

Equity Market Outlook

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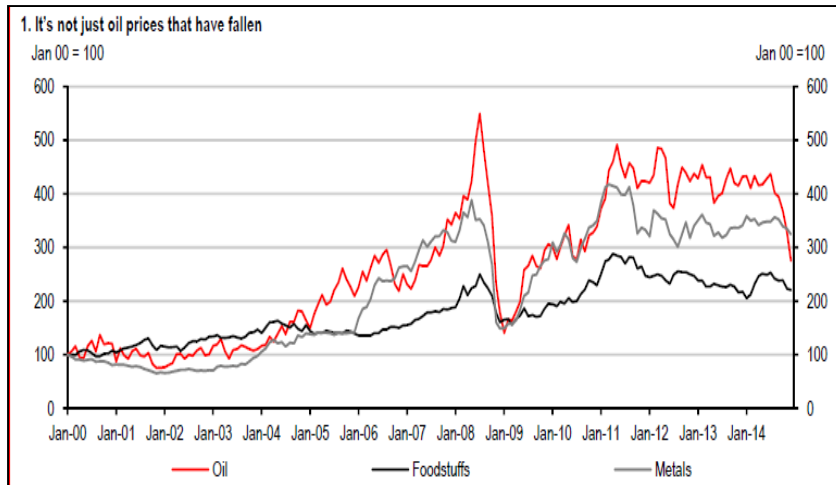
Equity Market Outlook

- Global deflation scare has once again resurfaced as global inflation is at the lowest level in a decade
- India is expected to register one of the fastest nominal GDP growth of 11% in the world in 2015¹
- Key driver for growth – investment cycle is undergoing slow and gradual recovery – sharp recovery in new project announcements for 2 successive quarters
- Current account deficit at 2% is comfortable, but fiscal deficit target of 4.1% for FY14-15 is a challenge
- If inflation sustains at current low levels, there is room for monetary easing
- For 3Q15, Sensex earnings growth are expected to be flat YoY
- Valuations are at 16% premium to long term average; in an expensive zone

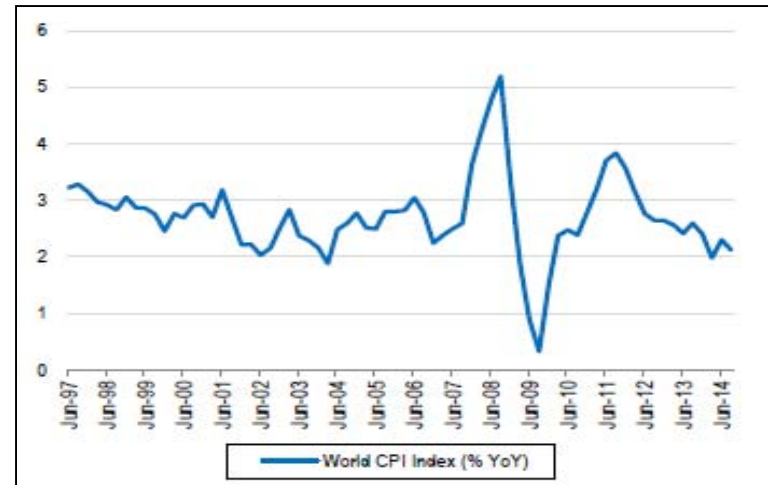
Global Macro - Global Disinflation a worry

– Demand a problem

Oil is not the only commodity to have fallen



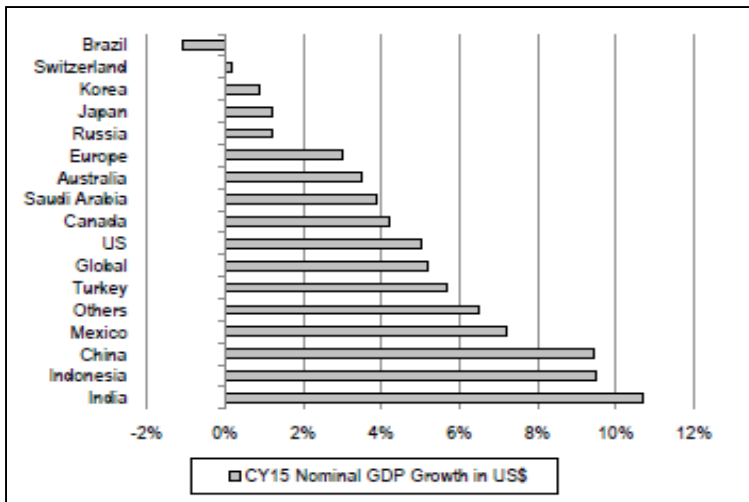
Global Inflation at multi year lows in Sep -14



