

Equity Markets : Current Environment and Outlook

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Current Environment

- Equity markets across the globe remained strong, with the MSCI World Index rising by 5.93%.
- Indian markets outperformed the global trend, rising by 6.68% in the month of March.
- Commodity prices continued to rally, with the benchmark CRB Reuters Jefferies total return index rising by 1.4%.
- In India, Metals was the best performing sector followed by the Healthcare sector. Realty and IT sectors delivered the worst return for the month.
- FII inflows were at Rs.199bn in March 2010, while DIIs recorded outflows of Rs.51.4bn. MF remained net sellers to the tune of Rs.38bn.
- Activity increased in the post budget month, with cash trading volumes (number of shares) increasing 16% MoM, but the average open interest remained flat MoM at a record high.

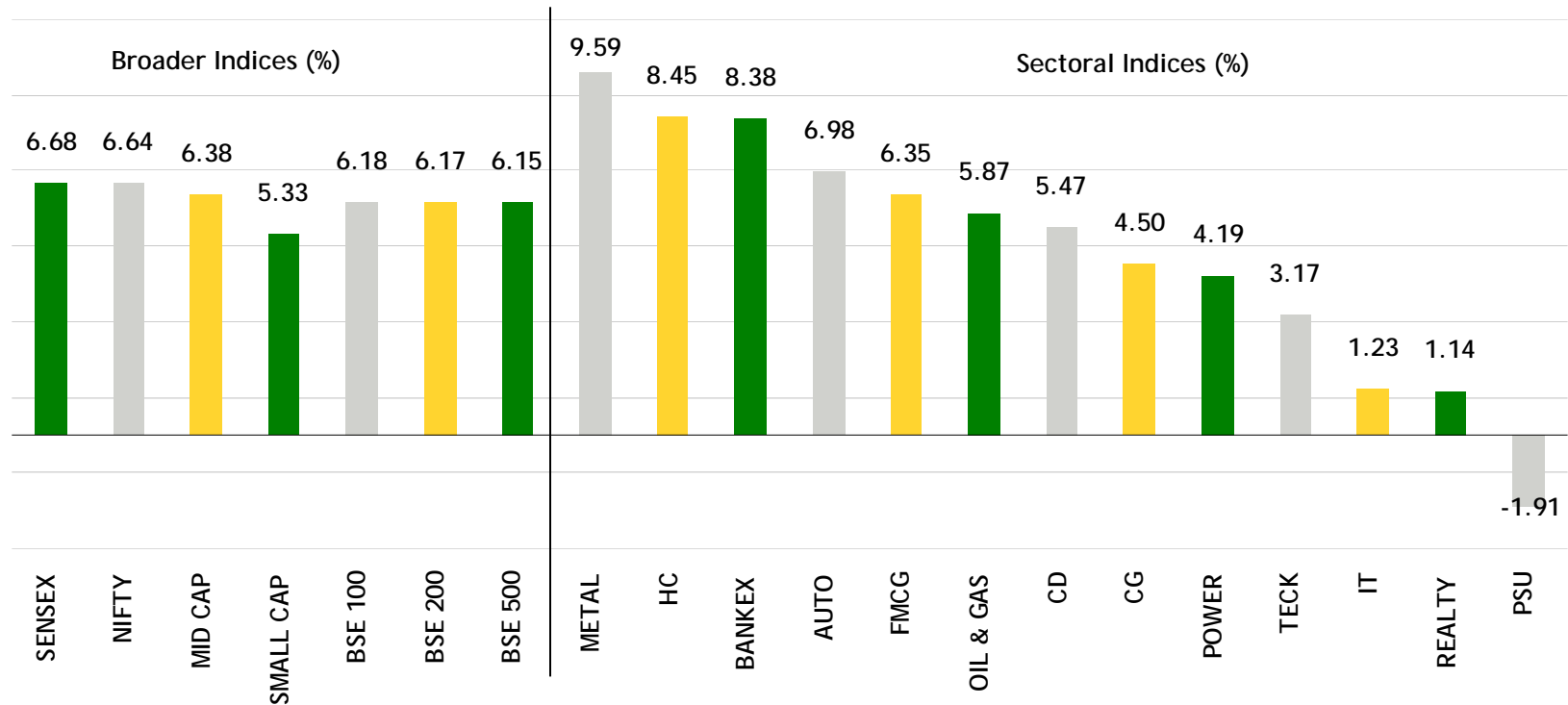
Global Equities

| Index | Country | Closing Price* | 1 Month Return (%) | YTD Return (%) | Category |
|---------------------------|-------------|----------------|--------------------|----------------|------------------|
| SSE Composite Index | China | 3109.11 | 1.87% | -5.13% | EM - Asia |
| BSE Sensex | India | 17527.77 | 6.68% | 0.36% | EM - Asia |
| Kospi | South Korea | 1692.85 | 6.16% | 0.60% | EM - Asia |
| Taiwan Weighted | Taiwan | 7920.06 | 6.51% | -3.27% | EM - Asia |
| Thailand SET 50 Index | Thailand | 558.28 | 9.97% | 7.22% | EM - Asia |
| Jakarta Composite Index | Indonesia | 2777.30 | 8.96% | 9.59% | EM - Asia |
| KLSE | Malaysia | 1320.57 | 3.92% | 3.75% | EM - Asia |
| Ibovespa Sao Paulo Index | Brazil | 70371.54 | 5.82% | 2.60% | EM |
| Mexico IPC | Mexico | 33266.43 | 5.16% | 3.57% | EM |
| Russian RTS Index | Russia | 1572.48 | 12.01% | 8.85% | EM |
| Philippine PSEi | Philippines | 3161.80 | 3.88% | 3.57% | EM |
| Merval Buenos Aires Index | Argentina | 2373.71 | 6.86% | 2.28% | EM |
| HangSeng | Hong Kong | 21239.35 | 3.06% | -2.89% | Developed - Asia |
| Nikkei | Japan | 11089.94 | 9.52% | 5.15% | Developed - Asia |
| Strait Times | Singapore | 2887.46 | 4.97% | -0.35% | Developed - Asia |
| Dow Jones | USA | 10856.63 | 5.15% | 4.11% | Developed |
| CAC 40 Index | France | 3974.01 | 7.15% | 0.96% | Developed |
| All Ordinaries Index | Australia | 4893.10 | 5.20% | 0.21% | Developed |
| DAX Index | Germany | 6153.55 | 9.92% | 1.74% | Developed |
| Swiss Market Index | Switzerland | 6873.37 | 2.42% | 5.00% | Developed |
| FTSE 100 | UK | 5679.64 | 6.07% | 4.93% | Developed |
| MSCI World Index | -- | 1200.53 | 5.93% | 2.74% | -- |

* as on 31st March 10. Source : Bloomberg
EM – emerging markets, Developed – developed markets.



