India still on high growth path despite strong challenges inside and outside

WEEKLY INTERVIEW

Ritu Arora, director of investment at Canara HSBC Oriental Bank of Commerce Life Insurance, says volatility is going to be the order of the day in the market for the rest of the year. Excerpts from an interview with Kumar Shankar Roy:

■ How do you review your portfolios given that markets, both local and domestic, are volatile?
We are long-term investors and that gives us the resilience and patience during volatile periods like the one last year. We regularly review our portfolio, but we do not indulge in trading, take cash positions or derivatives. We are focused on large-cap companies with strong balance sheets, business models and cash flows. We regularly rebalance our portfolio to take advantage of rupee-cost averaging. The market volatility with periods of correction gives us opportunities to enter stocks that otherwise are expensive.

■ While your equity funds have beaten their benchmark by a fair margin since inception, the past one-year performance shows the same funds failing to match their benchmarks. What's your view on this underperformance?
Yes, we have a very strong and consistent performance history. CAGR (compounded annual growth rate) of all our funds outperform the benchmark by a very healthy margin. The market has been extremely volatile over the past one year. We have experienced at least four peaks and four troughs over the period. This impacted short-term performance in some periods this year, but subsequently recovered. Since we are holding a fundamental portfolio with a long-term horizon, there will be periods of outperformance and underperformance. We see volatility as the order of the day and expect it continue for the rest of this year. So, while this volatility does challenge us in the short term, it also presents investment opportunities, which will play out later.

■ You said volatility would be there for the rest of this year. Why?
Both global and domestic economies are facing severe challenges, which show no signs of easing. Slowdown in growth is a global phenomenon. The Indian capital market is facing strong headwinds, and, despite all talk of markets having corrected, it is still trading at 15 times forward earnings. This means the market is neither cheap nor expensive and is still above its long-term average valuation. This implies that 'time correction' has to happen and markets will remain range bound. There are no positive triggers in sight, which

can spur and drive market performance.

■ We also have our own challenges. What is your take on this?
Yes, India has multiple challenges of its own. Governance deficit, stubborn inflation, high interest rates and rising commodity prices are strong headwinds. But growth is not tapering off despite the kind of interest rate increases we have had. We are still expecting GDP growth of 7.5 per cent to 8 per cent. This is still a very high growth rate for an economy, which is grappling with inflation and trying to cool off. I do not see a respite in the near future. But, I do hope, that inflation corrects after September.

■ Is too much being read into the US debt issue?
Yes, I think so. To me it is more of a political problem. Although, what worries me more is that the US economy is not being able to stand strong despite repeated efforts. The effects of QE2 are being witnessed now and some data show that it has been successful in some aspects. But, unemployment, housing sales or the macro data are still not robust. This, coupled with deficit cut targets, will be challenging. I hope momentum comes back in the US economy. The US not doing well is

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a big problem not only for them but also for everybody else.

■ Coming back to India, are we lacking momentum now?
The growth momentum that was built in India in the past, still keeps it going. If you look back at the past few years, there haven't been many reforms, new projects or growth enablers. Despite this, India continues to enjoy strong growth.

■ Banks as a sector hold so much importance for fund manager portfolios. If GDP growth slows down, what happens to banking stocks?
Over the long term, we remain bullish on the banking sector because India cannot achieve 8 per cent to 9 per cent GDP growth over the next decade, without credit growth of more than 20 per cent. With improved risk management, vigilant regulator and increased adoption of information technology, the sector is poised to benefit from the structural growth in India. Over the past three years, we have always been overweight or neutral on banks.

■ How do you view the IT sector?
We have a positive outlook on the IT sector but would be selective because valuations are not very cheap. Also, the IT sector is relatively buffered from most domestic economic problems such as inflation, interest rate hikes and high commodity prices, among other things.

■ FII (foreign institutional investor) inflows have not been encouraging this year. With more than half of the calendar year gone, FII inflows are not huge. Do you follow FII trends?
CY09 and CY10 have been very good years from the FII inflow perspective, with India receiving $17.5 billion and $29.3 billion, respectively. Compared with that, year-to-date, FII inflows in CY11 have been abysmal. We've received $2.2 billion in the first half and most of it has come in the past month alone. While we follow FII trends, we have found them to be very volatile and treat them as just another input in our research process.

■ Pharma as a defensive sector has given good returns. What's your reading?
We have always liked the pharma sector and have had good exposure. This is a sector, which we like in the present economic environment. The Indian pharma sector is likely to maintain strong growth. The sustained growth is driven by new product introductions and higher penetration in the domestic, as well as regulated markets. The domestic formulation market is expected to grow consistently over the next few years. The interesting thing about the sector is that each company is very different from the other in terms of products, profile and growth trajectory. Hence, we are more bottom-up, and do not have a generic view on all companies in the sector.

■ Is there any sector that you have become positive after remaining negative for a long time?
Telecom as a sector is relatively better positioned now than it was earlier. In the past, we were wary of the extent of competitive pressures, price wars and the high leverage the companies in this sector were facing. The recent price increase by the largest player (Bharti Airtel) in the space is very positive and indicative of weaning competitive pressure. New entrants have not been able to make any significant dent in the market shares of incumbents. ■

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