

Equity Markets

Current Environment and Outlook

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Chief Investment Officer

September 2013

Current Environment

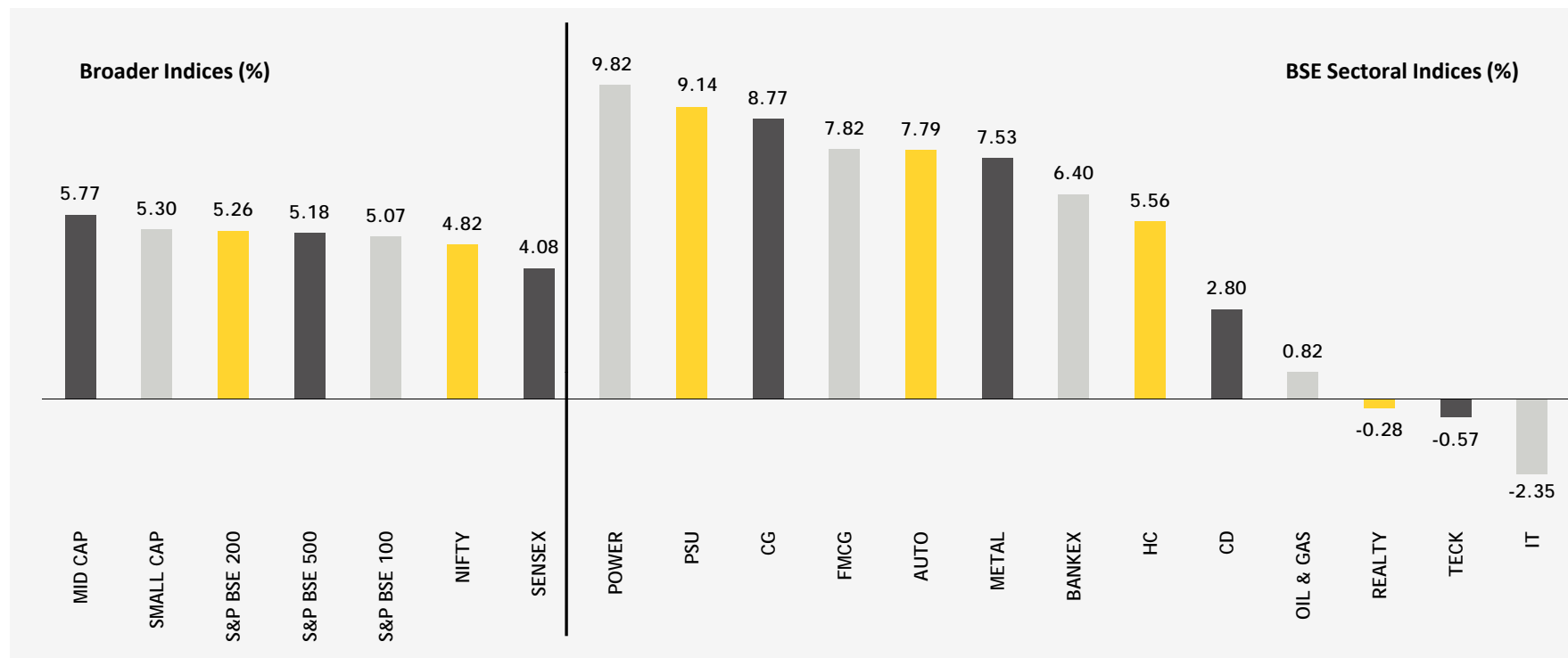
- Global Equity markets performed strongly in September 2013, with the MSCI World Index rising by 4.82% for the month
- In USD terms, Indian markets outperformed the global market and rose by 11%
- Commodity prices underperformed equities, as benchmark CRB Reuters Jefferies total return index decreased 1.9% during the month
- Power and PSU's delivered the best return for the month, while Information Technology and IT were the worst performing sectors during the month*
- FII inflows during the month were at Rs.131 bn . MF's and DII turned to being net sellers at Rs.28 bn and Rs.91bn during the month
- Trading Activity was mixed in September as cash market trading turnover increased by 13% MoM, while average open interest fell marginally by 4.5% MoM

