ALCHEMY
PRIVATE WEALTH

Investment Matters

NOVEMBER 2013

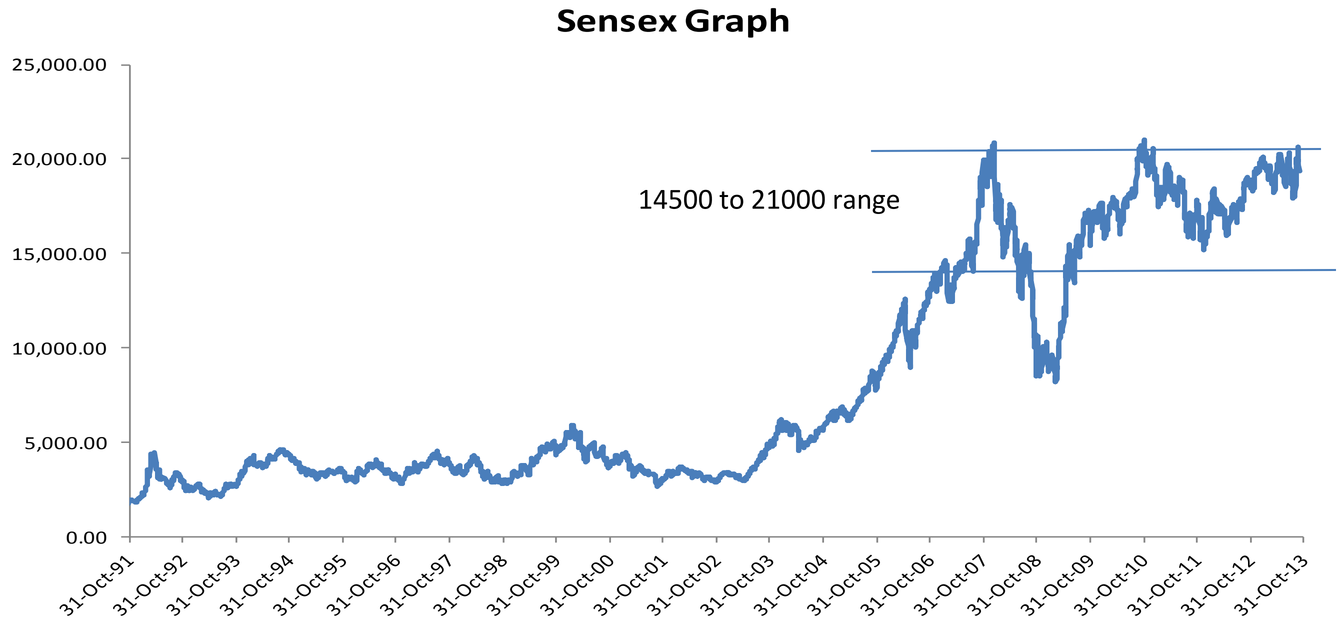
BESPOKE
FINANCIAL EXPERTISE
TO MAKE THE RIGHT
MOVES, MORE OFTEN.

EQUITY OUTLOOK FROM CIO'S DESK

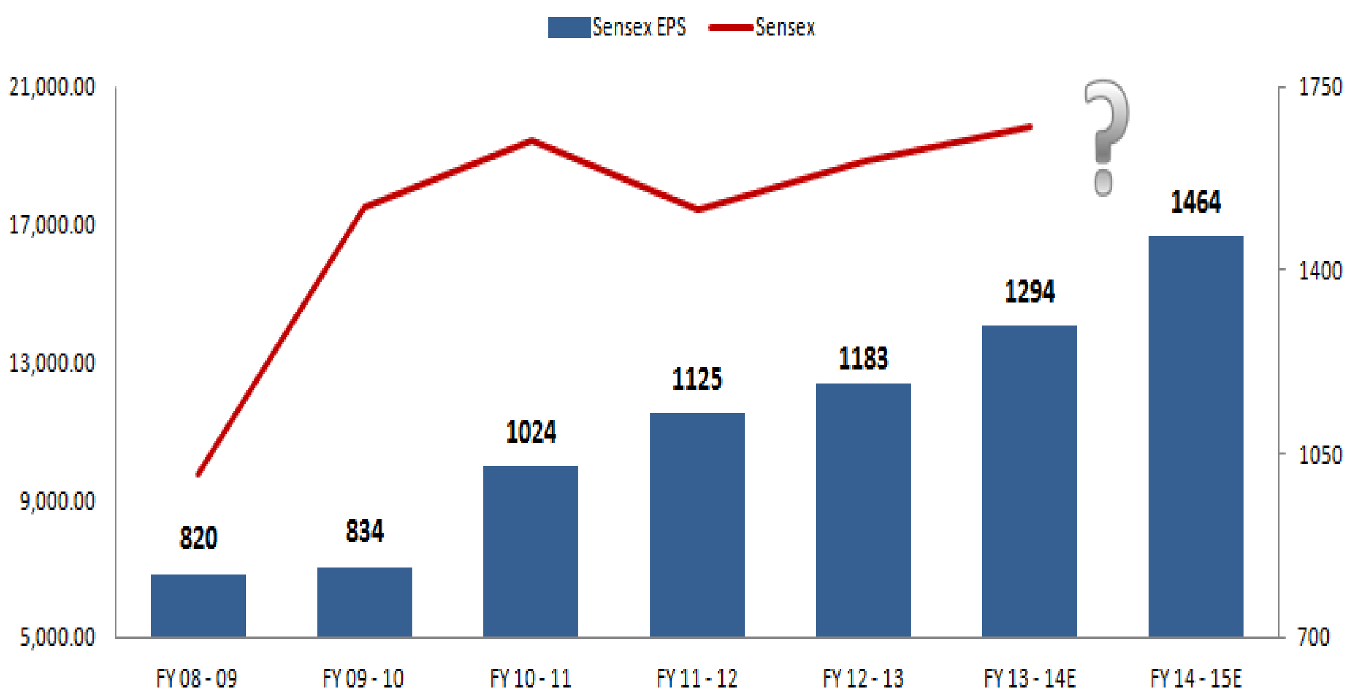
A new high in the Nifty and not many investors rejoicing yet – where from here? Is it time to sell and take your money out of equities or is it the start of the next bull cycle? Questions like these are logical especially in the face of a slowing economy, weak macro, general elections round the corner with most opinion polls suggesting high probability of a hung parliament, high cost of money i.e. high interest rates, and tight liquidity. In spite of such weak fundamental variables, equity markets are currently trading around the previous all time highs.

