

# Equity Markets : Current Environment and Outlook

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January 2010

# Current Environment

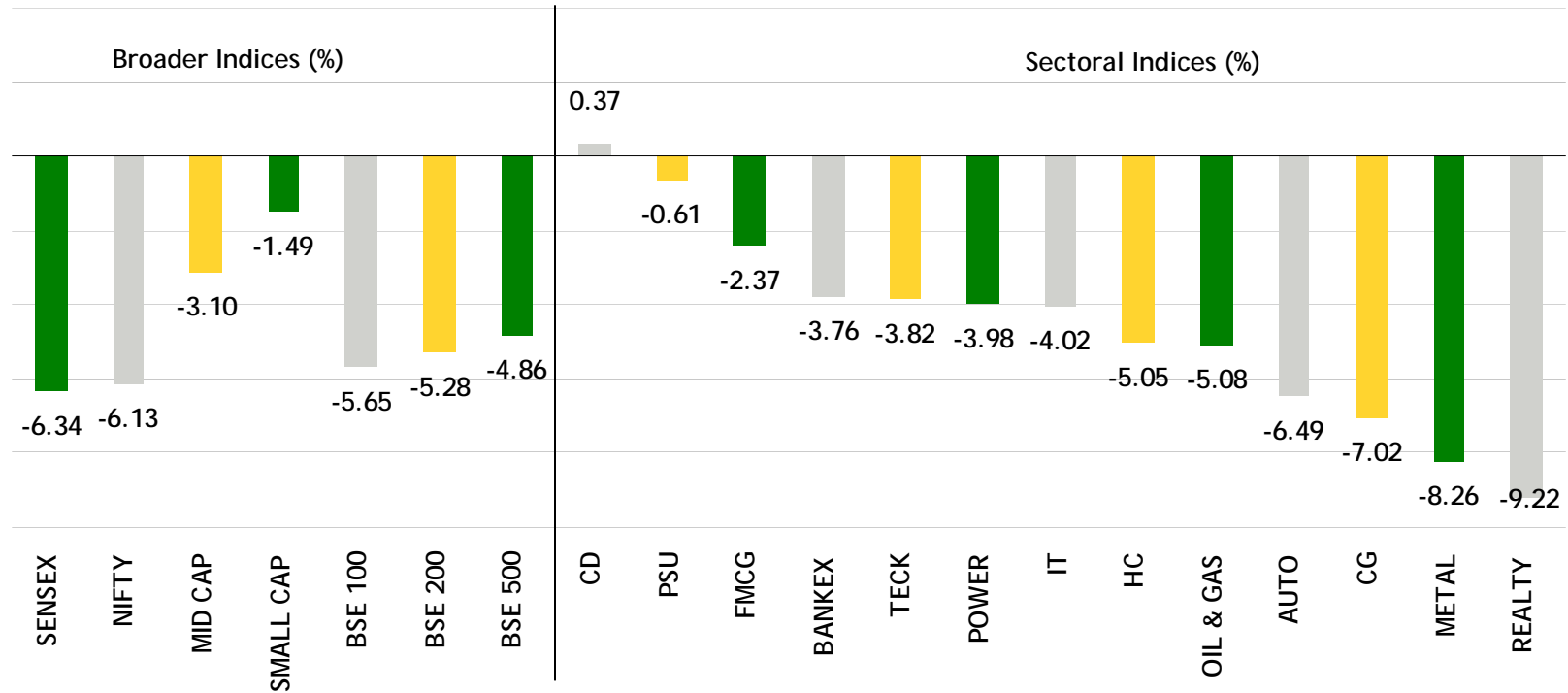
- Equity markets across the globe remained weak, with the MSCI World Index falling by 4.19%.
- Indian markets underperformed the global trend, falling by 6.34% in the month of January.
- Commodity prices mirrored the bearish trend prevailing in the equity markets, with the benchmark CRB Reuters Jefferies total return index falling by 10.6%.
- In India, Consumer Durables was the best performing sector followed by PSU companies. Realty and Metal sectors delivered the worst return for the month.
- FII inflows declined, for the first time after 10 months of inflows, by Rs.5bn in January 2010. FII inflows have remained negative on a YTD basis at Rs.5bn for CY10 after a Rs.670bn inflow in CY09.
- In January, cash trading volumes (number of shares) increased 18% MoM, while the average open interest remained flat MoM at its record highs.

# Global Equities

Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	2989.29	-8.78%	-8.78%	EM - Asia
BSE Sensex	India	16357.96	-6.34%	-6.34%	EM - Asia
Kospi	South Korea	1602.43	-4.77%	-4.77%	EM - Asia
Taiwan Weighted	Taiwan	7640.44	-6.69%	-6.69%	EM - Asia
Thailand SET 50 Index	Thailand	490.77	-5.75%	-5.75%	EM - Asia
Jakarta Composite Index	Indonesia	2610.80	3.02%	3.02%	EM - Asia
KLSE	Malaysia	1259.16	-1.07%	-1.07%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	65401.77	-4.65%	-4.65%	EM
Mexico IPC	Mexico	30391.61	-5.38%	-5.38%	EM
Russian RTS Index	Russia	1473.81	2.02%	2.02%	EM
Philippine PSEi	Philippines	2953.19	-3.26%	-3.26%	EM
Merval Buenos Aires Index	Argentina	2298.55	-0.96%	-0.96%	EM
HangSeng	Hong Kong	20121.99	-8.00%	-8.00%	Developed - Asia
Nikkei	Japan	10198.04	-3.30%	-3.30%	Developed - Asia
Strait Times	Singapore	2745.35	-5.26%	-5.26%	Developed - Asia
Dow Jones	USA	10067.33	-3.46%	-3.46%	Developed
CAC 40 Index	France	3739.46	-5.00%	-5.00%	Developed
All Ordinaries Index	Australia	4596.90	-5.85%	-5.85%	Developed
DAX Index	Germany	5608.79	-7.27%	-7.27%	Developed
Swiss Market Index	Switzerland	6440.72	-1.61%	-1.61%	Developed
FTSE 100	UK	5188.52	-4.14%	-4.14%	Developed
MSCI World Index	--	1119.54	-4.19%	-4.19%	--

\* as on 29<sup>th</sup> January 10. Source : Bloomberg  
EM – emerging markets, Developed – developed markets.

# India : Sector performances



- The markets fell by 6.34% over the previous month.
- Consumer Durables was the best performing sector followed by PSU companies.
- Realty and Metal sectors delivered the worst return for the month.

\*Source: BSE,NSE. one month performance as on 29<sup>th</sup> January 10.

