

Equity Markets : Current Environment and Outlook

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Current Environment - another strong month

- Indian markets continue to be one of the best performing markets in the emerging markets group with a 28.26% gain in the month of May
- Equity markets across the globe also continued to rally, with the MSCI World Index rising by 8.62%
- Commodity prices were also buoyant with the benchmark CRB Reuters Jefferies total return index rising 17.2%
- In India, Realty was the best performing sector followed by the Metals sector. FMCG sector delivered the worst return for the third consecutive month
- FII inflows have remained positive on a YTD basis for CY09 after a strong Rs.201bn inflow in May, highlighting fast deployment of portfolio cash
- In May, cash trading volumes (number of shares) rose 30% MoM and was at a new high, whereas the average open interest rose 1% MoM (fifth consecutive month of rise)

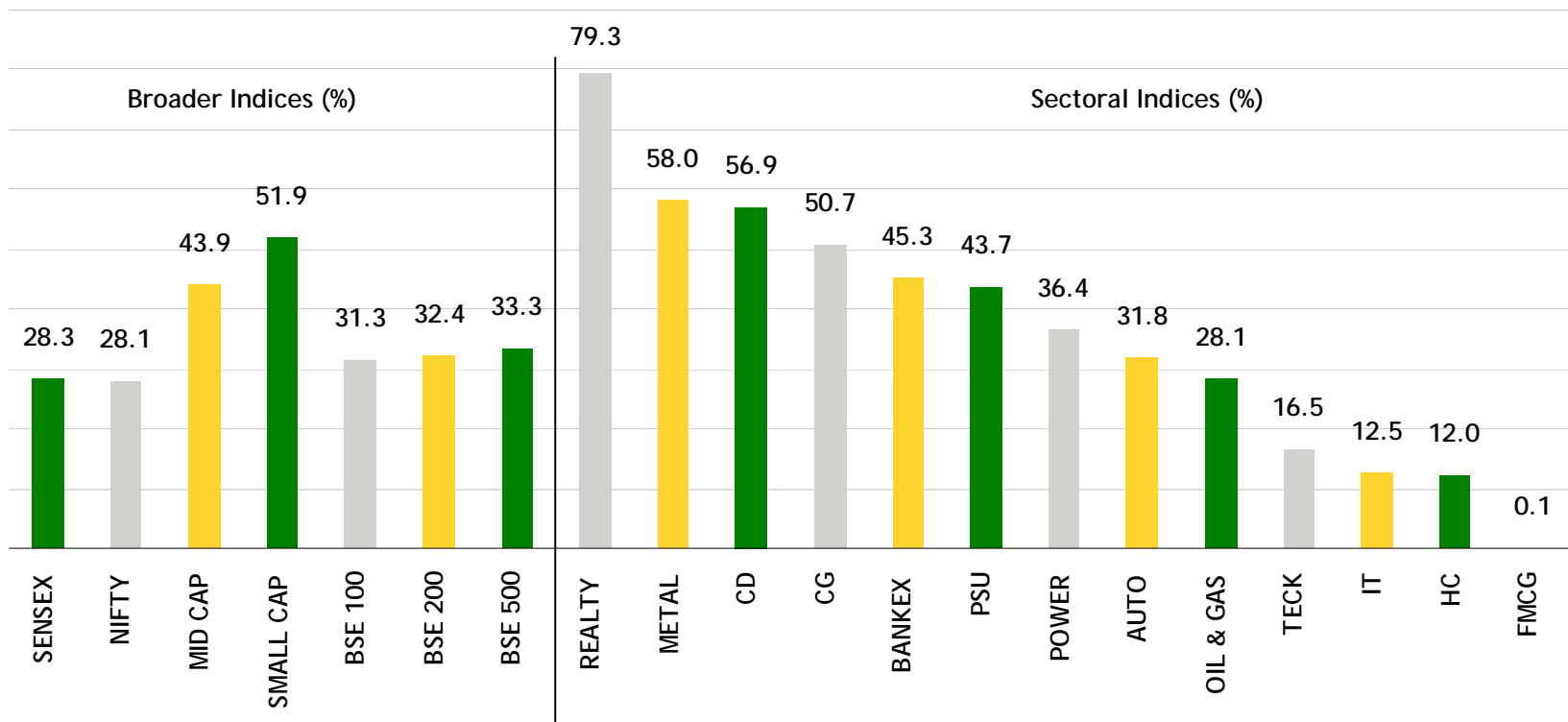
Global Equities - emerging markets outperform

Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	2632.93	6.27%	44.60%	EM - Asia
BSE Sensex	India	14625.25	28.26%	51.60%	EM - Asia
Kospi	South Korea	1395.89	1.94%	24.14%	EM - Asia
Taiwan Weighted	Taiwan	6890.44	14.98%	50.08%	EM - Asia
Thailand SET 50 Index	Thailand	398.36	14.86%	26.95%	EM - Asia
Jakarta Composite Index	Indonesia	1916.83	11.26%	41.42%	EM - Asia
KLSE	Malaysia	1044.11	5.39%	19.09%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	53197.73	12.49%	41.67%	EM
Mexico IPC	Mexico	24331.71	11.11%	8.72%	EM
Russian RTS Index	Russia	1087.59	30.58%	72.12%	EM
Philippine PSEi	Philippines	2389.31	13.59%	28.31%	EM
Merval Buenos Aires Index	Argentina	1587.21	24.46%	47.01%	EM
HangSeng	Hong Kong	18171.00	17.07%	26.30%	Developed - Asia
Nikkei	Japan	9522.50	7.86%	7.48%	Developed - Asia
Strait Times	Singapore	2329.08	21.29%	32.22%	Developed - Asia
Dow Jones	USA	8500.33	4.07%	-3.15%	Developed
CAC 40 Index	France	3277.65	3.73%	1.85%	Developed
All Ordinaries Index	Australia	3813.30	1.83%	4.21%	Developed
DAX Index	Germany	4940.82	3.59%	5.02%	Developed
Swiss Market Index	Switzerland	5349.74	2.37%	-3.34%	Developed
FTSE 100	UK	4417.94	4.11%	-0.37%	Developed
MSCI World Index	--	970.00	8.62%	5.41%	--

