Equity Markets :
Current Environment and Outlook

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June 2010

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Current Environment

- Equity markets dropped for the second consecutive month across the globe, with the MSCI World Index declining by 3.56%.
- Indian markets outperformed the global trend, rising by 4.46% in the month of June.
- Commodity prices were against the trend in equities, with the benchmark CRB Reuters Jefferies total return index rising by 0.8%.
- FMCG was the best performing sector followed by the Auto sector. Metal and Banking sectors delivered the worst return for the month.
- FII inflows were at Rs.105bn in June 2010. DIIs recorded outflows of Rs.48bn. MF remained net sellers to the tune of Rs.11bn.
- Trading Activity remained at subdued levels in June, with cash trading volumes (number of shares) rising by 3% MoM. However, the average open interest remained flat MoM at its highest level since Jan-08.

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Global Equities

Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	2398.37	-7.48%	-26.82%	EM - Asia
BSE Sensex	India	17700.90	4.46%	1.35%	EM - Asia
Kospi	South Korea	1698.29	3.48%	0.92%	EM - Asia
Taiwan Weighted	Taiwan	7329.37	-0.60%	-10.49%	EM - Asia
Thailand SET 50 Index	Thailand	547.46	4.45%	5.14%	EM - Asia
Jakarta Composite Index	Indonesia	2913.68	4.17%	14.97%	EM - Asia
KLSE	Malaysia	1314.02	2.26%	3.24%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	60935.90	-3.35%	-11.16%	EM
Mexico IPC	Mexico	31156.97	-2.75%	-3.00%	EM
Russian RTS Index	Russia	1339.35	-3.27%	-7.29%	EM
Philippine PSEi	Philippines	3372.71	3.05%	10.48%	EM
Merval Buenos Aires Index	Argentina	2185.01	-0.84%	-5.85%	EM
HangSeng	Hong Kong	20128.99	1.84%	-7.97%	Developed - Asia
Nikkei	Japan	9382.64	-3.95%	-11.04%	Developed - Asia
Strait Times	Singapore	2835.51	3.01%	-2.14%	Developed - Asia
Dow Jones	USA	9774.02	-3.58%	-6.27%	Developed
CAC 40 Index	France	3442.89	-1.84%	-12.54%	Developed
All Ordinaries Index	Australia	4324.80	-2.89%	-11.43%	Developed
DAX Index	Germany	5965.52	0.02%	-1.37%	Developed
Swiss Market Index	Switzerland	6128.06	-2.92%	-6.38%	Developed
FTSE 100	UK	4916.87	-5.23%	-9.16%	Developed
MSCI World Index	--	1041.32	-3.56%	-10.88%	--

* as on 30th June 10. Source : Bloomberg
EM – emerging markets, Developed – developed markets.

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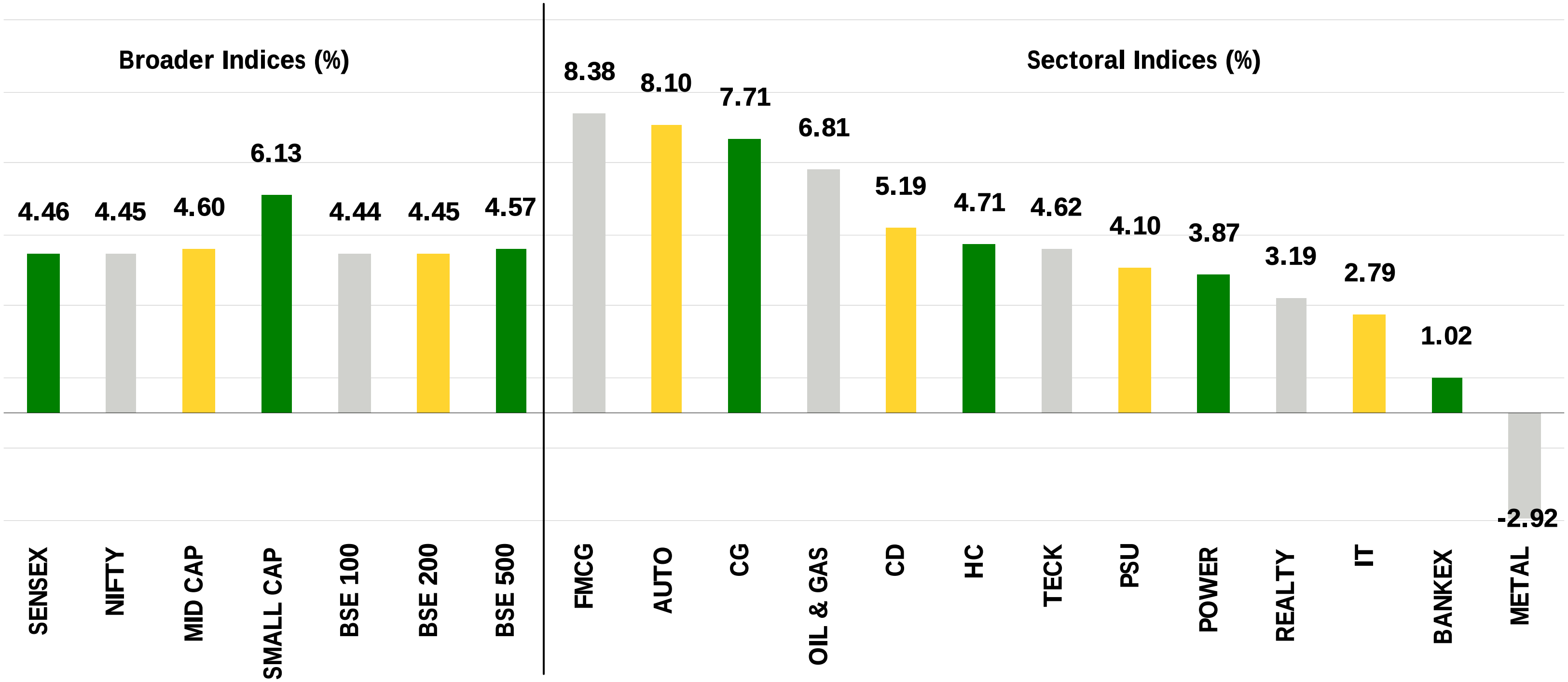
India : Sector performances



- The markets rose by 4.46% over the previous month.
- FMCG was the best performing sector followed by the Auto sector.
- Metal and Banking sectors delivered the worst return for the month.

*Source: BSE,NSE. one month performance as on 30th June 10.

Top Gainers / Losers - Nifty

Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
Rel. Comm.	321 / 131.5	198.3	36.81
Idea Cellular	84.8 / 47.8	59.35	17.52
Reliance Capital	976.65 / 611.1	762.75	16.62
Maruti Suzuki	1737.3 / 991.5	1423.75	15.11
B P C L	677.8 / 415.9	662.75	14.04
Top Losers for the month			
Losers	**52 week H/L**	**Last Price#**	**% Loss***
S A I L	267 / 139.05	192.7	-6.68
HCL Technologies	410 / 162.25	364.15	-4.76
Jindal Steel	753.9 / 390.22	624.5	-4.53
Wipro	453.51 / 219.3	384.5	-4.30
Hindalco Inds.	193 / 68.15	144.5	-3.83

closing price as on 30th June 2010.* one month performance as on 30th June 2010.
Source: Capitaline

