Equity Markets :
Current Environment and Outlook

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December 2012

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Current Environment

- Global Equity markets went up in December, with the MSCI World Index rising by 1.75%
- Indian markets under performed the global market trend and rose by 0.45%
- Commodity prices under performed the trend in equities, as benchmark CRB Reuters Jefferies total return index fell by 1.3%
- Metal and Auto were the best performing sectors, while IT and CD sectors delivered the worst return for the month*
- FII inflows during the month were at Rs.251bn. MF's were net sellers at Rs.27bn, while DII's were net sellers of Rs.89bn during the month
- Trading Activity increased in December as cash market trading turnover rose by 8% MoM. Average open interest remained flat MoM and was at a 13 month high

* Please refer slide 4 for sector performances

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 Source: RMF, Bloomberg

Global Equities

Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	2269.13	14.60%	3.17%	EM - Asia
BSE Sensex	India	19426.71	0.45%	25.70%	EM - Asia
Kospi	South Korea	1997.05	3.32%	9.38%	EM - Asia
Taiwan Weighted	Taiwan	7699.50	1.57%	8.87%	EM - Asia
Thailand SET 50 Index	Thailand	945.39	5.18%	31.60%	EM - Asia
Jakarta Composite Index	Indonesia	4316.69	0.95%	12.94%	EM - Asia
KLSE	Malaysia	1688.95	4.85%	10.34%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	60952.08	6.05%	7.40%	EM
Mexico IPC	Mexico	43705.83	4.48%	17.88%	EM
Russian RTS Index	Russia	1530.41	6.53%	10.75%	EM
Philippine PSEi	Philippines	5812.73	3.05%	32.95%	EM
Merval Buenos Aires Index	Argentina	2854.29	17.98%	15.90%	EM
HangSeng	Hong Kong	22656.92	2.84%	22.91%	Developed - Asia
Nikkei	Japan	10395.18	10.05%	22.94%	Developed - Asia
Strait Times	Singapore	3167.08	3.16%	19.68%	Developed - Asia
Dow Jones	USA	13104.14	0.60%	7.26%	Developed
CAC 40 Index	France	3641.07	2.36%	15.23%	Developed
All Ordinaries Index	Australia	4664.59	3.24%	13.46%	Developed
DAX Index	Germany	7612.39	2.79%	29.06%	Developed
Swiss Market Index	Switzerland	6822.44	0.03%	14.93%	Developed
FTSE 100	UK	5897.81	0.53%	5.84%	Developed
MSCI World Index	--	1338.50	1.75%	13.18%	--

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

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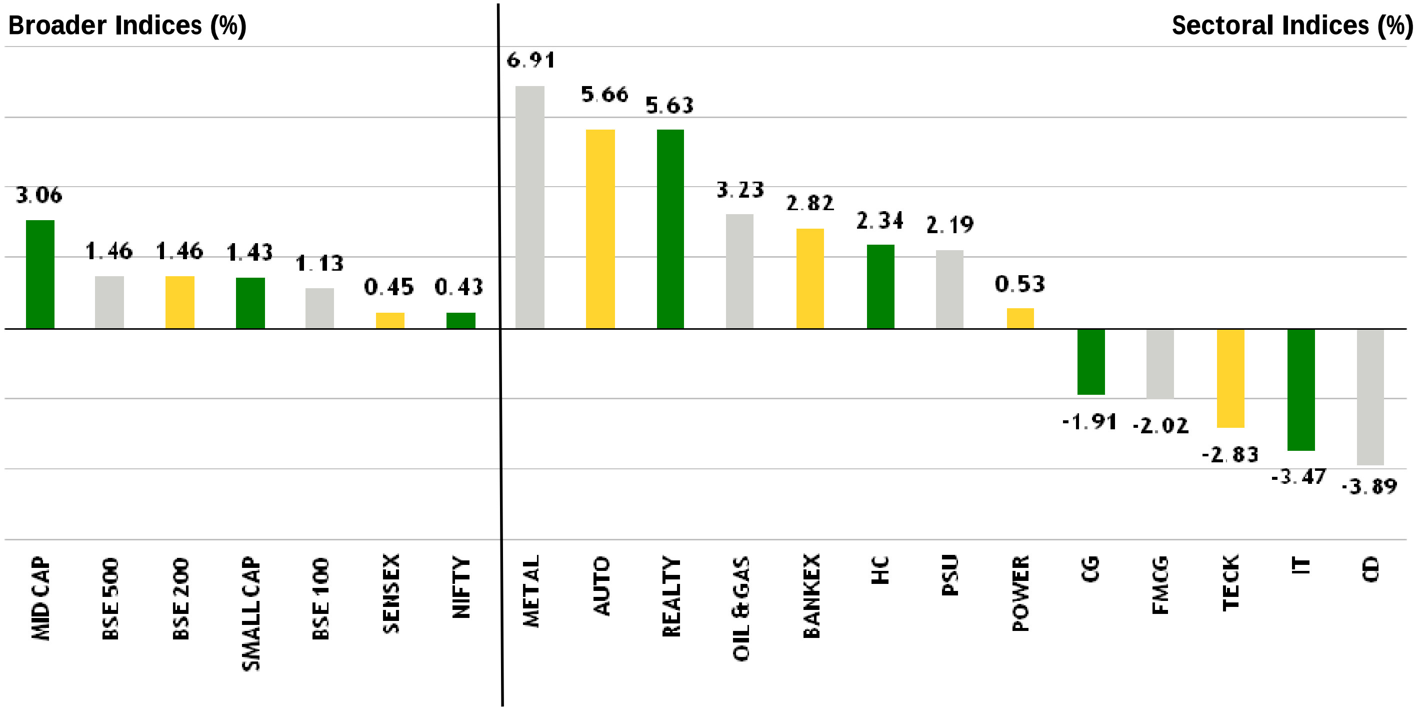
India : Sector performances