* Please refer slide 4 for sector performances

Global Equities

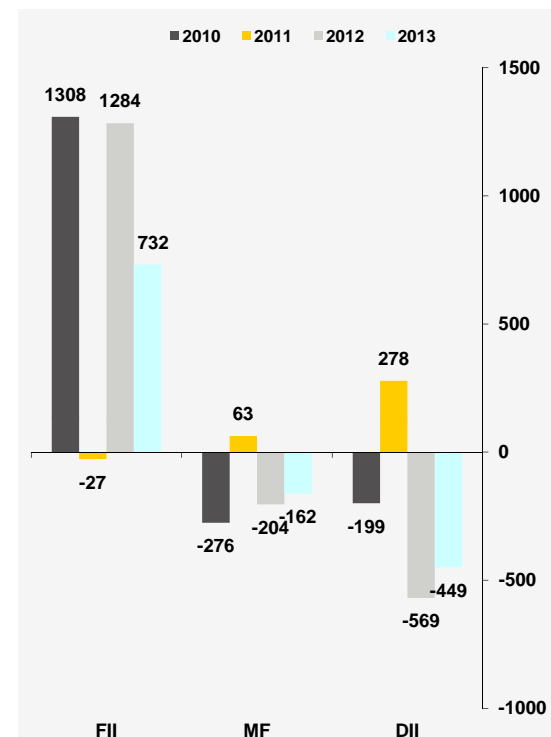
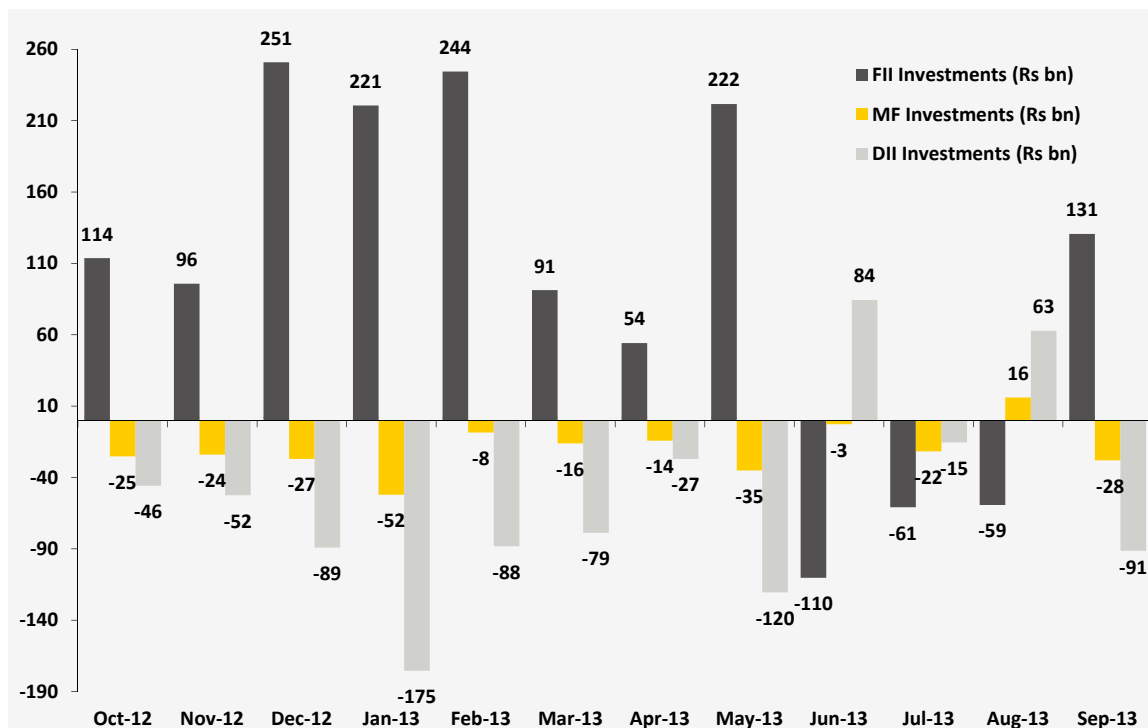
Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	2174.67	3.64%	-4.16%	EM - Asia
S&P BSE Sensex	India	19379.77	4.08%	-0.24%	EM - Asia
Kospi	South Korea	1996.96	3.66%	0.00%	EM - Asia
Taiwan Weighted	Taiwan	8173.87	1.89%	6.16%	EM - Asia
Thailand SET 50 Index	Thailand	940.88	6.56%	-0.48%	EM - Asia
Jakarta Composite Index	Indonesia	4316.18	2.89%	-0.01%	EM - Asia
KLSE	Malaysia	1768.62	2.38%	4.72%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	52338.19	4.66%	-14.13%	EM
Mexico IPC	Mexico	40185.23	1.75%	-8.09%	EM
Russian RTS Index	Russia	1422.49	10.19%	-6.84%	EM
Philippine PSEi	Philippines	6191.80	1.92%	6.52%	EM
Merval Buenos Aires Index	Argentina	4783.77	21.54%	67.60%	EM
HangSeng	Hong Kong	22859.86	5.19%	0.90%	Developed - Asia
Nikkei	Japan	14455.80	7.97%	39.06%	Developed - Asia
Strait Times	Singapore	3167.87	4.59%	0.02%	Developed - Asia
Dow Jones	USA	15129.67	2.16%	15.46%	Developed
CAC 40 Index	France	4143.44	5.33%	14.45%	Developed
All Ordinaries Index	Australia	5217.74	1.80%	11.36%	Developed
DAX Index	Germany	8594.40	6.06%	12.90%	Developed
Swiss Market Index	Switzerland	8022.60	3.57%	17.59%	Developed
FTSE 100	UK	6462.22	0.77%	9.57%	Developed
MSCI World Index	--	1543.67	4.82%	16.34%	--

India : Sector Performance



- Nifty delivered a positive return of 4.82% over the previous month
- Mid Caps and Small Caps out performed Large Caps with 5.77% and 5.3% rise respectively
- Power and PSU sectors delivered the best return for the month
- IT and Technology were the worst performing sectors

FII & DII Inflows



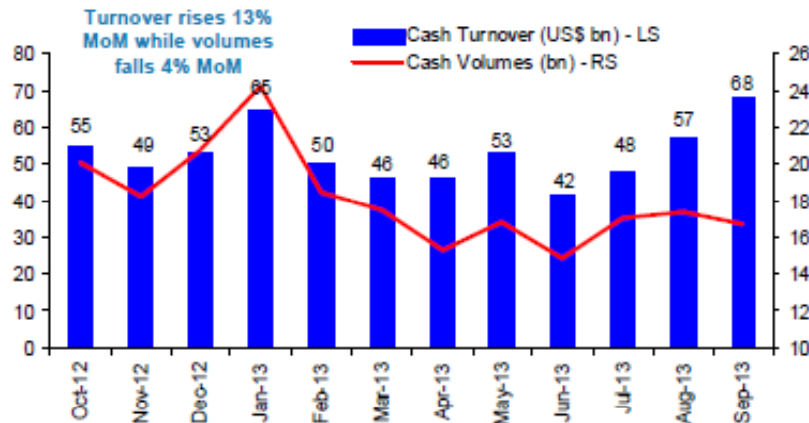
- FII flows were positive at Rs.131bn during the month
- MF's and DII turned to be net sellers at Rs.28 bn and Rs.91bn during the month
- Calendar YTD, FII inflows have been around Rs.732bn whereas MF's and DII's have been net sellers to the extent of Rs.162 bn and Rs.449 bn respectively

