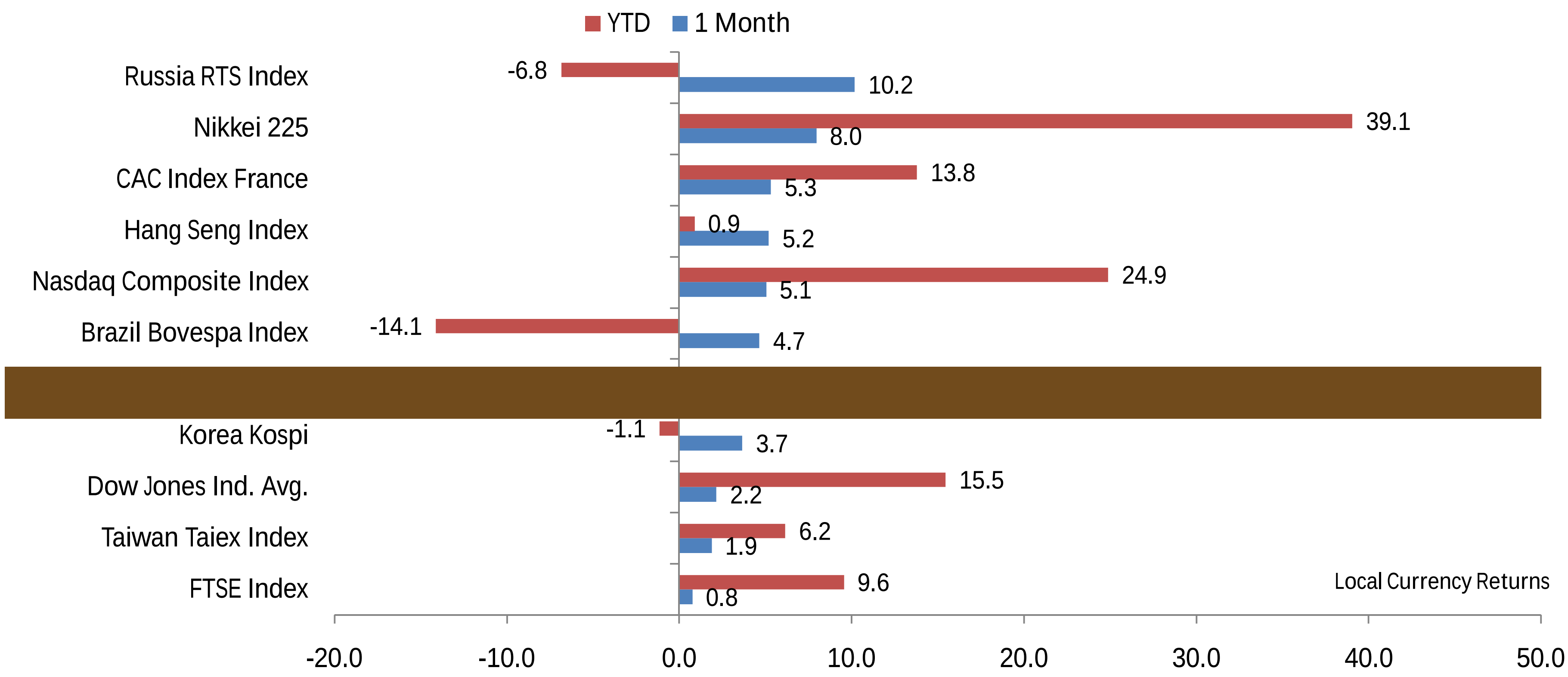
Indian investment scenario Analysis
ICAI

Contents

Global Indices Performance

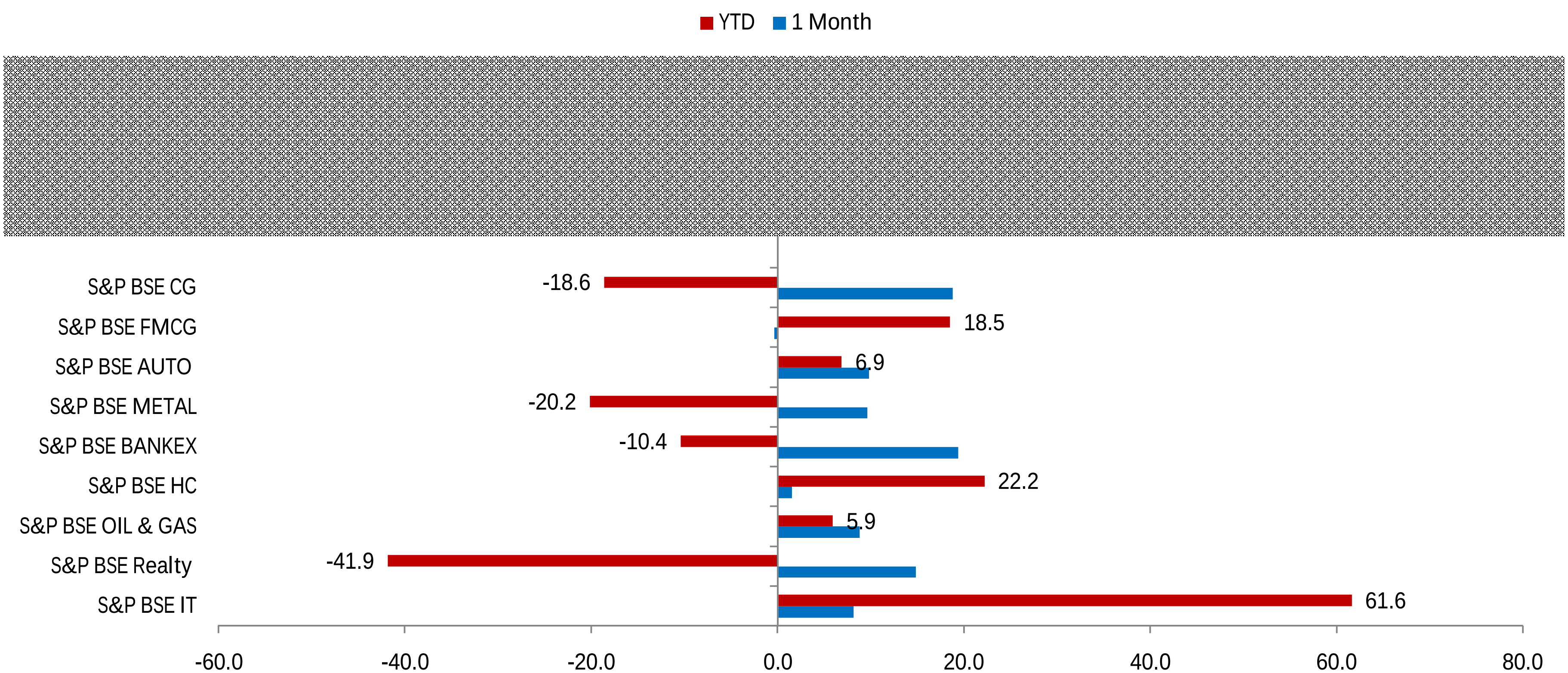
Indian market recovered from weak sentiments prevailing over the last few months. Recovery in currency value from the all-time low level and positives expectations from new RBI Governor helped the reversal of sentiments. Domestic economy meanwhile, remains on a weak footing as signs of green shoots remain elusive on economic activities.



