

# Equity Markets : Current Environment and Outlook

Vetri Subramaniam, Head of Equity Funds  
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# Current Environment

- Global Equity markets remained weak in November, with the MSCI World Index falling by 2.35% buffeted by tightening fears in China and sovereign debt concerns in Europe.
- Indian markets underperformed the global trend, falling by 2.55% in the month of November due to host of governance issues.
- Commodity prices contrasted the global trend in equities, with the benchmark CRB Reuters Jefferies total return index rising by 2.5%.
- Healthcare and Auto was the best performing sector followed by IT. Realty and PSU sectors delivered the worst return for the month.
- FII inflows were at Rs.183bn in November 2010, while DIIs recorded inflows of Rs.39bn. MF remained net sellers to the tune of Rs.1bn.
- Trading Activity has started abating in November, with cash trading volumes (number of shares) falling MoM and the average open interest declining by 11% MoM.

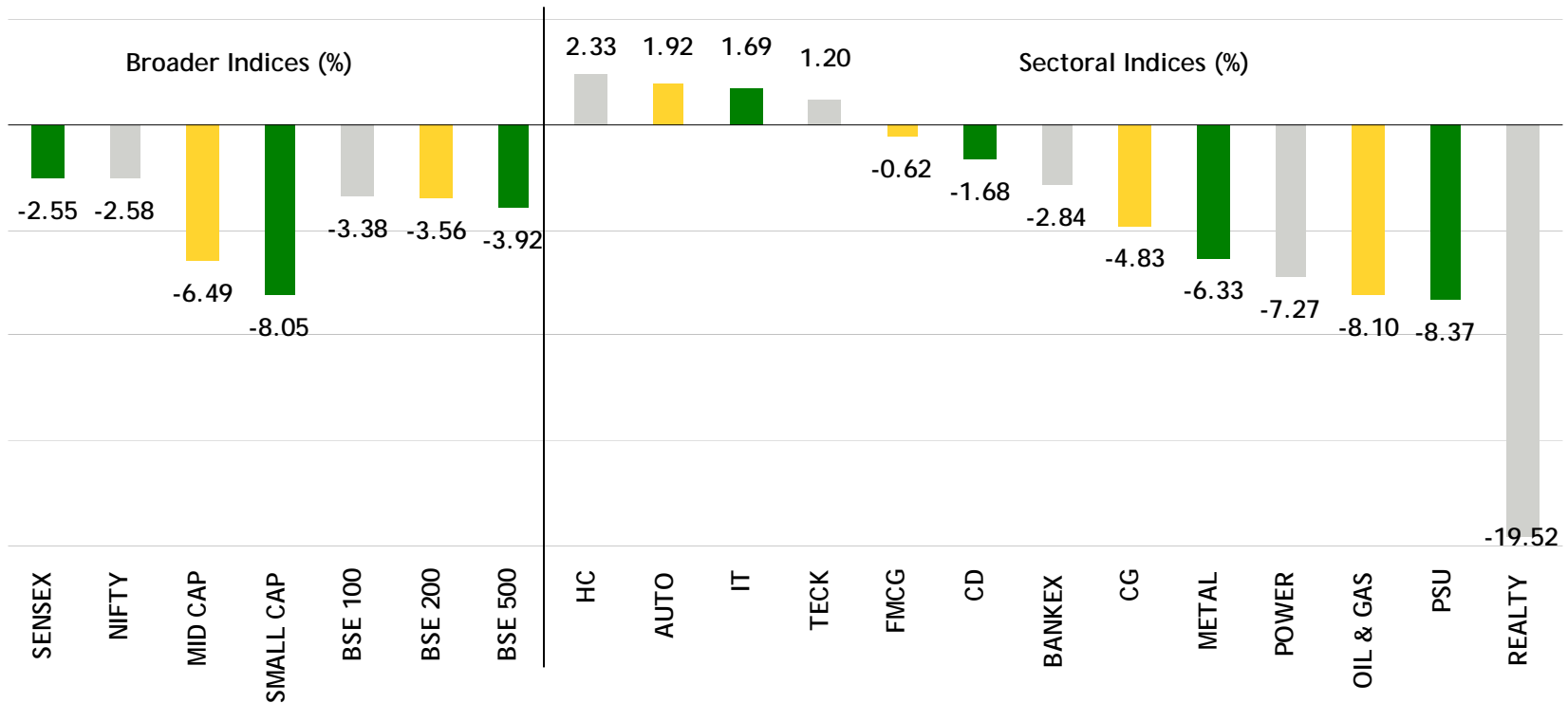
# Global Equities

Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	2820.18	-5.33%	-13.94%	EM - Asia
BSE Sensex	India	19521.25	-2.55%	11.77%	EM - Asia
Kospi	South Korea	1904.63	1.15%	13.18%	EM - Asia
Taiwan Weighted	Taiwan	8372.48	1.03%	2.25%	EM - Asia
Thailand SET 50 Index	Thailand	698.46	3.09%	34.14%	EM - Asia
Jakarta Composite Index	Indonesia	3531.21	-2.86%	39.33%	EM - Asia
KLSE	Malaysia	1485.23	-1.36%	16.69%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	67705.40	-4.20%	-1.29%	EM
Mexico IPC	Mexico	36817.32	3.51%	14.62%	EM
Russian RTS Index	Russia	1597.35	0.64%	10.57%	EM
Philippine PSEi	Philippines	3953.70	-7.38%	29.52%	EM
Merval Buenos Aires Index	Argentina	3261.49	8.45%	40.54%	EM
HangSeng	Hong Kong	23007.99	-0.38%	5.19%	Developed - Asia
Nikkei	Japan	9937.04	7.98%	-5.78%	Developed - Asia
Strait Times	Singapore	3144.70	0.07%	8.53%	Developed - Asia
Dow Jones	USA	11006.02	-1.01%	5.54%	Developed
CAC 40 Index	France	3610.44	-5.82%	-8.28%	Developed
All Ordinaries Index	Australia	4676.40	-1.20%	-4.23%	Developed
DAX Index	Germany	6688.49	1.32%	10.58%	Developed
Swiss Market Index	Switzerland	6312.43	-2.47%	-3.57%	Developed
FTSE 100	UK	5528.27	-2.59%	2.13%	Developed
MSCI World Index	--	1193.56	-2.35%	2.15%	--

\* as on 30<sup>th</sup> November 2010. Source : Bloomberg  
EM – emerging markets, Developed – developed markets.



# India : Sector performances



- Sensex fell by 2.55% over the previous month. MidCaps underperformed LargeCaps with a 6.49% loss for the MidCap index.
- Healthcare and Auto was the best performing sector followed by IT.
- Realty and PSU sectors delivered the worst return for the month.

\*Source: BSE,NSE. one month performance as on 30<sup>th</sup> November 10.

