

“Blockbuster net inflows from FIIs brought back the smile, pessimism may fade away”

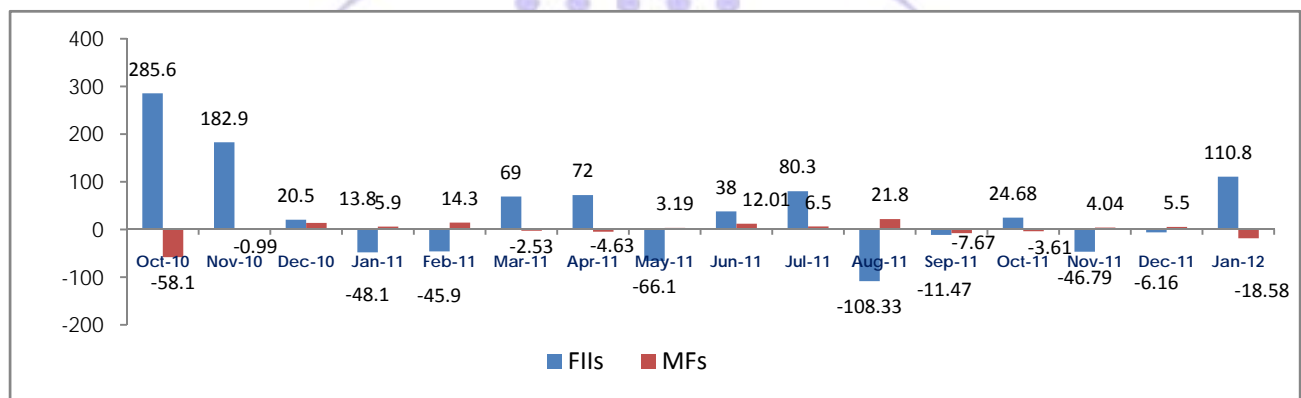
The domestic bourses recovered sharply and remained buoyant during the month of “January 2012” after being under tremendous pain in December 2011. The buoyancy was owing to market sentiments turning positive. This was on account of CRR cut by RBI to the tune of 50 bps to 5.50%, thus boosting the banks with Rs.32,000 crore liquidity and moderating inflationary concerns.

Globally, during the month, US Fed extended an accommodative monetary policy wherein interest rates would be kept low till late 2014 versus market expectation of an exit on this in mid 2013. Fed Chairman Ben Bernanke suggested the US central bank is open to buying more bonds in a bid to stimulate borrowing and investments. The robust performance of the domestic bourses has to be viewed in the light of Standard and Poor’s (S&P) downgrading France and Austria from AAA to AA+ and seven others (Malta, Slovakia and Slovenia by one notch and Italy, Spain, Portugal and Cyprus by two notches). In addition, Chinese data positively surprised the street.

Earlier during the month economic recovery signs were indicated by HSBC India manufacturing PMI which stood at 54.2 for the month of December 2011, as compared to November 2011 PMI of 51.

FIIs during the month “January – 2012” turned aggressive buyers and bought worth Rs. 110.8 bn. On the other hand, Mutual Funds sold worth Rs. 18.5 bn.

Trend in FII and MF activity in equity (Rs. bn)



Source: SEBI, Money control website

Monthly indices

Index	1st Feb, 2012	30th Dec, 2011	% change
Dow Jones	12,716.46	12,217.56	4.08
FTSE	5,790.72	5,572.28	3.92
Hang Seng	20,601.7	18,434.39	11.76
Nikkei	8,880.49	8,455.35	5.03
Nifty	5,235.7	4,624.3	13.2
Sensex	17,300.58	15,450	11.9
BSE -Midcap	5,937.19	5,135.05	15.6
BSE-500	6,605	5,778.68	14.3

Source: BSE, NSE, Ajcon Research

Ajcon's view

After the recent rally in domestic markets, we advice investors to book short term profits. At the current level of 17,233, the Sensex trades at a PE of 16x FY12E earnings estimate and 14x FY13E earnings estimate. At 14x, we trade below average valuations of 15x - one year forward earnings. We believe RBI may consider cutting rates by March-April 2012 which would provide the much needed support to the wounded domestic bourses.

