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Research
India

India Monthly Review

Retrospective – October 2008: Terrible Month

MORGAN STANLEY RESEARCH

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Retrospective – October 2008: Terrible Month

India underperformed EM, albeit marginally, in October. India is the second worst-performing emerging market year-to-date. The absolute fall of 24% in the Sensex during October was the worst month ever for the index. The following were notable market indicators in October:

- Technology was the best-performing sector for the month (fourth time since the start of the year) while Materials was the worst. (for the third consecutive month). Materials holds the same position while Consumer Staples retains the top position on a year-to-date basis. October witnessed moderate sector rotation with five out of 10 sectors changing relative performance month over month and underperformance of small- and mid-cap indices versus the large caps.
- FII continued to be net sellers in the cash market for a sixth straight month. October is the third occasion since FIIs first started investing in India that selling in the cash market exceeded US\$2 billion in a month. Domestic institutions remained net buyers for the month. FIIs' net purchases of derivatives continued.
- Trading activity fell MoM across both the cash and derivative markets, average open interest was lower, realized volatility was at an all-time high, Nifty put-call ratio dropped to a four-year low, average implied volatility spiked to an all-time high, and breadth collapsed to a multi-year low – all summarizing a terrible month for the market.
- The yield curve remained inverted for the first half of October but ended the month in positive territory. The rupee depreciated 4.6% against the USD while appreciating 7.4% against the euro. The rupee is now at an all-time low against the USD. Year to date, INR has depreciated 20% and 8% against the USD and euro, respectively.
- Consensus EPS estimates for the BSE Sensex constituents were lowered by 1.6% and 3.5% for F2009 and F2010, respectively. Consensus estimates are now 8.6% and 11.7% lower than their June-08 high for F2009 and F2010 respectively.

Market Performance

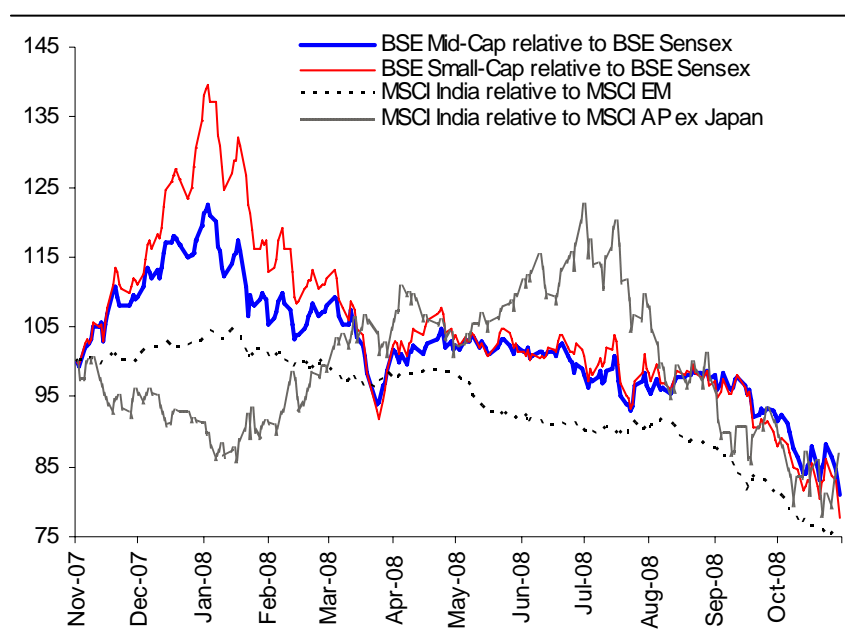
October was a second successive month of underperformance by Indian equities versus emerging and other regional markets. India's performance ranked 13 out of the 25 emerging markets in October, but it continues to be the second worst-performing emerging market in 2008. Mid- and small-cap indices underperformed the large-cap index in October for the second consecutive month and continue to trail the narrow market on a year-to-date basis. The absolute fall of 24% in the Sensex during October was the worst month ever for the index.

Equity Markets

| | Current | 1 Mth | 3 Mths | 12 Mths | YTD |
|---------------------------------|---------|--------|--------|---------|--------|
| MSCI India | 239 | -28.6% | -42.5% | -62.4% | -64.3% |
| MSCI EMF | 571 | -27.5% | -45.2% | -57.3% | -54.2% |
| MSCI EM Asia | 229 | -24.2% | -41.5% | -59.9% | -55.5% |
| MSCI Europe | 78 | -12.8% | -21.3% | -42.5% | -38.8% |
| MSCI ACWI | 236 | -19.9% | -31.7% | -44.8% | -41.4% |
| MSCI Asia Pacific | 244 | -24.6% | -41.5% | -58.4% | -54.0% |
| BSE Sensex | 9,788 | -23.9% | -31.8% | -50.7% | -51.8% |
| BSE 100 Index | 4,954 | -26.0% | -33.8% | -52.3% | -55.6% |
| BSE 200 Index | 1,146 | -26.4% | -34.5% | -53.0% | -56.9% |
| BSE 500 Index | 3,570 | -27.1% | -35.4% | -54.1% | -58.5% |
| BSE Midcap Index | 3,200 | -33.3% | -42.5% | -60.7% | -67.3% |
| BSE Smallcap Index | 3,765 | -32.5% | -45.5% | -61.6% | -71.8% |
| Dow Jones | 9,325 | -14.1% | -18.0% | -33.1% | -29.7% |
| Nasdaq | 1,721 | -17.7% | -26.0% | -39.8% | -35.1% |
| India's Rank In 25 EM countries | | 13 | 13 | 21 | 24 |

Note: All MSCI Indices are in USD. Source: Bloomberg, MSCI, Morgan Stanley Research

Relative Performance



Source: Bloomberg, MSCI, Morgan Stanley Research

Sector Performance

Technology was the best-performing sector for the month (fourth time since the start of the year) while Materials was the worst-performing sector for the month (for the third consecutive month). Consumer Staples and Materials continue to retain their top and worst positions on a year-to-date basis. October witnessed moderate sector rotation with five out of 10 sectors changing relative performance month over month. Year to date, all MSCI India sectors except consumer staples have underperformed their respective EM sectors with Consumer Staples being the best and Telecoms the worst.

India: Sector Performance

| | Absolute Performance | | | | | | Rank | | |
|---------------------|----------------------|---------------|---------------|---------------|---------------|---------------|-------|---------|-----|
| | Weights | 1 Mth | 2 Mths | 3 Mths | 12 Mths | YTD | 1 Mth | 12 Mths | YTD |
| MSCI India | 100% | -24.8% | -34.4% | -33.3% | -52.8% | -55.2% | | | |
| Cons. Discretionary | 3.2% | -21.1% | -24.3% | -19.0% | -43.2% | -45.4% | 3 | 4 | 4 |
| Consumer Staples | 6.4% | -16.7% | -16.6% | -14.7% | -13.2% | -19.3% | 2 | 1 | 1 |
| Energy | 23.2% | -31.4% | -36.7% | -37.9% | -50.4% | -52.3% | 8 | 5 | 5 |
| Financials | 24.0% | -24.5% | -34.4% | -30.9% | -58.1% | -61.5% | 4 | 7 | 7 |
| Healthcare | 3.8% | -26.1% | -35.4% | -33.0% | -21.4% | -30.5% | 5 | 2 | 2 |
| Industrials | 9.3% | -32.6% | -41.6% | -40.0% | -65.1% | -66.7% | 9 | 8 | 8 |
| Information Tech. | 13.6% | -4.7% | -24.9% | -18.8% | -32.4% | -30.6% | 1 | 3 | 3 |
| Materials | 7.7% | -36.1% | -51.2% | -52.0% | -70.4% | -72.1% | 10 | 10 | 10 |
| Telecommunication | 3.0% | -29.8% | -38.9% | -51.2% | -68.5% | -68.4% | 7 | 9 | 9 |
| Utilities | 5.8% | -26.4% | -33.1% | -32.9% | -53.1% | -59.1% | 6 | 6 | 6 |

All MSCI indices in local currency. Source: Bloomberg, MSCI, Morgan Stanley Research

