Investment Strategy- India

March 2007

sgprivatebanking.com

Equities: Sectoral moves in February

- **In the last one month -**
  - **Sensex loses 8%**
  - **Banks- worst hit- lose 11% post CRR hike**
  - **All sectoral indices in the red**

Index	1 month	Index	1 month
Sensex	-8.18%	Capital goods	-6.86%
Nifty	-8.26%	PSU	-9.31%
BSE 200	-8.64%	Bank	-11.74%
IT	-7.67%	Auto	-7.36%
CNX Midcap	-7.62%	Oil	-5.03%
FMCG	-6.31%	Metal	-8.29%
Healthcare	-8.03%	BSE Smallcap	-10.63%

Equities: Institutional Activity

- **FIIs invested US$ 827mn in Indian equities in February**
- **Mutual funds sold stocks worth US$ 196 mn in February**
- **Primary market activity building up. Issues expected in the first quarter are expected to mop up US$ 8bn from the market. Companies expected to approach the markets are from property and telecom**
- **Mega NFOs on the Mutual fund side expected once again from three large fund houses in the country**

India Economy Watch

- GDP growth at 8.6% y-o-y in 4QFY06
- December IIP growth at 11.1%
- Inflation close to a 2 year high
- Government announced price cuts for both petrol and diesel
- RBI hikes CRR by 50bp to check inflation
- Repo rate up by 0.25% to 7.5%
- Govt bans wheat exports
- Electoral reversals for ruling UPA coalition in two states

India Corporate Watch

- Vodafone buys Hutch for an Enterprise Value of US $19bn

- ICICI ups home loan rates by 100bps

- Hindalco has announced that it will acquire Novelis, an Atlanta-based 3 MT downstream producer, for about US$6bn

- Northrop Grumman Corp, the third largest US defense contractor, and Bharat Electronics plan to sign a preliminary agreement to explore joint production opportunities in aerospace and defense electronics technology

- BHEL has won an order valued at Rs 39bn to supply equipment for three units of 500MW each from Maharashtra State Power Generation Company.

India Budget Watch

- Nominal growth expected to be 13%
- 17% growth expected in tax revenues (conservative in our view)
- Fiscal deficit expected to be 3.3% of GDP
- Tax/ GDP now close to 12%
- Thrust on rural India with investments in irrigation
- Emphasis on education – plan to recruit 200,000 teachers
- Tax policy broadly stable
- New services brought under the service tax net

India Budget Watch (Capital Market)

- **PAN number to be the sole identification number for all investments**
- **MIN number done away with**
- **Short selling by institutions allowed**
- **Local MFs to launch dedicated infrastructure funds**
- **Issue of exchangeable bonds; which can be used by promoters to unlock their holdings to meet future financing requirements**

