

Monthly Market Round-up - Equity

February 2009

Markets plagued by weak economic data

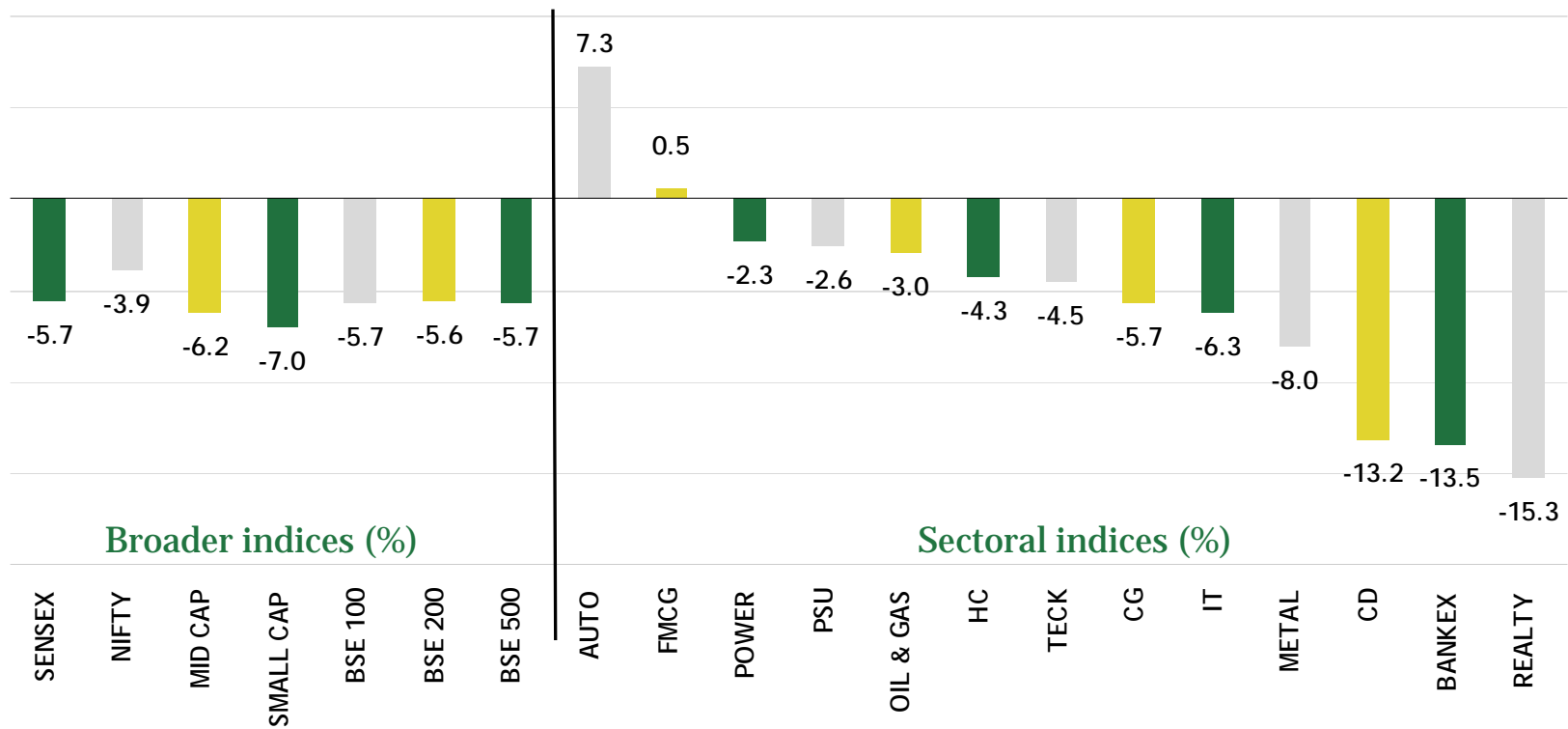
- Equity markets across the globe continued to fall in the month of February but emerging markets outperformed
- Global GDP now estimated to drop 1% in 2009, the worst performance since World War II
- US GDP in the quarter ended December 2008 declined at an annual rate of 6.2%, the worst since 1982
- Global trade on the back foot - Japanese exports drop 45.7% yoy and Chinese exports drop 17.5% yoy in January
- Indian GDP grew by 5.3 per cent in the quarter ended December 2008, the slowest quarterly growth in 6 years

