

January 20, 2011

## India Strategy

### ***MS Institutional Investor Survey: No Bulls in Sight***

#### ***MS Institutional Investor Survey – In Summary***

- *Only one-third of the investors are O/W on India with only one-fourth expecting India to outperform EM in 2011.*
- *Investors view domestic inflation as the biggest impediment to equity market performance.*
- *Investors expect inflation to peak between 9.0% and 9.5% in 2011.*
- *Government reforms and global markets are regarded as key drivers of market performance.*
- *Investors expect markets to touch a new high in 2011 (of about 22,100), although they expect the markets to close the year circa 10% higher.*
- *They expect the second half to be better for the market than the first half.*
- *Stock picking is the preferred strategy for 2011.*
- *Technology and Healthcare are favored sectors. Financials is the least-preferred sector.*
- *Among asset classes, gold and crude oil are at the top of the preferred list, while real estate is the most disliked asset class.*

Research  
India

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## MS Institutional Investor Survey: Investor Sentiment Bearish

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**Key Debate:** With the FII inflows turning negative and the domestic flows turning positive, the key debate is whether these two sets of investors will turn bearish and bullish on India, respectively, for 2011.

**Market View:** Our recent investor interactions and our investor survey underpin a rather bearish sentiment for India in 2011. Our customary semi-annual investor survey (with 89 participants) reveals the following:

- Only one-fourth of the buy-side investors believe that India will outperform EM in 2011 – This is first time since Jan-09 (when we launched the survey) that the majority of the participants expect India to underperform EM.
- About two-third the participating investors are underweight India – the lowest since Jun-09. The conviction levels on the Indian markets seem to be neutral to low for a majority of them.
- Investors expect RBI to hike rates between 75bp and 100bp (we expect 100bp), and almost unchanged 10-year bond yields.
- Investors expect the Sensex to close the year 11% higher than current levels. About one-fifth of the investors think that the market is not going higher in 2011. Three-quarters of the investors expect the 2H11 to be better than 1H11.
- Sensex earnings growth is expected to be around 17% in F2012 as compared to our estimate of 22%.
- Stock picking seems to be dominant theme among investors with one-half of the investors voting for it as the best way to make money in 2011. One-third think Indian equities are rich and they will only buy on corrections.
- Domestic investors believe that global markets will be the critical driver of Indian equities in 2011, while foreign investors seem to put more importance on government policies.
- One-third of the investors opine that domestic inflation is the biggest concern for India in 2011. They expect inflation to peak at between 9.0% and 9.5% in 2011 vs. the current level of 8.5%.
- Only 15% of the investors think that a spike in crude oil prices is the biggest concern for India. Investors are expecting oil prices to be in the US\$100-110/barrel range. Domestic investors are expecting crude prices to rise by 13% from the current levels, and crude is their preferred asset class for 2011.
- Technology (for foreign investors) and Healthcare (for domestic investors) are the favorite sectors, whereas Financials (which was the most-favored sector in the Jun-10 survey) and Utilities are the least favored. Overall, foreign investors rank gold as their favorite asset. Across all respondents, AAA corporate bonds top the list. Real estate is the least-preferred class for 2011.
- **Our view:** We expect moderate returns from the market, although the recent correction has taken our expected returns to around 16%. We believe that macro will continue to be the key driver and, hence, wider sector bets rather than stock picking are the preferred strategy. Our view is that crude oil prices could be the swing factor for India's relative performance. We think inflation has peaked and market interest rates (not policy rates) are close to peaks. Tactically, we are underweight Financials although looking for triggers to upgrade. We like investment-related sectors like Industrials, Utilities, Energy and Materials, and are Underweight consumption.

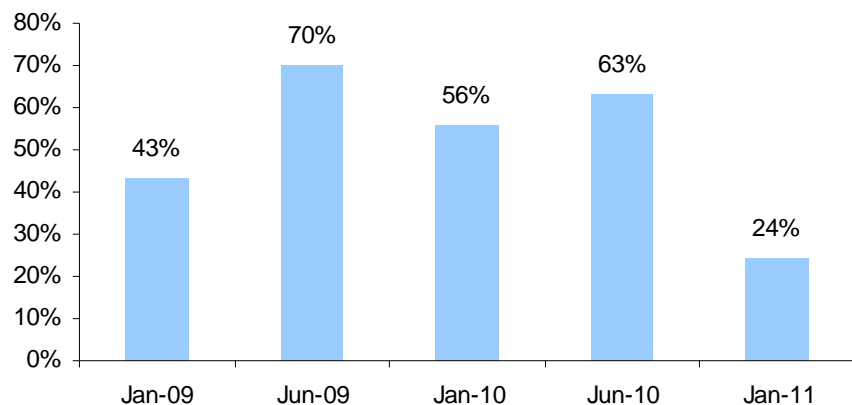
## Summary of Latest MS Institutional Investor Survey (Jan-11)

