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2011 going to be a tough year for stock markets: Hiren Ved

In an interview with ET Now, ***Hiren Ved, Director & CIO, Alchemy Capital*** *, talks about the market, India story, impact of FII selling on markets and his top picks in the current scenario.* ***Excerpts:***

Are you a bit surprised with the intensity of the fall, 6 weeks and 14% off?

Yes, while people could have expected a correction in a market which has done well last year - we have had several 10% plus corrections - but the intensity of the fall does surprise me a bit.

Suddenly the India story is looking so bleak, isn't it?

It is always a cumulative number of factors which lead you to where you are. It started in November when we had the issues with LIC Housing Finance and a couple of these corporate governance issues come up. Then we have had this persistent worry about rising inflation in India which people thought would taper off by the end of the year. But because of food prices, inflation accelerated and the allocations that one would have or everybody thought India would get in January after a reasonable year in 2010, did not really come through.

The fact of the matter is that the developed markets did well. So the whole political situation, worries on inflation and the whole Middle Eastern crisis with Egypt , oil being vulnerable - these are all playing truant right now. The macro picture was reasonably good last year with the 3G money coming into the government and the disinvestment programme was also looking like it was moving quite smoothly and successfully. A bit of those macro worries have now started to come back into the marketplace.

Are these valid fears or are our markets generally overreacting?

Some of them are really valid. People are concerned about general governance and the feeling is that government has no coherent strategy right now to fight inflation. Even if everything is not in their hand - because this is not just really an India problem, it is a global problem - the way they have communicated it there is a general perception that they are completely on the back foot and, therefore, we are not going to see any significant incremental reforms going forward.

So it is one of those mood swings which definitely has some basic or underpinnings. But once the mood deteriorates, it is not in your control, one after the other issues come up and you have an issue with the markets. That is what is happening right now.

So are markets looking attractive or are the Indian markets - even after the recent fall - still looking fairly valued?

No, I genuinely believe that we were fairly valued. With the correction, definitely value is coming back in the marketplace. While we cannot call a bottom, it is very difficult to always call a bottom, for a long term investor, this could be at least a beginning of a good entry point back into the marketplace.

Are you again picking up shades of 2008 crash that you should be a buyer and you should be buying shares?

I do not wish 2008 happens again. But if you go back and look at the Indian markets, a normal market correction has been around between 10-12%. You sometimes do have significant corrections where markets correct 20%, it is not out of place to think that. So it has always been a good strategy if you have a long term view to actually buy when these corrections happen.

While everything looks gloomy when the correction is underway, 6 or 12 months after the correction is over - if you have bought the right stocks and if you have mustered the courage to invest - rarely has been a case where you have not been rewarded.

So are you buying right now? Are you still protecting your cash?

We were sitting on some cash which we had created early this year and we are just about beginning to nibble a bit. We are not aggressively deploying but we are definitely starting to think about where we would like to deploy this cash.

What to your mind is really the fundamental bottom for this market? Technically we could overshoot, technically we could undershoot but what is the fundamental bottom?

Any level between 4800 to 5200 is a good level to really look at in terms of investing. Whether it bottoms out now or whether it bottoms out at 51 or goes to 4800 is anybody's guess. It is very difficult to pinpoint at. But the consensus earnings growth that most people have put out is between 19-20% in FY12.

Unless and until commodity prices completely crash, we should be able to deliver 15% earnings growth and if that has to happen, then trading at somewhere between 12 to 14 times forward is a good level to enter the markets. We are definitely below our long term average which has been at about 14-15 times. So anywhere below that is a good level to start investing.

Will you not be surprised if we go below 5000 on the Nifty for the year?

Anything can happen. FIIs have sold about 1 billion, if tomorrow there are significant redemptions that some of the ETFs or macro funds have and if there is a larger selling at a time when local liquidity is generally challenged, which is between now in March, you never know.

What if foreign institutional selling intensifies? Last year they pumped in about $29 billion and the markets went up only 17%. So far this year, the net sell figure is about $1.2 billion and markets are down 14%.

To put it in perspective, last year they put in $28.5 billion but a very large proportion of that did not actually flow into the secondary market in the sense that a lot of that went into QIPs and the IPOs of Coal India and so on and so forth. Last year, the domestic institutions were net sellers, so some of that got absorbed. We can always hypothesize what will happen if the FIIs pull out 4 billion or 5 billion this year. They have only done 1 billion so far, but if I were a serious long term investor and if I have a long term call on India - unless and until I have to sell because I am facing redemptions - why would I sell now when the relative differential in market returns between developed markets and Indian markets has become so wide and we are no longer in an overvaluation zone.

So valuation cannot be a reason why I would be selling down this market so heavily. So it is quite ironic. As of end of January, the worst performing market was Egypt. We were the second worst performing market and even Tunisia was better than us. I do not think that things have become so bad that today we are clubbed with countries where there is a real geopolitical problem and we have been punished to these levels.

If you look at auto sales for the month of January, for the month of December, they look decent. But auto stocks - on an average for the year - have slipped by about 15-20% on an average. Why is that?

Firstly, the reason is rising rates. Secondly, with commodity prices increasing like steel, rubber etc., definitely there is going to be some impact on the margins and people are seeing that probably margins could be impacted.

The third reason is that this was one sector which was a beneficiary of stimulus in 2008 where excise duties were cut. We are approaching Budget times. So people would want to think that there could be a marginal rollback of excise duties that could happen. So people may just want to trim. Also, it is one of the sectors where people have made the most money. So people want to take some money off the table, probably that is why autos have corrected from where they are.

