

Equity Markets:

# Current Environment and Outlook

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Chief Investment Officer

July 2013

# Current Environment

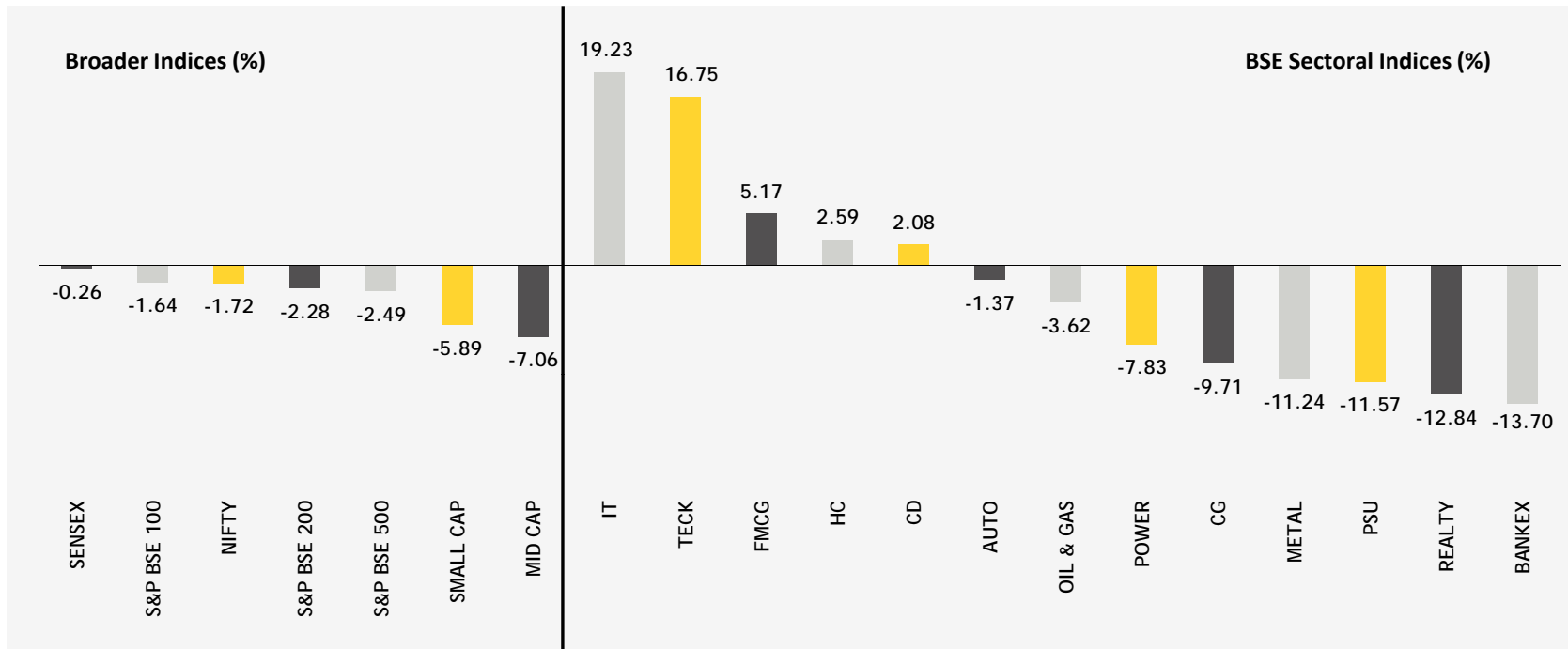
- Global Equity markets were sharply positive in July 2013, with the MSCI World Index rising by 5.19% for the month
- In USD terms, Indian markets underperformed the global market and fell by 0.26%.
- Commodity prices reflected the trend in equities, as benchmark CRB Reuters Jefferies total return index increased by 3% during the month
- IT and Teck delivered the best return for the month, while Banks and Realty were the worst performing sectors during the month\*
- FII outflows during the month were at Rs.61bn. MF's were net sellers at Rs.22bn, while DII's were net sellers to the tune of Rs.15bn during the month
- Trading Activity was higher in July as cash market trading turnover increased by 14% MoM, while Average open interest fell by 70% MoM to its lowest level since Sept'06