Top Gainers / Losers - Nifty

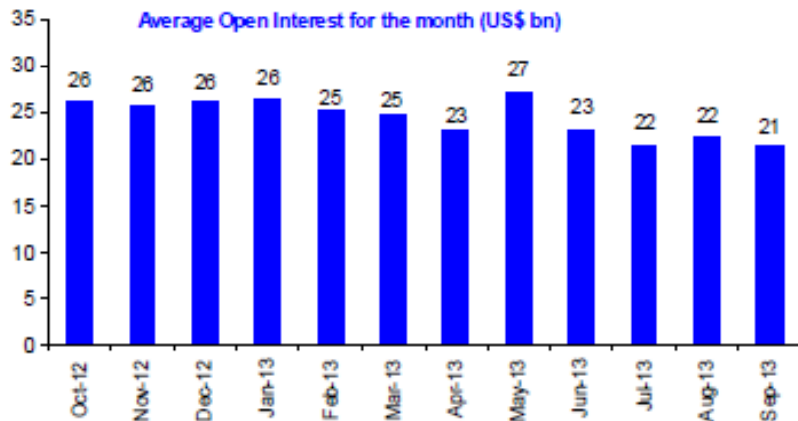
Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
UltraTech Cement Ltd	2154.2 / 1402.35	1809.30	22.68%
Bharat Petroleum Corporation Ltd	449 / 255.95	331.25	21.34%
Axis Bank Ltd	1549.9 / 763.4	1007.85	21.00%
Coal India Ltd	374.85 / 238.2	294.45	17.12%
Grasim Industries Ltd	3510 / 2105.6499	2646.05	17.08%

Top Losers for the month			
Losers	52 week H/L	Last Price#	% Loss*
Infosys Ltd	3188 / 2060.55	3013.00	-2.99%
Reliance Industries Ltd	955 / 682.35	822.40	-3.68%
Sesa Sterlite Ltd	205.45 / 119.3	180.75	-4.24%
Tata Consultancy Services Ltd	2078.8 / 1055	1927.80	-5.18%
Ranbaxy Laboratories Ltd	559.95 / 253.65	330.30	-19.01%

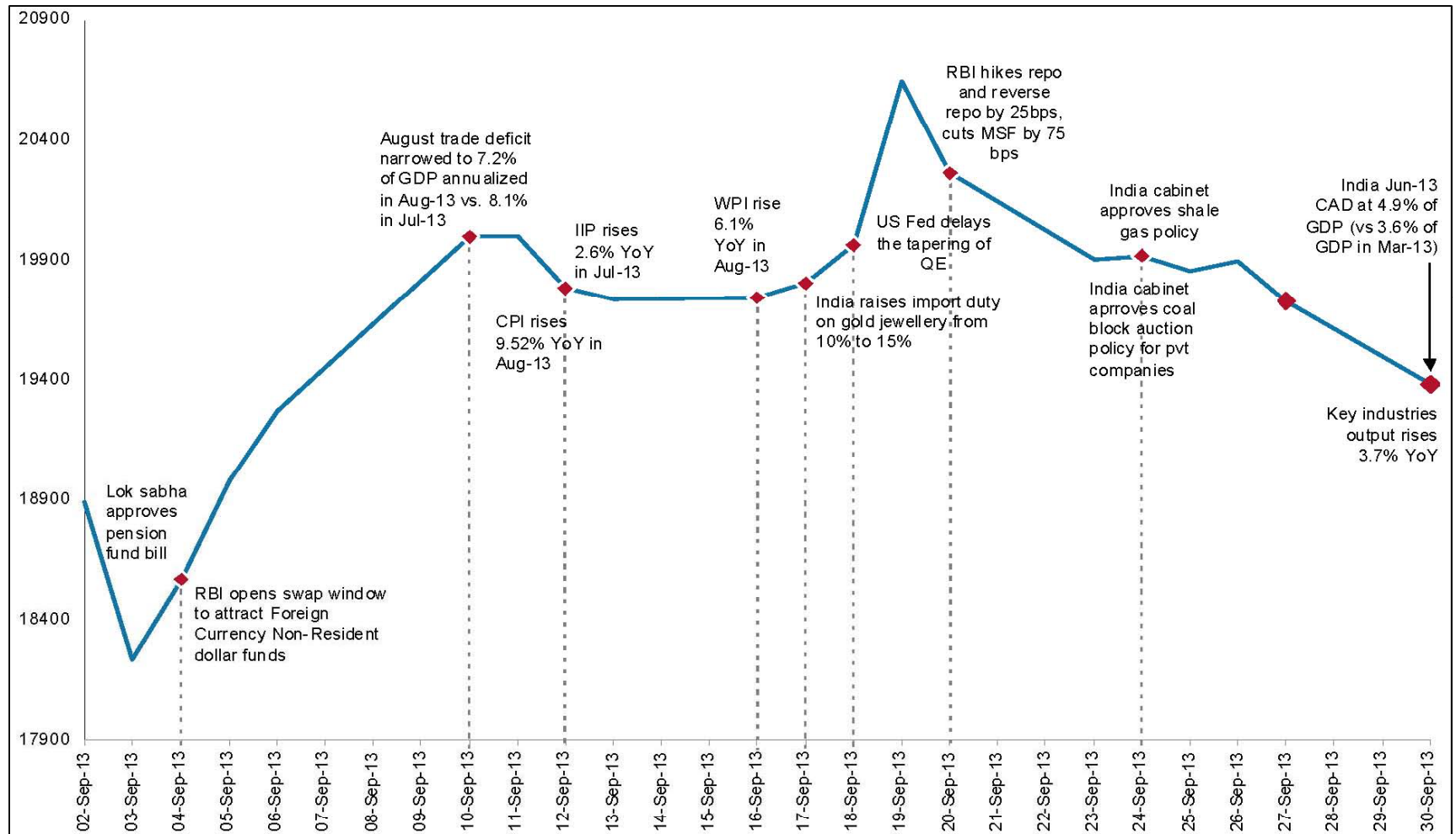
Market Activity (NSE & BSE)



