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India Strategy

2009: A year of risks - and opportunities

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2009: A year of risks - and opportunities

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- Near term global economic outlook continues to remain weak
  - Fears of recession and deflation are looming large, especially for developed economies
  - Despite huge stimulus packages, global economic recovery will be a long process

- India is not facing any crisis, but growth momentum is lost for the moment. Nevertheless, Indian economy is more resilient, due to
  - Large domestic consumption and low dependence on exports;
  - Favourable saving-investment dynamics, a sound financial sector, scope for infrastructure; and
  - Improvement of the fiscal and BoP situation at the margin

- However, elections in mid-CY09 is the key event risk

- Indian markets are offering good long term value at current valuations. Despite near-term macro-economic concerns, strong domestic liquidity will limit downside

- Key themes to play in CY09
  - Declining interest rates – overweight BFSI, Consumer Discretionary
  - Weak global economy – underweight IT
  - Falling commodity prices – underweight Materials

What drove markets in 2008?

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Source: Bloomberg, Edelweiss research

Key market drivers in 2009

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Expectations on	Q1 CY09		Rest of CY09	
	Outlook	Explanation	Outlook	Explanation
Global economy / markets				
Financial market stability	↔	Stabilising with policy support. Credit card delinquency key near term threat	↑	With support from governments, financial system is likely to recover.
Recovery in growth	↓	Growth missing globally. Stimulus measures attempting damage control	↔	Global recession risk remains; stimulus measures to stem downside
Risk appetite for equities	↓	Bond yields close to zero in the U.S. implying extreme risk aversion	↑	Higher credit off-take, stimulus measures to limit fall in confidence
Indian economy				
Growth (GDP, IIP)	↓	GDP growth likely to drop further. Expect recurrence of negative IIP growth	↓	Intensified slowdown in IIP, GDP
Fiscal situation	↓	Slowing tax revenue; overshooting borrowing	↔	Lower tax revenue; large stimulus spending; policy uncertainty. Absence of oil, fertilizer subsidy positive at the margin
Credit environment	↔	~25% growth possible with CRR cut, MSS unwinding. However, banks are averse to lending.	↑	Banks can support 20% credit growth. However, low business confidence may result in low credit offtake. Other sources of funds drying up
Inflation and interest rates	↑	Fast decline in inflation numbers. Softer policy rates, yields	↑	Expect negative inflation in mid-CY09. Continued monetary easing
BoP and Exchange rate	↔	Slow exports & FDI; FII outflow to decelerate, Possible obligations of debt repayment	↑	Smaller trade deficit (increased domestic oil and gas exploration); reduced FII outflows. Weakening USD may support INR
Corporate earnings				
Core earnings growth	↓	Expect zero growth to marginal decline in core earnings	↓	5% for Nifty; 3% for Sensex in FY10E
Possibility of surprise	↑	MTM gains on bank's investments, FX loans	↓	Topline growth can surprise on the downside
Valuations				
Historical	↔	Historical valuation lows still 15%-20% below current levels	↑	Expect 13x-14x 1-yr fwd earnings reasonable
Relative to peers	↔	India is no more an expensive market relative to peers	↑	Premium for more resilient growth (largely domestic) than peers
Liquidity				
Domestic Institutions	↑	Strong inflows from domestic mutual funds, insurance sector	↑	Strong inflows from insurance sector to continue
Foreign Institutions	↔	FII selling may continue, though at slower pace	↔	Absence of large FII outflows
Political scenario				
Uncertainty around elections	↔	Investors may hold back fresh investments as election is a key event risk	↔	NA
Policy initiatives	↔	Policy actions to address issues of immediate concern only	↔	Any coalition (BJP or INC led most likely) without Left positive for reforms
Geo-political environment	↓	Uncertain government stance on war against terror	↔	India-specific geo-political situation to stabilise

Source: Edelweiss research

Global economy continues to be in turmoil …

US: Record high delinquency rates ...

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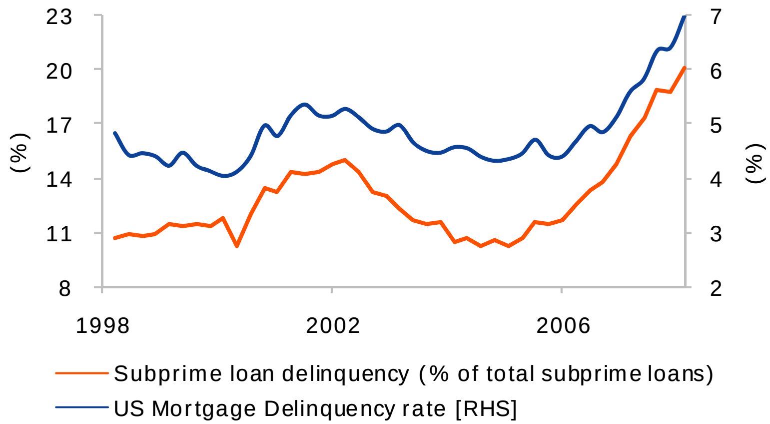
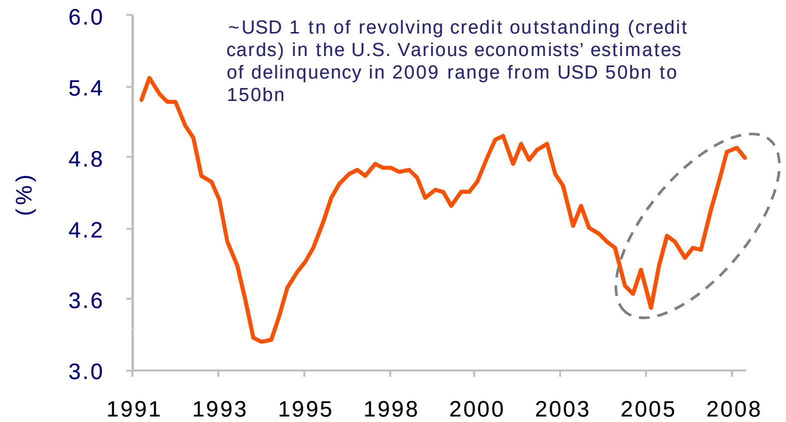
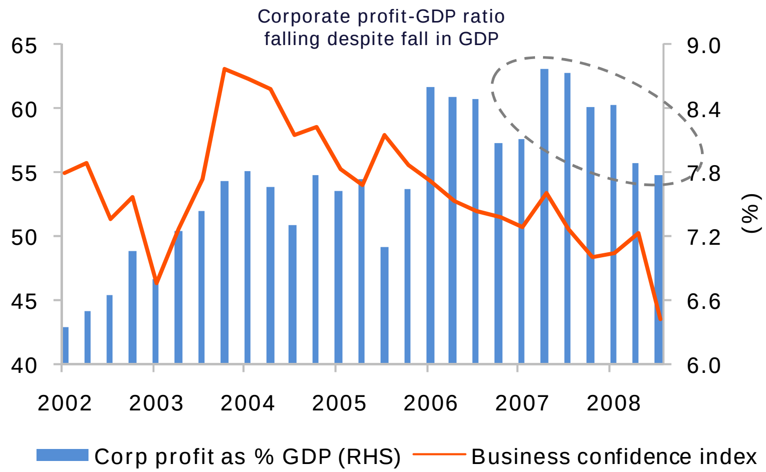
US mortgage & subprime delinquency rates at a historic high



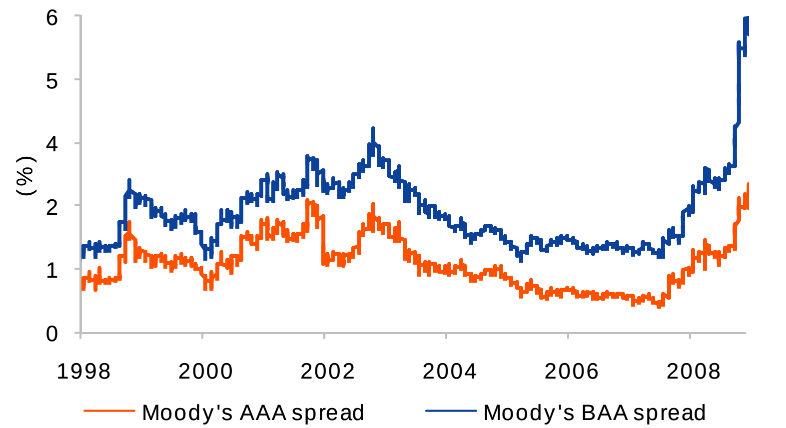
Credit card defaults are expected to rise in 2009



Corporate profit outlook weak; business confidence at a decade low



Corporate default risk is rising



Source: Bloomberg

… high unemployment leading to consumption slowdown

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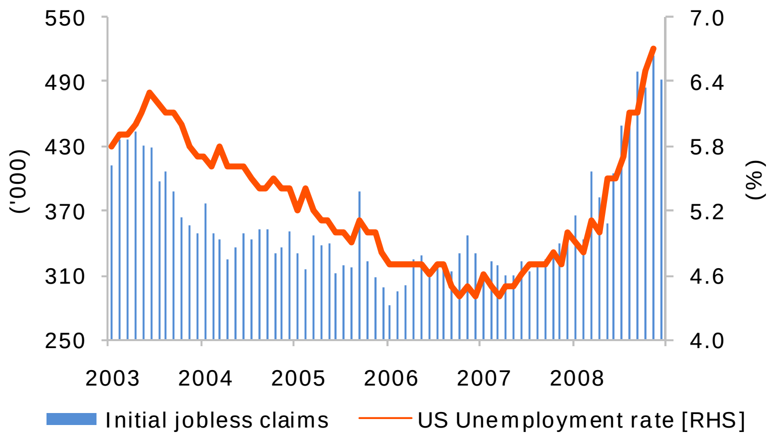
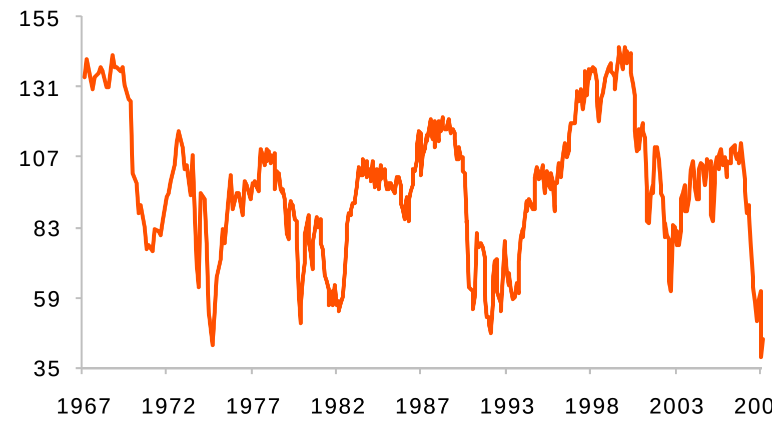
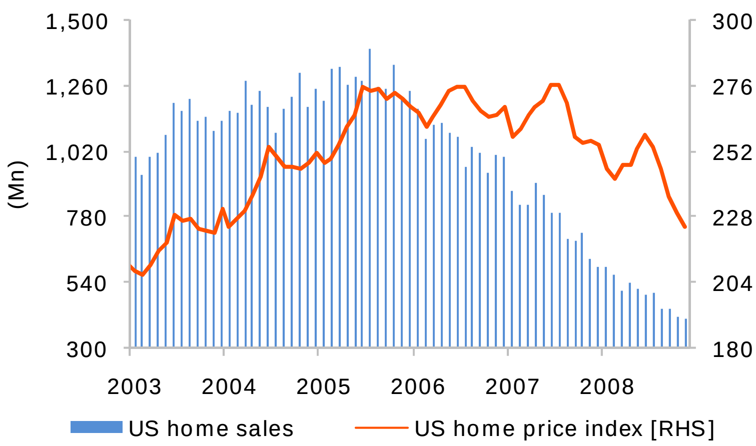
US unemployment has risen sharply



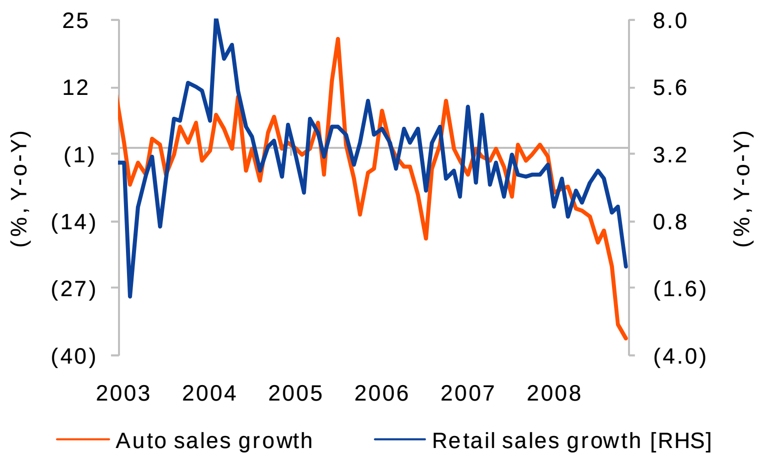
US Consumer Confidence has fallen to historic lows…



