November 5, 2013
Asia Pacific: Portfolio Strategy

Modi-fying our view: raise India to Marketweight

Portfolio Strategy Research

Recent visit highlights some positive developments

Previous stance

Our cautious stance on India was founded mainly on downside risks to economic growth and earnings growth, as well as vulnerability to changing global liquidity conditions given external and internal imbalances.

Reasons for change: politics, macro, micro

Following a detailed set of meetings in Delhi and Mumbai, we believe it is appropriate to raise our investment stance, recognizing the equity market has risen sharply from 3Q lows. Key reasons: **1)** Optimism over political change, led by BJP's prime ministerial candidate Mr. Modi, is dominating economic concerns. **2)** External capital account pressures have moderated, at least for now. **3)** There are early signs of cyclical pick up and structural improvement. **4)** The earnings outlook is stabilizing and we have raised our CY2014 EPS growth forecast from 8% to 11%. **5)** Midrange valuations are not a constraint if fundamentals continue to stabilize; midcaps trade at a 30% discount to the broad market. **6)** Retail redemption pressure could moderate, which could improve the equity demand/supply balance.

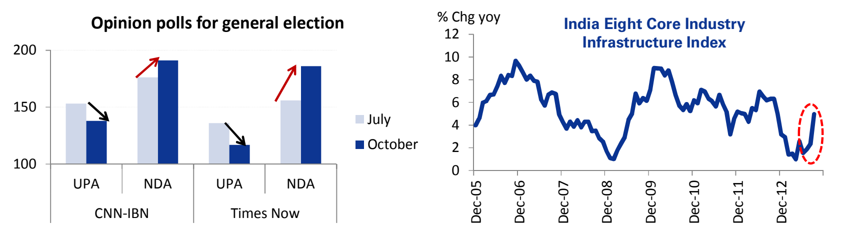
NIFTY 6900

We revise our NIFTY end-2014 target to 6900, which implies 9% upside from current levels and a 14.5x forward P/E. Favored sectors: Tech, health care, energy. Stocks ideas: Buy-rated names; inexpensive Infra midcaps.

Risks

Although we are more constructive, India continues to face challenges. Key risks include **a)** slow growth; **b)** the market's response when the Fed decides to taper (our current expectation is March 2014); **c)** a change in the currently positive political mood; and **d)** a faltering earnings recovery.

Political optimism and signs of cyclical upturn are helping equities



Source: Times Now, The Week, CNN-IBN, Haver, Ministry of Commerce and Industry

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Executive summary

Following three days of meetings with policy makers, companies and investors, we raise our view on India to Marketweight and increase our NIFTY index target to 6900, implying 9% potential upside from current levels.

Within the market, we focus on Infotech, healthcare and energy, and are more constructive on investment cyclicals. We highlight 10 Buy-rated names and screen for attractively valued midcap infrastructure plays.

Our change in view is driven by politics, macro and micro

Previous stance

Starting at the end of Q2, we took a progressively more cautious stance on India, given concerns about downside risks to economic growth and its vulnerability to changing global liquidity conditions in light of its external and internal imbalances. While the NIFTY index subsequently fell 22% in USD terms, since then, both the equity market and the currency have rebounded sharply, with NIFTY gaining nearly 30% in USD terms from the end-August low and returning to roughly the same level where we turned cautious. (See *3Q Views: Tighter liquidity, lower growth, muted upside*, July 1; and *India: Elusive recovery, rising vulnerability; move to UW*, July 31).

Reasons for changing our view

Following a detailed set of meetings in Delhi and Mumbai, we believe it is appropriate to raise our investment stance, recognizing the equity market has recently risen significantly.

1. **Politics are trumping economics**. Currently, the macro challenges that India faces in terms of external and fiscal imbalances, high inflation and tight monetary policy are being dominated by expectations of political change, specifically that the BJP-led National Democratic Alliance (NDA) could prevail in the next parliamentary elections that are due by May 2014. Equity investors tend to view the BJP as business-friendly, and the BJP's prime ministerial candidate Narendra Modi (the current chief minister of Gujarat) as an agent of change. Current polls show Mr. Modi and the BJP as faring well in the five upcoming state elections, which are considered lead indicators for the general election next year. Even though the actual general election outcome is uncertain, the market could trade this favorably over the next 2 quarters, which argues for modifying our stance.

2. **External pressures have moderated**. Although the delay of Fed tapering has been of general benefit to emerging markets with external deficits, measures instituted by the RBI have also helped stabilize the current account deficit and the currency. These include temporary—but effective—measures to stem pressure on the current and capital accounts including tightening gold imports, meeting oil import demand through reserves, and arranging swap facilities such as a US$50bn agreement with Japan. The results so far have been encouraging: from a peak of US$20.7bn in May (worst in a year), the trade deficit in September was $6.8bn (a 30-month low), well below August's $10.9bn and consensus expectations. While this pace of improvement will likely not sustain, the overall current account deficit is likely to improve to 3.5% of GDP for FY14 from 4.8% in FY13. In our recent meeting, the RBI signaled confidence in the current account issue and was more focused on inflation and moving towards positive real rates (with respect to CPI), albeit at a measured pace given a desire to monitor food prices.

3. **Early signs of cyclical pick up and structural improvement**. Some of the key data points and lead indicators related to investment demand have started to show signs of pick up. These include improvement in the production of core industries related to infrastructure as well as the raw materials inventory to sales ratio. More importantly, several large-scale government projects are making progress (e.g. the Dedicated Freight Corridor and the Delhi-Mumbai Industrial Corridor), coal supply bottlenecks are easing, and the Power Purchase Agreement, which allows power companies to pass on the cost of imported coal to customers, has been finalized. Thus, although India continues to face growth challenges, there have been some favorable developments in recent months.
4. **Better earnings outlook: raising 2014 numbers**. Earnings sentiment (the breadth of analyst revisions) has improved, and consensus market earnings forecasts have stabilized after persistent downgrades since January. The current 2QFY14 results season has come in fairly well relative to the weak macro backdrop, particularly the financials which have exceeded estimates. Looking forward, we raise our market EPS growth estimates from 8% to 11% (still below consensus) based on improving investment demand and moderating liquidity constraints for banks.
5. **Valuation- midrange; opportunities in midcaps**. India currently trades at 14.5x consensus forward earnings (+0.4 sd vs. range) and 2.6x trailing book value (-0.5 sd). As we have frequently noted, valuation signals are strongest at the extremes and weakest at the middle of the range. At current levels, valuations are not a binding constraint on the market as long as the macro and micro changes are favorable on balance. Moreover, positive political sentiment could fuel further valuation expansion, although this might be more short-term in nature. Of note, valuations are more attractive lower down the capitalization spectrum: mid-caps trade at a 30% discount to the NIFTY on an equal weighted basis (10.4x vs. 14.9x), indicating that value and alpha opportunities exist even after the recent rally.
6. **Flows: Foreign inflows persistent; retail redemption pressure could moderate.** Foreign inflows have been surprisingly strong and persistent despite the market's volatility ($16.3bn ytd, $4.6bn since September). Against this, domestic institutions have been net sellers, particularly mutual funds which have faced high redemption pressures. If the recent rally and optimism regarding leadership change stems the redemption outflow, the demand/supply balance could shift more favorably.

