

# Equity Market Outlook

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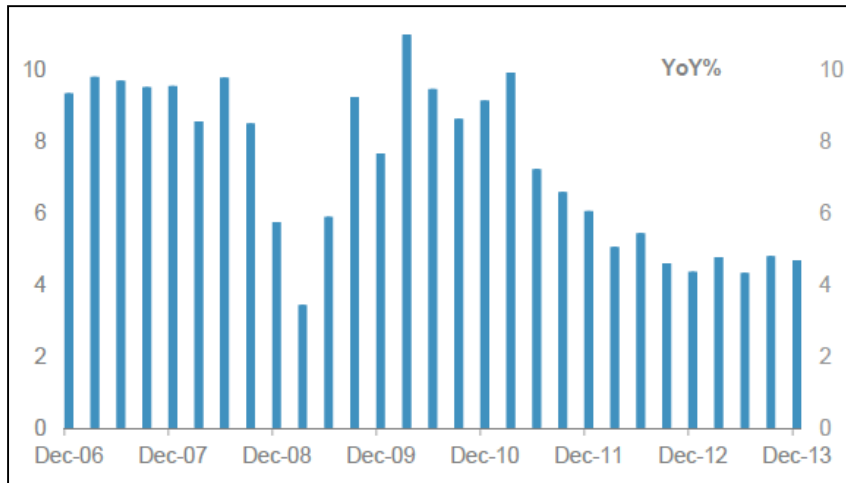
# Equity Market Outlook

- On the domestic side, India's GDP growth seems to have stabilized, albeit at lower levels, led by a sharp deceleration in Industrial output. Weak Industry is in turn led by weakness in investment cycle due to lack of new projects and old projects being stuck
- While the outgoing government has tried its best to revive the investment cycle in the last 1.5 years, the efforts have not been enough. Hence all eyes are on the upcoming elections, hoping for a stable government which can kick start the economy
- Early indications point to a majority, though not reaching the half way mark, for the NDA-led coalition
- India's current account deficit (CAD) narrowed sharply to \$4.2 billion (0.9% of GDP) in the 3QFY14 from \$31.9 billion (6.5% of GDP) in the 3QFY13. However, the fiscal deficit is likely to overshoot the budgeted 4.6% of GDP level for FY14
- The latest RBI policy posted no surprises with the Central Bank maintaining a status quo with respect to key rates while keeping its watchful eye on inflation
- Sensex currently trades at 16.78x its trailing earnings – marginally higher than its historical 20-year average trailing PE of 16.49x

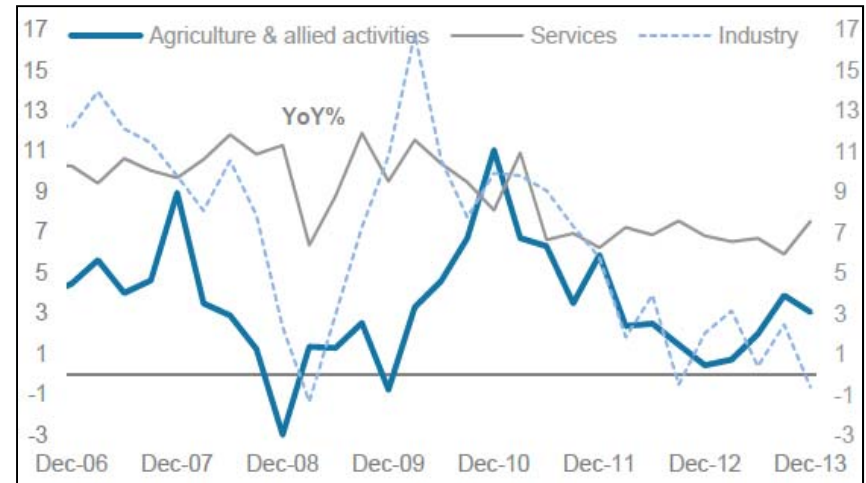
# India - GDP Growth

## Stabilising at lower levels

Quarterly Real GDP Growth (%)



