

2010 will be the year of normalisation



Driven by improving economic conditions and abundant liquidity globally, our markets had a good run last year with the Sensex reporting an astounding gain of ~80% for the year. What kind of returns can one expect of the market in 2010? **Devendra Nevgi**, the co-promoter, founder and principal partner of Delta Global Partners (DGP), a research and advisory firm, answered this billion-dollar question and more in a recent interview with **Sharekhan**. Devendra carries 15 years of experience in domestic and international fund management. Prior to DGP he was the CEO and CIO of Quantum Mutual Fund in India. We present some excerpts from the interview below.

With the markets trading at a 52-week high currently, where do you see the markets going in 2010?

The year of 2010 would be the year of "Normalisation". That includes the normalisation of interest rates, liquidity, government expenditure (exit strategies), fiscals and asset prices. It would be a year of normalisation of the returns from the stock markets too. One should not extrapolate the returns of 2009 into the year of 2010. Liquidity and hope of economic recovery drove the markets in 2009 and fundamentals and earnings will drive them in 2010. If there are no global shocks and FII flows remain buoyant, it's fair to expect returns of around 15% per annum from the stock markets over the next two to three years. India's growth is firmly in place for the next few years to deliver reasonable returns.

The markets are currently trading above their fair valuations—do you see the FIIs still pumping in liquidity in the Indian markets?

Valuations are both subjective and relative. I do agree that the markets are valued at a marginal premium to their long-term average one-year forward PE of 14.5-15x. The markets' valuations are also at a premium to those of the global emerging markets. But such premiums may last longer if India continues to deliver above par growth rate and earnings, and thus higher ROEs. The Indian economic growth is expected at almost two times the growth in the crisis-ridden developed markets. The drivers of the Indian economy over the longer term are firmly in place, viz favourable demography, urbanisation, demand for infrastructure, higher savings and low household leverage, consumption, low retail investment in equities etc.

How do you see the forthcoming Q3FY2010 results and the overall FY2010 results of India Inc? Which sectors you feel will be able to do well and which not so well in FY2010, in terms of the financial performance?

I do not rely much on the quarterly results. I feel the quarterly results are too noisy to reflect the right direction of the company. Again, honestly I am not a fan of the sector-driven strategy too. I am not sure that retail investors have the time or the resources to analyse sectors deeply. Just because a stock is in a particular sector which is doing well does not guarantee the performance of that stock. There may be donkeys amongst horses in a stable. One has to be careful. Satyam was in the IT sector which was doing well till the last year this time. The year of 2010 will be the year where generation of alpha will be possible only by stock

picking. Nevertheless, sectors such as infrastructure (especially road and power projects), banking and consumption-driven sectors are likely to do well. The oil & gas sector looks good due to its hidden reserves and possible liberalisation. Telecom might continue its under performance but looks attractive for the longer term.

What, according to you, will be the trigger/s for the Indian and global markets going forward? Which sectors are you bullish on in the short, medium and long terms and why?

Government policies and initiation of some long over due financial/economic reforms are the mid-term triggers for the markets. The coming budget should give a road map for fiscal consolidation, ensuring economic growth and controlling inflation. This will reduce the uncertainty in the markets. Global liquidity and calm are important for the stock markets. In 2010 the earnings need to catch up with the elevated estimates and a positive surprise will be a trigger for the markets. We have already discussed the strategies in the question above.

With inflation rising faster than expected and the interest rate cycle bottoming out, when do you see the RBI raising the interest rates? And with the interest rates rising, which are the sectors one should invest in and which are the ones to avoid?

The RBI will definitely raise the policy rates in 2010 and it has to but it will do it gradually. It will await the economic growth to be more entrenched. It will also withdraw some of the excess liquidity. But the rate hikes will not restrict the growth. Moreover due to weak monetary transmission in India, the rise in the cost of capital of Indian corporates will be lower than the rise in the policy rates. Interest rate sensitive sectors such as real estate and consumer discretionary may get negatively impacted. Banking will benefit from interest rate rises.

Looking at the volatile condition in the equity markets, the inflation rate that is expected to rise and gold that has done well in recent past, how would you go about deciding allocation of funds across various asset classes?

Asset allocation is a function of many individual aspects, such as risk tolerance, liquidity requirements, investment horizons, working years remaining etc.

In 2010, in my opinion generally 65-70% should go to diversified equities for the long-term wealth creation. Around 10% should be to gold through ETFs as a hedge against inflation and tail risks. About 10-15% should be allocated to non-government bond funds after the yields rise in the current year. Around 5% should be held in cash or liquid funds to meet critical emergencies such as medical ones.

The high fiscal deficit, larger thrust on the growth and rising inflation seem to be a cause for worry for the Indian economy going forward. And with the budget season around the corner, what is your outlook on the Indian economy? Which sectors you feel will be positively impacted and which negatively impacted by this budget and why?

The Indian economy will continue to grow at an average rate of around 7% for the next decade. There will be times when the growth will be higher or lower than 7% depending on business cycles. The performance of the agri sector is crucial and if the monsoon fails in 2010 again, the non-agri sectors in the economy would compensate for the deficit. As of now the non-agri sectors are growing at more than 9% yoy. There has to be a sustainable growth with little participation from the government. A higher deficit is a cause for worry, but with divestments,

3G auctions, the GST and some support from economic growth (higher revenues), India will be in a position to bring down the deficit to reasonable levels. Inflation specially the food one will continue to be a little higher in 2010 and may average at 5 % (the Wholesale Price Index) in the year.

I don't see much of impact of the budget on any specific sector. The budget will be important for progress in reforms and the roadmap for fiscal consolidation/control of inflation. The world over, annual budgets are non-events for the markets.

What is your advice to the retail investors in the current market scenario?

Stocks are the asset class to ride the growth story of India in the next few years. Invest regularly in a disciplined manner. In the long term, stocks will deliver good returns as they have done since 1978-79, at a CAGR of 17.5% and I have not even added the dividend yield. Don't act on tips or speculate. Always have patience when you invest in stocks. Do understand that very often liquidity and event risks might deviate the markets from their intrinsic value in the short run, but in the longer run, fundamentals are the winners. And please understand the risk in every product. If you don't understand the product, don't invest.

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