- In September 2013, cash market trading turnover increased by 19% MoM
- At the end of September 2013, average open interest fell 4.5% MoM



September 2013 events timeline



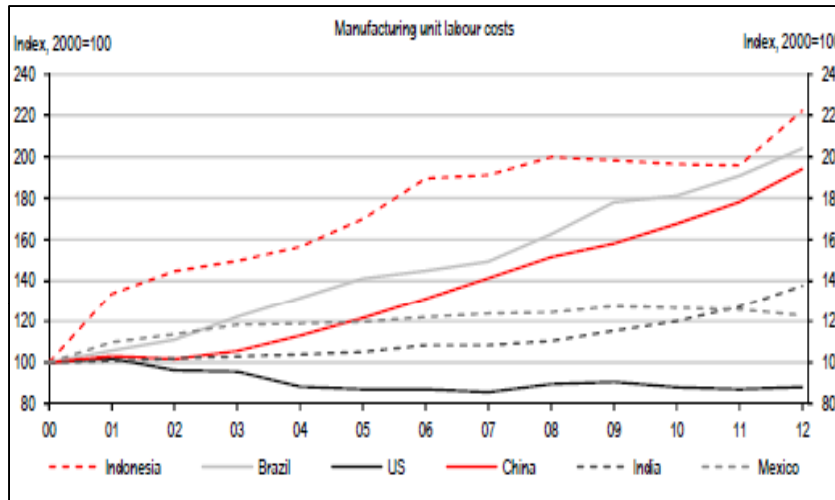
Equity Market Outlook and Opportunities

Equity Market Outlook

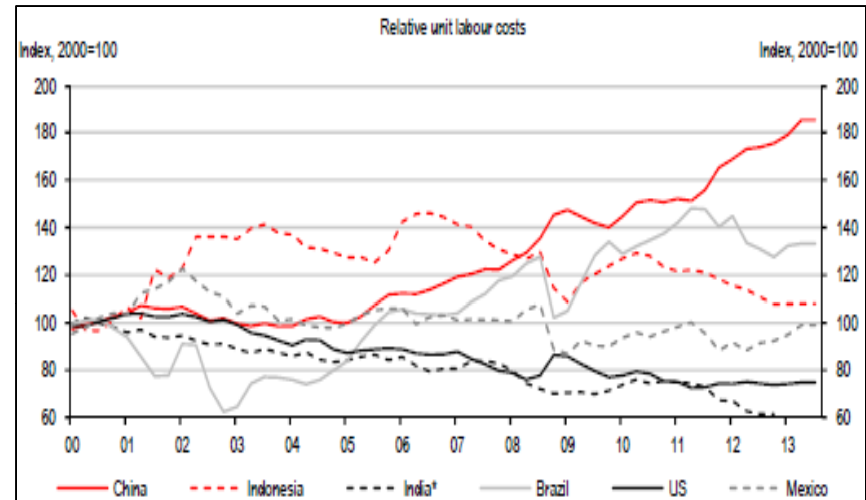
- Most emerging economies, including India have witnessed erosion of competitiveness in their manufacturing sector over last decade
- The sharp currency depreciation in recent times is restoring India's competitiveness
- India's current account deficit, although very high is expected to witness sharp improvement over the course of the year
- However high fiscal deficit and sticky inflation continue to remain a cause of concern
- Index of Industrial production has witnessed an improvement in July 13 and core eight sector data indicates continued improvement in August 13
- However, lead indicators like PMI and project sanction pipeline indicate continuous weakness ahead
- Strong monsoon is expected to be supportive for agriculture sector and boost rural demand and income
- Consensus EPS estimates for BSE Sensex companies for FY14 are expected to be in single digit at 9.7%

Global Macro – Loss of Competitiveness in Emerging Markets

Manufacturing unit labor costs in local currency terms



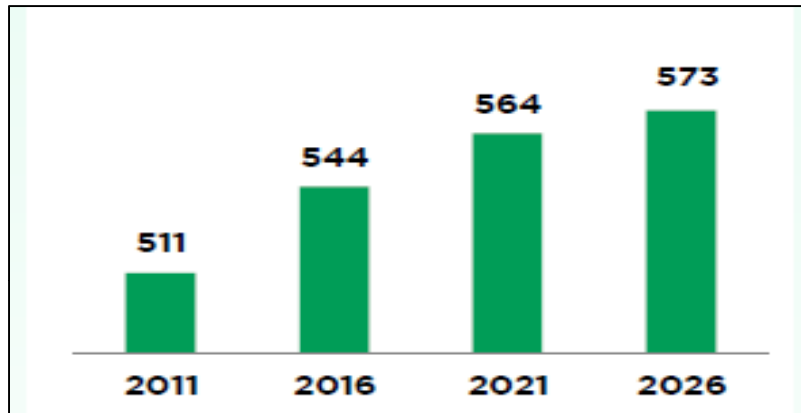
Manufacturing unit labor costs adjusted for currency movements