India : Sector performances



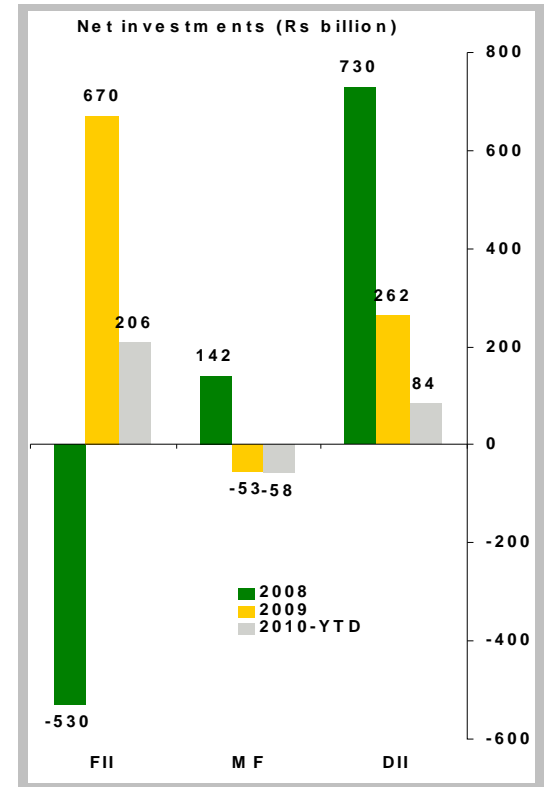
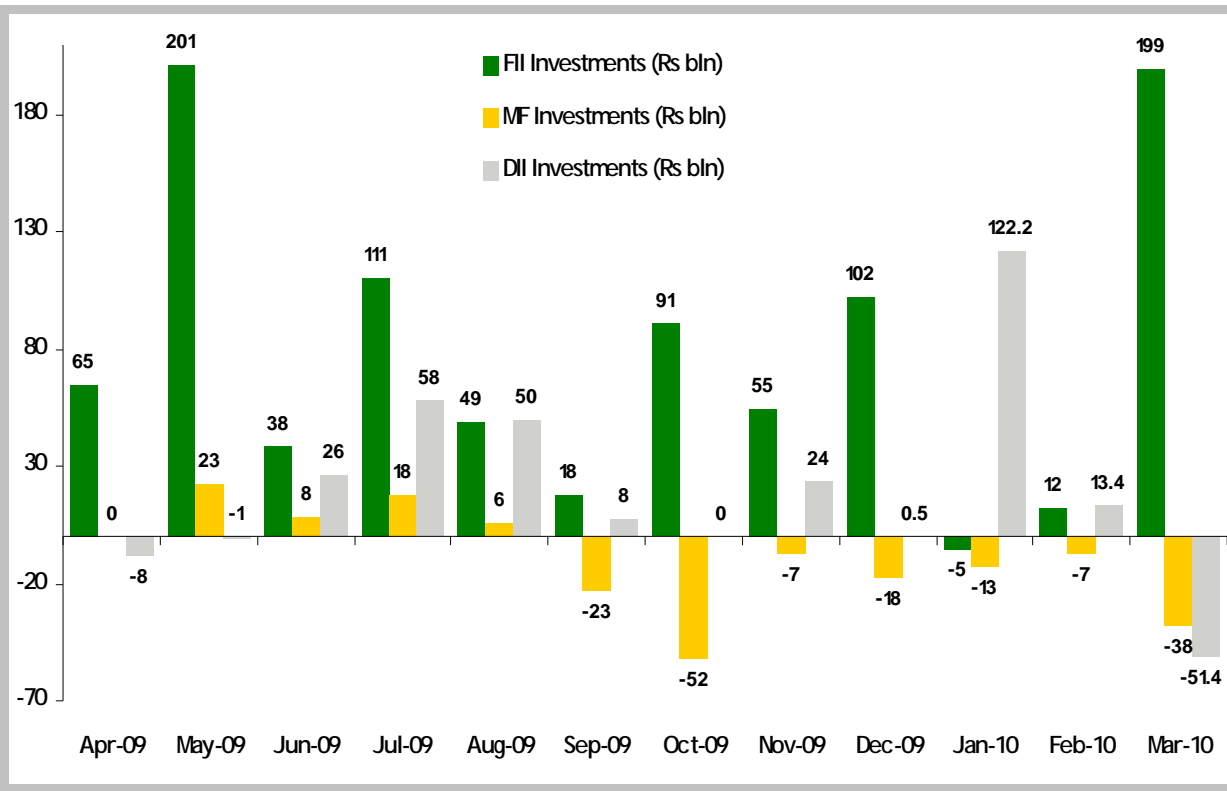
- The markets rose by 6.68% over the previous month.
- Metals was the best performing sector followed by the Healthcare sector.
- Realty and IT sectors delivered the worst return for the month.

Top Gainers / Losers - Nifty

| Top Gainers for the month | | | |
|---------------------------|------------------|-------------|---------|
| Gainers | 52 week H/L | Last Price# | % Gain* |
| Sun Pharma. | 1053.5 / 1806.95 | 1789.60 | 16.14 |
| S A I L | 93.1 / 258.3 | 251.80 | 15.27 |
| Cairn India | 175 / 310 | 305.30 | 14.73 |
| ITC | 177.35 / 272.7 | 263.15 | 13.40 |
| HDFC Bank | 904.1 / 1986 | 1932.50 | 13.37 |
| Top Losers for the month | | | |
| Losers | 52 week H/L | Last Price# | % Loss* |
| B P C L | 348.7 / 658 | 516.7 | -8.13 |
| Reliance Capital | 331.15 / 1066 | 754.65 | -4.04 |
| Maruti Suzuki | 741.5 / 1740 | 1416.15 | -3.24 |
| HCL Technologies | 99 / 388 | 357.8 | -2.63 |
| O N G C | 752.5 / 1273.5 | 1098.5 | -1.66 |

closing price as on 31st March 2010. * one month performance as on 31st March 2010.
Source: capitaline

FII & DII Inflows

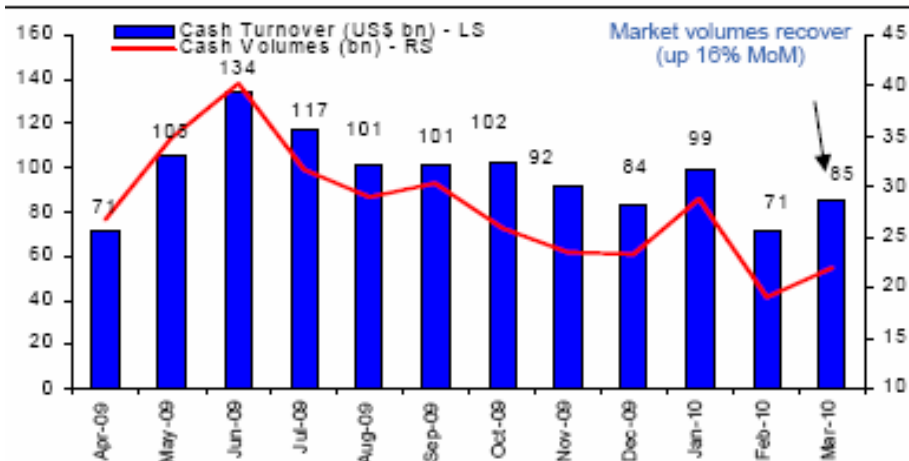


- FII inflows were at Rs.199bn in March 2010. FII inflows have remained positive on a YTD basis at Rs.206bn for CY10 after a Rs.670bn inflow in CY09.
- DII recorded outflows of Rs.51.4bn. MF remained net sellers to the tune of Rs.38bn.

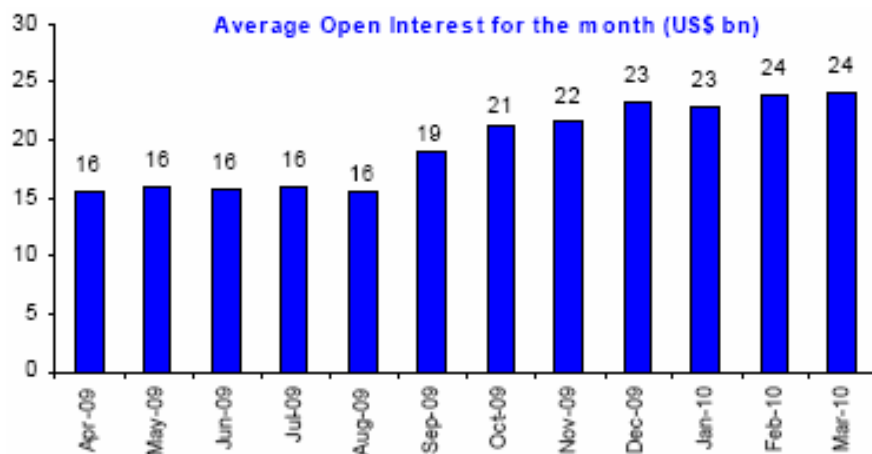


Market Activity

Cash Trading: Turnover and Volumes



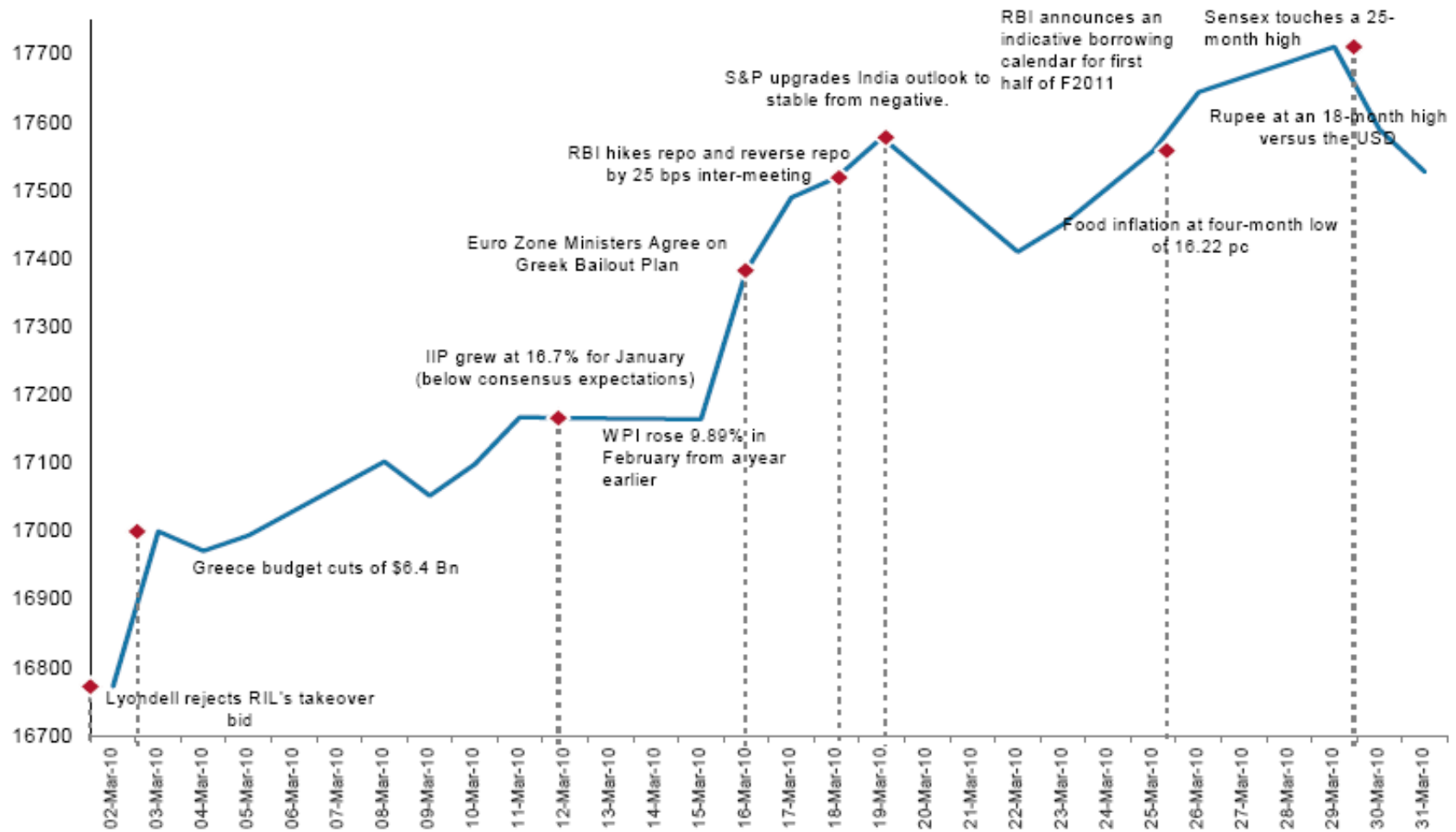
- In March, cash trading volumes (number of shares) increased sharply by 16% MoM.



