

# Equity Markets : Current Environment and Outlook

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# Current Environment

- Equity markets dropped across the globe, with the MSCI World Index declining by 9.91%.
- Indian markets outperformed the global trend, falling by 3.5% in the month of May.
- Commodity prices mirrored the trend in equities, with the benchmark CRB Reuters Jefferies total return index falling by 9.2%.
- FMCG was the best performing sector followed by the Healthcare sector. Metal and Realty sectors delivered the worst return for the month.
- FII outflows were at Rs.94bn in May 2010. DIIs recorded inflows of Rs.63.6bn. MF remained net buyers to the tune of Rs.1bn.
- Trading Activity remained at subdued levels in May, with cash trading volumes (number of shares) falling by 6% MoM. However, the average open interest increased 3.7% MoM at its highest level since Jan-08.

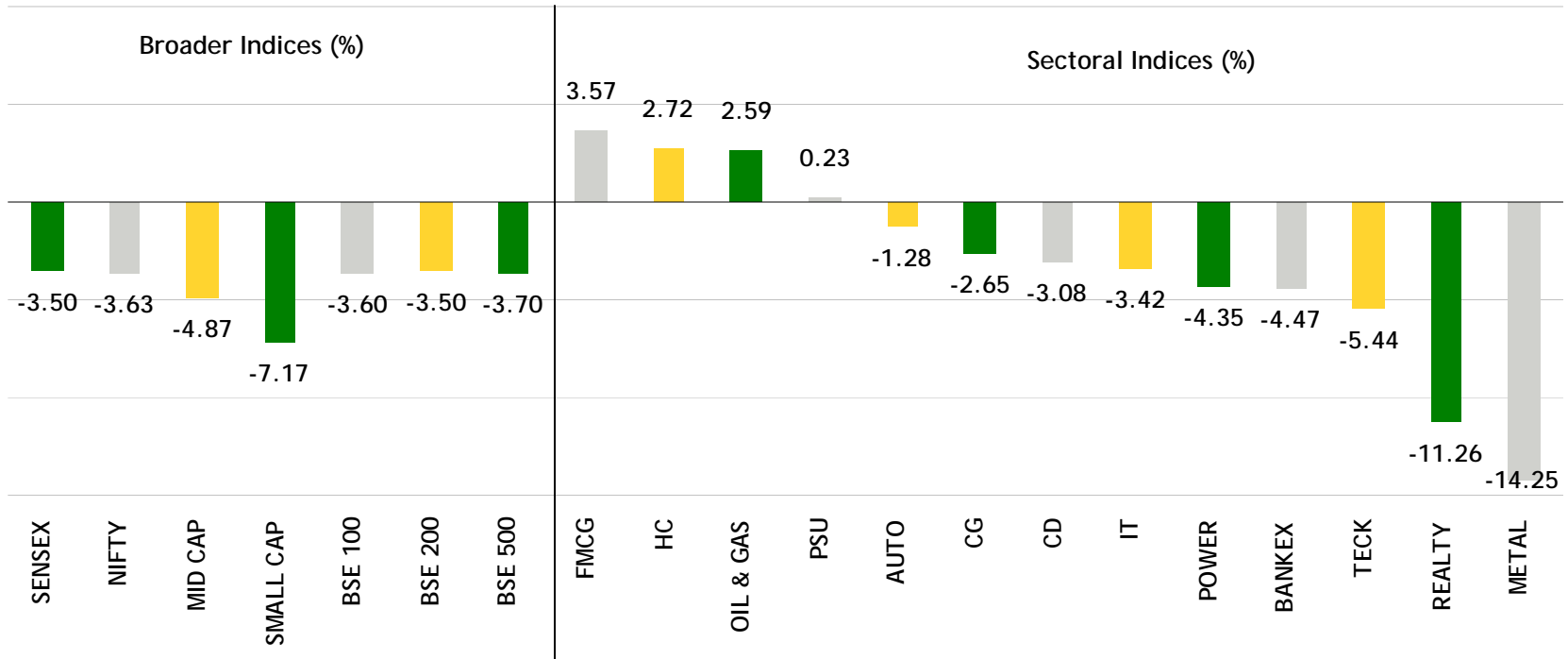
# Global Equities

Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	2592.15	-9.70%	-20.90%	EM - Asia
BSE Sensex	India	16944.63	-3.50%	-2.98%	EM - Asia
Kospi	South Korea	1641.25	-5.76%	-2.47%	EM - Asia
Taiwan Weighted	Taiwan	7373.98	-7.87%	-9.94%	EM - Asia
Thailand SET 50 Index	Thailand	524.14	-2.74%	0.66%	EM - Asia
Jakarta Composite Index	Indonesia	2796.96	-5.87%	10.36%	EM - Asia
KLSE	Malaysia	1285.01	-4.56%	0.96%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	63046.51	-6.64%	-8.08%	EM
Mexico IPC	Mexico	32038.53	-1.98%	-0.26%	EM
Russian RTS Index	Russia	1384.59	-11.97%	-4.15%	EM
Philippine PSEi	Philippines	3272.73	-0.53%	7.21%	EM
Merval Buenos Aires Index	Argentina	2203.60	-8.04%	-5.05%	EM
HangSeng	Hong Kong	19765.19	-6.36%	-9.63%	Developed - Asia
Nikkei	Japan	9768.70	-11.65%	-7.37%	Developed - Asia
Strait Times	Singapore	2752.60	-7.46%	-5.00%	Developed - Asia
Dow Jones	USA	10136.63	-7.92%	-2.79%	Developed
CAC 40 Index	France	3507.56	-8.11%	-10.89%	Developed
All Ordinaries Index	Australia	4453.60	-7.87%	-8.79%	Developed
DAX Index	Germany	5964.33	-2.79%	-1.39%	Developed
Swiss Market Index	Switzerland	6312.60	-4.60%	-3.56%	Developed
FTSE 100	UK	5188.43	-6.57%	-4.15%	Developed
MSCI World Index	--	1079.80	-9.91%	-7.59%	--

\* as on 31<sup>st</sup> May 10. Source : Bloomberg  
EM – emerging markets, Developed – developed markets.



# India : Sector performances



- The markets fell by 3.5% over the previous month.
- FMCG was the best performing sector followed by the Healthcare sector.
- Metal and Realty sectors delivered the worst return for the month.



\*Source: BSE,NSE. one month performance as on 31<sup>st</sup> May 10.

