

Equity Markets : Current Environment and Outlook

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Current Environment

- Global Equity markets remained bearish in May, with the MSCI World Index falling by 2.45%.
- Indian markets underperformed the global markets, falling by 3.31% in the month of May.
- Commodity price indices corrected sharply, with the benchmark CRB Reuters Jefferies total return index falling by 6%.
- FMCG and Healthcare were the best performing sectors, while Metals, Auto and Oil & Gas sectors delivered the worst return for the month.
- FII outflows during the month were at Rs.66bn. DIIs recorded inflows of Rs.41bn, while MF's were net buyers at Rs.4bn during the month.
- Trading Activity remained subdued in April, with both the cash trading turnover (US \$bn) and the average open interest declining by 3% MoM.

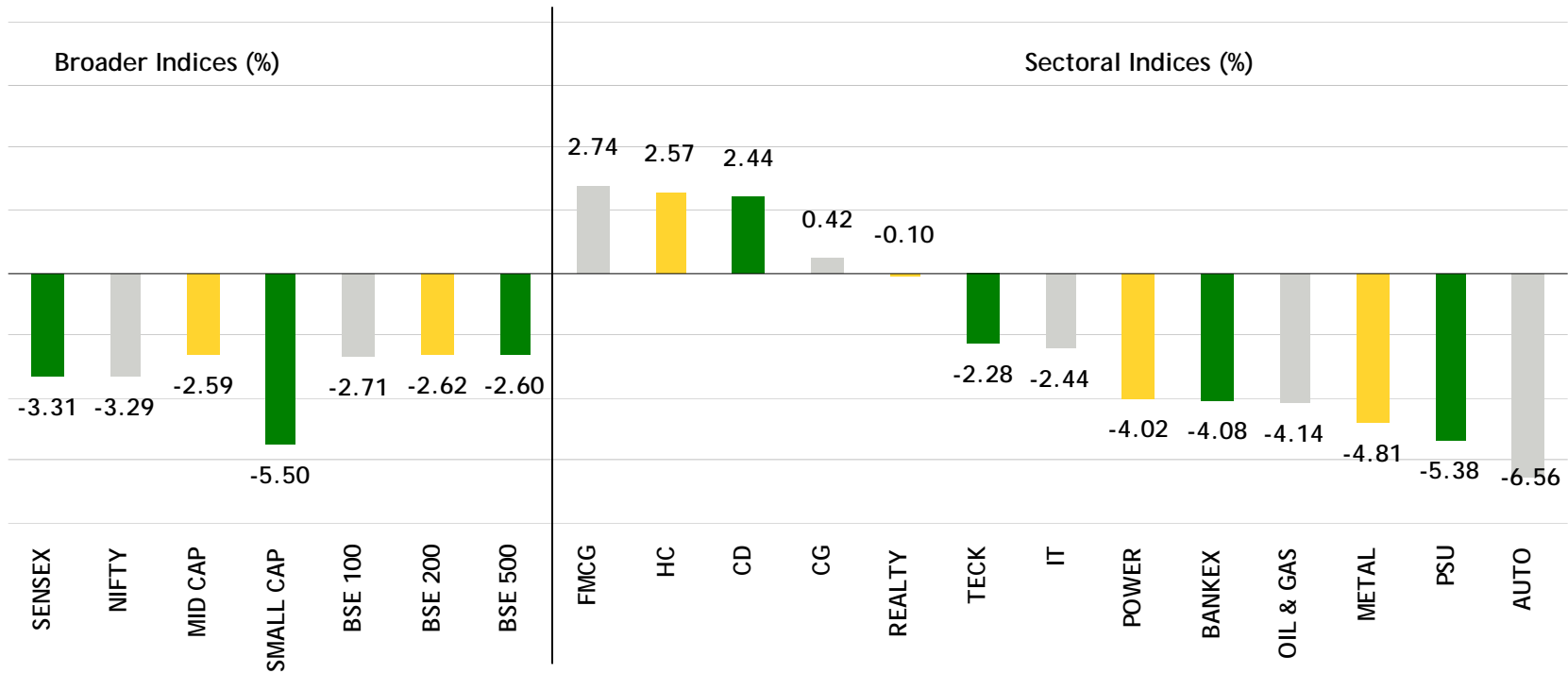
Global Equities

	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	2743.47	-5.77%	-2.30%	EM - Asia
BSE Sensex	India	18503.28	-3.31%	-9.78%	EM - Asia
Kospi	South Korea	2142.47	-2.28%	4.46%	EM - Asia
Taiwan Weighted	Taiwan	8988.84	-0.21%	0.18%	EM - Asia
Thailand SET 50 Index	Thailand	754.08	-2.16%	4.71%	EM - Asia
Jakarta Composite Index	Indonesia	3836.97	0.45%	3.60%	EM - Asia
KLSE	Malaysia	1558.29	1.52%	2.59%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	64620.08	-2.29%	-6.76%	EM
Mexico IPC	Mexico	35832.79	-3.06%	-7.05%	EM
Russian RTS Index	Russia	1888.60	-6.83%	6.55%	EM
Philippine PSEi	Philippines	4244.64	-1.73%	1.04%	EM
Merval Buenos Aires Index	Argentina	3250.91	-4.55%	-7.74%	EM
HangSeng	Hong Kong	23684.13	-0.15%	2.82%	Developed - Asia
Nikkei	Japan	9693.73	-1.58%	-5.23%	Developed - Asia
Strait Times	Singapore	3159.93	-0.63%	-0.94%	Developed - Asia
Dow Jones	USA	12569.79	-1.88%	8.57%	Developed
CAC 40 Index	France	4006.94	-2.43%	5.31%	Developed
All Ordinaries Index	Australia	4788.90	-2.25%	-1.20%	Developed
DAX Index	Germany	7293.69	-2.94%	5.49%	Developed
Swiss Market Index	Switzerland	6554.71	0.23%	1.84%	Developed
FTSE 100	UK	5989.99	-1.32%	1.53%	Developed
MSCI World Index	--	1354.61	-2.45%	5.82%	--

* as on 31st May 2011. Source : Bloomberg
EM – emerging markets, Developed – developed markets.



India : Sector performances



- Sensex fell by 3.31% over the previous month.
- MidCaps outperformed LargeCaps with a 2.59% loss for the MidCap index.
- FMCG and Healthcare were the best performing sectors.
- Metals, Oil & Gas and Auto sectors delivered the worst return for the month.

