

The Indian economy and markets' most exciting phase is just about to begin. The sweeping reforms of the past 25 years ushered in macro stability setting the stage for earnings and GDP growth. Just don't sit on the sidelines and wait for value to emerge. You may miss the bus, is the ET Markets Roundtable message to investors

Ready For Rio and the Samba

Street Abuzz With Quiet Confidence & Promise of Reform

NILESH SHAH

MANAGING DIRECTOR,
KOTAK MAHINDRA AMC

IT, some private sector banks, corporate focussed private sector banks have disappointed, but you could still see recovery continue. For some of the domestic focused companies, since they are not in a hurry to invest, higher capacity utilisation and pricing power should improve profits. The RBI's resolve to provide more liquidity should not be underestimated. Liquidity is the lubricant which drives the economy. In the last two years our credit growth was below 10%. If credit happens, then automatically growth recovers. We will see that. Market has already priced in one 25 bps rate cut, that is how the 10-year yields has fallen from almost 7.5% to 7.20% and this is the old 10-year, if the new 10-year is launched today that probably will go in fact to 7%.

Flows to market from mutual funds, EPFO, insurance and LIC should top ₹1.5 lakh crore this year. "Midcaps could continue to outperform as flows and fundamentals are in their favour."

Equity Valuations

Equity markets have run up on liquidity and hope, but as an investor you are also paying for growth. You have to take risk to generate return. You cannot stay outside hoping that one day everything will become cheap and I will buy. Who knows you will still end up buying higher from current levels. You are paying for a country whose micro is improving and macro could improve. Don't be trapped only into value buying. Always follow an asset allocation model. I.e. if markets go down from here, one should invest 20% and then when there is opportunity put in further money. But just don't stay out only as stocks are not available at February 2016 valuations.

Sector View

Good monsoon, liquidity, Pay Commission should help rural, consumption sectors, NBFCs, basically any sector that benefits from higher purchasing power and spending. It could be as simple as automobiles and auto components, it could be travel and entertainment, it could be cement, furniture, fittings, electrical appliances, white goods or people financing that.

Pharma is a falling knife. They are going to probably underperform for the next three-six months but this is good time to average into pharma and build your portfolio. Do not invest in equity with a six-eight month view, it is more likely to disappoint. If you are looking at March 2017, invest in fixed income.

GAUTAM CHHAOCHHARIA

HEAD OF INDIA RESEARCH, UBS

The India growth story remains intact for the long term. Even over the last two years, the broader domestic focused companies have been in reasonably good shape. We have been seeing a gradual grinding recovery over the last couple of years; it is not just the last quarter phenomenon. The question is whether it percolates to a broader based and accelerating growth that is critical for the markets to deliver abnormal or super returns, both in terms of earnings growth and valuations. In our view, we will again see the same cycle of earnings cuts happen this year. It will not be at the same scale we saw last couple of years, we will not go down to 0% or 2% growth, but single digit, maybe 10% growth rate, unless we see change in policy stance. Our base case is 10% earnings growth for the market this year.

PSU Banks & Bad Loans

In our view, NPL (non-performing loans) cycle has definitely peaked. The reporting will peak this year at worst. So in that sense, the worst is behind us. In PSU banks, the biggest worry for markets and us remains valuations. In our view, NPL (non-performing loans) cycle has definitely peaked. The reporting will peak this year at worst. So in that sense, the worst is behind. In PSU banks, the biggest worry for markets and us remains the valuations.

If you look at the underlying earnings, pre-provisioning operating profit still remains in good shape. While we worry about longer term franchise and digital, these concerns will be there. But in three to five years, these banks could become interesting if a lot of underlying profitability remains intact at current levels. It is a much more a high risk bet and one has to be stock specific.

We have been overweight more on the retail lenders. Having said that, the government, RBI and banks are making serious efforts on NPA resolution. I am very optimistic on governance reforms and this government is very serious about governance reforms in the whole of PSU space, including banks. The cyclical recovery will help them. There are three powerful forces in financial service sector — digitalisation, disintermediation, differential regulation — which will give birth to lot of new players. So structurally if you think few years down the line, large number of PSU banks will find it very tough to compete against these new players and in the new environment except for one or two banks who have invested in technology, have the franchise and good management.

In the near term, we see a leg down maybe a 5-10% on account of high valuations, earnings disappointment and global issues.

MAHESH PATIL

CO-CHIEF INVESTMENT OFFICER,
BIRLA SUNLIFE MUTUAL FUND

Strong domestic flows to some extent have got more channelled into the mid-cap sector and their valuations have gone up, while earnings have yet to catch up. The PE multiples look expensive from a historical perspective. But a lot of mid-cap companies are more domestic focused. We believe domestic recovery will be slow and gradual. As liquidity situation improves, interest costs come down, mid-caps can potentially report a better growth rate.

If you dissect the earnings and look at the last five years, our earnings growth has been in single digits, around 7-8% — which has been tracking well below the nominal GDP growth rate. You will see steady growth as capacity utilisations goes up and interest rates go down. The impact it will have on the bottom line will be much higher. Longer term earnings growth, if you take say the next decade or so, probably will be just around 12-13%. In the near term, we should be able to do much higher growth.

