

Equity Markets : Current Environment and Outlook

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Current Environment

- Global Equity markets remained bearish in March, with the MSCI World Index falling by 1.24%.
- Indian markets sharply outperformed after two consecutive months of underperforming the global markets, rising by 9.10% in the month of March.
- Commodity price indices were buoyed by rise in crude oil prices, with the benchmark CRB Reuters Jefferies total return index rising by 1.6%. This is the seventh consecutive month of rise for the index.
- Realty, Auto and Banking were the best performing sectors, while FMCG and Metals sectors delivered the worst return for the month.
- FII outflows reversed in March, with FII flows turning positive at Rs.69bn in March 2011. DIIs recorded marginal inflows of Rs.1bn while MF net buys almost equaled net sells during the month.
- Trading Activity remained subdued in March, with cash trading volumes (US \$mn) declining 1.4% MoM and the average open interest remaining flat MoM.

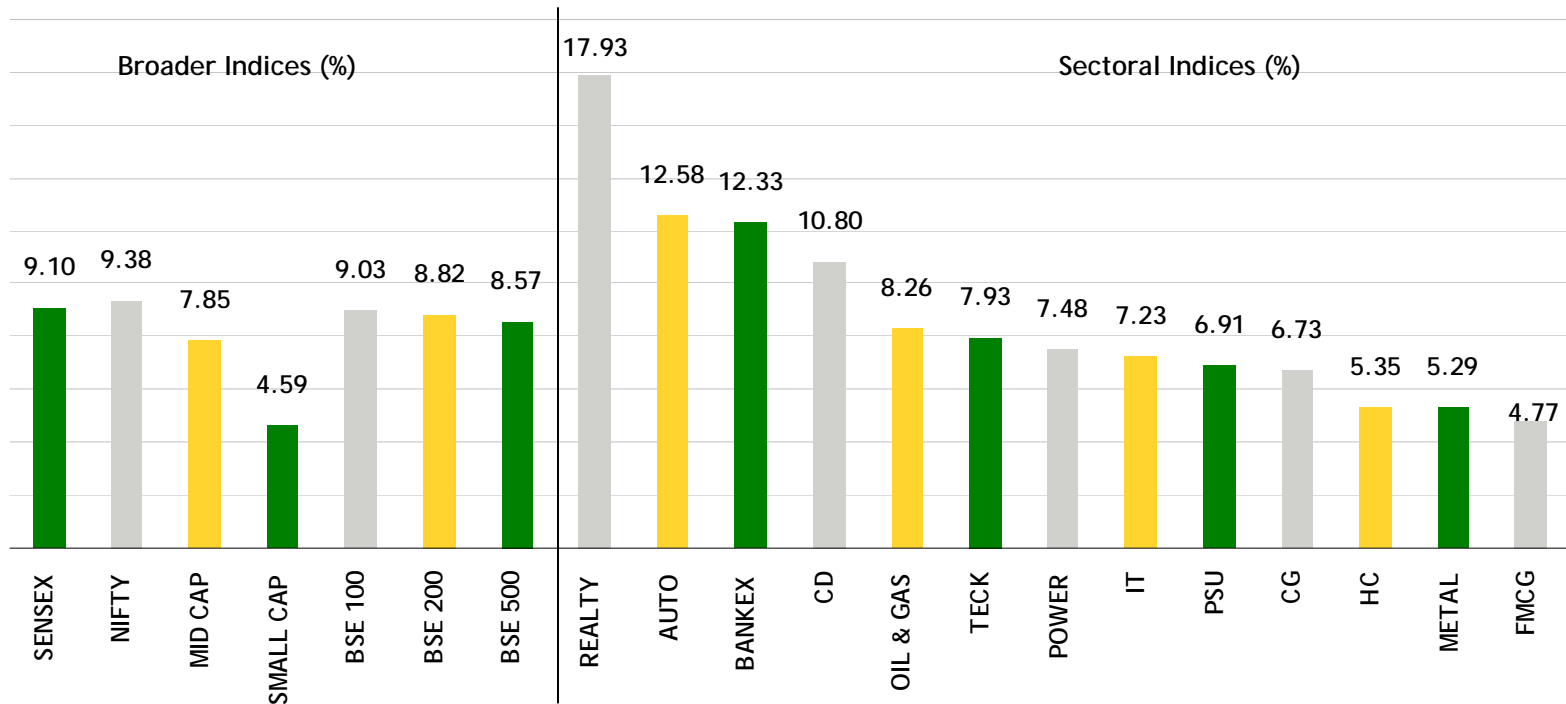
Global Equities

Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	2928.11	0.79%	4.27%	EM - Asia
BSE Sensex	India	19445.22	9.10%	-5.19%	EM - Asia
Kospi	South Korea	2106.70	8.63%	2.72%	EM - Asia
Taiwan Weighted	Taiwan	8683.30	0.97%	-3.22%	EM - Asia
Thailand SET 50 Index	Thailand	735.98	6.53%	2.19%	EM - Asia
Jakarta Composite Index	Indonesia	3678.67	6.00%	-0.67%	EM - Asia
KLSE	Malaysia	1545.13	3.61%	1.73%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	68586.70	1.79%	-1.04%	EM
Mexico IPC	Mexico	37440.51	1.14%	-2.88%	EM
Russian RTS Index	Russia	2044.20	3.77%	15.33%	EM
Philippine PSEi	Philippines	4055.14	7.66%	-3.48%	EM
Merval Buenos Aires Index	Argentina	3388.03	-1.96%	-3.85%	EM
HangSeng	Hong Kong	23527.52	0.81%	2.14%	Developed - Asia
Nikkei	Japan	9755.10	-8.18%	-4.63%	Developed - Asia
Strait Times	Singapore	3105.85	3.17%	-2.64%	Developed - Asia
Dow Jones	USA	12319.73	0.76%	6.41%	Developed
CAC 40 Index	France	3989.18	-2.95%	4.85%	Developed
All Ordinaries Index	Australia	4928.60	0.12%	1.69%	Developed
DAX Index	Germany	7041.31	-3.18%	1.84%	Developed
Swiss Market Index	Switzerland	6357.55	-3.83%	-1.22%	Developed
FTSE 100	UK	5908.76	-1.42%	0.15%	Developed
MSCI World Index	--	1334.93	-1.24%	4.29%	--

* as on 31st March. Source : Bloomberg
EM – emerging markets, Developed – developed markets.



India : Sector performances



- Sensex rose by 9.1% over the previous month.
- MidCaps underperformed LargeCaps with a 7.85% gain for the MidCap index.
- Realty, Auto and Banking were the best performing sectors.
- FMCG and Metals sectors delivered the worst return for the month.

