



# Burden of expectations

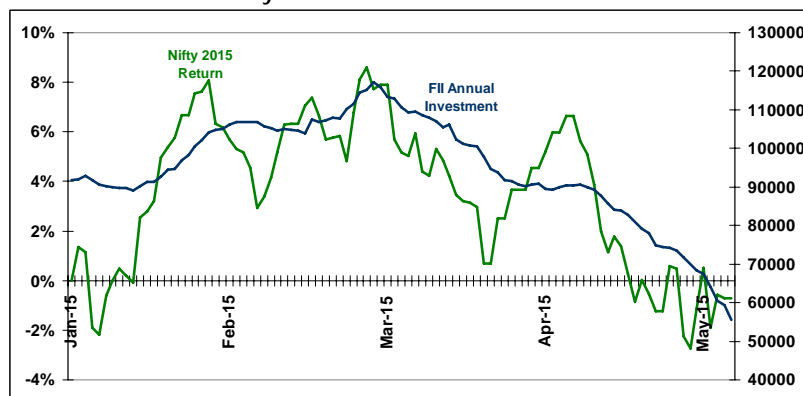
The Big Picture  
15<sup>th</sup> May 2015

## Overview

The Indian equity markets which started CY 2015 well enough to post gains of over 8% in the first two months, lost all their steam consequently and are now marginally down for the year. There are several reasons for this -

- Corporate earnings for the third quarter of FY 2014-15 were a surprising disappointment and the fourth quarter results are not looking any better.
- The central government's deliberate ambiguity on the tax treatment of foreign investors (which has persisted from the UPA government's days) has triggered selling by foreign institutional investors (FIIs), who have sold about Rs 15,000 crores in April and May.
- There is a growing realization that after one year of the NDA government, not much has changed on the ground in terms of an economic recovery and that the expectations were unrealistically high.

Nifty returns in 2015 and FII flows



At -0.7%, India is now the worst performing market among major equity markets. For CY-2015, the Impact Global-Market-Index is up 8.8%, Emerging-Market-Index is up 17.5% and significantly China is up 33.2%. Even over a one year period, Nifty gains of 14.6% pales in comparison to returns of 20% for the Global-Market-Index. India is increasingly looking like an under-performer and the disenchantment with India is taking root, with even the rupee starting to depreciate - a far cry from a year ago when it was expected to outperform by a long mile.

## One year hence

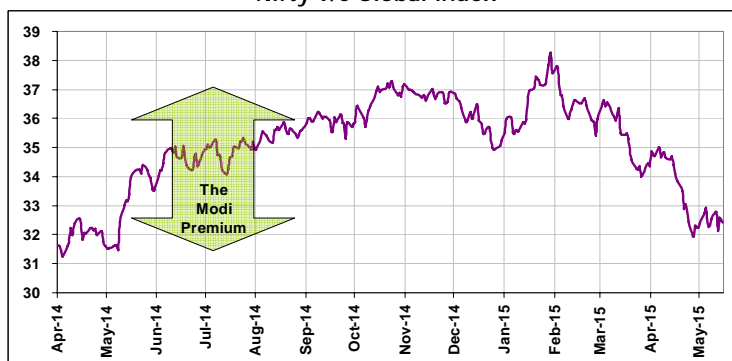
There were very high expectations that a market-friendly right-wing government at the centre would usher in reforms, manage the economy better and therefore trigger a long awaited economic recovery. In fact a year ago, we had had called it *“a big step towards an economic turnaround”*. Unfortunately, the data available and anecdotal evidence from the ground, suggest that it may have actually gotten a little worse over the last one year. With the exception of inflation which is at historically low, the current readings are worse than what they were during the UPA government. Even with regards to inflation, notwithstanding the fall in crude oil prices there is sufficient evidence to suggest that it could be due to demand destruction and loss of pricing power, which is a negative rather than a positive - the line between low inflation and deflation can be rather thin.

	Current	10-Y avg
Nifty Returns	14.6%	18.6%
Corporate Earnings Growth	1.4%	14.7%
Corporate Return on Book Value	16.1%	20.4%
IIP Growth	2.1%	6.5%
Inflation	1.3%	6.5%
Export Growth	-0.9%	18.7%
Import Growth	-0.6%	21.4%
Govt Bond Yields	7.95%	7.81%
Credit Growth	9.8%	22.4%

*Current: Last available data, 10-Y avg: Average from May-2004 to April-2014*

Post the election results, both domestic and foreign investors re-rated the Indian markets assigning it a significant premium over other global markets - what we would call *“The Modi Premium”*. Over the last three months, that premium has completely disappeared. In equity markets or in the economy, where sentiment and optimism over the future plays a big role, the government must surely rue the evaporation of this advantage. The causes are the same as we have been writing about in the past - insufficient progress on reforms, no significant improvement in ease of doing business, the same tax quagmire, no change in quantum of stalled projects and no real change in the way the government runs.

