

# Equity Markets : Current Environment and Outlook

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November 2009

# Current Environment

- Equity markets across the globe remained strong, with the MSCI World Index rising by 3.87%.
- Indian markets outperformed the global trend, rising 6.48% in the month of November.
- Commodity prices continued the bullish trend of the previous month with the benchmark CRB Reuters Jefferies total return index rising 2.1%.
- In India, Metals were the best performing sector followed by the Auto. Realty and Power sector delivered the worst return for the month.
- FII inflows have remained positive on a YTD basis at Rs.567bn for CY09 after a Rs.55bn inflow in November.
- In November, cash trading volumes (number of shares) fell 9% MoM, while the average open interest increased by 1% MoM to a record high. Trading volumes (value) fell 10% MoM and are 44% below the October 2007 peak

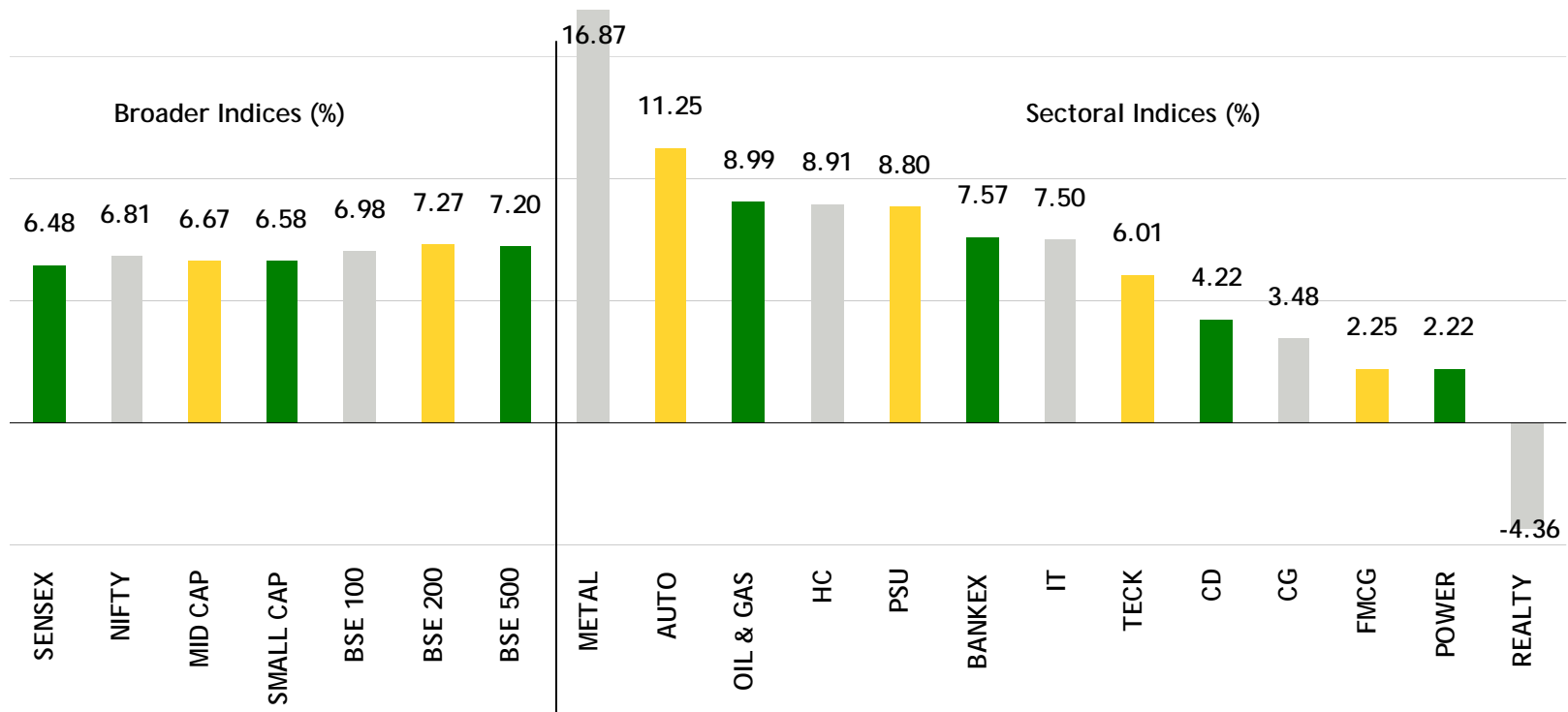
# Global Equities

Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	3195.30	6.66%	75.49%	EM - Asia
BSE Sensex	India	16926.22	6.48%	75.45%	EM - Asia
Kospi	South Korea	1555.60	-1.59%	38.34%	EM - Asia
Taiwan Weighted	Taiwan	7582.21	3.30%	65.15%	EM - Asia
Thailand SET 50 Index	Thailand	483.54	-0.03%	54.10%	EM - Asia
Jakarta Composite Index	Indonesia	2415.84	2.03%	78.24%	EM - Asia
KLSE	Malaysia	1259.11	1.28%	43.61%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	67044.44	8.93%	78.55%	EM
Mexico IPC	Mexico	30957.11	8.07%	38.32%	EM
Russian RTS Index	Russia	1374.93	1.96%	117.59%	EM
Philippine PSEi	Philippines	3044.97	4.69%	63.52%	EM
Merval Buenos Aires Index	Argentina	2147.25	1.49%	98.88%	EM
HangSeng	Hong Kong	21821.50	0.32%	51.67%	Developed - Asia
Nikkei	Japan	9345.55	-6.87%	5.49%	Developed - Asia
Strait Times	Singapore	2732.12	3.05%	55.10%	Developed - Asia
Dow Jones	USA	10344.84	6.51%	17.87%	Developed
CAC 40 Index	France	3680.15	2.01%	14.36%	Developed
All Ordinaries Index	Australia	4715.50	1.48%	28.86%	Developed
DAX Index	Germany	5625.95	3.90%	19.58%	Developed
Swiss Market Index	Switzerland	6260.95	-0.39%	13.13%	Developed
FTSE 100	UK	5190.68	2.90%	17.06%	Developed
MSCI World Index	--	1149.01	3.87%	24.86%	--

\* as on 30<sup>th</sup> November 09. Source : Bloomberg  
EM – emerging markets, Developed – developed markets.



# India : Sector performances



- The markets rose by 6.48% over the previous month
- Metals were the best performing sector followed by the Auto sector
- Realty and Power sector delivered the worst return for the month



\*Source: BSE,NSE. one month performance as on 30<sup>th</sup> November 09.

