Morgan Stanley

February 3, 2012

INSIGHTS

India Strategy

A New Bull Market?

MORGAN STANLEY RESEARCH
Asia

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Key debate: Narrow indices are past their 200DMA for the first time since February 2011. Sector rotation has hit a 15-month high. Cyclicals are back and the so-called defensives have underperformed. These are tell-tale signs of a new bull market. Is this a case of the market telling us where the fundamentals are heading or is this a head fake? Simply put, are we in a new bull market?

First, our view

New bull markets are started by favorable liquidity conditions and attractive valuations. At the end of December, both ingredients fell into place. Bull markets make progress as fundamentals improve. Fundamentals can come in various forms such as technology changes and favorable demographics, but ultimately all these changes imply upward revision in growth forecasts. Not surprisingly, fundamentals remain fuzzy. The market continues to have support from skeptical positioning and low expectations. We expect upward progress, although the pace of the recent move may induce volatility.

Now, the facts

If this is indeed a new bull market, the preceding bear market at 60 weeks and -26% return will prove to be the shortest and shallowest in 20 years – a far cry from the average 50% fall seen in previous bear markets. Valuations are around 30% higher than what they were at the end of the previous three bear markets. This could create doubts about this being the start of a new bull market.

The jury is out, but bears will be tested

What do we need to be sure that this sustains as a new bull market? The key difference between the 2003-08 period and now is that global growth is no longer supportive. To that extent, it needs an extra policy push to pull India's growth rate back to trend. Corporates are suffering from poor profitability – inflation needs to remain moderate for that to improve. That will also help rates to fall. The key risks remain Europe and oil. India needs time to adjust its macro to absorb risks from Europe and oil. If these risks do not unfold in say the coming six months, the second half of 2012 may prove to be even stronger for equities. None of these are differentiated insights, but the good news is very few believe these events will happen, and markets sometimes favor climbing walls of worries.

