GAAR, mid-term polls can be deal breakers for FIIs

By Bijoy Sankar Saikia Apr 01 2012
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There is a lot of uncertainty over the government's future and its ability to handle expectations on reforms and deficit, which may affect market sentiments, says **Vikaas M Sachdeva***, CEO of Edelweiss Mutual Fund. In an interview with* **Bijoy Sankar Saikia***, he says he is optimistic about a rate cut over the next two quarters. Excerpts:*

We have had multiple triggers for the stock market in March, a cautious tone from RBI, a non-event of a budget and now the worry over GAAR. Where is the market headed over the next two quarters?

We believe the market will continue to be range bound with a mildly positive bias in the coming quarters. There is still a lot of uncertainty around the political future of the government and its ability to handle expectations on reforms and deficit fronts. The coming month will give an idea on the steps the government takes to achieve the budget targets on subsidies at less than 2 per cent of GDP and fiscal deficit at 5.1 per cent. While market participants are revising the probability of a rate cut in April, we are fairly optimistic on rate cuts over the next two quarters. The uncertainty would be regarding the timing and the extent, and not the fact that there would be a cut or not. Additionally, the uncertainty over GAAR will have cleared and settled by then. These variables will take time to pan out and we will continue to see volatility until there is some clarity on these issues.

The 10 per cent gain in the benchmark indices so far this year were almost entirely driven by FIIs. With nothing really changing in terms of fundamentals, will the Indian market continue to attract retail FII interest going forward?

We believe India will continue to attract flows as growth is expected to pick up with the easing of the rate cycle. The scarce growth prospects in the developed world and the liquidity infusion by the central banks in Europe and the US will ensure that India will see substantial FII flows. The only caveat to this would be the regulatory/political angle. Any surprises like GAAR/mid-term elections would be deal breakers for FIIs.

What are your expectations on March quarter earnings? Will it trigger any further earnings downgrades? Which sectors are likely to perform poorly and which ones are likely to do well?

March quarter earnings are likely to be subdued. Importantly, the equity market has already priced it in and is looking at the earnings two quarters down the road. We believe that growth in India will pick up over the next two quarters and equity markets will reflect the improved prospects in the coming months. India faces major challenges from supply-side-led inflation to slowing growth and government action on reforms front and RBI's policy response would be key in deciding the mood of the market. A rate cut in April would benefit interest rate sensitives. The government's decision to provide compensation to downstream oil companies for FY12 is a positive for Gail, OIL and ONGC because it implies a subsidy burden of around 38 per cent.

Apart from RBI rate review on April 17 and the earnings numbers, what other triggers are you looking at to determine market direction going forward? Does the outlook for some of the hard-hit sectors change in view of the various measures being initiated at various levels?

A rate cut in April or a clear indication for a rate cut in June will be positive for the markets. Other triggers for the market would be action on the stalled reforms agenda and large-scale infrastructure projects like dedicated freight corridors, among others. The budget carried positive news for infrastructure, such as augmentation of cheaper, longer-term funds higher investment plans and investment incentives. The coming quarter could be volatile for these sectors; however, the initiatives undertaken at various levels should have a positive impact.

Does the US situation or the latest developments in the euro zone give you some comfort? Or, are there more concerns? Does China worry you?

Data coming out of the US since the start of the year has been comforting and that, in our opinion, has played a big part in driving equity prices the way they have moved since the year-end. For a while, Chinese data had been looked at as the game changer, but, recent patterns clearly indicate that good news out of the US has the potential to overshadow growth concerns or other negativity emerging out of China. On an aggregate basis, the markets looks likely to rally on continuing positive information out of the Americas, but, with momentary corrections, essentially because of weaker support from the euro zone and China.

And the rupee? Is it causing some worry for you? The balance of payment situation is said to be not very comfortable. What is your outlook on the currency front?

The balance of payment situation is a concern, even though targets set for FY13 in the budget look realistic. Subsidies and expenditure seem to have been appropriately accounted for, but, a big chunk of the subsidy will be oil-based, and hence, periodic analysis of budget deficit and, consequently, the Indian rupee will be a hostage to global crude prices. The currency will continue to be volatile but range bound as at weaker levels FII's would get tempted to bring in some of their investments besides the possibility of some structural announcement from RBI.

When you look at the entire asset basket, which is the asset class you feel will be safe and rewarding in the new financial year? Why?

The factors driving returns and performance this year are likely to be on a downtrend in the interest rate cycle and there is likelihood of an uptick in growth post infrastructure reforms. Events that can be unsettling are likely to be on the regulatory and political front domestically and growth woes globally. For the short run, short-term income funds are likely to be rewarding. For the medium to long run, equities are likely to be more rewarding.

How have you been playing the market of late? Which are the sectors you are buying and which are the ones you are avoiding? Why?

As mentioned above, we think interest-rate-sensitive-sectors are likely to be back in flavour once rate cuts begin. Also, discretionary spending, which has been hampered by a high rate environment, is likely to come back to the fore. These are the two predominant themes that we like. On the other hand, sectors with expensive valuations and moderate growth forecasts are to be avoided.

How would you advise investors to play equities at this stage?

Equity investing is for the long haul and right now, it seems like a good time to get back in. The growth environment is likely to improve going forward on absolute as well as relative basis. We will advise equity investors to pick a bouquet of predominantly mid-cap mutual funds with a few large-cap mutual funds. Equities have given a couple of years of below-par returns now and will look to strike back. So please sit back, relax and enjoy the flight!