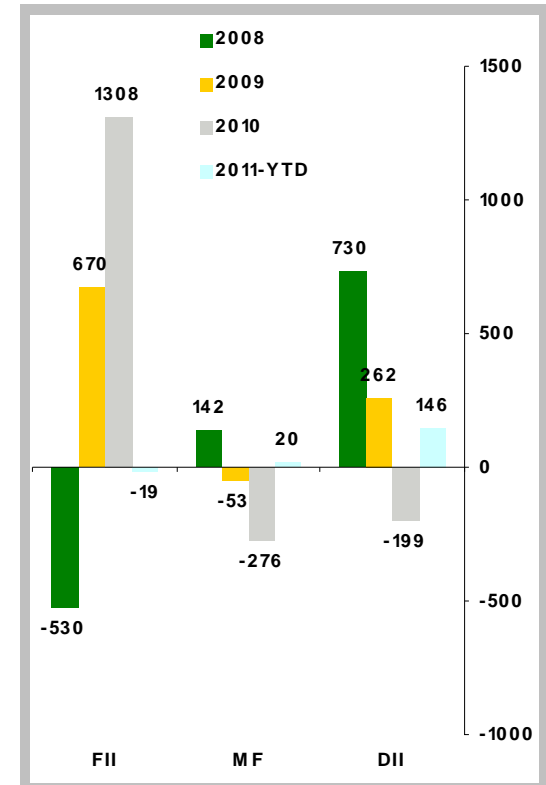
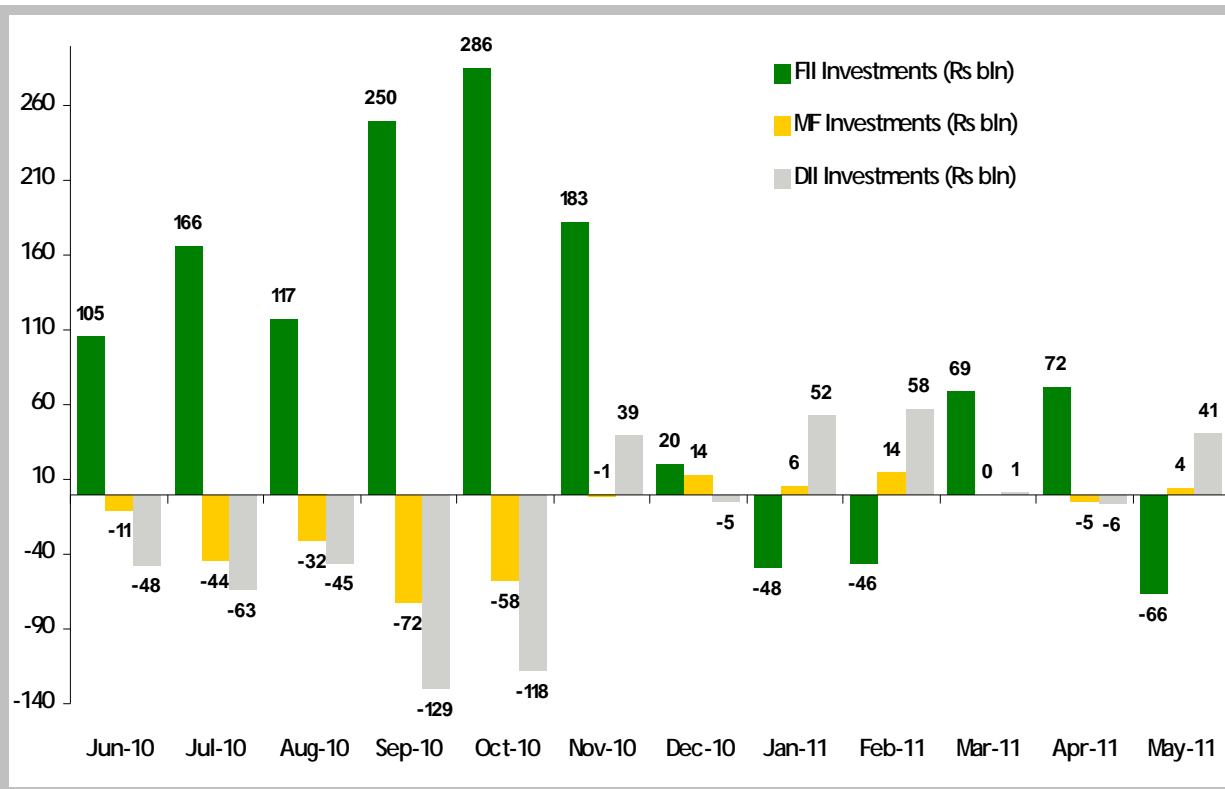
*Source: BSE,NSE. one month performance as on 31st May 11.



Top Gainers / Losers - Nifty

Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
St Bk of India	3515 / 2165	2297.95	22.05%
Reliance Infra.	1224 / 492.05	569.05	15.98%
Ambuja Cem.	166.8 / 105.55	138.75	14.02%
S A I L	234.35 / 138.4	140.60	13.30%
Tata Motors	1382 / 720.55	1095.30	12.92%
Top Losers for the month			
Losers	52 week H/L	Last Price#	% Loss*
Ranbaxy Labs.	624.2 / 413.5	551.90	-17.09%
Hero Honda Motor	2070 / 1375.75	1854.75	-7.80%
DLF	397.5 / 208.1	238.95	-6.76%
Hind. Unilever	329.9 / 232.35	304.55	-6.35%
Cipla	381 / 286.05	326.05	-5.08%

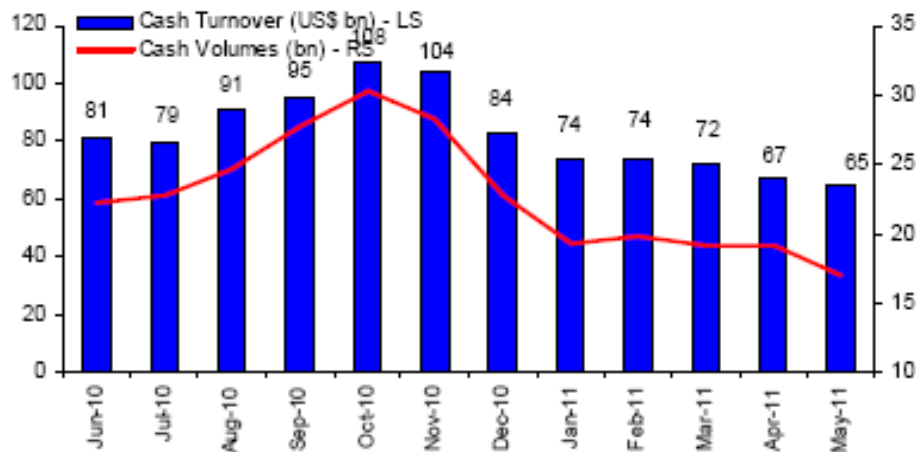
FII & DII Inflows



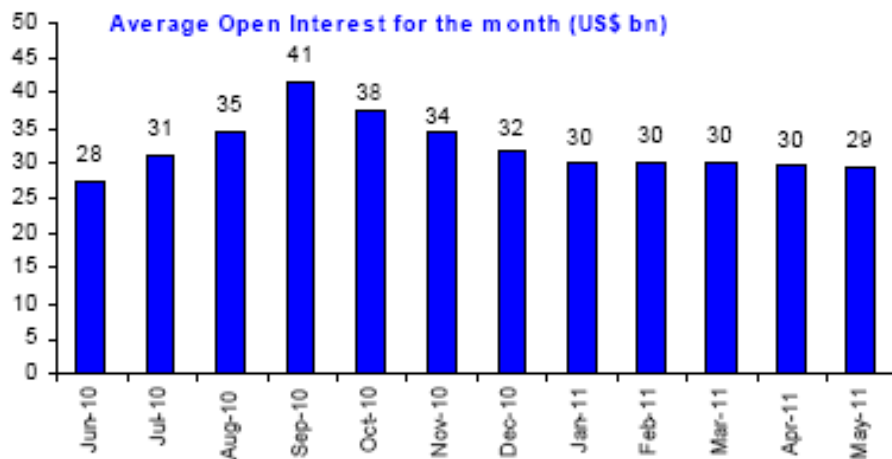
- FII outflows during the month were at Rs.66bn. FII outflows were at Rs.19bn for CY11 after a Rs.1308bn inflow in CY10 and Rs.670bn inflow in CY09.
- DII's recorded inflows of Rs.41bn. MF's were net buyers at Rs.4bn during the month.



