



mastermind

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Advantage Emerging Markets

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EQUITY MARKETS

Today, equity investors globally are favouring emerging markets over developed markets. India stands out among emerging markets, as its strong GDP growth is supported by favourable demographics, fuelling domestic consumption growth and related investments in infrastructure, and not exports to western markets.

India is a favoured destination for global fund managers and global liquidity has driven the Indian equity markets up in the last one year or so. We believe, as long as global recovery remains anaemic (and not double dip!), easy monetary policies will continue and are expected to lead to liquidity flows in emerging markets like India. Such easy money policies have the potential to lead to bubble-like situations in commodities, equities in emerging markets and precious metals. However, as an equity investor, one should also be aware of the concerns, which exist both on the domestic and global fronts, in the

medium term. While at one hand, economies in the western world need to unwind fiscal stimulus, they face the challenge of ensuring economic recovery while reducing the fiscal deficit. Whereas, in emerging economies like India and China, the challenge is to unwind the monetary stimulus to contain inflation. Both countries need to raise interest rates, prick real estate bubbles and reduce liquidity to bring down inflation. Both, unwinding of fiscal stimulus and monetary stimulus, are negative for global growth and thus for equity markets, in the short to medium term.

Thus, investors will have to tide over the short-term headwinds in the equity markets to benefit from the Indian economy's long-term growth story. Global liquidity is a short-term positive for the equity markets while the sovereign default worries are a medium term risk to global equity markets. However, in the long term, favourable demographics and a predominantly domestic consumption and

infrastructure-driven Indian economy offers good long-term investment opportunities. SIPs are an efficient way of investing in the current environment.

DEBT MARKETS

The markets have witnessed an immense liquidity crunch in the past few months. The liquidity squeeze took off from the 3G and BWA auctions concluded early this year. Apart from that, the current negative real interest rate is one of the primary reasons, which has led to abject liquidity situation in the banking system. The current consumption and savings pattern is undergoing a shift with higher portion of one's income being allocated to rising expenses. This structural shift is expected to lead to a drop in savings rate in the coming few years. Also, within one's savings, financial savings (ideally in the form of bank deposits) is fetching negative inflation adjusted returns. The current rates on fixed deposits are not attractive for investors, so banks have resorted to hik-

ing their rates in order to improve the deposit demand growth. In order to deal with the rising inflation, higher currency in the hand of the investor also enables him to pre-poner his spending on account of expected higher inflation in the coming months. Due to this negative real rate of return from financial savings, Indians have started investing in real assets like gold which has delivered better inflation adjusted returns in the past. The demand for gold has doubled in the last one year as a result of this negative real interest rates. With credit growth around 20%, banks may raise the rates to attract more deposits.

In conclusion, we believe that the emerging markets stand to benefit for a little while longer due to the recent round of 'quantitative easing' in the US, as both the US and Europe struggle with challenges within their own economies. Closer home, India continues to receive disproportionate share of attention, in particular, from institutional investors who have a rather limited choice for investments in their traditional markets. India continues to be powered by a strong domestic consumption story but inflation and political stability (given the numerous scams in the recent past) will place tremendous challenges before the current political leadership. The choices it makes in guiding the Indian economy will hold the key for the future growth of the Indian economy.