India: Relative to EM Sectors

| | Relative Performance | | | | | Rank | | |
|---------------------|----------------------|--------------|-------------|---------------|---------------|-------|---------|-----|
| | 1 Mth | 2 Mths | 3 Mths | 12 Mths | YTD | 1 Mth | 12 Mths | YTD |
| MSCI India | -1.5% | -2.4% | 4.9% | -10.5% | -22.1% | | | |
| Cons. Discretionary | 0.6% | 7.6% | 17.1% | -11.5% | -12.9% | 4 | 6 | 4 |
| Consumer Staples | 0.8% | 9.7% | 14.0% | -2.1% | 7.2% | 3 | 3 | 1 |
| Energy | -0.3% | 7.3% | 13.2% | -4.0% | -6.4% | 5 | 4 | 3 |
| Financials | 2.2% | -0.3% | 9.7% | -25.3% | -29.7% | 2 | 10 | 7 |
| Healthcare | -18.5% | -27.0% | -28.6% | 6.8% | -29.0% | 10 | 2 | 6 |
| Industrials | -6.5% | -9.7% | 3.8% | -6.1% | -24.9% | 6 | 5 | 5 |
| Information Tech. | 8.7% | -4.3% | 2.9% | 14.7% | -0.1% | 1 | 1 | 2 |
| Materials | -9.5% | -13.8% | -5.9% | -17.2% | -43.9% | 7 | 7 | 9 |
| Telecommunication | -16.5% | -22.0% | -34.6% | -24.6% | -52.9% | 9 | 9 | 10 |
| Utilities | -9.7% | -7.3% | -4.0% | -21.7% | -39.7% | 8 | 8 | 8 |

All MSCI indices in USD. Source: FactSet, MSCI, Morgan Stanley Research

NSE's Best- and Worst-performing Stocks in October with Market Caps above US\$500mn

India: Best-performing Stocks

| Company | Price (Rs) | 1-Mth (%) | YTD Perf (%) |
|---------------------|------------|-----------|--------------|
| Sterling Biotech | 185 | 8.0 | 3.7 |
| Tata Communications | 485 | 7.5 | -36.6 |
| Gtl Infrastructure | 38 | 5.1 | -59.5 |
| Indian Bank | 128 | 0.3 | -34.1 |
| Infosys Tech | 1,389 | -0.2 | -21.5 |
| Satyam Computer | 305 | -3.2 | -32.6 |
| Colgate-Palmolive | 380 | -3.9 | -6.6 |
| Bhushan Steel | 643 | -4.8 | -58.6 |
| Bajaj Auto | 545 | -5.6 | N.A. |
| Titan Inds | 1,008 | -6.5 | -35.5 |

Past performance is no guarantee of future results. Results shown do not include transaction costs. Source: Bloomberg, Morgan Stanley Research

India: Worst-performing Stocks

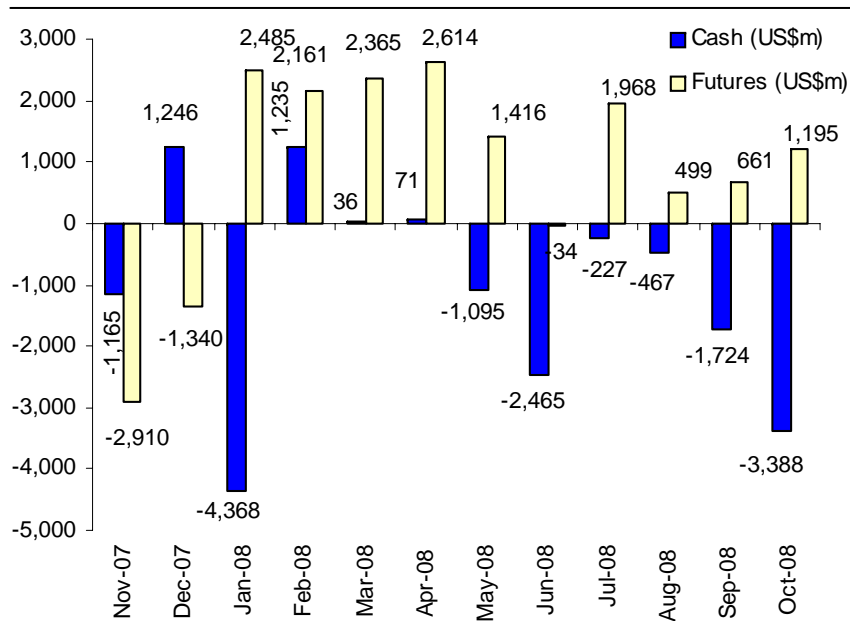
| Company | Price (Rs) | 1-Mth (%) | YTD Perf (%) |
|--------------------|------------|-----------|--------------|
| Essar Oil | 85 | -42.8 | -73.8 |
| Aditya Birla Nuvo | 544 | -43.7 | -72.9 |
| Tata Steel Limited | 210 | -46.6 | -77.6 |
| Tech Mahindra | 330 | -47.1 | -70.8 |
| BF Utilities | 678 | -48.3 | -69.7 |
| Tata Motors | 170 | -48.7 | -76.4 |
| Aban Off shore | 799 | -54.2 | -83.9 |
| National Aluminium | 159 | -54.4 | -67.2 |
| Unitech | 48 | -56.8 | -90.1 |
| Suzlon Energy | 44 | -69.9 | -88.5 |

Past performance is no guarantee of future results. Results shown do not include transaction costs. Source: Bloomberg, Morgan Stanley Research

Flows

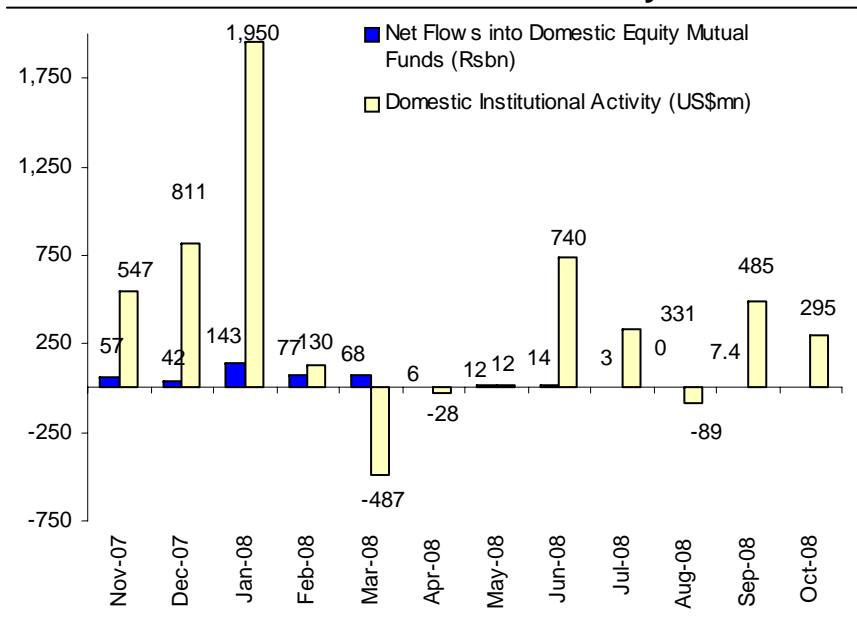
FII continued selling in the cash markets for a sixth straight month. October was the third occasion since FIIs first started investing in India that selling in the cash market exceeded US\$2 billion in a month. All the three occasions have been in 2008. FIIs were net buyers of derivatives – now for nine out of the past 10 months. Domestic institutions remained positive for the second consecutive month. Domestic institutions have purchased close to US\$3.3 billion so far in 2008, whereas FIIs have sold US\$12.4 billion in the cash markets – more than ever in a single calendar year – while notionally buying US\$15.3 billion in derivatives for the year to date.

