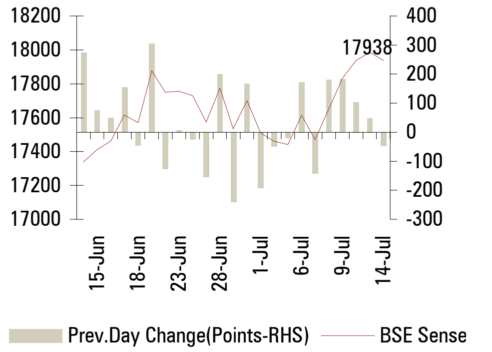
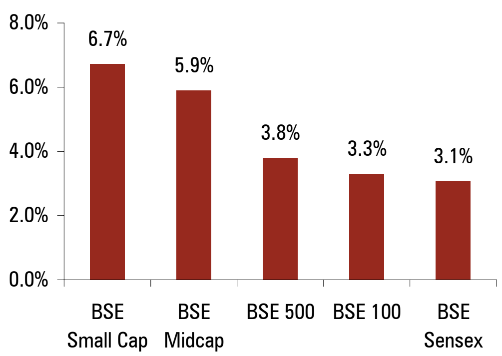
July 16, 2010

BSE Sensex



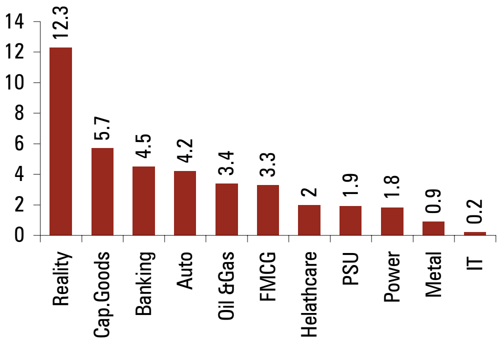
Source: Bloomberg, ICICIdirect.com Research

BSE Indices Return (%)



Source: Bloomberg, ICICIdirect.com Research
1 Month Returns as on June 15, 2010

BSE Sectoral Indices Returns (%)



Source: Bloomberg, ICICIdirect.com Research
1 Month Returns as on June 15, 2010

Analyst's name

Sachin Jain
sachin.ja@icicisecurities.com
Sheetal Ashar
sheetal.ashar@icicisecurites.com

Equity Markets

Update

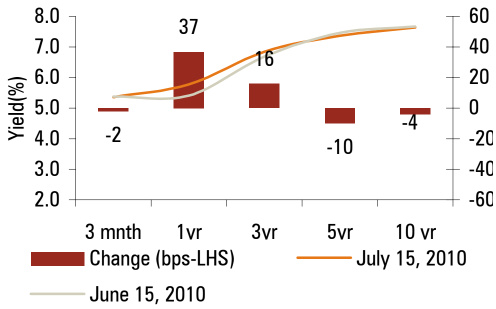
- Indian markets remained range bound in the last month with buying interest emerging after news flows on deregulation of oil prices
- Midcaps and small cap stocks outperformed their larger counterparts as investors focused on the smaller segment in search of better value
- Capital goods and the banking sector were among outperformers as expected because of a pick-up in order inflows/underperformance and pick-up in credit growth and improving business outlook, respectively. We had recommended infra and banking funds and the same has benefited as both these sector have been among major outperformers in the last two or three months
- Realty sector outperformed due to the recent underperformance and news flows on allowance of FDI in the sector
- The metal sector continued to underperform as expected due to pressure on global commodity prices and visible slowdown in China affecting its import of commodities. IT also delivered negative returns after lower-than-expected Infosys result hampered investors sentiments
- Global economic data in the US and China are indicating weakness in their economy affecting global equity markets
- IMF increased its world GDP forecast to 4.6% from the earlier projection of 4.2% while increasing India's GDP forecast to 9.5% from 8.8% earlier
- India's IIP softened to 11.5% in May from 17.6 in April while headline WPI inflation continued to be in double digits at 10.55%
- FIIs remained net buyers and brought equities to the tune of Rs 15000 crore in the last one month ending July 15, 2010 while mutual funds, reeling under redemption pressure, continued to be net sellers

