

Equity Markets:

Current Environment and Outlook

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Chief Investment Officer

August 2013

Current Environment

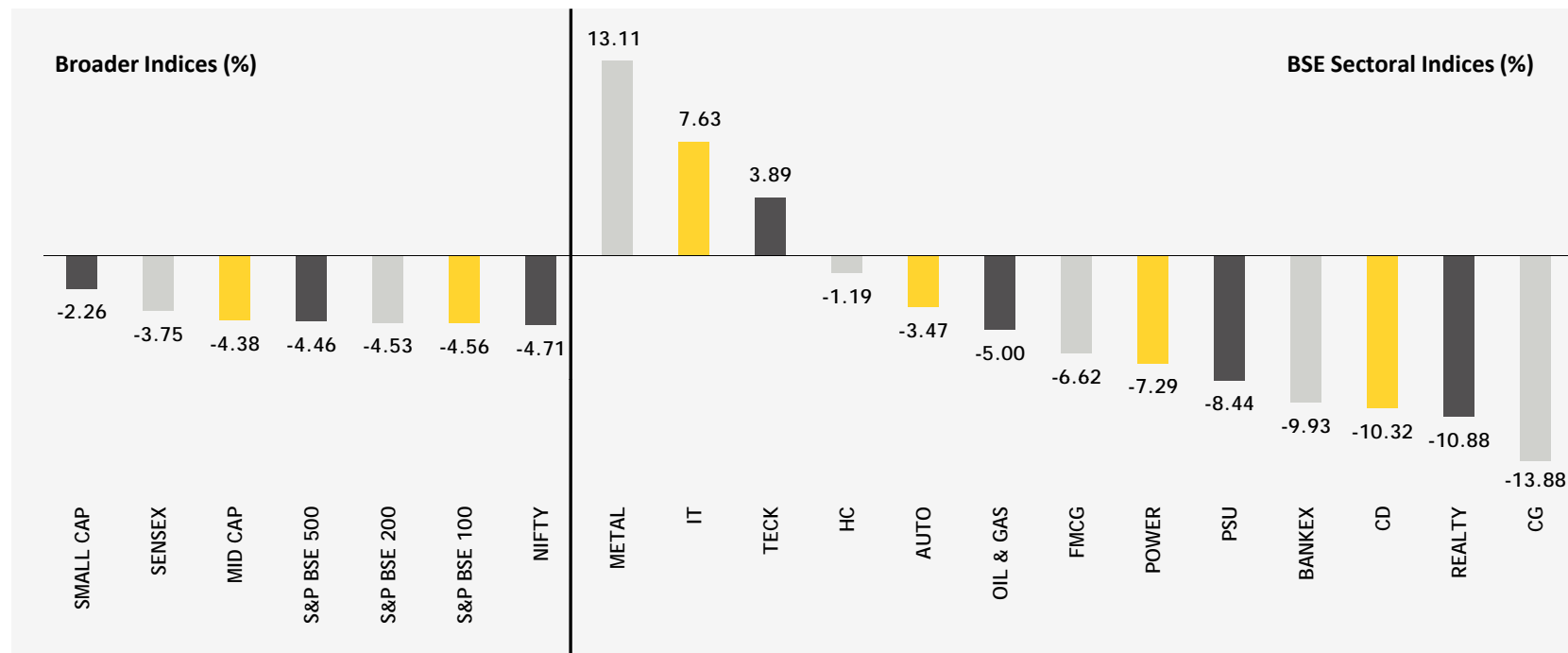
- Global Equity markets declined in August 2013, with the MSCI World Index falling by 2.33% for the month
- Indian markets underperformed the global market and fell by 3.75%.
- Commodity prices bucked the trend in equities, as benchmark CRB Reuters Jefferies total return index increased by 2.5% during the month
- Metals and IT delivered the best return for the month, while Capital Goods and Realty were the worst performing sectors during the month*
- FII outflows during the month were at Rs.59bn . MF's were net buyers at Rs.16bn, while DII's were net sellers to the tune of Rs.63bn during the month
- Trading Activity was higher in August as cash market trading turnover increased by 19% MoM, while Average open interest remained flat MoM

