



29 September 2008

BSE Sensex 12,596

Sensex (1 year trend)



BSE Sensex Performance (%)	1m	3m	12m
Absolute	-13.5	-8.7	-27.1

Key Indicators	Sensex	BSE-100
PE	17.3	18.2
P/BV	3.6	3.5
Div. Yield (%)	1.3	1.2

Energy and Precious Metal

Crude Oil Futures (USD/bbl)	91.1
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Gold 100 OZ FUTR (USD/t oz.)	742.1
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Forex and Money Market

India GSec Yield (10 Year %)	7.9
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USD/INR	44.0
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All prices are closing prices for September 26, 2008. Data is sourced from Bombay Stock Exchange (BSE), Bloomberg and the subject company. This report should be considered only a single factor in making investment decisions.

India Equity Market Update 2008

Equities to continue underperforming; anticipating decline in corporate earnings

Equities: Negative Outlook

As expected in the previous newsletter dated June 29, 2008, BSE Sensex is close to reach the downside target of 12,000. Now its time for another review. The downside target is revised to 10,000. On upside, 15,000 may be considered cap.

Worsening global outlook to impact FIIs flows

FIIs may face redemption pressure. Worsening sub-prime situation to destabilize US and European financial system. Decline in value of US dollar and devaluation by China may create imbalances in global trade and delay the recovery.

Indian corporate performance to decline

US slowdown and demand contraction may adversely impact the export earnings of Indian companies. The adverse impact of high interest and high inflation in India may get reflected in corporate results ending December 2008. Indian companies made overseas acquisitions at higher valuations; demand contraction in acquired companies and high leverage of acquirer would lead to underperformance in share prices of such Indian companies

Higher valuations to lead underperformance

Indian equity prices are expensive in comparison to other emerging markets and historical standards. It would lead to underperformance. Infrastructure and industrial sectors may underperform. Lack of immediate triggers and absence of reforms may correct the equity prices downward.

Market outlook: Negative

As expected in the previous newsletter dated June 29, 2008, BSE Sensex is close to reach the downside target of 12,000. Now its time for another review. The downside target is revised to 10,000. On upside, 15,000 may be considered limit. The downside bias in market is expected to continue. As expected earlier, Indian rupee is under pressure and has fallen by over 10% against USD since the last newsletter. Market is now focusing on high inflation and high interest rates

Worsening global business cycle to impact FII's flows

FII withdrawal from India may continue. Mainly FII's of US origin may face redemption pressure due to adverse US economic outlook, job losses and declining disposable income. Worsening sub-prime situation and its impact in European banking system may further destabilize financial system. In case US dollar loses substantial ground, it may open the possibility of devaluation of Yuan by China; it may create temporary imbalances in global trade. As a rare situation, most of the economies are entering recession.

Indian corporate performance to decline

US slowdown and demand contraction may adversely impact the export earnings of Indian companies. The adverse impact of high interest and high inflation in India may get reflected in corporate results ending December for Indian companies; these factors may also bring down GDP growth. The recent capacities added by Indian companies may go on stream in next 1-2 years; most of the capacities have also factored earnings from exports. Due to global demand contraction, there may be capacity overhang that would bring the realizations down and would result in adverse corporate performance of such companies.

The balance sheets of Indian companies are now more operationally and financially leveraged (than they were 5 years ago); most of the companies are on expansion/inorganic growth mode. High leveraged balance sheets increase earnings volatility, reduce flexibility to respond to adverse macro-economic situation and increase bankruptcy rates.

Indian companies in the last 2 years have made overseas acquisition. These were made at the peak of global economic cycle and at high valuation. Also, as per recent research conducted at a reputed North American university, due to the feeling of national pride, companies from emerging economies have paid excessively high valuations for big-ticket acquisitions. Indian companies those have made such acquisition (including TATA group companies) may suffer from declining performance of their target companies. Also, in case financing of such acquisition is in foreign currency that would increase debt service burden due to depreciation of Indian rupee. Such companies may underperform the broad market.

Higher valuation to lead underperformance

Banking, Construction, Engineering, Capital Goods, Hospitality, real-estate and logistics may underperform the broad market. The fall in oil and commodity prices is a positive aspect and would reduce long term input cost for companies, though in the current adverse sentiment, it may be ignored by the market. Indian equities are one of the best performers for the month of

Market target revised downward at 10,000

FII's to face redemption pressure

Export oriented companies to adversely hit. Excess capacity to impact earnings

Overseas acquisitions made at high valuations; such companies to underperform

Valuation of Indian equities is high in comparison to other emerging markets and historical standards

September. However, there doesn't seem to be fundamental reason for that. In the coming days, Indian equities would perform in line with other emerging markets (Brazil, China and Russia)

The valuation of Indian equities continues to be high in comparison to other international markets and historical valuation of Indian market. Current fundamentals don't support such rich valuations. Also, lack of immediate triggers and absence of reforms may correct the equity prices downward

Though there is an atmosphere of fear, which is conducive to create bottom, the continued negative news flow warrants against making long term position. Unless, domestic economy performs quite adversely, Indian structural story is expected to continue. The current fall may bring down the valuation of good companies at bankruptcy valuation levels and present the opportunity for long term investors to enter into. The market itself would give such indication of long term bottom. Though time wise and valuation wise, such condition is far, it is prudent to hold cash and patiently wait for such opportunities.

APPENDIX I

Disclosure Section

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Equity rating key for long-term investment opportunities

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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

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