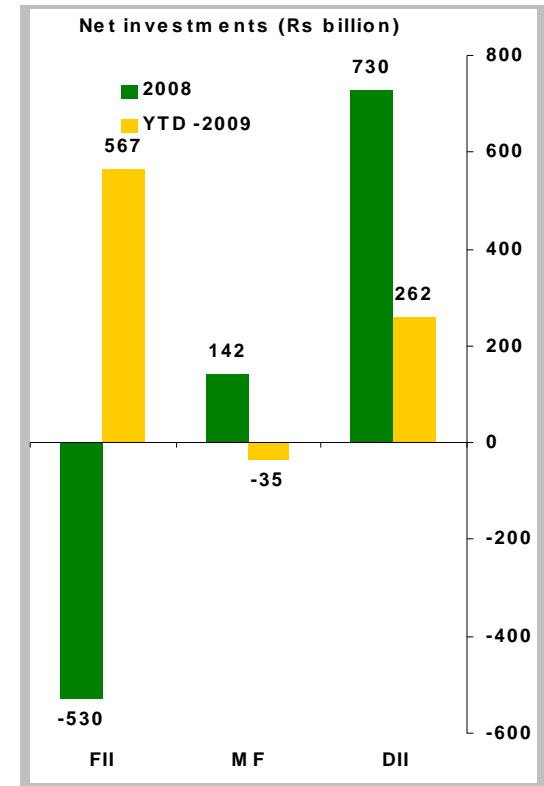
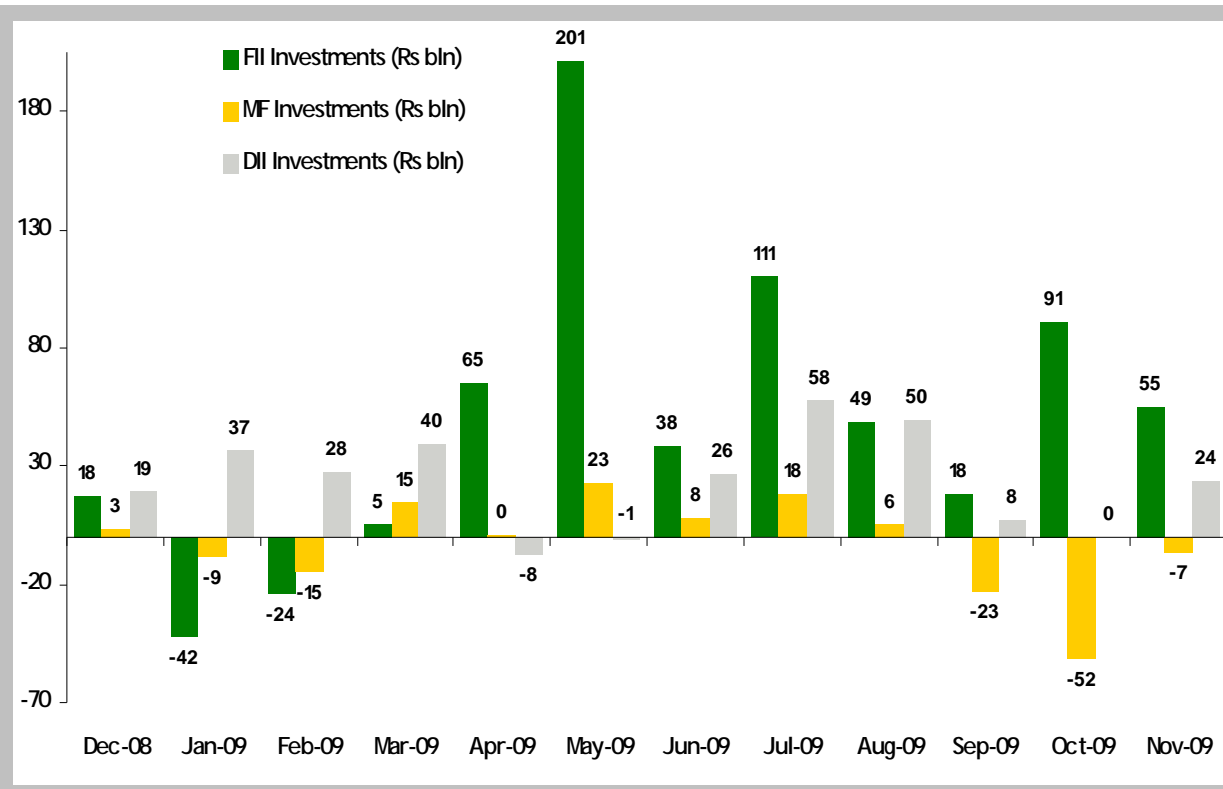
# Top Gainers / Losers - Nifty

Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
Tata Steel	146.5 / 585.4	579.2	22.83
GAIL (India)	186 / 424.85	418.65	20.22
S A I L	61.15 / 200.25	197.15	19.81
Suzlon Energy	33.05 / 145.7	78.8	17.88
Tata Motors	125.25 / 666.8	663.15	16.91
Top Losers for the month			
Losers	52 week H/L	Last Price#	% Loss*
DLF	124.05 / 519.9	351.6	-5.04
Power Grid Corpn	66.5 / 130	99.8	-4.36
A B B	343.35 / 834	741.05	-3.70
Unitech	21.65 / 116.65	79.3	-3.59
Rel. Comm.	131.1 / 362	171.85	-2.27

# closing price as on 30<sup>th</sup> November 09.\* one month performance as on 30<sup>th</sup> November 09.  
Source: capitaline



# FII & DII Inflows

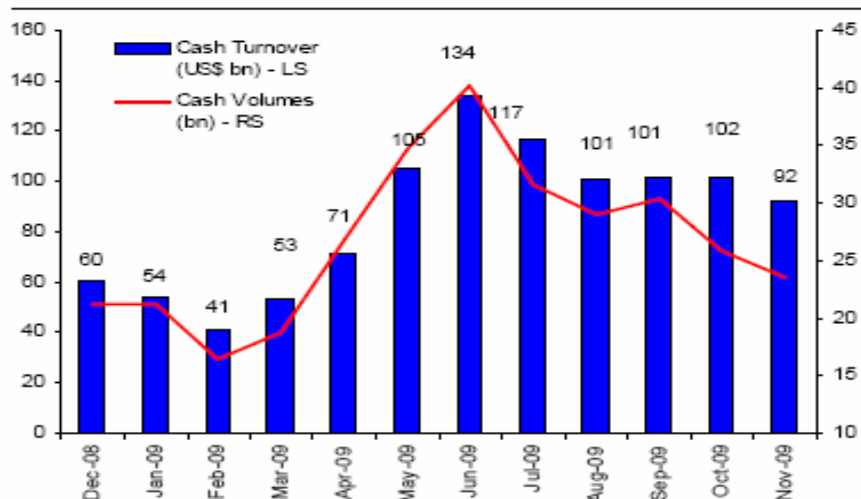


- FII inflows have remained positive on a YTD basis at Rs.567bn for CY09 after a Rs.55bn inflow in November.
- DIIs recorded strong inflows of Rs.24bn. MF, however, were net sellers to the tune of Rs.7bn.