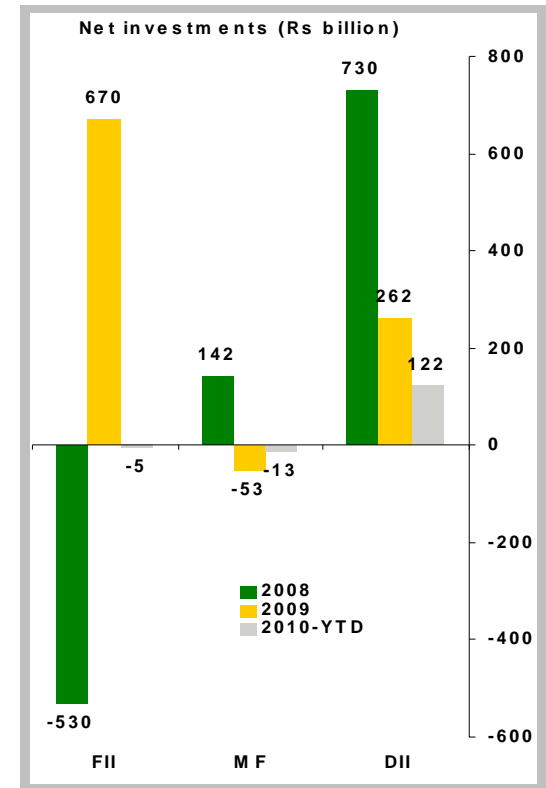
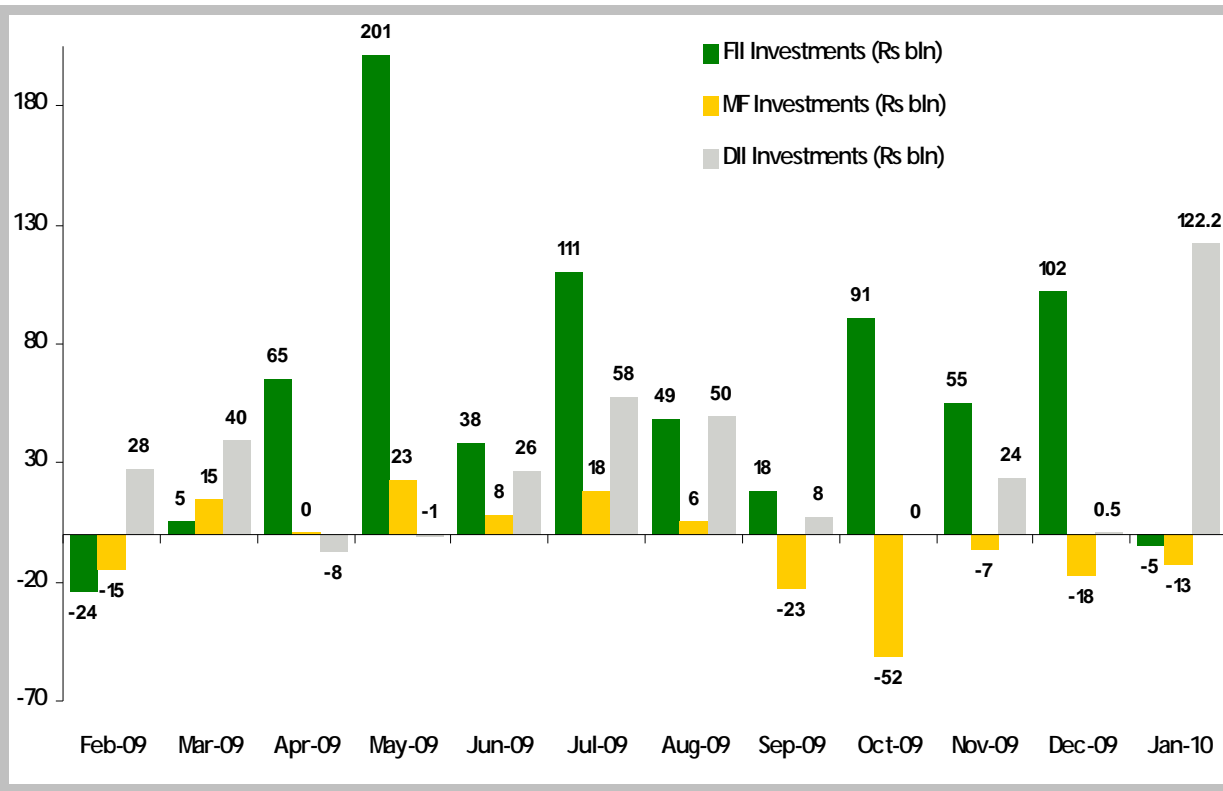
# Top Gainers / Losers - Nifty

Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
Siemens	190.5 / 677.6	642.95	10.41
A B B	343.35 / 881.5	811.00	5.72
Grasim Inds	1150.5 / 2940	2599.20	5.02
Axis Bank	278.25 / 1177.7	1025.70	3.69
Power Grid Corpn	76.6 / 130	112.70	2.32
Top Losers for the month			
Losers	52 week H/L	Last Price#	% Loss*
Larsen & Toubro	556 / 1729.4	1423.85	-15.13
B P C L	329.5 / 657.6	540.85	-14.90
Suzlon Energy	33.05 / 145.7	77.25	-14.50
Sterlite Inds.	215.2 / 928.9	753.1	-12.79
Ranbaxy Labs.	133.1 / 538.45	454.25	-12.30

# closing price as on 29<sup>th</sup> January 2010.\* one month performance as on 29<sup>th</sup> January 2010.  
Source: capitaline



# FII & DII Inflows

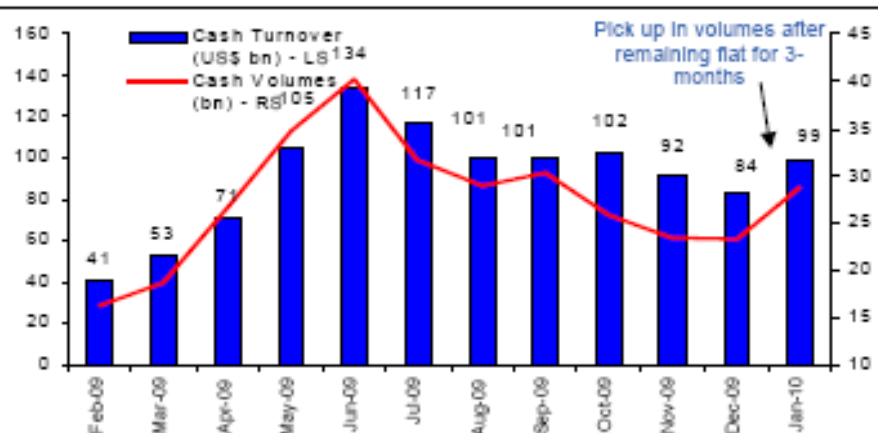


- FII inflows declined, for the first time after 10 months of inflows, by Rs.5bn in January 2010. FII inflows have remained negative on a YTD basis at Rs.5bn for CY10 after a Rs.670bn inflow in CY09.
- DII recorded strong inflows of Rs.122.2bn. MF however were net sellers to the tune of Rs.13bn.

