

# Equity Markets : Current Environment and Outlook

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# Current Environment

- Global Equity markets remained bullish in April, with the MSCI World Index rising by 4.02%.
- Indian markets sharply underperformed the global markets, falling by 1.59% in the month of April.
- Commodity price indices were buoyed by rise in crude oil prices, with the benchmark CRB Reuters Jefferies total return index rising by 2%. This is the eight consecutive month of rise for the index.
- FMCG and Healthcare were the best performing sectors, while Realty and IT sectors delivered the worst return for the month.
- FII inflows during the month were at Rs.72bn. DIIs recorded outflows of Rs.6bn, while MF net sales was at Rs.5bn during the month.
- Trading Activity remained subdued in April, as the cash trading turnover (US \$bn) declined sharply by 11% MoM, while the average open interest remained flat MoM.

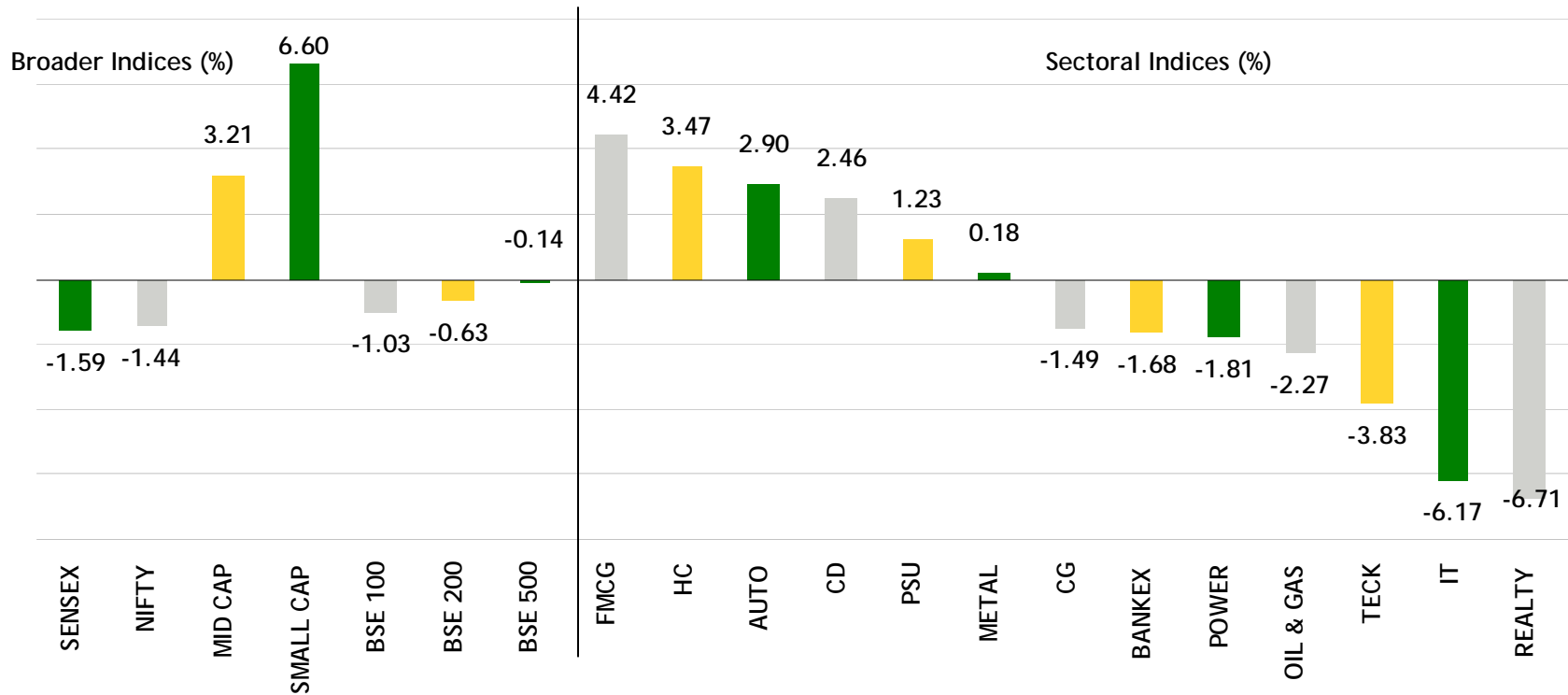
# Global Equities

| Index                     | Country     | Closing Price* | 1 Month Return (%) | YTD Return (%) | Category         |
|---------------------------|-------------|----------------|--------------------|----------------|------------------|
| SSE Composite Index       | China       | 2911.51        | -0.57%             | 3.68%          | EM - Asia        |
| BSE Sensex                | India       | 19135.96       | -1.59%             | -6.70%         | EM - Asia        |
| Kospi                     | South Korea | 2192.36        | 4.07%              | 6.89%          | EM - Asia        |
| Taiwan Weighted           | Taiwan      | 9007.87        | 3.74%              | 0.39%          | EM - Asia        |
| Thailand SET 50 Index     | Thailand    | 770.69         | 4.72%              | 7.01%          | EM - Asia        |
| Jakarta Composite Index   | Indonesia   | 3819.62        | 3.83%              | 3.14%          | EM - Asia        |
| KLSE                      | Malaysia    | 1534.95        | -0.66%             | 1.06%          | EM - Asia        |
| Ibovespa Sao Paulo Index  | Brazil      | 66132.86       | -3.58%             | -4.58%         | EM               |
| Mexico IPC                | Mexico      | 36962.62       | -1.28%             | -4.12%         | EM               |
| Russian RTS Index         | Russia      | 2026.94        | -0.84%             | 14.35%         | EM               |
| Philippine PSEi           | Philippines | 4319.51        | 6.52%              | 2.82%          | EM               |
| Merval Buenos Aires Index | Argentina   | 3406.02        | 0.53%              | -3.34%         | EM               |
| HangSeng                  | Hong Kong   | 23720.81       | 0.82%              | 2.98%          | Developed - Asia |
| Nikkei                    | Japan       | 9849.74        | 0.97%              | -3.71%         | Developed - Asia |
| Strait Times              | Singapore   | 3179.86        | 2.38%              | -0.32%         | Developed - Asia |
| Dow Jones                 | USA         | 12810.54       | 3.98%              | 10.65%         | Developed        |
| CAC 40 Index              | France      | 4106.92        | 2.95%              | 7.94%          | Developed        |
| All Ordinaries Index      | Australia   | 4899.00        | -0.60%             | 1.07%          | Developed        |
| DAX Index                 | Germany     | 7514.46        | 6.72%              | 8.68%          | Developed        |
| Swiss Market Index        | Switzerland | 6539.70        | 2.87%              | 1.61%          | Developed        |
| FTSE 100                  | UK          | 6069.90        | 2.73%              | 2.88%          | Developed        |
| MSCI World Index          | --          | 1388.62        | 4.02%              | 8.48%          | --               |

\* as on 29<sup>th</sup> April 2011. Source : Bloomberg  
EM – emerging markets, Developed – developed markets.



# India : Sector performances



- Sensex fell by 1.59% over the previous month.
- MidCaps outperformed LargeCaps with a 3.21% gain for the MidCap index.
- FMCG and Healthcare were the best performing sectors.
- Realty and IT sectors delivered the worst return for the month.

\*Source: BSE,NSE. one month performance as on 29<sup>th</sup> April 11.