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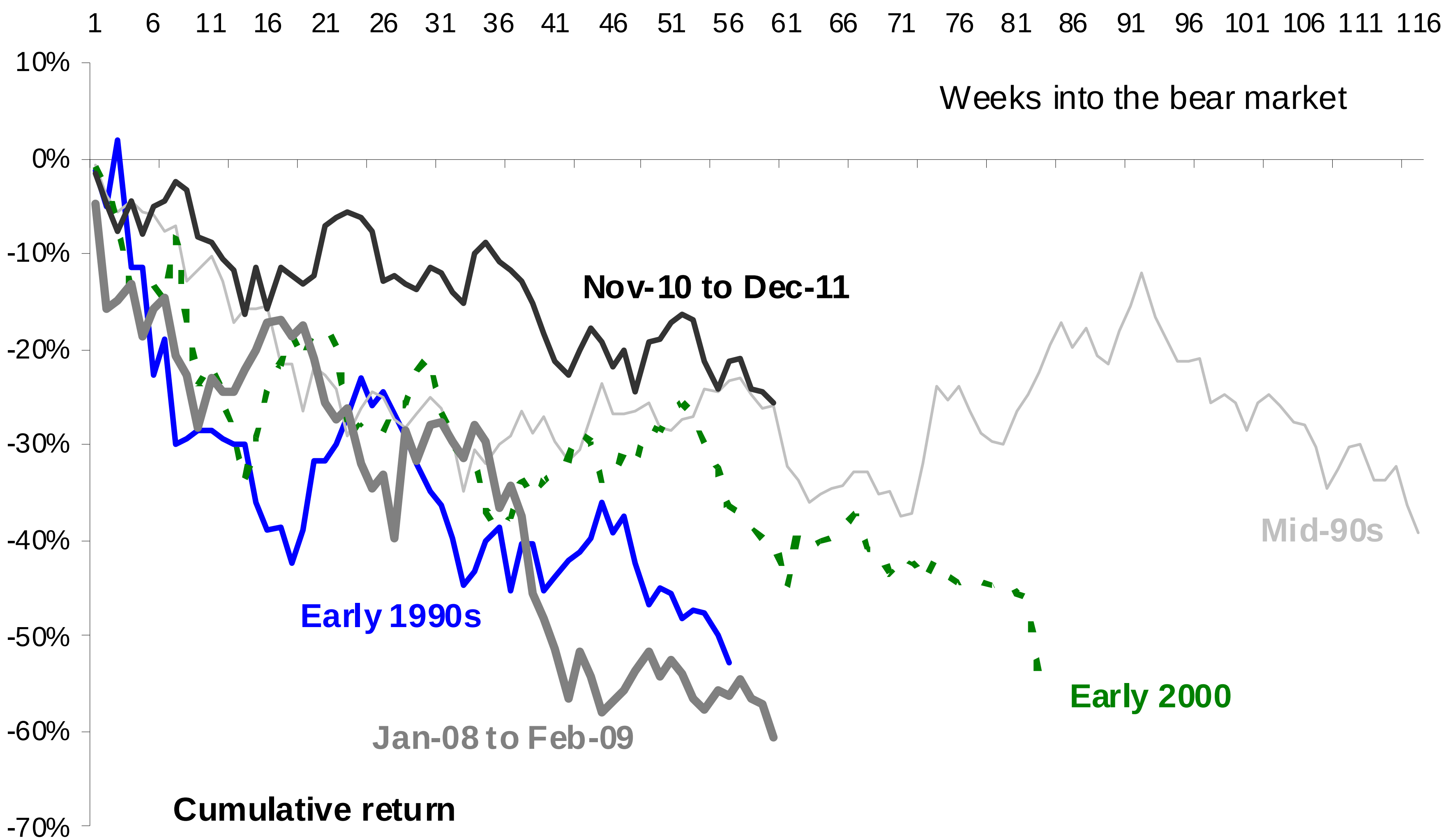
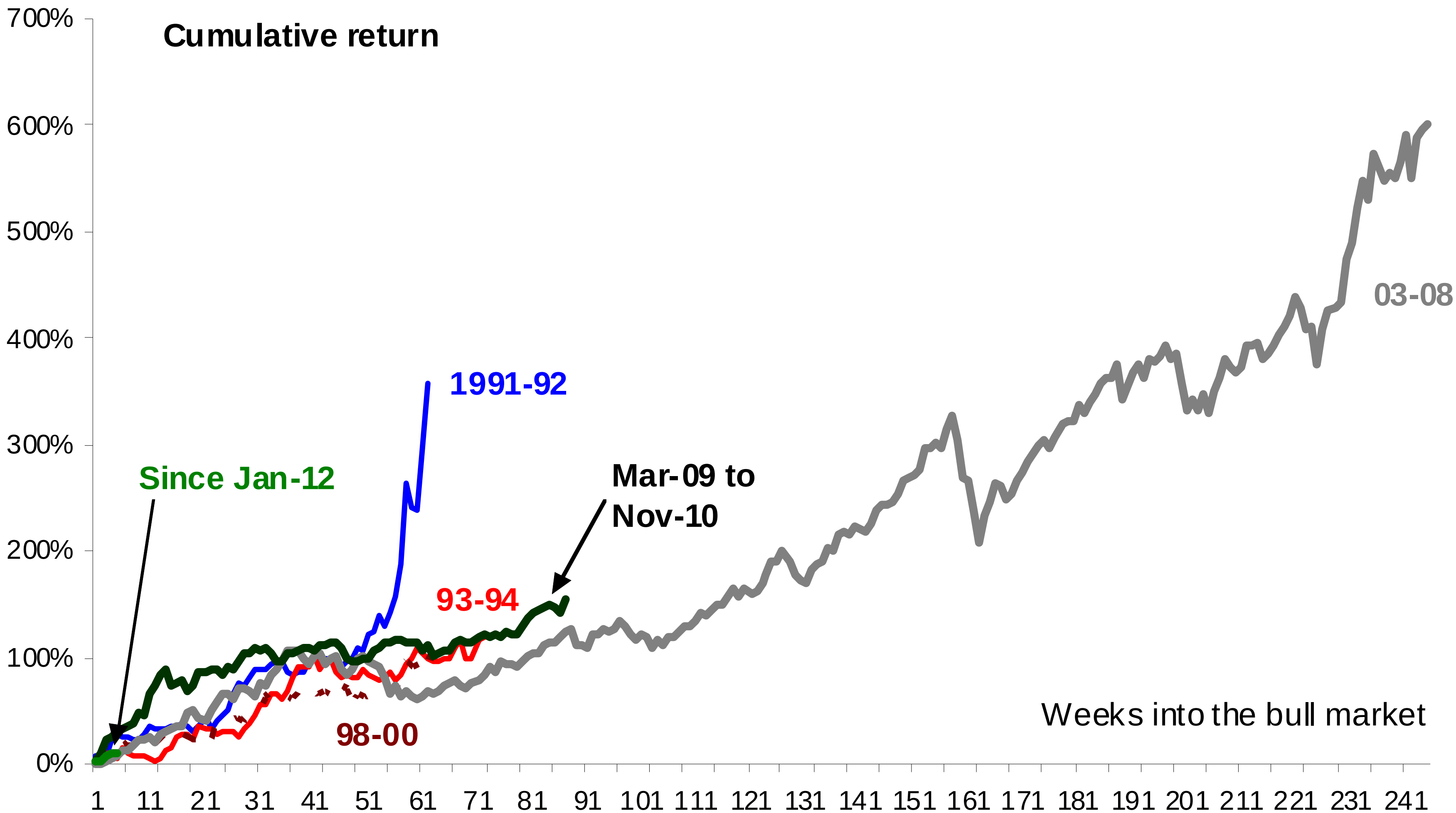
If the Bear Market is Over, It Was the Shortest and Shallowest in Two Decades



