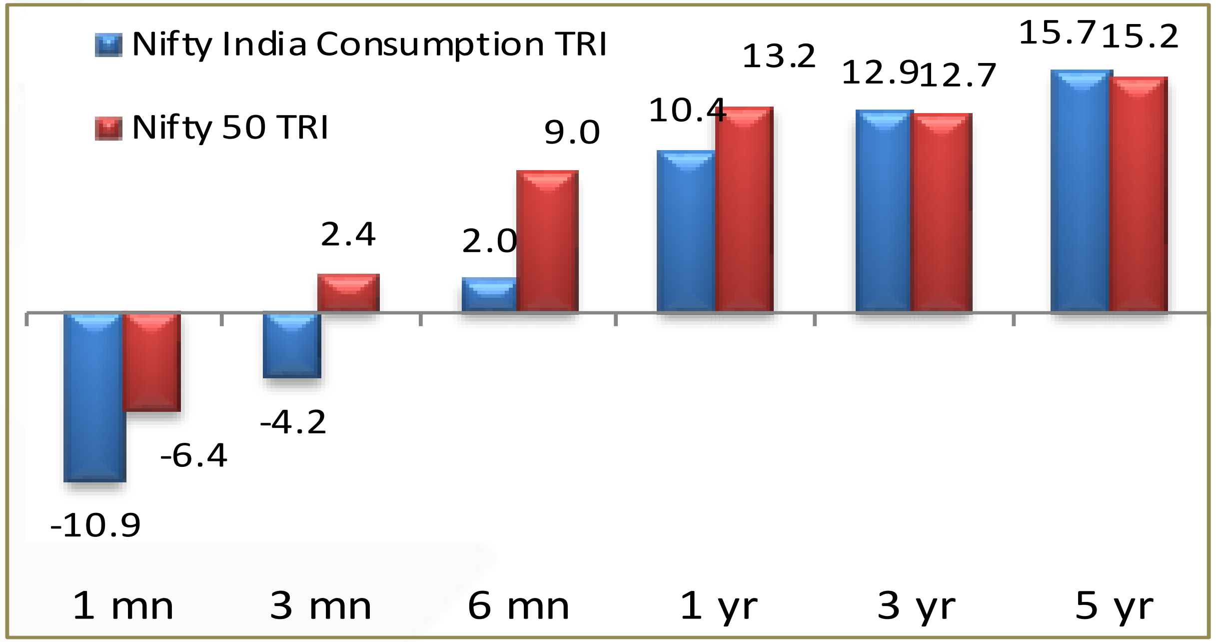
HEADWINDS

- High crude prices and chemicals to impact gross margins in general
- Confusion regarding the anti-profiteering act impacting the operations
- Hike in MSP and below average monsoon to impact gross margins

TAILWINDS

- Rural demand picking up
- Unorganized sector loosing share to benefit the organized players
- Commodity inflation resulting in more than required price hikes. To aid sales and margins.

CONSUMER GOODS – PORTFOLIO POSITION



Consumer Goods				
Funds	**Fund Weight**	**Index Weight**	**OW/UW Sept 18**	**OW/UW June 18**
Kotak Bluechip Fund	12.1%	10.6%	1.5%	0.8%
Kotak Equity Opportunities Fund	11.0%	12.9%	-1.9%	-2.2%
Kotak Standard Multicap Fund_AI	7.7%	12.9%	-5.1%	-3.5%
Kotak Smallcap Fund	16.2%	8.1%	8.1%	10.4%
Kotak Emerging Equity Scheme	11.8%	14.0%	-2.2%	2.2%
Kotak India EQ Contra Fund	18.2%	12.7%	5.5%	3.7%
Kotak Tax Saver Scheme	9.6%	13.2%	-3.6%	-1.6%
Kotak Equity Hybrid 99(EQ)	9.6%	10.6%	-1.0%	0.2%

Data: As of 28th Sept 2018. Source: Valuefy

- We are largely overweight on the consumer discretionary- segment, while maintaining an underweight position on the staples segment. Our underweight allocation in some funds may be due to unavailability of opportunities at reasonable valuation levels.
- We expect that the increase in disposable income as well as easy finance availability will boost the demand for consumer discretionary segments like durables. Our stock preference is based on high earnings growth visibility.
- High valuation multiples are a key risk.

Note: Index performance data as on 28th Sept 2018. Source: ICRA.

CONSTRUCTION –
Largescale opportunities ahead

Road project: Bharatmala provides robust order visibility

- Investment of INR6.9t over next 5 years with an aim to build additional 34,800kms.
- Funding will be met from INR2.4t from road fund, INR2.1t from borrowing, INR1.1t through PPP mode and INR0.6t of budgetary support.

Railways: Electrification to drive investment in near term

- INR1t is spending target for the sector towards electrification, gauge conversion, new routes, station upgrade, etc
- Related spending would also be seen in locomotives, wagons procurement.

Affordable housing is other major focus area

- Under the 'PMAY- Urban' scheme, 12mn units will be built with an outlay of INR1.85tn over the next 3 years.
- For 'PMAY – Gramin', ~10mn units are proposed to be built with an outlay of INR1.3tn by the Centre and States by March '19.

