

INVESTMENT MATTERS

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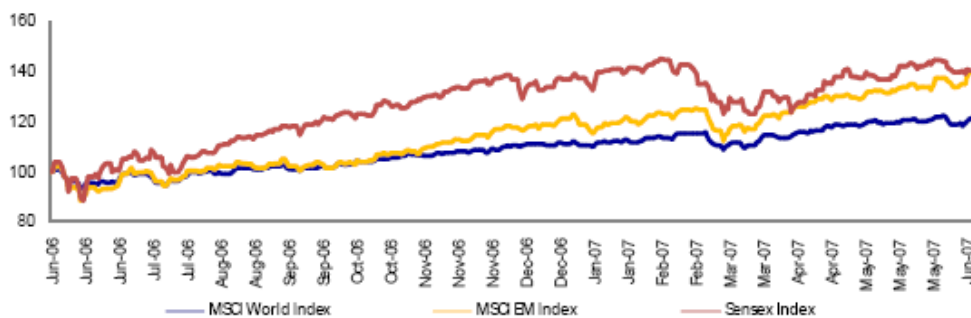
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Markets Ready for Olympics? Broader, Deeper, Stronger

Rising bond yields and hardening oil prices had only a temporary impact on global equity markets, as the MSCI World and MSCI Emerging markets equity indices continue to make new highs. India, in the recent past, responded hesitantly and continues to be amongst the bottom of the emerging market universe in terms of YTD 2007 performance. We maintain 2007 could be the year of consolidation for Indian equity markets. Hence, both domestic as well as foreign institutional investors continue to maintain a very cautious and relatively inactive stance - slapped into action by the occasional rallies in response to strong showing by other Asian markets (of which China is clearly the current leader).

MSCI World and EM indices



Source: Bloomberg

One of the oft mentioned reasons for a cautious outlook for the Indian markets - apart from the usual 'India looks expensive' (which I dealt with in reasonable detail in my communiqué of Oct 2006) - was the spate of large sized IPO' hitting the market and hence potentially crowding out investments from the secondary markets. Last month I did mention that I did not believe that should be the case. The current perception that large IPOs will impact the markets negatively is borne out by the historical experience of investors - when the markets were not as broad and deep, the number of institutional players, both domestic well as foreign were limited and there was a near absence of specialist funds.

Table 1

| (\$ billion) | Average Market Cap | FII Flows | MF Flows | Total Flows | IPO/ Rights | IPO as % of market cap |
|--------------|--------------------|-----------|----------|-------------|-------------|------------------------|
| CY2003 | 215.5 | 9.0 | 2.0 | 11.0 | 2.0 | 0.93% |
| CY2004 | 312.7 | 14.0 | 6.8 | 20.8 | 6.7 | 2.14% |
| CY2005 | 491.0 | 16.7 | 5.1 | 21.9 | 6.0 | 1.22% |
| CY2006 | 743.8 | 12.9 | 0.2 | 13.1 | 7.4 | 0.99% |
| YTD | 945.0 | 9.6 | 0.4 | 10.0* | 14.0 | 1.48% |

* (number will get adjusted upwards as allotment to FII's get finalized)

Today, the Indian market is significantly larger - total market cap at \$950 bn is - second highest amongst Asian markets ex-Japan. The number, category and size of institutional investors are significantly bigger and varied. A decade ago the only significantly large domestic players were the Unit Trust of India and the Insurance companies led by LIC. The domestic private MF industry was still very nascent and there were only a handful of long only FIIs like Capital International, Jardine Fleming (now JP Morgan Chase) and Morgan Stanley to name a few. Today the size of the private MF industry is growing, 1050 FIIs have registered with SEBI and there are many hedge funds which are very active in India. Then we have the large private equity funds who participate not only in purely private deals but increasingly in PIPEs (Public Investment in Private Equity) and secondary market offerings. And, there are specialist funds which are dedicated to certain specific sectors like real estate.