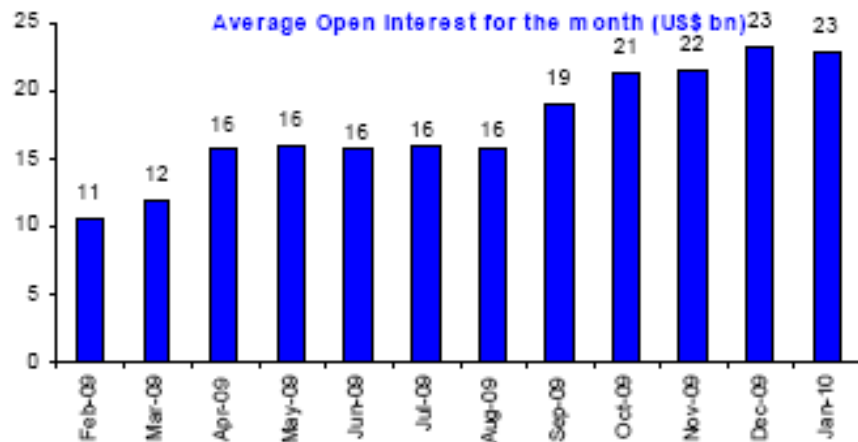


# Market Activity

## Cash Trading: Turnover and Volumes



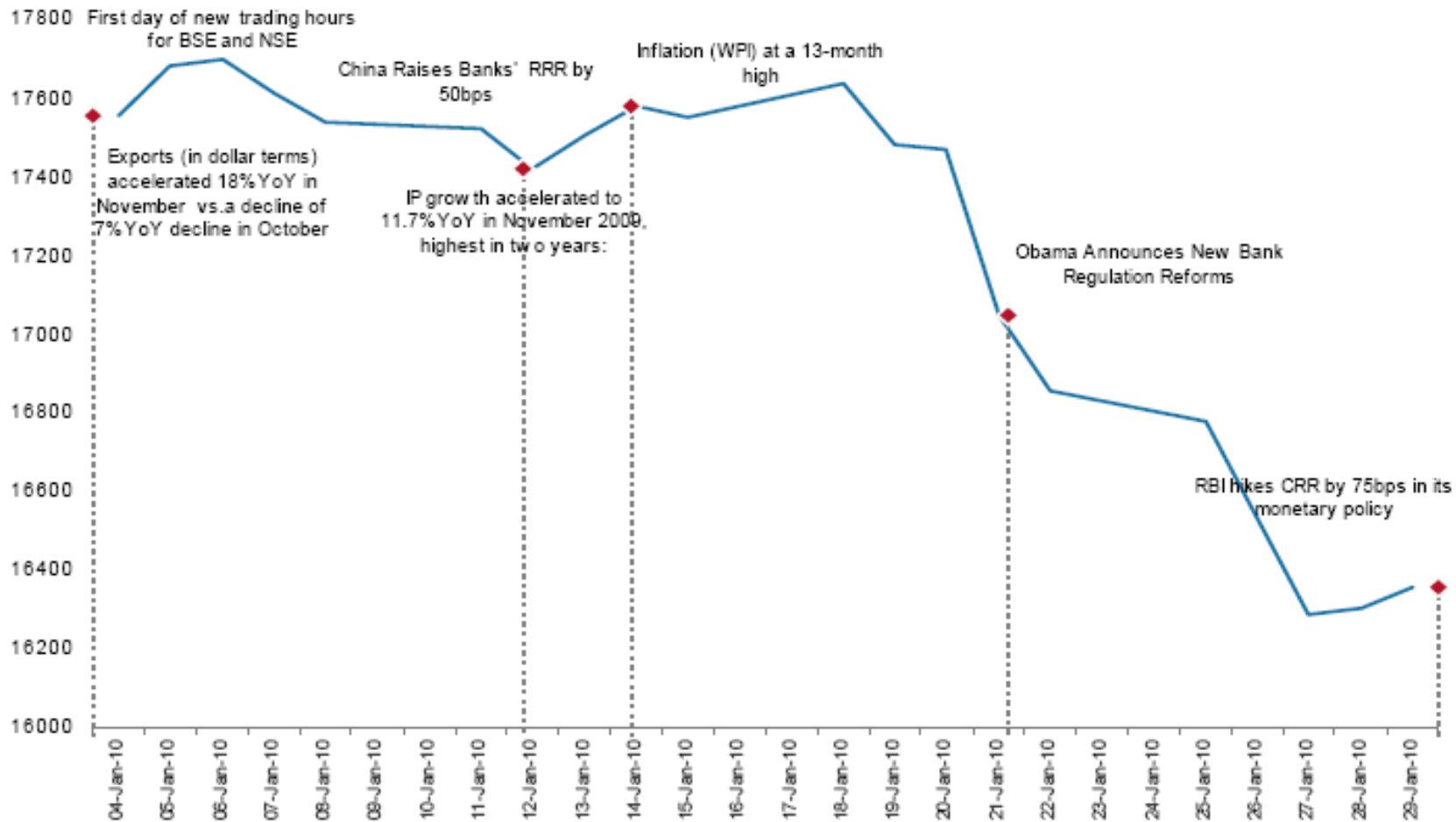
- In January, cash trading volumes (number of shares) picked up after falling for two months, up 18% MoM.



- At the end of January, average open interest remained flat at its highest level since Jan-09.



# January 2010 events timeline



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



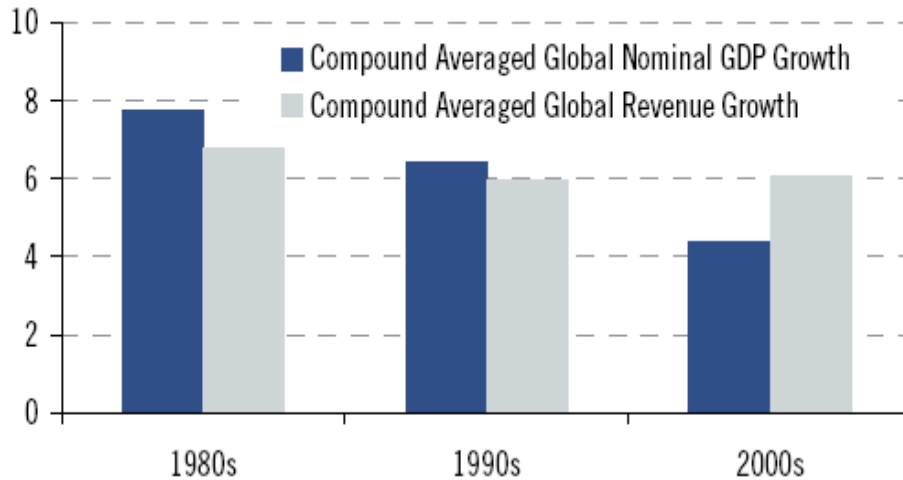
# Religare MF: Equity Market Outlook and Opportunities

# Equity Market Outlook

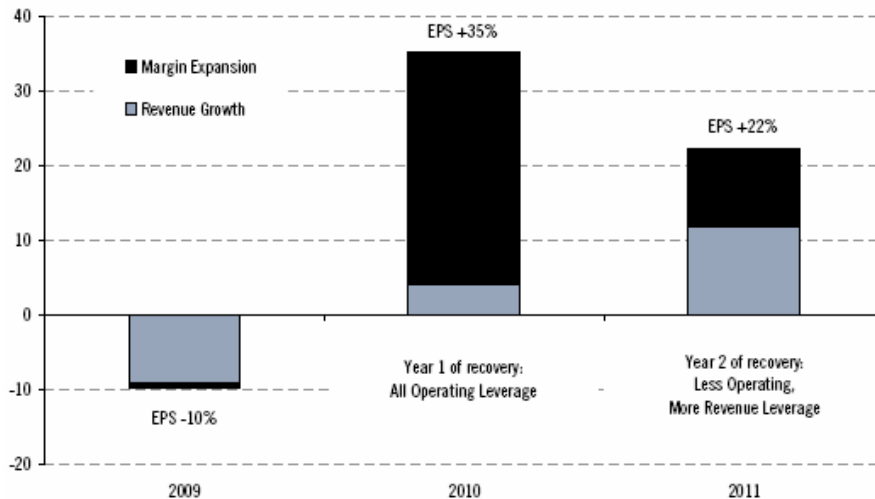
- The extent and quality of the recovery across the globe remains a question mark. Historical trends suggest that in the first year of a recovery, corporate earnings are driven by operating leverage but in the subsequent year it is a function of revenue growth and this is the risk to the currently healthy forecasts for 2011.
- India's manufacturing PMI rose to a 17-month high of 57.6 in January from 55.6 in December suggesting continued recovery in manufacturing output.
- The RBI, in its latest quarterly monetary policy review, hiked cash reserve ratio by 75bp to 5.75%, which was slightly higher than market expectations.
- The RBI policy statement articulated a public change in stance from 'managing the crisis' to 'managing the recovery'.
- Indian markets continue to exhibit high correlation with global trends and this remains a source for risk. History suggests that we should expect a bout of volatility in and around the budget.
- The December 2009 quarter Sensex earnings grew at 16% rate, in line with the expectations, albeit on a lower base.
- The Consensus expects a 5% decline in FY10 Sensex earnings over FY09 and a 27% growth in FY11 Sensex EPS over FY10.
- Nifty is currently trading at 20.35x its trailing earnings which is well above its historical averages; this is, however in line with trends seen across emerging markets.