…reflected in falling home sales and property prices…



… and weak demand for consumption goods



Source: Bloomberg

Other major economies not spared either

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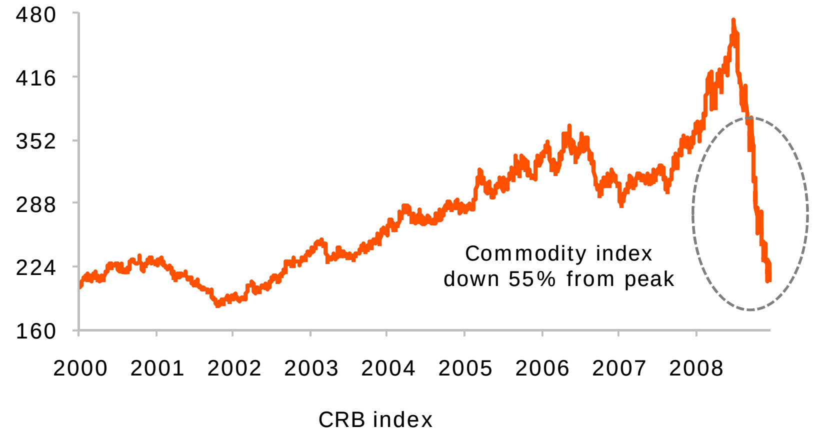
Economic slowdown to hit the entire globe

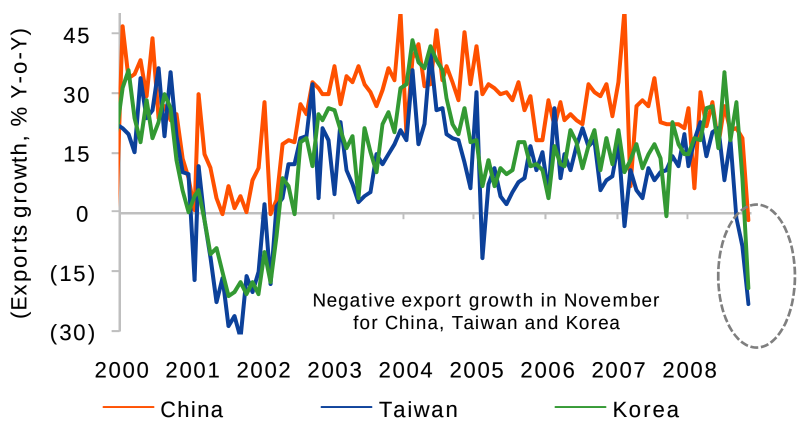
Country	GDP growth: Average 2004-08 (% Y-o-Y)	CY09E (% Y-o-Y)	Change in growth (% points)
Spain	3.5	(0.7)	(4.2)
United Kingdom	**2.7**	**(1.3)**	**(4.0)**
Russia	7.3	3.5	(3.8)
Singapore	7.1	3.5	(3.7)
United States	**2.8**	**(0.7)**	**(3.5)**
Hong Kong SAR	6.4	3.5	(2.9)
France	2.0	(0.5)	(2.5)
Canada	2.7	0.3	(2.4)
Japan	2.1	(0.2)	(2.3)
India	**8.6**	**6.3**	**(2.3)**
Germany	1.4	(0.8)	(2.2)
Philippines	5.8	3.8	(2.0)
Italy	1.1	(0.6)	(1.7)
Mexico	3.4	1.8	(1.6)
Norway	2.8	1.2	(1.6)
China	10.8	9.3	(1.6)
Malaysia	6.0	4.8	(1.3)
Australia	3.3	2.2	(1.1)
Thailand	5.6	4.5	(1.0)
Korea	4.4	3.5	(0.9)
Portugal	1.0	0.1	(0.9)
Brazil	3.8	3.5	(0.3)

Note: CY09 estimates are IMF projections as of November 2008.
Table sorted by change in GDP growth

Brazil, Russia, South Africa affected with commodity slowdown



Export dependent economies of China, Korea, Taiwan also hit



Source: Bloomberg, IMF

Co-ordinated monetary and fiscal stimulus is the hope …

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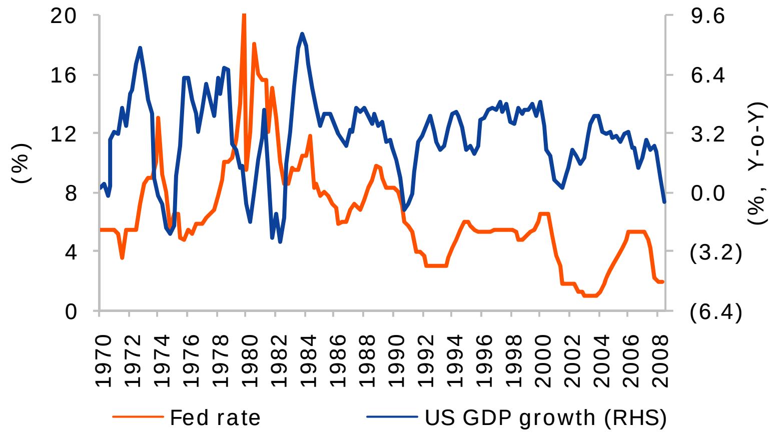
Low interest rates are likely to boost growth, as in the past



Governments introducing large stimulus packages across the globe

Country	Amount	Details
U.S.	$ 168 bn	Tax refunds. The Obama Administration is likely to announce further large package taking the total to ~USD 1 tn. However, US has already disbursed over USD 3 tn for several bailout packages.
U.K.	£ 20 bn	Restoring prudence to the public finances, cut in VAT & other taxes, capex projects, higher pension and child benefit
E.U.	€ 200 bn	Clean technology projects, tax breaks, infrastructure spending, auto sector sops, employment creation, incentives for home-buyers
Japan	~$ 700 bn	Employment creation, financing for corporates & SMEs, liquidity support to banks, mortgage relief for home-owners, direct financial assistance to households
China	~$ 600 bn	Housing, infrastructure, support farmers, tax cuts for investment
S.Korea	$11bn	New spending and tax cuts
Malaysia	7 bn ringgit	Infrastructure and public services, low-cost housing
Thailand	$35.78bn	Lending to SMEs, small farms, stock market, govt expenditure, subsidy for transport, electricity, low-income groups
Australia	$7.4bn	Pensioners, middle and low-income groups, first-time home buyers, labor, training, infrastructure

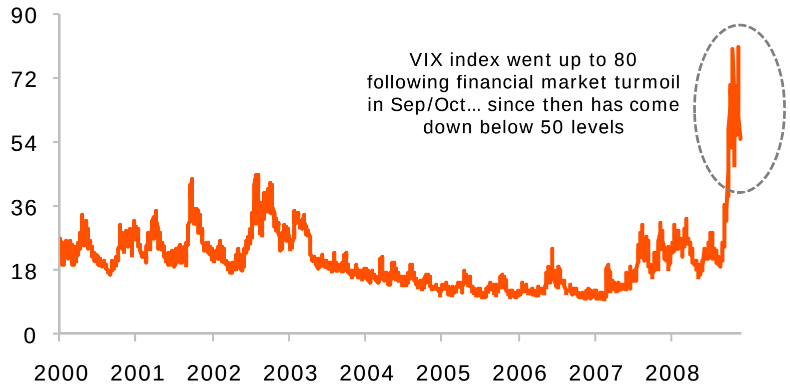
Monetary actions have been globally co-ordinated

	Central Banks policy rates		
	CY08 Peak (%)	Current (%)	Change from peak (%)
Hong Kong	4.5	0.5	(4.0)
United Kingdom	5.5	2.0	(3.5)
Australia	7.3	4.3	(3.0)
Norway	5.8	3.0	(2.8)
United States	**3.0**	**0.3**	**(2.8)**
Canada	4.0	1.5	(2.5)
India	**9.0**	**6.5**	**(2.5)**
Korea	5.3	3.0	(2.3)
China	17.5	15.5	(2.0)
Eurozone	**4.3**	**2.5**	**(1.8)**
Singapore	1.5	0.3	(1.3)
Thailand	3.8	2.8	(1.0)
Philippines	6.0	5.5	(0.5)
Japan	0.5	0.1	(0.4)
Malaysia	3.5	3.3	(0.3)
Brazil	13.8	13.8	-
Mexico	8.3	8.3	-
Russia	12.0	13.0	1.0

Note: Table sorted by most aggressive monetary easing

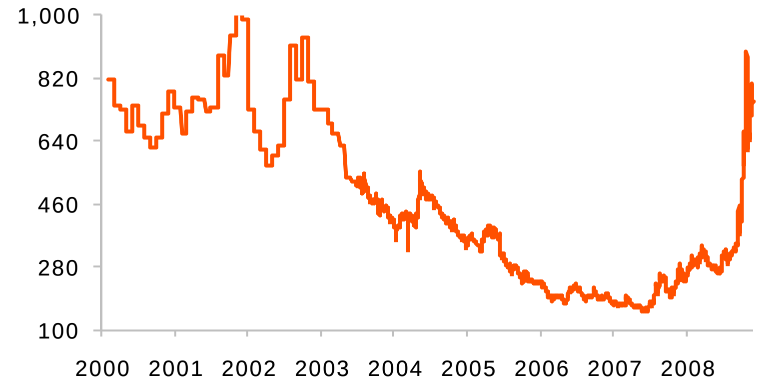
Source: Bloomberg, News sources

Risk appetite for US equities is low as market volatility is at multi-decade high



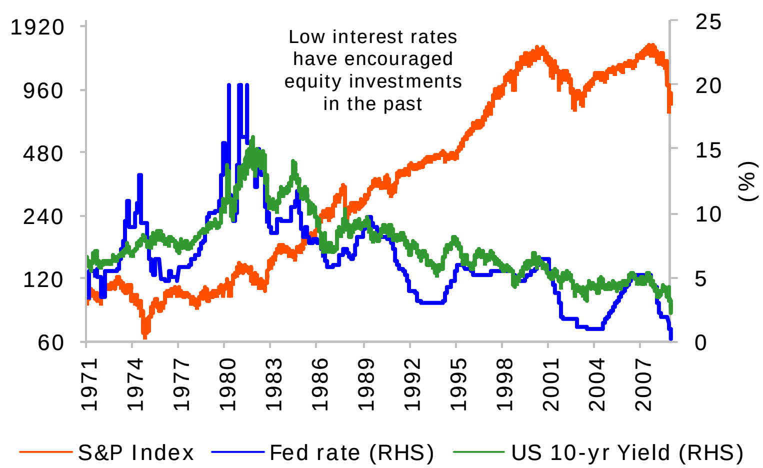
VIX Index

Risk appetite for EMs also low, reflected in high EMBI spreads

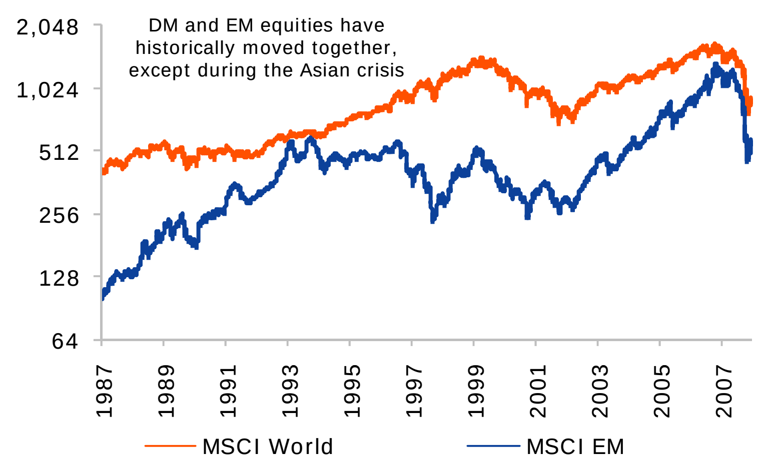


JP Morgan Emerging Market Bond Index (EMBI) spread

Low interest rates will revive risk appetite for equities with the first indication of economic stability …



… when that happens, EM equities are likely to move up simultaneously with the developed markets