Fund Flow & Market Volatility

Lumps sum money into domestic funds could be volatile, but SIPs give a lot of stability. PF money is also steady and it could touch ₹20,000 or on annualised basis. If that number further increases by around 10%, it would add to the stability in terms of flows. Historically, we have seen that market volatility is due to too much of dependence on FIIs. When FIIs pull out money, markets tank and so steady domestic flows this time could give some stability to the markets.

Sector Views

We are not in a big cyclical recovery. It is going to slow and gradual. IT does not look that attractive because growth is slowing down structurally. If you take a poll, anybody will be happy with say 15% return for the market over the next few years. Whether the sector can provide that kind of slightly better return is something that we will look at with lower risk and volatility. You need to have a balanced approach as we are not in a scenario like 2003 and 2007 when growth was 25-30%. Indian pharma still have a decent advantage and it is a stock specific story. Even consumer stocks are expensive but India's consumption story is a very long-term sustainable story. If rural consumption comes back, stocks will be expensive but earnings growth can improve. So whenever there is relative value within the consumer space or consumer discretionary, it looks good because they are still reporting compounded earnings of 14-16%. Earnings growth will be 14-15%. Nothing would be linear, we could see corrections, as the global environment is challenging. We could make a 7-8% return.

NAVNEET MUNOT

CHIEF INVESTMENT OFFICER,
SBI MUTUAL FUND

When everybody else is moving towards negative interest rates, India has positive real rates and good monetary policy framework. Everywhere else, foreign exchange reserves are depleting, but they are growing in India. In a yield-hungry, growth-starved world, India looks relatively attractive with regard to fund flows, and domestic investors remain positive, which is driving the market.

Growth Drivers

In India, there are structural growth drivers in place and the earnings growth is likely to pick up. Of course, liquidity is playing a big role, but there are also other factors with far bigger transformational effect. Number one, what is happening on the agriculture and rural economy in terms of crop insurance, dismantling of APMC, investment in rural roads, rural electricity, focus on irrigation and the digital highway connecting all the villages — all this can take rural economy to a completely different level in five or 10 years. The second big driver which is hugely underappreciated is availability and the access to finance. Retail credit is growing fast with small finance banks, MFIs and private sector banks in the fray. I am sure PSU banks will join the bandwagon. The cost of capital for households and small businesses is likely to go down and the access will improve substantially. The availability of money which was not there or there at 30 or 40% coming down to 10-15% can have a transformational effect.

Earnings & Valuations

Stock prices have to mimic earnings in long term, but valuations can take markets to a different trajectory in short to medium term compared to what earnings growth is suggesting. On a year-on-year basis, the correlation between market returns and earnings growth is very poor. If you take the transformation reforms of 1991-1992, markets delivered everything that could happen in India in the next eight years in just one year. The market went up manifold in 1992 and then you did not get anything. So waiting for that moment where you see earnings going up could be quite late in the day.

I hope the monetary policy framework is maintained and the government and RBI keep their focus on CPI. Macroeconomic stability over a longer period is far more critical than the gains that you can get in couple of quarters by reducing rates. We need positive real rates for savings to go up. Valuations have run up and the margin of safety has gone down. In the short term, sentiment and liquidity will drive the market and not necessarily growth in the next quarter. In the near term, we are in a world full of uncertainties and we should brace for higher volatility going forward.

SUNIL SINGHANIA

CIO - EQUITY INVESTMENTS,
RELIANCE MUTUAL FUND

Valuations are not cheap, which is very clear on the earnings front. It is a million dollar question whether earnings will revive in the near term or not. Our view is they have a potential of massively surprising even in the near term. One or two sectors caused earnings to be very bad last year — metals and PSU banks in particular. The metal sector has very decisively changed at least in the near term. We all look at the valuations but we don't look at it from a perspective that the weighted average cost of capital is sustainably coming down. It would mean that maybe a 16-17 PE or 18 PE would become the norm. That is a possibility. If \$15 trillion in the world are invested in negative yields, even a 6% or a 7% earning yield might look very attractive. We are no one to say that 10 PE is good or 20 PE is good or 30 PE is good.

During the last bull market, we had solid earnings growth, but before that 1999-2002, growth was flat and leverage very high. When demand came, capacity utilisation went up and the same balance sheet was sweating in more sales. Both operating leverage and financial leverage can come into play and that might surprise earnings on the upside. In a lot of mid cap stocks, I would caution that you have to be careful. At the same time, there are sectors and stocks where PE multiples are looking high, but it is because we are looking at a very depressed scenario on demand and earnings side.

Sector View

It is important to diversify your portfolio. In IT, different companies have different models, so being stock specific is important. Pharma will be interesting. No amount of disruption will stop you from consuming the best medicine. The Indian drug market is still growing in double digits.

Metals is a trading bet as we don't know what is going to happen to China and prices. In industrials, we are positive on companies with operating leverage rather than financial leverage. Infrastructure has great potential but listed infrastructure companies have no potential because I do not know whether they will survive in a lot of cases. If money is moving from physical to financial assets, then asset management, life insurance companies, wealth managers, facilitators could be big trends. We are all moving into scenarios we want to wear good clothes. So brands and fashion look good. Home materials as a segment can be very good because housing for all ultimately is going to happen. NPAs have peaked, but PSU banks have lost competitive advantage. The profitable accounts are in private banks and the loss-making accounts that you don't want are with PSU banks. PSU banks are just tactical plays, nothing more than that.



PHOTOS: BHADAT CHANDRA; IMAGING: VADANI SALVI