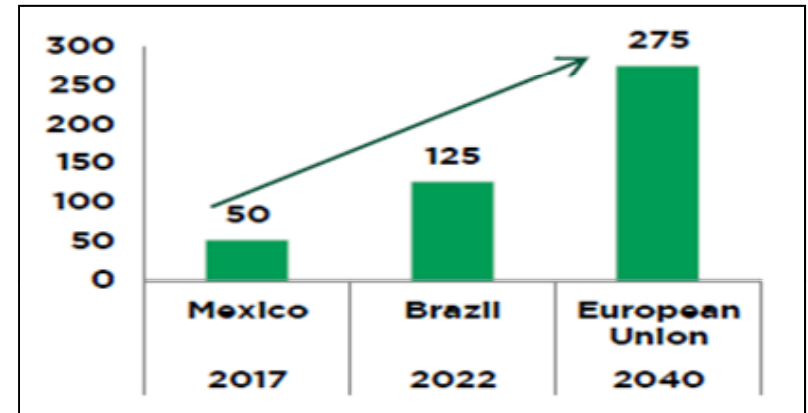
- Over last decade, many emerging nations have experienced rapid increases in unit labor costs – wages adjusted for productivity
- The above graphs indicate change in competitiveness of each nation relative to its own history – both in local currency terms and adjusted for currency movements with their main trading partners
- India has also experienced rapid rises in per unit labor cost, especially over last 5 years
- Loss of competitiveness has been one of the key reasons for high current account deficit and resultant pressure on local currency
- However, a sharp rupee depreciation has restored competitiveness to the manufacturing sector for the country

India Macro – Demographic Dividend but enormous employment challenges

India's 15-30 years old population over next few years (in millions)



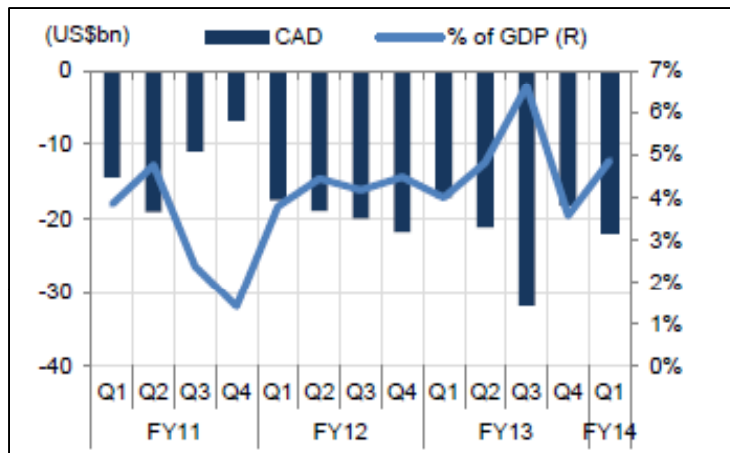
India's labor addition over the next 5, 10 & 20 years equals working population of Mexico, Brazil & European Union (in millions)



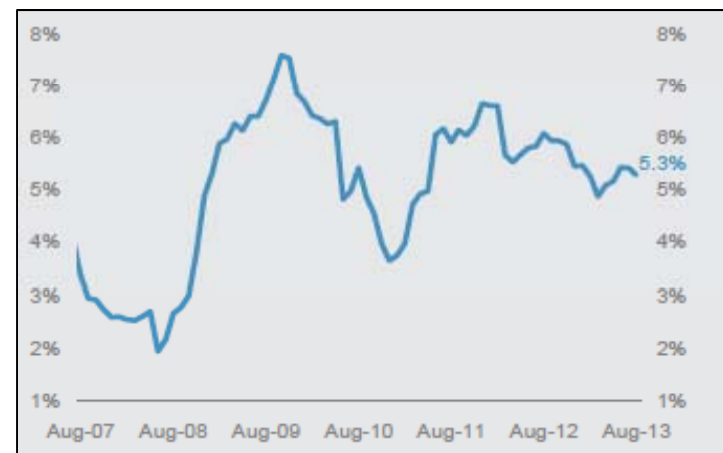
- Over next 20 years, India's working age population will grow faster than overall population growth thereby expanding the ratio of working age to dependent population even as other countries like China will experience a contraction in this ratio
- While this demographic profile has a potential to create the most compelling conditions for economic growth; policy framework will be extremely crucial in determining whether its captured. India cannot afford a repeat of last 5 years
- In next 10 years, 110-120 mln will enter workforce (2x of last 10 years and equivalent of the entire work force of Brazil)
- At current growth rates, the country could experience significant job shortages & this could be a source of social unrest

India Macro – Twin Deficit - Mixed Developments

Quarterly CAD Trend (USD bn, % of GDP)



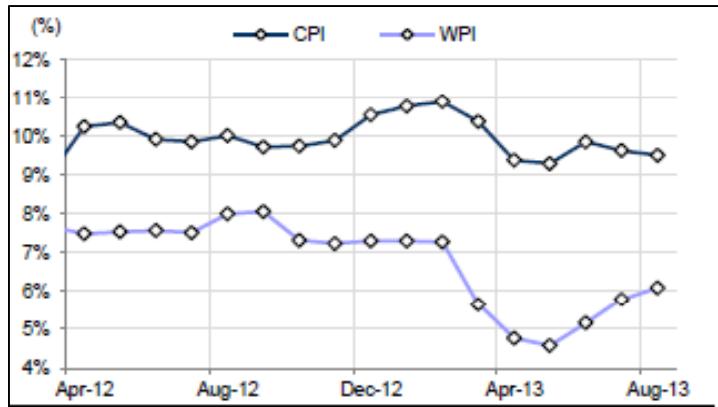
Fiscal Deficit (12M Trailing Sum % of GDP)