As on 30 Sep 2013
Source: BSLAMC Research, MFI

Sector Indices Performance

Midcaps and small caps pared the YTD lag against the largecap peers as market sentiments reversed from extreme negative. On similar lines, defensives and global cyclical sectors like Healthcare and IT had a breather to make way for bounce back from beaten down sectors.



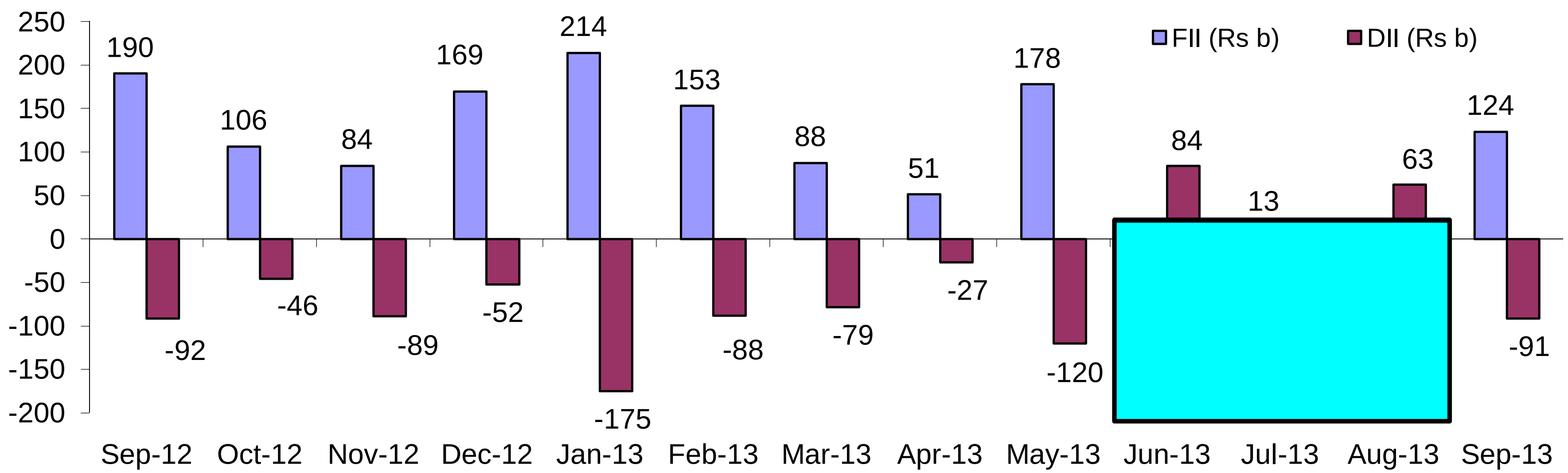
As on 31 oct 2013
Source: BSLAMC Research, MFI

Monthly FII/DII Flows

- Past few months witnessed negative FII flows primarily on negative sentiments related to QE tapering fears and concerns on domestic conditions
- FII flow has since bounced back in September. We expect FIIs to maintain a constructive stance primarily on deferred Fed tapering decision

In Rs. bn	FII	DII	Total
CY09	834	262	1096
CY10	1333	-214	1119
CY11	-27	278	251
CY12	1181	-569	612
YTD13	643	-449	193