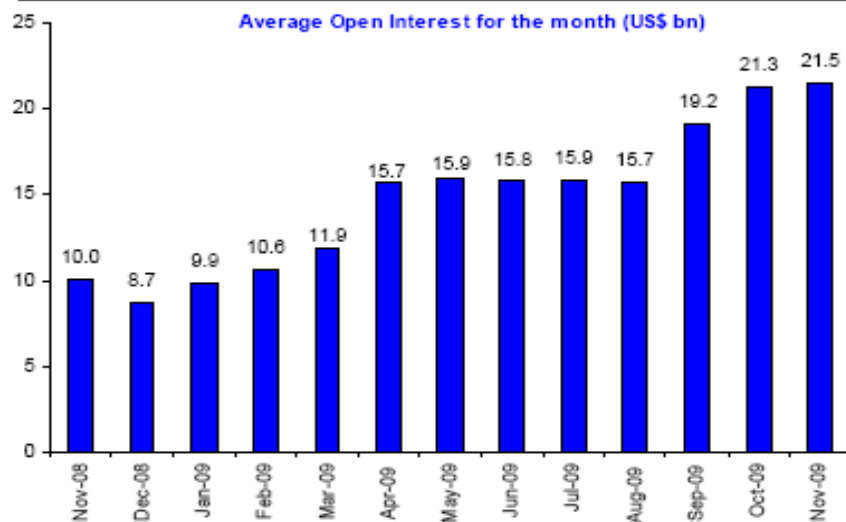


# Market Activity

## Cash Trading: Turnover and Volumes



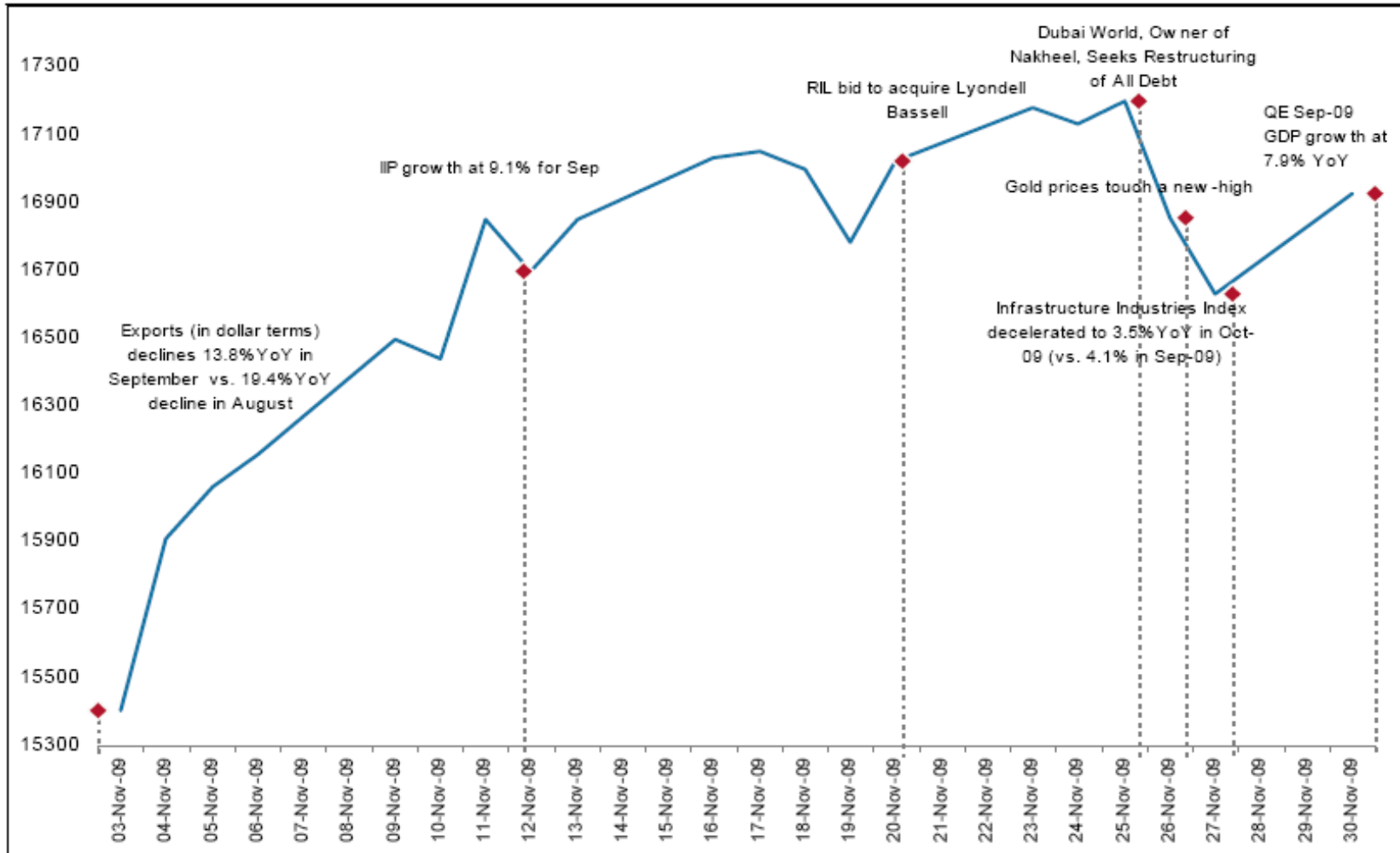
## Average Open Interest for the Month



- In November, cash trading volumes (number of shares) fell for the second month in a row, down 9% MoM, and is 42% below the Jun-09 peak
- Trading volumes (value) fell 10% MoM and are 44% below their October 2007 peak
- At the end of November, average open interest rose marginally, up 1% MoM, to its highest level since Jan-08



# November 09 events timeline



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



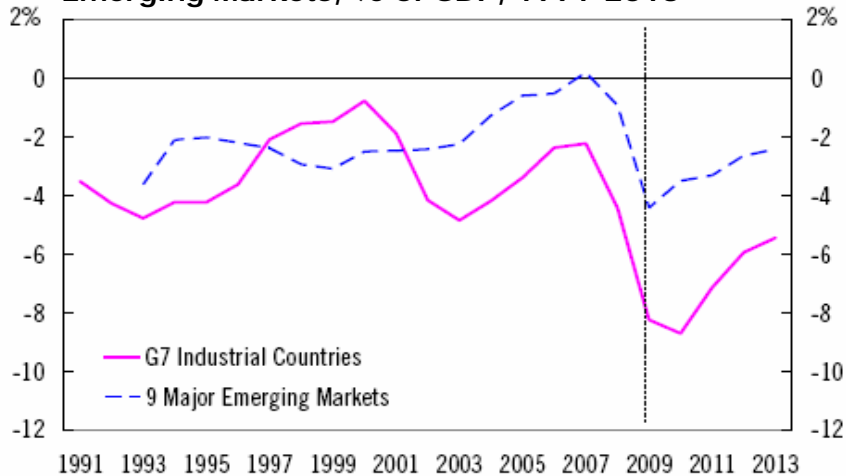
# Religare MF: Equity Market Outlook and Opportunities

# Equity Market Outlook

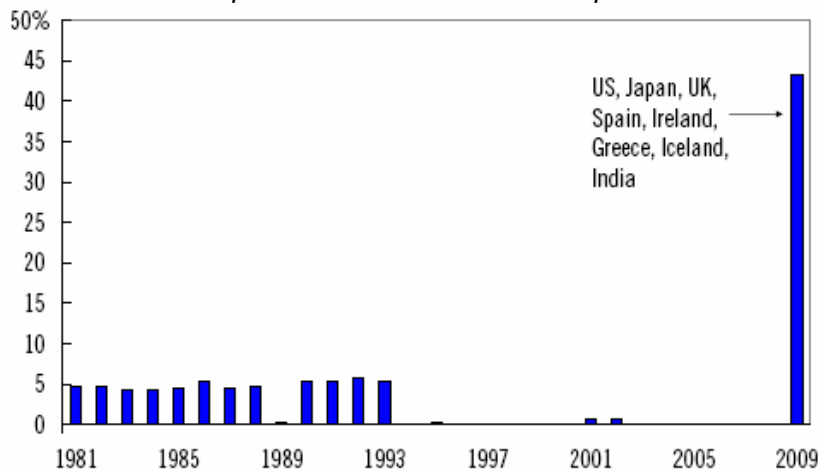
- With countries across the world having resorted to a significant fiscal stimulus in the past 18 months, fiscal deficits have climbed sharply
- The aggregate G7 fiscal deficit increased to about 10% of GDP in 2009, twice the peaks seen in last 30 years (5.1% of GDP)
- Seven industrial countries (US, Japan, UK, Spain, Greece, Ireland, Iceland), plus India, which together account for about 43% of global GDP, have fiscal deficits at or above 10% of GDP this year, which is an historic high
- However, with private demand for credit staying weak in most parts of the world (including India) this has not affected interest rates
- The call for a standstill on the liabilities of Dubai World resulted in fears over corporate and sovereign credit risk rising once again but this appears to have subsided.
- India's GDP grew by 7.9% in 2QFY10, being driven by government consumption that grew 27% yoy on back of the fiscal stimulus through wage hikes and other government spending
- Indian equities have displayed a significant inverse correlation with value of US Dollar since start of FY08 and could be at risk if the US Dollar starts to appreciate
- The consensus expects a 2% decline in FY10 Sensex earnings over FY09 and a 22% growth in FY11 Sensex EPS over FY10
- Nifty is currently trading at 22.8x its trailing earnings which is well above its historical averages; this is however in line with trends seen across emerging markets. The MSCI Emerging Market Index is also trading at approximately 23.3x trailing earnings

# Economic Stimulus - The Other Side Of The Coin

**Fiscal Deficits in Industrial Countries and Emerging Markets, % of GDP, 1991-2013**



**Major Economies With Fiscal Deficits at or Above 10% of GDP, as Share of Global GDP, 1981-2009**



- Fiscal costs of recession, fiscal stimulus and financial rescue measures, have lifted the aggregate G7 fiscal deficit to about 10% of GDP in 2009, twice the peaks seen in last 30 years (5.1% of GDP)
- IMF recently estimated that advanced economies on average will need to tighten fiscal policy (i.e. improve their structural primary balance) by 8% of GDP over the next 10 years to stabilize debt/GDP ratios at “moderate” and “safer” levels of 60% of GDP by 2030
- Seven industrial countries (US, Japan, UK, Spain, Greece, Ireland, Iceland), plus India, which together account for about 43% of global GDP, have fiscal deficits at or above 10% of GDP this year
- At prior peaks, countries with deficits of greater than 10% of GDP accounted for no more than 5%-6% of global GDP