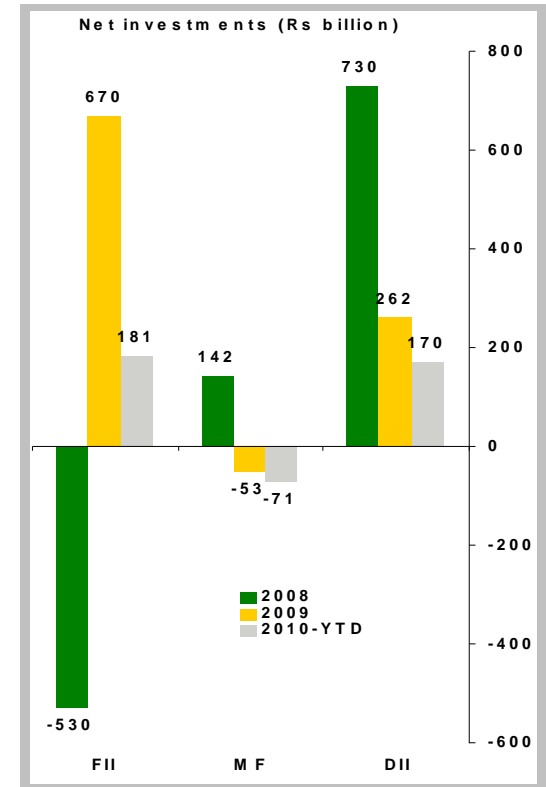
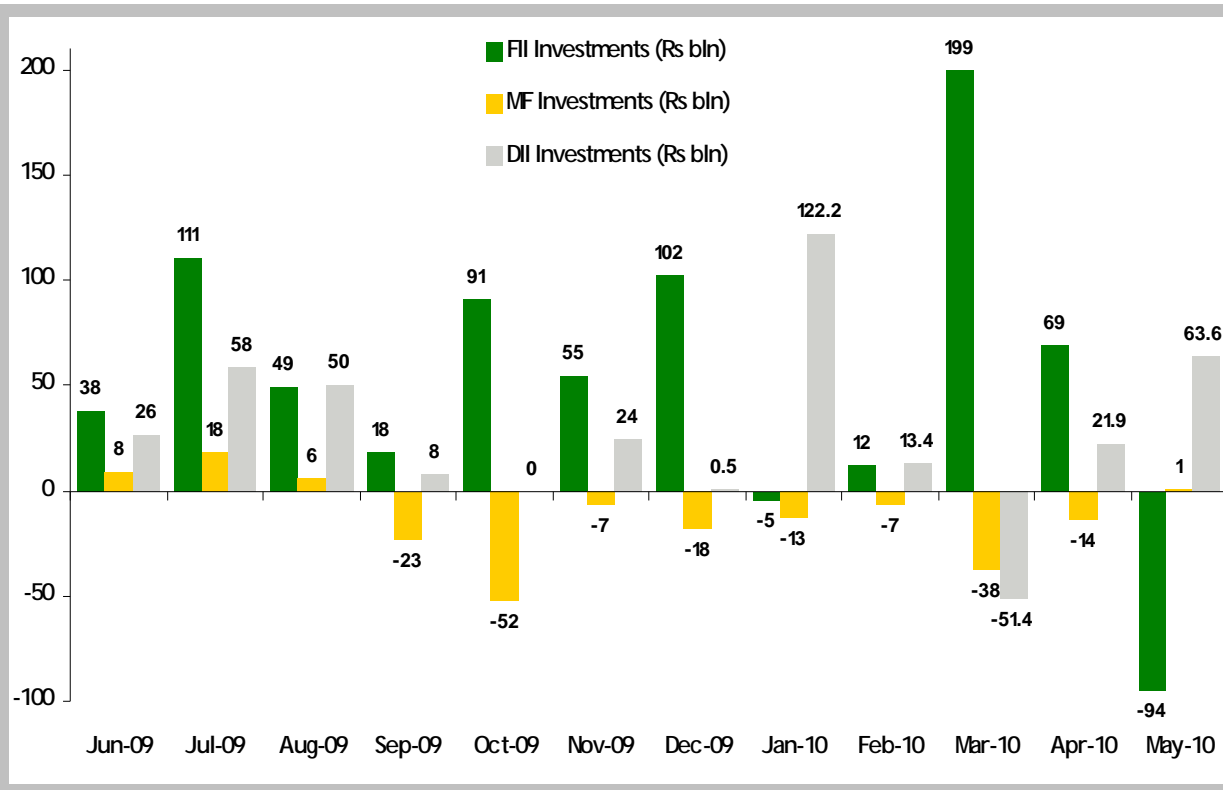
# Top Gainers / Losers - Nifty

Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
B P C L	657.6 / 408	581.15	12.30
O N G C	1277.65 / 934.25	1167.7	10.70
M & M	599.5 / 322.05	572.7	8.85
A B B	881.5 / 642	859	8.40
ITC	287.7 / 180.5	283.2	6.53
Top Losers for the month			
Losers	52 week H/L	Last Price#	% Loss*
Sterlite Inds.	928.9 / 532.5	662.4	-20.03
Tata Steel	739 / 330.1	500.7	-19.09
Suzlon Energy	145.7 / 53.8	56.25	-18.42
Idea Cellular	91.8 / 47.8	50.5	-17.42
Hindalco Inds.	193 / 68.15	150.25	-15.83

# closing price as on 31<sup>st</sup> May 2010. \* one month performance as on 31<sup>st</sup> May 2010.  
Source: Capitaline



# FII & DII Inflows

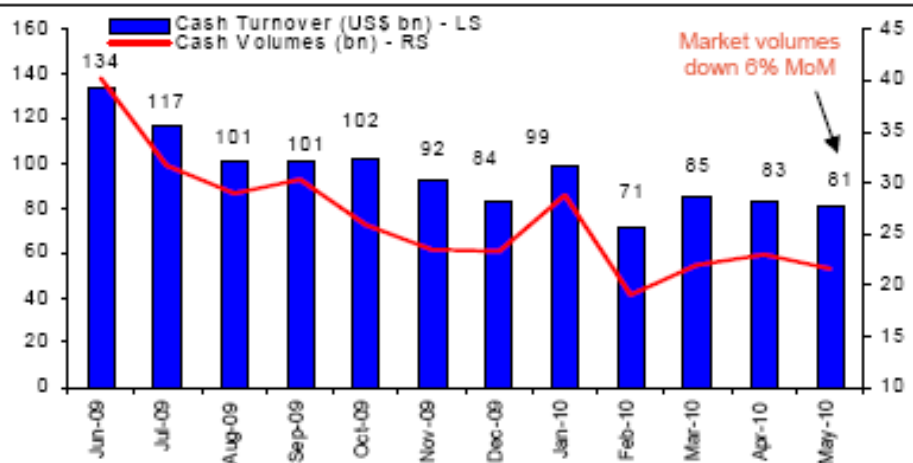


- FII outflows were at Rs.94bn in May 2010. FII inflows have remained positive on a YTD basis at Rs.181bn for CY10 after a Rs.670bn inflow in CY09.
- DII recorded inflows of Rs.63.6bn. MF remained net buyers to the tune of Rs.1bn.

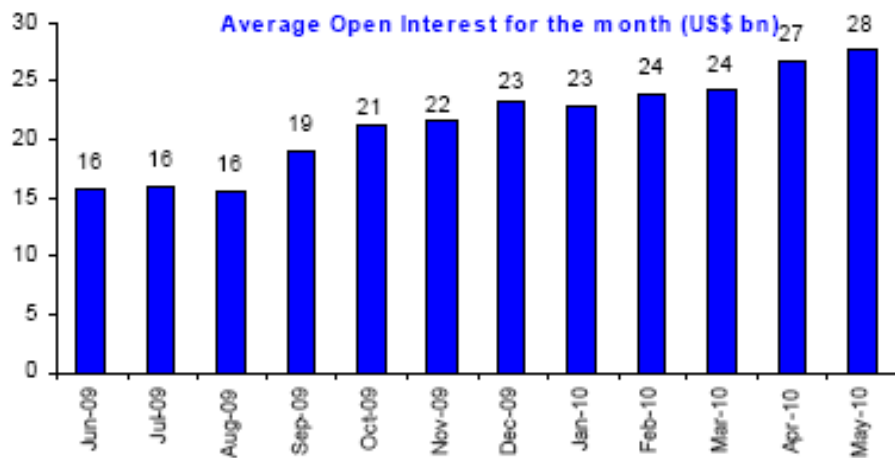


# Market Activity

## Cash Trading: Turnover and Volumes



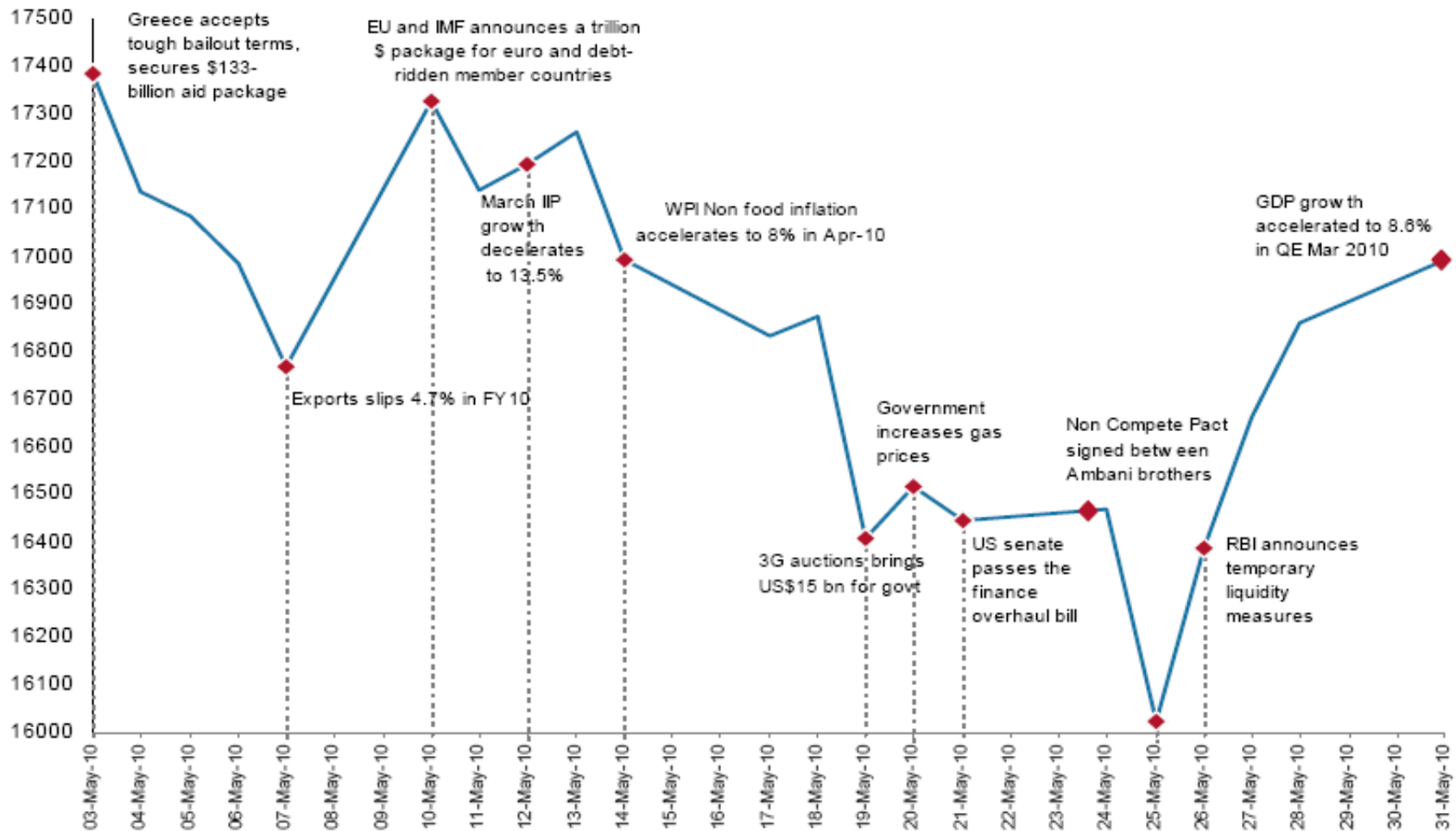
- In May, cash trading volumes (number of shares) decreased by 6% MoM.



