

Equity Markets : Current Environment and Outlook

Vetri Subramaniam, Head of Equity Funds
December 2009

Current Environment

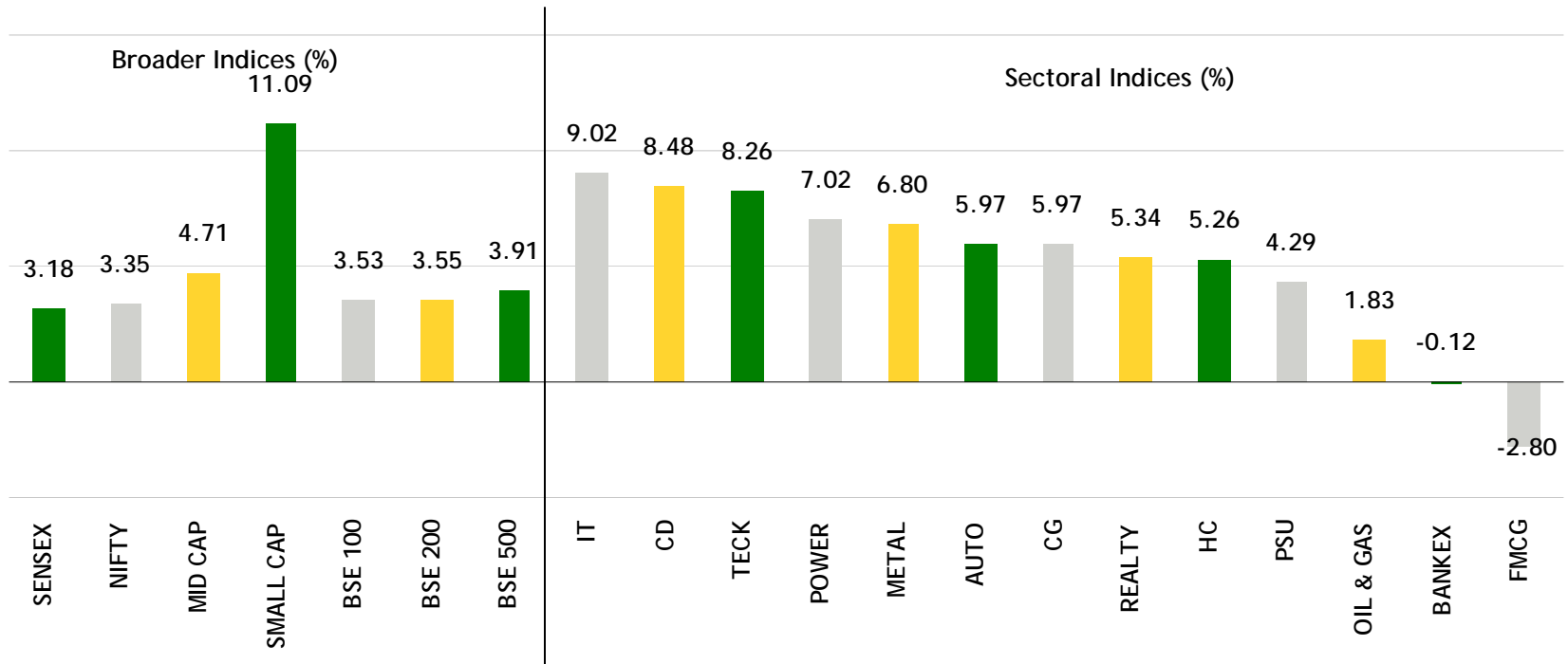
- Equity markets across the globe remained strong, with the MSCI World Index rising by 1.69%.
- Indian markets outperformed the global trend, rising 3.18% in December.
- Commodity prices continued the bullish trend of the previous month with the benchmark CRB Reuters Jefferies total return index rising 3.6%.
- In India, IT was the best performing sector followed by the Consumer Durables. Banking and FMCG sector delivered the worst return for the month.
- FII inflows have remained positive on a YTD basis at Rs.670bn for CY09 after a Rs.102bn inflow in December.
- In December, cash trading volumes (number of shares) fell 11% MoM, while the average open interest increased by 5% MoM to a record high.

Global Equities

Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	3277.14	2.56%	79.98%	EM - Asia
BSE Sensex	India	17464.81	3.18%	81.03%	EM - Asia
Kospi	South Korea	1682.77	8.17%	49.65%	EM - Asia
Taiwan Weighted	Taiwan	8188.11	7.99%	78.34%	EM - Asia
Thailand SET 50 Index	Thailand	520.69	7.68%	65.94%	EM - Asia
Jakarta Composite Index	Indonesia	2534.36	4.91%	86.98%	EM - Asia
KLSE	Malaysia	1272.78	1.09%	45.17%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	68588.41	2.30%	82.66%	EM
Mexico IPC	Mexico	32120.47	3.76%	43.52%	EM
Russian RTS Index	Russia	1444.61	5.07%	128.62%	EM
Philippine PSEi	Philippines	3052.68	0.25%	63.93%	EM
Merval Buenos Aires Index	Argentina	2320.73	8.08%	114.95%	EM
HangSeng	Hong Kong	21872.50	0.23%	52.02%	Developed - Asia
Nikkei	Japan	10546.44	12.85%	19.04%	Developed - Asia
Strait Times	Singapore	2897.62	6.06%	64.49%	Developed - Asia
Dow Jones	USA	10428.05	0.80%	18.82%	Developed
CAC 40 Index	France	3936.33	6.96%	22.32%	Developed
All Ordinaries Index	Australia	4882.70	3.55%	33.43%	Developed
DAX Index	Germany	5957.43	5.89%	26.62%	Developed
Swiss Market Index	Switzerland	6545.91	4.55%	18.27%	Developed
FTSE 100	UK	5412.88	4.28%	22.07%	Developed
MSCI World Index	--	1168.47	1.69%	26.98%	--

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

India : Sector performances



- The markets rose by 3.18% over the previous month.
- IT was the best performing sector followed by the Consumer Durables sector.
- Banking and FMCG sector delivered the worst return for the month.



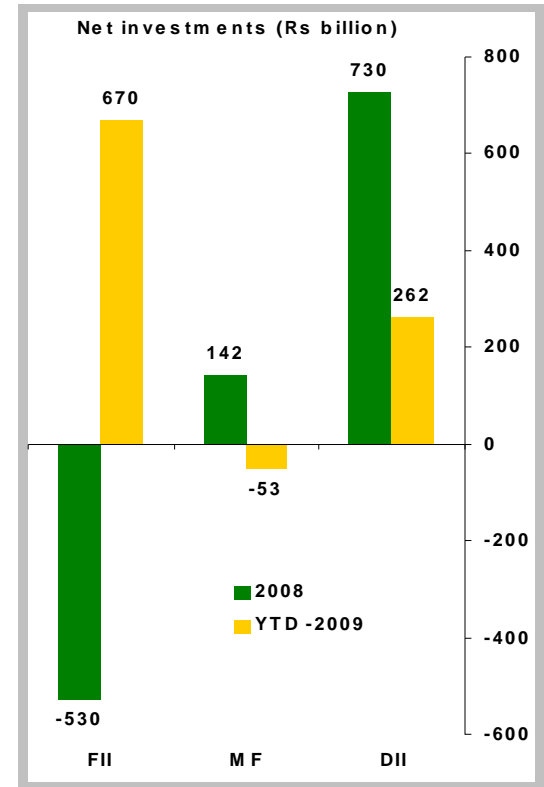
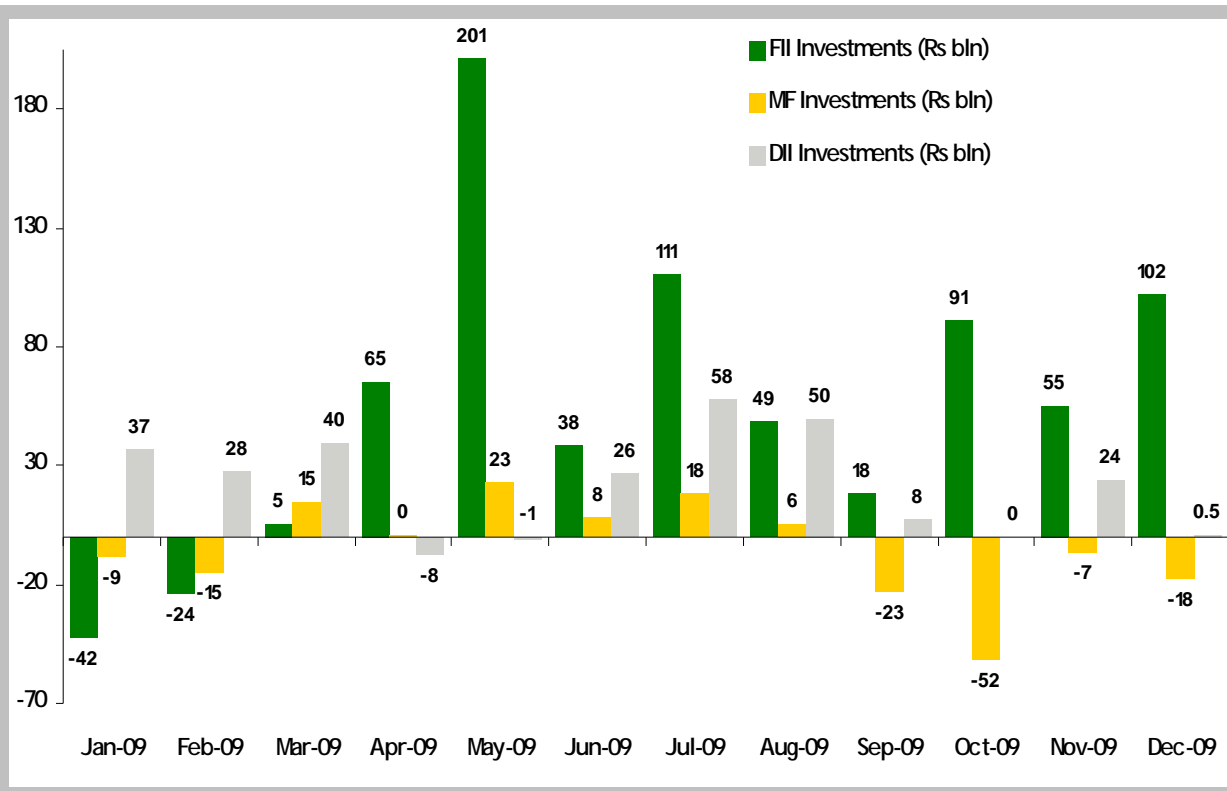
*Source: BSE,NSE. one month performance as on 31st December 09.

