

Equity Markets : Current Environment and Outlook

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Current Environment

- Global Equity markets declined in November, with the MSCI World Index falling by 2.69%.
- Indian markets under performed their global peers, falling by 8.93%.
- Commodity prices remained subdued falling by 0.5% on a MoM basis, as indicated by the benchmark CRB Reuters Jefferies total return index.
- In India Healthcare and FMCG were the best performing sectors, while Realty, CD and Metals sectors delivered the worst return for the month
- FII outflows during the month were at Rs.42bn. MF were buyers at Rs.8bn, while DII were net buyers of Rs.48bn during the month.
- Trading Activity picked up in November, with the cash trading turnover (US \$bn) rising by 2% MoM and the average open interest rising by 4% on a MoM basis.

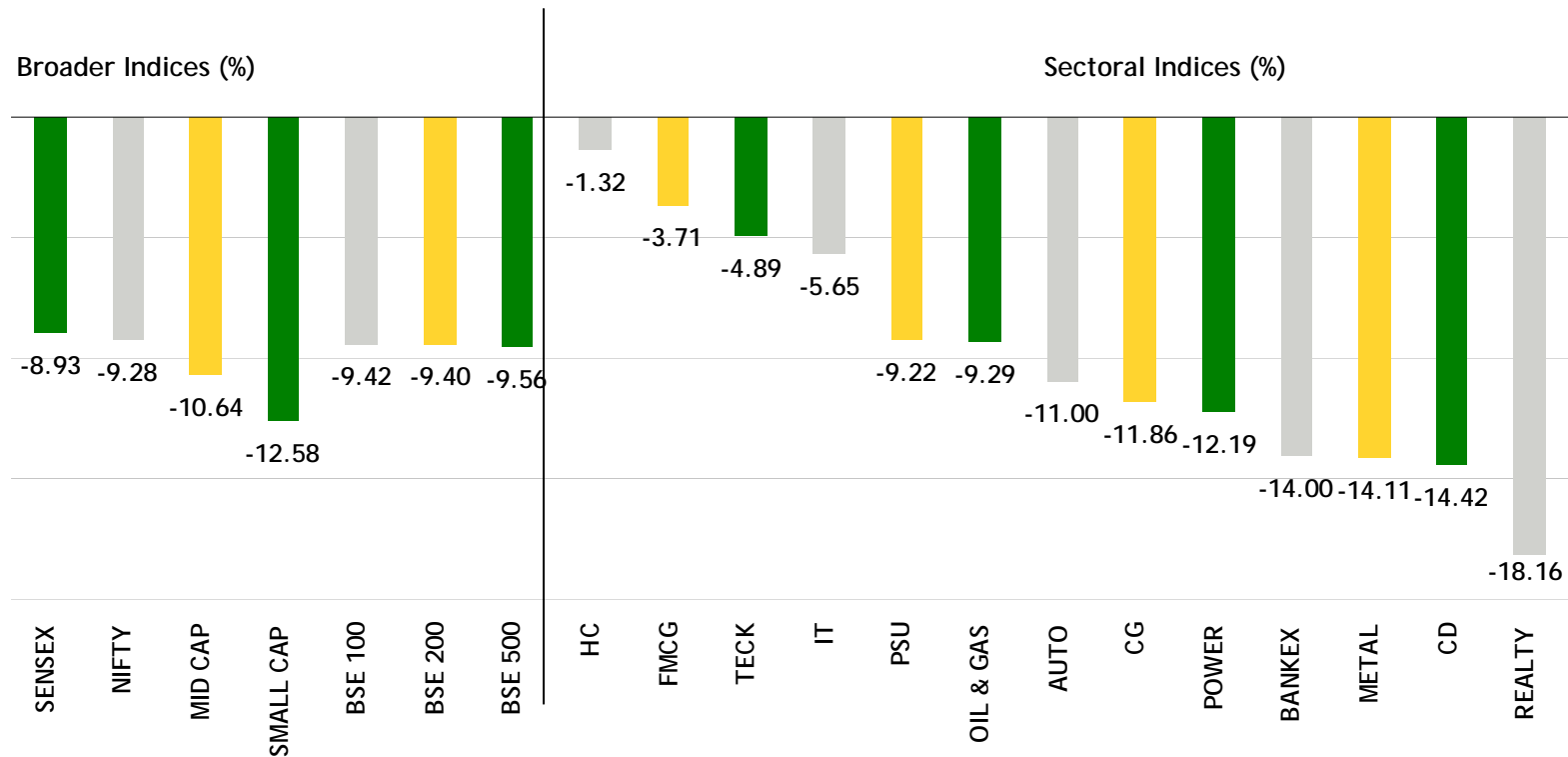
Global Equities

Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	2333.41	-5.46%	-16.90%	EM - Asia
BSE Sensex	India	16123.46	-8.93%	-21.38%	EM - Asia
Kospi	South Korea	1847.51	-3.22%	-9.92%	EM - Asia
Taiwan Weighted	Taiwan	6904.12	-9.01%	-23.05%	EM - Asia
Thailand SET 50 Index	Thailand	697.33	0.77%	-3.17%	EM - Asia
Jakarta Composite Index	Indonesia	3715.08	-2.00%	0.31%	EM - Asia
KLSE	Malaysia	1472.10	-1.33%	-3.08%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	56874.98	-2.51%	-17.94%	EM
