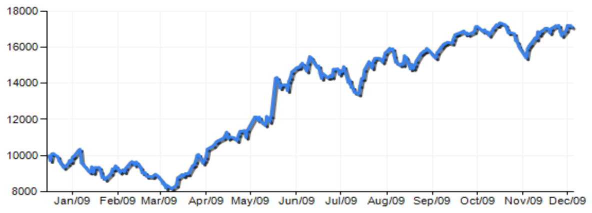
NextGen India Investments

11 February 2008

BSE Sensex	16,631

Market Outlook
Underweight (UW)

Sensex (1 year trend)



BSE Sensex Performance (%)	1m	3m	12m
Absolute	-19.2	-12.0	36.3

Key Indicators	Sensex	BSE-100
PE	22.2	22.5
P/BV	5.7	5.6
Div. Yield (%)	1.0	1.0

Energy and Precious Metal	
Crude Oil Futures (USD/bbl)	87.1
Gold 100 OZ FUTR (USD/t oz.)	885.9

Forex and Money Market	
India GSec Yield (10 Year %)	6.8
USD/INR	39.3

Issuer of the report: NextGen India Investments
Tel: +1 647 478 7735
Email: research@nextgeninvestment.com

Equity Strategy

India Equity Market Update 2008

Decoupling a myth; downtrend to continue

Equities: Negative Outlook

Downside target revised at 14,000. High valuations and negative sentiments to trigger further downside momentum. Mid caps and small caps would underperform.

Decoupling a myth

There is no historical evidence of theory of decoupling of Indian equity market with global equity markets. The recent fall provides evidence of absence of such decoupling. Going forward also, the movement in Indian equities is expected to be in line with global equity markets. Indian equity prices usually lead economic performance.

Fall in energy prices: Temporary?

Fall in interest rates and energy prices have positive impact on corporate earnings and liquidity. Technically crude is to fall below $65 for 3 consecutive months to confirm downtrend. So there is still inconclusive evidence of fall in energy prices. Recent fall in commodity prices should be viewed positively for corporate earnings. However long term bull market for commodities is intact therefore further evidence in this regard is needed to conclude about commodity prices.

Union budge to impact sentiments

Budgetary provisions and speech would provide further indications for expected performance. Till the market stabilizes, value stocks/sectors would outperform the broad market. However once market stabilizes, growth stocks would come back.

Market outlook: Negative

Downside momentum to trigger further fall; BSE Sensex target set at 14,000

As expected in the previous newsletter dated November 8, 2007, BSE Sensex is close to reaching the downside target of 16000. Valuations in terms of PE have come down to 20. However from top down perspective, the value for new buying is yet to emerge. Even the PE of 20 is high as per historical standards. For value to emerge, market needs to fall at more reasonable levels. Next downside target for BSE Sensex can be set at 14,000.

The upside momentum, as mentioned in earlier newsletter dated November 8, 2007 is over. It is replaced by downward momentum globally, the pace of which is quite high and Indian market is leading in downside momentum due to high valuation. This momentum has sufficient pace to trigger further fall. In case of further fall, midcaps and small caps would be affected more than Sensex stocks; and the extent of negative divergence would be quite severe. The failure of IPO's would have long term impact on the health of both primary and secondary markets.

Decoupling a myth

No evidence of decoupling with global economy

As mentioned earlier, there is no evidence of theory of decoupling of Indian equity market with global equity markets. And, the recent fall provides evidence of absence of such decoupling. Going forward also, the movement in Indian equities is expected to be in line with global equity markets.

Indian equity prices lead economic performance

Having said about decoupling, there is sufficient evidence that stock market in India and economic growth are co-related. Under this hypothesis, Indian equities lead corporate performance. That is correct for both recovery and recession. The same happened in fall of 1995 (equity market led the recession by one year), recovery from 2001 (equities led the recovery by 6 months). However, based on fall in Sensex, it is not reasonable to conclude about slowdown in Indian economy. It would be prudent to closely watch, credit off take numbers, resale rates of commercial vehicles and freight rates (normalized for fuel price changes).

Unlike North America, in India fall in equity prices is not sufficient cause to trigger downturn in economy. It is due to low exposure of Indian investors in equities. So fall in equity prices would have relatively moderate impact on Indian consumer demand.

Fall in energy prices: Temporary?

Fall in interest rates and energy prices have positive impact on corporate earnings and liquidity. However historically this impact translates into better earnings with lag effect. For equities, such lag effect can be anywhere between 12 and 24 months. Also, technically crude is to fall below $65 for 3 consecutive months to confirm downtrend. So there is still inconclusive evidence of fall in energy prices. Recent fall in commodity prices should be viewed positively for corporate earnings. However long term bull market for commodities is intact therefore further evidence in this regard is needed to conclude about commodity prices.

Risk aversion from equities to continue

Stability/ fall in gold prices would provide indication of initiation of positive sentiments towards global equities as an asset class. However, there is no indication of fall/stability of gold prices. Also, risk aversion from equities is the global trend.

Union Budget to impact sentiments

Union budget to impact corporate performance

For India, union budget has been a trigger to turnaround the sentiments. It has more sentimental impact than fundamental. Budgetary provisions would be closely observed by market players.

From bottom up approach, deep value has started emerging in certain stocks. For such buying, more focus should be placed on balance sheet based valuation on current numbers than valuations based on earnings or forward projections.

Sectors as mentioned earlier continue to be potential candidates for rerating. Budgetary provisions and speech would provide further indications for expected performance. Till the market stabilizes, value stocks/sectors would outperform the broad market. However once market stabilizes, growth stocks would come back. Indian market is essentially perceived as growth market by FII's and after stabilization it would be prudent to selectively pick growth stocks/sectors.

APPENDIX I

Disclosure Section

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Equity rating key for long-term investment opportunities

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Neutral (N) – The stock's total return is expected to be in line with the total return of the MSCI India Total Return Index, on a risk adjusted basis over the next 12-24 months

Underweight (UW) – The stock's total return is expected to be below the total return of the MSCI India Total Return Index, on a risk adjusted basis over the next 12-24 months

Not-Rated (NR) – Currently we do not have adequate conviction about the stock's total return relative to the MSCI India Total Return Index, on a risk adjusted basis over the next 12-24 months

Unless otherwise specified, the time frame for price targets included in NextGen India Investments Research is 12 to 24 months.

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Issuer of the report
NextGen India Investments
206-102, St. George Street
Toronto, ON M5R 2N6, Canada
Telephone- +1 647 478 7735
Website: www.nextgeninvestment.com

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