

‘Fed policy will decide we have upward or downward correction’

INDIAN markets are witnessing unprecedented inflows from foreign institutional investors. Our markets have rallied in the past few months on the back of these inflows, which could continue for some more time if the US government announces another stimulus package, says Anand Shah, head of equities at Canara Robeco Mutual Fund. He believes that US investors are willing to overpay for India because of the significant interest rate differential between the two countries. But robust inflows may not always be healthy. In a chat with Chirag Madia and Muthukumar K, Shah warns that excess money could create a bubble in Indian equities.

How are the September results panning out?

Results declared so far have been good. We expect that banks and consumption-oriented sectors like FMCG, pharma and retail will continue to deliver better-than-expected results. At the same time, infrastructure companies will continue to struggle with issues of land acquisition, environmental clearance and financial closure. The impact of subsidiaries' results like Corus, Novelis, JLR etc will be a big booster for parent companies. On an overall basis, September quarter results will be able to meet market expectations.

FII's have been buying into Indian markets over the last couple of months while domestic institutions have been selling.

At the end of the day, we have to look at why FIIs are buying and DIIs are selling. Lower interest rates in the US make Indian equity market attractive, which can't be necessarily said for Indian investors. This is because the interest rate on ten-year bonds in US is 2.5% p.a., whereas it is around 8% p.a. in India. So, to that extent, because of the differential in interest rates, US investors are able to overpay for India. This is the reason why FIIs are bullish on India and Indian investors not that bullish.

How have higher interest rates affected asset allocation?

Indian savers were disincentivised to save due to the negative real rate of return in bank deposits. The nature of savings, we believe, has changed from financials saving to non-financial saving. We believe Indian households, in search of returns higher than inflation, have gone ahead and invested in equity, gold and real estate. There investments in bank fixed deposits have reduced and that is why we have seen anemic growth in the first six months for deposit growth.

What's your view on the quantitative easing (QE) measures of the US? Could it benefit Indian



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equity markets?

The market did not initially react to QE1 and we were wondering why. Subsequently, we saw its effect in the form of a major rally (which we have seen over last 18 months) witnessed not only in Indian equities, but also other emerging markets and assets like gold and silver. We are keenly observing US QE2 because inflation expectations are low and unemployment is high. But we are not very far from a situation of real inflation in the US. Also, signals like deficit, point to a probable scenario of lesser consumer spending in the US.

QE1 is a big experiment by the Fed and it has not worked. Another round of QE can lead to inflation and if (US GDP) growth doesn't bounce back, we are talking about stagflation.

How would QE2 impact Indian markets?

If they announce a very large bond purchase programme in QE2 (more than it is priced in), then we will have a rally in Indian equity markets. However, it can also create a bubble if fundamentals (which is growth), do not follow high valuations. Its a trillion-dollar question though, if QE2 could bring growth back in the US or that in the global economy. In case of QE1, despite monetary base going up,

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money supply didn't go up as much, since the private sector deleveraged, and we have not seen sustainable GDP growth in the US.

Do you foresee a correction in the Indian equity market?

Over the short-term, in domestic markets, quarterly results will decide the direction of markets. We believe market expectations are not running very high and results will positively surprise. However, the challenge lies in maintaining growth rates in the second half.

On the international front, Fed policy in the first week of November will decide whether we have an upward or downward correction. Till then, markets will wait for the real economic numbers to come in. We have to also look at how much of QE

will be allowed by US lawmakers. If Fed delivers what is already priced in, then we might see some positive movement in the equity market.

How do you look at Indian market valuations at this juncture?

Indian markets are not as cheap as they were in October 2008 and not as expensive as in January 2008. We have QE2 measures which can take the market up further while several other issues weigh the market down.

In the short term, markets are driven by liquidity, but over the long term, by fundamentals. So it is wrong to discuss fundamentals while looking at the short term. Whatever we discuss in terms of price earning is irrelevant, if liquidity flows continue. If I say markets are expensive, it can become more expensive over the next three months. In the long term, a predominantly domestic consumption and infrastructure-driven economy offers scope for long-term investment. SIPs are an efficient way of investing in the current volatile environment.

Are mid-cap stocks relatively more attractive, given that they haven't rallied in the past few months?

It is unfair to say that mid-cap

have not rallied. They have not rallied in the initial part as well as in the last leg, but had a good time in between. They have not performed in the last month as FII and ETFs preferred large-cap stocks. In the current markets, one should prefer large caps over midcaps.

Oil is currently trading at around \$80 per barrel? Going forward, how could this affect Indian markets?

Rise in oil prices affects markets and the economy. Rising oil prices are bad for our economy, but good for Sensex companies. Indians are major oil consumers and lower commodities prices have a salubrious effect on our economy. Despite rising oil prices being negative for the economy, they have a positive impact on the market in the short term.

What's your current portfolio allocation strategy?

We will look at companies which will survive the global financial crisis, inflation and over a period of time, also create wealth. We take a long-term (at least 3 years) perspective and then look at the companies which are going to be resilient during a downturn as well as benefit from a pick-up.