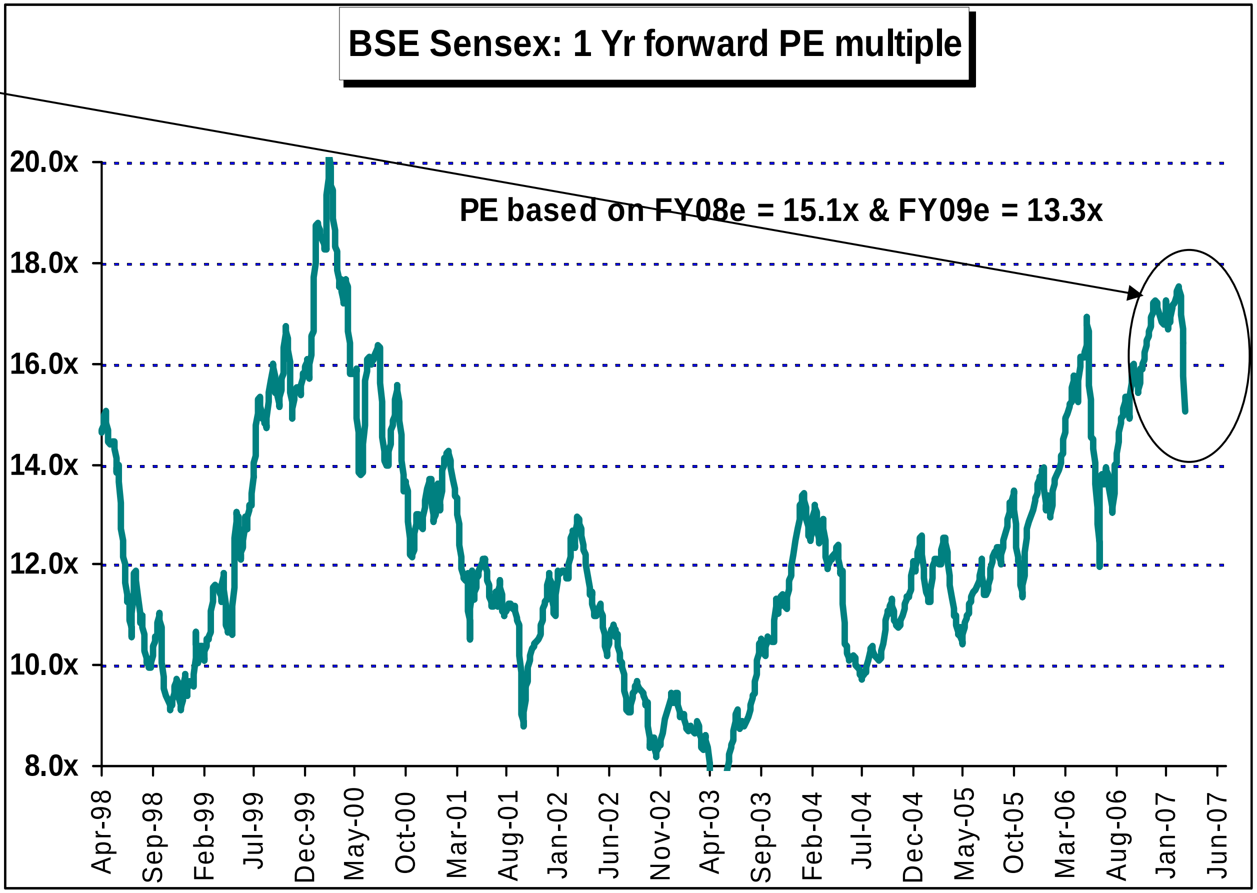
India Budget Watch (Sectors)

- IT companies to pay MAT
- Excise duty on cement increased to Rs 600/ton if retail price is above Rs 190/bag
- Dividend distribution tax increase to 25% on liquid funds will help mobilization of bank deposits
- 5% excise duty on cigarettes
- Two more UMPPs will be awarded in July 07
- Section 80IA benefit removed for construction companies from retrospective effect
- Excise duty on petrol and diesel reduced from 8% to 6%
- Export duty of Rs 300/ton on iron ore exports

Sensex Valuations

Valuations become comfortable once again with P/E ratios coming close to 15x. The fall in markets in Feb and earnings upgrades post last quarter results has resulted in P/Es correcting sharply.