# Global Earnings - Expectations hinge on GDP growth forecasts

**Nominal GDP vs Revenue By Decade**



**Global Earnings Growth Forecast Broken Down By Drivers (%)**

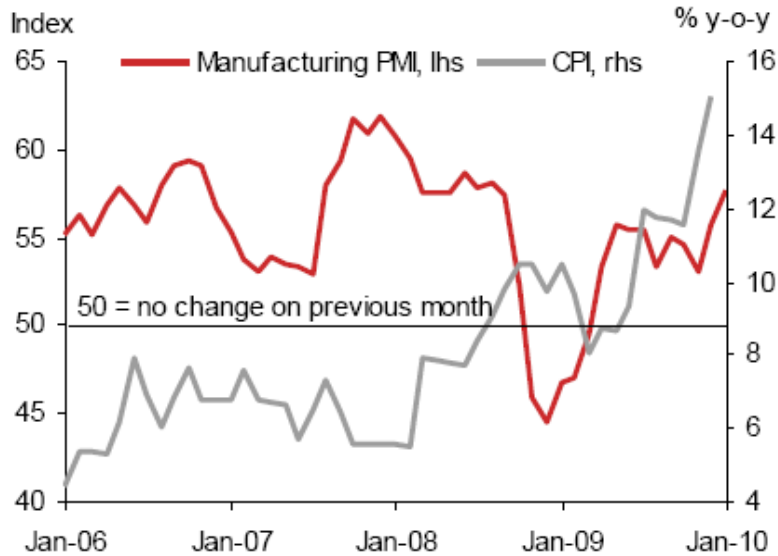


- Nominal GDP is the traditional top-down variable used to estimate changes to global corporate revenues.
- Downturns in global nominal GDP growth have usually been associated with slower global revenue growth and vice-versa.
- Global earnings forecast for 2011 relies more on revenue growth than on margin expansion.
- Thus, forecasts of global earnings growth in 2011 requires global GDP to grow at a higher pace than in 2010.
- Any risk to global GDP growth can put the 2011 earnings growth to risk.

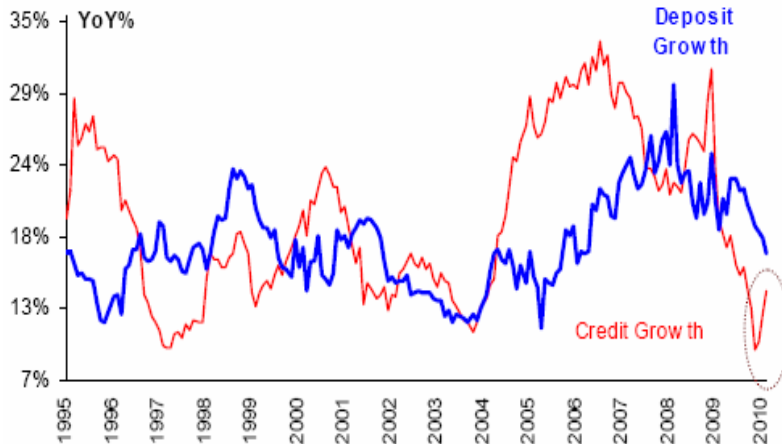


# Growth Revival in India continues with fresh signals

India's manufacturing PMI and CPI inflation



Credit & Deposit Growth (%)

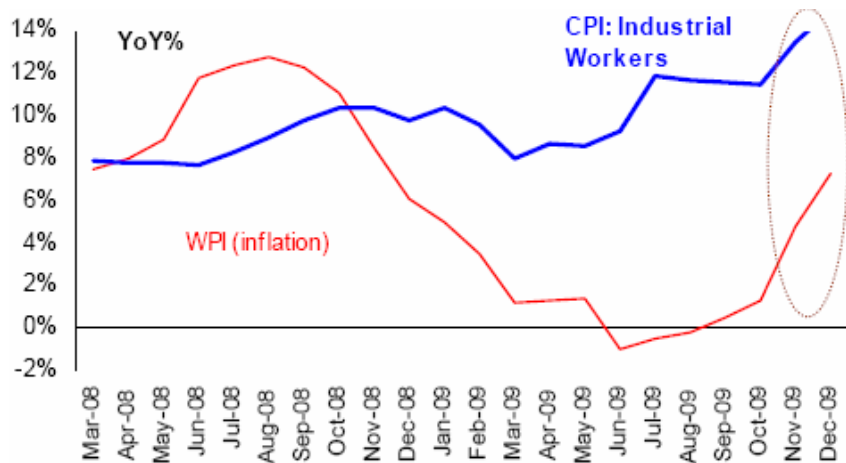
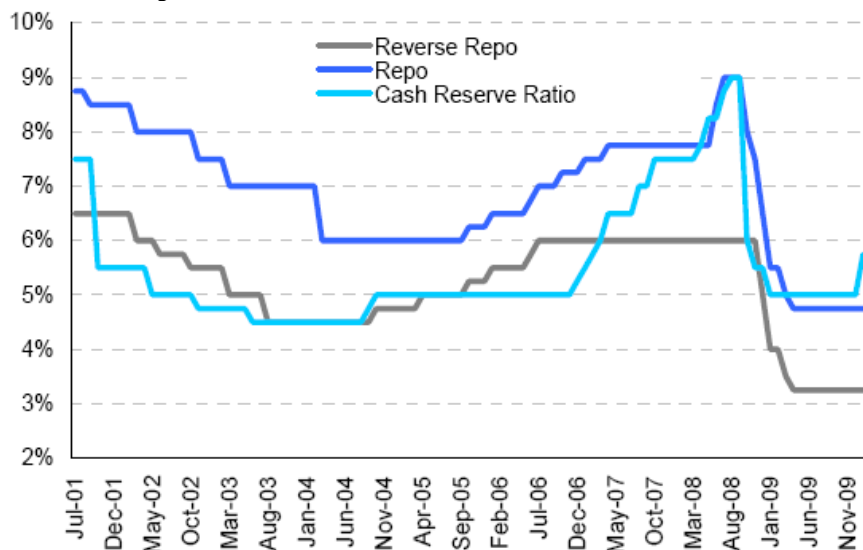


- India's manufacturing PMI rose to a 17-month high of 57.6 in January 2010 from 55.6 in December 2009.
- We believe this is significant because after moving to an expansion zone (above 50) between March and April 2009, the PMI had then consolidated for most of 2H09.
- The sharp jump in January 10 suggests that manufacturing output has shifted higher.
- Much of this rise is led by higher output and new orders from both domestic and external sectors.
- Credit growth finally recorded an up-move but such growth needs to be sustained to confirm that the recovery is gaining momentum.



# Monetary Policy - from crisis to recovery

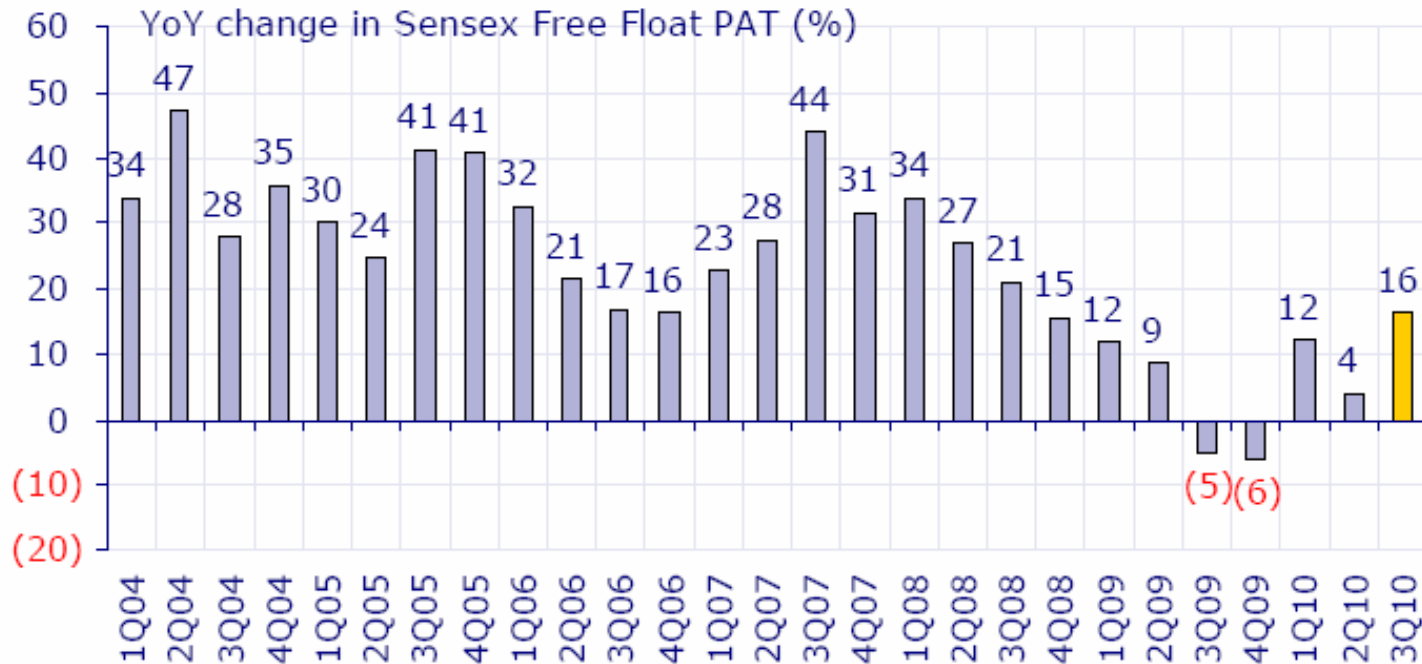
Policy Rate Movement



- RBI, in its latest quarterly monetary policy review, hiked cash reserve ratio by 75bp to 5.75%, compared with market expectation of 50bp.
- The RBI policy statement articulated a public change in stance from 'managing the crisis' to 'managing the recovery.'
- Highlighting the challenge facing policy makers the RBI statement takes note of concerns on inflation, but at the same time, it also notes that the recovery is yet to fully take hold.
- We see the RBI move as a normalization of monetary policy in line with the recovery of the economy rather than a bluntly hawkish policy.