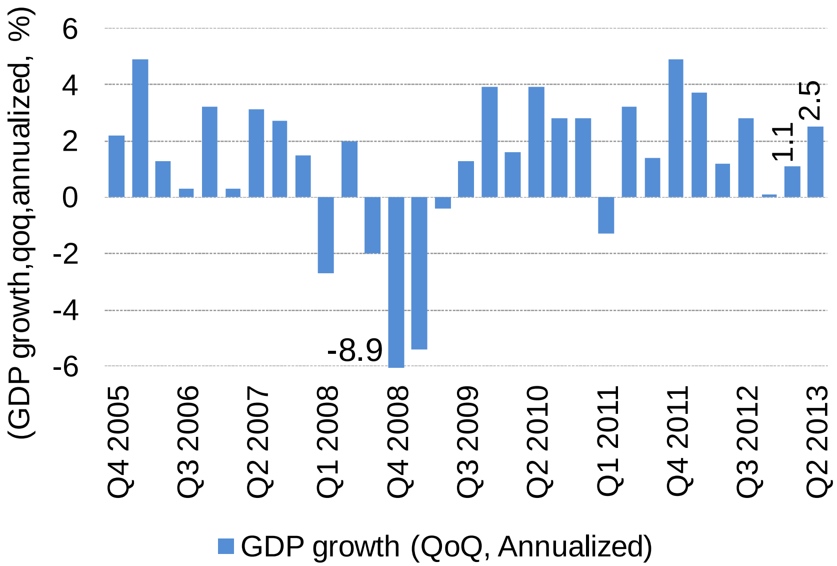
FII/DII Monthly Flow Data

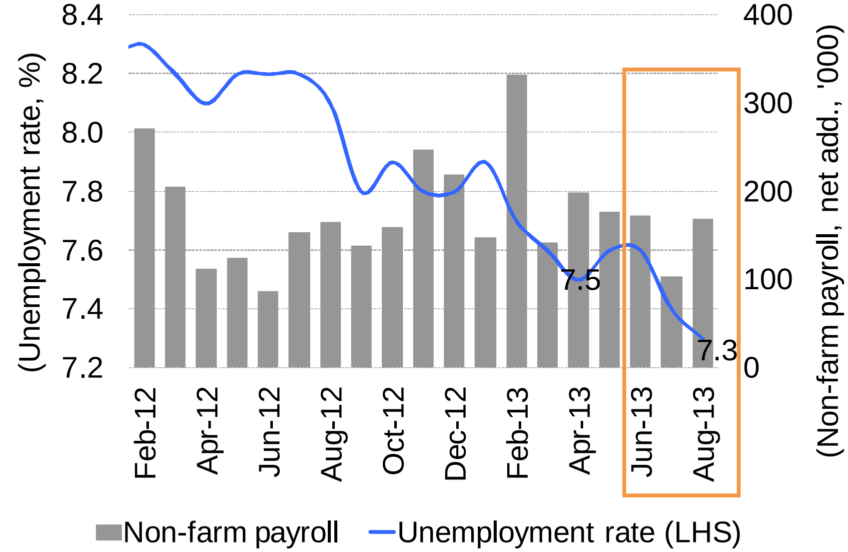


YTD 13 data till 30 September 2013, Source: Sebi, BSE

Global Outlook

US: Mixed data-prints on macros



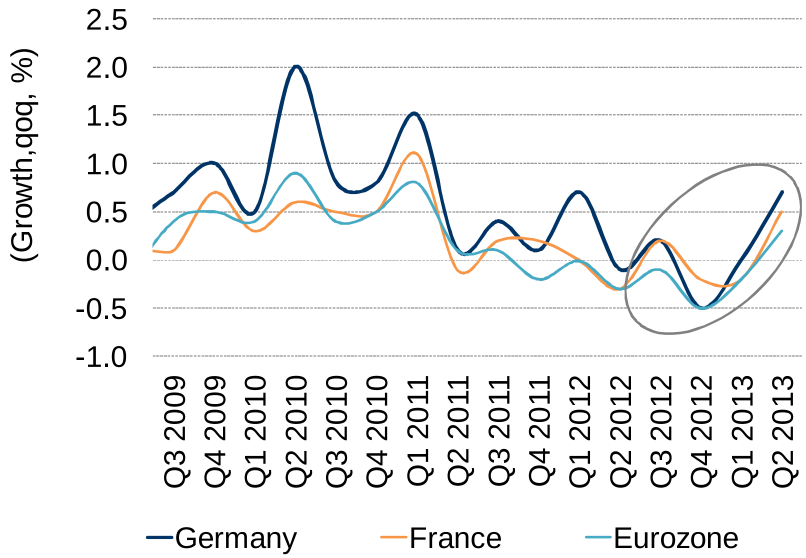


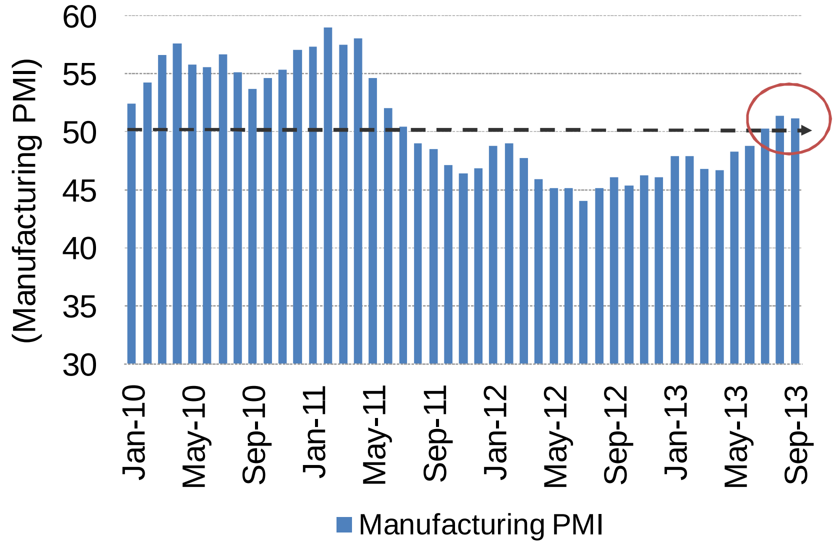
- US GDP grew 2.5% in the second quarter of 2013 after increasing 1.1% in the first quarter
- Rising exports, consumer spending and housing markets helped boost economic growth

- Unemployment rate declined to 7.3% in Aug’13
- Non-manufacturing index dropped to 54.4 in Sep’13 from 58.6 in Aug’13, indicating weakness in the service sector

While we are witnessing a recovery in US economy, the recovery is still not stable. Looking at the current environment & data points, FED’s decision to taper QE might be postponed to Mar14.

Eurozone: Steady recovery



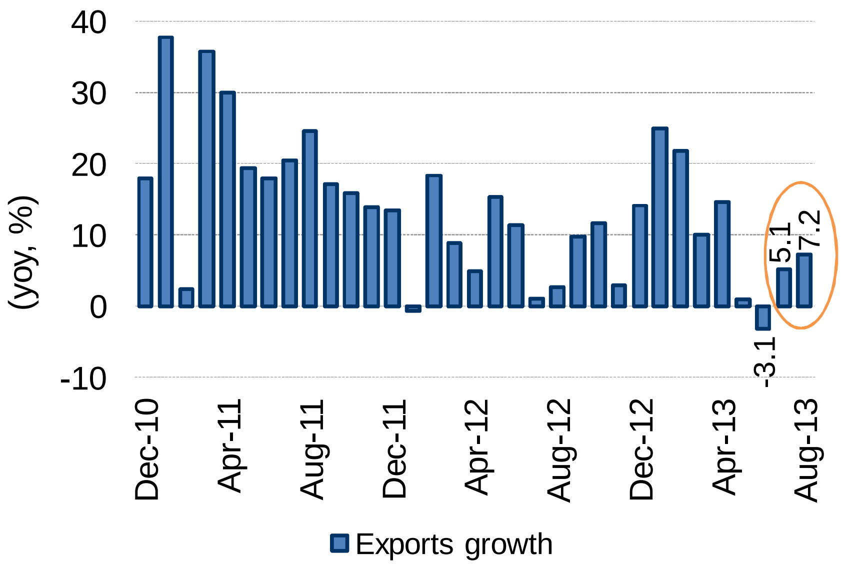


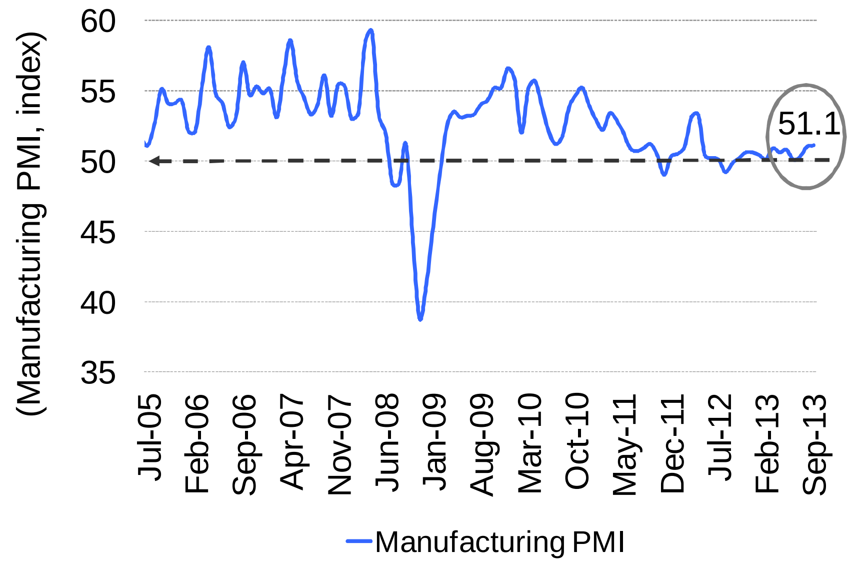
- Following contraction in the last six quarters, the Eurozone economy grew 0.3% qoq in 2Q 2013
- The recovery is led by Germany and France, which grew 0.7% and 0.5%, respectively

- Manufacturing PMI also came out of the contraction zone during Jul- Aug’13
- Retail sales rose by 0.7% m-o-m in Aug’13, higher than expectation of 0.2%
- Unemployment rate remained unchanged at 12% in Aug’13 but down from 12.1% in Jun’13

Euro zone economies seems to have averted a crises and are slowly restoring the fractured economy in a gradual manner