Top Gainers / Losers - Nifty

Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
S A I L	69.5 / 243.8	241.70	22.60
Tata Motors	128 / 799.6	791.55	19.36
Hindalco Inds.	36.75 / 163	160.85	16.47
Suzlon Energy	33.05 / 145.7	90.35	14.66
Idea Cellular	41.2 / 91.8	58.05	13.94
Top Losers for the month			
Losers	52 week H/L	Last Price#	% Loss*
Hind. Unilever	210.85 / 306.7	264.8	-7.15
I D F C	44 / 179	154.3	-6.99
HDFC Bank	774 / 1839	1702.25	-3.62
H D F C	1119 / 2865.7	2675.8	-3.29
JP Associates	38.77 / 179.97	146.85	-2.66

closing price as on 31st December 09.* one month performance as on 31st December 09.
Source: capitaline

FII & DII Inflows

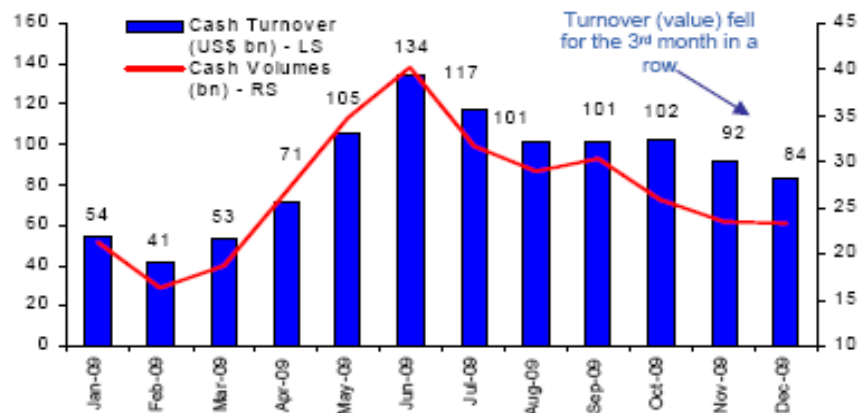


- FII inflows have remained positive on a YTD basis at Rs.670bn for CY09 after a Rs.102bn inflow in December.
- DIIs recorded muted inflows of Rs.0.5bn. MF's however, were net sellers to the tune of Rs.18bn.

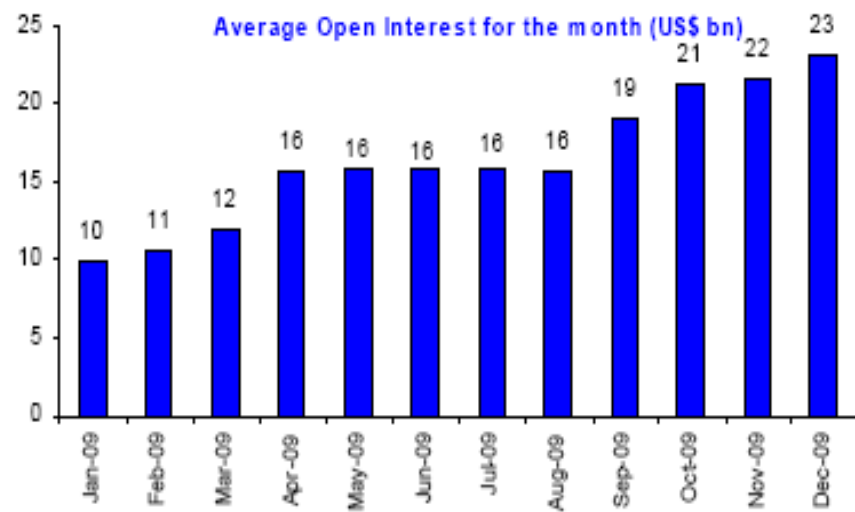


Market Activity

Cash Trading: Turnover and Volumes



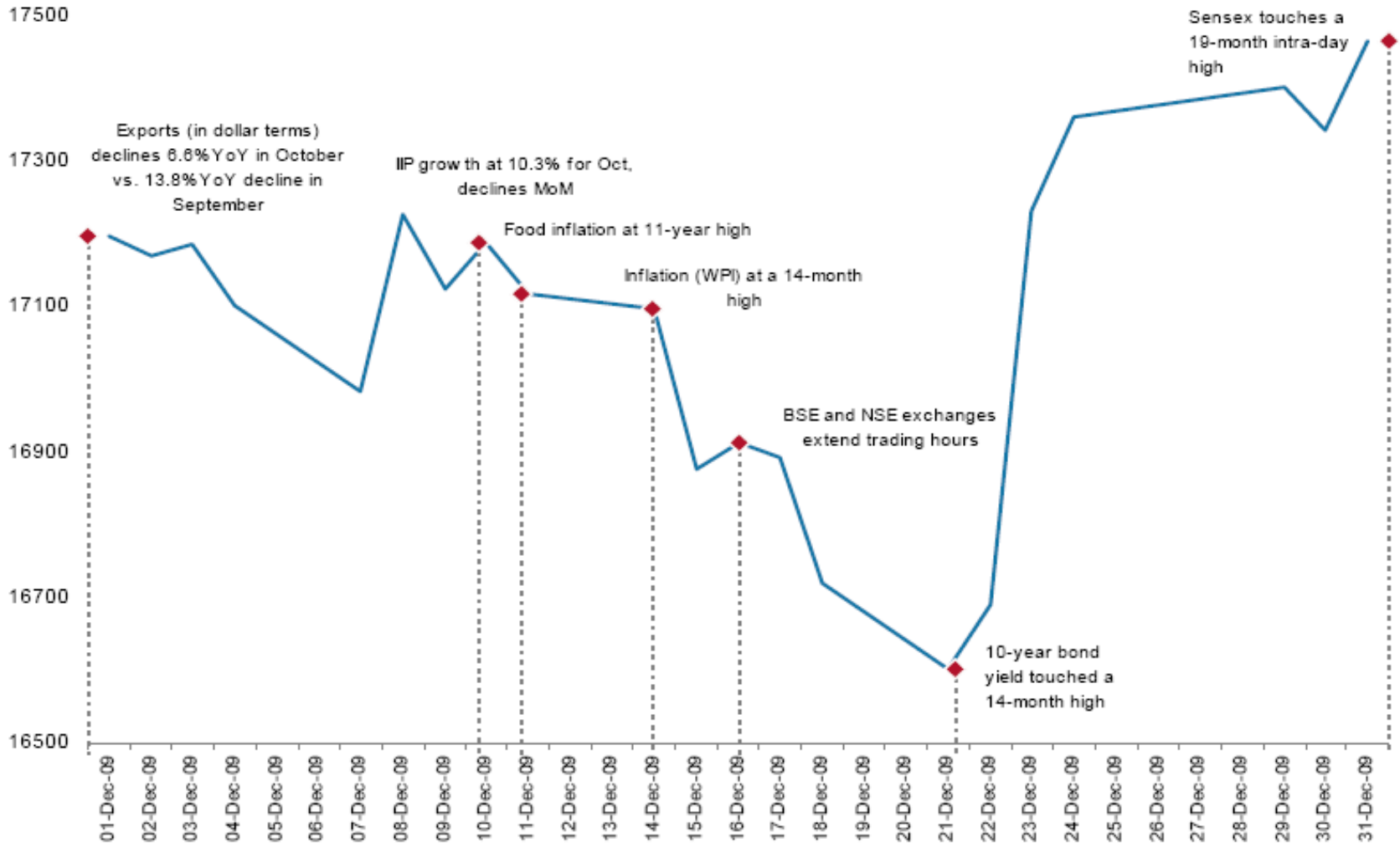
- In December, cash trading volumes (number of shares) fell for the third month in a row, down 11% MoM, and is 37% below the Jun-09 peak.



- At the end of December, average open interest rose marginally, up 5% MoM, to its highest level since Jan-09.



December 09 events timeline



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



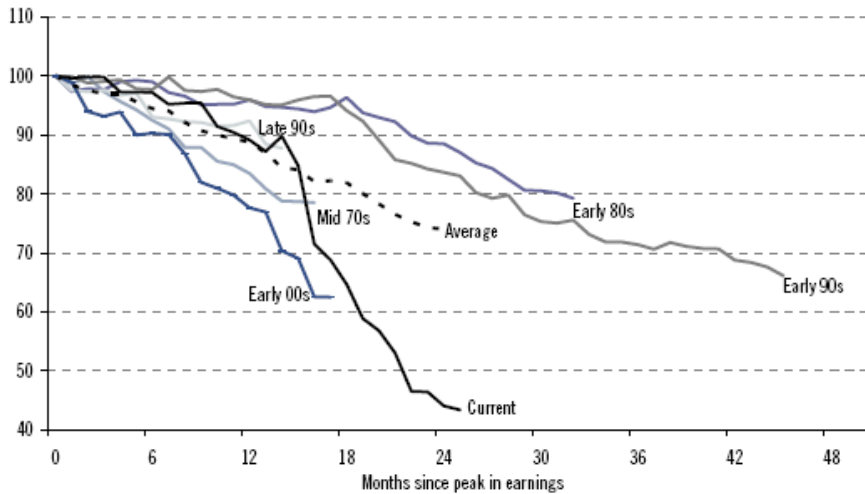
Religare MF: Equity Market Outlook and Opportunities

Equity Market Outlook

- MSCI AC World 12m trailing EPS index is currently down 57% from its November 2007 peak. However, the decline in earnings might be behind us considering the significant upgrades to earnings by analysts since July 2009.
- Various leading indicators in India point to the recovery spreading. The Naukri JobSpeak Index, run by India's largest job portal, has been rising for 5 of the past 6 months and is up 12.3% from its low.
- Government expenditure on rural development (like NREGA) has helped increase the share of rural consumption and blunt the impact of deficient rainfall on rural income by diversifying it.
- India's fiscal stimulus package despite being relatively small compared to the rest of the world, has contributed very significantly to growth last year.
- Areas of concern include the deceleration in investment spending, which has continued to trend down and increased food inflation
- India has received significant inflows through ETF (Exchange Traded Funds) funds, which could increase the volatility in the market.
- The consensus expects a 4% decline in FY10 Sensex earnings over FY09 and a 29% growth in FY11 Sensex EPS over FY10.
- Nifty is currently trading at 23.6x its trailing earnings which is well above its historical averages; this is, however, in line with trends seen across emerging markets.

