SHIV SHAKTI
International Journal in Multidisciplinary and Academic Research (SSIJMAR)
Vol. 1, No. 3, September-October (ISSN 2278 - 5973)

Emerging Trend in Stock Market: What to Conclude?

Mr. Mukesh R.Goyani*

Mr. Jignesh P.Vaghela**

ABSTRACT:

To understand Indian stock markets in the context of global scenario coupled with India centric problems. To take progressive look at major growth drivers, liquidity crunch and valuation. Study also deals with current investment themes.

The topic deals with state of current Indian market conditions and related global issues. It takes into account major economic indicators such as IIP and corporate sales correlation with it. Study elaborates Indian GDP estimates done by major reputed agencies and their implication. It further goes upon RBI policy action to stimulate growth and also takes into consideration policy reforms under the light of near term election scenario.

Practical case to case arguments have been given with sector specific approach for better evaluation of investment themes. Study throws more focus on high earning visibility, low dependence on fresh capital & positive leverage to lower commodity prices, lower interest rates and stronger rupee.

* R.V.Patel & V.L.Shah College of commerce Amroli, Surat. Gujarat

“EMERGING TREND IN STOCK MARKET: WHAT TO CONCLUDE?”

Index:

1. Executive summary: -

1.1 Indian Markets …. Tied to global concern Coupled with our own problems

1.2 Indian markets will be driven by global developments in the near term, but long term outlook still intact

1.3 Growth drivers are improving (commodity Prices, inflation, interest rates), though high Growth rates will return only with a (still Unknown) lag

2. Objectives of the Study

3. Research Methodology

4. Finding:

5. Conclusion

6. Reference

1.Executive summary:

Introduction: -

Globally equity markets are witnessing perhaps their toughest time ever amidst credit squeeze, rising risk aversion, falling asset values, rising unemployment and declining consumption. Being the part of globalized world, India can not remain aloof from this financial massacre. We here have tried to understand where Indian equity markets would move and which fundamental factors would be either in favor or in against of it. This includes both domestic and international scenarios. India has seen strong GDP growth over the period of last 3 years on the back of subdued interest rates, rising global demand and increasing asset values. But with sudden blow of credit crunch coupled with major fear of recession in US and other parts of the world, Indian companies will also face the hit on their profitability. Indian companies have seen good growth in both revenues and profits in last 3-5 years, but with broader slowdown (visualized by weaker IIP numbers & slowing GDP growth), our corporate will also observe slow down in revenue and will take contraction in their profitability due to higher interest and depreciation costs. Hence after considering all these parameters, we have covered current investments themes with their respective plus and minus points.

1.1 Indian Markets …. Tied to global concern Coupled with our own problems

Extreme risk aversion globally is depressing asset prices. De-rating of equity is classic example of the same. Sensex is currently trading at ~ 9 times its FY09E earnings against its peak valuation of 21 times when index was at ~ 21,000.

Liquidity to be tight in the short term; long term capital availability has declined sharply. Higher call rates, fixed deposit rates & T-bills rates are well justifying this fact.

Slowdown in industry & investments will put pressure on earning growth momentum. Due to lag effect of higher interest rates & commodity prices, there will be slowdown in growth momentum. As a result of this most leading agencies have reduced Indian GDP growth forecast for FY09. Below is list of the same.

UBS -	7.1%
Goldman Sachs-	7.5%

Citi Group -	6.6% (2009)
Morgan Stanley -	7.1% (FY09), 7.6% (FY10)
JP Morgan Chase -	7% (FY09)
CRISIL –	7.8%
NCAER –	7.6%

