

# Equity Markets : Current Environment and Outlook

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# Current Environment

- Equity markets across the globe remained bullish, with the MSCI World Index rising by 3.91%
- Indian markets however were flat in the month of August as concerns regarding impact of poor monsoons built up during the month. YTD BSE Sensex has appreciated by 62.3%
- Commodity prices retraced some of the earlier months gains with the benchmark CRB Reuters Jefferies total return index falling 1.4%
- In India, Realty was the best performing sector followed by the Consumer Durables sector. FMCG sector delivered the worst return for the month
- FII inflows have remained positive on a YTD basis at Rs.403bn for CY09 after a Rs.49bn inflow in August
- Corporate India has used the market buoyancy to raise capital via various routes, preferred being QIP. Total capital raised by Indian companies since April 2009 is \$6.7bn, while total capital raising planned is about \$13.6bn
- In August, cash trading volumes (number of shares) fell 8% MoM while the average open interest declined a modest 1.5% MoM

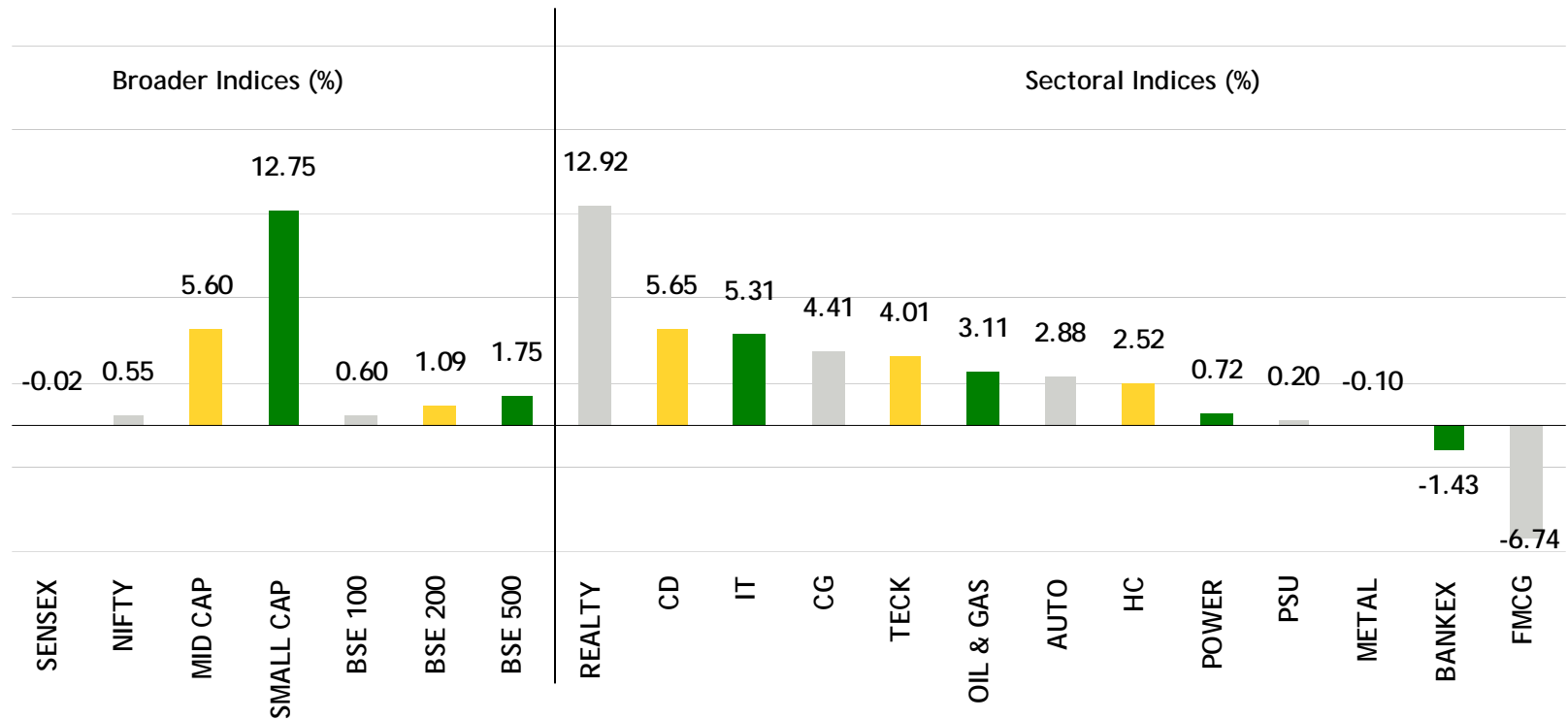
# Global Equities

Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	2667.75	-21.81%	46.51%	EM - Asia
BSE Sensex	India	15666.64	-0.02%	62.39%	EM - Asia
Kospi	South Korea	1591.85	2.22%	41.56%	EM - Asia
Taiwan Weighted	Taiwan	6825.95	-3.56%	48.67%	EM - Asia
Thailand SET 50 Index	Thailand	467.27	3.86%	48.91%	EM - Asia
Jakarta Composite Index	Indonesia	2341.54	0.79%	72.76%	EM - Asia
KLSE	Malaysia	1174.27	-0.05%	33.93%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	56488.98	3.15%	50.44%	EM
Mexico IPC	Mexico	28129.95	4.02%	25.69%	EM
Russian RTS Index	Russia	1066.53	4.82%	68.78%	EM
Philippine PSEi	Philippines	2884.18	3.07%	54.88%	EM
Merval Buenos Aires Index	Argentina	1781.89	3.61%	65.04%	EM
HangSeng	Hong Kong	19724.19	-4.13%	37.09%	Developed - Asia
Nikkei	Japan	10492.53	1.31%	18.43%	Developed - Asia
Strait Times	Singapore	2592.90	-2.49%	47.19%	Developed - Asia
Dow Jones	USA	9496.28	3.54%	8.20%	Developed
CAC 40 Index	France	3653.54	6.63%	13.54%	Developed
All Ordinaries Index	Australia	4484.10	5.52%	22.54%	Developed
DAX Index	Germany	5464.61	2.48%	16.15%	Developed
Swiss Market Index	Switzerland	6217.12	4.48%	12.33%	Developed
FTSE 100	UK	4908.90	6.52%	10.71%	Developed
MSCI World Index	--	1085.60	3.91%	17.97%	--

\* as on 31<sup>st</sup> August 09. Source : Bloomberg  
EM – emerging markets, Developed – developed markets.



