WRONG FORECASTS

Brokerages caught napping

MUMBAI

The Bombay Stock Exchange's benchmark Sensex index hit a record high of 21,206.77 points on 10 January, but followed it up with a sharp correction, losing some 21% to 16,729.94 points by 22 January in eight straight trading sessions.

Since then, the fall has been unremitting. What seemed a "correction" in end-January has turned out to be much worse than that. The bears now hold India's equity markets in a vice grip, with the Sensex losing some 38.26% since its peak.

Brokerages did not see this coming. Most said in their research reports—released between 21 and 25 January after the sharp fall—that the pain was over and investors should seize the opportunity to buy stocks as India's growth story was still intact. The reports also strongly recommended stocks investors should buy, with standard disclaimers.

They got it wrong. All of them have since been revising their estimates and outlook on stocks. Edited extracts of what some of the brokerages had said.

By Khushboo Narayan & Ashwin Ramarathinam

Macquarie Research on 23 January

Correction provides an opportunity

As global markets recover following the 75 basis points cut in the Fed funds rate, we think that this creates a sweet spot for India. Even factoring in the risk of a US recession, we think that the worst is over and we maintain our bullish stance.

We think that the Reserve Bank of India (RBI) will cut its reverse repo rate by 25 basis points on 29 January...

The RBI cut will accelerate the fall in interest rates and our top picks to play this are financials and property. ICICI Bank Ltd emerges as a strong idea...(other) top picks to play falling rates are HDFC Ltd, Axis Bank Ltd and DLF Ltd.

We think that the underlying India story remains strong and this correction remains an ideal opportunity to enter for the long term. There is too much noise in the market for us to give a view on the immediate term—this may not be the bottom or the worst that the market has seen in the short term. However, we strongly believe that the correction provides an opportunity from a one-year perspective.

CLSA on 21 January

India growth story not at risk

We continue to believe that India's growth will not be significantly impacted if US faces recession, although valuations are likely to correct.

Avoid global cyclicals and small/mid-caps. We remain buyers of our 2008 conviction picks—Bharti Airtel Ltd, Bharat Heavy Electricals Ltd, ICICI Bank Ltd, ITC Ltd and Tata Power Co. Ltd.

We believe the Indian growth story, led by an upsurge in investments and domestic consumption, remains largely intact. With corporate balance sheets remaining strong, delays in equity issuance are unlikely to delay major investments and with a busy calendar in 2H08 (second half of 2008) and 1H09 (first half of 2009), the government is likely to keep liquidity strong.

Nevertheless, in the event of a recession in the US, bellwether sectors such as information technology will face slowdown and can potentially impact domestic consumption—a reverse chain reaction at play. We estimate a 25% slowdown in the IT sector can dampen GDP growth by 0.5%. Sectors such as real estate

Sharekhan Ltd on 23 January

A strong opportunity to buy

The stock market has been brutally attacked by bears in the past few days, led by the global meltdown. As a part of collateral damage, several of our stock ideas have corrected significantly and are currently available at very attractive valuations. We view this correction as a strong opportunity to buy...

These are fundamentally sound companies and we remain bullish on them: Aban Offshore Ltd, Bank of Baroda, Bharat Heavy Electricals Ltd, Crompton Greaves Ltd, HDFC Ltd, Bank Ltd, Jaiprakash Associates Ltd, Orbit Corp. Ltd, Orchid Chemicals Ltd, Punj Lloyd Ltd, Shiv-Vani Oil and Gas Exploration Services Ltd, Tata Chemicals Ltd.

ICICI Securities Ltd on 23 January

The pain seems to be completely behind us

Indian markets have witnessed one of the sharpest declines in the past week due to vicious cycle of unwinding of leveraged positions, coupled with liquidity crisis, resulting from $30 billion being locked in IPOs (initial public offerings). We firmly believe that the sharp declines in stock prices are not a reflection of any significant adverse impact on fundamentals and provide a very attractive opportunity to buy. The pain resulting from unwinding of leveraged positions seems to be completely behind us.

Real estate, metals, power and oil and gas are the key sectors that have witnessed one of the sharpest declines in the past week. We believe that the stocks from these sectors that have been significantly battered down should be bought into as they are likely to offer one of the highest gains on rebound. We reiterate our Sensex target of 25,500 by December 2008.

Housing Development and Infrastructure Ltd, Sobha Developers Ltd, Lanco Infratech Ltd, Ashok Leyland Ltd, Tata Tea Ltd, Tata Steel Ltd, Mahanagar Telephone Nigam Ltd, Reliance Communications Ltd and Sesa Goa Ltd are some of the key stocks in our universe that have been fallen by over 20% in the last week, offering an upside of over 50% based on their fair value.