\* Please refer slide 4 for sector performances

# Global Equities

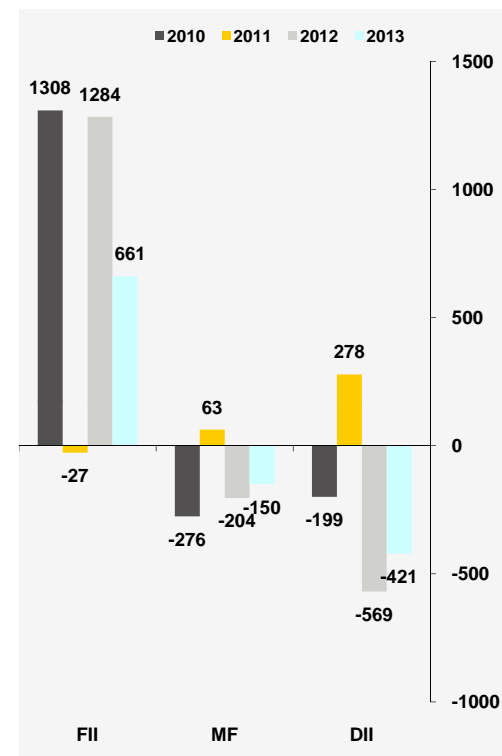
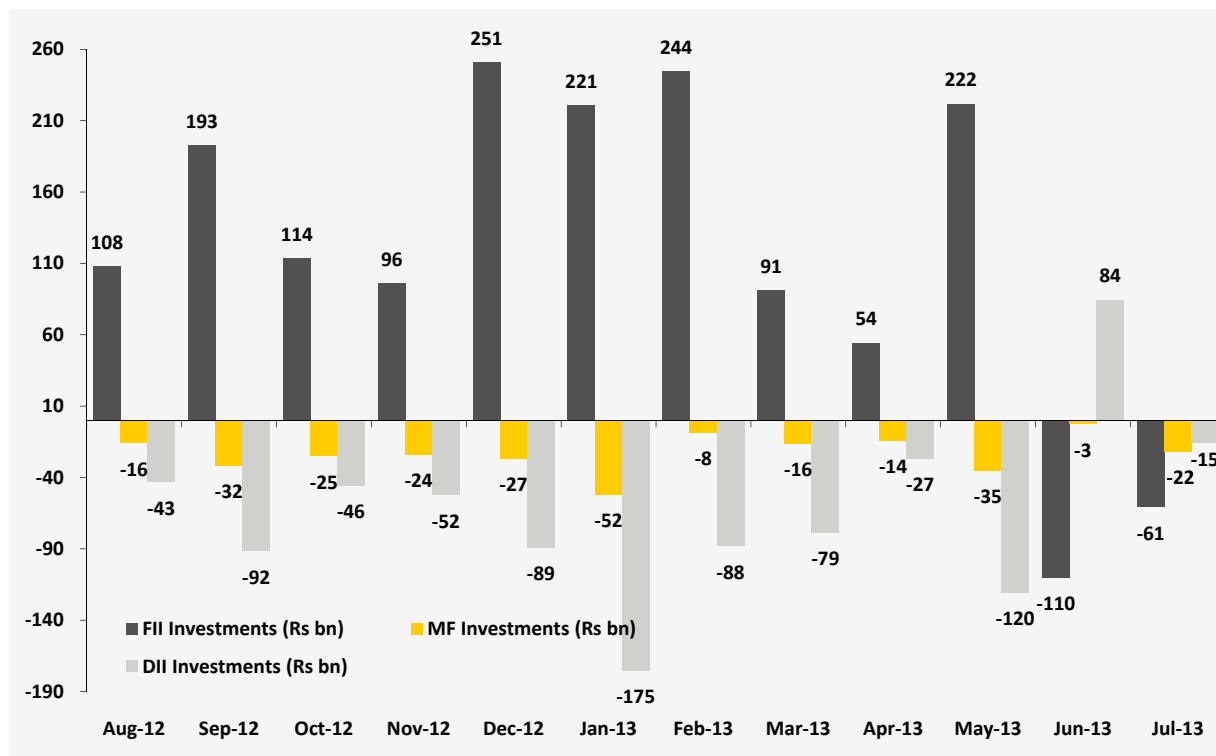
Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	1993.80	0.74%	-12.13%	EM - Asia
S&P BSE Sensex	India	19345.70	-0.26%	-0.42%	EM - Asia
Kospi	South Korea	1914.03	2.72%	-4.16%	EM - Asia
Taiwan Weighted	Taiwan	8107.94	0.57%	5.30%	EM - Asia
Thailand SET 50 Index	Thailand	966.03	-1.73%	2.18%	EM - Asia
Jakarta Composite Index	Indonesia	4610.38	-4.33%	6.80%	EM - Asia
KLSE	Malaysia	1772.62	-0.05%	4.95%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	48234.49	1.64%	-20.86%	EM
Mexico IPC	Mexico	40837.88	0.53%	-6.60%	EM
Russian RTS Index	Russia	1313.38	2.97%	-13.99%	EM
Philippine PSEi	Philippines	6639.12	2.69%	14.22%	EM
Merval Buenos Aires Index	Argentina	3357.86	12.82%	17.64%	EM
HangSeng	Hong Kong	21883.66	5.19%	-3.41%	Developed - Asia
Nikkei	Japan	13668.32	-0.07%	31.49%	Developed - Asia
Strait Times	Singapore	3221.93	2.27%	1.73%	Developed - Asia
Dow Jones	USA	15499.54	3.96%	18.28%	Developed
CAC 40 Index	France	3992.69	6.79%	10.29%	Developed
All Ordinaries Index	Australia	5035.67	5.45%	7.48%	Developed
DAX Index	Germany	8275.97	3.98%	8.72%	Developed
Swiss Market Index	Switzerland	7820.43	1.79%	14.63%	Developed
FTSE 100	UK	6621.06	6.53%	12.26%	Developed
MSCI World Index	--	1507.91	5.19%	13.65%	--

# India : Sector Performance



- Nifty fell by 1.72% over the previous month
- MidCaps and Small Caps underperformed LargeCaps with 7.06% fall and 5.89% fall respectively
- IT and Teck sectors delivered the best return for the month
- Banks and Realty were the worst performing sectors

# FII & DII Inflows



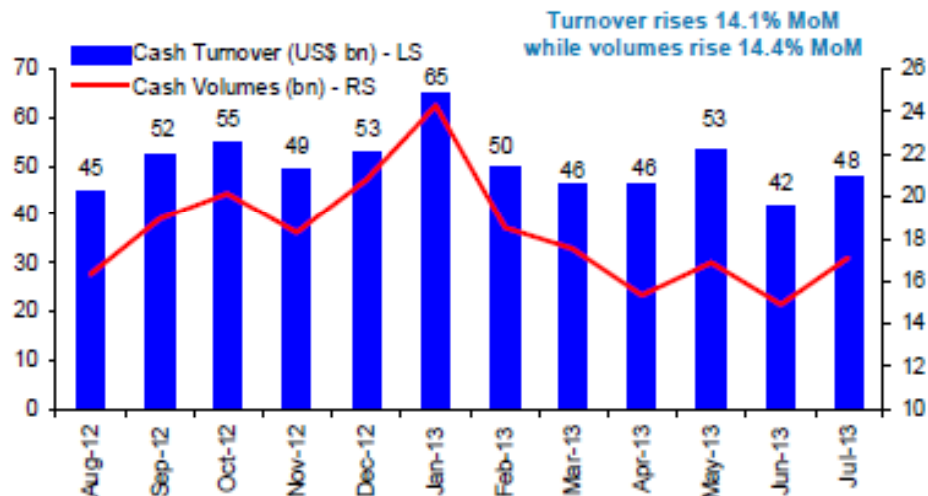
- FII inflows were negative at Rs.61bn during the month
- MF's continued to be net sellers at Rs.22bn. DII turned net sellers during the month at Rs.15bn
- Calendar YTD, FII inflows have been around Rs.661bn whereas MF's and DII's have been net sellers to the extent of Rs.150bn and Rs.421bn respectively

