

Crystal Ball gazing 2013



Technical Research

Nifty : 5,905
1st January, 2013

Key Highlights

- ✓ Inter-market and Macro Economic Indicators extend long term consolidation
- ✓ Nifty trends up with positive funds flow. Trailing support - 5650
- ✓ Cyclical to outperform Defensives

Markets in consolidation mode; Selective bets to pay-off

- India is placed as a leader on the Global Equity rotation chart
- Funds flow has been driving the market up
- Multiple technical indicators like - Gann Angles, Point & Figure, etc are coinciding with support at 5650
- Crucial point of resistance derived by the Elliot Wave theory is placed at 5970 / 6400
- Economic Indicators indicate consolidation in long term trend
- Depreciation in rupee despite positive funds flow remains a concern
- Cyclical like - Auto, Realty, Infra are expected to outperform defensives

Sector	Outlook
Auto	Positive
Infra	Positive
Realty	Positive
Mid-Cap	Positive
Banks	Positive
Media	Positive
IT	Negative
Energy	Negative

Nifty Vs	Correlation
Global Equity	Positive
Global Commodity	Positive
Nominal GDP	Positive
Fiscal Deficit	Negative
USDINR	Negative
India Vix	Negative

With an EYE on FUNDAMENTALS

- With an eye on the interest rate downcycle, we recommend 5 interest rate sensitives for 2013
- Revival of economy is accompanied by a boost to commodities - 3 commodity stocks should help ride the rising commodity price increase in 2013.

Large Cap	CMP	Target
Maruti	1490	1730
NMDC	165	217
DLF	230	286
Indusind Bank	417	500

Mid - Cap	CMP	Target
Karur Vysya	560	725
GMDC	216	284
Mcleod Russel	350	410
Canfin Homes	152	230

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Macro to Micro Trends



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2013 : Consolidating Macros

Nifty for the CY 2012 saw an appreciation of 28% with positive funds flow from foreign investors reported above \$22 billion. Despite the gains on Nifty the range was within the overall band of CY 2011 and on the long term chart Nifty is consolidating in the band of 4550 - 6350.

Inter-market Analysis

MSCI World Equity Index saw a consolidation and Nifty was an outperformer in the calendar year among other equity markets. International commodity index also oscillated with which emerging markets are positively correlated. Rupee reported a new low during the year signalling caution for Indian equities. The correlation of Nifty with Rupee remains positive.

Volatility across the globe was low during the year which provided a good diversification benefit for Global fund managers towards outperforming emerging equity market like India. Global volatility shot up during late year end which is a sign of caution and follow-up rise in volatility index may reduce the diversification benefit from emerging markets and global equity markets can turn more correlated.

Global Equity Rotation chart indicates that Nifty is still placed as a leader and until the chart breaks down below the crucial supports, the trend can be assumed to be positive. At this juncture, Indian equities are in a mature stage of outperformance and reward/risk is diminishing.

Macro Economic Indicators

Trends in economic Indicators such as - Real GDP, Fiscal Deficit, CPI and Currency indicates that the economy is consolidating and so is the Nifty on the long term chart which is stuck with a ceiling placed at 6350 post 2008. Nifty adjusted for CPI has been consistently moving lower since 2008, indicating that Nifty has been delivering negative real returns.

Prognosis

Inter-market indicators are not that lucrative from a long term perspective and most of them indicates oscillation for the market with a negative bias. However till the absolute price chart confirms a breakdown, action cannot be taken. Elliot wave study conducted on Nifty indicates that the index is in the larger Wave C which is corrective in nature. However, the wave is in a pullback mode with crucial points at 5970 & 6400 and the count will be negated only on sustenance above the maximum expected retracement of 6400.

Multiple studies like - Gann Angles, Point & Figure charts and Statistical optimized stop loss indicates that, support for the index is placed in the band of 5650-5700. Till the stated support level is taken out, the trend can be assumed to remain positive. In the case of breach below supports, the trend will have confirmation of reversal which could lead to confirmation of sub-wave III of Wave C, leading to a target price band of 5000-5100.

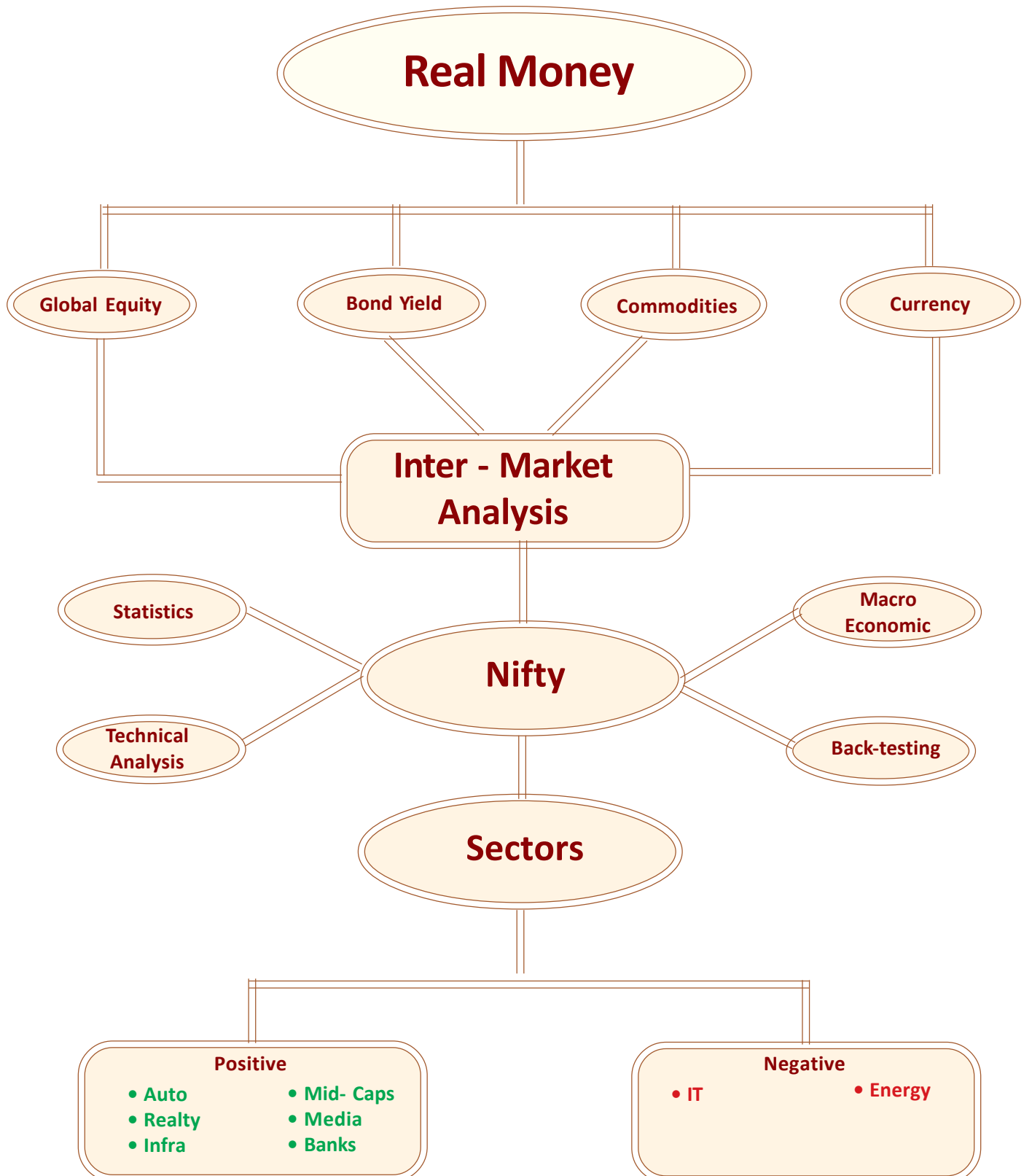
A switch has been witnessed in the sector rotation chart from Defensives to Cyclical and until we have a confirmation of trend reversing towards the south, cyclical is expected to rule the roost. Sectors for expected portfolio outperformance are - **Auto, Realty, Infra, Mid-caps, Media and Banks**. Metals is at a verge of positive breakout and on confirmation of Nifty making higher highs, the sector can significantly outperform other ones. Sectors to avoid are - **IT and Energy**.

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Top-Down Approach



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Inter-Market

MSCI World Equity Index

Chart 1



MSCI World Index has been consolidating for past few years and is yet to breakout from the resistance of 360. Till the breakout does not happen, the momentum could continue to be wanting.

US 10 Yr Bond Yield

Chart 2



US Bond yield has been declining for past 31 years. The log chart indicates that the channel has broken down with an acceleration which states climax and selling fatigue. This indicates a possible conclusion of the declining trend. Hence, the US bond yield can be expected to reverse in the next few years.

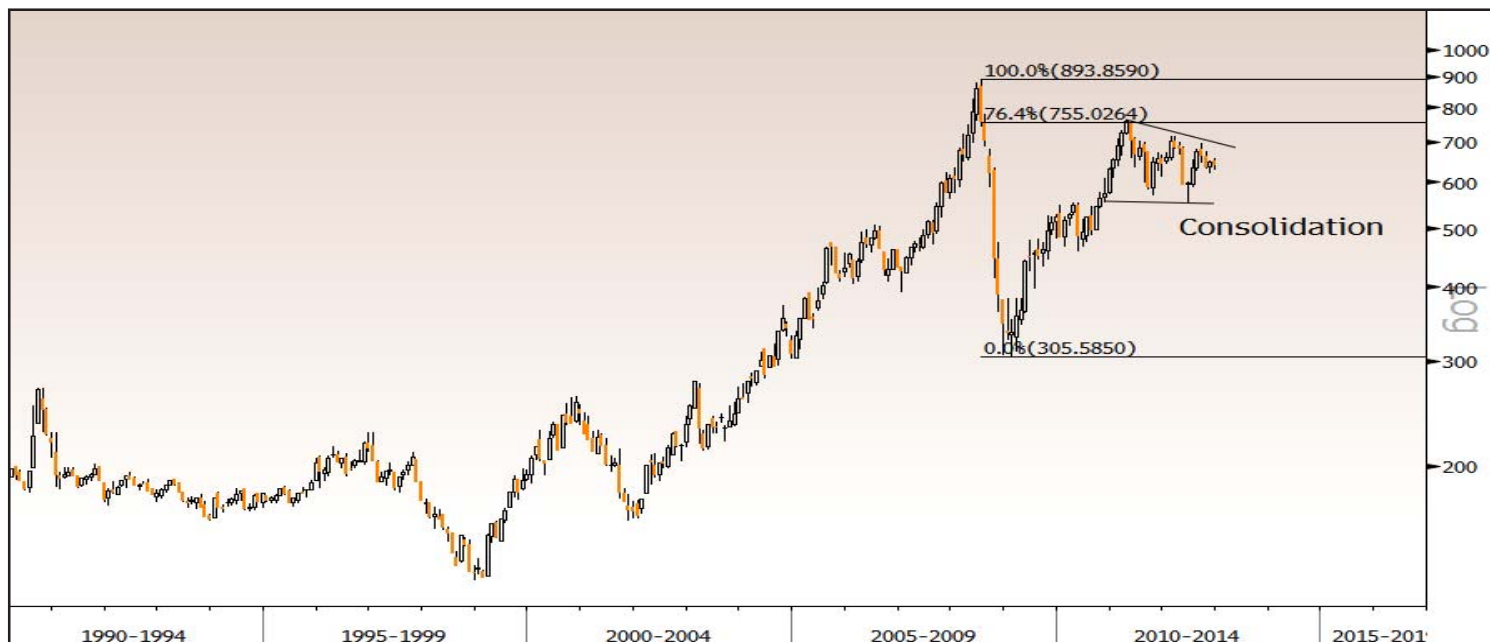
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GSCI Commodities Index

Chart 3



Goldman Sachs Commodities Index is in a consolidation post the pullback from the important hurdle of 755. Failure to surpass the stated level and a breach below 550 can clearly put the current trend in a sell mode.