# India : Sector performances



- BSE Sensex fell by 0.02% over the previous month
- Realty was the best performing sector followed by the Consumer Durables sector
- FMCG sector delivered the worst return for the month

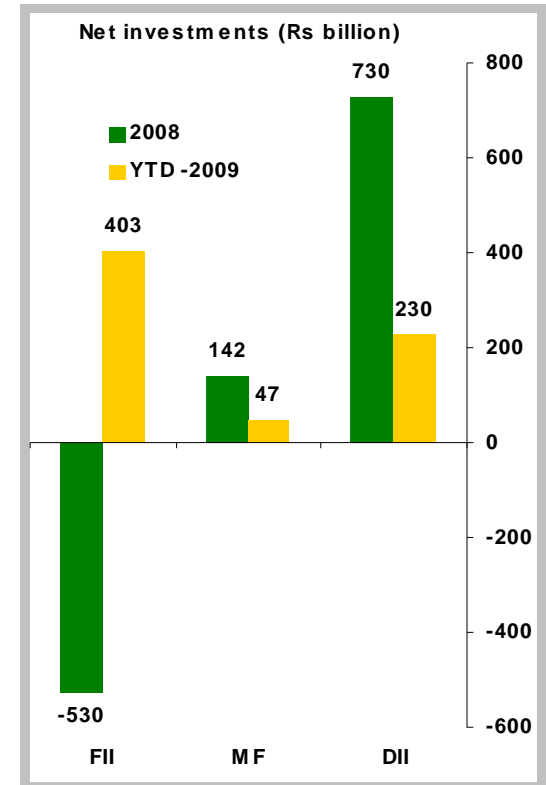
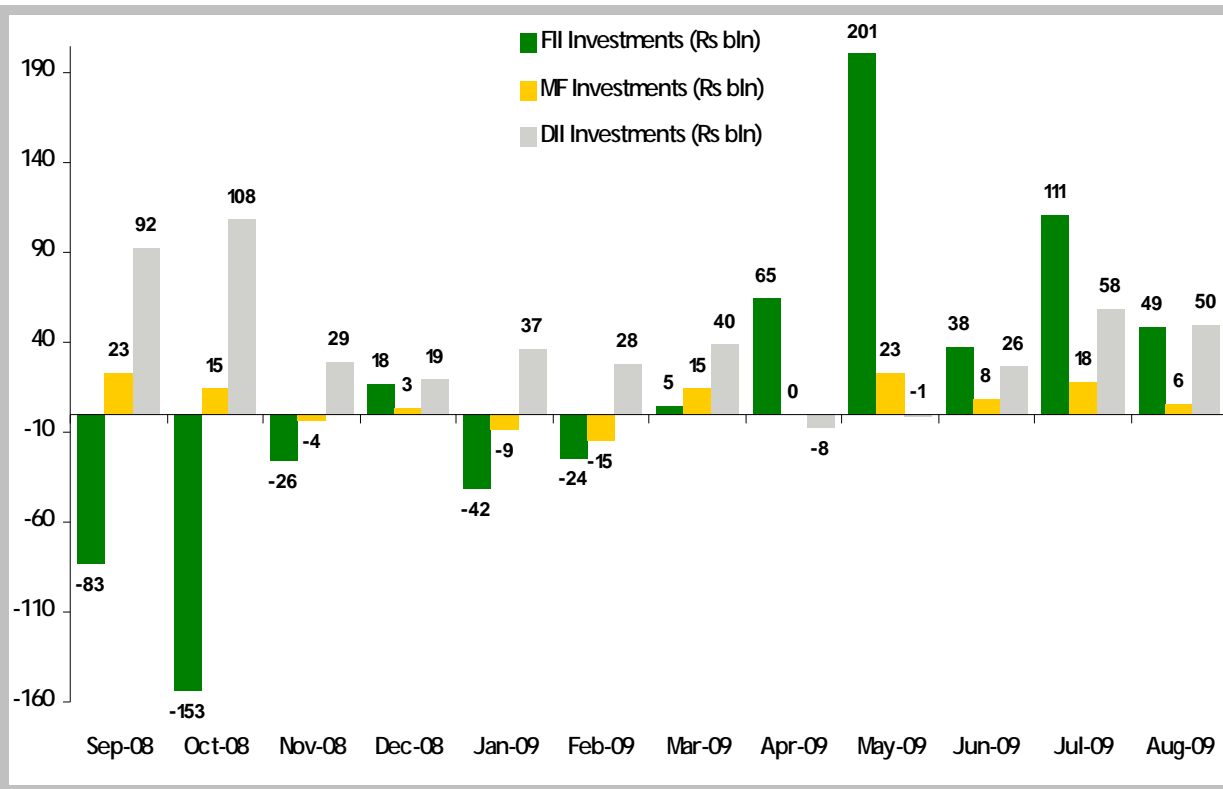
# Top Gainers / Losers - Nifty

Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
H C L Technologies Ltd.	319.9 / 86.65	300	24.48
Unitech Ltd.	173.5 / 21.65	107.35	19.15
Ranbaxy Laboratories Ltd.	514 / 133.1	327.85	17.07
Tata Motors Ltd.	505.7 / 124.8	489.7	16.17
Cairn India Ltd.	274 / 88.2	264.9	12.58
Top Losers for the month			
Losers	52 week H/L	Last Price#	% Loss*
Hindustan Unilever Ltd.	306.7 / 185.1	259.95	-10.82
Ambuja Cements Ltd.	111.8 / 43	99.15	-8.62
A C C Ltd.	928.8 / 365	807	-8.38
Power Grid Corpn. Of India Ltd.	130 / 52	107.6	-8.35
Tata Steel Ltd.	598 / 137.5	424.25	-8.24