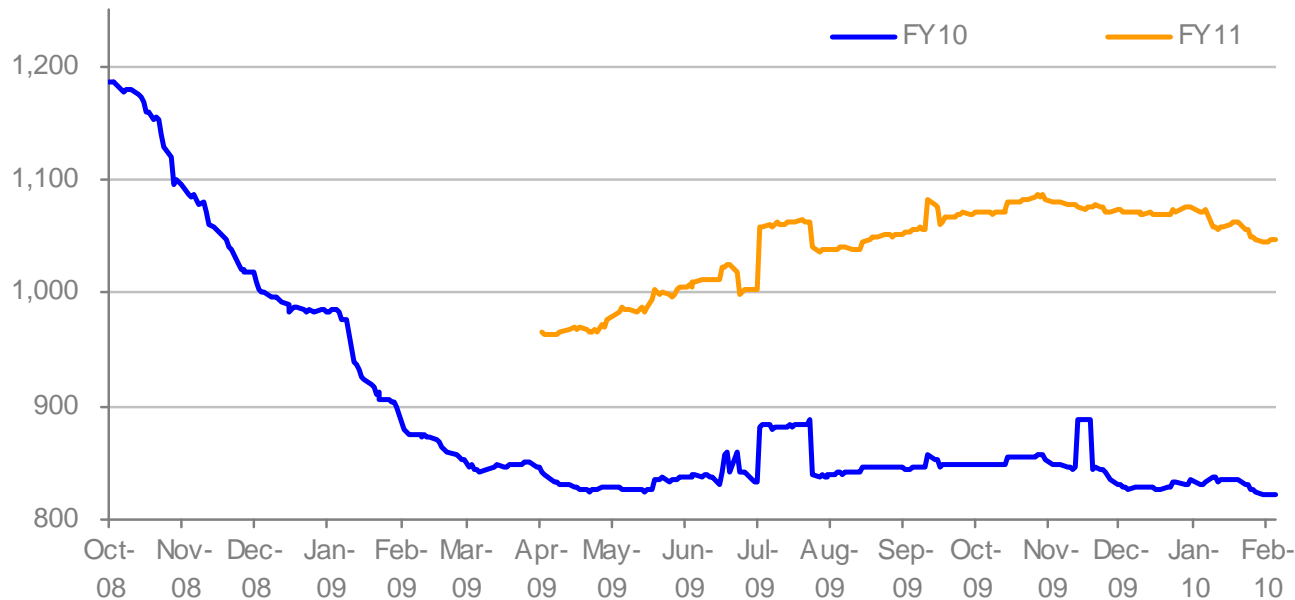
# Earnings - December '09 in line with expectations



- The December 2009 quarter Sensex earnings grew at 16% rate, in line with the expectations.
- Higher YoY growth was expected mainly due to base effect, as earnings in the same period previous year had declined.

# Earnings - Cut in forecasts despite an in-line quarter

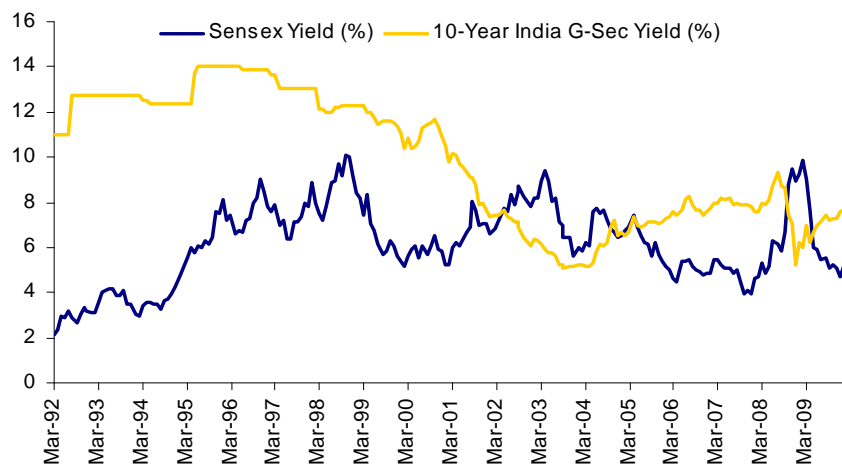
Sensex consensus earnings estimates



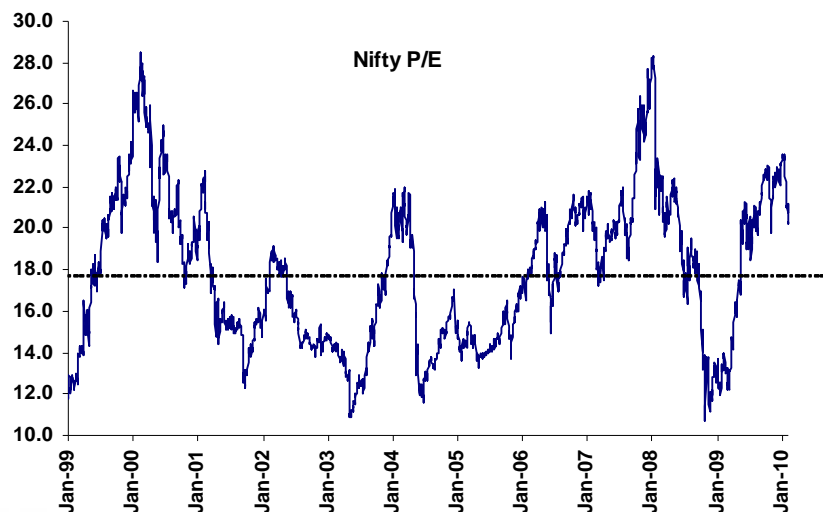
- Consensus expects a 5% decline in FY10 Sensex earnings over FY09 and a 27% growth in FY11 Sensex EPS over FY10.
- The FY 11 earnings forecast peaked in late October 09 and has been declining since then; this would appear to mirror the trend in the indices.
- Despite an in-line earnings season FY11 Consensus Sensex EPS has been cut by 2% in the month, highlighting risks to the forecasted high earnings in FY11.



# Valuations - ease a bit, but still above averages



- The gap between Sensex earnings yield and bond yield has decreased by 42 basis points over the previous month, but remains unfavourable for equity.
- Nifty is currently trading at 20.35x its trailing earnings. While the gap between the current multiple and historical average trailing PE has narrowed in the month, it still remains significantly higher than the historical average of 17.8x.



- The valuation surge is not unique to India. The MSCI Emerging Market Index is also trading at approximately 20.7x trailing earnings.