Market Activity

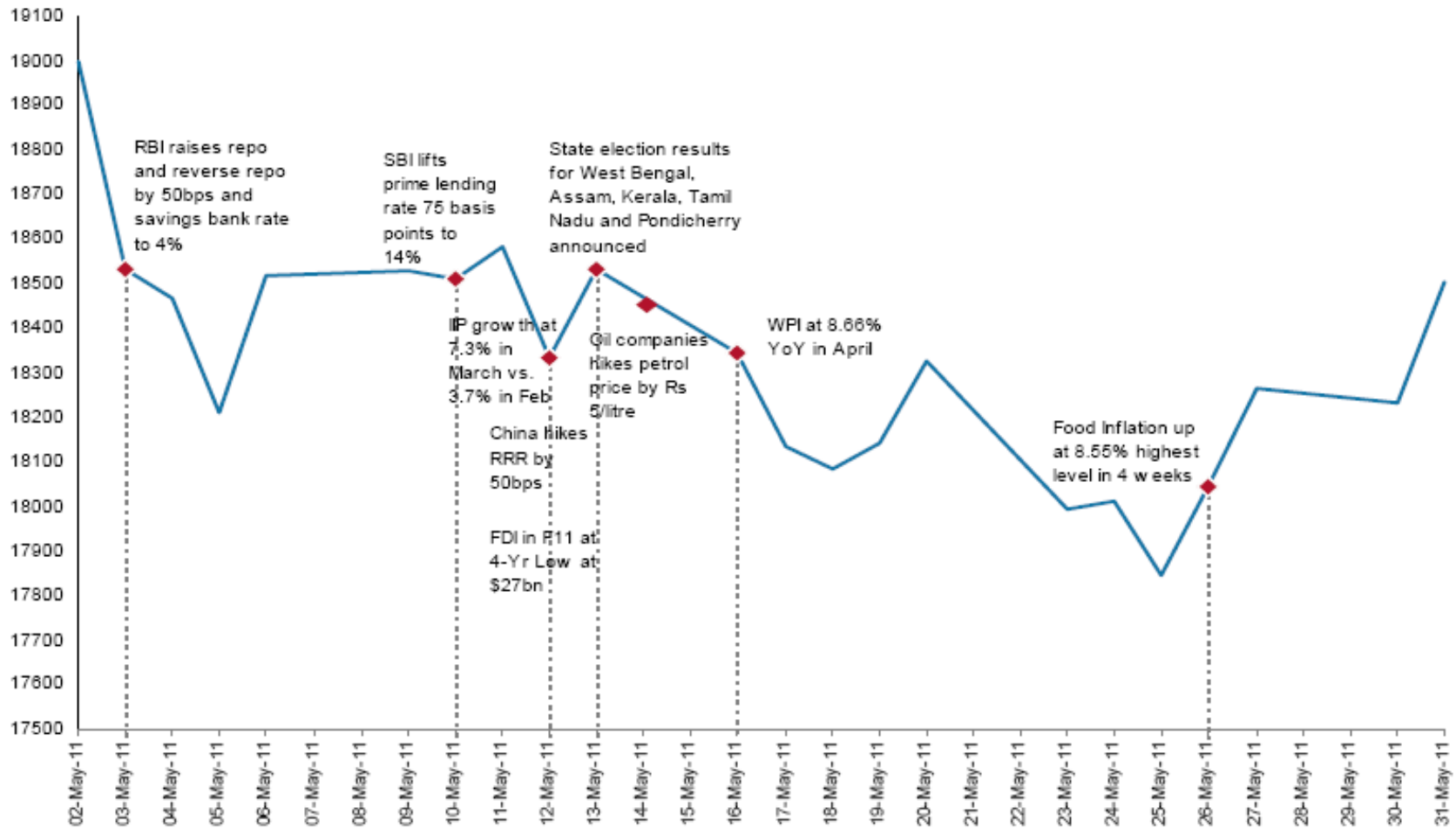


- In May 2011, cash trading turnover (US \$bn) declined marginally by 3% MoM.



- At the end of May 2011, average open interest declined 3% MoM.

May 2011 events timeline



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

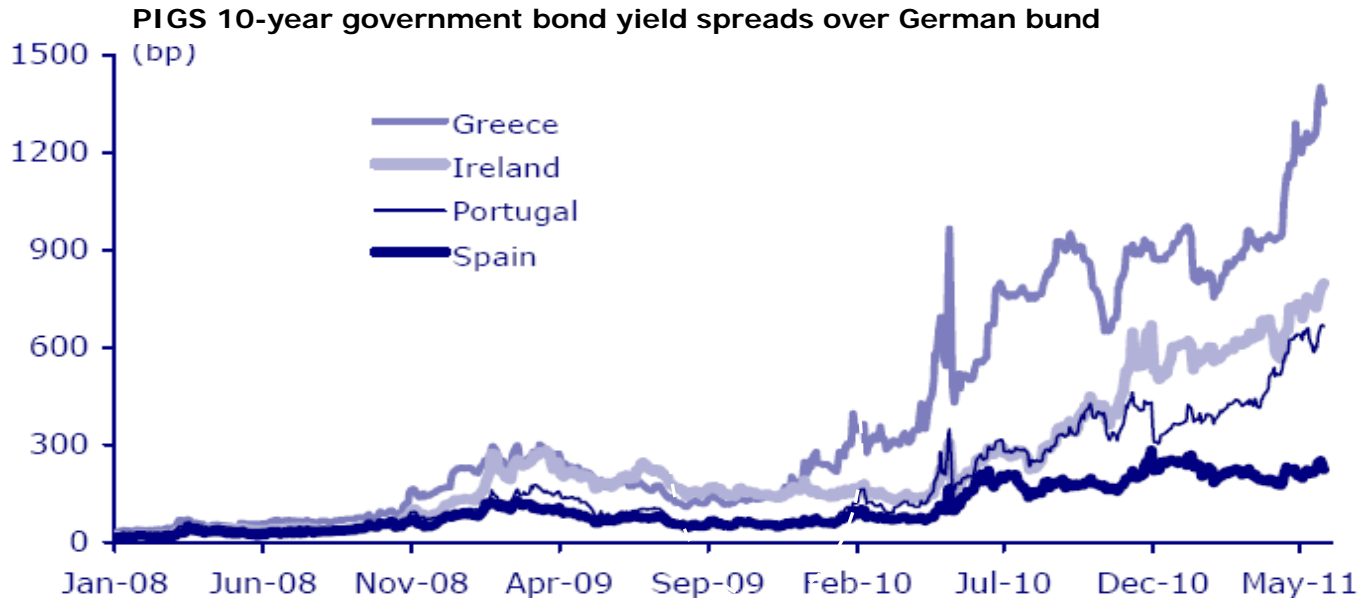


Religare MF: Equity Market Outlook and Opportunities

Equity Market Outlook

- European sovereign debt woes resurfaced during the month as Greece engaged with IMF and EU for a second massive refinancing of its debt. Greece has already been downgraded by Moody with its ratings implying a 50% chance of default.
- On the domestic front, India's 4QFY11 GDP came in at 7.8%, lower than expectations (Consensus 8.2%) and the 8.3% growth seen in 3QFY11.
- Slowdown in GDP was led by decline in investment demand, which commenced in 2QFY11 due to policy uncertainty, and continued in 4QFY11. Consumption trends remained broadly unchanged while net exports remained the key growth driver.
- The headline inflation rate (WPI) remained high at 8.7% YoY (consensus at 8.5%) in April compared to 9% YoY in March 2011.
- Global growth appears to be slowing with US economic data disappointing in recent weeks and Chinese growth softening in response to policy moves. A correction in commodity prices would reduce the fuel subsidy burden in India and also alleviate the 'imported' component of inflation.
- As regards 4QFY11 earnings, it has been the worst quarterly performance vs estimates in at least last 20 quarters. Against an average growth of 23% in 9MFY11, PAT declined 0.4% during the quarter.
- This has led analysts to downgrade their FY12E Sensex EPS by about 4%. Reported FY11 EPS was also down by about 4% leading to estimated earnings growth remaining almost unchanged at 19% for FY12E.