* Please refer slide 4 for sector performances

Global Equities

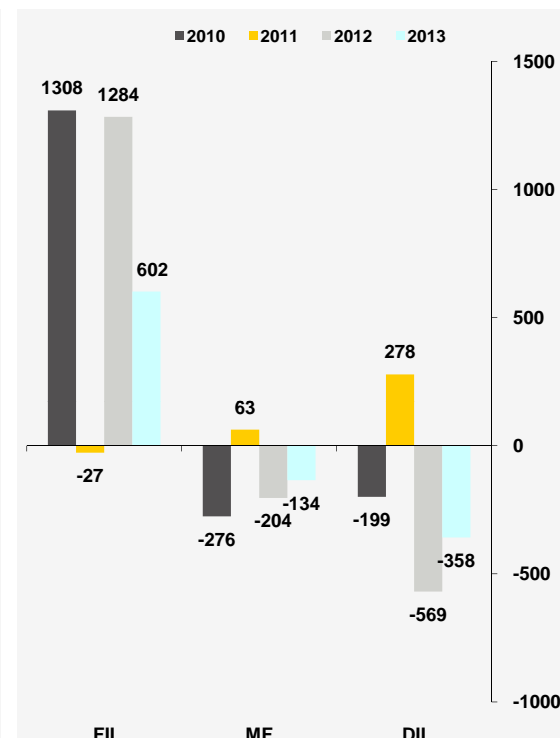
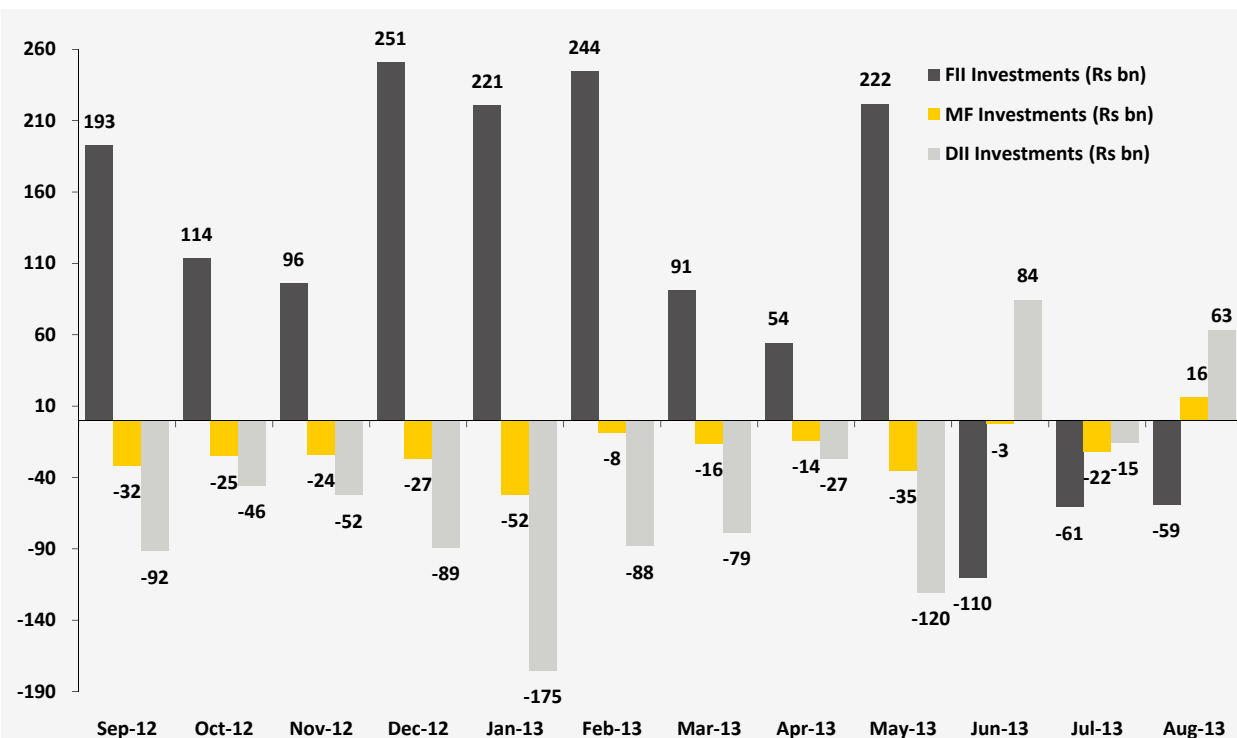
Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	2098.38	5.25%	-7.52%	EM - Asia
S&P BSE Sensex	India	18619.72	-3.75%	-4.15%	EM - Asia
Kospi	South Korea	1926.36	0.64%	-3.54%	EM - Asia
Taiwan Weighted	Taiwan	8021.89	-1.06%	4.19%	EM - Asia
Thailand SET 50 Index	Thailand	882.98	-8.60%	-6.60%	EM - Asia
Jakarta Composite Index	Indonesia	4195.09	-9.01%	-2.82%	EM - Asia
KLSE	Malaysia	1727.58	-2.54%	2.29%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	50008.38	3.68%	-17.95%	EM
Mexico IPC	Mexico	39492.37	-3.29%	-9.67%	EM
Russian RTS Index	Russia	1290.96	-1.71%	-15.46%	EM
Philippine PSEi	Philippines	6075.17	-8.49%	4.51%	EM
Merval Buenos Aires Index	Argentina	3935.89	17.21%	37.89%	EM
HangSeng	Hong Kong	21731.37	-0.70%	-4.09%	Developed - Asia
Nikkei	Japan	13388.86	-2.04%	28.80%	Developed - Asia
Strait Times	Singapore	3028.94	-5.99%	-4.36%	Developed - Asia
Dow Jones	USA	14810.31	-4.45%	13.02%	Developed
CAC 40 Index	France	3933.78	-1.48%	8.66%	Developed
All Ordinaries Index	Australia	5125.30	1.78%	9.39%	Developed
DAX Index	Germany	8103.15	-2.09%	6.45%	Developed
Swiss Market Index	Switzerland	7745.97	-0.95%	13.54%	Developed
FTSE 100	UK	6412.93	-3.14%	8.73%	Developed
MSCI World Index	--	1472.74	-2.33%	11.00%	--

India : Sector Performance



- Nifty fell by 4.71% over the previous month
- MidCaps and Small Caps out performed LargeCaps with 4.38% fall and 2.26% fall respectively
- Metals and IT sectors delivered the best return for the month
- Capital Goods and Realty were the worst performing sectors

FII & DII Inflows



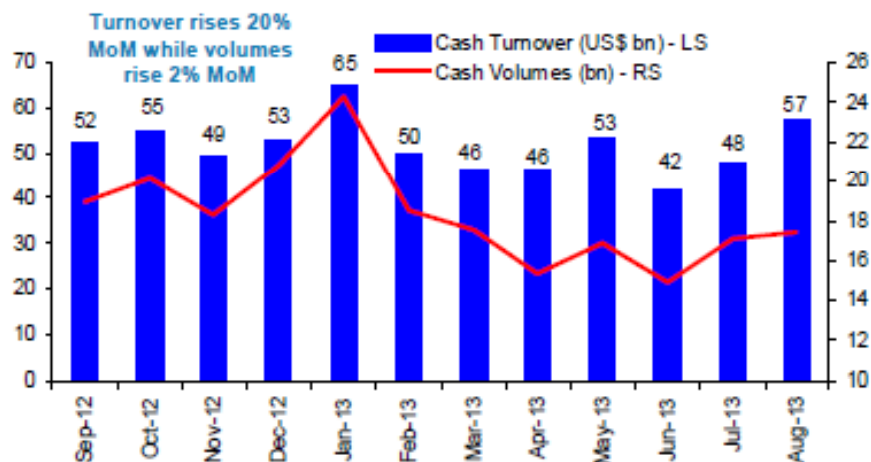
- FII flows were negative at Rs.59bn during the month
- MF's were net buyers at Rs.16bn. DII turned net buyers during the month at Rs.63bn
- Calender YTD, FII inflows have been around Rs.602bn whereas MF's and DII's have been net sellers to the extent of Rs.134bn and Rs.358bn respectively

