

# INVESTMENT MATTERS

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## Apocalypse Now??? No, not Now...

The past month has been very eventful for India. The Indian economy crossed a significant milestone - \$1 trillion GDP - making it the 10th economy in the world to achieve this. Its early acceleration to the "elite club" was courtesy the strengthening rupee which has appreciated by a significant 6.4% since the beginning of the year.

After being one of the top performing markets for four years, since January this year, the Sensex has dramatically underperformed the world indices on an YTD basis. This we believe is a result of two broad factors - the numerous headwinds (as discussed in our previous series) faced on both domestic and global fronts and the fact that periodically weak/strong markets do tend to underperform/outperform in comparison to their previous state. The table below clearly illustrates that the Chinese markets underperformed dramatically between 2003 and 2005, but have delivered very strong returns in 2006 and ytd. Similarly both Russia and India outperformed dramatically between 2003 and 2006 and are now underperforming some of their peers. So will we back in the reckoning and at the top of the league tables?

The table below shows the global markets since 2003.

Country	YTD	2006	2005	2004	2003
China	104.55%	97.53%	-11.74%	-16.59%	-2.60%
Malaysia	23.50%	21.83%	-0.84%	14.29%	22.84%
Chili	20.79%	37.10%	9.35%	20.99%	48.48%
Brazil	15.35%	32.93%	27.71%	17.81%	97.33%
Mexico	13.40%	48.56%	37.81%	46.87%	43.55%
Indonesia	13.04%	55.30%	16.24%	44.56%	62.82%
Philippines	12.06%	42.29%	14.99%	26.38%	41.63%
Korea	11.52%	3.99%	53.96%	10.51%	29.19%
Thailand	4.27%	-4.75%	6.83%	-13.48%	116.60%
Hong Kong	4.01%	34.20%	4.54%	13.15%	34.92%
Taiwan	3.49%	19.48%	6.66%	4.23%	32.30%
<b>India</b>	<b>1.23%</b>	<b>46.70%</b>	<b>42.33%</b>	<b>11.62%</b>	<b>72.23%</b>
Russia	-0.35%	70.75%	83.29%	8.26%	57.98%
Venezuela	-15.38%	156.11%	-31.91%	34.90%	177.02%

While I believe eventually we will, but not before we have done some hard work, consolidated and earned our way through. 2007 therefore could be our year of consolidation on a broad market basis.

There are generally two kinds of market corrections, price-wise and time-wise. In a price-wise correction the markets correct sharply and rebound quickly to deliver strong returns at the end of it all. So if one did not consider the intermediate period, the year end picture would still seem as if all was well in the end. The classic example was the correction in May-June 2006. While the correction was deep, the year 2006 still ended with a good 47% return on a market wide basis! In a time wise correction the market trades in a range, delivering either moderate gains or losses. This year to my reckoning we could experience a time wise correction on a broad market basis. Whether we would post moderate gains or losses would depend on several factors. While we were in double digit negative territory early in the year we have been able to clip back because global markets are on a tear. So if the global equity markets continue their strong performance then we are fine.

## Investment Matters

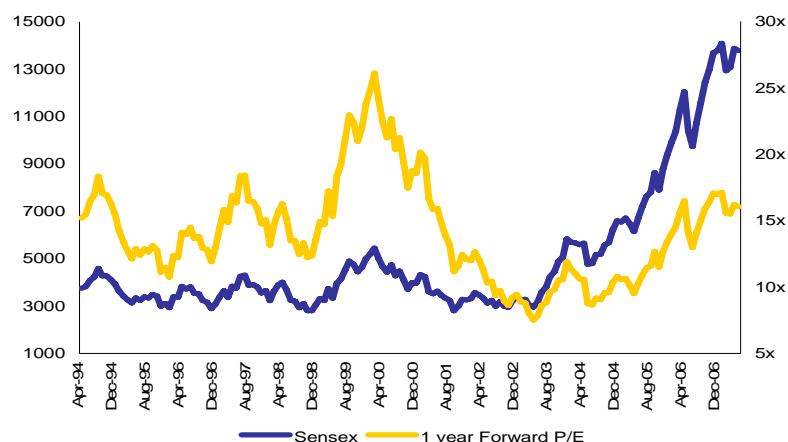
Also some of the headwinds could be turning favorable, atleast at the margin. The yen has slipped back to the 119-120 levels so the carry trade continues, subprime lending hasn't exploded in the face, Oil prices have lost momentum and inflation in India has moderated to 5.6%. On the domestic front Mayawati has won a clear majority in UP - which means political impact on markets would be neutral and not negative as many anticipated and Mr.Chidambaram has been able to quietly slip in a 10% stake sale in Maruti. With inflation receding interest rates could well be peaking out and should stay stable for a while. On the flipside there is a significant amount (\$7-8 bn) waiting to be raised from IPO's - ICICI Bank, ICICI Holdings, DLF and Tata Steel. While by historical standards it is a large amount, Indian markets do have the depth to take this in their stride. The other bug bear for international investors was the relatively expensive valuations (which we have consistently disputed in the past and continue to do so) of India amongst the peer group, the table below illustrates that this is no longer the case as well.

As we have consistently in the past, positioned our investment strategy to deliver absolute returns against this backdrop and will continue to focus on individual stock picking opportunities to drive returns.

*[Valuation wise also India seems to be attractive compared to the other Asian markets. The Sensex' ex-oil growth is 22% and RoE at 25.3% despite higher capex as margins are still robust- 12M forward P/E of 16x and P/BV of 3.8x for such growth/RoE is attractive in our view]*

Country	EPS Growth (%)		PE (x)		PB (x)		RoE (%)		Div Yield (%)	
	2007F	2008F	2007F	2008F	2007F	2008F	2007F	2008F	2007F	2008F
South Korea	13.2	20.5	12.4	10.3	1.5	1.3	12.8	13.9	1.8	1.9
Taiwan	19.6	14.7	14.2	12.4	2.2	2.0	15.2	15.9	3.7	4.2
Hong Kong	17.3	7.3	12.2	10.7	2.2	2.1	14.7	15.3	3.2	3.8
China	21.3	19.4	17.8	14.9	2.8	2.5	16.0	17.0	2.3	2.7
Singapore	11.5	10.6	17.9	16.2	2.3	2.1	12.8	13.1	2.8	3.1
Malaysia	13.3	7.2	17.6	16.5	2.6	2.3	18.4	18.0	3.1	3.1
Thailand	2.0	11.5	9.7	8.6	2.5	2.2	16.9	17.0	4.9	4.8
Indonesia	23.0	10.1	14.6	12.1	4.4	4.5	24.2	24.7	3.4	3.3
Philippines	13.4	4.3	14.7	14.1	2.2	2.5	15.2	17.9	2.1	1.9
Vietnam	10.0	8.0	39.5	36.2	3.8	3.6	20.2	19.6	1.1	1.0
Australasia	9.0	4.0	16.3	15.5	2.8	2.6	17.3	17.0	3.6	3.9
Pakistan	12.0	11.6	11.0	9.9	2.7	2.4	25.4	25.7	4.8	5.2
<b>India</b>	<b>16.5</b>	<b>10.3</b>	<b>16.8</b>	<b>15.2</b>	<b>3.7</b>	<b>3.3</b>	<b>24.3</b>	<b>23.1</b>	<b>1.5</b>	<b>1.6</b>

Source: Merrill Lynch



Source: Alchemy