WEEKLY INTERVIEW

A shaky govt will be negative for economy, market

*Ritu Gangarde Arora, chief investment officer of Canara HSBC OBC Life Insurance says the fundamentals of the economy have improved considerably over the past few months. In an interview with **Bijoy Sankar Saikia**, she says it will however take time for corporate earnings to recover. Excerpts:*

FY15 GDP growth projection is below 6 per cent, but the stock market is already up 7 per cent this year. Do you feel the Street has gone overboard?

The equity market has indeed demonstrated strong performance in the recent past. Over $4 billion FII inflow has provided the necessary momentum to the market, while improving macro-economic indicators like a correction in the current account deficit to 1 per cent of GDP, moderating inflation (WPI at 4.8 per cent and CPI at 8 per cent), a stronger rupee and the drop in imported price of crude provide the necessary support. There is also a euphoria building around the national elections. All these make India an attractive investment destination compared with other emerging markets.

However, it will take time for corporate earnings to recover. They are likely to remain sluggish in the range of 10-12 per cent in FY15; valuations are at long-term average level of 15 times FY15 earnings. I expect the market to generate returns in line with the earnings growth of companies, with sustained FII flow providing a little upside. In the near term, I expect the market to remain range-bound with a bullish bias.

We may not see a reversal in the interest rate cycle anytime soon. What can possibly drive earnings growth for India Inc?

Elevated interest rates do impact the capital formation cycle. In India, we have been experiencing negative real interest rate, which has also impacted flow of savings into the financial markets. I would like to believe that interest rates in the economy have peaked and will start to soften later this year. As clarified by the RBI governor, the focus will remain on the inflation (CPI) trajectory and fiscal consolidation. Interest rates have a bearing on the capex cycle, but are not the only factor for its revival. A stable government formulating clear policies and regulatory approvals can play an important role in capex revival. Companies are looking to deleverage balancesheets by selling assets and repaying debt.

The slow growth in consumption demand is another worry. Do you expect some revival anytime soon?

High inflation, slowing income growth and subdued sentiment have affected disposable income. Fiscal moderation by the government has also impacted consumption adversely. I believe consumption will take time to recover. Auto demand is a good indicator of economic well-being of households. The excise rate cut announced by the government did not help revive demand. We expect demand revival to be linked to an improvement in general sentiment and revival of growth in the economy.

Do you expect some big positive surprises this earnings season? If so, in which sectors?

Any big-ticket earnings upgrades seem unlikely based on the March quarter results. We expect earnings growth for the benchmark Nifty companies to be in the range of 10-12 per cent, driven mostly by export-driven sectors as domestic growth remains tepid. Appreciation of the rupee will adversely impact earnings growth this quarter.

DIIs have largely stayed away from the recent rally in stocks. What factors are behind this?

Domestic retail investors have not participated in the equity market in a big way due to their continued risk aversion. DIIs have been net sellers to the tune of more than $1.2 billion in the equity market since the start of this calendar while, FIIs have put in more than $4 billion over the same period. This has been due to a combination of both redemption pressure as well as some caution on the part of investors.

Do you agree with that the forthcoming elections will be a watershed for the stock market? If the polls throw up a shaky coalition, do you expect a rush among FIIs to exit India?

A lot of hope is being pinned on a strong and stable government, which would be focused on reforms to control fiscal deficit, bring down inflation and revive investment growth. The recent large out-performance by cyclical sectors, driven mostly by large FII inflows, is a clear reflection of the same. Any adverse outcome in the form of a shaky coalition and weak government not able to carry out policy reforms would be very negative for the economy and the market. This may be accompanied with large FII selling and would also adversely impact the rupee.

After this significant rally, would you suggest investors to sell some stocks and book profit? Some analysts say it would be a good idea to take some profit off the table before May 16.

The equity market has moved up 5-7 per cent over the past month. The domestic cyclical sectors and stocks have moved up quite significantly over the period. In the near term, I would expect the market to remain range bound with a bullish bias.

How have you been playing in the market of late? Have you made a decisive shift to cyclical stocks yet?

Our investment strategy has been focused on investing policyholders' funds in large, good quality companies with high earnings growth visibility; we continue to follow the same strategy. We also remain invested in high quality cyclical stocks in the portfolio. However, for making a decisive shift towards cyclical stocks, we need to see the outcome of the general elections and softening of interest rates, which would create a favourable environment for investments.

What's your outlook on the rupee? Investors seem to be deserting export-oriented sectors, especially IT. Is it a good strategy?

The rupee depreciated very sharply by 15 per cent last year but has strengthened since then. We believe any sharp appreciation of the rupee from current level could adversely impact the economy. As a strategy, investors should not desert export-oriented sectors despite currency volatility, as these sectors also continue to have strong demand environment with strong visibility of earnings growth.

Lastly, you manage Rs 8,000 crore of investor wealth. What according to you would the best positioning across asset classes in the new financial year?

We have invested across both debt and equity assets. We believe the interest rates have peaked. Hence, debt as an asset class should generate good returns for investors over the next two to three years. Equity investments look good from a long-term perspective and can generate superior inflation-adjusted return over the long run.

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