Equity Markets :
Current Environment and Outlook

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February 2010

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Current Environment

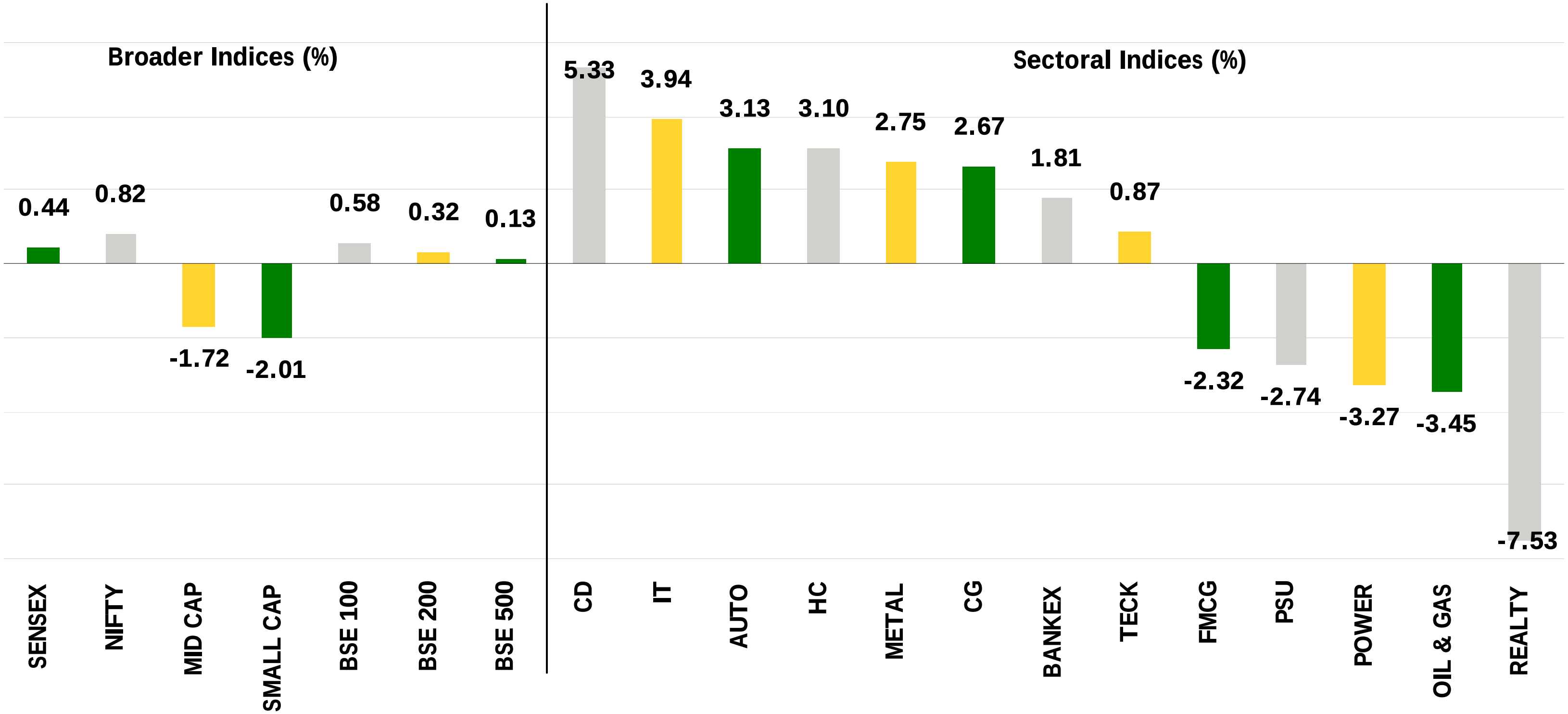
- Equity markets across the globe remained strong, with the MSCI World Index rising by 1.23%.
- Indian markets underperformed the global trend, rising by 0.44% in the month of February.
- Commodity prices recovered from the previous months sharp fall, with the benchmark CRB Reuters Jefferies total return index rising by 5.5%.
- In India, Consumer Durables was the best performing sector followed by the IT sector. Realty and Oil & Gas sectors delivered the worst return for the month.
- FII inflows were at Rs.12bn in February 2010, after declining in previous month. DIIs recorded inflows of Rs.13.4bn, while MF were net sellers to the tune of Rs.7bn.
- Activity was muted in the run-up to the budget, cash trading volumes (number of shares) declined 34% MoM but the average open interest increased 4% MoM to a record high.

Global Equities

Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	3051.94	2.10%	-6.87%	EM - Asia
BSE Sensex	India	16429.55	0.44%	-5.93%	EM - Asia
Kospi	South Korea	1594.58	-0.49%	-5.24%	EM - Asia
Taiwan Weighted	Taiwan	7436.10	-2.67%	-9.18%	EM - Asia
Thailand SET 50 Index	Thailand	507.68	3.45%	-2.50%	EM - Asia
Jakarta Composite Index	Indonesia	2549.03	-2.37%	0.58%	EM - Asia
KLSE	Malaysia	1270.78	0.92%	-0.16%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	66503.27	1.68%	-3.04%	EM
Mexico IPC	Mexico	31634.54	4.09%	-1.51%	EM
Russian RTS Index	Russia	1403.93	-4.74%	-2.82%	EM
Philippine PSEi	Philippines	3043.75	3.07%	-0.29%	EM
Merval Buenos Aires Index	Argentina	2221.38	-3.36%	-4.28%	EM
HangSeng	Hong Kong	20608.70	2.42%	-5.78%	Developed - Asia
Nikkei	Japan	10126.03	-0.71%	-3.99%	Developed - Asia
Strait Times	Singapore	2750.86	0.20%	-5.06%	Developed - Asia
Dow Jones	USA	10325.26	2.56%	-0.99%	Developed
CAC 40 Index	France	3708.80	-0.82%	-5.78%	Developed
All Ordinaries Index	Australia	4651.10	1.18%	-4.74%	Developed
DAX Index	Germany	5598.46	-0.18%	-7.44%	Developed
Swiss Market Index	Switzerland	6710.99	4.20%	2.52%	Developed
FTSE 100	UK	5354.52	3.20%	-1.08%	Developed
MSCI World Index	--	1133.35	1.23%	-3.01%	--

* as on 26th February 10. Source : Bloomberg
EM – emerging markets, Developed – developed markets.

India : Sector performances



- The markets rose by 0.44% over the previous month.
- Consumer Durables was the best performing sector followed by the IT sector.
- Realty and Oil & Gas sectors delivered the worst return for the month.

*Source: BSE,NSE. one month performance as on 26th February 10.

Top Gainers / Losers - Nifty

Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
Hero Honda Motor	915.55 / 1869	1777.65	14.03
Hindalco Inds.	37 / 179.75	162.65	10.38
Larsen & Toubro	557 / 1800	1564.3	9.86
Axis Bank	278.5 / 1175	1124.5	9.63
Siemens	190.35 / 718	684.25	6.42
Top Losers for the month			
Losers	**52 week H/L**	**Last Price#**	**% Loss***
DLF	136 / 490.8	298.45	-10.55
Bharti Airtel	229.5 / 495	279.35	-8.83
Rel. Comm.	131.35 / 359	157.55	-7.21
ITC	155.75 / 271.3	232.25	-7.16
Tata Power Co.	602 / 1518.55	1213.15	-7.03

closing price as on 26th February 2010.* one month performance as on 26th February 2010.
Source: capitaline