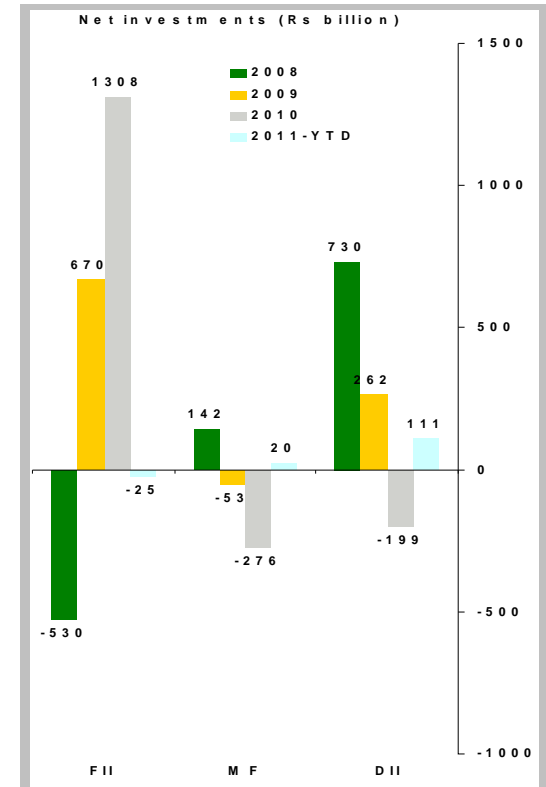
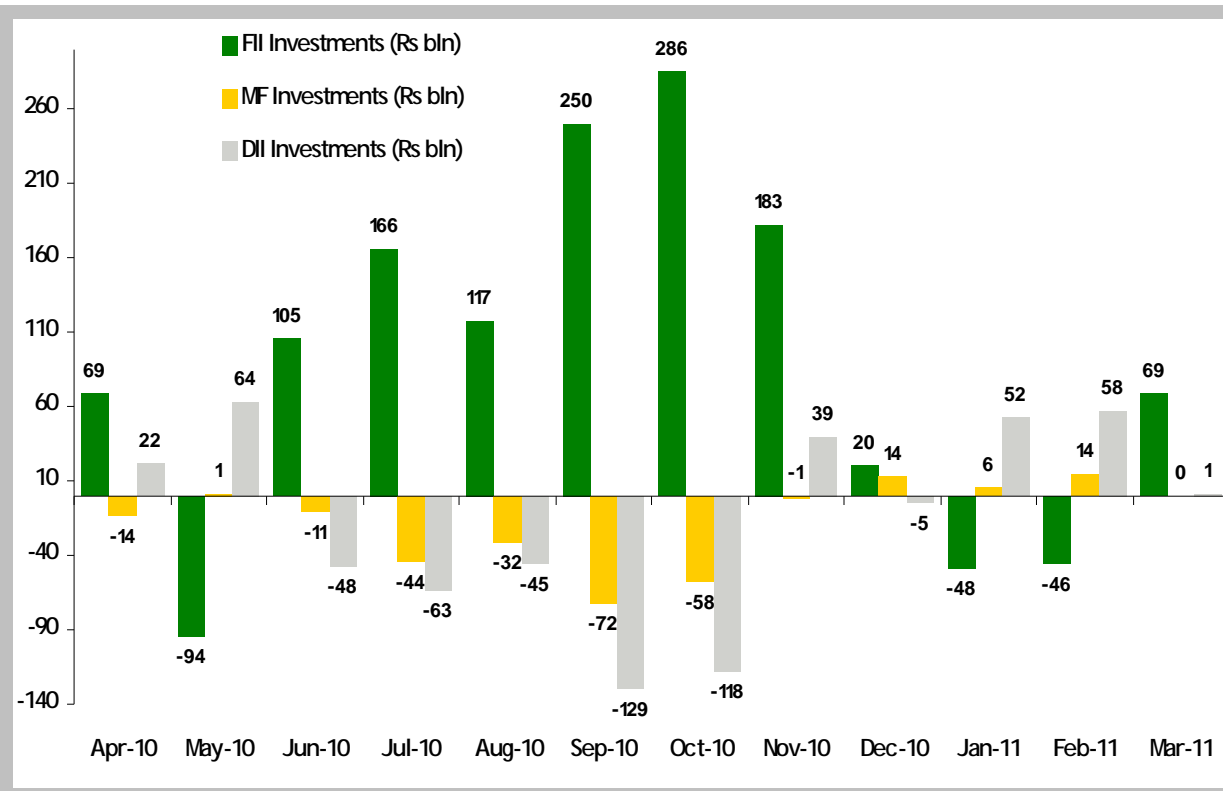
*Source: BSE,NSE. one month performance as on 31st March 11.

Top Gainers / Losers - Nifty

Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
DLF	397.5 / 208.5	268.55	26.76%
Rel. Comm.	207.8 / 84.25	107.65	25.54%
Ambuja Cem.	166.8 / 102.05	147.4	25.07%
Reliance Capital	882.3 / 388.4	583.15	22.65%
JP Associates	162.9 / 70.05	92.8	20.21%
Top Losers for the month			
Losers	52 week H/L	Last Price#	% Loss*
Hind. Unilever	329.9 / 220.7	287.1	1.81%
Tata Steel	739 / 449.1	622.25	2.49%
Ranbaxy Labs.	624.2 / 403.15	445.6	2.52%
Power Grid Corpn	120.5 / 91.8	101.9	2.98%
B H E L	2694 / 1901	2062.65	3.08%

closing price as on 31st March 2011.* one month performance as on 31st March 2011.
Source: Capitaline

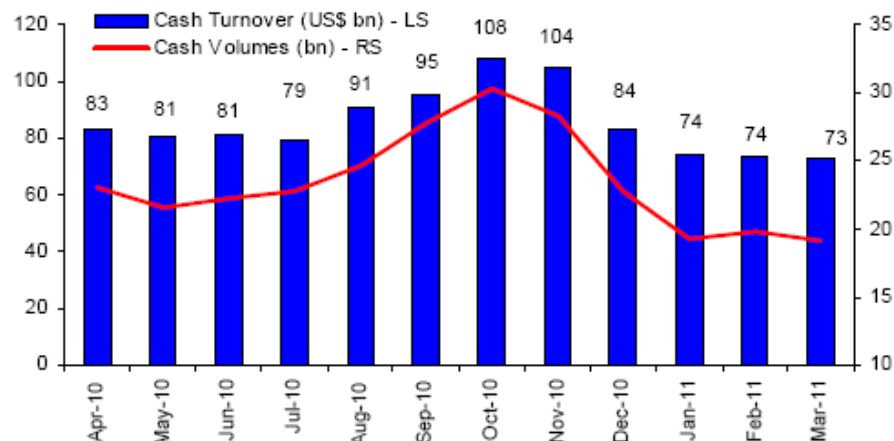
FII & DII Inflows



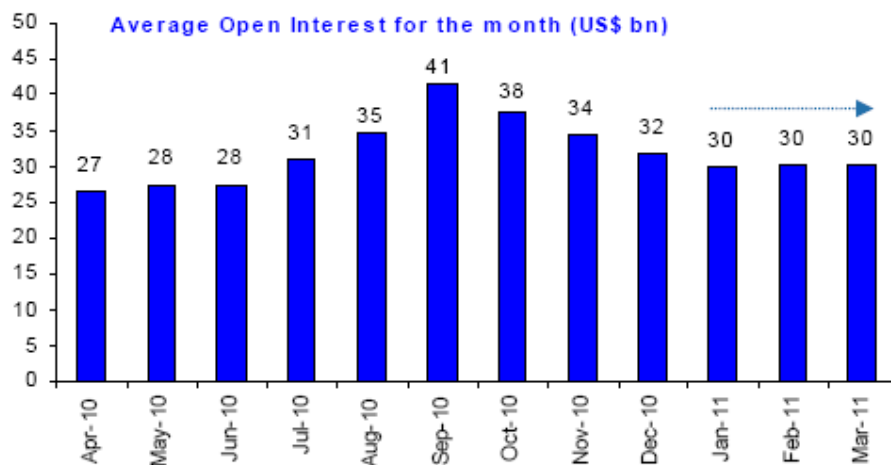
- FII outflows reversed in March, with FII flows turning positive at Rs.69bn in March 2011. FII outflows were at Rs.25bn for CY11 after a Rs.1308bn inflow in CY10 and Rs.670bn inflow in CY09.
- DIIs recorded marginal inflows of Rs.1bn. MF net buys almost equaled net sells during the month.