* as on 29th May 09. Source : Bloomberg
EM – emerging markets, Developed – developed markets.



India : Sector performances - midcap/smallcaps rally



- SmallCaps and Midcaps outperformed the Largecaps highlighting broad basing of the rally
- Realty was the best performing sector followed by the Metals sector
- FMCG sector, considered a defensive, delivered the worst return for the third consecutive month in a rising market

*Source: BSE,NSE. one month performance as on 29th May 09.

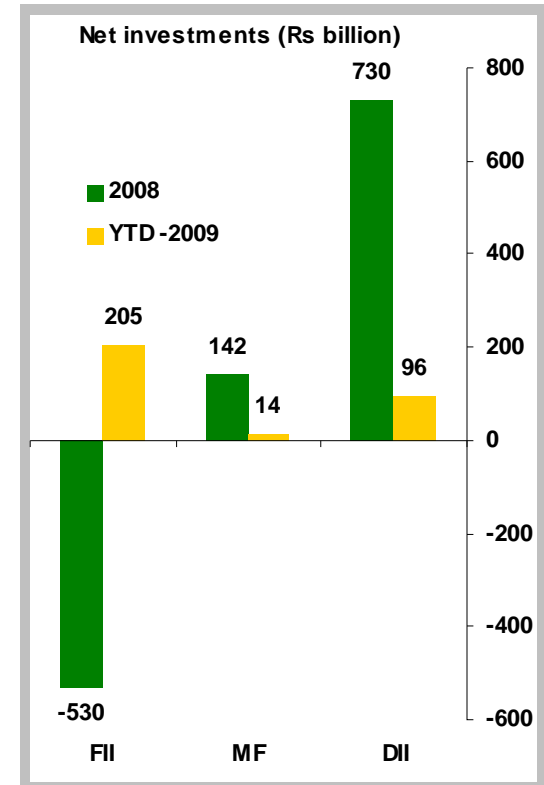
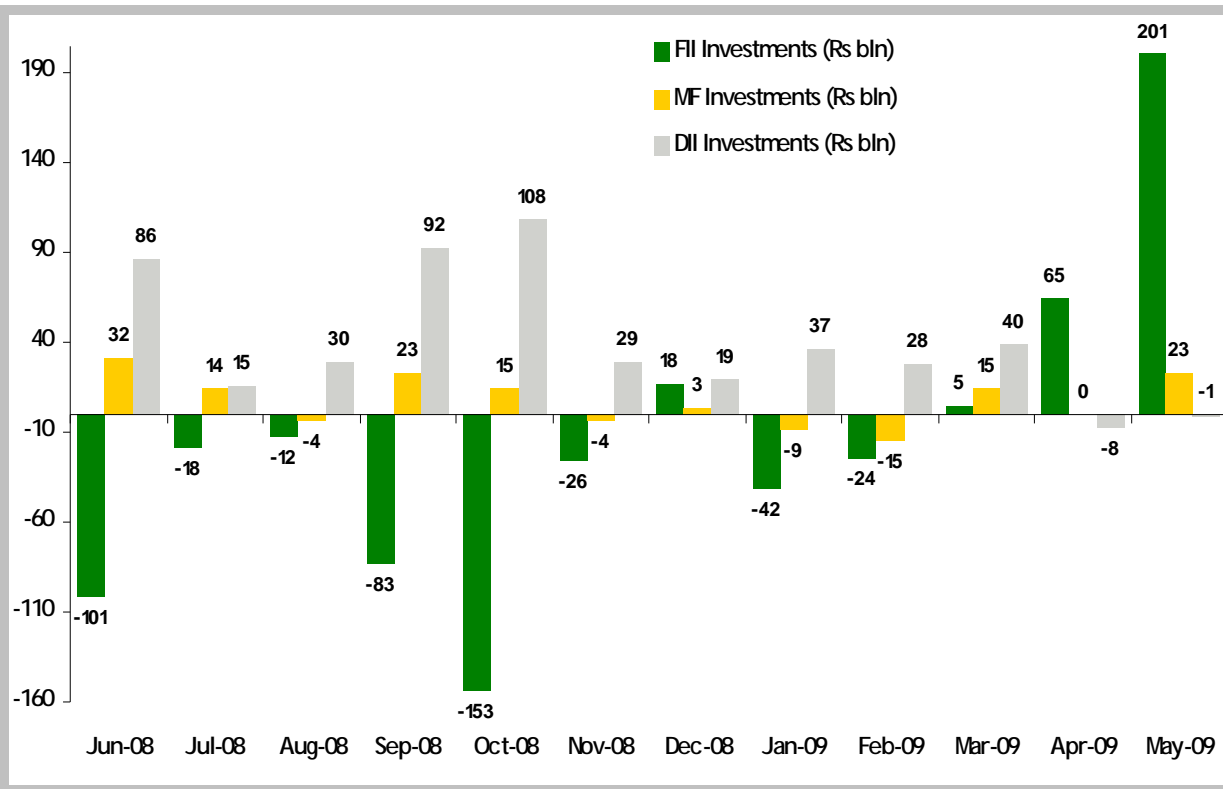
Top Gainers / Losers - Nifty

Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
Reliance Infrastructure Ltd.	1322.9 / 352.75	1272	82.97
Unitech Ltd.	244 / 21.65	79.6	80.70
Reliance Capital Ltd.	1474.9 / 274.1	942.45	79.69
D L F Ltd.	603 / 124.05	406.5	76.55
Tata Steel Ltd.	925 / 137.5	405.35	70.24
Top Losers for the month			
Losers	52 week H/L	Last Price#	% Loss*
Tata Communications Ltd.	660 / 323.05	467.8	-14.71
Cipla Ltd.	256.9 / 145	222.8	-7.46
Sun Pharmaceutical Inds. Ltd.	1599 / 954	1213.75	-5.06
I T C Ltd.	225 / 132.05	183.65	-2.78
Hindustan Unilever Ltd.	271.9 / 185.1	230.8	-1.68

closing price as on 29th May 09.* one month performance as on 29th may 09.
Source: cmie prowess



FII & DII Inflows: risk appetite returns



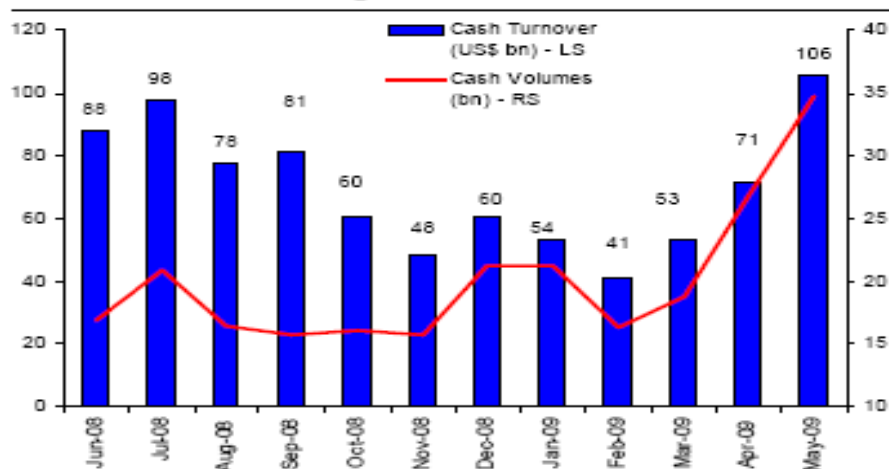
- FII inflows have remained positive on a YTD basis for CY09 after a strong Rs.201bn inflow in May, highlighting fast deployment of portfolio cash
- However DIIs continued to remain marginal net sellers for the second month in a row, after remaining net buyers for 11 consecutive months

FII - Foreign Institutional Investors, DII - Domestic Institutional Investors (Includes Bank, DFIs, Insurance and MF)
Source: SEBI, BSE



