

Equity Market Outlook

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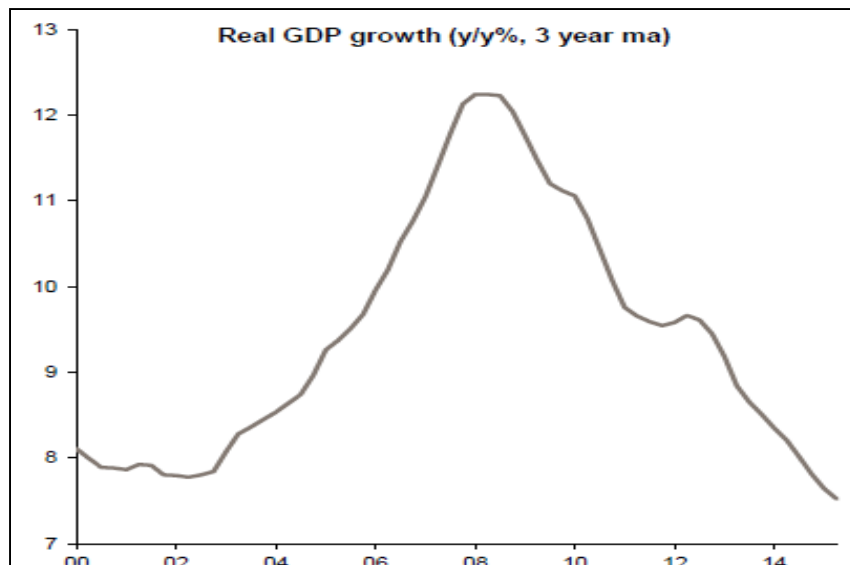


Equity Market Outlook

- India's economic indicators are exhibiting mixed outcomes
- Key driver for growth – investment cycle is undergoing slow recovery
- While FY16 fiscal trends are positive, there has been a recent deterioration in the deficit led by bunching¹ of expenses and slower direct tax collection. If this persists, the fiscal headroom with the government to increase developmental expenditure may reduce
- On the external front, trade deficit and current account deficit has witnessed a meaningful improvement
- In a surprise move, the RBI in its Monetary Policy reduced repo rate by 50 bps from 7.25% to 6.75%, thereby frontloading the headroom available in rates
- Monsoon has been weak at 14% below normal, creating headwinds for rural demand
- Valuations are at 11% premium to the long term average; closer to our comfort zone

Global Macro – China Slowdown, US Rate Increase

China GDP Growth (YoY %)



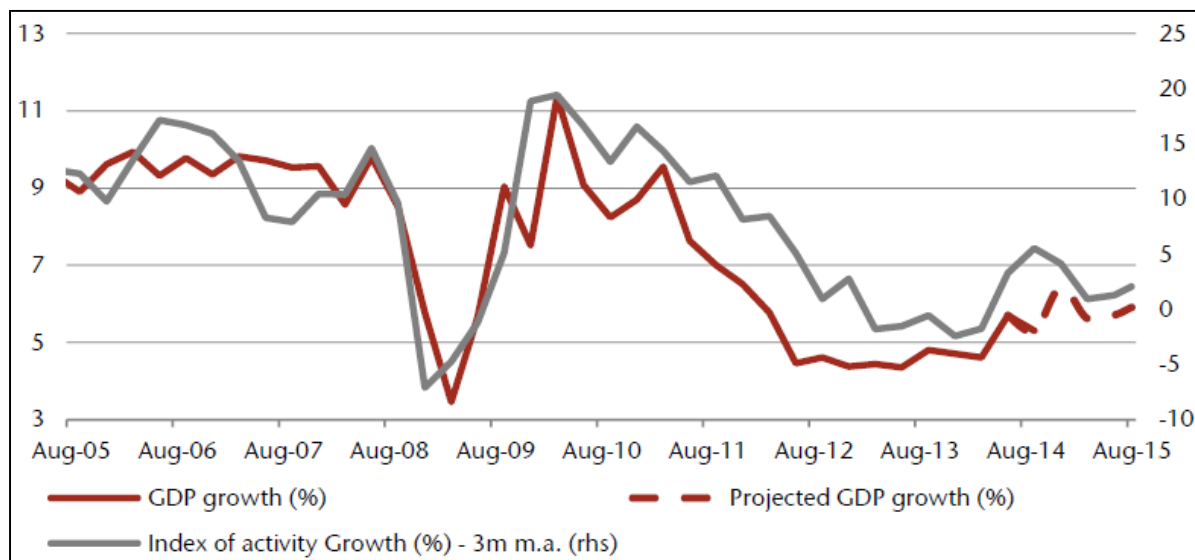
China Industrial Production Growth (YoY %)