Risks

The preceding points argue for neutralizing our cautious investment stance, particularly compared to other markets, such as Indonesia, where the recent changes on the macro or political fronts have not been as favorable. However, India continues to face challenges. The key risks include:

- **Slow growth**. Even with a modest cyclical improvement, India's likely growth range this year and next will fall well short of previous rates. More progress is needed regarding supply-side constraints to become more sanguine.
- **Response to taper**: Although the RBI actions and recent macro improvements probably reduce the sensitivity to Fed tapering, the market will likely be challenged when the Fed does decide to act, which we currently expect in March 2014.
- **Politics**: Opinion polls can change and state elections are not a guarantee of national election results. The more the equity market rallies on BJP optimism, the more risk there is of a setback if the political winds change.
- **Delayed earnings risks**: NPL formation often lags economic slowdowns, so the recent improvement in earnings sentiment (especially for the financials) could be temporary if the economy does not gain traction.

Reasons for changing our view

1) Politics will likely influence market behavior

The upcoming parliamentary elections (general elections), to be held before May 2014, will likely influence market behavior (See *Asia Economics Analyst: A primer on India's 2014 elections*, October 18, 2013 for more details on elections). The opposition BJP-led alliance has gained ground in opinion polls in last 3 months and current opinion polls suggest a higher probability of a BJP-led alliance forming the next government. Domestic equity investors tend to view the BJP as business-friendly, and the party's prime ministerial candidate Narendra Modi (the current chief minister of Gujarat) as an agent of change. **BJP and Mr. Modi, in particular, have been focussed on infrastructure and capital spending in the past and a BJP-led government may be beneficial for the investment demand pick up, in our view**.

There are state elections to be held in five states (Madhya Pradesh, Rajasthan, Chhattisgarh, Delhi and Mizoram) starting from November 11 with results announced by December 8. The current opinion polls suggest an edge for BJP in these state elections (Exhibit 2). These states account for 73 seats in Lok Sabha and will be **an important barometer of the public's mood for the general elections next year**.

Exhibit 1: Five crucial state elections will be held in November/December which will be an important barometer of the public's mood

	State Legislative Assembly					Lok Sabha (Parliamentary Elections)			
States	Total no of Assembly seats	Election Date	Current ruling party	No of seats won in 2009	% of seats won	Total no of Lok Sabha seats	Major Political party	No of seats won	% seats won
Madhya Pradesh	230	**25-Nov**	BJP	143	62%	29	BJP	16	55%
Rajasthan	200	**1-Dec**	INC	96	48%	25	INC	20	80%
Chhattisgarh	90	**11-19 Nov**	BJP	50	56%	11	BJP	9	82%
NCT Delhi	70	**4-Dec**	INC	43	61%	7	INC	7	100%
Mizoram	40	**4-Dec**	INC	32	80%	1	INC	1	100%
Overall	**630**					**73**			
Total Seats	**4120**					**543**			

	The Union Parliament (Lok Sabha)							
House	Total no of seats	Term end date	Current ruling party / alliance	# seats won in '09 elections	% seats won	Major Political party / alliance	# seats won in '09 elections	% seats won
Lok Sabha	**543**	**May-14**	INC / UPA	262	48%	BJP / NDA	160	29%

Note: INC = Indian National Congress; UPA = Congress-led alliance (United Progressive Alliance)
BJP = Bharatiya Janata Party; NDA = BJP-led alliance (National Democratic Alliance)

Source: Election Commission of India

Exhibit 2: BJP-led NDA has gained ground in opinion polls in last 3 months; opinion polls suggest an edge for BJP in the upcoming state elections

Opinion Polls for the general elections 2014

	No of seats won in 2009	CNN-IBN & The Week Period Jul-13	CNN-IBN & The Week Period Oct-13	Times Now-C Voter Period Jul-13	Times Now-C Voter Period Oct-13
UPA	262	149-157	134-142	136	117
NDA	159	**172-180**	**187-195**	**156**	**186**
Others	122	208-216	208-216	251	240
	543				

Opinion Polls for the state elections - Nov/Dec '13

	Total no of Assembly seats	Current ruling party	CNN-IBN & The Week by CSDS BJP	CNN-IBN & The Week by CSDS Congress	CNN-IBN & The Week by CSDS Others
Madhya Pradesh	230	BJP	**148-160**	52-62	13-25
Rajasthan	200	INC	**115-125**	60-68	7-25
Chhattisgarh	90	BJP	**61-71**	16-24	1-7
NCT Delhi	70	INC	**22-28**	19-25	19-25

** Note: Opinion polls as per survey conducted in the month of October*

Source: Times Now, The Week, CNN-IBN

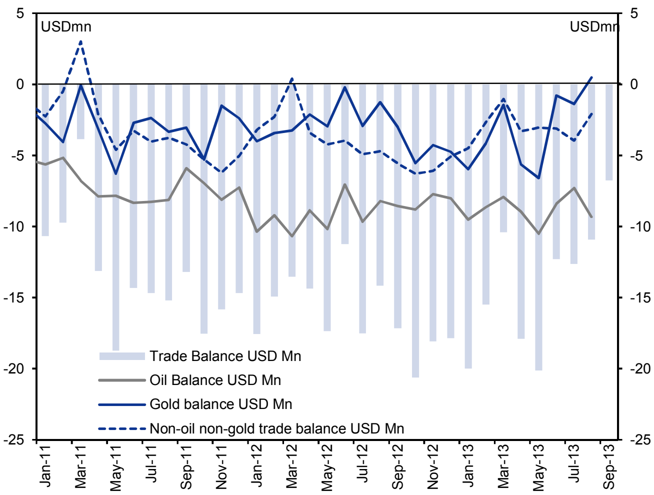
2) External pressures have moderated

Although the decline in US rates and the delay in timing of Fed tapering have come as a welcome respite for India, **the central bank (RBI) has also taken various measures to relieve immediate pressure on the current account and encouraged capital flows which have helped arrest INR weakness**. Notable among these have been measures related to FCNR deposits and overseas borrowing by banks (which have brought in US$10.1 bn so far), restrictions on gold imports and monetary tightening via raising the Marginal Standing Facility (MSF) rate. A detailed list on measures taken by authorities is shown in Exhibit 5.