| MS View   | International fund manager  | GEMS fund manager    | Long Short fund manager      | India dedicated overseas fund manager | Domestic fund manager | Aggregate Foreign Investors |
|---|---|----------------------|------------------------------|---------------------------------------|-----------------------|-----------------------------|
| <b>Macro and Market view for 2011</b>                     |   |                      |                              |                                       |                       |                             |
| GDP growth  | 8.7%  | 8.3%                 | 8.4%                         | 8.5%                                  | 8.1%                  | 8.3%                        |
| WPI (Inflation)   | 6.8%  | 7.6%                 | 7.3%                         | 7.2%                                  | 7.1%                  | 7.2%                        |
| WPI Peak in 2011  | NA  | 9.7%                 | 9.1%                         | 9.0%                                  | 9.6%                  | 9.4%                        |
| Policy rate   | 7.3%  | 7.3%                 | 7.1%                         | 7.3%                                  | 7.0%                  | 7.1%                        |
| 10-year bond yield  | NA  | 8.5%                 | 8.4%                         | 8.4%                                  | 8.3%                  | 8.2%                        |
| Crude prices/barrel                                       | NA  | 112                  | 107                          | 107                                   | 104                   | 103                         |
| Currency view   | NA  | 46                   | 46                           | 46                                    | 46                    | 45                          |
| High point for Sensex in 2011                             | NA  | 20,833               | 22,389                       | 22,333                                | 22,444                | 22,052                      |
| 2011 Year-end target for Sensex                           | 22,100  | 18,333               | 21,667                       | 21,000                                | 21,667                | 20,786                      |
| Will India outperform Emerging markets in 2011?           | NA  | No                   | No                           | No                                    | No                    | Not Sure                    |
| Current position on Indian equities?                      | NA  | Underweight          | Underweight                  | Equalweight                           | Equalweight           | Overweight                  |
| Sensex earnings growth                                    | 22%   | 14%                  | 16%                          | 17%                                   | 18%                   | 17%                         |
| Investment Horizon (months)                               | NA  | 29                   | 15                           | 10                                    | 17                    | 26                          |
| <b>Themes for 2011</b>                                    |   |                      |                              |                                       |                       |                             |
| Best description of the Indian equity markets             | Equities are expensive & I shall only buy on correction <-----Stock picking is the best strategy for 2011-----> |                      |                              |                                       |                       |                             |
| Single most important driver for Indian equities          | Global Markets  | Government Policies  | Government Policies          | Government Policies                   | Global Markets        | Government Policies         |
| Biggest concern   | <-----Domestic Inflation----->  |                      | Spike in Oil Prices          | <-----Domestic Inflation----->        |                       |                             |
| Conviction level for India equities                       | Just About Fine   | Just About Fine      | Low Conviction               | Just About Fine                       | Just About Fine       | Just About Fine             |
| Better market perf. expectation between 1H and 2H of 2011 | <-----Second Half----->   |                      |                              |                                       |                       |                             |
| Best performing sector                                    | Telecom   | Materials/Technology | Healthcare                   | Technology                            | Healthcare            | Technology                  |
| Worst performing sector                                   | Utilities/Industrials   | Utilities            | Financials/Telecom/Utilities | Telecom                               | Financials            | Utilities                   |
| Most preferred asset class                                | Gold  | Sensex               | Gold/Small & Mid Cap         | BSE Mid-cap index                     | Crude Oil             | Gold                        |
| Least preferred asset class                               | BSE Small-Cap index   | Cash                 | Cash                         | Real Estate                           | Real Estate           | Real Estate                 |