- At the end of March, average open interest remained flat MoM at its highest level since Jan-09.



March 2010 events timeline



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



Religare MF: Equity Market Outlook and Opportunities

Equity Market Outlook

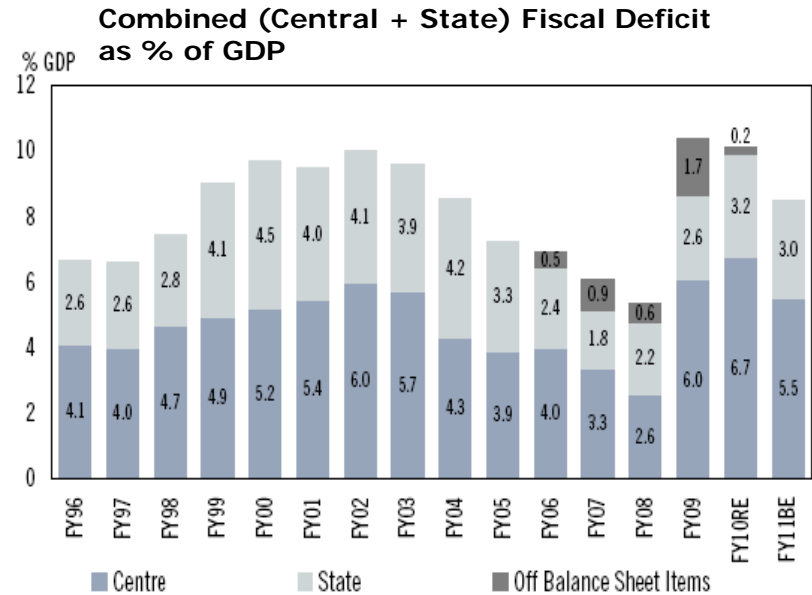
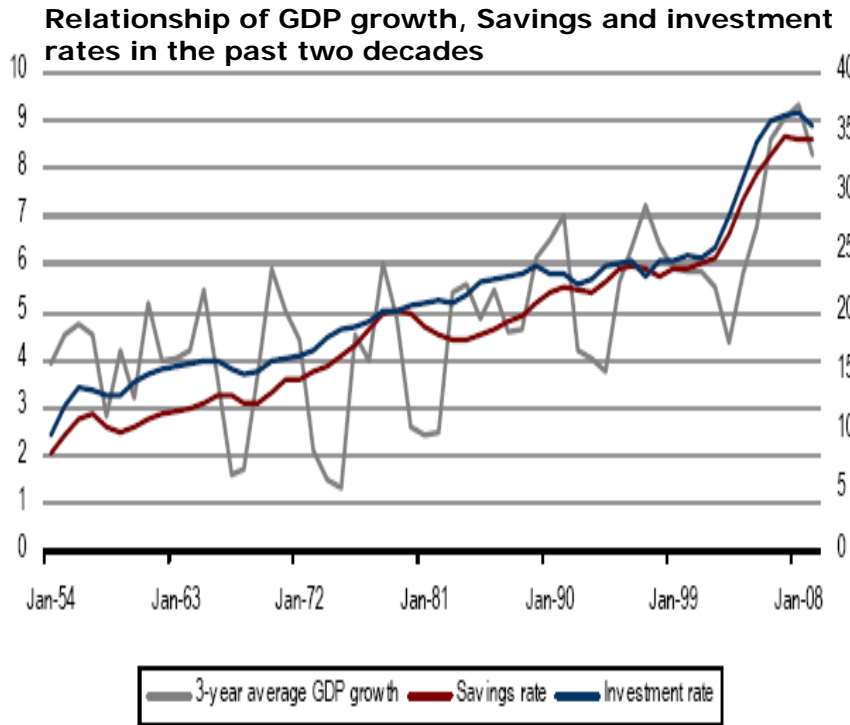
- Global GDP is expected to bounce back in CY10E with an estimated growth of about 3%.
- The G7 countries are expected to under perform the global GDP growth with an estimated growth of about 2%. However, higher global GDP growth is expected to be driven by both India and China.
- Six decades of data show that the longest and the fastest periods of Indian growth and contraction were accompanied by similar trends in savings and investment rates suggesting that 35%-plus savings and investment rates are essential for the economy to aim for 8-9% p.a. secular growth in GDP over a long period.
- Recent growth in India's GDP has been predominantly driven by increased consumption expenditure. Thus, compared to 2003-08, the trends of current GDP growth contribution are moving in a wrong direction due to excessive private and government consumption, which might lead to inflation.
- Inflation could be higher by 1.5 percent points versus expectations if the government allows full deregulation of auto fuel prices (there are few other alternatives).
- Consensus continues to expect a 6% decline in FY10 Sensex earnings over FY09 and a 27% growth in FY11 Sensex EPS over FY10. However, a consensus expectation of a 20% growth in FY12E Sensex EPS at 1252 might appear a bit stretched.
- Sensex is currently trading at 21.4x its trailing earnings which is well above its historical averages; this is however in line with trends seen across emerging markets.

Global GDP expected to bounce back in CY10



- Global GDP is expected to bounce back in CY10 with an estimated growth of about 3%.
- The G7 countries are expected to under perform the global GDP growth with an estimated growth of about 2%.
- China, India and other emerging economies to continue to lead growth around the world.

Sustainable High GDP Directly Correlated To Higher Investments

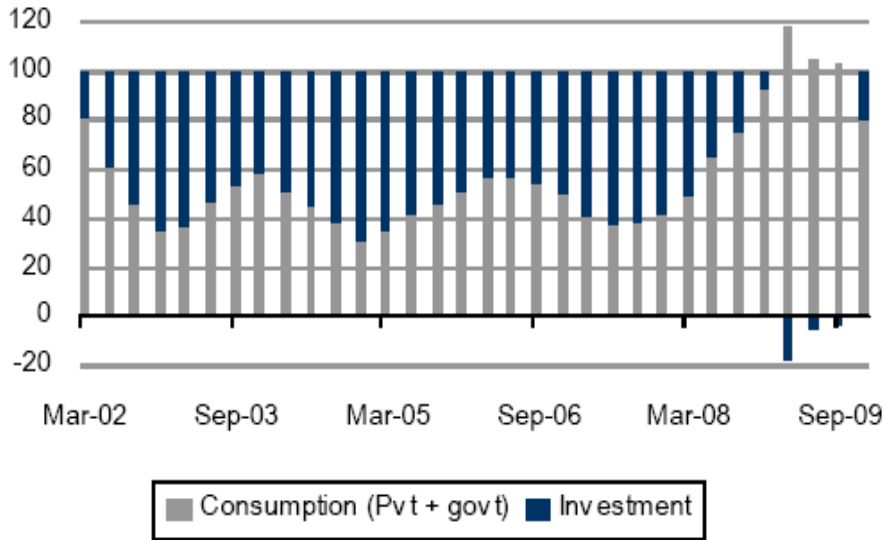


- Six decades of data show that the longest and the fastest periods of Indian growth and contraction were accompanied by similar trends in savings and investment rates.
- The data suggests that 35%-plus savings and investment rates are essential for the economy to sustain 8-9% p.a. secular growth in GDP.
- The high fiscal deficit (government dis-saving) reduces savings and investments and could lead to a crowding out of private investment expenditure.