Dollar Index

Chart 4



Dollar Index is consolidating for past 7 years leading to a formation of Symmetrical Triangle. The breakout points for the index are placed at \$90 on the upside and \$72 on the downside.

Conclusion

All the asset allocation markets are indicating consolidation on the long term scale.

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Comparison Global Equity

US Bond Yield vs. Dow Jones

Chart 5



Dow Jones (Indu Index) has an inverse relation with the Bond Yield (USGG10YR Index). The start of fall in bond yield during early 1980's was a trigger for Equities to enter a bull run which was consolidating for preceding 15 years. Any rise in bond yield indicates caution for US equities.

Commodities vs. Dow Jones

Chart 6



Commodity (SPGSCI Index) follows equity with a lag and is positively related to US equities (Indu Index). The circles on the chart, points out the cyclical lag between both the markets.

Conclusion

Commodities is positively correlated and Bond yield is negatively correlated with Dow Jones.

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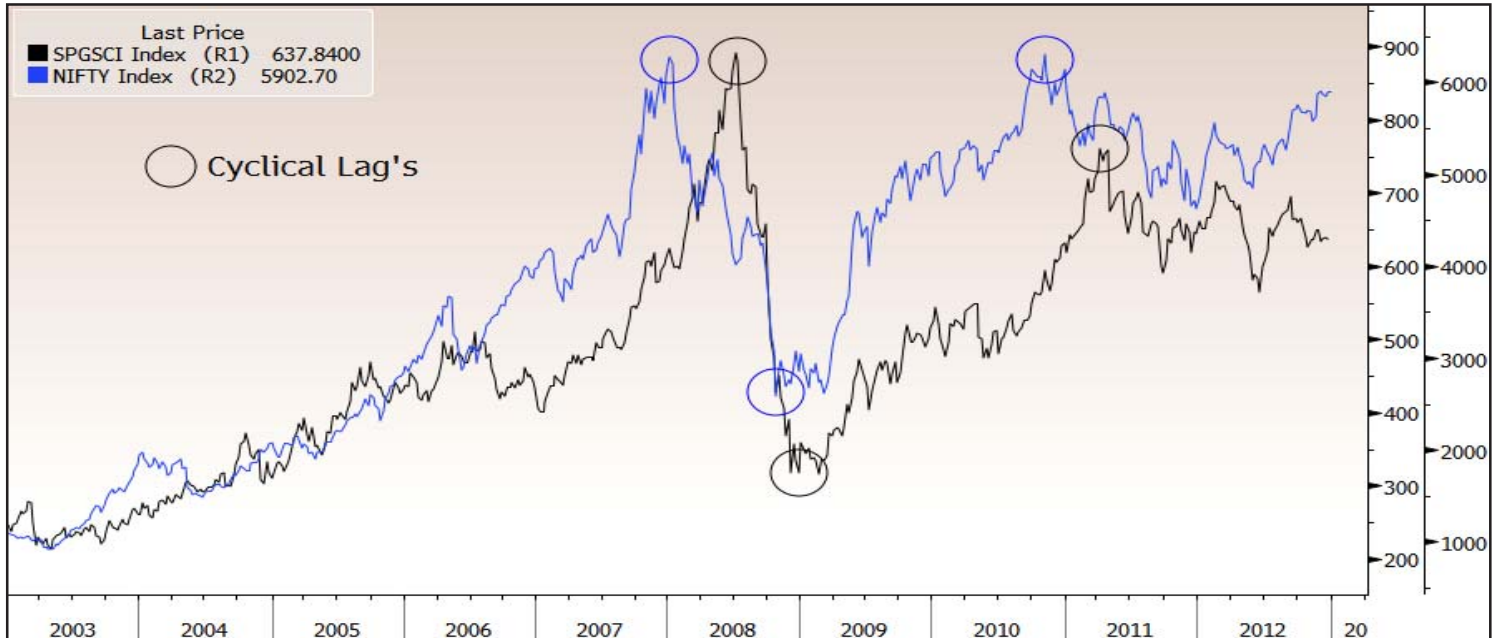
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Comparison Indian Equity

Nifty vs. Commodities

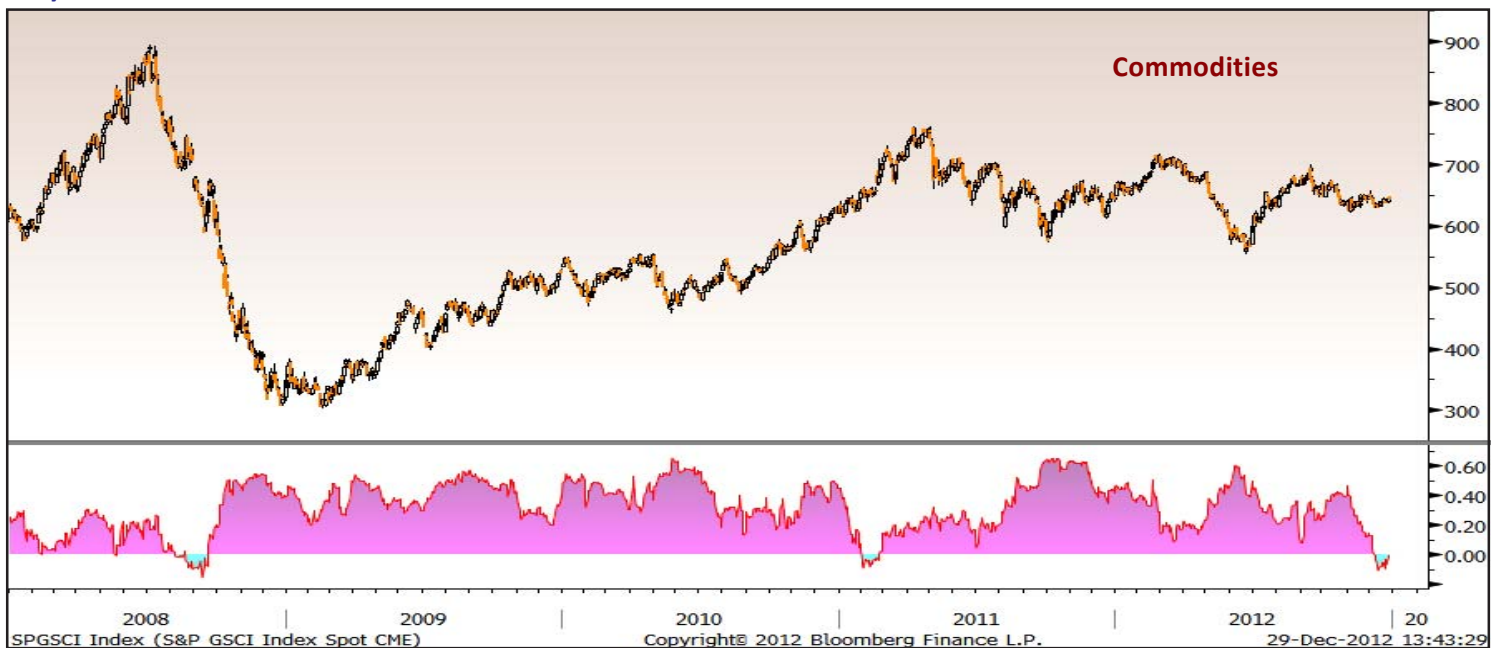
Chart 7



Nifty along with other emerging markets has a positive relationship with Commodities. There is a usual cyclical lag of commodities to equities at peaks & troughs.

Nifty vs. Commodities - Correlation

Chart 8



Medium term smooth correlation of Nifty with Commodities has mostly been positive. This indicates that both the markets can be expected to move in tandem. The strength of correlation could vary from time to time which gives short-term trading opportunities.

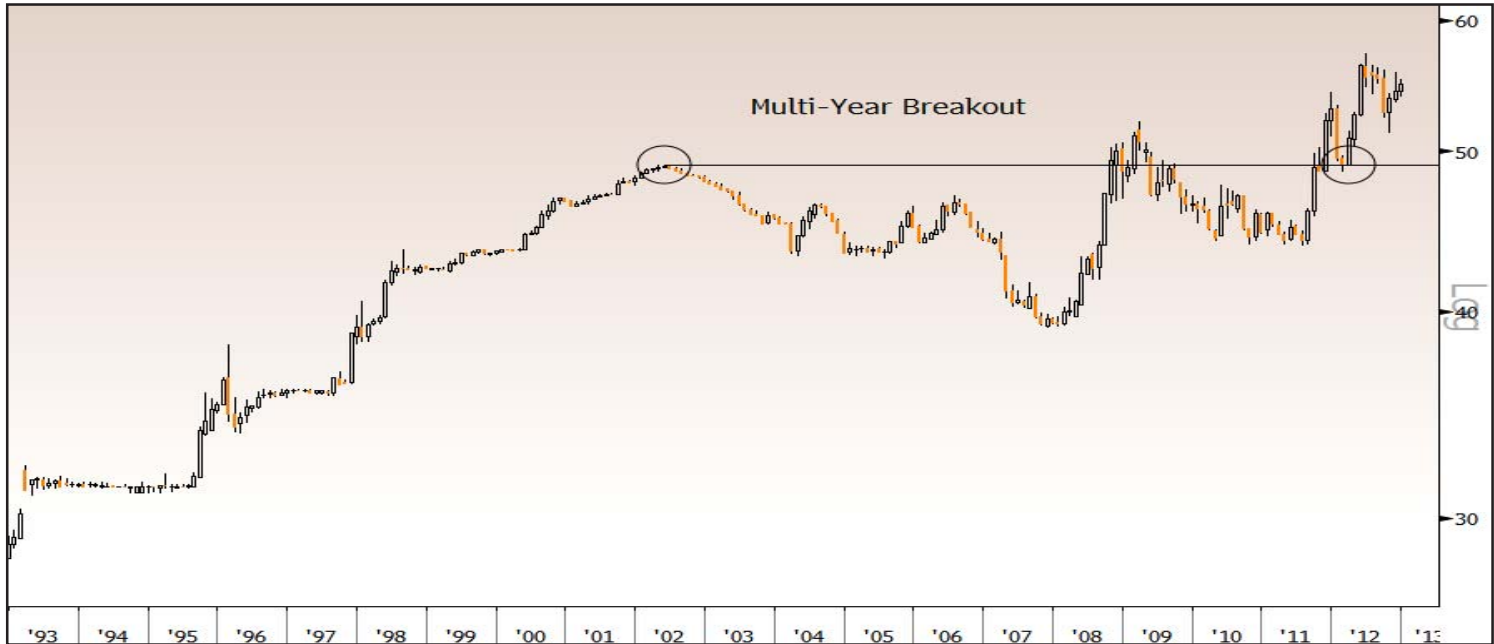
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USDINR