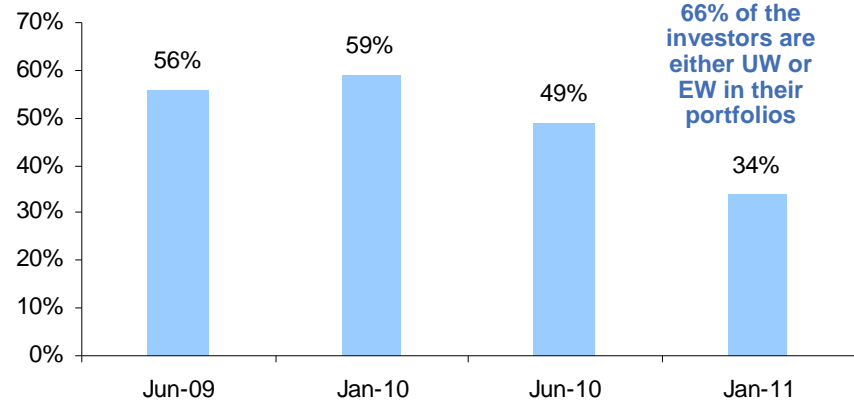
Source: Morgan Stanley Research

## India Position Falls Further, India Expected to Underperform

### Will India Outperform EM?



### OW Position in Portfolios



### Our Institutional Investor Surveys over Time: Sector Choices...

|        | Most Favoured Sector | Least Favoured Sector |
|--------|----------------------|-----------------------|
| Jan-09 | Consumer Staples     | Industrials           |
| Jun-09 | Industrials          | Consumer Staples      |
| Jan-10 | Financials           | Consumer Staples      |
| Jun-10 | Financials           | Telecom               |
| Jan-11 | Technology           | Utilities             |

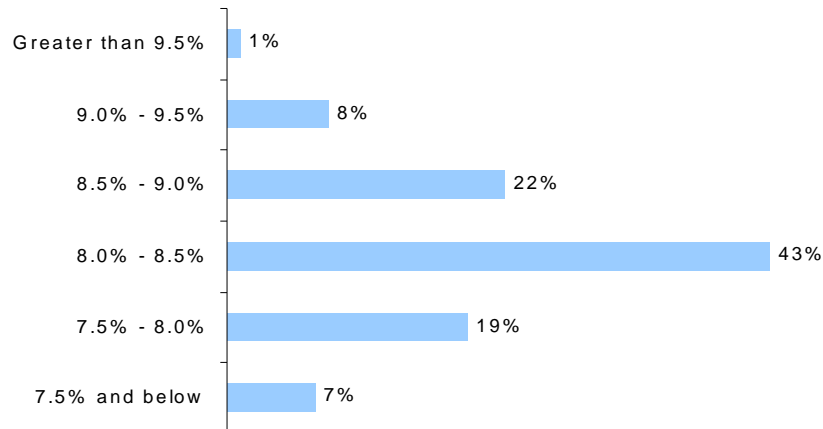
### ...Asset Class Choices

|        | Most Favoured Asset | Least Favoured Asset |
|--------|---------------------|----------------------|
| Jan-09 | Gold                | Real Estate          |
| Jun-09 | BSE Mid-cap Index   | Government Bonds     |
| Jan-10 | BSE Mid-cap Index   | Cash                 |
| Jun-10 | BSE Mid-cap Index   | Crude Oil            |
| Jan-11 | Gold                | Real Estate          |

