

# Equity Markets : Current Environment and Outlook

Vetri Subramaniam, Head of Equity Funds  
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# Current Environment

- Global equity markets remained bullish in September, with the MSCI World Index rising by 9.11%.
- Indian markets outperformed the global trend, rising by 11.67% in the month of September.
- Commodity prices reflected the global trend in equities, with the benchmark CRB Reuters Jefferies total return index rising by 6.4%.
- Banking was the best performing sector followed by the Metal. Oil & Gas and Power sectors delivered the worst return for the month.
- FII inflows were at a record Rs.250bn in September 2010, while DIIs recorded outflows of Rs.129bn. MF remained net sellers to the tune of Rs.72bn.
- Trading Activity remained at elevated levels in September, with cash trading volumes (number of shares) rising by 12% MoM and the average open interest rising by 17% MoM to its highest level since Jan-08.

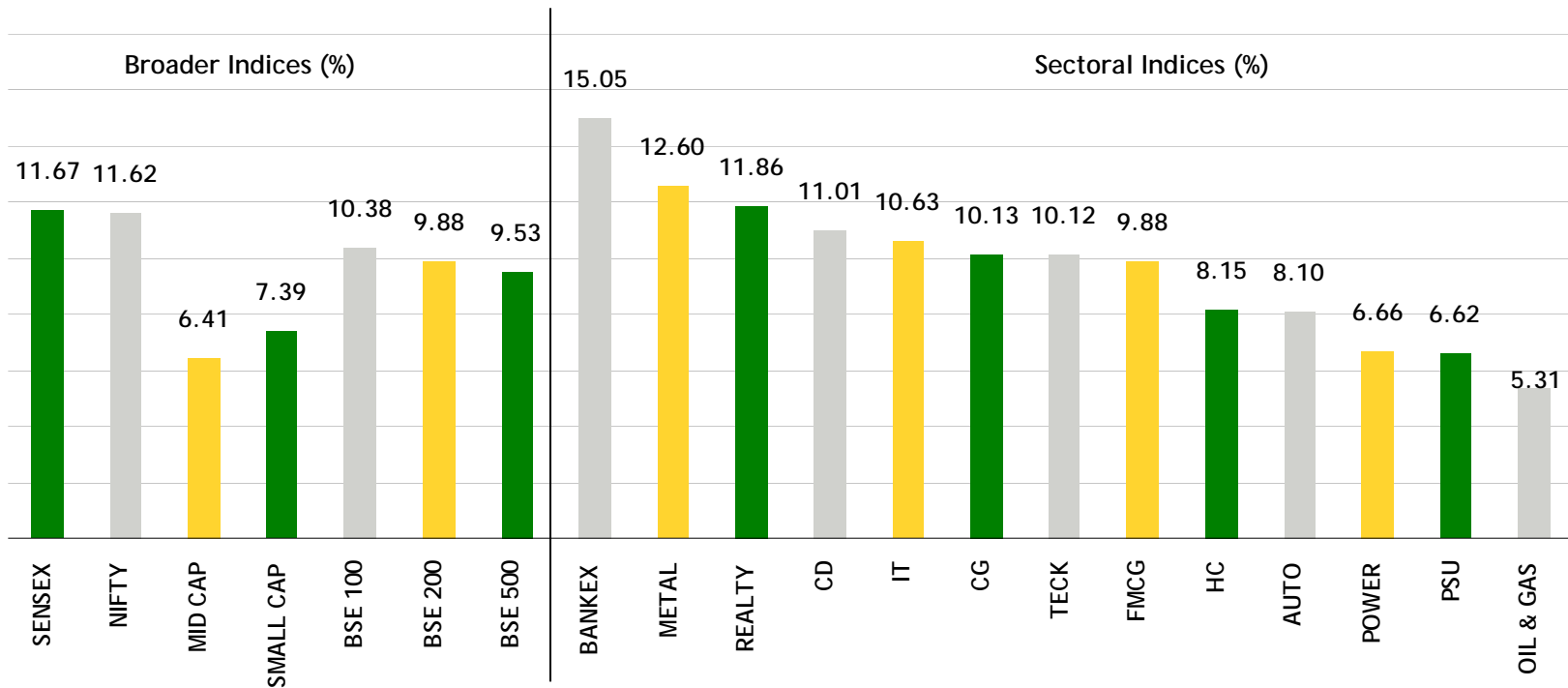
# Global Equities

Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	2655.66	0.64%	-18.96%	EM - Asia
BSE Sensex	India	20069.12	11.67%	14.91%	EM - Asia
Kospi	South Korea	1872.81	7.46%	11.29%	EM - Asia
Taiwan Weighted	Taiwan	8237.78	8.16%	0.61%	EM - Asia
Thailand SET 50 Index	Thailand	674.42	8.31%	29.52%	EM - Asia
Jakarta Composite Index	Indonesia	3501.30	13.61%	38.15%	EM - Asia
KLSE	Malaysia	1463.50	2.88%	14.98%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	69429.78	6.58%	1.23%	EM
Mexico IPC	Mexico	33330.34	5.21%	3.77%	EM
Russian RTS Index	Russia	1507.66	6.08%	4.36%	EM
Philippine PSEi	Philippines	4100.07	14.97%	34.31%	EM
Merval Buenos Aires Index	Argentina	2643.42	13.12%	13.90%	EM
HangSeng	Hong Kong	22358.17	8.87%	2.22%	Developed - Asia
Nikkei	Japan	9369.35	6.18%	-11.16%	Developed - Asia
Strait Times	Singapore	3097.63	4.99%	6.90%	Developed - Asia
Dow Jones	USA	10788.05	7.72%	3.45%	Developed
CAC 40 Index	France	3715.18	6.43%	-5.62%	Developed
All Ordinaries Index	Australia	4636.90	4.46%	-5.03%	Developed
DAX Index	Germany	6229.02	5.13%	2.99%	Developed
Swiss Market Index	Switzerland	6296.33	1.87%	-3.81%	Developed
FTSE 100	UK	5548.62	6.19%	2.51%	Developed
MSCI World Index	--	1179.19	9.11%	0.92%	--

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



# India : Sector performances



- Sensex rose by 11.67% over the previous month. MidCaps underperformed LargeCaps with a 6.41% gain for the MidCap index.
- Banking was the best performing sector followed by the Metal.
- Oil & Gas and Power sectors delivered the worst return for the month.



\*Source: BSE,NSE. one month performance as on 30<sup>th</sup> September 10.