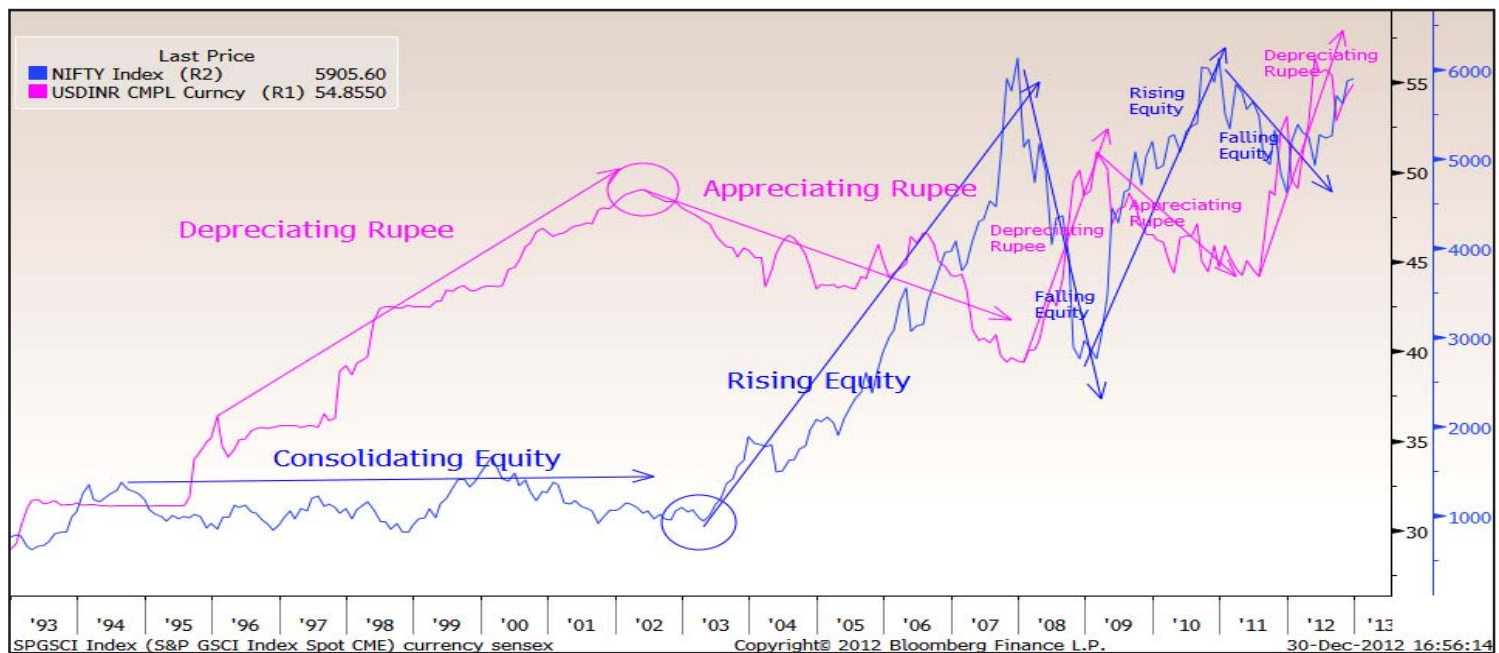
Chart 9



Rupee against dollar entered a phase of strength in 2002 and ended its momentum in late 2007. The trend prior to 2002 was a steep depreciation in rupee and after a multi-year consolidation, the currency can resume its trend of depreciation. Such a view calls for caution for Indian Equities.

Comparison Nifty vs. USDINR

Chart 10



The relationship of Nifty with USDINR is inverse and depreciation in rupee has ended up with a long term consolidation for Indian equities. With rupee expected to depreciate, long term trend in equities can remain oscillating to sideways.

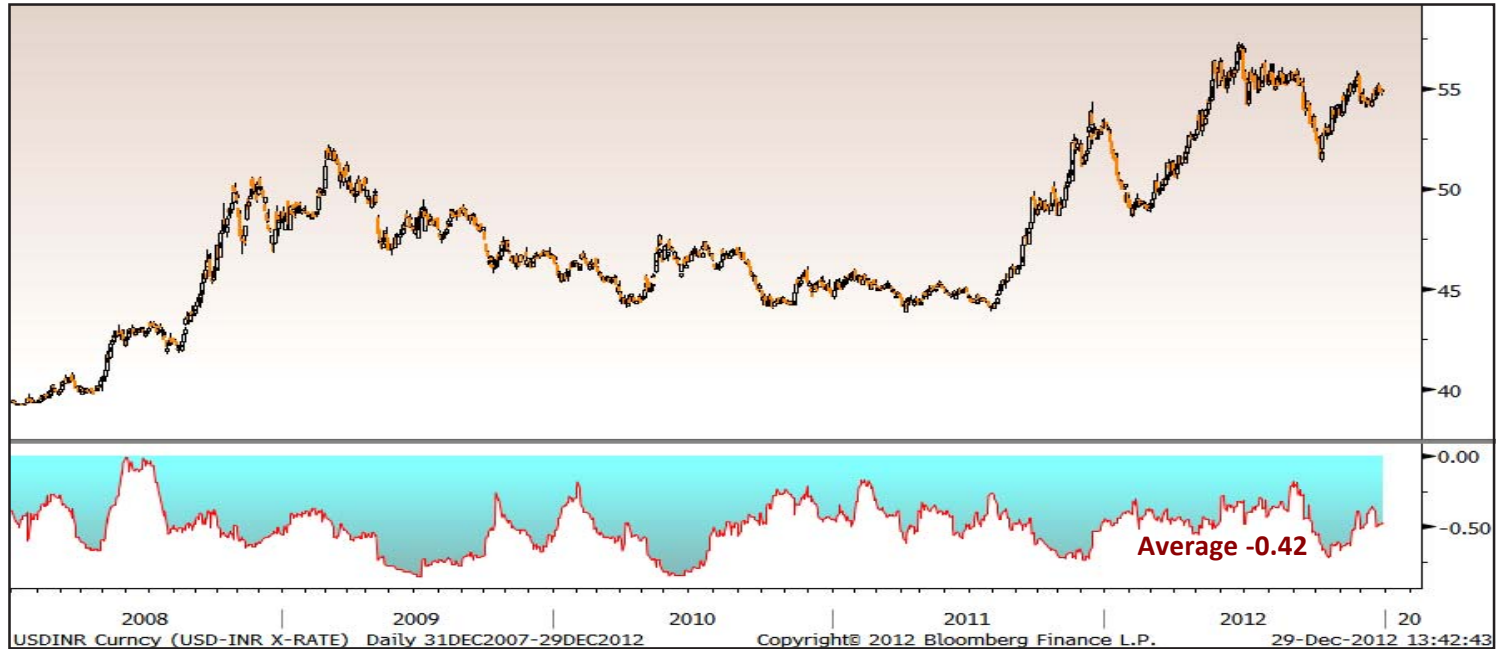
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Nifty vs. USDINR - Correlation

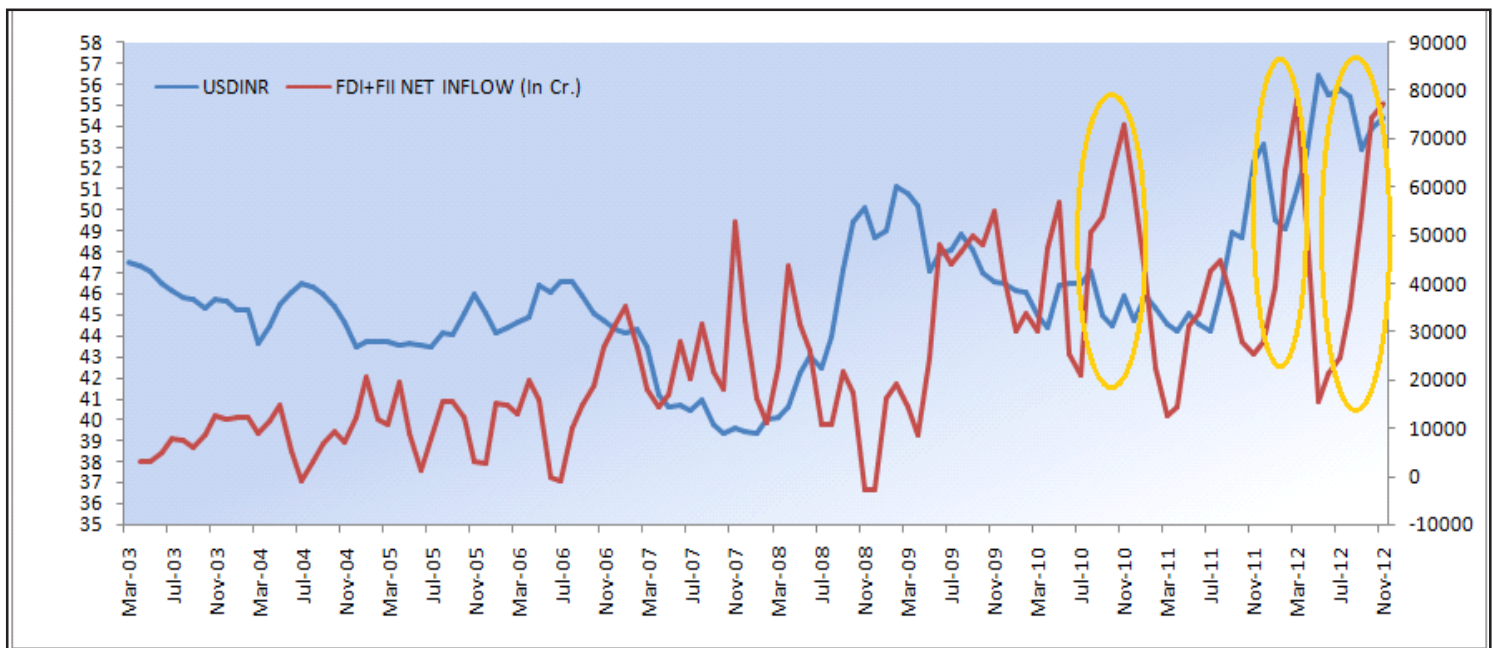
Chart 11



The medium term smooth correlation of Nifty with USDINR has historically been negative with not a single data point above zero. The current correlation is around the average indicating oscillation over the short term.

USDINR vs. Foreign Net Inflow

Chart 12



The chart explains that divergence in both the data series has been followed by negative funds flow for India. Despite the large inflow of dollars in the economy, rupee has refused to strengthen. This is an indication of a clear divergence.

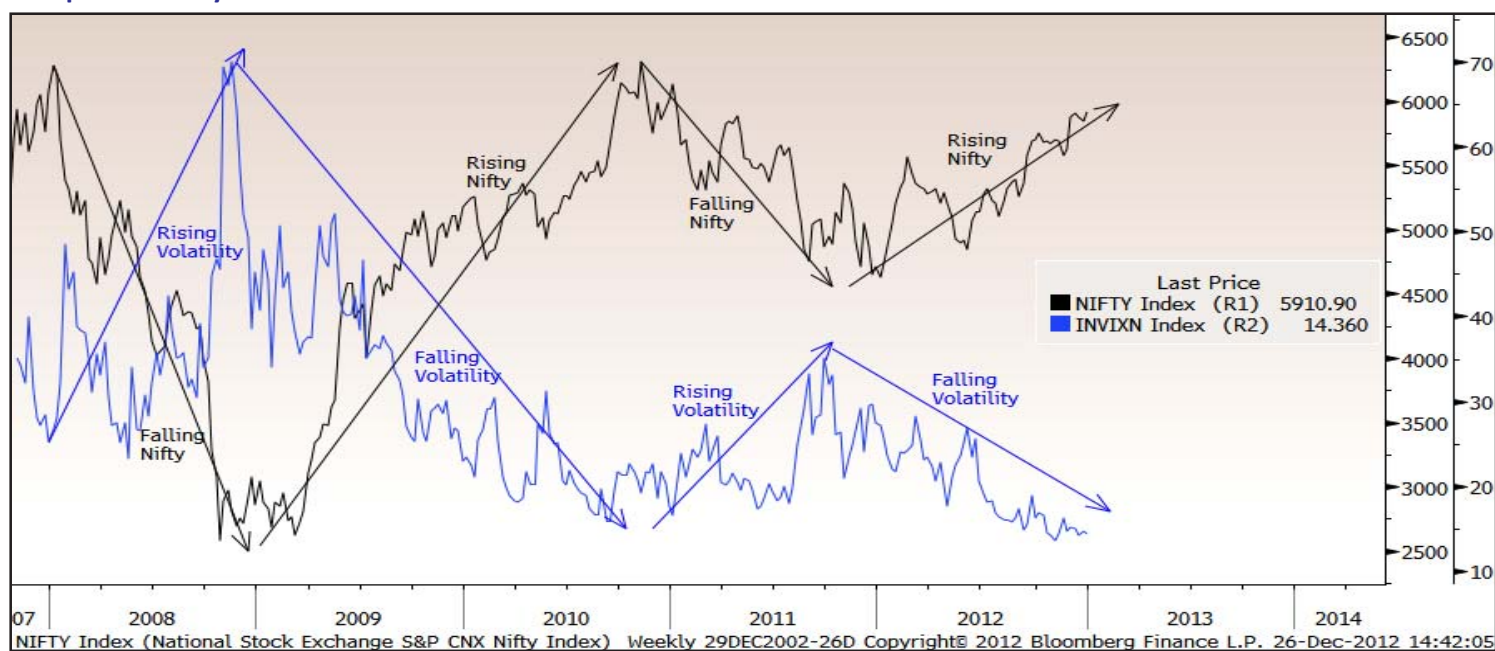
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Comparison Nifty vs. India VIX