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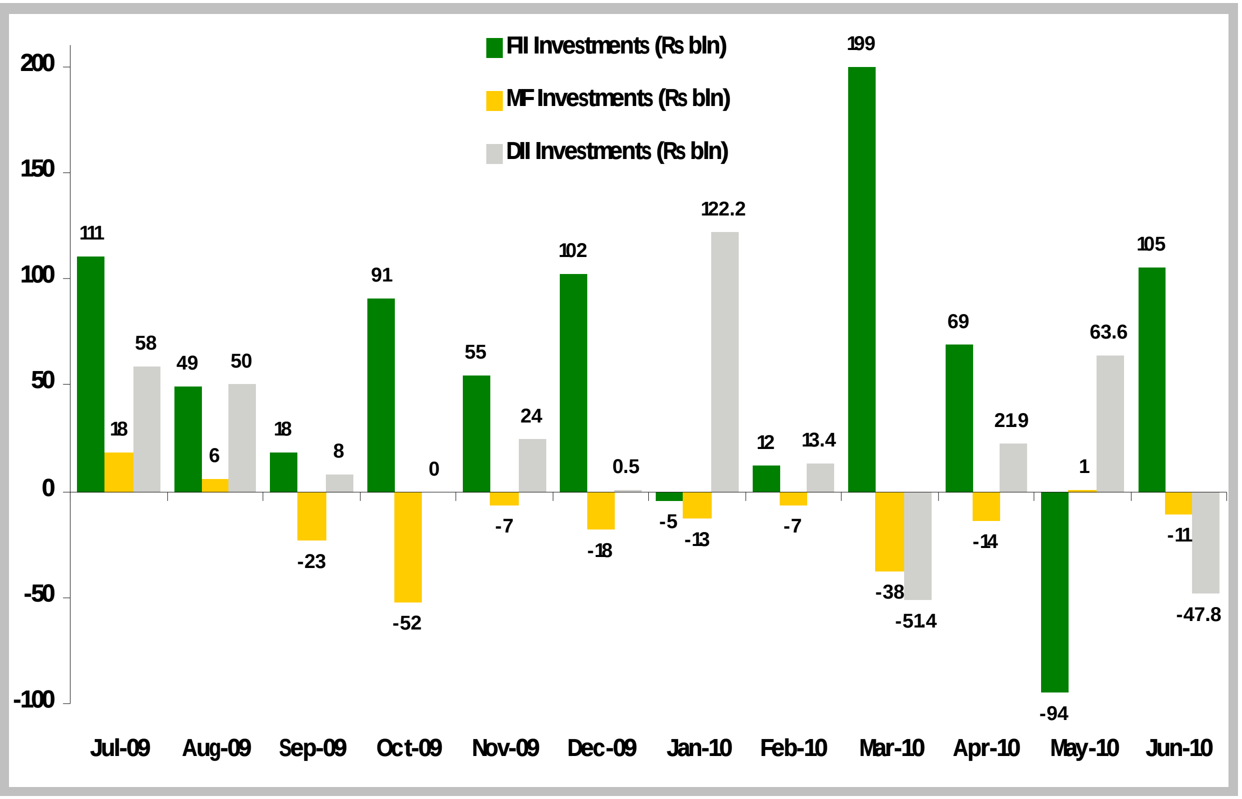
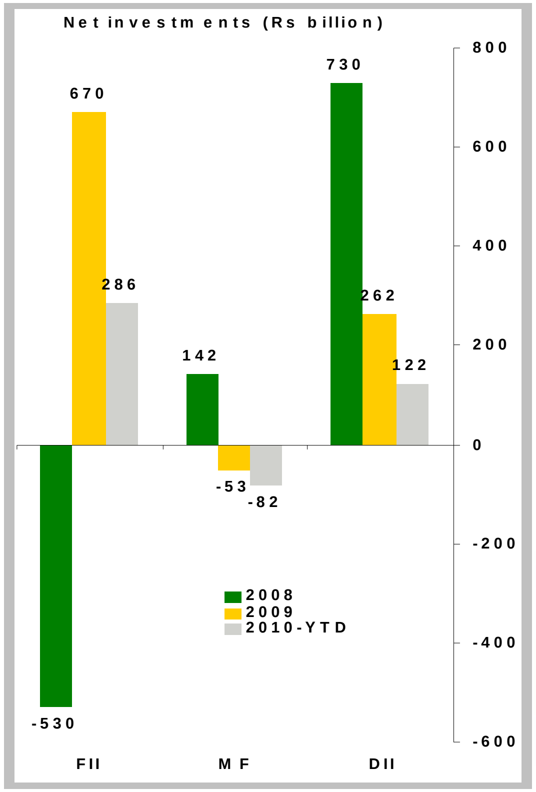
FII & DII Inflows





- FII inflows were at Rs.105bn in June2010. FII inflows have remained positive on a YTD basis at Rs.286bn for CY10 after a Rs.670bn inflow in CY09.

- DIIs recorded outflows of Rs.47.8bn. MF remained net sellers to the tune of Rs.11bn.

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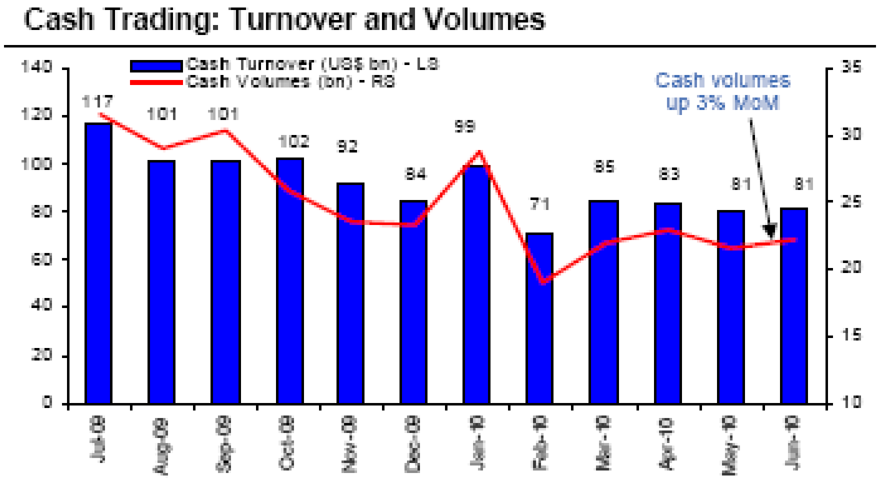
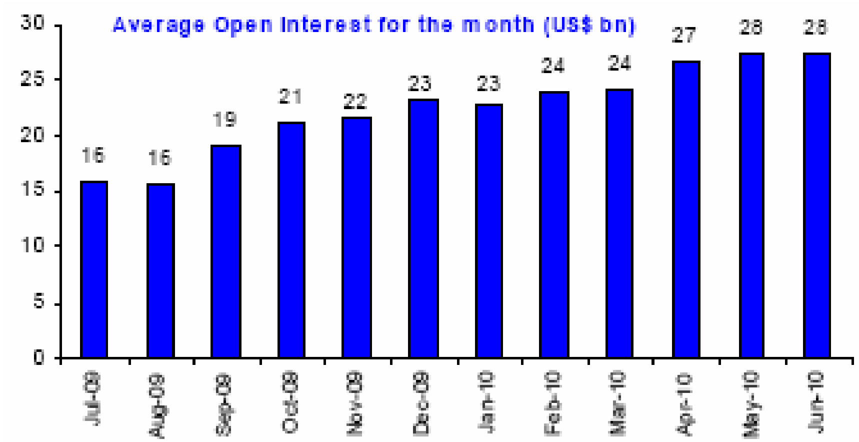
FII - Foreign Institutional Investors, DII - Domestic Institutional Investors (Includes Bank, DFIs, Insurance and MF)
Source: SEBI, BSE

Market Activity



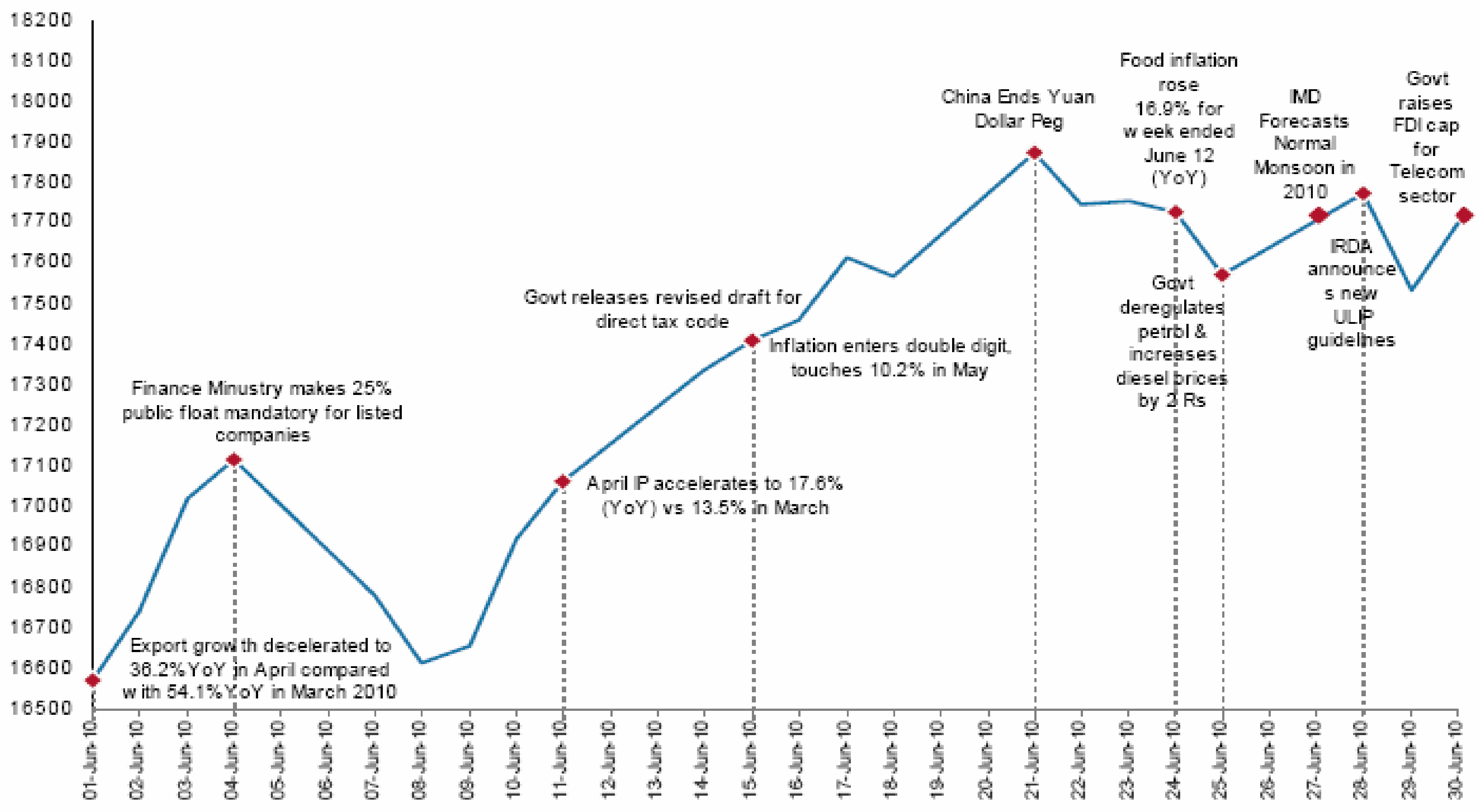
- In June, cash trading volumes (number of shares) increased by 3% MoM.