We believe that the current market scenario is sustainable and in fact are of the opinion that markets are likely to convincingly breakout of the all time high levels over the next 12 months. We see the markets rewarding investors who have invested over the past 3-5 years and who have waited patiently for so long and expect to recover the underperformance.
A few key points will explain why we think it is a new beginning for investors to look forward to a bright future–

Range bound markets for too long - The chart below highlights the fact that equity markets have been trading in a range over the past 6 long years with no meaningful movement. The Sensex has traded in the band of 14500 to 21000 index level since the global financial crisis. The fact that our index has reached a new high needs to be looked at from this perspective that while earnings for corporate have grown consistently leading to valuations becoming cheaper, the markets have remained range bound for a long time. Hence, at some point in time, indexes are bound to react to the fundamental factors. It would be interesting to note that though the Sensex is closer to the all time highs, other market benchmark indices like the BSE 500 and the CNX Mid Cap Index, which are much broader in terms of participation from companies, are still lower by 16% and 22% respectively to their all time high levels. The market performance over the past few years have been skewed towards select companies belonging to sectors like Consumer, Pharmaceuticals and IT whereas sectors like Industrials, Capital Goods, Banking, Oil & Gas have taken a large beating and valuations are trading at below averages for these sectors.



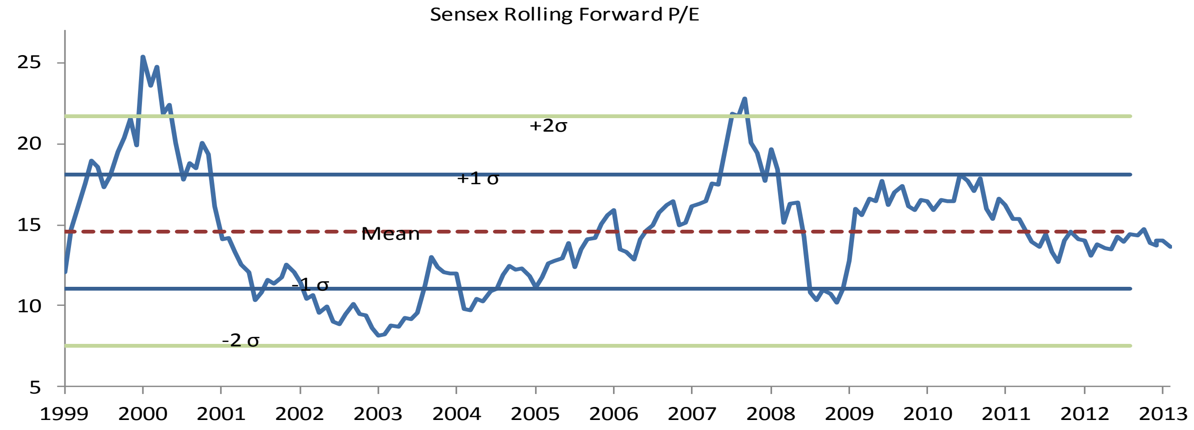
Growth in Earnings – Earnings growth is the primary driver for stock prices and investors prefer companies or markets where earnings can grow consistently over long periods with low volatility. India is one such market where earnings have grown consistently at around 15% CAGR over long periods of time. However, there are short period cycles where earnings in India have also been weak in terms of growth. Over the past 6 years, markets have remained range bound, however earnings for Sensex companies have grown by 50%+ absolute as can be seen from the chart below. This has made our valuations much cheaper currently at 14.5XFY15 earnings compared to >20XFY08. It is this change in valuations which is driving the current up move in the markets and hence making this rally more sustainable.