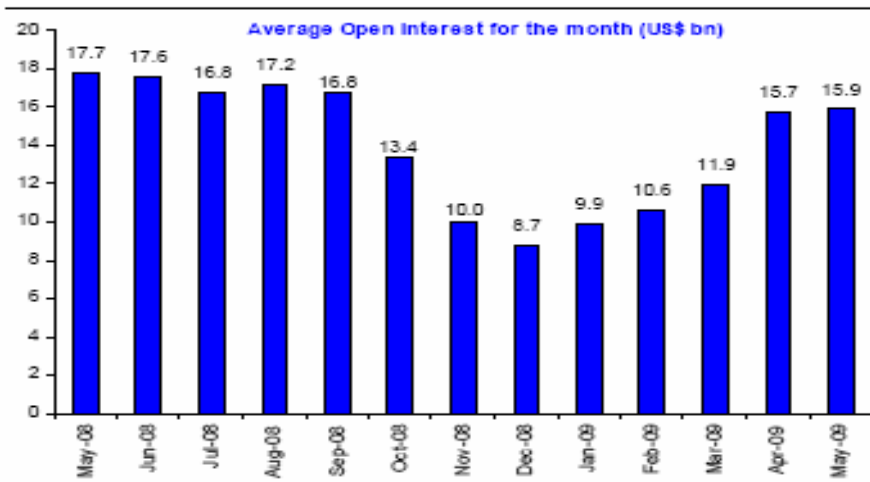
Market Activity

Cash Trading: Turnover and Volumes



Source: BSE, NSE, Morgan Stanley Research

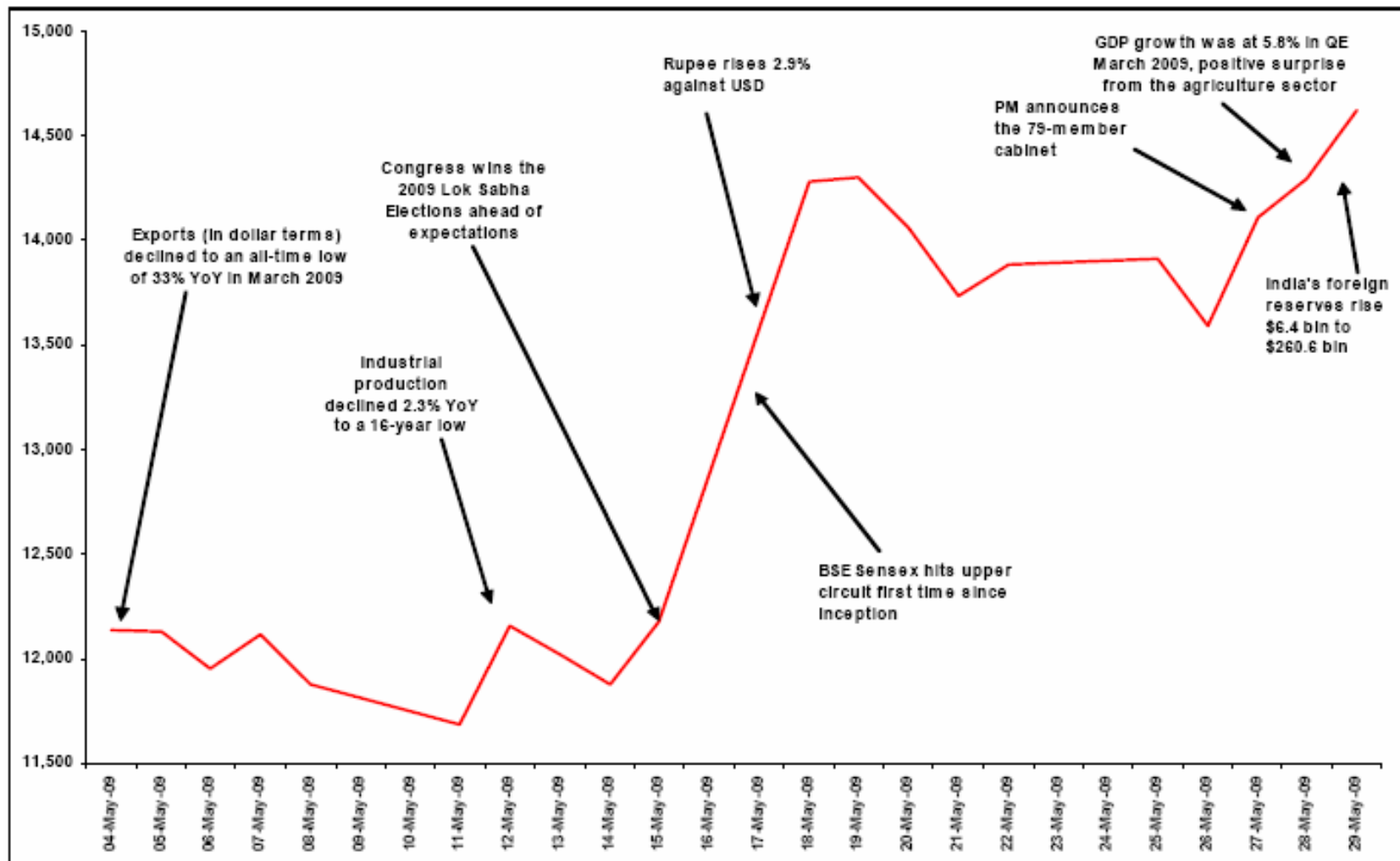
Average Open Interest for the Month



Source: Bloomberg, Morgan Stanley Research

- In May, cash trading volumes (number of shares) rose 30% MoM to a new high and was 19% above the December 2007 peak
- Trading volumes (value) rose 49% MoM and are now 36% below the October 2007 peak
- At the end of May, average open interest rose for the fifth consecutive month - up 1% MoM and is 43% off the January 2008 peak

May Events timeline



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

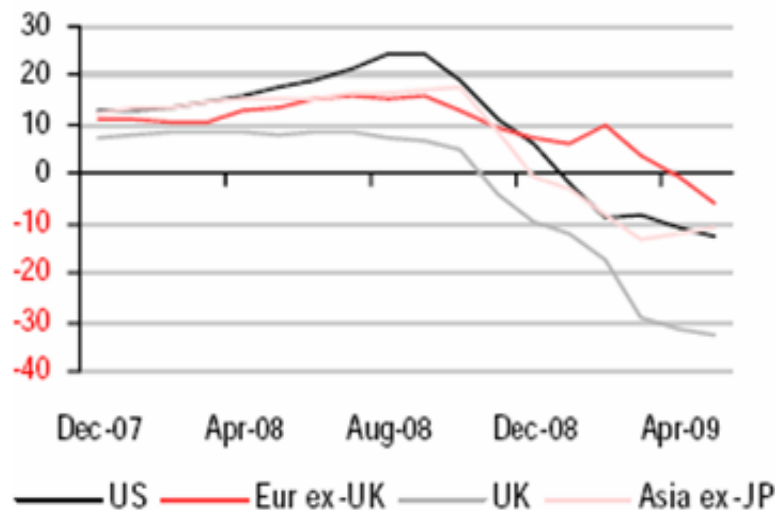
Religare MF: Equity Market Outlook and Opportunities