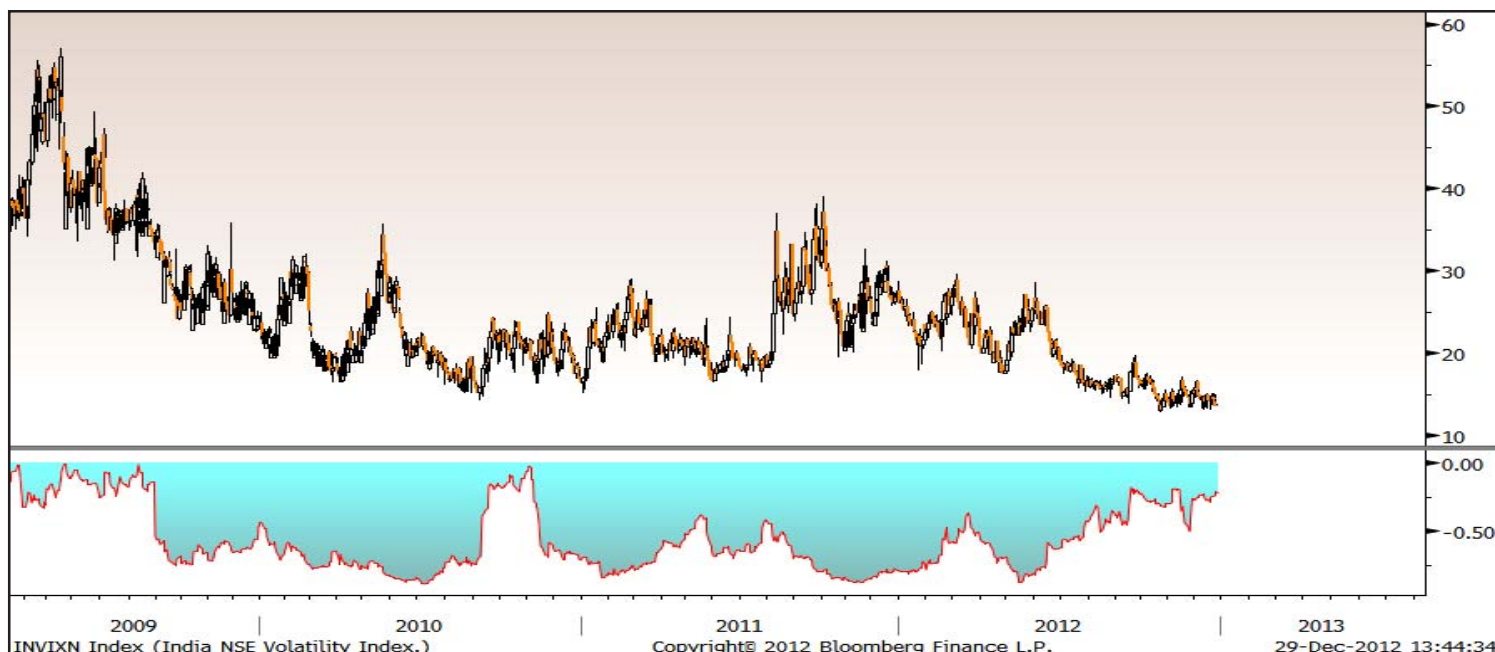
Chart 13



Nifty is inversely correlated with Volatility and a low level of volatility is a positive for the Nifty. Reversal in Vix will lead to a red flag for the continuation of uptrend in equities.

Nifty vs. India Vix

Chart 14



Medium term smooth correlation of Nifty with India Vix indicates a consistent flow in negative correlation. This correlation varies in strength from time to time. The current correlation is above average and could reach an extreme over the near future.

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Global Vix Index - Z-Score (Statistical Indicator)

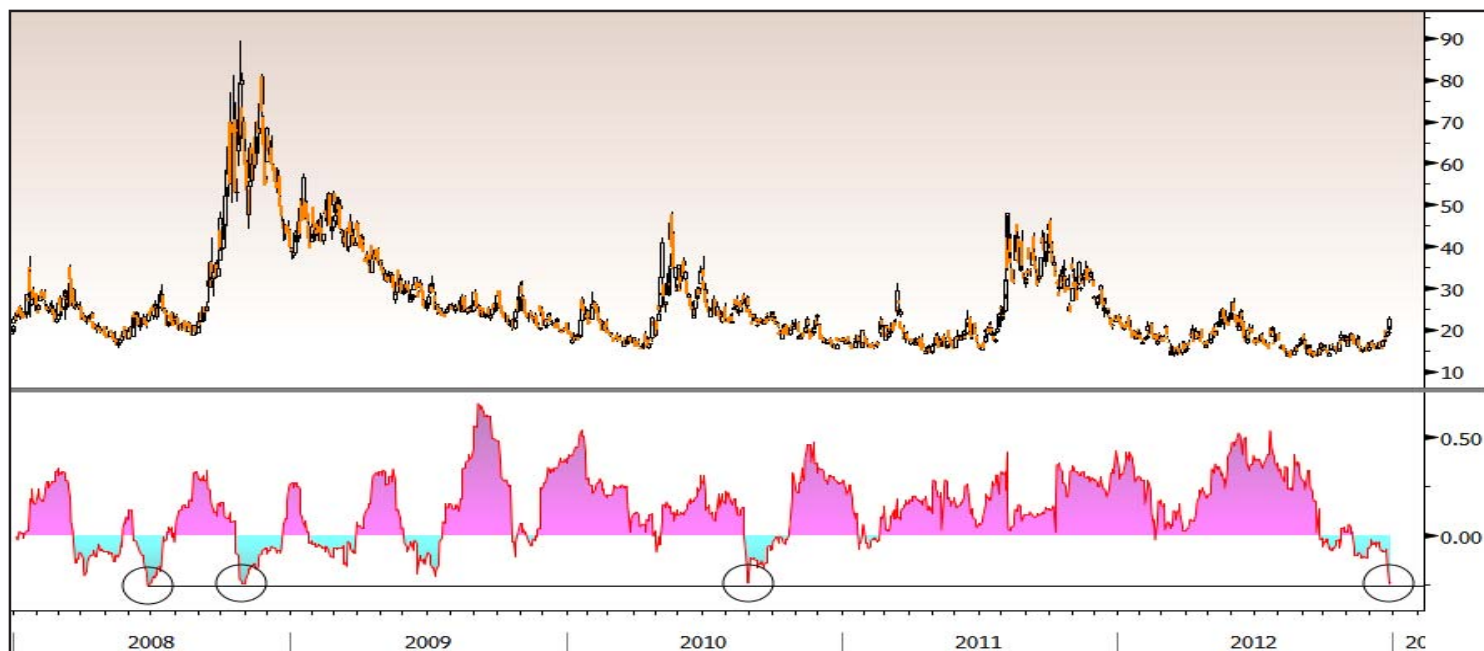
Chart 15



Z-score indicator on Global Vix has started to move up, indicating a reversal in Global Vix. In the case of rise in Global Vix, the diversification benefit of Emerging markets can diminish and world markets can get highly correlated.

India Vix vs. Global Vix

Chart 16



The correlation of India Vix with Global Vix is oscillating and the indicator has reached a lower historical extreme of decoupling. This indicates that India Vix can be expected to move towards equilibrium with Global Volatility.

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India Vix - Z-Score

Chart 17



A statistical indicator of Z-score has reached its historical lower extreme which suggests that a reversal could be expected in India Vix.

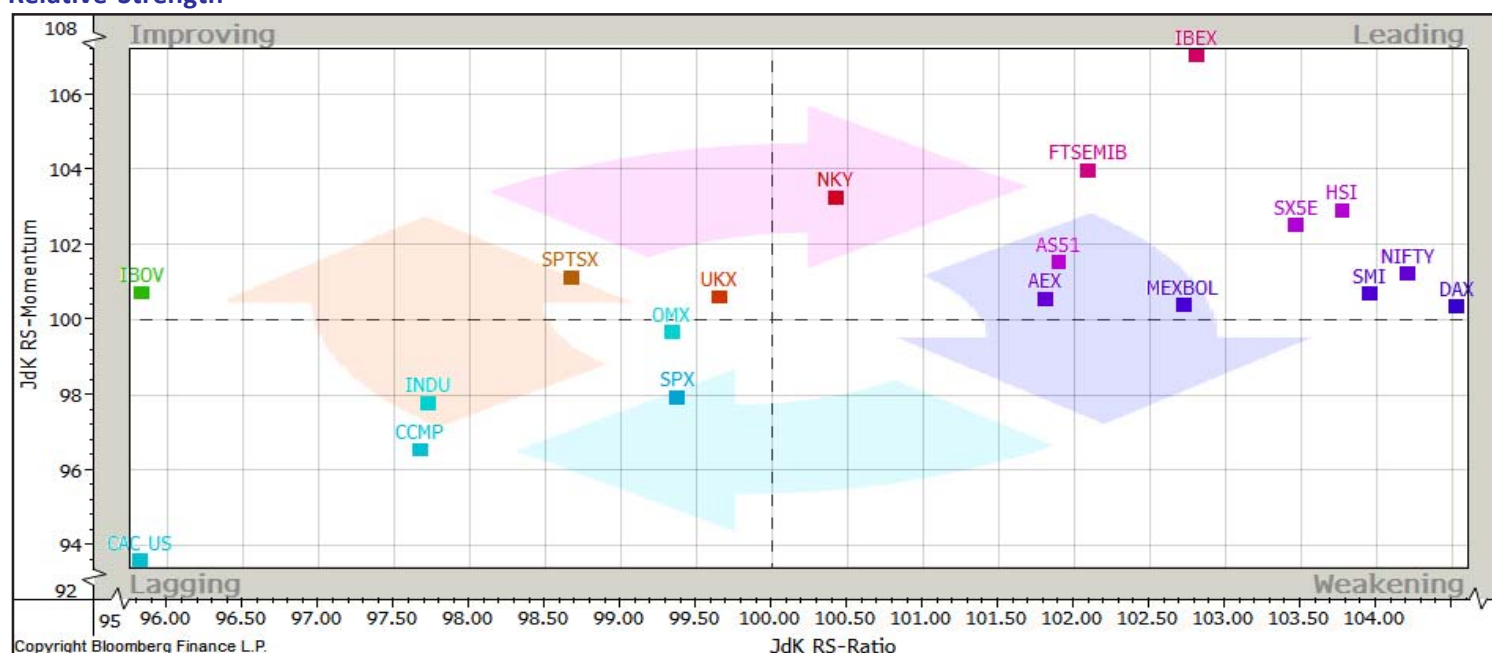
Conclusion

Commodities are expected to an increasing positive correlation with Nifty. India Vix is expected to increase over a period of some months which is negatively correlated with Nifty. Trend indicates depreciation in rupee, which is a risk factor.

