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Collateral Damage to Collateral Advantage!

Medicine for one has proven to be sugar syrup for another. That is what it has all turned out to be finally.

The problems in the sub-prime, housing and the credit markets had made equity markets very nervous in July and mid – August. I was fortunate to be right there in the midst of it all in early August during my trip to NY. During my interactions with the financial community there – the message was very clear – that as far the credit markets are concerned the problems are serious and that people associated with those markets had not seen or experienced anything like this in their past 20 years of industry experience. The credit markets in the US had literally shut down in August. Past experience has shown that high correlation amongst various markets would have meant negative fallout for equity markets as well. But that was not to be. The price action in the equity markets globally and more particularly in Asia and emerging markets – clearly show that the problems in the credit markets are not able to weaken the strength in equities. As a erstwhile colleague and a very dear friend (who currently runs a $30bn long only emerging markets fund) and who's views I respect a lot – put it very succinctly – "the reason why equity markets have not got impacted as widely expected is because global equity valuation still remain reasonable, there is no bubble like situation that would warrant an implosion and corporate fundamentals still remain very strong". Hence what we could be witnessing now is a probable decoupling between credit and equity markets.

Moreover, the central banks have been very proactive in responding to the crisis. Yesterdays fed fund and discount rate cut of 50 bps was aimed at easing the liquidity problems that the credit markets were facing and in response to the recent performance of the US economy. But the collateral advantage of this is that – this new liquidity should find its way to emerging equity markets. While we did mention in the previous Investment Matters of Asia decoupling – that now seems to be happening as the data on market behavior in recent times suggest.

But more than just strategists and commentators talking about it – the participants i.e. the institutional investors who actually manage large pools of money in Asia believe and are acting on this conviction. (I would strongly recommend readers to read this interview that appeared on CNBC in India called Asia Tigers -http://www.moneycontrol.com/india/news/mf-interview/asian-valuations-goodgrowth-attractivejf-am/04/10/302529

Country	24th July- 20 Aug	21st Aug- 19 Sept
China	14.47%	8.33%
Philippines	-3.75%	6.17%
Korea	-8.00%	9.59%
Russia	-8.66%	9.50%
Indonesia	-9.52%	16.07%
Malaysia	-9.56%	5.33%
Chili	-9.66%	1.02%
India	**-10.09%**	**16.68%**
Taiwan	-10.69%	5.28%
Hong Kong	-11.81%	17.60%
Mexico	-12.61%	7.12%
Venezuela	-13.10%	-4.78%
Thailand	-14.97%	6.20%
Brazil	-22.18%	13.75%

Closer home the only significant data point was the IIP (index of industrial production) data – which showed a slowdown in July 6.3% v/s 10.9%. This slow down was primarily in consumer durables and two wheeler sectors. That in many ways can be explained by a combination of high base effect in July 06 and a result of the tightening by the RBI early this year. This slowdown in industrial production data (though temporary according to us), coupled with the fed rate cut has given enough ammunition for people to expect the RBI to ease. While I do believe that we have reached a peak of the interest rate tightening cycle, I would be cautious on rate easing in India too soon - we need to see a continuation of a sustained moderation in inflation – especially since oil prices have climbed back to over $80/bbl.

Over the past several months, I have commented consistently on broad markets, linkages of Indian markets to global events/markets and many other such macro phenomenon. I feel that by now our investors would have got a broad drift of our convictions – our long term faith in emerging markets in general and India very much in particular. Over the next few months, I wish to deliberate more on the micro – an area of great interest to me – the kind of opportunities in India, the dynamism of its entrepreneurs, our experiences as these companies have grown, reflection of our hypothesis/assumptions going right and wrong, trends that are emerging in various industries/sectors and so forth. Not only will this give you a specific flavor of the opportunities but will also give you peak into our thought process. I hope you will enjoy and benefit from it.

Global Equity Market Performance

Index Performance as on 19-Sept-07	*1 month*	*3 months*	*6 months*	*1 year*	*YTD Returns*
Emerging Market Indices					
a) BRIC countries					
Brazil Bovespa	16.7	3.5	32.6	55.3	27.4
Russian RTS	7.4	5.4	9.7	27.5	4.0
BSE Sensex	15.4	15.9	31.3	35.2	18.4
China Se Shang Composite	14.8	18.5	92.3	246.5	170.6
b) Other EM					
Korea Kospi	16.2	5.3	33.2	38.4	32.6
Taiwan TAIEX	10.3	4.1	15.6	29.7	14.1
KL Composite	8.9	-5.5	9.7	34.3	18.3
Stock Exch of Thai	7.0	6.0	21.0	15.0	19.4
Jakarta Composite	21.2	8.8	30.1	56.9	28.1
PSEi - Phillippine Se IDX	16.6	-8.6	9.8	34.4	12.8
Chili IPSA	4.4	-5.8	8.6	41.9	17.6
Mexico BOLSA	7.3	-5.0	13.8	41.3	15.7
Venezuela	-5.3	0.3	-22.0	9.4	-26.5
Developed Market Indices					
Japanese Nikkei 225	7.3	-9.7	-2.2	3.2	-4.9
Dow Jones Indl Avg.	5.0	0.9	13.5	18.9	10.2
Nasdaq Composite	5.9	1.0	11.8	18.6	9.8
German DAX	4.7	-3.9	17.4	30.3	17.1
UK: FTSE 100	6.0	-4.1	4.8	9.1	3.3
France: CAC 40	5.9	-6.7	5.5	10.3	2.5
Singapore: Straits Times	14.8	-0.8	17.1	40.8	20.4
HK: Hang Seng Index	25.3	18.4	34.8	47.0	28.0