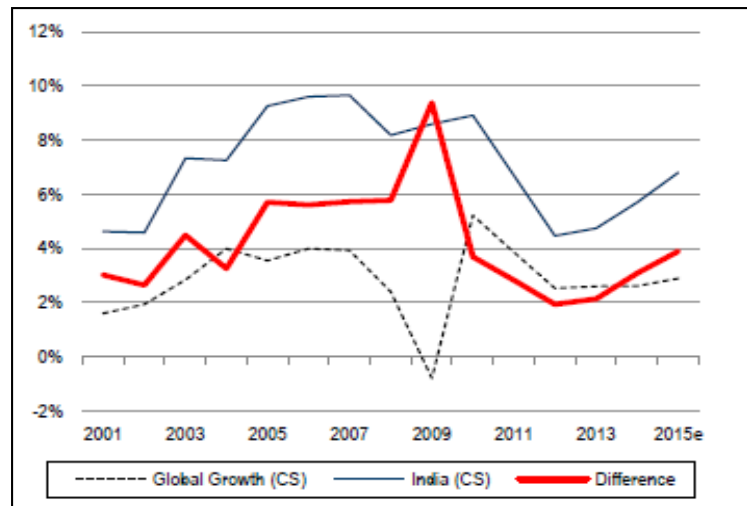
- Over past six months, deflationary concerns have risen, particularly in the Eurozone
- Global inflation in September was at the lowest levels in a decade, excluding financial crisis, even before the sharp decline in global commodity prices
- The global decline in commodity prices is not just a supply issue, there are demand concerns as well, as global growth remains weak

India – Growth: stands out

India to see the fastest nominal GDP growth



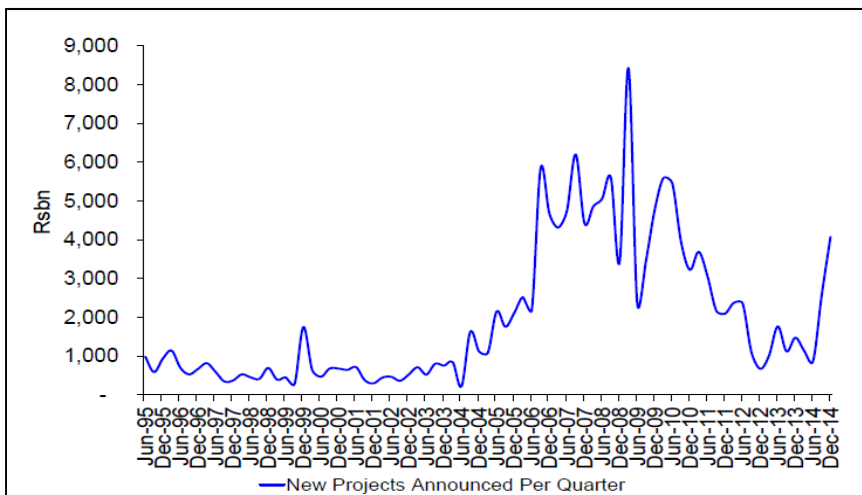
India's real growth gap to world widening again