# closing price as on 31<sup>st</sup> August 09. \* one month performance as on 31<sup>st</sup> August 09.  
Source: cmie prowess



# FII & DII Inflows:

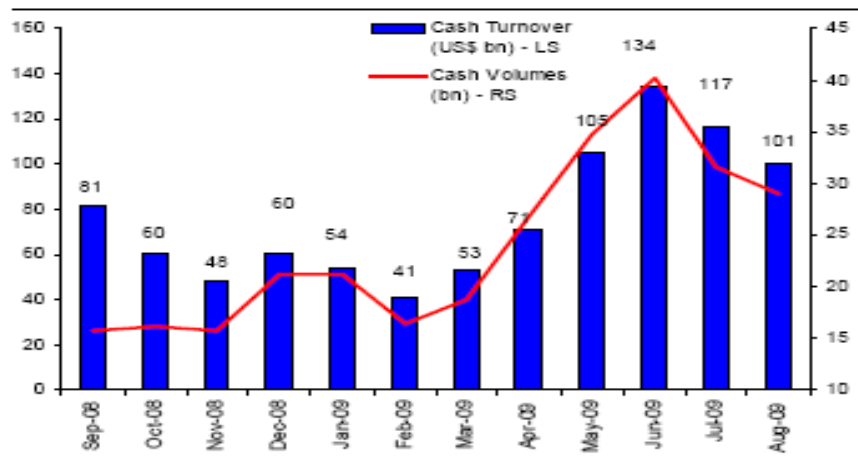


- FII inflows have remained positive on a YTD basis at Rs.403bn for CY09 after a Rs.49bn inflow in August
- DIIs remained net buyers with a Rs.50bn net buy