Source: Bloomberg

…… India feels the heat too…… still relatively less impacted……

……macro-indicators portray mixed picture

Prices deflating across the globe

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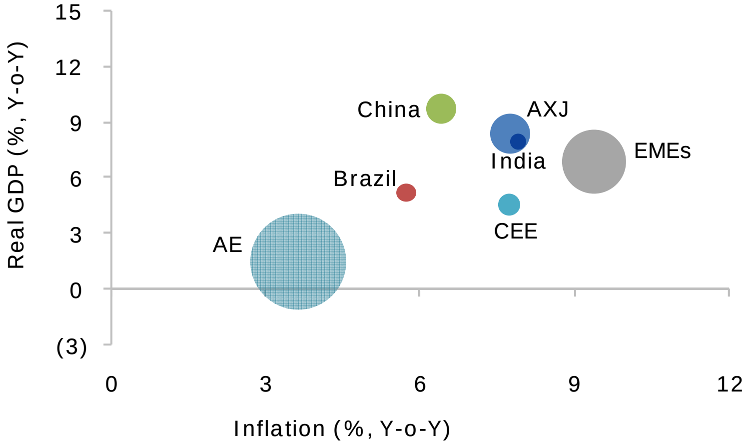
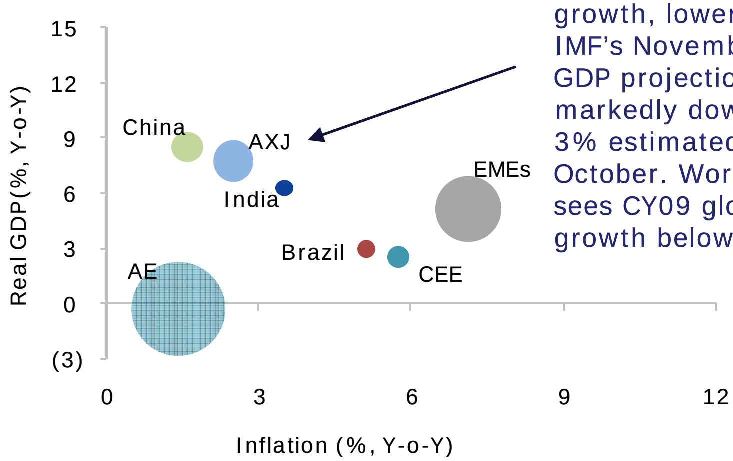
Global economy slipping into recession-deflation - Projections



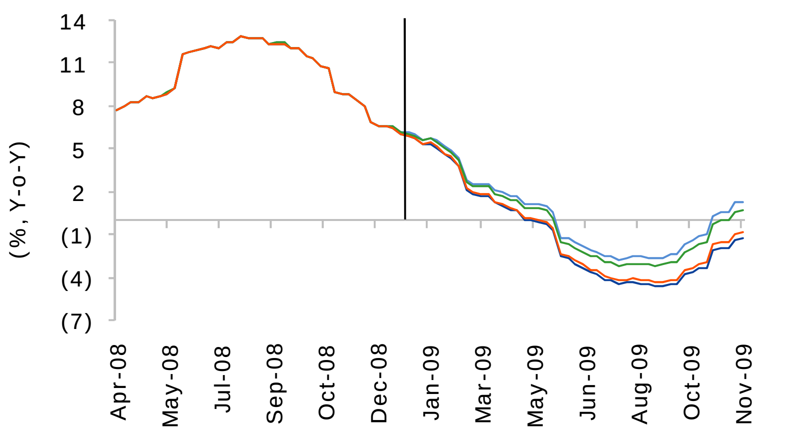


All bubbles moving south-west – slower growth, lower prices. IMF's November global GDP projection of 2.2% markedly down from 3% estimated in October. World Bank sees CY09 global growth below 1%.

AE: Advanced economies; AXJ: Asia ex-Japan; CEE: Central and Eastern Europe
Note: Size of bubbles indicate relative size of the respective economy/ economic zone by nominal GDP

Source: IMF, Focus Economics, Edelweiss research

Even India to witness negative inflation in 2009



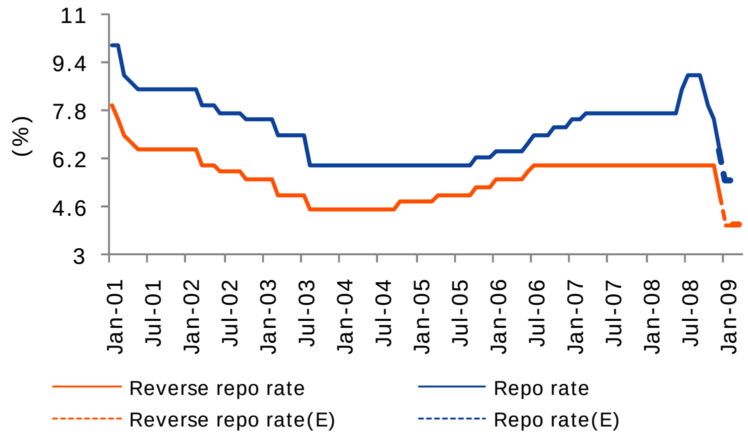
All probable scenarios* indicate a spell of negative inflation in India – first time in 30 years.

One may avoid calling it deflation as over a 2-year window annualised price rise is still 4%-5% - nevertheless, more leeway for aggressive monetary easing.

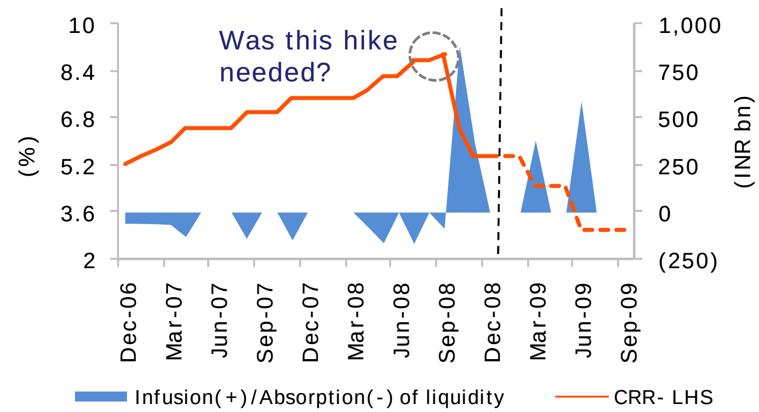
**: Scenarios include (a) no change in prices from now on; (b) 8% annualised increase in primary products and manufactured food items; (c) 5% annualised reduction in fuel prices on top of scenario (b); and (d) 5% annualised reduction in metals, chemicals, machinery and equipments prices on top of scenario (c).*

Source: Office of economic adviser, Edelweiss research

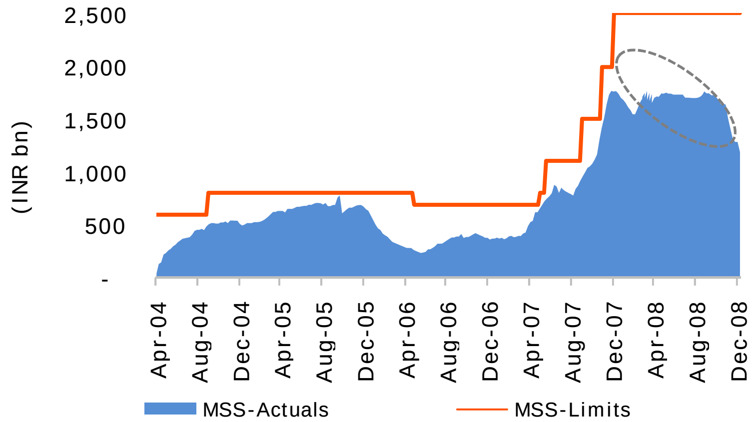
Policy rates slashed down sharply – likely to hit new lows in 2009



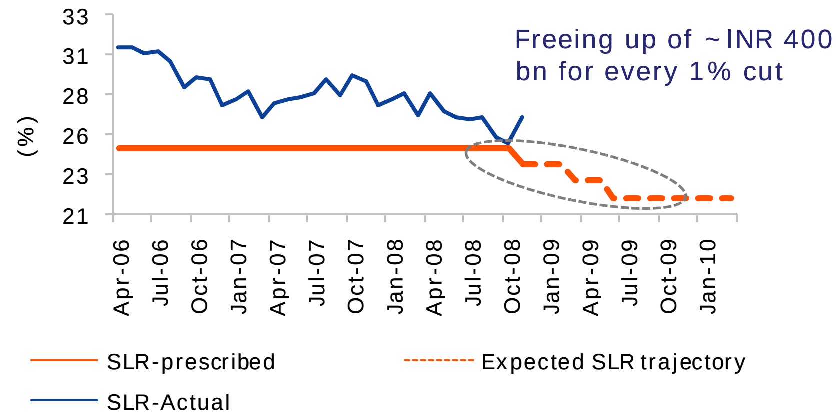
Rapid CRR reduction – infusion of liquidity of ~INR 1400 bn already



Aggressive MSS unwinding ahead – big chunk of potential liquidity infusion



SLR reduction freeing up funds for credit



Source: RBI, Edelweiss research

Market interest rates to ease further

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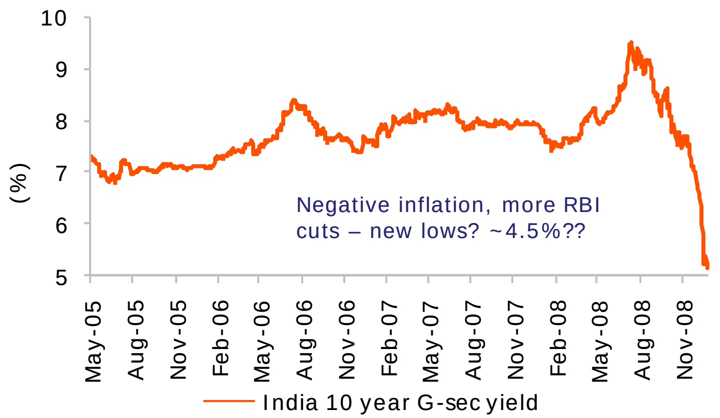
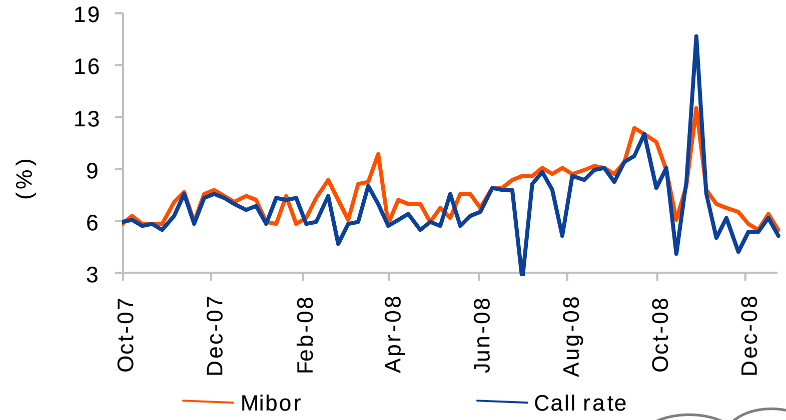
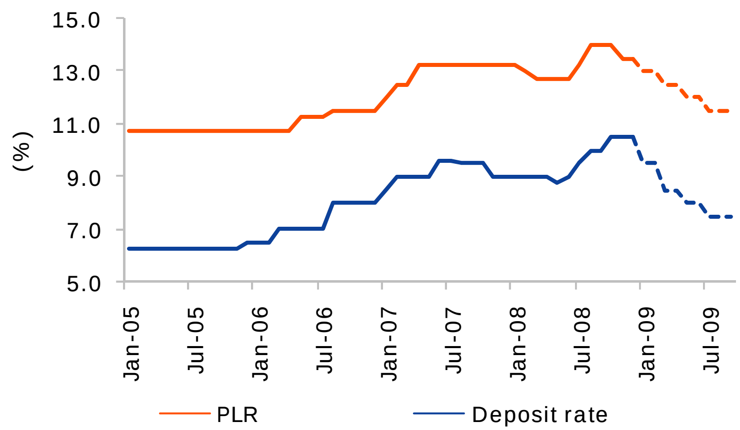
G-Sec yields have already halved, ...

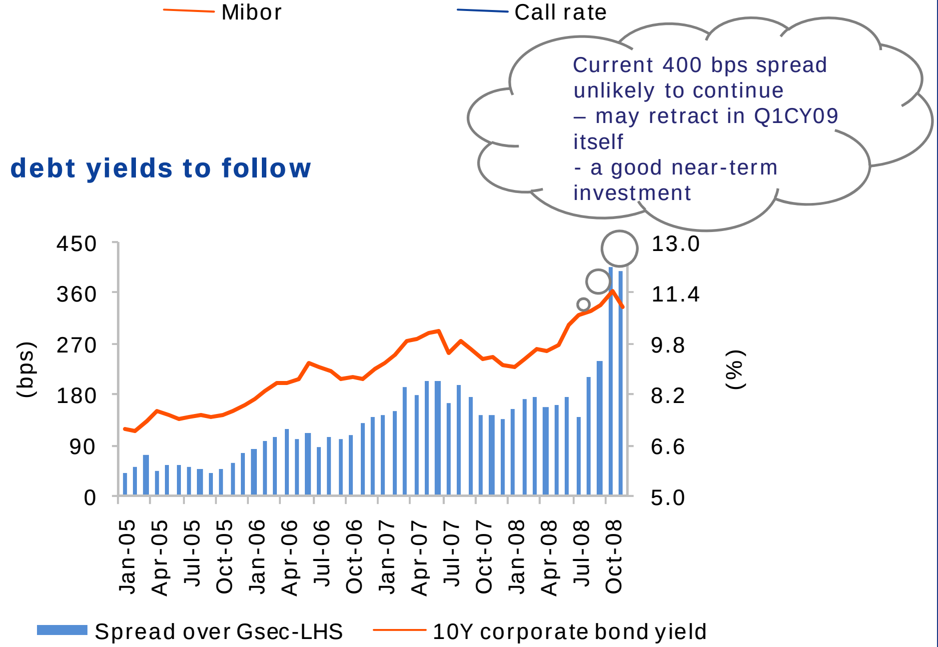


... MIBOR, call rates off the October spikes ...



