2012: The World Is Not Coming To An End…

Considering the way 2011 is being looked upon by investors and non-investors alike and inferences being drawn for 2012, it seems that the prophecy made by someone that 'the world will come to an end in 2012' is being taken too seriously!

Well, undoubtedly, if we make a list of the positive and the negative events of 2011, the latter will certainly outperform (we are not making the same here though). However, to assume that the world will not be able to rise above the challenges, sooner than later, will be naïve. Then why be pessimistic? If humans don't evolve in terms of solving financial problems, tackling nature's fury, and achieving improvement in technological and capital efficiency, then who will? How will the world grow?

And with India yet to cover substantial ground to reach the coveted 'developed economy' status, rest assured, the 1.2bn Indian workforce is working towards this goal. Add to this the 1.3bn workforce of China and we get over 35% of the world's 'young' population seriously racing to be part of the next super powers.

With the above optimism and faith in human prowess, and not trying to undermine the near-term challenges that need to be tackled, we look at a set of Q&A (definitely not exhaustive) that should help enlighten equity investors about many issues that are important from his/her investment point of view and may be at the top of his/her mind.

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1. **How is the global and domestic macro environment stacked up?**

   Challenging, is how one would describe the current global and domestic macro environments in one word.

   On the global arena, while the Euro zone debt crisis remains at the top of the challenges league that needs priority attention by policy makers / European governments to resolve the issue with minimal possible damage to the global financial system; the anemic US economy growth must also not be ignored.

   Further, the domestic macro-environment also remains a bit tricky in the near-term i.e. for the next couple of quarters, as the lagged impact (2-3 quarters) of RBI's interest rate hikes coupled with some impact of the global slowdown takes its toll on India's economic growth. Notably, the GDP growth of a mere 6.9% for the quarter ended September 2011 has already started to reflect the same.

2. **What are the headwinds that are collectively affecting consumer spending / corporate investments / economic growth / investor sentiments / stock market fortunes?**

   Debt, debt and more debt is what describes the single largest problem being faced by the developed economies at present resulting in flight of capital from riskier asset class like equities to (perceived) safer investment avenues like US bonds. This is on the assumption of a catastrophic end to one or more relatively small European economies, which will lead to a domino effect on the world financial system and its stability.

   As far as India is concerned, a consequence of challenges have emerged like high inflation leading to monetary tightening (RBI upping interest rates) contributing to GDP slowdown, which in turn has supported the deterioration of the country's fiscal position and led to the depreciation of the Indian currency.

3. **What is the probability of an improvement in the domestic economic scenario in 2012?**

   High! It must be noted that India is in a cyclical downturn and not a structural downturn. Though it may sound repetitive, but the fact remains that the India story is far from over. Aspiration and entrepreneurship continues to rule the Indian mindset and rest assured, there is no dearth of opportunists in the country waiting to take advantage of the huge latent and potential market called India. Despite this, periods of above and below average growth are part of the cycle depending upon various evolving economic factors – both domestic and global.

   In fact, for 2012, the hope comes from the fact that food inflation (~14% of WPI) in India has dropped to a 6-year low will reflect in the overall WPI numbers (currently 9%) and help in bringing the same down. Once this happens and keeping in mind the consequence of challenges highlighted earlier, it would actually lead to a reversal of trends. Thus, a fall in inflation would lead to monetary loosening (RBI cutting interest rates to re-energize the economy) contributing to resurgence in economic activity and GDP growth, which in turn will help uplift the country's fiscal health and support the strengthening of the Indian currency along with attracting foreign capital.

4. **So, when can one expect an easing in RBIs monetary policy?**

The RBI in its last monetary policy has already indicated of shifting its focus from managing inflation to managing growth and has accordingly opted for a pause in interest rate hikes on the assumption of a declining inflation trajectory. With this scenario now on the verge of getting materialized (assuming that there is no flare up of geo-political tensions in 2012 in the oil supplying nations), the probability of an interest rate cut in April 2012 is very high. We believe that the RBI may opt to wait a little longer beyond the January 2012 monetary policy to start easing until signs of inflation fall is concretized. In fact, notably, a public sector bank is already contemplating cutting its lending rate, which would give further credence to our belief of a sharp interest rate cycle reversal 2012 onwards.

