Equity Market Outlook

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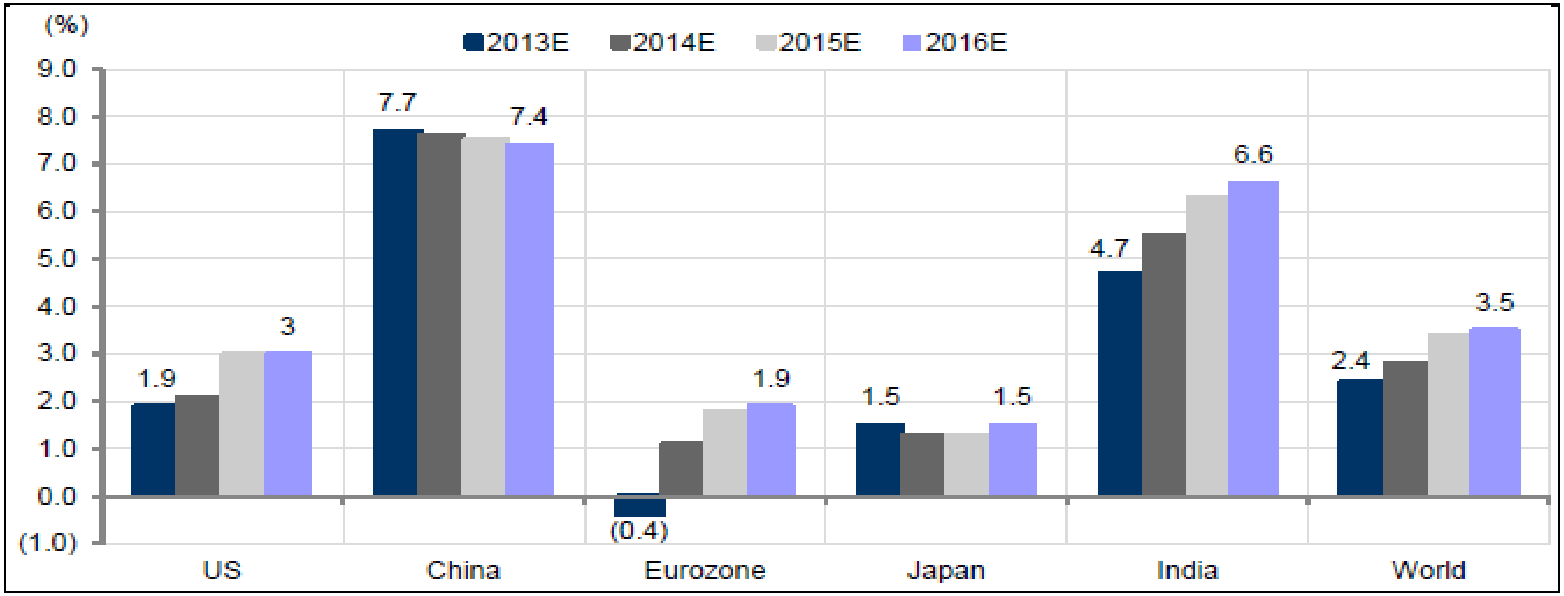
Equity Market Outlook

- Global growth has been revised downwards to 2.8% in 2014 and is expected to recover to 3.4% in 2015
- India's GDP growth appears to have stabilized, albeit at lower levels, led by a sharp deceleration in Industrial output
- The weakness in the investment is the key reason for slower growth, the new government is expected to revive the investment cycle through focus on faster clearances & reforms
- India's current account deficit (CAD) narrowed sharply to 1.7% of GDP in FY14 as compared to record high of 4.8% in FY13. However, the fiscal deficit already reached 46% of interim budget targets in first 2 months of FY15(E)
- Inflation is moderating but remains a concern area due to the threat of a weak monsoon
- Consensus expect Earnings growth to be at 14% in FY15E and 15% in FY16E
- Sensex currently trades at 18.3x its trailing earnings – 13% premium to its historical 20-year average trailing PE of 16.3x