The RBI in the latest policy meet (October 29) hiked the repo rate by 25 bp to 7.75%, in line with market expectations, to curb inflation. The central bank also reduced its growth forecast for FY14 while raising its inflation forecasts. Liquidity conditions were eased further by increasing the amount of term repo from 0.25% of bank deposits to 0.5% and cutting the MSF rate by 25 bps to 8.75%.

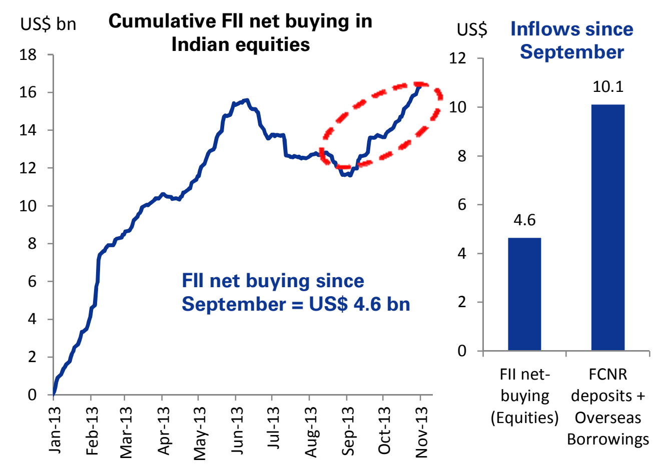
We expect inflation to remain elevated in the near-term due to pass-through of INR depreciation into the prices of manufactured products, along with elevated food and fuel inflation. The RBI's bias appears to be towards combatting inflation and moving towards positive real rates (with respect to CPI), but at a measured pace given a desire to monitor food prices.

Exhibit 3: A reduction in gold imports has helped improve the recent trade balance



Source: Haver, CEIC

Exhibit 4: Recent capital flows have been supportive as well



Source: Bloomberg, RBI, Goldman Sachs Global Investment Research

Exhibit 5: Various measures taken by authorities to relieve pressure on current account and capital flows

	Capital account measures
Continue to ease inflows	Banks can swap new US dollar deposits on non-resident Indians (>=3yrs tenor) with RBI at a fixed rate of 3.5%
	Banks can borrow 100% (raised from 50%) of their Tier I capital externally, and swap with RBI
	Exporters can re-book 50% of their cancelled forwards contracts, and importers 25%
	State-owned oil companies allowed to borrow overseas; Selected State-owned Companies allowed to issue quasi-sovereign bonds. RBI opened a FX swap window to meet dollar demand of oil-marketing companies
	Allowing Sovereign Wealth Funds to invest 30% in tax-free bonds
	Enhanced currency swap agreement with Japan to US$50 billion; Formation of US$100 billion BRICS currency reserve arrangement
	Abolished quota/auction system for foreign investors, investing into government bonds
Reduced capital outflows	Reduced limits on outward remittances
	Reduced limits of overseas FDI
	Current account measures
Tighten imports	Banned gold coin/bullion imports; Hiked import duty on gold, silver and platinum to 10%
	Sale of gold by importers to jewelers/bullion traders/banks only on upfront cash payment
Increase exports	Interest subsidy raised to 3% from 2% and offered to more sectors
	20% of imported gold required to be exported
	RBI raising limit for online repatriation of exports proceeds by 3x to US$10,000
	Monetary policy
Monetary tightening	Hiked Marginal Standing Facility rate by 200 bp to 10.25% in July. Subsequentlycut MSF rate to unwind these measures in a series of cuts as INR stablized. MSF now stands at 8.75%
	Hiked repo rate by 50 bp (25 bp each in last two policy meetings) to curb inflation. Repo rate now stands at 7.75%
	Capping overall amount that banks could withdraw from the repo window to 0.5% of their deposits

Source: RBI, Various media articles, Goldman Sachs Global Investment Research

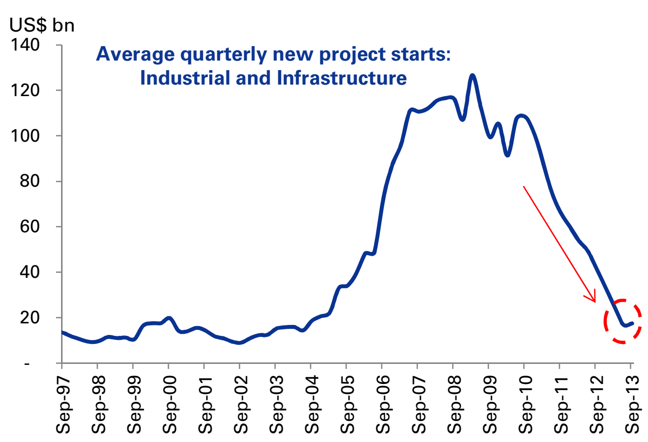
3) Early signs of cyclical pick up and progress on structural bottlenecks

Some of the key data points and lead indicators related to investment demand have started to show signs of pick up. The decline in new project starts in industrial and infrastructure projects seem to have halted in 2QFY14, although project starts still remain at low levels. We are also seeing early signs that fewer new projects have stalled – an indication that **we may be close to a trough in the investment cycle given recent policy initiatives from the government and new approvals coming through in power and road projects**.

In the manufacturing sector, the production of the core industries related to infrastructure (which includes Coal, Oil and natural gas, Fertilizers, Steel, Cement and Electricity) has picked up and the raw materials inventory to sales ratio (based on OBICUS survey of more than 1000 manufacturing companies) is turning up again which are generally lead indicators for pick-up in the investment demand.