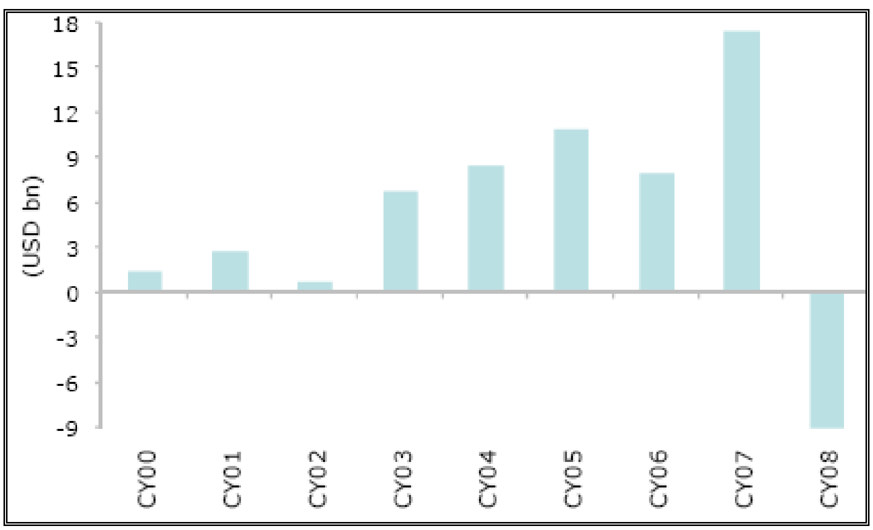
1.2 Indian markets will be driven by global developments in the near term

Until July our markets were dominated by domestic factors such as higher inflation & uncertain political scenario (vote of confidence), but now the axis has shifted to global factors at least for the rest of CY08 amidst huge credit crisis happening in US followed by Europe & UK.

As a result of credit crisis, risk aversion has touched sky and there has been huge sell off by FIIs in our markets as well.

FIIs, which were net buyers since 2000 have first time in this decade turned out to be a net seller in CY08. So, negative leverage to FII outflows will keep markets subdued.

Net FII flows negative for first time in this decade



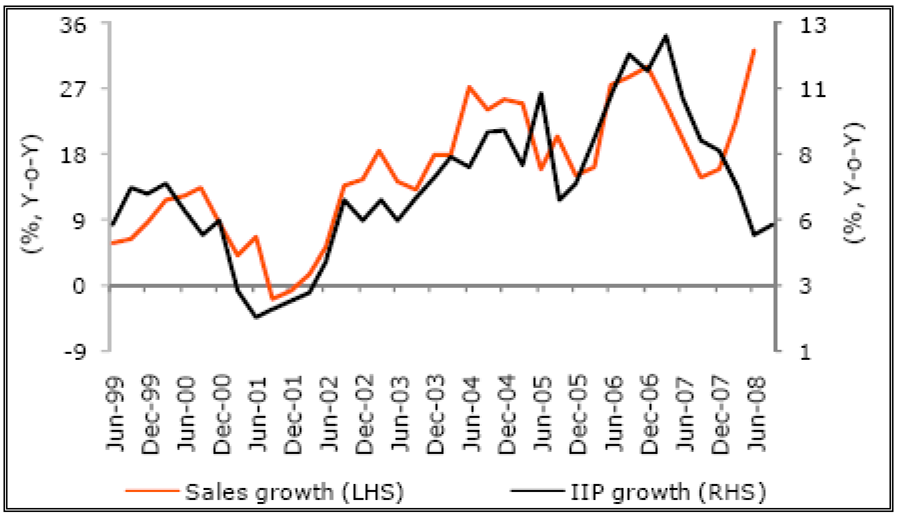
1.3 Growth drivers are improving (commodity prices, inflation, interest rates), though high growth rates will return only with a (still unknown) lag

Lower commodity prices (both agri-commodity & non agri-commodity), lower inflation & hence lower interest rates are basic growth drivers of any equity markets. All of these are actually witnessing cool-off from their peak.

However, their real benefit will not be immediately reflected in growth numbers as there is always time lag.