Top Gainers / Losers - Nifty

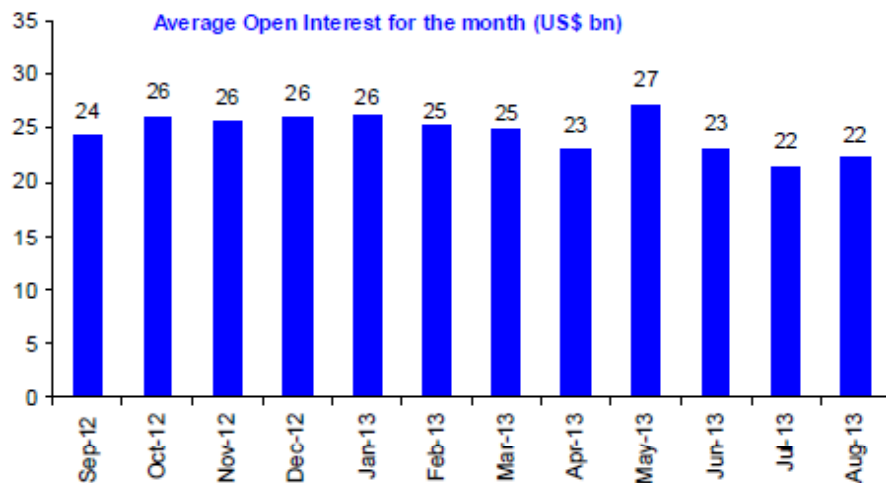
Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
Sesa Goa Ltd	205.45 / 119.3	188.75	47.63%
Ranbaxy Laboratories Ltd	578.4 / 253.65	407.85	42.36%
Tata Steel Ltd	448 / 195.3	274.00	27.03%
National Mineral Development Corporation Ltd	201.3 / 92.7	119.00	21.55%
Hindalco Industries Ltd	137.1 / 83.1	105.05	16.59%

Top Losers for the month			
Losers	52 week H/L	Last Price#	% Loss*
Axis Bank Ltd	1549.9 / 784	832.95	-19.49%
UltraTech Cement Ltd	2154.2 / 1411.9	1474.85	-19.70%
Punjab National bank	920 / 421	429.85	-24.60%
Bharat Heavy Electricals Ltd	272.35 / 100.15	119.00	-24.83%
Infrastructure Development Finance Co. Ltd	185.3 / 76.1	80.50	-26.48%

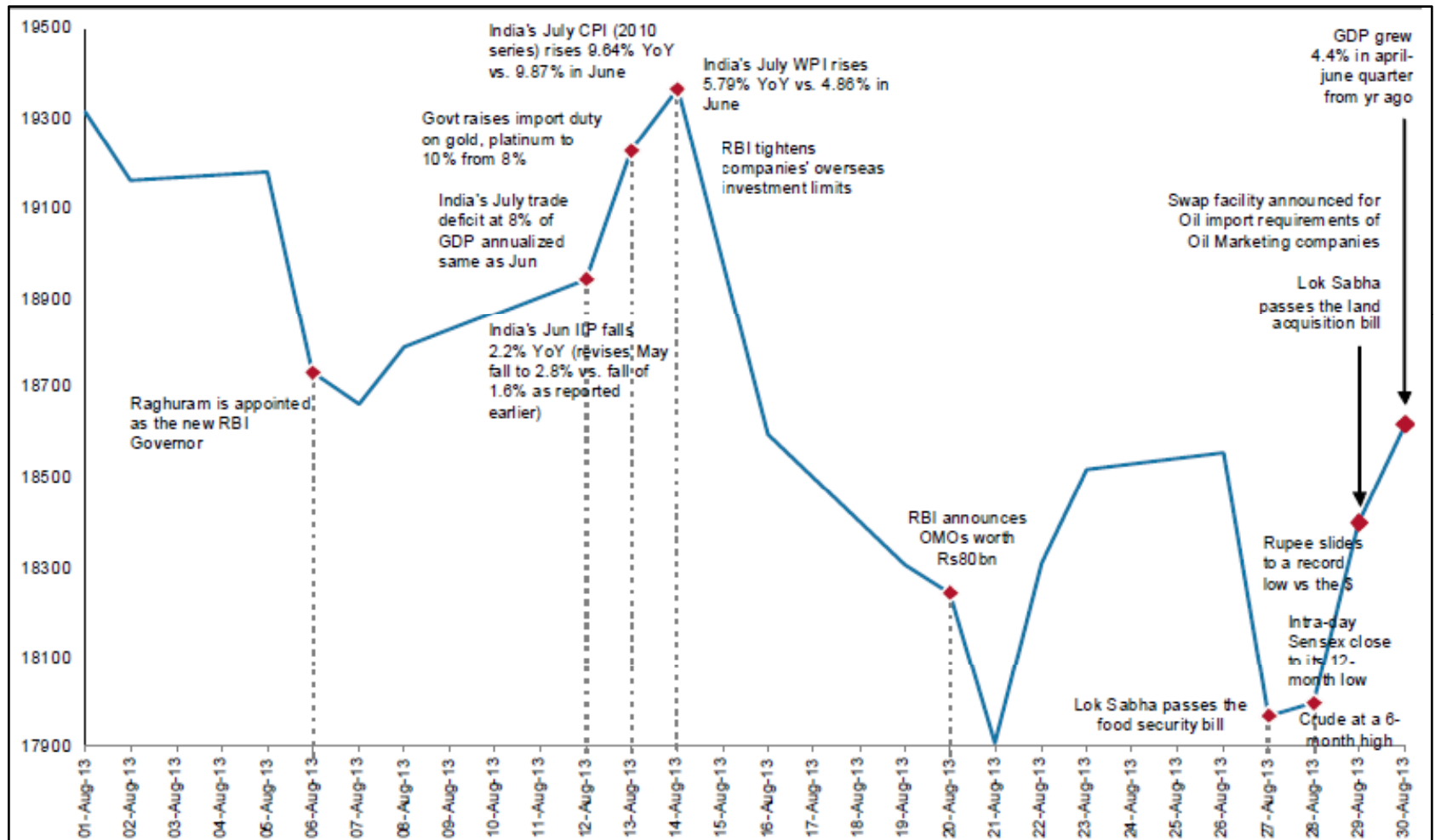
Market Activity (NSE & BSE)