# Top Gainers / Losers - Nifty

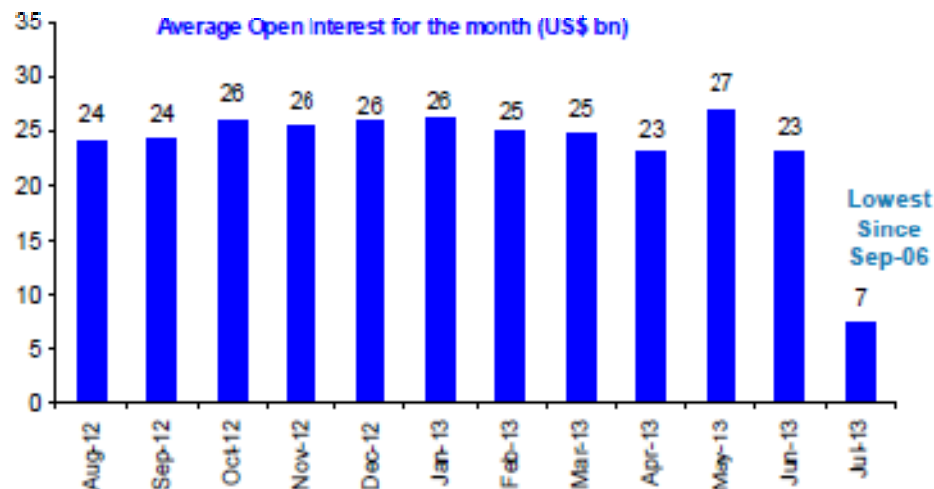
Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
HCL Technologies Ltd	950 / 515	938.00	20.88%
Tata Consultancy Services Ltd	1832 / 1055	1816.00	19.63%
Infosys Ltd	3010 / 2061	2970.00	18.85%
Bharti Airtel Ltd	371 / 216	345.00	18.15%
Sun Pharmaceutical Industries Ltd	581 / 290	565.00	11.66%

Top Losers for the month			
Losers	52 week H/L	Last Price#	% Loss*
DLF Ltd	289 / 146	150.00	-17.13%
IndusInd Bank Ltd	532 / 308	387.00	-17.13%
Tata Steel Ltd	448 / 202	216.00	-21.17%
Axis Bank Ltd	1550 / 927	1035.00	-21.89%
Jaiprakash Associates Ltd	107 / 35	36.00	-33.33%

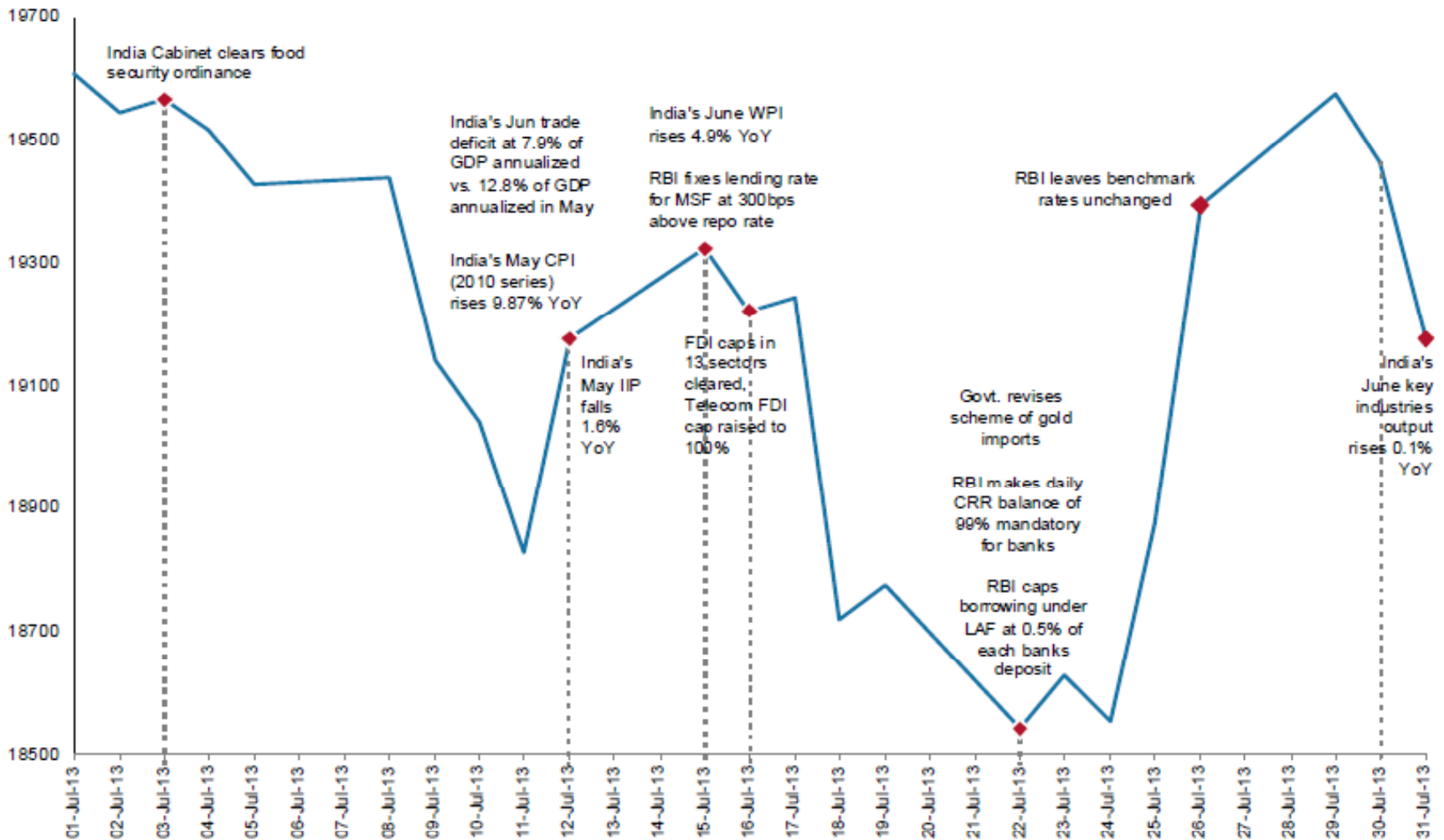
# Market Activity (NSE & BSE)