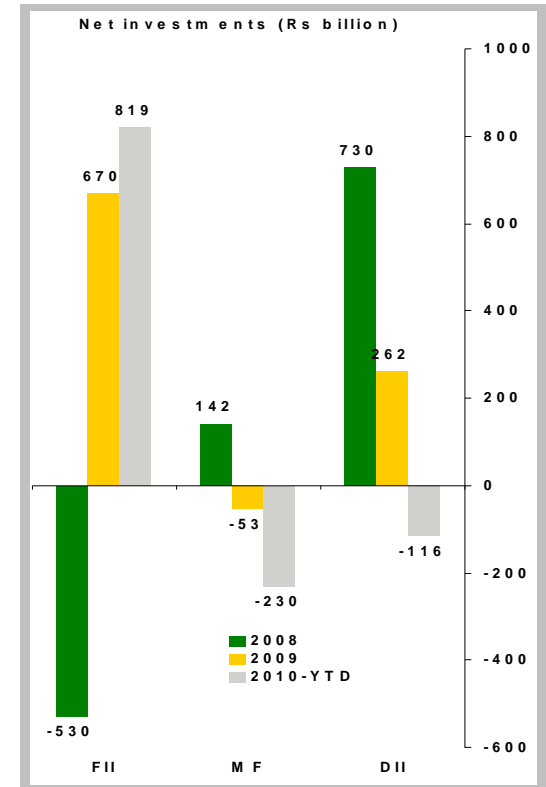
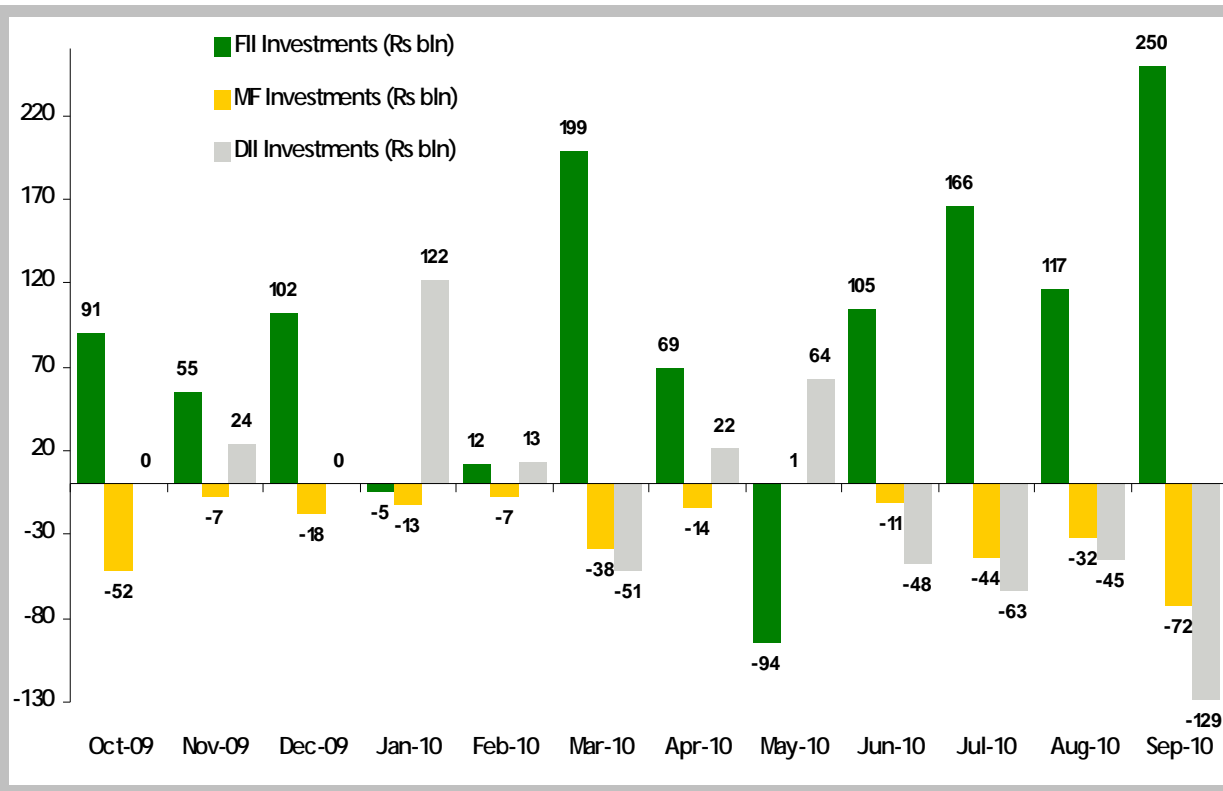
# Top Gainers / Losers - Nifty

Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
DLF	519.9 / 254.5	378.2	25.25
Tata Steel	739 / 433.2	651.85	24.71
Siemens	846.8 / 485.3	823.45	18.89
Hindalco Inds.	205.4 / 106.3	197.05	18.42
St Bk of India	3288 / 1863.1	3240.45	17.14
Top Losers for the month			
Losers	52 week H/L	Last Price#	% Loss*
Power Grid Corpn	121.45 / 95.05	106.5	-2.11
B P C L	840 / 481.8	749.55	-1.54
Cairn India	368.05 / 248.1	335	0.74
Reliance Capital	972.9 / 611.1	780.4	2.90
B H E L	2603.65 / 2103.05	2478.5	2.99

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



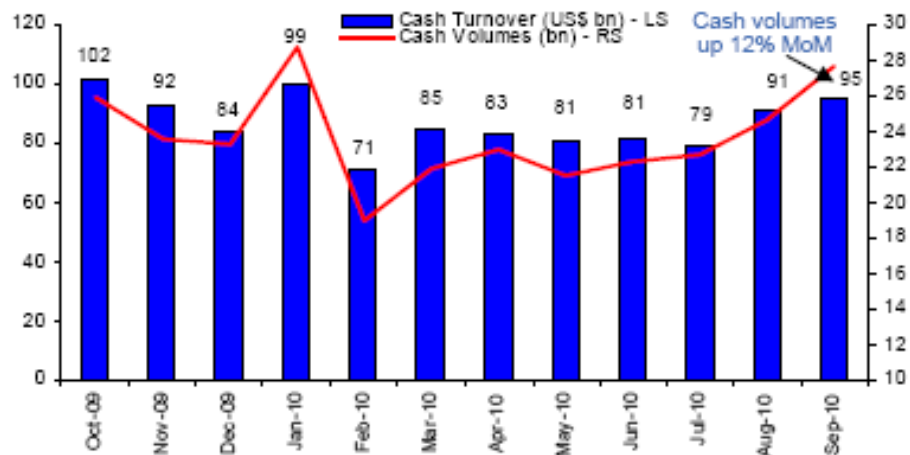
# FII & DII Inflows



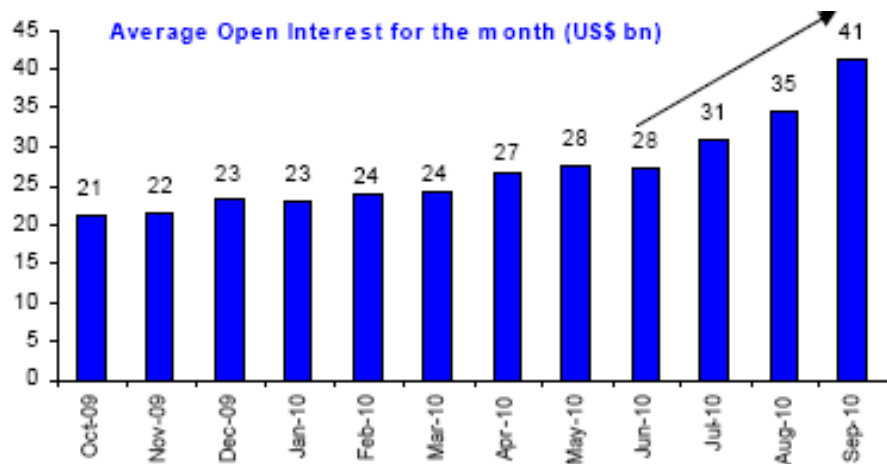
- FII inflows were at a record Rs.250bn in September 2010. FII inflows have remained positive on a YTD basis at Rs.819bn for CY10 after a Rs.670bn inflow in CY09.
- DIIs recorded outflows of Rs.129bn. MF remained net sellers to the tune of Rs.72bn.

# Market Activity

## Cash Trading: Turnover and Volumes



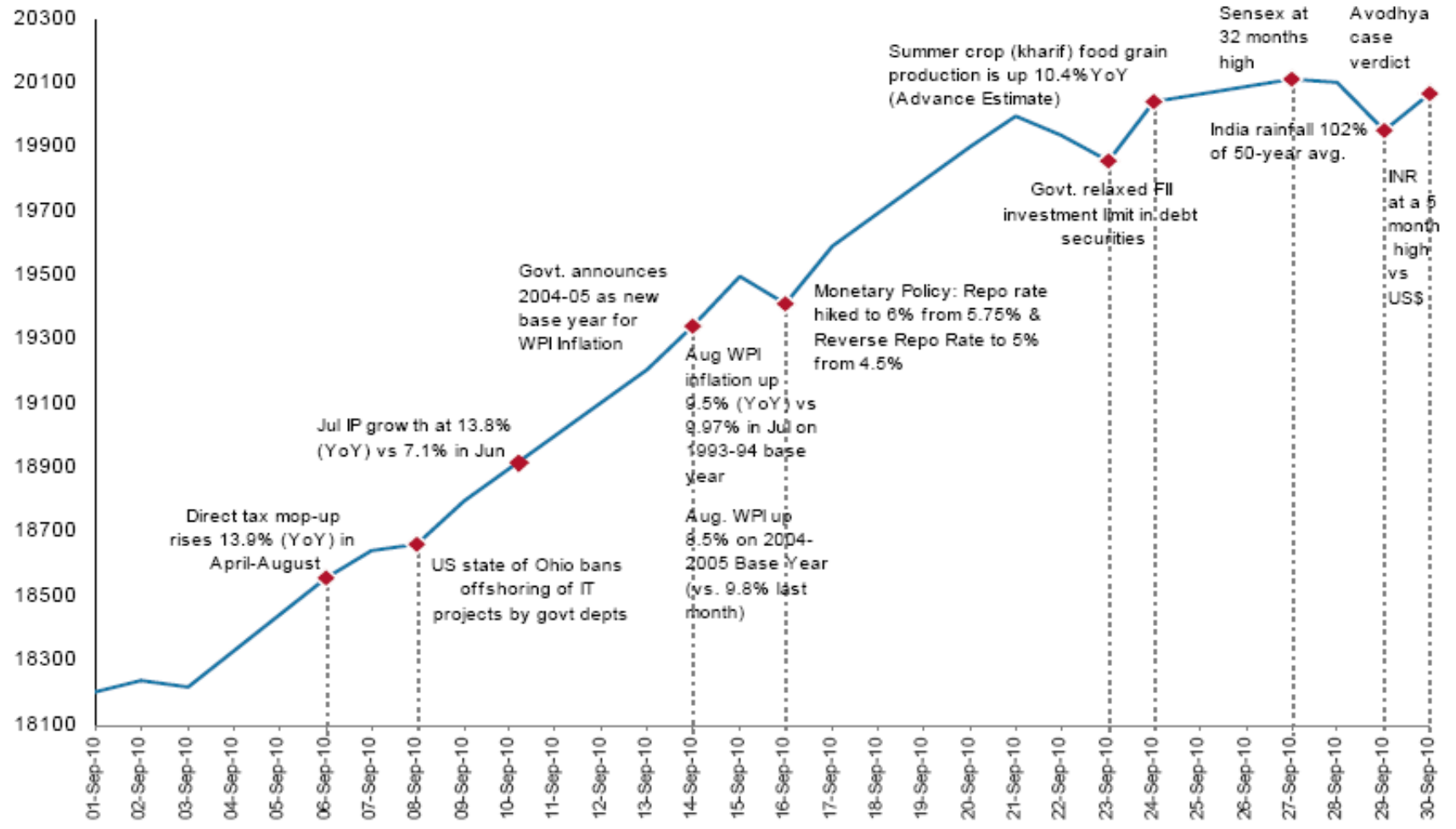
- In September, cash trading volumes (number of shares) increased by 12% MoM.