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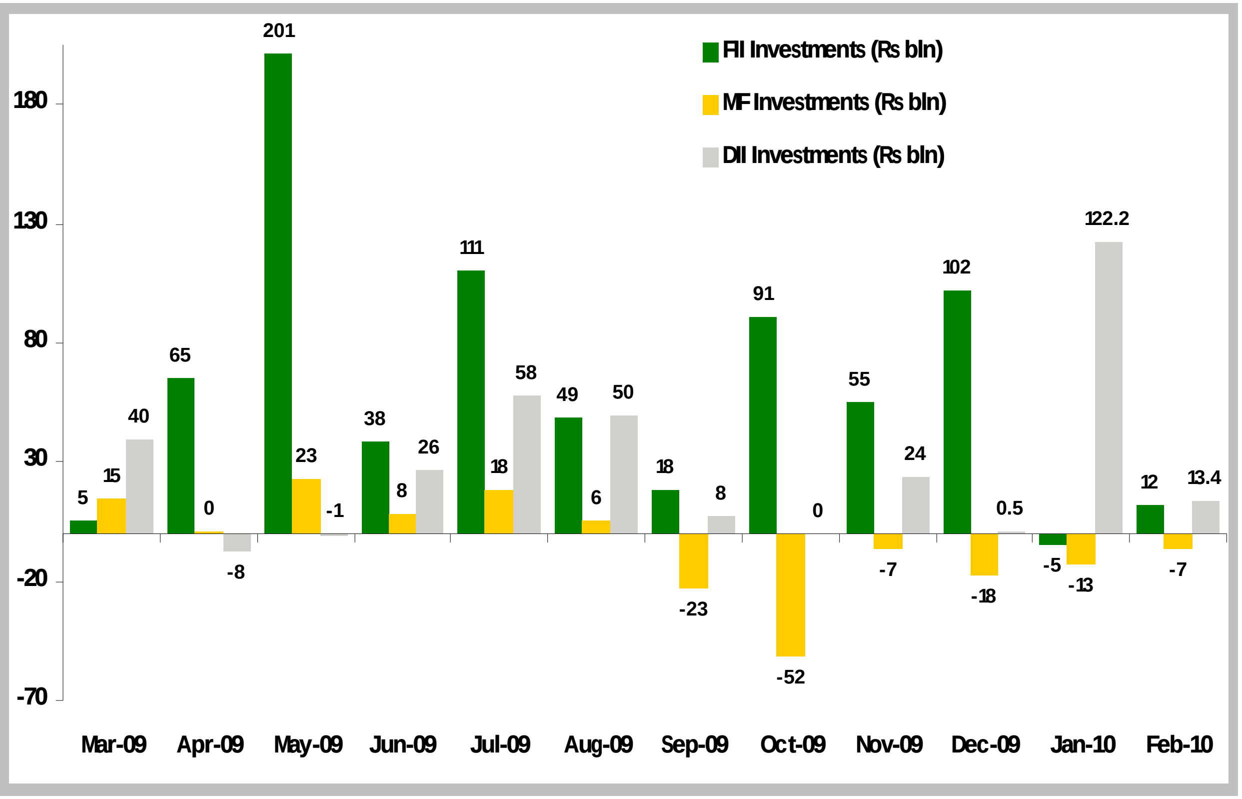
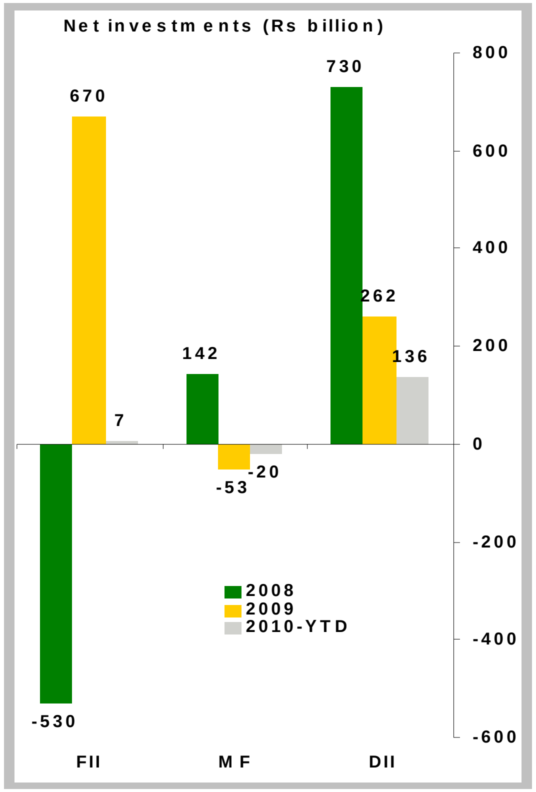
FII & DII Inflows





- FII inflows were at Rs.12bn in February 2010, after declining in previous month. FII inflows have turned positive on a YTD basis at Rs.7bn for CY10 after a Rs.670bn inflow in CY09.
- DIIs recorded inflows of Rs.13.4bn. MF however were net sellers to the tune of Rs.7bn.

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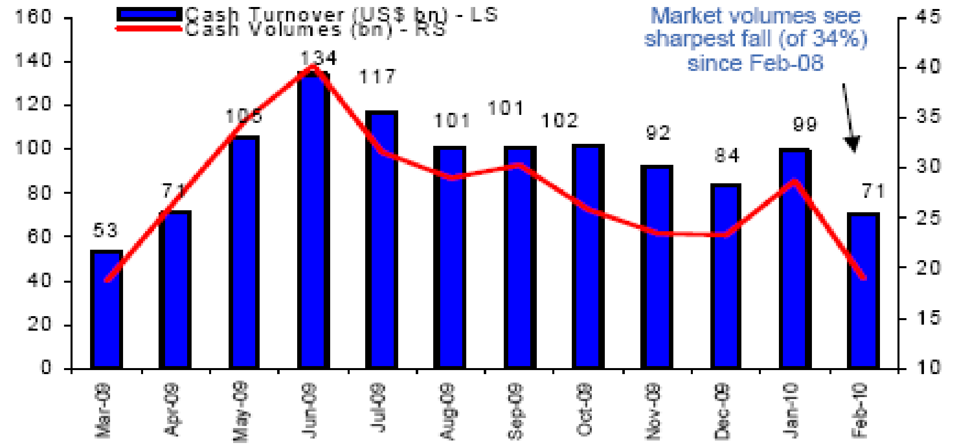
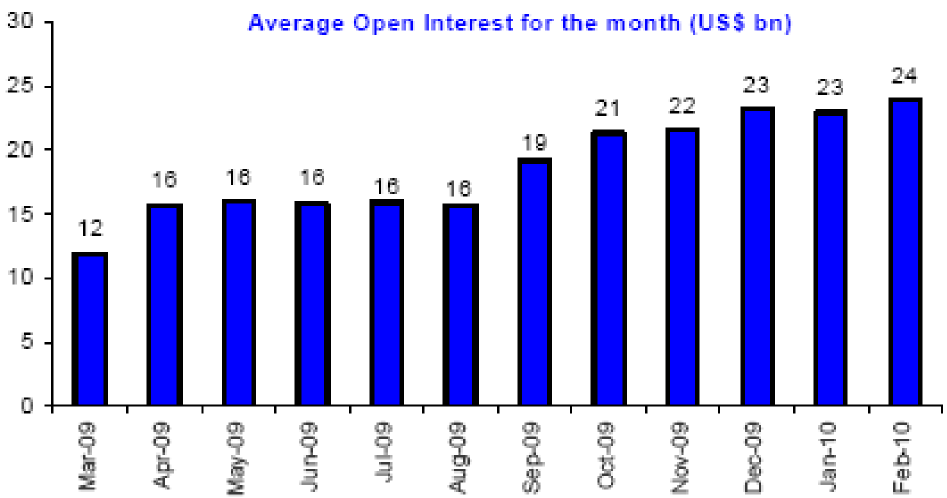
FII - Foreign Institutional Investors, DII - Domestic Institutional Investors (Includes Bank, DFIs, Insurance and MF)
Source: SEBI, BSE

Market Activity

Cash Trading: Turnover and Volumes



- In February, cash trading volumes (number of shares) declined sharply by 34% MoM.



- At the end of February, average open interest increased 4% to its highest level since Jan-09.

