



Mr. Ajmera's column as on 7th December, 2013

"State Election results on Sunday to determine market trend"...

The Hindu nationalist opposition Bharatiya Janata Party (BJP) emerged as the biggest winner in four key state elections, exit polls forecast on Wednesday, a possible blow to the ruling Congress ahead of a general election due next year. India has held elections in Delhi, Madhya Pradesh, Rajasthan and Chhattisgarh over the past month, as well as in Mizoram. Counting and results for all the states are due on Sunday. Despite the gains predicted for the BJP it was unable to win a majority of seats in the capital Delhi, two polls showed. One poll suggested the race was close in Chhattisgarh. The results are being closely watched by markets as a potential indicator of the mood of voters in the world's biggest democracy before the 2014 general election. Indian markets have rallied in recent weeks on signs the BJP's business-friendly candidate for prime minister Narendra Modi is gaining popularity.

Foreign institutional investors (FIIs) continue to pump in money into Indian equity markets, with their net inflow so far this year crossing the Rs. 1-lakh-crore mark on Friday. According to official data, the inflows touched a whopping Rs. 1,01,441 crore as of Friday. According to the Securities and Exchange Board of India, FIIs invested Rs. 100,577 crore (US\$18.07 billion) as of Thursday. On Friday, they invested an additional Rs. 864 crore (provisional data). Of the total net inflow, about Rs. 40,000 crore came in the last three months, following measures taken by the Reserve Bank of India (RBI) to boost the weakening rupee and revive economic growth. A delay in US Federal Reserve's quantitative easing tapering, coupled with better-than-expected September quarter earnings, ensured FIIs kept foreign money flowing into Indian equities. Since their entry into Indian capital markets in 1992-93, net FII inflows have exceeded Rs. 1,00,000 crore in 2010 and 2012. In 2012, FIIs had net invested Rs. 1,28,360 crore (\$24.4 billion), while in 2010, they made a record net inflow (in rupee terms) of Rs. 1,33,266 crore (US\$29.36 billion). Currently, market capitalisation is heavily skewed in favour of large companies. But analysts say there is ample potential for companies with strong fundamentals and sound business models in the mid-cap space. Latest data on shareholding pattern show FII holdings in BSE100 companies is estimated at 15.5 per cent.

These companies account for about 70 per cent of the total BSE market capitalisation. FIIs hold an average 11 per cent stake in BSE mid-cap companies, and eight per cent in small-cap companies.

While the tapering would lead to an increase in market volatility, it would be less painful if India manages to tame inflation and exports pick up meaningfully. For the quarter ending September, 70 per cent of the Sensex companies beat street estimates versus 57 per cent in the previous quarter indicating the earnings downgrade cycle is more or less coming to an end. There is clear under-ownership of Indian equities by domestic investors.

Globally, US stocks soared on Friday, with the Dow and the S&P 500 ending a five-day losing streak after a robust jobs report gave traders confidence that the economic recovery was gaining strength. The S&P 500 scored its best day in nearly a month, with all 10 S&P sector indexes solidly higher in the broad rally. About two-thirds of the stocks traded on both the New York Stock Exchange and Nasdaq ended in positive territory. Both the Dow and the S&P 500 closed slightly lower for the week, snapping eight-week rallies. US employers added 203,000 jobs to nonfarm payrolls in November, exceeding the forecast. The US unemployment rate fell to a five-year low of 7 percent in November from 7.3 percent in October, the Labor Department said. The Dow Jones industrial average jumped 198.69 points, or 1.26 percent, to close at 16,020.20. The Standard & Poor's 500 Index climbed 20.06 points, or 1.12 percent, to finish at 1,805.09. The Nasdaq Composite Index gained 29.36 points, or 0.73 percent, to end at 4,062.52. The S&P 500 recorded its best day since November 8, and the Dow's gain was its largest since October 16. After an eight-week run that pushed the S&P 500 up nearly 7 percent, the benchmark index had dropped 1.2 percent over the past five sessions, its longest losing streak since late September. For the week, the Dow fell 0.4 percent, and the S&P 500 dipped 0.04 percent, while the Nasdaq rose 0.07 percent.

The Indian equity markets have been buoyant since September 2013 and have rallied by about 20 per cent to a new lifetime high. However, one-year forward P/E multiple for the Sensex continues to be within its long-term mean of 14-15 times. Though the mid-caps and small-caps have seen some buoyancy over the last one month, one-year forward P/E multiple for BSE mid-cap and BSE small-cap indices suggest that the two indices are still trading at a discount of about 13 per cent and about 35 per cent to the Sensex, respectively.

At Ajcon, we believe, investors should focus on cyclical stocks and position themselves for other dominant themes, that is, rural and export-led businesses, reforms and earnings upgrade and related stories. We recommend selective bets in banks and cyclicals such as capital goods, infrastructure, metal and automobile. Companies in this space are trading at distress valuations, in some cases at a 50 per cent discount to the replacement cost. Valuations in defensives are very rich, with sectors like fast-moving consumer goods, pharmaceuticals and information technology trading at a significant premium. However, selective opportunities here are good to have in the investment portfolio. Quality mid-cap businesses, which are leaders in respective segment, can also be looked at for investment.

Your Friendly Advisor since 1986,

CA. Ashok Ajmera

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