- China GDP is rapidly slowing down since 2008, from more than 12% growth to currently around 7.5%. China's industrial production growth has also slowed from a high of around 20% growth in 2010 to current single digit growth
- The US Fed chose to delay the rate lift-off owing to global headwinds from China and Emerging Markets, despite noting its domestic economic improvements

India Economic activity - Mixed Bag

Activity Index Growth - Muted



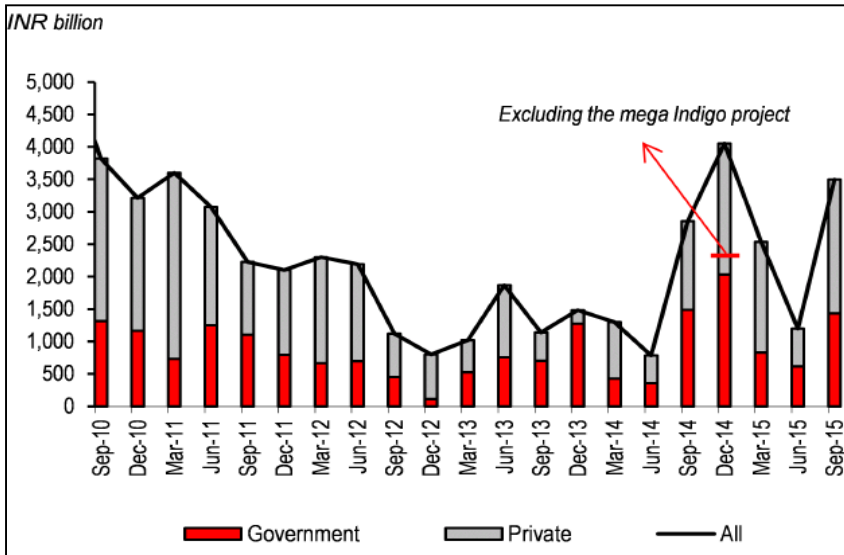
- Economic indicators are showing mixed trends
- The key positives included, the high-end consumption indicators, especially airport traffic
- However, the key negatives were the weak financial, export and industry indicators

Note: GDP growth and projections are based on old GDP series (2004 series)

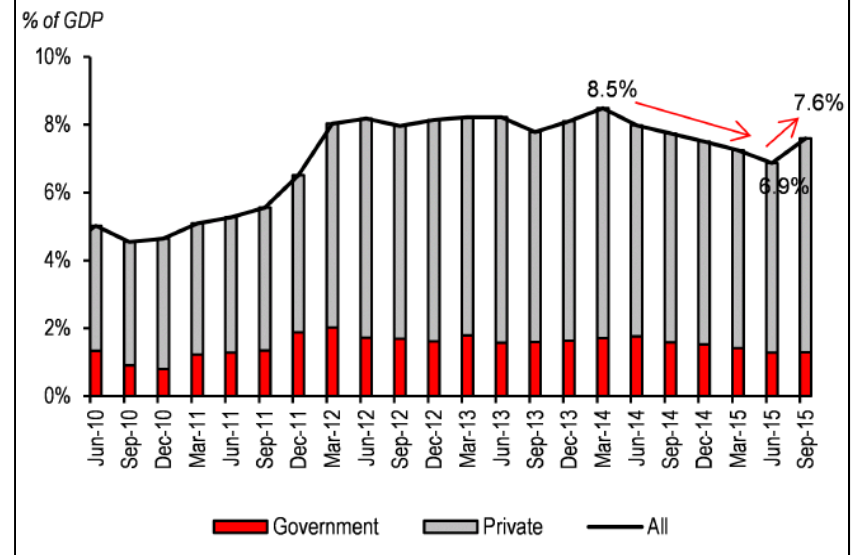
Activity Index = 10% weightage given to following 10 indicators – Railway Freight Growth, Export Growth, Passenger Vehicles Sales growth, CV sales growth, Two wheelers sales growth, Cement Production Growth, Oil Consumption Growth, Electricity Generation Growth, Deposit Growth and Credit Growth