Global Macro - Global GDP

Still weak, but recovery ahead

World Bank's growth forecasts for key regions globally

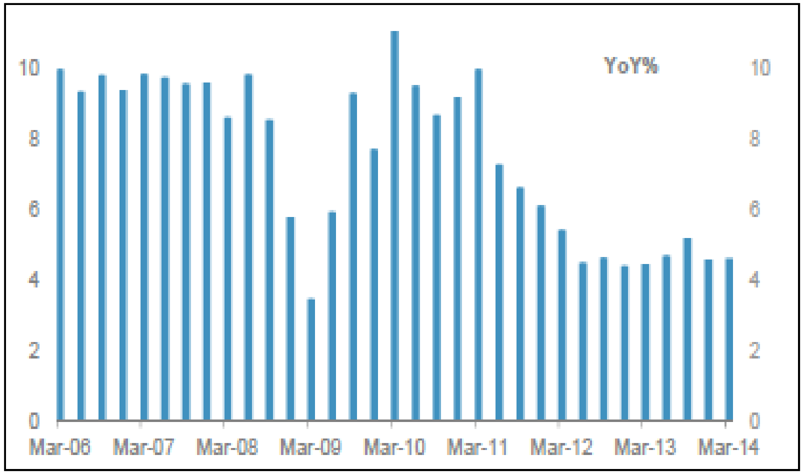


- World Bank has reduced its global growth forecasts for 2014 from 3.2% to 2.8% on account of poor US weather at the start of the year, global financial disturbances and the Ukraine Crisis
- However Growth is expected to pick up to 3.4% in 2015 and 3.5% in 2016 largely led by growth acceleration in high income countries
- For India, growth is expected to improve from sub 5% to 5.5%, 6.3% and 6.6% in 2014/15/16 respectively

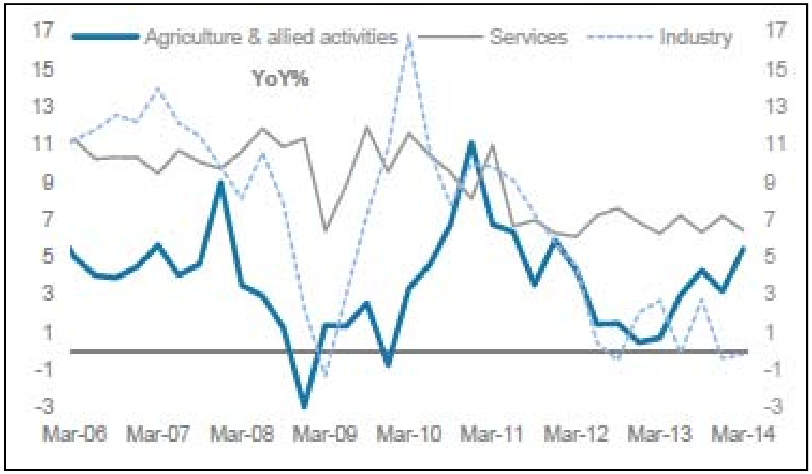
Source: World Bank

India - GDP Growth
Stabilising at lower levels

Quarterly Real GDP Growth (%)



YoY Growth in Agriculture, Industry & Services

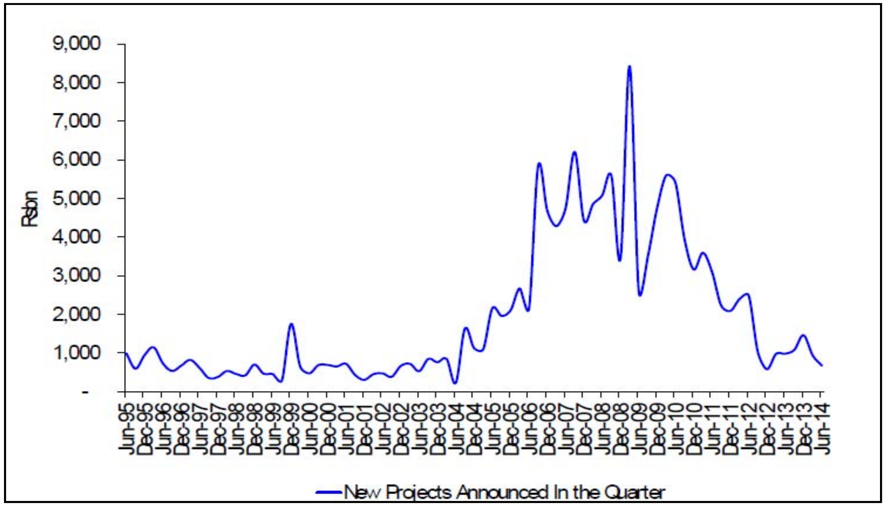


- India's GDP growth continues to remain below 5% levels for the ninth consecutive quarter, with 4QFY14 GDP growing at 4.6%
- Growth was led by a robust services and agriculture sector, offset by a decline in the industry growth