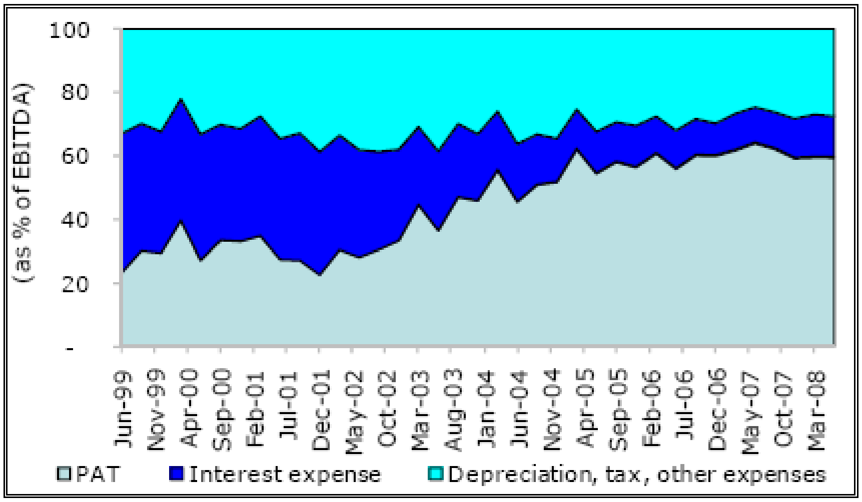
At this point of time, industry is observing slow down effect amidst past tightened monetary policies. We can see from below chart that, there is unidirectional movement between IIP growth & sales growth, but off late post Dec-07, we can see that there has been divergence between IIP growth & sales growth. With IIP being leading indicator, it is expected that sales growth to follow same trend adapted by IIP growth.

Sales Growth at Risk due to Sharp slowdown in IIP Growth



1.3.1 Earnings growth (below EBITDA level) driven by lower interest cost; at risk with rising interest rates

The regime of lower interest rates & depreciation rates has gone now as most corporates have gone for capital expenditure with increased funding & hence it ultimately will keep earnings growth and profitability of the Indian corporate sector under pressure in the near-term.



But there are good news as well..

Inflation is Peaking and will fall down to single digit growth.

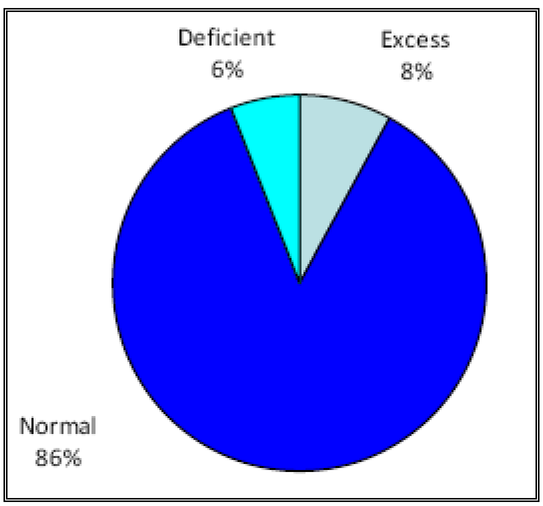
Inflation is coming down in most economies…

	Peak in CY08	Aug-08	Off from Peak
China	8.7	4.9	(3.8)
Thailand	9.2	6.4	(2.8)
Taiwan	5.9	4.8	(1.1)
Hungary	7.1	6.5	(0.6)
Israel	5.4	5.0	(0.4)
Argentina	9.3	9.0	(0.3)
South Korea	5.9	5.6	(0.3)
Euro zone	4.0	3.8	(0.2)
Brazil	6.4	6.2	(0.2)
United states	5.6	5.4	(0.2)

Chile	9.5	9.3	(0.2)
Russia	15.1	15.0	(0.1)
Indonesia	11.9	11.9	(0.1)

As seen from the above table, Inflation in most part of the world is coming down from the peak rates reported in CY08.