- At the end of June, average open interest remained same MoM at its highest level since Jan-08.

Sources: Bloomberg, Morgan Stanley

June 2010 events timeline



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

Religare MF: Equity Market Outlook and Opportunities

Equity Market Outlook

- The outlook for global growth has weakened materially in recent weeks with recent US data pointing to the downside even as growth in Europe remains weak and China also reduces it pace.
- Back home in India, gross fixed capital formation (GFCF) grew 25% YoY in the Q4FY10, suggesting a possible turn in the investment cycle.
- The Edelweiss ET-Now Lead Indicator Index (EELII) remains strong at ~126 in July 2010, indicating a non-agricultural GDP growth upwards of 9%.
- Inflation remains a concern; the fuel price hike will add 100-130bps and RBI itself points of that inflation is now more generalized and has spread beyond the food sector.
- RBI has hiked the Repo and Reverse Repo rates by 25 basis points and will have to continue normalizing rates through till the end of the year.
- The Government took its boldest reform step to date with a move to de-regulate fuel pricing, which will improve the country's fiscal health.
- The consensus estimates indicate high single digit growth for Sensex earnings in the June quarter with broader market expect to grow in mid teens.
- There have been no material changes to Consensus earnings expectations for FY11 during the month.

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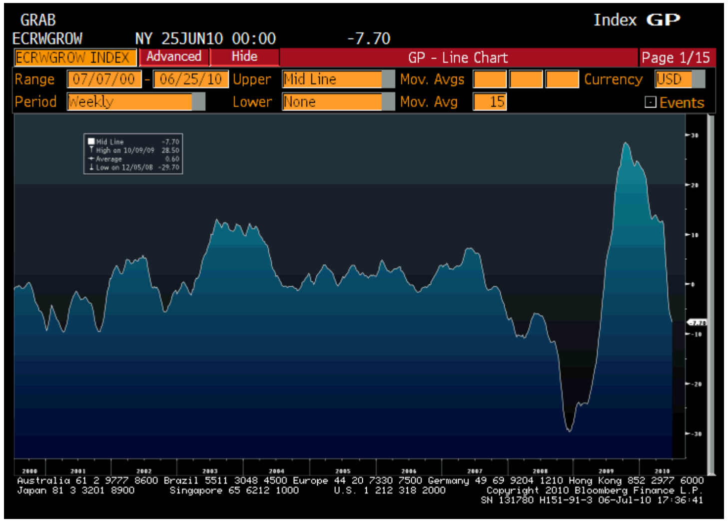
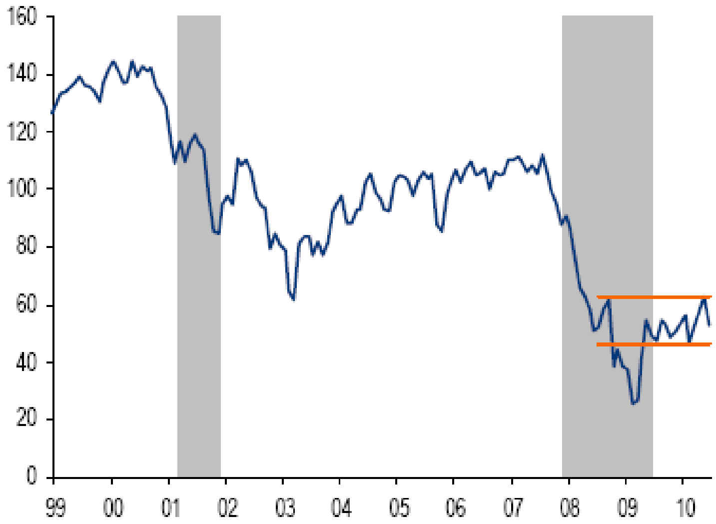
US GDP – Growth could falter

ECRI weekly leading index growth rate



Conference Board Consumer Confidence Index



- The US economic growth appears to have started tapering off as is indicated by ECRI weekly leading index growth rate, which is a composite index of many leading indicators of the US economy. It has corrected sharply in the previous month and is now closer to its 10-yr low levels.
- The Conference Board Consumer Confidence Index has also declined in the previous month, thus remaining in a tight band, which is closer to the 2009 lows and very far from the highs seen in the earlier part of the decade.
- In recent weeks forecasts for US GDP growth in 2010 and 2011 have been cut by 20 to 70 bps.

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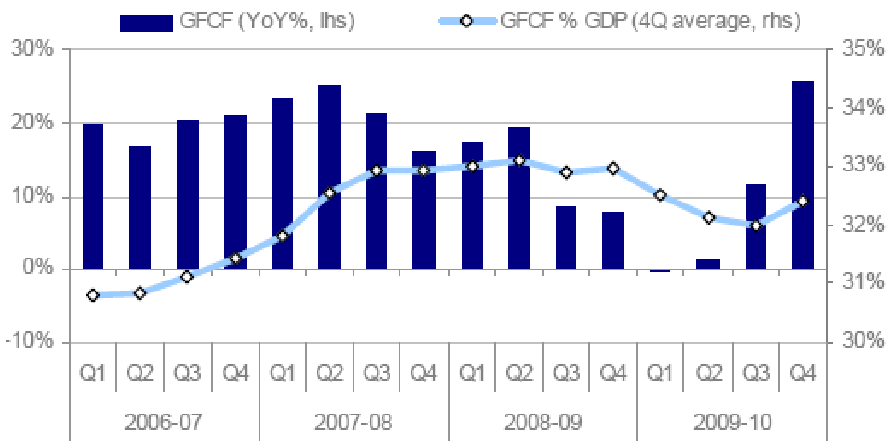
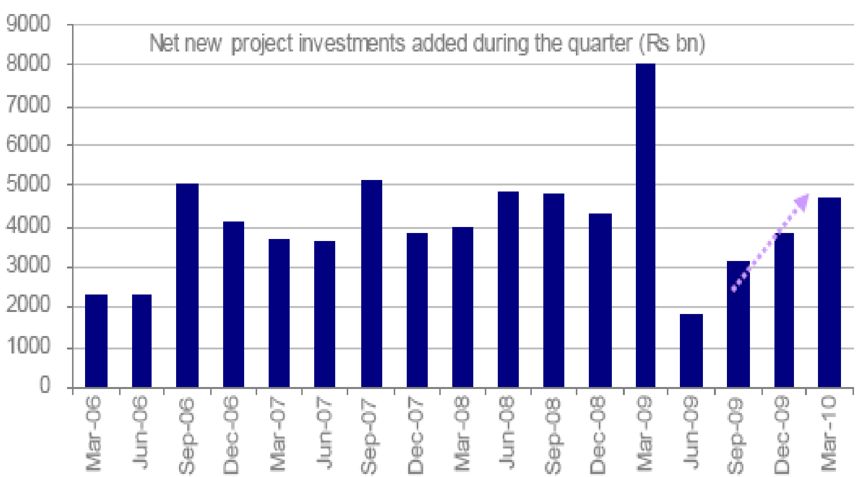
Sources: Bloomberg, Conference Board, BofA Merrill Lynch Global Research

India – Investment cycle appears to be turning





- In FY10, Corporate profitability has improved and large capital-raising has repaired corporate balance-sheets.
- In 4QFY10, Gross Fixed Capital Formation (GFCF) grew 25% YoY—fastest growth in at least five years.
- Further, on a trailing 4Q basis, share of GFCF in the GDP has increased, after declining for a few quarters.
- New project announcements have already increased sequentially for three consecutive quarters and in 4QFY10 they were back to FY08 levels.
- Sustaining the investment cycle is key to maintaining India's growth trajectory and this is a positive development.