It is quite ironical. Indian markets actually have peaked out on November 4. That is the day QE2 was announced and Coal India made its debut, why is that?

We can always go back and link these things to events. Obviously there were very significant flows which came in. In essence, every large IPO which attracts a lot of attention tends to happen when the markets are very good and those happen to be turning point for markets. So maybe this was one of them.

But has deep value surfaced up in any sector, in any cluster or any name where you are absolutely certain that being a money manager, you would like to buy fear and you are confident after 12 months, after 16 months, after 18 months you will be a winner?

More than sectors, overall the midcaps have significantly corrected. So there is value there but we have to have a long term view because typically whenever you have this correction, it takes a while for these stocks to come back. I would not necessarily like to be a big contrarian in this market because what has worked will continue to work. So markets will continue to reward companies which have strong balance sheets, which have good return on equity, which have free cash flow - that would continue to happen. So I would rather look at if some of those stocks have corrected significantly, then I would like to add to those.

The other area is banks. They have corrected significantly - 30-40% - from the top and really people had issues with asset quality, deposit rates going up. So probably NIMs would get contracted. But I do not think that those problems are really surfaced in Q3. In fact - if anything - NIMs have continued to remain very strong because they have been able to re-price the asset side pretty quickly. But it is going to take a while before the high cost deposits catch up and this is a phase where they are able to pass on higher rates to the customers.

So selectively banks, which did not grow aggressively between 2007 and 2008 and 2010 which was a tough period and which have a good deposit franchise, good CASA, should grow very well. So that is one area that I would look at.

The last area which has really corrected very sharply is the infrastructure space. That is a sector because it continuously needs capital which is again sensitive to interest rates. Combine it with the fact that government spending has not happened in the infrastructure space and we have had issues with many projects with the environment clearances and so on and so forth. That is really weighing on the sector. So at some stage, this has to pick off but the turning point will come. According to me, the triggers will be two-fold. One is that if we see signs of inflation topping out and, therefore, logically interest rates topping out. If we see that - that will come down maybe sometime during the second half of the year - and if we start seeing activity in terms of projects getting cleared, I do not think order books are an issue.

But execution getting underway would really be a trigger and there, I would still prefer to play the more high quality capital goods infrastructure company which has strong balance sheets, which do not really need capital to grow.

Do you like TTK Prestige?

Yes, it is a secular story. The company is doing extremely well. The third quarter numbers were fantastic. Obviously we do not expect them to keep growing 50% and 60% but they can easily grow at 25-30% compounding. So it is a great compounding stock and that is the stock that the markets are willing to give value.

Which is your other large cap high conviction idea, part of Nifty 50, part of Sensex 30?

One large cap idea that we have invested in this correction is ICICI Bank . After a couple of years of flat growth, they have got their CASA back up. So the wholesale funding issue is now behind them. They have not grown in the past. So I do not think that asset quality is going to be a big issue. So they are relatively starting with a clean slate and it is reasonably valued. That is where money can be made.

What is on your avoid list broadly speaking for the year 2011?

Certainly commodities, we have not played it on the way up. We do not want to look at that sector. We can always find 1 or 2 things that we think could be very good but it is more like a tactical call. In real estate, we have made some exceptions to that where we believe the land values are pretty cheap and so on and so forth. So we are very selective on infrastructure, more on the capital goods side, stronger balance sheets. But otherwise, we have no interest in real estate in general and nothing in commodities.

You like builders companies which construct roads, ports, dams, isn't it?

Yes, we do like them but only if they are a pure engineering and construction players and if they have a strong balance sheet and do not need to raise capital.

But why are infra stocks falling so much? If I look at specific names like IVRCL, JP Associates , Lanco, all of them have fallen about 25-30% this year.

Partly, it has to do with the fact that all these stocks were the darlings of the previous bull market. We know that the leaders with the previous bull market never ever become the leaders of the next wave or bull market. Secondly, there is this whole perception about infrastructure not really kicking off, spending not really kicking off as people would have liked it to be. All the news flow around the infrastructure space has not been really positive.

So that is not deep value available at a good price, is it?

There is value, but the question is that it can remain deep value for a long period of time. You never say no to anything. You always keep an open mind in the markets. But the triggers have to be there like the macro environment for infrastructure has to improve and we have to be convinced that interest rates will not rise from here and that is sometime away. So I would not like to be a contrarian and jump in right away.

So when we wrap out 2011, what to your mind could surprise us on the upside, earnings, liquidity or the macro environment?

It is going to be a tough year as far as liquidity is concerned. We do not know how the second half will pan out and how things pan out. When commodity prices actually correct very sharply, it generally tends to take the Nifty earnings down because the swing in the material companies is very big. So if they correct and if oil goes back to $80 or $75 and there is no further inflation in other commodities, then instead of 15% we can go back to that 19-20% that people do expect. But for that, things have to happen, inflation has to subside, interest rates have to stop rising.

Last but not the least, every time people get very distressed about the fact that government is not doing anything and write it off out of complete despair, some good things do emerge. So I am of the view that while crisis is never good for the markets in the short term, unless and until we have a crisis, people do not move and hopefully this crisis is significant enough for people to start getting to move for the government to start moving in the right direction.

Never ask a fund manager for a market outlook because he will always be bullish, isn't it?

Yes, longer term, you have to be a realist. But at the end of the day if you are not an optimist, you will never make money in the markets.

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