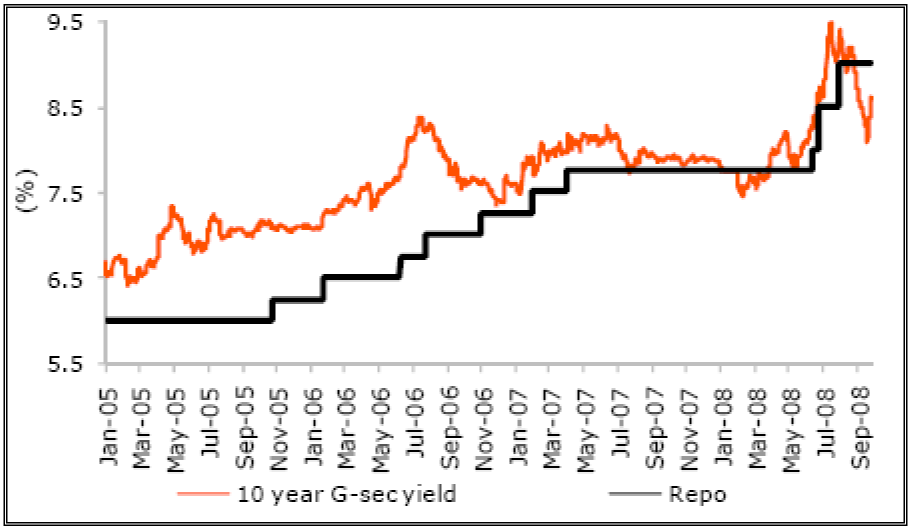
Monsoons have been by and large favorable



In India too, with falling crude oil prices and other commodities, inflationary pressure is likely to cool off by the end of CY08. Last week's reported number of 11.4% is first indicator of the same. Also normal monsoon in majority part across the geography (86%) will have normal crop accretion. Above chart depicts the details.

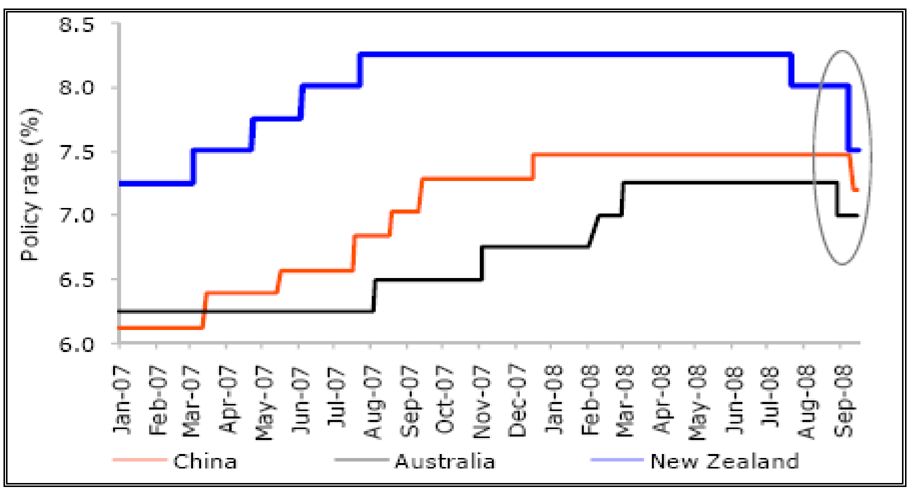
With fall in inflation, Interest Rates would also fall…best indicator is falling bond yields.

Bond yields peaked; policy rates to follow with a lag



Usually bond yields are best indicator of any interest rate cycles and policy maker's decision usually follow after yields movements. Above chart depicts the same detail.