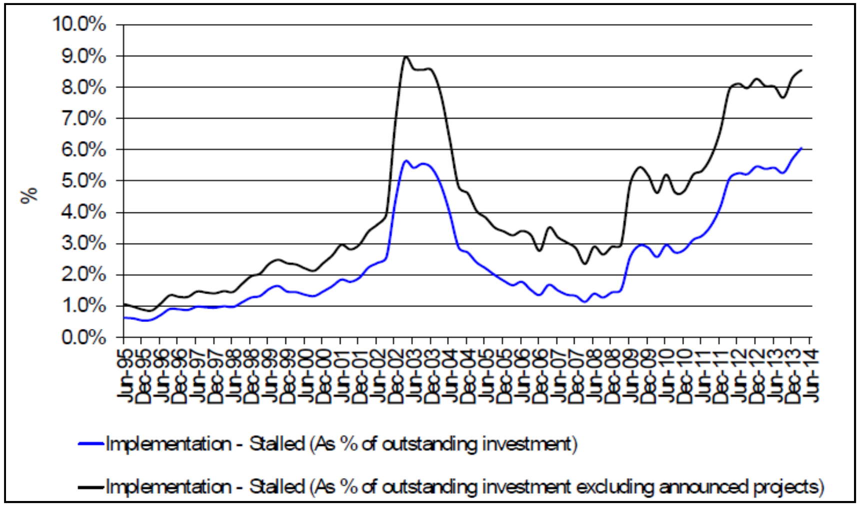
Source: CSO, Morgan Stanley Research

India - Investment Cycle
Weak

New Project announcements (Rs bn) – back to 96-FY04 levels



Projects under implementation but stalled as % of total O/S Projects



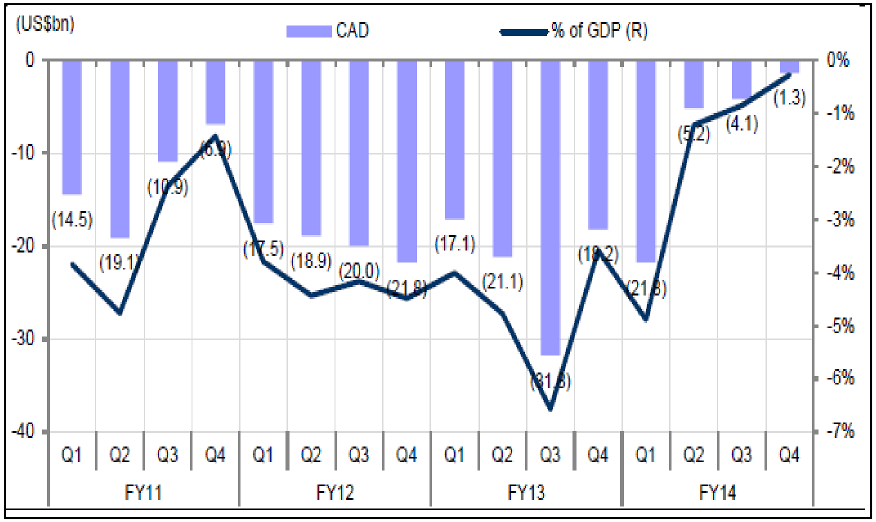
- New project announcements continued to struggle in 1Q15 - down 32% YoY and 29% QoQ
- “Projects under implementation but stalled “ continue to rise at 14% YoY and 2% QoQ
- In order to facilitate passage of high-value infra projects, government had set up a Project Monitoring Group (PMG) in June 2013
- Till April 2014, the group has so far resolved projects valued at Rs. 5.4 lakh crore
- Progress of these resolved projects and progress of PMG in resolving remaining projects would be a key factor in revival of the investment cycle in the future

 Source: CMIE, Citi Research

India - Twin Deficit
Mixed Bag

Fiscal Deficit (12M Trailing Sum % of GDP)

Quarterly CAD Trend (USD bn, % of GDP)



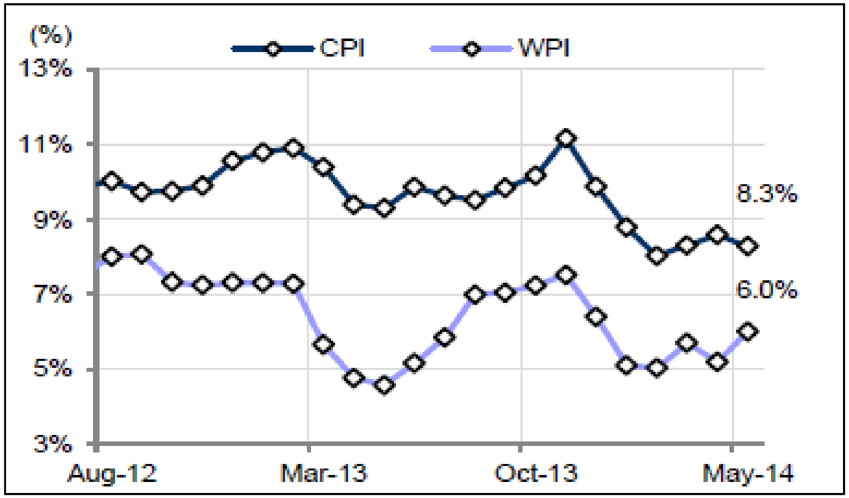
- The fiscal deficit for Apr-May 2014 stood at 46% of FY15BE as the expenditure growth stood at 18.3% yoy vis-à-vis just 7% growth in the revenues
- Moreover, on a 12-month trailing basis, fiscal deficit worsened to 4.9% of GDP in May 2014 vs. 4.6% of GDP in April-14 and 4.5% in March-14
- On the other hand, BOP position is much more comfortable as 4Q14 CAD at 1.3 bn (0.3% of GDP)-was the lowest in 20 quarters
- FY14 CAD came in at 1.7% of GDP vs a record high of 4.8% in FY13