With due consideration to interest rate cycle close to peaking out, we believe that rate sensitive cyclicals will stand to benefit. Accordingly, we recommend to increasing exposure in leading PSU banks. We recommend investors with 9-12 months horizon to adopt stock specific strategy for investment. In our view, investors can consider investing in companies like Canara Bank, Bank of Maharashtra, Jammu and Kashmir Bank, IFCI, Engineers India, Bajaj Finserv, Swaraj Engines, and Wheels India.

In this newsletter, we have touched upon "Gold". Please find a brief study attached below:



Brief Study on “Gold”

Precious metal “Gold” which was in limelight in CY2011 due to its bullish trend came back in picture. Gold prices were high at the start of 2012 in the aftermath of the Fed’s commitment to rock-bottom interest rates, which kept pressure on the US dollar. The price of gold has made an encouraging start to the year, rising by around 6% so far in US dollar terms and outperforming most other assets.

It closed at US\$1,739.19 an ounce, its strongest rise since October, 2011. Gold is still well below the peak of \$1,920 seen last September, and there are significant risks in both directions.

A strong rise in investment demand drove the growth in overall demand, as investors across the globe sought wealth preservation, portfolio diversification and strong returns. Total supply increased slightly, with mine production and recycling activity both contributing to the rise.

A snapshot from the start of each decade since 1970 reveals that gold market fundamentals have experienced dramatic change. Shifting dynamics have driven the market’s evolution from concentration to dispersion, across both borders and sources of demand and supply.

What has changed over the years?

While macroeconomic concerns are the current driving force of gold demand in certain investment spheres, panoply of fundamental factors underpin the prevailing price.

There is a common misconception that the price of gold is primarily determined by Western institutional investors. From time to time, and in the short term, this may be true given the size of individual trades on an institutional level. In the medium to long term, it is still only one of many equally important drivers. Equally, the investment component of demand often steals headlines in the press, overlooking the fact that gold jewellery still constitutes the dominant source of demand for gold. Furthermore, while gold market fundamentals have traditionally reflected events and activity in North America and Europe-whether from jewellery purchases, central bank activity or investment demand, a strong shift away from these two centers has taken place in the last 40 years. The rise of the BRIC countries and other high growth economies is diluting the influence of the West. This shift is undeniably conspicuous in the gold market.

The supply side of the market has not escaped the shifting sands either. In fact, the geographical concentration of supply has seen a far greater change than that of demand, particularly in mine production. Furthermore, a smaller proportion of supply is provided by mine production than in the past, with recycled gold making up the difference. A rising proportion of this increasing supply of recycled gold is stemming from emerging markets where such transactions are more fluid and less costly.

These changes in the structure of demand and supply have a direct impact on the gold price through dampening short term – volatility, swings associated with individual regional business cycles, and extreme moves brought by idiosyncratic events. Not only does this translate into a more stable market than in the past, but it also means that gold’s correlation with other asset classes is reduced.

For investors, gold therefore becomes a more attractive addition to their portfolio strategy. Gold also becomes less susceptible to sharp swings, heralding its value as a tail-risk hedge. Furthermore, some economic theory provides a framework by which gold should yield a return approximate to US inflation over the very long run, equivalent to a zero real return. However, gold's real return since the end of Bretton Woods has been well in excess of zero. The changing structure of the market may be well the driving force.

Opinions on the street for "Gold"

Metals consultancy Thomson Reuters GFMS is of the opinion that gold is nearing the end of a 10-year run that has lifted prices by more than 600% and it expects the metal to peak at a record above USD 2,000 an ounce between October 2012 and March 2013.

Spot gold has been a top-performing asset since 2001 as portfolio diversification, concerns over sovereign risk and rock-bottom interest rates have helped lift prices from a low near US\$ 250 an ounce in 2001 to a peak above USD 1,920 in September 2011.