Global Equities

Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	2082.85	4.63%	14.39%	EM - Asia
BSE Sensex	India	8891.61	-5.65%	-7.83%	EM - Asia
Kospi	South Korea	1063.03	-8.53%	-5.46%	EM - Asia
Taiwan Weighted	Taiwan	4557.15	7.28%	-0.74%	EM - Asia
Thailand SET 50 Index	Thailand	299.58	-1.32%	-4.53%	EM - Asia
Jakarta Composite Index	Indonesia	1285.48	-3.54%	-5.16%	EM - Asia
KLSE	Malaysia	890.67	0.70%	1.59%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	38183.31	-2.84%	1.69%	EM
Mexico IPC	Mexico	17752.18	-9.27%	-20.68%	EM
Russian RTS Index	Russia	544.58	1.78%	-13.82%	EM
Philippine PSEi	Philippines	1872.22	2.58%	0.54%	EM
Merval Buenos Aires Index	Argentina	1019.29	-5.37%	-5.59%	EM
HangSeng	Hong Kong	12811.57	-3.51%	-10.95%	Developed - Asia
Nikkei	Japan	7568.42	-5.32%	-14.57%	Developed - Asia
Strait Times	Singapore	1594.87	-8.68%	-9.46%	Developed - Asia
Dow Jones	USA	7062.93	-11.72%	-19.52%	Developed
CAC 40 Index	France	2702.48	-9.13%	-16.02%	Developed
All Ordinaries Index	Australia	3296.90	-5.21%	-9.90%	Developed
DAX Index	Germany	3843.74	-11.40%	-18.30%	Developed
Swiss Market Index	Switzerland	4690.67	-11.33%	-15.25%	Developed
FTSE 100	UK	3830.09	-7.70%	-13.62%	Developed
MSCI World Index	--	750.86	-10.49%	-18.40%	--

* as on 27th February 09. Source : Bloomberg
EM - emerging markets, Developed - developed markets.

Sector performance



- Realty and Banking retained the tops slots among the underperformers from last month
- Auto was the star sector with companies reporting unexpectedly large YoY gains in sales in February
- Mid and small cap companies underperformed

