TOP 10 ISSUES FOR 2015

Liquidity , events and valuations to drive the markets

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How did the World Equity Market behave in 2014?

Index	Country	Return for CY 2014
Shanghai Composite	China	53%
CNX Nifty Index	India	31%
S&P BSE SENSEX	India	30%
Jakarta Composite	Indonesia	22%
Nasdaq	USA	13%
Dow Jones	USA	8%
Nikkei 225	Japan	7%
NYSE	USA	4%
DAX	Germany	3%
Hang Seng	Hong Kong	1%
CAC 40	France	-1%
FTSE 100	UK	-3%
Bovespa	Brazil	-3%
Seoul Composite	South Korea	-5%
KLSE Composite	Malaysia	-6%
RTS Index	Russia	-45%

China, followed by India were the top performing equity markets globally in calendar year 2014

Russian markets fell the most after crude prices crashed.

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DOMESTIC SECTORAL RETURNS

Sector Index	Return for CY 2014
S&P BSE BANKEX	65%
S&P BSE AUTO Index	52%
S&P BSE Capital Goods	50%
S&P BSE Health Care	47%
S&P BSE PSU	39%
CNX Media	33%
S&P BSE Power Index	23%
CNX Infrastructure	23%
S&P BSE FMCG	18%
CNX IT	18%
S&P BSE TECk Index	16%
S&P BSE OIL & GAS Index	12%
S&P BSE Realty Index	8%
S&P BSE METAL Index	8%
S&P BSE SENSEX	**30%**
S&P BSE Mid-cap	**55%**
S&P BSE Small Cap	**69%**

- Auto and Health care stocks were surprising out performers of 2014
- Despite a lot of reforms in the Oil and Gas sector, the stocks delivered a subdued performance

LIQUIDITY

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FII FLOWS

Calendar Year 2014

Month	Equity (Rs bn)	Debt (Rs bn)	Total (Rs bn)
January	7	126	133
February	14	113	127
March	201	116	317
April	96	-92	4
May	140	198	338
June	140	167	307
July	131	230	361
August	54	167	221
September	51	159	210
October	-12	179	167
November	138	117	255
December	10	112	122

- **2014 saw record inflows of Rs 1.6 lakh crore into the debt markets and Rs 97,000 crore into equity, taking the total to Rs 2.56 lakh crore**
- **The expectations for 2015 are mixed. Some research houses like Credit Suisse expect the flows to halve in 2015. Others like J P Morgan expect the flows to sustain in 2015**
- **We expect: The FII flows in CY 2015 to be lower than CY 2014. Domestic institutions may play a more dominant role**

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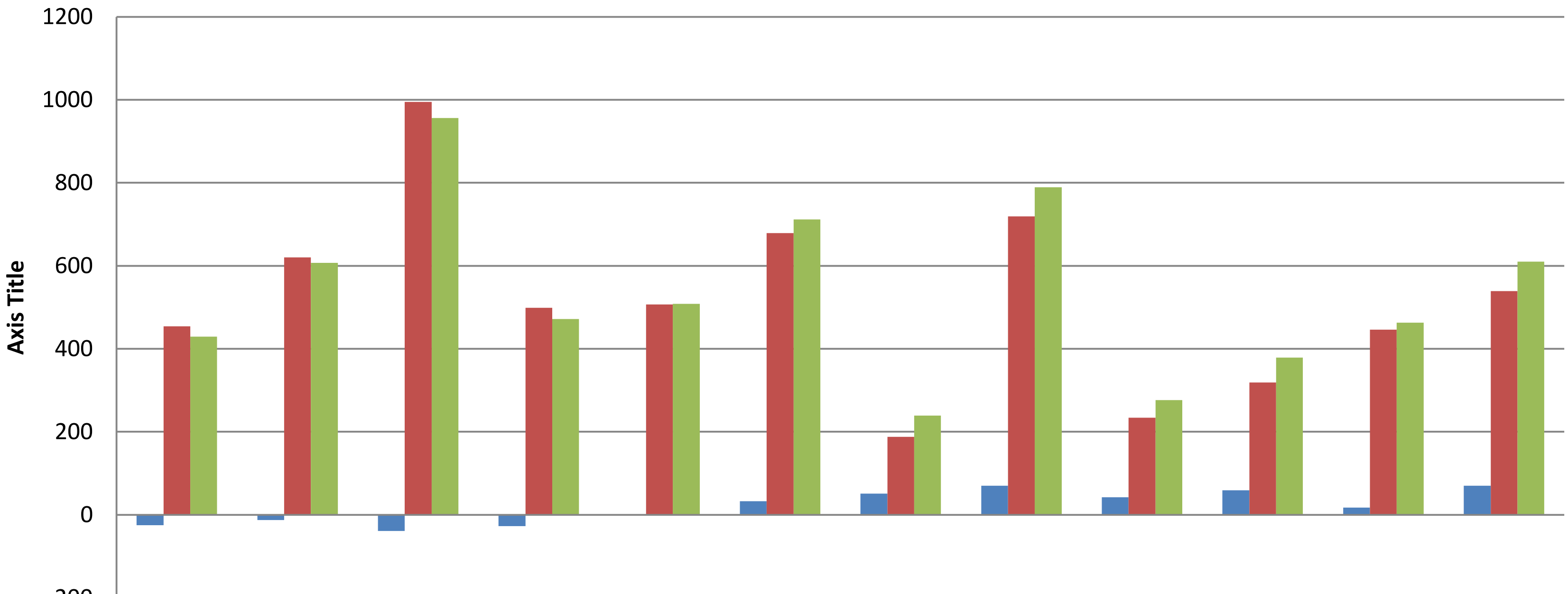
MF ACTIVITY