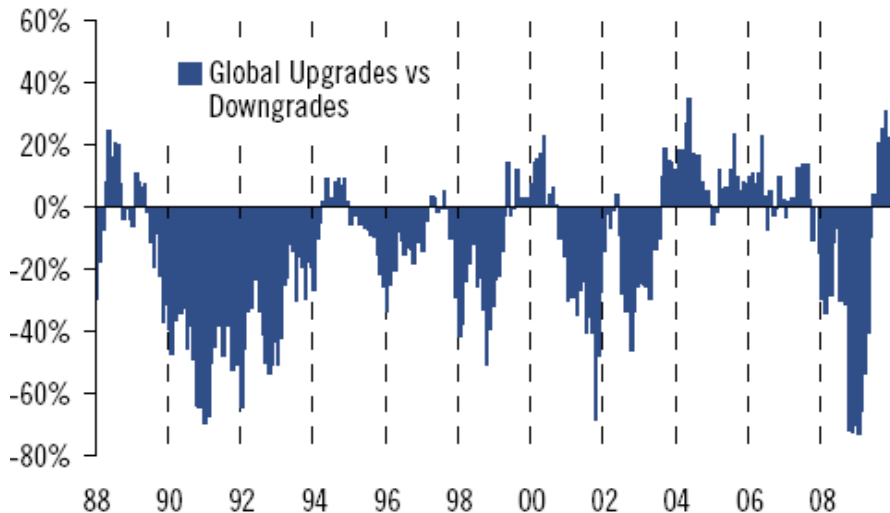
Global Earnings -upgrades dominate

Global EPS Recessions (Previous Peak = 100)

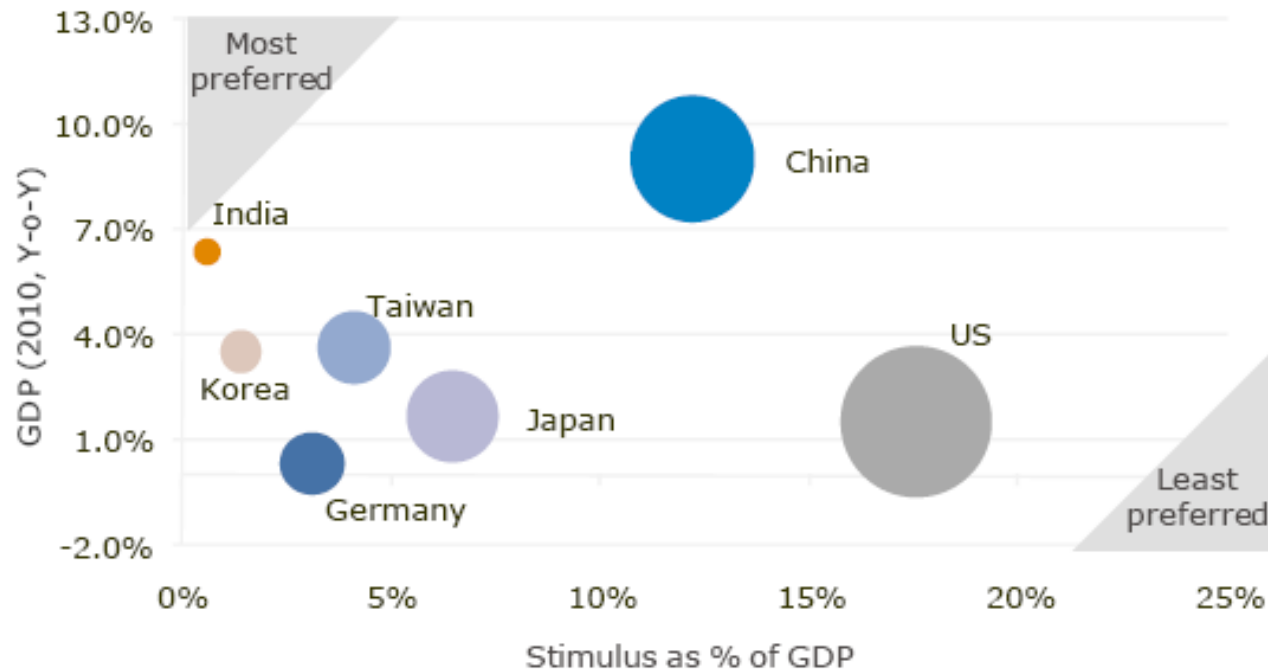


- MSCI AC World 12m trailing EPS index is currently down 57% from its November 2007 peak.
- The previous worst in the past 40 years was in the early 2000s, when EPS fell by 38%.
- While the overall size of the earnings contraction is greater than in previous cycles, the duration appears to be in line with the average 24-month experience.
- However, the decline in earnings might be behind us considering the significant upgrades to earnings by analysts since July 2009.

Global EPS Upgrades/Downgrades



India's growth revival less dependent on stimulus



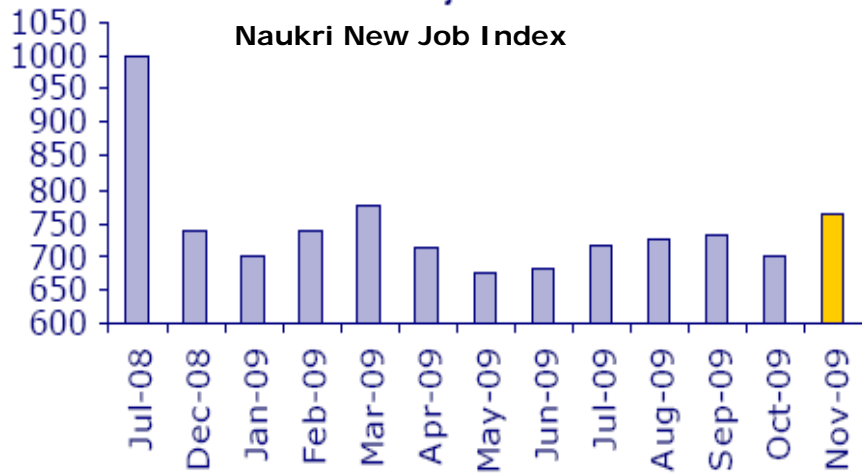
Note: 1. US data includes TARP, TALF. 2 Size of bubble indicates stimulus as % of GDP

- India's stimulus package accounted for less than 1% of the GDP, while that of countries such as Japan, China and the US announced packages worth 10% or more of their respective GDPs.
- In spite of a smaller stimulus, India is set to be the second fastest growing economy in the world.
- Thus, India's economic growth is resilient and less exposed to stimulus rollback.



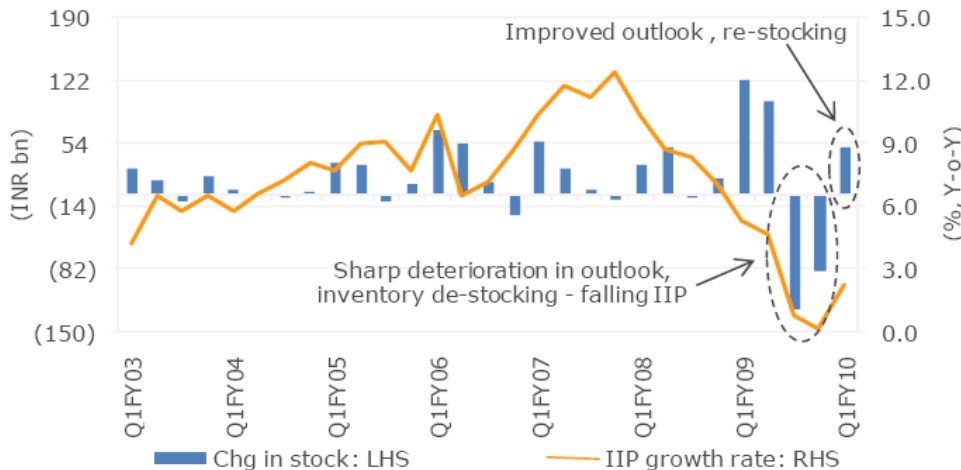
Leading indicators pointing to recovery

Naukri new job Index



- The Naukri JobSpeak Index, run by India's largest job portal, has been rising for 5 of the past 6 months and is up 12.3% from its low.
- The improving employment scenario is expected to drive stronger growth in consumption in Urban India.

Inventory re-stocking boosting production in FY10

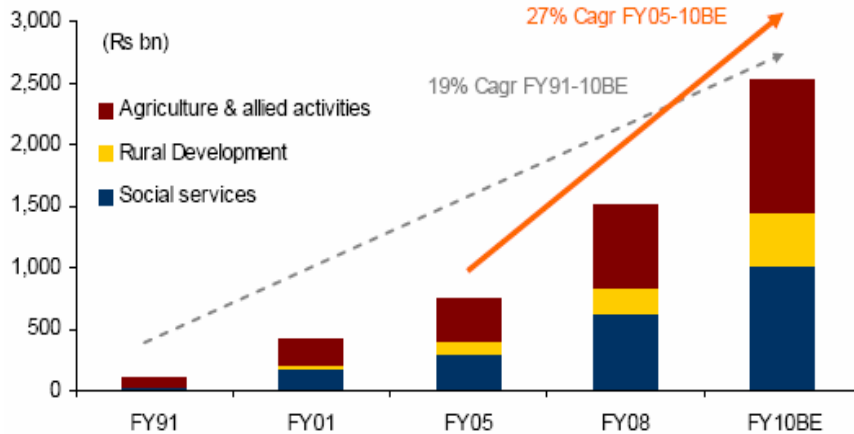


- Indian manufacturing had accumulated huge inventories during H1FY09, which had led to a sharp drop in production in the subsequent period as demand declined.
- By Q4FY09, however, there was significant inventory de-stocking, which finally made room for improved production since Q1FY10.

