

Equity Markets : Current Environment and Outlook

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July 2009

Current Environment

- Equity markets across the globe remained bullish, with the MSCI World Index rising by 8.37%%
- Indian markets returns of 8.12% in the month of July was in line with the global equity market returns
- Commodity prices also climbed higher with the benchmark CRB Reuters Jefferies total return index rising 3%
- Global cues remain firmly in the driver's seat and the data indicates that correlations between risky assets remain extremely high
- In India, Auto was the best performing sector followed by the Realty sector. Capital Goods sector delivered the worst return for the month
- FII inflows have remained positive on a YTD basis at Rs.354bn for CY09 after a Rs.111bn inflow in July, highlighting continued deployment of portfolio cash
- 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 \$6bn, while total capital raising planned is about \$14.1bn
- In July, cash trading volumes (number of shares) fell 21% MoM while the average open interest rose a modest 1% MoM

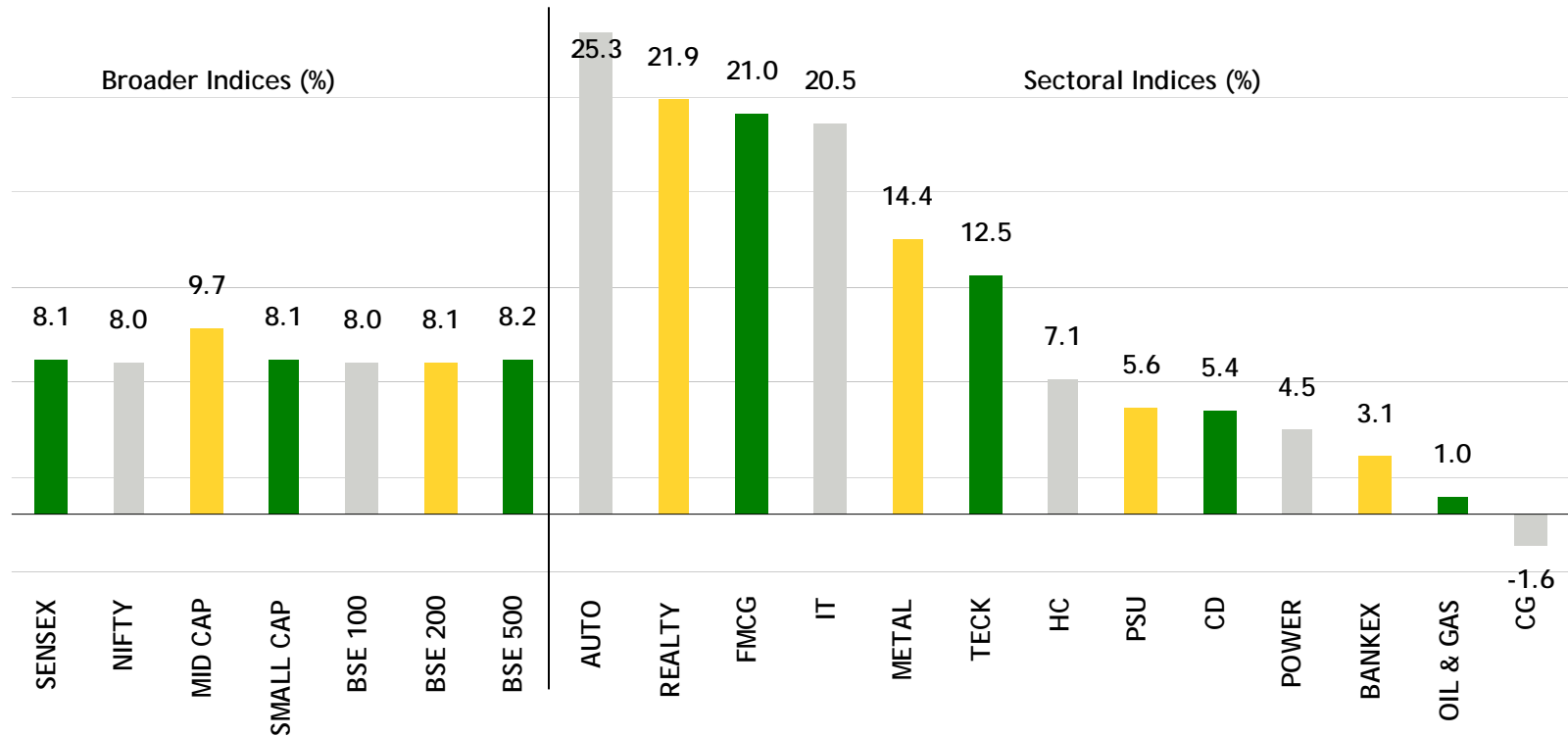
Global Equities

Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	3412.06	15.30%	87.39%	EM - Asia
BSE Sensex	India	15670.31	8.12%	62.43%	EM - Asia
Kospi	South Korea	1557.29	12.03%	38.49%	EM - Asia
Taiwan Weighted	Taiwan	7077.71	10.04%	54.16%	EM - Asia
Thailand SET 50 Index	Thailand	449.91	4.55%	43.38%	EM - Asia
Jakarta Composite Index	Indonesia	2323.24	14.63%	71.40%	EM - Asia
KLSE	Malaysia	1174.90	9.27%	34.01%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	54765.72	6.41%	45.85%	EM
Mexico IPC	Mexico	27043.50	10.98%	20.84%	EM
Russian RTS Index	Russia	1017.47	3.09%	61.02%	EM
Philippine PSEi	Philippines	2798.33	14.78%	50.27%	EM
Merval Buenos Aires Index	Argentina	1719.87	8.31%	59.30%	EM
HangSeng	Hong Kong	20573.33	11.94%	42.99%	Developed - Asia
Nikkei	Japan	10356.83	4.00%	16.90%	Developed - Asia
Strait Times	Singapore	2659.20	13.98%	50.96%	Developed - Asia
Dow Jones	USA	9171.61	8.58%	4.50%	Developed
CAC 40 Index	France	3426.27	9.10%	6.47%	Developed
All Ordinaries Index	Australia	4249.50	7.64%	16.13%	Developed
DAX Index	Germany	5332.14	10.89%	13.33%	Developed
Swiss Market Index	Switzerland	5950.69	10.12%	7.52%	Developed
FTSE 100	UK	4608.36	8.45%	3.93%	Developed
MSCI World Index	--	1044.75	8.37%	13.53%	--

* as on 31st July 09. Source : Bloomberg
EM – emerging markets, Developed – developed markets.