China: Gains from improving outlook in trading partners





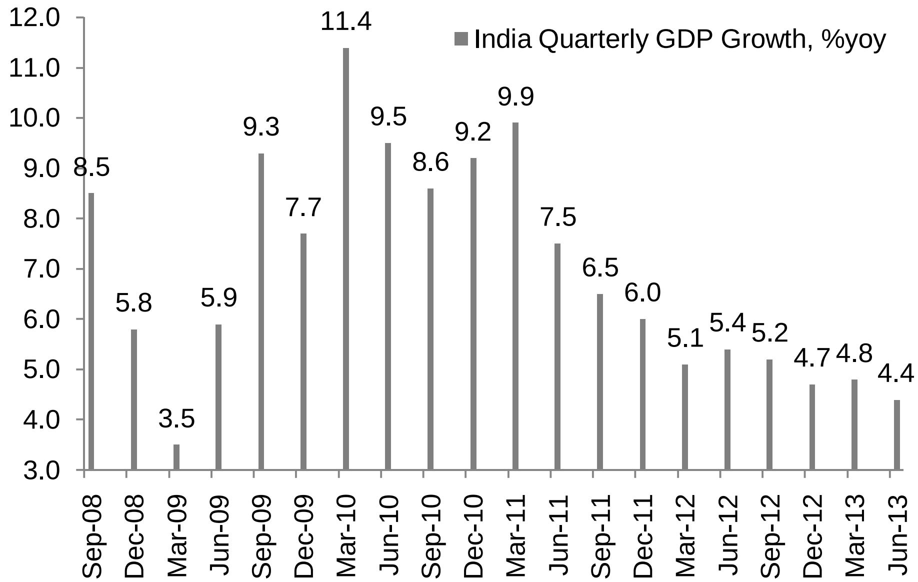
- China's GDP grew by 7.8% in September quarter (YOY).
- Exports growth has started showing traction after contracting in Jun'13; Exports grew by 7.2% in Aug'13 vs. 5.1% in Jul'13
- Improving outlook in the US and the Eurozone increasing hopes for China's growth recovery

- The manufacturing PMI indicates a gradual recovery in the manufacturing sector
- Industrial production grew by 10.4% in Aug'13, the highest in past 15 months

With gradual recovery in the key growth indicators, expectations of a hard landing have been put to rest for time being.

Domestic Outlook

Domestic Economy – Growth moderation continues



Sep'13 IIP growth table

Sector	May-13	Jun-13	Jul-13	Aug-13	Sep-13
Mining	-5.9	-4.3	-2.5	-0.2	3.3
Manufacturing	-3.2	-1.7	3.2	-0.1	0.6
Electricity	6.2	0.0	5.2	7.2	12.9
Basic Goods	-0.3	-1.5	1.5	1.5	5.4
Capital Goods	-3.7	-5.8	15.6	-2.0	-6.8
Intermediate goods	1.1	1.3	3.1	3.6	4.1
Consumer goods	-6.6	-1.9	-0.5	-0.8	0.6
- Durables	-18.3	-10.4	-8.9	-7.6	-10.8
- Non Durables	3.8	5.7	7.0	5.0	11.3
General	**-2.5**	**-1.8**	**2.8**	**0.6**	**2.0**

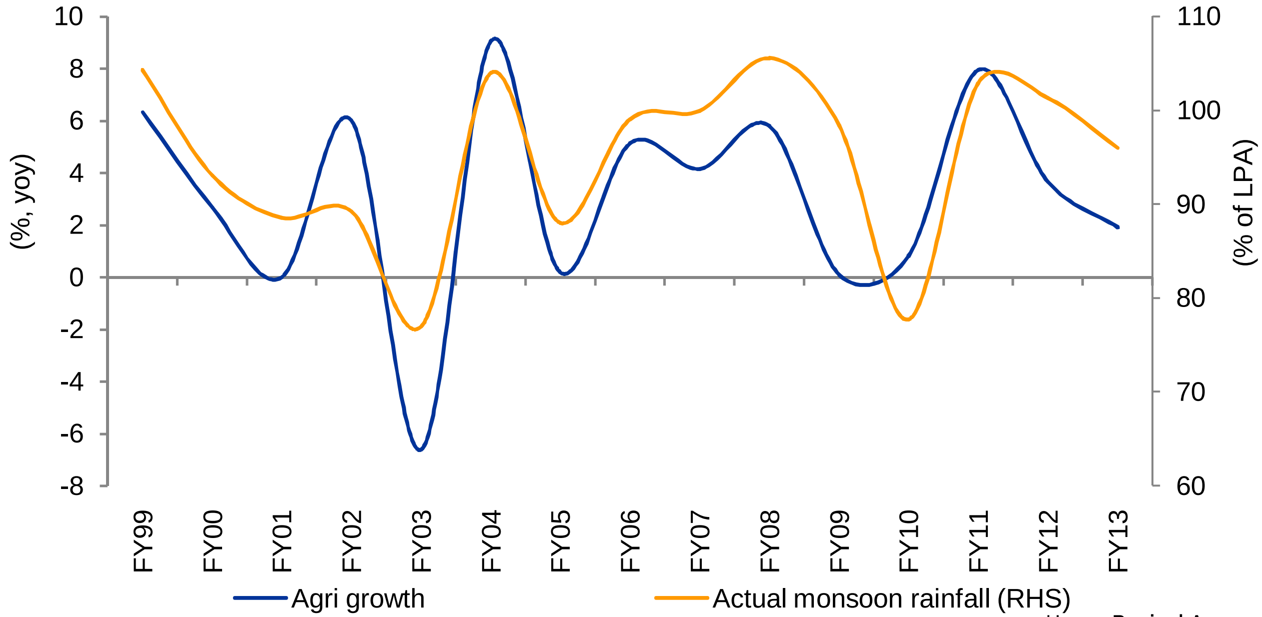
- India's GDP growth, at 4.4% in 1QFY14, was the lowest in the past 17 quarters.
- While agriculture (2.7%) and services (6.6%) showed marginal improvement over 4QFY13, industry with 0.2% growth was a major drag on GDP growth in 1QFY14

- The Industrial production (IP) growth decelerated to 0.6% YoY in Aug-13 compared to 2.8% in July
- The capital goods sector and the deceleration in consumer non-durables caused the slowdown in IIP.

GDP growth continues to decline, expect bottoming out in coming quarters on back of cyclical recovery