- At the end of September, average open interest increased 17% MoM to its highest level since Jan-08.



# September 2010 events timeline



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

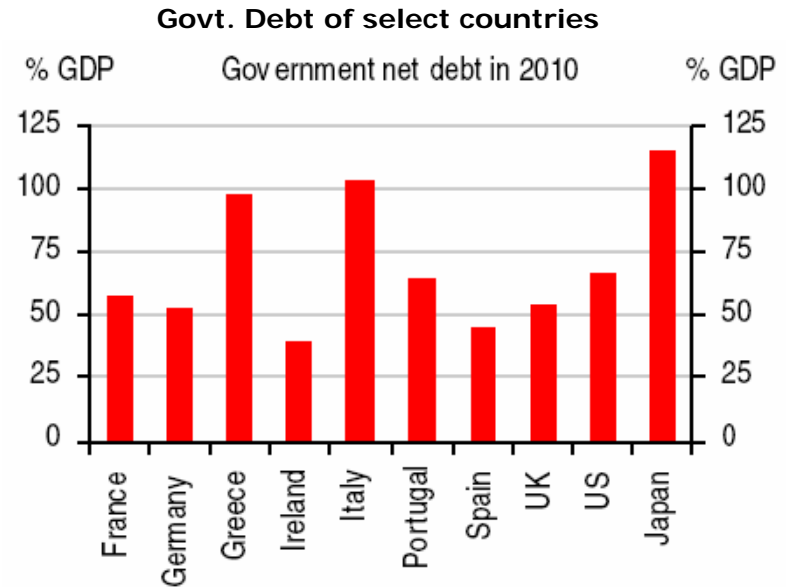
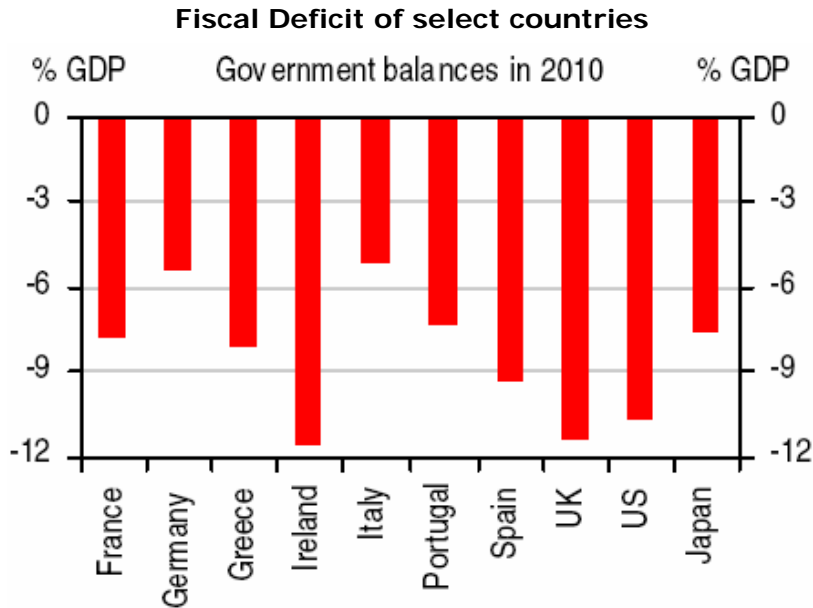


# Religare MF: Equity Market Outlook and Opportunities

# Equity Market Outlook

- Global economic recovery is not as swift as it should be (considering historical rebounds from recession).
- The key reason for the same is that the developed countries growth (which represent a large chunk of Global GDP) remains anemic, mainly due to high levels of indebtedness as well as the elevated levels of fiscal deficits.
- In contrast, the developing countries are growing at a fast clip; the Indian economy, is expected to grow at 8.2% in FY12E, which is far superior to 4% growth in World GDP and 1.8% growth in US GDP in similar period.
- However, a consistent increase in Core Inflation is one of the key risks, which can de-rail higher economic growth.
- The other potential worry remains the current account deficit (CAD), which widened to US\$13.7bn (4% of GDP, annualized) in QE-Jun 10 compared with a deficit of US\$13bn in QE-Mar 10.
- The US Dollar correlation with other asset classes re-asserted itself this month with US Dollar dropping on talks of another round of quantitative easing even as all other assets-equities, commodities and other currencies rallied.
- Analysts expect Sensex companies (ex oil & gas) to grow their revenues and profits by 21% and 18% on a YoY basis respectively, in September 2010 qtr.
- Consensus earnings expectations for FY11 & FY12 have remained unchanged during the month, with an expectation for a 29% growth in FY11 Sensex EPS over FY10 and a 20% growth in FY12E Sensex EPS over FY11E.

# Global GDP Recovery - Slowed Down By High Debt And Fiscal Deficits



- The pace of economic recovery in the developed countries (which represent a large chunk of Global GDP) remains anemic, despite the large doses of stimulus by government authorities.
- The key reason for the slower pace of global growth is high levels of indebtedness as well as the elevated levels of fiscal deficits in the developed world.
- In contrast, the developing countries have improved upon many of the above parameters and are now better than the developed world in terms of fiscal deficit and government indebtedness.
- This also partially explains the swift pace of economic recovery in developing nations.



# Expectations of US easing have started building

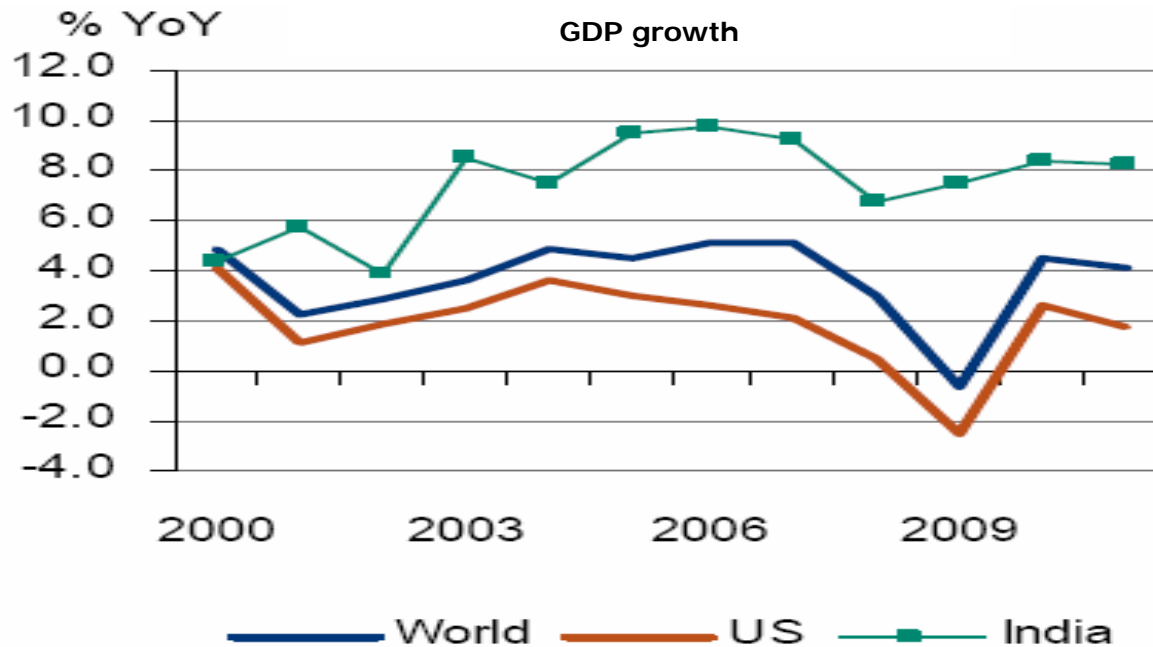
Dollar Spot Value Versus A Basket Of Currencies



- US dollar index has dropped on expectations of another round of quantitative easing, while most other asset classes – commodities (+6.4%), equities (9.1%) and currencies (+6.2%) - have rallied.