Market Activity



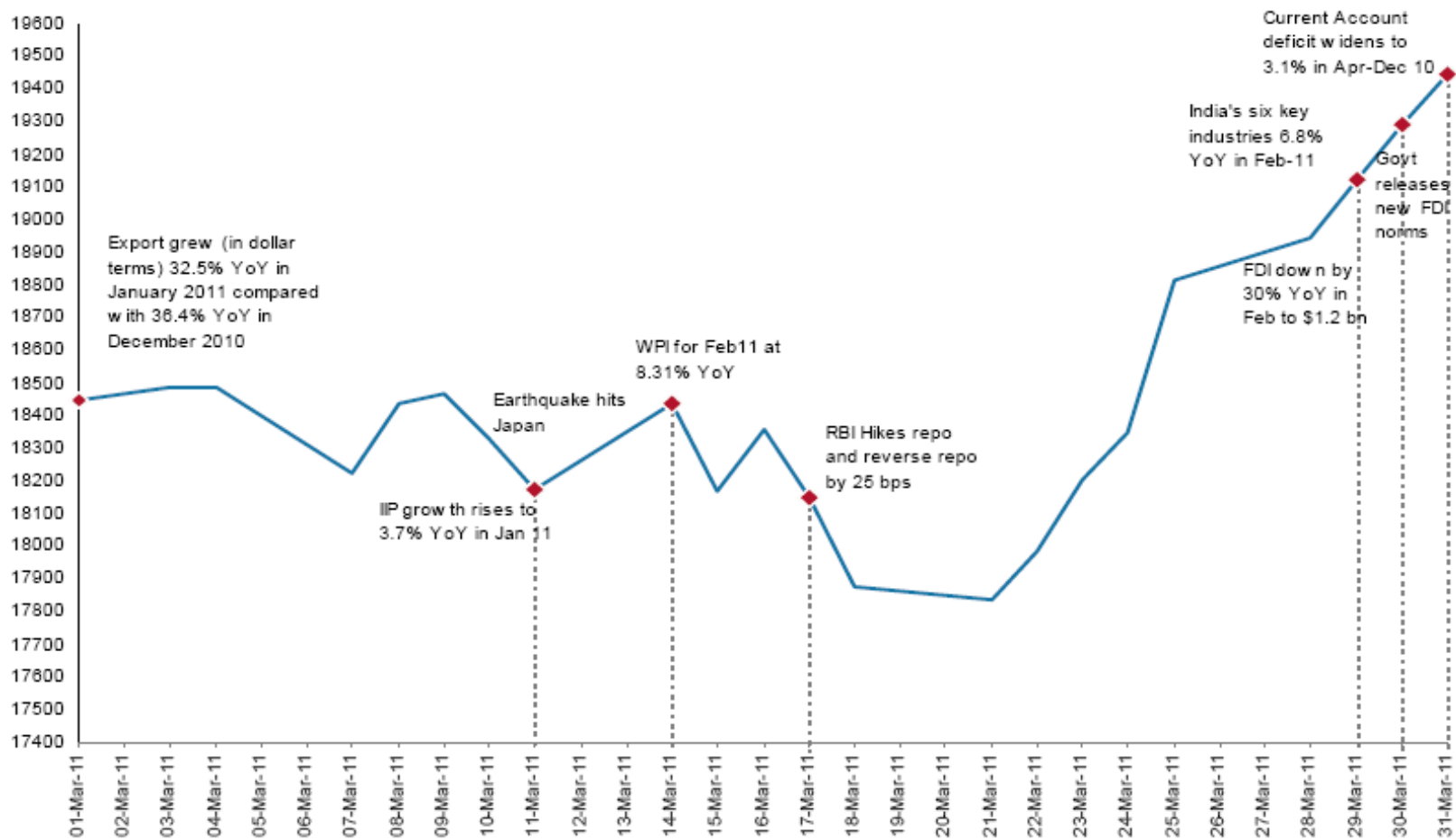
- In March 2011, cash trading turnover (US \$bn) declined 1.4% MoM.



- At the end of March 2011, average open interest remained flat MoM.



March 2011 events timeline



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

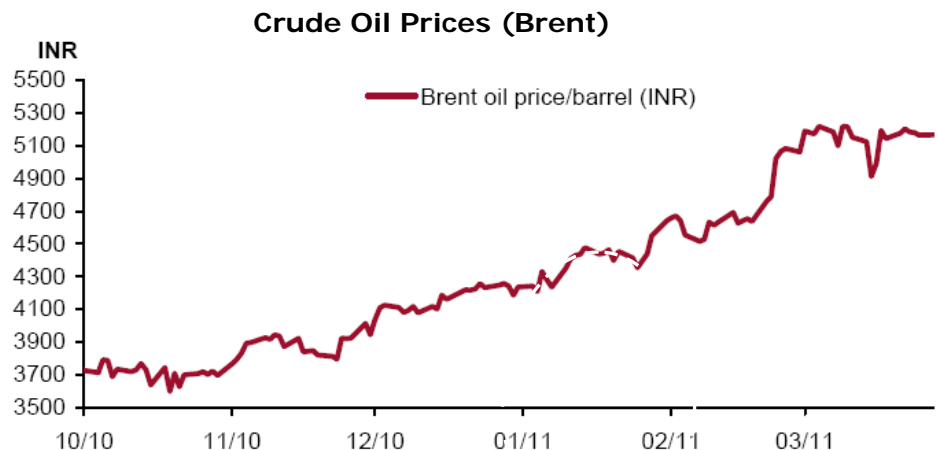


Religare MF: Equity Market Outlook and Opportunities

Equity Market Outlook

- 'Jasmine Revolution' has resulted in an increase in geopolitical tensions, which in turn has led to a spiking of crude oil prices. Crude is now up more than 35% since November 2010, and is showing no signs of abating.
- Crude Oil is not only an important fuel for industry and transport, but is also an important raw material for a host of downstream industries. Such a rise in raw material and freight cost is expected to threaten the global economic growth.
- Back home in India, WPI Inflation has proved far more sticky, falling to just 8.3% yoy and may probably be revised upwards by about 0.5 percentage points over the next couple of months.
- A silver lining amid this gloom is the shrinking of the current account deficit, which narrowed to 2.4% of GDP in QE-Dec 10 compared with a deficit of 4.3% in QE- Sep 10, with the improvement being led largely by a sharp rise in exports.
- Net foreign equity fund flows at US \$1.5bn have turned positive in March, after remaining negative for the previous two months of the calendar year 2011.
- Sensex (ex-oil) earnings growth is expected to slow down to 10.8% YoY in the January–March quarter 2011, backed by strong sales growth of ~17%, but with deteriorating margins.
- Consensus expects a 19% growth in FY12E Sensex EPS over FY11 and a 18% growth in FY13 Sensex EPS over FY12.
- However, we see cuts to FY12 and FY13 earnings estimates after the March reporting season and our back of the envelope calculation suggests FY12 earnings growth at 15% vs. consensus at 19%.

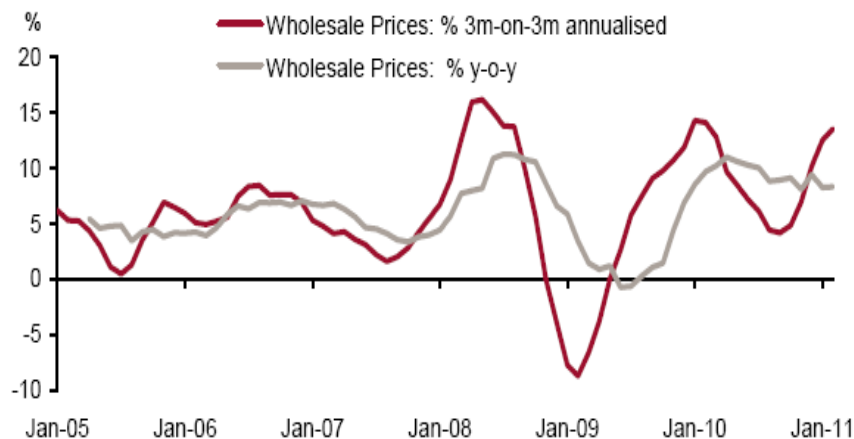
Crude Continues To Boil - Exposing Risks To Global Economic Growth



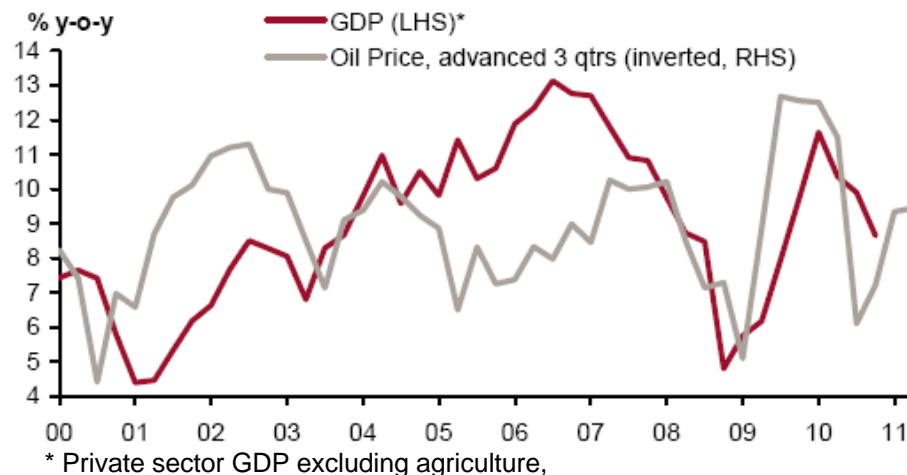
- 'Jasmine Revolution' in Tunisia a few months ago which led to the collapse of the government continues to spread. It has already spread to Egypt, Libya, Yemen, Bahrain and threatens to destabilize the political regime in many other countries as well
- Such geopolitical tensions have resulted in spiking of crude oil prices. Crude is now up more than 35% since November 2010, and is showing no signs of abating.
- Crude Oil is not only an important fuel for industry and transport, but is also an important raw material for a host of downstream industries.
- Such a rise in raw material and freight cost is expected to unleash inflation upon consumers resulting in demand destruction as well as may result in a decline in corporate profit margins globally. All the above, of course, works vice-versa also.