- At the end of May, average open interest increased 3.7% MoM at its highest level since Jan-08.



# May 2010 events timeline



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



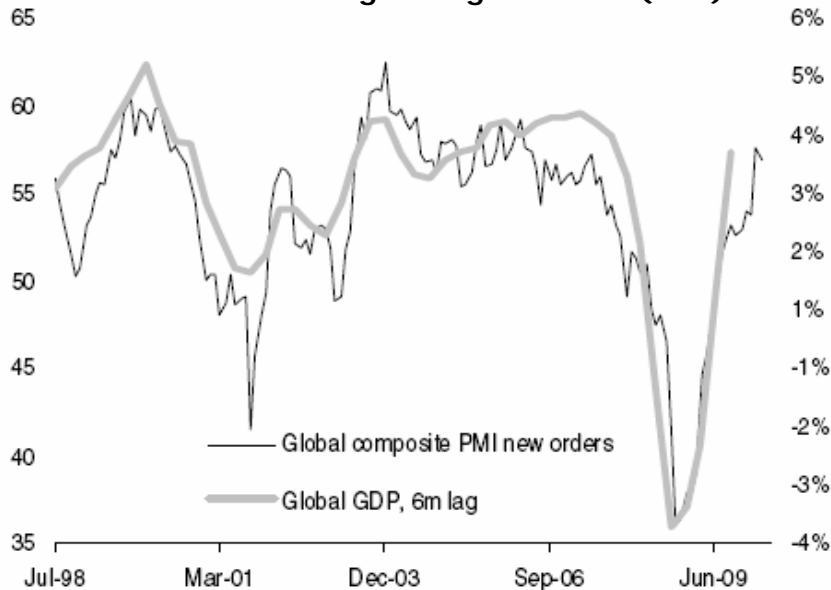
# Religare MF: Equity Market Outlook and Opportunities

# Equity Market Outlook

- Global Purchasing Managers Index (PMI), a significant lead indicator, continues its 'V' shaped recovery and it now indicates a Global GDP growth expectation of around 4%.
- However, a key risk to global GDP growth is the risk of a setback in Europe where a \$1trillion monetary package was unveiled earlier this month. Countries in the EU are targeting sharp cuts in fiscal deficits which is by definition contractionary in nature.
- FY10 GDP for India has been revised to 7.4% from 7.2% due to an upward revision in earlier quarters GDP numbers as well as a strong 8.6% GDP growth reported in Q4FY10.
- A key highlight in the latest quarter's GDP numbers was the uptick in investment demand as a percent of GDP. Increased investment demand is also corroborated by an increased nominal credit growth, as credit growth outpaces the nominal GDP growth.
- However, the core WPI inflation, which excludes the volatile fuel and food prices, continues to rise, which is now closer to its peak in 2010 at 6%. This indicates the fragility of the reported peaking of inflation index, as it can rise sharply in response to a small uptick in fuel or food prices.
- Europe is India's significant trading partner, with a 24% share of India's total exports and some negative impact can and should be expected on exports. However, the direct negative impact on GDP is at worst 0.5%.
- However a reduction in risk appetite as we saw this month resulted in net foreign selling of over \$2bn this month. With a trailing 12-month trade deficit of 8.1% on GDP; our dependence on portfolio inflows to fund the gap remains our Achilles heel.
- There have been no material changes to Consensus earnings expectation in the month.

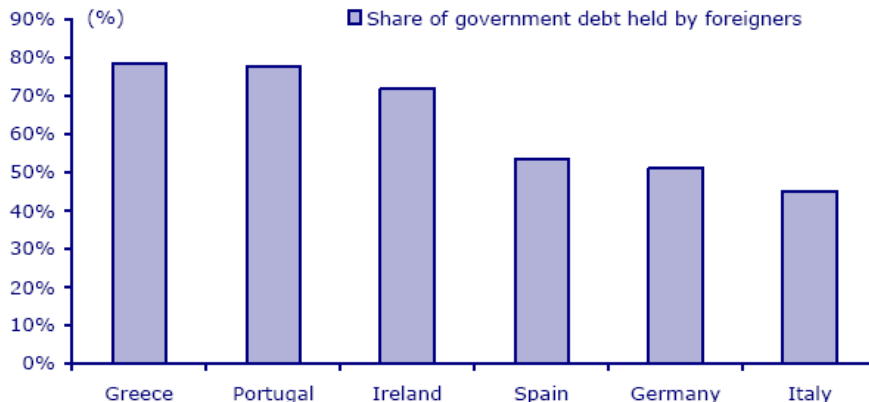
# Global GDP growth sustaining - EU the key risk

**Global Purchasing Managers Index (PMI)**

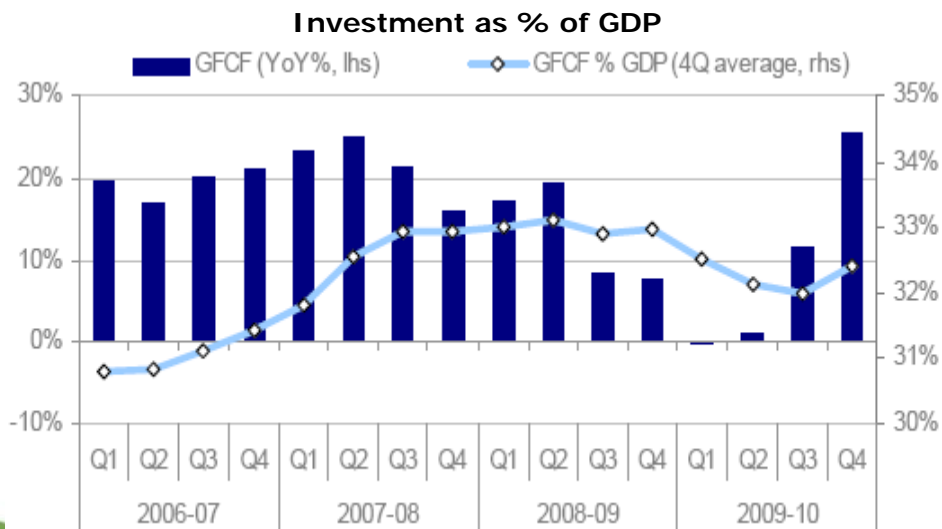
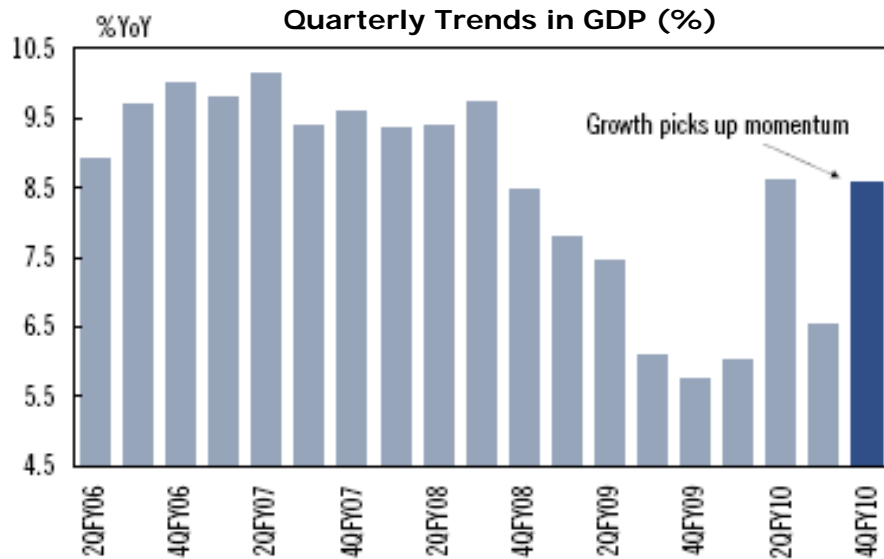