 Source: RBI, Morgan Stanley, RCML Research. BOP: Balance Of Payment. CAD: Current Account Deficit

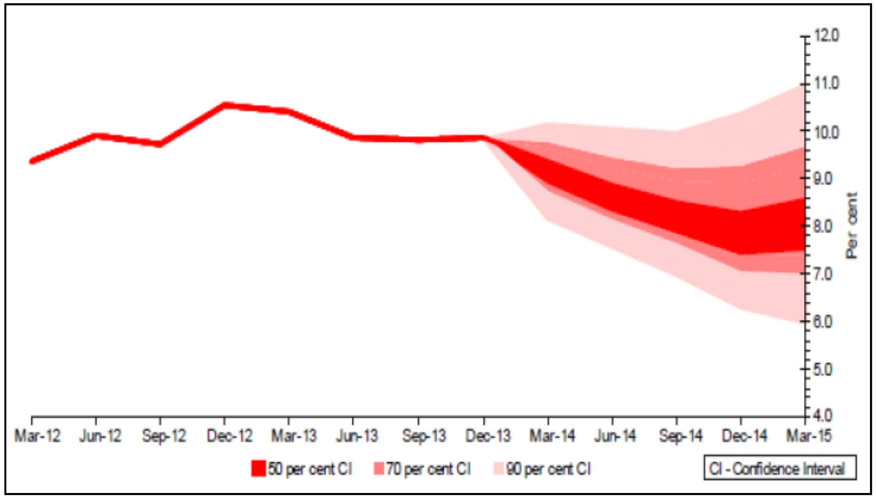
India – Inflation

Still cause of concern

Inflation – CPI and WPI (%)



RBI's 'Glide Path' for CPI Inflation



- Headline CPI rate decelerated to 8.28% YoY in May -14 from 8.6% YoY in March; Core CPI inflation remained was largely steady at 7.72% YoY in May-14 from 7.73% YoY in April-14
- On the other hand, Headline WPI increased to 6% YoY in May -14 from 5.2% YoY in April-14
- The RBI's glide path for CPI inflation envisages a drop to 8% in Jan 2015 and 6% in Jan 2016
- However this expectation faces the challenges from both fuel prices and risk of higher food inflation due to a weak monsoon

 Source: RBI, Morgan Stanley. CPI: Consumer Price Index. WPI: Wholesale Price Index

India – Monsoon

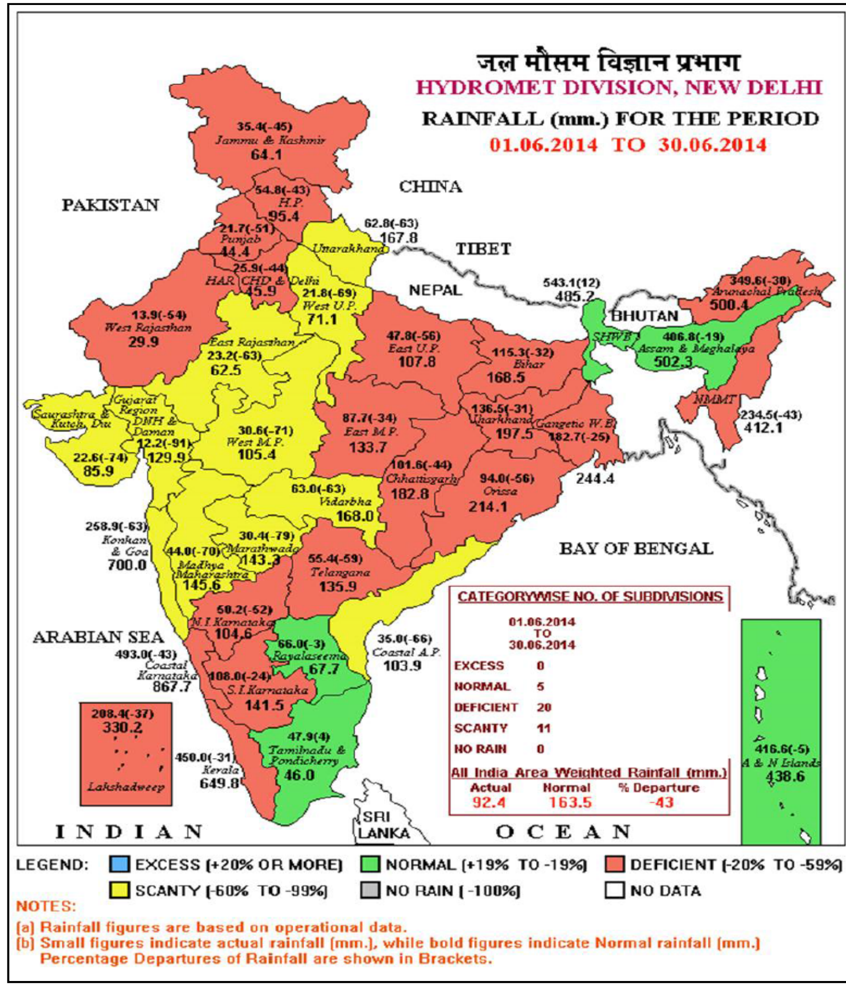
Deficient

India – Kharif Sowing Area (Mn Ha)