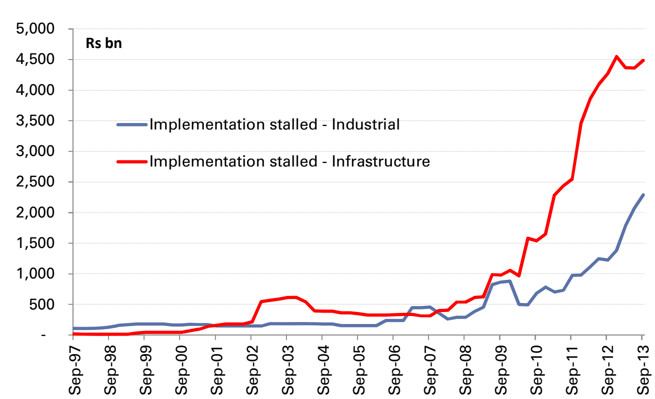
On the infrastructure front, some large-scale government projects are now progressing well, post initial delay. The Dedicated Freight Corridor (DFC), which aims at easing freight traffic bottlenecks, has acquired substantial land tracts and environmental clearances are almost completed. **The project has already secured international funding and execution appears on-track, with ordering for some phases already underway**. The Delhi-Mumbai Industrial Corridor (DMIC) project, which will consist of integrated Investment Regions (IRs) and Industrial Areas (IAs) within both sides of DFC between Delhi and Mumbai, has already seen implementation on track in parts of Dholera (Gujarat) for Industrial areas and Haryana for roadways (Exhibit 10). We expect more infrastructure contracts to be awarded from these projects over the course of next year. The power sector has also seen some progress in structural reforms. Coal-supply bottlenecks which have been a source of concern are easing. Coal India Limited (CIL) has already signed 140 of the 173 Fuel Supply Agreements (FSAs) till September for 60K MW out of 78K MW of coal based power projects. The Power Purchase Agreement (PPA), which allows power companies to pass on the cost of imported coal to customers, has also been finalized.

Exhibit 6: The decline in new project starts seem to have halted in 2QFY14, although it remains at a low level



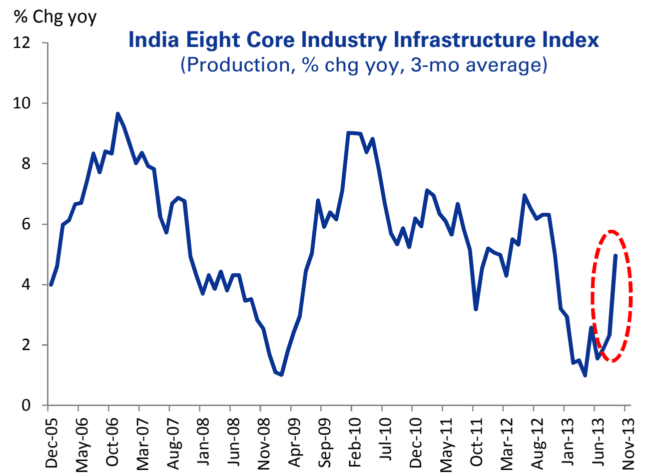
Source: CMIE Capex, Goldman Sachs Global Investment Research

Exhibit 7: Early signs that the number of stalled projects is moderating



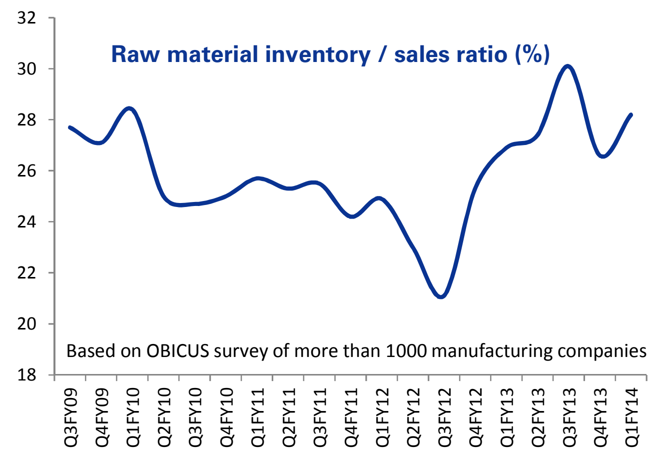
Source: CMIE Capex, Goldman Sachs Global Investment Research

Exhibit 8: Production of core industries related to Infrastructure has picked up



Source: Haver, Ministry of Commerce and Industry

Exhibit 9: Raw material inventory / sales ratio in manufacturing sector is turning up



Source: RBI

Exhibit 10: Infrastructure/ industrial projects seem to be progressing well...

	2013	2014E
Delhi-Mumbai Industrial Corridor (DMIC)	As per our estimates, DMIC could see investments of c.Rs4.9tn over its entire life till FY2040, with about **Rs2.7tn** being invested in phase I (2010-2020). Govt. of India is major stake holder at 49%, followed by Japan Bank for International Cooperation (JBIC) at 26% equity. Implementation started on parts of Dholera (Gujarat) for Industrial areas and Haryana for roadways. In Gujarat, government transferred 70,340ha of land to the Regional Development Authority for Phase I implementation.	We expect ordering and implementation to start soon with a focus on railways. Ongoing progress to be made on land acquisition in the other regions of the corridor.
Dedicated Freight Corridor (DFC)	Major land acquired (about **81%** as of June 2013) and environment clearances almost completed. Total estimated Investment: about **Rs 954 bn**. Has already secured international funding. Western DFC (80:20 Debt to Equity ratio) - debt is being funded by the Japan International Corporation Agency (JICA). Eastern DFC is being developed in parts by the World Bank, Indian Railways, and through the PPP route. Ordering has already started. EPC contracts awarded to (1) L&T (LART.BO) - Sojitz (2768.T) JV in June 2013; (2) Tata Projects India-Aldesa JV	We expect more Infrastructure contracts awarding.
Other Infrastructure related reforms		
Coal avalibility / Power	Coal India Limited (CIL) signed 140 of the 173 **Fuel Supply Aggrements** (FSAs) till September for 60K MW out of 78K MW of coal based power projects. The government would allocate 14 coal blocks to state-run firms. Government has allowed power companies to pass on the cost of imported coal to customers. The **Power Purchase Agreement** (PPA) has been finalized.	