- Global Purchasing Managers Index (PMI), a significant lead indicator, continues its 'V' shaped recovery, which started in early 2009.
- Global PMI now indicates a Global GDP growth expectation of around 4%.
- However, a key risk to global GDP growth is the decline in GDP in some of the PIIGS (Portugal, Italy, Ireland, Greece and Spain) nations.
- These countries have high fiscal deficits funded by debt borrowed from foreigners.
- The EU has organized a \$1 trillion monetary package to ease the tight situation.
- The accompanying targets to reduce fiscal deficits sharply has negative implications for GDP growth for the region.

**PIIGS counties debt held by foreigners**



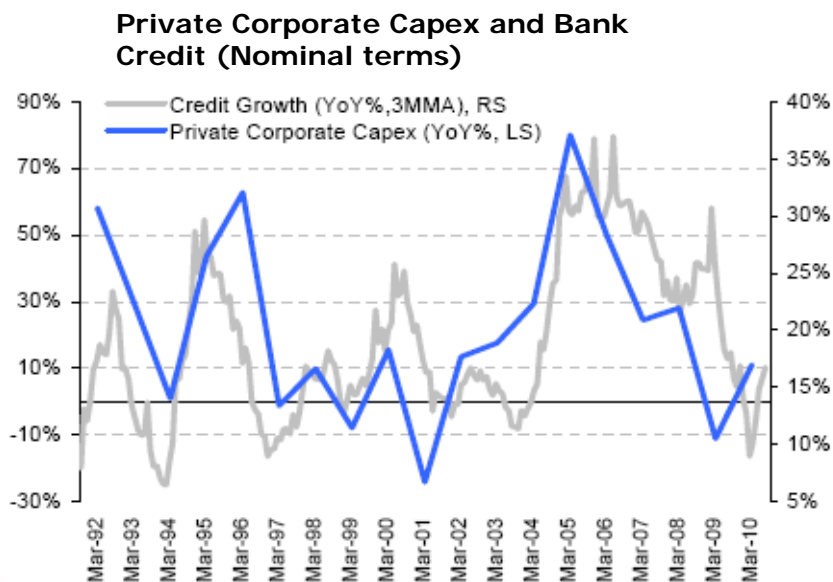
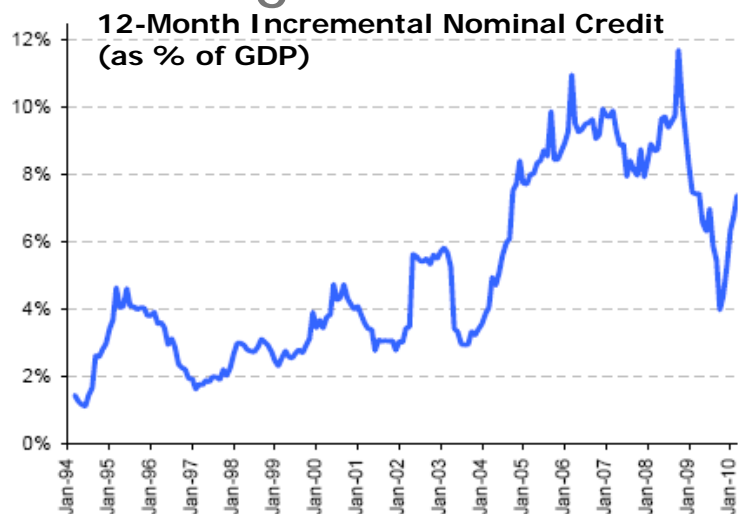
# India GDP growth continues to recover



- CSO (Central Statistical Organisation) has revised FY10 GDP to 7.4% from 7.2%.
- The release of the 4QFY10 GDP data, which pegged growth at 8.6% and upward revisions to 1Q, 2Q and 3QFY10 GDP resulted in the government's advance GDP estimates being revised up to 7.4% from 7.2% estimated earlier.
- A key highlight in the latest quarter's GDP numbers was the uptick in investment demand as a percent of GDP.
- GFCF (Gross Fixed Capital Formation) as a percent of GDP revived for the first time after declining for almost five consecutive quarters.
- Historically, India's GDP growth has been driven by investment demand. Thus, a revival in this core component of GDP lends sustainability to the current growth numbers.



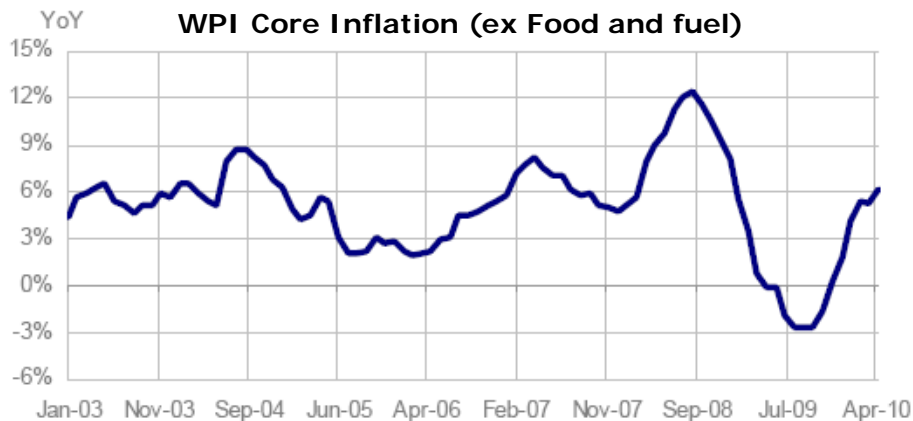
# Credit growth continues to be robust



- The incremental nominal credit continues its rebound, as credit growth outpaces the nominal GDP growth.
- A sharp rise in output over the last nine months has begun to improve capacity utilization.
- If the private corporate capex growth accelerates over the next six months, it can result in a much larger growth in credit.
- Moreover, infrastructure spending will also further accelerate growth in credit demand.

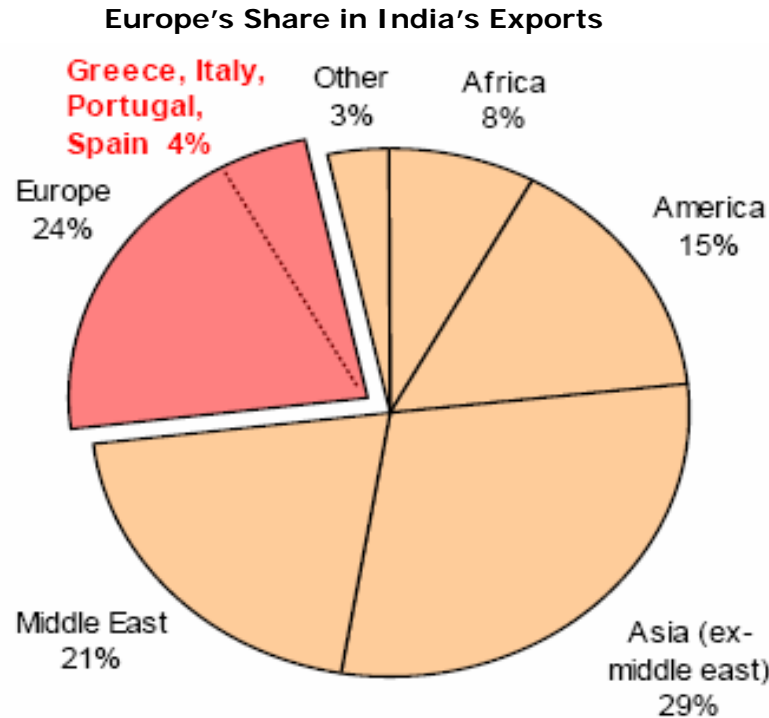


# Monetary policy-pulls and pushes



- The headline inflation number seems to have peaked as it has started to fall after reaching a recent peak of 10%.
- However, the core WPI inflation, which excludes the volatile fuel and food prices, continues to rise. It is now closer to its peak in 2010 at 6%.
- This indicates the fragility of the reported peaking of inflation index, as it can rise sharply in response to a small uptick in fuel or food prices.
- The RBI cannot ignore inflation trends but we suspect that the EU crisis has caused the RBI to give more weightage to growth over inflation