Mexico IPC	Mexico	36829.15	1.85%	-4.47%	EM
Russian RTS Index	Russia	1540.81	-1.44%	-13.07%	EM
Philippine PSEi	Philippines	4211.04	-2.83%	0.24%	EM
Merval Buenos Aires Index	Argentina	2562.85	-11.79%	-27.27%	EM
HangSeng	Hong Kong	17989.35	-9.44%	-21.91%	Developed - Asia
Nikkei	Japan	8434.61	-6.16%	-17.54%	Developed - Asia
Strait Times	Singapore	2702.46	-5.37%	-15.28%	Developed - Asia
Dow Jones	USA	12045.68	0.76%	4.04%	Developed
CAC 40 Index	France	3154.62	-2.72%	-17.09%	Developed
All Ordinaries Index	Australia	4184.70	-4.03%	-13.66%	Developed
DAX Index	Germany	6088.84	-0.85%	-11.94%	Developed
Swiss Market Index	Switzerland	5652.31	-1.38%	-12.18%	Developed
FTSE 100	UK	5505.42	-0.70%	-6.69%	Developed
MSCI World Index	--	1184.60	-2.69%	-7.46%	--

* as on 30th November, 2011. Source: Bloomberg
EM – emerging markets, Developed – developed markets.



India : Sector performances



- Sensex fell by 8.9% over the previous month.
- MidCaps underperformed LargeCaps with 10.6% loss in the MidCap index.
- Healthcare and FMCG were the best performing sectors.
- Realty, CD and Metals sectors delivered the worst return for the month.

*Source: BSE,NSE. one month performance as on 30th November 11.

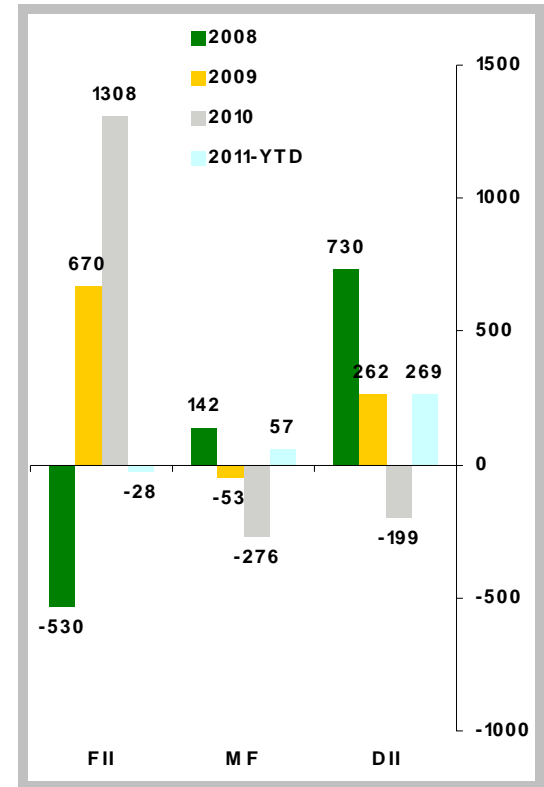
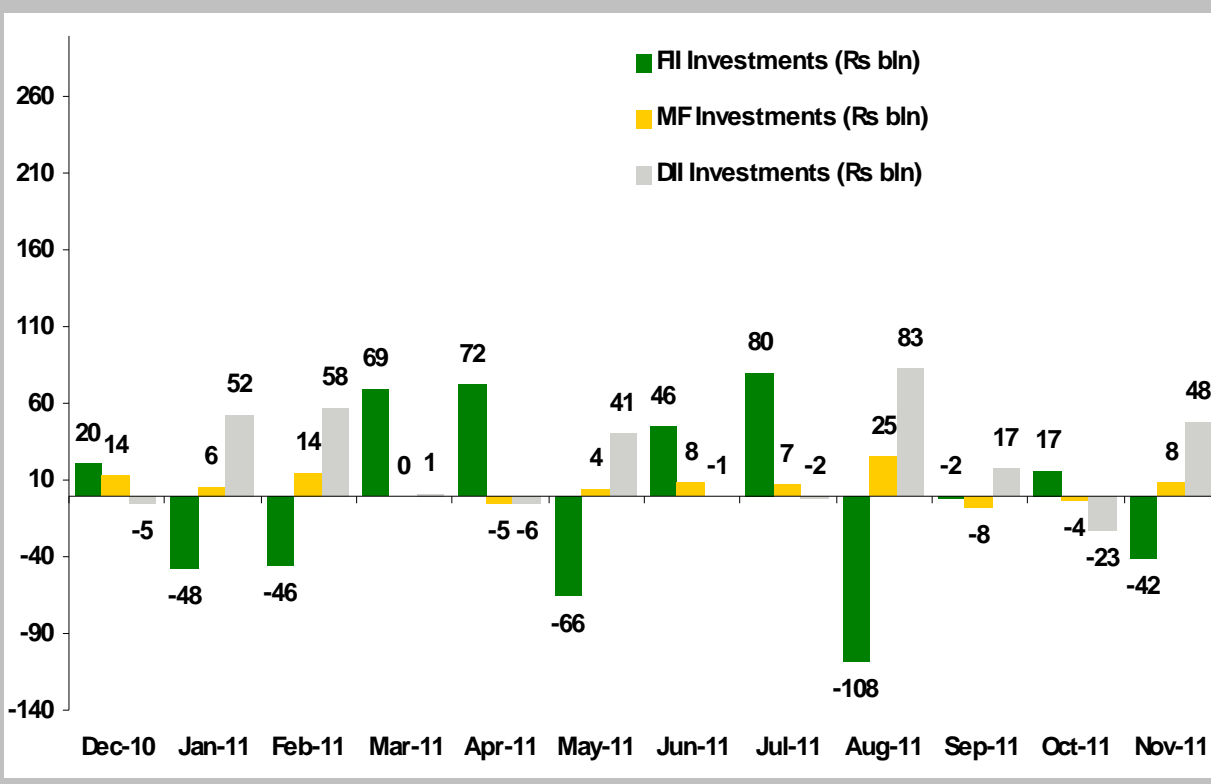
Top Gainers / Losers - Nifty

Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
Cipla	381 / 272.85	328.05	11.05%
Hind. Unilever	403.35 / 264.45	397.15	5.68%
Sun Pharma.Inds.	603 / 393.15	525.5	4.17%
Wipro	496.8 / 310.5	377.2	2.89%
Cairn India	372.35 / 249.3	301.45	1.06%
Top Losers for the month			
Losers	52 week H/L	Last Price#	% Loss*
S A I L	196.7 / 79.9	80.2	-28.52%
ICICI Bank	1202 / 704.9	712.45	-23.49%
Sterlite Inds.	195.95 / 98	99.3	-22.03%
Tata Steel	737 / 367	385.2	-20.22%
JP Associates	116.9 / 54.2	62.1	-19.82%

closing price as on 30th November 2011.* one month performance as on 30th November 2011.
Source: Capitaline



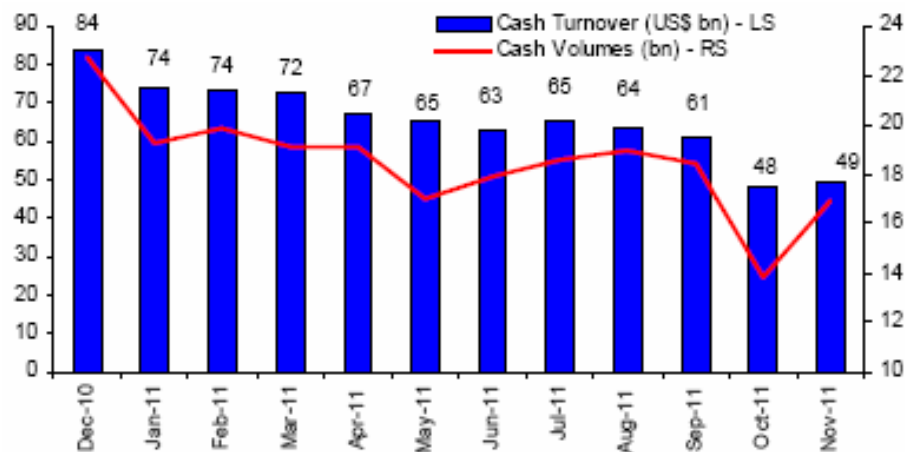
FII & DII Inflows



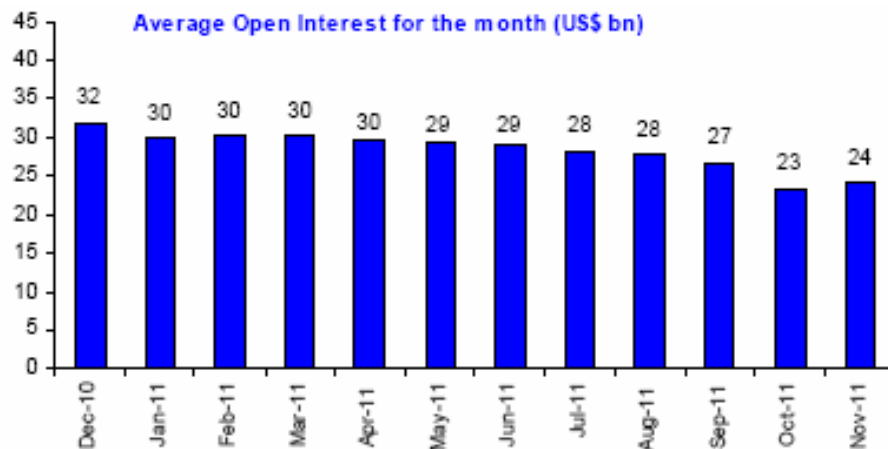
- FII outflows during the month were at Rs.42bn. FII outflows were at Rs.28bn for CY11 after a Rs.1308bn inflow in CY10 and Rs.670bn inflow in CY09.
- MF were buyers at Rs.8bn, while DII were net buyers of Rs.48bn during the month.



Market Activity



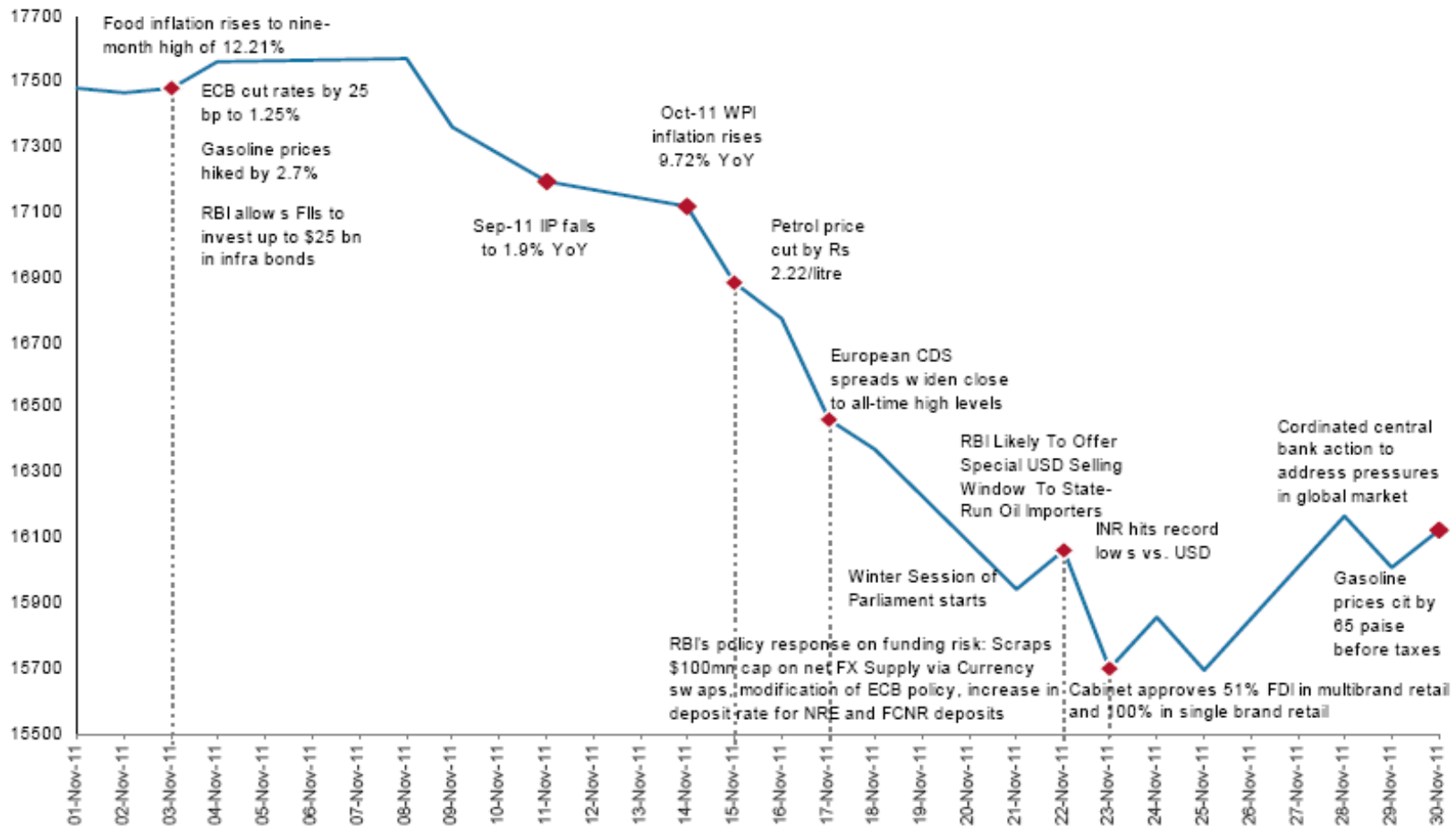
- In November 2011, cash trading turnover (US \$bn) increased marginally by 2% MoM.



