

# Equity Markets : Current Environment and Outlook

Vetri Subramaniam, Head of Equity Funds  
April 2010

# Current Environment

- Equity markets across the globe remained range bound, with the MSCI World Index declining by 0.16%.
- Indian markets outperformed the global trend, rising by 0.18% in the month of April.
- Commodity prices remained firm, with the benchmark CRB Reuters Jefferies total return index rising by 0.6%.
- Consumer Durables was the best performing sector followed by the Realty sector. Oil & Gas and Metal sectors delivered the worst return for the month.
- FII inflows were at Rs.69bn in April 2010, while DIIs recorded inflows of Rs.21.9bn. MF remained net sellers to the tune of Rs.14bn.
- Trading Activity remained at elevated levels, with cash trading volumes (number of shares) increasing 5% MoM and the average open interest increasing 12.5% MoM.

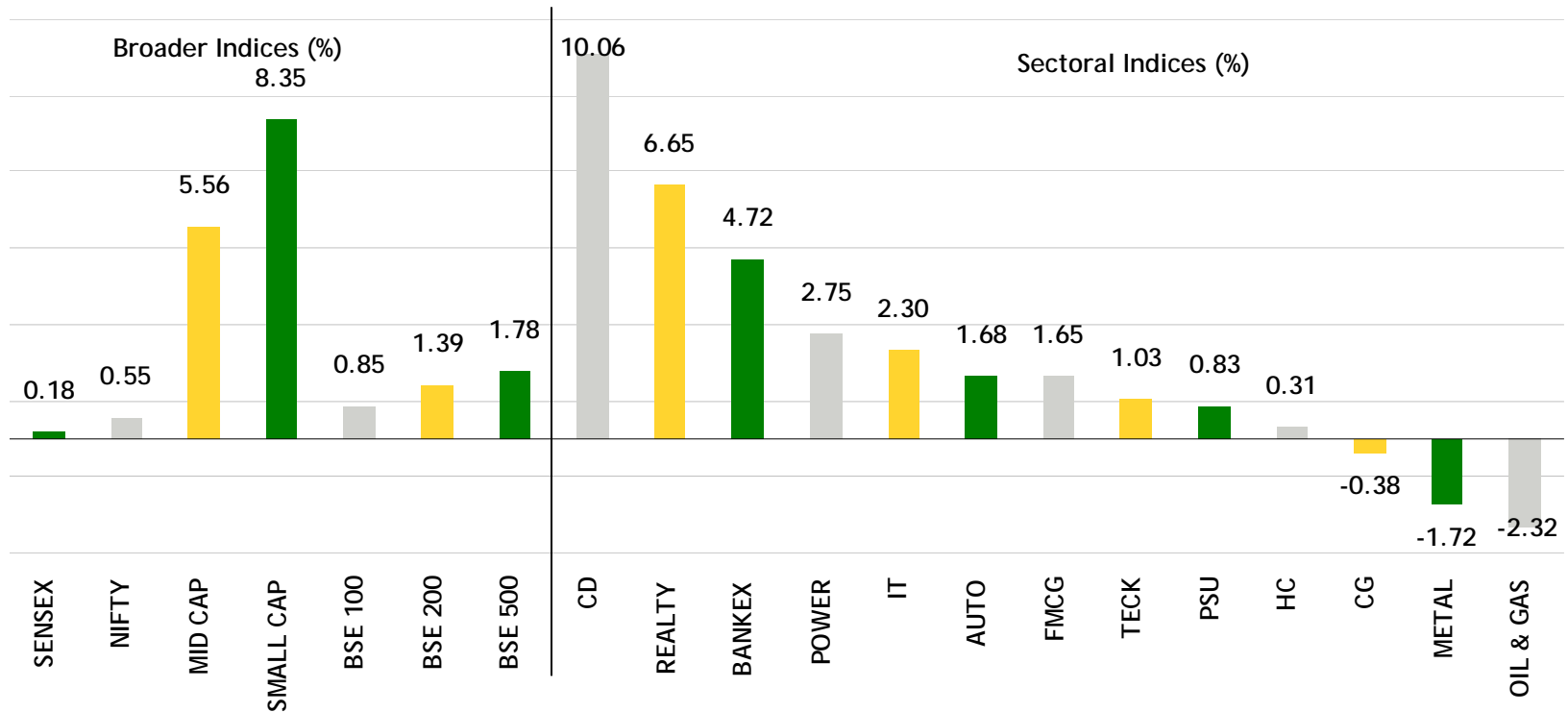
# Global Equities

Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	2870.61	-7.67%	-12.40%	EM - Asia
BSE Sensex	India	17558.71	0.18%	0.54%	EM - Asia
Kospi	South Korea	1741.56	2.88%	3.49%	EM - Asia
Taiwan Weighted	Taiwan	8004.25	1.06%	-2.25%	EM - Asia
Thailand SET 50 Index	Thailand	538.93	-3.47%	3.50%	EM - Asia
Jakarta Composite Index	Indonesia	2971.25	6.98%	17.24%	EM - Asia
KLSE	Malaysia	1346.38	1.95%	5.78%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	67529.73	-4.04%	-1.54%	EM
Mexico IPC	Mexico	32687.32	-1.74%	1.76%	EM
Russian RTS Index	Russia	1572.84	0.02%	8.88%	EM
Philippine PSEi	Philippines	3290.09	4.06%	7.78%	EM
Merval Buenos Aires Index	Argentina	2396.27	0.95%	3.26%	EM
HangSeng	Hong Kong	21108.59	-0.62%	-3.49%	Developed - Asia
Nikkei	Japan	11057.40	-0.29%	4.84%	Developed - Asia
Strait Times	Singapore	2974.61	3.02%	2.66%	Developed - Asia
Dow Jones	USA	11008.61	1.40%	5.57%	Developed
CAC 40 Index	France	3816.99	-3.95%	-3.03%	Developed
All Ordinaries Index	Australia	4833.90	-1.21%	-1.00%	Developed
DAX Index	Germany	6135.70	-0.29%	1.45%	Developed
Swiss Market Index	Switzerland	6616.82	-3.73%	1.08%	Developed
FTSE 100	UK	5553.29	-2.22%	2.59%	Developed
MSCI World Index	--	1198.56	-0.16%	2.58%	--

\* as on 30<sup>th</sup> April 10. Source : Bloomberg  
EM – emerging markets, Developed – developed markets.



# India : Sector performances



- The markets rose by 0.18% over the previous month.
- Consumer Durables was the best performing sector followed by the Realty sector.
- Oil & Gas and Metal sectors delivered the worst return for the month.