India Investment Cycle - Gradual Improvement

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



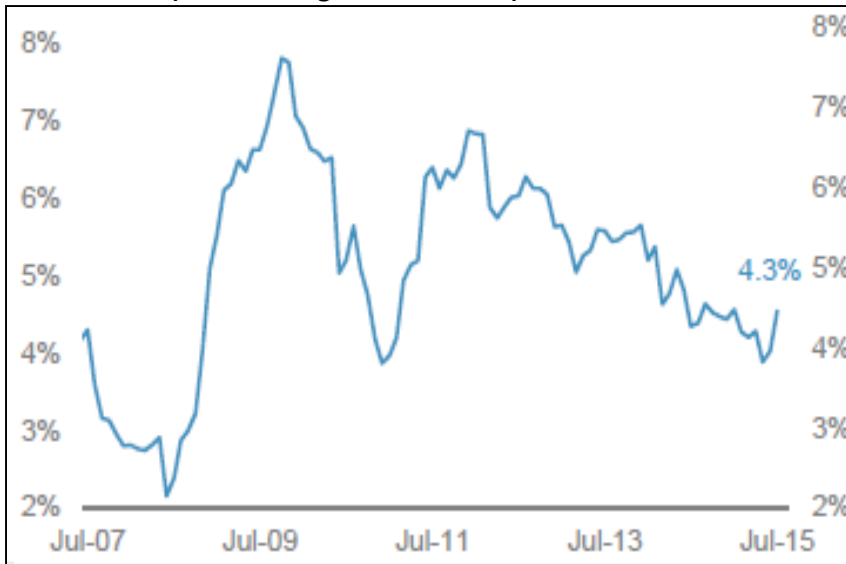
Projects under implementation but stalled as % of total O/S Projects



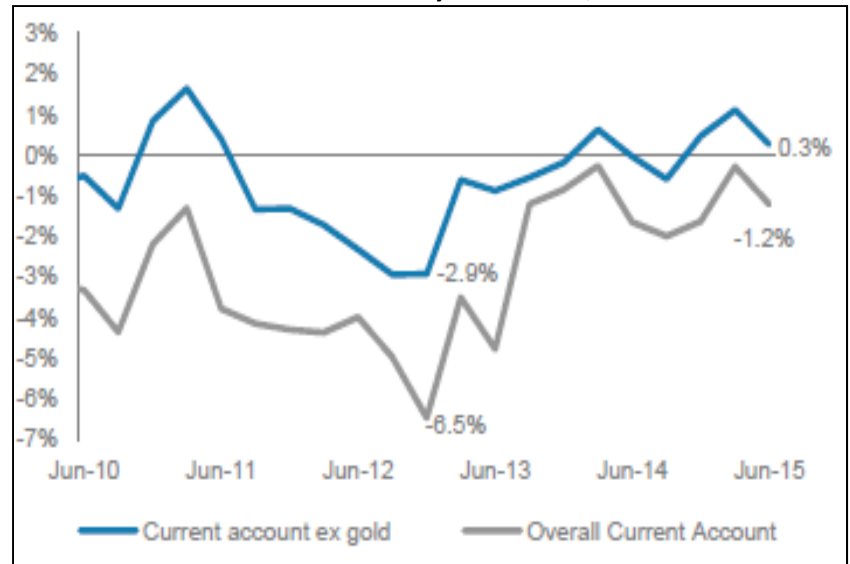
- New project announcements rose sharply led by some high profile projects like the recent \$5 bn Foxconn deal
- However, after moderating consistently for several quarters, stalled investment projects rose in the July-September period. A key driver of this was the languishing steel sector

India Twin Deficit - Broadly stable

Fiscal Deficit (12M Trailing Sum % of GDP)



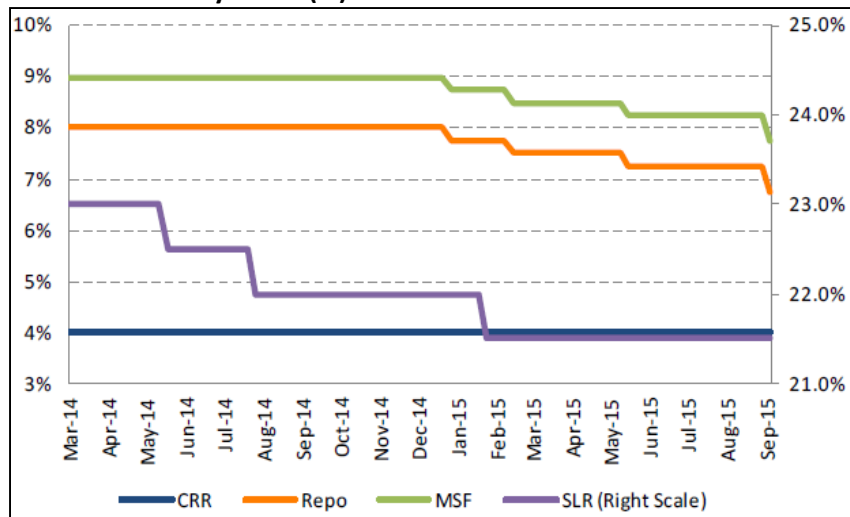
Current Account Deficit – Quarterly annualized, % of GDP



