

# Equity Market Outlook

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**March 2015**



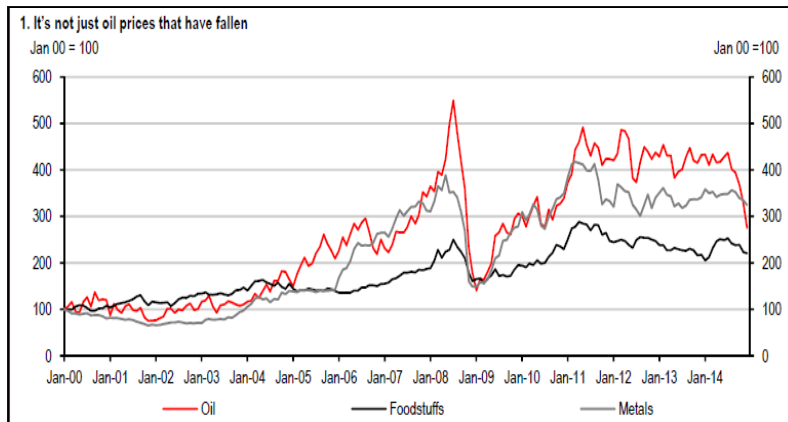
# Equity Market Outlook

- Global deflation scare has once again resurfaced as global inflation is at the lowest level in a decade
- However, India's Macro-Vulnerability Index (MVI) has improved dramatically from 2012 levels compared to some of its larger emerging market peers
- Key driver for growth – investment cycle is undergoing slow and gradual recovery
- India's Finance Minister presented a balanced budget, targeting the fiscal deficit of 3.9% (of GDP), instead of the earlier kept target of 3.6% for FY16
- This has been largely led by a mix of higher spend by the government and more tax transfer to states
- For 3Q15, Sensex earnings were down 8% YoY and were 6% below market estimates
- Valuations are at 22% premium to the long term average; in an expensive zone

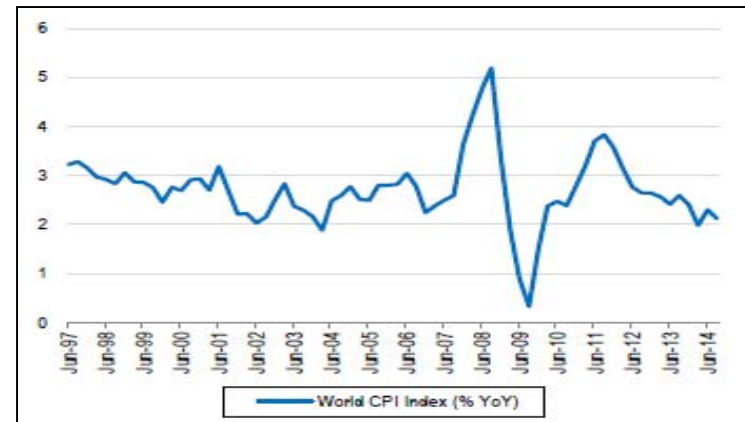
# Global Macro - Global Disinflation a worry

## – Demand a problem

### Oil is not the only commodity to have fallen



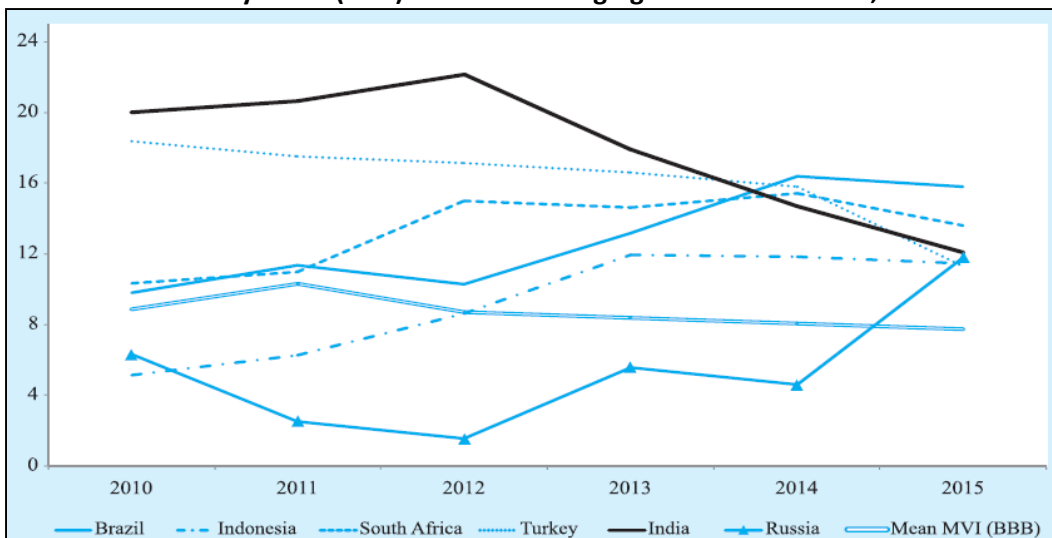
### Global Inflation at multi year lows in Sep -14