India : Sector performances



- The markets rose by 8.1% over the previous month
- Auto was the best performing sector followed by the Realty sector
- Capital Goods sector delivered the worst return for the month

*Source: BSE,NSE. one month performance as on 31st July 09.

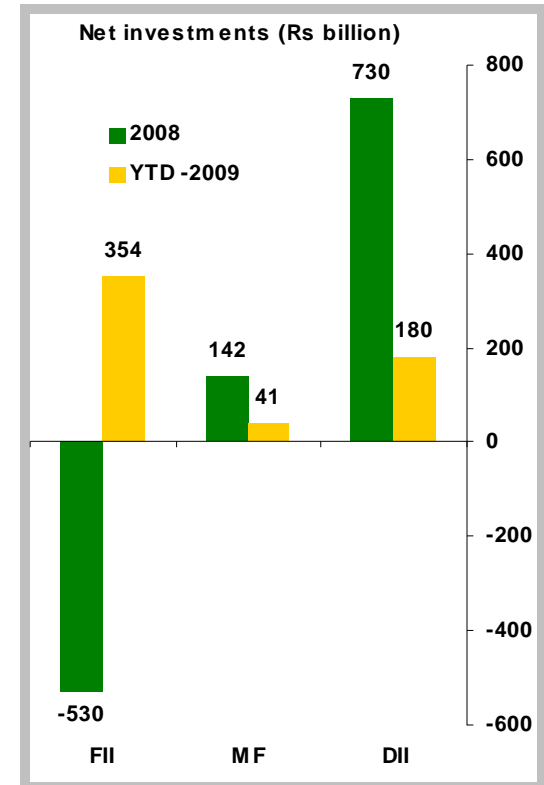
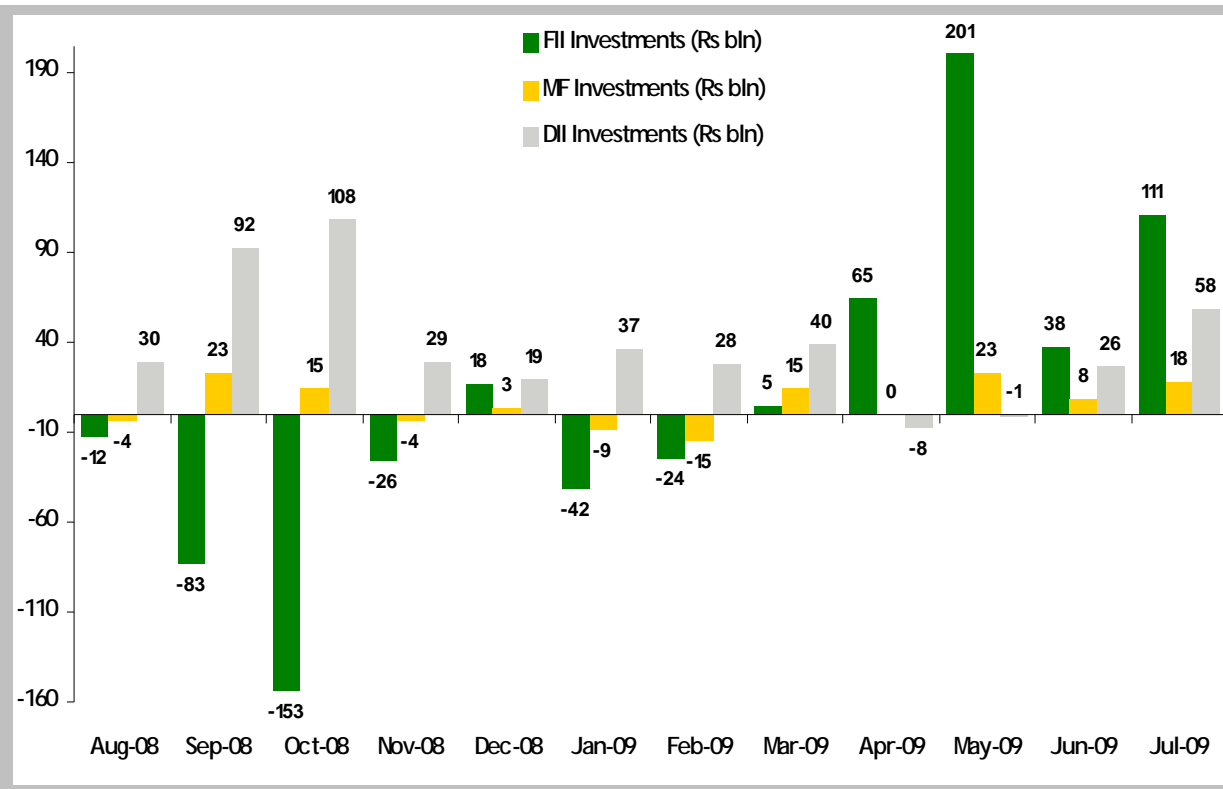
Top Gainers / Losers - Nifty

Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
Tata Motors Ltd.	439.95 / 124.8	421.55	44.99
Tata Consultancy Services Ltd.	545 / 207.68	525.95	34.91
Maruti Suzuki India Ltd.	1448.65 / 433	1414.45	32.32
I T C Ltd.	253 / 132.05	249.2	30.64
Wipro Ltd.	496 / 180.4	490.15	29.69
Top Losers for the month			
Losers	52 week H/L	Last Price#	% Loss*
A B B Ltd.	924 / 343.35	700.6	-9.99
Reliance Communications Ltd.	482.4 / 131.1	275.75	-4.73
Larsen & Toubro Ltd.	1698.7 / 556	1506.35	-3.92
Suzlon Energy Ltd.	253.85 / 33.05	99.8	-3.81
Reliance Industries Ltd.	2535 / 930	1955.4	-3.36

closing price as on 31st July 09. * one month performance as on 31st July 09.
Source: cmie prowess