# Looking Ahead...

- The macro environment in India continues to improve as is indicated by an improvement in various lead indicators including the manufacturing PMI index and credit offtake.
- We expect the Government to withdraw the fiscal stimulus in a gradual manner. The likely roadmap for this would be laid out in the budget later this month.
- On similar lines, we expect that the RBI will continue to nudge rates higher in line with the recovery in the economy.
- The above steps constitute a normalization of monetary policy and a return to better fiscal health, which are key to sustaining India's long term growth prospects, though they do increase uncertainty in the minds of investors in the short term.
- Given the performance in the second quarter we expect GDP growth for the full year to be slightly above 6.5% as against earlier expectations of 6-6.5%.
- The correlation between global equity markets remains high and so does the inverse correlation between risky assets and the dollar. This remains a source of risk.
- Even after the recent fall in the market, valuations are at the higher end of the comfort zone and upsides will have to be driven more by stock picking.

# Investment view

## Short term

- GDP growth likely to be slightly above 6.5% in FY10.
- We expect earnings to decline marginally in FY10 over FY09. The current consensus forecasts a healthy 27% in FY1,1 but we would be cautious about visibility of this estimate as significant contribution comes from global cyclicals.
- Markets are now finely priced with most measures trading above long term averages and a recovery is priced in.

## 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.
- The elevated valuation measures might reduce the returns to below earnings growth.

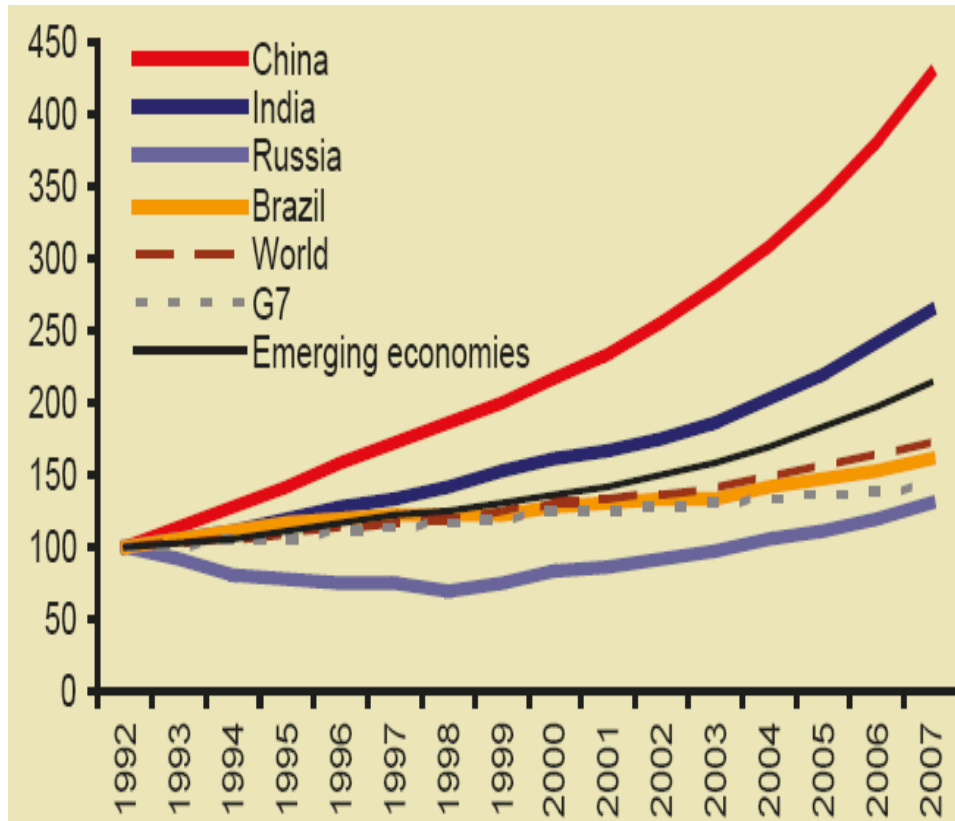
## Strategy for investors

- Last month we highlighted the unfavourable odds for forward returns due to valuations.
- The valuations have eased this month but are still at the higher end of the comfort zone and the need for caution is only slightly diminished from last month.
- Long term investors can continue with SIP.