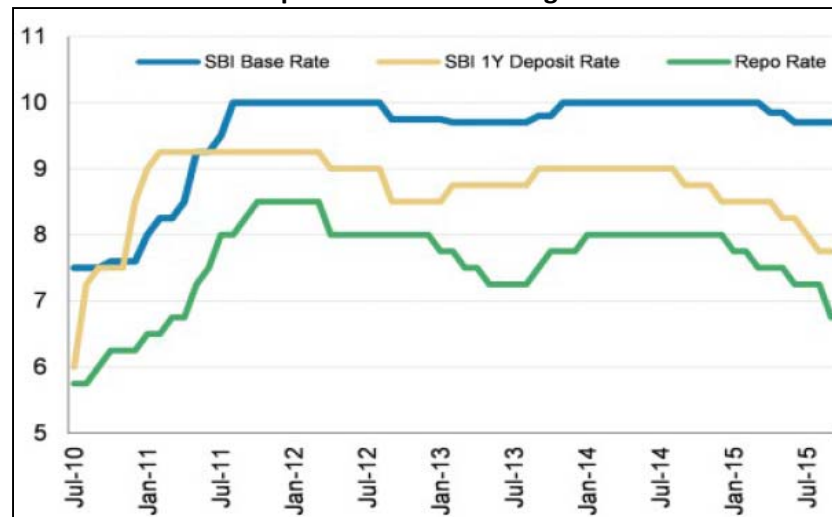
- On a 12 month trailing basis – fiscal deficit increased from 3.7% of GDP in June 2015 to 4.3% of GDP. The deterioration is mainly on account of bunched¹ expenses
- On the external front, trade deficit and current account deficit has witnessed a meaningful improvement

Monetary Policy –Frontloaded

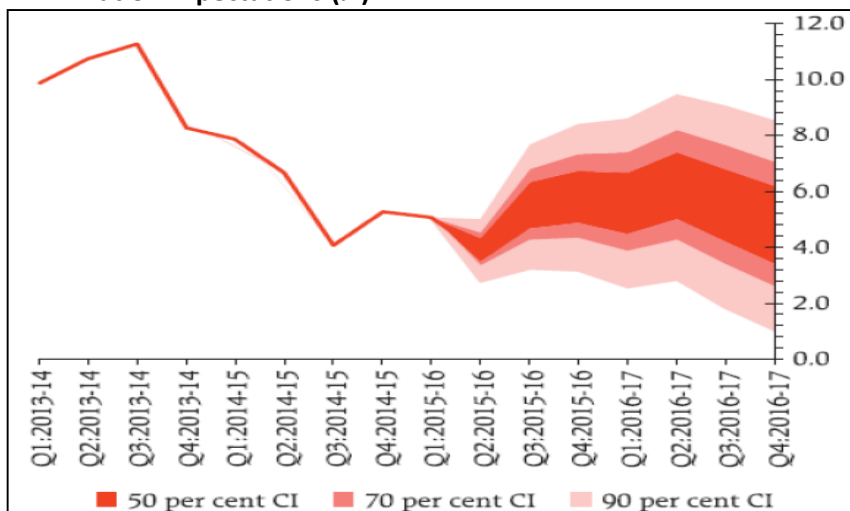
Benchmark Policy Rates (%)



Bank Base Rate vs. Deposit Rate and Lending Rates



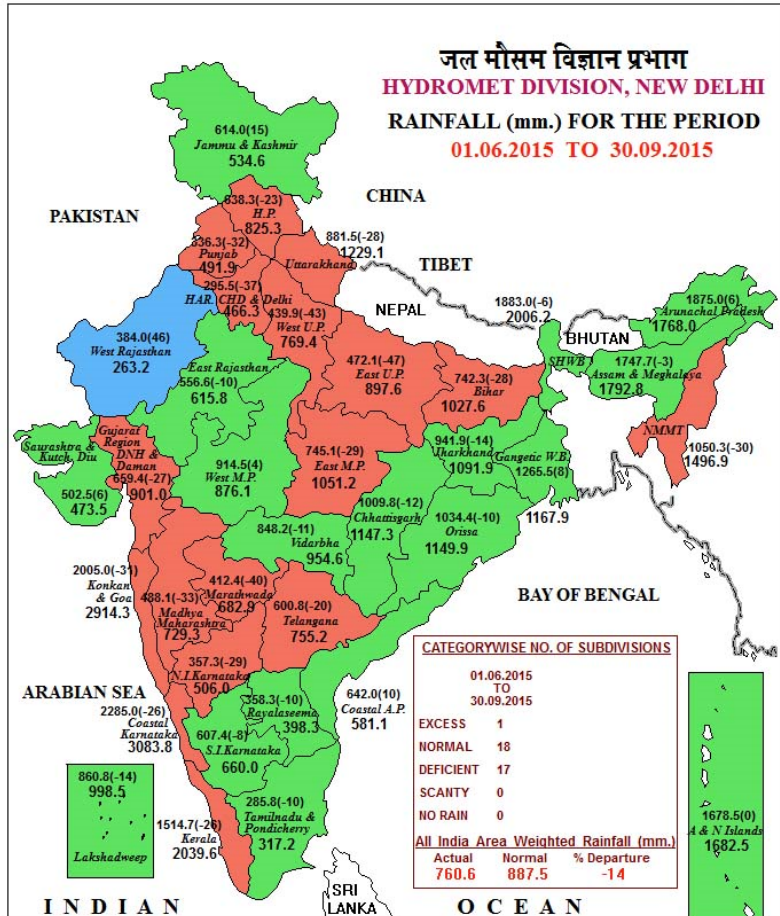
RBI Inflation Expectations (%)



