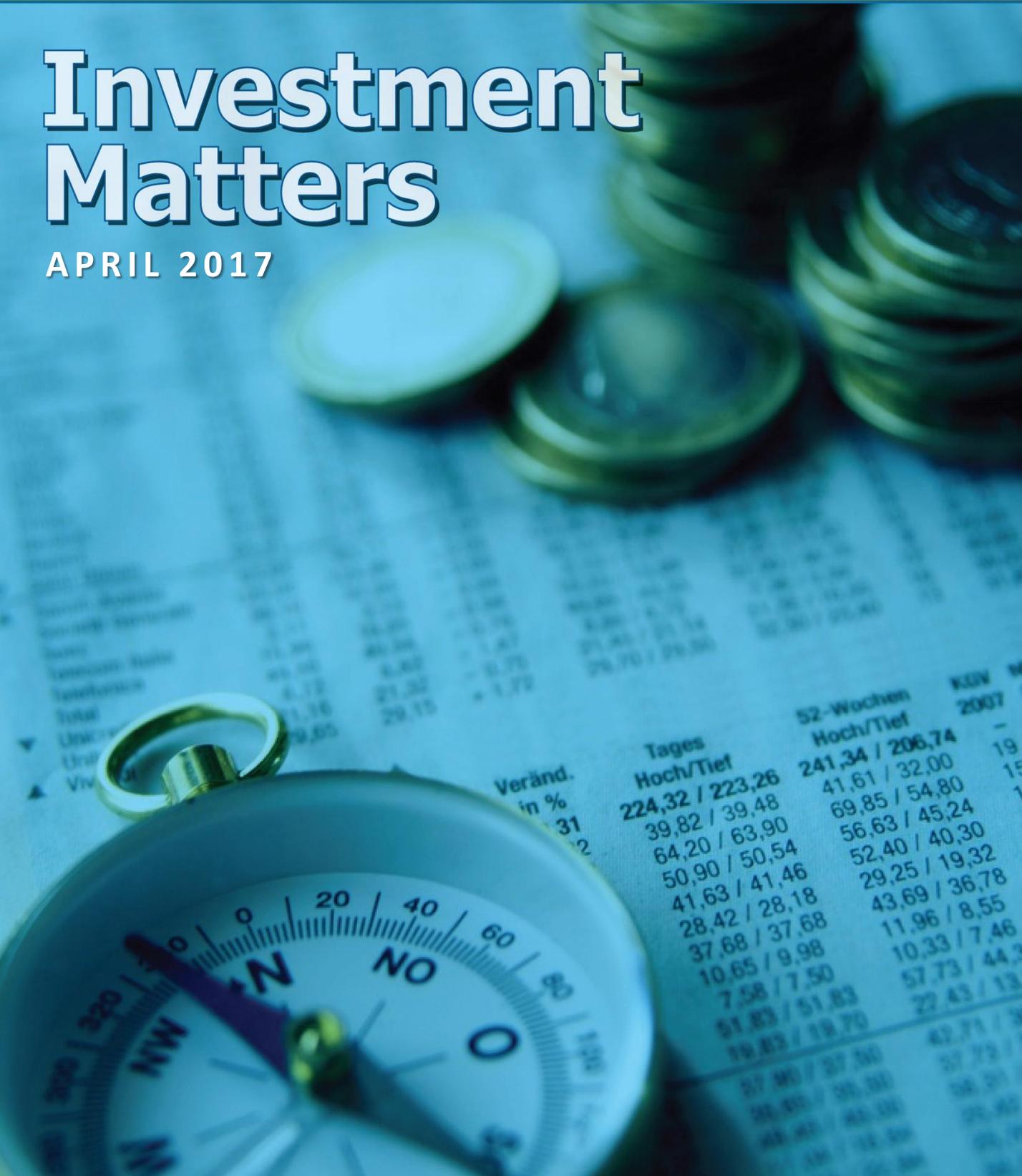


# Investment Matters

APRIL 2017



Veränd. in %	Tages Hoch/Tief	52-Wochen Hoch/Tief	KGV 2007
31	224,32 / 223,26	241,34 / 206,74	-
-2	39,82 / 39,48	41,61 / 32,00	19
	64,20 / 63,90	69,85 / 54,80	15
	50,90 / 50,54	56,63 / 45,24	1
	41,63 / 41,46	52,40 / 40,30	
	28,42 / 28,18	29,25 / 19,32	
	37,68 / 37,68	43,69 / 36,78	
	10,65 / 9,98	11,96 / 8,55	
	7,58 / 7,50	10,33 / 7,46	
	51,83 / 51,83	57,73 / 44,3	
	19,83 / 19,70	22,43 / 13	
	37,90 / 37,50	42,71 / 3	
	38,40 / 38,30	37,79 /	
	48,40 / 48,30	58,21	
	18 / 18,30	25,40	
	25,30	25,70	

## EQUITY OUTLOOK

### Market Overview

Over the past 12 months, Indian stock indices have moved in tandem with its Emerging Market and Asia Pacific peers, despite the sharp reset due to demonetisation.

### Performance of MSCI India versus Peers



Source: Bloomberg

Post the correction following demonetisation, stocks rallied as (i) Sell off seemed overdone as 3QFY17 results were not as bad as expected (ii) Domestic liquidity started moving out of real estate and gold and moved into stocks and (iii) Foreign inflows picked up following BJP winning 4 out of 5 state elections including the crucial state of Uttar Pradesh, India's one of the largest state. Foreigners invested around US\$5.14bn+ in the month of March 2017 alone. The recent wins in the state election by the BJP and strong performances at municipal level elections in various states strengthen the case for the BJP to come back for a second central term in 2019 with much better representation in the Rajya Sabha (Upper House), which would smoothen and expedite the reform process further.