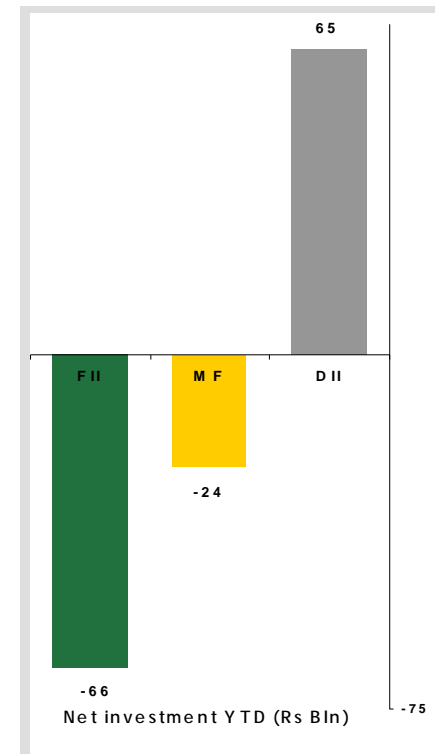
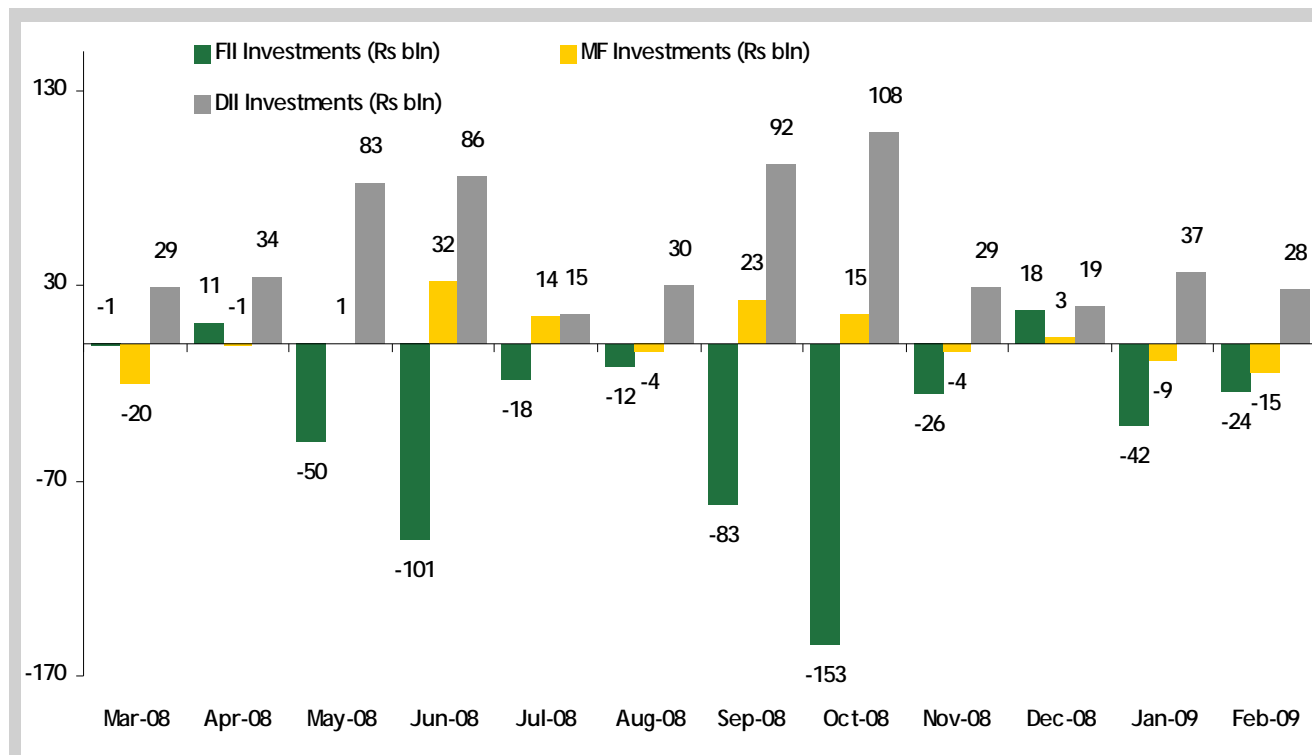
*Source: BSE, NSE. one month performance as on 27th February 09.

Top Gainers / Losers - Nifty

Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
Maruti Suzuki India Ltd.	945.55 / 428.4	677.60	18.67
Grasim Industries Ltd.	2930 / 831	1,371.50	14.55
Power Grid Corpn. Of India Ltd.	113 / 51.75	96.50	9.47
A C C Ltd.	855 / 369	539.80	6.92
Bharat Heavy Electricals Ltd.	2366 / 984.1	1,396.30	5.74
Top Losers for the month			
Losers	52 week H/L	Last Price#	% Loss*
Ranbaxy Laboratories Ltd.	613.7 / 159.65	161.80	-24.99
A B B Ltd.	1240 / 360	367.65	-23.37
Hindalco Industries Ltd.	191.03 / 38.05	38.60	-21.30
I C I C I Bank Ltd.	1113.8 / 282.15	328.10	-21.19
Housing Development Finance Corpn. Ltd.	2950 / 1193.3	1,269.20	-17.41

closing price as on 27th February 09.* one month performance as on 27th February 09. Source: cmie prowess