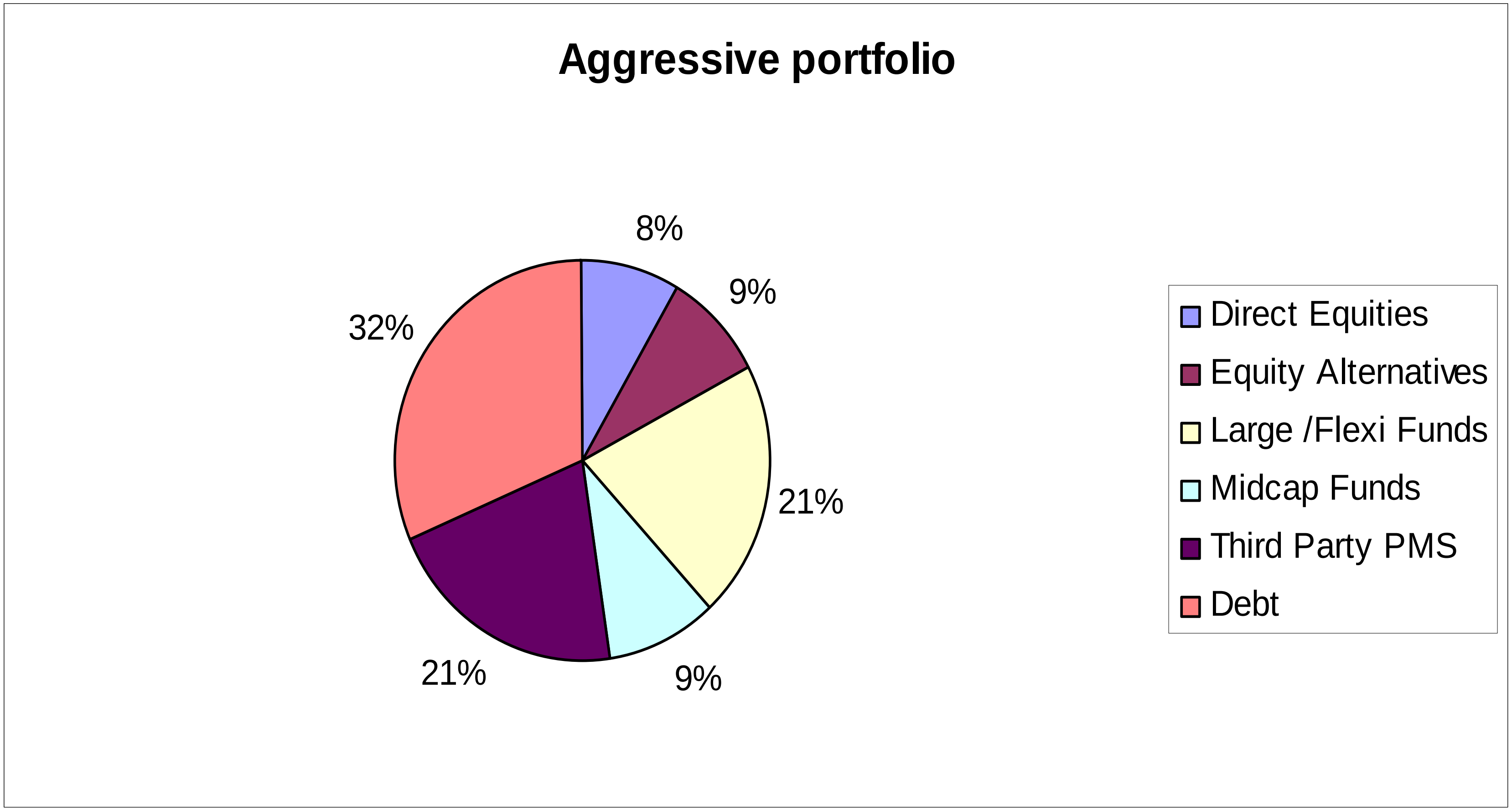
We are now comfortable once again with markets at current valuations



Equities: Our view going forward

- The budget has passed and the markets have corrected due to global factors
- Some sectors have corrected sharply due to budget measures
- We no longer feel that markets are in the expensive zone and the valuations are once again comforting
- We believe that the growth trajectory for the economy should be in the range of 8-9%. Earnings, hence, will continue to grow in their mid-teens
- We, at this juncture, feel the risk reward is in your favour while investing in equities