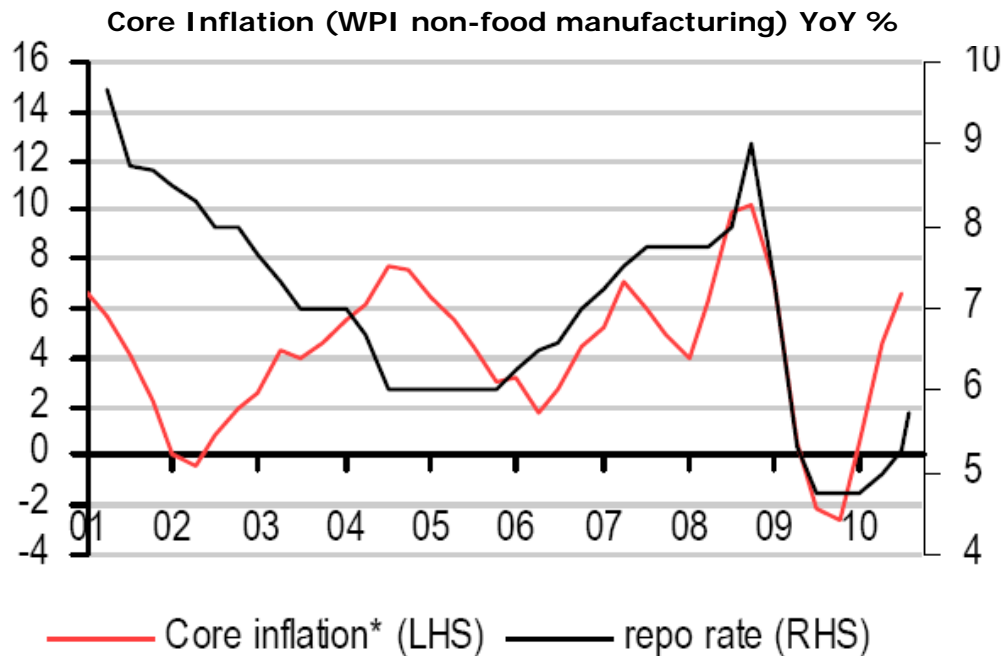


# India To Continue To Outperform Global Economic Growth



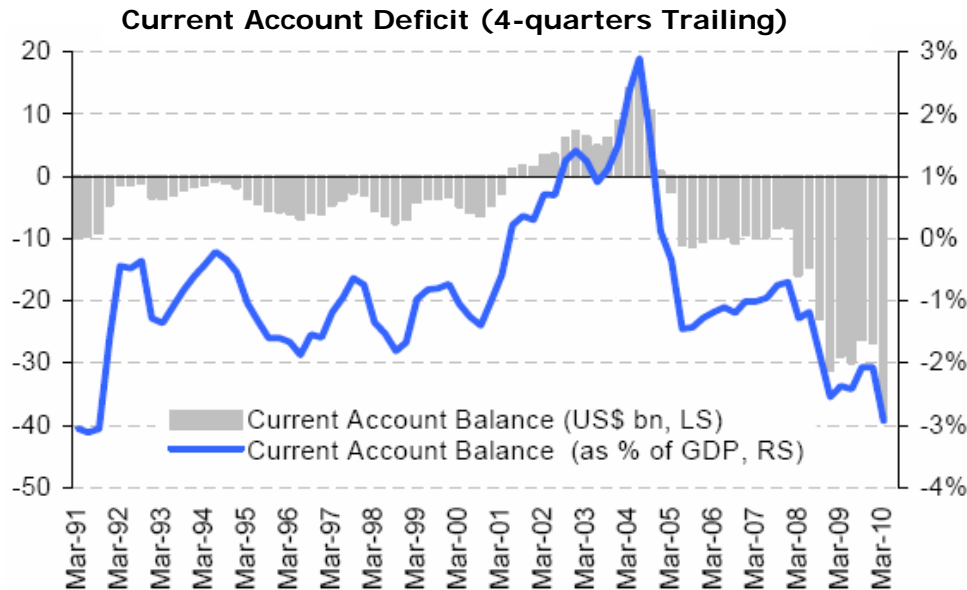
- Indian economy is expected to grow at 8.2% in FY12E, which is far superior to 4% growth in world GDP and 1.8% growth in US GDP in the similar period.
- Key reasons for India's economic resilience are a reasonable interest rate regime (rates are lower than that in FY09, when the growth rates had dipped substantially) and aggregate demand depending mainly on domestic demand.

# Potential Party Poopers - High Inflation



- Consistent increase in Core inflation is one of the key risks, which can de-rail higher economic growth.
- Markets expect the core inflation to remain at elevated levels due to the following reasons:
  - Govt has raised the Minimum Support Prices (MSP) for various important crops by 5-30%, and
  - Consistent increase in demand in spite of higher prices, resulting in sustainability of the higher price levels.
- However, RBI is trying to temper inflation being caused by higher aggregate demand by raising the benchmark interest rates.

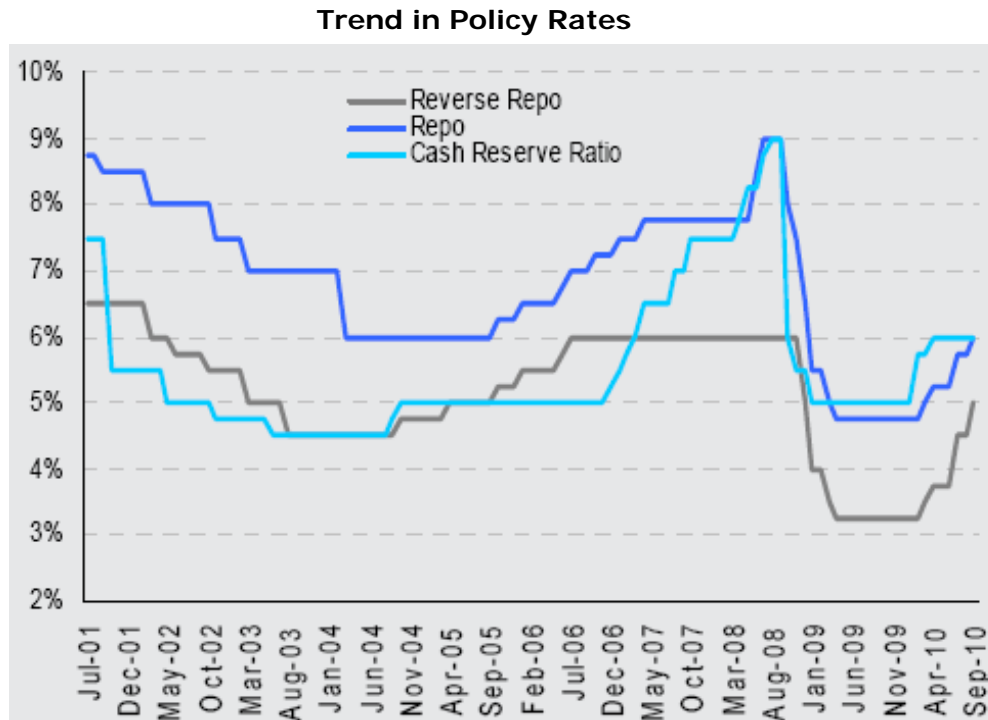
## Potential Party Poopers – High Current Account Deficit



- The current account deficit (CAD) widened to US\$13.7bn (4% of GDP, annualized) in QE-Jun 10 compared with a deficit of US\$13bn in QE-Mar 10. Even the four quarter trailing current account deficit is an all time high of around 3% of GDP.
- The decline in CAD was due to increase in both trade deficits as well as a decline in net invisibles inflow.
- Thus, Trade deficit widened further to US\$34.2 bn (10% of GDP, annualized) during QE-Jun 10 an increase of 33.4% YoY, while the Net Invisibles declined 3.4% YoY.
- The deficit balance was funded by an increase in capital flows, both FDI as well as FII.
- We feel a deterioration in CAD can lead to inflationary pressures leading to a rise in interest rates.