FII & DII Inflows:



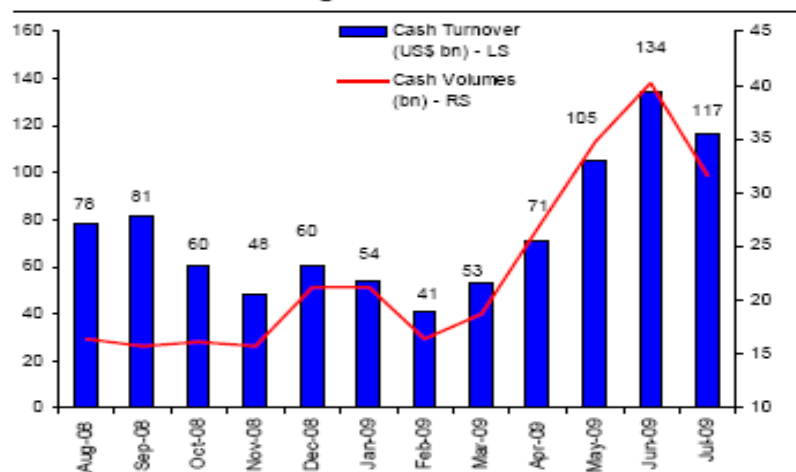
- FII inflows have remained positive on a YTD basis at Rs.354bn for CY09 after a Rs.111bn inflow in July, highlighting continued deployment of portfolio cash
- DIIs remained net buyers with a Rs.58bn net buy
- Total capital raised by Indian companies since April 2009 is \$6bn, while total capital raising planned is about \$14.1bn

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



Market Activity

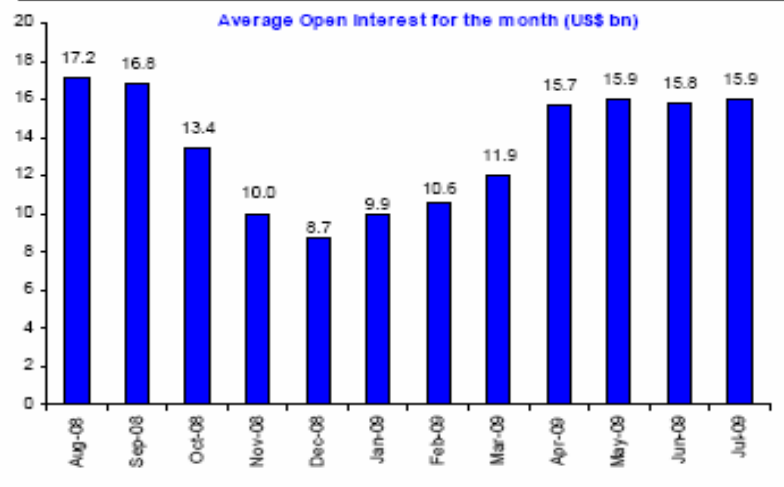
Cash Trading: Turnover and Volumes



Source: RSE, NSF, Morgan Stanley Research

- In July, cash trading volumes (number of shares) fell 21% MoM, after continuously rising for four months.
- Trading volumes (value) fell 13% MoM and are now 35% below the October 2007 peak