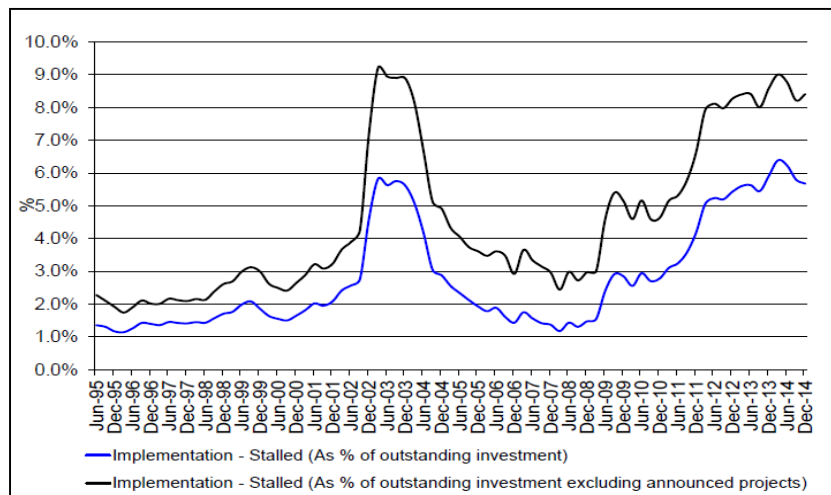
- In this environment India stands out as a rare economy with relatively strong growth
- Real growth gap between India and rest of the world is expected to widen in 2015
- India expected to deliver the fastest nominal growth in the world in 2015

India - Investment Cycle Rebound - Gradual Recovery Underway

Quarterly New Project announcements (Rs bn) – Rebound from lows



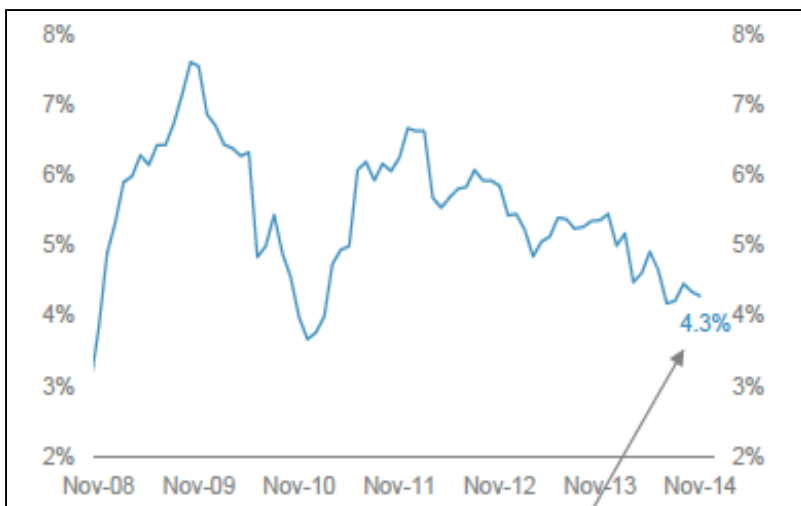
Projects under implementation but stalled as % of total O/S Projects



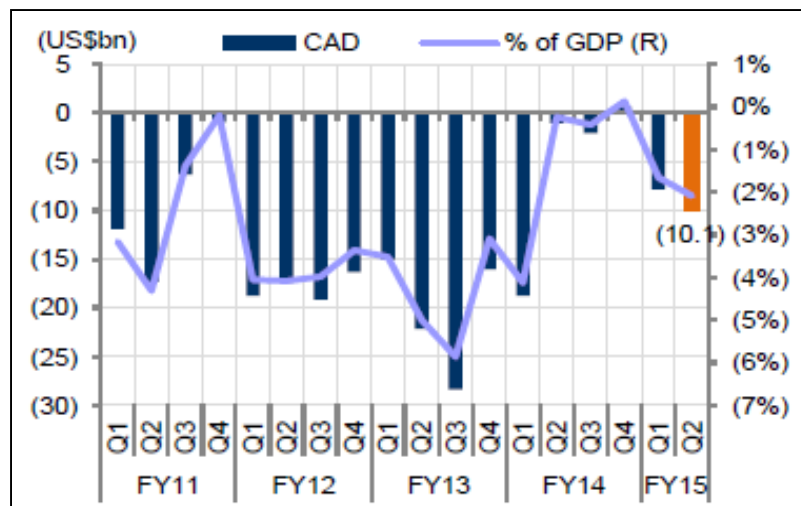
- New project announcements in 3Q15 rebounded sharply - however 37% of 3Q15 new orders were on account of aircraft procurement by indigo airlines (does not benefit domestic investment cycle)
- This is the second consecutive quarter of strong rebound in new project announcements
- Also projects under implementation but stalled are yet to exhibit any meaningful improvement indicating various measures to revive stall projects would take time to show results and recovery in investment cycle will be gradual