- In July 2013, cash market trading turnover increased by 14% MoM
- At the end of June 2013, average open interest fell by 70% MoM to its lowest level since Sept'06 to \$7 bn



# July 2013 events timeline



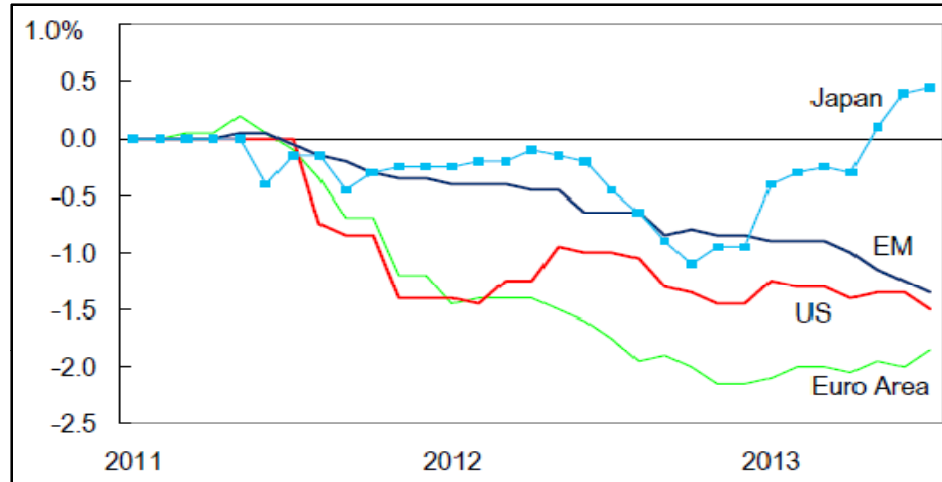
# Equity Market Outlook and Opportunities

# Equity Market Outlook

- In the recent U.S. Fed Open Market Committee (FOMC) meeting, the Federal Reserve signaled “tapering” of Quantitative easing provided Unemployment, growth and inflation outcomes are in line with their projections. This is likely to result in reduction in liquidity from global asset markets
- RBI’s recently announced liquidity tightening measures have significantly increased short term rates, thereby negatively impacting corporate profitability and increasing cost of capital
- These measures are likely to further reduce an already low investment demand, thereby impacting near-term GDP growth
- The government may find it difficult to achieve its fiscal promises considering the slippages in tax collections in the first quarter due to weak corporate profitability
- A silver lining has been a normal monsoon, which has till date been at 15% above normal
- The earnings seasons so far has been good wherein Sensex companies have reported slightly better than estimated earnings

# Global Macro – Fear of ‘tapering’ Quantitative Easing Pressure on financial markets

Cumulative Changes in forecast for GDP Growth of 2013 -14

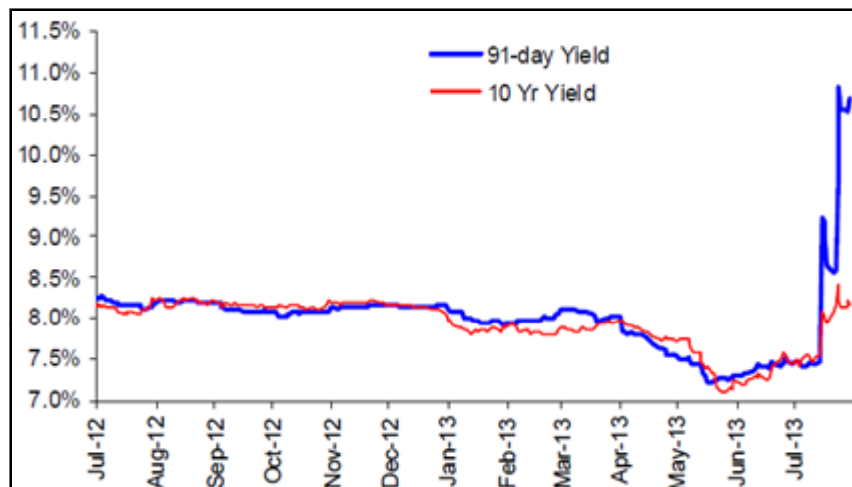


Citi estimates used as proxy for market forecasts

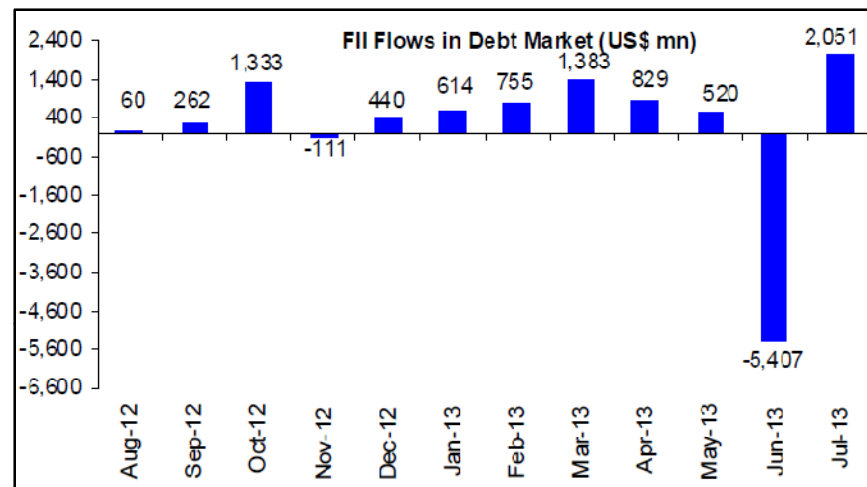
- In the recent Fed Open Market Committee (FOMC) meeting, Federal Reserve signaled “tapering” of Quantitative easing provided Unemployment, growth and inflation outcomes are in line with their projections
- Fear of ‘tapering’ of quantitative easing has led to local currency depreciation versus USD and rise in bond yields for most emerging markets
- India has also been negatively impacted as currency has depreciated the most among emerging markets and bond yields have also gone up
- However “tapering” is contingent upon US Fed’s economic projects which since 2009 have proven to be optimistic when compared to actual outcomes

