

Equity Markets : Current Environment and Outlook

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Current Environment

- Global Equity markets consolidated its gains in August with the MSCI World Index rising by 2.29%
- Indian markets under performed their global peers, rising by 1.1%, which is less than the gains in global equity markets
- Commodity prices reflected the gains in the global equity markets with the benchmark CRB Reuters Jefferies total return index rising by 3.2%
- IT and FMCG were the best performing sectors, while Realty and Metal sectors delivered the worst return for the month*
- FII inflows during the month were at Rs.108bn. MF were net sellers at Rs.16bn, while DII were net sellers of Rs.43bn during the month
- Trading Activity remained subdued in August with the cash market trading turnover declined by 4% MoM and average open interest increased by 9% on a MoM basis

* Please refer slide 4 for sector performances



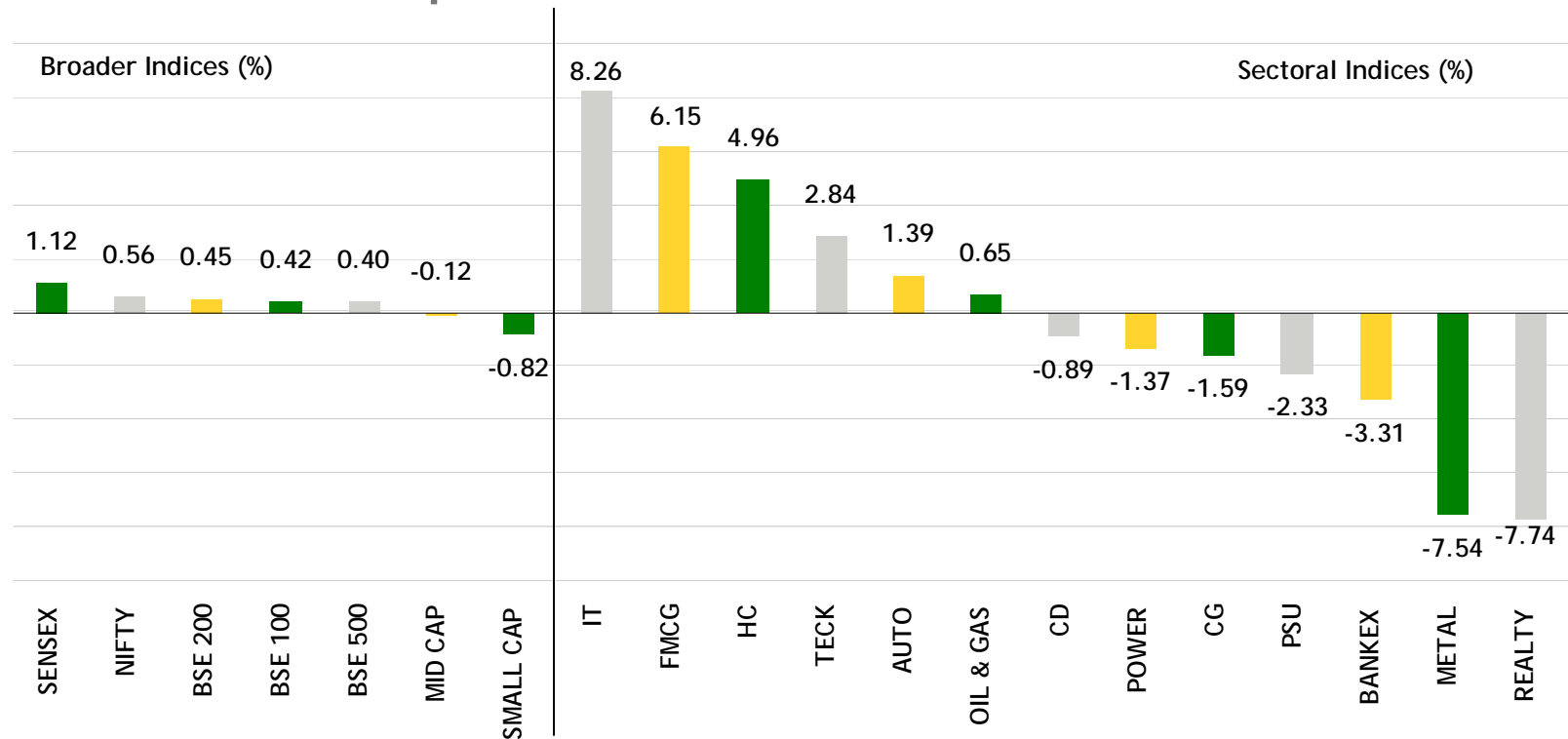
Global Equities

Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	2047.52	-2.67%	-6.91%	EM - Asia
BSE Sensex	India	17429.56	1.12%	12.78%	EM - Asia
Kospi	South Korea	1905.12	1.23%	4.35%	EM - Asia
Taiwan Weighted	Taiwan	7397.06	1.74%	4.60%	EM - Asia
Thailand SET 50 Index	Thailand	840.32	1.41%	16.97%	EM - Asia
Jakarta Composite Index	Indonesia	4060.33	-1.98%	6.24%	EM - Asia
KLSE	Malaysia	1646.11	0.89%	7.54%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	57061.45	1.72%	0.54%	EM
Mexico IPC	Mexico	39421.65	-3.15%	6.32%	EM
Russian RTS Index	Russia	1389.72	0.90%	0.57%	EM
Philippine PSEi	Philippines	5196.19	-2.10%	18.85%	EM
Merval Buenos Aires Index	Argentina	2408.38	0.34%	-2.20%	EM
HangSeng	Hong Kong	19482.57	-1.59%	5.69%	Developed - Asia
Nikkei	Japan	8839.91	1.67%	4.55%	Developed - Asia
Strait Times	Singapore	3025.46	-0.36%	14.33%	Developed - Asia
Dow Jones	USA	13090.84	0.63%	7.15%	Developed
CAC 40 Index	France	3413.07	3.69%	8.02%	Developed
All Ordinaries Index	Australia	4339.02	1.16%	5.55%	Developed
DAX Index	Germany	6970.79	2.93%	18.18%	Developed
Swiss Market Index	Switzerland	6388.01	-0.18%	7.61%	Developed
FTSE 100	UK	5711.48	1.35%	2.50%	Developed
MSCI World Index	--	1279.21	2.29%	8.17%	--