... bank lending rates, corporate debt yields to follow





Source: RBI, Bloomberg, Edelweiss research

Growth is a challenge in the near-term

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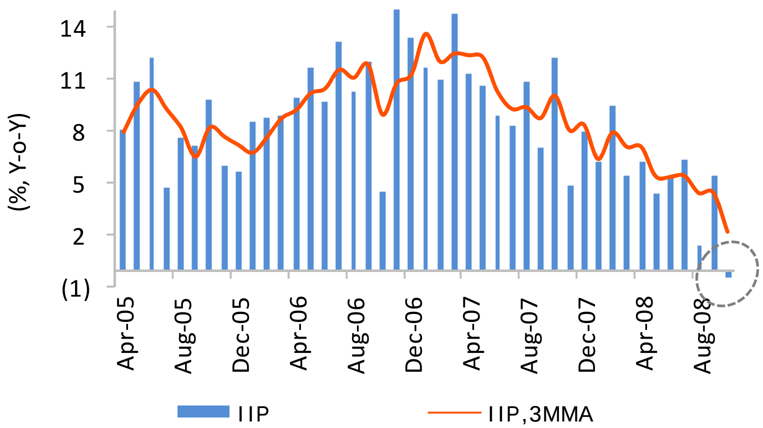
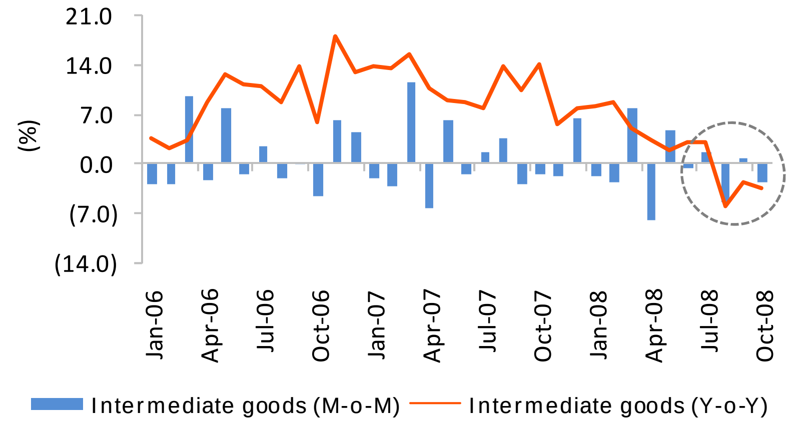
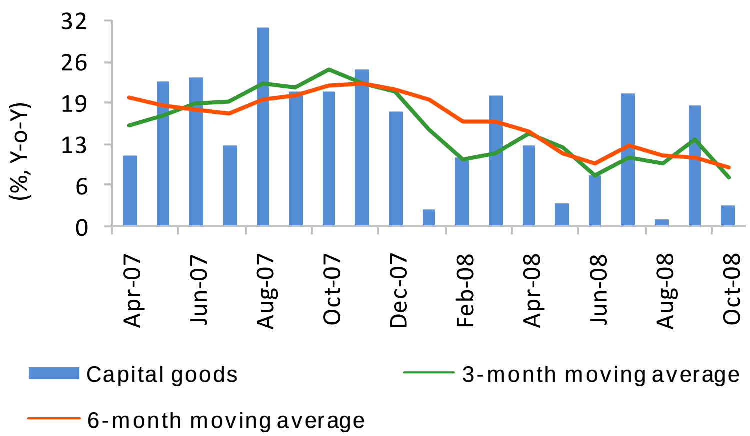
IIP growth has turned negative



Intermediate goods production down



Core sector growth remains erratic



Source: CSO, Edelweiss research

Erratic capital goods sector, negative growth for intermediate goods suggest more pain for industrial sector at the moment. Poor exports demand, uncertainty regarding credit availability (specially for smaller units) had been speed-breakers for industry.

Falling interest rates, falling input costs, reduction in indirect taxes, government endeavour to boost demand and credit disbursal are however incremental positives for industry – may help a gradual recovery for industry in H2CY09.

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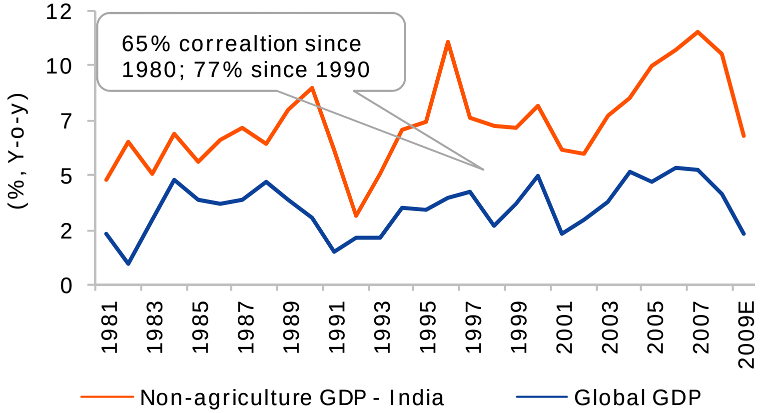
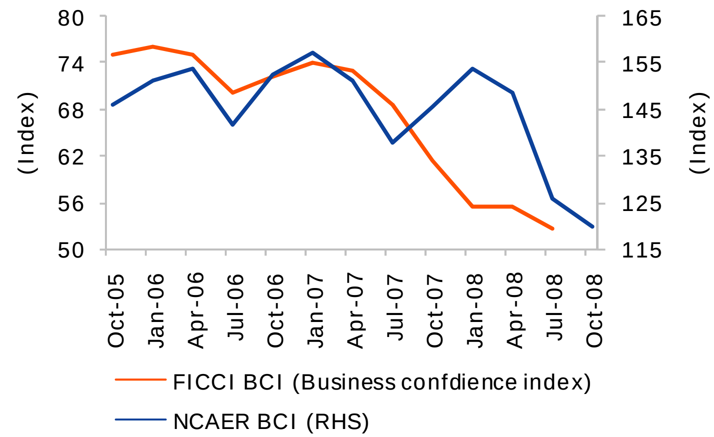
Weak global GDP to impact India



Business confidence is low



FY10 GDP may hit a trough of ~6%

	Share in real GDP [1]	CAGR (FY99-08)	FY08	FY09E	FY10E
Real GDP	100.0	7.1	9.0	7.4	6.0
Agriculture	17.8	3.2	4.6	3.5	3.0
Industry [2]	26.6	7.2	8.6	6.0	3.8
Services	55.6	8.8	10.8	9.2	7.9

(1) As per FY08 (%)   (2) Including Construction

Note: Data in % Y-o-Y, unless otherwise specified

Source: CSO, FICCI, NCAER, Edelweiss research

India’s integration with the global economy increasing – correlation of global and Indian growth (ex-agriculture) is ~77% since 1990.

However, India’s non-agriculture GDP growth has never been below 4.5% in last 25 years (barring FY92 – the year of initiating economic reforms) indicating inherent resilience of Indian growth.

… all lead indicators are down too …

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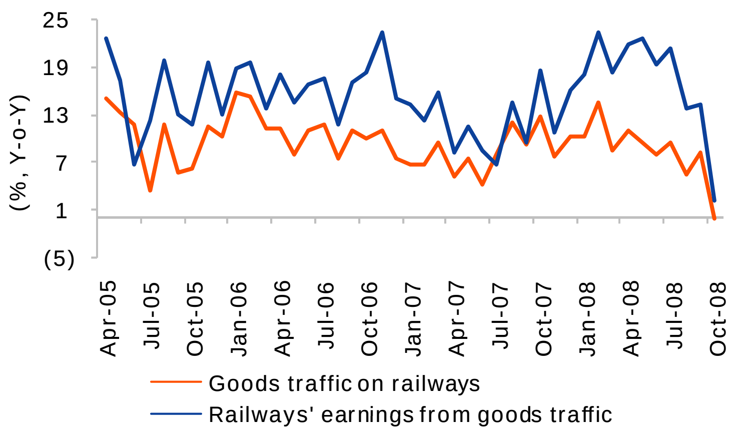