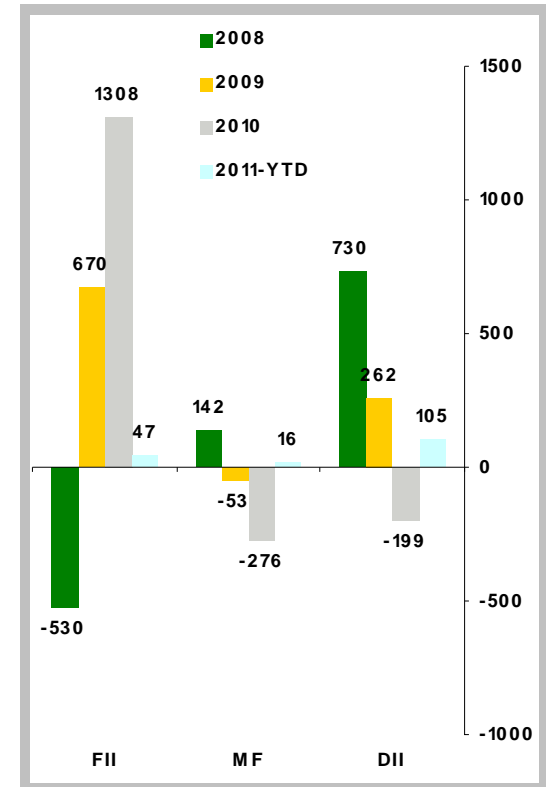
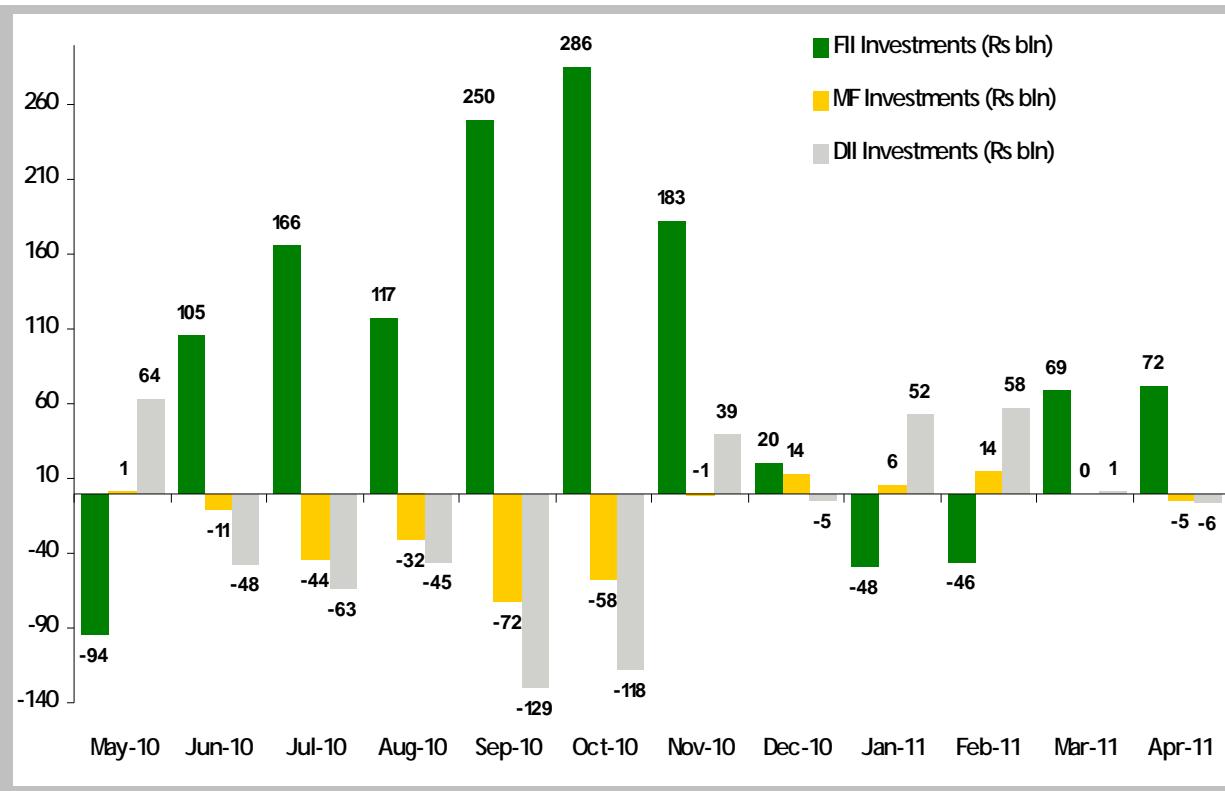
# Top Gainers / Losers - Nifty

| Top Gainers for the month |                  |             |         |
|---------------------------|------------------|-------------|---------|
| Gainers                   | 52 week H/L      | Last Price# | % Gain* |
| HCL Technologies          | 528 / 349.1      | 521.2       | 9.05%   |
| M & M                     | 826.7 / 502.6    | 756.4       | 8.00%   |
| Sesa Goa                  | 435.8 / 254.75   | 313.9       | 7.74%   |
| Hero Honda Motor          | 2070 / 1375.75   | 1710        | 7.58%   |
| Ambuja Cem.               | 166.8 / 102.05   | 158.2       | 7.33%   |
| Top Losers for the month  |                  |             |         |
| Losers                    | 52 week H/L      | Last Price# | % Loss* |
| DLF                       | 397.5 / 208.5    | 222.8       | -17.04% |
| Infosys Tech.             | 3499 / 2510.1    | 2906.25     | -10.34% |
| Axis Bank                 | 1608.5 / 1147.15 | 1286.6      | -8.35%  |
| Rel. Comm.                | 207.8 / 84.25    | 100         | -7.11%  |
| Reliance Inds.            | 1124.9 / 885.1   | 983.75      | -6.23%  |

# closing price as on 29<sup>th</sup> April 2011.\* one month performance as on 29<sup>th</sup> April 2011.  
Source: Capitaline



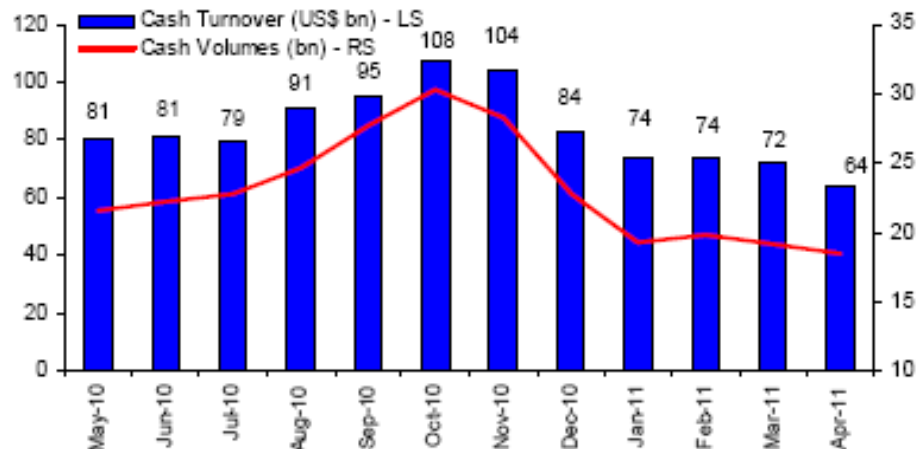
# FII & DII Inflows



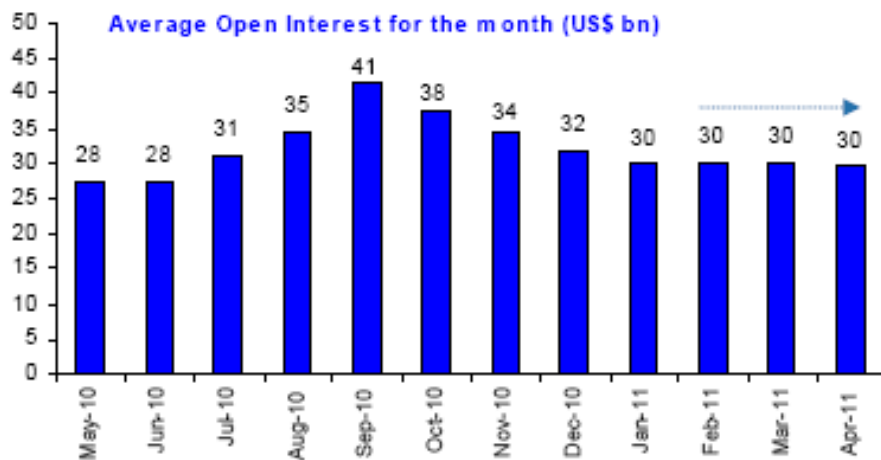
- FII inflows during the month were at Rs.72bn. FII net inflows were at Rs.47bn for CY11 after a Rs.1308bn inflow in CY10 and Rs.670bn inflow in CY09.
- DII recorded outflows of Rs.6bn. MF net sales was at Rs.5bn during the month.