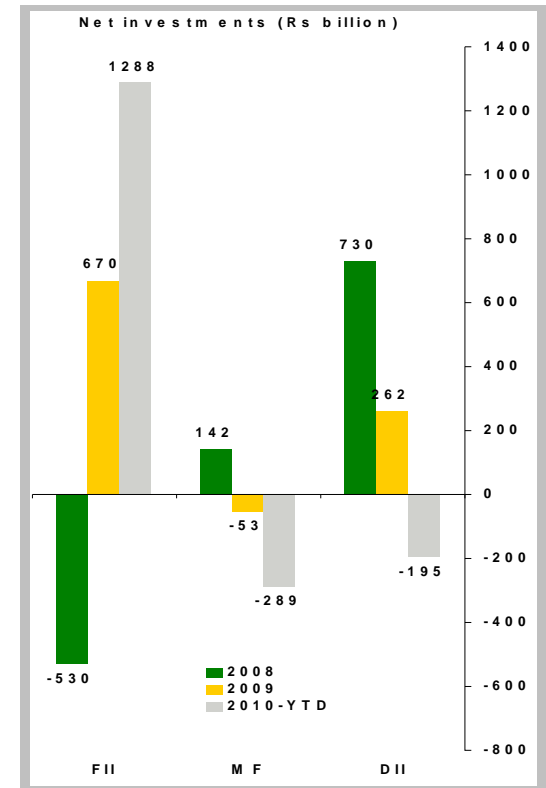
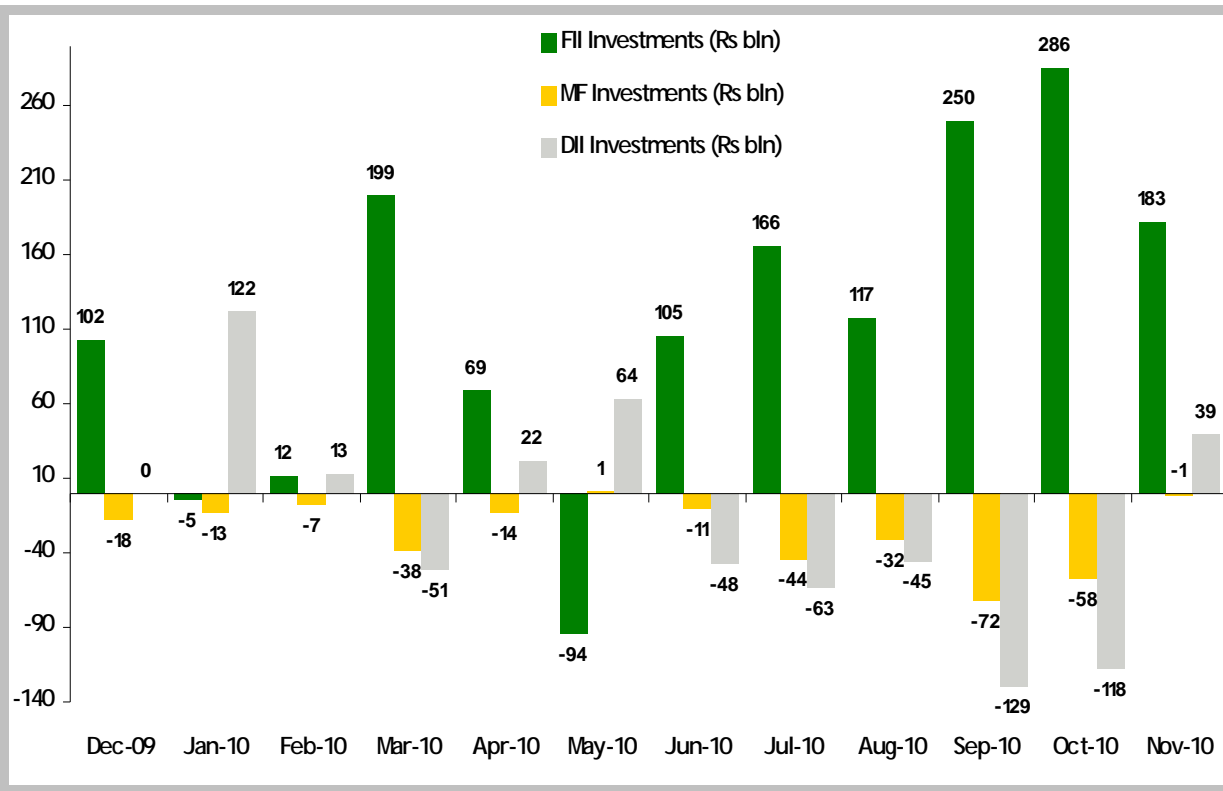
# Top Gainers / Losers - Nifty

Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
Bharti Airtel	376.95 / 252	360.15	10.59%
Dr Reddy's Labs	1813.5 / 1062.35	1786.7	7.66%
Tata Motors	1348 / 633.75	1234.95	6.55%
Hero Honda Motor	2094 / 1495	1982.7	6.30%
Sun Pharma.Inds.	476.79 / 280	447.55	6.05%
Top Losers for the month			
Losers	52 week H/L	Last Price#	% Loss*
Rel. Comm.	207.8 / 123	131.8	-26.82%
Reliance Capital	930 / 611.1	650.45	-20.08%
Reliance Infra.	1224 / 807.35	844.15	-18.52%
Suzlon Energy	97.37 / 43	47.75	-13.89%
DLF	403.5 / 254.5	306.75	-12.53%

# closing price as on 30<sup>th</sup> November 2010. \* one month performance as on 30<sup>th</sup> November 2010.  
Source: Capitaline



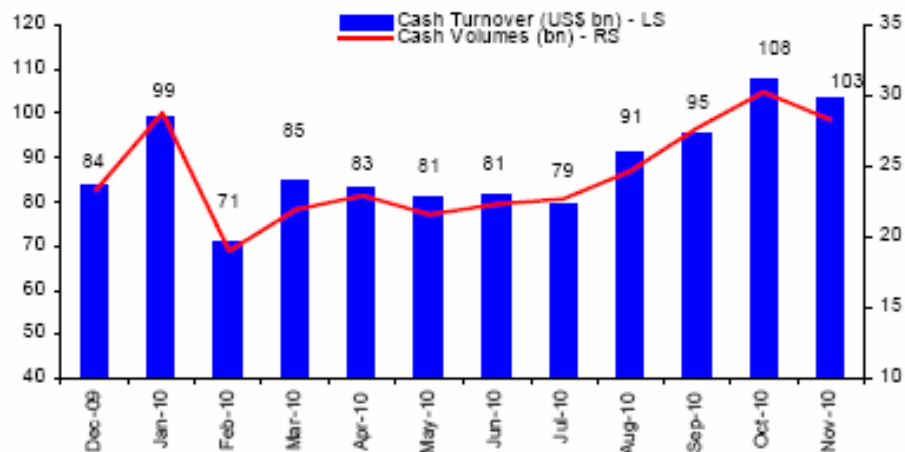
# FII & DII Inflows



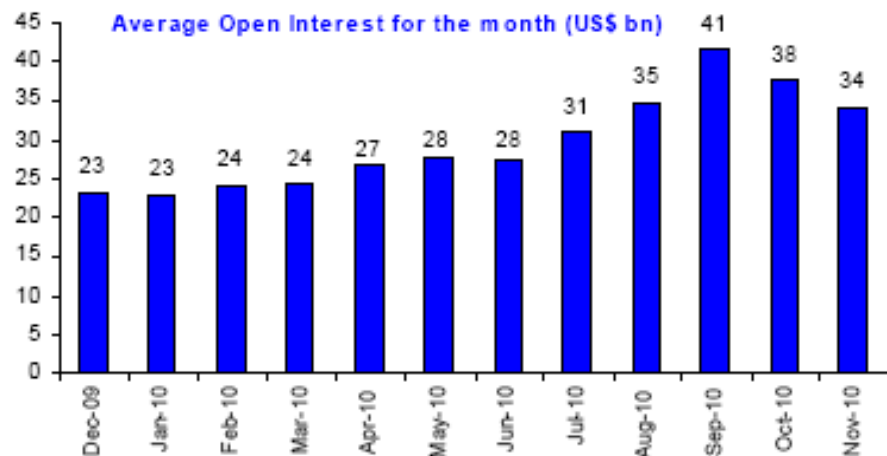
- FII inflows were at Rs.183bn in November 2010. FII inflows have remained positive on a YTD basis at Rs.1288bn for CY10 after a Rs.670bn inflow in CY09.
- DII recorded inflows of Rs.39bn. MF remained net sellers to the tune of Rs.1bn.