- **Flows into equity MFs turned positive post May which was the election month**
- **Total equity inflows for 2014: Rs 239 billion**

2014: Flows into Domestic MFs (Rs billion)



	January	February	March	April	May	June	July	August	September	October	November	December
Equity	-25	-13	-39	-27	1	33	51	70	42	59	17	70
Debt	454	620	995	499	507	679	188	719	234	319	446	539
Total	429	607	956	472	508	712	239	789	276	379	463	610

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EVENTS

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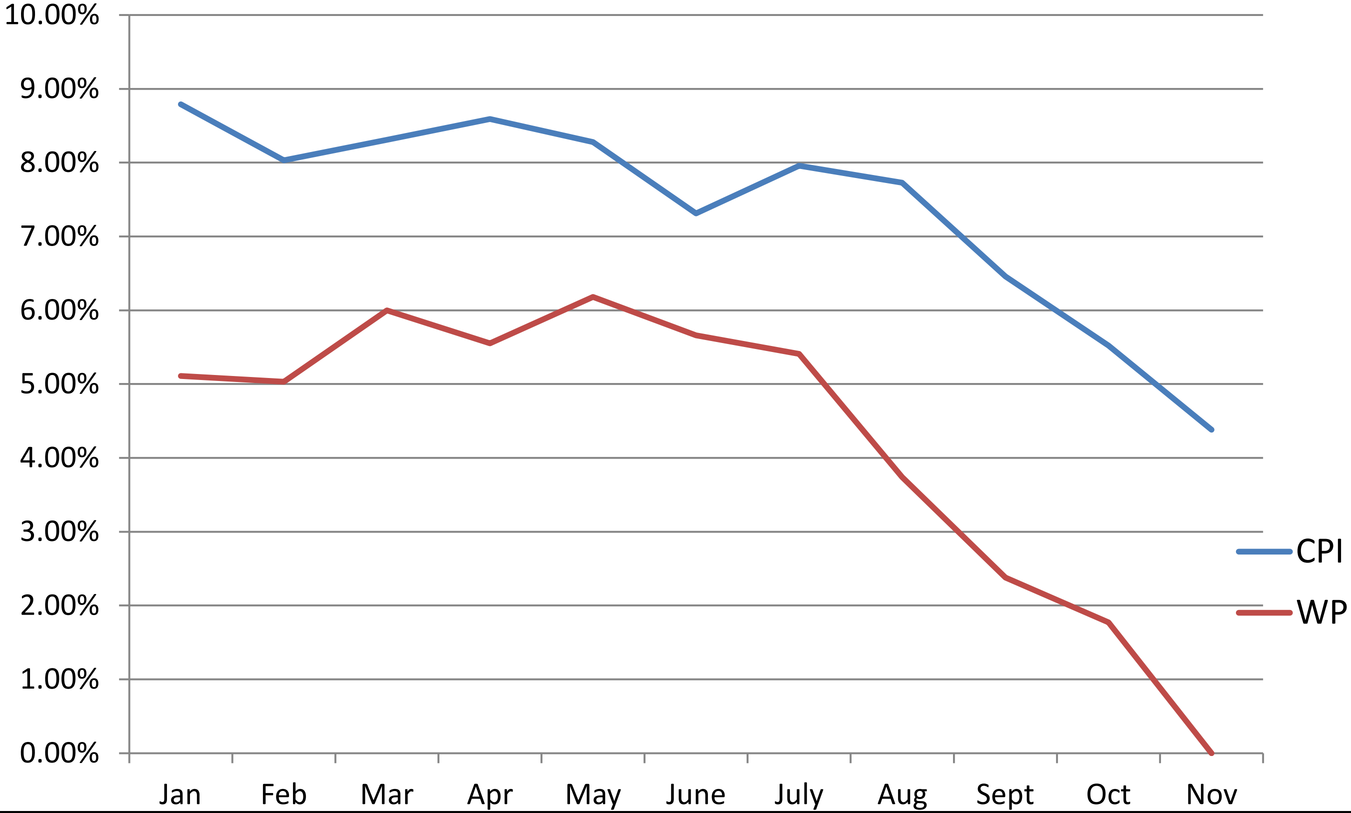
1. DOMESTIC MONETARY POLICY