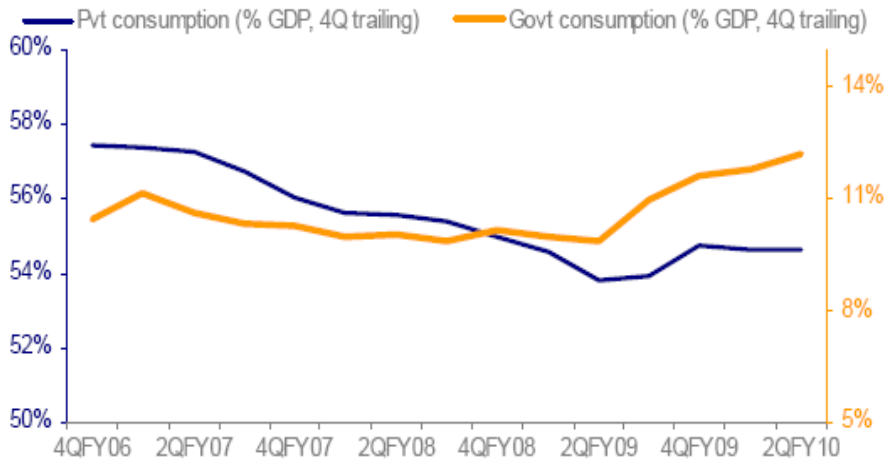


Government spend helped rural growth

Govt. spend on rural development



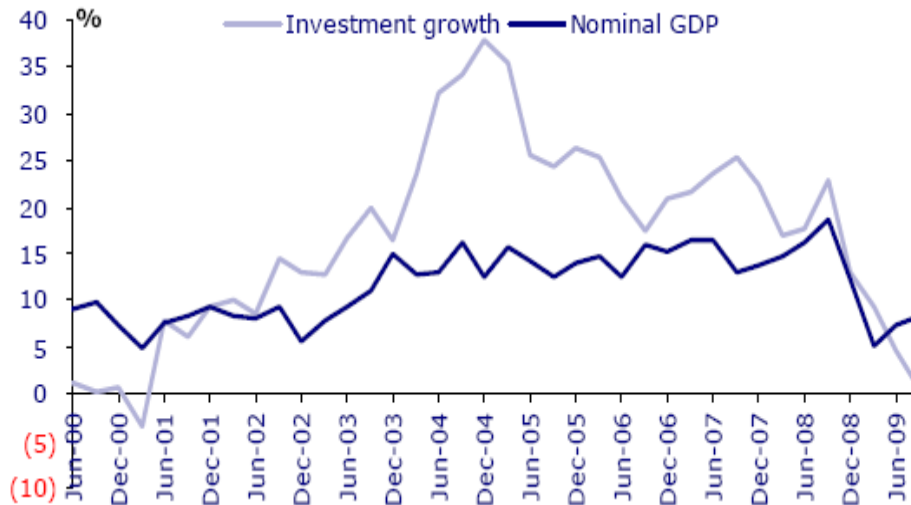
GDP breakup



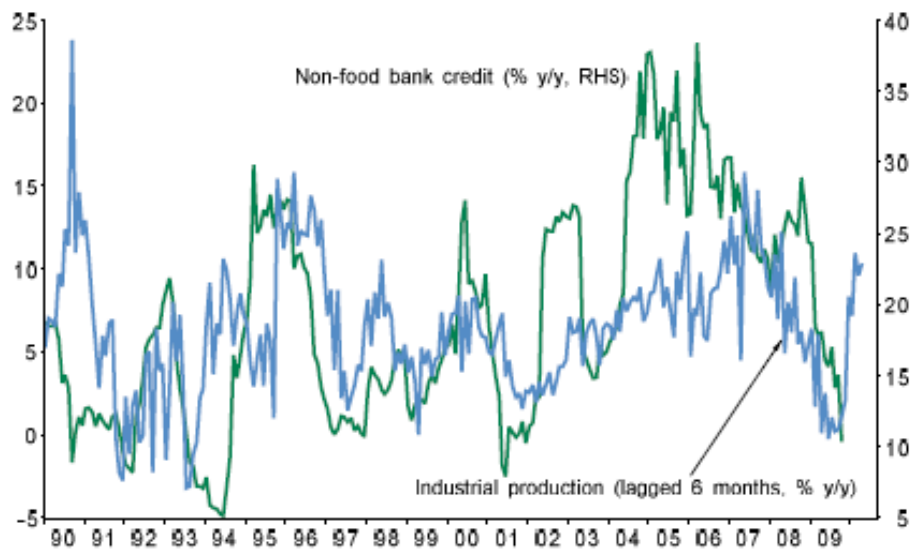
- Government expenditure on rural development (like NREGA) has helped increased the share of rural consumption.
- It has also helped blunt the impact of deficient rainfall on rural income by diversifying it.
- Growth in the last 18 months was driven primarily due to the fiscal stimulus, with government consumption alone contributing an estimated ~50% of GDP (expenditure side) growth during the October 2008-September 2009 period.
- However, going forward, growth is expected to be driven by acceleration in private final consumption growth.



Investment deceleration a concern



- The growth in investment spending (1.9% YoY in 2Q FY09, in real terms) has continued to trend down even as the overall GDP growth (7.9% YoY) has picked-up.
- Revival in investment spending is crucial to sustainable economic growth in India, as it is investment spending that has driven Indian economy since FY2000.

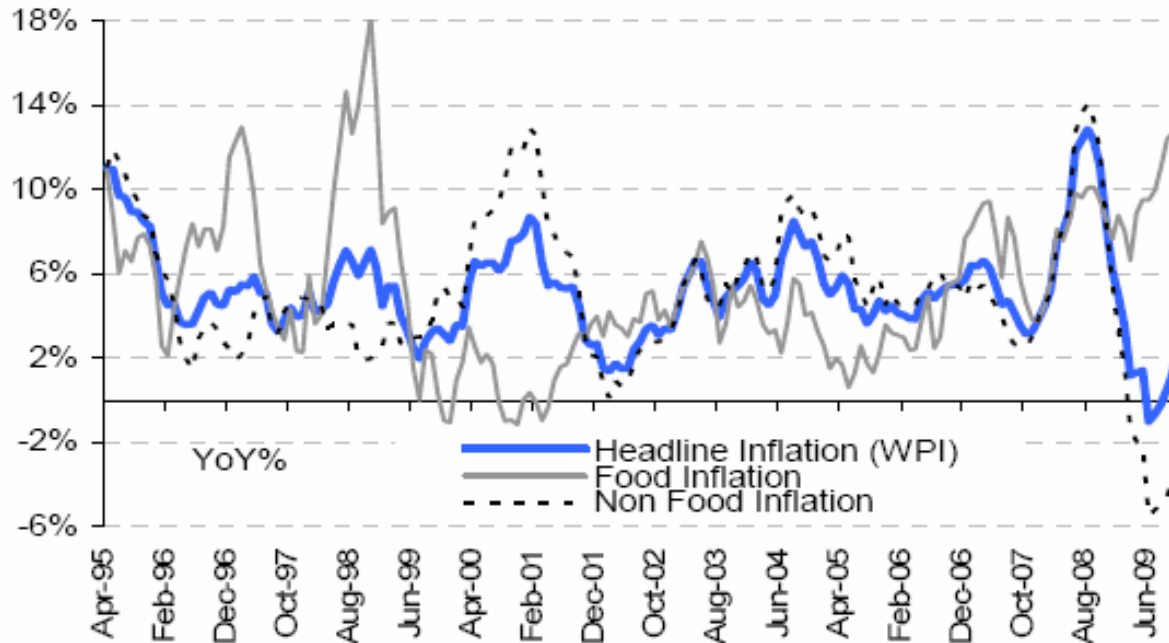


- Slower investment spending is being reflected in muted non-food credit off-take, which is at a multi-year low at 10% growth yoy.



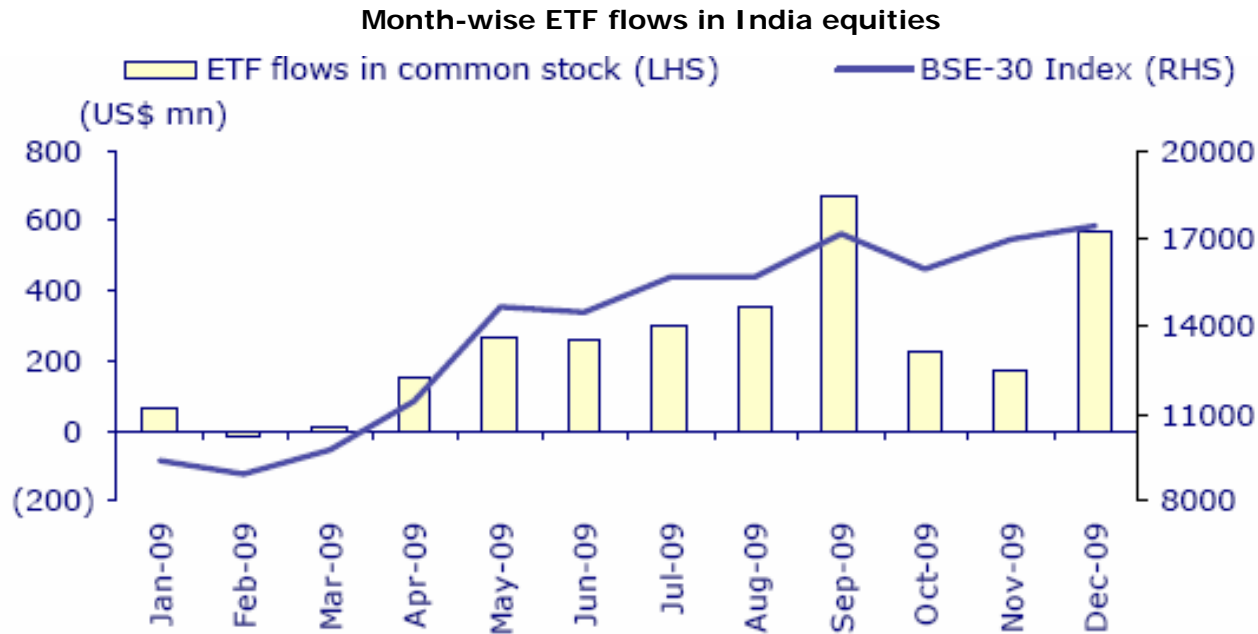
Food Inflation causing pain

WPI: Headline, Food and Non food Inflation, YoY%



- Food inflation has spiked up to 17.1% as of Nov-09, from 6.6% in Mar-09.
- Primary and manufactured food products with its weighting of 30.9% in WPI has contributed 5.3% points, pushing headline inflation to 4.8% even as non-food inflation is -0.7%YoY.