Good monsoon raises prospects for higher agri-production

Historic correlation between Monsoon & Agri GDP growth has been high at 0.8x

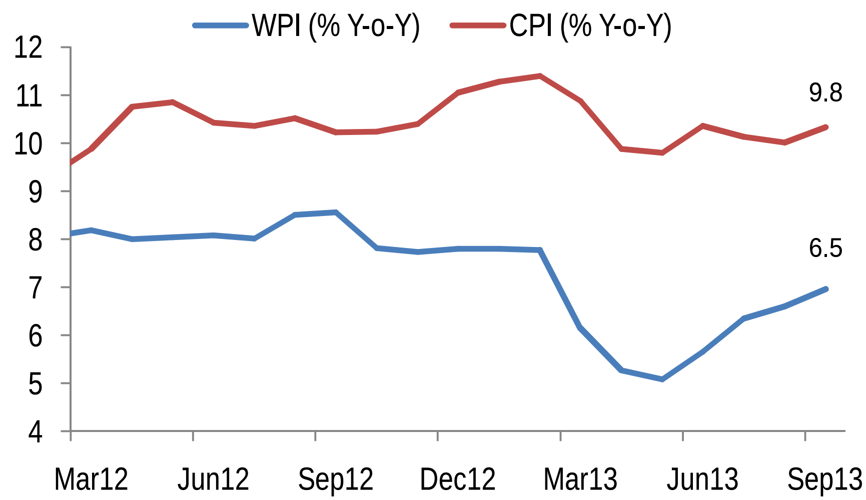


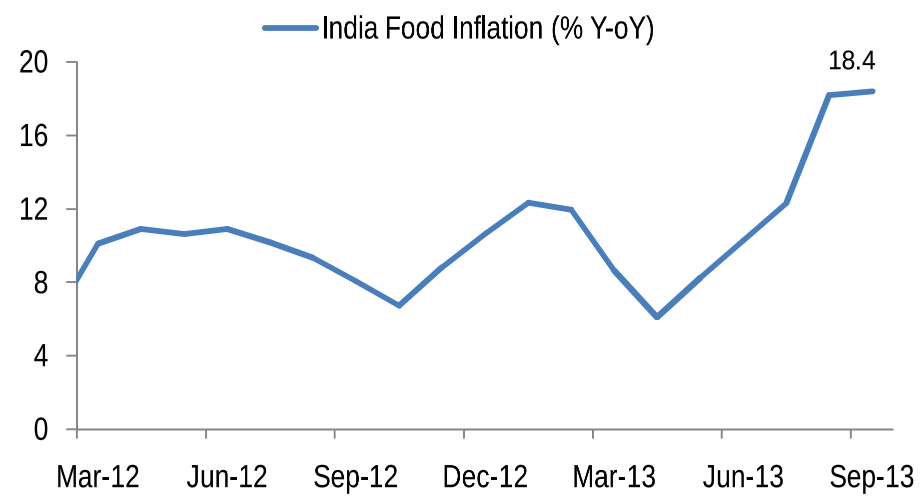
*Long Period Average,
Source: Indian Meteorological Department, CMIE

Agri contributes ~14% to GDP, and could help the overall GDP given good monsoon and higher sown area

- On a season-to-date basis, cumulative rainfall was 5% above normal up to September 25.
- Crop sowing also rose 5.3%yoy; though poor yields could affect production
- Reservoir levels at a 10-year high, bodes well for winter (rabi) crop as well
- Good crop would also bring relief to high Food Inflation

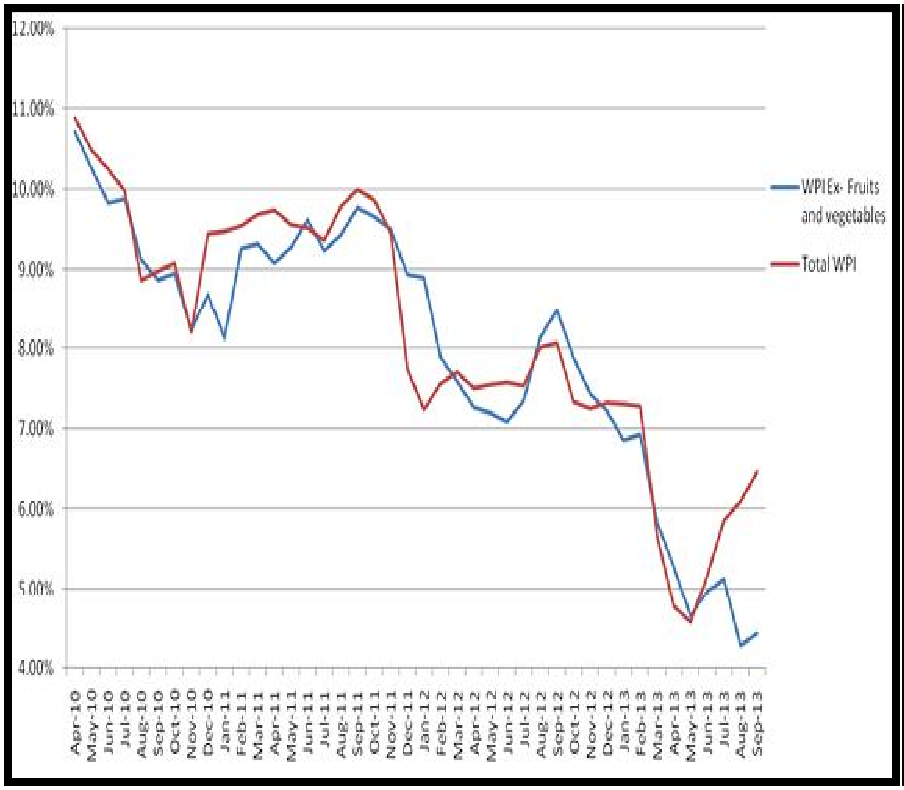
Inflation – Inching up again

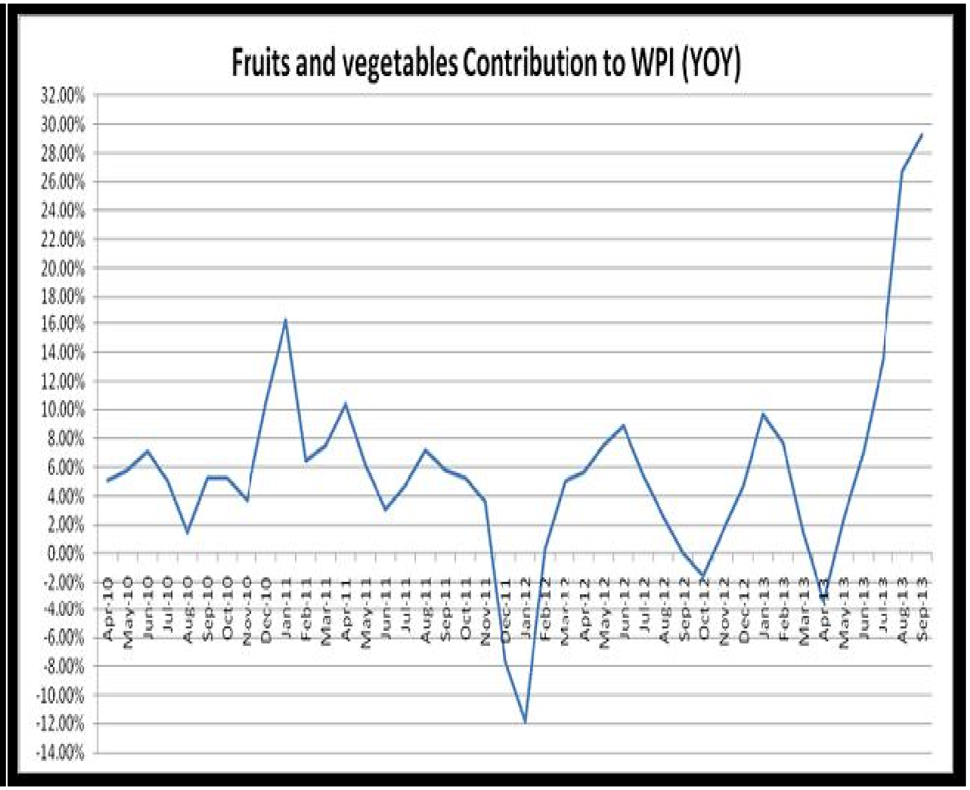




- Inflation metrics continue to be on the adverse side in September with the CPI inflation at 9.84% and WPI inflation at 6.46%y-o-y for Sep compared to 6.1% in Aug and consensus expectations at 6%
- The higher WPI was once again driven by sharply higher price indices of Food +18.4% (highest since May 2010) and continued high fuel inflation (10%)
- The high inflation in the Fruits & Vegetables group, in spite of an above-average monsoon, exposes the structural demand-supply issues
- Indian policymakers have historically used WPI as the preferred tool to track inflationary pressures for policy purposes. However, of late the focus is shifting towards CPI as an additional indicator to track inflation, as it reflects the underlying inflationary expectations of households which have remained elevated