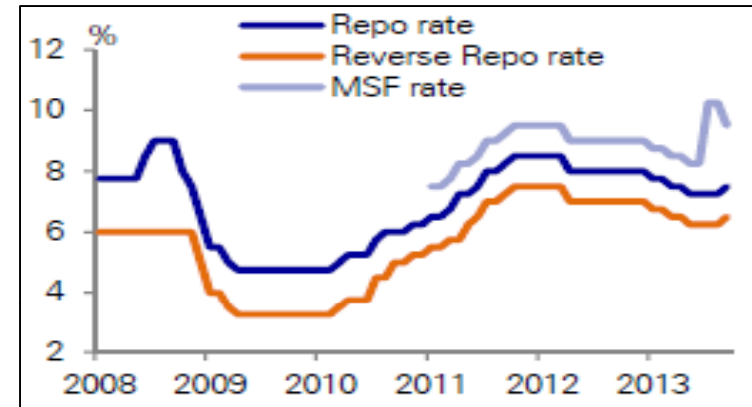
- India's 1Q14 Current account deficit came in at USD 21.8 bn or 4.9% of GDP largely led by high gold imports which were up 80% YoY
- However growth slowdown, a sharp restriction on gold imports & a pickup in exports is expected to result in substantial reduction in current account deficit thereby bringing some stability on the external front
- But fiscal deficit continues to be an area of concern as deficit in first 5 months has already reached 74.6% of full year budget estimates. Trailing 12 months Fiscal Deficit is at 5.3% against full year budgeted estimates of 4.8% of GDP
- Slippage on fiscal front is largely on account of shortfall in tax revenues as economic slowdown has impacted the earnings of the corporate sector

India Macro – Inflation – high and sticky

WPI inching up, CPI remains high



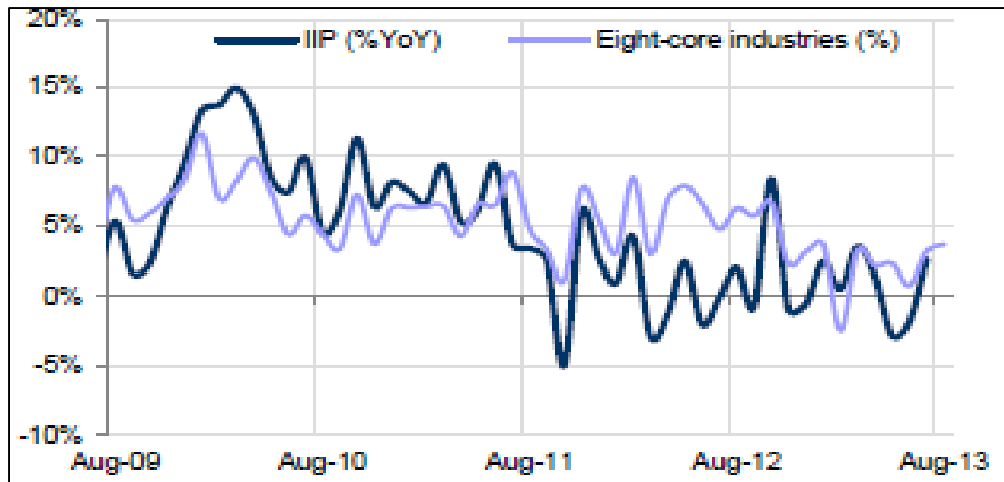
Policy Rates



- Stability on the external front enabled Reserve Bank of India to announce 75 bps reduction in marginal standing facility (MSF) rate to 9.5% (further reduced to 9.00% on 7th October, 2013) and reduction in minimum daily maintenance of Cash Reserve Ratio (CRR) to 95% of the requirement as against 99% earlier.
- However, rise in WPI inflation to 6.1% and high and sticky CPI inflation at 9.5% meant that monetary policy maintained a hawkish stance as RBI also announced an increase in Repo and Reverse Repo rate by 25 bps

India Macro – IIP deceleration halted

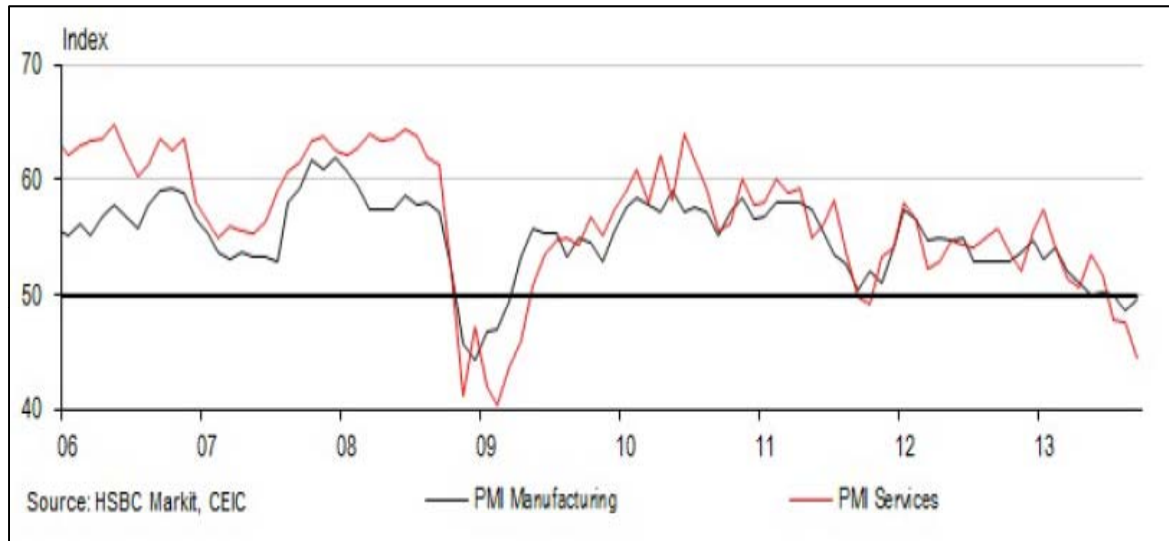
IIP & Eight Core Industries Growth



- IIP(Index of Industrial Production) grew by 2.6% YoY for July 2013 led by Manufacturing and Electricity sector even as Mining remained weak
- Eight core sector having 38% weight in IIP also grew by 3.7% YoY in August 2013, indicating uptick in August 2013 numbers for IIP