* as on 31st August, 2012. Source: Bloomberg
EM – emerging markets, Developed – developed markets.



India : Sector performances



- Nifty rose by 0.56% over the previous month
- MidCaps and SmallCaps under performed LargeCaps with 0.12% fall in the MidCap index and 0.82% fall in SmallCap index
- IT and FMCG were the best performing sectors
- Realty and Metal sectors delivered the worst return for the month

Source: BSE,NSE. one month performance as on 31st August, 2012. CD: Consumer Durables, CG: Capital Goods, HC: Health Care. FMCG: Fast Moving Consumer Goods



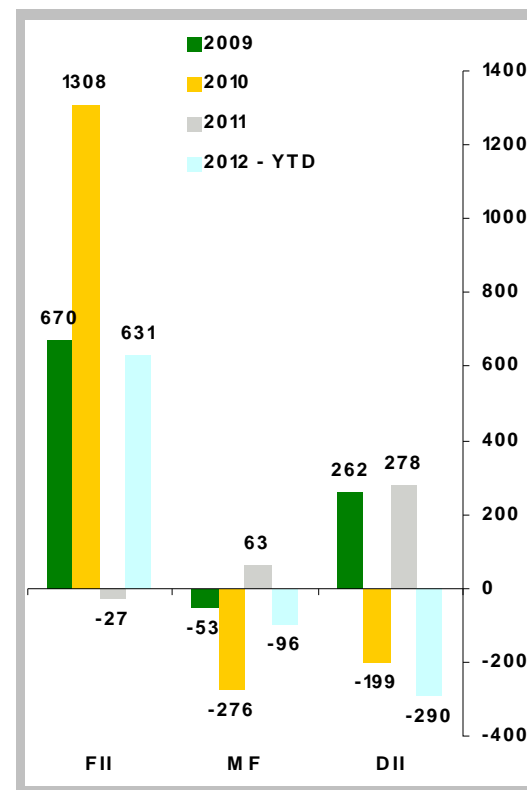
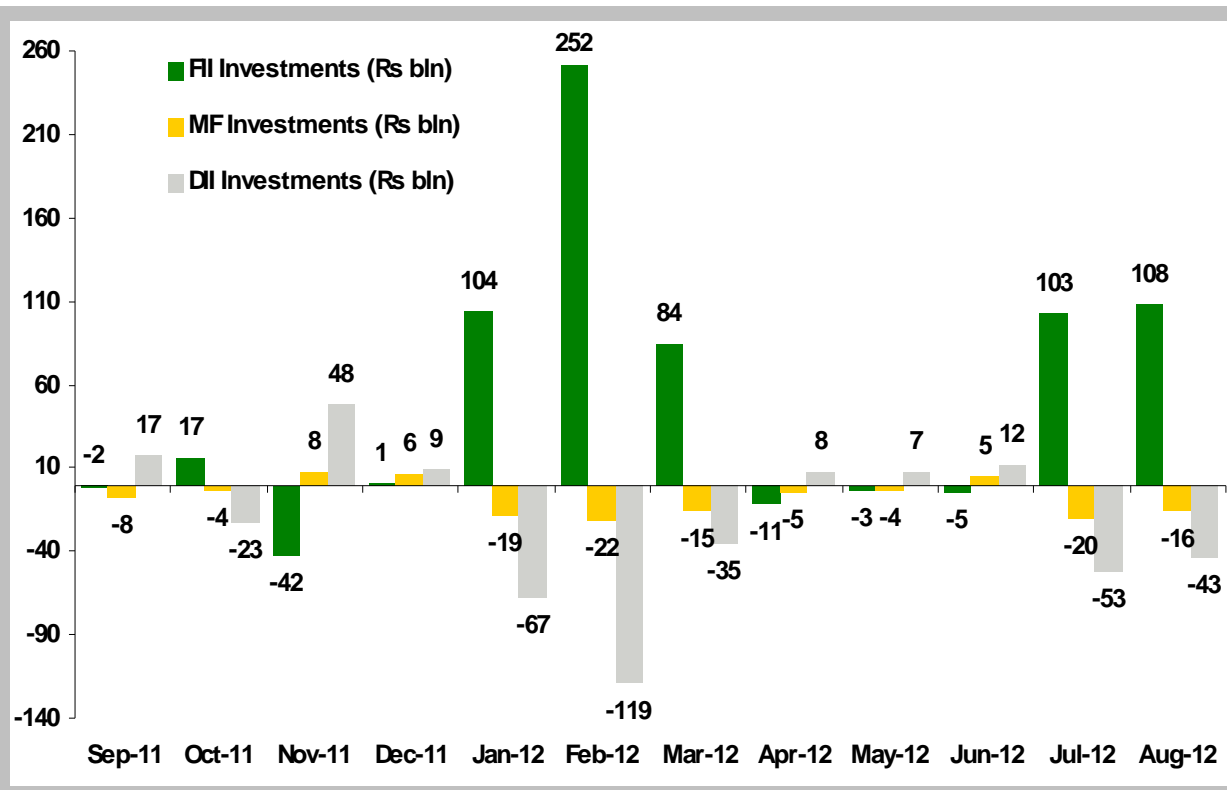
Top Gainers / Losers - Nifty

Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
Cipla	383.1 / 272.85	376.45	11.18%
Ranbaxy Labs.	562 / 365.5	551.70	10.89%
Hind. Unilever	550.85 / 314.95	515.10	10.22%
M & M	877.3 / 621.1	763.15	8.89%
TCS	1388.8 / 969	1343.75	8.05%
Top Losers for the month			
Losers	52 week H/L	Last Price#	% Loss*
JP Associates	88.95 / 50.35	64.55	-12.06%
Hero Motocorp	2279 / 1704	1763.00	-12.07%
Tata Steel	503.5 / 332.1	361.40	-12.80%
Hindalco Inds.	164.9 / 102.3	103.85	-13.53%
Bharti Airtel	418.95 / 238.45	247.80	-17.41%

closing price as on 31st August, 2012.* one month performance as on 31st August, 2012.
Source: Capitaline



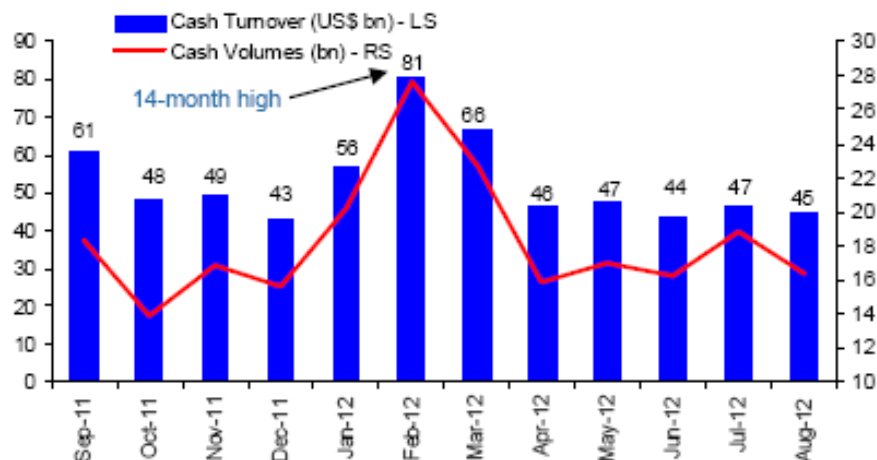
FII & DII Inflows



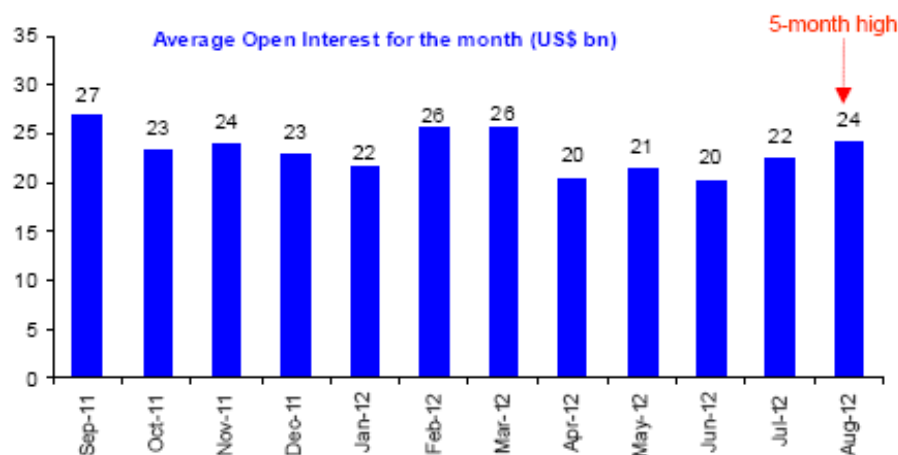
- Institutional activity remained upbeat in August
- FII inflows during the month were at Rs.108bn. FII inflows were at Rs.631bn for CY12 YTD after a Rs.27bn outflow in CY11 and Rs.1308bn inflow in CY10
- MF were net sellers at Rs.16bn, while DII were net sellers of Rs.43bn during the month