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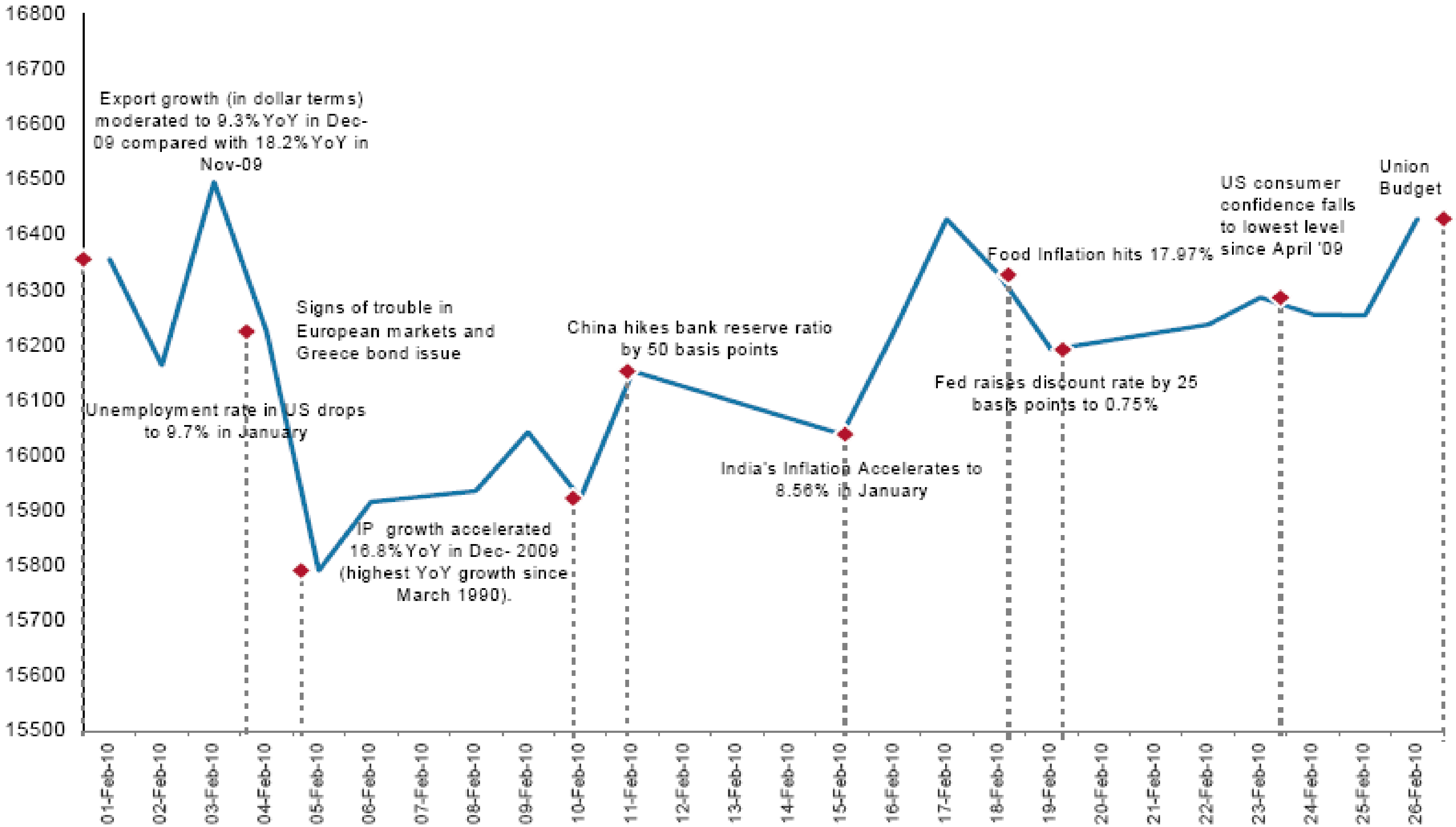
Sources: Bloomberg, Morgan Stanley

February 2010 events timeline



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

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Religare MF: Equity Market Outlook and Opportunities

Equity Market Outlook

- Global investors remained concerned of sovereign defaults, with Greece exacerbating the fears as reflected in a spike in its CDS spreads.
- Though Greece is just about 3% of total Eurozone debt, it is the domino impact on similar economies like Spain, UK (which are much larger in the Eurozone in terms of their size) that the markets are worried about.
- India's GDP growth decelerated in QE Dec 2009 at 6% compared with 7.9% registered in QE Sept 2009 and 6.1% registered in QE June 2009, on the back of a decline in agricultural output.
- The FY11 Union budget, announced in February 2010 is a step in the right direction-fiscal consolidation. More money has been put into consumers' pockets, creating an enabling environment for substituting government consumption with accelerated growth in personal consumption.
- Banks have hiked deposit and lending rates in recent days and gilt yields have continued to harden; pushing the benchmark 10-year yield closer to 8%.
- Consensus continues to expect a 5% decline in FY10 Sensex earnings over FY09 and a 27% growth in FY11 Sensex EPS over FY10.
- The key contribution to growth in FY2011 is from global commodities with commodity companies in the Sensex expected to grow profits by over 40% YoY.
- Sensex is currently trading at 20.7x its trailing earnings which is well above its historical averages; this is, however, in line with trends seen across emerging markets.

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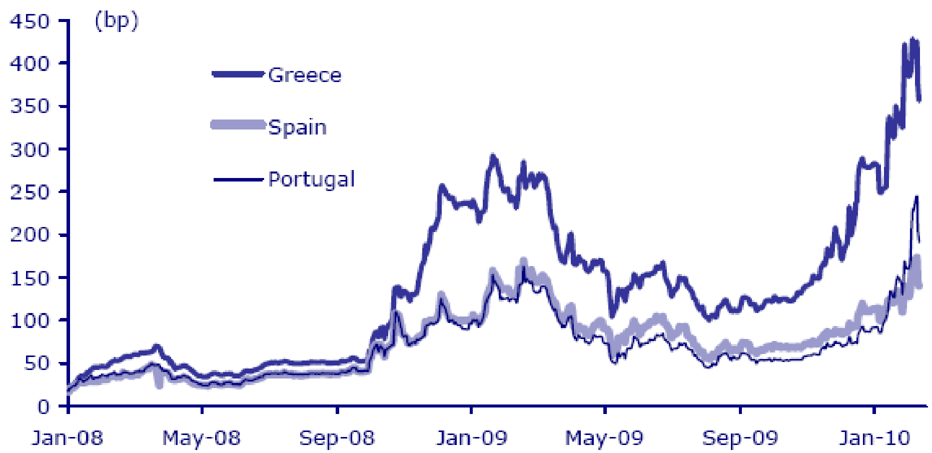
Sovereign Debt default – the latest concern in the West

Five-year CDS spreads on Greek, Spanish and Portuguese government debt



US$/Euro exchange rate

- Greece is the economy in the spotlight due to high fiscal deficits and rising government debt.
- The Credit Default Swaps or CDS (which indicate premium an investor pays to protect against the potential default of a debt instrument) for Greece government debt has risen to record highs following increased concerns of default on its sovereign debt.
- Impact of such an increase in fears of sovereign debt default has resulted in a sharp decline in Euro against the Dollar.
- Though Greece is just about 3% of total Eurozone debt, it is the domino impact on similar economies like Spain, UK (which are much larger in the Eurozone in terms of their size) that the markets are worried about.