Equity Market Outlook

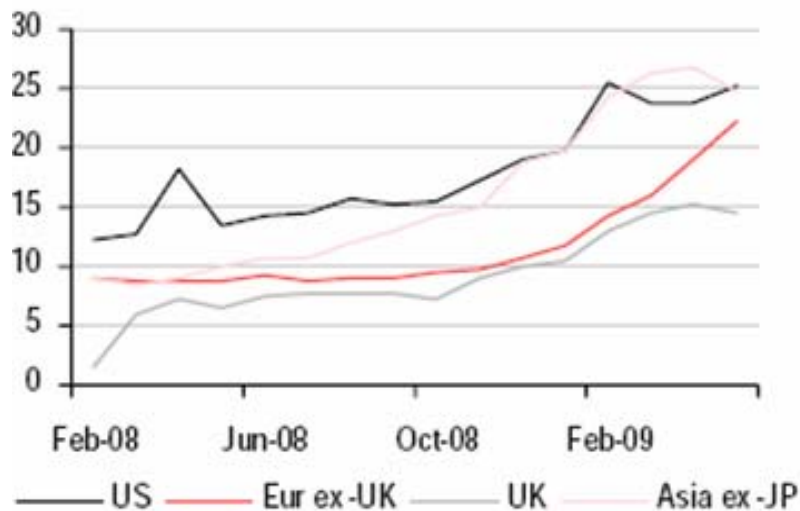
- Global economy outlook remains weak but incremental data has improved pointing to a reduction in the pace of deceleration
- Global earnings forecasts for CY2010 are witnessing upgrades as analysts factor in a recovery in CY2010. After 2 years of drops (CY08 and CY09) analysts now predict that global corporate earnings will rebound in 2010 thereby recouping the decline in the current calendar
- India reported a 4QFY09 GDP growth of 5.8% which was significantly ahead of consensus expectation of ~5-5.2%. Government spending, which increased substantially in Q3FY09 and Q4FY09 has supported the growth
- The new central government, UPA, has received one of the most decisive mandates in a decade, raising hopes of speedy implementation of reforms, as they are no longer dependent on the left parties
- The monetary policy transmission appears to have gained traction with credit spreads reducing and credit growth appears to be stabilizing
- The earnings downgrade cycle has displayed inflexion point with earnings being upgraded by 2.5% for FY10. The consensus now expects Sensex earnings to grow 17% in FY11, after a flat year in FY10
- The market valuations are now above the long term averages

Global Economy - Earnings upgrades flavor of the season

I/B/E/S consensus earnings growth 2009...



...and 2010 (%)

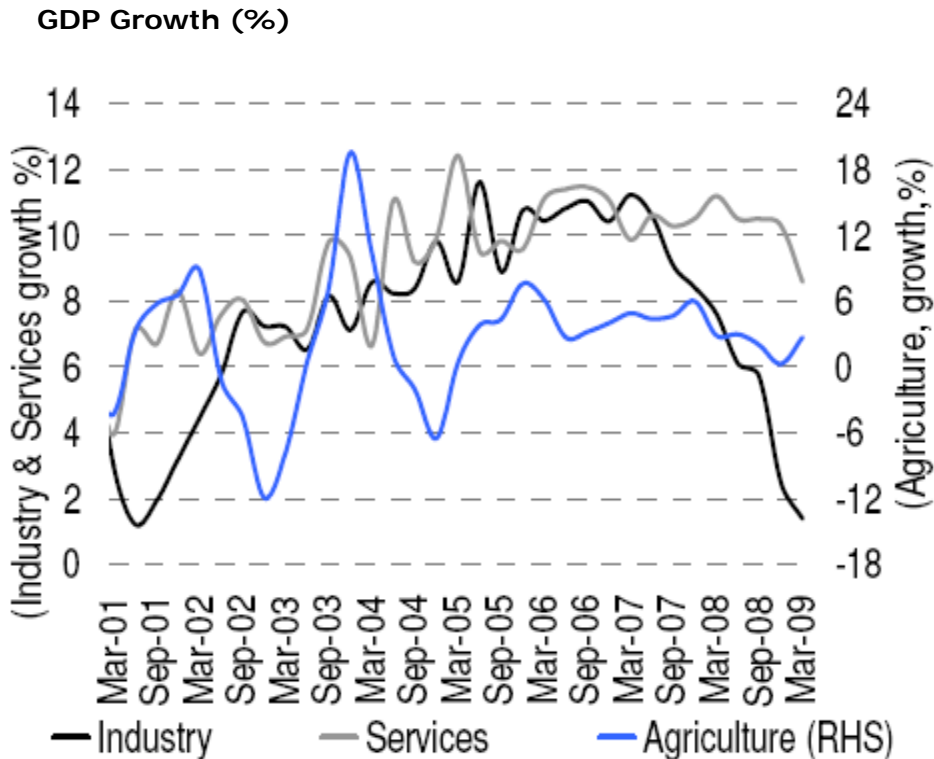


- Analysts earnings revision data indicates a worldwide recovery in 2010, and growth in 2010 is expected to at least match the earnings decline of 2009
- Even the earnings revisions ratio (the total number of earnings upgrades as a percentage of the total number of earnings revisions) increased from a low of just 13% in January 2009 for FTSE World index to current reading of 45%, which is higher than the long term average, highlighting a change in growth expectations