Crude May Impact Inflation And Ultimately GDP Growth

Inflation



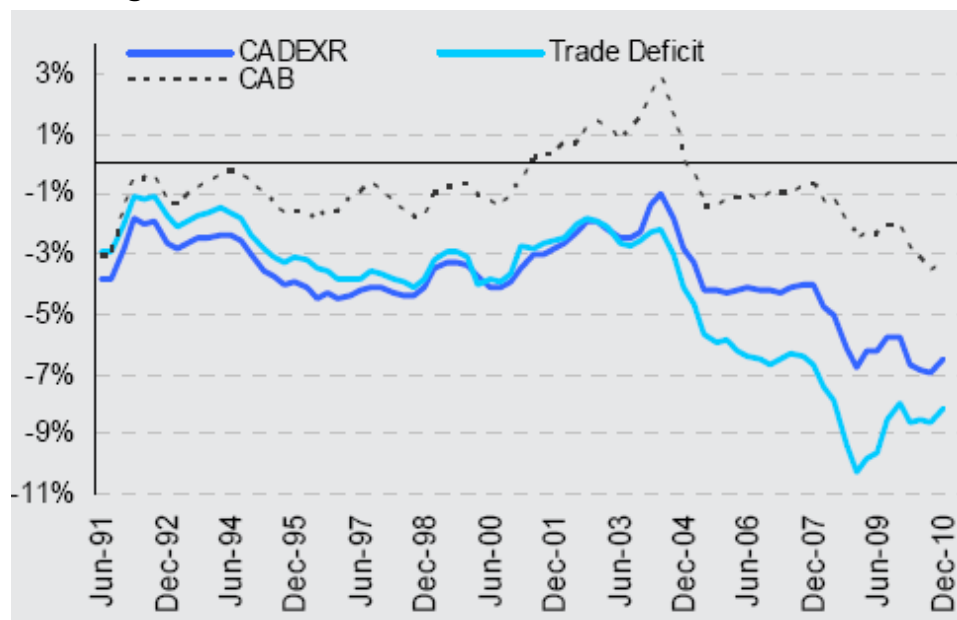
GDP Correlation to Oil Prices



- WPI Inflation has proved far more sticky, falling to just 8.3% year-on-year in the latest number for March (which, if recent trends are any guide, will probably be revised around 0.5 percentage points higher over the next couple of months).
- Even the RBI in its policy statement has continued to revised upwards the expected inflation.
- If the crude prices stay at current levels, it may also result in a downward revision of the GDP growth for FY12E.

Current Account Deficit Narrows Despite Increase In Crude Oil Prices

Trailing 4-Quarters Trade and Current Account Balance (As % of GDP)

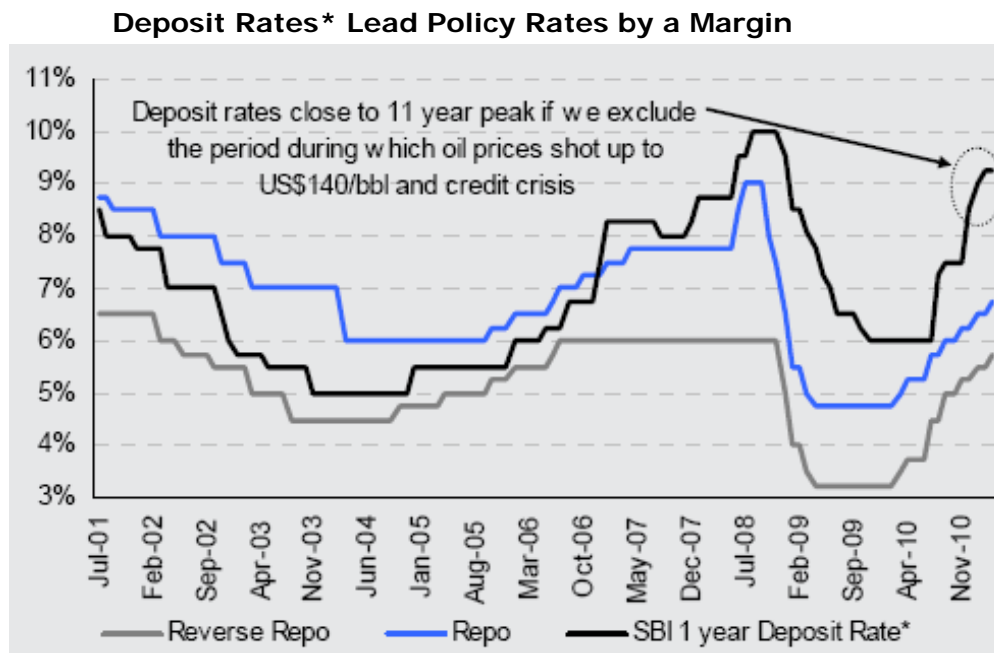


CADEXR = Current Account Deficit Excluding Remittances;

- The current account deficit narrowed to US\$9.7bn (2.4% of GDP, annualized) in QE-Dec 10 compared with a deficit of US\$16.8bn (4.3% of GDP, annualized) in QE- Sep 10.
- The Trade deficit also narrowed to US\$31.6 bn (7.7% of GDP, annualized) during QE- Dec 10 despite higher crude oil prices, due to higher export growth.
- Net invisibles growth was also at a higher 17%YoY during QE-Dec 10 compared with a growth of 2.9%YoY in the previous quarter.

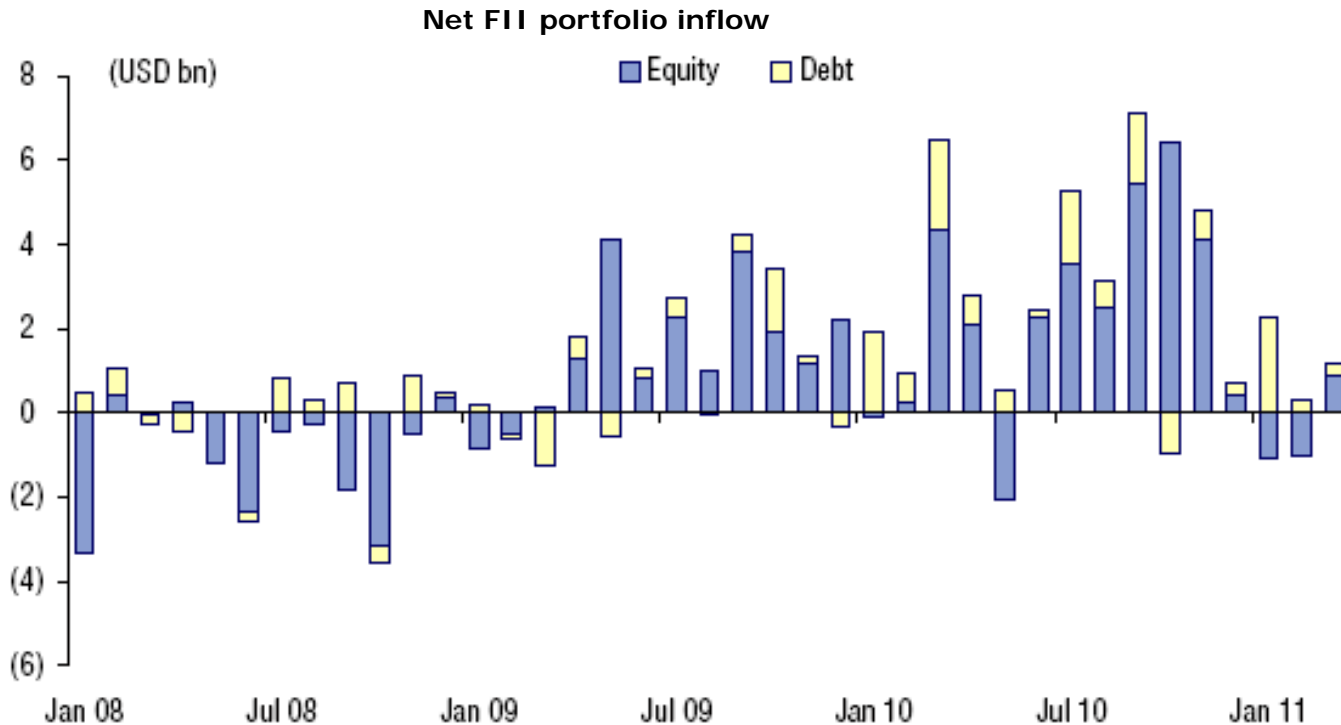


Monetary Policy - Turning Hawkish



- The Reserve Bank of India (RBI) in its mid-quarter review of monetary policy hiked the repo rate and the reverse repo rate by 25bps to 6.75% and 5.75%, respectively.
- The Central Bank is now decidedly hawkish as is evident in its conclusive statement “Based on the current and evolving growth and inflation scenario, the Reserve Bank is likely to persist with the current anti-inflationary stance”.