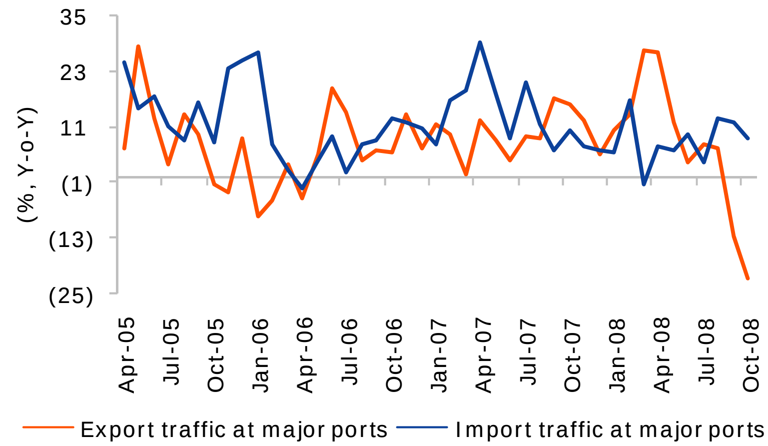

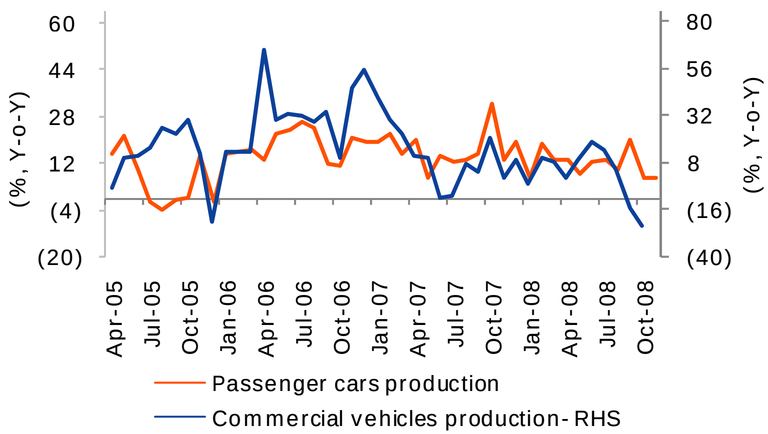

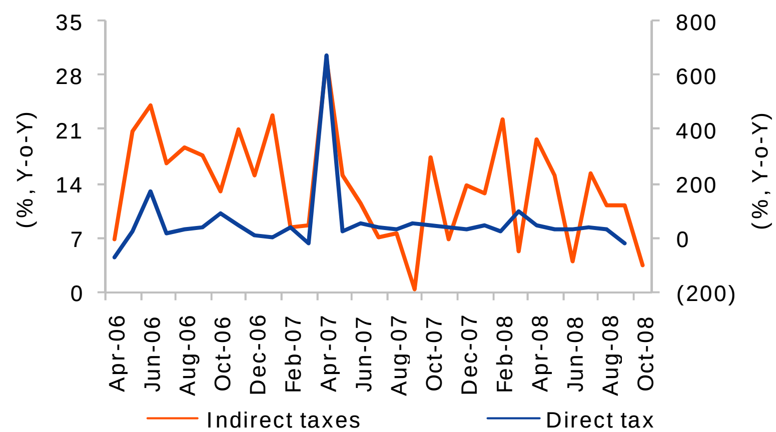

Source: CMIE

… but, consumption to provide cushion to growth

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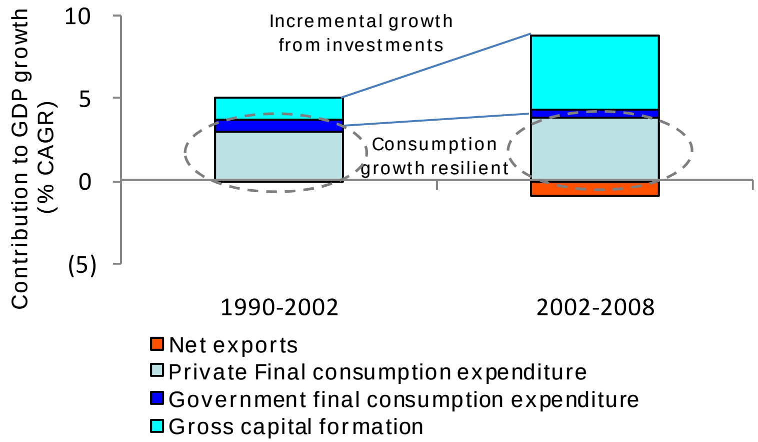
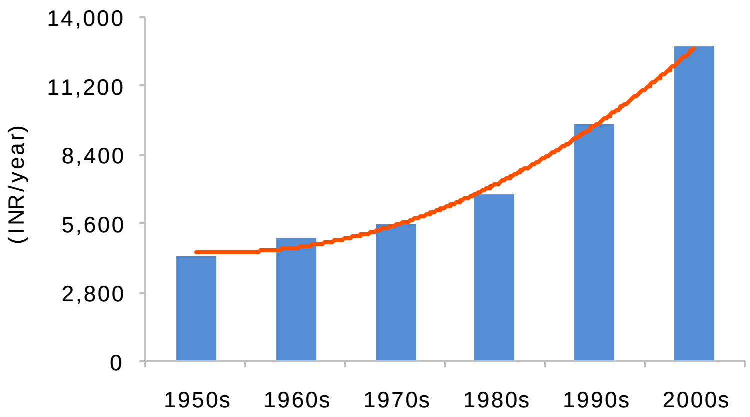
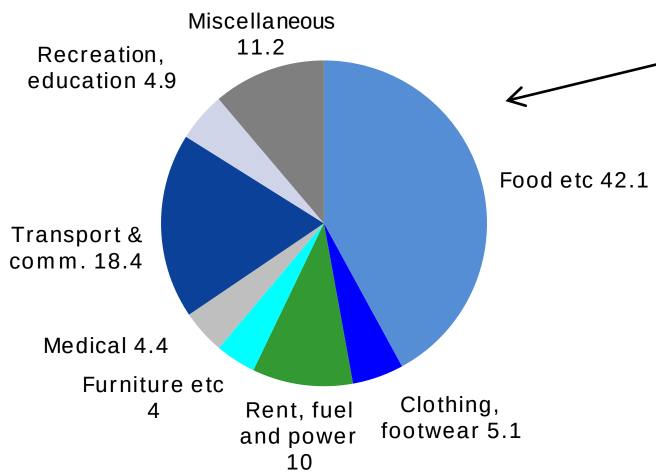
Domestic consumption remained the mainstay of growth on the back of …



… rising per capita income, …



… and non-discretionary nature of consumption



Over 2/3rd of the consumption basket is non-discretionary

Note: Numbers suggest percentage share of the total consumption basket .

Source: CSO, Census data, CMIE, Edelweiss research

Low export orientation acting as a buffer at current times

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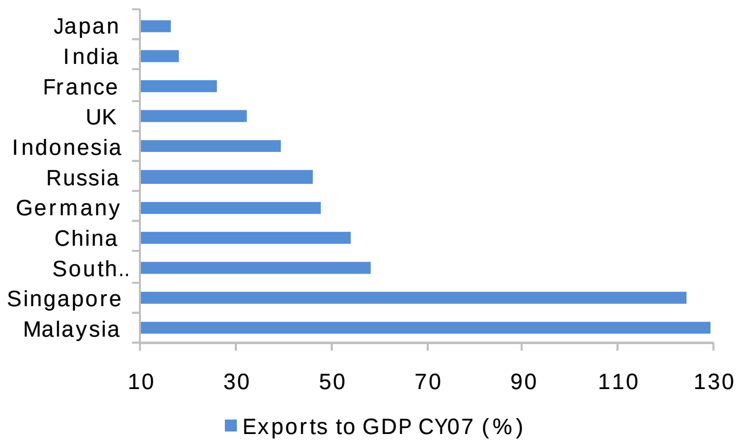
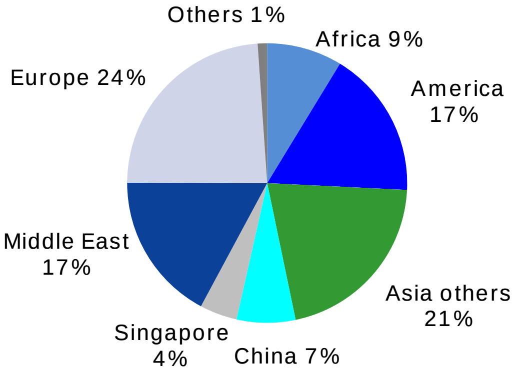
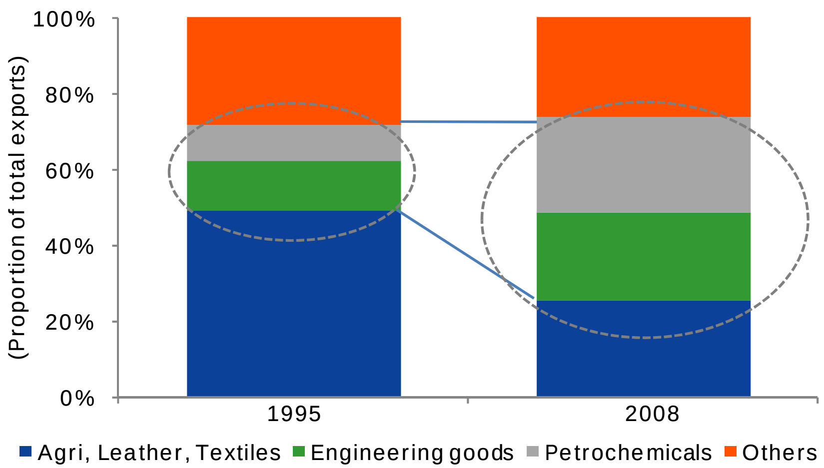
Low export dependence a huge positive amidst global turmoil



Export destinations remained diversified



Indian exports moving up the value ladder



Source: Bloomberg, CMIE, Edelweiss research

High domestic savings and investment a long-term positive

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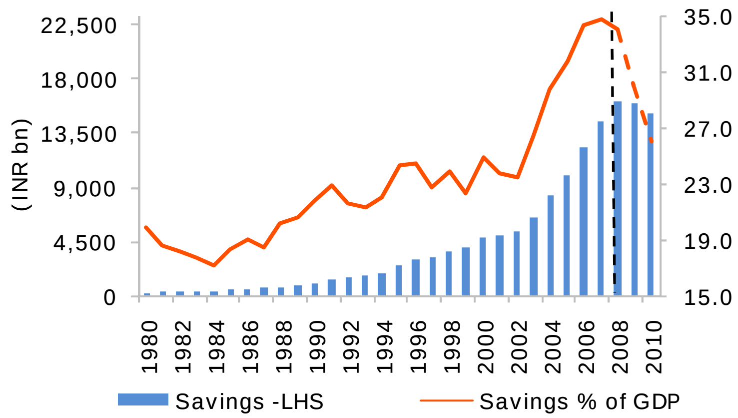
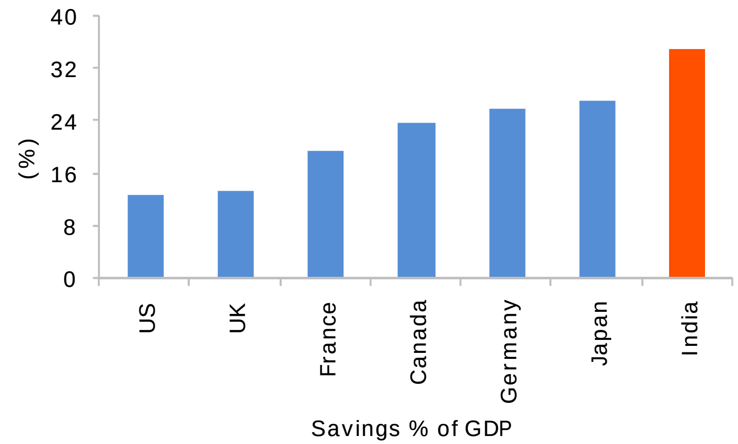
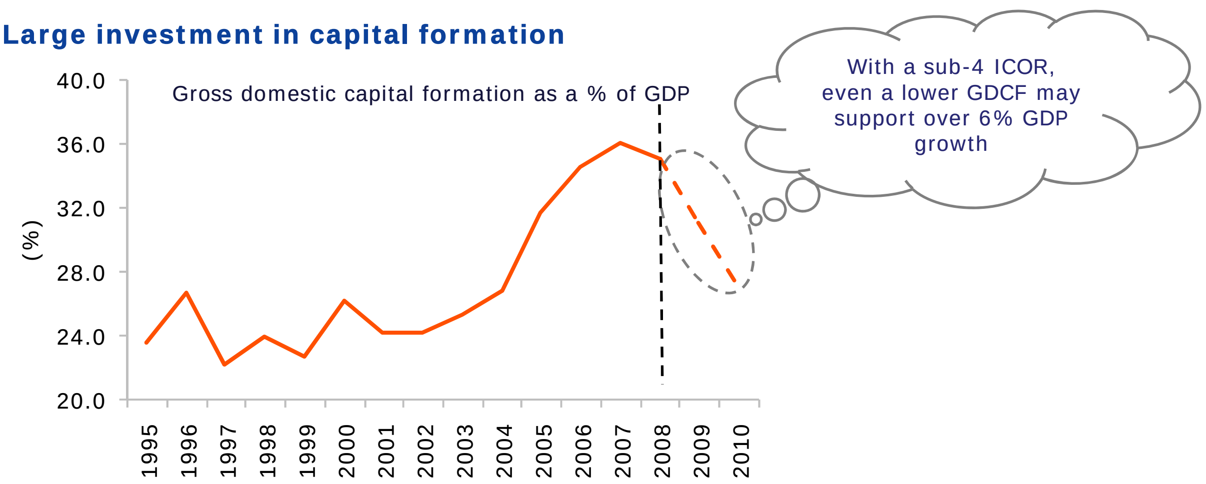
India has fast growth in savings and …



… higher savings rate compared to peers



Large investment in capital formation



Source: IMF, CMIE, RBI, Edelweiss research

Strong financials provide RBI flexibility to infuse liquidity

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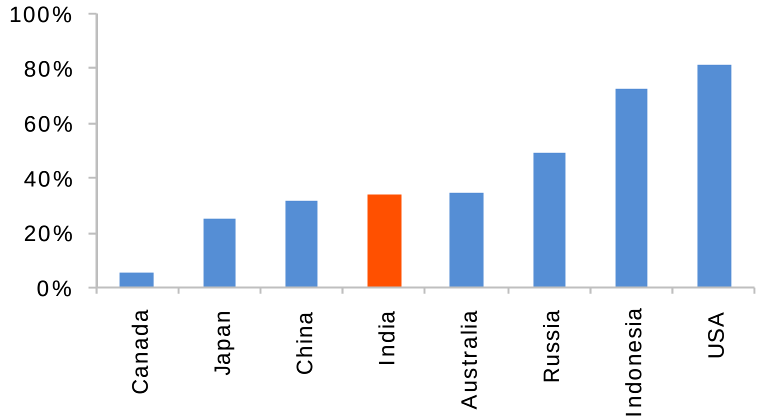
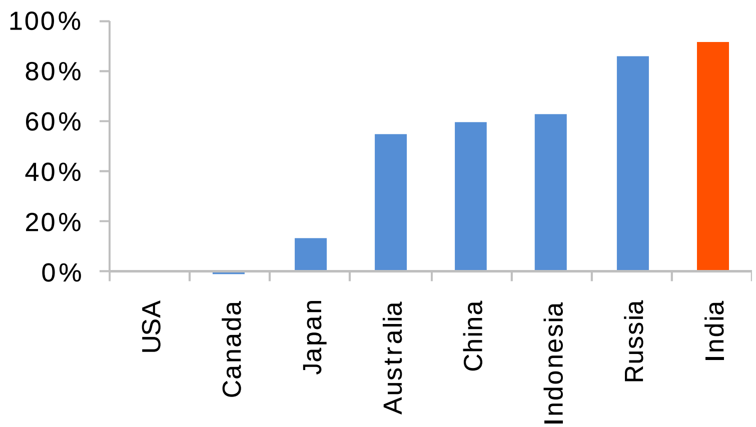
Central bank liabilities as % of GDP

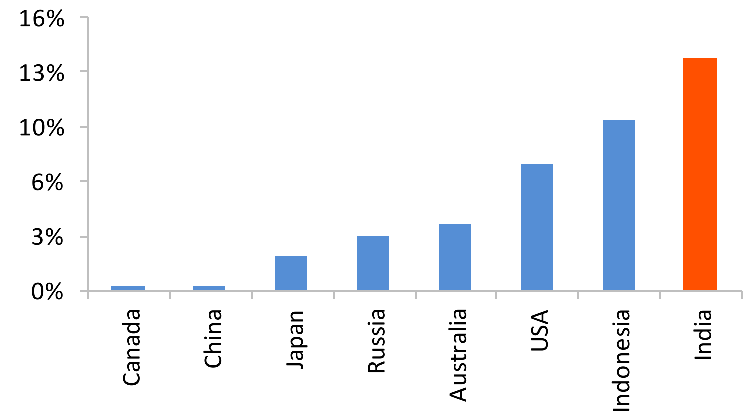


Compared to several peers, RBI holds higher proportion of forex assets, and high net worth. This enhances RBI's ability (1) to infuse large amount of primary liquidity; and (2) to provide large amount of credit to government for a year or two, if required, without compromising balance sheet quality.