# Market Activity

## Cash Trading: Turnover and Volumes: Drop MoM



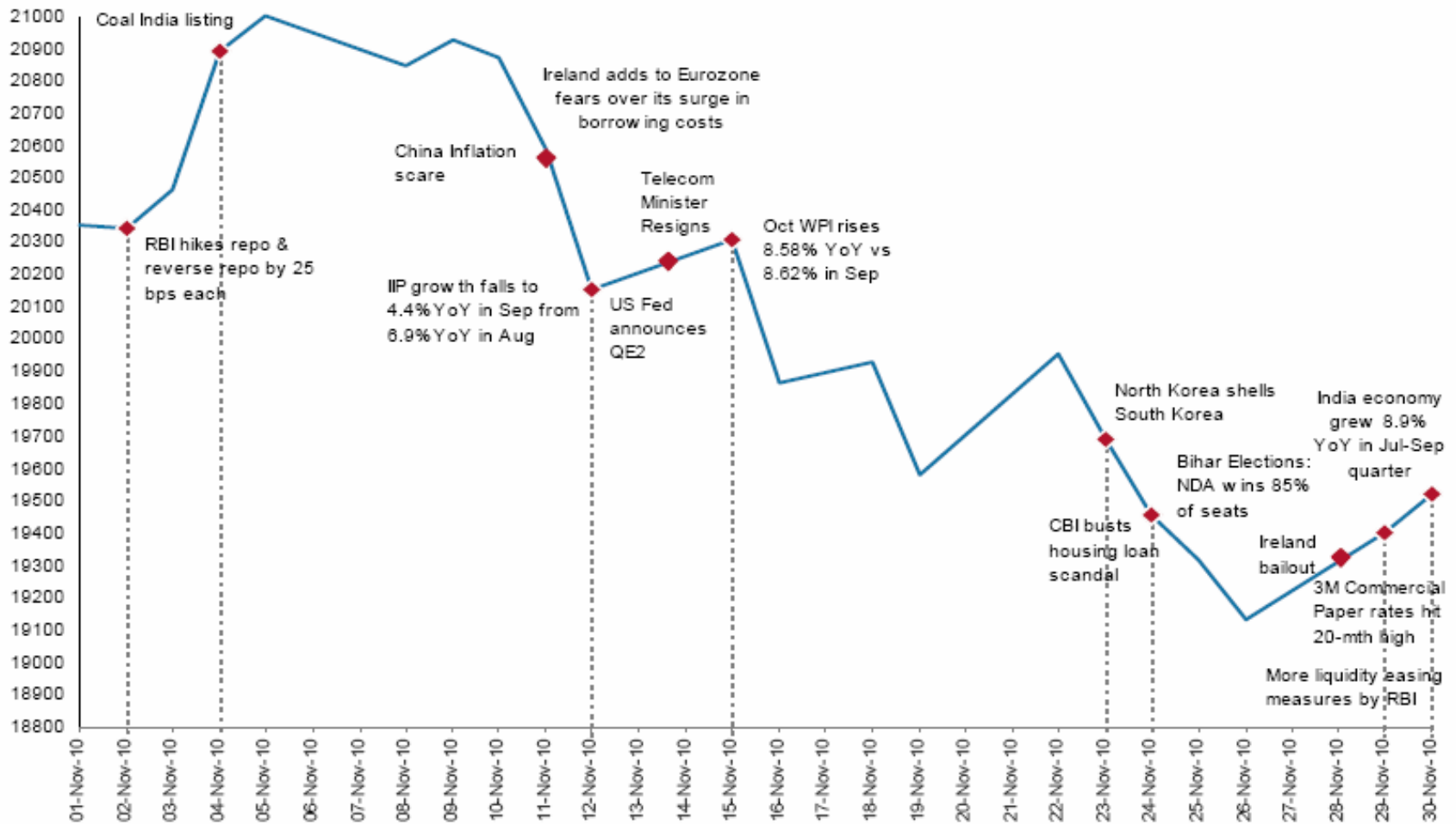
- In November, cash trading volumes (number of shares) decreased MoM after increasing for almost four months.



- At the end of November, average open interest decreased by 11% MoM. This is the second month of consecutive declines after six continuous months of rise.