India - Twin Deficit – Mixed Bag

Fiscal Deficit (12M Trailing Sum % of GDP)



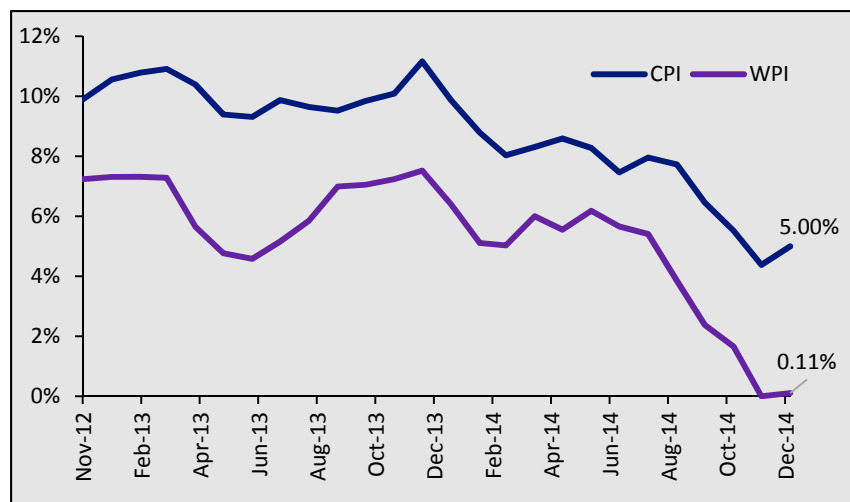
Sharp improvement in external balance



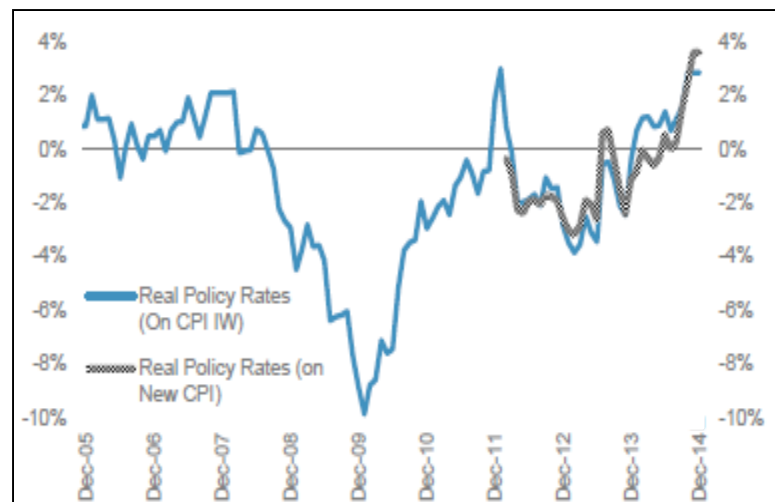
- Central government's fiscal data for April – Nov 2014 shows that fiscal deficit was at 98.9% of its full year target
- This is largely due to weak tax revenues. Gross tax revenue growth was muted at 6.5% YoY vs 9.7% in the same period last year.
- Trailing 12 months fiscal deficit is at 4.3% as compared to target of 4.1%
- Current account deficit for Q2 was much more comfortable at 2.1% of GDP.

Monetary Policy – Scope for Easing

Inflation downward trend continues



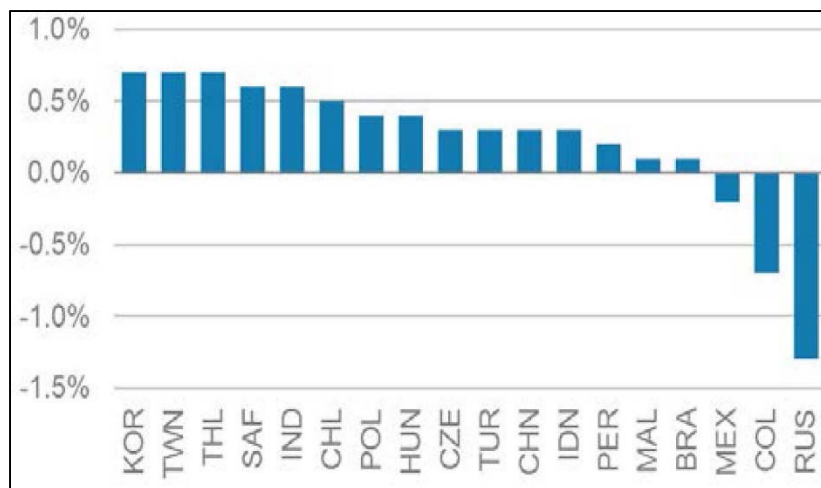
Real Policy Rate (adj for CPI)