# Market Activity

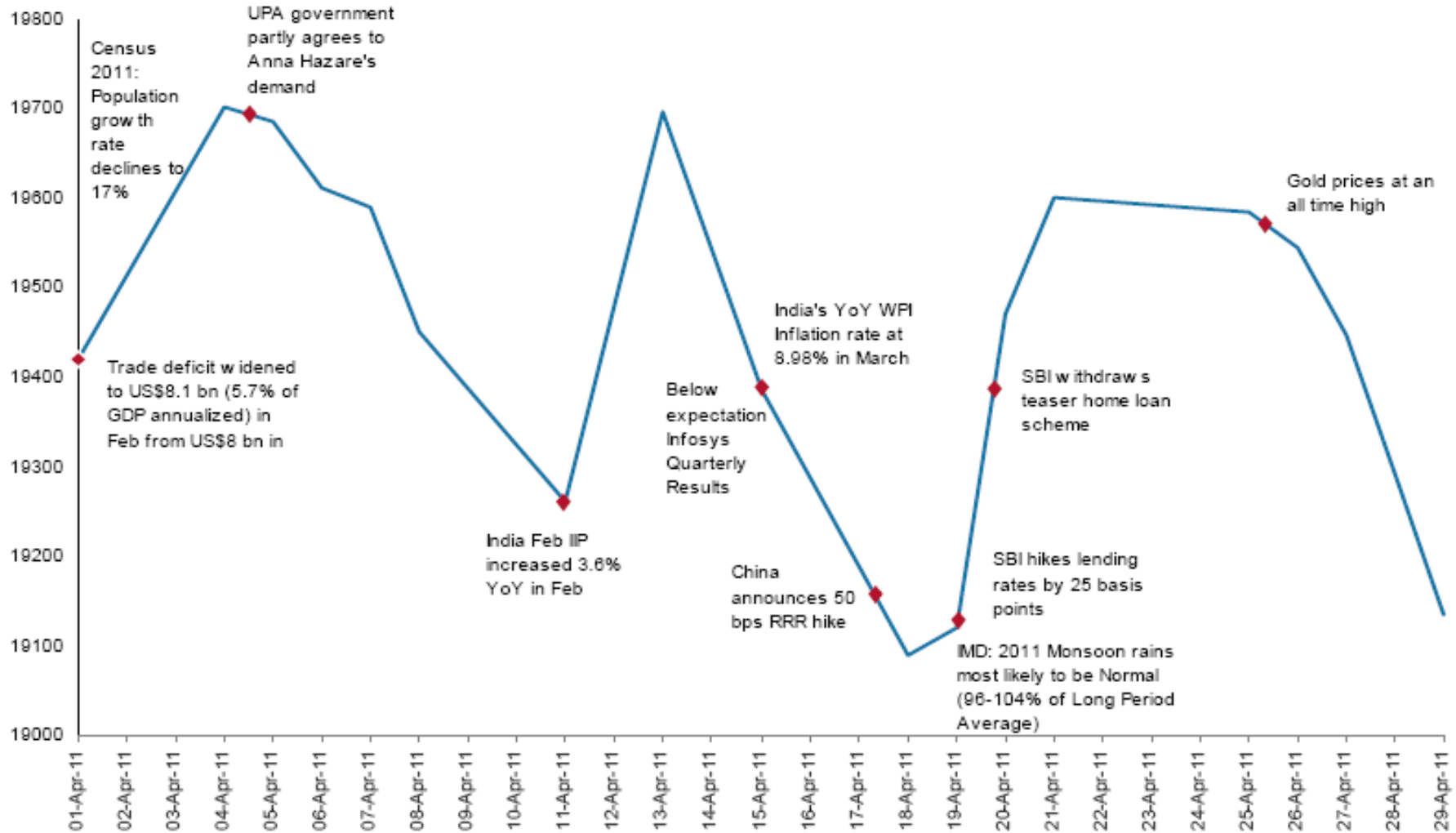


- In April 2011, cash trading turnover (US \$bn) declined sharply by 11% MoM.



- At the end of April 2011, average open interest remained flat MoM. This is the third consecutive month of flat open interest.

# April 2011 events timeline



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

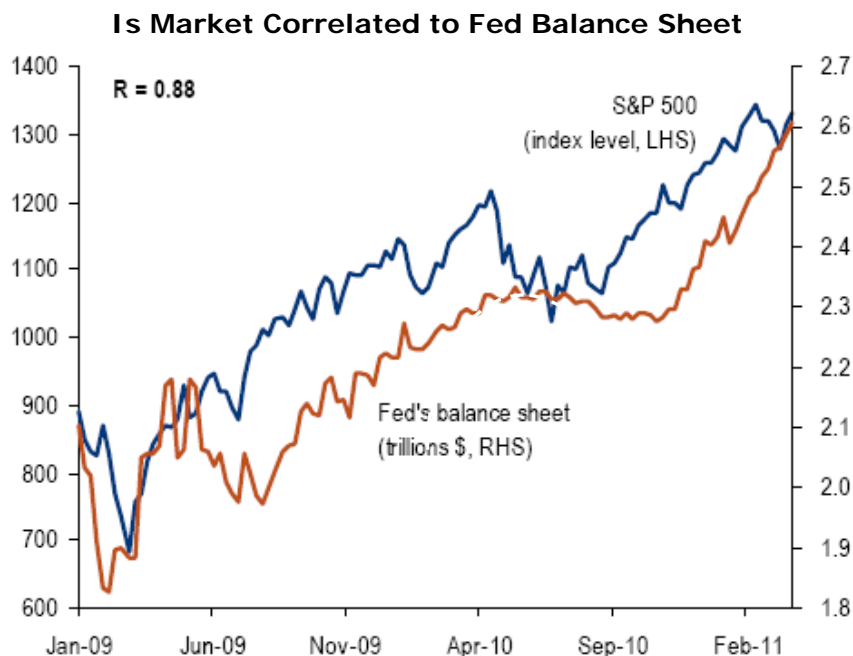


# Religare MF: Equity Market Outlook and Opportunities

# Equity Market Outlook

- The US Federal Reserve post its latest FOMC meeting has indicated that QE2 (second round of quantitative easing) would end in June 2011.
- There was a sharp correction in global risk assets post completion of previous round of QE. If the same experience were to repeat post QE2, then a correction in commodities can help in controlling inflation, which is one of the biggest macro threat for emerging markets like India.
- On the domestic side, India's trade deficit narrowed to US\$5.6 billion (3.9% of GDP annualized) in March 2011 from US\$8.1 billion in February 2011 on the back of a sharp growth in exports and a modest increase in imports.
- Also, as per the first forecast for the 2011 monsoon season (June to September) released by the IMD, rainfall for the country as a whole is most likely to be normal.
- In current earnings season, 19 out of 26 companies have beaten market expectations. However, an analysis of a broad sample of 254 companies (26% of market cap) that have reported earnings so far indicate stellar revenue growth of 27% but lower operating profit growth of 22% suggests that the inflationary pressure is having an impact on earnings.
- Earnings momentum remains negative with downgrades beating upgrades since the start of this year. We expect downgrade to pickup pace as the earnings season progresses.
- Consensus earning expectations for Sensex companies for FY12 and FY13 have been cut by 0.7% and 1.1% respectively for the month. Market expects a 18% growth in FY12E Sensex EPS over FY11 and a 17% growth in FY13 Sensex EPS over FY12.