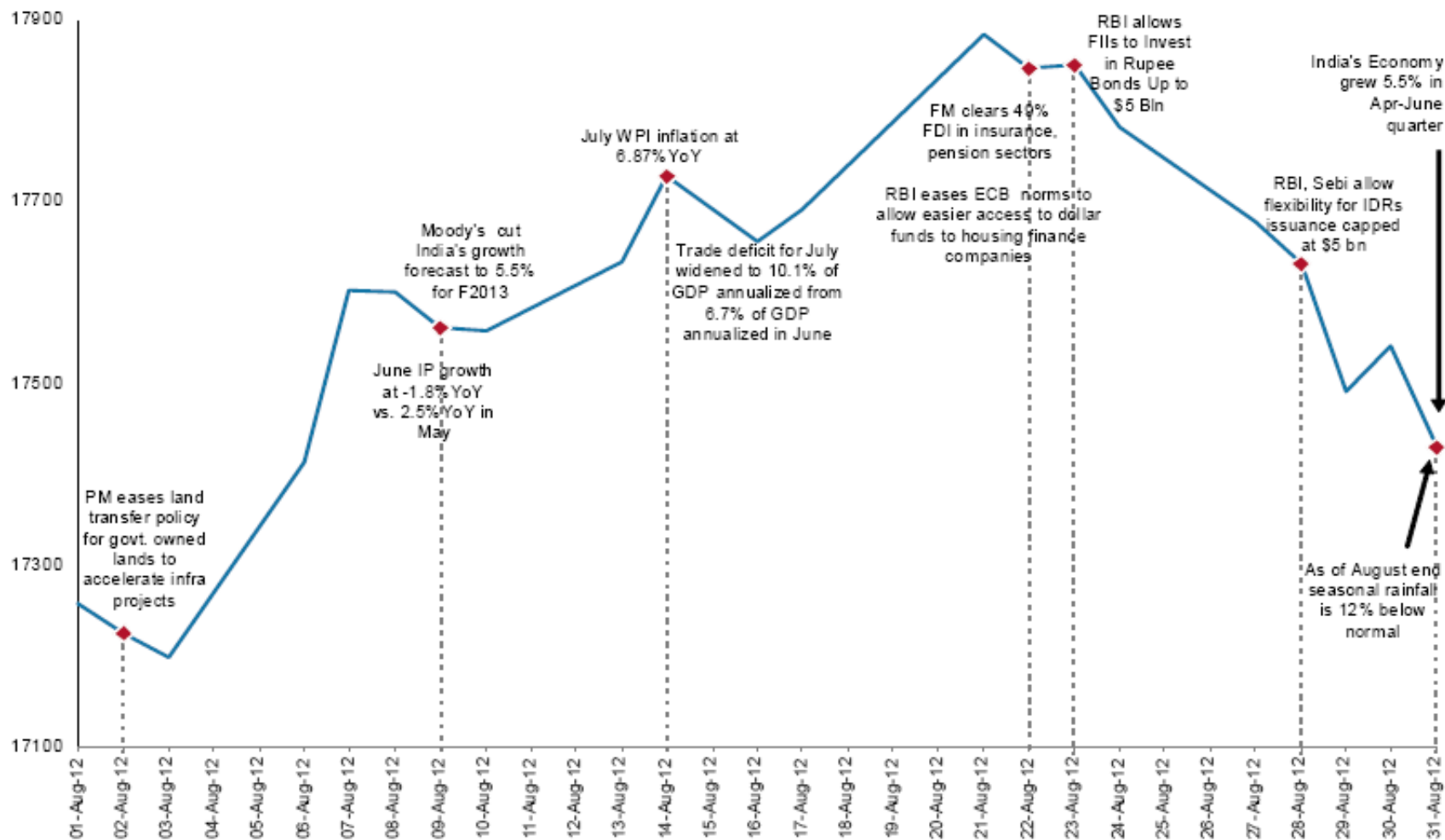
Market Activity



- In August 2012, cash market trading turnover declined by 4% MoM
- At the end of August 2012, average open interest increased by 9% on a MoM basis



August 2012 events timeline



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

Note: The above shown index is BSE Sensex .



Religare MF: Equity Market Outlook and Opportunities

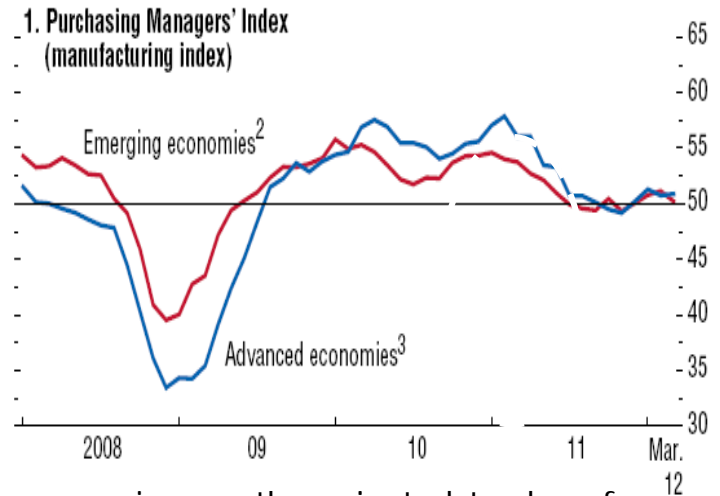
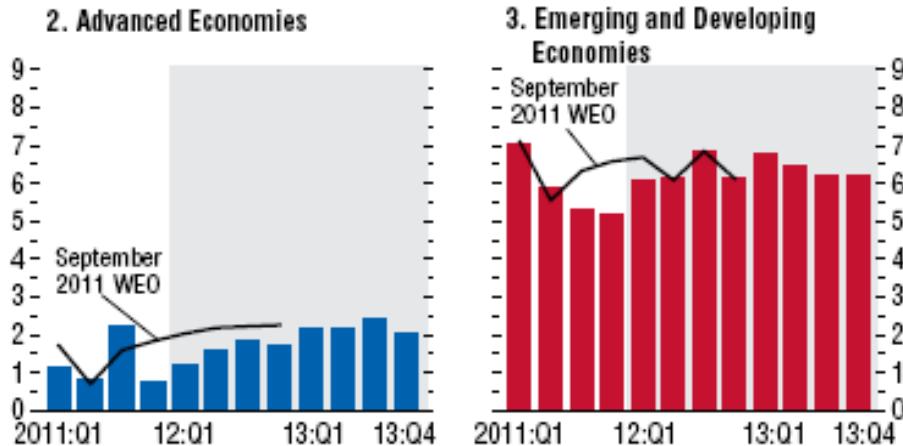
Equity Market Outlook