Model portfolios



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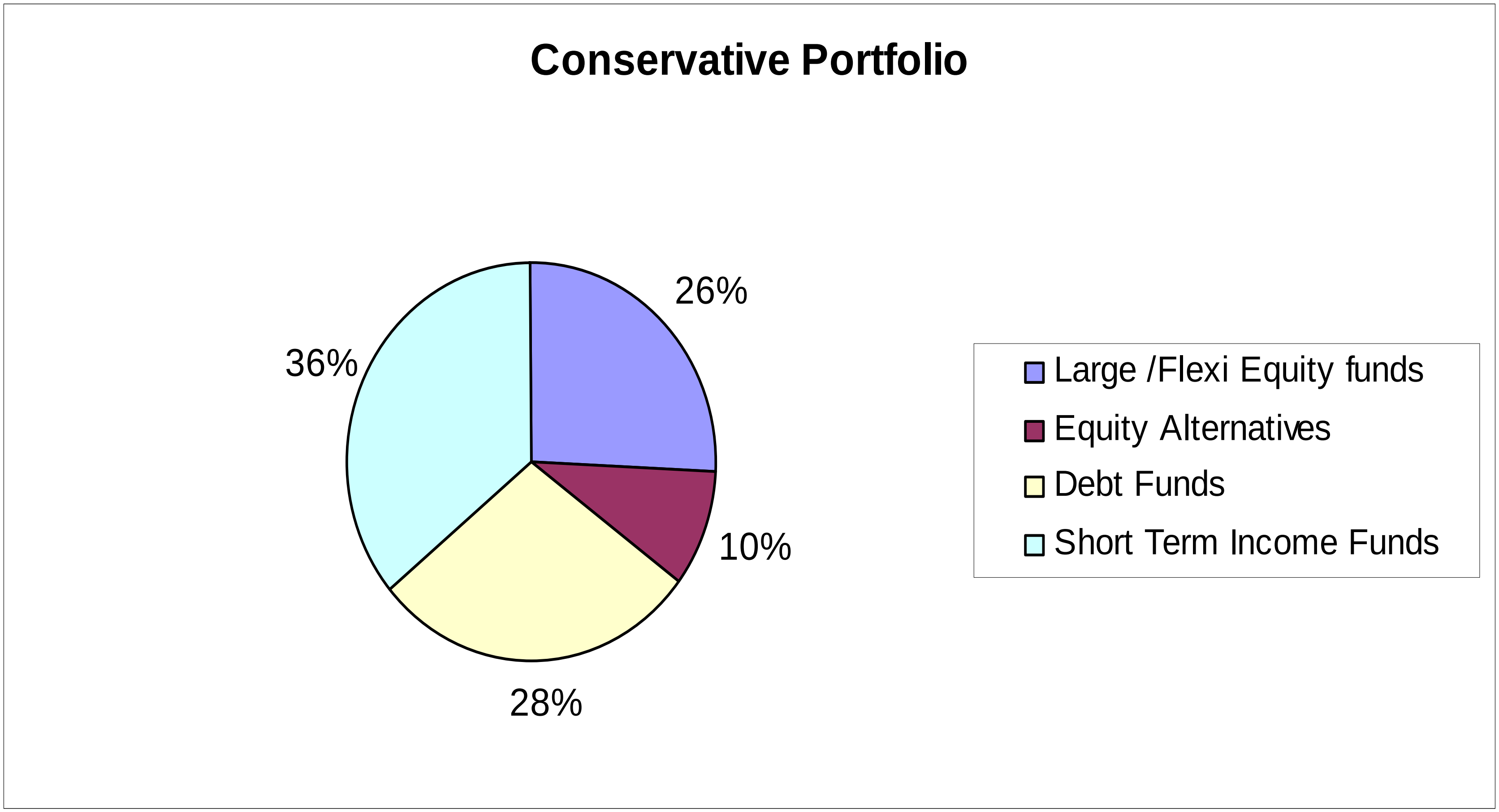