Early signs of monetary easing globally

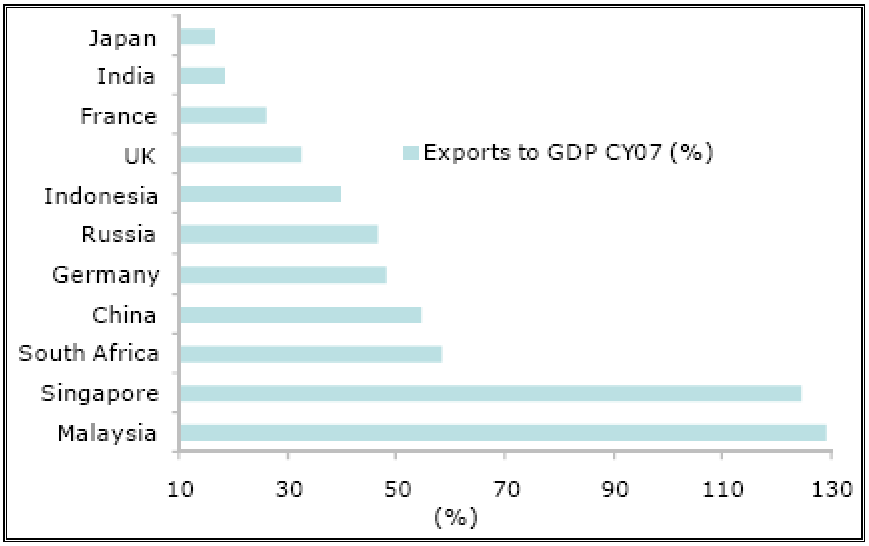


We have already seen fall in CRR by 350 bps and Repo rate cut 150 bps and we further anticipate RBI to cut the rate.

Global slowdown – India is relatively less connected to it

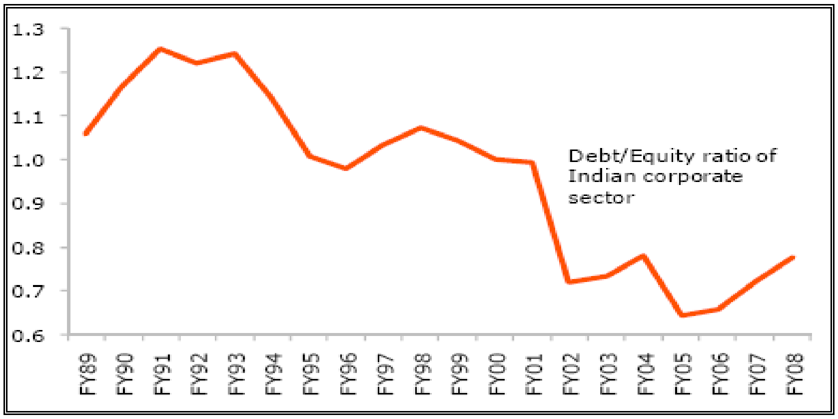
India is less impacted by slowing global growth due to low dependence on exports and resilience of domestic consumption

Low dependence on exports



Corporate India is still under-leveraged…

As seen from below chart, corporate India is now less leveraged compared to late 90's. Debt-Equity ratio of corporate India is still below much comfortable level of 1.



2. Objectives of the Study

Basic objective of the study is to understand the nitty-gritty of current emerging trends of current Indian stock markets in conjunction with globalize scenario. As we know that world financial markets are inter connected and present global credit squeeze coupled with slowing major developed economies are impacting other emerging markets such as India by way of capital outflow as well as business slowdown. However paper's objective is to analyze Indian markets future prospects based upon its inheriting fundamental strength apart from other factors such as political scenario. Objective of the paper is to highlight major sectors with their respective plus and minus points.

3. Research Methodology

In the preparation of the this study paper, we have adopted mainly top-down research methodology, which involves evaluation of macro factors study starting from global scenario and ending toward domestic values. So, we have moved down from top to bottom by way of analysis of global paramours affecting Indian equities coupled with little micro analysis of various sectors and industries with quick supportive fundamental comments on them.

4. Finding: -

Our finding in this paper is very interesting. We have discovered that liquidity is the mother of all price discoveries in short term. Hence, in long term asset prices are determined by inbuilt fundamentals but we also must not forget that in short term they are determined by liquidity. So, we can say that price is output of crowd's emotional input to the given fundamental event. We have found that our equity markets have rightly reacted to global credit crunch by way of sharp outflow done by FIIs. How our markets are too much dependent on capital inflows and how or markets are vulnerable to capital outflow. We have found that Indian corporate revenue has leg effect on its growth compared to IIP growth and their profitability would be impacted by sharp rise in interest rates and depreciation coupled with general slowdown. We have also found the importance of election on Indian equity market and how in the past our markets have performed post elections. We can say that for India growth drivers are improving such as falling commodity prices, inflation and interest rates, but at the same time we still do not know when growth rates will return due to still unknown time lag combined with uncertain global financial territory.