Source: HSBC, Thomson Financial DataStream



Domestic Economy - Agriculture growth recovers in Q4FY09

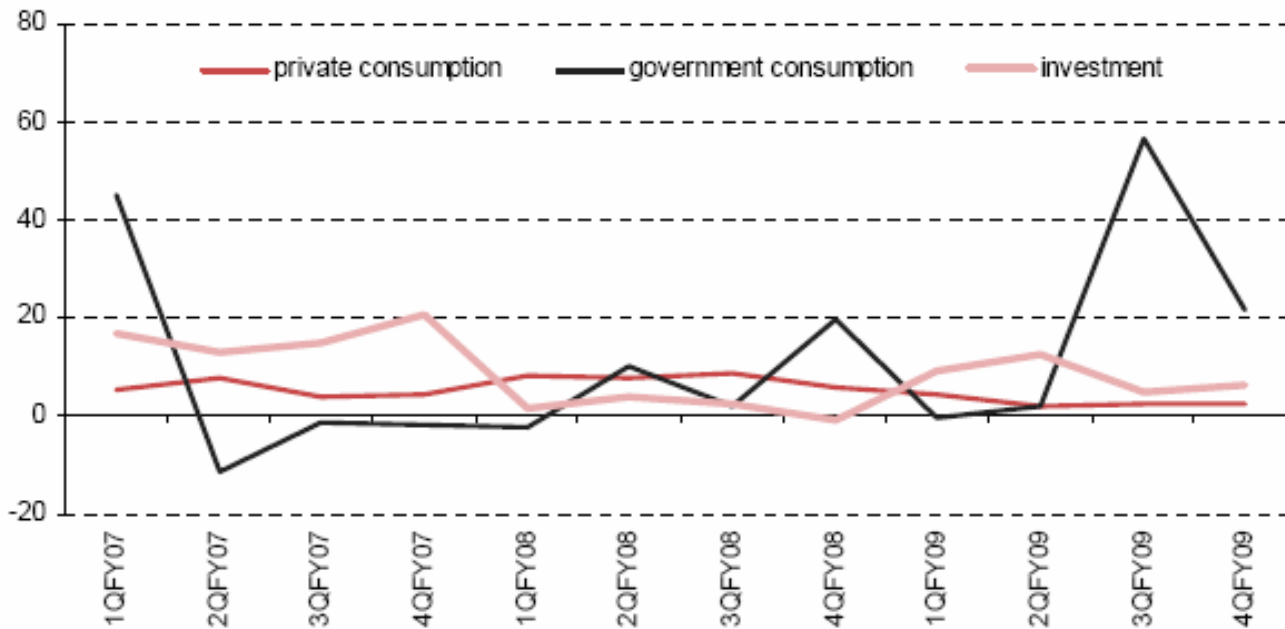


- India's 4QFY09 GDP growth was 5.8%—significantly ahead of consensus expectation of ~5-5.2%
- Sequentially, the improvement in agriculture was the biggest incremental contributor to growth in 4QFY09. Agricultural output grew 2.7% in 4Q (v/s a decline of 0.8% in 3Q)
- Full-year FY09 GDP grew 6.7%, slower than the 7.1% originally estimated by CSO, and down from 9% in FY08

Source: Government of India, Anand Rathi Research.

Domestic Economy - Government spending helps support aggregate demand

Growth in components of real aggregate demand, March fiscal year-ends, 1QFY07-4QFY09 (%)

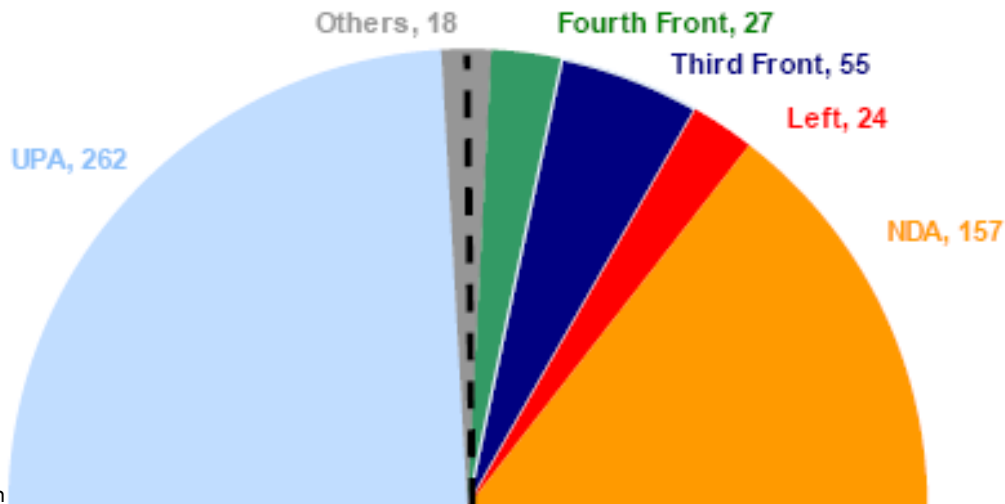


- While growth in government share of total demand has declined in Q4FY09 over that in Q3FY09, it still remains high relative to private consumption and investment demand.
- This clearly highlights how government spending (reflecting the pay commission hike) has stemmed economic deceleration

