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# Market Insights

July 2015

The Indian equity markets have corrected by about 7% from their peak levels. Year to date (YTD), the S&P BSE Sensex has gained just about 1% and the BSE Midcap index about 3%. The premium to the long term average has corrected from the peak of about 30% to being slightly over 20% at present.

It is obvious that the most attractive time to buy is when the valuations are below average, but presently, the fall in the P/E ratio is lower as compared to the decline in the share prices given the weak Q4 corporate earnings. While we do find relative value in a larger number of stocks today as compared to the first quarter of 2015, the number of stocks where we perceive the valuations to have dropped in absolute terms are very few.

Having said that, we do believe that sequentially there could be some improvement in earnings in the June ’15 quarter, especially given the low base effect of the March ’15 quarter that was impaired by the dramatic fiscal squeeze by the government. Current trends do suggest that the government spending should turn supportive this year. While the growth in government spending was flat in the month of May ’15 after a surge of 33% in the previous month and on Year to Date (YTD) basis; the two-month cumulative government spending at 15% of the FY 16 target is the third highest in nearly two decades. The constituents of spending are also encouraging with capital spending having sharply improved.

If we look at the economic growth, the FY 15 GDP growth at 7.3% is a significant improvement over the FY 14 GDP growth of 6.9% notwithstanding the subdued monsoon and sluggish consumption trends. This economic recovery is led by investments as seen by marginal improvement in the gross fixed capital formation to 4.6% from 3%. Consumption, on the other hand, has slowed down a tad to 6.4% from 6.5%. The consumer price inflation (CPI) too is well within RBI’s comfort zone despite having picked up marginally to 5% (May ’15) from 4.9% in the previous month while the WPI came in at -2.4% vs. -2.7%. The rise was primarily driven by pulses, vegetables and petrol.

The credit growth, however, continues to exhibit a lackluster trend. The RBI’s data (May ’15) shows that the non-food credit growth continues to be low at 9% year on year vis-à-vis 8.9% year on year in the previous month. Though there is some pick up in the lending to the services and retail sectors, the lending to industry sector has moderated. Meeting industry expectations, the RBI did trim the repo rates by another 25 bps in its June ’15 monetary policy to 7.25%, its third repo rate cut so far this calendar year, while leaving the CRR and the SLR unchanged at 4% and 21.5% respectively, in its bid to encourage credit growth. However, the central bank has clearly hinted that any further guidance on easing of interest rates would be data contingent with factors such as sub-par monsoon and moderation in minimum support prices (MSP) playing a key role in subsequent policy decisions.

The monsoon, despite having got to a good start with 16% above normal rains since June 1, is marred with concerns of getting deficient going forward, as has been predicted by the Indian Met Department (IMD). The IMD has forecast a 12% shortfall in the seasonal rainfall this year on concerns of strengthening of the El Nino following which the RBI has pared down its FY 16 GDP forecast by 20 bps to 7.6%.

We believe that there will be potential recovery in the economic growth over the next few years and we do recognize the prospects of mean reversion in profits. Presently a number of industries are struggling from lower capacity utilization and high interest rates and profits as a percentage of revenues and GDP are also at subdued levels. However, the industrial output for the month of April ’15 did improve to a healthy 6.1% from 4.5% last year. The CMIE data on capex related indicators for

Jun ’15 quarter also shows that the total projects under implementation grew by 8.4% year on year for the Jun ’15 quarter as compared to the 5.1% year on year growth in March ’15 quarter.

Notably, the projects under implementation by the private sector have grown for the first time in past eight quarters by 0.8% year on year in the Jun ’15 quarter vis-à-vis a contraction of 0.9% year on year in Mar ’15 quarter. Also, the new projects announced increased to Rs 1.1 trillion on a 4-quarter trailing basis, which is the highest since Sep ’11.

In view of the improving macro and economic health, we believe it fit to maintain a pro-cyclical exposure in investment portfolios where valuations are reasonable so as to benefit from the mean revision in profits in due course. Our bias is towards companies with healthy balance sheets & return ratios as we think these companies are best placed to exploit an upturn in growth.