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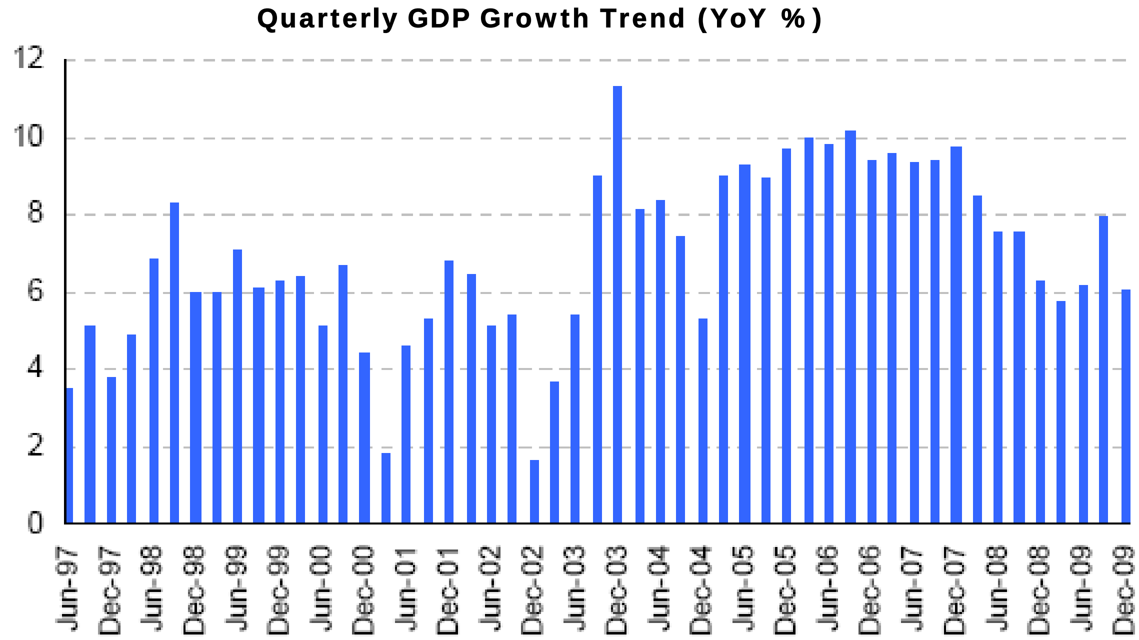
Sources: *Datastream, CLSA*

India's GDP growth hits a small bump in QE Dec 2009



- GDP growth in QE Dec 2009 was at 6% compared with 7.9% registered in QE Sept 2009 and 6.1% registered in QE June 2009.
- Deceleration of growth was mainly because of a 2.8% decline in agricultural output, which declined due to the adverse impact of delayed and severely sub normal monsoons.
- Industry grew by 11.8% in QE Dec 2009 compared to 8.2% in the previous quarter, while Services sector grew 6.3% in QE Dec 2009, compared with 9.3% in the previous quarter.

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Sources: *CSO, Morgan Stanley Research*

Union Budget 2010-2011 Highlights

- The FY11 Union budget is a step in the right direction-fiscal consolidation. The headline fiscal deficit target is set at 5.5% for FY11 (est 6.9% in FY10) and the budget lays down an ambitious target of reducing the fiscal deficit to 4.1% by FY13.
- More money has been put into consumers' pockets, creating an enabling environment for substituting government consumption with accelerated growth in personal consumption.
- As expected, the stimuli rollback was effected, albeit partially. The excise duty has been raised from 8% to 10%. The service tax rate has been kept constant at 10% but the scope of coverage has been widened.
- The budget also restored/hiked duties on petroleum products necessitating a hike in fuel prices.
- According to Finance Minister, both Goods and Service Tax (GST) and Direct Tax Code (DTC) shall be implemented by 1st April 2011.
- The 13th Finance Commission has stipulated that the share of States in net Union tax receipts be fixed at 32% p.a. during FY11-15, up from 30.5% earlier. This should help reduce the deficits at the state level.
- On the Direct Tax front, Income tax slabs have been broadened in a bid to raise savings rate and boost consumption. Surcharges on domestic companies reduced from 10% to 7.5% while Minimum Alternate Tax raised from 15% to 18% of book profits.
- Introduction of service tax on sales of under construction buildings is likely to increase residential property prices by about 3.3%. Also, the budget has raised excise duties on Cigarettes by about 17%, one of the steepest increase in 10 years.

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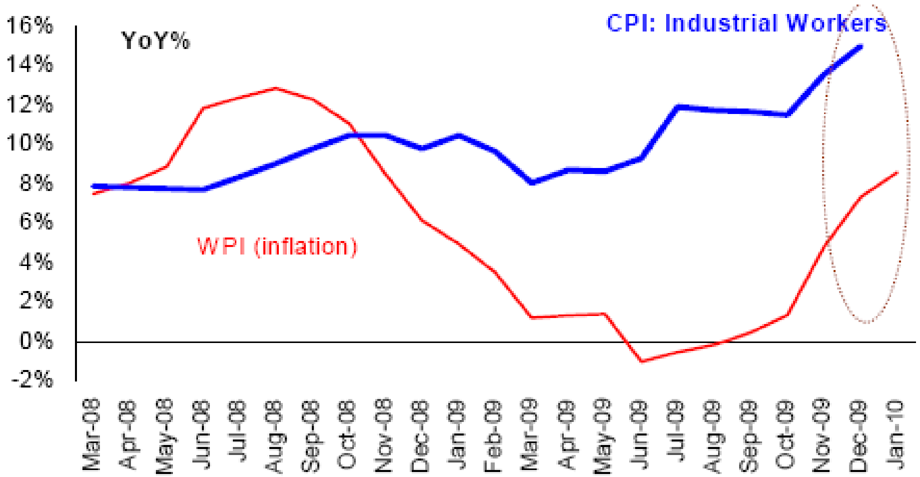
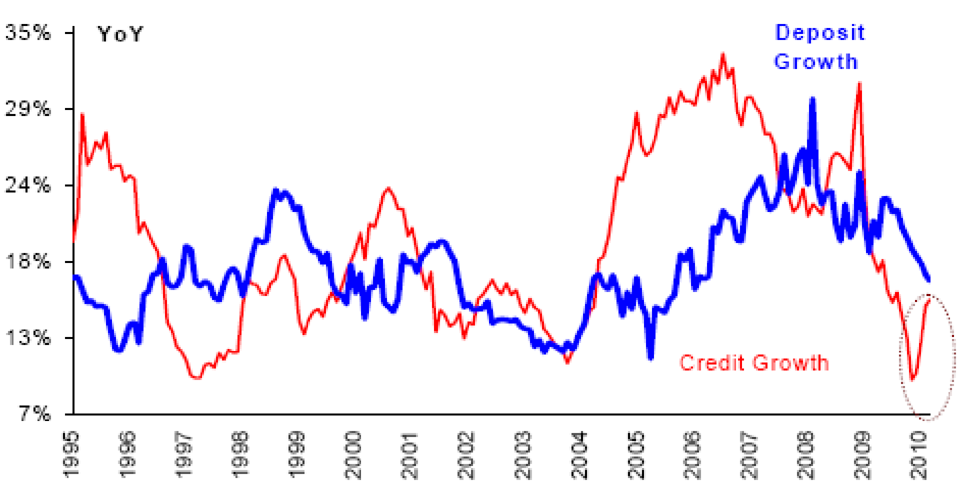
Sources: *Datastream, CLSA*

Inflation & Interest rates can play spoilsport





- Inflation continues to trend higher, with both WPI and CPI rising in the previous month.
- Deposit growth continues to ease and credit growth is recovering from a very modest base. But in recent days we have seen banks hike both deposit and loan rates.
- In the bond market yields have pushed higher after the budget with the benchmark 10-year yield now close to 8%.
- This raises concern about the trajectory of interest rates going forward.
- While a normalization of rates was expected a faster move up in rates will be negative for the economy.