Source: Central Statistical Organisation, Kotak Institutional Equities

Strongest government in a decade-raises hopes for reform

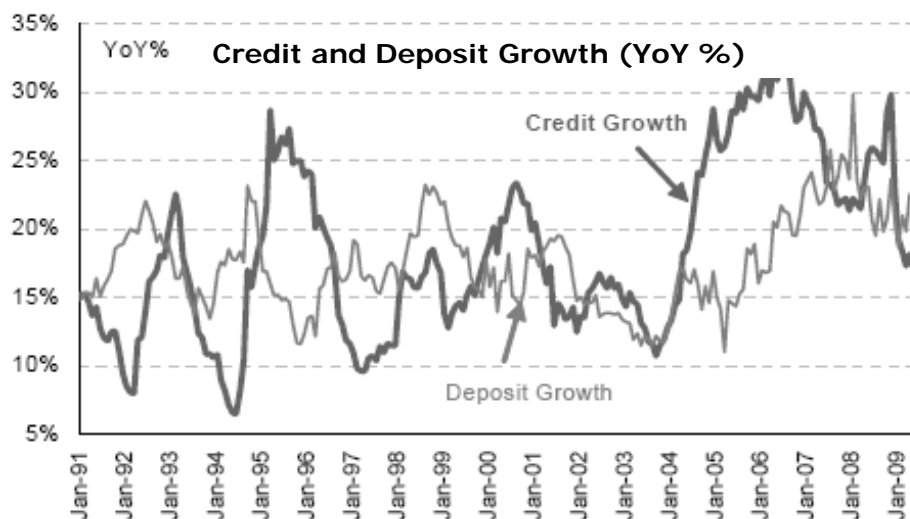
Indian Parliament post 2009 elections



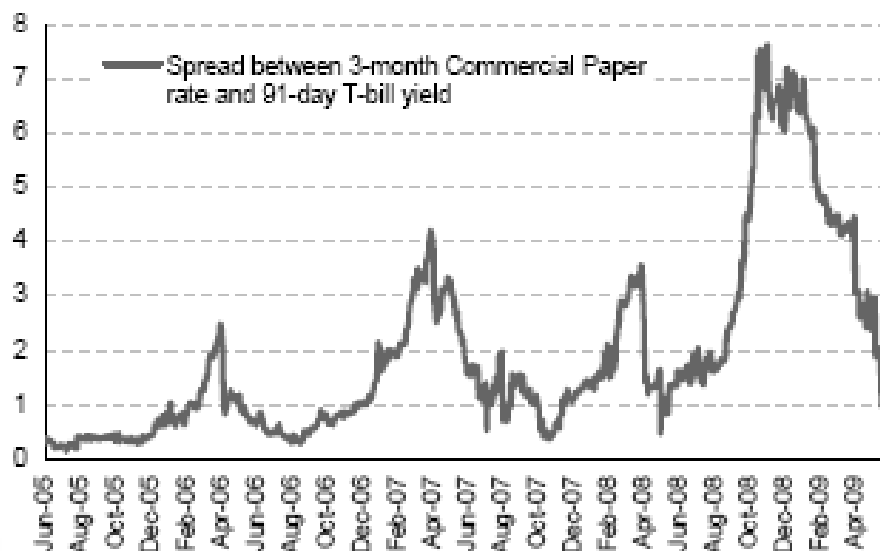
Source: Media, IIFL Research

- The new Congress led government at the centre, has one of the most decisive mandates in a decade and is unhampered by the left parties. This has raised hopes of a speedy implementation of reforms
- Announcements and news reports suggest that the government is looking at issues such as
 - Review of subsidies and fiscal consolidation
 - Divestment of stakes in PSU companies
 - Fuel price de-regulation
 - Infrastructure spending to be the centerpiece of growth

Monetary policy - finally getting transmitted



- Credit growth while still sluggish appears to be stabilizing
- Cost of credit has also reduced significantly for corporates, as can be seen from the compression in spreads between Commercial Paper rate over 91-day T-bill yield
- There is abundant liquidity in the system and as spreads drop further (banks cut rates) credit demand can be expected to recover



Domestic Earnings - Consolidating for now

Sensex consensus earnings estimates

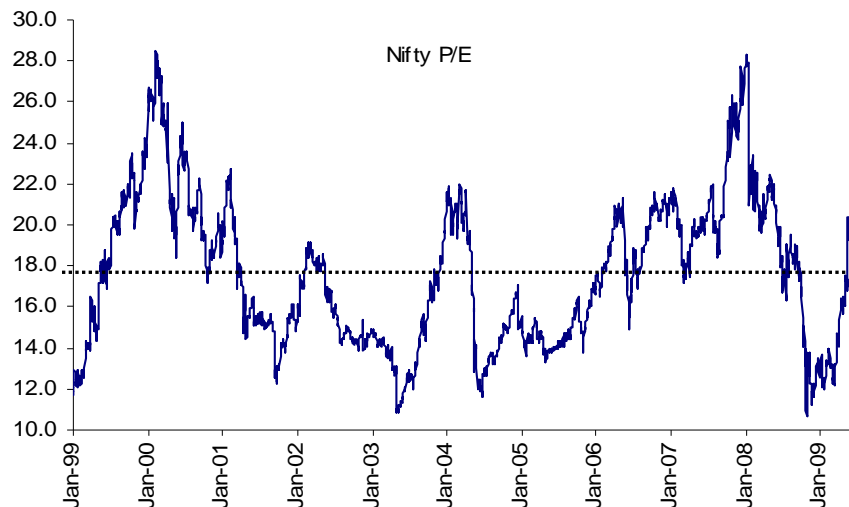


- FY10 consensus Sensex EPS estimate saw an upgrade of about 2.5% this month and has clearly stabilized after being cut by about 28% in seven months prior to that
- A meaningful upgrade to FY10 Sensex EPS will require improved global conditions, given that 42% of FY10 Sensex earnings is attributable to constituents with high global linkages like oil & gas, metals and software services
- Consensus now expects a modest 0.4% growth in FY10 Sensex earnings over FY09 and a 17.2% growth in FY11 Sensex EPS over FY10