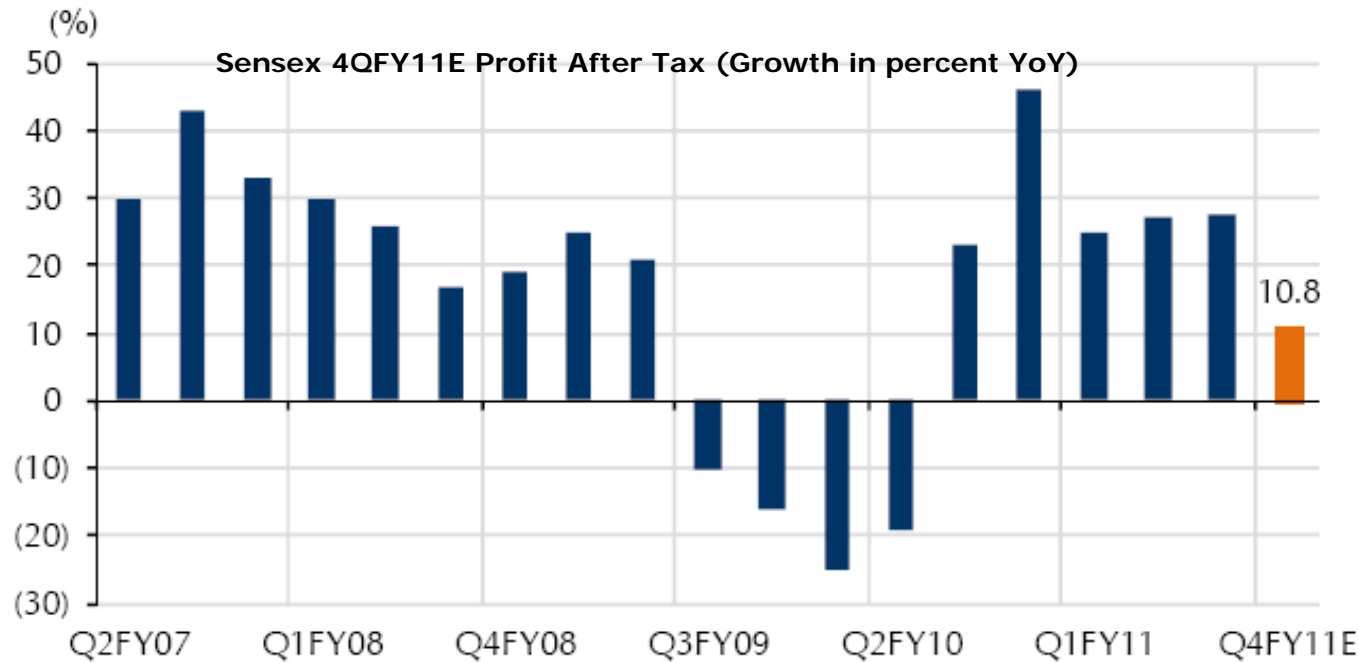
Foreign Fund Flows Back To India



- Net foreign equity fund flows have turned positive in March, after remaining negative for the previous two months of the calendar year 2011. Total FII inflows in March were to the tune of \$1.5bn.
- We believe a large portion of the inflow may be increasing in India dedicated Exchange Traded Funds (ETF) inflows.

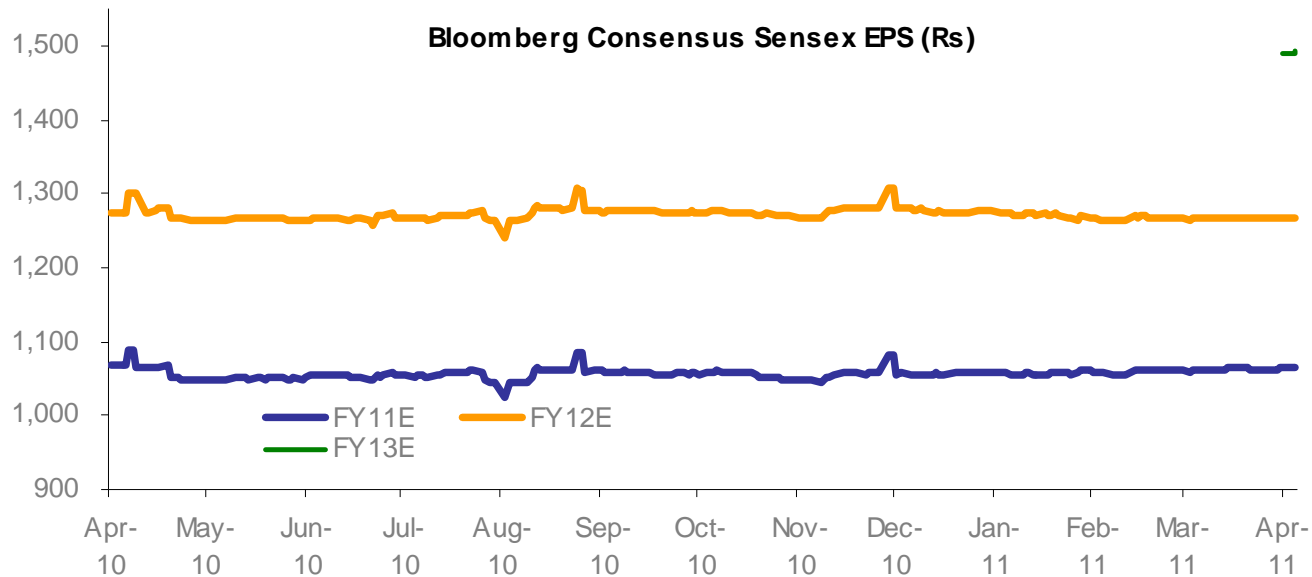


Earnings Season - Q4FY11 Preview



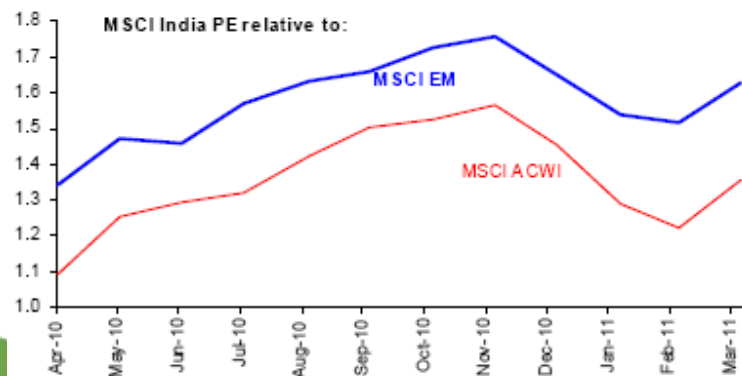
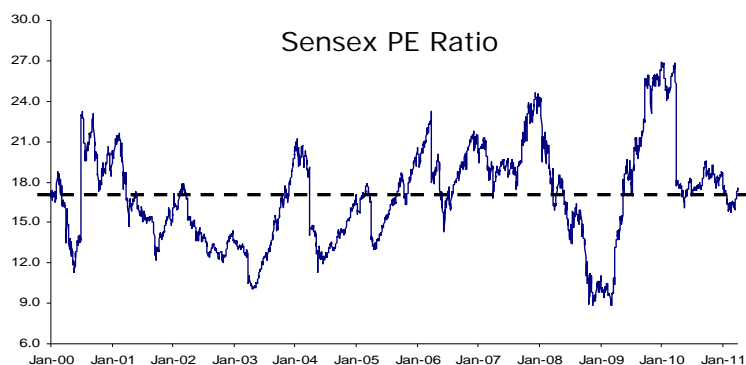
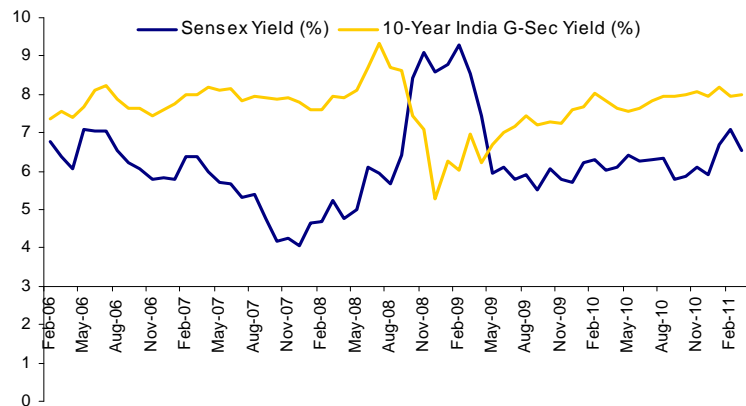
- Sensex (ex-oil) earnings growth is expected to slow down to 10.8% YoY in the January–March quarter 2011, backed by strong sales growth of ~17%, but with deteriorating margins.
- Margins would likely get weaker for the broader market due to lower pricing power in smaller companies.
- Stubborn input costs mean that margin pressures are unlikely to abate soon, even as sales growth remains robust, riding on strong aggregate demand in the broad economy.