- Nifty rose by 0.43% over the previous month
- MidCaps and Small Caps out performed LargeCaps with 3.06% rise and 1.43% rise respectively
- Metal and Auto were the best performing sectors
- IT and CD sectors delivered the worst return for the month

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

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Top Gainers / Losers - Nifty

Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
Bharti Airtel	400.95 / 215.8	317.1	6.28%
HCL Technologies	660.95 / 386	618.7	6.11%
Grasim Industries	3510 / 2210	3169.5	6.02%
Infosys	2994 / 2060.55	2318.7	5.10%
Tata Consultancy Services	1439.8 / 1045.3	1255.85	4.63%
Top Losers for the month			
Losers	52 week H/L	Last Price#	% Loss*
Punjab National Bank	1091.05 / 659.2	871.3	-9.92%
Jindal Steel	664 / 320.4	447.85	-10.00%
Hindalco Industries	164.9 / 100	130.5	-10.65%
Bank of Baroda	881 / 605.55	866.45	-11.99%
Tata Motors	320.75 / 178.8	312.65	-12.54%

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

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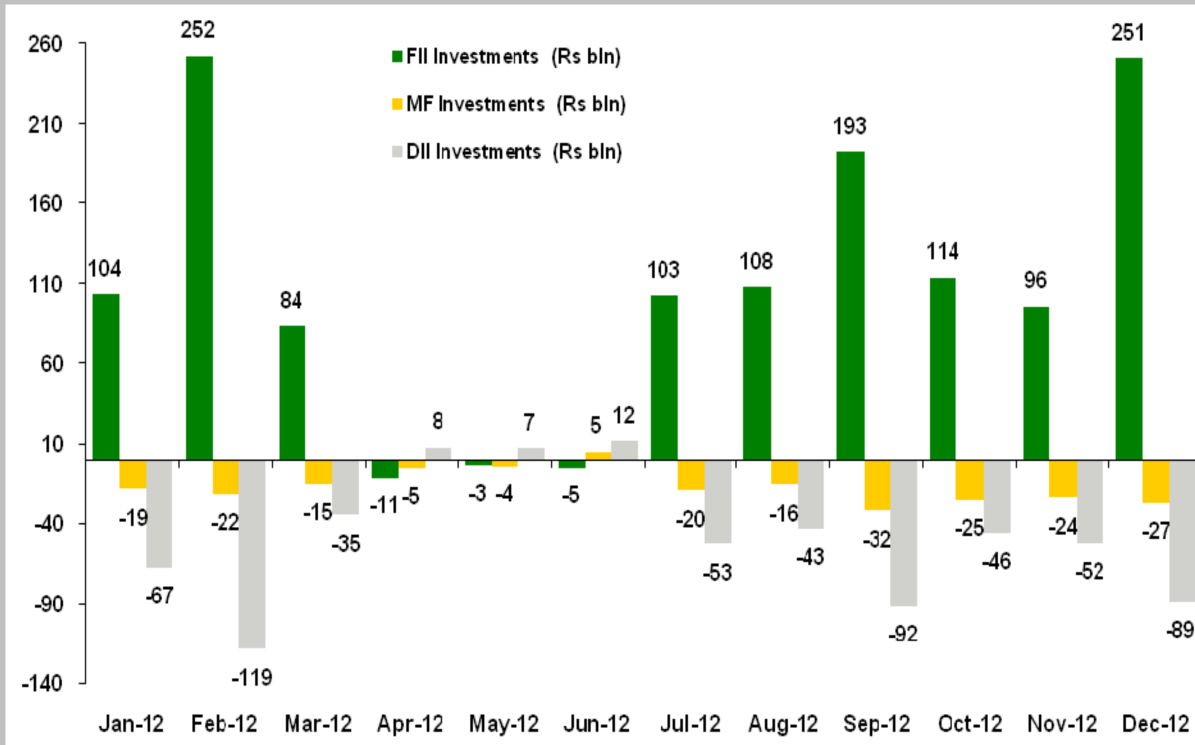
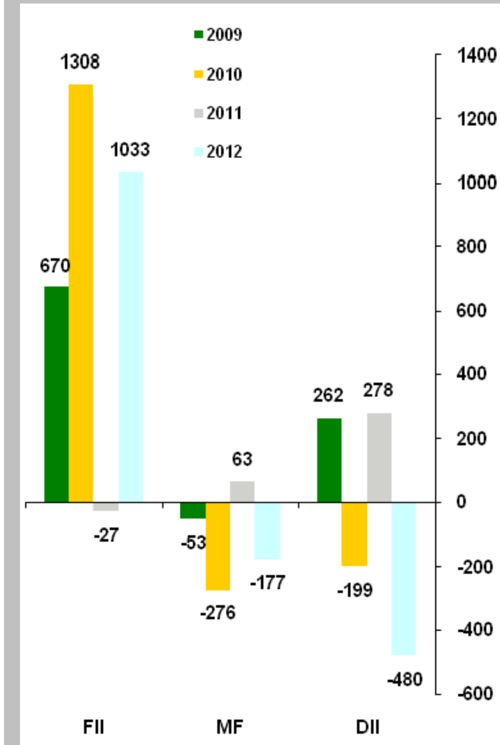
FII & DII Inflows