- **Inflation has been declining sharply**



	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov
CPI	8.79%	8.03%	8.31%	8.59%	8.28%	7.31%	7.96%	7.73%	6.46%	5.52%	4.38%
WPI	5.11%	5.03%	6%	5.55%	6.18%	5.66%	5.41%	3.74%	2.38%	1.77%	0.00%

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- **IIP numbers have been discouraging indicating slowing industrial activity**

- **RBI has been under pressure from the industry as well as government to cut rates but has refrained from doing so in 2014**
- **We expect:**

  RBI to cut rates in the range of 50 to 75 bps in 2015

Month	IIP (%)
Jan	0.8
Feb	-1.8
Mar	-0.5
Apr	3.72
May	5.6
Jun	3.9
Jul	0.4
Aug	0.48
Sep	2.8
Oct	-4.2

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2. FISCAL ACTION

- The Government is faced with a daunting task of achieving a target of 4.1% fiscal deficit this fiscal
- 99% of the year's target was reached by November-end (Rs 5.25 lakh crore against target of Rs 5.31 lakh crore)
- Revenue receipts have been sluggish
- High expectations are riding on the Union Budget 2015-16 which is expected to create more jobs and kick start the investment cycle
- Disinvestment has been way off the target of Rs 58,500 crs

We expect:

- **The Govt will just about meet the fiscal deficit target of 4.1% or will to window dress to camouflage the actual deficit.**
- **The market has already discounted this and may not react negatively**
- **Under the present circumstances, Govt. may abandon fiscal discipline in FY16 to revive growth.**

3. FED ACTION ON INTEREST RATES

- The US Federal Reserve's near-zero short term rates have been a major factor in driving investor returns and the relative attractiveness of debt markets in emerging markets like India
- When the Fed decides to increase interest rates it will have an enormous impact on the financial markets
- Employment and economic growth data has been encouraging

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3. FED ACTION ON INTEREST RATES..contd

- Most analysts expect the Fed to start increasing rates from 2015, with its June 17 meeting being the most likely date for the first increase
- Members of the Federal Open Market Committee (FOMC) - the rate-setting body within the Fed also provide their expectations for future rate levels using the now-famous "dot plot“. Currently, the members' average expectation is for rates to hit 1.27% at the end of 2015, 2.68% in 2016, 3.54% in 2017, and 3.79% in the long run.
- **We expect:**
- **That Fed may at best hike rates by 25 bp in 2015. And this may also be towards the later part of the year.**

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4. KEY REFORMS ANNOUNCED

- **FDI :** The **Insurance Laws (Amendment) Bill** aims to raise the ceiling on foreign direct investment (FDI) in insurance to 49 per cent from the current 26 per cent limit.
  - Increase FDI limit in **Railways and Defence**
- Fiscal/Budget: **Raised passenger and freight railway fares**
- '**Make in India**' Program: Focus on Mining, oil & gas, aviation, textiles & garments, autombile, leather, biotechnology, roads, highways, thermal power, renewable energy, defence manufacturing, pharmaceuticals, electrical machinery, ports and railways.
- **PM Jan Dhan Yojana:** Unveil an initiative to improve access to financial services for the two-fifths of Indians who lack a bank account and are often at the mercy of moneylenders who charge extortionate interest.
- The nationwide **Swachh Bharat Abhiyan** that aims to improve the cleanliness in the country in the next five years.