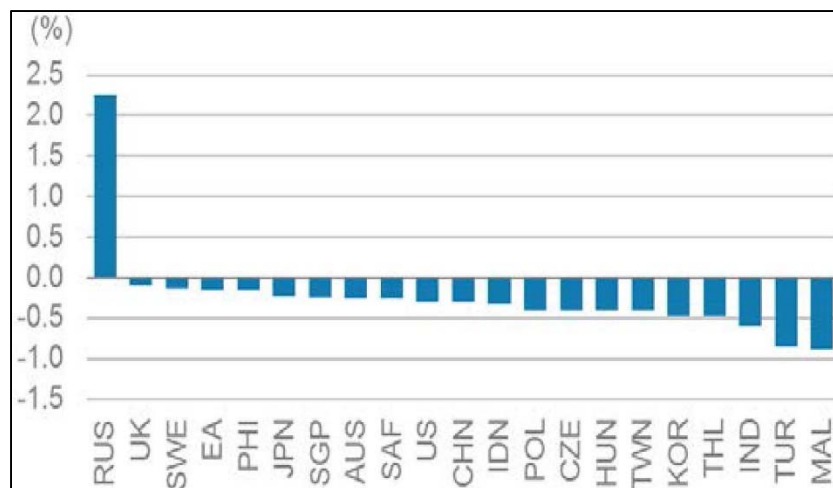
- Inflation continues to remain lower with December WPI at 0.11% and CPI at 5%
- Real Policy rates adjusted for CPI are at a highest level since 2005, creating scope for monetary easing by the Central bank during the course of the year

