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Investment Matters

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EQUITY OUTLOOK FROM CIO'S DESK

Indian markets are at new highs with every successive opinion poll confirming the BJP led National Democratic Alliance (NDA) moving closer to the majority mark of 272 seats needed to win the general elections. Not only has BJP's own seat tally increased from 161 in July-13 to 212 in March-14, with a large swing expected in its favour in the Hindi Heartland, but they have been successful in smartly attracting regional allies brushing across party differences. As per the polls, the NDA alliance will still need some outside support to form the government but the given the momentum in their favour, we believe it should not be a big challenge.

Latest opinion poll indicate NDA nearing the majority mark

Party	Lok Sabha Current	Avg of polls	Swing	CNN IBN & CSDS					C-Voter				ABP News - Nielsen			NDTV Hansa	
				Jul-13	Oct-13	Jan-14	Feb-14	Mar-14	Jul-13	Oct-13	Jan-14	Feb-14	Jan-14	Feb-14	Mar-14	Feb-14	Mar-14
UPA	228	119	-109	153	138	117	129	117	136	117	103	101	101	92	119	129	123
Congress	206	98	-108	135	120	100	102	100	119	102	91	89	81	73	91	106	104
Congress allies	22	21	-1	18	18	17	27	17	17	15	12	12	20	19	28	23	19
NDA	133	252	119	176	191	221	222	256	156	186	212	227	226	236	240	229	259
BJP	116	212	96	161	175	201	203	212	131	162	188	202	210	217	209	195	214
BJP allies	17	40	23	15	16	20	19	44	25	24	24	25	16	19	31	34	45
Others	182	172	-10	214	214	205	192	170	251	240	228	215	216	215	184	185	161
Total	543	543	0	543	543	543	543	543	543	543	543	543	543	543	543	543	543

Source: Media, MOSL

Note: Mar-14 projections for CNN-IBN and CSDS and ABP News – Nielsen includes TDP seats as predicted by these polls conducted before the announcement of the alliance. NDTV Hansa Research already included TDP in the NDA alliance

While current investor sentiment is extremely bullish citing "Modi Rally", the seeds of this rally were sown in Sept-13 when the Congress led UPA under pressure of the depreciating INR and pressure from global rating agencies to avoid a downgrade undertook a series of steps to curb India's Fiscal and Current Account Deficit (CAD). With help from the able stewardship of Raghuram Rajan as the RBI governor they were able to convincingly stabilise the INR. We would probably not have been such a strong so called 'Modi Rally' had the CAD been high and INR volatile.
So what can Narendra Modi as a potential Prime Minister bring to the table on top of some good work already done over the past 7-8 months?

A growth focussed Vision for the country compared to the practice of populist doles like subsidised food, water, power etc. Economic growth is the need of the hour to solve our problems.

Modi's chief ministership of Gujajrat has shown him to be a very decisive leader. Modi's decision making style is to get all concerned people in a room, debate the problem over 6-8 hours with all concerned members present and end with a decision on the way forward and monitor its implementation over subsequent months. This is in contrast to the current practice of first letting the problem explode in their faces, delay any decision, setup up committees to find solutions, delay a little more until the Supreme Court brings the issue under its ambit.

He bridges the Credibility Deficit that the current Government has lost over the last few years.

EQUITY OUTLOOK FROM CIO'S DESK

Being a Chief Minister Modi understands the need to work with states to bring critical legislation into effect. Most big reforms in India come under the purview of the state. This understanding should help him to fast track implementation of the much discussed reforms whether it is Goods & Service Tax (expected to drive 100-200 bps improvement in economic growth), Direct Tax Code (simplify taxation), Mining Policy, Infrastructure programmes, reviving the manufacturing sector, unshackling the potential of the agricultural sector etc. and restoring domestic and foreign investor confidence .