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KEY REFORMS EXPECTED

- **Passage of important bills**
  - Amendment to **Land Acquisition**: It will make the procurement of land for industrial activities easier and faster
  - **Goods and Services Tax**: This will allow the movement of goods across the nation in a structured manner. Some estimates suggest that once fully implemented nationwide, GST has the potential to add around 100-150 bps to GDP by FY2018-2019 (assuming it gets implemented in 2016).
  - Amendment to **Companies Act**:
- **Telecom Spectrum Auction**
- **Coal Sector Reforms:**
  - Auction of 72 coal mines which were de-allocated by the Supreme Court is likely to be completed by March 2015. The government targets to raise Coal India's production from 462 MT in FY14 to 925 MT in FY20 (12% CAGR) and India's total production from 565 MT in FY14 to 1200 MT in FY20 (12% CAGR). Coal India target output for 2015 is 510 MT
  - Coal block auction is also likely to bring in about Rs 3,000 crore into the government coffers hence helping it to reduce fiscal deficit

KEY REFORMS EXPECTED

- **Telecom Spectrum Auction:**
  - Any company holding a universal service license to provide telephony services or eligible to obtain the services can bid in the auction likely to take place in February 2015.
  - The government had generated about Rs 62,162 crore from the last auction of the 2G spectrum in February 2014.
  - 3G spectrum may also be put on auction simultaneously in February 2015 along with auction of other bands.
  - The auction may fetch almost Rs 100,000 crore to the government
- **Manufacturing reforms:**
  - India ranks 134 out of 180 countries as per World Bank's Ease of Doing Business Survey. The 'Make in India' campaign should help in improving this
  - To create 100 million additional jobs by 2022 in the manufacturing sector
  - Increase manufacturing sector growth to 12-14% per annum in the medium term

5. GDP GROWTH MOMENTUM

- **After touching a low in Q1 of CY2013 GDP has improved over the last 2 quarters**
- **Growth projections by different agencies:**

Agency	2014	2015
IMF	5.6	6.4
World Bank	5.6	6.4
Nomura	5.5	6.6
ADB	5.5	6.3
UN	5.4	5.9

- **We expect: the GDP growth in FY 16 to be around 6.5%**

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6. INFRASTRUCTURE

- Major announcements made in the Union Budget 2014-15:
- Rs 7,060 crore allocated for 100 new ‘Smart Cities’
- Rs 100 crore to set up National Industrial Corridor Authority to coordinate development of industrial corridors with smart cities
- Rs 500 crore for ‘Digital India’ initiative to set up broadband network in villages and promote local manufacturing of hardware and software products
- 15,000 km of additional pipeline to be developed through PPP mode in order to complete the gas grid
- Rs 50,000 crore for urban infrastructure projects. Metro projects in cities with 20 lakh people
- NHAI to target 8,000 km of road development
- Announced development of Metro rails in PPP mode; Rs. 100 crore set aside for metro scheme in Ahmedabad and Lucknow
- Airports to be developed and modernized in tier 1 and 2 cities. Allocated Rs 11,635 crore to develop existing ports & harbours and award 16 new port projects.
- Rs 500 crore for ultra mega solar power projects in Rajasthan, Gujarat, Tamil Nadu and Laddakh in J&K.

Infrastructure…contd

– The ministry of road transport and highways approved road projects worth about Rs 40,000 crore in 2014 and set a target of building 30 km of roads a day from 2016 .
– In Aug 2014 the government got Cabinet approval for 100% FDI in Railway infrastructure (construction, operation and maintenance in specified Rail Infra projects)
– As many as 189 highway projects with a total cost of around Rs. 1,80,000 crore were stuck when the government came in power due to problems such as land acquisition issues, clearance delays, etc.