India – Impact of fall in crude oil prices

Current Account / GDP Impact of a USD 10 Drop in Oil

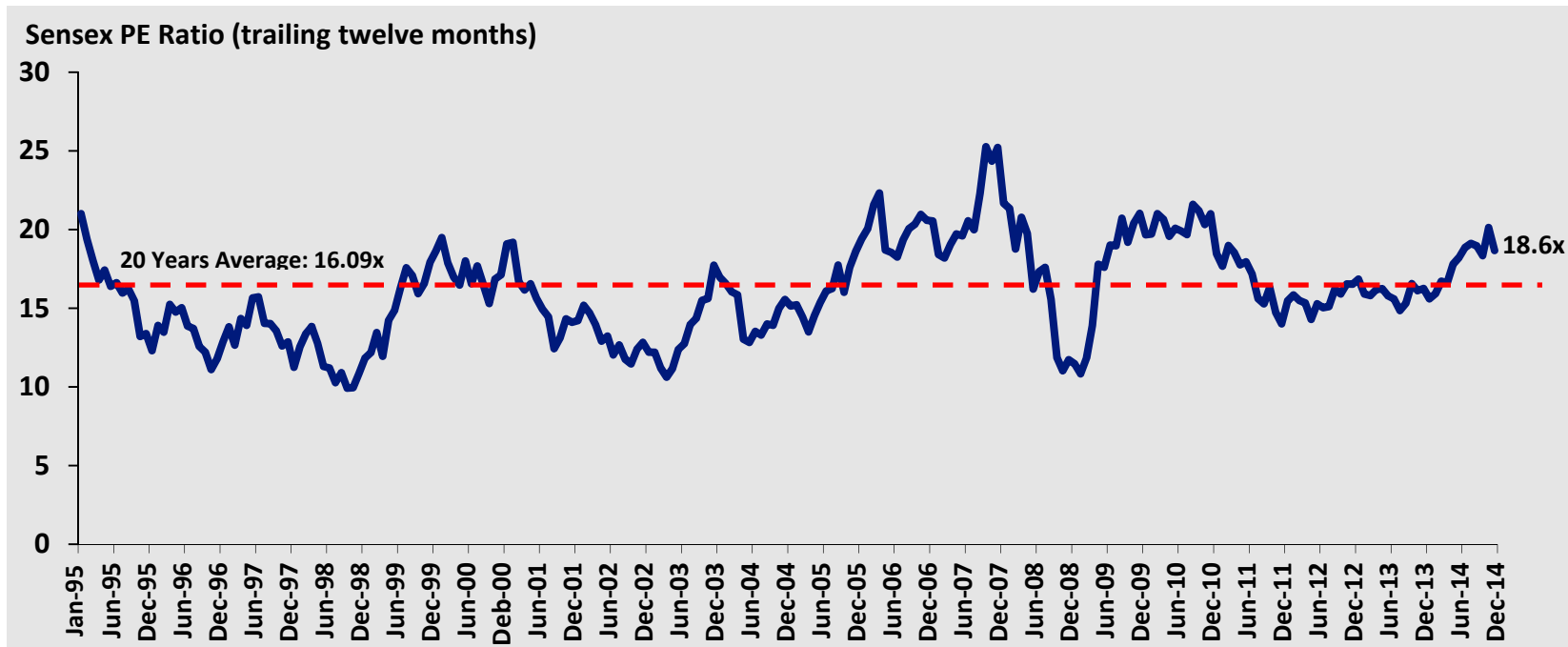


Inflation Impact of 10% Drop in Oil Prices



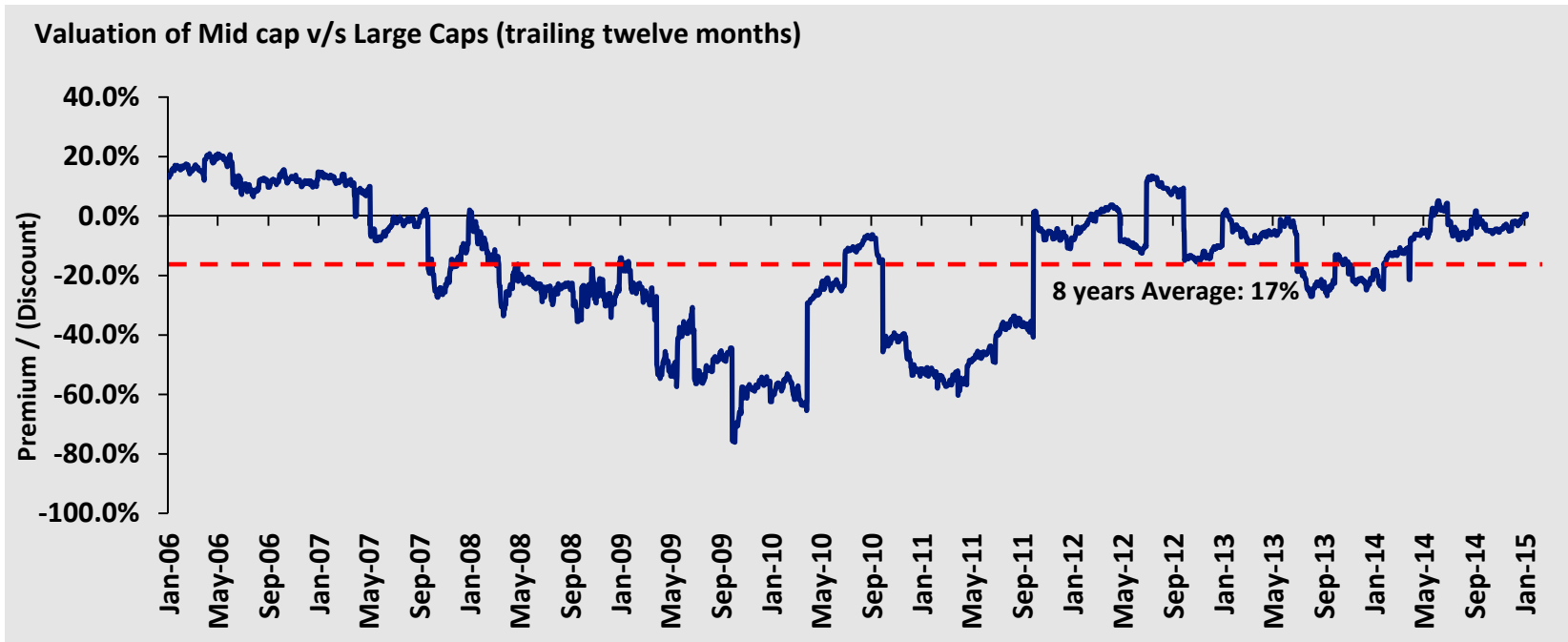
- On a top down basis, for every 10\$ fall in oil prices potentially improves India's current account deficit by more than 0.5%
- From an inflation perspective, 10% drop in oil prices could result in around 0.5% drop in inflation