- In August 2013, cash market trading turnover increased by 19% MoM
- At the end of August 2013, average open interest remained flat MoM



August 2013 events timeline



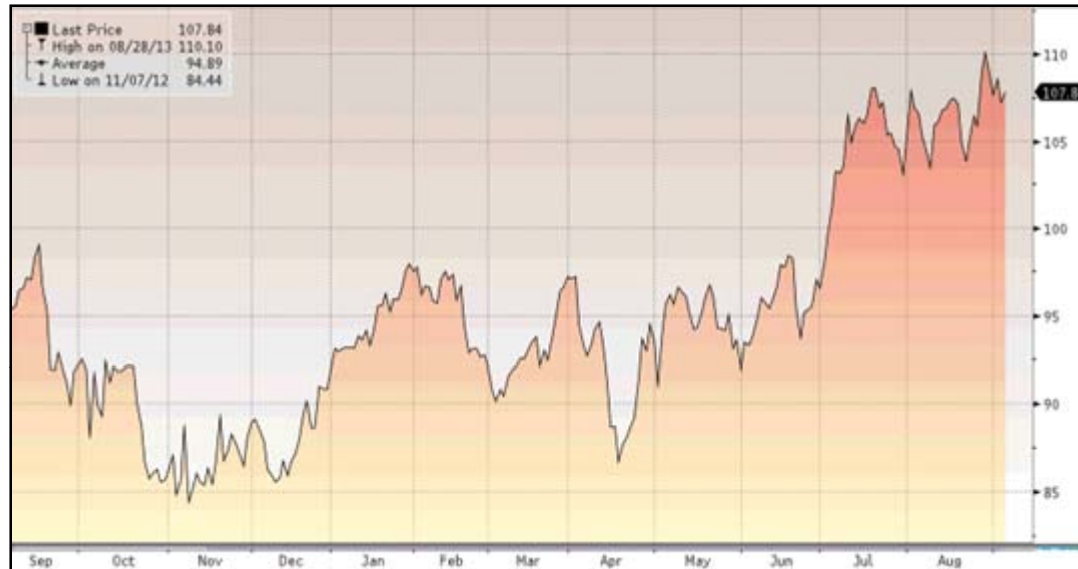
Equity Market Outlook and Opportunities

Equity Market Outlook

- Geo-political developments as the world focuses on Syria has caused volatility in markets & pushed oil prices higher
- The D&B India Business Optimism Index has dipped significantly in the last few years and the recent macro-political developments could push this down materially
- Consumer spends, the last leg of growth, have also started to soften and it is now visible in the weakness in both consumer staples as well as discretionary categories.
- Recently the Food Security Bill and the Land Acquisition Bill was passed by Parliament
- The above average monsoon has been a silver lining for the economy
- In the latest quarter, the Sensex Earnings missed analysts estimates by 3 percentage points and earnings declined YoY by 3%
- As a result, during the month Consensus EPS estimates for BSE Sensex companies have been sharply revised downwards by 2.5% for FY14E

Global Macro – Oil on the boil

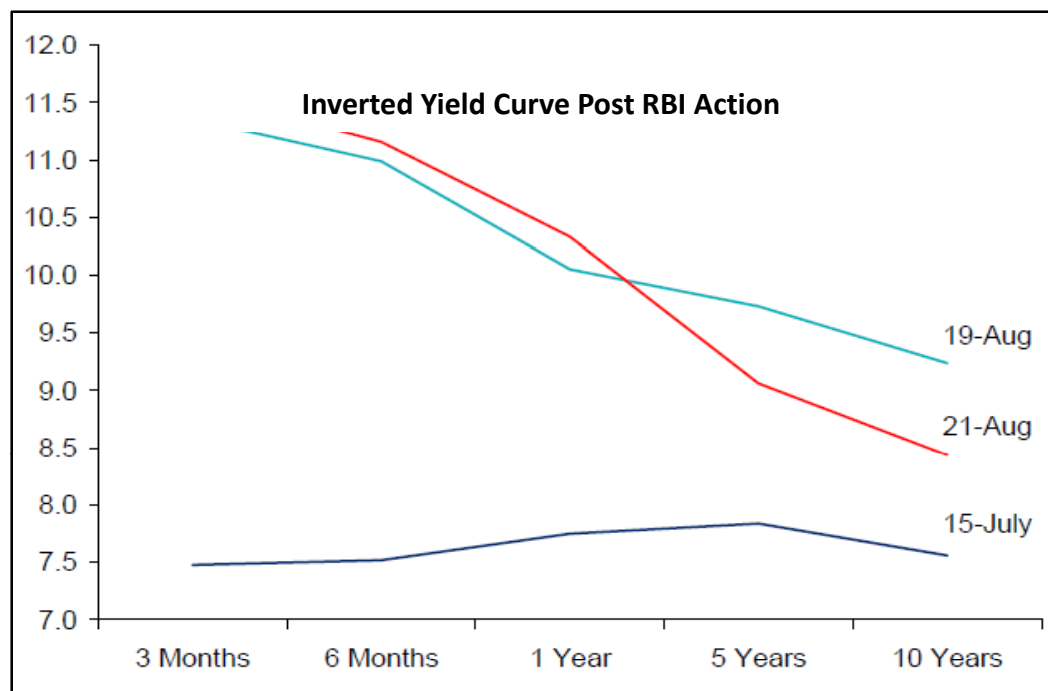
1-yr Price of Nymex Crude Oil (\$ / barrel) (Sep 2012 – Aug 2013)



- Following reports of a mass-casualty chemical attack in Syria on August 21, international pressure to respond with military force against the ruling Assad regime is mounting
- US Defense Secretary Chuck Hagel's August 27 comments suggest that limited "punitive" strikes could take place over the coming days
- The impact of the geo-political crisis has resulted in a spike in gold and crude oil prices
- However, as per media reports, military intervention in Syria, if it moves forward, is likely to be limited to air strikes on specific targets as regime change is not the explicit goal of the intervention