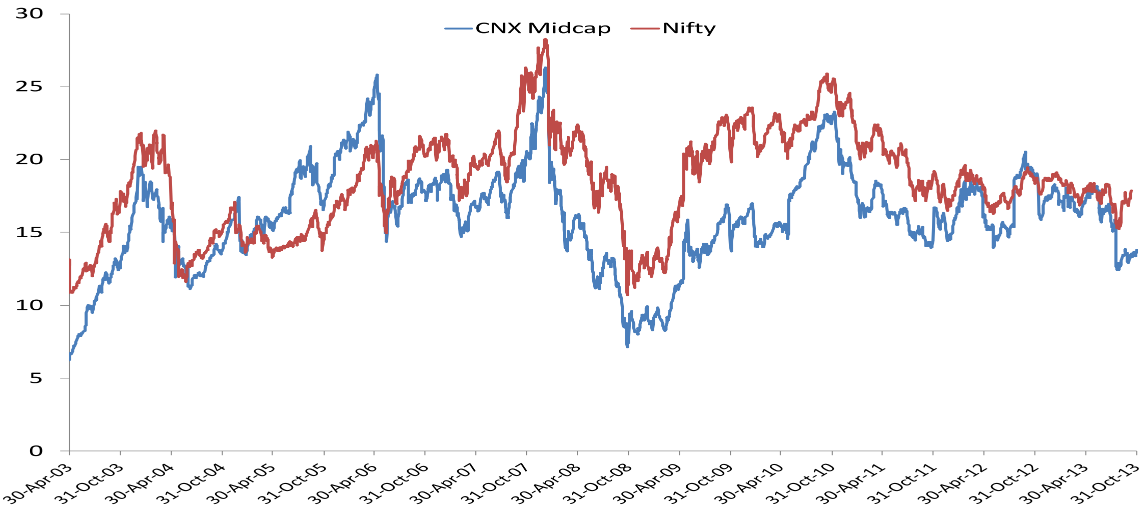


Source: Kotak Securities, Alchemy Research

EQUITY OUTLOOK FROM CIO'S DESK

Reasonable Valuations – valuations for our markets are reasonable and trade at below our long term averages. Sensex valuations today are at 14.5XFY15 earnings compared to long term average PE for our markets at 15-16X. Interestingly the mid cap valuations are trading at a significant discount to the Sensex valuations and that discount has widened in the recent past. We expect markets to trade firmly going ahead and the rally to be more broad based with larger participation from the mid cap segment of the market. Consequently, we expect the discount to narrow as well.





Pre-election run-up – Finally, markets tend to do well in the run-up to elections. In 6 of the last 7 elections, investors buying 6 months before elections have seen positive returns. If the election results come up with a strong stable government, markets will respond even more positively.

Hiren Ved

Chief Investment Officer
Alchemy Capital Management Pvt. Ltd

Source: Bloomberg, Alchemy Research

DEBT OUTLOOK

RBI in its policy meeting on 29th Oct 2013 announced following measures:

Increased the repos rate by 25 bps to 7.75%

Cut the MSF rate by 25bps to 8.75%

The limit under term repos of 7-day and 14-day tenor (which had been introduced to provide liquidity) has been increased from 0.25%of NDTL to 0.5% of NDTL

The overall policy remained focused on inflation, both measured in terms of the Wholesale Price Index (WPI) and the Consumer Price Inflation (CPI). The policy acknowledges that in emerging and developing economies, the prospect of delay in the taper of the Federal Reserve's bond purchases has brought calm to financial markets, and capital flows have resumed. Nevertheless, the headwinds to growth from domestic constraints continue to pose downside risks, and vulnerabilities to sudden shifts in the external environment remain.

Liquidity measures announced earlier in the month of July 2013 to arrest the Rupee depreciation is reversed by again bring back the spread between Repo and MSF rates to 100 bps from 300bps. RBI has clearly hinted that inflation both WPI and CPI is above its comfort level and RBI will take appropriate policy action to keep it under check. The WPI inflation in Sept-13 at 6.5% is increasingly out of RBI's comfort levels. This increase in WPI inflation is on account of sharp acceleration in price of primary commodities (food) and fuel. At that, the CPI based inflation also remains sticky. The high inflation, especially in the fruits and vegetables segment, continues to drive the prices up.

The money market yield curves declined as the MSF rate was slashed by 25 bps. Moreover, the borrowing limit enhancement under the 7 and 14 day LAF window has made around Rs 20,000 cr available. This has reduced the cost of borrowing in the system. Thus, the money market yields which have already declined by around 50-100 bps since the last month, are expected to reduce further going ahead. RBI is also mulling over introducing the Inflation Indexed Saving Securities. This is expected to improve the investor buying sentiment and limit the sell side pressure, going ahead.

The long end of the curve is expected to remain under pressure given this background, while the money market and short bond curves could get some relief from MSF easing. 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. Current high yields make them very attractive from long term investment perspective.

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