- At the end of November 2011, average open interest increased 4% on a MoM basis.



November 2011 events timeline



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

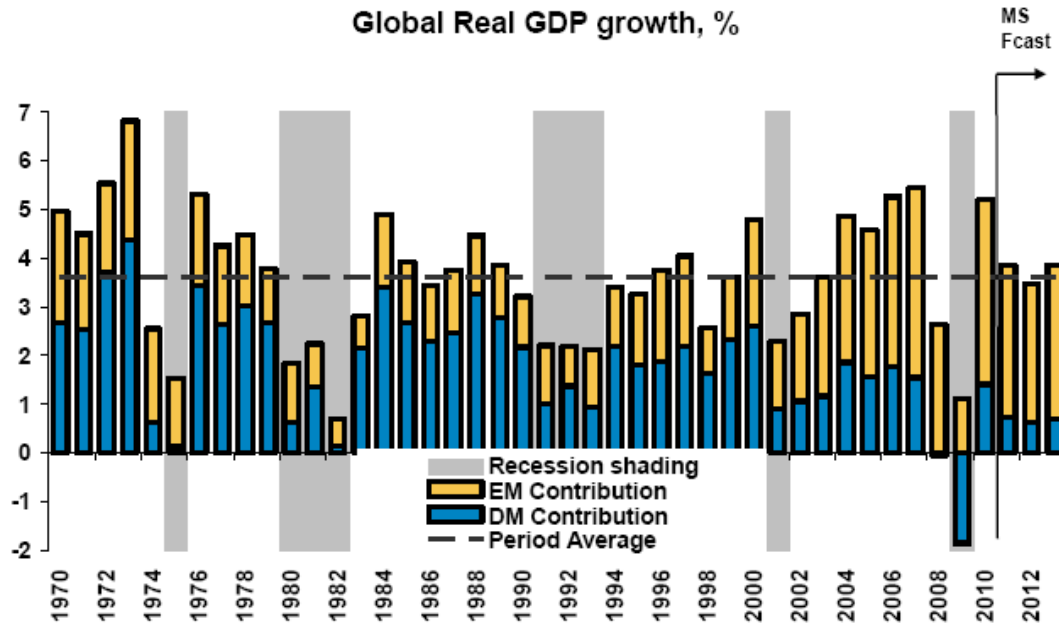


Religare MF: Equity Market Outlook and Opportunities

Equity Market Outlook

- Global GDP growth estimates have been cut further with World GDP growth now estimated at 3.5% in CY12. The cut is driven by a slowdown expected in Eurozone, Japan and Emerging Markets partially offset by some recovery in the USA.
- India's 3Q2011 GDP growth printed at 6.9 % yoy slowing markedly from 7.7% the previous quarter. Key reason for the decline was the slump in manufacturing, partially offset by strong Services growth.
- India's lead Indicators are pointing towards the first sub-7% GDP growth rate since the global financial crisis.
- Government continues to muddle along - it has formed a panel to fast track clearance of infrastructure projects but its headline grabbing effort to open up the Retail sector to FDI has been put on ice due to opposition from across the country.
- The earnings for Sensex companies in September 2011 quarter was slightly better than the lowered estimates, but all the same FY12 earnings estimates have been cut by a further 1.1% in November 2011 driven by a negative macro outlook and weak commentary.
- Our working assumption is that earnings for the Sensex will grow about 12% in both FY12 and FY13. Given where current market estimates for FY13 stand we expect cuts to the same.