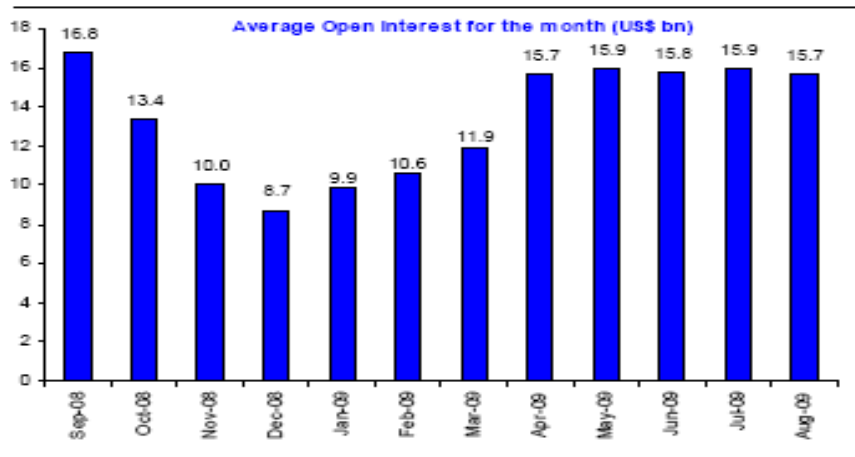
# Market Activity

**Cash Trading: Turnover and Volumes**



Source: BSE, NSE, Morgan Stanley Research

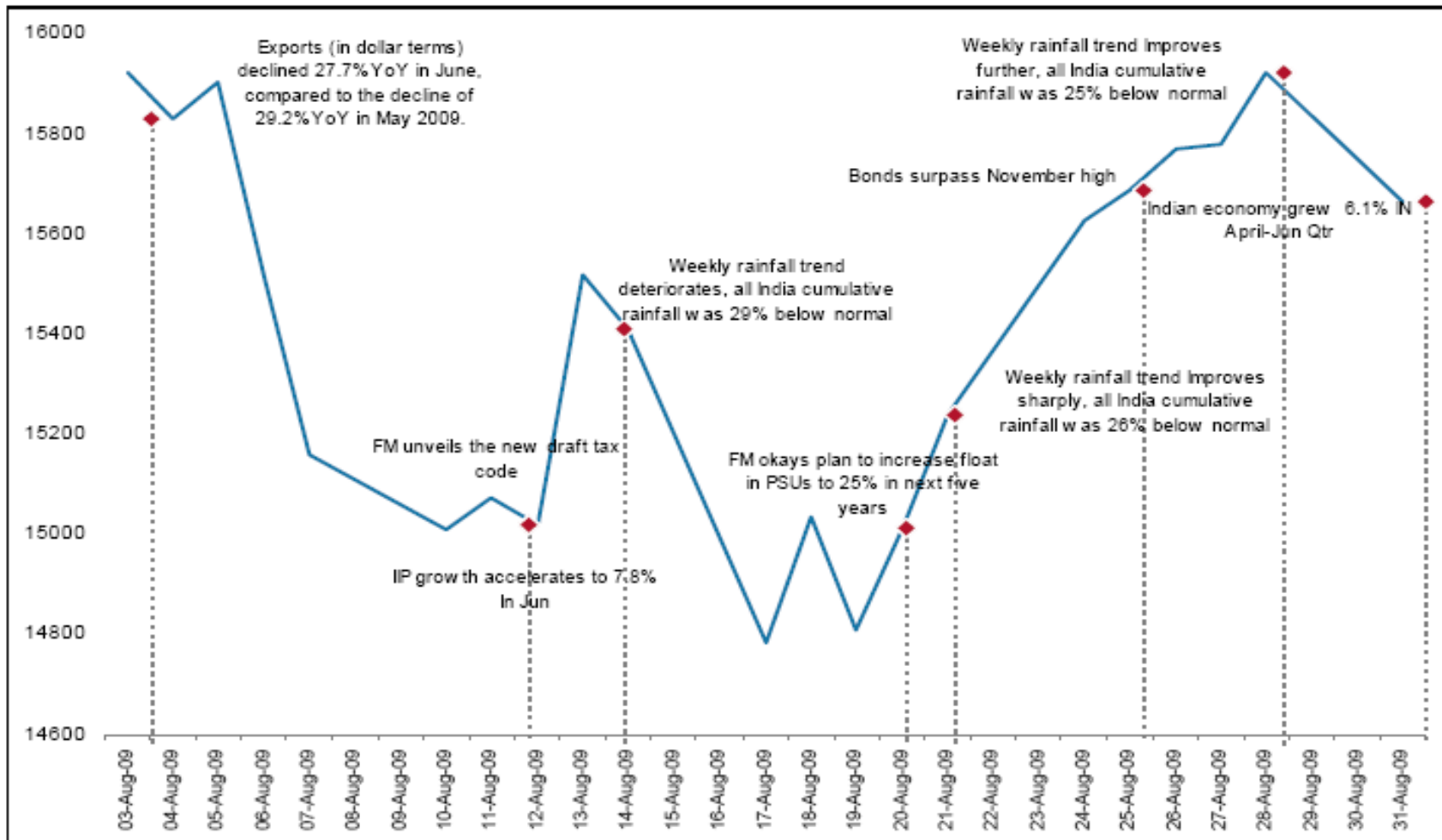
**Average Open Interest for the Month**



Source: Bloomberg, Morgan Stanley Research

- In August, cash trading volumes (number of shares) fell for the second consecutive month, down 8% MoM and is 28% below its Jun-09 peak
- Trading volumes (value) fell 14% MoM and are now 39% below the October 2007 peak
- At the end of August, average open interest fell marginally, down 1.5% MoM and 43% off its January 2008 peak

# August09 events timeline



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



# Religare MF: Equity Market Outlook and Opportunities

# Equity Market Outlook

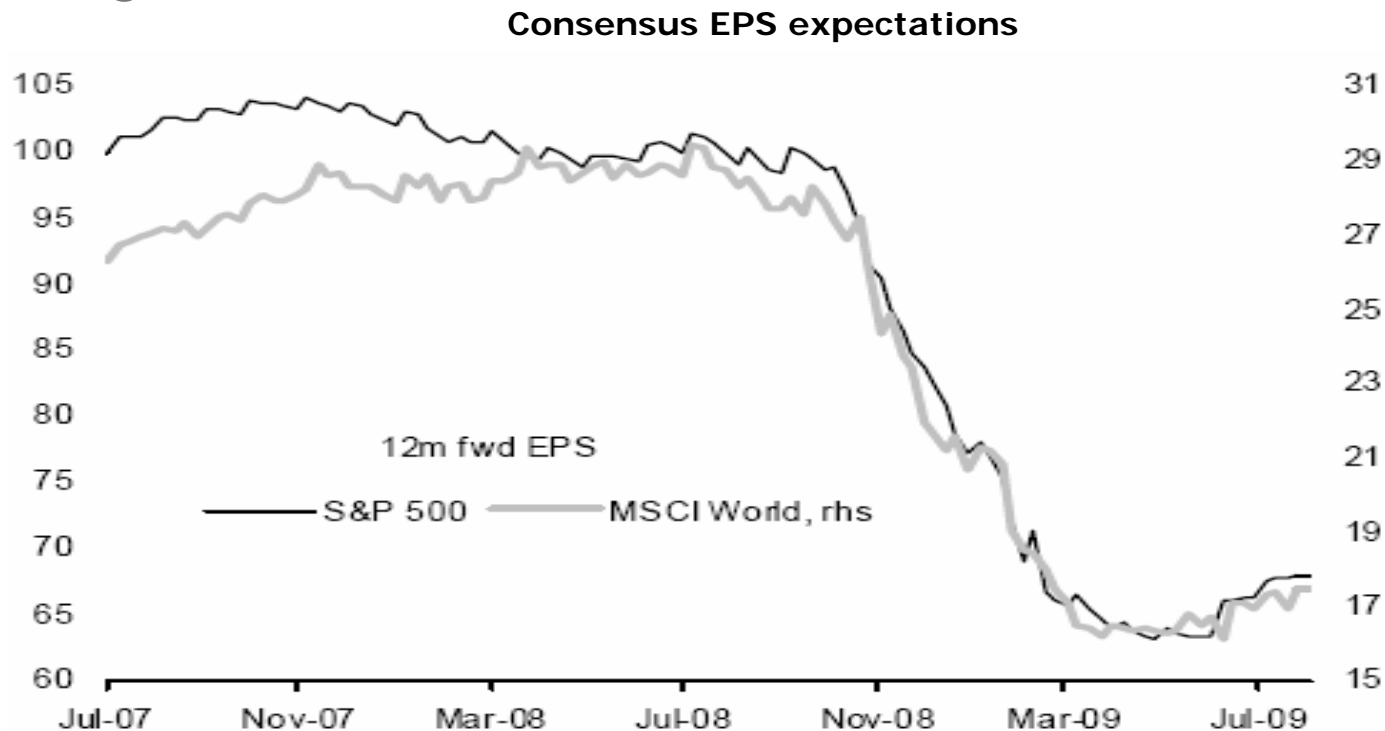
- Global earnings momentum has troughed in early June 2009—and we are now experiencing net earnings upgrades on a global basis for the first time since October 2007. However, while there are no earnings downgrades, the upgrades are also not very significant, implying no meaningful economic recovery is expected
- Similarly, while India's GDP growth at 6.1% in 1QFY10 (Apr-June '09) appears to have picked up on a sequential basis, the same is entirely led by an increase in industry growth, which is more volatile and led by investment demand. Services, which have traditionally been a steady contributor to GDP growth, have continued to decelerate
- Credit markets too have cooled with the spread between yield on 10-year AAA corporate bonds and similar tenure G-Sec came down to 147bps as on 2<sup>nd</sup> September 2009 from 251 bps six months back. Thus corporates can now raise money at much lower spreads over G-Sec yield compared to six months back
- Credit growth which is a key lead indicator of economic recovery has, however, not shown any signs of improvement. The growth in the non food credit further moved down to 14.9 % in the week ending August 14, 2009 from 15.7% in the preceding fortnight
- The poor monsoon threatens to weaken economic growth for this year. Based on cumulative rainfall up to August 26, the cropped area affected by below-normal rainfall (most important measure for assessing risk to crops) improved only slightly to 72.8% compared with 75.9% up to August 19