# RBI reverses stance - tightens the noose on liquidity

10-year G Sec Yield and 91-days T-Bill Yields



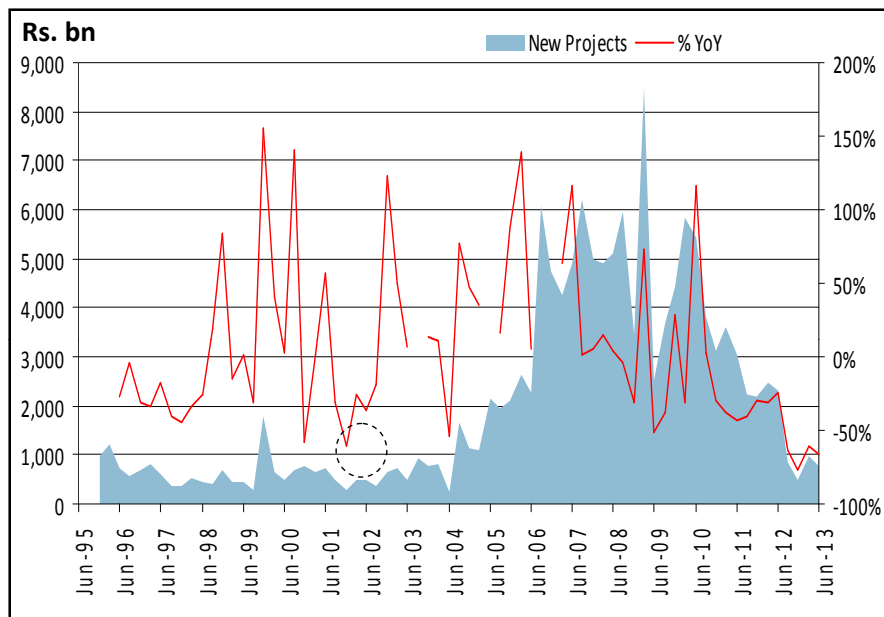
FII Debt Market Flows



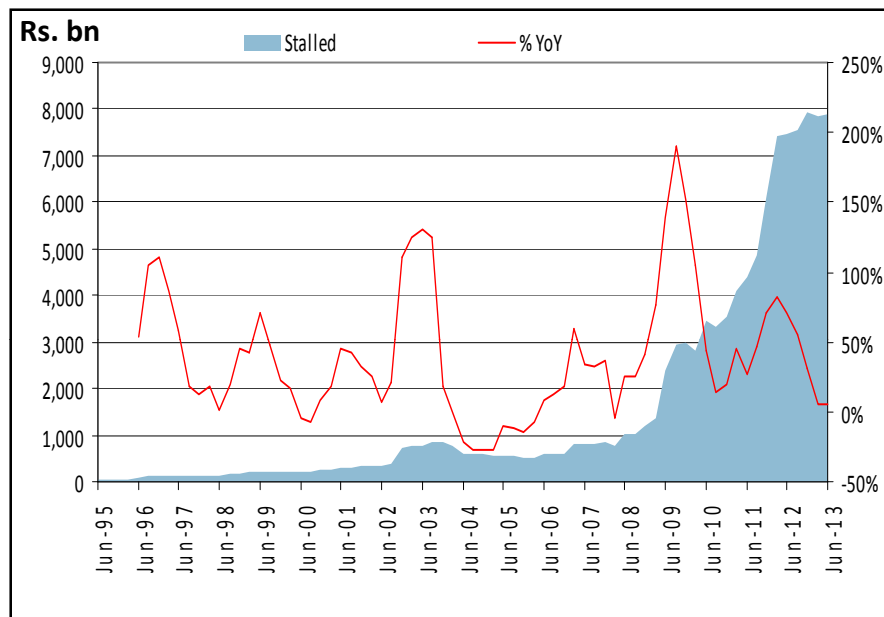
- RBI recently announced measures to significantly tighten liquidity and increase short term rates, thereby departing from its previously dovish policy stance
- Key measures were increase in Marginal Standing Facility (MSF) rate to 10.25% and capping the overall limit for access to Liquidity Adjustment Facility (LAF) for each individual bank at 0.5% of its own Net Demand and time Liabilities (NDTL)
- The measures are unprecedented (in the past RBI has resorted to such measures in 1998 for a brief time period) and according to the central bank the measures are intended to curb volatility in the foreign exchange market
- However, in the monetary policy itself, the RBI made no new big bang announcements.