Global Growth - EU pulls down, US holds on

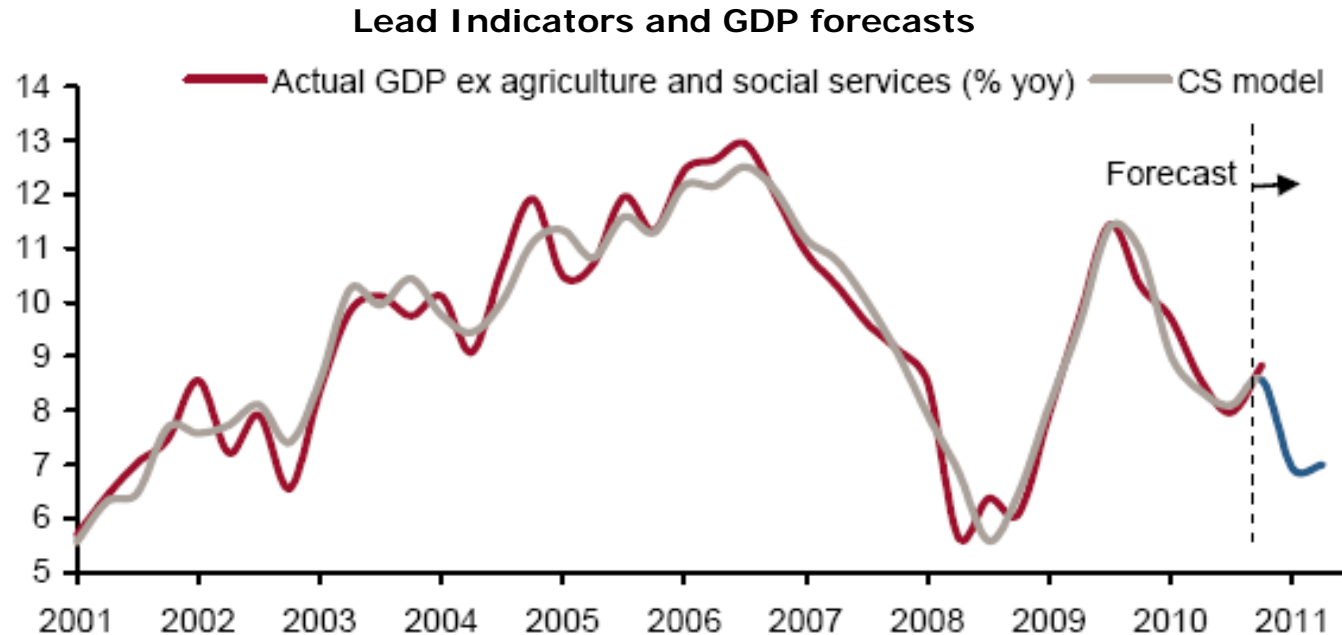


Note: Morgan Stanley Estimates used as proxy for market estimates

- Global GDP growth estimates have been cut further with World GDP growth now estimated at 3.5% in CY12.
- The key contributor for the slowdown is the cuts in Eurozone and UK economic growth estimates. Euro Zone Area is now expected to de-grow versus a nominal growth forecast earlier.
- Even the growth in emerging markets has been cut from 6.1% earlier to 5.7% currently.
- However, in stark contrast, the USA economic growth estimates have been revised upward from 2.1% growth to 2.2% growth forecast in 2012 now. This is also corroborated by recent improvement in US economic data like improvement in retail sales, decline in unemployment, etc.



India Growth Predicted To Be Weak in 2HCY12



- India's 3Q2011 GDP growth printed at 6.9 % yoy slowing markedly from 7.7% the previous quarter. Key reason for the decline was the slump in manufacturing, partially offset by strong Services growth.
- Also while the investment demand has collapsed to a degrowth of 0.6%, Consumption growth has also started to moderate (6.7% yoy) in 3Q2011.
- Lead Indicators are pointing towards the first sub-7% GDP growth rate since the global financial crisis.

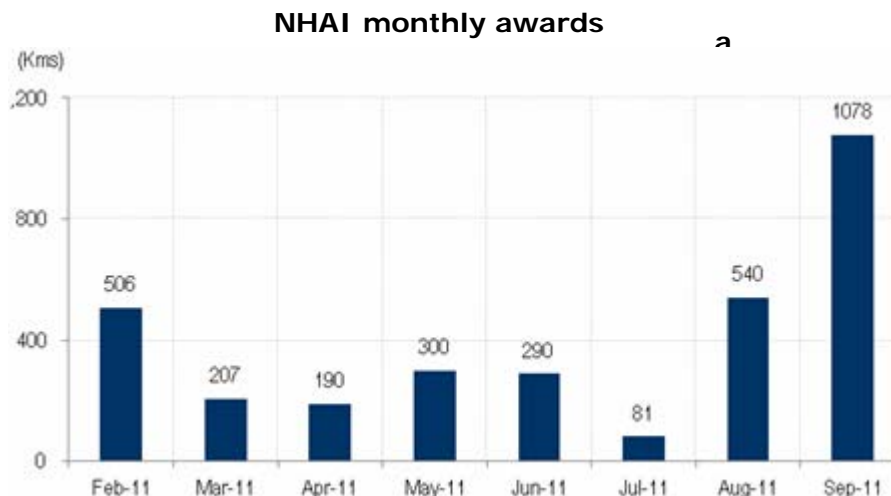


Currency Movement - Another Headache for RBI



- INR has depreciated by 16% in 2011 so far, and it is the worst performing currency in Asia. USD/INR has breached an all-time high of 51.97 (previously seen in March 2009) and is currently trading at 52.20.
- The main reasons for the large depreciation are widening trade deficit, weak capital inflows and reduced supply of f/x from European banks.
- The weakness in the currency is a variable the RBI will now have to consider when determining its monetary stand. It's stance cannot be determined solely by trends in inflation and growth.