Earnings Forecasts-unchanged over the earnings season



- Consensus earnings expectations for Sensex companies for FY11 and FY12 are largely unchanged for the month.
- Consensus expects a 19% growth in FY12E Sensex EPS over FY11 and a 18% growth in FY13 Sensex EPS over FY12.
- We see cuts to FY12 and FY13 earnings estimates after the March reporting season and our back of the envelope calculation suggests FY12 earnings growth at 15% vs. consensus at 19%.

Valuations - Corrected Materially



- The gap between Sensex earnings yield and bond yield has increased substantially by 60 basis points over the previous month due to the material decline in Sensex earnings yield.
- Sensex is currently trading at 17.5x its trailing earnings. It is now 3% higher than its historical 10-year average trailing PE of 17x.
- India's PE premium to MSCI Emerging markets has increased from its recent lows, and it is now at around 60% premium to MSCI EM PE currently.



Looking Ahead...

- Key headwinds facing India include tightness in domestic liquidity and hardening in commodity prices, which though transient, have ended the 'sweet spot' scenario that prevailed for most of 2010.
- Governance issues in companies and the government have been in the limelight in recent months; this has certainly caused sentiment among investors and business to deteriorate and slowed the pace of decision making.
- In CY2011, India faces similar risks (as most emerging markets) in the form of higher inflation and the impact of a global rally in commodity prices.
- In its latest monetary policy review, the RBI increased the repo rate (at which banks borrow from the RBI) and the reverse-repo rate (at which banks park money with the RBI) by 25bps each.
- We expect rate hikes to continue and expect further 25 to 50 basis points of rate action this year.
- An important structural macro data has been the increase in tax collections from the services sector, which are now equal to the manufacturing sector. Thus, increasingly the tax collection pattern is reflecting the GDP composition, which is by the services sector.
- The structural India growth story remains unchanged and 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.