- Over past six months, deflationary concerns have risen, particularly in the Eurozone
- Global inflation in September was at the lowest levels in a decade, excluding financial crisis, even before the sharp decline in global commodity prices
- The global decline in commodity prices is not just a supply issue, there are demand concerns as well, as global growth remains weak

# India – Macro Vulnerability Improved

Macro-Vulnerability Index (MVI) for select Emerging Market Countries , 2010 to 2015

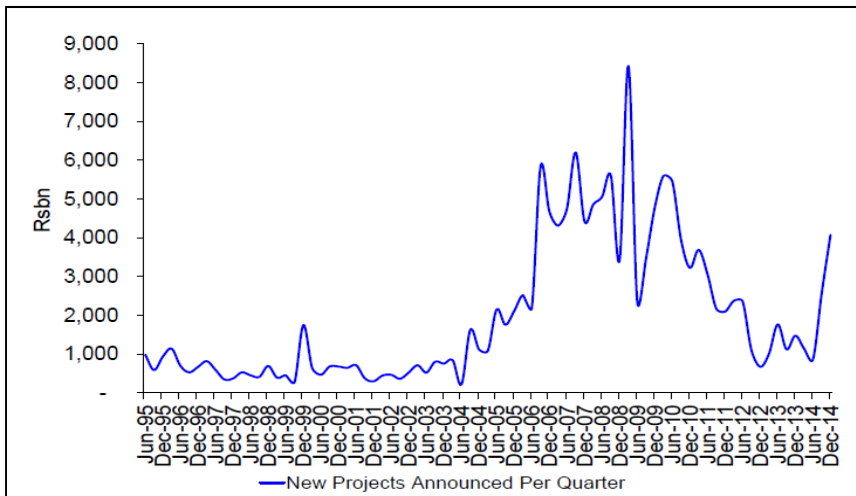


- The Macro-Vulnerability Index (MVI) combines a country's fiscal deficit, current account deficit, and inflation and is thus comparable across countries
- In 2012, India was the most vulnerable country as per the index, but it has improved significantly since then
- India is still more vulnerable than the mean of countries in its investor rating category (BBB) but is less so than many of its larger emerging market peers