Government Inaction Maybe Breaking - A Silver Lining



- Government finally appears to be moving in the right direction to revive capex cycle. It has formed an inter-ministerial panel to review infrastructure projects where individual banks have sanctioned loans of Rs1bn+ (140 such projects with total investments of Rs 2000bn). It is expected that a large number of these projects would be cleared over next few months.
- This panel has already cleared three major infra projects worth US\$5 billion including an electricity generation plant (Hinduja), metro rail system (L&T) and highway project (Andhra Pradesh).
- FinMin has also increased the FII limit in Government Securities and Corporate Bonds by US\$5bn each.
- While the parliament log jam has led to a suspension of FDI in retail, the intent of the government to go ahead with key reforms is quite strong.



September 2011 Earnings Season - Clearing a low hurdle

September 2011 PAT growth forecasts and actuals

YoY Earnings growth	Q3F11	Q4F11	Q1F12	Q2F12E	Q2F12A
MS coverage	25%	10%	11%	-9%	-6%
MS coverage ex-oil psu	15%	12%	3%	3%	6%
Broad Market	25%	14%	15%	-	-23%
Broad Market ex-oil psu	17%	14%	12%	-	-4%
BSE Sensex	26%	4%	9%	8%	15%

E = MS Analyst Estimate for MS coverage universe

E* = MS Analyst estimate for 119 companies that have reported thus far

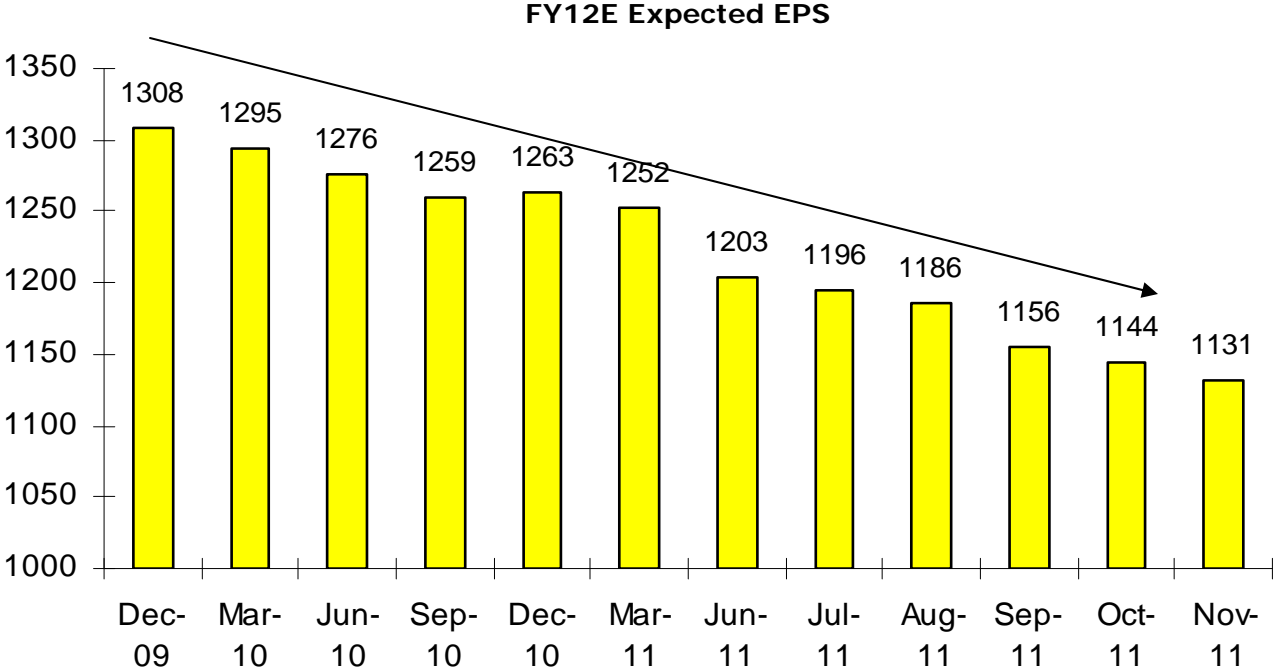
A = Actual earnings for the quarter for 118 companies that have reported thus far