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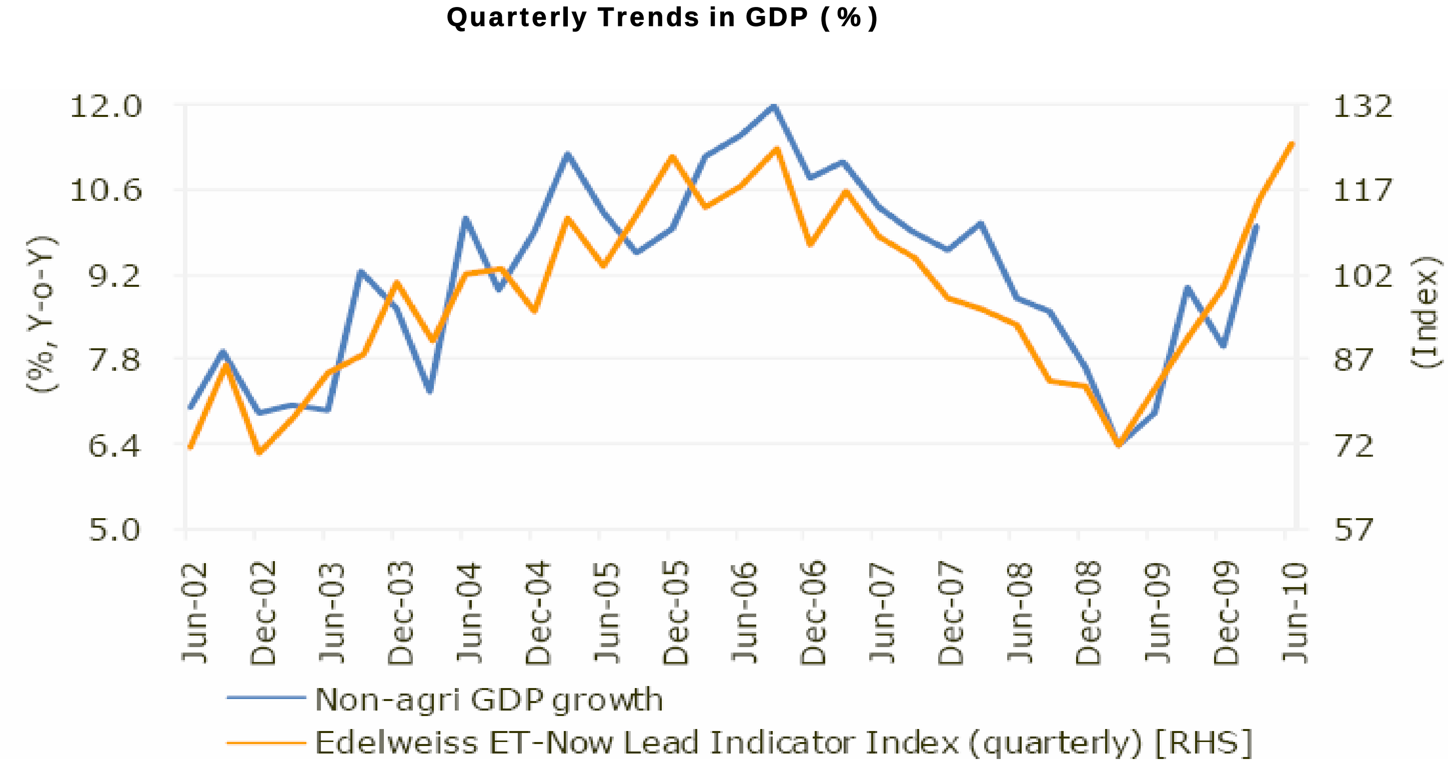
Sources: CSO, CMIE, IIFL Research

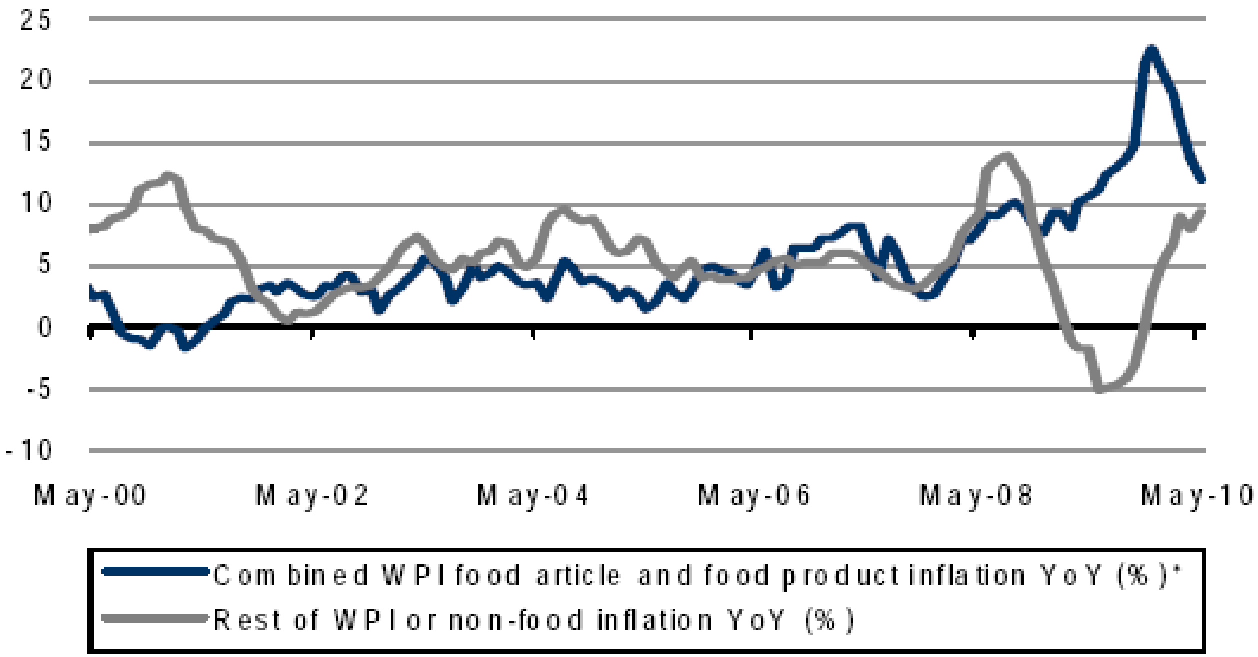
Lead indicators point to a strong growth ahead



- The Edelweiss ET-Now Lead Indicator Index (EELII) remains strong at ~126 in July 2010, comparable with ~125 in Q1FY11.
- A value of ~100 for EELII suggests non-agriculture GDP growth of ~9% Y-o-Y.

Sources: C

Inflation remains a cause for concern



- Non-food inflation is almost in double digits, which has caused nearly 3-4% shock in overall numbers compared with the forecasts as late as 2009 year-end.
- De-regulation of auto fuel prices will lead to a total impact of ~100-130bps on headline inflation.
- In the words of RBI – ‘ inflation is now very much generalised’ and ‘demand-side pressures are evident’

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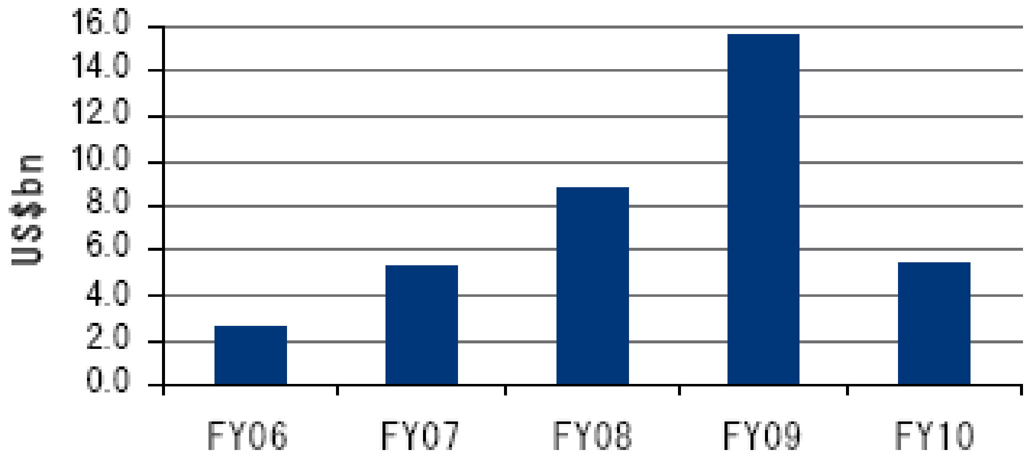
Sources: CMIE, Credit Suisse estimates

Oil price deregulation – signaling implementation of reforms

Subsidy borne by the Government in FY06-FY10



- The Government has announced deregulation of auto fuel pricing, withstanding immense pressure from coalition parties.
- Petrol prices have been completely deregulated and High Speed Diesel (HSD), Superior Kerosene Oil (SKO) & LPG prices have been hiked Rs2/litre, Rs3/litre and Rs35/cylinder respectively. The Government has also decided to deregulate HSD prices over an undisclosed period of time.
- The gross fiscal deficit including off budget items such as oil would drop by about 0.2-0.3% of GDP.