India FII Flows: Equity and Derivatives



Note: Updated through Oct 29 Source: SEBI, Morgan Stanley Research

Flows into Domestic Equity Mutual Funds and Domestic Institutional Activity

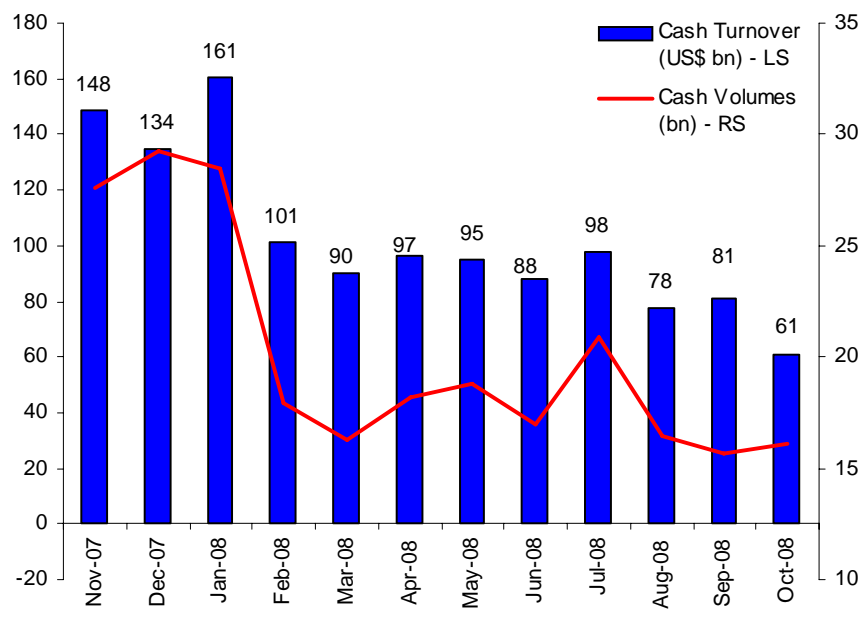


Note: Updated through Oct 29 Source: AMFI, SEBI, Morgan Stanley Research

Cash Trading

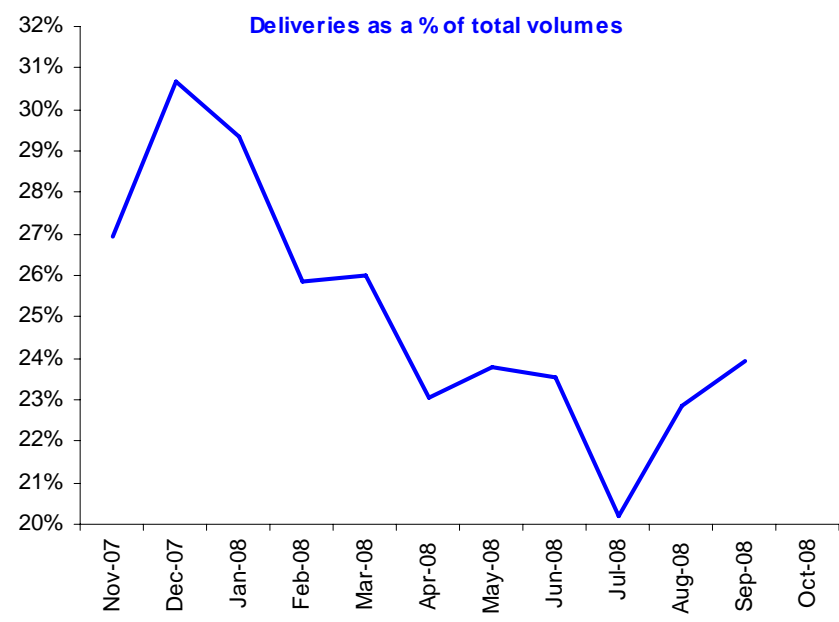
In October, cash trading volume (number of shares) rose 3% MoM but remains a good 45% below its December 2007 peak. However, trading volumes (value) fell 26% MoM to an 18-month low and are now 63% below their October 2007 peak. Shares purchased for delivery (as a percentage of total trading) rose 5% in September (data comes with a month's lag).

Cash Trading: Turnover and Volumes



Source: BSE, NSE, Morgan Stanley Research

Deliveries to Total Trading

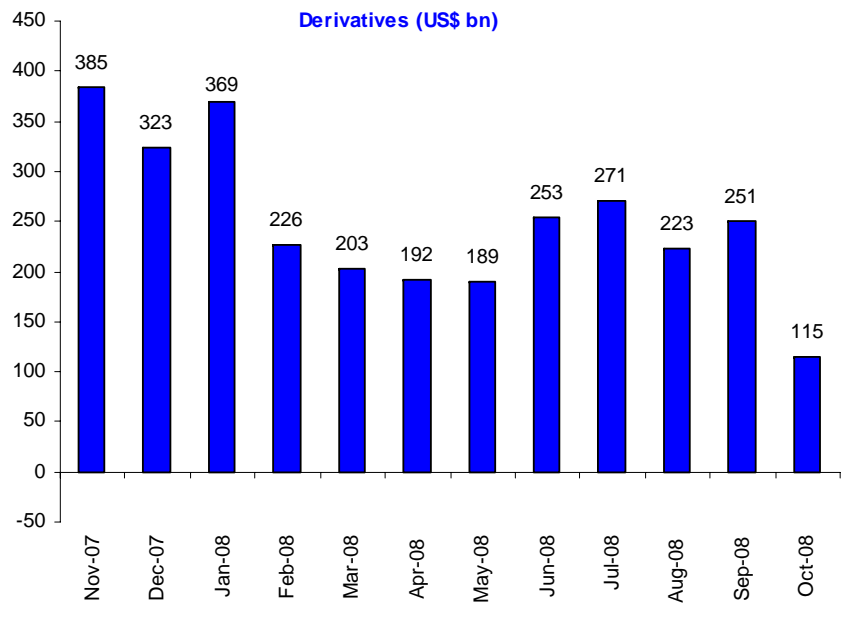


Source: BSE, NSE, Morgan Stanley Research

Futures Market

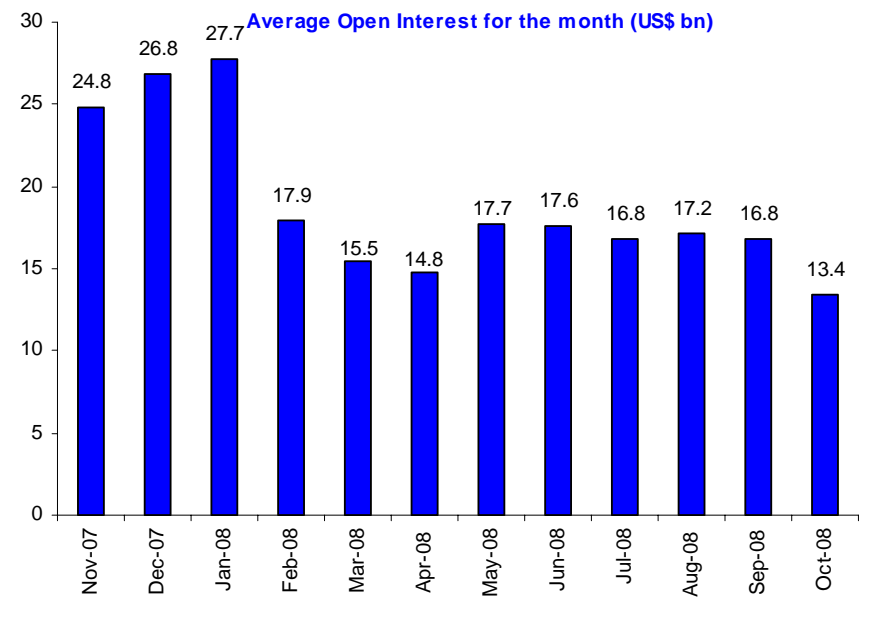
Futures market activity was subdued in October with derivative trading volumes falling 54% MoM. Derivative volumes are now 75% off their October 2007 peak. Average open interest was down 20% MoM in September and remains 39% off its January 2008 peak.