Source: Bloomberg,

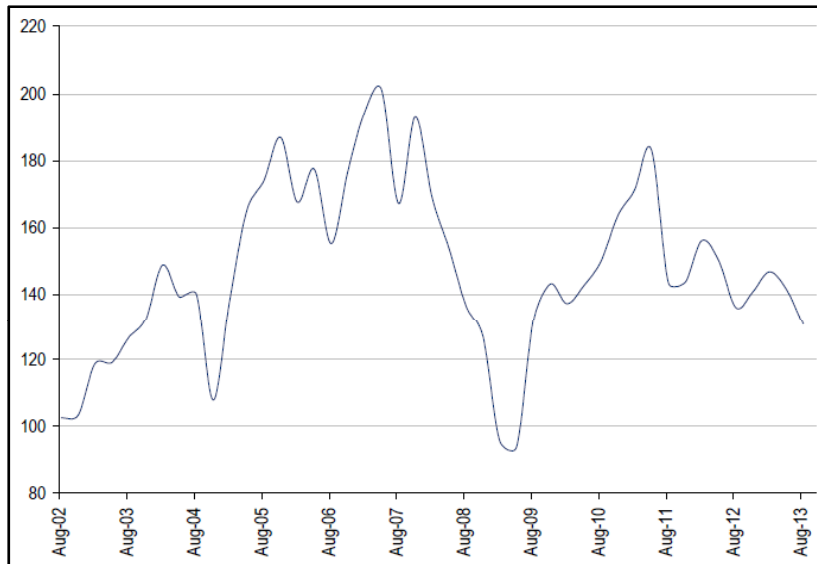
RBI – conducts own version of operation ‘twist’



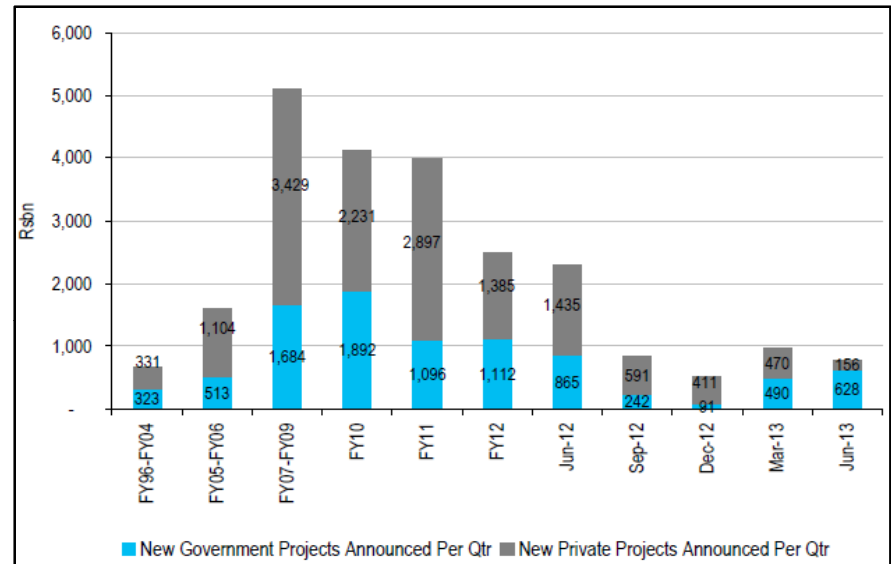
- The RBI has now put in place its own version of operation ‘twist’ – to sharply invert the yield curve. This has arrested the increase in yields of the benchmark 10-year bond
- The primary beneficiary of this cooling down of yield at the long end is the Government of India, which is the main issuer of longer dated paper
- However, the rates for all other borrowers-companies and individuals tend to be aligned more closely with short term yields, which continue to remain at elevated levels

India Macro – Capex Cycle continues to remain weak

D&B India Business Optimism Index



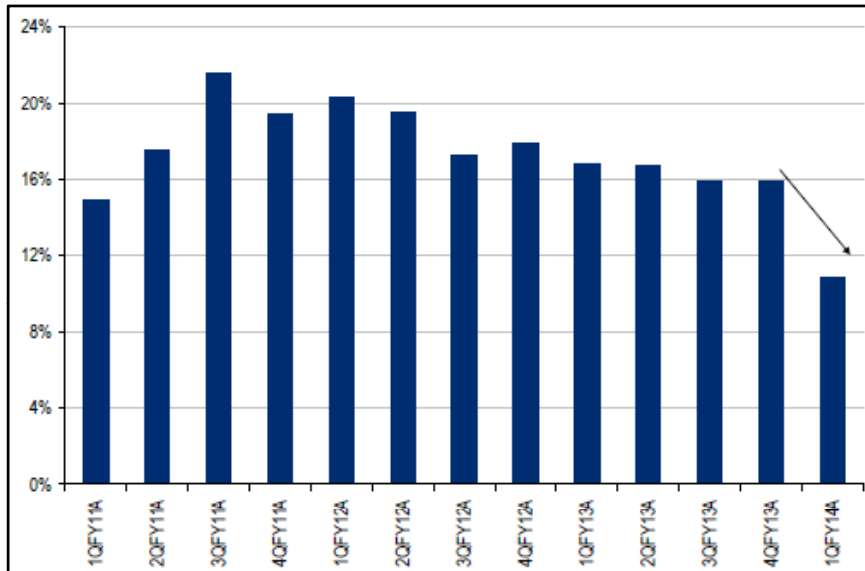
Trends in investment project announcements