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Sources: *RBI, CSO, CEIC, Morgan Stanley Research*

Sensex earnings growth – commodity boost

% growth	**FY10**	**FY11**
Domestic focused businesses	12.6%	16.9%
Commodity businesses	5.5%	40.6%
IT business	9.1%	13.3%
Aggregate	**8.5%**	**28.0%**

% of total	**FY10**	**FY11**
Domestic focused businesses	36.8%	33.6%
Commodity businesses	49.1%	53.9%
IT business	14.2%	12.6%
Aggregate	100.0%	100.0%

- A large proportion of FY11 Sensex earnings growth is contributed by strong earnings growth in commodity businesses profits.
- As a result their weight age of commodity business profits in the overall index profits is also rising sharply in FY 11.
- In our opinion commodity business earnings should be valued at much lower multiples than the current market average.
- The earnings of these commodity companies are largely dependent on global macro economic factors.
- The market is not as cheap, as it appears relative to growth, and if it is cheap it is because of its commodity component ,which is more a function of the global macro environment.

Note 1: The above analysis is for Sensex Earnings Growth and not Earnings Per Share growth.

Note 2: Analysis as on 24th February 2010.

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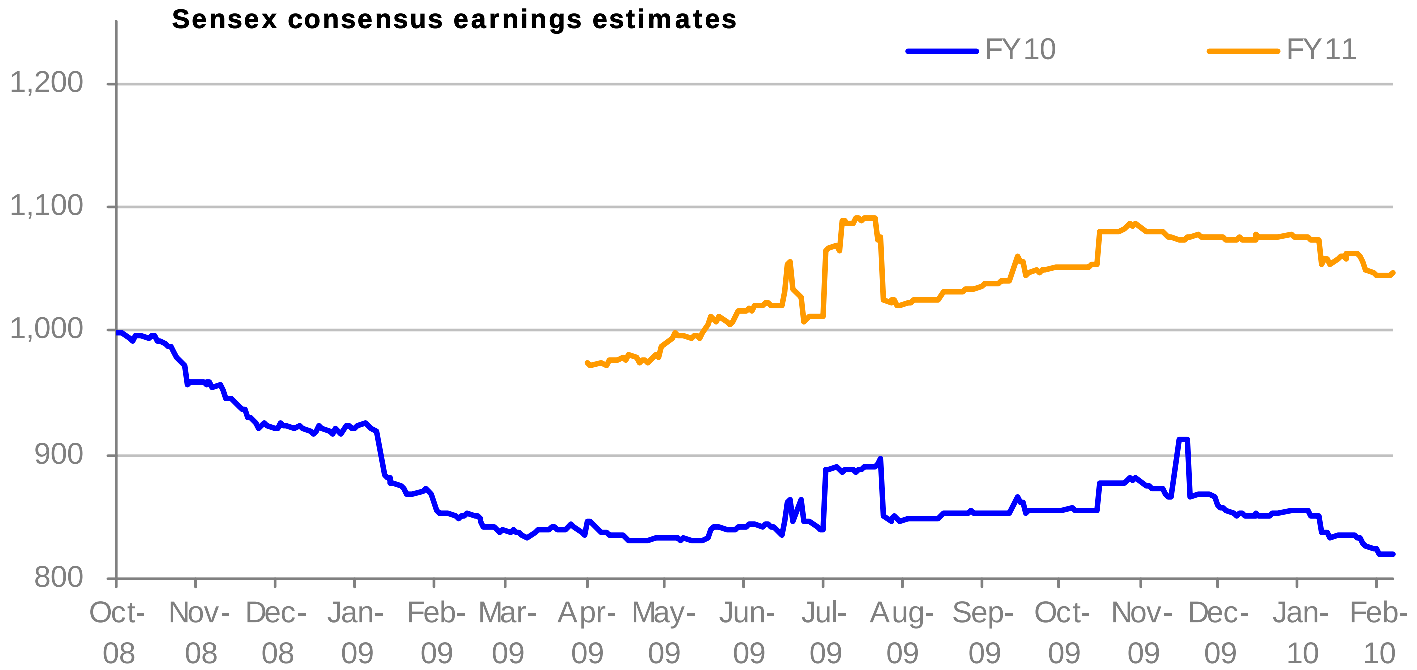
Sources: *Religare AMC Analysis, bloomberg*

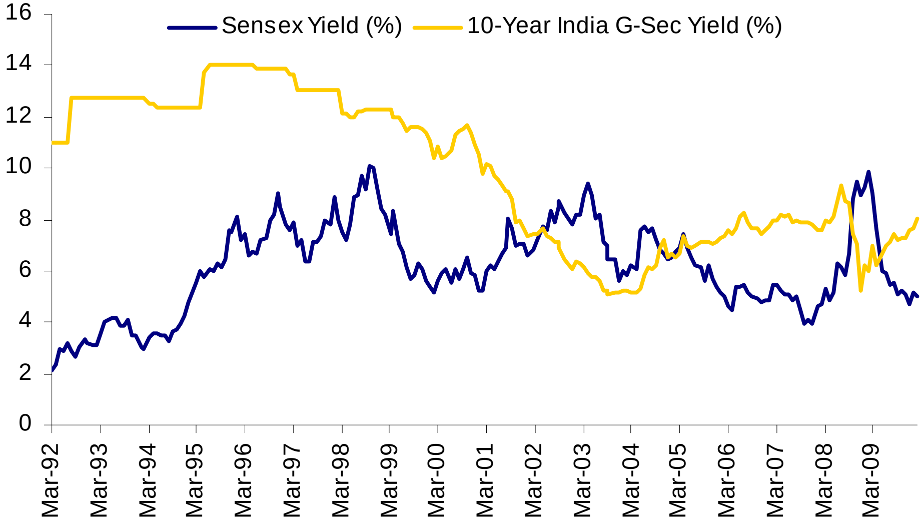
Earnings – Cut in forecasts despite an in-line quarter

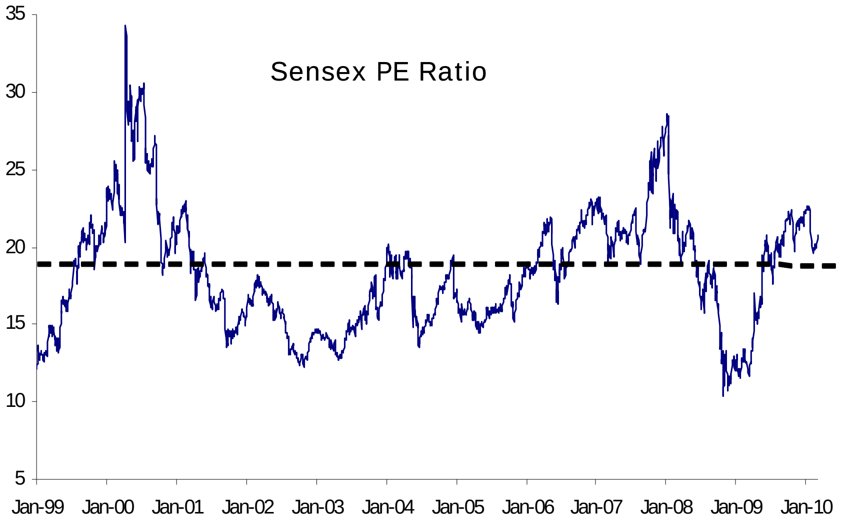


- There have been no material changes to Consensus earnings expectation in the month.
- Consensus continues to expect a 5% decline in FY10 Sensex earnings over FY09 and a 27% growth in FY11 Sensex EPS over FY10.

Sources: Bloomberg, IIFL Research

Valuations – ease a bit, but still above averages





- The gap between Sensex earnings yield and bond yield has increased by 52 basis points over the previous month. The Sensex yield has fallen and the bond yields have increased in the month, thereby widening the gap.
- Sensex is currently trading at 20.7x its trailing earnings. The gap between the current multiple and historical 10-year average trailing PE of 18.4x has widened in the month.
- The valuation surge is not unique to India. The MSCI Emerging Market Index is also trading at approximately 20.2x trailing earnings

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Source: NSE, MOSL Research

Looking Ahead...