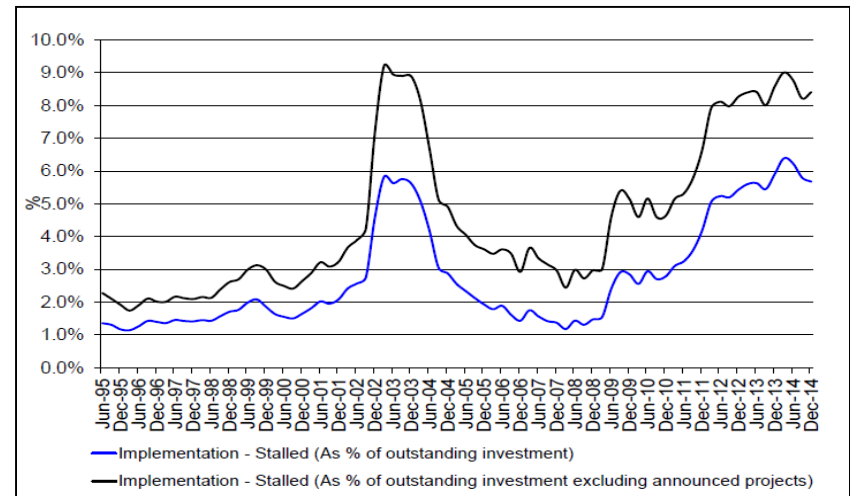
# India - Investment Cycle Rebound

## Gradual Recovery Underway

Quarterly New Project announcements (Rs bn) – Rebound from lows



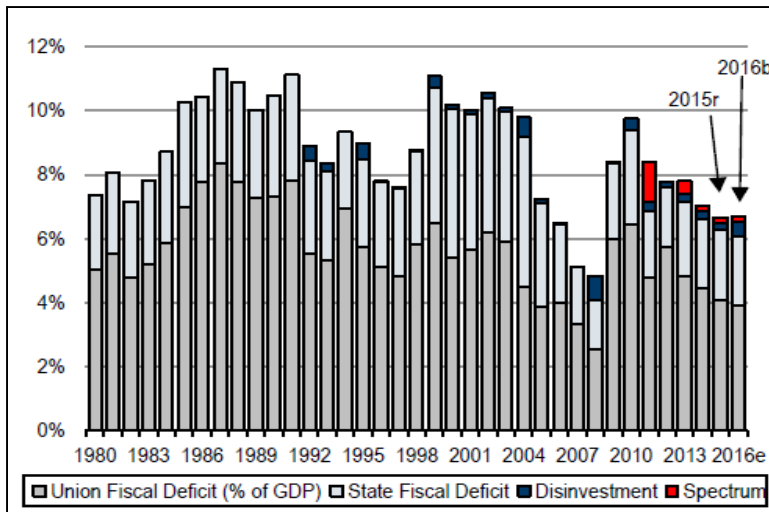
Projects under implementation but stalled as % of total O/S Projects



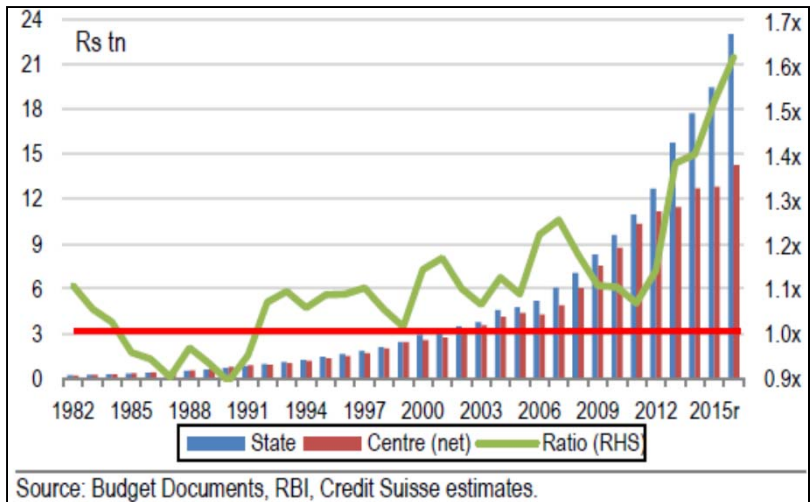
- New project announcements in 3Q15 rebounded sharply - however 37% of 3Q15 new orders were on account of aircraft procurement by Indigo airlines (does not benefit domestic investment cycle)
- Also projects under implementation but stalled are yet to exhibit any meaningful improvement

