India Equity Strategy

Cholamandalam Securities Limited

06th January 2012

Selling pressure intensifies in lower rung stocks

December saw the markets continuing its downward journey. The BSE Sensex closed lower by about 4% while the S&P CNX Nifty closed with a loss of 208 points at 4,624.3. Selling pressure intensified in lower rung stocks with the BSE Midcap and BSE Smallcap indices losing ~9% each. Volatility in the Sensex continued to remain at elevated levels, the index moved in a 1,900 points band as against more than 2,100 points in October and November. Volatility was also high in the the midcap and smallcap spaces. A surprise coordinated by the Federal Reserve and a few other central banks to keep credit flowing amid the worsening debt crisis in Europe helped fuel a rally in the equity markets. However, this rally was short lived as industrial production numbers spooked the markets.

Credit risk premiums increase

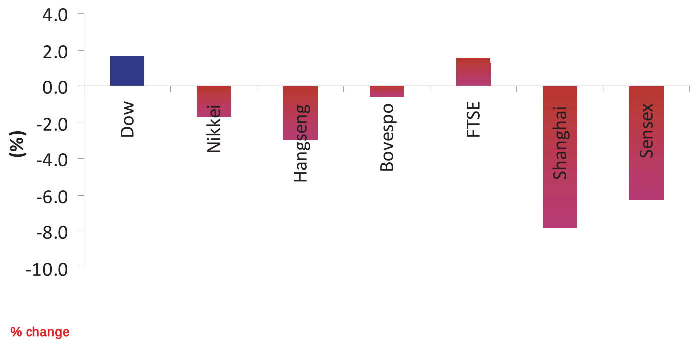
Italian debt yields decreased in early December, however, they were back at 7% by the end of the month. Yields on most of Europe's government bonds trended lower, yields on the Spanish 10-year note closed lower at ~5.1% debt, while that of German and UK dipped below the 2% mark (near two-decade old lows). Yields on the 10-year French paper were sluggish and closed at ~3%mark. Even as yields on major government bonds decreased rates of credit default swaps moved up indicating that money is moving to safer places. Central bankers across the globe appear to have turned their attention towards growth. The Reserve Bank of Australia slashed its cash rate (benchmark interest rate) by 25 basis points.

Commodities close weak

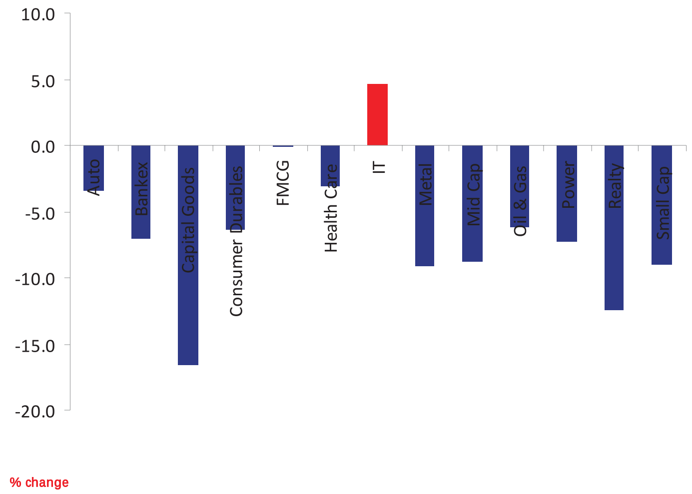
Weak November manufacturing PMI (purchasing managers' index) numbers for China appears to have led the decline in prices of most non-ferrous metals closed on the LME. Strengthening of the dollar also appears to have facilitated the decline. Bullion prices continued to decline in dollar terms, while crude oil and most soft commodities closed on a sluggish note.

Bankex and Consumer Durables index declined mor

Global Indices



Domestic Sectoral Indices



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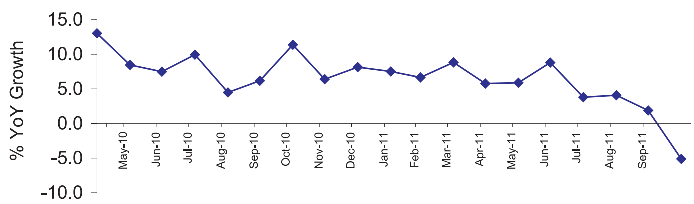