Global Equity Rotation

Relative Strength

Chart 18



Nifty is at a verge of breaking below the support of the global equity rotation chart on the major world indices. The funds flows from FII's were positive for past few months and India saw one of the highest funds inflows during the year. A confirmation of underperformance from Nifty will be a sign of caution which could trigger negative funds flow from foreign investors.

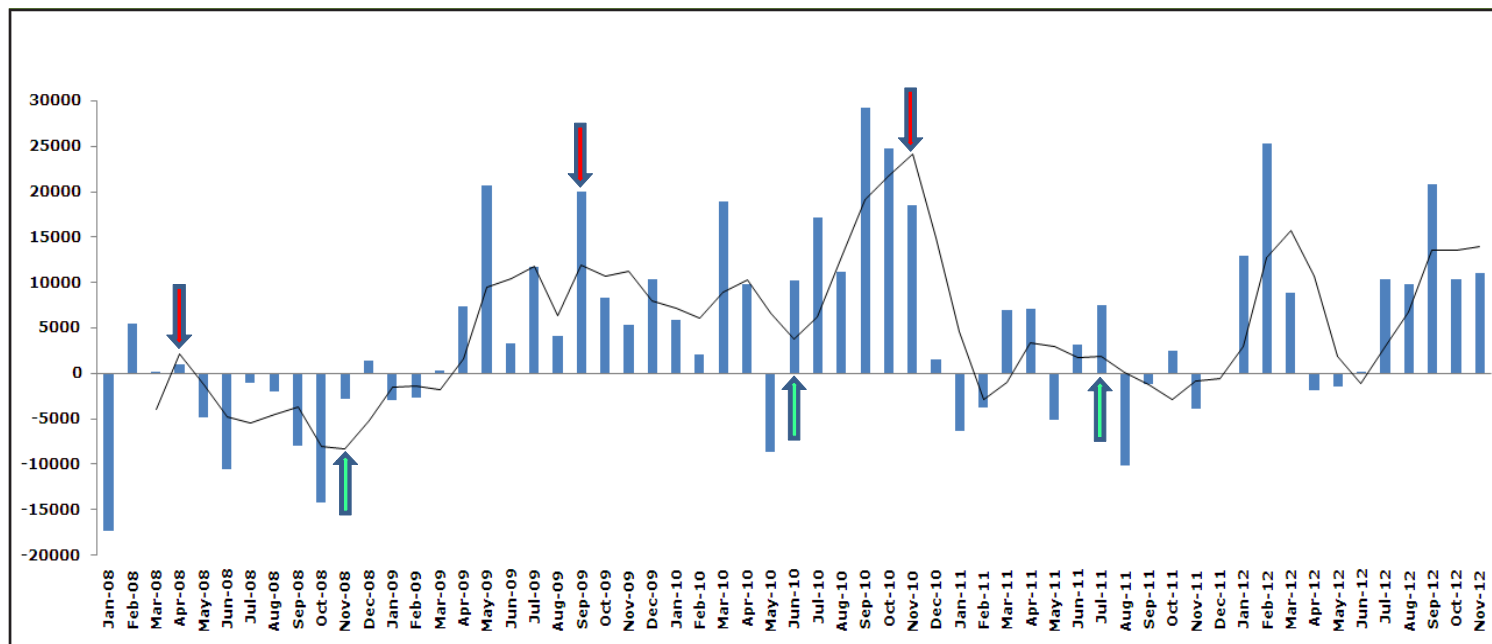
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Back-testing - Global Equity Rotation

Chart 19



A back-testing of the signals from the global equity rotation is stated above. Out of six signals generated, five have had positive results. Currently the indicator continues to remain on the buy side and needs to be followed closely for an indication of reversal followed by confirmation from price action.

Economic Indicator

Bloomberg Actual/Forecast

Chart 20

Country	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Economic Activity										
1) Real GDP (YoY%)	9.25	9.60	9.65	8.18	6.43	8.88	7.50	5.30	5.60	6.50
2) CPI (YoY%)	3.97	6.26	6.38	8.32	10.83	12.11	8.87	7.50	8.60	7.60
3) Unemployment (%)	-	-	-	-	-	-	-	-	-	-
External Balance										
4) Curr. Acct. (% of GDP)	-1.40	-1.15	-0.99	-2.63	-1.70	-3.43	-3.70	-	-3.70	-3.25
Fiscal Balance										
5) Budget (% of GDP)	-4.47	-3.50	-2.85	-5.21	-7.31	-4.08	-7.24	-	-5.70	-5.30
Interest Rates										
6) Central Bank Rate (%)	5.25	6.00	6.00	5.00	3.25	5.25	7.50	-	6.50	-
7) 3-Month Rate (%)	6.88	9.56	8.56	8.89	4.60	9.00	9.84	-	-	-
8) 2-Year Note (%)	6.18	7.26	7.67	4.98	5.62	7.46	8.08	-	-	-
9) 10-Year Note (%)	7.11	7.61	7.82	5.00	7.59	7.92	8.55	8.10	7.77	-
Exchange Rates										
10) USDINR	45.05	44.27	39.41	48.80	46.53	44.71	53.06	54.01	52.00	49.75

Forecasts for India's Real GDP, inflation, unemployment, current account and government budget balances refer to fiscal years.

Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2012 Bloomberg Finance L.P. SN 214602 H825-2072-0 30-Dec-12 14:48:21 IST GMT+5:30

Economic Indicators indicates a change in dynamics post 2008 and indicators like - Real GDP, CPI, Current Account Deficit and Currency indicates an economic consolidation.

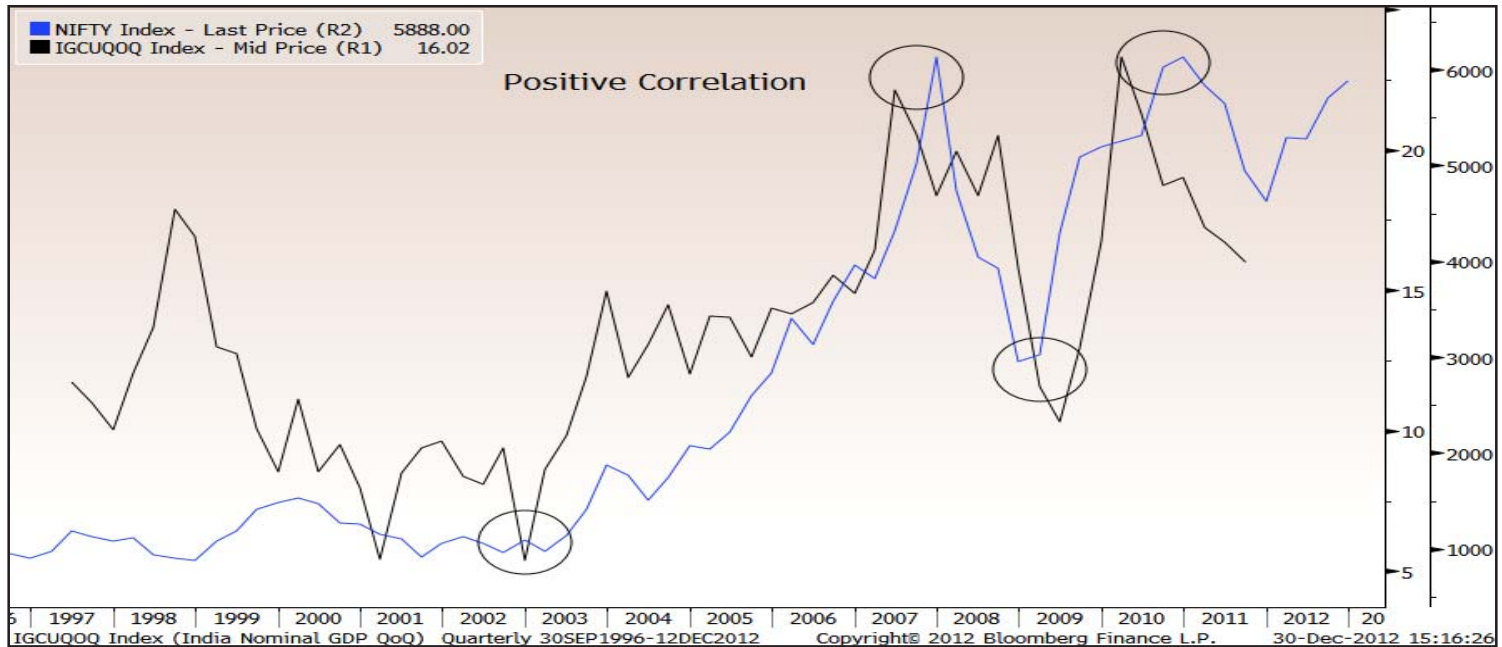
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Nifty vs. Nominal GDP

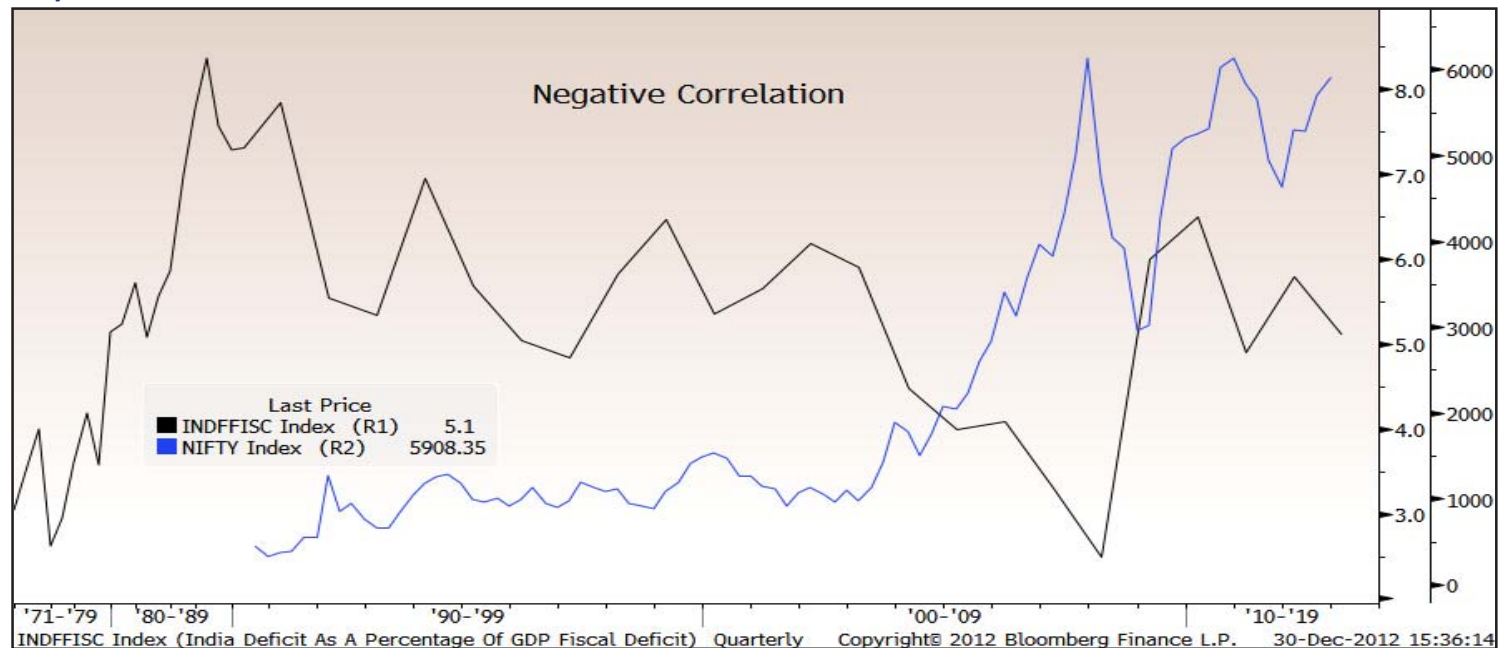
Chart 21



Nifty is positively correlated with the nominal GDP (IGCQUOQ Index). For the equities to go up, a revision is required in the expectations of Nominal GDP.