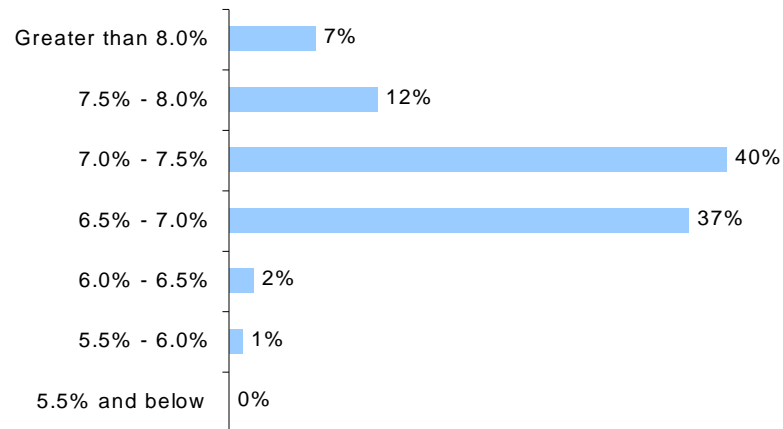
Source: Morgan Stanley Research

## Jan 2011 Survey: High Growth and Higher Inflation

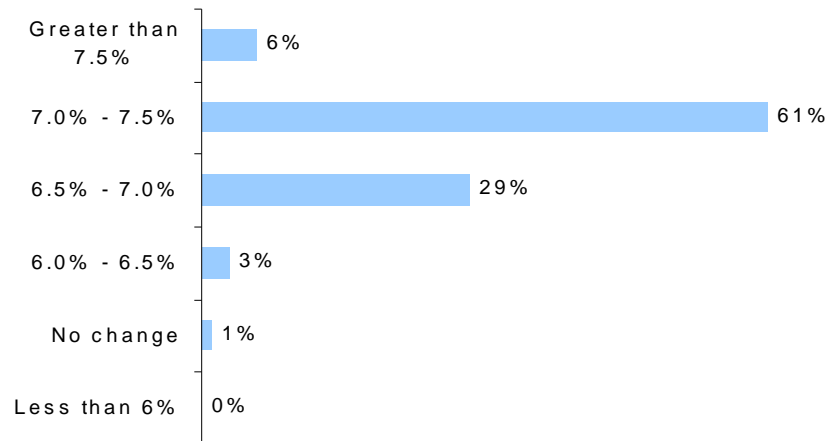
### F2012 GDP Growth



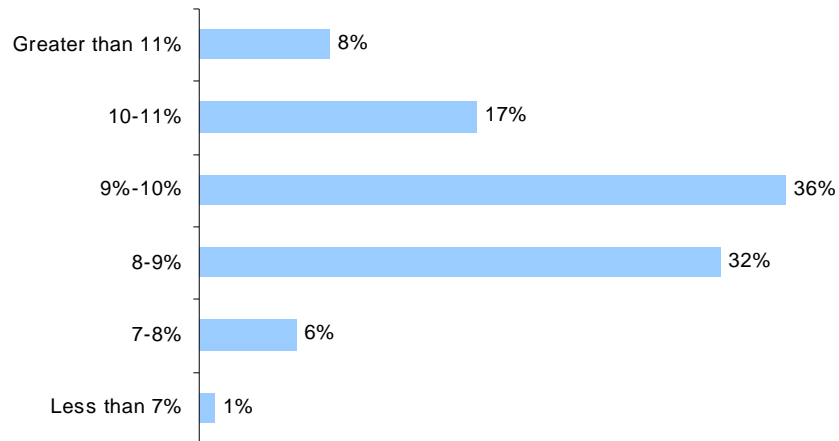
### F2012 Average WPI Inflation



### F2012 Year-end RBI Repo Rate



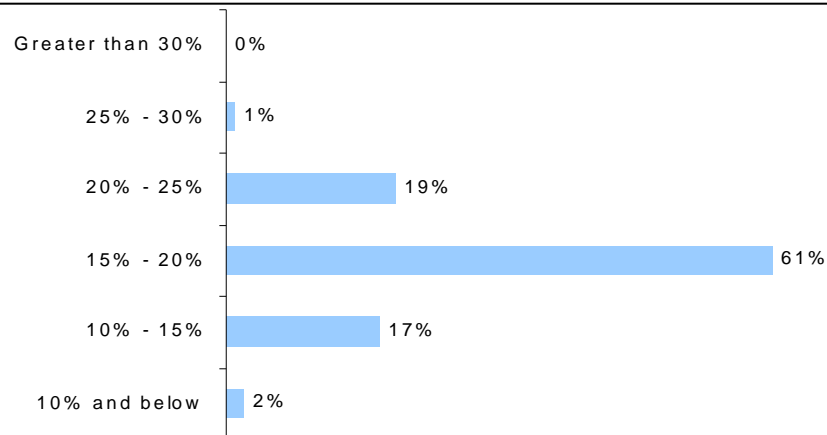