# November 2010 events timeline



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

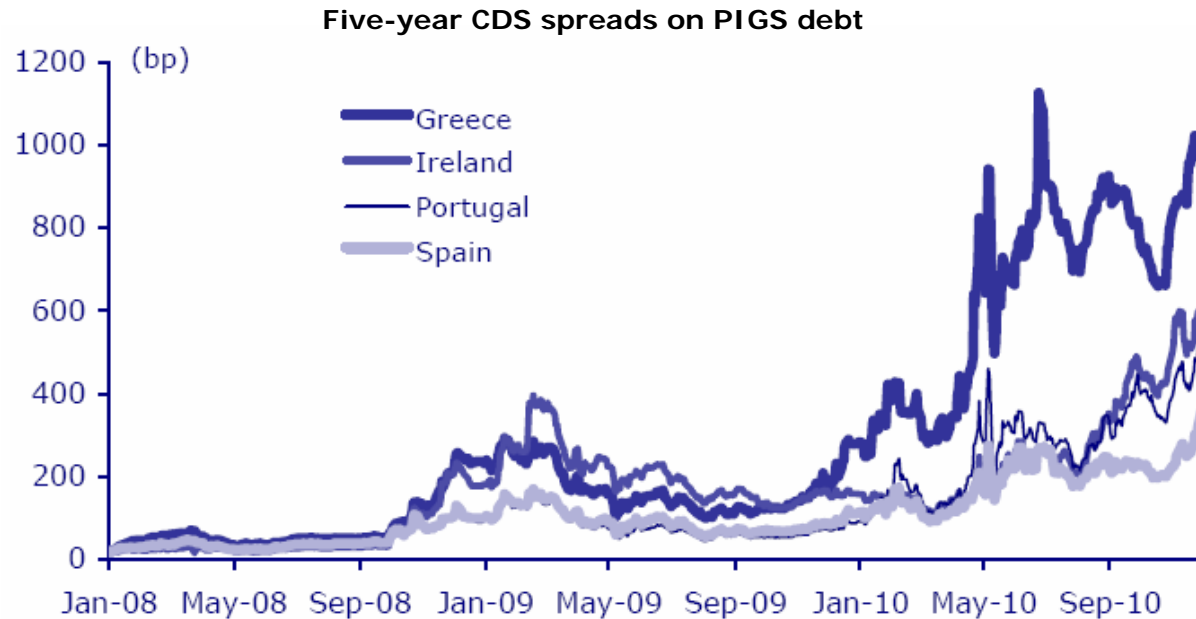


# Religare MF: Equity Market Outlook and Opportunities

# Equity Market Outlook

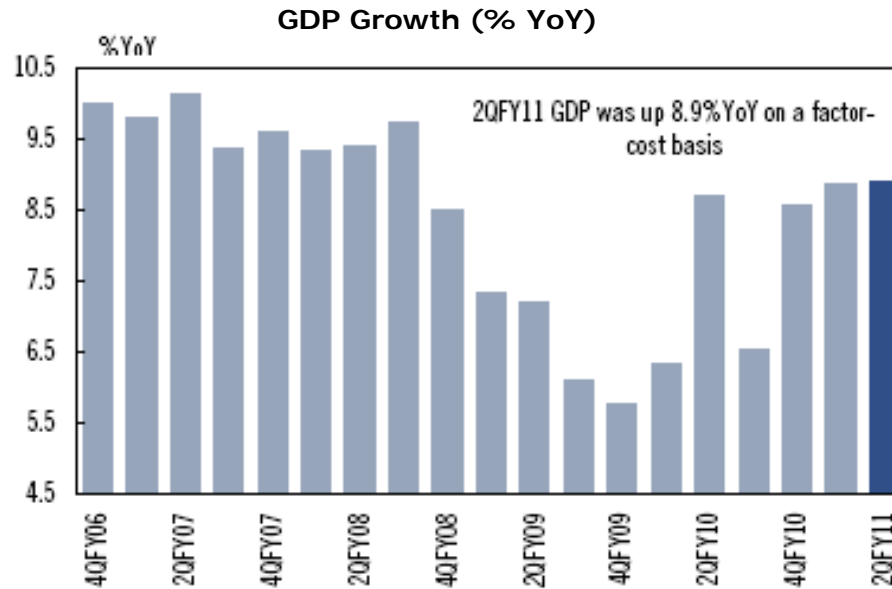
- Sovereign debt issues in Europe took centre stage again with Ireland following in the footsteps of Greece and needing a bailout.
- There has been a rise in CDS spreads of much larger economies like Spain and Italy also. The cost of bailing out these mammoth economies may be out of reach for even the EU or IMF.
- India continued to deliver robust numbers with the 2Q FY11 GDP growth at 8.9%, higher than consensus expectations.
- However the key risks to the India growth story seem to be the sticky high inflation and a recent moderation in the IIP. High inflation can lead to higher interest rates, which have the potential to lower the aggregate demand and in turn impact the GDP growth.
- Sep IIP slowed to 4.4%, significantly below consensus as Capital Goods showed de-growth for the 2<sup>nd</sup> month running. A recovery in IIP is essential to maintain the robust growth in corporate earnings, which are at risk if the current reading is maintained.
- The September quarter performance of corporate India, though robust, fell short of market expectations. Thus, Sensex ex-Oil (ex ONGC) net profit grew at 31% compared with market expectations of 36% growth.
- The Consensus earnings expectations of Sensex companies for FY11 & FY12 have been raised by 0.9% and 0.6% during the month, but are virtually unchanged over the earning season.

# EuroZone troubles: Ireland follows Greece



- Credit Default Swaps (CDS) spreads increased for some of the peripheral Eurozone economies, believed to be in financial trouble.
- The European Union and IMF provided an emergency rescue loan of about US \$90bn to Ireland to tide over the crisis.
- However, the financial problems in European Union appear far from over as is visible in rise in CDS spreads of much larger economies like Spain and Italy. The cost of bailing out these mammoth economies may be out of reach for even the EU or IMF.
- It is increasingly difficult to see the way out of this crisis for Europe-either the lenders will have to accept a debt restructuring or the debtor nations countries will need to devalue which would require an exit from the currency union

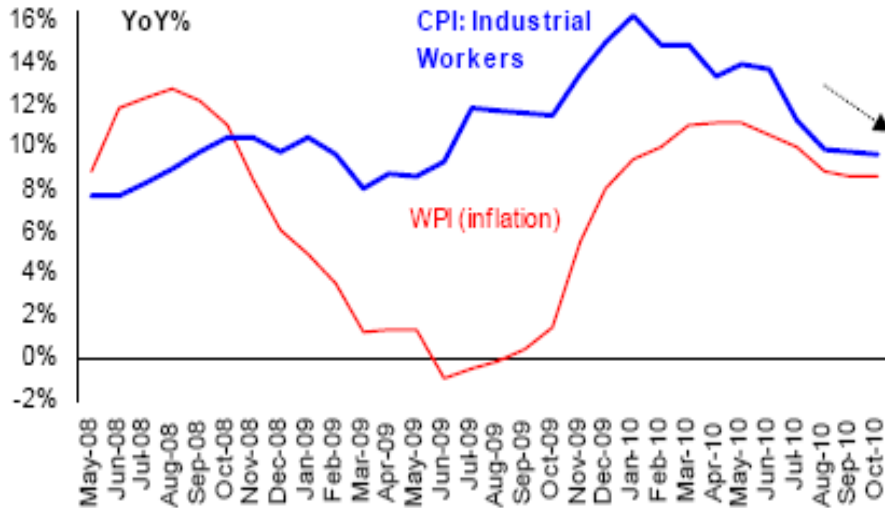
# India stays in top gear. GDP continues its dream ride



- India's 2Q FY11 GDP rose 8.9%, higher than consensus expectations (consensus at 8.2%).
- The 8.9% growth in 2QFY11 was led by
  1. Services up 9.8% with an uptrend seen in trade & hotels up 12.1% and financial services up 8.3%
  2. Industry moderated to 8.9% from double-digit trends seen in the last few quarters. Taking cues from the IIP, we expect the coming quarters to post lower trends
  3. Agriculture rose 4.4%, in line with the summer crop estimates.

# Inflation remains elevated, while industrial growth moderates.

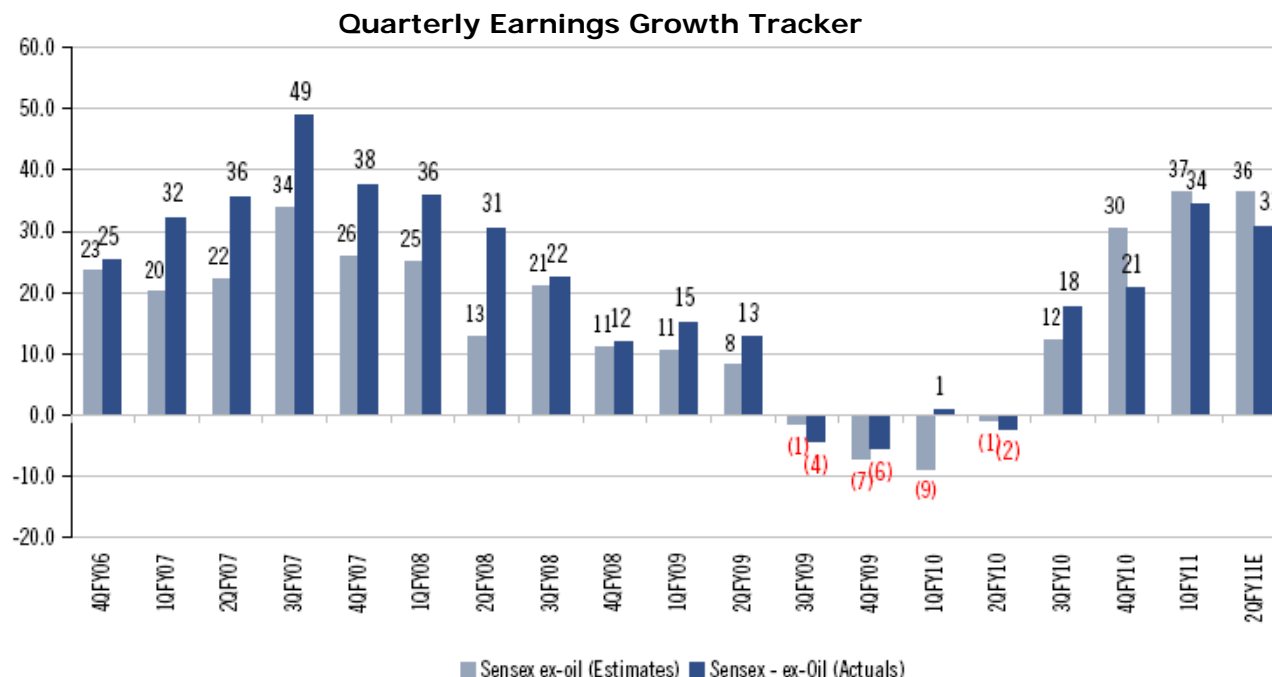
## Inflation



- October WPI headline inflation in India remained elevated at 8.6% y-o-y, despite last year's high base and this year's favorable supply conditions.
- Moreover, core inflation is inching upwards and demand-led price pressures are expected to build.
- The recent rise in crude oil, metal and agricultural commodities in global markets (post QE2) creates upside risk to forecasts of a decline in inflation.
- If the inflation does not moderate in the near term, it may lead to a continuation of monetary tightening stance by RBI.
- Sep Factory Output (IIP) slowed to 4.4%, significantly below consensus expectations of 6.4% as Capital Goods showed de-growth for the 2nd month running.
- A recovery in IIP is essential to maintain the robust growth in corporate earnings, which are at risk if the current reading is maintained.