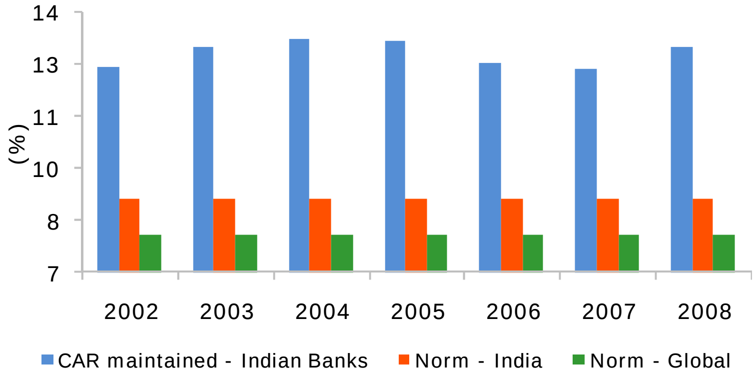
Forex backing of central bank balance sheet (%)



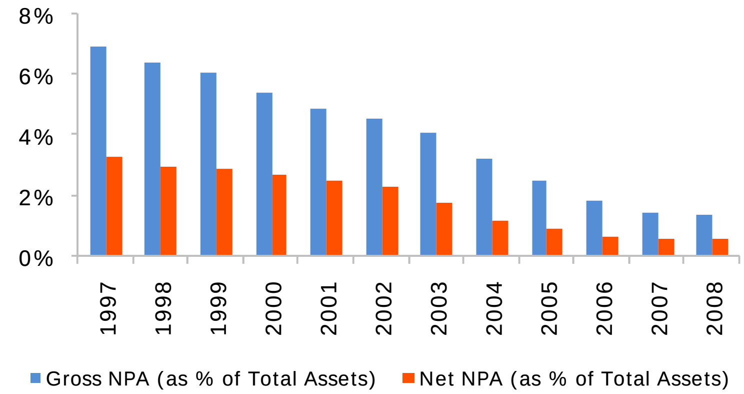
Net worth as % of central bank balance sheet



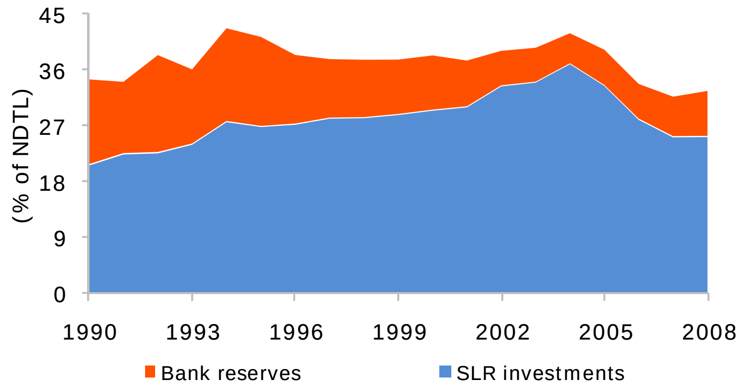
Source: RBI, Bloomberg, Edelweiss research



Indian banks are required to keep a minimum CAR of 9%, 1% higher than the global norm. However, banks in India have kept the CAR much higher than required (currently ~13%) rendering themselves sufficient cushion in difficult times.



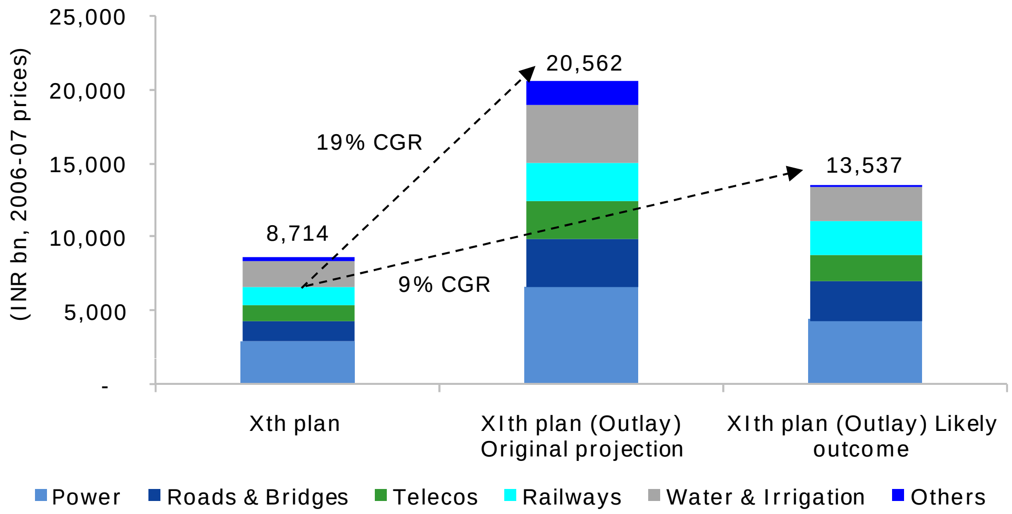
NPA levels have been declining continuously – for the system as a whole and for each bank group. Though there is a risk of worsening asset quality in this challenging business environment, the rise in NPA level, unless drastic, can be absorbed by the banking system.



Indian banks maintain huge proportion (currently over 30%) of their total assets in either SLR securities or in cash with RBI – a big in-built cushion for the system.

Source: RBI, Edelweiss research

Sector-wise infra investment projections during XIth plan



Source: Planning commission, Edelweiss research

With global turmoil, slowing growth and strained government finances, the initial target of ~USD 500 bn infrastructure investment during the XIth plan will be near-impossible to realize. However, under assumptions of tempered GDP and GCF growth, infra investments may still reach ~USD 300 bn during the XIth plan. That will still mean ~50% increase over the previous plan achievement of investment in infra.

Fiscal situation is a mixed bag

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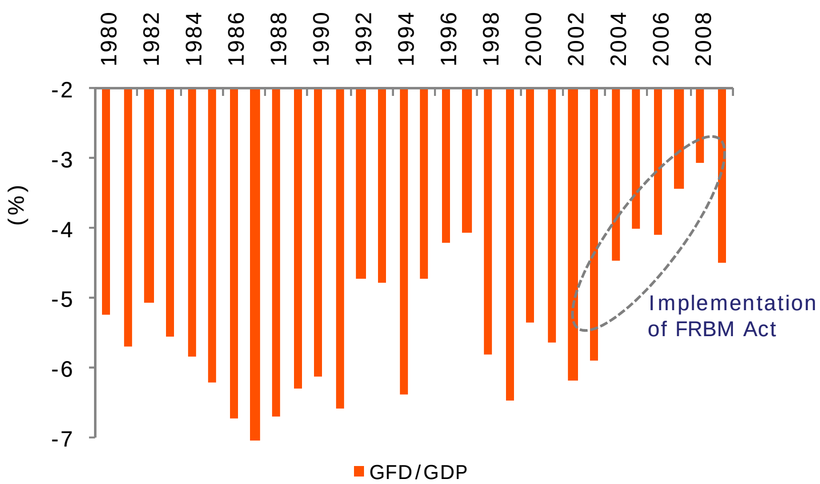
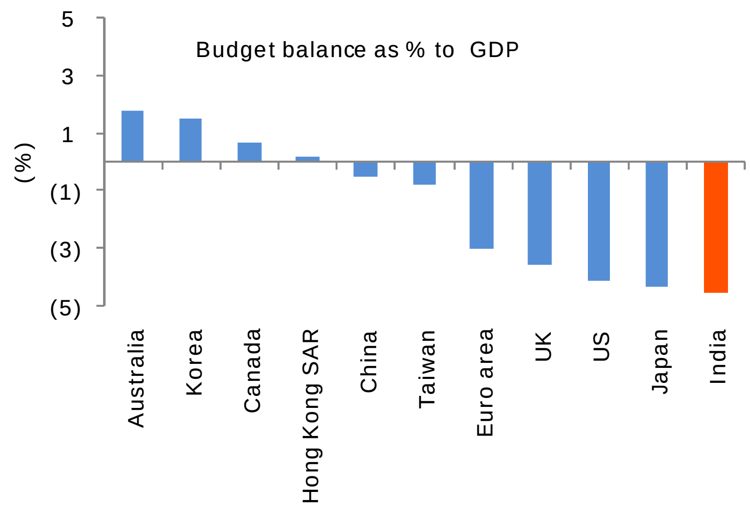
Fiscal health is a chronic problem despite improvement in 2000s …



… and weak compared to peers



However, large off-balance sheets burdens of FY09 will disappear

	(INR bn unless specified)
Bonds to be issued by	**FY09E**
Oil marketing companies (OMC's)	510
Fertiliser Companies	650
Food Corporation of India (FCI)	50
Total	1,210
Proportion of GDP (%)	2.3

Source: CGA, IMF, Bloomberg, Edelweiss research

Fiscal health will continue to be weak with likely dent in tax collection and high government spending.

However, reduced off-balance sheet burdens (like oil and fertiliser bonds) will be a distinct positive in FY10.

The reduced off-balance sheet burden can be utilised for more productive uses like stimulus packages etc.

BoP: Expect a better year ahead

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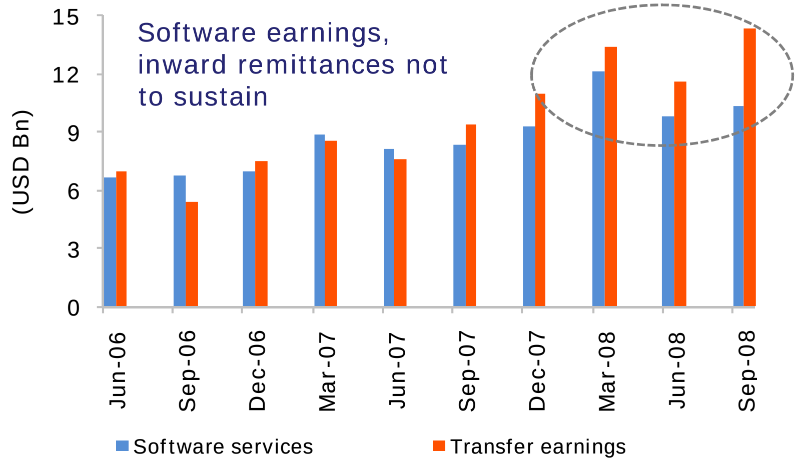
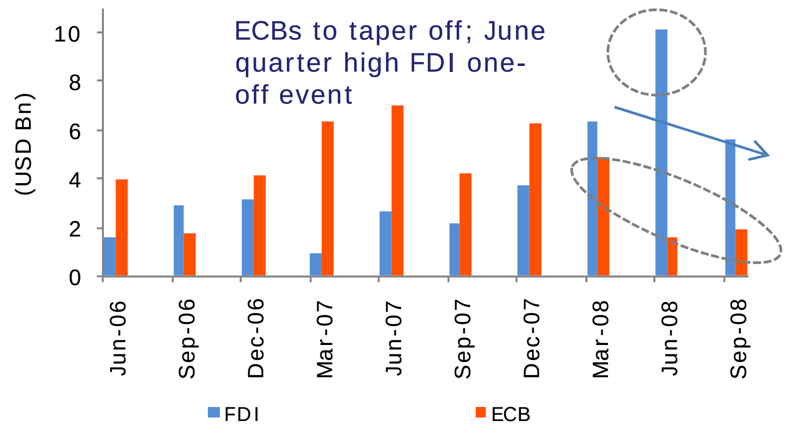
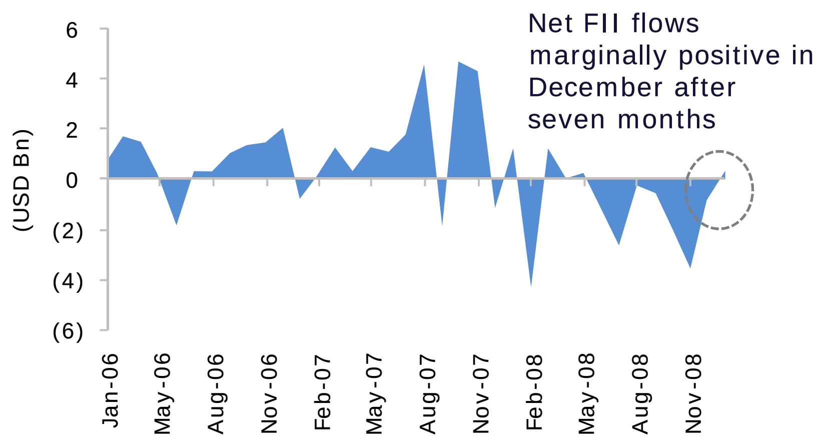
Invisible earnings to dip



Support from ECBs and FDI will be low



However, large FII outflow to be arrested



Source: Bloomberg, RBI

Export slowdown likely to continue. However, current crude price softening alone to save oil import bill of over USD 5bn every month and to compensate for the export slowdown.