ETF flows - a double edged sword

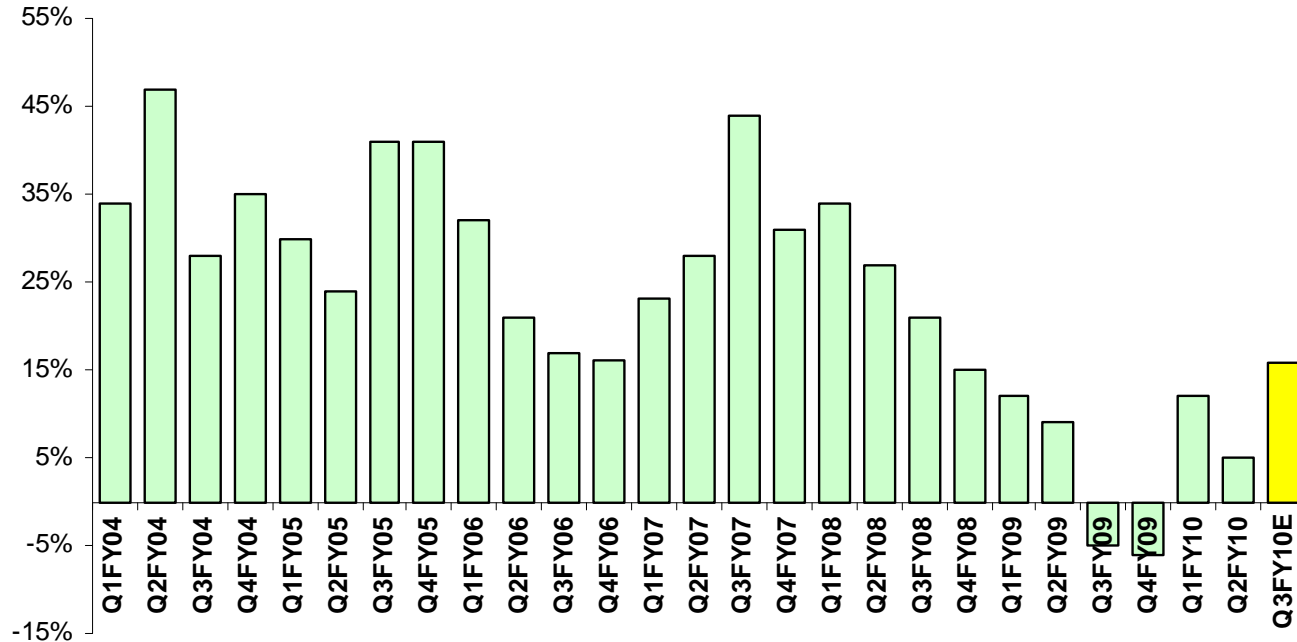


- India has received approximately US\$9bn of ETF funds from April 2009 onwards.
- Of the estimated US\$10.3bn of ETF AUMs in India, US\$5.6bn is through India dedicated funds, which is 0.4% of India's total market cap. AUMs of country dedicated ETFs for China, Russia and Brazil are US\$16bn, 1.7bn and 13.7bn respectively and account for 0.5-1.1% of the respective country market caps.
- ETF can potentially increase the volatility of the market as flows often change direction abruptly.



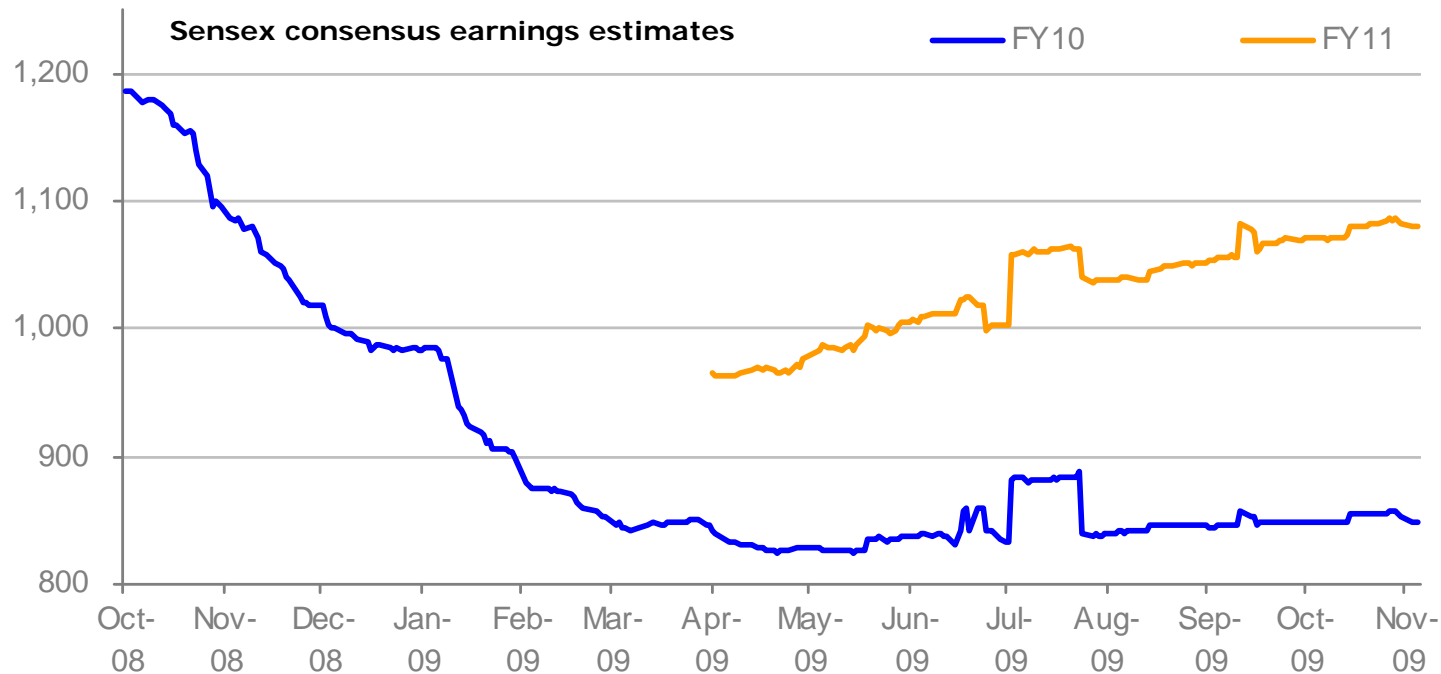
Domestic Earnings - December '09 Qtr Expectation

YoY Change in Sensex Free Float PAT



- Market expects the December 2009 quarter Sensex earnings to grow at 16% rate, higher than the 5% growth witnessed in September 2009 quarter.
- Higher YoY growth is expected mainly due to base effect, as earnings in the same period previous year had declined 5%.

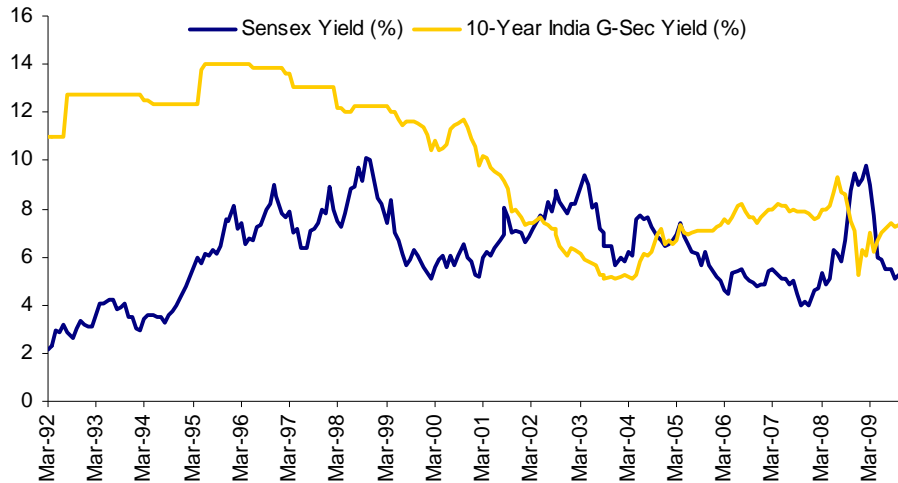
Domestic Earnings - Full Year Expectations



- Consensus expects a 4% decline in FY10 Sensex earnings over FY09 and a 29% growth in FY11 Sensex EPS over FY10.
- Consensus is thus expecting a significant rise in FY11 earnings, making next years earnings important for sustainability of the market.

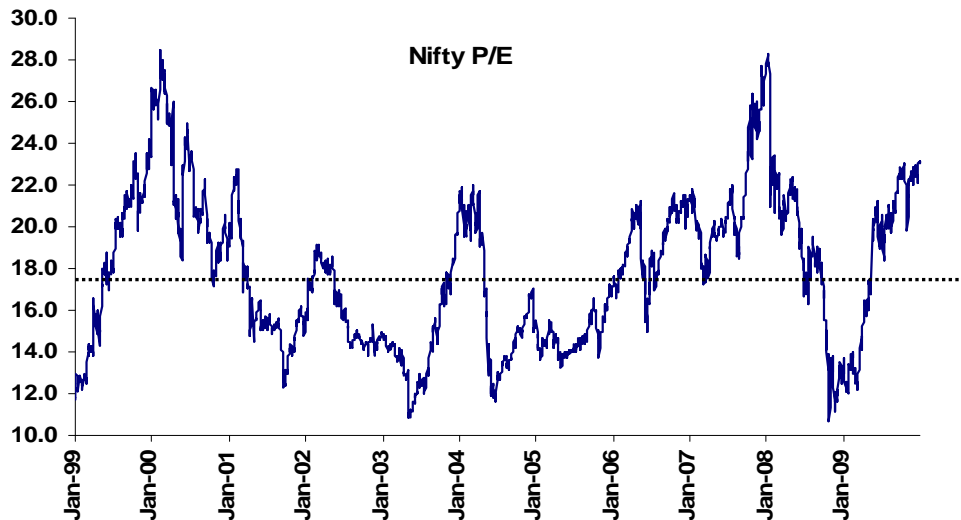


Valuations - Adverse widening of Yield gap



- The gap between Sensex earnings yield and bond yield has increased significantly by 76 basis points over the previous month; the Sensex yield dropped even as bond yields increased.