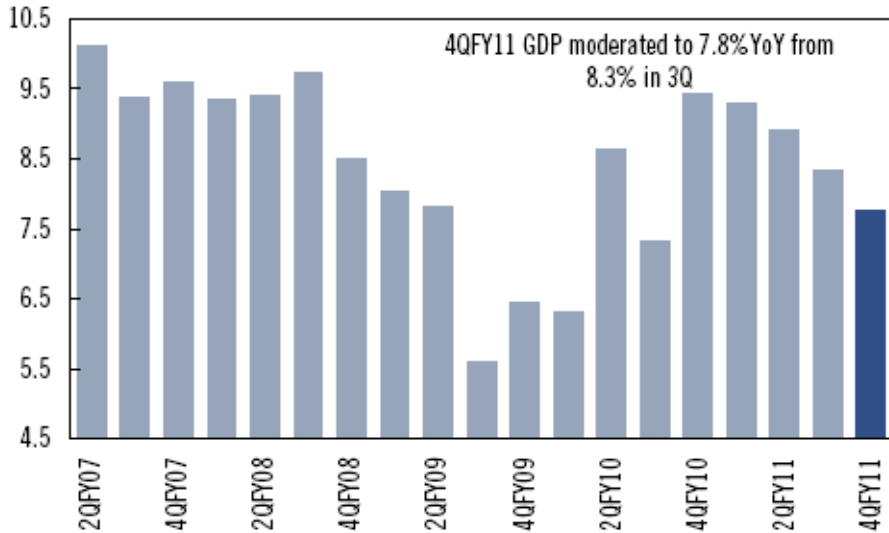
European Sovereign Debt Issue Crops up again



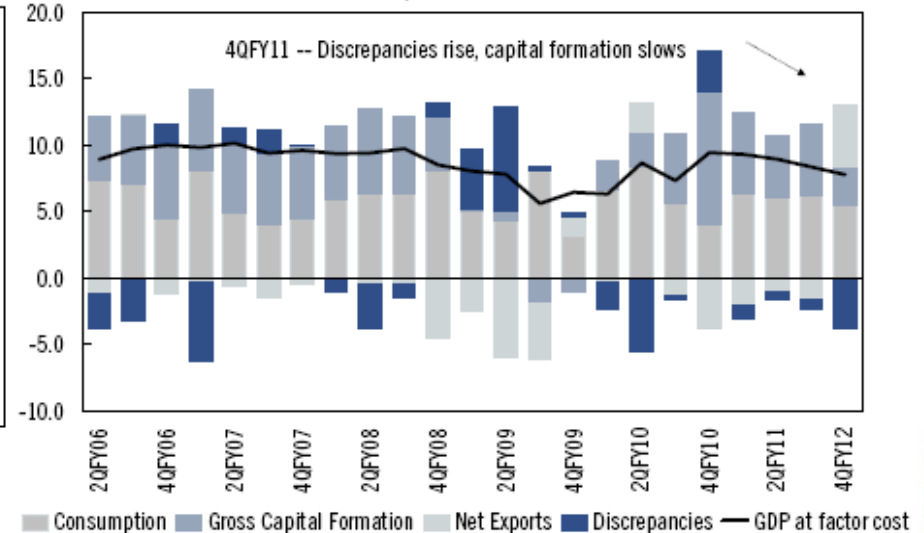
- One year after the first bailout Greece is once again in discussions with the IMF and EU for a second massive refinancing of its debt. Greece has already been downgraded by Moody with its ratings implying a 50% chance of default.
- The European Central Bank is opposed to a restructuring of the debt as it might hurt the bank's capital base significantly. The burden of the adjustment is thus on 'fiscal austerity' package that Greece has to implement.
- While the financiers appear to be close to an agreement the bigger challenge is the political fallout of the austerity package in Greece and at the opposite end is the political fallout from a bailout in Germany.

India GDP Growth Slows Led By Poor Investment Demand

Quarterly Trends in GDP (%YoY)



GDP – Contribution by Expenditure (% of total)

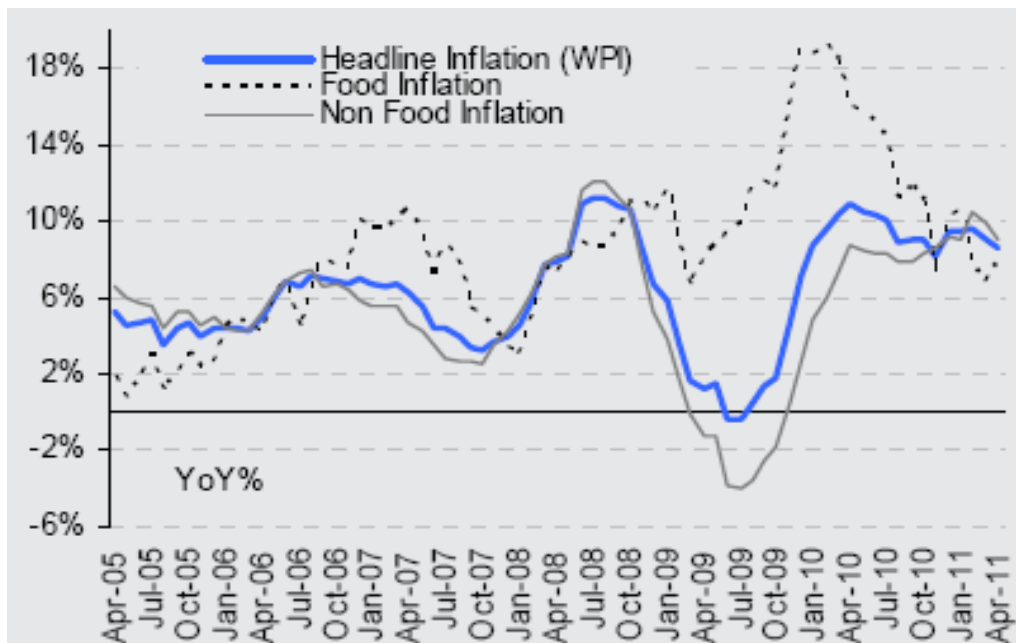


- India's 4QFY11 GDP came in at 7.8%, lower than expectations (Consensus 8.2%) and the 8.3% growth seen in 3QFY11.
- The deceleration in investments, which commenced in 2QFY11 due to policy uncertainty, continued in 4Q with growth slowing to 0.4%. Consumption trends remained broadly unchanged at 7.5%. Net exports remained the key growth driver.
- The deceleration is largely led by slowing investment demand, which is suffering due to several policy bottlenecks and the rise in the cost of money.



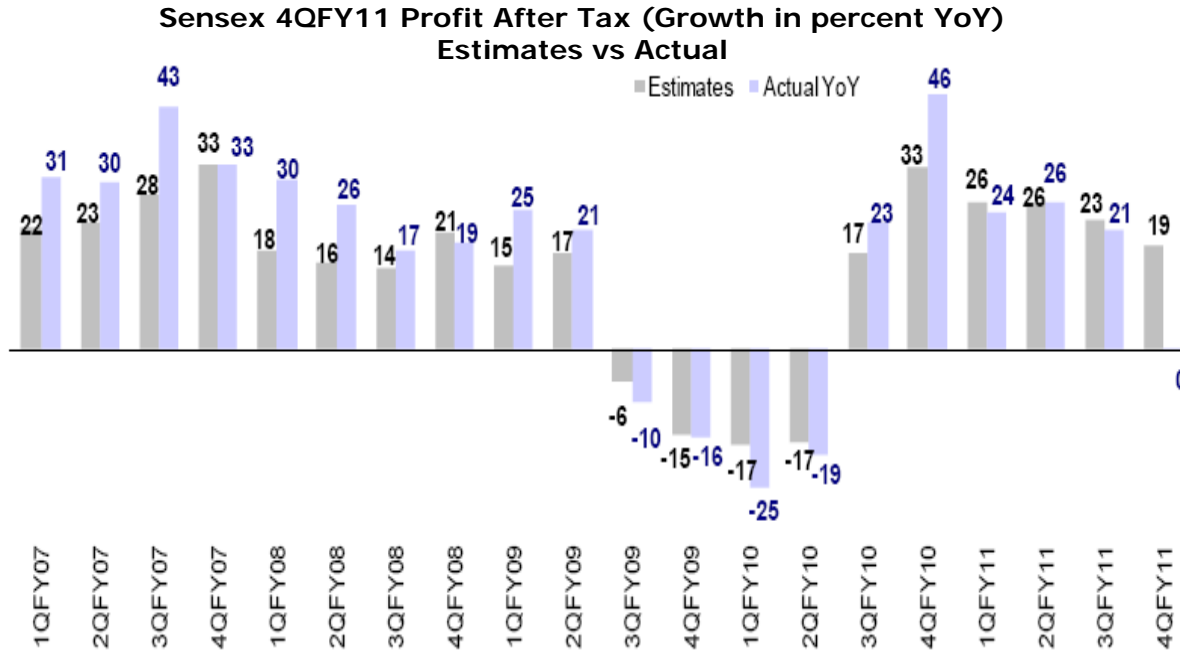
Inflation Continues To Remain Elevated

Inflation (WPI): Headline, Food & Non Food



- The headline inflation rate (Wholesale Price Index- WPI) remained high at 8.7% YoY (consensus at 8.5%) in April compared to 9% YoY in March 2011.
- The seasonally adjusted WPI index was up 0.2%MoM in April (vs. +1.1%MoM in March based on provisional data).
- We feel that India's Inflation may remain elevated till there is a significant correction in global commodities. A slowdown in global growth might cause such a correction in commodity prices.