Nifty vs. Fiscal Deficit

Chart 22



Nifty has a negative correlation with Fiscal deficit and for the equities to go up, the deficit in current account needs to be addressed.

Conclusion

Nominal GDP is positively correlated and Fiscal deficit is negatively correlated with Nifty.

Macro to Micro Trends

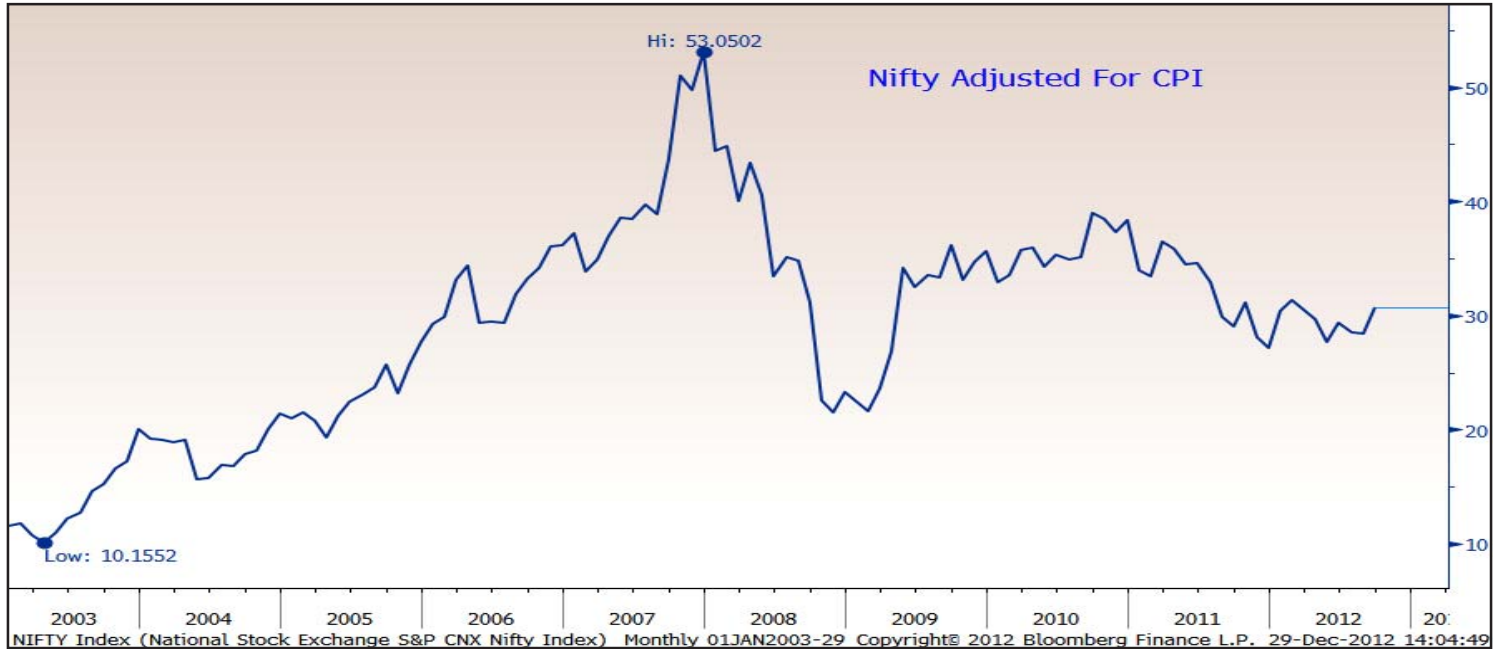
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Important Charts

Nifty Adjusted for CPI

Chart 23



Real returns on Nifty have been negative post 2007 and the downtrend in real Nifty continues unabated. So, despite Nifty moving up in absolute terms, real returns continues to remain negative.

Nifty in \$ terms

Chart 24



Nifty in dollar terms has been consistently making lower tops and the immediate resistance is placed at \$115. Only in the case the level is taken out on the upside, we can expect the funds flow to continue positive. Support for the index is placed at \$87.

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Nifty Price/Estimated Earnings

Chart 25



Nifty to Estimated earnings has a noticeable trend and an important band of exhaustion is placed between 15 -16. After breakdown in the relative chart in early 2011, the ratio has turned as an important resistance and until this headwind is taken out, the Nifty is expected to consolidate.

Technical Studies

Gann Angles

Chart 26



Support for Nifty according to the long term 1*1 angle was tested in late 2008 post which the 1*2 angle has been in action (providing support to uptrend). The trend line has support placed at 5600.

Macro to Micro Trends

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Optimized Stop Loss

Chart 27



A study of optimized stop loss for Nifty provides support on Nifty at 5700 and until the level is taken out the trend can be assumed to remain positive.

Nifty P&F

Chart 28



The point & figure chart is placed positive and is an healthy uptrend after the breakout from a downward sloping 45 degree trend line in early 2012. None of the upward sloping trend line is breached and this indicates that there is no sign of reversal from absolute price chart of Nifty. Support for the index is placed at 5650.

Conclusion

Individual studies of Gann Angles, Optimized Stop loss and Point & Figure indicates support in the zone of 5600-5700.

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Elliot Wave Analysis

Nifty Long Term

Chart 29



Nifty was sideways from 1992 to 2002 (both inclusive) accounting for a consolidation of 11 years. The sideways territory was broken with many changes in market dynamics and developments in early 2000's. The market turned more liberal to Foreign investors and liquidity increased with commencement of Futures market.

Nifty Wave Counts

Chart 30



Nifty has almost formed a full set of 8 Wave patterns from 2003 till date & the Wave C is still in progress.

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Wave Handbook

Wave 1

- ✓ Vertical rise after a long consolidation
- ✓ Sub-waves i & iii were motive while sub-wave ii was corrective

Wave 2

- ✓ An a-b-c correction
- ✓ Wave 2 ended approx 61.8% retracement of Wave 1

Wave 3

- ✓ Not the shortest wave
- ✓ Comprises of 5 sub-waves
- ✓ Sub-wave ii was an a-b-c correction and sub-wave iv was a simple correction

Wave 4

- ✓ Simple correction
- ✓ Did not enter the area of Wave 1
- ✓ Alternation to Wave 2
- ✓ Correction ended at approx 50% of Wave 3

Wave 5

- ✓ Consisted of 5 waves with sub-wave 3 as extended
- ✓ The sub-wave v was an ending diagonal

Wave A

- ✓ The correction ended at degree Wave 4

Wave B

- ✓ Complex pattern with a flat correction up to Wave 5

Wave C

- ✓ Still in action until the wave is negated with sustenance above 6400
- ✓ Immediate crucial point at 5970

Fibonacci Relationships

- ✓ Wave 2 approx 61.8% of wave 1
- ✓ Wave 3 approx 100% of wave 1
- ✓ Wave 4 approx 50% of wave 3
- ✓ Wave 5 approx 161.8% of wave 3
- ✓ Wave A approx 100% of wave 5
- ✓ Wave B approx 100% of Wave A
- ✓ Wave C approx 50% of Wave B (still in progress)

Important Notes

- | | |
|---|--|
| ✓ Wave 3 not the shortest wave | ✓ Wave 5 ended with an ending diagonal |
| ✓ Wave 4 was alternate to wave 2 | ✓ Wave A ended around wave 4 |
| ✓ Wave 4 did not enter the area of wave 1 | ✓ Wave B flat correction to wave A |
| ✓ Wave 5 was extended | |

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Wave 1 & 2

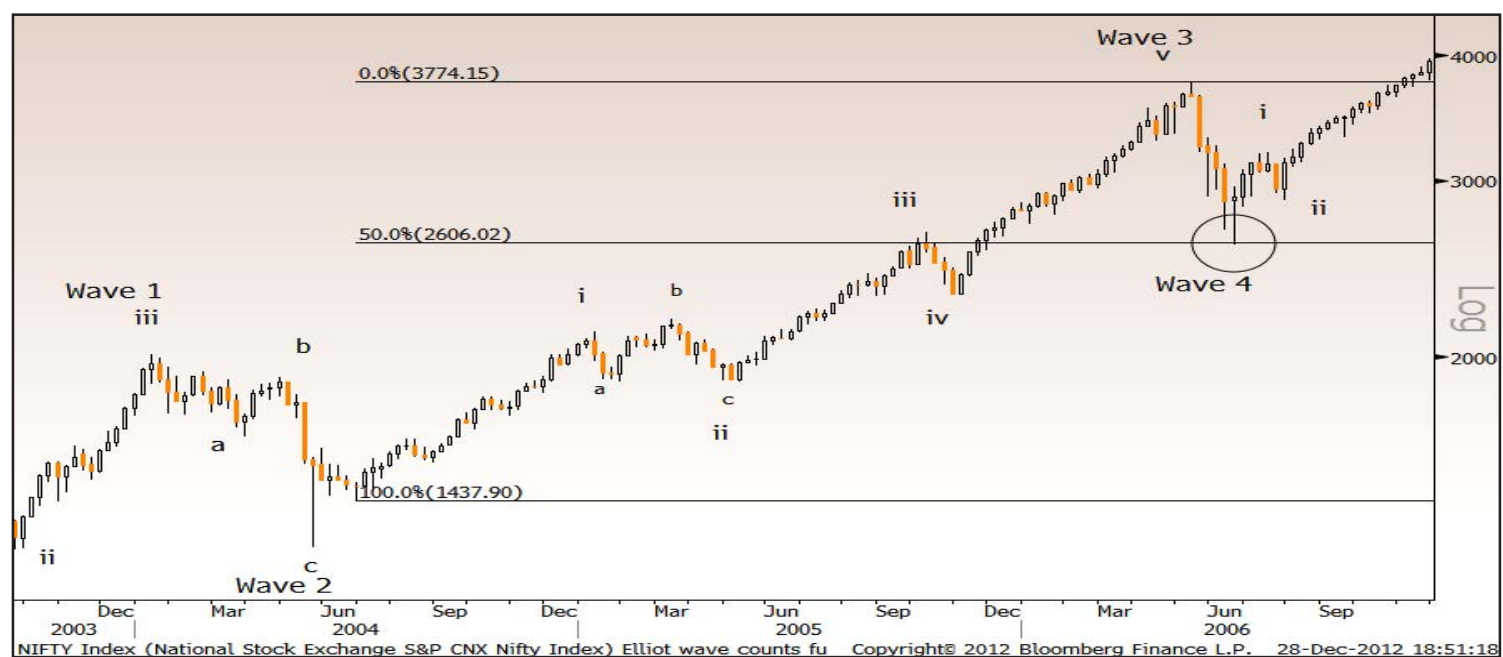
Chart 31



Wave 1 had three sub-waves and wave 2 ended its correction at approx 61.8% Fibonacci retracement which is the expected retracement to the rally after a decade of sideways consolidation.

Wave 3 & 4

Chart 32



Wave 3 was not the shortest wave among the five wave pattern and Wave 4 ended approx 50% Fibonacci retracement to the rally. Wave 4 did not enter the area of Wave 1 and justifies the rule to label the wave.