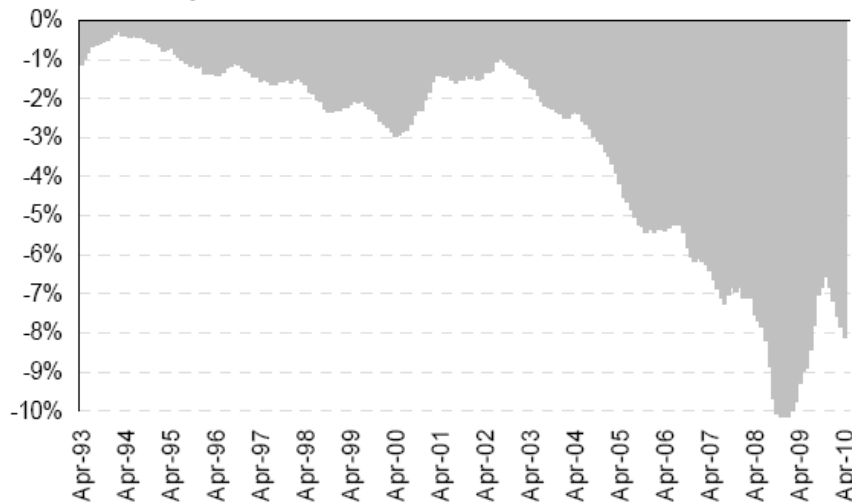
# Europe slowdown can hurt India



- Europe is India's significant trading partner, with a 24% share of India's total exports.
- The 14% appreciation in the Rupee vs the Euro in the current calendar year combined with a possible slowdown in Europe certainly poses a threat to India's export growth.
- However, the worst case impact on GDP is estimated at just 0.5%, an incremental negative data point but not a showstopper.

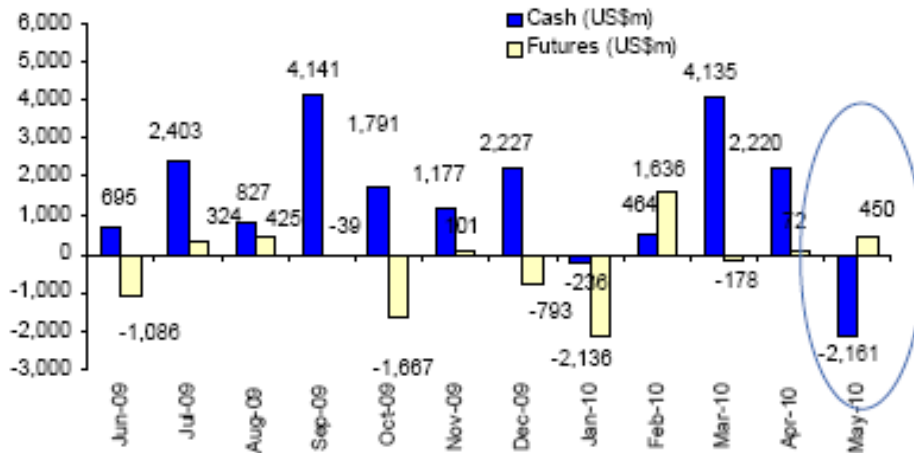
# Portfolio Flows Dependence - India's Achilles Heel

Trailing 12-month Trade Deficit (as % of GDP)

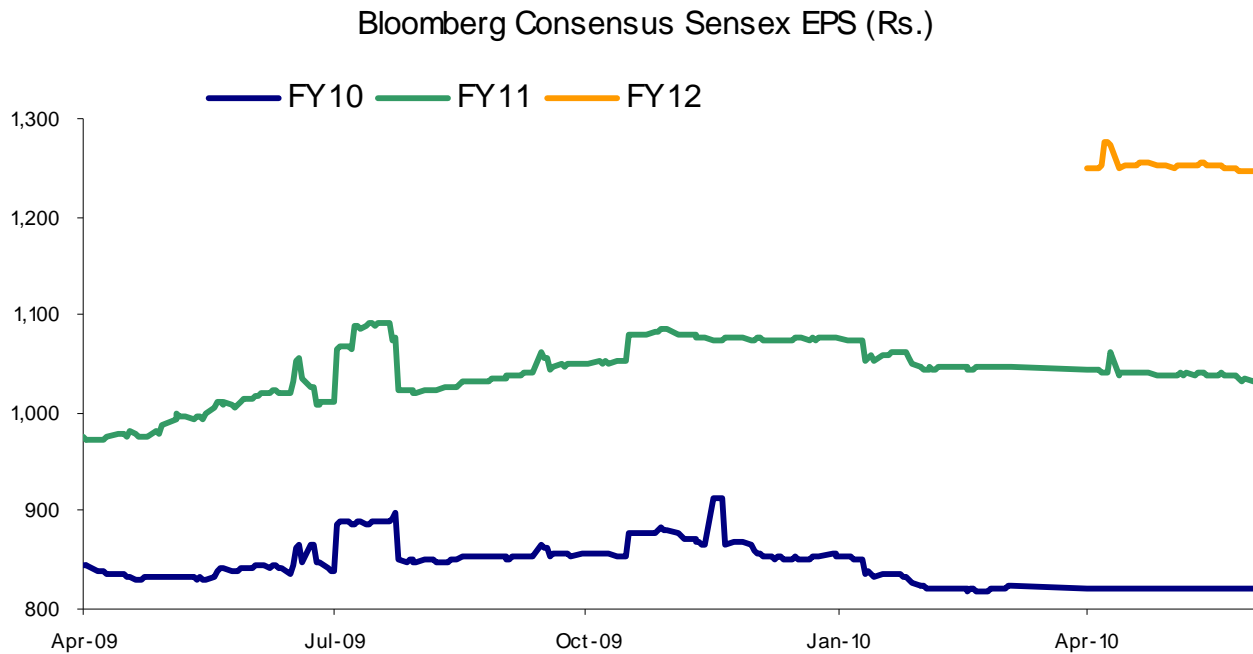


- India's Trade deficit continues to worsen. Thus, on a trailing 12-month basis, the trade deficit widened to 8.1% of GDP in April 2010, compared with 7.8% of GDP in March 2010.
- This is one of the worst deficits as a percentage of GDP, excluding the period of liquidity crunch in 2009.
- Also the portfolio flows have turned sharply negative in May 2010 due to a reduction in risk appetite, with the FII withdrawing a record \$2.1bn from the cash markets.
- Dependence on portfolio inflows to fund the trade deficit gap remains India's Achilles heel.