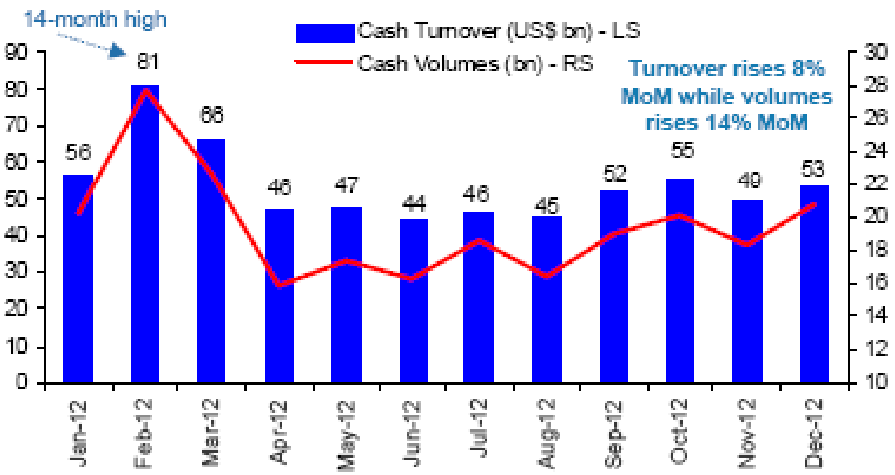


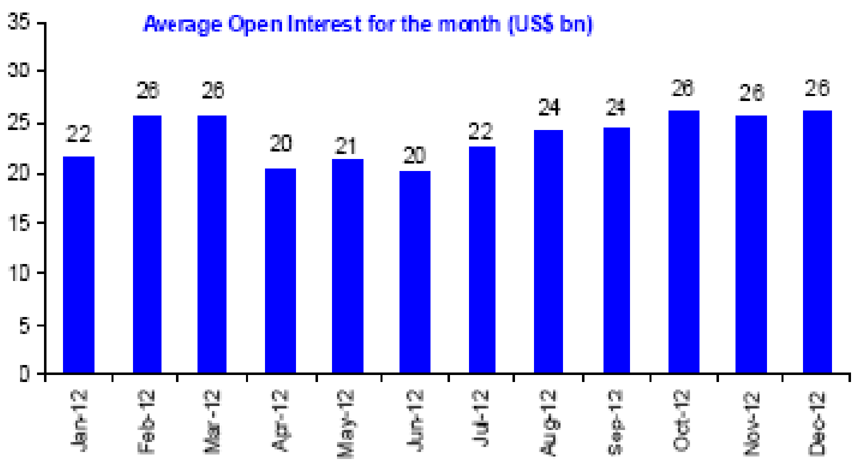


- Institutional activity continued to remain upbeat in December
- FII inflows during the month were at Rs.251bn. FII inflows were at Rs.1033bn for CY12 after a Rs.27bn outflow in CY11 and Rs.1308bn inflow in CY10
- MF's were net sellers at Rs.27bn, while DII's were net sellers of Rs.89bn during the month

FII - Foreign Institutional Investors, DII - Domestic Institutional Investors (Includes Bank, DFIs, Insurance and MF)
Source: SEBI, BSE