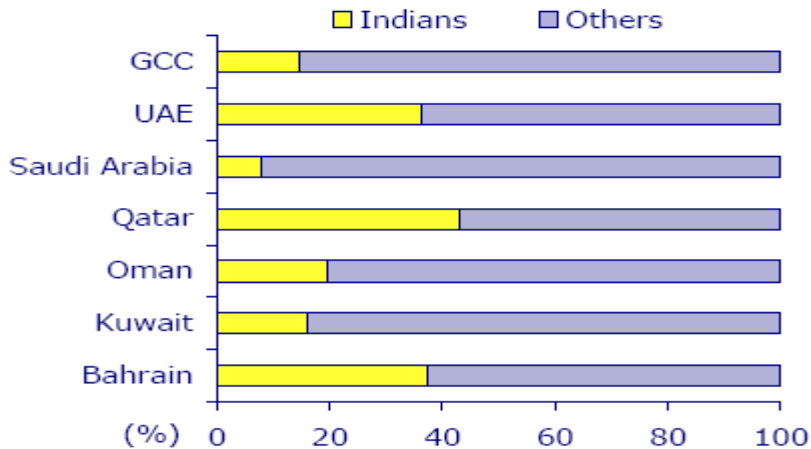
# Dubai World Default Brings Country Risk To Spotlight

Dubai five-year credit default swap (US \$)



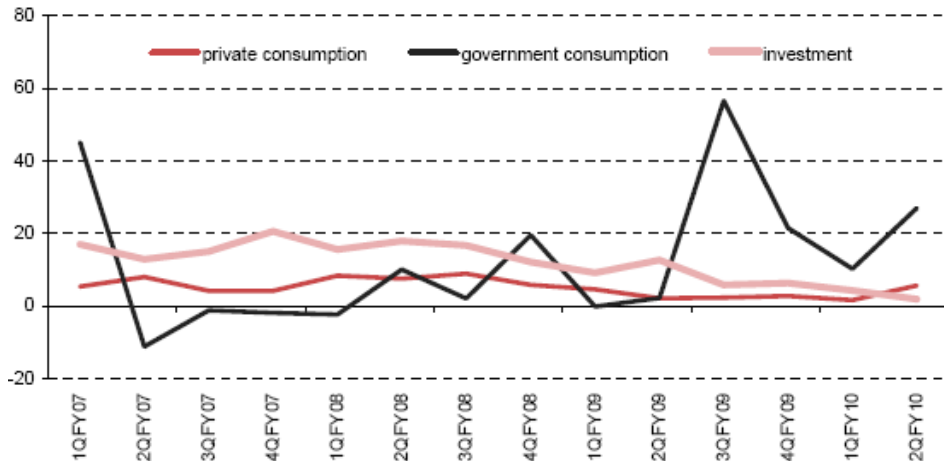
- In the last week of November 2009, Dubai announced that it would seek to delay debt payments of Dubai World, its flagship company. Dubai is a part of the U.A.E., whose capital is Abu Dhabi
- Credit Default Swap (CDS) or the cost of credit insurance for Dubai went up substantially following the announcement, implying increased risk of default
- The development is unlikely to have a very significant impact on India's economy
- There could be a negative impact on remittances as the share of UAE is estimated at about 10-12% of remittances into India
- In terms of merchandise trade, UAE forms ~8% of India's non-oil exports and 3.0-3.5% of India's non-oil imports
- There could, however, be a significant human cost as Indians form about 40% of the population of UAE, mostly as construction labour in Dubai

Indian population in Gulf



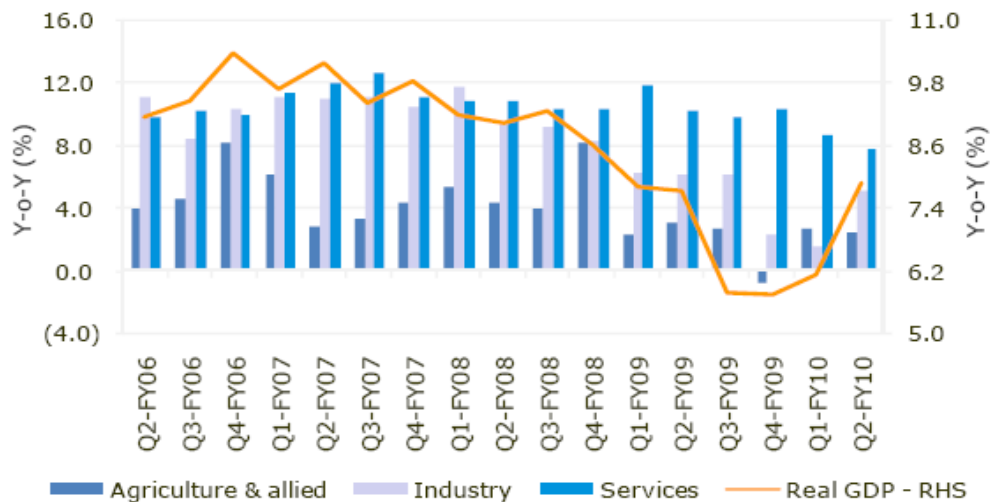
# India GDP Growth: Encouraging picture

Growth in components of real aggregate demand, (%)



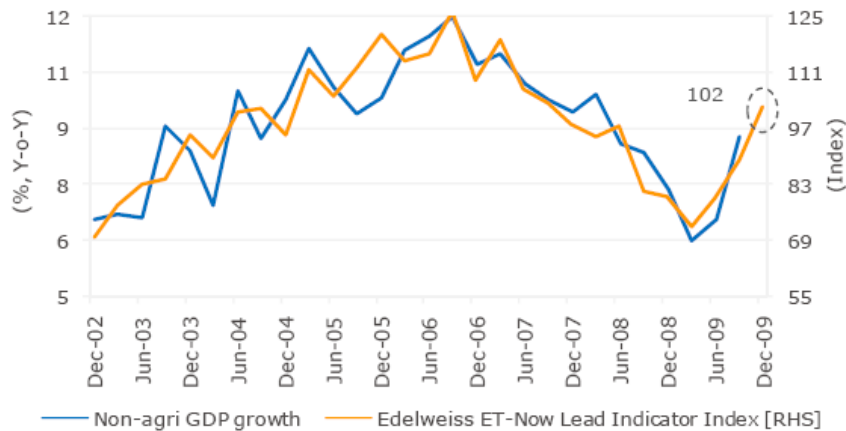
- India's GDP grew by 7.9% in 2QFY10.
- Private consumption grew 5.6% in 2Q, the highest in six quarters
- But a very significant contribution was from government consumption that grew 27% yoy on back of the fiscal stimulus through wage hikes and other government spending
- Gross capital formation grew less than 2% in contrast with anecdotal evidence that new investments are still strong, reflecting perhaps delays in actual investment spending
- While agriculture escaped a sharp fall it is likely to be hit in coming months due to impact of poor monsoons on Kharif crop
- For the full year FY10, we see upgrades of 0.2-0.4% to full year GDP growth

Growth in real aggregate demand by sector (%)



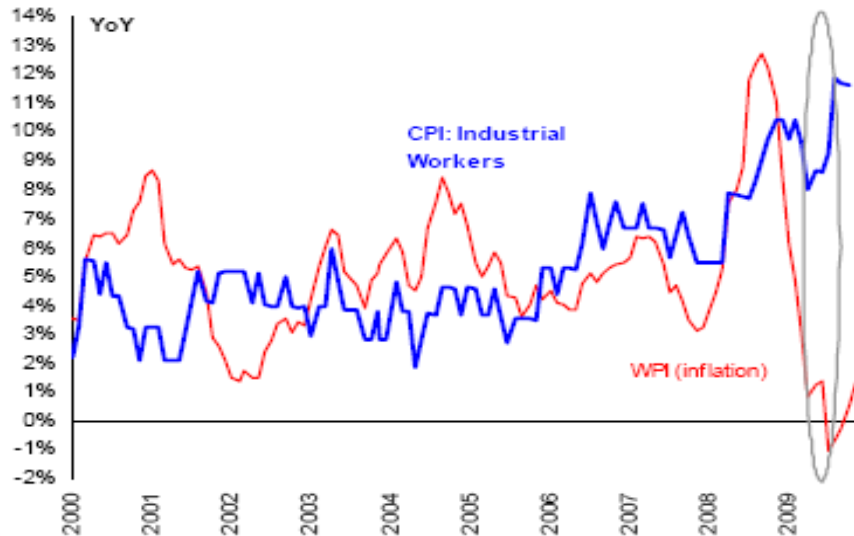
# Stimulus Rollback On The Horizon

**Edelweiss ET-Now Lead Indicator Index**



Edelweiss ET-Now Lead Indicator Index, a composite weighted average index with predictive ability of the core trends in the economy, has depicted a value of ~102 in Q3FY10, crossing the 100-mark for the first time since September 2007, implying a non-agriculture GDP growth of ~9% Y-o-Y in Q3FY10E

