



Good Morning

The Big Picture

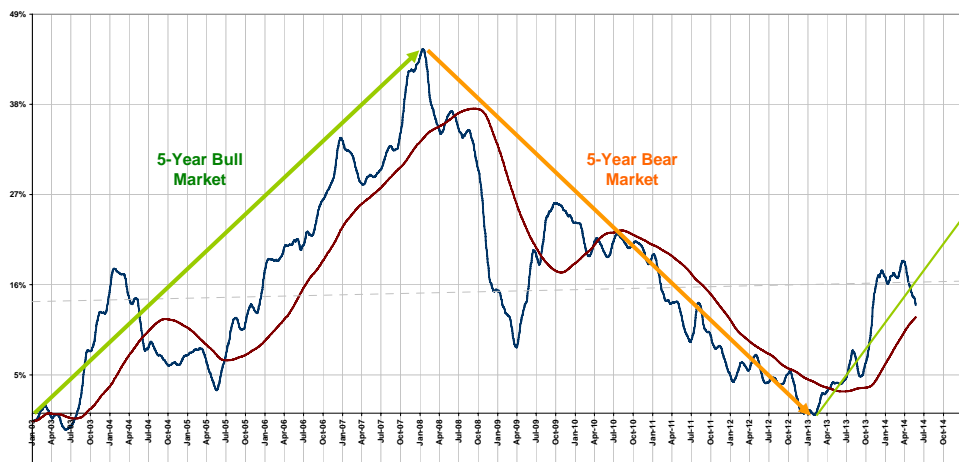
21st May 2014

Overview

The BJP-led coalition swept to power in the general elections, exceeding almost all expectations, and therefore we will have a strong government for the next five years. This is also momentous because this is the first time since independence that a right-wing party has an absolute majority in the parliament. From an ideological point of view, this could be a paradigm changing period for the economic governance of this country. And finally, in terms of the political superstructure, this is the best thing that has happened for the equity markets.

A New Bull Market

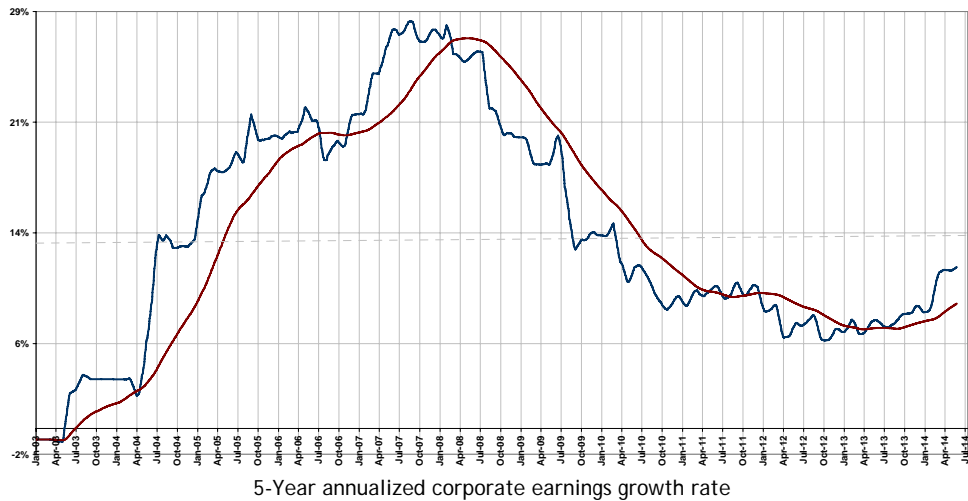
This political event may also coincide with several structural changes which were already happening in both the macro-economic environment and the corporate sector. A combination of these factors could propel us into a new bull market for the next five years. Markets tend to follow a 5-year cycle - either a bull, bear or a stagnant market. It appears that we may be in the early stages of the next bull market.