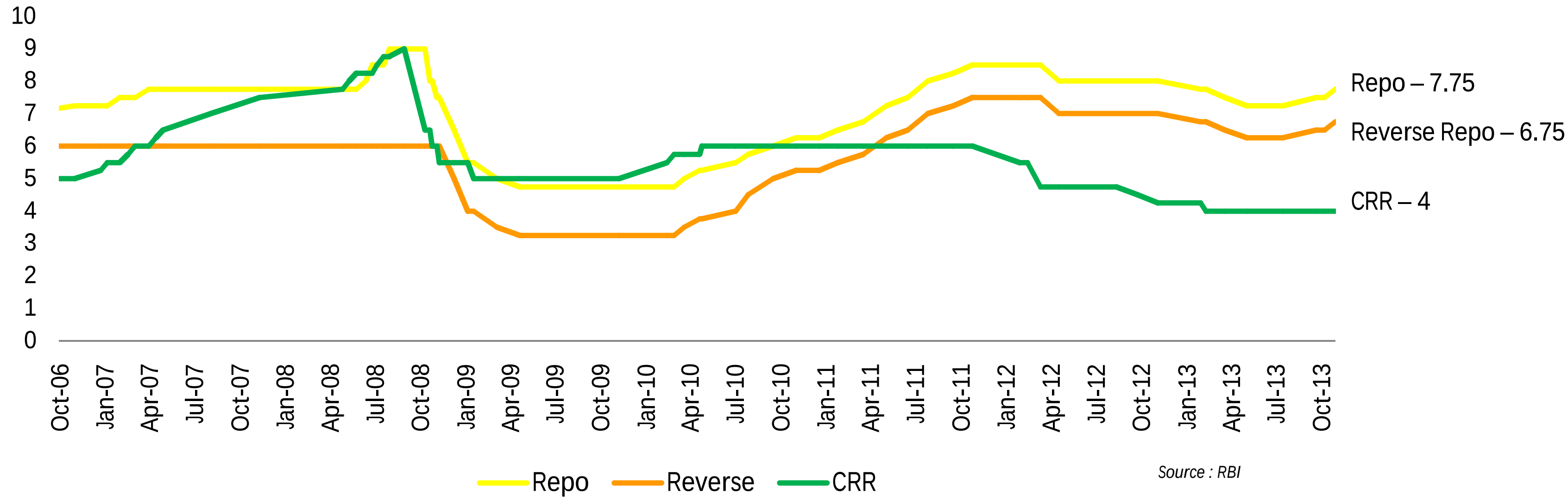
Inflation – Impact of fruits and vegetable prices





Source : IDFC AMC

Calibrated approach on rates & focus on CPI



- RBI signaled a change in the monetary stance by raising repo rate by 50 bps while the MSF rate was lowered by 150bps to bring it to 8.75%
- Currently, the RBI is injecting about ~Rs 1 trn into the system on a daily basis through LAF and MSF windows. RBI has also announced term repos of 7-day and 14-day tenors up to 0.50% of NDTL every Friday

RBI is recalibrating its monetary framework by lowering the MSF rate and raising the repo rate to tackle the elevated CPI

Policy measures taken by Dr. Raghuram Rajan

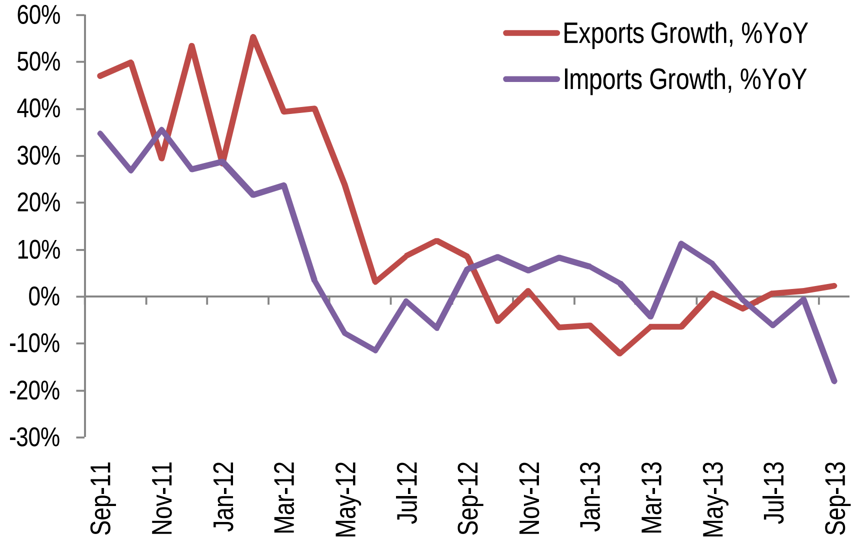
For Foreign currency flows:

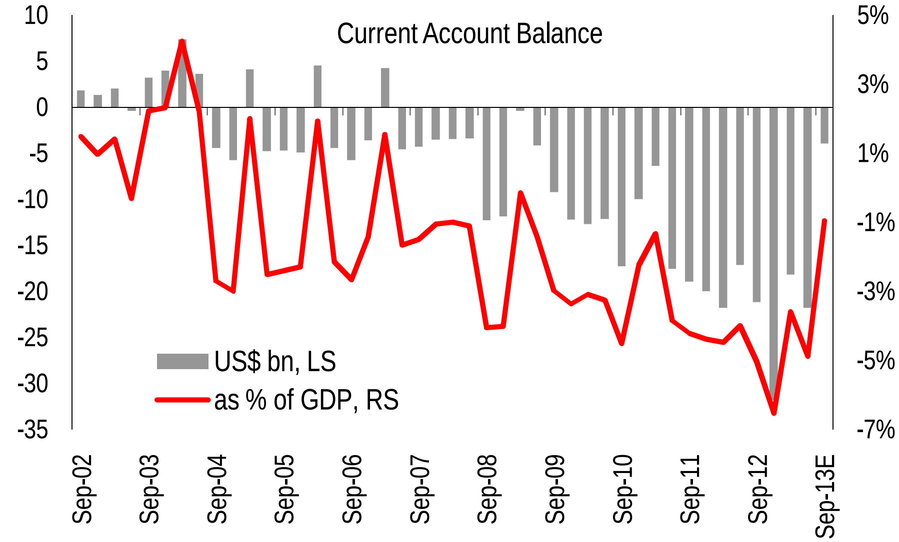
- The RBI to offer a window to banks to swap fresh FCNR (B) dollar funds, mobilized for a minimum tenor of three years and over, at a fixed rate of 3.5 per cent per annum for the tenor of the deposit
- RBI also increased the current overseas borrowing limit for banks from 50% of the unimpaired Tier I capital to 100%

For Banking – Opening the market for banks and enhancing efficiency:

- Intentions of **issuing new bank licenses** by early 2014. This move is different from the past and is targeted to encourage new banking formats and increase competitive intensity in the sector
- Proposed free **branch-licensing framework for banks**, to enable them to expanding in Tier I cities without pre approval
- RBI will explore room to reduce **SLR requirements;** based on improvement in government finances

BoP – Curb on gold imports helps reduce trade deficit





- Trade deficit narrowed to a 30 month low in the month of Sept. falling to 6.8 billion on account of lower gold imports and better exports,.
- From an average of ~16billion per month trade deficit in FY13 the run rate this year seems to have fallen to 10-11 billion this hints at remarkable decline in our FY 14 CAD.