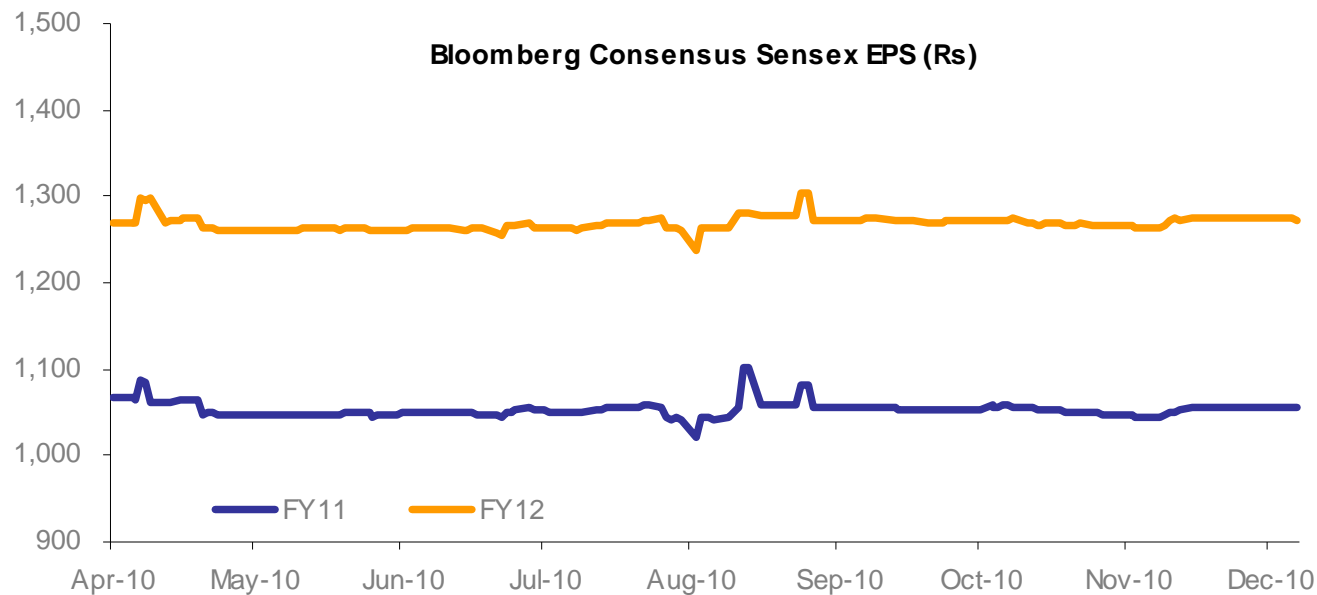
# Sept Qtr Earnings: falling short of high expectations



- The Sensex ex-Oil (ex ONGC) stock universe delivered a strong 31% growth in the Sep qtr, but it still fell short of the lofty expectations by 5%.
- Pharma was the only outperformer, with Telecom and Cement being the Laggards and Energy and Metals the drivers
- Higher foreign earnings was a significant positive swing factor. However, we feel that this can be a key risk to corporate earnings in the medium term.



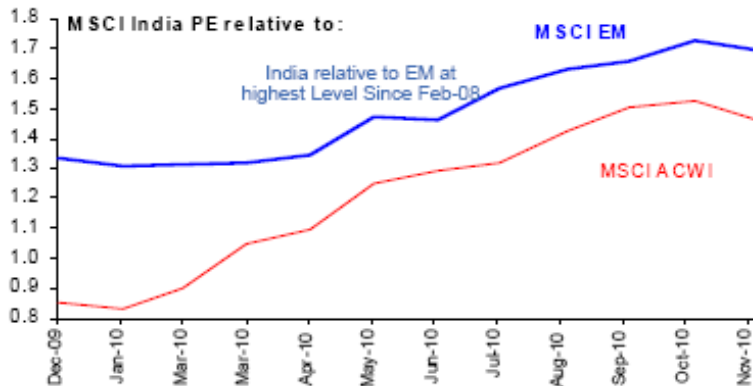
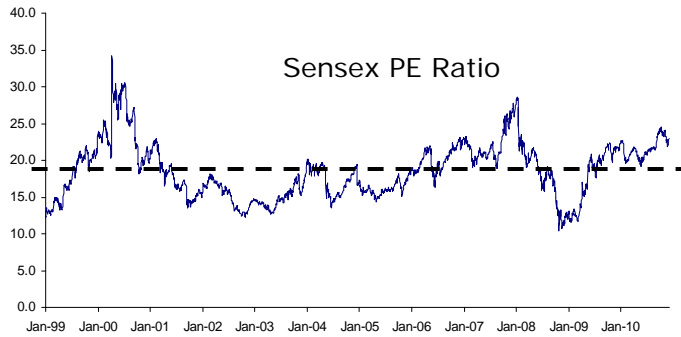
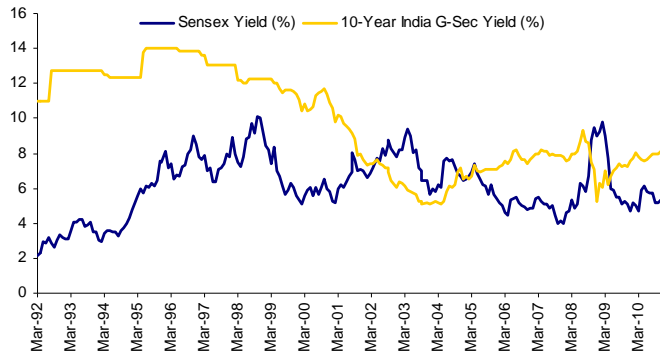
# Earnings Forecasts- unchanged for nearly a year



- Consensus earnings expectations for Sensex companies for FY11 & FY12 have been raised by 0.9% and 0.6% during the month.
- However estimates were largely unchanged over the course of the earnings season and are unchanged for nearly 12 months now.
- Consensus expects a 29% growth in FY11 Sensex EPS over FY10 and a 21% growth in FY12E Sensex EPS over FY11E.



# Valuations



- The gap between Sensex earnings yield and bond yield has decreased marginally by 7 basis points over the previous month.
- Sensex is currently trading at 22.92x its trailing earnings. The gap between the current multiple and historical 10-year average trailing PE of 18.6x has narrowed marginally in the month.
- The market has been trading between 15x and 17.5x forecasted 12-month forward earnings for over a year.
- India's PE premium to MSCI Emerging markets remains at peak levels, and it is now at around 70% premium to MSCI EM PE currently.



# Looking Ahead...

- India continues to remain in a sweet spot as regard foreign portfolio flows. It is viewed as one of the prime beneficiaries of a rise in global liquidity as a result of the US quantitative easing.
- Foreign investors continue to aggressively buy into the Indian market with total FII inflows of about US \$4.1bn in the month and the total YTD investments at US \$28.6bn. Thus liquidity flow into the market remains strong.
- A series of governance failures-political and corporate has raised concerns among all economic agents and this dampening of confidence can have a real impact on corporate and investor behavior.
- We expect a further 25bps of rate tightening by RBI in the Jan-March 2011 quarter. However it is important to note that the recent market action has pushed rates much higher already.
- Inflation and the pace and extent of pick up in the investment cycle in India are key issues in the months ahead for the markets.
- The US Fed policies to the extent that they cause commodities to rally would have implications for inflation and exchange rates in India and across the world.
- US economic data has been much stronger than anticipated in recent months and this is now a source of strength for both commodity prices and the dollar.
- The gains in Indian markets over the last 12 months can be explained largely by earnings-growth, but with markets trading at 16.3x forward 12 months earnings, further earnings upgrades will be required to drive the market higher. India's premium to the region has also remain elevated.
- Our focus remains on stock picking and sector allocation for generating alpha but we expect macro trends to increase their influence in the months ahead.