- Nifty is currently trading at 23.6x its trailing earnings. It is thus significantly above its historic average trailing PE of 17.8x.



- The valuation surge is not unique to India. The MSCI Emerging Market Index is also trading at approximately 24.4x trailing earnings



Looking Ahead...

- The macro environment continues to improve as is indicated by an improvement in various lead indicators including the employment index and the PMI index.
- With the Indian economy back in the growth zone and with inflation becoming the primary macro-concern, we expect stimulus to be withdrawn over CY2010. However, India on a relative basis should be lesser impacted than most other developed countries due to withdrawal of stimulus.
- In our view, the monetary policy tightening may commence in January 2010 and the tax cuts related to the three stimulus packages may start to be rolled back in FY2011 Union budget.
- Disinvestment in PSU's is one of the key policy responses of the government to address the fiscal deficit and this provides a degree of comfort.
- Given the performance in the second quarter we expect GDP growth for the full year to be slightly above 6.5% GDP growth expectation as against earlier expectations of 6-6.5%.
- Credit growth, an important lead indicator, has not shown much growth so far possibly indicating a conservative approach by both lenders and borrowers. This is also corroborated by an anemic growth in investment demand component in the GDP.
- The recent rally in the dollar has not impacted most risky assets suggesting a weakening in the inverse correlation but the equity market correlation remains high.
- 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 6.5% in FY10
- We expect earnings to be flat in FY10 over FY09. The current consensus forecasts a healthy 29% in FY11, but we would be cautious about visibility of this estimate as a 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 17.2x 1-year forward earnings. Based on historical trends the odds are not very favorable for forward returns.

Long term

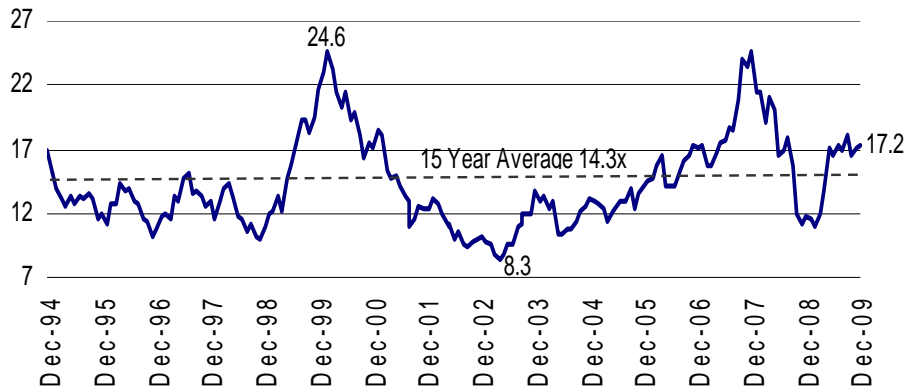
- India will double in size, adding \$1trillion to GDP over the next 5-7 years.
- Over the same period earnings should match nominal GDP growth @12-14% p.a. but will be back ended.
- The elevated valuation measures might reduce the returns to below earnings growth.

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

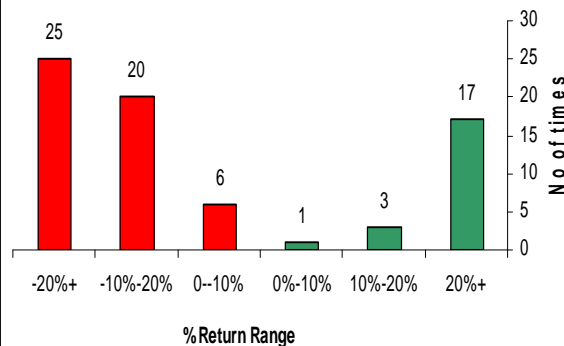
Near term odds not favourable-based on historic trends

Sensex 1 year forward P/E (x)

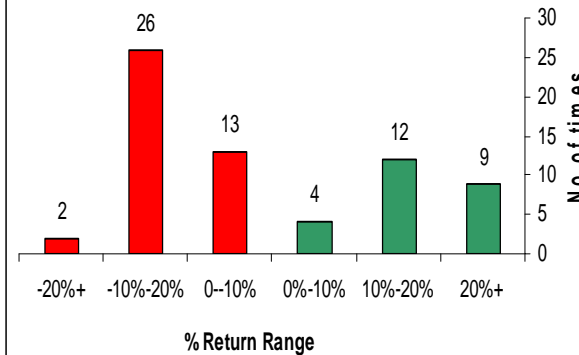


- The Sensex is currently trading at a P/E of 17.2x forward earnings.
- Since 1991, Sensex has traded above 17x forward P/E in 77 months out of 226 months.
- The 1-year forward return on buying the index in such a month (P/E greater than 17) was negative 71% of the time.
- Similarly, the 2-year forward return was negative 62% of the time and 3 years forward returns were negative 46% of the time.

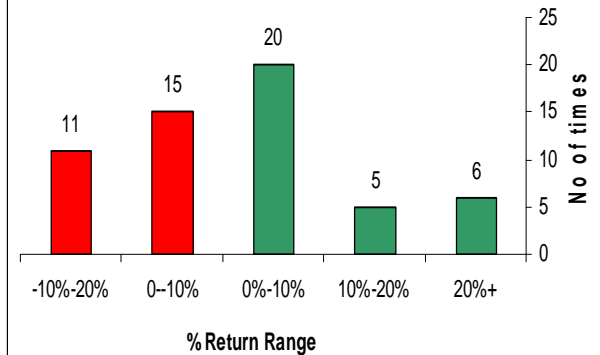
1 year Forward Return Distribution - 72 observations



2 year Forward Return Distribution - 66 observations



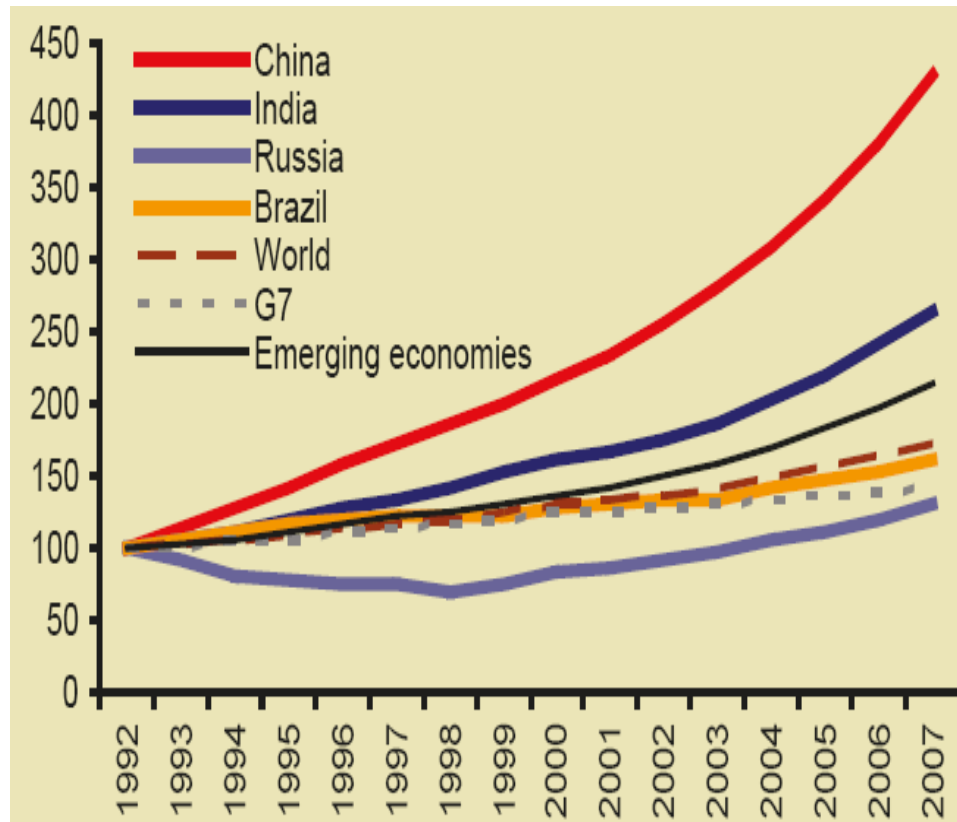
3 year Forward Return Distribution - 57 observations