# India – Union Budget 2015 Highlights

**FRBM target of 3% fiscal deficit pushed out by a year**



**More transfers to states :Total spending 1.6x that of Centre's**

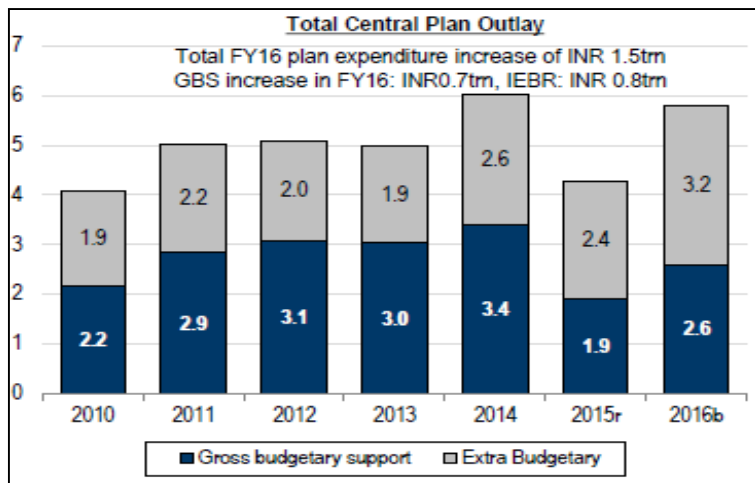


Source: Budget Documents, RBI, Credit Suisse estimates.

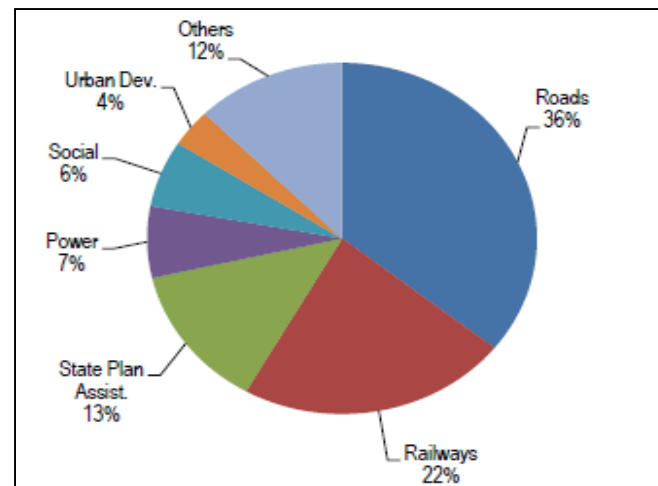
- Instead of 3.6% (of GDP) fiscal deficit, the Finance Minister has kept the target at 3.9% for FY16
- FRBM fiscal deficit target of 3% of GDP pushed out to FY18; new target for FY17 at 3.5%
- Fiscal architecture changes-states to receive total transfers amounting to 62% of total tax receipts

# India – Union Budget 2015 Highlights

FY16 Plan expenditure up by 36% YoY



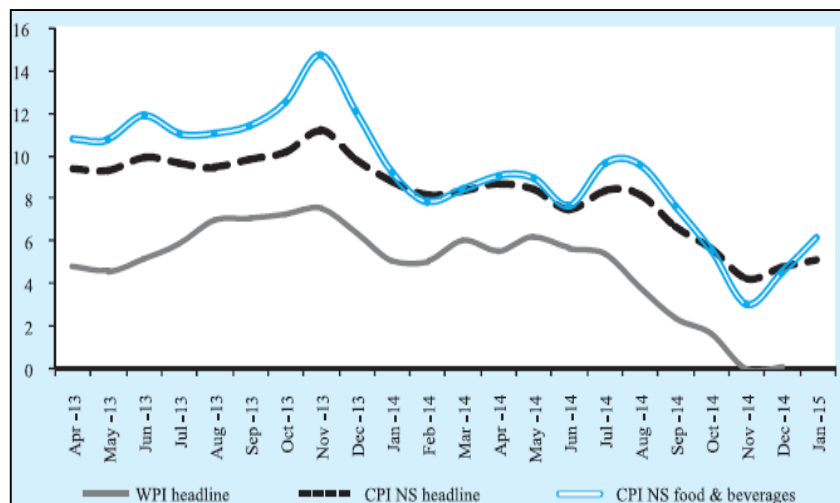
Split of the INR 1.5trn (~US\$25bn) incremental increase in plan spend