# Equity Market Outlook

- The impact of poor monsoons is expected to be less severe this time in comparison to the past due to better government intervention through schemes like NREGA which, according to various research estimates, covers about 30-35% of rural households during FY08-09, thereby diversifying the rural income to some extent
- FY10 & FY11 consensus Sensex EPS estimate both saw an upgrade of 0.1% and 1% respectively this month
- Indian markets trade at 20.9x trailing twelve months earnings, which is much above ten year average of 17.7x. However, the premium valuation is in line with that of its global peers with the MSCI Emerging Market Index trading at approximately 18.2x trailing earnings



# Global earnings momentum appears to have troughed

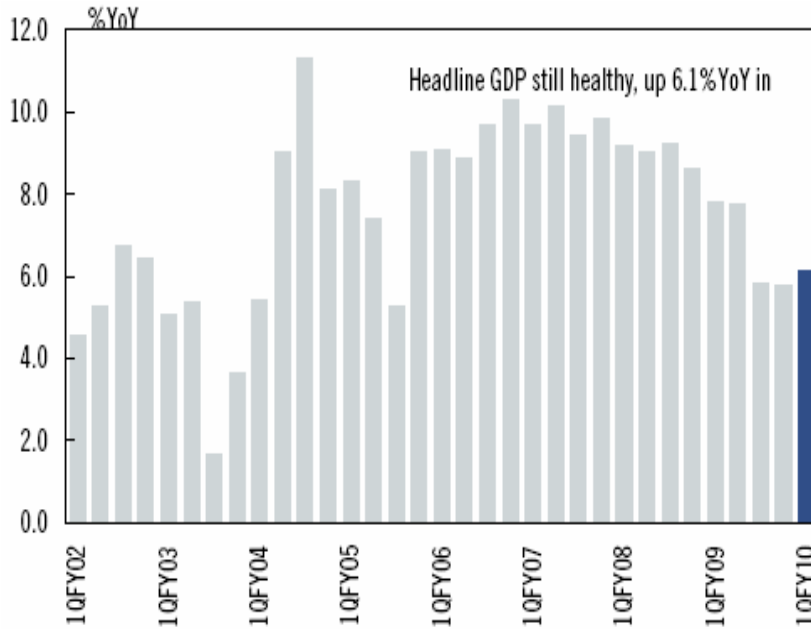


- Earnings momentum has troughed in early June 2009—and we are now experiencing net earnings upgrades on a global basis for the first time since October 2007
- However, while there are no earnings downgrades, the upgrades are also not very significant



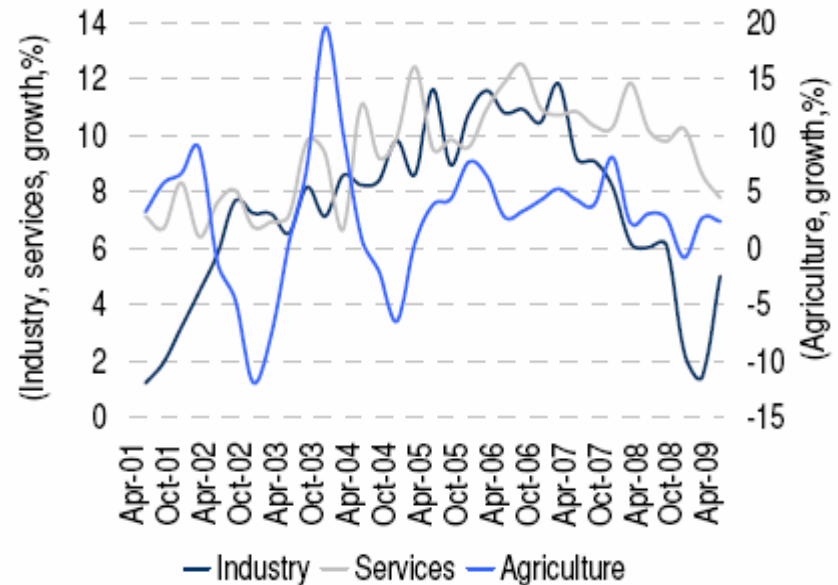
# India's economy also remains resilient

## Trends in Headline GDP (%YoY)



Source: CSO

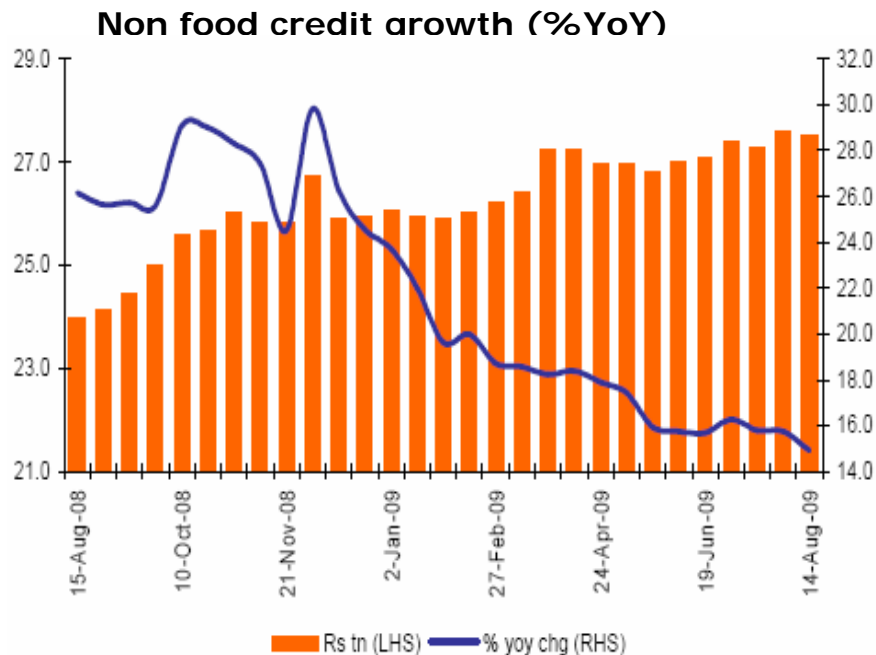
## GDP components growth (%YoY)



Source: Government of India, Anand Rathi Research.