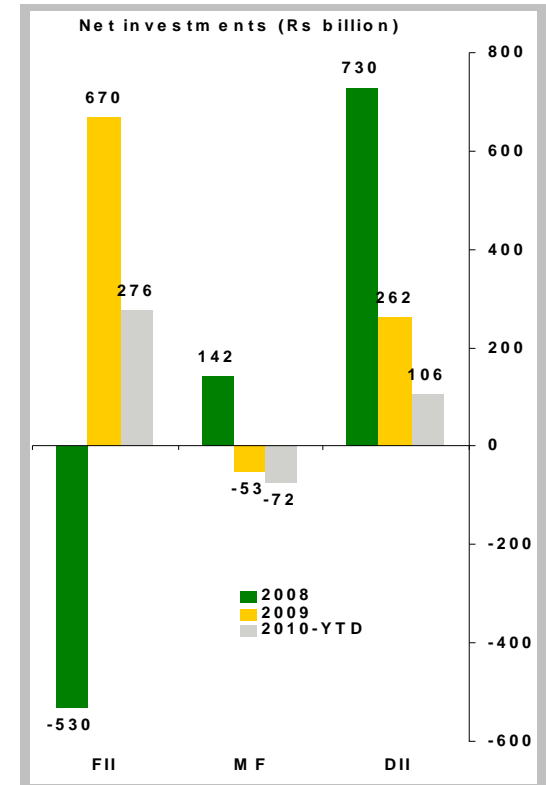
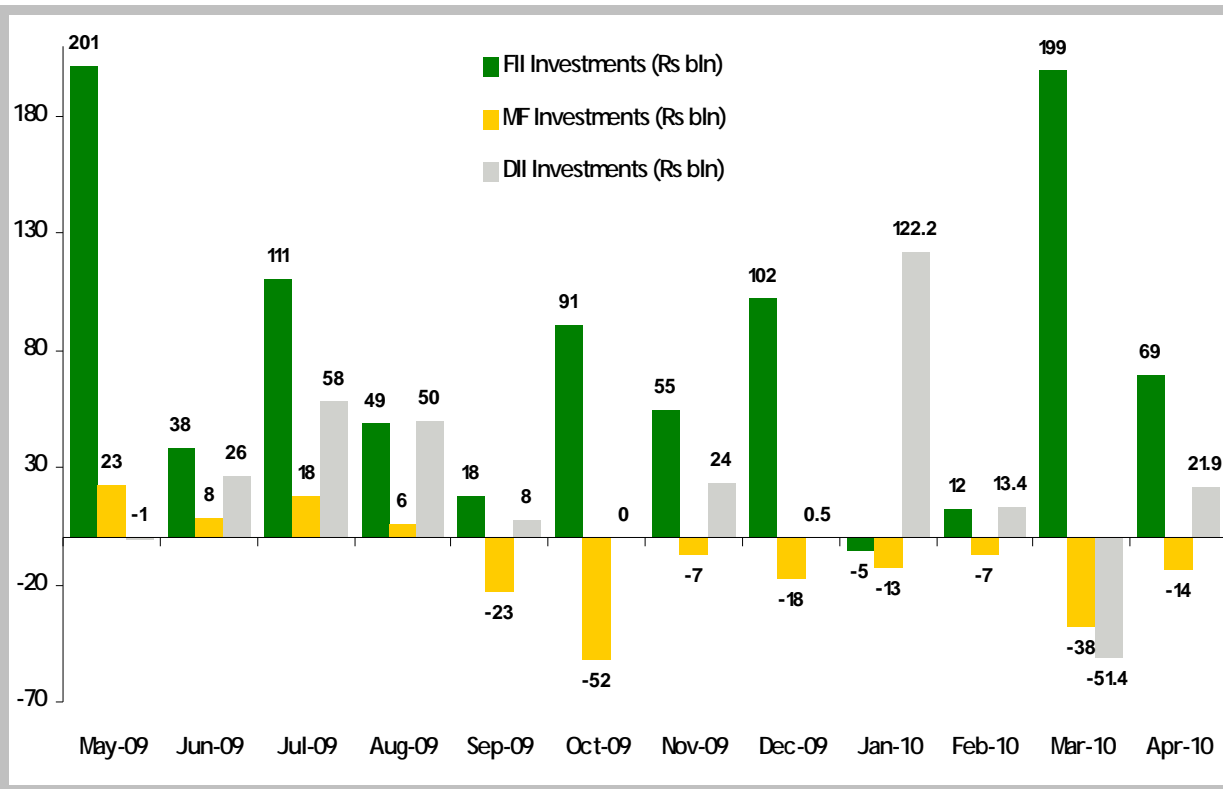
# Top Gainers / Losers - Nifty

Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
Unitech	46 / 116.65	85	15.49
Tata Motors	246.5 / 878.5	872.6	15.16
Reliance Infra.	715.95 / 1404.5	1137.4	13.85
State Bank of India	1219.45 / 2500	2300.7	10.71
HCL Technologies	130.55 / 398	394.45	10.06
Top Losers for the month			
Losers	52 week H/L	Last Price#	% Loss*
S A I L	112.25 / 267	218.3	-13.56
Sun Pharma.	1050 / 1853	1571.2	-12.32
Maruti Suzuki	795 / 1737.3	1279.7	-9.75
Ranbaxy Labs.	167.5 / 538.45	443.3	-6.75
Idea Cellular	47.8 / 91.8	61.15	-6.64

# closing price as on 30<sup>th</sup> April 2010.\* one month performance as on 30<sup>th</sup> April 2010.  
Source: capitaline



# FII & DII Inflows

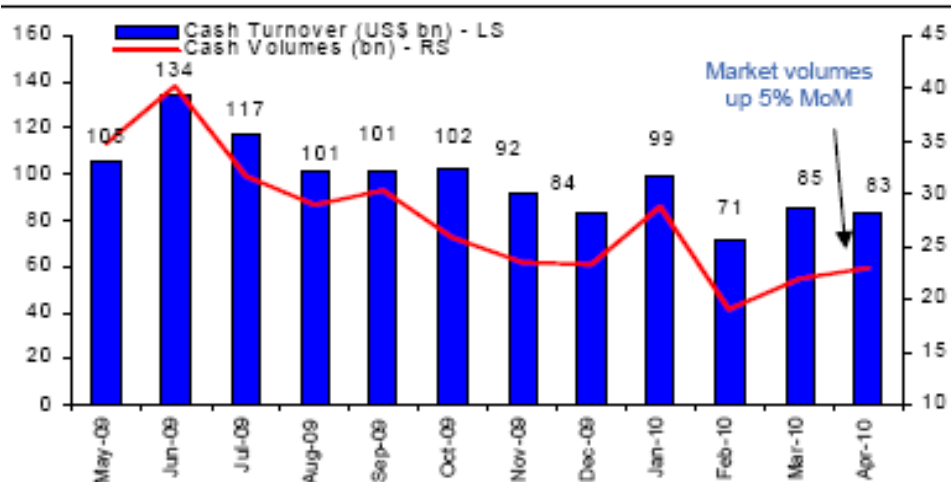


- FII inflows were at Rs.69bn in April 2010. FII inflows have remained positive on a YTD basis at Rs.276bn for CY10 after a Rs.670bn inflow in CY09.
- DII recorded inflows of Rs.21.9bn. MF remained net sellers to the tune of Rs.14bn.