## EQUITY OUTLOOK

### Institutional Flows into Indian Equities

Month	Net Equity Investments US\$Bn In India			
	Foreign	Dom MF	Dom Insurance	Total Dom
Apr-16	0.58	-0.09	-0.26	-0.35
May-16	0.39	1.06	0.00	1.06
Jun-16	0.77	-0.01	-0.31	-0.32
Jul-16	1.69	-0.01	-0.90	-0.90
Aug-16	1.46	0.41	-1.06	-0.66
Sep-16	1.40	0.57	-0.28	0.30
Oct-16	-0.75	1.37	-0.18	1.18
Nov-16	-2.61	2.03	0.66	2.69
Dec-16	-1.25	1.35	-0.01	1.34
Jan-17	-0.01	0.77	-0.07	0.70
Feb-17	1.56	0.31	-0.17	0.14
Mar-17	5.14	0.37	-1.02	-0.65

Source: SEBI

The market rally in face of a delay in earnings recovery by a few quarters due to demonetisation has made short term valuations challenging.

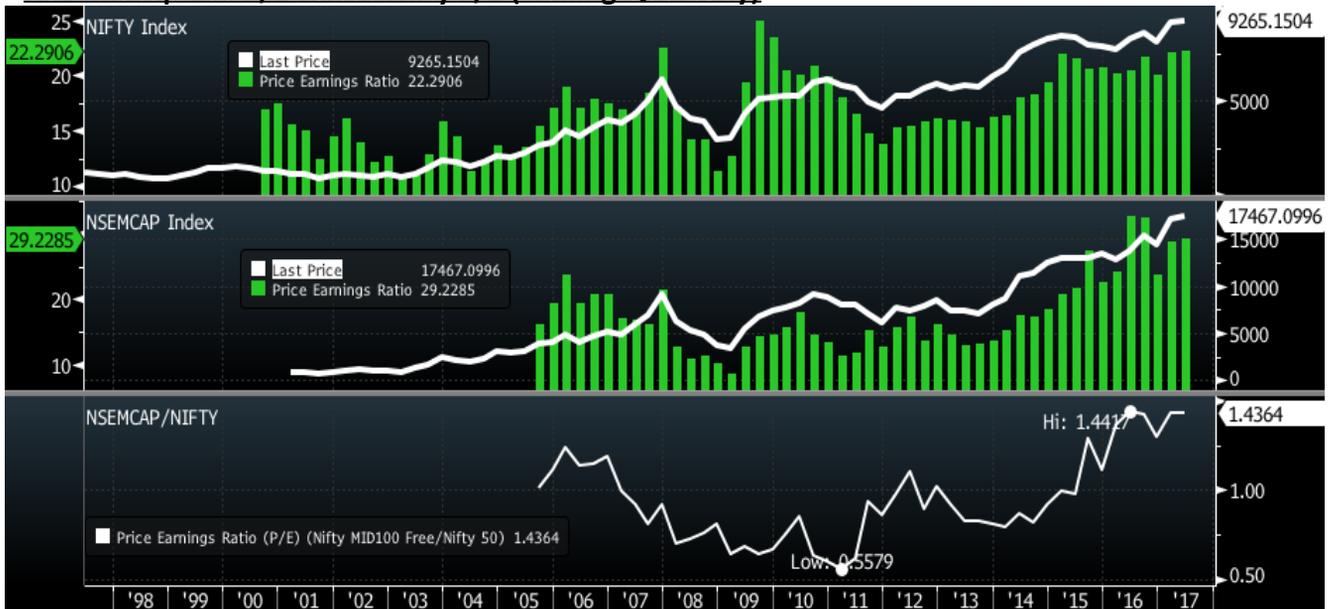
In case of Nifty Index, the Price Earnings Ratio (PER) at 22.3X trailing earnings is at or near levels from where we have seen sharp corrections in Jan'2008, Nov'2010 and Mar'2015. However, the difference between those instances and today is that in all previous corrections, earnings declined sharply compared to expectations whereas currently we are coming from a base where Nifty earnings have remained unchanged for the past 4 years from FY14 to FY17. We expect to see an earnings recovery in FY18, albeit could be slow and an acceleration post that. The slower FY18 earnings growth could be due to (i) some spill over effect of demonetisation into the next year, (ii) Goods and Service Tax (GST) regime has finally been passed in the parliament and may come into effect sometime in the middle of FY18. GST implementation has initially seen growth slowdown in many countries as channels destock to adjust to the new system, and (iii) IT, Pharma & Telecom sectors are facing structural headwinds whereas in case of banks credit growth is weak and those straddled with high NPAs may continue to see higher provisioning for one more year, unless the government and RBI can find a lasting solution to the problem. Solving the NPA problem is the next big item on agenda for the government after GST.

In case of midcap valuations, NSE Midcap 100 Index valuations is high both on an absolute basis at 29.2XP/E and in comparison to its own historical valuations compared to Nifty Index where it currently trades at a 43% premium. However, the NSE Midcap Index FY17 EPS is still expected to be below its FY10 peak by around 10-15%. A very sharp earnings recovery is expected somewhat akin to FY2006-2008 period where NSEMcap Index EPS grew at 90.5% CAGR vs Nifty Index EPS CAGR of 25.9% (Source: Bloomberg). In that cycle the NSE Micap Index traded at 25% premium to the Nifty Index.

## EQUITY OUTLOOK

While anecdotally there exist some amount of frothiness in midcaps the justifiable valuation premium will depend on multitude of factors; sharpness and duration of earnings recovery, relative growth opportunities, interest rates etc. On a selective basis we see good opportunities for stock picking on a 3-year earnings recovery basis.

### NSE Midcap 100 P/E versus Nifty P/E (Trailing Quarterly)



Source: Bloomberg

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