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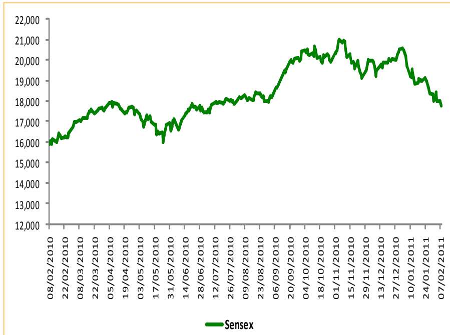
Strategy Note
February 10, 2011

Where is MONEY!!!!!

FII's selling, money has gone to....



	Returns		
	Since Jan 1,2011 to till	3-Months	1 Year
Sensex	-13.5%	-15.1%	11.5%

Source: BSE; IndiaNivesh Research

Since January 1, 2011, Sensex has tanked by 13.5%.There is a big panic in the market almost every script has fallen by huge percentage.

FIIs are the net seller of Rs ~59 billion *(since Jan 1, 2011 to 7th Feb 2011)*

Have FIIs lost their faith in India's macroeconomic growth story? Have latest corruption/ scams or high Inflation shattered their confidence? Are FIIs shifting their destination? Like this there are numerous questions going on in the minds of investors. We tried to find plausible answers to this query, (if any).

If FII are selling equity assets, they might be buying some other assets. We tried to find out the path through which money has gone to chase other assets.........

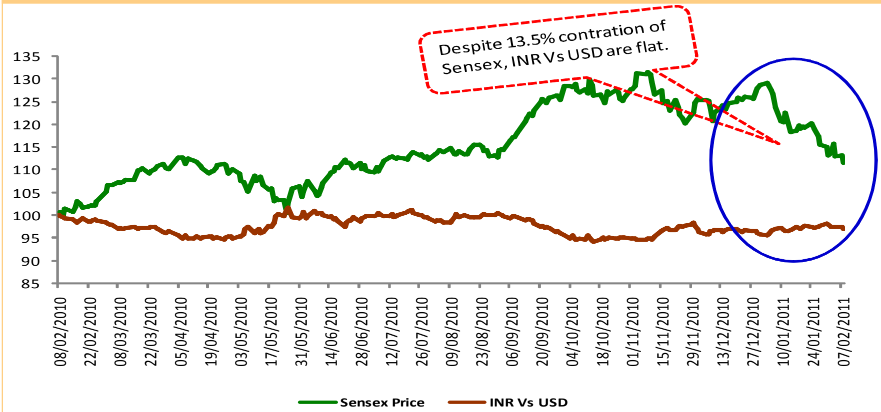
Q1. Has the money gone out of country?

There is a negative correlation between Sensex & INR vs USD. It means whenever, FIIs bring money into India via capital market, they have to buy INR *(by paying USD)*, as a result, price of INR will reduce *(i.e appreciation)* & Sensex would rise due to increase in demand for stocks.

If FIIs are net sellers in the Indian market & they want to repatriate this money back to home country they will have to buy international currency (most probably USD), as a result, INR price would increase*(depreciation)* due to decrease in demand.

However, in the last one month, despite a 13.5% correction in Sensex, INR vs USD exchange rate has remained almost flat. *(See graph given below)*. This implies that money has not left Indian shores.

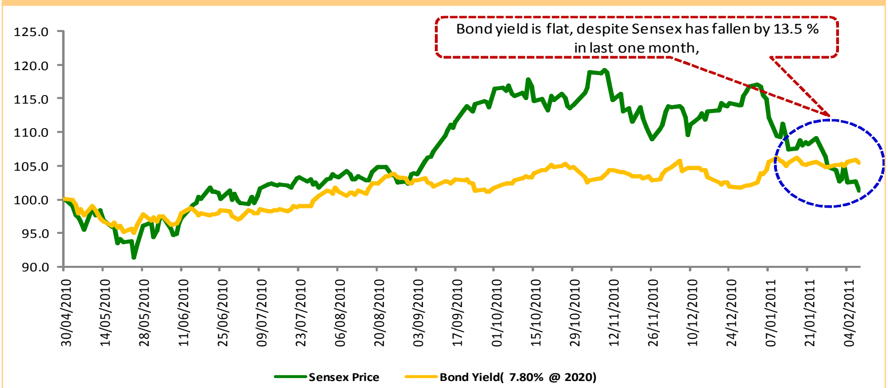
SENSEX v/s EXCHANGE RATE



Source: RBI; IndiaNivesh Research

Q2. Has the money shifted to long term debt?