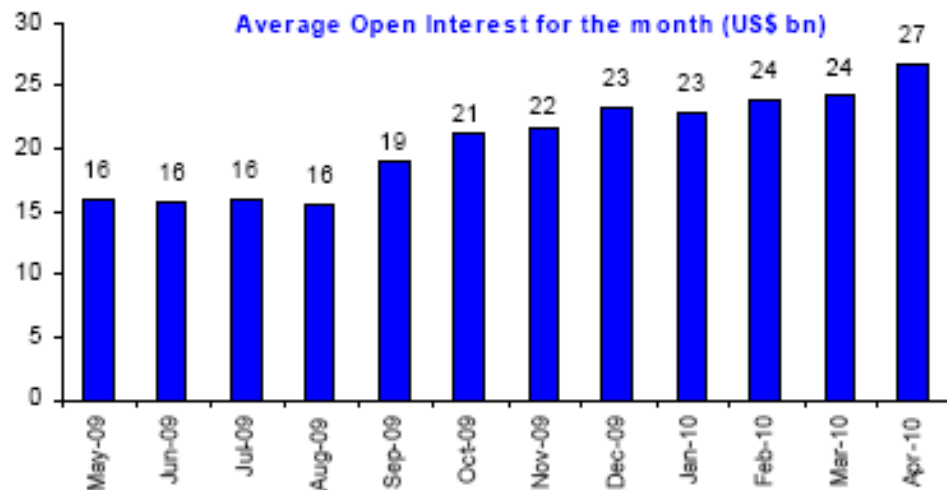


# Market Activity

## Cash Trading: Turnover and Volumes



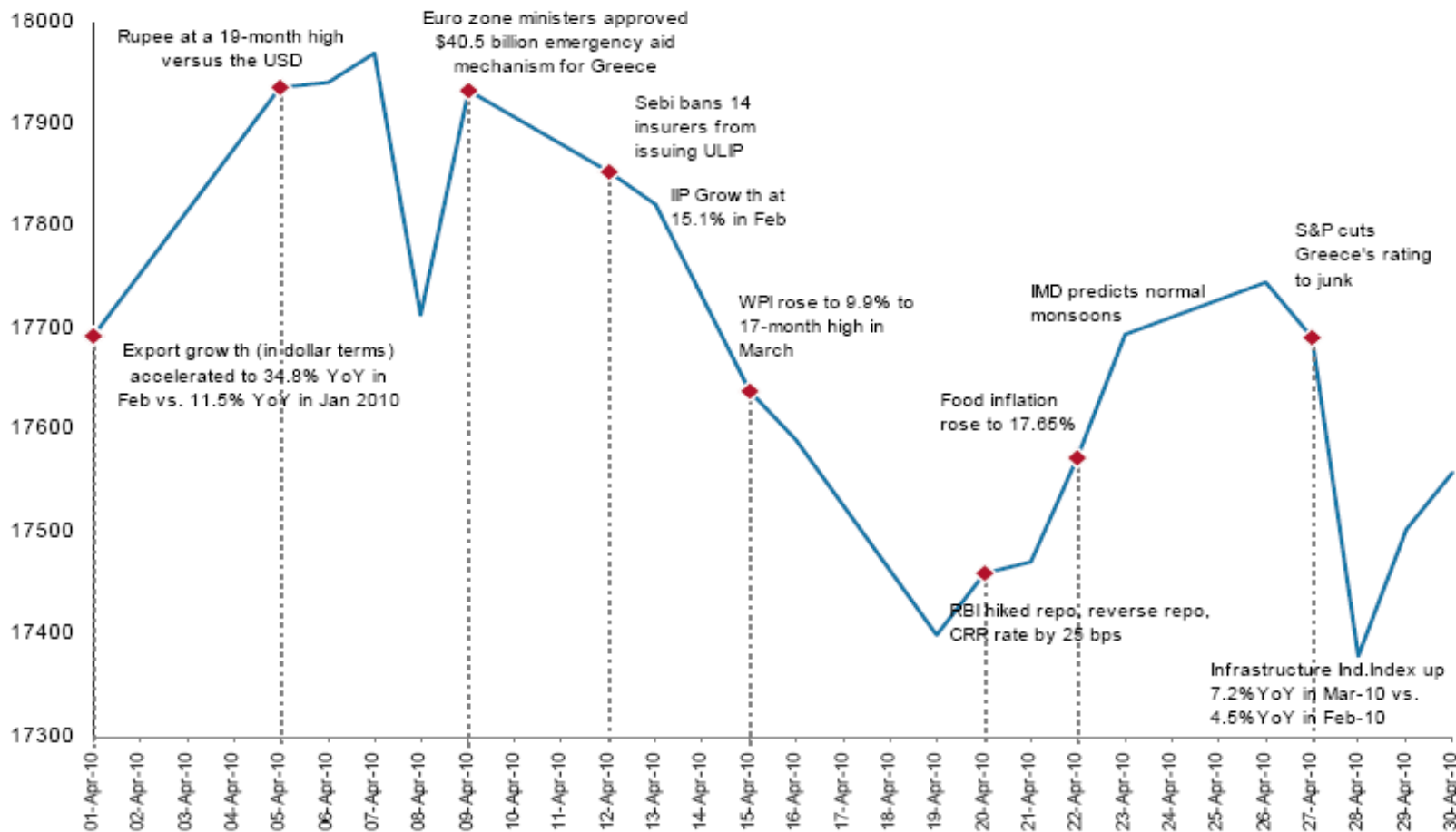
- In April, cash trading volumes (number of shares) increased by 5% MoM.



- At the end of April, average open interest increased 12.5% MoM at its highest level since Jan-08.



# April 2010 events timeline



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



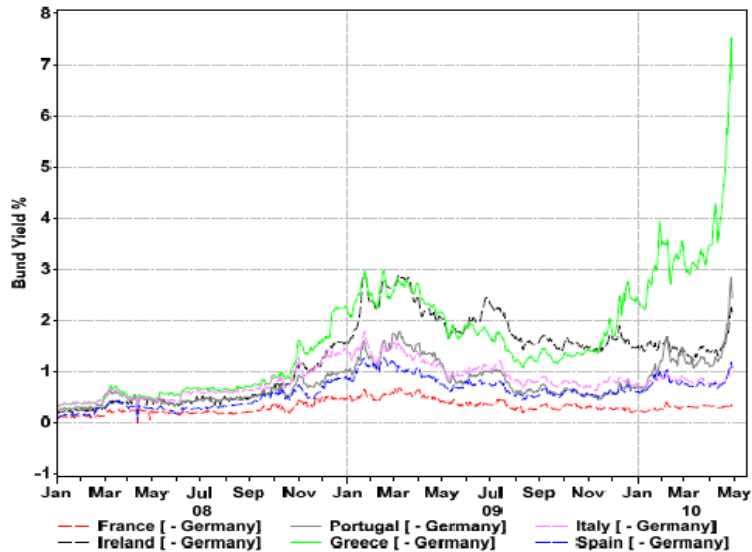
# Religare MF: Equity Market Outlook and Opportunities

# Equity Market Outlook

- The previous month saw a sharp spike in the bond yields as well as the credit default swaps (CDS) of some of the troubled European nations including Greece and Portugal on the back of sovereign downgrades by a leading credit rating agency.
- Greece is negotiating a \$142bn bailout with the IMF and the EU.
- Concerns about the health of European economies has caused the Euro to collapse by 17.25% from its December 2010 peak, to Euro 1.27/\$
- India's economic indicators point towards a sustained recovery. The growth of 3 month moving average IIP remained at a annual high above 16%, while the credit growth sustained at 17.5%.
- Inflation continues to remain at elevated levels with WPI for March 2010 touching 9.9%. However a normal monsoon may help ease the food inflation, a key component of core inflation.
- Corporate India's value creation, viz., the spread between the Return on Equity and Cost of Equity has dipped substantially in FY10 to just about 2.5%, down from a high of 10% in FY05.
- Exchange Traded Funds (ETFs) invested US\$829m in common stock between January-April 2010 accounting for 20% of FII flows in secondary markets—down from 34% in 2009. We feel the same is beneficial to markets as it reduces the risk of concentration of source of inflows.
- There have been no material changes to Consensus earnings expectation in the month. Consensus continues to expect a a 27% growth in FY11 Sensex EPS over FY10 and a 20% growth in FY12E Sensex EPS over FY11E.
- 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 remained the same in the month.

# Global markets - Sovereign debt risk at the fore

## Bond yields of select European nations



## Euro / Dollar rate in last one year

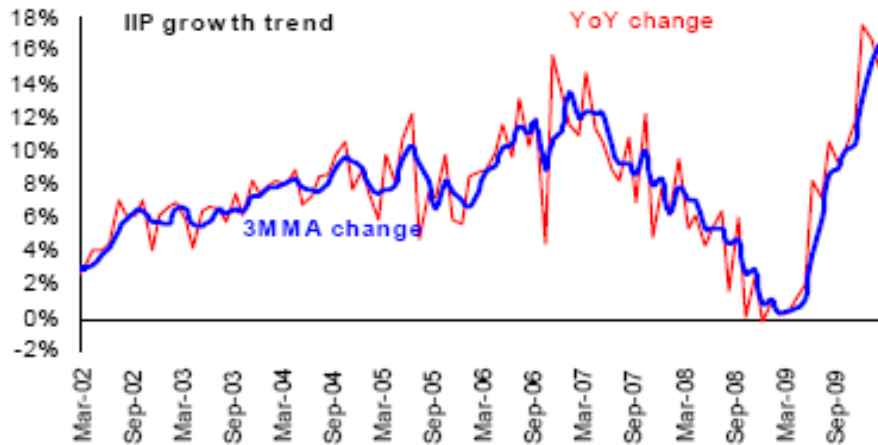


- Rating agency S&P lowered the credit rating on Greek sovereign debt to BB+, dropping it to junk category. It also lowered Portugal's debt two notches to A-.
- This was followed by a sharp spike in the bond yields as well as the credit default swaps (CDS) of some of the troubled European nations including Greece and Portugal.
- The Euro has also collapsed by 17.25% from its December 2009 peak, to Euro 1.27/\$



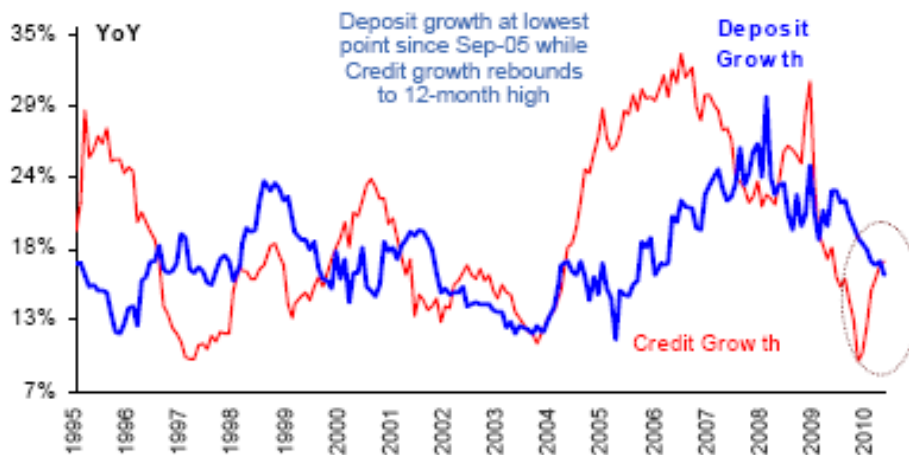
# India's economic recovery maintains momentum

## Industrial Production Growth



- The growth in index of industrial production dipped in February 2010 to 15.1%.
- However, the 3 month moving average remains robustly above 16% indicating sustained industrial recovery.