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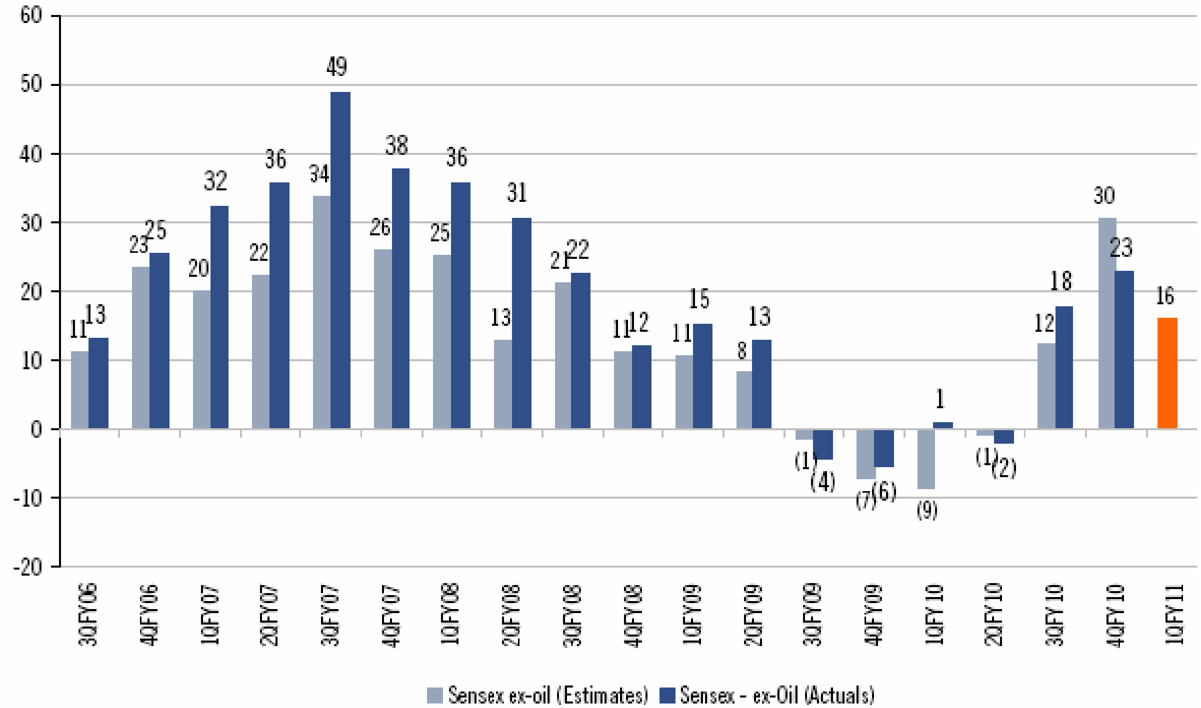
Sources: BofA ML Research

Earnings Preview – June 2010E earnings expected to grow strongly

Sensex ex-oil Earnings Growth – Estimates vs. Actual



- In quarter ended March 2010, earnings fell meaningfully short vs. expectations – unlike historically when actuals have typically been ahead of expectations (in good and bad years).
- Consensus forecasts for Sensex earnings for the quarter ending June suggest 6-8% earnings growth. Excluding oil earnings are forecast to grow 16% (Citi Research Estimates), for the Sensex.
- We expect strong market reactions to any material earnings surprises.

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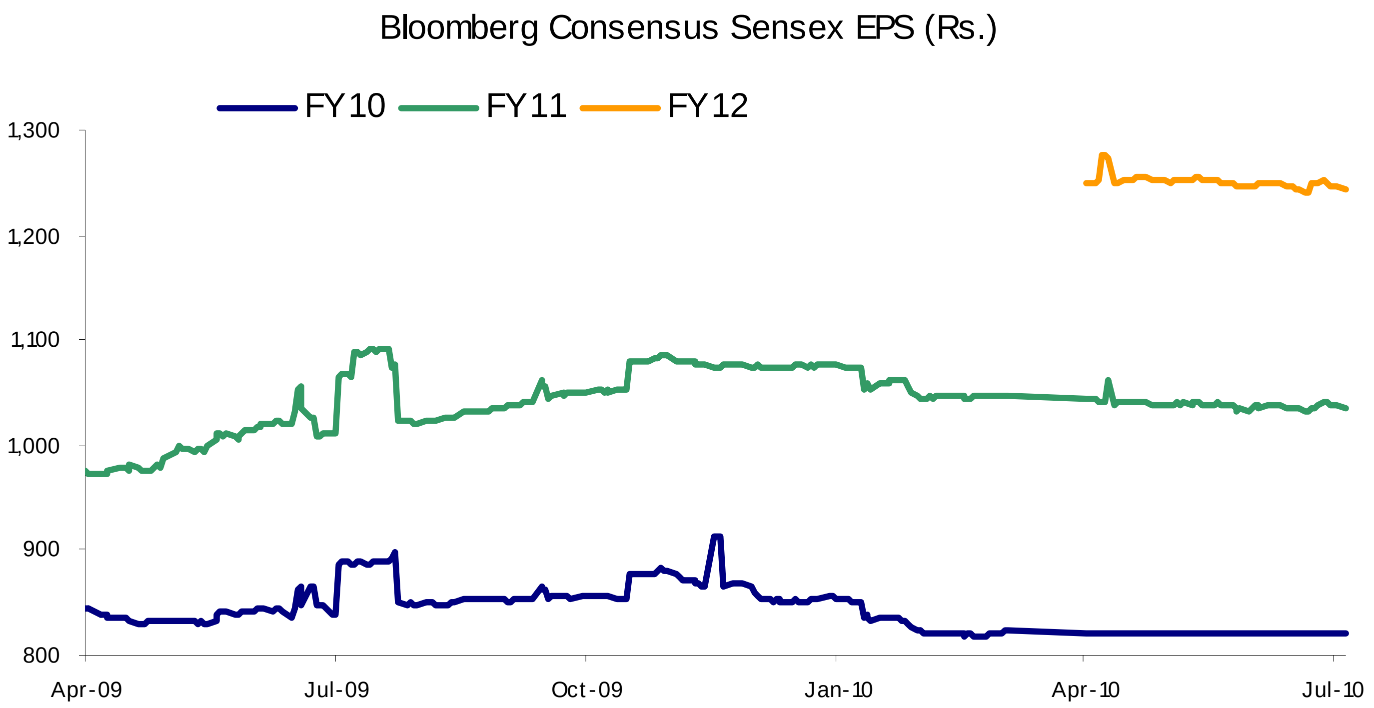
Sources: Company Data, Citi Investment Research and Analysis

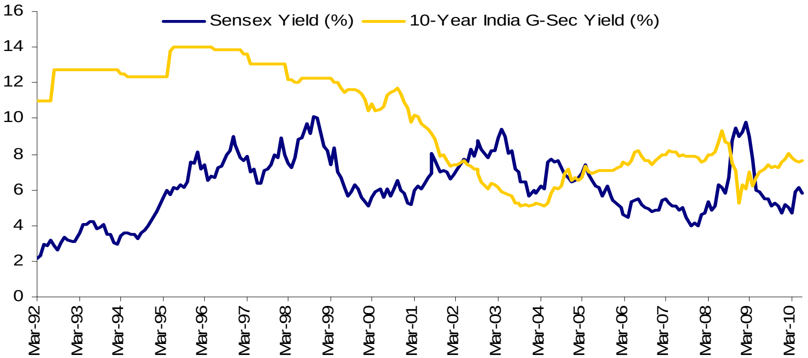
Earnings – No Material Changes In Expectation

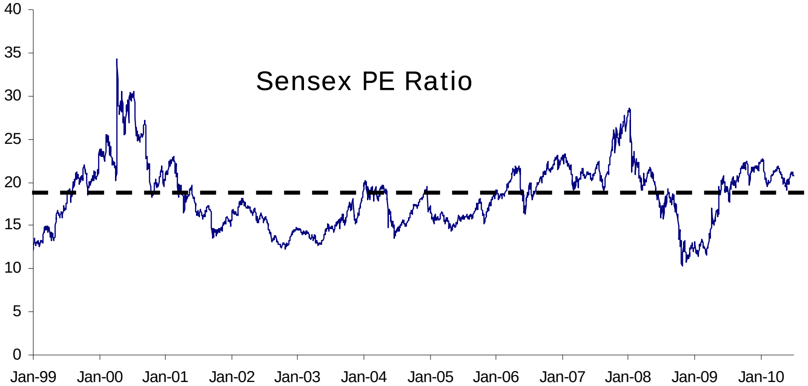


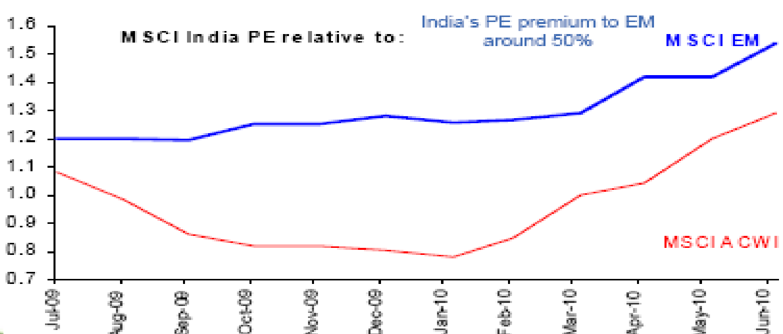
- There have been no material changes to Consensus earnings expectation in the month.
- Consensus continues to expect a 26% growth in FY11 Sensex EPS over FY10 and a 20% growth in FY12E Sensex EPS over FY11E.