- India's GDP grew at 6.1% in 1QFY10 (Apr-June '09)
- The GDP growth appears to have picked up on a sequential basis, the same is entirely led by an increase in industry growth, which is more volatile and led by investment demand
- However, services which have traditionally been a steady contributor to GDP growth, have continued to decelerate

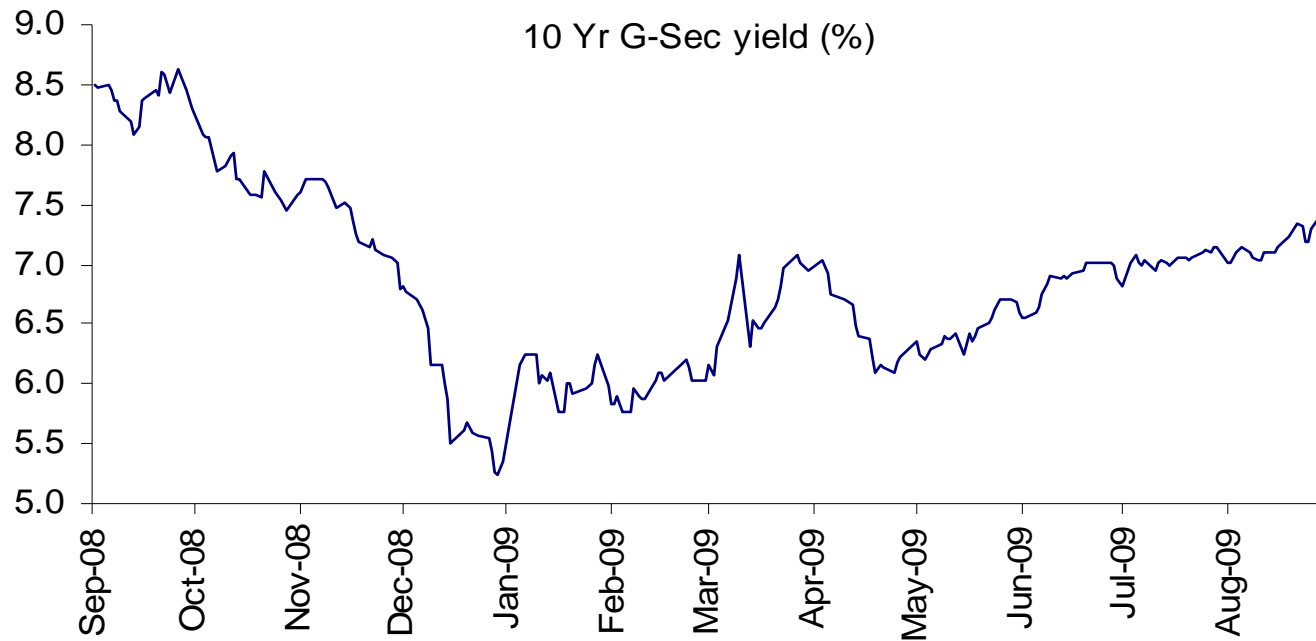
# Credit markets stabilized, but credit growth still elusive



- The spread between yield on 10-year AAA corporate bonds and similar tenure G-Sec came down to 147bps as on 2 September 2009 from 251 bps six months back. Thus corporates can now raise money at much lower spreads over G-Sec yield compared to a year back
- The growth in the non food credit moved down to 14.9 % in the week ending August 14, 2009 from 15.7% in the preceding fortnight