	27-Jun-14	28-Jun-13	%YoY
Area Sown	13.1	25.1	-47.8
Rice	2.2	3.9	-44.0
Pulses	0.4	1.1	-59.1
Coarse Cereals	2.0	2.9	-33.4
Oilseeds	0.5	6.1	-92.1
Sugarcane	4.4	4.7	-7.4
Cotton	2.9	5.6	-47.9

- On an all-India area-weighted basis, cumulative rainfall was 43% below Normal up to 30th June 2014
- Deficient rainfall has impacted sowing as gross sown area is down 48% YoY till 27th June 2014 with large declines in Pulses and oilseeds

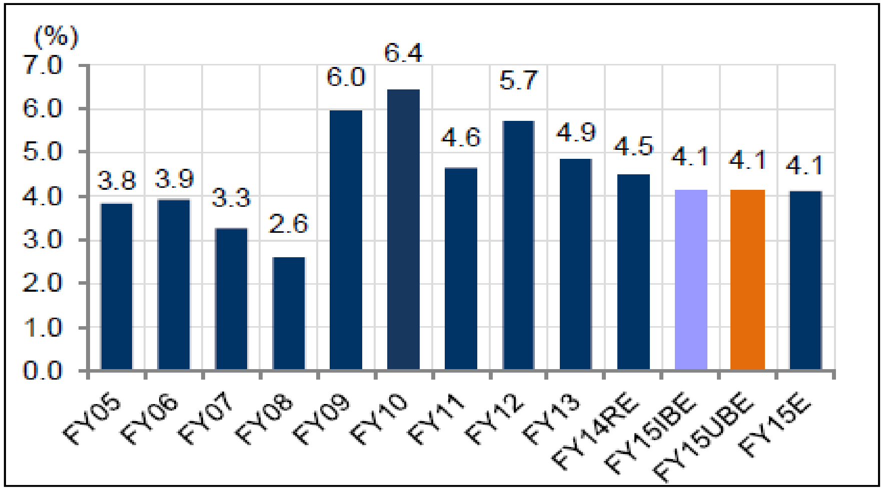
India – Rainfall for June 2014



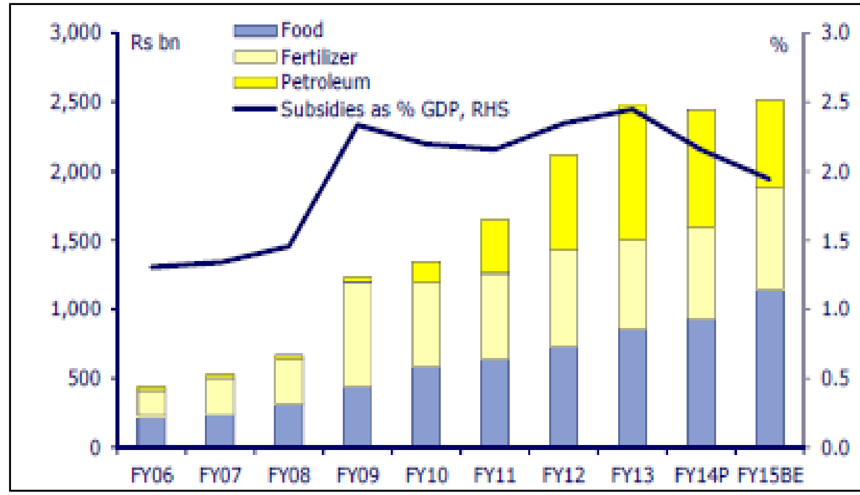
 Source: Indian Meteorological Department (IMD)

