

MADHUSUDAN KELA/RELIANCE CAPITAL

Equity is looking relatively better than fixed income

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Equities are looking relatively better than fixed income as central banks are pumping in trillions of dollars into the global financial system, said Madhusudan Kela, chief investment strategist at Reliance Capital Ltd.

Bond yields in majority of advanced economies are negative or zero, triggering a shift from bonds to equities, Kela said in an interview. This is "what is keeping the equity valuations elevated," he added. Edited excerpts:

Are you as optimistic or selectively in pockets have you started getting cautious on the valuation front?

I think in the beginning of the year, I remember in the same show we spoke when the Nifty was around 7,000 and one had the guts to turn the table and say that these are levels to buy and one is willing to stake. Obviously, markets have moved 30-35% in the main indices from there and there has been a lot of appreciation if you go a little deeper in the markets. So, it is a no-brainer to say that the comfort is not as high as it used to be when we were around 7,000 levels because valuations have moved up.

However, I just want to highlight, if you look at the valuation in the same metrics with which we are used to be looking for many years and again I dare say it is different this time, because there is so much liquidity in the world and so much money is being pumped in by the central bankers, so, basically, equity is looking relatively better than fixed income. As you are aware, roughly \$12-13 trillion of money is earning negative returns worldwide. Bonds... majority of the country's... we were looking at up to seven to eight years, majority of the country's bond yields are virtually negative or zero.

If the bond in Switzerland is trading, a 50-year bond at a negative yield, there is one certainty that if you keep the money in Switzerland bond for 50 years, you are going to lose money. So, the only trick which people are playing, why are people still investing money in these bonds is because of the capital appreciation. So, I am saying how negative can that yield go worldwide, forget India. So, our sense is that there is not much room for them to go further negative than here. So, obviously a small shift from bond to equity is what is keeping the equity valuation elevated. So, that is the only justification. It is not that only Indian valuations have moved up, valuations worldwide, across the world, have moved up and the only justification which I could come up is this shift from bond to equity which is keeping the valuation elevated.

That is an excellent point and that is precisely what is driving this tectonic shift in money flows across the world. However, just to scratch that point a bit deeper do you see any risk to this hypothesis which is driving global liquidity towards risk assets at this point in time which can rock the boat. This is not an India specific question; it is generally a question on whether the scenario that you just described, do you see that getting rattled for any chance in the fore-



Market analysis: Madhusudan Kela.

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seeable future?

May not be in a foreseeable future but there are two things which we are monitoring very closely which everyone who is monitoring this should monitor. One is that does the world get into any deeper recession than where we are today. I think, then it poses a different kind of a risk to the world and second does the inflation comes back in the world.

Right now as we examine it doesn't look like an imminent risk. Let me dig a little deeper on the inflation point, the inflation actually may not come back in the world because of the demand issue. The demand is very vibrant, but it could also come back because lot of supply is getting closed. If oil were to remain at \$30 maybe 10-15-20% of the supply would have come under threat. We have to monitor these things very closely. We are doing it very extensively, but is there an imminent risk of either a big recession in the world or inflation going up. The imminent risk is not there.

However, can it happen at some point of time over the next 12-18 months there is a possibility. That I cannot predict today only thing which we can do is to monitor these things very closely. However, the risk is there, one cannot rule out that world is always going to be this hunky-dory place where central banks will keep printing money and that money will keep coming in equity market, bonds will continue to trade in negative trajectory. Growth will not be there, but still you will be able to make a lot of money in equities. This looks very good, but it cannot last forever.

How much more can valuations expand out here and in other emerging markets? Valuations go up in two scenarios, when earnings are actually galloping where we are not there; earnings are improving but they are not galloping right now. We have seen markets trading at 25-27 P/E multiples also in good earnings scenarios which we don't have right now completely today. The other is the scenario that you described which is global cost of capital is so low that equity valuations are keeping

on expanding. So, now we are already at 18-19 times or 19-20 times whatever number you choose to look at, how much more of an expansion in valuation can we justify at this stage?

