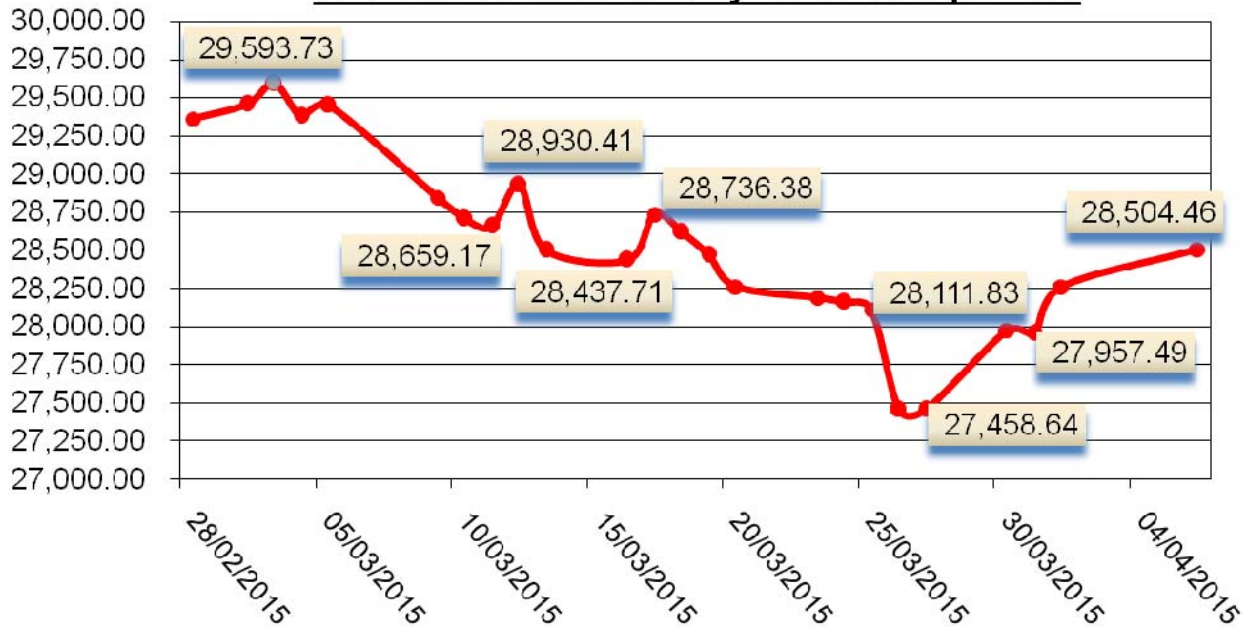




58, mittal chambers, 228, nariman point, mumbai - 400 021.
t: 6115 1919 f: 6115 1999 e mail:dipanmehta@vsnl.com

Stocks Markets Cool of in March

SENSEX from 28th February 2015 to 6th April 2015



Markets in Corrective Phase

After a relentless multi – month rally, stocks posted negative returns for March. The Sensex closed the month and the fiscal year at 27,957.49. The decline for the month was (-) 4.78 %, but the gain for the entire 2014-15 was an impressive 24.89 %.

International Markets Soft, China Out-performs

The news flow was tepid with no major events or developments. In the absence of any positive triggers, markets drifted lower. Traders and investors booked profits and volumes remained lackluster. Cues from global markets were also generally downbeat as most major markets, with the exception of Chinese and German markets, posting flat to negative returns (see underlying table).

| Index | Country | 27/02/2015 | 31/03/2015 | % Chg |
|--------------------|-----------|------------|------------|--------|
| Shanghai Composite | China | 3,310.30 | 3,747.90 | 13.22% |
| DAX | Germany | 11,401.66 | 11,966.17 | 4.95% |
| Nikkei - 255 | Japan | 18,797.94 | 19,206.99 | 2.18% |
| CAC | FRANCE | 4,951.48 | 5,033.64 | 1.66% |
| Hang Sang | Hong Kong | 24,823.29 | 24,900.89 | 0.31% |
| Bovespa | Brazil | 51,583.09 | 51,150.16 | -0.84% |
| NASDAQ | USA | 4,963.53 | 4,900.88 | -1.26% |
| S&P 500 | USA | 2,104.50 | 2,067.89 | -1.74% |
| Dow Jones | USA | 18,132.70 | 17,776.12 | -1.97% |
| FTSE 100 | U.K. | 6,946.66 | 6,773.04 | -2.50% |
| BSE Sensex | India | 29,361.50 | 27,957.49 | -4.78% |