## Credit and Deposit Growth

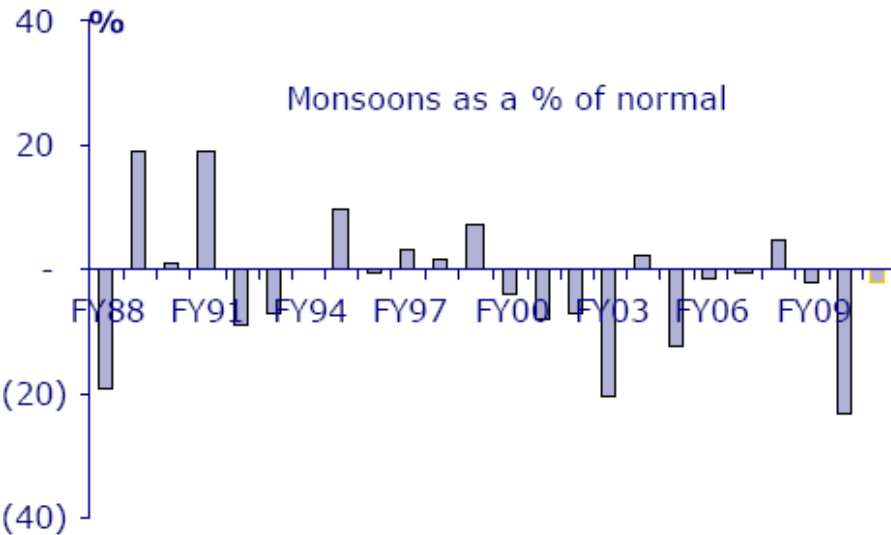
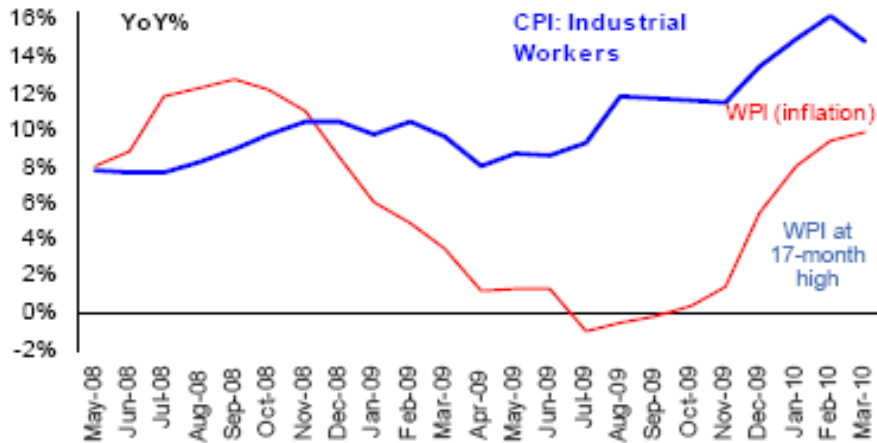


- The credit continues to grow at a faster pace with a growth of 17.5% for the fortnight ended ending April 23, 2010.
- In the fortnight, credit growth surpassed the deposit growth.



# Inflation might ease with help from a normal monsoon

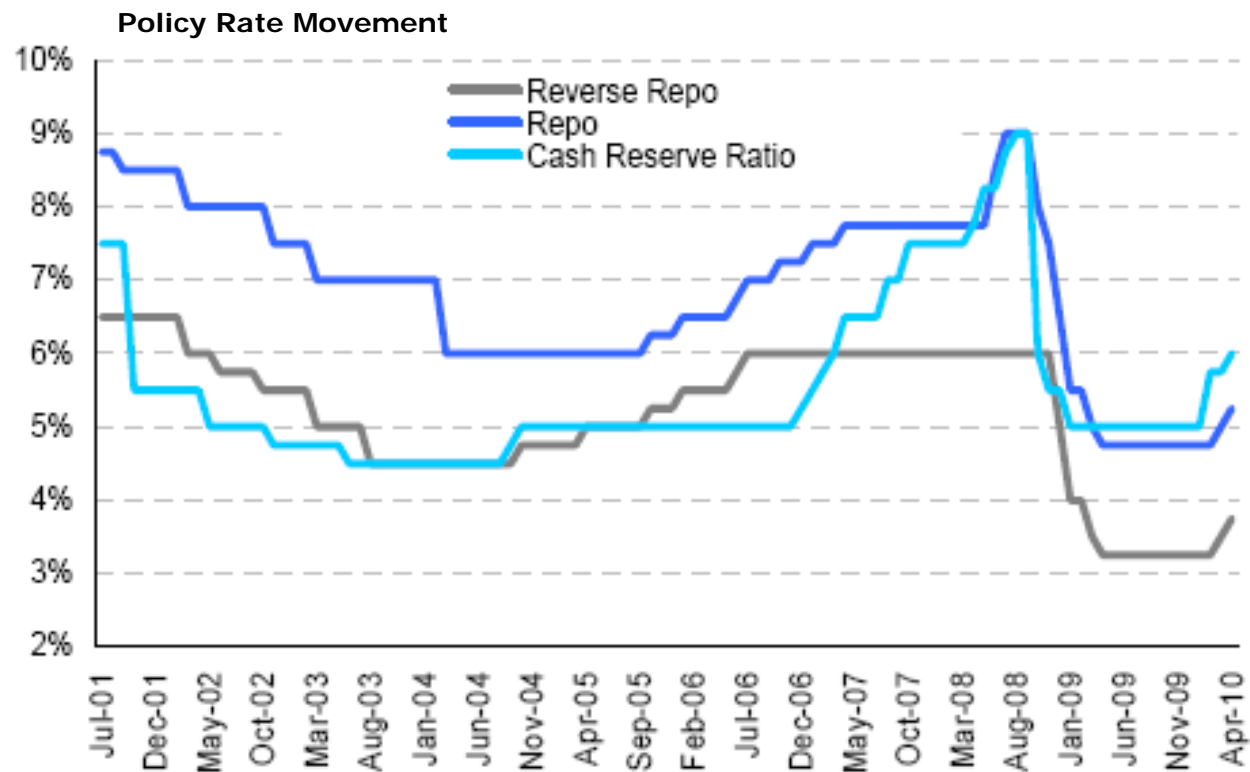
CPI and WPI (% change)



- Inflation continues to remain at elevated levels with WPI for March 2010 touching 9.9%.
- However, a CPI of 14.9% remains a key worry for policymakers.
- However a normal monsoon may help ease the food inflation, a key component of core inflation.
- The Indian Meteorological Department (IMD) expects rainfall to be 98% of its long period average in FY10.



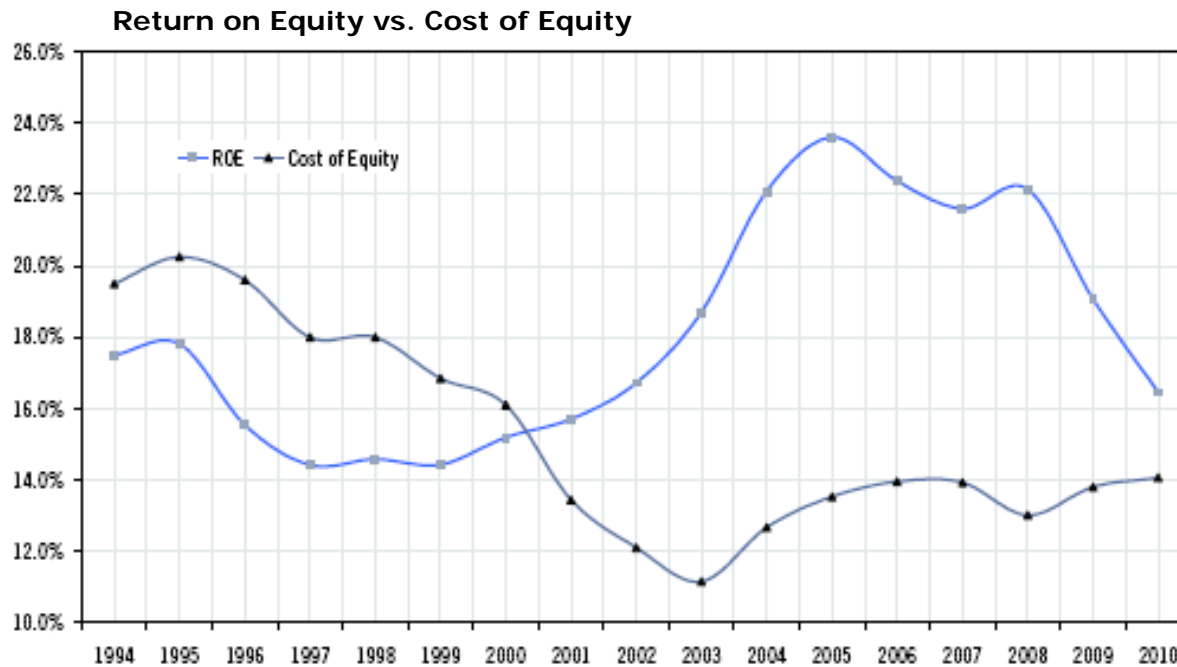
# Prompting Central Bank to hike key policy rates



- In an effort to anchor inflationary expectations, the Reserve Bank of India (RBI) In its quarterly monetary policy, announced a 25 bps hike in the repo rate, reverse repo rate and cash reserve ratio.
- No only did it hike rates, it also indicated that it may take incremental policy action even before the next monetary policy announcement.
- We expect another 75bps of rate action during this year.