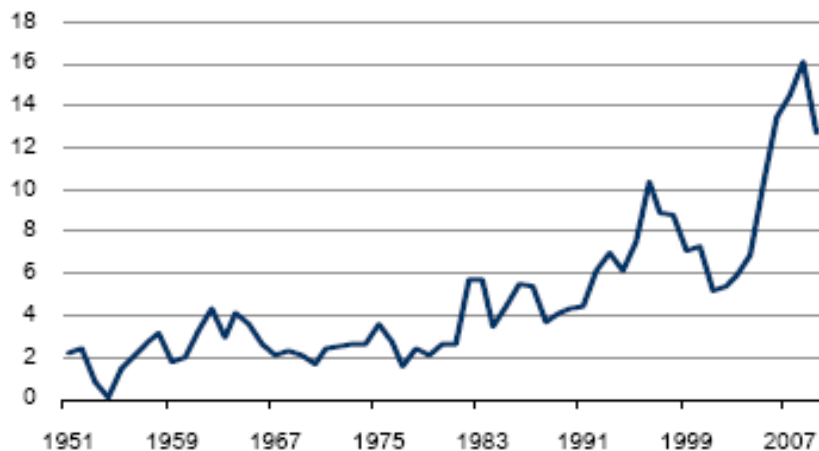


The baton must pass from consumption to investment

Contribution to GDP ex net exports growth (4qtrm.a.)

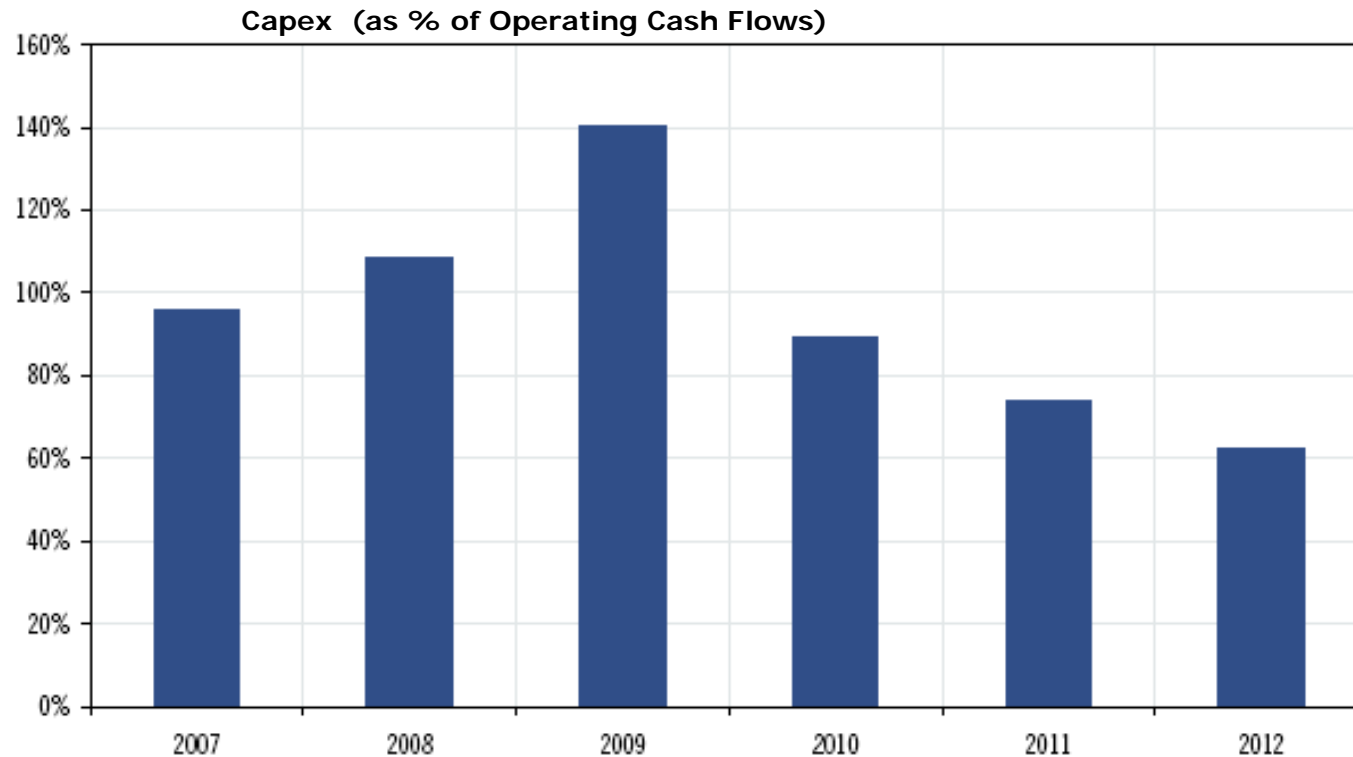


Private corporate sector gross investment as % of GDP



- Growth in GDP in recent quarters has been driven predominantly by increased consumption expenditure, but this is not a sustainable trend.
- This is unlike the growth trend of 2003-08 when the investment cycle was the key driver of growth.
- Consumption growth will remain stable but as stimulus measures abate and interest rates rise the baton must pass to the investment cycle.
- The private corporate sector's investments have dropped sharply as companies adjusted to last year's crisis.
- Continued consumption growth in the absence of a revival in the investment cycle will result in further inflationary pressure.

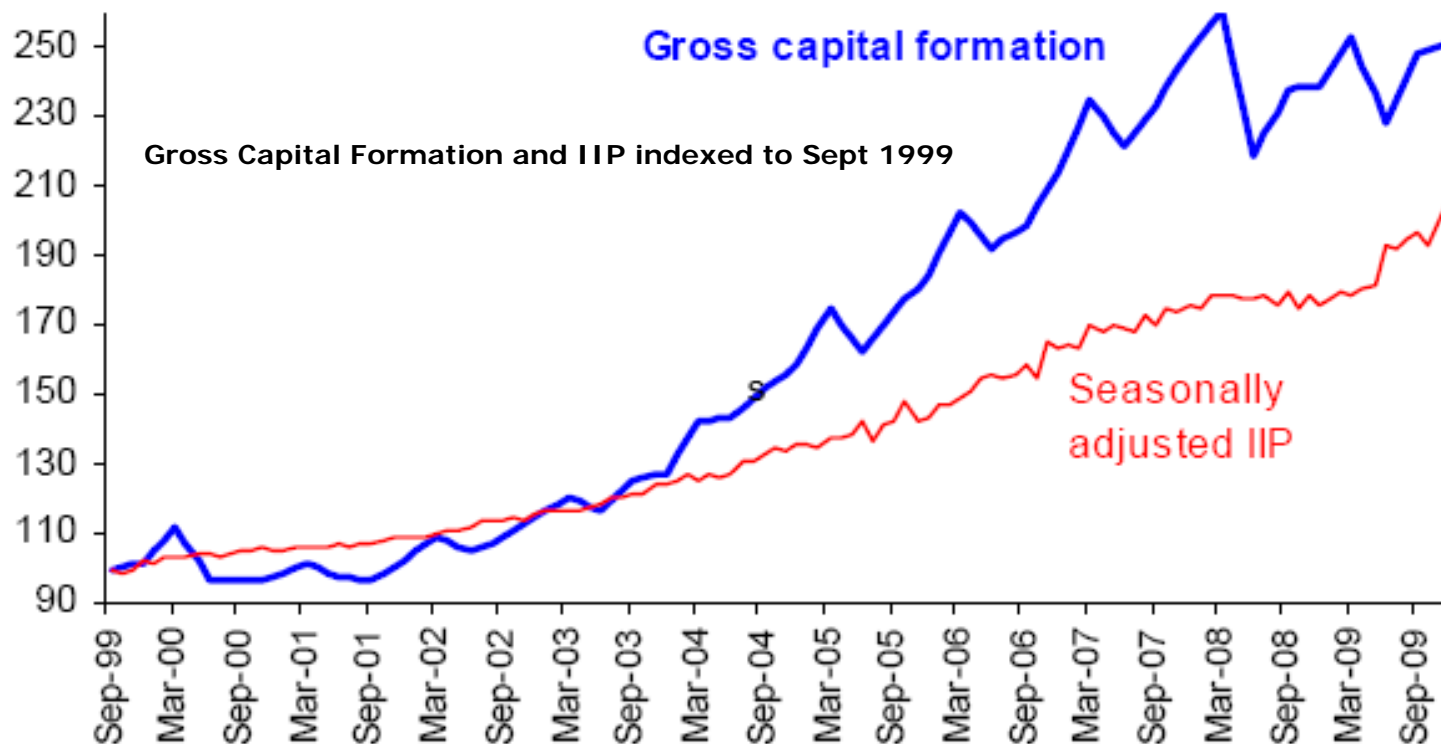
Rise in Free Cash Flows: Good or Bad?