The Shanghai Composite Index rallied by a phenomenal 13.22% in March. Over the past 9 months, this index has delivered an astonishing 82.97 % return by moving up from 2,048.33

(30/06/14) to 3,747.9 (31/03/15).

Reports from there suggest that the local Chinese investors have taken a sudden passion for trading (*read speculation*) in stocks. Notwithstanding that, there is no doubt that our stock markets have a strong competitor in the Chinese markets and we no longer hold the mantle of the “**Best Performing Stock Market**” in the world.

Investors Favor Mid Cap Blue Chips

Mid Cap stocks did much better in March with the CNX Mid Cap index declining by just (-) 0.88 % as against a near 5 % drop for the Sensex (- 4.78%) and the Nifty (-4.61%). What is even more remarkable is that this Index has rallied by nearly 51 % in the past 12 months, with many of its constituents doubling or even tripling. The year 2014-15 has been the year of Mid Cap stocks with many small and mid-sized companies delivering multi-bagger returns (see adjoining table).

Preference for Quality Businesses

As we analyze this list of exceptional performers and compare it with the stocks which under-performed, several interesting trends emerge.

Firstly, investors have gone for quality businesses or “*Blue Chips*” as in investor’s parlance.

Companies which have high return on investment (RoI), low debt, good corporate governance standards and steadily compounding top-line / bottom-line have been preferred over companies with low RoIs, capital intensive business models, suspicious governance standards and erratic performance.

Price Earnings Multiple Continue to Expand

Secondly, the Price to Earnings (PE) Multiple has not been a major factor in stock selection. Investors have avoided the “*value trap*”. Companies which meet the above mentioned criteria have been sought after despite their high valuations. In short, PE multiples of blue chips have moved up higher than that of other companies.

DEFINITION of 'Value Trap' by Investopedia

A stock that appears to be cheap because the stock has been trading at low multiples of earnings, cash flow or book value for an extended time period. Stock traps attract investors who are looking for a bargain because these stocks are inexpensive. The trap springs when investors buy into the company at low prices and the stock never improves.

It could be that investors are paying premium for growth. That is not surprising if one goes by the valuations at which deals are taking place in the private equity market.

| Best Performers in CNX Mid Cap Index | |
|--------------------------------------|--------------------|
| Company Name | Returns (in times) |
| Wockhardt | 4.08 |
| Ashok Leyland | 3.10 |
| Strides Arcolab | 3.04 |
| Bharat Forge | 3.03 |
| Bharat Electron | 2.92 |
| TVS Motor Co. | 2.71 |
| Eicher Motors | 2.67 |
| Britannia Inds. | 2.56 |
| UPL | 2.40 |
| IRB Infra.Devl. | 2.38 |
| Indiabulls Housing | 2.36 |
| Emami | 2.31 |
| Bajaj Finance | 2.29 |
| P & G Hygiene | 2.25 |
| SKS Microfinance | 2.23 |
| Torrent Pharma. | 2.22 |
| Dewan Housing Fin. | 2.12 |
| Amara Raja Batteries | 2.11 |
| H P C L | 2.1 |
| Max India | 2.07 |
| Motherson Sumi | 2.01 |
| JSW Energy | 2.00 |
| Other Mid Cap Performers BSE 500 | |
| Company Name | Returns (in times) |
| Hitachi Home | 8.39 |
| Century Ply. | 8.38 |
| NBCC | 6.08 |
| Kitex Garments | 6.03 |
| Shasun Pharma. | 5.24 |
| NCC | 5.17 |
| Bombay Burmah | 4.52 |
| Sonata Software | 4.05 |
| Suven Life Scie. | 4.01 |
| PTC India Fin | 3.90 |
| Solar Inds. | 3.85 |
| BEML Ltd | 3.75 |
| Orient Cement | 3.73 |

E-commerce and web / mobile based businesses are being bid at astronomical valuations as surfeit of liquidity chases the few growing business which are still around.