Our View:

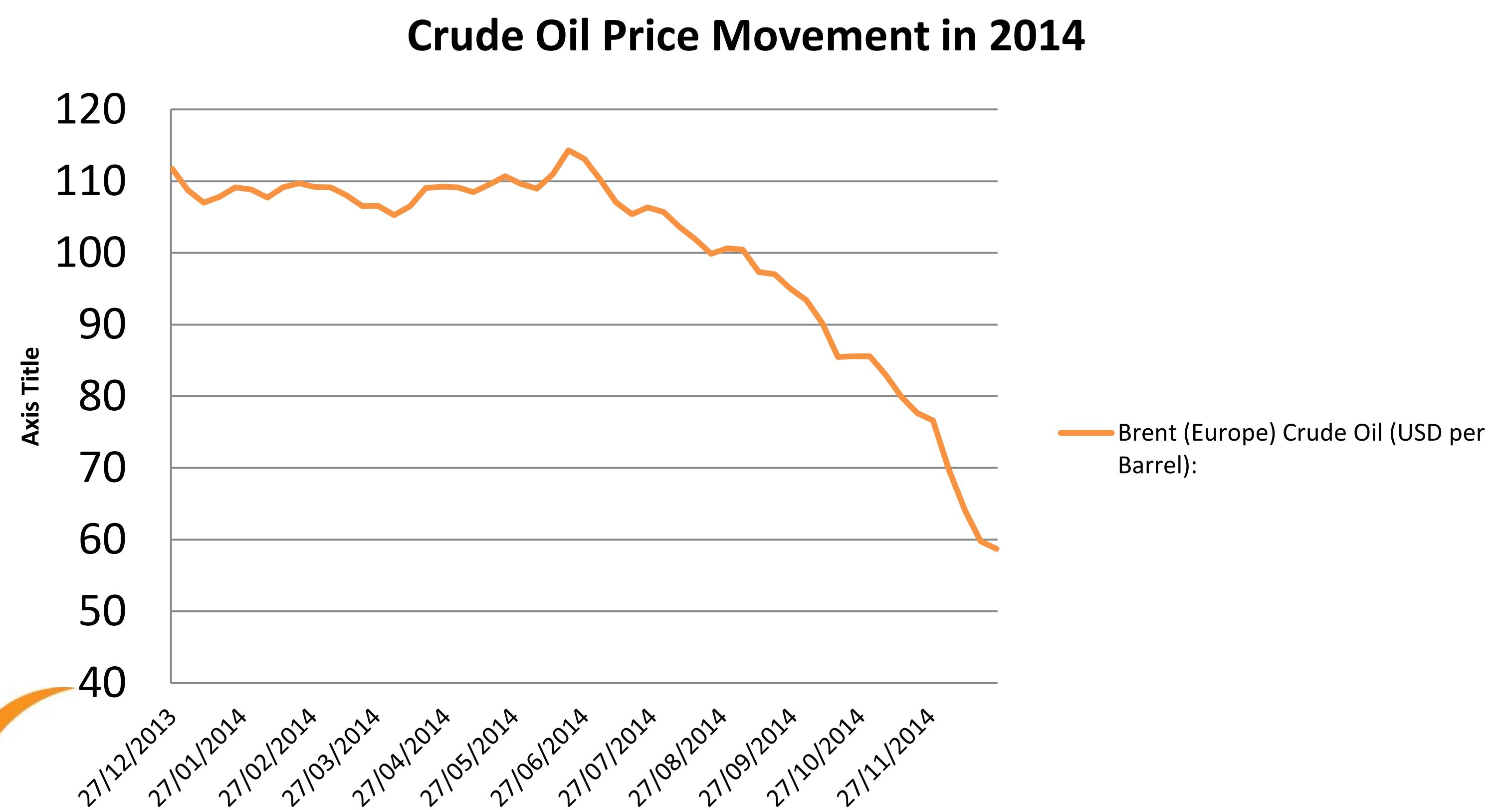
– **The government will focus on reviving stalled projects**
– **Aggressive Expenditure may be constrained due to very high fiscal deficit**
– **Government will focus on getting funding for infrastructure projects**

7. CURRENCY MOVEMENTS

- **2014 was stable for the Indian Rupee after a volatile 2013**
  - In CY 2014 the Indian Rupee depreciated by 2.6% ending at Rs. 63.38 against the US Dollar
  - The movement can be divided into 2 parts – It appreciated by 5.7% upto 23rd May to 58.28/USD after which it started depreciating. The depreciation from the high of 58.28 was 9%.
  - Strengthening of dollar contributed the depreciation to some extent
- **Factors which may contribute favourably to INR in 2015**
  - Revival in economic growth
  - Lower commodity prices (especially crude oil) which will lead to better trade balance
- **Risk: Fed increase in rates and strengthening of USD**
- **We expect: Rupee to volatile against the Dollar in the 1st half of 2015 and gradually strengthen to end the year with an appreciation**

8. CRUDE OIL & COMMODITY PRICES

- Crude oil prices nosedived in 2014.