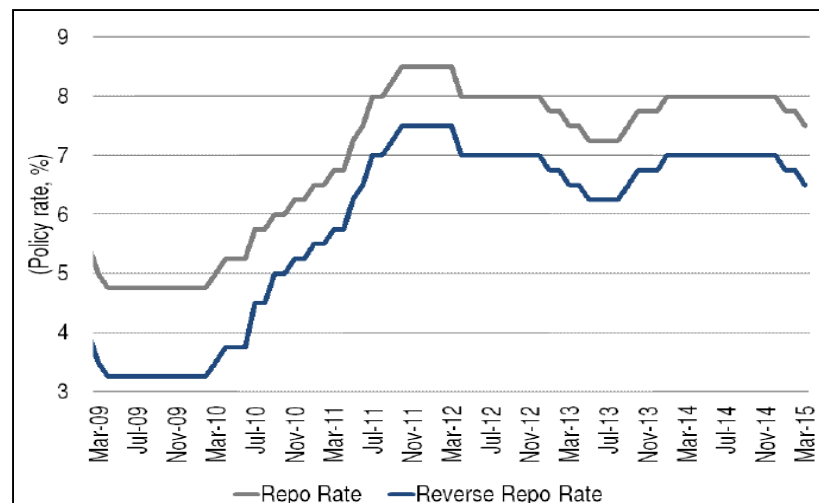
- After a weak FY15, when plan expenditure was cut/pushed out, to meet fiscal deficit targets, FY16 marks the return of growth in plan spend (a 1.1% of GDP increase)
- Of this, Rs.0.7 tn (0.5% of GDP) is the increase from budgetary resources and the rest from PSUs
- Almost 60% of plan expenditure is spent on just roads (Rs.540 bn) and railways (Rs.340 bn)

# Monetary Policy – Inflation Targeting

**Inflation downward trend continues**



**Benchmark Policy Rates (%)**

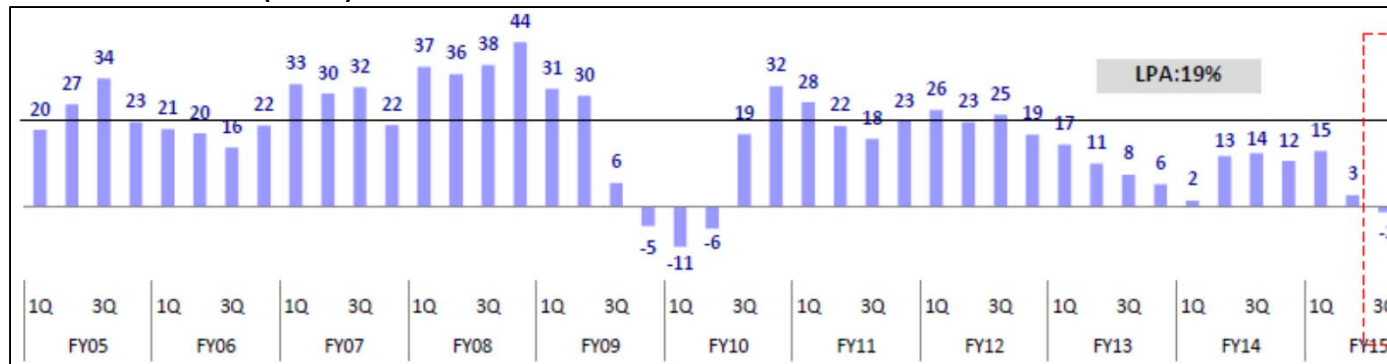


- RBI has cut the benchmark rates (Repo and Reverse Repo) by 25bps twice in CY15, one on 15<sup>th</sup> January, 2015 and second on 4<sup>th</sup> March 2015
- Key reasons cited for softening rates are continued benign CPI inflation, fiscal consolidation, a strong currency and continued weakness in some of the sectors of the economy
- Further actions are data-dependent
- Monetary policy framework sets 4% CPI target for Jan 18