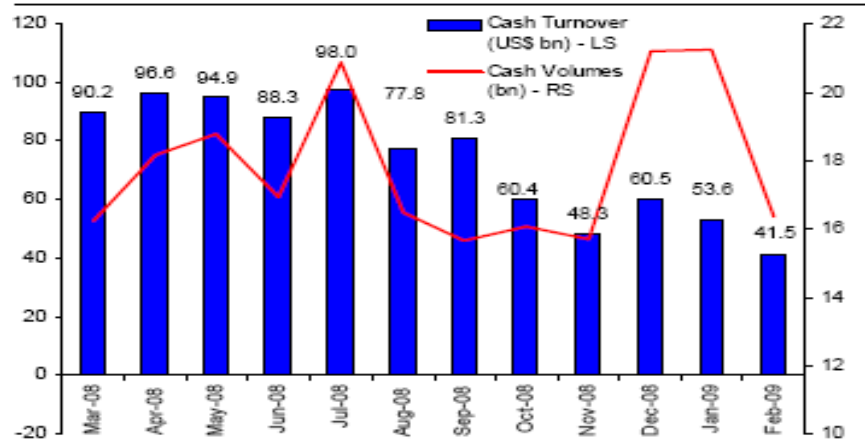
Insurance companies continue to buy, but...



- Domestic mutual fund were net sellers for the second month in a row and recorded their highest net sales since March 08.