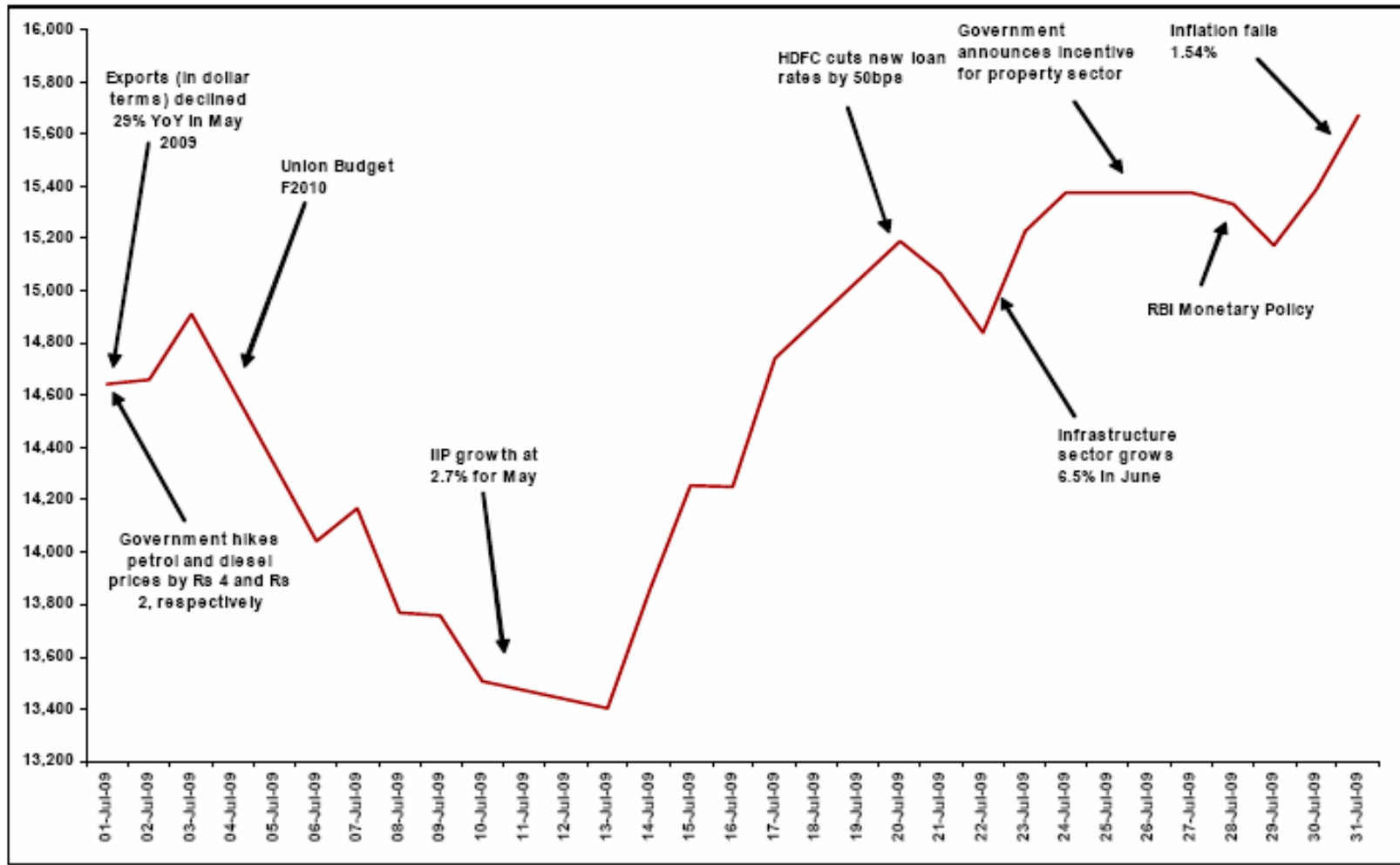
Average Open Interest for the Month



Source: Bloomberg, Morgan Stanley Research

- At the end of July, average open interest rose marginally-up 1% MoM and is 43% off its January 2008 peak.

July09 events timeline



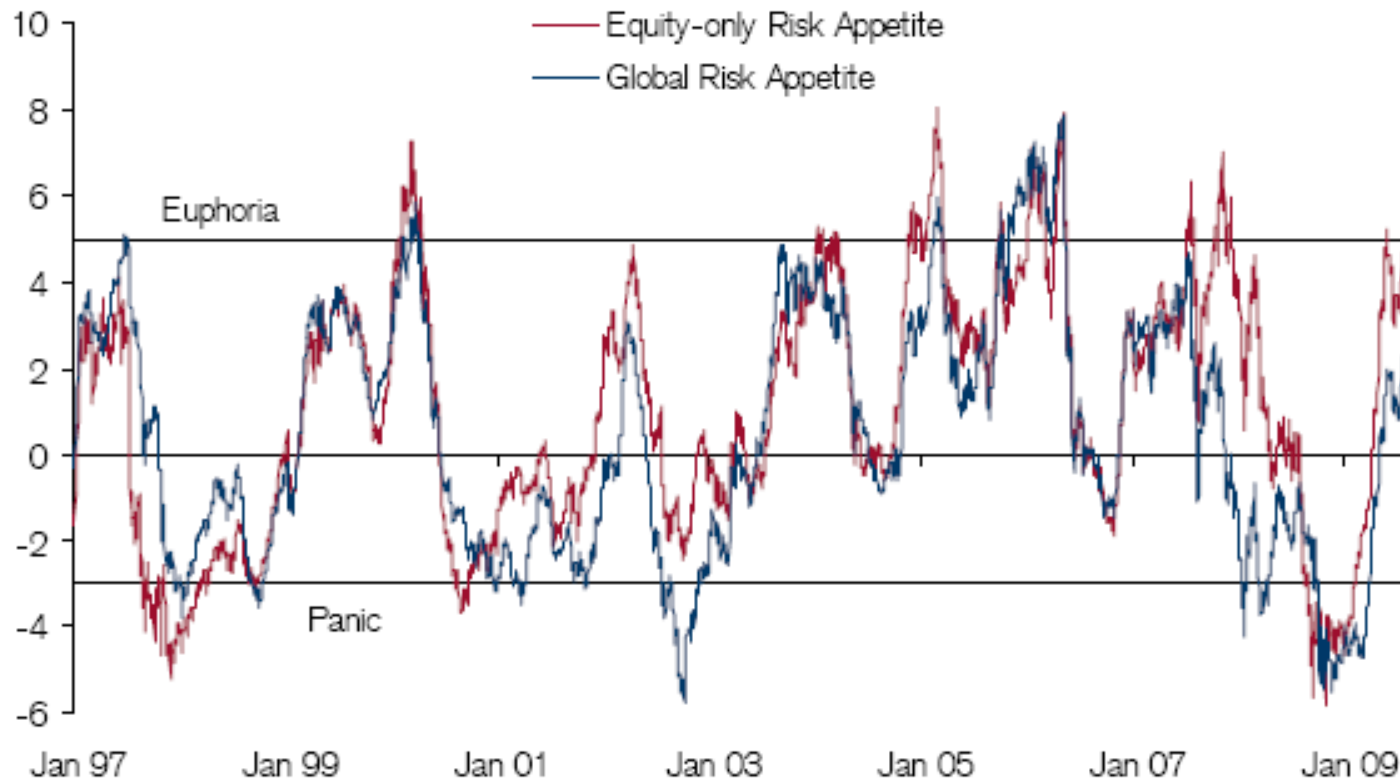
Source: Bloomberg, Economic Times, Business Standard, Morgan Stanley Research

Religare MF: Equity Market Outlook and Opportunities

Equity Market Outlook

- Global risk appetite has surged with Equity-only risk appetite outpacing it. This has resulted in increased fund inflows to emerging markets like India
- Lead indicators are pointing to an economic recovery in the near future. One such indicator, Dun & Bradstreet's survey of business confidence has turned around in the July month
- The 3 month moving average M&HCV sales declined by 24% in July 2009 over that in same period previous year, which is better compared to a 35% decline in June 2009
- Reserve Bank of India (RBI) kept the repo rate, the reverse repo rate and cash reserve ratio (CRR) unchanged at 4.75%, 3.25% and 5% respectively
- On the monsoon front, while the All India average rainfall is now 19% below normal, the crucial rice growing north east region is facing a drought-like situation and the rice growing acreage is down 25% from last year
- Government borrowings this year would consume ~40% of incremental M3, thus potentially crowding out private investment
- Q1FY10 Sensex free float PAT declined 5% on a YoY basis. The decline is softer than the 10% decline expected by consensus
- FY10 & FY11 consensus Sensex EPS estimate both saw a upgrade of 2.4% each this month. Consensus now expects a 2.8% decline in FY10 Sensex earnings over FY09 and a 19.7% growth in FY11 Sensex EPS over FY10
- The surge in valuations is not a feature unique to India. The MSCI Emerging Market Index is also trading at approximately 15.82x trailing earnings, compared to 21.1x multiple for Nifty

