MONDAY MARKET

Growth recovery round the corner, but the pace could be gradual

With fiscal and current account deficit being under control, reforms in the infrastructure and power sectors, and recovery in commodity prices like steel, aluminium and coal, a broad-based economic recovery over next two years is a strong possibility, said ***Anurag Jain****, chief investment officer at Canara HSBC Oriental Bank of Commerce Life Insurance Company in an interview with* ***Falaknaaz Syed****. Excerpts:*

■ How do you expect Q4 earnings to be? Are there any early signs of revival? If not, when do you expect revival in corporate earnings?

We expect Q4 earnings to be mostly on the lines of the previous quarter. Overall revenue growth and profit growth of the Nifty benchmark companies is likely to be in single digits. This would be driven mostly by cyclical sectors, which on a low base would deliver strong earning growth. The Indian economy is emerging from a cyclical downturn and macroeconomic environment is also stable. We believe growth recovery is around the corner though the pace will be gradual. Low interest rates, operating leverage driven by improving capacity utilisation and raw material costs broadly being under control, we expect next few years to be good earning growth years for India Inc.

■ The WPI inflation rose to 39-month high of 6.5 per cent YoY in February from 5.2 per cent YoY in January. Would you be concerned about such a sharp rise in the WPI right now? Some analysts expect RBI to hike rates in FY18. What's your take?

Wholesale prices are mainly dependent on global commodities, crude oil and energy prices. While global commodity prices have moved up from the bottom having fallen to unsustainable levels, we believe they should remain around current levels due to rising interest rates and global uncertainties. Thus, inflation would not be an immediate big challenge and broadly remain under control. RBI has changed its monetary policy stance from "accommodative" to "neutral" and we believe any rate hike would be sometime away as inflation is also not likely to be an imminent big issue and growth is yet to recover.

■ Is the market rally sustainable? How do you see the valuations now? Where do you see the index in 12 months?

The Indian equity market generated around 18.5 per cent return during FY17 and has been among the better performing markets globally. This good performance has been driven by favourable macro-economic outlook, expectation of improving corporate earning growth and receding political risk. The market is now trading at 18.5x FY18 earnings, which is above the long-term average valuation and room for further expansion of P/E multiple is limited. While in the near-term market may have run its course, over the medium- to long-term, we believe as earning growth of companies accelerates, valuations tend to become more reasonable and returns in-line with the earning growth can be generated.

■ What's your outlook on foreign fund flows into India with the looming Fed hikes?

The US has been the biggest source of liquidity for the world over the last decade. The US Fed monetary policy stance of tightening rates is leading to gradual withdrawal of liquidity from risky assets (emerging market equities/bonds, commodities) globally, to dollar-denominated assets. But with improving corporate earning growth outlook, India can garner a larger share of the liquidity flows and deliver returns in line with earnings.

■ MFs are registering strong inflows. How have been the flows in Ulips for the life insurance companies?

One of the big positives of demonetisation has been higher financial savings in the economy. With relatively lower attractiveness of gold, real estate and FDs as investment options, the trend is here to stay. Both MF and insurance industries have been beneficiaries of this trend and would continue to benefit from it over the next few years.

■ Where do you see the rupee by the year-end?

Over the long-term, exchange rates are dependent on inflation and interest rate differentials. Macro-economic environment is stable with inflation under control and interest rates low. The rupee also has a lot of positive factors supporting its outlook at this juncture and is likely to outperform in the region, driven by economic policy initiatives along with heavy capital inflows. There is likelihood of RBI intervening to manage the volatility and prevent sharp movements in the rupee. Thus, we expect the rupee to be stable to mildly depreciating from current levels.

■ Given that the rate easing cycle has ended, what's your outlook on rate sensitive sectors?

RBI has changed its monetary policy outlook from accommodative to neutral signaling an end to the interest rate easing cycle. While, this may temporarily impact rate sensitive sectors, interest rates are going to remain in a range and are not going to go up in a hurry. Thus, prevailing low interest rates would lead to recovery in growth and drive the next round of earnings and stock price performance for these sectors.

■ Should investors look at buying gold in the current scenario? Also what's your outlook on the dollar and the debt funds?

Gold has always been used as a safe haven to protect the portfolios from uncertainty in the global economy leading to volatility in the market. From the portfolio diversification perspective one can have small allocation into gold. But gold over the last decade has delivered very good returns but with global liquidity coming down gradually, gold as an asset class may not deliver similar performance. Interest rate over the past 3 years has come down by ~225bps (1 basis point is 1/100th of a per cent). This has led to good return generation in debt funds over the period. RBI is now signaling a change in the monetary policy stance indicating that there is little room for interest rates to go down further. Thus we expect debt funds to only generate accrual returns and have limited return potential from here on.

■ What are the major global and domestic negatives that can weigh on the market?

The Indian equity market has delivered strong returns over the last year and valuations are not cheap anymore. Thus, earning growth acceleration is crucial for the market to deliver returns from here on. Smooth transition to the GST regime and good monsoons would also be crucial. Globally, uncertainties with respect to Trump policies, Fed rate hikes, impact of Brexit, elections in EU countries and sharp increase in commodity prices could also weigh heavy on the market.

■ What big themes are you betting on?

We are positive on the Indian economy and believe the economy is emerging from a cyclical downturn and macro-economic indicators are also favourable. Hence, as the economic growth accelerates, stocks and sectors linked to the domestic economy would do well over few years. Also, there are sustainable long-term undercurrents in the economy "shift from the unorganised to organised sector", "shift from physical to financial savings", "focus on doubling farm income", which would drive earning growth and stock price performance of relevant sectors.

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