Equity Market View - December 2011

Indian equities market performance closed 2011 with in a dismal state. The key benchmark indices, SENSEX and Nifty, posted a performance of -24.64% and -24.61% respectively during the period.

The interest rate in the economy, as indicated by repo rate - increased by 225 bps over the year and stood at 8.50% at the year end. The rising cost of capital consequently dented the industrial savings and demand cycle. Consequently the IIP (Oct-11) has declined to 5.10% and is expected to remain in the negative.

Other than that, the approx 15% rally in brent crude and the commensurate 15% decline in the Rupee value against the dollar has significantly increased the oil import bill, which in turn has exacerbated the current account deficit. Additionally, the negative FII inflows in 2011 ensured that the inflows in the capital account also remained less than expected. The uncertainty in the domestic and international political economy only further dampened the investor sentiment.

Country Index	Country	2011 Performance
Dow Jones	USA	5.5%
Jakarta Composite Index	Indonesia	3.2%
KLSE	Malaysia	0.8%
Nasdaq	USA	-1.8%
FTSE	UK	-5.6%
Swiss Market Index	Switzerland	-7.8%
Kospi	S Korea	-11.0%
DAX Index	Germany	-14.7%
CAC 40 Index	France	-17.0%
Strait Times	Singapore	-17.0%
Nikkei	Japan	-17.3%
Ibovespa Sao Paulo Index	Brazil	-18.1%
HangSeng	Hong Kong	-20.0%
Taiwan Weighted	Taiwan	-21.2%
SSE Composite Index	China	-21.7%
RTS Index	Russia	-21.9%
S&P Nifty	***India***	-24.6%
Merval Buenos Aires Index	Argentina	-30.1%

Source: ICRA

The performance of sectoral indices reflected the interplay of the specific factors intrinsic and peculiar to each sector; and therefore varied accordingly. The top three sectoral gainers in 2011 month were FMCG (9.53%), Pharma (-10.01%) and Health care (-12.83%). On the other hand, Capital Goods (-47.66%), Metal (-47.68%), and Realty (-51.84%) remained on the lag end of the sectoral indices performance chart. (Source: NSE).

Other Economic News:-

INDIA'S OVERALL BALANCE OF PAYMENTS (In US$ Bn)	July-Sept 11	Apr-Sept 11
A. CURRENT ACCOUNT		
I. MERCHANDISE	-43.94	-85.76
II. INVISIBLES	27.03	52.92
Total Current Account (I+II)	**-16.91**	**-32.84**
B. CAPITAL ACCOUNT		
1. Foreign Investment (a+b)	3.18	13.66
a) Foreign Direct Investment (i+ii)	4.38	12.31
b) Portfolio Investment	-1.20	1.35
2.Loans	10.20	17.24
3. Banking Capital	6.68	19.34
4. Rupee Debt Service	0.00	-0.03
5. Other Capital	-1.63	-9.14
Total Capital Account (1 to 5)	**18.43**	**41.06**
C. Errors & Omissions	**-1.25**	**-2.50**
D. Overall Balance (A+B+C)	**0.28**	**5.72**

Source: RBI

- Exports recorded a growth of 47.2% (year-on-year) during Q2 of FY12 as against an increase of 20.1% during corresponding quarter of FY11.
- Similarly, on a BoP basis, imports registered a growth of 35.4% (year-on-year) during the quarter as against an increase of 21.9% during same quarter last year.
- Despite higher growth in exports relative to imports, the trade deficit widened to US$ 43.9 bn as compared to US$ 37.0 bn during corresponding quarter last year.
- Services receipts recorded a growth of 9.3% (yoy), led by software, travel and transportation. Services payments, however, declined by 3.9% to US$ 18.5 bn during the quarter from US$ 19.2 bn in corresponding quarter of last year.
- Consequently, the current account deficit (CAD) was US$ 16.9 bn in Q2 of FY12.
- During April-September 2011, the current account deficit widened to US$ 32.7 bn, largely reflecting the higher trade deficit.
- Export growth during April-September 2011 was higher at 40.8% than that in imports at 34.3%. The commodity-wise exports data released by the DGCI&S so far indicate that exports seems to have driven mainly by buoyancy in items such as engineering goods and petroleum products.
- Nevertheless, trade deficits (on BoP basis) widened to US$ 85.6 bn during April-September 2011 from US$ 69.0 bn during April-September 2010. It was mainly due to significant increase in international prices of imported commodities.
- The price of the Indian crude oil basket increased by 45.4% during H1 of FY12 over H1 of FY11 while price of gold rose by 32.3% during the same period.

Market Outlook

The long term outlook continues to remain positive for Indian equities as the economic growth momentum remains healthy with real GDP growth remaining at around 7%. We expect this growth to result in healthy corporate earnings and the earnings growth to translate on growth in equity markets. While the long term positive outlook remaining intact, the near term challenges can influence markets as it gets impacted by events / newsflows that can have a near term negative implications.

The Eurozone situation does not look like it will be resolved quickly. However recent newsflows indicate possibility of some compromises from Germany to ensure the survival of the euro. The US has entered the critical pre-election phase where it is unlikely that tough decisions will be taken. We could be close to the bottoming of the inflationary phase in the Indian economy. The RBI has also indicated that it is not in favor of any more rate hikes.

This would lead to the bottoming out of the stock market and a rally in equity markets from here. However the political situation is deteriorating and increasingly populist moves may burgeon the fiscal deficit. The upcoming UP elections will be an indicator of political policy direction going forward. Valuations are very cheap especially in midcap stocks at this point and quite a few stocks look to be promising buys.