Global equity-risk appetite continues to surge

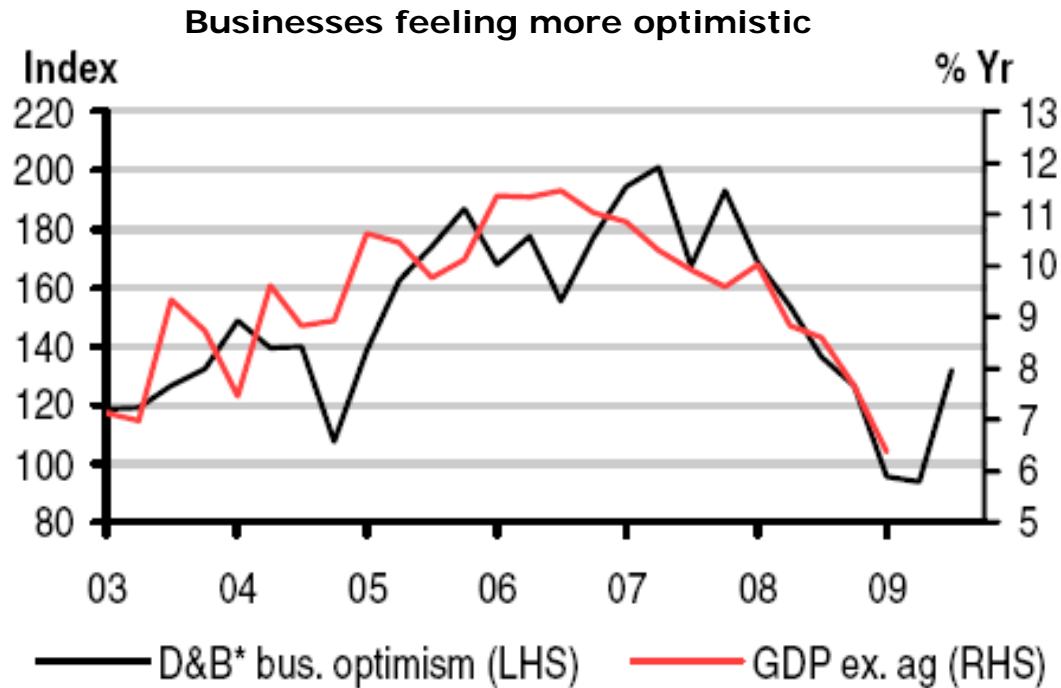


- Global risk appetite has surged with Equity-only risk appetite outpacing it
- This has helped increase fund inflows in to emerging markets like India

Source: Credit Suisse Research

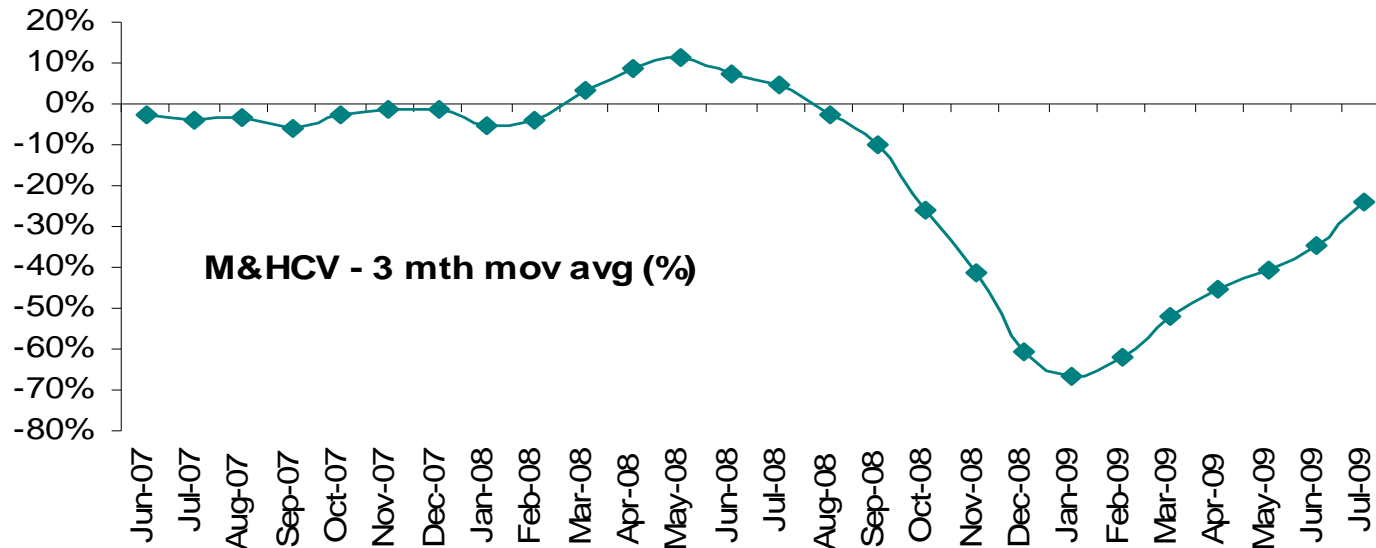


Lead indicators pointing to an economic recovery in near future... D&B Business Optimism Index