Market Activity

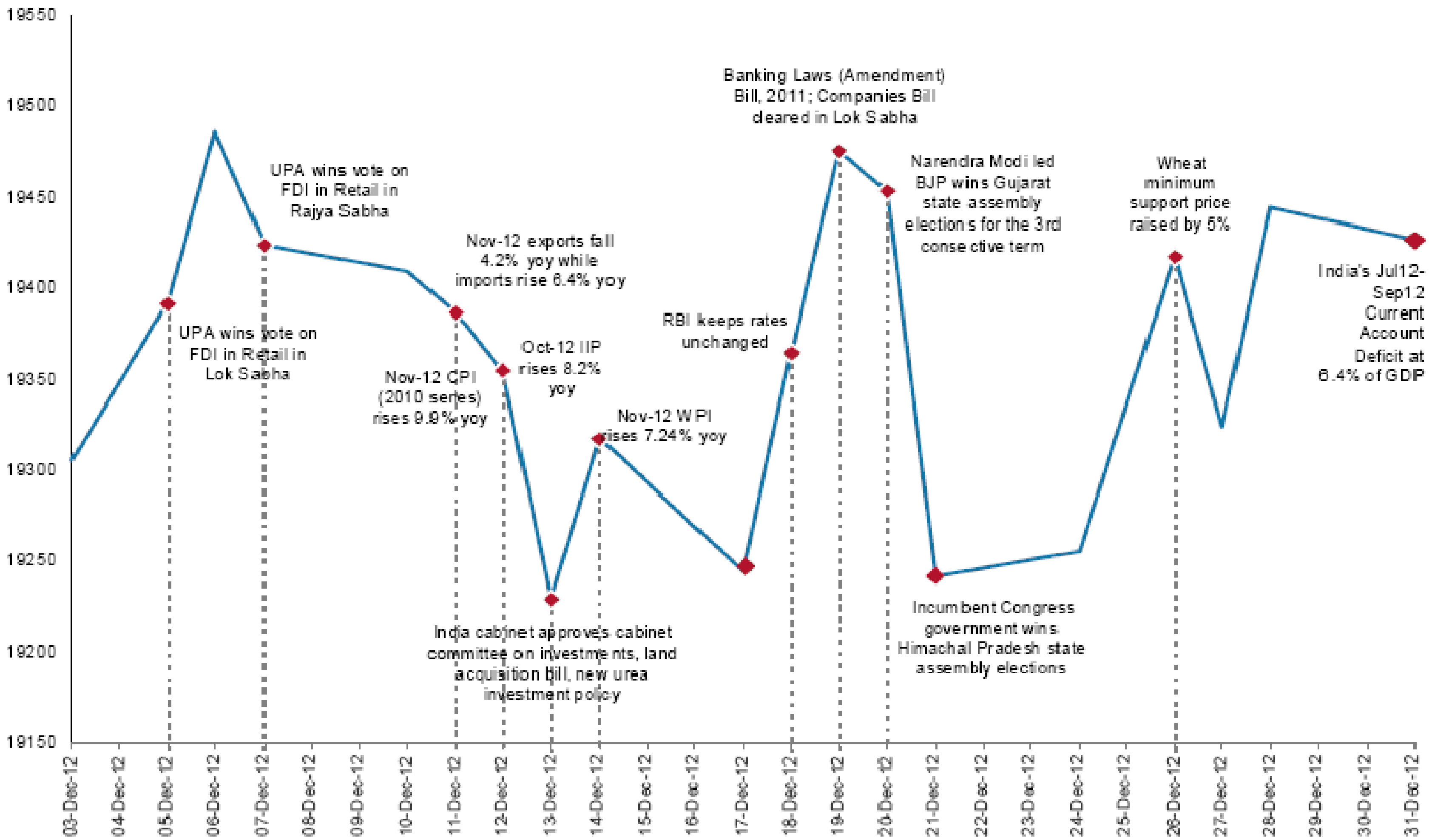




- In December 2012, cash market trading turnover rose by 8% MoM
- At the end of December 2012, average open interest remained flat on a MoM basis

Sources: Bloomberg, Morgan Stanley

December 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 aggregate non-financial sector (NFS) gross debt in 17 developed markets rose by almost 33% since 2008 in real terms. The de-leveraging of these economies is likely to weigh down heavily on their national income growth rate
- Policy-makers have adopted aggressive methods to push interest rates and bond yields down to unprecedented levels. However, even after four years of such unconventional monetary measures there has been no meaningful increase in New Capex implying its ineffectiveness
- India is currently facing severe headwind from its twin deficits – current and fiscal, which are a natural consequence of decline in savings rate
- According to various quarterly confidence indices by RBI, the current economic assessment remains weak. While the consumers are pessimistic about future expectations, the businesses have started turning a bit optimistic
- On a positive note, while India's economic growth has remained weak for the past few quarters, it has started stabilizing at the lower levels of 5-5.5% range
- In December 2012 earnings season, expectations are that Sensex companies shall mirror the previous quarter with weak headline profit growth of 4.7% on a consolidated basis
- The weak growth in profits in the quarter is likely to be driven by slower sales growth forecast along with an expectation of a decline in EBIDTA margins
- Consensus expectations for FY13E and FY14E earnings growth are at about 6.2% and 14.3% respectively, marginally revised downwards and upwards respectively during last couple of months

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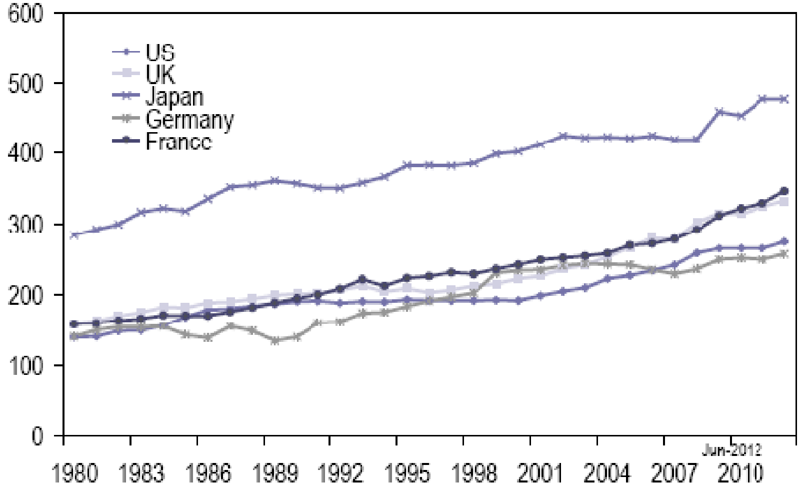
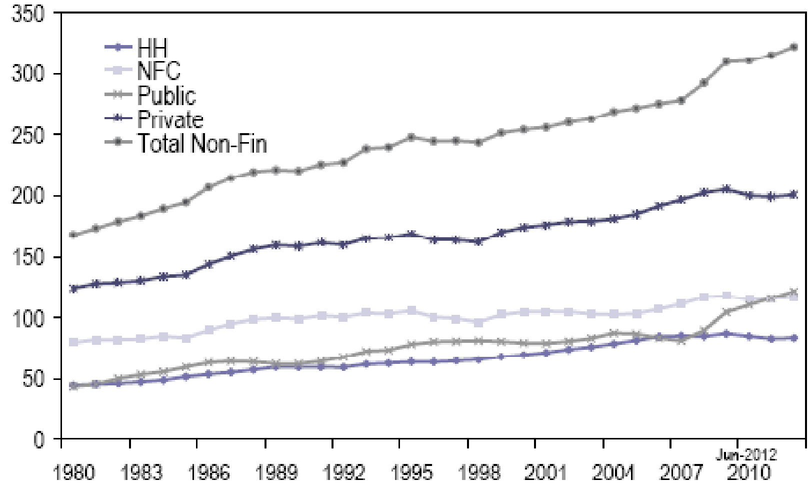
Source: RMF, FactSet, IBES Estimates, Morgan Stanley Research, Citi Research, Bloomberg

Global Macro – Debt stock fairly high, deleveraging ahead

Non Financial Sector Gross Debt as % of GDP



Advanced Economics – Gross Debt by Sector – (% of GDP)



- Total non-financial sector (NFS) gross debt in 17 developed markets rose from $12.3 trillion or 168% of the GDP in 1980 to $128.5 trillion (over 10X) in 2011 amounting to 315% of GDP
- Deleveraging is likely to continue to weigh heavily on growth in highly indebted economies

Note: Advanced economy gross debt by sector is constructed as gross debt weighted by shares of nominal GDP in 17 countries (Australia, Austria, Belgium, Canada, Finland, Germany, Greece, Italy, Japan, Korea, Netherland, Portugal, Spain, Sweden, UK and US). HH: House Hold, NFC: Non Financial Companies