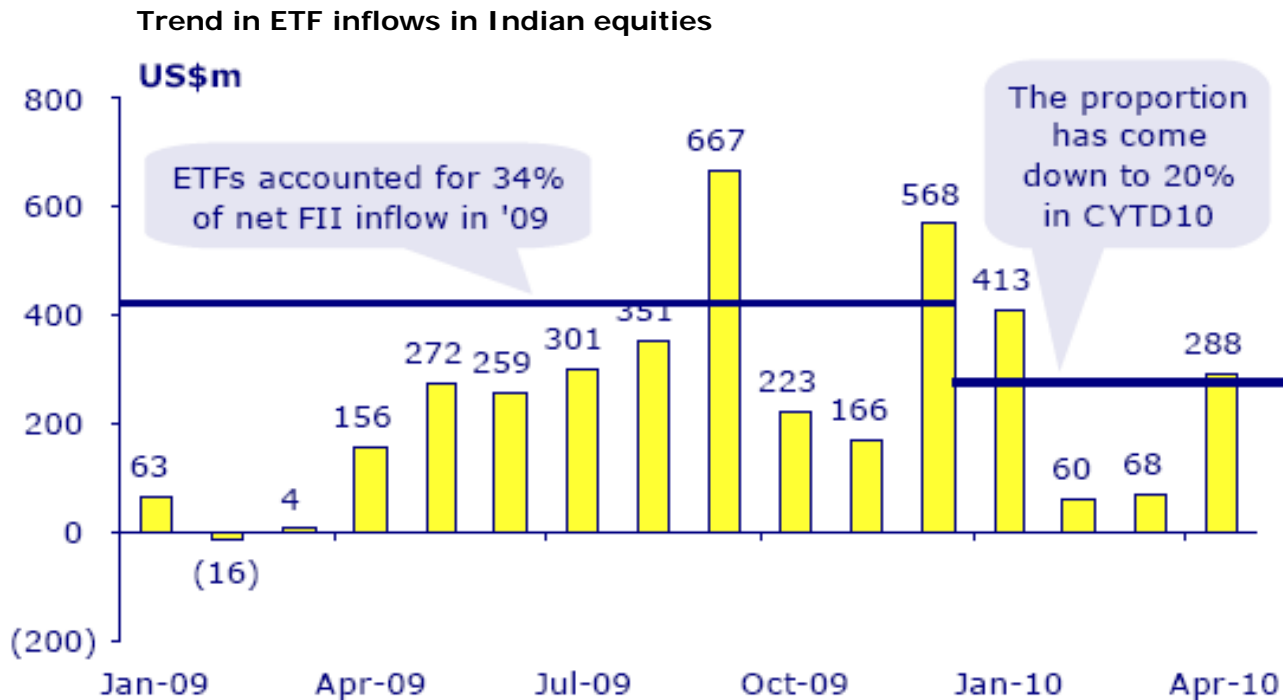


# Corporate India's value creation continued to decline in FY10



- Corporate India's value creation, viz., the spread between the Return on Equity and Cost of Equity has dipped substantially in FY10.
- The RoE dipped to 16.5%, while the cost of Equity remained almost constant at 14%.
- However this is forecast to rise to 16.7% in FY11, indicating a stabilization in earning power.

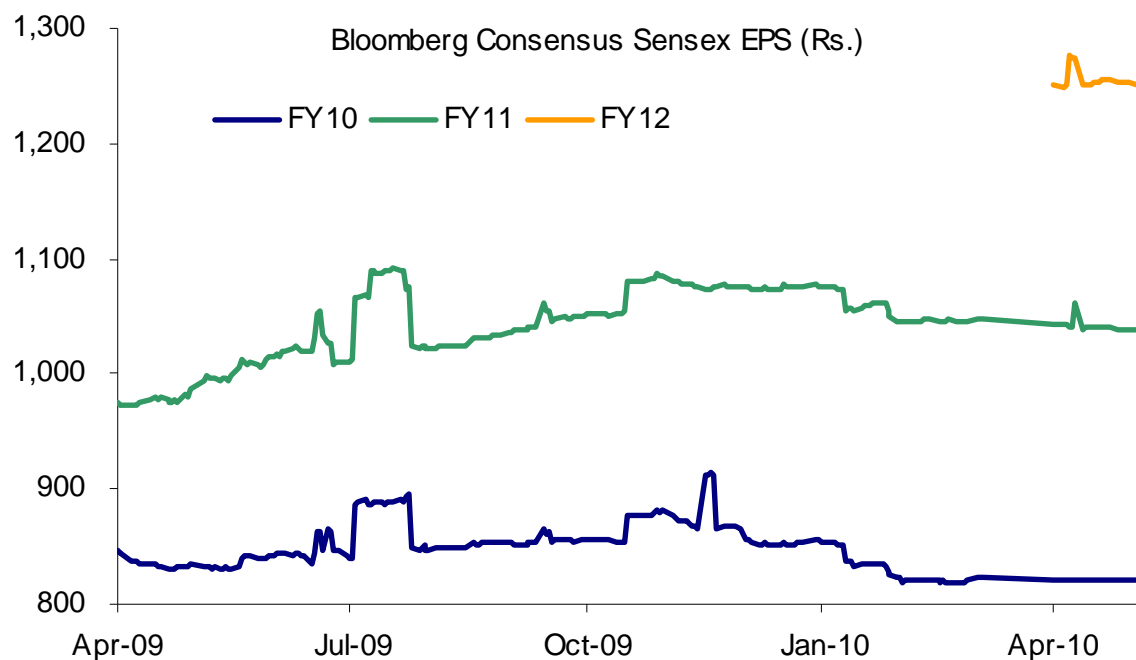
# ETF - contribution to incremental FII inflows declining



- Exchange Traded Funds (ETFs) invested US\$829m in common stock between January-April 2010 (updated till 26th April 2010).
- This accounts for 20% of FII flows in secondary markets—down from 34% in 2009. This reduces to some extent the risk of concentration of source of inflows.