- The macro environment continues to improve as is indicated by an improvement in various lead indicators including the credit offtake.
- As expected, the stimulus has been withdrawn, albeit partially in the Union Budget. We feel it should not materially impact the economic growth. The focus on growing private consumption improves the overall quality of GDP growth.
- We feel that with the Indian economy back in the growth zone and inflation a potential threat the RBI will continue to act to normalize policy and hike is imminent in the credit policy or maybe even before that.
- 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. However, proper pricing of IPO and FPO is the key to success of the divestment programme.
- Given the performance in the third 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%.
- 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.

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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 27% 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 priced in.
- The Sensex is trading at a P/E of 16.2x 1-year forward earnings which is back within the comfort zone but not very attractive.

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
- Elevated valuation measures might reduce the returns to below earnings growth

Strategy for investors

- By remaining largely unchanged since early October 2009 the market has effectively become a bit cheaper.
- Long term investors can continue with SIP

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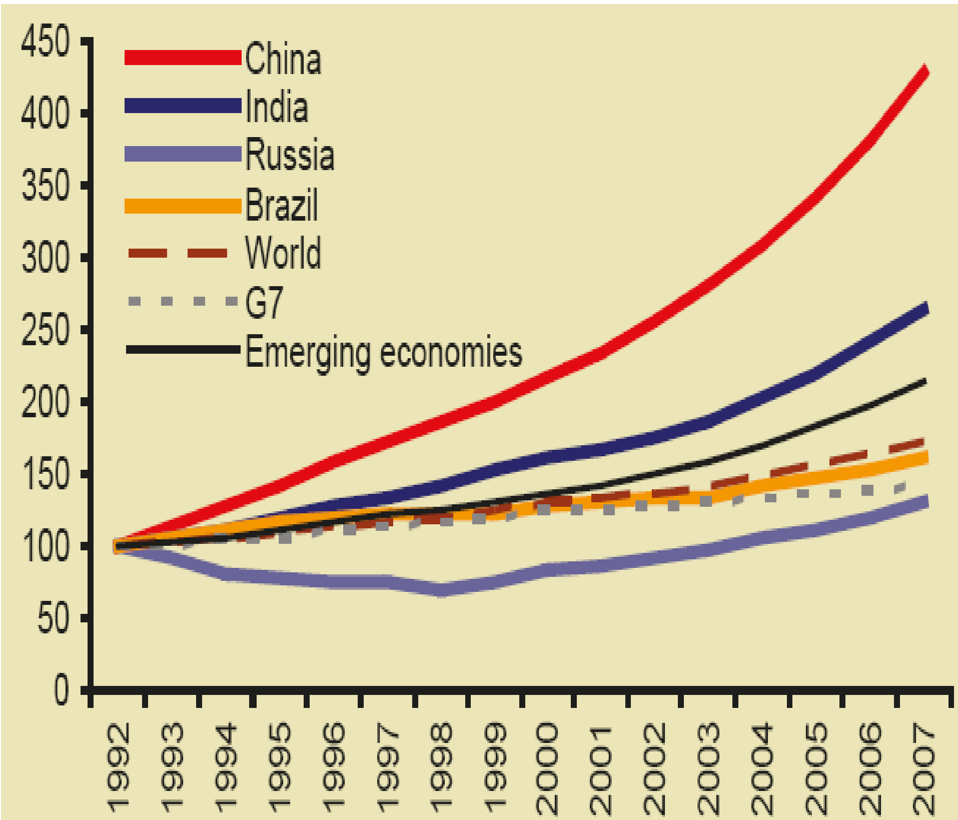
The Long Term Case For Indian Equities