Derivatives Volumes



Note: Only NSE Source: Bloomberg Morgan Stanley Research

Average Open Interest for the Month

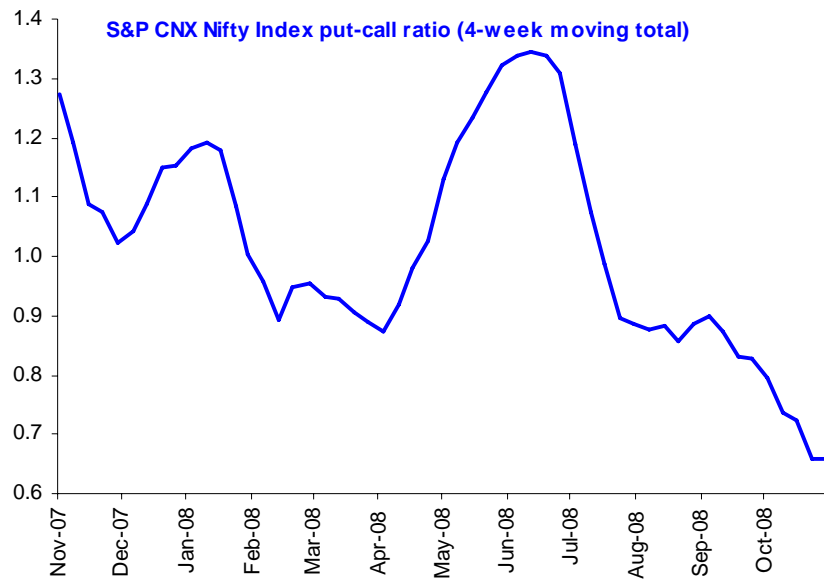


Source: Bloomberg, Morgan Stanley Research

Futures Market

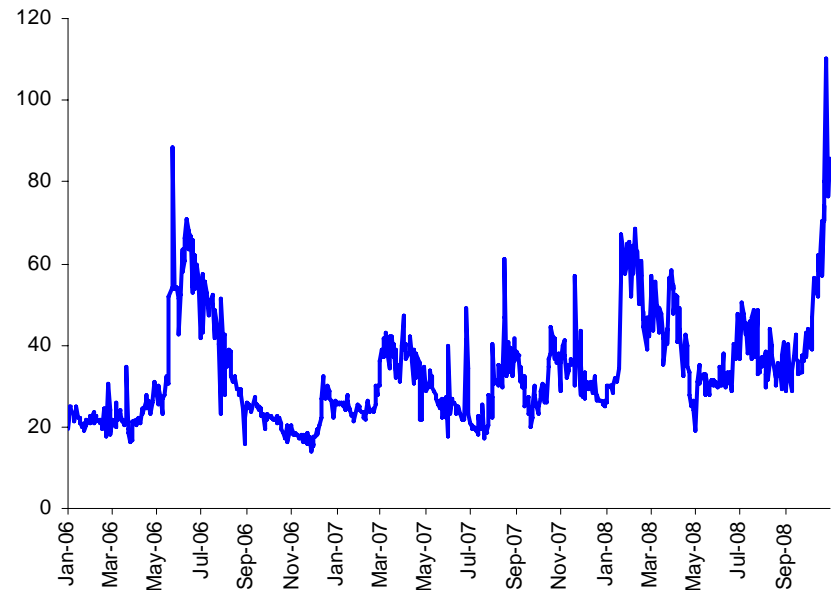
The put-call ratio dropped for a fifth consecutive month ending October, 21.5% lower compared to the previous month-end (lowest level since June-04). On a monthly average basis, implied volatility increased 26.4pp to 62.1% in October. During the month, the implied volatility touched 110% - an all-time high. The month-end number was higher by 49ppt compared to the September-end number.

S&P CNX Nifty Index Options: Put-Call Ratio



Source: ASA, Morgan Stanley Research

S&P CNX Nifty Index: Implied Volatility

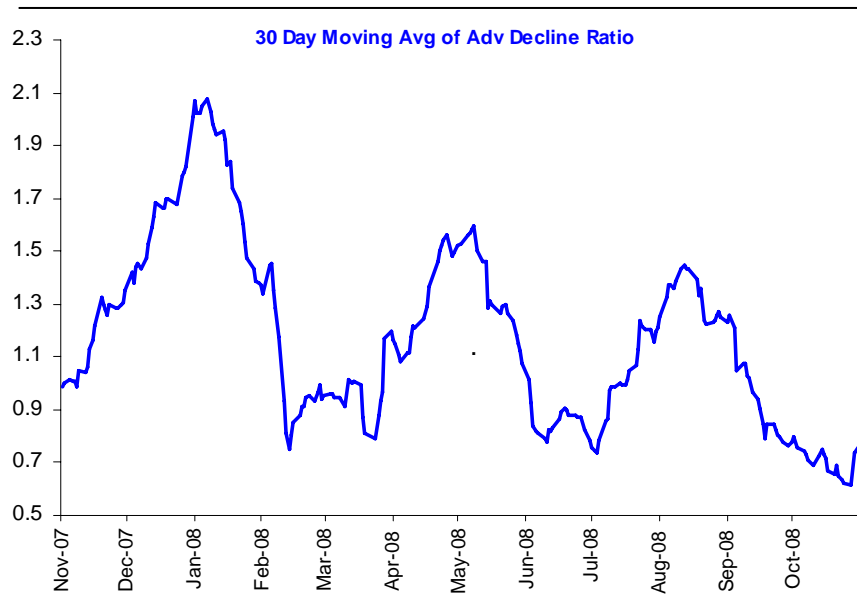


Source: Bloomberg, Morgan Stanley Research

Breadth and Volatility

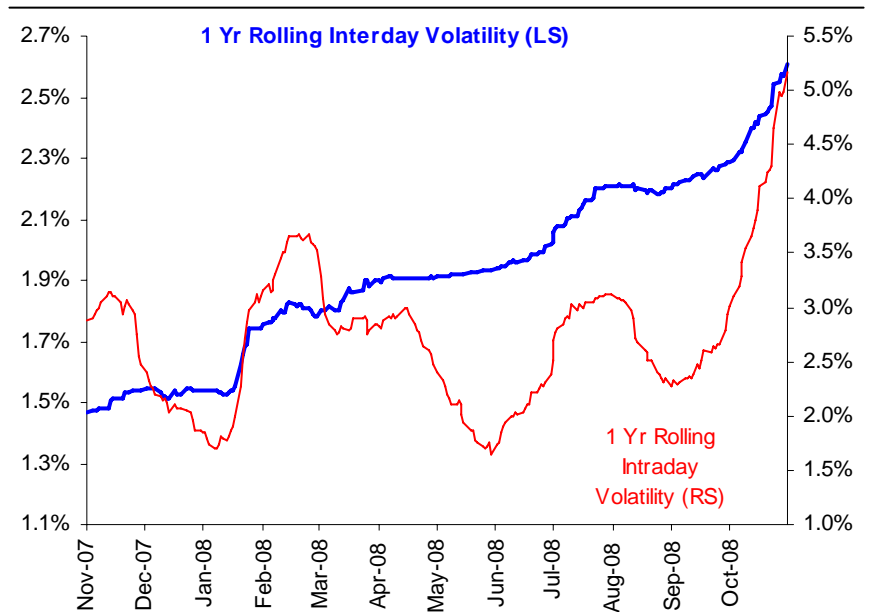
During the month, the market breadth fell to its lowest level since 1990 (when our data series starts). The recovery toward the month end meant that breadth finished the month 3% lower MoM and is down 64% from its Jan-08 high. Realized intraday volatility rose 223bp (MoM) to an all-time high level (our data stream starts in 1990). Inter-day volatility also rose 32bp and touched a 15-year high in October.