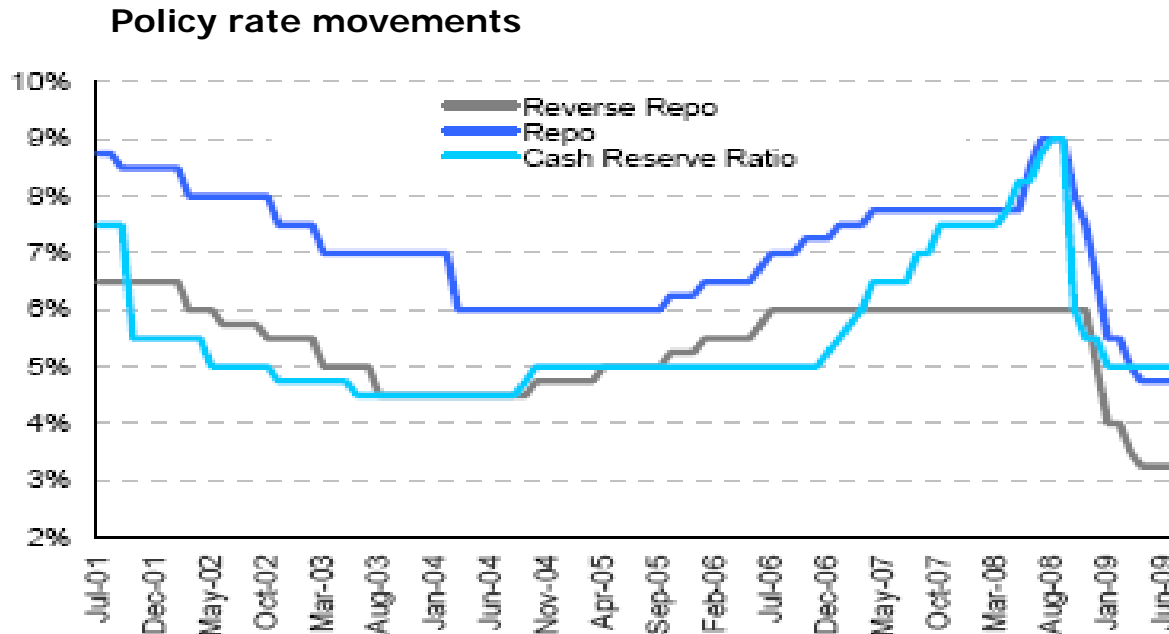
- Dun & Bradstreet's survey of business confidence has picked up in the July
- The index has historically been a lead indicator of growth in GDP ex-agriculture

Lead indicators pointing to an economic recovery in near future... Commercial Vehicles



- Data from the commercial vehicle industry indicates a gradual recovery in demand for commercial vehicles from the trough in January 09
- The 3 month moving average Medium and Heavy Commercial Vehicle (M&HCV) sales declined by 24% in July 2009 over that in same period previous year, which is better compared to a 35% decline in June 2009
- Commercial Vehicle (and M&HCV in particular) demand has historically been a lead indicator of economic activity

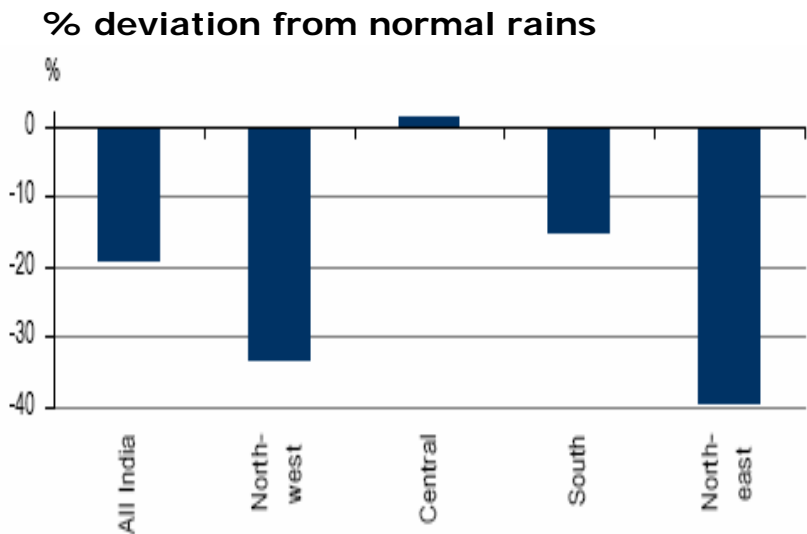
Monetary Policy July 2009 - No Change



Highlights:

- Reserve Bank of India (RBI) kept the repo rate, the reverse repo rate and cash reserve ratio (CRR) unchanged at 4.75%, 3.25% and 5% respectively
- It has left its growth estimate for FY2010 (12-months ended March 2010) at 6%, balancing out upside risk based on the improvement in industrial activity with downside risk stemming from the weak monsoon

Poor monsoons remain a concern



- While the All India average rainfall is now 19% below normal, the crucial rice growing north east region is facing a drought-like situation
- The rice growing acreage is down 25% from last year
- A poor rice crop alone could potentially shave off 0.5% from the GDP growth

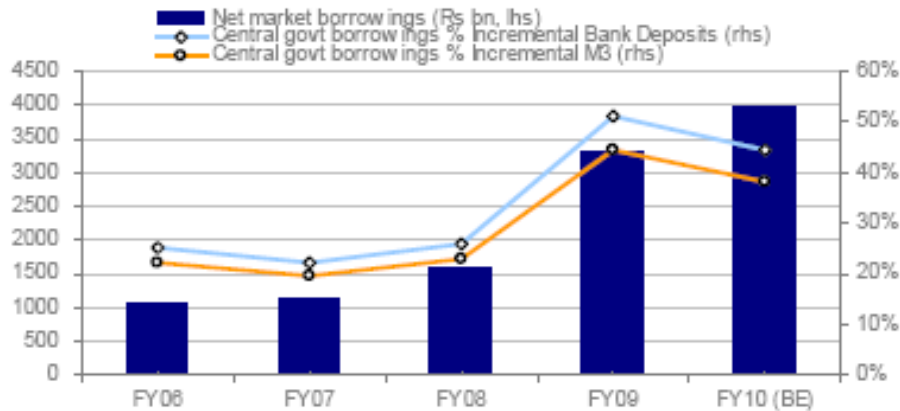
Crop	Normal area (mn hectares)	% of normal	% over last year
Rice	39.1	48.9	-25.5
Coarse cereals	22.9	69.7	4.1
Pulses	11.2	65.7	9.6
Foodgrains	73.2	58.0	-11.0
Oilseeds	15.9	89.2	-2.0
Cotton	8.4	107.0	14.9
Sugarcane	3.9	109.0	-2.9
Jute	0.8	86.1	-2.4
All crops	102.2	69.0	-6.0