- In a surprise move, the RBI in its Monetary Policy has reduced the repo rate by 50 bps from 7.25% to 6.75%
- Further, the RBI has emphasized the shift in focus towards transmission of lower interest rates
- RBI estimates 4.8% terminal inflation by 4QFY17. Also it estimates inflation to be well below its targeted 6% rate by January 2016

India – Monsoon- Weak Showing

Trends in Daily Rainfall



Monsoon deficiency concentrated in five states, three of which are well irrigated and have strong reservoir levels

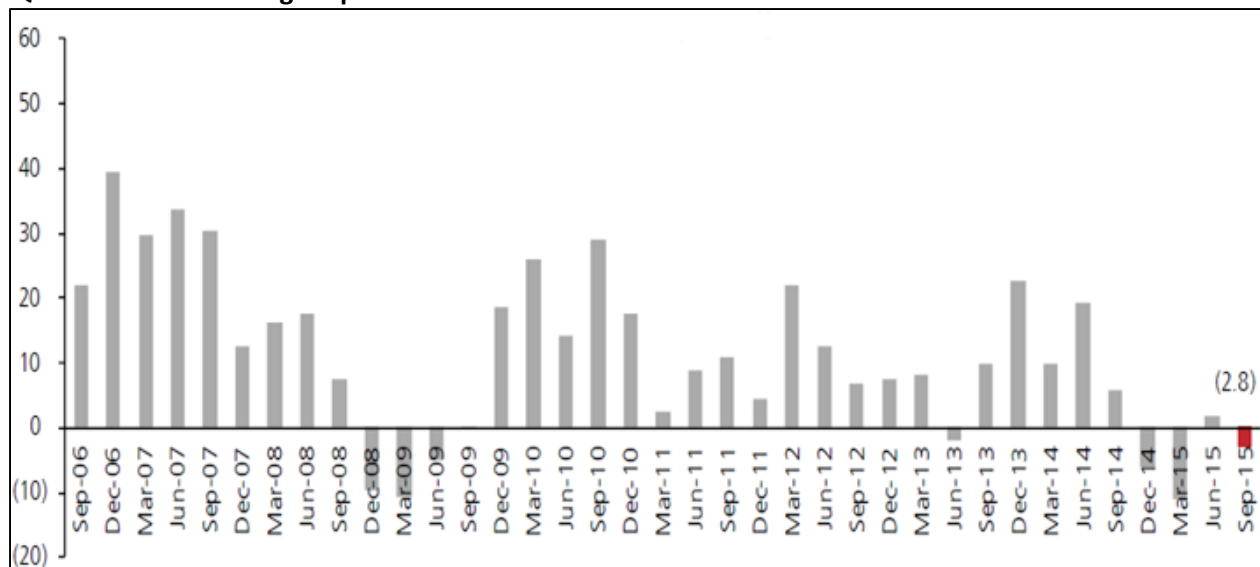
State	Rainfall deficit YTD	Late monsoon recovery	Irrigated area*	Reservoirs level**
Utter Pradesh	-45%	No	76%	76%
Maharashtra	-25%	Yes	16%	58%
Punjab	-41%	No	99%	86%
Haryana	-38%	No	89%	86%
Bihar	-29%	No	67%	60%

Source: Company data, Credit Suisse estimates, *food grain, **in region

- IMD's projection of 12% shortfall in full season rainfall has been unfortunately on target
- The actual rainfall in the monsoon season was 14% below long period average
- Kharif sowing as of September 24, 2015 is 1.2% higher than that of the same period last year
- However, kharif crop is only ~40% of the Agri GDP in India, and better irrigation and electricity have lowered the dependence on monsoons over the years.