According to GFMS, Gold is likely to surpass that level in the final quarter of 2012 or the first three months of next year, potentially breaking through the USD 2,000 an ounce level. A combination of factors will ensure that sufficient demand from investors and to a lesser extent official sector institutions comes into the market for it to clear at higher levels. Concern over nearly all currencies' long-term value remains acute, and this includes the US dollar, which to a large extent has found favour simply as the 'least bad' option, especially in light of growing fears over the break-up of the euro zone. However, a normalisation of the broader financial landscape in the next few years is likely to take some of the wind out of gold's sails. The report does acknowledge that the gold market is nearing the closing stages of its decade-long bull run and that, once the macroeconomic backdrop changes and investment in gold fades -- probably some time next year -- a secular retreat in the price will unfurl.

GFMS expects jewellery demand to soften by 3.1% in the first six months of 2012 to 1,027 tonnes, in line with a 2.2% decline in overall demand to 2,199 tonnes. ***China and Turkey are likely to be the main drivers of jewellery demand and the former may overtake India as the world's biggest gold consumer for the first time in the first six months of the year.*** In terms of calendar year 2011, India was ahead, but ... it does seem as though China, in terms of our data for the first half, may just tip ahead.

Central banks seen buying less: Official sector purchases, which are estimated to have leapt to their highest levels since 1964 last year, are seen dipping some 7% to 190 tonnes in the first half, still an historically elevated level. Physical bar sales are expected to rise another 1.4% in the first half after surging by more than a third last year to 1,194 tonnes. Demand for gold bars was particularly strong in German-speaking Europe last year as the debt crisis bit. Official coin and bar investment might continue to grow a fraction, but the implied (investment) figure should swing to net disinvestment owing to euro zone travails, dollar strength and constrained liquidity.

According to GFMS, World investment is expected to decline by some 250 tonnes in the first half of 2012 from the final six months of last year, to 680 tonnes. On the supply side of the market, mine output is expected to rise 3.2% in the first half of the year, although most new supply will come from existing, rather than new, projects. Gold scrap supply is seen dipping 3.1%, however,

as most available material will already have hit the market after a prolonged period of gold price strength. New sellers may also be put off by expectations of higher prices, it added.

Although the fundamentals call for far lower gold prices in the long term to achieve balance, the market's shorter term foundations are not as shaky as might be supposed.

Indian Scenario

Gold jewellery demand in India, a major global market, is estimated to have risen 5 to 7% in 2011. According to Mehul Choksi – Head of Gitanjali Gems, India's biggest jewellery retailer, Indian Gold Market is set to grow a further 10 to 15% this year with bullion prices falling back after recent gains. As per World Gold Council, India's jewellery demand dropped 26% in the third quarter of 2011 to 125.3 tonnes, hit by strong price swings and a weaker rupee.

India, which continues to surprise the world with its appetite for gold jewellery, saw demand for the adornment slipping 26 per cent to 125.3 tonnes in the third quarter of 2011. Even then, the managing director of Gitanjali Gems Mehul Choksi said in an interview with Reuters that last year closed with Indian gold jewellery demand rising between five and seven per cent. The third quarter demand slippage was largely due to seasonal dip in buying, local volatility in precious metal prices and high inflation, according to the World Gold Council (WGC). Choksi's forecast of Indian jewellery demand growing 10-15 per cent this year without being impacted by slowing economic growth will no doubt be encouraging for the gems and jewellery sector that provides employment to over 1.8 million people. But there is a caveat in the pronouncement that the more benign demand growth we saw last year will 'once again catch up the momentum' as prices of gold are to come down. The point is not to be missed that Choksi made the remark after the government virtually doubled the import tax on gold.