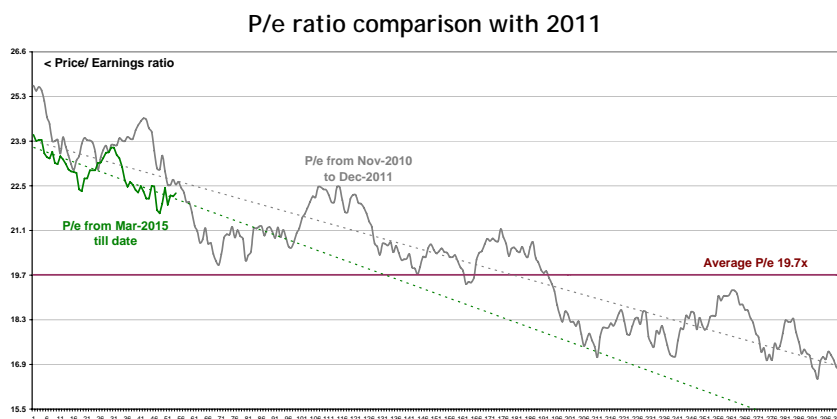
Nifty v/s Global Index



## Outlook

Indian equity markets continue to be a vulnerable position. The lack of an economic turnaround and consequently the deterioration in corporate earnings coupled with the reversal in sentiment will put a cap on any significant upside gains. Despite the correction, Price/Earnings multiple (P/e) continues to be over 22 - with the current EPS of 372, a move towards the long-term average of 19.7x would mean that Nifty could fall by another 11% (to 7318) - that will be the persistent risk.

In addition, the Federal Reserve is likely to start increasing rates sooner than later - US treasury yields have already started rising rapidly. That "taper tantrum" will affect all equity markets and especially emerging markets. A repeat of 2011, where Nifty fell by 28%, suddenly seems plausible. As we head into rougher weather, the NDA government may find that it has frittered away the advantage of business optimism and a benign macroeconomic environment to push through the required structural reforms. Whether it can do so in tougher times will be the true test, although the failure to pass the GST Bill is definitely an ominous sign.



Happy Investing.

**Sashank Vipparthi**  
sashank@idika.com

## Disclaimer

This document is designed by Impact Consultancy Private Limited (ICPL) to highlight its investment strategy in light of the macro economic trends in Indian economy, research analysis and research on equity markets. The contents of this document are subject to change without any notice.

The sole purpose of this document is to inform and is not intended as an offer or solicitation to purchase or sell any security, investment product or service or to attract any funds or deposits.

The investment products described herein contain risks at varying levels, including lack of liquidity and the potential loss of all or a part of the amount invested. Thus investment references may not be suitable for all clients. Before making any investment decision each investor should carefully consider the risk associated with each investment/product and also refer to the terms of the offer document. The investment decision should be based upon investor's own investment objectives, risk profile and illiquidity tolerance. Opinions expressed herein, if any, may differ from the opinions expressed by other businesses or affiliates of ICPL, are not intended to be a forecast of future events and are subject to change based on market and other conditions. Past performance is no guarantee of future results, and future results may not meet our expectations due to a variety of economic, market and other factors. In any event, any projections of potential risk or return are illustrative and should not be taken as limitations of the maximum possible loss or gain. Moreover, no guarantee or representation is given that any investment or asset allocation model will achieve its investment objectives. The information provided in this document is not sufficient basis upon which to make investment decisions.

This document has been prepared for the personal use of ICPL's clients or the prospective clients to whom it has been delivered. It is not to be reproduced or distributed to any other person except with the permission of ICPL or to the client's professional advisers. In addition although the information has been obtained from sources believed to be reliable, ICPL does not guarantee its accuracy or completeness and accepts no liability for any direct or consequential losses arising from its use. Distribution of this presentation may be restricted in certain jurisdictions; persons into whose possession this publication comes should inform themselves of and observe such restrictions. This document does not constitute the distribution of any information or the making of any offer or solicitation by anyone in any jurisdiction in which such distribution or offer is not authorized or to any person to whom it is unlawful to distribute such a presentation or make such an offer or solicitation.

At any time, ICPL, its employees or its affiliates may have a position, subject to change, in any securities or instruments referred to, or provide services to or otherwise have business dealings, with the issuers of those securities / investments.