Sources: Bloomberg, IIFL Research

Valuations







- The gap between Sensex earnings yield and bond yield has increased by 33 basis points over the previous month. The Sensex yield has fallen while the bond yields have risen in the month.

- Sensex is currently trading at 20.77x its trailing earnings. The gap between the current multiple and historical 10-year average trailing PE of 18.4x has remained almost the same in the month.

- India's PE premium to MSCI Emerging markets has increased substantially, and it is now at around 50% premium to MSCI EM PE currently.

Source: NSE, MOSL Research, FactSet, MSCI, Morgan Stanley Research

Looking Ahead...

- The outlook for global growth has weakened materially in recent weeks with recent US data pointing to the downside even as growth in Europe remains weak and China also reduces it's pace.

- The macro environment in India remains strong as indicated by the latest GDP growth data and as also Industrial growth, credit growth and lead indicators.

- The Government has finally de-controlled auto fuel pricing and has effectively capped the subsidies bill. We feel this is an extremely bold move requiring a lot of political will and signals Government pro-reform intent and actions to improve its fiscal condition.

- RBI has hiked key policy rates by 25 bps signaled its intent to anchor inflationary expectations. We have revised our expectation to a further 75bps of policy hikes from the RBI during the current fiscal.

- While India's beta relative to the rest of the world has come down the correlation between global equity markets remains high – this is a source of both upside as well as a downside risk for our markets.

- The here has been a valuation correction in India over the last 9 months as markets are unchanged even as forward earnings are now focused on FY11

- However, India's valuation premium to other emerging markets has expanded in recent months.

- Our focus remains on stock picking and sector allocation for generating alpha.

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Investment view

Short term

- GDP growth likely to be slightly above 8% in FY11.
- The current consensus forecasts a healthy 26% growth in FY11, but we would be cautious about visibility of this estimate as a significant contribution comes from global cyclicals.
- There has been valuation correction over time with the markets virtually unchanged over the past 8 months.
- However, without significant earnings acceleration further re-rating is unlikely.

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.

Strategy for investors

- The valuations are above historical averages but have eased off from their highs late last year.
- Global correlations remain a source of risk but further drops closer to historical averages can be used as buying opportunities.
- Long term investors can continue with SIP.

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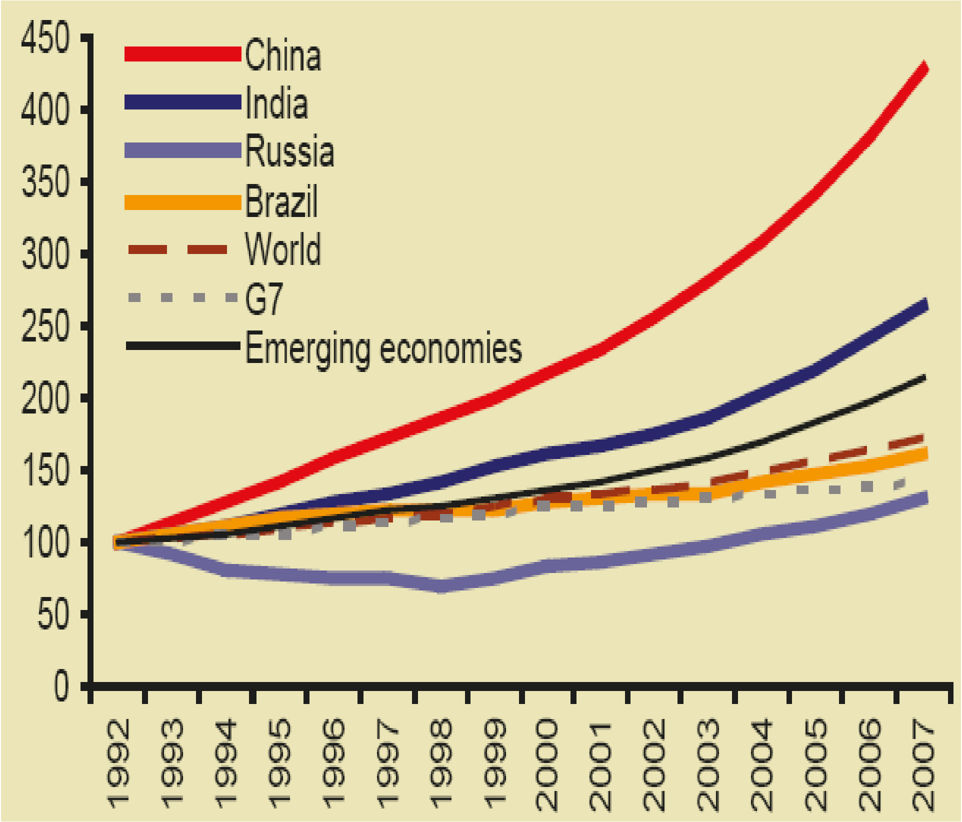
The Long Term Case For Indian Equities

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

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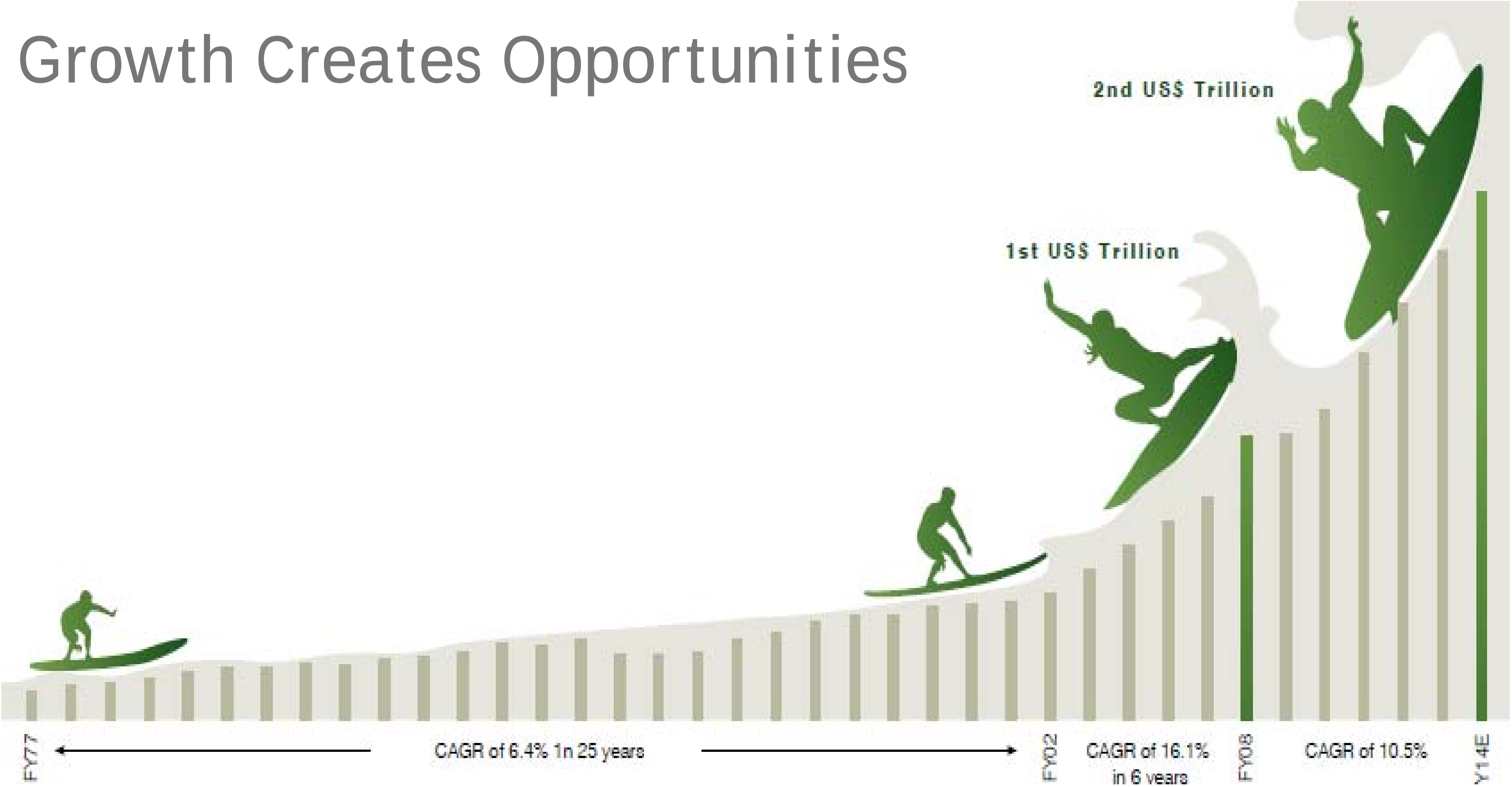
Growth Creates Opportunities