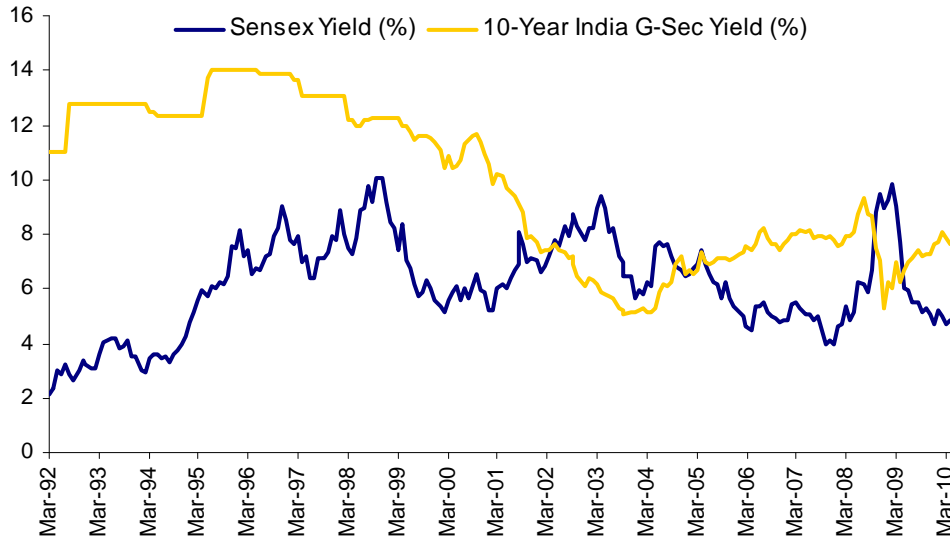


# Earnings - No Material Changes In Expectation

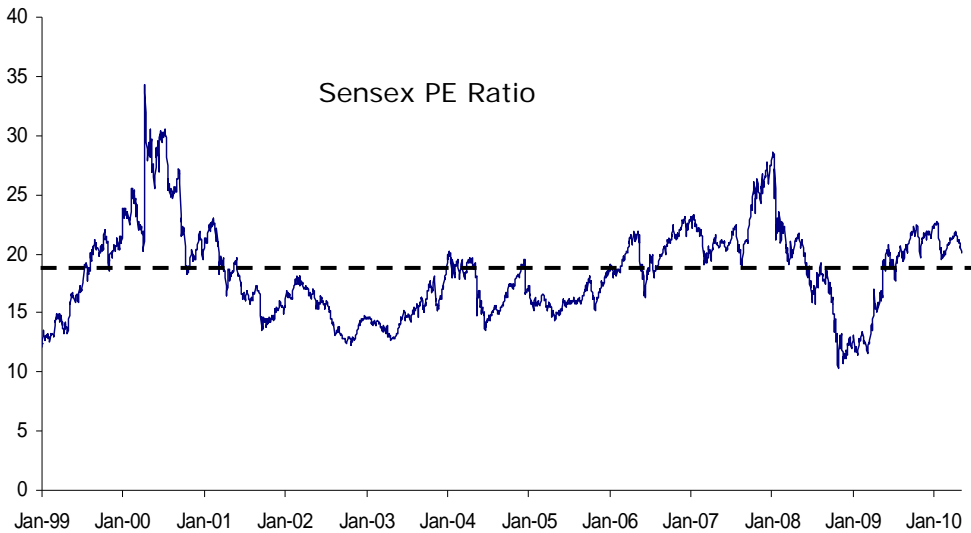


- There have been no material changes to Consensus earnings expectation in the month.
- Consensus continues to expect a a 27% growth in FY11 Sensex EPS over FY10 and a 20% growth in FY12E Sensex EPS over FY11E.

# Valuations



- The gap between Sensex earnings yield and bond yield has decreased by 33 basis points over the previous month. The Sensex yield has risen while 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 remained the same in the month.



# Looking Ahead...

- The macro environment continues to improve as is indicated by an improvement in various lead indicators including the credit offtake and IIP.
- India needs to urgently address the growing subsidy burden on account of fuel and fertilizer which threaten to offset gains from better receipts from telecom spectrum auction and divestment.
- The growing concerns in Europe over the crisis in Greece has implication not just for financial markets and risk appetite but also for global growth trends as the risk of an economic relapse in Europe has risen.
- The emergence of risk worries has implications for RBI's policy actions in the coming months. We continue to expect a further 75bps of policy hikes from the RBI.
- Earnings forecasts have stayed largely unchanged through the earnings season and it is hard to make a case for higher valuations unless we witness an upgrade cycle
- The correlation between global markets and commodities remains high –this is a source of upside and downside risk for our markets.
- 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 8% in FY11
- The current consensus forecasts a healthy 27% growth 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 16.4x 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