I have learnt in the markets in last 25 years that highs are always higher than what we expect and lows are lower than what we expect. So, it is very difficult to pinpoint that at 20 times it will become very expensive or 21 times it will become very expensive. Relative to the past, obviously it is elevated but I think if this scenario continues, there is another chance that it could melt up because one should not forget that even locally—what is working, specifically now if you come down to India, in the world where even 0.5-1% growth is so difficult to find in various pockets, we are still talking of 7.5-8% growth rate in India, we are still talking of select companies, good companies growing their earnings by 15-25% over the next two years. So, this is a real golden spot in the world and which is why a lot of money is coming.

To add to the liquidity point, what is happening locally is that people who put money in real estate, people who put money in fixed deposits are getting frustrated and

such a big bull market is going on in equity and we have missed it. Last four years if I were a real estate holder, I am scratching my head everyday that what have I done, 60-80% of my portfolio is become illiquid, I cannot sell it, there is no appreciation. So, Rs 1 lakh crore have come in mutual fund over the last 12-15 months and lot more money could come if the real estate scenario, if the fixed income scenario remains where it is. So, what I am trying to say that in this market it is very difficult to justify keeping historical trend that should I put a lot of money, can I turn the table and say that Nifty is a great buy at 9,000, the market is a great buy at 9,000. I don't have the guts but will the market tank given where the global liquidity is, given where the locals are positioned, I can't even say that market is ready to tank because the valuations have got elevated.

Clearly, the screen is suggesting that we are in a very bullish phase for the last many months but

there are pockets within the market which are not exhibiting that kind of momentum or interest, cases in points are like IT, pharmaceuticals, now telecom. Do you sense any kind of disconnect that some of these maybe global facing sectors don't have the same kind of tailwinds behind them?

See market is clearly only respecting earnings. So, wherever you have earnings growth or a forecast of a big earnings growth markets are disproportionately rewarding whether it are sectors or whether it is companies. However, the sectors which you mentioned whether it is IT or pharmaceuticals or fast moving consumer goods (FMCG) companies, consumer facing FMCG companies there has been an earnings downgrade to say the least over the last 12-18 months. Market is clearly not interested in these sectors right now because even though optically they look very comfortable in terms of valuation vis-a-vis the growth stocks or growth sectors.

However, market is just not willing to give that chance to these sectors as of now. In rotation even though I think the healthcare and the pharmaceutical sector there could be select opportunities as you know we were early on in these sectors. However, because this is a very long-term theme and if stocks become selectively cheap out here I think I would say that this is one sector which one should look at in all the downgrade sectors which are there.

What does one do with the sector with stocks like Bharti Airtel, Idea Cellular now which are seen under such a lot of threat because of the entry of a very aggressive player?

In our mind, it is still wait and watch. We have to see the whole rollout of Jio. The plans are very aggressive and let us see how the commercial launch happens. What kind of subscriber numbers do they get? One will have to evaluate post that only because this is unprecedented. This level and this scale of launch has not happened at least in India I have not seen. I would still wait and watch in this sector.

Do you think the days of serious wealth creation as a sector is in the past for a sector like telecom? The money, which people had to make they probably made a few years back and now it is no longer going to regain that kind of position?

That you can bet because if at all the intensity of competition is going to only increase and it is going to be very high, you have not yet seen what Bharti, Idea and Vodafone will do in terms of counter offers. To say the least they would like to protect their customer base.

They would like to protect whatever market share they have which effectively will mean that they will also have to do aggressive pricing than where they are today, which conversely means that there is the near-term earnings, next one-two year earnings might be under threat. So, it will be interesting to watch where the pricing battle, where does this competitive pricing settle down. Which is why I am saying that whatever wealth which had to be created the big wealth creation maybe in the past one-two years looks very competitive and extremely challenging from an earnings perspective for this sector.