Source: Bloomberg, Morgan Stanley Research

Bull Markets of the Past 20 Years



Source: Bloomberg, Morgan Stanley Research

Bull Market Characteristics

	25th Jan 91 to 2nd Apr 92	27th Apr 93 to 12th Sept 94	3rd Nov 98 to 14th Feb 00	28th Apr03 to 10th Jan 08	5th Mar 09 to 4th Nov 10
Trough of the BSE Sensex	947	2,037	2,774	2,904	8,198
Peak level of BSE Sensex	4547	4,643	6,151	21,207	20,894
Number of weeks the bull mkt lasted	62	72	67	246	87
Absolute Gain (BSE Sensex)	380%	128%	122%	630%	155%
Perf of BSE 200	NA	NA	142%	664%	172%
Perf of BSE 500	NA	NA	NA	755%	177%
MSCI India Performance	NA	124%	179%	592%	165%
MSCI EMF performance	NA	71%	71%	325%	136%
Top performing sector	NA	Technology	Technology	Industrials	Financials
Worst Performing sector	NA	Materials	Cons Staples	Cons Staples	Telecoms
Trailing P/E (start of bull market)	NA	21.9	13.3	9.7	11.1
Trailing P/E (end of bull market)	NA	39.7	38.3	29.7	22.0
Trailing 12M EPS growth (end of bull market)	NA	38.9%	-19.4%	30.0%	5.8%
Trailing ROE (start of bull market)	NA	14.1%	18.0%	17.9%	20.0%
Trailing ROE (end of bull market)	NA	15.2%	18.2%	23.5%	15.8%
Currency performance (Re vs. US $)	NA	-0.1%	-3.1%	20.5%	3.2%
Peak Interest Rate (10-year treasury yield)	NA	12.4%	10.5%	8.2%	8.2%
Average weekly return during bull market	6.1%	1.8%	1.8%	2.6%	1.8%
Volatility of weekly return during bull market	4.4%	2.8%	2.6%	3.2%	3.5%
Market cap at the start of the bull market ($ bn)	24	54	104	119	555
Peak market cap ($ bn)	113	135	266	1,900	1,696
Avg Daily Turnover ($ mn) during bull market	83	119	1,167	2,454	4,468
FII flows (US$ bn) during bull market	NA	2.8	2.0	52.3	47.5
Equity Issuances during bull market (US $ m)	NA	12,365	3,449	84,497	45,791
6M return from the peak	-28.6%	-26.3%	-27.2%	-29.8%	-11.6%
Avg Industrial growth in the last 3 mths of the bull market	2.5%	3.6%	7.0%	6.3%	7.3%
Avg Inflation rate in the last 3 mths of bull market	13.5%	10.2%	3.3%	3.8%	9.0%
Peak IIP growth during bull market	7.0%	10.6%	8.1%	15.8%	15.0%

- The rise in indices tends to be different across bull markets.
- The P/E ratio invariably rises significantly and accounts for a large part of the return. This is a reflection of the market's optimism on growth outlook. The starting point for P/Es now is higher than it was in the previous three bull market starts.
- The broader market outperforms the narrow market.
- New bull markets start with very strong rallies in the first few weeks, which look quite similar to the rallies of the previous bear markets. It is no different this time, except that this is the strongest first-month move ever. **At 11%, it is more than twice the average 5% move in the first month of the previous bull markets.**
- Each bull market of the past has created new highs in average daily trading.