- The decline in corporate capital expenditure or investment is visible in the estimated decline in capital expenditure as a percentage of Operating Cash Flows for the next three years for a sample of 141 listed companies. (source: Citi research)
- An increase in free cash flows arguably makes a case for higher valuations but for a growing economy like India, where the investment cycle is the key to sustaining high rates of GDP growth, this is a concern.



Are capacities fully utilized?

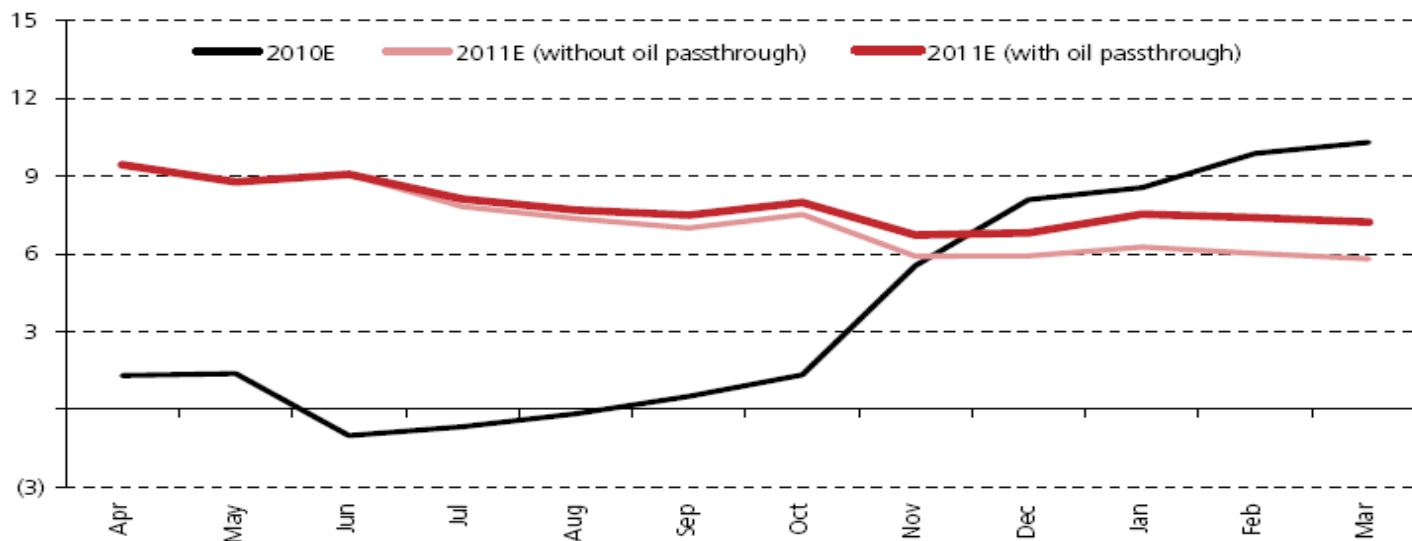


- The Index of Gross Capital Formation and IIP (indexed to September 1999) suggests that capital investment has grown much faster than production over the last decade.
- It is likely therefore that companies will wait for capacity utilization rates to move closer to full utilization before firming up further investment plans.
- Anecdotally companies still appear to be focused more on de-leveraging and stabilizing their recent investments rather than pursuing fresh capital investments.



Oil : a slippery slope

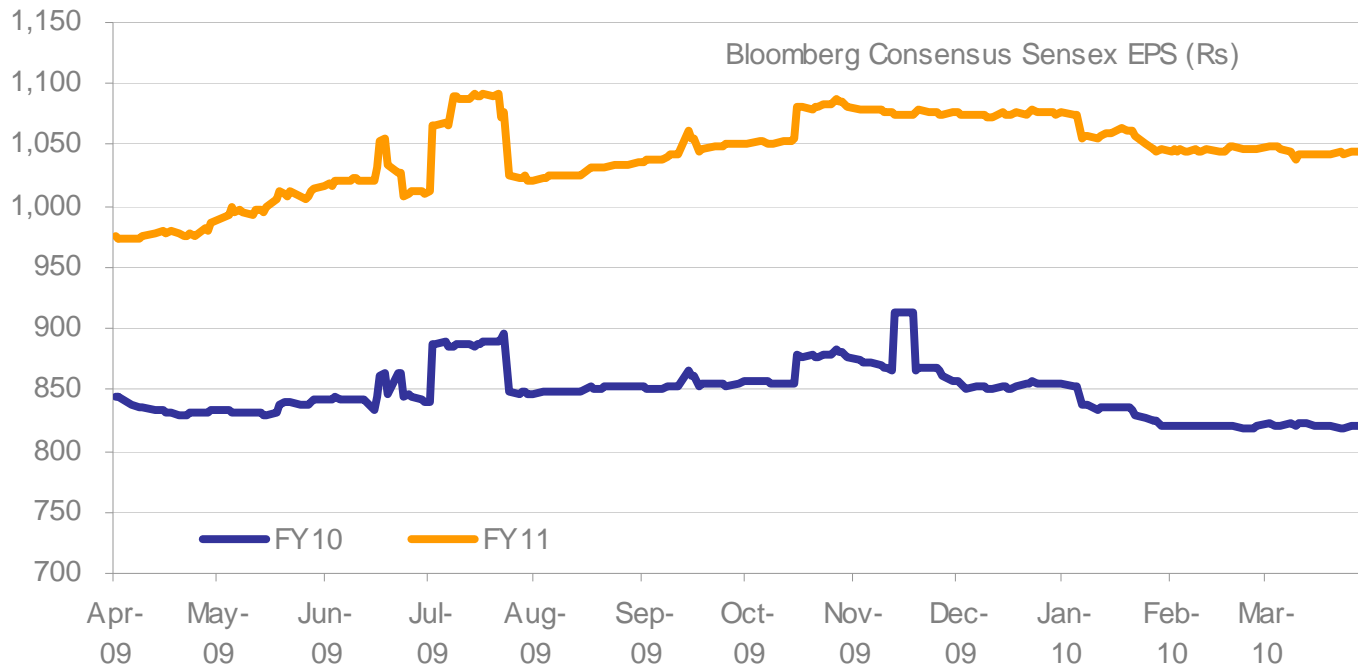
Headline WPI inflation rate (yoy), March fiscal year-ends, 2010-2011E (%)



- At the current level of retail fuel prices, Oil Marketing Companies have already indicated an aggregate loss of Rs.100,000 cr of which only 1/3 is likely to be compensated by the upstream companies.
- The rest will have to be borne by the government in effect resulting in further borrowing by the government or by the oil companies
- If the government hikes fuel prices to pass through the entire burden inflation could be higher by 1.5 percent points.



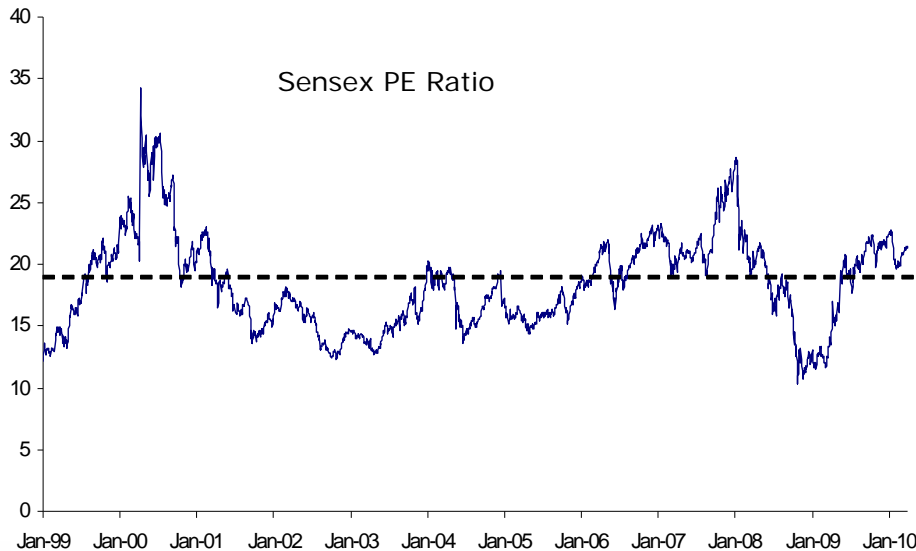
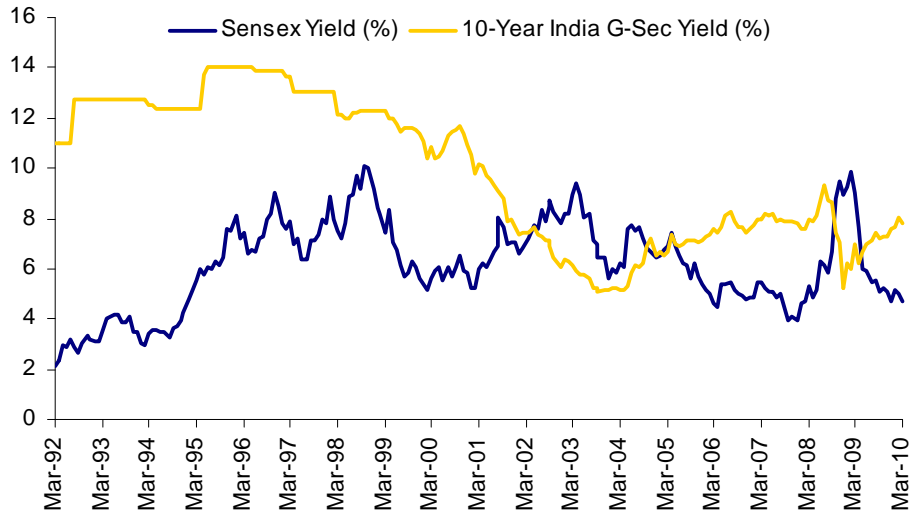
Earnings