Earnings Season - Disappointing Q4FY11 Led By Heavyweights

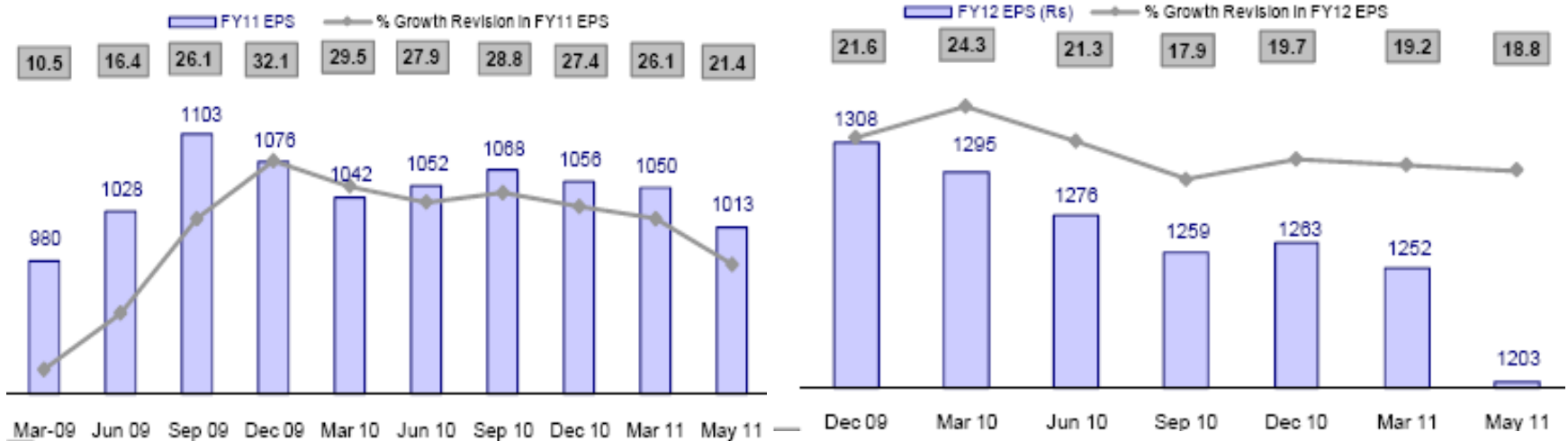


Note: Morgan Stanley estimates used as proxy for market estimates

- 4QFY11 has been the worst quarterly performance vs estimates in at least last 20 quarters.
- Against an average growth of 23% in 9MFY11, PAT declined 0.4% during the quarter.
- 14 companies lagged while 6 outperformed the estimates. SBI, ONGC, Tata Steel and Bharti were key laggards.

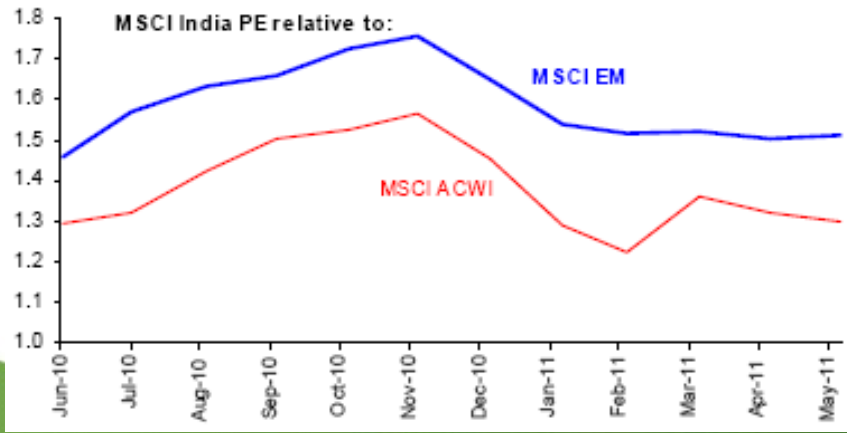
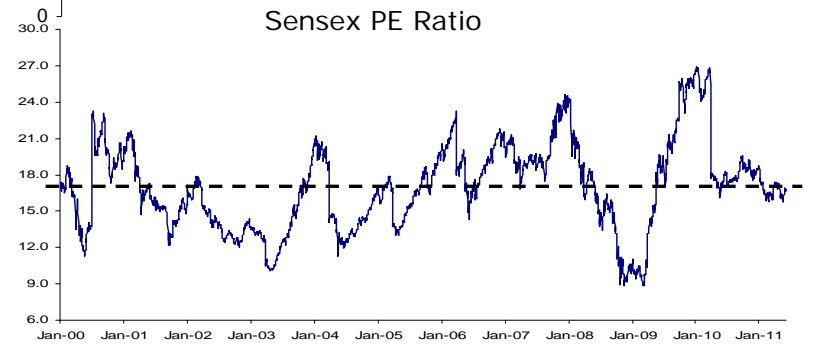
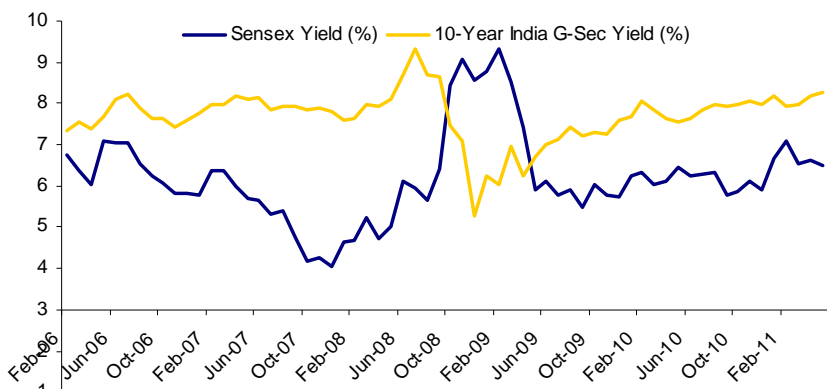


Earnings Forecasts – Sharp Downgrades In Estimates



- The current earnings season has led to a sharp round of earnings downgrades for FY12, due to both base effect (actual reported FY11 EPS being materially lower than expected) as well as weaker outlook.
- This is in line with our long held view that FY12 estimates would need to be revised down. However, with the estimates implying nearly 19% growth in FY12 we worry that the bar may need to be lowered again.

Valuations - Corrected Materially



- The gap between Sensex earnings yield and bond yield has increased by 20 basis points over the previous month due to decline in Sensex yield.
- Sensex is currently trading at 16.8x its trailing earnings. It is now 1% lower than its historical 10-year average trailing PE of 17x.
- India's PE premium to MSCI Emerging markets has slightly widened over the recent months, and it is now at around 50% 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 (some evidence of which was seen in Q4FY11 numbers).
- Since the RBI began tightening in early 2010 it has effectively raised policy rates by a total of 400bp. We expect a further 50bp of rate action but that should bring this round of tightening to an end in our opinion.
- 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 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 further to curtail the fiscal deficit which is providing unnecessary stimulus to the economy. Such price hikes can slowdown the aggregate demand, thereby helping reduce inflationary pressures.
- The structural growth story in India remains unchanged, and we feel the YTD outperformance and preference for developed markets is only tactical in nature.
- Financial markets worldwide could be vulnerable to a shock from the sovereign debt issues in Europe. Given slowing global growth momentum and high degree of leverage commodity markets could be the most vulnerable.
- Valuations are now in the comfort zone with markets trading near long term average multiples.
- We see more opportunities for stock picking as dispersion in company performance within sectors is quite high. Given the hazy macro outlook the focus on generating Alpha is now led largely by stock selection.