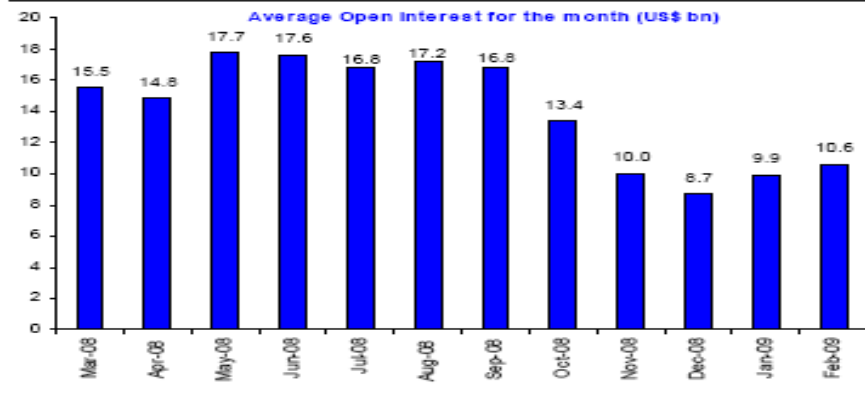
Activity continues to slow

Cash Trading: Turnover and Volumes



Source: BSE, NSE, Morgan Stanley Research

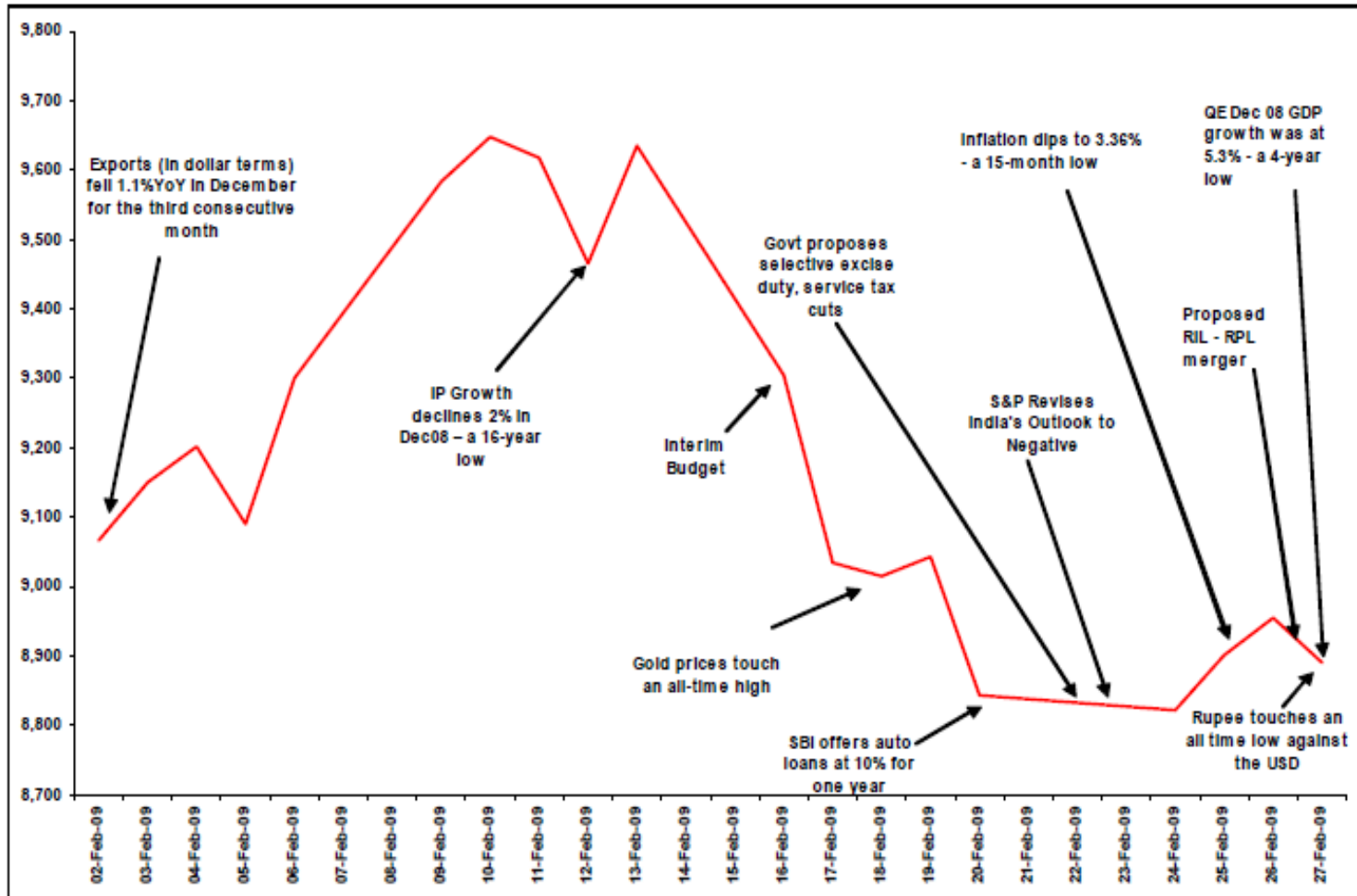
Average Open Interest for the Month



Source: Bloomberg, Morgan Stanley Research

- In February, cash trading volumes (number of shares) were down 23% MoM and are 44% below the December 2007 peak
- Trading volumes (value) fell 23% MoM and are now 75% below the October 2007 peak
- At the end of February, average open interest rose for the second consecutive month - up 7% MoM and is 62% off the January 2008 peak.

February timeline



Source: Bloomberg, Economic Times, Business Standard, Morgan Stanley Research

India Market Summary

- The benchmark index Sensex fell by 5.65% in the month. India underperformed emerging markets and other major indices in February, accentuated by the rupee's fall against the USD
- Markets rallied in the early part of the month on expectations that the vote-on-account may offer tax sops and sector-specific stimulus, but it turned out to be a non-event disappointing the stock markets
- S&P revised its outlook on India's sovereign rating to negative on worries about a ballooning fiscal deficit and in response, the Rupee dropped to an all time low
- The Dollex (BSE 200 index in \$) closed the month 71% below its peak and is at its lowest level since May 2005
- Before the parliament concluded its budget session the Finance Minister announced another fiscal stimulus package of Rs 300bn (0.3% of GDP) envisaging mainly cuts in excise duty and service tax