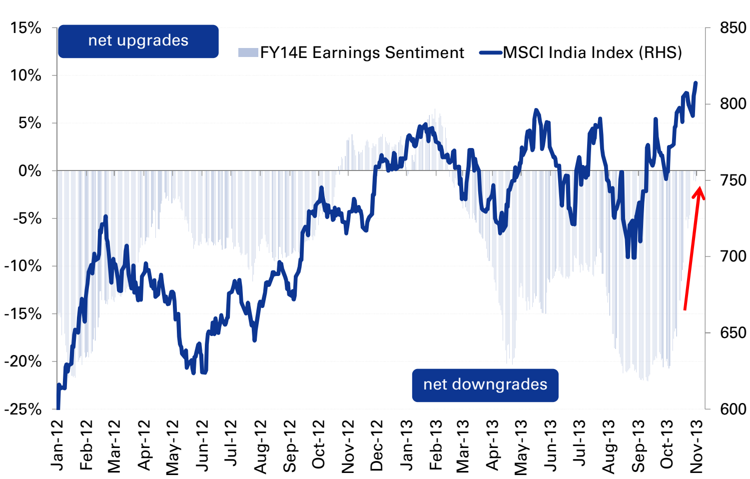
Source: DFCCIL, World Bank, DMICDC, Goldman Sachs Global Investment Research

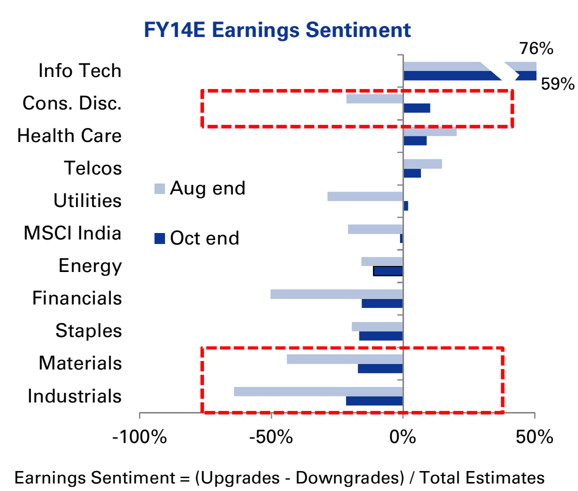
4) Better earnings outlook: raising 2014 numbers

Our below-consensus earnings estimates were based on a view of a less favorable growth outlook driven largely by expectations of continued decline in investment demand, weaker consumption demand, and tighter financial conditions. **Over the last month, earnings sentiment has improved significantly (notably for investment cyclicals) with early signs of pick up in investment demand**. Liquidity conditions have also improved which points to a slightly better earnings outlook (compared to our earlier expectations). We raise CY2014 earnings growth to 11% (from 8% earlier) but remain below consensus estimate of 14% growth due to growth / NPL risks. We summarize the main points below:

- **Earnings sentiment for the overall market has significantly improved, notably for investment cyclicals**. Over the past month, earnings sentiment (which measures breadth of analyst revisions) has significantly improved for the overall market (Exhibit 11). Investment Cyclicals (Industrials, Materials) and Financials have seen the sharpest improvement in sentiment.
- **Downgrades to consensus EPS have stabilized.** EPS estimates for FY14 and FY15 had been cut 8 and 7% respectively since the peak in January but have stabilized over the past month.
- **Financials have reported strong results despite tough macro.** So far, 76% of MSCI India has reported 2QFY14 results, with actual 6-month earnings tracking 47% of FY14 I/B/E/S estimates, in-line with the historical average. Financials (largely banks) have reported strong results ahead of estimates.
- **We raise our earnings growth estimate for next year from 8% to 11%, which is still below consensus expectations.** Our earlier estimate of 8% earnings growth incorporated much lower assumptions on banks (given slower loan growth, tighter liquidity and rising NPAs) and investment cyclicals (continued weakness in demand with negative operating leverage impacting margins). We raise our CY2014 earnings growth estimate from 8% to 11% to reflect an early pick up in investment demand and easier liquidity for banks (via MSF cuts and increase in amount of term repo). Consensus estimates still remain high at 14% earnings growth for 2014 due to expectations of significant margin expansion next year, while we expect margins to remain flat given muted growth and higher rate expectations.

Exhibit 11: Earnings sentiment for the overall market has significantly improved over the last month; Investment Cyclicals, Financials have seen the sharpest improvement





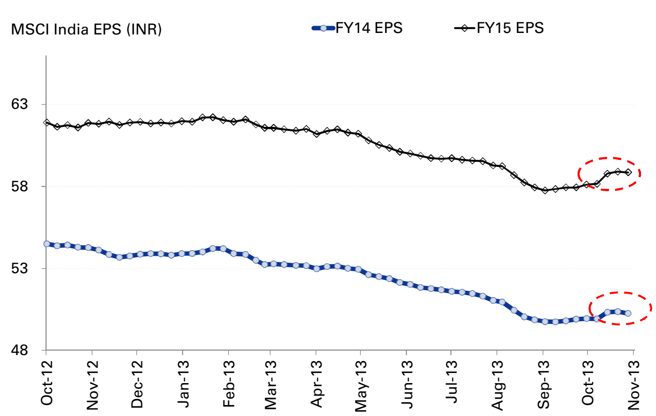
Source: MSCI, FactSet, I/B/E/S, Goldman Sachs Global Investment Research

Exhibit 12: Financials have reported strong results despite tough macro; overall results season tracking in line with historical average so far