- The IMF has cut its global growth outlook, with global economic growth projected to drop from about 4% in CY2011 to about 3.5% in CY2012 because of weak activity during the second half of 2011 and the first half of 2012
- The reacceleration of activity is expected only during the course of second half of CY2012, which in turn is expected to lead to global growth of about 4% in 2013 (as per IMF estimates)
- India's GDP growth for Q1FY13 was at 5.4%, slightly better than the 5.3% reported in Q4FY12. However, while the GDP growth is slightly better than expected, the slowdown in services is concerning and can lead to further slowdown in the near future
- Credit markets remained weak as CRISIL downgrade rate increased to 3.6%; while the upgrade rate dipped to its lowest in the past 24 months, highlighting increased stress in credit markets
- Monsoons staged a comeback in August after being depressed till July coming in at ~12% below normal in August vis-à-vis ~22% below normal in July. This improves the prospects for a normal winter crop this year as reservoir levels in the country have also risen to above average levels
- June 2012 earnings have disappointed with Nifty earnings about 6% lower than market expectations, led by margin disappointment. The performance of broader market (BSE 500) was worse than the narrow market (Nifty)
- Consensus expectations for FY13 earnings growth are at 11% growth, which appears reasonable



Global Macro – IMF raises red flag on global growth

Real GDP Growth (annualized quarterly % Chg)



- The IMF has cut its global growth outlook, with global economic growth projected to drop from about 4% in CY2011 to about 3.5% in CY2012 because of weak activity during the second half of 2011 and the first half of 2012
- The growth slowdown is expected to be led by Euro Area, which is expected to report a decline in GDP in CY12
- The reacceleration of activity is expected only during the course of second half of CY2012, which in turn is expected to lead to global growth of about 4% in 2013 (as per IMF estimates)
- Currently markets are fixated on announcements of fresh rounds of Quantitative Easing (QE) from central banks in both US and Europe (which has already announced unlimited but conditional QE)



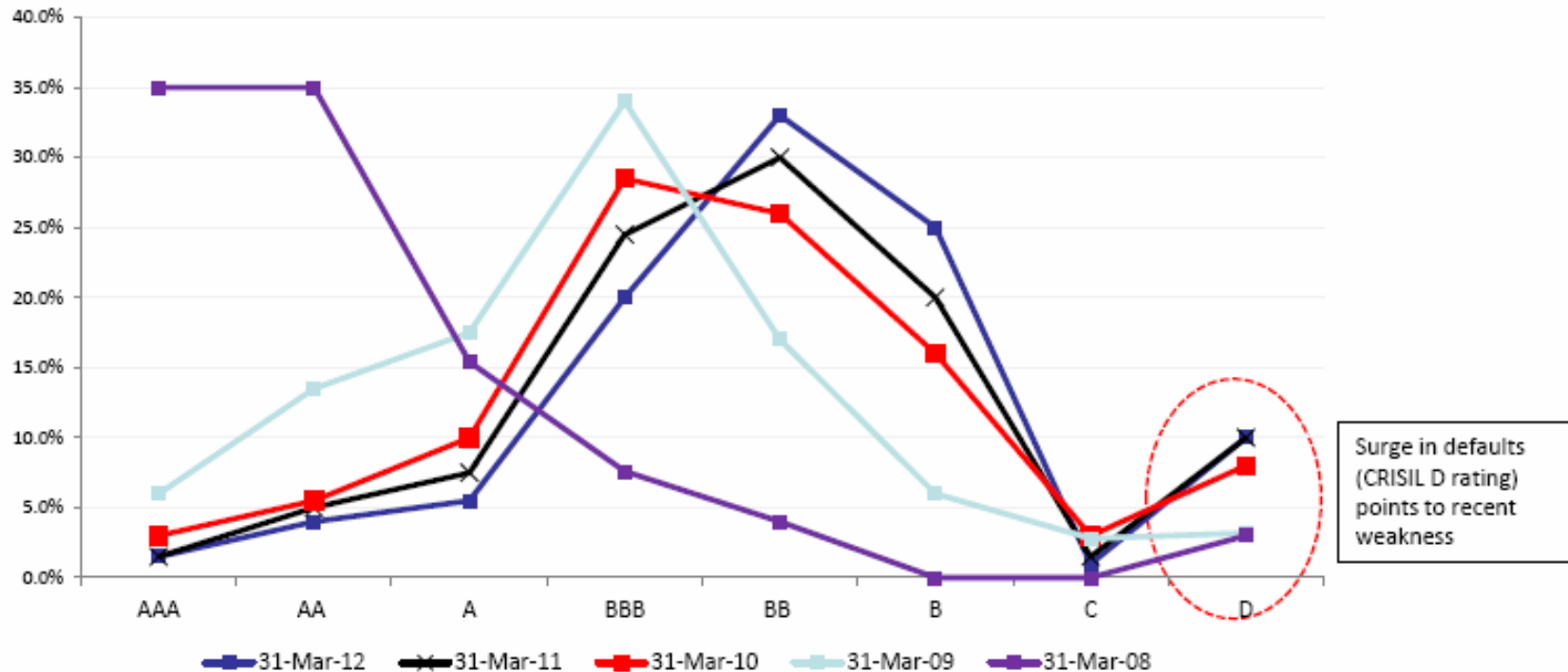
India's GDP Growth – slowdown continues



- India's GDP growth for Q1FY13 was at 5.4%, slightly better than the 5.3% reported in Q4FY12
- Both the agriculture and industrial growth were higher on a sequential basis, but are expected to slow down in the near term due to poor monsoons and subdued investment demand respectively
- Also while the GDP growth is slightly better than expected, the slowdown in services is concerning and can lead to further slowdown in the near future