Advance-decline Ratio



Source: ASA, Morgan Stanley Research

One-year Rolling Realized Volatility

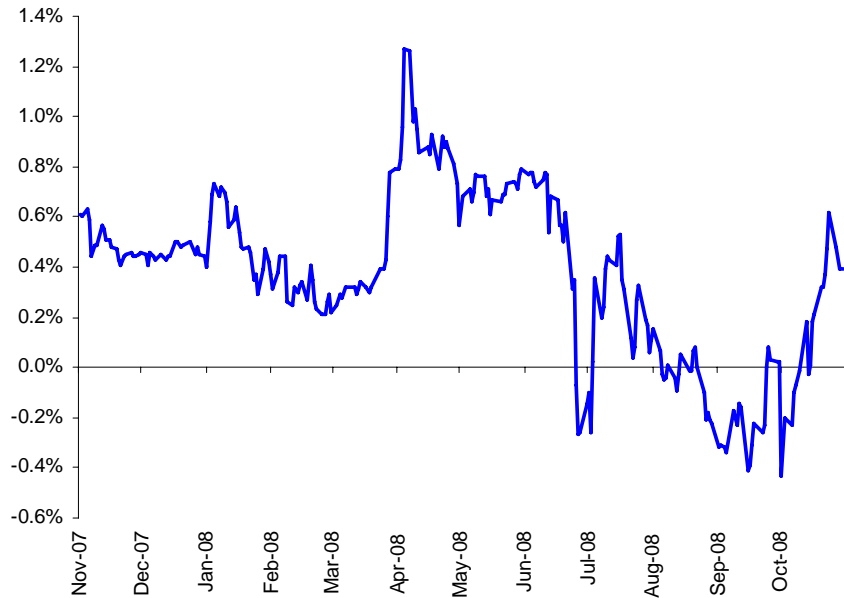


Source: Bloomberg, Bloomberg, Morgan Stanley Research

Bond Market

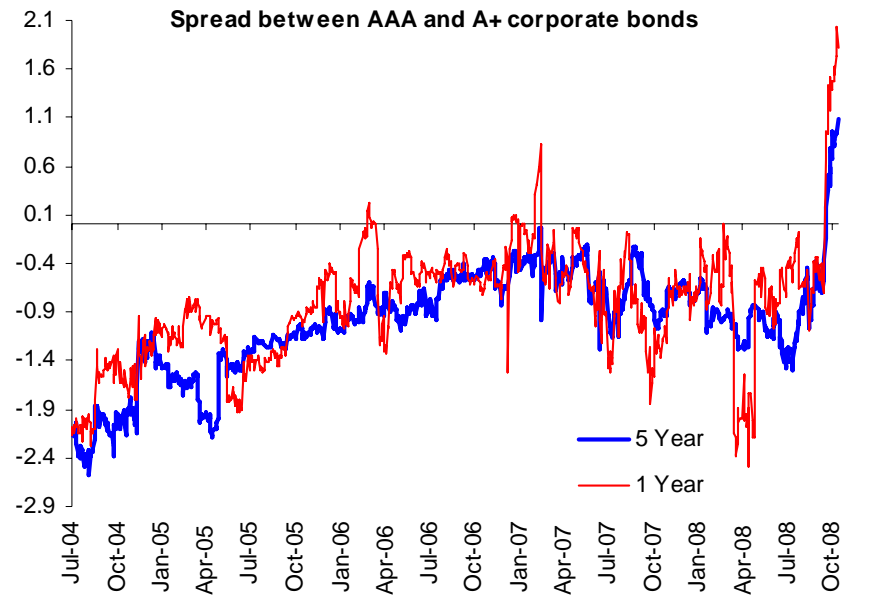
The yield curve remained inverted for the first half of October but ended the month in positive territory. The spread between Corporate AAA and A+ bonds for five-year maturity widened by 179bp to -109bp in October. The spread between Corporate AAA and A+ bonds for one-year maturity widened 241bp to -183bp (AAA yields are higher).

India: Yield Curve – Spread versus 10-year and 91-day Yield



Source: Bloomberg, Morgan Stanley Research

India: Corporate Bond Spread

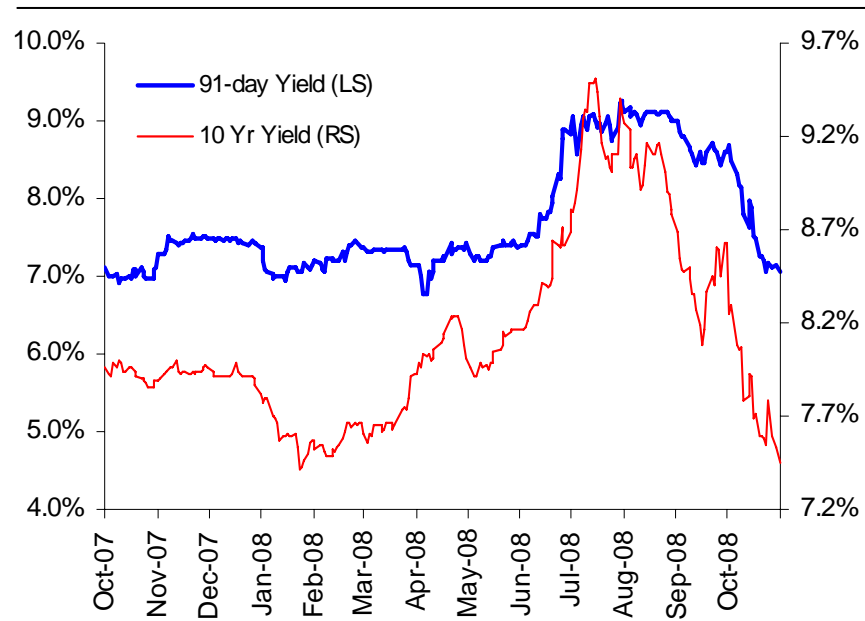


Source: Bloomberg, Morgan Stanley Research

Bond Market

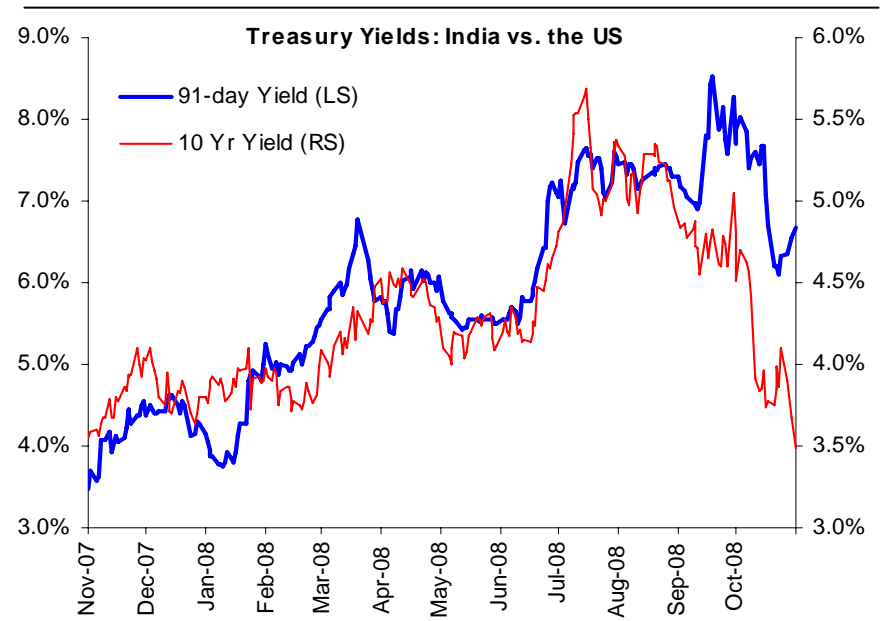
At the end of October, the 10-year bond yield fell to 7.45% - a nine-month low; while the 91-day yield closed the month at 7.06% - a six-month low.

India: 10-year and 91-day Yield



Source: Bloomberg, Morgan Stanley Research

Treasury Yields: India versus the US

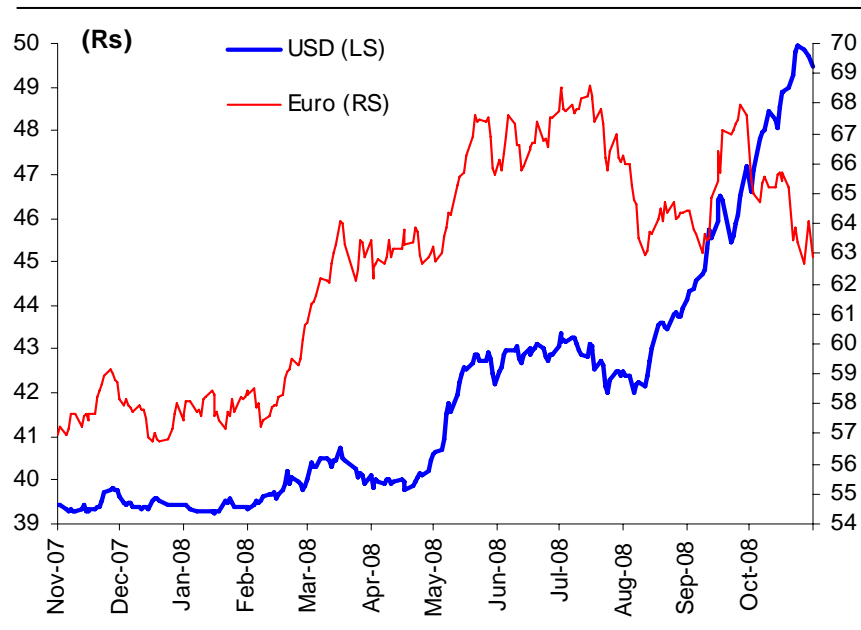


Source: Bloomberg, Morgan Stanley Research

Currency

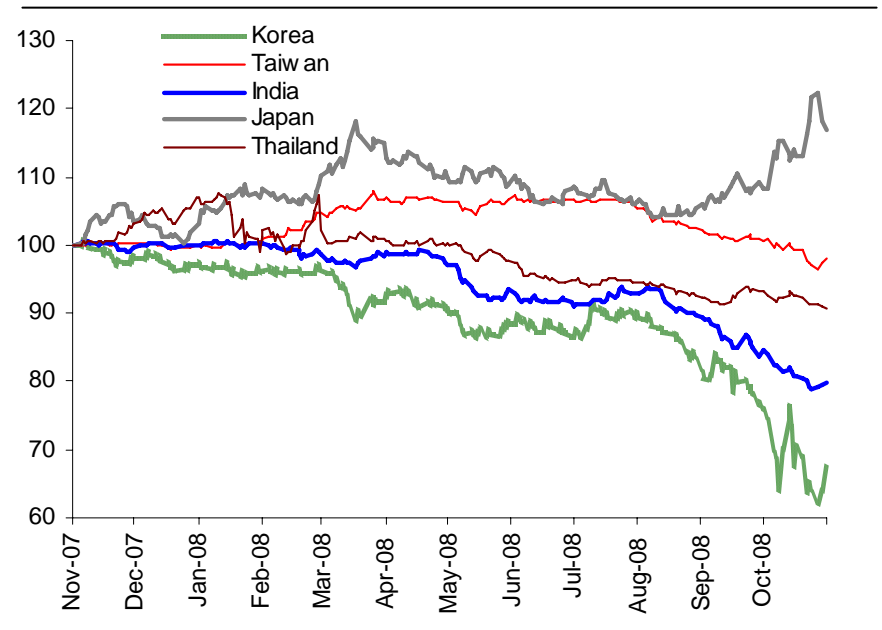
During October, the rupee depreciated 4.6% against the USD while appreciating 7.4% against the Euro. The rupee is now at an all-time low against the USD (since 1986 when our data stream starts). Year to date, INR has depreciated 20% and 8% against the USD and the euro, respectively.