# RBI Continues To Hike Rates

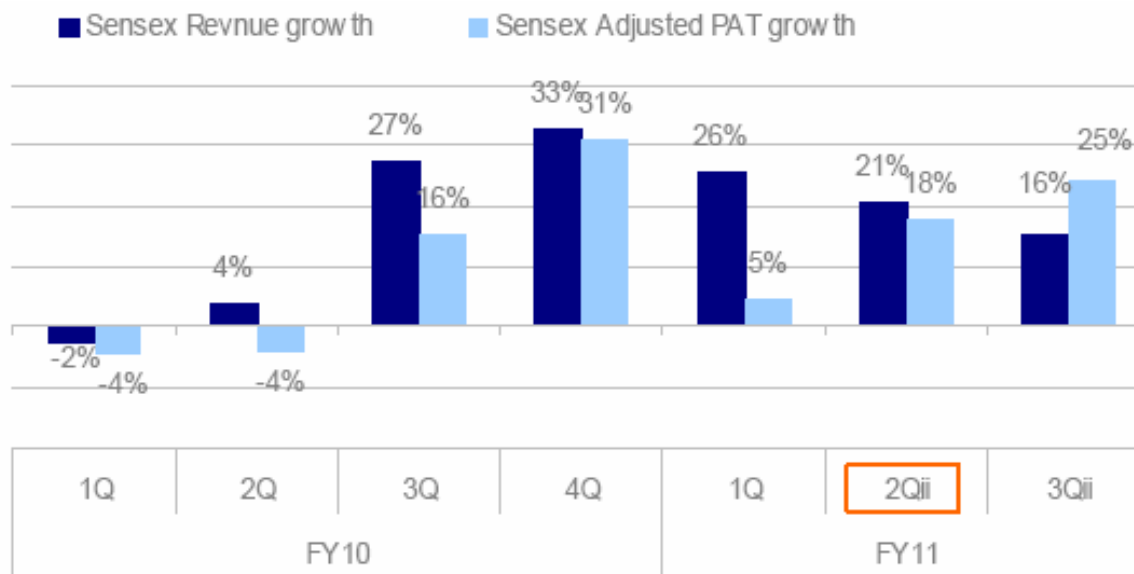


- The Reserve Bank of India (RBI) in its mid-quarter review of monetary policy hiked the repo rate by 25 bps to 6% and the reverse repo rate by 50 bps to 5% vs. consensus expectations of a 25 bps hike in both these rates.
- The policy statement highlighted that the recovery is consolidating and the economy is rapidly converging to its trend rate of growth.
- We expect the RBI to hike policy rates further by about 50 bps in FY11.



# Earnings Preview - September 2010E earnings expected to grow strongly

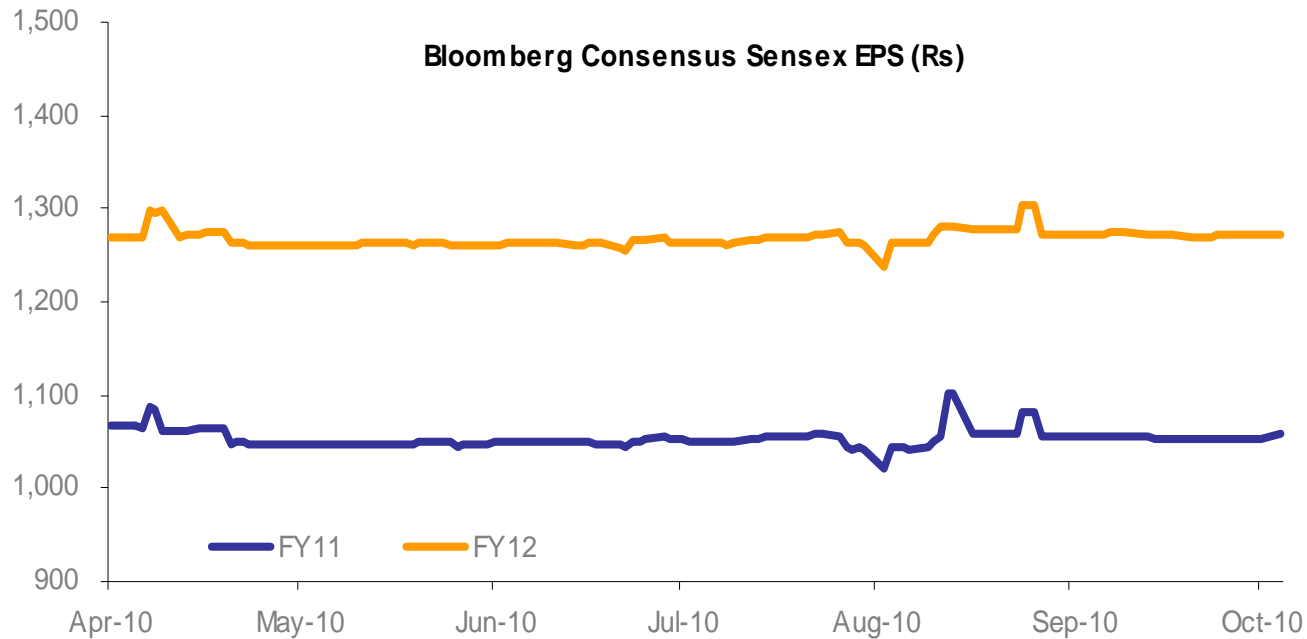
Sensex ex-oil Sales and Earnings Growth September 2010 Qtr Estimates



- Analysts expect Sensex companies (ex oil & gas) to grow their revenues by 21% on a YoY basis in September 2010 qtr, which is lower than the 26% revenue growth reported in June 2010 qtr.
- However, the profit growth is expected at 18% on a YoY basis in September 2010 qtr, which is higher than the 5% profit growth reported in June 2010 qtr.
- Rising input costs and lagged price increases are expected to reflect in margin compression.

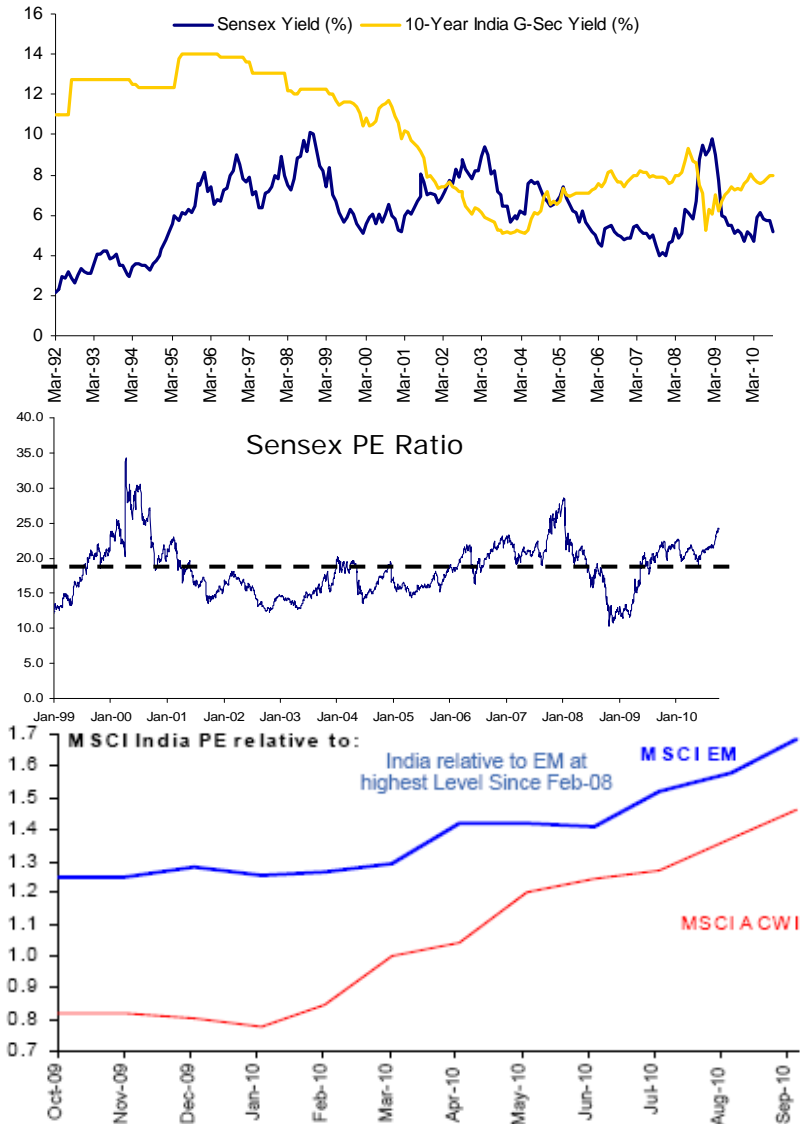


# Earnings - No Material Changes In Expectation



- Consensus earnings expectations for FY11 & FY12 have remained unchanged during the month.
- Consensus expects a 29% 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 increased materially by 55 basis points over the previous month.
- Sensex is currently trading at 24.2x its trailing earnings. The gap between the current multiple and historical 10-year average trailing PE of 18.5x has widened substantially in the month.
- India's PE premium to MSCI Emerging markets remains at elevated levels, and it is now at around 70% premium (compared to 60% premium in the previous month) to MSCI EM PE currently.