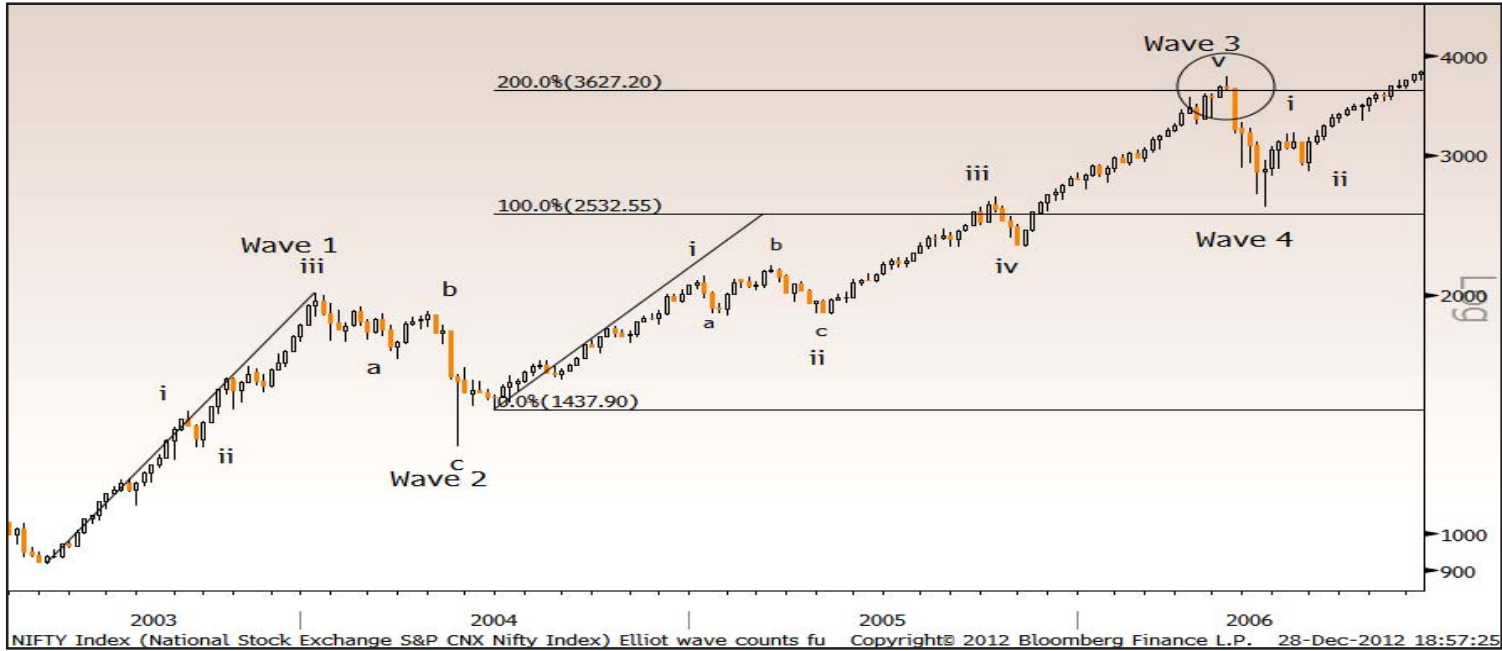
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Wave 1 & 3

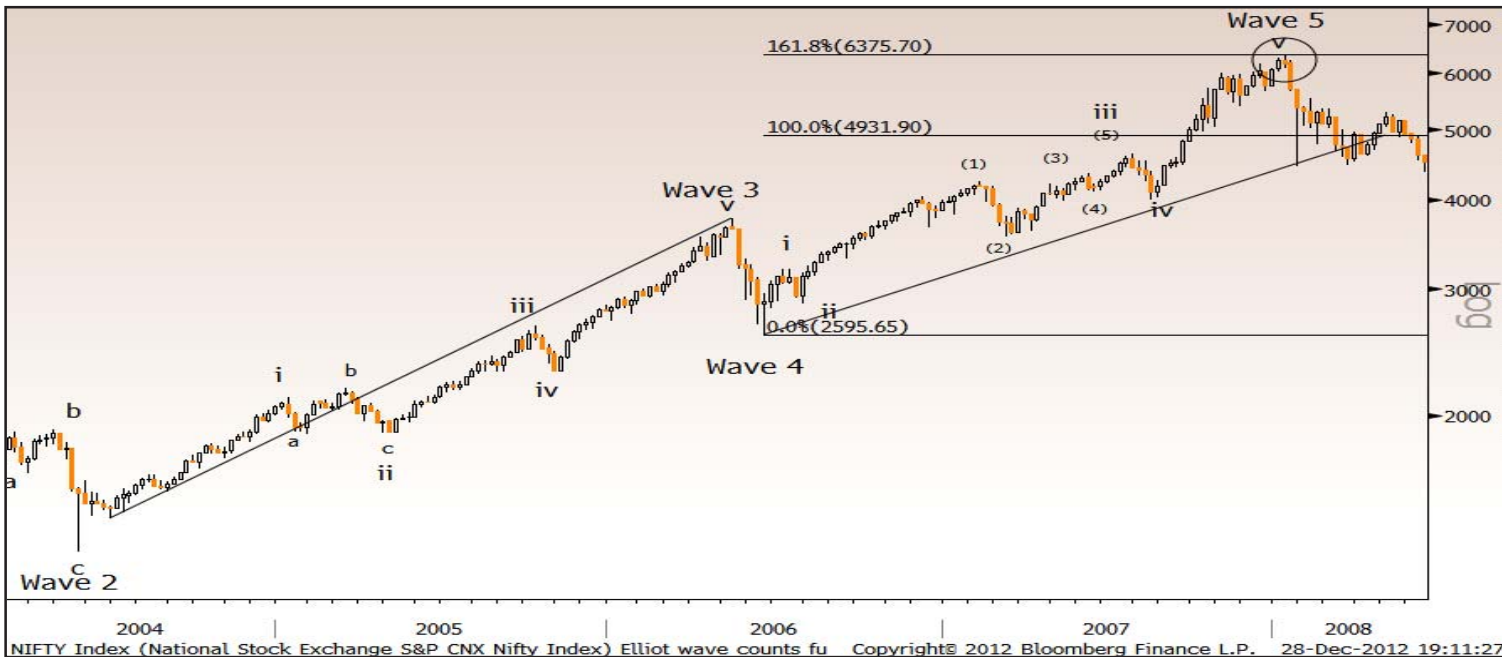
Chart 33



Wave 3 was Fibonacci related to Wave 1 with a 200% of extension.

Wave 3 & 5

Chart 34



Wave 5 was Fibonacci related to Wave 3 with an extension of 161.8%. Wave 5 ended with a formation of an ending diagonal which is generally expected in the last leg of Wave 5. The pattern was best placed at the top which led to reversal in trend.

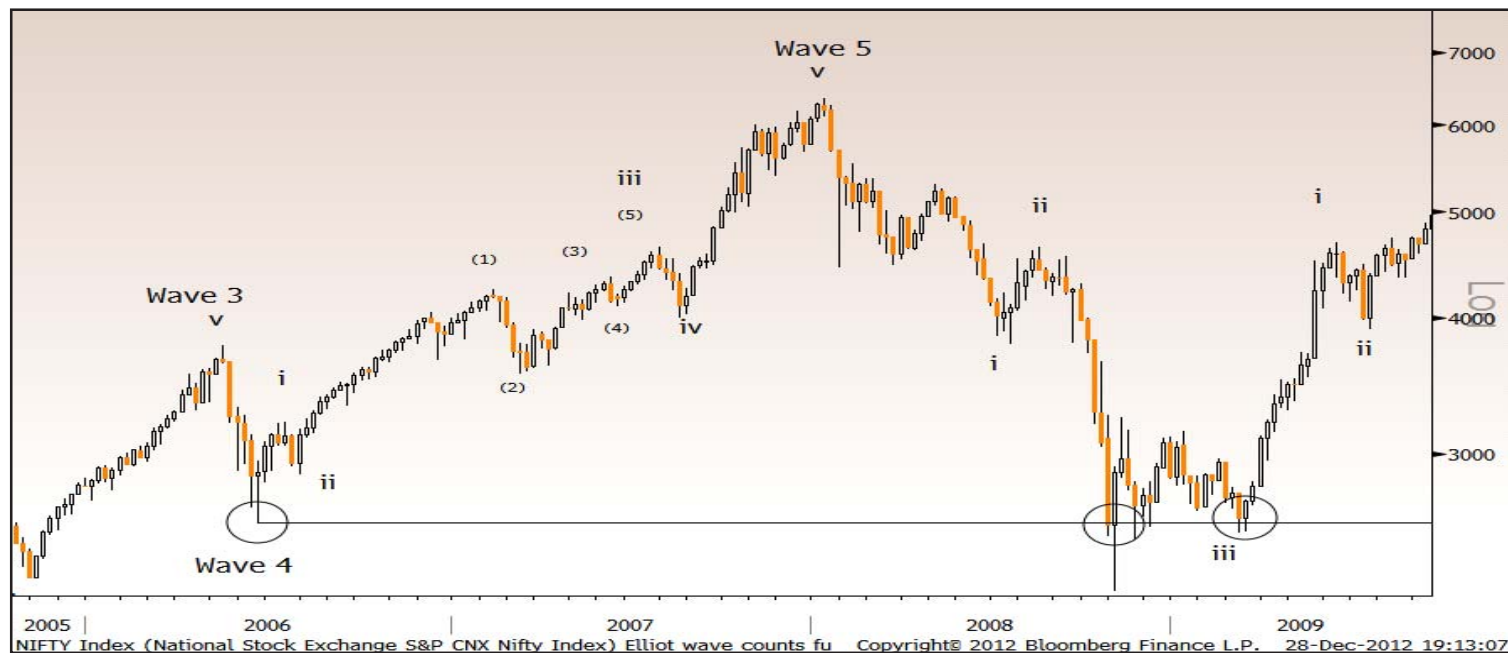
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Wave 4 & A

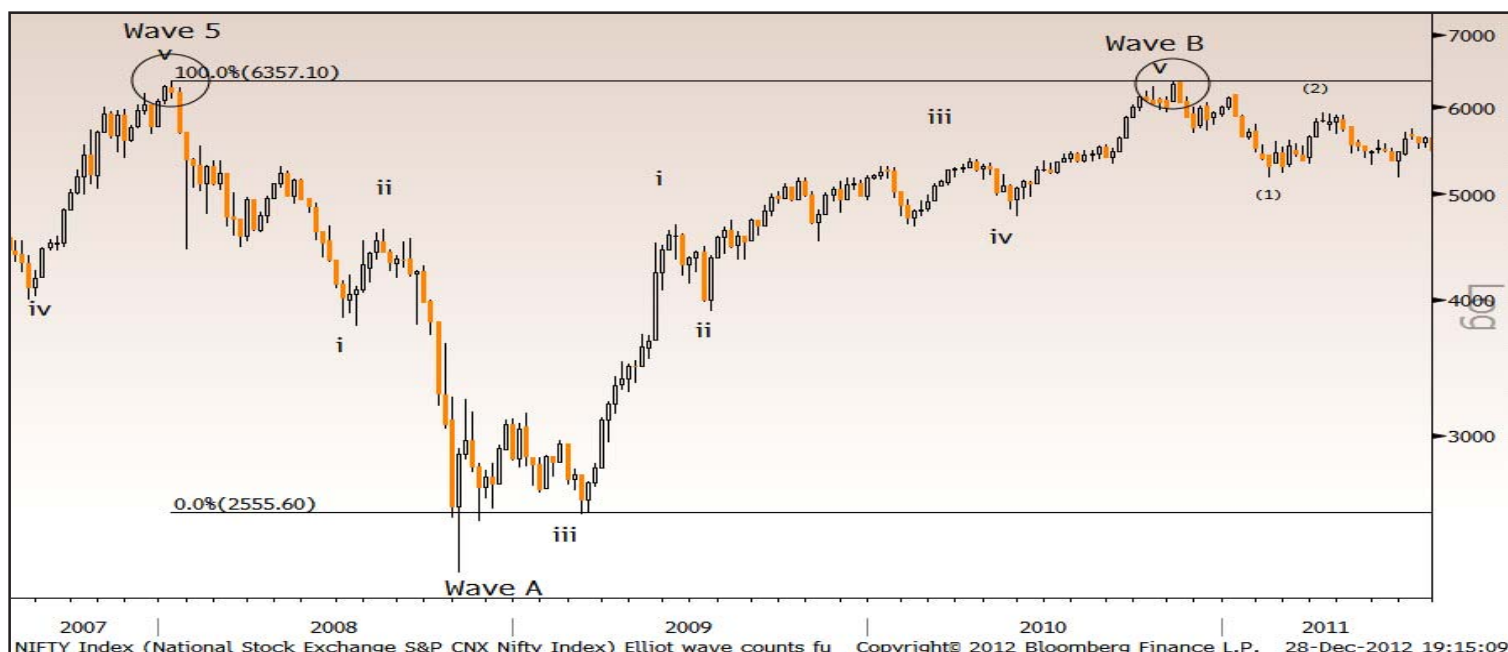
Chart 35



Wave A is generally expected to end around of above Wave 4 and the correction of 2008 ended at the exact support of through at Wave 4.

