Place your bets before the market creeps up

The stock market, now in a comatose phase, may creep up sooner than later as global hot money chases fundamentally strong stocks. But only alert investors will be able to strike it rich

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THE last thing stock investors want is a range-bound market for a prolonged period. That is exactly what is happening in the Indian market over the past seven to eight months.

Stocks are neither too cheap for investors to enter nor are valuations too high to book profit. It's a kind of comatose situation.

The emerging situation has created a dichotomy for investors and fund managers alike. For, after the recent 10-11 per cent fall, the market has not reacted negatively even to extreme negative triggers and the worst scenario appears to be in the stock prices already. Most market experts would tell you even if the Reserve Bank of India goes for another very hawkish rate hike, there would be limited downside for the equity benchmarks, as fresh buying would emerge.

Under the circumstances, there are chances that the domestic market will creep up quietly sooner then later as global hot money chases fundamentally strong stocks.

For, while the domestic economy is going through numerous headwinds and major global economies are wrestling with multiple challenges and excess liquidity in the system is scouting for opportunities everywhere.

There were instances in the past when the domestic market had rallied under similar circumstances. Only alert fund managers and smart investors end up with big gains in such a rally. Few equity mutual funds managed to strike it rich when the stock market rose from near 8,000 to around 16,000 in the later part of 2008.

"The situation is ideal for stock pickers. Though benchmark indices have not corrected much — 10 to 11 per cent this calendar — there are stocks at attractive valuations in the broader market," said N Arunagiri, CEO of portfolio management company TrustLine Holdings.

"We believe the bad news — higher interest rates, rising inflation, corrup-

This is keeping the market in check. Investors who are able to use a bottom-up approach can expect good returns once the clouds are cleared," he said. But stock picking does not really look easy at this stage. Every sector looks bruised, and most of the fundamentally strong stocks have not really fallen much in the recent correction and are ruling at fairly high valuations.

Rajesh Jain, EVP and head of retail research at Religare Securities, said though he was cautious on Indian equities in the short term due to inflation and higher interest rate returns for investors with a one- to two-year horizon.

Also, the higher domestic interest rate environment will allow foreign funds to park funds in Indian debt. "They are already doing that (putting funds in debt)," Jain said.

Already this calendar, FIIs have invested \$3.168 billion (Rs 14,275.70 crore) in the debt market, compared with just \$190.10 million (Rs 671.70 crore) in equities.

Total debt investment of FIIs stood at \$20.74 billion, according to Sebi, which means technically, they can invest another \$10 billion as the government has set a cap on FII investment in the country's debt and bond markets to \$30 billion.

The Lehman Brothers-led mortgage crisis of 2008 showed that India was not 'de-coupled' after foreign funds exited local stocks in a hurry. "The long-term India story is intact and we feel FIIs cannot ignore India's long-term potential," said Jain.

Foreign funds have "resumed their shift from equities to bonds in the first week of June," EPFR Global, which tracks fund flows, said on Friday.

"Globally, the situation is not rosy. While the US is grappling with ballooning deficit, Europe is yet to tackle member countries. And there is no end in sight for the problems in the West Asia," said Religare's Jain.

Though this may show India in better light, in reality, it is not, Jain said. "If the problem in the US worsens (economic data, including job figures, released last week were disappointing), investors may press the panic button, triggering heavy redemption by foreign funds," he explained.

With the domestic economy still wrestling with stubbornly high inflation, interest rates set to go up further and companies across sectors reeling under strong margin pressures, the

the short term, Jain felt.

Saurabh Mukherjea, head of equities at Ambit Capital, pointed out that the Indian market was trading at a premium to its emerging market cousins — Sensex is trading at 15.1 times FY12 earnings and at a 39 per cent premium to other emerging markets – despite powerful macroeconomic headwinds such as high and persistent core inflation, oil price persisting at elevated levels and a moderation in economic growth.

On Friday, US stocks fell for the sixth straight week, giving Dow Jones Industrial Average its longest slump since 2002, as fears of a possible slowdown intensified in the global economy.

Ambit Capital expects a de-rating of Sensex's forward P/E premium in the short term. "Sensex trades at a 39 per cent premium to the MSCI Emerging Market (on a forward P/E basis). Over the past 10 years, this premium has averaged at around 28 per cent. Given the outlook for the Indian economy, we believe it makes sense for the Sensex forward P/E premium to be de-rated by around 9 per cent (15.1 times going to 13.8 times) so that our premium to the MSCI EM becomes 28 per cent (in line with India's CY01-10 premium)," Mukherjea said.

According to Arunagiri, there are good stocks available in mid-cap IT and consumer discretionary such as auto component manufacturers (firms that supply parts to two-wheeler makers) and battery makers.

Several small and mid-cap IT firms that have zero debt and clean balance sheets are available at good valuations at the moment. However, large-cap IT stocks are not cheap, he said.

Divyesh Shah, CEO of Indiabulls Securities, said FMCG, pharma and software stocks would continue to do better in the present environment. "If you notice, FMCG and pharma stocks have not gone up significantly this year. We see good opportunities in these two sectors," he said.

Ambit Capital's Mukherjea is also cautious on power and construction sectors because of a negative macroeconomic environment as well as sector-specific challenges.

"While infrastructure stocks (excluding L&T) appear cheap, valuations are facing challenges not only on account of core construction financial performance (most importantly in terms of cash flows) but also on account of embedded values, which need more capital in the near term," he said. The end of QE2 also means there will be no incremental flow of cheap money for speculative transactions. "This means it is time to play safe in metals sector, especially in non-ferrous space which would be hit by the double-whammy of lower global demand and unwinding of financial transactions," said Chandrani De, metal analyst at Ambit Capital.