# Looking Ahead...

- India's real GDP grew ~8.8% Y-o-Y in Q1FY11, driven by non-agri GDP, which expanded at ~9.9% Y-o-Y, with healthy growth momentum in industry (at 10.3% Y-o-Y) and services sector (at 9.7% Y-o-Y).
- Foreign investors continue to aggressively buy into the Indian market with total FII inflows of about \$5.4bn in the month. However, domestic investors pulled out \$2.8bn out the market in the same period. Thus liquidity flow into the market remains strong.
- In a bid to control inflation, The Reserve Bank of India (RBI) in its mid-quarter review of monetary policy hiked the repo rate by 25 bps to 6% and the reverse repo rate by 50 bps to 5% vs. consensus expectations of a 25 bps hike in both these rates.
- We have revised our expectation to a further 50bps of policy hikes from the RBI during the current fiscal.
- While India's beta relative to the rest of the world has come down, the correlation between global equity markets remains high – this is a source of both upside as well as a downside risk for our markets.
- The US Fed policies to the extent that they cause commodities to rally would have implications for inflation and exchange rates in India and across the world.
- The gains in Indian markets over the last 12 months can be explained largely by earnings growth but with markets at 17.5x forward 12 months earnings further earnings upgrades will be required to drive the market higher. India's premium to the region has also expanded.
- Our focus remains on stock picking and sector allocation for generating alpha, but we expect macro trends to increase their influence in the months ahead.

# Investment view

## Short term

- GDP growth likely to be above 8% in FY11.
- The current consensus forecasts a healthy 28% growth in FY11, but we would be cautious about visibility of this estimate as a significant contribution comes from global cyclicals.
- Valuations are near the top end of the comfort zone; but supported by the prospect for continued earnings growth
- However, without significant earnings upgrades 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.

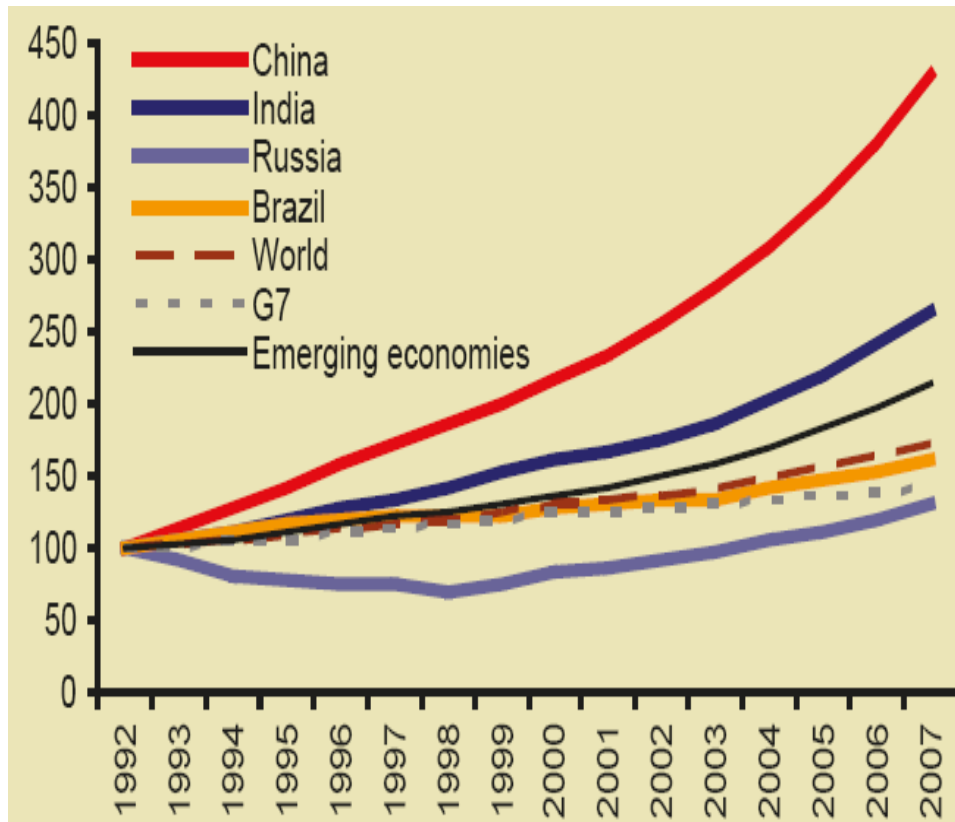
## Strategy for investors

- The valuations are above historical averages, are also at a premium to the region
- Global correlations remain a source of risk but 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