Top 10 Gainers S&P CNX 500		Top 10 Losers S&P CNX 500	
Welspun Corporation	22%	Sterling Biotech	-68%
Parsvnath Developers	20%	Everest Kanto	-41%
Indraprastha Medical	14%	ARSS Infra	-41%
Blue Dart Express	14%	3i Infotech	-37%
Unichem Laboratories	13%	VIP Industries	-35%
Zensar Technolgies	13%	Pantaloon Retail	-34%
GVK Power Infrastructure	12%	Jai Balaji Industries	-34%
Tata Communciations	11%	Jet Airways	-33%
Pipavav Defence	11%	Sintex Industries	-33%
Mastek	11%	Wockhardt	-33%

Secular downtrend, frontline IT stocks beat the blues

Most sectoral indices on the BSE ended the month of December on a weak note. The BSE Metals, Power, Bankex and Consumer Durables index declined more than 5%. Capital goods and Realty declined by 16.6% and 12.4% respectively. The BSE IT index bucked the trend to close with a 4.6% gain. The S&P CNX 500 that represents a broad array was down 5.6%. Selling pressure was evident with about 16 stocks declining for every three that advanced. A weakening rupee and flight of capital to frontline stocks augured well for gains in IT blue-chips.

Weak IIP numbers lead selling pressure in capital goods and mining

Negative IIP numbers (October) in the mining segment for the third straight month had a negative impact on mining stocks. Tracking the sharp drop in IIP numbers of capital goods (-25%), stocks of power equipment manufacturers also fell sharply. Utilities and materials faced intense selling pressure. Led by concerns on supply of coal, most energy utilities closed with a more than 10% decline. Gas distribution companies, staved off the selling pressure to close with modest declines. Metals declined sharply, led by a selloff in lower rung steel stocks. Upgrade on the Indian debt instruments by Moody's failed to enthuse sentiment in the financials space as they tracked the declines of banking stocks in the global markets.

Frontline cement stocks buck the trend

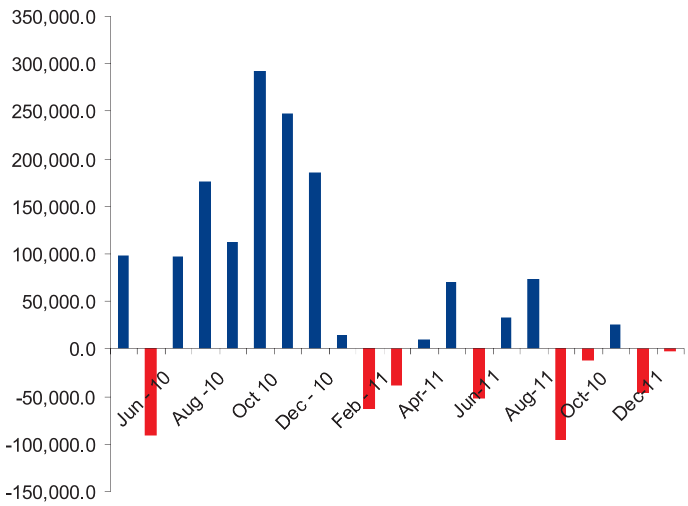
Stocks in the infrastructure and realty spaces continued to tumble. Concerns of lower interest coverage continued to haunt infrastructure players. Debt overhang and concerns on lower off take for housing projects were among the key reasons for the continued down trend in realty stocks. A healthy balance sheet position appears to have helped stave off selling pressure in frontline cement stocks.

Rate reversal on the cards

Lower yields in G-Secs and lower rates on overnight swaps indicate that debt markets are discounting peaking of interest rates. The RBI chief has further indicated in recent media interactions that a policy reversal is likely in its upcoming meet in late January. With food inflation moderating, growth is likely to take centre stage in the foreseeable future.

After two fiscals of strong growth, the current fiscal (FY12) has been a challenging one. September results were below expectations, while the sales growth along expected lines. Foreign exchange impact took center stage in the September quarter. Frontline IT stocks (Infosys, TCS and Wipro) have gone though earnings upgrades in the recent weeks, while Bharthi Airtel, Reliance and ONGC have been downgraded. At 15,800, the Sensex is trading at ~15X FY13 earnings estimates.

FII Net Equity Flows



(₹ Million)

The weakened rupee and upgrades are likely to augur well for frontline IT stocks. Lower commodity prices are likely to have positive impact on FMCG stocks. Stocks in this space, however, have gone through only a moderate correction. Investors would be better off sticking to large and midcap stocks in the FMCG space. Considering risk aversion in the debt markets; stocks with high-leverage, typically infrastructure, shipping and real estate need to be given a go-by. Bogged by asset quality concerns and capital adequacy concerns under Basell III the financial space has gone through a sharp correction. These appear to be overdone, at current levels midcap and large cap banking stocks appear attractive.

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