- India CAD reached life time high of 4.8% in FY13. Oil and Gold imports were the key contributed to a ballooning CAD number. This year with regulatory and administrative measure undertaken by govt. and RBI both oil and Gold imports are headed towards correction.
- This should help reduce the CAD to US$ 50-60 billion for FY 14.

Focus shifting toward Fiscal Deficit

- April- Aug data shows that fiscal deficit is 75% of Budget estimate. Data specially highlights the challenges on the revenue side
- Total divestment receipts in April-August 2013 is only Rs14 bn, against budget estimates of Rs400 bn of Government divestment and Rs140 bn of Government's stake sale
- Government is likely to have a significant challenge from the revenue side in its attempt to contain the GFD/GDP target of 4.8%
- Attempts to contain fiscal deficit would need reductions in the planned expenditure, which in turn would hurt the GDP growth

		chg (%)	YTD (Apr-Aug)		chg (%)		
Date	**Aug-13**	**yoy**	**2014**	**2013**	**yoy**	**2014BE**	**Actual/ Budget**
Total receipts	**777**	***41.4***	**2,583**	**2,278**	***13.4***	**11,228**	**23%**
Total expenditure	**1,418**	***10.7***	**6,629**	**5,654**	***17.3***	**16,653**	**40%**
Plan expenditure	334	*(1.8)*	1,831	1,479	*23.8*	5,553	33%
Non-plan expenditure	1,084	*15.2*	4,798	4,174	*15.0*	11,100	43%
Revenue expenditure	1,308	*12.1*	5,843	5,002	*16.8*	14,362	41%
Capital expenditure	113	*(1.2)*	789	652	*21.1*	2,291	34%
Fiscal deficit	**640**	***(12.4)***	**4,047**	**3,375**	***19.9***	***5,426***	***75%***

Source: Bloomberg; Kotak

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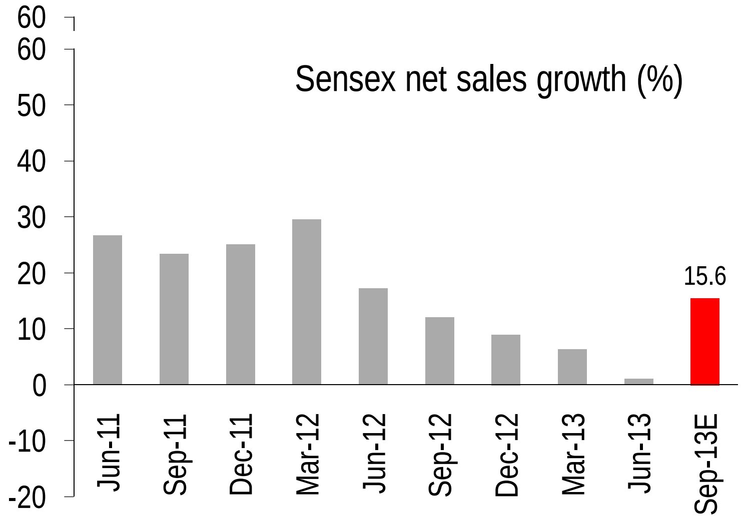
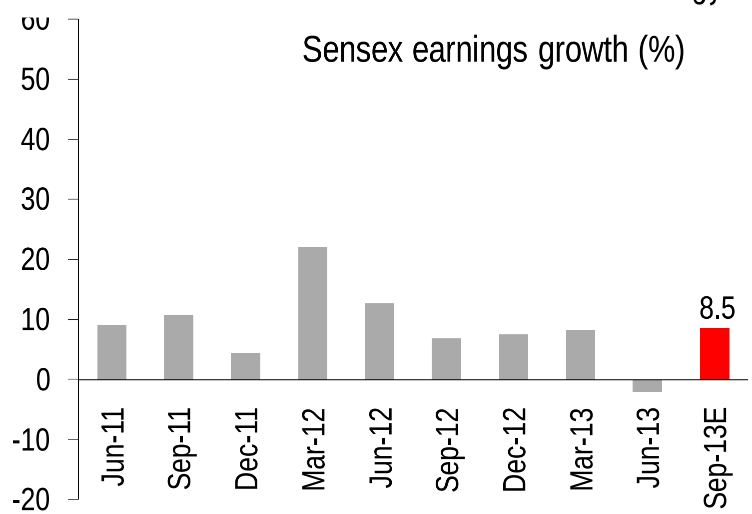
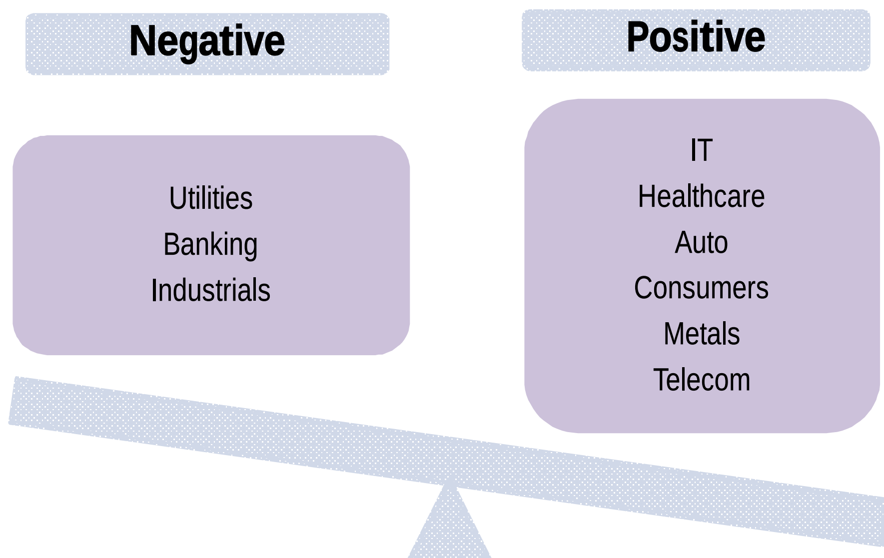
Jul-Sep13 Quarterly Preview: Global Cyclicals to rescue