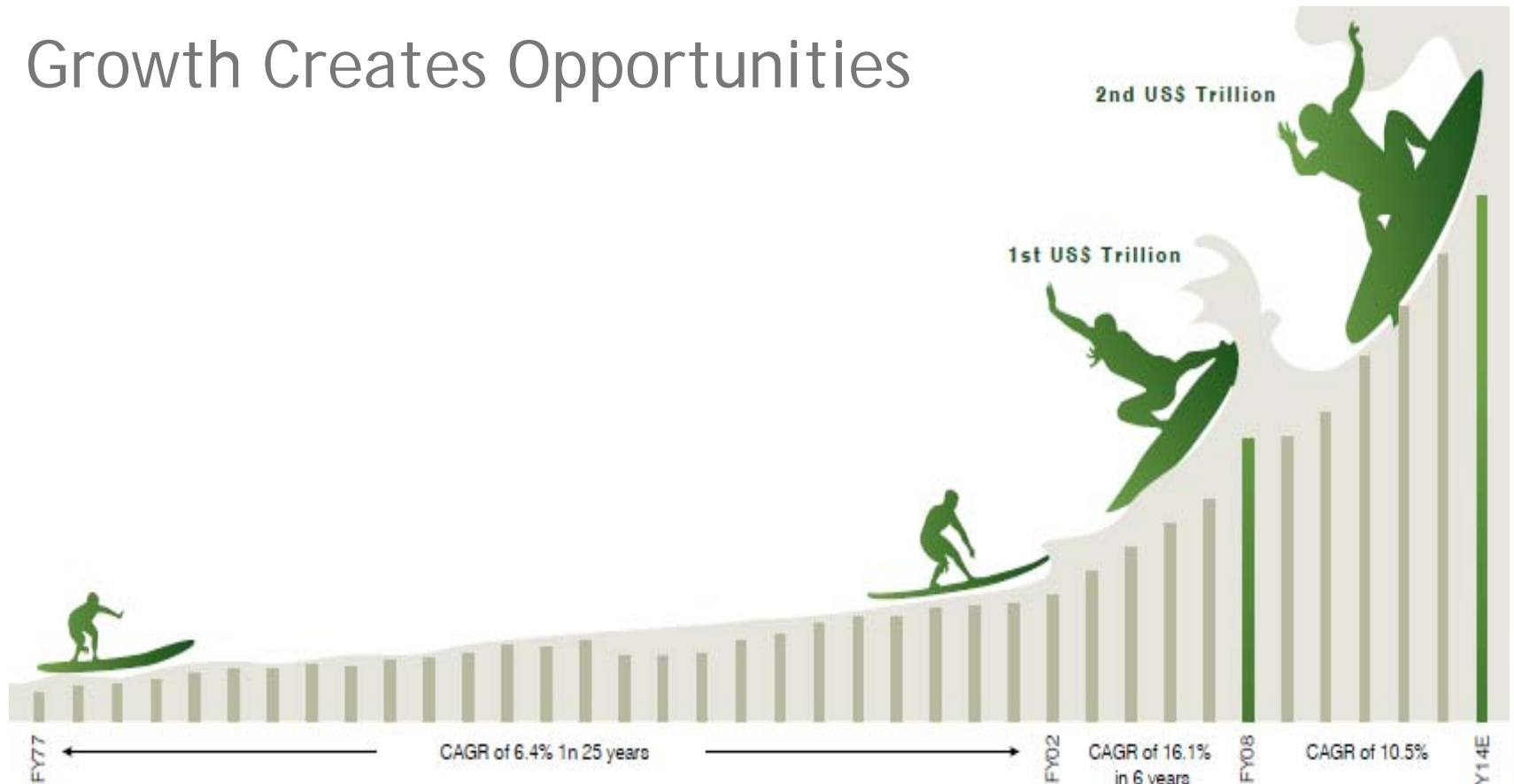
## GDP growth rebased to 1992



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

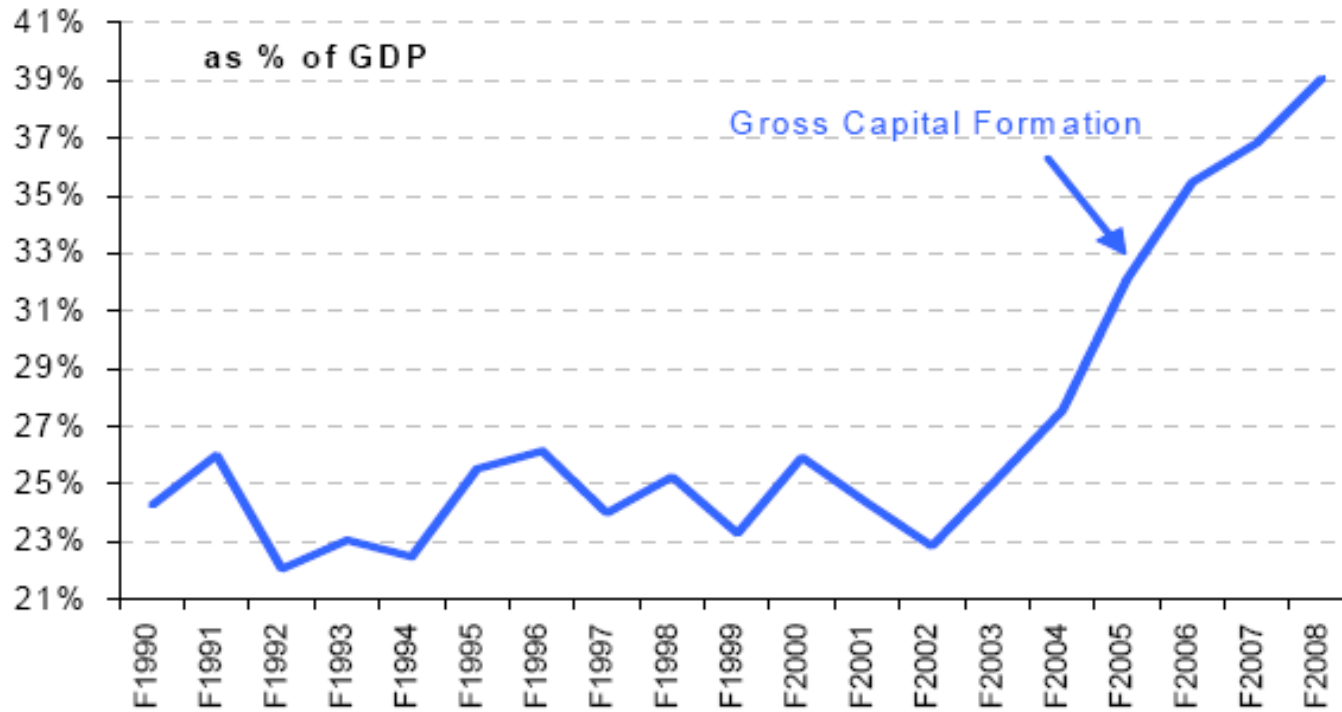
# Growth Creates Opportunities



- 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



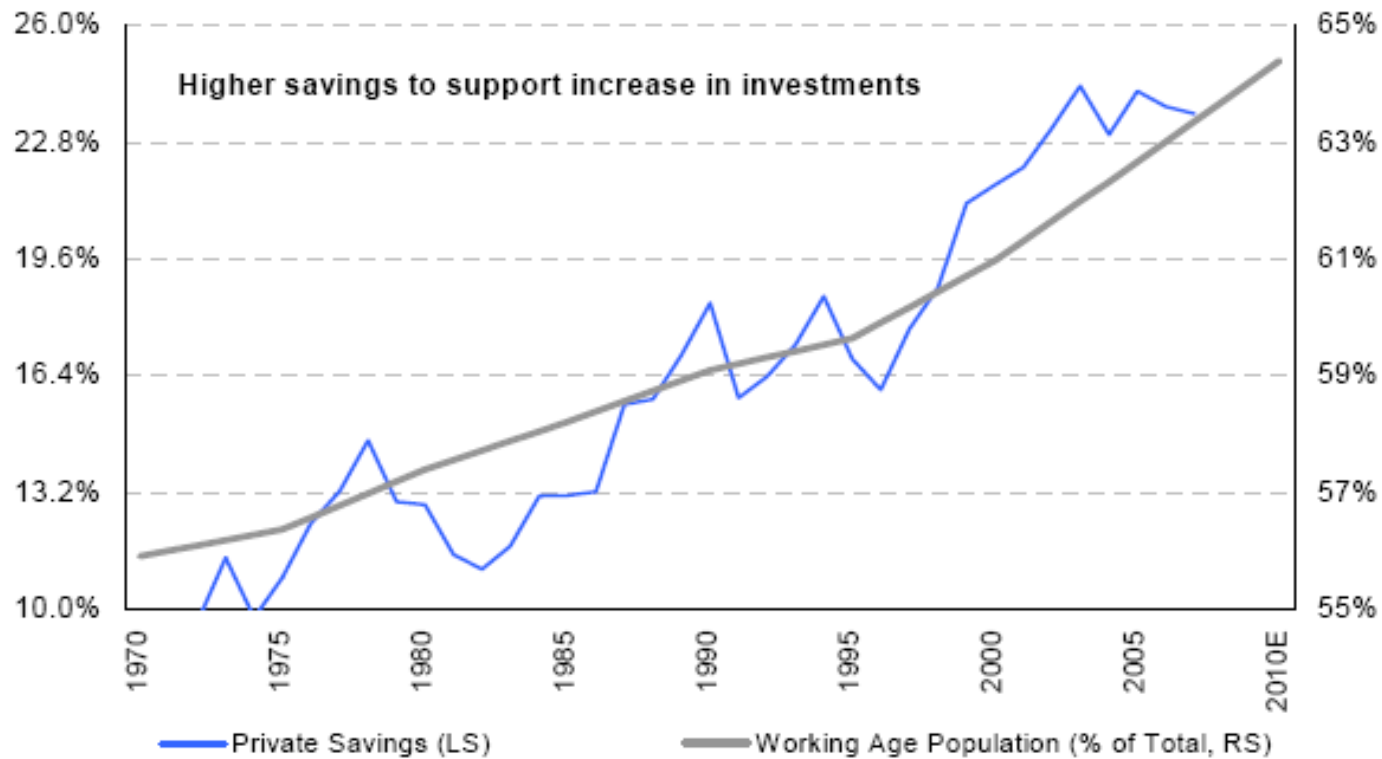
# Growth Is Being Led By A Rise In Capital Formation...