Investment view

Short term

- GDP growth likely to moderate to about 8% in FY12.
- Earnings estimates have been cut for FY12 as we have long expected but the implied growth rate is still 20% and that could prove to be a high bar.
- 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.

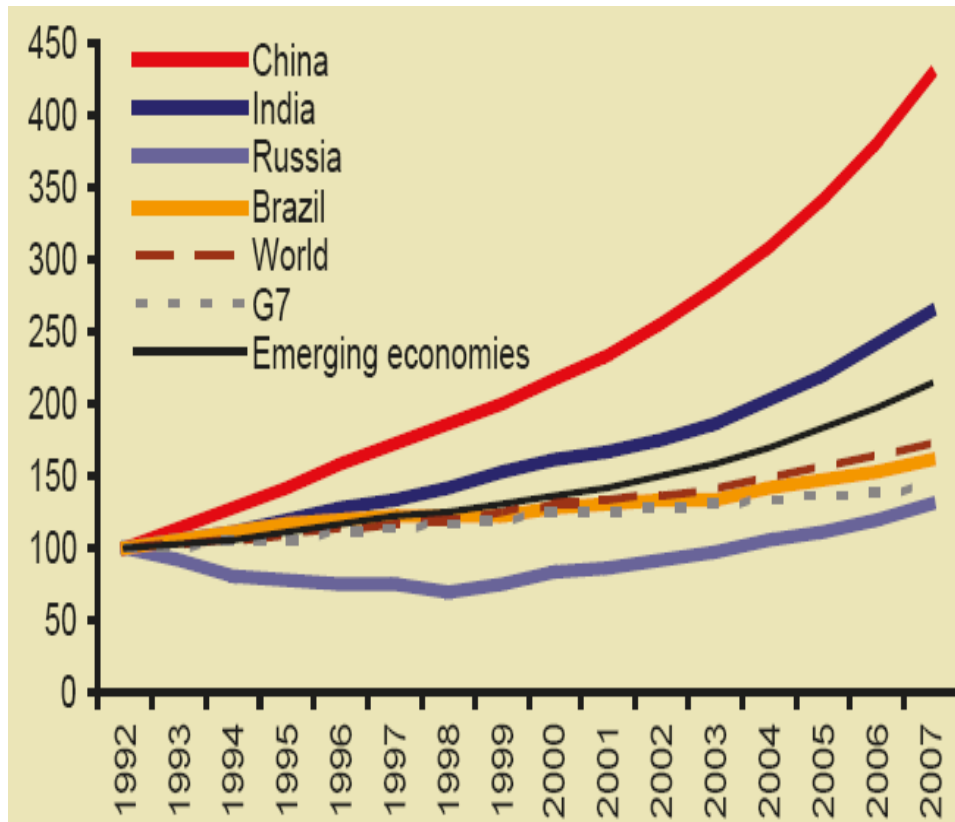
Strategy for investors

- 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

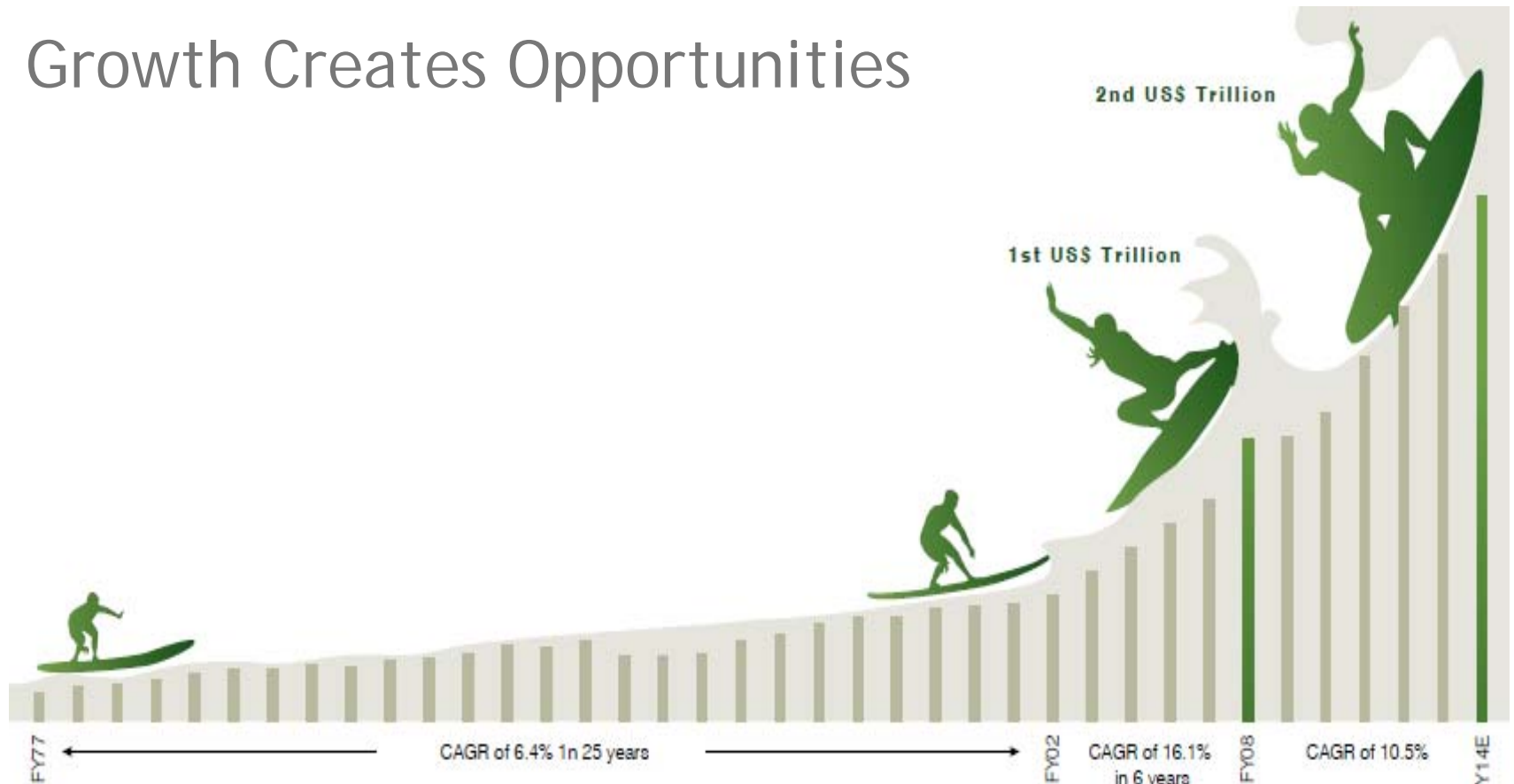