Valuations - Premium to Long term Average



- Markets are trading at premium to long term averages since Jan'95
- The large cap benchmark Sensex index trades at 16% premium to its long term trailing 12 months average P/E multiple

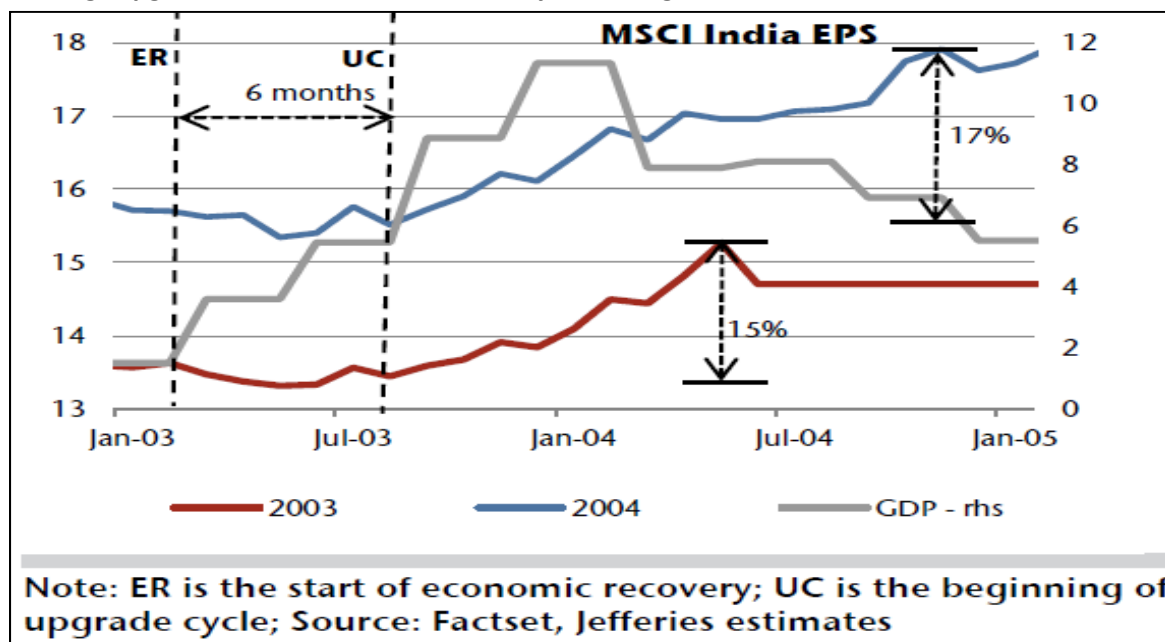
Valuations – Midcaps trading in line with large caps



- Midcap Index is currently trading inline with large cap index as compared to 17% discount on a long term basis

Valuations – The 2003 Earnings cycle experience

Earnings upgrade follows economic recovery with a lag of 4-6 months



- The 2003 economic upturn suggests that the earnings upgrade cycle normally lags the economic recovery cycle by about 4-6 months
- We are still at a very early stage of mild recovery in growth

- Falling commodity prices and weak demand has led to global concerns on Growth
- While India stands out in terms of high growth relative to rest of the world, recovery is slow and gradual
- Government focus is more on execution rather than Big Bang reforms
- Softening inflation trends provide scope for monetary easing
- Valuations now at 16% premium to long term average. From here the baton passes to earnings growth rather than P/E expansion
- Earnings growth still remains weak but expected to recover in FY16
- Sectors such as industrials, consumer discretionary and financials will benefit from cyclical recovery in growth
- Earnings growth for Mid cap companies will likely improve with a recovery in domestic growth and a more benign monetary environment
- Though there is a preference for pro cyclical stance, portfolio strategy is more balanced given the valuations changes over past year

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