FII Equity Flows: 4th Worst FII Outflows in the Cash Market

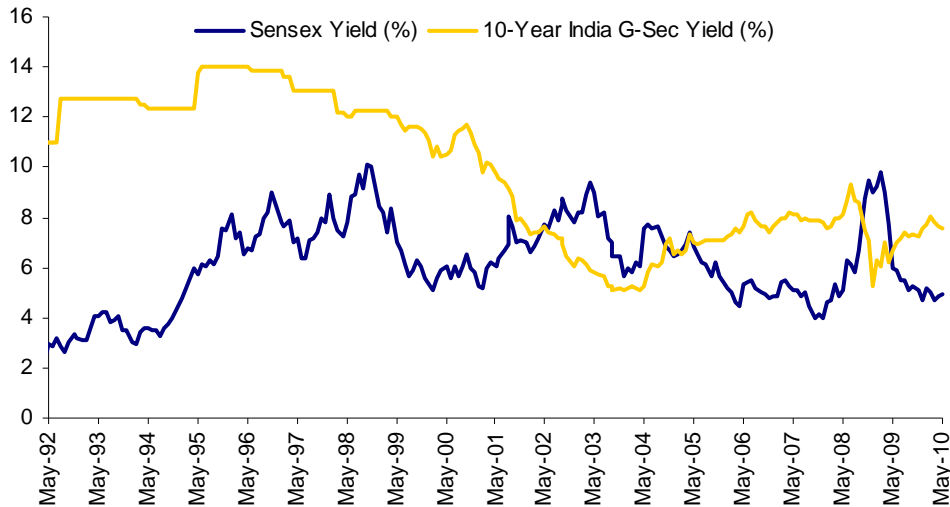


# Earnings - No Material Changes In Expectation

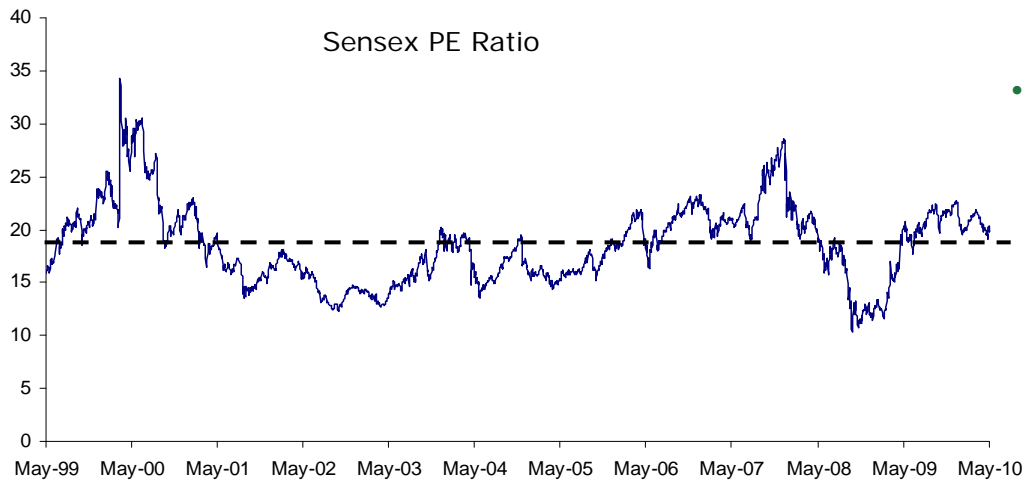


- There have been no material changes to Consensus earnings expectation in the month.
- Consensus continues to expect a 26% growth in FY11 Sensex EPS over FY10 and a 20% growth in FY12E Sensex EPS over FY11E.

# Valuations



- The gap between Sensex earnings yield and bond yield has decreased by 15 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 indicated by the latest GDP growth data and as also 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 crisis in the EU 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 as also continuous increase in core inflation has implications for RBI's policy actions in the coming months. We continue to expect a further 75bps of policy hikes from the RBI during the current fiscal.
- 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 both an upside as well as a downside risk for our markets.
- With market nearly unchanged over the last 8 months there has in effect been a valuation correction in the markets. The market appears to be trading a tight valuation range – somewhere between mildly attractive and fully valued.
- Our focus remains on stock picking and sector allocation for generating alpha.

# Investment view

## Short term

- GDP growth likely to be slightly above 8% in FY11
- The current consensus forecasts a healthy 26% growth in FY11, but we would be cautious about visibility of this estimate as significant contribution comes from global cyclicals
- There has been valuation correction over time with the markets virtually unchanged over the past 8 months.
- However, without significant earnings acceleration further re-rating is unlikely

## 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

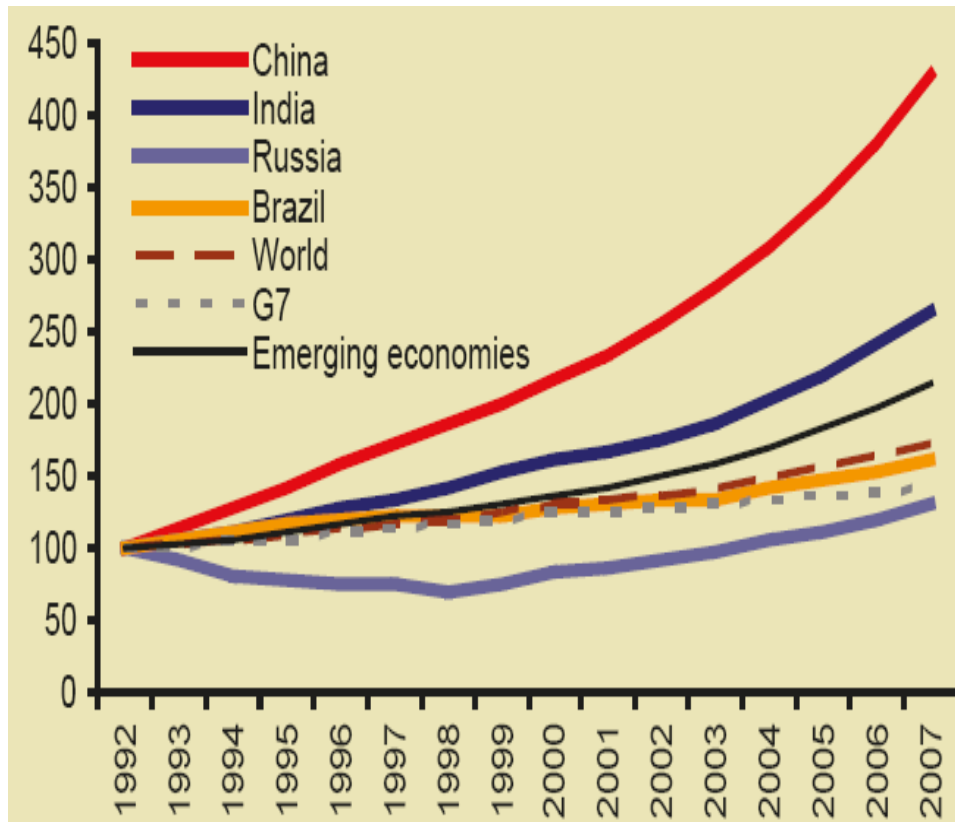
## Strategy for investors

- The valuations are above historical averages but have eased off from their highs late last year.
- Global correlations remain a source of risk but further drops closer to historical averages can be used as buying opportunities
- Long term investors can continue with SIP