# Investment view

## Short term

- GDP growth likely to be about 8.5% in FY11.
- With the first half of the year in the bag earnings appear to be on track for the forecast 29% earnings growth.
- Valuations are near the top end of the comfort zone; but supported by the prospect for continued earnings growth
- However, without significant earnings upgrades 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.

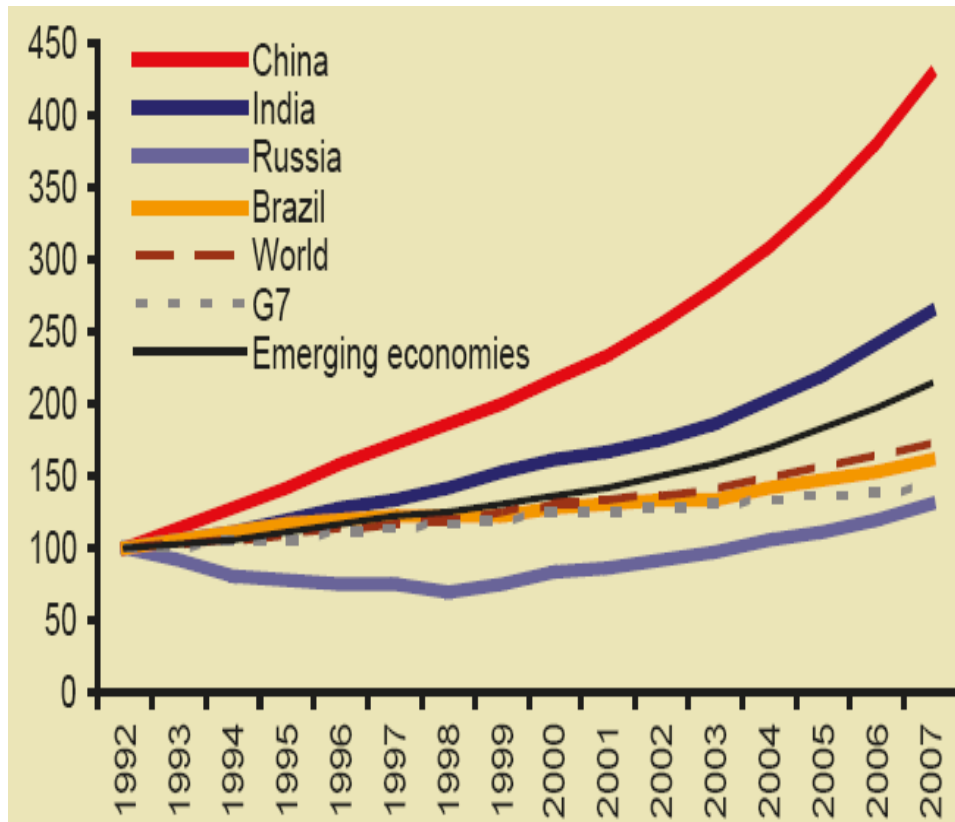
## Strategy for investors

- The valuations are above historical averages, are also at a premium to the region
- Global correlations remain a source of risk but drops closer to historical averages can be used as buying opportunities.
- Long term investors can continue with SIP.