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- **The following factors have been contributing to the oil price decline:**
  - Weak demand due to slower pace of economic growth, increased efficiency and switch to alternative fuels
  - High supply
    - OPEC (Organisation of Petroleum Exporting Countries) which controls nearly 40% of the world market remained undecided in its November meeting on whether to curb production. A production cut by OPEC can result in a spike in oil prices
    - Turmoil in Iraq and Libya has not affected their output
    - Saudi Arabia and its Gulf allies do not wish to sacrifice their market share in order to restore the prices. If they curb supply the main beneficiaries would be Iran and Russia which they do not want. They are in a position to live with low oil prices
    - US now imports much lesser oil as it has become the world's largest oil producer
- **Forecast**
  - **Oil prices are likely to remain subdued. Can be expected to be in the range of USD 55 -65 for most part of the year.**

- **Impact on India**
  - Crude oil and petroleum products make up around 34% of India's import bill. Lower crude prices, therefore, augur well for India's Current Account Deficit. According to estimates, USD 1/bbl fall in crude leads to an approximate saving of USD 1 billion per annum
  - Lower petrol and diesel prices will reduce inflation
  - It will give additional room to the government to increase excise duties on petroleum products, hence positively impacting fiscal deficit
  - Lower import bill combined with lower inflation will help in improving the value of the Indian Rupee

9. Global GDP and its implications for India

- According to World Bank, the recovery in high-income economies has been uneven, as some (the United States and the United Kingdom) have exceeded pre-crisis output peaks, but others (the Euro Area) are still below earlier peaks.
  - Middle-income economies have also been less dynamic than in the past for cyclical reasons, but also due to a structural slowdown.
  - Low-income countries continue to grow at a robust pace, despite a challenging global environment.
  - The key features of the lackluster global recovery have been accommodative monetary policies, falling commodity prices, and weak trade.
- Lower growth in China:
  - Slower growth in China will have important regional effects, which partly explains the downward revisions to growth in much of emerging Asia. The impact on India is offset by the boost to trade from lower oil prices.
- The World Trade Organization (WTO) has cut its 2014 global trade growth forecast to 3.1% (earlier estimate of 4.7%) and expects it to grow at 4% in 2015.
- Some improvement in global growth and recovery in industrial growth will drive the services sector growth in India
- The hope of exports growth recovering to 8-10% has faded due to weak and uneven global recovery.

10. Volatility and investor reaction to it

- Global factors will be the major source of volatility is the Indian markets
  - Primarily driven by developments in the financial markets of Europe and USA
  - Portfolio flows may be affected by these factors
  - “Risk on” and “risk off” approaches will influence local sentiments also
- Political developments, including state elections will have a bearing on the markets

Legislative Assembly Elections	Date
Jharkhand	Jan-2015
Jammu & Kashmir	Jan-2015
New Delhi	Feb-2015
Bihar	Nov-2015

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Volatility and investor reaction to it

- Sensex/Nifty movements of 8-12% may recur number of times
- This will restrain wholesome local participation in the India growth story
- At the same time investors will learn to live with volatility.

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OUTLOOK ON ASSET CLASSES

- **Equity vs Debt**
  - The Sensex/Nifty gave a return of 30% in 2014.
  - Most research houses expect Sensex to be in the range of 33,000 to 35,000 by December 2015
  - **We expect: While both equity and debt look attractive, equity will outperform debt**
  - **Within equity, mid and small cap stocks will outperform**
- **Financial Assets vs Real Assets**
  - **Financial assets likely to out perform gold and real estate**

VALUATION

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Valuation

- Markets are ruled by Liquidity and Events in the short term but by valuation in the long term
- Sensex EPS (earnings per share) forecast:

FINANCIAL YEAR	EPS (earnings per share) Rs	Implied Growth in earnings
FY 15	1525	18%
FY 16	1850	18%
FY 17	2200	20%

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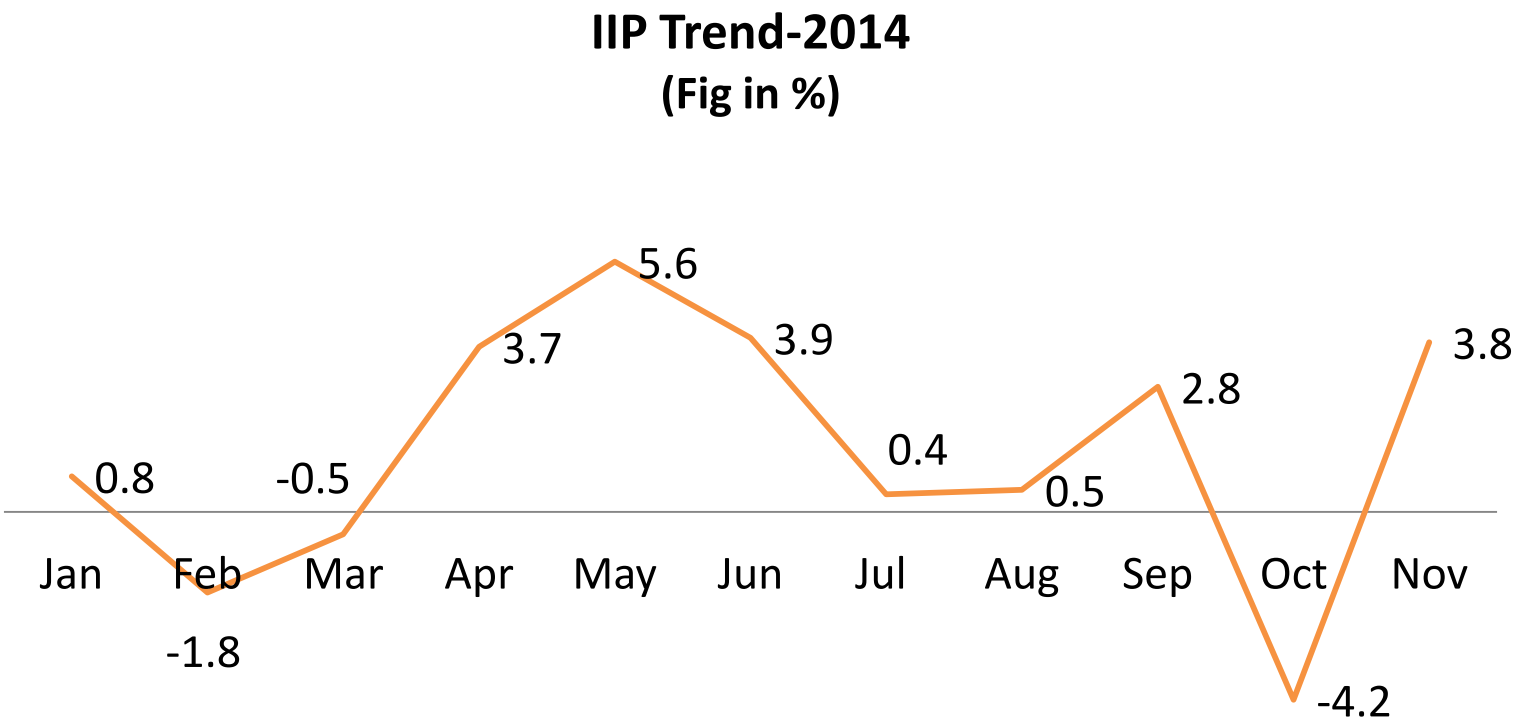
IIP Trend


IIP Trend-2014
(Fig in %)
0.8
-1.8
-0.5
3.7
5.6
3.9
0.4
0.5
2.8
-4.2
3.8
Jan
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov

Earnings outlook

- The delay in faster on-the-ground action my the Government has deferred revival in the economy
- The earning growth outlook for FY 15 is therefore likely to be revised downward
- Base effect will impact FY 16 and FY 17 projections
- Q2 FY16 will be the acid test for the markets for sustainability of the index levels supported by valuations.
- Budget 2015 and faster execution on the ground will be important to keep the sentiments alive.

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Thank you

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