# The Long Term Case For Indian Equities

# India - Growth On The Fast Track

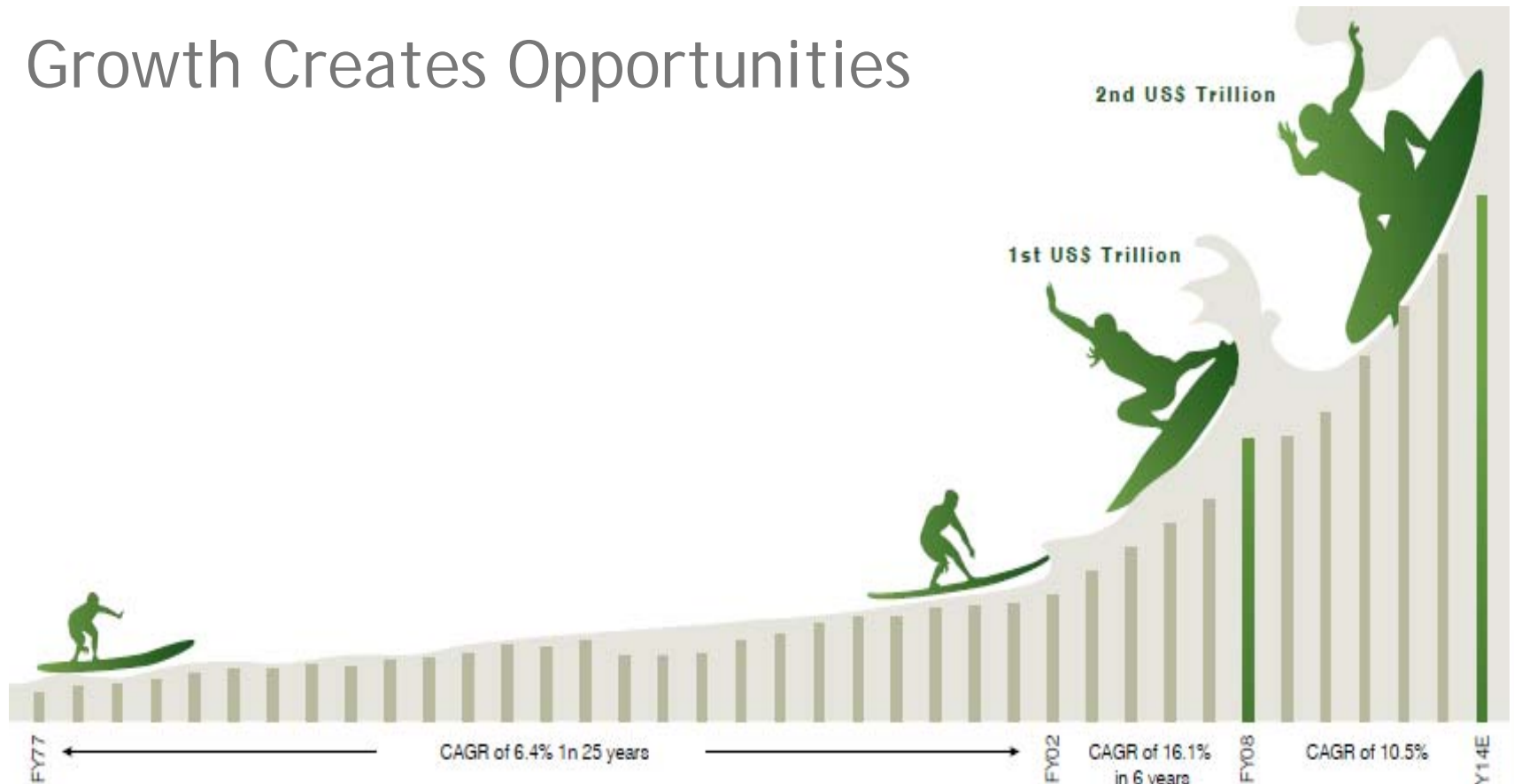
## GDP growth rebased to 1992



Source: IMF, IIFL Research

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

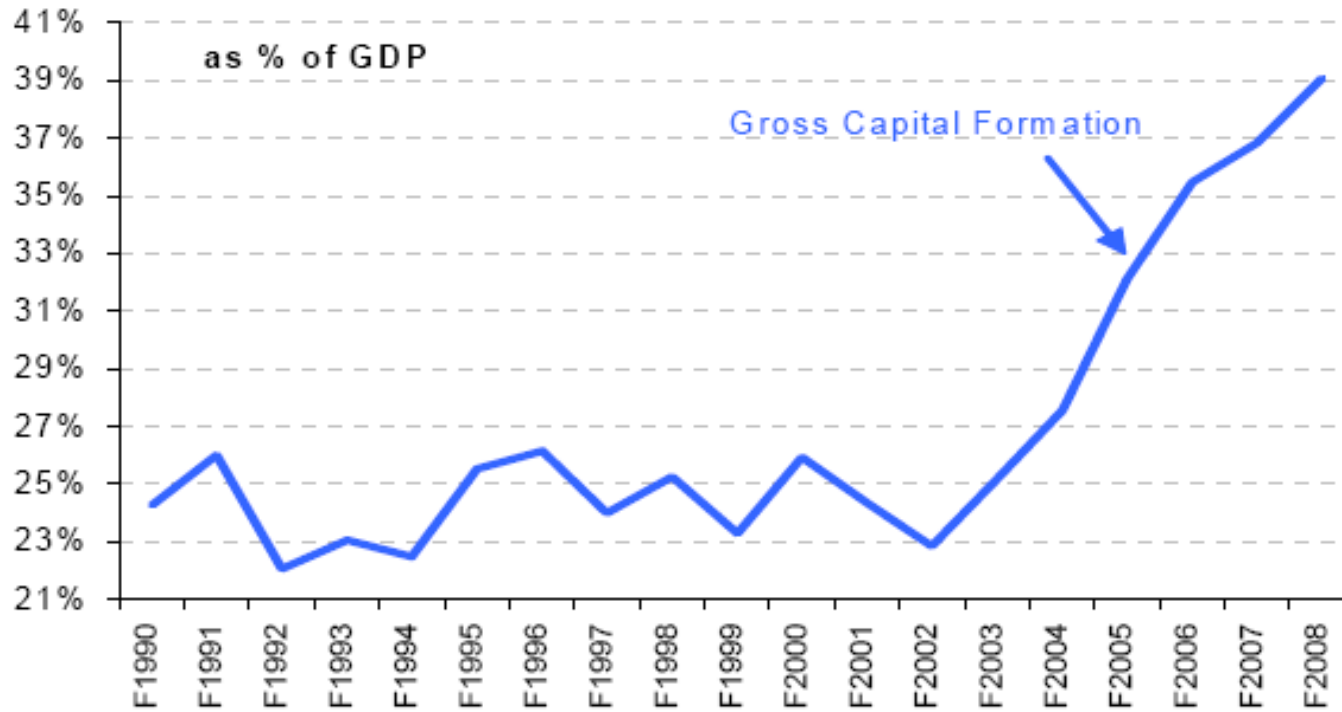
# Growth Creates Opportunities



- 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

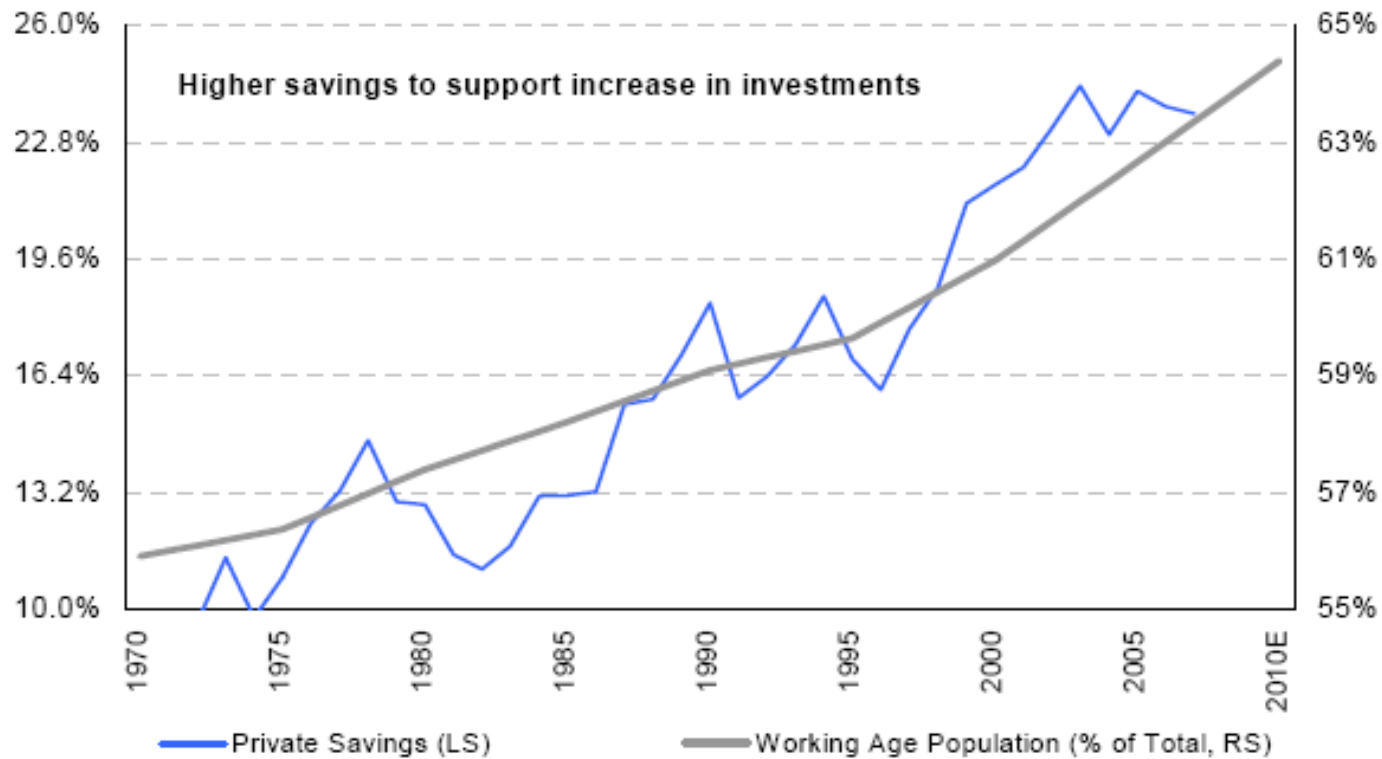


# Growth Is Being Led By A Rise In Capital Formation...



Source: CSO, Morgan Stanley Research

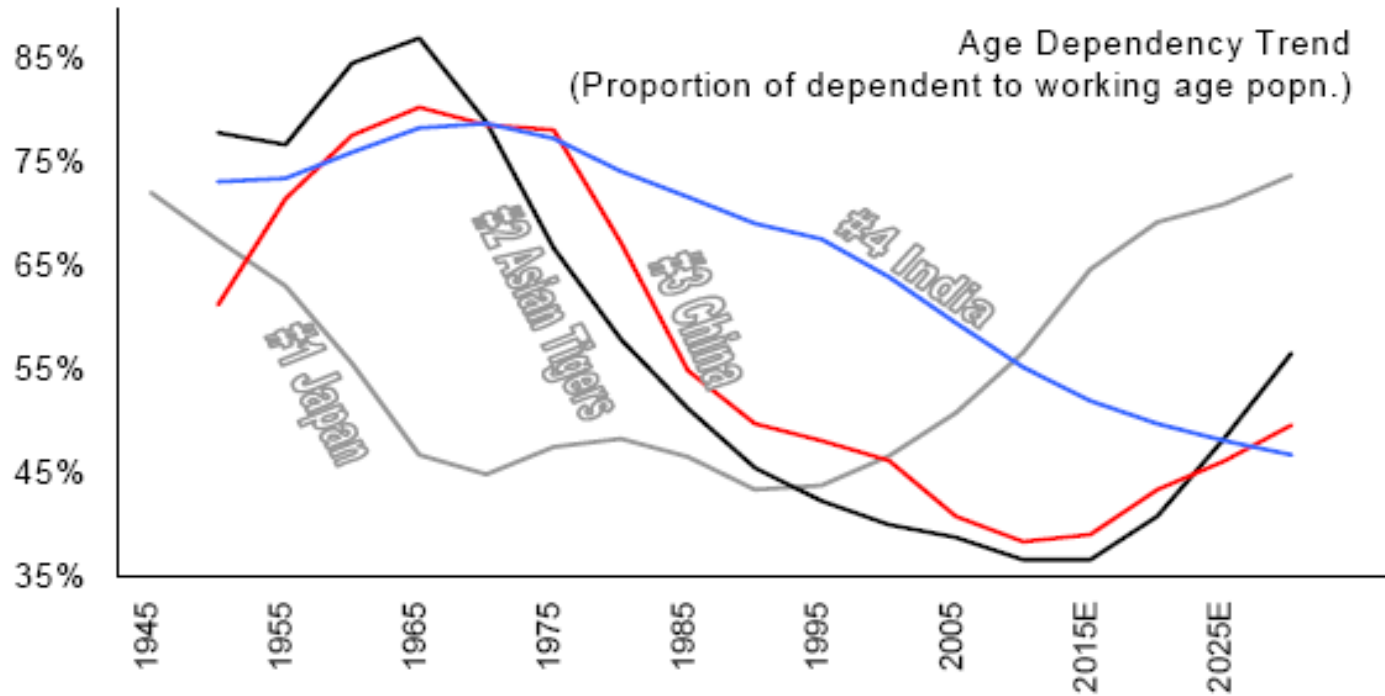
# ...Which Is Supported By A High Savings Rate