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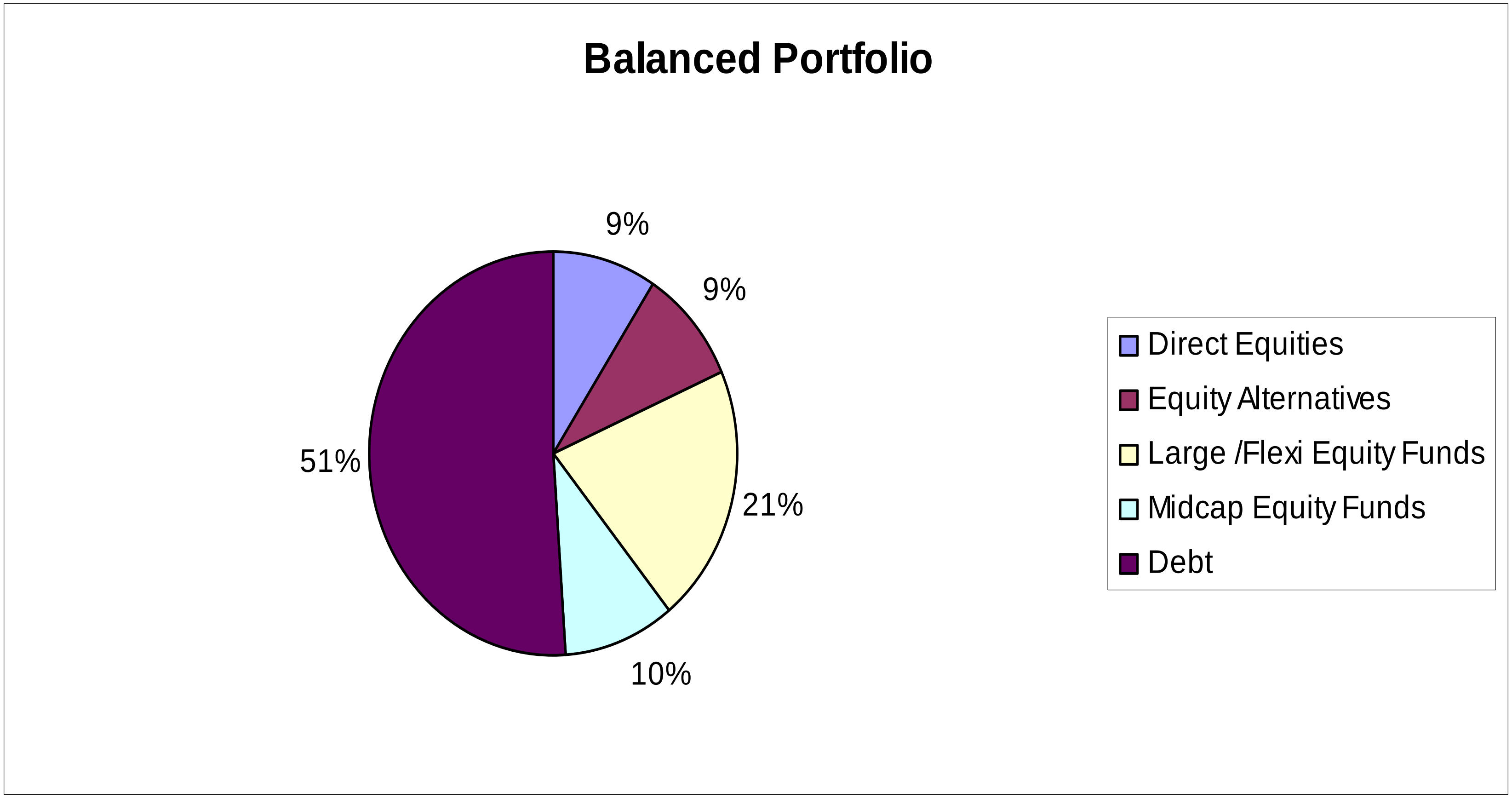


Debt - Budget Announcements

- FY07 gross market borrowing revised to INR1.465 trln.
- Net market borrowing for current FY revised to INR 1.075 trln from INR 1.096 trln.
- FY08 gross market borrowing aimed at INR 1.555 trln vs INR 1.465 trln current FY.
- Govt's FY08 net borrowing targeted at INR 1.096 trln.
- Govt to borrow INR 75 bln more by end FY07.
- INR 25 bln rupees allotted for gilt buyback pre-payment premium FY08.
- Cap on market stabilisation scheme issues up at INR 800 bln in FY08.

Debt: Outlook & Strategy

- **Call rates eased to 6.10 – 6.30% levels from 7.50% in previous month. Easy liquidity on account of RBI buying dollars and infusing INR into the system lead to call rates easing .**

- **Government securities yields on 10 year paper rose by 24bps to 7.98% for the month of February. Concerns over inflation as it crossed 6.50% during the month and uncertainty over liquidity lead to hardening of interest rates.**

- **Inflation for the week ended February 17, 2007 stood at 6.05%.**

- **Forex reserves stood at $188.912 billion for the week ended February 16, 2007 .**

Debt: Outlook & Strategy

- **Interest rates could remain in the band of 7.60% - 8.00% for ten year govt. security with some upward bias as expectation of rate hike in April continues.**
- **Short end of the yield curve may firm up marginally on account of financial end consideration.**
- **Yield on fixed maturity plan offering double indexation benefit could move up by 10 -20 bps as certificate of deposit rates could inch up further.**
- **Curbing inflation would be RBI's priority and if it continues to rule above 6.00%, we could see some more measures being taken by RBI.**