Outlook

- Indian markets have been outperforming global markets because of increased foreign inflows undermining its inherent fundamental strength
- Domestic institutional investors have been buyers at lower levels but are shying away from investment at the current higher levels
- We do not expect any major surprise in the first quarter result. Progress of monsoons and global markets are expected to decide the trend of the market
- Because of relative outperformance, vulnerability of a correction in the event of a global market correction has increased
- Markets are trading at a P/E of 16.7x FY 11 expected EPS and 14.5x expected FY12 EPS making its valuations fairly valued. Therefore, the short term performance may be muted
- However, with more than one year investment horizon, Indian markets offer good investment opportunities
- Diversified multi-cap funds offer better opportunity for risk averse investors
- Investment in a staggered manner at every dip should remain the investment strategy

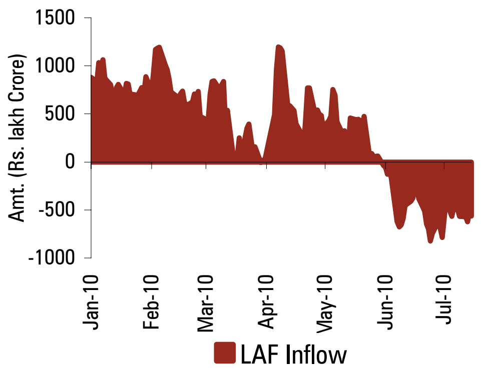
Debt markets

G-sec Yield Curve



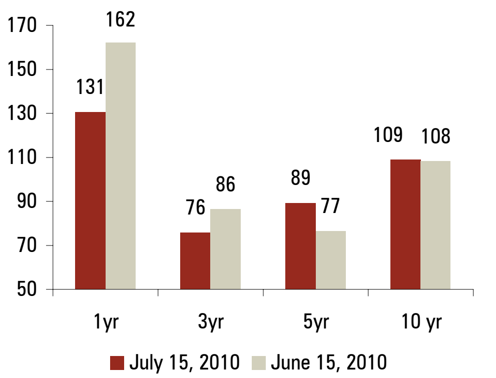
Source: Bloomberg, ICICIdirect.com Research

Expectation of further tightening reduces liquidity



Source: Bloomberg, ICICIdirect.com Research

Credit Spreads



Source: Bloomberg, ICICIdirect.com Research

Update

- The debt market remained range bound in the last month ending July 15, 2010. Short-term rates continued to remain under pressure as liquidity continued to remain tight
- RBI raised the benchmark repo and reverse repo rate by 25 bps on July 2, 2010 to contain inflationary expectations
- The RBI extended its liquidity enhancing measure (special reduced SLR requirement at 24.5% that was to expire on July 2) till July 16 to tackle the liquidity crunch
- Longer duration rates remained range bound taking cues from ranging longer dated US yields
- Corporate bond yields remained range bound following G-Sec yields
- AAA corporate bond spread remained in the range of 110-115 bps on the 10 year while they compressed to 137 bps on July 15 from 162 bps on June 15 mainly because of a rise in G-Sec yield
- Headline WPI inflation continued to remain in the discomfort double digit zone at 10.55% for July 2010
- The system continued to remain negative with average borrowing from repo facility above Rs 50000 crore on a daily basis as can be seen from the charts

Outlook

- We expect liquidity to ease off, going forward, in the next month and rates on money market instruments to ease off from the current higher levels
- Yields on the longer duration particularly on the G-Sec curve are unlikely to move up sharply from current levels. We expect the benchmark 7.80% 10 year G-Sec yields to trade in a range of 7.50-7.75% levels
- The RBI is expected to hike repo and reserve repo rates by 25 bps to contain inflationary expectations. However, the same may not have much of an impact on the market as it is widely expected
- Corporate bond spread is not expected to shrink from current levels and may rise if risk aversion increases
- The overall view on the debt market is positive. We expect the yields across the curve to remain range bound. However, supply of papers from both centre and state government may prevent the yields from falling sharply from current levels
- We believe the money market rates are at attractive levels and the trade-off is in favour of investing. Liquid funds and ultra short term funds provide a good investment opportunity
- Aggressive investors may look to invest some portion in longer duration income funds or G-Sec funds with more than one year investment horizon