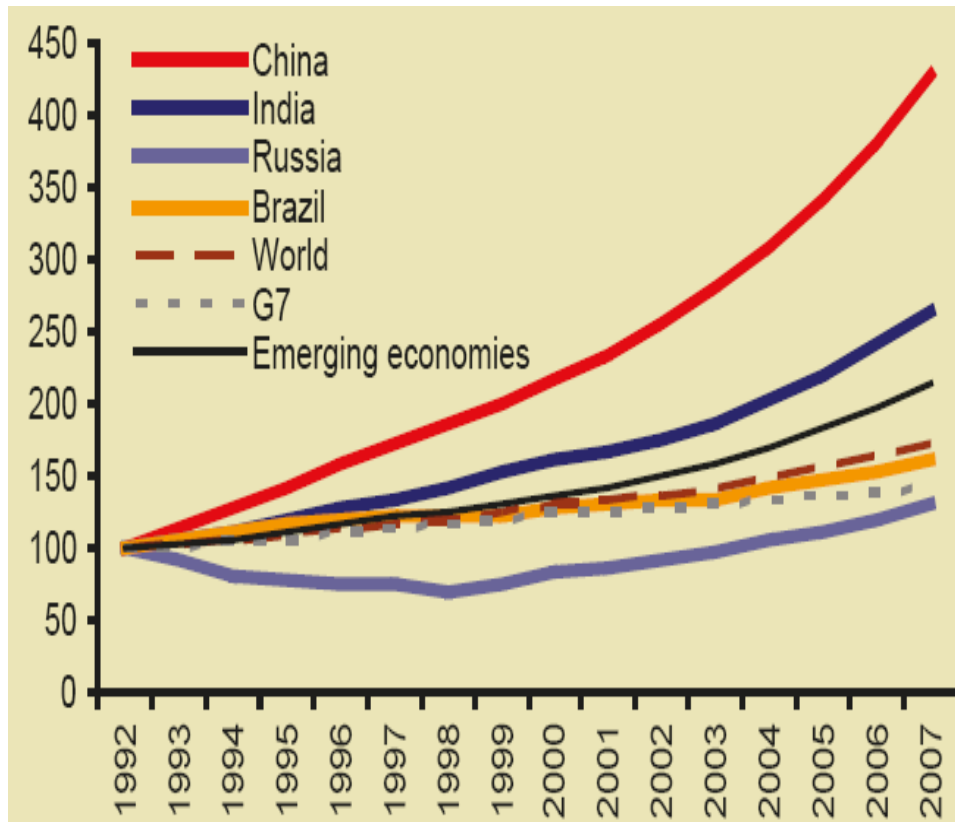
## Strategy for investors

- 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

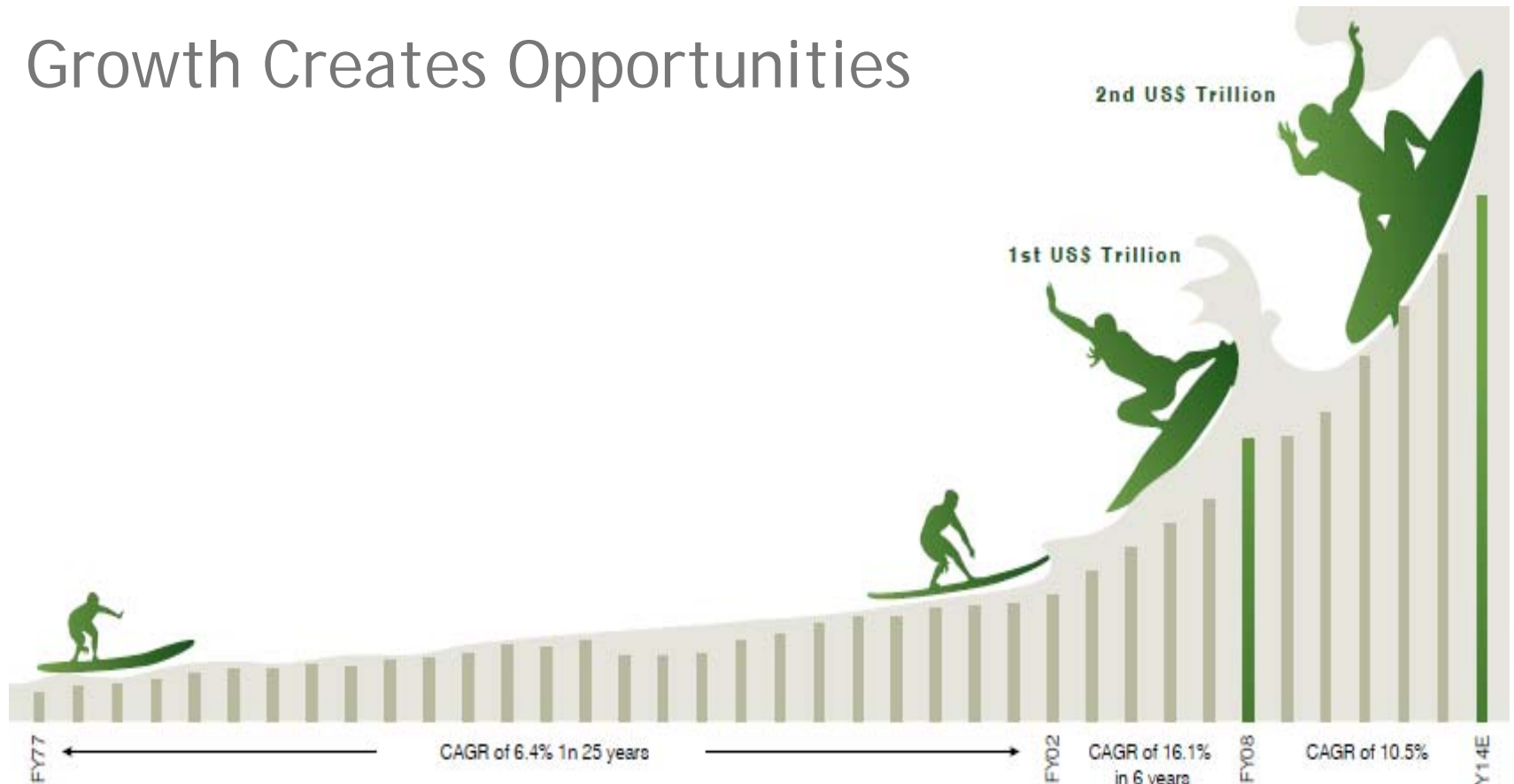
## GDP growth rebased to 1992



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

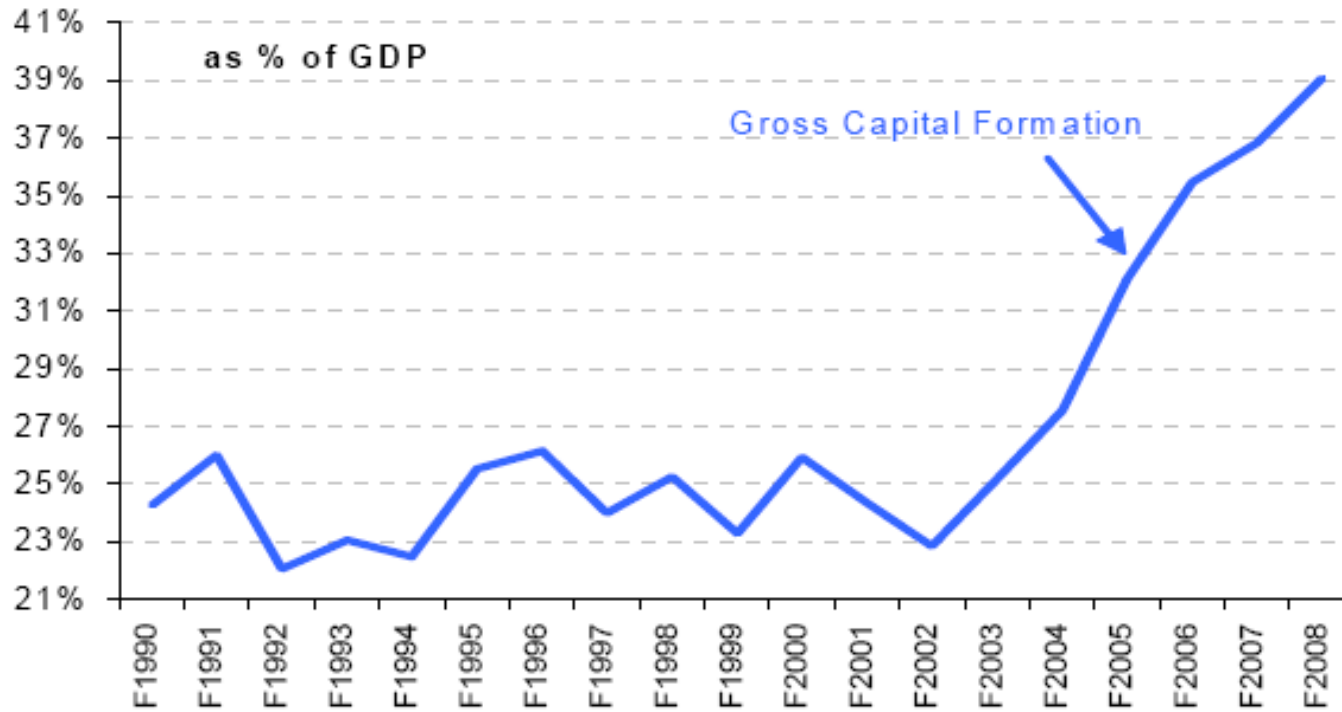
# Growth Creates Opportunities



- 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



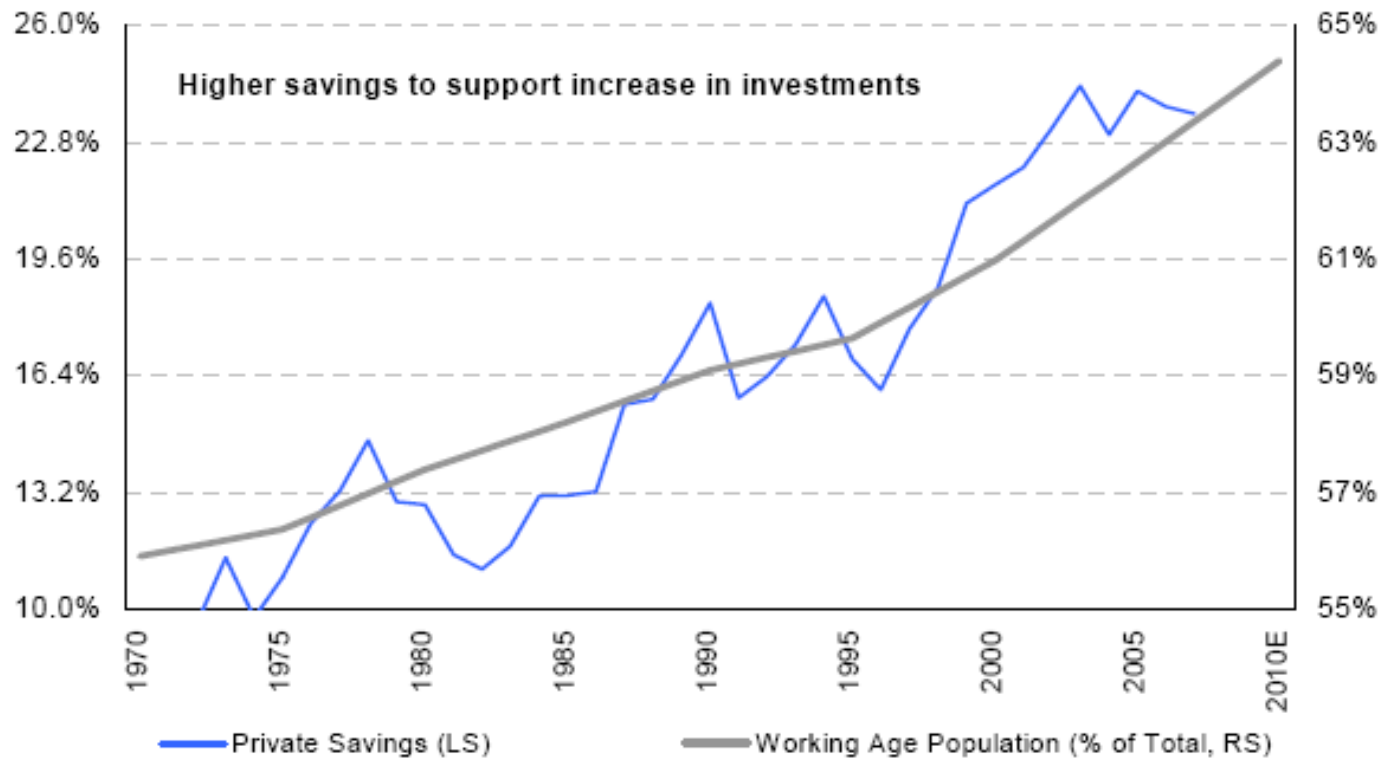
# Growth Is Being Led By A Rise In Capital Formation...