Investment Matters

Table 2

| | Average Daily Cash turnover (\$ bn) | Average Daily F&O Turnover (\$ bn) | Average Daily Total Turnover (\$ bn) | Total Market Cap (\$ bn) | FII (%) | MF (%) |
|----------|-------------------------------------|------------------------------------|--------------------------------------|--------------------------|---------|--------|
| FY03 | 0.8 | 0.4 | 1.1 | 125.9 | 6.5% | 2.2% |
| FY04 | 1.4 | 1.9 | 3.3 | 205.3 | 5.9% | 1.9% |
| FY05 | 1.5 | 2.3 | 3.8 | 305.0 | 8.4% | 2.1% |
| FY06 | 2.2 | 4.3 | 6.5 | 494.6 | 8.9% | 2.6% |
| FY07 | 2.6 | 6.8 | 9.4 | 714.4 | 9.2% | 2.4% |
| YTD 2007 | 3.3 | 8.2 | 11.4 | 940.5 | 9.2% | 2.6% |

Table 1 & 2 clearly indicates that the Indian markets have gotten to be broader, deeper, and more institutionalized. While, total monies raised from primary offerings has also increased manifold in absolute terms, as a percentage of total market capitalization it is still well within historical range of 1-2%. The average daily turnover has kept pace with the growth in market capitalization and the share of institutions (FIIs & MFs) continues to grow (8.7% to 11.8%). Therefore, it would be erroneous to just look at absolute numbers and fret over the size of the monies raised. In fact this, I believe, is just the beginning of the trend. All we need to be mindful of, always, is the quality of paper being issued!

Global Equity Market Performance

| Index Performance as on 20-June-07 | 1 month | 3 months | 6 months | 1 year | YTD Returns |
|------------------------------------|---------|----------|----------|--------|-------------|
| Emerging Market Indices | | | | | |
| a) BRIC countries | | | | | |
| Brazil Bovespa | 4.9 | 23.2 | 25.6 | 62.5 | 22.9 |
| Russian RTS | 2.3 | 3.9 | 2.0 | 39.8 | -1.0 |
| BSE Sensex | 0.7 | 13.4 | 8.0 | 46.7 | 4.5 |
| China Se Shang Composite | 7.6 | 56.6 | 127.4 | 200.6 | 126.0 |
| b) Other EM | | | | | |
| Korea Kospi | 10.6 | 23.5 | 23.7 | 45.5 | 24.4 |
| Taiwan TAIEX | 9.0 | 13.2 | 14.5 | 37.6 | 11.9 |
| KL Composite | 1.8 | 14.6 | 28.3 | 55.2 | 26.0 |
| Stock Exch of Thai | 6.1 | 15.1 | 11.8 | 19.5 | 13.7 |
| PSEi - Phillipine Se IDX | 7.8 | 22.4 | 31.4 | 79.8 | 24.7 |
| Chili IPSA | 4.7 | 15.3 | 26.2 | 66.8 | 26.6 |
| Mexico BOLSA | 4.5 | 17.0 | 26.3 | 80.3 | 21.2 |
| Venezuela | -2.2 | -19.3 | -18.1 | 28.2 | -25.2 |
| Developed Market Indices | | | | | |
| Japanese Nikkei 225 | 4.7 | 6.1 | 7.1 | 24.3 | 5.7 |
| Dow Jones Indl Avg. | 0.6 | 11.0 | 9.4 | 24.2 | 9.4 |
| Nasdaq Composite | 2.7 | 9.1 | 8.2 | 24.7 | 8.8 |
| German DAX | 6.5 | 21.0 | 23.0 | 47.5 | 22.8 |
| UK: FTSE 100 | 0.5 | 7.3 | 7.7 | 18.0 | 7.3 |
| Singapore: Straits Times | 3.5 | 16.7 | 24.5 | 56.2 | 21.8 |
| HK: Hang Seng Index | 3.7 | 12.0 | 12.7 | 38.9 | 8.6 |

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