**Inflation (WPI and CPI, % change)**

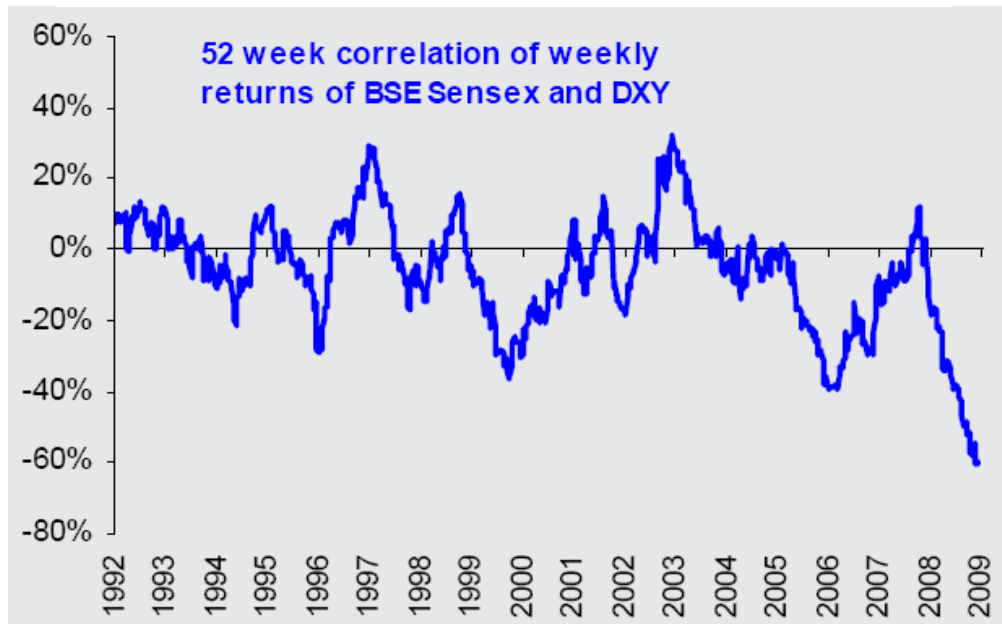


- Average Inflation, as measured by the Wholesale Price Index, was in positive territory for the second consecutive month, up 1.3% during October while the Consumer Price index remains elevated at 11.64% (at the end of September)
- With the Indian economy back in the growth zone and with inflation becoming the primary macro-concern, we expect stimulus to be withdrawn over CY2010
- In our view, the monetary policy tightening could commence in January 2010 and the tax cuts related to the three stimulus packages may start to be rolled back in FY2011 Union budget



# Inverse Correlation With Dollar - A Carry Trade?

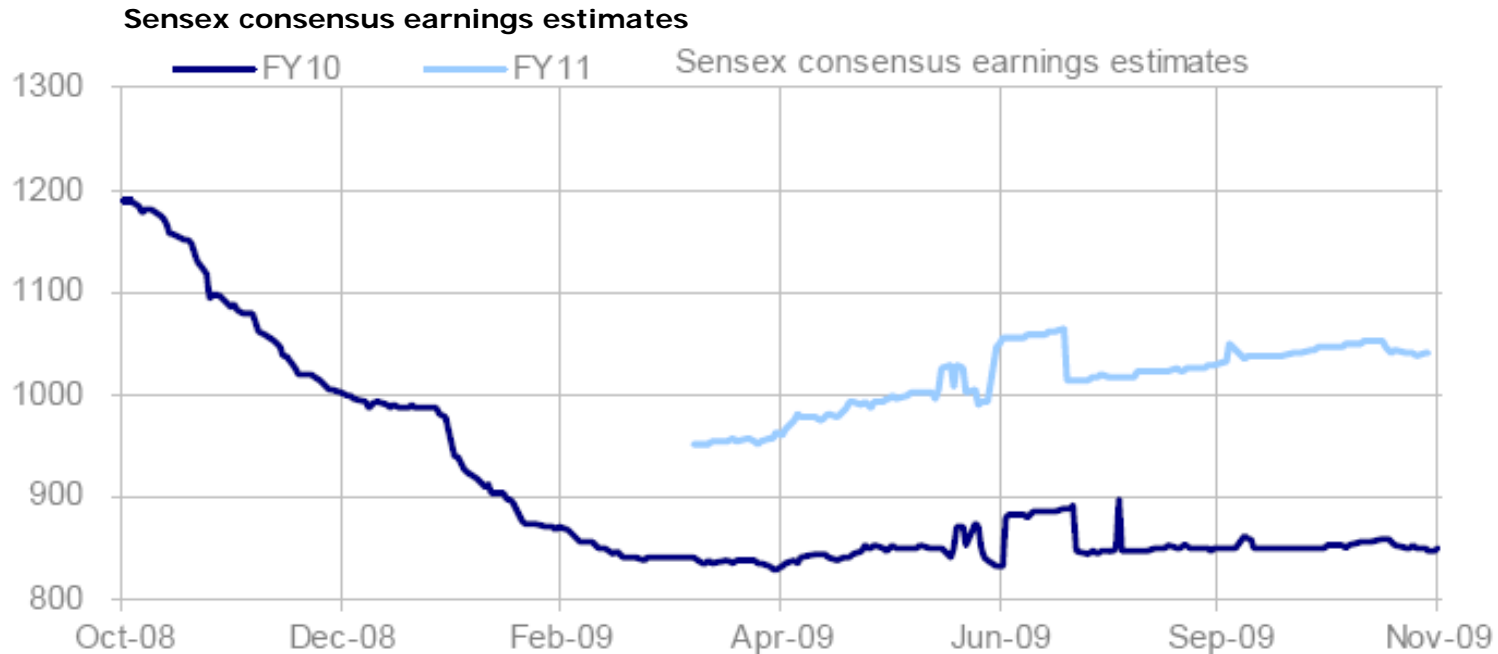
Sensex vs. DXY: High Inverse Correlation



- Indian equities have displayed a significant inverse correlation with value of US Dollar since the start of FY08 and the inverse correlation is reaching heightened levels
- Indian equities and for that matter, most risk assets could be at risk if the US Dollar starts to appreciate
- The US Dollar has been the funding currency for traders and speculators and a reversal in trend could lead to leveraged positions in risky assets being unwound



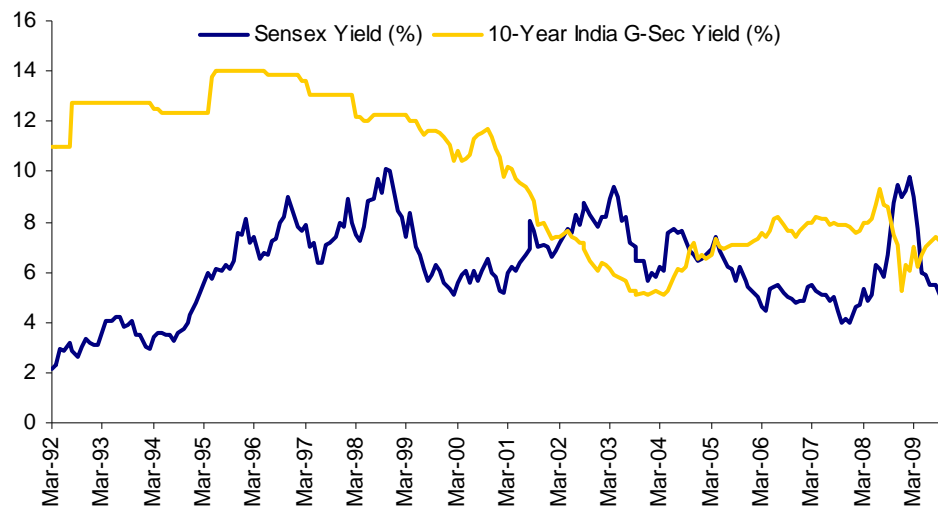
# Domestic Earnings - Full Year Expectations



- FY10 and FY11 consensus Sensex EPS estimate remained unchanged in the month.
- Consensus thus continues to expect a 2% decline in FY10 Sensex earnings over FY09 and a 22% growth in FY11 Sensex EPS over FY10.