India – Budget
Pragmatic

India Fiscal Deficit Trend



Key Subsidies an total Subsidy burden as % of GDP

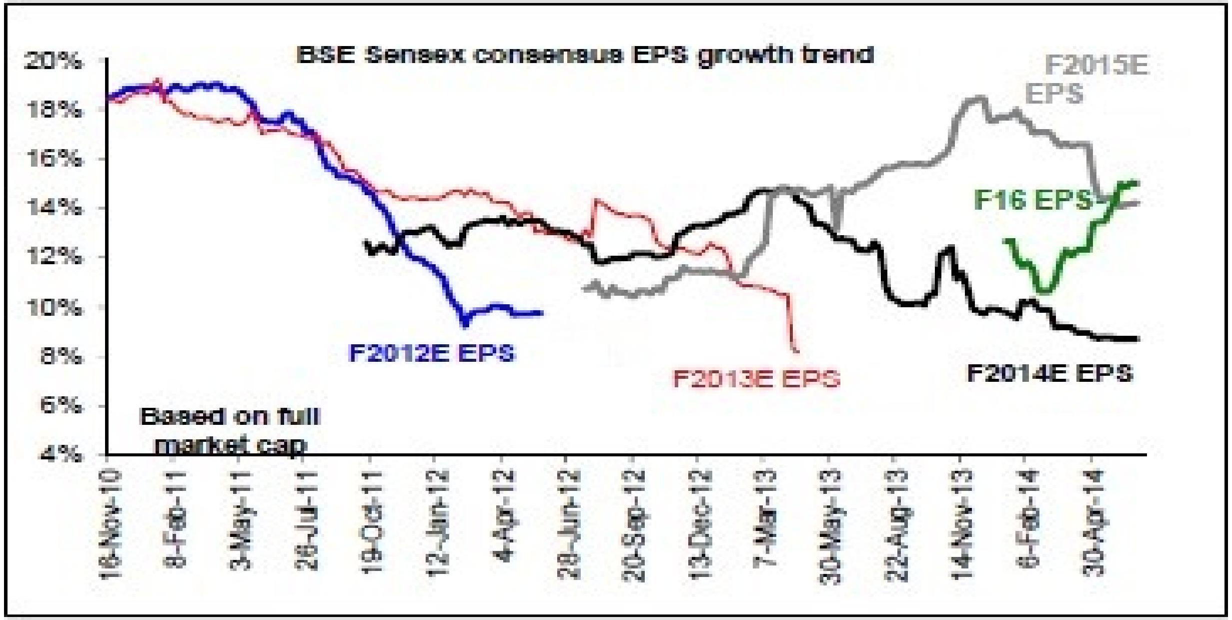


- The budget has maintained a fiscal deficit target of 4.1% for FY15E thereby exhibiting the government's commitment to fiscal consolidation. Long term FY17E fiscal deficit target has been maintained at 3%
- However achievement of current target seems challenging as assumption of 20% growth in Tax revenues is aggressive, accounting of subsidies is lenient and fiscal deficit has already reached 46% of Interim budget estimates in first 2 months
- Without being radical, the budget provides a sense of roadmap that government has adopted which means fiscal consolidation, continuity, boost to infrastructure, manufacturing and job creation, sops for individuals, strengthening the federal structure, simplifying tax structure and administration, encouragement for FDI's and FII thereby ticking most of the right boxes

Source: Budget Documents, CLSA, RCML Research. **Note**: It should be noted that the data, analysis, opinions, views mentioned / expressed above are based on the budget proposals presented by the Honorable Finance Minister in the Parliament of India on July 10, 2014 and the said budget proposals may change or may be different at the time the budget is passed by the Parliament and notified by the Government