2QFY14 reporting MSCI India	Reported Cos. # of Cos.	Reported Cos. % of Sector cap	EPS growth 2QFY14 YoY (%)	EPS growth 2QFY14 QoQ (%)	6M Actual vs. est. FY14	SPS growth 2QFY14 YoY (%)	SPS growth 2QFY14 QoQ (%)	2Q Earnings Surprises (equal-wgt) (% of stocks, total = 100%) Positive	In-Line	Negative
MSCI India	**41**	**76%**	**7%**	**6%**	**47%**	**14%**	**11%**	**28%**	**31%**	**41%**
Financials	10	88%	16%	2%	53%	8%	7%	33%	44%	22%
Energy	2	73%	11%	4%	49%	15%	18%	0%	100%	0%
Consumer staples	3	73%	18%	9%	49%	9%	4%	33%	0%	67%
Health care	4	33%	36%	73%	48%	15%	17%	25%	25%	50%
Information technology	4	100%	16%	11%	47%	27%	15%	25%	75%	0%
Consumer discretionary	4	45%	12%	1%	46%	8%	-6%	75%	25%	0%
Utilities	3	70%	-8%	9%	46%	16%	8%	0%	0%	100%
Telecommunication services	2	81%	3%	-17%	35%	8%	0%	50%	0%	50%
Industrials	3	65%	-25%	14%	30%	13%	14%	0%	33%	67%
Materials	6	57%	-61%	-13%	25%	13%	10%	17%	0%	83%

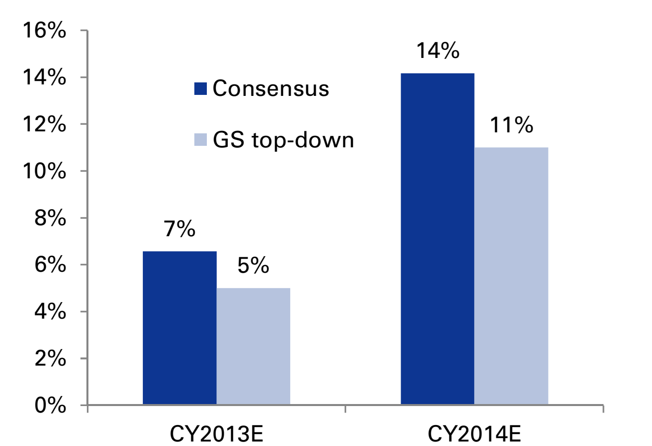
Source: Bloomberg, FactSet, MSCI, Goldman Sachs Global Investment Research

Exhibit 13: Consensus EPS cuts have stabilized over the past month



Source: MSCI, FactSet, I/B/E/S

Exhibit 14: We expect earnings to grow 5% and 11% for this year and next, which is below consensus estimates



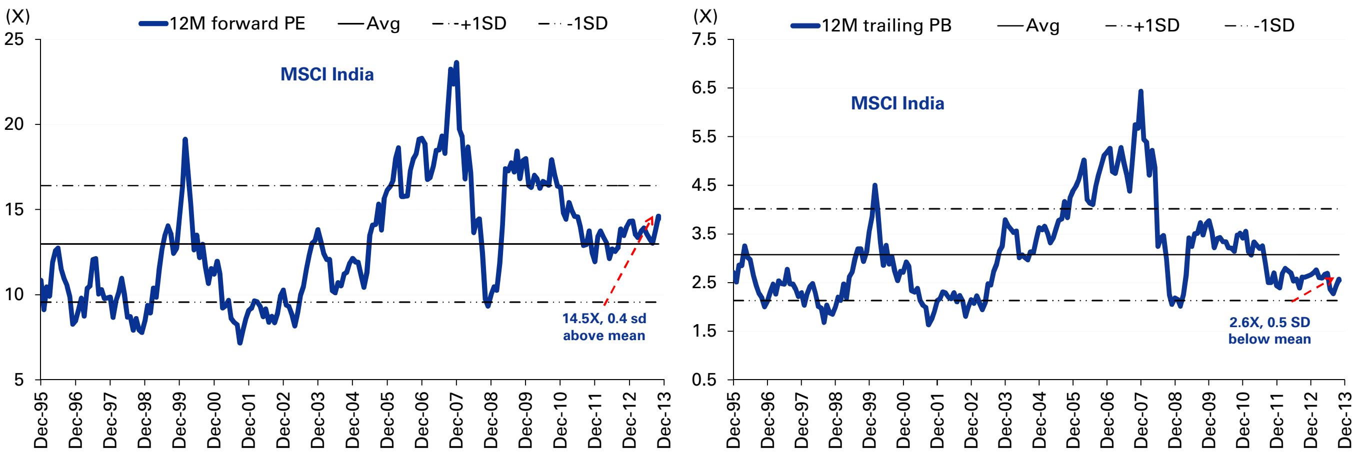
Source: FactSet, MSCI, I/B/E/S, Goldman Sachs Global Investment Research

5) Valuation—mid-range; opportunities in midcaps

MSCI India is currently trading at 14.5x forward P/E and 2.6x trailing book value. While the equity market has re-rated two PE points or 16% since September (from 12.5x PE), the current valuations are slightly above the long-run historical average since 1995. At 14.5x forward P/E, the market may have adequately priced in any upgrades in forward growth views and removal of macro "tail-risks", but we believe there may be potential for a near-term valuation overshoot driven by expectations of political change. **Based on our revised expectations, we raise our view on India to Marketweight and increase our NIFTY index target to 6900 (at a target PE of 14.5x), implying 9% potential upside from current levels**.

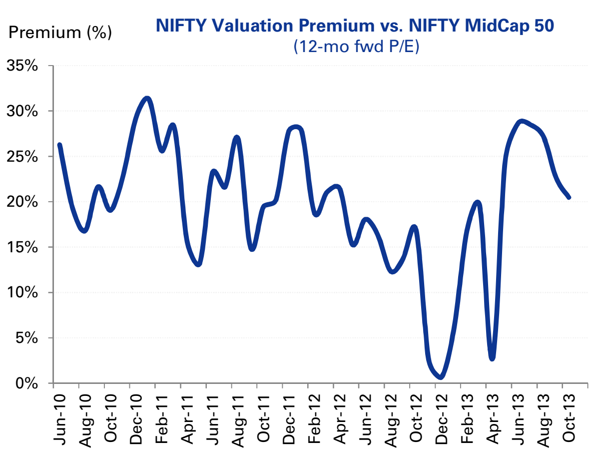
We also highlight the valuation divergence within the market capitalization spectrum. As an example, NIFTY, which is dominated by large cap stocks, had been trading at a 30% premium to the NIFTY MidCap 50 index as of Aug-end, which is near its three year high; consequently we saw inexpensive midcap stocks (particularly in Industrials and Utilities area) rallying the most over the past month. **The mid-cap index is still trading at more than 20% discount to the large-caps on a cap-weighted basis and at around 30% discount on an average (equal-weight basis).** We see potential alpha opportunities in the mid-cap space as a “catch-up” / laggard rally.