Currency: India versus USD and Euro



Source: Bloomberg, Morgan Stanley Research

Currency: Asian Countries (Rebased)

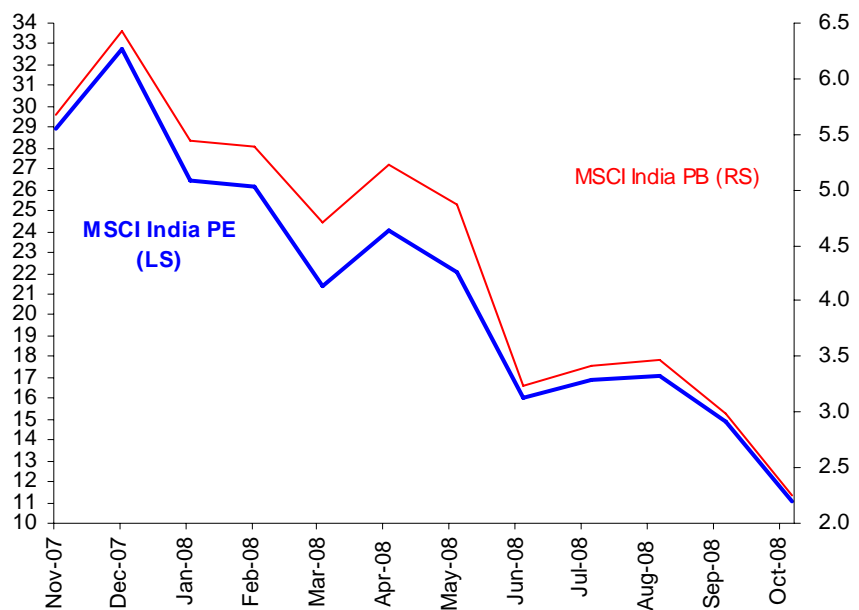


Source: Bloomberg, Morgan Stanley Research

Equity Valuation Snapshot

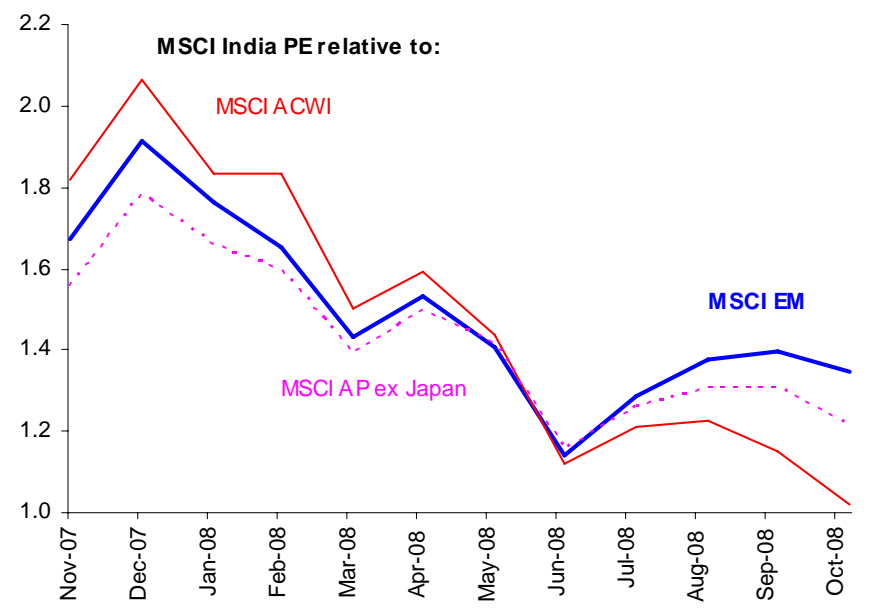
With the MSCI India underperforming MSCI EM and MSCI ACWI during October, its relative premium fell to 35% and 2%, respectively. MSCI India's relative trailing P/E premiums are now 30% and 51% below their all-time highs versus MSCI EM and MSCI ACWI, respectively.

MSCI India: P/E and P/B



Source: FactSet, Bloomberg, MSCI, Morgan Stanley Research

MSCI India P/E Relative to EM, ACWI, and Asia Pacific ex-Japan

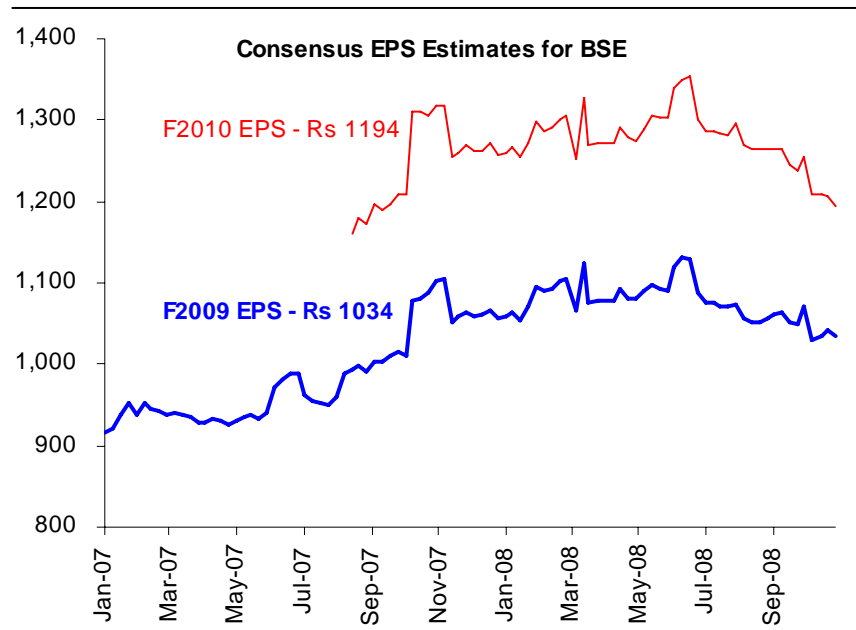


Source: FactSet, Bloomberg, MSCI, Morgan Stanley Research

Earnings Snapshot

In October, aggregate consensus EPS estimates for the BSE Sensex constituents were lowered by 1.6% and 3.5% for F2009 and F2010, respectively. Consensus estimates are now 8.6% and 11.7% lower than their June-08 highs for F2009 and F2010, respectively.

BSE Sensex: Consensus EPS Estimates



Source: IBES, Morgan Stanley Research

Top Earnings Revisions for 2009 by Consensus for Our Coverage Universe

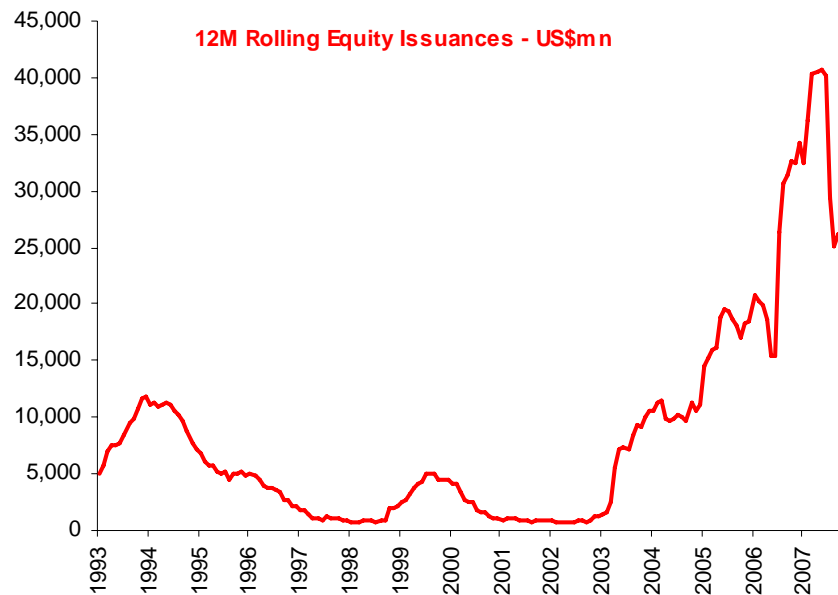
| Company | Earnings Revision | | Rel. Price Perf | |
|-----------------------------|-------------------|--------|-----------------|--------|
| | 1M | 3M | 1M | 3M |
| Mphasis Limited | 20.8% | 23.1% | 12.3% | 12.5% |
| Titan Industries Ltd | 10.8% | 13.1% | 28.1% | 40.8% |
| Bank of India | 7.8% | 4.4% | 12.0% | 29.5% |
| Canara Bank | 5.9% | -6.9% | 18.5% | 35.2% |
| AXIS Bank | 5.3% | 1.9% | 4.2% | 27.5% |
| Wockhardt Limited | -14.9% | -14.7% | 2.7% | -4.9% |
| Idea Cellular Ltd. | -15.2% | -14.8% | -26.9% | -30.7% |
| Shree Renuka Sugars Limited | -15.5% | -34.3% | -37.7% | -43.1% |
| Steel Authority Of India | -17.5% | -16.8% | -5.1% | -4.1% |
| Ashok Leyland Ltd. | -17.7% | -22.8% | -1.5% | 3.5% |