Debt: Outlook & Strategy

We recommend

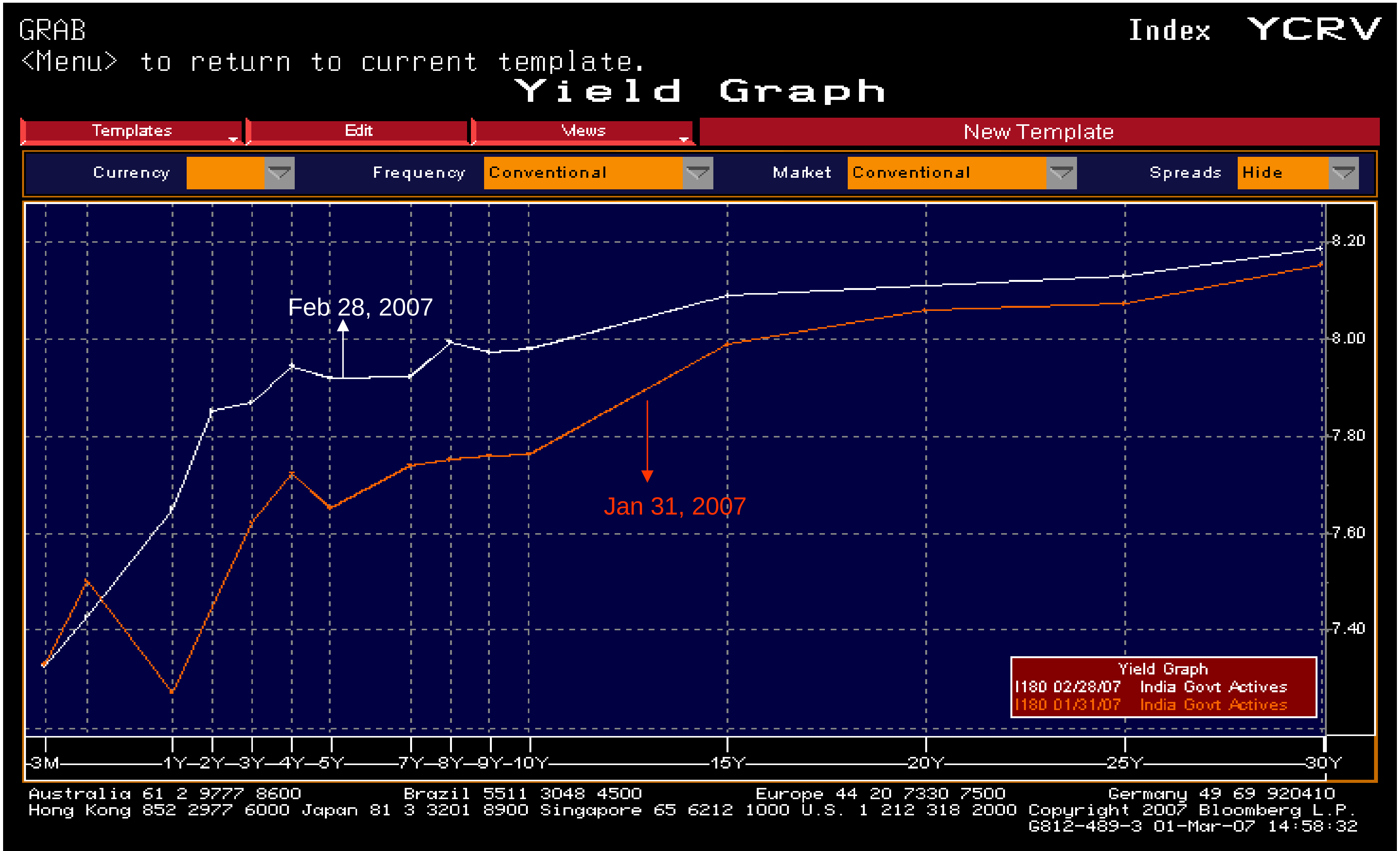
- **Exposure to Fixed maturity plans across various tenors as they offer in excess of 10% return.**

- **Investment in Short term income funds can be avoided as there is a possibility of shorter end of the yield curve firming up.**

- **Income Fund & Gilt funds can continue to under perform as RBI continues to have inflation as top priority.**

- **FMP's with three month maturity could outperform other short term debt alternatives as they offer 10.75% annualised yield.**