India Macro – But Lead Indicators suggest weakness ahead

Contraction in Manufacturing Slowed but accelerated in Services



- However lead indicators like Composite PMI fell further in September 2013 to 46.1 vs 47.6 in August 2013 indicating continued weakness in future growth
- Manufacturing PMI recovered from 48.5 in Aug 2013 to 49.6 in Sept 2013 but remained in contraction mode
- Service sector activity decelerated very sharply to 44.6 in Sept 2013 from 47.6 in August 2013

India – 2Q14 earnings season preview

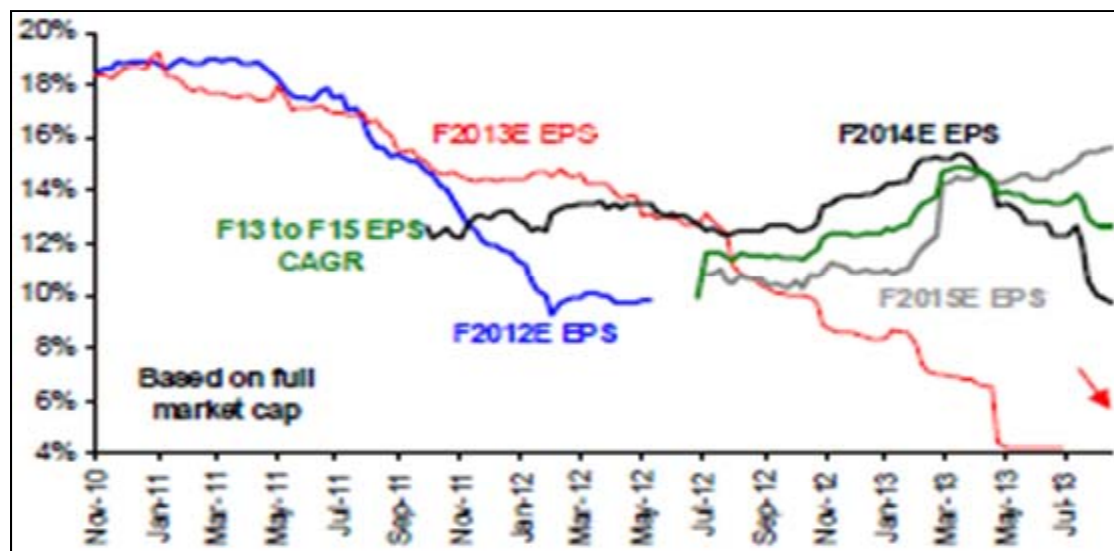
Sensex 2Q14 earnings expectation

(%)	Revenue Growth		EBITDA Growth		PAT Growth	
	YoY	QoQ	YoY	QoQ	YoY	QoQ
Sensex	10.9	9.6	12.6	8.7	5.1	6.2
Sensex ex-oil	10.7	9.2	12.5	6.2	7.0	3.6
Sensex ex-fin	10.7	9.9	14.8	12.6	6.8	8.7
Sensex ex-oil ex-fin	10.6	9.5	15.0	9.9	9.5	5.7

- Sensex ex - oil companies are expected to report a topline growth of 10.7% YoY, EBITDA growth of 12.5% YoY and PAT growth of 7% YoY
- Although YoY numbers are expected to be weak, expectations imply a strong QoQ revival as Sensex ex-oil companies delivered mere 0.3% topline growth, 3.2% EBITDA growth and 2.3% PAT growth in 1Q14