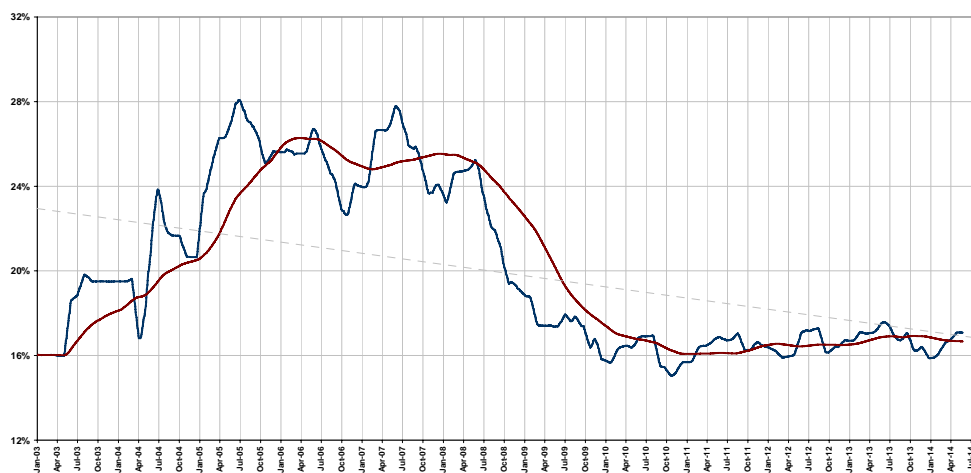
5-Year annualized growth rate of Nifty-50

Bull markets are typically characterized by an increase in corporate earnings growth and a simultaneous expansion of the Price/Earnings multiple. As we have mentioned earlier, corporate earnings growth over the last several quarters has shown signs of bottoming out - although it may

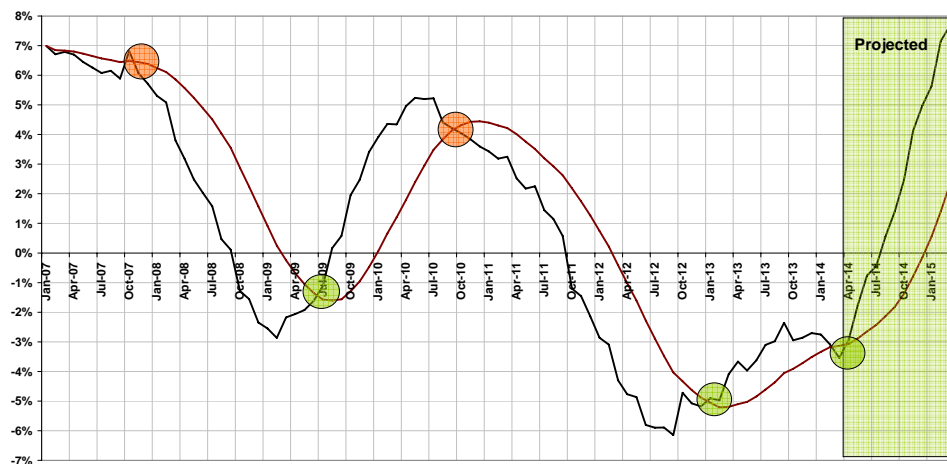
be early to pronounce a turnaround and currently a 5-year CAGR is still below the long-term average of 14%, an upswing appears to be a very likely event over the next few quarters.



Return on Capital employed, which we believe is the key determinant of the investment cycle, has been depressed for several years. This is a problem which cannot be fixed quickly by any government - this will be a function of structural changes, which will take a much longer time to fix.



On the macro-economic front industrial growth is projected to shoot up, although this is primarily due to the low base effect. Inflation at the moment appears that will be in the 5.5 to 6.5% range - but this could change if the monsoons are poor (due to el nino effect) and food inflation again shoots up.



Outlook

Although it may be fallacious to suggest a new government would be a panacea for all problems, it is a big step towards an economic turnaround. In the immediate term the change in sentiment and fixing the low-hanging fruit will itself be a booster. Issues such as infrastructure development, improving performance of Public Sector banks and companies, tax & legal reforms, water management, agricultural growth and social development will be in focus after the first six months - and this government's performance on these will determine the strength of the bull market.

If this government performs well on these counts, as we expect them to, we could see an annual growth of 25-30% in the equity market indices (as is typical of Indian bull markets). We would strongly recommend a much higher allocation to equities and suggest a move away from debt and real-estate - debt will not beat inflation (which will remain high, firstly because structural problems will not be fixed easily and secondly because growth itself will spur inflation) and real-estate in risk-on periods tends to considerably underperform equities. In five years time, it is possible that the number "25K" may be used to describe Nifty-50 rather than the Sensex! As the new Prime Minister said, it is time for "acche din".

Happy Investing.

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