5.Conclusion

1.“All of us know that in long term asset prices are determined by inbuilt fundamentals but we also must not forget that in short term they are determined by liquidity”

2.As global markets stabilize, focus should return to growth in India and the political situation.

3.Impact of falling commodity prices, inflation and interest rates will take a while to reflect in corporate earnings.

4.Investment demand is likely to pick up only postelections.

5.Outcome of state elections over next 2-3 months to determine government's decision on early elections. Currently it is expected to witness general elections in April 2009.

6.Elections have historically been positive for markets as new governments drive reforms in their early years.However, uncertainty on the composition of the next government could be a drag.

Election year	Sensex returns around election (%)			
	3m prior	1m prior	1m later	3m later
1980	(4.9)	1.5	3.3	8.4
1984	10.3	2.7	4.4	30.2

1989	(0.6)	(3.9)	11.9	(2.3)
1991	(2.8)	0.0	8.9	44.0
1996	9.3	11.8	3.0	(5.6)
1998	(20.2)	2.0	13.5	12.4
1999	29.1	2.9	(2.1)	14.0
2004	22.1	6.6	(10.7)	(5.8)

Current investment themes are:

(1) High earnings visibility

(2) Low dependence on fresh capital

(3) Positive leverage to lower commodity prices, lower interest rates and a stronger rupee

Sector	View	Investment argument	risks
Auto		Moderating steel price, lower input cost, Possibility of fuel price cut, Inflation and interest rates peaking	Economic slowdown may affect demand, Current interest rates are still high, Increasing competition

FMCG		Strong consumption demand, High visibility of earnings & cash flows, Favorable government policy	Down-trading due to high inflation, High valuations (still at 15-18 times forward P/E)
Media & Entertainment		Favorable demographics, Rapid urbanization, Strong lifestyle, consumption demand	Increasing competition, Lower ad revenue during slowdown
Pharmaceuticals		Defensive play during US slowdown, High visibility of earnings	Risks from R&D failures and litigations
Oil & gas	←→	Falling crude prices, refiners to benefit, Increase in E&P activity, High visibility of earnings	Falling refining margins, Possibility of fuel price cut
Telecom	←→	Increasing penetration, Strong consumption demand, High visibility of earnings	Lower rural growth, declining ARPUs, Increasing competition
Power	←→	Supportive government policies, Power infrastructure development	Execution challenges, High interest rates; capital availability issues & scarcity of key fuel inputs

Banking & Financial Services	←→	Falling bond yields (MTM gains), Possible interest rate easing, Attractive valuations (Most banks now trade at par to Book Value)	Reduced capital market activities, Concerns over quality of assets, Global credit environment worsening
Metals & Mining	↓	Only dependent on volume expansion plays, Most Indian players are integrated	Moderation in prices, Policy risk
IT	↓	INR depreciation help maintain margins, Insulated from inflation & interest rate, Strong management	Poor visibility because of economic slowdown, Potential pricing (billing) pressures
Capital Goods & Construction	↓	Infra spend to pick up post elections, Moderating input costs	Slowdown in investment cycle, Execution challenges
Real Estate	↓	Attracting private equity capital, Possible interest rate easing, Attractive valuations	Very high chances of correction in real estate prices, High interest rates; capital availability issues, Economic slowdown may affect demand

Cement	↓	Infrastructure spend to continue, Positive outlook for long-term	Concerns of over-capacity for the next 2 years, Policy risk

6. References: -

Reserve Bank of India

Security and Exchange Board of India

Bloomberg

CNN – Money

CRISIL

Edelweiss Capital

Web links: -

www.rbi.org.in

www.sebi.com

www.bloomberg.com

www.money.cnn.com

www.crisil.com