Source: CSO, Morgan Stanley Research



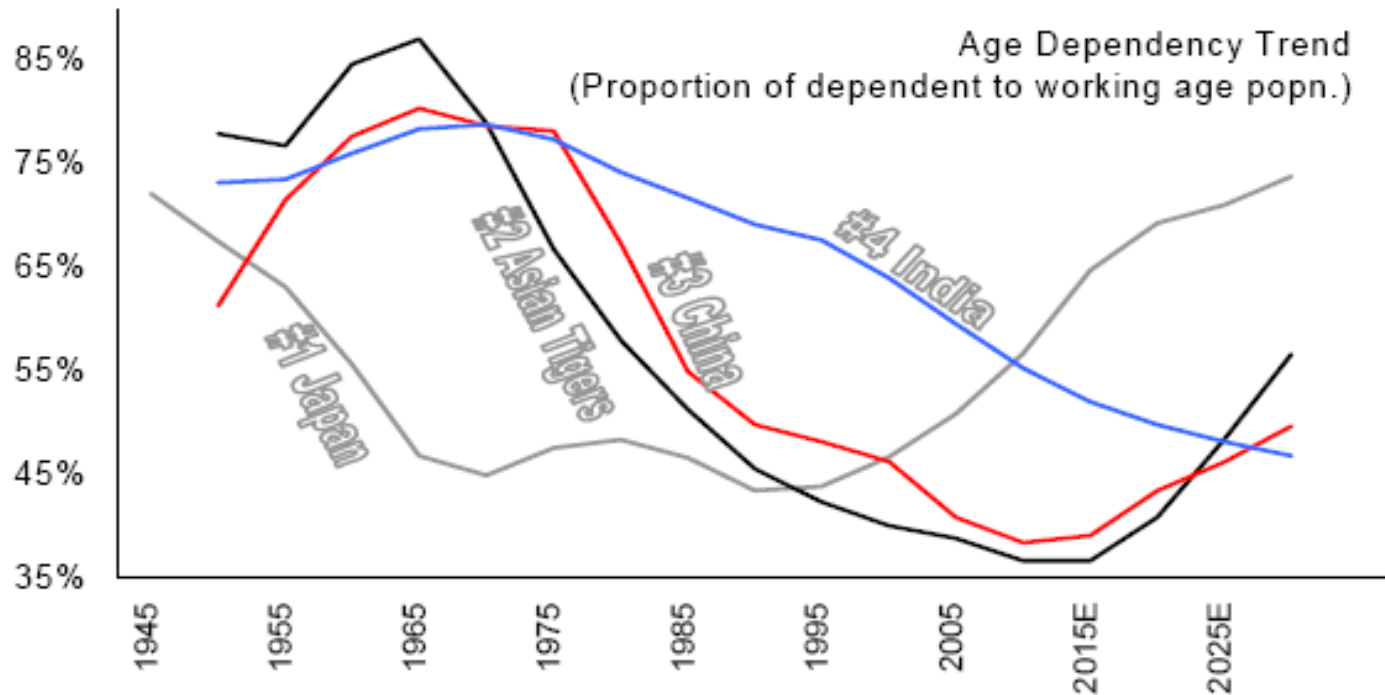
# ...Which Is Supported By A High Savings Rate



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



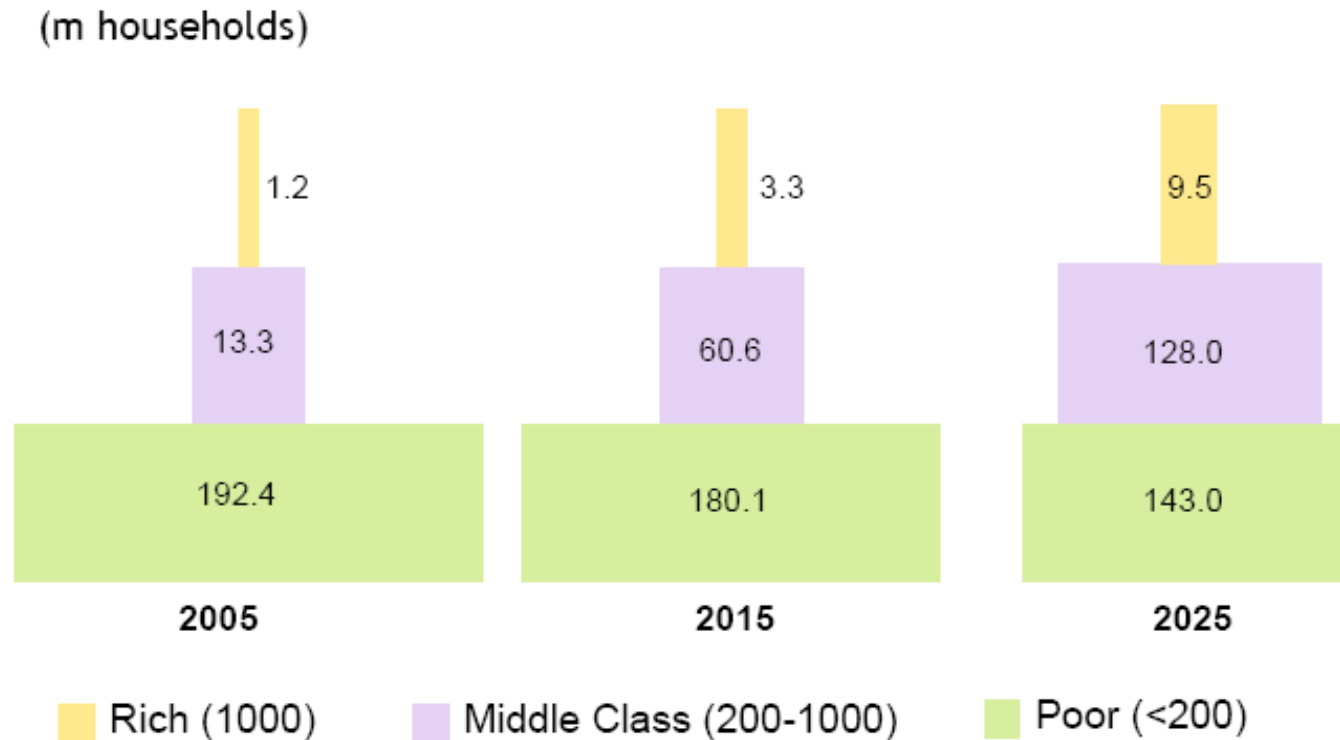
# India Is Poised To Reap Rich Demographic Dividend In Years To Come



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

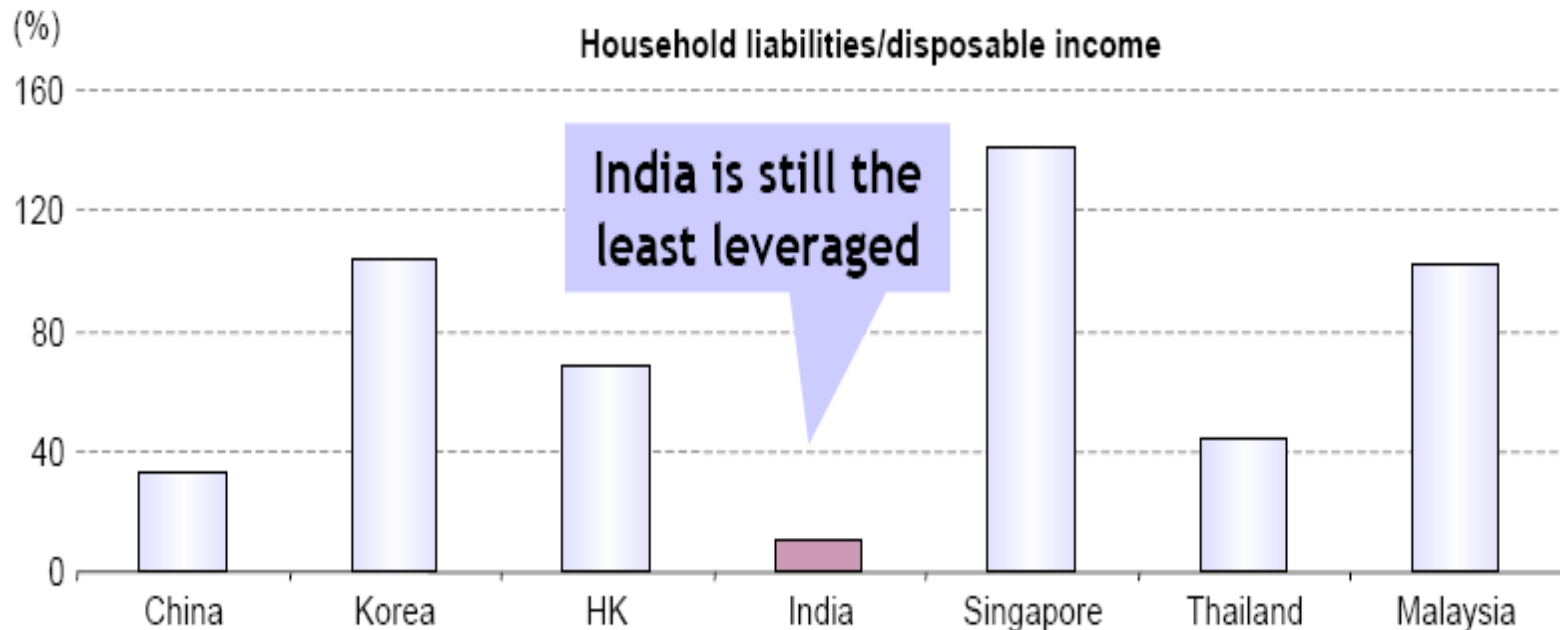


# Income Imbalance To Correct Leading To Rise In Consumption



Source: IDFC SSKI

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



Source: IDFC SSKI

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