Earnings Season – Slowdown Expected

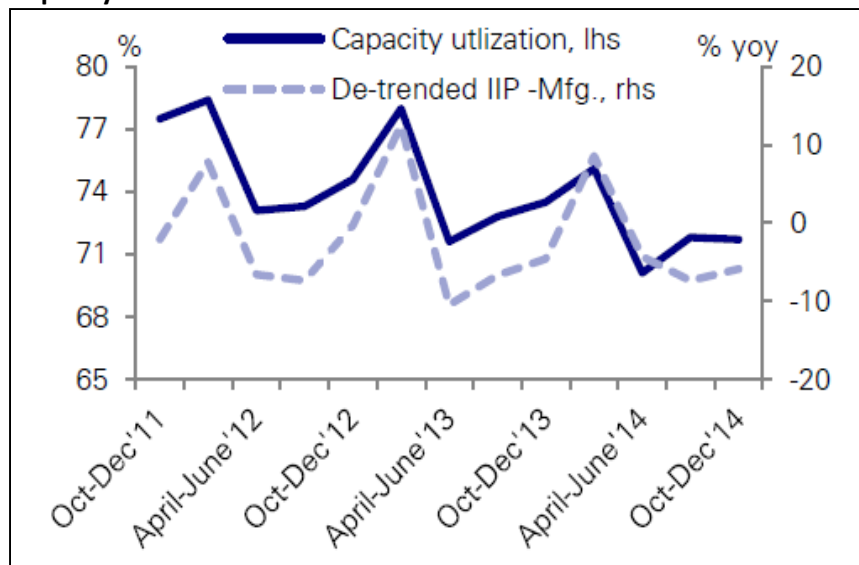
Q2FY16 Sensex Earnings expectation



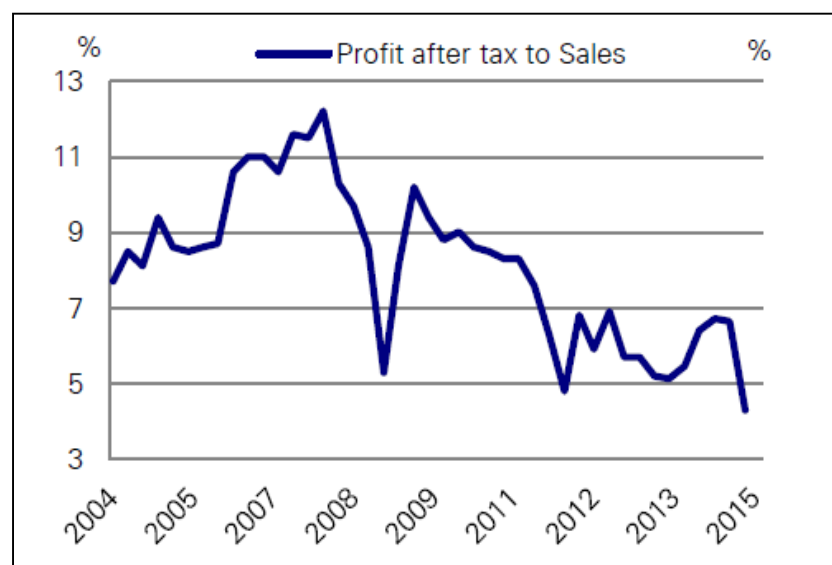
- Currently, analysts expect a 2.8% fall in Sensex earnings in Q2FY16
- The fall is led by Metals, Telecom, Utilities and Automobiles sector, partially offset by growth in earnings in Banking and Industrials sector