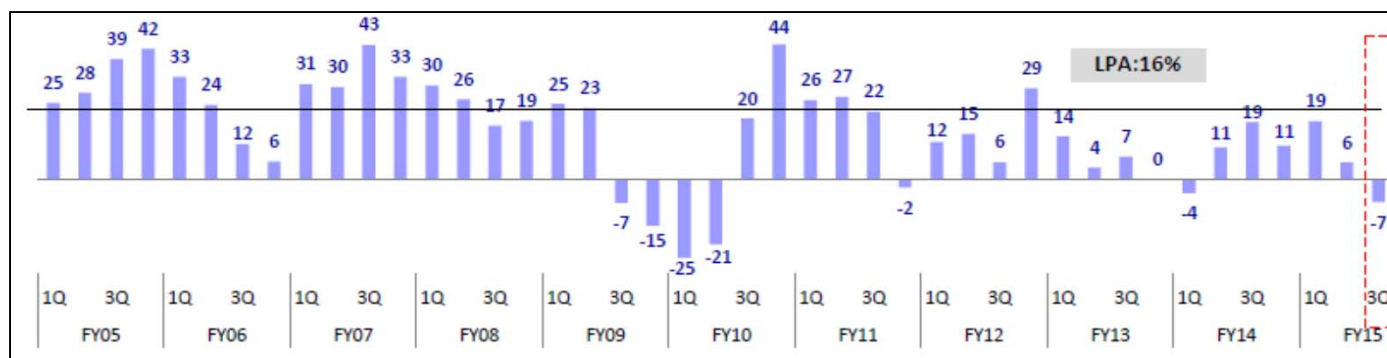


# Earnings Season – Weak Showing

**Sensex Sales Growth (% YoY)**



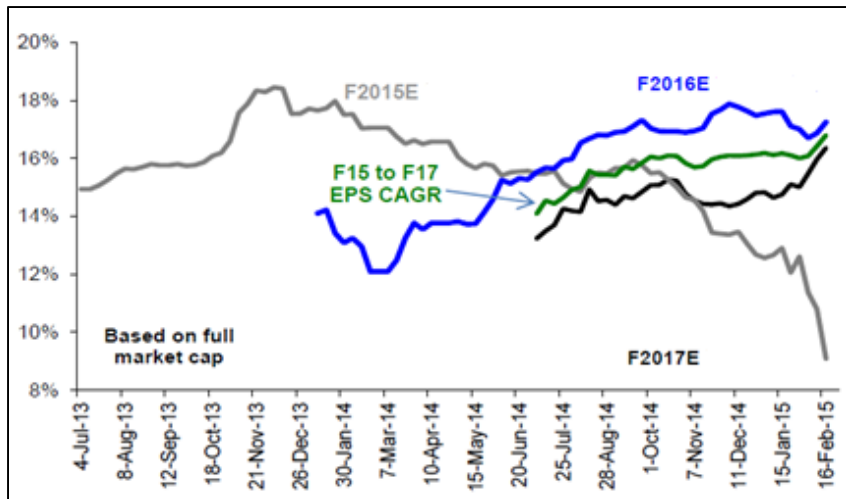
**Sensex PAT Growth (% YoY)**



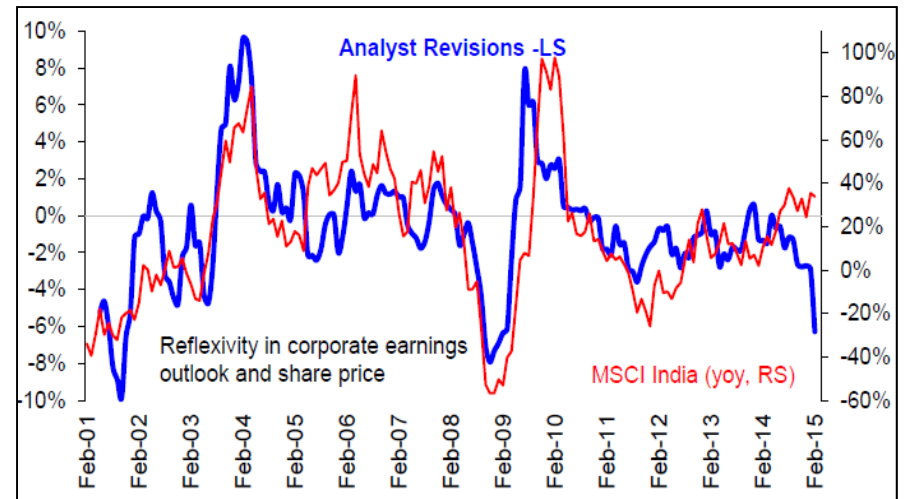
- Latest quarter sales for Sensex companies declined by 2%, while the net profits declined by 7%, significantly below Long Period Average Growth rates