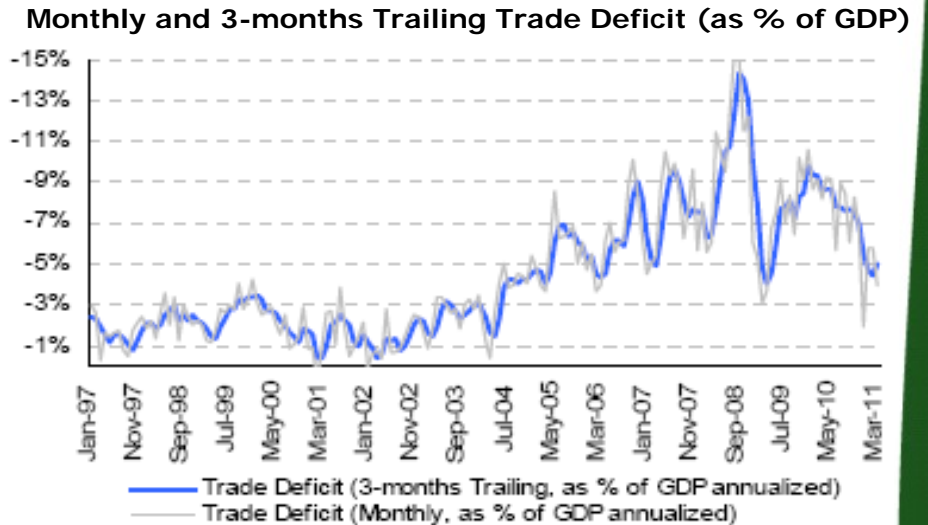
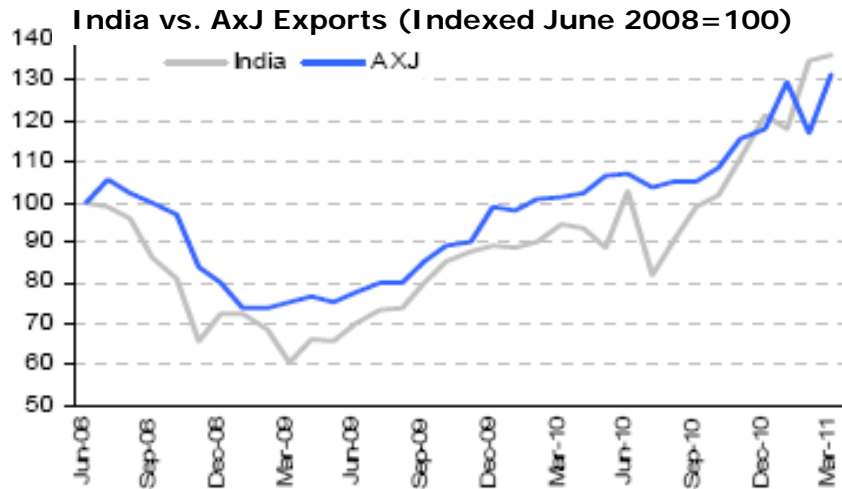
# Life after QE2: Short Term Pains But Long Term Gain



- The US Federal Reserve post its latest FOMC meeting has indicated that QE2 (second round of quantitative easing) would end in June 2011.
- While part of the rise in global risk assets (including equities and commodities) have been due to the continuing economic recovery, its has also received a boost due to the \$600bn QE2 programme.
- There was a sharp correction in global risk assets post completion of previous round of QE. If the same experience were to repeat post QE2, then a correction in commodities can help in controlling inflation, which is one of the biggest macro threat for emerging markets like India.



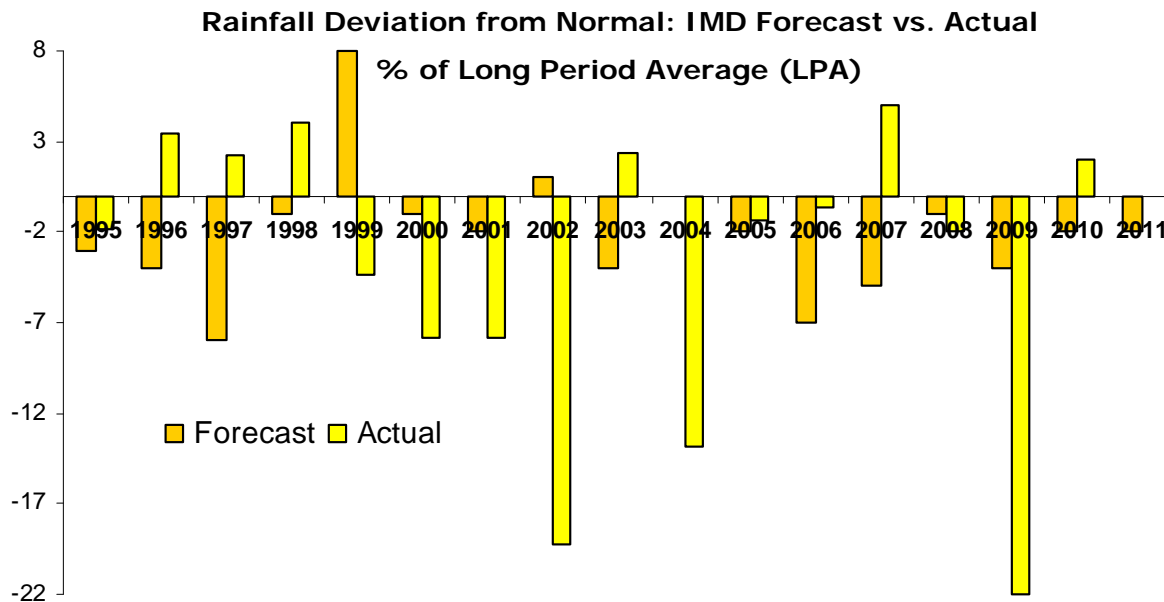
# Trade Deficit Under Control - A Positive Surprise



- Exports growth remained strong on a YoY basis (in dollar terms) at 43.8%YoY in March 2011 compared with 49.7%YoY in February 2011. The strength in exports reflects the recovery in G3 over the past six months.
- On a YoY basis, import growth (in dollar terms) decelerated to 17.3%YoY in March 2011 compared with 21.2% YoY in the previous month. The deceleration in imports has been led by a decline in non-oil import growth to 21%YoY (vs. 31% YoY in February).
- As a result of the above, the trade deficit narrowed to US\$5.6 billion (3.9% of GDP annualized) in March 2011 from US\$8.1 billion in February 2011.

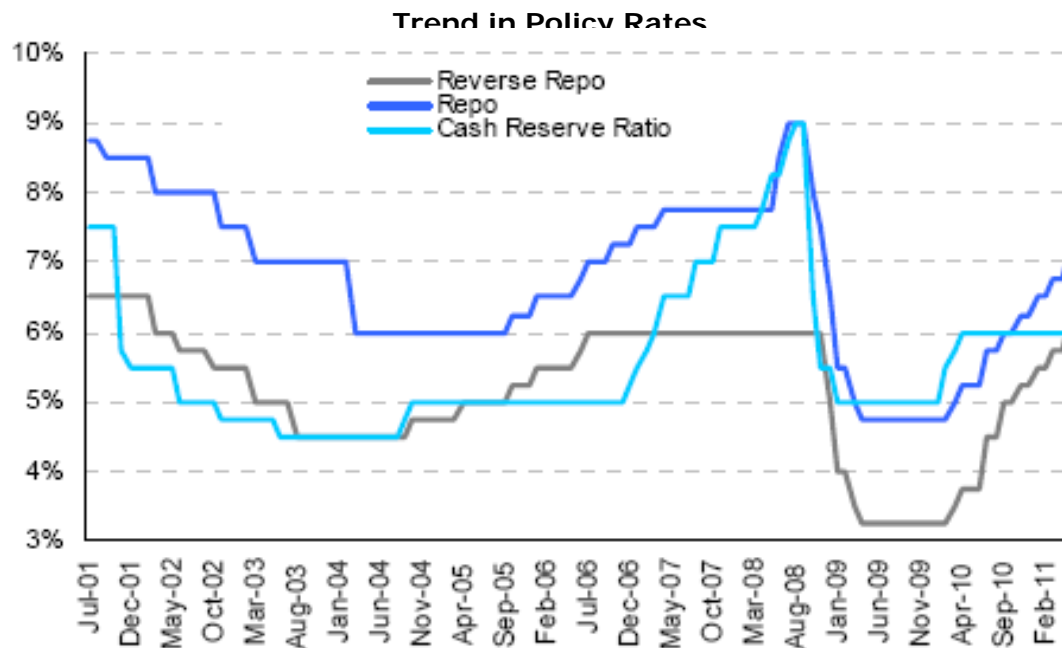


# IMD Forecasts Normal Monsoons in 2011



- As per the first forecast for the 2011 monsoon season (June to September) released by the IMD, rainfall for the country as a whole is most likely to be normal.
- IMD estimates total rainfall at 98% of the Long Period Average (LPA) with a model error of  $\pm 5\%$
- While actual rainfall may vary from this forecast, the year's forecast assumes importance in view of sharp hikes in food inflation (primary and manufactured food articles contribute to a 24.3% weight in overall wholesale price inflation).

# Monetary Policy - A Giant Step, Finally



- The Reserve Bank of India (RBI) in its annual monetary policy review hiked the reverse repo rate by 50bps to 6.25% and the repo rate by 50 basis points to 7.25%.
- The savings bank deposit rate was also increased by 50 bps to 4%.
- We feel the Central Bank is now ready to trade-off economic growth in its quest to control inflation, which has become its top stated priority.