YoY Growth in Agriculture, Industry & Services

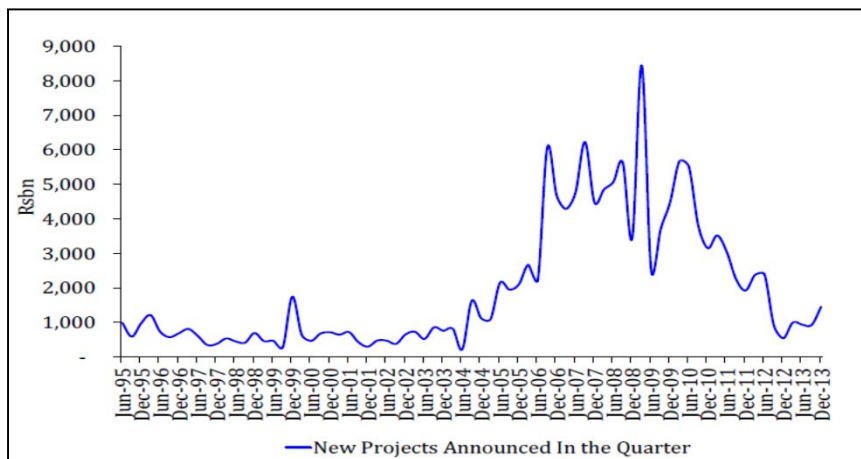


- India's GDP growth continues to remain below 5% levels for the eight consecutive quarter, with 3QFY14 GDP growing at 4.7%
- Growth was led by robust services and agriculture sector, offset by a decline in the industry growth

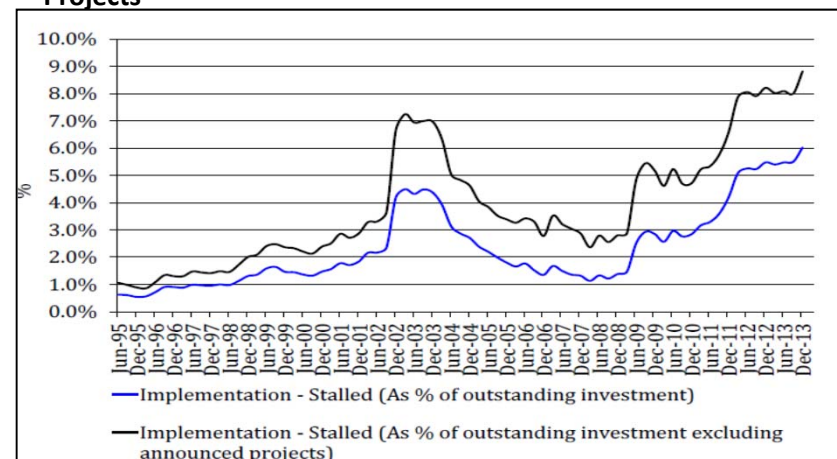
# India - Investment Cycle

## Weak

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



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

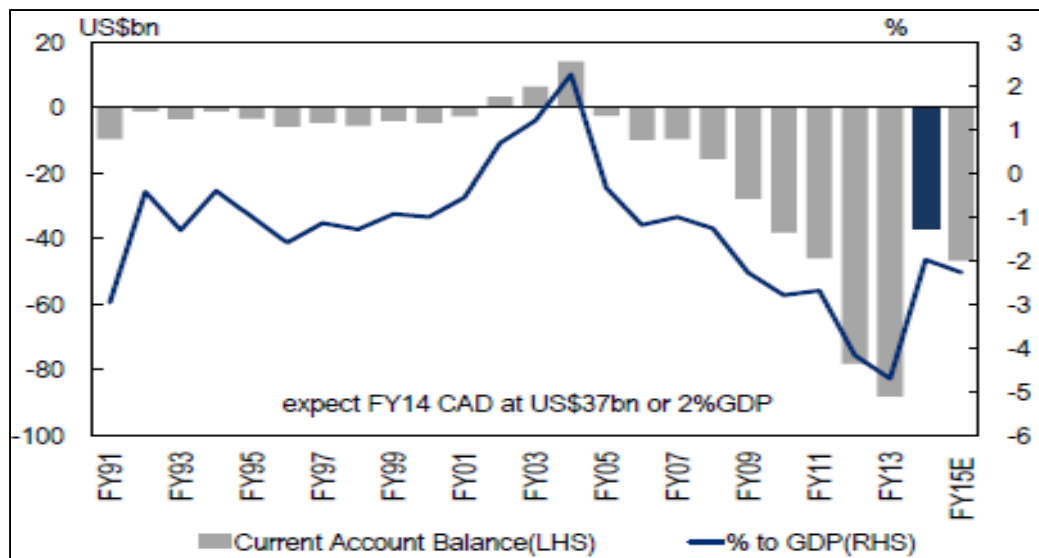


- New project announcements for CY13 are down 14% YoY, after declining 40% and 50% for FY12 and FY13 respectively
- “Projects under implementation but stalled” continue to rise and represent almost 10% of total projects under implementation
- In order to facilitate passage of high-value infra projects, government has set up a Project Monitoring Group (PMG) in June 2013
- The group has so far resolved projects valued at Rs. 5 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