Liquidity & Credit - stress in market visible

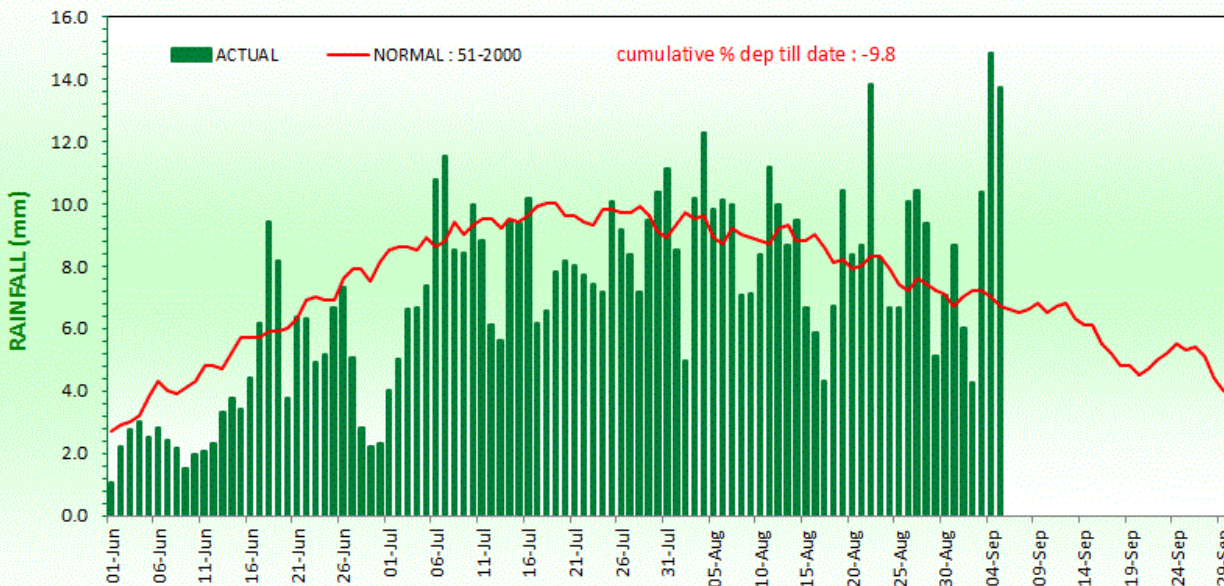


- CRISIL downgraded 292 ratings in H2-12, bringing the downgrade rate to 3.6%; the upgrade rate dipped to its lowest in the past 24 months, highlighting increased stress in credit markets
- More than a 1/3 rd of the 492 downgrades in FY 11/12 were to default category
- Credit spreads of 1 Year and 10 Year AAA bonds to Government securities have increased in 2012, also indicating elevated stress in the funding markets for corporates



Monsoons – springs a positive surprise in August

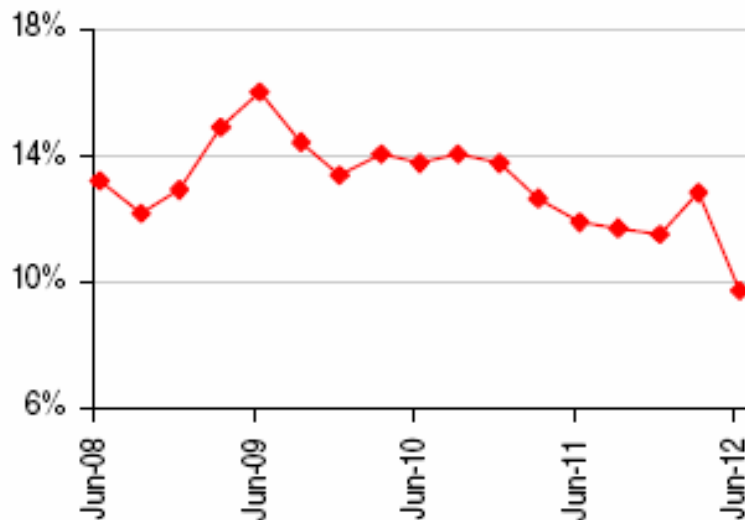
DAILY MEAN RAINFALL (mm) OVER THE COUNTRY AS A WHOLE (2012)