# India Macro –Capex Cycle continues to remain weak

**New Projects Announcement Rs bn and YoY Growth %**



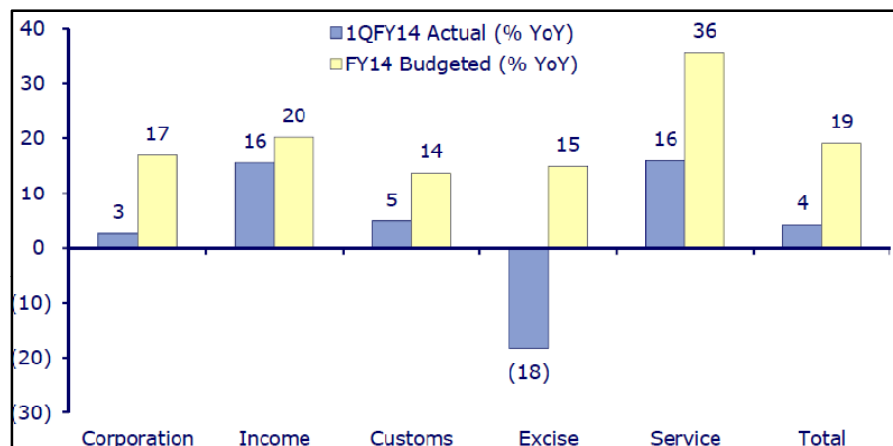
**Projects Stalled Rs bn and YoY %**



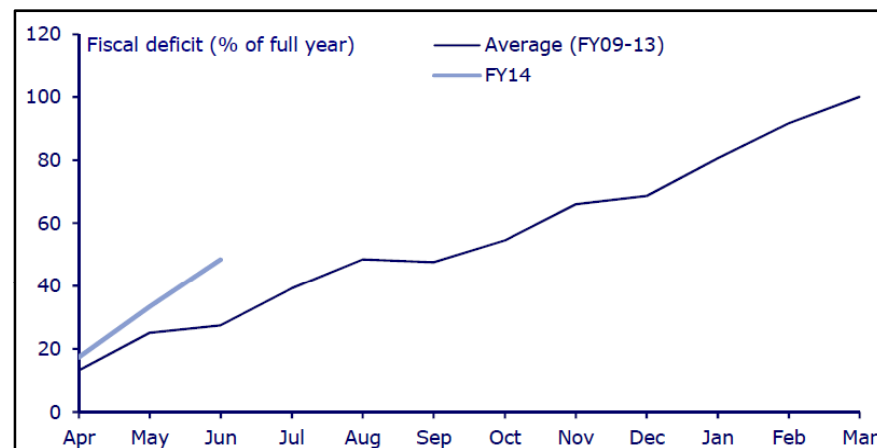
- India's capex cycle continues to remain weak as latest project data in 1q14 signal continued slowdown in new investments
- New project announcement fell by 68% YoY and 18% QoQ – 11<sup>th</sup> consecutive quarter of decline
- New project announcement have fallen 91% from the peak level of 4q09 of Rs. 8481 bn
- Stalled projects have gone up to Rs. 7893 bn (+6% YoY and 1% QoQ)
- Stalled projects as a percentage of Projects under implementation stand at 10%

# India – Fiscal worries re-emerge

Actual vs. Budgeted tax collections



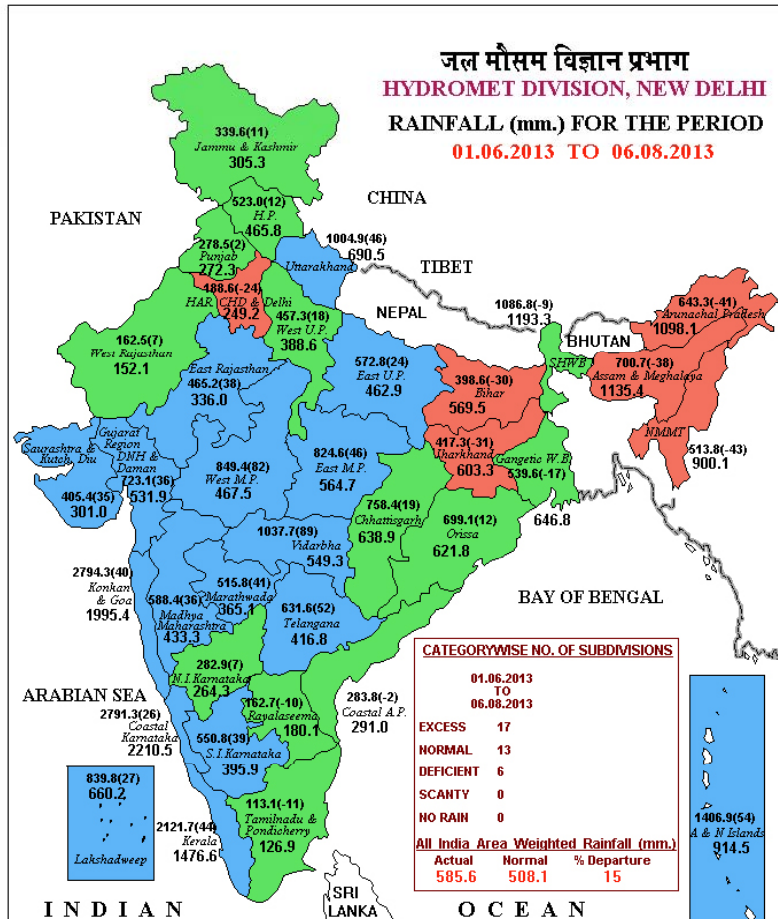
Fiscal deficit trend



- Government's 1QFY14 gross tax revenue growth of 4% is significantly lower than 19% budgeted
- Weak trend in corporation tax despite a 5% surcharge introduced in the budget on corporate tax rates highlights a slowdown in corporate profitability
- While 1Q is seasonally smaller quarter (15-16% of annual), given the weak corporate / economic activities, meaningful pick-up in tax growth appears unlikely. Also, given the INR depreciation vis-à-vis USD, fuel subsidy is likely to be higher than budgeted

# 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 15% above normal for July 2013
- Most of the states (except North Eastern states) have witnessed excess to normal rainfalls during July 2013

# India – Earnings Season so far

## Quarterly Earnings for QE Jun-13 Snapshot

YoY Revenue growth	Q2F13	Q3F13	Q4F13	Q1F14E	Q1F14E*	Q1F14
MS coverage	11%	11%	7%	2%	2%	3%
MS coverage ex-oil psu	14%	11%	6%	7%	2%	3%
MS coverage ex-energy	12%	9%	7%	5%	12%	13%
Broad Market (1115)	15%	10%	7%		-	-
Broad Market ex-oil psu	13%	10%	6%		-	-
Broad Market ex-energy	12%	9%	6%		-	-
BSE Sensex	12%	9%	6%	7%	-1%	1%
YoY Earnings growth	Q2F13	Q3F13	Q4F13	Q1F13E	Q1F13E*	Q1F14
MS coverage	64%	0%	3%	3%	8%	10%
MS coverage ex-oil psu	11%	5%	2%	0%	8%	10%
MS coverage ex-energy	13%	1%	-4%	-6%	7%	8%
Broad Market (1115)	58%	0%	-1%		-	-
Broad Market ex-oil psu	18%	7%	-4%		-	-
Broad Market ex-energy	18%	5%	-7%		-	-
BSE Sensex	4%	7%	7%	3%	13%	15%