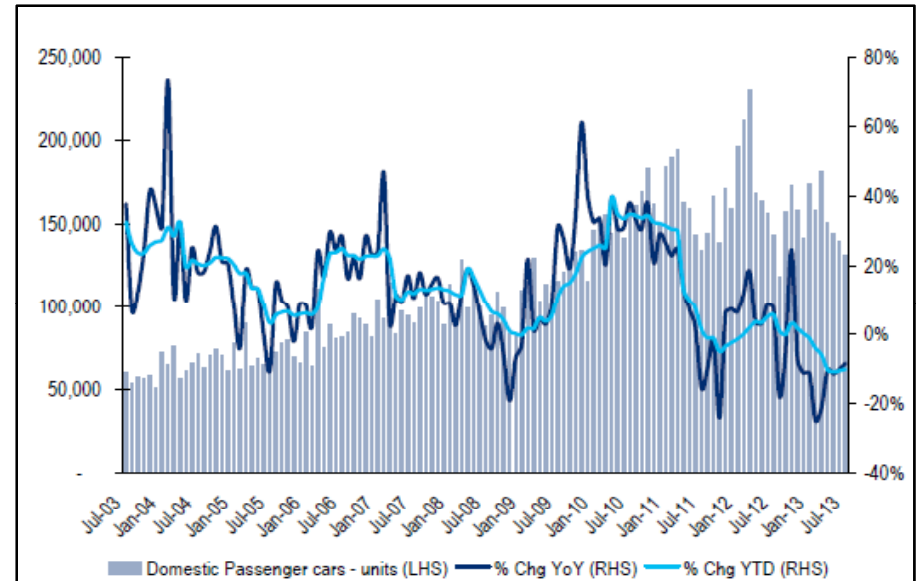
- The D&B India Business Optimism Index has dipped significantly in the last few years, with the ¹latest reading as on July 2013 dipping below the 2009 election highs
- The recent developments like the US tapering announcement, sharp depreciation of the Indian Rupee and heightened levels of consumer inflation could push this (D&B India Business Optimism Index) down materially
- Business pessimism manifests itself in the form of a weak investment cycle, which continues to remain vulnerable

India Macro – Consumer Spends have started to soften

Trend in key consumer staples players top-line growth



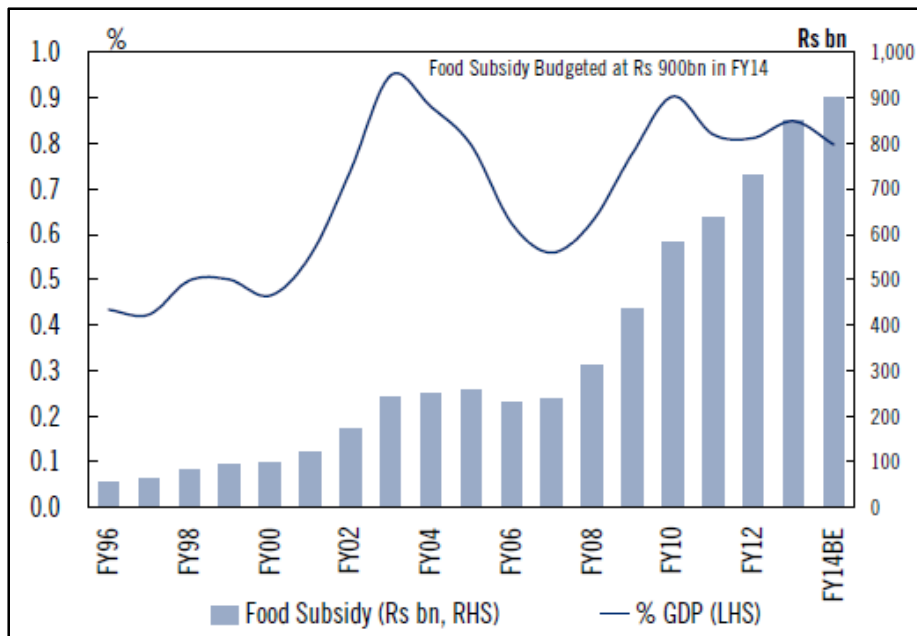
Domestic car sales trends



- Consumer spends have started to soften, and is now visible in the weakness in both consumer staples as well as discretionary categories
- Thus the growth in topline of the key consumer staples players declined to about 11%, sharply below the average of last 13 quarters
- Even the domestic car sales trends have remained weak in the past few quarters

Politics – Two Landmark Bills Passed

Trends in Food Subsidy (Rs bn, %GDP)



- Recently the Food Security Bill and the Land Acquisition Bill was passed by Parliament
- The Food Security Bill provides 5kg of food grains, namely rice, wheat and coarse cereals, to the beneficiaries at a subsidized rate of Rs 3, 2 and 1 per kg respectively per month
- In contrast, the government procures these grains at Rs.13.1, Rs.13.5 and Rs.15 through its minimum support price program. The government aims to cover up to 75% of the rural and up to 50% of the urban population.
- Compared to the requirement under existing PDS and other welfare schemes, the additional subsidy is estimated at Rs 237bn per annum or 0.2% of GDP
- The Land Acquisition Bill introduced the concept of social impact assessment as a pre-condition in case of every land acquisition which is likely to increase the project life cycle and project cost

India – Monsoon Progress – Silver Lining

भारत मौसम विज्ञान विभाग INDIA METEOROLOGICAL DEPARTMENT



LEGEND: ■ EXCESS (+20% OR MORE) ■ NORMAL (+19% TO -19%) ■ DEFICIENT (-20% TO -59%)
■ SCANTY (-60% TO -99%) ■ NO RAIN (-100%) ■ NO DATA

NOTES:

- (a) Rainfall figures are based on operational data.
 (b) Small figures indicate actual rainfall (mm.), while bold figures indicate Normal rainfall (mm.)
 Percentage Departures of Rainfall are shown in Brackets.

- Rainfall in aggregate for the country was 8% above normal till August 2013
- Most of the states (except North Eastern states) have witnessed excess to normal rainfalls till August 2013