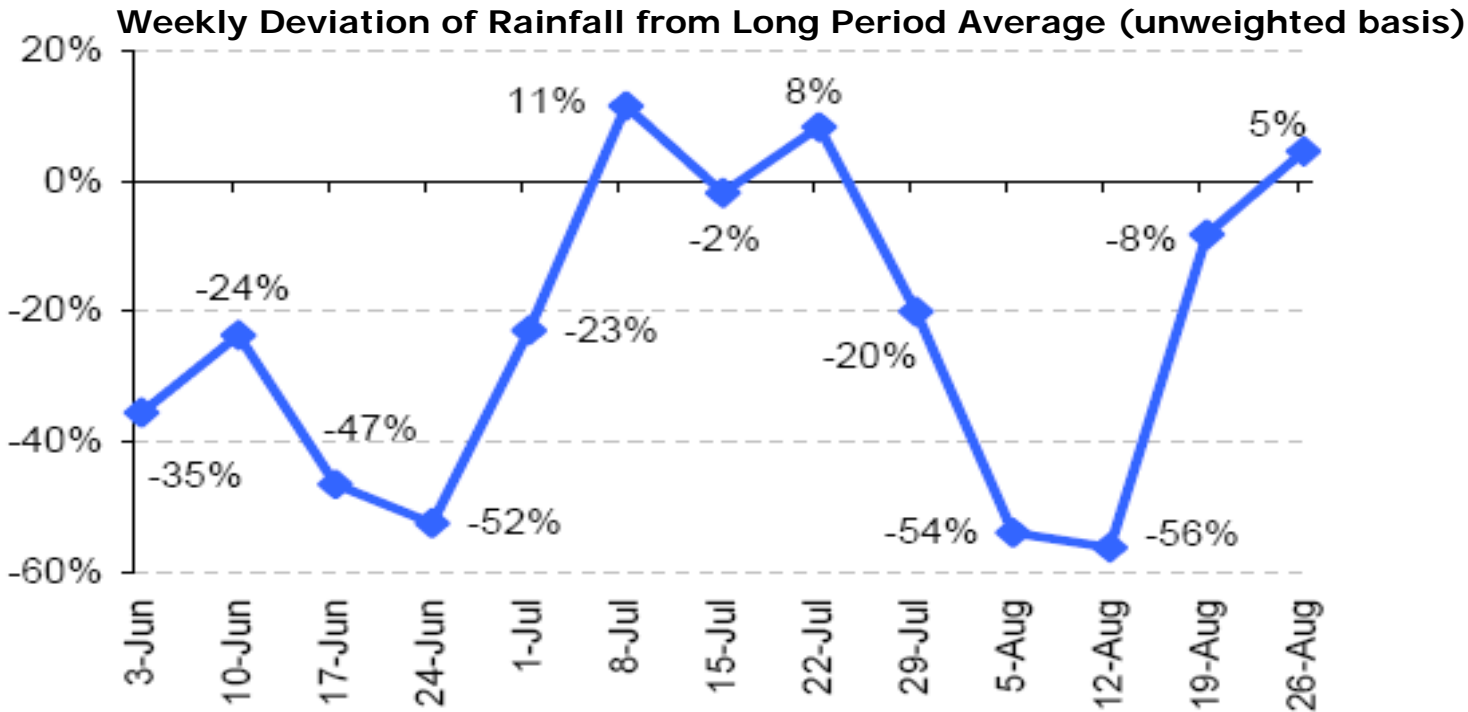
# Interest rates have started to harden



- The interest rates have continued to harden since January 2009
- Thus the 10 year G-Sec bond yield has risen from 5.24% in January to 7.37% currently



# Poor monsoons confirmed

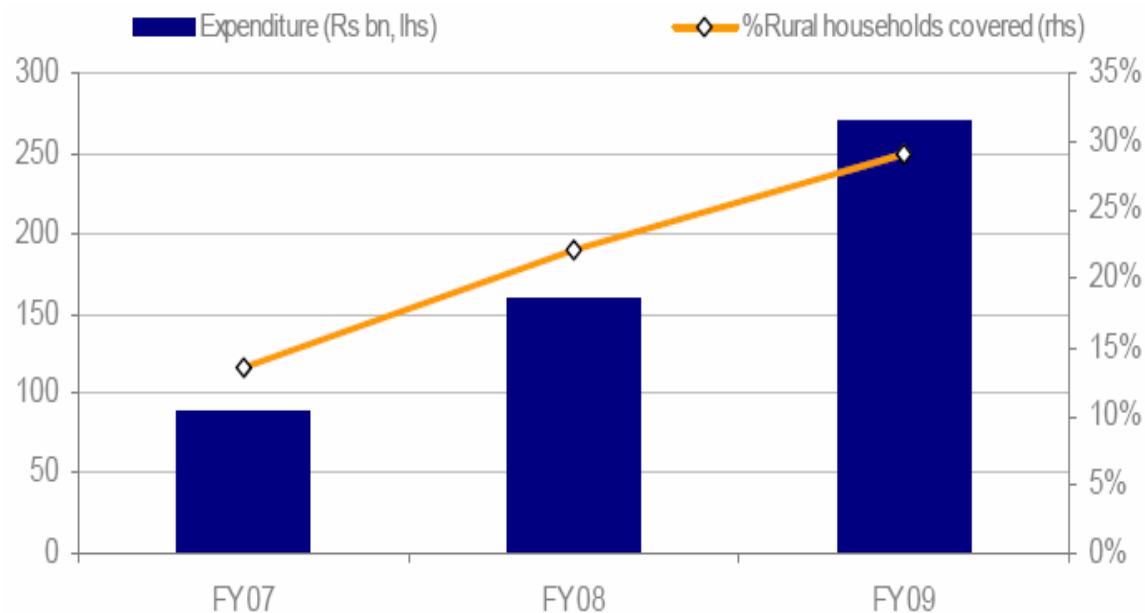


- On an unweighted basis, aggregate countrywide rainfall was 5% above normal for the week ended August 26, compared to 8% below normal in the previous week
- Based on cumulative rainfall up to August 26, the cropped area affected by below-normal rainfall (most important measure for assessing risk to crops) improved only slightly to 72.8% compared with 75.9% up to August 19. Thus, poor monsoons have impacted more than two-thirds of Indian crop, with low prospects of improving as the season is about to end



# Rural incomes to be partially insulated from poor monsoons

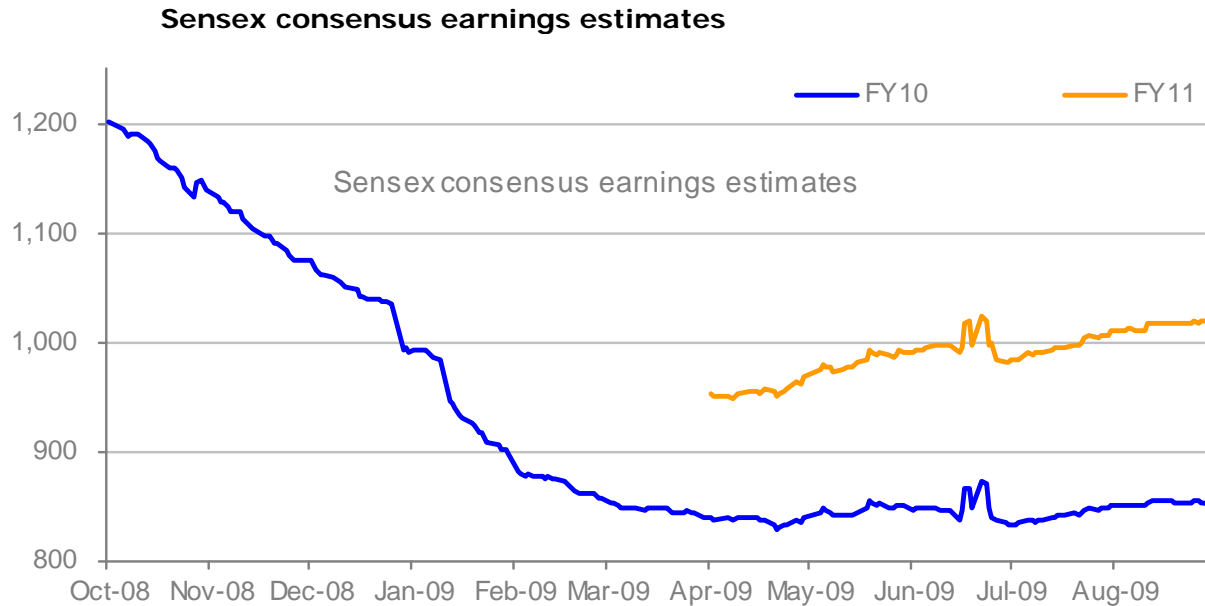
## NREGA currently covers ~30% of rural households