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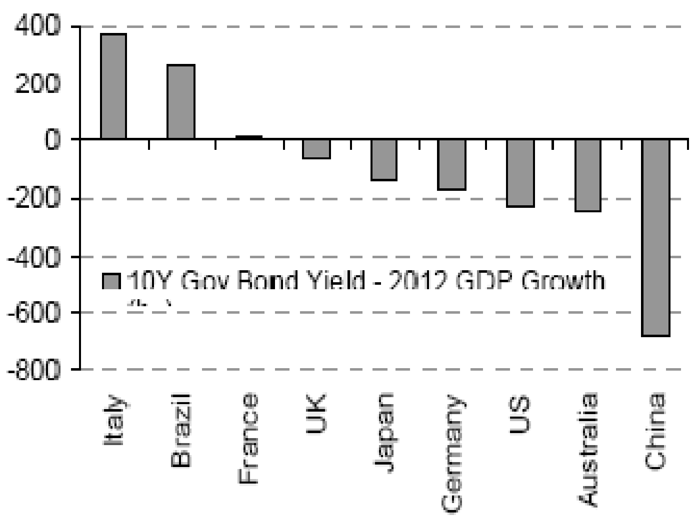
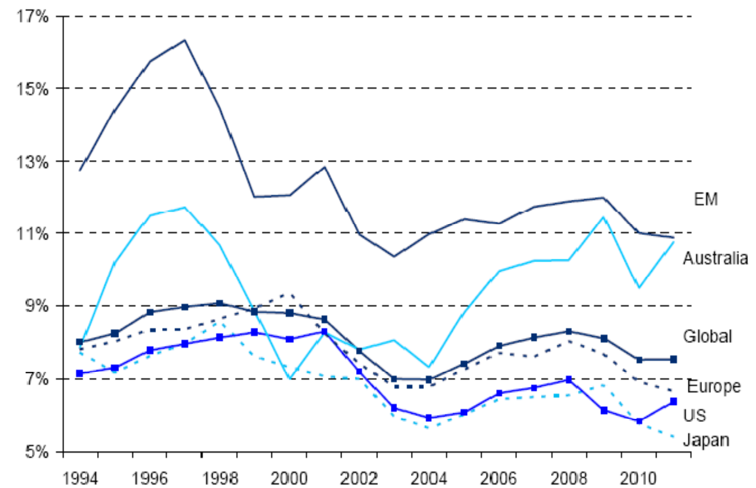
 Source: IMF, OECD, National Sources and Citi Research

Global Macro – Ultra low interest rates, but capex still subdued

10 YR Govt Bond Yield less GDP (bps)



Listed Company Capex to Sales (ex financials)

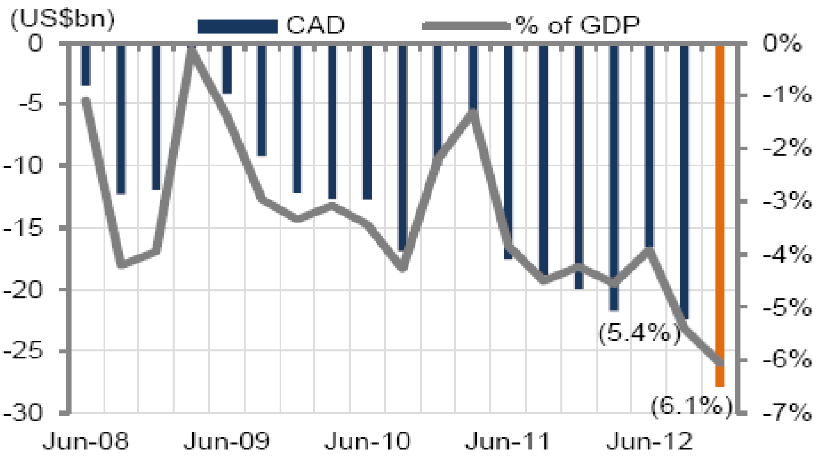


- Policy-makers have adopted aggressive methods to push interest rates and bond yields down to unprecedented levels
- Benchmark interest rates way below nominal GDP growth for most advanced countries resulting in negative spread.
- But both consumers as well as Governments being overleveraged are unable to respond to ultra low interest rates
- Even after four years of QE there has been no meaningful increase in New Capex implying its ineffectiveness

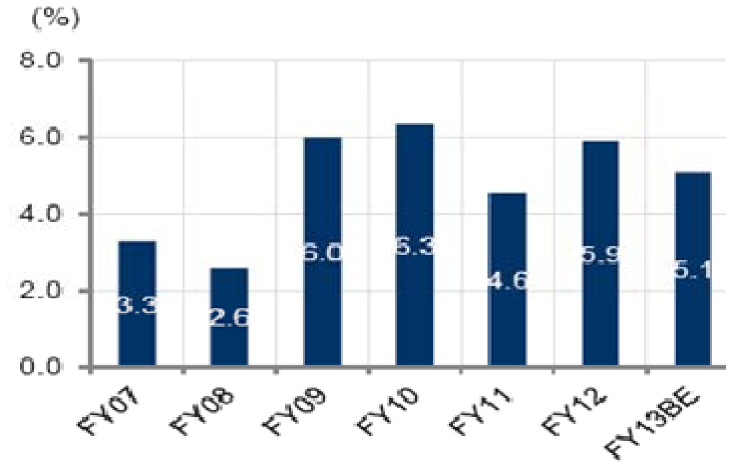
Source: Citi Research, Factset, worldscpe, datastream

India Macro – Grappling with the problems of twin deficit

India's Current account deficit as % of GDP



Fiscal deficit (% of GDP)