Earnings Expectations – Tough task

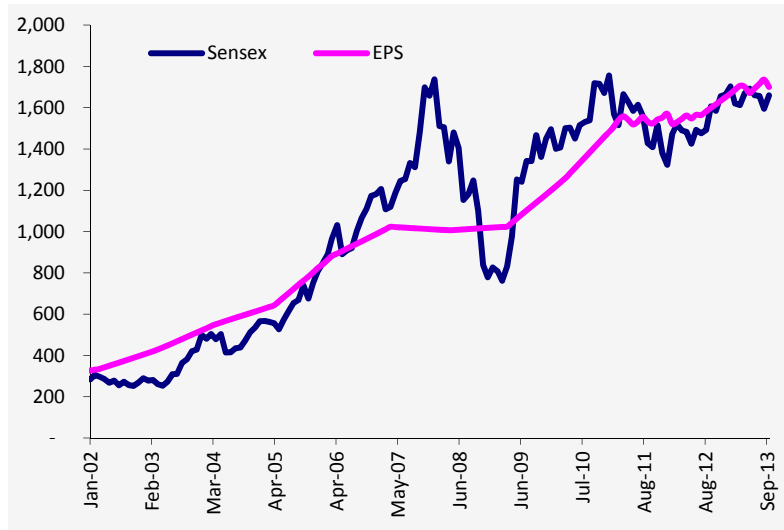
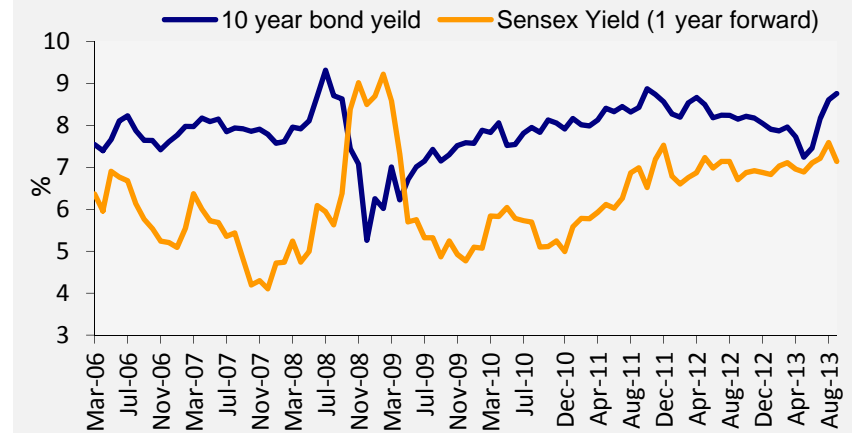
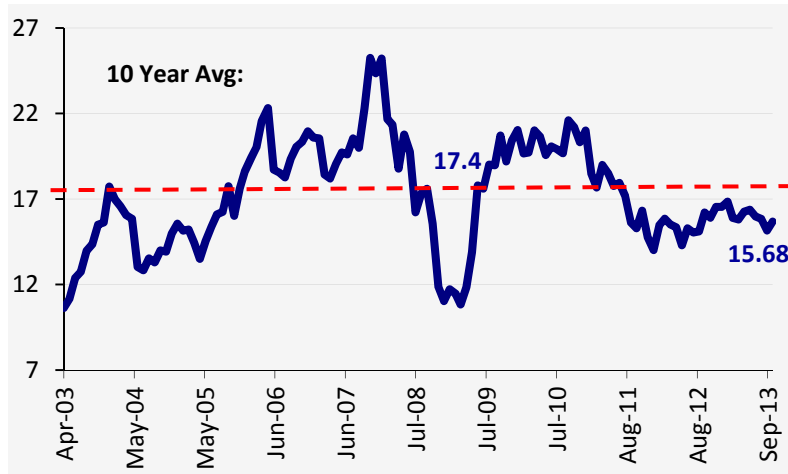
S&P BSE Sensex Consensus EPS growth trend



- Consensus EPS estimates for BSE Sensex companies been unchanged as compared to previous month and are expected to grow by 9.7% for FY14E
- Even single digit growth looks challenging, considering that earnings growth for FY13 was 2.8% and overall macro economic environment continues to remain weak

Valuations – At Reasonable Levels

Sensex PE Ratio (trailing twelve months)

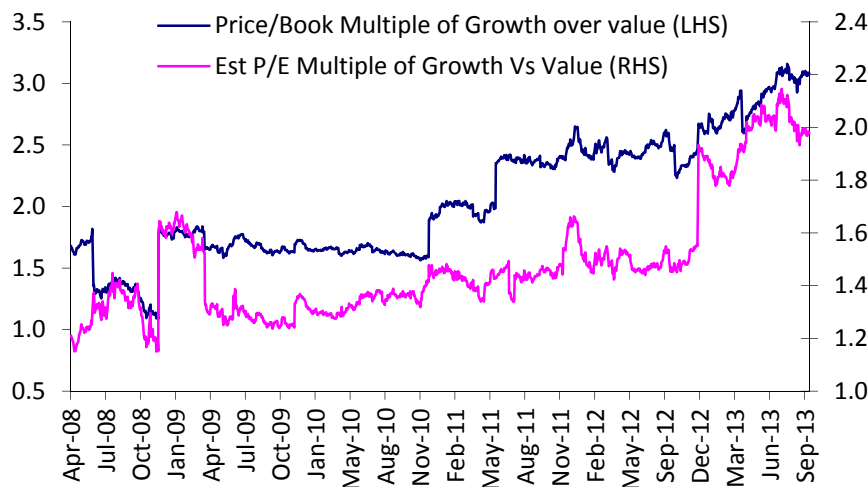


- Sensex is currently trading at 15.68x its trailing earnings. It is now 10% lower than its historical 10-year average trailing PE of 17.4x.
- The FY14 Sensex forward earnings yield gap with the 10-year bond yield widened to 160 bps as compared to 100 bps in Aug 2013
- The de-rating of market since 2007 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 19.9%
- Value index continues to widely underperform even MSCI India standard Index
- As of Sept 2013, valuation premium of growth index over value index stands at 3.1x in terms of Price/Book and 1.97x in terms of Est Price/Earnings



Looking Ahead...

- While global markets have been relative sanguine about US government shutdown, unexpectedly longer stalemate could risk US economic growth prospects and dislocations in market place
- US Fed Reserve's decision of putting on hold plans to reduce the asset purchases has provided a breathing time to emerging nations – especially those who were caught in spot of balance of payment bother to set their house in order
- In India, combination of US Fed decision, change of guard at RBI and their actions on gold imports, foreign-currency swap lines, etc. have eased the pressure on the external front
- However high fiscal deficit and inflation continue to remain concern areas
- As far as the fiscal deficit is concerned, India faces the risk of either rating downgrade or significant growth slowdown in 2nd half of 2014, as government tries to control expenditure to meet the target of 4.8% of GDP
- On the other hand, high and sticky inflation implies limited room for monetary easing, despite the growth slowdown
- Furthermore, with state elections in near horizon and central elections to follow – policy-making and implementation by government is at a risk
- In nutshell, India's growth outlook continues to remain weak; though good monsoon is a silver lining
- Based on current trends, the FY14E consensus growth expectations of about 10% looks challenging
- The market remains vulnerable given the challenging macro backdrop. But valuations are reasonable at a 10% discount to long term averages & provides comfort for long term investors.
- 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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Mutual Fund investments are subject to market risks, read all scheme related documents carefully

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