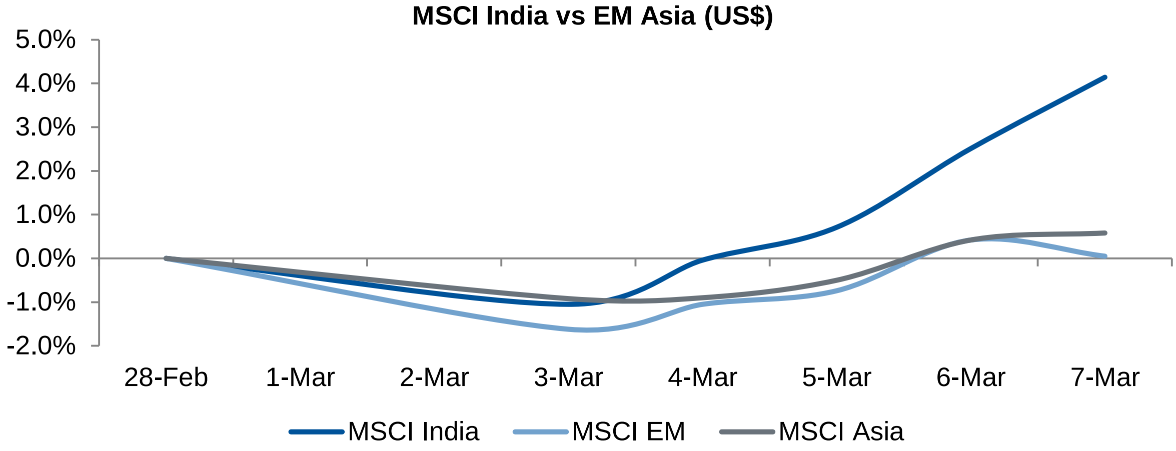
Thoughts on the new highs of the Indian market

Last week the Indian stock market reached new highs in local currency, outperforming its Asian and EM counterparts. The Sensex has rallied 3.8%, whilst the Rupee has appreciated 1.8% versus the Dollar. Total US$ return was 5.6%, for the week ending 7th March.

Furthermore a visible shift has been made; away from defensive, export dependent IT and Healthcare, towards more domestic and cyclically themed sectors, Banks, Industrials, Cap Goods.



Reasons for the rally

- Manufacturing PMI data for February expanded at its strongest pace for a year, scoring at 52.5 vs 51.4 in January
  - Most encouraging was the sub-index for new orders from both domestic and foreign companies, which clocked 54.9 (also the highest for a year)
- Current account deficit data released showed improvement: 0.9% of GDP Q3FY14 (6.5% in the same quarter last year)
  - April – December 2013 deficit was 2.3% of GDP vs 5.2% for the same period in 2012
- Latest opinion poll, this time by CNN / IBN last week showed the BJP-led NDA coalition achieving 212 – 232 seats out of 545
- Buying has been driven by Foreign Institutional Investors who were net purchasers of US$838.9m for the week
- Sentiment towards Emerging Markets is at all time lows, and cash positions at all time highs. (Source: Merrill Lynch Global Fund Manager Survey; 18-02-14)

Valuations

- The week showed evidence of sector rotation out of the defensives and into the cylicals, thus the CNX Bank Index gained 10.7%, verses -2.7% for the CNX IT Index and -4.3% for the BSE Healthcare Index
- The Sensex Trailing PE at 17.6x sits just below the 5 year average of 18.1x (Source: Bloomberg). This masks the huge disparity of valuations at a sector level

Conclusion

- First signs of sector rotation suggest that the equity market is starting to look beyond the current economic malaise
- This coincides with a period of currency stability
- The larger funds will find it harder (and take longer) to re-position portfolios if this trend continues. Size is the enemy of performance
- There is still value in the market, though headline numbers can paint a misleading picture
- Small and Midcaps provide the best opportunity to generate alpha at this point in the cycle

Important Information