Yield Curve Movement



Source: Bloomberg

Yield Movement of 10 Year Govt. Bond

Source: Bloomberg

Fixed Incomes - Global

- **The current slowdown in the US economy is a mid cycle correction rather than a recession. Economic momentum could pick up again towards the end of 2007.**
- **Consumers continue to show solid resiliency in the past few months. The labor market remains tight.**
- **The latest housing data suggest that the worst of housing slowdown in the US maybe over.**
- **Core inflation rate remained well above the Fed's comfort level while headline inflation rate fell sharply due to decline in energy prices.**
- **With moderation in economic growth and contained inflation, the FED may start to ease in the middle of the year. The Fed rate may reach 4.75%.**
- **The outlook for Euro-zone's interest rate is less certain. The ECB is expected to pause the tightening policy in the Q1 2007 so as to assess the impact from the fiscal tightening in Germany & Italy at the start of the year.**
- **US long bond yield may stay between 4.40% - 4.90% and European bond yield between 3.50% - 4.25% in 2007.**

Source: SG Private Banking, Asia

Mutual Fund Return (February – 07)

Fund Category	1 Month Return (Absolute %)
Debt: Floating Rate ST	0.14
Debt: Ultra Short-term	0.14
Debt: Floating Rate LT	0.13
Gilt: Short-term	0.08
Debt: Short-term	0.03
Debt: Medium-term	0.03
Gilt: Medium & Long-term	-0.08
Hybrid: Monthly Income	-1.04
Equity: FMCG	-4.35
Equity: Pharma	-5.27
Equity: Tax Planning	-6.64
Equity: Diversified	-6.74
Equity: Auto	-6.97
Equity: Banking	-7.28
Equity: Technology	-8.14

Source:Valueresearchonline

As of February 28, 2007

Mutual Funds

- **All equity fund categories generated negative return during February. Mid cap mutual funds outperformed Diversified equity mutual fund for the month of February. Standard Chartered Premier Equity, HDFC Capital Builder & Reliance Growth Fund fell the least in February.**
- **Technology sector fund were the worst performing across all categories after performing well in January.**
- **Debt Floating Rate Fund – Short Term along with Liquid Funds were the best performing segment in debt category.**
- **Arbitrage funds out performed well giving double digit annualised return due to compression of spread.**

Commodities

OIL

•Downward pressure on oil has been reduced by the following a) increased likelihood that OPEC will respect newly announced quotas thereby defending the 50-55 $/b floor b) return of cooler weather in the eastern US c) inventory drawdown

•Oil prices will in addition remain sensitive to geopolitical issues [Iran] and climate events which could be amplified by the El Nino effect.

•Range March 2007 : 58-63 USD BBL

GOLD

•Gold prices in the past two weeks have been driven by a lower dollar [weaker economic data implies greater likelihood of rate cuts] and [as for oil] geopolitical tensions between Iran and the US.

•Fundamentals remain strong due to a) decreased supply via reduced central bank gold sales from developed countries b) increased demand due to wealth effects in China and India as well as likely emerging market central bank reserve diversification c) Financial investment supported by continued financial market liquidity.

•Range March 2007: 670-700

Source: SG Private Banking, Asia

Real Estate- Budget Implications

- Service tax on commercial rentals in the budget is a negative for the sector
- Section 80 IB benefits have not been extended beyond March 2007 for residential sector. Developers will have to pay tax on future residential apartment constructions below 800 sq.ft
- Section 80 IA benefits removed for construction companies who used to work as sub-contractors
- Domestic VC funds investing in real estate (except hotels) will have to pay tax on gains. Pass through advantage has been removed
- 5 year tax holiday on 2,3, and 4 star hotels constructed in NCR region constructed between 2007-10.

Real Estate- Recent developments

- The government continues to focus on infrastructure; as confirmed by the budget.
- Focus by state governments on Public private partnerships to develop infrastructure
- Lot of foreign money waiting to pour in to the sector
- Large corporates have announced ambitious retail plans which will lead to further investments in the sector
- Many IPOs from developers expected in 2007.

Real Estate- Outlook

- **We expect the load of Service tax to be passed on mostly to end user. Rentals across Metros are expected to talk a breather post this**
- **Residential prices for small houses may jump in due course of time because of removal of Section 80 IB benefits**
- **Due to the interest rate increase and budget measures the real estate market may see a correction of 10-15% in certain areas of the country**
- **Over medium to long term the supply-demand dynamics remain favourable; we maintain our bullish stand on the sector.**

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