### Inflation Peak in 2011



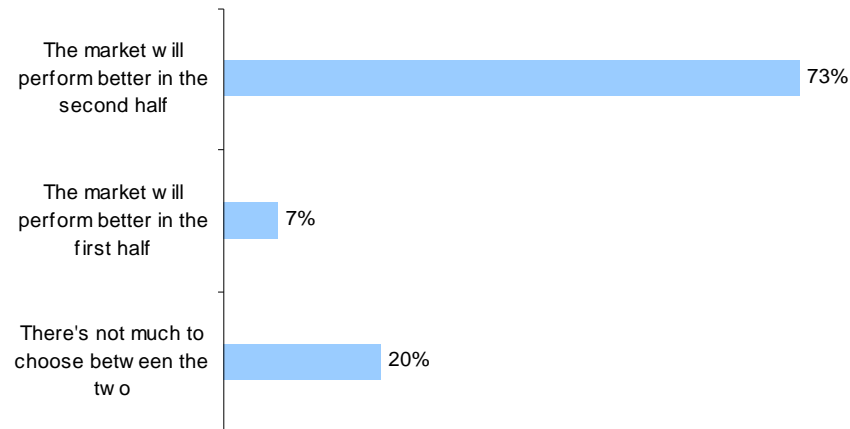
Source: Morgan Stanley Research

## Jan 2011 Survey: Moderate Returns Expected for the Market in 2011

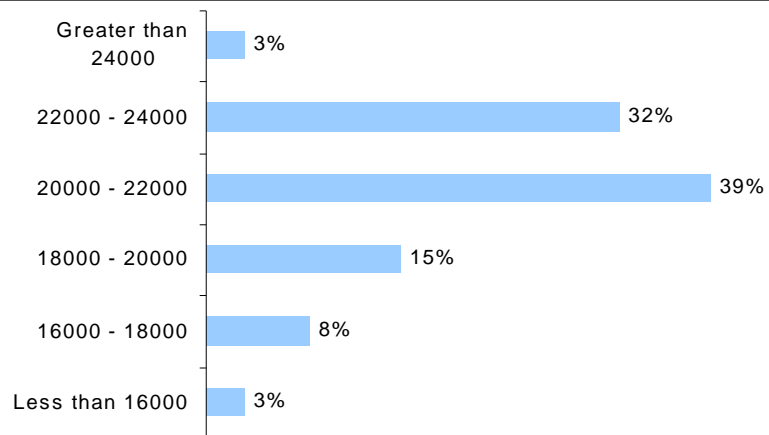
### F2012 Sensex Earnings Growth



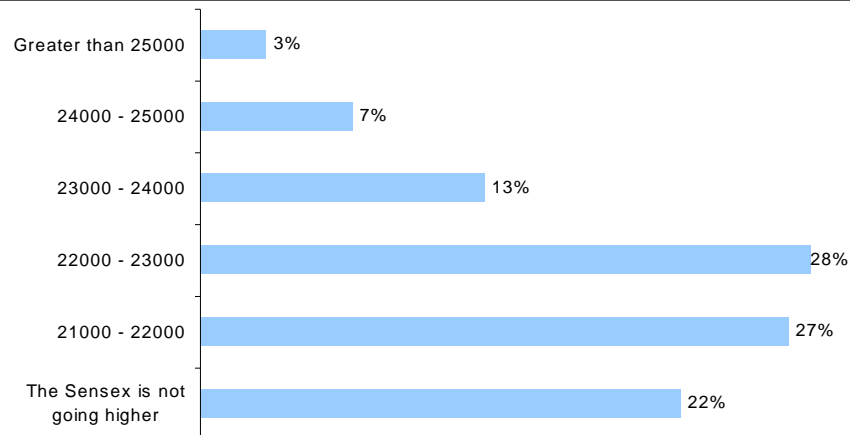
### Indian Equities' Performance in 2011