# India - Twin Deficit

## Some respite here!

Quarterly CAD Trend (USD bn, % of GDP)

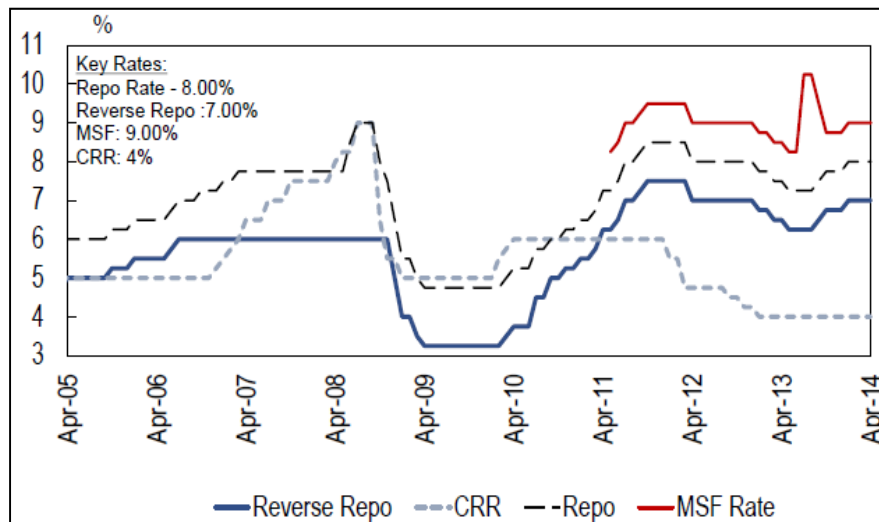


- India's current account deficit (CAD) narrowed sharply to \$4.2 billion (0.9% of GDP) in the 3QFY14 from \$31.9 billion (6.5% of GDP) in the 3QFY13
- Growth slowdown, fall in gold imports and a pickup in exports have all contributed to improvement
- However, on the fiscal front the Govt is running fiscal deficit at 114% of full year target in the first 11 months of the year (YTD till Feb 2014)
- The fiscal deficit target of 4.6% of GDP is in danger of being breached but divestments in March, aggressive tax collections & deferring of expense booking ,may still help the government stay in line

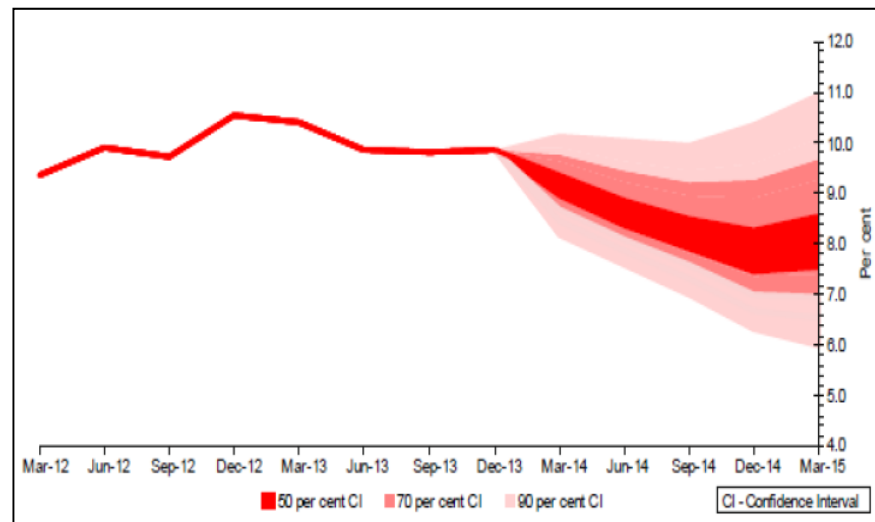
# India – RBI Policy

## Pause for now

Trends in Long-Term Rates (%)