Source: Merrill Lynch, IMD, Ministry of Agriculture



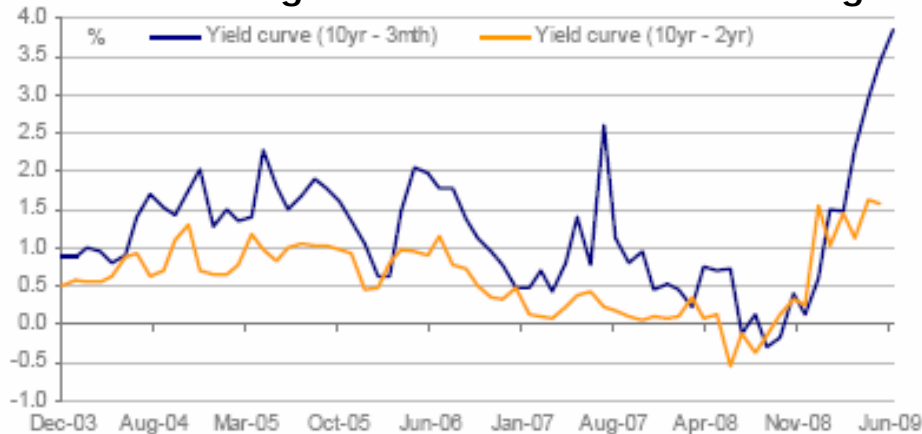
High Government borrowings are a key overhang on interest rates

Government borrowings



- Government borrowings this year would consume ~40% of incremental M3, thus potentially crowding out private investment

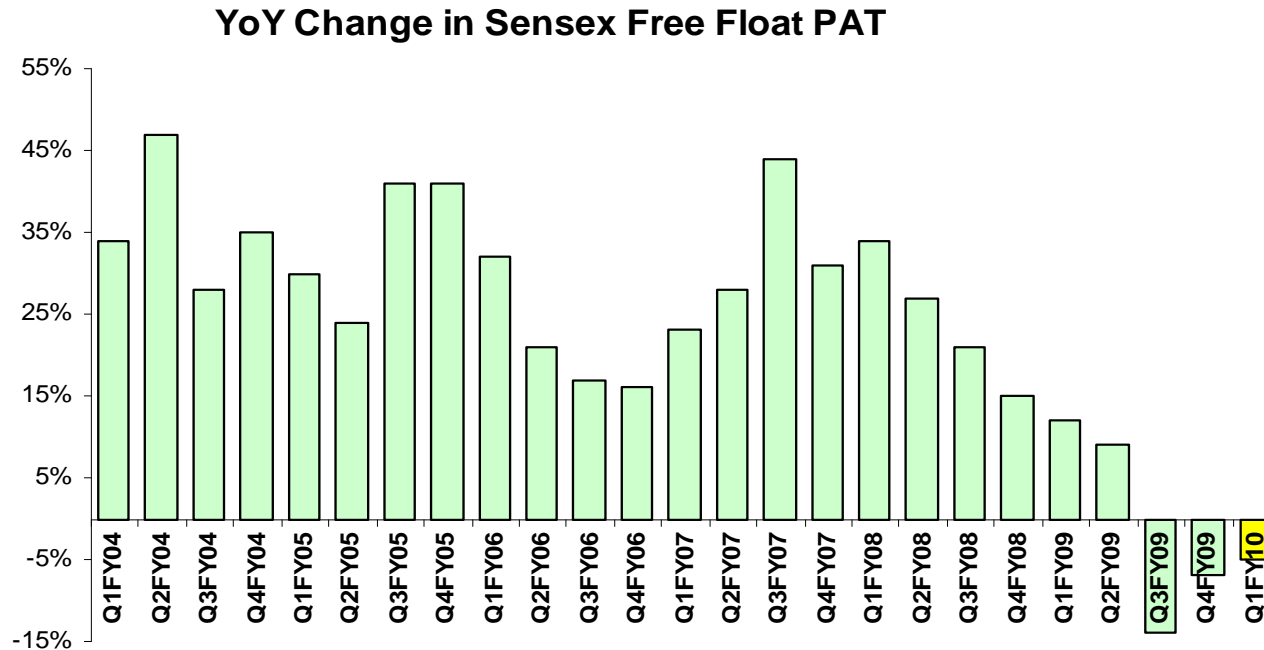
Yield curve continues to steepen further, with long-end rates rising and short-end rates remaining flat



- Yield curve continues to steepen further, with long-end rates rising and short-end rates remaining flat. Thus, cost of long term borrowing continues to increase substantially



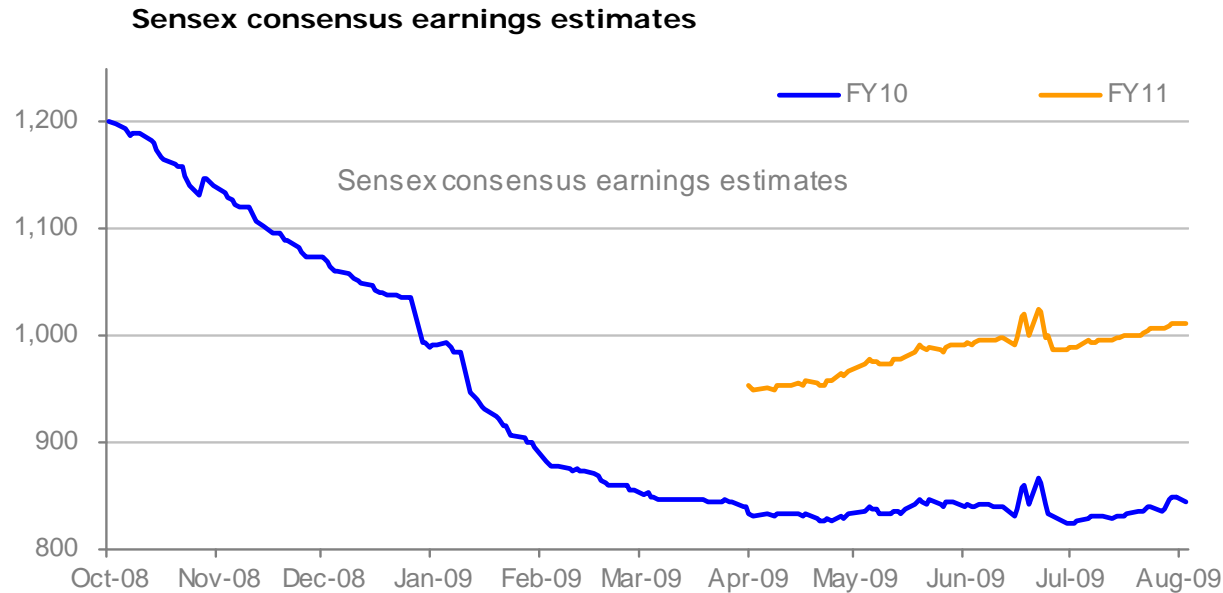
Q1FY10 Earnings - Better than expectation