India – Growth On The Fast Track

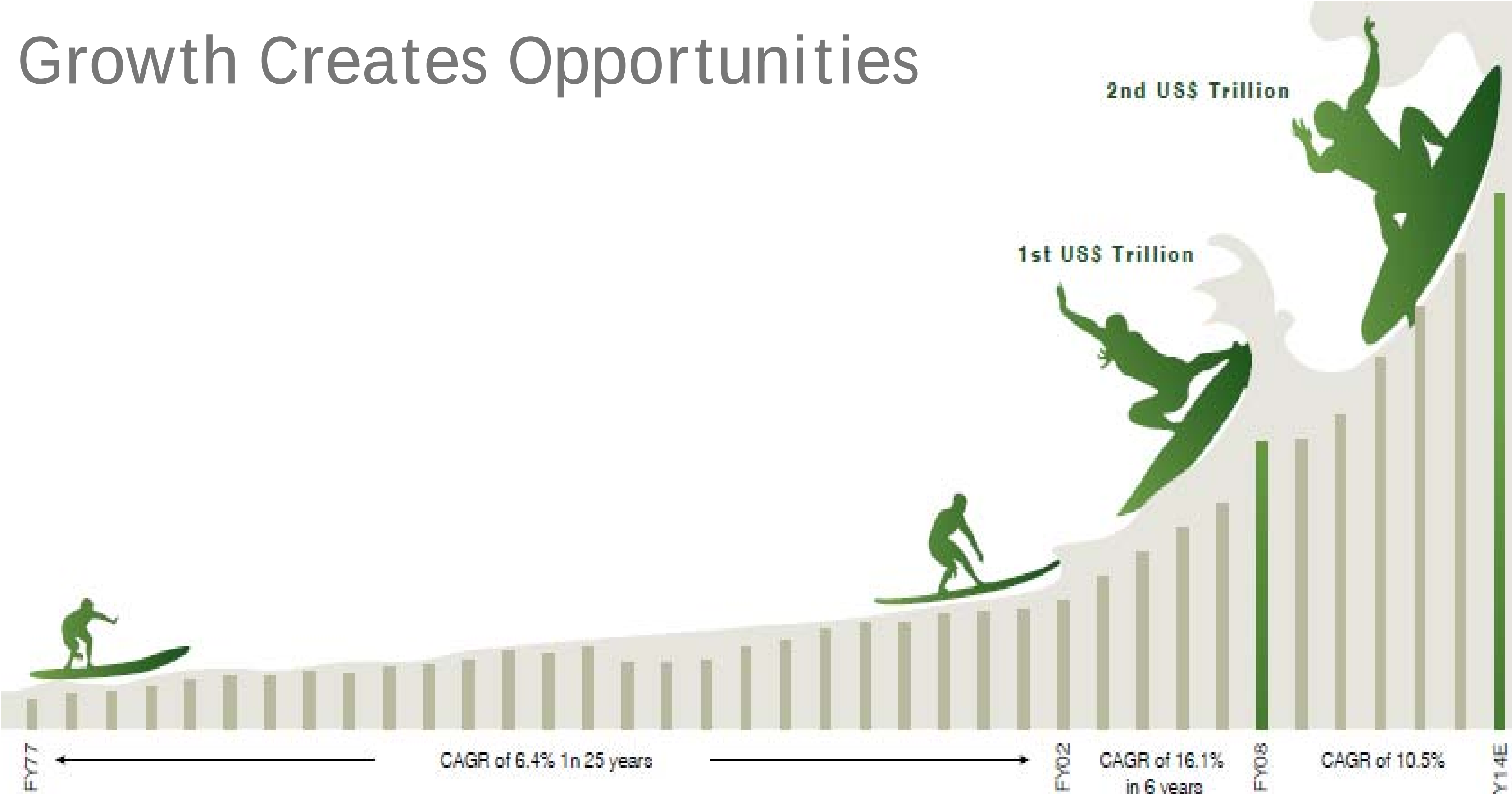
GDP growth rebased to 1992



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

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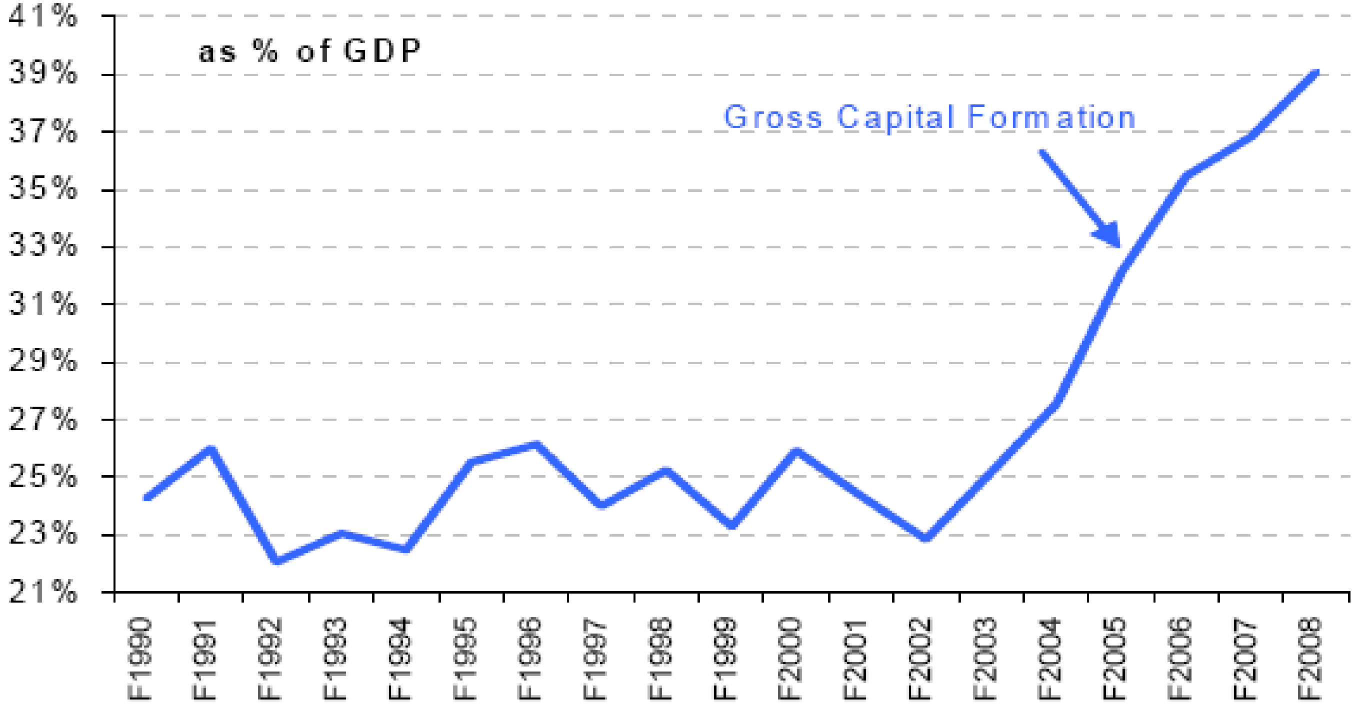
Source: Motilal Oswal Securities Ltd.

Growth Is Being Led By A Rise In Capital Formation…



Source: CSO, Morgan Stanley Research

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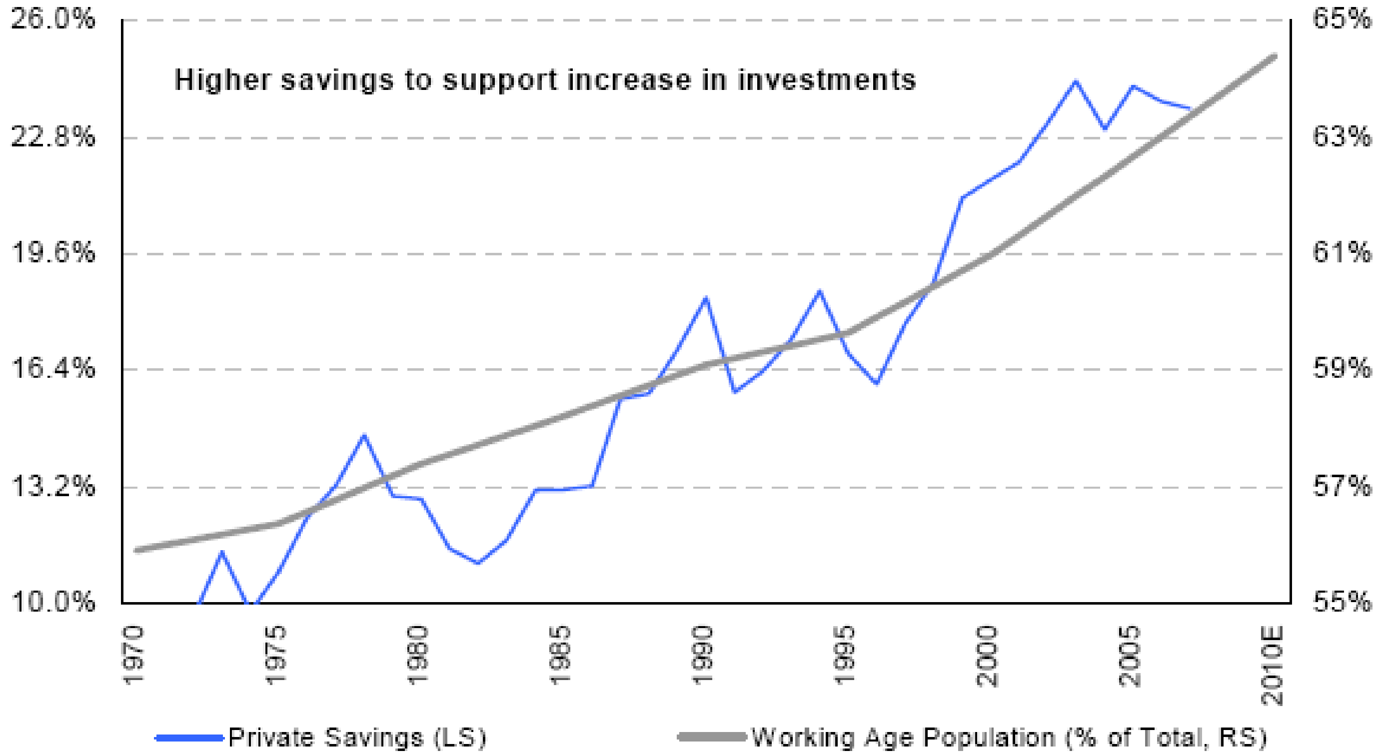
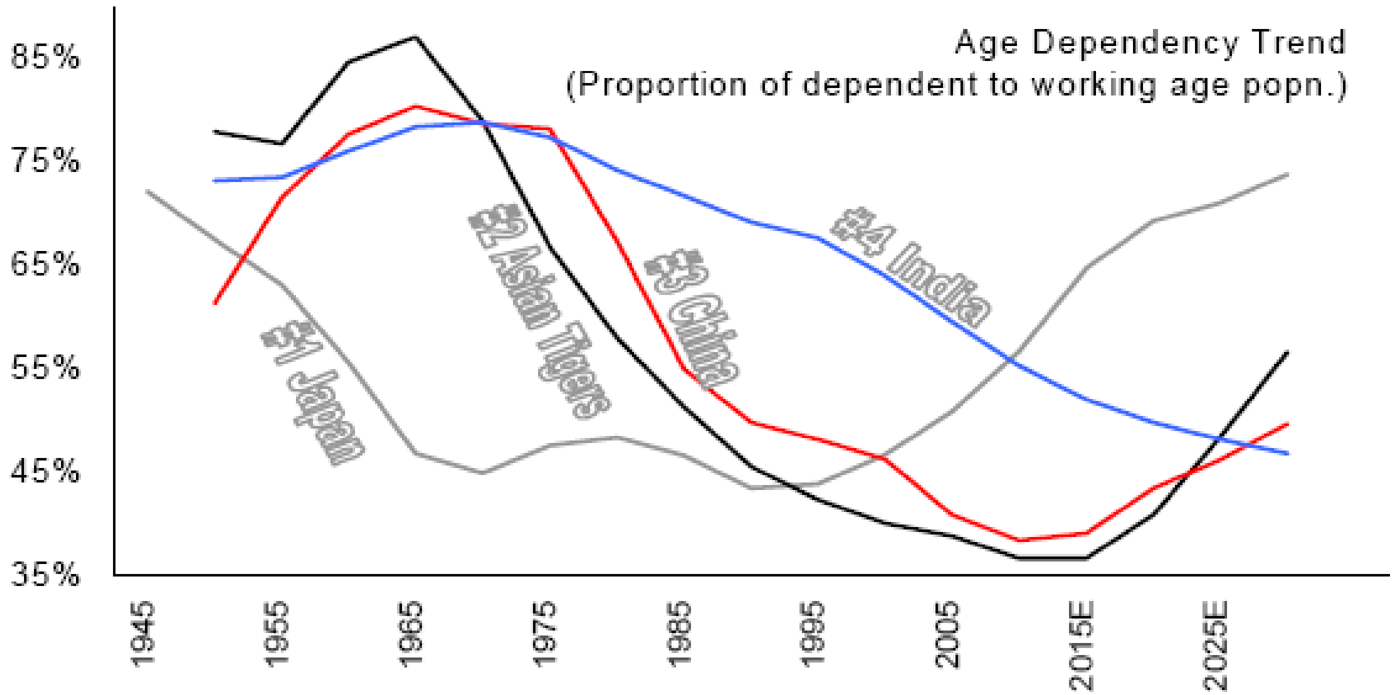
...Which Is Supported By A High Savings Rate