# Valuations - Similar To Emerging Market Peers



- Nifty is currently trading at 22.8x its trailing earnings. It has thus moved to one Standard Deviation above its historic average trailing PE of 17.8x.
- 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 increased by 13 basis points over the previous month.
- The valuation surge is not unique to India. The MSCI Emerging Market Index is also trading at approximately 23.3x trailing earnings



# Looking Ahead...

- The macro environment continues to improve as is indicated by an improvement in economic growth numbers (4 quarter high growth reported in the latest quarter).
- 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.
- 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 inverse correlation between global markets and most risky assets versus the dollar remains very high and is a source of risk.
- 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

- The improvement in industrial activity is being partially offset by the weak monsoon; GDP growth likely to be 6.5% in FY10
- We expect earnings to be flat in FY10 over FY09. The current consensus forecasts a healthy 22% in FY11 but we would be cautious about visibility of this estimate as significant contribution comes from global cyclical
- 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
- The elevated valuation measures might reduce the returns to below earnings growth

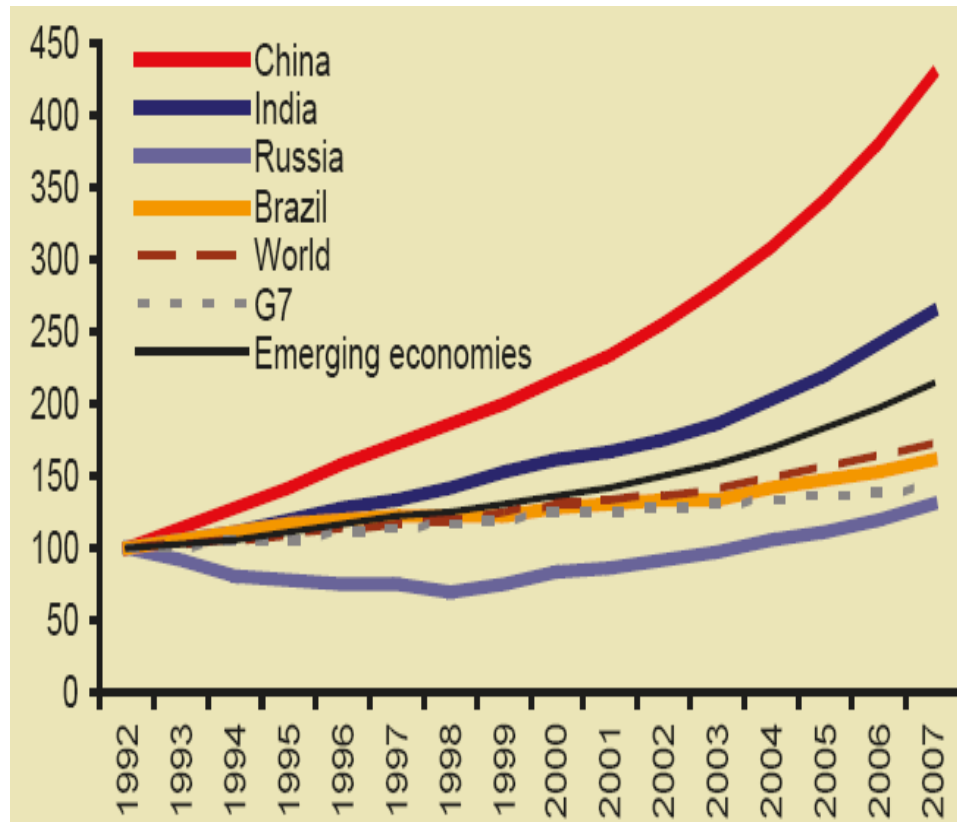
## Strategy for investors

- The valuations are edging above the comfort zone and hence further returns will have to be driven more by stock picking.
- Long term investors can continue with SIP