Interestingly, China overtook India as the world's largest gold jewellery market in the 2011 third quarter when its consumption year-on-year rose 13 per cent to 131 tonnes, fuelled mainly by buying in smaller cities. If China proved more than a match for India in jewellery buying in one quarter, its preference for gold for investment purposes is becoming increasingly stronger. According to Australian investment bank "Macquaire", it is likely that in the next few years China will leave India behind to become the world's largest gold consumer. India will perhaps not mind this dethroning as its recent import duty revision is intended to discourage large volume inflow of gold, seen as an idle asset.

There is more than one opinion as to how gold prices will behave as we go forward. One thing is clear: the remarkable price performance of gold in recent times has been largely due to the global investment community putting its faith in the metal. Its status as a safe haven or the investment of last resort has remained largely intact in spite of some liquidation of gold position for safety of the appreciating dollar last year-end.

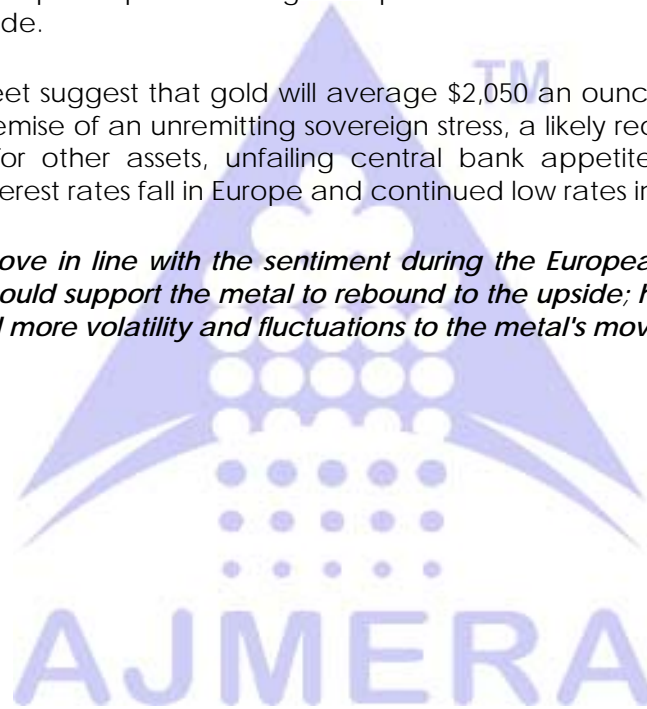
Because of such liquidation, gold shed close to 20 per cent from its record high of \$1,891.90 an ounce on August 22 through 2011 end. At that point, the metal travelled below its 200-day moving average for the first time since January 2009. Principally due to the pickup in investment demand since then, gold did recover some lost ground.

According to a spokesperson for the world's leading precious metals consultancy Thomson Reuters GFMS, the politico-economic condition likely to prevail through 2012 will be the prop for a high level of investment demand for gold. No one expects the sovereign debt crisis in the euro zone to go away quickly as the uncertainties surrounding the US and the West Asia will add to the lustre of gold. Thomson Reuters' belief is that negative real interest rates will remain a feature of this year, as will the possibility of quantitative easing by (the US) Federal Reserve and these issues together could encourage investor demand (for gold) to return to the market.

The premise being such, GMFS expects gold to approach US\$2,000 an ounce in this year's second half while prices in the first half are to "trade fairly weakly." Elaborating the point, the global head of metals analytics of GFMS says, "The euro zone debt crisis led some to seek out the dollar and US Treasuries as a least bad option. However, the re-emergence of US concerns, in particular any apparent need to adopt QE3 (quantitative easing) could really fire up the gold market. After all, gold's price spike last August/September followed from the US debt ceiling impasse and downgrade.

Analyst views from street suggest that gold will average \$2,050 an ounce this year. They arrived at the price on the premise of an unremitting sovereign stress, a likely recession in Europe, not so inspiring an outlook for other assets, unflinching central bank appetite for the yellow metal, prospects of further interest rates fall in Europe and continued low rates in the US.

We expect gold to move in line with the sentiment during the European session, where better than expected data could support the metal to rebound to the upside; however, a downbeat or mixed data could add more volatility and fluctuations to the metal's movement.



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