# Earnings Season - Q4FY11 So Far is A Mixed Bag

**Sensex 4QFY11E Profit After Tax (Growth in percent YoY) – Estimates vs Actual**

| YoY Earnings growth    | Q1F11 | Q2F11 | Q3F11 | Q4F11E | Q4F11E* | Q4F11A |
|------------------------|-------|-------|-------|--------|---------|--------|
| MS coverage            | -10%  | 48%   | 25%   | 14%    | 23%     | 23%    |
| MS coverage Ex-Energy  | 16%   | 29%   | 15%   | 16%    | 22%     | 26%    |
| Broad Market           | 0%    | 37%   | 25%   | -      | -       | 27%    |
| Broad Market Ex-Energy | 22%   | 24%   | 17%   | -      | -       | 33%    |
| BSE Sensex             | 2%    | 29%   | 26%   | 19%    | 26%     | 23%    |

E = MS Analyst Estimate for MS coverage universe

E\* = MS Analyst estimate for 26 companies that have reported thus far

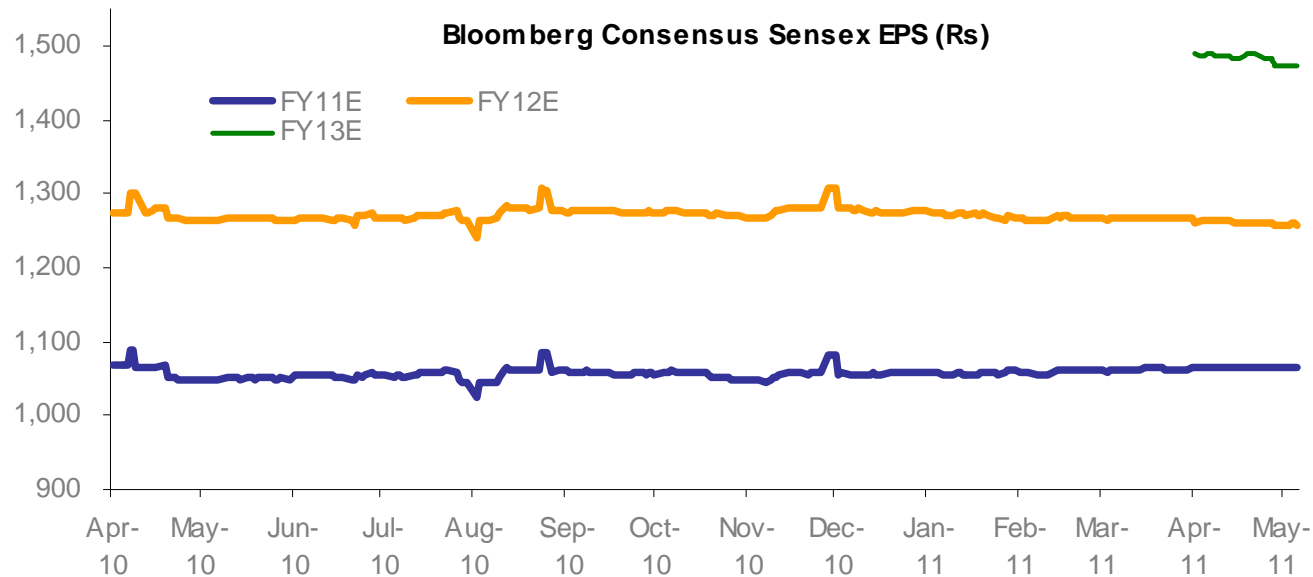
A = Actual earnings for the quarter for 26 companies that have reported thus far

Note: Morgan Stanley estimates used as proxy for market estimates

- In current earnings season, 19 out of 26 companies have beaten market (Morgan Stanley taken as proxy for market expectations) expectations.
- However, an analysis of a broad sample of 254 companies (26% of market cap) that have reported earnings so far indicate stellar revenue growth of 27% but lower operating profit growth of 22% suggests that the inflationary pressure is having an impact on earnings.
- As is indicated by better numbers from largecap universe (MS Universe) larger companies are doing better than smaller companies in protecting their margins with operating profit growth doing much better.
- However, Earnings momentum remains negative with downgrades beating upgrades since the start of this year. We expect downgrade to pickup pace as the earnings season progresses.



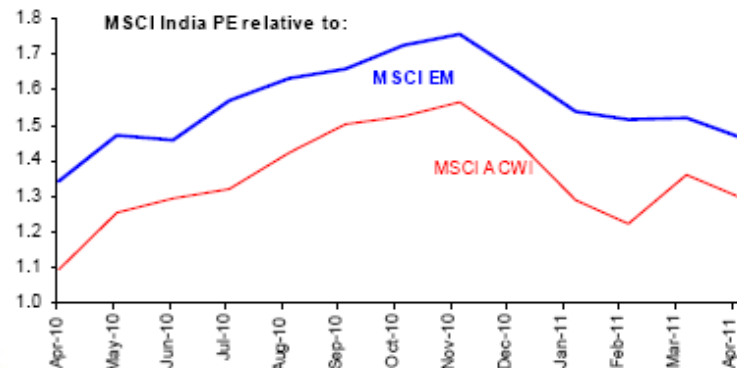
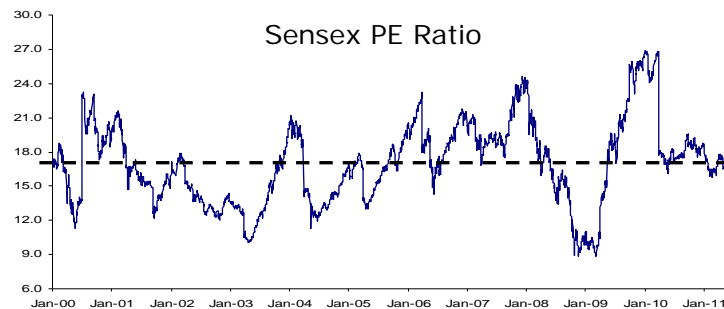
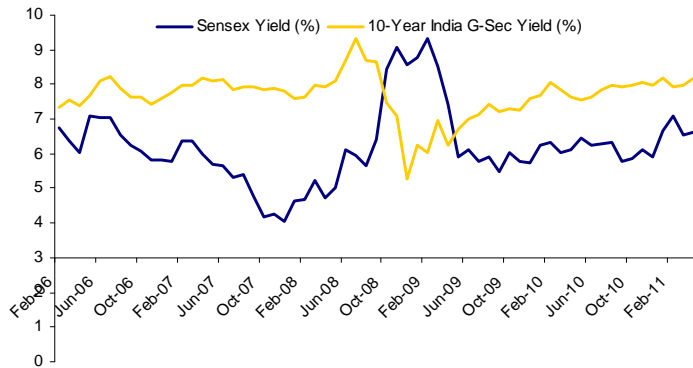
# Earnings Forecasts-unchanged over the earnings season



- Consensus earnings expectations for Sensex companies for FY12 and FY13 have been cut by 0.7% and 1.1% respectively for the month.
- Consensus expects a 18% growth in FY12E Sensex EPS over FY11 and a 17% growth in FY13 Sensex EPS over FY12.
- We see further cuts to FY12 and FY13 earnings estimates after the March reporting season is over and our back of the envelope calculation suggests FY12 earnings growth at 15% vs. consensus at 18%.



# Valuations - Corrected Materially



- The gap between Sensex earnings yield and bond yield has increased substantially by 12 basis points over the previous month due to the material increase in 10-year bond yield.
- Sensex is currently trading at 16.7x its trailing earnings. It is now 2% lower than its historical 10-year average trailing PE of 17x.
- India's PE premium to MSCI Emerging markets has slightly reduced over the recent months, and it is now at around 60% premium to MSCI EM PE currently.



# Looking Ahead...

- Key headwinds facing India include hardening commodity prices resulting into inflation, which threatens to soften demand and squeeze corporate margins.
- Industrial production trends continue to remain erratic – output of six core industries was at 7.4% in Mar'11 compared to 6.8% previous year but aggregate industrial production for the previous month moderated to 3.6% yoy.
- In the annual policy for 2011-12, the RBI has hiked the benchmark rates by a higher-than-expected 50bps. The latest hike was the ninth increase since the RBI began hiking rates in early 2010 and has effectively raised policy rates by a total of 400bp.
- RBI actions signals that it is ready to sacrifice some near-term growth for stronger sustainable medium-term growth in a lower inflation setting. The RBI's forecast for GDP growth for 2011-12 is around 8.0%, down from an estimated 8.6% in 2010-11. The official WPI inflation guidance (not target) for March 2012 is pegged at 6.0% YoY,
- We expect rate hikes to continue and expect further 50 basis points of rate action this year.
- We feel the other key element of the attempt to slow down the economic growth will be to get the fiscal deficit under control. Prices of fuel and fertilizer need to be hiked to curtail the fiscal deficit which is providing unnecessary stimulus to the economy. Such price hikes can slow down the aggregate demand, thereby helping reduce inflationary pressures
- The structural India growth story remains unchanged, and we feel the YTD outperformance and preference for developed markets is only tactical in nature.
- Our strategy remains focused more on stock picking with valuations not providing very clear signposts and the macro remaining slightly hazy.