A new effective leadership brings hope to both corporate and individuals for a better economic future helping reverse the Vicious cycle of 2011-13 where external capital dried up for India due to policy paralysis which lead to slower growth, strained balance sheets, mounting non-performing loans for the banking sector and reduced employment to a more Virtuous cycle of faster decision making, ample capital, thereby helping deleveraging corporate balance sheets (Already seeing Tata Steel, Jaiprakash Associates, GMR Industries to name a few sell down assets to pare debt) and strengthening of the financial system to help fund economic growth.

The last few years have seen corporates retool their cost structures and balance sheets for the current normal of low growth. Any sustainable pickup in growth will help companies kick in operating leverage and thus drive earnings growth over next 2-3 years. For e.g. Maruti Suzuki, a portfolio company (and like several others), over the past three years has been on a huge indigenisation and cost cutting drive while simultaneously investing in R&D to bring at least one new model to market every year for next 4-5 years. While new model launches have just begun, with the successful launch of Celerio AMT, lack of volume growth has not allowed operating leverage to kick-in which should eventually occur over the next 2-3 years as confidence in the economy increases.

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DEBT OUTLOOK

Macroeconomic indicators have provided some relief with better series from inflation (CPI at two year low) and current account deficit (CAD at 0.9% - lowest in 8 years). Food inflation was at a 10-month low. The Rupee continues to benefit from incremental improvement in external sector account, increased market confidence in the central bank, hopes for a stable, progressive government after elections and also strong FII flows. Rupee today stands privileged to be one of the best performing and least volatile currency within the emerging market basket over the last couple of months.

In First Bi-Monthly Monetary Policy Statement for FY 2014-15, RBI maintains the status quo on policy rates with the broad direction of policy setting influenced by the Dr Urjit Patel committee recommendations. The RBI has also announced additional measures to further refine the liquidity management operations, In line with the recent RBI stance of de emphasizing guaranteed liquidity access at the overnight Repo window, the access to overnight LAF has been reduced to 0.25% of NDTL, along with increase in term repo under 7 and 14 days to 0.75% of NDTL. The RBI has also restricted debt FIIs from investing in Treasury Bills, with incremental investment allowed only in Government securities with residual maturity of 1 year and above. The RBI has also cautioned about the year-end window dressing by banks, which have resulted in liquidity tightness and also abnormal moves in various segments of the financial market. The RBI is expected to announce proposals to mitigate these practices.

In terms of policy guidance, the RBI reiterated that stance will be firmly focused on achieving the disinflationary glide path that sees CPI at 8% by January 2015 and 6% by January 2016. At this juncture, it assesses it appropriate to hold rates at current level, allowing previous tightening to have effect in the economy. Moreover, it guides that if inflation continues along intended glide path, further tightening is not anticipated at this juncture. A more directional stance on rates would be primarily dependent on the new government’s fiscal stance, with external sector developments also influencing the outlook on inflation. A more pro active liquidity management as seen in the last few months with term repo being the primary instrument would ensure that the overnight rates remain in line with the prevailing policy stance and also the short end of the curve remains well anchored in the absence of any additional liquidity premium.

RBI also issued Borrowing calendar for the first half of this fiscal year. H1 gross borrowing pegged at INR 368,000 crores and net borrowing at INR 293,000 crores (comparable figures of INR 344,000 crores and INR 269,000 crores respectively for H1 last year). These constitute 62% of gross borrowing and 64% of net borrowing respectively (versus 61% and 57% respectively for last year). The resumption of Government borrowing after a gap of almost 2 months would have its own challenges in terms of absorption in the absence of both rate cut and OMO expectations. Also the possibility of review in borrowing numbers in the full year Budget post elections.

Given the RBI stance on achieving the disinflationary glide path that sees CPI at 8% by Jan 2015 and 6% by Jan 2016 and continuous supply of Govt. securities we expect yields will be range bound between 8.75% to 9% for coming month. High short term rates would continue in April and May so we believe FMP and accrual strategies will keep giving attractive yields. As long term yield i.e. 10 Year G-sec is trading above 9% we suggest 15-20% allocation in long term bonds.

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