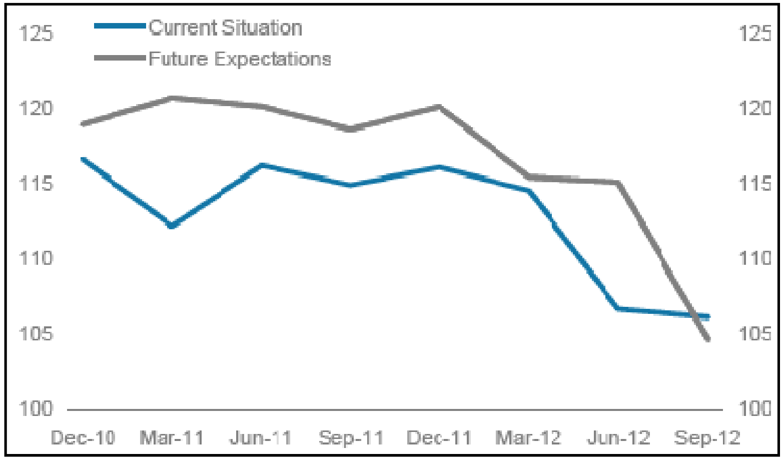


- Q2FY13 Current Account Deficit (CAD) at 5.4% of GDP was the highest ever. To make the matters worse, external account may deteriorate further in the near term
- The fiscal deficit for Apr-Nov'12 came in at 80.4% of FY13BE, which was slightly better than the last year's 85.6%, largely driven by government's efforts to cut down expenditure
- Achieving the FY13E fiscal deficit targets remains a challenge
- The headwinds from these twin deficits are largely a reflection of the poor savings rate in the economy

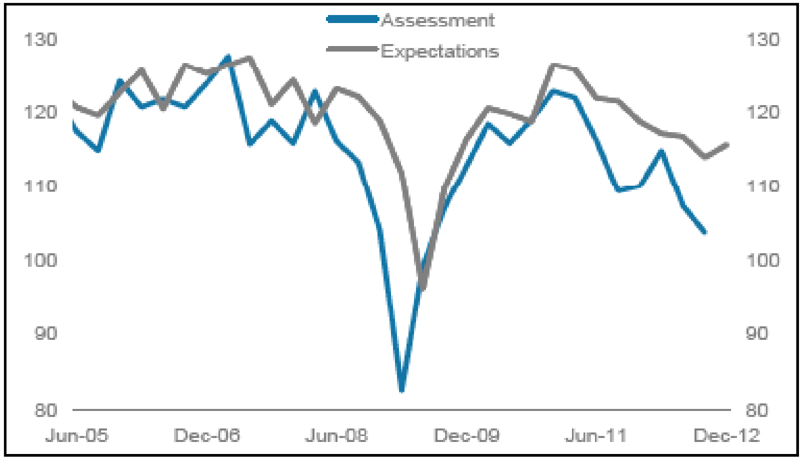
 Sources: RBI CG, RCML Research

India Macro - Confidence Indicators do not inspire confidence

Consumer Confidence Index



Business Expectations Index

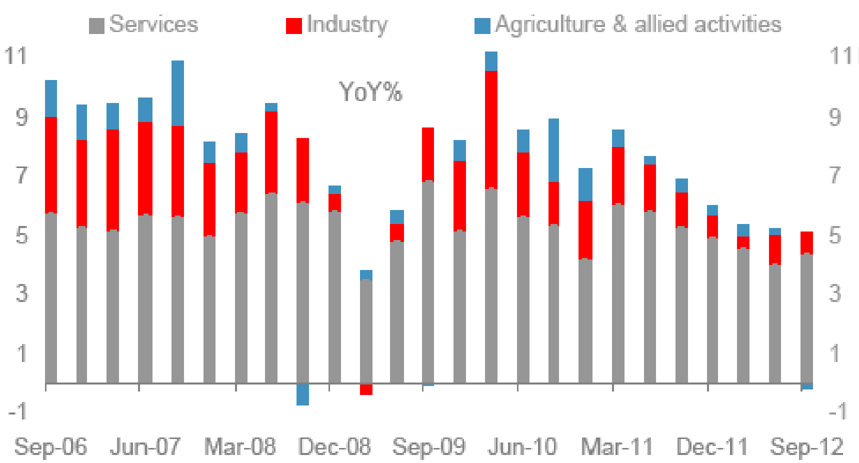


- According to various quarterly confidence indices by RBI, the current economic assessment remains weak
- While the consumers are pessimistic about future expectations, the businesses have started turning a bit optimistic

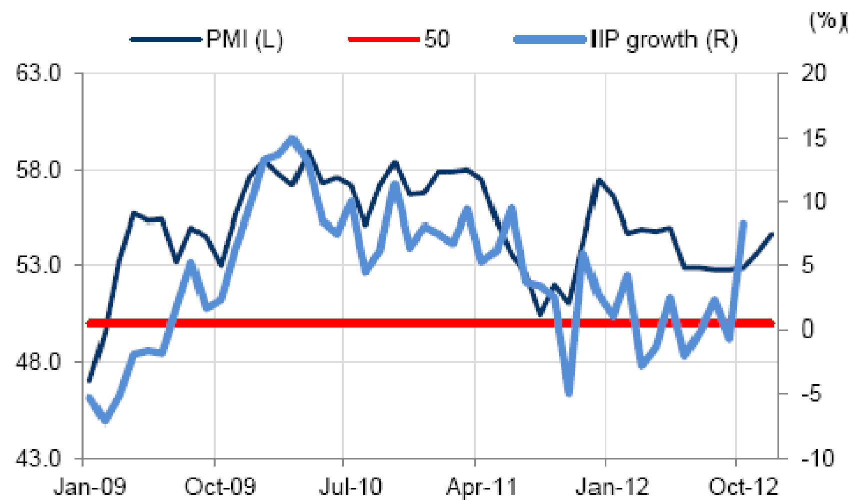
 Source: RBI, Morgan Stanley Research

India Macro - GDP Growth stabilizing at lower levels

Quarterly GDP growth trend



India Purchasing Managers Index (PMI)