Exhibit 15: Current valuations are now above long-term historical average on a P/E basis



Source: MSCI, FactSet, I/B/E/S, Goldman Sachs Global Investment Research

Exhibit 16: Large-cap stocks were trading at ~30% premium to mid-caps at Aug end, near previous highs



Source: MSCI, FactSet, NSE, Goldman Sachs Global Investment Research

Exhibit 17: While the mid-cap stocks have re-rated over the past two months, they still remain at significant discount to the large-caps on an average

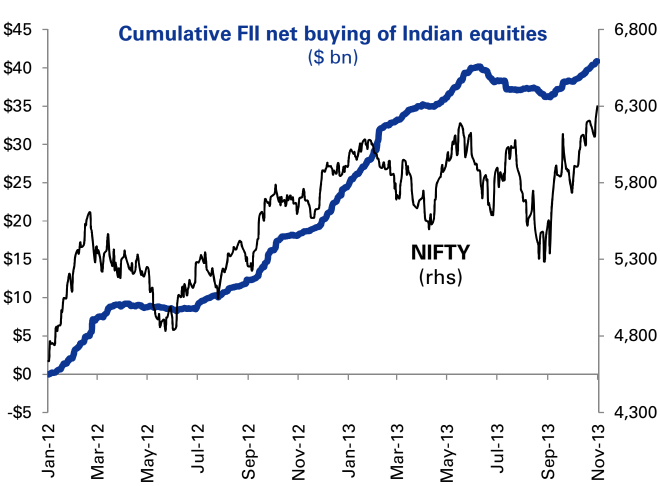
NIFTY MidCap-50 Average fwd. P/E (X)					
NIFTY MidCap	**Aug-end**	**Current**	**Diff.**	**NIFTY PE (Equal-Wgt)**	**Discount vs. NIFTY**
Industrials	7.2	**10.4**	44%	**11.4**	**-9%**
Utilities	4.4	**6.1**	39%	**12.5**	**-51%**
Health Care	10.8	**13.6**	25%	**21.0**	**-35%**
Financials	4.1	**5.1**	24%	**13.1**	**-61%**
Materials	8.4	**9.9**	18%	**14.2**	**-30%**
Telcos	22.4	**25.7**	15%	**25.7**	**0%**
Cons. Discretionary	17.0	**18.7**	10%	**14.2**	**32%**
Info Tech	13.5	**14.7**	9%	**16.0**	**-8%**
Energy	9.3	**8.6**	-7%	**9.5**	**-9%**
Consumer Staples	16.9	**13.6**	-20%	**30.8**	**-56%**
NIFTY Midcap 50 (Equal-Wgt)	**9.0**	**10.4**	**15%**	**14.9**	**-30%**

Source: MSCI, FactSet, NSE, Goldman Sachs Global Investment Research

6) Flows: foreign inflows persistent; retail redemption pressure could moderate

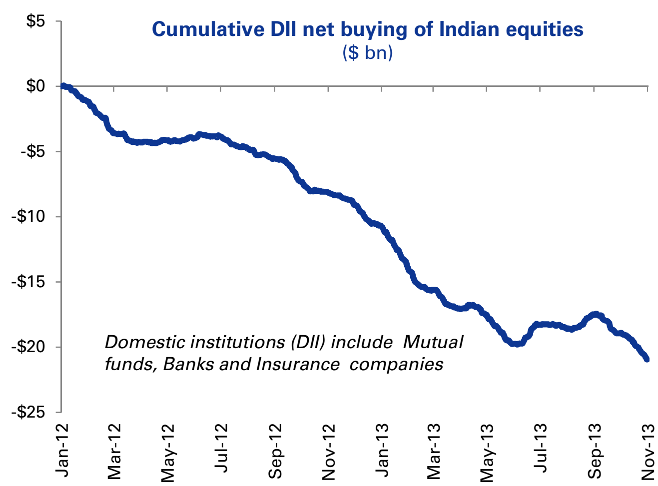
Foreign inflows into Indian equities have remained strong this year despite the excessive volatility and sell-off in emerging markets. FII have net bought US$16.3 bn of equities year-to-date with US$4.6bn inflows since September. While FII flows have been strong and "sticky", which has been supportive of the rally in equities, domestic institutions have been net sellers of equities. **The domestic institutions (particularly mutual funds) have been facing high redemption pressures given poor returns and excessive volatility in the markets**. If the recent rally and optimism regarding leadership change stem the redemption flow, the equity demand/supply balance could shift more favorably.

Exhibit 18: Strong FII inflows have been supportive of equities recently...