# Investment view

## Short term

- GDP growth likely to moderate to about 8-8.5% in FY11.
- Markets are factoring in a 19% growth in earnings in FY12, which may be a stretch in the current inflationary environment.
- However, valuations have corrected and are now in the comfort zone, with risk-reward attractive.

## Long term

- India is capable of sustaining nominal growth rates (12-14%) that will lead to the economy doubling in size over the next 5-6 years.
- This should enable corporate earnings growth to grow at about 15%pa over the same period.
- With valuations close to near term averages investors can benefit from an upward re-rating of valuations in the future.

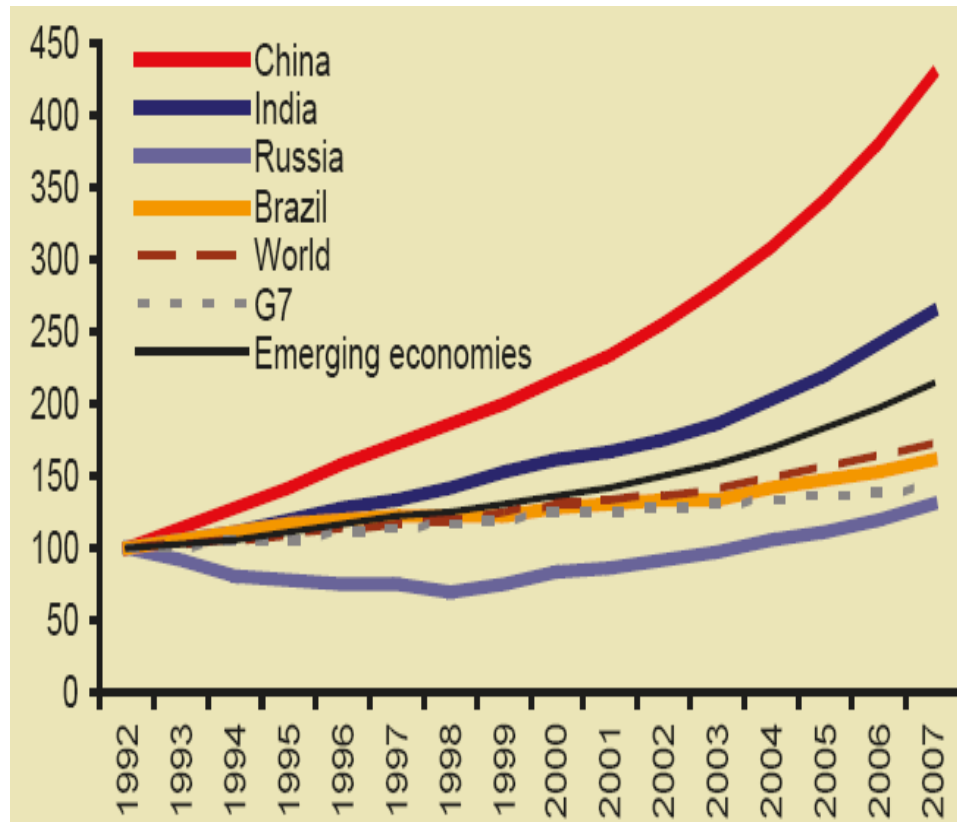
## Strategy for investors

- The case for increasing equity allocation is now favorable as valuations are near long term averages.
- Long term investors should continue with SIP.

# The Long Term Case For Indian Equities

# India - Growth On The Fast Track

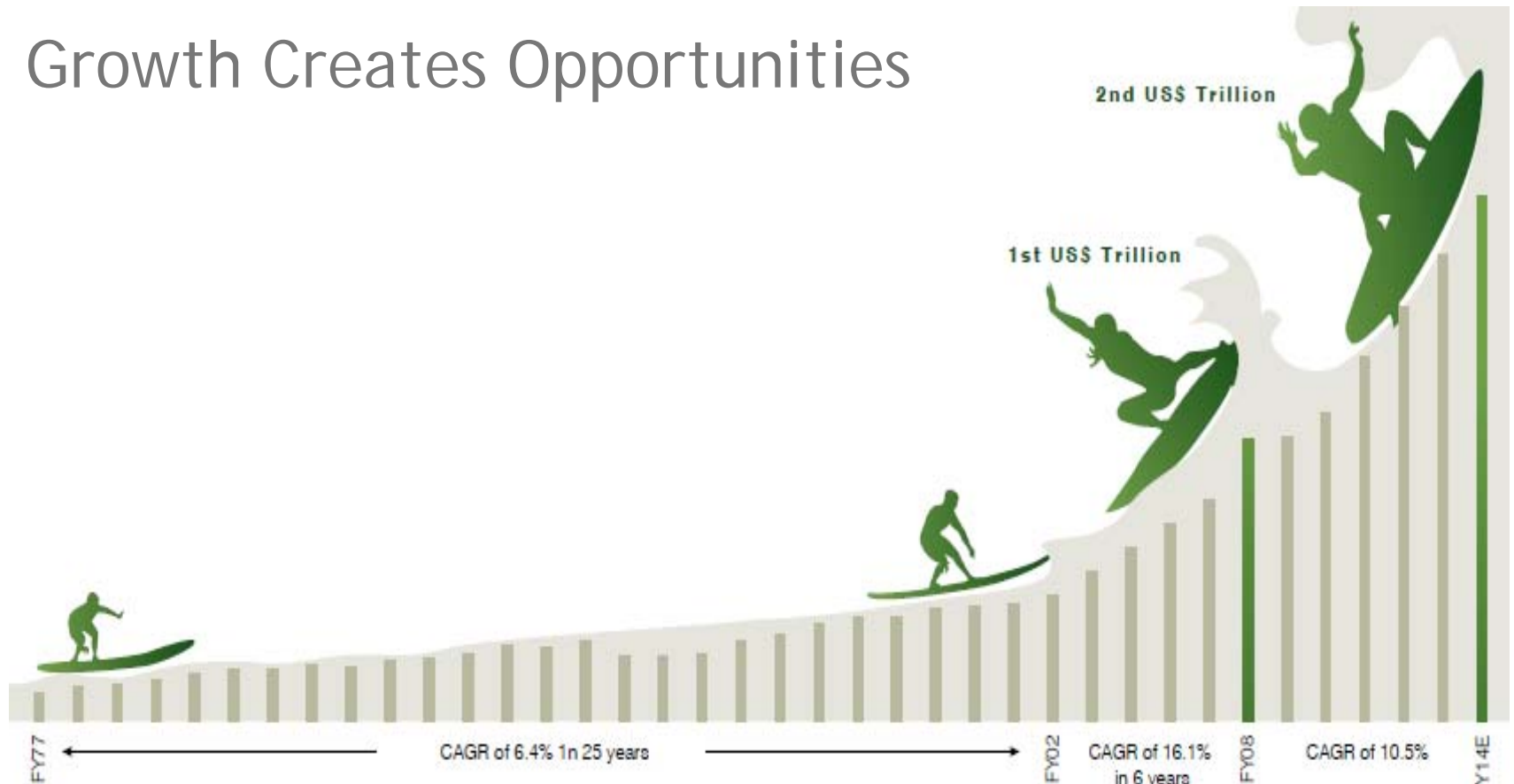
## GDP growth rebased to 1992



Source: IMF, IIFL Research

- India's economy has been among the fastest growing economies in the world driven by:
  - Increase in savings rate
  - Rising capital formation
  - Better demographics and
  - Rising consumption