# Earnings Season – Weak Showing

Sensex Consensus EPS Growth Estimates

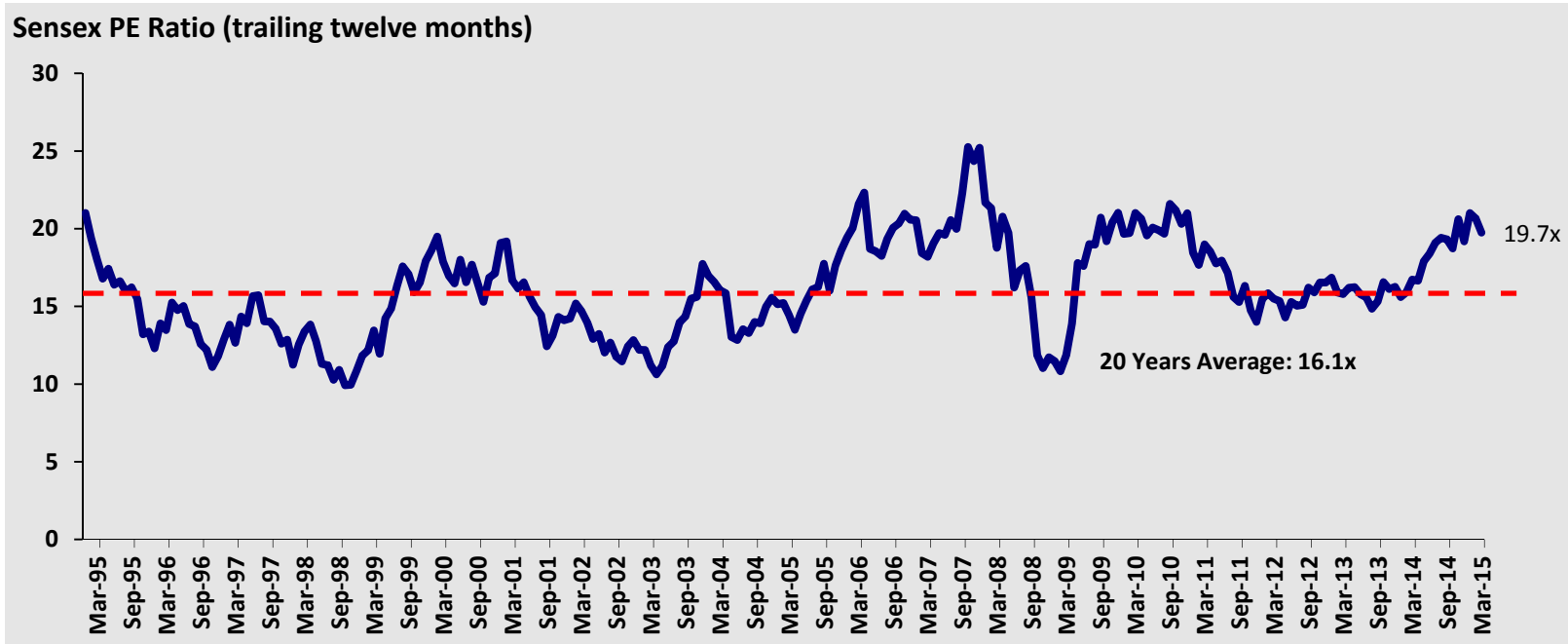


Earnings Revisions (%)



- In the latest reported earnings season ended December 2014, Sensex earnings were down 7% YoY and were 6% below market estimates
- Since the start of the earnings season, consensus has revised down Sensex F2015 and F2016 earnings growth estimates by 357bps (to 9% YoY) and by 35bps (to 17.2% YoY), respectively