RBI's 'Glide Path' for CPI Inflation



- The RBI policy posted no surprises with the Central Bank maintaining a status quo with respect to key rates while keeping its watchful eye on inflation
- The central bank left its macro forecasts unchanged with FY15 GDP estimated at 5-6% and CPI inflation at 8% by Jan-15
- The RBI envisages CPI inflation to trend within the 'glide path' towards 8% in Jan 2015 and 6% in Jan 2016 and states "If inflation continues along the intended glide path, further policy tightening in the near term is not likely at this juncture"

# India – Politics

## At the forefront

Election Schedule 2014

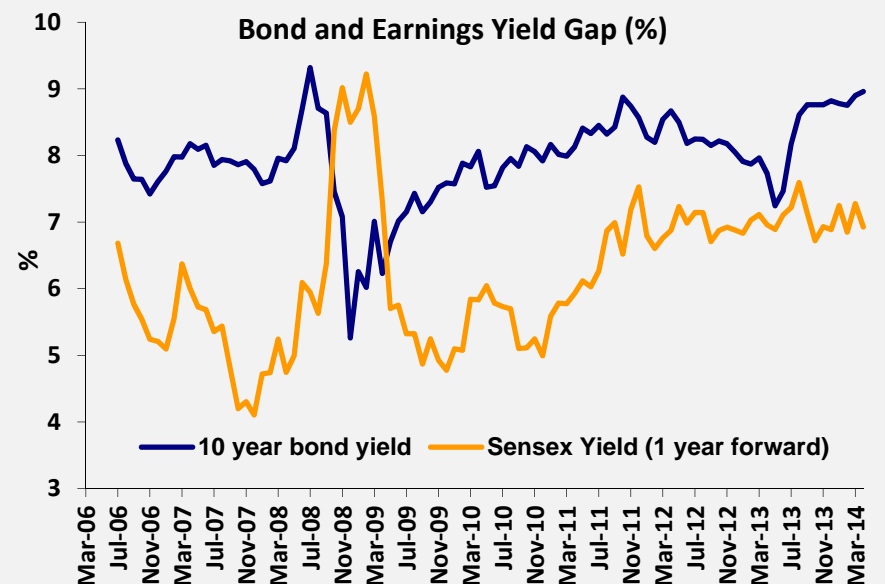
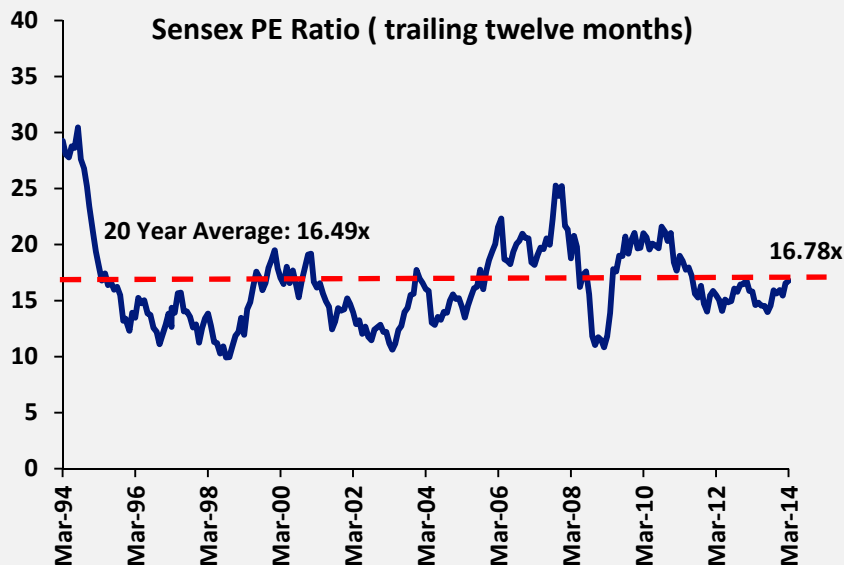
Date	No. Of States + Union Territories	No. Of Constituencies
7th Apr	2	6
9th Apr	5	7
10th Apr	14	92
12th Apr	3	5
17th Apr	13	122
24th Apr	12	117
30th Apr	9	89
7th May	7	64
12th May	3	41
<b>Total Constituencies</b>		<b>543</b>