5. **What global/local indicators must be watched out for in 2012 that will have a direct positive/negative impact on Indian equities?**

On the global front, any coordinated measure by central banks or by the key European economies (keep an eye on Germany) at salvaging the debt crisis will be welcomed by the market. Also, impactful austerity plans by European economies, again aimed at curtailing their debt, will be a positive. However, the action of the international credit ratings agencies needs to be kept a close watch as any unfavorable developments here could pose additional challenges for the debt-ridden economies. In the case of US, the anemic 1-1.5% economic growth needs to not only sustain but also gain strength. Notably, the recent signs with respect to personal consumption and the labor market have been encouraging and needs to remain so and improve. However, one still cannot take away the fact that the US economy is fragile in the near-term.

On India's front, apart from the interest rate cuts in the offing that would have a considerable positive impact on the country's economy; government measures at tackling the fiscal deficit needs to be watched closely. Also, while the Indian currency remains weak, continued (suspected) RBI intervention will be a positive. Further, with a plethora of bills awaiting government's clearance, one can only hope that the Indian government will move ahead on some. However, on the other hand, considering that five Indian states (UP, Punjab, Uttarakhand, Goa and Manipur) are due for election in 2012, the outcome of the poll results (especially UP) would be important for Indian politics and its equation. Again, one can only hope that the government does not put further pressure on the fiscal state of the country by announcing populist measures in wake of the elections.

6. **At what level is the market expected to bottom-out?**

Tackling this question from a technical point of view, the set-up continues to point towards further weakness for the Indian stockmarkets in the immediate future. In fact, 2011 (including the last trading day of the year) ended on a weak note. Currently, considering the behavior of the market and the macro-economic parameters (for now), the probability of Nifty drifting lower to the 4,000-4,200 zone is likely, where we see a high probability of the market bottoming out. However, it must be noted that this does not take into consideration any 'significant' positive announcement coming through in the interim at the global/domestic level, which has the power to reverse the trend. Nonetheless, even in such a scenario, a Nifty close above 4,850 could ensure a trend reversal for the Indian market for the medium-term.

However, in the meanwhile, considering that many large-cap stocks are in attractive valuation zones from a 1-2 year investment horizon and warrant systematic investing, waiting for that 'absolute bottom' may prove to be a costly wait in hindsight later.

7. What should be the investment strategy for equity investors in 2012?

The best strategy for an equity long-term investor 'always' is to buy systematically at regular intervals in limited quantities. However, in the current scenario, one can focus more on the beaten down blue-chip large-cap stocks which are facing only cyclical pressure on their businesses and whose stock price has corrected in much greater proportion than the deterioration in their short-term business fundamentals.

8. Which are the sectors one should look forward to in 2012?

At the current juncture, there is value across sectors and an investor can be really spoilt for choice. However, considering that the reversal of interest rates is likely to be the most important theme that could hog the limelight and set the base for all other stories to bounce back, it is advisable to consider investing in Banking stocks to begin with. Considering that the revival of India's GDP will be supported by banks by meeting the financial needs of consumers and corporates, not much math is required to pick this sector for the next couple of years and beyond. Another interest-rate sensitive where selective buying (considering the valuation of individual stocks) is warranted is the Automobile sector.

As far as the near non-cyclical sectors are concerned, Pharmaceutical, FMCG (selectively) and IT stocks too are available at some great discounted prices. Metals and Capital Goods stocks, despite the value in many (again preferable large-caps) from a long-term point of view, investments in these can be considered by an investor with a greater risk appetite, which in turn will be rewarded by greater returns if the world/domestic recovery is along 'scripted' lines.

9. Is there a possibility for an investor into Indian equities to make money in 2012?

Though the probability of a reasonable return in 2012 is high, a definitive answer to this question is difficult, as there are still many issues, some of which need to be resolved and some which will get resolved. Nonetheless, notwithstanding the anticipated weakness (as per technical studies) in the market in 1Q of 2012, systematic investing into stocks now and into the correction will only provide better investment points for investors, the benefits of which will be reaped in the coming quarters. What also goes in favour of investing at the current juncture is the fact that while the Sensex has lost 8 times on a calendar year basis in the past 33 years (excluding 2011), the "average returns" in the immediate following year has been over 20%!

10. Ok, so what is the conclusion for 2012? Is it the end of bad news?

Well it is certainly not the end of bad news; however, we believe that the efforts at overcoming the bad news will increase, which will be taken positively by the market. And considering that the markets have a tendency to react, to trend reversals in anticipation of one materializing, at least 4-6 months in advance (remember markets are forward looking), 2012 is expected to be a year of positive returns for Indian equities.

Happy New Year 2012!
&
Happy Investing, because…
The World Is Not Coming To An End!

Securities

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