PE Ratios in the “New Normal”

A rather unnoticed outcome of the “New Normal” is that despite the massive liquidity, created by the quantitative easing programs of the large central banks, growth in most sectors and geographies is anemic. However, liquidity is abundant and since there are only a few growth avenues, investors are left with no choice but to invest in these businesses at higher and higher valuations. It could be that in the “New Normal”, PEs are may remain high for an extended period of time; especially if interest rates remain absurdly low.

DEFINITION of 'New Normal' by Wikipedia
New Normal is a term in business and economics that refers to financial conditions following the financial crisis of 2007-2008 and the aftermath of the 2008–2012 global recession. The term has since been used in a variety of other contexts to imply that something which was previously abnormal has become commonplace

Correction Eludes Blue Chip Stocks

Thirdly, the correction in these blue chip stocks has been shallow as compared to the fall in large benchmark indices. Investors continue to own these shares even if the newsflow and broad market moves are negative. One aspect which explains this investor psyche is the scarcity of blue chip stocks. These companies rarely dilute and therefore their floating stock does not increase. Since their business models are asset light and large internal cashflows are more than sufficient to cover capex; there is no need to issue fresh equity.

These trends run counter to the widely held belief that economically sensitive stocks will do well once there is political stability and the government starts functioning.

Therein lies the dilemma we are in.

Risks of High PE Multiples

As mentioned earlier, quality businesses are trading at rich multiples. Over the past years, these multiples have moved up (See Table at the end). Investors will pay more only if there is conviction that growth will revive and higher valuations are justified. Since economic recovery is not a given, there is the resistance to buy at higher levels. Furthermore, since all round improvements in the economy are still not visible, new sectors / investment themes are not presenting themselves. The same old performers, which are anyways over owned, are being chased by investors and traders, and this is not a very healthy trend.

This is the principle reason for our bearishness on the market.

Our View on Stocks

In our previous newsletter, we had cited absence of positive triggers as one of the key reasons for our cautious outlook. While this remains a matter of concern, the high level of valuations is a primary source of worry. In the short term, PE multiples can expand or contract but over the long run, stocks are slaves of earnings and it is growth in earnings which eventually determine price earning multiples. There is grave risk in paying a huge premium on a business if growth assumptions are not met.

We maintain our cautious stance over the short to medium term and expect a pricewise / timewise correction. Our view may change if the upcoming earnings season throws up a few positive surprises. Most other triggers, be it interest rate cut by RBI, fall in crude prices or the government reforms program have been largely discounted.

A good monsoon may revive the sentiment and initial forecasts made by a few well reputed international weather forecasting agencies is encouraging.

Investors need to be patient at this point of time. Markets will revive as the year progresses and a few of the government / RBI measures and other recent macro developments translate into higher growth. With every passing day, the long term macros of our country are improving and stabilizing. It is only a matter of time before the micros, too, start looking up. The best piece of advice for investors at this point is again offered by the *Oracle of Omaha* – Warren Buffet

“Successful Investing takes time, discipline and patience....”