SENSEX v/s BOND YIELD (7.80% @ 2020)



Source: FIMDA;IndiaNivesh Research

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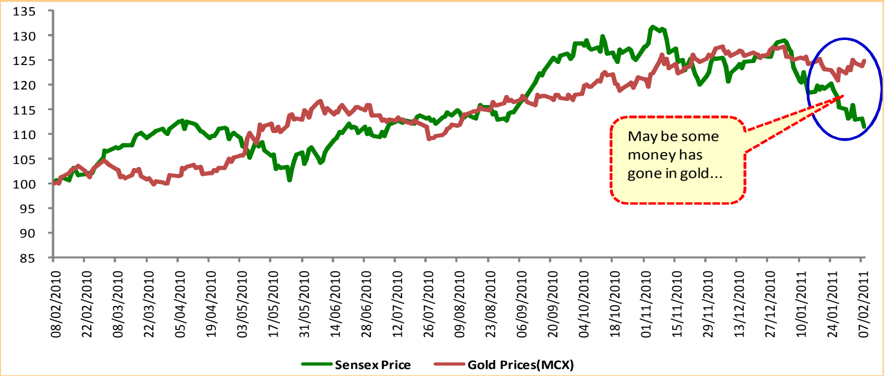
Bond yield has significant positive co-relation with Sensex, *(See graph given on previous page)*. In our model, for last one year, co-relation of bond yield with Sensex is 0.75, which we believe is very significant. However, in the last one month of carnage in equity markets the 10 yr bond yield has remained almost flat. This leads us to infer that perhaps the FII equity selling has not found its way into long term bonds.

Q3. Has the money moved into other asset class like (i.e GOLD):

Although in the recent past gold price do not show any significant correlation with any asset class, however due to it's safe haven status it finds favor with many investors especially in distress times like the current one. It's low or non-significant correlation with other asset classes, always makes it choice of portfolio of risk averse investors.

Currently, gold has shown some spike in its prices. *(See graph given below)*

SENSEX v/s GOLD PRICE



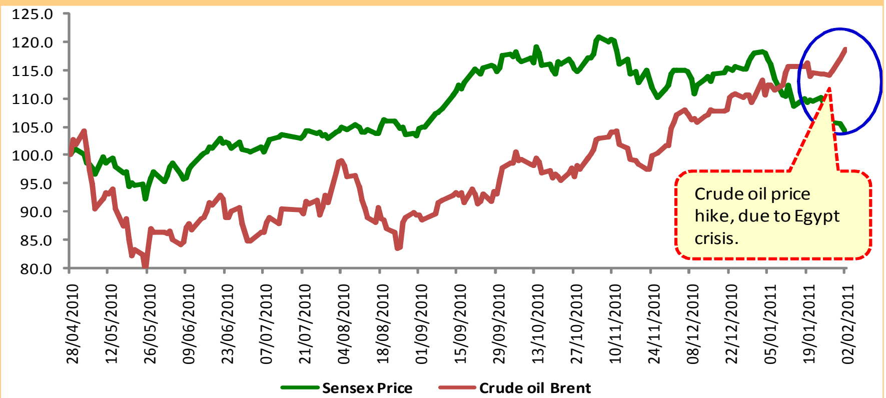
Source: MCX; IndiaNivesh Research

We believe the minor spike in gold prices may be due to small buying emanating from aforesaid reason. However, the sell off in equity markets may not have impacted too much till date.

Q4. Or has it gone in to crude oil?

Generally, crude oil prices & Sensex have negative correlation albeit with some time lag. We believe, as prices of crude oil goes up, it leads to increase in production cost for corporate, as a result, their earnings impact negatively & finally stock prices comes down. Generally, in downtrend & inflationary markets investors & many fund managers like to invest in commodities like crude oil to hedge their position in equity market.

SENSEX v/s CRUDE OIL PRICE (BRENT)



Source: Energy; IndiaNivesh Research

(See graph given above). A few days back crude prices have shown sudden spike in prices against big fall in Sensex, but we believe this may be due to Egypt crisis.

Hence, we believe that money has not gone to buy crude oil.

The big Question therefore remains Where is the money?