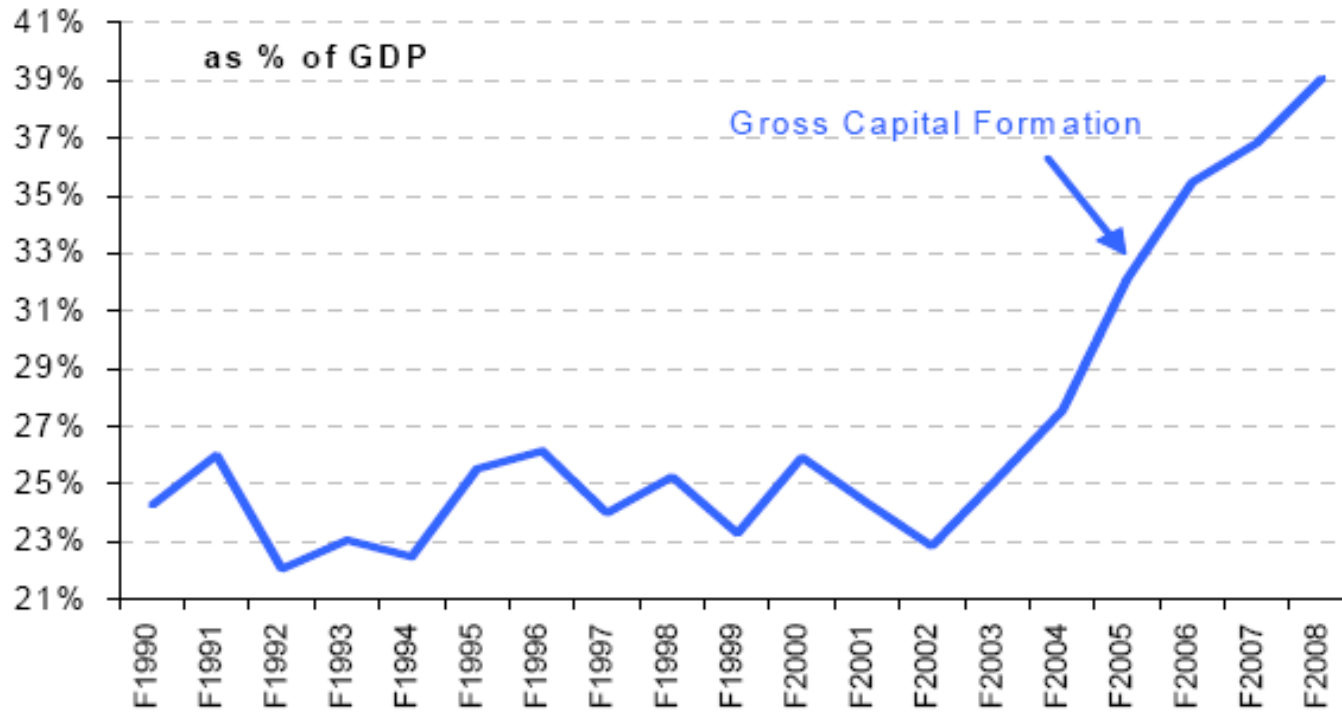
# Growth Creates Opportunities



- India became a Trillion Dollar Economy (12th largest country by GDP in FY2008)
- The economy is expected to add another Trillion Dollars to annual output in 6 Years i.e. 2014
- That is likely to make India the 8'th largest economy in the world.
- This is a structural transformation driven by increasing investments, growing consumption and a young workforce
- For equity investors : an attractive investment opportunity

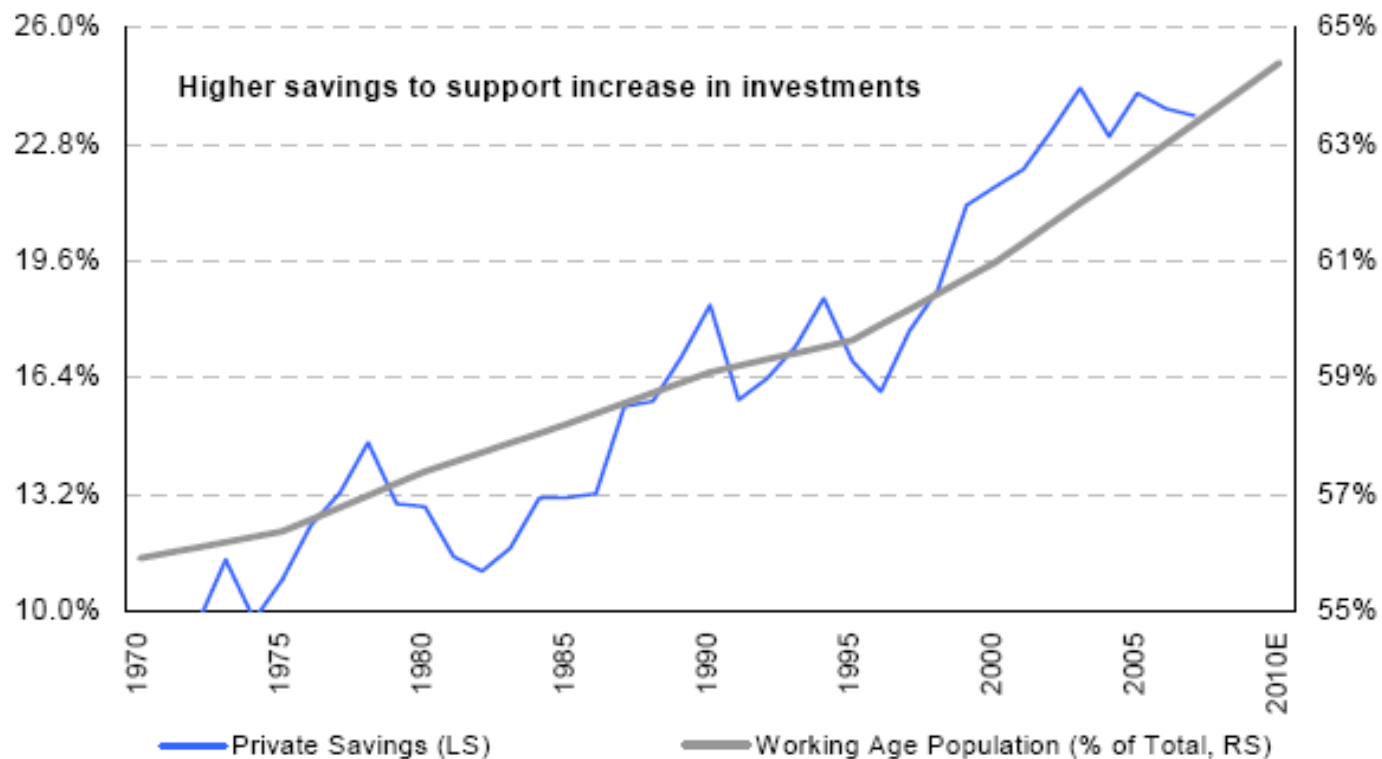


# Growth Is Being Led By A Rise In Capital Formation...



Source: CSO, Morgan Stanley Research

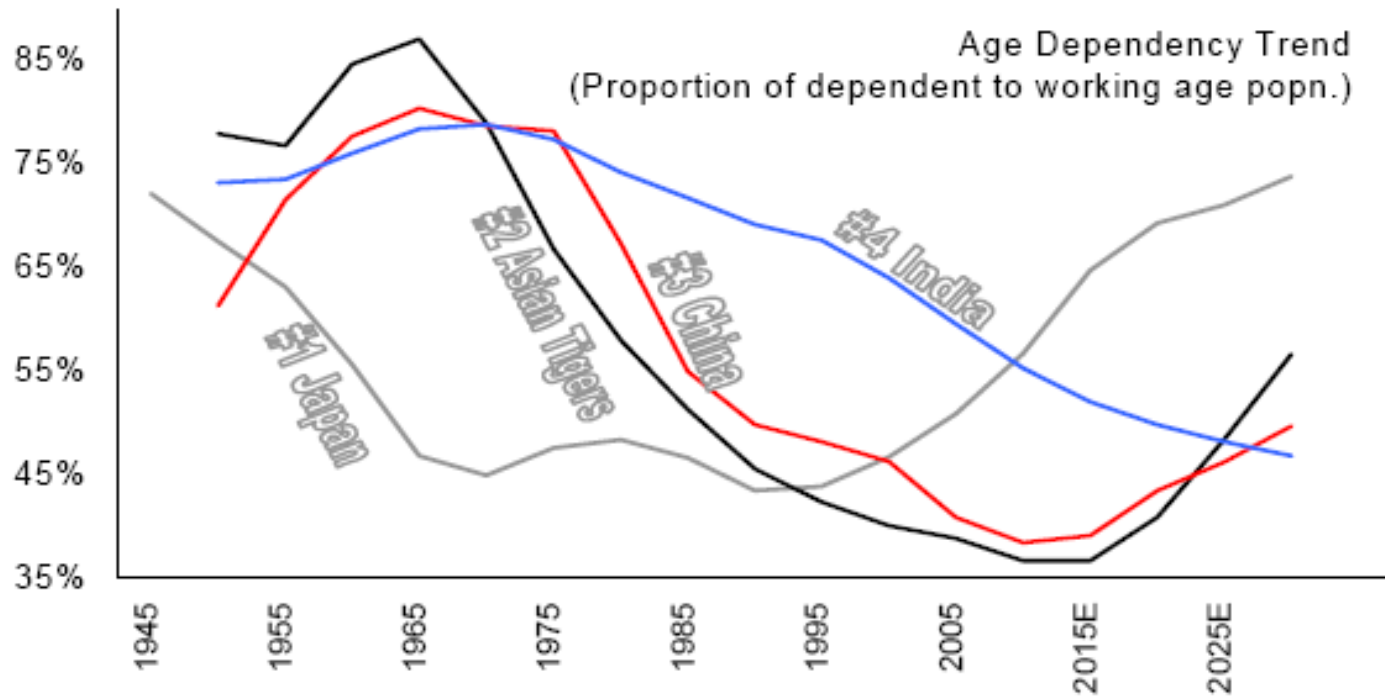
# ...Which Is Supported By A High Savings Rate