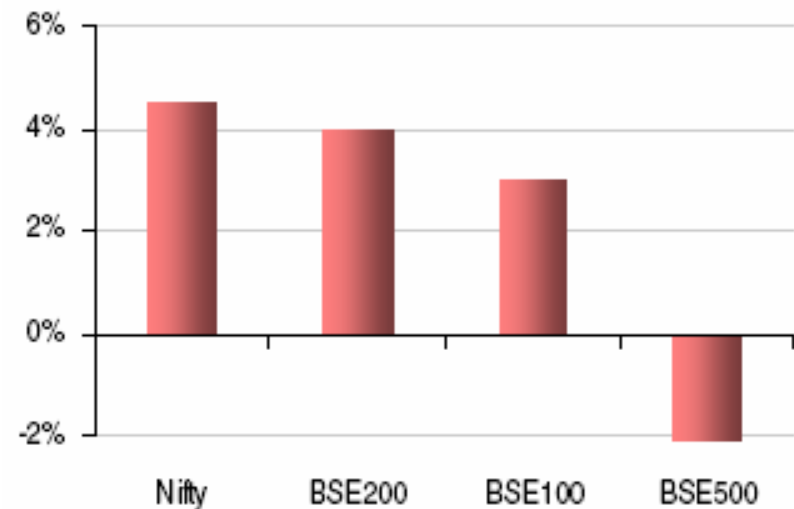
- Monsoons staged a comeback in August after being depressed till July. According to the last available data from the IMD, the monsoon has come off to ~12% below normal vis-à-vis ~22% below normal in July
- More importantly this raises the prospects for a normal winter crop (Rabi) this year as reservoir levels in the country have also risen to above average levels from their level a month ago

June 2012 Earnings Season – disappointing and polarized

Net profit margin of Nifty companies



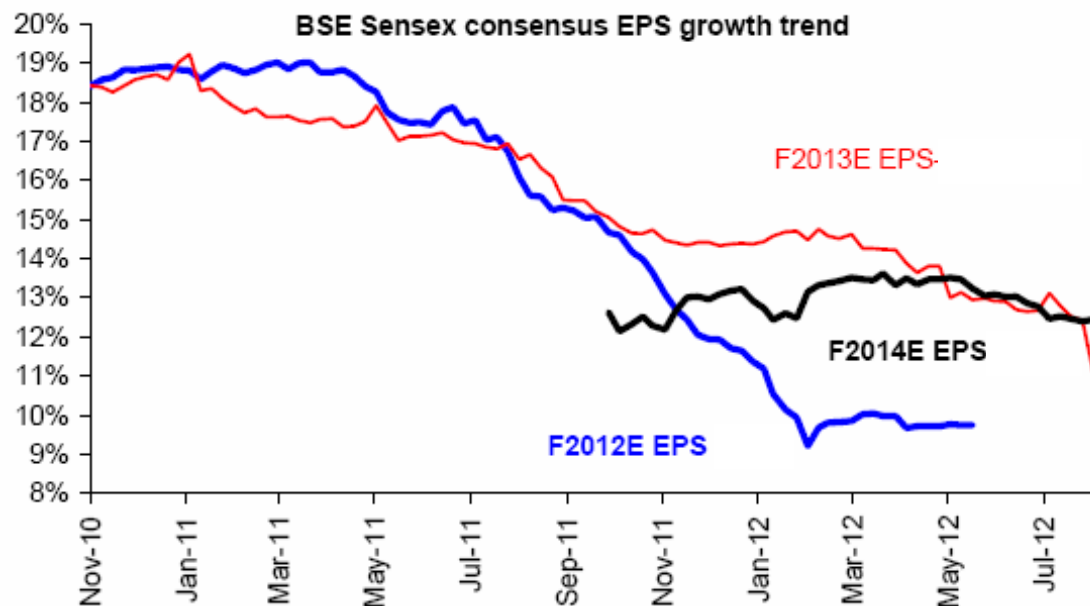
Earnings growth excluding oil marketing co's (y-o-y)



- June 2012 earnings have disappointed with Nifty earnings about 6% lower than market expectations, led by margin disappointment
- Net Profit Margins for Nifty companies corrected by 320 bps to 9.7%, led by increased raw material costs and interest expenses
- The performance of the narrow market was better than the broader market, with the earnings of Nifty companies growing by 4.5% compared to 2% decline for BSE 500 companies



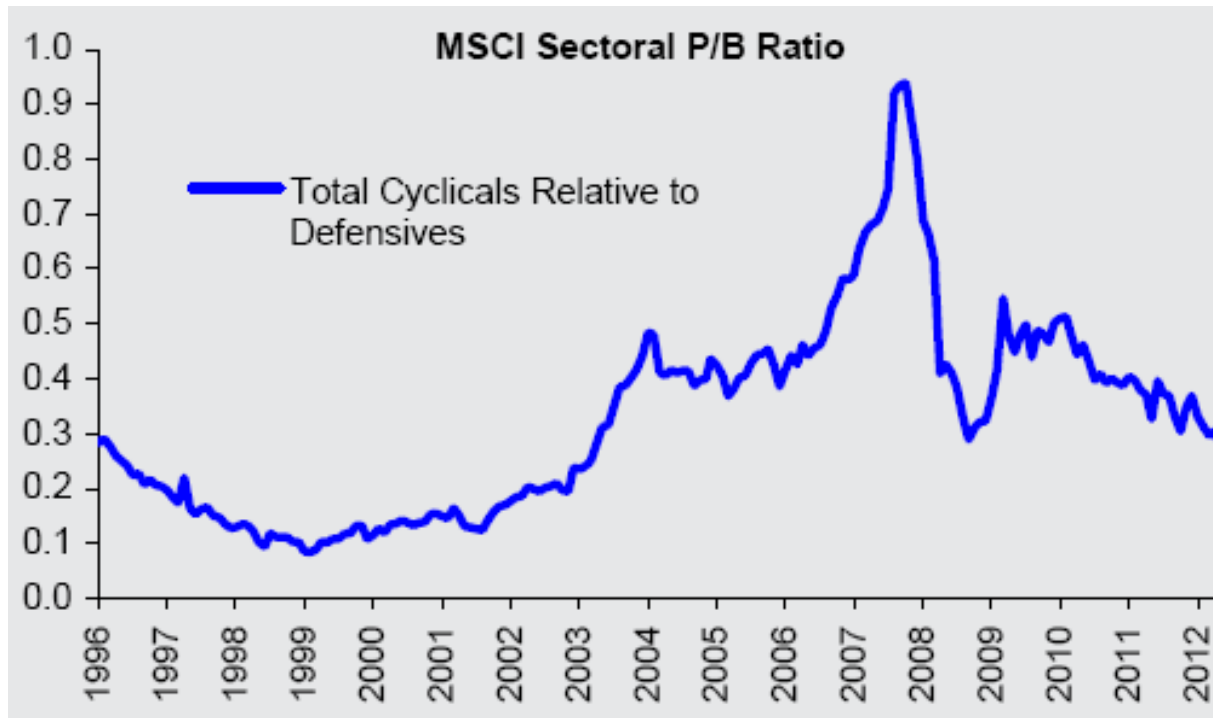
Earnings Forecasts – Earnings Expectations Moderated