Highlights for the month

- WPI inflation based on the wholesale price index (WPI) has come down to 3.36% in the week ended 14th February'09 - a 15-month low
- Dec-08 IIP growth declined 2% YoY
- The rupee depreciated 4.2% and 3.4% against the USD and the euro, respectively. On a 12-month trailing basis, the rupee has depreciated 22% against the USD
- By the end of February, the 10-year bond yield fell 22 bps MoM to 6.02%. The 91-day yield ended the month at 4.58%, down 17 bps MoM
- India's December exports declined 1.1% yoy to US\$12.7bn, while imports grew 8.8% yoy to US\$20.25bn
- Direct tax collection data for the period Apr'08-Jan'09 was released showing a modest growth of 11.9% (YoY) & Indirect tax collections declined by 11.13% (MoM)
- The Cabinet Committee on Economic Affairs has approved new guidelines for calculation of total foreign investment in Indian companies. Prima-facie this liberalizes the existing norms but there remains a lot of ambiguity on the issue and needs further clarification

Earnings continue to be downgraded

Consensus earnings continue to be downgraded



Source: Bloomberg

BSE 100 consensus sector earnings growth	Profit growth	
	FY09	FY10
Consumer Discretionary	-13.7%	11.4%
Consumer Staples	-8.8%	15.0%
Energy	7.4%	28.0%
Financials	-0.1%	14.0%
Health Care	-2.7%	15.7%
Industrials	-6.5%	16.4%
Information Technology	13.4%	4.1%
Materials	-7.1%	-21.8%
Real Estate	-37.4%	-16.6%
Telecommunication Services	12.6%	8.6%
Utilities	14.0%	6.8%
Aggregate	-0.7%	7.7%

Source: Bloomberg, IIFL Research

Note: All numbers are on consolidated basis except for Financials. For Reliance Industries and Tata Steel we have considered FY08 IIFL actual.

- In just over 4 months, FY10 consensus EPS (source: Bloomberg consensus) for the Sensex has seen a downgrade of over 25% from 1170 to 857
- In our view, there are more earnings downgrades to come, but the pace of downgrades will decelerate, hereon
- We believe that earnings for the Sensex could drop about 7% over the period FY2008-FY2010 resulting in an EPS of about Rs 750 for FY2010
- Analysts expect 6 out of 10 sectors to record an earnings drop in FY2009.
- But in FY2010 the analysts expect 8 out of 10 sectors to record earnings growth which could prove optimistic

Valuations



Source: Bloomberg, MSCI, IIFL Research



Source: IIFL Research

- On a trailing PE basis India is trading close to its historic premium to Emerging Markets (EM)
- Midcaps have re-rated relative to Large caps since the low in October 08