Dipan Mehta

| Sample of Market Favourites With Change in P E Ratio over the Past Year | | | | | | |
|---|--------------------------------------|-----------------------|------------------|-----------------------------------|-----------------|--------------------------------|
| Company Name | Latest Market Price--Unit Curr.(BSE) | Market Capitalisation | Latest P/E Ratio | Price to Earnings (PE) on 31/3/14 | % Change in PER | CAGR Adjusted Net Profit 5 Yrs |
| HDFC Bank | 1,033.75 | 2,59,108.95 | 30.61 | 26.15 | 17.06% | 31.29 |
| Infosys | 2,161.25 | 2,48,213.58 | 20.29 | 18.73 | 8.33% | 12.22 |
| Sun Pharma. Inds. | 1,151.95 | 2,38,591.88 | 39.93 | 24.89 | 60.43% | 26.10 |
| H D F C | 1,328.70 | 2,09,230.08 | 24.52 | 18.11 | 35.39% | 22.93 |
| Hind. Unilever | 911.00 | 1,97,091.66 | 63.30 | 40.39 | 56.72% | 7.81 |
| HCL Technologies | 933.00 | 1,31,151.44 | 18.13 | 18.90 | -4.07% | 39.29 |
| Maruti Suzuki | 3,601.00 | 1,08,779.01 | 44.26 | 27.40 | 61.53% | 18.23 |
| Kotak Mah. Bank | 1,385.40 | 1,07,001.74 | 38.31 | 24.29 | 57.72% | 30.89 |
| Lupin | 2,090.40 | 93,961.04 | 39.02 | 24.81 | 57.28% | 30.05 |
| Asian Paints | 835.30 | 80,121.98 | 58.65 | 44.33 | 32.30% | 25.99 |
| Bosch | 25,293.20 | 79,420.65 | 74.24 | 38.54 | 92.63% | 8.64 |
| Cipla | 727.90 | 58,447.49 | 49.47 | 22.53 | 119.57% | 12.92 |
| Dabur India | 274.25 | 48,172.34 | 47.37 | 35.59 | 33.10% | 19.39 |
| IndusInd Bank | 907.40 | 48,042.31 | 28.34 | 19.96 | 41.98% | 52.86 |
| Motherson Sumi | 509.00 | 44,888.71 | 41.89 | 34.29 | 22.16% | 44.26 |
| Eicher Motors | 15,950.40 | 43,237.20 | 78.88 | 42.99 | 83.48% | 51.11 |
| Aurobindo Pharma | 1,358.80 | 39,674.55 | 23.73 | 19.10 | 24.24% | 80.85 |
| Godrej Consumer | 1,142.85 | 38,907.97 | 43.68 | 38.30 | 14.05% | 35.86 |
| Yes Bank | 841.20 | 35,139.96 | 22.51 | 11.46 | 96.42% | 39.71 |
| Bharat Forge | 1,315.50 | 30,624.84 | 71.21 | 45.73 | 55.72% | 45.59 |
| Pidilite Inds. | 584.40 | 29,960.02 | 58.78 | 33.89 | 73.44% | 31.74 |
| United Breweries | 1,113.05 | 29,429.04 | 134.23 | 125.87 | 6.64% | 37.71 |
| Bharat Electron | 3,588.75 | 28,710.00 | 31.38 | 10.38 | 202.31% | 3.27 |
| Britannia Inds. | 2,259.30 | 27,100.30 | 52.01 | 26.64 | 95.23% | 23.84 |
| Marico | 392.00 | 25,283.29 | 45.64 | 30.23 | 50.98% | 19.95 |
| Cummins India | 871.10 | 24,146.89 | 32.79 | 25.54 | 28.39% | 6.97 |
| Emami | 1,037.10 | 23,542.17 | 50.29 | 25.63 | 96.22% | 34.67 |
| LIC Housing Fin. | 445.10 | 22,461.97 | 17.01 | 11.35 | 49.87% | 19.90 |
| Wockhardt | 1,978.70 | 21,780.13 | 48.09 | 4.77 | 908.18% | 13.87 |
| Bajaj Fin. | 4,337.50 | 21,751.37 | 25.64 | 12.81 | 100.16% | 84.24 |
| UPL | 472.65 | 20,257.98 | 18.76 | 9.09 | 106.38% | 16.45 |
| Havells India | 303.10 | 18,928.23 | 45.10 | 28.86 | 56.27% | 153.46 |
| Page Industries | 13,871.60 | 15,466.83 | 83.12 | 50.81 | 63.59% | 36.98 |
| Amara Raja Batt. | 848.75 | 14,496.65 | 37.08 | 19.38 | 91.33% | 35.66 |

Source : Cline