Likely oil and gas exploration in CY09 to reduce trade deficit substantially.

Moreover, the huge FII outflow (~USD 14 bn in CY08) will not be there in CY09. Likely global weakening of USD will help INR further to strengthen making investment in INR assets more attractive.

Corporate earnings growth expectation may surprise on the downside in CY09 …

… however, FY11 growth outlook will be increasingly important in H2 CY09

Earnings growth expectations polarised

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- We currently expect ~5% earnings growth for Nifty in FY10:-
  - ex-Oil & Gas: -0.5% (bulk of growth coming from RIL, RPET, Cairn)
  - ex-Steel: 12.6% (Tata Steel, SAIL - biggest drag to FY10E earnings growth)
  - ex-Commodities: 10.7% (Nifty excluding oil & gas, metals, cement)

Sector	Growth (%)		Contribution to growth (%)		Contribution to EPS	
	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E
Oil & Gas	6.0	20.9	1.5	5.2	66	80
Telecom	10.7	14.5	0.9	1.3	23	27
BFSI	20.3	9.4	2.2	1.2	33	36
Capital Goods	11.5	22.1	0.6	1.1	13	16
Power	12.1	13.3	0.8	1.0	19	22
FMCG	10.1	12.9	0.3	0.5	9	10
IT	19.6	3.8	2.0	0.4	30	31
Auto	(3.9)	9.6	(0.1)	0.3	8	9
Pharma	1.9	14.6	0.0	0.3	5	5
Real Estate	(24.5)	4.2	(1.5)	0.2	12	12
Media	7.3	22.1	0.0	0.1	1	1
Cement	(15.6)	(18.5)	(0.6)	(0.5)	8	6
Metals	(9.2)	(45.6)	(1.4)	(6.1)	35	19
Nifty	**4.8**	**4.9**	**4.8**	**4.9**	**262**	**275**

Source: Edelweiss research. Estimates based on aggregate of Nifty constituents

Risk of downgrades is high

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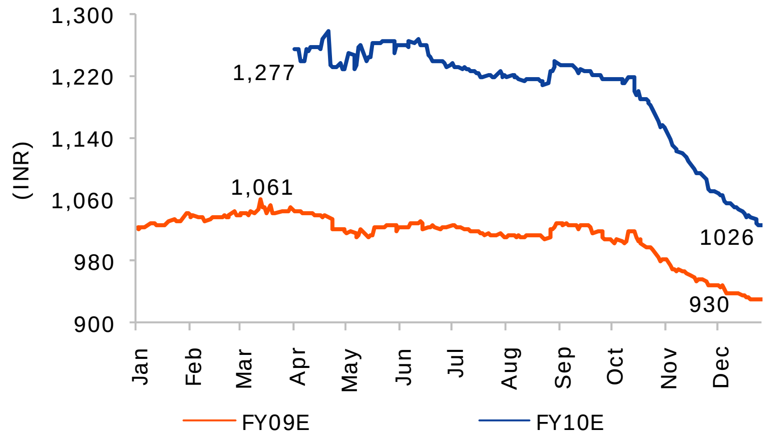
Consensus Sensex EPS is being revised down in CY08



Note: Bloomberg estimates

- Possibility of biggest surprise
  - Positive – improvement in steel prices (Tata Steel, SAIL); however, this will be negative for certain commodity consuming industries
  - Negative – delay in commissioning of new units of RIL, Cairn

We expect consensus expectations to get revised down further, closer to our estimates

	Nifty				Sensex			
	FY09E (% Y-o-Y)		FY10E (% Y-o-Y)		FY09E (% Y-o-Y)		FY10E (% Y-o-Y)	
Sector	Edelweiss	Consensus	Edelweiss	Consensus	Edelweiss	Consensus	Edelweiss	Consensus
Auto	(4)	16	10	11	(9)	24	3	10
BFSI	20	12	9	18	13	8	13	20
Capital Goods	12	19	22	25	25	25	21	27
Cement	(16)	(18)	(18)	(18)	(0)	(5)	(11)	(9)
FMCG	10	9	13	14	10	9	13	14
IT	20	20	4	9	24	24	0	8
Media	7	21	22	15	NA	NA	NA	NA
Metals	(9)	(8)	(46)	(18)	(1)	(4)	(46)	(27)
Oil & Gas	6	21	21	26	0	10	22	27
Pharma	2	2	15	14	(35)	(34)	65	60
Power	12	22	13	13	18	59	11	19
Real Estate	(24)	(7)	4	(7)	(28)	(7)	8	(6)
Telecom	11	19	15	17	9	18	13	16
Overall index	**4.8**	**11.2**	**4.9**	**11.7**	**5.7**	**10.3**	**3.2**	**10.3**
EPS (INR)	**262**	**279**	**275**	**312**	**888**	**930**	**917**	**1,026**

Source: Bloomberg, Edelweiss research

Valuations are supportive but markets lack upside trigger at the moment…

… markets will react positively on any early indications of economic recovery

Current valuations have limited downside; historic supports at…

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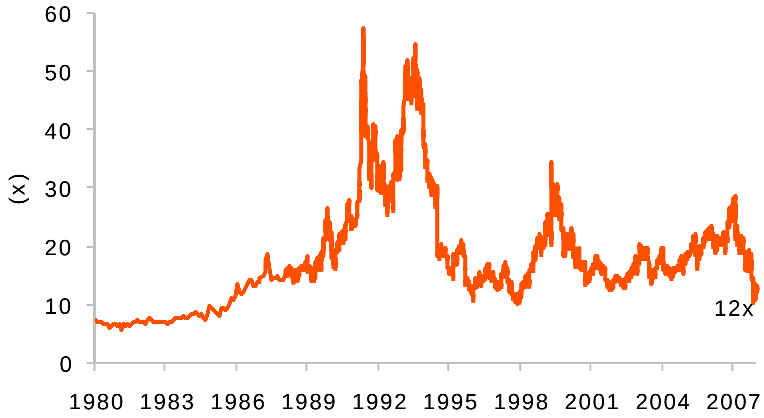
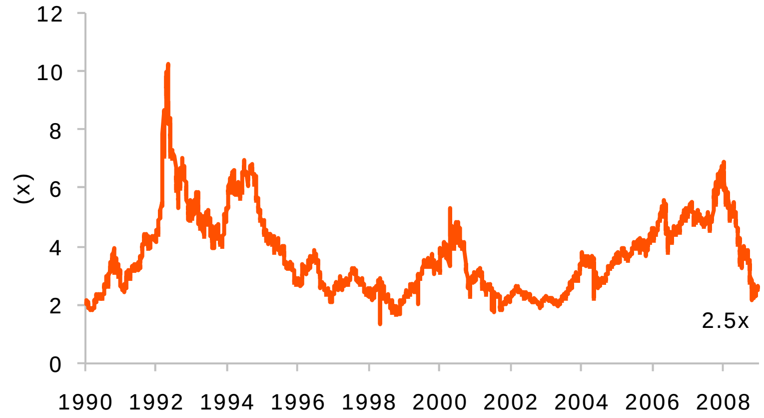
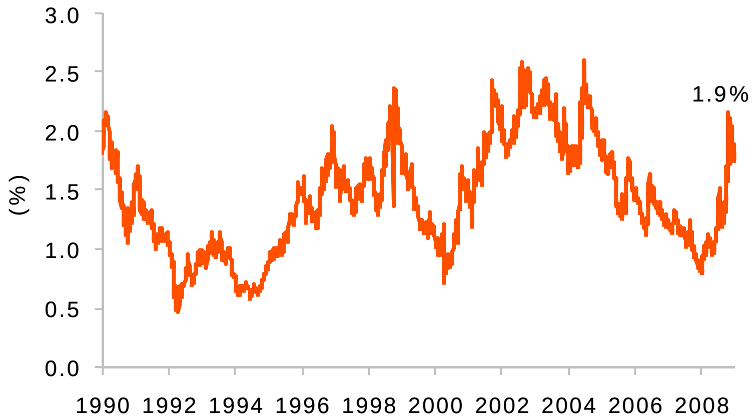
…Trailing PE of 10x



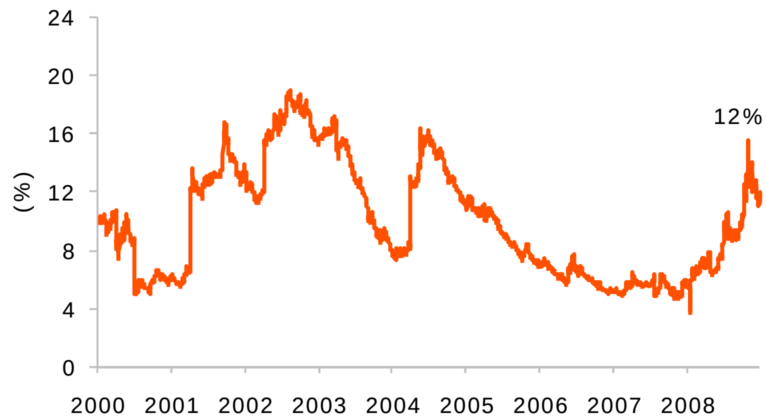
…P/B of 1.9x



…Dividend yield of 2.6%



…Cash flow yield of 16-19%



Note: All valuations are for Sensex

Source: Bloomberg

India is not an expensive market now …

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	Mkt Cap (USD bn)	PAT growth CY09 (%)	P/E CY08 (x)	P/E CY09 (x)	P/B CY07 (x)	DY CY08 (%)	ROE CY07 (%)	P/O CY07 (%)
Developed Markets		**3.6**	**11.1**	**10.7**	**1.4**	**3.8**	**11.4**	**42.5**
US	10,606	6.0	12.2	11.5	1.5	3.0	9.5	37.0
Japan	3,265	8.8	17.3	15.9	1.0	2.7	8.4	46.6
Europe	9,812	1.9	9.0	8.8	1.3	5.2	14.3	47.0
UK	1,995	(10.6)	7.9	8.8	1.4	5.4	17.1	43.0
Germany	1,077	14.0	10.6	9.3	1.2	4.7	12.0	49.8
Australia	656	0.6	10.2	10.1	1.6	6.3	16.2	63.8
Hong Kong	1,312	(5.4)	11.4	12.1	1.0	5.5	14.3	62.5
Singapore	248	(9.0)	9.3	10.2	1.2	5.9	16.5	54.6
Emerging Markets		**(1.2)**	**8.6**	**8.7**	**1.4**	**4.2**	**16.3**	**36.2**
Taiwan	387	(29.7)	12.5	17.7	1.4	6.6	15.1	81.7
Malaysia	186	3.7	11.7	11.3	1.5	4.9	13.9	57.2
Mexico	246	10.0	12.1	11.0	2.2	2.7	19.6	32.4
Philippines	49	12.4	11.6	10.3	1.8	5.6	15.3	64.7
China	1,776	8.0	10.7	9.9	1.8	3.6	17.7	38.0
India	**637**	**13.7**	**11.1**	**9.7**	**2.1**	**2.1**	**20.7**	**23.1**
Korea	484	6.3	10.1	9.5	1.0	2.2	9.8	22.7
South Africa	243	17.0	9.6	8.2	2.0	4.5	20.9	42.9
Indonesia	96	5.4	8.5	8.0	2.4	5.0	27.2	42.0
Thailand	99	(4.8)	7.2	7.5	1.1	6.0	14.3	42.9
Brazil	565	4.7	7.1	6.8	1.4	5.1	17.6	36.4
Russia	265	(22.3)	3.2	4.1	0.7	5.4	20.0	17.2

Source: Bloomberg, MSCI

Note: Valuations as of December 31, 2008. P/O is Payout Ratio and DY is Dividend Yield