India – Earnings

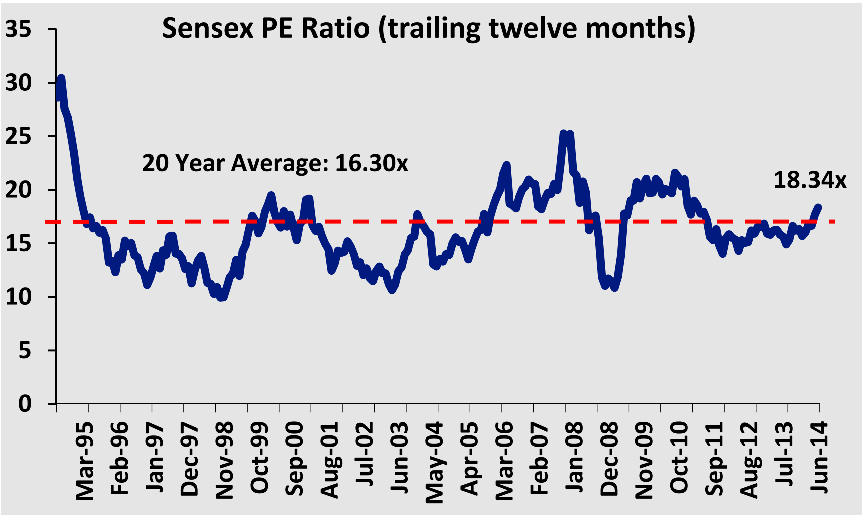
Near term weakness

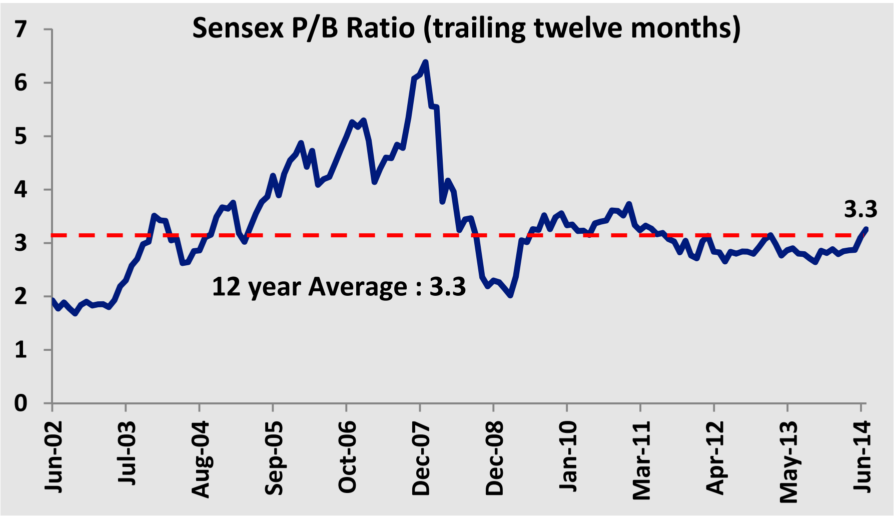


- Consensus expect Earnings growth to be at 14% in FY15E and 15% in FY16E
- While FY15 earnings are still being downgraded, FY16 earnings could surprise positively on a revival in the investment cycle and domestic growth

 Source: Morgan Stanley

Valuations – edged above long term averages





- While the Sensex is near to its lifetime high, its valuations are not
- Sensex is currently trading at a 13% premium to its 20 year average PE
- Based on Price/Book, it is currently trading in line with its 12 year average

Source: MOSL, Religare Invesco AMC Research

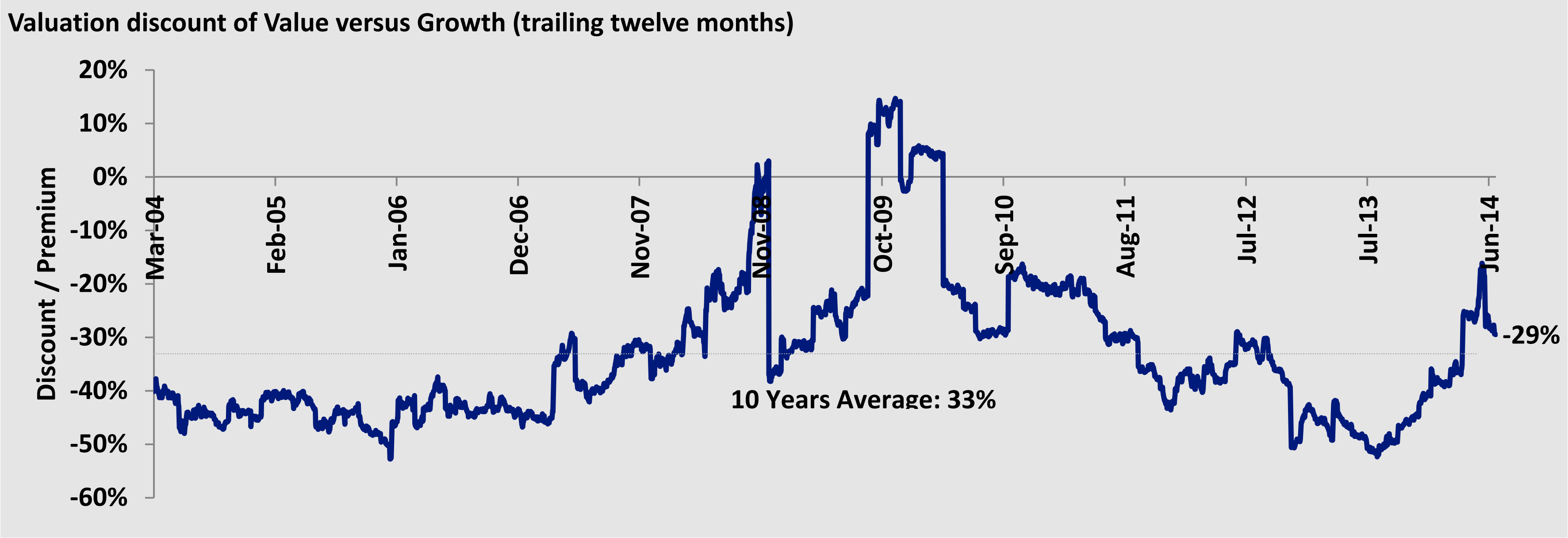
Opportunities – Midcaps vs Large Caps

RELIGARE Invesco Mutual Fund

- The CNX Midcap Index is currently trading at a slight premium of 2% - at a Trailing 12-months P/E of 17.8 versus 17.4 P/E for Nifty
- Nine year average discount has been 16% for Midcaps
- Over this period, midcap valuations have ranged between 76% discount to 38% premium versus large caps
- The valuation gap has narrowed driven by expectation of a pickup in economic growth as midcaps are more sensitive to macro economic environment