Electorate Distribution – by State

State	Electors Mn	% Total Electorate
<b>Uttar Pradesh</b>	<b>134.3</b>	<b>16.5</b>
Maharashtra	79.0	9.7
West Bengal	62.5	7.7
Andhra Pradesh	62.4	7.7
Bihar	62.1	7.6
Tamil Nadu	53.8	6.6
Madhya Pradesh	47.5	5.8
Karnataka	44.7	5.5
Rajasthan	42.6	5.2
Gujarat	39.9	4.9

- The Election Commission has announced the dates for India's 16th General Election. Polling is scheduled in nine phases beginning 7 April, with the ninth and last phase ending on 12 May. Counting and results will be on 16 May and a new house will be constituted by 31 May
- Opinion polls suggest a swing in favor of the BJP. The market is now discounting a stable government led by the BJP unlike earlier concerns of a fragmented mandate

# Valuations – edge above long term averages



- Sensex is currently trading at 16.78x its trailing earnings – marginally higher than its historical 20-year average trailing PE of 16.49x
- The FY14 Sensex forward earnings yield gap with the 10- year bond yield which had narrowed to 35 bps in June 2013 has now widened to 200 bps

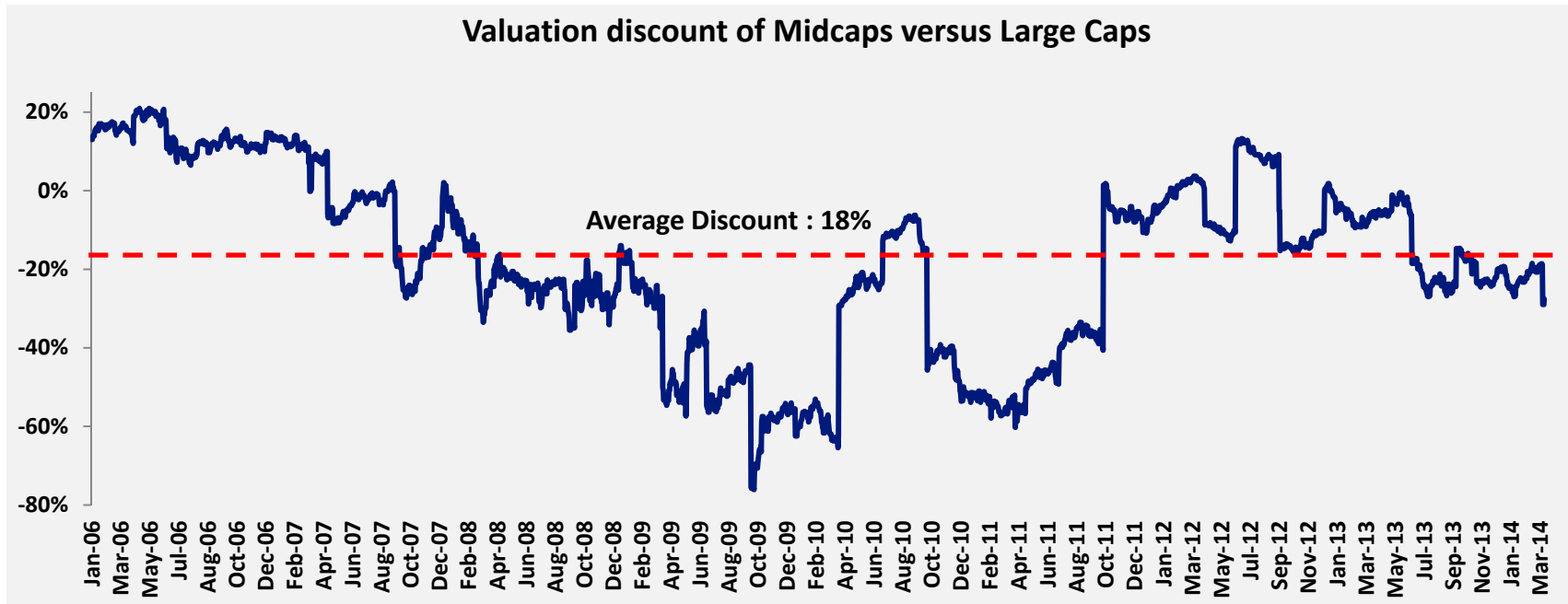
# Opportunities – Stock Picking

Sectors	2013		2012		2011	
	Best	Worst	Best	Worst	Best	Worst
Auto	50%	-16%	120%	0%	7%	-37%
FMCG	34%	-18%	287%	20%	31%	-66%
Oil & GAS	8%	-23%	49%	-7%	25%	-36%
Banks	13%	-44%	95%	11%	-4%	-45%
Healthcare	107%	-71%	470%	5%	24%	-68%
Capital Goods	45%	-62%	66%	-8%	19%	-67%
IT	126%	0%	599%	-16%	128%	-55%
Metal	26%	-41%	60%	-1%	-4%	-57%
Power	43%	-51%	90%	-8%	2%	-70%

**Note:** Percent stated above indicate the returns given by best stock & worst stock in respective sectors(in terms of returns). Returns are for calendar year.

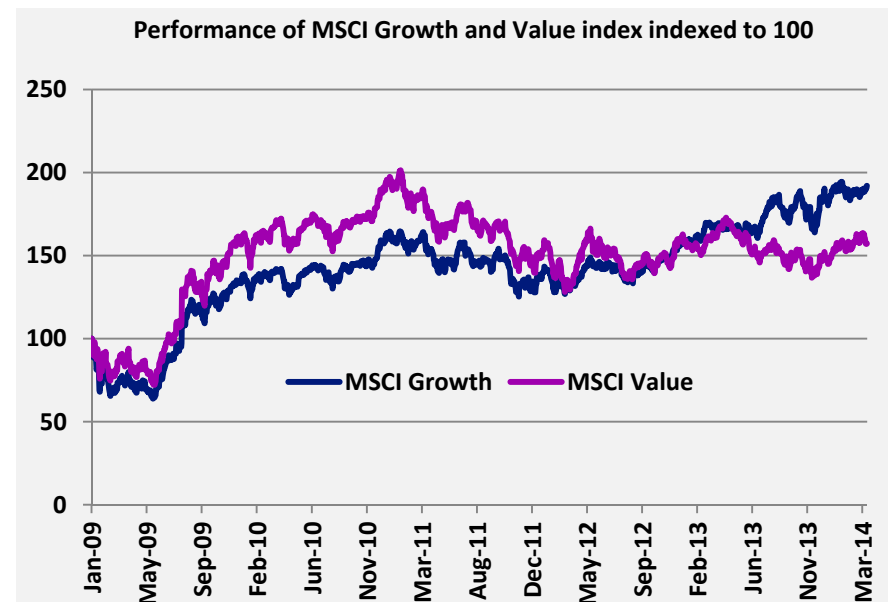
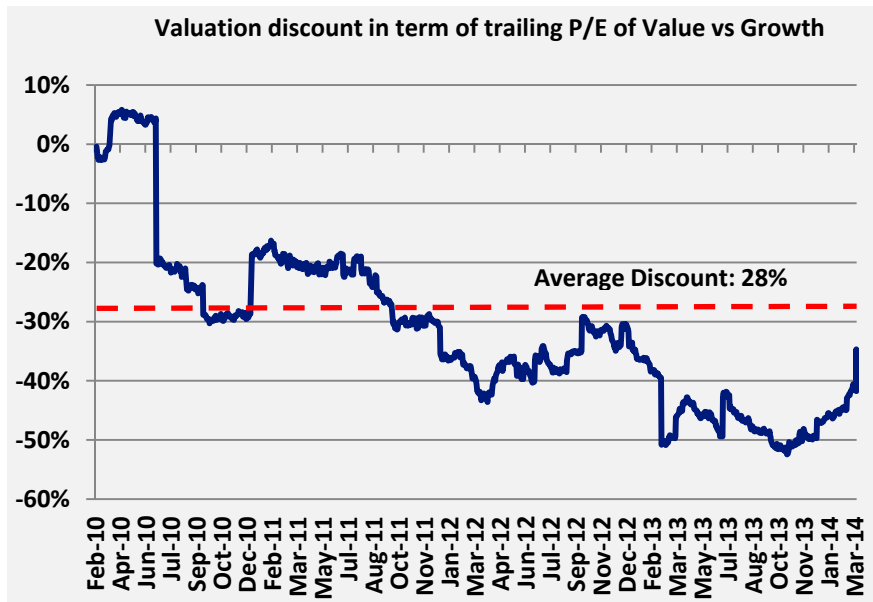
- Large Gap between best and worst performing stocks across all sectors highlights importance of stock picking

