'Focus on industries with global links, high cash flows'

Vikaas Sachdeva *has been busy lining up products to help investors deal with the volatility. With inflation, crude oil and other macro-economic concerns plaguing the market, there will be plenty to deal with for the retail investor, says the chief executive officer of Edelweiss Asset Management.*

Along with macro-economic concerns, a negative for the markets are the foreign institutional investors, who are unlikely to do an encore after emerging as net buyers of Indian equities by ₹1.36 lakh crore during 2010, Sachdeva told **Sachin P Mampatta** *in an interview. Excerpts:*

Monday Interview

Vikaas Sachdeva

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Indian markets are trading at a higher valuation than many of its peers and there is a recovery in developed economies. Do you see a change in capital flows in the new year?

The general consensus across the industry is that it will be difficult to match the foreign institutional flows we saw in 2010 — roughly $29 billion. Key factors are pickup in growth in the US, re-allocation of Asian equity funds towards economies that are more levered to growth in the US, inflation, crude oil prices and a tightening monetary policy that would chip away at the flows.

Having said that, the India story is now well entrenched and does not need to be 'sold' to international investors like it was 10 years ago. We generally expect flows to stay positive on an annual basis.

IIP numbers have come at 2.7% with consumer goods seeing sales dropping over the last year. What could this mean for the market and consumption as a theme?

Index of Industrial Production (IIP) numbers have been volatile, but the trend seems to be downward, at least in the immediate term. Rate hikes by the Reserve Bank of India (RBI) may have impacted demand. However, uptick in credit growth and exports in recent months as well as a robust PMI (Purchasing Managers' Index) are indicative of industrial activity recovering from its soft patch.

While the weakness in November was broad-based across sectors, consumer goods led the major decline in the headline number. The consumer durables sector, which was quite strong in the recent months (April-October, at average ~25%), has slowed down sharply to a little over 4% in November, partly reflecting the expected ebb in production in a post-Diwali month. Meanwhile, what is notable is the growth in the consumer non-durables category, which was on a weakening trend, turned negative in November. This weakness could partly be attributed to inflation.

Food inflation has been higher than expected, at 18.32%. How much of a concern is this going to be in the days ahead?

Inflation is a major concern. Much of it is because of food and commodities. It is believed that unseasonal rains and supply side bottlenecks have led to high food prices. It could be a significant concern for the market, if it does not cool down.

Monetary policy is generally regarded as ineffective in tackling supply-led inflation in food. However, the RBI is widely expected to tighten policy in its January 25, 2011 review as food inflation has spilt over to the broader economy. One would tend to assume a figure of 25 basis points (bps) in the January meeting and additional 50-75 bps over the course of CY2011.

How closely would you be watching crude oil prices in their ability to impact the market?

There is always a debilitating impact of higher oil prices on the Indian economy — prices above $100 per barrel start hurting the Indian economy disproportionately. On one hand, inflation starts to spiral upwards thereby hampering consumption growth. On the other hand, it is estimated that every $10 per barrel increase in Indian oil price basket adds roughly $7-8 billion to the current account deficit.

Banks have been demanding a cut in SLR and CRR. What is your take on the liquidity situation and the outlook on banking stocks in general?

Liquidity has started easing marginally; having said that we expect liquidity to remain tight till the second week of February. The RBI may continue with its temporary liquidity relief measures such as open market operations. However, any chances of permanent cut in statutory liquidity ratio or cash reserve ratio would depend on the inflation scenario.

Post mid-February, with end of the government borrowing programme for FY11, we expect liquidity conditions to improve as government spending picks up coupled with shift of money in circulation to the banking system due to higher deposit rates on offer.

Which are the sectors that you are bullish on?

Over a longer time frame, we would find that all sectors in an economy like India would pick up.

Currently, it looks like focusing on industries with global interfaces and high cash flow generation would make sense. The list includes energy, base metal producers, IT, healthcare and pharmaceuticals.