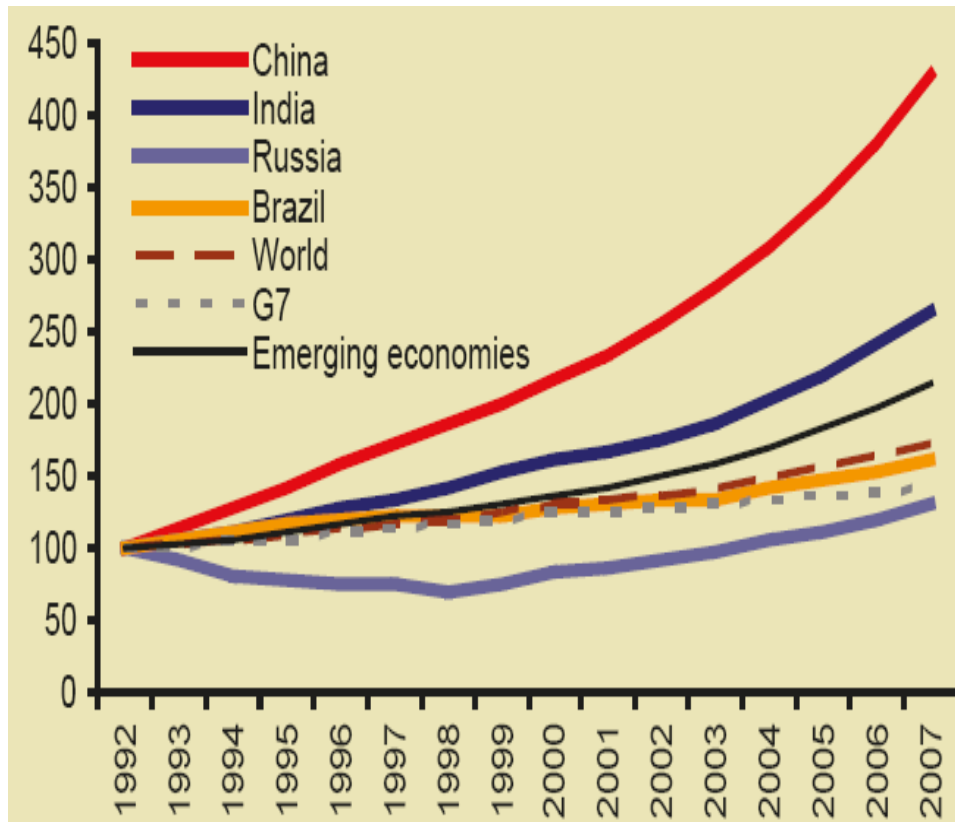
Strategy for investors

- 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

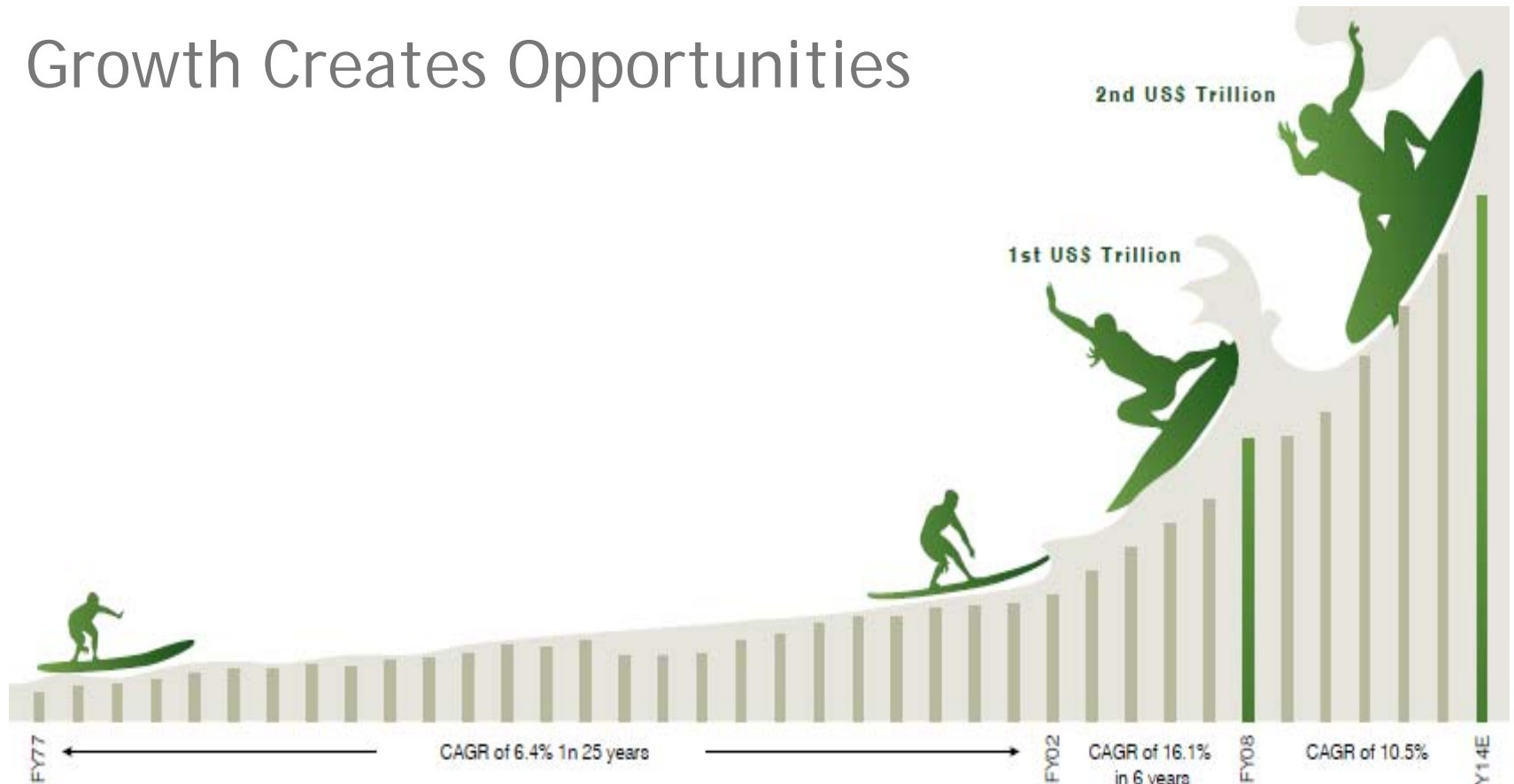
GDP growth rebased to 1992



Source: IMF, IIFL Research

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

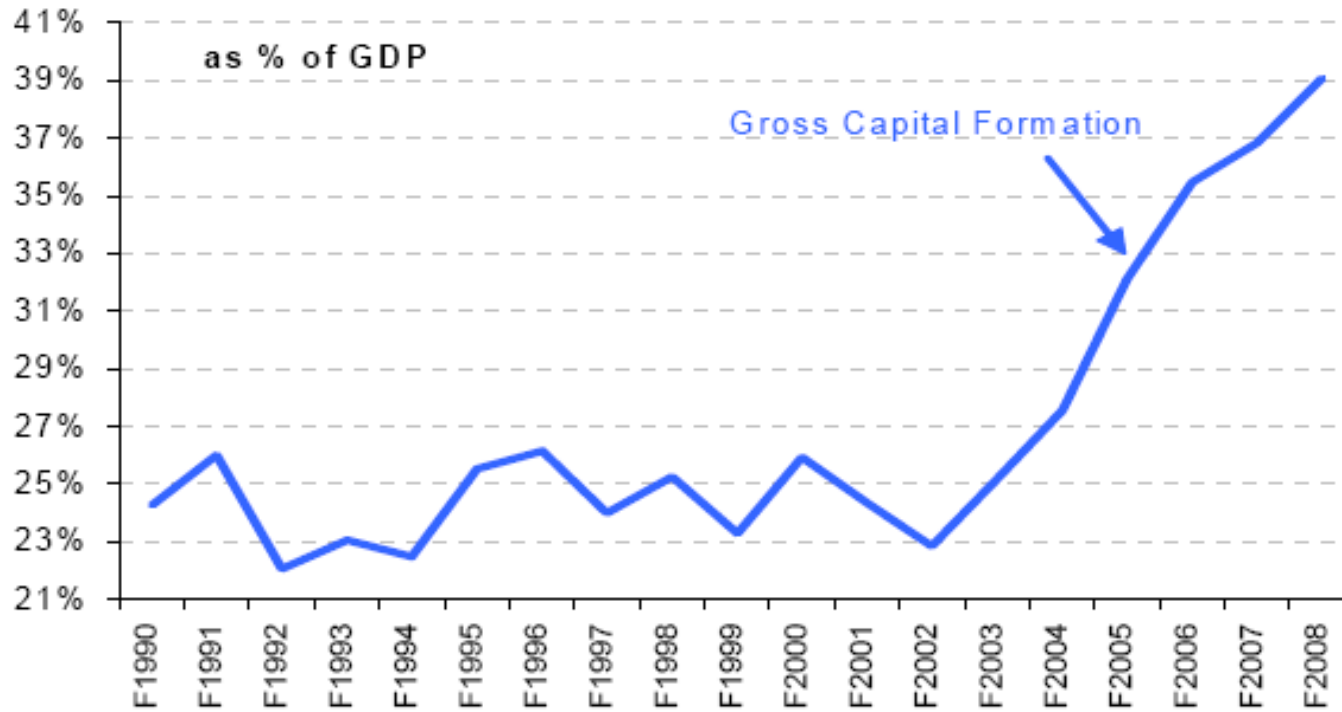
Growth Creates Opportunities



- 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

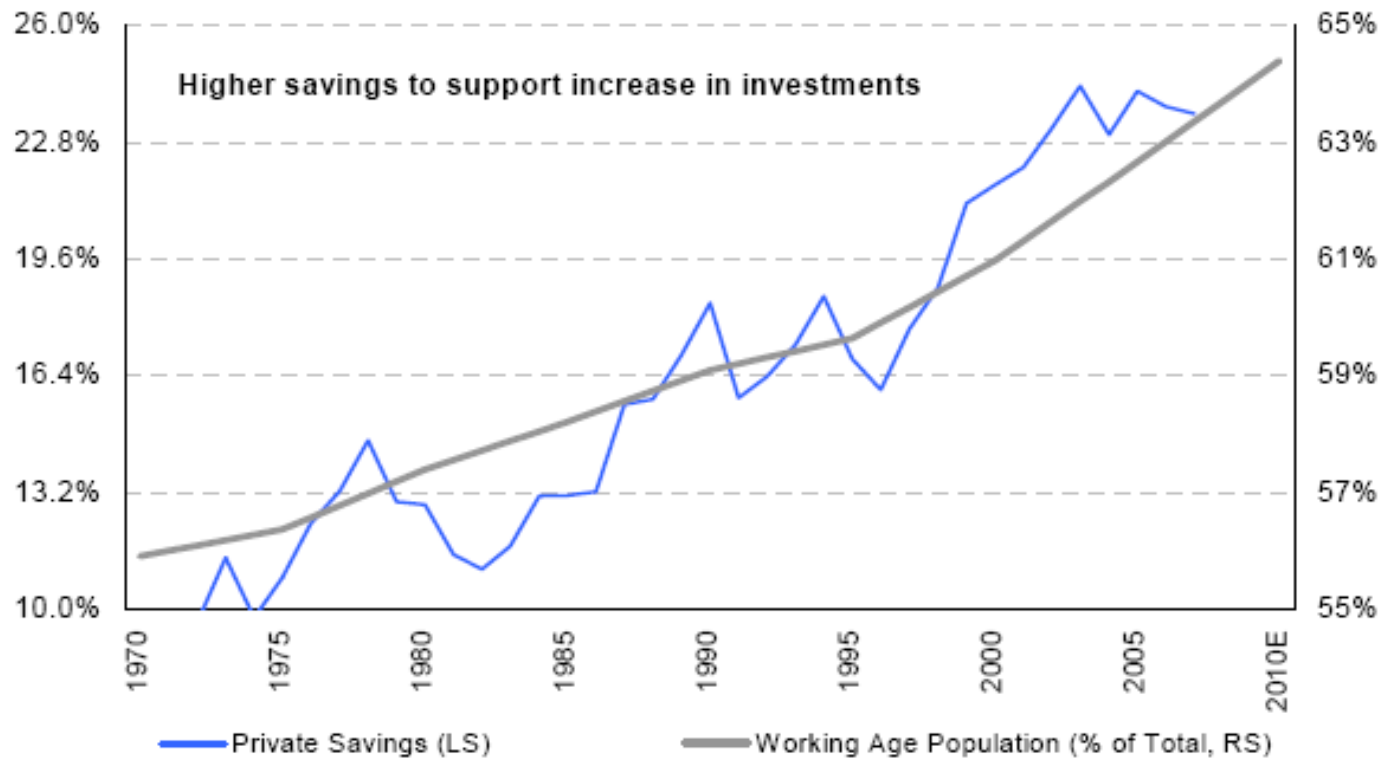


Growth Is Being Led By A Rise In Capital Formation...