The Long Term Case For Indian Equities

India - Growth On The Fast Track

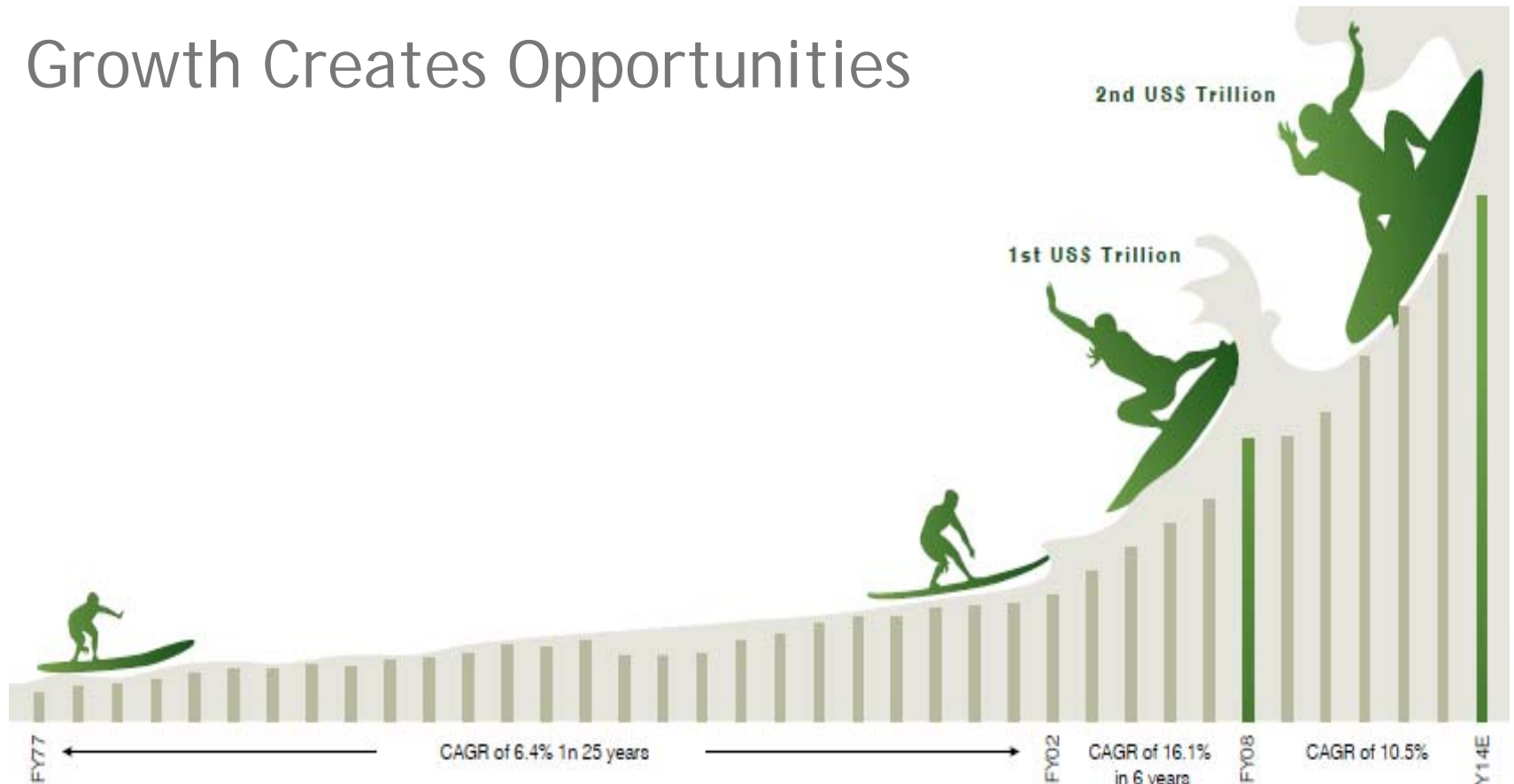
GDP growth rebased to 1992



Source: IMF, IIFL Research

- India's economy has been the among the fastest growing economies in the world driven by:
 - Increase in savings rate
 - Rising capital formation
 - Better demographics and
 - Rising consumption

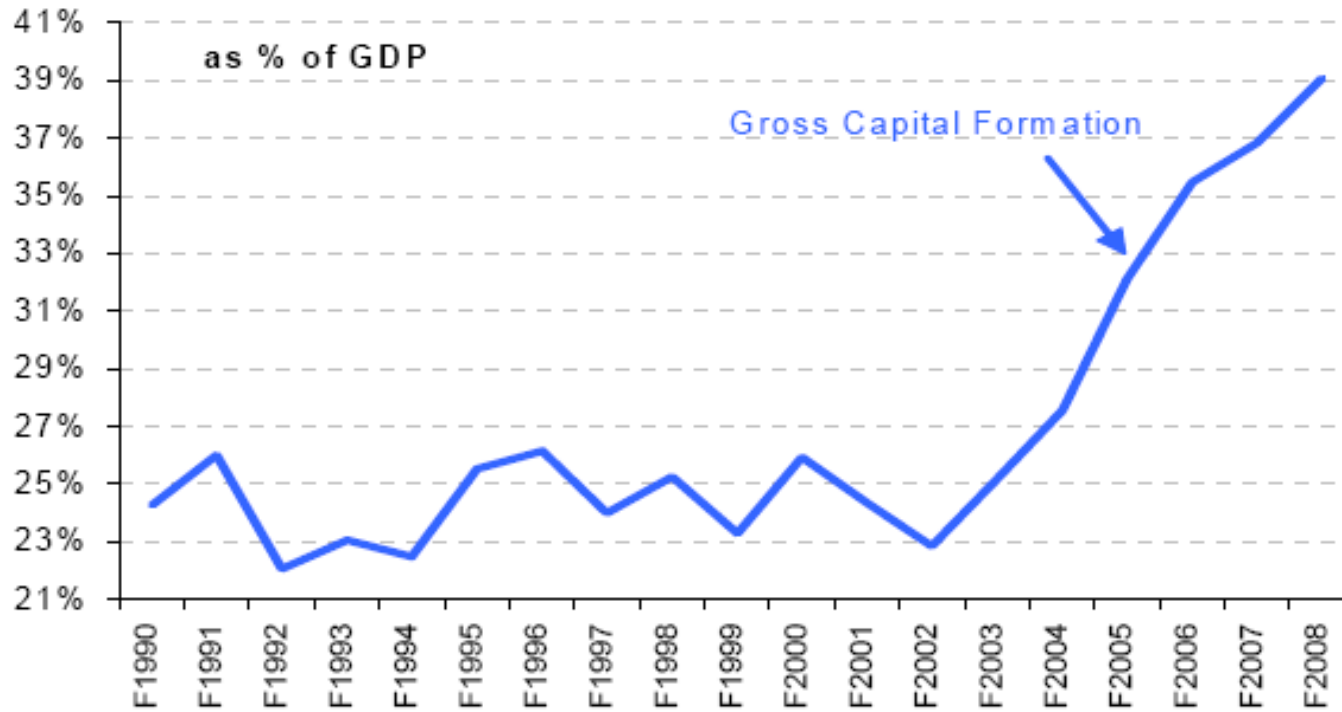
Growth Creates Opportunities



- 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

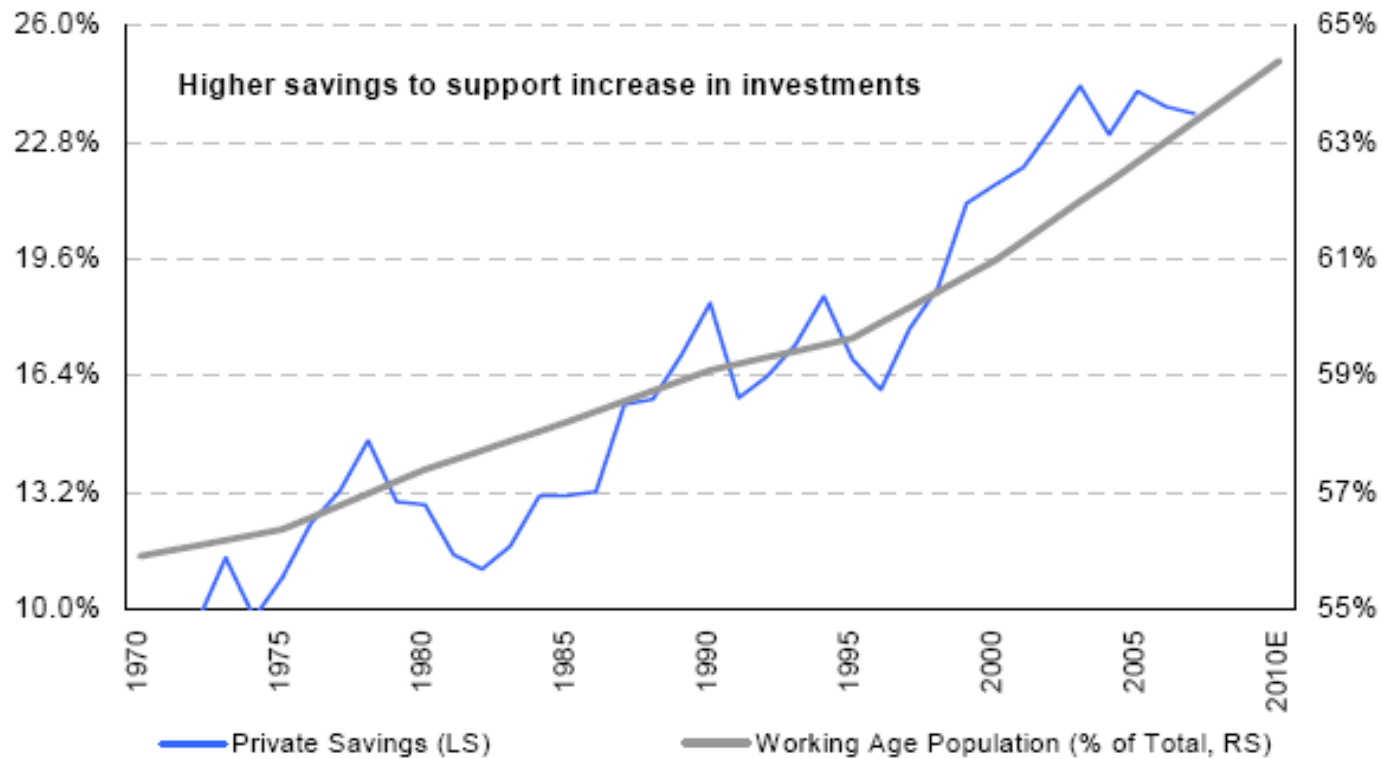


Growth Is Being Led By A Rise In Capital Formation...