- 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

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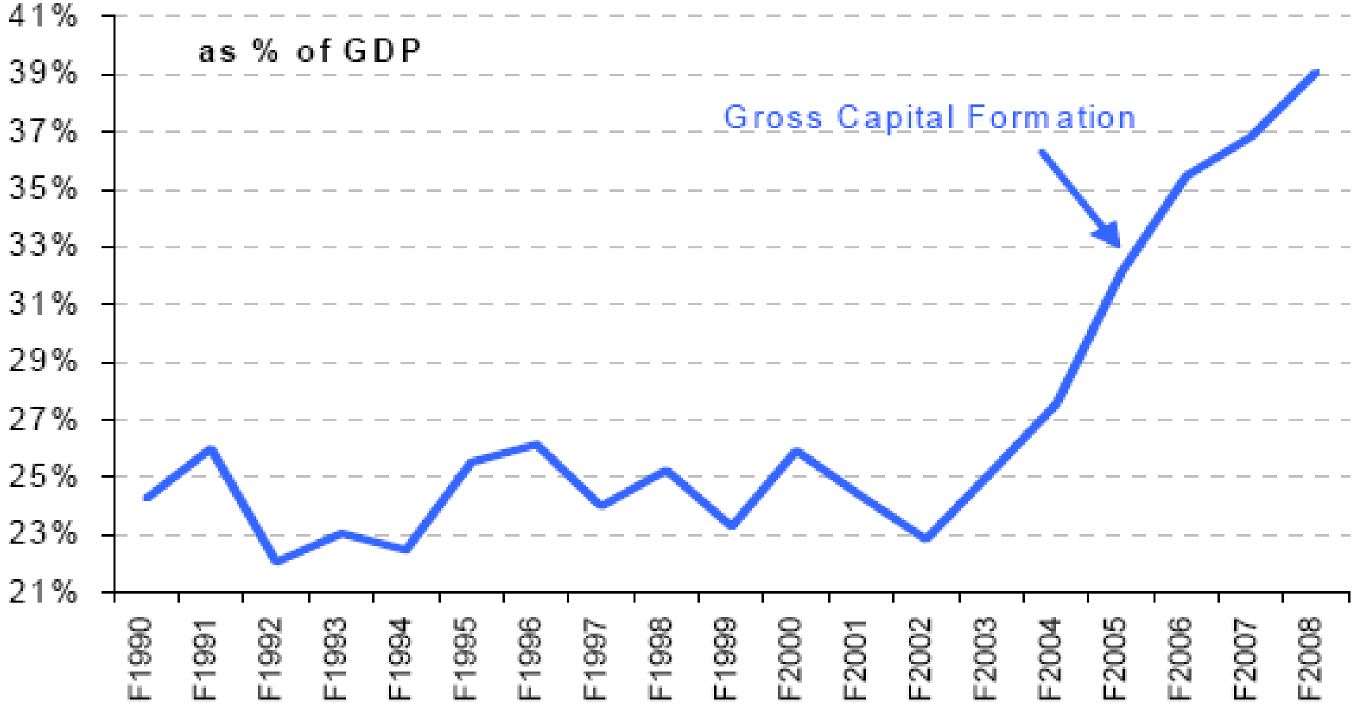
Source: Motilal Oswal Securities Ltd.

Growth Is Being Led By A Rise In Capital Formation…



Source: CSO, Morgan Stanley Research

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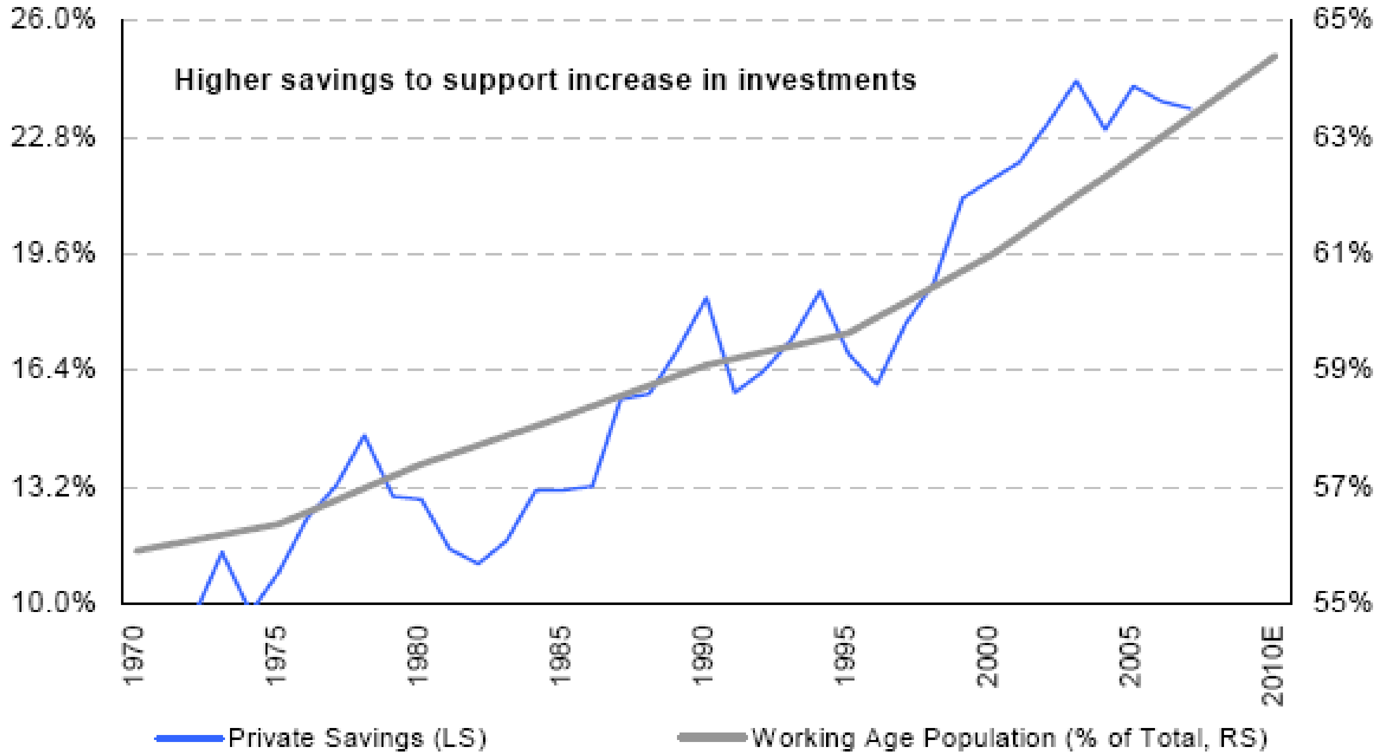
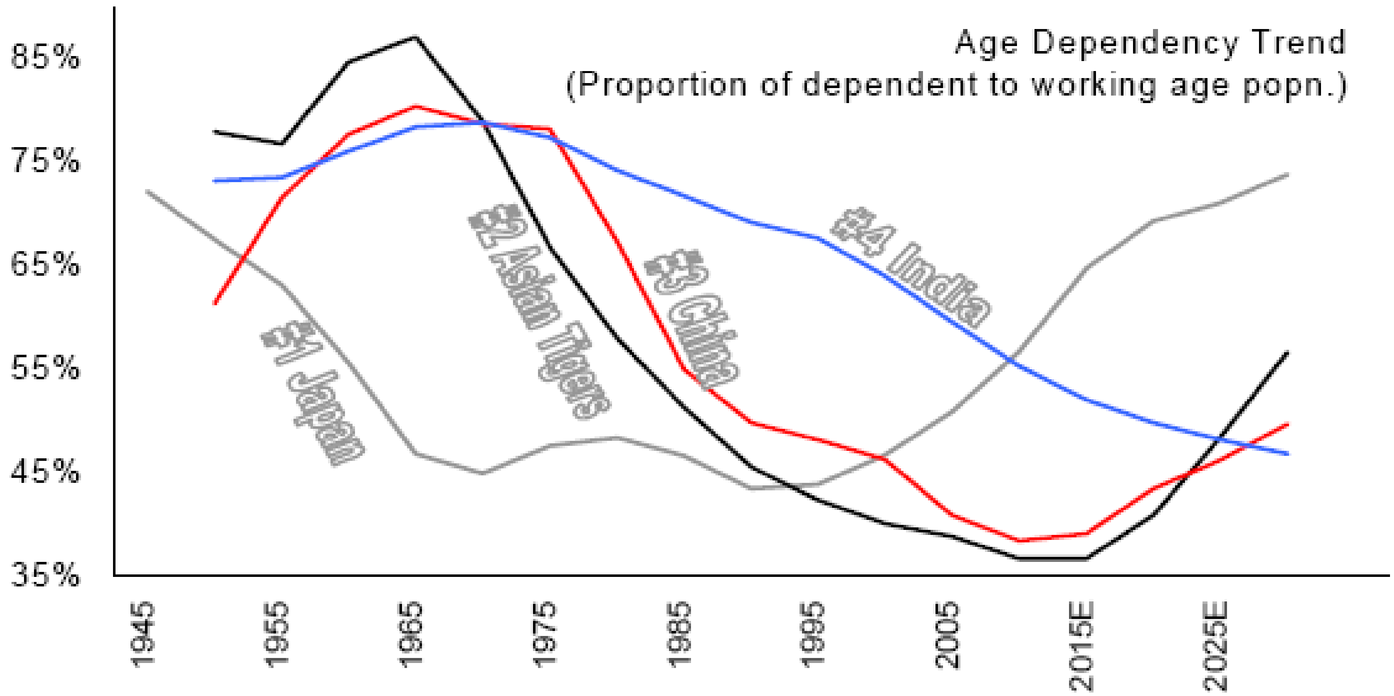
...Which Is Supported By A High Savings Rate