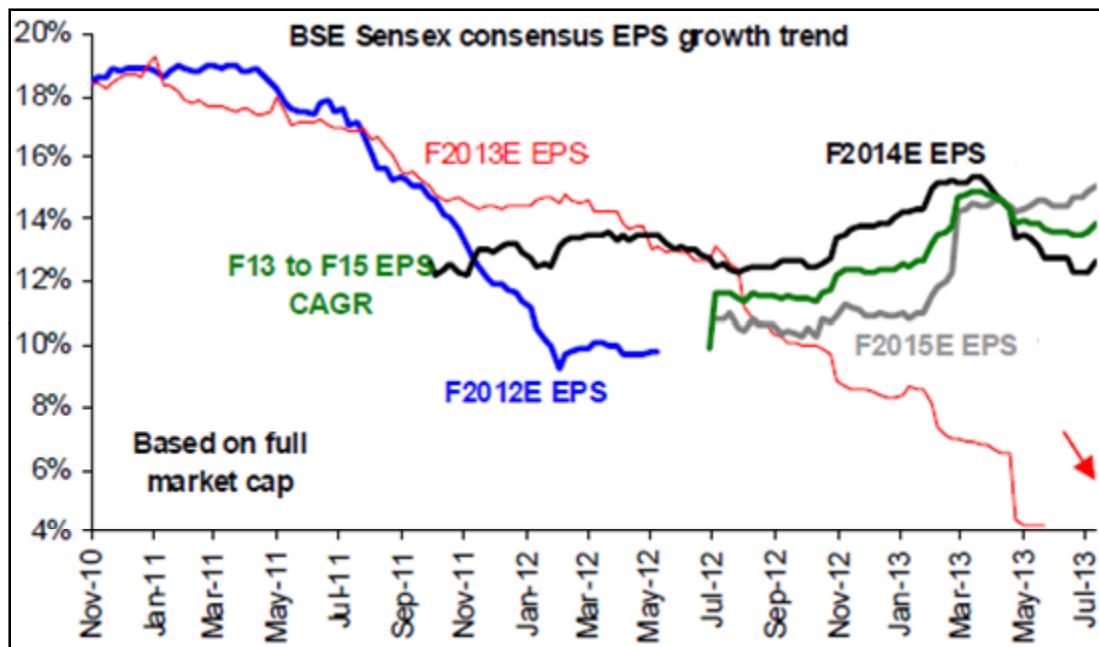
E = MS Analyst Estimate for MS coverage universe  
E\* = MS Analyst estimate for 27 companies that have reported thus far

Morgan Stanley estimates used as proxy for market

- Sensex companies have reported 1% revenue growth, higher than an estimated 1% decline
- The earnings growth of the same set grew by 15% YoY, 2 percentage point ahead of expectations. Ex-energy, earnings for Sensex companies are 2 percentage point ahead of expectations at 13% YoY

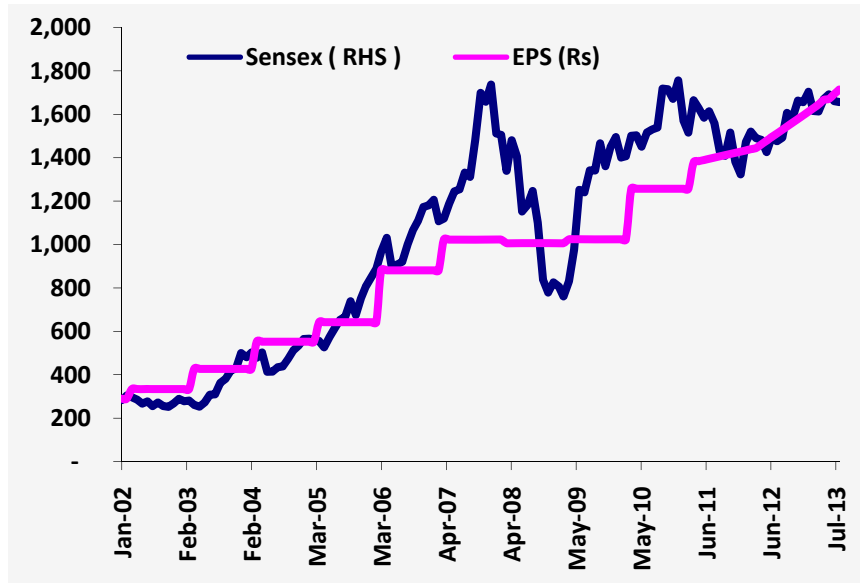
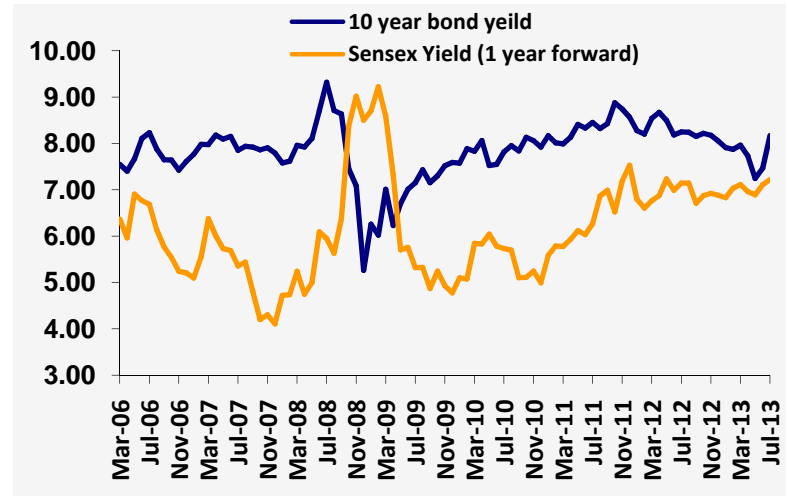
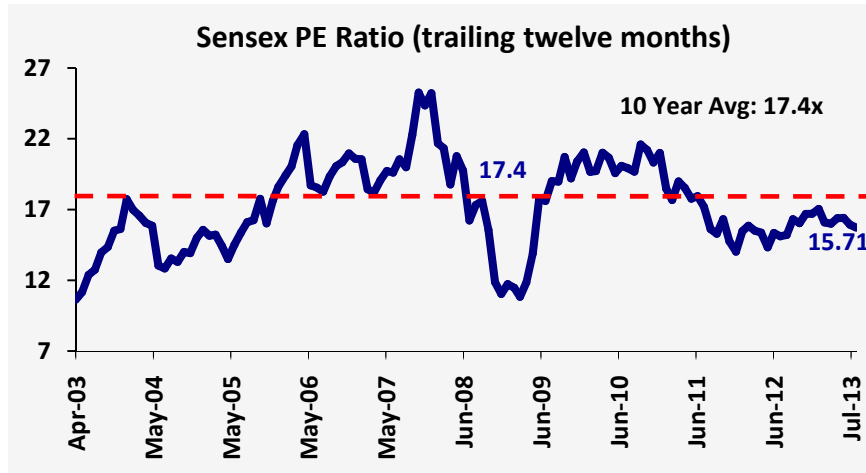
# Earnings Expectations – Tough task