Spotlight : Interest rate risk rises

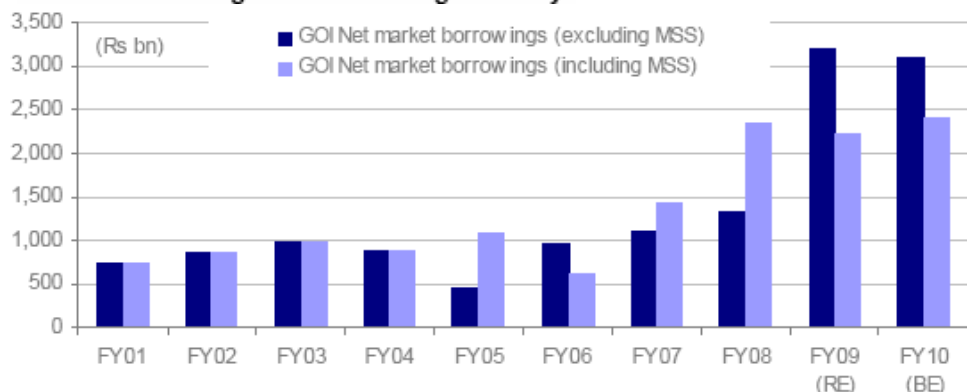
India's Consolidated Fiscal Deficit

(As % of GDP)	F2007	F2008	F2009E	F2010E
Central Fiscal Deficit	3.5%	2.7%	6.0%	6.0%
State Fiscal Deficit	1.9%	2.3%	2.7%	3.3%
Sub-total	5.3%	5.0%	8.7%	9.3%
<i>Inter-government adjustments</i>	0.3%	-0.1%	-0.1%	-0.1%
Combined Headline Deficit	5.6%	4.9%	8.6%	9.2%
<i>Major Off-budget expenditure items*</i>	1.9%	2.0%	3.2%	0.2%
Overall Fiscal Deficit	7.5%	6.9%	11.8%	9.4%

*Here the off-budget items include expenditure on food, fertilizer, oil and waiver of farm loans. We have included the full amount of farm loan waiver in the year in which the expenditure has been incurred i.e. F2009. The government has planned to amortize the cost over the period of four financial years. Source: RBI, Economic Survey, Ministry of Finance, Morgan Stanley Research; E= Morgan Stanley Research Estimates

- The consolidated national fiscal deficit (including central government, state government and off-budget expenditure) will be at 11.8% of GDP in FY2009.
- Given the risk to tax revenues in FY2010 it might sustain at above 10% of GDP despite a reduction in oil and fertilizer subsidies
- In FY2009 the sharp rise in the government's borrowing program was offset by the release of money earlier sterilized under the Monetary Stabilization Scheme (MSS)
- In FY2010 the buffer from MSS is marginal and the risk off an overshoot on the fiscal deficit and hence borrowing program is high
- The risk is that the fiscal stress and the rising borrowing program of the government overwhelms the impact of the interest rate cuts by the RBI

GOI net borrowings to increase significantly



Source: CGA, RBI, IIFL Research. RE - revised estimates, BE - Budget estimates

Looking Ahead....

- The environment remains challenging in terms of sluggish domestic demand, a decline in external demand (exports) and reduced availability of capital and/or a higher cost of capital
- Borrowing rates are coming down only gradually as banks remain risk averse
- Elections will be held in April/May and a new government will be in place by June. Expect volatility related to the elections outcome in the days ahead
- In recent history governments have been proactive in the early part of their term and we can expect the economic issues to be the key focus of the incoming governments agenda

Investment view

Short term

- Challenging growth environment with GDP growth likely to decelerate next year to 6%
- We now estimate that earnings during FY08-10 are likely to drop by 5-10%
- Inter-sector and Intra-sector performance variations are likely to increase

Long term

- India will double in size, adding \$1trillion to GDP over the next 5-7 years.
- Over the same period earnings should match nominal GDP growth @12-14% p.a but will be back ended
- If growth accelerates after 2010 then returns would be boosted by an improvement in valuations

Events Calendar

Date	Economy	Data release / Event	Period	Prior
12-Mar	India	Industrial production (%Y-o-Y)	January	-2.0
31-Mar	India	Balance of Payments	Q3FY09	--

Date	Economy	Data release / Event	Period	Expectations	Prior
5-Mar	Eurozone	Real GDP (% , Y-o-Y)	Q4CY08	-1.20	-1.2
5-Mar	UK	BoE interest rate announcement	5-Mar	0.50	1.00
5-Mar	Eurozone	ECB interest rate announcement	5-Mar	1.50	2.00
6-Mar	US	Unemployment Rate	Feb	7.9	7.6
12-Mar	Japan	Real GDP (% , Q-o-Q)	Q4CY08	--	--
18-Mar	Japan	BoJ interest rate announcement	18-Mar	--	0.10
26-Mar	US	GDP (Q-o-Q, annualised)	Q4CY08	--	-6.20

Source: Bloomberg

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