- Expect some improvement in the corporate results, aided by low base, Fx sensitivity, Global cyclicals buoyancy and secular defensiveness.
- Sales growth is expected to improve to ~15%yoy, and operating margins to expand by ~50 bps primarily on back of weak currency
- Sensex PAT is expected to grow lower at ~8% yoy

Sector Bias on Quarterly results



Market Valuations

Sensex Valuation Summary: Sensex@20,400											
Year to 31 March	**FY05**	**FY06**	**FY07**	**FY08**	**FY09**	**FY10**	**FY11**	**FY12**	**FY13e**	**FY14e**	**FY15e**
EPS	450	523	718	833	820	829	1016	1114	1199	1311	1519
EPS growth (%)	29.1	16.4	37.3	16.0	-1.7	1.1	22.6	9.6	7.6	9.3	15.9
P/E (x)	14.4	21.6	18.2	18.8	11.8	21.2	19.1	15.6	17.0	15.6	13.4
Div. yield (%)	2.1	1.5	1.4	1.3	1.9	1.4	1.3	1.7	1.6	1.7	1.9
P/B (x)	3.3	4.7	4.2	4.1	3.6	3.2	3.2	2.6	2.8	2.5	2.2
ROAE (%)	23.4	24.2	24.0	22.8	18.8	15.8	17.4	17.1	17.0	16.4	16.9

- FY14 and FY15 estimates have been cut by -3.3% and -2.7% since the beginning of the financial year
- Prolonged weakness in the underlying economic activities along with high interest rates regime have impacted the near term corporate earnings growth

Equity Outlook

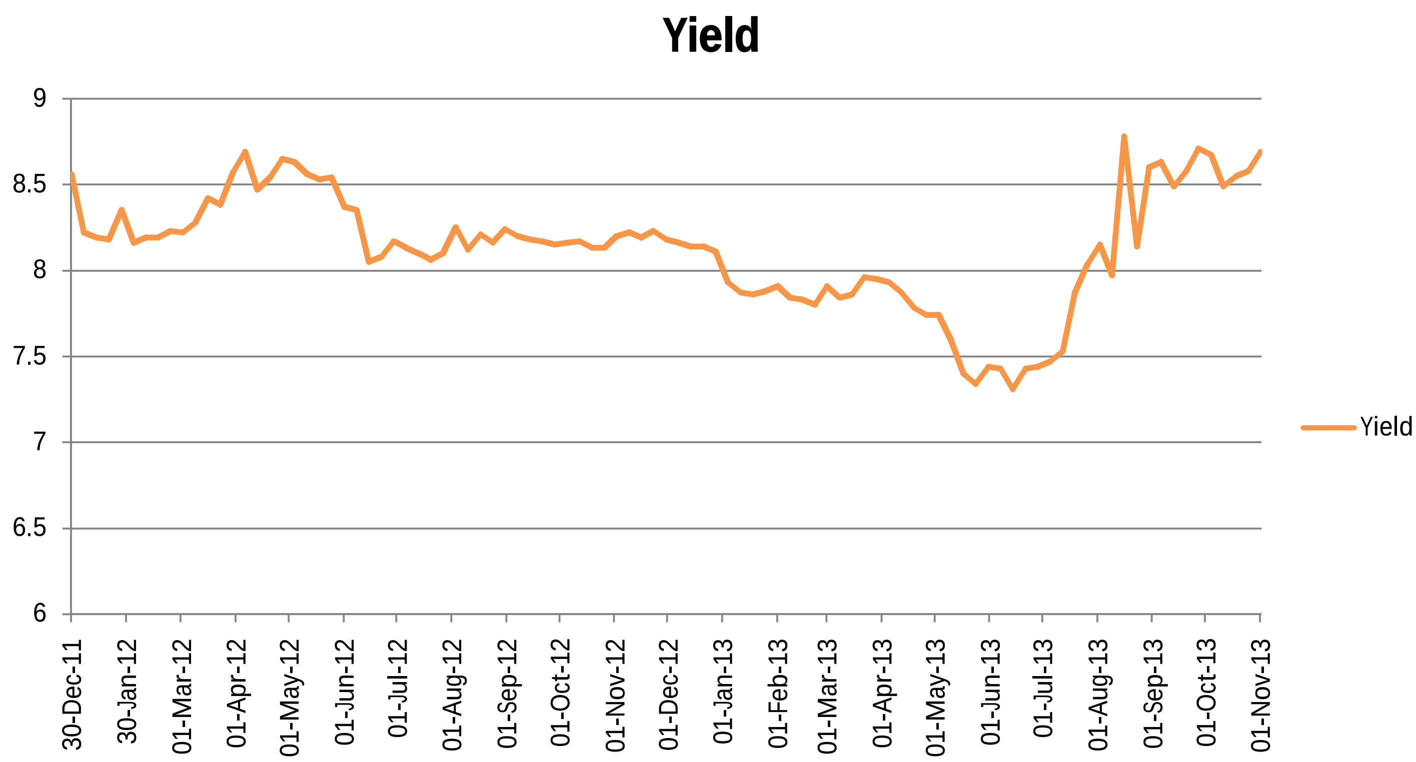
- Markets have been trading in a range bound manner over the last few quarters given lack of any clear signals on the longer term direction. Currently we are in upper band of the range driven by global risk-on and RBIs accommodative stance
- Global liquidity in the near term remains supportive primarily on continuing quantitative easing measures. Sentiments relating to forthcoming state elections along with a possible revival in economic activities will set the tone for market direction
- We are currently in the cyclical bottom of the economic cycle which might continue for a couple of quarters more, barring some events like Political developments, Policy imputes and Global phenomenon which could then set a clearer economic direction
- With market benefitting from the global risk-on move, valuation is now closer to long-term average at ~13.7x one year forward PE. We remain cautious at current levels – given that near economic fundamentals are still weak.
- From a slightly longer term perspective we feel equity markets provide a better risk-reward profile to long term investors as earnings growth normalizes with the cyclical recovery in the economy

We advice investors to remain invested in the market and look for to systematically increase exposure to equities with a three year view.

Fixed income

Outlook

10 year G sec movement



Fixed Income

- Mr Raghuram Rajan in his all speeches have been quiet effective and has had a effect on fixed income market.
- He has been successful in controlling the volatility of rupee till date and his measures have yielded desired effects.
- He has been facing few challenges which are very critical –
  - High CPI (high food inflation)
  - Highest level of credit deposit ratio
  - Slowing growth as RBI brought down the growth estimate down to 5% from 5.5%.
- We feel the domestic environment remains quiet challenging. RBI will not reduce the policy rates unless they see the underlying liquidity situation (credit deposit ratio) improving, the hard running CPI comes under control and most importantly US tapering event subsides.

Investment Avenues – Asset Classes

Asset Class	Avenues
Equity	• Mid cap & Small Cap • Structured products • Private Equity • Sophisticated derivative strategies
Fixed Income	• Long term debt mutual funds • Corporate Bonds • FMPs • Fixed deposits
Gold	• Ornaments • Physical gold • ETFs
Real Estate	• Residential • Commercial • Land (Urban & Rural)
Offshore Investments	• Equity • Fixed Income • Gold

Thank You