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

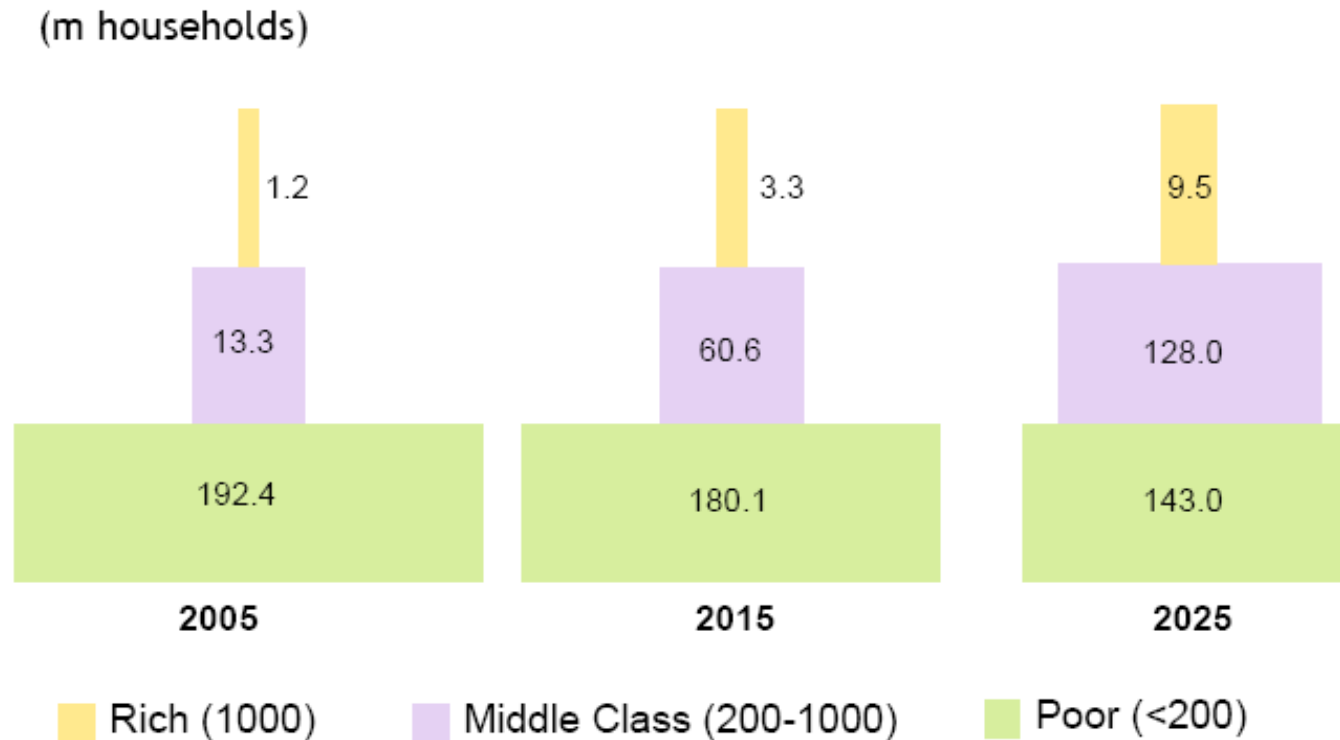


# India Is Poised To Reap Rich Demographic Dividend In Years To Come



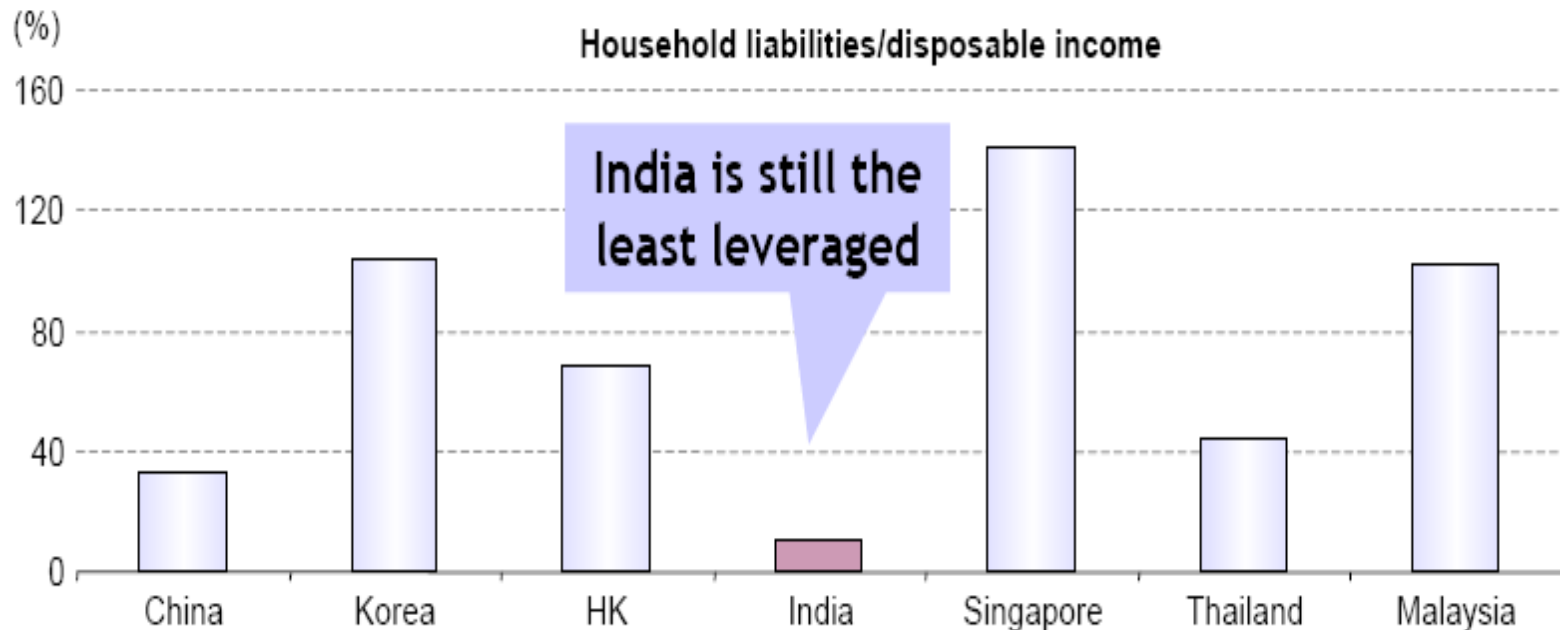
E= United Nations Research estimates Source: UN, Morgan Stanley Research

# 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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