Source: CSO, Morgan Stanley Research



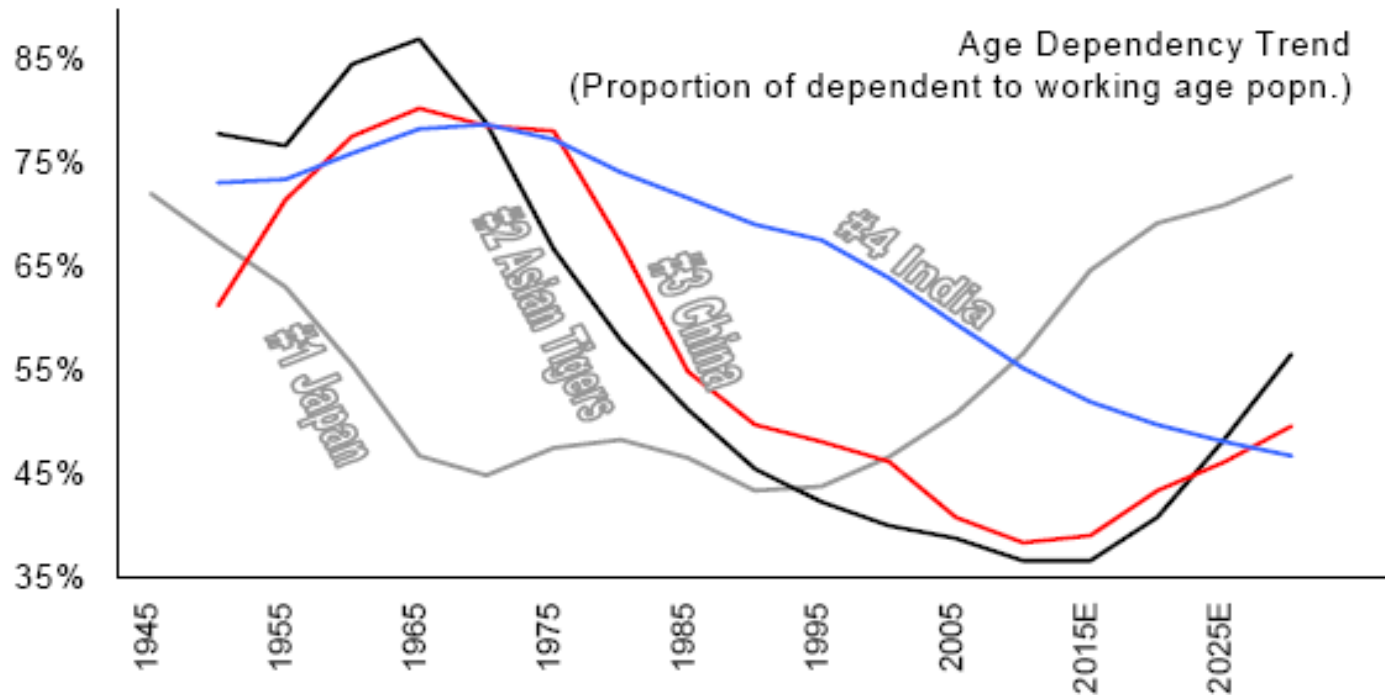
# ...Which Is Supported By A High Savings Rate



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



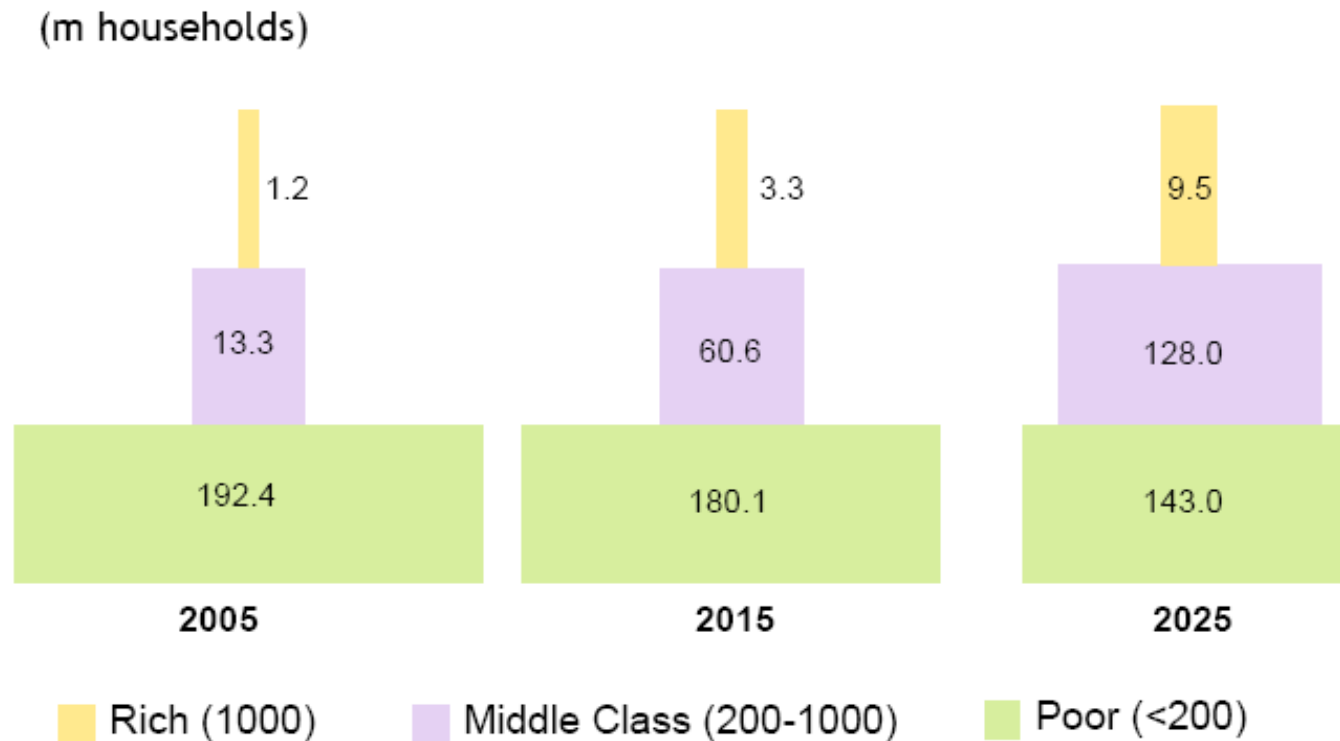
# India Is Poised To Reap Rich Demographic Dividend In Years To Come



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

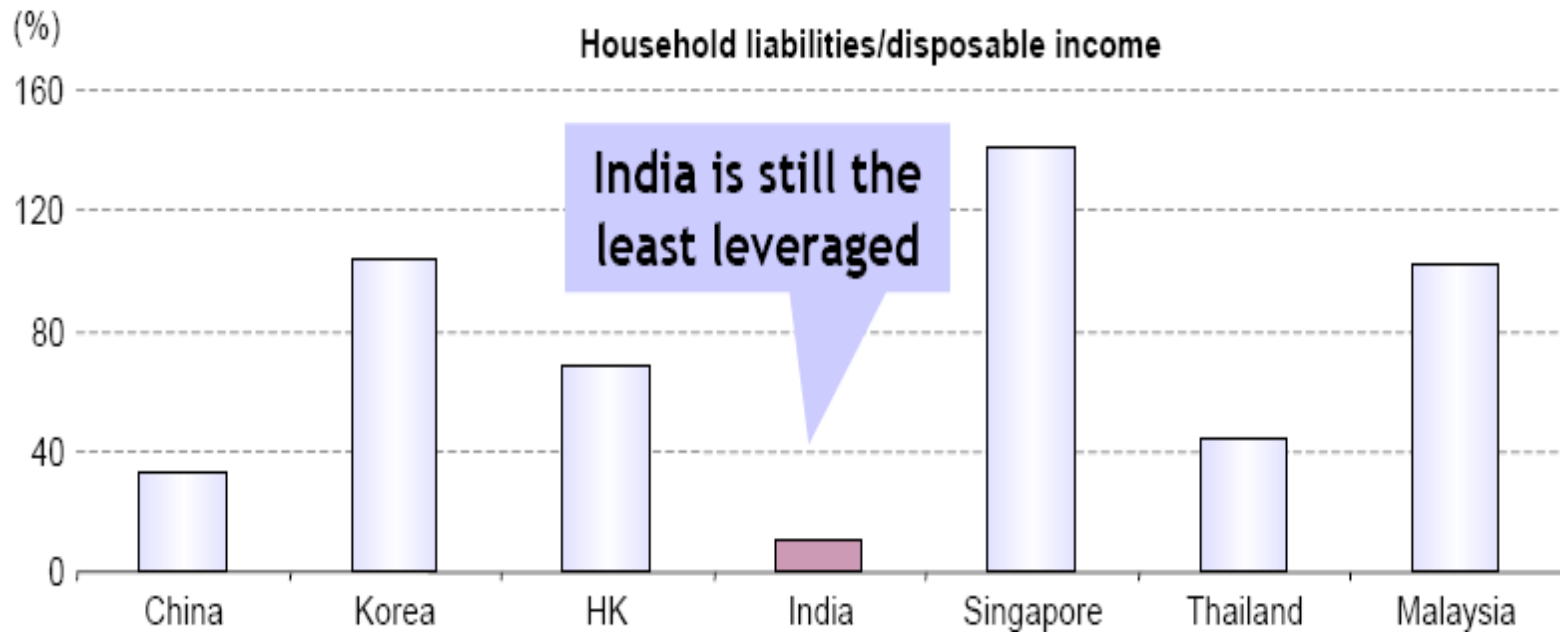


# Income Imbalance To Correct Leading To Rise In Consumption



Source: IDFC SSKI

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



Source: IDFC SSKI

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