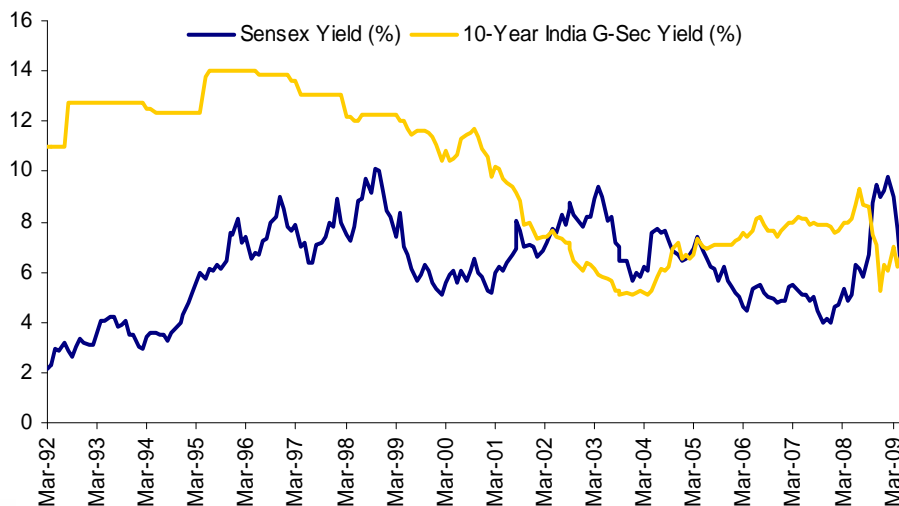
Sources: Bloomberg, IIFL Research



Valuation above long term averages



- Nifty is currently trading at 20.6x its trailing earnings, higher than the ten year average of 17.6x
- The Sensex earnings yield is now lower than the benchmark 10 year yield, unlike the attractive equation earlier this year
- The valuation surge is not unique to India. The MSCI Emerging Market Index is trading at its highest valuations since December 2007 at approximately 15x trailing earnings
- The MSCI World Index of 23 developed countries is trading at 18.2 times the average earnings of its 1,655 companies, the most expensive since 2004



Looking Ahead...

- The macro environment continues to improve, albeit marginally over the previous month, as is indicated by continued good growth seen in GDP and output of core infrastructure sector numbers. These improvements in indicators are consistent with our 6-6.5% growth expectation for GDP, but not much higher
- Borrowing rates are coming down gradually and credit growth is also stabilizing. However, if the government is unable to execute the balancing act of stabilizing the fiscal deficit, it could threaten the current softness in rates later this year particularly, if fuel prices rise again pushing inflation higher
- The election results have placed a strong coalition (UPA) in the central government. The nature of the mandate that the current Government has won in the elections gives them the scope to be more aggressive on reforms that could enable higher capital inflows into the country and stimulate investments in the infrastructure arena through public-private participation
- On the valuation front, the ascent has been rather steep. There has been a marginal 2.5% increase in consensus earnings forecasts for the Sensex in FY10 which means that the 80% increase in the value of the Sensex from mid March09 is driven largely by valuations gains (PE multiple expansion) rather than earnings gains. Earnings growth for FY10 is muted though confidence and visibility is improving
- Markets are now finely priced with most measures trading above long term averages
- As a result further upside to returns from here will have to be driven by bottom-up stock picking

Investment view

Short term

- Challenging growth environment with GDP growth likely to be 6-6.5%
- Given the slightly superior performance by companies in Q4 and upgrades to earnings of commodity companies we now expect earnings to be flat in FY10 over FY09
- Bottom up stock picking to drive 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
- Valuations would be supported if growth accelerates after 2010

Strategy for investors

- We continue to believe that the market is in a large trading zone
- Long term investors will do well to persist with SIP and gradual investments over time while the market stays in this range

Events Calendar

Date	Economy	Data release / Event	Period	Prior
12-Jun	India	Industrial production (%,Y-o-Y)	Apr	-2.3
30-Jun	India	Balance of Payments	Q1CY09	-14.6

Date	Economy	Data release / Event	Period	Expectations	Prior
5-Jun	US	Unemployment Rate	May	9.2	8.9
24-Jun	US	FOMC rate decision	25-Jun	--	0.25
25-Jun	US	GDP (%, Q-o-Q annualized)	Q1CY09	--	-5.7
3-Jun	Eurozone	GDP (%, Y-o-Y)	Q1CY09	-4.6	-4.6
11-Jun	Japan	GDP (%, Q-o-Q annualized)	Q1CY09	--	-16.0
12-Jun	China	Industrial production (%,Y-o-Y)	May	--	7.3
16-Jun	Japan	BoJ interest rate announcement	16-Jun	--	0.1

Source: Bloomberg



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