Earnings – Levers for Recovery

Capacity Utilisation trends

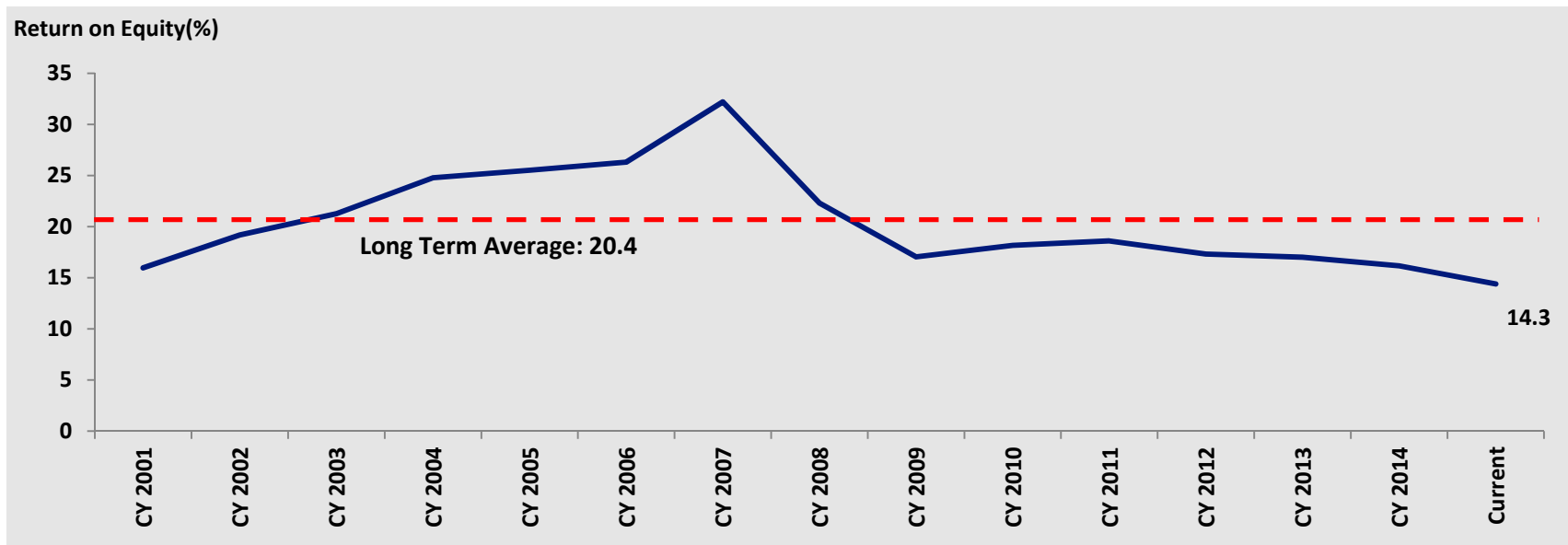


PAT to sales ratio



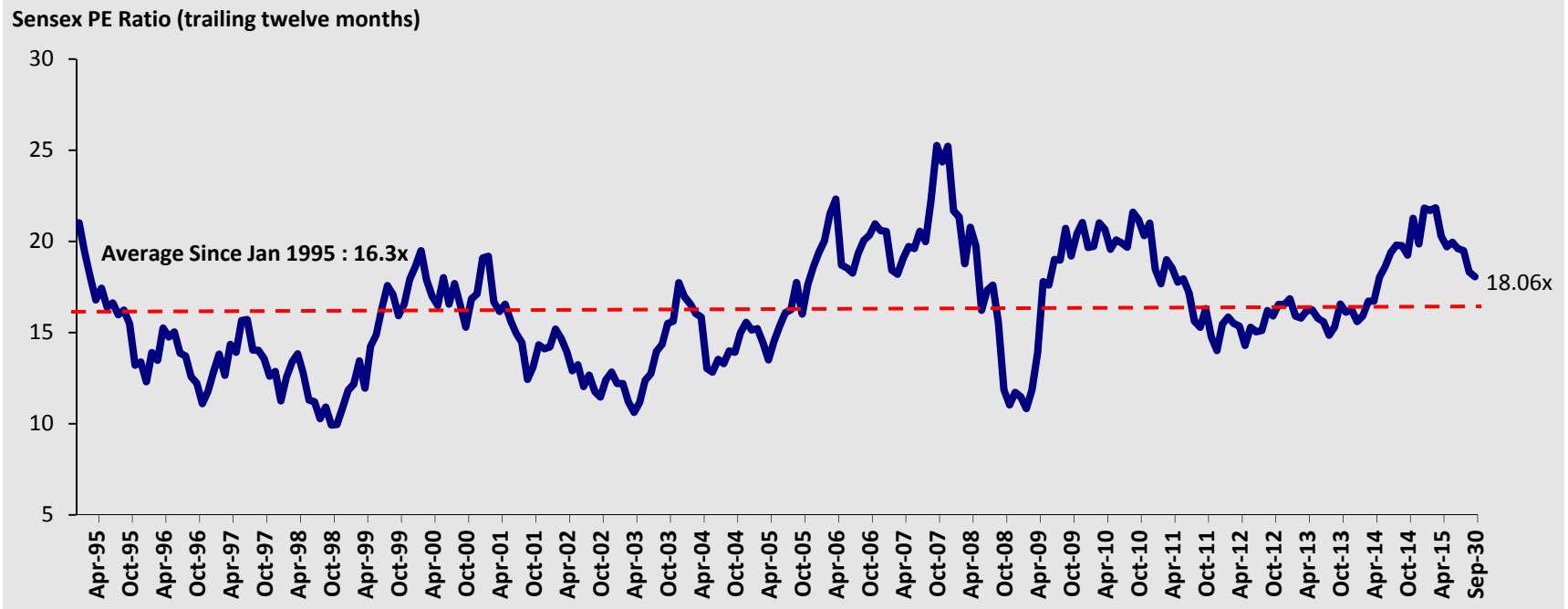
- While current earning cycle is weak, there are levers to earnings recovery
- Current capacity utilisation of Indian Companies is quite low implying significant operating leverage
- Profit to Sales ratio is also at a decade low and can mean revert in a cyclical upturn