Source: Bloomberg

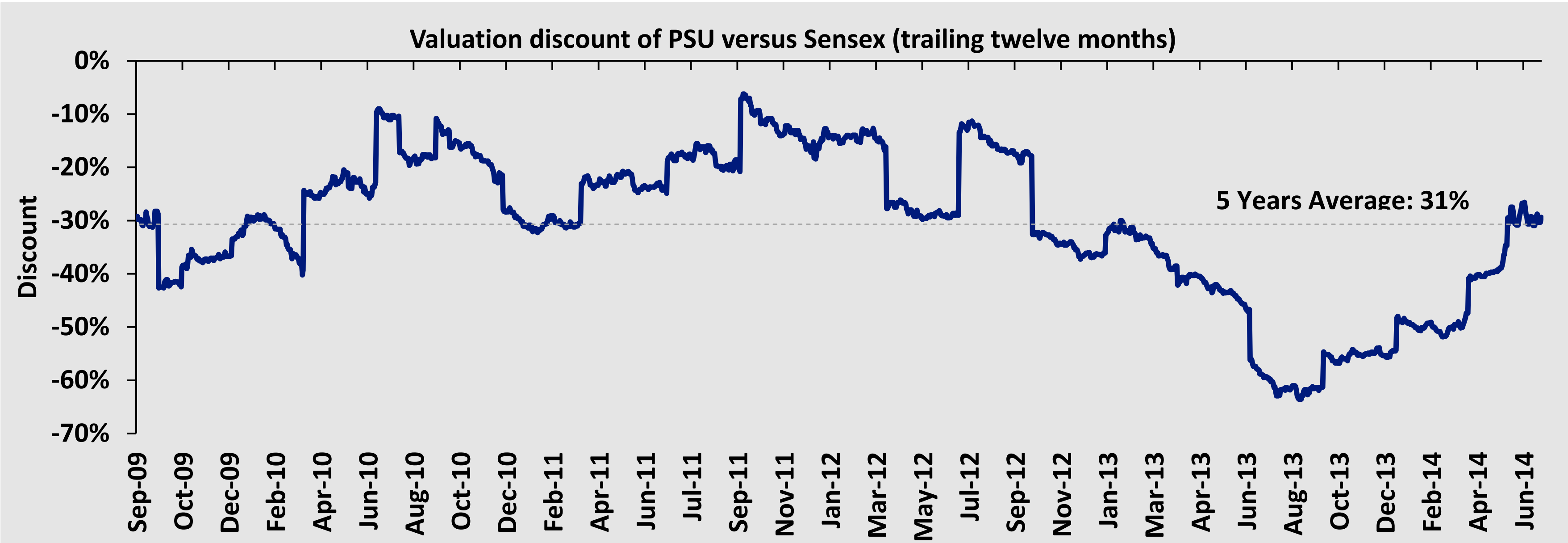
Opportunities – Valuation Gap between Growth and Value



- MSCI Value index (representing cyclical businesses) is trading at a trailing 12-months P/E of 15.3 P/E versus 21.7 P/E for MSCI Growth Index
- This translates into 29% discount at slightly lower than 10 year long term average of 33%
- Over last 10 years, valuation of MSCI value index has ranged from discount of 53% to premium of 15%
- The next leg up for cyclical has to be driven by a pick up in earnings momentum

Source: Bloomberg

Opportunities – Public Sector undertakings



- BSE PSU Index currently trades at P/E of 12.7x trailing 12 months earnings (1% premium to average) versus 17.98 x for Sensex which is trading slightly above its mean
- BSE PSU Index is currently trading at 29% discount to BSE Sensex as compared to 5 year average of 31%
- The discount of PSU's to the market has ranged between 6% in October 2011 to 64% in September 2013
- A new government with a supportive approach to PSU's can enhance valuations
- PSU's largely operate in cyclical sectors and are sensitive to macro economic environment

 Source: Bloomberg,

Market Outlook

- India now has a stable government with a focus on growth on economic development
- Growth revival in FY15 will be slow but new government can tackle low hanging fruit – Stalled projects, Disinvestment, GST to boost growth prospects next year
- Focus on enhancing manufacturing competitiveness by investing in Infrastructure. This is also key to harnessing the demographic dividend
- Monetary policy focused on inflation control; Deficient Rains pose short term challenges but winning this battle against inflation sets the path for growth revival in the longer term
- Valuations now at 13% premium to long term average. From here the baton passes to earnings growth rather than P/e expansion
- We are cautious about an earnings recovery in FY15 relative to consensus but in FY16 earnings could surprise the consensus positively
- Mid cap companies, cyclical businesses & PSU's will benefit from a cyclical recovery in growth & earnings

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