# The Long Term Case For Indian Equities

# India - Growth On The Fast Track

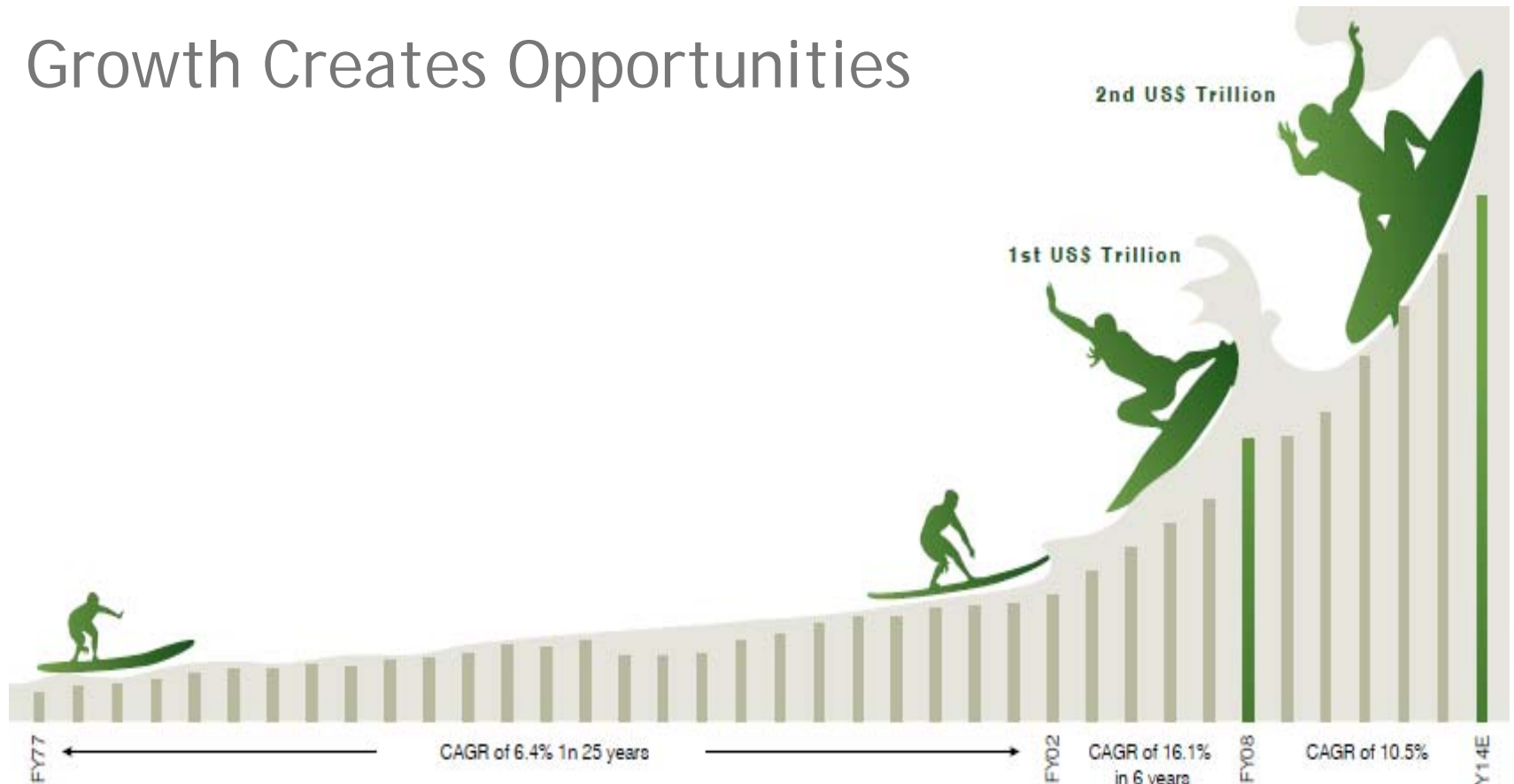
## GDP growth rebased to 1992



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

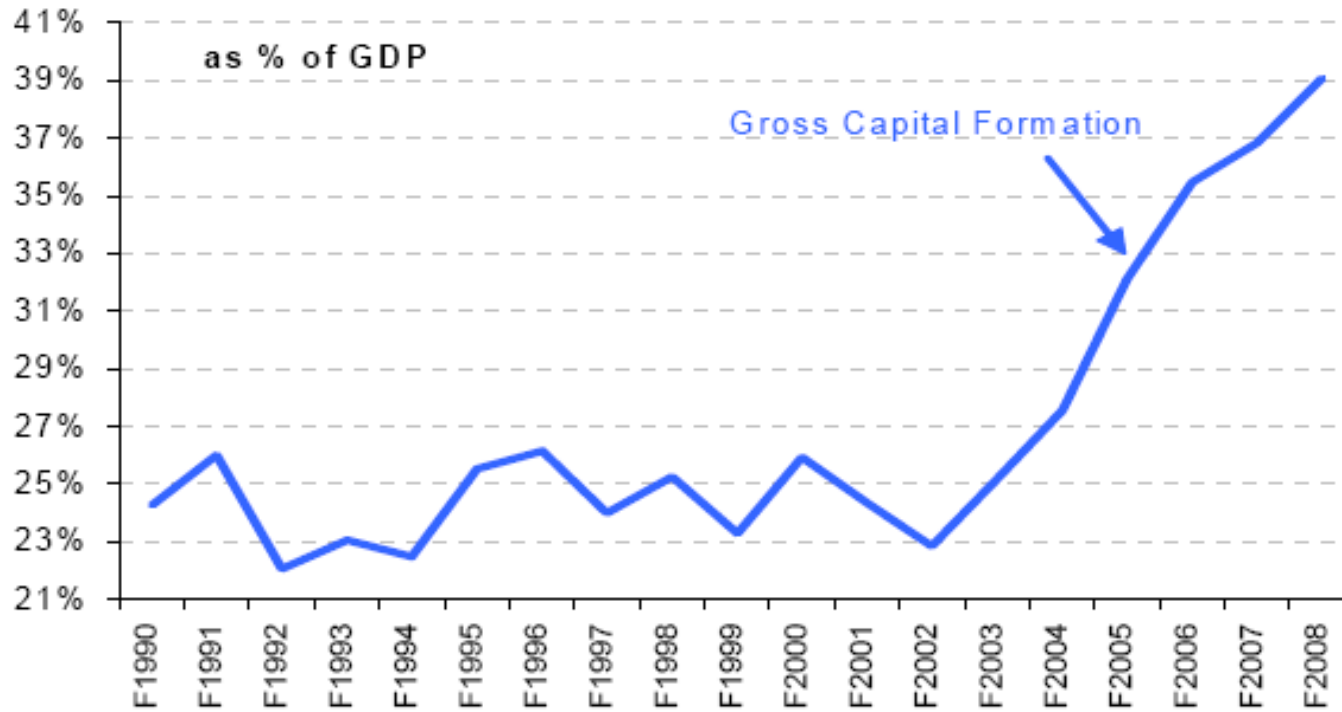
# Growth Creates Opportunities



- 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

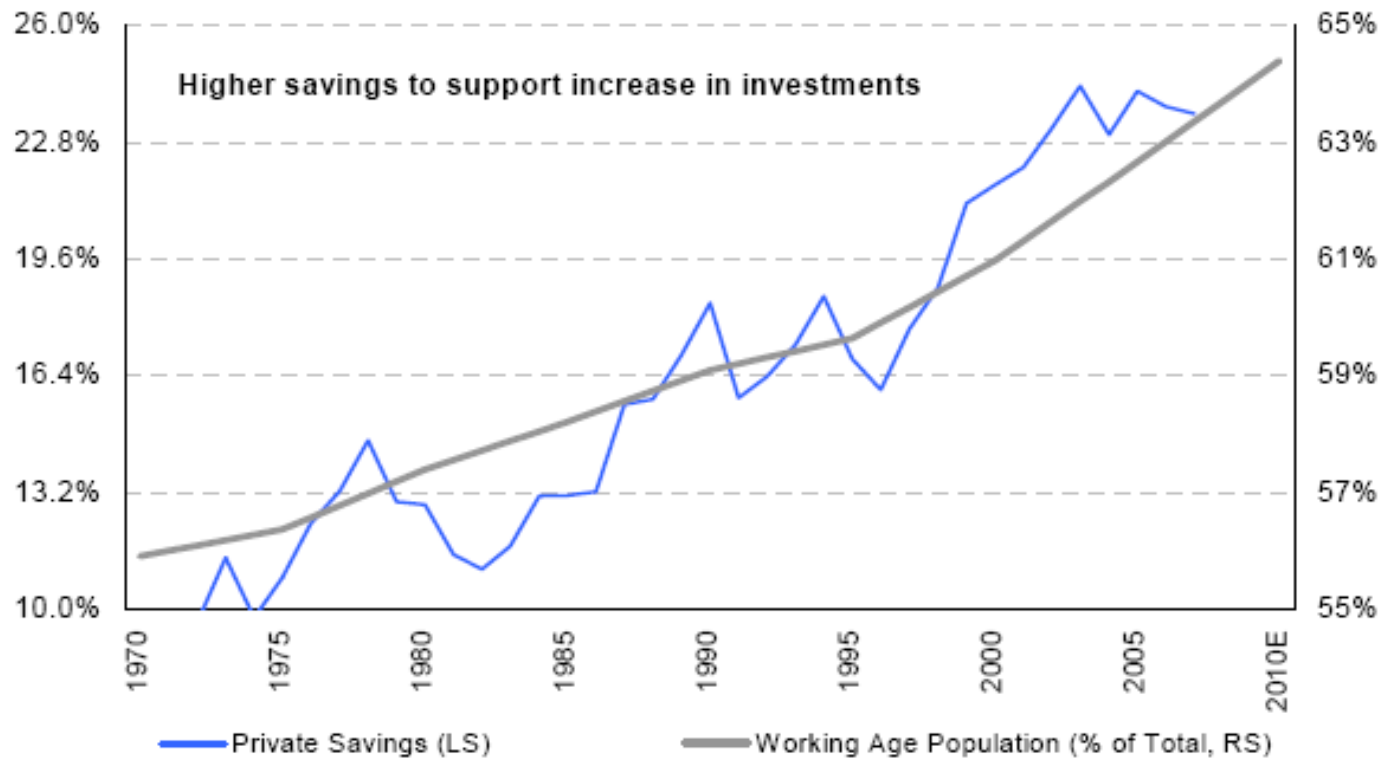


# Growth Is Being Led By A Rise In Capital Formation...



Source: CSO, Morgan Stanley Research

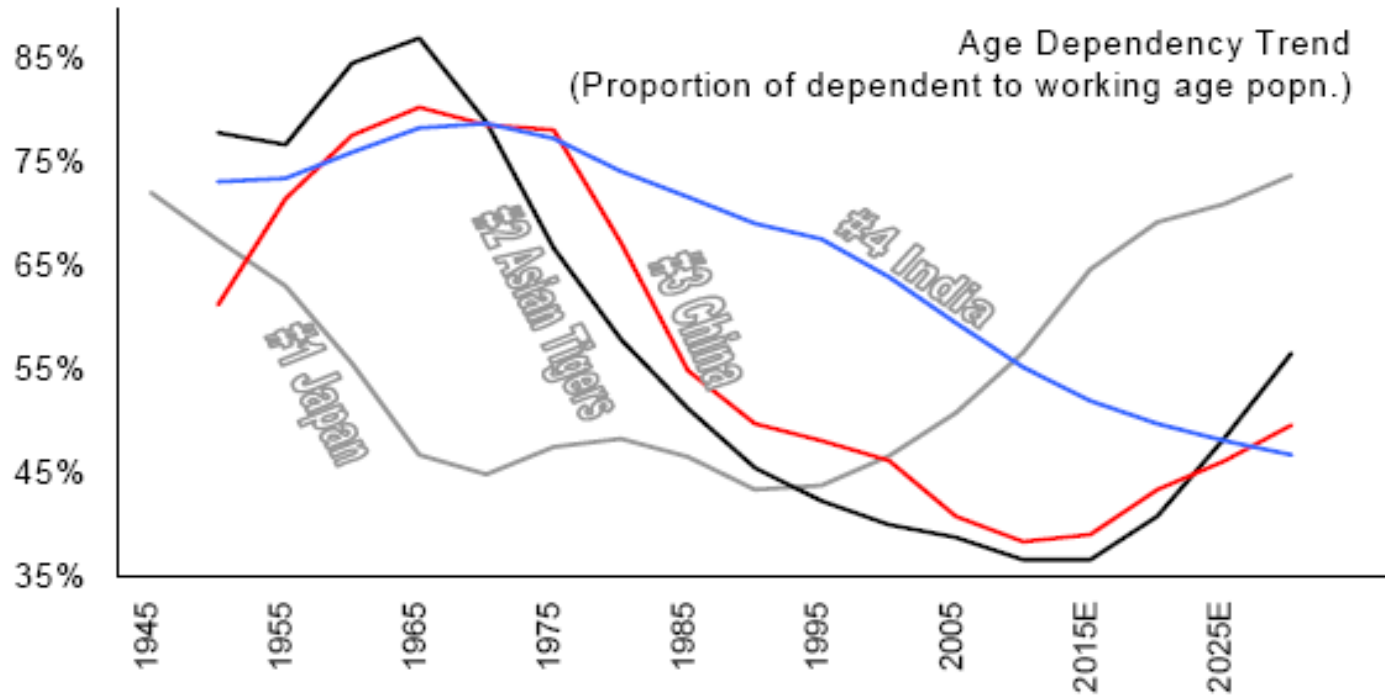