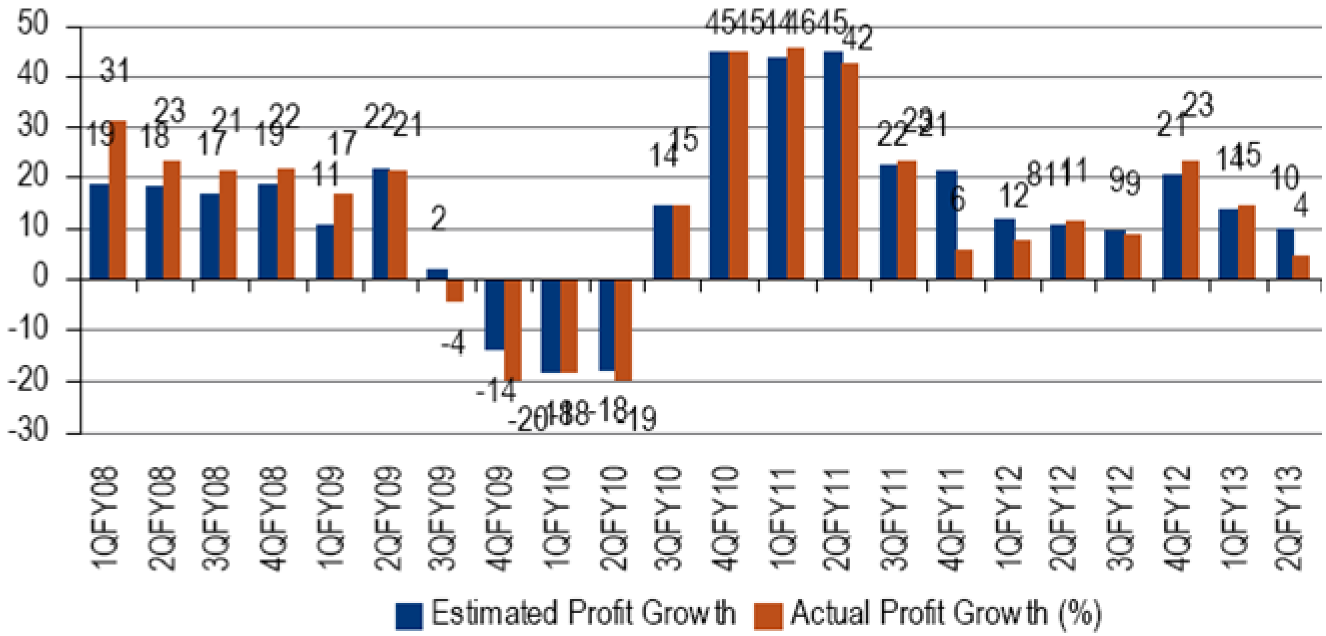


- India's GDP growth declined for four straight quarters of FY12. However in the first three quarters of FY13, it has stabilized at about 5% growth level
- Some of the lead indicators including the Purchasing Manager's Index, (PMI) has remained relatively stable in 53 to 55 band in FY13 after remaining volatile in FY12
- Thus, while there are no visible signs of an improvement, the signals of slowdown have also started dimming, indicating a stabilization of the economy at lower levels

 Source: Markit, Bloomberg, RCML Research, CSO, Morgan Stanley Research

Dec 2012 Earnings Preview– weakness to continue

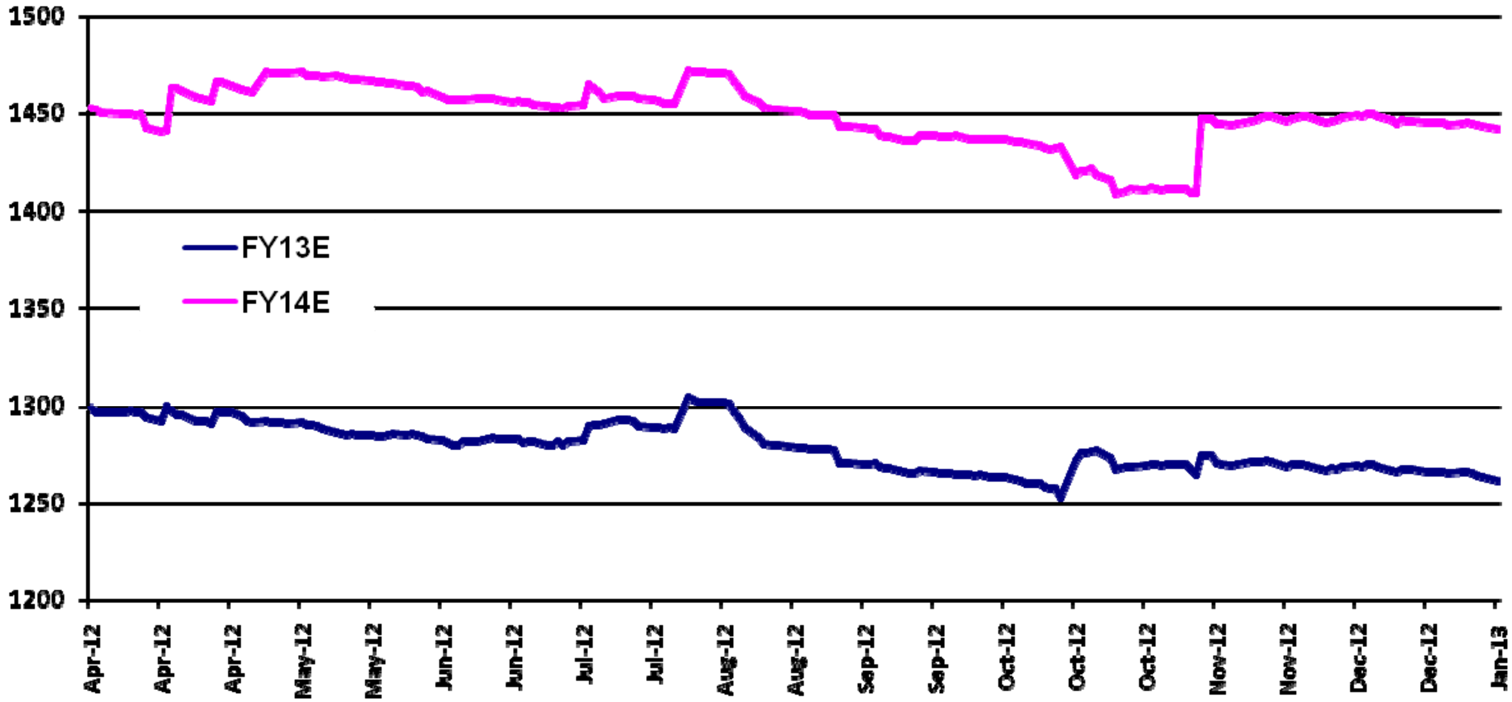
Quarterly Earnings Preview for QE Dec-12



