Mr. Ashok Ajmera, CMD

Mr. Ajmera's column as on December 15, 2014

Global concerns weigh on domestic bourses; bottom up stock picking is the key..

Domestic bourses extended their weekly losing streak to this week, pulling back from a six-week rally, as concerns mount over the ongoing global recovery. FIIs turned net sellers in Indian shares last week after pumping more than US$2bn last month. Cumulatively, they have poured US$17bn into local shares with two-and-a-half weeks to go. Including debt, their total inflows into Indian markets year-to-date stand at US$43bn

The rupee fell to a 10-month low of 62.50 against the US dollar, as the US Dollar remained strong in the overseas markets amid increasing worries over recovery in Eurozone, China and Japan. The rupee weakened past 62-per-dollar level even as data showed that the Current Account Deficit (CAD) widened slightly in Q2FY15 versus Q1FY15 due to higher gold imports. Still, **at 2.1% of GDP the CAD remains within comfortable zone**.

Meanwhile, consensus continued to elude the Central Government and States on the critical reform of GST amid growing concerns over the impending shortfall in FY15 tax receipts. Finance Minister **Arun Jaitley** was quoted as saying that the **GST Bill will be introduced in the Budget session of parliament**. Separately, a Parliamentary Committee approved an increase in Insurance FDI up to 49% but doubts remained over its passage in the parliament during the ongoing winter session.

Globally, Chinese data on foreign trade and industrial output fell short of expectations, adding to jitters over the health of the world's second-largest economy. **Nymex crude oil futures dropped below US$60 per barrel after OPEC scaled back its 2015 demand forecast for its oil**. The International energy Agency

(IEA) also cut its 2015 global oil demand estimate by 230,000 barrels per day.

In Europe, Greek stocks got pummeled after its government decided to hold presidential election two months in advance. The second round of ECB's targeted longer-term refinancing operation (TLTRO) came in below forecasts. The low uptake will likely put pressure on ECB to introduce more aggressive monetary easing to boost the sagging Eurozone economy.

Ajcon Global's view

While foreign investors maintained faith in the structural strength of the Indian economy through the cyclical downturn, it is good to see domestic investors ecoming back to equity markets. We believe markets are likely to consolidate their gains in the near term. We have a long way to go as India is still in an early stage of a structural long-term bull market.

The government has introduced symbolic initiatives such as Clean India and Make in India, which set the path of improving India's ranking on parameters such as the Human Conditions Index and ease of doing business. There would be focus on priorities such as general hygiene, higher literacy, skill development, financial inclusion, e-governance driving efficiency and compliance and infrastructure improvement, while steadily introducing structural reforms such as a national Goods and Services Tax and changes in land and labour laws. There is a clear thought to leverage the full potential of India's demographic dividend by improving the social infrastructure, skilling young people and creating jobs that would lead to higher disposable income and spending. Setting the stage for a larger and longer virtuous economic cycle.

Multiple steps, such as diesel deregulation, decision on gas prices, minor labour reforms, business-friendly compliance practices, and initialising a transparent and fair policy for coal mine auctions have been well navigated. Construction sector foreign domestic investment norms have also changed favourably, with focus on affordable housing. These initiatives would gain momentum in the backdrop of recent political gains. Softening of global commodities has reduced fiscal pressure, while improving the odds for a policy rate cut earlier than anticipated.

We must reckon that the world isn't in great shape. Geo-political risks abound, with West Asia and Russia-Ukraine still vulnerable. Sustained low crude oil prices could potentially invite geopolitical risks not envisaged now. The eurozone, Japan, China and several other emerging economies are struggling to keep the growth momentum on. With Quantitative Easing (QE) expected from the European Central Bank after the surprise 'QE Bazooka' from the Bank of Japan, markets would respond to global money flows. However, it also shows the underlying fragilities in a large part of the developed world. Global markets could witness higher volatility in 2015.

