SEPTEMBER 2010

ING ORANGE VIEW

ING INVESTMENT MANAGEMENT HOUSEVIEW

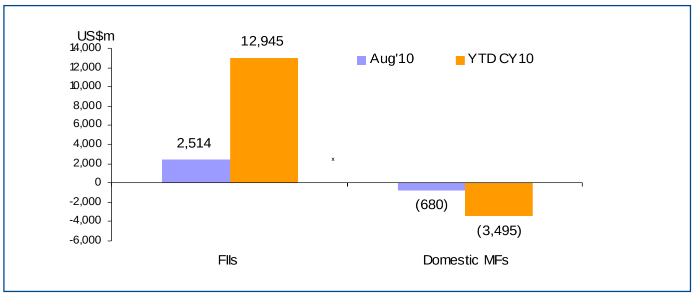
Indian Economic Outlook

- The long awaited Direct Tax Code was tabled in the Indian parliament which is expected to usher stable and efficient tax system. For full tax paying companies the effective tax rates are expected to come down because of removal of surcharges and cess. For companies under MAT, effective tax rates would slightly increase.
- Agricultural growth is expected to pick-up with the revival of monsoon in late July and August with replenishment of reservoirs and ground water table. According to the latest Indian Meteorological Department data, the season's rainfall deficiency stood at only 2% of long period average with 30 of the 36 divisions witnessing normal / excess rainfall.
- WPI inflation for the month of July provided some respite at 9.97% which was lower than market expectation of 10.4%. Though there was some upward pressure on inflation due to increase in fuel prices in June on account of partial deregulation of petroleum products, lower manufacturing products prices on a m-o-m basis had a cooling impact on overall inflation. On the flip side, the May inflation numbers were revised upwards to 11.14% from 10.16% as indicated earlier. It is expected that WPI inflation would continue to soften over the remaining part of the year due to good monsoon and favourable base effect.
- 1QFY11 GDP grew by a healthy 8.8% which was in-line with market expectation even though it was the best reported headline number in the last 10 quarters. A deeper analysis of the GDP leads us to believe that there are huge concerns on the demand side of GDP which could impact growth in the coming quarters.

Indian Equity Market Insights

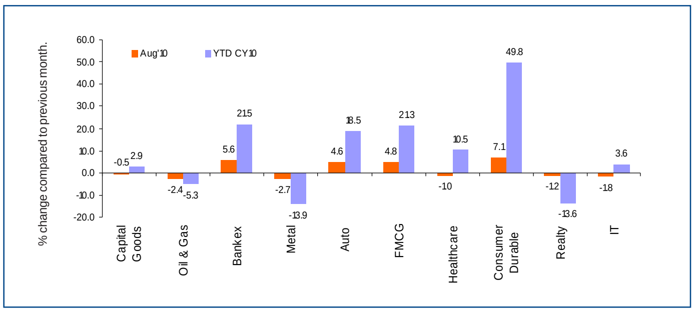
- After witnessing strong performance in July, the global markets were again under pressure in August. Major world indices have seen significant declines because of negative data points from US indicating slower than expected recovery.
- After a month of under performance, the Indian markets were back in favor. For the month of August the Indian markets have outperformed most major global indices on the back of renewed concerns on global growth.
- FIIs liking for Indian equities continued with net FII inflow of ~US$2514mn in August alone. FIIs have invested a total of ~US$12,945mn since the beginning of the year. Domestic MFs, however, continued their selling spree and sold US$680m worth of equities.
- Consumer Durables and Banks were in favour in August with both indices registering steller returns. Metals and oil & gas, on the other hand, did not have a great month with both the indices ending the month in red.

FII and MF Trend



Source: SEBI

Snapshot of Sectoral Trend *(% change compared to previous year)*



Source: Bloomberg

ING OVERVIEW OF SECTORAL TREND

INDUSTRIAL MANUFACTURING AND CONSTRUCTION

The order inflows for construction companies from manufacturing sector is picking up indicating gradual revival of manufacturing capex. The quarterly results have been a mixed bag but the underlying concern still remains that of slower execution levels which were partially off-set by margin expansion. We expect margins to start witnessing some pressures on the back of increased competition, withdrawal of fiscal incentives and increase in raw material prices. The current valuations are on the upper side of the historical valuations for the sector and thus we maintain our cautious stance.

BANKING

The banking sector has been witnessing steady improvement in credit demand with overall industry growth of 20.5% as of mid – 2QFY11. However, deposit growth remains sluggish at 14.1% YoY, forcing the banks to raise deposit rates. Simultaneous increase in lending rates, shifting to a base rate system and faster asset re-pricing, should help banks sustain Net Interest Margins to some extent. We prefer banks with higher proportion of low cost deposits in a rising interest rate environment. With core performance of banks on a strong footing, we believe that stock performance in near term is likely to trail asset quality performance of banks. We expect asset quality concerns to peak by 1HFY11E. Thereafter, any improvement coupled with better growth should drive valuations of banks.

INFORMATION TECHNOLOGY

Most large cap IT companies have seen robust demand coming from North American region; however, the economy has not come out of doldrums so far. Wide fluctuation in the currency is also a cause of concern for most corporate. However, pricing environment seems to have stabilized and provides a relief to all companies. We maintain our neutral stance on the sector.

TELECOM

First quarter saw a mixed set of numbers from Indian Telcos. While the uptake in MoU was visible for most operators, pressure on margin remains. There have been ongoing talks of regulatory changes in the sector allowing consolidation in the sector but nothing concrete has come up as yet. We maintain our cautious stance on the sector.

AUTO

The demand environment for two wheelers, cars and commercial vehicles continues to be strong in the run up to the festive season as dealers stock up on inventories in order to meet the expected surge in demand. The recent hike in prices across models by most car manufacturers is not expected to have any meaningful impact on demand. The combination of price hikes and lower commodity costs should result in improved margins for most car manufacturers in the 2nd quarter of FY2011.

CEMENT

Cement companies have recently announced a price hike in Mumbai region in-spite of the prevailing oversupply situation in the rest of the country. Cement prices continue to be weak in the rest of the country with prices in the key market of Andhra Pradesh being the lowest. Given the capacity glut that exists, we do not expect large cement price hikes until we exit the seasonally weak monsoon period.

METALS

Even as domestic Hot Rolled Coal prices are at ₹ 2500-3000/MT discount to landed prices, continued elevated inventories in the system would not increase the steel prices. As we had expected, the combination of a fall in steel prices and lower sales volumes resulted in weak quarterly results for most steel companies. We expect Indian steel makers to raise prices as construction restarts at the end of the monsoons and the onset of the festival season spurs home and car purchases.

CONSUMER STAPLES

Good monsoons coupled with tepid investor interest in other domestic consumption stories, has paved the way for outperformance from FMCG sector over last few months. We continue to rate concentrated product portfolio and high brand equity companies, attractive, primarily on lesser consumer price sensitivity, on rising per capita disposable incomes. At the same time, companies with strong cash cows feeding new brands in stable product segments, remain good growth propositions. We continue our over weight stance on Consumer Staples, with select themes, as mentioned above, to ride on.

UTILITIES

Utilities have been underperforming the market for long, owing to investor concerns on pace and quality of project execution. Gas Utilities, though, have shown promise on account of recent ramp ups in Reliance Industries' Krishna Godawari (KG) basin supply, coupled with timely capacity augmentation. City Gas Distribution as a space has displayed re-rating in its valuation multiples owing to clarity on gas costing and expansion potential in newer geographies. We maintain under weight on Utilities, while Gas Utilities and Distribution Franchisee themes are relatively attractive options.

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