Source: CSO, UN, Morgan Stanley Research E= United Nations Research estimates



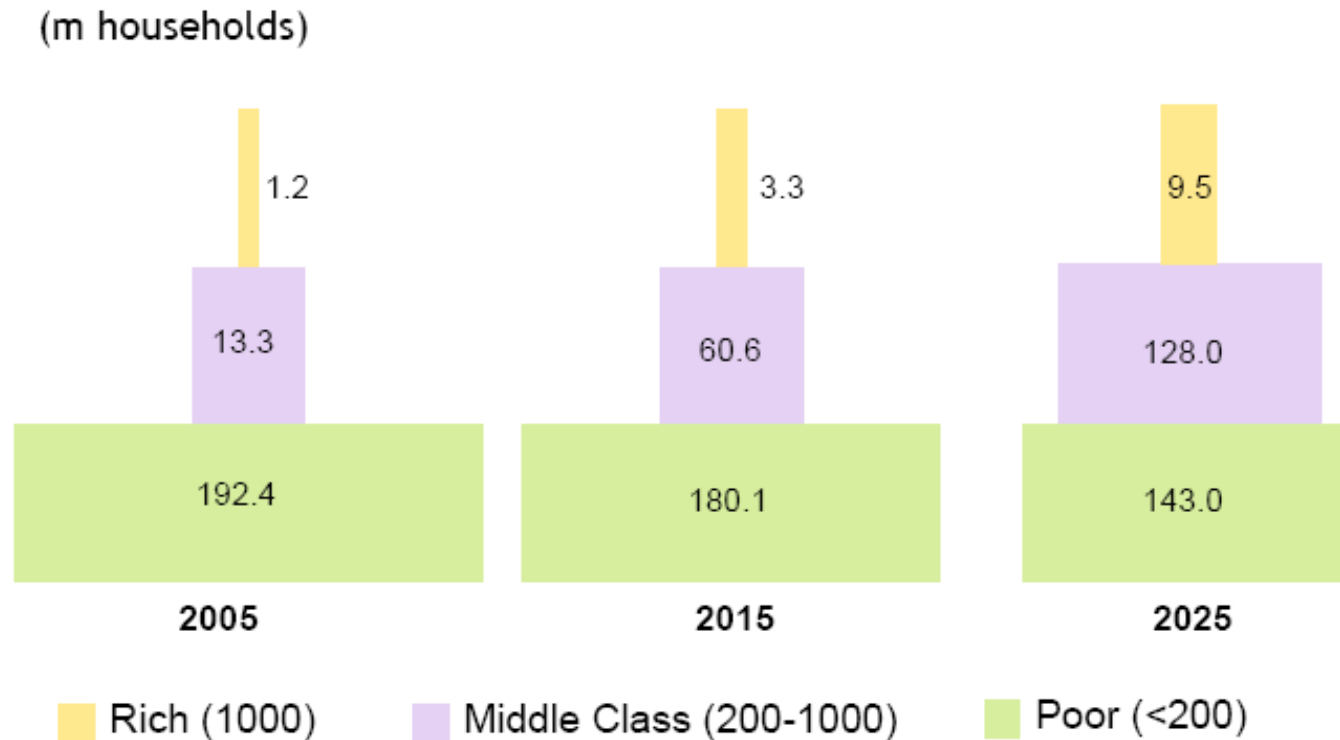
# India Is Poised To Reap Rich Demographic Dividend In Years To Come



E= United Nations Research estimates Source: UN, Morgan Stanley Research

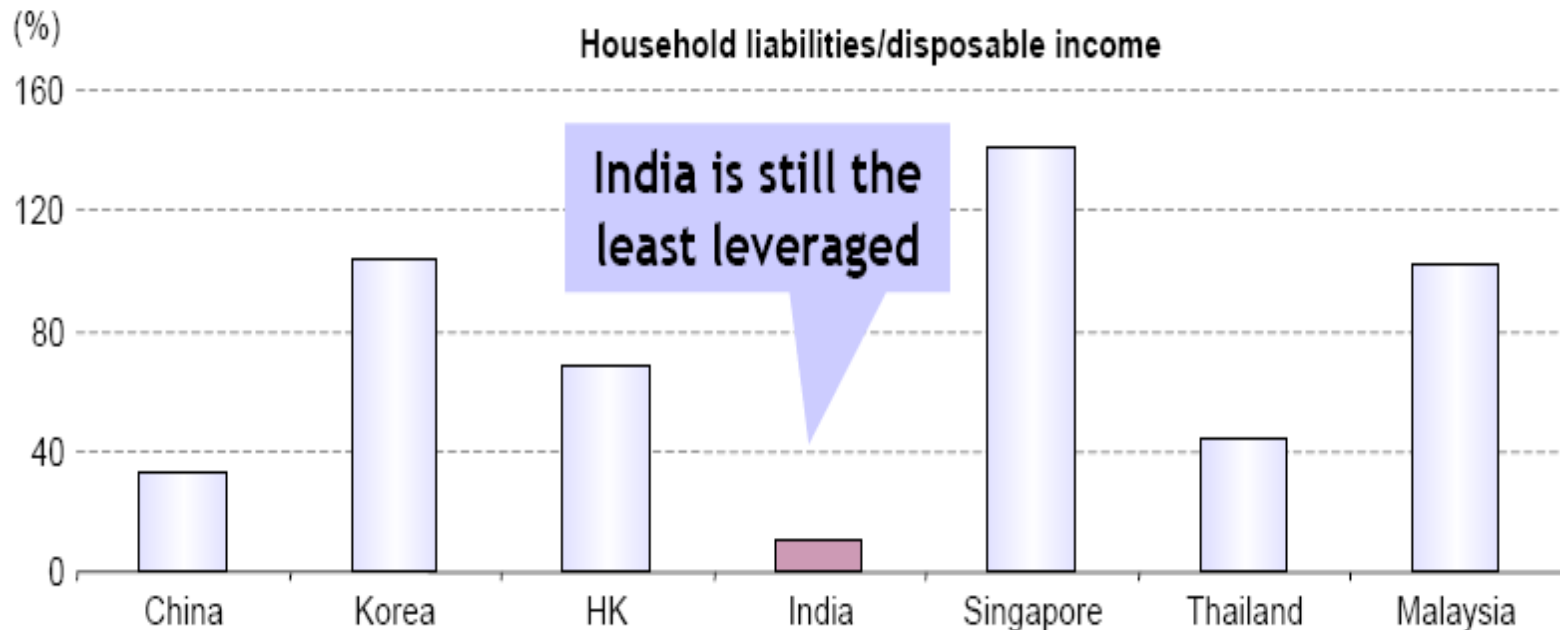


# Income Imbalance To Correct Leading To Rise In Consumption



Source: IDFC SSKI

# Indian Consumer Is Conservative; Consumption Largely Driven By Income Growth And Not Leverage



Source: IDFC SSKI

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