GDP growth rebased to 1992



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

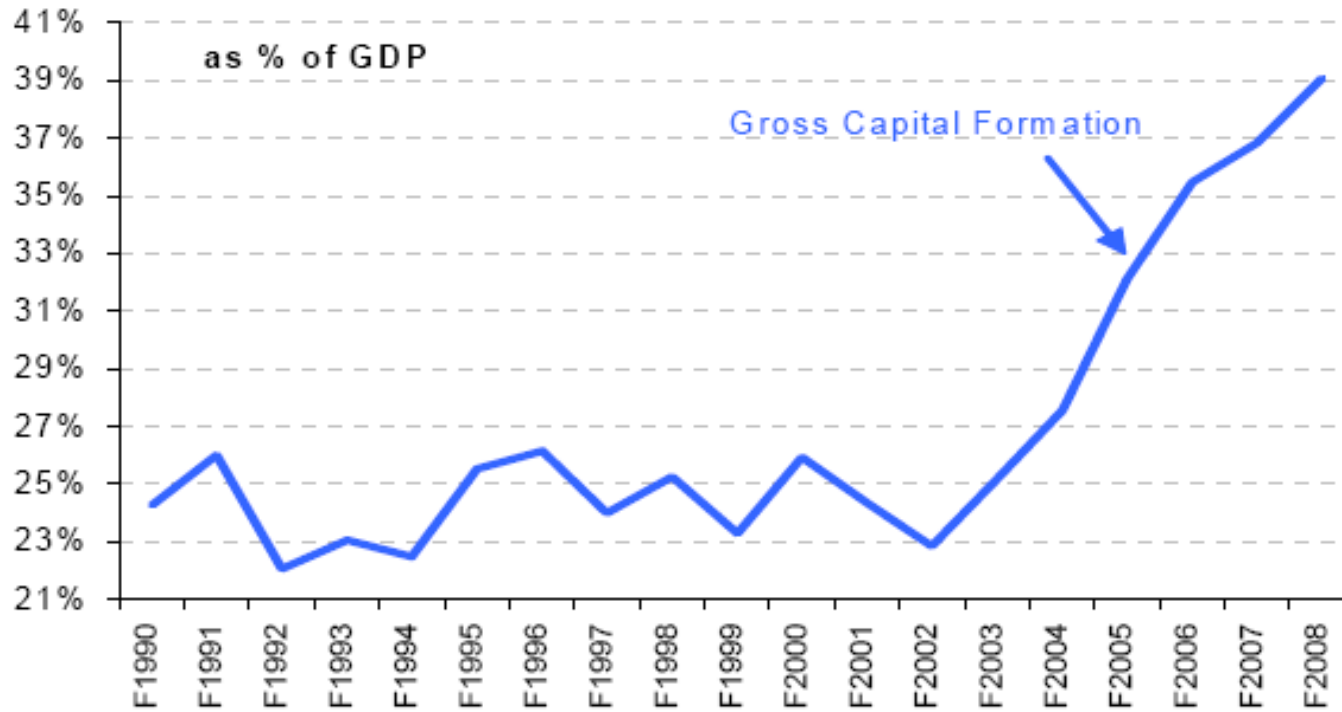
Growth Creates Opportunities



- 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

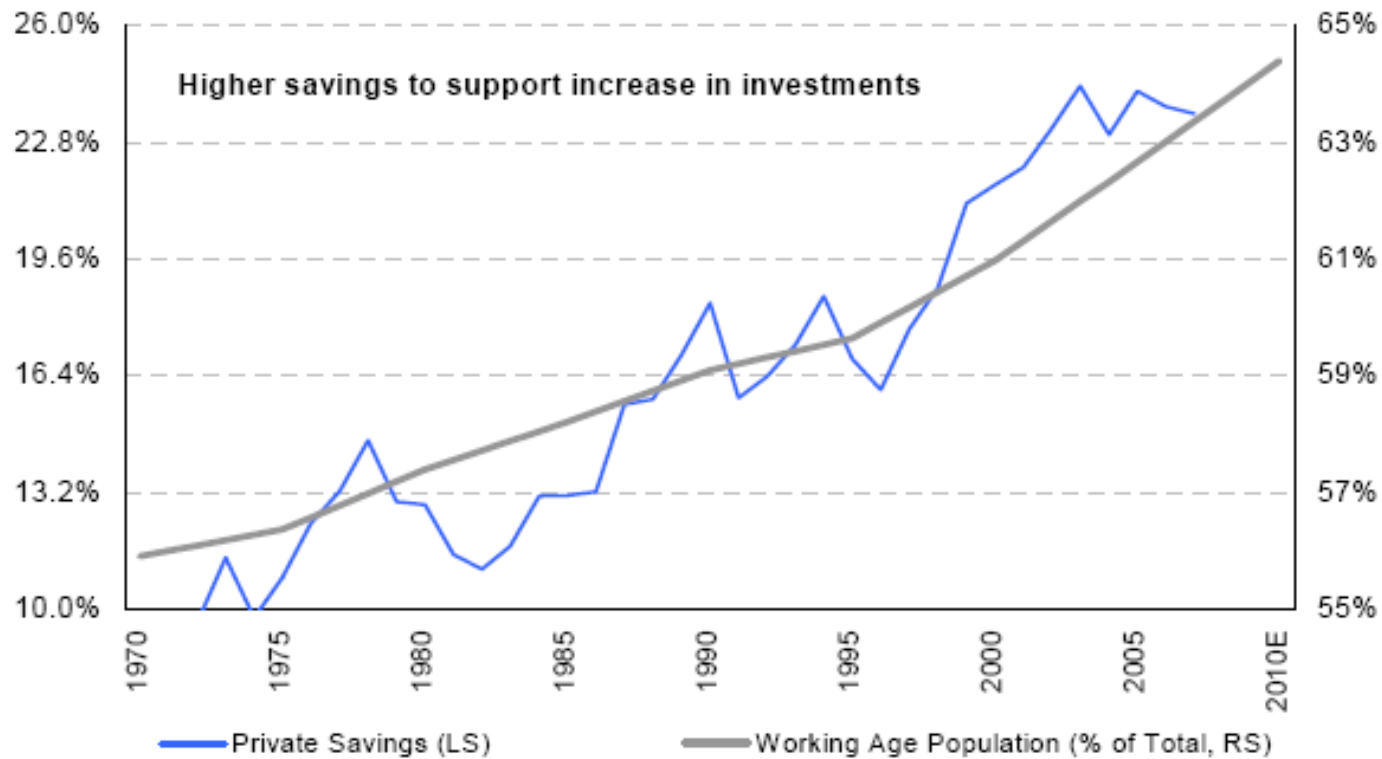


Growth Is Being Led By A Rise In Capital Formation...



Source: CSO, Morgan Stanley Research

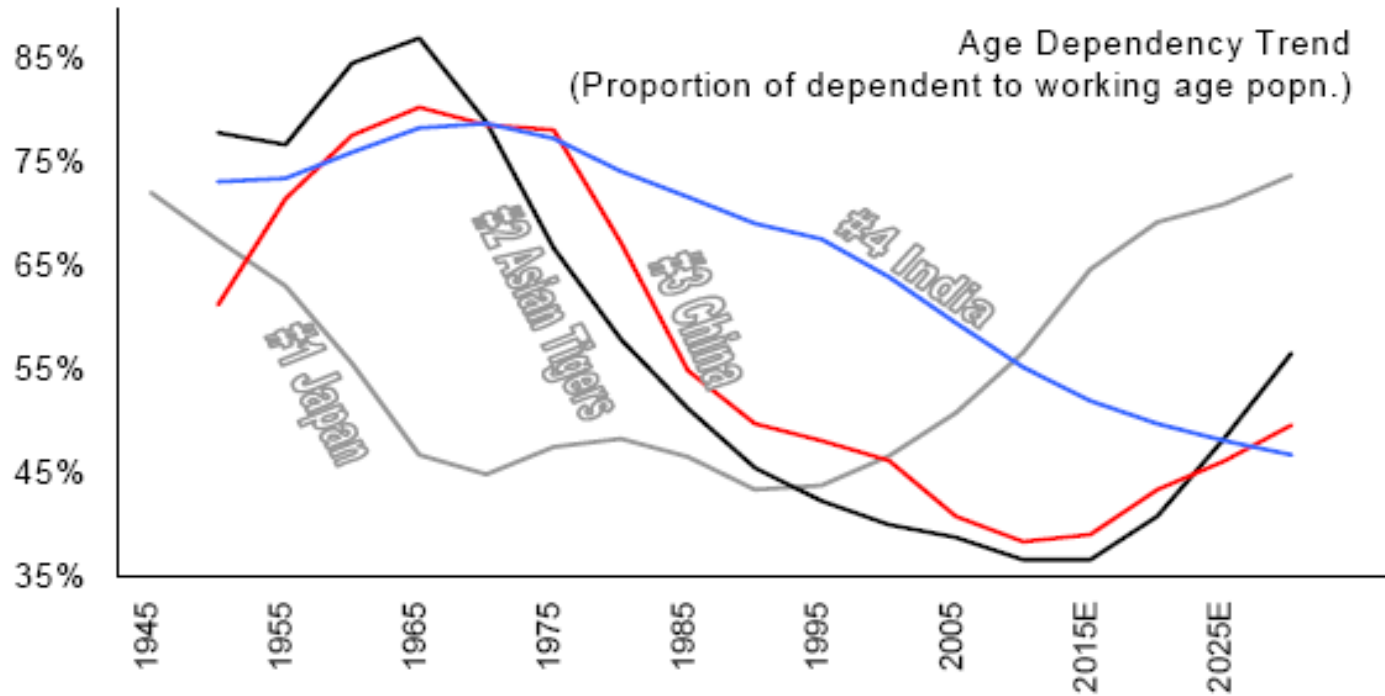
...Which Is Supported By A High Savings Rate