Since January 1, 2011, FII's are net seller of ~Rs 59 billion Indian equity market. But at the same point in time they are net investor of **Rs 107 billion in short term debt market.** Hence, we believe that FIIs has rotated their portfolio from equity to short term debt assets.

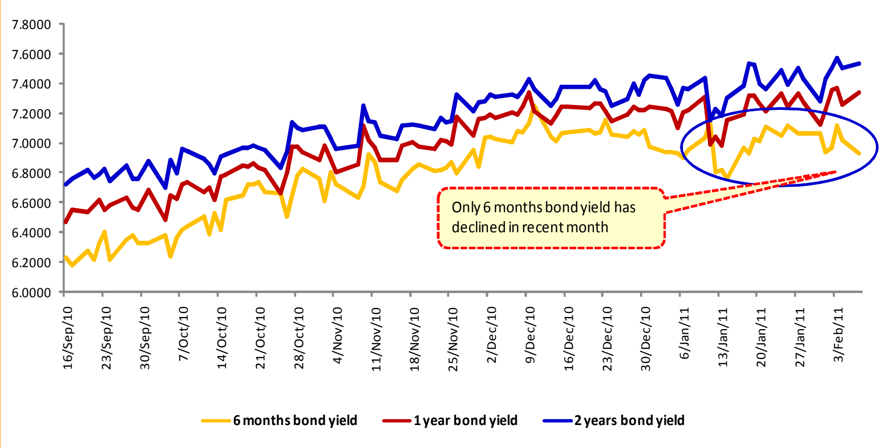
Why will FIIs do this?

Increasing inflationary environment is a cause of concern for FIIs & in the midst of lack of clarity on how the government of India will tackle this problem; a consensus is building that interest rates are going to harden in near term. Street as well as we expect that interest rates in India may go up by 75-100 bps in CY11. Since most FIIs believe the same they will be inclined to put money into short term debt instruments. However, too steep a hike in rates may hamper growth in long term, thus most people believe that rates in longer term will taper off. Hence the opportunity in near term lies in short term debt. Inline with this thought process FII money would have shifted into short term debt funds in last one month as is evident from the table below which shows FII sold off equities worth Rs 59 bn & increased exposure to debt fund by Rs 107bn in last one month. This is ratified by yield movement for short term.

Date	Sensex	FIIs Net Investment in Equity (In RS Mn)	FIIs Net Investment in Debt(In RS Mn)
03/01/2011	20,561	4,275	1,748
04/01/2011	20,499	7,793	700
05/01/2011	20,301	(924)	(1,873)
06/01/2011	20,185	(2,138)	2,319
07/01/2011	19,692	(9,646)	5,125
10/01/2011	19,224	(10,881)	7,189
11/01/2011	19,196	(11,235)	16,540
12/01/2011	19,534	(982)	17,088
13/01/2011	19,183	(1,126)	14,890
14/01/2011	18,860	(6,946)	47,581
17/01/2011	18,882	(537)	8,202
18/01/2011	19,092	1,764	(5,193)
19/01/2011	18,978	(2,080)	(3,980)
20/01/2011	19,047	(8,343)	(6,271)
21/01/2011	19,008	376	160
24/01/2011	19,151	1,949	(6,312)
25/01/2011	18,969	4,282	(2,294)
27/01/2011	18,684	(13,974)	6,839
28/01/2011	18,396	(5,924)	(5,537)
31/01/2011	18,328	(9,005)	13,943
01/02/2011	18,022	(4,257)	2,798
02/02/2011	18,091	(461)	(14,916)
03/02/2011	18,449	6,618	6,286
04/02/2011	18,008	2,244	3,083
07/02/2011	18,037	7	(1,000)
Total (Rs Mn)		**(59,151)**	**107,115**

Source: SEBI; IndiaNivesh Research

6MONTHS BOND YIELD, 1YEAR BOND YIELD & 2YEARS BOND YIELD



Source: CCIL; IndiaNivesh Research

Conclusion: Drawing inference from the aforesaid arguments, we conclude that FII money has not yet left the Indian shores. It has only changed colors-shifting from equities to short term debt. This could imply that ***India story is still intact***. Perhaps the sell off is only a tactical call right now to take the advantage of hardening interest rates in near term. We could also surmise that once the concerns on inflation & interest rates come down, this money may get re-channelized into equities. Therefore ***we advise NOT to panic & remain invested*** in the select quality stocks.

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