Liquidity drove the markets in CY07 and lack of it in CY08 …

… expect strong domestic institutional inflows to support markets in CY09

FII flows have been important for Indian markets

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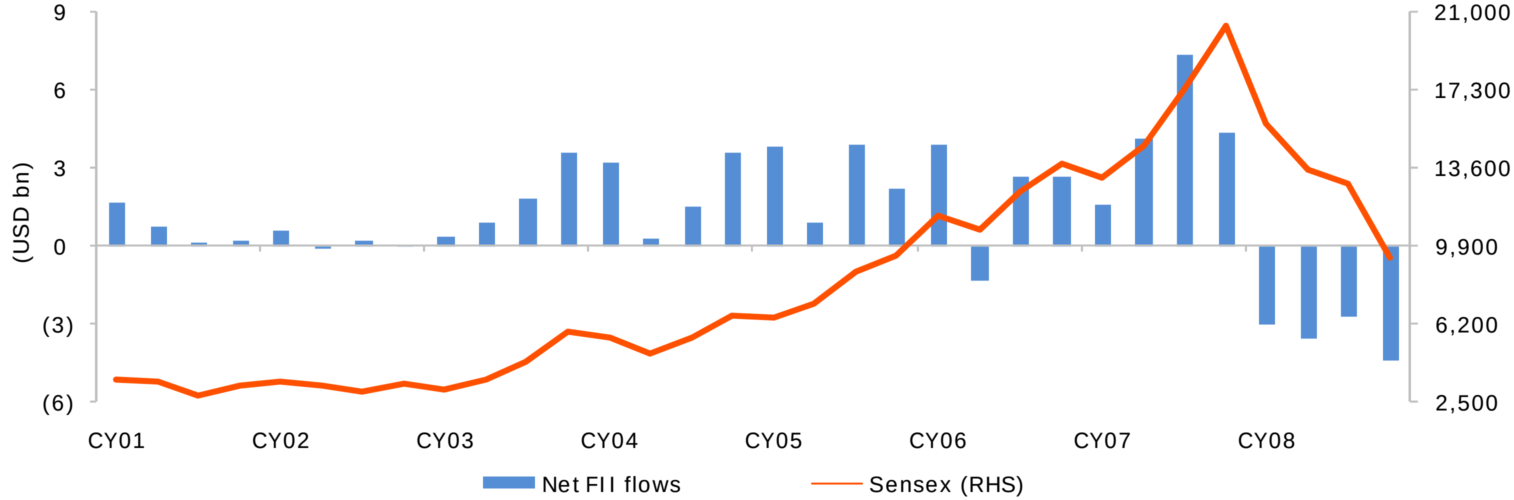
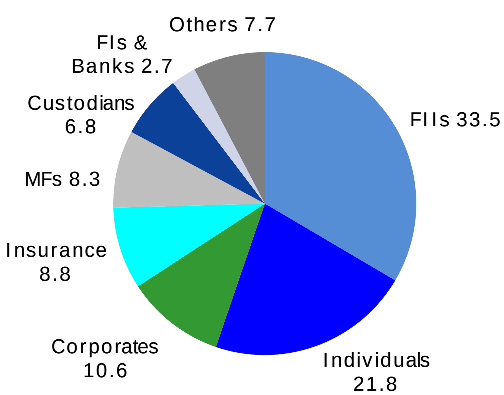
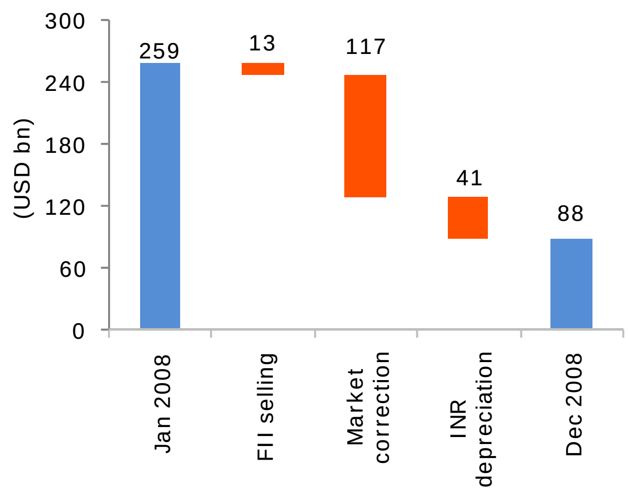
FII flows have been key driver for the Indian market



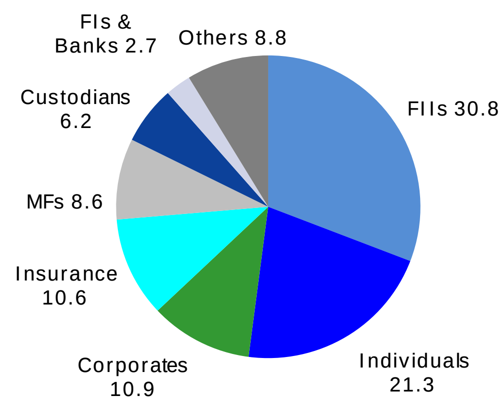
8% reduction in FII holdings has led to 54% price fall in 2008



Jan 2008: FII holding worth USD 259 bn



FII holding in India



Dec 2008: FII holding worth ~USD 88 bn

Note: Pie charts show % holdings in India's free float market cap

Source: CMIE, Bloomberg

Domestic flows will support markets in CY09

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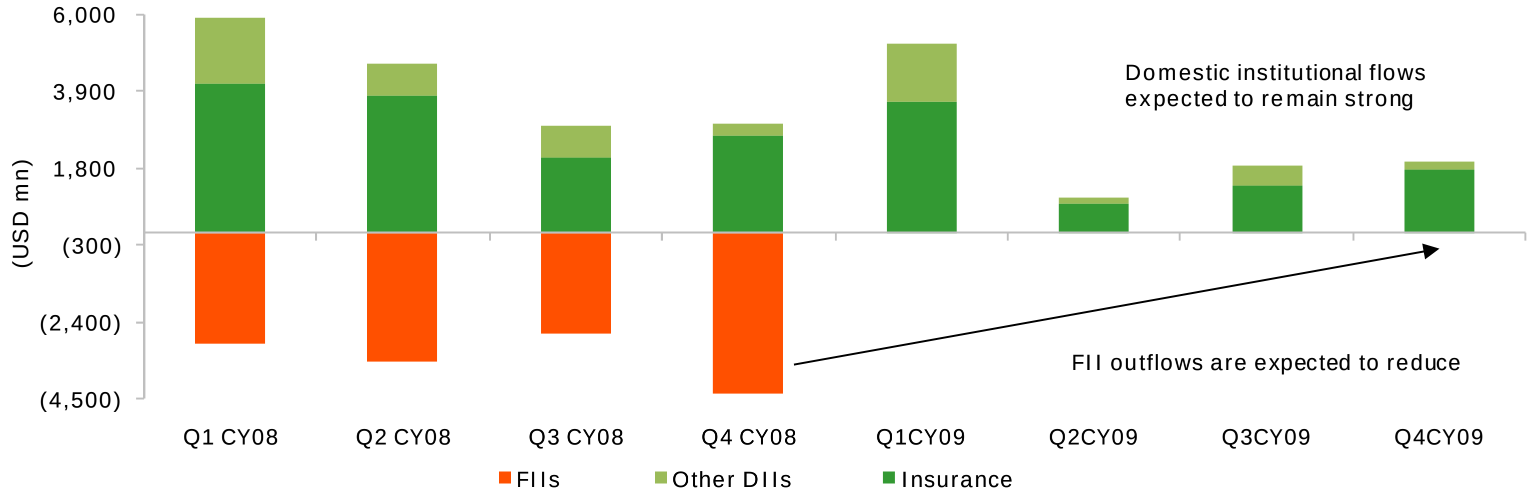
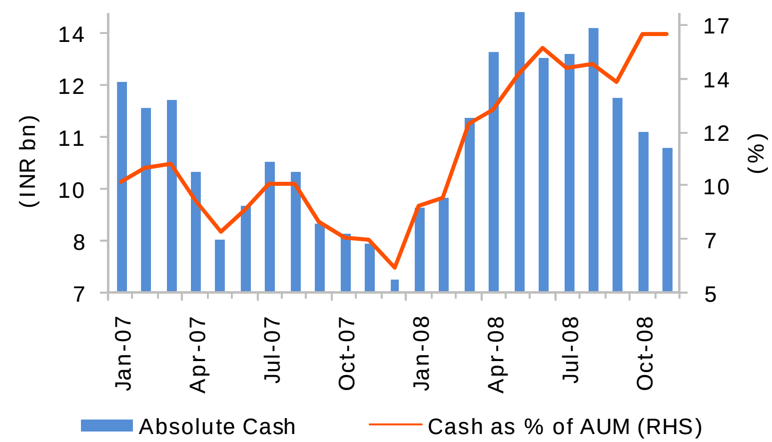
Insurance flows will become increasingly important for the market; likely to remain strong in CY09...



Strong insurance flows expected even on conservative assumptions

	Premium growth (% Y-o-Y)	% invested in equities
CY05	25.2	NA
CY06	38.1	NA
CY07	28.6	26.5
CY08	27.6	22.0
CY09E	13.2	15.0

MF cash levels also high; expected to support equities



Source: Bloomberg, Edelweiss research

Elections - the key event risk in CY09 ...

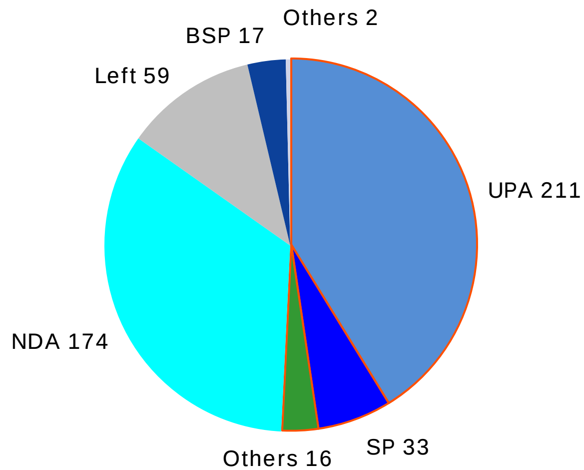
Coalition politics is a reality in India

Election year	Party gaining power	Type	Prime Minister	Sensex returns (%) 3M prior	1Y later
1980	INC	Majority	Indira Gandhi	(0.4)	26.4
1984	INC	Majority	Rajiv Gandhi	2.4	94.0
1989	Janata Dal-led National Front	Coalition	V.P. Singh; Chandrashekhar	(2.1)	90.8
1991	INC	Coalition	P.V. Narasimha Rao	7.1	142.8
1996	United Front	Coalition	H.D. Devegowda; I.K. Gujral	9.1	1.5
1998	BJP	Coalition	A.B. Vajpayee	2.2	(5.6)
1999	BJP	Coalition	A.B. Vajpayee	8.7	(12.4)
2004	INC	Coalition	Manmohan Singh	(6.2)	16.2

India has never seen a government with clear majority in the past 20 years

Coalition has not necessarily been negative for markets. On several instances, markets have been positive in the year following the elections, as new governments typically push more reforms in the initial years

Voting pattern of MPs: July 2008 trust vote



Source: Election Commission of India, Bloomberg

Note: Of the total 543, only 512 Members of parliament (MPs) cast their vote

Recent state elections also signal a divided Parliament

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State	Date	Recent assembly elections: Winning Party	Seats	%	Current Parliament Structure: Winning Party	Seats	%
Jammu & Kashmir	Dec-08	JKNC	28	32.2	INC	2	33.3
Madhya Pradesh	Dec-08	BJP	142	61.7	BJP	25	86.2
Rajasthan	Dec-08	INC	96	48.0	BJP	21	84.0
Chhattisgarh	Dec-08	BJP	40	44.4	BJP	10	90.9
Delhi	Dec-08	INC	42	60.9	INC	6	85.7
Mizoram	Dec-08	INC	32	80.0	MNF	1	100.0
Karnataka	May-08	BJP	110	49.0	BJP	18	64.0
Tripura	Mar-08	CPI(M)	46	77.0	CPI(M)	2	100.0
Nagland	Mar-08	NPF	26	43.0	NPF	1	100.0
Meghalaya	Mar-08	INC	25	42.0	INC & AITC	1	50.0

Source: Election Commission of India

- No political party emerged as a clear winner in the recent state assembly elections. It only re-affirmed the likelihood of a divided Parliament in the upcoming general elections
- Anti-incumbency factor did not work across states - BJP retained power in Madhya Pradesh and Chhattisgarh while INC retained power in Delhi
- Burning national issues like terrorism, inflation and economic slowdown did not harm INC much; this came as a surprise. INC took away power from BJP in Rajasthan and MNF in Mizoram
- Smaller parties and independent candidates lost their vote share to national parties

Any strong coalition without Left Parties is good for the markets

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- A coalition government led either by BJP or INC is near-certainty in the upcoming general elections (most likely in April-May)

- A critical factor for the markets would be whether the incumbent government will require support from Left parties. In case of dependence on the Left, the government's ability to carry out reforms will be seriously challenged

- If a third front (possibly led by Ms. Mayawati) comes into power, which is unlikely in our view, market sentiment can be severely damaged due to the 'lack-of-stability' factor

- A near-clear majority for either BJP or INC (again seemingly unlikely), would be strong positive for the markets as the government's ability to push reforms would be much higher

So what does all this mean for the market

and

how does one play it in CY09???

Market View and Key Themes for 2009

- Indian markets are offering good long term value at current valuations. Despite near-term macro-economic concerns, strong domestic liquidity will limit downside. Long-term investors should accumulate stocks for the next up-cycle

- In the near-term, volatility will persist, though lower than in CY08. Make the best use of the 8000-12000 range on Sensex until elections

- Fixed income investments are also attractive in the near-term as we expect yields to bottom out by Q2 CY09. Play the narrowing corporate bond spreads over G-sec yields over the next few months

- Key themes to play in CY09
  - Declining interest rates
  - Weak global economy
  - Low commodity prices

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