Debt Market Watch

The factors affecting the debt market performance remained in line with expectations of the market. Following is the summary of key changes in certain parameters from the previous month.

Particulars	Dec-11	Nov-11	Dec-10	M-o-M	Y-o-Y
10 YR IGB (Yield) (30th Dec 2011)	8.57%	8.65%	7.90%	-8 bps	67 bps
10 YR UST (Yield) (30th Dec 2011)	1.89%	2.03%	3.29%	-14 bps	-140 bps
Avg. LAF Surplus / Deficit (Rs. Cr)	-101,395.00	-81,384.00	-119,180.00	-20,011.00	17,785.00
Currency (Rs/$) (30th Dec 2011)	53.27	51.21	44.7	2.06	8.57
India's Forex Reserve (Billion $) (30th Dec 2011)	300.8	304.4	295	-3.60	5.80

Source: RBI; US Fed

Inflation

Snapshot of Latest Inflation in Percentage		
Groups	YoY	
	FY11	FY12
WPI (November month)	8.20	**9.11**
PRIMARY Articles (As on 17th Dec)	18.85	**2.40**
Food Articles	15.48	**0.42**
Non-Food Articles	26.05	**0.28**
Minerals	30.58	**23**
FUEL & Power (As on 17th Dec)	11.85	**14.37**
LPG	14.99	**14.27**
Petrol	25.06	**17.14**
High Speed Diesel	14.71	**9.24**
MANUFACTURED PRODUCTS (Nov month)	5.02	**7.70**

Source: Ministry of Commerce & Industry

The WPI based inflation grew at 9.11% (Nov 2011), indicating the on-setting of slowdown in the growth of inflation.

The inflation in the primary goods segment dipped sharply and stood at 2.40% yoy, with the inflation in the food articles sub-segment moderating to 14.37% yoy.

The fresh arrival from the Kharif season may have to assuaged the inflationary pressure in the agri-commodities. The prevalence of the high base-effect too may be attributable for this decline.

On the other hand, the prices of the select commodites in the energy and related segment continued to show buoyancy. The inflation in fuel & power segment as of Dec 17th, 2011 stood at 14.37%. During the same period last year, the inflation in this segment was at 11.85%.

The manufactured products segment displayed growth in the prices, registering a price growth of 7.70% yoy in November 2011

Outlook

We believe that key policy rates may start to ease from Q1 - FY 13 as the stance changes from "growth focus" to "inflation focus". CRR cut may be effected earlier so as to allow the system to breathe easy on liquidity. Recall that the system has been in the deficit mode for over 5 quarters now. Inflation is expected to ease off further in the 1st half of 2012 due to base effect and the softening impact of the primary articles. In the 2nd half of 2012, we may see the trend higher, albeit average for the calendar year may still be lower. The "China effect", which saw rally in commodities, could temper off as possibilities of China slowdown were to actually materialize. However, the currency may continue to remain under pressure in near term, and range bound for most part of the year. The 10yr Gsec yield may hover in the band of 7.75% to 8.25% for the year. Intermittently, either end of bands could be breached in response to ad hoc news. OMOs by RBI and slow down in credit disbursements to anchor any sharp rise in yields

Gold Corner

During the month of December, the spot gold closed at $ 1,574.50 per ounce, down $ 129.5, or 7.599%. In the period, the U.S. Trade-Weighted Dollar Index rose 2.28%. Over the calendar year of 2011, the prices of yellow metal increased by 11.65%. This is the record eleventh consecutive annual gain. The key reasons attributable for this performance is largely based on the uncertainty pertaining the economic recovery during the year and weakness in prominent currencies in early part of the year.

Gold was again one of the top performing assets as seen in the below table, Gold rose 11.65% in USD & 30.74% in INR during the year as compared to brent Crude (approx) 15%, SENSEX -24.64%, Dow Jones 5.53%, FTSE -5.55%, Hang Seng -19.20%, MSCI World Index -7.61% and US Dollar Index by 1.85%. Thus, gold again acted as a safe haven and protected and preserved wealth over the long term.

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Gold (INR)	23.16%	15.76%	-0.02%	21.43%	21.60%	17.28%	27.77%	18.88%	24.44%	30.74%
Indian Equities	3.52%	72.89%	13.08%	42.33%	46.70%	47.15%	-52.45%	81.03%	17.43%	-24.64%
Gilt	21.06	12.04	1.43	3.83	4.57	5.36	28.77	-4.72%	5.06%	7.04%
International Equities	-25.2	22.75	9.49	13.74	13.52	2.83	-40.11%	26.96%	9.55%	-7.61%

Source: ICRA & Bloomberg, Indian Equities: BSE SENSEX,
Gilt: Kotak Gilt Investment Plan, International Equities: MSCI World Index

Outlook

Uncertain Sovereign debt outlook in EU countries, currency debasement and inflation concerns continue to drive safe haven demand for gold, internationally. Uptil now, gold has recorded its 11th consecutive year in its price escalation. Gold rose some 11.65% in US dollar terms, 10.65% in sterling terms, and 13.67% in euro terms; and by nearly similar proportions in other major currencies. This is indicative that fiat currencies are losing purchasing power and being devalued internationally. This increases the attraction of precious metals and hard assets that are finite and cannot be debased as inflation hedges - especially gold. With recent surge in the investment demand and a largely invariant supply, we believe that gold may continue to test higher price levels.