Source: Bloomberg, SEBI, FactSet, MSCI, CMIE, Company Data, Morgan Stanley Research

Bear Market Characteristics

	2nd April 92 to 27th April 93	12th Sept 94 to 5th Dec 96	14th Feb 00 to 24th Sep 01	11th Jan 08 to 6th Mar 09	4th Nov 10 to 29th Dec 11
Peak level of BSE Sensex	4,547	4,643	6,151	21,207	20,894
Trough of the BSE Sensex	2,157	2,736	2,627	8,047	15,544
Number of weeks the bear mkt lasted	56	116	84	60	60
Absolute loss (BSE Sensex)	-53%	-41%	-57%	-62%	-26%
Perf of BSE 200	NA	-47%	-63%	-65%	-30%
Perf of BSE 500	NA	NA	-64%	-67%	-31%
MSCI India performance	NA	-49%	-64%	-64%	-28%
MSCI EMF performance	-2%	-18%	-52%	-60%	-21%
Best performing sector	NA	Utilities	Energy	Cons Staples	Cons Staples
Worst performing sector	NA	Energy	Technology	Telecoms	Telecoms
Trailing P/E (start of bear market)	NA	37.6	38.3	29.7	23.0
Trailing P/E (end of bear market)	22.3	13.1	12.3	9.7	14.9
Trailing 12M EPS growth (end of bear market)	NA	9%	8%	11%	15%
Trailing ROE (start of bear market)	NA	16.7%	18.2%	23.5%	15.8%
Trailing ROE (end of bear market)	15.0%	18.1%	16.1%	18.3%	18.2%
Currency performance (Re vs. US $)	-8.4%	-12.4%	-8.9%	-23.7%	-16.7%
Trough Interest Rate (10-year treasury yield)	NA	12.1%	9.1%	5.0%	7.2%
Avg weekly return during bear market	-0.9%	-0.4%	-0.7%	-1.0%	-0.4%
Volatility of weekly return during bear market	3.6%	2.2%	3.0%	4.3%	3.1%
Market Cap at the start of bear market ($ bn)	60	133	236	1817	1661
Market cap at the trough of bear market ($ bn)	56	123	91	515	1008
Avg Daily Turnover ($ mn) during bear market	66	119	1624	3911	3220
FII flows (US$ bn) during the bear market	NA	4.6	3.7	-15.0	2.3
Equity Issuances during bear market (US $ m)	1,362	15,522	4,783	18025	13574
6M return from the bottom	25%	42%	38%	99%	NA
Days taken to cross previous high	881	1,765	1,425	NA	NA
Avg Industrial growth in the last 3 months of the bear market	-2%	4.9%	2.4%	-0.1%	1.1%
Avg Inflation rate in the last 3 months of bear market	7%	4.8%	5.0%	2.9%	8.8%
12 M rolling current account to GDP	-1.8%	-2.6%	-1.3%	-2.4%	-2.7%
Trough IIP growth during bear market	-3.2%	2.2%	1.6%	-0.1%	-4.7%

- The average decline in the narrow index is around 50% from peak to trough. The most recent bear market produced only a 26% fall.
- The P/E ratio tends to drop by two-thirds from the peak. The starting P/E has been quite similar at 30 times or more. This time the starting P/E was lower and the ending P/E appears to be higher.
- The broader market underperforms the narrow market.
- Volatility of returns is not necessarily different from bull markets. The duration of bear markets is also not very different from bull markets but it is hard to point out any consistency in this regard.
- Bear market rallies tend to be powerful.
- It takes a long time to get back to previous bull market peaks. In the last bull market, we failed to cross the peak of the prior bull market. This assumes that the rally that started in March-09 was a new bull market.

Source: Bloomberg, SEBI, FactSet, MSCI, CMIE, Company Dat, Morgan Stanley Research

Market Psychology

The Varying Importance of Factors Driving Asset Prices Across Market Phases

Market Phase	**Bottom**	**Early Stage Recovery**	**Mid-Stage Bull Market**	**Peak of Bull Market**	**Bear Market**
General vertical direction (but not horizontal direction) of asset price movements					
Fundamentals	20% Improving but ignored	30% Solid underlying performance	40% Sweet summer of growth	20% Optimistic, long-duration projections	30% Overawareness of deteriorating conditions
Valuation	20% Attractive, but no takers	50% Abundant bargains	30% Willingness to pay up	20% Revised models justify stretching	20% Shocked recognition of outlandish prices paid
Psychology/ Technical	60% Exhaustion, disbelief, and demoralization	20% Doubt, reflection, and conversion	30% Faith, hope, and charity	60% Euphoria, greed, and extrapolation	50% Fear, panic, and loathing

Note: The percentages indicated above are hypothetical only and reflect the personal views of the author

Source: Morgan Stanley Research

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