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'We expect the market to trend upwards'

Aarati Krishnan

Not only individual investors, even fund managers have been surprised by the speed and extent of the recent market rally. How should investors interpret this rally? Is it a case of too much too soon? Business Line caught up with **Mr Dipen Shah**, *Vice-President, Private Client Group, Kotak Securities, for his take on these key issues.*

Excerpts from the interview:

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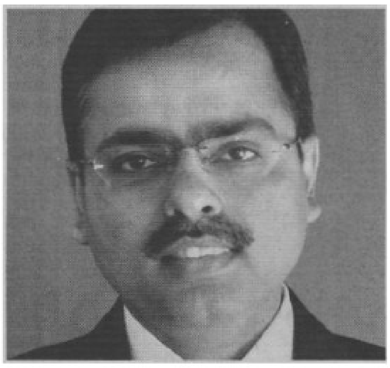
>
> DIPEN SHAH, VP, PRIVATE CLIENT GROUP, KOTAK SECURITIES



There is a view that just as the markets fell ahead of an earnings slowdown, they will recover ahead of an earnings upgrade cycle. Do you go with this view? If so, do you believe that the recent rally is the beginning of a new bull market in Indian stocks?

Markets normally discount the actual performance well in advance. We expect that the performance of the corporate sector should gradually improve over the next few quarters with the fiscal stimulus measures expected to take effect, further reforms expected to be initiated by the Government, interest rates on a downtrend, improving liquidity and business confidence showing an uptrend.

We expect the markets to gradually trend upwards (subject to intermittent volatility) after we get more visibility on the second half of FY10 and FY11 earnings. Till that time, we expect the markets to consolidate in a narrow range. No doubt, any unforeseen negative global events will have an impact.

The PE multiple for the Sensex has gone back to about 15 times trailing 12-month earnings. Does this make the Indian markets expensive, in your view?

Markets are fairly priced based on FY10 market estimates. The markets have also largely bridged the valuation gap which was there *vis-à-vis* a few other emerging markets. We need to get more comfort on the next year's growth before markets can follow a sustainable trend.

Is there too much optimism about the extent of reforms that a stable government can push through?

With a strong verdict in favour of a more stable coalition, there are expectations that the reforms process will be carried forward with renewed vigour. So, the optimism is not misplaced. However, we need to see both intent and implementation, in the forthcoming budget and beyond. If there is only intent and little implementation, markets may be disappointed.

FII inflows of about $2 billion over the past five weeks have been instrumental in driving this rally. However, there is trepidation in some quarters that this is not long term money, but short term bets by hedge funds because of the relaxation in P Note restrictions. Do you have a comment on the nature and sustainability of these FII flows?

While we do not have the information to back our views, we believe that, it is a mix of long term money and hot money. If the fundamentals of India improve, we will see more and more long-term and serious money flowing into India.

We are about halfway through the earnings season for the March quarter. What is Kotak Securities' sense of the earnings so far? Have they been better than expected? Which sectors did better than expected?

The results have been a mixed bag for us. While some stocks in sectors like IT, Construction and media have disappointed, others in cement and banking have surprised us on the upside.

One of the triggers to the ongoing stock market rally was the revival in commodity prices on the back of hopes of higher imports by China. What's your view on stocks of commodity players in metals, steel and the oil space? Have commodity prices bottomed out?

We do not expect the commodity prices to see their 2008 lows as economies including China and US seem to be in the stabilization / recovery mode. However, demand from major consuming economies needs to increase further for capacities to be fully utilized before which we can see prices move up on a sustainable basis.

We also note that, the prices are influenced by the movement of the dollar.

The realty sector which has led the stock market rally has shown poor earnings performance. There is also a widespread view that the realty sector will take some time to recover. What's your view on the sector and thus on the recent run-up in these stocks?

The sector is seeing some signs of revival after companies have reduced prices and the ticket sizes. Interest rates have also softened. Of late, funding constraints have also eased with companies being able to raise funds from institutions/ banks. However, the revival is seen only in budget residential housing sector with the commercial real estate sector still to see any appreciable uptrend. We expect the sector to revive gradually as overall confidence in the economy improves.

The recent run up in prices was in response to the above mentioned triggers. We expect the prices to sustain and move up further, as we see further improvement in housing and more importantly, the commercial real estate sector.

Some market watchers believe that the recent resurgence of the emerging markets and within them India, is a sign of FIIs finally recognising the stronger growth potential of India. Is it time to give the much-maligned "decoupling" theory another chance?

With a stable coalition at the centre with a strong lead party, India has every chance to implement reforms which will lead to a sustainable high growth. This is possible because structurally, Indian economy is better off as compared to several others. This, along with a relatively lower dependence on exports may allow us to perform much better than most other economies in the longer term.

We've seen quite a few Sensex target upgrades by leading institutional investors in the past couple of weeks. Is this driven mainly by expectations of liquidity or is the earnings picture too looking better?

The upgrades are in expectations that the reforms process will now gather pace, which will likely lead to better growth rates, in turn, attracting more flows. However, for a few cash-starved companies / sectors, liquidity flows into the business will be an important factor for delivering high growth.