Source: CSO, Morgan Stanley Research

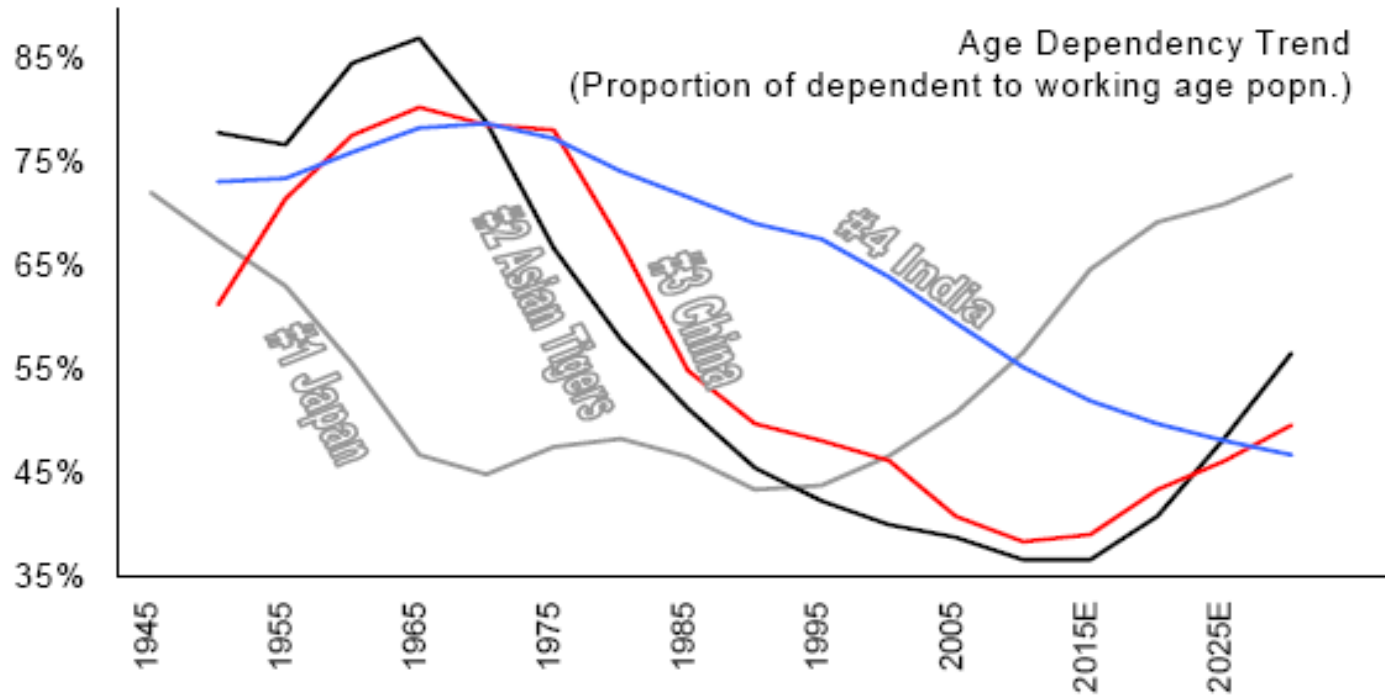
...Which Is Supported By A High Savings Rate



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

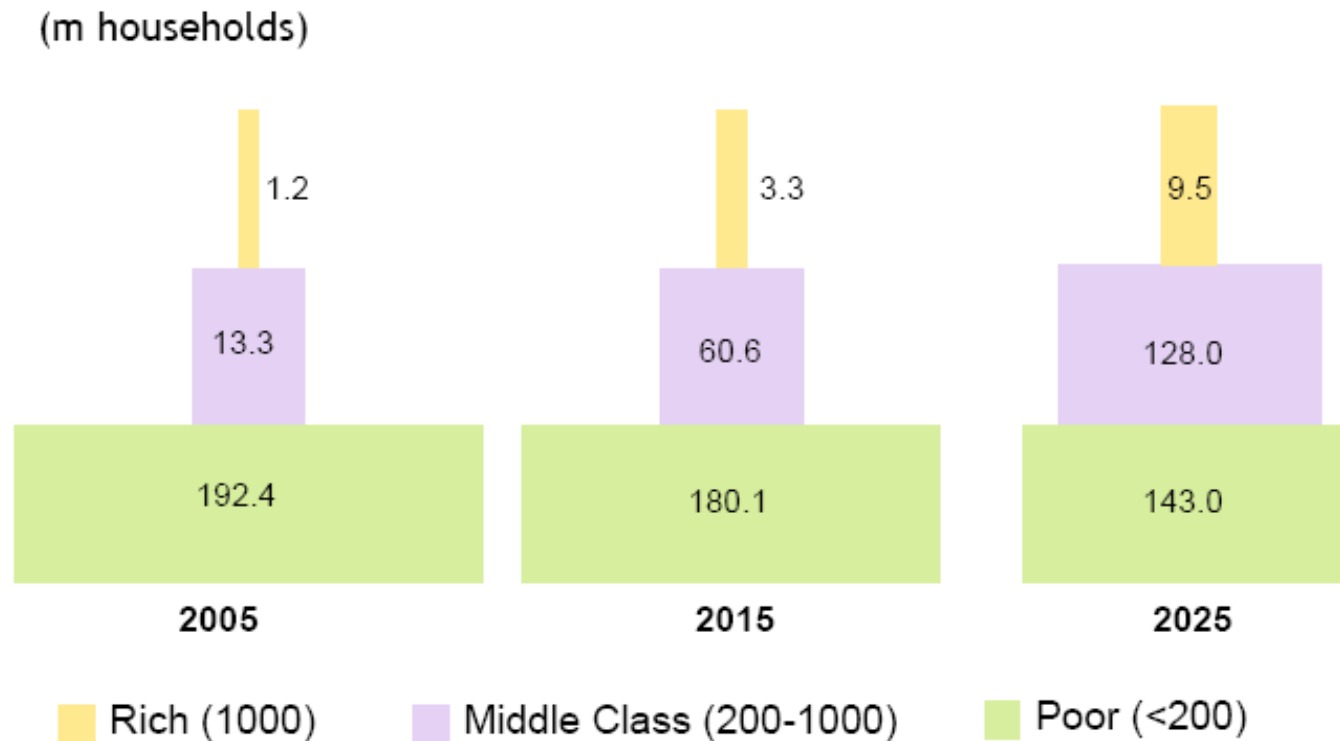


India Is Poised To Reap Rich Demographic Dividend In Years To Come



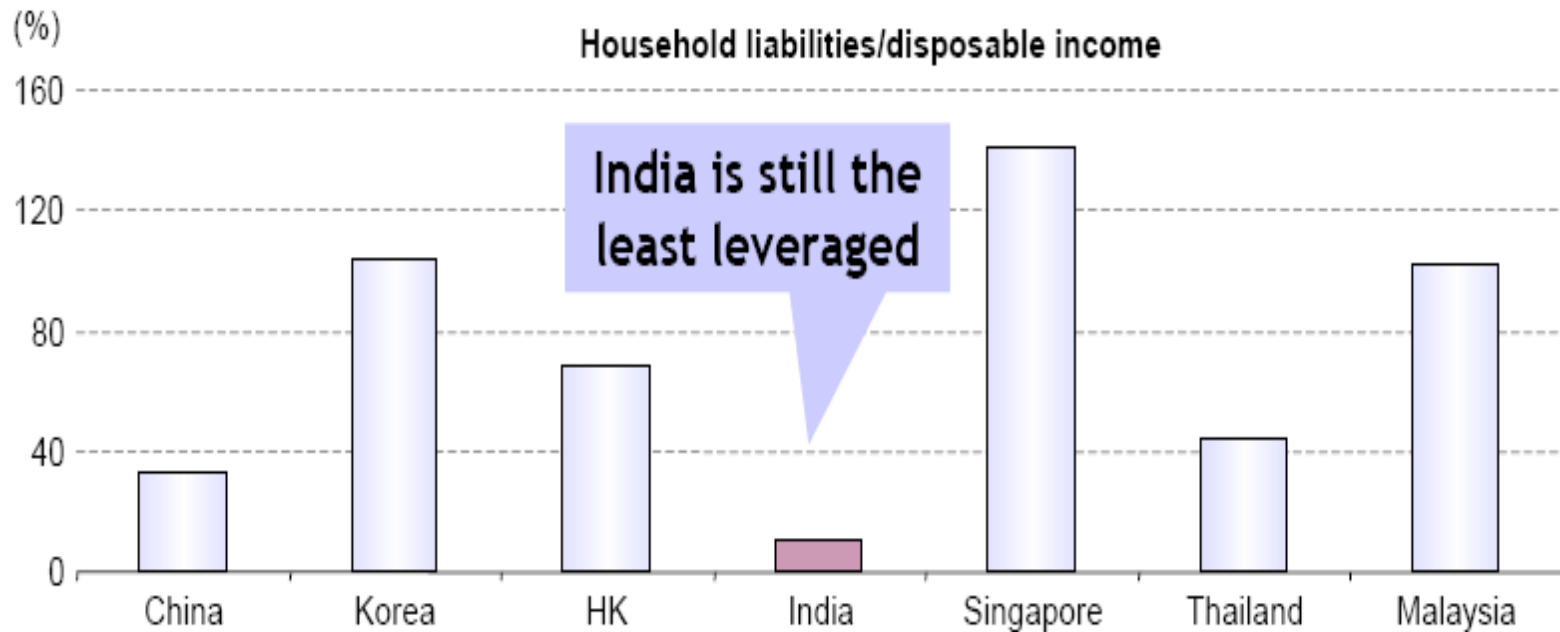
E= United Nations Research estimates Source: UN, Morgan Stanley Research

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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