Source: IBES, Morgan Stanley Research

Corporate Activity

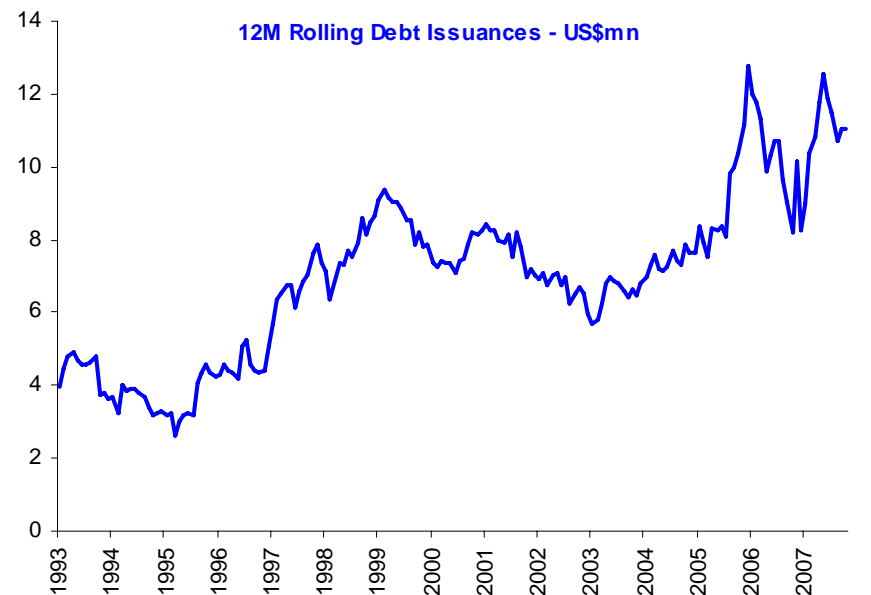
Equity issuances were up 7% MoM in September. The 12-month rolling number is now 35% of the highs for equities and 12% off the high for debt issuances.

Equity Issuances



Source: CMIE, Morgan Stanley Research

Debt Issuances

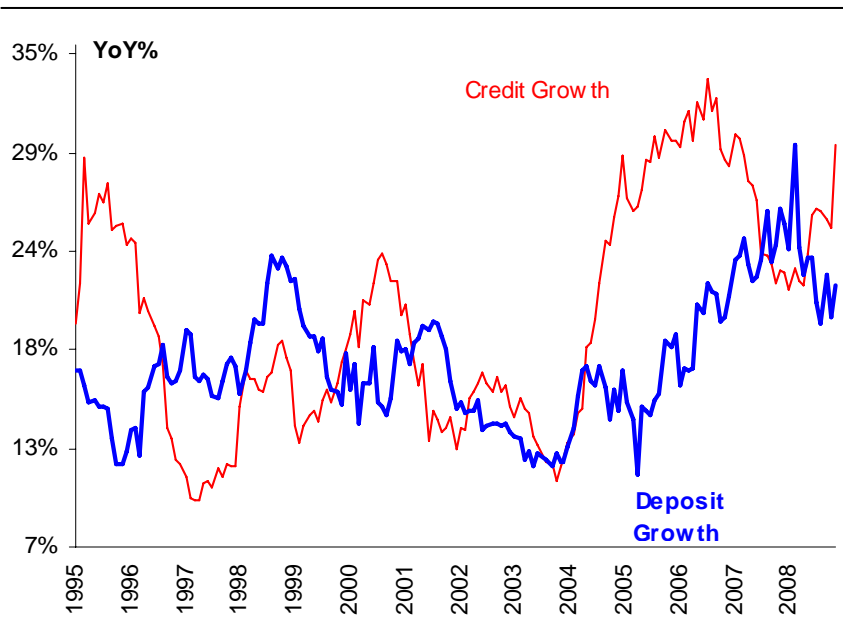


Source: CMIE, Morgan Stanley Research

Macro Indicators

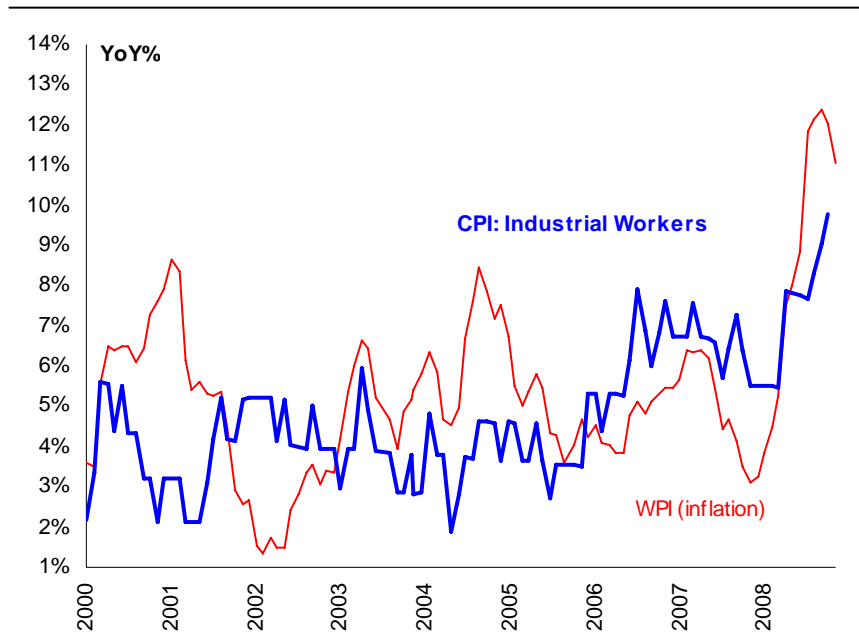
Credit growth picked up at 29.4% during October to a 21-month high, while deposit growth improved 180bp to 22.5%. Inflation, as measured by the Wholesale Price Index, fell well below 12% in October, and now it is at a five-month low. The consumer price inflation accelerated to multi-year highs (9.8% in September).