Wave B

Chart 36



Wave B was a flat correction to Wave A and retraced 100% of the movement. The probability of an extended flat was negated with a lower low confirmation after some months, indicating start of Wave C.

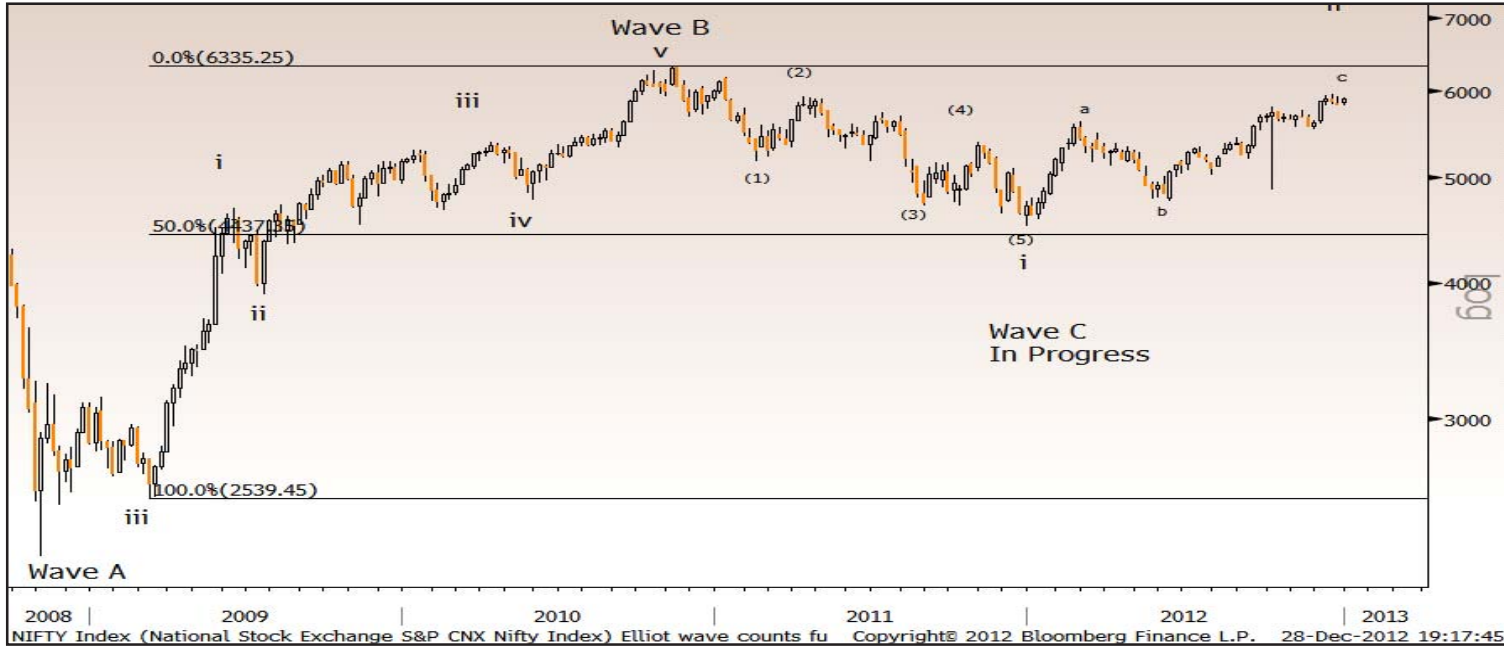
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Wave C

Chart 37



Retracement Wave C

Chart 38



Conclusion

Wave C is in progress which indicates crucial point of resistance at 5970 / 6350. The a new wave count will start only on sustenance above 6400, which will be a sign of a new expected bull run.

Macro to Micro Trends

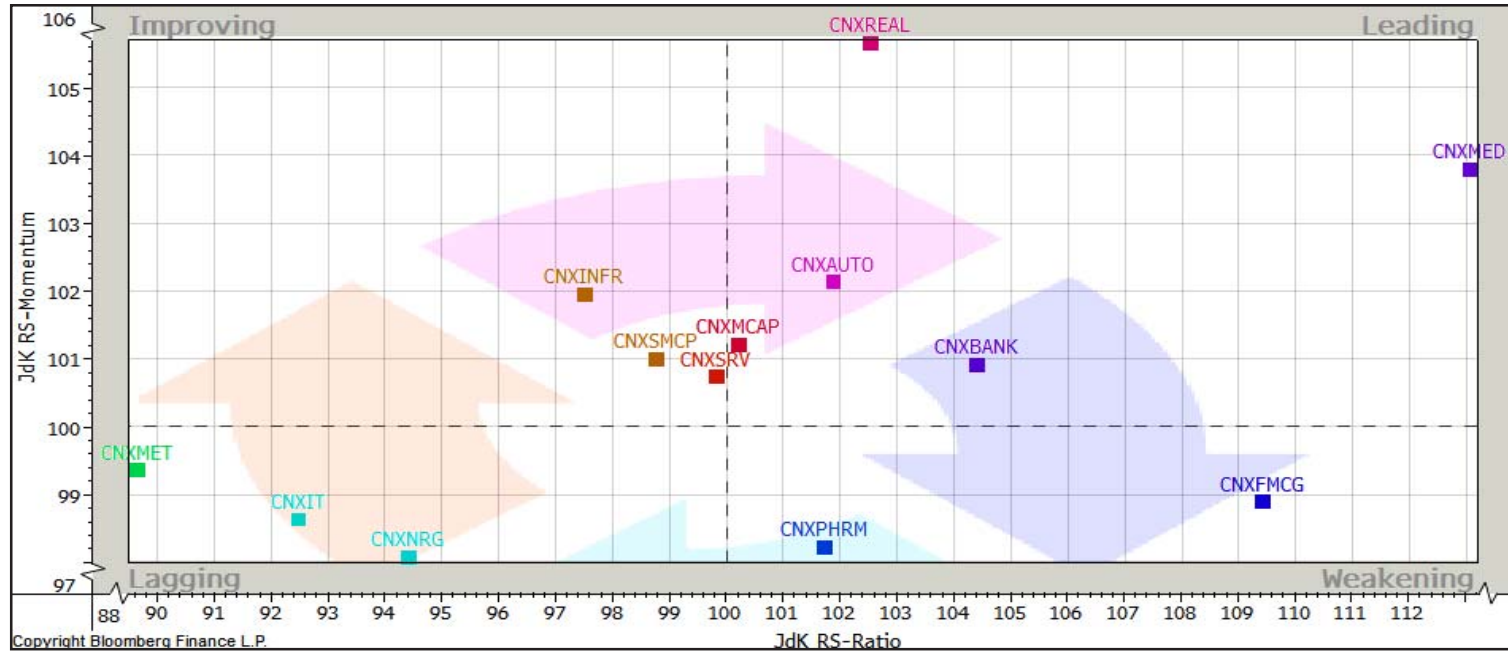
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Sector Rotation

Sectors

Chart 39



Sector rotation chart indicates that cyclical can outperform the Nifty in the case stated support levels are held. Top sectors to buy are - Media, Realty, Auto, Mid-caps, Infra, Banks & Metals. In the case Nifty breaches below support levels, selling opportunities can be seen in IT and Energy.

Fundamental Picks for 2013

1st January, 2013

Large Cap

Maruti

AUTOMOBILE

CMP : 1,490

Target : 1,730

52 Week: High / low : 1,540 / 971

- ✓ Operating environment improving with stable labour relationship and lower discounting
- ✓ Diesel engine availability to improve from Sep'13 with new capacity
- ✓ YEN weakening reduces payout on royalty and imports and adds to EPS
- ✓ Maruti to make cars in Sri Lanka and Africa - a true MNC

NMDC

METAL

CMP : 165

Target : 217

52 Week: High / low : 206 / 149

- ✓ India's largest iron ore producer with a capacity of 32mtpa
- ✓ Iron ore volumes to grow at a CAGR of 13% to 39mtpa over FY12-15
- ✓ Post offer for sale, NMDC's free float of 20% could allow index entry
- ✓ Global acquisitions could add to growth

DLF

REAL ESTATE

CMP : 230

Target : 286

52 Week: High / low : 261 / 170

- ✓ India's largest listed Real Estate company with 34 cr sq ft of development potential
- ✓ FDI in multibrand retail coupled with expected interest rate cuts - positives for Real Estate
- ✓ Sale of non-core assets to bring in cash - NTC mill land in Mumbai, Aman Resorts and windmills
- ✓ Near-term debt reduction of INR40-50b (target net DER 0.6x by FY14-end)

IndusInd Bank

BANKING

CMP : 417

Target : 500

52 Week: High / low : 436 / 222

- ✓ Rapid branch expansion (to 441 from 210 in FY10) adds customers, CASA and cross-selling fees
- ✓ FY12-15 loan CAGR of 25% is well above Industry growth
- ✓ Capital infusion of INR20b will improve Tier 1 capital to 15%+, no capital raising for next 3 years
- ✓ FY14 EPS upgraded by 8%, target by almost 20%

Fundamental Picks for 2013

1st January, 2013

MidCap

Karur Vysya Bank

BANKING

CMP : 560

Target : 725

52 Week: High / low : 565 / 340

- ✓ One of the best managed private sector banks with 10 year CAGR of 20% in net profit and delinquencies less than 2%
- ✓ Business size to be 2x by FY16 as company will increase branches to 700 from 500 currently.
- ✓ Highest dividend yield of 3% amongst all private sector banks and trades at 10% discount to them at 1.7x FY14E ABV (ex HDFC Bank).

GMDC

UTILITIES

CMP : 216

Target : 284

52 Week: High / low : 222 / 158

- ✓ Monopoly in lignite mining in Gujarat
- ✓ 15 cr tonnes of lignite reserves, 10 cr to be added in new mines
- ✓ Strong cash flows to add to current cash pile
- ✓ Industry leading EBIDTA margin of 47% in last 5 years

Mcleod Russel

CONSUMER

CMP : 350

Target : 410

52 Week: High / low : 372 / 175

- ✓ The largest tea producer in the world.
- ✓ Prices up 15% as adverse weather reduce India's tea production with demand steady
- ✓ Strong tea prices in new season to improve profits in FY14.

Canfin Homes

NBFC

CMP : 152

Target : 230

52 Week: High / low : 165 / 86

- ✓ Highest ever disbursement growth of 51% in H113 vs 10 year CAGR of 9%
- ✓ 24 new branches in the last 18 months vs NO branch additions during 1998-2011
- ✓ Inexpensive valuations, cheapest amongst all HFCs.

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