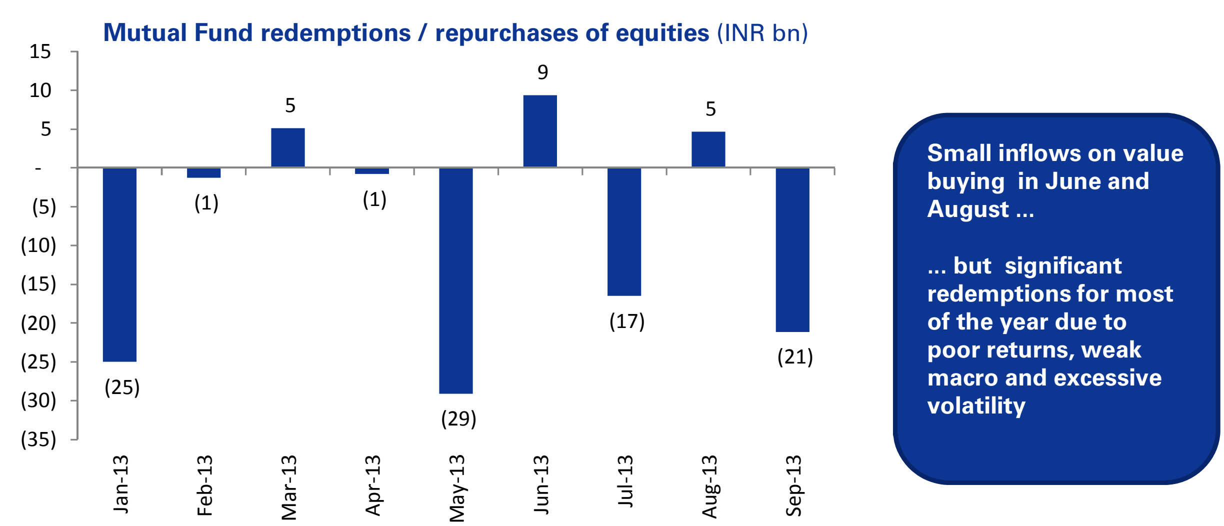
Source: Bloomberg

Exhibit 19: ..while domestic institutions remain net sellers in the market



Source: Bloomberg

Exhibit 20: Equity mutual funds have been facing high redemption pressures



Source: AMFI

Sector and Stock Implementation

We continue to like export-facing sectors like Infotech and Healthcare given tailwinds from better external growth. We also retain our Overweight stance on the Energy sector given attractive valuations and tailwinds from policy/fuel reforms. **Within the domestic cyclicals, we upgrade industrials to Marketweight from Underweight** and remain Marketweight on most of the domestic-demand related sectors like Materials, Autos, Telcos and Utilities. We remain Underweight on rate-sensitive Financials (including the Real Estate sector) and Consumer Staples. **Our cautious view on Consumer Staples stocks is largely driven by still weak consumer sentiment and expensive valuations**.

Exhibit 21: We continue to favor exporters but upgrade investment cyclicals to Marketweight; remain cautious on financials and consumer sectors

Sector scorecard

MSCI India Sectors	MSCI India Wgt	Macro Views	EPS Sentiment	Relative Valuation	Average Score	Overall Risk/reward
Info Tech		√√	√√		√√	Overweight
Energy		√		√√	√√	Overweight
Health Care		√√	√		√√	Overweight
Industrials		√	x	√√	√	Marketweight
Materials		√	x	√	√	Marketweight
Autos			√			Marketweight
Telcos			√	x		Marketweight
Utilities			x	√		Marketweight
Banks, Div. Fins.			x	x	x	Underweight
Real Estate		x			x	Underweight
Staples		x	x	xx	x	Underweight

40% 30% 30%

Weighted Average Score → Judgemental Overlay

Current "Simplified" Macro Views

Growth: Some early signs of cyclical pick up
Liquidity: External funding pressure moderated
Dom. vs. Extenal: External
Politics: Optimisim over potential change
INR (vs. USD): Neutral

Current metric is:

√√	Very favorable
√	Favorable
	Neutral
x	Negative
xx	Very Negative

Source: FactSet, MSCI, I/B/E/S, Goldman Sachs Global Investment Research

Our preferred stock ideas include a list of 10 stocks our analysts rate Buy which screen well on core fundamentals. Our aggregate list has an average potential upside of 19% from current levels with 15% earnings growth for 2014 and is trading at 11.9x forward P/E on an average. We highlight Infotech (**HCL Tech, Tech Mahindra**), Oil and Gas **(RIL, BPCL, Coal India**), Banks (**Yes Bank, IndusInd**) and select auto and cement stocks.

We also include a screen of midcap Infrastructure stocks which are trading at inexpensive valuations. Highlighted stocks include IPPs (**Adani Power, NHPC**), Materials stocks like **Grasim,** and Industrials stocks like **Container Corp** and **Adani Ports.**

Exhibit 22: Our preferred picks that screen well on fundamentals

Bloomberg	Name	GS Sector	Listed Mkt Cap (US$ mn)	3M ADVT (US$ mn)	Price (INR)	GS Rating	Potential +/(-)%	CY14E EPSg (%)	2014E P/E (X)
RIL IS	Reliance Industries	Oil and gas	47,429	57	908	B*	**29%**	10%	11.6
COAL IS	Coal India	Oil and gas	29,869	13	292	B*	**28%**	7%	10.0
BPCL IS	BPCL	Oil and gas	4,158	11	356	B	**27%**	15%	11.6
HCLT IS	HCL Technologies	Infotech	12,417	27	1,100	B	**21%**	24%	12.9
YES IS	Yes Bank	Banks	2,203	99	378	B	**19%**	19%	7.9
TECHM IS	Tech Mahindra	Infotech	5,734	32	1,526	B*	**16%**	10%	12.1
IIB IS	IndusInd Bank	Banks	3,804	28	449	B*	**16%**	23%	15.0
MM IS	Mahindra & Mahindra.	Autos	9,211	23	925	B	**14%**	13%	12.7
BJAUT IS	Bajaj Auto	Autos	9,939	17	2,124	B	**13%**	14%	15.4
GRASIM IS	Grasim Industries	Materials	4,181	4	2,816	B	**10%**	11%	9.4
Average (equal-weighted)							**19%**	**15%**	**11.9**

Priced as of November 1, 2013; B=Buy; *denotes stock is on our regional Conviction List.

Source: FactSet, MSCI, I/B/E/S, Goldman Sachs Global Investment Research.

Exhibit 23: We highlight mid-cap Infrastructure plays with inexpensive valuations

Bloomberg	Name	GS Sector	Listed Mkt Cap (US$ mn)	6M ADVT (US$ mn)	Price (Quote)	GS Rating	Upside Potential to post GFC high	2014 EPSg (%)	2014 P/E (X)	2014 P/B (X)
Railways, Ports										
CCRI IS	Container Corp. of India	Transportation	2,396	1	760	B	27%	9%	14.0	1.9
ADSEZ IS	Adani Ports & SEZ	Transportation	4,852	8	145	B	25%	21%	13.7	2.9
Infrastructure, Industrials, Cap Goods										
ADE IS	Adani Enterprises	Industrials	3,630	8	204	NC	278%	79%	8.4	0.9
JPA IS	Jaiprakash Associates	Industrials	1,756	32	49	N	261%	75%	8.1	0.7
VOLT IS	Voltas	Industrials	489	2	91	N	183%	40%	12.3	1.6
Power										
ADANI IS	Adani Power	Power	1,595	4	34	NC	317%	NA	NA	1.9
NHPC IS	NHPC	Power	3,680	2	19	NC	98%	9%	8.6	0.7
Materials										
GRASIM IS	Grasim Industries	Materials	4,181	4	2816	B	24%	11%	9.4	1.1

Priced as of November 1, 2013; B=Buy; N=Neutral; NC=Not Covered.

Source: FactSet, MSCI, I/B/E/S, Goldman Sachs Global Investment Research.

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Reg AC

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