# Opportunities – Midcaps trading at a discount to large caps



- Valuation discount of midcaps to large caps is 27% compared to the long term average of 18%
- Valuation gap provides attractive bottom opportunities in mid cap space

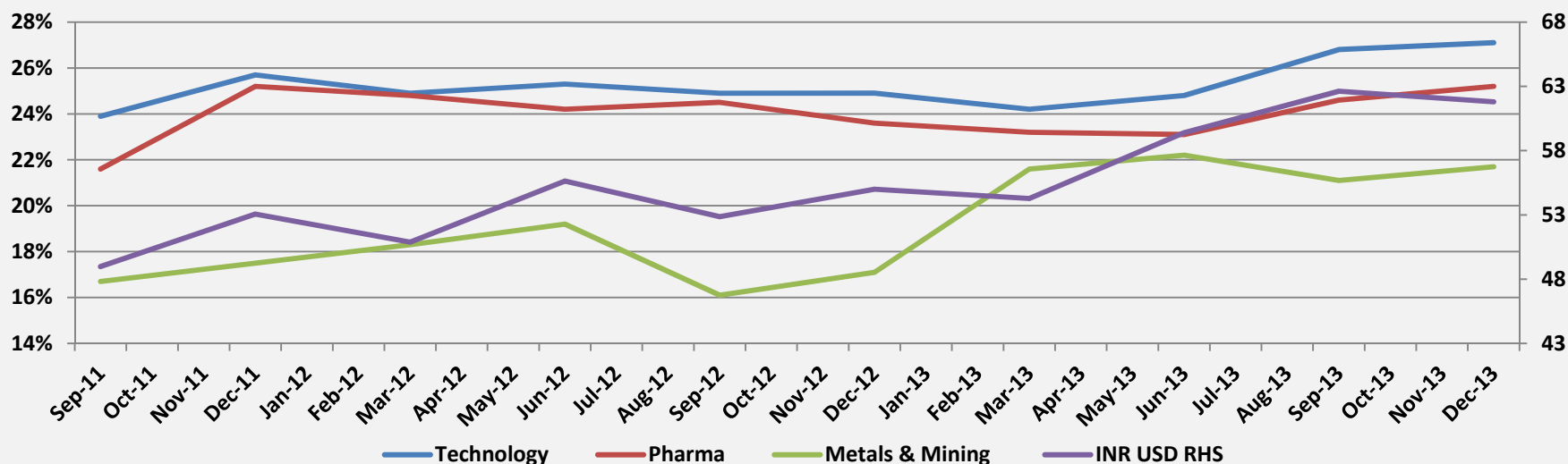
# Opportunities – Valuation Gap between Growth and Value



- Valuation discount of MSCI India Value Index to MSCI India Growth index is 35% compared to the long term average of 28%
- Though the valuation discount for the value basket is still higher than averages, it has significantly reduced in the recent quarter
- Since 2009, MSCI growth index has significantly outperformed MSCI Value index

# Opportunities – Beneficiaries of Currency Depreciation

EBITDA Margins of Export led sectors vis a vis INR



- INR Depreciation over the past 2 years has provided a significant lever for exporters. This can be utilised either to boost volumes or make investments
- 16 companies out of 30 companies of Sensex representing 58% of total market cap of Sensex are beneficiaries of currency depreciation

- Valuations have edged higher and are now slightly above the long term averages on a trailing basis. They remain in the comfort zone but for further market gains the baton now passes to earnings growth
- A strong and stable government would have a positive impact confidence which is a vital and often under-appreciated driver of the economy. The market has now clearly positioned itself for what it sees as a favourable election outcome
- Against our expectations the market has been far more macro oriented in the quarter gone by; with cyclical hopes rising based on the potential election outcome
- We continue to emphasize stock picking as we continue to see a challenging macro-economic environment
- The themes we have highlighted as being attractive-cheap cyclical stocks, Mid & Small cap companies have done extremely well. These themes remain attractive but their outperformance has clearly reduced the valuation gap which was very large in CY13
- Given the currency appreciation the exporters have been soft this quarter but we believe that these companies remain attractive
- We continue to avoid companies with balance sheet risk, though even that part of the market has seen excitement this quarter

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