Source: CSO, Morgan Stanley Research

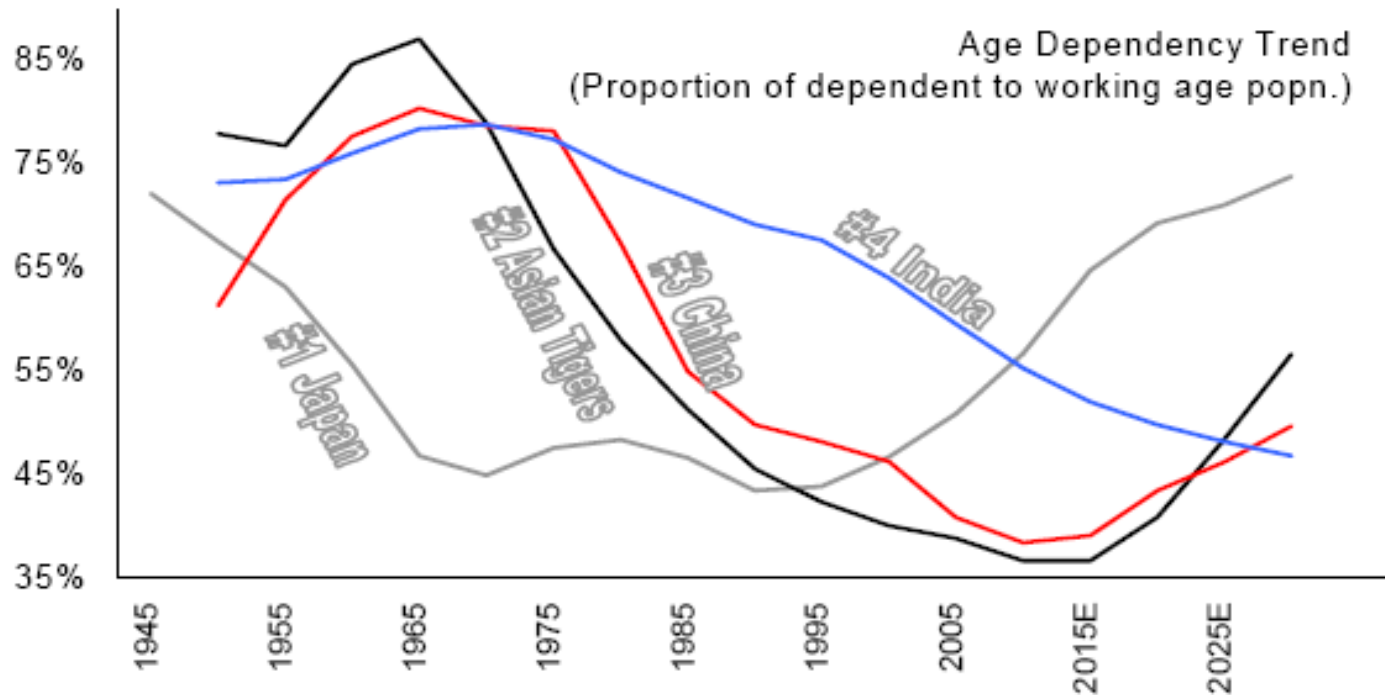
...Which Is Supported By A High Savings Rate



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



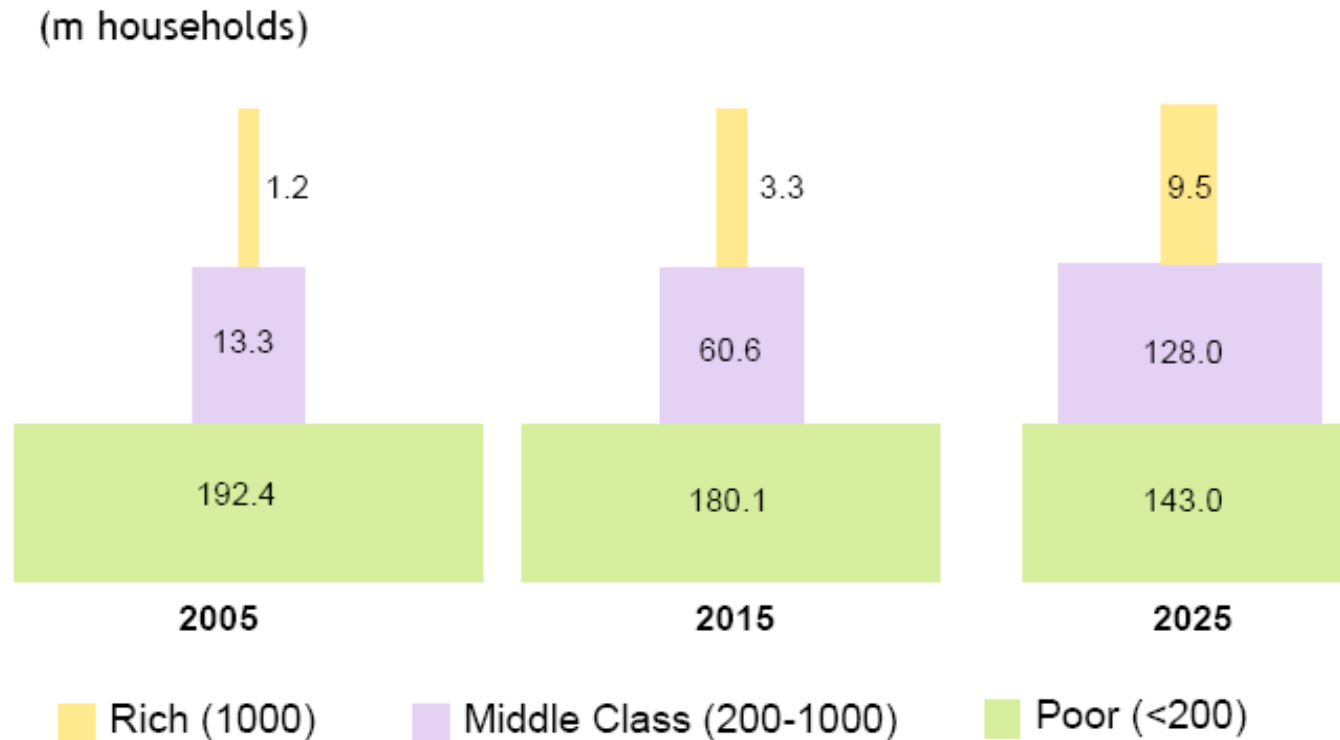
India Is Poised To Reap Rich Demographic Dividend In Years To Come



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

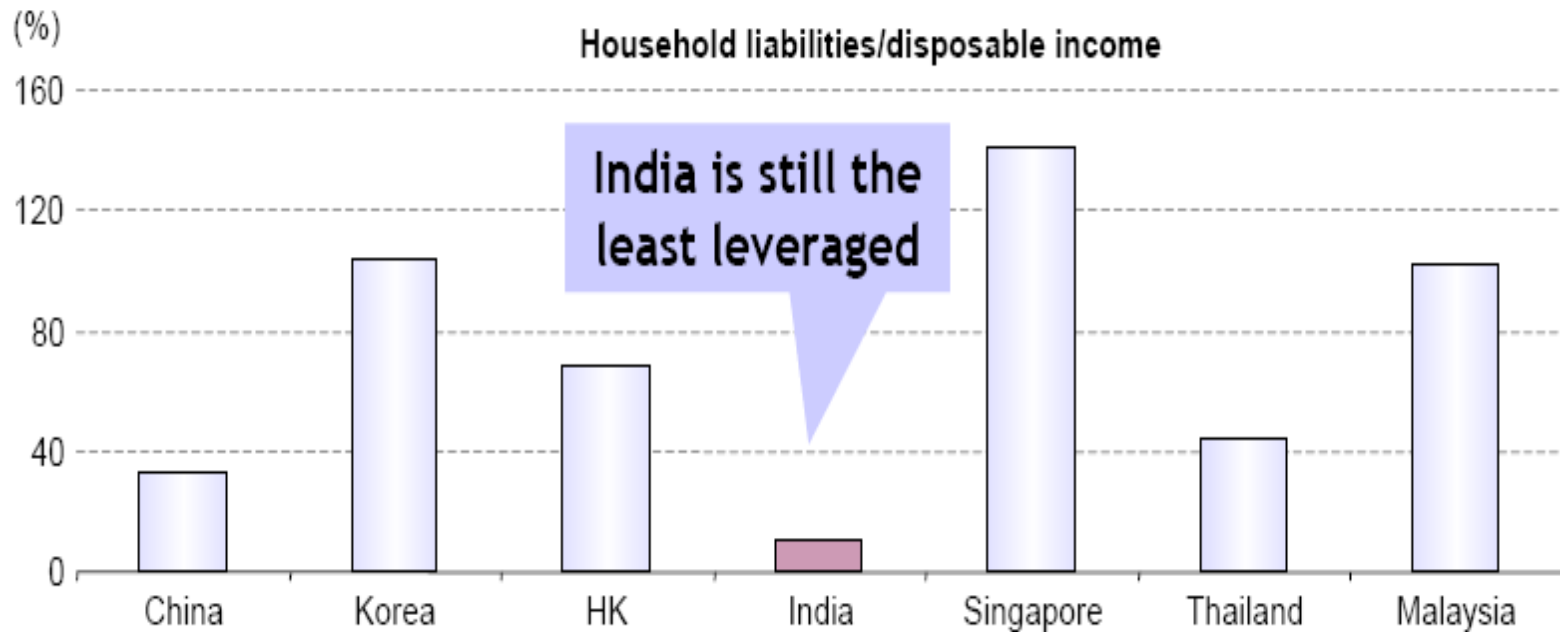


Income Imbalance To Correct Leading To Rise In Consumption



Source: IDFC SSKI

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



Source: IDFC SSKI

Disclaimer

Disclaimer: This presentation is for information purposes only and is not an offer to sell or a solicitation to buy any mutual fund units/securities. These views alone are not sufficient and shouldn't be used for the development or implementation of an investment strategy. It should not be construed as investment advice to any party. All opinions, figures, charts/graphs and estimates included in this presentation are as of this date and are subject to change without notice. Neither Religare Asset Management Company Limited (Religare AMC), nor any person connected with it, accepts any liability arising from the use of this information. The data used in this material is obtained by Religare AMC from the sources which it considers reliable. While utmost care has been exercised while preparing the presentation, Religare AMC does not warrant the completeness or accuracy of the information and disclaims all liabilities, losses and damages arising out of the use of this information. The recipient of this material should rely on their investigations and take their own professional advice. Mutual Fund and Securities Investments are subject to Market Risk. Performance of the Sponsor(s) has no bearing on the expected performance of the Mutual Fund or any of its Scheme(s). **Statutory Details:** Religare Mutual Fund has been set up as a trust sponsored by Religare Securities Ltd. (liability restricted to Rs. 1,50,000/-) with Religare Trustee Company Ltd. as the Trustee (Trustee under the Indian Trusts Act, 1882) and with Religare Asset Management Company Ltd. as the Investment Manager.

MKTG/RoundupEquity/1209/CO014