# The Long Term Case For Indian Equities

# India - Growth On The Fast Track

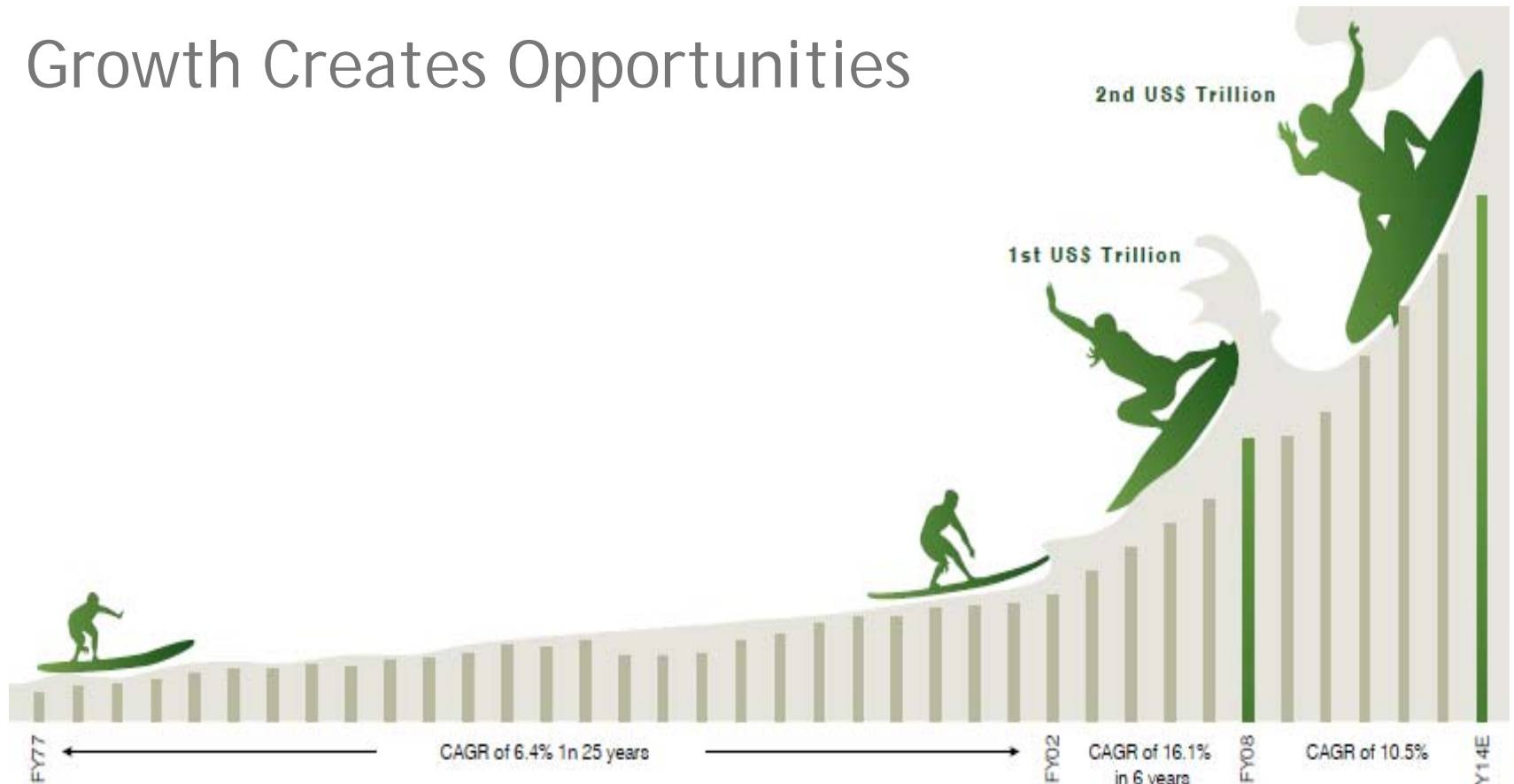
## GDP growth rebased to 1992



- 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

Source: IMF, IIFL Research

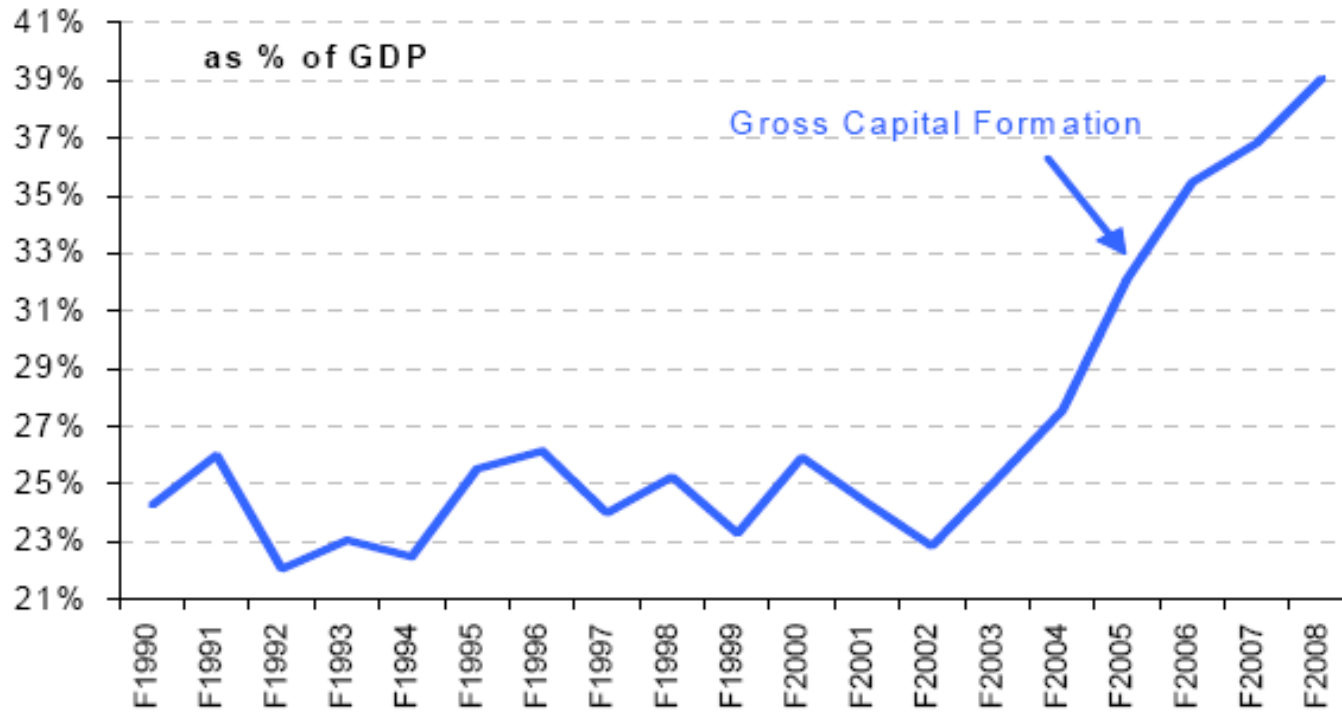
# Growth Creates Opportunities



- 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

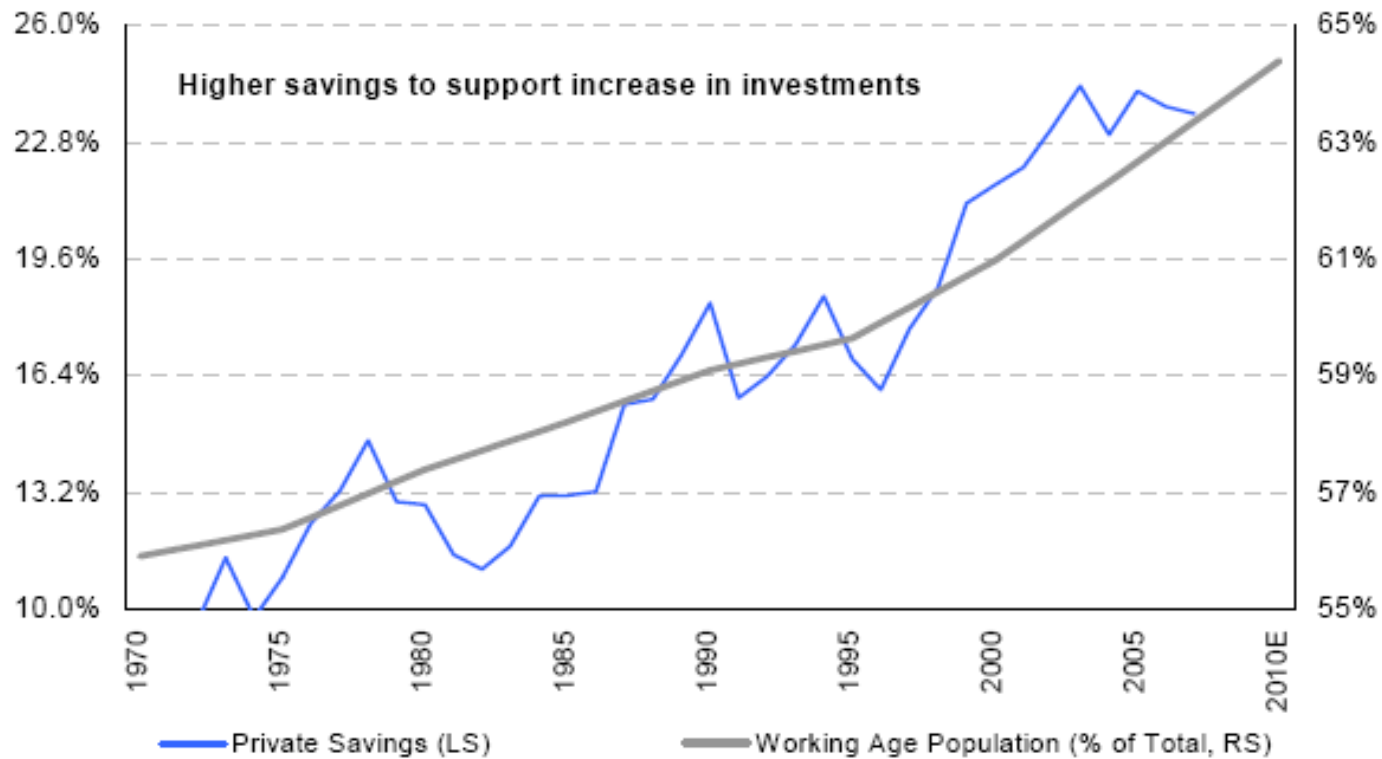


# Growth Is Being Led By A Rise In Capital Formation...



Source: CSO, Morgan Stanley Research