Note: Morgan Stanley Estimates used as proxy for market estimates

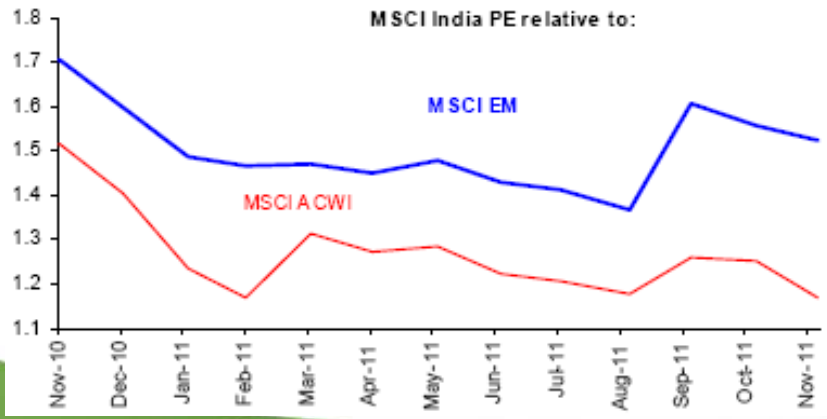
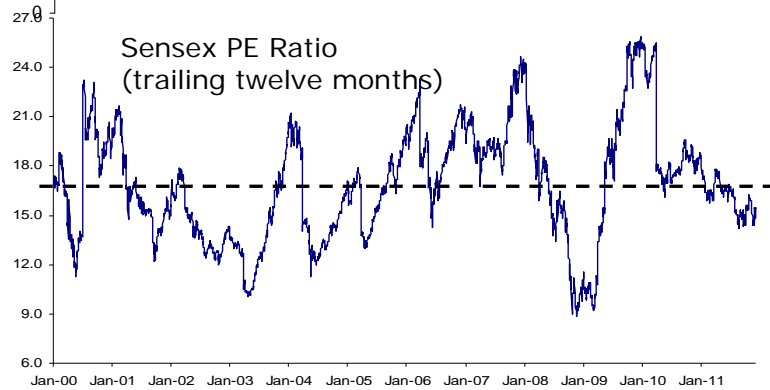
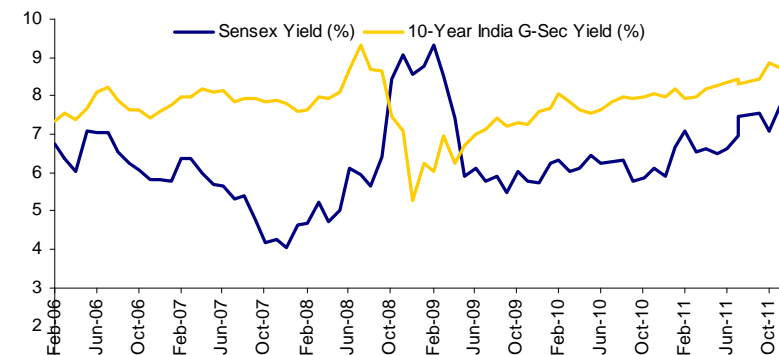
- The final earnings for Sensex companies was better than estimates, with net profit growing by 15% compared to an expectation of 8% growth.
- The aggregate Sensex earnings were dragged down by Bharti and Tata Steel, excluding which earnings grew 24%.
- Consensus has raised earnings for Technology and Staples sectors during the earnings season.



Earnings Forecasts - Still Falling



Valuations - Corrected Materially



- The gap between Sensex earnings yield and bond yield has narrowed by 88 basis points over the previous month as Sensex yield rose while the bond yield fell.
- Sensex is currently trading at 14.9x its trailing earnings. It is now 12% lower than its historical 11-year average trailing PE of 16.9x.
- On a 1-yr forward basis, Sensex is trading at 12.8x which is about 12% below its 15 year average PE.
- India's PE premium to MSCI Emerging markets has slightly contracted over the previous month, and is now at about 50% premium to MSCI EM PE currently.



Looking Ahead...

- The global macro environment is adverse with a slowdown looming in developed economies and emerging markets experiencing a policy induced slowdown in growth rates.
- The conflagration in sovereign debt issues in Europe is a key risk to financial markets across the globe due to the rising possibility of a disorderly outcome which causes financial markets to freeze up.
- There is an increasing expectation in the market for the RBI to start easing in the near future. However, we feel that the recent sharp depreciation in the value of Indian Rupee may constrain the Central Bank in doing so.
- The RBI in its mid quarter review has signaled that there is a very low probability of an upward rate action in the mid-quarter review of monetary policy in December provided that inflation outcomes are as per the expected trajectory.
- A key negative is the increase in government borrowing program due to fiscal slippages resulting in the hardening of the 10 year yield to 8.7%. We worry that this would have a negative impact on the investment climate, and it also pressurizes equity valuations.
- The Sensex is currently trading at 14.9x, which is 12% lower than its historical 11-year average trailing PE of 16.9x. Given the risk to earnings forecasts the trailing valuations provide a better benchmark and this number certainly provides comfort.
- We recognize the adverse macro economic challenges but prefer to focus on the ability of companies to withstand such pressures and emerge stronger when a cyclical upturn presents itself. Where valuations are supportive and bottom up credentials are healthy we would rather be constructive than be risk averse on macro considerations.

Investment view

Short term

- GDP growth likely to moderate to about 7- 7.5% in FY12.
- Earnings estimates have been cut for FY12 as we have long expected but the implied growth rate for FY13 is still 15-18% and we expect downgrades to this number
- 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 below average on trailing and forward basis investors can benefit from an upward re-rating of valuations in the future.

Strategy for investors

- The lesson from history is that valuations at entry are the crucial determinant of future returns and not the news flow.
- We recommend that investors should adopt a constructive approach towards equities given the comfort provided by valuations.

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