- According to various research estimates, 30-35% of rural households were covered by NREGA during FY08-09, thereby diversifying the rural income to some extent
- Also the composition of agricultural GDP and allied activities has changed; for instance, the contribution of livestock has increased from 13% in the 1960s to 27% currently, thereby partially insulating the overall rural income from crop declines due to monsoon shortfall



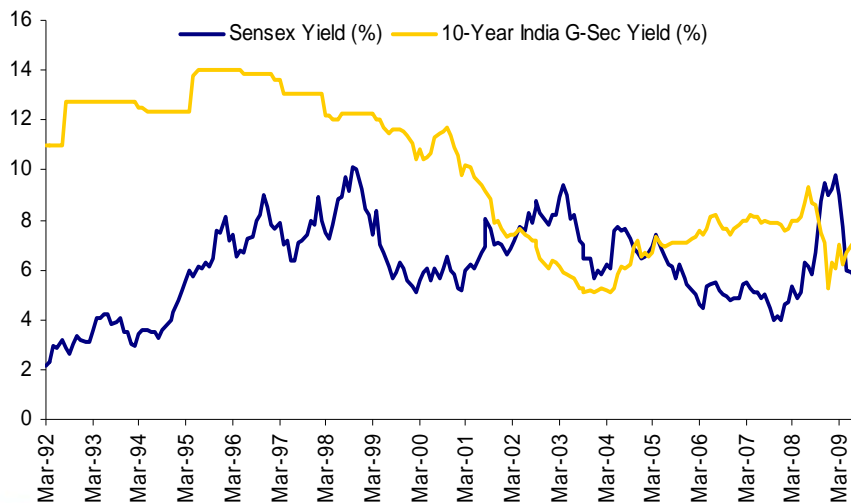
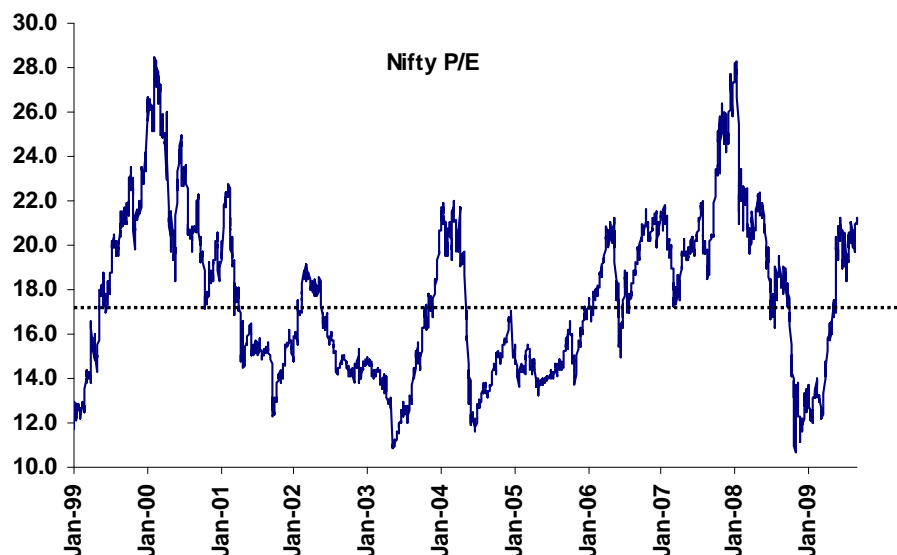
# Domestic Earnings - No major changes



- FY10 & FY11 consensus Sensex EPS estimate both saw an upgrade of 0.1% and 1% respectively this month
- 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 2% decline in FY10 Sensex earnings over FY09 and a 19.8% growth in FY11 Sensex EPS over FY10



# Valuation above long term averages



- Nifty is currently trading at 20.9x its trailing earnings, higher than the ten year average of 17.7x
- The Sensex earnings yield continues to remain lower than the benchmark 10 year yield, unlike the attractive equation earlier this year. The gap between Sensex earnings yield and bond yield has widened by 23 basis points over the previous month
- The valuation surge is not unique to India. The MSCI Emerging Market Index is also trading at approximately 18.22x trailing earnings



# Looking Ahead...

- The macro environment continues to improve as is indicated by an improvement in leading indicators like M&HCV sales (YoY growth of 24% reported by top 2 players in the month of August 09)
- 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, an increase in fiscal deficit and the resultant increased government borrowing is exerting pressure on interest rates. Thus the 10 year G-Sec bond yield has risen from 5.24% in January to 7.37% currently
- In recent days concerns have started to increase about the need for governments and central banks to find an exit strategy from the dramatic stimulus and easing they provided last year
- Israel is one of the first emerging markets to witness a rate hike this year and several other economies are also expected to act by the end of this calendar year
- Concerns that the markets have run ahead of the recovery in the real economy have started to surface . In China where there has been a slowdown in the expansion of credit - equity markets have reacted negatively
- 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

- The improvement in industrial activity is being partially offset by the weak monsoon; GDP growth likely to be 6-6.5% in FY10
- We expect earnings to be flat in FY10 over FY09. The current consensus forecasts a much healthier 20% in FY11 but we would be cautious about visibility of this estimate
- Markets are now finely priced with most measures trading above long term averages and a recovery is being priced in

## 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

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