Slew of other flagship scheme to build "New-India"

- Amongst the key flagship scheme where initial work has commenced include Namame Gange, River interlinking project, and Delhi Mumbai Industrial Corridors. Sizable investment in Urban Infrastructure development is reflected with increased investment in Airports (Navi Mumbai being flagship), connectivity projects (MTHL), Metro works, etc.

CONSTRUCTION –
Largescale opportunities ahead

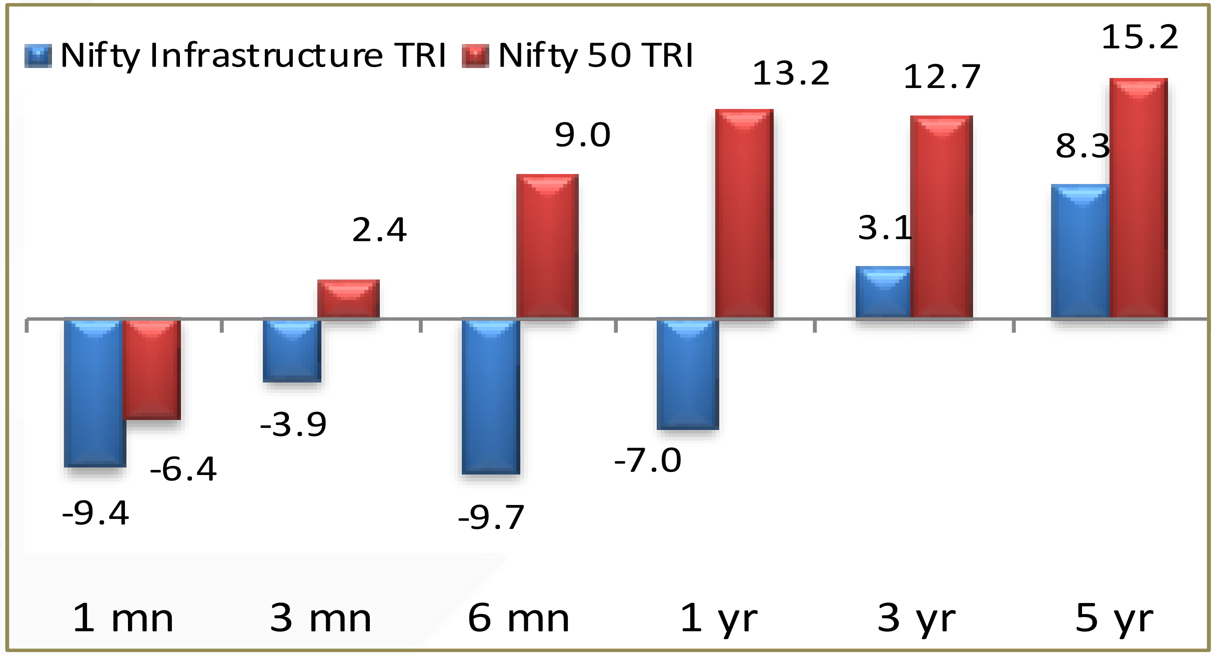
HEADWINDS

- Land acquisition has been amongst the key challenge for major infrastructure sector, and road sector in particular. Higher land compensation and inclusive development are enablers.
- Funding for infrastructure may emerge as challenge, given large dependence is placed on market borrowing while share of BS/funding from road development fund has been muted.
- Aggressive bidding by Developers, lack of balance sheet strength to achieve project financial closure has led to project re-award, delays in completion.
- Presence of large unorganised players tend to undercut on merely pricing front. Need for a broad developer based rating is needed.
- State government is equally involved in funding, land acquisition support and lack of administrative bandwidth, commitment to projects may hinder progress.

TAILWINDS

- DPRs are ready for 25,000 kms of work under Bharatmala and thus, project award is expected to be fast.
- Railways have improved ticket size for project award to weed out small players and improve qualification. Further, the supplier/vendor base is rationalised to improve execution.
- Significant changes in IT for developers and interest subvention for customer to promoter housing for all.
- Dispute resolution board has been given approval to weed out any issues during project execution.

CONSTRUCTION – PORTFOLIO POSITION



Construction				
Funds	**Fund Weight**	**Index Weight**	**OW/UW Sept 18**	**OW/UW June 18**
Kotak Bluechip Fund	2.9%	3.6%	-0.7%	0.5%
Kotak Equity Opportunities Fund	4.5%	3.5%	1.1%	-3.5%
Kotak Standard Multicap Fund_AI	5.9%	3.5%	2.5%	-3.1%
Kotak Smallcap Fund	8.3%	10.2%	-1.9%	4.5%
Kotak Emerging Equity Scheme	4.9%	4.8%	0.0%	-4.8%
Kotak India EQ Contra Fund	3.5%	3.3%	0.2%	-1.6%
Kotak Tax Saver Scheme	5.9%	3.8%	2.1%	-2.2%
Kotak Equity Hybrid 99(EQ)	7.7%	3.6%	4.1%	0.4%

Data: As of 28th Sept 2018. Source: Valuefy

- We maintain a largely overweight view on the sector.
- We believe that the massive outlay and rising growth momentum will provide a significant demand fillip for companies operating in this sector.
- Within the construction sector, we have a preference for companies with robust balance sheets, proven project management skills, and those having a substantial growth potential.

Note: Index performance data as on 28th Sept 2018. Source: ICRA.

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