ALCHEMY
PRIVATE WEALTH

Investment Matters

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BESPOKE
FINANCIAL EXPERTISE
TO MAKE THE RIGHT
MOVES, MORE OFTEN.

EQUITY OUTLOOK FROM CIO'S DESK

Equity markets have remained in a broad range of Sensex 14500 to 21000 for the past 7 years since 2007. During these 7 years corporate earnings have grown by 80% on an absolute basis and 8.7% CAGR. Valuations on the other hand have come down from a high of 24X PE in 2007 to current 14XFY15 estimated earnings. Corporate profits have compounded at single digits – CAGR 8.7% and valuations are still below long term averages. Our meetings with corporate houses across a cross section of industries – manufacturing/capital goods/cement/metals/financials as well as consumer discretionary including some financials indicate that a large number of them have now re-tooled their cost structures to be in sync with lower growth. Those in stressed sectors like infrastructure and highly leveraged companies have also embarked on the process of asset/business restructuring and de-leveraging. This we believe now sets a good base for corporate profits to grow at a higher rate when growth picks up and operating leverage kicks in.

We are of the view that the worst is over in terms of slow earnings growth and incrementally corporate performance will improve with Q3FY14 earnings growth till date at >15%. Consensus is building in a 12-16% earnings growth for Sensex companies for the 2HFY14 as well as FY15. We believe there is a high likelihood of these expectations being met. The key positive contributors to such high corporate performance for the next 12-18 months are a few sectors/themes ie IT, Pharmaceuticals, Telecom, Consumer, Auto and Private Banks. With a prospect of a change in the government at the centre post the general elections in May 2014, the current laggards ie PSU Companies, Capital Goods, Infrastructure, Oil & Gas etc may see a change in fortunes and earnings growth trajectory can move up driving the market as well as earnings growth expectations for FY15 and beyond.

Q3FY14 performance till date for our investee companies (See table below) have been very strong with average profit growth being higher than 30%. We expect this strong performance to be sustained going ahead and expect stock returns to reflect the same.

	Sales			Profit After Tax			EPS		
Name of Company	*Q3FY14(Rs Mn)*	*Q3FY13(Rs Mn)*	*% Growth*	*Q3FY14(Rs Mn)*	*Q3FY13(Rs mn)*	*% Growth*	*FY14E*	*FY15E*	*% Growth*
Adani Ports	10798	10420	4%	4495	3649	23%	11	13	20%
AIA Engineering	5262	4160	26%	880	531	66%	31	37	19%
Bajaj Finance	6722	5074	32%	1941	1601	21%	146	180	24%
Bayer Crop Science	6266	5590	12%	430	429	0%	62	75	21%
Bharti Airtel	219385	202395	8%	6102	2837	115%	9	18	106%
Cadila Healthcare	18716.9	16041.1	18%	1859.7	1029	81%	38	52	37%
CMC	5610	5608	0%	705	673	5%	93	117	25%
DB Corp	5182	4389	18%	945	708	33%	18	20	17%
Federal Bank	7018	7012	0%	2301	2108	9%	9	11	17%
Hero Motocorp	68768	61876	11%	5246	4879	8%	106	136	28%
Honda Siel Power Products Ltd	1512.6	1289.1	17%	70.5	60.5	17%	21	34	62%
ICICI Bank	70561	57136	23%	25322	22502	13%	83	100	20%
ING Vysya Bank	6307	5895	7%	1673	1623	3%	45	54	19%
IPCA Labs	8290	7010	18%	1380	1021	35%	44	54	24%
Lupin Ltd	29830	24639	21%	4761	3352	42%	39	50	28%
Maruti Suzuki	106197	109570	-3%	6811	5013	36%	93	110	18%
NBCC Ltd	10002	7162	40%	566	352	61%	20	25	25%
PTC India	27515	18778	47%	339	209	62%	4	6	33%
Rallis India	4008	3429	17%	304	220	38%	7	8	16%
Tata Consultancy Services	212940	160669	33%	53334	35496	50%	92	108	18%
Tata Global	20539	19020	8%	1196	803	49%	6	8	24%
Tech Mahindra	48985	36683	34%	8899	6155	45%	129	150	17%
Treehouse Education	397.3	290.7	37%	121	80.5	50%	13	18	44%
Voltas	11194	11525	-3%	577	260	122%	6	8	28%

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DEBT OUTLOOK

The RBI surprised by hiking repo rate by 25 bps today to 8%. Correspondingly, the reverse repo and MSF rates have also been hiked to 7% and 9% respectively. All other rates were kept unchanged. The move was surprising, subsequent to a status quo stance in its mid quarter monetary policy review in Dec'13, where the RBI decided to wait for more data before taking any action on key rates. With inflation for Dec '13 came as lower number, the market was expecting a status quo stance in this monetary policy as well. The 25 bps hike in repo rate may also have to be seen in the context of the Urjit Patel committee report which recommended a CPI inflation anchor for policy purposes and a CPI inflation target of 8% within a year. The rate hike reflects RBI's assessment of the required policy stance to achieve the desired inflation trajectory.

The RBI's decision was on the back of following reasons: Though vegetable prices have moderated, Consumer Price Index (CPI) inflation remains above 9% and core CPI inflation has remained sticky at around 8%; and the RBI governor has formally accepted the recommendations of the Urjit Patel committee, which targets CPI inflation below 8% by January 2015 and below 6% by January 2016. In the absence of any policy responses, there would have been upside risks to these targets. The stance clearly supports the view that there is no trade-off between growth and inflation, and price stability is for the time being priority which may also help to have a sustainable growth ahead.

Yields ended the month broadly unchanged with the current 10-year gilt yield rallying by 4 bps to 8.78% and 1-year gilt yield selling off by around 5 bps to 8.82%. Long end yields initially rallied sharply by more than 30 bps on the back of lower inflation data and strong FII debt purchases. However, with the surprise RBI policy hike and increased volatility in external currency markets, yields subsequently retraced the entire rally.

We believe that RBI has taken a cautious stance given the international uncertainties and the likely pressure on currency. The RBI has been maintaining its view for a long time now that inflation needs to be anchored to create a stable environment for sustainable growth, and by increasing repo rate despite subdued growth, the RBI is being clearly attentive towards persistently high retail inflation.

Going forward we expect inflation (both WPI and CPI) to decline led by falling vegetable prices and growth to remain weak in absence of any uptick in the industrial activity, and this may keep the RBI away from further rate hikes. While lower current account deficit which RBI expects to be at 2.5% may provide comfort, the RBI will be watchful on inflation and volatility in the currency.

The developments over the last couple of months and the changed RBI stance, with an emphasis on containing inflationary expectations has reduced the possibility of a near term downward trend in long term yields on a directional basis. We expect long term yields to be range bound. We reiterate our call to stay at the short end of the curve which benefits from relatively high carry (accruals) and possible roll-down as some steepness develops. Suggested Investment strategy is to follow asset allocation and diversify the debt portfolio between short term funds, long term funds and FMPs. Conservative clients can also look at allocating some amount to Tax free bonds.

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