Credit Suisse on 23 January

Not the time to sell, even with a dire world view

The steep Sensex fall has proven two of our fears—the Indian market is linked to the world if the global slowdown is not mild and foreign flows are the biggest drivers of the market.

For a value investor that does not have positive views on external flows, only a Sensex fall below 13,000 would represent an entry point justified from a valuation viewpoint.

That said, we believe that this is not the time to sell, even for those with dire views on the world economy. India is likely to be on a highly reflationary policy drive in the coming weeks unlike most others in the emerging world. We feel that the market fall has raised the chances of both interest and tax rates cut by February end.

Investors should remain in overweight sectors where underlying earnings growth has little to do with financial markets or the global economy—engineering goods, construction, natural gas, consumer staples and domestic growth themes such as rural income. In the likely market rebound in February, investors should aggressively trim equity market dependents such as stock brokers, energy companies, corporate event plays and companies with large subsidiaries without visible income.

In our year-beginning report, *The flow flaws and follow-ups*, we had talked of 16,500 as the end-2008 fair value for the Sensex without external liquidity support, but with highly aggressive assumptions. As risk aversion rises and we see more earnings downgrades, this could easily come down to around 13,000.

Morgan Stanley on 25 January

Keep a close watch on earnings

India's fabulous earnings story of the past four years may not be ending immediately, but investors need to recognize four risk factors going forward. Reflexivity between earnings and share prices, the fact that earnings appear to be well above trend, slowing macro growth due to high real rates, and the dependence on margins to sustain earnings growth given that topline growth is harder to come by, make earnings a bit more vulnerable than at any point over the preceding four years...

The consensus estimates BSE Sensex constituents' aggregate earnings growth at 18% and 28% for 2009 and 2010, respectively. We think the base of upward revisions is likely to be tested in the coming weeks and the growth itself could be in the low- to mid-teens. The biggest negative surprises could come in consumer discretionary; industrials and utilities while materials, telecom and energy could benefit from upward revisions, at least based on what Morgan Stanley analysts are forecasting for the coming 12-24 months.

Deutsche Bank on 23 January

Long-term investors should now increase India exposure

We expected 2008 to be a tougher year due to worries over a US-led correction, but were surprised at the ferocity of the recent sell-off. Despite the risk of further overshooting on the downside, rather than panic and go short/underweight at this stage, we think long-term investors should now increase their India exposure...

...Even if the US worsens, only 35% of the Sensex that consist of global cyclicals/IT/pharma could see earnings downgrades... and the remaining 65% of the index should benefit from the strong domestic capex cycle, with upside to growth from cuts in local interest rates and taxes (remember this is a pre-election year and tax receipts have been very strong).

Even though it is tempting to look at some beaten down small/mid-caps or momentum large-caps, we think that the global risks cannot be ignored and continue to suggest focus on large cap domestic plays.

Overweight—autos, private banks, capital goods, cement and media.

Underweight—metal, oil and gas/petrochem, pharmaceuticals and IT.

Our top 10 large-cap buys remain the same: ABB Ltd, ACC Ltd, Bharat Heavy Electricals Ltd, Grasim Ltd, HDFC Ltd, ICICI Bank Ltd, Infrastructure Development Finance Co. Ltd, ITC Ltd, Tata Motors Ltd and Zee Entertainment Enterprises Ltd.

Lehman Brothers on 23 January

We expect 33% return from the market over 12 months

We believe that the recent 20% correction in the market has brought valuations to reasonable levels... We believe this is not an unreasonably expensive (market) in view of growth and its relative insulation from global credit problems and the US slowdown. We believe the fall presents a good buying opportunity across several sectors and stocks.

We believe the Indian market is now attractively priced, given its growth in an absolute and relative context. We expect 33% return from the market over a 12-month period. From the current levels, we think the market should see a broad-based rally and we advise investors to run a broad-based portfolio. Over the next 12 months, we would recommend a mixture of interest-rate-sensitive stocks as well as some global cyclicals for which we believe the damage to valuations factors in the growth risks.

Within our India portfolio, we favour the following: ICICI Bank Ltd, Punjab National Bank, Tata Motors Ltd, Larsen and Toubro Ltd, Nagarjuna Construction Ltd, Infosys Technologies Ltd Nicholas Piramal Ltd, Reliance Industries Ltd, NTPC Ltd Unitech Ltd.

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