### Sensex 2011 Year-end Level



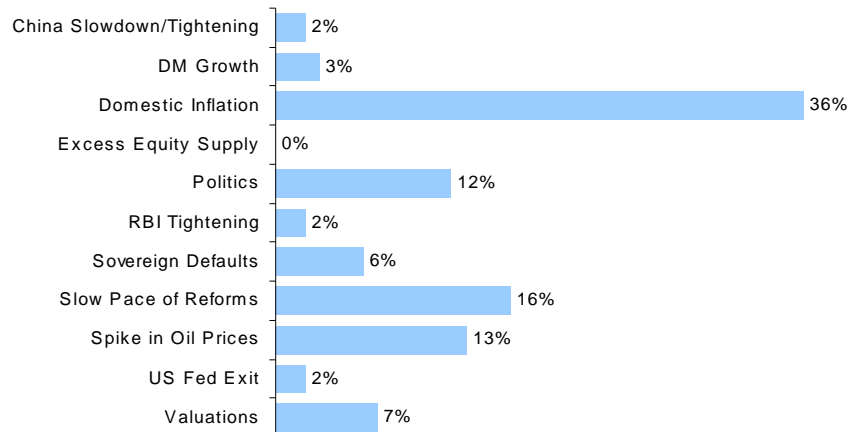
### Sensex High Point Range in 2011



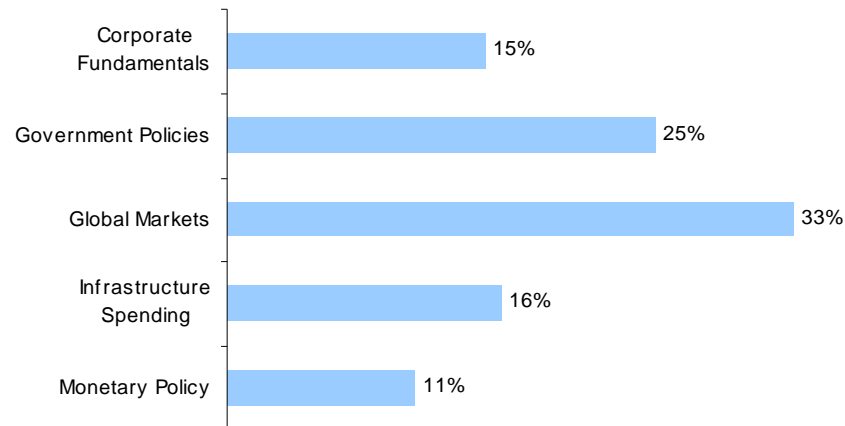
Source: Morgan Stanley Research

## Jan 2011 Survey: Key Worry: Domestic Inflation, Key Driver: Global Markets

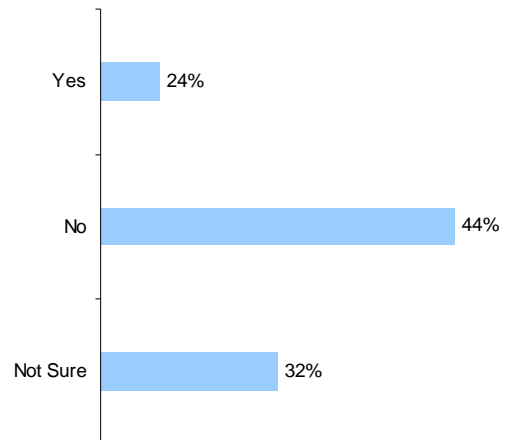
### Biggest Concern for Indian Equities for 2011



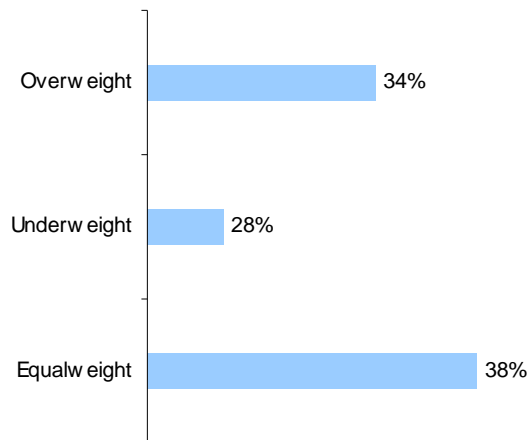
### Most Important Driver for Indian Equities for 2011



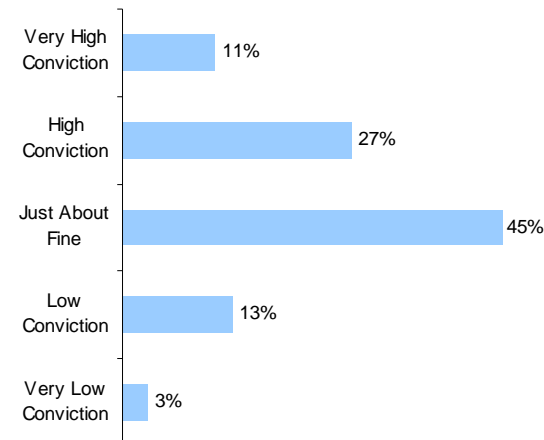
### Will India continue to Outperform EM in 2011?