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

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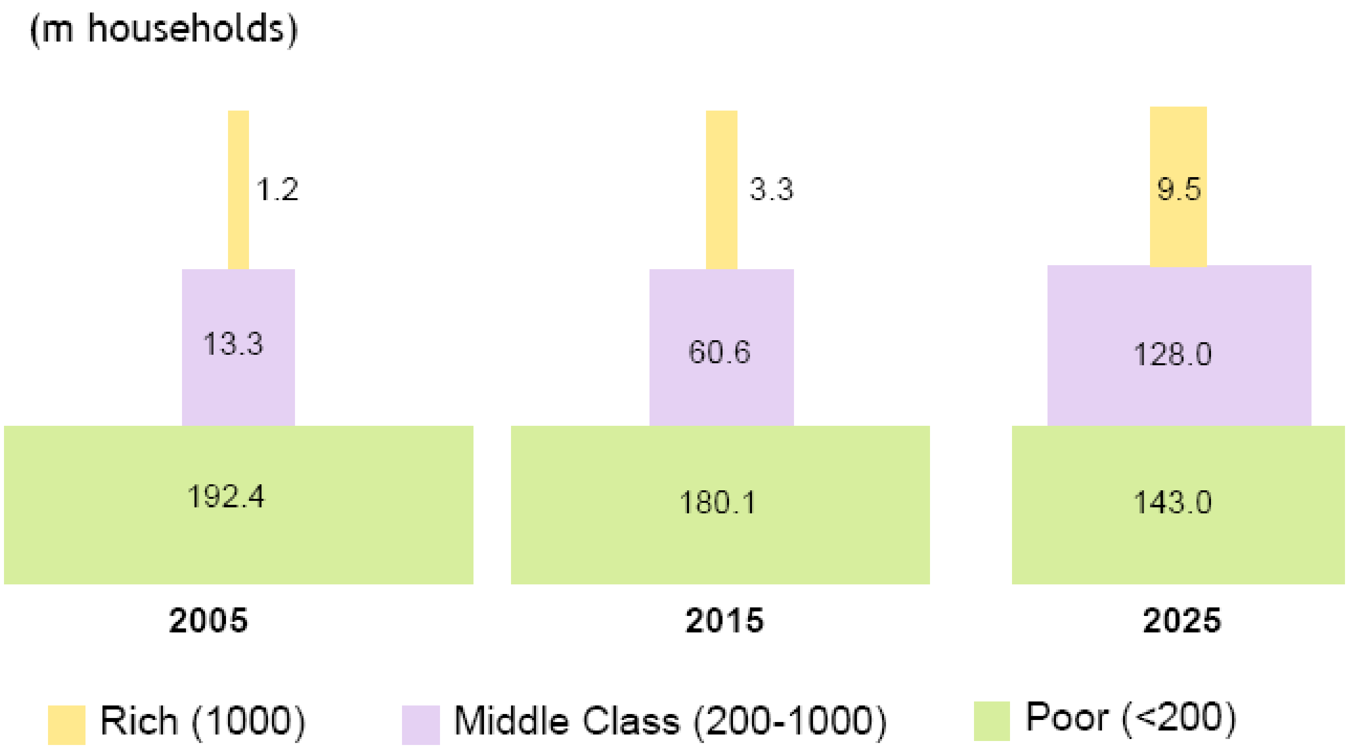
Income Imbalance To Correct Leading To Rise In Consumption



Source: IDFC SSKI

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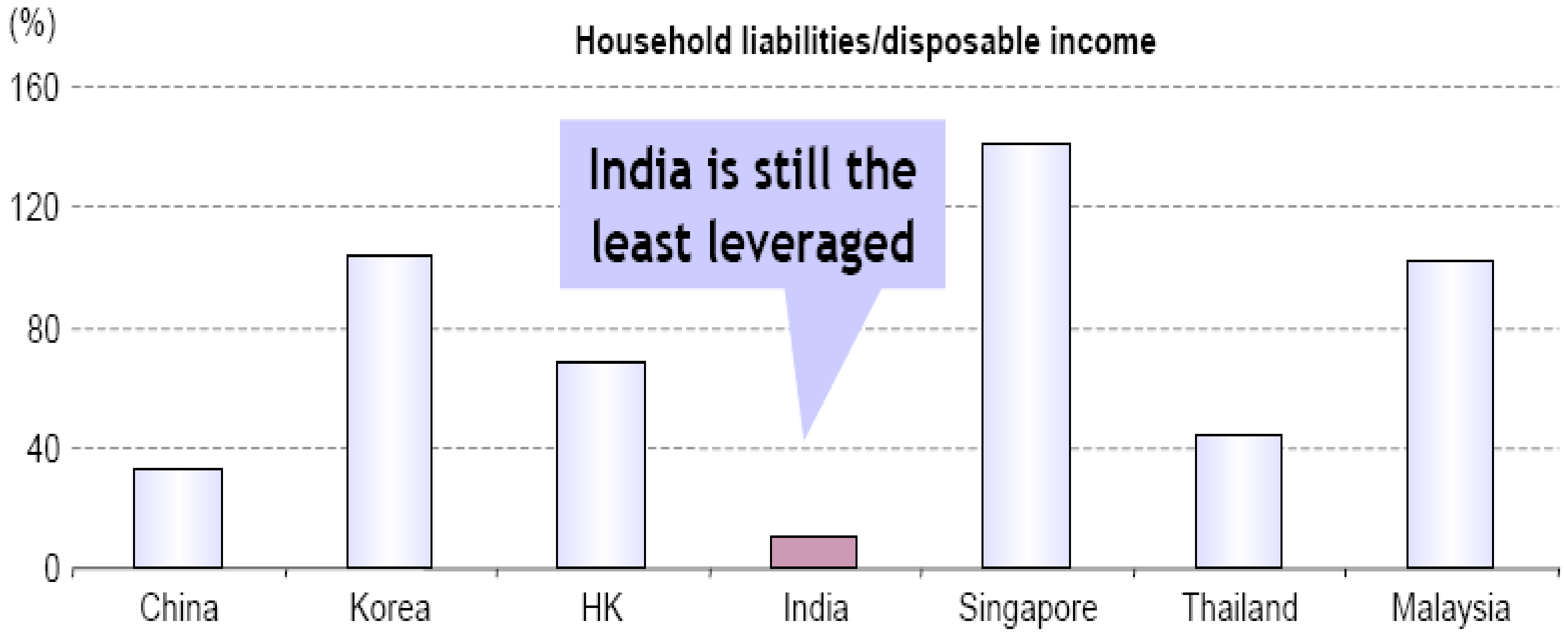
Indian Consumer Is Conservative; Consumption Largely Driven By Income Growth And Not Leverage



Source: IDFC SSKI

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