S&P BSE Sensex consensus EPS growth trend



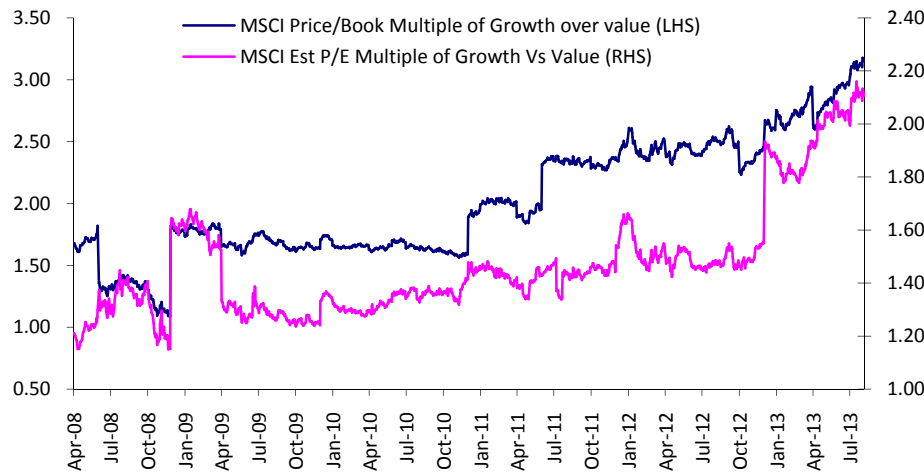
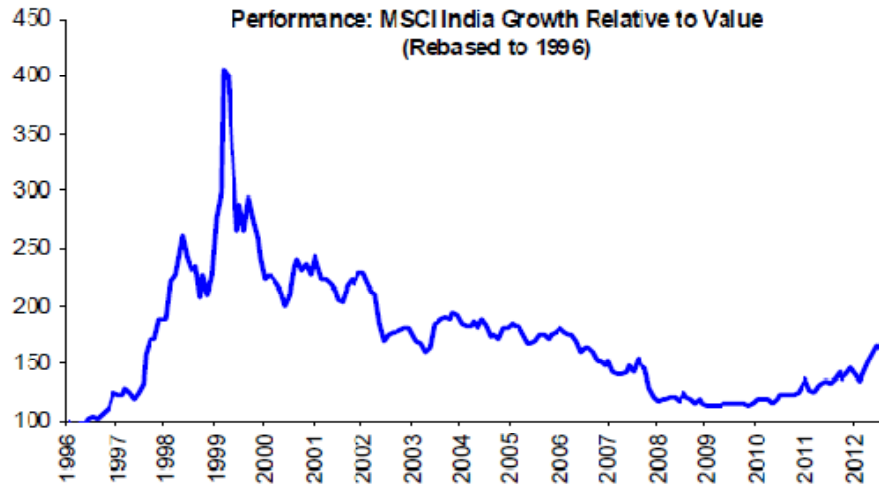
- Consensus EPS estimates for BSE Sensex companies have been revised downwards by 0.8% and earnings is now expected to grow by 12.6% for FY14E
- Despite downward revision, 12.6% for FY14E seems a tough ask, considering that earnings growth for FY13 was 2.8% and overall economic environment continues to remain weak

# Valuations – At Reasonable Levels



- Sensex is currently trading at 15.71x its trailing earnings. It is now 10% lower than its historical 10-year average trailing PE of 17.4x
- The FY14 Sensex forward earnings yield has once again diverged from 10 year bond yield, which spiked recently post liquidity tightening measures by RBI
- 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 growth and value



- MSCI India growth Index has significantly outperformed Value index by a wide margin from 2008
- YTD outperformance has been 17.8%
- Value index continues to widely underperform even MSCI India standard Index
- Resultantly, the valuation gap between MSCI India growth Index and Value index is at a 5 year high.
- As of July 2013, valuation premium of growth index over value index stands at 3.1x in terms of Price/Book and 2.0x in terms of Est Price/Earnings

# 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 key highlight this month in India was the intervention by the RBI in the currency market. The RBI effectively hiked short-term rates and tightened liquidity with a series of actions this month
- The policy framework of the RBI has so far been dominated by the inflation-growth paradigm. But now currency stability moves to the forefront and growth is now a lesser objective
- In the credit policy review by RBI at the month end, it sent a mixed message justifying its short-term actions even while suggesting that if not for the pressure on the currency it would have been inclined to ease the rate
- Based on current trends, FY14E consensus growth expectation of 12.6% looks challenging
- While valuations are reasonable and at a 10% discount to long term averages, the earnings outlook is challenging, making the market outlook for the near term challenging
- 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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