India – Earnings Season so far

Quarterly Earnings for QE Jun-13 Snapshot

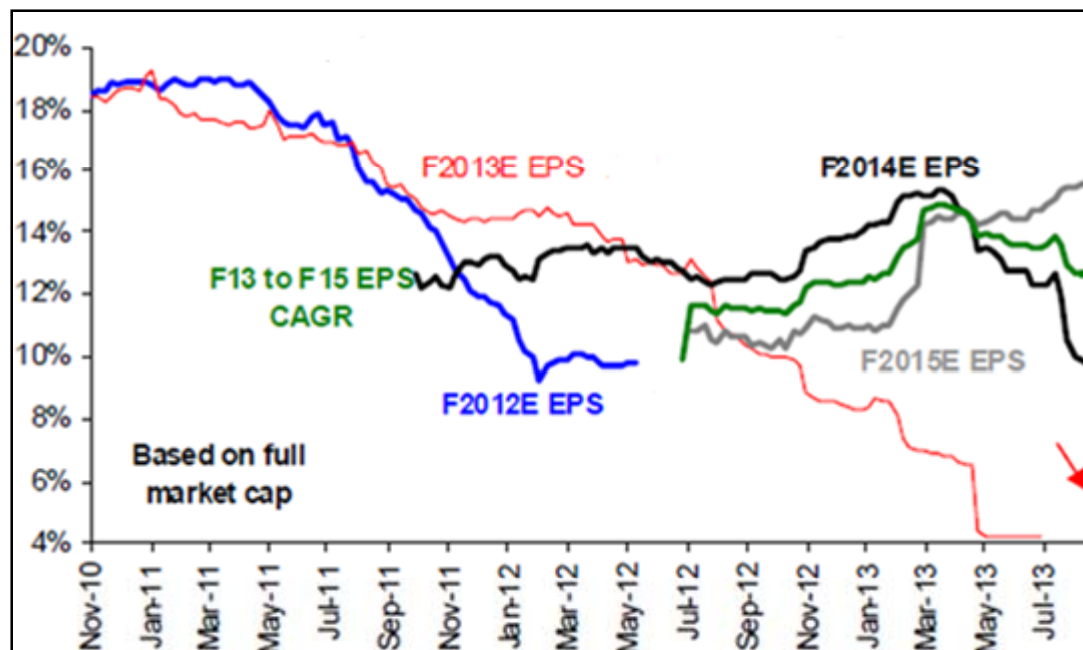
YoY Revenue growth	Q2F13	Q3F13	Q4F13	Q1F14
MS coverage	11%	11%	7%	5%
MS coverage ex-oil psu	14%	11%	6%	4%
MS coverage ex-energy	12%	9%	7%	5%
Broad Market (1115)	15%	10%	7%	6%
Broad Market ex-oil psu	13%	10%	6%	5%
Broad Market ex-energy	12%	9%	6%	6%
BSE Sensex	12%	9%	6%	2%
YoY Earnings growth	Q2F13	Q3F13	Q4F13	Q1F14
MS coverage	64%	0%	3%	27%
MS coverage ex-oil psu	11%	5%	2%	1%
MS coverage ex-energy	13%	1%	-4%	0%
Broad Market (1115)	58%	0%	-1%	55%
Broad Market ex-oil psu	18%	7%	-4%	-4%
Broad Market ex-energy	18%	5%	-7%	-4%
BSE Sensex	4%	7%	7%	-3%

Morgan Stanley estimates used as proxy for market

- Sensex Earnings missed analysts estimates by 3 percentage points and earnings declined YoY by -3%. However, ex-oil PSU, earnings growth for Sensex companies was at 1%
- Sensex Sales grew by 2%, while EBIDTA margins declined, resulting in EBIDTA growing by 1%
- Broader market earnings (ex-oil PSU) decline was at 4%, due to a higher margin erosion and impact of operating and financial leverage

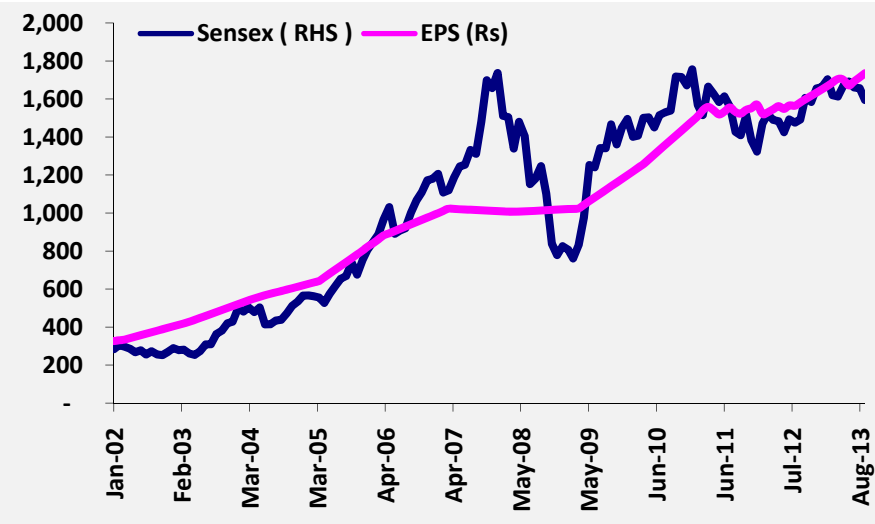
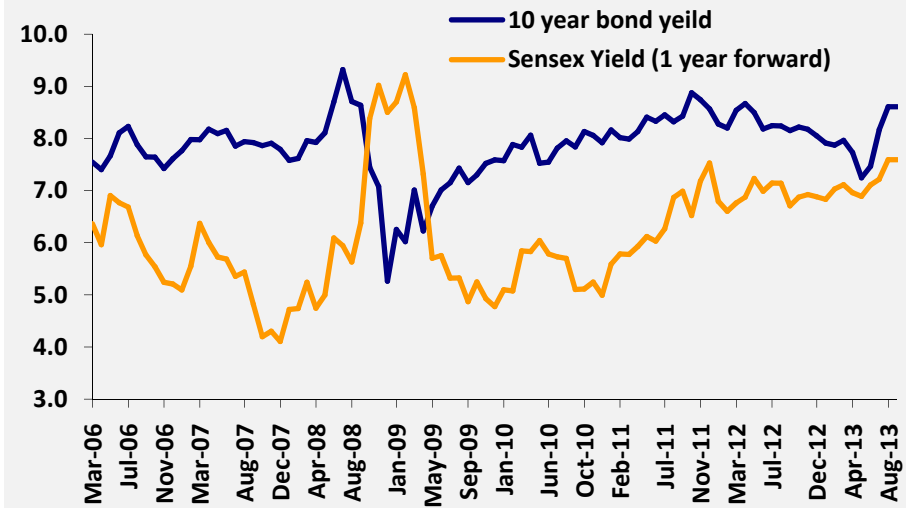
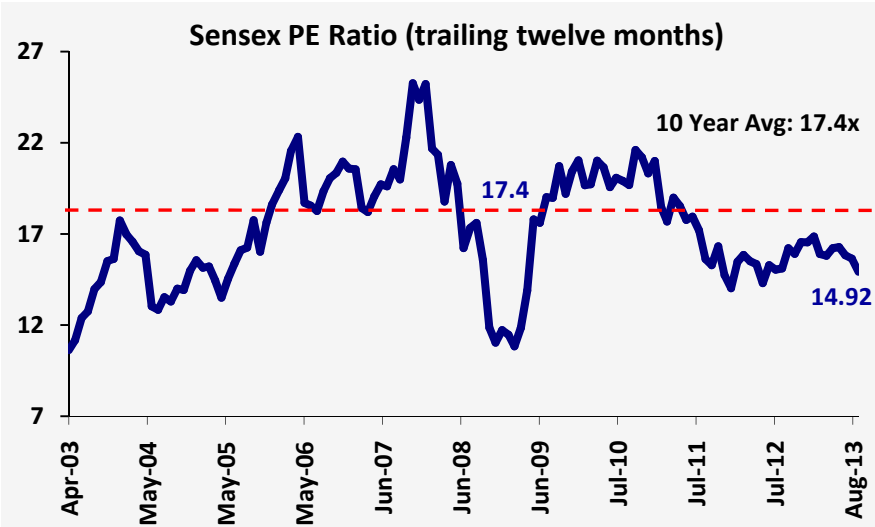
Earnings Expectations – Tough task

