RITU GANGRADE ARORA/CANARA HSBC ORIENTAL BANK OF COMMERCE LIFE INSURANCE

Don't expect a huge stock rally from current levels immediately

By Priyank Lakhia, Anu Jain & Abha Bakaya

INTERVIEW

Ritu Gangrade Arora, chief investment officer at **Canara HSBC Oriental Bank of Commerce Life Insurance Co. Ltd**, said she doesn't expect Indian stocks to stage a huge rally from their current levels immediately, but a gain of 5-7% is possible. Edited excerpts from an interview:

This is the big theme that we are exploring today: markets are at these new high levels, we seem to have been in a five-year bull run. Your reactions to what we are seeing pre-election and how much steam you are seeing in this rally?

I think a couple of things have come together for the market this time. Of course, there is huge anticipation around elections, but also more importantly the CAD (current account deficit) position has improved so significantly that it reflected in currency markets. Also, geopolitical worries that were looming over us over the last week have eased and fundamentals have started looking positive on the margins. There is a lot of positivity around the hope that there will be a clear majority government post-elections. So, I think all of that has come together to give market the strength.

As the big theme, as you mentioned, the election is also a mega-event that we are counting down to as well. But the markets are already at a life-time high. Do you think there could be more upside post the elections, without debating as to what kind of an outcome are we talking about, but do you see that there could be more rally for the market post-elections?

In terms of valuations, markets are currently trading at 14.5 times forward; FY2014 (fiscal year 2014) earnings growth estimated at about 14%. So markets are not so expensive. If you look at the range of about seven times to 20 times that is the minimum and maximum for markets, we are pretty much near the median. So with the positive factors getting built in, I would not be surprised with another 5-10% upside that the market could make. I do not see a huge rally from here, but another 5-7% is very possible.

That could just be the euphoria driving it up. I heard you say that you have seen data that is encouraging in terms of the economy as well. How do you think that will translate into earnings? We saw the fact that earnings weren't so bad. A lot of people argue that earnings weren't so bad, but that is also because we set the bar so low in the last quarter. Going into FY2015, which sectors, rather what earnings are you looking at in terms of multiples?

I would not expect this to translate into earnings in a hurry. I think there are a couple of quarters before which we will start this thing trickle into the earnings. But also remember, it is March that we are in, which is where the markets are flush with funds, be it insurance companies or mutual funds. So domestic investors are investing in the market. We don't see a big FII (foreign institutional investor) flow, but domestic flow is there, which also provides the support to the market. I think earnings will take a couple of quarters. It is just that on the fringes we are seeing some positivity giving way to huge negativity which is looming over us.

Stock pick: *Arora says she prefers the IT sector because of the valuations: while they look expensive, they are not at their all-time high.*

Considering that we seem to be in a free election rally, the stocks are in sectors of the market that will be impacted most by Narendra Modi's development agenda. Are you bullish on that pack? We have seen a return in focus to areas like infrastructure, cement, some people are starting to talk about agriculture. Are you also bullish on that theme going forward?

I very much prefer to maintain a balanced portfolio at this point in time because I do not see a direction in the market; a big bullish direction yet. Our fundamentals are still stressed. So I still like to hold cash-rich companies in a large pack and I still like to hold a balance of IT (information technology), pharma and FMCG (fast-moving consumer goods) in addition to the other sectors. As far as cap goods, infrastructure, automobiles—the interest rate sensitives—I would go a little slow and then selectively add. Some of them have already seen a run-up in a couple of weeks, but I would be selective in adding them in a hurry and I would maintain a balanced stance.

You mentioned about the flows there and it caught my attention. Do you think that the pressure that we saw from the DIIs (domestic institutional investors) selling earlier on last year is over? Do you think the pressure on the industry in terms of redemptions and all is over and DIIs are willing to come back to the market with some conviction now?

There definitely seems to be a positive turn of events there. We do see retail investors back in the market. I wouldn't be sure if it is a March effect or if it will sustain, but it is definitely a positive change and I hear more and more talk about retail investors having returned. But I would want to watch that in April and May before I can say that the tide has turned.

I want to ask about banking. I didn't hear that pack in your preferred or not-preferred list. Where does it stand in terms of your preference right now? Are you really worried about the non-performing assets (NPA) situation, or on the flipside, are the valuations looking too exciting to leave?

Personally, I prefer private sector banks over public sector banks, but would maintain a neutral stance on banks and the financial sector as such. The reason for preferring private sector banks is not so difficult to guess. They are better capitalized, they have credit pressures, credit-optic pressures, that in terms of balance sheets the fears on NPAs and stressed assets is still very limited. Public sector banks, I believe, still have pain going ahead before things turn. I would think at least two more quarters of stressed results from them and I am not trying to build new positions in PSU (public sector) banks yet, though valuations may look attractive. There has been some run-up, but I would still stick with the private sector banks.

Since you mentioned the banking pack, we have been talking to analysts, trying to get a sense regarding the entire recapitalization or even the funding itself. How do you see that event panning out when we talk about the banks, because clearly in the last couple of days, the kind of commentary that we have been picking up from the finance minister seems to be an area of concern for the banking industry?

Yes, I think banks are facing multiple stress; recapitalization as a big one. Besides that, with capital offtake not happening and economic growth remaining subdued, I fear that the asset quality could deteriorate further. So banking, I believe, will remain under stress for a while before we see things getting better and I guess one of the triggers could be inflation coming off and some respite on the high interest rates.

Let's talk about IT. You are very bullish on that sector. IT is the one pack in which we have seen a run-up consistently, not just in the near term but also for the last few years. At these valuations, would you continue to bet on that pack given yjr volatility in the currency markets and also given the fact that they have run up so much?

I still prefer IT sector for clear reasons on valuations. While they look expensive, they are not at their all-time high. And the earnings growth is well demonstrated. The volume growth supports this kind of valuations that the sector has. Also, the fact that the global economy is showing very good signs of improvement, both US as well as European data has been positive, which is where our IT companies have exposures. So we expect the earnings growth to sustain and clearly it is one of my most preferred sectors for an overweight, along with pharma. Of course, there is slight volatility on the currency front. But what matters most is the kind of extreme fluctuations that we were witnessing last year. The currency is reasonably more stable and with the CAD coming under control, I would expect it to be in this range with a little bit more appreciation probably from here. So all in all, the IT sector looks well positioned at this point in time, considering the other stressed sectors.

So IT and pharma are the pockets that you currently have exposure to. Are there any sectors that you are tracking closely, that one can actually look at going forward from here, in the next couple of months, that probably looks attractive right now at the back of valuations or could be an attractive bet to look at?

I would think that the obvious answer continues to be auto and capital goods. One should not have big underweight positions in these sectors. The tide could turn in a hurry and I would like to have positions in high-quality stocks in these sectors. I would be wary of going into mid-caps in the sector because conditions are still not conducive, but the large-caps of these sectors do look attractive.

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