# ...Which Is Supported By A High Savings Rate



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



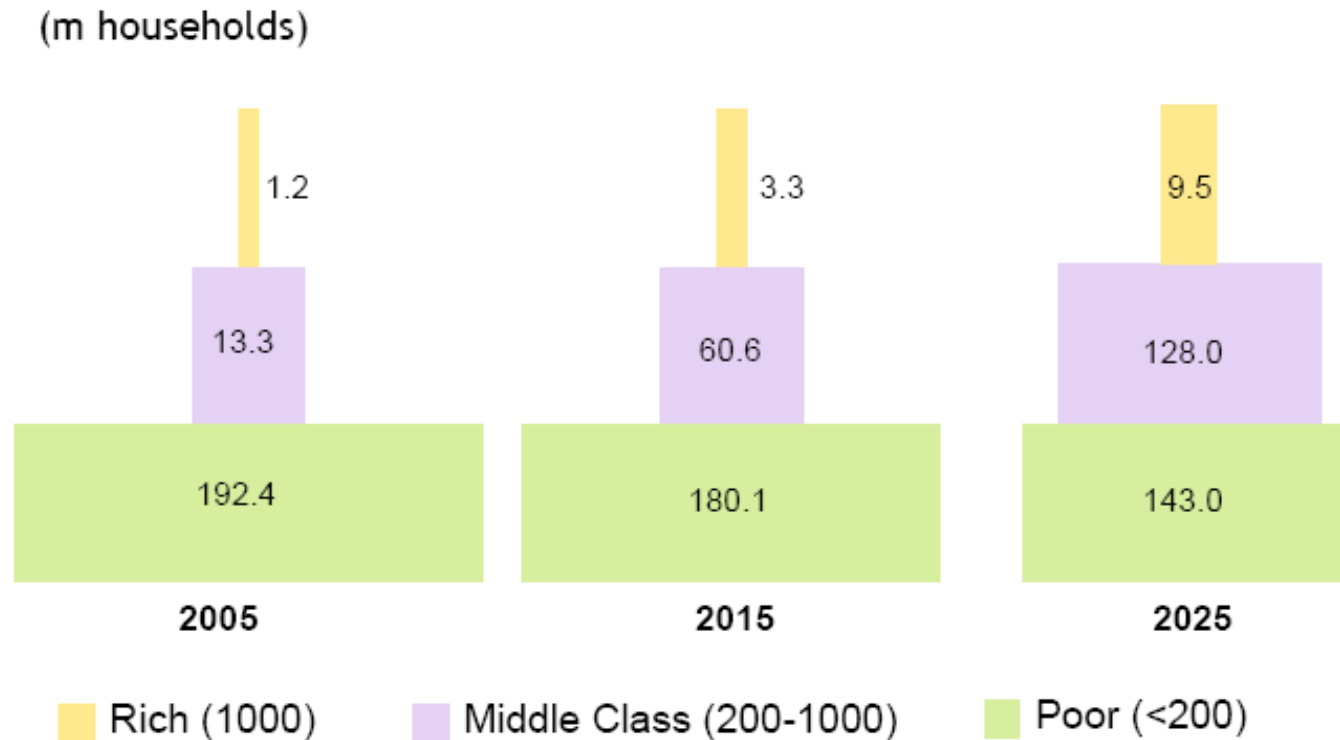
# India Is Poised To Reap Rich Demographic Dividend In Years To Come



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

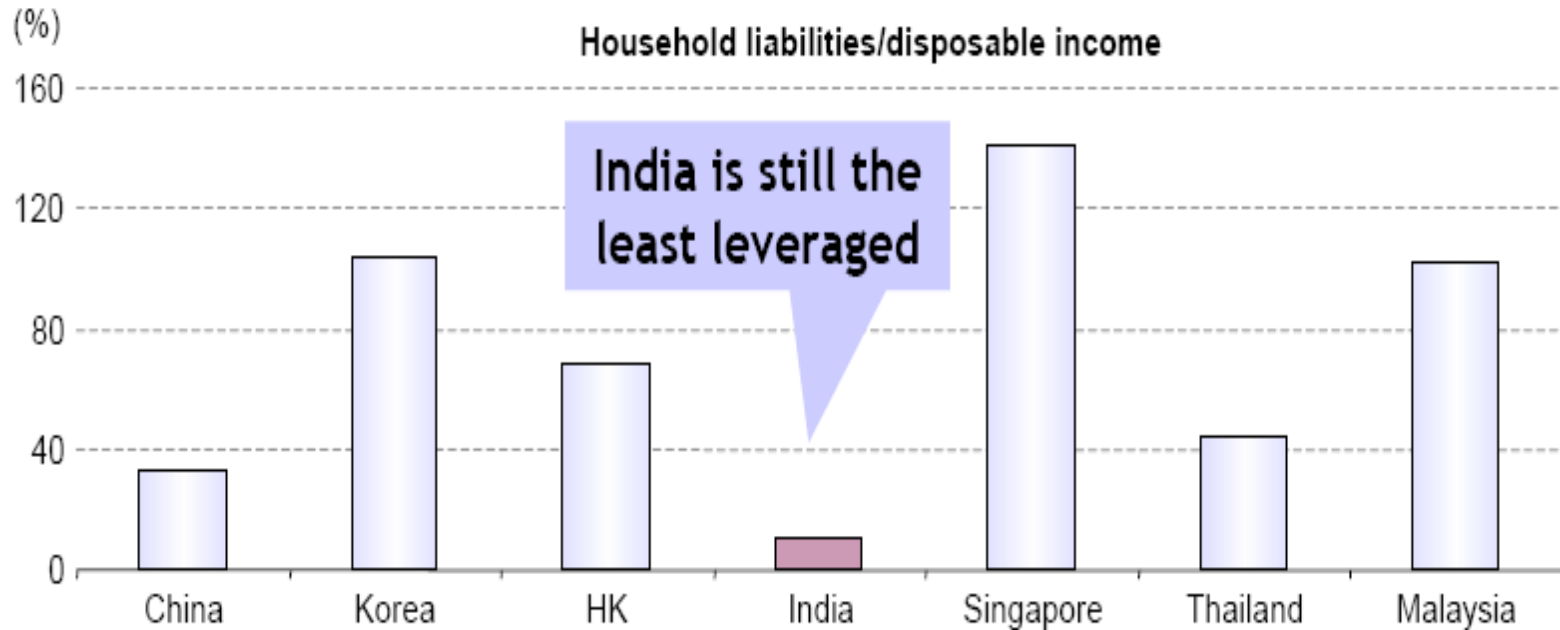


# Income Imbalance To Correct Leading To Rise In Consumption



Source: IDFC SSKI

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



Source: IDFC SSKI

# Disclaimer

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