### Current Position on India



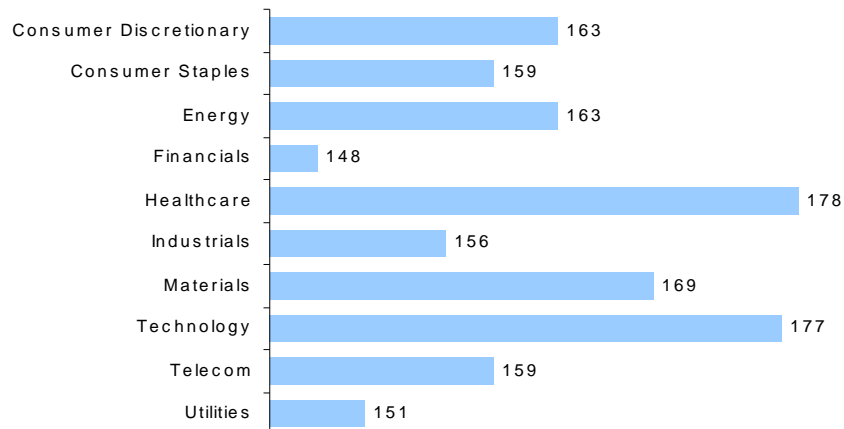
### Conviction Level for India Equities



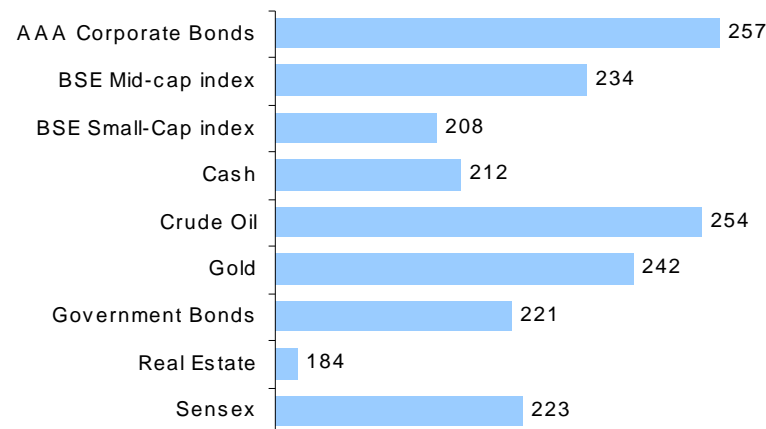
Source: Morgan Stanley Research

## Jan 2011 Survey: Stock Picking Is the Favored Strategy

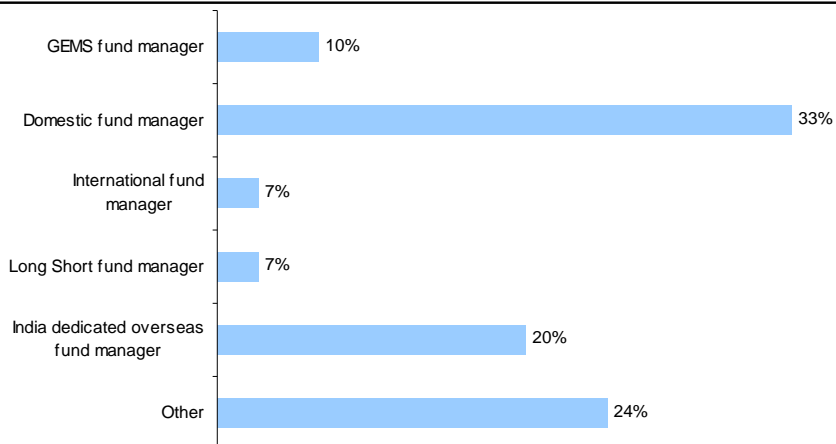
### Sector Performance Expectation in 2011\*



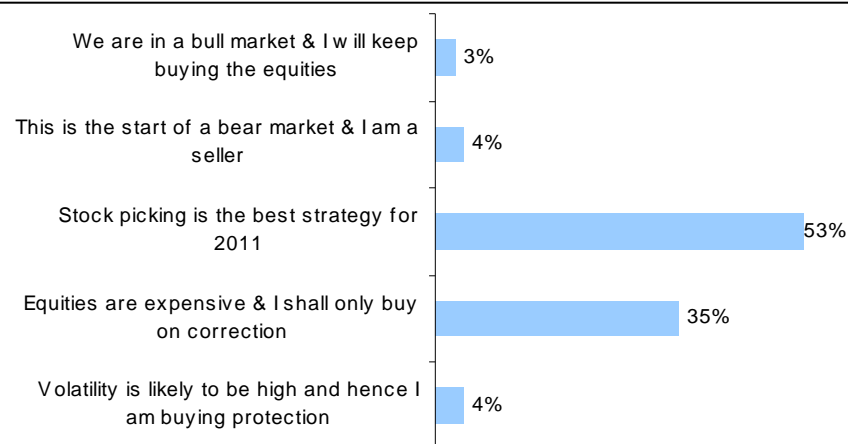
### Asset Class Attractiveness for 2011\*



### Participants' Landscape



### Indian Equity Markets Strategy for 2011



Source: Morgan Stanley Research, \* Score is based on votes, higher the score more bullish is the view.