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

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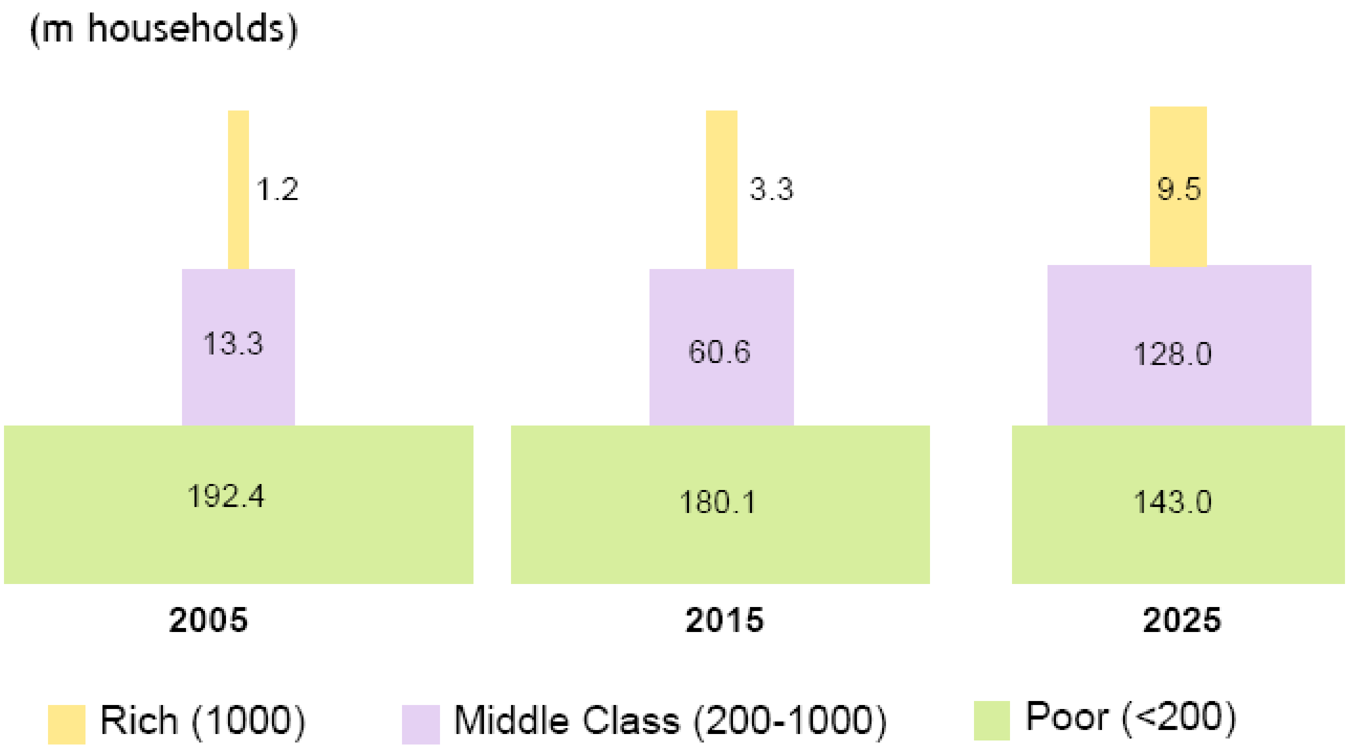
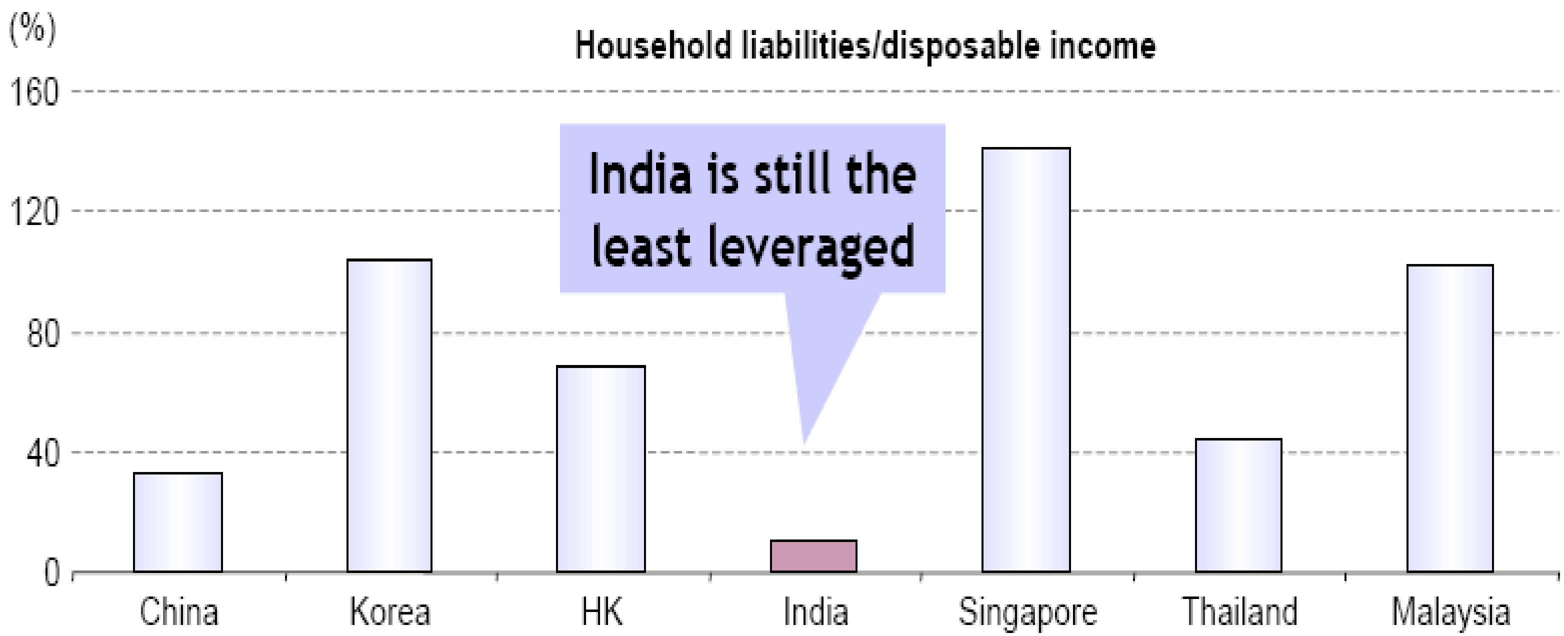
Income Imbalance To Correct Leading To Rise In Consumption



Source: IDFC SSKI

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



Source: IDFC SSKI

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