- The Sensex companies are expected to mirror the previous quarter with weak headline profit on a consolidated basis
- The weak growth in profits is driven by slower sales growth forecast along with an expectation of a decline in EBIDTA margins

 Sources: BofA Merrill Lynch Global Research

Earnings Forecasts – Some silver lining in dark clouds



- Consensus expectations for FY13E earnings growth are at about 6.2% growth, revised marginally downwards during the last couple of months
- However, expectations for FY14E EPS have also been revised marginally upwards implying a growth expectation of 14.3%

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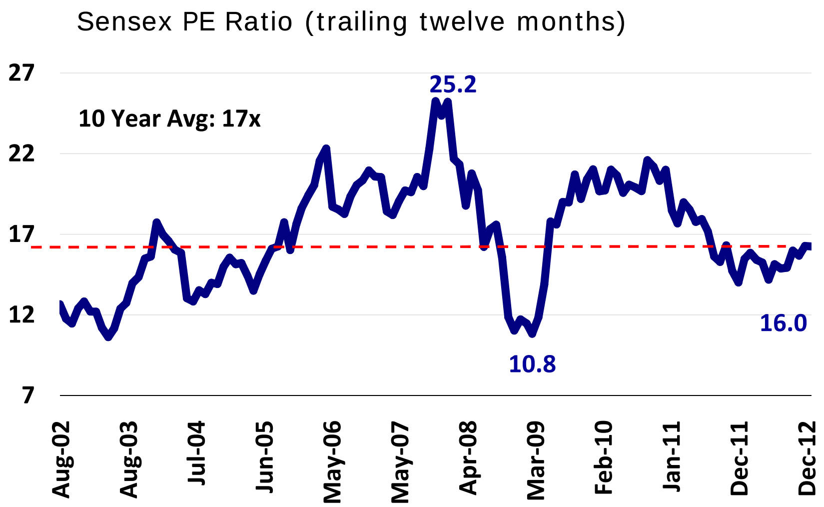
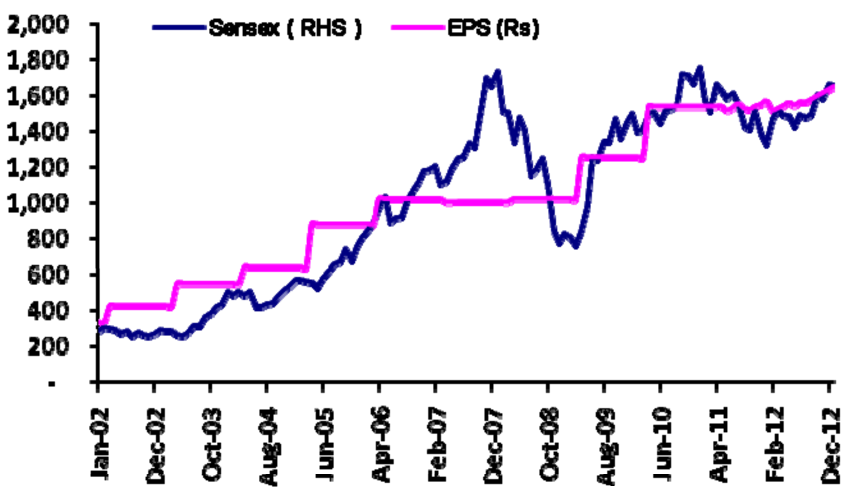
Sources: IBES Estimates, Bloomberg

Valuations – At Reasonable Levels





- Sensex is currently trading at 16.25x its trailing earnings. It is now 4% lower than its historical 10-year average trailing PE of 17x.
- On a 1-yr forward basis, Sensex is trading at 14.4x which is about 0.1% below its 10 year average PE.
- 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 the past 5 years

Source: Bloomberg; MOSL

Looking Ahead...

- Global economic growth trends remain mixed – The US appears stable but is offset by a recession in Eurozone. In Japan, a new government is set to depreciate the Yen in yet another attempt to stimulate the economy through its strong export sector
- US fiscal cliff has been only partially addressed, and a further showdown is likely in two months time when the spending cuts kick in, and the debt ceiling needs to be raised
- Recent opposition by some members of the FOMC to extending the QE beyond CY13 suggests that an end to loose US monetary policy may come sooner than expected
- While government in India seems keen to carry forward the reform agenda, with an productive Parliament session; it is yet to translate into momentum for the economy
- Also measures undertaken till date do not address the key variable determining the future growth outlook – revival of investment demand
- Valuations are reasonable; at a marginal discount to long term averages
- Gap in terms of valuations between cyclicals and non cyclicals is fairly high, with non cyclicals 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

FRBM: Fiscal Responsibility and Budget Management

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