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



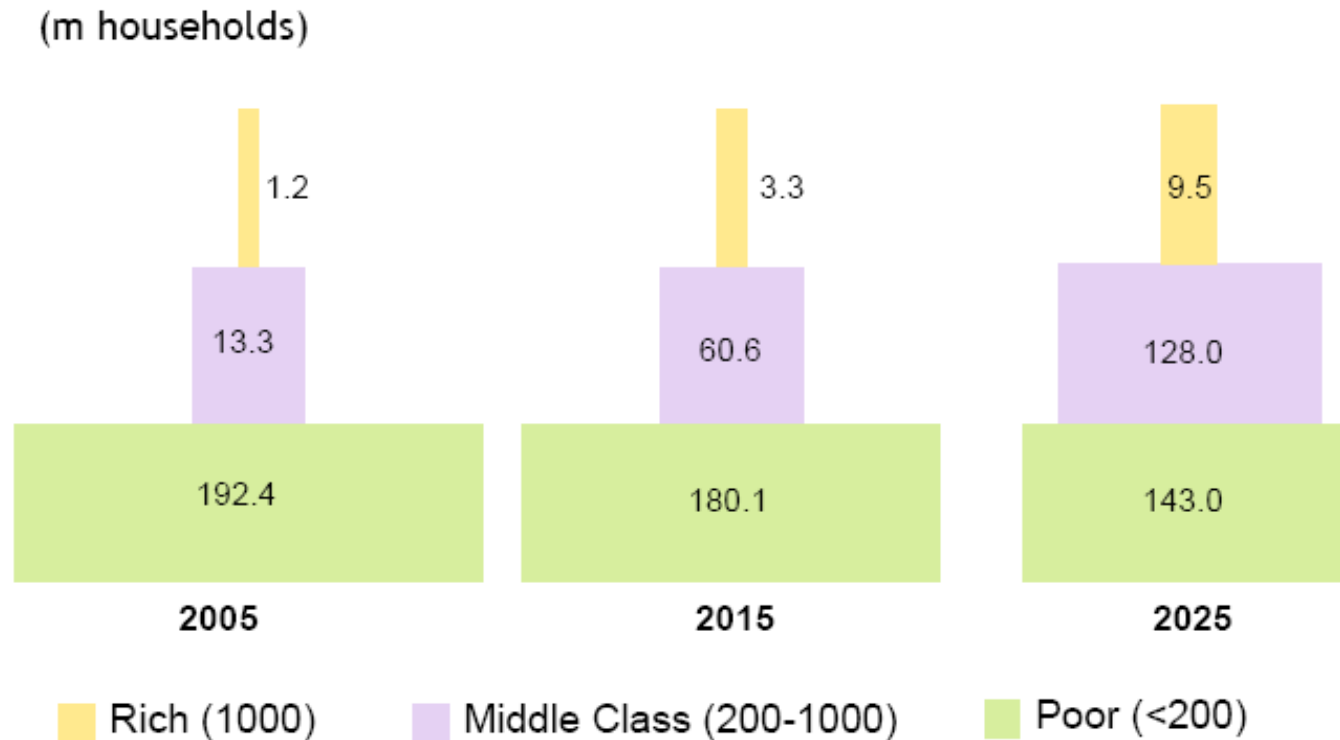
India Is Poised To Reap Rich Demographic Dividend In Years To Come



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

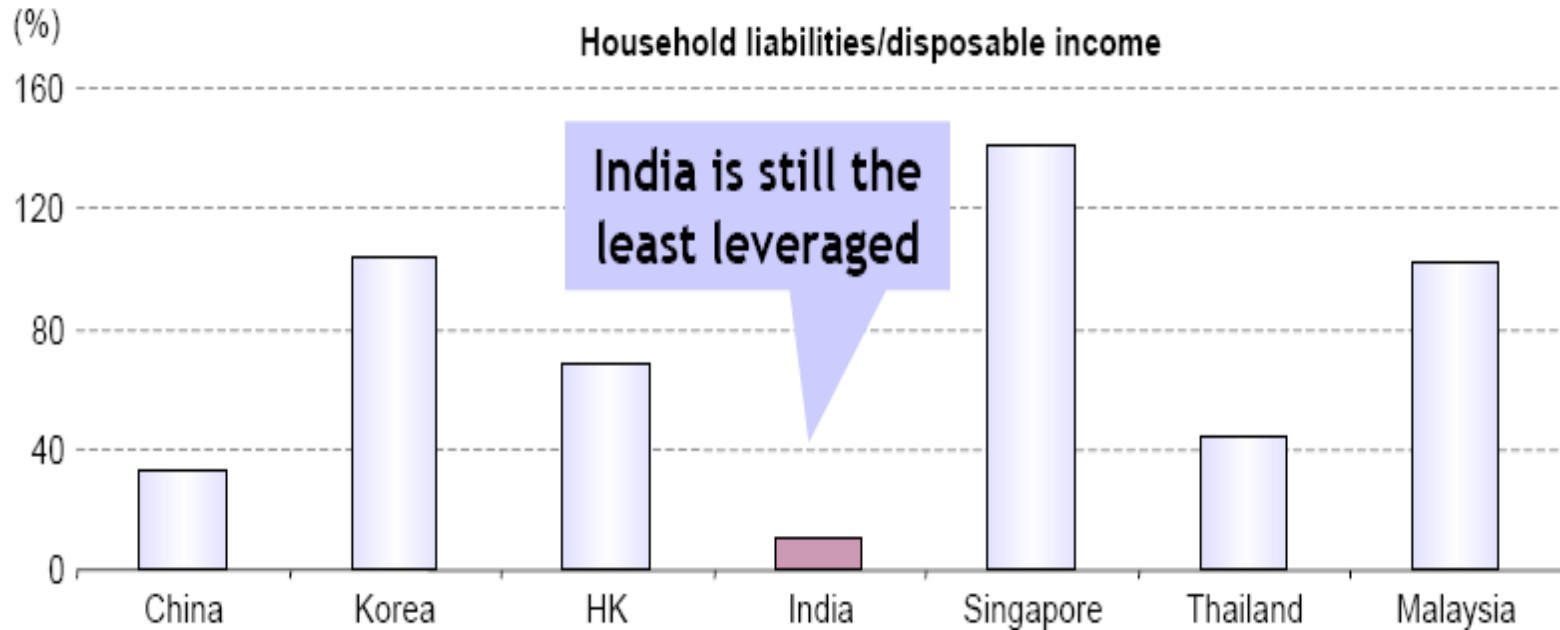


Income Imbalance To Correct Leading To Rise In Consumption



Source: IDFC SSKI

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



Source: IDFC SSKI

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