Credit and Deposit Growth



Source: RBI, Morgan Stanley Research

Inflation

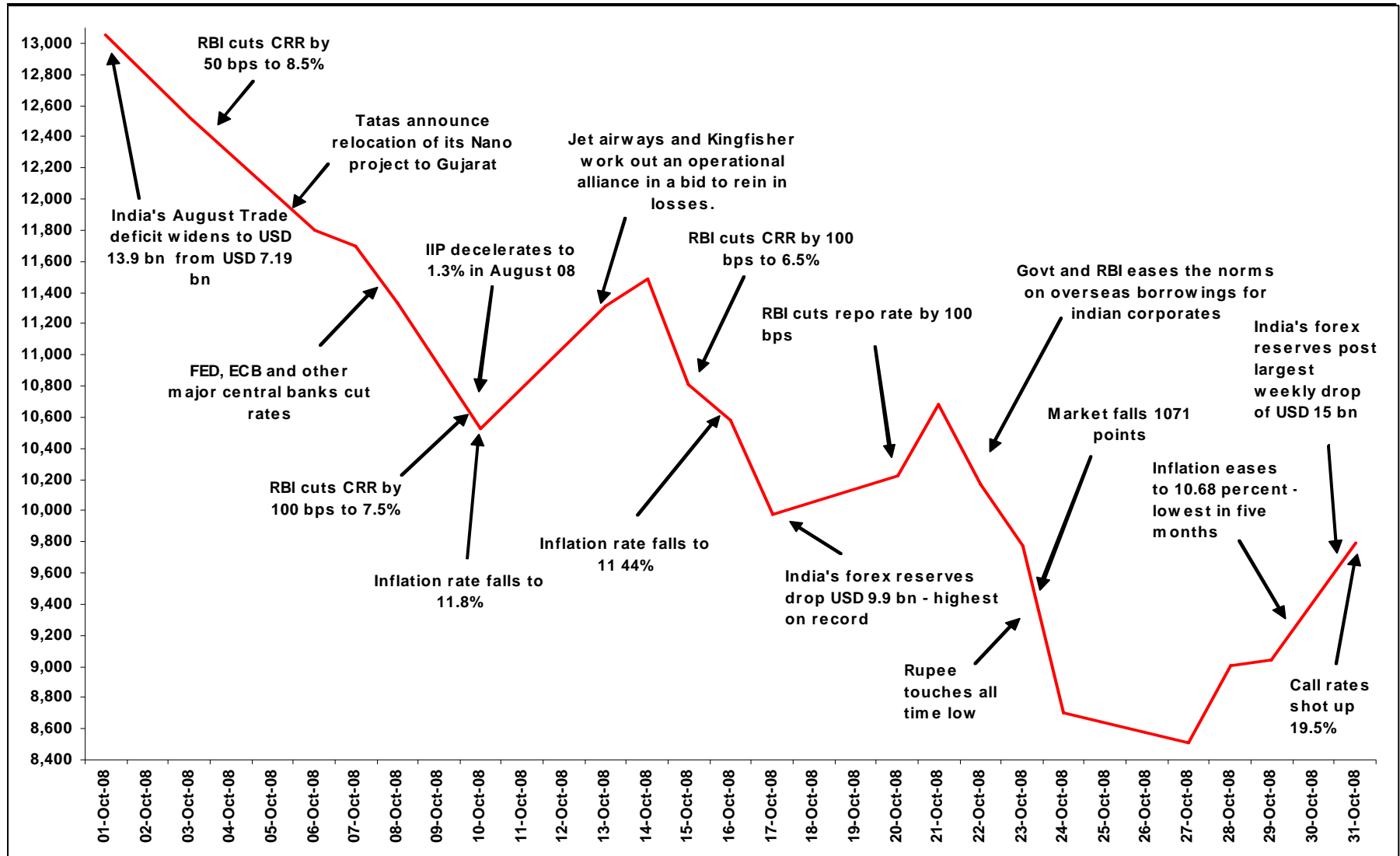


Source: CSO, Morgan Stanley Research

Macro Indicators

| | Nov-07 | Dec-07 | Jan-08 | Feb-08 | Mar-08 | Apr-08 | May-08 | Jun-08 | Jul-08 | Aug-08 | Sep-08 | Oct-08 |
|---|---------|--------|---------|--------|--------|--------|---------|---------|--------|--------|---------|---------|
| Trade Balance (US\$billion) | -7.6 | -5.4 | -9.4 | -4.2 | -6.9 | -9.9 | -10.8 | -9.8 | -10.8 | -13.9 | -10.6 | NA |
| Exports (US\$billion) | 12.8 | 12.3 | 13.1 | 14.2 | 16.3 | 14.4 | 13.8 | 14.7 | 16.3 | 16.0 | 13.7 | NA |
| Exports (YoY) | 30.6% | 16.0% | 20.5% | 35.3% | 26.6% | 31.5% | 12.9% | 23.5% | 31.2% | 26.9% | 10.4% | NA |
| Imports (US\$billion) | 20.4 | 17.7 | 22.5 | 18.5 | 23.2 | 24.3 | 24.5 | 24.5 | 27.1 | 29.9 | 24.4 | NA |
| Imports (YoY) | 32.8% | 18.1% | 63.6% | 30.5% | 35.2% | 36.6% | 27.1% | 25.9% | 48.1% | 51.2% | 43.3% | NA |
| Foreign Direct Investment (US\$million) | 1864 | 1558 | 1767 | 5670 | 4443 | 3749 | 3932 | 2392 | 2247 | NA | NA | NA |
| Foreign Exchange Reserves (US\$billion) | 273 | 272 | 284 | 301 | 309 | 312 | 314 | 311 | 306 | 295 | 291 | 258 |
| Net FII Flow s (US\$million) | (1,165) | 1,246 | (4,368) | 1,235 | 36 | 71 | (1,095) | (2,465) | (227) | (467) | (1,724) | (3,388) |
| Rs/US\$1 (period average) | 39.44 | 39.44 | 39.37 | 39.73 | 40.36 | 40.01 | 42.13 | 42.82 | 42.84 | 42.94 | 45.56 | 48.72 |
| M3 (YoY) | 23.3% | 22.1% | 22.4% | 21.2% | 20.7% | 21.2% | 22.5% | 20.7% | 20.0% | 21.0% | 21.0% | 19.0% |
| Bank Loans (Non-food credit, YoY) | 22.9% | 21.9% | 23.2% | 22.5% | 22.3% | 24.5% | 25.8% | 26.2% | 26.1% | 25.5% | 24.8% | 29.3% |
| Money Multiplier | 4.5 | 4.6 | 4.5 | 4.5 | 4.6 | 4.7 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Deposit Growth Rate (YoY) | 25.0% | 23.6% | 29.5% | 23.7% | 22.2% | 23.1% | 23.1% | 20.6% | 19.5% | 22.1% | 19.8% | 19.8% |
| Prime Lending Rate | 12.8% | 12.8% | 12.8% | 12.3% | 12.3% | 12.3% | 12.3% | 12.8% | 12.8% | 13.8% | 13.8% | 13.8% |
| One Year Deposit Rate | 8.0% | 8.3% | 8.8% | 8.8% | 8.8% | 8.8% | 8.8% | 9.5% | 9.5% | 10.0% | 10.0% | 10.0% |
| 364 day T-Bill Yield | 7.7% | 7.7% | 7.4% | 7.5% | 7.5% | 7.7% | 7.8% | 8.4% | 9.3% | 9.2% | 8.7% | 7.9% |
| 91 day T-Bill Yield | 7.4% | 7.5% | 7.1% | 7.3% | 7.3% | 7.2% | 7.3% | 7.9% | 9.0% | 9.1% | 8.6% | 7.7% |
| 10 yr Government Bond Yield | 7.9% | 7.9% | 7.6% | 7.6% | 7.7% | 8.1% | 8.0% | 8.4% | 9.2% | 9.0% | 8.4% | 7.8% |
| Manufacturing(in %) | 4.7% | 8.6% | 6.7% | 9.6% | 5.7% | 6.7% | 4.5% | 6.1% | 8.0% | 1.1% | NA | NA |
| Consumer Goods | -2.9% | 8.7% | 8.4% | 11.7% | 0.9% | 8.5% | 7.4% | 9.7% | 8.5% | 5.1% | NA | NA |
| Basic Goods | 5.2% | 3.4% | 3.6% | 7.3% | 3.3% | 4.0% | 3.0% | 2.5% | 5.4% | 3.9% | NA | NA |
| Capital Goods | 24.2% | 17.6% | 2.6% | 10.7% | 20.3% | 12.4% | 4.3% | 8.3% | 20.4% | 2.3% | NA | NA |
| Intermediate Goods | 5.5% | 7.6% | 8.0% | 8.5% | 4.9% | 3.1% | 1.9% | 2.5% | 2.7% | -6.2% | NA | NA |
| Consumer Price Index (YoY) | 5.5% | 5.5% | 5.5% | 5.5% | 7.9% | 7.8% | 7.8% | 7.7% | 8.3% | 9.0% | 9.8% | NA |
| Wholesale Price Index (YoY) | | | | | | | | | | | | |
| - All Commodities | 3.1% | 3.8% | 4.8% | 5.7% | 7.5% | 8.0% | 8.8% | 11.9% | 12.2% | 12.4% | 12.0% | 11.1% |
| - Manufactured Products | 3.5% | 4.0% | 4.5% | 4.6% | 7.3% | 8.4% | 9.7% | 10.9% | 11.2% | 11.1% | 11.6% | 10.9% |

News Flow and Market Performance



Source: Bloomberg, Economic Times, Business Standard, Morgan Stanley Research



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|--------------------------|-------------------|------------|----------------------------------|----------------|----------------------|
| | Count | % of Total | Count | % of Total IBC | % of Rating Category |
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| Total | 2,255 | | 650 | | |

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