- There have been no material changes to Consensus earnings expectation in the month.
- Consensus continues to expect a 6% decline in FY10 Sensex earnings over FY09 and a 27% growth in FY11 Sensex EPS over FY10.
- Consensus expects FY12E Sensex EPS at 1252, a growth of 20% over FY11E.



Valuations



- The gap between Sensex earnings yield and bond yield has widened by 12 basis points over the previous month. Both the Sensex yield and the bond yields have fallen in the month.
- Sensex is currently trading at 21.4x its trailing earnings. The gap between the current multiple and historical 10-year average trailing PE of 18.4x has widened in the month.
- The valuation surge is not unique to India. The MSCI Emerging Market Index is also trading at approximately 19.1x trailing earnings.



Looking Ahead...

- The macro environment continues to improve as is indicated by an improvement in various lead indicators including the credit offtake.
- The baton must now pass from private consumption and government spending to the investment cycle in order to sustain high levels of GDP growth.
- The forecasted rise in free cash flows signal that the private sector is not yet ready to embark on a new investment cycle.
- Capacity utilization rates may have to rise further before the private sector responds to market signals.
- As expected by us, RBI hiked the key policy rates by 25 basis points ahead of the credit policy, in a bid to tame inflation.
- We expect that with the Indian economy back in the growth zone and inflation as a potential threat, the RBI will continue to act to normalize policy and see further rate action to the tune of 100 basis points this year.
- Given the performance in the third quarter we expect GDP growth for the full year to be slightly above 6.5% GDP growth expectation as against earlier expectations of 6-6.5%.
- The inverse correlation between the dollar and asset markets (equities, commodities etc) appears to have broken in the first quarter of 2010 but the correlation between equity markets remains heightened.
- We believe that the recovery is now factored into earnings estimates and valuations and upsides are likely to be led more by stock picking.

Investment view

Short term

- GDP growth likely to be slightly above 6.5% in FY10
- We expect earnings to decline 5% in FY10 over FY09. The current consensus forecasts a healthy 27% in FY11 but we would be cautious about visibility of this estimate as significant contribution comes from global cyclicals
- Markets are now finely priced with most measures trading above long term averages and a recovery is being priced in.
- The Sensex is trading at a P/E of 16.8x 1-year forward earnings. Based on historical trends the odds are not very favorable for forward returns.

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
- The elevated valuation measures might reduce the returns to below earnings growth

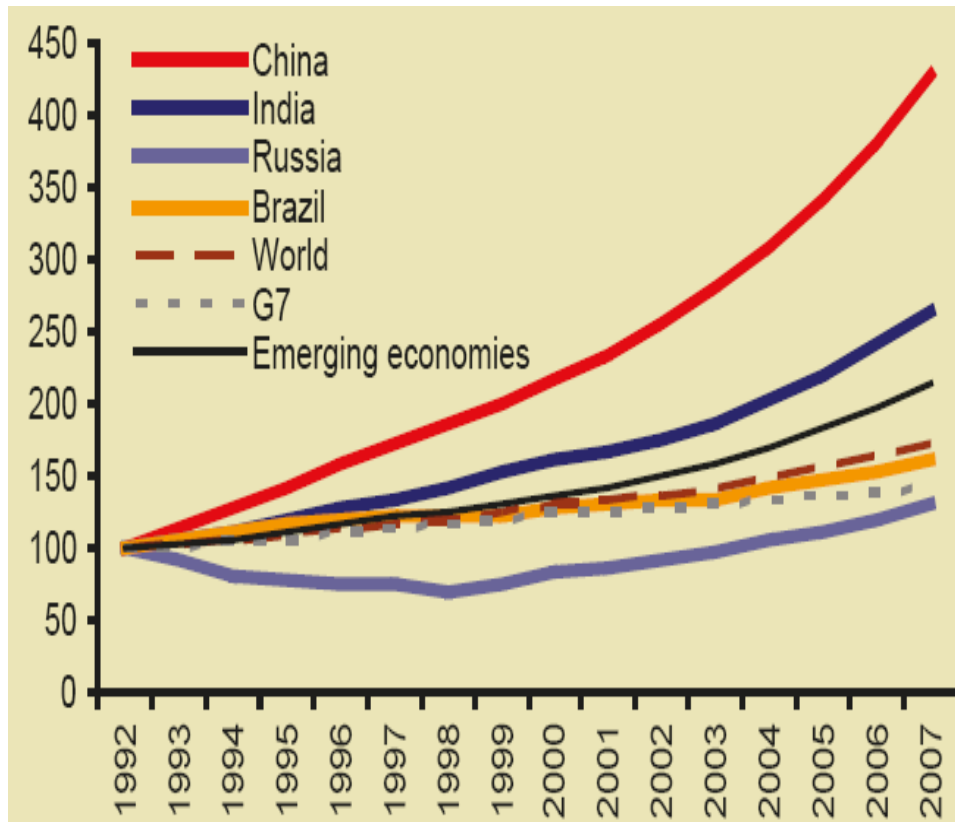
Strategy for investors

- The valuations are edging above the comfort zone which raises risk in the near term and calls for caution.
- Long term investors can continue with SIP