- Consensus expectations for FY13 earnings growth are at 11% growth, which appears reasonable
- Though the poor monsoon may not have a significant impact on aggregate earnings forecasts, however companies with higher exposure to rural markets could see pressures



Valuations – dichotomy between sectors

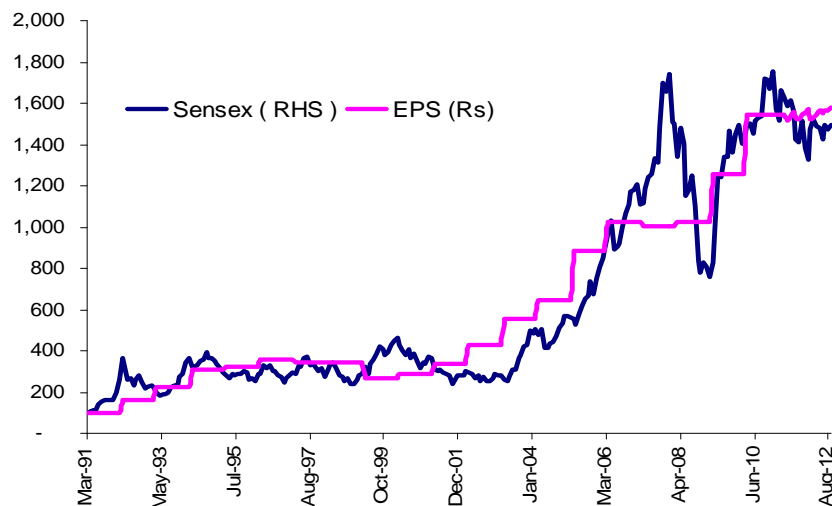
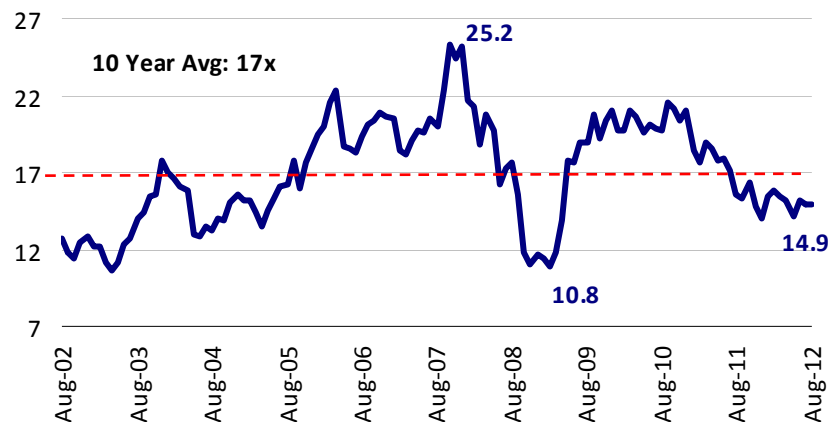


- Valuation premium of defensive vs cyclicals is currently at a 5-year high
- This is visible in both Global Emerging Markets (GEMS) as well as India PE ratios of defensives vs cyclical sectors



Valuations – At Reasonable Levels

Sensex PE Ratio (trailing twelve months)



- Sensex is currently trading at 14.9x its trailing earnings. It is now 12% lower than its historical 10-year average trailing PE of 17x
- On a 1-yr forward basis, Sensex is trading at 13.5x which is about 7% below its 10 year average PE
- The derating of market is evident in the accompanying chart with earnings considerably above the 2007 levels whereas the markets have not progressed much over the past 5 years



Looking Ahead...

- The ECB announced unlimited buying of bonds of countries that have reached an agreement on conditionality with the EFSF/ESM
- While the markets are focused on 'unlimited' quantitative easing, it may ignore the conditionality attached to the programme, which may include (highly political) one of having a near fiscal compact
- The government has taken some steps to improve the investment climate (GAAR may be deferred, divestment of PSU to be revived, etc), but more needs to be done to revive the investment cycle
- Fiscal control and policy moves to boost the supply side are a precursor to any RBI action. The RBI remains concerned about inflation
- The macro situation remains challenging. However, less cyclical components of the market are trading at rich valuations and pockets of under valuation exist in the cyclical areas
- Hence we are preferring to emphasize the bottom up stock selection over macro and sector views
- Companies with businesses having reasonable growth prospects and in a healthy financial position, which can ride out the challenging environment and benefit from an improvement in the economic outlook would be preferred. However, in areas where valuations already reflect a high degree of stress, we have been open to making selective investments

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