## Summary of Our Previous Institutional Survey (Jun-10)

|  | MS View   | GEMS fund manager       | Domestic fund manager  | International fund manager | Long Short fund manager | India dedicated overseas fund manager | Aggregate          |
|--|---|-------------------------|------------------------|----------------------------|-------------------------|---------------------------------------|--------------------|
| <b>Macro and Market view for F2011</b>           |   |                         |                        |                            |                         |                                       |                    |
| GDP growth                                       | 8.5%  | 8.1%                    | 8.5%                   | 8.4%                       | 8.5%                    | 8.7%                                  | 8.6%               |
| WPI (Inflation)                                  | 7.9%  | 7.7%                    | 8.0%                   | 8.4%                       | 8.3%                    | 8.4%                                  | 8.1%               |
| Policy rate                                      | 5.8%  | 6.2%                    | 6.1%                   | 6.0%                       | 6.0%                    | 6.1%                                  | 6.0%               |
| 10-year bond yield                               | NA  | 7.9%                    | 7.7%                   | 7.7%                       | 7.7%                    | 7.8%                                  | 7.7%               |
| Crude prices/barrel                              | NA  | 75                      | 75                     | 78                         | 74                      | 75                                    | 76                 |
| Currency view                                    | NA  | 45                      | 45                     | 46                         | 46                      | 46                                    | 45                 |
| High point for Sensex in 2010                    | NA  | 19611                   | 19362                  | 19071                      | 19367                   | 18971                                 | 19535              |
| 2010 Year-end target for Sensex                  | 19400   | 19056                   | 18667                  | 18536                      | 18594                   | 17853                                 | 18795              |
| Will India outperform Emerging markets in 2010?  | NA  | 22%                     | 52%                    | 21%                        | 38%                     | 29%                                   | 43%                |
| Current position on Indian equities?             | NA  | Overweight              | Overweight             | Overweight                 | Equalweight             | Overweight                            | Overweight         |
| Sensex earnings growth                           | 23%   | 21%                     | 21%                    | 19%                        | 21%                     | 21%                                   | 21%                |
| Broad market earnings growth                     | NA  | 23%                     | 23%                    | 22%                        | 23%                     | 24%                                   | 23%                |
| Investment Horizon (months)                      | NA  | 17                      | 20                     | 16                         | 15                      | 26                                    | 19                 |
| <b>Themes for 2010</b>                           |   |                         |                        |                            |                         |                                       |                    |
| Best description of the Indian equity markets    | <-----Stock picking is the best strategy for 2010-----> |                         |                        |                            |                         |                                       |                    |
| Single most important driver for Indian equities | <-----Global Markets----->                              |                         |                        |                            |                         |                                       |                    |
| Biggest concern                                  | Global Growth/Sovereign Debt/Inflation                  | Global Growth/Inflation | Inflation              | Sovereign Defaults         | Sovereign Defaults      | Sovereign Defaults                    | Sovereign Defaults |
| Best Performing sector                           | Cons. Disc./Technology                                  | Financials              | Materials              | Financials                 | Consumer Discretionary  | Financials                            | Financials         |
| Worst Performing sector                          | Materials   | Telecom                 | Cons. Disc./Technology | Healthcare                 | Telecom                 | Telecom                               | Telecom            |
| Most preferred asset class                       | Gold  | BSE Mid-cap index       | Cash                   | Gold                       | Gold                    | BSE Mid-cap index                     | BSE Mid-cap index  |
| Least preferred asset class                      | Real Estate   | Government Bonds/Cash   | BSE Small-Cap index    | Crude Oil                  | Crude Oil               | Crude Oil                             | Crude Oil          |

Source: Morgan Stanley Research



**Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations.** For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.

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| Stock Rating Category    | Coverage Universe |            | Investment Banking Clients (IBC) |                |                      |
|--------------------------|-------------------|------------|----------------------------------|----------------|----------------------|
|                          | Count             | % of Total | Count                            | % of Total IBC | % of Rating Category |
| <b>Overweight/Buy</b>    | <b>1145</b>       | <b>40%</b> | <b>437</b>                       | <b>44%</b>     | <b>38%</b>           |
| <b>Equal-weight/Hold</b> | <b>1192</b>       | <b>42%</b> | <b>422</b>                       | <b>42%</b>     | <b>35%</b>           |
| <b>Not-Rated/Hold</b>    | <b>119</b>        | <b>4%</b>  | <b>25</b>                        | <b>3%</b>      | <b>21%</b>           |
| <b>Underweight/Sell</b>  | <b>382</b>        | <b>13%</b> | <b>109</b>                       | <b>11%</b>     | <b>29%</b>           |
| <b>Total</b>             | <b>2,838</b>      |            | <b>993</b>                       |                |                      |

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Overweight (O or Over) - The stock's total return is expected to exceed the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

Equal-weight (E or Equal) - The stock's total return is expected to be in line with the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

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