The Long Term Case For Indian Equities

India - Growth On The Fast Track

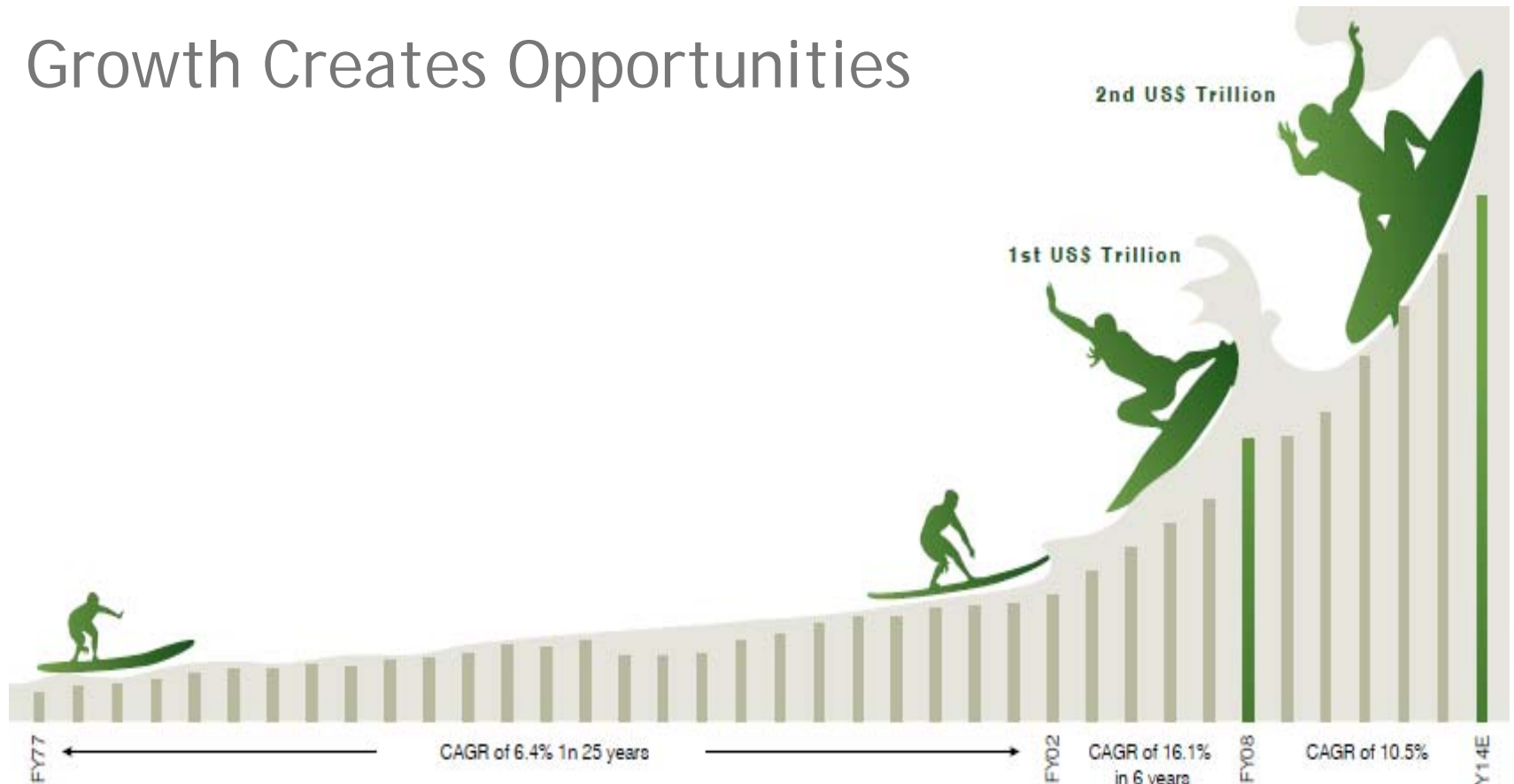
GDP growth rebased to 1992



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

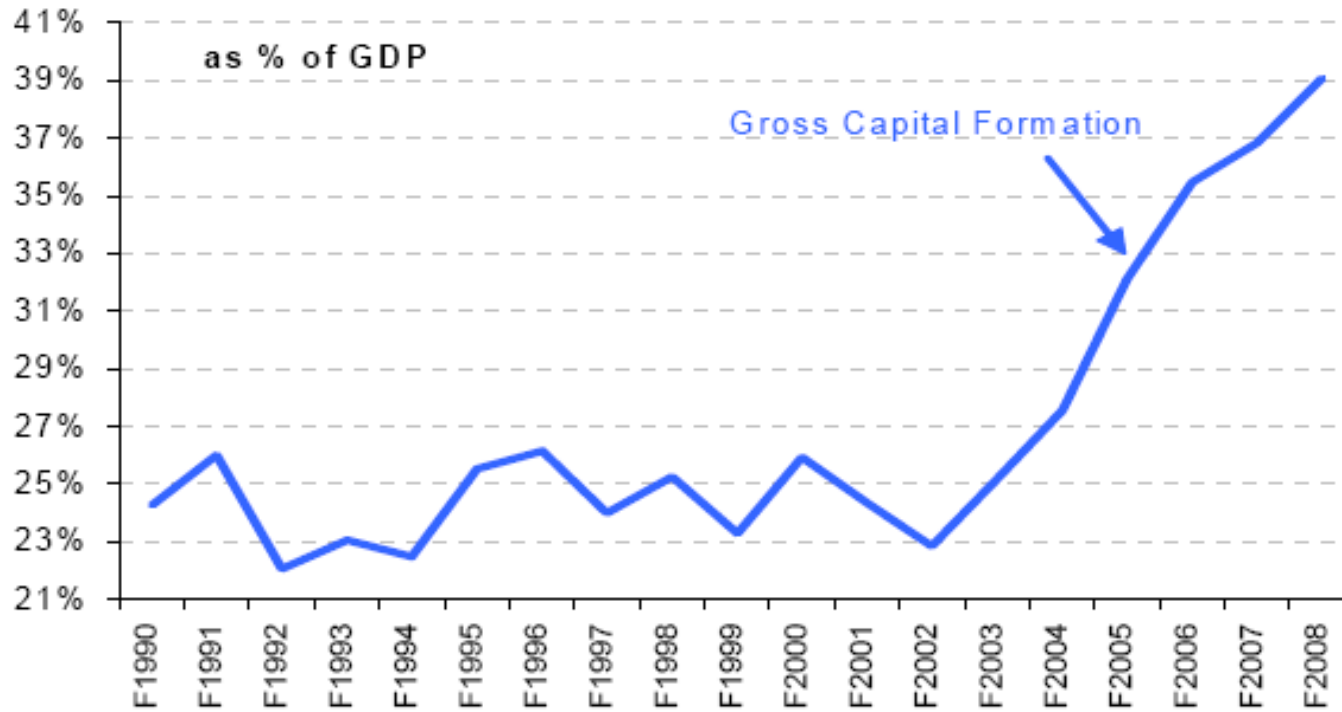
Growth Creates Opportunities



- 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



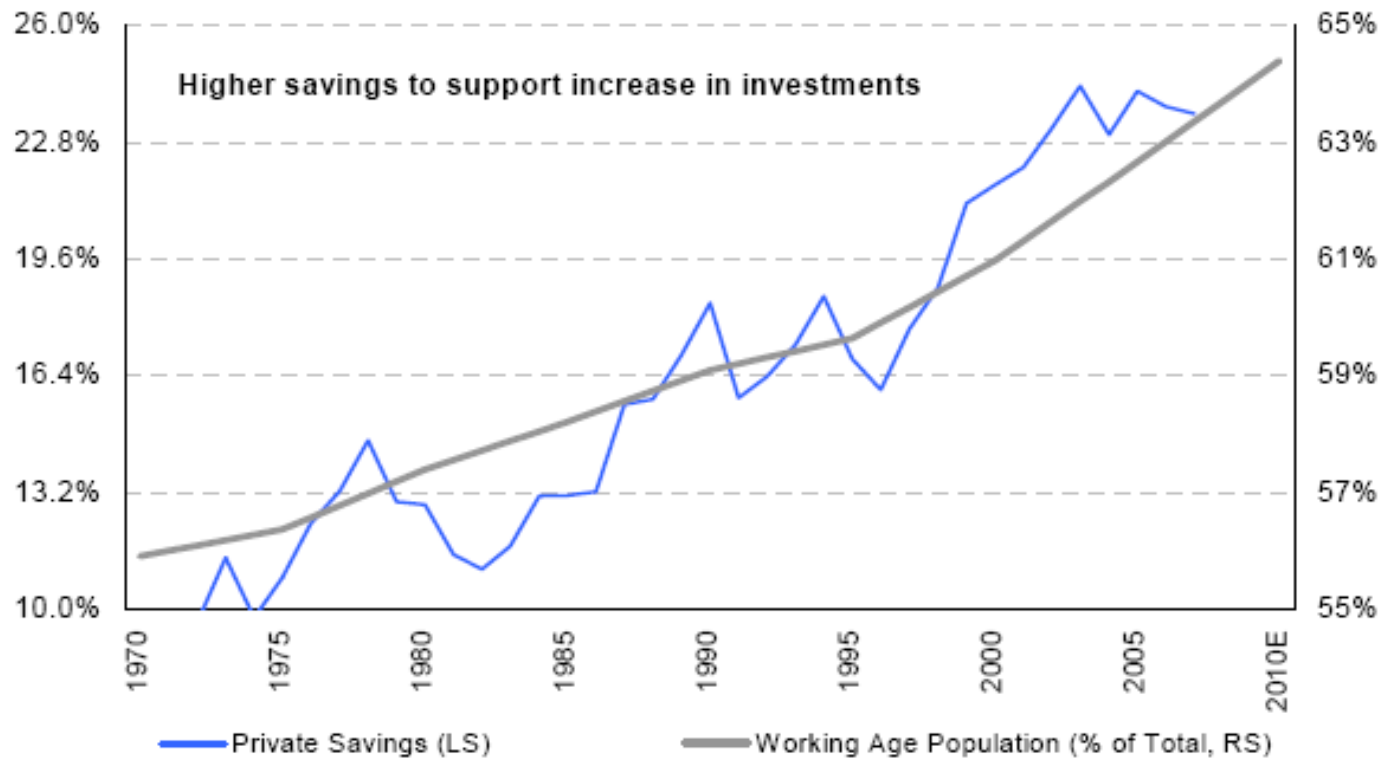
Growth Is Being Led By A Rise In Capital Formation...