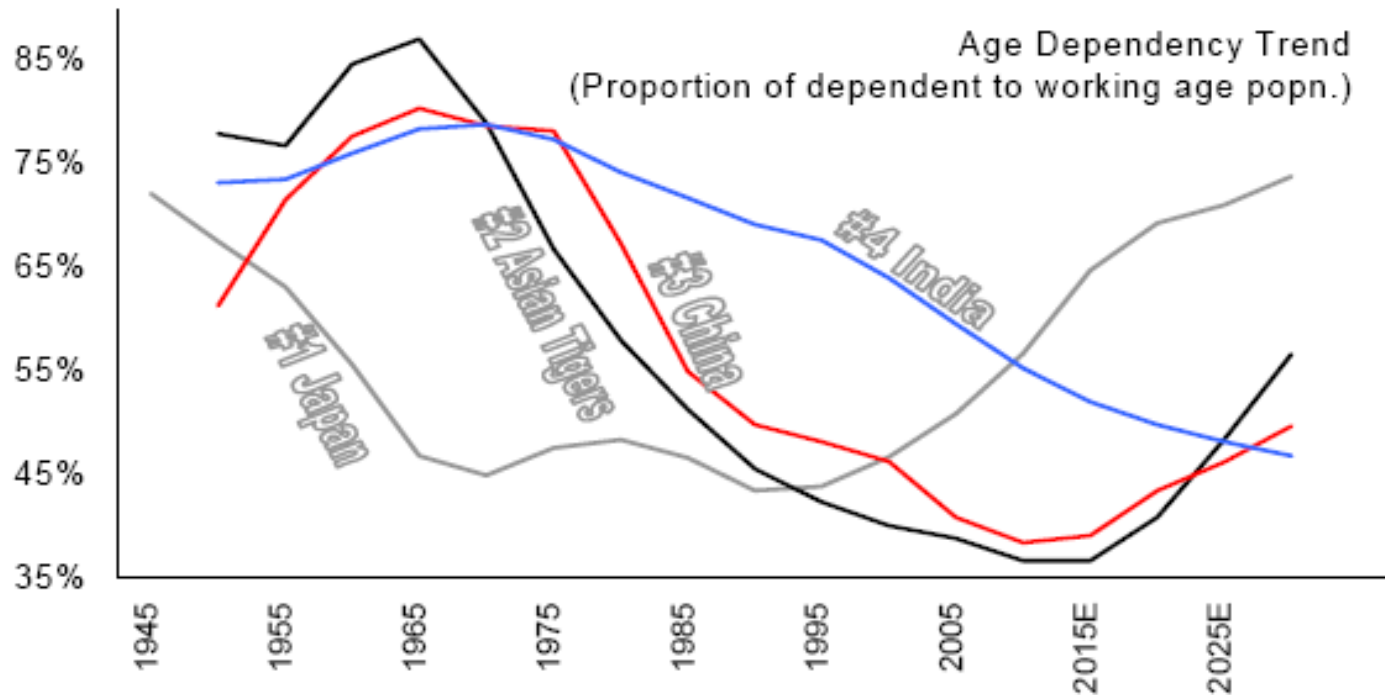
# ...Which Is Supported By A High Savings Rate



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

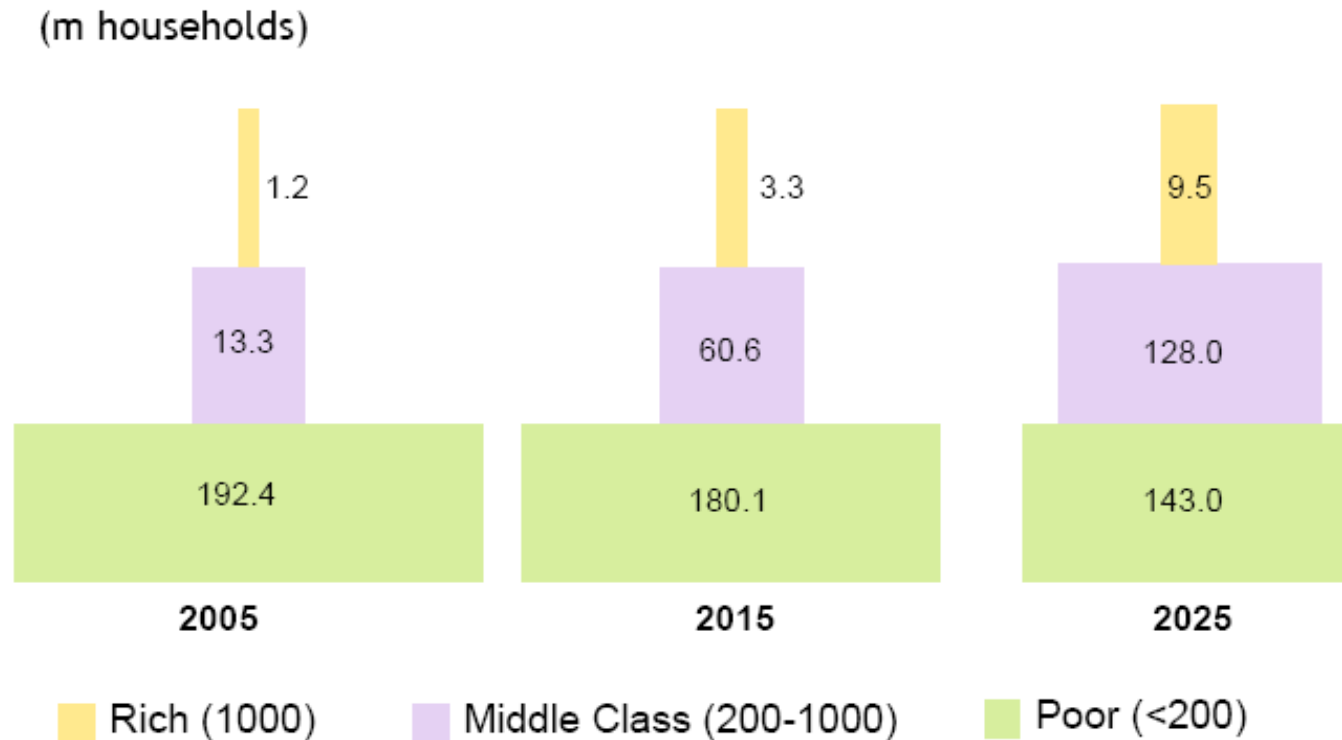


# India Is Poised To Reap Rich Demographic Dividend In Years To Come



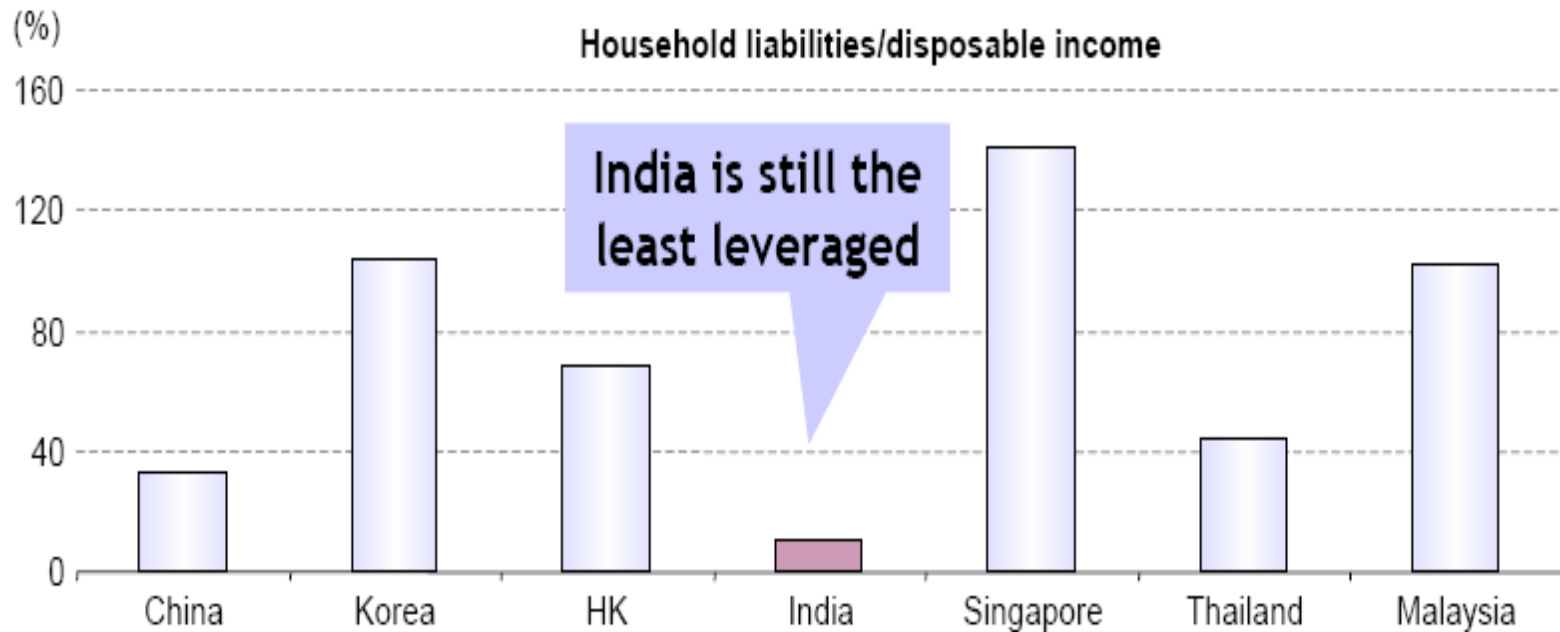
E= United Nations Research estimates Source: UN, Morgan Stanley Research

# 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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