# Valuations - Premium to Long term Average



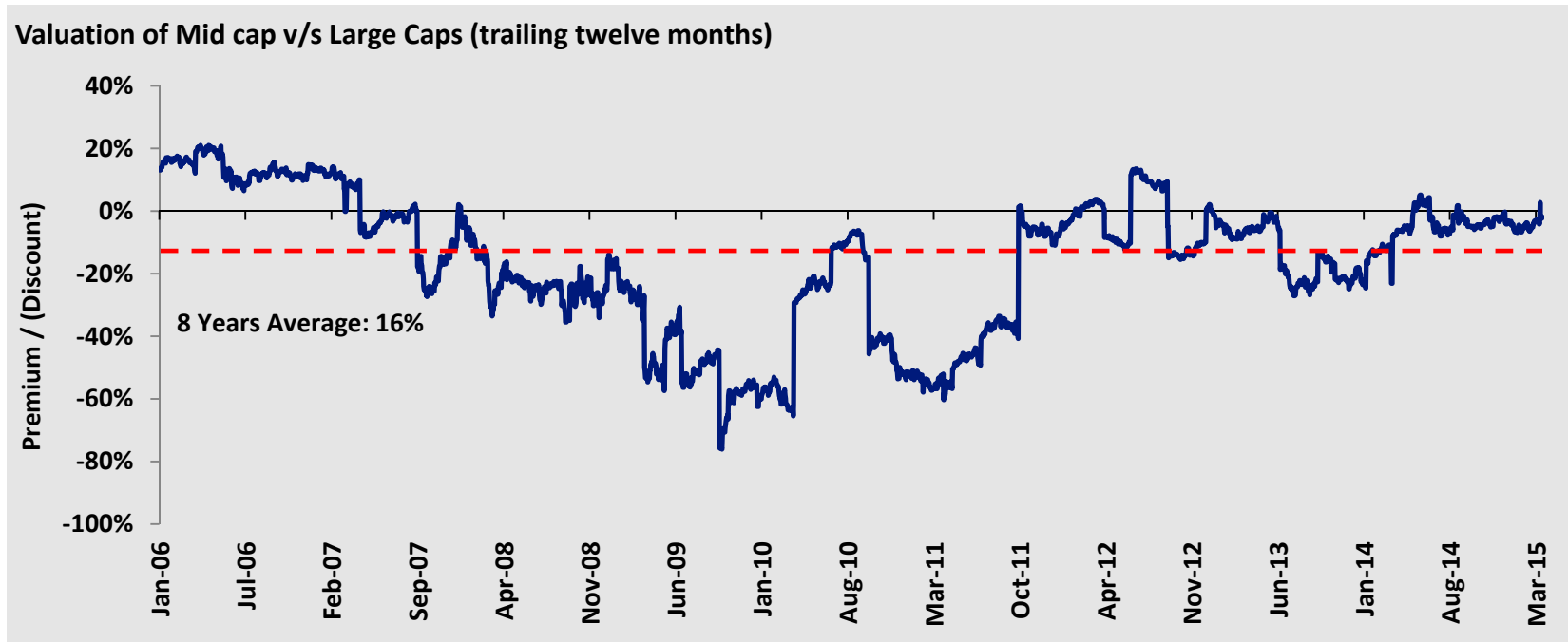
- Markets are trading at significant premium to its long term average (20 years)
- The large cap benchmark Sensex index trades at 22% premium to its long term trailing 12 months average P/E multiple

# Valuations – RoE subdued



- While markets are trading at significant premium to its long term average, the underlying Return on Equity (RoE) is below its long term average

# Valuations – Relative valuations of Midcaps vs Largecaps Higher than Long Period Avg



- Midcap Index valuation is currently at a 2% discount to its large cap peer (Nifty), as compared to a long period average of 16% discount

- Falling commodity prices and weak demand has led to global concerns on Growth
- Government focus is more on execution rather than Big Bang reforms
- Revenue share of States in Union revenues, has climbed to a historic high of 62%. The baton of spending now passes from Centre to States
- RBI has cut rates by 50 bps CYTD. Further easing is data dependent. Long term India has now officially accepted inflation targeting as the primary goal of the monetary policy.
- Valuations now at 22% premium to long term average. From here the baton passes to earnings growth rather than P/E expansion
- Earnings growth still remains weak but expected to recover in FY16
- Sectors such as financials, consumer discretionary and industrials will benefit from cyclical recovery in growth. Based on valuations we prefer the financials and consumer discretionary over Industrials
- Earnings growth for Mid cap companies will likely improve with a recovery in domestic growth and a more benign monetary environment
- Though there is a preference for pro cyclical stance, portfolio strategy is more balanced given the valuations changes over past year

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