Source: Morgan Stanley, Kotak Securities

- Q1FY10 Sensex free float PAT declined 5% on a YoY basis. The decline is softer than the 10% decline expected by consensus.
- However, excluding energy, the Q1FY10 Sensex free float PAT increased by 2.6%, compared to an expectation of a 3% decline, on a YoY basis
- The better than expected performance at an aggregate level was driven largely by better than expected operating margins as companies benefited from lower raw material costs, lower duties and other cost cutting measures

Domestic Earnings - No major changes

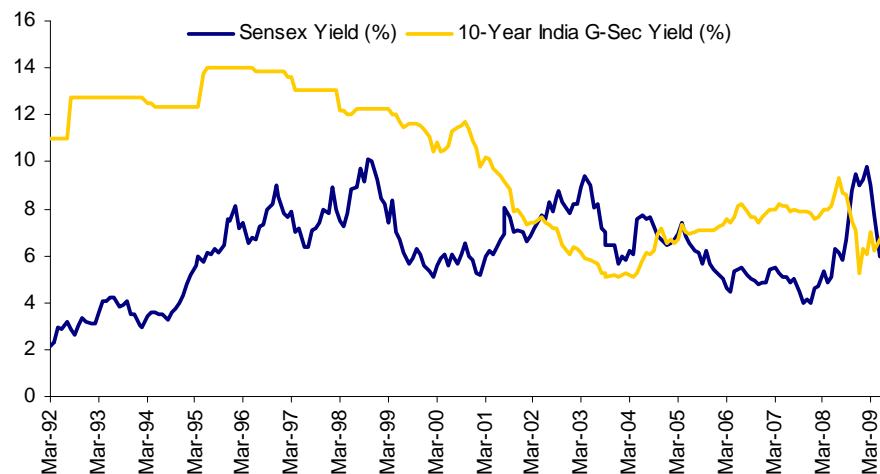
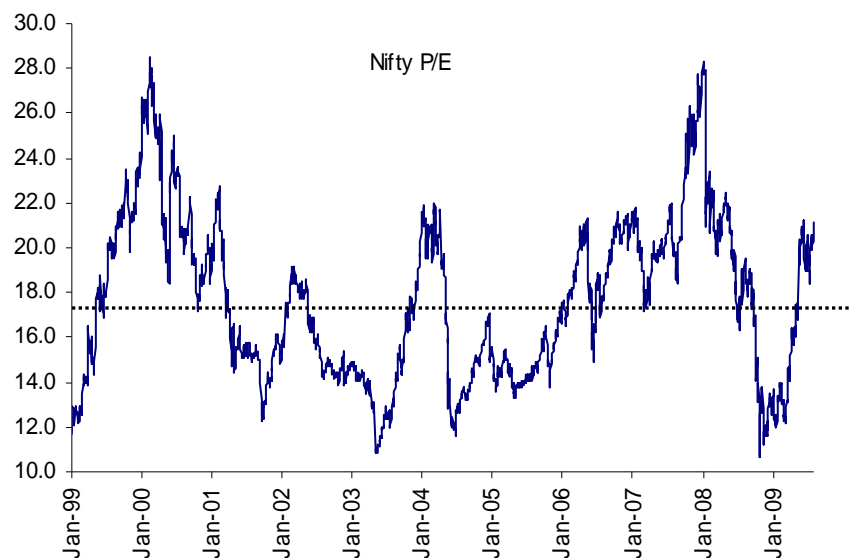


- FY10 & FY11 consensus Sensex EPS estimate both saw a upgrade of 2.4% each this month.
- A meaningful upgrade to FY10 Sensex EPS will require improved global conditions, given that 42% of FY10 Sensex earnings is attributable to constituents with high global linkages like oil & gas, metals and software services
- Consensus now expects a 2.8% decline in FY10 Sensex earnings over FY09 and a 19.7% growth in FY11 Sensex EPS over FY10

Sources: Bloomberg, IIFL Research



Valuation above long term averages



- Nifty is currently trading at 21.1x 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 bond yield, unlike the attractive equation earlier this year. The gap between Sensex earnings yield and bond yield has widened by 59 basis points over the previous month
- The valuation surge is not unique to India. The MSCI Emerging Market Index is also trading at approximately 15.82x trailing earnings



Looking Ahead...

- The macro environment continues to improve as is indicated by an improvement in leading indicators like business confidence indices and M&HCV sales
- 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, with an increase in fiscal deficit from 6.2% in FY09 to a projected deficit of 6.8% in FY10E, the increased borrowing can exert pressure on rates
- RBI in its recently announced monetary policy has kept all the policy rates unchanged and indicated that it would maintain an accommodative monetary stance until there were definite and robust signs of recovery
- Markets are now finely priced with most measures trading above long term averages and a recovery is being priced in
- Our approach at this point is guided more by bottom up value considerations and the key risk we perceive remains the global correlations

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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