Source: CSO, Morgan Stanley Research



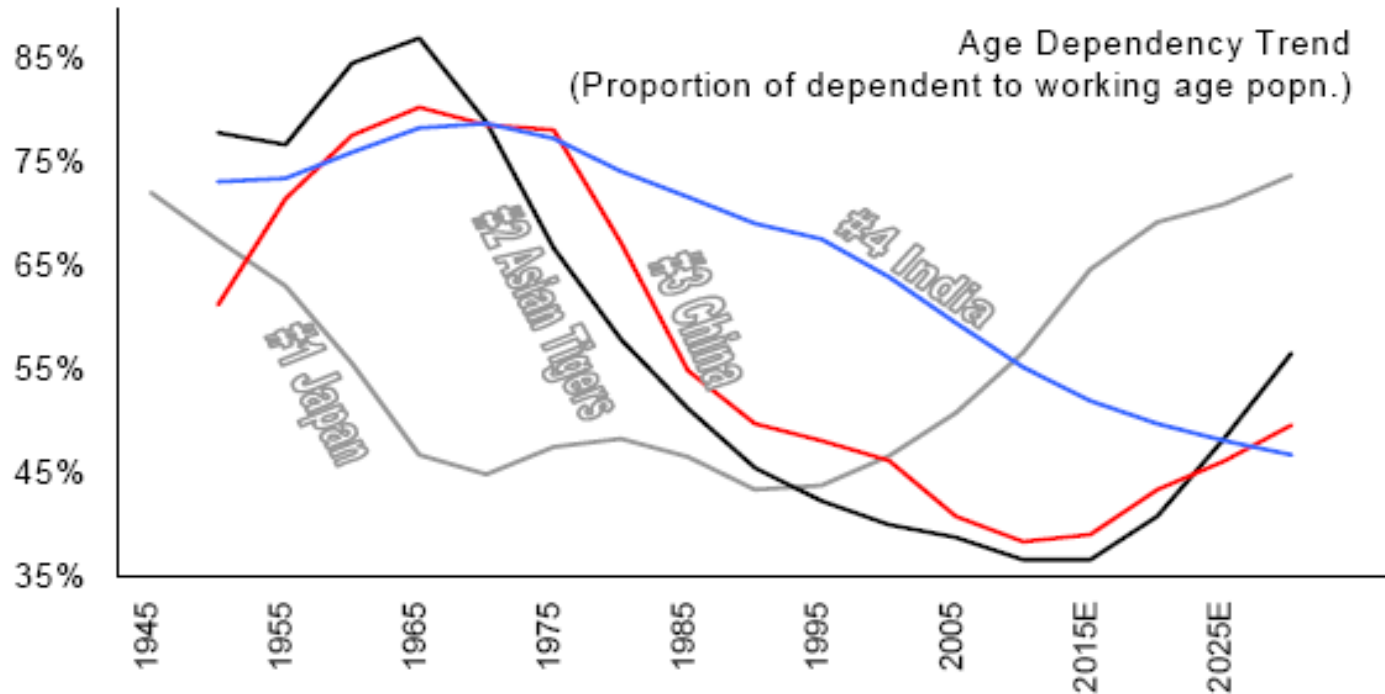
...Which Is Supported By A High Savings Rate



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



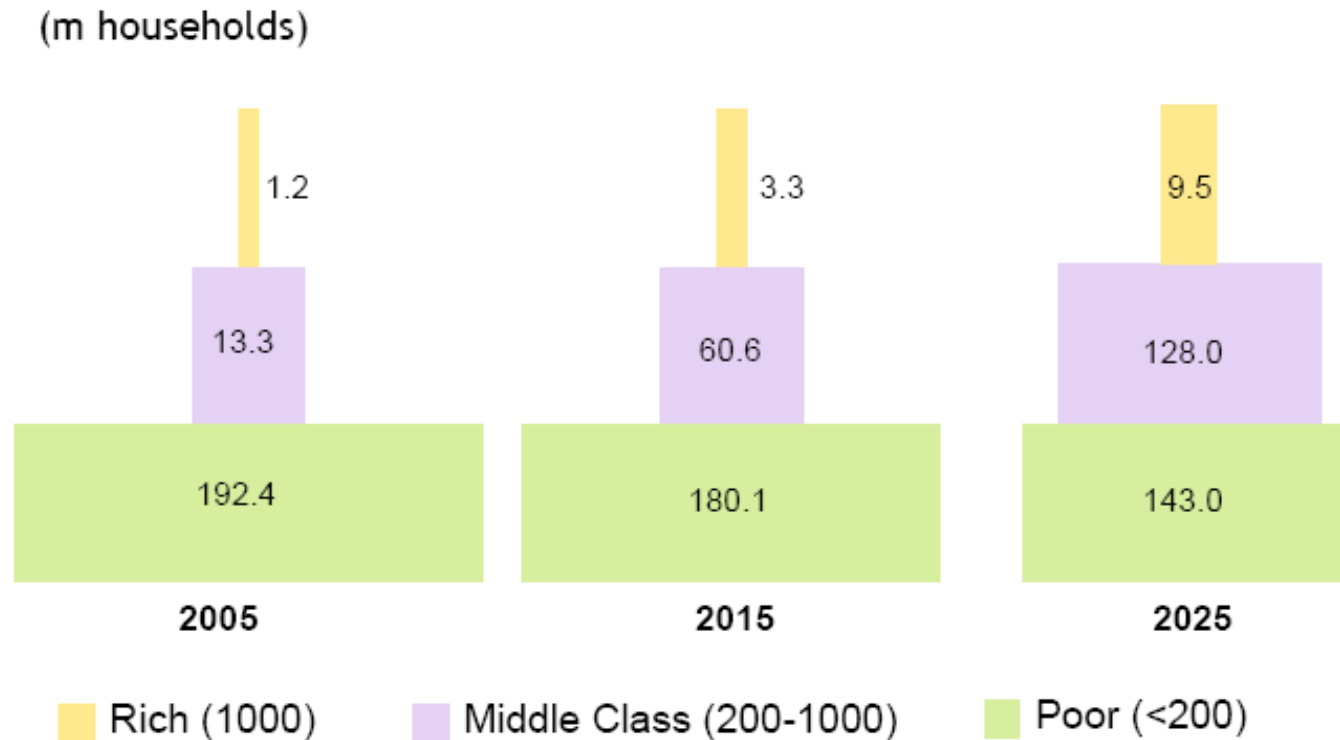
India Is Poised To Reap Rich Demographic Dividend In Years To Come



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

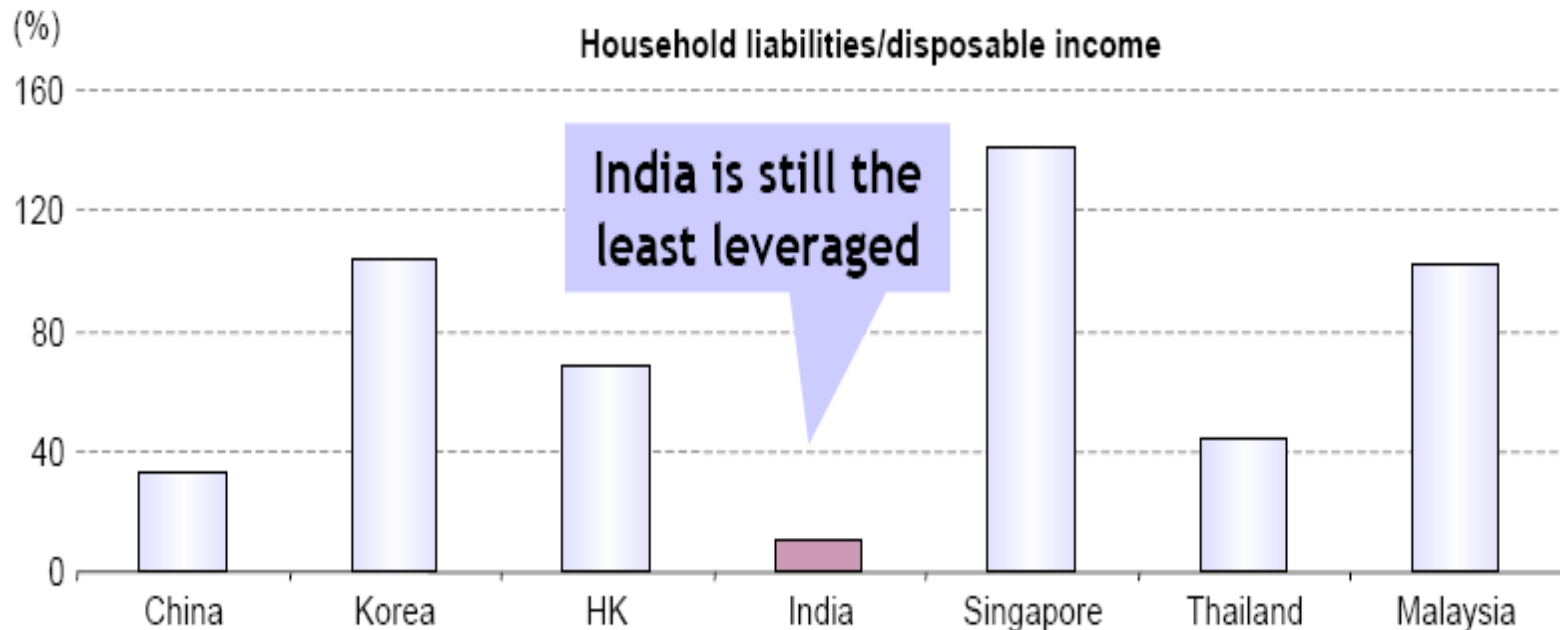


Income Imbalance To Correct Leading To Rise In Consumption



Source: IDFC SSKI

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



Source: IDFC SSKI

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MKTG/RoundupEquity/0310/CO014