# The Long Term Case For Indian Equities

# India - Growth On The Fast Track

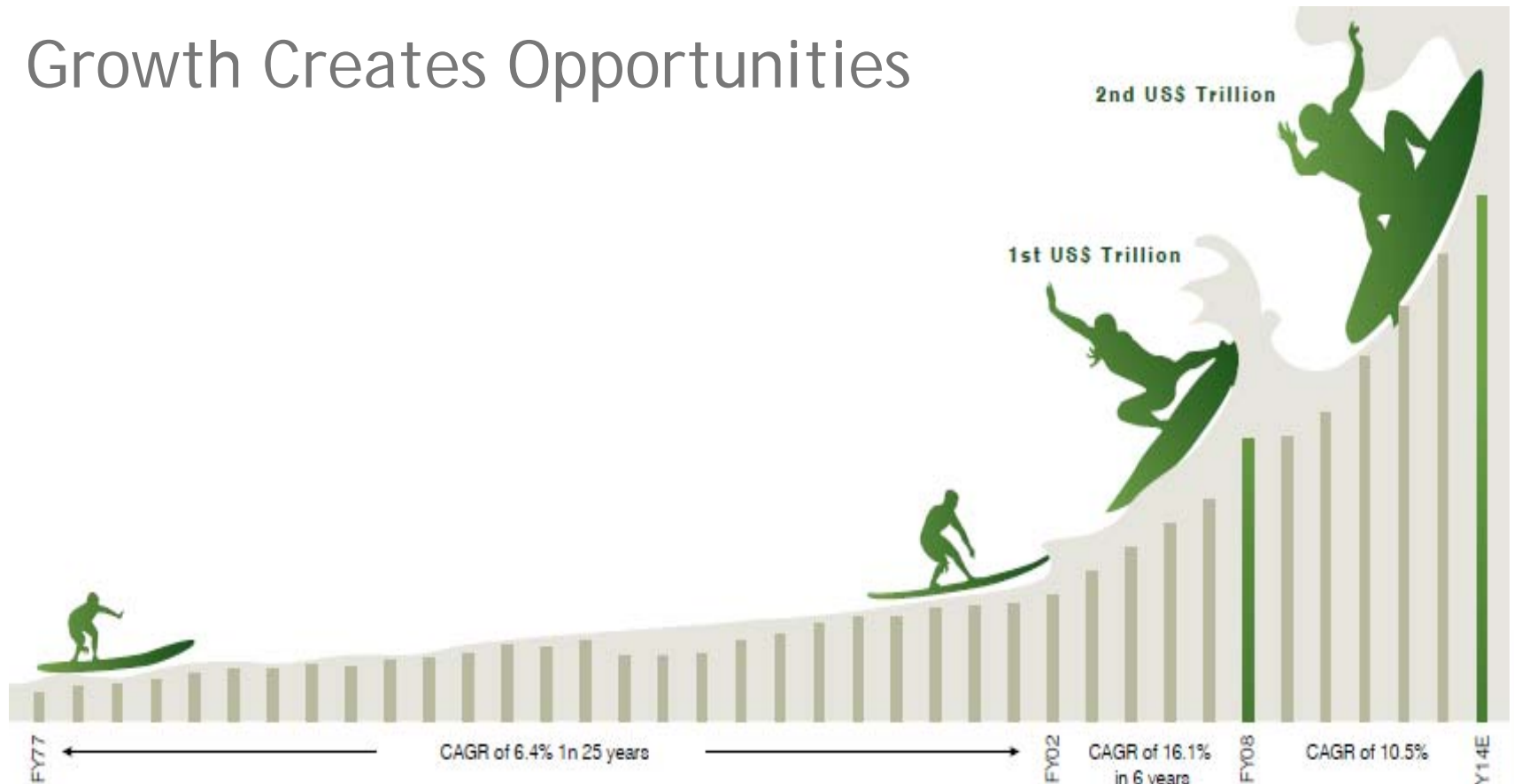
## GDP growth rebased to 1992



Source: IMF, IIFL Research

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

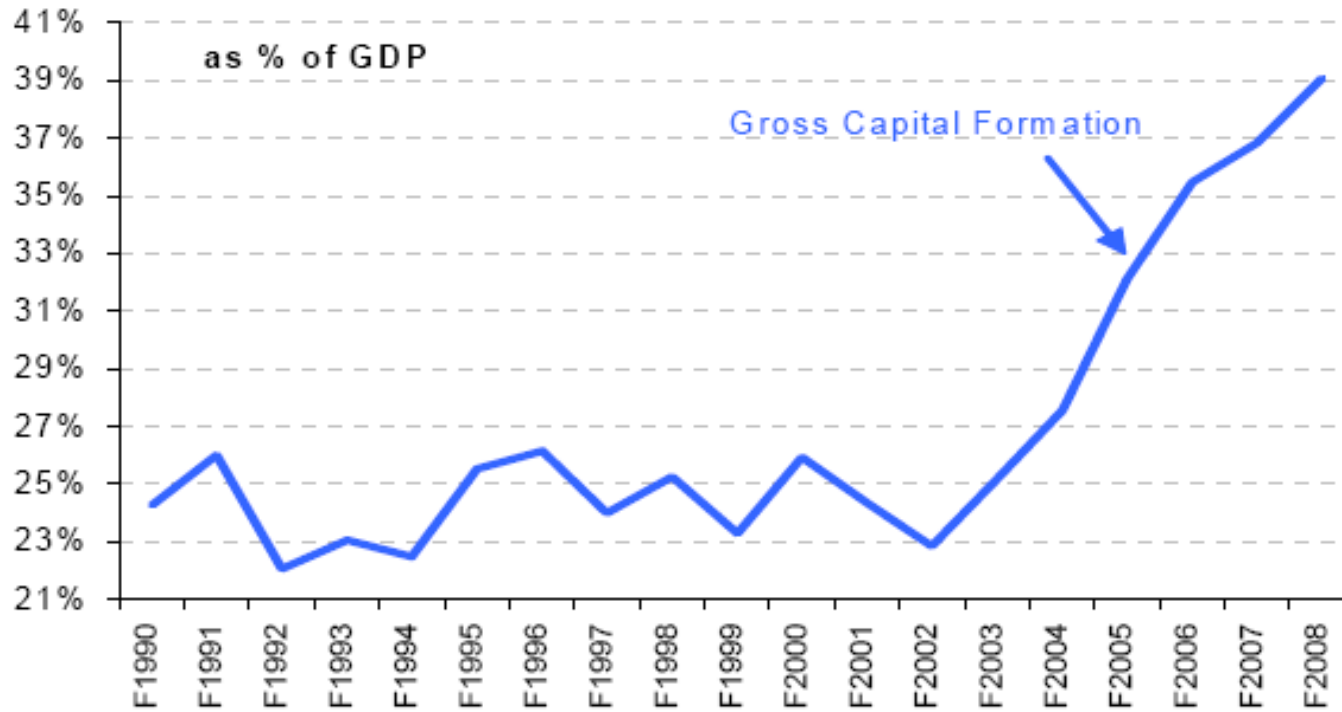
# Growth Creates Opportunities



- 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

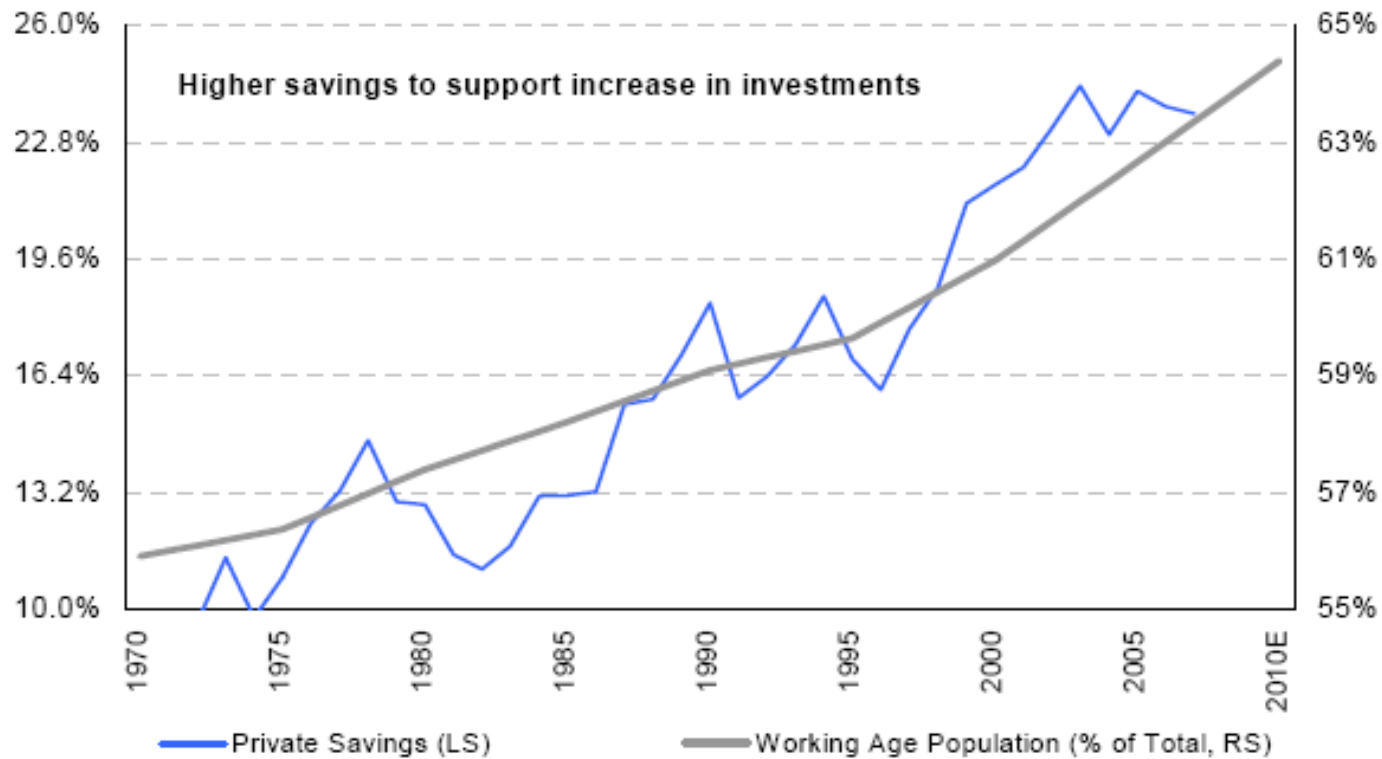


# Growth Is Being Led By A Rise In Capital Formation...



Source: CSO, Morgan Stanley Research

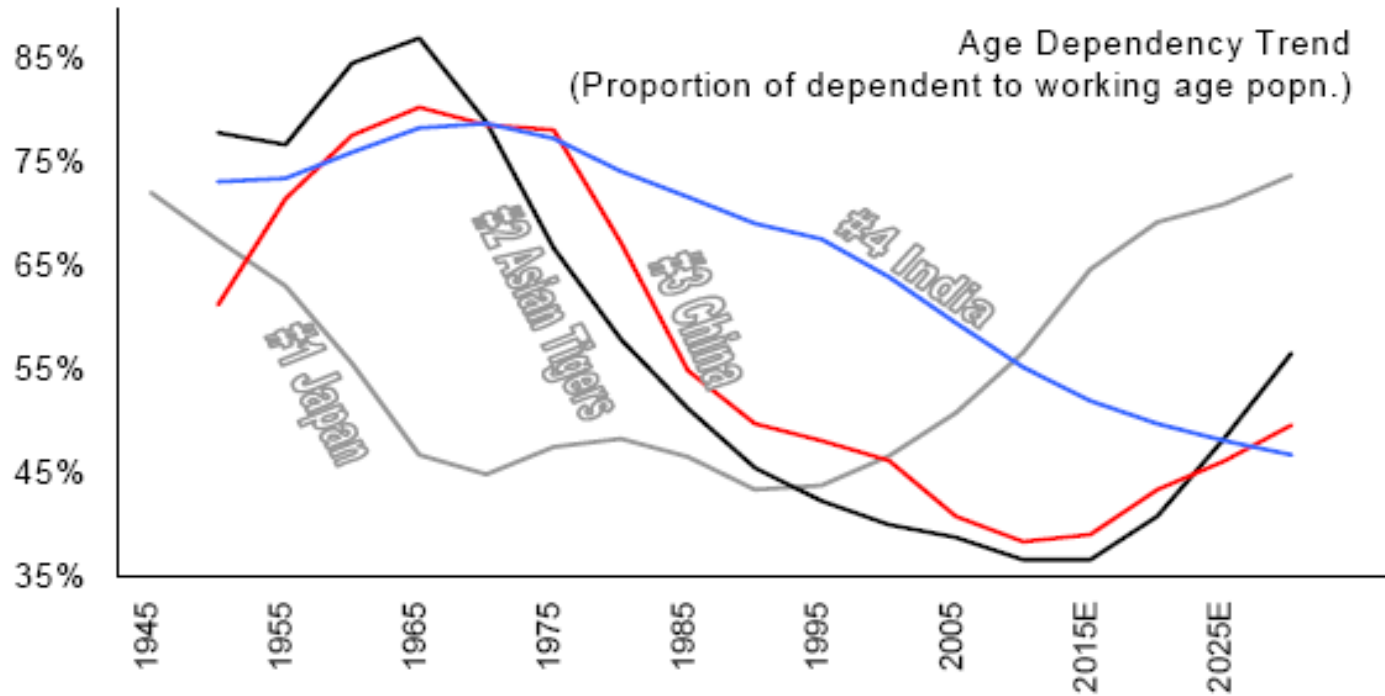
# ...Which Is Supported By A High Savings Rate