Valuations – RoE subdued



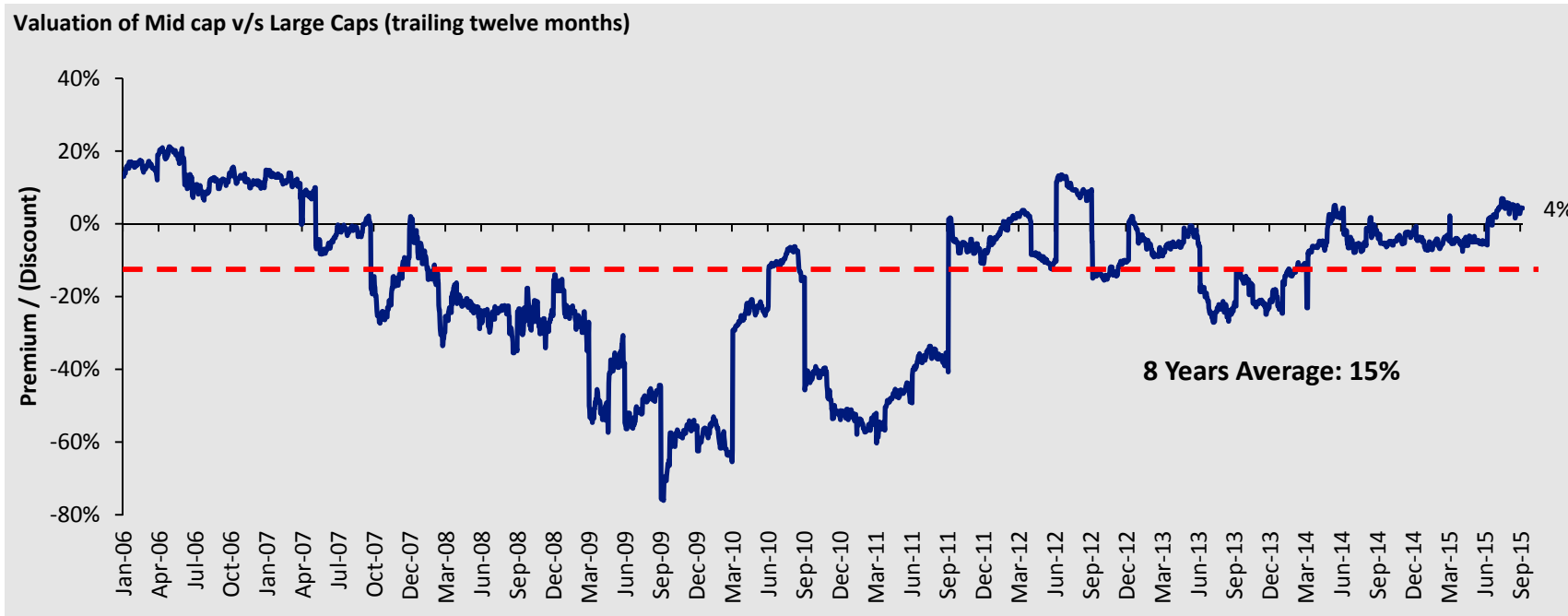
- While markets are trading at a premium to its long term average, the underlying Return on Equity (RoE) is below its long term average
- This is a reflection of the poor PAT to sales ratio (refer previous slide)

Valuations - Premium to Long term Average



- Recent price correction has resulted into meaningful valuation correction despite weak earnings
- Sensex now trades at a 11% premium to its long term trailing 12 months average P/E multiple as compared to 22% premium in March 2015

Relative valuation of Midcaps



- Midcap Index valuation is currently at a 4% premium to its large cap peer (Nifty), as compared to a long period average of 15% discount

- Falling commodity prices and weak demand has led to concerns on global growth
- In India, macro economic parameters like current account deficit , fiscal deficit and high inflation have shown significant improvement
- However, economic activity outcomes are mixed – demand conditions remain weak, but investment cycle is in a slow and intermittent recovery
- Valuations have corrected and are now at 11% premium to long term average. This is edging closer to the comfort zone
- Earnings growth still remains weak but has levers to improve as the recovery gains traction
- Sectors such as financials, consumer discretionary and industrials may benefit from cyclical recovery in growth. Based on valuations, we prefer the financials and consumer discretionary over industrials
- Earnings growth for midcap companies will likely improve with a recovery in domestic growth and a more benign monetary environment
- We favour, a pro cyclical stance to benefit from a recovery in the economic cycle but given current valuations, we are keeping it balanced and our portfolio strategy is focused on bottom up stock picking

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