S&P BSE Sensex Consensus EPS growth trend



- Consensus EPS estimates for BSE Sensex companies have been sharply revised downwards by 2.5% and earnings is now expected to grow by 9.7% for FY14E
- Despite downward revision, 9.7% growth for FY14E seems difficult, considering that earnings growth for FY13 was 2.8% and overall macro economic environment continues to remain weak

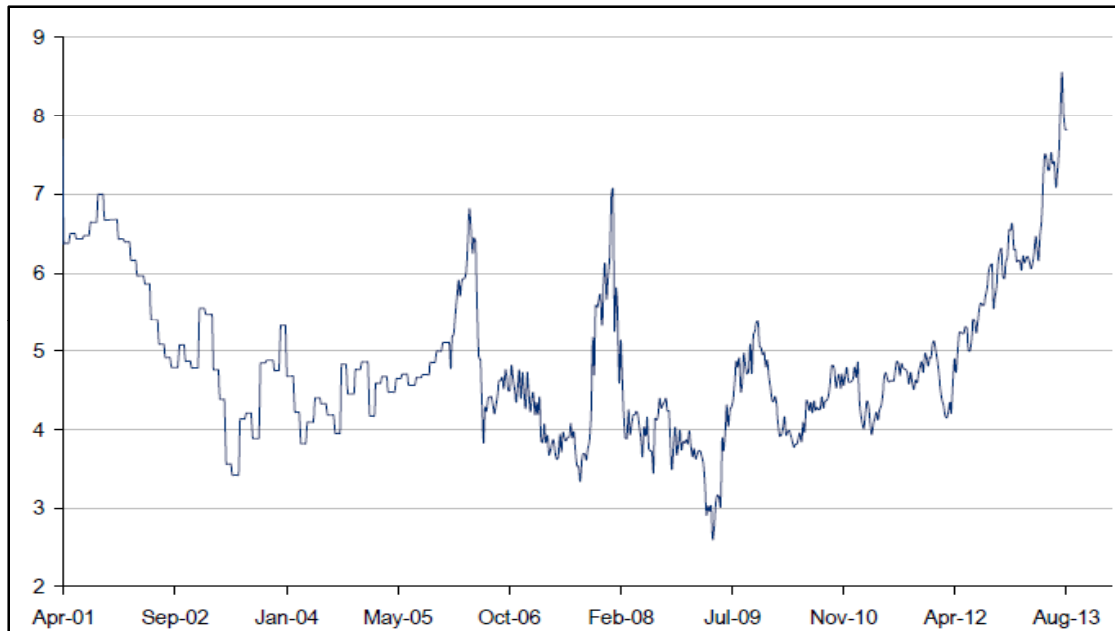
Valuations – At Reasonable Levels



- Sensex is currently trading at 14.9x its trailing earnings. It is now 14% lower than its historical 10-year average trailing PE of 17.4x.
- The FY14 Sensex forward earnings yield gap with the 10 year bond yield, remained similar to previous months at 100 bps.
- The de-rating of market since 2007 is evident in the accompanying chart with earnings considerably above the 2007 levels whereas the markets have not progressed much over past 5 years

Valuations – Huge Disparity between Sectors

Standard deviation of sector valuations



- Valuation disparity between sectors continues to remain at multi-year highs
- Non-cyclical sectors like Consumer Staples, IT and Healthcare continue to get rich valuations, while at the other end, cyclical sectors like industrial, financials and materials are available at a relatively cheaper valuation

Looking Ahead...

- Global growth has been patchy and uneven. Among advanced economies (AEs), during Q1 of 2013, growth in US and Japan improved while that in the euro area contracted. Even in US growth recovery has been slowest as compared to previous recessions
- US Fed signal of tapering Quantitative easing - timely reminder to financial markets that unprecedented monetary stimulus is not bound to stay forever
- The RBI has recently taken measures to sharply invert the yield curve. This has arrested the increase in yields of the benchmark 10-year bond, which could benefit the government the most as it is the biggest long-tenor borrower
- According to the new Governor at the RBI, the key responsibility of the central bank is to control inflation-irrespective of the source of the inflation
- Based on current trends, FY14E consensus growth expectation of about 10% looks challenging
- The market remains vulnerable given that the challenging macro backdrop valuations are reasonable at a 14% discount to long term averages & provides comfort for long term investors
- Gap in terms of valuations between cyclical and non cyclical is fairly high with non cyclical companies trading at very rich valuations
- Overall emphasis on bottom up stock selection continues
- 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. We are also open to making selective investments in areas where valuations already reflect a high degree of stress

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Mutual Fund investments are subject to market risks, read all scheme related documents carefully

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