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



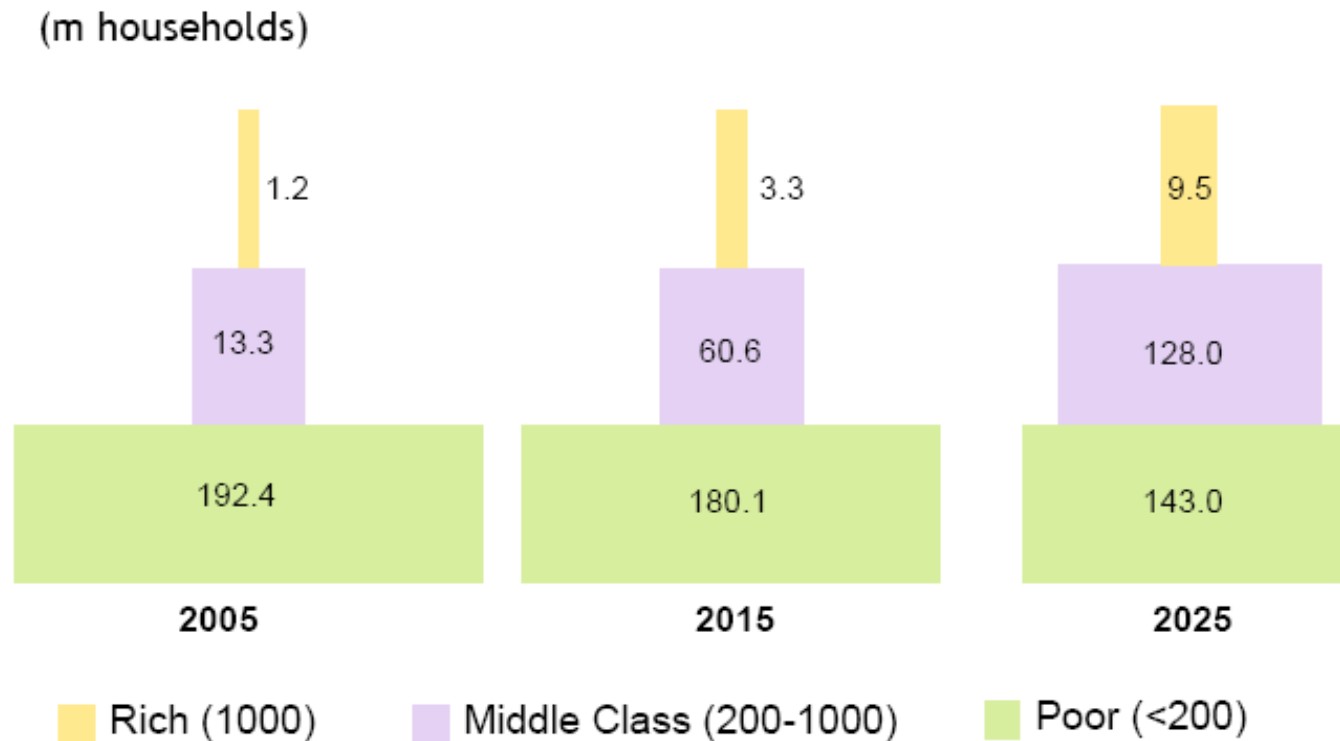
# India Is Poised To Reap Rich Demographic Dividend In Years To Come



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

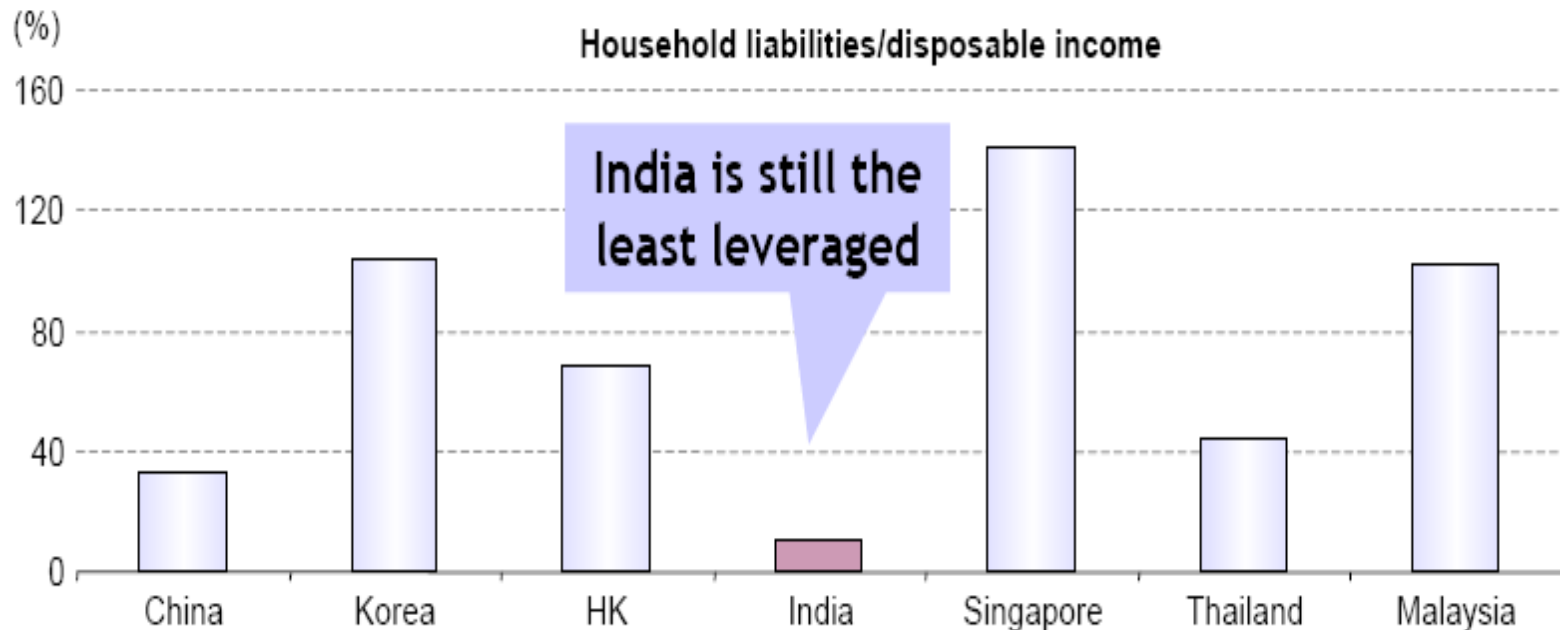


# Income Imbalance To Correct Leading To Rise In Consumption



Source: IDFC SSKI

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



Source: IDFC SSKI

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