Corporate profit growth is likely to be around 16-17 per cent annually for five years, while a valuation of around 16 times is in line with historical averages. We expect revival in the investment cycle, driven by infrastructure spending, followed by private capex at a later stage. We remain positive on the backdrop of a better outlook on economic variables, earnings outlook and continued liquidity flows. While keeping an eye on macro developments and identifying emerging themes and shifts, our greater focus remains on bottom up stock picking.

Ajcon's view – Sectoral outlook

Paint - The fall in crude oil prices will be beneficial as they use crude oil derivatives as inputs. Given that the entire benefit is not going to be passed on to the end consumer, there will be an expansion in margins. We believe price targets are expected to move up even on current price-earnings (P/E) multiple. However, gains are unlikely to come in the December quarter given that they carry inventory for one-and-a-half months.

Oil Marketing - The decision by the Organization of the Petroleum Exporting Countries (OPEC) to keep output unchanged and its fallout - the sharp fall in crude oil prices - mean a lot for oil marketing companies. As recommended earlier by us the stocks of oil marketing companies have gone up, and there is more upside, given the lower working capital requirement and interest cost savings. Lower working capital will result in better net profit margins, which are yet to be captured in prices.

BFSI- We are positive on select Private Banks. On the other hand, we believe PSU banks are trading at lower valuations on concerns of asset quality. We were impressed by SBI's performance and onward interview with SBI chairperson. Some specific stock picking based on pure fundamentals may give handsome returns. We recommend SBI, Bank of Baroda, Bank of India, Union Bank of India and Canara Bank. The rate cut as suggested by us will give a big boost to credit growth, which is prime concern to banks like SBI.

IT - We remain positive on this sector, as the US economy continues to recover gradually. INR volatility is a cause for concern. We prefer Infosys, TCS and Persistent Systems.

Automobiles - Our outlook is positive. We expect revival in FY15 due to improved policy climate, better consumer sentiment and enhanced infra spending. We believe the CV cycle is near bottom and will revive in the next few months. Hence we recommend Tata Motors, M&M and Maruti at current levels.

Capital Goods - We are bullish on this sector in the medium- to long-term as we are near the bottom of the economic cycle and expect revival in capex in H2 FY15. BHEL, ABB, L&T, Siemens fall in this category to be good investment.

Cement - With a new government at the Centre, there is expectation of a revival in demand for cement as infrastructure activity picks up slowly. We are thus turning bullish on the sector. Ultratech and Birla Corp are the right candidates to be picked up.

Consumption - Although sticky CPI inflation and muted income growth has hurt consumer demand in the past few months, there could be some revival if CPI inflation eases further.

Infrastructure - We are bullish on this sector from a medium term perspective, as a stable and decisive Government at the Centre would bring investment cycle back on track. GMR, IRB, Pratibha, J Kumar can be looked at in this sector from 1-2 years perspective.

Real Estate - We are neutral on this sector. Slow demand environment in most markets (except South India) has impacted sales. Post elections, project approvals could result in increased new launches in the southern market. Still the safe and debt free companies viz. Oberoi Realty and Godrej Properties can be bought.

At current levels, we would recommend buying in stocks in sectors like Banking, NBFCs, Realty, Capital Goods, Infrastructure, Pharma and OMCs. The entertainment and print media space also looks good.

Pharma – We are bullish on leading pharma companies in recent times on the back of a strong recovery in the domestic formulation business, better traction in the base business, gain market share with new product launches, and drug exclusivity in US markets. The quarterly numbers have been pretty good for the pharma companies. They have shown growth between 16 per cent and around 22 per cent, which is probably the best across industries and a lot of Indian companies are still having good product pipeline, especially in the US generic space. However, compliance issues in the US market will be a key risk. Given the fact, while valuations are slightly on the higher side, the sustainability in terms of earnings growth and that too in the high teens make some of the pharma names pretty good, more secular and sustainable stories even from a medium to long-term perspective despite the recent outperformance. At current level, we recommend Wockhardt which is expected to give much better returns in next two quarters. Among other pharma companies, Cipla, Lupin and Sun Pharma remain the best bet.

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